U.S. SECURITIES AND EXCHANGE COMMISSION
Admin. Proc. File No. 3-20127

In the Matter of the Application of :

ERIC S. SMITH :

For Review of Disciplinary Action Taken By :

FINRA :

APPLICANT ERIC S. SMITH'S REPLY BRIEF

TABLE OF CONTENTS

TABLE OF AUTHORITIES

INTRODUCTION

Applicant Eric S. Smith ("Smith") submits this reply brief in further support of his application to the U.S. Securities and Exchange Commission ("Commission") to reverse the decision issued by the FINRA National Adjudicatory Council dated September 18, 2020 (the "NAC Decision") and dismiss the FINRA disciplinary proceeding against him.

As described below, in its opposition brief submitted to the Commission, FINRA failed to identify any lawful basis for its exercise of self-regulatory disciplinary jurisdiction over Smith. Instead, FINRA attempts to relegate this fundamental issue to a footnote in the apparent hope that the Commission will ignore its duty to supervise FINRA and exercise its statutory responsibility for the review of all FINRA disciplinary actions and sanctions at the request of an aggrieved respondent. Here, Smith may be the ultimate aggrieved respondent because FINRA never had the legal authority to commence a disciplinary proceeding against him. Simply put, Smith has never been a member of this self-regulatory organization and has never consented to become subject to and bound by FINRA's by-laws, regulations and rules, including those that govern disciplinary proceedings. For that reason alone, the Commission must dismiss the FINRA disciplinary proceedings against Smith.

In addition, FINRA argues in its opposition to Smith's appeal to the Commission that FINRA should be able to impose fraud sanctions against a respondent even if its Department of Enforcement fails to prove by a preponderance of the evidence that any actual fraud occurred. Here, FINRA charged Smith with fraud based upon an alleged omission and several alleged misrepresentations concerning projected revenues in Offering Documents that were distributed in mid-2015. The record on this appeal to the Commission shows no evidence that any of the four investors were deceived and FINRA utterly failed to introduce any evidence to *prove*, not *argue*,

the materiality of the alleged omission and misrepresentations. The Commission cannot allow FINRA to impose fraud sanctions on Smith or any other respondent in a FINRA disciplinary proceeding without FINRA sustaining its burden of proof at an evidentiary hearing. For this reason as well, the Commission must vacate the NAC Decision and dismiss the FINRA disciplinary proceedings against Smith.

ARGUMENT

I.

THE FINRA ENFORCEMENT PROCEEDING MUST BE DISMISSED FOR LACK OF JURISDICTION

As a Delaware member corporation and SEC-registered self-regulatory organization, FINRA may bring disciplinary proceedings against both its members and all persons who affirmatively consent to be bound by FINRA's by-laws and rules. This group of potential respondents includes more than 3,500 member firms and more than 600,000 FINRA-licensed representatives of those member firms.[1] Applicant Eric Smith never applied for FINRA membership or any securities license from FINRA to serve as a registered representative or principal of a member firm. Smith never registered with FINRA in any capacity and never consented to be bound by FINRA's by-laws and rules. Based upon these undisputed facts, FINRA should have quickly concluded more than four years ago, during its investigation in this matter, that FINRA simply had no power to exercise self-regulatory jurisdiction and institute a disciplinary proceeding against Smith.

Instead, to this day, FINRA has ignored this existential limit on its power to commence disciplinary proceedings. As a *voluntary*, member-owned, non-Governmental, self-regulatory

[1] https://www.finra.org/media-center/statistics

organization, FINRA's source of power lies solely in the by-laws, regulations and rules that govern its members and the written contracts that it enters into with registered representatives of those member firms, through which those individuals voluntarily and affirmatively agree to be subject to and comply with FINRA's by-laws, regulations and rules.[2]

In Footnote 7 in its opposition brief, FINRA broadly argues that "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."[3] FINRA does not cite a single Federal court case, Commission decision, Federal statute or Commission rule that provides any support whatsoever for this claim of non-member/no-consent FINRA disciplinary jurisdiction. The Federal court case cited by FINRA in its opposition brief held that, under certain defined circumstances, FINRA rules concerning FINRA arbitration panels preempted California law because the Commission had approved those rules under the Exchange Act and, therefore, the Exchange Act preempted the conflicting California statute regarding arbitrator disclosure. *Credit Suisse First Boston Corp. v. Grunwald*, 400 F.3d 1119, 1128-36 (9th Cir. 2005). Nothing in the case remotely suggests that FINRA may rely on general "federal law" to institute and provide legal justification for self-regulatory disciplinary proceedings against non-member firms or individuals who did not consent to FINRA jurisdiction.

Rather than cite any actual Federal law in support of its claimed disciplinary jurisdiction over Smith, FINRA spends seven pages of its opposition brief arguing that Smith's activities while working for Consulting Services Support Corporation ("CSSC-Parent"), *not* the FINRA member firm, were sufficient to meet the definitions set forth in FINRA's by-laws and rules

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2 https://www.finra.org/sites/default/files/form-u4.pdf, Section 15A, ¶2, at page 15 of 39.

3 Brief of FINRA In Opposition to Application for Review ("FINRA Br.") at 17, fn. 7.

concerning "person associated with a member firm." FINRA Br., at 17-24. But those arguments merely beg the question of whether or not FINRA could exercise disciplinary jurisdiction over Smith at all. Tellingly, every single FINRA enforcement proceeding cited by FINRA in support of its factual arguments that Smith's activities met FINRA's definition of "person associated with a member firm" involved respondents *who had registered with FINRA and obtained securities licenses from FINRA*. Attached as Appendix A to this reply brief is a list of those individual respondents and links to their FINRA BrokerCheck information, confirming their status as FINRA registered and licensed persons.

Only one FINRA disciplinary proceeding cited by FINRA in its opposition brief involved a respondent who had not registered with FINRA – *Department of Enforcement v. Reichman*, Complaint No. 200801201960 (FINRA NAC July 21, 2011).[4] The *Reichman* decision was wrongly decided by FINRA and, in the interests of justice, should be belatedly reversed by the Commission.[5] In *Reichman*, a recent college graduate worked for the parent company of a FINRA member firm from 2001 – 2005 while attending Brooklyn Law School at night. After graduating from law school, she joined a "Regulatory Initiatives Group" at the FINRA member firm, where she worked as part of the firm's compliance function. During her roughly one year of employment at the FINRA member firm, she did not register with FINRA or seek to obtain any licenses from FINRA. Nonetheless, after she left her employment, FINRA's Department of Enforcement demanded, pursuant to FINRA's Rule 8210, that she appear for testimony in

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[4] A copy of the *Reichman* decision is attached as Appendix B.

[5] The *Reichman* decision was not appealed to the Commission. Under these circumstances, contrary to FINRA's opposition to Smith's motion for oral argument, noted in Footnote 20 of its opposition brief, the Commission would clearly benefit from hearing oral argument concerning a fundamental question concerning the legal limits of FINRA's disciplinary jurisdiction.

connection with an investigation that had been commenced. When her counsel objected that FINRA did not have authority to compel her to appear for such testimony because she had never registered with FINRA, the Department of Enforcement repeatedly re-scheduled the testimony over the next 20 months. FINRA then instituted a disciplinary proceeding against Reichman for failure to testify.

Like the Hearing Panel and the NAC in the proceedings involving Smith, in the *Reichman* decision, FINRA simply ignored the necessary fundamental limit on its *self-regulatory* disciplinary jurisdiction. Rather than actually address the question of jurisdiction, the *Reichman* decision jumped ahead to conclude that Ms. Reichman's duties and responsibilities involved the member firm's "investment banking or securities business" and, therefore, she met FINRA's definition of "person associated with a member firm." *Reichman*, pp. 8-9. In circular fashion, having determined that Ms. Reichman was an "associated person", FINRA also concluded that she had violated her obligation to appear for Rule 8210 testimony. *Id.*, p. 12.

The Commission must not allow FINRA's Department of Enforcement to ever again attempt to assert self-regulatory disciplinary jurisdiction over individuals who have not registered with FINRA, did not obtain any licenses from FINRA, and never voluntarily and affirmatively consented to be subject to FINRA's by-laws, regulations and rules. A voluntary self-regulatory organization may only impose disciplinary sanctions against members and persons who have voluntarily consented to that disciplinary jurisdiction. The vastly different jurisdictional powers of the Commission and FINRA are clearly defined and should be respected by FINRA. Therefore, the Commission must vacate the NAC Decision and dismiss the FINRA disciplinary proceedings against Smith because FINRA never had any power or legal authority to exercise disciplinary jurisdiction over him.

II.

FINRA FAILED TO PROVE ITS FRAUD CHARGES

Under well-established U.S. Supreme Court precedent, FINRA was required to prove by a preponderance of actual evidence that Smith's alleged misrepresentation or omissions were "material" – in other words, would have been viewed objectively by a reasonable investor as significantly altering the total mix of information received by the four persons who loaned monies to CSSC-Parent during August – November 2015. *See Basic Inc v. Levinson*, 485 U.S. 24, 231-32 (1988); *SEC v. Morgan, Keegan & Co., Inc.*, 678 F.3d 1233, 1245-47 (11th Cir. 2012). To prove materiality by a preponderance of the evidence, FINRA and Smith agree that FINRA did not need to introduce evidence that any of the four individual investors personally relied on the alleged misrepresentations or omissions when deciding whether or not to loan monies to CSSC-Parent and FINRA did not need to introduce direct testimony from any of the four investors.

