SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Release No. 101991 / December 19, 2024

Admin. Proc. File No. 3-20647

In the Matter of the Application of

PAUL ERIC FLESCHE

For Review of Disciplinary Action Taken by

FINRA

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION — REVIEW OF DISCIPLINARY PROCEEDING

Associated person of FINRA member firm appeals from FINRA disciplinary action finding that he failed to reasonably supervise one of the firm's registered representatives. *Held*, the proceeding is *remanded* to FINRA.

APPEARANCES:

Arash Shirdel of Pacific Premier Law Group and *Jonathan Uretsky* of Phillipson & Uretsky, LLP, for Paul Eric Flesche

Alan Lawhead, *Andrew Love*, and *Celia L. Passaro* for FINRA

Appeal filed: November 2, 2021
Last brief received: April 19, 2022

Paul Eric Flesche, a registered representative and principle of Glendale Securities, Inc. ("Glendale"), a FINRA member firm, seeks review of FINRA disciplinary action finding that he failed to reasonably supervise another registered representative of the firm in violation of FINRA Rules 3110 and 2010. FINRA suspended Flesche in all capacities for 30 days and fined him $30,000, jointly and severally with Glendale. Because the record before us lacks information necessary to determine the fairness of FINRA's proceeding, we remand to FINRA for further proceedings.

I. Background

Glendale is a broker-dealer located in Sherman Oaks, California, and has been a FINRA member since 2003. Its primary business is the deposit and liquidation of microcap securities for its customers.[1] Flesche served as Glendale's chief financial officer, financial and operations principal, and chief compliance officer. In October 2017, FINRA filed a six-count complaint against Glendale, Flesche, and four other Glendale principals and representatives. As relevant here, FINRA's complaint alleged that Flesche participated in the unlawful distribution of restricted securities, violated anti-money laundering ("AML") rules, and violated FINRA supervisory rules, including failing to properly supervise one of the firm's registered representatives.

A FINRA extended hearing panel issued a decision on April 5, 2019. As to Flesche, the hearing panel dismissed the unlawful distribution claims as unproved, found Flesche not liable for the AML rules violations, and found him liable for some, but not all, of the alleged supervisory violations. For these violations, the hearing panel imposed a $30,000 fine against Flesche, jointly and severally with Glendale, and a 30-business day suspension. The hearing officer dissented in part from the hearing panel's decision, stating that he would have found that the unlawful distribution allegations had been proved.

On April 15, 2019—ten days after the hearing panel issued its decision—FINRA's Chief Hearing Officer, who was not part of the panel that heard the case, held a conference call with the parties to inform them that the case would be stayed while an independent review of potential conflicts and bias was conducted. In doing so, the Chief Hearing Officer explained:

> FINRA has, and the Office of Hearing Officers has as well, policies and procedures that relate to conflicts and bias and matters of that sort to ensure that there is a fair process. Information has recently come to my attention that needs to be reviewed in connection with this case. So FINRA has engaged outside counsel, and outside counsel is going to conduct a review of the information that I've just recently learned. In light of that, I am going to stay the case until the completion of the review . . . . So there will be a review that's going to be conducted by outside counsel, and as soon as that is completed the parties will be informed. But that's really all I am able to say at this early juncture.

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[1] The term "microcap securities" applies to companies with low or micro capitalizations; the total value of the company's stock would typically be less than $250 or $300 million. *See* https://www.investor.gov/introduction-investing/investing-basics/glossary/microcap-stock.

Flesche's counsel raised a question about "the possible outcomes of the investigation." The Chief Hearing Officer replied: "I honestly, I don't know. This is out of my hands. I, you know, we received some information and outside counsel is going to look into it. I couldn't tell you what the options are or what the outcome could be." Later that day, the Chief Hearing Officer issued a one-sentence order staying the case "[f]or the reasons stated during the conference."

