

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of

Department of Enforcement,

Complainant,

vs.

Merrimac Corporate Securities, Inc.,

and

Robert G. Nash,

Respondents.

DECISION

Complaint No. 2011027666902

Dated: May 26, 2017

**Merrimac Corporate Securities, Inc. provided false documents to FINRA; sold unregistered securities; failed to establish and implement adequate AML policies; failed to maintain a reasonable supervisory system and adequate written supervisory procedures; and effected securities transactions while its registration was suspended.**

**Respondent Robert Nash provided false documents to FINRA and failed to maintain a reasonable supervisory system and adequate written supervisory procedures.**

**Held, findings and sanctions affirmed.**

**Appearances**

For the Complainant: Leo F. Orenstein, Esq., Michael Watling, Esq., Department of Enforcement, Financial Industry Regulatory Authority

For the Respondents: Pro se

**Decision**

Respondents Merrimac Corporate Securities, Inc. ("Merrimac") and Robert G. Nash appeal a March 31, 2015 Extended Hearing Panel Decision imposing sanctions for a number of

violations. The Extended Hearing Panel found that Merrimac and Nash submitted to FINRA documents that falsely represented that they had been subject to supervisory review and failed to establish, maintain, and enforce an adequate supervisory system, including adequate written supervisory procedures (“WSPs”). The Extended Hearing Panel also found that Merrimac caused the sale of unregistered securities, failed to establish and maintain procedures reasonably designed to achieve compliance with anti-money laundering (“AML”) rules and to monitor for and detect suspicious activity, and effected securities transactions while its registration was suspended for failure to timely pay annual registration fees. For this misconduct, the Extended Hearing Panel fined Merrimac a total of \$225,000 and imposed a one-year prohibition from receiving and liquidating penny stocks, a 30-day suspension from membership, and required Merrimac to retain an independent consultant to review and evaluate its WSPs. The Extended Hearing Panel fined Nash a total of \$50,000, imposed a one-year suspension in all principal capacities, and required requalification as a general securities principal.

On appeal, Merrimac and Nash dispute the findings and argue that the hearing process was unfair, that the Extended Hearing Panel’s decision was biased, and that the firm was targeted by FINRA’s Department of Enforcement (“Enforcement”).

After an independent review of the record, we affirm the Extended Hearing Panel’s findings of violation and the sanctions it imposed.

## I. Background

Merrimac was a broker-dealer based in Altamonte Springs, Florida, which became registered with FINRA in 1993. During the relevant time period, Stephen D. Pizzuti was Merrimac’s Chief Executive Officer, and the majority owner of the firm was Pizzuti’s wife. In March 2016, Merrimac was expelled from FINRA membership for failure to pay fines and costs. During the time it was a FINRA member, Merrimac was the subject of several disciplinary matters. These matters included: (1) a previous suspension and cancellation of its registration for failing to pay required fees; (2) a fine and order requiring the firm to retain an independent consultant for failures to reasonably supervise outside business activities and private securities transactions and for failure to establish, maintain, and enforce reasonable WSPs with respect to these activities; and (3) a fine for selling private placements in contravention of the terms of its membership agreement with FINRA.

Respondent Nash became registered with Merrimac in 2008 as a general securities principal. During the relevant time period, Nash served as Merrimac’s Chief Compliance Officer (“CCO”) and Merrimac’s WSPs specifically provided that Nash was responsible for the supervising and reviewing: (1) office of supervisory jurisdiction (“OSJ”) principals;<sup>1</sup> (2) securities transactions; (3) customer complaints; (4) customer accounts; (5) commissions and markups; (6) branch office reviews and examinations; (7) private placements; and (8) outside business activities. Nash is not currently registered with any FINRA member firm.

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<sup>1</sup> These principals included Pizzuti and John Dubrule.

## II. Procedural History

This proceeding arose out of several investigations conducted by separate FINRA offices, which were consolidated in FINRA's New York district office. The investigations focused on: (1) the outside business activities of two Merrimac registered representatives, John W. Dubrule and Kevin A. Tuttle, who operated an OSJ for Merrimac in Orlando, Florida; (2) the representations made on, and the firm's supervision of, investment-related websites operated by Pizzuti; (3) the sale of unregistered securities; and (4) Merrimac's supervisory and AML systems.

On July 3, 2013, Enforcement filed an eight-cause complaint against Merrimac, Nash, Pizzuti, Dubrule, Tuttle, and David W. Matthews, Merrimac's AML Compliance Officer ("AMLCO").<sup>2</sup> The complaint alleged, among other things, that: Merrimac and Nash provided false documents to FINRA, in violation of FINRA Rules 8210 and 2010 (Cause 3); Merrimac violated FINRA Rule 2010 by causing the sale of unregistered securities in contravention of Section 5 of the Securities Act of 1933 (the "Securities Act") (Cause 4); Merrimac and Nash failed to establish and implement an effective AML system, in violation of NASD Rule 3011(a) and FINRA Rules 3310 and 2010 (Cause 6); Merrimac and Nash failed to maintain an effective supervisory system, including adequate WSPs, in violation of NASD Rules 3010 and 2110 and FINRA Rule 2010 (Cause 7); and Merrimac violated Article IV, Section 1 of FINRA's By-Laws and FINRA Rule 2010 by effecting securities transactions while its registration was suspended (Cause 8).<sup>3</sup>

After a seven-day hearing, the Extended Hearing Panel issued a decision finding that Merrimac and Nash had committed the alleged violations and imposing sanctions against both respondents.<sup>4</sup>

This appeal followed.

## III. Merrimac and Nash Provided Documents with Falsified Signatures to FINRA

The Extended Hearing Panel found that Merrimac and Nash provided documents with falsified signatures to FINRA, in violation of FINRA Rules 8210 and 2010. After a de novo review, we affirm this finding.

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<sup>2</sup> Prior to the hearing, Pizzuti, Matthews, Dubrule, and Tuttle settled the claims against them and the case proceeded against Merrimac and Nash only.

<sup>3</sup> The conduct rules that apply in this case are those that existed at the time of the conduct at issue.

<sup>4</sup> The Extended Hearing Panel dismissed the claim against Nash for failure to establish and implement an adequate AML system.

A. Facts

1. Merrimac Registered Representative Falsifies Forms

From 2008 through 2010, Merrimac customers increasingly traded low-priced securities not listed on a national securities exchange (so-called “penny stocks”). When a customer deposited penny stocks in his or her account, Merrimac used a form provided by its clearing firm (the Deposit Securities Request for Bulletin Board, Pink Sheet and Unregistered Securities (the “DSR form”). The DSR form required the customer to provide information about the source of the stock for the purpose of determining whether it was qualified for resale either because it was registered or because it qualified for a valid exemption from registration. The DSR form was to be signed by the customer, who represented that the information provided was “true and correct,” and then signed by the registered representative. The registered representative would then forward the form for review and approval by either one or two Merrimac supervisors.

Merrimac and Nash learned that from February through September 2010, CS, a registered representative who assisted Dubrule in the Orlando branch office, had falsified a number of DSR forms by photocopying Dubrule’s and Nash’s signatures on the document.<sup>5</sup> The falsification of these documents resulted in expediting the deposit and clearing process. CS’s falsification came to light when she admitted her misconduct to Dubrule. Dubrule and CS subsequently had a meeting with Nash and Pizzuti to discuss what had happened. After learning that CS had falsified DSR forms, Merrimac and Nash did not take any additional steps to investigate the scope and impact of CS’s misconduct, did not make any written record of the incident, and did not take any disciplinary action against CS.

2. Nash Provides the Falsified Forms to FINRA

From September 2010 through December 2012, FINRA sent respondents four FINRA Rule 8210 requests for documents and information.<sup>6</sup> These requests were directed to Nash, and Nash supervised the collection and production of the documents to FINRA on behalf of Merrimac. In response to each request, Merrimac and Nash provided copies of DSR forms on which CS had photocopied signatures without informing FINRA of the falsification.

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<sup>5</sup> As discussed below, Merrimac and Nash have taken several contradictory positions about when they learned that CS had falsified the DSR forms.

<sup>6</sup> The September 23, 2010 and March 23, 2011 requests were sent by FINRA’s Office of Fraud Detection and Market Intelligence in connection with its investigation of the trading of two penny stocks. The January 6, 2011 request was sent in connection with FINRA’s 2010 routine cycle examination of Merrimac. The December 20, 2012 request was sent by FINRA’s New York district office after the various Merrimac investigations were consolidated there.

On September 23, 2010, FINRA sent a Rule 8210 request to Nash's attention requesting documents from Merrimac in connection with FINRA's investigation of the trading activity in a penny stock. Nash responded on behalf of Merrimac, producing responsive documents that included a DSR form filed in connection with the deposit of 70,000 shares of the penny stock by one of Dubrule's customers. This DSR form was one on which CS had photocopied Nash's signature.

On January 6, 2011, FINRA sent Nash a Rule 8210 request for documents in connection with FINRA's 2010 routine cycle examination of Merrimac. Among other things, the request asked for copies of the customer files for 22 customers who were actively trading penny stocks at Merrimac. In response to this request, Merrimac and Nash produced documents that included approximately 30 DSR forms on which CS had photocopied Nash's signature. The respondents did not inform FINRA that the production included these documents with falsified signatures.

