

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

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

THADDEUS J. NORTH
(CRD No. 2100909),

Respondent.

Disciplinary Proceeding
No. 2010025087302

Hearing Officer–DRS

HEARING PANEL DECISION

December 1, 2015

Respondent is (1) fined \$10,000 and suspended for 30 business days in any principal capacity for failing to report a relationship with a statutorily disqualified person; (2) censured and fined \$10,000 for failing to establish and maintain a reasonable supervisory system, including adequate written supervisory procedures; and (3) fined \$20,000 and suspended for two months in all principal capacities for failing to adequately review electronic correspondence. Respondent is also ordered to pay hearing costs.

Appearances

For the Department of Enforcement, Complainant, Sarah B. Belter, Esq., and Mark J. Fernandez, Esq., New Orleans, Louisiana.

For Thaddeus J. North, Respondent, Constance J. Miller, Esq., McLean, Virginia.

DECISION

I. Introduction

While Chief Compliance Officer at a FINRA member firm, Respondent Thaddeus J. North failed to report to FINRA that Leslie L. King, an associated person at his firm, was involved in a variety of business activities with a statutorily disqualified person, Todd Cowle. North also engaged in supervisory failures pertaining to his review of the firm's electronic correspondence.

Based on this conduct, the Department of Enforcement filed a Complaint against North.¹ Enforcement alleged that North failed to report King's business relationship with Cowle given that North knew or should have known of the relationship, in violation of NASD Conduct Rule 3070(a)(9) and FINRA Rules 4530(a)(1)(H) and 2010. Enforcement also charged North with failing to (1) establish and maintain a supervisory system, including written supervisory procedures, that was appropriate for the review of electronic correspondence; (2) conduct an appropriate review of the firm's email and Bloomberg communications; and (3) institute a heightened review of King's firm email and Bloomberg communications to monitor King's and Cowle's business relationship, in violation of NASD Conduct Rule 3010, and FINRA Rule 2010, and a willful violation of MSRB Rules G-27 and G-17.

North answered the Complaint, denying all charges and requesting a hearing. A hearing was held on April 13 and 14, 2015, in New York, New York.² At the hearing, North asserted that for much of the time period at issue, he neither knew about, nor had reason to know about, King's relationship with Cowle. And, by the time he learned of it, he concluded that he was not obligated to report it because FINRA already knew about the relationship or at least was investigating it. Regarding the supervision charges, North argued that both his firm's written supervisory procedures ("WSPs") and his review of electronic correspondence were reasonable. The Hearing Panel rejects North's defenses, finds that with one exception,³ Enforcement proved the violations alleged, and imposes the sanctions set forth below.

II. Findings of Fact

A. Respondent Thaddeus J. North

North first became registered with a FINRA member firm in 1994.⁴ Since then, he has been registered with seven firms, including Southridge Investment Group LLC ("Southridge" or the "Firm"),⁵ where he engaged in the misconduct charged in the Complaint. North was registered at Southridge from February 2008 until August 2011 in numerous capacities including General Securities Representative and General Securities Principal.⁶ At all relevant times, North

¹ The Complaint also named Leslie L. King and William E. Schloth as respondents. Schloth was the firm's Chief Executive Officer and King's supervisor. Before the hearing, these Respondents settled the charges filed against them.

² The parties completed post-hearing briefing on June 19, 2015. North attached to his Post-Hearing Brief a four-page appendix consisting of a December 30, 2014 letter, plus attachments, from Enforcement's counsel to North's counsel. The documents contained in the appendix were not offered or received into evidence at the hearing and are not part of the evidentiary record in this proceeding. Accordingly, the Hearing Panel did not consider these documents or any arguments relating to them.

³ Enforcement failed to prove that by not reporting King's relationship with Cowle to FINRA, North violated FINRA Rule 4530(a)(1)(H), the successor to NASD Conduct Rule 3070(a)(9).

⁴ CX-1, at 4.

⁵ CX-1, at 2. Southridge is no longer a FINRA member firm. Hearing Transcript ("Tr.") 242.

⁶ CX-1, at 3.

was Southridge’s Chief Compliance Officer (“CCO”).⁷ Currently, North is registered with another FINRA member firm.⁸

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

At all relevant times, King was associated with Southridge and registered as a General Securities Representative, General Securities Principal, and a Municipal Securities Principal.⁹ At various times between July 2009 and September 2011, while associated with Southridge, she primarily affected inter-dealer and customer trades in municipal bonds and government securities.¹⁰

Before working at Southridge, King was associated with FINRA member firm Southwest Texas Capital, LLC. There, she worked with Cowle,¹¹ a General Securities Representative.¹² In November 2007, a FINRA disciplinary hearing panel found that Cowle had willfully failed to update his Uniform Application for Securities Industry Registration or Transfer (“Form U4”) to reflect that federal tax liens had been filed against him.¹³ Consequently, under federal law and FINRA’s By-Laws, Cowle was statutorily disqualified from associating with any FINRA member firm.¹⁴ He was terminated from Southwest Texas Capital on June 22, 2009,¹⁵ and has not since been registered with a FINRA member firm.¹⁶

Nevertheless, while at Southridge, King continued her business dealings with Cowle. On July 15, 2009, King’s entity, King Asset Management (“KAM”),¹⁷ and Ultimate Tier Advisors (“UTA”), a company Cowle owned,¹⁸ entered into a Services Agreement.¹⁹ Under that

⁷ Answer (“Ans.”) ¶ 3.

⁸ CX-1, at 2.

⁹ Ans. ¶¶ 1, 5.

¹⁰ Ans. ¶¶ 1, 5, 29; *see also* Tr. 205.

¹¹ Tr. 196–97.

¹² CX-2, at 2.

¹³ CX-9.

¹⁴ CX-9; *see also* CX-2. Section 15(b)(4)(A) of the Securities Exchange Act of 1934 and FINRA By-laws Article III, Section 4.

¹⁵ CX-2, at 2.

¹⁶ CX-2, at 2.

¹⁷ Tr. 370–71.

¹⁸ CX-3, at 4, no. 11.

¹⁹ CX-7.

agreement, KAM agreed to pay UTA for: (1) “[i]ntroduction to business relationships,”²⁰ (2) unlimited phone calls to UTA regarding “research, business strategies and/or any business advice,” and (3) training sessions.²¹ The Services Agreement also recognized that additional business opportunities may present themselves, and, in those situations, KAM and UTA would discuss on an individualized basis the services to be provided and the compensation.²² The Services Agreement stated that UTA would remit invoices to KAM for services UTA provided and that KAM would pay those invoices “upon receipt or as soon as financially able.”²³ King signed the agreement on behalf of KAM. No one signed on behalf of UTA. In fact, the Services Agreement did not contain a signature line for UTA.

Over the next two years, from July 31, 2009, through September 30, 2011, KAM received and paid at least forty-two invoices from UTA totaling \$605,365 for various services.²⁴ Those services included Cowle introducing King to individuals who were bond brokers at certain broker dealers.²⁵ Additionally, FINRA’s principal investigator during the investigation, Leslie Jackson, testified that “it appeared” that King was also paying Cowle commissions.²⁶

C. North Learns of King’s Business Relationship with Cowle

Although KAM and UTA entered into the Services Agreement in July 2009, North did not know about it for eight months. Then, in March 2010, during FINRA’s routine examination of Southridge, North learned that the agreement existed.²⁷ While gathering documents for FINRA in connection with the exam, North obtained invoices from King that UTA had issued to KAM.²⁸ This was the first time that North had seen these invoices.²⁹ He looked at them briefly,³⁰ saw the reference to UTA,³¹ and sent them on to Schloth,³² who was the Firm’s CEO and King’s

²⁰ This service contemplated King paying Cowle to introduce her to bond brokers with whom Cowle had previously done business. Tr. 204.

²¹ Tr. 198, 202–06, 212; CX-7.

²² CX-7.

²³ CX-7.

²⁴ CX-8; Tr. 207, 384–85.

²⁵ Tr. 212–14.

²⁶ Tr. 202.

²⁷ Tr. 217–18, 287, 312–18, 320, 380; CX-3, at 4.

²⁸ Tr. 314, 318; CX-8.

²⁹ Tr. 313–14.

³⁰ Tr. 314.

³¹ Tr. 315.

