Jennifer Brooks
Associate General Counsel

Direct: (202) 728-8083
Fax: (202) 728-8264

February 17, 2021

BY ELECTRONIC MAIL

Vanessa A. Countryman, Secretary
Securities and Exchange Commission
100 F Street, NE
Room 10915
Washington, DC 20549-1090
apfilings@sec.gov

RE: In the Matter of the Application for Review of Eric S. Smith
Administrative Proceeding No. 3-20127

Dear Ms. Countryman:

Enclosed please find FINRA's Brief in Opposition to the Application for Review in the above-referenced matter. Please contact me at (202) 728-8083 if you have any questions.

Sincerely,

/s/ *Jennifer Brooks*
Jennifer Brooks

Enclosure

cc: Robert Knuts, Esq.

BEFORE THE

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC

In the Matter of the Application of

Eric S. Smith

For Review of Disciplinary Action

Taken by

FINRA

File No. 3-20127

BRIEF OF FINRA IN OPPOSITION TO APPLICATION FOR REVIEW

Alan Lawhead
Vice President and
Director – Appellate Group

Gary Dernelle
Associate General Counsel

Jennifer Brooks
Associate General Counsel

FINRA
1735 K Street, NW
Washington, DC 20006
(202) 728-8083
jennifer.brooks@finra.org

February 17, 2021

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Federal Decisions **PAGE**

SEC Decisions and Releases

Federal Rules and Statutes

FINRA Decisions

FINRA By-Laws, Guidelines, Notices, and Rules

BEFORE THE
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC

In the Matter of the Application of Eric S. Smith For Review of Disciplinary Action Taken by FINRA File No. 3-20127

BRIEF OF FINRA IN OPPOSITION TO APPLICATION FOR REVIEW

I. INTRODUCTION

In 2015, Eric S. Smith deceived investors when raising money for his failing financial services company, Consulting Services Support Corporation ("CSSC"). To entice investors and enable Smith's business to remain viable, Smith lied about CSSC's purported revenue streams in securities offering documents that he used to solicit investors. Smith also did not disclose in the offering documents that CSSC was incapable of repaying over $600,000 it owed to investors in its two prior offerings. Smith made these material omissions and misstatements with scienter. Smith therefore engaged in fraud, which is the most serious form of misconduct committed by a securities professional. The record fully supports these findings.

Consistent with the FINRA Sanction Guidelines ("Guidelines") and the seriousness of Smith's misconduct, the NAC barred him from association with any member firm in any

capacity and ordered that he pay $130,000 in restitution to four investors who lost the entirety of their investments. FINRA's sanctions are fully warranted. Smith stood to gain from the solicitations he made, which resulted in substantial investor harm. Smith's misconduct squarely reflects his inability to comply with regulatory requirements necessary for the protection of the investing public. The NAC's findings of liability are sound, and the NAC's sanctions are appropriately remedial.

On appeal, Smith presents no new or legitimate reason to disturb the NAC's findings of liability or the sanctions that the NAC imposed. Smith fails to present any legally cognizable defenses to his fraud. Smith does not dispute that the 2015 offering involved securities, that he omitted and misrepresented facts in the offering documents, or that he acted with scienter. Smith's claims about materiality, the only thing he contests regarding fraud, have no factual or legal merit.

In addition to engaging in fraud, Smith failed to register with FINRA as a general securities representative and principal despite engaging in conduct necessitating such registrations. Among other things, Smith controlled the finances of CSSC's broker-dealer, hired principals, participated in hiring registered representatives, requested that registered representatives assist him with identifying potential investors, and solicited directly broker-dealer customers to invest in CSSC's offerings. Smith's participation in the broker-dealer's securities business and his active engagement in the broker-dealer's management reflect that he was a person associated with a member and was required to register with FINRA. Irrespective of Smith's protests that FINRA unlawfully expanded the definition of an "associated person," and he never "voluntarily registered with FINRA" or consented to its jurisdiction, FINRA properly exercised its jurisdiction and imposed disciplinary sanctions for his misconduct in this case.

The bases underlying FINRA's jurisdiction and the NAC's findings are fully supported and incontrovertible. The Commission should dismiss Smith's application for review.

II. FACTUAL BACKGROUND

A. Smith's and CSSC's Background

Smith is a lawyer and CSSC's founder, chairman, chief executive officer, and majority owner. CSSC is not a FINRA member, and Smith has never registered with FINRA. (RP 835-38, 2163-64.)[1]

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. (RP 3767.) CSSC BD voluntarily became a FINRA member in 2006 and terminated its registration in 2018. (RP 3803-04; https://brokercheck.finra.org/firm/summary/141630#generalInfoSection.) Smith appointed Jennifer LaRose and Alex Martin as CSSC BD's co-presidents and made LaRose its chief compliance officer. (RP 1207, 1815-16, 1999.) CSSC and its subsidiaries, including CSSC BD and RIA, occupied the same office suite in Troy, Michigan. CSSC BD leased office space from CSSC. (RP 847, 2001, 2003.)

B. Smith Raises Cash for His Failing Businesses

Smith's businesses were failing in the wake of the 2008 financial crisis. (RP 4333-34.) Beginning in 2010, Smith undertook multiple efforts to raise cash to bolster CSSC's faltering financial condition. In 2010, Smith and CSSC issued a convertible debenture bond offering

[1] "RP" refers to the page numbers in the certified record of this case filed with the Commission. "CX" refers to admitted exhibits included in the certified record.

("2010 Bond Offering"), hoping to raise $5 million to satisfy financial obligations. (RP 2899.) The offering raised $2.45 million from March 2010 through March 2014. (RP 3214-15.)

Despite conducting the 2010 Bond Offering, CSSC continued to struggle, losing approximately $803,000 in 2012 and $883,000 in 2013. (RP 1012, 1085-86, 2701.) CSSC could not meet its day-to-day obligations without additional outside funding. (RP 2705.) As CSSC had done in the past, it deferred payments of salaries, commissions, and advisory fees to employees and representatives. (RP 1244, 1660-61, 1817-19, 1982-83, 2040-41, 2117-20.) In 2014, Smith and CSSC began offering "bridge loan notes" ("2014 Bridge Loan Note Offering") to raise additional funds to cover operational losses. (RP 1009.) Several of the investors in the 2010 and 2014 offerings were CSSC BD customers. (CX 89; RP 950-51, 1435, 1827-30, 1873, 2035, 2194.) Although the 2014 offering raised approximately $1.1 million, that amount proved insufficient to curtail CSSC's continued bleeding of money. (RP 1009, 3216.) CSSC had a net loss of $944,000 in 2014. (RP 3397, 3453.)

C. The 2015 Bridge Loan Note Offering, and Smith's Omissions and Misrepresentations in the Offering Documents

Smith sought to address CSSC's continuing financial woes by issuing more debt securities, in the form of another bridge loan note offering, in 2015 ("2015 Bridge Loan Note Offering"). The offering documents, which Smith drafted and disseminated, consisted of a "Confidential Report" and an "Important Memorandum," each of which went through several iterations. (RP 886-87, 894, 908, 981-87; CX 201-07, 210, 211.) 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. (RP 3392.) The offering documents described the 2015 Bridge Loan Notes as unsecured with a 12-month maturity, earning eight percent interest, with an additional "gift" of CSSC common stock from

Smith's shares. (RP 3391, 3495, 3499, 3511, 3547, 3553-54.) The 2015 Bridge Loan Note Offering Confidential Report stated that CSSC was "covering its operating deficits" with the note proceeds. (RP 2746.) 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." (RP 2771.)

