No. 24- _____

In the United States Court of Appeals for the Sixth Circuit

IN RE ERIC S. SMITH,

Petitioner.

PETITION FOR A WRIT OF MANDAMUS TO THE U.S. SECURITIES AND EXCHANGE COMMISSION

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Sixth Circuit Rule 26.1, undersigned counsel for Petitioner Eric S. Smith states that Petitioner is a natural person and that no publicly owned corporation, not a party to the appeal, has a financial interest in the outcome of this case.

/s/ Russell G. Ryan
Attorney of Record for Petitioners

STATEMENT REGARDING ORAL ARGUMENT

Petitioner Eric S. Smith respectfully requests oral argument. This case presents important questions involving due process of law and the fairness and alacrity of administrative enforcement adjudication—to wit, can a federal administrative agency indefinitely refuse to perform its constitutional and statutory duty to decide an adjudicative enforcement matter pending before it, thereby indefinitely depriving an aggrieved litigant of his livelihood and other economic opportunity, his ability to restore his reputation, and his day in court? And if so, what is the proper remedy? Oral argument will aid the Court in understanding the inner workings and practical realities of the adjudicative processes of the Financial Industry Regulatory Authority and the Securities and Exchange Commission, and the lengths to which the latter has gone in flouting its own rules and evading its constitutional and statutory duty to adjudicate cases within a reasonable time period.

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INTRODUCTION

"Relax," said the night man,
"We are programmed to receive.
You can check out any time you like,
But you can never leave."[1]

These haunting final lyrics to the iconic 1976 Eagles song ring all too familiar to Petitioner Eric S. Smith. In October 2020, pursuant to the procedures codified in § 19 of the Securities Exchange Act of 1934 (the "Exchange Act") and the rules of the Securities and Exchange Commission ("SEC" or "Commission"), Smith filed an application with SEC seeking appellate review of a disciplinary decision issued against him the previous month—with no jury trial—by the Financial Industry Regulatory Authority ("FINRA"), a private self-regulatory organization subject to SEC oversight. FINRA's disciplinary decision was not just wrong on the facts and applicable law; it was also unlawful and *ultra vires* because Smith has never been affiliated with FINRA nor otherwise consented to FINRA's assertion of disciplinary power over him.

Briefing of Smith's SEC appeal was completed nearly three years ago, yet SEC has thus far refused to decide his case. Through its willful and prolonged inaction, SEC is depriving Smith of his livelihood and good reputation, his constitutional right to due process of law, his statutory rights to fair procedures and

[1] EAGLES, HOTEL CALIFORNIA (Asylum Records 1976).

prompt agency action, and his ability to seek, if necessary, judicial review of his case on the merits in an Article III court.

Smith is not the only litigant trapped in SEC's adjudicatory version of the Hotel California. As of the filing of this petition, according to information available on SEC's public website, at least a dozen similarly situated litigants are endlessly waiting for the agency to decide their years-old pending appeals from disciplinary sanctions imposed by FINRA and other industry self-regulatory organizations. In each case, SEC has issued a series of perfunctory orders repeatedly extending its time to decide these appeals.

The agency has already issued *nine* such self-serving extension orders in Smith's case since the completion of briefing three years ago, the most recent one on January 8, 2024. Like Kafka's "man from the country" endlessly awaiting admittance to the Law, Smith endlessly waits for a decision in his SEC appeal and, if necessary, his ability to seek relief from an actual court of law.[2]

[2] FRANZ KAFKA, THE TRIAL 213 (W. Muir & E. Muir trans. 1937) (1925) ("[T]he doorkeeper says that he cannot admit the man at the moment. The man, on reflection, asks if he will be allowed, then, to enter later. 'It is possible,' answers the doorkeeper, 'but not at this moment.' … The doorkeeper gives him a stool and lets him sit down at the side of the door. There he sits waiting for days and years.").

RELIEF REQUESTED

As explained below, SEC's prolonged inaction gives this Court jurisdiction—and good reason—to intervene and issue a writ of mandamus that compels SEC to set aside FINRA's disciplinary decision. The Court should do so. In the alternative, at minimum the Court should compel SEC to promptly issue a decision and final order in Smith's case within a fixed period of no more than 30 days.

JURISDICTION AND VENUE

This Court has jurisdiction pursuant to the All Writs Act, 28 U.S.C. § 1651, the Exchange Act, 15 U.S.C. § 78y(a), and the Administrative Procedure Act ("APA"), 5 U.S.C. §§ 702, 706. *See Telecomms. Rsch. & Action Ctr. v. FCC*, 750 F.2d 70, 74–79 (D.C. Cir. 1984) (court of appeals has exclusive jurisdiction over mandamus petition to compel agency action unreasonably delayed); *In re Howard*, 570 F.3d 752, 756-57 (6th Cir. 2009) (citing *Telecomms. Rsch. & Action Ctr.*).

Venue is proper in this Circuit because Smith is a citizen of Michigan and thus, if SEC ever issues a final order against him, venue for a petition to review that order would be proper in this Circuit pursuant to Exchange Act § 25(a), 15 U.S.C. § 78y(a).

ISSUE PRESENTED

1. By refusing to decide Smith's administrative appeal, is SEC depriving Smith of his rights to due process of law under the Fifth Amendment and/or to a fair and prompt decision under the Exchange Act and the Administrative Procedure Act?

2. If so, should this Court issue a writ of mandamus to compel SEC to set aside FINRA's disciplinary decision or, in the alternative, to compel SEC to promptly issue a decision and final order in Smith's case within a fixed time period, such as 30 days, after this Court's decision?

FACTS

I. RELEVANT PARTIES

Petitioner Smith is a citizen and resident of Michigan. He is the founder, chairman, chief executive, and majority owner of Consulting Services Support Corporation ("CSSC"), which has several wholly owned subsidiaries, including a broker-dealer subsidiary (the "Brokerage Firm") that was a member of FINRA until June 2018. Neither Smith nor CSSC has ever been a member of FINRA or registered with FINRA, and Smith has never served as an officer, director, or employee of the Brokerage Firm (nor any other FINRA member firm). With the exception of the FINRA disciplinary matter at issue here, Smith has never before been the subject of any regulatory enforcement complaint filed by FINRA, SEC, nor any other financial regulator.

SEC is an agency of the United States government headquartered in Washington, DC.

FINRA is a private, nonprofit corporation incorporated under the laws of Delaware and headquartered in Washington, DC. It operates as a self-regulatory

organization within the securities industry subject to SEC oversight, with its lawful regulatory power extending only to firms and individuals—unlike Smith—who have consented to that jurisdiction.

II. PROCEDURAL BACKGROUND

Smith's ordeal with FINRA dates back to 2015, when FINRA staff employees commenced a regulatory examination of the Brokerage Firm. As noted above, the Brokerage Firm at the time was a FINRA member firm but its parent company, CSSC, was not and never has been a member of FINRA. While Smith was and still is the chief executive officer of the parent company, he has never been an officer, director, or employee of the Brokerage Firm nor any other FINRA member firm, and he has never consented to FINRA's exercising regulatory or disciplinary jurisdiction over him.

In August 2017, at the conclusion of its two-year examination, FINRA staff employees commenced a formal disciplinary proceeding against Smith and the Brokerage Firm alleging misconduct dating back to 2010. Over Smith's objection, FINRA claimed it could exercise regulatory and disciplinary jurisdiction over Smith, even though he has never consented to such jurisdiction and has never been an officer, director, nor employee of any FINRA member firm. After an eight-day, non-jury hearing in June 2018, before a panel comprised of a FINRA-employed hearing officer and two FINRA-selected employees of unrelated FINRA member

firms, the panel issued a decision in January 2019 ruling against Smith and the Brokerage Firm in all material respects. App.2 As punishment, the hearing panel imposed a lifetime industry bar against Smith; suspended the Brokerage firm from participating in private securities offerings for one year; imposed fines totaling $120,000 against the Brokerage Firm; and ordered Smith and the Brokerage firm, jointly and severally, to pay $130,000 in restitution to four investors plus approximately $12,000 as costs of the proceeding. App.50-51.

In accordance with FINRA procedural rules, Smith filed a timely appeal with FINRA's National Adjudicatory Council (the "NAC"), which is FINRA's internal appellate tribunal. (The Brokerage Firm did not appeal.) The NAC issued its decision in September 2020, affirming the hearing panel decision in all material respects and ordering Smith to pay another $1,200 in costs of the appeal. App.55.

In accordance with SEC procedural rules, Smith then filed an application for SEC appellate review of FINRA's decision in October 2020 and later requested oral argument. App.91. Briefing was completed in March 2021, yet SEC has still not scheduled oral argument nor issued any decision.

Under SEC's own rules, the agency should have decided Smith's appeal more than two years ago. Those rules say that appeals from FINRA "ordinarily" should be decided within no more than ten months after completion of briefing, even in the most complex cases.

Specifically, Rule 900 of SEC's Rules of Practice provides:

> Timely resolution of adjudicatory proceedings is one factor in assessing the effectiveness of the adjudicatory program in protecting investors, promoting public confidence in the securities markets *and assuring respondents a fair hearing*. Establishment of guidelines for the timely completion of key phases of contested administrative proceedings provides a standard for both the Commission and the public to gauge the Commission's adjudicatory program on this criterion. The Commission has directed that:
>
> ….
>
> (iii) Ordinarily, a decision by the Commission with respect to … a review of a determination by a self-regulatory organization … *will be issued within eight months from the completion of briefing* on the petition for review … . If the Commission determines that the complexity of the issues presented in a petition for review … warrants additional time, the decision of the Commission in that matter *may be issued within ten months of the completion of briefing*.

17 C.F.R. § 201.900(a)(1) (emphasis added).

But instead of deciding Smith's appeal and issuing a final order that Smith could then appeal to this Court, SEC has summarily granted itself nine successive ninety-day extensions of its time to decide the case—collectively delaying SEC's self-imposed decision deadline by more than 800 days (and counting). Each of the substantially identical extension orders has perfunctorily recited that, in its "discretion" and without any explanation, SEC found it "appropriate" to postpone its decision again (and again and again—nine times!). These now-farcical extension

orders are summarized in the following table and reproduced at pages App.94 through App.111 of the Appendix filed contemporaneously with this petition:[3]

Date of Order	New Deadline
01/10/2022	04/11/2022
04/11/2022	07/11/2022
07/11/2022	10/11/2022
10/11/2022	01/09/2023
01/09/2023	04/10/2023
04/10/2023	07/10/2023
07/10/2023	10/10/2023
10/10/2023	01/08/2024
01/08/2024	04/08/2024

All told, nearly three years have elapsed since briefing was completed in Smith's appeal to SEC—well more than *three times* what SEC's own rules say should "ordinarily" suffice for deciding even the most complex appeals from FINRA. And that's counting only the time since completion of appellate briefing before SEC in a continuing overall regulatory matter that began with FINRA in 2015 (focused on events dating back to 2010). *And there is still no end in sight*. As one Fifth Circuit judge quipped about another litigant's similar eight-year administrative ordeal with SEC, "[s]o much for efficiency." *Cochran v. SEC*, 20 F.4th 194, 235 (5th Cir. 2021) (*en banc*) (Oldham, J., concurring), *aff'd*, *Axon v. FTC and SEC v. Cochran*, 598 U.S. 175 (2023).

[3] All nine extension orders are also available on SEC's public website at https://www.sec.gov/litigation/apdocuments/3-20127 (last visited Mar. 5, 2024).

SEC's dereliction of its adjudicative duties contrasts sharply with the relative alacrity of federal appellate litigation. According to recent statistics, most federal circuit courts—including this one—routinely decide appeals within a year of *docketing* and within a matter of months after the close of briefing and any oral argument. *See* Taylor Dalton, *The Trajectory of Civil Cases in Federal Court*, Above the Law (May 28, 2021); *see also* Admin. Off. of the U.S. Courts, U.S. Courts of Appeals Federal Court Management Statistics (December 2023) (reporting that the total median time from filing of a notice of appeal to disposition in this Court is only 8.8 months). By contrast, Smith has already been stuck in SEC's adjudicative limbo for more than three years—following his five-year ordeal with FINRA—with no final decision expected anytime soon, if ever. And even if SEC eventually issues a final decision against Smith, that will only start the clock for another (comparatively reasonable) months-long appeal to this Court.

III. FURTHER CONTEXT

Smith's languishing appeal before SEC is not an anomaly; he is far from alone in his state of SEC interminable adjudicative limbo. At least a dozen other cases are similarly languishing on SEC's appellate docket despite having been fully briefed at least a year ago—some of them more than two years ago. In each one, as in Smith's case, SEC has granted itself a succession of perfunctory extensions of its time to decide. Collectively in these cases, SEC has granted itself dozens of extensions so

far. Moreover, even when SEC occasionally decides one of these languishing appeals, its decision often comes years after the appeal was initially docketed and after SEC has granted itself numerous perfunctory extensions. *See, e.g.*, *Southeast Investments, N.C., Inc.*, SEC Admin. Proc. File No. 3-19185 (2023) (four-and-a-half years and 24 extensions); *Wilson-Davis & Co.*, SEC Admin. Proc. File No. 3-19666 (2023) (nearly four years and 17 extensions); *Scottsdale Capital Advisors Corp.*, SEC Admin. Proc. File No. 3-18612 (2021) (three years and 17 extensions); *Robert R. Tweed*, SEC Admin. Proc. File No. 3-19652 (2023) (nearly four years and 17 extensions); *Metatron, Inc.*, SEC Admin. Proc. File No. 3-18567 (2023) (five-and-a-half years and 13 extensions).

SEC's docket backlog is nothing new; this problem has bedeviled the agency for decades. In the early 1990s, for example, SEC's then-Chair Richard Breeden formed a task force to address the problem, acknowledging that "[m]any cases seemed to take an extremely long time to be completed, and a large backlog of increasingly old cases had built up for various reasons." Comm'r Mary L. Schapiro, *Fair and Efficient Administrative Proceedings: Report of the Task Force on Administrative Proceedings of the United States Securities and Exchange Commission*, SEC Task Force on Admin. Procs. 1 (1993) (introductory note preceding report). The task force's 390-page report detailed SEC's chronic adjudicative delays, noting among other things that such delays had been a major

concern at the agency since the 1960s. *Id*. at 33 & n.46. The report further noted that, during SEC's 1992 fiscal year, "the average time from filing of the appeal to issuance of the opinion was 806 days," *id*. at 13-14, while later acknowledging that the total time from SEC's issuance of a briefing schedule order in cases on appeal *should* be "no more than nine months," *id*. at 16.

Ten years later, a 2003 memorandum from the agency's commissioners to its general counsel acknowledged the importance of timely decision-making but laid bare the persistent ugly reality:

> The Commission must lead by example and this means seriously tightening up the time frame from the date an appeal is taken from an ALJ or [self-regulatory organization] decision to the time the Commission issues its Opinion. The major issue that must be addressed by the Office of the General Counsel (OGC) is the time it takes for OGC to do the necessary review of the record and briefs and submit a draft opinion to the Commission. …
>
> …
>
> While these matters take time, statistics show an inordinate amount of delay in the Commission's issuance of appellate decisions. At the time we concluded our initial examination, well over a third of all the cases on appeal to the Commission had been waiting for decision for over two years, and 20% of cases on appeal had been awaiting decision for over 900 days. With respect to some cases decided by the Commission this year, more than 3½ years passed between the time of the initial decision and the time of the Commission's decision. Each opinion typically goes through three layers of review, by the Assistant General Counsel, Associate General Counsel, and the General Counsel, each layer of review taking between five and twelve months. Finally, when the opinion gets to the Commission, sometimes no action is taken for many months.

Mem. from the Comm'n Regarding Policy for Accelerating the Admin. Procs. Process 1-2 (Jun. 9, 2003).

The SEC commissioners' blunt assessment elsewhere in the same 2003 memorandum—"*There is no justifiable explanation for such delays*," *id*. at 2 (emphasis added)—applies with equal force today.

REASONS WHY THE WRIT SHOULD ISSUE

This Court has ample power to compel administrative agencies like SEC to perform in a timely manner the duties assigned to them by Congress. First, the All Writs Act provides that "all courts established by Act of Congress may issue all writs necessary or appropriate in aid of their respective jurisdictions and agreeable to the usages and principles of law." 28 U.S.C. § 1651. The APA further directs that a reviewing court "*shall* … compel agency action unlawfully withheld or unreasonably delayed." 5 U.S.C. § 706(1) (emphasis added). Courts frequently invoke these statutory powers to compel agencies to act. *See, e.g., In re La. Pub. Serv. Comm'n*, 58 F.4th 191, 192, 195 (5th Cir. 2023) (invoking statutes and ordering FERC to "provide [the] court … with a meaningful explanation for the length of time the Commission takes for final action" and retaining jurisdiction); *Telecomms. Rsch. & Action Ctr.*, 750 F.2d at 79 ("Claims of unreasonable agency delay clearly fall into that narrow class of interlocutory appeals from agency action over which we appropriately should exercise our jurisdiction.").

When an allegation of unreasonable delay is made, courts must "consider whether the agency's delay is so egregious as to warrant mandamus." *Id*. While there is no "single test" for when a writ should issue in cases alleging unreasonable delay, *see id.* at 79–80, this Court has considered several factors in making that determination:

> (1) the time agencies take to make decisions must be governed by a rule of reason;
>
> (2) where Congress has provided a timetable or other indication of the speed with which it expects the agency to proceed in the enabling statute, that statutory scheme may supply content for this rule of reason;
>
> (3) delays that might be reasonable in the sphere of economic regulation are less tolerable when human health and welfare are at stake;
>
> (4) the court should consider the effect of expediting delayed action on agency activities of a higher or competing priority;
>
> (5) the court should also take into account the nature and extent of the interests prejudiced by delay; and
>
> (6) the court need not find any impropriety lurking behind agency lassitude in order to hold that agency action is unreasonably delayed.

Barrios Garcia v. DHS, 25 F.4th 430, 451-52 (6th Cir. 2022) (quoting *Telecomms. Research & Action Ctr.*, 750 F.2d at 80).

Several of these factors weigh heavily in favor of granting Smith's requested relief here—the unreasonable length of time elapsed (more than 40 months since Smith filed his appeal with SEC); the nature and extent of Smith's interests

prejudiced by SEC's delay (*e.g.*, the ongoing deprivation of Smith's rights to due process of law, fair procedures, and prompt agency action, and his ongoing financial and reputational harm); and the presence of bad faith on SEC's part (*i.e.*, the agency's decades-long refusal to fix its appellate adjudication delays despite repeatedly acknowledging the problem). Although there is no statutory timetable with respect to the duration of SEC appellate adjudications, SEC has already egregiously exceeded the time limits set *by its own rules*, as previously described.

SEC's willful failure to perform the adjudicative duties assigned to it by Congress is unacceptable and has inflicted prolonged financial and reputational harm against Smith and others similarly situated. SEC's refusal to decide Smith's appeal has effectively kept him out of the brokerage industry ever since FINRA imposed its industry bar against him in September 2020—resulting in an irreversible and irremediable suspension against him for the past three and a half years (and counting) without any official SEC imprimatur—because FINRA sanctions *are not stayed during the pendency of an appeal to SEC*. *See* 15 U.S.C. § 78s(d)(2); 17 C.F.R. § 201.420(d). Likewise, throughout the pendency of his appeal to SEC, any company of which Smith is or becomes a director, executive officer, general partner, managing member, or greater than 20 percent owner is automatically disqualified from raising capital through securities offerings in reliance on certain commonly

used registration exemptions, such as private placements under SEC Regulations A and D. *See* 17 C.F.R. §§ 230.262(a), 230.506(d)(1)(vi).

SEC's inaction has also placed Smith in a perpetual state of anxiety and limbo—publicly branded by FINRA as a fraudster, unable as a practical matter to work in the securities industry, unable to achieve finality and repose with respect to FINRA's accusations, and unable to obtain vindication or judicial review on the merits of his aging case because SEC willfully refuses to issue an appealable final order. SEC's interminable delay in deciding Smith's case is especially troubling because he contends, among other things, that FINRA had no legitimate regulatory jurisdiction over him in the first place, yet the reputational and financial damage and economic restrictions resulting and from FINRA's *ultra vires* exercise of such jurisdiction persists unabated.

SEC's dithering is also depriving Smith of his constitutional and statutory rights to a fair and timely adjudication. "[a] fair trial in a fair tribunal is a basic requirement of due process," *Caperton v. A.T. Massey Coal Co.*, 556 U.S. 868, 876 (2009) (quoting *In re Murchison*, 349 U.S. 133, 136 (1955)), as well as an "inexorable safeguard" of individual liberty, *Ohio Bell Tel. Co. v. Pub. Utils. Comm'n of Ohio*, 301 U.S. 292, 304 (1937) (quoting *St. Joseph Stock Yards Co. v. United States*, 298 U.S. 38, 73 (1936)). The Exchange Act similarly demands that FINRA disciplinary proceedings provide a "fair procedure." 15 U.S.C. § 78o-

3(b)(8). As SEC itself has acknowledged when rebuking the securities industry self-regulatory adjudicators it oversees, unreasonably delayed regulatory enforcement proceedings deprive the accused of a fundamentally fair process. *See Jeffrey Ainley Hayden*, SEC Admin. Proc. File No. 3-9649, Securities Exchange Act Release No. 42772, 2000 WL 649146, at *2 (May 11, 2000) (dismissing New York Stock Exchange disciplinary sanctions, imposed after five years of combined investigation and adjudication based on aged conduct, because "[w]e believe that the delay in the underlying proceedings was inherently unfair"); *accord Dep't of Enf't v. Morgan Stanley DW Inc.*, No. CAF000045, 2002 NASD Discip. LEXIS 11, at *39 (NASD Nat'l Adjudicatory Council July 29, 2002) ("Based on the totality of circumstances, including the length of delay [more than five years of combined investigation and adjudication based on aged conduct] and harm to the respondents, we dismiss this action as being inherently unfair.").

SEC is also violating the APA's command that an agency "shall proceed to conclude a matter presented to it" within a "reasonable time" and without undue delay. 5 U.S.C. §§ 555(b),706(1). The egregious delay in Smith's case likewise contravenes Rule 900(a)(1) of SEC's own Rules of Practice which, as previously noted, codifies an expectation that appeals from FINRA disciplinary sanctions will "ordinarily" be decided no later than ten months after completion of briefing, even in the most complex cases. 17 C.F.R. § 201.900(a)(1)(iii).

Here, as noted above, SEC's defiance of its own rule is not measured in mere days or even weeks. Nearly *36 months* have already passed since completion of briefing in Smith's appeal, and that's ignoring the five years of FINRA examination, investigation, and administrative litigation that preceded Smith's appeal to SEC. Enabled by nine successive perfunctory orders extending its time to decide Smith's appeal, SEC has already taken *more than triple* the post-briefing decision time set forth in its own rule, *with no end in sight*.

The most appropriate and effective remedy for SEC's willful refusal to act is a writ of mandamus compelling SEC to set aside FINRA's disciplinary decision with prejudice. Exchange Act § 19(e)(1)(B) mandates that if, on an appeal from a FINRA disciplinary sanction, SEC does not make findings that (1) the appellant committed the violations alleged by FINRA and (2) that FINRA applied the relevant laws and rules in a manner consistent with the purposes of the Exchange Act, SEC "*shall*, by order, set aside the sanction imposed." 15 U.S.C. § 78s(e)(1)(B) (emphasis added). Here, SEC has made neither of these findings despite having had Smith's case on its docket for more than three years and fully briefed since March 2021, so this Court should issue a writ that compels SEC to obey the non-discretionary statutory command of § 19(e)(1)(B) and set aside FINRA's disciplinary decision and sanctions. In the alternative, at minimum the writ should compel SEC to issue a final decision in Smith's appeal within a fixed period of no more than 30 days so

that, if Smith is aggrieved by that decision, he can finally get his day in a real court after all these years stuck in interminable regulatory limbo.

CONCLUSION

Smith respectfully requests that the Court declare unconstitutional and unlawful SEC's ongoing refusal to decide his appeal from FINRA's disciplinary decision against him. In addition, Smith asks the Court to: (1) issue a writ of mandamus that compels SEC to set aside FINRA's disciplinary decision; or (2) in the alternative, issue a writ of mandamus that compels SEC to issue a final decision in Smith's appeal within a fixed time period of no more than 30 days after issuance of the writ.

March 6, 2024

Respectfully submitted,

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CERTIFICATE OF SERVICE

This petition and the accompanying appendix will be served on the following respondents pursuant to Fed. R. App. P. 21(c) via first-class mail, return receipt requested:

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CERTIFICATE OF COMPLIANCE

This petition complies with: (1) the type-volume limitation of Federal Rule of Appellate Procedure 21(d) because it contains 4237 words, excluding the parts of the petition exempted by Rule 32(f); and (2) the typeface requirements of Rule 32(a)(5) and the type style requirements of Rule 32(a)(6) because it has been prepared in a proportionally spaced typeface (14-point Times New Roman) using Microsoft Word (the same program used to calculate the word count).

/s/Russell G. Ryan
Russell G. Ryan

No. 24- _____

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PETITIONER'S APPENDIX TO PETITION FOR A WRIT OF MANDAMUS

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INDEX OF EXHIBITS

EXHIBIT A

FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, v. CSSC BROKERAGE SERVICES, INC. (CRD No. 141630), and ERIC S. SMITH, Respondents.	Disciplinary Proceeding No. 2015043646501 Hearing Officer–MC **EXTENDED HEARING PANEL DECISION** January 2, 2019

Respondents Eric S. Smith and CSSC Brokerage Services, Inc., knowingly made misrepresentations and omissions of material facts in connection with the sales of securities, in willful violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, and in violation of FINRA Rules 2020 and 2010. Smith actively engaged in the conduct of the firm's securities business as a representative and a principal without being registered. For his misconduct, Smith is barred from associating with any member firm in any capacity. CSSC Brokerage Services, Inc. is suspended for one year and fined $120,000. Respondents are also ordered to pay restitution of $130,000 plus interest, and hearing costs.

Appearances

For the Complainant: Kathryn S. Gostinger, Esq., Roger J. Kiley, Esq., Christopher M. Burky, Esq., Mark A. Koerner, Esq., and Jeffrey D. Pariser, Esq., Department of Enforcement, Financial Industry Regulatory Authority.

For Respondent Eric S. Smith: Robert Knuts, Esq., Sher Tremonte LLP.

For Respondent CSSC Brokerage Services, Inc.: No appearance.

DECISION

I. Introduction

Respondent Eric S. Smith is the chairman, chief executive officer, and majority owner of Consulting Services Support Corporation ("CSSC"), a financial services company he founded in 1988. CSSC owns several subsidiaries, including a registered investment advisor and insurance services entity. Smith never registered with FINRA and CSSC is not a FINRA member, but its wholly owned brokerage subsidiary, Respondent CSSC Brokerage Services, Inc. ("CSSC B/D" or "Firm"), successfully applied for FINRA membership in 2006.

From 2010 through 2015 ("relevant period"), CSSC encountered significant financial problems. In 2010 Smith and CSSC issued a convertible debenture bond offering ("2010 Bond Offering"), hoping to raise $5 million to satisfy pressing financial obligations. The offering raised $2.45 million. In 2014 Smith and CSSC issued "bridge loan" notes ("2014 Bridge Loan Note Offering") to garner additional funds to cover operational losses. The offering raised approximately $1.1 million. It was not enough. CSSC continued to lose money.

In a further attempt to cope with CSSC's persistent financial deterioration, Smith issued another bridge loan note offering in 2015 ("2015 Bridge Loan Note Offering"). This offering is the subject of the first three causes of action in the Complaint filed by the Department of Enforcement. Those causes of action allege that Smith and CSSC B/D engaged in fraud when offering the 2015 Bridge Loan Notes to prospective investors. The fourth and fifth causes of action allege that Smith engaged in the Firm's securities business and involved himself in the Firm's day-to-day operations in the capacities of representative and principal without registering. Smith's failure to register, the Complaint alleges, caused him and the Firm to violate NASD registration rules and FINRA's ethical conduct rule.

In their Answer, Respondents deny that the Firm had any involvement in the 2015 Bridge Loan Note Offering, and deny any fraudulent conduct. They disclaim participation by Smith in the operation of CSSC B/D's business and deny he was obligated to register as a representative or principal, claiming instead that he was properly exempt from FINRA's registration requirements.

Smith also contests FINRA's jurisdiction over him, insisting that he never engaged in the securities business of CSSC B/D as a representative or principal, and therefore is not subject to FINRA's rules.

Finally, Smith claims that FINRA is estopped from proceeding against him. He bases this claim on the premise that because FINRA conducted examinations of CSSC B/D before 2015—without questioning his role in the Firm's securities business or management—it tacitly conceded that he was exempt from having to register. Thus, he argues, FINRA cannot now charge him for failing to register.

For the reasons given below, the Extended Hearing Panel finds that Respondents engaged in the fraudulent misconduct the Complaint alleges in the first three causes of action. We base this conclusion on the facts established at the hearing, the applicable law, and careful consideration of the parties' arguments at the hearing and in their briefs. We reject Smith's jurisdictional challenge as well as his estoppel claim. Finally, we conclude that the seriousness of Smith's misconduct requires imposing a bar on him and a one-year suspension and fine of $120,000 on CSSC B/D.

II. Respondents

Smith formed CSSC B/D, a wholly owned subsidiary of CSSC, as a Michigan corporation in 2001.[1] The Firm applied for membership as a broker-dealer with NASD in August 2006.[2] It leased space in CSSC's office suite in Troy, Michigan, which it shared with the parent company and its other subsidiaries on the same uncompartmentalized floor.[3] The Firm filed a Form BDW in June 2018, and FINRA terminated its registration in August 2018. Because CSSC B/D was a registered FINRA member when it engaged in the alleged misconduct and when Enforcement filed the Complaint, FINRA maintains jurisdiction over the Firm for the purposes of this disciplinary proceeding pursuant to Article IV of FINRA's By-Laws.

During the relevant period CSSC was the sole owner of CSSC B/D, as well as other subsidiaries, including CSSC Investment Advisory Services, Inc ("CSSC RIA" or "RIA").[4] FINRA's jurisdiction over Smith is discussed below.

III. Origin of the Investigation

FINRA's Member Regulation Department conducted a routine onsite examination of CSSC B/D's main office in Troy, Michigan, and two branch offices in March 2015. The examination led FINRA staff to request production of the offering documents for the 2010 Bond Offering. Because the offering benefitted CSSC, the staff also issued a request for CSSC's general ledgers.[5] The examination report concluded that Smith appeared to be acting as a registered representative and principal of CSSC B/D without being registered. The Firm responded to the findings in mid-September 2015.[6]

It was then that Don Southwick, a recently terminated employee of CSSC, but still a registered broker with the Firm, informed FINRA that two of his customers had complained to him that they had not received interest and principal payments for their investments in bond and

[1] Respondent Smith's Exhibit ("RX")-1, at 31.