However, FINRA was required to present actual *evidence* of "materiality" concerning the alleged omission and misrepresentations and not just *argue* that the alleged omission and misrepresentations significantly altered the total mix of information received by the four investors. Argument is not evidence, no matter how many times or how stridently it is repeated. In *United States v. Litvak*, the Second Circuit Court of Appeals stated that the evidence introduced at trial concerning materiality must reflect:

> the parameters of the thinking of reasonable investors in the particular market at issue. In other words, *there must be evidence* of a nexus between a particular [testifying] trader's viewpoint and that of mainstream thinking of investors in that market. Materiality cannot be proven by the mistaken beliefs of the worst informed trader in a market.

889 F.3d 56, 64-65 (2d Cir. 2018) (rejecting defendant's argument that testimonial evidence concerning materiality of omissions required reversal but reversing conviction because other

improper testimony infected the jury's determination regarding the materiality of the alleged omissions) (emphasis added).[6] As reflected in its opposition brief, FINRA never presented actual evidence of materiality and has relied solely on arguments regarding materiality.

For example, FINRA argues that "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." FINRA Br. 28-29. There is no testimony or exhibit citation for this argument in the opposition brief. FINRA's "materiality" argument also ignores the numerous representations made by CSSC-Parent in the Offering Documents that CSSC-Parent had not been able to meet its financial obligations across the board (including bond redemptions and payment of short term notes), had suffered financial losses for a number of years, and it was raising funds, in part, to attempt to satisfy its financial obligations, although it was unsure of whether that task would be possible, and old bonds were coming due in less than one year. R. 2308, 2387-97. The following chart was included in the Offering Documents (R. 2747), along with many pages of additional financial disclosures:

[6] *Cf. U.S. v. Vilar*, 729 F.3d 62, 92-93 (2d Cir. 2013) (testimony by victim-investor was sufficient to establish materiality of misrepresentations even if such testimony could be described as "unclear" or "disjointed"); *SEC v. Morgan Keegan & Co., Inc.*, 678 F.3d at 1253 (to oppose motion for summary judgment based on absence of materiality, SEC presented evidence from customers who received the alleged oral misrepresentations).

CSSC Operational Results			
Year	**Total Revenue**	**Total Expenses**	**Net Income (Loss)**
12/31/09	4,789,423	5,968,303	-1,178,880
12/31/10	6,200,099	6,822,077	-621,978
12/31/11	6,310,997	7,894,396	-1,583,399
12/31/12	6,050,459	6,591,994	-901,536
12/31/13[7]	5,473,291	6,561,700	-1,088,409
12/31/14[8]	4,735,733	5,765,224	-1,029,491

In the context of these frank, robust disclosures concerning CSSC-Parent's losses and cash flow problems, FINRA failed to meet its burden of proof that an alleged omission concerning CSSC-Parent's inability to pay investors from prior offerings would have "significantly altered the total mix of information" concerning CSSC-Parent's financial condition.

FINRA's arguments regarding the materiality of any alleged misrepresentations concerning CSSC-Parent in the Offering Documents fare no better. In addition to the alleged "omission" regarding CSSC-Parent's inability to pay its maturing debts from operating revenues as of mid-June 2015, FINRA's fraud charges rested solely on statements made in the Offering

[7] The 2013 audited financial statements for CSSC-Parent, also included in the offering documents (see R. 2785), informed investors that the company had an "Accumulated deficit" of ($9,565,686), a "Total stockholder's deficit" of ($2,944,904), and a "Net Loss" of ($1,088,409); and that of the $1,170,000 the company raised from the issuance of bonds, it concluded 2013 with only $38,782 after accounting for its net loss and other expenses. (R. 2790–2794)

[8] The 2014 audited financial statements for CSSC-Parent, also included in the offering documents (see R. 2821), informed investors that the company had an "Accumulated deficit" of (10,643,647), a "Total stockholder's deficit" of ($3.963,958), and a "Net Loss" of ($1,047,961); and that of the $1,175,000 the company raised from the issuance of bonds and short term notes payable, it concluded 2014 at a cashflow deficit of (27,008) after accounting for its net loss and other expenses. (R. 2790–2794)

Documents concerning projected revenues that might or might not be received by CSSC-Parent from three specific potential revenue initiatives – Project X, South Dakota Trust Company and the City of Jacksonville. According to the Offering Documents, the potential future revenues from the South Dakota Trust Company and City of Jacksonville business relationships "could be substantial." R. 2753-54. The projected revenues from Project X were described in the Offering Documents as a $1 million consulting fee plus additional potential fees in the future. R. 2752. FINRA argues that the alleged misrepresentations concerning these revenue projections were "material" without citing any testimony or exhibits addressing the materiality of the alleged misrepresentations. FINRA Br. at 30-31.

In addition to resting solely on argument rather than evidence, FINRA's "proof" of materiality concerning the estimated revenue from these projects also ignores other representations made by CSSC-Parent in the Offering Documents. First, the Offering Documents specifically warned potential investors that there was no guarantee that CSSC-Parent would receive those projected revenues. R. 3393, 3395. Second, the Offering Documents described other projected revenue streams about which there are no disputes, including the following:

* CSSC-Parent had created "a wholly-owned technology subsidiary, separate and apart from the Company's core financial services . . . to focus on licensing opportunities for the Company's decision-assistance technology." R. 2773.[9]

* "[W]e expect our insurance-related revenue in 2015 to exceed $1 million . . . This increase in insurance revenue is an important additional reason why we believe the Company will achieve sustainable profitability this year." R. 2388

[9] The witnesses who testified at the Hearing all agreed that CSSC-Parent's patented technology was likely the most valuable asset and future source of revenues for CSSC-Parent. R. 1869, 1939-40, 1945-47 (Martin); R 1212-13, 1220, 1231-32, 1541 (Southwick); R. 1656, 1658, 1661, 1667, 1673, 1695, 1758 (Wheeler); R 2113, 2124, 2127-28, 2130 (Bryant); R 891, 921, 2170, 2173-74, 2181-82 (Smith).

* "[O]ur patented investment consulting process is Tibble-compliant today, and provides a 'best practices' solution to the problem highlighted in the Tibbs decision . . . We believe the unanimous Supreme Court decision in *Tibble v. Edison* will further help us to penetrate the larger institutional investment marketplace with both direct investment consulting services and our Special Reviewing Consultant Program." R. 2388

* "As noted earlier, an important obstacle to our return to sustainable profitability has been the recurring problem of late payments of revenue shares due to our Affiliates. We believe that the majority of our Affiliate base is still reluctant to generate any significant new business while they have any doubt about the CSSC's financial stability and viability. And, since (at least at this time) *more than 90% of the Company's revenue comes from the production of our Affiliated firms*, getting our Affiliated firms back into new business development and increasing revenue production is vitally important. So, the first order of business has naturally been to try to secure enough cash to catch up and end the ongoing recurring delays in Affiliate revenue sharing payments." R. 2382 [emphasis added.]

* "[W]e have developed two new service offerings that we believe will each have tremendous revenue production potential in the months and years ahead." R. 2433

Given the absence of actual evidence concerning what reasonably objective investors would consider important in mid-2015 concerning CSSC-Parent's existing financial condition, business development and revenue production projects, there is no basis (other than speculation) to conclude that any misrepresentations regarding three potential revenue streams (Project X, South Dakota Trust Company and the City of Jacksonville), as opposed to representations regarding other potential revenue streams and the value of CSSC-Parent's patented technology, significantly altered the total mix of information received by investors from CSSC-Parent in mid-2015.

None of the cases cited by FINRA in their opposition brief addressed the question at issue here—the complete absence of evidence concerning the materiality of the alleged omission and misrepresentations. Moreover, those cases are distinguishable as the record before the court in each of those cases contained evidence of materiality. In *SEC v. Better Life Club, Inc.*, for

example, the court found that the defendant's misrepresentations were material where "the evidence clearly established that the [proposed investment] was not a legitimate investment venture, but was instead a pyramid scheme, destined to collapse and to leave investors stranded, with millions of dollars in losses." *S.E.C. v. Better Life Club of Am., Inc.*, 995 F. Supp. 167, 176 (D.D.C. 1998), *aff'd* sub nom. *U.S. S.E.C. v. Better Life Club of Am., Inc*., 203 F.3d 54 (D.C. Cir. 1999). Similarly, in *S.E.C. v. Todd*, the court found that the defendant omitted material information based, in part, on witness testimony that the defendants improperly recorded revenue under GAAP policies, and failed to disclose a material change in the defendant company's accounting practices. 642 F.3d 1207, 1216 (9th Cir. 2011). *See also S.E.C. v. Loomis*, 969 F.Supp.2d 1226, 1237 (E.D. Cal 2013) (finding that the defendant's alleged misrepresentations were material based on "the record before the court" which included witness testimony and declarations from investors.); *Gould v. Am. Hawaiian S. S. Co.*, 331 F. Supp. 981, 986 (D. Del. 1971), supplemented, 387 F. Supp. 163 (D. Del. 1974) (finding "after a review of the evidence" that "the aggregate effect of various misrepresentations most clearly evinced their materiality."); *S.E.C. v. USA Real Est. Fund 1, Inc.*, 30 F. Supp. 3d 1026, 1034 (E.D. Wash. 2014) (finding that the defendant's representation that the fund had between $1 and $100 million in revenue was material where the record included the defendant's admission that the fund had never opened for business.").

