In the Court of Appeals
For the State of Michigan

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff-Appellee,

v.

MORNINGLIGHTMOUNTAIN, LLC, and MICHAEL GOODE,

Defendants-Appellants,

–and–

DOES 1–10,

Defendants–Not Participating.

Docket No.

Kalamazoo County Circuit Court
Case No.: 18-0153-CZ
HON. ALEXANDER C. LIPSEY

APPLICATION FOR LEAVE TO PURSUE AN INTERLOCUTORY APPEAL

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APPLICATION FOR LEAVE TO APPEAL

Under Rule 7.205, Defendants-Appellants MorningLightMountain, LLC ("**MLM**") Michael Goode (jointly, "**Defendants**") petition the Court for leave to appeal from an order denying summary disposition on controlling questions of law.

JURISDICTION

The Court has appellate jurisdiction to grant applications for interlocutory appeals that are filed within 21 days after entry of the order to be appealed. MCR 7.203(B)(1); MCR 7.205(A)(1). Defendants seek an interlocutory appeal from an order denying summary disposition ("**SDO**"), which the trial court entered on April 4, 2019. (SDO at 1 (APPX. 1a); Register of Actions (APPX. 18a).) This Application was timely filed 21 days later on April 25, 2019.

QUESTIONS PRESENTED

1. This is a defamation action. Summary disposition is "an essential tool" in defamation actions to protect against "forbidden intrusions into the field of free expression." *Kevorkian* v. *American Med. Ass'n*, 237 Mich. App. 1, 5 (1999). Should the Court grant leave to correct the errors of law in the SDO, as alleged in this Application, to protect Defendants' First Amendment interests?

2. If the Court grants leave and reverses the SDO, should the Court remand for entry of an order of dismissal with prejudice because further amendment would be futile?

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ALLEGATIONS OF ERROR

Scottsdale has sued MLM and Goode for an allegedly libelous statement posted at goodetrades.com, a blog reporting on news about penny-stock trading. The challenged statement—"If you have followed penny stocks and pump and dumps for a few years then you know Scottsdale Capital Advisors" (the "**Statement**")—appears in an article titled "FINRA fines Scottsdale Capital Advisors $1.5 million" (the "**Article**").

To adequately plead a claim for defamation, a libel plaintiff must prove that the defendant: (1) made a false statement of fact, (2) that was defamatory, (3) which was "of and concerning" the plaintiff, (4) in the form of an unprivileged publication to a third party, (5) with a level of fault amounting to at least negligence on the part of the publisher, and (6) damages. *Northland Wheels Roller Skating Ctr.* v. *Detroit Free Press*, 213 Mich. App. 317, 323 (1995). Defendants moved to dismiss the Third Amended Complaint under Rule 2.116(C)(8) because it failed to adequately plead several elements of a defamation claim. The trial court erroneously denied the motion for the following reasons:

1. **Failed to Apply Heightened Scrutiny to the Third Amended Complaint.** A heightened pleading standard applies to defamation claims. *Rouch* v. *Enquirer & News (After Remand)* ("*Rouch II*"), 440 Mich. 238, 272–27 (1992) (Riley, J. concurring) (opining on what the C8 standard should be in a C10 case); *Royal Palace Homes, Inc.* v. *Channel 7 of Detroit, Inc.*, 197 Mich. App. 48, 52–53 (1992) (adopting Justice Riley's concurrence for C8 cases). The trial court declined to apply the heightened standard, erroneously believing that it applies only in public-figure defamation actions despite Defendants providing caselaw showing that it also applies to private-figure claims.

2. **Failed to Consider the Statement in Context.** A C8 motion is reviewed on the pleadings. MCR 2.116(G)(5) (review of a (C)(8) motion is limited to the pleadings). By court rule, the pleadings include both the complaint *and* the answer. MCR 2.110(A). Records attached to a pleading are part of the pleading for all purposes. *Slater* v. *Ann Arbor Pub. Sch. Bd. of Educ.*, 250 Mich. App. 419, 427 (2002). The trial court declined to consider the entire Article, which

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Defendants attached to their Answer. Thus, it failed to consider the Statement in full context, as required under *Sanders* v. *Evening News Association*, 313 Mich. 334, 340 (1946), and *Croton* v. *Gillis*, 104 Mich. App. 104, 108 (1981).

3. **Failed to Address Rhetorical Hyperbole Argument.** A viable defamation claim requires a provably false statement of "actual, objectively verifiable facts." *Milkovich* v. *Lorain Journal Co.*, 497 U.S. 1, 17–22 (1990). Nonfactual hyperbole is not provably false. The Statement hyperbole that isn't provably false as a matter of law. The trial court failed to address this argument.

4. **Failed to Apply the Substantial-Truth Doctrine.** Substantial truth is an absolute defense to a defamation claim. *Collins* v. *Detroit Free Press*, 245 Mich. App. 27, 33 (2001). The article in which the Statement appears is based upon a decision from the Financial Industry Regulatory Authority ("**FINRA Decision**"), which recounts how Scottsdale facilitated pump-and-dump schemes in the penny stock market through culpable nonfeasance. Although the trial court had previously ruled that the challenged statement was substantially true, it incorrectly permitted an amended complaint that did not cure this defect by pleading material falsity.

Although the Statement is neither false nor defamatory on its face, Scottsdale also alleges that the Statement is defamatory by implication. Scottsdale argues that the Statement implicitly accuses it of criminal behavior. A court must, however, read the challenged statement in context, fairly and reasonably construing the entire article to determine whether the challenged statement is libelous. *Sanders*, 313 Mich. at 340; *Croton*, 104 Mich. App. at 108. A libel defendant "is not responsible for every defamatory implication a reader might draw from … true facts, absent evidence that [the defendant] intended the defamatory implication." *Royal Palace Homes*, 197 Mich. App at 56. The Complaint does not plead a factual basis for Scottsdale's alleged implication. Nor does it plead sufficient facts that, if proved, would show that Defendants intended that implication. And, in any event, the alleged implication is substantially true. The trial court failed to address these arguments.

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5. **Failed to Apply the Fair-Comment Privilege.** Defendants invoked Michigan's common law fair-comment privilege. This privilege can be overcome only by pleading and proving actual malice. *Dadd* v. *Mount Hope Church*, 486 Mich. 857 n.1 (2010) (quoting *Van Vliet* v. *Vander Naald*, 290 Mich. 365, 371 (1939)). Scottsdale has not pleaded facts that, if proved, would establish that Defendants knew the Statement was false or entertained serious doubts about the truth of the publication. The trial court failed to address Defendants' argument that Scottsdale had failed to adequately plead an *unprivileged* publication to a third party.

6. **Erroneously Held that Scottsdale Adequately Pleaded Fault.** Fault must be specifically pleaded in a defamation action. To adequately plead fault, a plaintiff must identify the level of fault that applies to the claim *and* allege facts that would establish that level of fault if proved. *Rouch II*, 440 Mich. at 279; *Gonyea* v. *Motor Parts Fed. Credit Union*, 192 Mich. App. 74, 76–77 (1991). There are two levels of fault: negligence and actual malice. *Ibid.* The negligence standard applies in cases involving private figures; the actual-malice standard applies in cases involving public officials, public figures, and limited-purpose public figures. *Ibid.* Scottsdale alleges that it is a private figure and that MLM and Goode are the direct and proximate cause of its damages, (Third Am. Compl. ¶ 29 (APPX. 804a)), so it impliedly pleads the level of fault to be negligence. Negligence is defined as the failure to use the care that an ordinary person would use under the circumstances. MICH. CIV. J. INSTR. 10.02. Thus, in order to meet the heightened pleading standard, Scottsdale must allege what a reasonably careful reporter and reasonably careful publisher would have done under the circumstances, *Michigan Microtech, Inc.* v. *Federated Publ'ns, Inc.*, 187 Mich. App. 178, 186 (1991), and then plead facts that, if proved, would show that Defendants failed to do those things, from the perspective of the "reasonable audience." *Air Wis. Airlines Corp.* v. *Hoeper*, 71 U.S. 237, 246–251 (2014). The trial court erroneously held that the Complaint satisfies these requirements.

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GROUNDS FOR APPEAL

This is a defamation action. It implicates core First Amendment principles. Scottsdale, a regulated securities broker, has sued MLM and Goode for unfavorable press coverage of a steep fine that the Financial Industry Regulatory Authority ("**FINRA**") imposed against Scottsdale. Scottsdale has aggressively sued those who deigned to cover the story. *See, e.g.*, *Scottsdale Cap. Advisors Corp.* v. *S&P Global, Inc.*, Civ. No. 18-1105 (D. Ariz. 2018) (defamation case dismissed by stipulation); *Scottsdale Cap. Advisors Corp.* v. *The Deal, LLC*, 887 F.3d 17 (CA1 2018) (defamation case dismissed for lack of jurisdiction). Scottsdale even sued FINRA to stop its disciplinary proceeding. *Scottsdale Cap. Advisors Corp.* v. *FINRA*, 844 F.3d 414 (CA4 2016) (injunctive action dismissed for lack of jurisdiction).

The present lawsuit is about one thing: shutting down free speech. It is known as a "strategic lawsuit against public participation" or "SLAPP suit." It is brought with the intent to censor the speaker's message because it is unwanted, not because it is false or defamatory.

The First Amendment no more allows a "litigation veto" than it does a "heckler's veto." The Court is particularly protective of First Amendment interests in libel cases lodged against the media. It has long favored early summary disposition to protect free-speech principles, and has repeatedly emphasized that early summary disposition is an "essential tool" for vindicating First Amendment rights. The Court grants interlocutory appeals to avoid the chilling effect on free speech that accompanies litigation. *See e.g.*, *Thomas M. Cooley Law Sch.* v. *Doe 1*, 300 Mich. App. 245, 268 (2013) (on appeal by leave, this Court reversed a trial court's order in a defamation case involving a private-figure plaintiff for several reasons, including the trial court's erroneous conclusion that "defamatory statements per se were not entitled to First Amendment protections"); *Levitt* v. *Digital First Media*, No. 330946, 2017 WL 2152729, at *4 (Mich. Ct. App. May 16, 2017) (on appeal by leave, this Court reversed a lower court's order in a defamation case involving a private-figure plaintiff because "the sting of the article's headline would not have a different effect on a reader than the literal truth.").

The SDO involves controlling questions of law on matters implicating the First Amendment. The trial court declined to apply heightened scrutiny when reviewing the

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pleadings. It held that heightened scrutiny does not apply in libel cases involving private-figure plaintiffs, even though Defendants supplied multiple private-figure cases applying such scrutiny. At the same time, however, the trial court expressed openness to appellate guidance on this issue. (Motion Hr'g Tr. 32:24–34:12 (APPX. 50a–52a).)

Challenged statements must also be viewed in light of the full article. *Sanders*, 313 Mich. at 340; *Croton*, 104 Mich. App. at 108. Defendants supplied the entire article with their Answer, and relied upon the article in support of their motion. Although Rule 2.116(G)(5) requires C8 motions to be reviewed on the "pleadings," a defined term that includes an Answer under Rule 2.110(A)(5), the court declined to review it. Applying a lower level of scrutiny to an incomplete version of the article precluded a proper assessment of Defendants' motion, which is critical to protecting First Amendment interests.

In addition, the court declined to decide whether the challenged statement is nonactionable rhetorical hyperbole; whether Scottsdale has pleaded a claim that, as alleged, cannot be proved false by any form of admissible evidence; or whether the Third Amended Complaint pleads around the fair-comment privilege. If the statement is not actionable hyperbole, not provably false, or privileged, there is no justification for allowing a "litigation veto" to proceed unabated.

Moreover, the trial court erroneously held that the challenged statement is capable of defamatory meaning by implication. Although Michigan recognizes claims for defamation by implication, our courts do not permit libel plaintiffs to squelch true speech by manufacturing an actionable "implication" that is not fairly supported by the article. *See Royal Palace Homes*, 197 Mich. App at 56; *Nehls* v. *Hillsdale Coll.*, 178 F. Supp. 2d 771, 779 (ED Mich. 2001), *aff'd* 65 Fed. Appx. 984 (CA6 2003) (citing Michigan law). Yet that is what the SDO permits here.

Finally, even in private-figure actions,[1] a plaintiff must plead facts that, if proved, would show that the Defendants intended the implication alleged. *See* Argument, Part IV.B,

[1] Defendants dispute Scottsdale's allegation that it is a private figure. Facts that would establish Scottsdale is a public figure are not pleaded in the Third Amended Complaint, so the time is not yet ripe for Defendants to seek summary disposition on the public-figure question.

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infra. The Third Amended Complaint is devoid of any alleged facts on this intent question. Nor are there any reasonable inferences that can be drawn from the pleaded facts that satisfy the pleading requirement.

Resolving these questions now would not only materially advance the timely and ultimate termination of this lawsuit, but it would also protect First Amendment interests that could not be adequately protected if Defendants must wait until an appeal of right (if one ever becomes necessary). Unlike the mine-run interlocutory appeal, where pleas to avoid the high cost of litigation are unpersuasive, the high cost of litigation in this case constitutes an injury to free-speech interests. Forcing a person to finance litigation to defend the exercise of their First Amendment rights chills speech—not only for the defendant, but for all of society. It leads to self-censoring to avoid the steep financial losses attendant to protracted litigation. The Court should grant leave to protect against the corrosive effect of litigation on First Amendment liberties.

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STATEMENT OF THE CASE

This case arises from the publication of an online article at goodetrades.com, a blog reporting on news about penny-stock trading.[2] Scottsdale alleges that Goode wrote and MLM published the Article, which contains the challenged Statement: "If you have followed penny stocks and pump and dumps for a few years then you know Scottsdale Capital Advisors." (APPX. 823a.)

The Penny Stock Market

A "penny stock" is a security issued by a small company that trades at less than $5.00 per share.[3] Also known as "microcap stocks," penny stocks are issued by companies, many of which do not file financial reports with the U.S. Securities & Exchange Commission.[4] The SEC describes these securities as "among the most risky," suffering from a scarcity of publicly-available information that allows "fraudsters [to] easily spread false information about microcap companies, making profits while creating losses for unsuspecting investors."[5] They are very speculative investments, and Congress has tightly regulated broker-dealers who facilitate penny-stock trading under the Exchange Act.[6]

One fraud particularly affecting penny stocks is the classic pump-and-dump scheme. The scheme involves touting a company's stock through false and misleading statements to the marketplace to ignite a buying frenzy that "pumps" the price of a stock (usually a penny

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[2] This isn't Scottsdale's first lawsuit against a publisher for reporting on Scottsdale's public discipline. *See, e.g.*, *Scottsdale Cap. Advisors Corp.* v. *S&P Global, Inc.*, Civ. No. 18-1105 (D. Ariz. 2018) (defamation case dismissed by stipulation); *Scottsdale Cap. Advisors Corp.* v. *The Deal, LLC*, 887 F.3d 17 (CA1 2018) (defamation case dismissed for lack of jurisdiction). SCA even sued FINRA to stop its disciplinary proceeding. *Scottsdale Cap. Advisors Corp.* v. *FINRA*, 844 F.3d 414 (CA4 2016) (injunctive action dismissed for lack of jurisdiction).

[3] U.S. Secs. & Exch. Comm'n ("**SEC**"), Penny Stock Rules (May 9, 2013) ("PENNY STOCK RULES") (available at http://bit.ly/SEC-Penny-Stock-Rules).

[4] SEC, Microcap Stock: A Guide for Investors, Introduction (Sept. 13, 2013) (available at http://bit.ly/SEC-Microcap-Guide).

[5] *Ibid.*

[6] PENNY STOCK RULES, *supra* at n.3.

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stock). The hucksters then sell (or "dump") their stocks at the "pumped" up price, realizing a handsome profit. Once they dump their shares and stop hyping the stock, the price falls and investors lose their money.[7]

The Biozoom Scheme

Defendants' report on news about the penny stock market, about including pump-and-dump schemes affecting the market. One of the schemes they reported on involved the Biozoom stock. Entertainment Art, Inc., a company that sold leather handbags, abruptly announced in April 2013 that it was changing its name to Biozoom and was becoming a biomedical technology company.

Scottsdale is a broker dealer that facilitated penny-stock trading and claims to be one of the dominant companies in the microcap securities market for handling more than $125 million worth of trades in 2015 alone.[8] Scottsdale accepted the new Biozoom stocks for deposit and facilitated their trading in the microcap market.

From March–June 2013, at least eight people opened accounts with broker-dealers and deposited millions of shares of Biozoom stock. They falsely claimed that they had recently purchased the stock from Entertainment Art's original shareholders and that the stock could be freely traded.[9] After pumping the stock, the fraudsters dumped (*i.e.*, sold) 14 million shares in three months. They netted almost $34 million, of which about $17 million was wired to overseas bank accounts.[10] Eventually, the stock collapsed.

In July 2013, the SEC brought an enforcement action, *U.S. Securities* & *Exchange Comm'n* v. *Tavella*, to recover the ill-gotten gains and make swindled investors whole. Many of the trading accounts frozen through the SEC's enforcement action were held at Scottsdale.[11]

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[7] SEC, "Pump-and-Dumps" and Market Manipulations (Jun. 25, 2013) (available at http://bit.ly/SEC-Pump-and-Dumps).

[8] Third Am. Compl. at 3, ¶ 11. (APPX. 801a).

[9] *SEC* v. *Tavella*, No. 13-4609 (SDNY), Compl. ¶¶ 3–5 (Jul. 3, 2013) (APPX. 832a–833a).

[10] *Id.* at 2–3, ¶¶ 6–7.

[11] *Tavella*, Stip. Order Granting Prelim. Inj., Asset Freeze, and Other Relief (R. 16, Jul.

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Indeed, since the filing of this lawsuit, the SEC has entered an order sanctioning Scottsdale's representative for facilitating the sale of 8.2 million Biozoom shares that generated $18.5 million in gains—just over half the shares and half the gains—for the fraudsters.[12] The representative's offense was "fail[ing] to conduct a searching inquiry into facts surrounding the proposed sales" of unregistered Biozoom stock, despite the presence of "significant red flags."[13]

Among other things, it was this same kind of failure to conduct searching inquiries that resulted in FINRA taking disciplinary action against Scottsdale. FINRA imposed a $1.5 million fine against Scottsdale for "institutionaliz[ing] misconduct as its standard way of doing business," among other aggravating factors.[14] Part of the institutionalized misconduct included Scottsdale's failure to revise its procedures to focus on potential sham transactions after botching its gatekeeping role in the Biozoom pump-and-dump scheme that led to the SEC's enforcement action.

The statement that Scottsdale claims is libelous is contained within the Article, which was published after the Biozoom fraud. The Article includes extensive quotations from FINRA's enforcement decision. It also includes a link to the decision.

The statement at issue in this case does nothing more than correctly note that penny stocks were illegally traded through Scottsdale brokerage accounts. Despite the accuracy of the statement, Scottsdale has sued MLM and Goode because it objects to the "juxtaposition" of the Article's headline in conjunction with the challenged statement.

16, 2013); Final J. Defs. Graciarena & Loureyro (R. 67, Dec. 8, 2014); Final Default J. against Tavella [and Others] (R. 69, Jan. 9, 2015).

[12] *In re Timothy* C. *Scarpino*, SEC No. 3-18483, Order Instituting Admin. and Cease-and-Desist Proceedings, Making Findings, Imposing Remedial Sanctions, and a Cease-and-Desist Order (May 15, 2018).

[13] *Id.* at 2, Part III, Summary.

[14] Amended Extended Hr'g Panel Decision 105 at Part IV.A(1)(d), *FINRA Dep't of Enforcement* v. *Scottsdale Cap. Advisors Corp.*, No. 2014041724601 (Jun. 20, 2017) (the "**FINRA Decision**") (APPX. 973a).

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PROCEDURAL HISTORY

After Scottsdale filed its Original Complaint, but before serving it upon Defendants, Scottsdale filed its First Amended Complaint as a matter of right.[15] The First Amended Complaint asserted a claim for defamation, alleging four libelous statements, and a claim for false light.[16] On Defendants' motion, the trial court dismissed the First Amended Complaint.[17] It correctly held that a corporation cannot maintain a false-light claim under Michigan, and that three of the four statements—including the Statement at issue on appeal—were inadequately pleaded.[18] The trial court incorrectly held, however, that one of the statements was adequately pleaded under the doctrine of *res ipsa loquitur*. The trial court granted Scottsdale leave to amend its pleading to save the other statements, if Scottsdale felt it could do so. Defendants moved for reconsideration, explaining that the doctrine of *res ipsa loquitur* cannot apply in defamation actions because negligence cannot be presumed in defamation cases—a plaintiff must plead facts that, if proved, show that the defendant acted with actual malice or negligence.[19] The Court declined to reconsider its ruling.[20]

Thereafter, Scottsdale filed a Second Amended Complaint, which tried to resurrect only one of the three dismissed statements.[21] In other words, Scottsdale's defamation claim shrank from four statements to two. One of the two statements is the Statement at issue on appeal. On Defendant's motion, the trial court dismissed the Second Amended Complaint.[22] It agreed that: (1) its earlier *res ipsa* ruling was incorrect; and (2) the Second Amended Complaint failed to adequately plead fault as to either statement.[23] The trial court granted

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15 Register of Actions at 1 (APPX. 16a).

16 First Am. Compl. ¶¶ 11–33 (APPX. 56a–60a).

17 Memorandum Order Dismissing First Am. Compl. at 9–10 (APPX. 14a–15a).

18 *Ibid.*

19 Defendants' Mot. for Reconsid. at 6–7 (APPX. 514a–515a).

20 Order Denying Mot. for Reconsid. (APPX. 3a–4a).

21 Second Am. Compl. (Nov. 13, 2018) (APPX. 575a).

22 Order Dismissing Second Am. Compl. (Dec. 14, 2018) (APPX. 2a).

23 *See ibid.*

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Scottsdale leave to amend its complaint because Scottsdale had relied upon the earlier *res ipsa* ruling when crafting the Second Amended Complaint.[24]

Scottsdale then filed its Third Amended Complaint, which asserted a claim for defamation based on just one statement: the Statement at issue on appeal. In other words, Scottsdale's defamation claim has now shrunk from four statements to one. Defendants filed an Answer and a motion for summary disposition under C8.[25] The motion argued that the Complaint failed to adequately plead a claim for defamation because the Statement is nonactionable hyperbole, substantially true, not defamatory, and protected under Michigan's fair-comment privilege.[26] Defendants also argued that the Third Amended Complaint failed to specifically plead fault.[27] After Scottsdale filed its opposition brief and Defendants filed their reply, the trial court heard oral argument on the motion. The trial court denied Defendants' motion in an oral ruling from the bench. Immediately thereafter, the trial court granted Defendants' oral motion for a stay of proceedings pending appeal. The parties submitted a proposed order, which the trial court entered on April 4, 2019. This timely application for interlocutory review of the ruling followed.

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[24] *Ibid.*

[25] Register of Actions at 1 (APPX. 16a).

[26] Defendants' Third Mot. Summ. Dispo. at 8–17 (Nov. 15, 2018) (APPX. 1000a–1009a).

[27] *Id.* at 17–18 (APPX. 1009a–1010a).

STANDARD OF REVIEW

As with all appeals from summary disposition, the Court's review is plenary. *Associated Builders & Contractors* v. *Wilbur*, 472 Mich. 117, 123 (2005).

GOVERNING STANDARD

Under MCR 2.116(C)(8), courts must dismiss a claim where the allegations on the face of the pleadings fail to state a claim recognized at law, such that no factual development could possibly justify recovery. *Singerman* v. *Municipal Serv. Bureau*, 455 Mich. 135, 139 (1997); *Wade* v. *Michigan Dep't of Corrections*, 439 Mich. 158, 162–63 (1992).

THE STATEMENT

"If you have followed penny stocks and pump and dumps for a few years then you know Scottsdale Capital Advisors."[28]

ARGUMENT

Scottsdale has failed to meet the basic pleading standards for its defamation claim. The trial court erred: (1) in failing to apply the applicable heightened pleading standard to the defamation claim; (2) in failing to consider both the Complaint and Answer and all exhibits attached thereto when ruling on the motion to dismiss; and (3) in finding Scottsdale's Third Amended Complaint to be adequately pleaded.

"When First Amendment freedoms are involved, this Court's role takes on added importance." *Ireland* v. *Edwards*, 230 Mich App 607, 613 (1998). An interlocutory appeal is necessary to vindicate MLM and Goode's First Amendment rights against "forbidden intrusion into the field of free expression." *Id.*[29] "In recognition of the constitutional privilege

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[28] Third Am. Compl. ¶ 13 (Jan. 11, 2019) (APPX. 801a).

[29] *See e.g.*, *Thomas M. Cooley Law Sch.* v. *Doe 1*, 300 Mich. App. 245, 268, 833 N.W.2d 331 (2013) (on an appeal by leave, this Court reversed a lower court's order in a defamation case involving a private-figure plaintiff for several reasons including the lower court's error in concluding that "defamatory statements per se were not entitled to First Amendment protections."); *Levitt* v. *Digital First Media*, No. 330946, 2017 WL 2152729, at *4 (Mich. Ct. App. May 16, 2017) (on an appeal by leave, this Court reversed a lower court's order in a

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of free expression secured by the First and Fourteenth Amendments, the courts in libel actions have recognized the need for affording summary relief to defendants in order to avoid the 'chilling effect' on freedom of speech and press." *Id.* at n.4. "Summary judgment is [therefore] an integral part of the constitutional protection afforded defendants in actions such as this." *Id.* MLM and Goode accordingly urge the Court to accept this case for expedited interlocutory review to guard not only their interests, but also "society's interest in free expression." *Id.* at 613.

I. SPECIAL PLEADING STANDARD: The trial court failed to apply the heightened First Amendment pleading standard that applies in all libel actions.

In defamation actions, courts have a special, heightened duty to review the sufficiency of the allegations before them because of the constitutional implications for free speech. *Bose Corp* v. *Consumers Union*, 466 U.S. 485, 511 (1984). Michigan courts have taken this duty seriously, long ago adopting an *Iqbal*-like pleading standard that requires plaintiffs to specifically plead: (1) the defamatory words and the facts that would establish the words are false; (2) the facts identifying the publication of those words to a third party; (3) the level of fault that must be proved and the facts that would establish that the speaker acted with that level of fault; and (4) the harm suffered by the publication. *Gonyea* v. *Motor Parts Fed. Credit Union*, 192 Mich. App. 74, 76–77 (1991). *Accord Ashcroft* v. *Iqbal*, 556 U.S. 662 (2009) (federal plaintiffs must "plausibly" plead claims through specific factual allegations). Pleading specific facts is a "relatively simple requirement," and defendants are entitled to summary disposition under C8 "on this ground alone" when plaintiffs fail to follow it. *Rouch* v. *Enquirer & News (After Remand)*, 440 Mich. 238, 279 (1992) ("*Rouch II*") (Riley, J., concurring).

Defamation claims are subject to this heightened scrutiny, regardless of whether the plaintiff is a public figure or a private figure. Heightened scrutiny allows courts to resolve several questions of law on the pleadings, including whether a statement is capable of being

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defamation case involving a private-figure plaintiff because "the sting of the article's headline would not have a different effect on a reader than the literal truth.").

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defamatory; the nature of the speaker and the level of constitutional protections afforded to the statement; and whether actual malice exists, if the plaintiff is required to show that level of fault. *Thomas M. Cooley Law Sch.* v. *Doe 1*, 300 Mich. App. 245, 342 (2013).

Scottsdale argues that the heightened scrutiny standard only applies in cases involving public figures, emphasizing that it has cast itself as a private figure in the Third Amended Complaint. This is incorrect. In *Rouch II*, a private-figure case reviewed on appeal from a C10 ruling, Justice Riley opined that the pleadings in a defamation case should also be reviewed with the same kind of heightened scrutiny when challenged under C8. This Court long ago adopted Justice Riley's concurrence for C8 appeals in private-figure cases. *See*, *e.g.*, *Royal Palace Homes, Inc.* v. *Channel 7 of Det., Inc*, 197 Mich. App. 48, 52–53 (1992); *Trost* v. *Buckstop Lure Co., Inc.*, 249 Mich. App. 580, 587 n.2 (2002).

Despite controlling caselaw applying *Rouch II* to private figure cases, the trial court refused to apply the required heightened scrutiny. In a ruling that conflated two separate and distinct concepts—*heightened scrutiny* of a complaint to protect a defendant's First Amendment interests on one hand and the plaintiff's duty to adequately plead the element of *fault* on the other—the trial court declined to review the pleadings under the heightened standard:

> [T]he Court has made a ruling with regard to whether there's a heightened standard relating to this particular Plaintiff and the Court is standing by its earlier ruling that Plaintiff does not have to establish actual malice in the publication of this particular article and actually this particular phrase which is the only thing left in terms of an action.

(Motion Hr'g Trans. 30:11-16 (Mar. 26, 2019) (APPX. 48a). *Compare with* Order on First Mot. Summ. Dispo. 3–5 (Oct. 4, 2018) (APPX. 8a–10a).) Thus, the trial court failed to properly examine Defendant's motion.

When subjecting Scottsdale's defamation claim to the required heightened scrutiny, the claim fails. Scottsdale has not pleaded specific facts that support its defamation claim. For the reasons argued in Parts III, IV, and VI, *infra*, the Third Amended Complaint—like the first

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three complaints—is filled with general allegations that are simply insufficient to satisfy the *Iqbal*-like pleading standard that applies.

II. FULL ARTICLE NOT CONSIDERED: The trial court failed to consider the full Article, which is required under Michigan law to fully assess the context of the Statement.

A court must read the challenged statement in context, fairly and reasonably construing the entire article to determine whether the challenged statement is libelous. *Sanders* v. *Evening News Ass'n*, 313 Mich. 334, 340 (1946); *Croton* v. *Gillis*, 104 Mich. App. 104, 108 (1981). A statement "does not become actionable merely because it could be taken out of context." *Nehls* v. *Hillsdale Coll.*, 178 F. Supp. 2d 771, 779 (ED Mich. 2001), *aff'd* 65 Fed. Appx. 984 (CA6 2003) (citing Michigan law).

A C8 motion is reviewed on the "pleadings." MCR 2.116(G)(5) (review of a C8 motion is limited to the "pleadings"). By court rule, the pleadings include both the complaint *and* the answer. MCR 2.110(A). Records attached to a pleading are part of the pleading for all purposes. *Slater* v. *Ann Arbor Pub. Sch. Bd. of Educ.*, 250 Mich. App. 419, 427 (2002). Thus, the trial court was required under both *Sanders* and *Croton* and under Rule 2.116(G)(5) to consider the entire Article when assessing the merits of Defendants' motion.

The entire Article includes the FINRA Decision and all of the other linked references in the Article. Scottsdale argued that the FINRA Decision is not part of the Article, citing *Nucor Corp.* v. *Prudential Equity Gp.*, 659 S.E.2d 483, 485 (N.C. App. 2008), and *Mandel* v. *O'Connor*, 99 S.W.3d 33, 37 (Mo. App. 2003), for the proposition that defamatory meaning is judged by the content within the "four corners of the publication." Defendants do not quarrel with that statement of the law conceptually, but the four corners of a publication includes documents attached to the publication, *Service Employees Int'l Union Local 5* v. *Professional Janitorial Serv. of Houston, Inc.*, 415 S.W.3d 387, 402–403 (Tex. App. 2013), just like attachments to a complaint are part of the complaint, *cf. Slater*, 250 Mich. App. at 427. Neither *Nucor Corp.* nor *Mandel* involved online publications or publications with attachments. Links embedded in online

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articles are the functional equivalent of attachments. See *Adelson* v. *Harris*, 973 F. Supp. 2d 467 (SDNY 2013), *aff'd* 876 F.3d 413 (CA2 2017); *Adelson* v. *Harris*, 402 P.2d 665 (Nev. 2017) (so holding in response to a certified question from the federal court). Scottsdale can't complain that the Article omits relevant information about the FINRA Decision, but then ignore that the Article provides the audience with a link to the decision—the digital equivalent of turning to a motion's index of exhibits, finding the right exhibit number, and then flipping to the correct tab.

The trial court declined to consider the FINRA Decision. (Motion Hr'g Tr. at 30:25–31:6 (APPX. 48a–49a)). It is unclear whether the trial court rejected *Adelson* or failed to consider the FINRA Report under *Sanders*, *Croton*, and Rule 2.116(G)(5). *Ibid.* Either way, it failed to analyze the Statement in the context of the entire Article. It therefore failed to properly examine Defendant's motion, for the reasons argued in Part V, *infra*.

III. NOT PROVABLY FALSE: The trial court should have dismissed the defamation claim because the Statement is not provably false.

To be actionable, the Statement must be provably false. *Ireland*, 230 Mich. App. at 636 (citing *Milkovich* v. *Lorain Journal Co.*, 497 U.S. 1, 17–22 (1990)). In other words, the statement must state "actual, objectively verifiable facts." *Milkovich*, 497 U.S. at 17–21. Nonfactual hyperbole is not provably false. As noted in Part IV.B, *infra,* Scottsdale has been connected to *at least two* pump-and-dump schemes in the years preceding publication of the Article. The Statement thus amounts to "everyone knows" about the connection, which is classic rhetorical hyperbole that is not actionable. *Komarov* v. *Advance Magazine Publ'rs, Inc.*, 691 N.Y.S.2d 298, 301–302 (N.Y. Sup. Ct. 1999) (holding that a statement that plaintiff was as "well known" in the community as the notorious mobster John Gotti was rhetorical hyperbole that cannot be proven false and therefore not actionable). *See also Hogan* v. *Winder*, 762 F.3d 1096, 1107–1108 (CA10 2014) (accusing someone of blackmail for threatening to sue a former employer was not actionable because, in context, it was nonactionable hyperbole); *Fasi* v. *Gannett Co.*, 930 F. Supp. 1403 (D Haw. 1995) ("Frank 'the Extortionist' Fasi is at it again" was hyperbole, not a true accusation of criminal activity); *Haberstroh* v. *Crain Publ'ns, Inc.*, 189

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Ill. App. 3d 267 (1989) (saying a professor was on an "acid trip" was not an accusation of illegal drug use); *McGilvray* v. *Springett*, 68 Ill. App. 275 (1896) (statement that the plaintiff had stolen money from the town treasury "and everybody knows it" was not slanderous; bystanders understood this was not an accusation of larceny, but allegedly overbilling the town for services).

Scottsdale cannot objectively prove that those who followed penny stock pump-and-dump schemes did *not* know of Scottsdale. It says that it could do so through a poll, (Third Am. Compl. ¶ 15 (APPX. 802a)), but we do not try cases by polling the community. Trials are not gameshows where people "text their vote" to the jury. The absence of any legal mechanism to conduct and admit such a poll into evidence only underscores that this is *Komarov*-style hyperbole, not a provable statement of fact.

Scottsdale suggested at oral argument that it could offer expert testimony or a focus group. No amount of specialized skill or training can establish community knowledge (*i.e.*, what is in the minds of a community) under Rule 702 of the Rules of Evidence; "mindreading" wouldn't pass muster under *Daubert*. A focus group is just another name for a poll. (*See* Motion Hr'g Tr. 13:11–18; 18:16–19:9 (APPX. 31a, 36a–37a).)

The trial court erroneously stated that this evidence-based line of argument is best raised in a C10 motion. (Motion Hr'g Tr. at 30:25–31:6 (APPX. 48a–49a).) Defendants respectfully disagree. Dismissal under C8 is appropriate when no factual development could possibly justify recovery. *Maiden* v. *Rozwood*, 461 Mich. 109, 119 (1999). Scottsdale has not proffered any method by which it could acquire and introduce admissible evidence on the question of community knowledge. Having failed to do so, a dismissal under C8 is proper.

IV. SUBSTANTIALLY TRUE: Even if the Court were to conclude that the Statement is a statement of fact, the trial court should still have dismissed the defamation claim because the Statement is not materially false.

A. As written, the Statement is not materially false.

As it did in the First Amended Complaint, Scottsdale argues in the Third Amended Complaint that the Statement is false because it has "never been involved in any 'pump and

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dump' schemes, has never been a defendant in any 'pump and dump' lawsuits, and has never been convicted of engaging in 'pump and dump' activity." (*Compare* First Am. Compl. ¶ 15 (APPX. 57a–58a) *with* Third Am. Compl. ¶ 15 (APPX. 802a).) Yet, on its face, the Statement doesn't accuse Scottsdale of any of these things. The trial court agreed that the Statement doesn't accuse Scottsdale of any of these things when it dismissed this Statement from the First Amended Complaint. (Order on First Mot. Summ. Dispo. at 7 (APPX. 12a).) Yet the trial court has now inexplicably allowed the Statement to proceed without Scottsdale curing the error. (*See* Motion Hr'g Tr. 29:18–31:18 (APPX. 47a–49a).) This was erroneous.

B. The implication Scottsdale draws from the Statement is not reasonable; even so, it is substantially true.

Scottsdale alleges that the juxtaposition of the headline "FINRA fines Scottsdale Capital Advisors $1.5 million" against the Statement implies that FINRA fined Scottsdale for affirmatively participating in a criminal act: the pump and dump of penny stocks. (Third Am. Compl. ¶ 14 (APPX. 801a).) Thus, Scottsdale alleges the existence of a defamatory meaning by implication.

In a lengthy and strongly worded opinion in *Locricchio* v. *Evening News Association*, 438 Mich. 84 (1991), the Michigan Supreme Court placed severe restrictions on "libel by implication." Relying on *Sanders* v. *Evening News Association*, 313 Mich. 334 (1946), the Court held that, under Michigan law, "imposing liability on a media defendant for facts it publishes accurately and without material factual omissions about public affairs" is prohibited. *Locricchio*, 434 Mich. at 117. Noting that defamation by implication was not so "analytically distinct" as to "require a departure from the guiding principles of general libel and First Amendment libel law," *id.* at 132, the Court emphasized the "severe constitutional" burden of proving falsity that a plaintiff must carry. *Id.* at 122. *Locricchio* renders it extremely difficult, if not practically impossible, to advance a defamation by implication claim under Michigan law. This is as it should be. The falsity requirement should be construed and applied in a manner that assures literally true speech is not punished.

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Courts look with extreme skepticism upon any theory that threatens to soften the requirement that a libel plaintiff plead and prove a specific false statement of fact. Emphasizing the principles articulated *Locricchio*, this Court has held that a libel defendant" is not responsible for every defamatory implication a reader might draw from his report of true facts, absent evidence that he intended the defamatory implication." *Royal Palace Homes*, 197 Mich. App. at 56. A statement "does not become actionable merely because it could be taken out of context." *Nehls*, 178 F. Supp. 2d at 779. There are no facts pleaded in the Third Amended Complaint that, if proven, would establish that Defendants intended to imply that Scottsdale was *affirmatively committing* pump-and-dump schemes, as opposed to serving as the means by which such schemes were accomplished.

As noted in Part II, *supra*, the Statement must be read in context, fairly and reasonably construing the entire article to determine whether the challenged statement is libelous. *Sanders*, 313 Mich at 340; *Croton*, 104 Mich App at 108. The FINRA Decision provides the context. It details how Scottsdale's business is susceptible to sham transactions.

For example, FINRA noted, among Scottsdale's many shortcomings, that the SEC had previously sued two of Scottsdale's registered representatives in a case involving a pump-and-dump scheme: a Panamanian-based pump-and-dump in 2008–2012 and a Bahamian-based pump-and-dump in 2008. FINRA Decision at 11–12 and nn. 18, 20, Part III.B(1)(a)(iv)(a) (APPX. 879a–880a). FINRA fined Scottsdale in part because FINRA directly tied the success of the $34 million Biozoom pump-and-dump scheme to Scottsdale's lax anti-fraud safeguards, which it never improved despite being on notice that its existing safeguards were inadequate to detect and prevent fraud. *Id.* at 107, Part IV.A(3) (APPX. 975a). FINRA explained that, in accepting penny stocks for deposit in the earlier schemes, Scottsdale failed to exercise its gatekeeping role to safeguard against being used by its customers as a *means* to execute a pump-and-dump fraud.

Scottsdale's subsequent failure to adequately police transactions—as it was required to do under SEC Rule 17a-8, the Bank Secrecy Act ("**BSA**"), and its implementing regulations, *see* BSA, 31 U.S.C. § 5311, *et seq.*; 31 C.F.R. §1023.320(a)(2); and 17 C.F.R. § 240.17a-8 (SEC

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regulation requiring brokers to follow the BSA and its rules)—signaled to FINRA that Scottsdale had not heeded the lessons of its earlier roles in pump-and-dump schemes. FINRA considered this an aggravating factor, which formed a basis for the $1.5 million fine:

> Finally, although [Scottsdale] was not charged in ... *Ruettiger*, *Gibraltar I*, *Gibraltar II*, and *Tavella*, those cases did involve alleged misconduct through accounts at [Scottsdale]. These cases put [Scottsdale] on notice of the risk of sham transactions and the use of nominees to conceal beneficial ownership and facilitate unlawful distributions of securities. They heightened the need for [Scottsdale] to be alert to red flags. *In light of this history, it is aggravating that Scottsdale performed its gatekeeping function so poorly.*

FINRA Decision at 104, Part IV.A(1)(d) (emphasis supplied) (APPX. 972a). Scottsdale mischaracterizes the FINRA Decision when it alleges that the decision and the fine have "nothing to do" with Scottsdale's role in pump-and-dump schemes. (*See* Third Am. Compl. ¶ 14 (APPX. 801a).)

Under Section 5 of the Securities Act, the sale of securities without registration is unlawful unless an exemption exists. 15 U.S.C. § 77e(a)(1). In selling penny stocks without registration, Scottsdale "usually relie[d] on a 'safe harbor' exemption created by the [SEC], Rule 144." FINRA Decision at 5, Part I.A (APPX. 873a). When a securities transaction involves "large blocks of thinly traded, little-known securities acquired in a chain of private transactions," like the Biozoom stock, it is "a red flag that the SEC and FINRA have both said requires a 'searching inquiry.'" *Id.* at 6, Part I.A(3) (APPX. 874a). "These red flags ought to have been investigated and properly resolved *before* the securities could be sold. [Scottsdale], however, *blinded itself* to the multiple red flags signaling that the transactions were unlawful public distributions of securities. It did not conduct the required searching inquiry. It [therefore] sold the securities without a reasonable basis for a Rule 144 exemption." *Id.* at 7, Part I.A(3) (emphasis supplied) (APPX. 875a).

Explaining Scottsdale's willful blindness, FINRA noted that "[Scottsdale] was on notice that its business was susceptible to sham transactions and the use of nominees to

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conceal the true beneficial owners of securities. *In four disciplinary actions* involving Scottsdale's own employees and customers, the SEC alleged that sham transactions and nominees were used in unlawful sales in violation of Section 5 of the Securities Act. Those unlawful sales in turn were used to facilitate fraud and manipulation." FINRA Decision at 11, Part III.B(1)(a)(iv)(a) (emphasis added) (APPX. 878a). FINRA identified the nature of the fraud and manipulation, two of which involved pump-and-dump schemes. *Id.* at 11–12 (APPX. 879a–880a). After detailing Scottsdale's shortcomings in each of the earlier regulatory actions—including the Biozoom fraud—FINRA held that those actions "should have caused [Scottsdale] to take special care ... to revise its procedures to focus on potential sham transactions and the use of nominees. [Scottsdale] did not." *Id.* at 13 (APPX. 881a).

Scottsdale tried to minimize the significance of its gatekeeping function, arguing that it was unfair to look back to the pump-and-dump schemes because no formal accusation had been made in the current disciplinary case that the challenged transactions were part of a pump-and-dump fraud. *Id.* at 13, Part III.B(1)(a)(iv)(b) (APPX. 881a). FINRA was unmoved: "It is not necessary, however, to prove that fraud occurred in order to conclude that [Scottsdale and other respondents] failed to perform their gatekeeping duty adequately." *Ibid.* In trying to make the same argument here, (Third Am. Compl. ¶ 14 (APPX. 801a)), Scottsdale ignores the central thrust of the Article: a company—with a history of being used as a tool to execute pump-and dump schemes because of its repeated failure to take its gatekeeping function seriously—was fined $1.5 million for yet again not doing its job to adequately safeguard the investing public.

Although Scottsdale essentially concedes that anyone reading the FINRA Decision would understand this context, it argues that the "damage is done" before the reader gets to the FINRA report. (Opp'n 8, Mot. Summ. Dispo., Third Am. Compl. (APPX. 1029a).) This is just another way of saying the reader can't be expected to read the entire article if it is too long. *But that isn't the law.* A court must read the challenged statement in context, fairly and reasonably construing *the entire article* to determine whether the challenged statement is libelous. *Sanders*, 313 Mich. at 340; *Croton*, 104 Mich. App. at 108.

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Here, Scottsdale argues that the statement falsely implies that FINRA fined it $1.5 million for its involvement in a penny stock pump-and-dump scheme, which it says is an "inference of criminal conduct." (Opp'n 7, Part C.1, Mot. Summ. Dispo., Third Am. Compl. (APPX. 1028a).) This is unpersuasive for three reasons.

First, FINRA is a *civil* regulatory authority that would have no authority to punish Scottsdale for *criminal* conduct. Keeping in mind that *Air Wisconsin Airlines Corp.* v. *Hoeper*, 71 U.S. 237, 246–251 (2014), requires the Court to assess the challenged statement from the perspective of the reasonable audience—here, sophisticated consumers of news concerning the penny-stock market—the implication Scottsdale wishes to read into the statement is not reasonable. The reasonable audience for the Article would understand that FINRA fines are civil in nature.

Second, even if the reasonable audience made that unreasonable inference, Scottsdale refuses to acknowledge that a libel defendant "is not responsible for every defamatory implication a reader might draw from his report of true facts, absent evidence that he *intended* the defamatory implication." *Royal Palace Homes*, 197 Mich. App. at 56 (emphasis added). Scottsdale has not pleaded any facts from which the Court could reasonably infer that Defendants *intended* the implication that Scottsdale tries to read into the statement. Tellingly, Scottsdale could not cite a single fact *pleaded in the complaint* to establish this intent element. (*See* Opp'n 7–9, Mot. Summ. Dispo., Third Am. Compl. (APPX. 1028a–1030a).)

Third, the implication of which Scottsdale complains is substantially true. Substantial truth is an absolute defense to a defamation claim. *Collins* v. *Detroit Free Press*, 245 Mich. App. 27, 33 (2001). The doctrine precludes liability if the gist or sting of the statement is true. *Ibid.* "[A] statement is not considered false unless it would have a different effect on the mind of the reader from that which the pleaded truth would have produced." *Hawkins* v. *Mercy Health Servs.*, 230 Mich. App. 315, 332 n.12 (1998) (cleaned up).

Here, the pleaded truth is that Scottsdale was fined for selling securities without a registration or an exemption from registration, not for engaging in pump-and-dump schemes.

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(Third Am. Compl. ¶ 22 (APPX. 803a); Opp'n 8, Mot. Summ. Dispo., Third Am. Compl. (APPX. 1029a).) Yet the FINRA Decision details how and why FINRA tied the fine to Scottsdale's failure to properly police transactions susceptible to pump-and-dump frauds. FINRA held that shares sold through Scottsdale were not exempt from registration because the exemption required Scottsdale *to properly police transactions*, which it did not do. (*Id.* at 12–13.) Thus, in FINRA's estimation, Scottsdale was partly responsible for the pump-and-dump schemes. Had Scottsdale done its job properly, innocent people would not have lost money.

Scottsdale's claim rests on the distinction between actively committing fraud and being used as a tool for fraudsters. A person who followed pump-and-dump schemes—*i.e.*, the reasonable audience—would know the difference between these two things *and* understand from the linked FINRA Decision that Scottsdale was involved in pump and dumps *as a tool*. Moreover, the linked FINRA Decision shows that regulators found Scottsdale to be a *willing* tool because it "institutionalized misconduct as its standard way of doing business." FINRA Decision at 105, Part IV.A(l)(d) (APPX. 973a). Anyone who followed pump-and-dump schemes would know of Scottsdale. Anyone who read the entire article (including the linked FINRA Decision) would also understand *how* Scottsdale was involved. At the same time, the reasonable audience—sophisticated consumers of news concerning penny stocks—would detect no meaningful difference between "engaging in" behavior and "being responsible for" that behavior. In both cases, the reasonable audience would understand Scottsdale was *legally culpable* for frauds perpetrated on the market.

Importantly, however, even if the Court were to conclude that the FINRA Decision is not part of the Article and cannot be considered on a C8 motion, the main text of the Article still belies the inference that Scottsdale asserts. The first paragraph introduces Scottsdale as a broker that allows the deposit and sale of penny stocks. Article ¶ 1 (APPX. 823a). The first paragraph also contextualizes the Statement, reminding readers that many of the accounts frozen in connection with the Biozoom pump-and-dump scheme were at Scottsdale. *Ibid.*

Accordingly, Scottsdale's claim is barred under the substantial-truth doctrine.

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V. FAIR-COMMENT PRIVILEGE: The trial court should have dismissed the defamation claim because the Article addresses a matter of public concern, making the Statement privileged under the common law fair-comment privilege.

"The principle of 'fair comment' affords legal immunity for the honest expression of opinion on matters of legitimate public interest when based upon a true or privileged statement of fact." *Deitz* v. *Wometco West Mich. TV*, 160 Mich. App. 367, 376 (1987). Although *Deitz* held that the fault standard for the fair-comment privilege is negligence in a private figure case, the Michigan Supreme Court held in *Dadd* v. *Mount Hope Church*, 486 Mich. 857 (2010), that a plaintiff must prove untruth *and* actual malice" when the privilege applies in a private-figure case. *Id.* at 857 n.1.[30]

Here, the statement is fair comment by a media defendant about disciplinary action taken against a regulated entity whose willful nonfeasance facilitated pump-and-dump frauds. Scottsdale says that "criminal matters" are not always matters of public interest, (Opp'n 11, Mot. Summ. Dispo., Third Am. Compl. (APPX. 1032a)), but that confuses the real issues of interest to the public in two respects. First, as noted in Part V, *supra*, the FINRA fine is a *civil* matter. Second, Defendants provide news to investors, including warnings about stock manipulation schemes to prevent them from being fleeced. The public has an interest in understanding how pump-and-dump schemes work, how they succeed (in part through companies like Scottsdale failing to police transactions), whether a scheme has been detected or is suspected (so that investors can protect themselves), and whether they have been victimized by a scheme (so they can seek redress), among other interests. Under *Dadd*, to overcome the privilege, Scottsdale must plead facts that, if proved, could establish actual malice. It has not done so. Therefore, the trial court should have dismissed the Third Amended Complaint for failing to plead an *unprivileged* publication of the Statement.

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[30] In a partial concurrence, Justice Markman traced the contours of the privilege. *See Dadd*, 486 Mich. at 860–862, 864–867 (Markman, J., concurring in part, dissenting in part). Justice Markman's discussion of the privilege is consistent with the majority opinion. The Court differed over whether the jury was properly instructed. The majority did not believe it reversible error for the instructions to omit a reference to "actual malice," finding the use of "reckless disregard" to be sufficient under the circumstances.

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VI. FAULT NOT ADEQUATELY PLEADED: The trial court should have dismissed the defamation claim because Scottsdale's general allegations of fault are legally insufficient to state a claim.

To adequately plead fault, a plaintiff must identify the level of fault that applies to the claim *and* allege facts that would establish that level of fault if proved. *Gonyea*, 192 Mich. App. at 76–77; *Rouch II*, 440 Mich. at 279. There are two levels of fault: negligence and actual malice. *Ibid.* The negligence standard applies in cases involving private figures; the actual-malice standard applies in cases involving public officials, public figures, and limited-purpose public figures. *Ibid.* Scottsdale alleges that it is a private figure and that MLM and Goode are the direct and proximate cause of its damages, (Third Am. Compl. ¶ 29 (APPX. 804a)), so it impliedly pleads the level of fault to be negligence.

Negligence is defined as the failure to use the care that an ordinary person would use under the circumstances. MICH. CIV. J. INSTR. 10.02. Thus, in order to meet the *Iqbal*-like pleading standard, Scottsdale must allege what a reasonably careful reporter and reasonably careful publisher would have done under the circumstances, and then plead facts alleging that MLM and Goode failed to do those things. *Michigan Microtech, Inc.* v. *Federated Publ'ns*, *Inc.*, 187 Mich. App. 178, 186 (1991). These standards are intertwined with the "reasonable audience" standard. *Air Wis. Airlines Corp.*, 71 U.S. at 246–251. The Complaint does not satisfy these pleading requirements.

Scottsdale alleges that a reasonably careful reporter "reads the documents he cites and would not report, or imply that a fine for procedural noncompliance is the equivalent of a fine for intentional pump and dump activity." (Third Am. Compl. ¶ 24 (APPX. 803a)). Scottsdale would presumably have the Court draw an inference that Goode did not read the FINRA Decision. Yet the Article in which the Statement appears quotes from the FINRA Decision at length. Thus, the Article itself precludes this from being a *reasonable* inference. *Lakeside Oakland Dev.* v. *H&J Beef Co.*, 249 Mich. App. 517, 530 n.4 (2002) ("[w]hen considering a motion under MCR 2.116(C)(8), ... any *reasonable* inferences or conclusions that can be drawn from the facts, are accepted as true." (cleaned up) (emphasis added)).

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Scottsdale's position is that a reasonable journalist would take the time to read source material, but: (1) a reasonable reader would not do so, even though the material forms part of the Article; and (2) the Court should not do so when assessing the sufficiency of the Complaint. Not only does the law presume that the reasonable reader reads the entire story, but in this case the law also presumes that they're sophisticated readers.

Under *Air Wisconsin*, Goode and MLM can reasonably expect that the reasonable audience of visitors to the Website are people familiar with the microcap market, including the players in the market and their roles (*e.g.*, depositor-sellers, broker-dealers, and buyers, etc.). Those readers, being versed in the industry, would conclude that Scottsdale was the *means* by which a pump-and-dump was accomplished, not that Scottsdale had itself engaged in illegal activity—particularly with the benefit of links to source documents.

Under *Rouch II*, a failure to plead *both* the level of fault that must be proved *and the facts* that would establish the speaker acted with that level of fault entitles MLM and Goode to summary disposition under MCR 2.116(C)(8). *Rouch II*, 440 Mich at 279 (Riley, J., concurring). Scottsdale's failure to plead facts adequately supporting a claim of negligence is fatal to the Complaint and the trial court erred in denying summary disposition under MCR 2.116(C)(8).

VII. AMENDMENT FUTILE: The Court should preclude Scottsdale from trying to amend its Complaint.

Leave to amend should be withheld when amendment would be futile. *Allegheny-Ludlam Corp.* v. *Michigan Dep't of Treas.*, 207 Mich. App. 604, 605 (1994). Amendment would be futile in this case. The Statement is nonactionable hyperbole, and no amount of re-pleading will change that. Even if it could be construed as a statement of fact, it is substantially true when considered in light of FINRA's disciplinary decision, it is not capable of defamatory meaning, and it is privileged.

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CONCLUSION

This Court is solicitous of the First Amendment in libel cases lodged against the media. It favors early summary disposition to protect free-speech principles. It requires plaintiffs to specifically plead the level of fault that applies and facts supporting its existence. It prohibits general allegations. And it performs an independent examination of the record to ensure against forbidden intrusions into the field of free expression. Despite these well-established standards, the trial court failed to apply the exacting level of scrutiny required in these cases. MLM and Goode urge the Court to accept their application for interlocutory review to stop this constitutionally infirm lawsuit.

In addition, the Statement is immunized from suit under the fair-comment privilege. Even absent such a privilege, the Statement would still be protected from liability under the substantial-truth doctrine. A reasonable person who reads the Article (an individual whom the law presupposes is a sophisticated reader) would conclude that Scottsdale was the means by which a pump-and-dump was accomplished, not that Scottsdale was engaging in illegal activity. Allowing this case to move forward under these circumstances without interlocutory review would only serve to chill protected speech.

PRAYER FOR RELIEF

WHEREFORE, Defendants respectfully seek leave to proceed with an interlocutory appeal and remand this action for entry of an order of dismissal with prejudice.

Respectfully submitted,

BUTZEL LONG, P.C.

Dated: April 25, 2019

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STATE OF MICHIGAN
MI Court of Appeals

Proof of Service

Case Title:	**Case Number:**
Scottsdale Capital Advisors Corporation v. MorningLightMountain, LLC	TEMP-G1SCZE26

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/s/ Joseph Richotte
Signature

Butzel Long

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In the Court of Appeals
For the State of Michigan

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff-Appellee,

v.

MORNINGLIGHTMOUNTAIN, LLC, and MICHAEL GOODE,

Defendants-Appellants,

–and–

DOES 1–10,

Defendants–Not Participating.

Docket No.

Kalamazoo County Circuit Court
Case No.: 18-0153-CZ
HON. ALEXANDER C. LIPSEY

APPLICATION FOR LEAVE TO PURSUE AN INTERLOCUTORY APPEAL

APPELLANT'S APPENDIX VOLUME I

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I	6a	Order Denying Mot. Summ. Dispo., First Am. Compl. (Oct. 4, 2018)
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V	777a	Opp'n, Mot. Summ. Dispo., Second Am Compl. (Dec. 3, 2018)
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In the Kalamazoo County Circuit Court
For the State of Michigan

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff,

v.

MORNINGLIGHTMOUNTAIN, LLC, MICHAEL GOODE, and DOES 1-10,

Defendants.

Civil No. 18-0153-CZ

HON. ALEXANDER C. LIPSEY

OMNIBUS ORDER
DENYING MOTION FOR SUMMARY DISPOSITION
AND GRANTING STAY OF PROCEEDINGS
PENDING COMPLETION OF INTERLOCUTORY APPEAL

For the reasons stated on the record, the Court denies Defendants' Motion for Summary Disposition of Third Amended Complaint.

The Court grants Defendants' oral motion for a stay of proceedings pending completion of an interlocutory appeal that will be taken from this order denying summary disposition.

Dated: 4/4/2019

HON. ALEXANDER C. LIPSEY
Circuit Judge

AGREED AS TO FORM:

/s/ Margo J. Arnold (w/consent)
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In the Kalamazoo County Circuit Court
For the State of Michigan

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff,

v.

MORNINGLIGHTMOUNTAIN, LLC, MICHAEL GOODE, and DOES 1-10,

Defendants.

Civil No. 18-0153-CZ

HON. ALEXANDER C. LIPSEY

ORDER GRANTING SUMMARY DISPOSITION

The Court grants Defendants' Motion for Summary Disposition for the reasons stated on the record. PLAINTIFF HAS 28 DAYS TO AMEND FROM TODAY'S DATE – JANUARY 11, 2018.

SO ORDERED.

Dated: December 14, 2018

HON. ALEXANDER C. LIPSEY
Circuit Judge

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STATE OF MICHIGAN
IN THE CIRCUIT COURT FOR THE COUNTY OF KALAMAZOO
****

RECEIVED
OCT 29 2018
JOSEPH E. RICHOTTE

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff,

v

MORNINGLIGHTMOUNTAIN, LLC, MICHAEL GOODE, and DOES 1-10,

Defendants.

Circuit Court File No. 2018-0[illegible]-7

Hon. Alexander C. Lipsey

ORDER DENYING DEFENDANTS' MOTION FOR RECONSIDERATION

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OCT 25 2018

At a session of Court in the City and County of Kalamazoo, State of Michigan, on this 25 day of October, 2018.

PRESENT: HONORABLE ALEXANDER C. LIPSEY, Circuit Court Judge

On October 4, 2018, this Court entered an Order and Opinion Denying Defendants' Motion for Summary Disposition. Pending now before this Court is Defendants' Motion for Reconsideration which was timely filed on October 25, 2018. Defendants argue that this Court committed palpable error by finding that there is no heightened pleading requirement in defamation cases, in reaching its decision about whether Plaintiff is a public or private figure, by

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finding it could not review Defendants' exhibits, by applying the doctrine of *res ipsa loquitur*, and by holding that Statement No. 2 is false and defamatory.

Pursuant to MCR 2.119(F), a motion for rehearing or reconsideration is discretionary, and where a motion merely presents issues already ruled on by the court, either expressly or by reasonable implication, it will not be granted. MCR 2.119(F)(3). To be granted, "the moving party must demonstrate a palpable error by which the court and the parties have been misled and show that a different disposition of the motion must result from correction of the error." MCR 2.119(F)(3).

