

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

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

MERRIMAC CORPORATE SECURITIES, INC.
(CRD No. 35463),

and

ROBERT G. NASH
(CRD No. 718820),

Respondents.

Disciplinary Proceeding
No. 2011027666902

Hearing Officer—MAD

**EXTENDED HEARING PANEL
DECISION**

March 31, 2015

Respondent Merrimac Corporate Securities violated (1) FINRA Rules 8210 and 2010 by providing false documents to FINRA; (2) FINRA Rule 2010 by selling unregistered securities in violation of Section 5 of the Securities Act of 1933; (3) NASD Rule 3011 and FINRA Rules 3310 and 2010 by failing to establish and implement Anti-Money Laundering (“AML”) policies and procedures that can be reasonably expected to achieve compliance with AML rules and regulations and monitor and detect suspicious activity; (4) NASD Rules 3010 and 2110 and FINRA Rule 2010 by failing to maintain a reasonable supervisory system; and (5) FINRA Rule 2010 by effecting securities transactions while its registration was suspended.

Respondent Robert G. Nash violated (1) FINRA Rules 8210 and 2010 by providing false documents to FINRA; and (2) NASD Rules 3010 and 2110 and FINRA Rule 2010 by failing to maintain a reasonable supervisory system and procedures. The Panel dismissed the AML charges against Nash, alleging violations of NASD Rule 3011 and FINRA Rules 3310 and 2010.

Merrimac is fined a total of \$225,000, suspended from FINRA membership for 30 business days, suspended for one year from receiving and liquidating penny stocks for which no registration statement is in effect, and required to retain an independent consultant to revise its written supervisory procedures. The sanctions associated with each violation are as follows: For violating FINRA Rules 8210 and 2010 by providing false documents to FINRA, Merrimac is fined \$50,000. For violating FINRA Rule 2010 by selling unregistered securities in violation of Section 5 of the Securities Act, Merrimac is fined \$50,000. For violating NASD Rule 3011 and FINRA Rules 3310 and 2010 by failing to

establish and implement AML policies and procedures that can be reasonably expected to detect and cause the reporting of suspicious transactions, Merrimac is fined \$25,000. For violating NASD Rules 3010 and 2110 and FINRA Rule 2010 by failing to maintain a reasonable supervisory system, Merrimac is fined \$50,000, suspended for one year from receiving and liquidating penny stocks for which no registration statement is in effect, and required to retain an independent consultant, acceptable to Enforcement, with experience in designing and evaluating broker-dealer procedures to review and approve its written supervisory procedures. For violating FINRA Rule 2010 by effecting securities transactions while its registration was suspended, Merrimac is fined \$50,000 and suspended from FINRA membership for 30 business days. Merrimac's suspension from receiving and liquidating penny stocks for which no registration statement is in effect shall run consecutive to Merrimac's 30-business day suspension from FINRA membership.

Nash is fined a total of \$50,000, suspended for one year in all principal capacities, and required to requalify as a principal. The sanctions associated with each violation are as follows: For violating FINRA Rules 8210 and 2010 by providing false documents to FINRA, Nash is fined \$25,000 and suspended for one year in all principal capacities. For violating NASD Rules 3010 and 2110 and FINRA Rule 2010 by failing to maintain a reasonable supervisory system and procedures, Nash is fined \$25,000, suspended for one year in all principal capacities, and required to requalify as a principal before acting in any capacity requiring that qualification. Nash's suspensions shall be concurrent.

In addition, Respondents are ordered to pay costs.

Appearances

Michael J. Watling, David Monachino, Aaron Mendelsohn, Elissa Meth Kestin, and Susan Light, New York, NY, for the Department of Enforcement, Complainant.

Stephen Pizzuti, Altamonte Springs, FL, representative for Merrimac Corporate Securities, Respondent.

Robert G. Nash, Altamonte Springs, FL, pro se, Respondent.

DECISION

I. INTRODUCTION AND ORIGIN OF THE DISCIPLINARY PROCEEDING

Merrimac Corporate Securities, Inc. is a general securities broker-dealer.¹ Merrimac became registered as a FINRA member firm in 1993.² Robert G. Nash is Merrimac's chief compliance officer ("CCO").³ He is registered with FINRA in multiple capacities through his association with Merrimac.⁴

This disciplinary proceeding arose as a result of multiple investigations of Merrimac by several FINRA offices, including FINRA's district offices in Boca Raton, Florida; Atlanta, Georgia; and New York, New York. Ultimately, FINRA Staff transferred the Boca Raton and Atlanta investigative files to the New York office for review and consolidation.

When the Staff reviewed the materials collected from Merrimac, they concluded that Merrimac, through Nash, provided false documents to FINRA when responding to FINRA requests for information. As a result of the investigations, the Staff also concluded that Merrimac and certain of its employees violated federal securities regulations and FINRA rules relating to a variety of topics.

The Boca Raton investigation reviewed the outside business activities of John W. DuBrule and Kevin A. Tuttle, two registered representatives at Merrimac. The Staff concluded that DuBrule and Tuttle committed fraud by (1) inflating valuations of illiquid investments owned by two hedge funds, which they managed as an outside business activity, and (2) misrepresenting or omitting material facts related to the value of two customers' investments in one of the hedge funds. FINRA staff also concluded that DuBrule and Tuttle misappropriated investor funds.

The Atlanta investigation reviewed two websites created by Stephen D. Pizzuti, Merrimac's chief executive officer ("CEO"). The Staff concluded that Pizzuti operated websites that provided misleading securities-related communications to the public.

The New York investigation reviewed Merrimac's securities sales and supervisory systems. The Staff concluded that Merrimac and DuBrule sold unregistered securities. The Staff also concluded that Merrimac, Nash, and David W. Matthews, Jr., Merrimac's president and anti-money laundering ("AML") officer, failed to maintain and implement an effective AML

¹ At the time, the Complaint was filed Merrimac operated one registered branch in Altamonte Springs, Florida, maintained 14 non-registered office locations, and had 54 registered representatives.

² CX-1, at 2. FINRA has jurisdiction over Merrimac because it is currently registered with FINRA.

³ Nash became Merrimac's CCO in April 2008; he was the firm's CCO during all the time periods referenced in the Complaint. Hearing Transcript ("Tr.") 982.

⁴ CX-4. FINRA has jurisdiction over Nash because he is currently registered with FINRA.

system. The Staff further concluded that Merrimac, Nash, Matthews, Pizzuti, and DuBrule failed to establish, maintain, and enforce reasonable supervisory systems.

A 2009 routine examination of Merrimac also revealed that Merrimac engaged in securities transactions while its registration was suspended.

As a result of FINRA's investigations and routine examinations, the Department of Enforcement filed an eight-count Complaint against Merrimac, Nash, DuBrule, Tuttle, Pizzuti, and Matthews.⁵ DuBrule, Tuttle, Pizzuti, and Matthews entered into settlements with FINRA prior to the hearing.⁶ Accordingly, this Decision focuses solely on the charges against Merrimac and Nash.

The causes of action against Merrimac and Nash are as follows: The third cause of action alleges that Merrimac and Nash violated FINRA Rules 8210 and 2010 by knowingly providing forged documents to FINRA, falsely reflecting that various stock transactions had been reviewed by Merrimac's supervisory and compliance departments when in fact no supervisory review had occurred.⁷ The fourth cause of action alleges that Merrimac violated FINRA Rule 2010 by selling unregistered securities in contravention of Section 5 of the Securities Act of 1933 (Securities Act). The sixth cause of action alleges that Merrimac and Nash violated NASD Rule 3011 and FINRA Rules 3310 and 2010 by failing to: (1) establish and maintain supervisory procedures reasonably designed to achieve compliance with AML rules, and (2) monitor and detect suspicious activity. The seventh cause of action alleges that Merrimac and Nash violated NASD Rules 3010 and 2110 and FINRA Rule 2010 by failing to establish, maintain, and enforce adequate supervisory systems. The eighth cause of action alleges that Merrimac violated Article IV, Section 1 of FINRA's By-Laws, and FINRA Rule 2010 by effecting securities transactions while its FINRA registration was suspended for failing to pay membership fees.

After careful consideration, the Extended Hearing Panel found Merrimac and Nash liable for the violations alleged against them in the Complaint and imposed sanctions. Each violation is addressed separately below.

⁵ Enforcement filed the Complaint with the Office of Hearing Officers on July 3, 2013.

⁶ The hearing was held on June 2-6 and June 9-10, 2014, in Boca Raton, Florida. At the conclusion of the hearing, the Extended Hearing Panel requested post-hearing briefs and findings of fact. The parties completed their post-hearing submissions on October 28, 2014.

⁷ In the Complaint, the heading associated with this cause of action states that Merrimac provided falsified documents; however, the text portion describes the documents as having been "forged." The Panel does not need to reach the issue of whether the documents were falsified or forged because providing either falsified or forged documents to FINRA would constitute a violation of Rule 8210. Throughout the decision, we refer to the documents as being falsified.

II. MERRIMAC AND NASH PROVIDED FALSE DOCUMENTS TO FINRA STAFF

The third cause of action alleges that Merrimac and Nash provided false documents to FINRA when responding to FINRA's requests for information and documents. As explained below, the Panel concluded that Merrimac and Nash violated FINRA Rules 8210 and 2010.

A. Background

Merrimac engaged in penny stock trading. Penny stocks are securities that are not listed on a national securities exchange and are priced under \$5.00.⁸ In 2008, Merrimac had customers trading in penny stock. Its penny stock trading increased between 2008 and 2010.⁹ In 2010 approximately 18% of Merrimac's total annual revenue was from penny stocks and approximately seven of Merrimac's registered representatives were trading penny stocks.¹⁰

Merrimac followed a particular protocol for the receipt of penny stock. When customers sought to deposit shares of penny stock into their accounts, Merrimac required its registered representatives servicing those accounts to ensure that their customers completed a Deposit Securities Request Form ("DSR Form"), a customer questionnaire regarding the source of the penny stock and its registration status. The purpose of the DSR Form was to provide Merrimac with sufficient information to ensure that shares of a given penny stock were legally qualified for resale, either because (1) the shares in question were registered under an effective registration statement filed with the Securities and Exchange Commission ("SEC"), or (2) the liquidating transaction of the shares in question qualified for a valid exemption from registration.¹¹ Upon completion of the DSR Form, Merrimac required the registered representative to: (1) sign the form, (2) obtain one or two additional levels of supervisory approval, and (3) attach supporting documentation as required by the clearing agent.

From February through September 2010, CS, a Merrimac registered representative who provided administrative support to DuBrule, falsified approximately 37 DSR Forms.¹² She falsified the DSR Forms by photocopying DuBrule's and Nash's signatures, which were required for supervisory approval, and altering the dates on the forms to coincide with the dates the

⁸ CX-89.

⁹ CX-42C; Tr. 1021, 1187, 1482. From April 28, 2008, to November 19, 2009, Merrimac customers conducted approximately 570 penny stock transactions. CX-42C; Tr. 1188.

¹⁰ Tr. 1026, 1482.

¹¹ CX-65, at 1-5; Tr. 83-85, 140, 548-49, 820-23, 1270-73. Merrimac's clearing agent created the DSR Form and provided it to Merrimac. CX-87, at 16; Tr. 83-84, 1120, 1125.

