16-1739-cv

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

TALMAN HARRIS,

Appellant/Petitioner,

v.

U.S. SECURITIES & EXCHANGE COMMISSION,

Appellee/Respondent.

Petition for Review of the Opinion of the
U.S. Securities & Exchange Commission

BRIEF OF PETITIONER

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Petitioner, Talman Harris ("Harris" or the "Petitioner"), hereby submits this brief in support of his petition for review of the decision of the United States Securities and Exchange Commission ("SEC"), and states the following:

I. INTRODUCTION

Harris is seeking the review of the decision of the SEC, which sustained the findings of violations and imposition of sanctions by the Financial Industry Regulatory Authority ("FINRA") and the National Adjudicatory Council ("NAC"), permanently barring Harris from associating with any FINRA member firm in any capacity. As described more fully below, the SEC's decision expanded a broker's duty to disclose well beyond that required by the precedent of this Court to an untenable standard where any prior dealings with an issuer – and even those with no nexus to the customers' transaction at all – must be disclosed. For that reason and the further reasons described below, the SEC incorrectly concluded that Harris violated Section 10(b) of the Securities Exchange Act (the "Exchange Act"), Rule 10b-5 thereunder, and FINRA Rules 2020 and 2010 (collectively, the "anti-fraud provisions"), and its decision should be reversed. Should this Court nevertheless determine that a violation did occur, the permanent bar the SEC imposed for the anti-fraud provisions violation and the sanctions the SEC failed to review (but were deemed appropriate though not imposed by the NAC) for the

outside business activities violation were not remedial, and were instead excessive, unwarranted, and oppressive, and should also be reversed.

II. STATEMENT OF THE CASE

Harris was registered as a general securities representative and an investment banking limited representative with Seaboard Securities, Inc. ("Seaboard Securities") from May 2009 to February 2010 and with First Merger Capital, Inc. ("First Merger") from February 2010 through March 2011. (R. 3369, FINRA Dep't of Enforcement v. Scholander et al., No. 2009019108901, at p. 1 (NAC Dec. 29, 2014) (the "NAC Decision").) He was also registered as a general securities principal during his final month with First Merger. (Id.)

On August 16, 2013, a FINRA Office of Hearing Officers' Hearing Panel issued a decision, finding that Harris and his former business partner, William Scholander, violated (a) Section 10(b) of the Exchange Act, Rule 10b-5 thereunder, and FINRA Rules 2020 and 2010 by failing to disclose to their customers that Deer Consumer Products, Inc. ("Deer") had paid Harris and Scholander $350,000 months earlier (the "Deer Payment"), imposing a permanent bar on Harris and Scholander; and (b) NASD Rule 3030 and FINRA Rule 2010 because they did not provide written notice to the broker-dealer with which they were registered at the time of the Deer Payment, but not imposing any sanctions in light of the bars. (R. 2801-50).

Harris and Scholander subsequently filed an appeal with the NAC, and the NAC issued its decision on December 29, 2014. In its decision, the NAC made the following factual findings:

- In November 2009, Scholander traveled to China to visit Deer with Maureen Gearty, an operations manager and an office manager with GunnAllen Financial. (R. 3369, NAC Decision, at pp. 5, 7.) Harris did not travel to China with Scholander and Gearty. (Id.)

- Later that month, while associated with Seaboard Securities, Scholander and Harris received the Deer Payment for advisory services,[1] which they spent in furtherance of a plan to acquire a broker-dealer, First Merger. (Id. at p. 1.)

- Scholander and Harris provided "certain advisory services" for the Deer Payment, "albeit very limited ones[, . . .] including advice provided by Scholander during his trip to China and opinions provided by Scholander and Harris during their participation on conference calls." (Id. at p. 14.)

- There was no testimony "that the advisory services were related in any way to sales of Deer stock." (Id. at p. 23.)

- "[T]he $350,000 payment from DEER reflected a single, substantial, non-transaction-based payment from an issuer in exchange for consulting services, which Scholander and Harris used to try to acquire a broker-dealer and to establish a branch office from which they sold the issuer's securities." (Id.)

- From February 2010 through November 2010, Scholander and Harris sold $961,825 of Deer securities to customers while associated with First Merger, generating $13,700 in gross commissions to Harris and Scholander. (Id. at pp. 1, 11.)

[1] There was no evidence (or finding) that Harris negotiated the Deer Payment.

- Prior to the Deer Payment, Scholander and Harris had prior business dealings with Deer that included: (1) selling Deer securities in two private placements in 2008, (id. at p. 5); and (2) "attempt[ing] to secure a contract with Deer to provide advisory services in connection with Deer's follow-on offering," (id. at p. 21.).

- Scholander and Harris did not disclose that they had received the Deer Payment or any prior business dealings with Deer to their customers. (Id. at p. 1.)

The NAC affirmed the Hearing Panel's findings of violations and imposition of sanctions with the exception of increasing the sanctions it deemed appropriate (but did not impose) for the outside business activities violation to a fine of $15,000 and a three-month suspension. (Id.) Harris and Scholander sought review of the NAC's decision by the SEC.

On March 31, 2016, the SEC issued its opinion in this matter, sustaining the findings of violations and sanctions imposed (the "SEC Opinion"). The SEC's findings of fact, while more abbreviated, are generally the same as those outlined above that were found by the NAC,[2] (see SEC Opinion, at pp. 3-5),

[2] The findings of fact of the SEC (and the underlying decisions) are not at issue for the purposes of this petition for review. Rather, for purposes of this petition for review only, and without admitting or denying any of the factual findings of the underlying decisions, Harris is assuming the factual findings as true because it does not alter the applicable legal conclusions. That is, even if the factual findings were accurate, the SEC (and the underlying decisions) incorrectly found that Harris violated the anti-fraud provisions, and the sanctions imposed by the SEC or found appropriate (but not imposed) by the NAC and FINRA were not remedial and were instead excessive, oppressive, and unwarranted.

and like the NAC, the SEC also found that the Deer Payment "was not tied to a specific transaction" and "was not a 'transaction-based payment,'" (id. at p. 9 n.32).[3] Nevertheless, the SEC sustained FINRA's findings of violations and imposition of sanctions. (Id. at pp. 6-18.) Specifically, the SEC sustained FINRA's finding that Harris violated (1) the anti-fraud provisions when he did not disclose prior business dealings with Deer, including the Deer Payment, when selling Deer's securities several months later to customers, (id. at pp. 6-10); and (2) NASD Rule 3030 and FINRA Rule 2010 when he did not disclose via written notice the receipt of funds from an issuer to the broker-dealer with which he was registered at the time because it was an outside business activity, (id. at p. 13). With respect to the imposition of sanctions, the SEC sustained FINRA's bar of Harris based upon its finding that there was a violation under the anti-fraud provisions, but did not consider the sanctions deemed appropriate for the outside business activities violation because FINRA and the NAC did not actually impose

[3] Despite this finding, the SEC then speculated about the payment in a manner unsupported by the record. (See SEC Opinion, at p. 6 ("[I]t appears that Deer's $350,000 payment compensated [Harris and Scholander] for both the limited consulting services and their recommendation that customers buy Deer securities."); id. at p. 9 n.32 ("[I]t appears that the payment was a form of *quid pro quo* for later, general recommendations of Deer securities by [Harris and Scholander]").) The SEC's guesses, however, do not constitute its or the NAC's findings – which was that the payment was "not transaction based" – and thus cannot constitute the basis of its decision.

those sanctions. (Id. at pp. 15-18.) Harris timely filed a petition for review of the SEC Decision with this Court. (Petition for Review (May 31, 2016).)

III. JURISDICTIONAL STATEMENT

This Court has jurisdiction pursuant to 15 U.S.C. § 78y(a)(1), which provides: "A person aggrieved by a final order of the Commission entered pursuant to this chapter may obtain review of the order in the United States Court of Appeals for the circuit in which he resides . . . by filing in such court, within sixty days after the entry of the order, a written petition requesting that the order be modified or set aside in whole or in part." As Harris resides in the state of New York and has been aggrieved by a final order of the SEC for which he filed a petition for review within the requisite time, this Court has jurisdiction.