[2] RX-1, at 1–22.

[3] Hearing Transcript ("Tr.") 65–66 (Smith).

[4] Tr. 86–87; RX-1, at 69.

[5] Tr. 826–29 (Kerr).

[6] Tr. 833 (Kerr).

bridge loan offerings.[7] One of the customers then contacted FINRA staff directly to complain.[8] These events led FINRA staff to issue additional document requests, to investigate further, and to file a complaint on August 4, 2017.

IV. The Complaint and Answer

The Complaint's first three causes of action focus on CSSC's 2015 Bridge Loan Note Offering. They allege that from June through December 2015, the Firm, through Smith, created and circulated offering documents to prospective investors containing omissions and misrepresentations of material facts.

More specifically, these three causes of action charge that Respondents, fully aware of CSSC's precarious financial condition, including its history of defaulting on principal payments to investors in previous offerings of securities, fraudulently failed to disclose in the 2015 Bridge Loan Note Offering documents that the company owed but could not pay principal due to investors in the 2010 Bond Offering and 2014 Bridge Loan Note Offering.[9] The alleged false representations included the following statements in the 2015 Bridge Loan Note Offering documents:

- CSSC had earned the first half of a million dollar consulting fee for working to form a new bank, and would be paid the balance before the end of the year;[10]
- CSSC had established a relationship with the South Dakota Trust Company ("SDTC"), a national trust company, to become the investment advisor of SDTC's funds, and would earn a substantial fee based on a percentage of assets under management;[11] and
- CSSC had a pending "engagement" with the City of Jacksonville, Florida, which would generate substantial revenue by bringing the Firm an additional $1 billion in assets under management.[12]

The first three causes of action are based on the same facts, alleging the same misrepresentations and omissions of material fact. They differ only in the legal elements required under different statutes and FINRA rules.

The first cause of action charges that Respondents knowingly or recklessly made material misrepresentations and omissions in connection with the sale of a security, in willful violation of

[7] Tr. 834–35 (Kerr).

[8] Tr. 838–39 (Kerr).

[9] Complaint ("Compl.") ¶¶ 39–42.

[10] *Id.* ¶¶ 45–46.

[11] *Id.* ¶¶ 61–65.

[12] *Id.* ¶¶ 66–73.

Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), Rule 10b-5 thereunder, and in violation of FINRA Rules 2020 and 2010.[13]

Enforcement charged the second and third causes of action as alternatives to the first. The second cause of action alleges that Respondents acted negligently when they made the fraudulent misrepresentations and omissions, violating Sections 17(a)(2) and (a)(3) of the Securities Act of 1933 ("Securities Act"), and thereby FINRA Rule 2010.[14] The third cause of action charges Respondents with violating the ethical requirements of FINRA Rule 2010, by failing to adhere to the just and equitable principles of trade that require fair dealing with customers.[15]

The fourth and fifth causes of action focus on Smith's alleged involvement in the securities business of the Firm without being properly registered during the relevant period. The fourth cause alleges that Smith acted as a representative when he solicited investments, starting in 2010 with the 2010 Bond Offering through 2015 with the 2015 Bridge Loan Note Offering. It charges that this activity required Smith to register as a representative, and that his failure to register caused him and the Firm to violate NASD Rule 1031(a) and FINRA Rule 2010.[16]

The fifth cause of action charges Smith with actively engaging in the management of the Firm's securities business without being registered as a principal. He allegedly engaged in this misconduct by, among other things, directing the payment of the Firm's expenses, including salaries, rent, and other costs of doing business; hiring all of the Firm's representatives and managers; supervising certain representatives; and conducting suitability reviews for investments in private offerings sold through the Firm. By these activities, Smith allegedly exercised control and management of the Firm, and he and the Firm violated NASD Rule 1021(a) and FINRA Rule 2010.[17]

In the Answer to the Complaint, CSSC B/D denies being involved in any way in the 2015 Bridge Loan Note Offering. It denies participating in the preparation or dissemination of any of the offering documents. CSSC B/D insists that CSSC, the parent company, handled all aspects of

[13] *Id.* ¶ 89.

[14] *Id.* ¶¶ 90–97.

[15] *Id.* ¶¶ 98–100.

[16] *Id.* ¶¶ 105–107.

[17] *Id.* ¶¶ 112–14.

the offering.[18] Respondents deny violating the registration rules, insisting that Smith was never required to be registered as a representative or a principal.[19]

Smith denies making any false statements or omissions in the 2015 Bridge Loan Note Offering documents. To the contrary he claims he had a reasonable, good-faith basis for believing that all of his representations were factually accurate when he made them.[20] Smith also challenges the allegation that the offering documents were misleading: the representations in them were appropriately qualified and limited. For example, he asserts that his offering documents used terms such as "pending" and "expected" to qualify the descriptions of agreements that "would generate" income to CSSC, alerting potential investors to the speculative nature of the investment. Smith maintains that the representations accurately characterized his then-reasonable expectations of pending initiatives that could have, but ultimately did not, come to fruition.[21] Smith argues the offering documents contained disclosures that sufficiently described CSSC's troubled financial condition, past and current losses, and warned of the risks of loss to potential investors.[22]

V. Smith's Jurisdictional Challenge

As noted, Smith insists that FINRA lacks jurisdiction over him and consequently the Panel must dismiss the Complaint in its entirety.

Because of the dispositive nature of this issue, we address it first. We begin by focusing on the facts alleged in the fourth and fifth causes of action concerning Smith's alleged involvement in the Firm's securities business in capacities requiring him to register both as a representative and as a principal. Enforcement's ability to prove the facts underlying these allegations determines whether Smith's jurisdictional challenge must be sustained or rejected.

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[18] Enforcement filed the Complaint on August 4, 2017. Counsel then representing both Respondents filed the Answer on their behalf on August 31. The Hearing Officer issued a Case Management Order on September 12. Enforcement provided discovery and the parties prepared for the hearing, set for two weeks, beginning on April 30, 2018. On February 27, 2018, Respondents' counsel filed a motion to withdraw. The Hearing Officer granted it on March 2. On March 15, present counsel filed his appearance on behalf of Respondent Smith only, representing that the Firm was unable to afford representation at the hearing. At his request, the extended hearing was postponed to June 18, 2018. No one appeared on behalf of the Firm at the hearing.

[19] Answer ("Ans.") ¶¶ 107, 114.

[20] *Id.* ¶ 57.

[21] *Id.* ¶¶ 66–68, 70–73.

[22] *Id.* ¶ 3.

A. Facts

1. CSSC B/D's New Member Application and Smith's Application for Exempt Status

Smith founded CSSC and is its chairman, CEO, and majority shareholder. CSSC is the parent company of CSSC B/D, a wholly owned subsidiary, as well as other wholly owned entities.[23] In August 2006, CSSC B/D filed a New Member Application Form ("Form NMA").[24]

The Form NMA refers applicants to NASD rules governing membership, registration, and qualification requirements.[25] It directs applicants to describe the "duties and responsibilities of any non-registered officers, directors, owners, and control persons." In addition, it requires applicants to submit attestations from associated persons who wish to be exempt from the requirement of registering. Such persons must affirm in writing that they "will not participate in the day-to-day securities operations of the Applicant or act in any capacity that would require that these individuals become registered." The Form NMA contains sample draft attestations.[26]

CSSC B/D's Form NMA provided no description of Smith's "duties and responsibilities."[27] With the Form NMA, Smith submitted a letter attesting that, pursuant to NASD Rule 1060, he was exempt from registering.[28] Smith specifically stated that he understood he would be "permitted to be exempt from NASD securities registration requirements, without having to register either as a registered representative or as a principal" as long as he was "not actively engaged in the management of the Firm's securities business, including the supervision, solicitation, [and] conduct of business." He concluded by acknowledging his understanding that he could not "become active in the Firm's securities business" without registering "as both an appropriately registered representative and principal as outlined in NASD Rules 1020-1032."[29]

In a memorandum written during the Firm's application process, CSSC B/D's then-president responded to FINRA's request for a "detailed description" of Smith's "duties and responsibilities" at CSSC and its subsidiaries. He wrote: "Mr. Smith has no role as an officer in any of the [CSSC's] subsidiaries . . . Mr. Smith has delegated the operation of all brokerage related activities to staff and has no intention or time to become involved in the day-to-day operations of that portion of the Company's business activities."[30] The memorandum did,

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[23] Tr. 54–57 (Smith).

[24] RX-1, at 1–22.

[25] RX-1, at 5.

[26] RX-1, at 5.

[27] RX-1, at 5.

[28] Tr. 58 (Smith); RX-1, at 81.

[29] RX-1, at 81.

[30] RX-3, at 2.

however, state that Smith had assumed "primary responsibility" for hiring new registered representatives.[31]

The extent to which Smith involved himself in the securities business of the Firm provides the basis for determining whether he should have registered as a principal and representative. We therefore now examine the evidence of his participation in the Firm's securities business.

2. The Offerings

a. The 2010 Bond Offering

By 2009, CSSC had experienced a number of financial adversities. In response, Smith set out to raise $5 million in much-needed cash. Through CSSC, he issued the 2010 Bond Offering to put the company on a sound financial footing. He hoped to use the funds raised to retire short-term company debts of $1,400,000; pay $100,000 to redeem a bond purchased by an investor in 2009; pay $160,000 in salaries owed to company employees; and pay $140,000 for legal expenses incurred defending lawsuits filed by former employees.[32]

The principal offering document, a self-described "Offering Circular," required minimum investments of $10,000. The bonds matured five years from the date of purchase, offered interest at eight percent per year, and permitted buyers to convert all or part of their bonds to CSSC common stock.[33]

The Offering Circular stated that CSSC did not intend to involve affiliated registered representatives as agents to sell the bonds, and no brokerage commissions or fees would be paid to them.[34] The Firm's co-presidents, Jennifer LaRose and Alex Martin, both testified that they understood this when the bonds were issued. Martin testified that CSSC B/D "was not intended to be involved in any way," and explained that was why he and LaRose did not set any guidelines for sales of the bonds by CSSC B/D's registered representatives.[35] LaRose, whom Smith made the Firm's Chief Compliance Officer as well as co-president,[36] testified that the Firm did not supervise the offering, did not review it for possible compliance issues, and did not conduct suitability reviews.[37] Martin testified that he believed the offering was "intended by design to not be a broker-dealer" offering.[38] Initially both Martin and LaRose thought Smith

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[31] RX-3, at 1.

[32] Complainant's Exhibit ("CX")-87, at 42.

[33] CX-87, at 1, 10.

[34] CX-87, at 1, 44.

[35] Tr. 1033 (Martin).

[36] Tr. 1207 (LaRose).

[37] Tr. 124–43 (LaRose).

[38] Tr. 1033–34 (Martin).

would be the only person soliciting investments in the offering on behalf of CSSC.[39] Later, however, they learned that the Firm's registered representatives helped Smith solicit their customers to purchase the bonds.[40]

According to Martin, registered representatives of CSSC B/D who wanted to present customers with copies of the Offering Circular would ask Smith for the documents.[41] For example, Martin testified that he arranged, "probably" through Smith, or CSSC's controller, or someone else at the company, to send the offering materials to his customer, SK.[42] Martin testified that Smith, not he, negotiated the terms of SK's bond purchases, and as a result, SK obtained a ten percent interest rate instead of eight percent.[43] Martin usually referred SK to Smith when the customer had questions.[44] Because Martin spoke with SK frequently, Martin sometimes asked Smith for answers to give SK about the offering.[45] SK invested $375,000 in the 2010 Bond Offering.[46]

LaRose knew that at least two other registered representatives offered the bonds to their customers. One registered representative, Ken Bryant, had a client interested in purchasing CSSC stock when none was available, so the client invested in the 2010 Bond Offering as a way to potentially obtain CSSC stock.[47] LaRose also found that some investors purchased bonds with funds from their brokerage accounts.[48] Another registered representative, Don Southwick, introduced the bonds to his clients,[49] who were customers of both the Firm and the RIA.[50] Southwick, who affiliated with CSSC in May 2012,[51] testified that Smith knew some of his clients had significant net worth, and told Southwick the bonds could be made available to them. Smith gave Southwick the bond offering documents to disseminate. The package included an

[39] Tr. 1243 (LaRose), 1030, 1033 (Martin).

[40] Tr. 1243 (LaRose), 1033–34 (Martin).

[41] Tr. 1035, 1037 (Martin).

[42] Tr. 1036–38 (Martin).

[43] Tr. 1041–42 (Martin).

[44] Tr. 1038–39 (Martin).

[45] Tr. 1042–43 (Martin).

[46] Tr. 1039 (Martin).

[47] Tr. 1246–47 (LaRose).

[48] Tr. 1250–51 (LaRose).

[49] Tr. 1243 (LaRose).

[50] Tr. 434 (Southwick).

[51] Tr. 430, 433–34 (Southwick).

offering memorandum, a confidential memorandum, and financial reports. Southwick presented the offering to clients,[52] and personally introduced some of them to Smith.[53]

Southwick testified that Smith and a lawyer he employed supervised the 2010 Bond Offering.[54] Smith and the lawyer coached Southwick on specifically how to introduce the offering. According to Southwick, they instructed him to say that previously Smith had made the bonds available primarily to his family and friends, but if a client were interested, Southwick could ask Smith to make some bonds available for purchase. He was not supposed to describe the details of the offering, but direct clients to contact Smith. Some clients subsequently met personally with Smith, sometimes with Southwick present. Southwick does not recall Smith asking him any questions about the suitability of the bonds for his clients, and does not recall if anyone conducted suitability reviews.[55] Southwick obtained signed customer questionnaires from clients and submitted them to the lawyer or Smith, depending on who was available.[56]

Southwick personally introduced clients to Smith.[57] One, JM, who invested $300,000, was retired and approximately 88 years old when she first invested in the bonds.[58] Southwick introduced JM to Smith when she visited the Troy office.[59] The suitability review section of her customer questionnaire is unsigned.[60]

Other Southwick clients purchased the bonds: DN invested $400,000; JK and PK invested $100,000; DG invested $200,000; SM invested $20,000;[61] and VH invested $200,000. One, customer JK, used retirement funds from his IRA to invest $100,000.[62] Some withdrew funds from their CSSC B/D accounts to make their investments.[63]

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[52] Tr. 647–48 (Southwick).

[53] Tr. 648–49 (Southwick).

[54] Tr. 648 (Southwick).

[55] Tr. 672 (Southwick).

[56] Tr. 666–67 (Southwick).

[57] Tr. 648–49, 653–54 (Southwick).

[58] Tr. 670–71 (Southwick).

[59] Tr. 649, 653 (Southwick).

[60] CX-93, at 5.

[61] Tr. 674–80 (Southwick); CX-98, at 4–5.

[62] Tr. 665–66 (Southwick).

[63] Tr. 1250–51 (LaRose).

For some of Southwick's clients, Smith signed as the recipient of the questionnaire, and as having conducted a suitability review.[64] For others, the questionnaire did not have a signature indicating the completion of a suitability review.[65]

Southwick did not receive compensation for the bond purchases his customers made.[66]

From May 2010 through March 2014, Smith raised $2.45 million,[67] not enough to meet his goal of raising $5 million with the 2010 Bond Offering or to solve the company's financial problems. The CSSC group of entities experienced losses of approximately $803,000 in 2012 and $883,000 in 2013.[68]

b. The 2014 Bridge Loan Note Offering

To address these losses, Smith and CSSC sought to raise additional funds with their 2014 Bridge Loan Note Offering. Smith drafted an offering document titled "Important Memorandum," labeled "Confidential," and directed to "Those who may be considering Making a Bridge Loan to CSSC." The stated purpose of the memorandum was to explain why CSSC was "seeking bridge financing," and it purported to describe the continuing impact of the "catastrophic market downturn in 2008–2009" on CSSC's profitability, resulting in losses and delays in paying affiliated investment advisors and brokers.[69]

Terms of this offering were similar to the 2010 Bond Offering. Like the bonds, the notes were unsecured and yielded eight percent interest. Smith preferred investments—he called them "loans"—of at least $50,000 but would accept lesser amounts if "special circumstances" warranted it. Smith wrote that the offering was not available to the public, but restricted "almost exclusively to friends, family, and those with whom we are currently, or soon expect to be, doing business." This was why, Smith explained, he would gift shares of CSSC common stock to investors. For $100,000, Smith would gift an investor 1,000 shares from his "personal holdings"; investors of larger or smaller amounts would receive proportionately more or fewer shares.[70]

Smith discussed his plan to issue the 2014 Bridge Loan Notes with CSSC's controller, assistant controller, and Southwick. As he had with the 2010 Bond Offering, Smith asked Southwick if he knew of any potential investors.[71] Southwick did, and sold notes in this offering

[64] Tr. 656–58; CX-90, at 5; CX-92, at 5.

[65] CX-91, at 5; CX-93, at 5.

[66] Tr. 666 (Southwick).

[67] CX-98, at 4–5.

[68] Tr. 301–02; CX-46, at 1.

[69] CX-106, at 1.

[70] CX-106, at 3–4.

[71] Tr. 681–82 (Southwick).

to three of his CSSC B/D clients.[72] Southwick received no compensation for the sales.[73] However, Smith made it clear to Southwick that the 2014 Bridge Loan Note Offering was important to provide CSSC with much-needed cash, and Southwick knew that the success of the offering would affect whether Smith could pay his salary.[74]

One customer Southwick approached was the elderly JM, who had earlier invested $300,000 in the 2010 Bond Offering. She made an initial investment of $100,000 in the 2014 Bridge Loan Notes Offering on June 6, 2014.[75] Smith later approached Southwick again about the possibility that JM would be willing to invest more.[76] Southwick testified that he again "made her aware" that the notes were still available.[77] JM subsequently made additional investments, increasing her total investment in the 2014 Bridge Loan Notes Offering to $550,000.[78]

Southwick claimed he did not actually *recommend* that his clients invest in the 2014 Bridge Loan Notes Offering. He testified that Smith told him specifically *not* to recommend the notes to customers but just to make customers "aware" of the offering. If they showed interest, then he was to say he would "see if it could be made available." Southwick referred to this as his "script" and testified that he "pretty much stuck to the script."[79] There were two other clients he "made aware" of the offering and in the end, Southwick's clients were responsible for providing most of the $1.1 million Smith raised through the offering.[80] In a FINRA action in April 2017, Southwick consented to a six-month suspension from association with any FINRA member firm in any capacity for making unsuitable investments in the 2010 Bond Offering and 2014 Bridge Loan Note Offering to his clients without conducting reasonable due diligence, and relying on a script provided by CSSC.[81]

The offering eased but did not cure CSSC's financial ills, or even cover previously delayed payments owed to affiliated brokers and advisors. In a November 19, 2014 memo to CSSC affiliates, Smith announced that although CSSC had been able to send brokerage

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[72] Tr. 683–85, 687, 692–93 (Southwick).

[73] Tr. 666 (Southwick).

[74] Tr. 686 (Southwick).

[75] Tr. 683–84 (Southwick); CX-106, at 12.

[76] Tr. 686 (Southwick).

[77] Tr. 686, 695 (Southwick).

[78] CX-98, at 6.

[79] Tr. 693–94 (Southwick).

[80] CX-98, at 6 (Customers JM, RR and M LLC, and SM). The Panel does not find that there is a distinction between Southwick as a broker, and Smith acting as a broker, "recommending" an investment and making customers "aware" of the opportunity to invest in the bond and note offerings. Under these facts, they clearly acted "to induce or attempt to induce the purchase" of a security under the terms of Section 15(a) of the Exchange Act. *SEC v. Martino*, 255 F. Supp. 2d 268, 283 (S.D.N.Y. 2003).

[81] Tr. 696–97; RX-78 (Southwick).

representatives and insurance affiliates their overdue checks, payments owed to investment advisors had "again been temporarily delayed." In an apparent effort to reassure them, Smith added that he was "pleased to report" that CSSC had obtained "capital commitments" large enough to end "the recurrent late payment."[82] A month later, on December 15, Smith recirculated the November memorandum with an addendum announcing that "[b]rokerage revenue sharing checks" had been mailed, but that payments owed to investment advisors and insurance affiliates had once more been delayed.[83]

c. Smith's Continued Attempts to Address CSSC's and the Firm's Financial Straits

Smith was keenly aware of how CSSC's poor cash flow affected its and its affiliated entities' operations in late 2014 and 2015. In December 2014, when Smith and Southwick were both traveling on business, Smith and CSSC's assistant controller, MD, exchanged email messages about the immediacy of the financial stresses facing CSSC. Smith noted that CSSC had "missed payroll," and he was worried that he and Southwick might be "stranded" because American Express was declining to accept charges Southwick had incurred on the road.[84]

MD responded with an update to Smith about some of the looming financial challenges. She said American Express declined the charges because CSSC's American Express account had been "over 30 days past due for the last 4 months."[85] She informed Smith that CSSC B/D "desperately needs to be paid the $20,000 that it is owed from the RIA for December."[86] She pointed out that CSSC B/D was "only $874 over the notification threshold" at which it would fall below its minimum net capital requirement. MD explained that because CSSC B/D owed CSSC more than $83,000 for December's rent, the Firm would fail to maintain its required level of net capital unless CSSC offset the rent with other revenue. That, however, would leave CSSC again unable to make payroll.[87] In the meantime, MD explained, she would also be unable to make an $11,000 past due payment Smith asked her to send Ken Wheeler, an affiliate with both RIA and brokerage clients, who urgently needed the funds to pay an insurance premium.[88]

Deferring payroll was nothing new for CSSC. As early as 2009–2010, Smith had delayed paying brokerage commission and advisory fee checks, sometimes for more than a year for the

[82] CX-34, at 2.

[83] CX-32.

[84] CX-40, at 5–6.

[85] Tr. 286–87 (Smith); CX-40, at 1.

[86] CX-40, at 2.

[87] Tr. 286–87 (Smith); CX-40, at 2.

[88] Tr. 293 (Smith); CX-40, at 2–3.

advisory fees.[89] CSSC's salaried employees, too, experienced delays in receiving their checks as well as their brokerage commissions and advisory fees.[90]

After completing the 2014 audit of CSSC and its affiliated entities, one of the auditors informed Smith that the audit raised questions about whether CSSC B/D would be "able to continue as a going concern."[91] The auditor summarized some of the "conditions that indicate there could be substantial doubt" about the Firm's future. One was CSSC B/D's financial dependence on the RIA. Although the Firm reported a net profit for the year, this was only because of a change to a compensation agreement by which the RIA provided the Firm with an additional $20,000 per month. Without this, CSSC B/D would have failed to meet its net capital requirement.[92]

Its financial support of the Firm was responsible for the RIA experiencing a net loss—$240,000—for the first time in 2014.[93] The auditor noted that CSSC's group of entities as a whole suffered losses of $803,000 in 2012, $883,000 in 2013, and $944,000 in 2014. He stated that CSSC's consolidated deficit exceeded $10 million as of December 31, 2014, and that CSSC "continues to experience difficulty in meeting its day-to-day obligations without significant outside funding."[94]

In March 2015 CSSC's inability to make interest and principal payments to holders of maturing notes was the focus of a discussion Smith had with CSSC's controller DW, Southwick, and MD.[95] By the start of July CSSC faced principal payments due totaling $655,000: $375,000 owed to 2014 Bridge Loan Notes investors,[96]and $280,000 owed to investors in the 2010 Bond Offering.[97] CSSC could not meet these obligations.

Recognizing CSSC's need for cash, Martin made a one-month loan to CSSC from his own funds of $50,000 at eight percent interest at the end of June 2015. He expected return of the principal in 30 days, but did not receive it.[98] By August 10 he had received only a partial payment of approximately $7,500.[99] Angry, he emailed Smith in late August asking if some of the funds from an "expected wire" to CSSC could be used to "further repayment" of his loan. In

[89] Tr. 872–73 (Wheeler).

[90] Tr. 459 (Southwick), 1026–28 (Martin), 1191–92 (Caudill), 1248–49 (LaRose), 1325–28 (Bryant).

[91] CX-50, at 2–3.

[92] CX-50, at 2.

[93] CX-50, at 2.

[94] CX-50, at 3.

[95] Tr. 231 (Smith), 465, 681 (Southwick).

[96] CX-98, at 6.

[97] CX-98, at 4.

[98] Tr. 1088 (Martin).

[99] Tr. 1090 (Martin); CX-78.

the email, he noted that CSSC "affiliate payments have been withheld" leaving him "holding on by a thin thread."[100] Martin did not agree to roll over the loan, and at the time of the hearing, the remainder was still unpaid.[101]

In May and June 2015 principal payments were due to investors in the 2010 Bond Offering and 2014 Bridge Loan Notes Offering. By the end of June CSSC owed $260,000 to investors in the 2010 Bond Offering and $375,000 to investors in the 2014 Bridge Loan Note Offering.[102]

d. The 2015 Bridge Loan Note Offering

i. Smith Created the 2015 Bridge Loan Note Offering Documents

It was in this context that Smith decided to launch the 2015 Bridge Loan Note Offering, essentially a renewal of the 2014 offering. Smith created and disseminated numerous offering documents describing terms he crafted to attract investors. Like the 2014 Bridge Loan Note Offering, this one consisted of unsecured notes maturing one year from the purchase date, paying interest at eight percent. In addition, Smith promised to gift investors 1,000 shares of CSSC common stock for every $100,000 investment, or proportionally more or fewer shares depending on the amount of the bridge loan note purchased.[103]

Smith titled the initial offering document "Confidential Report." Dated June 15, 2015, he first produced it for a CSSC shareholders meeting, and later provided it to potential investors with other offering documents.[104] Smith testified that he supplemented it with what he called an "Important Memorandum" directed to "Those Considering Making a Bridge Loan to CSSC," dated June 22, 2015, which he updated with revisions.[105] The first revision, dated June 22, 2015,[106] was followed by revisions dated July 12,[107] September 9,[108] and November 2, 2015.[109]

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[100] CX-30.

[101] Tr. 1100 (Martin).

[102] CX-98, at 4, 6.

[103] CX-201, at 2.

[104] Tr. 199–200 (Smith); CX-202.

[105] Tr. 201–2 (Smith); CX-201.

[106] Tr. 201 (Smith); CX-201.

[107] Tr. 200 (Smith); CX-203.

[108] Tr. 200 (Smith); CX-204.

[109] Tr. 202 (Smith); CX-206.

ii. Smith Successfully Solicited Four Investors for the 2015 Bridge Loan Note Offering

By his own estimate, Smith personally solicited 15 to 25 people to invest in the 2015 offering.[110] He sent them offering materials that included the "Confidential Report" and the memoranda. Some of the potential investors were registered representatives with CSSC B/D and some were customers whom he had not met but whose names he obtained from representatives. He raised a total of $130,000 from four persons he solicited. Smith maintains that although he solicited their participation in the 2015 Bridge Loan Note Offering, three of them did not purchase one-year bridge loan notes from the offering, but instead merely made shorter term "loans" to CSSC.[111]

(a) Customer TL

The first of the four was customer TL. Smith obtained TL's name from JC, a colleague and mutual acquaintance.[112] On July 21, 2015, early in his promotion of the 2015 Bridge Loan Note Offering,[113] Smith sent an email to TL with the subject line "CSSC's 'Bridge Loan Note' Offering – explanation/package," explaining he was sending "the complete package" of offering documents.[114] Smith wrote that the offering "really was originally designed for friends and family and for those doing business with CSSC," and it was "a great deal." He wrote that he had been "introducing this to one person at a time" and now was "expanding the range of those to whom this is being made available" so he could include TL. Smith claimed to have "successfully placed" $1.35 million in notes and hoped to complete the offering by placing $1.65 million "within the next 30 days," after which he was "not anticipating doing anything like this (individual offerings) again."[115] Smith wrote that he was going to New York City and invited TL to meet. They met at a restaurant and discussed the bridge loan notes. Afterwards, they stayed in contact and spoke again about the 2015 Bridge Loan Note Offering by phone in August.[116]

On August 17, 2015, Smith sent another email to TL. He attached the July 12, 2015 memorandum to prospective investors. TL had asked whether Smith would rescind the gift of promised CSSC stock if he exercised an early payoff of the note. Smith assured TL that he would not, and promised to send a stock certificate and the Note by overnight mail. Smith's efforts were

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[110] Tr. 102 (Smith).

[111] Tr. 135, 137, 143 (Smith).

[112] Smith met JC in early March 2015 and hired him to implement what he referred to as a new approach in marketing financial services through commercial banks in such a way as to satisfy FINRA that the recommendations were suitable. In his June 2015 Confidential Report, Smith introduced JC as "An Important New Addition to the CSSC Team," touted his background, purported accomplishments, and ability to introduce CSSC to his "investment banker contacts," and noted that JC held several FINRA licenses. CX-58, at 24–26.

[113] Tr. 103–4 (Smith).

[114] Tr. 100–102 (Smith); CX-8.

[115] CX-8.

[116] Tr. 1377–81 (Smith).

rewarded on August 24, 2015, when TL invested $50,000 in the 2015 Bridge Loan Note Offering.[117]

It was not until November 2015 that Smith sent the stock certificate to TL. The delay annoyed TL, who emailed JC, complaining that he had been waiting for weeks for Smith to send him the paperwork. TL stated he would refuse to accept delivery of the certificate and wanted a refund because his confidence in Smith was shaken.[118]

In response, professing to be "shocked" by the tone of TL's complaint, Smith informed him that he had "no present ability" to refund TL's investment, although Smith promised he would "be paying off the Notes at the earliest opportunity." In the meantime, Smith pointed out, TL's note was "earning interest at 8%" and Smith had gifted him CSSC common stock.[119]

(b) Thomas Scotto

Smith's second successful solicitation was to Thomas Scotto, a CSSC employee and registered representative of the Firm. Smith urged Scotto to solicit other investors.[120] On July 13, 2015, Smith sent Scotto an email directing him to replace the "Important Memorandum" in the offering package Smith sent earlier with an updated version dated July 12, 2015.[121] Smith urged Scotto to send the updated memorandum to anyone to whom he had given the earlier version. He attached a copy of a PowerPoint presentation he thought "should provide a quick way to introduce us to prospective new investors and others that you think might be good fits for a relationship with us."[122]

Scotto previously invested $215,000 in bond and note purchases, and expressed a need for return of his principal by the end of October 2015. Scotto responded to Smith's new solicitation by investing $20,000. CSSC's general ledger reflects it was deposited on August 31.[123] Smith claims that the $20,000 was not a one-year bridge loan note purchase, but a short-term loan.[124]

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[117] CX-23, at 12; CX-27.

[118] CX-11, at 2.

[119] CX-11, at 1.

[120] Tr. 114 (Smith); CX-25, at 2.

[121] CX-3, at 1. Smith informed Scotto that the earlier version of the "Important Memorandum" did not provide "an accurate or balanced view" of the offering and did not make clear why "someone might consider it beneficial (to them) to participate in the Offering."