Having reviewed all materials relevant to Defendants' Motion for Reconsideration, this Court finds that Defendants' motion presents the same issues already ruled on by this Court. Furthermore, this Court finds that Defendants have failed to demonstrate "a palpable error by which the court and the parties have been misled." MCR 2.119(F)(3). Therefore, Defendants' Motion for Reconsideration is **DENIED**.

IT IS SO ORDERED.

Dated: October 25, 2018

Honorable Alexander C. Lipsey
Circuit Court Judge

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PROOF OF MAILING

I, Kelly Dollar, certify that on this date I mailed a copy of this document to the parties in interest at their above stated addresses via

☑ first-class mail
and/or
☐ interoffice mail.

Dated: 10-25-18

Kelly L. Dollar
Law Clerk to the Hon. Alexander C. Lipsey

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STATE OF MICHIGAN
IN THE CIRCUIT COURT FOR THE COUNTY OF KALAMAZOO
****

SCOTTSDALE CAPITAL ADVISORS CORPORATION

Plaintiff,

v

MORINGLIGHTMOUTAIN, LLC, MICHAEL GOODE AND DOES 1-10,

Defendants.

Circuit Court File No. 2018-0153-CZ

Hon. Alexander C. Lipsey

OPINION AND ORDER

FILED
OCT 04 2018
9TH JUDICIAL CIRCUIT
COUNTY OF KALAMAZOO
KALAMAZOO, MICHIGAN

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At a session of Court in the City and County of Kalamazoo, State of Michigan, on this 4th day of October, 2018.

PRESENT: HONORABLE ALEXANDER C. LIPSEY, Circuit Court Judge

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STATEMENT OF FACTS AND PROCEDURAL HISTORY

Scottsdale Capital Advisors, the Plaintiff, is an investment banking company that partakes in penny stock trading. Penny stocks are smaller, non-SEC regulated stocks. Scottsdale was used by certain investors to perform a pump-and-dump scheme in order to alter the current stock value for a company called Biozoom. The Defendants, MorningLightMountain, Michael Goode, and Does 1-10, report via blog and social media posts about issues facing the trading and investment world.

On April 17, 2017 and June 14, 2017, MorningLightMountain through the website GoodeTrades.com published two articles which Plaintiffs allege were defamatory. Plaintiff claims the April article contains at least three defamatory, false remarks. The Plaintiffs quote the following three:

1. "If you have followed penny stocks and pump and dumps for a few years then you know Scottsdale Capital Advisors."
2. "They [SCA] are one of the few brokers left that have continued to allow the deposit and sale of shares of illiquid penny stocks. Larger brokers and discount brokers stopped allowing that over five years ago."
3. "When the big Biozoom (BIZM) pump happened back in 2013 many of the frozen accounts were at Scottsdale Capital."

The June article contains at least one defamatory, false remark including the following:

1. "Lest anyone think that these are just minor paperwork deficiencies with no real consequences, I remind you that one pump and dump alone, Biozoom, (BIZM) led to over $17 million in fraudulent profits for manipulators / insiders, and many of accounts were at Scottsdale Capital Advisors."

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Based on these alleged defamatory remarks, Plaintiff filed a summons and complaint on April, 16, 2018 in the 9th Circuit Court of Kalamazoo County. The Defendants filed a Motion for Summary Disposition on June 7, 2018. Plaintiffs responded on August 17, 2018 and Defendants replied on August 20, 2018.

STANDARD OF REVIEW

(C)(8)

A motion for summary disposition brought pursuant to MCR 2.116(C)(8) is appropriate when the opposing party has failed to state a claim on which relief can be granted. A Motion for Summary Disposition under MCR 2.116(C)(8) tests the legal sufficiency of the complaint solely on the basis of the pleadings. *Beaudrie v Henderson*, 465 Mich 124, 129 (2001). "[A]ll well pleaded allegations are accepted as true, and construed most favorably to the non-moving party." *Wade v Dep't of Corr*, 439 Mich 158, 162-163 (1992). A mere statement of conclusions, unsupported by factual allegations, is not sufficient to state a cause of action. *ETT Ambulance Svc Corp v Rockford Ambulance, Inc*, 204 Mich App 392, 395 (1994). A motion under MCR 2.116(C)(8) may be granted only where the claims alleged are "so clearly unenforceable as a matter of law that no factual development could possibly justify recovery." *Wade* at 163.

ANALYSIS

Through the parties' filed briefs, there are three issues at bar. First, there is a question regarding the standard of review. Second, there is a question what exhibits and evidence are admissible under review of MCR 2.116(C)(8). Third, there is a question whether the initial and amended complaint (the Complaint) properly give asserted factual basis for all the elements necessary to allege a defamation case.

1. THE STANDARD OF REVIEW IS NOT ALTERED JUST BECAUSE THE CASE AT BAR INVOLVES AN ALLEGED DEFAMATION.

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The first issue is whether there is a heightened scrutiny when reviewing defamation cases in the scope of MCR 2.116(C)(8). Defendant, the moving party, claims that there is a heightened scrutiny when reviewing a defamation case for legal sufficiency based on its pleadings. The Plaintiff properly states that this claim is without merit. The two cases the Defendants cite to, *Bose Corp. v Consumers Union* and *Thomas M Cooley Law School v Does 1*, are improperly interpreted. 466 US 485 (1984); 300 Mich App 245 (2013). In *Bose Corp.*, the Supreme Court references decisions made in light of *New York Times Co v Sullivan*. 466 at 487-86. This case pertains to public officials. In defamation cases, most states impart a higher standard for public officials to prove "actual malice" before a proper claim can be made. *New York Times Co v Sullivan*, 376 US 254, 268 (1964).

Furthermore, the Defendant's citation of *Thomas M Cooley Law School v Does 1* also fails to appreciate the different standard between a public official or figure and a private one. The Defendant does not assert that the Plaintiff is a public official or figure, and thus by Michigan law the Plaintiff is not required to prove "actual malice" since proof or assertion of "actual malice" is reserved for defamation cases in which a public figure is the victim of the alleged defamatory remarks. *Peterfish v Frantz*, 168 Mich App 43, 52 (1988).

Further, this Court should not find that the Plaintiff is a public figure, even though neither party has argued such. A public figure is a "person who by his accomplishments, fame, or mode of living, or by adopting a calling which gives the public a legitimate interest in his act ivies, affairs, and character, has become a public personage. *Arber v Sahlin*, 382 Mich 300, n 4 (1969). Scottsdale Capital Advisors Corporation does not avail itself, intentionally or otherwise, to the public domain. By its nature of investment banking, the average population does not know the company by name and surely does not have a legitimate interest in its affairs.

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For these reasons, this Court should not implement a higher standard as the Defendant suggests, but instead maintain a normal course of action regarding MCR 2.116(C)(8) that reviews only pleadings for legal sufficiency in light of the alleged wrongdoing. At bar, only normal defamation is being asserted by a private party.

2. THE EXHIBITS AND EVIDENCE PRODUCED IN THE MOVING PARTY'S ORIGINAL BRIEF FOR SUMMARY DISPOSITION ARE NOT CONSIDERED WHEN REVIEWING WHETHER OR NOT THE ORIGINAL AND AMENDED COMPLAINT SUFFICIENTLY PLEADS A CLAIM IN WHICH RELIEF CAN BE GRANTED.

The second issue is whether the Defendants' attached exhibits to their brief for their Motion for Summary Disposition are reviewable by this Court when deciding on a Motion brought under MCR 2.116(C)(8). The Plaintiff is correct that a Motion for Summary Disposition brought under MCR 2.116(C)(8) allows for the court to review only the pleadings already on file as evidence to support the moving party's Motion. *Dalley v Dykema Gossett*, 287 Mich App 296, 305 (2010). Because of this, the exhibits that were introduced via the Defendant's Motion are not to be reviewed when determining the Motion. This Court should only review the prior pleadings, both the original and the amended complaint, and any documents that were previously, properly submitted to the Court.

3. THE ORIGINAL AND AMENDED COMPLAINT SUFFICIENTLY ASSERT AT LEAST ONE FACTUAL BASIS FOR WHICH THIS COURT CAN GRANT RELIEF THAT IS BEING REQUESTED.

For recovery under MCR 2.116(C)(8), the moving party must prove that the Complaint does not establish the elements of the alleged wrongdoing with proper, factual basis. For a party to succeed in a defamation claim, the complainant must establish and prove that there were (1) false and defamatory statements concerning the plaintiff from an (2) unprivileged communication to a third party from (3) fault amounting at least to negligence on the part of the publisher and (4)

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either actionability of the statement irrespective of the special harm or the existence of special harm caused by publication. *Mitan v Campbell*, 474 Mich 21, 25 (2005).

While the parties may disagree on the some peripheral facts outside of the pleading, the issue before this Court is whether the Complaint by the Plaintiff establishes enough asserted factual basis for the Complaint to be properly pleaded. *Harte-Hanks Communications, Inc v Connaughton*, 491 US 657, 685 (1989). In the Complaint, there are four statements made by the Defendant's publication that the Plaintiff alleges to rise to the level of defamation. Only one of the statements need to be properly pleaded for the Motion for Summary Disposition to be denied.

When analyzing each statement, the question is not whether there is enough evidence to make a legal determination as to whether the Defendant is culpable, but rather the Complaint properly asserts a legal stance in which relief can be granted by this Court. In their brief, the Defendant does not address the second and fourth elements of defamation. Instead, the Defendant claims that either the Plaintiff did not establish in their Complaint that the statements were false or defamatory and/or that the duty of care, negligence, has not been met.

The Plaintiff asserts in the Complaint that the Defendant should have known that the statements were false, or in the least acted in reckless disregard when it published the articles.[1] While this statement does not have alleged evidence to prove directly that the Defendant knew of the claim's falsity, this assertion implies a fact basis. If the Defendants were journalist that work within the realm of the investment banking, as they do, then they would likely know if the statements were intentionally false.

This argument is convincing for two reasons. First, applying the legal theory of res ipsa loquitor, the Defendant's statements were made about a realm that they claim to have a lot of

[1] Amended Complaint, ¶ 26, April 20, 2018.

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experience in. If the statements prove to be false, then by its very nature they also meet the third element's standard that requires negligence on behalf of the wrongdoer. Second, Defendants have refused to retract, correct, or apologize for the statements and thus were on notice about their potential falsity.[2] If this court deems the statements to be false, then it consequently also determines that the Defendant's actions were negligent when reporting false statements. Because of this, only the falsity or defamatory nature will need to be assessed per statement within the Complaint.

A. "If you have followed penny stocks and pump and dumps for a few years then you know Scottsdale Capital Advisors."

The first statement from the April 2017 article implies that Scottsdale is associated with pump and dump schemes. The Court is not currently worried about whether this statement is true or false, but is ONLY worried about whether the Complaint filed by the Plaintiff properly asserts a factual basis that this statement by Defendant is false or defamatory. Defendants argue that this statement is factual because the statement does not explicitly state the Plaintiffs have never been a defendant in any pump and dump lawsuit, but claim that the Plaintiffs are still associated with pump and dump schemes because of their broker-dealer status in penny stocks.

The Plaintiff asserts that this statement implies that Scottsdale Capital Advisors are conducting pump and dump schemes. The Complaint alleges that the Plaintiff has never been a defendant and has never been convicted for engaging in pump and dump schemes. This is a strong argument since the Defendant's statements are not commenting on the Plaintiff's status in legal matters, but instead stating that pump and dump activity has been associated with the Scottsdale Capital Advisors. The Complaint does not properly allege a factual basis to refute this, for this reason the Defendant is correct, the Complaint does not properly give a basis to claim the first statement is false.

[2] Amended Complaint, ¶ 23, April 20, 2018.

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B. "They [SCA] are one of the few brokers left that have continued to allow the deposit and sale of shares of illiquid penny stocks. Larger brokers and discount brokers stopped allowing that over five years ago."

The second statement pertains to the amount of brokers who still partake in transactions of illiquid penny stocks. The Complaint attempts to prove this statement's falsity by asserting many large brokers continue to trade in penny stocks. The Defendant's statement asserts that all large brokers have stopped using this penny stock method. The alleged statements made by Defendants could shed a poor light on the Plaintiff in regards to what is common practice and whether the Plaintiff is following normal standards within the practice.

While the Defendant claims the statement is not false because some large brokers still trade in existing shares of penny stocks, instead of purchasing new penny stocks, this is not asserted in the statement and the Complaint properly asserts a basis to prove that statement #2 is false. Further, the statement is inherently defamatory by implying the practices of Scottsdale Capital Advising is not in line with others in its field. This statement would likely affect the opinions of its viewers, even if not illegal, that the practices by the Plaintiff are unusual and not for the betterment of its clients. For this reason, this statement is likely false and defamatory.

C. "When the big Biozoom (BIZM) pump happened back in 2013 many of the frozen accounts were at Scottsdale Capital."

This last statement from the April 2017 article is not false nor defamatory. The assertion in the Complaint states that "only a handful of accounts at SCA were frozen as a result of Biozoom trading. The difference between "many" and "only a handful" is meritless. Further, the Complaint asserts that SCA has never been a defendant in any lawsuit involving Biozoom stock. Once again, the statement by the Defendants do not declare that the Plaintiff was involved in a Biozoom related lawsuit, and thus the Complaint does not properly assert a factual basis for the claim.

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D. "Lest anyone think that these are just minor paperwork deficiencies with no real consequences, I remind you that one pump and dump alone, Biozoom (BIZM) led to over $17 million in fraudulent profits for manipulators / insiders, and many of their accounts were at Scottsdale Capital Advisors."

The final statement comes from the June 2017 article. Defendant's statement in the June article, unlike statement #2 from the April article, does not imply any wrongdoing by Scottsdale Capital Advisors and only states that the accounts that were wrongfully partaking in the pump and dump scheme were being held through the Plaintiff. The Complaint asserts that this statement by Defendant implies the Plaintiff was handling the trading of Biozoom stock and that it was involved in lawsuits regarding the same matter.

The Complaint seems to be making assertions regarding statements that were never made. The statement from the June 2017 article by the Defendants does not claim the Plaintiff is a party to a lawsuit involving Biozoom stock nor does it state that the Plaintiff was partaking in the pump and dump scheme. The only claim is that many of the accounts that were taking part in pump and dump were held at Scottsdale Capital Advisors. For this reason, this statement is also not properly pleaded in the Complaint to assert that it is factually false.

CONCLUSION

As noted above, all of the legality hinges on the falsity or defamatory nature of each statement and whether the Complaint has properly asserted a basis on which the overall claim can stand. Statement #1, #3, and #4 are not sufficiently pleaded because the Complaint does not assert facts that prove these statements were false. However, Statement #2 likely does meet this standard. Because of this, the overall Complaint is sufficiently pleaded when viewed in light favorable to the non-moving party.

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As to Count II, Invasion of Privacy; False Light, the Court having determined that Plaintiff Corporation would have no expectation of privacy Count II fails to state a claim under MCR 2.116(C)(8).

For the reasons cited above, Defendants' Motion for Summary Disposition is **DENIED**.

IT IS SO ORDERED.

Dated: October 4, 2018

Honorable Alexander C. Lipsey
Circuit Court Judge

PROOF OF MAILING

I, Denise Wilson, certify that on this date October 4, 2018 I mailed a copy of this document to the parties in interest at their above stated addresses via first-class mail and/or interoffice mail.

Denise H. Wilson
Judicial Aide to the Hon. Alexander C. Lipsey

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REGISTER OF ACTIONS

CASE NO. 2018-0153-CZ

Scottsdale Capital Advisors Corp. vs MorningLightMountain, LLC et al. § § § § § §

Case Type: **CZ - General Civil**
Date Filed: **04/16/2018**
Location: **Civil Division**
Judicial Officer: **Lipsey, Alexander C.**

PARTY INFORMATION

		Lead Attorneys
Defendant	**Does 1-10**	
Defendant	**Goode, Michael**	**Joseph E. Richotte** *Retained* 248-258-1407(W)
Defendant	**MorningLightMountain, LLC**	**Joseph E. Richotte** *Retained* 248-258-1407(W)
Plaintiff	**Scottsdale Capital Advisors Corp.**	**H Rhett Pinsky** *Retained* 269-451-8496(W)

EVENTS & ORDERS OF THE COURT

OTHER EVENTS AND HEARINGS

04/16/2018 Summons and Complaint - Civil - New Filing ^
04/17/2018 Notice of Review by Business Court Judge
04/20/2018 Amended Complaint
05/11/2018 Notice of Removal to Federal Court
05/25/2018 Stipulation with Order Regarding:
Fixing Deadline to Response to First Amended Complaint
05/25/2018 Substitution of Attorney and Order
05/29/2018 Court of Appeals - Supreme Court - Remand for:
Remanded from the Western Distict of Michigan
06/07/2018 Answer to Amended Complaint ^
06/07/2018 Motion for Summary Disposition
First Amended Complaint - with Brief in Support
06/07/2018 Praecipe
06/07/2018 Proof of Service
06/07/2018 Notice of Scheduled Proceeding ^
on Defendants Motion for Summary Disposition
06/27/2018 Civil Proceedings Scheduling Order MCR 2.401 ^
08/02/2018 Stipulation
Stipulation to Amend Scheduling Order
08/14/2018 Adjournment - Stipulation and Order
to Amend Scheduling Order
08/15/2018 Notice of Scheduled Proceeding ^
08/17/2018 Response to: (Specify)
in Opposition to Motion for Summary Disposition of First Amended Complaint
08/17/2018 Proof of Service
Reply in support of Defendants' Motion for Summary Disposition of First Amended Complaint
08/20/2018 Response to: (Specify)
Reply in support of Defendants' Motion for Summary Disposition of First Amended Complaint
08/20/2018 Proof of Service
on Plaintiff's Response in Opposition to Motion for Summary Disposition of First Amended Complaint
08/20/2018 Motion for Pro Hac Vice
Plaintiff's Motion for Temporary Admission of Out of State Attorney, Nicholas A. Kurtz with supporting documentation
08/20/2018 Proof of Service
on Plaintiff's Motion for Temporary Admission of Out of State Attorney, Nicholas A. Kurtz with supporting documentation
08/21/2018 Order for Pro Hac Vice
as to Nicholas A. Kurtz
08/22/2018 **Motion for Summary Disposition** (9:00 AM) (Judicial Officer Lipsey, Alexander C.)
Parties Present
Result: Held
09/14/2018 Notice of Scheduled Proceeding ^
Amended Trial date- orginial set for the wrong date
09/18/2018 Proof of Service
Plaintiff's First Set of Interrogatories to Defendants; Request for Production to Defendants
10/04/2018 Opinion ^
10/09/2018 Miscellaneous Filing

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Notice of Withdrawal of Plaintiff's Counsel Nicholas A. Kurtz

10/09/2018 **Proof of Service**
of Notice of Withdrawal of Plaintiff's Counsel Nicholas A. Kurtz

10/22/2018 **Transcript**
Motion for Summary Disposition - Wednesday, August 22, 2018

10/22/2018 **List of Witnesses that may be Produced**

10/22/2018 **Proof of Service**
of Plaintiff's Witness List

10/22/2018 **Proof of Service**
Served" Defendants' First Interrogatories, and First Request for Records

10/22/2018 **Proof of Service**
Defendant's Answers to Plaintiff's First set of Interrogatories and Request for Production

10/25/2018 **Motion for Reconsideration - Relief from Judgment ^**
with Proof of Service

10/25/2018 **Order Denying Motion for Reconsideration ^**
Order Denying Defendants' Motion for Reconsideration with proof of service

10/30/2018 **Return of Document**

11/13/2018 **Amended Complaint**
Defendants' Consent for Plaintiff to File Second Amended Complaint with Reliance on Jury Demand

11/13/2018 **Proof of Service**
of Defendants' Consent for Plaintiff to File Second Amended Complaint and Plaintiff's Second Amended Complaint and Reliance on Jury Demand

11/15/2018 **Answer to Amended Complaint ^**
Answer to Plaintiffs' First Amended Complaint with Affirmative and Other Defenses and Reliance on Jury Demand

11/15/2018 **Motion for Summary Disposition**
of Second Amended Complaint

11/15/2018 **Brief - Memorandum**
Supporting Motion for Summary Disposition of Second Amended Complaint

11/15/2018 **Praecipe**

11/15/2018 **Proof of Service**
of Motion for Summary Disposition of Second Amended Complaint, Answer to Plaintiff's First Amended Complaint with Affirmative and Other Defenses

11/15/2018 **Notice of Scheduled Proceeding ^**
of Motion for Summary Disposition scheduled for December 6 @ 1:30 pm

11/26/2018 **Motion for Pro Hac Vice**
Plaintiff's Motion for Temporary Admission of Out of State Attorney with supporting documentation

11/27/2018 **Order for Pro Hac Vice**
as to Jordan Susman

11/29/2018 **List of Witnesses that may be Produced**
Preliminary Witness List

11/29/2018 **Proof of Service**
of Defendants' Preliminary Witness list, Defendants' Second Interrogatories, and Defendants' Second Requests for Records

11/30/2018 **Notice of Scheduled Proceeding ^**
Defendants' Motion for Summary Disposition rescheduled from 12/06/2018 due to court scheduling conflict- parties also emailed notice on 11/30/2018

12/03/2018 **Response to: (Specify)**
Plaintiff's Response in Opposition to Motion for Summary Disposition of Second Amended Complaint

12/03/2018 **Proof of Service**
Plaintiff's Response in Opposition to Motion for Summary Disposition of Second Amended Complaint

12/10/2018 **Response to: (Specify)**
Reply in Support of Motion for Summary Disposition of Second Amended Complaint

12/10/2018 **Proof of Service**
of Defendants' Reply in Support of Motion for Summary Disposition on Second Amended Complaint

12/10/2018 **Motion for Pro Hac Vice**
Plaintiff's Motion for Temporary Admission of Out of State Attorney with supporting documentation

12/11/2018 **Order for Pro Hac Vice**

12/14/2018 **Motion for Summary Disposition** (2:30 PM) (Judicial Officer Lipsey, Alexander C.)
Rescheduled from 12/06/2018- parties were emailed notice of the change in date and time on 11/30/2018- tjc
Parties Present
12/06/2018 Reset by Court to 12/14/2018
Result: Held

12/14/2018 **Motion for Summary Disposition**
Granted for the reasons stated on the record. However, Plaintiff's has 28- days to file an Amended Complaint.

12/19/2018 **Transcript**
of Hearing on Motion for Summary Disposition that was held on Friday, December 14, 2018 @ 2:45 pm

01/11/2019 **Amended Complaint**
Plaintiff's Third Amended Complaint and Jury Demand

01/11/2019 **Proof of Service**
of Plaintiff's Third Amended Complaint, Plaintiff's Responses to Defendants' Second Requests for Records, and Plaintiff's Answers to Defendants' Second Interrogatories

02/01/2019 **Motion for Summary Disposition**

02/01/2019 **Brief - Memorandum**
Brief in support of Defendants' Motion for Summary Disposition

02/01/2019 **Praecipe**
Defendants' Motion for Summary Disposition

02/01/2019 **Proof of Service**
Defendants' Motion for Summary Disposition; Brief in support; Praecipe

02/01/2019 **Answer to Amended Complaint ^**
Defendants' Joint Answer to Third Amended Complaint with Reliance on Jury Demand

02/04/2019 **Notice of Scheduled Proceeding ^**
of Motion for Summary Disposition

02/06/2019 *CANCELED* **Settlement Conference** (1:30 PM) (Judicial Officer Lipsey, Alexander C.)
Other (specify)
12/26/2018

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Continued to 02/06/2019 - Stipulation and Order - Does 1-10; Goode, Michael; MorningLightMountain, LLC; Scottsdale Capital Advisors Corp.

03/20/2019 **Opposition to:**
Plaintiff's Response in Opposition to Motion for Summary Disposition of Third Amended Complaint

03/20/2019 **Proof of Service**
Plaintiff's Response in Opposition to Motion for Summary Disposition of Third Amended Complaint

03/22/2019 **Response to: (Specify)**
Defendant's Reply in Support of Motion for Summary Disposition of Third Amended Complaint

03/25/2019 **Proof of Service**
Defendant's Reply in Support of Motion for Summary Disposition of Third Amended Complaint

03/26/2019 **Motion for Summary Disposition** (10:00 AM) (Judicial Officer Lipsey, Alexander C.)
Result: Held

04/04/2019 **Order Denying Motion for Summary Disposition**
Omnibus Order Denying Motion for Summary Disposition and Granting Stay of Proceedings Pending Completion of Interlocutory Appeal

04/08/2019 **Reporter -Recorder Certificate-Ordering Transcript on Appeal**

04/08/2019 **Transcript**
March 26, 2019 - Motion for Summary Disposition

04/09/2019 *CANCELED* **Civil Jury Trial** (9:00 AM) (Judicial Officer Lipsey, Alexander C.)
Other (specify)

01/15/2019 Continued to 04/16/2019 - Stipulation and Order - Does 1-10; Goode, Michael; MorningLightMountain, LLC; Scottsdale Capital Advisors Corp.

04/16/2019 Reset by Court to 04/09/2019

FINANCIAL INFORMATION

Defendant Goode, Michael

	Total Financial Assessment			514.00
	Total Payments and Credits			514.00
	Balance Due as of 04/24/2019			**0.00**
10/19/2018	Transaction Assessment			18.00
10/19/2018	Counter	Receipt # 2018-04608	Goode, Michael	(18.00)
11/19/2018	Transaction Assessment			333.00
11/19/2018	Counter	Receipt # 2018-05082	Goode, Michael	(333.00)
12/14/2018	Transaction Assessment			63.00
12/14/2018	Counter	Receipt # 2018-05451	Goode, Michael	(63.00)
02/04/2019	Transaction Assessment			40.00
02/04/2019	Counter	Receipt # 2019-00456	Goode, Michael	(40.00)
03/22/2019	Transaction Assessment			5.00
03/22/2019	Counter	Receipt # 2019-01299	Goode, Michael	(5.00)
04/12/2019	Transaction Assessment			55.00
04/12/2019	Counter	Receipt # 2019-01675	Goode, Michael	(55.00)

Defense Attorney Richotte, Joseph E.

	Total Financial Assessment			40.00
	Total Payments and Credits			40.00
	Balance Due as of 04/24/2019			**0.00**
06/07/2018	Transaction Assessment			20.00
06/07/2018	Counter	Receipt # 2018-03284	Richotte, Joseph E.	(20.00)
02/04/2019	Transaction Assessment			20.00
02/06/2019	Mail	Receipt # 2019-00645	Richotte, Joseph E.	(20.00)

Plaintiff Attorney Gordon, Deborah L.

	Total Financial Assessment			280.00
	Total Payments and Credits			280.00
	Balance Due as of 04/24/2019			**0.00**
04/16/2018	Transaction Assessment			260.00
04/16/2018	Counter	Receipt # 2018-01597	Gordon, Deborah L.	(260.00)
08/21/2018	Transaction Assessment			20.00
08/21/2018	Mail	Receipt # 2018-03624	Gordon, Deborah L.	(20.00)

Plaintiff Attorney Pinsky, H Rhett

	Total Financial Assessment			40.00
	Total Payments and Credits			40.00
	Balance Due as of 04/24/2019			**0.00**
11/27/2018	Transaction Assessment			20.00
11/27/2018	Mail	Receipt # 2018-05213	Pinsky, H Rhett	(20.00)
12/11/2018	Transaction Assessment			20.00
12/11/2018	Mail	Receipt # 2018-05396	Pinsky, H Rhett	(20.00)

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FILED
Apr 8 2019
9TH JUDICIAL CIRCUIT
COUNTY OF KALAMAZOO
KALAMAZOO, MICHIGAN

STATE OF MICHIGAN
9TH JUDICIAL CIRCUIT COURT
FOR THE COUNTY OF KALAMAZOO

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff,

v Case No.: 2018-0153-CZ

MORNINGLIGHTMOUNTAIN, LLC,
MICHAEL GOODE, and DOES 1-10,

Defendants.
_____/

MOTION FOR SUMMARY DISPOSITION

BEFORE THE HONORABLE ALEXANDER C. LIPSEY, CIRCUIT JUDGE

Kalamazoo, Michigan - March 26, 2019

APPEARANCES:

For the Plaintiff: **MS. MARGO ARNOLD, (CA#278288)**
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For the Defendant: **MR. JOSEPH RICHOTTE, (P70902)**
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Bloomfield Hills, MI 48304
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AUDIO/VIDEO RECORDED

TRANSCRIBED BY: Ms. Rebecca S. Quarry, CER 8376
Certified Electronic Recorder
(269) 377-7330

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WITNESSES: **PAGE**

None.

EXHIBITS: **IDENTIFIED** **RECEIVED**

None.

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Kalamazoo, Michigan

Tuesday, March 26, 2019 - 10:18 a.m.

THE CLERK: Court is now in session. Please be seated.

THE COURT: Okay.

THE CLERK: Court calls the case of Scottsdale Capital Advisors Corporation versus MornignLightMountain, LLC. Case number 2018-0153-CZ. Please state your appearances for the record.

MS. ARNOLD: Good morning, your Honor, Margo Arnold for the Plaintiff.

MR. RICHOTTE: Good morning, your Honor, Joe Richotte, appearing on behalf of the Defendants and present with me this morning is Mr. Goode.

THE COURT: Good morning. We are here on another motion for summary disposition filed by Defendants citing MCR 2.116(C)(8).

Mr. Richotte, it is your motion.

MR. RICHOTTE: Thank you, your Honor.

Your Honor, we had an opportunity yesterday morning to file our reply to the response brief from the Plaintiff's. I just want to hit a couple of high points and then ask if the Court has any questions that I can address.

The first is an issue that has been recurring here and that is the special standard of review that we believe

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applies in this First Amendment cases. Of course with respect to that issue the Court had in the first motion for summary disposition addressed that issue believing it only applied to a public figure litigation. We had supplied some additional cases here with this motion outlining why we believe that also applies to a private figure case.

With respect to the statement itself -- as the Court knows we have gone from four statements to two statements to one statement. With the remaining statement that we have here we believe that this falls within the scope of the doctrine on rhetorical hyperbole. And while I might agree with what I suspect sister Counsel will argue that the *Komarov* case is not perhaps 100 percent fact for fact on point the legal principle we believe is the same and that is statements of the everyone knows variety are not provably false.

One of the core problems that we pointed out in our opening brief is that the complaint relies on this notion of polling the community. If you ask enough people then you would have a sufficient quantum of evidence, if you will, that people in fact do not know this, but, of course, as we pointed out in our opening brief there is no mechanism in the law to allow for polling the community in that fashion and so there isn't really a viable means of proving the falsity of the statement, of course, that is the whole point of the

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rhetorical hyperbole doctrine is if a statement is not provably false than it isn't actionable.

Even if the Court believes that it is provably false and that there is a vehicle for them to introduce such evidence we believe that the substantial truth of the statement also renders this not actionable.

Importantly Scottsdale does not argue that the actual words of the statement are false. Indeed, the Court has already agreed with Defendants that the statements are literally true.

What we are here about is an alleged implication and that is that there is an inference of criminal conduct by the juxtaposition of the headline that FINRA fined Scottsdale 1.5 million for its involvement in a penny stock pump and dump scheme.

First FINRA is a civil regulatory authority and that would have no authority to punish Scottsdale for criminal conduct. Keeping in mind that *Air Wisconsin* -- the Supreme Court case that talks about the reasonable audience standard we have to keep in mind here that the reasonable audience is a sophisticated consumer of news regarding the penny stock market and the implication that Scottsdale wishes to read into the statement is not reasonable from that perspective.

A reasonable audience for the article would

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understand that FINRA fines are civil in nature only.

Second even if the reasonable audience made that unreasonable inference Scottsdale refuses to acknowledge that a liable defendant is not responsible for every defamatory implication that a reader may draw from the report of true facts absent evidence and -- this is the important point -- that he intended the defamatory implication.

One of the main issues, your Honor, as you will recall when you dismissed the last version of the complaint, is you acknowledged that the Plaintiff has to plead that fact even if it is difficult for them to do so. Even if they believe that the evidence is within our possession there is still an obligation for them to plead facts and what I think is rather telling is its opposition brief Scottsdale does not cite to a single pleaded fact to establish that intent element.

Third, your Honor, the implication that they are actually drawing here, we believe is substantially true even if the Court feels compelled to reach that issue. Of course, a statement is not considered false unless it would have a different effect on the mind of the reader from which the pleaded truth would have produced.

Here the pleaded truth, of course, is that Scottsdale was fined for selling securities without a registration or an exemption for registration.

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But, of course, Scottsdale doesn't dispute that Defendants' analysis of the FINRA panel's decision outlines why FINRA tied the fine to Scottsdale's failure to properly police transactions that are susceptible to pump and dump transactions.

Thus, in FINRA's estimation because Scottsdale didn't properly police transactions that it was required to police that it was partly responsible for the pump and dump schemes. That's why the fine was increased or at least set at the 1.5 level as an aggravating factor.

Had Scottsdale done its job properly frankly innocent people would not have lost money and the reasonable audience, again sophisticated consumers of securities news would detect no meaningful difference between engaging in behavior and being responsible for that behavior. In both cases the reasonable audience would understand that Scottsdale was culpable for the frauds perpetrated on the market.

The next element, of course, your Honor, is defamatory meaning -- and before we go any further there is a footnote in Scottsdale's brief where it asks for sanctions, we of course have responded with a footnote of our own outlining that, of course, the issue of sanctions we believe is inappropriate here where we are reraising arguments necessary to preserve issues for appeal.

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With respect, your Honor, to the element itself, the defamatory meaning Scottsdale argues first that we can't really get to the FINRA report for contextual purposes on the defamatory meaning because that article is not part of -- or excuse me -- that report is not part of the article.

They cite cases from North Carolina and Missouri. *Nucor Corp* and *Mandel* for the proposition that the defamatory meaning has to be judged within the four corners of the document -- the four corners of the article and frankly we don't quarrel with that notion.

Where we differ is on the idea of attachments. Hyperlinks as we have cited in our brief, the *Slater* case and the *Adelson* case -- attachments to a document are no different than you would think of an attachment to a complaint, it is part of the document. When you click on a link it would be no different than flipping to a tab on a motion where you are going to an exhibit and that is what the link provided for here. It allowed readers to click over to the FINRA website and within ten keystrokes, three clicks of a mouse they have the document in front of them.

Now certainly, it is a long document. We have, I am sure, exhausted the patience of the clerk's office with the number of times we have filed the full 110 pages of that document, your Honor, but the fact is it is part of the report, it has to be considered under the case law that we

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have cited and Scottsdale's response that damage is already done before you get the link doesn't really change the analysis. They are assuming that the reader would be essentially too lazy to read through the entirety of the FINRA report with, but the law doesn't presume laziness in the reasonable audience. It presumes that they will read that document and that is why the whole article including its attachments have to be considered.

Your Honor, with respect to the fair comment privilege this would only, of course, be reached if the Court were to find against us on these first several elements, the challenged statement is privileged under Michigan's fair comment privilege and we seem to have a disagreement in briefs as to the nature of the privilege that we are asserting.

We do contend that it is the fair comment privilege, not the public interest privilege. The fair comment privilege still remains intact and has been recently called the qualified privilege in the *Dadd* case. That is a 2010 case from Michigan Supreme Court. I would also note, your Honor, that that is a private figure case where the Supreme Court held that Plaintiffs must prove untruth and actual malice when that privilege applies.

On indeed and partial concurrence Justice Markman traced the contours of the privilege. Where Justice Markman

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and Justice Corrigan diverged from majority in that opinion, your Honor, was really on the language of the jury instruction, not on the nature of the scope of the privilege. So I think in this case, Justice Markman's concurrence is rather instructive on where that privilege stands today.

The principal of fair comment affords legal immunity for the honest expression of opinion on matters of legitimate public interest when based upon a true or privileged statement of fact. Now here, of course, we have no disagreement between the parties that that statement itself is literally true. The issue comes down to whether it is a matter of legitimate public interest.

We agree that conceptually *Rouch* outlines the idea that not every criminal matter is a matter of public interest, of course, some still are. Where I think we have some disagreement between two parties is that there is really different issues that are in play here.

First of course, FINRA is a civil fine as we talked about earlier so we are not talking about criminal matters, although I suspect what we are going to hear is that that there is some analogues, of course, within the securities act that violations of certain regulations can be criminal violations, but again reasonable audience looking at FINRA taking action would understand that that is civil in nature.

But more importantly, your Honor, the Defendants

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provide news to investors. They include warnings about stock manipulation schemes to prevent them from being fleeced. The public has an interest in understanding how pump and dump schemes work, how they succeed, in part through companies like Scottsdale failing to police transactions, whether a scheme has been detected or is suspected so the investors can take action to protect themselves and whether they have been victimized by a scheme so that they can seek redress and, of course, these are just a handful of the legitimate public interest that are served by this reporting.

So to overcome the privilege Scottsdale must plead and prove actual malice under *Dadd* even if it claims to be a public figure -- or excuse me -- a private figure, but, of course, it has not done so as we have already discussed.

Finally, your Honor, on the issue of fault. Scottsdale alleges that a reasonable journalist reads the documents he cites. We tend to agree with that as a concept. The article here in which the statement appears quotes extensively from the FINRA report and so I think the only reasonable inference that eh Court can draw from that is that Mr. Goode did, in fact, read the article -- or excuse me -- read the report.

Scottsdale also alleges that a reasonable journalist would not report or imply that a fine for procedural noncompliance is the equivalent of a fine for

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intentional pump and dump schemes. Of course, as we have already discussed the Court has ruled that the Defendants did not report this. So if we are going to proceed by the implication theory that requires Scottsdale to plead facts from which the Court can infer that the Defendants intended the implication so that you see the tie in as we were talking earlier.

In their opening-- or excuse -- in our opening brief and as we have already laid out here this morning Scottsdale has not pleaded any facts. That is a core deficiency in the complaint that has not been remedied with this third amended complaint. It merely points to the conclusory allegation that Defendants "acted negligently." But that, of course, is insufficient. That is a legal conclusion that will not carry them across the finish line.

With that, your Honor, I would like to see if the Court has any questions before yielding the floor to opposing Counsel.

THE COURT: Well, I am going to ask you to yield the floor because I want to hear both sides of this particular coin so.

MR. RICHOTTE: Very good. Thank you, your Honor.

THE COURT: (Inaudible).

MS. ARNOLD: To start -- pardon me -- with whether or not there is a heightened pleading standard for defamation

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when there is a private figure. The extra cases cited by Defendants do not state that there is a heightened pleading standard for every element. The cases cited explain that there is a specific pleading standard for the defamatory statement.

And here in our case we've specifically plead the defamatory statement as well as attached it to the complaint. So to the extent that they have offered new arguments for this I believe that we sufficiently addressed them in our amended complaint.

Moving to the next issue as to whether or not the defamatory statement is hyperbolic. Everyone knows is not a exaggerated automatically hyperbolic statement. It would be possible to determine whether or not everyone knows that Scottsdale is associated with pump and dump schemes by seeking the testimony of an expert or putting a focus group into evidence. There are many ways to do this where it is not an everyone knows hyperbolic exaggerated statement.

Moving next to the defamatory meaning of statement number one. We argue that you would consider the full 111 page report because you look at that four corners of the defamatory article to determine the context. You look at more than just the statement because it may be an opinion piece, it may be a satirical place in the onion, you look at that to get the full content.

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But to expect a reasonable reader to go to every cite in a report or to look up every referenced report in an article would essentially be setting the standard that an article could be completely defamatory, but as long as it is citing to another report that gets it right it -- the reader is supposed to be reading that report and coming to the conclusion of, oh this article may have gotten it wrong, but I now understand because I have done my own research.

It is just not reasonable to assume that a reader is going to look at an article where it is expecting to get an accurate report of the news and then do its own research into all of the cites that that article came from.

Defendants argue that the statement is substantially true and therefore cannot be liable for defamation.

First we claim that this article is defamatory for two respects.

First that it falsely makes the association that Scottsdale Capital Advisors is known as a pump and dump. That is not true. The article doesn't claim that it is true. The -- I apologize -- the report doesn't claim that it is true.

The second defamatory meaning that we have from the article is that FINRA fined Scottsdale for its involvement in pump and dump activity.

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Now the reasonable audience would interpret this as meaning that it wasn't -- that it was fined for some sort of involvement when the reality is the report was explaining that FINRA fined Scottsdale for failing to adhere to some administrative requirements. Specifically that it did not have registration to act as it did and it did not meet an exception for -- to be -- not have registration. This is substantially different than being involved in pump and dump activity.

While there may be some concerns that it is failures to act in a way to get an exemption, for instance to have safeguards that may have prohibited pump and dump activity from occurring by its clients, that is in no way suggesting that it was actively involved in pump and dump activity.

Essentially this would be saying that -- someone saying there is a warrant out for my arrest for unpaid parking tickets is the same as a warrant out for my arrest because of a hit and run. While, yes the same thing is true, there is a warrant out there, what I did is substantially different and in the eyes of a reasonable reader that would create a material difference in how they view the defamatory implication from that statement.

Defendant has also argued that we have failed to claim -- proficiently plead defamation by implication because

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a defendant is not liable for every inference that a reader makes.

This is absolutely true, however the defendant is liable for the reasonable implications that a reader would draw and we plead that it was reasonable for a reader to assume that a headline reading FINRA fines Scottsdale and the first line of the article being, if you are familiar with pump and dumps you are familiar with Scottsdale that the implication is reasonable Scottsdale has been fined for involvement in pump and dump activity.

Additionally a defendant is liable for defamation by implication if it has omitted a fact that creates a false implication and that is exactly what happened here. Defendants did not write in their article that Scottsdale was fined for failing to have a registration, rather it says Scottsdale was fined and then goes on to talk at length about its involvement in alleged pump and dump activity.

Defendants for the first time raise the argument that their article is protected by the fair comment privilege and if we look -- putting aside our argument as whether or not they were discussing fair comment versus public -- fair public interest -- if we look at fair comment the rule is that it protects honest opinion based on true fact -- true or privileged fact.

Here we do not have an honest opinion based on true

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or privileged fact. We have an article that is saying it is reporting on a FINRA decision. This isn't an opinion, this is a statement of fact and it is not based on a true fact either. If the report, which again the Court has seen -- it is 100 pages -- is very clear that FINRA has fined Scottsdale for an administrative failure. It did not have the proper registration and did not fall into an exemption.

To opine then that this means that they were held -- they were fined for pump and dump activity or are affiliated with pump and dump activity is not an opinion based on this true fact, rather it is creating a new fact based on this report.

Finally, your Honor, with respect to negligence I believe we all agree that in Michigan the negligence standard is that the Defendants' actions have to measure to those of a reasonably careful journalist. And here Scottsdale pleads that a reasonable journalist reads the documents he cites and would not report or imply that a fine for procedural noncompliance is the equivalent of a fine for intentional pump and dump activity.

We adequately plead that Defendants were negligent because they created the implication of false statement number one that FINRA fined Scottsdale 1.5 million for participating in illegal pump and dump schemes despite the fact that the report that they are contending to report on

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states that they were fined -- not for their involvement in a pump and dump scheme, but for the administrative failure to have a registration or qualify for an exemption.

Given the pleading standard of whether or not the pleadings assumed -- taken to be true and in the lights most favorable to the Plaintiff sufficiently give the Defendant notice of the claims and plead the elements sought -- this should -- excuse me -- I believe Plaintiffs have adequately pled their cause of action and that this should be dis -- denied.

THE COURT: Thank you.

MR. RICHOTTE: Your Honor, I have a habit of telling you I will be brief and then I go long. I will try to -- try to stick to it this time.

THE COURT: Standard for attorneys.

MR. RICHOTTE: Let's see. Let's start with hyperbole. It is possible to prove through an expert or a focus group. What we don't have is any way of knowing how you could establish community knowledge through an expert. An expert might have special knowledge or training on a particular issues, but what is in the minds of a community is really beyond the -- if you will pardon the expression -- expertise of an expert.

When we talk about focus groups we run into the problem that we are really still talking about a poll. A

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focus group is by nature going to be limited. This is a online article, which I am sure is why it has drawn the attention of Scottsdale to this courtroom. How is it that we are going to poll a focus group from all across the country and get everybody here to talk about what their views are -- and then of course even then that is not going to be everybody, it is going to be a subset of everybody so how you extrapolate that for the jury I think still raises ultimate proof problems.

Within the question about defamatory meaning and whether you can consider the report, I will assume at this point, your Honor, for argument purposes that the Court will actually consider the report, what we get down to is really a fundamental disagreement as to whether linked out information is part of the article and if the Court were to read the *Adler* case from Nevada and there's both a -- I should say all -- there is three cases, there is a Federal District Court decision where the matter originated. It then went up to the, I believe, 10th Circuit governs Nevada -- or is that a - the 9th --

MS. ARNOLD: 9th Circuit.

MR. RICHOTTE: -- it is 9th Circuit. Our friends in the 9th Circuit certified the question to the Nevada Supreme Court and both the Federal District Court and the Nevada Supreme Court found that linked out information is

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something that should be considered when assessing the action ability of an article.

With respect, your Honor, to substantial truth I would like to focus a moment on the warrant analogy because I think it is a good one, but I also think it is very helpful to us. If a news report -- if a police blogger for example in you local newspaper were to have a story in there that somebody had an arrest warrant period. No explanation. Just there is an arrest warrant. If you know this person either let them know or bring it to the attention of the police. All right. But it doesn't talk about parking, it doesn't talk about what the underlying charge is.

Would the person have a cause of action to come into court and say, well, Judge, they didn't tell everybody that it was just a parking ticket, now I have got people in the community thinking I am some very bad vicious criminal because I have an arrest warrant.

What we are really talking about at that point isn't the accuracy of the news -- we are not even talking about fair implications, what we are talking about is editorial control over the paper.

And that is really what is going on here. If you actually go back to the statement that we are all talking about. It is sometimes easy to overlook as we dive in. The statement is, if you have followed penny stocks and pump and

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dumps for a few years than you know Scottsdale Capital Advisors. Well, what is that you know? Right. Not that they have been involved in a pump and dump scheme because remember the juxtaposition here is the headline. FINRA fines Scottsdale 1.5 million. Doesn't say why they fine them 1.5 million. It says fined them 1.5 million. If you follow pump and dumps than you know Scottsdale Capital Advisors.

If the Court goes back and takes a look at that opening paragraph it introduces the reader to the topic that is being discussed. Scottsdale and the fine that it is going to be talking about.

The second paragraph is where we actually start talking about the FINRA report and when we talk about the FINRA report there is a huge excerpt there talking about John Hurry and the deviousness -- it is an actual quote from the FINRA report -- all right -- that the deviousness of what happened with respect to Scottsdale's failure to comply with regulatory requirements merited an increase in the fine.

And indeed I would like to point the Court to page 11 of our opening brief where we talk about the Panamanian pump and dump from 2008 to 2012 to the Bahamian pump and dump in 2008 and those are in the FINRA panel decision, pages 11 and 12.

Later on after FINRA has talked about Scottsdale's role in those two pump and dumps -- and it is talking about

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aggravating factors for the $1.5 million fine FINRA writes finally, although -- and I am going to use Scottsdale as opposed to the company or the other reference that is used as an oblique reference to Scottsdale -- finally although Scottsdale was not charged in Reuttiger, Gibraltar I, Gibraltar II and Tavella -- and those are cases that tie back to those pump and dumps -- those cases did involve alleged misconduct through accounts at Scottsdale. Those cases put Scottsdale on notice of the risk of sham transactions and the use of nominees to conceal beneficial ownership and facilitate unlawful distributions of securities. They heightened the need for Scottsdale to be alert to red flags. In light of this history it is aggravating that Scottsdale performed its gatekeeping function so poorly.

So part of this $1.5 million fine -- we are not contending that all of it -- is attributable to pump and dumps, but FINRA specifically noted you have a history of facilitating pump and dumps by your nonfeasance. You aren't doing what you are required to do and people are getting scammed. It put you on notice. You have to improve your policing function if you are to continue to do business with FINRA.

And Scottsdale's response was, we do just fine, thank you very much, we don't need to improve. Well Scottsdale saw that -- excuse me -- FINRA saw that

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differently and decided that a $1.5 million fine was necessary to coerce Scottsdale into improving its actions.

When you talk about a $1.5 million fine and you talk about everybody knowing Scottsdale -- anybody in the securities market -- at least the penny stocks side of the securities market that has followed pump and dumps would be aware of the Panamanian scheme, would be aware of the Bahamian scheme, be aware of the litigation that was surrounding that and would be aware that it was Scottsdale that assisted inserting those shares into the market.

So under those circumstances, your Honor, we believe that the substantial truth is evident from the article.

On the final issue of privilege and whether what we are talking about here is an opinion it seems pretty clear to me that if you are talking about -- and this goes back as well to the rhetorical hyperbole side of things, everybody knows, right, if you have been paying attention to penny stocks over the last few years you know about frauds that have gone on in the market. If you know of frauds that have gone on in the market then you would know of the Panamanian scheme, of the Bahamian scheme.

So we get back to is it a fair comment to say, kind of, here we go again, right, if you've paid attention you know about these guys and here is what FINRA has done about

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their failure to uphold their end of the regulatory scheme.

So given that, your Honor, unless the Court has any questions I would be happy to take a seat.

THE COURT: Thank you.

MS. ARNOLD: Just a couple points.

THE COURT: Sure.

MS. ARNOLD: Going back to the arrest analogy and whether or not we are trying to stifle editorial opinion by going into -- the Defendants did just say that FINRA issued a fine, but explained what they believed the fine was for. There is a substantial difference in saying that somebody was fined by FINRA or by saying somebody was arrested.

The reader can draw their own conclusions, but when the publisher is explaining what that fine is for or what that arrest is for they are telling the reader this is what she should be thinking, this is the implication of this fine and in that they are creating a negative defamatory conclusion. In this case if Defendants had just written FINRA fines Scottsdale that would leave the readier to draw their own conclusions as to how severe that fine is.

That is not what Defendants did. Defendants went a step further and said FINRA fines Scottsdale and that that fine was associated with pump and dump activity which draws the reader to conclude that this wasn't just a mere fine, but one associated with pump and dump activity. Something that's

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both illegal and frowned upon in the investment community.

To discuss substantial truth going into the report -- the FINRA report and how it went through the history of pump and dumps and some of Scottsdale's client's affiliations with such pump and dumps, FINRA never stated in its report that Scottsdale was affirmatively participating in or allowing pump and dump activities to occur. Rather it said that enough of these have happened and that FINRA was not satisfied with Scottsdale changing its gatekeeping activities to prevent this.

Now Scottsdale disagreed and in fact they have appealed this FINRA decision, but their failure to adequately gate keep to FINRA's expectation does not mean that they were actively involved in pump and dump activity or doing anything beyond their administrative duties.

To say that it is substantial true that people in t the investment community who are familiar with pump and dump activities and familiar with penny stocks would then be familiar with Scottsdale essentially defeats the hyperbole argument. If that is something that would could prove is substantially true than it is not hyperbole, it is capable of being proved -- proven true or false.

However, it is not substantially true because they have not been associated with pump and dump activity. They have been associated with failing to properly gate keep, to

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receive an exemption to a registration requirement. They have been associated with administrative failure, again, which they are appealing. They are not associated with pump and dump activity or affirmatively acting within the pump and dump schemes.

If your Honor has any questions I am happy to answer them at this time.

THE COURT: No, no question as this point.

MR. RICHOTTE: Your Honor, I appreciate the Court indulging and extended argument this morning.

THE COURT: Sure.

MR. RICHOTTE: I want to focus -- I will make these kind of my final remarks and reply -- the focus that Scottsdale is asking the Court to hone in on is the juxtaposition between the headline, FINRA fines Scottsdale Capital Advisors 1.5 million and the opening statement -- the lead if you will of the article, which is sentence 1, paragraph 1, if you have followed penny stocks and pump and dumps for a few years then you know Scottsdale Capital Advisors, herein referred to as Scottsdale Capital.

Your Honor, if we go back to what the reasonable audience would understand when they look at this, who is Scottsdale Capital Advisors? What is their role in the securities market? Their role is essentially to facilitate the entry of stocks in the marketplace. They don't -- they

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may trade on behalf of their clients if you will, but their role isn't to create the stock. All right. Their role is to simply provide a means, a vehicle by which stock enters the market.

So what would a reasonable audience member understand from that? They would understand that the company that is supposed to be policing these transactions has been involved in pump and dump schemes that clearly got past whatever policing functions had been created internally. All right.

But I think you also have to zoom out from the headline and the lead. You have to take a look at the rest of the article. And, of course, we have talked about the FINRA report itself, I don't need to exhaust the Court's patience on that issue. Even if you look at just the rest of the first paragraph. They are one the of the few brokers left -- brokers, so now we have -- even for people who might have a marginal knowledge of the market we have identified these people as brokers -- that continue to allow the deposit and sale of shares in illiquid penny stocks. So we have now defined who is Scottsdale, what do they do, what is their role in the securities market? Larger brokers and discount brokers stopped allowing that over five years ago. Right. That statement is no longer part of this action either.

When the big Biozoom pump happened in 2013 many of

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the frozen accounts were at Scottsdale Capital. So again this is further evidence that we are not talking about a person who has concocted a scheme, what we are talking about is a business that -- and I -- we used this analogy, I think back on our very first motion, right, to the bank -- right -- where laundered funds are deposited and the bank is supposed to have things in place to stop that from happening, right, they are supposed to have reports that go out to (Inaudible) --

THE COURT: (Inaudible).

MR. RICHOTTE: Yes, exactly, your Honor. So nobody would confuse the bank for having engaged in the money laundering, right, it is the unwitting tool.

Now, here, right the unwitting nature of Scottsdale's participation according to FINRA is no longer really that unwitting, right. When you have consistently been snookered by people who are looking to commit frauds on the market you have got to pay a little bit more attention and up your game and they didn't do that. All right.

That, of course, is the second, third and ongoing paragraphs of the article, right. So, of course, we referenced the fine, we give people a link to it and then we give an expert -- excerpt. And what does the excerpt talk about? Right. The excerpt talks about -- right -- all of the problems and why it is that FINRA issued the fine.

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So it isn't as if reading this article you get the conclusion you are fined for pump and dumps, right. It is very clear you have violated a bunch of regulatory provisions, this is a civil regulatory institution, you have been fined civilly, right, and we understand in part why because you have been engaged in lax oversight that has allowed these pump and dumps.

So, again, what does the reasonable audience understand. That is the touchstone under *Air Wisconsin*. There is really no confusion here from the standpoint of the reader. What is it that is being conveyed? It isn't that Scottsdale has engaged in pump and dump activity. All right. It is that Scottsdale has been the conduit through which pump and dump activity has occurred because of inadequate oversight.

Thank you, your Honor.

THE COURT: Thank you.

This matter is before the Court on summary disposition motion under Michigan Court Rule 2.116(C)(8).

This is kind of the third time through so I think parties are clear that the Court is clear that the function at this particular juncture is for the Court to analyze in this case the third amended complaint as to whether -- looking simply at the pleadings -- whether the Plaintiff has -- has or has not stated a claim upon which relief can be

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granted.

I would note parties have made substantial arguments regarding what can or cannot be shown in terms of whether the Plaintiff actually falls under a -- I guess I will take the last argument -- under a lax enforcement mechanism, an active engagement in pump and dump or some other status which would cause the public to lose faith in the Plaintiff.

The Court has -- and I will take a little diversion here -- the Court has made a ruling with regard to whether there's a heightened standard relating to this particular Plaintiff and the Court is standing by its earlier ruling that Plaintiff does not have to establish actual malice in the publication of this particular article and actually this particular phrase which is the only thing left in terms of an action.

But, the question still needs to be determined as to the other pieces that the Defendant has raised -- so called barriers to going forward with this action based upon the latest amended complaint.

I would note the question of negligence, hyperbole, of whether in fact there is falsehood involved, where in fact the statement itself is defamatory in nature goes to, in essence, proofs that may or may not be available to the Plaintiff. The arguments raised, the citation as to the

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various -- both the FINRA report, which the Court understands is rather elaborate and had a whole lot of matters that don't necessarily touch on this particular issue, all of those are considerations that the Court might well determine in a (C)(10) motion as dispositive of this proceeding, but I am not considering this as dispositive in a (C)(8) proceeding.

Looking at the amended complaint the Court is satisfied that the issue at this point has been properly raised so that it can be properly disposed of by this Court upon full exposition of the underlying facts. I'm convinced that the parties have so narrowed the -- sharpened the focus, I guess, is the best way of saying it, of this matter as to the specific legal issues as related to the facts that -- as each side sees it that a court can, in fact, grant relief either by way of dismissal or of affirmation to the respective parties.

So for that reason the Court is going to deny motion for summary disposition under 2.116(C)(8).

Ms. Arnold, I guess you can prepare a quick order --

MS. ARNOLD: Yes, your Honor.

THE COURT: -- for the reasons stated on the record.

MR. RICHOTTE: Your Honor, just a few housekeeping matters --

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THE COURT: Sure.

MR. RICHOTTE: -- based on that ruling. The first is taking a look at the docket sheet I saw that we have trial scheduled for rather early --

THE COURT: I saw that this morning too.

MR. RICHOTTE: -- next month.

THE COURT: And I am not sure that that is really going to give you guys much of a period to do discovery if nothing else.

MR. RICHOTTE: I would agree, your Honor. Perhaps Counsel can work out a case management order and submit that for your consideration.

THE COURT: That would be acceptable. I -- we have narrowed down the particular, I guess, focus in terms in terms of statements to the point where I think things can be fairly efficiently handled, but it still is going to require a little bit of time and probably some exchange in documents so I would -- yes, if you can provide a reasonable scheduling criteria in this case. I hate disrupting people's summers but my suspicion is we could probably get to this sometime in mid to late summer.

MR. RICHOTTE: Okay.

THE COURT: I think that would be good.

MR. RICHOTTE: All right. And on that note, your Honor, I hope you will understand the spirit of which this is

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offered, it is fairly common in these kinds of cases for a Defendant to seek an interlocutory review --

THE COURT: Sure.

MR. RICHOTTE: -- because there are appellate standards that --

THE COURT: Yep.

MR. RICHOTTE: -- come into play in defamation actions.

THE COURT: Yep.

MR. RICHOTTE: I can talk further obviously with Mr. Goode after this as to whether he intends to pursue that, but at least preliminary indications that I have from him were that he would like to pursue that option. So what I would like to do is first ask the Court -- before we go into the scheduling issue --

THE COURT: Sure.

MR. RICHOTTE: -- for a stay as the Court may be aware I have to ask the Court for a stay before I would even be able to --

THE COURT: Stay of proceedings.

MR. RICHOTTE: Stay of the proceedings, right before proceeding to the Court of Appeals. I would like to at least make that oral motion now.

THE COURT: Yeah. Ms. Arnold, do you have any position on that?

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MS. ARNOLD: No. No objection.

THE COURT: You probably object, but you don't really have any position that can be winnable in front of the Court at that point. Court will grant your request for a stay of these proceedings pending an interlocutory appeal. Quite honestly I -- well, I guess, it probably wasn't ripe earlier because the Court had dismissed each of the other amended complaints, but I anticipated that you would want to at least test the Court with regard to the question of public versus private and that is fine and you may have some other things so I have no problem with going ahead and getting guidance from that standpoint.

MR. RICHOTTE: All right. I appreciate that, your Honor.

THE COURT: No problem.

MR. RICHOTTE: In that case I will be more than happy to prepare that order, we can I am sure exchange them and submit them as stipulated orders for the Court's entry.

THE COURT: No problem. Thank you --

MR. RICHOTTE: All right.

THE COURT: -- very much. I appreciate it.

T MR. RICHOTTE: hank you, your Honor.

THE COURT: Yep. Court will stand in recess.

(At 11:08 a.m., proceeding concluded)

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STATE OF MICHIGAN)
COUNTY OF KALAMAZOO)

I certify that this transcript, consisting of 35 pages, is a complete, true, and correct transcript to the best of my ability of the proceedings held and testimony taken in this case on Tuesday, March 26, 2019, before the Honorable Alexander C. Lipsey, Circuit Judge.

Dated: 04.06.19

Rebecca S. Quarry (CER 8376)
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STATE OF MICHIGAN
IN THE CIRCUIT COURT FOR THE COUNTY OF KALAMAZOO

SCOTTSDALE CAPITAL ADVISORS CORP., an Arizona corporation,

Plaintiff,

v.

MORNINGLIGHTMOUNTAIN, LLC, a Michigan limited liability company d/b/a GoodeTrades.com; MICHAEL GOODE, an individual; and DOES 1-10, inclusive,

Defendants.