IV. STATEMENT OF THE ISSUES

The proposed issues of this matter include:

A. Whether this Court should reverse the decision of the SEC sustaining FINRA's findings that Harris violated Section 10(b) of the Securities Exchange Act (the "Exchange Act"), Rule 10b-5 thereunder, and FINRA Rules 2020 and 2010 because Harris had no duty to disclose the receipt of funds from an issuer where there was no nexus between the receipt of those funds and sales of the issuer's securities several months later and Harris also lacked the requisite scienter;

B. Whether this Court should reverse the decision of the SEC to sustain FINRA's imposition of sanctions as to Harris for the violations of the anti-fraud provisions because the sanctions were unwarranted, excessive, and oppressive given the remedial purpose of sanctions, the many mitigating factors at issue here,

including the lack of any customer harm, and sanctions in other enforcement actions for violations of the anti-fraud provisions; and

C. Whether this Court should reverse the decision of the SEC in refusing to determine the appropriateness of the sanctions FINRA and the NAC deemed appropriate (but did not impose) as to Harris for the violations of NASD Rule 3030 and FINRA Rule 2010 because the sanctions were unwarranted, excessive, and oppressive given the remedial purpose of sanctions, the many mitigating factors at issue here, including the lack of any customer harm, and sanctions in other enforcement actions for violations under NASD Rule 3030 and FINRA Rule 2010.

V. SUMMARY OF THE ARGUMENT

Harris is seeking the review of the SEC's incorrect conclusion as to a novel issue: whether a registered representative has a duty to disclose the receipt of funds from or any prior dealings with an issuer when there is *no nexus* between the receipt of those funds or other dealings with the issuer and sales of the issuer's securities several months later. No prior decision has ever held that such a situation triggers a duty to disclose; rather, the precedent of this Court, including decisions relied upon by the SEC, requires a fiduciary duty or a nexus between the payment and the transaction to trigger the duty to disclose, neither of which are present here. See U.S. v. Chestman, 947 F.2d 551, 565 (2d Cir. 1991) (holding that a duty to disclose or abstain arises only from "'a fiduciary or other similar relation of trust and confidence between [the parties to the transaction]'") (quoting Chiarella v. U.S., 445 U.S. 222, 228 (1980)); Press v. Chemical Investment

Services Corp., 166 F.3d 529, 536 (2d Cir. 1999) (holding that there is a duty to disclose information necessary for the "narrow task of consummating the transaction requested"); U.S. v. Nouri, 711 F.3d 129, 141 (2d Cir. 2013) (finding that there had been no error in a jury instruction because the instructions made clear that the defendant could be found guilty of securities fraud if the jury found he had "participated in a scheme for the payment by the [Defendant and his company] of bribes to the brokers in return for getting their customers to buy [the company's stock] where there was testimony that the defendant paid the broker $1 for every transaction).

The SEC – as did the NAC in its decision – found that the Deer Payment "was not tied to a specific transaction" and "was not a 'transaction-based payment.'" (SEC Opinion, at p. 9 n.32; see also R. 3369, NAC Decision, at p. 23 (There was no testimony "that the advisory services were related in any way to sales of Deer stock."); id. ("[T]he $350,000 payment from DEER reflected a single, substantial, non-transaction-based payment from an issuer in exchange for consulting services, which Scholander and Harris used to try to acquire a broker-dealer and to establish a branch office from which they sold the issuer's securities.").) With that finding, the analysis should have been concluded as there was simply no nexus. Nevertheless, the SEC, in its decision, opined that there was a duty to disclose this type of payment because there was some "economic self-

interest that created a conflict," and that because Harris did not disclose the payment or its prior dealings with the issuer that were also not related to the customer's transactions, he had somehow violated the anti-fraud provisions. (SEC Opinion, at p. 9.) In doing so, the SEC and the underlying decisions of the NAC and FINRA broadened the requirement to disclose conflicts of interest related to the particular transaction to an untenable standard. Fundamentally, if left intact, the decisions would add a requirement that any prior dealings with an issuer must be disclosed, even those wholly unrelated to the transaction. The SEC's conclusion was incorrect and improper. Since the payment was a "non-transaction-based payment," there was no duty to disclose it and thus no violation of the anti-fraud provisions.

Furthermore, Harris lacked the requisite scienter under the anti-fraud provisions. The failure to disclose the Deer Payment was not "highly unreasonable" representing an "extreme departure from the standards of ordinary care," see Novak v. Kasaks, 216 F.3d 300, 308 (2d Cir. 2000), because no prior precedent requires prior dealings with an issuer to be disclosed without it having a link to the particular transaction at issue, and a link was not present here. Thus, the scienter requirement is not met here. Therefore, the SEC incorrectly concluded that Harris violated the anti-fraud provisions, and its decision should be reversed.

Should this Court nevertheless affirm the SEC's finding as to the anti-fraud provisions, the sanctions imposed for the anti-fraud violations – and specifically, the permanent bar imposed – were unwarranted, excessive, and oppressive and should be reversed. The SEC did not properly consider many mitigating factors at issue here under the FINRA Sanction Guidelines, or sanctions in other enforcement actions for violations under the anti-fraud provisions, see In re Kunz, Exchange Act Release No. 45290, 2002 WL 54819 (Nov. 17, 1999), and In re: James Altschul, AWC No. 2009019108904, at *2 (FINRA Dec. 21, 2011). Additionally, the sanctions are not appropriate given the remedial purpose of sanctions, and the SEC's failure to articulate a reason that the bar – a draconian sanction tantamount to capital punishment in the securities industry – was remedial and not punitive here. See McCarthy v. SEC, 406 F.3d 179, 188 (2d Cir. 2005); see also Saad v. SEC, 718 F.3d 904, 910 (D.C. Cir. 2013). Thus, the bar the SEC imposed for the anti-fraud provisions violation should be reversed.

Furthermore, the sanctions the NAC deemed appropriate, but did not impose, with respect to the violations of NASD Rule 3030 and FINRA Rule 2010, which included a three-month suspension and a $15,000 fine, were also unwarranted, excessive, and oppressive. First, the SEC failed to address these sanctions at all, and the sanctions should be overturned on that basis. See McCarthy, 406 F.3d at 188 (requiring the SEC to provide a "meaningful statement

of the reasons or basis" of the sanction); Saad, 718 F.3d at 913 (noting that the SEC "must explain its reasoning"). Furthermore, the sanctions are not appropriate given the remedial purpose of sanctions, the many mitigating factors at issue here under the FINRA Sanction Guidelines, including the lack of any customer harm, and sanctions in another enforcement action for violations under NASD Rule 3030 and FINRA Rule 2010, In re Andrew P. Schneider, No. C10030088, 2005 WL 3358082 (NAC Dec. 7, 2005). Thus, its decision not to review the NAC's sanction should be reversed and the sanction should be reduced.

VI. ARGUMENT

This Court must review the SEC's legal conclusions, including its sanction determinations, for whether they are "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A). Under this standard, this Court should reverse the SEC's decision to bar Harris from the industry because Harris did not violate the anti-fraud provisions. Contrary to the SEC's holding, Harris had no duty to disclose the Deer Payment and thus did not commit any fraudulent omission in connection with the purchase or sale of Deer securities, and Harris also did not have the requisite scienter. To the extent this Court would determine that a violation of the anti-fraud provisions did occur, however, this Court should overturn and reduce the sanction imposed – a permanent bar from the industry – because it is excessive, unwarranted, and

punitive, not remedial. Furthermore, the sanctions for the OBA violation deemed appropriate (but not imposed) by the NAC (and not reviewed by the SEC) are similarly excessive, unwarranted, and punitive, not remedial and should also be reduced.