[122] CX-3, at 1.

[123] Tr. 115–19 (Smith); CX-23, at 12; CX-107.

[124] Tr. 116, 377 (Smith).

(c) Customer BB

Shortly after Scotto sent the $20,000 check, Smith solicited an investment in the 2015 Loan Note Offering from a college classmate, BB.[125] As with Scotto, Smith urged BB to solicit additional investors. On the afternoon of September 12, 2015, Smith emailed BB with the subject line "FW: CSSC's 'Bridge Loan Note' Offering – explanation/package," similar to the email he sent to TL the previous July.[126] In the email, Smith referred to a conversation he and BB had earlier that day and recapitulated their discussion about the offering not being "applicable" to BB's circumstances. Smith wrote that they would consider alternative ways for BB to become "involved" in the offering. The attachments consisted of the large package of offering documents including, among other documents, two "Confidential Reports" and an "IMPORTANT UPDATE." Smith urged BB to let him know if he—or "others that you believe we should consider including that would be good for us to 'have in the family'"—wanted to "get involved."[127]

Approximately two weeks later, BB sent $10,000 to Smith. In an email exchange between DW and Smith with the subject heading "Noteholders" DW informed Smith that BB's note was one of several that "[t]erms have not been specified for."[128] In response, Smith wrote that it was a "6 month Note."[129]

(d) Gavin Clarkson

The fourth investment in the 2015 Bridge Loan Note Offering described in the Complaint was made by Gavin Clarkson, a licensed investment advisor and broker registered with CSSC since 2012. Clarkson is an attorney who worked with Native American tribes attempting to facilitate release of tribal funds held by the Bureau of Indian Affairs.[130] Smith sent Clarkson an email on October 29, 2015, attaching the "Confidential Report," the "Important Update," a version of the "Memorandum to Those Considering Making a Bridge Loan" that Smith revised just four days earlier, and a promissory note and certificate. The email invited Clarkson personally to invest, and to solicit his tribal contacts for investments. Noting CSSC's "current short-term cash needs," Smith stressed his hope that the bridge loan notes "might indeed be a good 'fit' with you and possibly one or more of your tribal connections—that you and/or some of them will be able to take advantage of the opportunity" to invest.[131]

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[125] Tr. 1385 (Smith).

[126] CX-13.

[127] CX-13, at 1.

[128] CX-28.

[129] CX-27.

[130] Tr. 172–73, 1389–90 (Smith).

[131] CX-16.

Smith continued to communicate with Clarkson. Several days after sending the offering documents, on November 2, 2015, Smith sent Clarkson another email with updates to "two of the principal documents" in the package of offering materials he revised that day, asking Clarkson to "dispose of the earlier versions" and "replace with these."[132]

On November 12, 2015, Smith emailed wiring instructions to Clarkson and wrote that he would "resend the rest of the disclosure package."[133] Fourteen minutes later, Smith did so in an email attachment that included the 2015 Bridge Loan Note Offering documents and, again, the wiring instructions.[134] Clarkson invested $50,000 on November 13, 2015, and in an email to CSSC's controller, as with BB, Smith characterized it as a "6 month Note."[135]

B. Failure to Register

1. Registration as a Representative

a. The Standard

FINRA's By-Laws define an associated person as a "natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by a member, whether or not any such person is registered or exempt from registration."[136]

NASD Rule 1031(a) requires all persons engaged in a member firm's securities business who function as representatives to be registered. Its definition of representative includes all persons associated with a member firm who engage in "supervision, solicitation or conduct of business of securities." Soliciting, recommending, and accepting orders for the purchase of securities are indicia of engaging in the securities business of a firm. Communicating with potential investors to find out if they might make an investment, discussing the particulars of an investment, and recommending an investment, are all activities requiring registration as a representative.[137]

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[132] CX-17.

[133] CX-19.

[134] CX-18.

[135] CX-27.

[136] FINRA By-Laws, Art. I (rr).

[137] *Dep't of Enforcement v. Gallison*, No. C02960001, 1999 NASD Discip. LEXIS 8, at *51 (NAC Feb. 5, 1999) (functions of a representative include, but are not limited to, communicating with members of the public to ascertain interest in investing, recommending securities purchases, discussing the nature of investments, and accepting orders for securities purchases).

b. Discussion

Smith argues that he did not need to register as a representative because he did not engage in "any . . . securities business within or on behalf of CSSC-BD or any other firm."[138] Admittedly, he "participated in the sale of securities by CSSC-Parent, including a 2010 Bond Offering and the 2014-2015 Bridge Loan Note Offering."[139] He claims that when he sold those securities, he did so to raise money solely in his capacity as chairman and CEO of the parent company, not as a CSSC B/D broker. Smith adds there is no evidence he received any transaction-based compensation in connection with his selling of securities.[140]

In response, Enforcement points to the evidence that Smith was "instrumental in marketing and selling" the securities to customers of the Firm whom he and the Firm's brokers solicited.[141]

As reflected in the facts recited above, and admitted by Smith, he actively engaged in the solicitation of investments in all three offerings during the relevant period. Smith created and distributed offering documents to CSSC B/D's customers both personally and through the Firm's brokers. For example, Southwick introduced Smith to Firm customers and Smith scripted solicitations he and Southwick made to raise desperately needed funds for the parent company.

2. Registration as a Principal

a. The Standard

NASD Rule 1021 requires registration of principals, including sole proprietors and partners "actively engaged" in managing a member firm's "investment banking or securities business." Active engagement in a firm's management includes "supervision, solicitation, [and] conduct of business." NASD Rule 1021(a) requires that "all persons engaged or to be engaged in the investment or securities business of a member who are to function as principals shall be registered as such."

NASD Rule 1060, specifically cited by Smith in his attestation letter, allows exemptions from registration that are available to "persons associated with a member" under certain circumstances. Enforcement argues that by filing the attestation letter explicitly pursuant to NASD Rule 1060, Smith acknowledged he was an associated person. By the terms of the rule, one must be an associated person to qualify for an exemption. Furthermore, in his attestation letter Smith agreed to comply with the requirements of Rule 1060, and not actively engage in the

[138] Smith's Initial Post-Hr'g Br., at 12.

[139] *Id.* at 13.

[140] *Id.*

[141] Enforcement's Post-Hr'g Reply Br., at 4.

management of the Firm's securities business without first filing for the appropriate registrations.[142]

To determine whether a person functions as a principal, it is necessary to consider all relevant facts and circumstances bearing on whether the person influences the management of a firm's business affairs. Some indicators of acting in a principal capacity include

- hiring and firing personnel, supervising, controlling and holding an ownership interest in a firm's parent company;[143]
- making financial decisions for the firm, including controlling commission payments to registered representatives and payments to firm vendors;[144]
- presenting oneself as acting on behalf of the firm;[145] and
- being physically present at the firm's office with interaction in meetings with the firm's representatives and principals.[146]

b. Discussion

Smith disputes Enforcement's arguments that he acted as a principal and therefore should have been registered.[147] Smith denies Enforcement's assertion that by submitting his attestation letter with the Firm's Form NMA, he acknowledged he was an associated person subjecting himself to FINRA's jurisdiction. He argues that when he submitted the letter, he was merely complying with FINRA's requirement that an indirect partial owner of an applicant must submit an attestation pursuant to NASD Rule 1060.[148] He cites the lack of a contract empowering him to direct or manage the Firm and its personnel as evidence that he had nothing to do with the management or operation of the Firm.[149]

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[142] RX-1, at 81.

[143] *Dep't of Enforcement v. Gallagher*, No. 2008011701203, 2012 FINRA Discip. LEXIS 61, at *8–11 (NAC Dec. 12, 2012) (These factors "demonstrate . . . [respondent] actively engaged" in a firm's securities business and its day-to-day operations and "consequently, acted as an unregistered principal."); *Dep't of Enforcement v. Harvest Capital Invs., LLC*, No. 2005001305701, 2008 FINRA Discip. LEXIS 45, at *26–27 (NAC Oct. 6, 2008) (citing *Kirk A. Knapp*, 50 S.E.C. 858, 861 (1992) (hiring representatives and principals for a firm, after meeting and discussing scope of employment, are facts to consider in determining if person acted in a principal capacity)).

[144] *Gallagher*, 2012 FINRA Discip. LEXIS 61, at *8.

[145] *Id.*

[146] *Dist. Bus. Conduct Comm. v. Pecaro*, No. C8A960029, 1998 NASD Discip. LEXIS 13, at *19 (NBBC Jan. 7, 1998) (physical presence in firm's office, interaction with principals and representatives, and interactions with clients give appearance of being involved in firm's business).

[147] Smith's Initial Post-Hr'g Br., at 12–13.

[148] Smith's Rebuttal Br., at 14.

[149] *Id.* at 13.

Smith insists that he did not engage actively in the "day to day conduct" of CSSC B/D's "securities business and implementation of corporate policies related to such business."[150] Smith argues further that he did not directly or indirectly control the Firm because he did not own shares of CSSC B/D stock, was not an officer or director, and did not manage the operations of the Firm, but left its management to LaRose and Martin.[151]

As Enforcement notes, the language of NASD Rule 1060 states that associated persons are exempt from registering only if they "are not actively engaged in the investment banking or securities business."[152] Enforcement points out that in his attestation letter Smith explicitly echoed this when he acknowledged that he would be exempt from the registration requirement only "so long as I am not actively engaged in the management of the Firm's securities business, including the supervision, solicitation, conduct of business . . . associated with the Firm."[153]

Enforcement also rejects Smith's claim that he sold securities acting solely in his capacity as chairman and CEO of the parent company, and therefore beyond FINRA's jurisdiction and registration requirements. Enforcement cites a recent SEC decision rejecting a similar challenge to jurisdiction, holding that it did not matter whether the respondent acted in his capacity as a registered representative or as principal of a private fund advisor, because as an associated person he was subject to FINRA's jurisdiction.[154]

3. Smith's Participation in the Business of CSSC B/D

The evidence shows that Smith significantly involved himself in the Firm's day-to-day business operations and influenced the management of CSSC B/D's affairs.

Smith convened weekly meetings that all employees and affiliated persons sharing space in CSSC's office suite attended, including the Firm's registered representatives.[155] And, as previously noted, Smith was responsible for hiring all affiliates who became registered representatives. It was he who made Martin and LaRose co-presidents of the Firm and placed LaRose in the role of co-chief compliance officer in 2008.[156] It was Smith, not they, who recruited, hired, and negotiated details of terms of employment in the affiliation agreements for

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[150] *Id.* at 14–15 (quoting Notice to Members 99-49, NASD Regulation Provides Interpretive Guidance on Registration Requirements (June 1999)).

[151] Smith's Rebuttal Br., at 12–13.

[152] Enforcement's Post-Hr'g Reply Br., at 8 (quoting NASD Rule 1060(a)(2)).

[153] *Id.* (quoting RX-1, at 81).

[154] *Id.* at 9–10 (citing *Louis Ottimo*, Exchange Act Release No. 83555, 2018 SEC LEXIS 1588, at *49 (June 28, 2018)).

[155] Tr. 493, 578–80 (Southwick), 1165 (Caudill).

[156] Tr. 84 (Smith), 1207 (LaRose).

registered representatives Ken Wheeler,[157] Ken Bryant,[158] and Don Southwick.[159] The standard affiliation agreement provided that Smith could terminate the relationship upon a willful failure to comply with his directives.[160] When LaRose left the firm, Smith hired the new chief compliance officer.[161]

Smith exercised authority over the Firm in ways that are consistent with acting in principal capacities, while the Firm's co-presidents did not. For example, Martin conceded in his hearing testimony that people at the Firm may have viewed him as president "in title only," and the amount of "daily hands-on work" he did during his tenure as co-president was "fairly small."[162] When Smith introduced the 2010 Bond Offering, LaRose was unaware of anyone at the Firm reviewing the offering for suitability or compliance issues, even though registered representatives were soliciting customers to invest.[163]

Smith controlled the flow of money from CSSC's RIA to the Firm. It was he who decided to defer payment of salaries, brokerage commissions, and advisory fees,[164] and wrote memoranda in 2013 and 2014 to personnel explaining that their compensation would be deferred, promising better days were coming.[165] When DW and MD, CSSC's controller and assistant controller, needed to address the Firm's lack of operating funds and net capital issues, they did so with Smith, not LaRose and Martin. Smith, not the Firm's co-presidents, gave them directions. Smith told MD which bill payments to prioritize and informed DW he would ensure that the CSSC RIA diverted sufficient funds to the Firm to allow it to maintain its minimum net capital. Similarly, in February 2015, upon completion of the 2014 audit of CSSC B/D when the auditor had to alert the Firm that there was "substantial doubt about the BD's future" and uncertainty over whether it "will be able to continue as a going concern," he notified Smith. It was Smith who responded to the auditor to assuage his alarm, with the same optimistic recitation of his unfounded expectations of imminent profitability expressed in the 2015 Bridge Loan Note Offering documents. Smith informed the auditor:

> [W]e estimate that we could finish this quarter with a net profit of as much as $500,000. We are for instance expecting an installment payment of a portion of a

[157] Tr. 867–69 (Wheeler).

[158] Tr. 1320–24 (Bryant).

[159] Tr. 426–27, 438–39 (Southwick); CX-222.

[160] Tr. 94–96 (Smith); CX-223, at 8.

[161] Tr. 84–85 (Smith).

[162] Tr. 1025–26 (Martin).

[163] Tr. 1242–47 (LaRose).

[164] Tr. 1027 (Martin), 1247–49 (LaRose).

[165] CX-32; CX-33; CX-34.

> $1 million consulting fee–the earned portion and expected payment being $500,000.
>
> The remaining portion of the fee is expected to be earned and paid before the end of the third quarter of 2015. A second, nearly identical consulting engagement, with a total fee of $800,000 is expected to be commence [sic] later in 2015 and a portion of it may also be earned and paid in 2015. Even if corporate earnings from all other operations and operating expenses remained the same ([sic] and overall corporate operating expenses declined from the 1st to the 4th quarter in 2014, fees from this one engagement would be sufficient to make CSSC profitable.[166]

As noted above, Smith solicited and sold investments to CSSC B/D customers directly and through registered representatives.[167] When suitability reviews of CSSC B/D customer purchases of notes were conducted, it was Smith who conducted them.[168]

C. Conclusions

1. Smith Was an Associated Person of CSSC B/D

FINRA broadly defines the role of "associated person" consistent with its mission to protect the public interest[169] and FINRA "has jurisdiction to discipline all associated persons of a member firm."[170]

As Enforcement points out, Smith wrote in the attestation letter he filed with CSSC B/D's Form NMA that he understood he would "be permitted to be exempt" from having to register "so long as [he was] not actively engaged in the management of the Firm's securities business," including supervision and solicitation.[171] Thus, Smith implicitly acknowledged (i) he was associated with CSSC B/D and (ii) was subject to the requirement that he register if he actively engaged in the management of the Firm's securities business. As Rule 1060 clearly states, the exemption is available to persons associated with a firm; hence, Smith's application for exemption and his statement of his understanding of how he qualified for the exemption evidenced acknowledgement that he was a person associated with a FINRA member, and subject to FINRA's disciplinary jurisdiction.[172]

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[166] CX-50.

[167] Tr. 1087 (Martin), 1246 (LaRose).

[168] Tr. 73–77 (Smith).

[169] *Dep't of Enforcement v. Hedge Fund Capital Partners, LLC*, No. 2006004122402, 2012 FINRA Discip. LEXIS 42, at *31 (NAC May 1, 2012); *Dist. Bus. Conduct Comm. v. Paramount*, No. C3A940048, 1995 NASD Discip. LEXIS 248, at *12 (DBCC Oct. 20, 1995).

[170] *Ottimo*, 2018 SEC LEXIS 1588, at *49.

[171] RX-1, at 81; Enforcement's Post-Hr'g Reply Br., at 8.

[172] *Ottimo*, 2018 SEC LEXIS 1588, at *49.

2. Smith Acted in the Capacity of a Representative in CSSC B/D's Securities Business

It is not disputed that Smith solicited CSSC B/D customers to invest in CSSC's offerings during the entire relevant period. Smith wrote the offering documents, disseminated them to CSSC B/D brokers, solicited and sold bonds and bridge loan notes through them, and obtained introductions to offer securities personally. He negotiated the terms of sales, offered variations to individuals interested in participating but seeking shorter maturity periods, and even gave one investor a higher interest rate. The SEC has found that persons with far less involvement in a member firm's business than Smith's involvement with CSSC B/D's securities business were sufficiently engaged in the firm's securities business to require registration.[173] The evidence shows that Smith participated in CSSC B/D's securities business as a registered representative, was required to register as such, and is therefore subject to FINRA's jurisdiction.

3. Smith Acted in a Principal Capacity in CSSC B/D's Operation

The evidence establishes that Smith hired and designated Martin and LaRose as co-presidents of the Firm and that in important matters they were answerable directly to him. In addition, despite writing in his attestation letter that he would not do so, Smith exercised both direct and indirect control over CSSC B/D. His indirect control derived from his position as chairman, CEO, and owner of the Firm's parent company, the sole owner of the Firm. Smith demonstrated his direct control over the Firm by possessing and exercising sole authority to hire and fire, select principals, negotiate compensation of Firm personnel, allocate funds from the RIA to the Firm to maintain minimum net capital requirements, and direct registered representatives to solicit sales of bonds and bridge loan notes to Firm customers.

Smith even handled complaints that customers sent to LaRose at the Firm. SM was a customer of the Firm who sent LaRose a written complaint in October 2015. LaRose treated it as a complaint to the Firm, and informed SM that she was looking into it. LaRose took the complaint directly to Smith; he informed LaRose that the principal invested by SM was due but unpaid, and that he would deal with the customer.[174] LaRose wrote SM a second letter, telling her that she should work with CSSC to resolve her problem. Smith told LaRose "he had reached out" to the customer.[175] LaRose had no further contact with SM.[176] Smith then informed LaRose

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[173] *See, e.g.*, *Stephen M. Carter*, 49 S.E.C. 988, 989 (1988) (cashier for firm who performed primarily clerical duties such as receiving and recording checks and securities, but did not buy or sell securities to customers, was sufficiently engaged in the firm's securities business to make him an associated person under the By-Laws and subject to regulatory jurisdiction); *Ottimo*, 2018 SEC LEXIS 1588, at *49 (rejecting claim that FINRA lacked jurisdiction over respondent because he was acting as principal of private fund advisor and not in capacity of registered representative; holding that as an associated person of a member firm, he was subject to FINRA's jurisdiction).

[174] Tr. 1251–53 (LaRose).

[175] Tr. 1261–62 (LaRose).

[176] Tr. 1262 (LaRose).

that he prepared a memo to send to all investors in CSSC's offerings, including the Firm's clients, in anticipation of possible additional complaints.[177]

Thus, we find on the evidence presented that Smith participated in the conduct of the Firm's securities business in the capacity of a principal, and should have been registered as such.[178]

4. Both Smith and the Firm Violated FINRA Registration Rules

We also conclude that Smith and CSSC B/D share culpability for the violations of the registration rules. It is well established that member firms are responsible for misconduct by their agents.[179] Smith acted as an agent of the Firm by soliciting Firm customers to invest in the offerings he promoted. The Firm's co-presidents knew that Smith was acting as a representative by engaging in sales of securities with the Firm's customers during the relevant period.[180] They were also aware Smith acted in the capacity of a principal.

VI. The Fraud Allegations

A. Facts

As described above, Smith drafted and disseminated the 2015 Bridge Loan Note Offering documents to induce potential investors to purchase unsecured promissory notes maturing in twelve months, paying eight percent interest. In addition, for every $100,000 invested, he promised investors a "gift" of 1,000 shares of CSSC common stock from his personal holdings. The omissions and representations he made in the offering documents form the basis for the Complaint's allegations of fraud.

The offering documents Smith created contained, among other papers, an "Important Memorandum" directed to "Those Who May Be Considering Making a Bridge Loan to CSSC." The earliest version is dated June 22, 2015,[181] with later revisions dated July 12,[182] September

[177] Tr. 1260–61 (LaRose).

[178] *Richard F. Kresge*, Exchange Act Release No. 55988, 2007 SEC LEXIS 1407, at *49–50 (June 29, 2007) (frequent presence in firm's office, attendance at meetings with registered representatives, playing a role in office finances, and active involvement in hiring demonstrate acting in capacity of unregistered principal).

[179] *Dep't of Mkt. Regulation v. Yankee Fin. Group*, No. CMS030182, 2006 NASD Discip. LEXIS 21, at *68, 77 (NAC Aug. 4, 2006) (holding firm responsible for failure to register person as representative and principal).

[180] Tr. 1243, 1246–47 (LaRose).

[181] CX-201.

[182] CX-203.

9,[183] October 25,[184] November 2,[185] and December 12, 2015.[186] There were also several versions of a "Confidential Report," dated June 15,[187] September 9,[188] and October 25, 2015.[189] In all iterations, the Important Memorandum and the Confidential Report contained the same allegedly material omissions and repeated similar allegedly material and false representations.

1. The Omissions

The original Important Memorandum and each revision contained a section titled "Risk Factors to be Considered." The section described in general terms the risks that attend "an unsecured loan to a company that is experiencing current cash flow shortfalls," with "a significant amount of risk," and warned that "there is no guarantee" that the expected "significant appreciation in the value of CSSC's common stock" would occur or "the loan will be repaid, with interest, when due."[190] These warnings of risk were appropriate. Smith, as noted earlier, claims they were sufficient to inform prospective investors of CSSC's financial challenges.

However, none of the 2015 offering documents disclosed that, at the time Smith created and began disseminating them, CSSC owed $260,000 in principal and interest to investors in the 2010 Bond Offering and $375,000 in the 2014 Bridge Loan Note Offering.[191]

Smith was clearly aware—even as he solicited investments in the 2015 Bridge Loan Note Offering—of CSSC's inability to pay what it owed to investors.[192] As Enforcement argues, Smith knew he was obligated to disclose this adverse information, having done so in the 2010 Bond Offering materials.[193] In them, he explicitly stated that CSSC had been unable to pay previously issued notes that came due in 2009.[194]

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[183] CX-204.

[184] CX-210.

[185] CX-206.

[186] CX-209.

[187] CX-202.

[188] CX-205.

[189] CX-211.

[190] CX-201, at 3.

[191] CX-98, at 4, 6.

[192] Tr. 265 (Smith).

[193] Enforcement's Post-Hr'g Br., at 8.

[194] CX-87, at 19.

2. The Misrepresentations

a. Project X

i. Southwick's Concept

In a November 19, 2014 memorandum to affiliated brokers, investment advisors, and insurance agents who had not received their RIA "revenue share" checks, Smith sought to explain delays in paying them. In the memorandum, Smith made vague references to infusions of cash that he anticipated receiving and believed would make CSSC profitable for the first time in years. Despite being unable to pay people their earnings, he stated, he was "pleased to report" an imminent "large revenue event . . . produced from our banking initiatives," large enough to cure the "recurrent late payment" of salaries, fees, and commissions. He wrote that he expected "to have these funds in hand . . . well before the close of the year."[195] Later, in February 2015, he explained another delay in paying CSSC RIA and insurance affiliates but further described "the anticipated receipt of the earned portion of a large consulting fee."[196] The "large revenue event" was a "consulting fee" for CSSC's work in creating a special purpose bank, which came to be referred to as "Project X."[197]

In the July 12, 2015 Important Memorandum he distributed early in soliciting investments in the 2015 Bridge Loan Note Offering, Smith touted the special purpose bank as chief among several "important new initiatives." In the section "Important Disclosures in the Accompanying 'Confidential Report,'" Smith wrote: "CSSC is being paid a $1 million consulting fee for its work on the design and formation" of the bank, "the payment of which in 2015 will ensure CSSC's profitability in 2015 and likely make 2015 CSSC's most profitable year so far."[198] In the "Confidential Report," revised in June 2015, accompanying the Important Memorandum, Smith made more detailed claims. He wrote that half of the $1 million consulting fee had already "been earned and should be received very soon." Smith went on to explain that he expected CSSC would receive the other half of the fee when the bank began operating, and that he expected to accomplish this "prior to the 3rd quarter of 2015." Then, Smith continued, CSSC was slated to be paid additional fees for replicating the banks. According to Smith, in 2015 he expected CSSC to be paid $1.4 million—$1 million for creating the first bank and $400,000, half the fee for creating the second bank—from Project X alone.[199]

Southwick conceived of Project X in the fall of 2014. CSSC affiliate and Firm broker Ken Wheeler had approached Southwick for advice on what investments he might recommend to SB, a wealthy, prominent Florida cardiologist who had a large network of contacts with other

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[195] CX-34, at 2.

[196] CX-35, at 2.

[197] Tr. 461–63 (Southwick).

[198] CX-9, at 2–3.

[199] CX-202, at 9–10.

Florida physicians. Wheeler had provided estate planning services for SB. Southwick suggested he could "build a bank" for SB to invest in.[200] Southwick had a banking background and had in 1996 participated in the creation of a nationally chartered special purpose bank. Southwick understood SB to have sufficient wealth to provide the necessary capital to enable the bank to obtain regulatory approval.[201]

According to Southwick, getting approval for the bank would be a "huge, monumental task," and would take one to two years.[202] He suggested calling it Health Pro Bank,[203] and pending its approval, Southwick proposed forming a financial advisory group, Health Pro Bank Financial Services, LLC ("HPB Financial Services"). The bank would affiliate with and generate revenue for CSSC by providing financial services, including insurance and investment recommendations, to SB's network of physicians. Then when the bank was chartered, the advisory group would provide bank customers with financial services, generating additional revenue for the bank and, in turn, CSSC. Southwick hoped he could take the concept to a reputable source of private equity that would invest in the bank, pay CSSC a consulting fee for creating the enterprise, and possibly take an ownership interest in the bank, although he did not know if regulators would approve that.[204]

Southwick testified that he contemplated the consulting fee would be "like a million dollars for the first bank that was up and running," and then CSSC would replicate the structure and charge a reduced consulting fee for each additional bank.[205]

Southwick hoped CSSC would also be able to share ownership of the bank, but did not know whether the bank regulators would approve.[206] He believed that even if the bank ultimately failed to receive a charter, HPB Financial Services would have established itself as a financial services provider for SB's network of physicians.[207]

Wheeler told Southwick that SB liked the idea,[208] had expressed "extreme excitement,"[209] and was "very interested in building a bank."[210] Because SB insisted on keeping

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[200] Tr. 478–480 (Southwick).

[201] Tr. 484 (Southwick).

[202] Tr. 486, 490–91, 505–6 (Southwick).

[203] Tr. 485 (Southwick).

[204] Tr. 494–96 (Southwick).

[205] Tr. 496 (Southwick).

[206] Tr. 496–97, 505 (Southwick).

[207] Tr. 507–8 (Southwick).

[208] Tr. 480 (Southwick).

[209] Tr. 482 (Southwick).

[210] Tr. 486–87 (Southwick).

the project confidential, at Wheeler's suggestion Southwick decided to call the endeavor "Project X." Wheeler also informed Southwick that he alone would handle contact with SB.[211]

Soon after his initial discussions with Wheeler, Southwick told Smith about Project X, and briefed him on the "progress" of the project thereafter.[212]

Southwick explained that the bank's charter would have to be approved by the Office of the Comptroller of the Currency ("OCC") as well as other bank regulators.[213] He contacted a lawyer from the Chicago law firm he had worked with to establish the special purpose bank in 1996, to ask for legal guidance in creating Health Pro Bank and HPB Financial Services. In early November 2014, Southwick informed Wheeler that he would soon send him "work product" from the law firm, the OCC, and a major private equity firm, that he hoped to involve in financing the bank.[214]

Southwick prepared several slides for a November 11, 2014 presentation to a weekly meeting of all of the CSSC affiliates in the Troy, Michigan office, to inform them about Project X, as well as other prospective sources of revenue for CSSC. The presentation described Project X as creating a nationally chartered private purpose bank that would produce consulting fees for CSSC, and provide an opportunity for CSSC to obtain equity in the bank. It identified lawyers from the law firm and individuals employed at the equity firm and OCC who would be involved.[215]

ii. Smith's Claims about Project X

In truth, as Southwick testified, virtually all of this was suppositional, "not firm."[216] He had no idea if bank regulators would allow CSSC or the equity firm to share ownership in the bank; no information on whether the project would receive OCC approval; had not spoken to and knew none of the OCC officials he listed, having obtained their names from public records; and had not yet attempted to contact individuals at the private equity firm or made a proposal to them.[217] A reference to $200 million in assets, and a consulting fee of $1 million "initially paid

[211] Tr. 482–83 (Southwick).

[212] Tr. 486–87, 516 (Southwick).

[213] Tr. 490–93 (Southwick).

[214] Tr. 487–490 (Southwick); CX-225.

[215] Tr. 491–93 (Southwick); CX-224, at 9–12.

[216] Tr. 496 (Southwick).

[217] Tr. 496–99 (Southwick). Southwick testified that around early March 2015, prior to a meeting about Project X at the Chicago law firm, he spoke by telephone with a representative of the private equity firm and attempted to explain Project X, but the representative told him he was not interested. When Southwick called a second time, the representative hung up on Southwick. Tr. 527–28 (Southwick).

up front with [equity firm] funds" was, Southwick testified, "prospective" only—no consulting agreement existed.[218]

Nevertheless, starting with the June 15, 2015 revision of the Confidential Report, Smith represented to prospective investors that Southwick was "in the final stages of creating a '*Special Purpose Bank*' to exclusively serve the medical/dental/healthcare communities" and had "brought one of the largest law firms in the country together with a large private equity firm to work in conjunction with the Office of the Comptroller of the Currency." Smith claimed, "CSSC is being paid a $1 million consulting fee" for forming the bank, and "half of that fee has now been earned" with the rest "due and payable when the new bank opens its doors for business, an event we expect to occur prior to the end of the 3rd quarter of 2015." He wrote that CSSC would be paid an additional $400,000 for consulting services in establishing a second special purpose bank, and he expected CSSC to be paid "$1.4 million in 2015."[219]

In stark contrast, Wheeler testified that in June 2015 the special purpose bank was far from being in "the final stages" of being established. There was no arrangement for a consulting fee to be paid to CSSC for the project. Furthermore, there was no work done or contemplated for a second bank. Wheeler described Smith's characterizations as "delusional."[220]

At the hearing, Smith admitted that he never saw any evidence of an agreement by which CSSC would be paid a $1 million consulting fee, and he did not know what would have to be accomplished for CSSC to be paid half a million dollars. All he had was an "expectation" that CSSC would be paid, based on what Southwick told him.[221] And when he asked Southwick for evidence documenting the commitment that CSSC would be paid, Southwick never provided any.[222]

And Smith needed documentation. He was trying to place $1.6 million in 2015 Bridge Loan Notes with a wealthy potential investor who insisted that first Smith produce a copy of a written commitment by HPB Financial Services that CSSC would provide it with financial services.[223] In August Smith told Southwick he needed the documentation. When Southwick said he did not have it, Smith had Southwick, in Smith's presence, call the lawyer Southwick knew at the law firm and ask him for the agreement. The lawyer replied that there was no agreement, and that HPB Financial Services had not been formed.[224]

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[218] Tr. 503–4 (Southwick).