The record before the Commission clearly demonstrates that FINRA failed to sustain its burden of proof concerning the fraud charges brought against Smith. There is simply no evidence that any of the four investors – who loaned a total of $130,000 to CSSC-Parent during 2015 – were deceived in any way. And there is no evidence that the alleged omission and misrepresentations identified by FINRA would have significantly altered the total mix of

information for a reasonably objective investor in CSSC-Parent in mid-2015. It appears that FINRA invented fraud charges against Smith concerning a mid-2015 offering in which no actual investor claimed he was deceived and then FINRA failed to even attempt to introduce evidence that the alleged omission and misrepresentations were important to anyone, either the actual investors or otherwise. The Commission must reverse the FINRA disciplinary proceeding's fraud findings against Smith.

CONCLUSION

For the reason set forth above and in Applicant's Opening Brief, as well as the entire evidentiary record in this proceeding, the NAC Decision should be vacated and the FINRA disciplinary proceedings against Eric S. Smith should be dismissed.

Dated: March 10, 2021
New York, New York

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APPENDIX A

Case Cited by FINRA	Individual	Individual's BrokerCheck Link	**License**
Howard Brett Berger, Exchange Act Release No. 58950, 2008 SEC LEXIS 3141 (Nov. 14, 2008)	Howard Brett Berger	https://brokercheck.finra.org/individual/summary/2284367	Series 7 – General Securities Representative Examination (Nov. 27, 1992)
Louis Ottimo, Exchange Act Release No. 83555, 2018 SEC LEXIS 1588, at *49 (June 28, 2018)	Louis Ottimo	https://brokercheck.finra.org/individual/summary/2606438	Series 7 – General Securities Representative Examination (Mar. 6, 2009)
Bruce Zipper, Exchange Act Release No. 84334, 2018 SEC LEXIS 2709, at *14 (Oct. 1, 2018)	Bruce Zipper	https://brokercheck.finra.org/individual/summary/1019731	Series 7 – General Securities Representative Examination (Nov. 27, 1981)
Credit Suisse First Bos. Corp. v. Grunwald, 400 F.3d 1119, 1128-30 (9th Cir. 2005)	Michael Scott Grunwald	https://brokercheck.finra.org/individual/summary/2261239	Series 7 – General Securities Representative Examination (Oct. 19, 1992)
DWS Sec. Corp., 51 S.E.C. 814, 822 (1993)	Stephen M. Rangel	https://brokercheck.finra.org/individual/summary/1419324	Series 7 – General Securities Representative Examination (Nov. 16, 1985)

Case Cited by FINRA	Individual	Individual's BrokerCheck Link	**License**
	Hugh M. Liddle Jr.	https://brokercheck.finra.org/individual/summary/1021230	Series 7 – General Securities Representative Examination (Oct. 19, 1985)
Michael F. Flannigan, 56 S.E.C. 8, 17-18 (2003)	Michael F. Flannigan	https://brokercheck.finra.org/individual/summary/1135700	Series 7 – General Securities Representative Examination (May 21, 1983)
Gordon Kerr, 54 S.E.C. 930, 938 (2000)	Gordon Kerr	https://brokercheck.finra.org/individual/summary/268444	Series 7 – General Securities Representative Examination (Apr. 27, 1995)
Richard F. Kresge, Exchange Act Release No. 55988, 2007 SEC LEXIS 1407, at *50 (June 29, 2007)	Richard F. Kresge	https://brokercheck.finra.org/individual/summary/729077	Series 7 – General Securities Representative Examination (Feb. 16, 1985)
Kirk A. Knapp, 50 S.E.C. 858, 861 (1992)	Kirk A. Knapp	https://brokercheck.finra.org/individual/summary/702720	Series 7 – General Securities Representative Examination (Dec. 15, 1979)
Dennis Todd Lloyd Gordon, Exchange Act Release No. 57655, 2008 SEC LEXIS 819, at *28-29 (Apr. 11, 2008)	Dennis Todd Lynn Gordon	https://brokercheck.finra.org/individual/summary/1614614	Series 7 – General Securities Representative Examination (Jan. 20, 1990)

Case Cited by FINRA	Individual	Individual's BrokerCheck Link	**License**
Vladislav Steven Zubkis, 53 S.E.C. 794, 799-800 (1998)	Vladislav Steven Zubkis	https://brokercheck.finra.org/individual/summary/1745808	Series 7 – General Securities Representative Examination (Aug. 20, 1988)

In addition to the cases described above, FINRA also cites to *First Capital Funding, Inc.*, 50 S.E.C. 1026, 1028-30 (1992). This case was omitted from the chart because no BrokerCheck record currently exists for Patrick J. Allen, the individual respondent in that case, presumably because more than 10 years have elapsed since his last registration. Mr. Allen served as President of the member firm and was not charged with failure to register with FINRA in that proceeding.

APPENDIX B

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of

Department of Enforcement,

Complainant,

vs.

Rebecca Amy Reichman,

Respondent.

DECISION

Complaint No. 200801201960

Dated: July 21, 2011

Unregistered associated person refused to provide FINRA with information and testimony regarding her resignation from a member firm based on objection to FINRA jurisdiction. The Hearing Panel upheld FINRA's exercise of jurisdiction and barred the respondent. Held, findings and sanctions affirmed.

Appearances

For the Complainant: Ronald Sannicandro, Esq., Linda Riefberg, Esq., and Myles Orosco, Esq., Department of Enforcement, Financial Industry Regulatory Authority

For the Respondent: Charlita Mays, Esq., Justin Deabler, Esq., and Linda Imes, Esq., Spears & Imes LLP, New York

Decision

Pursuant to NASD Rule 9311, Rebecca Amy Reichman ("Reichman") appeals a FINRA Hearing Panel's October 5, 2009 decision finding that Reichman violated NASD Rules 8210 and 2110 by failing to provide information to FINRA and appear for testimony.[1] For these

[1] Following the consolidation of NASD and the member regulation, enforcement and arbitration functions of NYSE Regulation into FINRA, FINRA began developing a new "Consolidated Rulebook" of FINRA Rules. The first phase of the new consolidated rules became effective on December 15, 2008. *See FINRA Regulatory Notice 08-57*, 2008 FINRA LEXIS 74 (Dec. 8, 2008). Because the complaint in this case was filed before December 15,

[Footnote continued on next page]

violations, the Hearing Panel barred Reichman and assessed hearing costs. After a thorough review of the record and consideration of appellate briefs and oral argument, we affirm the Hearing Panel's findings and sanctions.

I. Background

Reichman has never been registered with a FINRA member firm. From August 2001 through October 2005, Reichman was employed by Merrill Lynch & Co. ("ML & Co."). ML & Co. is the non-member parent company of several registered broker-dealers, including Merrill, Lynch, Pierce, Fenner & Smith ("MLPFS"), a registered broker-dealer and FINRA member firm.

While employed with ML & Co., Reichman attended law school. Reichman was admitted to practice law in the state of New Jersey in May 2005 and the state of New York in September 2005. From June 2005 until October 2005, Reichman was employed in ML & Co.'s Regulatory Exams and Inquiries Group ("REIG"), which was part of ML & Co.'s Office of General Counsel ("OGC"). Reichman's title in REIG was assistant vice president.

On October 10, 2005, Reichman left the parent company and joined MLPFS, the FINRA member firm and registered broker-dealer subsidiary of ML & Co.[2] At MLPFS, Reichman joined the Regulatory Initiatives Group ("RIG") in the Global Private Client ("GPC") compliance management section of the firm's regulatory compliance unit in OGC. RIG focused mainly on regulatory compliance for MLPFS's retail securities business. In February 2006, MLPFS promoted Reichman to vice president. Reichman remained with RIG/GPC until August 7, 2006, when she joined the Global Markets and Investment Banking Compliance Equities ("GMI") group. This department was also part of the MLPFS's regulatory compliance unit in OGC, but its focus was on the firm's institutional securities business. Reichman terminated her employment with MLPFS on September 18, 2006, when she abruptly submitted her resignation.

Reichman is not currently associated with a FINRA member firm.

II. Procedural History

In September 2008, FINRA's Department of Enforcement ("Enforcement")[3] filed a complaint alleging that Reichman violated NASD Rules 8210 and 2110 by failing to appear for on-the-record testimony and respond to FINRA written inquiries. From the outset, Reichman

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[cont'd]

2008, the procedural rules that apply are those that existed on December 14, 2008. The conduct rules that apply are those that existed at the time of the conduct at issue.

[2] Although Reichman was licensed as an attorney during her employment with MLPFS, she does not contend that any of the information that FINRA sought was subject to attorney-client privilege.

