

BEFORE THE NATIONAL ADJUDICATORY COUNCIL  
FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of

Department of Enforcement,

Complainant,

vs.

Thaddeus James North  
Brookfield, CT,

Respondent.

DECISION

Complaint No. 2012030527503

Dated: August 3, 2017

**Respondent failed to enforce his member firm's written supervisory procedures regarding the review of electronic communications. Held, findings and sanctions affirmed.**

**Appearances**

For the Complainant: Paul D. Taberner, Esq., Bonnie S. McGuire, Esq., Department of Enforcement, Financial Industry Regulatory Authority

For the Respondent: Constance J. Miller, Esq.

**Decision**

Pursuant to FINRA Rule 9311, Thaddeus James North appeals the Hearing Panel's decision in this matter. The Hearing Panel found that North failed to enforce his member firm's written supervisory procedures ("WSPs") regarding the oversight of electronic communications, in violation of NASD Rule 3010 and FINRA Rule 2010.<sup>1</sup> The Hearing Panel fined North \$5,000. After a complete review of the record, we affirm the Hearing Panel's findings of violation and the sanctions that it imposed.

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<sup>1</sup> The conduct rules that apply in this case are those that existed at the time of the conduct at issue. NASD Rule 3010 has been superseded by FINRA Rules 3110 and 3170. *FINRA Regulatory Notice 14-10*, 2014 FINRA LEXIS 17 (Mar. 2014).

## I. Background

North entered the securities industry in 1994 and first registered as a general securities representative in 1997. He has been associated with several member firms in various capacities since that time. North's conduct relevant to this decision occurred during the time when he was associated with Ocean Cross Capital Markets, LLC ("Ocean Cross"). North associated with Ocean Cross in August 2011 and was the firm's chief compliance officer ("CCO") throughout his employment with the firm. North was registered in numerous capacities while associated with Ocean Cross: general securities representative and principal, equity trader limited representative, limited representative – investment banking, and registered options representative and principal. North remained employed by Ocean Cross until January 2013. He is currently associated with another FINRA member firm.

Ocean Cross received FINRA approval to operate in August 2011.<sup>2</sup> Ocean Cross was based in Westport, Connecticut, had approximately 15 associated persons, and three principals: its president, William E. Schloth ("Schloth"); North; and its municipal securities principal. Ocean Cross generated a significant amount of its revenue from its municipal securities business. Ocean Cross's largest producer, Leslie King ("King"), was the source of the firm's municipal securities business. King worked out of the firm's Plano, Texas office and was the only registered representative to use Bloomberg instant messaging.

FINRA cancelled Ocean Cross's registration in July 2013, and the firm is no longer operating.

## II. Procedural History

This case arose out of FINRA on-site examinations of Ocean Cross in January 2012 and March 2012. The Department of Enforcement filed a complaint against North in October 2013, which alleged that during the period from September 8, 2011, through April 30, 2012 (the "Review Period"), North failed to enforce Ocean Cross's WSPs regarding the oversight of the firm's electronic correspondence and the recording of that review. Enforcement alleged that, as a result, North violated NASD Rule 3010 and FINRA Rule 2010.

Following a hearing featuring North's extensive and credible testimony, the Hearing Panel determined that North engaged in the alleged misconduct. The Hearing Panel fined North \$5,000. This appeal followed.

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<sup>2</sup> Ocean Cross was not operational in August 2011 because several states where it planned on doing business had not approved the firm's registration. The firm was fully operational beginning in September 2011.

### III. Facts

#### A. Ocean Cross's WSPs Regarding Review of Electronic Correspondence

Ocean Cross's WSPs designated the review of email and instant messaging to the firm's "President or designated principal." In relevant part, the WSPs required that the president or designated principal perform a "daily" "[r]eview of an appropriately sized sample of incoming and outgoing e-mail / IM [instant message] correspondence; OR review any e-mails / IMs flagged by filtering software (if utilized)." The WSPs also required the president or designated principal, in conducting the review of the firm's electronic correspondence, to "[m]aintain all reviewed e-mails / IM in a separate folder (electronic or hardcopy); initial and date electronic correspondence review log; [and] initial and maintain record of any findings and actions taken."

#### B. North's Role Related to the WSPs

North admitted in his hearing testimony that he was responsible for reviewing the firm's WSPs. North did not draft the firm's WSPs, but instead purchased a generic version from a third-party compliance business. North modified slightly the generic WSPs to require the firm's president or designated principal to conduct the review of electronic correspondence. North testified, "I did not put myself in as the supervisor to review emails because I knew what it was like to do that." North elected not to modify the WSPs' requirement of a daily review of electronic correspondence.<sup>3</sup>

Importantly, North admitted that he was responsible for enforcing the firm's WSPs, and he knew that the firm's president, Schloth, was not conducting regular reviews of the firm's electronic correspondence. In addition, Schloth had not expressly designated another principal to undertake the required review of the firm's electronic communications. North admitted repeatedly throughout these proceedings that he knew that Schloth was routinely not reviewing the firm's emails prior to April 30, 2012, and instead North "would step in and do it."

#### C. Archiving of the Firm's Electronic Communications During the Review Period

During the Review Period, Ocean Cross used Smarsh, Inc. ("Smarsh") to retain its electronic communications, including email and Bloomberg instant messages.<sup>4</sup> Smarsh provides software and systems that may be used by compliance personnel at broker-dealers to produce reports that evidence the extent of supervision activity, including the review of electronic correspondence such as emails and instant messages. Smarsh provided Ocean Cross with such web-based applications to enable firm staff to perform supervisory functions related to archived electronic communications at the firm.

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<sup>3</sup> North testified that he did not have the time to tailor fully the WSPs to Ocean Cross during the Review Period.

<sup>4</sup> Smarsh is an archiving company that specifically caters to the financial services industry and archives electronic correspondence to comply with SEC and FINRA rules.