A. Harris Did Not Violate the Anti-Fraud Provisions

This Court must review the SEC's conclusion that Harris violated the anti-fraud provisions to determine if it is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A). Section 10(b) of the Securities Act of 1934, 15 U.S.C. § 78j(b), and Rules 10b–5 and 10b–10, 17 C.F.R. 240.10b–5 and 240.10b–10, promulgated thereunder, prohibit fraudulent activities in connection with the purchase or sale of securities. Section 10(b) provides that:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchanges-
>
> . . . .
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

1. Harris Had No Duty to Disclose the Deer Payment

SEC Rule 10b–5, promulgated pursuant to section 10(b), more specifically delineates what constitutes a "manipulative or deceptive device or contrivance." See 17 C.F.R. § 240.10b–5. To find a violation under Rule 10b–5 for an omission, the registered representative must have "omit[ted] to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, . . . in connection with the purchase or sale of any security." Id. § 240.10b–5(b). For the reasons described below, Harris did not commit a securities fraud violation under Section 10(b) of the Exchange Act and Rule 10b-5. Harris Had No Duty to Disclose the Deer Payment

To establish liability under Section 10(b) of the Exchange Act, and Rule 10b-5, FINRA's Department of Enforcement needed to demonstrate that, among other things, Harris "made a material misrepresentation, or a *material omission if [he] had a duty to speak*." SEC v. First Jersey Sec., Inc., 101 F.3d 1450, 1467 (2d Cir. 1996) (emphasis added); see also U.S. v. Skelly, 442 F.3d 94, 97 (2d Cir. 2006) ("[A] seller or middleman may be liable for fraud if he lies to the purchaser or tells him misleading half-truths, but not if he simply fails to disclose information that he is under no obligation to reveal."). The Supreme Court of the United States, its underlying circuit and district courts, and the SEC have all

recognized this requirement. See, e.g., Basic Inc. v. Levinson, 485 U.S. 224, 239 n.17 (1988) (stating that, in addition to being material, "[t]o be actionable, of course, a statement must be misleading," and "[s]ilence, absent a duty to disclose, is not misleading under Rule 10b-5"); Overton v. Todman & Co., CPAs, P.C., 478 F.3d 479, 483 (2d Cir. 2007) ("A fundamental principle of securities law is that before an individual becomes liable for his silence, he must have an underlying duty to speak."); First Jersey Securities, Inc., 101 F.3d at 1467 (stating that, to establish liability under the anti-fraud provisions, there must be "a duty to speak" (emphasis added)); Hoxworth v. Blinder, Robinson & Co., Inc., 903 F.2d 186, 200 n.19 (3d Cir. 1990) ("Silence, absent a duty to disclose, is not misleading under Rule 10b-5."); Hoffman v. UBS-AG, 591 F. Supp. 2d 522 (S.D.N.Y. 2008) (noting that, because "the basic requirement of Rule 10b-5 . . . holds parties liable for misleading statements, not merely incomplete statements," the respondents could not be liable for omissions when their statements were not otherwise misleading); In re David J. Montanino, Release No. 773, 2015 WL 1732106, *29 (SEC Apr. 16, 2015) (stating that "[w]ithout a duty to speak, [respondent's] silence is not actionable" and holding that the respondent had no duty to speak because the Division of Enforcement had not shown that the respondent was either a fiduciary or had a similar relationship of trust and confidence with the investor); In re Monetta Financial Services, Inc., Release No. 162, 2000 WL 320457, at *20 (SEC

Mar. 27, 2000) (noting that "a duty to speak arises, and material omissions become fraudulent" only when there is a "fiduciary or similar relationship of trust and confidence").

Here, the SEC, just as the NAC did in its decision below, made a fatal error by neglecting to analyze the critical issue of whether a duty exists at all. Instead, the SEC incorrectly assumed that a duty existed, relying on the premise that a duty to speak somehow arises *per se* when there is a material omission, which is patently incorrect and would improperly supersede the requirement that there must first be a duty to speak. (See SEC Opinion, at pp. 7-9.) Materiality, on which the SEC focuses its decision, is a separate and distinct requirement. See, e.g., Basic Inc., 485 U.S. at 239 n.17 (stating that, in addition to being material, "[t]o be actionable, of course, a statement must be misleading," and "[s]ilence, absent a duty to disclose, is not misleading under Rule 10b-5"); In re Lazard Freres & Co. LLC, Release No. 7671, 1999 WL 232594, at *3 (SEC Apr. 21, 1999) ("A duty to speak arises, and material omissions become fraudulent, when a person or entity has information that another is entitled to know because of a fiduciary or similar relationship of trust and confidence." (emphasis added)).

Thus, omissions (regardless of materiality) do not become fraudulent until there is a finding of a duty requiring disclosure. As discussed more fully below, there was no showing, and the SEC (nor the NAC) made no finding, that

Harris was in a fiduciary or similar relationship of trust and confidence such that he could be held liable under the anti-fraud provisions.

a. *Press* is the Controlling Law, and It Requires a Fiduciary Duty or a Transactional Nexus for a Duty to Disclose to Exist

For purposes of Rule 10b-5, the SEC needed to look to state law to determine whether there is a duty to speak. See, e.g., Press v. Chemical Investment Services Corp., 166 F.3d 529, 536 (2d Cir. 1999) (applying New York law to determine the scope of the fiduciary duty of a broker in the context of the anti-fraud provisions); In re Lazard Freres & Co. LLC, Release No. 7671, 1999 WL 232594 (SEC Apr. 21, 1999) (applying New Jersey law to determine whether a fiduciary duty existed where the respondent resided in New Jersey); In re O'Brien Partners, Inc., Release No. 7594, 1998 WL 744085 (SEC Oct. 27, 1998) (stating that Washington and California state law imposed a fiduciary duty where plaintiff and respondent resided in those respective states). As Harris is a New York resident and operated out of New York, New York law applies here.

Under New York law as determined by this Court, a duty to disclose or abstain arises only from "'a fiduciary or other similar relation of trust and confidence between [the parties to the transaction].'" Chestman, 947 F.2d at 565 (quoting Chiarella v. U.S., 445 U.S. 222, 228 (1980)). In other words, there is no

duty to disclose unless there is a (1) fiduciary relationship; or (2) a "relation of trust and confidence" between the broker and the customer.

There is no duty to disclose based on a general fiduciary duty here. There "is no general fiduciary duty inherent in an ordinary broker/customer relationship." U.S. v. Wolfson, 642 F.3d 293, 295 (2d Cir. 2011).[4] Thus, any requirement to disclose does not stem from a "general fiduciary duty" here, and as a result, the question is what constitutes a "relation of trust and confidence" that necessitates disclosure.

The Second Circuit has previously explained that "a relationship of trust and confidence does exist between a broker and a customer with respect to *those matters that have been entrusted to the broker*." Wolfson, 642 F.3d 293, 295 (emphasis added). Under Press and its progeny, the Second Circuit has characterized "the matters entrusted to the broker" as the "*narrow task of consummating the transaction requested*." Press, 166 F.3d at 536 (emphasis

[4] The Second Circuit has explained that a fiduciary duty is owed for a discretionary account or under "special circumstances" for a non-discretionary account where the client is dependent on the broker. See de Kwiatkowski v. Bear, Stearns & Co., Inc., 306 F.3d 1293, 1308 (2d Cir. 2002) (citing as potential "special circumstances" those involving a "client who has impaired faculties, or one who has a closer than arms-length relationship with the broker, or one who is so lacking in sophistication that de facto control of the account is deemed to rest in the broker"). FINRA's Department of Enforcement provided no evidence as to Harris' customers, however, and thus, a fiduciary duty under either of these scenarios is not applicable here.

added); see Hoffman, 591 F. Supp. 2d at 535 ("[I]t is well-established Second Circuit law that the fiduciary duty in the broker/customer relationship is only to 'the narrow task of consummating the transaction requested.'" (quoting Press, 166 F.3d at 536)); In re Refco Securities Litigation, 759 F. Supp. 2d 301, 323 (S.D.N.Y. 2010) ("[W]here a broker does not have discretionary trading authority over an account, the broker's only duty is the proper execution of transactions upon explicit customer instructions."); Thermal Imaging, Inc. v. Sandgrain Securities, Inc., 158 F. Supp. 2d 335, 344 (S.D.N.Y. 2001) ("As the Second Circuit has recognized, a broker/customer relationship ordinarily does not give rise to a fiduciary duty under New York law. Accordingly, a fiduciary obligation will only arise where the customer has delegated discretionary trading authority to the broker. Absent such discretion, a broker's fiduciary duty extends only to those matters with which it is entrusted—namely, the completion of transactions." (internal citations and quotations omitted)); Bissell v. Merrill Lynch & Co., Inc., 937 F. Supp. 237, 246 (S.D.N.Y. 1996) ("The fiduciary obligation between a broker and customer under New York law is limited to affairs entrusted to the broker, and the scope of affairs entrusted to a broker is generally limited to the completion of a transaction."), aff'd, 157 F.3d 138 (2d Cir. 1998); Jordan v. UBS AG, 11 A.D.3d 283 (N.Y. App. Div. 2004) ("Absent agreement to the contrary, . . . a broker does not owe fiduciary duties to a purchaser of securities . . . excepting

executing trades in accordance with the customer's instructions."). Press and its progeny, therefore, require a duty to disclose information only with respect to the "narrow task of consummating the transaction requested."