[3] The term "Enforcement" will be used to refer to FINRA, NASD, and NYSE Regulation Departments of Enforcement.

admitted that she did not appear for testimony and respond to FINRA inquiries. Rather than answer the complaint, Reichman filed a motion to dismiss Enforcement's complaint for lack of jurisdiction. Reichman claimed that her job duties and responsibilities at ML & Co. and MLPFS did not make her an "associated person" of a member firm, as that term is defined in FINRA's By-Laws. The Hearing Officer issued an order in which he stated that FINRA's Code of Procedure does not explicitly allow for parties in FINRA disciplinary proceedings to file motions to dismiss complaints. The Hearing Officer determined to treat the motion to dismiss the complaint as a motion for summary disposition under NASD Rule 9264. The Hearing Officer noted that motions for summary disposition may be filed only after the respondent's answer has been filed and Enforcement has made documents available to the respondent for inspection and copying pursuant to NASD Rule 9251. Because neither precondition had been met, the Hearing Officer deferred ruling on the motion.

Reichman filed an answer in which she admitted the factual allegations of the complaint, but reasserted her jurisdictional objection. She also renewed her motion to dismiss the complaint for lack of jurisdiction. The Hearing Officer subsequently denied Reichman's motion to dismiss the complaint, and proceeded to hearing to resolve the sole issue of jurisdiction.

At the Hearing Panel hearing, the Hearing Officer denied Enforcement's request to compel Reichman to testify during its presentation. The Hearing Officer ruled that, if Reichman chose to testify in her own defense, she would not waive her jurisdictional argument, and the subject matter of her testimony would be limited to the general scope of her duties while employed with member firm MLPFS. Reichman did not testify at the Hearing Panel hearing.

The Hearing Panel held that Reichman was an associated person of MLPFS and therefore subject to FINRA jurisdiction, that she failed and refused to respond to Rule 8210 requests for information and testimony, and that, in doing so, she violated NASD Rules 8210 and 2110. The Hearing Panel found several aggravating factors present, barred Reichman in all capacities, and assessed hearing costs. We affirm the Hearing Panel's findings that Reichman was an associated person of MLPFS and that FINRA properly exercised jurisdiction over her. We also find that, by failing to comply with FINRA's requests for information and testimony, Reichman violated NASD Rules 8210 and 2110. We affirm the bar in all capacities.

III. Facts

A. Reichman's Job Responsibilities During Her Employment with MLPFS's RIG/GPC Group

MLPFS operated with two distinct business lines – institutional sales and retail sales. RIG was part of the GPC group, which worked exclusively within the retail business line. RIG/GPC was part of the compliance section of MLPFS's OGC. Reichman admitted that her core job responsibilities included working with retail compliance and business professionals to complete the firm's cataloging of compliance policies, supervisory procedures, and testing programs in order to fulfill MLPFS's requirements under NASD Rule 3013.[4] Reichman's

[4] During the period applicable here, NASD Rule 3013 (now FINRA Rule 3130), in relevant part, required the chief executive officer ("CEO") of each member firm to certify

[Footnote continued on next page]

immediate supervisor in RIG/GPC was Martha Dennis ("Dennis"), GPC senior compliance officer. Dennis reported to Sharyn Handelsman ("Handelsman"), the managing director for GPC compliance.

Reichman's official job description in RIG/GPC was "regulatory initiatives coordinator." Her main job function was to facilitate the review and analysis by each business unit in GPC of the rules that were pertinent to the CEO's Rule 3013 annual certification. To accomplish this, she worked closely with the compliance officer for each business unit to identify and report on firm policies and supervisory procedures that were included in the CEO certification. She identified gaps in various departments' rule coverage (i.e., areas in which the department had no or inadequate supervisory procedures related to an identified rule). Reichman assessed the level of risk associated with each gap in coverage and established a time frame for addressing the gap. Reichman also became the point person for questions from the compliance officers on all issues related to Rule 3013 compliance. As such, she provided guidance to both registered and unregistered compliance personnel and officers.

Dennis testified that the job that Reichman held was not considered a "low-level compliance position." Dennis hired Reichman because she felt that Reichman's training as a lawyer and her familiarity with securities rules and regulations (from her experience with REIG in the parent company) could be useful to her. Dennis hired Reichman to provide a level of intelligent guidance to the compliance officers in the various GPC departments. According to Dennis's testimony, Reichman conducted much of her work with GPC compliance officers by reviewing standardized Rule 3013 templates for accuracy and quality control. If she identified an entry on a template that was inconsistent or incorrect, she would meet with the compliance officer to rectify the issue. If gaps in coverage were noted in a template, Reichman would conduct research to verify that the gap truly existed and ensure that the gap was expeditiously rectified. Dennis testified that any suggestion that Reichman made to a compliance officer would have been taken seriously and acted upon promptly. Overall, Dennis testified that Reichman was pivotal to MLPFS's meeting its Rule 3013 responsibilities.

Reichman's position in RIG/GPC also entailed other duties. Reichman reviewed new and revised rules and regulations weekly to determine their impact, if any, on the retail portion of

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annually that senior executive management has in place processes to: (1) establish, maintain, and review written compliance policies and written supervisory procedures reasonably designed to achieve compliance with applicable NASD and Municipal Securities Rulemaking Board rules and federal securities laws and regulations; (2) modify such policies and procedures as business, regulatory, and legislative changes and events dictate; and (3) test the effectiveness of such policies and procedures on a periodic basis, the timing of which is reasonably designed to ensure continuing compliance. Rule 3013 also required that the CEO certify that he has conducted one or more meetings with the chief compliance officer in the preceding 12 months to discuss the firm's processes and procedures for rule compliance. *See NASD Notice to Members 04-71* (Oct. 2004). A firm that fails to comply with Rule 3013 or is negligent in its compliance with the rule could be subject to disciplinary action.

MLPFS's business. Reichman identified the compliance officer responsible for compliance with the particular rule or regulation, helped the compliance officer understand the requirements of the new or revised rule, and tracked the compliance officer's progress in implementing the rule or revising the firm's processes for compliance and supervision. She also ensured that the identified rules were addressed adequately in the firm's written policies and supervisory procedures.

Reichman's job responsibilities also included facilitating GPC compliance management's participation in industry groups by assisting with preparation for, and follow-up to, meetings and events. In particular, Reichman assisted Handelsman with follow-up from Securities Industry Association meetings. Reichman also coordinated, managed, and completed firm responses to regulatory inquiries and requests. Finally, Reichman worked on special projects, particularly for Handelsman. Two of Reichman's special projects were to revise MLPFS's policy on financial advisors working from locations other than branch offices (such as, for example, working from home) and to interface with the examiner who conducted an examination of the firm's Miami office.

B. Reichman's Job Responsibilities During Her Employment with MLPFS's GMI Group

Reichman transferred to the GMI unit in August 2006. GMI serviced MLPFS's institutional business line and was also part of the firm's OGC. Reichman admitted that, in GMI, she assisted her supervisor in conducting one branch examination of a middle market office and in completing other compliance-related tasks. Reichman reported to Jeffrey Lau ("Lau"), director in the GMI unit of compliance support for middle markets and regional offices.

Lau testified that his "department" consisted only of him before he hired Reichman in August 2006. He testified that they (he and Reichman) advised the institutional sales force with respect to complying with applicable rules and regulations. Lau stated that he hired Reichman specifically to assist him with answering daily inquiries from administrative managers who were responsible for supervising sales offices, performing regulatory branch examinations, and conducting continuing education and mandatory compliance meetings for the registered personnel in those offices. Reichman's tenure in Lau's department was unexpectedly short because she resigned from MLPFS effective September 18, 2006.

Lau had expected that Reichman would eventually perform branch office reviews and conduct mandatory continuing education and compliance meetings for registered personnel on her own. Lau testified that Reichman left before she could perform the work on her own. During Reichman's six weeks in GMI, however, she assisted Lau in performing an examination of MLPFS's New York middle markets sales office. Lau testified that, as part of this review, Reichman interacted with sales personnel, support staff, and middle markets management in the New York office. Reichman also participated with Lau in one mandatory compliance training session (for Series 7 registered employees of MLPFS). Reichman was identified as a presenter on the written materials for the mandatory compliance session, but Lau could not recall if Reichman actually spoke at the meeting, or if she attended as part of her training for future presentations. Lau did recall, however, that Reichman spoke in a professional capacity to sales people in various MLPFS offices, although he was unfamiliar with the specific topics of their conversations.

C. FINRA's Investigation of MLPFS

Enforcement commenced an investigation of MLPFS in December 2005 after receiving a referral from an NYSE Regulation investigative report. In September 2006, MLPFS informed Enforcement that Reichman had resigned, but refused to provide additional information about her resignation because the firm was conducting an internal review of the occurrence.

In November 2006, Enforcement sought information from Reichman. In a November 8, 2006 letter from Enforcement to Reichman, Enforcement advised Reichman that it was investigating the circumstances surrounding her termination of employment with MLPFS and other matters, including the possibility that, during her employment with the firm, she may have made misstatements and instructed other firm employees to make misstatements in connection with regulatory examinations of the firm. Enforcement directed her to report for on-the-record testimony on December 11, 2006.[5]

On December 4, 2006, Reichman's counsel sent a letter to Enforcement in which she challenged FINRA's jurisdiction over Reichman and indicated that Reichman would not appear for on-the-record testimony or otherwise provide requested information.[6] In a December 27, 2006 letter, Enforcement renewed its request for Reichman's on-the-record testimony, rescheduled for January 16, 2007, and again requested a written statement. Reichman did not appear on January 16. Counsel for Enforcement and Reichman's attorney corresponded further, and Reichman continued to assert a jurisdictional defense. In a September 25, 2007 letter, Enforcement requested that Reichman appear pursuant to NASD Rule 8210 and provide on-the-record testimony on October 22, 2007.[7] In a letter dated October 18, 2007, Reichman's attorney reiterated her position that FINRA lacked jurisdiction over Reichman. Reichman did not appear to testify on October 22.