FILED
APR 20 2018
9TH CIRCUIT COURT
COUNTY OF KALAMAZOO
KALAMAZOO, MICHIGAN

Case No: 18-0153-CZ
Hon. Alexander C. Lipsey

PLAINTIFF'S FIRST COMPLAINT AND JURY DEMAND

Plaintiff Scottsdale Capital Advisors Corp., for its Complaint against MorningLightMountain, LLC d/b/a GoodeTrades.com and Michael Goode, alleges as follows:

INTRODUCTION

1. Plaintiff Scottsdale Capital Advisors Corp. ("SCA") is a successful securities broker-dealer.

2. In an effort to smear SCA's reputation, MorningLightMountain, LLC d/b/a GoodeTrades.com and Michael Goode (collectively, "Defendants") published two articles on their website, www.goodetrades.com, on April 17, 2017 and June 14, 2017 which contained numerous false, defamatory, and highly misleading statements of and concerning SCA. Among other things, the articles falsely alleged that SCA is involved in penny stock "pump and dump" schemes and improperly permits the trading of penny stocks.

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3. By this action, SCA seeks to clear its good name and hold Defendants liable for the harm caused by their misconduct.

THE PARTIES

4. Plaintiff Scottsdale Capital Advisors Corp. is, and at all times relevant hereto was, a corporation organized under the laws of the State of Arizona, with its principal place of business in Maricopa County, Arizona.

5. SCA is informed and believes and based thereon alleges that Defendant MorningLightMountain, LLC d/b/a GoodeTrades.com ("MorningLightMountain") is, and at all times relevant hereto was, a corporation organized under the laws of the Michigan, with its principal place of business in Eaton County, Michigan. SCA is informed and believes and based thereon alleges that MorningLightMountain owns and operates the website goodetrades.com.

6. SCA is informed and believes and based thereon alleges that Defendant Michael Goode ("Goode") is an individual who resides in Kalamazoo County, Michigan. Upon information and belief, Goode is the sole owner and officer of Defendant MorningLightMountain.

7. SCA is informed and believes and based thereon alleges that the fictitiously-named defendants sued herein as Does 1 through 10, and each of them, are in some manner responsible or legally liable for the actions, events, transactions and circumstances alleged herein. The true names and capacities of such fictitiously-named defendants, whether individual, corporate, or otherwise, are presently unknown to SCA, and SCA will seek leave of Court to amend this Complaint to assert the true names and capacities of such fictitiously-named defendants when the same have been ascertained. For convenience, each reference to a named defendant herein shall also refer to Does 1 through 10. All defendants, including

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MorningLightMountain, LLC d/b/a GoodeTrades.com, Michael Goode, and those referred to herein as Does 1 through 10, are collectively referred to herein as "Defendants."

JURISDICTION AND VENUE

8. This Court has personal jurisdiction over Defendants because they have minimum contacts with the State of Michigan, and defendant Goode is a domiciliary of the State of Michigan.

9. Venue in Kalamazoo is proper because Defendant resides in Kalamazoo County.

10. The amount in controversy exceeds Twenty Five Thousand Dollars ($25,000.00) exclusive of interest, costs, and attorney fees and the matter is otherwise within the jurisdiction of this Court.

FACTS COMMON TO ALL CAUSES OF ACTION

11. Founded in 2002, SCA is a full service broker-dealer focused on serving the microcap securities market, often referred to as the OTC market. In this time, SCA has grown to become one of the dominant companies in the OTC market, with more than $125 million worth of trades in 2015.

12. On April 17, 2017, Defendants published an article written by Goode on the website goodettrades.com, entitled "FINRA fines Scottsdale Capital Advisors $1.5 million" (the "April Article"): https://www.goodetrades.com/2017/04/finra-fines-scottsdale-capital-advisors-1-5-million/. A true and correct copy of the April Article is attached hereto as **Exhibit 1** and incorporated by this reference.

13. The April Article contained numerous statements that are defamatory and outright false, including:

a. **False Statement #1:** "If you have followed penny stocks and pump and dumps

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for a few years then you know Scottsdale Capital Advisors."

In truth, SCA has never been involved in any "pump and dump" schemes, has never been a defendant in any "pump and dump" lawsuits, and has never been convicted of engaging in "pump and dump" activity.

b. **False Statement #2:** "They [SCA] are one of the few brokers left that have continued to allow the deposit and sale of shares of illiquid penny stocks. Larger brokers and discount brokers stopped allowing that over five years ago."

In truth, numerous large brokers continue to trade in penny stocks, including without limitation, interactive brokers, Merrill Lynch, Charles Schwab, Scottrade, Cor Clearing, and TradeKing.

c. **False Statement #3:** "When the big Biozoom (BIZM) pump happened back in 2013 many of the frozen accounts were at Scottsdale Capital."

In truth, only a handful of accounts at SCA were frozen as a result of Biozoom trading. Moreover, SCA has never been a defendant in any lawsuit involving the trading of Biozoom stock.

14. On June 14, 2017, Defendants published a second article written on goodetrades.com by Goode, entitled "SEC Sues Alpine Securities, continuing a run of bad news for owner John Hurry" (the "June Article"): https://www.goodetrades.com/2017/06/ sec-sues-alpine-securities-continuing-a-run-of-bad-news-for-owner-john-hurry/. A true and correct copy of the June Article is attached hereto as **Exhibit 2** and incorporated by this reference.

15. The June Article contains statements that are defamatory and outright false, including:

a. **False Statement #1:** "Lest anyone think that these are just minor paperwork

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deficiencies with no real consequences, I remind you that one pump and dump alone, Biozoom (BIZM) led to over $17 million in fraudulent profits for manipulators / insiders, and many of their accounts were at Scottsdale Capital Advisors."

In truth, other than hosting a handful of accounts that traded in Biozoom shares, SCA had nothing to do with the trading of Biozoom shares. Moreover, as discussed above, SCA has never been involved in any "pump and dump" schemes (including any "pump and dumps" involving Biozoom shares), has never been a defendant in any "pump and dump" lawsuits, and has never been convicted of engaging in "pump and dump" activity.

16. On September 21, 2017, SCA's counsel sent a letter to Defendants identifying the foregoing false statements in the April Article and June Article (collectively, the "Articles"), and demanding that Defendants remove each one and publish a retraction, correction, and apology as to each of those statements. Defendants have failed and refused to comply with SCA's demand.

17. The false, defamatory, and highly misleading statements written and published by Defendants have caused and are continuing to cause SCA economic harm and damage to its reputation. Accordingly, SCA has no alternative but to file this lawsuit for compensatory damages, punitive damages, and injunctive relief, as explained more fully herein.

COUNT ONE
(Against All Defendants)
(Defamation)

18. SCA incorporates by reference all of the preceding paragraphs as though fully restated herein.

19. Defendants wrote and published the defamatory statements of fact about SCA referred to in Paragraphs 13 and 15 herein (collectively, the "Defamatory Statements").

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20. The Defamatory Statements are false. Moreover, the statements, individually and jointly, tend to so harm the reputation of Plaintiff as to lower its reputation in the community or deter third persons from associating or dealing with it.

21. The Defamatory Statements involve materially false implications.

22. The Defamatory Statements have caused SCA to be damaged.

23. Defendants have refused to retract, correct or apologize for the Defamatory Statements after being given notice and ample time to do so.

24. As a direct and proximate result of Defendants' conduct, SCA has suffered damages to its reputation and business interests in an amount to be determined at trial, and in an amount not less than the jurisdictional minimum of this Court. SCA's damages may also be presumed because the Defamatory Statements impute to SCA offenses regarded by public opinion as involving moral turpitude, and unfitness for the proper conduct of its lawful business, trade, and profession.

25. SCA is a private figure for purposes of a defamation analysis.

26. Notwithstanding SCA's status as a private figure, at the time the Defamatory Statements were published, Defendants knew the Defamatory Statements were false and/or acted in reckless disregard of whether the Defamatory Statements were true or false. As such, in addition to compensatory damages and/or presumed damages, SCA is entitled to an award of punitive damages in an amount to be determined at trial.

COUNT TWO
(Against All Defendants)
(Invasion of Privacy: False Light)

27. SCA incorporates by reference all of the preceding paragraphs as though fully restated herein.

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28. Defendants' publication of the Defamatory Statements also caused there to be publicity concerning SCA that placed SCA in a false light in the public eye.

29. By publishing the Defamatory Statements, Defendants broadcast to the public in general, or to a large number of people, information that was unreasonable and highly objectionable by attributing to SCA characteristics and/or conduct that were false and placed SCA in a false position.

30. At the time Defendants published statements, they knew the Defamatory Statements were false and/or acted in reckless disregard as to the falsity of the publicized matter and the false light in which SCA would be placed.

31. Defendants' conduct was not for any proper purpose, nor was it within the scope of Defendants' authority or otherwise immune or privileged.

32. As a direct and proximate result of Defendants' conduct, Plaintiff has suffered damages in an amount to be determined at trial, and in an amount not less than the jurisdictional minimum of this Court.

33. Defendants' conduct deliberately and intentionally injured the Plaintiff; their acts were willful and malicious and are not dischargeable in bankruptcy.

JURY TRIAL DEMAND

SCA hereby demands a jury trial of all issues in this case.

PRAYER FOR RELIEF

WHEREFORE, SCA requests that judgment be entered against the Defendants, and each of them, as follows:

A. For compensatory, consequential, exemplary, and punitive damages in an amount to be determined at trial;

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B. For pre- and post-judgment interest on the foregoing sum at the highest lawful rate from entry of judgment until paid in full;

C. For an injunction enjoining further publication of the Defamatory Statements;

D. For SCA's costs of suit; and

E. For all other relief the Court deems appropriate.

Dated: April 19, 2018

Respectfully submitted,

DEBORAH GORDON LAW

By _____

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FINRA fines Scottsdale Capital Advisors $1.5 million

April 17, 2017 | By Michael Goode | All Categories, Fraud, Microcap, SEC actions

If you have followed penny stocks and pump and dumps for a few years then you know Scottsdale Capital Advisors (hereafter referred to as Scottsdale Capital). They are one of the few brokers left that have continued to allow the deposit and sale of shares in illiquid penny stocks. Larger brokers and discount brokers stopped allowing that over five years ago. When the big Biozoom (BIZM) pump happened back in 2013 many of the frozen accounts were at Scottsdale Capital.

On March 31st, FINRA fined Scottsdale Capital $1.5 million. Unfortunately I cannot find any public posting of that news so the prior link is to a Stockwatch article (full article only available to subscribers; see this copy if not a subscriber). In addition to the fine, John Hurry, owner of Scottsdale Capital, was permanently banned from working in the securities industry.

The full 111-page FINRA decision can be found on their website. Unfortunately FINRA prevents direct-linking so you need to go to http://disciplinaryactions.finra.org/Search/ and then enter "John Hurry" as the name. I have downloaded a copy of the decision in case they delete it.

Excerpt from the decision:

> Hurry's violation of his duty to observe high standards of commercial honor and just and equitable principles of trade was purposeful and egregious. These two qualities lead us to conclude that Hurry is a threat to investors and the integrity of the markets. Our concern is compounded by our credibility findings. We found that he repeatedly testified falsely, and that there was a pattern of doing so when he thought no contradictory evidence would come to light.
>
> When misconduct is intentional, General Principle 1 provides that adjudicators should 572 assess sanctions that exceed the recommended range in the Guidelines. Principal Consideration 13 also focuses on whether a respondent's misconduct is the result of an intentional act, recklessness, or negligence.573 When a violation is egregious, the Guidelines often suggest more severe sanctions. In egregious cases in connection with violations of Rule 2010 and Section 5, the specific Guidelines recommend that an individual be suspended for up to two years or barred.
>
> Even though he has no disciplinary history, the devious nature of Hurry's violation evidences disregard for regulatory requirements, an aggravating factor under General Principle 2 and Principal Consideration 10.574 We have no confidence that if he remained in the securities industry he would not again devise a way to evade the law and regulatory requirements. For this reason also, we believe Hurry is a threat to the investing public.

The decision also shows just how remunerative running Scottsdale Capital has been for Hurry — in 2014 he and his wife made "approximately $6.2 million in directors' fees and $1.45 million in net income."

Disclaimer. No position in any stocks mentioned and I have no relationship with anyone mentioned in this post. This blog has a** terms of use **that is incorporated by reference into this post; you can find all my disclaimers and disclosures there as well.

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SEC Sues Alpine Securities, continuing a run of bad news for owner John Hurry

June 14, 2017 | By Michael Goode | All Categories, All Categories, Fraud, Microcap, SEC actions, Stock Promotions

As I wrote back in April, FINRA fined Scottsdale Capital Advisors $1.5 million for doing a really poor job at preventing illegal sales by penny stock insiders (FINRA Rule 2010). The owner, John J. Hurry, was barred from the industry. The full 111-page FINRA decision can be found on their website. Unfortunately FINRA prevents direct-linking so you need to go to http://disciplinaryactions.finra.org/Search/ and then enter "John Hurry" as the name. I have downloaded a copy of the decision in case they delete it.

From the FINRA report:

> The Respondent firm violated FINRA Rule 2010 by selling securities without registration and without an exemption, in contravention of Section 5 of the Securities Act of 1933. The firm's owner, Respondent John Hurry, also violated Rule 2010, because he engaged in activities designed to enable the unlawful transactions and evade regulatory scrutiny.
>
> The Respondent firm and its Chief Compliance Officer, Respondent Timothy DiBlasi, violated NASD Rules 3010(a) and (b) and FINRA Rule 2010 by failing to establish and maintain a supervisory system, including written supervisory procedures, reasonably designed to ensure that the firm complied with Section 5 of the Securities Act.
>
> The Respondent firm and its President, Respondent Michael Cruz, violated NASD Rule 3010(b) and FINRA Rule 2010 by failing to supervise and failing to respond appropriately to numerous red flags indicative of unlawful unregistered distributions.
>
> The Respondent firm is fined $1.5 million. Hurry is barred in all capacities. He would also be fined $100,000, but, in light of the bar, the fine is not imposed. DiBlasi is suspended for two years and fined $50,000. Cruz is suspended for two years and fined $50,000. In addition, Respondents are ordered to pay costs, for which they are jointly and severally liable.

From the same FINRA report, John "Hurry is a threat to the investment public." The SEC must agree because on June 5, 2017 they sued Alpine Securities, which is another broker specializing in penny stocks owned by John Hurry.

The FINRA report on Scottsdale and Hurry describes the close relationship among them, Alpine Securities, and CSCT, which was based in the Cayman Islands.

> Respondent Hurry thus owns and controls all three firms involved in the transactions at
> issue in this proceeding-Scottsdale, Alpine, and CSCT. In fact, the three firms were almost a
> self-contained system for processing and distributing microcap securities. CSCT did all its
> business through Scottsdale, and Scottsdale in turn did all its business with Alpine. Alpine's
> current CEO described Alpine as a small"boutique" clearing firm with a focus on the kind of
> business brought to it by CSCT. No independent third party was involved in

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> preparing,
> approving, or clearing the deposits of stock certificates by CSCT at Scottsdale for resale.

SEC litigation release against Alpine Securities
SEC complaint against Alpine securities (PDF)

From the litigation release against Alpine Securities:

> Securities and Exchange Commission v. Alpine Securities Corporation
>
> Civil Action No. 7:17-CV-4179 (S.D.N.Y., filed June 5, 2017)
>
> SEC CHARGES BROKERAGE FIRM WITH FAILING TO COMPLY WITH ANTI-MONEY LAUNDERING LAWS
>
> Washington D.C., Jun. 5, 2017 – The Securities and Exchange Commission today charged a Salt Lake City-based brokerage firm with securities law violations related to its alleged practice of clearing transactions for microcap stocks that were used in manipulative schemes to harm investors.
>
> To help detect potential securities law and money-laundering violations, broker-dealers are required to file Suspicious Activity Reports (SARs) that describe suspicious transactions that take place through their firms. The SEC's complaint alleges that Alpine Securities Corporation routinely and systematically failed to file SARs for stock transactions that it flagged as suspicious. When it did file SARs, Alpine Securities allegedly frequently omitted the very information that formed the bases for Alpine knowing, suspecting, or having reason to suspect that a transaction was suspicious. As noted in the complaint, guidance for preparing SARs from the U.S. Treasury Department's Financial Crimes Enforcement Network (FinCEN) clearly states that "[e]xplaining why the transaction is suspicious is critical."
>
> The SEC's complaint charges Alpine Securities with thousands of violations of Section 17(a) of the Securities Exchange Act of 1934 and Rule 17a-8.

From the complaint, the SEC alleges:

> This case concerns Alpine's practices relating to filing Suspicious Activity Reports ("SARs") with the U.S. Treasury Department's Financial Crimes Enforcement Network
> ("FinCEN"). Alpine acts as a clearing firm for many microcap over-the-counter ("OTC") stock
> transactions. Since 2011, Alpine has cleared thousands of deposits of microcap securities, most
> of them involving Scottsdale Capital Advisors Corp. ("Scottsdale") as the introducing broker,
> and many of which were used as part of various stock manipulation and other schemes

Alpine's alleged failures with regard to filing suspicious activity reports (SARs) seem egregious:

> Systematically omitting from at least 1,950 SARs material, "red-flag" information of
> which it was aware and was required to report under its own BSA Compliance Program, such as a customer or issuer's criminal or regulatory history, evidence of
> stock promotion, or whether a customer was a foreign financial institution, including
> at least 1,150 SARs which included only the customer name, date of deposit, dollar
> value of deposit, and the name of the security deposited;

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> • Filing SARs only on the deposit of stock in approximately 1,900 instances in which
> the stock was subsequently liquidated, but failing to file required SARs on subsequent
> related transactions such as the liquidation, or transfer of funds resulting from the
> liquidation, even though it had identified the deposit of the security as suspicious; and
> • Failing to file at least 250 SARs within the required 30 days after the date the suspicious activity was detected.

Alpine has previously been investigated and cited by FINRA for inadequate SARs in 2012 and 2015.

Lest anyone think that these are just minor paperwork deficiences with no real consequences, I remind you that one pump and dump alone, Biozoom (BIZM), led to over $17 million in fraudulent profits for manipulators / insiders, and many of their accounts were at Scottsdale Capital Advisors.

One interesting thing I noticed: this lawsuit against Alpine Securities came on June 5th, which is exactly the day that the bar against a couple employees of Scottsdale Capital Advisors began. From the FINRA complain from April (emphasis mine):

> V. CONCLUSION
>
> The Firm, Scottsdale Capital Advisors, violated FINRA Rule 2010. Accordingly, it is ordered to pay a fine of$ 1.5 million. John J. Hurryviolated FINRA Rule 2010. For his
> misconduct he is barred from association with any FINRA member in any capacity. He would be
> fined $100,000, but, in light ofthe bar, the fine is not imposed. Timothy B. DiBlasi violated
> NASD Rules 3010(a) and (b) and FINRA Rule 2010. For his misconduct, he is suspended for
> two years from association with any FINRA member in any capacity and fined $50,000. D.
> Michael Cruz violated NASD Rule 3010(b) and FINRA Rule 2010. For his misconduct, he is
> suspended for two years from association with any FINRA member in any capacity and fined
> $50,000.
>
> Respondents are also ordered to pay costs in the amount of$22,124.29, which includes a
> $750 administrative fee and $21,374.29 for the cost of the transcript. If this decision becomes
> FINRA's final disciplinary action, Hurry's bar will take immediate effect. **DiBlasi's and Cruz's**
> **suspension will begin with the opening of business on June 5, 2017** The fines and assessed costs
> shall be due on a date set by FINRA, but not sooner than 30 days after this decision becomes
> FINRA's final disciplinary action in this proceeding.

Disclaimer. I have no position in any stock mentioned above. I was long BIZM when trading in it was suspended by the SEC and lost money because of that. I have no relationship with any parties mentioned above. This blog has a *terms of use* ***that is incorporated by reference into this post; you can find all my disclaimers and disclosures there as well.***

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One thought on "SEC Sues Alpine Securities, continuing a run of bad news for owner John Hurry"

krs1 says:

June 14, 2017 at 4:22 pm

This is why you're a millionaire imo. Because you do what others don't! Nice work. Thanks for posting!

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In the Kalamazoo County Circuit Court
For the State of Michigan

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff,

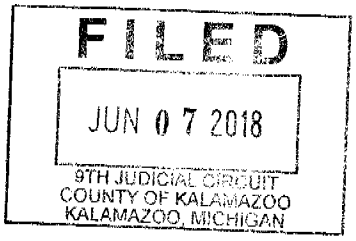
v.

MORNINGLIGHTMOUNTAIN, LLC, MICHAEL GOODE, and DOES 1-10,

Defendants.

Civil No. 18-0153-CZ

HON. ALEXANDER C. LIPSEY



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ANSWER TO PLAINTIFF'S FIRST AMENDED COMPLAINT WITH AFFIRMATIVE AND OTHER DEFENSES

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Under MCR 2.108, as amended by the Stipulated Order Fixing Deadline to Respond to First Amended Complaint, Defendants MorningLightMountain, LLC ("MLM"), and Michael Goode jointly answer Plaintiff Scottsdale Capital Advisors Corp. ("SCA") First Amended Complaint as follows:

INTRODUCTION

1. Plaintiff Scottsdale Capital Advisors Corp. ("SCA") is a successful securities broker-dealer.

ANSWER: MLM and Goode admit that SCA is a broker-dealer of securities. They deny the allegation that SCA is a "successful" broker-dealer for lack of knowledge or information sufficient to form a belief about whether it is true.

2. In an effort to smear SCA's reputation, MorningLightMountain, LLC d/b/a GoodTrades.com and Michael Goode (collectively, "Defendants") published two articles on their website, www.goodetrades.com, on April 17, 2017 and June 14, 2017 which contained numerous false, defamatory, and highly misleading statements of and concerning SCA. Among other things, the articles falsely alleged that SCA is involved in penny stock "pump and dump" schemes and improperly permits the trading of penny stocks.

ANSWER: MLM admits that it operates the website www.goodetrades.com (the "Website"). MLM admits that it published, and Goode admits that he caused MLM to publish, on the Website an article on April 17, 2017, and an article on June 14, 2017. MLM and Goode deny the rest of the allegations in Paragraph 2 as untrue.

3. By this action, SCA seeks to clear its good name and hold Defendants liable for the harm caused by their misconduct.

ANSWER: Denied.

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THE PARTIES

4. Plaintiff Scottsdale Capital Advisors Corp. is, and at all times relevant hereto was, a corporation organized under the laws of the State of Arizona, with its principal place of business in Maricopa County, Arizona.

ANSWER: MLM and Goode deny the allegations for lack of knowledge or information sufficient to form a belief about whether they are true.

5. SCA is informed and believes and based thereon alleges that Defendant MorningLightMountain, LLC d/b/a GoodeTrades.com ("MorningLightMountain") is, and at all times relevant hereto was, a corporation organized under the laws of the [State of] Michigan, with its principal place of business in Eaton County, Michigan. SCA is informed and believes and based thereon alleges that MorningLightMountain owns and operates the website goodtrades.com.

ANSWER: Denied. In the interest of judicial economy, however, MLM admits the following: (1) it is a limited liability corporation organized under the laws of the State of Michigan; (2) its principal place of business is Kalamazoo County; and (3) it operates the Website.

6. SCA is informed and believes and based thereon alleges that Defendant Michael Goode ("Goode") is an individual who resides in Kalamazoo County, Michigan. Upon information and belief, Goode is the sole owner and officer of Defendant MorningLightMountain.

ANSWER: MLM and Goode admit these allegations.

7. SCA is informed and believes and based thereon alleges that the fictitiously-named defendants sued herein as Does 1 through 10, and each of them, are in some manner responsible or legally liable for the actions, events, transactions and circumstances alleged herein. The true names and capacities of such fictitiously-

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named defendants, whether individual, corporate, or otherwise, are presently unknown to SCA, and SCA will seek leave of Court to amend this Complaint to assert the true names and capacities of such fictitiously-named defendants when the same have been ascertained. For convenience, each reference to a named defendant herein shall also refer to Does 1 through 10. All defendants, including MorningLightMountain, LLC d/b/a GoodeTrades.com, Michael Goode, and those referred to herein as Does 1 through 10, are collectively referred to herein as "Defendants."

ANSWER: MLM and Goode lack knowledge or information sufficient to form a belief about whether the Doe defendants exist or have engaged in any acts giving rise to liability. For purposes of answering the First Amended Complaint, MLM and Goode treat the term *Defendants* as applying only to them. None of their answers shall be construed to admit the existence or liability of the Doe defendants or to in any way answer for the Doe defendants.

JURISDICTION AND VENUE

8. This Court has personal jurisdiction over Defendants because they have minimum contacts with the State of Michigan, and defendant Goode is a domiciliary of the State of Michigan.

ANSWER: MLM and Goode submit to the personal jurisdiction of the Court without objection.

9. Venue in Kalamazoo is proper because Defendant [sic] resides in Kalamazoo County.

ANSWER: MLM and Goode are unable to admit or deny this allegation because it does not specify which Defendant resides in Kalamazoo County. In the interest of judicial economy, however, MLM and Goode admit that venue is proper in

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the Kalamazoo County Circuit Court under MCL 600.1621(a) because Goode resides in Kalamazoo County.

10. The amount in controversy exceeds Twenty Five Thousand Dollars ($25,000.00) exclusive of interest, costs, and attorney fees and the matter is otherwise within the jurisdiction of this Court.

ANSWER: MLM and Goode admit that SCA seeks to recover an amount in excess of $25,000, but they deny that SCA is entitled to any recovery.

FACTS COMMON TO ALL CAUSES OF ACTION

11. Founded in 2002, SCA is a full service broker-dealer focused on serving the microcap securities market, often referred to as the OTC market. In this time, SCA has grown to become one of the dominant companies in the OTC market, with more than $125 million worth of trades in 2015.

ANSWER: MLM and Goode admit that SCA is a broker-dealer that services the microcap securities market, which is often referred to as the OTC [over-the-counter] market. MLM and Goode deny the rest of the allegations in Paragraph 11 for lack of knowledge or information sufficient to form a belief about whether they are true.

12. On April 17, 2017, Defendants published an article written by Goode on the website goodtrades.com, entitled "FINRA fines Scottsdale Capital Advisors $1.5 million" (the "April Article"): https://goodtrades.com/2017/04/finra-fines-scottsdale-capital-advisors-1-5-million/. A true and correct copy of the April Article is attached hereto as Exhibit 1 and incorporated by this reference.

ANSWER: MLM admits that it published, and Goode admits that he caused MLM to publish the April Article. They also admit that Exhibit 1 is a true and correct

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copy of the April Article. MLM and Goode deny the rest of the allegations in Paragraph 12 for lack of knowledge or information sufficient to form a belief about whether they are true.

13. The April Article contained numerous statements that are defamatory and outright false, including:

a. **False Statement #1:** "If you have followed penny stocks and pump and dumps for a few years then you know Scottsdale Capital Advisors."

In truth, SCA has never been involved in any "pump and dump" schemes, has never been a defendant in any "pump and dump" lawsuits, and has never been convicted of engaging in "pump and dump" activity.

b. **False Statement #2:** "They [SCA] are one of the few brokers left that have continued to allow the deposit and sale of shares of illiquid penny stocks. Larger brokers and discount brokers stopped allowing that over five years ago."

In truth, numerous large brokers continue to trade in penny stocks, including without limitation, interactive brokers, Merrill Lynch, Charles Schwab, Scottrade, Cor Clearing, and TradeKing.

c. **False Statement #3:** "When the big Biozoom (BIZM) pump happened back in 2013 many of the frozen accounts were at Scottsdale Capital."

In truth, only a handful of accounts at SCA were frozen as a result of Biozoom trading. Moreover, SCA has never been a defendant in any lawsuit involving the trading of Biozoom stock.

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ANSWER: MLM and Goode admit that the April Article contains the three quoted statements in Paragraphs 13a, 13b, and 13c. They deny SCA's characterization of those statements as false and defamatory. Without in any way limiting their defenses, MLM and Goode answer the unnumbered "in truth" sentences that follow Paragraphs 13a–13c as follows:

Regarding the unnumbered "in truth" sentence after Paragraph 13a, MLM and Goode deny SCA's averment that it has never been involved in any pump-and-dump schemes. Involvement in a scheme can be direct or indirect, and knowing or unknowing. Without limiting their defenses in any way, MLM and Goode note that SCA admits to being "involved" in the Biozoom pump-and-dump scheme, acknowledging that Biozoom accounts traded through SCA were frozen through enforcement activity initiated by the U.S. Securities and Exchange Commission ("SEC"). MLM and Goode deny the rest of the allegations in the unnumbered paragraph for lack of knowledge or information sufficient to form a belief about whether they are true.

Regarding the unnumbered "in truth" sentence after Paragraph 13b, MLM and Goode deny SCA's allegations for lack of knowledge or information sufficient to form a belief about whether they are true.

Regarding the unnumbered "in truth" sentence after Paragraph 13c, challenged Statement No. 3 does not state that "many SCA accounts" were frozen; it says "many of the frozen accounts" were at SCA. In connection with *United States Secs. & Exch. Comm'n* v. *Tavella*, Civ. No. 13-4609 (SDNY), an enforcement action filed in connection with the Biozoom pump-and-dump scheme to recover ill-gotten gains and make investors whole, the SEC obtained temporary restraining orders freezing the Biozoom stocks of 10 defendants. SCA held accounts for 5 of the 10

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defendants. *See* Exhibit A, Complaint (R. 1, Jul. 3, 2013); Exhibit B, Stipulation and Order Granting Prelim. Inj., Asset Freeze, and Other Relief (R. 15-1, Jul. 16, 2013); Exhibit C, Biozoom Fair Fund Notice. In the final judgments in *Tavella*, 7 of the 10 defendants agreed to pay funds or Biozoom shares, or cancel Biozoom shares, held in SCA accounts. *See, e.g.*, Exhibit D, Final J. Defs. Graciarena and Loureyro (R. 67, Dec. 8, 2014); Exhibit E, Final Default J. and Order Granting Inj. and Other Relief Against Defendants Tavella, Ficicchia, Blaya, Hernando, Lorenzo, Bagattin, Goldman, and Ferrari (R. 69, Jan. 9, 2015).

Regarding the unnumbered "in truth" sentence after Paragraph 13c, MLM and Goode deny SCA's allegation that it has never been a defendant in any lawsuit involving the trading of Biozoom stock for lack of knowledge or information sufficient to form a belief about the truth of the allegation. MLM and Goode do note, however, that the SEC recently filed *United States Secs. & Exch. Comm'n* v. *Villena*, Civ. No. 18-04309 (SDNY), an enforcement action filed in connection with the Biozoom pump-and-dump scheme. On the same day the SEC filed the *Villena* case, Timothy Scarpino, who worked for SCA during the Biozoom pump-and-dump scheme, entered into an administrative settlement with the SEC. Exhibit F, *In the Matter of Timothy C. Scarpino*, SEC No. 3-18483, Order Instituting Admin. and Cease-and-Desist Proceedings, Making Findings, Imposing Remedial Sanctions, and a Cease-and-Desist Order. Although Scarpino neither admitted nor denied the SEC allegations, the SEC found, *based on Scarpino's settlement offer*, that:

> From late May 2013 to mid-June 2013, Timothy Scarpino ("Scarpino"), then a registered representative at registered broker dealer [SCA], willfully violated Sections 5(a) and 5(c) of the Securities Act when he engaged in the illegal distribution of the securities of Biozoom, Inc. ("Biozoom" or "BIZM") by offering and selling shares of BIZM, which was quoted on the Over-the-Counter Bulletin Board

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("OTCBB"), on behalf of four Argentine customers (the "Argentines"). The scope of this illegal distribution was massive, as Scarpino offered and sold approximately 8.2 million BIZM shares, which constituted almost 14% of BIZM's total outstanding shares, and over 40% of BIZM's total number of shares that did not bear a restrictive legend. The Argentines reaped proceeds of over $18.5 million from the less than four weeks of trading activity facilitated by Scarpino.

Id. at 2, Part III, Summary. The SEC also found, *again based on Scarpino's settlement offer*, that the illegal distribution of securities occurred because Scarpino "failed to conduct a searching inquiry into facts surrounding the proposed sales" of the unregistered Biozoom stock despite the presence of "significant red flags." *Id.*

Among other things, it was this same failure to conduct searching inquiries for a claimed registration exemption that resulted in the Financial Industry Regulatory Authority ("FINRA") taking disciplinary action against SCA. Exhibit G, *FINRA* v. *Scottsdale Capital Advisors Corp.*, No. 2014041724601, Amended Extended Hr'g Panel Decision (Jun. 20, 2017). FINRA imposed a $1.5 million fine against SCA for an "egregious" violation and SCA's "institutionalization of the misconduct as its standard way of doing business," among other aggravating factors. Part of the institutionalized pattern of misconduct included SCA's failure to revise its procedures to focus on potential sham transactions after its role in the Biozoom pump-and-dump that led to the SEC's *Tavella* enforcement action. *Id.* at 11–12, 101–102, 104.

Finally, MLM and Goode deny the rest of the allegations in Paragraph 13, including each of its subparts, for lack of knowledge or information sufficient to form a belief about whether they are true.

14. On June 14, 2017, Defendants published a second article written on goodetrades.com by Goode, entitled "SEC Sues Alpine Securities, continuing a run

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of bad news for owner John Hurry" (the "June Article"): https://www.good-trades.com/2017/06/sec-sues-alpine-securities-continuing-a-run-of-bad-news-for-owner-john-hurry/. A true and correct copy of the June Article is attached hereto as Exhibit 2 and incorporated by this reference.

ANSWER: MLM admits that it published, and Goode admits that he caused MLM to publish the June Article. They also admit that Exhibit 2 is a true and correct copy of the June Article. MLM and Goode deny the rest of the allegations in Paragraph 12 for lack of knowledge or information sufficient to form a belief about whether they are true.

15. The June Article contains statements that are defamatory and outright false, including:

a. **False Statement #1:** "Lest anyone think that these are just minor paperwork deficiencies with no real consequences, I remind you that one pump and dump alone, Biozoom (BIZM) led to over $17 million in fraudulent profits for manipulators / insiders, and many of their accounts were at Scottsdale Capital Advisors."

In truth, other than hosting a handful of accounts that traded in Biozoom shares, SCA had nothing to do with the trading of Biozoom shares. Moreover, as discussed above, SCA has never been involved in any "pump and dump" schemes (including any "pump and dumps" involving Biozoom shares), has never been a defendant in any "pump and dump" lawsuits, and has never been convicted of engaging in "pump and dump" activity.

ANSWER: MLM and Goode admit that the June Article contains the quoted statement in Paragraph 15a. They deny SCA's characterization of that statement as false and defamatory.

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Regarding the unnumbered "in truth" sentence after Paragraph 15a, MLM and Goode deny SCA's averments and incorporate their answers to the unnumbered "in truth" paragraphs after Paragraphs 13a and 13c, without in any way limiting their defenses.

16. On September 21, 2017, SCA's counsel sent a letter to Defendants identifying the foregoing false statements in the April Article and June Article (collectively, the "Articles"), and demanding that Defendants remove each one and publish a retraction, correction, and apology as to each of those statements. Defendants have failed and refused to comply with SCA's demand.

ANSWER: MLM and Goode admit that SCA's counsel sent a letter to them demanding that they remove the four statements identified in Paragraphs 13a–13c and 15a, and publish a retraction, correction, and apology. MLM and Goode also admit that they did not remove the statements or publish a retraction, correction, or apology. MLM and Goode deny that the statements are false or that they had any duty to comply with SCA's demand. MLM and Goode deny the rest of the allegations in Paragraph 16 as untrue in the manner and form stated.

17. The false, defamatory, and highly misleading statements written and published by Defendants have caused and are continuing to cause SCA economic harm and damage to its reputation. Accordingly, SCA has no alternative but to file this lawsuit for compensatory damages, punitive damages, and injunctive relief, as explained more fully herein.

ANSWER: MLM and Goode deny that the four statements identified in Paragraphs 13a–13c and 15a are false, defamatory, or highly misleading. They deny the rest of the allegations in Paragraph 17 for lack of knowledge or information sufficient to form a belief about whether they are true.

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COUNT 1
DEFAMATION

18. SCA incorporates by reference all of the preceding paragraphs as though fully restated herein.

ANSWER: MLM and Goode incorporate by reference all of their answers to the preceding paragraphs as though fully restated herein.

19. Defendants wrote and published the defamatory statements of fact about SCA referred to in Paragraphs 13 and 15 herein (collectively, the "Defamatory Statements").

ANSWER: MLM admits to publishing, and Goode admits to writing, the four statements identified in Paragraphs 13a–13c and 15a. They deny that the statements are defamatory. They also deny that each of the statements are "statements of fact" or "about SCA." MLM and Goode deny the rest of the allegations in Paragraph 19 for lack of knowledge or information sufficient to form a belief about whether they are true.

20. The Defamatory Statements are false. Moreover, the statements, individually and jointly, tend to so harm the reputation of Plaintiff as to lower its reputation in the community or deter third persons from associating or dealing with it.

ANSWER: MLM and Goode deny these allegations as untrue.

21. The Defamatory Statements involve materially false implications.

ANSWER: MLM and Goode deny these allegations as untrue.

22. The Defamatory Statements have caused SCA to be damaged.

ANSWER: MLM and Goode deny that the four statements identified in Paragraphs 13a–13c and 15a are defamatory. They deny that the statements have caused SCA damages for lack of knowledge or information sufficient to form a belief about

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whether it is true.

23. Defendants have refused to retract, correct or apologize for the Defamatory Statements after being given notice and ample time to do so.

Answer: MLM and Goode admit that they did not retract the four statements identified in Paragraphs 13a–13c and 15a. They deny that the statements are incorrect, false, or defamatory. The law does not require an apology. MLM and Goode deny that SCA gave them "ample time" to respond to SCA's demands; SCA demanded a response within 24 hours. MLM and Goode deny the rest of the allegations in Paragraph 23 as untrue in the manner and form stated.

24. As a direct and proximate result of Defendants' conduct, SCA has suffered damages to its reputation and business interests in an amount to be determined at trial, and in an amount not less than the jurisdictional minimum of this Court. SCA's damages may also be presumed because the Defamatory Statements impute to SCA offenses regarded by public opinion as involving moral turpitude, and unfitness for the proper conduct of its lawful business, trade, and profession.

ANSWER: MLM and Goode deny the allegations as untrue as to themselves. They deny the rest of the allegations in Paragraph 24 for lack of knowledge or information sufficient to form a belief about whether they are true.

25. SCA is a private figure for purposes of a defamation analysis.

ANSWER: MLM and Goode deny this allegation as untrue.

26. Notwithstanding SCA's status as a private figure, at the time the Defamatory Statements were published, Defendants knew the Defamatory Statements were false and/or acted in reckless disregard of whether the Defamatory Statements were true or false. As such, in addition to compensatory damages and/or presumed

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damages, SCA is entitled to an award of punitive damages in an amount to be determined at trial.

ANSWER: MLM and Goode deny the allegations as untrue as to themselves. They deny the rest of the allegations in Paragraph 26 for lack of knowledge or information sufficient to form a belief about whether they are true.

COUNT 2
INVASION OF PRIVACY: FALSE LIGHT

27. SCA incorporates by reference all of the preceding paragraphs as though fully restated herein.

ANSWER: MLM and Goode incorporate by reference all of their answers to the preceding paragraphs as though fully restated herein.

28. Defendants' publication of the Defamatory Statements also caused there to be publicity concerning SCA that placed SCA in a false light in the public eye.

ANSWER: MLM and Goode deny that the statements referenced in Paragraph 13a–13c and 15a were defamatory or caused there to be publicity concerning SCA that placed it in a false light in the public eye. MLM and Goode deny the rest of the allegations in Paragraph 28 for lack of knowledge or information sufficient to form a belief about whether they are true.

29. By publishing the Defamatory Statements, Defendants broadcast to the public in general, or to a large number of people, information that was unreasonable and highly objectionable by attributing to SCA characteristics and/or conduct that were false and placed SCA in a false position.

ANSWER: MLM and Goode deny that the statements referenced in Paragraph 13a–13c and 15a are defamatory, that the information in the statements was

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unreasonable or highly objectionable, or that the statements attributed to SCA characteristics and/or conduct that were false or placed SCA in a false position. MLM and Goode deny the rest of the allegations in Paragraph 29 for lack of knowledge or information sufficient to form a belief about whether they are true.

30. At the time Defendants published statements, they knew the Defamatory Statements were false and/or acted in reckless disregard as to the falsity of the publicized matter and the false light in which SCA would be placed.

ANSWER: MLM and Goode deny that the statements referenced in Paragraph 13a–13c and 15a are false or defamatory, that they acted in reckless disregard for the truth, or that SCA was placed in a false light. MLM and Goode deny the rest of the allegations in Paragraph 30 for lack of knowledge or information sufficient to form a belief about whether they are true.

31. Defendants' conduct was not for any proper purpose, nor was it within the scope of Defendants' authority or otherwise immune or privileged.

ANSWER: MLM and Goode deny these allegations as untrue as to themselves. They deny the rest of the allegations in Paragraph 31 for lack of knowledge or information sufficient to form a belief about whether they are true.

32. As a direct and proximate result of Defendants' conduct, Plaintiff has suffered damages in an amount to be determined at trial, and in an amount not less than the jurisdictional minimum of this court.

ANSWER: MLM and Goode deny the allegations as untrue as to themselves. They deny the rest of the allegations in Paragraph 32 for lack of knowledge or information sufficient to form a belief about whether they are true.

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33. Defendants' conduct deliberately and intentionally injured the Plaintiff; their acts were willful and malicious and not dischargeable in bankruptcy.

ANSWER: MLM and Goode deny the allegations as untrue as to themselves. They deny the rest of the allegations in Paragraph 33 for lack of knowledge or information sufficient to form a belief about whether they are true.

AFFIRMATIVE AND OTHER DEFENSES

Under MCR 2.111(F), MLM and Goode assert the following special, affirmative, and other defenses that may apply in whole or in part to the claims that SCA purports to assert in the First Amended Complaint, without assuming the burden of proof on any matters where the burden rests with SCA or any other party.

MLM and Goode give notice that they lack knowledge or information sufficient to form a belief as to the truth of many of the allegations in the First Amended Complaint. Until they avail themselves of their rights to discovery, they cannot determine which, if any, of the following defenses will be asserted at trial or by dispositive motion. These defenses are pleaded to preserve MLM and Goode's right to assert them at trial or by motion, to give fair notice of their intention to assert these defenses, and to avoid a waiver of any defenses.

MLM and Goode reserve the right to assert all special, affirmative, and other defenses that may appear or become available during discovery in this case. They also reserve the right to amend their Answer under MCR 2.118(A)(1), or to seek leave from the Court to amend their Answer under MCR 2.118(A)(2) if necessary, to assert such defenses.

Subject to the foregoing, SCA's claims and requests for relief are barred in whole or in part for one or more of the following reasons:

1. The Complaint fails to state a claim upon which relief can be granted.

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2. The challenged statements are not actionable because they are statements of opinion, not statements of fact.

3. The challenged statements are not materially false.

4. The challenged statements are not defamatory.

5. The challenged statements are not "of and concerning" SCA.

6. SCA has failed to plead fault with the specificity required by law.

7. SCA is a public figure for purposes of this lawsuit.

8. If SCA is a public figure, the challenged statements are not actionable because MLM and Goode did not know any of the statements were false.

9. If SCA is a public figure, the challenged statements are not actionable because MLM and Goode did not act with reckless disregard for whether they were false (*i.e.*, with "actual malice").

10. If SCA is a public figure, the challenged statements are not actionable because SCA cannot prove, with clear and convincing evidence, that MLM and Goode published the statements with actual malice.

11. If SCA is a private figure, the challenged statements are not actionable because MLM and Goode did not negligently publish them.

12. The challenged statements are privileged under the statutory fair-report privilege codified at MCL 600.2911.

13. None of the challenged statements give rise to any defamatory inference or innuendo because of the omission of material facts.

14. The challenged statements are matters of legitimate public interest and concern and received from reliable and official sources, and are privileged under (*a*) the common law and statutes of Michigan; (*b*) Article I, Section 5 of the Michigan Constitution of 1963; and (*c*) the First Amendment to the U.S. Constitution.

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15. SCA is libel-proof.

16. MLM and Goode are not the proximate cause of any damages SCA claims to have suffered; SCA or persons other than MLM and Goode caused SCA's damages.

17. SCA is barred from recovering punitive and/or exemplary damages because that would violate Article I, Section 5 of the Michigan Constitution of 1963 and the First Amendment to the United States Constitution.

18. All of the constitutional and legal defenses applicable to libel actions apply equally to SCA's alternative theory of recovery, "Invasion of Privacy: False Light."

19. The facts about which SCA complains were not private, nor were they highly offensive to the reasonable person.

20. SCA has no right or expectation of privacy with regard to the subject matter of the publications at issue.

21. SCA cannot sue on the challenged statements under the doctrine of judicial estoppel.

22. SCA cannot sue on the challenged statements under the doctrine of collateral estoppel.

23. If SCA was damaged as alleged, then SCA failed to reasonably mitigate its damages.

24. All special, affirmative, and other defenses asserted by a Doe defendant who becomes identified or by any other defendant later added to this action, which MLM and Goode adopt and incorporate as additional defenses.

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RELIANCE ON JURY DEMAND

MLM and Goode rely on SCA's demand for a jury trial on all issues that can be tried to a jury, but object to SCA's demand for a jury trial on its request for injunctive relief. There is no right to a trial by jury on equitable issues. *Smith* v. *University of Detroit*, 145 Mich. App. 468 (1985).

RELIEF REQUESTED

WHEREFORE, MLM and Goode respectfully request that the Court:

1. Dismiss the First Amended Complaint with prejudice;

2. Declare this lawsuit "frivolous" within the meaning of MCR 2.114(F), MCR 2.625(A)(2), and MCL 600.2591. SCA's primary purpose in initiating this strategic lawsuit against public participation is to harass or injure MLM and Goode; SCA has no reasonable basis to believe that the facts underlying its legal position are true; and/or SCA's legal position is devoid of arguable merit.

3. Grant such other and further relief as it deems appropriate.

Respectfully submitted,

BUTZEL LONG

Dated: JUNE 6, 2018

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JUDGE BUCHWALD

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, v. MAGDALENA TAVELLA, ANDRES HORACIO FICICCHIA, GONZALO GARCIA BLAYA, LUCIA MARIANA HERNANDO, CECILIA DE LORENZO, ADRIANA ROSA BAGATTIN, DANIELA PATRICIA GOLDMAN, MARIANO PABLO FERRARI, MARIANO GRACIARENA, and FERNANDO LOUREYRO, Defendants.	Civil Action No. Jury Trial Demanded

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CASHIERS

COMPLAINT

Plaintiff Securities and Exchange Commission (the "Commission") for its Complaint alleges as follows:

1. The Commission brings this civil law enforcement action against Magdalena Tavella, Andres Horacio Ficicchia, Gonzalo Garcia Blaya, Lucia Mariana Hernando, Cecilia De Lorenzo, Adriana Rosa Bagattin, Daniela Patricia Goldman, and Mariano Pablo Ferrari (collectively, the "Selling Defendants") on an emergency basis to prevent millions of dollars of proceeds from unlawful sales of securities being transferred out of the country. Over the past month, the Selling Defendants have sold almost $34 million worth of securities in Biozoom, Inc. ("Biozoom") (f/k/a Entertainment Art, Inc.), a penny stock company traded on the Over-the-Counter Bulletin Board ("OTCBB"), and

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millions more shares are sitting in defendants' brokerage accounts and likely to be sold unlawfully to the public. No registration statement was in effect for the Selling Defendants' resale of securities, thus their sales were in violation of Section 5 of the Securities Act of 1933 (the "Securities Act") [15 U.S.C. § 77e]. Further, almost $17 million of the Selling Defendants' ill-gotten proceeds have been transferred out of the United States. Unless an asset freeze covering the Selling Defendants' Biozoom shares is issued, the unlawful sales of securities and transfer or dissipation of the proceeds from sales of the securities will likely continue.

2. The Commission also brings this civil law enforcement action against Mariano Graciarena and Fernando Loureyro. These defendants recently deposited over a total of approximately 4.4 million shares of Biozoom stock into their respective brokerage accounts. Like the shares sold by the Selling Defendants, there is no registration statement in effect permitting the lawful resale of the Biozoom shares held by Graciarena and Loureyro. Because Graciarena and Loureyro are likely to engage in the sale of securities in violation of Section 5 of the Securities Act, the Commission seeks to enjoin them from offering for resale their Biozoom shares until such time as a registration statement is filed and in effect.

3. From March 2013 to June 2013, defendants opened brokerage accounts at broker-dealers and deposited millions of shares of Biozoom, Inc. (f/k/a Entertainment Art, Inc.) that they claimed did not bear a restrictive legend and were free-trading shares. All of the defendants claimed that they had purchased all or some of their shares from some of the original shareholders of Entertainment Art in transactions between November 2012 and March 2013.

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4. To bolster their claims, each of the defendants submitted stock purchase agreements dated between November 2012 and March 2013 that purportedly evidenced their purchase of Entertainment Art stock from the former Entertainment Art shareholders. Based on these stock purchase agreements and other documentation, the defendants – between March 2013 and June 2013 – deposited a total of 20,130,000 shares of Biozoom into their brokerage accounts.

5. The defendants could not, however, have purchased any of their shares from the original Entertainment Art shareholders as they claimed because those shareholders ceased to have any interest in the company on or around May 2009 –more than ***three years*** earlier than the defendants' claimed purchases.

6. Almost immediately after defendants deposited shares of Biozoom in their brokerage accounts, Biozoom began issuing a series of press releases and a stock promotional campaign for the company began. Following these press releases and stock promotional campaign, from May 16, 2013 to June 21, 2013, the company's stock price and volume increased dramatically. For example, prior to May 16, 2013, no shares in Biozoom had traded. However, from May 16, 2013 to June 21, 2013, Biozoom's stock price shot past $4 per share, with total volume of more than 87 million shares.

7. During this same period, eight of the defendants sold millions of Biozoom shares into the rising market — reaping millions of dollars in proceeds as a result. In total, over an approximately one month period from May 16, 2013 – June 17, 2013, eight of the defendants sold a total of over 14 million shares of Biozoom stock into the public markets for proceeds of almost $34 million.

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8. None of these sales were made pursuant to an effective registration statement. By engaging in the foregoing conduct, the eight Selling Defendants violated the registration provisions of the federal securities laws, Sections 5(a) and 5(c) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. 15 U.S.C. §§ 77e(a) and 77e(c)].

9. While the remaining two defendants – Graciarena and Loureyro – have yet to sell any of their Biozoom shares, they are likely to do so unless restrained. They recently deposited millions of shares into their respective brokerage accounts, claiming (as the other defendants) that these shares have no restrictive legend and are available for resale to the public. Therefore, the Commission seeks an order pursuant to Securities Act Section 20(b) [15 U.S.C. 77t(b)] to enjoin them from violations of Sections 5(a) and 5(c) of the Securities Act.

JURISDICTION AND VENUE

10. The SEC brings this action pursuant to Section 5 [15 U.S.C. § 77e] and Section 20(b) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. § 77t(b)]. Defendants have directly or indirectly made use of the means or instrumentalities of interstate commerce, or of the mails, or the facilities of a national securities exchange in connection with the acts, practices, transactions, and courses of business alleged in this Complaint.

11. This Court has jurisdiction over this action pursuant to Section 22 of the Securities Act [15 U.S.C. § 77v], and 28 U.S.C. § 1331.

12. Venue is proper in this Court pursuant to Section 22(a) of the Securities Act [15 U.S.C. §77v], because certain acts, practices, and courses of business constituting the violations alleged herein have occurred within the Southern District of New York.

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13. Defendants will, unless restrained and enjoined, continue to engage in the acts, practices, transactions, and courses of business alleged in this Complaint, or in acts, practices, transactions, and courses of business of similar purport and object.

THE DEFENDANTS

14. Defendant Andres Horacio Ficicchia resides in Buenos Aires, Argentina and is an Argentine citizen.

15. Defendant Gonzalo Garcia Blaya resides in Buenos Aires, Argentina, and is an Argentine citizen.

16. Defendant Luciana Mariana Hernando resides in Buenos Aires, Argentina, and is an Argentine citizen.

17. Defendant Cecilia De Lorenzo resides in Buenos Aires, Argentina, and is an Argentine citizen.

18. Defendant Magdalena Tavella resides in Buenos Aires, Argentina, and is an Argentine citizen.

19. Defendant Adriana Rosa Bagattin resides in Buenos Aires, Argentina, and is an Argentine citizen.

20. Defendant Daniela Patricia Goldman resides in Buenos Aires, Argentina, and is an Argentine citizen.

21. Defendant Mariano Pablo Ferrari resides in Buenos Aires, Argentina, and is an Argentine citizen.

22. Defendant Mariano Graciarena resides in Buenos Aires, Argentina, and is an Argentine citizen.

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23. Defendant Fernando Loureyro resides in Buenos Aires, Argentina, and is an Argentine citizen.

OTHER RELEVANT ENTITIES

24. Biozoom, Inc. (f/k/a Entertainment Arts, Inc.) is a Nevada corporation with its principal place of business in Kassel, Germany. Biozoom purports to be in the business of researching, developing, and licensing technologies relating to the mobile remote collection of biomedical data as well as bilateral diagnostic communication. Biozoom's common stock is registered with the Commission pursuant to Section 12 of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. §78l] and is quoted on the Over-the-Counter Bulletin Board ("OTCBB") under the trading symbol "BIZM."

25. Legend Securities ("Legend") is a registered broker-dealer located in New York, New York.

26. Scottsdale Capital Advisors ("Scottsdale") is a registered broker-dealer located in Phoenix, Arizona.

FACTUAL BACKGROUND

A. The Creation of Entertainment Art and Initial Sale of Company

27. On June 15, 2007, Entertainment Art was incorporated under the laws of the state of Nevada. In public filings, Entertainment Art represented that it was a developmental stage company formed to design, produce, and sell a line of leather bags, with offices located in West Hempstead, New York. Entertainment Art was controlled by the three members of company management.

28. From November 2007 through March 2008, Entertainment Art offered and sold a total of 610,000 shares to 34 different investors in private placement transactions.

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A share certificate reflecting Entertainment Art share ownership was issued to each investor.

29. On July 18, 2008, Entertainment Art filed a Form S-1 registration statement with the Commission to register the resale transactions for the 34 shareholders who acquired Entertainment Art stock in these private placements ("the Form S-1 Shareholders"). In particular, of the total 1,810,000 shares outstanding at the time of the Form S-1, Entertainment Art's S-1 covered 610,000, or approximately one-third, of the company's then outstanding shares.

30. The remaining 1,200,000 shares of Entertainment Art stock were held by the three company officers in three identical 400,000 share blocks.

31. On May 1, 2009, Entertainment Art announced, in a public filing with the Commission, that the three Entertainment Art officers sold their total 1,200,000 shares of Entertainment Art to Medford Financial Ltd. ("Medford Financial"), a Belizean entity, for a purchase price of $120,000.

32. Contrary to this disclosure, however, Medford Financial purchased more than 1,200,000 shares of Entertainment Art. In fact, Medford Financial also purchased all of the 610,000 shares that had been purchased by the Form S-1 shareholders. Thus, in this transaction, Medford Financial purchased *all* of the outstanding shares, including the shares then held by the Form S-1 Shareholders.

33. Each of the Form S-1 shareholders received their initial investment back, with an additional, small return on their investment. Thus, by on or around May 2009, each of the Form S-1 shareholders had no remaining shares or other interest in Entertainment Art.

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34. According to company filings, on June 30, 2009, Entertainment Art's board of directors approved the implementation of a 33:1 forward split for Entertainment Art stock without correspondingly increasing the authorized shares of common stock for Entertainment Art. On July 21, 2009, the forward split became effective, and as a result of the forward split, the company had 59,730,000 shares of common stock outstanding – which was ***all*** owned by Medford Financial.

B. Another Sale of Entertainment Art and Acquisition of Biozoom Technology

35. On October 25, 2012, Entertainment Art reported, in a public filing with the Commission, that on October 19 Medford Financial sold 39,600,000 common shares of Entertainment Art in a private transaction with Le Mond Capital for a purchase price of $430,000, which equates to approximately $0.01 per share.

36. Le Mond Capital purports to be a foreign entity based in the British Virgin Islands. As a result of the sale, Entertainment Art disclosed that Le Mond Capital controlled over 66.3% of the Company's issued and outstanding common stock.

37. However, on information and belief, Le Mond Capital purchased the *entire* company from Medford Financial – and all of 59,730,000 outstanding shares.

38. The owner of Le Mond Capital, Sara Deutsch, became Entertainment Art's new President, Chief Executive Officer, Principal Executive Officer, Treasurer, Chief Financial Officer, Secretary, Treasurer, and Director. On information and belief, Deutsch is a resident of Buenos Aires, Argentina.

39. From September 2011 to at least October 2012, Deutsch worked as a manager of Magdalena's Party. According to the business' website, Magdalena's Party is

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a restaurant located in Buenos Aires, Argentina. According to another website describing Magdalena's Party, it is co-owned by Deutsch, defendant Magdalena Tavella, and others.

40. On March 12, 2013, Entertainment Art filed a Form 8-K with the Commission in which it announced a dramatic change in its business operations from a company that developed fashionable leather bags to a company that was involved in the biomedical industry. In particular, Entertainment Art announced a transaction pursuant to which its newly formed subsidiary, Biozoom Technologies, Inc., acquired certain patents, licenses, and related assets from each of three separate companies: Opsolution Spectroscopic Systems, Opsolution NanoPhotonics, and Opsolution GmBH, (the "Opsolution acquisition") in exchange for cash of $50,000 and 39 million shares of Entertainment Art common stock.

41. Entertainment Art described that, through Biozoom, it was now in the business of "researching, developing, and licensing technologies relating to the mobile remote collection of biomedical data as well as bilateral diagnostic communication."

42. Entertainment Art further disclosed that – as of immediately after closing of the Opsolution acquisition and filing of the Form 8-K – Deutsch would step down as CEO and Chief Financial Officer of Entertainment Art, but would stay on as a Director only.

43. As a result of the transaction, the 59,730,000 outstanding shares of Entertainment Art were allocated in the following manner. First, Le Mond Capital returned 39,000,000 shares to the company, and then those 39,000,000 shares were allocated – as shares bearing a restrictive legend – to four entities that were associated with the Opsolution entities.

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44. Thus, after these allocations, 20,730,000 shares of Entertainment Art remained. Le Mond Capital retained 600,000 of these shares bearing a restrictive legend. The remaining 20,130,000 shares – which represented the total shares purchased by the Form S-1 Shareholders (and subsequently sold in the Medford Financial transaction on or around May 2009) – were unallocated.

45. On April 1, 2013, Entertainment Art changed its name to Biozoom, under the trading symbol "BIZM" on the OTC Bulletin Board.

C. Defendants Deposit Biozoom Shares In Their Newly Opened Brokerage Accounts

46. From January 2013 to May 2013, brokerage accounts were opened at Legend, a registered broker-dealer based in New York, in the name of four of the defendants: Ficicchia, Blaya, Hernando, and De Lorenzo.

47. In May 2013, brokerage accounts were opened at Scottsdale, a registered broker-dealer based in Phoenix, Arizona, in the name of another four defendants: Tavella, Bagattin, Goldman, and Ferrari.

48. According to the account opening documentation – and as reflected in the table below – with one exception, none of the defendants worked in fields related to securities.

Defendant	Profession
Ficicchia	Self-employed music producer
Blaya	Music producer-stock investments
Hernando	Marketing Manager
De Lorenzo	Self-employed marketing specialist

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Defendant	Profession
Tavella	Attorney practicing administrative, political, intellectual property, and patent law
Bagattin	Retired Teacher
Ferrari	Sales and Marketing
Goldman	Delicatessen owner

1. Accounts at Legend

Andres Horacio Ficicchia

49. Defendant Ficicchia opened his account at Legend on or about January 24, 2013 and funded the account with $26,000 cash.

50. On November 30, 2012, Entertainment Art's transfer agent issued an Entertainment Art certificate for 165,000 shares to Ficicchia.

51. On March 13, 2013, Entertainment Art's transfer agent issued an Entertainment Art certificate for 1,237,500 shares to Ficicchia.

52. The certificate for 1,237,500 shares was accompanied by a corporate certification stating that Deutsch certified – at a board meeting of Entertainment Art on March 22, 2013 – the company approved the issuance of that certificate to Ficicchia.