¹² CX-35, at 5; CX-35A, at 5-121; CX-35B, at 17; CX-45A, at 64-67; CX-71B, at 1-4; CX-75; Tr. 147-52, 155-63.

customers deposited securities into their accounts.¹³ CS's falsification of the DSR Forms expedited the deposit and clearing process of the customers' penny stock by five to eight days.¹⁴

At some point, CS admitted to her supervisor, DuBrule, that she falsified DSR Forms.¹⁵ When Nash learned of the falsified DSR Forms, he and Pizzuti, Merrimac's CEO, met with DuBrule and CS.¹⁶ There was no written record of the meeting; and, after the meeting, no one at Merrimac conducted an investigation to determine the scope of CS's misconduct or took disciplinary action against her.¹⁷ In addition, Merrimac never reported CS's misconduct to FINRA.¹⁸

B. Facts

In response to four FINRA Rule 8210 requests for information, Merrimac provided 37 falsified DSR Forms to FINRA.¹⁹ Nash, Merrimac's CCO, acknowledged that he was responsible for the information provided to FINRA in response to FINRA Rule 8210 information requests.²⁰ Neither Nash nor anyone else on Merrimac's behalf ever notified FINRA that the Rule 8210 responses contained falsified DSR Forms.²¹ The four FINRA Rule 8210 information requests and responses from Merrimac are discussed below.

1. The September 23, 2010 Request

On September 23, 2010, FINRA Staff requested documents from Merrimac related to the receipt, delivery, and transfer of Issuer A stock.²² The Staff addressed the September 23 request to Nash. Nash supervised the collection, review, and production of documents regarding

¹³ Tr. 149-50, 333, 1057, 1086.

¹⁴ Tr. 1058.

¹⁵ According to DuBrule, CS admitted to falsifying five to seven DSR Forms. CX-87, at 9.

¹⁶ Tr. 1084-85. No one at Merrimac can agree when the meeting regarding the falsified documents took place. Enforcement contends that during Pizzuti's investigative testimony, he told the Staff that the meeting took place 6 to 60 days before Merrimac revised its procedures regarding penny stock in September 2010. Tr. 855-57; CX-65, at 1. At the hearing, Pizzuti testified that the meeting took place in March or April 2011; however, he also stated that, coincidentally, the last falsified DSR Form was created the same month that Merrimac created the Penny Stock Procedures. Tr. 1447, 1450. Nash believed that the meeting took place in April or May 2011. Tr. 1075, 1079, 1084-85. In Merrimac's Post-Hearing Brief, Merrimac asserted that the meeting occurred in 2013. Merrimac's Post-Hr'g Br. at 16.

¹⁷ Tr. 1076-77, 1080, 1087-88, 1090-91. According to Nash, Merrimac relied on CS's "word" that "only ... two" DSR Forms were falsified. Tr. 1083.

¹⁸ Tr. 1388-90, 1423-24.

¹⁹ CX-75; Tr. 1062-63, 1096, 1100, 1102. Merrimac provided four falsified forms more than once.

²⁰ Tr. 1062-63, 1065.

²¹ Tr. 1076-77, 1080-82, 1517.

²² CX-35; Tr. 143-44.

Merrimac's response to the request.²³ On September 24, Nash provided FINRA Staff with a DSR Form concerning a customer's deposit of 70,000 shares of Issuer A stock.²⁴ The DSR Form for those shares contained falsified signatures of DuBrule, as the reviewing representative and reviewing principal, and Nash, as the CCO, that had been copied from a previously signed DSR Form and pasted onto the DSR Form pertaining to Issuer A.²⁵

2. The January 6, 2011 Request

On January 6, 2011, FINRA Staff requested documents from Merrimac related to 22 Merrimac customer accounts that actively traded in penny stocks.²⁶ Particularly, the Staff requested due diligence files and other materials Merrimac used to confirm that the large blocks of low-priced securities deposited into customers' accounts were legally qualified for resale.²⁷ The Staff addressed the January 6 information request to Merrimac, care of Nash.²⁸ Merrimac, through Nash, provided FINRA with approximately 33 falsified DSR Forms.²⁹

3. The March 23, 2011 Request

On March 23, 2011, FINRA Staff issued Merrimac a request for business records regarding Issuer F stock.³⁰ The Staff addressed the March 23 request to Nash.³¹ Again, Nash supervised the collection, review, and production of documents, and on March 25, Nash provided FINRA with a DSR Form regarding a customer's deposit of 300,000 shares of Issuer F.³² The DSR Form contained falsified signatures for Nash and DuBrule.³³

²³ Tr. 1059-61; CX-35, at 1.

²⁴ CX-35, at 2-5; Tr. 144-45.

²⁵ Tr. 144-47, 162-63; CX-35, at 2-5.

²⁶ CX-35A, at 1-4.

²⁷ CX-35A, at 1-4; Tr. 151.

²⁸ CX-35A, at 1.

²⁹ CX-35A, at 5-121; Tr. 262-63, 1073.

³⁰ CX-45, at 6.

³¹ CX-45, at 6.

³² CX-45A, at 64-67; Tr. 1093-96.

³³ CX-45A, at 67; Tr. 1095-96.

4. The December 20, 2012 Request

On December 20, 2012, the Staff issued Merrimac a request for business records pertaining to the deposit and liquidation of shares of low-priced equity issuers for three customers.³⁴ The Staff sent the letter to Nash, care of Merrimac's outside counsel.³⁵ Nash supervised the collection, review, and production of documents, including the retrieval of DSR Forms from DuBrule's office in Orlando, Florida.³⁶ Merrimac responded to FINRA on January 15, 2013.³⁷ The response included falsified DSR Forms related to two customers.³⁸

C. Discussion

FINRA Rule 8210(a) provides, in pertinent part, that for the purpose of an investigation or examination authorized by FINRA's By-Laws or rules, FINRA Staff shall have the right to "require a member, person associated with a member, or any other person subject to FINRA's jurisdiction to provide information ... in writing ... or electronically ... with respect to any matter involved in the investigation ... [or] examination" The rule further authorizes FINRA Staff to "inspect and copy the books, records, and accounts of such member or person with respect to any matter involved in the investigation ... examination, or proceeding."

FINRA Rule 8210 "provides a means, in the absence of subpoena power, for [FINRA] to obtain from its members information necessary to conduct investigations."³⁹ The rule "is at the heart of the self-regulatory system for the securities industry."⁴⁰ Providing false and misleading information to FINRA staff during an investigation "mislead[s] [FINRA] and can conceal wrongdoing" and thereby "subvert[s]' [FINRA's] ability to perform its regulatory function and protect the public interest."⁴¹ As the National Adjudicatory Council ("NAC") has stressed, "it is

³⁴ CX-35B, at 1-4.

³⁵ CX-35B, at 1.

³⁶ Tr. 1157-58.

³⁷ CX-35B, at 5-17. Merrimac's response was titled, "Robert G. Nash's Responses and Objections to FINRA December 20, 2012 letter, Our File No. 5164." CX-35B, at 5. Although Merrimac's counsel sent the letter to FINRA, Nash believes he received a copy of the letter. Tr. 1100.

³⁸ CX-35B, at 5-17; Tr. 160-61. Merrimac provided the same falsified DSR Forms regarding the same two customers in response to the January 6, 2011 request. Tr. 1080-82, 1096.

³⁹ *Richard J. Rouse*, 51 S.E.C. 581, 584 (1993).

⁴⁰ *Howard Brett Berger*, Exchange Act Release No. 58950, 2008 SEC LEXIS 3141, at *13 (Nov. 14, 2008), *pet. denied*, 347 F. App'x. 692 (2d Cir. 2009); *see PAZ Sec., Inc.*, Exchange Act Release No. 57656, 2008 SEC LEXIS 820, at *12 (Apr. 11, 2008) ("[C]ompliance with Rule 8210 [is] essential to enable [FINRA] to execute its self-regulatory functions."), *aff'd*, 566 F.3d 1172 (D.C. Cir. 2009).

⁴¹ *Geoffrey Ortiz*, Exchange Act Release No. 58416, 2008 SEC LEXIS 2401, at *32 (Aug. 22, 2008) (quoting *Michael A. Rooms*, 58 S.E.C. 220, 229 (2005), *aff'd*, 444 F.3d 1208 (10th Cir. 2006)).

axiomatic that Procedural Rule 8210 prohibits an associated person from providing false or misleading information to [FINRA] in connection with an examination or investigation.”⁴²

In his defense, Nash claimed that he did not learn about the falsified DSR Forms until April or May 2011.⁴³ He explained that, during the meeting about the falsified DSR Forms, DuBrule and CS told him that there were only two falsified forms;⁴⁴ however, he now knows there were many more.⁴⁵ At the time, Nash accepted CS’s explanation and did not conduct any other investigation.⁴⁶ Nash also stated that, upon learning of the falsified forms, he never reviewed Merrimac’s prior productions to FINRA to determine if Merrimac had provided other falsified documents.⁴⁷ There is no evidence that Merrimac conducted a supervisory review of the DSR Forms that CS falsified.

Regardless of when Nash learned of the falsified documents, or whether he knew the true extent of the misconduct, “scienter is not an element of a Rule 8210 violation.”⁴⁸ Here, in response to four requests for documents, Merrimac, through Nash, provided falsified documents to FINRA, which falsely indicated that the DSR Forms had been reviewed by Merrimac’s supervisory and compliance personnel. The Panel concludes that Merrimac and Nash violated FINRA Rules 8210 and 2010.

III. MERRIMAC SOLD UNREGISTERED SECURITIES

As discussed above, the falsification of the DSR Forms caused penny stock deposits by Merrimac customers to avoid any supervisory review. The lack of an effective supervisory review contributed to Merrimac’s sales of unregistered penny stock into the market.

The fourth cause of action alleges that Merrimac violated FINRA Rule 2010 by selling unregistered securities in contravention of Section 5 of the Securities Act. Specifically, the Complaint alleges that Merrimac, on behalf of Customer J, sold unregistered, non-exempt shares of United States Oil and Gas Corp (“USOG”) stock in the over-the-counter market.⁴⁹ The

⁴² *Dep’t of Enforcement v. Masceri*, No. C8A040079, 2006 NASD Discip. LEXIS 29, at *36 (NAC Dec. 18, 2006) (discussing NASD Rule 8210, the predecessor to FINRA Rule 8210).

⁴³ Tr. 1075, 1079, 1081.

⁴⁴ Tr. 1083.

⁴⁵ Tr. 1087.

⁴⁶ Tr. 1083-91.

⁴⁷ Tr. 1080-82.

⁴⁸ *Berger*, 2008 SEC LEXIS 3141, at *39.

⁴⁹ Customer J’s DSR Form was one of the forms that CS falsified by photocopying the signatures of DuBrule (Customer J’s registered representative) and Nash. CX-75 (lines 8 and 36 identify Customer J’s 56.5 million share deposit).

Complaint further alleges the shares were restricted because Customer J purchased the shares through a private transaction with the issuer.⁵⁰

After careful consideration, the Panel concludes that Merrimac sold unregistered shares of USOG in contravention of Section 5 of the Securities Act, and thereby violated FINRA Rule 2010.