On March 23, 2011, FINRA sent Nash a Rule 8210 request in connection with the trading in another penny stock. Merrimac and Nash produced responsive documents that included a DSR form on which CS had photocopied Nash's signature, but again, did not inform FINRA of the falsification.

Finally, on December 20, 2012, FINRA sent Nash another Rule 8210 request, which sought documents concerning the deposit and liquidation of penny stocks by three Merrimac customers. Nash's response on behalf of Merrimac to this request included DSR forms for two customers on which CS had photocopied Nash's signature. Again, the respondents did not alert FINRA that the DSR forms had been falsified.

## B. Discussion

### 1. Applicable Law

FINRA Rule 8210(a) provides that FINRA staff may "require a member, person associated with a member, or any other person subject to FINRA's jurisdiction to provide information orally, in writing, or electronically . . . with respect to any matter involved in the investigation, complaint, examination, or proceeding" and to "inspect and copy the books, records, and accounts of such member or person with respect to any matter involved in the investigation, complaint, examination, or proceeding."

FINRA Rule 8210 is indispensable to FINRA's ability to fulfill its regulatory functions. Because FINRA does not have subpoena power, it "must rely on [FINRA] Rule 8210 to obtain information . . . necessary to carry out its investigations and fulfill its regulatory mandate." See *CMG Inst. Trading, LLC*, Exchange Act Release No. 59325, 2009 SEC LEXIS 215, at \*15 (Jan. 30, 2009); see also *Howard Brett Berger*, Exchange Act Release No. 58950, 2008 SEC LEXIS 3141, at \*13 (Nov. 14, 2008) (stating that Rule 8210 "is at the heart of the self-regulatory system for the securities industry"), *aff'd*, 347 F. App'x 692 (2d Cir. 2009); *PAZ Sec., Inc.*, Exchange Act Release No. 57656, 2008 SEC LEXIS 820, at \*12 (Apr. 11, 2008) (stating that FINRA's "lack of subpoena power thus renders compliance with Rule 8210 essential to enable [FINRA] to execute its self-regulatory functions"), *aff'd*, 566 F.3d 1172 (D.C. Cir. 2009). A violation of

FINRA Rule 8210 constitutes a violation of FINRA Rule 2010. *See Dep't of Enforcement v. Reichman*, Complaint No. 200801201960, 2011 FINRA Discip. LEXIS 18, at \*29 (FINRA NAC July 21, 2011).

It is well settled that providing false or misleading information to FINRA in response to a FINRA Rule 8210 request violates both Rule 8210 and FINRA Rule 2010.<sup>7</sup> *See Geoffrey Ortiz*, Exchange Act Release No. 58416, 2008 SEC LEXIS 2401, at \*23 (Aug. 22, 2008); *Dep't of Enforcement v. Masceri*, Complaint No. C8A040079, 2006 NASD Discip. LEXIS 29, at \*36 (NASD NAC Dec. 18, 2006) (explaining that “[i]t is axiomatic that Procedural Rule 8210 prohibits an associated person from providing false or misleading information to [FINRA] in connection with an examination or investigation”); *Dep't of Enforcement v. Walker*, Complaint No. C10970141, 2000 NASD Discip. LEXIS 2, at \*26-27 (NASD NAC Apr. 20, 2000) (affirming a violation of FINRA Rule 8210 where an associated person made false statements during on-the-record testimony). Providing false information to FINRA “can conceal wrongdoing and thereby subvert [FINRA’s] ability to perform its regulatory function and protect the public interest.” *Ortiz*, 2008 SEC LEXIS 2401, at \*32 (internal quotations omitted). Scierter is not an element of a FINRA Rule 8210 violation and, accordingly, there is no requirement that we find that false information was intentionally submitted to FINRA. *See Berger*, 2008 SEC LEXIS 3141, at \*39 (holding that scierter is not an element of a Rule 8210 violation); *Richard J. Rouse*, 51 S.E.C. 581, 585 (1993) (rejecting the argument that a violation of FINRA Rule 8210’s predecessor required a finding of scierter).

Merrimac and Nash submitted a number of DSR forms on which Nash’s signature had been copied by a Merrimac registered representative and which falsely represented that the documents had been subject to supervisory review. For the reasons set forth below, we agree with the Extended Hearing Panel that by submitting these falsified documents to FINRA, without notifying FINRA of the falsification, Merrimac and Nash violated FINRA Rules 8210 and 2010.<sup>8</sup>

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<sup>7</sup> FINRA Rule 2010 provides that a “member, in the conduct of [its] business, shall observe high standards of commercial honor and just and equitable principles of trade.” A violation of any FINRA Rule, including FINRA Rule 8210, is also a violation of FINRA Rule 2010. *See William J. Murphy*, Exchange Act Release No. 69923, 2013 SEC LEXIS 1933, at \*26 n.29 (July 2, 2013), *aff’d sub nom., Birkelbach v. SEC*, 751 F.3d 472 (7th Cir. 2014). FINRA Rule 2010 applies to associated persons through FINRA Rule 0140(a), which provides that the rules “shall apply to all members and persons associated with a member” and that “[p]ersons associated with a member shall have the same duties and obligations as a member under the Rules.”

<sup>8</sup> The parties argued extensively at the hearing about whether the DSR forms with the photocopied signatures qualified as “forgeries.” We agree with the Extended Hearing Panel that we need not reach this issue. The complaint refers to the DSR forms in question as both “falsified” and “forged.” It is sufficient for the finding of violations here that the documents were falsified by the photocopying of Nash’s signature, which falsely represented that the document had been subject to his supervisory review.

## 2. Respondents' Arguments on Appeal

Merrimac and Nash advance several arguments on appeal to support their position that they did not violate FINRA Rules 8210 and 2010 by submitting falsified documents. Merrimac and Nash argue that they did not know about the falsified DSR forms until after responding to the relevant FINRA Rule 8210 requests and that there were not 37 falsified DSR forms as the Extended Hearing Panel found. Respondents also move to introduce additional evidence on appeal that they claim shows that the signatures on certain of the DSR forms were genuine. Nash further argues that he had no motive to submit falsified documents to FINRA and that the documents were not "produced" to FINRA by Nash, but rather, were the responsibility of another Merrimac employee. We address each argument below.

### a. Nash Was Responsible for Merrimac's Responses to FINRA's Rule 8210 Requests

Nash argues that he is not responsible for the submission of the falsified DSR forms because the collection and production of these documents were handled by RB and MT, other Merrimac principals. Nash's argument is unavailing.

All four FINRA Rule 8210 requests were directed to Nash and the record supports that Nash oversaw the responses. The law is clear that Nash, as the person at Merrimac to whom the Rule 8210 requests were directed and who oversaw the firm's responses, had responsibility over the falsified responses to FINRA, and cannot shift his responsibility to others. *See Michael Markowski*, 34 F.3d 99, 104 (2d Cir. 1994) (rejecting the argument that the senior officer of a brokerage firm relied on reasonable delegation of his obligation to produce documents to an employee); *see also Dep't of Enforcement v. Eplboim*, Complaint No. 2011025674101, 2014 FINRA Discip. LEXIS 8, at \*22-23 (FINRA NAC May 14, 2014) (finding that the respondent had an obligation to produce documents under a FINRA Rule 8210 request directed to him and rejecting his attempt to shift responsibility to his firm); *Michael David Borth*, 51 S.E.C. 178, 181 (1992) (rejecting respondent's attempt to shift responsibility to respond to NASD Rule 8210 requests). Nash produced falsified documents in response to FINRA Rule 8210 requests directed to him and he failed to inform FINRA that the documents had been falsified.

### b. Respondents' Knowledge of the Falsified DSR Forms

Respondents have told several contradictory stories about the timing of the meeting between Nash, Pizzuti, Dubrule, and CS during which they learned that CS had been photocopying Dubrule's and Nash's signatures on DSR forms. In sworn, on-the-record testimony given prior to the filing of the complaint, Pizzuti testified that the meeting occurred around the time that Merrimac adopted a new procedure for penny stocks in September 2010

(i.e., at or around the time of the first FINRA Rule 8210 request).<sup>9</sup> During his testimony at the hearing, Pizzuti changed his previous sworn statement and claimed that the meeting occurred in April or May 2011. Then, in the post-hearing brief submitted by Pizzuti on Merrimac's behalf, he claimed the meeting occurred in 2013. Nash also testified during the hearing that the meeting occurred in April or May 2011, but in his application for review to the NAC, claimed he did not learn of the falsified DSR forms until 2013.

The record supports Pizzuti's original admission with respect to the timing of when Merrimac and Nash learned of the falsified DSR forms (i.e., that the meeting at which they learned of the falsifications occurred in or around September 2010). Pizzuti's testimony is corroborated by the fact that CS's falsification of the DSR forms ceased in September 2010 and by Merrimac's adoption of the new penny stock procedure, which specifically provided that all DSR forms "must be signed by compliance or corporate management before being forwarded to the clearing firm." Respondents' subsequent coordinated, self-serving, and contradictory statements made after this disciplinary proceeding commenced about the timing of when they learned about CS's misconduct are unsupported by the record.<sup>10</sup> Based on this evidence in the record, we find that Merrimac and Nash learned of the falsification in or around September 2010, prior to the January 6, 2011, March 23, 2011, and the December 20, 2012 FINRA Rule 8210 requests.