³² Tr. 315–16, 318–19.

supervisor.³³ The Firm then produced them to FINRA.³⁴ After receiving the invoices, FINRA requested any agreements relating to them.³⁵ It was then that North first saw the Services Agreement,³⁶ and either he or Schloth gave it to FINRA.³⁷

North was not familiar with UTA before he first saw the Services Agreement³⁸ and he did not know that Cowle was connected with UTA.³⁹ Nevertheless, North did not question King about the agreement,⁴⁰ did not investigate the relationship between UTA and King,⁴¹ and did not attempt to learn the details about UTA.⁴² At the hearing, North explained his lack of due diligence: “I don’t think I would ever look at a company—if Leslie hired a cleaning service, I wouldn’t look at the cleaning service and try to find out who owns it and who operates it and things like that.”⁴³ Besides, he observed, there was nothing on the face of the Services Agreement that struck him as “illegal or immoral.”⁴⁴

North eventually learned that UTA was Cowle’s company, but it is unclear exactly when and how this occurred. He may have learned of the connection as early as March 2010 during the FINRA exam. Or, he may have learned of it nine months later, during the FINRA investigation that led to this disciplinary proceeding.⁴⁵ In December 2010, FINRA began investigating the

³³ Ans. ¶¶ 2, 8, 38.

³⁴ Tr. 217, 319.

³⁵ Tr. 321.

³⁶ Tr. 320.

³⁷ Tr. 324–25.

³⁸ Tr. 319, 325.

³⁹ Tr. 322, 325; *see also* Tr. 363. North testified that he “did not really realize who Todd Cowle was until FINRA starting talking about him,” apparently referring to FINRA’s later, December 2010 investigation, discussed above. Tr. 210–11.

⁴⁰ Tr. 320.

⁴¹ Tr. 320–21.

⁴² Tr. 326. North did discuss the agreement with Schloth, however, who told him it was “okay” and did not violate any laws. Tr. 322.

⁴³ Tr. 326.

⁴⁴ Tr. 327.

⁴⁵ In North’s post-hearing briefing, he stated that he learned of the King–Cowle business connection in March 2010, rather than in December 2010. *See* North’s Post-Hrg. Br. at 2–5; North’s Post-Hrg. Resp. Br. at 2. But North’s testimony on this subject was far less clear. He testified that he did not know if he learned of the relationship in a conversation with Schloth in December 2010. Nor did he know if he was aware of the relationship when FINRA began its investigation that month. Tr. 330, 332. Further, North stated that he was not sure if he “put two and two together” when FINRA sent the Firm its requests because Cowle’s name never appeared on an invoice. Tr. 331. During his investigative testimony in February 2012, however, North testified that he learned of the relationship when FINRA sent investigative requests to the Firm. Tr. 331–32. Given the state of the record, we are unable to resolve whether he learned of the relationship in March 2010 or, later, in December 2010.

King–Cowle relationship after receiving a tip that King and another person were paying Cowle commissions for referrals.⁴⁶ While conducting the investigation, FINRA sent Southridge requests for information.⁴⁷ Specifically, FINRA requested additional UTA invoices—invoices that KAM had received after the March 2010 FINRA exam.

Around the time North saw the UTA invoices, he realized that King was involved in a business relationship with Cowle.⁴⁸ (It is unclear, however, whether this realization occurred after North saw the invoices produced in connection with the March 2010 exam or the December 2010 investigation). After learning of the King–Cowle relationship, North did not investigate the matter,⁴⁹ instead, leaving it with Schloth to conduct any follow up.⁵⁰ It then came out, according to North, that UTA “was Todd Cowle.”⁵¹ After learning of the relationship, however, North did not check to determine if Cowle was statutorily disqualified.⁵²

Although North first learned of the Cowle–UTA connection in March or December 2010, this was not the first time that Cowle had come to his attention. In the summer of 2009, shortly before the Firm hired King, Schloth considered hiring Cowle and requested that North run a CRD report on him.⁵³ As a result, North learned that Cowle had been statutorily disqualified, and Schloth decided not to hire him for that reason.⁵⁴ North testified that months later, when he finally learned of the Cowle–UTA connection, he did not immediately remember that Cowle was the person that Southridge had declined to hire because he was statutorily disqualified. But around the time when FINRA began sending the Firm information requests during the investigation, North said, he “put two and two together” and remembered that Cowle was the statutorily disqualified person whom the Firm had considered hiring.⁵⁵

D. North Fails to Report King’s Business Relationship with Cowle to FINRA

Southridge’s WSPs required the Firm, through North, to report to FINRA if one of its associated persons was involved in certain activities with a statutorily disqualified person. From

⁴⁶ Tr. 196–97.

⁴⁷ Tr. 330–34.

⁴⁸ Tr. 332–33, 385.

⁴⁹ Tr. 335.

⁵⁰ Tr. 335, 364, 371–72, 409–10. He and Schloth did discuss the Service Agreement with King after they learned of its existence, but it is not clear from the record when that occurred—during the routine exam or, later, during the investigation. Tr. 380–81. During those discussions, King denied paying anyone commissions. Tr. 381–82.

⁵¹ Tr. 364. North and Schloth then discussed with King her business relationship with Cowle, and King told them Cowle would introduce her to people. Tr. 385–86.

⁵² Tr. 388–90.

⁵³ Tr. 198, 386–87, 390; Ans. ¶¶ 1, 5, 29.

⁵⁴ Tr. 386–93.

⁵⁵ Tr. 389.

July 2009 through August 2011, the Firm had two sets of WSPs. The first set, in effect beginning in 2008 (“2008 WSPs”),⁵⁶ required Southridge to report to FINRA, via electronic media, within 10 days of knowing, or when it should have known, that one of its associated persons “is associated in any business or financial activity” with someone “subject to a ‘statutory disqualification’” as defined in the Securities Exchange Act of 1934.⁵⁷ The 2008 WSPs designated the CCO (i.e. North) as the person responsible for “Regulatory Reporting.”⁵⁸ Similarly, the later set of WSPs, in effect beginning in November 2010 (“2010 WSPs”),⁵⁹ designated the CCO as responsible for filing with FINRA reports regarding customer complaints and other reportable events under NASD Rule 3070.⁶⁰ The 2010 WSPs specifically identified North as the CCO.⁶¹ It is undisputed that North never reported King’s business relationship with Cowle to FINRA.⁶²

E. Conclusions of Law—North Violated NASD Conduct Rule 3070(a)(9) and FINRA Rule 2010

The Complaint charges North with violating FINRA’s rules requiring that firms report to FINRA if one of their associated persons has certain dealings with a statutorily disqualified person.⁶³ Under NASD Conduct Rule 3070(a)(9), effective through June 30, 2011,⁶⁴ a firm was obligated to report whenever it, or one of its associated persons, was “associated in any business or financial activity with any person who is subject to a ‘statutory disqualification’. . . and the member knows or should have known of the association.” Individuals are deemed statutorily disqualified if they are found in a proceeding by a self-regulatory organization to have willfully violated the federal securities law.⁶⁵ The scope of the revised Rule, FINRA Rule

⁵⁶ CX-10, at 14.

⁵⁷ CX-10, at 9–10.

⁵⁸ CX-10, at 10.

⁵⁹ CX-10, at 15. The 2010 WSPs were in effect through the end of the review period for the investigation, namely, August 2011. Tr. 241. The Firm had no later version of its WSPs. Tr. 242.

⁶⁰ CX-10, at 34.

⁶¹ CX-10, at 36.

⁶² Tr. 252–53, 323–26, 336.

⁶³ Under FINRA Rule 0140(a), associated persons are subject to all rules applicable to FINRA member firms. *Dep’t of Enforcement v. Gallagher*, No. 2008011701203, 2012 FINRA Discip. LEXIS 61, at *11, n.9 (NAC Dec. 12, 2012).

⁶⁴ See FINRA Regulatory Notice 11-06 (Feb. 2011) <http://www.finra.org/sites/default/files/NoticeDocument/p122888.pdf>.

⁶⁵ FINRA By-Laws, Article III, Section 4 and Sections 3(a)(39)(F) and 15(b)(4)(D) and (E) of the Securities Exchange Act of 1934.

4530(a)(1)(H)(ii), which became effective on July 1, 2011,⁶⁶ is narrower. It only requires each firm to report whenever the firm or one of its associated persons “is involved in the sale of any financial instrument, the provision of any investment advice or the financing of any such activities with any person who is subject to a ‘statutory disqualification.’”