On July 31, 2008, Enforcement issued another request pursuant to NASD Rule 8210 for Reichman to appear and provide on-the-record testimony. The testimony was scheduled for August 11, 2008, and Reichman failed to appear.

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[5] Reichman's counsel responded in a November 14, 2006 letter in which counsel represented that neither she nor Reichman was available to appear on December 11. Enforcement responded with a November 17, 2006 letter in which Enforcement requested a written statement from Reichman and rescheduled her on-the-record testimony for January 8, 2007.

[6] At the time, NASD and NYSE Regulation had not yet merged. Reichman's December 4, 2006 letter, therefore, argues that NYSE Regulation lacked jurisdiction. In later correspondence with Enforcement, Reichman similarly disputed NASD's and FINRA's jurisdiction over her.

[7] In correspondence, Enforcement advised Reichman that, in addition to other matters that it previously had indicated it was investigating, it also was investigating whether she or other MLPFS employees had violated NASD Rule 3070 (Reporting Requirements).

IV. Discussion

A. Reichman Was an Associated Person of MLPFS and FINRA Properly Exercised Jurisdiction Over Her

During the relevant period, NASD Rule 8210 required, in pertinent part, members, persons associated with members, and persons subject to FINRA's jurisdiction to provide information orally, in writing, or electronically and to testify under oath with respect to any matter involved in a FINRA investigation, complaint, examination, or proceeding. NASD Rule 0120 stated that, unless otherwise defined in the rules, terms used in NASD's rules and interpretive materials, if defined by NASD's By-Laws, shall have the meaning provided in the By-Laws.

At the relevant time, Article I of the By-Laws defined "person associated with a member," in relevant part, as:

> a sole proprietor, partner, officer, director, or branch manager of a member, or other natural person occupying a similar status or performing similar functions, *or 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* with the NASD under these By-Laws or the Rules of the Association . . . . (Emphasis added.)

Rule 8120 stated that the terms used in the Rule 8000 Series shall have the meanings provided in Rule 0120 unless otherwise stated. The Rule 8000 Series did not provide an alternate definition of the term associated person. Thus, the applicable definition of the term "associated person" or "person associated with a member," as used in Rule 8210, is the definition contained in the By-Laws. Furthermore, Article 5, Section 4(a) of the By-Laws stated that a person whose association with a member had been terminated shall continue to be required to respond to Rule 8210 requests for information for two years after the effective date of termination.

Reichman does not dispute that she was employed by MLPFS, a member firm, from October 10, 2005, through September 18, 2006, and therefore controlled by MLPFS. Reichman argues, however, that her job duties and responsibilities did not make her an associated person and that the phrase "engaged in the investment banking or securities business" should be narrowly construed. She argues that we must find that she was actively involved in the sales of securities at MLPFS in order to conclude that she was an associated person. We disagree.[8]

[8] Before the Hearing Panel, Reichman produced evidence of the many job responsibilities that she did *not* possess at MLPFS. Reichman demonstrated that she did not purchase or sell securities, interact with customers, process trades, handle funds or securities, or receive transaction-based compensation. While these assertions may be accurate, they are not necessarily dispositive as to whether Reichman was an associated person. Customer contact, handling securities and customer funds, and the receipt of transaction-based compensation are not mandatory elements for determining associated person status. *See Joseph Patrick Hannan*, 53 S.E.C. 854, 855 (1998) (finding that an unregistered person who received an hourly wage, answered telephones, photocopied, prepared sales reports and received and opened packages was

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"[T]he Supreme Court repeatedly has held that provisions governing the securities industry should be construed, not strictly and technically, but flexibly to achieve their remedial purpose." *Reed A. Hatkoff*, 51 S.E.C. 769, 773 (1993). Construing Rule 8210 flexibly, as the Supreme Court has directed, the Commission has held that "[f]airly interpreted, Article IV, Section 5 [now Rule 8210] was directed to every professional in any way subject to [FINRA's] jurisdiction." *Hatkoff*, 51 S.E.C. at 772. Our focus in this appeal is on the actions that Reichman took as part of her two jobs at MLPFS and whether those actions were part of MLPFS's investment banking and securities business.

We have considered Reichman's specific duties and responsibilities in each of her positions at MLPFS and conclude that Reichman was engaged in MLPFS's investment banking or securities business. As the regulatory initiatives coordinator in RIG/GPC, Reichman served an important function in MLPFS's process for completing CEO certification under Rule 3013. She worked closely with compliance officers for various business units and provided overall quality control for MLPFS Rule 3013 certification, which was an integral part of MLPFS's securities business.[9] Reichman identified for MLPFS areas in which the firm had insufficient policies or procedures to ensure compliance with Rule 3013 and other FINRA rules and worked on resolving such issues. She also served as point person for answering questions from compliance officers, and she provided overall guidance on FINRA's rules to registered and unregistered personnel.

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an associated person); *Vladislav Steven Zubkis*, 53 S.E.C. 794, 799-800 (1998) (finding that individual who acted as chief executive officer of an issuer whose stock the firm sold, paid some firm expenses, sometimes "took care of" firm registered representatives, and possessed some firm documents was an associated person); *cf. DBCC for Dist. No. 3 v. Paramount Invs. Int'l*, Complaint No. C3A940048, 1995 NASD Discip. LEXIS 248, at *11-13 (NASD NBCC Oct. 20, 1995) (finding that individual acted as an associated person in case in which individual did not interact with customers). We agree that Reichman had no interaction with customers and did not handle funds or securities. These actions, however, are a small part of the universe of conduct that may qualify an individual as an associated person of a member firm. Even without the presence of such actions, an individual's purposeful interaction with a member firm's retail securities business could qualify the person as an associated person.

[9] Compliance with Rule 3013 is imperative to a member firm's securities business. FINRA publicized the importance of member firms' supervisory systems to investor protection and the integrity of the financial markets in Notice to Members 04-71. *See NASD Notice to Members 04-71* (Oct. 2004) (explaining Rules 3012 and 3013 and IM-3013). FINRA explained that operational and sales practice abuses can stem from ineffective supervisory controls and that NASD Rules 3010, 3012 and 3013, taken together, provide an important and overarching regulatory scheme for the supervision of member firms. Specifically, FINRA acknowledged that the "establishment of the supervisory system required to be adopted in Rule 3010 should result from the processes that are the subject of the certification of Rule 3013." *Id.*

Reichman's other job duties in RIG/GPC also qualified her as an associated person. Reichman reviewed new and revised FINRA rules and federal regulations weekly to determine if revisions to MLPFS's policies and procedures were necessary to accommodate the rule changes. She developed the firm's procedures for representatives who sought to work from a location other than the firm's offices, and she interfaced with an examiner during an examination of one of MLPFS's offices.

Reichman's work for the GMI group is equally compelling evidence of her status as an associated person. She assisted Lau, her supervisor, in completing a branch examination of a middle markets office. Although she accompanied Lau on the examination, he was training her eventually to complete similar examinations on her own, and he testified that she interacted significantly with registered and unregistered staff in the office. Reichman also participated in some manner in a mandatory compliance session for Series 7 registered employees of MLPFS. The evidence is unclear as to whether she made a presentation at the session, but Lau testified that he planned one day to allow her to conduct the sessions on her own. Reichman was identified as a presenter on the materials for the session, and Lau testified unequivocally that his department (which consisted only of Lau and Reichman) advised the institutional sales force on rule compliance and conducted continuing education and compliance meetings.

In all aspects of her job, Reichman supported the securities business of MLPFS and her work was part of the core function of MLPFS. Although she did not sell securities to the public, she provided support for the firm's supervision of securities sales and, by extension, its securities business. Reichman's job responsibilities included ensuring that MLPFS's registered representatives and compliance officers complied with securities laws and FINRA rules, enabling compliance officers to meet their obligations under Rule 3013, and providing other types of support to registered personnel. We deem these activities to be essential parts of MLPFS's securities business. MLPFS would not have been able to function as a registered broker-dealer and member firm without the compliance support that Reichman and others like her provided. Reichman's purposeful interaction with firm employees who bought and sold securities and interacted with firm customers made her one of many integral parts of MLPFS's broad securities business. Based on her conduct, we find that she participated in the firm's investment banking or securities business and was an associated person of MLPFS.

B. We Reject Reichman's Argument That the Rule 1010 Series Applies in this Case

Reichman argues that FINRA's By-Law definition of associated person must be read in conjunction with a definition established in and applicable to NASD's Membership Rules ("the Rule 1010 Series"). She argues that, when the definitions of associated person contained in the By-Laws and the Rule 1010 Series are read together, Reichman does not meet the definition of associated person. We disagree on both points. The Rule 1010 Series does not apply in this case and, even if it did apply, Reichman would qualify under the Rule 1010 Series as an associated person.