On May 2, 2019—about two weeks after the stay was entered—the Chief Hearing Officer issued an order stating that review by outside counsel had been completed and that the stay was lifted, but without further explanation. On May 23, 2019, FINRA's Department of Enforcement ("Enforcement") appealed part of the hearing panel's decision on the merits, and on June 17, 2019, a review subcommittee of FINRA's National Adjudicatory Council ("NAC") called for the review of another portion of the hearing panel's decision.[2]

On July 17, 2019, Flesche and another respondent filed a motion to dismiss Enforcement's appeal as untimely on the grounds that the Chief Hearing Officer did not have authority under FINRA rules to "issue a stay, or, to re-set, and unilaterally extend the appeal period." Flesche's motion also noted that respondents were never "advised regarding what alleged bias was being investigated, or the results of the investigation" and were "never provided with a report, outlining the find[ings] of the alleged independent investigation of bias." The motion further asserted that respondents have "a right to know that the proceedings they were involved in . . . were fair and free of bias against them." And the motion requested "all information, and investigation material regarding any bias in this matter." Two other respondents filed motions joining Flesche's motion. Enforcement opposed the motions.

A NAC subcommittee considered the motions to dismiss and denied them on August 28, 2019. In doing so, the subcommittee's responded to Flesche's request for additional information about the investigation by outside counsel by stating only that the information Flesche sought "is not part of the record on appeal before the NAC; nor is it required to be."

The appeal to the NAC proceeded to briefing, in which Flesche challenged the merits of the hearing panel's findings, while also reiterating that he and the other respondents were denied an opportunity to participate in the investigation of bias and were not provided any information about the investigation. He argued that he had not been informed about "what the basis of the allegations of 'bias' were; who made the allegations of 'bias'; or even what the outcome of the 'investigation' was." Flesche thus requested all documents related to the investigation, "including notes, reports, witness statements, charging allegations, and final report."

On October 6, 2021, the NAC affirmed the hearing panel's liability findings and imposition of sanctions as to Flesche. The NAC also agreed with the subcommittee's denial of Flesche's request for information about the alleged conflict and bias because, the NAC stated, that information was not part of the record. The NAC further noted that FINRA's rules do not "require that the contents of a confidential investigation conducted by [the Office of Hearing

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[2] The parties were notified of the call for review by letter dated June 26, 2019.

Officers] into possible conflicts of interest or bias be included in the record, and there is no precedent for doing so."

Flesche appealed the NAC's decision to the Commission, challenging both whether FINRA's proceedings were fair and the underlying merits of FINRA's decision.

II. Analysis

We review a FINRA disciplinary action to determine (1) whether the applicant engaged in the conduct FINRA found, (2) whether that conduct violated the rules specified in FINRA's determination, and (3) whether those rules are, and were applied in a manner, consistent with the purposes of the Securities Exchange Act of 1934.[3] Under the last prong, we note as relevant here that one of the Exchange Act's purposes is for self-regulatory organizations such as FINRA to provide a fair procedure for disciplining persons associated with its members.[4] And we have held that we must reverse self-regulatory organization decisions where the proceedings improperly prejudiced the party or were inherently unfair, regardless of the merits of the underlying substantive and procedural issues involved.[5] To conduct that inquiry, we review the "overall fairness" of a FINRA disciplinary action based on the "entirety of the record."[6] But here, we cannot determine on the record before us whether FINRA's proceeding was fair.

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3 Exchange Act Section 19(e)(1), 15 U.S.C. § 78s(e)(1).

4 *See* Exchange Act Section 15A(b)(8), 15 U.S.C. § 78*o*-3(b)(8) ("An association of brokers and dealers shall not be registered as a national securities association unless the Commission determines that . . . . [t]he rules of the association are in accordance with the provisions of subsection (h) of this section, and, in general, provide a fair procedure for the disciplining of members and persons associated with members."); *id.* § 78*o*-3(h) (requiring registered securities associations in disciplinary proceedings to "bring specific charges, notify such member or person of, and give him an opportunity to defend against, such charges, and keep a record."); *see also Scott Epstein*, Exchange Act Release No. 59328, 2009 WL 223611, at *15 (Jan. 30, 2009) (noting that, although self-regulatory organizations "are not subject to the Constitution's due process requirements . . . the Exchange Act requires NASD to provide 'fair procedure[s]' for its disciplinary actions").