Enforcement also charged North with violating FINRA Rule 2010, which requires associated persons to conduct their business in accordance with “high standards of commercial honor and just and equitable principles of trade.” A violation of another FINRA or Securities and Exchange Commission (“SEC”) Rule or regulation is a violation of FINRA Rule 2010.⁶⁷

The Complaint alleges that “North knew, or should have known, about King’s business relationship with Cowle as of July 2009.”⁶⁸ North denied this allegation,⁶⁹ and the evidence did not establish it. King’s July 8, 2009 hiring documents include an outside business activity disclosure.⁷⁰ The disclosure, however, which North received,⁷¹ referenced neither Cowle nor UTA⁷² and predated the Service Agreement. Further, neither the due diligence he conducted at that time regarding KAM,⁷³ nor his involvement in the Firm’s consideration of hiring Cowle, showed either a connection between Cowle and UTA or a business relationship between Cowle and King. Moreover, Enforcement failed to present evidence demonstrating that North knew or should have known of these relationships before March 2010.

But the evidence did establish that, at a minimum, North should have known of these relationships by March 2010, after seeing the Services Agreement and the invoices issued by UTA under that agreement. At that point, when North learned that King and UTA had a business

⁶⁶ On July 1, 2011, FINRA Rule 4530 superseded NASD Rule 3070. See FINRA Regulatory Notice 11-06. By amendment effective March 4, 2013, firms are currently exempted from certain reporting requirements, including those contained in Rule 4530(a)(1)(H), if they disclose the reportable event on Forms U4 or U5 (Uniform Termination Notice for Securities Industry Registration). See Rule 4530(e); FINRA Regulatory Notice 13-08 (Feb. 2013) <http://www.finra.org/sites/default/files/NoticeDocument/p207600.pdf>.

⁶⁷ *Dep’t of Enforcement v. McCune Overland Park*, No. 2011027993301, 2015 FINRA Discip. LEXIS 22, at *7 n.5 (NAC July 27, 2015) (citing *William J. Murphy*, Exchange Act Release No. 69923, 2013 SEC LEXIS 1933, at *26 (July 2, 2013), *aff’d sub nom. Birkelbach v. SEC*, 751 F.3d 472 (11th Cir. 2014)), *appeal docketed*, No. 3-16768 (SEC Aug. 25, 2015).

⁶⁸ Complaint (“Compl.”) ¶¶ 3, 48, 60. It appears that Enforcement abandoned this allegation. In its opening statement, Enforcement re-asserted the allegation. Tr. 189. But in its closing, Enforcement did not argue that North should have known of the relationship in July 2009. Tr. 466–69. And, in its Post-Hearing Brief, Enforcement maintained that North first learned of the relationship in the spring of 2010. *Enf’s Post-Hrg. Br.* at 3–4, 10–12, 24–25.

⁶⁹ *Ans.* ¶ 48.

⁷⁰ RX-13.

⁷¹ RX-13, at 20–22.

⁷² Tr. 399.

⁷³ Tr. 343–44.

relationship,⁷⁴ he knew nothing about UTA, including the identity of anyone connected with it. As the Firm's CCO⁷⁵ and the person responsible for Rule 3070 reporting, North should have followed-up by seeking all relevant details of King's relationship with UTA, as well as inquiring about the identity of the person or persons behind it. Significantly, the Services Agreement was only executed by King and not by anyone on behalf of UTA. By itself, this peculiarity—which hid the identity of persons connected with UTA—was a red flag that should have caused North to inquire further. Had he done so and asked King who she was dealing with at UTA, North likely would have learned of Cowle's connection to UTA and his ongoing relationship with King.

Certainly during the December 2010 FINRA investigation, North was aware of Cowle's business relationship with King. And, North eventually realized that Cowle was the same person whom the Firm had declined to hire because of the statutory disqualification. Yet, he failed to report King's business relationship with Cowle to FINRA.

North does not dispute that he failed to report the King–Cowle business relationship. Nor does he deny that the relationship was a reportable event under FINRA rules. Instead, he argues that he was not required to report it because FINRA already knew about the relationship, or, at a minimum, because FINRA was investigating the relationship.⁷⁶ “As far as a 3070 filing,” North explained, “I didn't think that I already needed – I didn't think that I needed to tell them what they already knew twice.”⁷⁷ Moreover, he asserts that “no person from FINRA even hinted that” the Firm needed to file a report “in the context of an on-going inquiry.”⁷⁸

These arguments are unpersuasive. Although FINRA received the Services Agreement around March 2010, and thus knew of King's connection with UTA, the record does not show that FINRA knew at that time that UTA also was connected with Cowle. But, in any event, the National Adjudicatory Council (“NAC”) has held that FINRA's knowledge of a reportable event under Rule 3070 does not negate the reporting obligation.⁷⁹ Additionally, the SEC and FINRA have repeatedly held that a respondent cannot shift its burden of regulatory compliance to FINRA.⁸⁰ Therefore, the Panel rejects these arguments.

⁷⁴ Tr. 329.

⁷⁵ Tr. 319.

⁷⁶ Resp's. Post-Hrg. Br. at 5–7; *see also* Tr. 323, 409.

⁷⁷ Tr. 409. What North meant by “knew twice” was that Schloth had already talked with FINRA in connection with whether or not to hire Cowle and therefore FINRA was aware that Cowle was statutorily disqualified. And later, “when FINRA came back with this, the invoices and the service agreement, they clearly knew.” Tr. 409.

⁷⁸ Resp's Post-Hrg. Resp. Br. at 2.

⁷⁹ *Dep't of Enforcement v. Inv. Management Corp.*, No. C3A010045, 2003 NASD Discip. LEXIS 47, at *21–23 (NAC Dec. 15, 2003).

⁸⁰ *See, e.g., Hans N. Beerbaum*, Exchange Act Release No. 55731, 2007 SEC LEXIS 971, at *19 n.22 (May 9, 2007) (a respondent cannot shift the burden of compliance to FINRA); *Dep't of Enforcement v. The Dratel Group, Inc.*, No. 2009016317701, 2015 FINRA Discip. LEXIS 10, at *43 (NAC May 6, 2015).

In sum, North was aware, or should have been aware, by March 2010 that King had a reportable relationship with a statutorily disqualified person. Under the Firm’s WSPs, North was obligated to report this relationship to FINRA on behalf of the Firm. He failed to do so and, accordingly, violated NASD Conduct Rule 3070(a)(9) and, by virtue of that violation, FINRA Rule 2010. Enforcement, however, failed to prove that King was involved in the sale of a financial instrument, the provision of any investment advice, or the financing of any such activities with Cowle. Indeed, the record is devoid of any evidence that she was involved in any of these activities. Consequently, Enforcement did not establish that North violated FINRA Rule 4530(a)(1)(H), and that charge is dismissed.

F. North Fails to Establish and Maintain a Reasonable Supervisory System

Between July 2009 and September 2011, North had shared responsibility with Schloth for establishing, maintaining and enforcing supervisory controls and procedures at the Firm.⁸¹ More specifically, North was responsible for establishing and maintaining appropriate WSPs, including those governing the review of electronic correspondence.⁸²

Under both sets of WSPs, North, the Firm’s CCO, was responsible for reviewing electronic correspondence.⁸³ The 2008 WSPs designated the Firm’s CCO as the person responsible for maintaining the WSPs.⁸⁴ These WSPs also contained provisions addressing the review of electronic communications.⁸⁵ They stated that “[t]he firm utilizes an outsourced email hosting and compliance archiving service through [Smash, Inc.],”⁸⁶ company that provides electronic message archiving and a platform for reviewing those archived messages.⁸⁷ The 2008 WSPs further provided that North was to review “a sample of the daily electronic communications by either selecting ‘random message’ or sometimes by individual [registered representative] mailbox.”⁸⁸ But they did not specify a method and frequency of review, the size of the review sample, or how North should document his reviews.⁸⁹

⁸¹ Ans. ¶ 39.

⁸² Ans. ¶¶ 3, 39; Tr. 255–58, 293–94, 317; CX-3, at 9, 10; CX-4, at 3; CX-10, at 3–4, 11–12, 24–25, 38.