53. In order to deposit the certificate for 1,237,500 shares and the certificate of 165,000 shares of Entertainment Art into his brokerage account at Legend, defendant Ficicchia completed a "Deposit for Securities Request Certificate Questionnaire" that was required by Legend, and provided additional documentation.

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54. The documentation reflected that Ficicchia acquired the 1,237,500 shares pursuant to two private sales that were completed on February 19, 2013: (1) a purchase of 412,500 shares from Investor A and (2) a purchase of 825,000 shares from Investor B. The documentation also reflected that Ficicchia paid a total of approximately $6,300 for these shares, which equals approximately $.005 per share. For the following reasons, the documentation submitted by Ficicchia was false.

55. Investor A was one of the Form S-1 shareholders who had sold his shares of Entertainment Art on or around May 2009 – almost four years before Ficicchia's claimed purchase of shares from Investor A. Investor B was purportedly a shareholder that acquired its shares from some of the Form S-1 shareholders in 2011 – approximately two years after the Form S-1 shareholders actually sold their shares.

56. The documentation further reflected that Defendant Ficicchia acquired the 165,000 shares pursuant to a private sale that was completed on November 30, 2012 with Investor C – shares that he acquired for $24,750, which equals $0.15 per share. Investor C was also one of the Form S-1 Shareholders who had sold his shares of Entertainment Art on or around May 2009 – over three years before Ficicchia's claimed purchase of shares from Investor C.

57. On March 5, 2013, Ficicchia deposited 165,000 shares of Entertainment Art not bearing a restrictive legend into his brokerage account at Legend; and then on March 27, 2013, Ficicchia deposited an additional 1,237,500 shares (again not bearing a restrictive legend) – for a total of 1,402,500 shares.

58. On April 1, 2013, due to the name change of Entertainment Art to Biozoom, these shares became Biozoom shares. Thus, defendant Ficicchia held

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1,402,500 shares of Biozoom that were purportedly available to be sold on the public markets.

Gonzalo Garcia Blaya

59. On or about March 26, 2013, defendant Blaya opened an account at Legend and funded this account with $26,000 cash.

60. On March 22, 2013 – just four days prior to opening this account – Entertainment Art's transfer agent issued a certificate for 1,485,000 Entertainment Art shares to Blaya.

61. In order to deposit his certificate for 1,485,000 shares of Entertainment Art into his brokerage account at Legend, defendant Blaya completed a "Deposit for Securities Request Certificate Questionnaire" that was required by Legend, and provided additional documentation. For the following reasons, the documentation submitted by Blaya was false.

62. The documentation reflected that Blaya acquired the 1,485,000 shares in four separate private sales that were completed on March 4, 2013: (1) a purchase of 165,000 shares from Investor D; (2) a purchase of 495,000 shares from Investor E; (3) a purchase of 165,000 shares from Investor F; and (4) a purchase of 660,000 shares from Investor G. The documentation also reflected that Blaya paid a total of approximately $6,765 for these shares, which equals approximately $.005 per share.

63. Each of Investors D, E, F, and G were Form S-1 Shareholders who had sold their Entertainment Art shares on or around May 2009 – almost four years before Blaya's claimed purchase of shares from these investors.

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64. On April 16, 2013, Blaya deposited 1,485,000 shares of Entertainment Art not bearing a restrictive legend into his brokerage account at Legend. As a result of the business name change on April 1, 2013, these shares became Biozoom shares. Thus, defendant Blaya held 1,485,000 shares of Biozoom that were purportedly available to be sold on the public markets.

Luciana Mariana Hernando

65. On or about March 7, 2013, defendant Hernando opened an account at Legend and funded the account with $50,000 cash.

66. On March 22, 2013, Entertainment Art's transfer agent issued a certificate for 1,815,000 Entertainment Art shares to Hernando.

67. In order to deposit her 1,815,000 shares of Entertainment Art into her brokerage account at Legend, defendant Hernando completed a "Deposit for Securities Request Certificate Questionnaire" that was required by Legend, and provided additional documentation. For the following reasons, the documentation submitted by Hernando was false.

68. The documentation reflected that Hernando acquired the 1,815,000 shares pursuant to two separate private sales that were completed on March 5, 2013: (1) a purchase of 1,650,000 shares from Investor H; and (2) a purchase of 165,000 shares from Investor I. The documentation also reflected that Hernando paid a total of approximately $5,445 for these shares, which equals approximately $.003 per share.

69. Both Investors H and I were Form S-1 shareholders who had sold their Entertainment Art shares on or around May 2009 – almost four years before Hernando's claimed purchase of shares from these investors.

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70. On May 14, 2013, defendant Hernando deposited 1,815,000 shares of Entertainment Art not bearing a restrictive legend into her brokerage account at Legend Securities. As a result of the business name change on April 1, 2013, these shares became Biozoom shares. Thus, defendant Hernando held 1,815,000 shares of Biozoom that were purportedly available to be sold on the public markets.

Cecilia De Lorenzo

71. On or about February 4, 2013, defendant De Lorenzo opened an account at Legend and funded the account with $50,000 cash.

72. On March 13, 2013, Entertainment Art's transfer agent issued a certificate for 2,062,500 shares to De Lorenzo.

73. The certificate was accompanied by a corporate certification stating that Deutsch certified – at a board meeting of Entertainment Art on March 22, 2013 – the company approved the issuance of the above certificate to De Lorenzo.

74. In order to deposit her 2,062,500 shares of Entertainment Art into her brokerage account at Legend, De Lorenzo completed a "Deposit for Securities Request Certificate Questionnaire" that was required by Legend, and provided additional documentation. For the following reasons, the documentation submitted by De Lorenzo was false.

75. The documentation reflected that De Lorenzo acquired the 2,062,500 shares pursuant to two separate private sales that were completed on February 19, 2013 – the same day as the purported purchases of Entertainment Art stock by Ficicchia: (1) a purchase of 1,650,000 shares from Investor J; and (2) a purchase of 412,500 shares from

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Investor K. The documentation also reflected that Defendant De Lorenzo paid a total of approximately $8,300 for these shares, which equals approximately $.004 per share.

76. Both Investors J and K, however, were Form S-1 shareholders who had sold their Entertainment Art shares on or around May 2009 – almost four years before defendant De Lorenzo's claimed purchase of shares from these investors.

77. On March 22, 2013, defendant De Lorenzo deposited 2,062,500 shares of Entertainment Art not bearing a restrictive legend into her brokerage account at Legend. As a result of the business name change on April 1, 2013, these shares became Biozoom shares. Thus, defendant De Lorenzo held 2,062,500 shares of Biozoom that purportedly could be sold on the public markets.

2. Accounts at Scottsdale

Magdalena Tavella

78. On March 22, 2013, Entertainment Art's stock transfer agent issued a certificate for 1,815,000 shares of Entertainment Art to Tavella.

79. On or about May 16, 2013, defendant Tavella opened an account at Scottsdale.

80. In order to deposit her 1,815,000 shares of Entertainment Art into her brokerage account, Scottsdale, using information and documentation provided by Tavella, completed a securities deposit checklist. For the following reasons, the documentation submitted by Tavella was false.

81. The documentation reflected that Tavella acquired the 1,815,000 shares pursuant to three separate private sales that were completed on March 5, 2013 – the same day as the purported purchases of Entertainment Art by defendant Hernando: (1) a

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purchase of 165,000 shares from Investor L; (2) a purchase of 165,000 shares from Investor M; and (3) a purchase of 1,485,000 shares from Investor N. The documentation reflected that Tavella paid a total of approximately $9,075 for these shares, which equals approximately $.006 per share.

82. Investors L and M were two of the Form S-1 shareholders who had sold their shares of Entertainment Art on or around May 2009 – almost four years before Tavella's claimed purchase of shares from them. Investor N was purportedly a shareholder that acquired its shares from some of the Form S-1 shareholders in March 2011 – almost two years after the Form S-1 shareholders sold their shares.

83. On May 22, 2013, defendant Tavella deposited 1,815,000 shares of Entertainment Art not bearing a restrictive legend into her brokerage account at Scottsdale. As a result of the business name change on April 1, 2013, these shares became Biozoom shares. Thus, defendant Tavella held 1,815,000 shares of Biozoom that were purportedly available to be sold on the public markets.

Adriana Rosa Bagattin

84. On March 13, 2013, Entertainment Art's transfer agent issued a certificate for 2,310,000 Entertainment Art shares to defendant Bagattin.

85. On or about May 10, 2013, defendant Bagattin opened an account at Scottsdale.

86. In order to deposit her 2,310,000 shares of Entertainment Art into her brokerage account, Scottsdale, using information and documentation provided by Bagattin, completed a securities deposit checklist. For the following reasons, the documentation submitted by Bagattin was false.

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87. The documentation reflected that Bagattin acquired the 2,310,000 shares pursuant to three private sales that were completed on February 26, 2013: (1) a purchase of 1,650,000 shares from Investor O; (2) a purchase of 330,000 shares from Investor P; and (3) a purchase of 330,000 shares from Investor Q. The documentation reflected that Defendant Bagattin paid approximately $6,930 for these shares, which equals approximately $.003 per share.

88. Each of Investors O, P, and Q, however, were Form S-1 Shareholders who had sold their Entertainment Art shares on or around May 2009 – almost four years before defendant Bagattin's claimed purchase of shares from these persons.

89. On May 22, 2013, Bagattin deposited 2,310,000 shares of Entertainment Art not bearing a restrictive legend into her brokerage account at Scottsdale. As a result of the business name change on April 1, 2013, these shares became Biozoom shares. Thus, defendant Bagattin held 2,310,000 shares of Biozoom that were purportedly available to be sold on the public markets.

Daniela Patricia Goldman

90. On March 22, 2013, Entertainment Art's transfer agent issued a certificate for 2,485,000 Entertainment Art shares to Goldman.

91. On or about May 13, 2013, defendant Goldman opened an account at Scottsdale.

92. In order to deposit her 2,485,000 shares of Entertainment Art into her brokerage account, Scottsdale, using documentation and information provided by Goldman, completed a securities deposit checklist. For the following reasons, the documentation submitted by Goldman was false.

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93. The documentation reflected that Goldman acquired the 2,485,000 shares pursuant to two private sales that were completed on March 4, 2013: (1) a purchase of 1,485,000 shares from Investor R; and (2) a purchase of 1,000,000 shares from Investor S. The documentation also reflected that Goldman paid approximately $7,455 for these shares, which equals approximately $.003 per share.

94. Investor R purportedly obtained its shares from some of the Form S-1 Shareholders in March 2011 – almost two years after the Form S-1 shareholders sold their shares. Investor S was one of the Form S-1 shareholders and sold his shares on or around May 2009 – almost four years before defendant Goldman's claimed purchase of shares from him.

95. On May 22, 2013, Goldman deposited 2,485,000 shares of Entertainment Art not bearing a restrictive legend into her brokerage account at Scottsdale. As a result of the business name change on April 1, 2013, these shares became Biozoom shares. Thus, defendant Goldman held 2,485,000 shares of Biozoom that were purportedly available for sale on the public markets.

Mariano Pablo Ferrari

96. On March 22, 2013, Entertainment Art's transfer agent issued a certificate for 2,310,000 Entertainment Art shares to Ferrari.

97. On or about May 20, 2013, Ferrari opened an account at Scottsdale.

98. In order to deposit his 2,310,000 shares of Entertainment Art into his brokerage account, Scottsdale, using documentation and information provided by Ferrari, completed a securities deposit checklist. For the following reasons, the documentation provided by Ferrari was false.

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99. The documentation reflected that Ferrari acquired the 2,310,000 shares pursuant to two private sales that were completed on March 5, 2013: (1) a purchase of 1,650,000 shares from Investor T; and (2) a purchase of 660,000 shares from Investor U. The documentation also reflected that Goldman paid approximately $9,240 for these shares, or approximately $.004 per share.

100. Investor T was one of the Form S-1 shareholders and sold his shares on or around May 2009 – almost four years before defendant Ferrari's claimed purchase of shares from him. Investor U purportedly obtained its shares from some of the Form S-1 shareholders in September 2009.

101. On May 22, 2013, Ferrari deposited 2,310,000 shares of Entertainment Art not bearing a restrictive legend into his brokerage account at Scottsdale. As a result of the business name change on April 1, 2013, these shares became Biozoom shares. Thus, defendant Ferrari held 2,310,000 shares of Biozoom that were purportedly available for sale on the public markets.

Two Other Accounts in Names of Defendants Graciarena and Loureyro

102. On March 22, 2013, Manhattan Transfer issued a certificate for 2,145,000 Entertainment Art shares to Graciarena and 2,300,000 Entertainment Art shares to Loureyro. Graciarena and Loureyro submitted documentation reflecting that they had obtained their shares in the same manner as the other eight defendants – i.e. – by purportedly purchasing shares from the Form S-1 shareholders.

103. On or about June 14, 2013, Fernando Loureyro and Mariano Graciarena opened separate accounts at Scottsdale. Like the other eight defendants, both stated in brokerage firm documents that they resided in Buenos Aires, Argentina.

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104. On June 18, 2013, these shares were deposited in the brokerage accounts of these two individuals. To date, none of these shares have been sold.

105. In sum, from November 2012 to June 2013, the ten defendant accounts received a total of 20,130,000 shares of Entertainment Art. These shares represented all of the shares that were unallocated after the Opsolution acquisition. Moreover, these shares represented *100%* percent of the total shares without a restrictive legend outstanding in Biozoom at the time, and more than *33%* percent of the total outstanding shares of Biozoom.

D. Defendants Sell Millions of Biozoom Shares

106. Beginning on May 22, 2013 – and after nearly all of the defendants had deposited their Biozoom shares not bearing a restrictive legend in their accounts – Biozoom began issuing a series of press releases in which it claimed it "created the world's first portable, handheld consumer device" to instantly and non-invasively measure certain biomarkers. These claims were also made by other entities, including Global Financial, Inc., Stock Preacher.com, among others.

107. Following these positive claims concerning Biozoom's prospects, the accounts in the name of eight of the selling defendants sold substantial amounts of their Biozoom stock that did not bear a restrictive legend for massive proceeds. In particular, and as reflected in the chart below, eight of the defendants sold 14,078,406 shares of BIZM stock for proceeds of $33,997,152.

Defendant	Shares Sold	Dates Sold	Proceeds	Shares Remaining
Blaya	1,312,053	5/16/13 – 6/13/13	$3,014,965	172,947
De Lorenzo	1,328,000	6/17/13 – 6/18/13	$4,809,836	734,500
Hernando	1,815,000	6/6/13 – 6/17/13	$5,048,217	0

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Defendant	Shares Sold	Dates Sold	Proceeds	Shares Remaining
Ficcichia	1,402,500	5/20/13 – 6/5/13	$1,979,389	272,620[1]
Tavella	1,592,444	6/7/13 – 6/11/13	$3,116,894	382,956[2]
Bagattin	2,176,726	6/10/13 – 6/18/13	$6,223,310	133,724
Ferrari	1,994,038	6/7/13 – 6/19/13	$5,456,690	315,962
Goldman	2,457,645	5/28/13 – 6/6/13	$3,771,761	27,355

108. All of the eight selling defendants placed their orders to sell Biozoom stock in the same manner – via e-mail and instant message to either Legend or Scottsdale.

109. Upon selling shares in Biozoom, several of the defendants instructed their brokerage firms to wire the proceeds of their sales to foreign bank accounts in various countries:

- **Ficicchia**: On June 7, 2013, defendant Ficicchia instructed Legend, to wire $1 million to Alpine Securities, Inc., a registered clearing broker-dealer. Alpine provides clearing services for Scottsdale, and as described earlier, Ficicchia opened an account at Scottsdale on or around June 10, 2013 and funded it with this $1 million. On June 25, 2013 – the same day as the Commission's order suspending trading in Biozoom – Ficicchia instructed Scottsdale to wire $325,000 to a bank account in Cyprus. This wire was not executed. Ficicchia's brokerage account at Legend currently has a cash balance of slightly over $1 million, and Ficicchia's brokerage account at Scottsdale currently has a cash balance of approximately $328,000.

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[1] On or around June 10, 2013, Ficicchia opened an account at Scottsdale and funded this account with $1 million from his account at Legend. Ficicchia's "Shares Remaining" column reflects Biozoom purchases that he has made in his account at Scottsdale.

[2] Tavella's "Shares Remaining" column includes 160,400 Biozoom shares that she purchased in the open market on June 19, 2013.

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- **Blaya**: On June 14, 2013, Blaya instructed Legend to wire "all settled funds except $30,000" to an account held in Geneva, Switzerland. This wire was not executed. This account currently has a cash balance of approximately $3.5 million.
- **Hernando**: On June 13, 2013, Hernando instructed his broker-dealer, Legend, to wire "all available settled cash" in her account, which at the time, was approximately $600,000, to an account held at Hellenic Bank Public Company Limited in Lemesos, Cyprus. This wire was executed. On June 17, 2013, Hernando instructed his broker-dealer, Legend, to wire $2 million, again to an account held at Hellenic Bank Public Company Limited in Lemesos, Cyprus. This wire was not executed by Legend. This account has a cash balance of approximately $4.5 million.
- **De Lorenzo**: De Lorenzo has not yet attempted to wire any money out of her account. De Lorenzo has a bank account in Dar Es Salaam. The account has a cash balance of approximately $4.8 million.
- **Tavella**: On June 25, 2013 – the day of the Commission's order suspending trading in the securities of Biozoom – Tavella attempted to wire approximately $2,450,000 out of her account at Scottsdale to a bank account in St. Vincent and the Grenandines. This wire has not been executed. The current cash balance in Tavella's brokerage account is approximately $2.47 million.
- **Bagattin**: On June 20, 2013, Bagattin instructed Scottsdale to wire approximately $4.33 million to a bank account in Cyprus. This wire was executed. On June 24, 2013, Bagattin instructed Scottsdale to send an additional

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approximately $1.89 million to the same bank account. This wire was also executed. The current cash balance in Bagattin's brokerage account is $3,000.

- **Goldman:** On June 11, 2013, Goldman instructed Scottsdale to wire approximately $3.77 million to an account held at a bank in Geneva, Switzerland – a bank where Blaya also holds an account. This wire was executed. The cash balance in Goldman's account is $0.
- **Ferrari:** On June 19, 2013, Ferrari instructed Scottsdale to wire $500,000 to an account held at a bank in Panama. This wire was executed. On June 24, 2013, Ferrari instructed Scottsdale to wire an additional $4.9 million, this time to a bank in Belize. This wire was also executed. The cash balance in Ferrari's account is $0.

F. No Registration Statement Was In Effect At the Time Defendants Sold Biozoom Shares

110. Section 5 of the Securities Act makes it unlawful for any person, directly or indirectly, to offer or sell securities, using the U.S. mails or interstate commerce, unless such offer or sale is registered with the Commission.

111. No registration statement was in effect for the shares sold by the Selling Defendants.

112. No registration statement is in effect for the Biozoom shares held by defendants Graciarena and Loureyro.

G. Biozoom Is A Penny Stock As Defined By The Securities Exchange Act of 1934 ("Exchange Act")

113. Biozoom's stock is a "penny stock" as defined by the Exchange Act. At times relevant to this Complaint, the stock's shares traded at less than $5.00 per share. During the same time period, Biozoom's stock did not meet any of the exceptions to

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penny stock classification pursuant to Section 3(a)(51) and Rule 3a51-1 of the Exchange Act.

114. For example, the company's stock: (1) did not trade on a national securities exchange; (2) was not an "NMS stock," as defined in 17 C.F.R. § 242.242.600(b)(47); (3) did not have net tangible assets (i.e., total assets less intangible assets and liabilities) in excess of $5,000,000; and (4) did not have average revenue of at least $6,000,000 for the last three years. (*See* Exchange Act, Rule 3a51-1(g).)

COUNT I

VIOLATION OF SECTION 5 OF THE SECURITIES ACT, 15 U.S.C. §77e

(Defendants Tavella, Ficicchia, Blaya, Hernando, De Lorenzo, Bagattin, Ferrari, Goldman)

115. Paragraphs 1 through 114 are hereby re-alleged and incorporated by reference.

116. Defendants, by engaging in the conduct described above, directly or indirectly, and without a registration statement in effect as to such securities:

(a) made use of means or instruments of transportation or communication in interstate commerce or of the mails to sell, through the use or medium of a prospectus or otherwise; or

(b) carried or caused to be carried through the mails or in interstate commerce, by any means or instruments of transportation, securities for the purpose of sale or for delivery after sale.

117. Defendants, by engaging in the conduct described above, also directly or indirectly, made use of the means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or

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medium of any prospectus or otherwise securities, without a registration statement having been filed as to those securities.

118. By engaging in the foregoing conduct, Defendants directly or indirectly, violated, and unless restrained and enjoined will continue to violate Sections 5(a) and 5(c) of the Securities Act [15 U.S.C. §§ 77e(a) and 77e(c)].

COUNT II

INJUNCTION PURSUANT TO SECTION 20(b) OF THE SECURITIES ACT

(Defendants Graciarena and Loureyro)

119. Paragraphs 1 through 114 are re-alleged and incorporated by reference herein.

120. Securities Act Section 20(b) provides that "whenever it shall appear to the Commission that any person is engaged in or is about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this title, the Commission may in its discretion, bring an action in district court to enjoin such acts or practices . . ."

121. Defendants Graciarena and Loureyro have deposited shares of Biozoom in their respective brokerage accounts. Those shares do not bear a restrictive legend. However, no registration statement is in effect for the offer of sale of those shares.

122. Unless restrained and enjoined, Graciarena and Loureyro are likely to offer or sell their Biozoom shares to the public in violation of Section 5 of the Securities Act.

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PRAYER FOR RELIEF

WHEREFORE, the Commission respectfully requests that this Court:

I.

Issue findings of fact and conclusions of law that defendants Ficicchia, Blaya, Hernando, De Lorenzo, Tavella, Goldman, Bagattin, and Ferrari committed the violations charged and alleged herein.

II.

Enter an order temporarily restraining and enjoining defendants Ficicchia, Blaya, Hernando, De Lorenzo, Tavella, Goldman, Bagattin, Ferrari, Graciarena, and Loureyro, their officers, agents, servants, employees, attorneys and those persons in active concert or participation with defendants who receive actual notice of the Order, by personal service or otherwise, and each of them from, directly or indirectly, engaging in the transactions, acts, practices or courses of business described above, or in conduct of similar purport and object, in violation of Sections 5(a) and 5(c) of the Securities Act [15 U.S.C. §§ 77e(a) and 77e(c)].

III.

Enter an order freezing the brokerage accounts and any assets of defendants Ficicchia, Blaya, Hernando, De Lorenzo, Tavella, Goldman, Bagattin, and Ferrari derived from the sale of Biozoom stock; and, freezing the brokerage accounts of defendants Graciarena and Loureyro holding Biozoom shares.

IV.

Enter an order requiring defendants Ficicchia, Blaya, Hernando, De Lorenzo, Tavella, Goldman, Bagattin, and Ferrari to return to the United States any proceeds from the sale of Biozoom stock that have been transferred abroad and those proceeds which are

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returned be frozen in a domestic bank during the pendency of this action to preserve such assets for the satisfaction of disgorgement.

V.

Enter an Order of Permanent Injunction restraining and enjoining defendants Ficicchia, Blaya, Hernando, De Lorenzo, Tavella, Goldman, Bagattin, Ferrari, Graciarena, and Loureyro, their officers, agents, servants, employees, attorneys and those persons in active concert or participation with defendants who receive actual notice of the Order, by personal service or otherwise, and each of them from, directly or indirectly, engaging in the transactions, acts, practices or courses of business described above, or in conduct of similar purport and object, in violation of Sections 5(a) and 5(c) of the Securities Act [15 U.S.C. §§ 77e(a) and 77e(c)].

VI.

Enter an Order requiring defendants Ficicchia, Blaya, Hernando, De Lorenzo, Tavella, Goldman, Bagattin, and Ferrari to disgorge the ill-gotten gains received as a result of the violations alleged herein, including prejudgment interest.

VII.

Issue an Order imposing upon defendants Ficicchia, Blaya, Hernando, De Lorenzo, Tavella, Goldman, Bagattin, and Ferrari appropriate civil penalties pursuant to Section 20(d) of the Securities Act [15 U.S.C. §77t(d)].

VIII.

Issue an order permanently and unconditionally barring, pursuant to Section 20(g) of the Securities Act [15 U.S.C. § 77t(g)], the Selling Defendants from participating in an

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offering of penny stock as defined by Exchange Act Section 3(a)(51) [15 U.S.C. § 78c(a)(51)] and Rule 3a51-1 thereunder [17 C.F.R. § 240.3a51-1].

IX.

Retain jurisdiction of this action in accordance with the principles of equity and the Federal Rules of Civil Procedure in order to implement and carry out the terms of all orders and decrees that may be entered or to entertain any suitable application or motion for additional relief within the jurisdiction of this Court.

X.

Grant such other relief as this Court deems appropriate.

Dated: July 3, 2013

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

By: Richard E. Simpson

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

MAGDALENA TAVELLA, ANDRES HORACIO FICICCHIA, GONZALO GARCIA BLAYA, LUCIA MARIANA HERNANDO, CECILIA DE LORENZO, ADRIANA ROSA BAGATTIN, DANIELA PATRICIA GOLDMAN, MARIANO PABLO FERRARI, MARIANO GRACIARENA, and FERNANDO LOUREYRO,

Defendants.

USDC SDNY
DOCUMENT
ELECTRONICALLY FILED
DOC #:
DATE FILED: 07/17/2013

Civil Action No. 13-CIV-4609 (NRB)

Judge Naomi Reice Buchwald

STIPULATION AND ORDER GRANTING PRELIMINARY INJUNCTION, ASSET FREEZE, AND OTHER RELIEF

This cause having come before the Court previously on July 3, 2013, on Plaintiff Securities and Exchange Commission's ("Commission's") Motion for a Temporary Restraining Order and Asset Freeze and For an Order to Show Cause Why a Preliminary Injunction Should Not Be Issued, the Court having considered the Commission's Complaint, motion, supporting memorandum of law, and the exhibits and declarations submitted in support of the Plaintiff's motion, and the Plaintiff and all Defendants by counsel having appeared and, without admitting any wrongdoing, consented to the entry of this Order, this Court finds as follows:

1. On July 3, 2013, this Court entered an order that, among other relief granted, enjoined the disposition, sale, transfer, pledge, encumbrance, assignment, concealment, or other

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disposal of stock of Biozoom, Inc. (hereafter "Biozoom") or the proceeds derived from the sale thereof; froze accounts holding funds or assets of the Defendants; and ordered preservation of documents related to Biozoom, any proceeds from the sale or transfer of Biozoom stock, or related to accounts through which Biozoom stock was traded or proceeds derived from the sale thereof were deposited, and all communications concerning the foregoing. The Order entered on July 3, 2013 also set a hearing for this matter on July 17, 2013 at 11:00 a.m.

2. There is no admission by Defendants that the allegations in the Complaint filed by the Commission are true or accurate.

3. Defendants have consented and stipulated to the entry of this Order, which continues the asset freeze and other relief set forth below, pending final adjudication of this case or until further order of this Court.

IT IS THEREFORE ORDERED:

A. ASSET FREEZE ORDER

IT IS HEREBY ORDERED that, until a final adjudication on the merits may be had, Defendants and each of their agents, servants, employees, attorneys-in-fact, and those persons in active concert or participation with them who receive actual notice of this Order by personal service or otherwise, and each of them, hold and retain within their control, and otherwise prevent any disposition, sale, transfer, pledge, encumbrance, assignment, dissipation, concealment, or other disposal whatsoever of any shares of Biozoom and all proceeds derived from sales of Biozoom stock under their control or over which they exercise actual or apparent investment or other authority, wherever located, in whatever form such assets may presently exist, or in any account whatsoever.

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IT IS FURTHER ORDERED that the freeze described in this Section A, includes but is not limited to all Biozoom stock and all funds in the following accounts (hereafter, "Group A Accounts"):

(i) Andres Horacio Ficicchia's account at Legend Securities, Inc. with account number ending in "CICC".

(ii) Andres Horacio Ficicchia's account at Scottsdale Capital Advisors, Inc. with account number ending 2927.

(iii) Gonzalo Garcia Blaya's account at Legend Securities, Inc. with account number ending in "LAYA".

(iv) Luciana Mariana Hernando's account at Legend Securities, Inc. with account number ending in "ANDO".

(v) Cecilia De Lorenzo's account at Legend Securities, Inc. with account number ending in "ENZO".

(vi) Magdalena Tavella's account Scottsdale Capital Advisors, Inc. with account number ending 3831.

(vii) Adriana Rosa Bagattin's account at Scottsdale Capital Advisors, Inc. with account number ending 5435.

(viii) Daniela Patricia Goldman's account at Scottsdale Capital Advisors, Inc. with account number ending 3536.

(ix) Mariano Pablo Ferrari's account at Scottsdale Capital Advisors, Inc. with account number ending 5327.

IT IS FURTHER ORDERED that the freeze described in this Section A further includes but is not limited to all Biozoom stock, and all proceeds from the sale or disposition of Biozoom

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stock in any other accounts whatsoever, including but not limited to the following accounts (hereafter, "Group B Accounts"), whether deposited directly or transferred from another account:

(i) Luciana Mariana Hernando's account at Hellenic Bank Public Company Limited in Lemesos, Cyprus, with an account number ending in – 13 01.

(ii) Adriana Rosa Bagattin's account at FBME Bank Limited in Nicosia, Cyprus, with an account number ending in – 644.

(iii) Daniela Patricia Goldman's account at CBH Compagnie Bancaire Helvetique SA in Geneva, Switzerland with an account number ending in – 345.

(iv) Mariano Pablo Ferrari's account at HSBC Bank in Panama City, Panama, with an account number ending in – 590.

(v) Mariano Pablo Ferrari's account at Choice Bank Limited in Belize City, Belize, with an account number ending in – 521.

IT IS HEREBY FURTHER ORDERED that any financial or brokerage institution or other person or entity holding any funds or other assets derived or related to the sale of Biozoom stock, in the name of, for the benefit of, or under the control of defendants, their agents, servants, employees, attorneys-in-fact, and those persons in active concert or participation with them, wherever located, shall hold and retain within their control and prohibit the withdrawal, removal, transfer or other disposal of any such funds or other assets except as otherwise ordered by this Court, including all shares of Biozoom held on behalf of Defendants, and including but not limited to: (a) all funds and Biozoom stock in the Group A Accounts; and (b) all funds in the Group B Accounts that are proceeds from the sale of Biozoom stock, whether deposited directly in those accounts or transferred from other accounts.

B. PRELIMINARY INJUNCTION FROM VIOLATIONS OF SECURITIES ACT SECTION 5

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IT IS HEREBY FURTHER ORDERED, ADJUDGED, AND DECREED that Defendants and Defendant's agents, servants, employees, attorneys, and all persons in active concert or participation with them who receive actual notice of this order by personal service or otherwise shall be and are hereby preliminarily restrained and enjoined, pending entry of a Final Judgment in this action, from violating Section 5(a) and 5(c) of the Securities Act [15 U.S.C. § 77e] by, directly or indirectly, in the absence of any applicable exemption:

(a) Unless a registration statement is in effect as to a security, making use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or

(c) Making use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed with the Commission as to such security, or while the registration statement is the subject of a refusal order or stop order or (prior to the effective date of the registration statement) any public proceeding or examination under Section 8 of the Securities Act [15 U.S.C. § 77h].

C. ORDER PROHIBITING DESTRUCTION OF RECORDS

IT IS HEREBY FURTHER ORDERED that Defendants and their agents, servants, employees, attorneys-in-fact, and those persons in active concert or participation with them who receive actual notice of this Order by personal service or otherwise, and each of them, are hereby restrained from destroying, mutilating, concealing, altering, or disposing of any document referring or relating in any manner to any transactions involving or related in any way to Biozoom, any proceeds from the sale or transfer of Biozoom stock, any accounts holding or

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through which Biozoom stock was traded or proceeds derived from sales were deposited, including but not limited to the Group A Accounts and Group B Accounts, and any communications concerning the foregoing. As used in this Order, "document" means the original and all non-identical copies (whether non-identical because of handwritten notation or otherwise) of all written or graphic matter, whether in paper, electronic, or any other form, however produced, and any other tangible record, or electronic data compilation capable of reproduction in tangible form, including, without limitation, correspondence, memoranda, minutes, telephone records, e-mails, reports, studies, telexes, diaries, calendar entries, contracts, letters of agreement, and including any and all existing drafts of all documents.

D. ORDER PROVIDING ALTERNATIVE MEANS OF SERVICE

IT IS HEREBY FURTHER ORDERED that, pursuant to Rule 4 of the Federal Rules of Civil Procedure, service of all pleadings and other papers, this Order and all documents filed in support thereof, and all other documents to be served in this action, may be made personally, by facsimile, by overnight courier, or by electronic mail upon each Defendant, his or her attorney, his or her U.S. agents or his or her foreign agents to the extent permitted by law, or by an alternative provision for service permitted by Rule 4 of the Federal Rules of Civil Procedure, or as this Court may direct by further order.

E. ORDER IS BINDING ON ALL PERSONS WITH ACTUAL NOTICE OF THE ORDER

IT IS HEREBY FURTHER ORDERED, that this Order shall be, and is, binding upon each Defendant, and each of his or her agents, servants, employees, attorneys-in-fact, and those persons in active concert or participation with him or her who receive actual notice of this Order by personal service, facsimile service, or service in accordance with Section D of this Order, or otherwise.

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F. OTHER RELIEF

IT IS HEREBY FURTHER ORDERED, that the United States Marshall in any district in which any Defendant resides, transacts business or may be found is authorized and directed to make service of process upon any Defendant at the request of the Commission.

G. TIME FOR DEFENDANTS TO RESPOND TO COMPLAINT

Defendants shall answer or otherwise respond to the Commission's Complaint on or before August 26, 2013.

IT IS HEREBY FURTHER ORDERED that this Stipulation and Order may be modified for good cause shown, and this Court shall retain jurisdiction of this matter for all purposes.

IT IS HEREBY FURTHER ORDERED that pursuant to Federal Rule of Civil Procedure 65(c), no security is required of the Commission.

SO ORDERED:

Dated this 17th day of July, 2013.

Judge Naomi Reice Buchwald

STIPULATED AND AGREED:

FOR PLAINTIFF:

7/16/2013

Richard E. Simpson (RS5859)
David J. Gottesman (admitted pro hac vice)
Patrick M. Bryan (admitted pro hac vice)
U.S. Securities & Exchange Commission
100 F Street, NE Washington, DC 20549
Telephone: (202) 551-4420
Fax: (202) 772-9245
SimpsonR@sec.gov
GottesmanD@sec.gov
BryanP@sec.gov

FOR DEFENDANTS:

Bruce A. Langer
McLaughlin & Stern, LLP
260 Madison Avenue
New York, NY 10016-2404
Telephone (202) 448-6216
Fax: (202) 448-0066
sschuster@mclaughlinstern.com
blanger@mclaughlinstern.com

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, v. MAGDALENA TAVELLA, ANDRES HORACIO FICICCHIA, GONZALO GARCIA BLAYA, LUCIA MARIANA HERNANDO, CECILIA DE LORENZO, ADRIANA ROSA BAGATTIN, DANIELA PATRICIA GOLDMAN, MARIANO PABLO FERRARI, MARIANO GRACIARENA, and FERNANDO LOUREYRO, Defendants.	Civil Action No. 13-CIV-4609 Judge Naomi Reice Buchwald

BIOZOOM, INC. FAIR FUND NOTICE

The United States Securities and Exchange Commission authorized this Notice.
This is not a solicitation from a lawyer.

If you purchased or otherwise acquired Biozoom, Inc. ("Biozoom"; OTCBB ticker: BIZM; CUSIP: 09072T100) common shares in the United States during the Relevant Period, on or between May 16, 2013 and June 25, 2013, you are eligible for damages if the shares were sold at a loss or continue to be held. Per the Plan of Allocation you may be entitled to receive a monetary payment from the Biozoom Fair Fund ("Fair Fund").

Background

On July 3, 2013, the Securities and Exchange Commission ("SEC" or "Commission") filed a complaint in United States District Court Southern District of New York alleging that Magdalena Tavella, Andres Horacio Ficicchia, Gonzalo Garcia Blaya, Lucia Mariana Hernando, Cecilia De Lorenzo, Adriana Rosa Bagattin, Daniela Patricia Goldman, and Mariano Pablo Ferrari (collectively, the "Defendants") had unlawfully sold to the public almost $34 million worth of securities in Biozoom (f/k/a Entertainment Art, Inc.) a penny stock company traded on the Over-the-Counter Bulletin Board. No registration statement was in effect for the selling Defendants' resale of securities and thus their sales were in violation of Section 5 of the Securities Act. Though the Defendants claimed that they had purchased the stock between November 2012 and March 2013 from the original shareholders, this was impossible because those original shareholders ceased to have any interest in the company more than three years earlier than the selling Defendants' claimed purchases.

From March 2013 to June 2013, Defendants opened brokerage accounts at broker-dealers and deposited millions of shares of Biozoom that they claimed did not bear a restrictive legend and were free-trading shares. All of the Defendants claimed that they had purchased all or some of their shares from some of the original shareholders of Entertainment Art in transactions between November 2012 and March 2013.

On July 9, 2013, a Temporary Restraining Order ("TRO") was granted freezing the brokerage accounts of the Defendants holding Biozoom shares and any accounts held by financial institutions or brokers that have the proceeds of the Biozoom sales on behalf of the Defendants. Pursuant to the Final Judgment, a Fair Fund was

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established to distribute the disgorged funds for the benefit of investors pursuant to the Fair Fund provisions of Section 308(a) of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley"), 15 U.S.C. § 7246(a).

In partial satisfaction of the amounts owed by Defendants, Defendants accounts that were frozen pursuant to the TRO, were ordered to be turned over. To date, the Commission recovered from the frozen assets a total of $16,117,936. The Commission invested $16,022,574 with United States Department of the Treasury at the Bureau of the Fiscal Service ("BFS"). It is doubtful, but possible, that additional funds will be recovered from the Defendants from various foreign sources.

Plan of Allocation

The purpose of this distribution is to compensate investors in the Defendants' misrepresentations and omissions in its sale of Biozoom common stock.

The Net Available Fair Fund for the Biozoom distribution will be allocated to Eligible Claimants according to the Plan of Allocation relative to the total disgorgement. The calculations made pursuant to the Plan of Allocation are not intended to be estimates of the amounts that investors might have been able to recover. Nor are the calculations pursuant to the Plan of Allocation intended to be estimates of the amounts that will be paid to Eligible Claimants. Appendix I to the Distribution Plan details the Plan of Allocation methodology and calculation which is designed to equitably distribute the Fair Fund to those Eligible Investors who suffered economic losses. Appendix I to the Distribution Plan is posted on the Fair Fund website at www.BiozoomFairFund.com.

Preliminary calculations will be made for all Eligible Claimants on a *pro rata* basis determined by an Eligible Claimant's investment in Biozoom common stock divided by the sum of all Eligible Claimants' investments in the Biozoom common stock. After the preliminary calculations have been made, any Eligible Claimant whose preliminary calculation amount is less than the Distribution *De Minimis* Amount of $10 will be removed from the pool of Eligible Claimants.

Final calculations will then be made for all remaining Eligible Claimants on a *pro rata* basis as described above, but excluding Eligible Claimants whose preliminary calculation amounts are less than the Distribution *De Minimis* Amount, to arrive at a Recognized Claim amount. In the event that the number of claims submitted by Eligible Claimant(s) is such that the Eligible Claimant(s) would receive a recovery in excess of their Recognized Claim amount, the recovery per claim is limited to the Recognized Claim. The excess amount in the Fair Fund shall be distributed to the U.S Treasury.

Fund Administration

On August 25, 2015, the Commission issued an Order appointing KCC as the Distribution Agent, to assist in overseeing the administration and distribution of the Fair Fund in coordination with Commission staff, pursuant to the terms of the Distribution Plan.

Fair Fund

The Fair Fund is a "Qualified Settlement Fund" ("QSF") as defined in U.S. Treas. Reg. Sec. 1.468B-1 et seq. The distribution is intended to compensate you for losses incurred with respect to your investment in Biozoom common stock as a result of the conduct described in the Order.

Generally, your distribution is not income to you to the extent of your basis in your investment. However, you must reduce your basis by the amount of your distribution. If your distribution exceeds your tax basis in your investment, then the excess is includable in your income as capital gain. Any such capital gain is long-term capital gain, unless you disposed of your investment before holding it for longer than one year. If you do not have reasonable access to records indicating the tax basis of your

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investment, then you may assume that your tax basis is zero and that the entire losses component of your distribution is includable in your income as capital gain. ***The QSF is not required to – and will not – issue a Form 1099 to you with respect to the losses component of the distribution.***

You should consult your tax advisor or accountant as to the treatment of the payment you are receiving under this Fair Fund, as the Distribution Agent and the SEC cannot provide you with tax advice.

How to Participate

If you believe you are a Potential Claimant and would like to participate, you must follow the enclosed instructions and complete the Proof of Claim Form included in this packet. Fill out the Proof of Claim Form completely, sign it, include copies of all required supporting documentation, and return it in the enclosed envelope to the Distribution Agent's address listed below.

Excluded Parties shall mean Defendants, Biozoom, and all other entities or individuals who improperly helped in establishing a market for, and escalating the price of, Biozoom stock, based on the stock trading of those entities or individuals.

The submission of the Proof of Claim Form and the receipt and acceptance of a distribution by an Eligible Claimant is not intended to be a release of an Eligible Claimant's rights and claims against any party.

Deadline to Submit a Claim	October 31, 2016
More Information	
Website	www.BiozoomFairFund.com
Write	Biozoom Fair Fund Distribution Agent c/o KCC P.O. Box 30233 College Station, TX 77842-3233
Phone	1-855-730-8647
Investor Options for this Fair Fund	
Submit a Claim	The only way to get a payment from the Fair Fund.
Do Nothing	Receive no payment.

Questions

This notice provides only summary information regarding the Fair Fund. We strongly recommend that you read the Distribution Plan, including the Plan of Allocation, and other relevant case documents in their entirety for more complete details. The documents can be found at www.BiozoomFairFund.com.

If you need assistance completing the Proof of Claim Form or if you have any questions about this Fair Fund, you may obtain more information by visiting the Fair Fund website at www.BiozoomFairFund.com, by calling the dedicated toll-free number at 1-855-730-8647 or sending an email inquiry to info@BiozoomFairFund.com.

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Special Notice to Brokers and Nominees

If you purchased or held Biozoom common stock for the beneficial interest of a person or organization other than yourself, within fourteen (14) calendar days of receipt of this Fair Fund Notice you must either: (1) request additional copies of the Fair Fund Notice and Proof of Claim Form from the Distribution Agent, and, within fourteen (14) calendar days of receipt of such copies, send copies by first-class mail directly to beneficial owners; or (2) provide a list of the names and last known addresses of the beneficial owners (preferably in excel format) to the Distribution Agent by email to notifications@Gilardi.com or by mail to the following address:

Biozoom Fair Fund
c/o KCC
P.O. Box 30233
College Station, TX 77842-3233

If you choose to mail the Fair Fund Notice and Proof of Claim Form yourself, you may obtain from the Distribution Agent (without cost to you) as many additional copies of these documents as you will need to complete the mailing. If you choose the second option, KCC will send a copy of the Fair Fund Notice and Proof of Claim Form to the persons and/or entities whose names and address you supply.

In either case, you may obtain reimbursement for reasonable administrative costs actually incurred in connection with forwarding the Fair Fund Notice that would not have been incurred but for the obligation to forward the Fair Fund Notice and Proof of Claim Form, upon submission of appropriate documentation to the Distribution Agent.

Regards,

KCC
Distribution Agent

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

MAGDALENA TAVELLA, ANDRES HORACIO FICICCHIA, GONZALO GARCIA BLAYA, LUCIA MARIANA HERNANDO, CECILIA DE LORENZO, ADRIANA ROSA BAGATTIN, DANIELA PATRICIA GOLDMAN, MARIANO PABLO FERRARI, MARIANO GRACIARENA, and FERNANDO LOUREYRO,

Defendants.

USDC SDNY
DOCUMENT
ELECTRONICALLY FILED
DOC #:
DATE FILED: 12/08/2014

Civil Action No. 13-CIV-4609 (NRB)

Judge Naomi Reice Buchwald

FINAL JUDGMENT AS TO DEFENDANTS MARIANO GRACIARENA AND FERNANDO LOUREYRO

The Securities and Exchange Commission ("SEC" or "Plaintiff") having filed a Complaint and Defendants Mariano Graciarena ("Graciarena") and Fernando Loureyro ("Loureyro") (collectively, the "Defendants" for purposes of this Final Judgment), having entered a general appearance; consented to the Court's jurisdiction over Defendants and the subject matter of this action; consented to entry of this Final Judgment without admitting or denying the allegations of the Complaint (except as to jurisdiction); waived findings of fact and conclusions of law; and waived any right to appeal from this Final Judgment:

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I.

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that within three (3) days of service upon him of a copy of this Final Judgment, Graciarena shall provide written instruction in the form attached to Alpine Securities and Scottsdale Capital Advisors to return Entertainment Art, Inc. (currently known as Biozoom, Inc.) stock certificate number 1115, representing 2.145 million shares issued in the name Mariano Augusto Graciarena and deposited into Scottsdale Capital Advisors brokerage account -xxxxx8720 bearing his name, to the company's transfer agent, VStock Transfer, LLC, 18 Lafayette Place, Woodmere, NY 11598, with instructions that the transfer agent cancel the certificates, as "cancellation" is defined in Securities Exchange Act Rule 17Ad-19(a)(1) [17 CFR §240.17Ad-19(a)(1)]. Graciarena shall copy the Plaintiff on all correspondence to or from Alpine Securities or the company's transfer agent concerning cancellation of the foregoing stock certificate.

II.

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that within three (3) days of service upon him of a copy of this Final Judgment, Loureyro shall provide written instruction in the form attached to instruct Alpine Securities and Scottsdale Capital Advisors to return Entertainment Art, Inc. (currently known as Biozoom, Inc.) stock certificate number 1111, representing 2.3 million shares issued in the name Fernando Loureyro and deposited into Scottsdale Capital Advisors brokerage account -xxxxx7518 bearing his name, to the company's transfer agent, VStock Transfer, LLC, 18 Lafayette Place, Woodmere, NY 11598, with instructions that the transfer agent cancel the certificates, as "cancellation" is defined in Securities Exchange Act Rule 17Ad-19(a)(1) [17 CFR §240.17Ad-19(a)(1)]. Loureyro shall

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copy the Plaintiff on all correspondence to or from Alpine Securities or the company's transfer agent concerning cancellation of the foregoing stock certificate.

III.

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that Defendants shall relinquish all claim, title or interest in Entertainment Art, Inc. (currently known as Biozoom, Inc.) stock certificates held in their name, except as necessary to effectuate the cancellations described in paragraphs I and II of this Final Judgment.

IV.

IT IS FURTHER ORDERED, ADJUDGED, AND DECREED that the Consent is incorporated herein with the same force and effect as if fully set forth herein, and that Defendants shall comply with all of the undertakings and agreements set forth therein.

V.

IT IS FURTHER ORDERED, ADJUDGED, AND DECREED that this Court shall retain jurisdiction of this matter for the purposes of enforcing the terms of this Final Judgment.

Dated: December 4, 2014

Hon. Naomi Reice Buchwald
UNITED STATES DISTRICT JUDGE

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EXHIBIT A

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Date: _____, 2014

Alpine Securities
Attn.: Legal – Physical Certificate Deposit
39 Exchange Place
Salt Lake City, UT 84111

Scottsdale Capital Advisors
Attn.: D. Michael Cruz
7170 E. McDonald Drive
Scottsdale, AZ 85253

Re: Entertainment Art, Inc. (currently known as Biozoom, Inc.) stock certificate number 1115 - Alpine Securities brokerage account #[redacted]8720

To Whom It May Concern:

By this letter, I am instructing Alpine Securities and Scottsdale Capital Advisors to return Entertainment Art, Inc. (currently known as Biozoom, Inc.) stock certificate number 1115 (representing 2.145 million shares issued in the name Mariano Augusto Graciarena and deposited into Scottsdale Capital Advisors brokerage account #[redacted]8720 in my name) to the company's transfer agent, VStock Transfer, LLC, 18 Lafayette Place, Woodmere, NY 11598, with instructions that the transfer agent cancel the certificates, as "cancellation" is defined in Securities Exchange Act Rule 17Ad-19(a)(1) [17 CFR §240.17Ad-19(a)(1)].

Enclosed for your information is a copy of an order of the U.S. District Court for the Southern District of New York directing the cancellation of the above-reference certificate.

Sincerely,

Mariano Augusto Graciarena
[redacted]
Buenos Aires, Argentina

cc: Patrick M. Bryan
U.S. Securities and Exchange Commission
100 F. Street, NE
Washington, DC 20005

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Date: _____, 2014

Alpine Securities
Attn.: Legal – Physical Certificate Deposit
39 Exchange Place
Salt Lake City, UT 84111

Scottsdale Capital Advisors
Attn.: D. Michael Cruz
7170 E. McDonald Drive
Scottsdale, AZ 85253

Re: Entertainment Art, Inc. (currently known as Biozoom, Inc.) stock certificate number 1111 - Alpine Securities brokerage account # [redacted]7518

To Whom It May Concern:

By this letter, I am instructing Alpine Securities and Scottsdale Capital Advisors to return Entertainment Art, Inc. (currently known as Biozoom, Inc.) stock certificate number 1111 (representing 2.3 million shares issued in the name Fernando Loureyro and deposited into Scottsdale Capital Advisors brokerage account # [redacted]7518 in my name) to the company's transfer agent, VStock Transfer, LLC, 18 Lafayette Place, Woodmere, NY 11598, with instructions that the transfer agent cancel the certificates, as "cancellation" is defined in Securities Exchange Act Rule 17Ad-19(a)(1) [17 CFR §240.17Ad-19(a)(1)].

Enclosed for your information is a copy of an order of the U.S. District Court for the Southern District of New York directing the cancellation of the above-reference certificate.

Sincerely,

Fernando Loureyro
[redacted]
Buenos Aires, Argentina

cc: Patrick M. Bryan
U.S. Securities and Exchange Commission
100 F. Street, NE
Washington, DC 20005

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

MAGDALENA TAVELLA, ANDRES HORACIO FICICCHIA, GONZALO GARCIA BLAYA, LUCIA MARIANA HERNANDO, CECILIA DE LORENZO, ADRIANA ROSA BAGATTIN, DANIELA PATRICIA GOLDMAN, MARIANO PABLO FERRARI, MARIANO GRACIARENA, and FERNANDO LOUREYRO,

Defendants.

USDC SDNY
DOCUMENT
ELECTRONICALLY FILED
DOC #:
DATE FILED: 1/9/2015

Civil Action No. 13-CIV-4609

Judge Naomi Reice Buchwald

FINAL DEFAULT JUDGMENT AND ORDER GRANTING INJUNCTIVE AND OTHER RELIEF AGAINST DEFENDANTS MAGDALENA TAVELLA, ANDRES HORACIO FICICCHIA, GONZALO GARCIA BLAYA, LUCIA MARIANA HERNANDO, CECILIA DE LORENZO, ADRIANA ROSA BAGATTIN, DANIELA PATRICIA GOLDMAN, AND MARIANO PABLO FERRARI

WHEREAS this matter came before this Court on the Motion of Plaintiff Securities and Exchange Commission ("Commission"), seeking entry of a judgment by default, and providing the relief requested in its Complaint against defendants Magdalena Tavella, Andres Horacio Ficicchia, Gonzalo Garcia Blaya, Lucia Mariana Hernando, Cecilia De Lorenzo, Adriana Rosa Bagattin, Daniela Patricia Goldman, and Mariano Pablo Ferrari (collectively, the "Defaulting Defendants"); and

WHEREAS the Court has entered a Memorandum and Order dated January 6, 2015, in which the Court concluded that the Commission is entitled to a final judgment

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against the Defaulting Defendants that permanently enjoins them from violating Section 5 of the Securities Act of 1933 ("Securities Act") [15 U.S.C. § 77(e)], (2) orders the Defaulting Defendants to individually disgorge ill-gotten gains, and (3) imposes civil penalties; and

WHEREAS the Court deferred judgment to afford the Commission an opportunity to supplement its submission as to the amount of prejudgment interest that should be disgorged; and

WHEREAS the Commission has submitted a proposed order "in lieu of such supplemental submission on prejudgment interest," which the Court interprets as abandoning the Commission's claim to prejudgment interest on the disgorgement amounts; it is hereby

ORDERED THAT:

I.

Defaulting Defendants, their agents, servants, employees, attorneys, and all persons in active concert or participation with them who receive actual notice of this final judgment by personal service or otherwise are permanently restrained and enjoined from violating, directly or indirectly, Section 5(a) and 5(c) of the Securities Act [15 U.S.C. § 77e] by, in the absence of any applicable exemption:

(a) Unless a registration statement is in effect as to a security, making use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise;

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(b) Unless a registration statement is in effect as to a security, carrying or causing to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale; or

(c) Making use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed with the Commission as to such security, or while the registration statement is the subject of a refusal order or stop order or (prior to the effective date of the registration statement) any public proceeding or examination under Section 8 of the Securities Act [15 U.S.C. § 77h].

II.

Defaulting Defendants (Magdalena Tavella, Andres Horacio Ficicchia, Gonzalo Garcia Blaya, Lucia Mariana Hernando, Cecilia De Lorenzo, Adriana Rosa Bagattin, Daniela Patricia Goldman, and Mariano Pablo Ferrari) are permanently barred from participating in an offering of penny stock, including engaging in activities with a broker, dealer, or issuer for purposes of issuing, trading, or inducing or attempting to induce the purchase or sale of any penny stock as defined by Section 3(a)(51) of the Securities Exchange Act of 1934 [15 U.S.C. §78c(a)(51) and Rule 3a51-1 thereunder [17 C.F.R. § 240.3a51-1].

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III.

Defendants are liable for disgorgement (representing profits gained as a result of the conduct alleged in the Complaint), and civil penalties pursuant to Section 20(d) of the Securities [15 U.S.C. § 77t(d)], in the following amounts:

Defendant	Disgorgement Amount	Civil Penalty	Total
Magdalena Tavella	$3,107,819	$160,000	$3,267,819
Andres Horacio Ficicchia	$1,948,339	$160,000	$2,108,339
Gonzalo Garcia Blaya	$3,008,200	$160,000	$3,168,200
Lucia Mariana Hernando	$5,042,771	$160,000	$5,202,771
Cecilia De Lorenzo	$4,801,536	$160,000	$4,961,536
Adriana Rosa Bagattin	$6,216,380	$160,000	$6,376,380
Daniela Patricia Goldman	$3,764,306	$160,000	$3,924,306
Mariano Pablo Ferrari	$5,447,450	$160,000	$5,607,450

Defendants shall satisfy these obligations within ten business days and make payment of all funds to the Commission, which shall provide detailed ACH transfer/Fedwire instructions upon request. The Defendants shall satisfy these obligations from proceeds contained in their various accounts including, but not limited to, the following:

- Andres Horacio Ficicchia's account at Legend Securities, Inc. with account number ending in "CICC".

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- Andres Horacio Ficicchia's account at Scottsdale Capital Advisors, Inc. with account number ending 2927.
- Gonzalo Garcia Blaya's account at Legend Securities, Inc. with account number ending in "LAYA".
- Luciana Mariana Hernando's account at Legend Securities, Inc. with account number ending in "ANDO".
- Luciana Mariana Hernando's account at Hellenic Bank Public Company Limited in Lemesos, Cyprus, with an account number ending in – 1301.
- Cecilia De Lorenzo's account at Legend Securities, Inc. with account number ending in "ENZO".
- Magdalena Tavella's account Scottsdale Capital Advisors, Inc. with account number ending 3831.
- Adriana Rosa Bagattin's account at Scottsdale Capital Advisors, Inc. with account number ending 5435.
- Adriana Rosa Bagattin's account at FBME Bank Limited in Nicosia, Cyprus, with an account number ending in – 644.
- Daniela Patricia Goldman's account at Scottsdale Capital Advisors, Inc. with account number ending 3536.
- Daniela Patricia Goldman's account at CBH Compagnie Bancaire Helvetique SA in Geneva, Switzerland with an account number ending in – 345.
- Mariano Pablo Ferrari's account at Scottsdale Capital Advisors, Inc. with account number ending 5327.

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- Mariano Pablo Ferrari's account at HSBC Bank in Panama City, Panama, with an account number ending in – 590.
- Mariano Pablo Ferrari's account at Choice Bank Limited in Belize City, Belize, with an account number ending in – 521.

IV.

In partial satisfaction of the amounts owed by Defendants pursuant to this Final Judgment, the following entities shall transfer all funds and BIZM shares held in Defaulting Defendants' accounts (including the accounts listed below) and make payment such funds and shares held in Defaulting Defendants' names to the Commission, which shall provide detailed ACH transfer/Fedwire instructions upon request:

A. Legend Securities LLC

1. Gonzalo Garcia Blaya
2. Lucia Mariana Hernando
3. Andres Horacio Ficicchia
4. Cecilia De Lorenzo

B. Scottsdale Capital Advisors

1. Magdalena Tavella
2. Daniela Patricia Goldman
3. Adriana Rosa Bagattin
4. Mariano Pablo Ferrari
5. Andres Horacio Ficicchia

Payment may also be made directly from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm. Payment may also be made by

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certified check, bank cashier's check, or United States postal money order payable to the Securities and Exchange Commission, which shall be delivered or mailed to

Enterprise Services Center
Accounts Receivable Branch
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

and shall be accompanied by a letter identifying the case title, civil action number, and name of this Court; the name of the defendant in this action; and specifying that payment is made pursuant to this Final Judgment. Defaulting Defendant payer shall simultaneously transmit photocopies of each such payment and letter to the Commission's counsel in this action: Patrick M. Bryan, 100 F Street, N.E., Washington, D.C. 20549-4030. Defaulting Defendants relinquish all legal and equitable right, title, and interest in all funds paid pursuant to this Final Judgment, and no part of the funds shall be returned to Defaulting Defendants. The Commission may enforce the Court's judgment for disgorgement by moving for civil contempt (and/or through other collection procedures authorized by law) at any time after ten days following entry of this Final Judgment. In response to any such civil contempt motion by the Commission, Defaulting Defendants may assert any legally permissible defense.

V.

Further to the Stipulation and Order Granting Preliminary Injunction, Asset Freeze, and Other Relief, entered on 7/17/2013 (the "Asset Freeze Order") freezing the assets of Defendants, including those held in the accounts referenced above in Section III and previously enumerated in the Asset Freeze Order, the Court finds that such assets are the proceeds of the violations alleged in the Commission's Complaint. Accordingly, pursuant to the Court's personal jurisdiction over Defaulting Defendants, Defaulting

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Defendants are hereby ordered to repatriate the referenced assets by 30 days after entry of a judgment of default, to the Commission, which shall provide detailed ACH transfer/Fedwire instructions upon request, and to execute any consents, pleadings, or other legal documents as the Commission may require to effect the transfer of such assets in accordance with this Final Judgment, with the understanding that such assets shall be used to satisfy disgorgement only.

VI.

The Commission shall deposit the funds received pursuant to sections III, IV, and V of this Final Judgment into an interest bearing account which, together with any interest and income earned thereon (collectively, the "Fund"), shall be held in the interest bearing account until further order of the Court.

The Commission may by motion propose a plan to distribute the Fund subject to the Court's approval. Such a plan may provide that Fund shall be distributed pursuant to the Fair Fund provisions of Section 308(a) of the Sarbanes-Oxley Act of 2002. Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil penalties pursuant to this Judgment shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Defendants shall not, after offset or reduction of any award of compensatory damages in any Related Investor Action based on any payment of disgorgement in this action, argue that he, she or it is entitled to, nor shall he, she or it further benefit by, offset or reduction of such compensatory damages award by the amount of any part of Defendant's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, the

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Defendant beneficiary of such Penalty Offset shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the United States Treasury or to a Fair Fund, as the Commission directs. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this Judgment. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against a Defendant in this action by or on behalf of one or more investors based on substantially the same facts as alleged in the Complaint in this action. Defendants shall pay post-judgment interest on any delinquent amounts pursuant to 28 USC § 1961.

VII.

IT IS FURTHER ORDERED, ADJUDGED, AND DECREED that this Court shall retain jurisdiction over this matter for the purposes of enforcing the terms of this Final Judgment.

VIII.