The Smarsh platform permitted designated staff at Ocean Cross to log onto the system, run searches, view the search results, and open the messages for review. Smarsh's system recorded, among other things, the identity of the user who logged onto the system, the searches run by the user, the search history, the message review history, and the number of messages located through the search. Smarsh recorded automatically all of this information, including a user's search activity, in Smarsh's computer database.

North was provided log-in credentials to use the Smarsh system to review the firm's archived emails and Bloomberg instant messages. In order to review Bloomberg instant messages, North was required to conduct a separate search of the Smarsh archive because Bloomberg messages are a different file type than emails and stored in a separate database. Ocean Cross's WSPs required the person reviewing electronic correspondence to store all reviewed email and Bloomberg messages in a separate folder and initial and date an electronic correspondence review log. North did not do this. Instead, North relied upon the Smarsh system to record his review of electronic communications and did not create a separate record of his reviews as directed by the firm's WSPs. North stated that he knew from prior experience using Smarsh that "somewhere in the system, it's recorded . . . [as] an electronic initial."

D. The Smarsh Reports

As part of its investigation, Enforcement requested that Smarsh submit reports ("Smarsh Reports") that reflected North's review of the firm's electronic communications during the Review Period. The Hearing Officer in this matter conducted a two-day evidentiary hearing in advance of the disciplinary hearing to determine the admissibility and reliability of the Smarsh Reports. Enforcement offered the telephonic testimony of Smarsh's Director of Web Services, Jimmy Douglas ("Douglas"), to explain and authenticate the Smarsh Reports. North's counsel extensively cross-examined Douglas during the evidentiary hearing.

The Hearing Panel determined that Douglas's testimony was credible and that the Smarsh Reports were reliable and admissible evidence. The Hearing Panel expressly found that Douglas credibly testified that "every action that is taken inside Smarsh's archiving system is attributed to the specific user who logged onto the system, and Smarsh's system can generate a report to demonstrate supervisory search and review activity." With respect to the Smarsh Reports, the Hearing Panel also found that Douglas credibly testified that Ocean Cross's review of its electronic communications was stored in a Smarsh database, which recorded the actions taken within the Smarsh web-based application. Thus, the Smarsh Reports were generated from North's electronic communications review activity recorded by Smarsh's database.<sup>5</sup>

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<sup>5</sup> North, relying on Federal Rules of Evidence 803(6), 901, 902, and 1006, argues that the Smarsh Reports were summary exhibits that the Hearing Officer improperly admitted without the underlying supporting electronic communications and without proper authentication. While the formal rules of evidence do not apply in FINRA proceedings, FINRA adjudicators may look to the Federal Rules of Evidence for guidance. See *Dep't of Enforcement v. Ahmed*, Complaint No. 2012034211301, 2015 FINRA Discip. LEXIS 45, at \*112 n.98 (FINRA NAC Sept. 25, 2015) (citing FINRA Rule 9145(a)), *appeal docketed*, Admin. Proceeding No. 3-16900 (SEC Oct. 13,

The Smarsh Reports reflect the following examples of North's review of electronic communications. Between September 8, 2011 (the first day of the Review Period), and January 31, 2012, North logged onto the Smarsh system and reviewed a total of six emails.<sup>6</sup> North reviewed email on 10 days in February 2012, seven days in March 2012, and two days in April 2012.<sup>7</sup>

With respect to the Bloomberg instant messages, the Smarsh Reports reflect an even more sporadic review. Smarsh retained Bloomberg messages for the firm beginning on October 21, 2011. The Smarsh Reports illustrate that North's first review of Bloomberg messages did not occur until February 2, 2012.<sup>8</sup> North reviewed Bloomberg messages on eight days during the Review Period.<sup>9</sup>

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2015). The Smarsh Reports were not summary exhibits, but 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. Douglas properly authenticated the Smarsh Reports at the evidentiary hearing and explained how they were created and what data was used. We reject North's assertion that the Hearing Officer improperly admitted the Smarsh Reports and that Douglas was not a qualified witness to authenticate them. We also reject North's contention that Douglas gave false testimony. The Hearing Panel expressly found that Douglas's testimony was credible. We find no substantial evidence to overturn this finding. *See William Scholander*, Exchange Act Release No. 77492, 2016 SEC LEXIS 1209, at \*30 n.45 (Mar. 31, 2016) (explaining that credibility determinations "based on hearing the witness's testimony and observing demeanor . . . are entitled to considerable deference").

<sup>6</sup> North logged onto the Smarsh system that stored firm email on two days in September 2011, one day in December 2011, and two days in January 2012.

<sup>7</sup> North logged onto the Smarsh system that stored firm email on 11 days in February 2012, 10 days in March 2012, and two days in April 2012. The Smarsh Reports reflect that while North logged onto the system on February 1, March 6, March 7, and March 13, 2012, he did not review any email on those days.

<sup>8</sup> North's initial review of any Bloomberg messages took place in the midst of FINRA's first on-site examination of Ocean Cross that commenced on January 30, 2012, and lasted for one week.

<sup>9</sup> North logged onto the Smarsh system that archived the firm's Bloomberg messages on five days in February, seven days in March, and one day in April. The Smarsh Reports reflect that while North logged onto the system on February 1, February 13, March 7, March 9, and March 16, 2012, he did not review any Bloomberg messages on those days.

#### IV. Discussion

##### A. North's Failure to Enforce Ocean Cross's WSPs

The complaint alleged, and the Hearing Panel found, that North failed to enforce Ocean Cross's WSPs regarding the firm's oversight of electronic communications, in violation of NASD Rule 3010 and FINRA Rule 2010. We affirm this finding.