⁸³ CX-3, at 9–10; CX-10, at 11–12, 24–25; Tr. 297.

⁸⁴ CX-10, at 3–4; Tr. 255–56.

⁸⁵ CX-10, at 11.

⁸⁶ CX-10, at 11.

⁸⁷ Tr. 65.

⁸⁸ CX-10, at 11–12.

⁸⁹ CX-10, at 11–12. Enforcement argues that the procedures required daily review of electronic correspondence. *See, e.g.*, Tr. 460, 464–65; Enf’s Post-Hrg. Br. at 21. But, in fact, the 2008 WSPs required a review of a sample of the daily electronic communications, not a daily review of them. CX-10, at 12.

The 2010 WSPs designated North, by title and name, as the person responsible for reviewing and amending the WSPs.⁹⁰ Under the 2010 WSPs, North was responsible for ensuring that Southridge had “appropriate policies and procedures in effect covering all electronic communications, internal and external (i.e., incoming and outgoing) that are used by associated personnel.”⁹¹ The 2010 WSPs relating to the review of electronic correspondence provided that North would: (1) use Smarsh’s services “to view random samples of emails;” (2) “utilize an appropriate lexicon that can be amended, as necessary;” and (3) “maintain appropriate documentation of electronic communications review (SMARSH).”⁹² The 2010 WSPs did not specify how often the Firm should conduct the reviews, the size of the random samples, or designate a specific percentage or other definable sample size of electronic correspondence that the Firm should review. Nor did they clearly specify which review method the Firm should use (in some places providing for a random sampling, in others, a lexicon search).⁹³ The 2010 WSPs addressed random sampling of emails in sections pertaining to incoming and outgoing emails. But in those sections, the place for specifying the “percentage or other definable sample size” was not completed.⁹⁴

G. North’s Defenses

North denies that the WSPs were insufficient. He concedes that they lack specific provisions governing the frequency of electronic correspondence review. He argues, however, that such specificity is unnecessary. Instead, North maintains, they need only be reasonably designed and that the Firm’s WSPs were, in fact, comprehensive and detailed, identifying the “task of and protocols for electronic correspondence review.”⁹⁵ Indeed, he goes further and asserts that it would be imprudent for the WSPs to have been more detailed, as “FINRA would surely criticize the firm for any deviation.”⁹⁶

North’s arguments are unpersuasive. FINRA expects member firms to have procedures specifying sample size, the amount of emails that the firm would review, and the frequency of reviews. In December 2007, FINRA issued Regulatory Notice 07-59 which contained “principles that firms should consider in developing supervisory systems and procedures for electronic communications to aid in accomplishing that they [sic] are reasonably designed to achieve compliance with applicable federal securities laws and [self-regulatory organization] rules.” In connection with this guidance, FINRA addressed random sampling techniques. It told members that they could “use a reasonable percentage sampling technique, whereby some percentage of

⁹⁰ CX-10, at 38.

⁹¹ CX-10, at 24, 38; Tr. 257–58.

⁹² CX-10, at 24.

⁹³ CX-10, at 20, 22, 24.

⁹⁴ CX-10, at 20, 22.

⁹⁵ Resp’s Post-Hrg. Brief at 8–12.

⁹⁶ Resp’s Post-Hrg. Brief at 12.

the electronic communications generated by the member is reviewed.” Recognizing that “[t]here is no prescribed minimum or fixed percentage that is required by regulation,” FINRA instructed that “the amount of electronic communications chosen for review must be reasonable given the circumstances (for example, member size, nature of business, customer base and individual employee circumstances).” The Regulatory Notice further instructed firms to monitor for compliance with their supervisory procedures’ prescribed frequency, timeliness and quantity parameters.” The Notice also stated that firms “should prescribe reasonable timeframes within which supervisors are expected to complete their reviews of correspondence.”

Southridge’s WSPs did not follow this guidance. They did not address the sample size, the amount or percentage of emails that the Firm would review, and the frequency of reviews. These omissions made the WSPs deficient.⁹⁷

H. Conclusions of Law—North Violated NASD Conduct Rules 3010(a) and (d), and FINRA Rule 2010 and Willfully Violated MSRB Rules G-27(b) and (e), and MSRB Rule G-17

The Complaint charges that North violated various FINRA and MSRB rules because of inadequacies in the Southridge’s supervisory system, particularly in the Firm’s WSPs pertaining to the review of electronic communications. “Assuring proper supervision,” according to the SEC, “is a critical component of broker-dealer operations.”⁹⁸ To that end, NASD Conduct Rule 3010(a) requires that each FINRA member firm “establish and maintain a system to supervise the activities of each registered representative, registered principal and other associated persons that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD rules” MSRB G-27(b)(i) contains a similar provision and also requires that firms establish and maintain procedures for the review of electronic correspondence (as required by MSRB G-27(e)).⁹⁹ The facts and circumstances of

⁹⁷ North argues that when he became registered at FINRA, the 2008 “WSPs were already in place and there is no evidence that the WSPs had been criticized nor was there any cautionary letter issued respecting the WSPs.” Resp’s Post-Hrg. Br. at 8; North’s Post-Hrg. Resp. Br. at 7. This argument is meritless. *See* n.95, above. *See also The Dratel Group, Inc.*, 2015 FINRA Discip. LEXIS 10, at *43 (finding that the respondent “cannot blame FINRA for his own supervision problems”). Additionally, “[a] regulatory authority’s failure to take early action neither operates as an estoppel against later action nor cures a violation.” *W.N. Whelen & Co.*, 50 S.E.C. 282, 284 (1990).

⁹⁸ *Richard F. Kresge*, Exchange Act Release No. 55988, 2007 SEC LEXIS 1407, at *27 (June 29, 2007); *Dep’t of Enforcement v. Rooney, Jr.*, No. 2009019042402, 2015 FINRA Discip. LEXIS 19, at *59 (NAC July 23, 2015) (quoting *Ronald Pellegrino*, Exchange Act Release No. 59125, 2008 SEC LEXIS 2843, at *33 (Dec. 19, 2008)).

⁹⁹ MSRB Rules apply because this case involves electronic communications relating to municipal securities subject to MSRB regulation. FINRA’s By-Laws provide that its members and persons registered with members agree to comply with MSRB Rules, and FINRA is authorized to impose sanctions for violations of MSRB Rules. Article IV, § 1(a)(1) (agreement by firms); Article V, § 2(a)(1) (agreement by registered persons); FINRA By-Laws Article XIII, § 1(b) (authorization to impose sanctions for violation of MSRB Rules). The MSRB Rules are found at www.msrb.org.

each case dictate whether a firm’s supervisory system or set of written procedures is in fact reasonably designed to achieve compliance.¹⁰⁰

Regarding electronic correspondence, NASD Rule 3010(d)(1) requires member firms to “establish procedures for the review and endorsement by a registered principal in writing, on an internal record ... the review by a registered principal of incoming and outgoing written electronic correspondence of its registered representatives with the public relating to the ... securities business of such member.” The Rule further provides that the “procedures must be in writing and be designed to reasonably supervise each registered representative.” MSRB G-27(e)(i) is substantially the same.

NASD Rule 3010(d)(2) also requires that each member “develop written procedures that are appropriate to its business, size, structure, and customers for the review of incoming and outgoing ... electronic correspondence with the public relating to its investment banking or securities business. ...” MSRB G-27(e)(ii) contains a similar provision.

North was responsible for ensuring that Southridge’s WSPs were adequate. But as detailed above, the 2008 and 2010 WSPs were inadequate and not designed to reasonably supervise the electronic communications of the Firm’s registered representatives. Accordingly, North violated NASD Rules 3010(a) and (d) and MSRB Rules G-27(b) and (e).

North also violated MSRB Rule G-17. This Rule, the MSRB corollary to FINRA Rule 2010,¹⁰¹ states that “[i]n the conduct of its municipal securities or municipal advisory activities, each broker, dealer, municipal securities dealer, and municipal advisor shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice.” Rule G-17, though similar to FINRA Rule 2010, is not a “true analogue” in the sense that a violation of any MSRB rule does not, by itself, constitute a Rule G-17 violation.¹⁰² Rather, a violation of G-17 requires

¹⁰⁰ *Ronald Pellegrino*, Exchange Act Release No. 59125, 2008 SEC LEXIS 2843, at *32–33 (Dec. 19, 2008).