RULE 54(b) CERTIFICATION

There being no just reason for delay, pursuant to Rule 54(b) of the Federal Rules of Civil Procedure, the clerk is ordered to enter this Final Judgment forthwith and without further notice.

DATED January 9, 2015.

NAOMI REICE BUCHWALD
UNITED STATES DISTRICT JUDGE

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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 10496 / May 15, 2018

SECURITIES EXCHANGE ACT OF 1934
Release No. 83236 / May 15, 2018

INVESTMENT COMPANY ACT OF 1940
Release No. 33097 / May 15, 2018

ADMINISTRATIVE PROCEEDING
File No. 3-18483

In the Matter of TIMOTHY C. SCARPINO, Respondent.	ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER AND NOTICE OF HEARING

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted against Timothy C. Scarpino ("Scarpino" or "Respondent") pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), and Section 9(b) of the Investment Company Act ("Investment Company Act").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these

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proceedings, which are admitted, and except as provided herein in Section IV, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to 8A of the Securities Act of 1933, Sections 15(b) and 21C of the Securities Exchange Act of 1934, and Section 9(b) of the Investment Company Act, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order and Notice of Hearing ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

Summary

From late May 2013 to mid-June 2013, Timothy Scarpino ("Scarpino"), then a registered representative at registered broker-dealer Scottsdale Capital Advisors ("Scottsdale"), willfully violated Sections 5(a) and 5(c) of the Securities Act when he engaged in the illegal distribution of the securities of Biozoom, Inc. ("Biozoom" or "BIZM") by offering and selling shares of BIZM, which was quoted on the Over-the-Counter Bulletin Board ("OTCBB"), on behalf of four Argentine customers (the "Argentines"). The scope of this illegal distribution was massive, as Scarpino offered and sold approximately 8.2 million BIZM shares, which constituted almost 14% of BIZM's total outstanding shares, and over 40% of BIZM's total number of shares that did not bear a restrictive legend. The Argentines reaped proceeds of over $18.5 million from the less than four weeks of trading activity facilitated by Scarpino.

Sections 5(a) and 5(c) of the Securities Act make it unlawful for any person, directly or indirectly, to offer or sell securities by any means or instruments of transportation or communication in interstate commerce unless a registration statement has been filed with the Commission with respect to Section 5(c) and is in effect with respect to Section 5(a), or an applicable exemption from registration applies. This governs resales of deposited securities, such as Scarpino's sales of the BIZM shares on behalf of the Argentines. No registration statement was in effect as to Scarpino's BIZM offers and sales, and no exemption from registration was applicable to them. Although brokers may rely on an exemption under Section 4(a)(4) of the Securities Act, this exemption would be available to Scarpino for the offers and sales of BIZM only if, after engaging in a reasonable inquiry into the facts surrounding the proposed sales, Scarpino was not aware of facts indicating that the customers would be engaging in an unlawful distribution of securities. Moreover, because Scarpino was presented with red flags of a potential unlawful distribution, he needed to conduct a searching inquiry to determine that the proposed sales were not part of an unlawful distribution of securities. Despite these significant red flags, Scarpino failed to conduct a searching inquiry into facts surrounding the proposed sales, and thereby violated Sections 5(a) and 5(c) of the Securities Act.

Respondent

[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

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1. Timothy Scarpino, 35, resides in Scottsdale, Arizona. Scarpino was, from 2009 until 2013, a registered representative at Scottsdale. Currently, he is not working in the securities industry.

Relevant Entity

2. Scottsdale has been registered with the Commission as a broker-dealer with its principal place of business in Scottsdale, Arizona since May 2002.

Facts

A. Scarpino Opens Foreign Accounts at Scottsdale Based on Referrals from James Benjamin Panther II

3. In or around early May 2013, James B. Panther II ("Panther"), a longtime Scottsdale customer, informed Scarpino and Scottsdale's owner (the "Owner") that Panther planned to refer several individuals to open brokerage accounts and deposit stock certificates at Scottsdale. The Owner told Scarpino that Panther had referred significant business to Scottsdale in the past and that Scarpino should provide special treatment to Panther's referrals because Panther was an important customer.

4. On May 2, 2013, Scarpino emailed an associate of Panther's ("Panther Associate"), writing that Panther had suggested that Scottsdale might be able to assist Panther Associate in "depositing OTC/Pinksheet stocks." Scarpino attached Scottsdale account opening forms for foreign customers to his email.

5. Panther Associate provided Scarpino the names and email addresses of four individuals who Panther was referring to Scottsdale – the Argentines. Scarpino then emailed each of the Argentines offering to assist them in opening accounts and depositing shares at Scottsdale.

6. Starting on May 10, 2013, the Argentines opened accounts at Scottsdale with Scarpino as their registered representative. During the account-opening process, Scarpino learned that the Argentines shared several unusual characteristics, which suggested that they might be acting in concert. In particular, Scarpino knew:

- Each of the Argentines stated that they intended to deposit physical certificates of BIZM stock in significant amounts, ranging from 1.815 million to 2.37 million shares for a total of 8.2 million shares; and
- Each of the Argentines requested the ability to place orders with Scarpino via instant message, which was not a functionality that Scottsdale offered its customers.

7. The initial account opening documents Scarpino received for each of the Argentines listed Panther as the referral source. In response to inquiries from Scarpino and compliance personnel at Scottsdale, however, the Argentines claimed they did not know Panther.

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Ultimately, Panther's name was deleted from each of the account opening documents and the referring source was left blank.

B. Panther Confirms His Connections to Biozoom and the Argentines

8. On May 15, 2013, Scarpino and the Owner flew on the Owner's private jet to meet with Panther in California to discuss the Argentines. During their meeting, Panther told Scarpino that the Argentines planned to deposit share certificates into their respective accounts for trading.

9. Panther explained that he worked with Biozoom and similar start-up companies to maintain their share prices. Panther also told Scarpino and the Owner that the Argentines could bring a good amount of business to Scottsdale.

10. In return for what Panther suggested could be significant trading commissions to Scottsdale, he confirmed specific accommodations for the accounts, several of which he had previously requested. These accommodations included permitting the Argentines to place trades through instant message and significantly reducing commissions for the Argentines. Although some of these requests ran contrary to existing Scottsdale policies, the Owner directed Scarpino to grant them for Panther's referrals.

11. Panther's confirmation that he was connected with both Biozoom and the Argentines was a red flag that the Argentines were potentially affiliates of BIZM.

C. Scarpino Was Aware of Red Flags as He Deposited Substantial Amounts of Penny Stock for the Argentines

12. On May 16, 2013 – the day after Scarpino's meeting with Panther – the Argentines began working with Scarpino to deposit physical certificates of Biozoom stock into their new accounts. Scarpino knew that these certificates had been sent to Scottsdale from another broker-dealer that had rejected the Argentines' attempted deposits of the same certificates.

13. Each Argentine completed a Deposit Securities Request Questionnaire ("DSRQ"), which was necessary for the certificates to be deposited. These DSRQs required the Argentines to, among other things, explain how they obtained their shares and whether they planned to trade the shares in concert with anyone else. The Argentines' completed DSRQs provided no information on Panther's relationship or involvement with the Argentines, even though Scarpino knew that Panther had referred them to Scottsdale and was connected both to them and to BIZM.

14. The Argentines' DSRQs and related documentation raised numerous red flags of a potential unregistered distribution, which Scarpino knew or should have known:

- The Argentines were depositing a large volume of BIZM stock, which had no significant public trading in its history. Collectively, the Argentines' certificates represented 8.92 million BIZM shares, which constituted approximately 15% of BIZM's total outstanding shares, and approximately 44% of BIZM's total shares not bearing a restrictive legend;

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- The Argentines claimed to have purchased their 8.9 million shares of BIZM at prices between $0.003 and $0.005 per share, spending a total of only approximately $33,000; and

- All of the Argentines' certificates had been issued less than two months earlier, and they all purportedly acquired their shares in transactions with investors in Biozoom's predecessor company between February 26 and March 5, 2013.[2]

15. Because, as described above, Scarpino knew that the Argentines were connected to Panther and further knew that Panther had previously discussed Biozoom with Scarpino and the Owner, the numerous and significant red flags raised by the Argentines' share deposits – including the percentage of BIZM shares they controlled, nominal amounts they supposedly paid for the shares, the recent issuance of their share certificates, and other evidence of their connections to one another and to Panther – should have raised significant questions for Scarpino about their possible involvement in an unregistered distribution of BIZM stock coordinated by Panther. Scarpino, however, took no additional steps to investigate this possibility, and did not inform anyone else at Scottsdale about the accumulation of red flags of which he was aware.

D. Scarpino Was Aware of Additional Red Flags During the Unregistered Distribution of BIZM Stock

16. From May 28, 2013 until June 19, 2013, Scarpino offered and sold approximately 8.2 million BIZM shares through the OTCBB for proceeds of nearly $18.6 million on behalf of the Argentines. Given that the Argentines claimed to have paid a total of $32,700 for all of their deposited shares, they realized aggregate returns of more than 56,000% on Scarpino's sales of the shares they had supposedly purchased less than four months earlier.

17. No registration statement was filed or in effect with regards to Scarpino's offers and sales of the BIZM shares and no exemption from the registration requirements was available for those sales. Throughout the trading period, even more red flags of an illegal unregistered distribution appeared:

- The Argentines began liquidating their BIZM shares almost immediately after they were cleared for trading;

- Scarpino's offers and sales occurred amid a dramatic spike in trading of BIZM. Prior to May 16, 2013, the stock of BIZM and its predecessor company had traded once since its inception in 2007, a 300 share trade in November 2012 for $1.02 per share. From May 16, 2013 to June 19, 2013, BIZM's stock price increased from a starting price of $1.10 per share to as high as $4.50 per share. Over the same period, daily volume spiked from 10,000 shares to a high of 11.6 million shares.

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[2] Biozoom came into existence on April 1, 2013 via a reverse merger with a penny stock company named Entertainment Art, Inc. ("EERT"), followed by a name and ticker change. EERT was formed in 2007.

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This market was completely inconsistent with the prior trading history of BIZM and its predecessor company;

- This spike in activity coincided with a promotional campaign touting BIZM in radio, web, and print ads. The promotional campaign also involved mailers put out by third party media sources and was supported by numerous press releases issued by the company; and

- As Scarpino completed liquidating all or substantially all of the BIZM shares on behalf of an Argentine, that Argentine quickly asked Scarpino to wire out the proceeds to offshore accounts. In total, between June 11 and June 24, the four Argentines requested to wire out nearly $17 million, all of which was proceeds from the sale of the recently-deposited and sold BIZM shares.

18. On June 25, 2013, the Commission suspended trading in the BIZM securities. On July 3, 2013, the Commission charged four of the Argentine customers and others with violating Sections 5(a) and (c) of the Securities Act. The Commission obtained default judgments against all defendants in that matter. The Court granted injunctive relief and ordered the Argentines to pay disgorgement of $18,535,955 and penalties of $640,000.

E. Scarpino Did Not Engage in a Reasonable Inquiry

19. Sections 5(a) and 5(c) of the Securities Act prohibit the offer and sale of securities through interstate commerce or the mails, unless a registration statement is filed with the Commission and is in effect, or the offer and sale are subject to an exemption. 15 U.S.C. §§ 77e(a) and (c).

20. Section 4(a)(4) of the Securities Act exempts from the registration requirements of Section 5 "brokers' transactions executed upon customers' orders on any exchange or in the over-the-counter market but not the solicitation of such orders." 15 U.S.C. § 77d(4). Rule 144(g)(4) provides that for a transaction to qualify as a "brokers' transaction" under Section 4(a)(4), the broker must engage in a "reasonable inquiry" prior to the transaction, and after such inquiry he must not be "aware of circumstances indicating that the person for whose account the securities are sold is an underwriter[3] with respect to the securities or that the transaction is a part of a distribution of securities of the issuer." 15 U.S.C. § 77d(a)(4); 17 CFR § 230.144(g)(4).

21. The "reasonable inquiry" should consider, among other factors:

- the length of time the seller has held the securities;

- the nature of the transaction in which the securities were acquired; and

[3] Section 2(a)(11) of the Securities Act defines an underwriter as "any person who has purchased from an issuer, with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking." 15 U.S.C. § 77b(a)(11).

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- the number of shares of the class outstanding or the relevant trading volume. Notes to 17 CFR § 230.144(g)(4).

22. However, certain facts and circumstances surrounding the transaction might require additional inquiry in order for the broker to rely on the Section 4(a)(4) exemption. For example:

> A dealer who is offered a modest amount of a widely traded security by a responsible customer, whose lack of relationship to the issuer is well known to him, may ordinarily proceed with considerable confidence. On the other hand, when a dealer is offered a substantial block of a little-known security, either by persons who appear reluctant to disclose exactly where the securities came from, or *where the surrounding circumstances raise a question* as to whether or not the ostensible sellers may be merely intermediaries for controlling persons or statutory underwriters, then ***searching inquiry*** is called for.

Distribution by Broker-Dealers of Unregistered Securities, Securities Act Rel. No. 4445 (Feb. 2, 1962) (emphasis added). *See also Bloomfield et al.*, Exchange Act Rel. No. 71632, at 5 (Feb. 27, 2014) ("The accounts received large blocks of privately obtained shares of obscure penny stocks. Although the securities initially traded at low prices and in low volumes, the prices of, and trading volume in, these securities quickly escalated around the time of large deposits into the [ ] accounts. The escalation in prices and trading volume was generally associated with coordinated transactions among the various [] accounts and often accompanied by spam email campaigns touting the issuers' prospects. Once prices had risen substantially, the accounts started selling blocks of stocks. Eventually the stocks' prices collapsed. These indicia raised red flags of a possible unlawful distribution and market manipulation."); *Midas Securities, LLC and Jay S. Lee*, Exchange Act Rel. No. 66200, at 14 (Jan. 20, 2012) (holding that because "[t]he amount of inquiry required necessarily varies with the circumstances of the proposed transaction," in certain circumstances, a broker-dealer may need to "conduct a searching inquiry to assure itself that . . . proposed sales [are] exempt from the registration requirements and not part of an unlawful distribution.").

23. When conducting a reasonable inquiry, a registered representative may not rely on others, such as counsel's advice, to fulfill his reasonable inquiry obligation. *Wonsover v. SEC*, 205 F.3d 408, 415-16 (D.C. Cir. 2000) (rejecting registered representative's reliance on clearing firm, the transfer agent, counsel, and reliance on the clearance of sales by the "Restricted Stock Department" of his firm); *see also World Trade Financial Corp. v. SEC*, 739 F.3d 1243, 1249 (9th Cir. 2014) (rejecting argument that duty of reasonable inquiry was satisfied by reliance on third parties in conformity with industry practice and stating "brokers rely on third parties at their own peril, and will not avoid liability through that reliance when the duty of reasonable inquiry rests with the brokers").

24. It is not sufficient "for [the registered representative] merely to accept 'self-serving statements of his sellers and their counsel without reasonably exploring the possibility of contradictory facts.'" *Distribution by Broker-Dealers of Unregistered Securities*, Securities Act Rel. No. 4445 (Feb. 2, 1962) (quoting *SEC v. Culpepper*, 270 F.2d 241, 251 (2d Cir. 1959)). Nor may a broker "rely upon the absence of restrictive legends on the stock certificates when the circumstances surrounding the transaction indicate the need for a thorough investigation."

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Transactions in the Securities of Laser Arms Corporation by Certain Broker-Dealers, Exch. Act Rel. No. 34-28878, 1991 WL 292009 (Feb. 14, 1991).

25. No registration statement was filed or in effect as to Scarpino's offer and sale of the BIZM shares on behalf of the Argentines and no exemption from the registration requirements was available for these sales. Scarpino made use of means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell, sell, and deliver after sale the BIZM shares to the public.

26. Scarpino was presented with numerous and significant red flags raised by the deposits of BIZM shares and subsequent sales of those shares, which should have raised questions as to whether the Argentines were engaged in an unlawful distribution by, for example, acting as underwriters. These red flags included:

- the Argentines opened new accounts and delivered physical certificates representing a large block of thinly traded and low-priced securities;
- the deposited share certificates had been recently issued and represented a large percentage of the float for the security;
- the Argentines had a pattern of depositing physical share certificates, immediately selling the shares and then wiring out the proceeds to offshore accounts;
- there was a sudden spike in volume, coupled with a rising price in, a thinly traded and low-priced security; and
- Scarpino had reason to believe the Argentines were acting in concert with one another and in coordination with an affiliate of the issuer.

27. Throughout the process of opening the Argentines' accounts, depositing their certificates, and then offering and selling those shares into the market on behalf of the Argentines, Scarpino was confronted with red flag after red flag that he was facilitating an unregistered distribution of those shares. Despite the presence of these ample and glaring red flags, Scarpino did not perform a "reasonable inquiry" regarding the facts and circumstances surrounding those transactions, let alone the "searching inquiry" he was required to perform.

Violation

28. As a result of the conduct described above, Scarpino willfully violated Sections 5(a) and 5(c) of the Securities Act.

IV.

Pursuant to this Order, Respondent Scarpino agrees to additional proceedings in this proceeding to determine what, if any, civil penalties pursuant to Section 8A(g) of the Securities Act against Respondent Scarpino are in the public interest. In connection with such additional proceedings: (a) Respondent Scarpino agrees that he will be precluded from arguing that he did not violate the federal securities laws as described in this Order; (b) Respondent Scarpino agrees

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that he may not challenge the validity of this Order; (c) solely for the purposes of such additional proceedings, the allegations of the Order shall be accepted as and deemed true by the hearing officer; and (d) the hearing officer may determine the issues raised in the additional proceedings on the basis of affidavits, declarations, excerpts of sworn deposition or investigative testimony, and documentary evidence.

V.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Scarpino's Offer.

Accordingly, pursuant to Section 8A of the Securities Act, Sections 15(b) and 21C of the Exchange Act, and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent Scarpino shall cease and desist from committing or causing any violations and any future violations of Sections 5(a) or 5(c) of the Securities Act.

B. Respondent Scarpino be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization;

prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter; and

barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock,

with the right to apply for reentry after five (5) years to the appropriate self-regulatory organization, or if there is none, to the Commission.

C. Any reapplication for association by Respondent Scarpino will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory

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organization, whether or not related to the conduct that served as the basis for the Commission order.

D. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Timothy Scarpino as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Antonia Chion, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549.

It is further ORDERED, pursuant to Rule 100(c) of the Commission's Rules of Practice, 17 C.F.R. § 201.100(c), in the interest of justice and without prejudice to any party to the proceedings, that a public hearing for the purpose of taking evidence on the questions set forth in Section IV hereof shall be convened at a time and place to be fixed by, and before, an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110, following the entry of a final judgment against the last remaining defendant(s) in any action(s) arising out of or related to the facts in this Order ("Related Actions").

If Respondent Scarpino fails to appear at a hearing after being duly notified, Respondent Scarpino may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310.

This Order shall be served forthwith upon Respondent Scarpino personally or by certified mail.

It is further ORDERED pursuant to Rule 100(c) of the Commission's Rules of Practice, 17 C.F.R. § 201.100(c), in the interest of justice and without prejudice to any party, that the

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Administrative Law Judge shall issue an initial decision no later than 150 days from the date of the entry of a final judgment in any Related Actions.

VI.

It is further Ordered that, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. § 523, the findings in this Order are true and admitted by Respondent, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent under this Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the violation by Respondent of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. § 523(a)(19).

By the Commission.

Brent J. Fields
Secretary

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FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. SCOTTSDALE CAPITAL ADVISORS CORPORATION (CRD No. 118786), JOHN J. HURRY (CRD No. 2146449), TIMOTHY B. DIBLASI (CRD No. 4623652), and D. MICHAEL CRUZ (CRD No. 2450344), Respondents.	Disciplinary Proceeding No. 2014041724601 Hearing Officer–LOM **AMENDED EXTENDED HEARING PANEL DECISION**[1] June 20, 2017

The Respondent firm violated FINRA Rule 2010 by selling securities without registration and without an exemption, in contravention of Section 5 of the Securities Act of 1933. The firm's owner, Respondent John Hurry, also violated Rule 2010, because he engaged in activities designed to enable the unlawful transactions and evade regulatory scrutiny.

The Respondent firm and its Chief Compliance Officer, Respondent Timothy DiBlasi, violated NASD Rules 3010(a) and (b) and FINRA Rule 2010 by failing to establish and maintain a supervisory system, including written

[1] The original Extended Hearing Panel Decision has been amended to correct a factual error. The amendment does not change the substance of the decision.

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supervisory procedures, reasonably designed to ensure that the firm complied with Section 5 of the Securities Act.

The Respondent firm and its President, Respondent Michael Cruz, violated NASD Rule 3010(b) and FINRA Rule 2010 by failing to supervise and failing to respond appropriately to numerous red flags indicative of unlawful unregistered distributions.

The Respondent firm is fined $1.5 million. Hurry is barred in all capacities. He would also be fined $100,000, but, in light of the bar, the fine is not imposed. DiBlasi is suspended for two years and fined $50,000. Cruz is suspended for two years and fined $50,000. In addition, Respondents are ordered to pay costs, for which they are jointly and severally liable.

Appearances

For the Complainant: Jeffrey D. Pariser, Esq., Gregory R. Firehock, Esq., Laura Leigh Blackston, Esq., and Heather L. Freiburger, Esq., Department of Enforcement, Financial Industry Regulatory Authority.

For the Respondents: Kevin J. Harnisch, Esq., Michael J. Edney, Esq., and Ryan E. Meltzer, Norton Rose Fulbright US LLP.

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DECISION

I. INTRODUCTION

A. The Respondent Firm

The Respondent firm, Scottsdale Capital Advisors Corporation ("Scottsdale" or the "Firm"), is primarily engaged in the business of liquidating penny stocks for its customers without registration. The sale of securities without registration is unlawful unless an exemption exists. In selling securities without registration, Scottsdale usually relies on a "safe harbor" exemption created by the Securities and Exchange Commission ("SEC"), Rule 144. But the securities at issue here did not qualify for the Rule 144 exemption. Thus, the sales were unlawful.

1. The Firm Relied On The Rule 144 Exemption

SEC Rule 144 is highly detailed and technical. It both restricts some transactions and permits others that meet certain conditions. It comes into play where securities have been acquired from the issuer or an affiliate in an unregistered private transaction. Such securities typically are marked with a restrictive legend, and the holder may not sell such securities in the public marketplace unless an exemption applies to the sale.

In determining whether a sale of securities is exempt from registration under Rule 144, a broker-dealer must conduct an inquiry that focuses primarily on identifying the individual who is the beneficial owner of the securities to be sold, analyzing that person's relationship (if any) to the issuer of the securities, investigating the circumstances of that person's acquisition of the securities, and calculating how long the person has held the securities. Rule 144 imposes different holding periods on affiliates and non-affiliates of an issuer before they can resell the issuer's securities. In some circumstances, the holder can "tack" his holding period to that of his predecessor in the chain of holders to meet the applicable holding period.

The purpose of the Rule 144 inquiry is to ensure that the transaction is not a subterfuge for an issuer or its affiliates to distribute securities to the public while evading the disclosure requirements that accompany registration. Representations made by the parties interested in selling the securities must be carefully scrutinized by a broker-dealer firm because of the incentive to misrepresent the circumstances and conceal the true beneficial owners.

2. The Firm Lacked A Basis For "Tacking" To Achieve The Required Holding Period Under SEC Rule 144

In the transactions at issue, the purported beneficial owners claimed that neither they nor their predecessors were affiliates of the issuer. Their lack of affiliate status was critical to their ability to sell the shares pursuant to SEC Rule 144 because of the shorter holding period and fewer restrictions on non-affiliates.

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Even as non-affiliates, however, none of the purported beneficial owners of the shares that Scottsdale accepted for resale had held the shares long enough to qualify for the Rule 144 safe harbor holding period. Each seller therefore claimed that the applicable Rule 144 holding period was satisfied by tacking his holding period to the holding period of a prior holder.

In the transactions at issue, one prior holder claimed that he had forgiven a loan that he had made to the issuer and had exchanged the right to payment on the loan for stock. One of the prior holders forgave a promissory note that the issuer had used to pay him for consulting services. Another prior holder claimed to have extended an oral line of credit to the issuer and then to have accepted shares in satisfaction of a sum owed on the line of credit. A third prior holder forgave a portion of a promissory note extending an open-ended line of credit.

Each of these prior holders received the shares around the same time that he transferred them. Thus, the prior holder did not actually hold the shares long enough for his successor to satisfy the applicable holding period by tacking, creating an impediment to resale.

To overcome that impediment, the sellers of the securities claimed the benefit of another tacking provision under Rule 144. Rule 144 provides that where a holder of a security exchanges that security for another of the same issuer's securities, without any additional compensation, the holder may tack the holding period of the first security to the holding period of the second. The theory is that the exchange of one security for another of the same issuer does not change the nature of the holder's capital at risk, so the holding period for the new security can tack back to the date the old security was acquired. The sellers here characterized their prior holders' exchanges of notes for stock as exchanges of one security for another. On that basis, the sellers claimed that they could tack back to the inception of the prior holders' loans.

Whether the first instrument in the chain was a security is thus a threshold issue. The Firm treated the prior holders' promissory notes and lines of credit as securities and the conversion of that debt into stock as the exchange of one security of the issuer for another security of the same issuer. As a result, the Firm concluded that the sellers were permitted to tack their holding period all the way back to the inception of the prior holders' loans.

The Firm erred. The promissory notes and lines of credit were not securities. Rather, they were ordinary debt liabilities. Accordingly, the purported beneficial owners could not establish the requisite holding period, and the Rule 144 exemption did not exist.

3. The Firm Also Failed To Address Red Flags Signaling Unlawful Distributions

The transactions at issue involved persons seeking to sell large blocks of thinly traded, little-known securities acquired in a chain of private transactions originating with the issuer—generally a red flag that the SEC and FINRA have both said requires a "searching inquiry." The sellers acquired the shares from the prior holders and sought to resell the shares almost immediately. The immediate resale of a large block of stock that has never been the subject of registration disclosures strongly suggests an attempt to distribute securities to the public without

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registration. In addition, there were a large number of discrepancies and suspicious circumstances indicating that sham transactions, false documents, and nominees were being used to evade the securities laws and effect unlawful securities sales without registration. These red flags ought to have been investigated and appropriately resolved before the securities could be sold.

The Firm, however, blinded itself to the multiple red flags signaling that the transactions were unlawful public distributions of securities. It did not conduct the required searching inquiry. It sold the securities without a reasonable basis for a Rule 144 exemption. Because of the suspicious circumstances known to the Firm, it also was not entitled to the so-called "broker's exemption" under Section 4(4) of the Securities Act for ordinary trading.

B. Other Respondents

1. John Hurry

Scottsdale is owned indirectly by Respondent John Hurry and his wife, Justine Hurry, through other entities they own and control. John Hurry also owns the clearing firm that handles Scottsdale's business, Alpine Securities Corporation ("Alpine"), and an off-shore foreign financial institution ("FFI") located in the Cayman Islands, Cayman Securities Clearing and Trading SECZ, Ltd. ("CSCT").

Hurry set up CSCT in 2013 to act as a conduit through which other FFIs could deposit penny stocks at Scottsdale for resale in the U.S. securities market. During the relevant period, December 1, 2013, through June 30, 2014, CSCT deposited billions of shares of penny stocks for resale by Scottsdale. All the transactions at issue were routed through CSCT to Scottsdale.

2. Timothy DiBlasi

Respondent Timothy DiBlasi became Scottsdale's chief compliance officer ("CCO") shortly before the events at issue, and he remains its CCO. He maintains, however, that his responsibilities do not extend to the Firm's Rule 144 business.

3. Michael Cruz

Respondent Michael Cruz was the Firm's president, but now serves as general counsel to the collection of Hurry enterprises. During the relevant period, Cruz had final approval authority over the Rule 144 transactions at issue. In that role, he reviewed the information collected by others and determined whether it was sufficient to approve a deposit of stock certificates for resale. Everyone at the Firm, including Henry Diekmann, who headed the Firm's Rule 144 team at the time of the transactions at issue, and who is now the Firm's president, considered Cruz responsible for Rule 144 compliance.

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C. Parties To The Transactions At Issue

This case concerns Scottsdale's sales of stock issued by three little-known companies—Neuro-Hitech Inc. ("NHPI"), VoipPal.com ("VPLM"), and Orofino Gold Corp. ("ORFG"). CSCT deposited millions of the three issuers' shares in certificate form at Scottsdale for resale. Alpine cleared them, and Scottsdale sold them into the U.S. securities market pursuant to Rule 144 without registration.

In making the deposits of NHPI, VPLM, and ORFG stock, CSCT acted on behalf of three other FFIs: (i) Montage Securities ("Montage"), (ii) Titan International Securities ("Titan"), and (iii) Unicorn International Securities ("Unicorn"). Montage was located in Panama; Titan and Unicorn were in Belize. The FFIs, in turn, purported to act for the benefit of other entities, which were represented to be owned by individuals identified in documents as the beneficial owners of the shares.

II. PROCEDURAL HISTORY

FINRA's Department of Enforcement ("Enforcement") filed the Complaint on May 15, 2015. After an extension of time, Respondents filed an Answer on June 26, 2015. On December 11, 2015, Respondents filed a motion for summary disposition that challenged FINRA's authority to bring a disciplinary action for misconduct associated with the sale of unregistered securities. Briefing on the motion was completed on January 29, 2016. The Hearing Officer issued an Order on February 26, 2016, denying the motion and finding that FINRA has authority to bring this proceeding.

The hearing ran a total of 12 days in two sessions. The first session in Los Angeles, California, was held June 13-24, 2016. The second session in Washington, D.C. was held July 11-12, 2016. Ten witnesses testified at the hearing, including two experts.[2] In addition, the full transcript of an on-the-record interview ("OTR") was admitted into evidence, along with more

[2] In addition to Hurry, DiBlasi, and Cruz, the following persons testified: Henry Diekmann, the Firm's current president; Jay Noiman, a former Scottsdale employee who served as CCO until DiBlasi took on that responsibility; David Byrne, a FINRA examiner who is a manager of the AML Investigative Unit; Craig D'Mura, a former Scottsdale employee who worked for a couple of months at CSCT; Christopher Frankel, the current CEO of Alpine; Marc Menchel, Respondents' expert; and Brian Underwood, Enforcement's rebuttal expert.

References to hearing testimony are in the following format: "Hearing Tr. (last name of witness), page of transcript." For example, Hurry's testimony is cited as "Hearing Tr. (Hurry) 1542-43."

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than 200 other exhibits.[3] On September 9, 2016, Enforcement and Respondents each filed one post-hearing brief.[4]

III. FINDINGS AND CONCLUSIONS

A. Jurisdiction

FINRA has jurisdiction to bring this proceeding against Scottsdale, Hurry, and DiBlasi because they are currently registered, and the Complaint charges them with misconduct committed while they were registered. FINRA has jurisdiction as to Cruz although he is no longer registered, because the Complaint was filed within two years of the time he was registered and it charges him with misconduct committed while he was registered.[5]

B. Background

We provide substantial background regarding Respondents and others connected to the transactions at issue to provide the context needed to understand the transactions, the Firm's

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[3] Gregory V. Ruzicka, who worked at CSCT during the relevant period, gave an OTR on May 27, 2015. The OTR became an exhibit. Complainant's exhibits are referred to with the prefix "CX" and an identifying number. Respondents' exhibits are referred to with the prefix "RX" and an identifying number. Joint exhibits are referred to with the prefix "JX" and an identifying number. Ruzicka's OTR is CX-178.

[4] References to the post-hearing briefs are as follows: Enf. PH Br. and Resp. PH Br. Respondents attached graphs and other materials to their post-hearing brief that were not offered or admitted into evidence. Respondents apparently created the graphs after the hearing based on exhibits that were admitted into the record. However, the graphs were not subject to any testimony explaining their creation or testing their accuracy. Respondents' post-hearing brief also contained references to website articles that were not admitted into the record. No copies of the articles were attached to the post-hearing brief. Respondents have not asked permission to reopen the record to admit any of these materials. Respondents simply refer and rely on the non-record materials. The Hearing Panel has not considered any of the following items (or assertions made in argument based on them) in formulating its decision:

- Huperzine A in Alzheimer's Disease—website article relating to NHPI (Resp. PH Br. 5, n.9);
- Same (Resp. PH Br. 7, n.20);
- OTCMarkets.com website on VPLM (Resp. PH Br. 7, n.22);
- The Markets OTCQB website article on VPLM (Resp. PH Br. 7, n.23);
- Historical price figures derived from data on OTCMarkets.com (Resp. PH Br. 12, n.58);
- A purported page from a FINRA Continuing Education Module (Resp. PH Br. 17, n.86; Appendix A);
- Graphs generated by Respondents purporting to use data in JX-264 and JX-268 (Resp. PH Br. 19, n.94; Appendix B);
- Graphs generated by Respondents purporting to use data in JX-279 and JX-281 (Resp. PH Br. 25, n.129; Appendix C);
- Graphs generated by Respondents purporting to use data in JX-308 and JX-310 (Resp. PH Br. 29, n.155; Appendix D); and
- Statement about trading volume attributable to CSCT's sales of ORFG (Resp. PH Br. 29, n.156; statement made without reference to source of information or record citation).

[5] FINRA By-Laws, Art. IV, Section 6; Art. V, Section 4.

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culture, and the Respondents' failure to take reasonable action in response to obvious red flags in connection with the transactions at issue. The background also provides information important in assessing the witnesses' credibility, and in evaluating the Respondents' likely future compliance with the laws and regulations governing Scottsdale's business.

1. Respondents

a. Scottsdale

i. The Firm's Focus On Rule 144 Business

Scottsdale, which is located in Scottsdale, Arizona, has been a FINRA member since 2002.[6] During the relevant period, the Firm had approximately 14 to 20 employees.[7]

Scottsdale's principal business is the deposit and liquidation of penny stocks for its customers.[8] Throughout the proceeding, the penny stocks sold by Scottsdale were also referred to as "microcap" securities.[9] Scottsdale sells most of these securities without registration. The primary exemption that Scottsdale relies on is Rule 144, so it has a dedicated Rule 144 team to review deposits of stock certificates for resale, and its procedures are oriented to Rule 144.[10] Scottsdale obtains customers by advertising in OTC Markets and through referrals.[11]

ii. The Firm's Direct Business With FFIs

Prior to Hurry's creation of CSCT in 2013, Scottsdale did business with FFIs directly. Two of the FFIs involved in this case (Titan and Unicorn) had pre-existing direct relationships with Scottsdale before they started doing business through CSCT.[12]

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[6] CX-1, at 3-9.

[7] Hearing Tr. (Cruz) 116; Hearing Tr. (Diekmann) 1496.

[8] Hearing Tr. (Hurry) 1318; Hearing Tr. (Cruz) 83; Hearing Tr. (Noiman) 1180. DiBlasi acknowledged that during the relevant period penny stock transactions accounted for most of the Firm's revenues, and that over 95% of the transactions that Scottsdale executed for its customers involved penny stocks, most of them unregistered. Hearing Tr. (DiBlasi) 1923.

[9] Microcap securities may be defined as low-priced stock issued by small companies with a market capitalization of $300 million or less. Microcap securities are generally more volatile and less liquid than the stock of larger companies. Most important, because many microcap issuers do not file financial reports with the SEC, it may be difficult for investors to obtain information about the management, products, services, and finances of microcap issuers. https://www.sec.gov/investor/pubs/microcapstock.htm. The SEC has expressed concern that the lack of publicly available information about microcap issuers can enable the spread of false information that misleads investors. *Id.* Many microcap securities trade in the "over-the-counter" ("OTC") market instead of a national exchange such as the New York Stock Exchange or NASDAQ. *Id.*

[10] Hearing Tr. (Cruz) 577, 583; Hearing Tr. (DiBlasi) 1952-54; Hearing Tr. (Diekmann) 818-19, 875-76, 884-86; Hearing Tr. (Hurry) 1600.

[11] Hearing Tr. (Cruz) 116.

[12] Hearing Tr. (Cruz) 192; Hearing Tr. (Diekmann) 727, 817-18; Hearing Tr. (Noiman) 1140-52.

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iii. The Firm's Disciplinary History

Scottsdale has been disciplined previously for selling unregistered securities and having inadequate supervisory procedures and written supervisory procedures ("WSPs") to detect and prevent the sale of unregistered securities. In October 2011, the Firm settled these and other charges, agreeing to a censure and a total fine for all the charges of $125,000 ("2011 Settlement").[13]

The Firm has also settled other types of disciplinary charges against it, which are relevant to the sanctions determinations. In 2009, it agreed to a censure and a $7,500 fine to settle charges that it had bought bonds from customers at unfair prices ("2009 AWC").[14] In August 2012, the Firm settled charges that it had failed to take appropriate action after being on notice that one of its representatives had been using his name and CRD number in stock promotion press releases. The Firm agreed to a censure and a $7,500 fine ("2012 AWC").[15] In 2015, the Firm agreed to a censure and a fine of $10,000 to settle charges that it had submitted reports to FINRA for the Order Audit Trail System that were inaccurate, incomplete, or in the wrong format ("2015 AWC").[16]

iv. The Firm Had Notice That Sham Transactions And The Use Of Nominees Were A Risk In Its Rule 144 Business With FFIs

(a) Four Prior SEC Disciplinary Actions

We find that prior to the events at issue in this case, the Firm was on notice that its business was susceptible to sham transactions and the use of nominees to conceal the true beneficial owners of securities. In four disciplinary actions involving Scottsdale's own employees and customers, the SEC alleged that sham transactions and nominees were used in unlawful sales in violation of Section 5 of the Securities Act of 1933. Those unlawful sales in turn were used to facilitate fraud and manipulation.

In December 2011, two of Scottsdale's registered representatives were named in an SEC complaint ("*Ruettiger*") involving the supposed assignment of portions of a convertible note to satisfy the applicable Rule 144 holding period, the use of nominees to conceal the identity of the true beneficial owners, the use of a "pump-and-dump"[17] scheme to manipulate the market for the stock, and an unlawful distribution of securities without registration. According to the complaint,

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[13] CX-12.

[14] CX-11.

[15] CX-13.

[16] CX-14.

[17] "Pump-and-dump" schemes involve the touting of a company's stock (typically small, so-called "microcap" companies) through false and misleading statements to the marketplace. https://www.sec.gov/answers/pumpdump.htm.

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Scottsdale's registered representatives handled some of the accounts involved in the scheme, and one of them had an interest in an entity that received and sold some of the securities. The complaint alleged that a single person had used 16 Panamanian corporations to conceal his identity and enable him to sell approximately $6 million of stock without registration.[18]

In March 2013, the SEC filed a complaint ("*Gibraltar I*") against a number of people and entities alleging a market manipulation scheme that was facilitated by a Scottsdale customer, Gibraltar. That complaint alleged that individual defendants had secretly sold shares through Gibraltar while simultaneously promoting the stocks and encouraging others to buy. It also alleged that Gibraltar had provided false affidavits and misleading statements that allowed an individual defendant to secretly sell shares of companies he was promoting.[19]

In April 2013, the SEC filed a second complaint against Gibraltar and its owner ("*Gibraltar II*"), alleging that they had facilitated unlawful sales of securities without registration through the use of nominees. According to that complaint, Gibraltar liquidated low-price, thinly traded stocks on behalf of its clients, often during periods of suspicious promotion. Gibraltar assisted its clients to incorporate international business corporations ("IBCs") and encouraged them to use nominee officers and directors so that their identities would remain confidential. The SEC charged that two persons had opened "fake nominee accounts" at Scottsdale.[20]

Gibraltar had been a direct customer of Scottsdale since before the spring of 2010, at least two years before the SEC filed charges against it.[21] It shut down after the filing of the two *Gibraltar* complaints, and some of its customers transferred to Titan, one of the FFIs involved in this case.[22]

In July 2013, the SEC filed an action against ten Argentinians, four of whom had opened accounts at Scottsdale ("*Tavella*"). That complaint alleged that the defendants had submitted false documentation to accompany their securities deposit checklist at Scottsdale, and sold millions of shares into the public markets without registration in violation of Section 5. The defendants claimed that they had purchased their shares from former shareholders, but the former shareholders had already sold their shares years before. Thus, the transactions in which the defendants claimed that they had acquired the shares were a sham.[23]

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[18] *SEC v. Ruettiger*, No. 2:11-cv-2011 (D. Nev. filed Dec. 16, 2011), available at https://www.SEC.gov/litigation/complaints/2011/comp22198.pdf.

[19] Hearing Tr. (Cruz) 195-99; *SEC v. Carrillo Huettel*, No. 13 Civ. 1735 (S.D.N.Y. filed Mar. 15, 2013), available at https://www.SEC.gov/litigation/complaints/2013/comp-pr2013-39.pdf.

[20] Hearing Tr. (Cruz) 185-192; *SEC v. Gibraltar Global Sec., Inc.*, No. 13 Civ. 2575 (S.D.N.Y. filed Apr. 18, 2013), available at https://www.sec.gov/litigation/complaints/2013/comp22683.pdf.

[21] Hearing Tr. (Diekmann) 1912-13.

[22] Hearing Tr. (Diekmann) 727.

[23] *SEC v. Tavella*, No. 13-cv-4609 (S.D.N.Y. filed July 3, 2013), available at https://www.SEC.gov/litigation/complaints/2013/comp-pr2013-122.pdf.

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These regulatory actions should have caused the Firm to take special care when dealing with FFIs, and to revise its procedures to focus on potential sham transactions and the use of nominees. The Firm did not. Its main reaction to *Ruettiger* was to eliminate the branch office involved in the case. Cruz believed that the misconduct identified in the *Gibraltar* cases was "isolated."[24] Scottsdale's current president, Diekmann, who was the head of the Rule 144 team when the *Tavella* complaint was filed, testified that he could not remember if the Firm conducted any investigation of the four Argentinians named in the *Tavella* complaint who had Scottsdale accounts.[25] In Diekmann's view it was "just impossible to know that there was somebody else behind this."[26] Cruz similarly said, "[I]t's almost impossible to detect these nominees, that they're going to be … misrepresenting the—you know, the true identity of these persons."[27] Although the Firm changed some procedures as a result of *Tavella* (it would not accept more than 9.9% of a security at any one time from its customers and it instituted a stock watch list to monitor trading and promotions), Diekmann could not remember doing anything different to address the problem of nominees.[28]

(b) Respondents' Arguments Minimizing Significance Are Rejected

In their post-hearing brief, Respondents argue that the SEC complaints are not relevant because they were classic pump-and-dump cases, and no charge is made here that the transactions at issue were part of a pump-and-dump fraud. It is not necessary, however, to prove that fraud occurred in order to conclude that Respondents failed to perform their gatekeeping duty adequately. The focus here is on Respondents' failure (i) to recognize as a threshold matter that the transactions lacked a legal underpinning, and (ii) to respond appropriately to an accumulation of red flags and suspicious circumstances, either conducting further investigation to make sure an exemption existed or declining to sell the securities.

Respondents also claim that references in the prior complaints to nominees were "peripheral."[29] To the contrary, the use of nominees was critical to facilitating the fraud and manipulation charged in those cases. We reject Respondents' attempt to brush aside the SEC complaints.

Cruz took a different approach at the hearing to minimizing the significance of the SEC complaints, which we also reject. He insisted on a benign definition of the term "nominee" to mean only someone designated to act on behalf of another. He declined to view the *Ruettiger* complaint as raising a concern about the use of nominees. He said, "I wasn't sure if this is a

[24] Hearing Tr. (Cruz) 219.

[25] Hearing Tr. (Diekmann) 732-33.

[26] Hearing Tr. (Diekmann) 732.

[27] Hearing Tr. (Cruz) 213-14.

[28] Hearing Tr. (Diekmann) 733-34.

[29] Resp. PH Br. 36-37.

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situation where the—the nominees here that are being listed were purposely hiding their identity. It could be, but … that just was not my takeaway when I was looking at this … Complaint."[30] When asked whether the allegation of "fake nominee entities" gave him pause, Cruz responded, "I have no idea what fake – I mean, if it's an entity – I mean, if it – I don't know what they mean by 'fake.'"[31] Cruz refused to admit that the complaint in *Ruettiger* put him on notice of the possibility of nominees hiding the actual true beneficial owner of securities. He testified, "I would say this is probably not a case that gave me a great concern about the nominee issue, per se …. There might be a nominee issue in there. I guess I don't know the context of that."[32]

We find Cruz's refusal to acknowledge the plain import of the SEC's allegations in *Ruettiger* and the other complaints disingenuous. Even Respondents' expert agreed that Scottsdale was on notice that its customers could be nominees for beneficial owners as of the relevant period in this case.[33]

(c) Later Actions Confirm Risk Of Sham Transactions And Nominees

The risky nature of Scottsdale's Rule 144 business with FFIs became undeniable in the summer of 2014, when the SEC and criminal authorities initiated two new proceedings charging that certain Scottsdale customers and others had used sham transactions and nominees to sell penny stocks unlawfully without registration. These proceedings were brought based on extensive evidence gathered through the use of undercover agents, cooperating witnesses, and recorded conversations. The allegations appeared well founded, and they finally caused Scottsdale and CSCT to react.

The SEC filed a complaint on July 11, 2014 ("*Amogear*"), charging five individuals with using nominee accounts in FFI trading to conceal beneficial ownership and facilitate a pump-and-dump scheme. The SEC alleged that Titan had agreed to assist in the scheme and that Alpine, the clearing firm, was involved in readying shares for trading in connection with the scheme. In reaction to *Amogear*, Scottsdale froze its FFI trading for a couple of months.[34]

On September 8, 2014, prosecutors filed an indictment in federal district court in New York ("*Bandfield*") that charged Titan, Unicorn, and several individuals with whom Scottsdale and CSCT did business with securities fraud, tax fraud, and a money-laundering conspiracy. Those individuals included the following persons, who were also involved in the transactions at issue here: Cem ("Jimmy") Can at Unicorn; Kelvin Leach and Rohn Knowles at Titan; and Robert Bandfield and Andrew Godfrey, who purported to represent customers of Montage,

[30] Hearing Tr. (Cruz) 191.

[31] Hearing Tr. (Cruz) 192.

[32] Hearing Tr. (Cruz) 184.

[33] Hearing Tr. (Menchel) 2488-89.

[34] Hearing Tr. (Diekmann) 705-12; Hearing Tr. (Cruz) 204-08; CX-250.

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Unicorn, and Titan and appeared in connection with numerous sub-accounts and sub-sub-accounts at Scottsdale. According to the indictment, Robert Bandfield claimed in a recorded conversation that he had created Titan and more than 5000 sham companies. In that conversation, he explained how reporting requirements could be circumvented and beneficial ownership concealed by using nominees.[35] After the indictment was unsealed and became public, CSCT's business substantially diminished.[36]

b. John Hurry

Indirectly, through a trust and a holding company, John Hurry and his wife, Justine Hurry, own Scottsdale.[37] From the Firm's inception in 2002 until December 2012, Respondent Hurry was a registered representative, among other roles.[38] John Hurry again registered with the Firm in October 2014, and remains registered today.[39] Hurry admitted in his Answer to the Complaint that he has been the Firm's director since 2002. However, at the hearing, he claimed that he first became a director of Scottsdale in January 2013. Justine Hurry became its second director in May 2013.[40]

Scottsdale has been highly profitable for Hurry and his wife. According to the Annual Audited Report Form for Scottsdale during the year beginning July 1, 2013, and ending June 30, 2014, the Firm paid $6,222,550 in directors' compensation. Since John and Justine Hurry were the Firm's only directors, this expense presumably was paid to them. [41] The Firm paid other

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[35] CX-244; CX-226; Hearing Tr. (Cruz) 224-30; Hearing Tr. (Diekmann) 1725-26, 1781.

[36] Hearing Tr. (Cruz) 237-38; Hearing Tr. (Hurry) 1529-30.

[37] CX-1, at 7-9; CX-5; Hearing Tr. (Cruz) 81-82.

[38] CX-15, at 11.

[39] CX-15, at 4-5.

[40] CX-1, at 3-9 (showing the Firm's direct owners and directors); CX-17, at 1. In his Answer, Hurry admitted that he had been a director of Scottsdale since 2002. Answer ¶ 16. At the hearing, however, Hurry denied that he had been a director of Scottsdale before January 2013. He did so despite the fact that his signature appeared over the designation "sole director" in a December 2012 document authorizing the creation of the Firm's Management Committee. At the hearing, he claimed that the designation as sole director was a typographical error and that he was acting president prior to January 2013, not sole director. CX-3; Hearing Tr. (Hurry) 1306-09. Cruz testified as to the December 2012 document that Hurry had established the Firm's Management Committee in his capacity as director of the Firm. Hearing Tr. (Cruz) 74-76.

The conflict between the Answer and Hurry's testimony is inexplicable. We find the conflict between Hurry's testimony and the Firm's record of the creation of the Management Committee disturbing, because it reflects a lack of transparency and accountability. We find the typographical error explanation with regard to something as important as corporate authority to designate the responsibilities of senior management—particularly in a simple one-page document—not credible. There is no explanation for the conflict between Hurry's testimony that he was not a director of the Firm in December 2012 and Cruz's testimony that he was. The conflict in the evidence on this point diminishes Hurry's credibility.

[41] RX-42, at 7, 11. When Cruz officially became Scottsdale's president in March 2014, it was by unanimous consent of the Board of Directors, John and Justine Hurry. CX-4.

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compensation of $1,665,574 and professional and consulting fees of $1,138,090. When these payments and other expenses were subtracted from the Firm's gross profit of $11,569,817, the Firm reported net income of $1,446,655. Because Scottsdale is an S corporation, this income flowed through to the shareholders. In the next year, ending June 30, 2015, although the Firm reported only $589 in net income, the Firm paid directors' compensation of $3,255,200.[42]

During the relevant period, Respondent Hurry also was the indirect owner of Scottsdale's clearing firm, Alpine, which is located in Salt Lake City, Utah. Hurry has been its director since March 2011,[43] and has been registered with Alpine since May 15, 2015.[44]

In 2013, Hurry established CSCT, the Cayman Islands broker-dealer through which the securities at issue were deposited at Scottsdale.[45] Hurry owns CSCT,[46] and, as more fully discussed below, he made decisions, both large and small, about how it conducted its business.[47] Despite the highly specialized nature of CSCT's business, Hurry hired Gregory Ruzicka—an out-of-work California real estate attorney who had no prior experience in the securities broker-dealer industry, much less in the specialized business of liquidating microcap securities—to run CSCT.[48] Ruzicka went down to the Cayman Islands in October 2013 to take on his CSCT duties.[49] Hurry then monitored Ruzicka's activities almost daily, right down to his cigarette breaks, and visited the Cayman Islands at least monthly.[50]

Although Hurry attempted to conceal the extent of his involvement in CSCT's business, he admits that he spoke with the three CSCT customers involved in this case (Montage, Titan, and Unicorn), and that he personally visited two of them, Montage in Panama and Unicorn in Belize.[51] He claims that he did not solicit business for CSCT, but, as discussed below, that claim is not credible.

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[42] RX-42, at 27. See also the Firm's FOCUS Reports for 2013-Q4, 2014-Q1, 2014-Q2, 2015-Q3, 2015-Q4, and 2016-Q-1, and the summary of them created by Enforcement. CX-6 through CX-10.

[43] CX-15, at 3, 11; CX-18.

[44] Hearing Tr. (Hurry) 1307.

[45] Hearing Tr. (Hurry) 1329; Hearing Tr. (Noiman) 1117-18; CX-29.

[46] CX-178, at 40-41.

[47] Hearing Tr. (Hurry) 1333-35.

[48] Hearing Tr. (Hurry) 1631; CX-178, at 13-24. Ruzicka had limited experience in the early 1980s with intrastate real estate limited partnership offerings. In that context, he handled post-foreclosure unlawful detainers, relief from automatic bankruptcy stays, and receiverships on commercial properties. CX-178, at 15-18.

[49] CX-178, at 20.

[50] Hearing Tr. (Hurry) 1437-40; CX-178, at 138-41, 151-52; CX-132; CX-133.

[51] Hearing Tr. (Hurry) 1406-08, 1412-14, 1421-22.

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That Hurry was in charge was obvious to his employees and to CSCT customers. Ruzicka referred to him as "the big boss."[52] As noted below, one of the persons at Scottsdale who approved CSCT to become a Scottsdale customer did not even consider rejecting CSCT's application because he knew that Hurry had brought CSCT to the Firm.[53] Similarly, Ruzicka said that CSCT never considered using any broker-dealer except Scottsdale because of Hurry.[54] As Hurry acknowledged, customers also sought direct contact with him because he is "highest on the totem pole."[55]

Respondent Hurry thus owns and controls all three firms involved in the transactions at issue in this proceeding—Scottsdale, Alpine, and CSCT. In fact, the three firms were almost a self-contained system for processing and distributing microcap securities. CSCT did all its business through Scottsdale,[56] and Scottsdale in turn did all its business with Alpine.[57] Alpine's current CEO described Alpine as a small "boutique" clearing firm with a focus on the kind of business brought to it by CSCT.[58] No independent third party was involved in preparing, approving, or clearing the deposits of stock certificates by CSCT at Scottsdale for resale.

c. Timothy DiBlasi

DiBlasi first entered the securities industry in 2002. From December 2002 through March 2012, he was a compliance analyst at First Investors Corporation in New Jersey. DiBlasi has been associated with Scottsdale since April 2012. In June 2012, he became the Firm's anti-money laundering chief officer ("AMLCO"). In October 2013, shortly before the events at issue, DiBlasi became the Firm's CCO, and he remains the Firm's CCO today. Prior to joining the Firm, DiBlasi had limited experience in microcap securities, and he had not handled the type of restricted stock deposits that are the bulk of Scottsdale's business.[59]

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[52] CX-240; Hearing Tr. (Diekmann) 1764-65.

[53] Hearing Tr. (Noiman) 1079, 1103, 1105-06, 1117-18. See also CX-29, at 10, 25 (forms to establish CSCT as a Scottsdale customer listed Hurry as referral or source of the business).

[54] CX-178, at 108.

[55] Hearing Tr. (Hurry) 1432.

[56] Ruzicka testified that CSCT never considered using a firm other than Scottsdale because of Hurry. CX-178, at 108.

[57] Hearing Tr. (Cruz) 143, 306, 382; Hearing Tr. (Diekmann) 759; Hearing Tr. (D'Mura) 2293. The person Hurry hired to run CSCT, Gregory Ruzicka, described CSCT as an "adjunct" of Hurry's operations at Scottsdale. CX-178, at 34.

[58] Hearing Tr. (Frankel) 2342-43. Alpine did do business with other FFIs in addition to CSCT during the relevant period. Hearing Tr. (Frankel) 2343.

[59] Hearing Tr. (DiBlasi) 1919-21; Hearing Tr. (Cruz) 122; CX-19.

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d. Michael Cruz

Cruz entered the securities business in 1994, when he began working at a San Francisco investment banking firm on underwritings, asset-backed securities, and private placements. After approximately six years, he joined FINRA's predecessor, NASD, starting in its San Francisco office as a cause examiner and then moving to New York as a cycle examiner. He then took a job with Citigroup Smith Barney in their central risk group, reporting to the General Counsel and CCO. Subsequently, he moved with his family to Arizona and passed the bar there. In Arizona, he first worked for Wells Fargo in its audit department and then took a similar position at Countrywide in its bank legal department. He left Countrywide when Bank of America acquired it, and he began working at Scottsdale in May 2008.[60]

Cruz has held Series 7, 24, and 63 licenses. However, since January 29, 2015, he has not been registered through Scottsdale. He currently is the general counsel for the holding companies that own Scottsdale and its clearing firm, Alpine.[61]

At the beginning of the relevant period, Cruz was listed on the Firm's Form BD as legal counsel and member of the Management Committee.[62] Cruz officially became the Firm's president by a board resolution dated March 17, 2014. He testified that, at least since December 1, 2013, he had been acting as *de facto* president.[63] The Firm amended its Form BD on March 31, 2014, to disclose that Cruz was the president, as well as legal counsel.[64]

During the relevant period, Cruz approved Rule 144 deposits, including the transactions at issue.[65] Cruz signed the Deposited Securities Checklist ("Checklist") for the transactions at issue under the heading "144 Compliance Approval." Between that heading and his signature is the statement "[B]ased on the information received and reviewed as described in this Deposited Securities Checklist, SCA [Scottsdale] reasonably believes the subject securities are free trading."[66]

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[60] Hearing Tr. (Cruz) 72-73, 557-59, 661; CX-20.

[61] Hearing Tr. (Cruz) 72-73; CX-20.

[62] CX-17, at 1.

[63] Hearing Tr. (Cruz) 78-79; CX-4. Cruz said that the original plan had been for Justine Hurry to be president of the Firm. Hearing Tr. (Cruz) 79. Cruz's testimony that he was the acting president in December is inconsistent with Hurry's testimony that he was president at that time. This conflict concerning who was in charge illustrates the Firm's lack of appropriate supervisory procedures that clearly delegated authority and created accountability.

[64] CX-17, at 7.

[65] Hearing Tr. (Diekmann) 693-94.

[66] RX-1, at 2, 79, 159; RX-2, at 2, 107; RX-3, at 2.

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Cruz acted as the conduit between senior management of the Firm and the board of directors, John and Justine Hurry.[67]

2. Other Key Figures At Scottsdale

a. Henry Diekmann

After graduating from college with a degree in history, Diekmann spent approximately a year as a financial trainee with Morgan Stanley. He then was an insurance salesman for four months. After that, he was unemployed for about a year-and-a-half before he joined Scottsdale in March 2010 as an office assistant. In January 2011, he moved to the Firm's Rule 144 team, where he spent two years before being promoted to head the team. Although many members of the team were lawyers, Diekmann is not. He had no experience with low-priced securities or in clearing unregistered securities for trading before he joined Scottsdale. He was trained to review deposits by Cruz and another person who worked on the Rule 144 team.[68]

During the relevant period, Diekmann focused solely on reviewing CSCT deposits. But he did not have authority to approve a deposit of certificates. Final approval authority rested with Cruz.[69]

Since January 2015, Diekmann has been the Firm's president.[70] As the Firm's current president, Diekmann now has the authority that once belonged to Cruz.[71]

b. Eric Miller

Eric Miller was a Scottsdale salesman. He called potential customers and assisted in conducting due diligence on new accounts.[72] Miller sometimes referred clients to Ruzicka at CSCT.[73]

Although Miller did not testify at the hearing, there is substantial evidence that he was involved with Unicorn's deposits. Miller had a relationship with Unicorn because it had been Scottsdale's direct customer before moving its business to CSCT, and he continued to have contact with Unicorn even after it started doing business with Scottsdale through CSCT, as Diekmann admitted.[74]

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[67] Hearing Tr. (Cruz) 80-82.

[68] Hearing Tr. (Diekmann) 686-90.

[69] Hearing Tr. (Diekmann) 694, 886.

[70] Hearing Tr. (Diekmann) 685; Hearing Tr. (DiBlasi) 1954.

[71] Hearing Tr. (Cruz) 129-30, 583-84; Hearing Tr. (Diekmann) 685-86, 694, 908-09.

[72] Hearing Tr. (Cruz) 116-17; Hearing Tr. (Noiman) 1075-76; CX-29, at 9.

[73] CX-178, at 167-68.

[74] Hearing Tr. (Diekmann) 858, 934-35.

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The fact that Miller continued to have at least some direct contact with Unicorn is significant for the following four reasons:

First, the evidence regarding Miller casts doubt on the effectiveness of the Firm's compliance and supervisory efforts. Diekmann claimed that Miller's direct contact with Unicorn was prohibited and that Miller was "written up" a number of times for corresponding by email with Unicorn. Diekmann did not identify any written prohibition against direct contact with Unicorn, but he said that the prohibition was something that was a matter of business practice at the Firm.[75] The supposed prohibition is inconsistent with the record, which contains a number of emails to and from Unicorn that include Miller as a sender or recipient.[76] Moreover, in some Unicorn emails, Diekmann is a recipient along with Miller.[77] There is no evidence that Diekmann protested Miller's involvement or reprimanded him. If Miller was "written up" a number of times for contact with Unicorn, as Diekmann testified, it apparently had little effect. Diekmann's testimony regarding the supposed prohibition was not credible.

Second, the emails indicate that Miller was a "back door" for Scottsdale in dealing with Unicorn. Although the Unicorn deposits supposedly came through CSCT, Miller and others at Scottsdale corresponded directly with Unicorn personnel and directed Unicorn as to what needed to be done.