NASD Rule 3010(a) required member firms to establish and maintain a supervisory system reasonably designed to achieve compliance with the applicable securities laws, rules, and regulations. NASD Rule 3010(b) further required member firms to establish, maintain, and enforce written supervisory procedures reasonably designed to achieve compliance with applicable laws, rules, and regulations and to supervise the activities of the firm's associated persons that are reasonably designed to achieve compliance with applicable securities laws, rules, and regulations. As relevant here, NASD Rule 3010(d) required members to develop written procedures for the review, by a registered principal, of the firm's registered representatives' incoming and outgoing written and electronic correspondence with the public relating to the firm's investment banking or securities business.<sup>10</sup> "It is well established that the presence of procedures alone is not enough. Without sufficient implementation, guidelines and strictures do not ensure compliance." *KCD Fin. Inc.*, Exchange Act Release No. 80340, 2017 SEC LEXIS 986, at \*34 (Mar. 29, 2017) (internal quotation marks omitted). Thus, "[i]n addition to requiring an adequate supervisory system and procedures, the duty of supervision includes the responsibility to investigate 'red flags' that suggest that misconduct may be occurring and to act upon the results of such investigation." *Dep't of Enforcement v. Brookstone Sec., Inc.*, Complaint No. 2007011413501, 2015 FINRA Discip. LEXIS 3, at \*98 (Apr. 16, 2015) (internal quotation marks omitted).

Ocean Cross's WSPs assigned Schloth or other designated principal as the supervisor tasked with reviewing the firm's electronic communications on a daily basis. The WSPs further

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<sup>10</sup> North argues that under new FINRA Rule 3110, he would not have been an appropriate supervisor to review email and Bloomberg messages related to King's municipal securities business because he was not a municipal securities principal. We reject this argument. North was charged with violating NASD Rule 3010, which required a registered principal to review the firm's registered representatives' incoming and outgoing written and electronic correspondence. Moreover, North, during the Review Period, was the person responsible for enforcing the firm's WSPs, including those related to the review of the firm's email and Bloomberg messages, and was a registered general securities principal—a registration that qualified North to supervise the firm's general securities business. *See also* FINRA Rule 3110(b)(4) ("Reviews of correspondence and internal communications must be conducted by a registered principal and must be evidenced in writing, either electronically or on paper."). Had North been reviewing King's messages in harmony with the WSPs and uncovered a potential issue related to her municipal securities business, North could have escalated the matter to the firm's municipal securities principal and documented this course of action as required by the WSPs.

required Schloth or other designated principal to document that review by maintaining “all reviewed e-mails / IM in a separate folder (electronic or hardcopy); initial and date electronic correspondence review log; [and] initial and maintain record of any findings and actions taken.” The record supports the finding that neither a daily review of the firm’s emails and Bloomberg messages was being conducted nor was the firm documenting that review in compliance with the methodology set forth by the WSPs. North argues that he is not responsible for the firm’s supervisory failings in this regard because the WSPs expressly listed Schloth as the designated principal.

North admitted, however, that he was responsible for enforcing the WSPs.<sup>11</sup> Moreover, North’s testimony reveals that he knew that Schloth was not conducting reviews of the firm’s

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<sup>11</sup> The Hearing Panel credited the testimony of a FINRA examiner who testified at the hearing that during FINRA’s onsite examination of Ocean Cross, both North and Schloth identified North as the principal responsible for reviewing the firm’s electronic communications. The examiner also testified that during the onsite, North demonstrated for FINRA staff how he logged onto the Smarsh system and conducted email review. North now argues that this testimony was impermissible hearsay. “Hearsay statements may be admitted in evidence and, in an appropriate case, may form the basis for findings of fact.” *Charles D. Tom*, 50 S.E.C. 1142, 1145 (1992). “[H]earsay evidence is admissible in administrative proceedings if it is deemed relevant and material.” *SEC v. Otto*, 253 F.3d 960, 966 (7th Cir. 2001); *Dillon Sec., Inc.*, 51 S.E.C. 142, 150 (1992).

According to the Commission, the following factors must be considered when evaluating hearsay evidence: possible bias of the declarant; the type of hearsay involved; whether the statements are signed and sworn rather than anonymous, oral or unsworn; whether the statements are contradicted by direct testimony; whether the declarant was available to testify; and whether the hearsay is corroborated. *Tom*, 50 S.E.C. at 1145. The Hearing Panel weighed these factors and found the examiner’s testimony reliable and material. *See* FINRA Rule 9263 (setting forth a Hearing Officer’s authority to receive evidence). The examiner’s testimony was corroborated by a February 12, 2012 letter Ocean Cross sent to FINRA in response to a Rule 8210 request after the onsite, and North’s own sworn testimony that he was responsible for enforcing the WSPs, that he knew that Schloth was not conducting the required reviews, and that North stepped in to help with those reviews at least once per week. North’s statements to the examiner also were admissions, and by definition, not hearsay. *See Joseph S. Barbera*, 54 S.E.C. 967, 977-78 & n.31 (2000). We do not find that the Hearing Officer abused her discretion in accepting this evidence. *See Robert J. Prager*, 58 S.E.C. 634, 664 (2005).

North also argues that the Rule 8210 letter did not ask who was responsible for email review at the firm, but presupposed that it was North. The firm could have clarified responsibility for this task in its response letter. Instead, the letter stated that North conducted a periodic random search and review of Ocean Cross’s emails, which was consistent with what the FINRA examiner was told during the onsite examination and North’s own testimony. In addition, the firm’s response letter referred FINRA to Smarsh to support North’s review of email. The Hearing Panel found both the FINRA examiner’s and North’s testimony credible.