¹⁰¹ *Dep’t of Enforcement v. Grey*, No. 2009016034101, 2014 FINRA Discip. LEXIS 31, at *11 n.11 (NAC Oct. 3, 2014), *aff’d*, Exchange Act Release No. 75839, 15 SEC LEXIS 3630 (Sept. 3, 2015). The case law applicable to NASD Rule 2110 (now FINRA Rule 2010) is viewed as applicable to Rule G-17. *District Bus. Conduct Comm. No. 7 v. Northridge*, 1995 NASD Discip. LEXIS 231, at *19 (NBCC May 24, 1995) (“it is our understanding that the MSRB itself regards Rule G-17 as a counterpart to Article III, Section 1 of the NASD Rules [now FINRA Rule 2010], and looks to the case law which has construed the NASD provision for guidance in applying the MSRB counterpart.”).

¹⁰² *Dep’t of Enforcement v. Sisung Sec. Corp.*, No. C05030036, 2006 NASD Discip. LEXIS 16, at *53 n.40 (NAC Aug. 28, 2006), *aff’d in part*, Exchange Act Release No. 56741, 2007 SEC LEXIS 2562 (Nov. 5, 2007) (finding that Rule G-17 is “not a true analogue to NASD Rule 2110” in the context of fraud cases, as, unlike Rule 2110, it contains “an antifraud prohibition and imposes affirmative disclosure obligations for dealers” and declining to impose liability for a violation of MSRB Rule G-17 stemming from the violation of another Board rule.).

“a showing of at least negligence.”¹⁰³ The Hearing Panel finds that North’s violations of Rule G-27 were at least negligent, and, therefore, he violated Rule G-17 as well.¹⁰⁴

Enforcement also charges that North’s MSRB rule violations were willful. A violation is deemed willful if “the person charged with the duty knows what he is doing.”¹⁰⁵ The Panel need not find that North intentionally violated the provisions.¹⁰⁶ Additionally, it is irrelevant to a willfulness determination if North was attempting to comply with the law.¹⁰⁷ Instead, to find that North acted willfully, we need only find that he “voluntarily committed the act that constituted the violation.”¹⁰⁸ Here, North’s violative acts were voluntary, and, hence, his MSRB Rule violations were willful. Finally, by virtue of each of the above violations, North also violated FINRA Rule 2010.¹⁰⁹

I. North Fails to Adequately Review Electronic Correspondence

From July 1, 2009, through August 31, 2011, Southridge’s registered persons used at least two types of electronic communications: email and Bloomberg communications.¹¹⁰ King, in particular, communicated electronically through her Southridge email address and used Bloomberg communications, including Bloomberg email, IM messages, and chats.¹¹¹ The 2008 and 2010 WSPs required North, as the Firm’s CCO, to review the Firm’s electronic communications, including its associated persons’ electronic correspondence.¹¹² He failed to adequately perform this responsibility. First, during the relevant period, July 2009 through

¹⁰³ *Dep’t of Mkt Regulation v. Field*, No. CMS040202, 2008 FINRA Discip. LEXIS 63, at *34 n.23 (NAC Sept. 23, 2008) (citing *Dep’t of Enforcement v. Sisung Sec. Corp.*, No. C05030036, 2006 NASD Discip. LEXIS 16, at *53 n.40 (NAC Aug. 28, 2006), *aff’d in part*, Exchange Act Release No. 56741, 2007 SEC LEXIS 2562 (Nov. 5, 2007)).

¹⁰⁴ *See Sisung*, 2006 NASD Discip. LEXIS 16, at *53 n.40.

¹⁰⁵ *Michael Earl McCune*, 2015 FINRA Discip. LEXIS 22, at *11 (quoting *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000)).

¹⁰⁶ *Id.*

¹⁰⁷ *Dep’t of Enforcement v. Merrimac Corp. Sec., Inc.*, No. 2007001751101, 2012 FINRA Discip. LEXIS 43, at *36 (Bd. of Governors May 2, 2012).

¹⁰⁸ *Gallagher*, 2012 FINRA Discip. LEXIS 61, at *25; *Arthur Lipper Corp. v. SEC*, 547 F.2d 171, 180 (2d Cir. 1976) (holding that finding of willfulness does not require intent to violate the law, but merely intent to do the act that constitutes a violation of the law).

¹⁰⁹ *See* n.102, above. *See also Dep’t of Enforcement v. Midas Sec., LLC*, No. 2005000075703, 2011 FINRA Discip. LEXIS 62, at *21–23 (NAC Mar. 3, 2011), *aff’d*, Exchange Act Release No. 66200, 12 SEC LEXIS 199 (Jan. 20, 2012) (finding that a violation of NASD Rule 3010 is also a violation of FINRA Rule 2010).

¹¹⁰ *See, e.g.*, Tr. 78 (Smash archived email and Bloomberg communications for Southridge), 302–03 (Bond traders, among others, used Bloomberg to communicate).

¹¹¹ Tr. 220–21; CX-3, at 9. A Bloomberg chat is a type of instant message. Tr. 79.

¹¹² Ans. ¶¶ 3, 4, 57; CX-3, at 9, 10; CX-10, at 12, 24, 36; Tr. 222–23, 242–44, 293–94, 296, 317.

August 2011, North reviewed no Bloomberg communications.¹¹³ Second, his email reviews were infrequent and insufficient.

The primary evidence against North regarding his email reviews consists of reports created by Smarsh.¹¹⁴ These reports purportedly reflect: (1) the date of North's searches; (2) the random percentage that he used to search emails; (3) the number of results obtained by the searches; (4) the number of messages archived; and (5) the maximum number of messages he reviewed. The Hearing Panel found these reports reliable. We base this finding on the testimony of RS, a Smarsh senior manager of client data and manager of a team that handles data that is imported into and exported from Smarsh.¹¹⁵

RS testified about the relevant Smarsh data system. He explained that Southridge used a platform offered by Smarsh for email and Bloomberg messages and chat archiving and review.¹¹⁶ The platform permitted Southridge to log onto the platform, run searches, see the search results, and open the messages for review.¹¹⁷ Smarsh's system recorded searches run by users; search history; message review history; the identity of the user who logged onto the system; the length of time of the search; and the number of messages located through the search.¹¹⁸ After a search located messages, the user could review the messages by clicking on them.¹¹⁹ All of this information—including a user's search activity—was recorded in Smarsh's computer data base automatically and in "real time."¹²⁰ North was Southridge's only user of the system that logged in during the relevant period.¹²¹

RS also addressed the reports that Smarsh created based on the data stored in its computer system. RS testified that Enforcement requested that Smarsh provide information regarding North's searches of electronic communications.¹²² He then oversaw the preparation of

¹¹³ Tr. 112–14, 234, 300–01. North did not search for Bloomberg messages, apparently not realizing that in order to do so, he needed to perform a search in Smarsh's archiving platform that was separate from his email searches. He testified that he mistakenly thought he had been reviewing all electronic correspondence, including Bloomberg communications. Tr. 298–301, 342. But even if that were the case, he could not reasonably have believed that his Bloomberg reviews were adequate, given the infrequency of his electronic communications reviews. *See* pp. 13–15 above.

¹¹⁴ CX-13; CX-14; and CX-16.

¹¹⁵ Tr. 65–66.

¹¹⁶ Tr. 69–71, 78, 83.

¹¹⁷ Tr. 71–72.

¹¹⁸ Tr. 73–74.

¹¹⁹ Tr. 74–76.

¹²⁰ Tr. 76–77, 81.

¹²¹ Tr. 83–85.

¹²² Tr. 85–86. Enforcement provided the search criteria to Smarsh. Tr. 167–69 (representation made by Enforcement counsel).

the reports,¹²³ which were compiled and run by members of his team (or by members of other teams, at the request of his team).¹²⁴ According to RS, the reports were based on the search and review history pertaining to the emails contained in Smarsh's data base.¹²⁵ This data existed in the system before Smarsh ran the reports.¹²⁶ Significantly, as discussed below, the reports were not prepared by using the information derived from the emails themselves.¹²⁷

RS reviewed the reports after they were run and was familiar with them.¹²⁸ He did not, however, check to see if they conformed to his directions.¹²⁹ Indeed, Enforcement offered no evidence that anyone at Smarsh checked the reports after they were run to ensure that they accurately reflected the data stored in Smarsh's computer system. This was a factor that the Panel considered in evaluating the weight it should accord the reports. Nevertheless, RS's testimony reflected a thorough understanding of the relevant Smarsh archiving system, as well as the reports that Smarsh generated from that system. His testimony, which was not undercut by cross examination, established that the reports were reliable and accurately reflected North's email reviews.