For example, Miller engaged in extensive email correspondence with Natalie Bannister at Unicorn in November 2013 about setting up its account with CSCT. Miller instructed her that the stock certificates to be deposited at Scottsdale had to be made out in CSCT's name and sent by CSCT to Scottsdale. Bannister indicated that she did not like transferring ownership to CSCT, "especially with it not in writing." Miller insisted, "These are important details." He said that the account at Scottsdale was in CSCT's name and the "cert[tificate deposit] NEEDS to be in [CSCT's] name, that is all there is to it."[78] Thus, it was Scottsdale—not CSCT—that was making the arrangements and instructing the customer on what had to be done.

Miller shepherded Unicorn's due diligence packages through CSCT. In March 2014, he instructed Unicorn staff and Ruzicka to get together on the telephone to discuss which documents were needed and could be provided for a deposit.[79] Similarly, in May 2014, Miller engaged in email correspondence directly with Unicorn's Back Office Manager, Chinique Lewis, asking her about ORFG, one of the stock deposits at issue in this case. He asked her—not Ruzicka—how the package was coming along. Then Lewis emailed Miller—not Ruzicka—to ask if there was "[a]nything on the [ORFG] as yet?" At that point, Miller emailed her back

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[75] Hearing Tr. (Diekmann) 1664-65.

[76] See CX-216.

[77] See CX-119.

[78] CX-270.

[79] CX-171.

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directing her to call Ruzicka and have him call Miller.[80] Miller's last instruction in the correspondence appears to us to reflect an awareness that Scottsdale should be seen to be dealing only with and through CSCT, when, in fact, Scottsdale, through Miller, was continuing to guide the business with Unicorn.

In April 2014, when Diekmann was unable to obtain the information he needed on a deposit of stock certificates by Unicorn from Ruzicka at CSCT, he emailed Miller a copy of his request to Ruzicka, saying he had not received a response. And Miller, in turn, forwarded the email directly to two persons at Unicorn, Cem Can and Chinique Lewis, asking them to "please address this ASAP."[81] Diekmann denied that he had asked Miller to obtain the information for him, but the correspondence has no other reasonable explanation. Diekmann's testimony in this regard was not credible.[82]

In May 2014, Miller obtained information from Chinique Lewis at Unicorn about the purported beneficial owner of the entity that had deposited VPLM stock through Unicorn for sale by Scottsdale and forwarded that to Diekmann. The email correspondence was included in the VPLM due diligence package.[83]

The degree to which Miller corresponded directly with Unicorn and managed the Unicorn deposits raises the question whether there was any need for CSCT at all. As discussed below in the credibility section, Hurry's decision to route Scottsdale's FFI business through CSCT had little discernible business rationale. His implementation of that decision and staffing of CSCT with Ruzicka, who was unqualified to run CSCT, coupled with the evidence of Miller's continuing role as a "back door" to Scottsdale, demonstrate that CSCT was a façade.

Third, we interpret certain email correspondence between Miller and a client as suggesting that the Firm assisted its clients "all the time" to conceal beneficial ownership of stock. Scottsdale supposedly had a policy not to accept business from Canadian citizens residing in Canada, but, when a client in the Bahamas asked on behalf of a friend whether a Canadian citizen residing in Canada could do business with Scottsdale, Miller suggested that the friend set up a corporation to do the business. Miller called it a "work around." The client responded, "If they get a corporation set up US, Panama, Belize or wherever won[']t your Compliance want to know who is beneficial owner?" Miller responded, "Yes they will but the account holder is the corporation. Trust me on this one, we do it all the time."[84]

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[80] CX-311, at 1.

[81] Hearing Tr. (Diekmann) 1668-71; CX-221.

[82] CX-221; Hearing Tr. (Diekmann) 1665-71. In denying that he intended for Miller to obtain the information from Unicorn that Ruzicka had failed to supply, Diekmann testified that he had no interest whatever in whether he obtained the information. Hearing Tr. (Diekmann) 1665-71. That statement is not credible. If he had no interest, there would have been no reason to send the email to Miller.

[83] RX-3, at 17.

[84] CX-210; Hearing Tr. (Diekmann) 1672-77.

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We are unconvinced by Diekmann's benign reading of this correspondence. He testified that he thought that the client was asking something different, "Won't your compliance know that a Canadian resident owns the LLC and, therefore, won't they reject the deposit or account opening?"[85] Diekmann's interpretation is a rewriting of the client's words. It ignores that Miller's implicit point was that the corporation would be identified as the account holder, not the Canadian owner. That is why the Canadian's deposit would not be rejected. Furthermore, Diekmann's interpretation does not reflect the tone of Miller's comments. When Miller suggested that the shares could be put in the name of the corporation, he treated that as a magical solution to the problem, saying "and wa-la! We get it done that way."[86] Finally, if Diekmann's interpretation of the question were correct, then Miller never answered the question. Miller never explained why the Firm would not reject the deposit if it knew that a Canadian resident owned the LLC.

Fourth, according to Diekmann, after Miller left the Firm in April 2016, the Firm discovered that he had set up his work email to be forwarded to his personal email.[87] This means that Miller could have engaged in communications with FFIs like Unicorn "off the record," avoiding oversight. Although Diekmann testified that all of Scottsdale's emails remained on its system, and were not removed by Miller, Diekmann provided no basis for knowing whether that was true. Diekmann testified that the Firm had asked Miller to confirm he had not removed any emails from the Firm's system but that Miller had not responded.[88]

The inquiry suggests that the Firm in fact does *not* know whether Miller removed emails from the Firm's system. There was no evidence that the Firm employed any technical analysis of its systems to find out if emails or other information had been deleted. There also was no evidence that the Firm made any effort to recover any email correspondence that Miller might have had with customers using only his personal email. Thus, it is undisputed that Miller communicated directly with Unicorn, and it is impossible to know the number or substance of all those communications.

Given the allegations against Unicorn and Cem Can in the *Bandfield* indictment, the inability to review Miller's communications with them is a serious concern. The Firm's reaction—simply to ask Miller to confirm he did not remove any emails from the Scottsdale's system—is an inadequate response. If Miller took emails from Scottsdale's system or deleted them, he would hardly be likely to confess to that wrongdoing. That is particularly so where the emails were with persons subject to a criminal indictment and might place Miller under suspicion. The request to a potential wrongdoer to confirm that he committed no wrongdoing is almost farcical. The inadequacy of the Firm's response mirrors the inadequacy of its checklist

[85] Hearing Tr. (Diekmann) 1673.

[86] CX-210, at 5.

[87] Hearing Tr. (Diekmann) 1662-63.

[88] Hearing Tr. (Diekmann) 1663-64.

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approach to Rule 144 due diligence and contributes to our conclusion that stringent sanctions are required here.

c. Jay Noiman

Jay Noiman joined Scottsdale in September 2011 and left at the end of December 2014.[89] Prior to October 2013, when DiBlasi became CCO, Noiman was the Firm's CCO.[90] He was on the Management Committee from approximately January 2013 through January 2014. He served as vice chairman of the Management Committee and second in command after Cruz. During the relevant period, Noiman was the trading manager and had responsibility for supervising the traders and sales staff. He identified DiBlasi as his supervisor.[91]

Noiman was responsible for reviewing the blotter for restricted stocks. He focused on FFIs,[92] and he approved the account opening documents for CSCT, which was an FFI. Noiman never considered not approving the CSCT account. He knew at the time that it was a referral from Hurry.[93]

Noiman also signed documents in the due diligence packages for the transactions in this case. His signature appears on the Checklist under the heading "Broker Approval." Between the heading and Noiman's signature was the statement that he had carefully reviewed the Checklist and the supporting documents and that to the best of his knowledge "any resale will be made in compliance with firm policy and all applicable laws."[94] By that language, the Checklist makes it appear that Noiman was certifying that he believed that the transaction would comply with the law.

Noiman testified, however, that his signature signified only that all the necessary forms were in the file—a check-the-box function.[95] The parties stipulated that Noiman's signatures on the documents in the three due diligence packages meant the same thing: he checked that the documents were filled out but did not substantively approve or review them.[96] Thus, Noiman's signature on the Checklist created only a façade of compliance and accountability.

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[89] Hearing Tr. (Noiman) 1041-42.

[90] Hearing Tr. (Noiman) 1043.

[91] Hearing Tr. (Cruz) 81, 564; Hearing Tr. (Noiman) 1043-44.

[92] Hearing Tr. (Noiman) 1045-46, 1049-51.

[93] Hearing Tr. (Noiman) 1139-40.

[94] RX-1, at 2; RX-2, at 2; RX-3, at 2.

[95] Hearing Tr. (Noiman) 1156-68, 1171-73.

[96] Hearing Tr. (Noiman) 1172-73.

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During the relevant period, Noiman, like Miller, had contact with one of the FFIs involved in this case, Titan.[97] Noiman talked with Rohn Knowles of Titan at least monthly and sometimes weekly and engaged in email correspondence with Knowles.[98] Both Titan and Knowles were defendants in the *Bandfield* indictment. As discussed below, Noiman obtained information directly from Knowles, which he forwarded to Cruz, to resolve a serious potential problem with a CSCT deposit of VPLM stock. CSCT's staff was not involved.[99] Thus, Noiman was another "back door" to a CSCT customer, raising once again the question why CSCT even existed.

3. CSCT And Its Key Figures

a. Gregory V. Ruzicka

Prior to joining CSCT, Gregory Ruzicka was a real estate attorney in Newport Beach, California. He began his legal career advising exclusively on real estate issues and continued in the real estate field. He did not advise on the federal securities laws.[100] Before beginning work at CSCT, Ruzicka had no experience with Rule 144 or any of the other exemptions from registration under the federal securities laws.[101] Nor did Ruzicka have any prior experience with Cayman Islands law, the Bank Secrecy Act, or anti-money laundering rules and regulations.[102]

Ruzicka met John Hurry in 2002 when Hurry hired him to do some work on a commercial real estate issue. From time to time after that, Ruzicka did work for Hurry, but none of that work involved the securities laws or Hurry's broker-dealer business.[103]

Later, Ruzicka suffered a substantial financial setback that left him out of work and adrift.[104] At this point, Ruzicka asked Hurry to give him a job at a bicycle shop that Hurry owned. Hurry admitted that he was "kind of taken back a little bit."[105] Hurry proposed instead

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[97] Prior to the events at issue, Noiman was involved in the customer due diligence on Titan when it was a direct customer of Scottsdale. On January 18, 2012, Noiman signed a due diligence form as a principal of the Firm representing that to the best of his knowledge the information provided by Titan was true and correct. Noiman also signed the form as the person giving compliance approval. CX-242, at 48.

[98] Hearing Tr. (Noiman) 1185-87. Ruzicka was under the impression that Titan "had a special pipeline to Scottsdale." CX-178, at 110. He spoke of a young woman as being the "private liaison for Titan." CX-178, at 110.

[99] CX-296; CX-294; Hearing Tr. (Noiman) 1187-98. *See infra* at __.

[100] CX-178, at 12-20.

[101] CX-178, at 22-23.

[102] CX-178, at 18-19, 22-24.

[103] CX-178, at 25-29

[104] CX-178, at 14-15, 19-20, 30, 38, 54.

[105] Hearing Tr. (Hurry) 1631, 1635-36. Hurry told D'Mura that Ruzicka had asked, "Would you be able to help me out? Is there any position or something? Could I work at your bike shop or your ice cream shop? You know, you don't have to pay me a lot, but at this point, I don't have anything. I have $50 in my pocket." Hearing Tr. (D'Mura) 2262.

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that Ruzicka go to the Cayman Islands to run Hurry's operation there. According to Ruzicka, Hurry told him that Ruzicka would be running the business and acting as Hurry's lawyer.[106] Ruzicka had been to the Cayman Islands once before to go scuba diving, but he was willing to relocate because he had been through such a hard time and wanted a "change of scenery."[107] Hurry told Ruzicka that he had 30 days to read about Rule 144,[108] so Ruzicka read Rule 144, the Securities Act of 1933, and what he could find on the internet about the Rule 144 exemption.[109]

In mid-October 2013, Hurry flew with Ruzicka in Hurry's private plane to the Cayman Islands so that Ruzicka could begin work.[110] Ruzicka remained with CSCT until mid-October 2014.[111]

Diekmann testified that if CSCT had been his business, Ruzicka would not have been his choice to run the Cayman Islands broker-dealer. Ruzicka lacked securities experience, and he seemed disorganized, sending materials to Scottsdale piecemeal and failing to follow instructions.[112]

Ruzicka never had a securities license or registered with FINRA. Consequently, FINRA had no jurisdiction to compel him to testify. Ruzicka testified voluntarily at an OTR, and he considered testifying voluntarily at the hearing. However, after being contacted by counsel for Respondents, as discussed below in the credibility section, Ruzicka declined to testify. Consequently, Ruzicka's entire OTR was admitted into evidence.

b. Craig D'Mura

Craig D'Mura graduated from Arizona State University in May 2006 and shortly afterward began work at Vanguard Group in the retirement participant services department. After a year and a half, he went to law school at Syracuse University. Although he finished law school, he never took the bar examination and did not become licensed as an attorney. He returned to Phoenix and started a broker training program in 2010. However, he did not feel that being a broker was his "calling."[113]

D'Mura was unemployed in summer of 2011. He responded to an advertisement on Craigslist for an operations position at Scottsdale. In July or August 2011, after an interview with

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[106] CX-178, at 38-40.

[107] CX-178, at 54.

[108] CX-178, at 40.

[109] CX-178, at 22, 62-63.

[110] CX-178, at 37.

[111] CX-178, at 231.

[112] Hearing Tr. (Diekmann) 759-61, 765.

[113] Hearing Tr. (D'Mura) 2246-47.

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Justine Hurry, Scottsdale hired him. Prior to his work at Scottsdale, D'Mura was not even aware of the microcap securities industry.[114]

After two or three weeks in the operations position, D'Mura joined the Rule 144 team. His training was ongoing. By summer of 2013, he was handling more complicated deposits and was able to review files as a principal. However, he did not review deposits by FFIs.[115]

In summer of 2013, Hurry began discussing with Scottsdale staff his plan to open a broker-dealer in the Cayman Islands, and Cruz asked D'Mura if he might be interested in working there. D'Mura began filling out the paperwork necessary if he took the position in the Cayman Islands, and in January 2014, he flew with Hurry in Hurry's private airplane to the Cayman Islands to visit and consider a position with CSCT.[116] D'Mura decided to take the position, returned to Phoenix for a few days, and then went back to the Cayman Islands on January 28, 2014. He stayed with CSCT only about six weeks. After concluding that the situation was intolerable and would never improve, he left on March 14, 2014.[117]

c. CSCT

i. Hurry Set Up CSCT

In early 2013, Hurry set up CSCT in the Cayman Islands.[118] He became its director and intended to have overall management supervision of it and its business.[119] Through a chain of entities, a Hurry family trust owns CSCT, and Hurry and his wife serve as co-trustees of the trust.[120]

Hurry claimed that he set up CSCT because Alpine, his U.S. clearing firm, wanted to be relieved of IRS tax withholding obligations. According to Hurry, Alpine wanted to do business only with FFIs that had agreed with the IRS to take on tax withholding obligations, thereby becoming what is known as a qualified intermediary ("QI").[121] Hurry testified that withholding obligations are complicated and burdensome.[122] He also testified that there are risks in getting

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[114] Hearing Tr. (D'Mura) 2247-48.

[115] Hearing Tr. (D'Mura) 2248-51.

[116] Hearing Tr. (D'Mura) 2252-58.

[117] Hearing Tr. (D'Mura) 2266, 2306-09.

[118] Hearing Tr. (Hurry) 1329, 1333-34.

[119] Hearing Tr. (Hurry) 1394-95; CX-160, at 3.

[120] CX-21, at 2.

[121] Hearing Tr. (Hurry) 1373-74, 1552-61; Hearing Tr. (Frankel) 2345-46, 2349-51. Resp. PH Br. 8.

[122] Hearing Tr. (Hurry) 1554-57.

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the paperwork wrong and incurring penalties, and that there were tax advantages to generating and retaining funds offshore.[123]

Hurry's testimony was at a high level of generality, and there was no corroborating evidence to show the analysis. There was no evidence regarding how Alpine made the decision that it would only do business with QIs, or who made the decision. There was no evidence other than Hurry's testimony to demonstrate that CSCT made business sense. It is unclear how the expense of establishing and staffing a separate offshore office was less burdensome than Alpine's withholding obligations, or why the same goal of eliminating Alpine's withholding obligation could not have been achieved less expensively by requiring the Firm's FFI customers to obtain QI certification in order to do business with Scottsdale and Alpine. Moreover, since Hurry ultimately bore the costs regardless of which entity had the obligation, Alpine or CSCT, we are not persuaded that the claimed reason for creating CSCT made sense.[124]

Nor did the creation of CSCT make sense from the perspective of achieving regulatory compliance. As Cruz agreed, it is easier to spot problems with direct accounts than through an FFI like CSCT that operated as an intermediary for sub-accounts and sub-sub-accounts.[125]

Hurry's intense involvement in CSCT's operations did not abate after he hired Ruzicka in October 2013 to run CSCT's day-to-day operations. Hurry located and rented office space for CSCT before Ruzicka began work and then continued to closely oversee the details of establishing and opening the office after Ruzicka arrived. Hurry obtained a floor plan from Ruzicka, told Ruzicka it was not correct, and asked Ruzicka to take measurements and create a revision.[126] Hurry provided Ruzicka with contact information for shippers to ship furniture Hurry had found for the office.[127] Hurry reviewed the proposed CSCT website design and asked about the costs.[128] Hurry made the final decision on hiring a bookkeeper[129] and all the decisions on entering contracts.[130]

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[123] Hearing Tr. (Hurry) 1554-57.

[124] Hurrry testified that he had allocated between $4 and $5 million for the project and had invested well over seven figures in CSCT. Hearing Tr. (Hurry) 1552. When asked what he had taken out of CSCT, he said "Zero." Hearing Tr. (Hurry) 1553.

[125] Hearing Tr. (Cruz) 220.

[126] CX-48; CX-50; CX-52; CX-55; CX-75.

[127] CX-52; CX-53.

[128] CX-49; CX-84.

[129] CX-178, at 43-44.

[130] CX-178, at 46.

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Hurry instructed Ruzicka on fundamental business operations, as well. For example, he explained to Ruzicka that he should open a separate bank account for customer funds to keep their funds separate from CSCT's funds.[131]

Hurry decided that CSCT should be in the Special Economic Zone within the Cayman Islands, and that it should apply to be exempt from regulation by the Cayman Islands Monetary Authority ("CIMA"). In addition, Hurry instructed Ruzicka to apply to the IRS for QI status.[132] Although Ruzicka expressed concerns about the obligations and representations associated with QI status and was reluctant to make the required representations without further study, Hurry insisted that Ruzicka do it.[133]

Hurry determined the fees and commissions CSCT clients would pay. He instructed Ruzicka to take whatever Scottsdale charged CSCT and tack on 200 basis points.[134] Hurry in turn obtained a discount from Scottsdale on its charges to CSCT.[135] By this means, he kept the cost of doing business through CSCT roughly the same as doing business directly with Scottsdale. Otherwise, the rerouting of the FFI business through CSCT would have made no economic sense for the customers. However, there was no evidence that it made economic sense for Hurry to keep customer expenses roughly the same as they would have been working directly with Scottsdale when he was incurring substantial extra expenses setting up and staffing the extra office in the Cayman Islands.[136]

Hurry was intimately involved in setting up CSCT's technical systems. Hurry made the arrangements for computer software for CSCT and instructed Ruzicka to download Office 2010 for two users.[137] Similarly, Hurry selected computer equipment for CSCT and brought it down to the Cayman Islands in mid-January 2014 at the same time that he brought D'Mura to look at joining CSCT. D'Mura testified that Hurry set up the office network for CSCT.[138] When Ruzicka showed Hurry the information he planned to send to clients, Hurry told him he should make it look better and instructed him on how to do that. Hurry told Ruzicka to print to PDF and get a clean file to email customers. He advised Ruzicka that he could do that on his computer.[139]

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[131] CX-83.

[132] CX-178, at 48-53.

[133] CX-105; CX-107; CX-178, at 50-53.

[134] CX-178, at 106-09.

[135] Hearing Tr. (Cruz) 141-43; Hearing Tr. (D'Mura) 2294-95.

[136] Hurry and Diekmann testified that routing the FFI business through CSCT was actually a little less expensive for customers than dealing with Scottsdale directly. Hearing Tr. (Hurry) 1642-44; Hearing Tr. (Diekmann) 1652-53. If true, that testimony further undercuts the business justification for CSCT.

[137] CX-94; Hearing Tr. (Hurry) 1461.

[138] Hearing Tr. (D'Mura) 2263, 2266-68.

[139] CX-77; CX-78.

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Ruzicka, by contrast, was fairly unsophisticated about technology. He was vague on even identifying the programs that he used at CSCT.[140]

ii. Hurry Micro-Managed CSCT's Business

Although Hurry portrayed Ruzicka as being in charge of CSCT,[141] the evidence is otherwise. Hurry micro-managed CSCT, and he bullied Ruzicka and D'Mura to get them to do what he wanted them to do. Hurry also closely tracked CSCT's business with Scottsdale and with its FFI customers.

Ruzicka considered himself to be only an intermediary.[142] Hurry dictated what should be done, and Ruzicka complied. Ruzicka said with respect to Hurry, "You don't discuss; you do as you are ordered."[143] For example, when Ruzicka protested that he was not comfortable with signing off on the QI application, Hurry responded, "Stupid, just do it." Ruzicka said that he "kind of dropped the subject at that point."[144] Ruzicka signed off, despite his discomfort, because he knew if he did not "there is a ticket back to LA coming tomorrow."[145]

Similarly, although Ruzicka thought that Unicorn engaged in some suspicious trading and constant pressure from Cem Can at Unicorn gave him the "creeps," Ruzicka did not think he had authority to terminate the relationship with Unicorn. If he had done so without clear authority from Hurry, he thought that would have been his last day at CSCT.[146] D'Mura confirmed that neither he nor Ruzicka could terminate a client relationship, and, although they hated dealing with Cem Can at Unicorn, they did not consider it an option to turn away the business.[147]

Some of the initial customers of CSCT were pre-existing customers of Scottsdale. When Ruzicka asked the commonsense question why the pre-existing business was going to flow through the new entity, Hurry told him to shut up. After that, Ruzicka just did as he was told.[148]

Ruzicka testified in his OTR, and D'Mura testified at the hearing, that Hurry barraged them with telephone calls while they were working at CSCT. Hurry called Ruzicka almost every day, sometimes multiple times. He called D'Mura less often, probably a couple of times a week.

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[140] CX-77; CX-178, at 24-25.

[141] Hearing Tr. (Hurry) 1433, 1436, 1549-50. Hurry claimed that he hired Ruzicka to fulfill an "executive role." Hearing Tr. (Hurry) 1648.

[142] CX-178, at 46.

[143] CX-178, at 51.

[144] CX-178, at 51-52.

[145] CX-22; CX-178, at 52-53.

[146] CX-178, at 177-80, 188-89.

[147] Hearing Tr. (D'Mura) 2283-86.

[148] CX-178, at 79-80.

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The calls could come at all hours as well.[149] Often the calls were followed by demanding, abrupt, and increasingly impatient emails saying "call me."[150] In one email, Hurry wrote "Your phone is not working TURN IT ON. I need a call."[151] In another he wrote, "Call me in 60 minutes. DO YOU NOT UNDERSTAND THAT?"[152] In another the subject line was "pick up your phone!!!!!!!!"[153]

Hurry developed an Excel spreadsheet to track various aspects of CSCT's business. Although Hurry characterized it in his testimony as an "empowerment tool" that enabled his people to track their work for themselves without his having to keep track of their progress,[154] that characterization is not consistent with the evidence.

The spreadsheet tracked daily gross production, number of trades placed, certificate deposits approved, new certificate deposits received, and number of new accounts. It also tracked Ruzicka's start and finish times.[155] Ruzicka said that in telephone calls Hurry would even ask about how many cigarettes he had smoked during the day.[156] An email from Hurry corroborated Ruzicka's testimony. In the email, Hurry told Ruzicka "Need all the below," including start time, finish time, and "number of cig breaks."[157] Hurry acknowledged that the email included an inquiry about cigarette breaks, but he claimed that he was trying to help Ruzicka get himself organized. He claimed to know that Ruzicka was only in the office for ten minutes in an hour, which meant things were not getting done.[158]

Hurry wanted the numbers prepared every day, even if he did not ask for the information every day. Ruzicka and D'Mura prepared themselves for Hurry's frequent telephone calls and tried to have talking points and updated information ready to go if Hurry should call.[159]

Hurry tracked Ruzicka's and D'Mura's contacts with CSCT customers, including the FFIs involved in the transactions at issue. Ruzicka testified that in their frequent telephone calls Hurry would ask him about whether he had talked to Rohn Knowles at Titan or Cem Can at

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[149] Hearing Tr. (D'Mura) 2301-02; CX-178, at 67-73.

[150] CX-63; CX-68; CX-71; CX-74; CX-118; CX-121; CX-126; CX-127.

[151] CX-121.

[152] CX-127.

[153] CX-118.

[154] Hearing Tr. (Hurry) 1433-39.

[155] CX-131; Hearing Tr. (Hurry) 1433-34.

[156] CX-178, at 140-41.

[157] CX-133; Hearing Tr. (Hurry) 1438-39.

[158] Hearing Tr. (Hurry) 1438-40.

[159] CX-178, at 140-41; Hearing Tr. (D'Mura) 2301-04; Hearing Tr. (Hurry) 1436-40.

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Unicorn or other particular people from the Bahamas, Panama, or Belize.[160] D'Mura testified that Hurry would ask about customers, not particular deposits, but he and Ruzicka did discuss with Hurry how they were doing on specific deposits.[161] For example, in email correspondence and telephone conversations, Ruzicka discussed with Hurry the amount of trading in at least two of the symbols at issue here, NHPI and VPLM.[162]

D'Mura decided to leave CSCT and the Cayman Islands, in part, as a result of Hurry's constant demands. Hurry had called on a day that Ruzicka was attending a wedding as best man and D'Mura was working at his rented condominium instead of the office. Hurry expressed aggravation that neither of them was in the office and spoke of "having a come to Jesus moment" when he arrived in the Cayman Islands in a few days.[163] D'Mura then packed his bag and said good-bye to Ruzicka, who expressed the wish that he could leave, too. However, Ruzicka said he had nowhere to go and no alternative. D'Mura left before Hurry arrived; Ruzicka stayed.[164]

Eventually, in October 2014, Ruzicka also left CSCT. Its business had dwindled in reaction to the SEC complaint in *Amogear* and the *Bandfield* indictment.[165] According to Ruzicka, in October 2014 Hurry offered him other positions back in the United States, but Ruzicka concluded that he "did not want to work any long[er] for that man," referring to Hurry. Ruzicka said, "I don't care what he offered, you know. Incremental value of that last dollar just was not worth it."[166]

iii. Hurry Prospected For CSCT Customers

CSCT did not advertise[167] or engage in cold-calling to try to generate business.[168] Hurry's business plan was for CSCT to develop clients through contacts and referrals,[169] but Ruzicka, who had no prior industry experience, had no network he could cultivate for potential customers.

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[160] CX-178, at 74-77, 84-85.

[161] Hearing Tr. (D'Mura) 2304-05.

[162] CX-132.

[163] Hearing Tr. (D'Mura) 2308-09. Hurry confirmed that he was frustrated that Ruzicka and D'Mura were not in the office. Hearing Tr. (Hurry) 1602-03. When people called CSCT and did not get an answer, they called Alpine trying to find Hurry. Hearing Tr. (Hurry) 1622-23.

[164] Hearing Tr. (D'Mura) 2306-10.

[165] Hearing Tr. (Cruz) 237-38.

[166] CX-178, at 232.

[167] CX-178, at 218. In contrast, even though Scottsdale had been in business for ten years, it advertised for business. Hearing Tr. (Cruz) 116.

[168] Hearing Tr. (D'Mura) 2279-80.

[169] CX-160, at 3; Hearing Tr. (Hurry) 1393.

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Customers simply appeared seeking to establish a business relationship with CSCT. They were referred to CSCT by Hurry or by someone at Scottsdale or Alpine.[170] Ruzicka testified at his OTR that he had an "express representation" that two of the FFIs involved in this case, Titan and Unicorn, were referred by Hurry.[171] Ruzicka did not know how Montage "found" CSCT.[172]

At the hearing, Hurry flatly contradicted Ruzicka's testimony that Hurry had referred Titan and Unicorn to CSCT.[173] We do not credit Hurry's testimony because he gave the testimony only after he knew that Ruzicka would not appear at the hearing to dispute Hurry's statement. To the extent that Hurry means that the referral came from someone at Scottsdale, we do not regard that as proving that Hurry was not the ultimate source of the referral, even if he made the link to CSCT through Scottsdale. Hurry had a pre-existing relationship with Titan while it was a direct customer of Scottsdale,[174] and he admitted talking to existing Scottsdale customers about his plan to establish CSCT.[175] He also admitted, as discussed below, to talking directly to Titan and other customers even after they became CSCT customers.

Hurry admits that he had at least one face-to-face meeting with Montage in Panama[176] and another face-to-face meeting with Unicorn in Belize.[177] He flew to Central America in January 2014 for these meetings, after dropping off D'Mura on his initial visit to CSCT. He did not take Ruzicka with him.[178]

At the hearing, Hurry claimed not to recall discussing business with either Montage or Unicorn during these visits.[179] Hurry claimed that he went to Montage because Ruzicka had asked him to evaluate a back-office system Montage was using to see if it would be suitable for CSCT. Hurry did not identify the nature of the system. He said that in the end they determined that it was not suitable for CSCT. He did not explain why it was unsuitable.[180]

We do not find Hurry's testimony with respect to his visit with Montage credible. Ruzicka was not technologically sophisticated and was too subordinate to suggest such a thing to

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[170] CX-178, at 104, 167-68.

[171] CX-178, at 203-04.

[172] CX-178, at 203.

[173] Hearing Tr. (Hurry) 1410, 1416.

[174] Hurry was listed as the registered representative and financial consultant for Titan when it was a direct customer of Scottsdale. Hearing Tr. (Hurry) 1413-14, 1610-12; CX-242, at 44, 48.

[175] Hearing Tr. (Hurry) 1401-06.

[176] Hearing Tr. (Hurry) 1412-13, 1612-13.

[177] Hearing Tr. (Hurry) 1406, 1422, 1613-14.

[178] Hearing Tr. (D'Mura) 2300-01; Hearing Tr. (Hurry) 1617-19.

[179] Hearing Tr. (Hurry) 1406, 1618-19.

[180] Hearing Tr. (Hurry) 1612-13, 1617-19.

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Hurry. Furthermore, D'Mura testified that he remembered no discussion of evaluating a back office system.[181] Hurry's testimony was vague and lacked specificity, and, again, Hurry gave his testimony only after it was clear that Ruzicka would not appear at the hearing. Hurry knew he would not be contradicted.

Hurry counseled Ruzicka to do business with Montage and, in particular, to do business with a person who was not identified in Montage documents as being connected with it. Ruzicka testified in his OTR that he was unclear about the role of a Montage contact with whom Hurry spoke from time to time. When Ruzicka asked Hurry about the contact, Hurry said to him "Hey, that's fine, you can interface with that guy. He's part of the operation."[182] This evidence shows that Hurry knew more about Montage than Ruzicka did, and that Hurry was instructing Ruzicka with regard to customer dealings.

Hurry claimed at the hearing that he only went to Belize to meet with Cem Can at Unicorn (both named defendants in the *Bandfield* indictment) because Ruzicka asked him to do so. According to Hurry, Ruzicka was trying to open the account and Can had requested a meeting with Hurry. Hurry said it is not uncommon for people to want to meet the owner of a business.[183] However, in somewhat inconsistent testimony, Hurry testified that he did not recall discussing business during his visit with Unicorn.[184]

Hurry's hearing testimony was impeached by his OTR. In his OTR, Hurry testified that Cem Can had asked him whether it would be better to do business with Scottsdale or CSCT. Hurry told him that it might be quicker to go directly to Scottsdale, but there could be "holdups" because of potential withholding there. On the other hand, because CSCT was a QI, Hurry told Can the "holdup" would be eliminated.[185]

There was additional evidence that Hurry discussed business with Unicorn. In late January 2014, Chinique Lewis of Unicorn sent an email to Eric Miller, Diekmann, and Ruzicka asking for Hurry to join a call on the processes and procedures to be used in connection with Unicorn's business with CSCT and Scottsdale. She said from "our personal face to face conversation with Mr. Hurry, I am certain he will not mind getting on a call."[186]

With respect to the request to involve him on a call with Unicorn, Hurry testified that it was no more than the common desire to deal with the person at the head of an organization.[187]

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[181] Hearing Tr. (D'Mura) 2300-01.

[182] CX-178, at 123-24.

[183] Hearing Tr. (Hurry) 1613-14.

[184] Hearing Tr. (Hurry) 1406.

[185] Hearing Tr. (Hurry) 1407-10, 1421-22.

[186] CX-119.

[187] Hearing Tr. (Hurry) 1432

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We find his explanation unconvincing. He traveled to a potential CSCT client without taking Ruzicka, the designated head of CSCT, discussed that client doing business with CSCT, and was viewed by the client as an important participant in the client's business dealings with CSCT.

Although he denied it, Hurry provided other leads and referrals to Ruzicka, too. In an email dated November 17, 2013, for example, Hurry wrote to Ruzicka, "Referrals and Leads call me on them." In the email, Hurry provided a couple of names and telephone numbers. One of those named was an "Andrew Farmer."[188] On November 20, 2013, Ruzicka wrote Hurry that he had tried to call "Andy" at the number Hurry had given him but the call did not go through. That same day Hurry provided another telephone number.[189] Hurry maintained he had identified the people in the email to Ruzicka not as prospects or potential customers but because they knew FFIs.[190]

Hurry revealed that, in fact, he was guiding Ruzicka's customer dealings, when he volunteered that Ruzicka did not in the end talk to the people Hurry had identified in the email. Hurry said that he had afterward found out that they had some "issues" and had told Ruzicka, "Don't bother."[191]

D'Mura testified that while he was at CSCT Hurry and Ruzicka met with another potential customer, Caledonian Securities. CSCT received over 50 Caledonian deposits afterward.[192]

Despite this evidence that Hurry was critical to developing CSCT's business, Hurry portrayed himself as offering only slight help to Ruzicka. He claimed that all he did was to recommend to Ruzicka that he get a book of international financial institutions and prospect for customers using that.[193] This testimony is not credible. Since Ruzicka and D'Mura engaged in no cold calling, they had no use for a book to help them prospect for customers.[194] Furthermore, such an approach to business promotion—cold calling people out of a book—was not likely to be successful. Hurry would certainly have known that, and he would not have been satisfied with

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[188] CX-51.

[189] CX-62.

[190] Hearing Tr. 1401-04; CX-51.

[191] Hearing Tr. (Hurry) 1404.

[192] Hearing Tr. (D'Mura) 2295-97. D'Mura testified that he received the initial documents from Caledonian in the last week before he left Scottsdale and laid them out on a table to review, so he was well aware of the volume submitted to CSCT. The Caledonian-related deposits were not passed on to Scottsdale before he left CSCT. Hearing Tr. (D'Mura) 2317.

[193] Hearing Tr. (Hurry) 1403-04.

[194] Hearing Tr. (D'Mura) 2279.

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that approach to marketing CSCT. He wanted CSCT to be successful and worked hard to make it so.[195]

iv. Hurry Tried To Conceal His Involvement With CSCT

Both Ruzicka and D'Mura had the impression that secrecy was important to Hurry. Ruzicka said that Hurry "flat told me, 'I'm going to Caymans, because that way I don't have to give anything to anybody.'"[196] D'Mura testified that when he first flew down to the Caymans with Hurry, Hurry spent time discussing with him the privacy laws of the Cayman Islands. Hurry noted that some of them were criminal, not just civil.[197] In so doing, Hurry stressed the serious consequences if a person failed to comply.

Hurry denied any particular interest in secrecy.[198] Hurry's denial is not credible. We find that he was intensely concerned with secrecy and concealing his involvement with CSCT's customers and business. His concern was manifested in the following ways.

(a) Use Of Email Address That Hid His Identity

Hurry used an email address that hid his identity. When Ruzicka started working at CSCT, he used as his work email address gr@csct.ky. The address identified him by his initials, the firm by its initials, and the Cayman Islands location by the last two letters. Ruzicka set up a similar email address for Hurry, using Hurry's first initial and last name: jhurry@csct.ky.[199]

Hurry had an extreme reaction to his email address. Ruzicka said that Hurry "just crucified me." Hurry told Ruzicka that the address was too long, and instructed Ruzicka to change the individual identifier to x.[200] Thus, during the relevant period Hurry's email address at CSCT was x@csct.ky, which did not identify Hurry.

At the hearing, Hurry repeated the same explanation for changing his email address. He testified that he wanted an address that was short.[201]

We find Hurry's explanation to be false. He volunteered elsewhere in his testimony that his main email address is JHurry@hurry.com.[202] Thus, Hurry's main email address is constructed in the same way that Ruzicka initially constructed Hurry's address at CSCT. If that construction

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[195] Hearing Tr. (Hurry) 1417-18; CX-178, at 74-75, 135-42.

[196] CX-178, at 36.

[197] Hearing Tr. (D'Mura) 2259.

[198] Hearing Tr. (Hurry) 1361-62, 1364-65.

[199] CX-178, at 146-47.

[200] CX-178, at 146-47.

[201] Hearing Tr. (Hurry) 1459.

[202] Hearing Tr. (Hurry) 1426.

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was not too long for Hurry's main email address, then it was not too long for his CSCT address. Furthermore, we find that the choice of x instead of an identifier such as JH was designed to conceal Hurry's involvement in CSCT business and perhaps give him the possibility of denying that it was his address. Finally, the extreme nature of his reaction to the initial email address—making Ruzicka feel almost "crucified"—strongly suggests that Hurry was concerned with something more important than having a short email address.

(b) Assertion Of Attorney-Client Privilege

Hurry insisted on asserting the attorney-client privilege even where it was not appropriate. Hurry almost always marked his emails with Ruzicka as attorney-client privileged. He did so even when his emails simply asked Ruzicka to call him and when his emails concerned only floor plans and office furniture and the like, which emails neither sought nor received nor reflected any legal advice.[203] In contrast, Ruzicka rarely marked his emails to Hurry as privileged,[204] even though Hurry instructed Ruzicka that he should mark all his email correspondence with Hurry as attorney-client privileged.[205]

Hurry claimed at the hearing that he marked his emails privileged because Ruzicka advised him to use the privilege designation.[206] That claim is not credible in light of Ruzicka's practice of not marking his emails with Hurry as privileged. Nor is Hurry's claim consistent with the written record that it was Hurry who instructed Ruzicka to use the privilege designation, not the other way around. We find that Hurry wanted all his correspondence with Ruzicka marked privileged because he believed that he might be able to shield that correspondence from future regulatory scrutiny or litigation discovery. Similarly, in his hearing testimony, Hurry sometimes used the phrase "on advice of counsel" in his answer, as though it were a talisman against more probing inquiry or criticism.[207]

(c) Avoiding Written Record

Hurry tried to avoid creating a written record. Ruzicka wrote in an email to Diekmann that Hurry had directed him to take a particular deposit, specifying the symbol, SVLE. Diekmann forwarded the email to Hurry and DiBlasi. When Hurry saw the email, he "tore" into Ruzicka

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[203] CX-48; CX-49; CX-50; CX-51; CX-52; CX-55; CX-58; CX-62; CX-63; CX-71; CX-75; CX-77; CX-78; CX-79; CX-83; CX-84; CX-92; CX-94; CX-107; CX-129; CX-151.

[204] CX-53; CX-62; CX-75; CX-77; CX-79; CX-84; CX-151.

[205] CX-53 and CX-84.

[206] Hearing Tr. (Hurry) 1485.

[207] Hearing Tr. (Hurry) 1333-35.

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"like you wouldn't believe."[208] Hurry told Ruzicka something to the effect of "Never put in writing that I am directly involved in business decisions."[209]

Ruzicka said that Hurry did not want any permanent record of his communications.[210] For that reason he communicated with Ruzicka primarily through FaceTime, the iPhone tool for video communications. Hurry called Ruzicka frequently, sometimes as many as four times in a day. He called early in the morning and as late as 9:30 p.m.; he called on weekends as well as business days. Ruzicka viewed the video calls as invasive, but Hurry told him that he used FaceTime because it was free.[211] Notably, emails are similarly "free" communications once you have paid the internet provider, and Hurry would have incurred no additional expense if he had communicated with Ruzicka by email.

Hurry disputed Ruzicka's testimony that he did not want a written record of his communications with CSCT.[212] However, D'Mura confirmed that Hurry did not want a written record of his involvement in CSCT business. D'Mura testified that Hurry expressed to him and Ruzicka both specifically and generally not to send him documents.[213]

(d) Use Of FaceTime To Conceal Contacts With Customers

Hurry also communicated with CSCT customers (including all three FFIs involved in this case) using FaceTime, thereby concealing his contacts with them. Hurry would call Ruzicka at CSCT and ask Ruzicka to call a customer on CSCT's landline. Then Ruzicka would hold his iPhone next to the landline telephone so that Hurry and the customer could talk. Ruzicka did not participate in the calls, although he had to be present to hold the telephones together. This manner of conducting the telephone conversation would avoid a record that Hurry had talked to the customer. To the extent there was any record, it would appear that Hurry had only called CSCT. Ruzicka testified at his OTR that this happened roughly a dozen times and that Hurry had conversations in this manner with Rohn Knowles and Kelvin Leach at Titan, Cem Can at Unicorn, and an individual at Montage.[214]

In hearing testimony, D'Mura similarly described a FaceTime conference call with Caledonian. Caledonian was on the speaker phone in the CSCT office and Hurry was on the iPhone. Ruzicka would hold the telephones next to each other. D'Mura remembered at least one

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[208] CX-178, at 155-61.

[209] CX-178, at 161.

[210] CX-178, at 70.

[211] CX-178, at 67-71.

[212] Hearing Tr. (Hurry) 1540.

[213] Hearing Tr. (D'Mura) 2300.

[214] CX-178, at 118-27.

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other time that such a FaceTime conference happened.[215] D'Mura believed that it was Hurry's idea to conduct the calls this way.[216]

Hurry does not deny that he conducted telephone calls with CSCT customers in this manner. However, he gives the practice an innocent explanation. He claims that he used the iPhone app because it cost less and because he found it difficult to do a conference call on his cell phone. He claimed that Ruzicka was a participant in the call, disputing Ruzicka's OTR testimony after he knew that Ruzicka would not appear at the hearing.[217]

We find Hurry's explanation not credible. Hurry generally did not conduct his business in such a frugal manner. He flew back and forth to the Cayman Islands in his own private airplane, and flew to Panama and Belize from there to meet with Montage and Unicorn.[218] He funded expensive offices for CSCT[219] and provided Ruzicka and D'Mura with housing when they worked there.[220] He instructed Ruzicka to buy Hurry a seven-seat vehicle to use while he was in the Cayman Islands.[221] He liked to tell people how rich he is.[222] It is unlikely that the costs associated with a dozen international telephone calls would trouble him much.

We also find Hurry's assertion that he used FaceTime because he was too technologically challenged to figure out how to do a conference call on his cell phone not credible. Hurry was technologically sophisticated enough to set up CSCT's computer network.[223] He instructed Ruzicka on how to use PDFs and other software, and he created an elaborate Excel spreadsheet.[224] When he was asked whether he was aware that his use of FaceTime to speak with customers would conceal his involvement in a conversation with the customers, Hurry answered evasively, avoiding a direct yes or no.[225]

Hurry testified that he started using FaceTime in February 2014.[226] Coincidentally, his email traffic with Ruzicka and D'Mura at CSCT dropped to nearly nothing.[227] We find a

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[215] Hearing Tr. (D'Mura) 2297-98.

[216] Hearing Tr. (D'Mura) 2302-03.

[217] Hearing Tr. (Hurry) 1540-42.

[218] Hearing Tr. (D'Mura) 2252-58, 2300-01; Hearing Tr. (Hurry) 1412-13, 1613-14, 1617-19.

[219] CX-178, at 35.

[220] Hearing Tr. (Hurry) 1447, 1649-51; Hearing Tr. (D'Mura) 2265, 2316-17.

[221] CX-58.

[222] CX-178, at 26, 70.

[223] Hearing Tr. (Hurry) 1461; Hearing Tr. (D'Mura) 2263, 2266-68; CX-94.

[224] Hearing Tr. (Hurry) 1433-34; CX-178, at 24-25; CX-77; CX-131.

[225] Hearing Tr. (Hurry) 1541.

[226] Hearing Tr. (Hurry) 1540.

[227] Resp. PH Br. 45.

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significant connection between the two events. Hurry's purposeful use of FaceTime enabled him to stop creating a trail of emails.

C. The Firm's General Practice For Reviewing Deposits

Everything that Scottsdale knew about a deposit when the Firm concluded that it could sell the deposited securities pursuant to the Rule 144 exemption is contained in a due diligence package for the deposit.[228] Generally, at the top of the package is a two-page Deposited Securities Checklist ("Checklist"). That is followed by various other documents, including a Beneficial Ownership Declaration signed by the purported beneficial owner of the shares deposited for resale by Scottsdale.[229]

Scottsdale's general process for reviewing and approving a deposit of stock certificates was for a person on the Rule 144 team to assemble the due diligence package, working from the Checklist. Then, the person who had put together the file (sometimes referred to as the first reviewer) would go to Cruz and talk with him about it. Depending on the complexity of the deposit, the talk could take 15 minutes to an hour. Cruz did not review every page in the file. He would read through the Checklist and ask questions. He might ask to see particular documents and conduct Google searches while sitting together with the initial reviewer.[230]

The Firm heavily depended upon the representations made in the Beneficial Ownership Declaration for its conclusion that the purported beneficial owner was not an affiliate of the issuer and was the person who had the economic interest in the shares on deposit. Diekmann initially denied that the persons signing as beneficial owners could be lying. He testified that he saw no reason for them to lie, and he emphasized that the document is very clear about the information it requests. Only upon being pressed did he eventually agree that if someone were acting as a nominee for a secret beneficial owner one would expect them to lie.[231] We find his testimony on this subject evasive.

Cruz similarly focused on the fact that the Beneficial Ownership Declaration was the tool that the Firm used to find out who owned the shares.[232] He stressed that the Declaration was "unequivocal," and that the parties to the transactions understood the Firm's expectations when they made parallel representations regarding the person identified as the beneficial owner.[233] When asked whether language on Unicorn's website offering to appoint nominee officers and directors would be a red flag to him, Cruz responded that it "could have been." He suggested that the way he would deal with that red flag would not be to seek independent verification. Rather,

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[228] Hearing Tr. (Diekmann) 1916-17.

[229] RX-1, at 1-2, 11-12, 78-79, 88-89, 158-59, 169-70; RX-2, at 1-2, 12-13, 106-07, 117-18; RX-3, at 1-2, 11-12.

[230] Hearing Tr. (Diekmann) 694-96; Hearing Tr. (Cruz) 278.

[231] Hearing Tr. (Diekmann) 1895-96.

[232] Hearing Tr. (Cruz) 201-03.

[233] Hearing Tr. (Cruz) 202.

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he would simply emphasize to the interested persons the importance of disclosure. He said that the Firm would "reiterate and make sure they understand the purpose of our forms and … that they need to – to disclose the underlying beneficial owner."[234]

Cruz testified that during the relevant period, from December 2013 through June 30, 2014, the Firm did not conduct a specific search for nominees.[235] Diekmann testified that he thought the Firm's general practice would pick up a problem with nominees, but he could not cite any particular procedures that were geared to do that. He said the "procedures in sum" would address the nominee problem.[236] Cruz confirmed, however, that the term "nominee" appears nowhere in the Firm's policies and procedures.[237]

Given the complexity of the analysis required, and the high potential for interested parties to obfuscate and make misrepresentations, we find the Firm's general process for final approval inadequate. A conversation that may last fifteen minutes and not involve review of all the documents in the file is not enough to analyze the content of the representations and understand whether the business transactions made sense. We also find that the Firm's reliance on the honesty of the interested parties filling out the forms was unreasonable in light of the high potential for the use of nominees.

We are concerned that the Firm's general process for review and approval was so poor when the processing of microcap stock certificates for resale to the public was its primary business. We are further concerned because the transactions at issue here were typical of Scottsdale's business. Cruz testified that the Firm's customers typically were persons who made loans to issuers and then sold the loans to others who then attempted to profit by exchanging them for shares. Thus, the Firm's lack of a good process for review and approval was not a minor aspect of the Firm's business.[238]

D. Transactions

The Firm followed a check-the-box approach to its Rule 144 reviews, without evaluating and independently verifying the information it gathered. This approach is apparent from the following in-depth analysis of the three NHPI deposits. The Firm followed the same approach with the VPLM and ORFG deposits, which we discuss in less detail.

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[234] Hearing Tr. (Cruz) 307-08.

[235] Hearing Tr. (Cruz) 199-202, 211-13; Hearing Tr. (Diekmann) 908-10.

[236] Hearing Tr. (Diekmann) 922.

[237] Hearing Tr. (Cruz) 666-67.

[238] Hearing Tr. (Cruz) 352-53.

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1. NHPI (Three Unicorn deposits derived from Collins promissory note)

a. Due Diligence Package

i. Purported Beneficial Owners

CSCT made three NHPI deposits. They all came from Unicorn, which, in turn, purported to act on behalf of other supposedly independent entities: Sky Walker, Inc. ("Sky Walker"), Swiss National Securities ("Swiss National"), and Ireland Offshore Securities ("Ireland Offshore"). The beneficial owner of Sky Walker is identified on the Checklist as Patrick Gentle; the beneficial owner of Swiss National is identified on a separate Checklist as Talal Fanni (apparently a misspelling, since the person signed documents as Talal Fouani); and the beneficial owner of Ireland Offshore is identified on the third Checklist as Jeff Cox.[239]

Each purported beneficial owner signed a Beneficial Ownership Declaration representing that he was not an affiliate of the issuer, that the issuer was not to his knowledge a shell, and that the securities were free trading, without resale restrictions under Rule 144. The documents were not witnessed or notarized. No address, telephone number or other contact information was given for the purported beneficial owner.[240]

Scottsdale did nothing to identify the purported beneficial owners more specifically. While it did a Google search combining the name of the beneficial owner with the words "securities fraud" and put the first page of the initial index of results in the due diligence package, it did not search for the person's name alone, or the person's name in combination with the name of the entity through which he acquired the shares, or the person's name along with the names of the issuer and issuer's principals.[241]

The purpose of the Google search using the name of the purported beneficial owner with the words securities fraud is unclear in light of the fact that Diekmann testified that a "hit" on such a search indicating that a person was engaged in some sort of securities fraud would be unrelated to beneficial ownership.[242] That testimony demonstrates the check-the-box attitude of the Firm. Diekmann was insensitive to the possibility that if a person was engaged in securities fraud, then the representations made by that person and others connected to a deposit could be false.

As discussed below, the three deposits shared the same origin.

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[239] RX-1, at 1-2, 11-12, 78-79, 88-89, 158-59, 169-70.

[240] RX-1, at 11-12, 88-89, 169-70.

[241] RX-1, at 67, 152, 223. The Firm misspelled Fouani's name when it did the Google search, illustrating its careless approach to conducting due diligence. RX-1, at 67.

[242] Hearing Tr. (Diekmann) 927.

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ii. Prior Holder Transaction

The Checklists for the Sky Walker, Swiss National, and Ireland Offshore deposits state that the issuer, NHPI, gave a $10,000 promissory note dated May 1, 2012, to someone named Thomas Collins. Each NHPI depositor purports to tack back its holding period to that date and that note.[243]

A copy of the May 2012 promissory note is included with the Sky Walker and Ireland Offshore deposits. The note was due and payable no later than July 1, 2012. It provided that if NHPI did not pay the note by the due date, Collins would have the right to convert the debt into common shares. No address or contact information is given for the company or for Collins. Although the note provided that Collins would have a right of conversion upon the company's default, it contained no provision for either party to give notice to the other in the event of a default. The signatures for NHPI and Collins were not witnessed or notarized.[244]

According to the attorney opinion in the due diligence package, the May 2012 note was the company's promise to pay Collins a fee for services.[245] The unaudited financial statements in the due diligence package similarly indicated that the note was for consulting services.[246]

With respect to Collins' identity and possible connection to the issuer, the due diligence package contains a statement signed by Collins declaring that he had never been an affiliate of the issuer. Again, the statement is not witnessed or notarized, and no contact information is provided.[247]

The issuer did provide the stock transfer agent with an address for Collins when it instructed the transfer agent to issue new unrestricted shares to him, as reflected in the instructions to the transfer agent, which are in the due diligence package. Collins had a Texas address.[248] Also in the due diligence package is the transfer agent's list of shareholders, which showed that all active shareholders of NHPI had U.S. addresses.[249]

Scottsdale did not run a Google search on Collins using the address contained in the due diligence package. Nor did it search to see whether Collins had any links to the other persons on the NHPI shareholder list. Rather, it ran a Google search linking Collins' name to the words "securities fraud." Apparently, a person named Thomas Collins had been involved in a securities fraud, but the Firm obtained an SEC litigation release indicating that that person had died prior to

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[243] RX-1, at 1, 78, 158.

[244] RX-1, at 106, 183.

[245] RX-1, at 22, 101, 178.

[246] RX-1, at 40, 122, 198.

[247] RX-1, at 25.

[248] RX-1, at 31.

[249] RX-1, at 37.

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1997. The Firm never determined the identity of the particular Thomas Collins involved in the NHPI deposits.[250]

iii. Acquisition Of Shares By Depositors

Collins gave Sky Walker, Swiss National, and Ireland Offshore each a separate $50,000 note dated September 1, 2013. The notes were to be paid in full by November 7, 2013. The notes specified that in the event of a default the entire sum would become due.[251] Each note was ostensibly secured by a Stock Pledge Agreement pledging 20 million shares of NHPI,[252] which, at the time, Collins did not own. These notes, like the note between Collins and NHPI, contain no address or contact information for any party and no provision for either party to give notice to the other in the event of a default. They are neither witnessed nor notarized.[253]

The next items in the chronology are three Note Satisfaction Agreements dated September 16, 2013. These three identical Agreements indicate that Collins had already defaulted on the $50,000 note, although the due date was not until November 7, 2013. Each depositor declared a desire to take title to the NHPI shares described in the pledge agreement.[254] The Securities Deposit Pre-Review Request Unicorn submitted for Swiss National likewise gives September 16, 2013, as the date of acquisition, referring to the Note Satisfaction Agreement,[255] as does the Deposited Securities Request Form submitted for Ireland Offshore.[256]

On November 15, 2013, more than a year after the due date for the May 2012 note, the issuer and Collins purportedly entered into a note conversion agreement whereby Collins agreed to forgive 90% of the note in return for 90 million shares of NHPI.[257] The Note Conversion Agreement included in the due diligence package, like the May 2012 promissory note, contains no address or contact information for the company or for Collins and is not witnessed or notarized. The Note Conversion Agreement does not explain why the conversion occurred so

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[250] RX-1, at 57-58.

[251] RX-1, at 32, 112, 190.

[252] RX-1, at 113-16, 191-94.

[253] RX-1, at 32, 112, 190.

[254] RX-1, at 33, 117, 195.

[255] RX-1, at 13.

[256] RX-1, at 161. Other documents give conflicting, later dates as the acquisition date. Some documents represent that the three depositors acquired the securities on November 25, 2013, pursuant to a Stock Purchase Agreement. RX-1, at 11, 19, 88, 98, 169. However, the due diligence package for NHPI contains no Stock Purchase Agreement. Another document says that the acquisition date was November 15, 2013, the same date that Collins entered into the Note Conversion Agreement and the shares were issued to him. RX-1, at 81. The Firm did not resolve the discrepancy between the September acquisition date and the November acquisition dates before selling the securities.

[257] RX-1, at 1, 78, 158.

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long after the default or how the remaining unpaid 10% of the May 2012 promissory note was to be treated.[258]

NHPI issued the 90 million shares to Collins on November 15, 2013, the same day as the note conversion agreement.[259]

Although the exact date that Collins assigned the shares to the three beneficial owners is not clear, it was at most a few days after NHPI issued the shares to Collins. Thus, the transaction between the issuer and Collins, the issuance of the stock, and the transactions between Collins and the three purported beneficial owner entities all happened almost simultaneously.

Although the transactions happened almost simultaneously, the value given to the shares differed substantially. There is no evidence of a corporate event or other explanation for the variance. In return for forgiving a debt of $9,000, Collins obtained 90 million shares, but each beneficial owner entity forgave a debt of $50,000 for its 20 million shares. No money actually changed hands in these transactions.

iv. Issuer Filings

Although NHPI had once been a reporting company with the SEC, it stopped being a reporting company in 2009. After that it made less frequent and less regular filings on OTC Markets.[260] On November 20, 2013, a few days after the NHPI shares were issued and around the time that Sky Walker, Swiss National, and Ireland Offshore acquired the shares, the issuer filed an annual report for the year ending December 31, 2012.[261] In the November 20, 2013 report, NHPI mainly discussed its pharmaceutical business and then stated in a single sentence that it had entered into the oil and gas business. It declared that further disclosure related to the oil and gas business was in an Interim Information and Disclosure Statement for the period ended November 20, 2013.[262]

In the annual report filed on November 20, 2013, notes to unaudited financial statements declared that NHPI had given Collins a promissory note for unspecified consulting services.[263] Scottsdale relied upon this disclosure to verify the existence of the May 1, 2012 promissory note, which was critical to the ability of the beneficial owners to sell the securities without registration.

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[258] RX-1, at 26-28, 106-09, 184-86.

[259] RX-1, at 29.

[260] Hearing Tr. (Byrne) 2069-75; CX-255; CX-256; CX-260; CX-261; RX-1, at 130.

[261] CX-256. Diekmann testified that it appeared that the company had had a gap in its reporting prior to its November 2013 filing. Hearing Tr. (Diekmann) 939. However, he did not believe that such a gap would be suspicious, even if it were as long as two-and-a-half years. Hearing Tr. (Diekmann) 1011-13.

[262] CX-256, at 4. One page from the Interim Information and Disclosure Statement was in the due diligence package for the NHPI deposits. But that page did not contain the disclosure relating to the oil and gas business. RX-1 at 39.

[263] RX-1, at 40.

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The only evidence that the note existed, however, was created about the same time as the transactions leading up to the sale of securities into the public markets.

In order to determine that NHPI was not a shell, Scottsdale relied on the representation by the president of NHPI that it was not a shell.[264] It also relied on descriptions of the company's assets and liabilities in unaudited financial statements contained in the annual report filed in November 2013 and in a quarterly report filed about the same time to cover the period ending June 30, 2012. However, those descriptions were vague; they showed mostly unspecific cash assets, not physical assets. In the annual report, for example, the company reported that it had less than $28,000 in a checking account, accounts receivable over $600,000, unspecified inventory over $70,000, and investment assets over $750,000. The financial statements also show that the issuer had incurred some expenses. The financial statements do not provide, however, any indication of the nature of the expenses or the business activities that supposedly gave rise to them. The issuer disclosed no verifiable facts.[265]

The company's public filings created a significant discrepancy between the disclosure in those filings and the NHPI deposits. The interim financial report for the period ending November 20, 2013, states that 981,408,909 shares were outstanding, of which 970,326,182 were restricted.[266] That means that only around 11 million shares were free-trading shares. But the three depositors deposited 60 million for resale to the public. There is no evidence that the Firm investigated this discrepancy.

v. Attorney Opinion Letter

The Firm relied upon an attorney opinion letter stating that the shares could be issued as free trading shares and sold pursuant to Rule 144. However, that opinion made plain that the attorney relied on certifications by the principal officers of NHPI. The attorney assumed that all signatures were genuine and the facts set forth in the certificates were correct.[267] The attorney relied on the company's filings for his conclusion that the company was actively marketing its pharmaceutical products and exploring one or more strategic alliances and licensing arrangements.[268] Similarly, the attorney relied on company filings as showing that NHPI was actively pursuing the acquisition of mineral rights leases.[269] The attorney did not independently verify the facts in his opinion letter.

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[264] RX-1, at 24.

[265] RX-1, at 38-40.

[266] RX-1, at 43.

[267] RX-1, at 20.

[268] RX-1, at 21.

[269] RX-1, at 21.