Moreover, the respondents took no steps after learning of the falsification to determine whether and to what extent falsified documents were produced in response to FINRA's Rule 8210 requests or to alert FINRA to the falsification issue. *See DBCC v. Pelaez*, Complaint No. C07960003, 1997 NASD Discip. LEXIS 34, at \*10 (NASD NBCC May 22, 1997) (finding that respondents violated FINRA Rule 8210's predecessor because they knew that forged documents had been submitted to NASD by the firm, but "did not take any steps to advise . . . NASD of this fact").

The totality of the record supports that Nash and Merrimac produced falsified documents to FINRA knowing of the falsification in advance, taking no steps to determine whether and to what extent falsified documents were produced in response to FINRA's requests, and failing to

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<sup>9</sup> In his on-the-record testimony, Pizzuti testified that the meeting occurred within 6 and 60 days of adoption of the September 2010 policy.

<sup>10</sup> Merrimac's and Nash's late claim that they did not learn of the falsification until 2013, the year FINRA filed the complaint in this proceeding, is even more problematic. Nash and Pizzuti gave sworn, on-the-record testimony in March and February 2013, respectively. At that time, Pizzuti stated that the meeting with Nash, Dubrule, and CS had occurred around the time of the adoption of the penny stock procedure in 2010 and Nash indicated that he learned of the falsification in 2011. It defies logic that if that meeting had actually just occurred sometime in the previous three months, neither Pizzuti nor Nash would not have remembered that fact during their on-the-record testimony.



alert FINRA that the responsive documents might contain DSR forms with falsified signatures.<sup>11</sup> We find that this misconduct violated FINRA Rules 8210 and 2010.

c. Respondents' Challenges to the Number of Falsified DSR Forms

The Extended Hearing Panel found that 37 falsified DSR forms were submitted to FINRA. Merrimac and Nash dispute this number and have moved to introduce additional evidence purporting to show that certain of the signatures on these DSR forms were genuine. After reviewing respondents' motions and the record evidence, we deny the motions and affirm the finding that respondents submitted in excess of 30 falsified DSR forms to FINRA.

On appeal, respondents each submitted motions seeking to introduce additional evidence.<sup>12</sup> Among other things, the motions seek to admit 10 emails that were sent from Nash to CS which purport to forward the signature page for nine<sup>13</sup> of the DSR forms for which the Extended Hearing Panel found Nash's signature was falsified, but which Nash claims he actually signed and returned.

A subcommittee of the NAC ("Subcommittee") denied the respondents' motions to introduce this evidence and we adopt the Subcommittee's ruling as our own. FINRA Rule 9346(b) provides that a motion to introduce additional evidence shall demonstrate that there was good cause for failing to introduce the evidence in the hearing below and why the evidence is material to the proceeding. *See Dep't of Enforcement v. KCD Fin., Inc.*, Complaint No. 2011025851501, 2016 FINRA Discip. LEXIS 38, at \*83 (FINRA NAC Aug. 3, 2016), *aff'd*, 2017 SEC LEXIS 986 (Mar. 29, 2017). The respondents' motions do not establish either of these requirements.

The respondents do not demonstrate good cause why they did not introduce this evidence in the hearing below. These emails are Merrimac documents from February through June 2010

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<sup>11</sup> Nash's argument that he had no "motive" to submit falsified evidence to FINRA is not relevant. There is no requirement that intent or motive be proven.

<sup>12</sup> On June 11, 2015, Nash submitted a motion to introduce additional evidence to the Office of Hearing Officers more than a month after Nash's Notice of Appeal to the NAC was acknowledged and Nash was instructed to submit any additional filings to the NAC. Despite Nash's faulty filing of his motion, we will treat his motion as made to the NAC under FINRA Rule 9346(b). On June 17, 2015, Merrimac submitted a motion joining in Nash's motion and seeking to introduce an additional category of documents.

<sup>13</sup> Nash submitted 10 such emails, but two appear to be duplicates.

that were available to the respondents at the time of the hearing. Indeed, in a June 18, 2015 email to FINRA submitting additional documents, Nash indicates that documents were located by Merrimac's "IT person." The respondents attempt to blame Enforcement for their failure to introduce this evidence. Nash writes that Enforcement "had access to these e-mails yet they never produced them or never investigated them." No party, however, had better access to Nash's emails than Merrimac and Nash.

Most of the documents the respondents proffer are also not relevant. Of the nine DSR form signature pages submitted, four contain signatures for Nash that are very different from his purported signature on the comparable DSR forms in evidence, and thus do not provide any evidence concerning whether the subject DSR forms were falsified. If anything, these documents support the finding that the DSR forms in evidence were falsified. Another three are signature pages with no indication for which customer or transaction they were signed, and another does not match any of the transactions for which there are DSR forms in evidence.<sup>14</sup>

Respondents have failed to demonstrate how these emails, which they could have introduced at the hearing, are relevant to the DSR forms which the Extended Hearing Panel found were falsified. Consequently, we adopt the Subcommittee's ruling and deny respondents' motions to introduce this evidence.<sup>15</sup>

Respondents also argue that two of the 37 DSR forms found by the Extended Hearing Panel to be falsified were duplicates of two others. They further claim another two were inadvertently split and actually refer to a single transaction, and that another should not be considered because that transaction was "not cleared."

Assuming respondents' arguments with respect to these five DSR forms are correct, it does not change our analysis. The fact that respondents produced the same two falsified DSR forms in response to two separate FINRA Rule 8210 requests does not change the fact that they twice submitted falsified documents to FINRA. Similarly, the fact that two of the DSR forms

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<sup>14</sup> Two of the emails submitted appear to possibly match the DSR forms in evidence. Given the respondents' failure to meet the standard under FINRA Rule 9346(b) and the fact that they have provided no evidence to contradict the Extended Hearing Panel's findings with respect to the remaining 35 DSR forms, this evidence does not change our underlying analysis that Merrimac and Nash submitted false documents to FINRA.

<sup>15</sup> Nash filed a renewed motion to introduce new evidence on October 23, 2015. We adopt the Subcommittee's denial of this motion. In addition to failing to establish the requirements of FINRA Rule 9346(b), the motion was untimely.

were in connection with transactions that were ultimately consolidated into one transaction does not change the fact that Merrimac's records contained, and respondents produced to FINRA, two DSR forms with falsified signatures. It is not the underlying transaction that is at issue, but the fact that the respondents submitted documents to FINRA falsely reflecting a supervisory review that actually never occurred without telling FINRA the forms had been falsified. The same analysis applies to the DSR form for the transaction respondents claim did not "clear."

We affirm the finding that Merrimac and Nash violated FINRA Rules 8210 and 2010 by producing falsified documents to FINRA in response to FINRA Rule 8210 requests.

#### IV. Merrimac Sold Unregistered Securities

##### A. Facts

On July 15, 2010, Merrimac Customer J purchased shares of United States Oil & Gas Corporation ("USOG"), a company traded on the Pink Sheets electronic over-the-counter market. Customer J purchased 100 million shares for \$50,000 from JT through a stock purchase agreement. JT had sold an oil and gas company he owned, Company A, to USOG for a cash payment and a \$3.75 million convertible promissory note and acquired his USOG shares through the exercise of his conversion rights under the note.<sup>16</sup> The note was convertible for up to 400 million shares of USOG, an amount totaling 38% of USOG's outstanding shares.

The stock purchase agreement indicated that USOG securities could not be resold unless they were registered or exempt from registration. On August 9, 2010, Customer J deposited 56.5 million of these USOG shares into its Merrimac account. From October 1 through October 8, 2010, Customer J sold all the USOG stock in its Merrimac account for \$124,000 in gross proceeds.

A DSR form was completed in connection with Customer J's deposit and sale of the USOG shares. This was one of the DSR forms on which CS falsified Dubrule's and Nash's signatures. Customer J indicated in the DSR form that it had purchased the USOG shares from JT. The DSR stated that JT's shares of USOG were acquired subject to a registration statement even though they were not. The DSR also represented that JT was not an affiliate or 10% holder of the issuer, USOG. Customer J provided Merrimac with an August 4, 2010 stock certificate for its USOG stocks which did not contain a restrictive legend.

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<sup>16</sup> After the May 15, 2009 sale, Company A was a wholly owned subsidiary of USOG. In connection with the sale, JT signed an employment agreement pursuant to which he agreed to serve as Company A's President for three years. In a December 31, 2009 SEC filing, USOG identified JT as an executive officer of USOG.

B. Discussion

The Extended Hearing Panel found that Merrimac violated FINRA Rule 2010 by causing the sale of unregistered securities in violation of Securities Act Section 5 when it sold USOG shares for Customer J's account. We agree.