A. Facts

USOG was a development-stage company whose stock traded on the Pink Sheets Electronic Over-The-Counter Market.⁵¹ Below we discuss (1) how Customer J obtained its USOG stock, (2) the deposit of its USOG stock at Merrimac, and (3) the liquidation of its USOG stock.

1. Customer J Obtains USOG Stock

Customer J purchased 100 million shares of USOG stock from JT through a stock purchase agreement on July 15, 2010.⁵² JT had obtained his stock directly from USOG, the issuer. At the time JT sold the stock to Customer J, JT was affiliated with USOG.

JT owned Company A, an oil and gas company. On May 15, 2009, USOG acquired Company A from JT in exchange for a \$3.75 million promissory note.⁵³ Approximately nine months later, JT and USOG amended the promissory note to increase the principal amount to \$4 million.⁵⁴ As a result of the acquisition, Company A was a wholly owned subsidiary of USOG.⁵⁵

When USOG acquired Company A, JT entered into an employment agreement whereby he agreed to serve as Company A's president for three years.⁵⁶ As of December 31, 2009, as reflected in USOG's SEC Form 10 dated April 29, 2010, JT was an executive officer of USOG.⁵⁷

⁵⁰ "Restricted stock" is defined as "[s]ecurities acquired directly or indirectly from the issuer, or from an affiliate of the issuer, in a transaction or chain of transactions not involving any public offering." 17 C.F.R. § 230.144(a)(3)(i) (2012).

⁵¹ CX-67, at 44, 72.

⁵² CX-68.

⁵³ CX-67, at 10.

⁵⁴ CX-67A.

⁵⁵ CX-67, at 4.

⁵⁶ CX-67, at 41; CX-70.

⁵⁷ CX-67, at 39. USOG's Form 10/A, filed with the SEC and dated June 25, 2010, identifies JT as a "Key Employee." CX-67B, at 42.

On July 15, 2010, JT converted \$200,000 of a USOG note payable to him into 400 million shares of USOG common stock.⁵⁸ USOG had 1,029,378,400 common shares issued and outstanding at that time.⁵⁹ Accordingly, JT controlled more than 38% of USOG's outstanding common stock.⁶⁰ That same day, JT, through a stock purchase agreement, sold 100 million shares of USOG stock to Customer J for \$50,000.⁶¹ According to the stock purchase agreement, these shares were not registered under the Securities Act or any state securities laws.⁶² The agreement warned Customer J that the securities could not be resold unless the shares were registered or exempt from registration.⁶³

2. Customer J Deposits USOG Stock at Merrimac

Customer J deposited 56.5 million of its 100 million USOG shares into its Merrimac account.⁶⁴ To accomplish the deposit of the USOG shares, Customer J completed a DSR Form and provided it to Merrimac.⁶⁵

On the DSR Form, Customer J indicated that it obtained the USOG stock from JT.⁶⁶ The DSR Form asked about the seller's relationship to the issuer, USOG. Specifically, the form asked whether the prior owner, i.e., JT, was an officer, director, affiliate, control person, or 10% holder of securities at the time of the sale or within 90 days of the owner's receipt of the security.⁶⁷ Although JT previously had been identified on USOG's SEC Form 10 filing as an executive officer and owner of 38% of the outstanding USOG stock at the time of the sale, Customer J responded "no" to the question.⁶⁸ The DSR Form also inquired if the USOG stock was registered.⁶⁹ Although the stock purchase agreement clearly stated that USOG securities were not

⁵⁸ CX-67D, at 14.

⁵⁹ CX-67D, at 4, 12. The above figures are as of June 30, 2010. USOG was authorized to issue up to 1.875 billion shares of common stock.

⁶⁰ $400,000,000 / 1,029,378,400 = 0.388584$ (38.86%).

⁶¹ CX-68.

⁶² CX-68, at 3.

⁶³ CX-68, at 3.

⁶⁴ CX-71B, at 33. On August 31, 2010, the only USOG stock in Customer J's account was the 56.5 million shares. CX-71B, at 32 (Portfolio Positions information). Customer J deposited a physical certificate for 6.5 million common shares of USOG on July 30, 2010; however, it moved these shares out of its Merrimac account on August 13, 2010. CX-71B, at 27, 33-34.

⁶⁵ CX-71B, at 1-18. The DSR Form related to the USOG deposit was one of the DRS Forms that CS falsified. CX-75.

⁶⁶ CX-71B, at 1.

⁶⁷ CX-71B, at 2.

⁶⁸ CX-71B, at 2.

⁶⁹ CX-71B, at 2.

registered, Customer J responded “yes,” indicating that the shares were registered pursuant to Form S-1, and stated that the shares were “Free Trading.”⁷⁰ Contrary to the representations on the DSR Form, the 56.5 million USOG shares were not registered.⁷¹

Customer J also provided Merrimac with a copy of the front of the stock certificate, dated August 4, 2010, certifying that it was the recorded holder of the 56.5 million USOG shares.⁷² The certificate contained no restrictive legend.⁷³

3. Customer J Sells USOG Stock

From October 1 through 8, 2010, Customer J, through its account at Merrimac, sold all 56.5 million USOG shares in the over-the-counter market.⁷⁴ The sales generated approximately \$124,000 in gross proceeds for Customer J, and more than \$5,500 in gross commissions for Merrimac.⁷⁵

B. Discussion

Section 5 of the Securities Act prohibits the offer and sale of a security unless there is a registration statement in effect or an exemption available for the transaction.⁷⁶ The purpose of the registration requirement is to “protect investors by promoting full disclosure of information thought necessary to [make] informed investment decisions.”⁷⁷

1. Enforcement Established a Prima Facie Case

To establish a prima facie case for a Section 5 violation against Merrimac, Enforcement was required to show that: (1) Merrimac directly or indirectly sold or offered to sell the securities at issue; (2) no registration statement was in effect or filed as to the transactions in which the securities were sold; and (3) the sale or offer to sell was made through the use of interstate

⁷⁰ CX-71B, at 2.

⁷¹ Enforcement presented evidence that the USOG shares were not registered and Respondents presented no evidence to the contrary. Tr. 274-75, 290; CX-68, at 3.

⁷² CX-71B, at 5.

⁷³ CX-71B, at 5. A “restrictive legend” is a statement placed on the certificate of a restricted stock used to notify the holder of the stock that it may not be resold without registration. *World Trade Financial v. SEC*, 739 F.3d 1243, 1246 n.2 (9th Cir. 2014) (citing *Geiger v. SEC*, 363 F.3d 481, 483, 361 U.S. App. D.C. 45 (D.C. Cir. 2004)).

⁷⁴ CX-71B, at 40-44.

⁷⁵ CX-71B, at 40-44; CX-41, lines 2087 - 2611 (identifying sales of USOG, market maker MPID, and gross commission information).

⁷⁶ 15 U.S.C. § 77e(a) and (c); see also *Jacob Wonsover*, Exchange Act Release No. 41123, 1999 SEC LEXIS 430, at *15-16 (Mar. 1, 1999), *aff'd*, 205 F.3d 408 (D.C. Cir. 2000).

⁷⁷ *SEC v. Ralston Purina Co.*, 346 U.S. 119, 124 (1953).

facilities or the mails.⁷⁸ A showing of scienter is not required because “[t]he Securities Act of 1933 imposes strict liability on offerors and sellers of unregistered securities.”⁷⁹

Here, no registration statement was in effect with respect to the 56.5 million shares of USOG.⁸⁰ Merrimac sold the securities on behalf of its customer.⁸¹ The sales involved interstate activity because the shares were sold into the over-the-counter market, thereby entering interstate commerce.⁸²

2. Merrimac Failed to Prove an Exemption to the Registration Requirements

Exemptions from the registration requirements are affirmative defenses that must be established by the person claiming the exemption, and such exemptions “are construed strictly to promote full disclosure of information for the protection of the investing public.”⁸³

Merrimac asserted that JT was not an affiliate of USOG; and, therefore, it was permitted to sell the USOG stock.⁸⁴ For example, Merrimac argued that the Notice of Conversion of Promissory Note that USOG filed with the SEC was dispositive of this issue because it stated that JT was not an affiliate of USOG.⁸⁵ However, Merrimac cannot simply accept the assertions of USOG, the issuer. In Regulatory Notice 09-05, FINRA reminded its members of the SEC’s requirement of a firm’s obligation prior to reselling securities.

[A] dealer who offers to sell, or is asked to sell a substantial amount of securities must take whatever steps are necessary to be sure that this is a transaction not involving an issuer, person in a control relationship with an issuer or an underwriter. For this purpose, it is not sufficient for him merely to accept “self-

⁷⁸ *Gordon Brent Pierce*, Exchange Act Release No. 71664, 2014 SEC LEXIS 4544, at *27 (Mar. 7, 2014).

⁷⁹ *Alvin W. Gebhart*, Exchange Release Act No. 53136, 2006 SEC LEXIS 93, at *53 n.73 (Jan. 18, 2006) (quoting *Swenson v. Engelstad*, 626 F.2d 421, 424 (5th Cir. 1980)).

⁸⁰ Tr. 824; CX-71B, at 10.

⁸¹ CX-41; CX-71B, at 40-44.

⁸² CX-41 (USOG trades executed with market maker identified as NITE).

⁸³ *Pierce*, 2014 SEC LEXIS 4544, at *30 (citing *SEC v. Cavanaugh*, 445 F.3d 105, 115 (2d Cir. 2006)).

⁸⁴ Merrimac’s Post-Hr’g Reply Br. at 4. Merrimac’s argument that JT was not an affiliate is a post-hoc rationalization as no review was conducted at the time of the deposit and related sales. As noted above, when Customer J deposited the USOG stock, Merrimac accepted the representations on the DSR Form. The DSR Form indicated that the shares were registered and “Free Trading.” CX-71B, at 2. Because CS falsified the DSR Form, and Merrimac and Nash failed to investigate upon learning of the falsified forms, the DSR Form was sent to the clearing firm without any supervisory review by Merrimac.

⁸⁵ CX-69, at 2.

serving statements of his sellers and their counsel without reasonably exploring the possibility of contrary facts”⁸⁶

An affiliate of an issuer is “a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, such issuer,” such as an officer, director, or controlling shareholder.⁸⁷ Merrimac was required to analyze JT’s status and determine whether he was an issuer. Had it done so, it would have learned that, at the time of JT’s sale to Customer J, he owned 38% of the outstanding USOG stock and had been identified as an USOG executive officer within the past three months.

Section 4(1) of the Securities Act provides an exemption for the routine trading of already-issued securities. However, it does not exempt sales by an issuer, or a control person of the issuer, or an underwriter or dealer. For Section 4(1) purposes, an underwriter is broadly defined to “encompass all persons who engage in steps necessary to the distribution of securities.”⁸⁸ The Section 4(1) exemption “was intended to exempt only trading transactions between individual investors with respect to securities already issued and not to exempt distributions by issuers or acts of other individuals who engage in steps necessary to such distributions.”⁸⁹

Customer J received its USOG shares from JT, an affiliate of the issuer. Because Customer J obtained the securities from an affiliate of the issuer in a transaction not involving a public offering, the securities were restricted.⁹⁰ Customer J deposited those shares into its account at Merrimac, and Merrimac, on its behalf, sold the shares to the public. The fact that Customer J quickly began selling its USOG shares indicates that it purchased the stock with a view toward its distribution, not as an investment.⁹¹ Merrimac was a necessary participant to distribute the USOG shares in those transactions.