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electronic communications and therefore North affirmatively assumed the responsibility. North stated that before April 30, 2012, which was the last day of the Review Period and date of his on-the-record interview (“OTR”) with FINRA staff, he was aware that Schloth was not reviewing any of the firm’s electronic communications.<sup>12</sup> North acknowledged during his OTR that he reviewed the firm’s emails as part of his responsibilities at Ocean Cross. Indeed, North was reviewing email for the firm because he knew that no one else at Ocean Cross was undertaking the required review.<sup>13</sup> North stated that “[i]t was Bill [Schloth] and I running the entire place, and if he was not reviewing emails, then I would do it to be a good person and get in there and make sure it’s done.” North was familiar with the Smarsh system because he had used it at another firm, and it “made sense” that he “help out” with the electronic communication review. North further explained that the hectic state of the firm led to Schloth’s lax review. North stated that he “knew that [Schloth] wasn’t doing it in the beginning because we were so busy doing all sorts of other stuff, and he was trying to get business in the door, that . . . if [Schloth] wasn’t doing it, then I would step in and do it.” North stated that, prior to his OTR, he reviewed a random sample of email “at least once a week.”<sup>14</sup>

We agree with the Hearing Panel that North’s review of Ocean Cross’s electronic communications was not reasonable under the circumstances. “Whether supervision is ‘reasonable’ depends on the particular circumstances of each case.” *KCD*, 2017 SEC LEXIS 986, at \*35. “Once a person has supervisory responsibilities by virtue of the circumstances of a particular situation, he must either discharge those responsibilities or know that others are taking appropriate action.” *Dist. Bus. Conduct Comm. v. Gallison*, Complaint No. C02960001, 1999 NASD Discip. LEXIS 8, at \*45 (NASD NAC Feb. 5, 1999) (finding that a firm’s compliance officer who was responsible for enforcing the firm’s supervisory procedures was required to investigate and follow up when he knew the firm’s penny stock trading was not being effectively supervised), *aff’d sub nom La Jolla Capital Corp.*, 54 S.E.C. 275 (1999); *see also Dep’t of Enforcement v. Levitov*, Complaint No. CAF970011, 2000 NASD Discip. LEXIS 12, at \*24-26

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The initial fact-finder’s credibility determinations are entitled to considerable deference, which may only be overcome by substantial evidence. *Wanda P. Sears*, Exchange Act Release No. 58075, 2008 SEC LEXIS 1521, at \*7 (July 1, 2008). We will not disturb the Hearing Panel’s findings here where the record contains no substantial contrary evidence.

<sup>12</sup> North stated that the firm’s review improved after his OTR with FINRA in April 2012 and that he and Schloth “became much more active in reviewing emails.”

<sup>13</sup> North argues that Enforcement “targeted only Mr. North for Email review, failed to inquire at any time about, or request, or produce any evidence of Email review performed by others.” North’s own testimony, however, shows that he knew that no one else at Ocean Cross was reviewing the firm’s electronic communications and that he “step[ped] in” to do it.

<sup>14</sup> North testified that after his OTR, he began using keyword searches when reviewing email and Bloomberg messages.



(NASD NAC June 28, 2000) (finding firm's director of compliance failed to supervise staff over whom he had no supervisory authority once he discovered sales practice violations). The Commission has made it abundantly clear that supervisors must act decisively when an indication of irregularity is brought to their attention. *See Consolidated Inv. Serv., Inc.*, 52 S.E.C. 582, 588 (1996).

While we credit that North engaged in some action when he knew that Schloth was not reviewing the firm's email, we determine that North's responsive action fell short. North was well aware that Schloth's focus was on generating business and not reviewing email or other electronic communications. Nonetheless, when North "step[ped] in," he did not conduct his own review according to the WSPs that he admittedly modified at least slightly and put in place for the firm and was charged with enforcing. By North's own admission, he was not reviewing the firm's electronic communications daily. Rather, he testified that he was reviewing email "at least once a week."<sup>15</sup> And North did not follow the WSPs regarding creating a separate record of his reviews, initialing and dating an electronic correspondence review log, or initialing and maintaining a record of any findings and actions taken after reviewing electronic correspondence. North stated that he merely relied upon Smarsh to record his review and maintain a record for him.

Other evidence in the record bolsters our conclusion derived from North's testimony that North failed to enforce the firm's WSPs. The Smarsh Reports, which the Hearing Officer found reliable and admissible evidence, support that North was not conducting a daily review of electronic communications as mandated by the WSPs.<sup>16</sup>

North's limited actions were not sufficient to comply with the WSPs that he admittedly put in place and was charged with enforcing. *See Wedbush Sec., Inc.*, Exchange Act Release No. 78568, 2016 SEC LEXIS 2794, at \*27 (Aug. 12, 2016). Thus, North's response to Schloth's inaction was "inadequate, and unreasonable, under the circumstances." *See Robert E. Strong*,

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<sup>15</sup> North argues that daily review of electronic communications is not required by any statute, regulation, regulatory notice, or other rule. While NASD Rule 3010 does not set forth the frequency of a required review of a firm's registered representatives' incoming and outgoing electronic correspondence, those procedures must be reasonably designed to achieve compliance with the applicable securities laws, rules, and regulations. What is relevant here is that the procedures that North himself put in place—and was obligated to enforce—required a daily review of electronic communications, either of an appropriately sized sample or of any flagged communications if filtering software was used, and that was not done.

<sup>16</sup> North has argued extensively throughout these proceedings about purported spoliation of the firm's email records and that the Smarsh Reports, reflecting North's search and review of the electronic communications archives, are inherently unreliable. *See infra* Part IV.B. We determine that North's testimony provides sufficient evidence to find that he failed to enforce the firm's WSPs related to review of electronic communications and in violation of NASD Rule 3010 and FINRA Rule 2010. The Smarsh Reports merely confirm that finding, and we need not give these reports more than minimal weight.