[219] CX-58, at 18–19.

[220] Tr. 896–900, 908 (Wheeler).

[221] Tr. 316–17 (Smith).

[222] Tr. 322–25 (Smith).

[223] Tr. 329–30, 332, 334 (Smith); CX-79; CX-81.

[224] Tr. 327–30 (Smith), 1117–18 (Martin).

Despite knowing this, Smith continued to assure his potential investor that written confirmation of the commitment was forthcoming. Smith wrote him that the "bank is nearing completion" and the document confirming that CSSC would provide "the investment advisory and brokerage platform" to HPB Financial Services would be executed "very soon since meetings with the perspective (sic) investors began, financial services introductions have already been set."[225] Finally, in September 2015, the investor informed Smith that he would "pass" on the investment opportunity, and asked, "please do not contact me again."[226]

In their testimony, the co-presidents of CSSC B/D indicated they had no inkling that CSSC was about to receive a million dollar consulting fee. LaRose referred to Project X as "a fluid project," not sufficiently underway for her to even review it as an outside business activity for Martin, who was supposed to take a significant position in HPB Financial Services.[227] Similarly, based on what Southwick, who was spearheading Project X, said in his presentations at weekly meetings, the undertaking was just the subject of "early-on discussions" and there was little talk of raising capital until August 2015.[228] According to Martin, in the spring of 2015 when Smith asked him if he had seen any documentation regarding the consulting fee, he told Smith he had not seen anything.[229]

As discussed above, the first two investors in the 2015 Bridge Loan Note Offering, TL and Scotto, made their investments in August 2015, after receiving offering materials that included the July 12 version of the memorandum to potential investors. The last two, BB and Clarkson, made their investments after Smith had fired Southwick on September 8, 2015. On September 9, Smith revised two of the offering documents, the Important Memorandum[230] and Confidential Report.[231] In them, Smith stated that progress on Project X had been "unexpectedly interrupted," the revenue he had represented as already having been earned "may not materialize until 2016, if at all,"[232] and that the interruption, caused by a "plan to deprive" CSSC of "an expected $2.15 million," meant that the special purpose bank revenue "now appears unlikely to take place within the 4th quarter of 2015."[233] Nonetheless, on September 12, Smith sent BB a package of materials that included the June 15 Confidential Report describing the likely receipt of revenue from Project X.[234] And on October 29, Smith sent an email to Clarkson continuing to

[225] Tr. 332–34 (Smith).

[226] Tr. 208–10, 269 (Smith); CX-213, at 206.

[227] Tr. 1309–10 (LaRose).

[228] Tr. 1226–28 (LaRose).

[229] Tr. 1063 (Martin).

[230] CX-204.

[231] CX-205.

[232] CX-204, at 3.

[233] CX-205, at 6.

[234] CX-13, at 1, 10.

solicit him and his "tribal connections" to invest in the 2015 Bridge Loan Note Offering.[235] Although the updated offering materials accompanying the email included the disclosure that Project X had been "unexpectedly interrupted,"[236] they continued to make other false claims about projected large increases in revenues to CSSC.[237]

b. The South Dakota Trust Company

In the 2015 Confidential Report, Smith also touted "two new service offerings that we believe have tremendous revenue production potential in the months and years ahead."[238] He claimed that he and Southwick had "been active in the formation of an important new strategic alliance with South Dakota Trust Company." He stated that Southwick was helping SDTC create "new investment funds that are known as 'common and collective trust funds'" that "only a trust company can create and administer." He asserted, "CSSC will be the investment advisor" for the funds and "will earn a fee based on a percentage of the assets under management." He wrote that he personally was working on "the creation of a client referral relationship" by which SDTC would refer clients to CSSC to provide services. He asserted that CSSC expected to have the "new revenue sources" from this relationship "up and running" before the end of the year.[239]

On March 3, 2015, he and Southwick met in New York with representatives of SDTC. That meeting did not produce an agreement between SDTC and CSSC, and as of June 2015, no understanding—that CSSC would advise SDTC in administering new "common and collective trust funds" it helped SDTC to create—existed.[240] Southwick unsuccessfully pursued a follow-up meeting with SDTC representatives until Smith fired him.[241] Smith thus knew before he distributed the June 2015 Confidential Report that there was no basis for him to represent that CSSC was about to become the advisor for any trust funds at SDTC or was about to establish a client referral relationship with SDTC.[242]

c. The City of Jacksonville

Smith made representations in the 2015 Bridge Loan Note Offering documents about another project that he claimed was about to lead to important new revenue streams for CSSC. It was a "pending engagement with the City of Jacksonville, Florida." Smith represented that CSSC was "in the final stages of being engaged as a Special Reviewing Consultant with regard to the investment management of Jacksonville's nearly $1 billion in short-term operating funds."

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[235] CX-16, at 1.

[236] CX-16, at 8–9.

[237] CX-16, at 7–8.

[238] CX-58, at 20–21.

[239] CX-58, at 19.

[240] Tr. 630–35 (Southwick).

[241] Tr. 636–38 (Southwick).

[242] Tr. 132–33 (Smith).

Smith claimed that this engagement, about to be finalized, would increase CSSC's "reportable assets under management by nearly $1 billion." [243]

As with the other supposedly promising projects, it was Southwick who was primarily responsible for pursuing the possibility of obtaining the city as a client. His idea was for CSSC to review and monitor the city's investments, and he arranged to meet with a city official. He offered CSSC's services to manage one or more of the city's investment pools, or act as a consultant by analyzing the city's investment strategies and making recommendations. According to Southwick, the city showed some interest, but it was on a scale considerably less grand than Smith described in the offering documents. In his November 2014 slide presentation to CSSC's weekly staff meeting, Southwick estimated that CSSC might earn a quarterly fee of $40,000, not for managing assets but for providing limited consulting services.[244]

In April 2015 the city informed Southwick that it was not interested in CSSC's original proposal.[245] Southwick testified that he continued to pursue a relationship with the City of Jacksonville and kept Smith informed of his efforts.[246] In July 2015, Smith drafted a proposal to perform consulting services, not managing assets but evaluating the performance of the city's asset managers. The proposal called for the city to pay CSSC $15,000 per quarter, a level of compensation based on what the city indicated it was willing to pay. Southwick sent the proposal to the city on July 27, but received no response.[247] The deal never materialized.[248]

B. Conclusions of Law

1. Elements of Fraud in Violation of Exchange Act Section 10(b) Rule 10b-5 thereunder, and FINRA Rules 2020 and 2010

To prove the allegations in the first cause of action that Smith and the Firm violated Exchange Act Section 10(b) and Rule 10b-5 thereunder, Enforcement must establish by a preponderance of the evidence that Smith and CSSC B/D, through Smith, made[249]

- a misrepresentation or omission of a material fact;
- in connection with the purchase or sale of a security;
- with scienter;

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[243] CX-58, at 21.

[244] Tr. 589–93 (Southwick).

[245] Tr. 597 (Southwick).

[246] Tr. 598–99 (Southwick).

[247] CX-246, at 12–13; Tr. 607–11, 614–15 (Southwick).

[248] Tr. 624 (Southwick).

[249] *Mitchell H. Fillet*, Exchange Act Release No. 75054, 2015 SEC LEXIS 2142, at *18 (May 27, 2015).

- using the instrumentalities of interstate commerce.[250]

To prove its allegations that Respondents committed fraud in violation of FINRA Rule 2020, also charged in the first cause of action, Enforcement must show by a preponderance of the evidence that Respondents effected transactions or induced the purchase or sale of a security by using a manipulative, deceptive, or fraudulent device. Proof of these violations also establishes violations of the ethical standards imposed by FINRA Rule 2010.[251]

a. Materiality of Omissions and Misrepresentations of Fact

Materiality must be determined by analysis of the particular facts of a case.[252] The standard for determining materiality of a fact is an objective one.[253] The test is whether there is a substantial likelihood that a reasonable investor would consider the misstated or omitted fact to be important in making an investment decision,[254] that is, whether it would alter the "total mix" of information available to evaluate the risk of a prospective investment.[255]

While Smith acknowledges this well-established definition of materiality,[256] he argues that Enforcement failed to prove that his alleged factual omissions and representations in the 2015 Bridge Loan Note Offering documents were material.[257] He contends that Enforcement must present evidence from the four persons who invested in the 2015 Bridge Loan Notes Offering[258] to establish the materiality of any representations or omissions. He insists that Enforcement's burden is to prove, through testimony of customers or experts, that those who received the offering materials "considered the alleged misstatements and/or omissions . . . to be a significant factor in their investment decisions." Smith complains that Enforcement did not present customer or expert testimony concerning the potential materiality of the omissions and misrepresentations.[259]

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[250] *SEC v. Platforms Wireless Int'l Corp.*, 617 F.3d 1072, 1092 (9th Cir. 2010); *SEC v. Wolfson*, 539 F.3d 1249, 1256 (10th Cir. 2008) (citing *Geman v. SEC*, 334 F.3d 1183, 1192 (10th Cir. 2003)).

[251] A violation of a FINRA rule is inconsistent with just and equitable principles of trade; thus, it also violates Rule 2010. *See, e.g.*, *John Edward Mullins*, Exchange Act Release No. 66373, 2012 SEC LEXIS 464, at *44 n.45 (Feb. 10, 2012).

[252] *Basic Inc. v. Levinson*, 485 U.S. 224, 238–39 (1988).

[253] *Worlds of Wonder Sec. Litig*., 1992 U.S. Dist. LEXIS 10503, at *12, 14 (N.D. Cal. July 9, 1992) ("Under the federal securities laws, materiality is determined by an objective standard: the hypothetical 'reasonable investor' is the yardstick used to measure materiality . . . and it is for the trier of fact to decide whether defendants' omissions were, in fact, material.") (citing *Basic*, 485 U.S. at 231).

[254] *United States v. Litvak*, 889 F.3d 56, 89 (2d Cir. 2018).

[255] *Basic*, 485 U.S. at 231–32 (1988) (quoting *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)).

[256] Smith's Rebuttal Br., at 3.

[257] Smith's Initial Post-Hr'g Br., at 13–14.

[258] Smith's Rebuttal Br., at 6–7.

[259] Smith's Initial Post-Hr'g Br., at 13–14; Smith's Rebuttal Br., at 3–4.

Smith's protestations are ill founded. Although Smith concedes that actual reliance by a customer is unnecessary, he seems to insist on the functional equivalent of proof of reliance by demanding "actual, competent evidence that the alleged misrepresentations or omissions were material."[260] But proof establishing materiality does not require testimony of individual customers that a representation or omission was important and substantially altered the total mix of information to be weighed.[261]

It is well established that statements and omissions relating to the financial condition of a company are material.[262] "False claims of substantial unearned revenue" are material.[263] In this case, Smith claimed in the 2015 Bridge Loan Note Offering materials with strong positive representations that, because of the consulting fee from Project X and the agreements with the City of Jacksonville and SDTC that were being "finalized," 2015 would be the most profitable year in CSSC's history. Smith knew potential investors would be reassured by these positive prospects and feel more confident that they would receive the promised interest and principal on maturity of the notes. But because Smith's predictions were unsubstantiated, and because he knew they had no sound factual basis, they were misrepresentations of material fact within the meaning of Section 10(b) and Rule 10b-5.[264]

Similarly, Smith's failure to disclose that CSSC had been unable to repay principal owed to investors in the prior bond and bridge loan offerings was a material omission in the 2015 Bridge Loan Note Offering documents, and violated his obligation to "disclose material adverse facts" known to him.[265]

The Panel concludes that reasonable investors would have considered the claims Smith, and through him the Firm, made about large, imminent expected revenues, and his omissions about CSSC's failure to make interest and overdue principal repayments to previous investors, to be material. Smith and the Firm breached their obligation to be truthful and not mislead potential investors.[266]

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[260] Smith's Rebuttal Br., at 3.

[261] *Dep't of Enforcement v. Jordan*, No. 2005001919501, 2009 FINRA Discip. LEXIS 15, at *17 n.7 (NAC Aug. 21, 2009) (citing *RichMark Capital Corp*., Exchange Act Release No. 48758, 2003 SEC LEXIS 2680, at *15 (Nov. 7, 2003), *aff'd*, 86 F. App'x 744 (5th Cir. 2004)).

[262] *SEC v. Todd*, 642 F.3d 1207, 1220–21 (9th Cir. 2011) ("Information regarding a company's financial condition is material to investment" and "how officers . . . describe revenue growth to investors is important.").

[263] *SEC v. USA Real Estate Fund 1, Inc.*, 30 F. Supp. 3d 1026, 1034 (E.D. Wash. 2014).

[264] *Marx v. Computer Sciences Corp.*, 507 F.2d 485, 489 (9th Cir. 1974) (citing *G & M, Inc. v. Newbern*, 488 F.2d 742, 745–46 (9th Cir. 1973) (prediction without sound factual or historical basis is actionable)).

[265] *Dep't of Enforcement v. McGee*, No. 2012034389202, 2016 FINRA Discip. LEXIS 33, at *25–26 (NAC July 18, 2016), *petition for rev. denied*, 733 Fed. Appx. 571 (2d Cir. 2018).

[266] *Ottimo*, 2018 SEC LEXIS 1588, at *31.

b. In Connection with the Purchase of Securities

Smith created and disseminated the 2015 Bridge Loan Note Offering documents to prospective investors with the specific purpose of attracting investments to raise funds for CSSC. Section 10(b) requires that fraudulent omissions and misrepresentations must be "in connection with" a securities transaction. The requirement is to be liberally construed, however. It is met when the evidence shows, as it does here, the omissions or misrepresentations are contained in documents disseminated to investors that are designed to persuade them to purchase a security.[267]

i. Smith's Characterization of the 2015 Bridge Loan Note Transactions

There is no dispute, and Smith concedes, that customer TL invested $50,000 in the 2015 Bridge Loan Note Offering, and was, as Smith wrote in an email to him about his investment, a "Note holder."[268] However, Smith argues that the other three participants in the 2015 Bridge Loan Note Offering—Scotto, Clarkson, and customer BB—did not invest in securities when they "participated" in the 2015 Bridge Loan Note Offering,[269] but simply loaned money to CSSC.[270]

In light of Smith's contentions, it is appropriate to examine the nature of the notes in the context of the definitions of securities in the securities acts and case law.

ii. Discussion

As discussed previously, the 2015 Bridge Loan Note Offering provided investors with the opportunity to purchase unsecured notes maturing in twelve months, earning an attractive eight percent interest, with an additional "gift" of CSSC common stock.[271]

The Securities Act declares "any note" maturing more than nine months after issuance to be a security, and the Exchange Act includes virtually "any note" as a security, unless the circumstances of the note's issuance or terms require a different result. This is consistent, as courts have observed, with the recognition that "the target of §§ 10(b) of the Exchange Act and 17(a) of the Securities Act is fraud."[272] The United States Court of Appeals for the Second Circuit has applied, and the Supreme Court has noted with approval, the presumption that a note with a term of more than nine months is a security.[273] The Supreme Court has stated, "the

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[267] *Wolfson*, 539 F.3d 1249, 1262–63 (citing *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 126 (2006)).

[268] Tr. 342–43 (Smith); CX-11, at 1.

[269] Tr. 149–53, 170–73 (claiming Clarkson did not invest in a bridge loan note) (Smith).

[270] Tr. 153 (Smith).

[271] CX-201, at 1; CX-203, at 1; CX-204, at 1; CX-206, at 1; CX-209, at 1; CX-210, at 1–2.

[272] *Exchange Nat'l Bank of Chicago v. Touche Ross & Co.*, 544 F.2d 1126, 1137 (2nd Cir. 1976).

[273] *Reves v. Ernst & Young*, 494 U.S. 56, 65–66 (1990) (citing *Exchange Nat'l Bank of Chicago*, 544 F.2d at 1137).

Securities Acts define 'security' to include 'any note,'" giving rise to the presumption that every note is a security. The presumption is "not irrebutable," however. The Court has identified four factors ("*Reves* factors") relevant to assessing whether a note qualifies as a security under the Exchange Act.[274]

The first factor concerns the motives of the buyer and seller. If "the seller's purpose is to raise money for the general use of a business enterprise . . . and the buyer is interested primarily in the profit the note is expected to generate" it is "likely to be a 'security.'"[275] The second factor entails evaluation of the "plan of distribution," whether the note is traded for speculation or investment. The third factor encompasses the "reasonable expectations" of public investors. The fourth is whether there is some other regulatory protection of the investing public over the sales of the note that might make "application of the Securities Acts unnecessary."[276]

When soliciting investments in the 2015 Bridge Loan Note Offering, Smith made it clear that his purpose was to raise funds for the general use of CSSC. The 2015 Bridge Loan Note Offering "Confidential Report" stated that CSSC was "covering its operating deficits" with proceeds from the Offering,[277] and in the "Important Memorandum" he wrote that "funds raised will be used to smooth out Company cash flows and cover any operating deficits" until CSSC attained profitability from the pending "new initiatives" he touted.[278] Here, the evidence shows that Smith crafted the offering documents to emphasize the potential profit to purchasers of the notes. Smith acknowledged that he drafted the offering documents with the offer of an eight percent return and gifts of CSSC stock to make the offering attractive to investors.[279] The offering documents stressed the strong likelihood that CSSC's other ventures were about to bring in major revenue streams ensuring the company's ability to pay interest and principal to investors. The documents clearly appealed to investors seeking profit.

Notably, CSSC's records describe the transactions as investments. For example, a document titled "Bridge Loan note holders" includes the names of two of the four participants in the offering—TL and Scotto— as "Bridge Loan note holders," showing maturity dates in 2016, and the total of their interest due at eight percent on maturity.[280] A third participant, BB, appears

[274] *Reves*, 494 U.S. at 65–66.

[275] *Id.* at 66 (noting that if "the note is exchanged to facilitate the purchase and sale of a minor asset or consumer good, to correct for the seller's cash-flow difficulties, or to evidence some other commercial or consumer purpose, on the other hand, the note is less sensibly described as a 'security.'").

[276] *Id.* at 66–67.

[277] CX-58, at 12.

[278] CX-58, at 37.

[279] Tr. 104–6 (Smith).

[280] CX-89, at 2.

in a list of "Other note holders"[281] who invested in the bridge loan notes, listing his $20,000 note with a maturity date of August 30, 2016, at eight percent interest.[282]

At the hearing, Smith initially conceded the "Bridge Loan note holders" list shows holders, including Scotto and TL, of bridge loan notes with their maturity dates. He testified that the "Other Note holders" list did not identify note holders, but persons who had simply made "loans" to the company. Then he reversed his original concession and testified that Scotto was not a Bridge Loan Note purchaser, but was mistakenly listed as one.[283] However, as the discussion above establishes, it was only after Smith solicited Scotto with emails and sent him the package of offering documents for prospective investors in the 2015 Bridge Loan Notes that Scotto sent Smith his $20,000.[284]

Smith testified that when he solicited potential purchasers of the notes, some were interested but "needed the money more quickly" than the one-year term the offering permitted. For example, when he made Scotto aware of the 2015 Bridge Loan Note Offering, Scotto said he wanted to participate but would need the principal returned by the end of the year. Smith accommodated Scotto by agreeing to "[d]o it differently." In other words, Smith was willing to adjust the terms to satisfy those who wanted to participate in the offering but with terms that differed from its original terms.[285] These circumstances show that Smith solicited Scotto to invest in the 2015 Bridge Loan Note Offering, and Scotto did so after negotiating Smith into accepting a shorter term for maturity than the standard one year.

In July 2015, Smith sent TL offering materials with an email stating that he was "expanding the range" of people to whom he was making the 2015 Bridge Loan Note Offering available, so that TL could invest. Smith claimed he was "moving very rapidly" and expected to finish "within the next 30 days" after which the offering would no longer be available to individual investors. He arranged to meet with TL in New York.[286] When asked if he was soliciting TL, Smith characterized his actions as "giving him the information so he could evaluate it," although Smith conceded his goal was to get TL to invest.[287]

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[281] CX-89, at 3.

[282] Tr. 234–36 (Smith); CX-89, at 2. CX-89 is a three-page document, each page containing a list. The first page purports to be a list of CSSC debenture bond investors. The second is titled "Bridge Loan note holders." Scotto is listed three times, as holding a $75,000 note that came due in May 2015, a $50,000 note that came due in March 2016, and a $20,000 note that came due in August 2016. TL is listed as holder of a $50,000 note that also came due in August 2016. The third page is titled "Other note holders." Smith testified that this page identified "unsecured loans . . . not a part of the offering." Tr. 236.

[283] Tr. 235–37 (Smith).

[284] *See* discussion of Smith's solicitation of Scotto above at V. A. 2. d. ii. b.

[285] Tr. 406–8 (Smith).

[286] CX-8, at 1.

[287] Tr. 99–101 (Smith).

Similarly, although he wrote to customer BB that the 2015 Bridge Loan Note Offering was not "applicable" to him, in September 2015 Smith sent him the package of offering materials and stated in an accompanying email that if BB wished "to get involved," they would "consider some alternatives," and invited BB to let Smith know if he decided "to get involved."[288] According to Smith, when BB reviewed the offering documents, he said he wanted to participate, but asked if he could do so with only a $10,000 "loan." BB also was interested in receiving CSSC stock. As he did with Scotto, Smith again agreed to vary from the original terms of the offering. Moreover, he asked BB to introduce the offering to his connections in investment banking and venture capital circles.[289]

Smith concedes that he solicited Clarkson to invest in the offering.[290] He sent offering documents and wiring instructions to Clarkson hoping he would purchase a Bridge Loan Note and seek out other potential investors among the Native American tribes he knew. At the end of October 2015 he emailed Clarkson that he was "finishing the placement of the remaining $1.6 million available in our current Bridge Loan Note Offering," described it as "a great opportunity" that he hoped would be "a possible 'fit'" for Clarkson and his "tribal connections" to "take advantage of."[291]

As we do with Scotto, the Panel finds that Smith solicited TL, BB, and Clarkson to invest in 2015 Bridge Loan Notes and they did so, even though Smith allowed both Scotto and BB's notes to mature in less than a year.

Other evidence adds weight to the conclusion that the four transactions at issue were purchases of securities, not mere short-term loans. In November 2015, when DW, CSSC's controller, emailed Smith to inform him that "[t]erms have not been specified for the following notes," he included the notes at issue here: Scotto's $20,000, BB's $10,000, TL's $50,000, and Clarkson's $50,000 investments.[292] In response, Smith identified Scotto's $20,000 and customer TL's $50,000 as being "in the Bridge Loan Note Offering," and customer BB's $10,000 and Clarkson's $50,000 as "6 month Note[s]."[293] He did not contend at that time that they were just short-term loans to CSSC.

iii. Conclusion

Considering the entirety of the circumstances, the offering documents, together with the evidence of Smith's solicitations of BB, TL, Scotto and Clarkson, the Panel finds that Enforcement met its burden of proof: Smith made the material omissions and misrepresentations

[288] CX-13, at 1.

[289] Tr. 1388–89 (Smith).

[290] Tr. 136–37 (Smith).

[291] CX-16, at 1.

[292] CX-28.

[293] CX-27.

in the 2015 Bridge Loan Note Offering documents that solicited them to purchase securities. Applying the *Reves* factors, Smith offered the notes as securities with a maturity date of a year from purchase; intended to use the proceeds for the general needs of CSSC; and offered significant profit as the incentive for purchasing the notes, at a rate identical to prior offerings of securities that investors found attractive. While Smith was willing to shorten the maturity date for some note holders on request, doing so did not transform the transactions, as Smith contends, from securities transactions to short-term loans. The Panel concludes that the 2015 Bridge Loan Notes qualify as securities and that this is an appropriate case for the application of the Securities Acts, in the interest of protecting the investing public.

c. Scienter

Scienter is "a mental state embracing intent to deceive, manipulate, or defraud."[294] Scienter may be established by recklessness,[295] encompassing "a highly unreasonable misrepresentation or omission."[296] Recklessness is "an extreme departure from the standards of ordinary care . . . which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it."[297]

i. Smith's Claims of Reasonable Reliance on Southwick

Smith denies that he possessed any deceptive intent. Rather, he claims that he reasonably relied on Southwick's reports to him that the project to establish the special purpose bank was progressing.[298] Smith insists there is no evidence that he knew Southwick's representations were false.[299] He points to a letter he wrote to the equity firm on September 25, 2015,[300] after firing Southwick, and emails sent to the law firm by a lawyer Smith hired,[301] as evidence of his good-faith reliance on Southwick.[302] In the equity firm letter, Smith asked to meet with representatives of the firm to explore pursuing Project X, asserting that the firm had already evaluated its viability and made a "substantial financial commitment to it."[303] The lawyer's emails to the law

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[294] *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976).

[295] *Fillet*, 2015 SEC LEXIS 2142, at *26.

[296] *Dep't of Enforcement v. Abbondante*, No. C10020090, 2005 NASD Discip. LEXIS 43, at *28 (NAC Apr. 5, 2005), *aff'd*, 58 S.E.C. 1082 (2006).

[297] *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1569 (9th Cir. 1990).

[298] Smith's Initial Post-Hr'g Br., at 3, 8, 14–15.

[299] *Id.* at 3; Smith's Rebuttal Br., at 8–9.

[300] RX-67.

[301] RX-68.

[302] Smith's Rebuttal Br., at 9.

[303] RX-67, at 2.

firm threatened legal action against the firm for improperly acting to prevent CSSC from profiting from Project X.[304]

ii. Discussion

In evaluating Smith's assertions, it is useful to review the context in which he wrote and promulgated the 2015 Bridge Loan Note Offering documents. Smith knew that CSSC owed investors hundreds of thousands of dollars in principal payments for bonds and notes that came due in mid-2015, and was struggling to pay the Firm's registered representatives and the RIA's advisors. He had reason to avoid disclosing CSSC's precarious financial condition to potential investors, and motive to make unfounded rosy projections of imminent new revenues. Smith needed to raise money to keep CSSC afloat.

As shown above, Smith made his representations about Project X without verifying the existence of the purported consulting agreement, or even asking to see a draft application to bank regulators for approval of a special purpose bank. It is also relevant that this is not a case of a single improvident aspirational representation. Here, Smith disseminated multiple revisions of the offering documents over a period of months, all containing the misrepresentations and omissions charged in the Complaint.

Given these facts, Smith's claim that he reasonably relied on Southwick's mischaracterizations of Project X's progress—particularly that CSSC was about to be paid $500,000 in earned consulting fees[305]—is unpersuasive. As Enforcement points out, Southwick's employment contract, written by Smith, forbade Southwick from committing CSSC "to any project, contract or engagement without conferring in advance" and obtaining approval from Smith.[306] When Southwick told Smith that half of the existing million dollar consulting fee had been earned, Smith had neither seen nor approved any "project, contract or engagement" of that nature. As shown above, although Smith asked Southwick for documentary evidence supporting the existence of the consulting fee, Southwick never produced any.

In addition, as Enforcement also points out, Smith cannot say he relied on Southwick's claims about the SDTC and City of Jacksonville consulting agreements. The facts recited above show that Smith had actual knowledge that CSSC was not in the final stages of reaching lucrative agreements with either SDTC or the City of Jacksonville and misrepresented the truth in every iteration of the offering documents.

Smith and Southwick met with SDTC personnel in March 2015,[307] and Smith exchanged emails with SDTC on July 13, 2015, stating "a referral agreement" and the issue of managing

[304] RX-68.

[305] Tr. 310.

[306] Enforcement's Post Hr'g Reply Br., at 16–17.

[307] Tr. 630–32 (Southwick); CX-108.

funds were the subject of "discussions," not an actual agreement between SDTC and CSSC.[308] Yet Smith wrote in the June, September, and November 2015 offering documents that "CSSC will be the investment advisor of the common and collective trust funds it is helping to create [for SDTC], and CSSC will earn a fee based on a percentage of the assets under management."[309]

Similarly, Smith knew there was no basis to believe that CSSC had reached the final stage of completing a profitable agreement with the City of Jacksonville that would bring CSSC close to $1 billion in assets under management.[310] Smith had seen no documentation evidencing the existence of such an agreement. In fact, the City of Jacksonville had rejected the original proposal. The scaled-down proposal Smith personally drafted in July 2015 and sent to the City of Jacksonville had no provision for CSSC to acquire responsibility for a billion dollar valuation of assets under management. Rather, it called for a far humbler $15,000 quarterly fee if the City of Jacksonville agreed to have CSSC provide evaluations of the City's money managers.[311]

The Panel therefore concludes that Smith, and through him CSSC B/D, acted intentionally when he solicited investors in the 2015 Bridge Loan Note Offering and, in the offering documents, consciously did not disclose that CSSC owed but was unable to pay $655,000 in principal to investors in the 2010 Bond Offering and 2014 Bridge Loan Note Offering.

The Panel finds that Respondents made their affirmative misrepresentations about imminent revenue streams from consulting agreements while cognizant that no such agreements were nearing completion with the City of Jacksonville and SDTC. Moreover, Smith acted knowingly, or at a minimum recklessly, when he misled prospective investors to believe that CSSC was about to receive large cash infusions from an existing consulting agreement, for "Project X." All of these omissions and misrepresentations were material.

d. Smith Made the Omissions and Misrepresentations Using Instrumentalities of Interstate Commerce

Smith admits that he communicated "with investors and others principally by email and overnight courier."[312] Consistent with his admission, Smith provided the four investors in the 2015 Bridge Loan Note Offering with the misleading offering documents by email and overnight mail, and therefore utilized the instrumentalities of interstate commerce to make his fraudulent solicitations.

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[308] CX-109.

[309] CX-202, at 10; CX-205, at 4-5; CX-207, at 5–6.

[310] CX-202, at 12.

[311] Tr. 610–11 (Southwick); CX-246, at 12–13.

[312] Ans. ¶ 88.

e. CSSC B/D Is Liable for Smith's Fraudulent Misconduct

As shown above, Smith was the indirect owner and acted as both principal and registered representative in the securities business of CSSC B/D, and therefore he acted as an agent of the Firm. Member firms are responsible for the misconduct of their agents. Just as the Firm shares liability with Smith for failing to register as a principal and representative, it shares liability with him for the fraudulent misconduct charged in the Complaint's first three causes of action.[313]

f. Conclusion

For these reasons, the Panel finds that Enforcement has proven by a preponderance of the evidence that, as charged in the Complaint's first cause of action, Smith, and through him CSSC B/D, acted with scienter and willfully[314] violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, by intentionally or recklessly making untrue statements and omissions of material facts in connection with the sales of securities, specifically the 2015 Bridge Loan Note Offering, using instruments of interstate commerce to send offering materials and solicit registered representatives and customers of CSSC B/D and, by these acts, to induce the purchase of the 2015 Bridge Loan Notes by means of a manipulative, deceptive, fraudulent contrivance in violation of FINRA Rule 2020, thereby violating FINRA Rule 2010.