Rule 144 of the Securities Act provides a safe harbor under Section 4(1) for persons who adhere to its requirements and, therefore, are not deemed to be underwriters. This safe harbor provision, however, is not available here. Rule 144(d)(1)(i) provides that “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”⁹² JT was an

⁸⁶ FINRA Regulatory Notice 09-05, at 4 (Jan. 2009) (quoting Exchange Act Release No. 4445, 1962 SEC LEXIS 74 (Feb. 2, 1962)); *see also* Section 21(a) Report, *Transactions in the Securities of Laser Arms Corp. by Certain Broker-Dealers*, 50 S.E.C. 489 (1991).

⁸⁷ 17 C.F.R. § 230.144(a)(1); *Cavanaugh*, 445 F.3d 105, 111.

⁸⁸ *Harden v. Raffensperger, Hughes & Co.*, 65 F.3d 1392, 1400 (7th Cir. 1994).

⁸⁹ Securities Act Release No. 33-5223, 1972 SEC LEXIS 49, at *8 (Jan. 11, 1972).

⁹⁰ 17 C.F.R. § 230.144(a)(3).

⁹¹ *Cavanaugh*, 445 F.3d 105, 115-16.

⁹² 17 C.F.R. § 230.144(d)(1)(i).

affiliate of USOG, and Customer J acquired its USOG shares from him in a private transaction approximately three months before reselling them. Accordingly, the relevant six-month holding period was not satisfied, and Rule 144's safe harbor provision was unavailable.

The Panel determines that Merrimac has not established an exemption to the Section 5 registration requirements.⁹³

3. Conclusion

The Panel concludes that Merrimac sold unregistered securities in contravention of Section 5 of the Securities Act. FINRA Rule 2010 requires members and associated persons to "observe high standards of commercial honor and just and equitable principles of trade." A violation of Section 5 constitutes a violation of FINRA Rule 2010.⁹⁴ Accordingly, the Panel finds that Merrimac violated FINRA Rule 2010 by selling unregistered securities in violation of Section 5.

IV. MERRIMAC FAILED TO ESTABLISH AND IMPLEMENT AN EFFECTIVE AML SYSTEM

The sixth cause of action alleges that, from May 2009 through January 2011, Merrimac and Nash failed to establish and maintain supervisory procedures reasonably designed to achieve compliance with AML rules and regulations, and failed to monitor and detect suspicious activity in violation of NASD Rule 3011 and FINRA Rules 3310 and 2010. The Panel concludes that Merrimac violated NASD Rule 3011 and FINRA Rules 3310 and 2010; however, because Merrimac specifically designated Matthews as its AML Officer, the Panel dismissed the AML charges against Nash.

⁹³ Merrimac has not argued that any other exemptions to the registration requirements apply to it. Section 4(2) of the Securities Act exempts sales made by an issuer not involving a public offering. This exemption is inapplicable because Merrimac was not an issuer. Section 4(4) of the Securities Act provides an exemption for unsolicited brokers' transactions. However, this exemption is available only if a broker is not aware, after a reasonable inquiry, of circumstances indicating that the selling customer is participating in a distribution of securities. The Panel finds that Merrimac did not conduct a reasonable inquiry. The DSR Form applicable to this deposit and sale of USOG was one of the forms that CS falsified so it was sent to the clearing agent without supervisory review. CX-75. In addition, Merrimac never contemplated that this resale would be made pursuant to an exemption as the DSR Form stated that the shares were registered pursuant to Form S-1. CX-71B, at 2.

⁹⁴ *Gebhart*, 2006 SEC LEXIS 93, at *54 n.75 ("Further, because we have consistently held that a violation of a Commission or [FINRA] rule or regulation is inconsistent with just and equitable principles of trade, we find that the Gebharts' sale of the unregistered [securities] also constitutes a violation of [FINRA] Rule [2010]."); *Stephen J. Gluckman*, 54 S.E.C. 175, 185 (1999).

A. Facts

Merrimac's AML policies, procedures, and internal controls were described in its AML Program Compliance and Supervisory Procedures, dated October 12, 2007 (2007 AML Procedures), and in revised procedures dated January 1, 2010 (2010 AML Procedures).⁹⁵ Matthews was Merrimac's AML Officer;⁹⁶ he was responsible for Merrimac's AML program.⁹⁷ As set forth below, his responsibilities included drafting the AML procedures, reviewing them annually, monitoring accounts for suspicious activity, and documenting when and how the monitoring was carried out.⁹⁸

The 2007 AML Procedures made only a passing reference to penny stocks. The procedures failed to provide any guidance on how to monitor, detect, or investigate potentially suspicious activity related to penny stock.⁹⁹ Although Merrimac began trading penny stocks by at least 2008, which grew to approximately 18% of its business in 2010, Merrimac did not amend the 2007 AML Procedures before it started its penny stock business.¹⁰⁰

In 2010, when Matthews revised Merrimac's AML procedures, he used the FINRA Small Firm Template.¹⁰¹ Matthews acknowledged the procedures were not customized for Merrimac.¹⁰² For example, if Merrimac staff identified red flags or other suspicious activity, the 2010 AML Procedures failed to include specific procedures to escalate the red flags or suspicious activity for review. Specifically, in the subsection entitled "Responding to Red Flags and Suspicious Activity," the 2010 AML Procedures stated that "[w]hen an employee of the Firm detects any red flag or other activity that may be suspicious, he or she will notify [*include procedures for escalation of suspicious activity*]."¹⁰³ Although the italicized writing indicated that such procedures would be added, none were.¹⁰⁴ Merrimac also failed to customize other sections of the FINRA Small Firm Template before adopting it as the firm's 2010 AML Procedures, including, but not limited to: (1) whether Merrimac would verify customer identity through documentary or

⁹⁵ Tr. 93-102; CX-36; CX-37.

⁹⁶ CX-84C, at 10; CX-84G, at 18. Matthews reported directly to Merrimac's CEO, Pizzutti.

⁹⁷ CX-36, at 1; CX-37, at 2; CX-84E, at 8-9.

⁹⁸ CX-36, at 1-2, 11; CX-37, at 2, 16; CX-84E, at 32-34.

⁹⁹ See generally CX-36 (procedures only reference penny stocks in one of the "red flags" and provide no guidance).

¹⁰⁰ CX-84G, at 24-25; see CX-42C (reflecting that Merrimac traded in penny stocks in 2008); Tr. 1482-83.

¹⁰¹ CX-84G, at 24. The current version of FINRA's Small Firm Template is available at <http://www.finra.org/industry/anti-money-laundering-template-small-firms>.

¹⁰² CX-84G, at 24.

¹⁰³ Tr. 1031; CX-37, at 20.

¹⁰⁴ Tr. 115-16; CX-37, at 20.

non-documentary methods, or both;¹⁰⁵ (2) what specific reporting agency database(s) it would use to independently verify customer identity when Merrimac utilized non-documentary methods;¹⁰⁶ and (3) thresholds for certain account values or specific account types or specific customer types where Merrimac believed that additional customer due diligence was warranted.¹⁰⁷

In September 2010, Merrimac implemented written policies and procedures for processing penny stocks (Penny Stock Procedures).¹⁰⁸ The one-page Penny Stock Procedures required that registered representatives processing penny stock transactions submit completed DSR Forms; however, they provided no guidance to determine if stock was freely tradable.¹⁰⁹ As discussed above, the DSR Form was a customer questionnaire regarding the source of the penny stock and its registration status.¹¹⁰ The DSR Forms required the customer to attest that the information regarding the subject security was true and correct.¹¹¹ Although Merrimac developed Penny Stock Procedures, it failed to ensure that its registered representatives properly used the DSR Forms. Indeed, at least three registered representatives had their clients pre-sign blank DSR Forms.¹¹²

The Penny Stock Procedures required registered representatives to report any suspicious activity they uncovered to compliance personnel.¹¹³ While both the 2007 and 2010 AML Procedures identified red flags that signaled possible money laundering,¹¹⁴ Merrimac failed to timely and consistently identify red flags in its penny stock business.¹¹⁵ For example, Merrimac's customers conducted suspicious transactions in penny stocks by depositing large blocks of shares

¹⁰⁵ Tr. 1029; CX-37, at 8.

¹⁰⁶ Tr. 1030; CX-37, at 9.

¹⁰⁷ Tr. 1031; CX-37, at 12.

¹⁰⁸ Complaint (“Compl.”) ¶ 111; Answer (“Ans.”) ¶ 111.

¹⁰⁹ Compl. ¶ 111; Ans. ¶ 111.

¹¹⁰ *See, e.g.*, CX-65.

¹¹¹ CX-65, at 5.

¹¹² CX-66; CX-66A; CX-66B.

¹¹³ CX-65, at 1. The Penny Stock Procedures also required that the DSR Form be signed by the registered representative as well as compliance or Merrimac management. CX-65, at 1. By signing the DSR Form, the registered representative and supervisory personnel attest that the information in the form “is true and correct and is made in compliance with all applicable federal and state securities laws and regulations.” CX-65, at 5.

¹¹⁴ CX-36, at 12-14; CX-37, at 17-20. The 2010 AML Procedures identified certain securities transactions as red flags, such as “[c]ustomer transactions include a pattern of receiving stock in physical form or the incoming transfer of shares, selling the position and wiring out proceeds.” CX-37, at 18.

¹¹⁵ Enforcement and Merrimac stipulated that Merrimac identified some suspicious activity in 2010, 2011, and 2012. *See* Joint Stipulation, dated June 4, 2014. One customer identified on the Joint Stipulation was discussed at the hearing. *Compare* Joint Stipulation with CX-77, at 2-3.

into their accounts and, shortly thereafter, liquidating those positions.¹¹⁶ The liquidations often occurred close in time with press releases about the issuer.¹¹⁷ These same customers also wired their sales proceeds from their Merrimac accounts to outside bank accounts.¹¹⁸

Merrimac asserted that its compliance professionals reviewed the firm's trading on a daily basis.¹¹⁹ However, despite the fact that its AML procedures required the AML Officer to document when and how Merrimac monitored accounts for suspicious activity,¹²⁰ Merrimac failed to present any documentary evidence reflecting the trading reviews conducted by its AML professionals.

In addition to its written procedures, Merrimac had a policy of researching each new customer's background.¹²¹ Despite this policy, several of Merrimac's customers had extensive securities-related disciplinary histories.¹²² Although Merrimac's background check required a search for any securities-related disciplinary history,¹²³ Matthews, Merrimac's AML Officer, was not familiar with FINRA's BrokerCheck system, a free tool to research the professional backgrounds of brokerage firms and brokers currently or formerly registered with FINRA or a national securities exchange.¹²⁴

One Merrimac representative acknowledged that he was unaware of his customer's regulatory disciplinary history.¹²⁵ He also acknowledged that he never asked his customer if he was ever registered with FINRA.¹²⁶ When the representative learned that his customer had been permanently barred from the securities industry based on several types of misconduct, including misappropriation, he stated he would not have accepted this individual as one of his customers.¹²⁷

¹¹⁶ CX-76; CX-77.

¹¹⁷ CX-76; CX-77.