Smith's omissions and misrepresentations in the 2015 Bridge Loan Note Offering documents form the basis of the NAC's findings that Smith committed fraud.

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

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 initiated the 2015 Bridge Loan Note Offering in June 2015, CSSC owed more than $600,000 to the investors in the 2010 Bond Offering and the 2014 Bridge Loan Note Offering. (RP 3214-16.) 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 and knew CSSC was unable to pay interest and principal to investors in CSSC's 2010 and 2014 offerings. (RP 1048-49.) Smith erroneously believed that CSSC would be current on its obligations to these investors by August 2015; thus, he purposefully did not disclose in the 2015 Bridge Loan Note Offering materials CSSC's inability to pay the investors in these prior offerings. (RP 1048-49.)

2. Smith Misrepresents Facts Related to Project X and CSSC's Business with the South Dakota Trust Company and the City of Jacksonville

a. Project X

In November 2014, CSSC RIA and BD representative Ken Wheeler was looking for novel investment ideas to present to a wealthy cardiologist ("SB") who had a large network of contacts with other physicians. (RP 1267.) Wheeler approached Donald Southwick, another

CSSC BD registered representative, for advice on what investments he might recommend. Southwick suggested he could "build a bank" in which SB could invest.[2] (RP 1263-65.) SB insisted on keeping the project confidential, and they referred to the undertaking as "Project X." (RP 1267-68.)

Southwick told Smith about Project X soon after he and Wheeler began discussing it. (RP 1271-72.) Wheeler made clear that he did not want Smith participating in Project X, but Southwick continued to inform Smith about what was happening. (RP 1300-01, 1675-76.) Southwick explained to Smith that the Office of the Comptroller of the Currency ("OCC"), as well as other bank regulators, would have to approve the bank's charter. (RP 1275-76.) Southwick contacted a lawyer with whom he had worked previously 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. (RP 1273-75, CX 225.)

In November 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. (RP 1286.) 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. (RP 1278-94, 3629-43.) 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. (RP 1278-94, 3629-43.) Southwick testified

---

[2] 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. (RP 1269.)

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." (RP 1288.)

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. (RP 1275-76, 1670, 1672-74, 1681-83.) Southwick explained that virtually everything with Project X was suppositional, "not firm." (RP 1281.) Southwick had no idea if bank regulators would allow CSSC or the private equity firm to share ownership in the bank; he did not know whether OCC would approve the project; he had not spoken to any of the OCC representatives; and he had not yet attempted to contact individuals at the private equity firm nor made a proposal to them. (RP 1282-84.) Most significantly, no consulting agreement ever existed. (RP 1288-89.) Southwick testified that sometime around March 2015, he contacted the private equity firm, and it was not interested in Project X. (RP 1312-14.) Southwick stated that getting approval for the bank would be a "huge, monumental task," and would take one to two years. (RP 1271, 1291.)

Notwithstanding the tentative and inconclusive status of Project X, Smith featured it prominently in the offering materials for the 2015 Bridge Loan Note 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.**" (RP 3403.) 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.

(RP 3403.) Smith went on to state in the offering materials that CSSC's receipt of the $1.4 million in consulting fees "should ensure that 2015 is not only profitable, but also that it will be the most profitable year in CSSC's history." (RP 3404.)

In the July 12, 2015 Important Memorandum, Smith highlighted the special purpose bank as foremost among several CSSC's "important new initiatives." (RP 3495, 3496.) Specifically, in the section "Important Disclosures in the Accompanying 'Confidential Report,'" Smith again emphasized 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.**" (RP 3497.)

When Smith made these representations in the offering documents, he knew of the many challenges that made the likelihood of Project X coming to fruition speculative. Smith knew when he drafted the offering documents that only three banks in the previous five years had received national charters. (RP 1105.) Smith also admitted he never reviewed or approved any consulting agreement and 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. (RP 1100-01, 1106-07.) Smith admitted, however, that he never received any documentation from Southwick evidencing that CSSC would be paid any fee. (RP 1108-12.)

Smith also had no conversations with the private equity firm purportedly involved with Project X about the payment of the consulting fee. (RP 2201.)

Furthermore, 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. (RP 1684-88.) 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." (RP 1684-88.) 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." (RP 1685-86.)

b. The South Dakota Trust Company

Smith also claimed in the June 15, 2015 Confidential Report 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 of which CSSC "will be the investment advisor" and for which it "will earn a fee based on a percentage of the assets under management." (RP 1140.) 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.

(RP 3404.)

None of Smith's representations materialized. 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. (RP 1415-17.) 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. (RP 1419.) 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 CEO never happened. (RP 3373.) CSSC never became the investment advisor to any SDTC funds, nor did it enter into a client referral agreement with SDTC. (RP 914-15.)

c. City of Jacksonville

Smith also described in the June 15, 2015 Confidential Report the purported 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.

(RP 3406.)

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. (RP 1392, 3692-93.) The city did not agree to CSSC's proposal. (RP 1409.)

Nonetheless, 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 by the end of 2015. (RP 2476.) In fact, as Smith acknowledged at the hearing, Jacksonville never engaged CSSC to serve as a reviewing consultant. (RP 1147-48.)

D. Investors in the 2015 Offering

Smith personally solicited between 15 and 25 people to invest in the 2015 Bridge Loan Note Offering and raised $130,000 from four of them: TL, Thomas Scotto, BB, and Gavin Clarkson.[3] (RP 884, 917, 919, 924-25.) Smith does not dispute that these four investors lost their entire investments in the offering.

Scotto and Clarkson were registered representatives of CSSC BD. (RP 898-901, 954-55, 2181, 2664.) TL and Scotto were the first two investors in the 2015 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. (CX 9, 10, 27; RP 2303, 2548, 2549, 3361.)

[3] Investors TL and BB are identified in Enforcement's Schedule of Abbreviations and References filed with its complaint in this matter. (RP 187.)

1. TL

On July 21, 2015, Smith emailed TL promoting the 2015 Bridge Loan Note Offering. Another CSSC employee referred Smith to TL. (CX 8.) 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." (RP 882-84, 2333.) Smith invited TL to meet him later that week in New York City, where they discussed the 2015 Bridge Loan Note Offering. (RP 2169-73, 2333.) Smith stayed in contact and spoke again with TL about the offering by phone in August 2015. (RP 2339.)

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." (RP 2335-38, 2339.) Smith promised to send a stock certificate and the note by overnight mail to TL. (RP 2339.) On August 24, 2015, TL invested $50,000 in the 2015 Bridge Loan Note Offering. (RP 2548, 2667.)

Smith did not send the stock certificate to TL until November 2015. TL had been waiting for weeks for Smith to send him the paperwork, and as a result, TL's "trust" had been "seriously

shaken," he intended to refuse to accept delivery of the certificate and wanted a refund from 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. (RP 2341-42.)

2. Scotto

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 Important Memorandum in the offering documents that Smith had sent earlier with an updated July 12, 2015 version. Smith directed Scotto to send the updated memorandum to anyone to whom he had given the earlier version. 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." (RP 2303.)

In response to Smith's email, Scotto invested $20,000 of his personal funds in the 2015 Bridge Loan Note Offering on August 31, 2015. (RP 2549, 3361.)

3. 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. (RP 2177, 2375.) 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. (RP 2375.) Smith attached to this email various offering

documents, including the June 15, 2015 Confidential Report. (RP 2376-2402.) 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.'" (RP 2375.)