In applying this standard (either expressly or implicitly), this Court has found that a duty to disclose exists where there is a transactional nexus, i.e. a nexus between the transaction and the issue to be disclosed. For example, this Court has held that excessive charges to the customer with respect to the particular transaction being consummated and the broker or the firm's receipt of additional funds or other financial interest tied to that particular transaction triggers a duty to disclose. See, e.g., Wolfson, 642 F.3d at 294 (requiring disclosure where brokers received "exorbitant" commissions in exchange for selling securities for prices "far above" actual value); U.S. v. Santoro, 302 F.3d 76, 80-81 (2d Cir. 2002) (requiring disclosure where broker received 30% gross commission on specific sales); U.S. v. Szur, 289 F.3d 200, 212 (2d Cir. 2002) (requiring disclosure where brokers received 45-50% commissions on all sales of a specific company's stock). In Press, the Court recognized that it may be difficult to determine what information needed to be disclosed and debated whether the broker's mark-up of a T-bill triggered the duty to disclose, ultimately finding that it fell into a "grey area" that did not require disclosure. 166 F.3d at 536. Nevertheless, in all of these cases, as well as the cases described in further detail below, one common and necessary fact

was that the information to be disclosed related to the particular transaction at issue.

Indeed, the SEC has not pointed to a single case where there was not a nexus between the transaction and the issue to be disclosed. In fact, the two cases on which the SEC primarily relies, U.S. v. Nouri, 711 F.3d 129, 141 (2d Cir. 2013) and Derek L. DuBois, Exchange Act Release No. 48332, 2003 WL 21946858, at *3 (Aug. 13, 2003), both involved a direct nexus between the transaction and the payment received by the broker. In Nouri, this Court found that there had been no error in a jury instruction because the instructions made clear that the defendant could be found guilty of securities fraud if the jury found he had "participated in a scheme for the payment by the [Defendant and his company] of bribes to the brokers in return for getting their customers to buy [the company's stock]" where there was testimony that *the defendant paid the broker $1 for every transaction*. 711 F.3d at 141-42. Thus, there was a direct link between the transaction and the payment at issue. Id. Similarly, in DuBois, there was evidence demonstrating that the broker received payment directly related to the sales of shares of stock. 2003 WL 21946858, at *2-3. These cases are not controlling in this matter given that the Deer Payment "was not a transaction-based payment." (SEC Opinion, at p. 9 n.32; see also R. 3369, NAC Decision, at p. 23.)

b. There Is No Transactional Nexus with the Deer Payment (or Other Prior Dealings with Deer), and Thus No Duty to Disclose

Here, the "narrow task" of completing the transaction did not require disclosure of the Deer Payment. There has not been a single finding tying the sales of the Deer securities to any excessive charges to the customers or any additional funds to Harris based on the particular transaction.[5] According to the SEC and the NAC, Harris received the DEER Payment and spent the money to acquire the broker-dealer, and several months thereafter, Harris sold Deer shares to customers. (See SEC Opinion, at pp. 4-5; R. 3369, NAC Decision, at p. 1.) The NAC expressly stated that there was no testimony "that the advisory services [for which the Deer Payment was made] were related in any way to sales of Deer stock." (R. 3369, NAC Decision, at p. 23.) Thus, the only payment that Harris ever received from Deer came before the sales at issue, and FINRA's Department of Enforcement offered no evidence that the payment was made in exchange for recommendations to purchase Deer securities. Indeed, both the SEC (and the NAC) found that the Deer Payment "was not tied to a specific transaction" and "was not a 'transaction-based payment.'" (SEC Opinion, at p. 9 n.32; see also R.

[5] Even if the SEC had found that it had been transaction-based compensation, the Deer Payment would not necessarily need to be disclosed. See Skelly, 442 F.3d at 97-98 (holding that "a registered representative is under no inherent duty to reveal his compensation," and he must reveal the compensation only if he has a "fiduciary duty").

3369, NAC Decision, at p. 23 (finding that the Deer Payment "reflected a single, substantial, *non-transaction-based payment* from an issuer in exchange for consulting services" (emphasis added)).) Therefore, there was no transactional nexus, i.e., no link between the Deer Payment and Harris' customer's transactions (as found by the SEC and the NAC), and Harris had no duty to disclose the Deer Payment to his customers.

In finding that Harris had a duty to disclose to his customers, the SEC also stated that Harris' "failure to disclose [his] business relationship with Deer also violated his] duty to disclose a conflict of interest to [his] customers." (See SEC Opinion, at p. 8.) This appears to be much like the NAC's findings that Harris needed to disclose the following "potentially competing motivations" in addition to the Deer Payment: (1) "Deer was a potentially lucrative source of business" because Harris and Scholander had "previously handled two private placements for Deer" and had "attempted to secure a contract with Deer to provide advisory services in connection with Deer's follow-on offering"; and (2) "their dealings with Deer resulted from [Harris and Scholander's] longstanding business relationship with Person A and Person B, who over the years introduced respondents to several Chinese companies, including Deer." (See R. 3369, NAC Decision, at p. 21.) Harris' prior handling of two private placements for and failed contractual negotiations with Deer, however, had no transactional nexus to the

sales of securities months (or even years) later. Harris' relationship with "Person A and Person B" is even further afield, and again, there is no transactional nexus to the sales of Deer securities to customers. Thus, to the extent the SEC is referring to these other business dealings with Deer, it incorrectly concluded that Harris' prior business dealings with Deer or its relationships with individuals who introduced him to Deer needed to be disclosed here.

In sum, the SEC incorrectly concluded that there was a fraudulent omission here; Harris had no duty to disclose the Deer Payment or (any of his prior dealings with Deer) because they were not in any way tied to the "narrow task of consummating the transaction" for their customers.[6] Therefore, Harris had no duty to speak.

c. Any Additional Case Law to Which the SEC Cites Is Distinguishable Because Each Includes a Link Between the Issue to Be Disclosed and the Transaction

i *Kunz* Is Not Applicable Because It Fulfilled the Transactional Nexus Requirement

The SEC – like the NAC – incorrectly relied on In re Kunz, Exchange Act Release No. 45290, 2002 WL 54819 (Nov. 17, 1999), in finding that the Deer

[6] Should this Court somehow find that there was some transactional component to the Deer Payment, which Harris denies, or that there was some other basis to find that Harris had a duty to disclose the Deer Payment, any duty to disclose would fall into a grey area that did not need to be disclosed. See Press, 166 F.3d at 536.

Payment constituted a conflict of interest that had to be disclosed. (See SEC Opinion, at p. 8 & nn. 23, 25; R. 3369, NAC Decision, at pp. 21-22.) Kunz is distinguishable from the present case because there was a transactional nexus between the "conflict of interest" and the transactions at issue.

In Kunz, the issuer of the securities, Vescor, tapped one of its current employees, who was not even a registered representative at the time, to begin his own broker-dealer for the sole purpose of fulfilling the issuer's desire to issue securities through a private placement. 2002 WL 54819, at *2. In doing so, Vescor provided the financing for opening the broker-dealer with the intention that the broker-dealer would then "act as selling agent or underwriter for the private placement offerings and possibly for an anticipated, later 'SB-2 public offering." Id.

The Private Placement Memoranda for the offerings, however, did not disclose "the relationship between Vescor[, the issuer] and [the former employee-turned-broker] and the [newly-formed broker-dealer]"; the memoranda also did not disclose "the consulting fees paid to [the former employee-turned-broker] by Vescor" or "Vescor's financing of [the broker-dealer]." Id. at *2, 6. The SEC held that these omissions were material facts that needed to be disclosed to the investors receiving the memoranda. Id. In doing so, it stated: "The existence of these relationships would have been material to any prospective investor. When a

broker-dealer has a self-interest (other than the regular expectation of a commission) in serving the issuer that could influence its recommendation, it is material and should be disclosed." Id. at *6.

The SEC relied on this quoted language in reaching its conclusion. (SEC Opinion, at p. 9 & n. 23.) Divorced from the actual facts, this quotation arguably could be read as requiring the disclosure of any prior relationship with the issuer of securities. The actual facts demonstrate otherwise. There was a transactional nexus between the representative's "conflict of interest" – the prior employment, the financing of the broker-dealer, and the consulting fees – and the sale of the particular securities at issue. The entire purpose of the scheme was to use the broker-dealer, financed by the issuer, to sell the issuer's securities for which the registered representative would be further compensated. Therefore, all of the funds received by the representative were tied to the particular transactions at issue. See Kunz, 2002 WL 54819, at *2, 6.