¹¹⁸ CX-76; CX-77.

¹¹⁹ Tr. 1034-35.

¹²⁰ CX-36, at 1-2, 11; CX-37, at 2, 16.

¹²¹ Compl. ¶ 112; Ans. ¶ 112.

¹²² *See, e.g.*, CX-48B; CX-49B; CX-54, at 9-16; Tr. 174-76, 213-14, 231-33.

¹²³ Compl. ¶ 112; Ans. ¶ 112.

¹²⁴ CX-84G, at 39, 69.

¹²⁵ CX-90, at 11.

¹²⁶ CX-90, at 14. The registered representative believed that Merrimac's back office conducted the searches for securities-related disciplinary history. CX-90, at 11.

¹²⁷ CX-90, at 15.

B. Discussion

FINRA Rule 3310, formerly NASD Rule 3011, requires each member firm to “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 [(“BSA”)] . . . , and the implementing regulations promulgated thereunder by the Department of the Treasury.” Rule 3310(a) requires each member to establish and implement policies and procedures “that can be reasonably expected to detect and cause the reporting of” suspicious activity and transactions.

In Notice to Members 02-21, which provides guidance to member firms concerning AML compliance programs, FINRA emphasized to its members that to be effective, AML procedures “must reflect the firm’s business model and customer base.”¹²⁸ Members were advised that “in developing an appropriate AML program . . . , [a firm] should consider factors such as its . . . business activities, the types of accounts it maintains, and the types of transactions in which its customers engage.”¹²⁹ The Notice emphasized each firm’s duty to detect red flags that might be a sign of money laundering; and, if a firm detects any, to “perform additional due diligence before proceeding with the transaction.”¹³⁰

To assist small firms in fulfilling their responsibilities to establish an AML program, FINRA published the Small Firm Template. The template, however, was not intended to address every firm’s needs or to “provide a safe harbor from regulatory responsibility.”¹³¹ In fact, FINRA included the following warning on the first page of the template that each firm must tailor its AML program to fit its particular situation.

[T]his 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. . . . 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 your plan fits your firm’s risk level and that you implement the program.¹³²

Merrimac failed to develop adequate AML policies and procedures that complied with the requirements of NASD Rule 3011 and FINRA Rule 3310. Merrimac failed to timely update its procedures to address its penny stock business. When Matthews did revise the AML procedures, he copied FINRA’s Small Firm Template, leaving all the instructions and examples

¹²⁸ Special NASD Notice to Members 02-21, 2002 NASD LEXIS 24, at *17 (Apr. 2002).

¹²⁹ *Id.* at *20.

¹³⁰ *Id.* at *37.

¹³¹ FINRA’s Small Firm Template at 1.

¹³² FINRA’s Small Firm Template at 1 (emphasis in original).

from the template in the 2010 AML Procedures.¹³³ As a result, Merrimac's AML procedures failed to provide specific guidance to persons associated with the firm.

Not only were Merrimac's policies and procedures inadequate, Merrimac failed to implement them in at least three ways. First, registered representatives obtained pre-signed, blank DSR Forms from their customers. Second, Merrimac failed to consistently and timely identify and document suspicious penny stock activity. Third, Merrimac failed to identify customers with regulatory disciplinary histories.

The Panel concludes that Merrimac violated NASD Rule 3011 and FINRA Rules 3310 and 2010 by failing to develop and implement adequate AML policies and procedures. The Panel dismisses the AML charges as they relate to Nash because Nash was not the firm's designated AML Officer and was not responsible for Merrimac's AML program during the period at issue.

V. MERRIMAC AND NASH FAILED TO ESTABLISH AND MAINTAIN A REASONABLE SUPERVISORY SYSTEM, INCLUDING WRITTEN SUPERVISORY PROCEDURES

The seventh cause of action alleges that, from November 2007 to January 2013, Merrimac, and in some instances Nash, failed to establish and maintain a reasonable supervisory system, including written supervisory procedures, in violation of NASD Rules 3010 and 2110 and FINRA Rule 2010. The Complaint identifies four areas where Merrimac's supervisory systems, including written supervisory procedures, were inadequate: (1) DuBrule's and Tuttle's private securities transactions, (2) Merrimac's penny stock deposits and the related DSR Forms, (3) two websites created by Pizzuti, and (4) Merrimac's utilization of foreign finders. The Panel finds that Merrimac failed to have a reasonable supervisory system for the activities of, and the business transacted by, Merrimac in each of the four areas identified above. The Panel also finds that Nash failed to (1) reasonably supervise Merrimac's penny stock deposits and related DSR Forms, (2) establish procedures clearly identifying websites as advertising material, and (3) timely establish reasonable procedures for Merrimac's utilization of foreign finders.

A. Facts

In general, Merrimac's written supervisory procedures addressed a number of business lines and activities in which Merrimac engaged and designated a Merrimac principal with responsibility for conducting the supervisory functions in each area. We address below the areas where Merrimac failed to establish and maintain a reasonable supervisory system, and to conduct appropriate supervisory functions associated with each such area.

¹³³ *Dep't of Enforcement v. Domestic Sec., Inc.*, No. 2005001819101, 2008 FINRA Discip. LEXIS 44, at *18 (NAC Oct. 2, 2008) (holding that respondent did not establish adequate AML policies and procedures when it failed to tailor the FINRA Small Firm Template to fit the firm's business).

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

When Tuttle first became employed with Merrimac in September 2007, he and DuBrule met with Matthews, Nash, and Pizzuti to discuss their involvement with two pre-existing hedge funds.¹³⁴ On September 14, 2007, Tuttle and DuBrule sent a letter to Matthews requesting permission to participate in Tuttle Asset Management, an entity owned and controlled by Tuttle and DuBrule that managed the assets for the two hedge funds.¹³⁵ On November 15, 2007, Matthews sent a letter to Tuttle permitting him to engage in his outside business activities, in accordance with NASD Rule 3040.¹³⁶ The approval letter also stated that Matthews was satisfied that Tuttle would not continue to solicit participation in the funds by any individuals, including Merrimac customers.¹³⁷ Tuttle signed the letter and agreed to abide by the terms outlined in the approval letter.¹³⁸ When DuBrule joined Merrimac in September 2008, he also requested permission to participate in the management of the hedge funds, which Matthews reviewed and approved.¹³⁹

Pursuant to NASD Rule 3040, if a firm provides approval for private securities transactions, the private securities transactions shall be recorded on the books and records of the firm, and the firm shall supervise the associated person's participation in the private securities transactions as if they were executed on behalf of the member. Despite the fact that Tuttle agreed not to solicit additional investors for the hedge funds, during 2009, DuBrule and Tuttle solicited three customers, who invested a total of \$4.1 million.¹⁴⁰ Merrimac was unaware of the additional investments in the hedge funds.¹⁴¹ It never learned of the investments "until well after the fact."¹⁴²

Merrimac's written supervisory procedures designated Nash as the principal who was responsible for reviewing and monitoring outside business activities.¹⁴³ However, Nash testified that Matthews was responsible for monitoring Tuttle's and DuBrule's involvement with the hedge funds.¹⁴⁴ Because Nash believed that Matthews was handling the supervision of DuBrule's and Tuttle's participation with the hedge funds, he never requested or reviewed monthly or quarterly statements, promissory notes, private placement memoranda, or other relevant financial

¹³⁴ CX-24.

¹³⁵ CX-24; Tr. 989-90; CX-8, at 2, 41-42.

¹³⁶ CX-25.

¹³⁷ CX-25.

¹³⁸ CX-25.

¹³⁹ CX-26.

¹⁴⁰ CX-27, at 3; CX-27A; CX-27B; CX-28; CX-30.

¹⁴¹ CX-34A, at 4.

¹⁴² CX-34C, at 3.

¹⁴³ CX-73A, at 30.

¹⁴⁴ Tr. 998-99, 1011.

documents provided to investors or prospective investors in the funds.¹⁴⁵ Moreover, Nash never reviewed any documentation regarding the funds to determine if DuBrule and Tuttle consistently followed the hedge funds' investment objectives set forth in the funds' private placement memoranda, and Nash did not review the management fees that DuBrule and Tuttle received from the hedge funds.¹⁴⁶ At some point in 2009, Nash learned that DuBrule and Tuttle failed to provide Merrimac with information about the operation of the funds; however, he never requested that they send him such information.¹⁴⁷

Merrimac's responses to inquiries from FINRA also confirmed that, despite its designation of Nash as the supervisory principal responsible for outside business activities, Merrimac tasked Matthews with reviewing DuBrule's and Tuttle's private securities transactions.¹⁴⁸ That said, Matthews' supervision of Tuttle's and DuBrule's participation in the funds was limited at best. Matthews only reviewed the brokerage statements for the funds to ensure that DuBrule and Tuttle were complying with Merrimac's front-running directives and that firm clients were not participating in these investments.¹⁴⁹

2. Penny Stock Transactions and DSR Forms

Nash signed DSR Forms in connection with penny stock deposits to evidence his supervisory approval. As discussed above, the purpose of the DSR Form was to provide Merrimac with sufficient information to ensure that shares of a given penny stock were legally qualified for resale, either because (1) the shares in question were registered under an effective registration statement filed with the SEC, or (2) the liquidating transaction of the shares in question qualified for a valid exemption from registration. CS falsified numerous DSR Forms. CS worked in a Merrimac branch office, and Nash was responsible for the supervision of that branch office.¹⁵⁰ Although Nash did not learn of the falsified DSR Forms until some point after the misconduct occurred, he neither determined the scope of the misconduct nor reviewed the related penny stock activity to ensure that the stocks that Merrimac sold were properly registered or exempt from registration. As a result, Merrimac, on behalf of one of its customers, sold more than 56 million shares of unregistered, non-exempt shares in contravention of Section 5 of the Securities Act.

¹⁴⁵ Tr. 994-97, 1003-06.

¹⁴⁶ Tr. 1011-14.

¹⁴⁷ Tr. 1001-02.

¹⁴⁸ CX-34A, at 4-5; CX-34C, at 3-4.

¹⁴⁹ CX-34A, at 4.

¹⁵⁰ Tr. 996, 998; CX-73A, at 28 (identifying Nash as the designated principal for overall supervision of Merrimac's Office of Supervisory Jurisdiction principals).

3. Evaluvest Websites

From September 2010 to February 2012, Pizzuti created two websites, www.evaluvest.com and www.evaluvestp4.com (the Evaluvest Websites).¹⁵¹ The Evaluvest Websites were accessible to the public.¹⁵² They offered a subscription-based “stock analyzer” that used “computational algorithms” to identify stocks with the “highest Alpha and strongest performance.”¹⁵³ The Evaluvest Websites were also available to Merrimac registered representatives to use as an account management tool.¹⁵⁴

The Evaluvest Websites disseminated securities-related communications that: (1) provided insufficient information to evaluate the products offered; (2) failed to define relevant terminology; (3) made misleading statements about the impact of its products on investors and the market; (4) failed to adequately disclose risks; (5) failed to prominently disclose their relationship with Merrimac; (6) failed to disclose the relationship between Pizzuti and Merrimac; and (7) generally presented to the public information that was misleading, exaggerated, and unwarranted.¹⁵⁵

Although the advertising section of Merrimac’s written supervisory procedures did not specifically address websites, the procedures did state that “all advertising will be reviewed for misleading or inaccurate statements.”¹⁵⁶ The procedures designated Matthews as the principal responsible for reviewing and approving all advertising.¹⁵⁷ Matthews testified that he never reviewed or approved the Evaluvest Websites.¹⁵⁸ He stated that the failure to review the websites was an inadvertent error.¹⁵⁹ There is no evidence that any principal at Merrimac reviewed or

¹⁵¹ CX-73; CX-86, at 11; Tr. 587, 622-23, 1511.