On September 29, 2015, BB invested $10,000 in the offering. (RP 2550.)

4. Clarkson

On October 29, 2015, Smith sent Clarkson an email, 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. (RP 2407.) Smith knew that Clarkson worked with Native American tribes attempting to facilitate release of tribal funds held by the Bureau of Indian Affairs. (RP 2181-83.) Smith encouraged Clarkson to invest personally and to solicit his Native American contacts for investments. (RP 2407.)

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." (RP 2407.)

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." (RP 2453.) Smith emailed wiring instructions to Clarkson on November 12, 2015, and wrote that he would soon "resend the rest of the disclosure package." (RP 2533.) In an email a few minutes later, Smith attached the 2015 Bridge Loan Note Offering documents and the wiring instructions. (RP 2469.) The

materials Smith sent continued to make statements about large increases in revenues to CSSC related to the SDTC and engagement with Jacksonville and failed to disclose that CSSC was unable to pay the investors from the two prior offerings. (RP 2413-14, 2476-77.) The following day, Clarkson invested $50,000 in the 2015 offering. (RP 2667.)

III. PROCEDURAL BACKGROUND

The Department of Enforcement ("Enforcement") filed a complaint against Smith and CSSC BD on August 4, 2017. (RP 6-28.) As relevant to Smith's appeal, Enforcement 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. Enforcement further 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.

After an eight-day hearing, the Hearing Panel found Smith and CSSC BD liable for the violations alleged in the complaint and imposed sanctions.[4] (RP 4242-44, 4262, 4265, 4268.) After Smith appealed, the NAC affirmed the Hearing Panel's findings that Smith willfully violated the federal securities laws and FINRA rules by fraudulently failing to disclose and misrepresenting material facts to four investors. (RP 4506-17.) The NAC also found that Smith

[4] The Hearing Panel suspended CSSC BD from participating in private securities offerings in all capacities for one year and fined the firm $100,000 for its participation in the fraud. (RP 4268.) The Hearing Panel also ordered that Smith and CSSC BD be held jointly and severally liable for paying $130,000 in restitution to the four affected investors. (RP 4265, 4268.) For CSSC BD's failure to register Smith as a representative and principal, the Hearing Panel fined the firm $20,000. (RP 4268.) CSSC BD did not appeal to the NAC.

acted as an unregistered representative and principal, in violation of FINRA's registration rules. (RP 4517-23.) The NAC, finding numerous aggravating factors, barred Smith for his fraud and ordered that he pay to the four investors restitution totaling $130,000, jointly and severally with CSSC BD.[5] (RP 4523-25 & n.24.)

On October 19, 2020, Smith filed this appeal with the Commission. (RP 4573-75.)

IV. ARGUMENT

The Commission should sustain FINRA's action in all respects. FINRA acted within its statutory mandate by exercising properly its jurisdiction to bring this disciplinary action against Smith, who was a person associated with a member. Smith displayed an utter disregard for FINRA rules and his obligation to register before acting in the capacities of representative and principal.

The evidence overwhelmingly supports the NAC's findings that Smith engaged in fraud, and Smith has provided no legitimate reason to overturn these findings. Smith has not demonstrated that the bar and restitution order imposed upon him are excessive or oppressive. By engaging in fraud, Smith has demonstrated that he is not fit to participate in the securities industry. The Guidelines fully support Smith's sanctions. The bar and restitution serve to remediate Smith's egregious misconduct and protect investors.

[5] The NAC fined Smith $75,000 and suspended him in all capacities for two years for acting as an unregistered principal. For acting as an unregistered representative, the NAC fined Smith an additional $50,000 and concurrently suspended him for one year in all capacities. Considering the bar for fraud, however, the NAC declined to impose these additional sanctions for Smith's registration violations. (RP 4526-27.)

A. FINRA Properly Exercised Its Jurisdiction over Smith Who Was Associated and Required to Register as a Representative and Principal

Smith became subject to FINRA's jurisdiction by engaging in CSSC BD's securities business as an associated person and acting in the capacities of a general securities representative and principal. Nevertheless, Smith has contested FINRA's jurisdiction to bring this disciplinary action against him. His protests continue here with arguments that FINRA has acted beyond its statutory authority.[6] (Br. at 1, 2, 4, 5, 7, 19, 20, 21.) Smith's arguments are a red herring intended to distract from his misdeeds that the NAC properly disciplined.

FINRA By-Laws define an associated person functionally 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).[7] NASD Rule 1031 provides that any person engaged

---

[6] Smith states in his brief that he sought legal advice for various things. (Br. at 7, 10.) Smith has not, however, asserted reliance on advice of counsel and, even if he did, he has not established this as a defense. To establish an advice of counsel defense, Smith had to demonstrate that he: (1) completely disclosed his intended action to an attorney; (2) requested the attorney's advice as to the legality of the intended action; (3) received counsel's advice that the conduct would be legal; and (4) relied in good faith on the advice. *See Howard Brett Berger*, Exchange Act Release No. 58950, 2008 SEC LEXIS 3141, at *38 (Nov. 14, 2008), *aff'd*, 347 F. App'x 692 (2d Cir. 2009).

[7] Smith's argument that FINRA By-Laws cannot affect the conduct of members and associated persons is incorrect. (Br. at 18-19.) The Exchange Act requires most broker-dealers to be members of FINRA and requires the Commission to approve (or allow to become immediately effective) FINRA's rules, including FINRA By-Laws. 15 U.S.C. §§ 78o(b)(8), 78s(b)(1), (2); FINRA By-Laws Art. XVI (stating amendments to FINRA By-Laws must be approved by SEC). FINRA's rules apply not only to FINRA member firms, but also to individuals, whether registered or not, and they are violated when an individual is acting in a registered capacity without registering. *See Dep't of Enforcement v. Reichman*, Complaint No. 200801201960, 2011 FINRA Discip. LEXIS 18, at *16-21, 27-28 (FINRA NAC July 21, 2011); *see also Credit Suisse First Bos. Corp. v. Grunwald*, 400 F.3d 1119, 1128-30 (9th Cir. 2005) (stating FINRA rules have the force of federal law).

in the securities business of a member firm and functioning as a "representative" must register with FINRA. NASD Rule 1031 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." It is uncontroverted that "FINRA has jurisdiction to discipline all associated persons of a member firm." *Louis Ottimo*, Exchange Act Release No. 83555, 2018 SEC LEXIS 1588, at *49 (June 28, 2018).[8]

NASD Rule 1021 requires all individuals acting as principals to register and 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." 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.*

[8] Smith cites to Exchange Act Section 15A to assert that FINRA registration is purportedly voluntary (Br. at 20) but ignores the statute's text that requires FINRA to have rules to discipline persons associated with members. *See* 15 U.S.C. § 78o-3(b)(6), (7).

Smith also quibbles with the NAC's citation of three SEC cases in its discussion of the reach of FINRA's jurisdiction. (Br. at 18 n.3.) These cases stand for the general proposition that FINRA may discipline a person associated with a member, and the NAC properly relied on them. (RP 4518.)