There is no such tie here. In fact, the only factual similarity between Kunz and the present case is that there was a finding here that the funds from the Deer Payment were used as part of the financing to open up the broker-dealer. (See SEC Opinion, at pp. 3-4; R. 3369, NAC Decision, at p. 23.) There was no evidence tying the opening up or financing of the broker-dealer to any of the particular transactions at issue here. (See R. 3369, NAC Decision, at p. 23 (stating

that there was no testimony "that the advisory services [for which the Deer Payment was made] were related in any way to sales of Deer stock").) To the contrary, both the SEC and the NAC expressly found that there was no transaction-based component to the Deer Payment. (See SEC Opinion, at p. 9 n.32 ("The $350,000 payment occurred prior to [Harris'] recommendations of Deer securities and, as a result, was not tied to a specific transaction (and was not a 'transaction-based payment')."); R. 3369, NAC Decision, at p. 23 ("[T]he $350,000 payment from DEER reflected a single, substantial, *non-transaction-based payment* from an issuer in exchange for consulting services, which [Harris and Scholander] used to try to acquire a broker-dealer and to establish a branch office from which they sold the issuer's securities.").) Thus, Kunz is not applicable.

ii The Remaining "Conflicts of Interest" Case Law Relied Upon by the SEC Does Not Require Disclosure Here

In addition to Kunz, the holdings of all of the remaining cases cited by the SEC similarly demonstrate that, in each case, the "conflict of interest" or "adverse interest" was tied in some way to the particular transaction at issue.

For example, the SEC cited Richard H Morrow, Exchange Act Release No. 43092, 1998 WL 556560 (Sept. 2, 1998) for the proposition that "a securities professional must not only avoid affirmative misstatements but also must disclosure 'material adverse facts', including any self-interest that could influence

the salesman's recommendation.'" (SEC Opinion, at p. 7 & n.21) In Morrow, there was a clear nexus between the omission and the particular transaction: the registered representative, in recommending securities via a private placement, failed to disclose that he would receive an "8% selling commission" and a "10% back end equity kicker fee," which would entitle the representative to a portion of the profit of the eventual sale of the property acquired in the private placement and "have an effect on the ultimate profitability of the clients' investment in the partnership." 1998 WL 556560, at *7-8.

The SEC also cited SEC v. Hasho, 784 F. Supp. 1059, 1110 (S.D.N.Y. 1992), (see SEC Opinion, at p. 7 n.22), but in Hasho, the registered representatives violated the anti-fraud provisions because they misrepresented that they would receive no commissions for the transactions at issue and then failed to disclose "the amount of commissions that they were earning on customer purchases of in house stocks." 784 F. Supp. at 1110. The Court's holding that "[m]isrepresenting or *omitting to disclose a broker's financial or economic incentive in connection with a stock recommendation* constitutes a violation of the anti-fraud provisions," therefore, was limited to the narrow task of completing the transaction and had the requisite transactional nexus. Id.

The SEC also cited to a case involving anti-fraud provision violations where a registered representative failed to disclose that his firm was a market

maker for the particular security at issue. (See, e.g., SEC Opinion, at p. 7 n.22 & p. 9 n.31 (citing Chasins v. Smith, Barney & Co., Inc., 438 F.2d 1167, 1171-72 (2d Cir. 1970).) This case, however, tied the omission of the market-making status to the customer's particular transaction, because it was possible that the customer's particular transaction would have an economic impact on the broker-dealer. See Chasins, 438 F.2d at 1171-72 (market-making omission violated anti-fraud provisions because broker-dealer could "well be caught in either a 'short' position or a 'long' position in a security, because of erroneous judgment of supply and demand at given levels, [and i]f over supplied, it may be to the interest of a market maker to attempt to unload the securities on his retail clients").[7] Thus, this market-making case similarly had the required transactional nexus.

[7] The NAC had cited to two additional market-making cases, which the SEC did not rely upon in its decision, but the result is the same: these decisions are not applicable because there was a link between the customer's transaction and the firm's status as a market maker. See Affiliated Ute Citizens of Utah v. U.S., 406 U.S. 128, 153 (1972) (market-making omission violated anti-fraud provisions because the sellers had the "right to know that the defendants were in a position to gain financially from their sales and that their shares were selling for a higher price in that market"); Dep't of Market Regulation v. Jaloza, Complaint No. 2005000127502, at 8 (FINRA NAC July 28, 2009) (registered representative violated anti-fraud provisions when he failed to disclose to his customers the broker-dealer with which he was associated "had agreed to make a market" for the particular stock involved in the transactions and "had taken a significant position in the stock" or that it had a pending consulting agreement with the issuer under which it would receive 150,000 options).

Finally, the SEC also incorrectly cited to Dep't of Enforcement v. Donner Corp. Int '1, Exchange Act Release No. 55313, 2007 WL 516282, at *13 (Feb. 20, 2007), as support for its finding of a violation. The violation of the anti-fraud provisions in Donner involved the failure to disclose compensation for drafting research reports within a research report, constituting a direct nexus between payment for drafting the research report (i.e., the conflict) and the provision of that report. Id. at * 13-14. Therefore, Donner is inapplicable.

The same holds true for In re: Richmark Capital Corp., Exchange Act Release No. 48758, 2003 WL 22570712 (Nov. 7, 2003), to which the NAC also cited. (See R. 3369, NAC Decision, at pp. 20 n.29 & 21.) In Richmark, the SEC stated that the broker-dealer was "obligated to disclose their financial incentive in recommending the [issuer's securities] so that investors could make an informed judgment." 2003 WL 22570712, at *6. Again, that "financial incentive" was tied to the particular transaction. Id. The registered representatives actually had two financial incentives tied to the transaction: (1) they were selling their own shares of a corporation while concurrently recommending that their customers buy the stock, thus increasing the value of their stock at the time they were selling it; and (2) they had an investment banking agreement with the issuer that provided a monthly retainer plus financial incentives for selling certain numbers of shares on a monthly basis. Id. Thus, the sales of the securities were again tied to the particular transaction, not just the investment banking relationship as a whole.

In the one remaining "adverse interest" case cited by the NAC, there was also a transactional nexus. See Dep't of Market Regulation v. Burch, Complaint No. 2005000324301, at 12 (FINRA NAC July 28, 2011) (registered representative violated anti-fraud provisions when, only hours after his wife had purchased 50,000 shares of a company that had "no material business operations or assets," he recommended that his customers purchase shares of it, and then his wife sold her shares immediately after the price of the shares had risen).

Based on the foregoing, the SEC, in its decision, improperly concluded that there was a conflict of interest requiring disclosure despite the lack of a transactional nexus with the Deer Payment (and Harris' prior dealings with Deer). In doing so, it broadened the conflicts of interest requirement to an untenable standard where any prior dealings with an issuer must be disclosed, not just those issues related to the particular transaction. That is not the requirement of the prior precedent; rather, as demonstrated above, all of the cases with an interest requiring disclosure tied that interest directly to the particular transaction in some way. Since the $350,000 payment from DEER was "not tied to a specific transaction (and was not a 'transaction-based payment')," (SEC Opinion, at p. 9 n.32), Harris had no duty to disclose it, and as such, he did not violate the anti-fraud provisions by failing to disclose it.[8]

2. Harris Did Not Have the Requisite Scienter

In addition to requiring a duty to disclose the Deer Payment, there must be "a mental state embracing intent to deceive, manipulate, or defraud" in order to satisfy the scienter requirement under Section 10(b) of the Exchange Act

[8] Should this Court choose to extend the case law to find that there is an independent duty to disclose all prior dealings with an issuer regardless of a transactional nexus, Harris denies that there was a conflict of interest with the Deer payment or his prior dealings with Deer, which occurred months or years before any sales of securities occurred, and furthermore, at most, any duty to disclose here would fall into a grey area that did not need to be disclosed. See Press, 166 F.3d at 536.

and Rule 10b-5. Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 319 (2007). Generally, scienter may be established by showing a reckless disregard for the truth. Id. at 319 n.3. This Court has explained, however that, "[b]y reckless disregard for the truth, we mean 'conscious recklessness—i.e., a state of mind approximating actual intent, and not merely a heightened form of negligence.'" S. Cherry St., LLC v. Hennessee Group LLC, 573 F.3d 98, 109 (2d Cir. 2009) (quoting Novak, 216 F.3d at 312) (internal quotation marks omitted). Thus, "reckless conduct" is defined as:

> [A]t the least, conduct which is "highly unreasonable" and which represents "an extreme departure from the standards of ordinary care . . . to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it.

Novak, 216 F.3d at 308 (internal quotations and citations omitted); see also Sundstrand Corp. v. Sun Chemical Corp., 553 F.2d 1033, 1045 (7th Cir. 1977) (defining reckless conduct as "a highly unreasonable omission, involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and 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.").