¹⁵² Although the websites contained some subscription-only content, the communications at issue were publicly accessible. CX-73; Tr. 587, 622-23, 1511. The Panel found the FINRA examiner who testified about the Evaluvest Websites to be very credible. She testified that she reviewed the Evaluvest Websites and determined that they were active and accessible to the public. Tr. 587, 595-96, 622-23.

¹⁵³ CX-73, at 5, 7.

¹⁵⁴ CX-84F, at 33. Pizzutti testified that his participation with the Evaluvest stock analyzer program has “always been listed as a 3040” with Merrimac. Tr. 1455, 1513-14. In November 2009, Merrimac conducted its business in an Evaluvest office, which was down the street from Merrimac’s home office as reflected in CRD. Tr. 691-93, 797-98.

¹⁵⁵ CX-73, at 6-8, 10, 12, 16, 20; CX-82; Tr. 598-99, 602.

¹⁵⁶ CX-73A, at 16.

¹⁵⁷ CX-73A, at 29; CX-84C, at 15; CX-84E, at 17, 37-38; CX-84F, at 22-26, 28.

¹⁵⁸ CX-84F, at 32; CX-86, at 11, 21.

¹⁵⁹ CX-84F, at 34.

approved the Evaluvest Websites.¹⁶⁰ Further, Merrimac never submitted the Evaluvest Websites to FINRA’s Advertising Regulation Division for approval prior to their use by Pizzuti.¹⁶¹

4. Foreign Finders

Merrimac entered into a Foreign Finder Referral Agreement with a foreign-based entity located in Mexico (Foreign Entity) on November 19, 2010.¹⁶² Pursuant to the terms of this agreement, Merrimac offered its broker-dealer services to the Foreign Entity customers located in Mexico.¹⁶³ The Foreign Entity was the primary point of contact for clients who needed account-related support.¹⁶⁴ Merrimac began paying transaction-based compensation to the Foreign Entity in March 2011.¹⁶⁵ Prior to June 2011, Merrimac’s transaction confirmations for the clients that its Foreign Entity referred failed to indicate that compensation was being paid to a foreign-based entity.¹⁶⁶

When Merrimac entered into the Foreign Finder Referral Agreement with the Foreign Entity, its written supervisory procedures did not contain any provisions addressing supervision of foreign finders.¹⁶⁷ Merrimac did not create procedures to address its foreign finder business until approximately six months after it entered into the agreement with the Foreign Entity.¹⁶⁸ Merrimac’s foreign finder procedures consisted of a one-page document that listed the requirements for a foreign finder exemption when a firm pays transaction-based compensation to non-registered foreign persons. The foreign finder supervisory procedures failed to (1) provide guidance on the permissible activities of non-registered foreign persons introducing business to Merrimac as foreign finders, and (2) identify the Merrimac principal responsible for supervising compliance with Merrimac’s new foreign finder procedures.¹⁶⁹

B. Discussion

“Assuring proper supervision is a critical component of broker-dealer operations.”¹⁷⁰ NASD Rule 3010(a) requires that FINRA members “establish and maintain a system to

¹⁶⁰ CX-86; Tr. 599-600.

¹⁶¹ Tr. 1514.

¹⁶² CX-58.

¹⁶³ CX-58.

¹⁶⁴ CX-58, at 1, 8.

¹⁶⁵ Tr. 1056-57.

¹⁶⁶ Tr. 1478-80, 1492-95.

¹⁶⁷ CX-73A.

¹⁶⁸ CX-58; Tr. 1057, 1332.

¹⁶⁹ CX-60.

¹⁷⁰ *Richard F. Kresge*, Exchange Act Release No. 55988, 2007 SEC LEXIS 1407, at *27 (June 29, 2007).

supervise the activities of each registered representative, registered principal, and other associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with the Rules of [FINRA].”¹⁷¹ NASD Rule 3010(b) further requires that a member “establish, maintain, and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of registered representatives, registered principals, and other associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable Rules of [FINRA].”¹⁷² “The standard of ‘reasonableness’ is determined based on the particular circumstances of each case.”¹⁷³

1. Merrimac Failed to Supervise DuBrule’s and Tuttle’s Private Securities Transactions

Merrimac failed to appreciate its supervisory responsibilities once it provided its approval for DuBrule and Tuttle to engage in private securities transactions. It was required to supervise the associated person’s participation in the private securities transactions as if any such transaction was executed on behalf of the member. Merrimac, however, was unaware of the \$4.1 million of new funds invested by three investors in the funds after DuBrule and Tuttle joined Merrimac. There is no evidence that Merrimac recorded those transactions on its books. In addition, Merrimac failed to ensure that DuBrule and Tuttle provided relevant information to the firm about their participation in the management of the hedge funds.

The Hearing Panel finds that Merrimac failed to supervise DuBrule’s and Tuttle’s participation in their private securities transactions.¹⁷⁴

2. Merrimac and Nash Failed to Supervise Penny Stock Transactions and DSR Forms

Nash provided the supervisory review for penny stock deposits and signed the DSR Forms to evidence his supervisory approval. Upon learning that CS had falsified DSR Forms by photocopying his signature and sending the forms directly to the clearing firm, Nash neither took steps to identify the true scope of her misconduct nor reviewed the related penny stock activity to ensure that the stocks sold were properly registered or exempt from registration.

¹⁷¹ NASD Rule 3010(a).

¹⁷² NASD Rule 3010(b).

¹⁷³ See, e.g. *Christopher J. Benz*, Exchange Act Release No. 38440, 1997 SEC LEXIS 672, at *12 (Mar. 26, 1997) (citing *In re Consol. Inv. Servs., Inc.*, 52 S.E.C. 582 (Jan. 5, 1996)).

¹⁷⁴ Enforcement devoted a large portion of its post-hearing brief and findings of fact to arguing that Nash should be held liable for the failure to supervise DuBrule’s and Tuttle’s private securities transactions. The Panel did not find Nash liable for failing to supervise DuBrule’s and Tuttle’s activities because the supervisory charges against Nash in the Complaint did not include any allegations involving DuBrule and Tuttle. Compl. ¶¶ 8, 149-57.

The Hearing Panel finds that Merrimac and Nash failed to reasonably supervise the penny stock deposits and sales, as well as the related DSR Forms.

3. Merrimac Failed to Supervise Pizzuti's Websites and Nash Failed to Establish Advertising Procedures for Websites

Although Merrimac's procedures did not specifically state that websites were advertising materials, the Evaluvest Websites constituted advertising.¹⁷⁵ Matthews was responsible for reviewing and approving all advertising. He testified that his failure to review the websites was an inadvertent error.

The Hearing Panel finds that Merrimac, through Matthews, failed to supervise the Evaluvest Websites.¹⁷⁶ The Hearing Panel also finds that Merrimac and Nash failed to establish procedures that clearly identified websites as advertising material.

4. Merrimac and Nash Failed to Timely Establish Procedures for Foreign Finders

Merrimac did not create procedures to address its foreign finder business until approximately six months after it entered into the agreement with the Foreign Entity and had already begun accepting transactions initiated through the Foreign Entity. When Merrimac created the foreign finder procedures, it failed to provide guidance on how to supervise this new business area or to even identify the Merrimac principal responsible for supervision of the firm's new foreign finder business, including the adoption of procedures to guide those engaging in this business. Nash, as the CCO, was responsible for Merrimac's written supervisory procedures.

The Hearing Panel finds that Merrimac and Nash failed to timely establish and maintain reasonable written supervisory procedures for this area of its business.

5. Conclusion

The Hearing Panel concludes that Merrimac and Nash violated NASD Rules 3010 and 2110 and FINRA Rule 2010 by failing to supervise and, in certain instances, failing to establish and maintain adequate written supervisory procedures.

¹⁷⁵ See NASD Rule 2210(a)(1) (providing that websites are advertising). Pizzuti understood that websites constituted advertising. Tr. 1511.

¹⁷⁶ The Complaint charged Nash with failing to review and approve the websites. Compl. ¶ 161. The Panel did not find Nash liable for this supervisory violation because Merrimac designated Matthews as its supervisory principal for the review and approval of all advertising.

VI. MERRIMAC EFFECTED SECURITIES TRANSACTIONS WHILE ITS REGISTRATION WAS SUSPENDED

The eighth cause of action charges Merrimac with violating FINRA By-Laws Article IV, Section 1, and FINRA Rule 2010 by effecting securities transactions while its registration was suspended for failing to pay its annual FINRA registration fee. The Panel concludes that Merrimac effected securities transactions while its registration was suspended, and thus violated Article IV, Section 1 of FINRA's By-Laws, and FINRA Rule 2010.

A. Facts

Each year FINRA requires all member firms to pay an annual registration fee. Merrimac has been a FINRA member since 1993. Accordingly, it was aware of its obligation to pay its annual registration fee.

In 2009, FINRA sent several notifications to Merrimac regarding the payment of its annual registration fee. In April 2009, FINRA sent an invoice to Merrimac for the annual registration fee.¹⁷⁷ FINRA mailed the invoice to Merrimac's address of record in the Central Registration Depository ("CRD").¹⁷⁸ After not receiving Merrimac's payment of the invoice, in May 2009, FINRA sent a second letter marked "Reminder Notice."¹⁷⁹ FINRA sent the letter to Merrimac's CRD address.¹⁸⁰ In June 2009, FINRA sent Merrimac a third letter marked "SECOND REQUEST" to Merrimac's CRD address.¹⁸¹ In July 2009, FINRA sent Merrimac a fourth letter marked "FINAL REQUEST" to Merrimac's CRD address.¹⁸² In August 2009, over four months after not receiving Merrimac's payment of the invoice, FINRA sent Merrimac a fifth letter marked "NOTICE OF INTENT TO SUSPEND MEMBERSHIP FOR FAILURE TO PAY DUES, FEES AND OTHER CHARGES TO FINRA."¹⁸³ The letter stated that Merrimac's suspension would be effective on September 2, 2009.¹⁸⁴ FINRA sent this letter by overnight mail to Merrimac's CRD address, and it was delivered on August 13, 2009.¹⁸⁵ There was no evidence that any of the letters were returned to FINRA.

¹⁷⁷ CX-61, at 2-3.

¹⁷⁸ Tr. 653-57.

¹⁷⁹ Tr. 656; CX-61A.

¹⁸⁰ CX-61A.

¹⁸¹ CX-61B.

¹⁸² CX-61C.

¹⁸³ CX-62, at 1.

¹⁸⁴ CX-62, at 1.

¹⁸⁵ CX-62, at 7-8; Tr. 661-66.