1. Smith Was Associated and Acted as a Representative

CSSC's subsidiary firm, CSSC BD, became a FINRA member in 2006. (RP 3803-04.) Thereafter, 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). Smith, however, attempts to downplay his involvement in CSSC's 2010 and 2014 offerings, maintaining that he did not conduct any securities business on behalf of CSSC BD, and contending that his engagement in any securities sales was solely to raise money for CSSC as its chairman and CEO. (Br. 4-5, 7, 10, 11, 25, 26.) But Smith's actions, including selling securities to CSSC BD customers and creating a script for CSSC BD representatives to sell CSSC's offerings, were those of person who was conducting a securities business.[9] *Cf. DWS Sec. Corp.*, 51 S.E.C. 814, 822 (1993) (rejecting respondents' assertion that NASD had no jurisdiction to oversee their activities as entrepreneurs, which they viewed as distinct from their actions as securities professionals); *see also infra* Part IV.A.2 (discussing Smith's actions as a principal).

The record directly undermines Smith's unrealistic view of his activities, which made him not only an associated person over whom FINRA had jurisdiction but also one who was required to register. FINRA has delineated the functions of a registered representative to include

[9] Smith misunderstands the nature of membership requirements for firms and registered persons. (Br. at 1, 2, 19-21.) Before it begins doing business, a broker-dealer must become a member of an SRO. If a broker-dealer effects securities transactions other than on a national securities exchange of which it is a member, however, including any over-the-counter business, it must become a member of FINRA, unless it qualifies for the exemption in SEC Rule 15b9-1. 15 U.S.C. § 78o(b)(8). After FINRA approved CSSC BD's membership, FINRA rules required Smith to register once he engaged in CSSC BD's securities business. He was also required to pass qualification examinations for a representative and principal to demonstrate his competence in securities activities—requirements he ignored.

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. NASD Rule 1031; *Dist. Bus. Conduct Comm. v. Gallison*, Complaint No. C02960001, 1999 NASD Discip. LEXIS 8, at *52 (NASD NAC Feb. 5, 1999). "[A]ctivities requiring registration are a subset of those that constitute 'associating' with a FINRA member firm." *Bruce Zipper*, Exchange Act Release No. 90737, 2020 SEC LEXIS 5226, at *29 (Dec. 21, 2020). Despite Smith's attempts to camouflage CSSC BD's role in CSSC's 2010 and 2014 debt offerings, the facts show that the firm actively participated in them at Smith's behest. Smith orchestrated and directed the involvement of CSSC BD brokers and their customers in CSSC's private offerings.

Smith solicited CSSC BD's customers to invest in CSSC's 2010 and 2014 debt offerings and sold these securities to some of these customers. (CX 89; RP 950-51, 1435, 1873, 2035, 2194.) Martin introduced customer SK to the 2010 Bond Offering, but Smith finalized SK's $375,000 investment. (RP 1827-30; CX 89.) Southwick also introduced Smith to several of his CSSC BD customers, who then invested in the 2010 Bond Offering.[10] In addition, some investors in the 2010 Bond Offering used funds from their CSSC BD accounts to invest in the 2010 Bond Offering. (RP 2042-43.)

Smith also created and distributed the offering documents for the 2010 and 2014 offerings to CSSC BD customers directly and through the firm's brokers, including Southwick for whom Smith prepared scripted solicitations. (RP 1479-80.) Smith provided these representatives with the offering documents to do so. (RP 1824, 1826.) Smith discussed the

[10] These customers included: JM, who invested $300,000; DN who invested $400,000; PK who invested $100,000; DG who invested $200,000; and SM who invested $20,000. (RP 1434-40, 3214-15.)

2014 Bridge Loan Note Offering with Southwick, who then sold it to his CSSC BD customers, including SM and JM, who had invested in the 2010 Bond Offering. (RP 1467-68, 3132; CX 106 at 12, 16, 20, 24, 28, 32.) 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. (RP 1472.) 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." (RP 1479-80.) 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. (RP 1469-70, 1472, 1481, 3340.)

By engaging in these activities, Smith was an associated person who acted in the capacity of a general securities representative over whom FINRA has jurisdiction. *See 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").

2. Smith Acted as a Principal

The 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, which

required him to register with FINRA 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.").

Smith recruited and hired registered representatives and officers of CSSC BD. For example, Smith made the decision to appoint LaRose and Martin as co-presidents of CSSC BD. (RP 865, 1815-16, 1999.) *See 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); *Kirk A. Knapp*, 50 S.E.C. 858, 861 (1992) (finding applicant hired individuals and thus acted in a principal capacity). When individuals became registered representatives of CSSC BD, they also affiliated with all the various CSSC entities because Smith required them to sign an affiliation agreement. (RP 2003-04.) Smith personally recruited, hired, and negotiated employment terms for several CSSC BD representatives. (RP 1211-12, 1221-25, 1655-57, 2113-16.)

LaRose and Martin as co-presidents answered directly to Smith, and they acted on behalf of CSSC BD at Smith's direction. Martin testified that his "hands-on work" as co-president was "fairly small." (RP 1817.) LaRose testified that she never hired or fired a CSSC BD registered representative without first discussing it with Smith. (RP 2005-06.) The affiliation agreement gave Smith the authority to terminate the employment relationship if an employee willfully failed to comply with Smith's directive. (RP 876-67, 1422-23, 3620.) The hiring and firing of a firm's personnel are activities that support the need for principal registration. *See Dennis Todd Lloyd Gordon*, Exchange Act Release No. 57655, 2008 SEC LEXIS 819, at *28-29 (Apr. 11, 2008).

The evidence shows also that Smith acted as a principal by making 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. (RP 1818; CX 40.) Control of a firm's finances is an activity that demonstrates that an associated person is actively engaged in a firm's securities business and should register as a principal. *Kresge*, 2007 SEC LEXIS 1407, at *50; *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). Smith controlled when CSSC BD would receive money from CSSC. (RP 1818, 2039-41; CX 32-34.) LaRose testified that if an employee of the broker-dealer had a question about a salary deferral, she directed the employee to Smith. (RP 2041.) When CSSC BD needed money to meet its net capital requirement, CSSC's controller communicated with Smith—not Martin or LaRose. (RP 2686.) Smith directed which bill payments to prioritize, and he ensured that CSSC RIA diverted funds to enable CSSC BD to maintain minimum net capital. (RP 1073, 2687-89.) When the CSSC BD's auditors had concerns about whether CSSC BD could continue as a going concern, they contacted Smith. (RP 2703-05.)

The depth of Smith's wide-ranging involvement in CSSC BD's management even included suitability reviews of CSSC BD customers' purchases of CSSC's offerings and the handling of broker dealer customer complaints. (RP 854-59, 2043-45, 2052-54.)

Smith's activities were not only part of the conduct of a securities business that made him an associated person, but his active participation required FINRA registration. 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. The

Commission should affirm the NAC's finding that Smith participated in CSSC BD's securities business as a general securities representative and principal and therefore violated NASD Rules 1031, 1021, and FINRA Rule 2010 by acting in these capacities without registration.[11] *See Kresge*, 2007 SEC LEXIS 1407, at *51 & n.45.

B. Smith Committed Fraud

The evidence shows that Smith committed securities fraud when he failed to disclose and misstated material facts while soliciting investors to purchase the 2015 Bridge Loan Notes. Smith admits that he failed to disclose CSSC's inability to pay substantial sums to investors in CSSC's 2010 Bond and 2014 Bridge Note Loan Offerings. Smith also misrepresented the status of CSSC's business related to the design and formation of a special purpose bank (Project X) and CSSC's business with SDTC and Jacksonville. None of Smith's bold claims in the offering documents related to these businesses had occurred or ever came to fruition. Smith willfully

---

[11] Smith protests that he never voluntarily consented to FINRA jurisdiction irrespective of the letter he signed in July 2006 (Smith erroneously refers to the letter's date as August 2005) in support of CSSC BD's new member application form and attempts to rely upon unadmitted documents. (Br. at 1, 2, 19-21, 25.) In the July 2006 letter, however, Smith acknowledged that he was exempt from registration under NASD Rule 1060 but was an associated person. (RP 3779.) Contrary to Smith's interpretation, his signing of the acknowledgment letter did not insulate him from FINRA's jurisdiction over his subsequent rule violations. Regardless of his intentions in 2006, Smith participated and actively engaged in CSSC BD's securities business in the ensuing years. Once he did that, Smith gave up his exemption from FINRA registration.