During the period at issue, the Rule 1010 Series established NASD's membership requirements. Rule 1011 provides a definition of associated person specifically for the Rule 1010 Series that differs in wording from the definition contained in the By-Laws. Rule 1011(b) defines associated person as:

> (1) a natural person registered under NASD Rules; or (2) a sole proprietor, or any partner, officer, director, branch manager of the Applicant [entity that applies for membership], or any person occupying a similar status or performing similar functions; (3) any company, government or political subdivision or agency or instrumentality of a government controlled by or controlling the Applicant; *(4) any employee of the Applicant, except any person whose functions are solely clerical or ministerial;* (5) any person directly or indirectly controlling the Applicant whether or not such person is registered or exempt from registration under NASD By-Laws or NASD Rules; *(6) any person engaged in investment banking or securities business controlled directly or indirectly by the Applicant whether such person is registered or exempt from registration under NASD By-Laws or NASD Rules;* or (7) any person who will be or is anticipated to be a person described in (1) through (6) above. (Emphasis added.)

The requirements for registration as a representative are included in the NASD Rule 1030 Series. Rule 1031 establishes registration requirements for associated persons who function in capacities requiring registration. The rule states:

> (a) All Representatives Must Be Registered
> *All persons engaged or to be engaged in the investment banking or securities business of a member firm who are to function as representatives shall be registered as such* with NASD in the category of registration appropriate to the function to be performed as specified in Rule 1032 . . . . A member may, however, maintain or make application for the registration as a representative of a person who performs legal, compliance, internal audit, back-office operations, or similar responsibilities for the member, or a person who performs administrative support functions for registered personnel, or a person engaged in the investment banking or securities business of a foreign securities affiliate or subsidiary of the member.
>
> (b) Definition of Representative
> *Persons associated with a member,* including assistant officers other than principals, *who are engaged in the investment banking or securities business for the member* including the functions of supervision, solicitation or conduct of business in securities or who are engaged in the training of persons associated with a member for any of these functions are designated as representatives. (Emphasis added.)

Rule 1060(a) exempts from registration the following individuals: (1) associated persons whose functions are ministerial; (2) associated persons who are not actively engaged in the investment banking or securities business; (3) associated persons whose functions are related exclusively to the member's need for nominal corporate officers or capital participation; and (4) associated persons whose functions are related exclusively to effecting transactions on exchange floors, commodities, municipal securities, and securities futures.

Reichman advances a number of arguments to support her conclusion that she does not qualify as an associated person subject to FINRA's jurisdiction. Reichman argues that, because Enforcement did not allege in the complaint that she should have

been registered, FINRA has conceded that Reichman did not need to be registered to perform her job. Additionally, Reichman argues, Enforcement conceded that she does not fall into any of the categories of individuals exempt from registration. (Enforcement states in its prehearing submission that Reichman's duties at MLPFS were not clerical in nature.) Reichman contends that, if a person is engaged in the investment banking or securities business of a member and is not subject to a Rule 1060 registration exemption, under Rule 1031, the person must be registered. Reichman argues that, because there was no requirement for her to be registered to perform her duties, Enforcement cannot argue that she was engaged in the investment banking or securities business, and therefore Enforcement's basis for arguing that Reichman was an associated person (that she was engaged in MLPFS's investment banking or securities business) also must fail.

We reject Reichman's arguments and ultimate conclusion for several reasons. First, the definitions established in the Rule 1010 Series apply only to that series of rules, which are the rules related to membership. There are no membership issues in this case. Reichman was not alleged to have violated a rule in the Rule 1010 Series, and Enforcement never suggested that Reichman's job duties required registration under the Rule 1030 Series. The complaint alleges that Reichman violated NASD Rules 8210 and 2110, and Rules 0120 and 8120 clearly establish that the definitions applicable to Rules 8210 and 2110 are the definitions contained in the By-Laws.

Second, we do not concur that, because Enforcement did not allege that Reichman should have been registered, FINRA is precluded from finding that she engaged in MLPFS's investment banking or securities business. Reichman makes this leap and then backs into the argument that, because the Rule 1030 Series defines a representative as a person engaged in the investment banking or securities business of a member, and FINRA is not asserting that she needed to be registered, she must not be engaged in the investment banking or securities business. We find this reasoning circular and unpersuasive. The Rule 1010 Series provides a wholly separate definition of the term associated person and those rules apply to membership determinations. Furthermore, even relying on the definitions contained in the Rule 1010 Series, as Reichman seeks to do, Reichman still would qualify as an associated person. Rule 1011(b)(4) defines the term associated person to include all employees of a broker-dealer who are not functioning in solely clerical or ministerial capacities. As Reichman's counsel contends on appeal, she did not function in a ministerial or clerical capacity, and she absolutely was an employee of MLPFS. Thus, even under a strict reading of the Rule 1010 Series, Reichman is an associated person.

Finally, we note an additional shortcoming in Reichman's argument that we should rely on the definitions contained in the Rule 1010 Series. Reichman extrapolates from the registration requirements contained in Rule 1031 that all associated persons fall into three categories: (1) registered individuals; (2) individuals exempt from registration under Rule 1060; and (3) individuals who are not registered but who, under FINRA's Rule 1030 Series, are required to be registered. Reichman relies on Rule 1031(a)'s connection between "registration" and "persons engaged in the investment banking or securities business of a member."

Reichman fails, however, to consider the rule in its entirety. As set out above, Rule 1031(a) states that all persons who engage in the investment banking or securities business of a member *and who are to function as a representative* shall be registered. Reichman fails to account for the "who are to function as a representative" modifier, and it is this modifier which allows for the existence under FINRA's Rules of unregistered (and non-exempt) associated persons who do not intend to function as representatives. Reichman's argument overlooks an entire category of associated persons – those who are not registered and, based on their job duties, are not required to be registered, but who are nonetheless associated persons because they engage in the investing banking or securities business of a member. Reichman falls into this category of associated person.

We reject Reichman's efforts to rely on the Rule 1010 Series to find that FINRA lacked jurisdiction over her.

C. Reichman Violated NASD Rules 8210 and 2110 by Failing to Appear for On-the-Record Testimony and Respond to Requests for Information

Reichman does not dispute that she received and failed to comply with two Rule 8210 requests for written statements and on-the-record testimony.

Rule 8210 requires associated persons and persons subject to FINRA's jurisdiction to provide information and testify under oath on matters related to FINRA investigations. We find that Reichman was an associated person of member firm MLPFS from October 10, 2005, through September 18, 2006. During the relevant period, Article 5, Section 4(a) of FINRA's By-Laws stated that a person whose association with a member had been terminated shall continue to be required to respond to Rule 8210 requests for information for two years after the effective date of termination. Reichman therefore was within FINRA's jurisdiction when she received and failed to comply with two FINRA Rule 8210 requests dated September 25, 2007, and July 31, 2008. We therefore find that she violated Rule 8210.

We also find that Reichman violated NASD Rule 2110 (now FINRA Rule 2010). Rule 2110 required members and associated persons to observe high standards of commercial honor and just and equitable principles of trade. It is well established that a violation of Rule 8210 is a violation also of Rule 2110. *See CMG Inst. Trading, LLC*, Exchange Act Rel. No. 59325, 2009 SEC LEXIS 215, at *30 (Jan. 30, 2009); *Stephen J. Gluckman*, 54 S.E.C. 175, 185 (1999). We affirm the Hearing Panel's findings of violation.

D. FINRA Afforded Reichman a Fair Process

In determining the fairness of FINRA's disciplinary proceedings, the Commission looks to whether the proceedings were conducted in accordance with FINRA's rules and whether FINRA implemented its procedures fairly. *Robert J. Prager*, Exchange Act Rel. No. 51974, 2005 SEC LEXIS 1558, at *48-49 (July 6, 2005). On appeal, Reichman contends that FINRA failed to provide a fair process based on three arguments: (1) the Hearing Officer denied Reichman adequate opportunity for discovery of FINRA's investigative materials; (2) the Hearing Officer unfairly curtailed Reichman's arguments regarding Enforcement's delay in commencing this action; and (3) FINRA failed to provide Reichman with an adequate means of challenging FINRA's jurisdiction over her. We address each argument in turn.

1. The Hearing Officer Did Not Unfairly Deny Reichman Discovery of Documents in Enforcement's Investigative Files

During the relevant period, Rule 9251 required Enforcement to make available for inspection and copying by respondent documents prepared or obtained by Enforcement in connection with the investigation that led to the complaint. During the Rule 9251 discovery process in this case, Enforcement filed a motion to withhold from production otherwise discoverable documents in its investigative files. In particular, Enforcement sought leave to withhold documents related to any topics other than Reichman's job title, duties, and responsibilities at MLPFS and her failure to respond to Rule 8210 requests for information. Enforcement alleged that the production of other documents in its investigative files could compromise its larger investigation of MLPFS and other MLPFS employees and would be irrelevant to the only issues to be resolved in this case – whether FINRA has jurisdiction over Reichman and whether she responded to Rule 8210 requests. Reichman opposed the motion. She argued that the documents may be relevant to the issue of whether Reichman's refusal to respond delayed or otherwise adversely affected Enforcement's investigation.