North did not present persuasive evidence that the Smarsh reports were unreliable. For example, North sought to discredit the reports' accuracy by testifying about his review practices. But his recollections were sketchy and at times inconsistent. First, he testified that he did not recall how frequently he conducted email reviews, though he did not dispute his investigative testimony during which he said that he conducted a 10% review of electronic correspondence approximately three times every two weeks.¹³⁰ Then he testified that he periodically accessed the Smarsh system, pressing a 15% random review button, and conducting email reviews.¹³¹ He testified that his goal was to do that review once a week, though he was unsure if he achieved that goal, given that he "was one man reviewing hundreds of thousands of e-mails for 50 different registered representatives."¹³²

¹²³ Tr. 86, 94–95.

¹²⁴ Tr. 139–140, 147–49.

¹²⁵ Tr. 127–28.

¹²⁶ Tr. 153.

¹²⁷ Tr. 128.

¹²⁸ Tr. 140, 148.

¹²⁹ Tr. 150. He did testify, however, that he had no reason to believe that the reports were run incorrectly, adding that he had worked with the people who prepared them and was confident in the quality of their work. Tr. 142–43, 147–50.

¹³⁰ Tr. 297–99.

¹³¹ Tr. 337–39.

¹³² Tr. 338.

Further explaining his review methodology, North testified that he would bring up on his computer screen a page of emails and look at their subject headings.¹³³ He was unclear, however, about whether or how often he actually reviewed the content of the emails, as opposed to just the information contained in the headers.¹³⁴ Also, he did not document his reviews (i.e. maintain his own review log), relying, instead, on Smarsh to do so.¹³⁵ Nor did he print any reports documenting his reviews or ask Smarsh for reports similar to those that Smarsh created in connection with this matter.¹³⁶ (According to North, he did not run his own reports, in part, because he could see on the system, in real time, that the Smarsh system was accurately recording his reviews).¹³⁷

Given that North's testimony was tentative, uncorroborated, and at times inconsistent, the Panel did not credit it regarding the frequency of his reviews. Instead, we relied on the Smarsh reports as the more accurate reflection of North's email review history.¹³⁸

The Smarsh reports showed that North's email reviews were inadequate in three ways: the frequency of reviews, the number of emails reviewed, and the percentage of email reviewed. From July 1, 2009, through September 1, 2011, a period of slightly more than two years, North conducted email reviews 36 times.¹³⁹ In 13 of the 27 months comprising this period, he reviewed no emails.¹⁴⁰ Once he failed to review emails for five consecutive months;¹⁴¹ once he did not review emails for four consecutive months;¹⁴² and once he failed to review emails for three consecutive months.¹⁴³ During the 15-month period of June 2010 through August 2011, North

¹³³ Tr. 337–38.

¹³⁴ Tr. 338.

¹³⁵ Tr. 222–23, 304–05, 356–57, 375.

¹³⁶ Tr. 306, 374–75.

¹³⁷ Tr. 376.

¹³⁸ The reports were hearsay. And while hearsay is admissible in these proceedings, “it is necessary to evaluate its probative value, reliability, and fairness of use. Factors to consider include, among other things, the type of hearsay at issue, whether the evidence is signed or sworn, whether the evidence is contradicted by direct testimony, and whether the evidence is corroborated.” *Dep’t of Enforcement v. Brookstone Sec. Inc.*, No. 2007011413501, 2015 FINRA Discip. LEXIS 3, at *114–15 (NAC Apr. 16, 2015) (internal citations omitted). We find the reports probative and reliable. They directly relate to the issue of North's email review practice; they were prepared from data stored in the ordinary course of business; they were authenticated by a credible witness, RS; and their reliability was not contradicted by credible direct testimony. Finally, there was no unfairness in their use, as North testified that he relied on Smarsh to document his email reviews, and he had the opportunity at the hearing to cross examine RS about their creation.

¹³⁹ CX-13.

¹⁴⁰ CX-13 (October 2009; June 2010; July 2010; August 2010; September 2010; October 2010; December 2010; January 2011; February 2011; May 2011; June 2011; July 2011; and August 2011).

¹⁴¹ CX-13, at 8–11 (June 2010–October 2010).

¹⁴² CX-13, at 15–17 (May 2011–August 2011).

¹⁴³ CX-13, at 12–13; (December 2010–February 2011).

reviewed Firm emails six times: once in November 2010,¹⁴⁴ twice in March 2011,¹⁴⁵ and three times in April 2011.¹⁴⁶

When North did review emails, choosing the 15% random-sample search approach on the Smarsh system,¹⁴⁷ he often looked at only a small number of emails flagged by the system. For example, according to the Smarsh reports, North reviewed no more than¹⁴⁸ 87 emails from January 2010–March 2010¹⁴⁹ and no more than 11 emails from March 2011–April 2011.¹⁵⁰ In certain months, he looked at very few emails: February 2010 (50); March 2010 (27); August 2009 and November 2010 (25 each month); May 2010 (18); January 2010 (10); March 2011 (5); and April 2011 (2). Finally, North reviewed a very small percentage (.3%) of the total email messages that the Firm archived (no more than 1,522 out of 472,757 emails).¹⁵¹

In sum, North's email review was inadequate with respect to the frequency of his reviews and the number and percentage of email reviewed. His review was also inadequate with respect to King, in particular. As discussed above, by March 2010, he had learned of the King-UTA relationship, knew that it was a business relationship, and should have conducted due diligence to learn the scope of it. This due diligence should have included conducting a heightened review of King's electronic communications, given that he was the CCO and responsible under the WSPs for regulatory reporting and email review. But he did not do so.¹⁵² His failure to subject her electronic communications to a heightened review was unreasonable.

J. North's Defense

In defending against the charge that his email review was inadequate, North attacks the Smarsh reports on multiple fronts. Mainly, he asserts that the reports are unreliable and do not accurately reflect the frequency of his email reviews. North claims that the reports are unreliable because Smarsh spoliated the entire data base it was to have archived. He further argues that Smarsh failed to properly migrate certain data, resulting in the destruction of all relevant

¹⁴⁴ CX-13, at 11.

¹⁴⁵ CX-13, at 14.

¹⁴⁶ CX-13, at 14.

¹⁴⁷ Tr. 337–39; CX-3, at 10.

¹⁴⁸ The report did not reflect how many unique messages North reviewed, only the maximum number he reviewed. This is because Smarsh's computer system did not differentiate between one review of multiple emails, or multiple reviews of the same email, and did not record the number of unique searches performed. In other words, if North reviewed two emails only once, or reviewed the same email twice, the system would reflect that he had reviewed two messages. Tr. 96–99.

¹⁴⁹ CX-13, at 4–6.

¹⁵⁰ CX-13, at 13–15.

¹⁵¹ Tr. 107–08, 110; CX-16.

¹⁵² North testified that he used the random 15% for everyone at the Firm, including King, and did not specifically focus on her emails. Tr. 339

evidence of Bloomberg and other email review.¹⁵³ He claims that the Smarsh reports “were derived from re-ingested data after a data migration that lost email review data.”¹⁵⁴

North failed to demonstrate spoliation regarding any data that could impact the reports’ reliability. North’s spoliation arguments focused on purported anomalies and deficiencies contained in the content and headers of the emails. But according to RS, as discussed above, that information was not used to create the reports. Instead, the reports were based on search and review history data, making any spoliation of the content of the mails irrelevant to the reports’ reliability.¹⁵⁵ Accordingly, North did not show that the reports were unreliable because of any alleged spoliation of the content of the emails.¹⁵⁶

North also failed to show that the unsuccessful data migration impacted the reliability of the reports. In early 2014, Smarsh migrated to a new system the archived communications and data for existing and certain former clients. In connection with the migration, Smarsh chose not to migrate Bloomberg-related communications and related data of former clients who not been clients for a long period of time. Southridge was one of those former clients whose Bloomberg information Smarsh did not migrate to the new system.¹⁵⁷ As a result, Southridge’s Bloomberg information was no longer accessible afterward. But this did not undermine the Smarsh reports admitted at hearing, as they reflect email reviews of data migrated by Smarsh, not Bloomberg message reviews.