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vi. Scottsdale Approval And Sales

During the first week of February 2014, Noiman and Cruz approved the first NHPI deposit, Sky Walker, for resale by Scottsdale. At the time, the 20 million shares were given an estimated value of $268,000.[270] Noiman and Cruz approved the Swiss National NHPI deposit on April 9, 2014, which was given a value of $98,000.[271] They approved the Ireland Offshore NHPI deposit at the end of April 2014 with a given value of $82,000.[272]

Sales of NHPI shares began on February 26, 2014, and continued through May 7, 2014. Periodically, Scottsdale would wire out the proceeds of the sales of NHPI and other securities in the CSCT account.[273] As with all transactions conducted with CSCT and its customers, after Scottsdale wired the proceeds of the sales to CSCT's bank account, Scottsdale did not know where the funds flowed after that.[274] Thus, it did not know who received the economic benefit.

vii. Promotional Activity

In December 2013, not long after the series of transactions by which the purported beneficial owners acquired their shares of NHPI, there was promotional activity regarding NHPI, as reflected in the due diligence file for the NHPI deposits. Diekmann testified that he would have looked at the promotional activity but he did not recall doing so. He asserted that promotional activity was not necessarily a red flag, but that he might try to see if there was a link to the customer. He acknowledged, however, that it would be difficult to know if a customer was behind the promotion if a nominee were being used.[275]

In February and March 2014, there also was promotional activity regarding NHPI.[276] In a February 19, 2014 email, Ruzicka wrote to Diekmann that Unicorn was particularly eager to trade NHPI. Diekmann did not remember the email, and did not think it particularly remarkable. He said that no customer wants "to miss an opportunity to trade."[277] Scottsdale sold NHPI shares deposited by CSCT during February and March 2014, when the promotional activity was ongoing.[278]

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[270] RX-1, at 78-79 (Sky Walker).

[271] RX-1, at 1-2.

[272] RX-1, at 158-59.

[273] JX-268.

[274] Hearing Tr. (Cruz) 661-62.

[275] Hearing Tr. (Diekmann) 1014-16; RX-1, at 132-33; CX-262, at 6.

[276] CX-262, at 2-5; CX-263.

[277] Hearing Tr. (Diekmann) 1016-18.

[278] JX-268.

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b. Red Flags Signifying A Scheme To Evade The Securities Laws

Even aside from the fact that the May 2012 promissory note was not a security, as discussed below, the circumstances of the three NHPI deposits raised a number of red flags signaling that the transactions were likely sham transactions using nominees to conceal the identity of the persons actually benefiting from the sale of securities. Some, but not all, of the red flags are listed below.

First, Collins and NHPI entered the agreement to convert the note he held from the company to shares—and NHPI issued the shares—almost simultaneously with his execution of three separate agreements to transfer a portion of those shares to Sky Walker, Swiss National, and Ireland Offshore. The almost simultaneous transactions are compelling evidence that the parties were not truly independent. The suspect nature of the transactions is heightened by the identical terms of the notes to Sky Walker, Swiss National, and Ireland Offshore.

Respondents attempted to rebut any suspicion arising from the timing and identical terms of the Sky Walker, Swiss National, and Ireland Offshore transactions. Diekmann testified that he assumed that one person had put together the loan transactions for Collins, and that was why the three entities had agreed with Collins to the same loan terms. He acknowledged that he did not know who that person might be, but he did not think it was a red flag that Sky Walker, Swiss National, and Ireland Offshore agreed to the same terms or that the same documents were used for the three loan transactions.[279] We find that Diekmann's unverified hypothesis did not excuse the failure to investigate this red flag.

Second, Collins entered into the agreement with the three depositors, along with the agreement pledging NHPI shares as security, before he actually had any shares. However, he represented in the pledge agreement that he held title to them already. It should have been a concern that Collins apparently misrepresented his ownership. It also is suspicious that the depositors would loan him $50,000 each without verifying that he owned the shares. It is even more suspicious that Collins would take on a $150,000 obligation without knowing whether he could obtain the shares. The facts support the conclusion that Collins entered into the agreement with the depositors because he (or whoever was pretending to be Collins) was affiliated with the issuer and knew that the shares could be obtained. Further investigation was required before proceeding to sell the securities.

Third, the documents relating to the NHPI transactions in 2012 lack important elements that would permit verification. For example, the 2012 Collins-NHPI promissory note bears no physical address, telephone number, or other contact information for Collins or NHPI. Similarly, the documents relating to the loan notes Collins gave the three depositors do not include any contact information for Collins or for the depositors. The lack of contact information is odd because there is no provision for where and how payment should be made. It is almost as though there is no expectation of payment.

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[279] Hearing Tr. (Diekmann) 1699-1700.

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Fourth, the obviously impossible September date declaring Collins in default on the notes held by the depositors—even before the notes became due on November 7, 2013—should have been investigated. The fact that the identical mistake was made in three separate documents supposedly involving independent parties is suspicious. If the parties were independent, one would have expected someone to notice the mistake. That is particularly so where the error was not a transposition of numbers but, rather, an incorrect month. The error would have been easier to spot.

Diekmann testified that the September 16, 2013 date on the note satisfaction agreement had to be a typographical error. "In all likelihood," he said, "that's supposed to read November 16, 2013."[280] When asked about the fact that the same error appears in all three note satisfaction agreements signed by Sky Walker, Swiss National, and Ireland Offshore, Diekmann said that was not surprising. He noted that the agreements were all executed the same day, and hypothesized that someone must have done a search and replace function to change the words without noticing the mistake.[281] Cruz similarly explained the date as a typographical error. He testified that even though the same mistake occurred in connection with the documentation for three purportedly separate transactions it gave him no pause.[282]

Between hearing days, Respondents obtained a copy of the relevant stock certificate, which was then introduced into evidence. It showed a transfer date of November 21, 2013. They argue that this proves that the September date was a typographical error.[283]

Respondents miss the point. Nothing in the due diligence package shows that the Firm noticed or investigated the discrepancy before selling the securities. Furthermore, if the September date was a typographical error generated by a search and replace function in documents governing supposedly independent transactions, that only increases the appearance of coordination among the parties to those transactions.

Fifth, Diekmann admitted that there was no evidence contemporaneous with the May 2012 note to show that the note existed.[284] The only evidence that the 2012 promissory note from NHPI to Collins existed was created after Collins purported to convert the note to NHPI shares. Rather than confirming the existence of the note, the timing of the late filing suggests the fabrication of false evidence to support the tacking period necessary for the exemption.

Sixth, it is peculiar that Collins did not enforce his right to conversion of the shares at the time if NHPI defaulted in July 2012 on the $10,000 promissory note. There is no explanation why he would have waited more than a year—until November 2013—to do so.

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[280] Hearing Tr. (Diekmann) 949, 1835-37.

[281] Hearing Tr. (Diekmann) 949-52, 956.

[282] Hearing Tr. (Cruz) 365-66, 390-98.

[283] RX-115; Resp. PH Br. 15.

[284] Hearing Tr. (Diekmann) 939.

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Seventh, there were signs that NHPI was a shell. The change from being in the pharmaceutical business to entering the oil and gas business, without any explanation for why, when, and how it had done so, was not consistent with a real business plan. The Firm collected no information regarding the change in business, and the attorney opinion letter, which relied on representations by the interested parties and assumed the asserted facts to be true, was not a sufficient basis for concluding that NHPI was not a shell.

Respondents maintained that the oil and gas business was added to NHPI's pharmaceutical business as a "supplement" to its business line.[285] We reject this characterization. These were radically different businesses that involved different expertise and different business models.

Eighth, the transactions have an air of fantasy. Collins supposedly took the $10,000 note in exchange for unspecified consulting services—no money changed hands. And then he took shares in return for forgiving the note—no money changed hands. When Collins supposedly borrowed $50,000 each from Sky Walker, Swiss National, and Ireland Offshore, nothing in the documents provided how, when, or where he would receive the money. There is no evidence that any money changed hands then either. Collins merely entered into a promissory note with each purported lender in which he pledged to give them stock if he defaulted; and then he defaulted. No money changed hands when Sky Walker, Swiss National, and Ireland Offshore took the pledged shares.[286]

Ninth, there is little evidence to support the value given to the NHPI securities. Within the span of a few months the value of NHPI shares varied substantially without any explanation. In November 2013, Collins received 90 million shares in return for forgiving $9,000 of his loan to NHPI. Simultaneously, he realized $150,000 for 60 million of those shares. By early February 2014, the 20 million shares in the Sky Walker deposit were estimated to have a value of $268,000. There is no evidence of a basis for the increase in value. Then, in April 2014 the value of the shares held by Swiss National and Ireland Offshore declined to less than $100,000—again, without explanation. This is particularly suspicious in light of the promotional activity that occurred in February and March 2014.

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[285] Resp. PH Br. 16 and n.80.

[286] Diekmann testified that the only evidence the Firm had that the September 1, 2013 notes between Collins and the three depositors existed was the notes themselves. He never asked for documentation showing that $50,000 actually was transferred from Sky Walker to Collins. He was satisfied that the document looked like a loan to an individual and not an effort by a small company to raise capital. Hearing Tr. (Diekmann) 943-45.

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2. VPLM (Montage deposit derived from Kipping oral line of credit)

a. Due Diligence Package

i. Purported Beneficial Owner

There was evidence in the record about two VPLM deposits by CSCT. The one included in the allegations of the Complaint was through Montage for the further benefit of VHB International. The Checklist identifies Victor Bretel as the president of VHB International. The deposit was for 9.3 million shares.[287]

ii. Prior Holder Transaction

In the Montage deposit, the prior holder in the VPLM chain was an entity called Locksmith Financial. The Checklist noted that Locksmith Financial was affiliated with Richard Kipping, who was the former president of VPLM. The Checklist stated, however, that Kipping was no longer an affiliate of the issuer because he had resigned more than two years earlier.[288]

In concluding that Kipping was not an affiliate, the Checklist relied on an attorney opinion dated September 6, 2013, stating that Kipping had resigned more than two years before.[289] As discussed below, that attorney opinion was insufficient to support the conclusion that Kipping was no longer an affiliate of VPLM. Cruz testified at the hearing that the Firm also relied on a December 16, 2013 letter signed by VPLM's Chairman, Thomas Sawyer, which made a representation that Locksmith was not an affiliate of the issuer.[290] The Sawyer letter declared that the parties to the sale of securities from Locksmith to VHB International (discussed below) were not affiliates of the issuer.[291]

The Checklist for the VPLM deposit indicated that the depositor had satisfied the Rule 144 holding period by tacking back to a "verbal [oral] line of credit" whereby the prior holder, Locksmith, had loaned the issuer, VPLM, $58,636.24. The Checklist stated that the last advance on the line of credit was made July 6, 2012.[292]

An August 15, 2013 written agreement purported to document and formalize the oral line of credit. According to the 2013 document, Locksmith agreed in 2012 to advance funds as loans

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[287] RX-2, at 1.

[288] RX-2, at 1, 268.

[289] RX-2, at 1, 19-21.

[290] Hearing Tr. (Cruz) 441.

[291] RX-2, at 23-24.

[292] RX-2, at 1.

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against a revolving line of credit and had received the right to demand payment in full or in part at any time.[293]

On the same day, August 15, 2013, a debt settlement agreement was executed between the issuer and Locksmith. In that document, the issuer indicated that it wanted to settle the amount it owed Locksmith by giving stock to Locksmith. The parties agreed to settle the company's $58,636.24 debt as of July 31, 2012.[294]

Although VPLM did not issue the shares to Locksmith until September 2013,[295] the Beneficial Ownership Declaration later signed by Bretel treated the date on which Locksmith acquired the shares as August 1, 2012.[296] The depositor thus relied on tacking his holding period to Locksmith's oral line of credit.

iii. Acquisition Of Shares By Depositor

On August 23, 2013, Locksmith entered into a stock purchase agreement with VHB International. It was roughly a week after Locksmith had memorialized the purported oral line of credit and before the shares were actually issued. The aggregate purchase price for the stock was $240,000.[297] There is no evidence explaining why Locksmith was able to sell the shares for more than four times the value placed on the shares when Locksmith and the issuer entered into the debt settlement agreement only days before.[298] The buyer, VHB International, purported to acquire the shares for investment and not with a view to resale or distribution.[299]

Although Victor Bretel was identified as the beneficial owner of VHB International, Andrew Godfrey signed the Stock Purchase Agreement.[300] The Firm made an inquiry, and Montage responded that Godfrey "handles day to day operations due to Mr. Victor Bretel's travel schedule." Montage represented that Bretel remained the beneficial owner of VHB International.[301] Diekmann testified that the response was, as far as he was concerned, sufficient.[302]

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[293] RX-2, at 26-27.

[294] RX-2, at 28.

[295] RX-2, at 12.

[296] RX-2, at 13.

[297] RX-2, at 33.

[298] RX-2, at 32.

[299] RX-2, at 35.

[300] RX-2, at 37.

[301] RX-2, at 38.

[302] Hearing Tr. (Diekmann) 1744-45.

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iv. Issuer Filings

The Firm relied on public filings for proof of the existence of the oral line of credit. The Firm characterized the oral line of credit as "generally disclosed" in the issuer's annual report for September 30, 2012.[303] The annual report for the period ending September 30, 2013, which was only published on November 6, 2013—*after* the oral line of credit had been memorialized in writing—attached a grid showing that the issuer had settled many of its debts and payments for professional services by issuing VPLM stock. According to the grid, on August 15, 2013, VPLM issued a little over 29.3 million shares to Locksmith Financial as a debt settlement.[304]

The grid actually raised more red flags. It showed that the company regularly followed a practice of compensating affiliates and others with stock. During the period from October 12, 2011, through August 15, 2013, VPLM issued shares to Locksmith three times and shares to Locksmith's owner, the former president of VPLM, Richard Kipping twice. Thus, during the two-year period, Kipping received, either directly or through Locksmith, roughly 80 million shares of VPLM. In fact, according to the grid, during the same period the company issued more than 185 million shares to various persons and entities, including Dennis Chang, the issuer's president, Thomas Sawyer, its Chairman and CEO, and Carl Mattera, an authorized signatory for the issuer.[305]

Curiously, in May 2013 VHB International received directly from the issuer approximately 2.4 million shares of VPLM. This was only a few months before it received the 29 million shares from Locksmith Financial.[306] That VHB had already received shares directly from the issuer raised a red flag that it might be an affiliate or might be coordinating its acquisition and resales of shares with others who were affiliates. There is no evidence that Scottsdale took note of that red flag.

v. Scottsdale Approval And Sales

On February 10, 2014, Noiman and Cruz approved the VPLM shares deposited by VHB International for sale to the public.[307] Sales began on February 20, 2014, and continued through June 5, 2014. Periodically, Scottsdale wired out the proceeds from those and other sales for the account of CSCT.[308]

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[303] RX-2, at 1.

[304] RX-2, at 40.

[305] RX-2, at 40 (excluding an additional 265 million shares issued to consummate an acquisition of another company).

[306] RX-2, at 40.

[307] RX-2, at 2.

[308] JX-281.

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b. Red Flags Signifying A Scheme To Evade The Securities Laws

A number of red flags were raised by this VPLM deposit. Here we discuss two that required the Firm to conduct further inquiry to establish that an exemption existed.

First, the Firm knew that Kipping had been an affiliate of the issuer at some point. This red flag required heightened scrutiny of the transaction. The Firm failed, however, to gather sufficient evidence to conclude that Kipping was no longer an affiliate.

There is no copy of a resignation letter in the due diligence package. Scottsdale did not even have a specific resignation date. It had a vague statement in a legal opinion that Kipping had resigned from the issuer over two years before. The attorney declared that she had reviewed documents filed with the SEC and had determined that Locksmith was not an affiliate or control person of the issuer, but she did not specify the documents she reviewed or explain how she arrived at her conclusion. She did not say she had seen the resignation letter. The attorney further stated that Locksmith and Kipping had represented to her that they were not controlled by any of the officers or directors of the issuer. In making that statement, the attorney was little more than a conduit for representations by the interested parties.[309] Diekmann was unaware of anything that anyone at Scottsdale did to confirm that Kipping no longer had any duties as president of the issuer.[310]

Cruz vaguely testified that he thought the Firm had some sort of resignation or acknowledgement of Kipping's resignation in the file.[311] Cruz may have been referring to the December 16, 2013 letter from VPLM's Chairman, which represented that none of the parties to the sale of the securities to VHB International had been an affiliate of the company within 90 days of the sale.[312] That bare representation provides no detail whatever. It does not indicate when Kipping might have resigned as an officer of VPLM or provide any other verifiable fact. For purposes of ensuring that an issuer is not behind a chain of transactions designed to effect a public distribution without registration, a representation by a principal of the issuer must be viewed more skeptically.

Even more important, from the outset, Scottsdale had affirmative evidence in its due diligence package indicating that Kipping might be affiliated with the issuer regardless of whether he had resigned as president. Under Rule 144, if Locksmith and Kipping held 10% or more of the issuer, they would be affiliates for purposes of the exemption. The grid showed that Kipping, either directly or through Locksmith, had received 80,318,000 shares of VPLM between October 2011 and August 2013.[313] The total outstanding shares of the company at the

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[309] RX-2, at 19-21.

[310] Hearing Tr. (Diekmann) 1719-20.

[311] Hearing Tr. (Cruz) 440-41.

[312] RX-2, at 23-24.

[313] RX-2, at 40.

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time that Scottsdale evaluated the deposit were 730,460,237.[314] Thus, Kipping and Locksmith received at least a 10.996% ownership interest in VPLM and Kipping could have been an affiliate regardless of whether he was still an officer of the company.

There were other signs that Kipping could have been an affiliate. In the due diligence file is the first page of results from a Google search for "Richard Kipping + securities fraud." One of the results dated May 15, 2013, contains a fragment of content apparently referring to VPLM. That fragment says, "So Richard Kipping still has personal interest in this penny scam."[315] Another entry dated May 7, 2013, also refers to VPLM and says, "The next few days will show if the stock can keep its unprecedented … in fraud look at the shareholders Richard kipping pretty much owns the …"[316] The Google search page was filed in the package, apparently without anyone looking at the full stories concerning Kipping or following up on his ownership of VPLM shares.

If Scottsdale had conducted further due diligence, it might have discovered that Kipping was indeed an affiliate of VPLM. During the relevant period, the Board of Directors of VPLM ordered a review of Kipping and Locksmith's debt conversions to VPLM stock. The resulting "forensic audit" dated June 5, 2014, described Kipping as a director and shareholder of VPLM. It indicated that, at the time of the August 15, 2013 stock conversion that was the basis for tacking VHB International's holding period, Kipping had executive responsibilities at both VPLM and Locksmith, including check signing privileges at VPLM.

The accountant who performed the forensic audit opined that many aspects of the August 15, 2013 agreement purporting to memorialize the earlier oral line of credit were problematic. Many of the items that appeared to him to indicate that the arrangement was not a true arms-length transaction were facts known to Scottsdale at the time it approved the sale of VHB International's shares based on tacking to the oral line of credit. Among other things, the accountant noted that the written memorialization was a year after the purported oral line of credit. He also noted that the stock for debt agreement did not specify any particular terms for the conversion, and he viewed Locksmith's right to demand payment in full or part at any time as onerous.[317]

The forensic audit illustrates that an objective analysis of the facts known to Scottsdale would raise strong doubt that Kipping was independent of VPLM at the time of the August 15, 2013 agreement and stock conversion.

Second, the grid attached to the November 2013 public filing shows that the issuer had a pattern of paying for services and its business expenses with stock. It issued much of this stock to

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[314] RX-2, at 1.

[315] RX-2, at 95.

[316] RX-2, at 95.

[317] RX-292, at 6-7.

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company insiders.[318] The pattern suggests that the issuer may have substituted the issuance of stock for compensation to insiders and business partners, leaving them to realize any monetary benefit by selling the stock to others. The constant flow of new issuer stock looks like a two-step process for unlawfully distributing securities into the public marketplace without registration.

This pattern is particularly troubling because all three parties in the chain of holders for the deposit—Kipping, Locksmith, and VHB International—were on the list of persons and entities that had converted debt to shares.[319] This was a red flag that they and the issuer could be coordinating. The Firm should have further investigated before concluding that the transaction was exempt under Rule 144.

3. VPLM (Titan deposit derived from Kipping and Locksmith through the Lees)

a. Due Diligence Package

i. Purported Beneficial Owner

CSCT deposited another 13 million shares of VPLM for the benefit of Titan and for the further benefit of Cumbre Company. The Checklist identified Patrick Gentle as the ultimate beneficial owner of Cumbre and the VPLM stock.[320]

We discuss the evidence regarding this transaction as evidence of other similar conduct for purposes of sanctions and as additional evidence that CSCT was no more than a façade. Scottsdale continued to deal directly with the FFI and to ignore CSCT.

ii. Prior Holder Transactions

This is the one transaction that was not derived from the conversion of a debt liability into shares. However, it also traces back to Kipping and Locksmith in a chain of holders.

The Checklist identified two prior holders, Jung Ju Lee and Soon Deuk (Kang) Lee.[321] Jung Ju Lee acquired 1.5 million shares by a Stock Purchase Agreement dated June 12, 2012, from Richard Kipping. In that Stock Purchase Agreement, Kipping represented that he was not an affiliate of the issuer and had not been an affiliate at least for the previous 90 days. An attachment to the Stock Purchase Agreement indicated that Lee paid Kipping $13,000 for the shares. A copy of a check written to Locksmith for $13,000 was attached. It appears to be written by Brooks K-9 Services Ltd., but it bears a notation saying "re VPLM certs."[322] Nothing in the

[318] RX-2, at 40.

[319] RX-2, at 40.

[320] RX-2, at 106.

[321] RX-2, at 106.

[322] RX-2, at 126-29.

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due diligence package explains the connection between Brooks K-9 Services and Lee or the nature of Brooks K-9 Services.

Jung Ju Lee acquired another 500,000 shares for $5,000 from Locksmith Financial pursuant to a Stock Purchase Agreement dated October 19, 2012. Locksmith made the same representation that it was not an affiliate of the issuer. Kipping signed on behalf of Locksmith. Another check from Brooks K-9 Services Ltd. was attached.[323]

Soon Deuk (Kang) Lee acquired three million shares of VPLM from Locksmith by a Stock Purchase Agreement dated August 1, 2012, for $20,000. Locksmith represented that it was not an affiliate of the issuer. Kipping signed on behalf of Locksmith.[324]

iii. Acquisition Of Shares By Depositor

Cumbre acquired five million shares of VPLM from Soon Deuk (Kang) Lee on January 10, 2014.[325] In a separate document written to Cumbre, Lee confirmed receipt of $60,000 for the shares.[326] On January 13, 2014, in a separate document, Jung Ju Lee similarly confirmed receipt of $20,000 for 500,000 shares of VPLM.[327]

iv. Scottsdale Approval

On May 29, 2014, Noiman and Cruz signed the Checklist approving the shares of VPLM for sale.[328]

v. Blackout Period On Trading VPLM Shares

On June 5, 2014, Thomas Sawyer, the Chairman of the Board of Directors of VPLM, sent Titan by email a signed declaration notifying it of a blackout period starting June 6, 2014, on trading VPLM stock by certain "covered persons." Covered persons were defined to include directors, officers, and holders of 10% or more of the company's outstanding shares, among others. Richard Kipping (and his assigns) and Locksmith were on the list of covered persons. So was VHB International. The list also included FFIs and broker-dealers. Montage, Titan, Alpine, and Scottsdale were all on the list.[329] Noiman discussed the blackout notice with Titan and requested a copy.[330]

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[323] RX-2, at 136-39.

[324] RX-2, at 147-49.

[325] RX-2, at 160.

[326] RX-2, at 155.

[327] RX-2, at 145.

[328] RX-2, at 107.

[329] CX-294.

[330] RX-104.

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On June 6, 2014, a lawyer named David Wise, who had often done work for Scottsdale, wrote an email to Sawyer claiming to represent unnamed clients on the covered-person list and threatening to sue Sawyer and others for "slow[ing] down or prevent[ing] the transfer of shares by my clients." Wise called the blackout notice an attempt to prevent sales of VPLM stock in order to conduct a promotional campaign to raise the share price. He characterized Sawyer's actions as "clearly illegal" and said he would be calling the SEC.[331]

On June 6, 2014, Wise sent a copy of his email to Sawyer to Kelvin Leach at Titan and to both Noiman and Diekmann at Scottsdale. His cover note to them was breezy: "Hi Guys, See below. David." The tenor of the cover note indicates that Scottsdale and Titan were working closely together to address the problem of the blackout notice.

On June 9, 2014, Titan forwarded the blackout notice to Noiman, and Noiman immediately forwarded it to Cruz.[332] That same day, Noiman also forwarded the Wise email to Cruz.[333] The Firm stopped selling VPLM shares held by VHB International in order to investigate.[334]

On June 11, 2014, Titan received what appears to be an unsigned clarifying memorandum from Sawyer stating that the broker-dealers and FFIs such as Scottsdale and Titan were only on the list because they had been known to trade VPLM stock for covered persons. The memorandum declared that the broker-dealers and FFIs were still free to trade on behalf of *non*-covered persons. Titan forwarded the clarification that same day to Noiman and Diekmann,[335] and Noiman forwarded it to Cruz.[336] The clarifying memorandum did not take Kipping (and his assigns), Locksmith, or VHB International off the list of covered persons. Nor did it explain why they were listed as covered persons. When Noiman forwarded the clarification to Cruz on June 11, 2014, he wrote that "Titan received the attached after David Wise's VPLM notice."[337]

On June 24, 2014, a lawyer claiming to represent VPLM wrote to Noiman as Scottsdale's "Compliance Officer." Scottsdale had requested the transfer of two stock certificates, and the lawyer stated that the stock certificates appeared to be owned by covered persons. Kipping (and his assigns), Locksmith, and VHB International were on the attached list of covered persons. One of the two stock certificates identified, 2985, related to the VPLM deposit by Titan on

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[331] Hearing Tr. (Cruz) 578-79. Wise provided an attorney opinion letter on which the Firm relied in connection with the ORFG stock deposit. RX-3, at 70. Wise also went to the Cayman Islands to assist Ruzicka for a couple of weeks after D'Mura left. Hearing Tr. (Hurry) 1603-04.

[332] CX-294.

[333] Hearing Tr. (Noiman) 1265-67; RX-104.

[334] Hearing Tr. (Cruz) 442-43; JX-281.

[335] CX-295.

[336] CX-296.

[337] CX-296.

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behalf of Cumbre.[338] The other, 2228, may relate to a VPLM deposit not part of the record in this case. The certificate number for the deposit by VHB International is 2525.[339]

Notably, although the Titan deposit on behalf of the Lees nominally came through CSCT, Ruzicka was not included on any of the correspondence about the blackout period.[340] The correspondence reveals that Scottsdale, through Noiman, was continuing to manage FFI deposits without regard to CSCT. CSCT was performing no real function in connection with the VPLM deposit.[341]

b. Red Flags Signifying A Scheme To Evade The Securities Laws

Given what Scottsdale already had in its file on VPLM, it should not have approved the VPLM shares deposited by Cumbre for resale without obtaining better evidence that Kipping was not an affiliate of the issuer. The Lee transactions closely followed the VHB International transaction and revealed a pattern—Kipping was continually acquiring and selling large blocks of VPLM shares. When coupled with the information from the grid showing that VPLM followed a practice of issuing stock to insiders in settlement of its debts, the circumstances raised a strong suspicion that the issuer or an affiliate was unlawfully distributing securities without registration in a two-step process designed to obscure what was actually happening and who was benefiting from the sales of stock.

4. ORFG (Unicorn deposit derived from Forward line of credit)

a. Due Diligence Package

i. Purported Beneficial Owner

In connection with the deposit of approximately 13.2 million shares of ORFG, CSCT acted for Unicorn, and Unicorn acted for an entity called Media Central, which named Geovanni Moh as the beneficial owner.[342] Media Central was identified as a Belize corporation, and Moh

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[338] RX-2, at 106-09.

[339] RX-2, at 3.

[340] When Ruzicka was shown the blackout notice at his OTR, he expressed shock. He testified that he had never seen it, and that if he had he would not have processed the VPLM deposit for resale. He would have expected Scottsdale to treat it as a problem or red flag. CX-178 at 257-60.

[341] In the middle of explaining what he did in connection with investigating the VPLM blackout, Cruz made a half-hearted assertion that CSCT was involved, saying, "I asked or I briefed with CSCT to—to get an explanation if they—if they could." Hearing Tr. (Cruz) 442-43. We do not find that testimony credible. There is no corroborating evidence of any kind, and his testimony about CSCT, in contrast to his detailed testimony about Wise, was vague. Cruz did not say he had a conversation with Ruzicka—who was the only person at CSCT. Rather Cruz referred to CSCT in the abstract. Nor did Cruz say anything about the content of what he "asked" or "briefed" when he supposedly had contact with CSCT.

[342] RX-3, at 1.

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was identified as a citizen of Belize.[343] Media Central was originally incorporated on February 14, 2014, under the name Lock Investments Ltd. Only two weeks later, on February 27, 2014, the name was changed to Media Central.[344] Nothing in the due diligence package explains the reason for the name change or whether there was any change in the identity of the principals of the company.

ii. Prior Holder Transaction

Media Central claimed that it had satisfied the holding period for a non-affiliate by tacking to a prior holder's note as of September 1, 2012.[345] The prior holder was a person named Casey Forward. He purportedly took the issuer's note in return for an open-ended line of credit up to the maximum amount of $600,000. The note provided that the issuer would pay on "loans, advances and debt as of August 31, 2011 ... with interest on the principal balance outstanding from time to time" up to a principal amount of $600,000.[346] The note provided Forward with a right to convert any portion of the unpaid principal amount of note to restricted common stock. This right was open-ended and did not specify a particular amount that could be converted or a particular date when the conversion could take place.[347] Furthermore, the note provided that the holder could transfer in whole or in part any portion of the note without the prior consent of the company. Any such transfer was at the discretion of the holder.[348]

Forward subsequently assigned a $50,000 portion of the note to an entity called Anything Media in exchange for shares of Anything Media. As described on the first page of the Deposited Securities List, that transaction was reflected in an Assignment and Modification Agreement dated January 18, 2014, by which ORFG agreed to modify the terms of the original note.[349]

iii. Acquisition Of Shares By Depositor

On April 16, 2014, Anything Media sold 15 million shares of ORFG to Media Central for $75,000 pursuant to a stock purchase agreement. However, at that time, Anything Media did not own the shares. It acquired shares of ORFG only a few days afterward, on April 22, 2014, when it converted a $9,000 portion of the note into 15 million shares of ORFG.[350] There is nothing in the due diligence package to explain why Anything Media sold ORFG shares before it actually owned them. Nor is there anything to explain why the shares could be sold for $75,000 when

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[343] RX-3, at 9, 13.

[344] RX-3, at 15-16.

[345] RX-3, at 36-41.

[346] RX-3, at 36.

[347] RX-3, at 38.

[348] RX-3, at 40.

[349] RX-3, at 1, 42-45.

[350] RX-3, at 1.

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they only had a value of $9,000 when they were converted a few days later. Cruz testified that he did not consider these matters red flags that required further inquiry and that the Firm did not conduct further inquiry based on these matters.[351]

iv. Scottsdale Approval And Sales

On June 5, 2014, Noiman and Cruz signed the Checklist for ORFG approving the sale of securities.[352] Sales began June 11, 2014, and continued through the end of the relevant period on June 30, 2014. Periodically, Scottsdale would wire out the proceeds along with the proceeds from the sales of other securities out of CSCT's account.[353]

v. Promotional Activity

From early May through early July, ORFG was the subject of multiple promotions.[354] Cruz testified that the promotions were consistent with the reviewer's findings on the Checklist. He said he probably would have looked at a couple of pages of printouts showing the existence of promotions. The Firm typically would look to see whether the customer had any involvement and whether the promotions were having any effect on the trading done in the security.[355]

b. Red Flag Signifying A Scheme To Evade The Securities Laws

We discuss here only one of the red flags in the ORFG deposit. The initial transaction underlying the deposit made no business sense. With respect to the original line of credit, no reasonable company would agree to borrow money on a line of credit that permitted the lender to convert the debt to stock at any time in any amount at the holder's discretion. Certainly a company would not agree that the open-ended conversion option could be assigned to an unknown third party without the issuer's prior consent. Under such an agreement the company would not know whether it was going to be required to pay back some or all of the money it borrowed on the line of credit or whether it would be required to issue shares. Nor could it know to whom the conversion option might be assigned. It could not manage its finances or be certain of its shareholder dynamics and corporate control.

As the forensic audit of the Kipping-Locksmith loan found with respect to the open-ended line of credit in that transaction, the onerous terms from the issuer's perspective were a sign that the loan was not an arms-length transaction. Unless the Firm investigated and discovered some sensible explanation, it could not lawfully sell the securities.

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[351] Hearing Tr. (Cruz) 533-34.

[352] RX-3, at 2.

[353] JX-310.

[354] CX-303, at 17-25.

[355] Hearing Tr. (Cruz) 537-38.

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E. Credibility

1. Ruzicka

As noted above, Ruzicka was never registered with FINRA and was never subject to its jurisdiction. He voluntarily testified at an OTR, and considered testifying voluntarily at the hearing. Throughout the first week of the hearing, Enforcement reported at the end of each day on the likelihood of Ruzicka appearing.[356] On Friday of the first week, Enforcement announced that Ruzicka had agreed to appear the following Monday.[357]

However, Ruzicka changed his mind over the weekend and never appeared. He apparently changed his mind because of a text that Respondents' counsel sent to him on the Saturday after the first week of hearing. That text, although portrayed by counsel afterward as nothing more than a request to talk, appears to us to have been an attempt to sow distrust between Ruzicka and Enforcement counsel. It made Ruzicka angry at the way he thought he was being portrayed by Enforcement at the hearing and unwilling to be "put through hell" by appearing.[358]

Respondents' counsel telephoned Ruzicka on Saturday but only received an automated instruction to leave a message or text. Respondents' counsel then left him a text saying the following, which included quotations from Enforcement's opening statement:

> You may want to know how FINRA has been characterizing you during the first week of the hearing. For example, you were "hapless," "malleable," and "bereft of other options." You may want to know the other side of what FINRA is telling you. I would welcome the opportunity to discuss.[359]

After receiving the text from Respondent's counsel, Ruzicka texted Enforcement counsel saying, in part, "If even veracity, I am done."[360] We interpret Ruzicka's response to mean he was offended at the portrayal of him as desperate and easily manipulated, and to mean that he would not appear at the hearing if that was an accurate picture of Enforcement's comments about him.

Enforcement reported at the hearing that it had neither confirmed nor denied to Ruzicka what Respondents' counsel told him in the text. Enforcement took the position that it could not reveal what was said in the proceeding because it was confidential.[361]

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[356] Initially, the discussions of Ruzicka's likely participation were off the record. Later, they were on the record. Hearing Tr. (remarks of counsel) 748, 840-41, 1032, 1275, 1277.

[357] Hearing Tr. (remarks of counsel) 1275, 1277.

[358] Hearing Tr. (counsel reading text into record) 1288.

[359] Hearing Tr. (counsel reading text into record) 1288.

[360] Hearing Tr. (counsel reading text into record) 1287.

[361] Hearing Tr. (remarks of counsel) 1299.

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Enforcement argued that Respondents' counsel had violated at least the spirit of the sequestration order in the case; Respondents' counsel asserted that the sequestration order was about witness testimony and that counsel's quotations from Enforcement's opening statement did not violate the order. The Hearing Officer declined to rule on the charge of misconduct.[362]

Based on legal analysis separate from the alleged misconduct of Respondents' counsel, as laid out at the hearing on the record, the Hearing Officer admitted the entire transcript of Ruzicka's OTR. The Hearing Officer declared that the Hearing Panel would determine the probative value and weight to give the OTR after it had reviewed the OTR in the context of the evidence at the hearing, taking into account the circumstances that led to the admission of the OTR in lieu of live testimony from Ruzicka.[363]

The Hearing Panel now specifically finds that Ruzicka's testimony at his OTR was credible. It was consistent with other evidence in the record and corroborated by D'Mura's testimony. Wherever Ruzicka's testimony is cited here, it is cited because we credit it.

We reject Respondents' arguments for discounting Ruzicka's testimony.

First, Respondents assert that it is unfair to rely upon Ruzicka's testimony because they did not have an opportunity to cross-examine him.[364] The short answer to that argument is that Respondents' counsel was responsible for that lack of opportunity to cross-examine the witness. Respondents cannot complain about it now.

Second, Respondents argue that Ruzicka was angry and biased against Hurry, so his OTR should not be viewed as reliable.[365] After review of the transcript, we conclude that, although Ruzicka evidently did not like the way Hurry treated him, Ruzicka was truthful as to the facts and as to Hurry's intimidating and controlling manner.

Third, Respondents claim that Ruzicka gave inconsistent information in a prior telephone call with FINRA staff.[366] However, the inconsistency was explained by the fact that Ruzicka still felt "beholden" to Hurry at the time of the telephone call. By the time of the OTR he did not feel that way.[367]

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[362] Hearing Tr. (remarks of Hearing Officer) 1302.

[363] Hearing Tr. (remarks of Hearing Officer) 1302-05. There had always been uncertainty about whether Ruzicka would give testimony at the hearing. In light of that uncertainty, the parties had earlier briefed the issue of whether the OTR should be admitted. The Hearing Officer's ruling was informed by that earlier briefing.

[364] Resp. PH Br. 44 and n.253.

[365] Resp. PH Br. 44 and n.253.

[366] Hearing Tr. (remarks of counsel) 1296.

[367] Hearing Tr. (remarks of counsel) 1298.

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Fourth, Respondents claim that Ruzicka gave an affidavit inconsistent with his OTR. They assert that Ruzicka swore that Montage, Titan, and Unicorn came to CSCT through a referral from Scottsdale. However, Ruzicka signed that affidavit at Hurry's request while still working for Hurry.[368] By the time of his OTR, Ruzicka no longer worked for Hurry. For that reason, we credit his OTR testimony that he was told that Titan and Unicorn came to CSCT through Hurry. Moreover, the affidavit saying that the three FFIs were referred by Scottsdale is not inconsistent with Ruzicka's understanding that ultimately Hurry was behind the referral. Even if Hurry persuaded the FFIs to do business with Scottsdale through CSCT, it would be consistent with his desire for secrecy for him to arrange for someone at Scottsdale to make the necessary introductions.

Finally, we observe that although Ruzicka's OTR testimony is valuable, his absence from the hearing deprived the Extended Hearing Panel of what would have been helpful live testimony and the opportunity for the Panel to ask him questions. Ruzicka's absence also encouraged Hurry to dispute the OTR testimony without fear of being contradicted, as discussed below. The distrust sown by Respondents' counsel impeded our adjudicatory process.

2. Hurry

As indicated above in connection with specific testimony, we repeatedly found that Hurry was not credible. Many of Hurry's self-serving explanations were not convincing on their face. His testimony was often inconsistent with other reliable evidence. Much of what he said also conflicted with Ruzicka's OTR testimony, which we find more credible than Hurry's uncorroborated assertions.

Hurry's ostensible purpose for setting up CSCT—to relieve Alpine of IRS withholding obligations—was not supported by any evidence that it made business sense. Rather, we conclude from Cruz's and Diekmann's testimony regarding heightened regulatory scrutiny in the period leading up to the establishment of CSCT, and the filing of the four prior SEC complaints against Scottsdale customers and employees, that Hurry sought to insulate his business from regulatory oversight by moving Scottsdale's FFI business offshore. This conclusion is reinforced by the fact that Scottsdale personnel continued to manage the FFI business with entities such as Unicorn and Titan (through Miller and Noiman). They needed to do that because Ruzicka was not qualified to run a broker-dealer, particularly one in the highly specialized business of liquidating microcap stock pursuant to Rule 144. Moreover, CSCT got its business through Hurry and Scottsdale. CSCT did not, and indeed could not, operate as an independent entity. CSCT served no function that Scottsdale could not have performed without it.

[368] Hearing Tr. (Hurry) 1565-69, 1638-39; RX-110.

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Hurry disputed that Ruzicka was not qualified to run CSCT and emphasized how accomplished Ruzicka was.[369] His testimony in this regard was not credible. It is plain from Ruzicka's inquiry about working in Hurry's bike shop that Ruzicka had no relevant experience and was desperate.[370] D'Mura described trying to educate Ruzicka about the securities industry and the elements for free-trading securities. D'Mura said it was "rough going" and that Ruzicka "wasn't picking it up."[371] D'Mura said that Ruzicka was anxious, stressed, and not capable of handling due diligence on microcap deposits by himself.[372] Even more important for our purposes here, D'Mura testified that he had conversations with Hurry about Ruzicka's difficulties and how Ruzicka was not "getting it."[373] Thus, contrary to his hearing testimony, Hurry knew that Ruzicka was not capable of running CSCT.

Hurry's assertion that he had little to do with CSCT was disproved. D'Mura testified that Hurry frequently bombarded him and Ruzicka with telephone calls about CSCT business and that he and Ruzicka tried to prepare for those calls with updated information about deposits. D'Mura portrayed Hurry as an intense and constant presence in their lives while they worked at CSCT, and emails corroborate that testimony. Emails show that Hurry oversaw every detail of CSCT's business, and Hurry admitted that he traveled to the Cayman Islands at least once a month. He so closely oversaw the CSCT operation that he claimed to know that Ruzicka was in the office only ten minutes out of every hour.

To the extent that Cruz, Diekmann, D'Mura, and Ruzicka all testified that Ruzicka, not Hurry, ran the daily operations of CSCT, as Respondents assert in their post-hearing brief,[374] we do not view that testimony as contradicting the evidence that Hurry was deeply involved in

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[369] Hearing Tr. (Hurry) 1574-77. When asked why he did not hire someone who had broker-dealer experience and who knew about FFIs to run CSCT, Hurry said that he hired Ruzicka to play an "executive role," someone who was "an all-around person, somebody who had some entrepreneurial skills, some management skills, proven to be able to do that." Hearing Tr. (Hurry) 1648.

[370] Hearing Tr. (Hurry) 1631, 1635-36.

[371] Hearing Tr. (D'Mura) 2273-77.

[372] Hearing Tr. (D'Mura) 2277-78.

[373] Hearing Tr. (D'Mura) 2274-77. D'Mura may not have been emphatic about Ruzicka's difficulties—he testified that it was against his self-interest to cause Hurry to fire Ruzicka—but D'Mura did raise concerns with Hurry. Hearing Tr. (D'Mura) 2314-15.

Email correspondence corroborates D'Mura's judgment that Ruzicka did not understand the business. For example, in May 2014, Ruzicka sought Diekmann's approval to consider a deposit of 11 million shares with an ostensible value of two million dollars. Diekmann wrote back that the issuer's shares traded in so little volume—roughly 3,500 per day—that it would take a "bazillion" years to sell the entire deposit. Diekmann said it was inappropriate to set the value that high and the transaction was the kind that should be avoided. CX-241.

This email correspondence also illustrates that CSCT served no real function independent of Scottsdale. Ruzicka sought Diekmann's guidance before even considering the deposit. Ruzicka was not independently vetting deposits before presenting them to Scottsdale. CX-241, at 2.

[374] Resp. PH Br. 45.

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CSCT's business. Ruzicka was responsible for the day-to-day processing of paper, but Hurry was responsible for bringing in business, cultivating the clients, and making all important decisions. Ruzicka, an out-of-work real estate attorney, did not have the background to do more than process the paper as directed. For Hurry to maintain that he left Ruzicka on his own to prospect for customers and manage client relationships defies belief.

Based on D'Mura's testimony and various emails, Hurry's contention that he was not concerned with secrecy was false. D'Mura testified that Hurry emphasized to him the privacy laws of the Cayman Islands, and D'Mura thought Hurry was very concerned about secrecy. Hurry's concern with secrecy was manifested in multiple ways, from his admitted use of FaceTime to confer with Montage, Titan, Unicorn, and other customers, to his obsession with labeling every email to and from Ruzicka as privileged, to his use of an email address that did not reveal its connection to him, to his refusal to use emails to discuss business and insistence on using telephone calls to do that.

Ruzicka's testimony only confirms D'Mura's. Ruzicka testified that Hurry told him that he was moving the FFI business to the Caymans precisely because he would not have to "give anything" to anyone. According to Ruzicka, Hurry was fanatical about not creating a record of his involvement with CSCT.

As for Hurry's efforts to develop business for CSCT, Hurry admitted having telephone calls with principals of Montage, Titan, and Unicorn, and he admitted personally visiting Montage in Panama and Unicorn in Belize. Although he claimed that he discussed a back-office system with Montage at Ruzicka's request, his testimony was vague and unspecific. There was no corroboration for Hurry's assertion, and he only made it when he knew that Ruzicka would not appear at the hearing to contradict him. Similarly, as to Hurry's initial assertion that he did not discuss business with Unicorn when he went to Belize, Hurry was impeached by his own OTR testimony. In his OTR he testified that he discussed pros and cons of doing business with Scottsdale directly or going through CSCT. Emails showed that Hurry provided other leads and referrals to Ruzicka, and D'Mura testified that Hurry was involved in developing Caledonian as a CSCT customer.

We further find Hurry not credible when he testified that he could not remember anything about his meetings with Montage in Panama and Unicorn in Belize. Hurry appeared to have excellent recall of other information and events. He testified in detail about the intricacies of taxation in the Cayman Islands and how it differed for Canadians and U.S. citizens, as well as the way the special economic zone in the Caymans operates.[375] He also testified about the Cayman Islands Monetary Authority, CIMA, and its information sharing agreement with the SEC, noting

[375] Hearing Tr. (Hurry) 1554-65, 1647-48.

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that the original agreement was in 2005 and that it was updated in 2012.[376] He insisted that he knew the exact days on which Ruzicka and D'Mura began at CSCT.[377]

We observe that Hurry appeared to be a canny, sophisticated, controlling, and hard-driving businessman. Hurry's attempt to portray himself as a distant figure, far removed from CSCT's business was not credible. Although he claimed that he likes to empower his people to run their businesses on their own,[378] that is demonstrably untrue.

3. DiBlasi

We find DiBlasi's testimony that he was the CCO—but not in connection with the Firm's Rule 144 business—astonishing.[379] Almost all of the Firm's business involved Rule 144 sales. As explained below in discussing DiBlasi's violation, DiBlasi was responsible for the WSPs, and nothing in the WSPs clearly allocated Rule 144 compliance to Cruz. Indeed, during much of the relevant period, the WSPs assigned the CCO specific responsibilities in connection with Rule 144.[380] DiBlasi's testimony may accurately reflect what he believes his job responsibilities to be, but, if so, his designation as CCO was misleading.

4. Cruz

Cruz's testimony was vague and unreliable. He often said he could not recall whether he had looked at various materials in conducting his due diligence reviews but that he "could" have done so.[381] Cruz also changed his testimony or made it vaguer as he was testifying if he became uncomfortable with his original statement. For example, he said that the change in NHPI's business from pharmaceuticals to oil and gas was not so important because the company's "management team had been stable. It's not the situation where we had a roaming management team."[382] But when asked how he knew that the management team was stable, he could point to nothing in the due diligence package or elsewhere. He ended by denying that he had said that the management team had been stable, saying, "I didn't see any change of – evidence of a change of management. I didn't use 'stable.'"[383] When pressed whether certain items were red flags calling for a searching inquiry about the issuer, Cruz resorted to general statements such as it "depends

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[376] Hearing Tr. (Hurry) 1630.

[377] Hearing Tr. (Hurry) 1620, 1624.

[378] Hearing Tr. (Hurry) 1550.

[379] Hearing Tr. (DiBlasi) 1921-23, 1946-47, 1952-53, 1965-66.

[380] Hearing Tr. (DiBlasi) 1967-73.

[381] Hearing Tr. (Cruz) 279, 284, 292-96, 301-03, 308.

[382] Hearing Tr. (Cruz) 288.

[383] Hearing Tr. (Cruz) 288-91.

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on the facts and the circumstances."[384] He never explained any basis for determining which facts and circumstances would trigger the duty to conduct a searching inquiry.

5. Diekmann

We find Diekmann's testimony vague, evasive, and unreliable. He characterized documents in ways that on their face the documents did not support, such as the Miller email indicating that a Canadian citizen could conceal himself by using a corporate entity as the owner of his Scottsdale account. Diekmann asserted that the Firm's procedures would root out a nominee problem but could point to nothing in the procedures that was designed to do that.[385] He was insensitive to suspicious circumstances such as a Google search that turned up information suggesting that a person was engaged in securities fraud,[386] or the identical terms and circumstances of the three supposedly independent NHPI deposits.[387] He contradicted his own OTR testimony.[388] He repeatedly resisted admitting that inconsistencies and suspicious circumstances could signify that a transaction was a sham until he had to admit what was obvious.[389]

Given Diekmann's position as the Firm's current president, we are concerned about his ability to ensure that the Firm responds appropriately in the future to obvious red flags and suspicious circumstances. This concern bears on the need for stringent sanctions, as discussed below.

Illustrative of the issue is Diekmann's testimony regarding information on Unicorn's website. Unicorn advertised the use of nominees to give customers an "extra level of confidentiality" because the customer's "name will not show up."[390] At his OTR, Diekmann testified that he had not seen this page of the Unicorn website before his OTR, but if he had it would have caused him concern whether the true beneficial owner was being disclosed.[391] At the hearing he testified differently. He said that he would not be concerned about the information on Unicorn's website because he had seen nothing on the website that suggested that Unicorn was offering to affirmatively lie about beneficial ownership.[392] When asked whether Unicorn would

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[384] Hearing Tr. (Cruz) 293.

[385] Hearing Tr. (Diekmann) 737-38.

[386] Hearing Tr. (Diekmann) 927.

[387] Hearing Tr. (Diekmann) 1853-54, 1901-04.

[388] Diekmann testified at his OTR that a print-out from the Unicorn website caused him concern about whether Patrick Gentle was the true beneficial owner of stock deposited at Scottsdale in his name. At the hearing, however, he denied that the information on the Unicorn site was a concern. Hearing Tr. (Diekmann) 925-30.

[389] Hearing Tr. (Diekmann) 1881-84, 1886-87.

[390] Hearing Tr. (Diekmann) 1818-19.

[391] Hearing Tr. (Diekmann) 1875-78.

[392] Hearing Tr. (Diekmann) 1819.

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have had to offer to lie about the beneficial owner before the website language would concern him, Diekmann answered "Yes."[393] That is not consistent with his and the Firm's gatekeeping function.

A second example of Diekmann's insensitivity to suspicious circumstances is his response to questions concerning an email exchange between one of the Rule 144 staff members and Titan. The staff member sent an email to Ryan Mendez at Titan saying that Scottsdale had multiple subaccounts at Scottsdale with Andrew Godfrey as the authorized signer. She requested a statement from Godfrey that explained the purpose for the multiple entities and provided an explanation of "any distinguishing features among the separate entities." She then named the eight entities.[394]

Godfrey provided an astoundingly broad and vague response:

> [The eight companies] are holding company's [sic] that are used to invest in development and exploration stage companies that engage in local, regional, multinational, global, sporting, manufacturing, wholesale, transportation, technology and eco friendly companies, etc., etc. Each investment is placed into a holding company based on investment criteria such as location, industry, long or short-term investment etc., etc.

Godfrey made no distinction among the companies. He provided no facts that could be verified. The response was undated and addressed "To Whom It May Concern." Godfrey provided no address, telephone number, or other contact information for himself or any of the companies. The response was forwarded by email from Titan to Scottsdale.[395]

Diekmann characterized Godfrey's response as reasonable.[396] We do not find it so. It lacks specificity and has no indicia of reliability or authenticity.

Finally, Diekmann displayed a lack of the skepticism, analytic acuity, and ingenuity that are required to perform the broker-dealer's gatekeeping function in the Rule 144 context. He testified that the identical documentation for the NHPI transactions did not trouble him because some unidentified person could have put Collins together with the three parties seeking to sell the NHPI shares they acquired from him. When asked whether that unidentified person could be the secret beneficial owner of the three sub-sub-accounts, he said that there was nothing in the documentation indicating that was so. He further declared that he did not know how you would

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[393] Hearing Tr. (Diekmann) 1875.

[394] CX-247.

[395] CX-248.

[396] Hearing Tr. (Diekmann) 891.

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investigate whether it was so. He seemed content not to know who the unidentified person was and to assume that it was a person who had put the three depositors in touch with Collins.[397]

Diekmann said that "there's always a risk that there could be some puppet master pulling the s[t]rings."[398] But he expressed frustration at the thought that the Firm could and should have done more to ascertain whether a puppet master was at work. As he remarked regarding the Argentinian nominees in the *Tavella* case, "It's just impossible to know that there was somebody else behind this."[399]

For purposes of assessing the Firm's ability to avoid violations in the future and crafting remedial sanctions, his remarks cause us concern. Diekmann said that what happened with NHPI happens all the time.[400]

6. Experts

a. Marc Menchel

We give little weight to the testimony of Respondents' expert, Marc Menchel. Although he opined that Scottsdale's procedures were reasonable and consistent with industry custom and practice, his experience related to Rule 144 was both a long time ago and in a much different context than Scottsdale's business. Menchel ran a Rule 144 desk at a large broker-dealer more than 30 years ago. That desk did not concentrate the way Scottsdale does on large blocks (100,000 shares or more) of microcap stocks.[401]

Furthermore, Menchel did not opine on the sufficiency of Scottsdale's due diligence in the context of the specific transactions at issue. He did not review the exhibits or the investigative testimony. While he did look at all the relevant due diligence packages, he did not review them with the idea of "second guessing" the Firm's handling of the deposits. He merely looked to see whether the due diligence packages contained the sorts of items that one would expect them to contain.[402] Essentially, Respondents' expert, like Respondents, took a check-the-box look at the due diligence packages.

Finally, Menchel's opinion seemed influenced by his admittedly idiosyncratic view that Regulatory Notice 09-05 goes beyond Rule 144, and his claim that many of the red flags listed in the Regulatory Notice are not really red flags for purposes of Rule 144.[403] Menchel's opinion

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[397] Hearing Tr. (Diekmann) 1901-03.

[398] Hearing Tr. (Diekmann) 720.

[399] Hearing Tr. (Diekmann) 732.

[400] Hearing Tr. (Diekmann) 1901, 1903.

[401] Hearing Tr. (Menchel) 2459-61.

[402] Hearing Tr. (Menchel) 2478-80, 2496-98, 2529-33, 2554-65, 2572-73, 2575.

[403] Hearing Tr. (Menchel) 2503-07, 2515-24.

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similarly seemed influenced by his view that FINRA has no authority to charge a broker-dealer firm with a Rule 2010 violation for a Securities Act violation, a view that he admits has no decisional support.[404] Menchel's opinion regarding FINRA's authority is contrary to the Hearing Officer's prior determination in the Order dated February 26, 2016, that FINRA has jurisdiction to bring this case. We decline to accept Menchel's view for the reasons stated in that Order, which we do not repeat here.[405]

b. Brian Underwood

We find the opinion of Enforcement's expert, Brian Underwood, more reliable, more persuasive, and entitled to greater weight than Menchel's. His experience with Rule 144 was more extensive and more recent. Until retiring in 2008, Underwood served as the Chief Compliance Officer of two major broker-dealers for a combined period of almost 20 years. The broker-dealers traded microcap securities on a fairly frequent basis and their Rule 144 desks reported to Underwood through one of his direct reports.[406] He also served on two NASD working groups in the 1990s that reviewed roughly 300 sets of policies and procedures as part of an effort to develop a model set of procedures.[407] Underwood has maintained a consulting practice since he retired, and in that capacity he has more recently seen between 20 and 25 entire policies and procedures of different firms.[408]

Underwood also reviewed more of the materials relating to the particulars of this case, including the pleadings, the parties' memoranda, the exhibits, and the OTRs conducted in connection with the investigation.[409] He, unlike Menchel, evaluated the substance of Scottsdale's due diligence and whether it was consistent with industry custom and practice.[410]

Underwood expressed the following opinions, among others, which we find consistent with our own views and supportive of our conclusions:

(i) In its WSPs, the Firm did not adequately address the risk of nominees being used to conceal the identity of the beneficial owners of the shares—it did not even mention the risk.[411]

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[404] Hearing Tr. (Menchel) 2593-99.

[405] *See also KCD Financial Inc.*, Exchange Act Release No. 80340, slip op. at 5-6 & nn.8-13 (SEC Mar. 29, 2017).

[406] Hearing Tr. (Underwood) 2609, 2615-21.

[407] Hearing Tr. (Underwood) 2711-12.

[408] Hearing Tr. (Underwood) 2712-13.

[409] Hearing Tr. (Underwood) 2619-20.

[410] Hearing Tr. (Underwood) 2651-57, 2665-67, 2669-71, 2673-78, 2685-89, 2691-94.

[411] Hearing Tr. (Underwood) 2682-83.

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(ii) The Firm's practice of placing all FFIs on its red flag list was counterproductive because it did nothing to narrow the focus to the kinds of anomalies that required a searching inquiry.[412]

(iii) The Firm's general practice of accepting the registered agent's address without requiring the physical address of the entities and persons purporting to own the shares was inconsistent with industry custom and practice.[413]

(iv) Even though the Firm gathered large volumes of paper in connection with the transactions, it failed to analyze the information, did not identify issues raised by the files, and did not conduct the type of searching inquiry necessary to resolve those issues.[414] As Underwood testified, a searching inquiry "means asking questions. It means not just assuming an answer that is possible to explain the transaction when there are other answers that might not properly explain or satisfy the question. It means asking and inquiring and doing it independently ...."[415]

(v) Underwood made plain that a broker-dealer cannot go forward with a Rule 144 transaction simply because it finds it too difficult to determine the identity of the beneficial owner. The broker-dealer must have reliable evidence of the identity of the purported beneficial owner. Otherwise it cannot proceed with the transaction.[416]

Underwood also explained that it would be typical in the industry to use other resources in addition to the internet to verify representations by the interested parties and make sure that those parties were not actually participating in an unregistered distribution of securities. With respect to whether the issuer is a shell, for example, it is not enough to obtain a representation from the issuer's principal as to its non-shell status. Underwood said that it would be common in the industry to obtain what is known as a "Bradstreet report." That report "can be quite enlightening in terms both of [the issuer's] operations, revenues, assets, who the key officers and directors are, shareholders—a great deal of information that is not necessarily available simply by going on the internet."[417]

Underwood concluded that a firm engaged in Rule 144 sales would also have more detailed written procedures that "would describe who did what, when, and how."[418] He said that

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[412] Hearing Tr. (Underwood) 2685-86, 2752-55.

[413] Hearing Tr. (Underwood) 2679-80.

[414] Hearing Tr. (Underwood) 2689.

[415] Hearing Tr. (Underwood) 2694.

[416] Hearing Tr. (Underwood) 2734.

[417] Hearing Tr. (Underwood) 2661.

[418] Hearing Tr. (Underwood) 2677-78.

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a firm would "anticipate questions that would be investigated with respect to issuers, with respect to sellers, with respect to the transfers of securities."[419] Furthermore, they would analyze the information collected and would "independently satisfy themselves to clear any red flags that arose. And that did not happen in any of these instances in my opinion."[420] He declared that the Firm did not meet the industry custom and practice for the conduct of this type of business.[421]

F. Law And Regulations Relating to Section 5

1. It Is Unlawful To Sell Securities Without Registration, Unless An Exemption Exists

It is unlawful for a firm to sell securities without an effective registration statement in place unless an exemption applies. Sections 5(a) and 5(c) of the Securities Act prohibit the "sale" and "offer for sale" of securities in interstate commerce unless a registration statement has been filed or is in effect, or an exemption from registration applies.[422] The prohibition applies to "any person,"[423] and the Securities Act defines "person" broadly to include both individuals and entities such as corporations and partnerships.[424] The prohibition also applies to any person who "directly or indirectly" sells or offers to sell securities.[425] Thus, Section 5 may be violated by a person who does not pass title to the securities but who is involved in the process of offering the securities for sale.[426]

The registration requirements are not merely technical—they are the "heart" of the Securities Act.[427] They serve to protect investors by promoting full disclosure of information thought necessary to informed investment decisions.[428] As the preamble to the Securities Act

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[419] Hearing Tr. (Underwood) 2678.

[420] Hearing Tr. (Underwood) 2678.

[421] Hearing Tr. (Underwood) 2689.