This definition of recklessness "is equivalent to willful fraud." Sundstrand Corp., 553 F.2d at 1045; see also Rolf v. Blyth, Eastman Dillon & Co.,

Inc., 570 F.2d 38, 46 (2d Cir. 1978) ("[S]ecurities law cases have recognized that recklessness may serve as a surrogate concept for willful fraud."); Ottmann v. Hanger Orthopedic Group, Inc., 353 F.3d 338, 343-44 (4th Cir. 2003) (noting that the reckless conduct must be "a slightly lesser species of intentional misconduct" (quoting Nathenson v. Zonagen Inc., 267 F.3d 400, 408 (5th Cir. 2001)). Requiring a "highly unreasonable omission" and an "extreme departure" that "is equivalent to willful fraud" also comports with the Supreme Court's observation that "[t]he words 'manipulative or deceptive' used in conjunction with 'device or contrivance' strongly suggest that [Section] 10(b) was intended to proscribe knowing or intentional misconduct." Ottmann, 353 F.3d at 343-44 (quoting Ernst & Ernst v. Hochfelder, 425 U.S. 185, 197 (1976)). Because the inquiry requires an examination of both the "state of mind" of the actor and "what a reasonably prudent securities professional under the circumstances would do," the recklessness standard for scienter has been characterized as containing both an objective and a subjective component. See Gebhart v. SEC, 255 Fed. App'x 254, 255-56 (9th Cir. Nov. 21, 2007) ("The objective component of scienter asks what a reasonably prudent securities professional under the circumstances would have done. . . . The subjective component looks at an actor's actual state of mind at the time of the relevant conduct.").

In the present case, the failure to disclose the Deer Payment was not a "highly unreasonable omission." As described more fully infra, no prior precedent requires all prior dealings with an issuer to be disclosed unless there is some link to the particular transaction at issue, and a link was not present here. Thus, the omission simply could not be an "extreme departure from the standards of ordinary care" such that scienter is met. See Novak, 216 F.3d at 308.

Further supporting this objective component is the reactions of other securities professionals who were well aware of the Deer Payment, which demonstrates that the omission here is not "unreasonable," let alone "highly unreasonable." The Deer Payment was not hidden from anyone at First Merger. In fact, many people were aware of it, including:

- Maureen Gearty, the operations manager for First Merger who had worked in the securities industry for over 30 years (see R. 908:9-11, 1012:21-1013:5, 1064:3-1067:8);
- Richard Nummi, a securities lawyer for First Merger (see R. 929:18-22, 963:25-965:15, 967:20-968:2,1089:5-23, 1091:17-1092:8);
- James Sloan Altschul, the Chief Compliance Officer ("CCO") of First Merger who has held a Series 24 license as a general securities principal since 2002 and was also the supervisor of the trades (see R. 1813:4-13, 2269-70; see also James Altschul, AWC No. 2009019108904, at 2 (FINRA Dec. 21, 2011); and
- Mark Simonetti, the owner and director of First Merger who also held a Series 24 license as a general securities principal (see R. 1813:4-13;see also Mark Simonetti, AWC, No. 2009019108902, at 1, 2 (FINRA Jan. 31, 2012)).

Ms. Gearty knew about the Deer Payment, and she also testified that she informed Nummi of the Deer Payment. (See R. 1093:3-8 ("Q. . . . [S]omewhere between your trip to China and the fee coming in, you told Mr. Nummi, amongst other things, that 'I went to China to visit this company DEER and DEER is going to send us $350,000,' correct? A. Yes.")). She "had asked [Nummi] as [First Merger's] attorney for advice on how [she] was going to get this fee sent to First Merger." (R. 965:9-11). Furthermore, both Altschul and Simonetti were well aware of the Deer Payment as CCO and the Owner and Director of First Merger, respectively; in fact, Altschul testified that Simonetti informed him of the Deer Payment. (See R. 1813:4-13; see also James Altschul, AWC No. 2009019108904, at 2 (FINRA Dec. 21, 2011); Mark Simonetti, AWC, No. 2009019108902, at 2 (FINRA Jan. 31, 2012)).

Yet, despite being long-standing securities professionals who were aware of the Deer Payment, there is no evidence that any of these securities professionals – Gearty, Nummi, Altschul, or Simonetti (the latter two of whom held Series 24 licenses) – suggested, at any point, that the Deer Payment needed to be disclosed when selling Deer securities. In fact, Gearty even testified that she "did not know it had to be disclosed." (R. 1066:3-7). Altschul and Simonetti, having Series 24 licenses as securities principals for a combined total of over 25 years before the Deer Payment occurred, were in the best position to identify that a

disclosure was necessary but never did. Thus, the reasonableness of Harris' belief at that time that it did not need to be disclosed demonstrates that it was not a "highly unreasonable" omission.

Furthermore, the fact that Harris did not attempt to conceal the Deer Payment in any way, as evidenced by the CCO's (as well as others') knowledge of it, demonstrates that the "subjective component" of scienter is missing as well. Had Harris had the "actual state of mind at the time of the relevant conduct," Gebhart, 255 Fed.App'x at 255-56, one would think that the Deer Payment would not be known by anyone else, let alone the CCO of the firm. Thus, this was not "reckless conduct" that was "equivalent to wilful fraud." Rather, this is a case where either there was no duty to disclose or the duty is in such a "grey area" of the law that no one understood that it needed to be disclosed, see Press, 166 F.3d at 536, not a case where there was some "conscious recklessness" that is "equivalent to willful fraud."

Based on the foregoing, Harris' conduct was not a "highly unreasonable omission" equivalent to "wilful fraud" or "intentional misconduct," and thus, the scienter requirement was not met under the anti-fraud provisions.

B. Even if Harris Violated the Anti-Fraud Provisions, the Sanctions Imposed Were Excessive, Oppressive, and Punitive, Not Remedial.

Should this Court nevertheless affirm the SEC's finding as to the anti-fraud provisions, the sanctions imposed – and specifically, the permanent bar imposed – were unwarranted, excessive, and oppressive given the remedial purpose of sanctions, the many mitigating factors at issue here (including the lack of any customer harm), and sanctions in other enforcement actions for violations under the anti-fraud provisions. Harris should not be barred for the rest of his life, and the sanctions against him should therefore be reversed and reduced.

This Court must review the SEC's sanction determinations for whether they are "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A). This Court will overturn such sanctions if they are "unwarranted in law" or "without justification in fact" and has discretion to reduce or eliminate a sanction if it is "excessive or does not serve its intended purposes." See McCarthy v. SEC, 406 F.3d 179, 188 (2d Cir. 2005); see also Saad v. SEC, 718 F.3d 904, 910 (D.C. Cir. 2013). Similarly, this Court's sister circuit has explained that it is "bound to reverse an administrative action if the agency has 'entirely failed to consider an important aspect of the problem' or has 'offered an explanation for its decision that runs counter to the evidence before

the agency.'" Saad, 718 F.3d at 910-11 (quoting Motor Vehicle Manufacturers Ass'n of U.S., Inc. v. State Farm Mutual Auto. Ins. Co., 463 U.S. 29, 43 (1983)).

In evaluating the SEC's conclusions regarding sanctions against FINRA registered representatives, courts will look to the FINRA Sanction Guidelines. See id. at 911. For reckless or intentional misconduct, the Guidelines recommend that adjudicators consider imposing a fine between $10,000 to $100,000, a suspension in any or all capacities of ten business days to two years, and in egregious cases, a bar. See FINRA Sanction Guidelines, at 88. Before imposing a bar, however, the SEC "must be particularly careful to address potentially mitigating factors" because a lifetime bar is "the securities industry equivalent of capital punishment." See Saad, 718 F.3d at 912-13 (quoting PAZ Securities, Inc. v. SEC, 494 F.3d 1059, 1065 (D.C. Cir. 2007)). The SEC may only approve expulsion "not as a penalty[,] but as a means of protecting investors." Id. at 913 (quoting PAZ Securities, 494 F.3d at 1065). The purpose of the order must be remedial, not penal. See id. at 912-13; see also McCarthy, 406 F.3d at 188 ("[T]he purpose of expulsion or suspension from trading is to protect investors, not to penalize brokers.").