Exchange Act Release No. 57426, 2008 SEC LEXIS 467, at \*22-23 (Mar. 4, 2008); *see also Steven P. Sanders*, 53 S.E.C. 889, 904 (1998) (holding that “even where supervisory responsibility is shared between firm executives, each can be held liable for supervisory failure”). We find that North failed to enforce the firm’s WSPs related to the firm’s oversight of electronic communications, in violation of NASD Rule 3010 and FINRA Rule 2010.<sup>17</sup>

B. Procedural Arguments

North raises several additional objections related to the admissibility of evidence and fairness of these proceedings. We find no merit to any of these arguments, and we reject them.

1. Spoliation of Smarsh Records and Expert Witness Testimony

North’s primary argument on appeal is that the electronic communications provided to him by Enforcement were compromised by alleged spoliation, including alteration of the content and appearance of the underlying emails and alteration of information in the Smarsh Reports. North has argued throughout these proceedings that Smarsh archived these purportedly spoliated records, therefore the Smarsh Reports reflecting North’s search and review of these archives are unreliable. North made these arguments in numerous prehearing motions before the Hearing Officer in an effort to offer expert witness testimony and attendant evidence on the purported spoliation. We determine that North has not met his burden of showing that the Hearing Officer abused her discretion when denying North’s motions.

a. August 29, 2014 Motion

On August 29, 2014, North moved to offer testimony of proposed expert AT. North argued that AT examined all of the electronically-stored evidence that Enforcement provided to North during discovery and that AT would testify to the spoliation of that evidence. North asserted that AT had reviewed King’s Bloomberg emails and that AT would testify that some of those emails were missing from information that Enforcement produced in discovery. North further asserted that AT would testify that the format of the emails produced by Enforcement does not match the Bloomberg native format and the appearance of the produced emails in this matter appear different than those in other proceedings involving the same individuals. The Hearing Officer determined that North had failed to comply with FINRA Rule 9242(a)(5) by timely providing a statement of AT’s qualifications and failing to provide a list of AT’s publications and other proceedings in which AT had given expert testimony. The Hearing Officer further determined that North had failed to meet his burden of showing that AT’s testimony would be relevant and that it would assist the Hearing Panel in adjudicating this matter. The Hearing Officer determined that the issues raised by North were not relevant to whether the electronic communications culled from Ocean Cross’s system and archived by

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<sup>17</sup> A violation of NASD Rule 3010 also constitutes a violation of just and equitable principles of trade (FINRA Rule 2010). *See Prager*, 58 S.E.C. at 635 n.3. FINRA Rule 0140 extends these rule requirements to persons associated with a member.

Smarsh were reviewed and documented according to the firm's WSPs. And accordingly, the Hearing Officer denied North's motion to offer AT's testimony and declaration.

b. September 11, 2014 Motion

On September 11, 2014, North filed a motion to stay these proceedings to enable North to petition a federal court for injunctive relief due to the alleged spoliation of the electronic information that Enforcement produced in discovery and offered as proposed exhibits.<sup>18</sup> These were the same underlying issues that North had identified in his August 29 motion. The Hearing Officer denied North's motion for a stay, but continued the hearing to a later date to allow the parties to participate in the evidentiary hearing to resolve North's challenges to the electronic information provided by Smarsh and determine the admissibility and reliability of the Smarsh Reports. *See supra* Part III.D. When ordering the evidentiary hearing, the Hearing Officer stated that "evidence regarding North's logging into the Smarsh system to review emails, the number of the emails available for North's review, the number of emails he reviewed, the number and content of North's word searches of emails, and the dates of his email reviews is potentially relevant to this proceeding."

c. October 7, 2014 Filing

On October 7, 2014, North filed a "Brief Respecting Evidentiary Issues Related to Alleged Spoliation, Admissibility of Evidence and Testimony, and Motion to Compel Production of CDJob Requests and Smarsh Event Logs." North again offered AT's testimony on alleged spoliation of electronic records. The Hearing Officer granted in part North's motion to present AT's testimony. While AT was precluded from testifying about alleged spoliation and other

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<sup>18</sup> We take judicial notice of North's federal actions. *See* FINRA Rule 9145(b) (authorizing "official notice of such matters as might be judicially noticed by a court"). North petitioned the United States Court of Appeals for the District of Columbia Circuit for an emergency petition for writ of mandamus, temporary and permanent injunctive relief, and stay of proceedings before FINRA. The court denied the petition. *In re North*, No. 14-1274, 2014 U.S. App. LEXIS 23348 (D.C. Cir. Dec. 11, 2014). North subsequently filed an action in the United States District Court for the District of Columbia against FINRA and Smarsh alleging that the data produced by Smarsh and relied upon by FINRA in this proceeding and another against North was spoliated and tampered. North sought monetary damages for the intentional or negligent spoliation of data and to enjoin FINRA's disciplinary actions against him as well as to prevent the dissemination and use of such data in any future proceeding. The district court dismissed the action on December 4, 2015. *North v. Smarsh, Inc.*, 160 F. Supp. 3d 63 (D.D.C. 2015). In dismissing the action, the court identified that FINRA's allegations against North in this proceeding—"whether Mr. North reviewed sufficient electronic correspondence as required by the securities laws and regulations—have nothing to do with the content of the spoliated ESI [electronically stored information]." *Id.* at \*86.

matter previously deemed not relevant,<sup>19</sup> the Hearing Officer permitted AT to testify at the evidentiary hearing regarding: “North’s logging onto Smarsh’s email review system during the review period; the number of any such Smarsh-archived emails available for North’s review during that period; the number of Smarsh-archived emails that North reviewed during the review period; the number and content of North’s word searches of Smarsh-archived emails during the review period; and the dates of North’s email reviews during the review period.” Despite being allowed to present AT’s testimony at the evidentiary hearing, North withdrew his request on October 31, 2014, and chose not to call AT to testify.

d. November 24, 2014 Motion

On November 24, 2014, North filed a motion to supplement his proposed hearing exhibits and submitted a declaration seeking to offer the expert testimony of either Jonathan Gibney, the Chief Executive Officer of Southridge Technology, LLC (“Southridge”) or Tom McKay, Senior Services Technician at Southridge. The Hearing Officer denied the motion. North’s motion to supplement the record was untimely pursuant to the case’s Scheduling Order and North’s proposed exhibits and witnesses could have been included by the filing deadline. In addition, the Hearing Officer determined that the proposed testimony of the Southridge employees was not relevant to the issues in this matter. The Hearing Officer explained that “[t]estimony or evidence suggesting that Southridge maintained backup files that included more or different emails and messages from those archived by Smarsh for Ocean Cross is not relevant to this proceeding.”