1. Enforcement Established a Prima Facie Case of a Section 5 Violation

Section 5 of the Securities Act prohibits the offer and sale of a security unless a registration statement is in effect for the security or a valid exemption from registration applies to the transaction. 15 U.S.C. § 77e(a), (c). The purpose of the registration requirement of Section 5, and the Securities Act as a whole, is to “protect investors by promoting full disclosure of information thought necessary to informed investment decisions.” *See SEC v. Ralston Purina Co.*, 346 U.S. 119, 124 (1953). In order to establish a violation of Section 5, Enforcement must show that Merrimac sold or offered to sell USOG while no registration statement was in effect through the use of interstate facilities or mail. *See Gordon Brent Pierce*, Exchange Act Release No. 71664, 2014 SEC LEXIS 4544, at \*27 (Mar. 7, 2014) (setting forth the elements of a prima facie case for a Section 5 violation); *World Trade Fin. Corp.*, Exchange Act Release No. 66114, 2012 SEC LEXIS 56, at \*23-24 (Jan. 6, 2012) (same). There is strict liability for violations of Section 5 and no showing of scienter is required. *See Alvin W. Gebhart*, Exchange Act Release No. 53136, 2006 SEC LEXIS 93, at \*53 (Jan. 18, 2006), *aff'd*, 595 F.3d 1034 (9th Cir. 2010), *aff'd*, 561 U.S. 1008 (2010). A violation of Securities Act Section 5 is a violation of high standards of commercial honor and just and equitable principles of trade under FINRA Rule 2010. *See, e.g., Id.* at \*54 n.75; *Stephen J. Gluckman*, 54 S.E.C. 175, 185 (1999).

We agree that enforcement established a prima facie case of a violation of Section 5 here. It is undisputed that Merrimac offered Customer J's USOG shares for sale when there was no registration statement in effect. Because the sales were effected through an over-the-counter market, the interstate instrumentalities requirement is met. *See, e.g., Dep't of Enforcement v. ACAP Fin., Inc.*, Complaint No. 2007008239001, 2012 FINRA Discip. LEXIS 55, at \*10 (FINRA NAC Sept. 26, 2012) (noting that use of over-the-counter market constitutes use of interstate means), *aff'd*, Exchange Act Release No. 70046, 2013 SEC LEXIS 2156 (July 26, 2013), *aff'd*, 783 F.3d 763 (Apr. 3, 2015).

2. Merrimac Failed to Prove an Applicable Exemption From Registration

Once a prima facie case of a violation of Section 5 is established, the burden shifts to the respondent to prove the affirmative defense of an applicable exemption of registration. *See Pierce*, 2014 SEC LEXIS 4544 (noting that exemptions from registration are affirmative defenses that must be established by the party asserting the defense). The exemptions “are construed strictly to promote full disclosure of information for the protection of the investing public.” *Id.* at 30 n.29 (citing *SEC v. Cavanagh*, 445 F.3d 105, 115 (2d Cir. 2006)).

Securities Act Section 4(a) provides certain exemptions from registration. 15 U.S.C. § 77d(a). Section 4(a)(1) states that the provisions of Section 5 shall not apply to “[t]ransactions

by any person other than an issuer, underwriter, or dealer.” The terms “issuer” and “underwriter” are broadly defined by the Securities Act. *See, e.g., Cavanagh*, 445 F.3d at 111 (explaining that the definition of issuer in the Securities Act is interpreted broadly); *Harden v. Raffensperger, Hughes & Co.*, 65 F.3d 1392, 1400 (7th Cir. 1994) (stating that the term underwriter has been interpreted broadly). An underwriter is defined as “any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has direct or indirect participation in any such undertaking.” 15 U.S.C. § 77b(a)(11). An “issuer” is defined as “every person who issues or proposes to issue any security.” 15 U.S.C. § 77b(a)(4). Under this broad definition, JT was an underwriter for USOG stock for purposes of Section 5.

Merrimac appears to rely on Securities Act Rule 144 as the grounds for arguing that the USOG shares sold for Customer J’s account were exempt from registration. Rule 144 provides a safe harbor for parties who are deemed not to be engaged in the distribution of securities and, accordingly, not to fall within the broad definition of an “underwriter.” 17 C.F.R. § 230.144. However, the safe harbor is limited by a holding period that must be met by the person claiming the safe harbor. Rule 144(d)(1)(i) provides that when the securities sold are restricted, if the issuer is or has been subject to the reporting requirements of Sections 13 or 15(d) of the Exchange Act for a period of at least 90 days immediately before the sale, “a minimum of six months must elapse between the later of the date of the acquisition of the securities from the issuer, or from an affiliate of the issuer, and any resale of such securities in reliance on this section for the account of either the acquiror or any subsequent holder of those securities.” 17 C.F.R. § 230.144(d)(1)(i). An “affiliate” of an issuer is defined by Rule 144 as “a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, such issuer.” 17 C.F.R. § 230.144(a)(1). Factors the SEC has indicated as relevant to the determination of “control” include an individual’s status as a director, officer, or 10% shareholder. *See American-Standard*, 1972 SEC No-Act. LEXIS 3787, at \*1 (Oct 11, 1972).

We agree with the Extended Hearing Panel that Merrimac has not met the burden of proving an applicable exemption for Customer J’s sales of USOG stock. As stated above, JT was an “underwriter” for the purposes of Section 5 and the shares of USOG sold by JT to Customer J were not sold subject to a registration statement. Moreover, the safe harbor for resales of restricted securities under Securities Act Rule 144 does not apply to Customer J’s sales of USOG. Customer J acquired the USOG shares through a stock purchase agreement from JT on July 15, 2010, the same day that JT converted a portion of his note into those USOG shares. On that day, JT was an affiliate of USOG and thus the time limits set forth in Securities Act Rule 144 applied.<sup>17</sup> JT controlled more than 10% of USOG’s outstanding stock, had been identified

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<sup>17</sup> As discussed above, on June 11, 2015, Nash submitted a motion to introduce additional evidence on appeal. On June 17, 2015, Merrimac also moved to introduce additional evidence, joining in Nash’s motion. In both motions, respondents seek, in part, to introduce four notices of conversion by JT of amounts due under this promissory note with USOG to shares of stock of USOG and four stock purchase agreements for sales of these shares to other parties, including

as an executive officer of USOG in an SEC filing six months before, and was President of USOG's wholly owned subsidiary. Customer J sold the USOG stock in his Merrimac account in October 2010, before the six month holding period had run.

Merrimac's reliance on the statement in JT's Notice of Conversion of the Promissory Note that JT was not an affiliate is insufficient. FINRA member firms are required to take "whatever steps necessary to ensure that the [transaction] does not involve an issuer, a person in a control relationship with an issuer or an underwriter." *FINRA Regulatory Notice 09-05*, 2009 FINRA LEXIS 7, at \*4 (Jan. 2009). Firms "must take reasonable steps to ensure that the transaction qualifies for the exemption, regardless of whether the sale is for its own accounts or on behalf of customers" and the firm "may not rely solely on others" to make this determination. *Id.* at \*3-4. The record supports that Merrimac did not take these steps and relied solely on a DSR form which contained a falsified signature.

We find that Merrimac failed to prove an applicable exemption from the registration requirements for Customer J's sales of USOG and, consequently, violated FINRA Rule 2010 by causing sales of unregistered securities in contravention of Securities Act Section 5.

V. Merrimac Failed to Establish and Implement Effective AML Policies and Procedures

The Extended Hearing Panel found that, from May 2009 through January 2011, Merrimac failed to establish and maintain supervisory procedures reasonably designed to achieve compliance with AML laws and to monitor and detect suspicious activity, in violation of NASD

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Customer J. Respondents argue that these documents show that JT was not an affiliate of USOG because JT never owned more than "9.9%" of USOG stock "at any one time."

The Subcommittee denied respondents' motion to introduce this evidence and we adopt that recommendation as our own. Other than to state that the proffered documents were "recently received" from JT, respondents failed to show good cause for failing to introduce the evidence in the hearing below as required under FINRA Rule 9346(b). These documents are dated July and August 2010 and, accordingly, existed years before the hearing in this matter.

The documents are also not relevant to prove an applicable exemption from registration as Merrimac claims. The documents show that on three consecutive days in July 2010—July 13, 14, and 15—JT converted and, on the same day, sold 100 million shares of USOG. Another 100 million shares were converted and sold on August 31, 2010. The documents indicate an intentional structuring of the transaction to attempt to avoid the appearance that JT was a control person for purposes of Rule 144. However, even if we disregard the August 31, 2010 conversion, over the span of three days in July, JT converted and sold 300 million USOG shares, amounting to approximately 29% of outstanding USOG shares. Accordingly, the proffered documents do not change our analysis.

Rule 3011 and FINRA Rules 3310 and 2010. The Extended Hearing Panel also dismissed these claims against Nash because he was not the firm's designated AMLCO. We agree and affirm.

A. Facts

During the relevant time period, Matthews was Merrimac's designated AMLCO and was responsible for drafting Merrimac's AML procedures and monitoring for suspicious activity. Three sets of Merrimac AML procedures were in effect during the relevant time period. The first, Merrimac's AML Program Compliance and Supervisory Procedures dated January 1, 2007 ("2007 AML Procedures"), made only passing reference to penny stocks and provided no guidance on how to monitor penny stock trading.