From September 2 through 17, 2009, Merrimac's registration with FINRA was suspended for its failure to pay its annual registration fee.¹⁸⁶ During that time period, it effected more than 750 securities transactions.¹⁸⁷

B. Discussion

Article IV, Section 1, of FINRA's By-Laws requires that all FINRA members pay dues, assessments, and other charges as required by FINRA's By-Laws. To maintain its FINRA membership, a firm is required to pay an annual registration fee. A failure to do so can result in suspension of the member firm. Effecting a securities transaction while a FINRA member firm is suspended is a violation of FINRA Rule 2010.¹⁸⁸

During a two-week period in September 2009, while Merrimac's registration with FINRA was suspended for failure to pay its annual registration fee, Merrimac effected securities transactions. Merrimac claimed that it did not receive FINRA's notice of intent to suspend the Firm's registration.¹⁸⁹ However, the Panel does not find Merrimac's explanation to be credible. FINRA sent numerous letters to Merrimac at its CRD address, indicating that its annual registration payment was due to FINRA.¹⁹⁰ FINRA also sent a notice to Merrimac that FINRA intended to suspend Merrimac's registration.¹⁹¹ This notice was sent by overnight mail to Merrimac's CRD address, and the courier provided FINRA with written confirmation that it was delivered.¹⁹² The Panel finds that Merrimac received proper notice of its suspension.¹⁹³ Furthermore, having been a FINRA member for over 15 years, Merrimac knew that it was obligated to pay its annual registration fee.

The Panel concludes that Merrimac violated FINRA Rule 2010 by effecting securities transactions while its registration was suspended.

¹⁸⁶ Tr. 666.

¹⁸⁷ CX-81; Tr. 667-68.

¹⁸⁸ *In re Troy A. Wetter*, 51 S.E.C. 763, 767-68 (1993); *Dep't of Enforcement v. Usher*, No. C3A980069, 1999 NASD Discip. LEXIS 56 (OHO May 21, 1999).

¹⁸⁹ Merrimac Post-Hr'g Br. at 46, 49. In November 2009, approximately two months after the period at issue, a FINRA examiner attempted to conduct an on-site examination of Merrimac, but found its home office, as reflected in CRD, to be locked and unoccupied. Tr. 691-92. The examiner found Merrimac operating in a strip mall down the street. Tr. 693. The sign on the new office said "Evaluvest." Tr. 694. There was no reference to Merrimac on the outside of the office. Tr. 694. *See In re William T. Banning*, 50 S.E.C. 415, 416 (1990) (holding that member firms have a continuing duty to notify FINRA of their current addresses).

¹⁹⁰ CX-61; CX-61A; CX-61B; CX-61C.

¹⁹¹ CX-62.

¹⁹² CX-62, at 7.

¹⁹³ FINRA Rule 9134 requires that the courier service "generates a written confirmation of receipt or of attempts at delivery." Rule 9134(a)(3).

VII. SANCTIONS

A. False Documents Provided to FINRA

FINRA's Sanction Guidelines ("Guidelines") prescribe sanctions for failures to comply with Rule 8210 requests for information. In the case of an individual, a bar is standard for failing to respond or failing to respond truthfully.¹⁹⁴ If mitigation exists, the Guidelines direct adjudicators to consider suspending the individual for up to two years. In the case of a firm, the Guidelines state that in egregious cases expulsion is the appropriate standard. If there are mitigating factors present, the Guidelines recommend consideration of a suspension for up to two years with respect to any or all activities or functions. In addition, the Guidelines recommend monetary sanctions from \$2,500 to \$50,000 depending on the nature of the violation.¹⁹⁵

The Guidelines also direct adjudicators to consider the importance of the information requested.¹⁹⁶ The Hearing Panel finds that FINRA's requests concerned important information regarding Merrimac's penny stock deposits and sales, and whether Merrimac took the necessary steps to ensure that it did not sell unregistered securities.

In this case, the Rule 8210 violations stemmed from Merrimac's failure to effectively supervise its registered representatives. At the time CS falsified the DSR Forms, Merrimac and Nash were unaware of her misconduct. However, when they learned of her misconduct, they did not investigate the extent of the misconduct, the consequences of the misconduct to their supervision of the relevant transactions, or review their productions to FINRA to ensure that FINRA was not erroneously relying on falsified documents during its investigation.

The Panel finds that Merrimac's and Nash's misconduct was a serious violation of Procedural Rule 8210 and their obligations thereunder. In light of the foregoing, and under the particular facts and circumstances of this case, the Panel will impose a \$50,000 fine upon Merrimac, and a 12-month suspension in all principal capacities and a \$25,000 fine for Nash. The Panel determined that a suspension in all principal capacities was appropriate here because Nash's violation occurred as a result of his failure to reasonably supervise the collection of Merrimac documents for submission to FINRA. Such sanctions are appropriately remedial under the circumstances and reflect the serious nature of Merrimac's and Nash's violations.

¹⁹⁴ *Dep't of Enforcement v. Harari*, No. 2011025899601, 2015 SEC LEXIS 899, at *32 (NAC Mar. 9, 2015) (noting that the Guidelines treat a failure to respond truthfully to a Rule 8210 request as equivalent to a complete failure to respond, and provide that a bar is standard for such violations). This case can be located on LEXIS at the above cite; however, it is actually a decision issued by the NAC.

¹⁹⁵ FINRA Sanction Guidelines at 33 (2013), www.finra.org/sanctionguidelines.

¹⁹⁶ Guidelines at 33.

B. Unregistered Securities

The Guidelines for the sale of unregistered securities recommend a fine of \$2,500 to \$50,000, and, in egregious cases, a suspension of the firm with respect to any and all activities or functions for up to 30 business days or until procedural deficiencies are remedied.¹⁹⁷ The Guidelines further set forth specific considerations for such violations, four of which are applicable to this case: (1) whether the respondent attempted to comply with an exemption from registration; (2) share volume and dollar amount of transactions involved; (3) whether the respondent had implemented reasonable procedures to ensure that it did not participate in an unregistered distribution, and (4) whether the respondent disregarded “red flags” suggesting the presence of an unregistered distribution.¹⁹⁸ In addition, the Hearing Panel considered the Principal Considerations in Determining Sanctions, which are applicable to all violations.¹⁹⁹

The Hearing Panel determined that, at the time Merrimac received the USOG stock and sold it, it did not attempt to ascertain if the USOG stock was registered or if an exemption from registration applied. Instead, it relied on the lack of a restricted legend and clearance by the transfer agent. The law is clear that reliance on transfer agents that a stock was “free trading” will not excuse a broker’s failure to make a reasonable inquiry into the facts.²⁰⁰ The Hearing Panel noted that while the dollar amount of the sales in the aggregate was not high, a large number of shares were sold to members of the public. In total, Customer J sold over 56 million shares, generating sales proceeds of approximately \$124,000. The Panel determined that Merrimac’s Penny Stock Procedures were not reasonable. Although the Penny Stock Procedures required registered representatives to ensure the DSR Forms were completed, they failed to provide guidance to determine if stock was freely tradable. Lastly, Customer J’s deposit of a large block of stock and liquidation of the entire block within three months was a red flag that was not addressed.

The Hearing Panel found Merrimac’s failure to conduct any meaningful due diligence on the USOG stock to be problematic. Customer J deposited a large block of USOG stock and began liquidating its shares soon after depositing them. The Hearing Panel finds that Merrimac’s misconduct was egregious. Merrimac turned a blind eye to the registration requirements of Section 5 of the Securities Act. Its lack of understanding of the registration requirements for Section 5 was clear. Throughout the hearing, Merrimac insisted that the USOG stock was freely

¹⁹⁷ Guidelines at 24.

¹⁹⁸ Guidelines at 24.

¹⁹⁹ Guidelines at 6-7.

²⁰⁰ See *Wonsover*, 1999 SEC LEXIS 430, at *29-30 (finding that reliance on transfer agent and respondent’s firm did not relieve the individual broker of his obligation to explore whether shares are freely tradable); *Robert G. Leigh*, Exchange Act Release No. 27667, 1990 SEC LEXIS 153, at *14 (Feb. 1, 1990) (“[T]he transfer agent’s willingness to reissue the certificates without restrictive legends did not relieve [the registered representative] of his obligation to investigate.”).

tradable. Taking all of the foregoing factors into careful consideration, and in the absence of any mitigating factors, the Panel finds that a \$50,000 fine is the appropriate remedial sanction.

C. AML Violations

The Guidelines do not specifically address violations of NASD Rule 3011, now FINRA Rule 3310. However, in substance, the rules requiring firms to implement AML programs are supervisory requirements. Accordingly, the Panel considered the Guidelines for supervisory violations (delineated below) in determining the appropriate remedial sanction in this case.²⁰¹

It is important as a matter of national policy that every FINRA member implements an effective AML program. During the AML period described in the Complaint, suspicious trading occurred at Merrimac that should have prompted an investigation. The suspicious trading included the sales of penny stock, which at times occurred soon after the issuance of press releases. In addition, Merrimac ignored its own policy and failed to conduct adequate background checks on its customers. As a result, several of its customers who engaged in penny stock sales had serious regulatory disciplinary histories. The Panel finds Merrimac's misconduct was very serious.

The Panel concludes that the appropriate sanction under the facts and circumstances of this case is a \$25,000 fine for Merrimac.

D. Supervision Violations

The Guidelines for failure to supervise recommend a fine of \$5,000 to \$50,000, suspension of the responsible individuals in all supervisory capacities for up to 30 business days, and a restriction on the activities of appropriate branch offices or departments for up to 30 business days. In egregious cases, the Guidelines suggest limiting activities of the branch office or department for a longer period or suspending the firm with respect to any or all activities or functions for up to 30 business days, and suspending the responsible individual in any or all capacities for up to two years or barring the responsible individual.²⁰² The Guidelines set forth the following considerations when determining the appropriate sanction for a failure to supervise: (1) the quality and degree of the supervisor's implementation of the firm's supervisory procedures and controls; (2) whether respondent ignored "red flag" warnings that should have resulted in additional supervisory scrutiny; and (3) the nature, extent, size, and character of the underlying misconduct.²⁰³

The Guidelines for deficient written supervisory procedures provide for fines ranging from \$1,000 to \$25,000.²⁰⁴ In egregious cases, the Guidelines recommend suspending the

²⁰¹ *Domestic Sec., Inc.*, 2008 FINRA Discip. LEXIS 44, at *21 n.9.

²⁰² Guidelines at 103.

²⁰³ Guidelines at 103.

²⁰⁴ Guidelines at 104.

responsible individual in all capacities for up to one year and suspending the firm with respect to any or all relevant activities for up to 30 business days and thereafter until the supervisory procedures are amended to conform to rule requirements.²⁰⁵ The Guidelines for deficient supervisory procedures provide two considerations to determine the appropriate sanctions: (1) whether the deficiencies allowed violative conduct to occur or to escape detection; and (2) whether the deficiencies made it difficult to determine the individual or individuals responsible for specific areas of supervision or compliance.

Merrimac's supervisory violations concerned four areas: (1) DuBrule's and Tuttle's private securities transactions; (2) Merrimac's penny stock deposits and the related DSR Forms; (3) Pizzuti's Evaluvest Websites; and (4) Merrimac's utilization of foreign finders. Each is addressed separately below.