In concluding that evidence of spoliated email was irrelevant, the Hearing Officer determined that the central issue in this case is “whether North was responsible during the relevant period for reviewing Ocean Cross’s electronic correspondence and, if so, whether he conducted the daily review required by the firm’s written procedures and documented the review, as also required by the firm’s procedures.” FINRA Rule 9263 states that a Hearing Officer shall receive all relevant evidence and has discretion to exclude all evidence that is irrelevant, unduly repetitious, or unduly prejudicial. The NAC reviews the admission or exclusion of evidence only for an abuse of discretion. *See Prager*, 58 S.E.C. at 664. “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. North*, Complaint No. 2010025087302, 2017 FINRA Discip. LEXIS 7, \*34 (FINRA NAC Mar. 15, 2017) (internal quotation marks omitted), *appeal docketed*, Admin. Proceeding No. 3-17909 (SEC Apr. 6, 2017).

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<sup>19</sup> The Hearing Officer’s order expressly precluded testimony about “the content and number of emails contained in the Bloomberg vault of Ocean Cross’s associated person; the format, content, and appearance of emails produced by Enforcement or archived by Smarsh; comparisons of electronic information produced during discovery in this matter to electronic information produced during discovery in other FINRA disciplinary proceedings; and the appearance and content of printed emails archived by Smarsh.”

North argues that the Hearing Officer erred because the emails were relevant as the source material of the Smarsh Reports, and that the email and its metadata are admissible to prove the failures of the archive. North specifically contends that the “metadata demonstrates Smarsh and Enforcement tampered with and pervasively spoliated [e]mail and [e]mail related evidence.”<sup>20</sup> North contends that the metadata “layers within the [e]mail files at issue reveal” that “Smarsh intentionally did not perform compliance archiving for the Ocean Cross firm emails”; “Smarsh facilitated FINRA employee interception of, spoliation and alteration to the electronic communications in real time”; “Enforcement used federal government and foreign entity resources to strip the [e]mail of encryption and security in order to alter critical compliance information”; and “Smarsh affixed facsimile information to the files altered by Enforcement to make it appear that Smarsh maintained a searchable archive for compliance.”

We determine that North has not met his burden to show that the Hearing Officer abused her discretion in denying North’s motions for expert testimony and related evidence on the alleged spoliation. Whether the emails themselves were spoliated would not affect the reliability of the Smarsh Reports. Douglas credibly testified that Smarsh generated the Smarsh Reports from North’s search and review history of using Smarsh’s web application and searching within Smarsh’s database. North’s proffered expert testimony about purported spoliation and tampering of email files does not address the reliability of the Smarsh Reports and the real-time database from which they were created. North has not offered a cognizable argument that spoliated emails could affect the data in the Smarsh Reports concerning the frequency of North’s email review, which is centrally at issue in this case.

Notably, North had an opportunity to present AT’s testimony at the evidentiary hearing regarding “North’s logging onto Smarsh’s email review system during the review period; the number of any such Smarsh-archived emails available for North’s review during that period; the number of Smarsh-archived emails that North reviewed during the review period; the number and content of North’s word searches of Smarsh-archived emails during the review period; and the dates of North’s email reviews during the review period.” North, however, declined to call AT to testify. *See, e.g., Scott Epstein*, Exchange Act Release No. 59328, 2009 SEC LEXIS 217, at \*60 (Jan. 30, 2009) (explaining that “the failure of a respondent to . . . adduce available evidence to meet the charges against him and show mitigating factors does not entitle him to have the proceedings reopened after the issuance of an adverse decision” (internal quotation marks omitted)), *aff’d*, 416 F. App’x 142 (3d Cir. 2010). Whether the emails were spoliated does not affect our findings that North failed to enforce Ocean Cross’s WSPs related to the firm’s review of electronic communications and documentation of that review.

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<sup>20</sup> North argues that the underlying emails are relevant because the Smarsh Reports were created on a “Y2K non-compliant system” and were “altered by Enforcement staff because of the Y2K non-compliance.” The FINRA examiner testified that he corrected the Smarsh Reports to reflect the date of February 29, 2012, because “when the report was generated, it didn’t recognize the leap year date.” The examiner explained that he did not change any other information in the Smarsh Reports, including the “messages reviewed” columns.

2. North's Motion to Adduce Additional Evidence

During this appeal, North moved to adduce additional evidence. Specifically, North sought to introduce two declarations of FH, a purported expert in computer programming, and numerous attachments in support of FH's opinion that the emails at issue in this case were spoliated. The FH declarations describe purported "corruptions," "falsifications," and "alterations" of the firm's archived electronic data. North asserted that FH's declarations were relevant to show that "government resources were used to intercept and divert the communication files to entities overseas, where the files were spoliated and returned to a false database made to appear like an archive."