Smith's purported reliance on FINRA's prior examinations not identifying "license issues" with his role at CSSC BD is unavailing. (Br. at 8.) "A regulatory authority's failure to take early action neither operates as an estoppel against later action nor cures a violation." *W.N. Whelen & Co.*, 50 S.E.C. 282, 284 (1990); *see Thomas C. Kocherhans*, 52 S.E.C. 528, 531 (1995) (holding respondent cannot shift his responsibility for compliance with applicable requirements to FINRA). And it was a FINRA examination that culminated in this action against Smith. (RP 1615-16.)

made misrepresentations and omissions of material fact, in violation of Exchange Act Section 10(b), Exchange Act Rule 10b-5, and FINRA Rules 2020 and 2010.

Exchange Act Section 10(b) prohibits individuals from using or employing, in connection with the purchase or sale of any security, any manipulative or deceptive device or contrivance. 15 U.S.C. § 78j(b). Exchange Act Rule 10b-5 further prohibits individuals from making "any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made . . . not misleading."[12] 17 C.F.R. § 240.10b-5. 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." *Ottimo*, 2018 SEC LEXIS 1588, at *31. "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.*; *see also William Scholander*, Exchange Act Release No. 77492, 2016 SEC LEXIS 1209, at *16 (Mar. 31, 2016) ("When recommending securities to a prospective investor, a securities professional must not only avoid

[12] As the NAC found, Smith was the drafter of the 2015 Bridge Loan Notes Offering documents with the ultimate authority over these documents and their contents; therefore, he 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). In addition, Smith's conduct in this case occurred by means or instrumentality of interstate commerce. Smith admits that he communicated with the investors through telephone calls and email, which thereby satisfies the interstate commerce requirement of Section 10(b) and Rule 10b-5. (Br. at 13); *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), *aff'd*, 159 F.3d 1348 (2d Cir. 1998).

affirmative misstatements but also must disclose material adverse facts . . . ."), *aff'd sub nom. Harris v. SEC*, 712 F. App'x 46 (2d Cir. 2017).

FINRA Rule 2020 is FINRA's anti-fraud rule. It 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." "[C]onduct that violates [Exchange Act] Rule 10b-5 also violates FINRA Rule 2020." *See Fuad Ahmed*, Exchange Act Release No. 81759, 2017 SEC LEXIS 3078, at *53 (Sept. 28, 2017). A violation of the Exchange Act, rules thereunder, or FINRA rules constitutes a violation of FINRA Rule 2010.[13] *See Scholander*, 2016 SEC LEXIS 1209, at *14-15.

Smith engaged in fraud because a preponderance of the evidence demonstrates that he omitted and misrepresented material facts with scienter, in connection with the purchase or sale of securities. *See Ahmed*, 2017 SEC LEXIS 3078, at *25.

1. The 2015 Bridge Loan Note Was a Security

Smith's fraud in this case involved the 2015 Bridge Loan Notes, which the NAC correctly found, and Smith does not dispute, were securities. (RP 4508-10.) 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 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. (RP 3391, 3495, 3499, 3511, 3547, 3553-54.) Under *Reves*, a note is presumed to be a security. 494 U.S. at 65-66. The 2015 Bridge Loan Notes satisfy the elements of *Reves*.

[13] FINRA Rule 2010 requires FINRA members to observe high standards of commercial honor and just and equitable principles of trade in conducting their businesses.

The 2015 Bridge Loan Note Offering documents show that CSSC issued the short-term notes to raise capital for its general business operations and 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. (RP 2746.) 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." (RP 2771.)

Furthermore, Smith drafted the offering documents to emphasize the potential profit to note purchasers. 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. (RP 887-88.) The 2015 Bridge Loan Notes provided 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). 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.

The NAC correctly found, based on these considerations, that the 2015 Bridge Loan Notes satisfied *Reves* and were securities. (RP 4508-09.)

2. Smith's Omissions and Misrepresentations Were Material

The NAC also correctly found that Smith's omissions and misrepresentations in the 2015 Bridge Loan Note Offering documents were unmistakably material. The Supreme Court held in *Basic, Inc. v. Levinson* that information is material if there is a substantial likelihood that a reasonable investor would consider the information important in making an investment decision, 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." 485 U.S. 224, 231-32 (1988).

When soliciting investments in the 2015 Bridge Loan Notes, Smith knowingly failed to disclose that CSSC was unable to pay more than $600,000 owed to the investors in CSSC's 2010 Bond Offering and 2014 Bridge Loan Note Offering. (RP 3214.) Smith in fact admitted that when he was soliciting investments in the 2015 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 two prior offerings. (RP 1048-49.) Smith believed CSSC would be current on its obligations to these investors by August 2015. (RP 1048-49.) Courts and the SEC have held that a company's floundering financial condition and its ability to pay its debts are material to prospective investors. *See SEC v. Todd*, 642 F.3d 1207, 1221 (9th Cir. 2011) (holding a company's financial condition is material to investments); *SEC v. Murphy*, 626 F.2d 633, 653 (9th Cir. 1980) ("Surely the materiality of information relating to financial condition, solvency and profitability is not subject to serious challenge."); *Ahmed*, 2017 SEC LEXIS 3078, at *41 ("A reasonable investor would have considered it important to know the state of STI's finances during the Note offering, particularly its creditworthiness and debt load, because this information would influence STI's ability to repay the Notes."); *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").

Contrary to Smith's attempt to downplay the significance of these debts and his assertion that materiality under these facts is "pure speculation," a reasonable investor would have considered CSSC's inability to pay investors in its prior offerings an unquestionably important

factor when evaluating whether to invest in the 2015 Bridge Loan Note Offering and whether that investment would pay off. (Br. at 22-23); *see Ahmed*, 2017 SEC LEXIS 3078, at *40; *cf. SEC v. Better Life Club, Inc.*, 995 F. Supp. 167, 176-77 (D.D.C. 1998) (finding material that defendant failed to disclose use of offering proceeds to pay existing investors).

Smith also made false material representations regarding CSSC's anticipated revenue from Project X, SDTC, and Jacksonville. Smith misrepresented the status of these significant revenue events in the 2015 Bridge Loan Note Offering documents and concluded that 2015 likely would be CSSC's most profitable year so far. (RP 3497.) Smith, without any basis, stated CSSC was being paid $1.4 million in consulting fees for its work on the design and formation of Project X, the payment "will ensure CSSC's profitability in 2015," and CSSC had already earned $500,000 from this project. (RP 2375, 2384.) Smith also falsely claimed CSSC would be the investment advisor for a range of new investment funds that CSSC was helping SDTC create, CSSC would earn a fee based on a percentage of the assets under management, and CSSC was forming "a client referral relationship" with SDTC for a range of financial services that SDTC does not currently offer. Smith claimed, "the revenue and profit potential from client referrals to CSSC could be quite substantial." (RP 3404.) Smith further misrepresented in the offering documents that CSSC would increase its assets under management by nearly $1 billion through its engagement with Jacksonville. (RP 2476, 3406.)