The Hearing Officer conducted an in camera review of the documents that Enforcement proposed to withhold. The Hearing Officer ruled that: (1) Enforcement may withhold documents related to Reichman's employment with the parent company, ML & Co., if the documents are not exculpatory; (2) Enforcement may withhold documents related to Reichman's employment with MLPFS if the documents relate to FINRA's broader investigation of MLPFS or other MLPFS employees and the documents are not exculpatory; (3) Enforcement must conduct a search of its investigative files to locate all exculpatory documents and provide the Hearing Officer with an affidavit indicating that it has done so; and (4) Enforcement must produce to Reichman all exculpatory documents contained in its investigative file, regardless of whether the documents fall into one of the two categories of documents that may be withheld.

We considered a similar argument in *Dep't of Enforcement v. Sturm*, Complaint No. CAF000033, 2002 NASD Discip. LEXIS 2 (NASD NAC Mar. 21, 2002). Like this case, *Sturm* involved a violation of Rule 8210. Sturm argued that he was entitled to discovery of all documents relating to NASD's investigation of his activities. We disagreed and interpreted Rule 9251's requirement that Enforcement produce documents prepared or obtained "in connection with the investigation that led to the institution of proceedings" as including only documents related to FINRA's Rule 8210 requests. We held that documents related to Enforcement's underlying investigation were not within the scope of documents that Rule 9251 required Enforcement to produce.

We find similarly here. This proceeding centers on whether FINRA properly exercised jurisdiction over Reichman and whether Reichman complied with Rule 8210 requests for information. Documents that Enforcement prepared or obtained in connection with its larger investigation of other misconduct by MLPFS or other MLPFS employees did not necessarily lead to the institution of these proceedings and, in any event, are not relevant to the matters at issue in this case.

Reichman argues that Enforcement's withholding of these documents left her unable to address the question of whether her failure to cooperate with Enforcement hindered

Enforcement's investigation and that she therefore was prejudiced by her inability to access these documents. The Hearing Officer ordered Enforcement to produce all exculpatory documents and a list of the documents withheld. Reichman has failed to establish what documents in Enforcement's possession were necessary to her defense and how the denial of such documents prejudiced her case. *Cf. Kirlin Sec., Inc.*, Exchange Act Rel. No. 61135, 2009 SEC LEXIS 4168, at *82 (Dec. 10, 2009) (rejecting argument that proceedings were procedurally flawed because applicants failed to establish what information Enforcement withheld and how the withholding prejudiced their case). Furthermore, Reichman could have cross-examined FINRA examiner Robert Butani ("Butani") when he testified on the issue of whether Reichman's refusal to testify hindered FINRA's investigation.[10] Finally, rather than focus on the potentially adverse effect of Reichman's refusal to comply with Rule 8210 requests for information, we considered with respect to sanctions the nature of the information that Enforcement requested, as instructed by FINRA's Sanction Guidelines. For this, we relied on the content of the information requests and the subject matter of Enforcement's investigation as identified in the requests. We did not rely on Butani's testimony.

We do not find that Reichman was prejudiced by the Hearing Officer's discovery rulings.

2. Reichman Was Not Prejudiced by The Hearing Officer's Actions in Curtailing Her Argument Regarding Enforcement's Delay in Filing the Complaint

Reichman argues that the Hearing Officer unfairly curtailed her argument on the issue of Enforcement's delay in filing the complaint. She contends that the Hearing Officer limited her argument, yet the Hearing Panel nonetheless found that her failure to cooperate occurred over an extended period of time. She claims that Enforcement's delay in filing the complaint should not be blamed on her and that her failure to respond would not have occurred "over an extended period," as the Hearing Panel found, if Enforcement had been more timely in filing the complaint.

At the outset, we note that, as discussed in more detail with respect to sanctions, we have not considered aggravating that Reichman failed to testify and provide information over an extended period of time. The issue of whether or not Enforcement could have filed its complaint sooner is not relevant. Enforcement's correspondence with Reichman and her responses are part of the record, and we can see the time that elapsed between each series of letters and when Enforcement filed the complaint. The timing of events is clear from the record, and the issue need not be considered further. We do not find that Reichman was prejudiced by the Hearing Officer's limiting her argument that Enforcement failed to timely file the complaint. *Cf. Mark H. Love*, Exchange Act Rel. No. 49248, 2004 SEC LEXIS 318, at *16 (Feb. 13, 2004) (holding that Enforcement's delay in filing the complaint did not affect the overall fairness of the proceeding or respondent's ability to mount a defense).

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[10] Butani testified that, as Enforcement's investigation developed, the information that Enforcement sought from Reichman evolved. He also testified that, after Reichman's first refusal to testify, Enforcement's interest in her testimony increased because more employees from MLPFS's OGC abruptly resigned. Although Butani could not testify as to what information Reichman did or did not possess, he indicated that her refusal to provide any information at all delayed Enforcement's investigation.

We find no prejudice in the Hearing Officer's limiting Reichman's argument regarding the date when Enforcement filed its complaint.

3. FINRA Provided Reichman with Adequate Opportunity to Challenge Jurisdiction

Reichman claims that she was denied a fair process because FINRA provided an inadequate means for her to challenge FINRA's jurisdiction over her. We reject Reichman's argument and find that FINRA provided Reichman with sufficient opportunity to raise and argue jurisdiction.

After Reichman filed an answer to the complaint (in which she challenged jurisdiction) and Enforcement provided Reichman with discovery, the Hearing Panel considered Reichman's motion to dismiss for lack of jurisdiction. Reichman also requested and was granted an order enabling her to appear and testify at the Hearing Panel hearing (although she ultimately chose not to testify) without waiving her jurisdiction argument.[11] The Hearing Officer refused Enforcement's request that Reichman be compelled to testify at the hearing and ordered that, if Reichman chose to testify in her own defense, Enforcement's cross examination would be limited to questions relevant to the issue of jurisdiction.

Reichman was not denied a fair process simply because she lost on the jurisdiction argument. FINRA provided Reichman with an adequate opportunity to raise and argue lack of jurisdiction. *See Howard Brett Berger*, Exchange Act Rel. No. 55706, 2007 SEC LEXIS 895, at *31 (May 4, 2007) (holding that "subjecting oneself to NASD's disciplinary process and relying on NASD's procedures is the appropriate route to challenge NASD jurisdiction" and is "in accordance with the 'fair procedure[s]' contemplated by [the Exchange Act]"), *remanded on other grounds*, No. 07-2692 (2d Cir. Sept. 13, 2007) (remand order); *Dep't of Enforcement v. Gurfel*, Complaint No. C9B950010, 1998 NASD Discip. LEXIS 52, at *19 (NASD NAC June 12, 1998) ("The better practice is to raise the jurisdictional or procedural argument at the outset and defend on the merits, subject to a reservation of the right to contest the jurisdictional or procedural issue on appeal should the argument be rejected by the DBCC."), *aff'd*, 54 S.E.C. 56 (1999), *aff'd*, 205 F.3d 400 (D.C. Cir. 2000).

FINRA provided Reichman with adequate opportunity to challenge jurisdiction.

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[11] Reichman refused to testify at the Hearing Panel hearing, although she appeared and was represented by counsel. The Hearing Panel, at Enforcement's encouragement, drew an adverse inference from Reichman's refusal to testify. Although we acknowledge that an adjudicator in a FINRA proceeding may draw an adverse inference from a respondent's refusal to testify, *see DBCC v. Douglas John Mangan*, Complaint No. C10960162, 1998 NASD Discip. LEXIS 33, at *11-12 (NASD NAC July 29, 1998), we find no need to draw such an inference here because we find that the evidence, standing alone, fully demonstrates that Reichman was an associated person of MLPFS.

V. Sanctions

The Hearing Panel barred Reichman in all capacities and assessed hearing costs of $4,878.66. We affirm these sanctions.

We first turn to FINRA's Sanction Guidelines ("Guidelines").[12] *See Howard Brett Berger*, Exchange Act Rel. No. 58950, 2008 SEC LEXIS 3141, at *16 (Nov. 14, 2008) (endorsing FINRA's reliance on the Guidelines), *petition for rev. denied*, 347 F. App'x 692 (2d Cir. 2009), *cert. denied*, 2010 U.S. LEXIS 3557 (U.S. Apr. 26, 2010). The Guidelines for failing to respond to Rule 8210 requests for information and testimony state that, when an individual has failed to provide any of the requested information, a bar in all capacities is the standard sanction.[13]

Reichman argues that the Hearing Panel erred in failing to treat her good faith jurisdiction argument as a mitigating factor. There is no basis for treating Reichman's argument that FINRA lacked jurisdiction as mitigating. The requirement to comply with Rule 8210 is not reduced or abandoned because of the grounds on which an associated person refuses to comply, even if the refusal is in good faith. *See Charles C. Fawcett IV*, Exchange Act Rel. No. 56770, 2007 SEC LEXIS 2598, at *18-19 (Nov. 8, 2007) (holding that there is no distinction between those who refuse to comply with Rule 8210 on substantive grounds and those who refuse to comply on other grounds); *Rooney A. Sahai*, Exchange Act Rel. No. 55046, 2007 SEC LEXIS 13, at *10 (Jan. 5, 2007) (holding that recipients of NASD requests for information may not set conditions on their compliance). Furthermore, FINRA's two Rule 8210 requests both countered Reichman's jurisdiction argument and warned Reichman that her failure to respond could result in formal disciplinary action and possibly a bar from the securities industry. Reichman was aware of the potential repercussions from a failure to respond and chose nonetheless not to cooperate. She offers no compelling support for treating her jurisdictional argument as a mitigating factor. Furthermore, the Commission has rejected similar arguments. *See Berger*, 2008 SEC LEXIS 3141, at *20 (rejecting argument in failure to respond case that an "objectively reasonable" jurisdiction argument should preclude imposition of or mitigate sanctions).