North also sought to adduce an excerpt from the testimony of RS, a witness from Smarsh who testified in a separate FINRA proceeding against North and involving North's misconduct while he was associated with a different member firm, Southridge Investment Group LLC. *See generally North, 2017 FINRA Discip. LEXIS 7* (finding North failed to establish and maintain a reasonable supervisory system for the review of electronic correspondence and failed to adequately review electronic correspondence at Southridge Investment Group LLC). In addition, North sought to introduce his complaint and exhibits from the lawsuit that he filed against Smarsh and FINRA in federal district court and the "Declaration of Bonnie Page in Support of Smarsh, Inc.'s Opposition to Plaintiffs' Motion for Order Permitting Sur-Response an Sur-Reply" also filed in the same federal action.<sup>21</sup>

Pursuant to FINRA Rule 9346(b), a motion for leave to introduce additional evidence shall demonstrate that there was good cause for failing to introduce the evidence below and why the evidence is material. The National Adjudicatory Council ("NAC") Subcommittee empaneled to consider this matter denied North's request to introduce any additional evidence, finding the proposed evidence was not material. The data that FH examined was available to North well in advance of the hearing in this matter. In addition, North's offer of FH's declarations is an attempt to circumvent the Hearing Officer's prior rulings related to expert testimony. The Hearing Officer denied North's motion to offer the testimony of AT, a different proposed expert, on the issue of alleged spoliation of electronic evidence. When the Hearing Officer allowed North the opportunity to present AT's testimony on issues related to North's review of the electronic communications, North declined to call AT to testify. *See Epstein, 2009 SEC LEXIS 217*, at \*60.

The RS testimony offered in a different disciplinary matter involving North's misconduct occurring at a different firm has no bearing on the issue before us now of whether North properly enforced Ocean Cross's WSPs. North's complaint and exhibits and the Bonnie Page declaration filed in North's federal district court action are likewise immaterial to this appeal. We concur with the Subcommittee's ruling to deny North's motion to adduce and adopt it as our own.

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<sup>21</sup> Bonnie Page is the General Counsel of Smarsh.

### 3. Hearing Officer Bias

North claims that by denying him the opportunity to call expert witnesses to testify about the purported spoliation and to introduce evidence on the same issue, the Hearing Officer was biased against him. North, however, has waived any argument that he may have concerning the Hearing Officer's bias. North was afforded the opportunity to file a motion to disqualify the Hearing Officer, but he failed to do so. FINRA rules provide that 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. FINRA Rule 9233(b). North claims that the Hearing Officer's bias was evident both before and during the hearing. It was therefore incumbent on him to raise the issue of bias then. *See Dep't of Enforcement v. Bullock*, Complaint No. 2005003437102, 2011 FINRA Discip. LEXIS 14, at \*50 (FINRA NAC May 6, 2011); *see also Davis v. Cities Service Oil Co.*, 420 F.2d 1278, 1282 (10th Cir. 1970) ("Promptness in asserting disqualification is required to prevent a party from awaiting the outcome before taking action."). North, however, affirmatively chose to proceed with the hearing before the Hearing Officer without making any such motions and belatedly raised his objection in this appeal. North has waived his right to object to the Hearing Officer's participation in the proceedings below. *See* FINRA Rule 9233(b); *see also Bullock*, 2011 FINRA Discip. LEXIS 14, at \*51 (failing to make timely motion to disqualify Hearing Officer waives objection on appeal).

Moreover, these wholly unsubstantiated assertions of bias "are an insufficient basis to invalidate" FINRA's proceedings. *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. 2002) (table). North claims that the Hearing Officer's adverse evidentiary rulings were "clearly designed" to hide a purported conspiracy between Smarsh and Enforcement to corrupt Ocean Cross's emails and Bloomberg messages. North is basing his claims of bias on the Hearing Officer's adverse rulings, but adverse rulings, without more, do not evidence bias. *See Epstein*, 2009 SEC LEXIS 217, at \*62; *Dep't of Enforcement v. Kirlin*, Complaint No. EAF0400300001, 2009 FINRA Discip. LEXIS 2, at \*76-77 (FINRA NAC Feb. 25, 2009), *aff'd in relevant part*, Exchange Act Release No. 61135, 2009 SEC LEXIS 4168 (Dec. 10, 2009). "[B]ias by a hearing officer is disqualifying only when it stems from an extrajudicial source and results in a decision on the merits based on matters other than those gleaned from participation in a case." *See Epstein*, 2009 SEC LEXIS 217, at \*62 (internal quotation marks omitted). We find that the record evidence before us does not demonstrate bias on the part of the Hearing Officer. *See, e.g., Robert Fitzpatrick*, 55 S.E.C. 419, 431-32 (2001) (finding no evidence of Hearing Panel bias and holding that there is no evidence that the Hearing Panel member formed an opinion in the case based on anything other than the evidence before it), *aff'd*, 63 F. App'x 20 (2d Cir. 2003); *Dan Adlai Druz*, 52 S.E.C. 416, 429 (1995) (rejecting a "myriad of accusations of impropriety involving fraud, corruption, and collusion by the Chief Hearing Officer, the Exchange's Division of Enforcement, and [the respondent's firm]"), *aff'd*, 103 F.3d 112 (3d Cir. 1996) (table).

The evidence in this case demonstrates that the Hearing Officer formulated her opinion based on the record before her, including on North's own testimony, and that she and the remainder of the Hearing Panel imposed liability against North based on that evidence. The record in this case provides no support for North's argument that the Hearing Officer was biased

against him. Finally, the NAC's de novo review of this case ensures that the overall disciplinary proceeding conducted against North was fair and without bias if any had existed.<sup>22</sup> *See Bullock*, 2011 FINRA Discip. LEXIS 14, at \*52 (confirming that the NAC's de novo review cures any alleged Hearing Panel bias).

## V. Sanctions

The Hearing Panel fined North \$5,000 for his violation of NASD Rule 3010 and FINRA Rule 2010. We affirm this fine.