In 2008, Merrimac customers began trading penny stocks and, by 2010, the amount of penny stock trading at Merrimac had grown significantly. On January 1, 2010, Merrimac adopted new AML procedures ("2010 Procedures"). These procedures consisted of the small firm template provided by FINRA. The template, however, was not customized for Merrimac's business. In numerous places where Merrimac should have inserted information into bracketed areas, Merrimac did not do so. The 2010 Procedures provided no specific guidance for what to do if red flags were identified.

In September 2010, Merrimac adopted a one-page policy and procedure specifically for penny stocks (the "Penny Stock Procedure"). The Penny Stock Procedure required the completion of the DSR form for penny stock transactions, signing of the DSR form by compliance or corporate management, and directed representatives to ensure that the law firm "attesting to the supporting documentation" attached to the DSR form was not on the OTC market's prohibited attorneys list. The Penny Stock Procedure provided no guidance on how to determine whether stock was tradable and no guidance on detecting red flags and what to do if red flags were detected.

B. Discussion

The Bank Secrecy Act ("BSA")<sup>18</sup> provides the framework for the AML obligations applicable to financial institutions. The Department of the Treasury delegated its authority to administer the BSA to the Financial Crimes Enforcement Network ("FinCEN").<sup>19</sup> NASD Rule 3011, now FINRA Rule 3310, requires FINRA members to develop and implement a written AML program reasonably designed to achieve and monitor compliance with the requirements of the BSA and its implementing regulations.<sup>20</sup> *See Dep't of Enforcement v. N. Woodward Fin.*

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<sup>18</sup> 31 U.S.C. § 5311 *et seq.*

<sup>19</sup> *See* Amendment to the Bank Secrecy Act Regulations—Requirement that Broker or Dealers in Securities Report Suspicious Transactions, 67 Fed. Reg. 44048 (July 1, 2002).

<sup>20</sup> NASD Rule 3011 was adopted as FINRA Rule 3310 without substantive changes, effective January 1, 2010. *See FINRA Regulatory Notice 09-60*, 2009 FINRA LEXIS 171 (Oct.

*Corp.*, Complaint No. 2011028502101, 2016 FINRA Discip. LEXIS 35, \*29 (FINRA NAC July 19, 2016). The rule sets forth the minimum requirements for an AML compliance program, including the requirement that a firm establish and implement policies, procedures, and internal controls reasonably designed to achieve compliance with the BSA and the implementing regulations thereunder. *See* NASD Rule 3011(b); FINRA Rule 3310(b); *see also* *N. Woodward*, 2016 FINRA Discip. LEXIS 35, at \*29. A violation of NASD Rule 3011 or FINRA Rule 3310 also constitutes a violation of FINRA Rule 2010. *See* *Kenny Akindemowo*, Exchange Act Release No. 79007, 2016 SEC LEXIS 3769, at \*13 (Sept. 30, 2016) (finding that it is “well established that a violation of an SRO rule is conduct inconsistent with just and equitable principles of trade and therefore is also a violation of FINRA Rule 2010”).

FINRA has provided explicit guidance concerning firms’ AML compliance obligations. *See* *NASD Notice to Members 02-21*, 2002 NASD LEXIS 24, at \*16-20 (Apr. 2002). A firm’s AML procedures must be tailored to “reflect the firm’s business model and customer base” and take into account factors such as the firm’s “business activities, the types of accounts it maintains, and the types of transactions in which its customers engage.” *Id.*; *see also* *Dep’t of Enforcement v. Domestic Sec., Inc.*, Complaint No. 2005001819101, 2008 FINRA Discip. LEXIS 44, at \*11 (FINRA NAC Oct. 2, 2008). Notice to Members 02-21 reminds member firms of their duty to detect and investigate red flags indicating potential money laundering and sets forth a non-exhaustive list of such red flags. 2002 NASD LEXIS 24, at \*37-42. Red flags include, without limitation, the questionable background of the customer, a customer’s lack of concern with commissions, and whether the customer tries to avoid the firm’s documentation procedures. *Id.* at \*37-40. Transactions involving speculative, low-priced, “penny” stocks also can constitute a red flag requiring further inquiry. *Id.* at \*40. Once a firm identifies suspicious activity, it is required to file a suspicious activity report (“SAR”) with FinCEN. *Id.* at \*42-43.

FINRA published a small firm template to assist small firms in developing AML procedures. The template, however, is a starting point and warns firms that the procedures should be tailored to the firm’s business and that use of the template does not “provide a safe harbor from regulatory responsibility.”<sup>21</sup> On the first page of the template, FINRA cautions

This template is provided to assist small firms in fulfilling their responsibilities to establish an Anti-Money Laundering (AML) Program as required by the Bank Secrecy Act (BSA) and its

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2009). NASD Rule 3011 and FINRA Rule 3310, in relevant part, provide that “[e]ach member shall develop and implement a written anti-money laundering program reasonably designed to achieve and monitor the member’s compliance with the requirements of the Bank Secrecy Act . . . and the implementing regulations promulgated thereunder.”

<sup>21</sup> FINRA’s Small Firm Template, at 1. A copy of the Small Firm Template is available at <http://www.finra.org/sites/default/files/industry/p011419.doc>.



implementing regulations and FINRA Rule 3310 (AML Compliance Program). Nothing in this template creates any new requirements for AML programs. **Furthermore, following this template does not guarantee compliance with AML Program requirements or provide a safe harbor from regulatory responsibility.** There is no exemption from the AML rules for small broker-dealers.<sup>22</sup>

The template also explains that:

The language in this template is provided only as a helpful starting point to walk you through developing your firm's program. If any of the language does not adequately address your firm's business situation in any respect, you will need to prepare your own language. You are responsible for ensuring that the program fits your firm's risk level and that you implement the program.<sup>23</sup>

We agree that Merrimac failed to develop and implement adequate AML procedures. Despite starting penny stock trading in 2008, Merrimac did not implement any procedures to monitor penny stocks until 2010. And, when it did so, it adopted FINRA's small firm template with virtually no tailoring to its particular business. *See, e.g., Domestic Sec., 2008 FINRA Discip. LEXIS 44, at \*18* (finding that respondent failed to establish adequate AML procedures where the firm did not tailor FINRA's small firm template). Merrimac did not even bother to fill in obvious blanks where the template called for the firm to insert information.

We also agree that Merrimac failed to implement its procedures. The record reflects that at least three Merrimac registered representatives received blank DSR forms from customers that were signed but not filled out, despite the fact that the customer's signature attested to the accuracy of the information provided on the form. Merrimac's argument that these customers required "help" filling out the form is unavailing. The record also shows that Merrimac failed to detect, investigate, and document red flags in penny stock trading, including patterns of large deposits and liquidations of penny stocks. Finally, the record shows that Merrimac failed to identify a number of customers trading in penny stocks with significant disciplinary histories, including bars from the securities industry, the fact that several customer acquired their shares as a result of stock promotion activities, and the timing of penny stock trading with positive press releases.

For these reasons, we find that Merrimac failed to develop and implement adequate AML procedures, in violation of NASD Rule 3011 and FINRA Rules 3310 and 2010.

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<sup>22</sup> *Id.* at 1.

<sup>23</sup> *Id.* at 1-2.

VI. Merrimac and Nash Failed to Establish a Reasonable Supervisory System

The Extended Hearing Panel found that Merrimac and Nash failed to establish and enforce an adequate supervisory system, including adequate WSPs, in violation of NASD Rules 3010 and 2110 and FINRA Rule 2010.<sup>24</sup> We affirm these findings.

A. Facts

The Extended Hearing Panel found that respondents' supervision and procedures were inadequate in four areas, including the supervision of: (1) Dubrule's and Tuttle's private securities transactions; (2) penny stock deposits; (3) investment-related websites operated by Pizzuti; and (4) Merrimac's use of foreign finders.

1. Dubrule's and Tuttle's Private Securities Transactions

When Dubrule and Tuttle joined Merrimac, they owned, operated, and managed the assets of two hedge funds, the Dellinger Fund and the TAM Dynamic Allocation Fund. Upon joining Merrimac, Dubrule and Tuttle requested approval to continue operating the funds and Merrimac approved their requests. In its approval letter, Merrimac provided that Dubrule's and Tuttle would not solicit additional investments in the funds, including from Merrimac customers. Under Merrimac's WSPs, Nash was responsible for reviewing and monitoring Dubrule and Tuttle's activities with the funds. Nash, however, testified that he did not do so because he believed Matthews (the firm's AMLCO) was supervising these activities. The record supports that Matthews' review was limited to reviewing statements for the funds.

During the time Dubrule and Tuttle were associated with Merrimac, they solicited new investments in the funds from three customers, including Merrimac customers. These three customers invested a total of \$4.1 million in the funds. Dubrule and Tuttle failed to submit documentation with respect to these transactions and their management of fund assets to Merrimac.

2. Supervision of Penny Stock Deposits

As discussed above, CS, a registered representative in the Orlando Merrimac branch, falsified more than 30 DSR forms in connection with deposits of penny stocks by photocopying Nash's signature on the documents. As a result, Merrimac caused the sale of unregistered securities in contravention of Securities Act Section 5. Nash was responsible for supervising the Orlando branch. When he learned of the falsification, Nash did not take any steps to investigate the scope, extent, or effect of CS's misconduct.

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<sup>24</sup> NASD Rule 2110 is the predecessor to FINRA Rule 2010 in effect prior to December 15, 2008. See *FINRA Regulatory Notice 08-57*, 2008 FINRA LEXIS 50 (Oct. 2008).