5 *See, e.g.*, *Jeffrey Ainley Hayden*, Exchange Act Release No. 42772, 2000 WL 649146, at *2 (May 11, 2000) (setting aside disciplinary action after finding the proceeding to be "inherently unfair"); *Datek Secs. Corp.*, Exchange Act Release No. 32560, 1993 WL 243632, at *2-3 (June 30, 1993) (reversing self-regulatory organization proceeding because of panel member's conflict of interest, while recognizing "that the NASD considered the conduct at issue in this case to be serious" and that the case involved "important substantive and procedural issues that we have not yet confronted").

6 *Mark H. Love*, Exchange Act Release No. 49248, 2004 WL 283437, at *4 (Feb. 13, 2004).

As a threshold matter, we note that this is not a case where a respondent is alleging that the proceeding was unfair because of an unsubstantiated accusation of conflicts or bias.[7] Rather, FINRA's Chief Hearing Officer herself *sua sponte* raised the issue of potential conflicts and bias during the proceeding below—an issue serious enough that FINRA determined that it required an investigation by an outside law firm and a stay of the proceeding pending that investigation. But FINRA provided no further record about the issue or how it was resolved. Instead, when the Chief Hearing Officer lifted the stay, she said only that the outside counsel's "review is completed." Flesche and the other respondents repeatedly sought information from FINRA about the potential conflicts and bias that FINRA itself had raised. But FINRA denied their requests, making the somewhat circular argument that the information Flesche and other respondents sought was not part of the record, with the NAC stating that "there is no precedent" for including such information in the record.

FINRA, in both the NAC's decision and its brief to the Commission, has emphasized its interest in ensuring a fair proceeding, and it contends in its brief to the Commission that "[i]mplicit in the lifting of the stay is that this investigation [by outside counsel] discovered no conflict or bias." But under the Exchange Act, we must still conduct our own review to determine whether the proceeding was fair. We base that review on the record, and we cannot rely solely on FINRA's assurances in its briefs.[8] Indeed, even if we were to take FINRA's conclusory assertion as true, we would still have no basis to identify the potential conflict or bias, let alone any basis to make our own determination—as required by our review function—of whether such conflict or bias existed and, if so, whether it rendered the proceeding unfair and to what degree.[9]

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[7] *See Bruce Zipper*, Exchange Act Release No. 81788, 2017 WL 4335072, at *4 (Sept. 29, 2017) ("We have previously rejected requests for discovery related to unsubstantiated allegations that FINRA is biased, and do so again here because Zipper has failed to substantiate any claim of bias.").

[8] *See* Exchange Act Section 19(e)(1), 15 U.S.C. § 78s(e)(1) (providing that review of disciplinary action by a self-regulatory organization "may consist solely of consideration of the record before the self-regulatory organization"); *see also Atlantis Internet Grp. Corp.*, Exchange Act Release No. 75168, 2015 WL 3643461, at *8 n.26 (June 12, 2015) ("We must base our decision on the record before us, and parties may not use arguments in briefs . . . to fill in gaps in the record."); *Camaj v. Holder*, 625 F.3d 988, 991 n.3 (6th Cir. 2010) (noting that assertions of counsel in briefs are not record evidence).

[9] Although we ordinarily require prejudice to grant the extreme remedy of setting aside a FINRA disciplinary proceeding, here we have no basis to determine whether the potential conflicts or bias were prejudicial. *See, e.g., Devin Lamarr Wicker*, Exchange Act Release No. 100148, 2024 WL 2188603, at *9 (May 15, 2024) (citing *Trautman Wasserman & Co.*, Exchange Act Release No. 55989, 2007 WL 1892138, at *6 (Jun. 29, 2007)) (declining to set aside disciplinary proceeding because FINRA ameliorated potential unfairness and respondent was not otherwise prejudiced); *Thomas P. Reynolds Sec., Ltd.*, Exchange Act Release No. 29689, 1991 WL 292140, at *4-5 (Sept. 16, 1991) (sustaining NASD action, despite "the placement of

(*continued*…)

Where, as here, the record does not contain an adequate explanation for FINRA's findings or conclusions, we cannot properly discharge our review function.[10] We accordingly remand to FINRA for further proceedings.[11] In doing so, we express no view on the procedures FINRA uses on remand, except that whatever procedures it uses should involve the parties' meaningful participation and input.[12] And those procedures should provide sufficient information so that the Commission is able to assess whether FINRA has afforded Flesche a fair procedure and hearing.