2. Elements of Fraud in Violation of FINRA Rule 2010 and Sections 17(a)(2) and (3) of the Securities Act

The allegations contained in the second cause of action, pleaded alternatively to the first cause, require Enforcement to prove by a preponderance of the evidence that respondents made material misrepresentations and omissions in violation of Sections 17(a)(2) and (3) of the Securities Act, thereby violating FINRA Rule 2010. As noted above, Section 17(a) makes it unlawful in the offer or sale of securities to use the mails or to communicate in interstate commerce to obtain money through an untrue statement of material fact or omitting to state a material fact needed to render statements made not misleading; or to engage in a course of business operating as a fraud or deceit on the purchaser. The signal difference between the charges in the first and second causes of action is that culpability for violation of Sections 17(a)(2) and (3) does not require proof of scienter.[315] All that is required is that a respondent negligently, rather than intentionally, misrepresent or omit to state a material fact.[316]

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[313] *Yankee Fin. Group*, 2006 NASD Discip. LEXIS 21, at *67–68; *Armstrong, Jones & Co. v. SEC*, 421 F.2d 359, 361–62 (6th Cir. 1970).

[314] Willfulness in this context means intentionally committing the act that constitutes the violation. *See Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000). Willful violations of Section 10(b) of the Exchange Act give rise to statutory disqualification. *See* 15 U.S.C. § 78c3(a)(39)(F).

[315] *United States v. Aaron*, 446 U.S. 680, 697–99 (1980).

[316] *SEC v. Morgan Keegan & Co.*, 678 F.3d 1233, 1244 (11th Cir. 2012).

For the third cause of action, pleaded alternatively to the first and second causes, Enforcement must establish by a preponderance of the evidence that Respondents engaged in conduct inconsistent with just and equitable principles of trade by obtaining money from the public for the 2015 Bridge Loan Note Offering by means of material misrepresentations and omissions of fact regarding those investments.

Having found that Respondents possessed scienter when making the fraudulent solicitations for investments in the 2015 Bridge Loan Note Offering, the Panel concludes that Respondents also violated FINRA Rule 2010 by violating Sections 17(a)(2) and (3) of the Securities Act, requiring the lesser included element of negligence in making misrepresentations and omissions of material facts.

Thus, the Panel finds that Enforcement has met its burden of proving by a preponderance of the evidence that Respondents engaged in the fraudulent misconduct as alleged in each of the first three causes of action.

VII. Smith's Estoppel Claim

Smith argues that FINRA should be estopped from proceeding against him for failing to register as a principal or representative, arguing that he disclosed his ownership interest in CSSC and CSSC's ownership of the Firm when it filed its membership application in 2006. Based on the disclosures, his request to be exempt from registration requirements was granted.[317] Onsite examinations of CSSC B/D were completed in 2007 and 2011 and FINRA did not raise any questions about the roles he played as CEO and chairman of the parent company and his interactions with the Firm.[318]

Given these facts, Smith contends, FINRA should be equitably estopped from now asserting jurisdiction over him and pursuing disciplinary action for his failure to register.[319] Smith cites one federal case in support of his estoppel claim, relying on its finding that under federal case law a party may be estopped from seeking relief when it has made a misrepresentation of fact to another party, reasonably expecting the other party to rely on it, and the other party does so, to its detriment.[320] In essence, Smith claims that since FINRA approved the Firm's membership application without requiring him to register as a principal or representative, and failed to question his role in the Firm's business after conducting two routine examinations, FINRA may not now assume jurisdiction over him and sanction him for failing to register. Smith's contentions are without merit.

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[317] Smith's Initial Post-Hr'g Br., at 6.

[318] *Id.* at 7.

[319] *Id.* at 12.

[320] *Id.* at 12 (citing *Kosakow v. New Rochelle Radiology Assoc., P.C.*, 274 F.3d 706, 725 (2d Cir. 2001)).

The single case he cites is inapposite. FINRA made no misrepresentation to Smith, an essential prerequisite for triggering estoppel under the authority of the case.

Furthermore, two of the exhibits he filed in advance of the hearing are examination reports FINRA provided him after the two routine examinations, and both put him on notice that the examinations focused on specific aspects of the Firm's business and therefore should not be interpreted as relieving the Firm from complying with all applicable rules. The first states that the examination "sampled selected aspects" of the Firm's operations.[321] The second explained that the 2011 examination was "not an audit" and did not relieve Firm management from the obligation to conform to all "appropriate securities rules and regulations."[322]

In asserting his estoppel claim, Smith attempts to transfer responsibility for his failure to comply with FINRA's registration requirements from the Firm and himself, where it belongs, to FINRA, on the improper assumption that he did not need to register unless FINRA first discovered he was acting in registered capacities and told him so. The SEC has held that FINRA is not estopped from taking action later just because it did not do so immediately after an investigation, and a previous failure to sanction misconduct does not excuse a respondent's failure to comply with the requirements of applicable rules.[323]

VIII. Sanctions

A. Respondent Smith

1. Fraud – First Cause of Action

Characterizing Smith's intentional or reckless fraudulent omissions and misrepresentations in the sales of the 2015 Bridge Loan Notes charged in the first cause of action as egregious, Enforcement recommends imposing a bar. Enforcement cites as aggravating factors that Smith fraudulently solicited investments in the notes for prolonged period, from June through December 2015; obtained $130,000 from four investors and has not repaid them; was motivated by monetary gain; has not accepted responsibility for his actions; and apparently does not appreciate that his acts were wrongful.[324]

FINRA's Sanction Guidelines ("Guidelines") instruct adjudicators that the "overriding purpose of all disciplinary sanctions is to remedy misconduct and protect the investing public."[325] The Guideline pertaining to an individual's sales practice violations involving

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[321] RX-8, at 1.

[322] RX-14, at 3.

[323] *Dep't of Enforcement v. The Dratel Group, Inc.*, No. 2009016317701, 2015 FINRA Discip. LEXIS 10, at *43 (NAC May 6, 2015), *aff'd*, Exchange Act Release No. 77396, 2016 SEC LEXIS 1035 (Mar. 17, 2016) (citing *W.N. Whelen & Co.*, 50 S.E.C. 282, 284 (1990)).

[324] Enforcement's Post-Hr'g Br., 20–21.

[325] FINRA Sanction Guidelines at 10 (2018), http://www.finra.org/industry/sanction-guidelines.pdf.

fraudulent misrepresentations and omissions of fact recommends that adjudicators strongly consider imposing a bar.[326]

With these precepts in mind, the Panel finds there are significant aggravating factors under the Guidelines applicable to this case. First, the evidence that Smith acted intentionally is strong.[327] He knowingly concealed the fact that CSSC was unable to repay principal to participants in the 2010 Bond Offering and the 2014 Bridge Loan Note Offering. He knew his representations about the imminent finalization of lucrative consulting contracts with SDTC and the City of Jacksonville were unfounded, and he either knew or was reckless in not knowing that CSSC had not earned half of a million dollar consulting fee through Project X.

Second, Smith made his fraudulent solicitations to multiple potential investors over an extended period.[328]

Third, his goal was monetary gain for himself and CSSC.[329]

Fourth, despite the convincing evidence of the exclusive control he exercised over the creation and marketing of the 2015 Bridge Loan Note Offering, Smith strongly denies any personal responsibility.[330]

Finally, his fraudulent solicitations for the 2015 Bridge Loan Note Offering resulted in financial loss to investors whom he has not repaid.[331]

The Panel finds no mitigating factors present. We therefore bar Smith from associating with any FINRA member firm in any capacity for his fraudulent sales practices as alleged in the first cause of action.

In addition to imposing the bar, because the Panel has found that Smith's intentional and reckless fraudulent solicitations resulted in identifiable financial harm to four people, we order him to pay restitution to the purchasers of the 2015 Bridge Loan Notes, with interest.

2. Fraud – Second and Third Causes of Action

For the negligent fraudulent solicitations charged alternatively in the second cause of action, the applicable Guideline recommends a fine of $2,500 to $73,000, and consideration of suspension in any and all capacities for 31 calendar days to two years. This Guideline also

[326] Guidelines at 89.

[327] Guidelines at 8 (Principal Consideration No. 13).

[328] Guidelines at 7 (Principal Consideration No. 9).

[329] Guidelines at 8 (Principal Consideration No. 16).

[330] Guidelines at 7 (Principal Consideration No. 2).

[331] Guidelines (Principal Consideration No. 11).

applies to the third cause of action, charging conduct inconsistent with just and equitable principles of trade in obtaining money by fraudulent means.[332]

In the Panel's view, many of the aggravating factors we considered in connection with the first cause of action are also relevant to the second and third causes of action. Even without the element of intentionality, the Panel finds Smith's misconduct egregious because he acted without regard to the interests of those he solicited to invest in the 2015 Bridge Loan Note Offering. This was evident in the cavalier manner in which he dismissed the request of investor TL, holder of a $50,000 note who, when his confidence in Smith was shaken, asked for a refund. Smith bluntly refused TL's request, saying "there is no present ability to provide you with a 'refund'" and continued to claim, without foundation, that there was little "if any" risk to Note holders because CSSC's assets "far exceed" its debts.[333] Smith's persistence in soliciting investors to purchase 2015 Bridge Loan Notes even after he fired Southwick on September 8, 2015, also illustrates disregard for his ethical obligations to investors. By then Smith had no doubt that Project X was a sham, and he knew there were no prospects of large scale profits from consulting agreements with SDTC or the City of Jacksonville. Yet Smith continued to solicit investors with offering materials touting the "Pending Strategic Relationship" with SDTC and the "pending engagement with the City of Jacksonville."[334] Subsequently investor BB purchased his six-month note on September 29 and Clarkson invested $50,000 in a six-month note on November 13, 2015.[335]

Having imposed a bar on Smith for the first cause of action, the Panel finds it unnecessary to impose additional sanctions for the second and third causes of action. Were we to impose sanctions for the negligence-based violations alleged in the second cause of action or the ethics-based allegations in the third cause of action, however, we would impose a bar upon Smith in all capacities, and order him to pay restitution with interest to the four investors in the 2015 Bridge Loan Note Offering.

3. Registration – Fourth and Fifth Causes of Action

For registration violations, the Guidelines recommend a fine of $2,500 to $73,000 and a suspension in any or all capacities for up to six months, or, in egregious cases, up to two years or a bar. The Principal Considerations in Determining Sanctions are whether a respondent has filed a registration application, and the nature and extent of the unregistered person's responsibilities.[336]

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[332] Guidelines at 89 n.3.

[333] CX-11, at 1.

[334] CX-18, at 8–9.

[335] CX-27.

[336] Guidelines at 45.

Enforcement seeks a bar for Smith's registration violations.[337]

The Panel concurs with Enforcement's characterization of Smith's registration violations as egregious. They occurred over the entire relevant period, from May 2010 through 2015.[338] During that time, Smith, acting in the capacity of a representative, solicited CSSC B/D customers—personally and through the Firm's brokers—to invest in a series of bonds and notes. He asked registered representatives to find interested investors among their customers, and then personally met with a number of them to solicit their investments, sometimes successfully, other times not.

Acting in the capacity of a principal, Smith involved himself in the management of CSSC B/D in several important ways. He determined how the co-presidents would manage the Firm. He held regular meetings attended by employees and affiliated persons, including registered representatives and registered investment advisors. He recruited new hires and set the terms of their employment. He decided whom to fire. He oversaw the finances of CSSC's subsidiaries, channeling funds from the RIA to the Firm to maintain minimum net capital for CSSC B/D. He responded to concerns of the auditors monitoring the Firm's finances. He responded to customer complaints.

In sum, the evidence leads the Panel to conclude that Smith chose intentionally not to register in an attempt, successful for years, to conduct business through CSSC B/D while avoiding the appearance of doing so.[339] Smith's claim of exemption from the registration requirements permitted him to act as a registered representative and a principal with no oversight while he made his solicitations to benefit himself and CSSC.[340] He has not accepted responsibility for failing to register.[341]

Having imposed a bar for Smith's fraudulent sales practices, the Panel finds it unnecessary to impose additional sanctions for his registration violations. Were we to do so, we would deem it appropriate to impose separate suspensions of one year in all capacities, and fines of $50,000 each, for his violations of the registration requirements as charged in the fourth and fifth causes of action.

B. CSSC B/D

1. Fraud – First Three Causes of Action

As noted above, CSSC B/D, through Smith, participated in the intentional fraudulent solicitations of securities charged in the first three causes of action. As with Smith, the Panel

[337] Enforcement's Post-Hr'g Br., at 44.

[338] Guidelines at 7 (Principal Consideration No. 9).

[339] Guidelines at 8 (Principal Consideration No. 13).

[340] Guidelines at 8 (Principal Consideration No. 16).

[341] Guidelines at 7 (Principal Consideration No. 2).

finds that imposing appropriately remedial sanctions against the Firm for the first cause of action makes it unnecessary to impose additional sanctions for the second and third causes of action. We find that all of the aggravating factors applicable to Smith also apply to CSSC B/D. We are mindful, however, of Enforcement's observation that the Firm has no history of discipline or compliance issues, and the Firm's participation in Smith's fraudulent solicitations of the 2015 Bridge Loan Note Offering was not reflective of its compliance record.

Accordingly, the Panel agrees with Enforcement that the appropriately remedial sanctions for the Firm's fraudulent misconduct are a suspension from participating in private securities offerings for one year, and a fine of $100,000. In addition, the Firm shall pay restitution, jointly and severally with Smith, to the four investors in the 2015 Bridge Loan Note Offering, with interest.

Were we to impose sanctions for the second or third causes of action, we would, again in agreement with Enforcement's recommendations, impose a suspension from participating in private offerings for 90 days, and a fine of $73,000.

2. Registration – Fourth and Fifth Causes of Action

The Guidelines recommend a suspension of up to 30 business days and a fine of $2,500 to $73,000 for a firm's violations of registration requirements.[342] As with Smith, we find the length of time the Firm failed to register Smith to be an aggravating factor. An additional aggravating factor is that Smith, by recommending and selling the 2010 Bond Offering, the 2014 Bridge Loan Note Offering, and the 2015 Bridge Note Loan Offering, acted as an associate of the Firm. He had access to the Firm's customer base, which he exploited to make his fraudulent solicitations.

For these reasons, we concur with Enforcement's recommendation and impose a fine of $20,000 on CSSC B/D for the registration violations charged in the final two causes of action.[343]

IX. Order

For knowingly or recklessly misrepresenting and omitting to disclose material facts in connection with the sales of securities, in willful violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, as alleged in cause one, Respondent Eric S. Smith is barred from associating with any FINRA member firm in any capacity, and Respondent CSSC Brokerage Services, Inc., is suspended from participating in private securities offerings in all capacities for one year and fined $100,000.

For knowingly or recklessly misrepresenting and omitting to disclose material facts in connection with the sales of securities, in violation of Sections 17(a)(2) and (3) of the Securities

[342] Guidelines at 45.

[343] Tr. 1447; Enforcement's Post-Hr'g Br., at 43-44.

Act of 1933, and FINRA Rules 2020 and 2010, the panel finds it unnecessary to impose any additional sanctions in light of the bar.

For actively engaging in the conduct of the Firm's securities business in the capacities of a principal and a representative, supervising registered representatives, and soliciting sales of securities without being registered, in violation of NASD Rules 1021 and 1031, and FINRA Rule 2010, as alleged in the fourth and fifth causes of action, the Extended Hearing Panel finds it unnecessary to impose any additional sanctions against Smith in light of the bar already imposed. For the Firm's failure to register Smith as a representative and as a principal, as charged in the fourth and fifth causes of action, we impose a fine of $20,000.

Respondents shall be jointly and severally responsible for paying restitution as ordered. We also order Respondents, jointly and severally, to pay the costs of this proceeding, $12,107.09, which includes the cost of the hearing transcript and a $750 administrative fee.[344]

If this decision becomes FINRA's final disciplinary action, Respondent Smith's bar shall become effective immediately, and Respondent CSSC's suspension shall become effective with the opening of business on Monday, March 4, 2019, and end at the close of business on March 3, 2020. Restitution, fines, and costs shall be payable on a date set by FINRA, but not sooner than 30 days after this decision becomes FINRA's final disciplinary action.[345]

Matthew Campbell
Hearing Officer
For the Extended Hearing Panel

[344] Restitution is owed to the following persons, plus interest at the rate set forth in Section 6621(a) of the Internal Revenue Code, 26 U.S.C. § 6621(a)(2), until the date that restitution is paid: customer TL, $50,000, with interest accruing from August 24, 2015; Thomas Scotto, $20,000, with interest accruing from August 31, 2015; customer BB, $10,000, with interest accruing from September 29, 2015; Gavin Clarkson, $50,000, with interest accruing from November 13, 2015. If Respondents are unable to locate a customer, the Firm must provide Enforcement with proof that it has made a bona fide attempt to locate the customer. Any restitution Respondents are unable to pay to a customer must be paid to FINRA (without interest) as a fine. Customers BB and TL are identified in Enforcement's Schedule of Abbreviations and References in its Complaint filed in this matter on November 14, 2017. Restitution shall be paid jointly and severally with the Firm.

[345] The Extended Hearing Panel considered and rejected without discussion all other arguments by the parties.

Copies to:
CSSC Brokerage Services, Inc. (via overnight courier, and first-class mail)
Eric S. Smith (via email, overnight courier, and first-class mail)
Robert Knuts, Esq. (via email and first-class mail)
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Roger J. Kiley, Esq. (via email)
Christopher M. Burky, Esq. (via email)
Mark A. Koerner, Esq. (via email)
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EXHIBIT B

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of Department of Enforcement, Complainant, vs. Eric S. Smith Troy, MI, Respondent.	DECISION Complaint No. 2015043646501 Dated: September 18, 2020

Respondent fraudulently misrepresented and omitted material facts in connection with the sale of securities and failed to register as a general securities representative and principal despite engaging in conduct requiring registration. Held, findings affirmed and sanctions affirmed in relevant part.

Appearances

For the Complainant: Kathryn S. Gostinger, Esq., Roger J. Kiley, Esq, Department of Enforcement, Financial Industry Regulatory Authority

For the Respondent: Robert Knuts, Esq.

Decision

Eric S. Smith appeals an Extended Hearing Panel ("Hearing Panel") decision. The Hearing Panel found that Smith fraudulently made material misrepresentations and omissions of fact in offering documents, in willful violation of the federal securities laws and FINRA rules. The Hearing Panel barred Smith from associating with any FINRA member in any capacity for this misconduct and ordered that he pay, jointly and severally with his firm, $130,000 in restitution to four investors.

The Hearing Panel also found that Smith actively engaged in the conduct of his firm's securities business in the capacities of a general securities principal and representative without being registered, in violation of NASD and FINRA rules. In light of the bar for Smith's fraud, the Hearing Panel assessed, but did not impose, additional sanctions for Smith's registration violations.

After a thorough review of the record, we affirm the Hearing Panel's liability findings and the bar and restitution ordered for Smith's fraud. We, however, modify the Hearing Panel's assessed sanctions for Smith's registration violations. For acting as an unregistered principal, we increase the fine from $50,000 to $75,000 and the suspension in all capacities from one year to two years. For acting as an unregistered general securities representative, we affirm the Hearing Panel's recommended $50,000 fine and one-year concurrent suspension in all capacities. Like the Hearing Panel, we decline to impose the sanctions for the registration violations in light of the bar imposed for Smith's fraud.

I. Background

Smith founded the financial services company, Consulting Services Support Corporation ("CSSC") in 1998. CSSC is not a FINRA member. Smith is CSSC's chairman, chief executive officer, and majority owner. Prior to founding CSSC, Smith practiced law in private practice and later worked for a broker-dealer named North American Financial, as its chief operating officer. Smith has never registered with FINRA.

CSSC is the parent company of several wholly owned subsidiaries, including CSSC Brokerage Services, Inc. ("CSSC BD"), as well as a registered investment advisor ("RIA") and an insurance business. CSSC BD's registered representatives became affiliated with all the various CSSC entities through an affiliation agreement that Smith required. CSSC and its subsidiaries, including CSSC BD and RIA, occupied the same office suite in Troy, Michigan. CSSC BD leased office space from CSSC.

CSSC BD became a FINRA member in 2006 and terminated its registration in 2018. As part of CSSC BD's application for FINRA membership, Smith attested that he was exempt from registration pursuant to NASD Rule 1060 because he would not be actively engaged in the management of the firm's securities business. Keith Frye, who Smith knew from North American Financial, was the initial president and chief compliance officer ("CCO") of CSSC BD. After Frye left the firm, Smith appointed Jennifer LaRose and Alex Martin as CSSC BD's co-presidents, and he also made LaRose its CCO.[1]

The conduct at issue in this case occurred from 2010 through 2015, while CSSC BD was a FINRA member.

II. Procedural History

During a routine examination of CSSC BD in 2015, FINRA's Department of Member Regulation found that Smith appeared to be acting as a general securities representative and principal of the firm without being registered. Around this time, a former CSSC employee,

[1] Smith also knew LaRose and Martin from their time working at North American Financial. Martin worked for CSSC RIA before joining CSSC BD as a registered representative. LaRose joined CSSC BD in 2006 as a general securities principal.

Donald Southwick, complained to FINRA that two of his customers had not received interest and principal payments for certain investments offered through CSSC BD. One of these customers also complained to FINRA directly. These matters were referred to FINRA's Department of Enforcement ("Enforcement") for further investigation.

After concluding its investigation, Enforcement began disciplinary proceedings on August 4, 2017, when it filed a five-cause complaint alleging that Smith and CSSC BD engaged in misconduct for which FINRA should impose sanctions. The first three causes of action involve a bridge loan note offering that Smith issued in 2015 ("2015 Bridge Loan Note Offering") to address CSSC's deteriorating financial condition. Cause one alleged that Smith and CSSC BD fraudulently misrepresented or omitted material facts in connection with the 2015 Bridge Loan Note Offering, in willful violation of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), Exchange Act Rule 10b-5, and FINRA Rules 2020 and 2010.[2] Enforcement pleaded the second and third causes of action as alternatives to cause one. Cause two alleged that Smith and CSSC BD acted negligently when they made the fraudulent misrepresentations and omissions, in violation of Sections 17(a)(2) and (a)(3) of the Securities Act of 1933 ("Securities Act"), and FINRA Rule 2010. Cause three alleged that Smith and CSSC BD violated FINRA Rule 2010 because they failed to adhere to just and equitable principles of trade by making unethical misrepresentations and omitting to disclose material facts to investors.

Causes four and five of the complaint involve Smith's active involvement in CSSC BD's securities business without maintaining the proper securities registrations. Enforcement alleged that Smith and CSSC BD violated NASD Rules 1021 and 1031 and FINRA Rule 2010 by failing to register Smith as a general securities representative and principal of CSSC BD.

In their answer, CSSC BD denied all involvement in the 2015 Bridge Loan Note Offering, and Smith denied making any false statements or omissions in the 2015 Bridge Loan Note Offering documents. Smith and CSSC BD also denied violating the registration rules, asserting that FINRA does not have jurisdiction over Smith and therefore he was never required to be registered as a representative or a principal. As discussed in detail below, we agree with the Hearing Panel's findings that FINRA has jurisdiction over Smith to bring this disciplinary action against him and that Smith was required to register.

After conducting an eight-day hearing, the Hearing Panel found that Smith and CSSC BD engaged in the alleged misconduct. For knowingly or recklessly misrepresenting and failing to disclose material facts in connection with the sales of securities, in willful violation of Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5, as alleged in cause one, the Hearing Panel barred Smith from associating with any FINRA member firm in any capacity. The Hearing Panel suspended CSSC BD from participating in private securities offerings in all capacities for one year and fined the firm $100,000. The Hearing Panel also ordered that Smith

[2] The conduct rules that apply in this case are those that existed at the time of the conduct at issue.

and CSSC BD be held jointly and severally liable for paying $130,000 in restitution to four affected investors.

For Smith's acting in the capacities of a principal and a representative without being registered, in violation of NASD Rules 1021 and 1031, and FINRA Rule 2010, as alleged in the fourth and fifth causes of action, the Hearing Panel assessed, but declined to impose, any additional sanctions in light of the bar already imposed. For CSSC BD's failure to register Smith as a representative and principal, the Hearing Panel fined the firm $20,000.

Smith timely appealed the Hearing Panel's decision. CSSC BD did not appeal, and the Hearing Panel's decision is final with respect to the firm.

III. Facts

A. CSSC's Efforts to Raise Cash Through Offerings in 2010 and 2014

In the wake of the 2008 financial crisis, CSSC's revenues dropped because of a reduction in investment advisory fees earned by its RIA subsidiary. Smith and CSSC undertook multiple efforts to raise cash to bolster CSSC's faltering financial condition. In 2010, Smith and CSSC issued a convertible debenture bond offering ("2010 Bond Offering"), hoping to raise $5 million to satisfy financial obligations. The offering raised only $2.45 million. In 2014, Smith and CSSC began offering "bridge loan notes" ("2014 Bridge Loan Note Offering") to garner additional funds to cover operational losses. This offering raised approximately $1.1 million. That amount proved insufficient as CSSC continued losing money. To address CSSC's ongoing financial decline, Smith initiated CSSC's issuance of the 2015 Bridge Loan Note Offering, which is the subject of the first three causes of action in Enforcement's complaint.

1. The 2010 Bond Offering and Smith's Role

It was Smith's decision to conduct the 2010 Bond Offering. The intended use of the proceeds was to retire short-term debt of $1.4 million, including $480,000 in short-term promissory notes that were due. CSSC also needed money to pay $160,000 in deferred salaries and $140,000 in legal fees. The offering document stated that the bonds were unsecured, had a five-year maturity date, offered an annual interest rate of eight percent, and permitted buyers to convert the bonds to CSSC common stock.

The offering document stated that CSSC had "no plans to use the services of registered representatives to act as agents of [CSSC] in selling the Bonds," and no brokerage commissions or fees would be paid to them. Because it was assumed that CSSC BD would not be marketing or selling the 2010 Bond Offering, the firm established no parameters for its registered representatives' marketing or selling of this investment. CSSC BD's representatives, however, did sell the 2010 Bond Offering to their customers, and Smith provided these representatives with the offering documents in order to do so. CSSC BD's representatives also introduced Smith directly to their customers for him to sell the 2010 Bond Offering directly to those customers.

For example, Martin introduced customer SK to the 2010 Bond Offering, but Smith finalized the $375,000 investment. Southwick also introduced Smith to several his CSSC BD customers, who then invested in the 2010 Bond Offering. These customers included: JM who was approximately 88 years old at the time she invested $300,000; DN who invested $400,000; PK who invested $100,000; DG who invested $200,000; and SM who invested $20,000. Some investors in the 2010 Bond Offering used funds from their CSSC BD accounts to invest in the 2010 Bond Offering.

From March 2010 through March 2014, CSSC and Smith raised a total of $2.45 million through the 2010 Bond Offering.

2. The 2014 Bridge Loan Note Offering and Smith's Role

After conducting the 2010 Bond Offering, CSSC's business continued to struggle; the firm lost approximately $803,000 in 2012 and $883,000 in 2013. CSSC could not meet its day-to-day obligations without additional outside funding. As CSSC had done in the past, it deferred payments of salaries, commissions, and advisory fees to employees and affiliates. To cover ongoing losses, CSSC conducted the 2014 Bridge Loan Note Offering. This offering consisted of one-year, unsecured promissory notes bearing simple interest at eight percent. Buyers were promised 1,000 shares of CSSC common stock from Smith's holdings for every $100,000 invested.

Smith made Southwick aware of the 2014 Bridge Loan Note Offering, and Southwick then sold it to his customers, including SM and JM, who also had invested in the 2010 Bond Offering. Smith specifically asked Southwick whether JM, who had invested $300,000 in the 2010 Bond Offering, would also invest in the 2014 Bridge Loan Note Offering. Southwick testified that Smith told him not to recommend the investment, but rather to make his customers "aware" of the offering and to tell them he would "see if it could be made available," which Southwick referred to as his "script." CSSC and Smith raised approximately $1.1 million in the 2014 Bridge Loan Note Offering, including $550,000 from JM, who was approximately 90 years-old at the time.[3] JM initially invested $100,000 in the 2014 offering, but made subsequent investments after Smith asked Southwick whether JM would invest more. Southwick "made her aware" that more notes were available, which led to her additional $450,000 investment.

CSSC and Smith raised most of the money in the 2014 Bridge Loan Note Offering from Southwick's CSSC BD customers. While Southwick received no compensation for these sales, Smith expressed their importance to him. Southwick knew the offering's success was integral to whether Smith could pay Southwick his salary as CSSC continued to suffer financial difficulties.

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[3] In April 2017, Southwick settled a disciplinary action with FINRA. Southwick consented to findings that he made unsuitable recommendations to his customers to invest in the 2010 Bond Offering and 2014 Bridge Loan Note Offering without conducting reasonable due diligence and by relying upon a sales script that CSSC provided. Southwick was suspended from FINRA membership for six months in all capacities.

B. CSSC's Ongoing Financial Instability in Advance of the 2015 Bridge Loan Note Offering

CSSC's financial problems persisted into 2015 following the 2014 Bridge Loan Note Offering. Indeed, CSSC had a net loss of $944,000 in 2014. Smith was keenly aware of the company's financial struggles at the time of the 2015 offering.

For example, in December 2014, American Express started declining charges on the CSSC company credit card after four successive months in which the company's payments were more than thirty days past due. Smith and Southwick were traveling on business at the time, and Smith was worried that he and Southwick might be "stranded" because American Express was declining the charges that they had incurred. While traveling, Smith emailed CSSC's assistant controller, MD, about the immediacy of the financial strain facing CSSC. MD informed Smith that CSSC BD "desperately needs to be paid the $20,000 that it is owed from the RIA for December." MD highlighted that CSSC BD was "only $874 over the notification threshold" when it would fall below its minimum net capital requirement. MD explained that because CSSC BD owed CSSC more than $83,000 for the December 2014 rent, CSSC BD would fail to maintain its required level of net capital unless CSSC offset the rent with other revenue. Smith acknowledged that CSSC already had "missed payroll" and that offsetting the rent payment would leave CSSC unable to make payroll again. MD further explained to Smith that she was unable to make an $11,000 past due payment that Smith had asked her to send Ken Wheeler, a CSSC affiliate with CSSC BD and RIA, who needed the funds to pay insurance premiums.

In addition, in February 2015, CSSC's auditor alerted Smith that the company's accumulated deficit had surpassed $10 million at the end of 2014. The auditor also questioned whether CSSC BD could continue as a going concern and noted that CSSC BD would have been net capital deficient without the monthly $20,000 "stipends" it received from CSSC RIA. The auditor noted that CSSC's group of entities suffered losses of $803,000, $883,000, and $944,000 in 2012, 2013, and 2014, respectively. The auditor highlighted that CSSC "continues to experience difficulty in meeting its day-to-day obligations without significant outside funding."