In addition to challenging the reliability of the reports, North also argues that the Hearing Officer should not have admitted them for two reasons. First, he asserts that Enforcement did not lay a sufficient evidentiary foundation for their admission.¹⁵⁸ North contends that RS was unqualified and that RS failed to explain sufficiently how the reports were prepared. North points out that while RS was familiar with the nature and function of the reports, he did not prepare them and did not directly observe or participate in their preparation.¹⁵⁹ Second, North maintains

¹⁵³ Resp.’s Post-Hrg. Br. at 13–19. Before the hearing, North and then-Respondent King moved for summary disposition, or alternatively, for dismissal, on the grounds that Enforcement engaged in intentional, bad faith, spoliation of large quantities of relevant evidence that it gathered during the investigation that led to this proceeding. The Hearing Officer denied that motion because movants failed to show that there were no genuine issues of material fact.

¹⁵⁴ Resp.’s Post-Hrg. Br. at 14.

¹⁵⁵ Before the hearing, the Hearing Officer denied North’s request to call expert testimony regarding spoliation of data. This proposed testimony did not specifically address the Smarsh reports or find that they were unreliable based on problems with the integrity of the emails. Rather, the expert intended to opine on the purported alteration and manipulation of the headers and contents of certain emails. Accordingly, the Hearing Officer denied the request.

¹⁵⁶ The Panel makes no finding about whether the Firm’s emails contained anomalies and deficiencies or whether any spoliation occurred.

¹⁵⁷ Tr. 114–15.

¹⁵⁸ The Hearing Officer found that Enforcement laid a sufficient foundation to support their admissibility and admitted them over objection. Tr. 173–74.

¹⁵⁹ Resp.’s Post-Hrg. Br. at 16.

that the reports were summary exhibits created from Smarsh's business records, and, therefore, the underlying data for those reports should have been produced to North for his review.¹⁶⁰

Neither of these arguments demonstrates that the reports were inadmissible. As a threshold matter, under the FINRA Code of Procedure, the Hearing Officer "shall receive relevant evidence, and may exclude all evidence that is irrelevant, immaterial, unduly repetitious, or unduly prejudicial."¹⁶¹ It is undisputed that the reports were relevant. Moreover, RS sufficiently authenticated the reports, which, contrary to North's characterization, were not summary exhibits. Although the formal rules of evidence do not apply in FINRA proceedings,¹⁶² FINRA adjudicators frequently look to the Federal Rules of Evidence for guidance.¹⁶³ Even under those rules, the reports are admissible.

First, RS properly authenticated the reports because he was familiar with the reports as well as the inputting, compilation, and storage of the underlying data used to create them. This constitutes adequate authentication under the Federal Rules of Evidence to support their admission into evidence.¹⁶⁴

Second, the Smarsh reports were not summary exhibits under the Federal Rules of Evidence, and, therefore, the Rule governing their admissibility is inapplicable, even in federal court. Federal Rule of Evidence 1006 allows "the contents of voluminous writings ... which cannot conveniently be examined in court" to be presented in the form of a "summary, chart, or calculation." The Rule requires that originals or duplicates be made available for examination or copying, or both, by the other party. This Rule, however, is inapplicable to the Smarsh reports. Rather than constituting summary exhibits, the Smarsh reports were print outs of data, compiled at or near the time of North's reviews, and stored in a computerized data system in the ordinary course of Smarsh's business. Hence, the reports themselves constituted the business records,

¹⁶⁰ Tr. 157; Resp.'s Post-Hrg. Br. at 17.

¹⁶¹ FINRA Rule 9263(a).

¹⁶² FINRA Rule 9145(a).

¹⁶³ See, e.g., *Dep't of Enforcement v. Ahmed*, No. 2012034211301, 2015 FINRA Discip. LEXIS 45, at *112 (NAC Sept. 25, 2015), *appeal docketed*, No. 3-16900 (SEC Oct. 13, 2015); *Dep't of Enforcement v. Ranni*, No. 20080117243, 2012 FINRA Discip. LEXIS 6, at *39 (OHO Mar. 9, 2012).

¹⁶⁴ See *U-Haul Intern., Inc. v. Lumbermens Mut. Cas. Co.*, 576 F.3d 1040, 1044 (9th Cir. 2009) (holding that "[t]he witness must only be in a position to attest to [the evidence's] authenticity") (quoting *United States v. Smith*, 609 F.2d 1294, 1302 (9th Cir. 1979)). Further, the authenticating witness "need only be familiar with the company's recordkeeping practices." *Id.* at 1045. Finally, "[a] computer printout may be authenticated by 'one who has knowledge of the particular system.'" *Id.* (quoting *United States v. Miller*, 771 F.2d 1219, 1237 (9th Cir. 1985)).

admissible even in federal court under the business records exception to the hearsay rule.¹⁶⁵ They were not summaries of other evidence.¹⁶⁶

K. Conclusions of Law—North Violated NASD Conduct Rule 3010(b) and FINRA Rule 2010 and Willfully Violated MSRB Rules G-27(a) and (c), and MSRB Rule G-17

In addition to establishing and maintaining reasonable and appropriate WSPs, NASD Rule 3010(b)(1) requires members to enforce the WSPs when supervising its business and the activities of their associated persons. The MSRB rules contain substantially the same requirement.¹⁶⁷ Because North failed to review the associated persons' Bloomberg communications and inadequately reviewed their email correspondence, we find that North did not enforce Southridge's WSPs regarding the review of electronic correspondence, though the WSPs required him to do so. His review of King's electronic emails was also inadequate, as he should have subjected them to a heightened review after March 2010. As a result, North violated NASD Rule 3010(b) and FINRA Rule 2010. Because, his conduct was voluntary and he knew what he was doing, he willfully violated MSRB Rules G-27(a) and (c). And, because his conduct was reckless, it also violated and Rule G-17.

III. Sanctions

In considering the appropriate sanctions to impose on North, the Hearing Panel looked to FINRA's Sanction Guidelines ("Guidelines").¹⁶⁸ The Guidelines contain General Principles Applicable to All Sanction Determinations ("General Principles"), overarching Principal Considerations, as well as guidelines for specific violations. The General Principles explain that "sanctions should be designed to protect the investing public by deterring misconduct and upholding high standards of business conduct."¹⁶⁹ Adjudicators are therefore instructed to "design sanctions that are meaningful and significant enough to prevent and discourage future misconduct by a respondent and deter others from engaging in similar misconduct."¹⁷⁰ Further, sanctions should "reflect the seriousness of the misconduct at issue,"¹⁷¹ and should be "tailored to address the misconduct involved in each particular case."¹⁷²

¹⁶⁵ See Fed. R. Evid. 803(6). Under this Rule, records of regularly conducted business activities meeting various criteria constitute an exception to general prohibition against hearsay evidence, a prohibition that does not exist in FINRA proceedings. *Brookstone Sec.*, 2015 FINRA Discip. LEXIS 3, at *114–15.

¹⁶⁶ *Lumbermens Mut. Cas. Co.*, 576 F.3d at 1045–46.

¹⁶⁷ MSRB Rule G-27(a) and (c).

¹⁶⁸ FINRA Sanction Guidelines (2015) ("Guidelines"), <http://www.finra.org/industry/sanction-guidelines>.

¹⁶⁹ *Guidelines* at 2 (General Principles Applicable to All Sanction Determinations, No. 1).

¹⁷⁰ *Id.*

¹⁷¹ *Id.*

¹⁷² *Guidelines* at 3 (General Principles Applicable to All Sanction Determinations, No. 3).

A. North is Fined \$10,000 and Suspended for 30 Business Days in any Principal Capacity for Failing to Report a Relationship with a Statutorily Disqualified Person

Under the Sanction Guidelines, the recommended fine for failing to report a relationship with a statutorily disqualified person is \$5,000 to \$146,000. The adjudicators should consider suspending the responsible principal in all supervisory capacities for 10 to 30 business days. In egregious cases, the adjudicators should consider suspending the responsible principal in any or all capacities for up to two years or barring the responsible principal in all supervisory capacities.