The Panel finds Merrimac's failure to supervise the activities of DuBrule and Tuttle to be egregious. Merrimac abdicated its supervisory responsibility. Although Merrimac had designated Nash as the principal responsible for monitoring outside business activities, Matthews handled the approval and review of DuBrule's and Tuttle's private securities transactions. Once Merrimac permitted DuBrule and Tuttle to engage in the private securities transactions, it failed to supervise their participation in the hedge funds. Merrimac did not obtain relevant information from them, and was unaware of additional fund investments that DuBrule and Tuttle had solicited and accepted after joining Merrimac. It was clear to the Panel that Merrimac did not understand the significance of its supervisory role once it agreed to allow DuBrule and Tuttle to engage in the private securities transactions.

Merrimac's and Nash's failure to supervise the penny stock deposits and DSR Forms was very serious. The purpose of the forms was to reasonably ensure that unregistered stock was not sold to the public. Once Merrimac and Nash learned that CS falsified forms, they failed to effectively address the misconduct. The SEC has stressed that "[i]t is especially imperative that those in authority exercise particular vigilance when indications of irregularity reach their attention."²⁰⁶ As CCO of Merrimac, Nash was in a position of authority. Rather than merely accepting CS's explanation and continuing with business as usual, CS's misconduct should have resulted in additional supervisory scrutiny. Merrimac's and Nash's failure to follow up facilitated Merrimac's sales of unregistered securities in violation of Section 5 of the Securities Act.

Merrimac's failure to supervise Pizzuti's Evaluvest Websites was also serious. Merrimac's procedures should have specifically identified the websites as advertising; however, this lack of specificity was not the cause of this violation. Matthews understood that he was responsible for reviewing all advertising, and he described the lack of approval and review of the websites as an inadvertent error. Just as Merrimac failed to monitor DuBrule's and Tuttle's activities, it also failed to monitor Pizzuti and the websites he created.

²⁰⁵ Guidelines at 104.

²⁰⁶ *Dennis S. Kaminski*, Exchange Act Release No. 65347, 2011 SEC LEXIS 3225, at *25-26 (Sept. 16, 2011).

Merrimac’s and Nash’s failure to timely establish reasonable procedures for its new foreign finders business was serious as well. Merrimac failed to establish procedures prior to entering into and implementing the agreement with the Foreign Entity. Although there is no evidence that Merrimac’s lack of reasonable procedures allowed violative conduct to occur in the foreign finders area of its business, it further demonstrates Merrimac’s lax approach to supervision and its failure to take required proactive measures before entering a new line of business. Merrimac embarked on this new area of business without even ensuring that it had a designated supervisory principal. As a securities professional with more than two decades of experience, Nash should have understood the requirement to have appropriately customized written supervisory procedures covering his firm’s business.

In determining the appropriate remedial sanctions for these violations, the Hearing Panel also considered Merrimac’s disciplinary history. Merrimac has a significant disciplinary history including, among other things, failing to: (1) establish and maintain reasonably designed written supervisory policies and procedures; and (2) monitor its registered representatives’ outside business activities and private securities transactions.²⁰⁷

After a disciplinary hearing in August 2010, a hearing panel found that, from 2004 to July 2007, Merrimac violated NASD Rule 3010 by failing to establish and maintain written supervisory procedures reasonably designed to supervise its sale of five different investment products. The panel found that Merrimac’s procedures were “especially deficient” in light of the significance of the sale of those five products to the firm’s business—they accounted for up to 20% of the firm’s total sales from 2004 to 2007. The hearing panel fined Merrimac \$18,500, which included a \$2,500 fine for failing to establish and maintain adequate written supervisory procedures for sales of certain types of securities. On June 4, 2012, the FINRA Board of Governors affirmed the hearing panel’s findings and upheld the sanctions imposed.²⁰⁸

In June 2012, FINRA filed a complaint against Merrimac alleging that two Merrimac registered representatives operated a company and sold investments away from the firm. The registered representatives solicited approximately 30 individuals, most of whom were Merrimac customers, to invest over \$4 million in the company from 2006 to April 2009.²⁰⁹ After a hearing, the hearing panel found that Merrimac failed to: (1) adequately implement procedures regarding participation in outside businesses and participation in private securities transactions; (2) implement reasonable procedures regarding the use of outside custodians; (3) adequately inquire into the registered representatives’ outside business activities and involvement in private securities transactions, despite personal knowledge about both; and (4) follow up on numerous

²⁰⁷ CX-1, at 9-27.

²⁰⁸ CX-1, at 15-18; *Dep’t of Enforcement v. Merrimac Corp. Sec., Inc.*, No. 2007007151101, 2012 FINRA Discip. LEXIS 43 (Bd. of Governors May 2, 2012).

²⁰⁹ *Dep’t of Enforcement v. Merrimac Corp. Sec., Inc.*, No. 2009017195204, 2013 FINRA Discip. LEXIS 41 (OHO Nov. 19, 2013), *appeal docketed*, NAC (Dec. 5, 2013) (on appeal to the NAC solely on a claim of an inability to pay a stipulated \$100,000 fine).

red flags regarding these activities.²¹⁰ On November 19, 2013, the hearing panel imposed a \$100,000 fine and required Merrimac to retain a consultant to review its written supervisory procedures.²¹¹

The Hearing Panel also considered Respondents' refusal to accept responsibility for their misconduct.²¹² Respondents argued that Enforcement's allegations were "unfound[ed]" and that Enforcement "attempt[ed] to create violations that simply didn't exist."²¹³

After careful consideration, the Hearing Panel determines that Merrimac's and Nash's supervisory violations warrant significant sanctions. Merrimac is fined \$50,000, suspended for one year from receiving and liquidating penny stocks for which no registration statement is in effect, and required to retain an independent consultant, acceptable to Enforcement, with experience in designing and evaluating broker-dealer procedures to review and approve its written supervisory procedures.²¹⁴ Nash is fined \$25,000, suspended for one year in all principal capacities, and required to requalify as a principal before acting in any capacity requiring that qualification.

E. Effecting Securities Transactions with Suspended Registration

For registration violations, the Guidelines provide for fines ranging from \$2,500 to \$50,000.²¹⁵ In egregious cases, the Guidelines recommend suspending the firm with respect to any or all activities for up to 30 business days.²¹⁶

The Hearing Panel finds that Merrimac's misconduct was egregious. It ignored numerous notices from FINRA requesting payment of its annual registration fee. Then, despite receiving the notice of suspension, it continued to effect securities transactions. The Hearing Panel determines that Merrimac's registration violation warrants a 30 business-day suspension from FINRA membership and a \$50,000 fine.

²¹⁰ *Id.*

²¹¹ Because the prior hearing panel decisions were issued during or after the relevant periods at issue in this case, the Panel did not find that Merrimac was on notice of specific misconduct. Rather, the Panel determined that Merrimac's disciplinary history demonstrates that it has had ongoing serious supervisory system deficiencies with respect to various lines of business for a number of years.

²¹² Guidelines at 6 (Principal Consideration No. 2).

²¹³ Merrimac Post-Hr'g Br. at 1.

²¹⁴ *Cf. ACAP Fin.*, Exchange Act Release No. 70046, 2013 SEC LEXIS 2156, at * 25-26 (July 26, 2013) (providing similar sanctions for failing to supervise penny stock transactions).

²¹⁵ Guidelines at 45.

²¹⁶ Guidelines at 45.

VIII. ORDER

The Extended Hearing Panel concludes that Respondent Merrimac Corporate Securities, Inc. violated (1) FINRA Rules 8210 and 2010 by providing false documents to FINRA; (2) FINRA Rule 2010 by selling unregistered securities in violation of Section 5 of the Securities Act; (3) NASD Rule 3011 and FINRA Rules 3310 and 2010 by failing to establish and implement AML policies and procedures that can be reasonably expected to achieve compliance with AML rules and regulations and monitor and detect suspicious activity; (4) NASD Rules 3010 and 2110 and FINRA Rule 2010 by failing to maintain a reasonable supervisory system; and (5) FINRA Rule 2010 by effecting securities transactions while its registration was suspended.

Respondent Robert G. Nash violated (1) FINRA Rules 8210 and 2010 by providing false documents to FINRA; and (2) NASD Rules 3010 and 2110 and FINRA Rule 2010 by failing to maintain a reasonable supervisory system and procedures. The Panel dismissed the AML charges against Nash, alleging violations of NASD Rule 3011 and FINRA Rules 3310 and 2010.

Merrimac is fined a total of \$225,000, suspended from FINRA membership for 30 business days, suspended for one year from receiving and liquidating penny stocks for which no registration statement is in effect, and required to retain an independent consultant to revise its written supervisory procedures. The sanctions associated with each violation are as follows: For violating FINRA Rules 8210 and 2010 by providing false documents to FINRA, Merrimac is fined \$50,000. For violating FINRA Rule 2010 by selling unregistered securities in violation of Section 5 of the Securities Act, Merrimac is fined \$50,000. For violating NASD Rule 3011 and FINRA Rules 3310 and 2010 by failing to establish and implement AML policies and procedures that can be reasonably expected to detect and cause the reporting of suspicious transactions, Merrimac is fined \$25,000. For violating NASD Rules 3010 and 2110 and FINRA Rule 2010 by failing to maintain a reasonable supervisory system, Merrimac is fined \$50,000, suspended for one year from receiving and liquidating penny stocks for which no registration statement is in effect, and required to retain an independent consultant, acceptable to Enforcement, with experience in designing and evaluating broker-dealer procedures to review and approve its written supervisory procedures. For violating FINRA Rule 2010 by effecting securities transactions while its registration was suspended, Merrimac is fined \$50,000 and suspended from FINRA membership for 30 business days. Merrimac's suspension from receiving and liquidating penny stocks for which no registration statement is in effect shall run consecutive to its 30-business day suspension from FINRA membership.

Nash is fined a total of \$50,000 and suspended from associating with any FINRA member in all principal capacities for one year. The sanctions associated with each violation are as follows: For violating FINRA Rules 8210 and 2010 by providing false documents to FINRA, Nash is fined \$25,000 and suspended from associating with any FINRA member in all principal capacities for one year. For violating NASD Rules 3010 and 2110 and FINRA Rule 2010 by failing to maintain a reasonable supervisory system and procedures, Nash is fined \$25,000 fine, suspended from associating with any FINRA member in all principal capacities for one year, and

required to requalify as a principal before acting in any capacity requiring that qualification. Nash's suspensions shall be concurrent.

The costs for this proceeding total \$13,507.15, which include the hearing transcript fees and an administrative fee of \$750. Merrimac is ordered to pay \$6,753.58, and Nash is ordered to pay \$6,753.57.

If this decision becomes FINRA's final disciplinary action, Merrimac's suspension for 30 business days shall commence at the opening of business on June 1, 2015, and shall end at the close of business on July 13, 2015; Merrimac's suspension from receiving and liquidating penny stocks for which no registration statement is in effect shall commence at the opening of business on July 14, 2015. Nash's principal capacity suspensions shall commence at the opening of business on June 1, 2015. The fines and assessed costs shall be due on a date set by FINRA, but not sooner than 30 days after this decision becomes FINRA's final disciplinary action in this proceeding.²¹⁷

Maureen A. Delaney
Hearing Officer
For the Extended Hearing Panel

²¹⁷ The Hearing Panel considered and rejected without discussion all other arguments of the parties.