In May and June 2015, principal began to become due to investors in the 2010 Bond Offering and the 2014 Bridge Loan Note Offering. When Smith began the 2015 Bridge Loan Note Offering, CSSC owed $635,000 to investors in the prior offerings. Smith knew that CSSC was unable to pay these investors. Smith, however, believed that CSSC would be current on its obligations to these investors by August 2015, and he did not disclose in the 2015 Bridge Loan Note Offering materials CSSC's inability to pay its investors in these prior offerings.

At the end of June 2015, CSSC BD's co-president, Martin, recognized CSSC's need for cash and extended to CSSC a loan of $50,000 at eight percent interest to be paid back in 30 days. CSSC, however, did not repay Martin when the principal became due. In August 2015, Martin demanded at least partial payment from CSSC. While CSSC repaid Martin approximately $7,500 by August 10, 2015, the balance remained unpaid as of the date of the hearing in this matter.

C. The 2015 Bridge Loan Note Offering

Smith sought to address CSSC's financial woes by issuing more debt securities, in the form of the 2015 Bridge Loan Note Offering. The terms of this offering were essentially the same as those of the 2014 Bridge Loan Note Offering, including Smith's promise to give investors 1,000 shares of his own CSSC stock for every $100,000 invested.[4] The offering documents, which Smith drafted and disseminated, consisted of a "Confidential Report" and an "Important Memorandum," each of which went through several iterations. Smith's omissions and misrepresentations in the 2015 Bridge Loan Note Offering documents form the basis of the Hearing Panel's findings that Smith committed fraud.

1. Smith's Failure to Disclose CSSC's Inability to Pay Prior Investors

Smith failed to disclose in the 2015 Bridge Loan Note Offering documents that CSSC was unable to pay substantial sums to the investors in the 2010 Bond Offering and 2014 Bridge Loan Note Offering. When Smith commenced the 2015 Bridge Loan Note Offering in June 2015, CSSC owed more than $200,000 to the 2010 investors and $300,000 to the 2014 investors. Smith admittedly was aware that CSSC was unable to pay those investors what they were owed. Smith acknowledged in his hearing testimony that, when he was soliciting investments in the 2015 Bridge Loan Note Offering, he was aware of CSSC's financial condition at the time and that he knew CSSC was unable to pay interest and principal to investors in the 2010 Bond Offering and 2014 Bridge Loan Note Offering.

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[4] Regarding the stock, the 2015 Bridge Loan Note terms stated that investors

> **will also receive 1,000 shares of CSSC common stock for every $100,000 loaned (and proportionally more and less for greater and lesser loan amounts).** These shares will **not** be coming from the Company, but from the personal holdings of Eric Smith, CSSC's Founder, Chairman, and Chief Executive Officer. He is giving these shares as an expression of his gratitude for the important help being provided by these loans. Although the value of CSSC's common stock has not been professionally evaluated, the latest Company transaction involving such shares occurred on April 30, 2012, when 11 CSSC Bondholders converted their Bonds to common stock at $20 per share.
>
> **Although these bridge loan Notes are not "convertible," the Company is currently planning an offering of CSSC common stock to provide an opportunity for the holders of CSSC debt instruments, including these bridge loan Notes and CSSC Bonds (from a prior offering), to acquire CSSC common stock in exchange for all or part of their CSSC Bonds or bridge loan Notes. The Company plans to initiate this new Offering sometime within the third quarter of 2015.**

2. Smith Misrepresented Facts Related to Project X

In November 2014, CSSC affiliate and registered representative Wheeler was looking for novel investment ideas to present to SB, a wealthy client and cardiologist who had a large network of contacts with other physicians. Wheeler, who also was an estate planner in Florida, provided estate planning services for SB. Wheeler approached Southwick for advice on what investments he might recommend. Southwick suggested he could "build a bank" in which SB could invest. Southwick had a background in commercial banking and previously had participated in the creation of a nationally chartered special purpose bank. Southwick understood SB to have enough wealth to provide the necessary capital to enable a new bank to obtain regulatory approval.

Wheeler told Southwick that SB had expressed "extreme excitement" and was "very interested in building a bank." SB insisted on keeping the project confidential, and they referred to the undertaking as "Project X." Wheeler informed Southwick that he alone would handle contact with SB.

Southwick told Smith about Project X soon after he and Wheeler began discussing it. Wheeler made clear that he did not want Smith participating in Project X, but Southwick continued to inform Smith about what was happening. Southwick explained that the Office of the Comptroller of the Currency ("OCC"), as well as other bank regulators, would have to approve the bank's charter. Southwick contacted a lawyer with whom he had worked to establish a special purpose bank in 1996 to ask for legal guidance. On November 9, 2014, Southwick informed Wheeler that he would soon send him "work product" from the law firm, the OCC, and a major private equity firm, that he hoped to involve in financing the bank.

On November 11, 2014, Southwick made a presentation regarding Project X to CSSC affiliates in a weekly meeting held at CSSC's office in Michigan, and Southwick shared all this information with Smith. In the presentation, Southwick described Project X in broad terms and provided a lengthy list of tasks that would have to be completed to form a national bank. The presentation described Project X as creating a nationally chartered private purpose bank that would produce consulting fees for CSSC and provide an opportunity for CSSC to obtain equity in the bank. Southwick testified that all of this information, including a consulting fee for CSSC of $1 million "initially paid up front with [equity firm] funds," was "[p]rospective" and there were "no [p]lans or agreements," "assets under management," or any "entity created."

Southwick and Wheeler both testified that, at the time, they understood that chartering the bank would be a long and arduous process and that success was far from assured. Southwick explained that virtually everything with Project X was suppositional, "not firm." Southwick had no idea if bank regulators would allow CSSC or the private equity firm to share ownership in the bank; he had no information on whether OCC would approve the project; he had not spoken to any of the OCC representatives; and had not yet attempted to contact individuals at the private equity firm nor made a proposal to them. Importantly, no consulting agreement ever existed. Southwick testified that sometime around March 2015, he contacted the private equity firm, and it was not interested in Project X. According to Southwick, getting approval for the bank would be a "huge, monumental task," and would take one to two years.

Notwithstanding the tentative and inconclusive status of Project X, Smith featured it prominently in the offering materials for the 2015 Bridge Loan Notes Offering. In the June 15, 2015 Confidential Report, Smith represented that "**CSSC is being paid a $1 million consulting fee for its work on the design and formation of this new Bank, the payment of which will ensure CSSC's profitability in 2015.**" He further wrote:

> One-half of that fee has now been earned and should be received very soon. The remainder will be due and payable when this new bank opens its doors for business, an event we expect to occur prior to the end of the 3rd quarter of 2015. For each additional bank of this type that CSSC helps to create, CSSC will receive an additional consulting fee, declining by $200,000 for each new bank created, with consulting fees ending with the 5th such Special Purpose Bank formed. CSSC expects to receive the full consulting fee for the first Bank during 2015, plus at least one half of the consulting fee for the second Special Purpose Bank amounting to $400,000 during 2015, for a total bank design-related consulting fee-income to CSSC of $1.4 million in 2015.

Smith went on to state in the offering materials that CSSC's receipt of the $1.4 million consulting fees "should ensure that 2015 is not only profitable, but also that it will be the most profitable year in CSSC's history."

In the July 12, 2015 Important Memorandum, Smith highlighted the special purpose bank as foremost among several CSSC's "important new initiatives." Specifically, in the section "Important Disclosures in the Accompanying 'Confidential Report,'" Smith again represented that "**CSSC is being paid a $1 million consulting fee for its work on the design and formation of this new Bank, the payment of which will ensure CSSC's profitability in 2015**." He added that this project would "**likely make 2015 CSSC's most profitable year so far.**"

Wheeler testified that contrary to Smith's representations in the offering documents as of June 2015, the special purpose bank was far from being in the final stages. The project organizers were "nowhere close" to creating a special-purpose bank. CSSC had no arrangement in place to be paid a consulting fee for the project nor was there work done or contemplated toward a second bank. Wheeler described Smith's representations about Project X in the offering materials as "delusional." When asked at the hearing whether he believed, at the time of the 2015 Bridge Loan Note Offering, that the bank would be opening its doors for business in the third quarter of 2015, Wheeler answered, "Absolutely not." Wheeler explained that they first had to form the financial services entity and prove the concept to the regulators. They then had to apply for the bank's charter, which may not have been granted. Wheeler surmised that they "were looking probably at a year or more in June of 2015 to accomplish all of that."

When Smith made these representations in the offering documents, he was aware of challenges involved with Project X coming to fruition. At the hearing, Smith admitted that he knew when he drafted the offering documents that only three banks in the previous five years had received national charters. Smith also admitted he never reviewed or approved any

consulting agreement. He also never saw any evidence of an agreement by which CSSC would be paid a $1 million consulting fee. And despite his representation in the offering documents that "[o]ne-half" of the $1 million fee "had been earned and should be received very soon," Smith admitted "[w]e did not know exactly the triggering event of when the payment" would be made. Smith testified that it was his "expectation" that CSSC would be paid based on what Southwick had told him. Smith admitted, however, that he never received any documentation from Southwick evidencing that CSSC would be paid any fee. Smith also had no conversations with the private equity firm purportedly involved with Project X about the payment of the consulting fee.

3. Smith Misrepresented CSSC's Business with the South Dakota Trust Company

In the June 15, 2015 Confidential Report, Smith claimed that he and Southwick were working on establishing an "important new strategic alliance with South Dakota Trust Company ('SDTC')." Smith claimed that CSSC was helping SDTC create a range of new investment funds for which CSSC "will be the investment advisor" and for which CSSC "will earn a fee based on a percentage of the assets under management." Smith also claimed he was forming "a client referral relationship with SDTC" whereby SDTC clients "would be referred to CSSC for a range of financial services that SDTC does not currently offer." Smith further asserted in the Confidential Report:

> With over $80 Billion of investment assets of wealthy families across the country in SDTC administered trust accounts, the revenue and profit potential from client referrals to CSSC could be quite substantial. . . . [T]he Company [CSSC] expects to have both of these potentially important new revenue sources up and running before the end of calendar year 2015.

These representations, however, were largely baseless. In March 2015, based on an introduction provided by a CSSC affiliate who was on SDTC's board of directors, Southwick and Smith had met with representatives of SDTC to discuss a possible referral agreement. At the meeting, SDTC emphasized that CSSC was not to disclose the prospective relationship to avoid jeopardizing SDTC's relationships with other investment professionals. As of June 2015, Smith knew there was no client referral agreement in place between CSSC and SDTC and that CSSC was not about to become the advisor for any SDTC funds. Nevertheless, Smith disregarded SDTC's request for confidentiality and touted the prospective relationship with SDTC in the offering documents for the 2015 Bridge Loan Note Offering.

In July 2015, a planned follow-up meeting with SDTC's chief executive officer never materialized.[5] And, in reality, CSSC never became the investment advisor to any SDTC funds, nor did it enter into a client referral agreement with SDTC.

[5] Southwick unsuccessfully attempted to meet with SDTC representatives until Smith fired him in September 2015.

4. Smith Misrepresented the Status of CSSC's Business with the City of Jacksonville

Smith also misrepresented in the June 15, 2015 Confidential Report the status of CSSC's business with Jacksonville, Florida. Smith stated in the Report:

> We are currently in the final stages of being engaged as Special Reviewing Consultant with regard to the investment management of Jacksonville's nearly $1 billion in short-term operating funds. . . . In addition to the revenue this case will generate, it will also increase our reportable assets under management by nearly $1 billion — a very significant credentialing plateau.

Southwick was primarily responsible for pursuing the city as a client. When Smith made this representation in June 2015, CSSC had not yet sent the city a proposal. When it did so on July 27, 2015, the proposal was confined to CSSC's providing a quarterly performance review of the city's investment portfolio, not managing its investments. For providing this review, CSSC proposed a $15,000 quarterly fee. The city did not agree to CSSC's proposal.

Even after Smith terminated Southwick in September 2015, Smith continued falsely representing to investors in an "October 2015 Important Update" offering document that CSSC had a pending engagement with Jacksonville that would result in an additional $1 billion in assets under management, and that the engagement was expected to begin by the end of 2015. In fact, as Smith acknowledged at hearing, the city of Jacksonville never engaged CSSC to serve as a reviewing consultant. Even if the city had accepted the proposal, CSSC's acting as "special reviewing consultant" would not have increased its assets under management at all, let alone by $1 billion.

D. Investors in the 2015 Bridge Loan Note Offering

Smith personally solicited between 15 and 25 people to invest in the 2015 Bridge Loan Note Offering and succeeded in raising $130,000 from four of them: TL, Thomas Scotto, BB, and Gavin Clarkson.[6] Scotto and Clarkson were registered representatives of CSSC BD.

TL and Scotto were the first two investors in the 2015 Bridge Loan Note Offering and made their investments in August 2015, after receiving the offering materials that included the July 12, 2015 version of the Important Memorandum to potential investors. On September 9, 2015, Smith revised the Important Memorandum and Confidential Report related to Project X. Smith stated in the revised documents that progress on Project X had been "unexpectedly interrupted," the revenue he previously had represented as already having been earned "may not materialize until 2016, if at all," and that the interruption, caused by a "plan to deprive" CSSC of

[6] Investors BB and TL are identified in Enforcement's Schedule of Abbreviations and References filed with its complaint in this matter.

"an expected $2.15 million," meant that the special purpose bank revenue "now appears unlikely to take place within the 4th quarter of 2015. Consequently, it now appears unlikely that, unless other revenue sources are secured, 2015 will be profitable and the best year in the Company's history." Despite these revisions made a few days earlier, Smith, on September 12, 2015, sent investor BB a package of materials that included the June 15, 2015 Confidential Report, which described the likely receipt of revenue from Project X, as follows: **"CSSC is being paid a $1 million consulting fee for its work on the design and formation of this new Bank, the payment of which will ensure CSSC's profitability in 2015.**"

In October and November 2015, Smith sent emails to Clarkson soliciting him and his connections to invest in the 2015 Bridge Loan Note Offering. Although Smith attached updated offering materials to the emails, including the disclosure that Project X had been "unexpectedly interrupted and revenue from it now is doubtful in 2015," the materials continued to make other false claims about projected large increases in revenues to CSSC related to the SDTC and engagement with the city of Jacksonville. Smith's emails to Clarkson also failed to disclose that CSSC was unable to pay the investors from the 2010 Bond Offering and the 2014 Bridge Loan Note Offering.

1. Investor TL

JC, who was affiliated with CSSC, referred Smith to TL. On July 21, 2015, Smith emailed TL promoting the 2015 Bridge Loan Note Offering. The email, with the subject line "CSSC's 'Bridge Loan Note' Offering - explanation/package," stated that Smith was sending TL "the complete package" of offering documents. Smith represented that the offering was a "great deal" that "really was originally designed for friends and family and for those doing business with CSSC." Smith told TL that he had been "introducing this to one person at a time" but had "recently changed that approach" and now was "expanding the range of those to whom this is being made available." Smith represented to have "successfully placed" $1.35 million in notes and hoped to complete the $3 million offering by placing $1.65 million "within the next 30 days." Smith said he was "not anticipating doing anything like this (individual offerings) again." Smith invited TL to meet him later that week in New York City, where they discussed the 2015 Bridge Loan Note Offering. Smith stayed in contact and spoke again with TL about the offering by phone in August 2015.

On August 17, 2015, Smith followed-up with TL via email. To that email Smith attached the July 12, 2015 Important Memorandum to prospective investors, which Smith described as "[a] summary discussion of why we are seeking bridge financing, the new initiatives and changes being implemented, and important financial information/disclosures." TL had asked Smith whether he would rescind the offer of promised CSSC stock if TL exercised an early payoff of the note. Smith assured TL that he would not and promised to send a stock certificate and the note by overnight mail. On August 24, 2015, TL invested $50,000 in the 2015 Bridge Loan Note Offering.

Smith did not send the stock certificate to TL until November 2015. TL complained to JC in email about the delay, indicating that he had been waiting for weeks for Smith to send him the paperwork. TL told JC that his "trust has been seriously shaken" and that he would refuse to

accept delivery of the certificate and wanted a refund from Smith. JC did not respond and forwarded the email to Smith. Smith informed TL that he had "no present ability" to refund his investment and promised he would "be paying off the Notes at the earliest opportunity." Smith highlighted that TL's investment was "earning interest at 8%" and Smith had gifted him CSSC common stock. TL has not been repaid his $50,000 investment.

2. Investor Scotto

Scotto, a CSSC registered representative and an employee of CSSC RIA, previously had invested $215,000 in bond and note purchases with CSSC. Smith made Scotto aware of the 2015 Bridge Loan Note Offering to enable him to solicit prospective investors. In July 2015, Smith sent Scotto an email directing him to replace the June 2015 version of the "Important Memorandum" in the offering documents that Smith sent earlier with the updated July 12, 2015 version.[7] Smith directed Scotto to send the updated memorandum to anyone to whom he had given the earlier version. Smith explained that the June memorandum "did not give an accurate or balanced view of what we are doing and why . . . someone might consider it beneficial (to them) to participate in the Offering." He also attached a copy of a PowerPoint presentation he thought "should provide a quick way to introduce us to prospective new investors and others that you think might be good fits for a relationship with us."

In response to Smith's email, Scotto sent $20,000 of his personal funds to CSSC on August 31, 2015. Smith claimed during the hearing that the $20,000 was not an investment in the 2015 Bridge Loan Note Offering but was instead a short-term loan to CSSC. In an email exchange on November 18, 2015, between CSSC's controller, DW and Smith, however, DW informed Smith that Scotto's $20,000 was one of several "notes" that "[t]erms have not been specified for." In response, Smith wrote that Scotto's funds were "in the Bridge Loan Note Offering." Scotto has not been repaid his $20,000 investment.

3. Investor BB

In September 2015, Smith solicited BB, a college classmate, to invest in the 2015 Bridge Loan Note Offering and encouraged BB to solicit other investors in the offering. Smith emailed BB on September 12, 2015, with the subject line "FW: CSSC's 'Bridge Loan Note Offering' - explanation/package." In the email, Smith referred to a conversation he and BB had earlier that day and referenced their prior discussion that the offering was not "applicable in [BB's] case." Smith stated that they should "consider some alternatives" for BB to become "involved" in the offering. Smith attached to this email various offering documents, including the June 15, 2015 version of the "Confidential Report." Smith encouraged BB to let him know if he thought the offering would be a "fit" for him or "others that you believe we should consider including that would be good for us to 'have in the family.'"

[7] The record does not detail their prior conversations.

On September 29, 2015, BB sent $10,000 to Smith. Smith indicated to CSSC's controller that BB's investment was a "6 month Note." BB has not been repaid his $10,000 investment.

4. Investor Clarkson

In October 2015, Smith solicited Clarkson to invest in the 2015 Bridge Loan Note Offering. Clarkson was a licensed investment advisor and broker who had been registered with affiliates of CSSC since 2012. Smith sent Clarkson an email on October 29, 2015, attaching the "Confidential Report," the "Important Update," a version of the "Memorandum to Those Considering Making a Bridge Loan" that Smith had revised four days earlier, and a promissory note and certificate. Smith encouraged Clarkson to invest personally and to solicit his contacts for investments. Smith knew that Clarkson also worked with Native American tribes attempting to facilitate release of tribal funds held by the Bureau of Indian Affairs. Smith referenced CSSC's "current short-term cash needs," and stated that he hoped the 2015 offering "might indeed be a good 'fit' with you and possibly one or more of your tribal connections—that you and/or some of them will be able to take advantage of the opportunity." Smith told Clarkson that it would be "good [to] have some new folks 'on the team'—especially in the tribal world, and if you are the one recommending them."

On November 2, 2015, Smith sent Clarkson another email with updates to "two of the principal [offering] documents" that Smith had revised that day, and asked Clarkson to "dispose of the earlier versions in the package(s)" and "replace with these." Smith emailed wiring instructions to Clarkson on November 12, 2015, and wrote that he would soon "resend the rest of the disclosure package." In a subsequent email sent 14 minutes later, Smith attached the 2015 Bridge Loan Note Offering documents and the wiring instructions. The following day, Clarkson invested $50,000. In an email to CSSC's controller, Smith characterized Clarkson's investment as a "6 month Note." Clarkson has not been repaid his $50,000 investment.

IV. Discussion

We affirm the Hearing Panel's findings that Smith engaged in fraud when he failed to disclose material facts and made material misrepresentations in connection with the 2015 Bridge Loan Notes Offering. We further affirm the findings that Smith acted in the capacities of a general securities representative and principal without being registered. We discuss the violations in detail below.

A. Smith Committed Fraud When He Omitted and Misrepresented Material Facts

Exchange Act Section 10(b) makes it "unlawful for any person, directly or indirectly . . . [t]o use or employ, in connection with the purchase or sale of any security . . . , any manipulative or deceptive device or contrivance in contravention" of Commission rules. 15 U.S.C. § 78j(b). Exchange Rule 10b-5(b) makes it unlawful for any person "directly or indirectly" to "make any untrue statement of a material fact or omit to state a material fact necessary in order to make the

statements made . . . not misleading."[8] 17 C.F.R. §240.10b-5(b). Thus, under Section 10(b) and Rule 10b-5, "one who elects to disclose material facts must speak fully and truthfully, and provide complete and non-misleading information with respect to the subjects on which he undertakes to speak." *Louis Ottimo*, Exchange Act Release No. 83555, 2018 SEC LEXIS 1588, at *31 (June 28, 2018) (internal quotation marks omitted). "That duty is a general one, and arises whenever a disclosed statement would be misleading in the absence of the disclosure of additional material facts needed to make it *not* misleading." *Id.* (internal quotation marks omitted).

A violation of Section 10(b) and Rule 10b-5 constitutes a violation of FINRA's antifraud rule, FINRA Rule 2020, which prohibits FINRA members and their associated persons from effecting "any transaction in, or induc[ing] the purchase or sale of, any security by means of any manipulative, deceptive or other fraudulent device or contrivance." *William Scholander*, Exchange Act Release No. 77492, 2016 SEC LEXIS 1209, at *15 (Mar. 31, 2016), *aff'd sub nom. Harris v. SEC*, 712 F. App'x 46 (2d Cir. Oct. 25, 2017). Proof of scienter is required to establish a violation of each of the foregoing provisions.[9] *See Dept. of Enforcement v. Luo*, Complaint No. 2011026346206, 2017 FINRA Discip. LEXIS 4, at *20 (FINRA NAC Jan. 13, 2017). Such conduct also violates FINRA Rule 2010. *Scholander*, 2016 SEC LEXIS 1209, at *14-15.

Enforcement alleged, and the Hearing Panel found, that Smith committed securities fraud when he failed to disclose and made material misstatements of fact when he solicited investors to purchase the 2015 Bridge Loan Notes. Enforcement's fraud allegations stemmed from: (1) Smith's failure to disclose CSSC's inability to pay previous investors in CSSC's 2010 Bond and 2014 Bridge Note Loan Offerings; and (2) Smith's representations related to Project X and CSSC's business with the SDTC and the city of Jacksonville. We agree with the Hearing Panel that Smith committed securities fraud.

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[8] Smith, as the drafter of the 2015 Bridge Loan Notes Offering documents with the ultimate authority over these documents and their contents, was the maker of the misstatements and omissions contained within them for purposes of liability under Exchange Act Rule 10(b)-(5)(b). *See Janus Capital Grp., Inc. v. First Derivative Traders*, 564 U.S. 135, 142-43 (2011).

[9] Section 10(b) and Rule 10b-5 include jurisdictional elements that prohibit fraud by "any means or instrumentality of interstate commerce." *See* 15 U.S.C. § 78j; 17 C.F.R. 240.10b-5. Smith's conduct in this case occurred by means or instrumentality of interstate commerce, such as communicating through telephone calls, email, or the U.S. mail service, thereby satisfying the interstate commerce requirement. *See Grubbs v. Sheakley Grp., Inc.*, 807 F.3d 785, 803 (6th Cir. 2015) ("[T]he very act of sending an e-mail creates the interstate commerce nexus necessary for federal jurisdiction."); *SEC v. Softpoint, Inc.*, 958 F. Supp. 846, 865 (S.D.N.Y. 1997) (determining that the jurisdictional requirements of the federal antifraud provisions are interpreted broadly and are satisfied by intrastate telephone calls or the use of the U.S. mail), *aff'd*, 159 F.3d 1348 (2d Cir. 1998).

1. The 2015 Bridge Loan Notes Were Securities

We agree with the Hearing Panel's determination that the 2015 Bridge Loan Notes were securities. The offering documents describe the 2015 Bridge Loan Notes as unsecured with a 12-month maturity, earning eight percent interest, with an additional "gift" of CSSC common stock. The Exchange Act defines a "security" to include "any note," except notes with maturities of less than nine months. 15 U.S.C. § 78c(a)(10); *see Reves v. Ernst & Young*, 494 U.S. 56, 65-66 (1990). The Supreme Court in *Reves* adopted the "family resemblance" test, along with four factors, to consider in determining whether a note is a security under Section 3(a)(10) of the Exchange Act. 494 U.S. at 66-67. The *Reves* four factors determine whether the transaction nonetheless involves a security by evaluating: (1) the motivations of the buyer and seller (i.e., whether the seller is raising money for general use of a business enterprise and whether the buyer is interested in the profit the note is expected to generate); (2) the plan of distribution (i.e., whether the note is an instrument in which there is a common trading for speculation or investment); (3) the reasonable expectation of the investing public; and (4) the existence of another regulatory scheme that makes oversight by federal securities laws unnecessary. *Id.* Under the *Reves* test, a note is presumed to be a security. *Id.* That presumption may be rebutted only by demonstrating that the note bears a strong resemblance to one of the enumerated categories of instrument that are deemed as non-securities when considering the four factors of the *Reves* test.[10] *Id.* at 66-67. If a note is not sufficiently similar to the enumerated categories of non-securities, the family resemblance test requires an examination, based on the same four factors, of whether another category should be added. *Id.*

The 2015 Bridge Loan Note Offering documents show that CSSC issued the short-term notes to raise capital for its general business operations and that the notes were crafted to appeal to investors seeking profit. The 2015 Bridge Loan Note Offering Confidential Report stated that CSSC was "covering its operating deficits" with the note proceeds. In the "Important Memorandum," Smith wrote that "funds raised will be used to smooth out Company cash flows and cover any operating deficits until the revenue expected from" pending "new initiatives begins to be received."

Furthermore, the evidence reflects that Smith drafted the offering documents to emphasize the potential profit to note purchasers. Indeed, Smith acknowledged that he drafted the offering documents with the offer of an eight percent return and gifts of CSSC stock to make the offering attractive to potential investors. The 2015 Bridge Loan Notes provided its holders an attractive interest rate of eight percent; thus, the investing public reasonably would view them as "securities." *See Stoiber v. SEC*, 161 F.3d 745, 750 (D.C. Cir. 1998) (explaining that notes

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[10] The categories of notes that are not securities are notes that are: (1) delivered in consumer financing; (2) secured by a mortgage on a home; (3) short-term notes secured by a lien on a small business or some of its assets; (4) evidencing a character loan to a bank customer; (5) short-term notes secured by an assignment of accounts receivable; or (6) which simply formalize an open-account debt incurred in the ordinary course of business (particularly if, as in the case of the customer of a broker, it is collateralized). *Id.* at 65.

with a favorable interest rate indicate that profit was the lender's primary goal). In addition, the notes were uninsured and not subject to the federal banking laws and therefore would otherwise escape federal regulatory oversight if they were deemed non-securities. Based on these considerations, we conclude that the 2015 Bridge Loan Notes were securities. The notes did not bear a strong family resemblance to the notes listed as non-securities, and there is no basis for adding a new category considering the *Reves* factors.

While Smith conceded that customer TL invested $50,000 in the 2015 Bridge Loan Note Offering, he asserted that Scotto, Clarkson, and BB merely loaned money to CSSC. In evaluating the 2015 Bridge Loan Notes under the *Reves* factors, however, we conclude that the notes were securities that Smith offered to TL, Scotto, Clarkson, and BB, who were investors in the securities offering. Smith offered the notes for investment purposes and not in commercial or consumer contexts with a standard maturity date of one year from purchase. While Smith was willing to shorten the maturity date to less than one year for some note holders, he did so only after investors negotiated a shorter term for the notes' maturity in exchange for their investment. For example, Smith testified that Scotto said he would participate in the offering, but needed his principal returned by the end of the year. Smith accommodated Scotto by agreeing to "[d]o it differently." Thus, Smith was willing to adjust the terms to satisfy those who wanted to participate in the offering, but with terms that differed from its original terms. It was only after Smith solicited Scotto with emails and sent him the package of offering documents for prospective investors that Scotto sent Smith $20,000. As the Hearing Panel found, these circumstances show that Smith solicited Scotto to invest in the 2015 Bridge Loan Note Offering, and Scotto invested in the offering only after negotiating a shorter term for maturity than the standard one year.

Similarly, with respect to BB, Smith in September 2015 sent BB the offering materials for the 2015 Bridge Loan Note Offering, including the June 15, 2015 version of the "Confidential Report." Smith stated in an accompanying email that if BB wished "to get involved," Smith would "consider some alternatives," and invited BB to let Smith know if he decided "to get involved." When BB reviewed the offering documents, he said he wanted to participate, but asked if he could do so with only a $10,000 "loan" and that he was interested in receiving CSSC stock to have "a stake in the company." Smith again agreed to vary from the original terms and shorten the offering's standard one-year maturity, referring to it as a "6 month Note," in order to obtain BB's $10,000. Like he did with Scotto, Smith solicited BB to invest in the 2015 Bridge Loan Note Offering and obtained BB's investment only after modifying the offering's standard terms. Smith also encouraged BB to introduce the offering to his connections in investment banking and venture capital circles to obtain more investors.

While Smith admitted in his hearing testimony that he solicited Clarkson to invest in the 2015 Bridge Loan Note Offering, Smith contends that Clarkson instead made a shorter-term loan. Smith, however, sent the 2015 Bridge Loan Note Offering documents and wiring instructions to Clarkson hoping he would purchase a Bridge Loan Note and solicit other potential investors among his Native American tribal contacts. In October 2015, Smith emailed Clarkson that he was "finishing the placement of the remaining $1.6 million available in our current Bridge Loan Note Offering," and described it as "a great opportunity" that he hoped would "be a good 'fit'" for Clarkson and his "tribal connections—that you and/or some of them will be able

to take advantage of the opportunity." Smith's willingness to make individual modifications to the terms of the offering to obtain certain investors does not alter that the 2015 Bridge Loan Note Offering was a securities offering under the Exchange Act and *Reves* analysis. *See* 15 U.S.C. § 78c(a)(10); *Reves*, 494 U.S. at 65-66.