For the above reasons, we remand this case to FINRA for further proceedings consistent with this opinion.

An appropriate order will issue.

By the Commission (Chair GENSLER and Commissioners CRENSHAW and LIZÁRRAGA; Commissioner UYEDA, with whom Commissioner PEIRCE joins, dissenting).

Vanessa A. Countryman
Secretary

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an ineligible person on the Hearing Panel," where applicants failed to "demonstrate any actual prejudice").

[10] *See Keith Patrick Sequeira*, Exchange Act Release No. 81786, 2017 WL 4335070, at *5 (Sept. 29, 2017) (holding that the Commission "cannot discharge properly our review function and remand is appropriate" where FINRA "does not clearly explain the bases for its conclusions"); *see also Donald R. Gates*, Exchange Act Release No. 36109, 1995 WL 497444, at *2 (Aug. 16, 1995) (noting that if a self-regulatory organization "fails to [explain itself clearly], applicants are impaired in their ability to defend themselves before us, and we cannot discharge our review function").

[11] *See, e.g.*, *In re: Kensington Int'l Ltd.*, 353 F.3d 211, 223 (3d Cir. 2003) (remanding for "the evidentiary record in this case be developed" on the issue of a judge's recusal so that the appeals court could "discharge [its] judicial function"); *Hummel v. Heckler*, 736 F.2d 91, 95 (3d Cir. 1984) (holding "where information relating to a contention bearing on the fundamental fairness of the agency hearing is in the possession of the government, discovery is available" to a Social Security claimant upon remand so she could attempt to show that the administrative record should be reopened because the administrative law judge was biased).

[12] *Cf. In re: Kensington Int'l*, 353 F.3d at 223 ("Briefs without an evidentiary basis and oral argument are, however, a poor substitute for a developed evidentiary record which can result from an adversarial discovery process.").

Commissioner UYEDA, with whom Commissioner PEIRCE joins, dissenting:

Section 15A(b)(8) of the Exchange Act obligates self-regulatory organizations such as FINRA to provide a fair procedure for disciplining persons associated with its members.[1] To FINRA's credit, its Chief Hearing Officer identified potential conflicts and bias with respect to Flesche's disciplinary hearing. A stay of the matter was instituted and Flesche was advised that review by outside counsel would be undertaken. On May 2, 2019, an order was issued stating that the review by outside counsel was completed and that the stay was lifted but without further explanation. Despite requests from Flesche for information relating to the resolution of the potential conflicts and bias, none has been provided.

I agree with the Commission's observation that "this is not a case where a respondent is alleging that the proceeding was unfair because of an unsubstantiated accusation of conflicts or bias."[2] FINRA had multiple opportunities, including by a NAC subcommittee and the NAC itself, to explain the basis for concluding that no conflict or bias existed. In the current proceeding before the Commission, FINRA asks the Commission to take it at its word that no conflict or bias existed.

As the Commission concluded, reliance solely on FINRA's assurances in its briefs is insufficient to determine whether the proceeding was fair.[3] I dissent from the Commission's remand to FINRA for further proceedings consistent with this opinion, which provides no view on the procedures to be used. Flesche, who has consistently requested information relating to FINRA's conclusion of no conflict of bias, is now subject to additional time, legal fees, and other burdens to address a FINRA issue for which he played no role. In other words, Flesche is essentially being penalized for FINRA's shortcomings in demonstrating, under the facts described, that the FINRA process was fair.

FINRA has the obligation to provide—and therefore bears the burden to show that it provided—a fair hearing. FINRA, having raised the issue of fairness on its own, offers no evidence to support the view that the hearing was fair. The action should be dismissed. For that reason, I dissent.

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1 15 U.S.C. § 78o-3(b)(8).

2 *See Majority Opinion* at 5.

3 *Id.*

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 101991 / December 19, 2024

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In the Matter of the Application of

PAUL ERIC FLESCHE

For Review of Disciplinary Action Taken by

FINRA

ORDER REMANDING DISCIPLINARY ACTION TO FINRA

On the basis of the Commission's opinion issued this day, it is

ORDERED that this disciplinary action be, and it hereby is, remanded to FINRA for further proceedings consistent with the Commission's opinion.

By the Commission.

Vanessa A. Countryman
Secretary