We apply the FINRA Sanction Guidelines (“Guidelines”) for failure to supervise because North failed in his supervisory responsibility to enforce the firm’s WSPs. The Guidelines for an individual’s failure to supervise recommend a fine of \$5,000 to \$73,000 and consideration of a suspension of the responsible individual in all supervisory capacities for up to 30 business days.<sup>23</sup> In determining the proper remedial sanction, the Guidelines for supervisory violations recommend that adjudicators consider whether the responsible individual ignored “red flag”

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<sup>22</sup> North argues that the “combined actions of Enforcement and Smarsh violate the United States Constitution,” including the Fourth and Fifth Amendments, myriad federal criminal statutes including those related to mail and wire fraud and the destruction of records in federal investigations, and numerous torts. Because FINRA is not a state actor, however, it is not subject to constitutional requirements. *Michael Earl McCune*, Exchange Act Release No. 77375, 2016 SEC LEXIS 1026, at \*37 n.52 (Mar. 15, 2016), *aff’d*, 2016 U.S. App. LEXIS 21690 (10th Cir. Dec. 6, 2016); *see also D.L. Cromwell Invs., Inc. v. NASD Regulation, Inc.*, 279 F.3d 155, 162 (2d Cir. 2002) (stating that it is a well-settled principle that FINRA’s predecessor, NASD, is not a governmental actor); *Jones v. SEC*, 115 F.3d 1173, 1182-83 (4th Cir. 1997) (rejecting claim based on the Fifth Amendment’s Double Jeopardy Clause because NASD is not a government agency); *David Kristian Evansen*, Exchange Act Release No. 75531, 2015 SEC LEXIS 3080, at \*28 n.35 (July 27, 2015) (stating that the Commission has “long held the requirements of constitutional due process do not apply to FINRA proceedings because FINRA is not a state actor”); *Mark H. Love*, 57 S.E.C. 315, 322 n.13 (2004) (“We have held that NASD proceedings are not state actions and thus not subject to constitutional requirements.”). In addition, the criminal statutes and torts cited are irrelevant to the issue of whether North violated NASD Rule 3010 and FINRA Rule 2010 by failing to enforce his firm’s WSPs. North also raised many of these claims in his federal lawsuit, which the district court found meritless. *See North*, 160 F. Supp. 3d at 77 (determining that North had no private right of action to enforce criminal obstruction of justice statutes and that these laws do not apply to FINRA). The district court subsequently denied North’s motion to amend his complaint against Smarsh and FINRA alleging other federal mail and wire fraud violations as well as conspiracy to convert and tortious conversion of electronic data and conspiracy to spoliage and tortious spoliage of electronic data. *North v. Smarsh, Inc.*, Civil Action No. 15-494 (D.D.C. Jan. 21, 2016).

<sup>23</sup> *FINRA Sanction Guidelines* 104 (2017), [http://www.finra.org/sites/default/files/Sanctions\\_Guidelines.pdf](http://www.finra.org/sites/default/files/Sanctions_Guidelines.pdf) [hereinafter *Guidelines*].



warnings that should have resulted in additional supervisory scrutiny; the nature, extent, size, and character of the underlying misconduct; and the quality and extent of the supervisor's implementation of the firm's WSPs and controls.<sup>24</sup>

We agree with the Hearing Panel's findings that North's misconduct was not egregious and that the record contains no evidence of underlying misconduct that the firm's supervisory inadequacies failed to detect.<sup>25</sup> Nonetheless, the quality of North's enforcement of the WSPs related to electronic correspondence was insufficient and reflects his inattention to his responsibilities in this regard. We credit North's acceptance that he was responsible for enforcing the WSPs, and when he discovered that Schloth was not overseeing the firm's electronic communications, North began doing it himself.<sup>26</sup> In assuming this supervisory responsibility, North was required to exercise reasonable supervision when performing his reviews. Even crediting his testimony that he performed reviews of the firm's email "at least once a week," North fell short of the daily reviews obligated by the WSPs, and he failed to maintain and initial a separate electronic correspondence review log as set forth by the WSPs.<sup>27</sup>

We conclude, as did the Hearing Panel, that North's violations resulted from negligence, not intentional or reckless misconduct.<sup>28</sup> There is no evidence in the record that North was attempting to circumvent FINRA rules or conceal his misconduct.<sup>29</sup> Rather, North was dealing with the hectic environment in establishing Ocean Cross as a new firm. *See Strong*, 2008 SEC LEXIS 467, at \*45-48. At the time, in addition to being the firm's CCO and anti-money laundering compliance officer, North was handling the firm's "operational functions." North testified that during the first three months at Ocean Cross, he was "overwhelmed" with FINRA Rule 8210 requests for information concerning his former employer firm while also handling compliance and some back office duties for Ocean Cross. He was also migrating "hundreds and hundreds of accounts from one firm to another." North recalled that the firm also was examined by the State of Connecticut and the SEC at that time.

We determine that a \$5,000 fine is an appropriate sanction under the circumstances and will satisfy FINRA's remedial goals.

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

<sup>25</sup> *See id.*

<sup>26</sup> *Id.* at 7 (Principal Considerations in Determining Sanctions, No. 2).

<sup>27</sup> We, like the Hearing Panel, do not consider the duration of the misconduct to be aggravating in this case given the environment at the firm under which North was operating. *See id.* at 7 (Principal Considerations in Determining Sanctions, Nos. 8, 9). North did not ignore completely the required review of the firm's electronic communications.

<sup>28</sup> *Id.* at 8 (Principal Consideration in Determining Sanctions, No. 13).

<sup>29</sup> *Id.* at 7 (Principal Consideration in Determining Sanctions, No. 10).

VI. Conclusion

North failed to enforce Ocean Cross's WSPs related to the firm's oversight of electronic communications, in violation of NASD Rule 3010 and FINRA Rule 2010. Accordingly, we fine North \$5,000. We affirm the Hearing Panel's imposition of hearing costs in the amount of \$1,985.99 and order appeal costs of \$1,582.18.<sup>30</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>30</sup> Pursuant to FINRA Rule 8320, the registration of any person associated with a member who fails to pay any fine or costs imposed in this decision, after seven days' notice in writing, will summarily be revoked for non-payment.