In addition, CSSC records describe the note transactions in terms of investments rather than loans in a document titled, "Bridge Loan note holders." In this document, TL and Scotto were listed by name as "Bridge Loan note holders," with the amounts of their investments, August 2016 maturity dates of their notes, and total interest due at eight percent upon maturity for each investor. Investor BB's name appears on another CSSC document titled, "Other note holders," and lists his $10,000 investment with a September 2016 maturity date, which was one year after his investment, and $799.99 interest due at maturity.

As the Hearing Panel found, other evidence supports the conclusion that the four transactions at issue were purchases of securities in the 2015 Bridge Loan Note Offering rather than short-term unaffiliated loans to CSSC. In November 2015, when CSSC's controller emailed Smith to inform him that "[t]erms have not been specified for the following notes," he included the notes at issue here: Scotto's $20,000; BB's $10,000; TL's $ 50,000; and Clarkson's $50,000 investments. Smith then identified Scotto's and TL's funds as "in the Bridge Loan Note Offering," and BB's and Clarkson's funds as "6 month Note[s]."

2. Smith's Omissions and Misstatements of Fact Were Material

The information that Smith omitted to disclose and misstated in the 2015 Bridge Loan Note Offering documents was material. Whether information is material "depends on the significance the reasonable investor would place on the . . . information." *Basic Inc. v. Levinson*, 485 U.S. 224, 240 (1988). Information is material "if there is a substantial likelihood that a reasonable [investor] would consider it important in deciding how to [invest] . . . [and] the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Id.* at 231-32 (quoting *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)).

When soliciting investments in the 2015 Bridge Loan Notes, Smith failed to disclose that CSSC was unable to pay the investors in CSSC's 2010 Bond Offering and 2014 Bridge Loan Note Offering. Smith does not dispute that he failed to disclose CSSC's inability to satisfy its pre-existing debt obligations. He in fact admitted that when he was soliciting investments in the 2015 Bridge Loan Note Offering, he was aware of CSSC's deteriorating financial condition at the time and knew CSSC was unable to pay interest and principal to investors in the 2010 and 2014 offerings. Indeed, when Smith was soliciting investors in the 2015 offering, CSSC owed a combined $635,000 to the 2010 and 2014 investors. A reasonable investor would have considered the fact that CSSC was unable to pay investors in its prior debt offerings an important factor when evaluating whether an investment in the 2015 Bridge Loan Note Offering was prudent. *See SEC v. Todd*, 642 F.3d 1207, 1221 (9th Cir. 2011) (holding a company's financial condition is material to investments); *Dep't of Enforcement v. McGee*, Complaint No. 2012034389202, 2016 FINRA Discip. LEXIS 33, at *33 (FINRA NAC July 18, 2016), *aff'd*, 2017 SEC LEXIS 987 (Mar. 27, 2017), *aff'd*, 733 F. App'x 571 (2d Cir. 2018); *see, e.g.*, *Aubrey*

v. Barlin, No. A-10-CA-076-SS, 2011 U.S. Dist. LEXIS 15332, at *23 (W.D. Tex. Feb. 16, 2011) (finding "the omitted facts material, as any reasonable investor would want to know if the entity to which they were loaning money was already defaulting on its prior obligations"). This omission was material.

Smith also made false material representations regarding CSSC's anticipated revenue from Project X, SDTC, and the city of Jacksonville. Smith misrepresented the status of these significant revenue events in the 2015 offering documents and concluded that 2015 likely would be CSSC's most profitable year so far. For example, he stated that CSSC was being paid $1.4 million in consulting fees for its work on the design and formation of Project X, and that the payment "will ensure CSSC's profitability in 2015." Smith also stated without support that CSSC had already earned $500,000 from this project. Smith claimed that CSSC would be the investment advisor for a range of new investment funds that CSSC was helping SDTC create, that CSSC would earn a fee based on a percentage of the assets under management, and that CSSC was forming "a client referral relationship" with SDTC for a range of financial services that SDTC does not currently offer. Smith claimed that "the revenue and profit potential from client referrals to CSSC could be quite substantial."

As of June 2015, Smith knew that CSSC had not earned anything from Project X, that there was no client referral agreement in place between CSSC and SDTC, and that CSSC was not about to become the advisor for any SDTC funds. Smith further misrepresented in the offering documents that CSSC would increase its assets under management by nearly $1 billion through its engagement with the city of Jacksonville. These statements, which were demonstrably false when Smith made them, were at the heart of his sales pitch to potential investors. "[T]he materiality of information relating to financial condition, solvency and profitability is not subject to serious challenge." *SEC v. Murphy*, 626 F.2d 633, 653 (9th Cir. 1980); *see also SEC v. USA Real Estate Fund 1, Inc.*, 30 F. Supp. 3d 1026, 1034 (E.D. Wash. 2014) ("False claims of substantial unearned revenue, or the substantial overstatement of revenue, are 'material' to reasonable investors."); *Dep't of Enforcement v. Gomez*, Complaint No. 2011030293503, 2018 FINRA Discip. LEXIS 10, at *44 (FINRA NAC Mar. 28, 2018) ("The truth that Praetorian and the Praetorian G entities did not own pre-IPO shares of Groupon or Zynga, and that U.S. Coal had no plans to pursue an IPO, would have undoubtedly been material to the investors Gomez solicited. Gomez's false statements to the contrary significantly altered the total mix of information available to these investors and any reasonable investor."). The statements that Smith included in the 2015 Bridge Loan Note Offering documents about CSSC's financial prospects related to Project X, SDTC, and the city of Jacksonville were information that "altered the total mix of information made available" to the investors for the 2015 offering, and any reasonable investor would consider this information important to an investment decision in the offering. *See Basic*, 485 U.S. at 231-32; *Ottimo*, 2018 SEC LEXIS 1588, at *33.

Smith argues that the Hearing Panel erroneously decided materiality "as a matter of law," and failed to consider evidence of whether any of the specific investors relied on the information in making their investment decisions. Moreover, he states that one investor, Scotto, continued "loaning" CSSC money in 2015 despite having "loaned" CSSC money earlier that the firm had not yet repaid. The Commission and the courts, however, have rejected arguments mirroring

Smith's, and we do so here. As the Supreme Court has explained in the context of deciding materiality as a matter of law:

> The determination [of materiality] requires delicate assessments of the inferences a reasonable shareholder would draw from a given set of facts and the significance of those inferences to him, and these assessments are peculiarly ones for the trier of fact. Only if the established omissions are so obviously important to an investor, that reasonable minds cannot differ on the question of materiality is the ultimate issue of materiality appropriately resolved as a matter of law by summary judgment.

TSC Indus., 426 U.S. at 450 (internal quotation marks omitted).[11] The Hearing Panel, as the trier of fact, decided materiality correctly as a mixed question of law and the relevant facts of this case. *See id.* Relevant precedent also does not require that Enforcement present evidence of an individual investor relying upon a misstatement or omission when deciding to invest. "[T]o be material, a fact need not be outcome-determinative—that is, it need not be important enough that it would necessarily cause a reasonable investor to change his investment decision." *SEC v. Meltzer*, 440 F. Supp. 2d 179, 190 (E.D.N.Y. 2006). And the reasonableness of an investor's reliance is not an element of a FINRA enforcement action for fraud. *See Dep't of Enforcement v. Kaweske*, Complaint No. C07040042, 2007 NASD Discip. LEXIS 5, at *21 n.16 (NASD NAC Feb. 12, 2007). The "reaction of individual investors is not determinative of materiality, since the standard is objective, not subjective." *Ottimo*, 2018 SEC LEXIS 1588, at *38; *see also Kenny Akindemowo*, Exchange Act Release No. 79007, 2016 SEC LEXIS 3769, at *17 (Sept. 30, 2016) (finding misstatements material "because a reasonable investor would want to know how their funds were actually being used").

Smith further contends that the "total mix of information" that he provided to prospective investors included "stark warnings" of CSSC's "financial losses and its then-current inability to pay its debts from operating revenues." Smith overstates these purported disclosures, which do not serve to counteract his omissions and misstatements. "Materiality is not judged in the abstract, but in light of the surrounding circumstances." *Rosenzweig v. Azurix Corp.*, 332 F.3d 854, 866 (5th Cir. 2003); *see also ZPR Inv. Mgmt. v. SEC*, 861 F.3d 1239, 1251-52 (11th Cir. 2017) (explaining that it is "well-established principle that a statement or omission must be considered in context"), *cert. denied*, 138 S. Ct. 756 (2018); *United States v. Rigas*, 490 F.3d

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[11] Smith also objects to Enforcement's failure to call an expert to offer testimony on materiality. Smith, however, could have filed his own motion before the Hearing Officer to permit expert testimony. *See* FINRA Rule 9242(a)(5). Regardless, expert testimony is not necessary for the Hearing Panel or the NAC to assess what Smith omitted and disclosed to investors and whether those disclosures were false and misleading in light of the circumstances of this case. *See Fuad Ahmed*, Exchange Act Release No. 81759, 2017 SEC LEXIS 3078, at *79 (Sept. 28, 2017) ("Rather, the relevant evidence concerned the representations that Respondents made in offering the STI notes. Both FINRA and the Commission . . . have the expertise to evaluate such evidence without expert testimony." (internal quotation marks omitted)).

208, 231 (2d Cir. 2007) ("Analysis of the misrepresentations must be in the context in which they were made.").

While the 2015 Confidential Report referred to CSSC's ongoing financial difficulties, it did so in the context of how CSSC was overcoming those struggles through its new initiatives including Project X, its business with SDTC, and its business with the city of Jacksonville. The "warnings" that Smith highlights were boilerplate risk-disclosure language in the 2015 Important Memorandum, which stated, "[m]aking an unsecured loan to a company that is experiencing current cash flow shortfalls involves a significant amount of risk," "that there was no guarantee that the loan would be repaid with interest when due," "[l]oans of this type should be made only by those financially able and willing to accept the risk that all or part of the loan could be lost." Smith's warnings, however, were offset by his statement that, "we believe that the measures described and discussed in the accompanying Confidential Report (which you are urged to read) will restore the Company to sustainable and growing profitability, and could result in significant appreciation in the value of CSSC's common stock." Here, Smith's numerous falsehoods and his omission of key financial information that CSSC was unable to pay its prior investors were made to portray the 2015 Bridge Loan Note Offering as an ostensibly profitable investment. *See, e.g.*, *Gould v. Am. Hawaiian S.S. Co.*, 331 F. Supp. 981, 997 (D. Del. 1971) (finding aggregate effect of numerous falsehoods most clearly evidenced materiality).

The NAC moreover rejected arguments like Smith's in *Department of Enforcement v. Escarcega*, Complaint No. 2012034936005, 2017 FINRA Discip. LEXIS 32 (FINRA NAC July 20, 2017). The NAC found unpersuasive Escarcega's argument that because he provided written material that described risks of an investment in detail, such as the prospectus, any alleged misrepresentations that he made cannot be considered material in the context of the total mix of information. *Id.* at *36-37; *see also Dep't of Enforcement v. Brookstone Sec., Inc.*, Complaint No. 2007011413501, 2015 FINRA Discip. LEXIS 3, at *81 (FINRA NAC Apr. 16, 2015) (rejecting respondents' argument that a broker's misrepresentations are rendered immaterial when written risk disclosures are made available to customers).

We conclude that the information that Smith failed to disclose and misrepresented was material.

3. Smith Acted with Scienter

We also find that Smith acted with scienter when he omitted material facts and made material misrepresentations to investors. Scienter is defined as "a mental state embracing intent to deceive, manipulate, or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976). Scienter is established if a respondent acted intentionally or recklessly. *See Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 n.3 (2007). Scienter includes recklessness, which is defined as conduct that is "an extreme departure from the standards of ordinary care . . . which presents a danger [of deceiving investors that] is either known to the [respondent] or is so obvious that the [respondent] must have been aware of it." *Dolphin & Bradbury, Inc. v. SEC*, 512 F.3d 634, 639 (D.C. Cir. 2008) (internal quotation marks and emphasis omitted). Recklessness may be inferred from circumstantial evidence suggesting an obvious risk of misleading investors that is so great that it is simply implausible that a respondent did not know

about it. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 390-91 n.30 (1983); *Vernazza v. SEC*, 327 F.3d 851, 860-61 & n.8 (9th Cir. 2003).

In the case of a material omission, "scienter is satisfied where . . . the [respondent] had actual knowledge of the material information." *Brookstone*, 2015 FINRA Discip. LEXIS 3, at *78-79. Smith knew when he drafted the 2015 Bridge Loan Note Offering documents that CSSC was experiencing extreme financial difficulties. In March 2015, CSSC's controller informed Smith that $635,000 was coming due to prior investors by the end of June 2015. Smith knew that CSSC was unable to pay these investors but failed to disclose that fact in the 2015 offering documents that he drafted.

We also find as additional evidence of scienter that Smith had disclosed in the 2010 Bond Offering documents that short-term notes CSSC issued in 2009 had become due, and it was "fortunate" to secure agreements to exchange the notes for new notes. Smith disclosed in the 2010 offering documents that "serious consequences," including CSSC being unable to continue as a going concern, could result if the note holders did not continue to agree to similar exchanges. Smith included no similar language in the 2015 offering documents. While Smith stated in the 2015 documents that CSSC had conducted previous offerings, he did not disclose that those investors were not being paid. This omission served to mislead new investors and furthered Smith's self interest in obtaining much needed capital infusions from these investors.[12] *See, e.g.*, *Warwick Capital Mgmt., Inc.*, Investment Advisers Act Release No. 2694, 2008 SEC LEXIS 96, at *29 (Jan. 16, 2008) ("His self-interest in providing inaccurate information about Warwick is apparent."). The evidence unquestionably reflects that Smith knew these adverse facts and intentionally withheld them.

Smith also misled investors about the status of Project X and CSSC's purported agreements with SDTC and the city of Jacksonville. Affirmative statements concerning the purchase or sale of a security come with the "ever-present duty not to mislead." *See Basic*, 485 U.S. at 240 n.18. Smith lacked a reasonable basis for his statements concerning these initiatives and the circumstances reveal it was implausible that he did not know or was extremely reckless in not knowing the truth when he made these statements. *See Gebhart v. SEC*, 595 F.3d 1034, 1041 (9th Cir. 2010) ("Scienter may be established, therefore, by showing that the [respondents] knew their statements were false, or by showing that [respondents] were reckless as to the truth or falsity of their statements.").

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[12] In further support of Smith's scienter, we note that Smith initiated the 2015 Bridge Loan Note Offering in the wake of extreme financial pressure on CSSC. For example, in December 2014, American Express had been declining charges on the CSSC company credit card for nonpayment, and Smith was worried that he and Southwick might be "stranded" while traveling as a result. In February 2015, CSSC's auditor alerted Smith that the company's accumulated deficit had surpassed $10 million at the end of 2014. The auditor also questioned whether CSSC BD could continue as a going concern. The auditor highlighted that CSSC "continues to experience difficulty in meeting its day-to-day obligations without significant outside funding."

Smith represented in the multiple iterations of the 2015 Bridge Loan Note Offering documents that CSSC was set to receive $1.4 million in total consulting fees in 2015 from Project X alone, consisting of $1 million for creating the first bank and $400,000 for creating the second bank. Smith represented that Project X would make 2015 the "most profitable year in CSSC's history." Smith stated that half of the $1 million consulting fee had already "been earned and should be received very soon." Smith went on to explain that he expected CSSC would receive the other half of the fee when the bank began operating, and that he expected this would be accomplished prior to the third quarter of 2015. Smith represented that CSSC then was slated to be paid additional fees for replicating the banks. None of this was remotely accurate.

Smith made these representations without reviewing or approving a consulting agreement or reviewing an application to bank regulators for the special purpose bank. And the evidence shows that Smith knew (or was extremely reckless in not knowing) that there was no consulting agreement in place when he made these statements. For example, in July 2015, a wealthy potential investor LC, with whom Smith was trying to place $1.6 million in 2015 Bridge Loan Notes, insisted that Smith produce a copy of a written commitment reflecting that CSSC would be providing financial services for the special purpose bank. On July 28, Smith wrote to LC that the "bank is nearing completion," and the document confirming that CSSC would provide "the investment advisory and brokerage platform" would be executed "very soon since meetings with the [prospective] investors began, financial services introductions have already been set." Smith then asked Southwick for the documentation. When Southwick said he did not have any, Smith had Southwick, in Smith's presence, call the lawyer who Southwick knew was advising on the project and ask him for the agreement. The lawyer replied that there was no agreement, and that the financial services entity had not been formed. On July 31, 2015, Smith informed LC "that the document that establishes that CSSC will be providing the investment advisory and brokerage platform for the . . . banks, has not yet been signed." Despite knowing that there was no agreement, Smith continued to assure LC that written confirmation of the commitment was forthcoming: "I was told that they expected that agreement to be finalized and executed within the next 7-14 days."[13]

Moreover, both Southwick and Wheeler testified there was no work being done yet on a second special purpose bank. Wheeler also had no knowledge of a $1 million consulting fee owed to CSSC. Southwick, when asked whether Smith's representations regarding the purported $1.4 million consulting fees were accurate, repeatedly answered, "No." In short, Smith's representations regarding the status of Project X and its imminent beneficial effects on CSSC's finances were uniformly baseless.

CSSC BD's co-presidents, LaRose and Martin, also testified about that status of Project X. LaRose first learned the details of Project X around August 2015 when Southwick submitted an outside business activity approval form to her when there were discussions of doing a capital raise for the initiative. LaRose referred to Project X as "a fluid project," which was not

[13] In September 2015, LC informed Smith that he would "pass" on the 2015 Bridge Loan Note Offering and requested that Smith not contact him again.

sufficiently underway for her to even review it as an outside business activity for Martin, who was supposed to take a significant position in the financial services company that would provide brokerage and advisory services to the banking clients. Martin testified that when Smith asked him in the spring of 2015 if he had seen any documentation regarding the Project X consulting fee, he told Smith he had not seen anything.

Smith contends that he relied on Southwick for updates on Project X and that Southwick misled him about the progress and imminent earning of consulting fees. Smith's claims are unpersuasive and do not negate his scienter. Smith first made the representations about Project X in the June 2015 offering documents without any confirmation of their truth. After Southwick could not produce any documentation that Smith requested in July 2015 to provide to LC, Smith knew from his and Southwick's conversation with the lawyer on Project X that no agreement existed. Nonetheless, Smith continued to misrepresent the status of Project X to investors. Contrary to his assertions, Smith must have known that, when he made his misrepresentations, his actions presented an unacceptable danger of misleading investors. *See Alvin W. Gebhart*, Exchange Act Release No. 58951, 2008 SEC LEXIS 3142, at *35 (Nov. 14, 2008) ("A respondent's asserted good faith belief is not plausible if he ignores facts that place him on notice of a risk of misleading clients."), *aff'd*, 595 F.3d 1034 (9th Cir. 2010). In addition, Southwick's employment contract precluded him from committing CSSC to "any project, contract or engagement" without "conferring in advance with" Smith and "securing his prior advice and consent." Smith also cannot shift to others his responsibility to refrain from committing fraud. *See Dane S. Faber*, 57 S.E.C. 297, 309-10 (2004) (rejecting argument that respondent did not possess the scienter necessary to establish liability for fraudulent misrepresentations and omissions when respondent argued that he relied on information provided by his firm).

We have no difficulty in finding that the requisite scienter existed here considering Smith's statements to investors about the supposed consulting agreement and its purported financial benefits to CSSC when there was no actual consulting agreement in place. It is simply implausible that Smith, who is CSSC's chairman, chief executive officer, majority owner, and a lawyer, did not know that he was deceiving investors. *See Vernazza*, 327 F.3d 851 at 860-61 & n.8. These circumstances go beyond mere recklessness and indicate a deliberate intent to defraud investors. *See John Edward Mullins*, Exchange Act Release No. 66373, 2012 SEC LEXIS 464, at *38 (Feb. 10, 2012) (finding that circumstantial evidence in the record lends further support to the conclusion individual acted with intent).

We also find Smith acted with scienter regarding his statements in the 2015 Bridge Loan Note Offering documents about CSSC's business with SDTC and the city of Jacksonville. Smith knew that CSSC had formed no "strategic alliance" with SDTC or client referral relationship and that there was no agreement in place for CSSC to be the investment advisor for SDTC's new investment funds. Instead, Smith had direct knowledge that discussions with SDTC had stalled. Likewise, in June 2015, when Smith first represented that CSSC was in the final stages of engagement with the city of Jacksonville to manage its $1 billion in assets, CSSC had not sent the city such a proposal. When Smith drafted a proposal for the city in July 2015, CSSC's role was limited to providing a performance review of the city's investment portfolio—a service that did not increase CSSC's assets under management at all—for a $15,000 quarterly fee. And as Smith acknowledged, the city never engaged CSSC.

We conclude that Smith failed to disclose material information and made material misrepresentations in connection with the offer and sale of the 2015 Bridge Loan Notes and he did so with scienter. As a result, Smith violated Exchange Act Section 10(b), Exchange Act Rule 10b-5, and FINRA Rules 2020 and 2010.[14]

4. Smith Acted Willfully and Is Statutorily Disqualified

We also affirm the Hearing Panel's findings that Smith acted willfully when he made material misrepresentations and omissions with scienter, in violation of the Exchange Act and the rules promulgated thereunder. "A willful violation under the federal securities laws simply means 'that the person charged with the duty knows what he is doing.'" *Robert D. Tucker*, Exchange Act Release No. 68210, 2012 SEC LEXIS 3496, at *41 (Nov. 9, 2012) (quoting *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000)); *see also Mathis v. SEC*, 671 F.3d 210, 216-18 (2d Cir. 2012) (explaining that "willfulness" does not require awareness that one "is violating one of the Rules or Acts," and holding that a person may be subject to statutory disqualification under Section 3(a)(39) as long as he "intentionally submitted an application to register with a FINRA member knowing that the application contained material false information"); *Allen Holeman*, Exchange Act Release No. 86523, 2019 SEC LEXIS 1903, at *38 (July 31, 2019) (requiring "subjective intent" for a willful violation), *appeal docketed*, No. 19-1251 (D.C. Cir. Nov. 26, 2019).

Smith knew that CSSC was unable to pay investors in CSSC's prior offerings but failed to disclose this key fact in the 2015 Bridge Loan Note Offering documents. He also was at least extremely reckless when he represented the imminent finalization of lucrative contracts with SDTC and the city of Jacksonville and that CSSC had earned a $500,000 consulting fee through Project X. Consequently, Smith is subject to statutory disqualification. *See* Exchange Act Section 3(a)(39)(F) (incorporating by reference Exchange Act Section 15(b)(4)(D), which together provide that a person is subject to statutory disqualification if he has willfully violated any provision of, among other things, the Exchange Act and its rules and regulations); FINRA By-Laws, Article III Section 4 (providing that a person is subject to statutory disqualification if he is disqualified pursuant to Exchange Act Section 3(a)(39)).

B. Smith Acted as an Unregistered General Securities Representative and Principal

We also find that Smith violated FINRA's registration rules because he acted as an unregistered general securities representative and principal while associated with CSSC BD, as alleged in causes four and five of Enforcement's complaint. Smith has argued throughout these proceedings that FINRA lacks jurisdiction to bring this enforcement action against him, asserting that he was not a "person associated with a member." We disagree.

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[14] We decline to make any findings with respect to the alternative allegations in causes two and three of the complaint related to violations of Sections 17(a)(2) and (a)(3) of the Securities Act and FINRA Rule 2010.

1. Smith Was an Associated Person Who Acted as an Unregistered General Securities Representative

NASD Rule 1031 provides that any person engaged in the securities business of a FINRA member firm and functioning as a "representative" must register with FINRA. NASD Rule 1031(b) defines a representative as a person "associated with a member . . . who [is] engaged in the investment banking or securities business for the member including the functions of supervision, solicitation or conduct of business in securities." FINRA By-Laws define an associated person as a "natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by a member, whether or not any such person is registered or exempt from registration." FINRA By-Laws, Art. I (rr). "FINRA has jurisdiction to discipline all associated persons of a member firm," including Smith. *See Ottimo*, 2018 SEC LEXIS 1588, at *49; *see also Stephen Grivas*, Exchange Act Release No. 77470, 2016 SEC LEXIS 1173, at *14 n.15 (Mar. 29, 2016) ("There is no dispute that FINRA has jurisdiction over a registered representative associated with a member firm or that FINRA has jurisdiction to discipline associated persons." (citing 15 U.S.C. § 78o-3(b), (h); FINRA By-Laws Articles V and XIII)); *Keilen Dimone Wiley*, Exchange Act Release No. 76558, 2015 SEC LEXIS 4952, at *11 (Dec. 4, 2015) (finding that FINRA has jurisdiction to discipline a person associated with a member firm and that an associated person's "unethical business-related conduct, even while performing insurance-related activities, falls under FINRA's jurisdiction"), *aff'd*, 663 F. App'x 353 (5th Cir. 2016).

Under FINRA's By-Laws, "investment banking or securities business'" includes "the business, carried on by a broker . . . of underwriting or distributing issues of securities." FINRA By-Laws, Art. I(u). The Commission has interpreted the definition of associated person broadly, and has held that "FINRA has the authority to discipline associated persons who engage in misconduct in connection with their management of an investment fund where the misconduct is 'business-related . . . , even if that management was not of a FINRA member firm.'" *Ottimo*, 2018 SEC LEXIS 1588, at *49-50. Even clerical staff are included in the category of an associated person if their duties are part of the conduct of a firm's securities business. *See, e.g.*, *Stephen M. Carter*, 49 S.E.C. 988, 989 (1988) (employee who worked as a "dealer cashier" was an associated person because he received checks and securities and entered them in the firm's computer system, prepared firm checks for signature in payment of customer balances, prepared deposit slips, and furnished account balances and other information to customers).

Smith asserts that he was not associated and "never knowingly consented to FINRA jurisdiction." Regardless of Smith's intentions, the evidence shows that he was associated with CSSC BD. In July 2006, as part of CSSC BD's new member application form ("Form NMA"), Smith acknowledged that he was exempt from registration, and therefore an associated person, under NASD Rule 1060 when he stated:[15]

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[15] NASD Rule 1060 stated:

(a) The following persons associated with a member are not required to be registered with the Association:

[Footnote continued on next page]

> I understand that I will be permitted to be exempt from NASD securities registration requirements, without having to register either as a registered representative or as a principal, so long as I am not actively engaged in the management of the Firm's (CSSC Brokerage Services, Inc.) securities business, including the supervision, solicitation, conduct of business or the securities training of persons associated with the Firm. I understand that I will not be permitted to become active in the Firm's securities business until such time as I have completed the registration as both an appropriately registered representative and principal as outlined in NASD Rules 1020-1032.

We find that Smith participated in the firm's securities business, evidencing that he was associated. "[O]ne whose functions are part of the conduct of a securities business is an associated person engaged in that business." *Bruce Zipper*, Exchange Act Release No. 84334, 2018 SEC LEXIS 2709, at *14 (Oct. 1, 2018) (internal quotation marks omitted). Smith contends that he did not conduct any securities business on behalf of CSSC BD and his participation in any securities sales was solely to raise money for CSSC as its chairman and chief executive officer. We reject Smith's unrealistic view of his activities. It is undisputed that Smith solicited CSSC BD's customers to invest in CSSC's debt offerings and sold these securities to some of these customers. Smith also created and distributed the offering documents to CSSC BD customers directly and through the firm's brokers, including Southwick for whom Smith prepared scripted solicitations. Southwick also introduced Smith to CSSC BD's customers for purposes of soliciting their investments in CSSC's offerings. *See Dep't of Enforcement v. Hedge Fund Capital Partners, LLC*, Complaint No. 2006004122402, 2012 FINRA Discip. LEXIS 42, at *24-25 (FINRA NAC May 1, 2012) (contacting potential investors and marketing hedge funds to them constituted investment banking or securities business requiring FINRA registration).

[Cont'd]

> (1) persons associated with a member whose functions are solely and exclusively clerical or ministerial;
> (2) persons associated with a member who are not actively engaged in the investment banking or securities business;
> (3) persons associated with a member whose functions are related solely and exclusively to the member's need for nominal corporate officers or for capital participation; and
> (4) persons associated with a member whose functions are related solely and exclusively to:
>
> > (A) effecting transactions on the floor of a national securities exchange and who are registered as floor members with such exchange;
> > (B) transactions in municipal securities;
> > (C) transactions in commodities; or
> > (D) transactions in security futures, provided that any such person is registered with a registered futures association.

We also find that Smith's activities are part of the conduct of a securities business and made him not only an associated person, but that his active participation required FINRA registration. "Activities requiring registration are a subset of those that constitute 'associating' with a FINRA member firm." *Dep't of Enforcement v. Dakota Sec. Int'l, Inc.*, Complaint No. 2016047565702, 2019 FINRA Discip. LEXIS 11, at *16-17 (FINRA NAC Mar. 18, 2019), *appeal docketed*, SEC Admin. Proceeding No. 3-19138 (Apr. 5, 2019). By engaging in these activities without proper FINRA registration, Smith violated NASD Rule 1031.

The functions of a registered representative include communicating with members of the public to determine their interest in making investments, discussing the nature or details of particular securities or investment vehicles, recommending the purchase or sale of securities, and accepting orders for the purchase or sale of securities. *Dist. Bus. Conduct Comm. v. Gallison*, Complaint No. C02960001, 1999 NASD Discip. LEXIS 8, at *52 (NASD NAC Feb. 5, 1999). Smith claims that he "had precluded CSSC-BD from becoming involved in the private offerings made by CSSC-Parent." But the evidence shows that Smith orchestrated and directed the involvement of CSSC BD brokers and their customers in CSSC's private offerings. For example, Martin introduced CSSC BD customer SK to the 2010 Bond Offering, but Smith finalized the $375,000 investment. Smith also specifically asked Southwick whether CSSC BD customer JM, who had invested $300,000 in the 2010 Bond Offering, would also invest in the 2014 Bridge Loan Note Offering. Smith directed Southwick not to recommend the investment outright, but rather to make his customers "aware" of the offering and to tell them he would "see if it could be made available." Smith solicited CSSC BD customers to invest in CSSC's offerings, disseminated the offering documents to CSSC BD brokers whom he directed to sell the securities, and obtained customer introductions from CSSC BD brokers in order to solicit the customers personally. Smith's activities fell within the definition of a representative and required appropriate registration. *See Zipper*, 2018 SEC LEXIS 2709, at *14; *Michael F. Flannigan*, 56 S.E.C. 8, 17-18 (2003) (affirming finding that firm and its president violated FINRA's registration rules by permitting unregistered individuals to solicit customers and confirm indications of interest for an initial public offering); *First Capital Funding, Inc.*, 50 S.E.C. 1026, 1028-30 (1992) (finding that member firm and its president violated FINRA's registration rules by permitting an unregistered individual to send pre-qualification forms with information regarding an investment to potential investors and that firm was "engaged at least in an 'attempt to induce' the purchase or sale of securities").