### 3. Supervision of Pizzuti's Websites

Pizzuti created and operated the Evaluvest website, a subscription-based stock analysis tool which used computational algorithms to identify stocks for investment. While respondents have argued that the website was not intended to be active, the record supports that the website was active and available to the public at various times from 2010 through 2013 and the content at issue was available without a subscription.<sup>25</sup>

The website claimed that it could identify stocks with “the highest Alpha and strongest performance” and made other exaggerated claims with no substantiation. It was unclear from the website what exactly was being provided and there were no definitions for the terminology used. The website failed to adequately disclose risks and did not prominently disclose its relationship to Merrimac or the relationship between Pizzuti and Merrimac.

Merrimac's WSPs provided that all advertising would be reviewed for misleading or inaccurate statements, but did not identify websites as advertising to be reviewed. The procedures designated Matthews as the person responsible for his review, but the record reflects that Matthews never reviewed the Evaluvest website. No Merrimac principal reviewed Pizzuti's website and the website was not submitted to FINRA Advertising Regulation Department for prior approval.

### 4. Foreign Finders

On November 19, 2010, Merrimac entered into an agreement, the Foreign Finder Referral Agreement, with a Mexican entity in connection with Merrimac's offer of broker-dealer services to Mexican customers. Merrimac paid transaction-based compensation under the agreement.

When Merrimac entered into the agreement, its WSPs contained no procedures for the supervision of foreign finders. Merrimac adopted a one-page procedure six months after entering into the Foreign Finder Referral Agreement.

#### B. Discussion

NASD Rule 3010 requires that each FINRA member establish and maintain a supervisory system, including written supervisory procedures, to supervise the activities of the persons that are associated with it and that the supervisory system is reasonably designed to achieve compliance with the federal securities laws and FINRA rules. *See* NASD Rule 3010(a)(1),

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<sup>25</sup> As part of its June 17, 2015 motion to introduce evidence, Merrimac sought to submit various screenshots of the Evaluvest website. Merrimac's motion does not demonstrate good cause for failing to introduce these documents at the hearing as required under FINRA Rule 9346(b) and, consequently, we adopt the Subcommittee's denial of the motion.

(b)(1).<sup>26</sup> A 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). The supervisory duties imposed under NASD Rule 3010 include a responsibility to investigate and act upon “red flags” that reveal irregularities or the potential for misconduct. *Id.* We agree with the Extended Hearing Panel that Merrimac and Nash failed to fulfill their supervisory responsibilities.

Merrimac failed to adequately supervise Dubrule’s and Tuttle’s conduct with respect to the funds.<sup>27</sup> Merrimac failed to ensure that Dubrule and Tuttle provided all the relevant records concerning the funds to Merrimac. Merrimac was not aware that Dubrule and Tuttle had solicited new investments from three customers totaling \$4.1 million, in contravention of the terms of Merrimac’s approval of these outside business activities. Dubrule and Tuttle’s management of the funds was essentially unsupervised by Merrimac.

Merrimac and Nash also failed to adequately supervise the deposit of penny stocks into Merrimac customer accounts and the DSR forms used by the firm in connection with these deposits. Merrimac’s procedures were ineffective to detect CS’s misconduct and the respondents did not learn of that misconduct until CS admitted it to Dubrule. Moreover, when Merrimac and Nash did learn that CS had been falsifying the DSR forms, they took no steps to investigate the extent and scope of CS’s misconduct or to review the underlying transactions to determine if Merrimac had caused the sale of unregistered securities.

Pizzuti’s websites constituted advertising. *See* NASD Rule 2210(a)(1) (providing that websites constitute advertising). With respect to Pizzuti’s website, Merrimac’s procedures did not specifically state that websites were advertising and Merrimac through Matthews, who was designated to review advertising, failed to review the website. Merrimac’s procedures provided that Nash was responsible for establishing adequate procedures. Nash, however, failed to establish procedures which provided for the review of websites as advertising.

Finally, we agree that Merrimac and Nash failed to timely adopt procedures concerning foreign finders and, when they did adopt procedures, they were inadequate. The one-page foreign finder procedure was not adopted until six months after Merrimac entered into the Foreign Finder Referral Agreement. That procedure failed to identify who would supervise foreign finders and how that supervision would be conducted.

We find, accordingly, that Merrimac and Nash failed to establish and maintain an adequate supervisory system, in violation of NASD Rules 3010 and 2110 and FINRA Rule 2010,

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<sup>26</sup> NASD Rule 3010 was replaced by FINRA Rule 3110 effective December 1, 2014. *See FINRA Regulatory Notice 14-10*, 2014 FINRA LEXIS 17 (Mar. 2014).

<sup>27</sup> We agree with the Extended Hearing Panel’s dismissal of the claim against Nash with respect to supervision of the funds because the complaint did not contain allegations against Nash concerning the funds.

with respect to the supervision of penny stocks, foreign finders, and Pizzuti's websites. Merrimac also violated NASD Rules 3010 and 2110 and FINRA Rule 2010 with respect to the supervision of DuBrule's and Tuttle's outside business activities.

## VII. Merrimac Effected Securities Transactions While Its Registration Was Suspended

The Extended Hearing Panel found that Merrimac effected securities transactions while its registration was suspended for failure to pay its annual registration fee, in violation of FINRA Rule 2010. We agree and affirm the Extended Hearing Panel's finding of violation.

### A. Facts

On April 6, 2009, FINRA sent Merrimac an invoice for its annual registration fee in the amount of \$4,114.04. The invoice was sent to Merrimac's address of record as reflected in FINRA's Central Registration Depository ("CRD"®). After Merrimac failed to remit its payment, FINRA sent Merrimac a "Reminder Notice" dated May 15, 2009. The Reminder Notice, which was also mailed to Merrimac's CRD address, noted that Merrimac's payment was 30 days past due and provided Merrimac with instructions on how to make the payment. On June 22, 2009, when Merrimac's payment was 60 days past due, FINRA sent another notice to Merrimac's CRD address requesting payment. Merrimac, however, did not respond to any of these requests, and on July 27, 2009, FINRA sent a final notice to the CRD address. The final notice stated that Merrimac's payment was "seriously past due" and warned that if Merrimac did not make payment within five business days, FINRA would begin suspension proceedings against it. Merrimac did not respond.

In August 2009, FINRA sent a notice under FINRA Rule 9553 to Merrimac at its CRD address informing Merrimac that it would be suspended effective September 2, 2009, unless before that date, Merrimac: (1) paid the fee it owed in full; (2) filed for bankruptcy; or (3) requested a hearing to challenge the suspension. Merrimac took no action and on September 2, 2009, the suspension became effective. Merrimac's registration remained suspended until September 17, 2009, when Merrimac paid the outstanding fee. During Merrimac's suspension, it effected more than 750 securities transactions.

### B. Discussion

Article IV, Section 1(a)(2) of FINRA's By-Laws require that member firms pay "dues, assessments, and other charges" imposed by FINRA. This includes the annual registration fee assessed to member firms. FINRA Rule 9553 sets forth procedures for the suspension or cancellation of a firm's membership for failure to pay fees required by FINRA. Effecting securities transactions while a firm's registration is suspended is a violation of FINRA Rule 2010. *See Troy A. Wetter*, 51 S.E.C. 763, 767-68 (1993) (finding that effecting securities transactions while a firm was suspended was a violation of high standards of commercial honor and just and equitable principles of trade); *Dep't of Enforcement v. Perpetual Secs., Inc.*, Complaint No. C9B040059, 2006 NASD Discip. LEXIS 18, at \*43-4 (NASD NAC Aug. 16, 2006), *aff'd*, Exchange Act Release No. 56613, 2007 SEC LEXIS 2353 (Oct. 4, 2007) (finding

that a firm violated NASD Rule 2110, the predecessor to FINRA Rule 2010, by conducting a securities business while it was suspended).

Merrimac concedes that it did not pay its annual registration fee on time and that it effected securities transactions while its registration was suspended. Merrimac argues (through Pizzuti), however, that it did not receive FINRA's notices in connection with the unpaid fees and, consequently, was not aware that its registration was suspended. The Extended Hearing Panel found that Merrimac's claim was not credible and that Merrimac violated Rule 2010. We agree.

The Extended Hearing Panel found it not credible that Merrimac did not receive FINRA's notices. While we review de novo the Extended Hearing Panel's decision on appeal, a hearing panel's findings concerning credibility are entitled to deference absent substantial evidence to the contrary. *See, e.g., Daniel D. Manoff*, 55 S.E.C. 1155, 1161-62 & n.6 (2002); *Dep't of Enforcement v. Elgart*, Complaint No. 2013035211801, 2017 FINRA Discip. LEXIS 9, at \*24-5 (FINRA NAC Mar. 16, 2017), *appeal docketed*, SEC Admin. Proceeding No. 3-17925 (Apr. 11, 2017). We find no reason to disturb the Extended Hearing Panel's credibility determination here. We agree with the Extended Hearing Panel that by 2009, Merrimac had been a FINRA member firm for more than 15 years and was aware of its obligation to pay its annual registration fee. Moreover, the fact that Merrimac may have been operating out of another office location does not excuse its violations because it was Merrimac's obligation to promptly update its address in CRD. *See* Section 1(c) of Article IV of the FINRA By-Laws.<sup>28</sup> FINRA properly sent all its notices to Merrimac's CRD address and Merrimac is deemed to have received them.<sup>29</sup> Accordingly, we find that Merrimac effected securities transactions while its registration was suspended, in violation of FINRA By-Laws, Art. IV, Sec. 1 and FINRA Rule 2010.