As of June 2015, Smith knew CSSC had not earned anything from Project X, there was no client referral agreement in place between CSSC and SDTC, and CSSC was not about to become the advisor for any SDTC funds. (RP 1419.) Jacksonville never engaged CSSC to serve in any capacity. (RP 1147-48.) Moreover, even if Jacksonville 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. These statements, which were demonstrably false when Smith made them, were at the heart of his sales pitch to potential investors and would have undoubtedly been material to the investors Smith solicited. *See, e.g., SEC v. Reys*, 712 F. Supp. 2d 1170, 1176-77 (W.D. Wash. 2010) (finding a failure to disclose the company's inability to obtain a specially formulated compound, which was essential to the company's business, to be material); *Peritus Software Servs., Inc. Sec. Litig.*, 52 F. Supp. 2d 211, 222 (D. Mass. 1999) (finding company's recognition of revenue on fictitious licenses was a material misrepresentation); *Kevin M. Glodek*, Exchange Act Release No. 60937, 2009 SEC LEXIS 3936, at *9 (Nov. 4, 2009) (finding representations about issuer's imminent listing on stock exchange when issuer had not filed necessary listing application was material), *aff'd*, 416 F. App'x 95 (2d Cir. 2011). Smith's numerous falsehoods and his failure to disclose 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). Smith's false statements significantly altered the total mix of information available to these investors and any reasonable investor. *See Murphy*, 626 F.2d at 653; *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.").

Smith contends that the "total mix of information presented" precluded a finding of materiality because the 2015 offering documents disclosed CSSC was unable "to meet its financial obligations," had lost money the prior year, and there was no guarantee that the money it was seeking to raise in the offering would ensure CSSC could meet its obligations. (Br. at 22-

23.) 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 and its business with SDTC and Jacksonville, which was false, and did not address that CSSC was unable to pay the 2010 and 2014 investors. (RP 3393, 3498.)

Smith's omissions and misrepresentations were material facts that significantly altered the total mix of information. The general warnings that Smith identifies are insufficient to overcome his specific false statements and critical omission of investor debts that CSSC knowingly could not pay. *See Ahmed*, 2017 SEC LEXIS 3078, at *46 (stating "language warning that investments are risky or general language not pointing to specific risks is insufficient to constitute a meaningful cautionary warning"); *cf. SEC v. Loomis*, 969 F. Supp. 2d 1226, 1236-37 (E.D. Cal. 2013) (rejecting defendant's argument that Commission had "not shown that he acted with scienter" because "the disclosures in the PPM that the investments were risky mitigate the statements he made regarding the anticipated rate of return").

3. Smith Acted with Scienter

Smith acted with scienter when he solicited investors in the 2015 Bridge Loan Notes by failing to disclose and misrepresenting material facts in the offering documents used in those solicitations. Scienter is a "mental state embracing intent to deceive, manipulate, or defraud." *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976). "This means that the defendants either knew that the representations they made to investors were false or were reckless in disregarding a substantial risk that they were false." *Ahmed*, 2017 SEC LEXIS 3078, at *43 (applying this standard to both omissions and misrepresentations); *see Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 n.3 (2007) ("Every Court of Appeals that has

considered the issue has held that a plaintiff may meet the scienter requirement by showing that the defendant acted intentionally or recklessly . . . .").

Smith was desperate for additional financing and initiated the 2015 Bridge Loan Note Offering in the wake of extreme financial pressure on CSSC. 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. (RP 2685.) While traveling, Smith emailed CSSC's assistant controller about the immediacy of the financial strain facing CSSC. She informed Smith that CSSC BD "desperately needs to be paid the $20,000 that it is owed from the RIA for December." The controller highlighted that CSSC BD was "only $874 over the notification threshold" when it would fall below its minimum net capital requirement. She 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. (RP 2686.) Smith acknowledged that CSSC already had "missed payroll" and that offsetting the rent payment would leave CSSC unable to make payroll again. (RP 2690.) The controller further explained to Smith that she was unable to make an $11,000 past due payment that Smith had asked her to send to representative Wheeler who needed the funds to pay insurance premiums. (RP 2686-87.)

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. (RP 2705.) 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. (RP 2704-05.) The auditor highlighted that CSSC's group of entities suffered losses of $803,000, $883,000, and $944,000 in 2012, 2013, and 2014, respectively. The auditor

expressly told Smith that CSSC "continues to experience difficulty in meeting its day-to-day obligations without significant outside funding." (RP 2705.)

a. Omissions

With respect to his omissions, Smith's fraudulent intent is established because he had actual knowledge of the material information he withheld. *See Ahmed*, 2017 SEC LEXIS 3078, at *43-45. 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. (RP 3211-14.) Smith knew that CSSC was unable to pay these investors but nonetheless concealed that fact in the 2015 offering documents that he drafted. (RP 1048-49.)

The NAC found Smith's disclosures in the 2010 Bond Offering documents as additional evidence of scienter. Smith had disclosed in the 2010 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. (RP 2917.) 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. (RP 2915, 2917.)

Smith knowingly included no similar language in the 2015 offering documents. While Smith stated in the 2015 documents that CSSC had conducted previous offerings, he knowingly did not disclose that those investors were not being repaid. This omission served to mislead new investors and furthered Smith's self interest in obtaining much needed capital infusions from these investors. *See, e.g.*, *Tellabs*, 551 U.S. at 325 (2007) (stating that although absence of motive is not fatal to a claim of securities fraud, "motive can be a relevant consideration" [in making the scienter determination], and "personal financial gain may weigh heavily in favor of a

scienter inference"); *SEC v. Pirate Inv'r LLC*, 580 F.3d 233, 243 (4th Cir. 2009) ("Given such a clear financial motive for the misrepresentations, the district court's conclusion that they were made with scienter is hardly surprising."); *Gopi Krishna Vungarala*, Exchange Act Release No. 90476, 2020 SEC LEXIS 4938, at *24 (Nov. 20, 2020) (finding motive relevant to scienter when respondent stood to gain financially from his misrepresentations and omissions); *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."). As the NAC found, the evidence unquestionably reflects that Smith acted with scienter when he knew these adverse facts and intentionally withheld them.

b. Misrepresentations

Smith also misled investors about the status of Project X and CSSC's purported agreements with SDTC and 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 evidence reveals he either knew, 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.").

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. (RP 3403-04.) 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." (RP 2871-73.) Smith then asked Southwick for the documentation. (RP 1113-14.) 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. (RP 1114.) On July 31, 2015, Smith represented to 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." (RP 2873.) Despite knowing that there was no agreement, Smith continued to assure LC without any basis that written confirmation of the commitment

was forthcoming, as Smith stated: "I was told that they expected that agreement to be finalized and executed within the next 7-14 days." (RP 2873.)

Moreover, both Southwick and Wheeler testified there was no work being done yet on a second special purpose bank. (RP 1685, 1326-27.) Wheeler, who was deeply involved in the project, also had no knowledge of a $1 million consulting fee owed to CSSC. (RP 1685.) Southwick, when asked at the hearing whether Smith's representations regarding the purported $1.4 million consulting fees were accurate, repeatedly answered, "No." (RP 1327-29.)

CSSC BD's co-presidents, LaRose and Martin also testified about the status of Project X. 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. (RP 1855.) LaRose referred to Project X as "a fluid project," which was not sufficiently underway for her to even review it as an outside business activity for Martin or Southwick in August 2015. (RP 207-20, 2101-02.) These facts support that Smith acted with scienter.