As described above, Harris did not violate the anti-fraud provisions. As a result, no sanctions should have been imposed against Harris, let alone a bar from associating with any member firm. Therefore, this Court should reverse the

bar of Harris imposed by FINRA and the NAC and affirmed by the SEC. (SEC Opinion, at pp. 15-18.) Even if this Court were to determine that Harris committed a violation of the anti-fraud provisions on appeal, a permanent bar from associating with any member firm is excessive, oppressive, unwarranted, and downright draconian. A lifetime bar is the equivalent of a death penalty to working in the industry, and it is unwarranted and excessive here given that, at most, the purported violation falls within a "grey area" of the law for the reasons described above and was not egregious as incorrectly determined by the SEC. (See SEC Opinion, at p. 15.)

Furthermore, the SEC improperly found certain aggravating factors applied and did not give adequate consideration to the many mitigating factors at issue here. First and foremost, the SEC did not adequately consider Harris' argument that the sanction against him should have been "batched" or "aggregated" under the FINRA Sanction Guidelines. (See SEC Opinion, at p. 16.) The FINRA Sanction Guidelines provide that "it may be appropriate to aggregate similar violations" under certain circumstances, including where the "conduct did not result in injury to public investors" or "the violations resulted from a single systemic problem or cause that has been corrected." See FINRA Sanction Guidelines, General Principles No. 4 ("Aggregation or 'batching' of violations may be appropriate for purposes of determining sanctions in disciplinary

proceedings"). Even if a disclosure was required here – which it was not – it would be most appropriate to "batch" or "aggregate" the alleged omissions here (much like the complaint did in charging Harris) given that this case stemmed from a single systemic problem, i.e., the reasonable belief that the Deer Payment and prior dealings with Deer did not need to be disclosed, not some grand, fraudulent scheme to defraud customers. See id. The SEC's finding that FINRA "batched" violations "by imposing a unitary sanction" does not ring true, however, given that the SEC concluded that the violation did "not stem from a single incident," finding instead that Harris "engaged in a large number of separate transactions over a nine-month period." (See SEC Opinion, at p. 16.) Thus, by counting each separate omission, the SEC appears to have improperly found it to be an aggravating factor, or at a minimum, improperly failed to batch the violations, when, in actuality, it should be a mitigating factor here.

Furthermore, neither Harris' customers nor the investing public were injured, which in addition to being a basis for aggregating sanctions, is also a mitigating factor. See FINRA Sanction Guidelines, Principal Consideration No. 11 ("With respect to other parties, including the investing public, the member firm with which an individual respondent is associated, and/or other market participants, (a) whether the respondent's misconduct resulted directly or indirectly in injury to such other parties, and (b) the nature and extent of the injury."); In re:

Bukovcik, Compl. No. C8A050055 (NAC July 25, 2007) (citing "the lack of any customer harm" as one of "a number of mitigating factors" in reducing the sanctions imposed by the Hearing Panel). But rather than being "particularly careful to address" this mitigating factor, the SEC failed to consider it at all, claiming that a lack of customer harm "would not be mitigating." (See SEC Opinion, at p. 17.) In so claiming, the SEC purportedly relied on a number of cases, all of which are distinguishable[9] (particularly where, as here, the sanction involves a lifetime bar), and completely ignored the FINRA Sanction Guidelines. See id. The SEC should have considered the FINRA Sanction Guidelines, and because there was no harm to any customers or the investing public, the SEC

[9] In support of its refusal to apply Principal Consideration No. 11, the SEC cited to the following distinguishable cases where, perhaps a lack of customer harm was not mitigating: Edward S. Brokaw, Exchange Act Release No. 70883, 2013 WL 6044123 (Nov. 15, 2013) (involving market manipulation, which is "one of the most serious securities offenses" and which will rarely cause direct harm to customers because it is an offense "perpetrated not merely on particular customers but on the entire market"); Howard Braff, Exchange Act Release No. 666467, 2012 WL 601003 (Feb. 24, 2012) (involving a $25,000 fine and two-year suspension); PAZ Securities, Inc., Exchange Act Release No. 57656, 2008 WL 1697153 (Apr. 11, 2008) (involving a violation of FINRA Rule 8210, which "will almost never result in direct financial gain . . . . [or] direct harm to a customer"); Coastline Fin., Inc., Exchange Act Release No. 41989, 1999 WL 798874 (Oct. 7, 1999) (involving a fraudulent scheme involving "outright falsehoods" to sell purportedly collateralized debt secured by AAA-rated U.S. government securities when, in fact, "nothing secured the notes," and the firm would have had to liquidate all of its assets just to pay off "substantially all of the notes"). Here, it is.

should have treated it as factor in favor of aggregating the sanction, as well as a mitigating factor.

Additionally, a prior SEC decision – as well as settlements in the same underlying matter – demonstrates that a bar of Harris is both excessive and oppressive. First, while Harris disputes that In re: Kevin D. Kunz, 55 S.E.C. 551, 2002 WL 54819 (2002), is necessarily applicable here, the NAC claimed that it is a "relevant analogy" to the present case, (see R. 3369, NAC Decision, at p. 21), and the SEC relied upon it in reaching its decision, (see SEC Opinion, at p. 8 & nn. 23 & 25). In Kunz, despite having several, additional violations beyond violations of the anti-fraud provisions based on omissions that were considered "egregious" – including making material misrepresentations in private placement memoranda, selling unregistered, non-exempt securities, and compensating an unregistered individual for securities transactions, none of which occurred here – the sanctions were far more minimal than the sanctions at issue here. Kunz, 2002 WL 54819, at *1. Furthermore, in Kunz, and as described more fully infra, the transactional nexus was present, and thus, unlike here, there should have been no question that disclosure was needed given the prior precedent requiring the disclosure of conflicts of interest related to a transaction. See id. Also unlike here, the representative was a principal at the time of the conduct at issue and thus was expected to have extensive knowledge regarding the underlying securities laws at

issue and his disclosure obligations. See id. But despite the far more egregious nature of his conduct, the Kunz representative was fined only $5,000 individually and suspended for only 30 days from acting as a representative and one year from acting as a principal. Id. Although the NAC believed Kunz to be a proper comparison, it imposed a lifetime bar against Harris, which the SEC affirmed. Thus, Kunz further demonstrates that the lifetime bar against Harris is excessive, oppressive, and unreasonable, and the SEC's wholesale failure to consider Kunz was arbitrary, capricious, and an abuse of discretion.

Finally, the sanctions doled out to James Altschul, First Merger's CCO and the individual supervising Harris' trades, for failure to supervise in connection with the failure to disclose the Deer Payment demonstrates the excessive and oppressive nature of the bar here. See In re: James Altschul, AWC No. 2009019108904, at *2 (FINRA Dec. 21, 2011). Altschul was the supervisor for Harris and knew about the Deer Payment, yet FINRA imposed a mere $10,000 fine and a three-month suspension from utilizing the Series 24 license. Id.

According to the SEC, "comparisons to sanctions in settled cases are inappropriate because pragmatic considerations justify the acceptance of lesser sanctions in negotiating a settlement such as the avoidance of time-and-manpower-consuming adversary proceedings." (SEC Opinion, at p. 17.) However, the SEC's wholesale failure to at least look to Altschul for *some* guidance is misplaced—this

is not just any settlement involving anti-fraud violations. Rather, the allegations against Altschul stemmed from the very same underlying facts as those present here. *The same underlying facts – even accounting for a settlement and the purportedly attendant "pragmatic considerations" – should not result in a lifetime bar of a registered representative yet a mere $10,000 fine and three-month supervisory suspension for his supervisor.* Either the remedial purpose of the sanctions was not at all served with respect to Altschul, see FINRA Sanction Guidelines, General Principle No. 1, or Harris's failure to disclose the Deer Payment was not even remotely "egregious" as found by the SEC. Harris submits that it is the latter, and the SEC's blanket disregard of the sanctions levied against Altschul evinces its failure to properly "consider an important aspect of the problem." See Saad, 718 F.3d at 910-11.

Not only did the SEC fail to properly consider the above factors, but it also "failed to articulate a remedial rather than punitive purpose" for the lifetime bar (as opposed to a lesser sanction), and its decision should be reversed on this basis as well. See Saad, 718 F.3d at 912-13; see also McCarthy, 406 F.3d at 188 ("[T]he purpose of expulsion or suspension from trading is to protect investors, not to penalize brokers."). While "deterrence has sometimes been relied upon as an additional rationale for the imposition of sanctions," it "is not, by itself, sufficient justification for expulsion or suspension." Id. at 188-89. Furthermore, while

"characteristics of the offense will often be relevant to remedial justifications for suspension," the SEC must go beyond that and "address the remedial and protective efficacy of the chosen sanction." Id. at 190 (holding that the SEC did not adequately consider the mitigating facts and circumstances in suspending a broker for two years because it did not consider whether the suspension "will not serve remedial interests and will work an excessive and punitive result – namely, the destruction of the brokerage practice [the broker] has built during several years of rule-abiding trading").