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<sup>28</sup> Article IV, Section 1(c) of FINRA's By-Laws provides that "(e)ach applicant and member shall ensure that its membership application with the Corporation is kept current at all times by supplementary amendments via electronic process or such other process as the Corporation may prescribe to the original application. Such amendments to the application shall be filed with the Corporation not later than 30 days after learning of the facts or circumstances giving rise to the amendment."

<sup>29</sup> FINRA Rule 9134(b)(2) governs service of notices of suspension in FINRA Rule 9553 proceedings on entities. *See* FINRA Rule 9553(b). FINRA Rule 9134(b)(2) provides that papers "shall be served at the entity's business address as reflected in the Central Registration Depository." Service may be accomplished "through the U.S. Postal Service by using first class mail, first class certified mail, first class registered mail, or Express Mail . . . ." *See* FINRA Rule 9134(a)(2).

## VIII. Other Arguments on Appeal

The respondents argue that they were unfairly targeted by Enforcement, that the proceedings were unfair, and that the Extended Hearing Panel's decision was biased. We have conducted a careful de novo review of the record and find that respondents' claims are baseless.

### A. Respondents' Claim of Selective Prosecution Is Baseless

Respondents have not demonstrated that Enforcement engaged in selective prosecution. Respondents argue that they were targeted by Enforcement and unfairly subjected to multiple investigations. FINRA has wide discretion in deciding when to bring a disciplinary case. *See Nicholas Avello*, 55 S.E.C. 1197, 1209 n.19 (2002) (rejecting a claim of selective prosecution), *aff'd*, 454 F.3d 619 (7th Cir. 2006). To establish selective prosecution, the respondents must demonstrate that they were singled out for enforcement while others similarly situated were not and that such prosecution was motivated by arbitrary or unjust considerations such as race, religion, or the desire to prevent the exercise of a constitutionally protected right. *See Dep't of Enforcement v. Casas*, Complaint No. 2013036799501, 2017 FINRA Discip. LEXIS 1, at \*39-41 (FINRA NAC Jan. 13, 2017) (citing *Terrance Yoshikawa*, Exchange Act Release No. 53731, 2006 SEC LEXIS 948, at \*28-29 (Apr. 26, 2006), *aff'd*, F. Appx. 475 (9th Cir. 2007)); *see also Scott Epstein*, Exchange Act Release No. 59328, 2009 SEC LEXIS 217, at \*53 (Jan. 30, 2009), *aff'd*, F. Appx. 142 (3d Cir. 390) (rejecting a claim of selective prosecution where respondent failed to show that he was unfairly singled out for prosecution based on improper considerations such as race, religion, or the desire to prevent the exercise of a constitutionally protected right). The respondents have not presented any evidence to support their claims and, consequently, we reject those claims.

### B. The Proceedings Were Fair

Respondents contend that FINRA was biased against them and that the proceedings were unfair. Respondents argue that the evidentiary rulings at the hearing were unfairly decided against them and that the Extended Hearing Panel ignored the evidence they presented. The record is devoid of evidence supporting these contentions.

Section 15A(b)(8) of the Securities Exchange Act of 1934 (the "Exchange Act") provides that FINRA disciplinary proceedings must be conducted in accordance with fair procedures. *See Epstein*, 2009 SEC LEXIS 217, at \*51 (holding that FINRA must provide fair procedures for its disciplinary actions). Section 15A(h)(1) of the Exchange Act requires that FINRA, in a disciplinary proceeding, "bring specific charges, notify such member or person of and give him an opportunity to defend against, such charges, and keep a record." 15 U.S.C. § 780-3. Here, we find that the proceedings before the Extended Hearing Panel were fair and conducted in accordance with FINRA rules.

The respondents had ample notice of the allegations against them. Those allegations were explained in a lengthy, detailed complaint. Merrimac was represented by counsel at the hearing and the hearing transcript shows that Merrimac and Nash were given great latitude in presenting their defenses, including recalling a witness several times. The Extended Hearing

Panel went to great lengths to explain the process to the parties and to allow them to present their defenses.

We have also reviewed the Extended Hearing Panel's evidentiary rulings and find that the Hearing Officer properly admitted evidence that was probative, reliable, and fairly used in this case, and properly denied the admission of proffered evidence that was not. 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 No. 2010022601501, 2016 FINRA Discip. LEXIS 34, \*36-37 (FINRA NAC July 21, 2016), *appeal docketed*, SEC Admin. Proceeding No. 3-17909 (Apr. 6, 2017). We find that respondents have not met this burden.

We find that the proceeding here was conducted in accordance with FINRA rules and the requirements of the Exchange Act and respondents' claims of unfairness are baseless.

#### IX. Sanctions

In assessing sanctions for respondents' violations, we have considered FINRA's Sanction Guidelines ("Guidelines"),<sup>30</sup> including the Principal Considerations in Determining Sanctions (the "Principal Considerations"). For the reasons set forth below, we affirm the sanctions imposed by the Extended Hearing Panel for Merrimac's and Nash's violations.

##### A. False Documents Provided to FINRA

For providing falsified DSR forms to FINRA in response to FINRA Rule 8210 requests, the Extended Hearing Panel fined Nash \$25,000 and imposed upon him a one-year suspension in all principal capacities and fined Merrimac \$50,000. We agree that these are appropriately remedial sanctions for these violations.

The Guidelines specifically address violations of FINRA Rule 8210. For failures to respond to FINRA Rule 8210 requests truthfully, the Guidelines recommend a fine of \$25,000 to \$50,000.<sup>31</sup> For individuals, the Guidelines recommend a bar or, where mitigation exists, a suspension in any or all capacities of up to two years.<sup>32</sup> For firms, the Guidelines recommend

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<sup>30</sup> *See FINRA Sanction Guidelines* (2013). In this case, we apply the Sanction Guidelines in effect at the time of the Extended Hearing Panel Decision.

<sup>31</sup> *Guidelines*, at 33.

<sup>32</sup> *Id.*



expulsion in egregious cases and, where mitigation exists, a suspension for up to two years with respect to any or all activities and functions.<sup>33</sup> The principal consideration in determining sanctions for this type of violation under FINRA Rule 8210 is the importance of the information requested as viewed from FINRA's perspective.<sup>34</sup>

We agree with the Extended Hearing Panel that the information requested here, which concerned Merrimac's supervision of penny stock transactions, was important, and that the violation here resulted from Merrimac's supervisory failures. After learning that CS had falsified signatures on at least some DSR forms, Merrimac and Nash failed to take any steps to investigate the scope of CS's misconduct. We find that respondents knew that certain DSR forms had been falsified, but failed to inform FINRA that responsive documents had been falsified. Respondents submitted more than 30 falsified DSR forms in response to multiple FINRA Rule 8210 requests over the course of several months, knew that DSR forms had been falsified, but failed to inform FINRA of the falsified documents.<sup>35</sup>

The falsified documents were important to FINRA's evaluation of whether Merrimac was properly supervising penny stock transactions and the respondents' violations were serious. Accordingly, we find that the sanctions imposed by the Extended Hearing Panel are appropriately remedial, and we affirm the \$25,000 fine and one-year suspension in all principal capacities imposed on Nash and the \$50,000 fine imposed on Merrimac.

#### B. Sales of Unregistered Securities

For violating FINRA Rule 2010 by causing the sale of unregistered securities in contravention of Securities Act Section 5, the Extended Hearing Panel fined Merrimac \$50,000. We affirm this sanction.

The Guidelines for the sale of unregistered securities provide for a fine of \$2,500 to \$50,000 and direct us to consider a higher fine in egregious cases.<sup>36</sup> The Guidelines also recommend that we consider suspending a firm in egregious cases with respect to any or all activities and functions for up to 30 business days or until procedural deficiencies are remedied.<sup>37</sup> The relevant principal considerations for determining sanctions for sales of unregistered securities include: (1) whether the respondent attempted to comply with an exemption from registration; (2) the share volume and dollar amount of the transaction; (3) whether the respondent had implemented reasonable procedures to ensure that it did not

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

<sup>34</sup> *Id.*

<sup>35</sup> *Guidelines*, at 6-7 (Principal Considerations Nos. 8, 9).

<sup>36</sup> *Id.* at 24.

<sup>37</sup> *Id.*

participate in unregistered distributions; and (4) whether the respondent disregarded “red flags” suggesting the presence of an unregistered distribution.<sup>38</sup>

The Extended Hearing Panel found that Merrimac’s conduct was egregious, that it failed to conduct any due diligence concerning the sale of the USOG stock, and that it “turned a blind eye” to its obligations to ensure compliance with the registration requirements of Section 5. We agree.