Smith also acted with scienter regarding his statements in the 2015 Bridge Loan Note Offering documents about CSSC's business with SDTC and 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. (RP 1419, 1422-23, 3373.) Likewise, in June 2015, when Smith first represented that CSSC was in the final stages of engagement with Jacksonville to manage its $1 billion in assets, CSSC had not sent the city such a proposal. (RP 1392-93, 3406.) When Smith drafted a proposal for the city in July 2015, CSSC's role was limited to a $15,000 quarterly fee for providing a performance review of the city's investment portfolio—a service that did not increase CSSC's assets under

management at all. (RP 1143, 1146, 1394-96, 3692-93.) As Smith acknowledged, Jacksonville never engaged CSSC. (RP 1147-49.)

The evidence shows that Smith's representations regarding the status of Project X and business with SDTC and Jacksonville, and their imminent beneficial effects on CSSC's finances, were uniformly baseless. In these circumstances, Smith knew or must have known of the risk that investors would be misled. *See, e.g.*, *Mitchell H. Fillet*, Exchange Act Release No. 79018, 2016 SEC LEXIS 3773, at *14-15 (Sept. 30, 2016) (finding that respondent acted recklessly because he drafted a term sheet for an offering that he knew was "subject to contingencies that had not yet occurred" and yet "failed to use any cautionary language in the Term Sheet alerting investors to the contingencies"). Indeed, as the NAC correctly found, 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 v. SEC*, 327 F.3d 851, 860 (2003). These circumstances therefore 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).

4. Smith's Remaining Arguments Are Without Merit and Do Not Undermine the NAC's Fraud Findings

Smith argues that Enforcement failed to prove that the omissions and misrepresentations were material. He contends that Enforcement was required to present evidence from the four investors, "circumstantial evidence" from other fact witnesses, or expert testimony to establish materiality by a preponderance of the evidence. (Br. at 3, 4, 22, 23.) To that end, Smith asserts that the NAC failed to rely on "any evidence" of materiality, other than the 2015 Bridge Loan Note Offering documents. (Br. at 4, 22, 23, 24.)

While Smith acknowledges that the "reasonable investor" standard is an objective one and proof of investor reliance is not required here, he nonetheless asserts, contrary to legal precedent, that testimony from the specific investors was necessary for Enforcement to carry its burden. (Br. at 15, 22-23.) Proof establishing materiality does not require testimony of individual investors that a representation or omission substantially altered the total mix of information. As the Commission has held, the "reaction of individual investors is not determinative of materiality, since the standard is objective, not subjective." *Ottimo*, 2018 SEC LEXIS 1588, at *38. That is an accurate statement of the law and not, as Smith's describes it, FINRA's "opinion." (Br. at 3, 4, 24.)

Smith, to counteract the NAC's materiality findings, relies on Scotto's investment in the 2015 offering despite not being repaid after investing previously with Smith. (Br. at 15.) There is no evidence, however, that Scotto, when he invested in the offering in August 2015, knew the extent to which Smith and CSSC owed prior investors.[14] Regardless, "to 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).

The Commission further has held that expert testimony is not necessary for FINRA to assess whether Smith's omissions and representations in connection with the sale of the 2015 Bridge Loan Notes were fraudulent. *See Ahmed*, 2017 SEC LEXIS 3078, at *79 ("And in determining whether securities law violations have occurred, neither we nor [FINRA] is hindered

[14] In an August 2015 email to Smith, Scotto stated that he now had $225,000 in outstanding loans to CSSC and demanded $50,000 of that returned to him no later than October 31, 2015, to pay his taxes. (RP 3361.)

by the lack of, or is bound by, expert testimony."). "Rather, the relevant evidence concerned the representations that [Smith] made in offering the . . . notes. Both FINRA and the Commission . . . have the expertise to evaluate such evidence without expert testimony." *Id.*

Enforcement satisfied its burden by introducing, among other evidence, Smith's omissions and misrepresentations of material facts contained in the offering documents that Smith drafted, the other representations that Smith made to the investors in connection with the 2015 Bridge Loan Note Offering, and testimonial evidence presented at the hearing, including Smith's.[15] *See id.* Smith then had the burden to marshal persuasive evidence that refuted Enforcement's evidence, and he failed to do so.[16] *See Kirlin Sec., Inc.*, Exchange Act Release No. 61135, 2009 SEC LEXIS 4168, at *64 n.87 (Dec. 10, 2009) (explaining that respondent bears the burden to produce evidence to support claimed defenses); *PHLO Corp.*, Exchange Act Release No. 55562, 2007 SEC LEXIS 604, at *28 (Mar. 30, 2007) (finding that, once Enforcement presented evidence of the allegations, the burden of going forward shifted to respondents to refute the evidence). "Absent such a shift in the burden of proof, Enforcement

---

[15] Smith contends the NAC determined materiality "as a matter of law." (Br. at 22-23.) No part of this case was decided as a matter of law by summary disposition or found to be "per se material." (Br. at 24.) Rather, the Hearing Panel (as the trier of fact) and the NAC (which conducts a de novo review) each determined materiality as a mixed question of law and the facts of this case. (RP 4253-54, 4510-12); *Fecht v. Price Co.*, 70 F.3d 1078, 1081 (9th Cir. 1995) ("[W]hether a public statement is misleading, or whether adverse facts were adequately disclosed is a mixed question to be decided by the trier of fact."); *cf. TSC Indus. v. Northway, Inc.*, 426 U.S. 438, 450 (1976) ("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.").

[16] Smith conveniently ignores that he could have filed his own motion before the Hearing Officer to permit expert testimony but did not. *See* FINRA Rule 9242(a)(5). Smith also faults Enforcement for not calling investor Scotto as a witness. (Br. at 15.) But Smith too could have called and questioned Scotto or the other investors at the hearing but did not.

would be faced with an impossible task; no matter how much evidence [Enforcement] presented, a [respondent] could argue that there might be other information somewhere that would prove [Enforcement's] evidence to be insufficient." *PHLO*, 2007 SEC LEXIS 604, at *28 n.38.

The Commission should uphold the NAC's finding that Smith, acting with scienter, failed to disclose and misstated material information in connection with the 2015 Bridge Loan Note Offering, in violation of the Exchange Act and FINRA rules.[17]

C. The Sanctions that the NAC Imposed on Smith Are Neither Excessive nor Oppressive

The NAC carefully considered numerous factors, including the highly serious nature of Smith's fraudulent misconduct, in determining that barring Smith and ordering that he pay (joint and several with CSSC) $130,000 in restitution to harmed investors were appropriate sanctions. Fraud strikes at the heart of securities regulation. The Commission has consistently held that fraud violations are "especially serious and should be subject to the severest of sanctions under the securities laws." *Kenny Akindemowo*, Exchange Act Release No. 79007, 2016 SEC LEXIS 3769, at *36 (Sept. 30, 2016); *Scholander*, 2016 SEC LEXIS, 1209 at *36 & n.55. Given the gravity of his misconduct, barring Smith and ordering restitution are neither excessive nor oppressive. *See* 15 U.S.C. § 78s(e)(2).

1. The Guidelines Support Barring Smith

In determining what sanctions to impose, the NAC considered the Guidelines for intentional or reckless misrepresentations of material facts, the Principal Considerations in

[17] The Commission should also sustain the NAC's findings that Smith willfully violated the Exchange Act. *See Vungarala*, 2020 SEC LEXIS 4938, at *28 & n.36 (finding respondent acted willfully when he also acted with scienter when making misrepresentations and omissions). A willful violation under the federal securities laws simply means "that the person charged with the duty knows what he is doing." *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000).