The SEC's entire basis for the supposedly "remedial" purpose of its bar of Harris is deterrent based. (See SEC Opinion, at p. 18 ("The bars FINRA imposed on [Harris is] remedial because [it] will protect the investing public by encouraging brokers to disclose all material adverse facts and conflicts of interest when they recommend securities to their customers. The bars also will deter others from selling securities to investors without disclosing all information necessary to avoid misleading those customers regarding the soundness and objectivity of their recommendations.").) While it did briefly discuss some of the factors it deemed at issue, it did not address the remedial purpose of barring Harris for life, thus failing to meet the requirements under McCarthy and Saad. Thus, the bar of Harris should also be reversed on this basis as well.

Based on the foregoing, the bar imposed on Harris is unwarranted, excessive, oppressive, and punitive, not remedial, and the SEC's conclusions regarding the bar are arbitrary, capricious, and an abuse of discretion and should be overturned.

C. The SEC Should Have Reviewed the Sanctions Deemed Appropriate, But Not Imposed, by the NAC for the OBA Violation, Because They Were Excessive, Oppressive, and Punitive, Not Remedial, and Should Be Reduced

The sanctions the NAC deemed appropriate, but did not impose, with respect to the violations of NASD Rule 3030 and FINRA Rule 2010, were also unwarranted, excessive, and oppressive given the remedial purpose of sanctions, the many mitigating factors at issue here, including the lack of any customer harm, and sanctions in other enforcement actions for violations under NASD Rule 3030 and FINRA Rule 2010, and should be reversed and reduced. The standard of review is the same as the standard of review described infra for section (VI)(B).

The NAC did not impose any sanctions for the outside business activity violation that it found, (see R. 3369, NAC Decision, at p. 33), but it did find that a three-month suspension and a $15,000 fine were an appropriate sanction, increasing that sanction from the $10,000 fine deemed appropriate by the Hearing Panel. The SEC chose not to review the Hearing Panel's or the NAC's decision on this issue, (see SEC Opinion, at p. 18 n.68), and thus, this Court should overturn those decisions because the sanction is excessive, oppressive, and

unwarranted and because the SEC failed to articulate any reasons supporting the sanction at all. See McCarthy, 406 F.3d at 188 (requiring the SEC to provide a "meaningful statement of the reasons or basis" of the sanction); Saad, 718 F.3d at 913 (noting that the SEC "must explain its reasoning"). Furthermore, the SEC (as well as the NAC) failed to properly review the many mitigating factors at issue here under the FINRA Sanction Guidelines. See Saad, 718 F.3d at 913; McCarthy, 406 F.3d at 188.

For an OBA violation, the FINRA Sanction Guidelines recommend a fine of $2,500 to $50,000, as well as (i) a suspension of up to 30 days for no aggravating conduct, (ii) a suspension of up to one year for violations involving aggravating conduct; or (iii) a bar for egregious conduct. See FINRA Sanction Guidelines, at p. 13. The Sanction Guidelines identify five "principal considerations" for determining sanctions for violating Rule 3030. Id. They are (i) "[w]hether the outside activity involved customers of the firm"; (ii) "[w]hether outside activity resulted directly or indirectly in injury to customers of the firm and, if so, the nature and extent of the injury"; (iii) the "duration of the outside activity, the number of customers, and the dollar volume of sales"; (iv) "[w]hether the respondent's marketing and sale of the product or service could have created the impression that the employer (member firm) had approved the product or service"; and (v) "[w]hether the respondent misled his or her employer member

firm about the existence of the outside activity or otherwise concealed the activity from the firm." Id.

Here, the NAC incorrectly found aggravating factors that were not present and did not apply mitigating factors that were present. First and foremost, the NAC found that the OBA involved a customer of Seaboard Securities because it identified Deer as a customer, (see R. 3369, NAC Decision, at p. 33); Deer, however, was an issuer, not a customer of the firm. Thus, no customers were at issue, and this was not an aggravating factor. Furthermore, and as explained supra, there was no customer harm whatsoever with respect to the Deer Payment, and the lack of customer harm is a mitigating factor. As evidenced by the first three "principal considerations" for OBA violations set forth above, whether customers are involved and the extent of their harm are the most significant factors in determining the violation. See FINRA Sanction Guidelines, at p. 13, subs. (i)-(iii). In this matter, there were no customers involved and no injury.

Furthermore, the other two principal considerations specific to OBA violations do not apply. Harris did not market or sell any product or service as part of the OBA violation. See FINRA Sanction Guidelines, at p. 13, subs. (iv). There was also no evidence and no finding that Harris misled Seaboard Securities or actively concealed the OBA from Seaboard Securities. Id., subs. (v). Rather, the

holding was simply that written disclosure of the Deer Payment needed to be made, and it was not disclosed. (See R. 3369, NAC Decision, at pp. 29-30.)

Additionally, another mitigating factor is that the Deer Payment was an isolated incident. See id., Principal Consideration No. 8 (suggesting that an adjudicator consider "[w]hether the respondent engaged in numerous acts and/or a pattern of misconduct"); id., Principal Consideration No. 9 (suggesting that an adjudicator consider "[w]hether the respondent engaged in the misconduct over an extended period of time"). There was no evidence that Harris committed any prior OBA violations.

These mitigating factors alone demonstrate that the NAC's decision to increase the sanctions to a three-month suspension and a $15,000 fine was inappropriate, excessive, and unwarranted, and a prior NAC decision further supports the conclusion that these sanctions were excessive. See In re Andrew P. Schneider, No. C10030088, 2005 WL 3358082 (NAC Dec. 7, 2005). In Schneider, the registered representative formed a corporation that operated a website and organized seminars to potential investors regarding hedge funds. Id. at *1. Using this corporation, he diverted business from his current broker-dealer to another. Id. at *3. The NAC found several aggravating factors with respect to the principal considerations for OBA violations, including: (1) the OBA involved potential customers of the broker-dealer; (2) the representative's actions "created the

appearance that [his current broker-dealer] approved of his outside business activities"; and (3) the broker-dealer "was unaware of [the representative's] outside activities because he affirmatively attempted to conceal them." Id. at *6. The NAC further found an aggravating factor based upon the representative's misleading and inaccurate testimony regarding his activities at the hearing. Id. In all, the NAC found this to be a "serious violation." Id. at *7. Nevertheless, the NAC ultimately only fined the representative $5,000 and suspended him for 2 months for this violation. Id.

In comparison to Schneider, which constituted a "serious violation," the three-month suspension and $15,000 fine appears excessive, oppressive, and unwarranted. As described more fully above, Harris does not have any of the aggravating factors with respect to the principal considerations for OBA violations whereas Schneider had three. See id. at *6. Furthermore, although there was similarly a finding of inaccurate testimony here, which Harris is accepting as true for purposes of this appeal only, the same finding was made in Schneider, yet the sanctions were far less significant. Thus, the sanctions deemed appropriate by the NAC here were excessive and unwarranted in comparison to Schneider.

Based on the foregoing, the sanctions deemed appropriate as to Harris for the OBA violations are unwarranted, excessive, oppressive, and punitive, not

remedial, given the above considerations, and the SEC's decision not to review it should be reversed and the sanction should be reduced.

VII. CONCLUSION

The SEC's legal conclusion as to this novel question of law is incorrect because Harris had no duty to disclose the Deer Payment and lacked the requisite scienter under the anti-fraud provisions. Furthermore, even if Harris had committed a violation by failing to disclose the Deer Payment, the sanction imposed upon Harris is excessive, oppressive, and unwarranted, and not remedial. Therefore, the SEC's decision should be reversed as to the anti-fraud violations, and even if it is not, Harris should not be permanently barred from the industry. Furthermore, the sanctions deemed appropriate as to Harris for the OBA violation by the NAC is unwarranted, excessive, oppressive, and punitive, not remedial, given the above considerations, and thus, the SEC's decision not to review this sanction should also be reversed and the sanction should be reduced.

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CERTIFICATE OF SERVICE

I, Amy E. Sparrow, hereby certify that on October 7, 2016, I caused a true and correct copy of the foregoing Brief of Petitioner to be filed via ECF and via United Parcel Service, overnight delivery, with the United States Court of Appeals for the Second Circuit, and to be sent via email and United Parcel Service, overnight delivery, to the following:

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