The principal consideration in imposing sanctions for this violation is whether the unreported event would have established a pattern of potential misconduct.¹⁷³ Here, this factor is aggravating. Had North reported King’s relationship with the statutorily disqualified Cowle, it likely would have led to the discovery of a pattern of potential misconduct by King, namely, aiding and abetting Cowle’s circumvention of the registration requirements of the federal securities law.¹⁷⁴ Additionally, North was aware of King’s relationship with UTA by March 2010. And, at a minimum, he should also have discovered her relationship with Cowle at that time, as well. Therefore, North’s failure to report the King–Cowle relationship in or about March 2010 was at least negligent. But by December 2010, he clearly knew of that relationship and consciously decided not to report it. His failure to report the relationship, at that time, was intentional, and this is an aggravating factor.¹⁷⁵ Finally, it is also aggravating that North failed to accept responsibility for his misconduct, maintaining at the hearing that he was “being charged with not being clairvoyant.”¹⁷⁶

Taking these considerations into account, and the lack of mitigation, the Panel finds that North’s conduct was serious, but not egregious, and imposes a fine of \$10,000 and suspends North from associating with any member firm in any principal capacity for 30 business days for failing to report a relationship with a statutorily disqualified person.

B. North is Censured and Fined \$10,000 for Failing to Establish and Maintain a Reasonable Supervisory System, Including Adequate Written Supervisory Procedures

For deficient written supervisory procedures, the Guidelines recommend imposing a fine of \$1,000 to \$37,000 and, in egregious cases, suspending the responsible individual in any or all

¹⁷³ *Guidelines* at 74.

¹⁷⁴ In this proceeding, Enforcement charged King with violating FINRA Rule 2010 and MSRB Rule G-17 by aiding and abetting Cowle’s violation of the registration requirements of Sections 15(a)(1), 15B(c), and 15C(a) of the Securities Exchange Act of 1934. Compl., First Cause of Action. *See* n.1, above. She settled those charges through an Offer of Settlement.

¹⁷⁵ *Guidelines* at 7 (Principal Considerations in Determining Sanctions, No. 13).

¹⁷⁶ Tr. 388; *Guidelines* at 6 (Principal Considerations in Determining Sanctions, No. 2).

capacities for up to one year.¹⁷⁷ The Guidelines direct that the adjudicators consider whether the deficiencies allowed violative conduct to occur or to escape detection, and whether they made it difficult to determine the individual or individuals responsible for specific areas of supervision or compliance. This factor is aggravating in this case because the deficient procedures allowed violative conduct to occur. North failed to conduct adequate reviews of Southridge's electronic communications. The deficiencies in the WSPs contributed to his failure by not providing him with guidance regarding sample size or the frequency of reviews of electronic correspondence. Also aggravating was the length of time of the violation, which extended over two years,¹⁷⁸ and North's failure to accept responsibility for the misconduct.¹⁷⁹

Finally, North's conduct was at least negligent.¹⁸⁰ FINRA informed its members that WSPs should address the percentage of email selected as part of a random review, as well as the frequency of the review. Yet, North did not follow that guidance and did not ensure that the WSPs addressed these subjects. The Panel finds that there were no mitigating factors. After taking into account the relevant considerations, the Hearing Panel determines that the misconduct was not egregious and that an appropriately remedial sanction is a censure and fine of \$10,000.

C. North is Fined \$20,000 and Suspended for Two Months in All Principal Capacities for Failing to Adequately Review Electronic Correspondence

The Sanction Guideline for failure to supervise recommends that the adjudicator impose a fine of \$5,000 to \$73,000, consider suspending the responsible individual in all supervisory capacities for up to 30 business days, and, in egregious cases, consider suspending the responsible individual in any or all capacities for up to two years or barring the responsible individual.¹⁸¹ The Guideline contains three principal considerations in imposing sanctions for supervisory violations: (1) whether respondent ignored "red flag" warnings that should have resulted in additional supervisory scrutiny (and, in this regard, whether the individuals responsible for underlying misconduct attempted to conceal misconduct from the respondent); (2) the nature, extent, size and character of the underlying misconduct; and (3) the quality and degree of the supervisor's implementation of the firm's supervisory procedures and controls.¹⁸²

Several of these considerations are aggravating. North ignored a "red flag" warning that should have resulted in additional scrutiny. He became aware of King's relationship with UTA,

¹⁷⁷ *Guidelines* at 104. The Guideline applies to violations of both NASD Rule 3010 and MSRB Rule G-27. *See Guidelines* at 104, n.1.

¹⁷⁸ *Guidelines* at 6 (Principal Considerations in Determining Sanctions, No. 9).

¹⁷⁹ *Cf. Guidelines* at 6 (Principal Considerations in Determining Sanctions, No. 2).

¹⁸⁰ *Guidelines* at 7 (Principal Considerations in Determining Sanctions, No. 13).

¹⁸¹ *Guidelines* at 103. The Guideline applies to violations of both NASD Rule 3010 and MSRB Rule G-27. *See Guidelines* at 103 n.1.

¹⁸² *Guidelines* at 103.

and later, with Cowle, yet failed to increase his scrutiny of King's electronic communications.¹⁸³ Additionally, North's misconduct was egregious and reckless,¹⁸⁴ given the length of time of the violation (it extended over two years;)¹⁸⁵ and in light of his failure, over numerous months, to review any emails. He also failed to accept responsibility for his wrongdoing.¹⁸⁶ Finally, while the Firm's supervisory procedures and controls were deficient, as discussed above, North compounded the situation by not diligently implementing them, namely, by not reviewing any Bloomberg communications and by infrequently and inadequately reviewing emails. In weighing these various considerations, and finding that there are no mitigating circumstances, the Panel determines that an appropriately remedial sanction is a fine of \$20,000 and a suspension from associating with any member firm in any principal capacity for two months.

IV. Order

Respondent Thaddeus J. North is:

(1) fined \$10,000 and suspended from associating with any member firm in any principal capacity for 30 business days for failing to report a relationship with a statutorily disqualified person in violation of NASD Rule 3070(a)(9) and FINRA Rule 2010; (2) censured and fined \$10,000 for failing to establish and maintain a reasonable supervisory system, including adequate written supervisory procedures, in willful violation of MSRB Rules G-27(b) and (e), and MSRB Rule G-17 and, in violation of NASD Conduct Rules 3010(a) and (d), and FINRA Rule 2010;¹⁸⁷ and (3) fined \$20,000 and suspended from associating with any member firm in any principal capacity for two months for failing to adequately review electronic correspondence in willful violation of MSRB Rules G-27(a) and (c), and MSRB Rule G-17, and in violation of NASD Conduct Rule 3010(b) and FINRA Rule 2010.¹⁸⁸

The suspensions shall run consecutively. North is also ordered to pay the costs of the hearing in the amount of \$4,404.51, which includes a \$750 administrative fee and the cost of the hearing transcript.¹⁸⁹ If this decision becomes FINRA's final disciplinary action, the suspension shall become effective with the opening of business on Tuesday, January 19, 2016, and end on Tuesday, May 1, 2016. The fines in the total amount of \$40,000 plus the assessed costs shall be

¹⁸³ Arguably, King attempted to conceal her misconduct from North, as the Services Agreement she signed lacked Cowle's signature on behalf of UTA. But, as discussed above, while the lack of a signature hid Cowle's existence, it also served as a red flag that should have prompted heightened email review.

¹⁸⁴ *Guidelines* at 7 (Principal Considerations in Determining Sanctions, No. 13).

¹⁸⁵ *Guidelines* at 6 (Principal Considerations in Determining Sanctions, No. 9).

¹⁸⁶ *Cf. Guidelines* at 6 (Principal Considerations in Determining Sanctions, No. 2).

¹⁸⁷ This fine is apportioned as follows: \$5,000 is imposed for the MSRB Rule violations, and \$5,000 is imposed for the NASD and FINRA Rule violations.

¹⁸⁸ This fine is apportioned as follows: \$10,000 is imposed for the MSRB Rule violations, and \$10,000 is imposed for the NASD and FINRA Rule violations.

¹⁸⁹ The Hearing Panel considered and rejected without discussion all other arguments by the parties.

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.

Finally, because Enforcement failed to prove that North violated FINRA Rule 4530(a)(1)(H), that charge is dismissed.

David R. Sonnenberg
Hearing Officer
For the Hearing Panel