Customer J deposited a large block—more than 56 million shares—of USOG stock and began liquidating it and transferring out the proceeds shortly thereafter. USOG was a low-priced security traded on the Pink Sheets. The record shows that Merrimac relied largely on the lack of a restrictive legend on the stock certificate and took no steps to confirm whether the stock was registered or an exemption applied to the sale. Merrimac’s lack of reasonable supervisory procedures contributed to the violation. The DSR form submitted for this transaction was one on which Nash’s signature was falsified. Under these circumstances, we agree that a fine of \$50,000 is appropriate and affirm this sanction.

### C. AML Violations

For Merrimac’s AML violations, the Extended Hearing Panel imposed a fine of \$25,000. We affirm this sanction.

In the absence of specific Guidelines for AML violations, the Extended Hearing Panel applied the Guidelines for a failure to supervise. *See Domestic Sec.*, 2008 FINRA Discip. LEXIS 44, at \*21 n.9 (applying guideline for failure to supervise in an AML violation case). In this instance, we agree that applying these Guidelines are appropriate.

For a failure to supervise, the Guidelines recommend a fine of \$5,000 to \$50,000.<sup>39</sup> In egregious cases, the Guidelines recommend considering limiting the activities of a firm for up to 30 business days or a longer suspension of up to two years where the firm’s violations involve systemic supervisory violations.<sup>40</sup> The Guidelines instruct us to consider three principal considerations: (1) whether the firm ignored “red flags” 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.<sup>41</sup> All of these considerations are aggravating here.

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<sup>38</sup> *Id.*

<sup>39</sup> *Guidelines*, at 103.

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

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

Merrimac failed to timely adopt procedures when it began penny stock trading and when it did so, its adoption of procedures consisted of simply taking FINRA's small firm template with virtually no tailoring of it for Merrimac's business. Its implementation of AML monitoring was similarly flawed and Merrimac failed to detect and investigate penny stock trading consisting of deposits and liquidations of large blocks of stock. Merrimac also failed to detect the disciplinary history of several customers even though its policy required background checks and the timing of sales after press releases. We agree with the Extended Hearing Panel that Merrimac's AML violations were serious, and we affirm the \$25,000 fine.

D. Supervisory Violations

For their supervisory violations, the Extended Hearing Panel fined Merrimac \$50,000, imposed a one-year suspension from receiving and liquidating penny stocks for which no registration statement is in effect, and required Merrimac to retain an expert to evaluate and approve its WSPs. The Extended Hearing Panel fined Nash \$25,000, imposed a one-year suspension in all principal capacities, to run concurrently with his suspension for providing falsified documents to FINRA, and required him to requalify as a general securities principal. We find that these sanctions are appropriate given respondents' egregious misconduct and affirm them.

As discussed above, the Guidelines for failure to supervise recommend a fine of \$5,000 to \$50,000 and direct us to consider limiting the activities of the appropriate branch or department for up to 30 business days.<sup>42</sup> In egregious cases, the Guidelines recommend considering limiting all activities of a firm for up to 30 business days or a longer suspension of up to two years or an expulsion where the firm's violations involve systemic supervision violations.<sup>43</sup> For individuals, the Guidelines instruct us to consider a fine apart from any imposed on the firm and a suspension in all supervisory capacities of up to 30 business days.<sup>44</sup> In egregious cases, the Guidelines recommend considering a longer suspension of up to two years or a bar.<sup>45</sup> The Guidelines instruct us to consider three principal considerations: (1) whether the firm ignored "red flags" which 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.<sup>46</sup>

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<sup>42</sup> *Id.* at 103.

<sup>43</sup> *Id.*

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

<sup>45</sup> *Id.*

<sup>46</sup> *Id.*

For deficient supervisory procedures the Guidelines recommend a fine of \$1,000 to \$25,000.<sup>47</sup> In egregious cases, the Guidelines recommend suspending the responsible individual in any or all capacities for up to one year and the firm with respect to any or all activities or functions for up to 30 business days and until procedures are amended to conform with the rules.<sup>48</sup> The Guidelines direct us to consider: (1) whether the deficiencies allowed violative conduct; and (2) whether the deficiencies made it difficult to determine the individual responsible for specific areas of supervision and compliance.<sup>49</sup>

We agree with the Extended Hearing Panel that the violations here were egregious and necessitate the imposition of serious sanctions. With respect to Dubrule's and Tuttle's fund activities, Merrimac provided virtually no supervision. Merrimac's and Nash's failures with respect to penny stock deposits caused CS's misconduct to go undetected and led to Merrimac causing the sale of unregistered securities in contravention of Section 5 of the Securities Act. When they learned of the falsification of the DSR forms, the respondents failed to conduct any investigation and submitted these falsified documents in response to FINRA's Rule 8210 requests, resulting in further violative conduct. Merrimac's procedures failed to provide for the review of websites as advertising and, here again, Merrimac and Nash abdicated all supervisory responsibility for the representations in Pizzuti's website. With respect to finder's fees, Nash did not adopt procedures until six months after Merrimac entered into the finder's agreement and, when he did, the procedures failed to identify who would supervise the activity and how the supervision would be conducted.

Respondents' supervisory violations are demonstrative of their overall lax approach to supervision and failure to appreciate the importance of their supervisory roles and responsibilities. Merrimac's disciplinary failures are particularly troubling in light of its disciplinary history, which included sanctions for, among other things, inadequate supervisory procedures and failures to supervise outside business activities and private securities transactions.<sup>50</sup> Nash has demonstrated a complete failure to appreciate the responsibilities of his supervisory role, particularly his responsibility to identify and respond to red flags.

In light of these facts and circumstances, we find that the \$50,000 fine and one-year suspension from receiving and liquidating penny stocks imposed on Merrimac, and a \$25,000

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<sup>47</sup> *Guidelines*, at 104.

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

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

<sup>50</sup> *See Id.* at 2, 6 (General Principles Applicable to All Sanctions Determinations No. 2; Principal Considerations No. 1) (explaining that a respondent's relevant disciplinary history should be considered in determining sanctions and sanctions should be more severe for recidivists).

fine, one-year suspension in all principal capacities, and requirement to requalify as a general securities imposed on Nash are appropriately remedial and we affirm.

E. Securities Transactions While Registration Was Suspended

For effecting securities transactions while its registration was suspended, the Extended Hearing Panel applied the Guidelines for membership agreement violations and imposed on Merrimac a \$50,000 fine and a 30-day suspension from membership, to run consecutively to the suspension imposed above. We agree and affirm this sanction.

While there are no Guidelines specifically for violations of FINRA Rule 2010, we agree with the Extended Hearing Panel that application of the Guidelines for membership agreement violations is appropriate in this instance. The Guideline provides for a fine of \$2,500 to \$50,000 and, in egregious cases, recommends consideration of a suspension or expulsion.<sup>51</sup> The Extended Hearing Panel found Merrimac's violation egregious and we agree.

Merrimac ignored five separate notices from FINRA sent over a period of more than five months notifying it that its registration fee was past due and that it would be suspended for failure to pay. The notices were properly sent to Merrimac's CRD address. We agree with the Extended Hearing Panel that Merrimac's claim that it did not receive the notices is not credible. Notwithstanding these multiple notices, Merrimac effected more than 750 securities transactions over a two-week period when its registration was suspended. Under these circumstances, we agree that a \$50,000 fine and a 30-day suspension is an appropriately remedial sanction. *Cf. Perpetual Sec., Inc.*, 2006 NASD Discip. LEXIS 18, at \*69-70 (expelling a firm for conducting a securities business while suspended).

X. Conclusion

Merrimac and Nash provided false documents to FINRA, in violation of FINRA Rules 8210 and 2010. For this violation, Merrimac is fined \$50,000, and Nash is fined \$25,000 and suspended for one year in all principal capacities. Merrimac violated FINRA Rule 2010 by causing the sale of unregistered securities in contravention of Securities Act Section 5. For this violation, Merrimac is fined \$50,000. Merrimac failed to establish and maintain an effective AML system, in violation of NASD Rule 3011 and FINRA Rules 3310 and 2010. For this violation, Merrimac is fined \$25,000. Merrimac and Nash failed to maintain and enforce effective supervisory procedures, in violation of NASD Rules 3010 and 2110 and FINRA Rule 2010. For these violations, Merrimac is fined \$50,000, prohibited from receiving and liquidating penny stocks for one year, and required to retain an independent consultant to review and approve its procedures. For the supervisory violations, Nash is fined \$25,000, is suspended in all principal capacities for one year (to run concurrently with the suspension for submitting falsified documents to FINRA), and must requalify as a general securities principal. Finally, Merrimac effected securities transactions while its registration was suspended, in violation of FINRA By-

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<sup>51</sup> *Id.* at 44.

Laws Art. IV, Sec. 1 and FINRA Rule 2010. For this violation, Merrimac is fined \$50,000 and suspended from membership for 30 days (to run consecutively to its suspension for the supervisory violations). We also affirm the Extended Hearing Panel's order that Merrimac pay \$6,753.58 and Nash pay \$6,753.57 in hearing costs and order them, jointly and severally, to pay appeal costs in the amount of 1,703.83.<sup>52</sup>

On behalf of the National Adjudicatory Council,

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Jennifer Piorko Mitchell  
Vice President and Deputy Corporate Secretary

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<sup>52</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.