Reichman argues that the Hearing Panel erred by finding that aggravating factors exist. Specifically, she argues that the Hearing Panel was wrong to find that her violation was intentional, that her refusal to respond adversely affected Enforcement's investigation, and that Reichman refused to respond to numerous requests over an extended period of time.

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[12] *FINRA Sanction Guidelines*, at 6-7 (Principal Considerations in Determining Sanctions) and 33 (Failure to Respond to Requests Made Pursuant to FINRA Rule 8210), http://www.finra.org/web/groups/industry/@ip/@enf/@sg/documents/industry/p011038.pdf [hereinafter *Guidelines*].

[13] The Guidelines indicate that, if mitigation exists, the adjudicator may consider a suspension in any or all capacities for up to two years. *Guidelines* at 33. The Guidelines also recommend consideration of a fine of $25,000 to $50,000. *Id.*

We first address the Hearing Panel's finding that it was aggravating that Reichman refused to comply with numerous requests for information over an extended period of time.[14] While we agree that Enforcement's attempts to obtain Reichman's cooperation occurred over many months,[15] we do not concur with the Hearing Panel that this should be considered as an aggravating factor. Enforcement could have filed a complaint against Reichman after her first refusal. By failing to treat as aggravating the length of time that elapsed before the complaint was filed, we are not second-guessing Enforcement's choices as to when to file the complaint. We do not find, however, that the length of time necessarily is an aggravating factor here. Fairly early on in Reichman's dealings with Enforcement, she indicated that she disputed FINRA's exercise of jurisdiction over her, and her position, although faulty, has remained consistent throughout Enforcement's efforts to obtain information from her. We have not held the number of requests or length of time before Enforcement filed the complaint to be aggravating.

We do find, however, that Reichman's failure to comply with Rule 8210 requests was intentional.[16] There is no question that Reichman received all of Enforcement's requests and chose nonetheless to refuse to testify or provide a written responsive statement. In ongoing correspondence, Enforcement provided Reichman with an explanation of its basis for claiming jurisdiction over her and warned her in several instances that her refusal to cooperate could result in disciplinary action and a possible bar from the securities industry. Reichman should have been aware of what was at stake if she continued to refuse to comply with information requests. Her choice not to comply was intentional.

We next address the Hearing Panel's finding that Reichman's failure to comply adversely affected Enforcement's investigation. Rather than assess whether Reichman's failure to comply adversely affected Enforcement's ongoing investigation, we instead focus on the principal considerations listed in the Guidelines. The Guidelines for failing to comply with Rule 8210 requests for information and testimony list as principal considerations the nature of the information requested and whether any of the information requested has been provided.[17] It is undisputed that Reichman has not provided any information responsive to Enforcement's requests. As to the nature of the information requested, the Hearing Panel found that Reichman,

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[14] *Guidelines*, at 6-7 (Principal Considerations in Determining Sanctions, Nos. 8, 9).

[15] Enforcement's initial request that Reichman appear at an on-the-record interview occurred in November 2006. Her last failure to appear occurred with respect to an interview scheduled for August 2008.

[16] *Guidelines*, at 6-7 (Principal Considerations in Determining Sanctions, No. 13).

[17] Effective February 2011, FINRA revised the Guidelines. *See FINRA Notice to Members 11-07*, 2011 FINRA LEXIS 5 (Feb. 2011). As part of these revisions, FINRA revised and expanded the principal considerations particular to the Guidelines for failing to respond to Rule 8210 requests. Because the parties and the Hearing Panel relied on FINRA's pre-February 2011 version of the Guidelines when arguing and deciding this case, we too are relying on the older version, which listed as principal considerations "the nature of the information requested" and "whether the requested information has been provided."

by failing to cooperate, adversely impacted Enforcement's investigation of her conduct and the conduct of others under investigation. Reichman argues that it was unfair for the Hearing Panel to rely on FINRA examiner Butani's testimony regarding the effect on Enforcement's investigation because the Hearing Officer curtailed Reichman's ability to obtain documents related to the overall investigation. Rather than rely on Butani's testimony, we have reviewed the written requests that Enforcement sent to Reichman, each of which explained to Reichman the specific nature of the information that Enforcement sought and the subject matter of Enforcement's investigation.[18] Based on Enforcement's letters, we find that the information requests to which Reichman refused to respond involved potentially significant rule violations and that Reichman, by virtue of her positions at MLPFS, was in a position to respond but did not.[19]

Finally, we address Reichman's argument that the Hearing Panel's imposition of a bar is punitive and unsupported by the record. We do not agree. "A failure to comply with Rule 8210 is a serious violation because it subverts [FINRA's] ability to execute its regulatory responsibilities." *Joseph Ricupero*, Exchange Act Rel. No. 62891, 2010 SEC LEXIS 2988, at *21 (Sept. 10, 2010), *petition for rev.*, No. 10-4566 (2d Cir. Filed Nov. 15, 2010). As the Commission stated in *PAZ Sec., Inc.*, Exchange Act Rel. No. 57656, 2008 SEC LEXIS 820, at *10 (Apr. 11, 2008), *aff'd*, 566 F.3d 1172 (D.C. Cir. 2009), "[a] complete failure to respond to a request for information issued pursuant to Rule 8210 renders the violator presumptively unfit for employment in the securities industry because the self-regulatory system of securities regulation cannot function without compliance with Rule 8210 requests." FINRA lacks subpoena power. Rule 8210 therefore is pivotal to FINRA's fulfilling its self-regulatory function of protecting investors and the markets by investigating potential rule violations. Given these facts, the Commission has stated that "[t]he imposition of a bar as the standard sanction for a complete failure to respond . . . 'reflects the judgment that, in the absence of mitigating factors, a complete failure to cooperate with NASD requests for information or testimony is so fundamentally incompatible with NASD's self-regulatory function that the risk to the markets and investors posed by such misconduct is properly remedied by a bar.'" *PAZ Sec.*, 2008 SEC LEXIS 820, at *9 (citing *Fawcett*, 2007 SEC LEXIS 2598, at *23-24).

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[18] Enforcement's requests for information indicated that the following matters were under investigation: the possibility that Reichman made misstatements and instructed other firm employees to make misstatements in connection with an NYSE Regulation investigation of the firm, potential MLPFS violations of NYSE Rules 351(b) (Reporting Requirements) and 476(a) (Disciplinary Proceedings Against Members) and NASD Rule 3070 (Reporting Requirements), Reichman's possible involvement in those rule violations, and whether Reichman or others failed to report to regulators rule violations and violations of federal securities laws.

[19] Because Reichman refused to cooperate in any manner and provided no information responsive to Enforcement's requests, we cannot know with any certainty how much or how little Reichman's refusal to respond hindered Enforcement's investigation. We can, however, glean from the information requests the nature of Enforcement's investigation and, based on the evidence of Reichman's job responsibilities and duties, determine if she possibly may have possessed information responsive to those requests.

Reichman refused to comply in any manner with FINRA requests for information. We find no mitigating factors present here. The Guidelines advise us that, in the absence of mitigating factors, a bar is the standard sanction for failures to comply in any manner, and the Commission has endorsed this principle. *See Ricupero*, 2010 SEC LEXIS 2988, at *25 (upholding bar and finding that, in the absence of mitigating factors a bar is warranted by a failure to respond in any manner); *Berger*, 2008 SEC LEXIS 3141, at *19 (finding that FINRA's standard sanction, in the absence of mitigation, of a bar for the failure to respond "protects investors not only by removing from the securities industry an individual or firm that has already shown a refusal to be investigated" but also by deterring others who know that their best chance of avoiding a bar is by cooperating with FINRA's investigation). We affirm the Hearing Panel's imposition of a bar in all capacities. We also affirm the Hearing Panel's assessment of costs[20] and impose appeal costs of $1,605.50.

VI. Conclusion

We affirm the Hearing Panel's findings that Reichman violated NASD Rules 8210 and 2110 by refusing to respond to FINRA requests for information and testimony. For these violations, we bar Reichman from associating with any member firm in any capacity. We also affirm the Hearing Panel's assessment of costs of $4,876.66, and we impose appeal costs of $1,605.50. The bar is effective upon service of this decision.[21]

On Behalf of the National Adjudicatory Council,

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Marcia E. Asquith, Senior Vice President
and Corporate Secretary

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[20] Reichman objects to the Hearing Panel's imposition of costs as punitive. We reject Reichman's claim. FINRA Rule 8330 provides for the imposition of fair and appropriate costs in connection with disciplinary proceedings. *See John M. W. Crute*, 53 S.E.C. 870, 879 (1998) (finding assessment of costs in a disciplinary proceeding fair and appropriate), *request for reconsideration denied*, 53 S.E.C. 1112 (1998).

[21] We also have considered and reject without discussion all other arguments advanced by respondent.