We affirm the Hearing Panel's finding that Smith participated in CSSC BD's securities business as a general securities representative and therefore violated NASD Rule 1031 and FINRA Rule 2010 by acting in this capacity without registration. "FINRA is empowered to bring disciplinary actions and impose sanctions to enforce its members' compliance with federal securities laws, SEC regulations, and FINRA's own rules and regulations." *Birkelbach v. SEC*, 751 F.3d 472, 475 (7th Cir. 2014). Thus, FINRA has the authority to discipline Smith for violating the antifraud provisions of the securities laws and FINRA's registration rules—regardless of whether he believed he was not associated at the time of the misconduct. *See Ottimo*, 2018 SEC LEXIS 1588, at *49.

2. Smith Acted as an Unregistered Principal

In addition, Smith engaged in activities that required principal registration. NASD Rule 1021(a) requires that all individuals acting as principals register. The rule defines "principal" as an associated person who is "actively engaged in the management of the member's . . . securities business, including supervision, solicitation, conduct of business or the training of persons associated with a member for any of these functions." NASD Rule 1021(b). The definition of principal includes not only officers and directors of corporations who "actively engage[] in the management of the member's investment banking or securities business," but applies equally to others who engage in management or supervision. *NASD Notice to Members 99-49*, 1999 NASD LEXIS 24, at *2 (June 1999). An individual must register as a principal, when the individual is involved in the "day-to-day conduct of the member's securities business and the implementation of corporate policies related to such business." *Id.* (explaining that registration determination turns on the functions that an individual performs).

The evidence establishes that Smith was actively engaged in the management of CSSC BD's securities business, which required Smith to register as a principal. *See, e.g.*, *Gordon Kerr*, 54 S.E.C. 930, 938 (2000) ("[A] person acting in a supervisory capacity must be registered as a general securities principal."). First, Smith recruited and hired registered representatives and officers of CSSC BD. Smith made the decisions to appoint LaRose and Martin as co-presidents of CSSC BD and elevate LaRose as the firm's CCO. The NAC has found the selection and hiring of firm employees such as principals to reflect active management of a broker dealer. *Dep't of Enforcement v. Harvest Capital Invs., LLC*, Complaint No. 2005001305701, 2008 FINRA Discip. LEXIS 45, at *26-27 (FINRA NAC Oct. 2008); *see also Kirk A. Knapp*, 50 S.E.C. 858, 861 (1992) (considering that the applicant hired individuals in determining that applicant acted in a principal capacity).

Smith was central to the hiring and firing of registered representatives at the firm. When individuals became registered representatives, they also affiliated with all the various CSSC entities because Smith required them to sign an affiliation agreement. For example, Smith recruited, hired, and negotiated employment terms for CSSC BD representatives Wheeler, Ken Bryant, and Southwick. LaRose testified that she never hired or fired a CSSC BD registered representative without first discussing it with Smith. The affiliation agreement gave Smith the authority to terminate the employment relationship if an employee willfully failed to comply with Smith's directive. And it was Smith who fired Southwick. The hiring and firing of a firm's personnel are activities that favor principal registration. *See Dennis Todd Lloyd Gordon*, Exchange Act Release No. 57655, 2008 SEC LEXIS 819, at *28-29 (Apr. 11, 2008) (determining that employee's hiring and firing of firm's registered representatives supports that employee acted as unregistered principal); *Richard F. Kresge*, Exchange Act Release No. 55988, 2007 SEC LEXIS 1407, at *50 (June 29, 2007) (finding that employee's active involvement in firm's hiring demonstrates that employee acted as unregistered principal).

And it was Smith who made financial decisions for CSSC BD, including directing the maintenance of its minimum net capital and controlling the payments of salaries and commissions to firm personnel. Smith controlled when CSSC BD would receive money from CSSC. LaRose testified that if an employee of the broker-dealer had a question about a salary

deferral, she directed the employee to Smith. When CSSC BD needed money in order to meet its net capital requirement, CSSC's assistant controller, MD communicated with Smith—not Martin or LaRose. She told Smith that CSSC BD "desperately needs to be paid the $20,000 that it is owed from the RIA for December" and was "only $874 over the notification threshold" when it would fall below its minimum net capital requirement. MD explained that because CSSC BD owed CSSC more than $83,000 for the December 2014 rent, CSSC BD would fail to maintain its required level of net capital unless Smith offset the rent with other revenue. Smith told MD which bill payments to prioritize and Smith ensured that CSSC RIA diverted funds to enable the broker dealer to maintain minimum net capital. When the firm's auditors had concerns about whether CSSC BD could continue as a going concern, they contacted Smith. Control of a firm's finances is an activity that suggests that an associated person is actively engaged in a firm's securities business and should register as a principal. *See Kresge*, 2007 SEC LEXIS 1407, at *50 (finding that employee's "substantial role" in firm's finances supports that employee acted as unregistered principal); *Vladislav Steven Zubkis*, 53 S.E.C. 794, 799-800 (1998) (explaining that applicant's financial support of firm, including payment of firm expenses such as rent, telephone charges, and compensation of brokers, evidences need for principal registration); *Harvest*, 2008 FINRA Discip. LEXIS 45, at *27 (controlling firm checking account and making financial decisions for firm is an example of activities requiring principal registration). Smith also was involved in selecting CSSC BD's clearing firm. *Cf. Harvest*, 2008 FINRA Discip. LEXIS 45, at *27-28 (negotiating potential clearing agreements on behalf of firm was activity that demonstrated that an individual acted in a principal capacity).

LaRose and Martin as co-presidents answered directly to Smith and acted on behalf of CSSC BD at Smith's direction. *See Harvest*, 2008 FINRA Discip. LEXIS 45, at *27. Martin testified that his "hands-on work" as co-president was "fairly small."[16] Martin admitted that he "relied on other people to do a lot of the hands-on work," and that "people might have" seen his role as "in title only." Smith's wide-ranging involvement even included suitability reviews of CSSC BD customers' purchases of CSSC's offerings and the handling of broker dealer customer complaints. LaRose testified that when CSSC BD customer, SM, complained to the broker dealer about her investment in one of the CSSC offerings, LaRose consulted with Smith. Smith informed LaRose that SM's principal was due but unpaid and that he would speak with SM. LaRose informed SM that she should work with CSSC directly to resolve her complaint. Smith told LaRose that he had prepared a memo in anticipation of additional complaints that would be sent to the other broker dealer customers who had invested in CSSC's offerings.

Smith argues that he was engaged in these activities solely in his capacity as chairman and chief executive officer of CSSC. The evidence shows, however, that he was deeply involved in CSSC BD's securities business and does not support Smith's limited view of his activities. While, for example, an officer of a broker-dealer's parent corporation who sits on the board of directors of the broker-dealer and is not actively engaged in the management of the broker-dealer is considered an outside director and does not need to be registered, that is not the case here. The

[16] In addition to co-president of the broker dealer, Martin was president of CSSC's insurance subsidiary and a senior consultant for CSSC RIA.

record shows that although Smith was not registered as a principal, he controlled CSSC BD and was actively engaged in the management of the firm's securities business. *See Dep't of Enforcement v. Gallagher*, Complaint No. 2008011701203, 2012 FINRA Discip. LEXIS 61, at *10-11 (FINRA NAC Dec. 12, 2012) (finding respondent acted as unregistered principal through his activities including hiring, firing, and supervision and his ownership and control of the broker-dealer's parent company).

Consequently, we find that Smith engaged in activities requiring principal registration, and that he violated NASD Rule 1021 and FINRA Rule 2010.

V. Sanctions

For Smith's fraudulent omission and misrepresentations of material facts, the Hearing Panel barred Smith and ordered that he pay $130,000 in restitution (joint and several with CSSC BD) to the four investors in the 2015 Bridge Loan Note Offering. The Hearing Panel recommended, but declined to impose, additional sanctions for Smith's registration violations, in light of the bar. For the reasons set forth below, we affirm the bar and restitution order. We also assess, but do not impose, additional sanctions for Smith's violations of FINRA's registration rules.

A. Fraudulent Omissions and Misrepresentations of Material Facts

In assessing sanctions, we consider FINRA's Sanction Guidelines ("Guidelines"), including the Principal Considerations in Determining Sanctions and any other case-specific factors. Fraud violations are "especially serious and subject to the severest of sanctions under the securities laws." *See Marshall E. Melton*, 56 S.E.C. 695, 713 (2003). The Guidelines for intentional or reckless omissions or misrepresentations of material fact therefore recommend that we strongly consider barring an individual respondent, unless mitigating factors predominate.[17]

We conclude that there are numerous aggravating factors, and no mitigating factors, that support a decision to bar Smith for his fraud. Smith engaged in numerous acts of fraud over an extended period involving several investors who lost the entirety of their investments.[18] By his own admission, Smith solicited a minimum of 15 people to invest in the 2015 Bridge Loan Note Offering. Of those, four people invested $130,000 in the offering in which Smith misrepresented and failed to disclose the material facts. Smith intentionally failed to disclose the critical fact that CSSC owed prior investors hundreds of thousands of dollars that it could not repay.[19] The

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[17] *See FINRA Sanction Guidelines* 89 (2019), http://www.finra.org/sites/default/files/Sanctions_Guidelines.pdf [hereinafter *Guidelines*]. They also recommend a fine of $10,000 to $155,000. *Id.*

[18] *See Guidelines*, at 7 (Principal Considerations in Determining Sanctions Nos. 8, 9, 11).

[19] *See id.* at 8 (Principal Considerations in Determining Sanctions, No. 13).

evidence shows that Smith was desperate to raise funds for CSSC, which was struggling to pay its employees and remain viable.

In addition, Smith knew or was reckless in not knowing that his representations about CSSC's financial prospects resulting from Project X and CSSC's business with the SDTC and the city of Jacksonville were unfounded and would persuade investors to purchase the 2015 Bridge Loan Note Offering.[20] *See, e.g.*, *Mitchell H. Fillet*, Exchange Act Release No. 75054, 2015 SEC LEXIS 2142, at *14-15 (May 27, 2015) (finding respondent acted recklessly, which served to aggravate sanctions, when drafting an offering term sheet knowing that it contained inaccurate descriptions subject to contingencies that had not yet occurred and failing to alert investors to the contingencies); *Gomez*, 2018 FINRA Discip. LEXIS 10, at *51 ("Under these circumstances, Gomez's "'refusal to see the obvious, or to investigate the doubtful,' gives rise to an inference of reckless misconduct."). Even after Smith fired Southwick in September 2015, Smith continued to solicit investors when it was obvious that his claims in the offering materials touting Project X and the purportedly pending engagements with SDTC and the city of Jacksonville were false.

In November 2015, one of the four investors, TL, requested a refund from Smith of his $50,000 investment after he had not received documents related to his investment that he made in August 2015. TL stated that his "trust has been seriously shaken." Smith told TL that he had "no present ability" to refund his money and attempted to assuage TL's concerns by claiming without support that CSSC's assets "far exceed" CSSC's total debt. Smith's fraudulent omission and misrepresentations resulted not only in the potential for monetary gain, but $130,000 in actual gain for Smith and CSSC for his sales to the four investors.[21]

We are also troubled by Smith's blaming of others for his own misrepresentations related to the 2015 Bridge Loan Note Offering.[22] *See also John B. Busacca, III*, Exchange Act Release No. 63312, 2010 SEC LEXIS 3787, at *63 (Nov. 12, 2010) (aggravating for purposes of sanctions that representative blamed others for his own misconduct), *aff'd*, 449 F. App'x 886 (11th Cir. 2011); *Janet Gurley Katz*, Exchange Act Release No. 61449, 2010 SEC LEXIS 994, at *69 (Feb. 1, 2010) ("Katz cannot shift the blame for her violations to others or claim that others' misconduct somehow excuses her own misdeeds"), *aff'd*, 647 F.3d 1156 (D.C. Cir. 2011). Throughout these proceedings, Smith blamed Southwick and denied his own responsibility despite ample evidence of Smith's direct involvement and control over the offering. Smith ignored the high standards of conduct that FINRA expects in the sale of privately placed securities. *See FINRA Regulatory Notice 10-22*, 2010 FINRA LEXIS 43, at *4-5 (Apr. 2010). Smith defrauded investors and his "conduct demonstrates a fundamental unfitness for association in the securities industry." *See Akindemowo*, 2016 SEC LEXIS 3769, at *39.

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20 *See id.*

21 *See Guidelines*, at 8 (Principal Considerations in Determining Sanctions, No. 16).

22 *See id.* at 7 (Principal Considerations in Determining Sanctions, No. 2).

We also determine that restitution is an appropriate remedy in this case. Restitution may be appropriate when an "identifiable person" otherwise would unjustly suffer "quantifiable loss proximately caused by a respondent's misconduct."[23] "An order requiring restitution . . . seeks primarily to return customers to their prior positions by restoring the funds of which they were wrongfully deprived." *Newport Coast Sec. Inc.*, Exchange Act Release No. 88548, 2020 SEC LEXIS 911, at *37 (Apr. 3, 2020). Although the Commission and courts have not adopted a single approach to proximate causation, we agree with the Hearing Panel's determination that the losses suffered by the four investors in the form of the full amount of their investment in the 2015 Bridge Loan Note Offering were the foreseeable, direct, and proximate result of Smith's fraud. *See id.*; *McGee*, 2016 FINRA Discip. LEXIS 33, at *79. Smith used CSSC BD as one way to obtain investors and the firm shared liability with Smith for the fraudulent misconduct. We therefore order Smith to pay restitution, jointly and severally, with CSSC BD, to the four investors in the amounts set forth below in footnote 24 plus prejudgment interest until paid in full.[24] *See Newport*, 2020 SEC LEXIS 911, at *38 n.112 (finding when "there are multiple parties liable for misconduct, it was appropriate to impose that obligation on respondents jointly and severally").

Accordingly, we bar Smith from associating with any FINRA member in any capacity for violating Exchange Act Section 10(b), Exchange Act Rule 10b-5, and FINRA Rules 2020 and 2010 and order that he pay restitution to the four purchasers of the 2015 Bridge Loan Notes.

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[23] *Guidelines*, at 4 (General Principles Applicable to All Sanction Determinations, No. 5).

[24] Prejudgment interest shall be paid at the rate established for the underpayment of income taxes in Section 6621(a) of the Internal Revenue Code, 26 U.S.C. § 6621(a). *Guidelines*, at 11; *see McGee*, 2016 FINRA Discip. LEXIS 33 at *80. The restitution amount for each investor is as follows: TL, $50,000, with interest accruing from August 24, 2015; Thomas Scotto, $20,000, with interest accruing from August 31, 2015; BB, $10,000, with interest accruing from September 29, 2015; and Gavin Clarkson, $50,000, with interest accruing from November 13, 2015. If Smith is unable to locate an investor, he must provide Enforcement with proof that he has made a bona fide attempt to locate the investor. The Hearing Panel ordered that if Smith cannot locate an investor, Smith is to pay the restitution owed to FINRA as fine. We disagree with this approach and order instead that if investors cannot be located, unpaid restitution should be paid to the appropriate escheat, unclaimed property, or abandoned property fund for the states of the investors' last known residences. *See Guidelines*, at 11.

B. Registration Violations

For registration violations, the Guidelines recommend imposing a fine of $2,500 to $77,000 and suspending the individual in any or all capacities for up to six months.[25] In egregious cases, the Guidelines recommend a lengthier suspension of up to two years, or a bar.[26] In assessing sanctions for registration violations, the Guidelines advise adjudicators to consider whether the respondent has filed an application for registration and the nature and extent of the unregistered respondent's responsibilities.[27]

Smith's registration violations were egregious. Smith actively engaged in a multitude of activities as a principal and representative despite his lack of registration. Smith deliberately ignored the requirements of the registration rules.[28] Smith knew that he was required to register as a principal in order to manage CSSC BD's day-to-day securities business. Smith acknowledged in the Form NMA that he was exempt from registration *only if* he was not actively engaged in the firm's management. The record shows, however, that Smith was active in most every aspect of firm management: the hiring and firing of firm staff; appointing officers; overseeing and unilaterally controlling the firm's finances; channeling money from the RIA to the firm to maintain minimum net capital; responding to firm auditors about the broker dealer's ability to continue as a going concern; conducting suitability reviews; and responding to firm customer complaints. Smith appointed Martin and LaRose as co-presidents largely in name only when it was Smith who actively managed the firm and its employees. Smith's misconduct spanned the duration of the review period, occurring for more than five years.[29]

Smith also acted as a representative without oversight when he directly, and through other CSSC BD representatives, solicited firm customers to invest in CSSC's debt offerings. These solicitations resulted in some firm customers investing in CSSC offerings and provided CSSC with much needed cash infusions. Thus, Smith had the potential for monetary gain from these investments that served to keep his business afloat.[30]

As the Hearing Panel found, Smith chose not to register in order to conduct business through CSSC BD while attempting to avoid the appearance of doing so. At every turn, Smith has refused to accept any responsibly for his conduct.[31] *See Hans N. Beerbaum*, Exchange Act

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25 *Guidelines*, at 45.

26 *Id.*

27 *Id.*

28 *Id.* at 8 (Principal Considerations in Determining Sanctions, No. 13).

29 *Id.* at 7 (Principal Considerations in Determining Sanctions, No. 9).

30 *Id.* at 8 (Principal Considerations in Determining Sanctions, No. 16).

31 *Id.* at 7 (Principal Considerations in Determining Sanctions, No. 2).

Release No. 55731, 2007 SEC LEXIS 971, at *18 (May 9, 2007) (explaining respondent's "conduct and statements raise significant uncertainty about his willingness to comply with registration and other regulatory requirements in the future"). FINRA's "registration requirement provides an important safeguard in protecting public investors and strict adherence to that requirement is essential." *See Flannigan*, 56 S.E.C. at 17 (internal quotation marks omitted). We are particularly troubled by Smith's wide-ranging actions as an unregistered principal. As the Commission has observed, "the registered principal is the person at a broker-dealer to whom [FINRA] looks to ensure compliance with regulatory requirements." *Beerbaum*, 2007 SEC LEXIS 971, at *14 (internal quotation marks omitted); *see Douglas Conrad Black*, 51 S.E.C. 791, 794 (1993). And that "regulatory compliance is dependent, to a significant degree, on the qualifications of the principal, and those qualifications are assessed through the examination process," a process that Smith conveniently and impermissibly circumvented. *See Beerbaum*, 2007 SEC LEXIS 971, at *14.

Accordingly, we modify the Hearing Panel's sanctions for Smith's registration violations to reflect the seriousness and degree of Smith's activities as an unregistered principal.[32] For acting as an unregistered principal, we fine Smith $75,000 and suspend him in all capacities for two years. For acting as an unregistered representative, we fine Smith an additional $50,000 and concurrently suspend him for one year in all capacities. In light of the bar for fraud, however, we decline to impose these additional sanctions for Smith's registration violations.

VI. Conclusion

We find that Smith fraudulently failed to disclose and misrepresented material facts to investors, in violation of Section 10(b) of the Exchange Act, Exchange Act Rule 10b-5, and FINRA Rules 2020 and 2010. We also find that Smith acted as an unregistered representative and principal, in violation of NASD Rules 1021 and 1031 and FINRA Rule 2010. Accordingly, we bar Smith from associating with any FINRA member in any capacity for his fraud and order that he shall pay to the affected investors as set forth in footnote 24 above, restitution totaling $130,000, jointly and severally with CSSC BD. The bar is effective immediately upon issuance of this decision. In light of the bar, we assess but do not impose additional sanctions for Smith's registration violations. We also affirm the Hearing Panel's order that Smith pay hearing costs, jointly and severally with CSSC BD, of $12,107.09 and impose appeal costs of $1,283.

On behalf of the National Adjudicatory Council,

Jennifer Piorko Mitchell

Jennifer Piorko Mitchell, Vice President and
Deputy Corporate Secretary

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[32] For acting as an unregistered principal, the Hearing Panel assessed a $50,000 fine and a one-year suspension in all capacities. For acting as an unregistered general securities representative, the Hearing Panel assessed a $50,000 fine and a one-year concurrent suspension in all capacities.

EXHIBIT C

U.S. SECURITIES AND EXCHANGE COMMISSION

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In the Matter of the Application of :

ERIC S. SMITH :

For Review of Disciplinary Action Taken By :

FINRA :

----------x

APPLICATION OF ERIC S. SMITH FOR REVIEW
OF DISCIPLINARY ACTION TAKEN BY FINRA

Pursuant to Rule 420 of the Rules of Practice of the U.S. Securities and Exchange Commission ("Commission"), by and through undersigned counsel, Mr. Eric S. Smith hereby applies to the Commission for review of disciplinary action taken by the National Adjudicatory Council of the Financial Industry Regulatory Authority ("FINRA"), in a decision dated September 18, 2020 (the "Determination") [FINRA Complaint No. 2015043646501].

Mr. Smith seeks review by the Commission of the following *erroneous* findings and conclusions in the Determination:

(a) FINRA had jurisdiction to institute a disciplinary action against Mr. Smith despite the fact that Mr. Smith never consented to FINRA jurisdiction in any way whatsoever;

(b) FINRA's Department of Enforcement is not required to prove each and every element of a cause of action by a preponderance of the evidence in order for FINRA to find a respondent liable for a violation;

(c) the alleged misrepresentations and omissions were "material", thereby ignoring the fact that FINRA's Department of Enforcement introduced no evidence concerning the materiality of alleged misrepresentations and omissions;

(d) actual disclosures concerning the risks of the loans made by four persons during the Summer and Fall of 2015 should be ignored as "boilerplate" when assessing the materiality of the alleged misrepresentations and omissions;

(e) the financial statements and other financial information included in the documents distributed to potential lenders did not matter when assessing the materiality of the alleged misrepresentations and omissions;

(f) Mr. Smith acted with scienter;

(g) Mr. Smith acted "willfully";

(h) loans made by three out of four persons in the Summer and Fall of 2015 met the definition of "securities" when, in fact, they were merely short-term loans;

(i) Mr. Smith engaged in fraudulent conduct and securities fraud in connection with the 2015 Bridge Loan Notes Offering;

(j) Mr. Smith acted as an unregistered general securities representative and principal of a FINRA member firm;

(k) the sanction of a bar from association with FINRA member firms was warranted by the actual evidence presented during the disciplinary proceeding;

(l) the sanction of a $130,000 restitution order was warranted by the actual evidence presented during the disciplinary proceeding; and

(m) fines of $125,000 and suspensions from association with FINRA member firms, based upon the alleged failure to obtain FINRA licenses to act as a general securities representative and principal of a FINRA member firm, were warranted by the actual evidence presented during the disciplinary proceeding.

The FINRA disciplinary proceeding instituted against Mr. Smith is erroneously based upon the assertion by FINRA – a privately-owned corporation that is licensed as a self-regulatory organization by the Commission – that it may institute disciplinary proceedings against any person in the United States regardless of whether that person has consented to FINRA's jurisdiction to bring such a proceeding. This egregious abuse of self-regulatory authority by FINRA must be reversed emphatically by the Commission. Never again should a non-licensed person such as Mr. Smith be subjected to more than five (5) years of investigation and disciplinary proceedings, at a devastating financial and personal cost, when FINRA never had any jurisdiction over that person in the first place.

In addition to the wrongful assertion of jurisdiction, FINRA compounded its violation of Mr. Smith's rights by making findings of liability based on assumption rather than actual evidence presented at the hearing. Unless reversed by the Commission, FINRA's argument that liability may be found without actual evidence introduced by its Department of Enforcement would have the effect of turning a FINRA disciplinary proceeding (with supposed rights of cross-examination) into a type of "show trial", with pre-determined outcomes, favored by autocrats and dictatorships throughout history.

For these reasons and based upon the additional submissions to be made by Mr. Smith, the Commission should reverse the Determination in its entirety and prohibit FINRA from pursuing any further disciplinary proceeding against Mr. Smith.

Mr. Smith can be served upon undersigned counsel, who is contemporaneously filing a Notice of Appearance pursuant to Rule 102(d). Counsel can be contacted at the address and telephone number listed below.

Dated: October 19, 2020
New York, New York

SHER TREMONTE LLP

By: 
Robert Knuts

90 Broad Street, 23rd Floor
New York, New York 10004
Tel: 212.202.2638
rknuts@shertremonte.com

Attorneys for Applicant Eric S. Smith

TO:

Attn: Jennifer Brooks
Office of General Counsel
FINRA
1735 K Street, N.W.
Washington, D.C. 20006
Jennifer.Brooks@finra.org

EXHIBIT D

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 93944 / January 10, 2022

Admin. Proc. File No. 3-20127

In the Matter of the Application of

ERIC S. SMITH

For Review of Disciplinary Action Taken by

FINRA

ORDER EXTENDING TIME TO ISSUE DECISION

The Commission has determined, in its discretion, that it is appropriate to extend by 90 days the period within which the decision in this matter may be issued. Accordingly, IT IS ORDERED that such period be, and hereby is, extended to April 11, 2022.[1]

By the Commission.

Vanessa A. Countryman
Secretary

[1] April 10, 2022 is a Sunday.

EXHIBIT E

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 94675 / April 11, 2022

Admin. Proc. File No. 3-20127

In the Matter of the Application of

ERIC S. SMITH

For Review of Disciplinary Action Taken by

FINRA

ORDER EXTENDING TIME TO ISSUE DECISION

The Commission has determined, in its discretion, that it is appropriate to extend by 90 days the period within which the decision in this matter may be issued. Accordingly, IT IS ORDERED that such period be, and hereby is, extended to July 11, 2022.[1]

By the Commission.

Vanessa A. Countryman
Secretary

[1] July 10, 2022 is a Sunday.

EXHIBIT F

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 95252 / July 11, 2022

Admin. Proc. File No. 3-20127

In the Matter of the Application of

ERIC S. SMITH

For Review of Disciplinary Action Taken by

FINRA

ORDER EXTENDING TIME TO ISSUE DECISION

The Commission has determined, in its discretion, that it is appropriate to extend by 90 days the period within which the decision in this matter may be issued. Accordingly, IT IS ORDERED that such period be, and hereby is, extended to October 11, 2022.[1]

By the Commission.

Vanessa A. Countryman
Secretary

[1] October 9, 2022 is a Sunday, and October 10, 2022 is a federal holiday.

EXHIBIT G

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 96031 / October 11, 2022

Admin. Proc. File No. 3-20127

In the Matter of the Application of

ERIC S. SMITH

For Review of Disciplinary Action Taken by

FINRA

ORDER EXTENDING TIME TO ISSUE DECISION

The Commission has determined, in its discretion, that it is appropriate to extend by 90 days the period within which the decision in this matter may be issued. Accordingly, IT IS ORDERED that such period be, and hereby is, extended to January 9, 2023.

By the Commission.

Vanessa A. Countryman
Secretary

EXHIBIT H

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 96615 / January 9, 2023

Admin. Proc. File No. 3-20127

In the Matter of the Application of

ERIC S. SMITH

For Review of Disciplinary Action Taken by

FINRA

ORDER EXTENDING TIME TO ISSUE DECISION

The Commission has determined, in its discretion, that it is appropriate to extend by 90 days the period within which the decision in this matter may be issued. Accordingly, IT IS ORDERED that such period be, and hereby is, extended to April 10, 2023.[1]

By the Commission.

Vanessa A. Countryman
Secretary

[1] April 9, 2023, is a Sunday.

EXHIBIT I

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 97275 / April 10, 2023

Admin. Proc. File No. 3-20127

In the Matter of the Application of

ERIC S. SMITH

For Review of Disciplinary Action Taken by

FINRA

ORDER EXTENDING TIME TO ISSUE DECISION

The Commission has determined, in its discretion, that it is appropriate to extend by 90 days the period within which the decision in this matter may be issued. Accordingly, IT IS ORDERED that such period be, and hereby is, extended to July 10, 2023.[1]

By the Commission.

Vanessa A. Countryman
Secretary

[1] July 9, 2023, is a Sunday.

EXHIBIT J

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 97864 / July 10, 2023

Admin. Proc. File No. 3-20127

In the Matter of the Application of

ERIC S. SMITH

For Review of Disciplinary Action Taken by

FINRA

ORDER EXTENDING TIME TO ISSUE DECISION

The Commission has determined, in its discretion, that it is appropriate to extend by 90 days the period within which the decision in this matter may be issued. Accordingly, IT IS ORDERED that such period be, and hereby is, extended to October 10, 2023.[1]

By the Commission.

Vanessa A. Countryman
Secretary

[1] October 8, 2023, is a Sunday, and October 9, 2023, is a holiday.

EXHIBIT K

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 98711 / October 10, 2023

Admin. Proc. File No. 3-20127

In the Matter of the Application of

ERIC S. SMITH

For Review of Disciplinary Action Taken by

FINRA

ORDER EXTENDING TIME TO ISSUE DECISION

The Commission has determined, in its discretion, that it is appropriate to extend by 90 days the period within which the decision in this matter may be issued. Accordingly, IT IS ORDERED that such period be, and hereby is, extended to January 8, 2023.

By the Commission.

Vanessa A. Countryman
Secretary

EXHIBIT L

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 99285 / January 8, 2024

Admin. Proc. File No. 3-20127

In the Matter of the Application of

ERIC S. SMITH

For Review of Disciplinary Action Taken by

FINRA

ORDER EXTENDING TIME TO ISSUE DECISION

The Commission has determined, in its discretion, that it is appropriate to extend by 90 days the period within which the decision in this matter may be issued. Accordingly, IT IS ORDERED that such period be, and hereby is, extended to April 8, 2024.[1]

By the Commission.

Vanessa A. Countryman
Secretary

[1] April 7, 2024, is a Sunday.

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

Kelly L. Stephens
Clerk

100 EAST FIFTH STREET, ROOM 540
POTTER STEWART U.S. COURTHOUSE
CINCINNATI, OHIO 45202-3988

Tel. (513) 564-7000
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Filed: March 07, 2024

Mr. Ryan G. Russell
New Civil Liberties Alliance
1225 19th Street NW
Suite 450
Washington, DC 20036

Re: Case No. 24-1189, *In re: Eric Smith*
Originating Case No. 3-20127

Dear Counsel,

The petition for writ of mandamus has been docketed as case number **24-1189** with the caption listed above. If you have not already done so, you must mail a copy of the petition to the U.S. Securities and Exchange Commission and counsel for all the other parties.

Counsel for petitioner must file an Appearance of Counsel form and, if not admitted, apply for admission to the 6th Circuit Bar by **March 21, 2024**. The forms are available on the court's website.

The U.S. Securities and Exchange Commission to whom this petition refers has been served with this letter.

Sincerely yours,

s/Jill E Colyer
Case Management Specialist
Direct Dial No. 513-564-7024

cc: Ms. Megan Barbero
Ms. Vanessa A. Countryman
Mr. Robert Knuts