Determining Sanctions, and the General Principles. (RP 4523-25.) The Commission in its review of sanctions gives weight to whether the sanctions are within the allowable sanction range under the Guidelines and uses them as a "benchmark" for its review. *See Vungarala*, 2020 SEC LEXIS 4398, at *35; *Howard Braff*, Exchange Act Release No. 66467, 2012 SEC LEXIS 620, at *18-19 (Feb. 24, 2012). Reflecting the seriousness of fraud, the Guidelines recommend that an adjudicator should "strongly consider barring an individual" in response to intentional or reckless misrepresentations or omissions of material fact.[18] Barring Smith is within the parameters of the Guidelines and consistent with these recommendations.

The NAC properly determined that Smith's fraud was accompanied by numerous aggravating factors and no mitigation. (RP 4523.) Smith poses a danger to the investing public and exhibits a troubling disregard for fundamental principles of the securities industry, which necessitate barring him. *See Saad v. SEC*, 980 F.3d 103, 109 (D.C. Cir. 2020). Smith victimized four investors who lost their entire investments, totaling $130,000. (RP 4523); *see Guidelines*, at 7 (Principal Nos. 8, 11).

Smith's fraudulent omission and misrepresentations also resulted not only in the potential for monetary gain, but $130,000 in actual gain for Smith and CSSC from his sales to the four investors. (RP 4524); *see Guidelines*, at 8 (Principal No. 16). And Smith outright refused to repay one investor (TL) in November 2015 when he requested a refund from Smith of his $50,000 investment after he had not received documents related to his August 2015 investment. TL stated that his "trust has been seriously shaken." (RP 2342.) Smith told TL that he had "no

[18] *See FINRA Sanction Guidelines* 89 (2019), https://www.finra.org/sites/default/files/2020-10/2019_Sanctions_Guidelines.pdf.

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. (RP 2341.)

Smith's fraud was not an isolated incident but occurred over the course of several months and involved several separate, wrongful and purposeful acts. (RP 4523); *see Guidelines*, at 7-8 (Principal Nos. 9, 13). For example, when Smith was desperate to raise cash for CSSC through the 2015 offering, he repeatedly and intentionally failed to disclose that CSSC owed prior investors more than $600,000 that it could not repay.

Smith further knew or was reckless in not knowing that his representations about CSSC's financial prospects resulting from Project X and CSSC's purported business with the SDTC and Jacksonville were unfounded and would persuade investors to purchase the 2015 offering. (RP 4524); *see Guidelines*, at 8 (Principal No. 13).

Smith's misconduct was accompanied by efforts to blame others for his actions. Throughout the proceedings, Smith blamed Southwick despite ample evidence of Smith's direct involvement and control over the offering. Notwithstanding a record replete with evidence that Smith violated the most fundamental tenets applicable to a securities professional, he disavows his responsibility and contends that FINRA has no jurisdiction over his misconduct despite the plethora of evidence to the contrary. 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's misconduct poses a serious risk to the investing public that he will, if given the opportunity to continue in the securities industry, engage in similar misconduct in the future. *See Guidelines*, at 7 (Principal No. 2); *see, e.g.*, *Robert D. Tucker*, Exchange Act Release No. 68210, 2012 SEC LEXIS 3496, at *64 (Nov. 9, 2012) (finding that applicant's "persistent attempts to

deflect blame onto others . . . suggests that he is likely to engage in similar misconduct in the future"); *Scott Epstein*, Exchange Act Release No. 59328, 2009 SEC LEXIS 217, at *75 (Jan. 30, 2009) ("We agree with FINRA that Epstein's demonstrated insouciance and indifference towards his responsibilities under NASD rules poses a serious risk to the investing public."). The Commission should affirm the bar imposed upon Smith to protect investors, and such sanctions are not excessive or oppressive considering the nature of, and circumstances surrounding, his egregious misconduct.

2. The Guidelines Support Ordering Restitution

The NAC also appropriately ordered that Smith pay $130,000 in restitution to the defrauded investors. (RP 4525 & n.24.) The Guidelines provide that, restitution is appropriate when an "identifiable person" otherwise would unjustly suffer "quantifiable loss proximately caused by a respondent's misconduct." *Guidelines*, at 4 (General Principle No. 5). As the Commission has recognized, "[a]n 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). Four investors lost the full amount of their investments totaling $130,000 as a direct result of Smith's fraud. The restitution order restores the investors to the position they would have been in if they had not been subject to Smith's fraud.[19] *See id.*

[19] The NAC ordered Smith to pay restitution, jointly and severally, with CSSC BD because Smith used CSSC BD as one way to obtain investors and the firm shared liability with Smith for the fraudulent misconduct. (RP 4525.)

Under the circumstances, the bar and $130,000 restitution order imposed upon Smith are needed to protect the investing public and to deter Smith from engaging in similar fraudulent conduct in the future. The Commission should affirm the NAC's sanctions.

V. CONCLUSION

The Commission should sustain FINRA's action in all respects and dismiss Smith's application for review.[20]

Respectfully submitted,

/s/ *Jennifer Brooks*
Jennifer Brooks
Associate General Counsel
FINRA
1735 K Street, NW
Washington, DC 20006
(202) 728-8083
jennifer.brooks@finra.org

February 17, 2021

[20] On January 18, 2021, Smith filed a motion requesting oral argument. Because the issues have been thoroughly briefed and can be adequately determined based on the record, the Commission should deny Smith's request for oral argument. *See* Commission Rule of Practice 451, 17 C.F.R. § 201.451 (providing for Commission consideration of appeals based on the "papers filed by the parties" unless the "decisional process would be significantly aided by oral argument"); *Allen Holeman*, Exchange Act Release No. 86523, 2019 SEC LEXIS 1903, at *2 n.1 (July 31, 2019), *aff'd*, 2021 U.S. App. LEXIS 208 (D.C. Cir. Jan. 5, 2021).

CERTIFICATE OF SERVICE

I, Jennifer Brooks, certify that on this 17th day of February 2021, caused a copy of the foregoing Brief of FINRA in Opposition to Application for Review, In the Matter of the Application of Eric S. Smith, Administrative Proceeding File No. 3-20127, to be served by electronic service on:

Vanessa A. Countryman
The Office of the Secretary
U.S. Securities and Exchange Commission
100 F St., NE
Room 10915
Washington, DC 20549-1090
apfilings@sec.gov

and:

Robert Knuts, Esq.
Sher Tremonte LLP
90 Broad Street, 23rd Floor
New York, New York 10004
rknuts@shertremonte.com

Respectfully submitted,

/s/ *Jennifer Brooks*
Jennifer Brooks
Associate General Counsel
FINRA
1735 K Street, NW
Washington, DC 20006
(202) 728-8083
jennifer.brooks@finra.org

CERTIFICATE OF COMPLIANCE

I, Jennifer Brooks, certify that this brief complies with the Commission's Rules of Practice by filing a brief in opposition not to exceed 14,000 words. I have relied on the word count feature of Microsoft Word in verifying that this brief contains 13,665 words.

/s/ *Jennifer Brooks*
Jennifer Brooks
Associate General Counsel
FINRA
1735 K Street, NW
Washington, DC 20006
(202) 728-8083
jennifer.brooks@FINRA.org