[422] 15 U.S.C. § 77e(a), § 77e(c). *See also Ronald S. Bloomfield*, Exchange Act Release No. 71632, 2014 SEC LEXIS 698, at *20-21 (Feb. 27, 2014). A violation of Securities Act Section 5 also is a violation of FINRA Rule 2010, which requires members and associated persons to conduct their business consistent with high standards of commercial honor and just and equitable principles of trade. *Midas Sec.*, Exchange Act Release No. 66200, 2012 SEC LEXIS 199, at *46 n.63 (Jan. 20, 2012); *Dep't of Enforcement v. Padilla*, No. 2006005786501, 2012 FINRA Discip. LEXIS 46, at *1 n.2 (NAC Aug. 1, 2012).

[423] 15 U.S.C. § 77e(a), § 77e(c).

[424] 15 U.S.C. § 77b(a)(2).

[425] 15 U.S.C. § 77e(a), § 77e(c).

[426] *Pinter v. Dahl*, 486 U.S. 622, 642-47 (1988).

[427] *ACAP Fin. Inc.*, Exchange Act Release No. 70046, 2013 SEC LEXIS 2156, at *28 (July 26, 2013) (quoting *Pinter v. Dahl*, 486 U.S. at 638), *aff'd*, 783 F.3d 763 (10th Cir. 2015).

[428] *SEC v. Elliott*, 2012 U.S. Dist. LEXIS 82992, at *1 (June 12, 2012); *Bloomfield*, 2014 SEC LEXIS 698, at *21; *ACAP*, 2013 SEC LEXIS 2156, at *28 (quoting *Pinter*, 486 U.S. at 638); *Dep't of Enforcement v. KCD Fin., Inc.*, No. 2011025851501, 2016 FINRA Discip. LEXIS 38, at *49 (NAC Aug. 3, 2016), *aff'd, KCD Fin. Inc.*, Exchange Act Release No. 80340, slip op. at 5-6 & nn.8-13 (SEC Mar. 29, 2017).

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states, the purpose of the Act is "[t]o provide full and fair disclosure of the character of securities ... and to prevent frauds."[429]

2. Sales Are Not Exempt If They Involve A Distribution By An "Underwriter"

A sale of securities is not exempt from registration if it involves a distribution of securities to the public. The Securities Act distinguishes between a distribution—which requires registration—and ordinary trading, which does not. In general, a distribution involves the sale of a substantial block of securities that is accompanied by sales solicitations, recommendations and other promotional activities that may induce investors to make investment decisions without the benefit of accurate information concerning the issuer, its management, and its plans and prospects. That is the reason registration is required. In contrast, ordinary trading by an individual investor who has little or no influence over the issuer is not accompanied by the same promotional pressures, and, consequently, the same protections are less necessary.[430]

The distinction between a distribution and ordinary trading is reflected in Section 4(a)(1) of the Securities Act, which exempts a securities transaction from registration if it does not involve "an issuer, underwriter, or dealer."[431] In this case, the term "underwriter" is critical. The term is not limited to financial industry professionals. It encompasses individual investors "if they act as links in a chain of transactions through which securities move from an issuer to the public."[432] Section 2(a)(11) of the Securities Act broadly defines the term to include "any person" who has purchased from an issuer "with a view to ... the distribution of any security."[433]

Because it is difficult to know whether a person acquired securities "with a view to" distributing them to the public, the surrounding circumstances and the investor's actions after acquiring the securities must be analyzed. For example, when a person acquires securities from the issuer in a non-public transaction and shortly thereafter resells, the circumstances suggest that the person acquired the securities with a view to distribution, which would make that person an underwriter. The transactions function like a two-step indirect distribution and may be a public offering in disguise.[434]

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[429] Securities Act of 1933, Pub. L. No. 22, § 1, 48 Stat. 74, ch. 38.

[430] *See* the Preliminary Note to Rule 144 ("If any person sells a non-exempt security to any other person, the sale must be registered unless an exemption can be found for the transaction.").

[431] *See generally* Hicks, *Resales of Restricted Securities* at § 2.4, 12-13, § 2:10, 22-23, § 2.11, 23-24 (2015 ed.). *See* the Preliminary Note to Rule 144 ("Section 4(1) of the Securities Act provides one such exemption for a transaction 'by a person other than an issuer, underwriter, or dealer.'").

[432] Preliminary Note to Rule 144.

[433] 15 U.S.C. § 77b(a)(11). *See also SEC v. McNamee*, 481 F.3d 451, 455 (7th Cir. 2007).

[434] *See generally* Hicks, *Resales of Restricted Securities* at § 4:101, 250 (2015 ed.). *See* the Preliminary Note to Rule 144.

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3. Broker-Dealer Has The Burden Of Showing A Reasonable Basis For An Exemption

Once a *prima facie* case is made out, as it was here,[435] a broker-dealer has the burden of showing that it had a reasonable basis at the time it sold the securities for concluding that an exemption from registration existed.[436] Exemptions from the registration requirements are affirmative defenses that must be established by the person claiming the exemption.[437] The Securities Act requires a broker-dealer and its associated persons to act as gatekeepers to prevent unlawful distributions, and the responsibility rests on them to take all steps reasonable in the circumstances to assure themselves that an exemption applies before they sell securities without registration.[438]

A broker-dealer's duty to investigate is not satisfied by simply checking boxes on a checklist. Rather, a firm must examine the information it receives with a skeptical eye because the interested parties have an incentive to mislead and deceive a firm in order to facilitate their sale of securities. A broker-dealer must independently investigate suspicious facts to satisfy itself that an exemption exists. As the SEC has explained,

> A dealer who offers to sell, or is asked to sell a substantial amount of securities must take whatever steps are necessary to be sure that this is a transaction not involving an issuer, person in a control relationship with an issuer[,] or an underwriter. For this purpose, it is not sufficient for him merely to accept "self-serving statements of his sellers and their counsel without reasonably exploring the possibility of contrary facts."[439]

Exemptions from registration requirements are construed narrowly.[440] Accordingly, evidence in support of an exemption must be "explicit, exact, and not built on mere conclusory statements."[441]

It is important to bear in mind that there are two distinct burdens in this case. While it was Enforcement's burden to prove the elements of its claims, it was the Firm's burden before

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[435] *See infra* p. 80.

[436] *Bloomfield*, 2014 SEC LEXIS 698, at *23; *ACAP*, 2013 SEC LEXIS 2156, at *29 (citations omitted); *Dep't of Enforcement v. Midas Sec., LLC*, No. 2005000075703, 2011 FINRA Discip. LEXIS 62, at *11 & n.8 (NAC Mar. 3, 2011), *aff'd*, 2012 SEC LEXIS 199, at *28 & n.36.

[437] *Midas Sec.*, 2011 FINRA Discip. LEXIS 62, at *28 & n.36, *38.

[438] *Padilla*, 2012 FINRA Discip. LEXIS 46, at *29.

[439] *Laser Arms Corp.*, 50 S.E.C. 489, 503 (Feb. 14, 1991) (quoting *Distribution by Broker-Dealers of Unregistered Securities*, Exchange Act Release No. 4445, 1962 SEC LEXIS 74 (Feb. 2, 1962)).

[440] *Midas Sec.*, 2011 FINRA Discip. LEXIS at *11-12 (quoting *SEC v. Blazon*, 609 F. 2d 960, 968 (9th Cir 1979).

[441] *Midas Sec.*, 2011 FINRA Discip. LEXIS at *12 (quoting *Robert G. Weeks*, Exchange Act Release No. 48684, 2003 SEC LEXIS 2572, at *42 n.34 (Oct. 23, 2003).

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selling the securities to establish a reasonable basis for the existence of an exemption from registration.

4. Respondents Claim Two Exemptions

With respect to the transactions at issue, Respondents claim that Rule 144 applied to the transactions, or, failing that, the so-called "broker's exemption" in Section 4(a)(4) of the Securities Act for ordinary unsolicited trading.[442]

a. Securities Act Rule 144

The SEC adopted Rule 144 both to provide a "safe harbor" for certain transactions and to protect against transactions by non-professionals as a means of circumventing the registration requirements. Among other things, Rule 144 restricts the resale of securities acquired directly or indirectly from the issuer or an affiliate in a transaction not involving a public offering. The SEC defines such securities as "restricted securities," and requires an owner of restricted securities to hold them for a length of time before reselling them in another transaction without registration. The holding period and other conditions for resale differ if the holder of the restricted securities is an affiliate or non-affiliate.[443] Thus, the identity of the person selling the securities and the nature of any relationship that person might have to the issuer become important to the exemption analysis.

Rule 144 defines an affiliate of an issuer as a person who directly or indirectly controls or is controlled by or is under common control with the issuer. Although Rule 144 does not define control, it is commonly understood that the definition in SEC Rule 405 of Regulation C applies. It defines control as "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person whether through the ownership of voting securities, by contract, or otherwise." Control depends on the totality of the circumstances and does not turn simply on whether a person is an officer of a company or the holder of a certain amount of stock.[444]

The identity of the issuer is important, too. The Rule 144 safe harbor is not available for shell companies. A shell company is defined as an issuer "with no or nominal operations and no or nominal non-cash assets."[445]

A person who satisfies the applicable conditions of Rule 144 is deemed not to be engaged in a distribution of the securities and therefore not to be an underwriter for purposes of the

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[442] Resp. PH Br. at 2-5.

[443] 17 C.F.R. § 230.144. *See generally* Hicks, *Resales of Restricted Securities* at § 2.4, 12-13, § 2:10, 22-23, § 2.11, 23-24 (2015 ed.).

[444] *SEC v. Zenergy Int'l, Inc.*, 141 F. Supp. 3d 846, 853-54 (N.D. Ill. 2015).

[445] *Id.* at 853.

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Securities Act.[446] The burden is on the person claiming an exemption under Rule 144 to prove that all the applicable conditions have been met.[447]

The provisions of Rule 144(d)(3) relating to tacking are important here because tacking was the only way that the sellers in the transactions at issue could satisfy the required holding period. There are two categories of tacking. One category applies where a person who acquires restricted securities cannot personally meet the applicable holding requirement, but he is able to tack the holding period of another person to his. The other category applies where a person seeks to tack the period of time he has held restricted securities to the time he held other securities of the same issuer.[448]

Both categories are relevant in this case. *First*, to establish the requisite holding period, the purported beneficial owners needed to tack their holding period to that of the prior holders. Their ability to tack depended on the prior holders not being affiliates of the issuer. *Second*, in connection with the transactions charged in the Complaint, the prior holders needed to tack their acquisition of the securities to the earlier inception of the debt obligation exchanged for the securities. In order to do that, the debt obligation had to be a security. Rule 144 permits tacking based on the exchange of a security for another security of the same issuer (as long as no additional consideration is involved).[449]

In this case, Respondents claim that they had sufficient evidence that the sellers of the securities at issue were not affiliates of the issuers, the issuers were not shell companies, and the sellers had met the applicable holding period for the securities. We conclude that they did not.

b. Broker's Exemption Under Section 4(4)

Respondents argue they were entitled to the so-called broker's exemption under Section 4(4) of the Securities Act even if the transactions at issue were not exempt under Rule 144.[450]

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[446] *See generally* Hicks, *Resales of Restricted Securities* at § 4:1, 86 (2015 ed.).

[447] *See* Rule 144(b).

[448] *See generally* Hicks, *Resales of Restricted Securities* at § 4:139, 318 (2015 ed.).

[449] *See generally* Hicks, *Resales of Restricted Securities* at § 4:139, 318-19 (2015 ed.). Rule 144(d)(3) contains the provisions governing tacking. Two provisions are relevant here. Rule 144(d)(3)(iv) provides that securities that are acquired as a result of a default on a bona fide pledge of the securities shall be deemed to have been acquired when they were acquired by the pledger. However, if the securities were pledged without recourse they shall be deemed to have been acquired by the pledgee at the time of the pledge. Rule 144(d)(3)(ii) permits a person to tack the period of time he has held certain restricted securities to the period of time he has held related securities of the same issuer. It provides for tacking where the securities to be sold were acquired from the issuer solely in exchange for other securities of the same issuer.

[450] Resp. PH Br. 4-5.

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Section 4(4) is intended to exempt ordinary trading transactions that a broker may be asked to execute.[451]

As discussed above, a person can be an underwriter within the meaning of the Securities Act if he acquires the securities from an issuer or affiliate of the issuer with a view to distribution. In order to ensure that the person offering restricted securities for resale is not acting as an underwriter, it is necessary for a broker to evaluate the circumstances in which that person acquired restricted securities and offers them for resale. A broker cannot be a mere order taker. It must make whatever inquiries are necessary under the circumstances to ensure that its customer is not an underwriter.[452]

This exemption is not available when the broker "knows or has reasonable ground[s] to believe" that his customer is an underwriter, since in that event the broker would also violate Section 5 by participating in a non-exempt transaction.[453] As FINRA has stated, "[T]his exemption is available only if a broker is not aware, after a reasonable inquiry, of circumstances indicating that the selling customer is participating in a distribution of securities."[454]

Contrary to Respondents' arguments, we conclude that Respondents were confronted by abundant evidence that they were likely participating in unlawful distributions of securities. They cannot claim that they were unaware of facts signifying that possibility or the need to conduct further inquiry.

5. Both Exemptions Required A "Searching Inquiry" To Ensure That No Underwriter Was Involved

Neither the Rule 144 exemption nor the broker's exemption is available if the person selling the securities is an underwriter within the meaning of the Securities Act. Accordingly, where there are red flags indicating the possibility that a person may be acting as an underwriter, both exemptions require that a broker make a "searching inquiry" to satisfy itself that an exemption applies. Only then can a broker ensure that it does not participate in an unlawful distribution of unregistered securities.[455]

The SEC observed over half a century ago, "[W]here the surrounding circumstances raise a question as to whether or not the ostensible sellers may be merely intermediaries for controlling persons or statutory underwriters, then searching inquiry is called for."[456]

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[451] *World Trade Fin. Corp.*, Exchange Act Release No. 66114, 2012 SEC LEXIS 56, at *26 (Jan. 6, 2012).

[452] *Bloomfield*, 2014 SEC LEXIS 698, at *24-25 & nn.35-36.

[453] *Bloomfield*, 2014 SEC LEXIS 698, at *24; *World Trade Financial Corp.*, 2012 SEC LEXIS 56, at *26 & n.31.

[454] CX-197 at 2 (emphasis supplied).

[455] CX-197.

[456] *Bloomfield*, 2014 SEC LEXIS 698, at *26-27.

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6. FINRA Guidance On Red Flags Signaling That Underwriter May Be Involved

In Regulatory Notice 09-05, FINRA published guidance on the specific kinds of facts that give rise to the duty of conducting a searching inquiry.[457] In that guidance, FINRA made plain that "[a]ll firms must have procedures reasonably designed to avoid becoming participants in the potential unregistered distribution of securities."[458] It further explained, "Before selling securities in reliance on an exemption, a firm must take reasonable steps to ensure that the transaction qualifies for the exemption ...."[459]

Regulatory Notice 09-05 identifies a non-exhaustive list of red flags that signal the "possibility of an illegal, unregistered distribution."[460] These red flags are by no means comprehensive. They are merely illustrative. The generally recognized red flags in the Notice include the following: [461]

1. A customer opens a new account and delivers physical certificates that represent a large block of thinly traded or low-priced securities.

2. A customer has a pattern of depositing physical share certificates, immediately selling the shares, and then wiring out the proceeds of the resale.

3. A customer deposits share certificates that are recently issued or represent a large percentage of the float for the security.

4. Share certificates reference a company or customer name that has been changed or that does not match the name on the account.

5. The lack of a restrictive legend on deposited shares seems inconsistent with the date the customer acquired them or the nature of the transaction in which they were acquired.

6. There is a sudden spike in investor demand for a thinly traded or low-priced security, coupled with a rising price.

7. The company was a shell company when it issued the shares.

8. A customer with little or no assets at the firm receives an electronic transfer or journal transactions of large amounts of low-priced unlisted securities.

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[457] CX-197.

[458] CX-197, at 2.

[459] CX-197, at 2.

[460] CX-197, at 1.

[461] CX-197, at 3-4.

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9. The issuer has been through several recent name changes, business combinations or recapitalizations, or the company's officers are also officers of numerous similar companies.

10. The issuer's SEC filings are not current, are incomplete, or are nonexistent.

G. Ethical Violations (First Cause Of Action—Scottsdale And Hurry)

The First Cause of Action charges that Scottsdale and Hurry violated FINRA Rule 2010 by acting in contravention of Section 5 of the Securities Act. It alleges that during the relevant period, Scottsdale sold millions of shares of securities without registration and without an exemption. It further alleges that Hurry was a necessary participant and substantial factor in the unlawful transactions through his close management and control of all the entities involved in the process of depositing, approving, and reselling the securities, and through his prospecting for CSCT customers. The Complaint alleges that Hurry took actions to evade regulatory scrutiny and enable the Firm to make the unlawful sales.

1. Rule 2010

FINRA Rule 2010 requires FINRA members and their associated persons to "observe high standards of commercial honor and just and equitable principles of trade" in the conduct of their business. The Rule requires members of the securities industry not merely to conform to legal and regulatory requirements, but to conduct themselves with integrity, fairness, and honesty.[462]

Scienter is not required for a Rule 2010 violation. Rather, the SEC has established a disjunctive test for a Rule 2010 violation that applies either (i) to intentional or conscious bad conduct or (ii) to a failure to meet ethical norms, regardless of intention. The SEC has held that Rule 2010 may be violated if the respondent has acted either in bad faith or unethically.[463] In the context of a Rule 2010 violation, the SEC has defined bad faith as a dishonest belief or purpose,

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[462] *Robert Marcus Lane*, Exchange Act Release No. 74269, 2015 SEC LEXIS 558, at *22 n.20 (Feb. 13, 2015) (discussing NASD predecessor to FINRA Rule 2010: "[T]his general ethical standard . . . is broader and provides more flexibility than prescriptive regulations and legal requirements. [FINRA Rule 2010] protects investors and the securities industry from dishonest practices that are unfair to investors or hinder the functioning of a free and open market, even though those practices may not be illegal or violate a specific rule or regulation.") (internal quotations omitted).

[463] *Blair Alexander West*, Exchange Act Release No. 74030, 2015 SEC LEXIS 102, at *20 (Jan. 9, 2015); *Thomas W. Heath, III*, Exchange Act Release No. 59223, 2009 SEC LEXIS 14, at *13-17 & nn.9-16 (Jan. 9, 2009), *aff'd*, 586 F.3d 122, 130 (2d Cir. 2009), *cert denied*, 2010 U.S. LEXIS 3029 (Apr. 5, 2010) (discussing NYSE predecessor of Rule 2010); *Dep't of Enforcement v. Shvarts*, No. CAF980029, 2000 NASD Discip. LEXIS 6, at *11-18 (NAC June 2, 2000).

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and unethical conduct as conduct inconsistent with the moral norms or standards of professional conduct.[464]

Because the securities industry is built on trust, any ethical failure damages the industry generally by casting doubt on the integrity of its participants. An ethical failure also casts doubt on the ability of the particular miscreant to conform to ethical norms in the future. Enforcement of FINRA Rule 2010 is therefore fundamental to FINRA's regulatory mission, which, as expressed in FINRA's Sanction Guidelines, "is the building of public confidence in the financial markets."[465]

2. Enforcement Established A *Prima Facie* Case Of A Section 5 Violation

The elements of a *prima facie* case for violation of Section 5 are the following: (i) respondents sold or offered to sell securities; (ii) through use of interstate facilities or the mails (the jurisdictional means); and (iii) when no registration statement was filed or in effect as to those securities. Scienter is not an element.[466] A Section 5 violation does not require a showing that the sale actually facilitated a fraud. A sale without registration and without an exemption is an unlawful distribution of securities regardless of whether it is proven to be connected to a fraud.

Enforcement established a *prima facie* case. It proved that from December 1, 2013, through June 30, 2014, Scottsdale sold shares of three issuers, NHPI, VPLM, and ORFG, using the jurisdictional means and without registration.[467]

Respondents do not dispute these facts. They argue only that the transactions were exempt from registration.[468]

3. The Firm Lacked A Reasonable Basis For An Exemption

Scottsdale failed to have a reasonable basis for an exemption at the time that it sold the securities in the transactions at issue.

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[464] *Edward S. Brokaw*, Exchange Act Release No. 70883, 2013 SEC LEXIS 3583, at *33 (Nov. 15, 2013). *See also Simpson v. Bear, Stearns & Co.*, No. C07950030, 1997 NASD Discip. LEXIS 13, at *27 n.9 (NAC Jan. 29, 1997) ("Term 'bad faith' is not simply bad judgment or negligence, but rather it implies the conscious doing of a wrong because of dishonest purpose or moral obliquity....").

[465] FINRA Sanction Guidelines at 1 (2016) (Overview), https://www.finra.org/industry/sanction-guidelines.

[466] *Bloomfield*, 2014 SEC LEXIS 698, at *22 & n.29. *See also SEC v. Cavanagh*, 445 F.3d 105, 111 n.13 (2d Cir. 2006); *SEC v. Calvo*, 378 F.3d 1211, 1214-15 (11th Cir. 2004).

[467] RX-1; RX-2; RX-3; JX-268; JX-281; JX-310.

[468] Resp. PH Br. 2-5.

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First, in its due diligence the Firm did not even address the question whether the debt obligation was a security, despite having lawyers on its Rule 144 review team and despite Respondent Cruz being a lawyer with significant experience in the securities laws. It had no foundation for the tacking necessary to achieve the required holding period because the promissory notes and lines of credit on which the tacking was based were not securities.

Second, the documentation to support the Rule 144 exemption was rife with discrepancies and suspicious circumstances—all of which raised red flags strongly suggesting that the chain of transactions leading to deposits at Scottsdale were sham transactions using false documents and nominees to conceal the identity of the beneficial owners.

Although the Firm compiled thick due diligence packages for the transactions, it did so with a "check-the-box" attitude. It did not appropriately evaluate the information in the due diligence packages, did not investigate the many red flags, and did not independently verify the information received from the interested parties. The due diligence packages created only the false appearance of due diligence.

The Firm's conduct was unethical and did not meet the industry norms. The persons involved in the Rule 144 review did not obtain any meaningful information about the individuals and entities involved in the transactions. Diekmann confessed that he knew nothing about the purported beneficial owner of one of the deposits other than that the person was a client of CSCT's client. Scottsdale knew little more about any of them. It failed to perform its gatekeeping function. The testimony of Enforcement's expert only confirms our conclusion that the Firm failed to conduct itself in a manner consistent with industry norms.

a. The Prior Holders' Debt Obligations Were Not Securities Available For Tacking

i. *Reves* Governs Whether Note Is A Security

Not every note or debt obligation is a security.[469] The Supreme Court's decision in *Reves* governs the analysis.[470] Any note with a term of more than nine months is presumed to be a security unless it resembles one of the judicially enumerated instruments that are not securities, such as a note delivered in connection with consumer finance or a mortgage. In *Reves*, the Court set the analytic framework for determining whether a note bears a resemblance to one of the enumerated instruments or should be held to be a security. Four factors may be considered in deciding whether a note is a security:

(i) whether the seller's purpose is to raise money for general use of business or to finance substantial investments, and the buyer is motivated by the profit to be

[469] *Reves v. Ernst & Young*, 494 U.S. 56, 65-67 (1990).

[470] *Id.*

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generated, in contrast to a note to facilitate a minor purchase or sale or to correct for cash-flow difficulties;

(ii) whether the note involves an individual transaction or common trading for speculation or investment;

(iii) whether there is a reasonable public expectation that the note would be viewed as security; and

(iv) whether another regulatory scheme applies that would reduce risk of the instrument.[471]

In another case, the Court later summed up the distinguishing characteristic of a security as "any instrument that might be sold as an investment."[472]

As we explain below, we conclude that none of the debt obligations held by the prior holders were securities. That includes the NHPI note in payment for consulting services, the oral line of credit to VPLM, and the outstanding balance on the ORFG line of credit. As a result, when the prior holder accepted stock in satisfaction of the debt, it was not an exchange of securities that would support tacking.

ii. NHPI

It is plain that the note written by NHPI to Collins, the prior holder in the chain of holders, was not a security. We observe at the outset that the note's term was much shorter than the nine months required to presume a note to be a security—roughly two months. But it also fails the test set forth in *Reves*. NHPI did not enter into the note agreement in order to finance its general business or to make a substantial investment. Nor was Collins motivated by some profit to be generated from the note. According to documents in the due diligence package, the note was no more than a promise to pay Collins $10,000 for consulting services. Furthermore, the note was issued in a single transaction. A note that "merely reflects a single transaction" and is "not offered to the public" is not a security.[473] Nor could there be any public expectation that an individual note promising to pay for services was a security. The fourth factor, whether another regulatory scheme applied and diminished the need for treating the instrument as a security, is inapplicable where no other factor supports labeling the note a security.

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[471] *Id.* at 65-67. *See also Bass v. Janney Montgomery Scott, Inc.*, 210 F.3d 577, 583-86 (6th Cir. 2000).

[472] *SEC v. Edwards*, 540 U.S. 389, 393 (2004). *See also Frankfurt v. Mega Entertainment Group II*, 2016 U.S. Dist. LEXIS 73613, at *11 (N.D. Ill. June 7, 2016) (stating that "only those notes that were issued in an investment context" are securities).

[473] *New Earthshell Corp. v. Jobookit Holdings Ltd*, 2015 U.S. Dist. LEXIS 27141, at *10-11 (S.D.N.Y. Mar. 5, 2015)

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As another similar note was aptly described by a federal district court, the note held by Collins was "akin to an 'IOU' for services rendered."[474]

iii. VPLM

With respect to the issue of whether the oral line of credit extended by Locksmith to VPLM was a security, the focus at the hearing was on whether there is any distinction between an oral agreement and a written agreement. Diekmann maintained that there is no difference between an oral line of credit and a written line of credit for purposes of Rule 144 and tacking. He understood that in either case the successor holder could tack back to an advance on the line of credit. He based his understanding on his experience with the treatment of written lines of credit and discussions with legal counsel—who exactly he could not recall.[475]

In their post-hearing brief,[476] Respondents relied on a Seventh Circuit Court of Appeals decision, *Canadian Imperial Bank*.[477] Their reliance is misplaced. The issue in *Canadian Imperial Bank* was whether a private plaintiff had sufficiently pleaded the existence of a security for purposes of establishing subject matter jurisdiction. The plaintiff alleged that a certificate of deposit from a Bahama bank was a security, but no document was attached that could be analyzed for purposes of jurisdiction. The Court held that the complaint did not allege sufficient facts to establish jurisdiction, but it hastened to say that its decision did not mean that only written instruments can be securities, noting that oral promises of participation in a profit sharing plan have been held to be investment contracts even where not evidenced in writing.[478] The Court's remarks regarding oral promises as investment contracts provide no basis for concluding that the oral credit line here was a security.

The oral line of credit, unlike an oral promise of participation in a profit sharing plan, was not represented to be an investment. Nor was it easily tradeable as an investment. There was no means of being certain of the terms, confident of the effective transfer of rights, or sure that those rights might later be enforced. Accordingly, the oral line of credit was not a security.

Moreover, even if written, the line of credit did not meet the *Reves* test. The line of credit was a loan to the issuer by a single individual. Such an individual transaction would not be viewed as a security by the public and would not ordinarily be traded as an investment.

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[474] *SEC v. Garber*, 959 F Supp. 2d 374, 377 (S.D.N.Y. 2013).

[475] Hearing Tr. (Diekmann) 1711-17.

[476] Resp. PH Br. 22 n.114.

[477] *Canadian Imperial Bank of Commerce Trust Co. v. Fingland*, 615 F. 2d 465 (7th Cir. 1980).

[478] *Id.* at 466-67 & n.5.

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iv. ORFG

The open-ended line of credit extended by Forward to ORFG for $600,000 was not a security. As discussed above in connection with the other debt conversion transactions, it did not meet the *Reves* test. It was an individual transaction that was not designed to trade as an investment. Nor would the public view it as a security.[479]

b. The Firm Ignored Red Flags

Even if the notes had been securities, the transactions were not entitled to the safe harbor of Rule 144. Many of the red flags set forth in Regulatory Notice 09-05[480] existed in the transactions at issue. The following red flags are examples:

- All the stock deposits in the transactions at issue consisted of large blocks of thinly traded, low-priced stocks issued by obscure companies. (Reg. Notice 09-05 Red Flag 1).

- CSCT had a pattern of making large deposits of thinly traded microcap stocks, selling the securities, and immediately wiring out the proceeds. Respondents knew that CSCT was acting on behalf of its FFI customers involved in the transactions and that the FFIs also engaged in the same pattern while acting on behalf of other entities and individuals. Despite the pattern, Scottsdale did nothing to investigate who actually was receiving the funds from the securities sales. Because the only account at Scottsdale was in the name of CSCT, Scottsdale could not and did not track where the proceeds ultimately went. It could not tell if the proceeds went to the different purported beneficial owners or to other persons who were repeatedly engaging in the deposit and immediate resale of securities. (Reg. Notice 09-05 Red Flag 2).

- The deposited shares were recently issued, which suggested that the issuer or its control persons could be initiating a distribution. Nothing in the due diligence packages indicates that Scottsdale took any note of that fact. (Reg. Notice 09-05 Red Flag 3).

- Although the issuer claimed not to be a shell corporation, there was little evidence of ongoing business operations. The Firm mainly relied on a representation by a principal of the issuer that the entity was not a shell. (Reg. Notice 09-05 Red Flag 7).

- Two of the issuers involved in this case had business histories that suggested shell status. Only a few months before the deposit of NHPI securities at Scottsdale, NHPI, a pharmaceutical company, announced it was going into the oil and gas business. ORFG,

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[479] Furthermore, even if the note had been a security, Forward did not transfer the ORFG note for securities of ORFG. He transferred a portion of the note for securities of a different entity, Anything Media. He also did so in connection with an agreement by ORFG to modify the terms of the original line of credit. His exchange involved securities of a different issuer and different consideration. Accordingly, Media Central was not entitled to tack back to Forward's original note.

[480] *See supra* pp. 78-79.

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which described itself as an automotive detailing company that used casual part-time labor as required, similarly indicated it was considering going into mineral exploration and set forth an anticipated payment schedule for three unspecified mining concessions. In both cases, the new business venture was radically different from the old line of business, the information regarding either line of business was scant, and the company's purported resources did not appear sufficient to engage in the new line of business. (Reg. Notice 09-05 Red Flags 7 and 9).

Finally, we note that it is critical in a Rule 144 transaction to know the identity of the purported beneficial owners and any relationship they might have to the issuers or affiliates of the issuers of the shares they seek to sell. Even after collecting voluminous documents, the Firm in fact knew nothing about the purported beneficial owners or about the businesses through which they held the securities except their names. Diekmann, who headed the Rule 144 team at the time of the transactions at issue, admitted that he knew nothing about the purported beneficial owner of one of the NHPI deposits other than that the person was a customer of Unicorn.[481] The Firm knew little more than that about any of the other purported beneficial owners involved in the transactions at issue. Diekmann's testimony is a stark confession that the Firm did not perform its gatekeeping function and did not adhere to high standards of commercial honor and just and equitable principles of trade.

c. Respondents' Arguments Are Unavailing

i. NHPI

Respondents' arguments relating to the NHPI deposits rest on treating the representations by the interested parties in the documentation for the NHPI deposits as though they were true. For example, Scottsdale asserts that Collins was not an affiliate of NHPI, and therefore he could freely sell the stock derived from his note in the fall of 2013 regardless of any tacking to the inception of the May 2012 note.[482] Respondents then reason that Collins' transactions with Sky Walker, Ireland Offshore, and Swiss National could not be fake loan transactions, as Enforcement portrays them, because, as a non-affiliate holder for more than a year, Collins could simply have sold the shares to the three depositors. Respondents conclude that there could be no reason to fake the loan transactions. Respondents likewise assert that the beneficial owners of Sky Walker, Ireland Offshore, and Swiss National were not affiliates of NHPI based on the representations to that effect by the interested parties.[483]

In making arguments that depend upon the truth of the representations made by the interested parties, Respondents only demonstrate their continuing lack of appropriate response to

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[481] Hearing Tr. (Diekmann) 911-13, 919.

[482] In so arguing, the Firm abandons the basis on which the deposit was justified at the time Scottsdale sold the shares. On its Checklist for the transaction, the Firm relied on tacking back to the inception of the May 2012 note. RX-1, at 1.

[483] Resp. PH Br. 13-15.

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the suspicious circumstances and glaring red flags raised by the NHPI deposits. As the SEC has noted, a broker-dealer may not rely on representations by interested parties because those interested parties have an incentive to make misrepresentations.[484]

ii. VPLM

Again, Scottsdale's arguments largely assume the truth of the representations by the interested parties. They assert that they reasonably relied on those representations.[485] We reject Respondents' position. Red flags signaled that the transaction could be a scheme to evade the registration requirements while distributing securities to the public. The Firm could not sell the securities unless it investigated further and obtained better support for an exemption.

Scottsdale also argues that Enforcement failed to prove that any proceeds of the sales of VPLM flowed back to the issuer or that there were any links between the issuer and the persons involved in selling VPLM stock through CSCT and Scottsdale.[486] As discussed above, the Firm misunderstands the law. It was not Enforcement's burden to prove who was behind the transactions; rather, it was Respondents' burden to probe the suspicious circumstances and establish that the transaction was entitled to the Rule 144 exemption before the Firm sold the securities.

iii. ORFG

As with the other transactions, Respondents' arguments assume the truth of the representations in the transaction documents. For instance, they argue that the Firm obtained satisfactory evidence that the transaction met the requirements of Rule 144 because the Firm obtained a letter from ORFG's Chairman and CEO dated May 19, 2014, confirming that Media Central and its purported owner were not affiliates of the company.

Given that the underlying transaction—the $600,000 open-ended credit line giving the holder discretion to convert stock at will—made no sense, it was unreasonable to rely on that letter as the only evidence that the seller was not an affiliate. If the chain of transactions were really a series of steps in a distribution for the ultimate benefit of the issuer or those persons controlling the issuer, then such a representation by the issuer's Chairman and CEO would be in service of the unlawful distribution of securities without registration.

4. Hurry's Violation

The First Cause of Action also charges that Hurry was a necessary participant and substantial factor in the unlawful transactions, through his close management and control of all the entities involved in the process of depositing, approving, and reselling the securities, and

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[484] *Laser Arms*, 1991 SEC LEXIS 257, at *36.

[485] Resp. PH Br. 21.

[486] Resp. PH Br. 22.

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through his prospecting for CSCT customers. It expressly alleges that Hurry purposely established CSCT as a means of evading regulatory scrutiny and enabling the Firm to make the unlawful sales. Enforcement proved the charges.

a. Hurry Was A Necessary Participant And Substantial Factor

Section 5 makes it unlawful for a person to offer or sell securities without registration. Liability, however, is not limited to the person or entity that ultimately passes title to the security. Courts have developed the "necessary participant/substantial factor" test as a way of holding other persons involved with the transactions accountable under Section 5 as offerors or sellers.[487] The "necessary participant/substantial factor" test is based on statutory language in Section 5, which imposes liability on persons who "directly or indirectly" offer or sell securities in violation of Section 5.[488]

The "necessary participant/substantial factor" test distinguishes between those persons who have only a *de minimis* or insubstantial role in securities sales in violation of Section 5 and those who should be liable. The test is more than a "but for" test. Even if a person is necessary to the completion of the transaction, such as a transfer agent might be, that does not necessarily mean the person was a substantial factor in the violation. Determining whether someone was a substantial factor in the unlawful sales is a fact issue requiring extensive analysis.[489]

It is not clear that the "necessary participant/substantial factor" test is appropriate here. Hurry is not charged with offering or selling securities in violation of Section 5. He is charged with an ethical violation under Rule 2010. He does not have to be proven to be an offeror or seller in order to be proven to have violated Rule 2010.

The parties briefed Hurry's liability using the "necessary participant/substantial factor" test, however, and we use it to assist in determining whether Hurry was sufficiently linked to the transactions at issue to hold him liable for violating Rule 2010 in connection with them. We also separately apply the more familiar standard for Rule 2010 violations, which we discuss below.

Based on the above factual record and analysis, which we do not repeat in detail here, we conclude that Hurry was a necessary participant and a substantial factor in the transactions. He was sufficiently linked to the transactions to hold him accountable for his conduct in connection with them. His role was not *de minimis* or insubstantial.

We reject Hurry's argument that he cannot be linked to the transactions at issue. He asserts that there is "not a single document relating to the stocks in question with [his] name

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[487] *SEC v. CMKM Diamonds, Inc.*, 729 F.3d 1248, 1255 (9th Cir. 2013).

[488] *SEC v. Boock*, 2011 U.S. Dist. LEXIS 95363, at *47 & n.17 (S.D.N.Y. Aug. 25, 2011).

[489] *CMKM Diamonds*, 729 F.3d at 1255-57; *SEC v. Blackburn*, 2015 U.S. Dist. LEXIS 178325, *8-9 (E.D. La. Sept. 11, 2015).

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anywhere on it."[490] While there was little in the way of a paper trail directly linking Hurry to the particular transactions at issue, the absence of such a direct link was the result of Hurry's own demonstrated obsession with secrecy. He purposely concealed his involvement in CSCT's business. It is not surprising that there is not a single document relating to the deposits at issue with his name on it, because he made sure of it.

In fact, Hurry was the master puppeteer for all the FFI business that flowed through CSCT to Scottsdale and, ultimately, to public investors. CSCT existed only because he established and closely managed it. Given Ruzicka's lack of experience, qualifications, and contacts, CSCT could not have survived without Hurry's active involvement. We reject Hurry's assertion that, because Ruzicka had decades of experience as a real estate lawyer who ran his own law firm, hiring Ruzicka to run CSCT was a reasonable and logical decision.[491]

With respect to the particular transactions at issue, there is sufficient evidence of a link between Hurry and the FFIs that made the deposits. Hurry developed CSCT's business with the three FFIs that engaged in those transactions, Montage, Titan, and Unicorn. As set forth more fully above, Hurry admits that he flew to Panama to see Montage and to Belize to see Unicorn and that he discussed with Unicorn doing its business through CSCT. He admits to talking to the principals of Montage, Titan, and Unicorn multiple times using FaceTime. He admits to creating the spreadsheet that tracked CSCT deposits, including those by Montage, Titan, and Unicorn. D'Mura testified that he and Ruzicka talked about deposits with Hurry, and an email shows that Hurry specifically discussed trading in NHPI and VPLM with Ruzicka. Ruzicka testified that Hurry told him to deal with a specific contact at Montage. Both Ruzicka and D'Mura said they disliked dealing with Cem Can at Unicorn, but that they knew that they had no authority to decline his business without Hurry's consent.

Hurry's direct contact with the three FFIs involved in the transactions at issue made him a substantial factor in their transactions. He did not take Ruzicka with him when he flew to Panama and Belize to talk to Montage and Unicorn, and Ruzicka testified in his OTR that he did not participate in Hurry's FaceTime calls with customers. Hurry was the critical link between CSCT and the three FFIs. Hurry's importance was reflected in Unicorn's demand for Hurry to join a telephone call with Miller, Diekmann, and Ruzicka to discuss the processes and procedures to be used in connection with Unicorn's business with Scottsdale through CSCT. Whenever something beyond paper-pushing was involved, Hurry's input was necessary. We reject Hurry's argument that he merely displayed the normal interest of an owner in the overall financial performance of his firm.[492] His involvement in CSCT's business was intense and pervasive.

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[490] Resp. PH Br. 45.

[491] Resp. PH Br. 43-44.

[492] Resp. PH Br. 46-47.

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Hurry further argues that the case law only imposes liability under Section 5 where the defendant has either sold the unregistered securities himself or has taken concrete steps necessary to effectuate those sales, such as negotiating transactions, issuing opinion letters, or directing the issuance of shares. He contends that he engaged in no such activities here.[493]

We reject the argument. As noted above, Hurry is not charged with a Section 5 violation, but, rather, a Rule 2010 violation. Unethical conduct in violation of Rule 2010 is not constrained by case law defining who is liable as a statutory seller under Section 5. In any event, substantial participation is a broad concept without precise bounds. One who conceives of and plans a scheme, or one who is a substantial motivating factor behind it, can be liable under Section 5.[494] To hold otherwise would allow a person to mastermind a Section 5 violation, and, by directing others to perform the mechanical tasks necessary to effect the sale of securities without registration, escape liability.

b. Hurry Acted In Bad Faith

FINRA Rule 2010 is a broad ethical principle that may be violated either by conduct that fails to meet ethical norms, regardless of intention, or conduct that is undertaken in bad faith. We find here that, in connection with the business he routed through CSCT, Hurry acted in bad faith and violated FINRA Rule 2010. We conclude that he was engaged in a scheme to evade the securities laws, in particular the registration requirements of Section 5.

Hurry claimed that he established CSCT because Alpine wanted to shed its IRS tax withholding obligations, but there was no evidence that it made business sense to set up an office in the Cayman Islands to do that. In fact, the insertion of CSCT into the process of preparing stock certificates for resale to the public made no business sense because, due to the discounts Scottsdale extended to CSCT, Hurry's enterprises as a collective group made no more money than when Scottsdale was handling the business directly—but CSCT imposed additional costs.

That Hurry had no legitimate business reason for setting up CSCT is further apparent from the way the Firm handled the business purportedly routed through CSCT. The Firm, through Miller and Noiman, continued to deal directly with the FFIs and often handled issues that arose with the deposits without involving Ruzicka or CSCT. Rather than independently preparing deposits for submission to Scottsdale, Ruzicka also sought guidance from Diekmann as to what deposits he should consider.

Further casting doubt on the legitimacy of Hurry's reasons for setting up CSCT, Diekmann testified that an individual in Belize or Panama could have a direct account with

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[493] Resp. PH Br. 46 and n.261.

[494] *SEC v. Elliott*, 2011 U.S. Dist. LEXIS 91946, at *20 (S.D.N.Y. Aug. 17, 2011). *See also SEC v. Holschuh*, 694 F. 2d 130, 139-40 (7th Cir. 1982); *SEC v. Friendly Power Co.*, 49 F. Supp. 2d 1363, 1372 (S.D. Fla. 1999) (a person has indirectly sold a security to the public if he has "employed or directed others to sell ... or has conceived of and planned the scheme by which the unregistered securities were offered or sold").

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Scottsdale without going through an FFI like Unicorn or CSCT.[495] Cruz admitted that it would be easier to conduct due diligence on a direct customer of the Firm than a customer who came through an FFI such as CSCT or Unicorn.[496] In fact, the creation of CSCT diminished Scottsdale's access to information about the purported beneficial owners, and neither Scottsdale nor Alpine, Hurry's clearing firm, knew where the proceeds from sales of the securities were flowing.[497] This testimony raises the question of the purpose served by the multiple layers of entities—if not to conceal the identity of the true beneficial owners of the securities.

Hurry's bad faith was amply proven by his elaborate stratagems for concealing his involvement in CSCT's business, including his use of the "x" email address at CSCT, his insistence on using the attorney-client privilege in inappropriate circumstances, and his use of FaceTime to conceal his contacts with customers. He specifically wrote to Ruzicka in an email that there should be no written record of Hurry's involvement, which is powerful evidence of Hurry's scheme to avoid regulatory scrutiny. Ruzicka testified in his OTR that Hurry told him he was going to the Cayman Islands so that he would not have to "give anything to anyone."

Hurry's actions betray an attitude antithetical to the public interest, and his attempt to evade regulatory scrutiny is inconsistent with his duties as a securities professional. He failed to adhere to high standards of commercial honor and just and equitable principles of trade, thereby violating FINRA Rule 2010.

H. Supervisory Violations (Second And Third Causes Of Action—DiBlasi And Cruz)

1. NASD Rule 3010 Imposes Supervisory Duties

NASD Rule 3010(a) mandates that each member firm "shall establish and maintain a system to supervise" the activities of its associated persons. It further mandates that a firm's supervisory system be "reasonably designed to achieve compliance with the applicable securities laws and regulations, and with applicable NASD Rules."

Rule 3010(a)(1) provides that a firm's supervisory system "shall provide, at a minimum," for the "establishment and maintenance of written procedures." Rule 3010(b) details requirements for WSPs. Rule 3010(b)(1) requires that a member firm "shall establish, maintain, and enforce written procedures to supervise the types of business in which it engages." Those WSPs must be "reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable Rules of NASD."

Rule 3010(b)(3) further requires that the WSPs set forth the titles, registration status, locations and responsibilities of each of its supervisory personnel, and that assignments be made

[495] Hearing Tr. (Diekmann) 1675.

[496] Hearing Tr. (Cruz) 220.

[497] Hearing Tr. (Cruz) 661-62; Hearing Tr. (Frankel) 2349-50.

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covering all relevant areas of the firm's business and the applicable securities laws and FINRA Rules. Firms are required to preserve a record of these designations and their effective dates for at least three years. Under Rule 3010(b)(4), a firm is required to amend its WSPs as changes occur in its supervisory system.

Broadly speaking, WSPs are a written set of policies and procedures that describe concrete steps to supervise a firm's activities. They identify who is responsible for taking those steps and set up a system of documentation to allow for review and ensure proper implementation. Every broker-dealer firm must create, maintain, update, and adhere to those policies and procedures.[498] Those policies and procedures contribute to the establishment and maintenance of a supervisory system that is reasonably designed to achieve compliance with the laws, regulations, and rules applicable to the firm's business. To achieve accountability and ensure compliance, the WSPs must be clear and accurate regarding the allocation of supervisory responsibilities.

2. DiBlasi's Violation

a. Charge

The Second Cause of Action charges that Scottsdale and DiBlasi, the Firm's CCO, violated NASD Rules 3010(a) and (b) and FINRA Rule 2010. The Complaint alleges that DiBlasi failed to establish a supervisory system, including WSPs, reasonably designed to ensure compliance with Section 5. This failure occurred even though DiBlasi knew that the Firm had been sanctioned once before in settling prior charges of selling unregistered nonexempt securities. Among other things, the Complaint charges that the Firm's WSPs were deficient because they did not set forth clear responsibilities for its personnel and did not provide for a reasonable inquiry into beneficial ownership. The Complaint alleges that the WSPs did not require that the Firm's personnel take steps to independently verify the self-serving representations made by parties interested in the transactions and did not address the possible use of nominees to obscure the identity of the true beneficial owners of unregistered securities deposited at the Firm for resale. Enforcement proved the charge.

b. DiBlasi Had Responsibility For The Firm's WSPs

Throughout the relevant period, DiBlasi was the Firm's CCO; and he is still the Firm's CCO. DiBlasi contends, however, that he has never had responsibility for the Firm's Rule 144 business. He asserts that he does only what he calls "broker-dealer compliance," and not Rule 144 compliance.[499] According to DiBlasi, the Firm's former president, Cruz, had responsibility

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[498] *Dep't of Enforcement v. Ranni*, No. 20080117243, 2012 FINRA Discip. LEXIS 6, at *15-16 (OHO Mar. 9, 2012).

[499] Hearing Tr. (DiBlasi) 1921-22, 1927, 1952-53, 1976-77. DiBlasi described what he meant by broker-dealer compliance. He makes sure that the Firm's filings, such as the Form BD and the Forms U4 and U5, are done. He maintains records and makes sure correspondence and emails are reviewed. He summed up his work as taking care of all the "back office" tasks. Hearing Tr. (DiBlasi) 1976-77.

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for Rule 144 procedures and everyone deferred to him.[500] DiBlasi agreed that Cruz had a longstanding practice regarding responsibilities for Rule 144 compliance.[501]

We reject DiBlasi's assertion that he had no responsibility for the Firm's procedures in connection with the Firm's Rule 144 business for two reasons. First, in the circumstances of this case, the assertion is inconsistent with his designation as the Firm's Chief Compliance Officer; and, second, the assertion is inconsistent with the WSPs themselves, as is plain from reading them.

First, DiBlasi is the sole person disclosed on the Firm's Form BD as CCO. There is no co-CCO.[502] That means that DiBlasi has been identified to the Firm's regulator as the one person responsible for establishing and maintaining the Firm's WSPs.

The Firm's WSPs were required to cover its Rule 144 business, since the Firm's business is almost entirely the liquidation of unregistered microcap stocks. DiBlasi acknowledged in his testimony that during the relevant period 95% of the transactions Scottsdale did for its customers involved penny stocks, and penny stocks accounted for most of the Firm's revenue.[503] That business required heightened attention to compliance issues, as DiBlasi knew. The Firm had previously settled regulatory charges that it had improperly sold unregistered securities without an applicable exemption.[504]

In these circumstances, the designation CCO carried with it responsibility for the WSPs relating to the Firm's Rule 144 business. DiBlasi's abdication of responsibility as to that business is fundamentally incompatible with what it means to be the Firm's CCO.

We reject DiBlasi's assertion that Enforcement is trying to hold him liable by virtue of his title alone.[505] Rule 3010 requires the designation and disclosure of a person responsible for establishing and maintaining a firm's procedures. By definition under the Rule, the person disclosed as the CCO has responsibility for the Firm's WSPs. The Rule further sets a standard for the design of those procedures, which must be reasonably designed to achieve compliance with the laws and regulations applicable to the firm's business. The designation and disclosure of a firm's CCO is more than a meaningless title. It is one of the building blocks of a supervisory system reasonably designed to achieve compliance, and the CCO designation carries with it

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[500] Hearing Tr. (DiBlasi) 1944-47, 1952-53, 1965-66.

[501] Hearing Tr. (DiBlasi) 1970. According to DiBlasi, his predecessor as CCO had no responsibility for Rule 144 compliance either. *Id.*

[502] Hearing Tr. (DiBlasi) 1981.

[503] Hearing Tr. (DiBlasi) 1923, 1946.

[504] Hearing Tr. (DiBlasi) 1923-24; CX-12.

[505] Resp. PH Br. 38 n.220.

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responsibilities. If DiBlasi is not carrying out those responsibilities, then the disclosure on the Firm's Form BD is false and misleading.[506]

Second, throughout the relevant period the Firm's WSPs expressly provided that the CCO—DiBlasi—had the duty to establish, maintain, and enforce all of the Firm's WSPs. There were two sets of WSPs during the relevant period, the May 2013 WSPs that were in effect in October 2013 when DiBlasi became CCO, and the modified WSPs that became effective in May 2014. The main body of both sets of WSPs expressly assigned to the CCO responsibility to "[e]stablish, maintain and update, as required the firm rules and procedures" and specified that that responsibility included Appendix A and Appendix B to the WSPs.[507] Appendix A to both sets of WSPs listed principals and branches.[508] Appendix B to both sets of WSPs expressly assigned to DiBlasi, by name, the responsibility to "[e]stablish, maintain and update, as required, the firm rules and procedures."[509] Appendix B assigned to Cruz, Diekmann, and others various operational tasks in conducting Rule 144 due diligence, but it did not assign them responsibility for the WSPs.[510]

DiBlasi conceded that there was no written delegation in the 2013 WSPs that gave responsibility for Rule 144 policies and procedures to anyone other than the CCO.[511] Moreover, the 2013 WSPs expressly imposed certain specific responsibilities on the CCO in connection with sales of unregistered securities. The main body of the WSPs included a specific section dealing with Rule 144 stock that was headed "Rule 144 Restricted and Control Stock Sales."[512] In that section, the 2013 WSPs stated that the CCO was responsible for establishing procedures reasonably designed to ensure that a stock certificate was validly issued and owned by the customer.[513] Importantly, the 2013 WSPs also provided that the CCO should establish

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[506] The cases cited by Respondents are not relevant here. The cases did not involve the issue of whether a CCO was responsible for a firm's WSPs. *Dep't of Enforcement v. Mutual Serv. Corp.*, No. EAF0400630001, 2008 FINRA Discip. LEXIS 62, at *90-93 (OHO Dec. 16, 2008) (compliance department subordinates who were told to abandon red flag blotter review did not have supervisory responsibility for that review); *Dep't of Enforcement v. Kemweis*, No. C02980024, 2000 NASD Discip. LEXIS 49, at *67-70 (OHO Feb. 16, 2000) (Director of Compliance held not to have line responsibility for unsuitable trading by registered representatives).

[507] CX-179, at 6 ("The Chief Compliance Officer ('CCO') is responsible for the establishment and maintenance [of Scottsdale's] policies and procedures."); CX-180, at 6 (same).

[508] CX-179, at 158; CX-180, at 151.

[509] Hearing Tr. (DiBlasi) 1930; CX-181, at 2 (DiBlasi assigned to "[e]stablish, maintain and update, as required the firm rules and procedures, includes Appendices A and B"); CX-182, at 2 (same). It appears that Appendix B to the May 2013 WSPs were modified on November 13, 2013, to identify DiBlasi by name as responsible for the WSPs. CX-181, footer bearing date of "11/13/2013."

[510] CX-181, at 8-9; CX-182, at 8-9. For example, Appendix B assigned to Diekmann responsibility for Rule 144 stock deposit due diligence and approval. CX-181, at 9; CX-182, at 9.

[511] Hearing Tr. (DiBlasi) 1933, 1945, 1955-56.

[512] CX-179, at 63-65 (Rule 144 Restricted and Control Stock Sales, 8.18 through 8.18.11).

[513] CX-179, at 64 (8.18.2).

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procedures to ensure that the resale of such a security was made in reasonable reliance on an exemption from registration.[514] The 2013 WSPs further provided that the CCO should be notified and consulted regarding the processing of Rule 144 sales.[515] They also specified that the CCO was responsible for "developing and implementing policies and procedures that provide for the review, approval and resale of Rule 144 transactions."[516]

Nevertheless, DiBlasi argues that he was not responsible for the 2013 WSPs because he inherited them.[517] The fact that the 2013 WSPs already existed when DiBlasi became CCO, however, does not absolve him of responsibility to examine them, and, if necessary, to amend them.[518] As noted above, Rule 3010 contemplates that amendments should be made to WSPs if there are changes in a firm's supervisory processes, so that the WSPs accurately reflect what the firm is doing. Indeed, shortly after DiBlasi became the Firm's CCO, in November 2013, the Firm modified Appendix B to identify DiBlasi by name as the person responsible for establishing, maintaining, and updating the Firm's WSPs, including Appendices A and B.[519] If Cruz had responsibility for WSPs to the extent that they related to its Rule 144 business, the correction could and should have been made in November 2013.

DiBlasi also attempts to explain away aspects of the 2013 WSPs that contradict his position—such as the specific assignment of Rule 144 compliance tasks to the CCO. He testified that the 2013 WSPs "didn't accurately reflect how the division of responsibility was set up throughout the company. And it needed to be corrected."[520] The 2013 WSPs, however, clearly stated that DiBlasi was responsible for the Firm's policies and procedures and made him specifically responsible for policies and procedures relating to the Firm's Rule 144 business. His disclaimer of responsibility cannot override that plain statement.

Approximately six months after DiBlasi became CCO, in May 2014, the WSPs were modified.[521] Even then, however, the WSPs did not clearly reflect the division of responsibility that DiBlasi described in his testimony. The WSPs did not say that Cruz had responsibility for all aspects of Rule 144 compliance, including the WSPs relating to Rule 144.

In place of the CCO, the main body of the modified WSPs designated the "General Principal" as responsible for developing procedures to ensure that a stock certificate was validly issued and owned by the customer, and that the resale of such a security was made in reasonable

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[514] Hearing Tr. (DiBlasi) 1940-41; CX-179, at 64 (8.18.2).

[515] CX-179, at 64 (8.18.3).

[516] CX-179, at 64 (8.18.3).

[517] Hearing Tr. (DiBlasi) 1932-33. See Resp. PH Br. 38-39.

[518] *Ranni*, 2012 FINRA Discip. LEXIS 6, at *27 & n.93.

[519] CX-182, at 2.

[520] Hearing Tr. (DiBlasi) 1969.

[521] Hearing Tr. (DiBlasi) 1921, 1932-33, 1939-42.

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reliance on an exemption.[522] Similarly, the modified WSPs instructed that the General Principal should be consulted in connection with Rule 144 transactions. Under the modified WSPs, the General Principal was responsible for developing and implementing Rule 144 policies and procedures.[523]

Although the title "General Principal" might appear to refer to a single person, the term General Principal was defined in the modified WSPs as the "Management Committee."[524] The WSPs declared that the Management Committee had been set up to serve in the role of president of the Firm.[525] The Management Committee was defined in yet another location to consist of four persons—including DiBlasi.[526] Accordingly, even under the modified WSPs, as a member of the Management Committee, DiBlasi still retained some vaguely defined responsibility for Rule 144 transactions.

DiBlasi relies on the delegation to the Management Committee in arguing that he had no responsibility for compliance matters related to the Firm's Rule 144 business. He maintains that the specific assignment of responsibility for the WSPs to him by name in Appendix B did not "overwrite" the provision in the main body of the WSPs referring to the Management Committee.[527]

Given the ambiguity of the delegation of responsibility in the main body of the WSPs—ostensibly to the General Principal but actually to a committee that included DiBlasi—we think the clear, explicit assignment of responsibility for the WSPs to DiBlasi by name contained in Appendix B forecloses DiBlasi's argument. That conclusion is bolstered by the description in the main body of the WSPs of the CCO's duties, which include responsibility for the Firm's policies and procedures.

DiBlasi's argument also is undermined by the fact that he took actions in connection with certificate deposits. For example, he signed a foreign account application by Unicorn under the label "Compliance Approval."[528] Furthermore, others at the Firm reached out to him in connection with issues regarding certificate deposits. For example, Diekmann had concerns about a deposit because Ruzicka said that the customer was pressing to start trading a stock when

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[522] CX-180, at 64 (8.18.2).

[523] CX-180, at 64 (8.18.3).

[524] CX-180, at 7 (Compliance and Supervision 1.1.2).

[525] Hearing Tr. (DiBlasi) 1972; CX-180, at 7.

[526] Hearing Tr. (DiBlasi) 1933-34, 1939-40, 1942-43. The other members of the Management Committee were Cruz, Jay Noiman, and Elizabeth Arndt. Hearing Tr. (Noiman) 1065-66; Hearing Tr. (DiBlasi) 1972.

[527] Hearing Tr. (DiBlasi) 1974-75.

[528] Hearing Tr. (DiBlasi) 1956-57. DiBlasi maintained that his signature meant nothing more than that a foreign financial institution was involved. Hearing Tr. (DiBlasi) 1957. Whatever it meant, DiBlasi's signature appeared under the heading "Compliance Approval," and it demonstrated that he was involved in some type of compliance review in connection with the Firm's penny stock accounts.

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there was zero market for it, so Diekmann forwarded the correspondence to DiBlasi. Diekmann said that he did so because he thought Ruzicka's comment called into question whether the deposit should have been approved by Scottsdale in the first place. He sent the email to DiBlasi because DiBlasi was the CCO.[529]

c. The Firm's WSPs Were Not Reasonably Designed To Ensure Compliance With Section 5

i. The WSPs Did Not Accurately Reflect The Way The Firm Conducted Its Rule 144 Business

The Firm's WSPs were not reasonably designed to ensure compliance with Section 5 because they did not accurately reflect the way the Firm conducted its Rule 144 business. DiBlasi testified that Cruz was the principal responsible for Rule 144 compliance and the establishment of policies and procedures relating to that business. Cruz testified that DiBlasi never had any role in the Rule 144 review process.[530] Cruz created the procedures for Rule 144 transactions that were in effect during the relevant period, the Firm's OTC Restricted Stock Deposit Procedures, dated November 2012.[531] He testified, however, that during the relevant period DiBlasi had responsibility for updating them.[532]

Accepting Respondents' testimony about the allocation of responsibilities, during the relevant period the WSPs should have clearly said which aspects of the WSPs were Cruz's responsibility and which were DiBlasi's. Neither the 2013 WSPs nor the modified WSPs had any clear indication of who was responsible for what.

DiBlasi admitted that the 2013 WSPs did not accurately reflect the way the Firm was operating its Rule 144 business.[533] We further find that the modified WSPs also did not accurately reflect the way the Firm operated its business.

DiBlasi's testimony revealed that the modified WSPs allocated responsibility to a committee that no longer existed. DiBlasi testified that in January 2014 the Management Committee disbanded. He said that Justine Hurry took on the Committee's responsibilities in February 2014. Then, in March 2014, Cruz officially became president of the Firm and took on

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[529] Hearing Tr. (Diekmann) 782-87; CX-222a.

[530] Hearing Tr. (Cruz) 563-64.

[531] Hearing Tr. (Cruz) 582; RX-27.

[532] Hearing Tr. (Cruz) 665-66; RX-27.

Confusion over who had responsibility for the WSPs apparently is nothing new at the Firm. Cruz did not remember who the CCO was at the time he created the Rule 144 procedures, and he did not recall anyone specifically delegating to him the responsibility for creating the procedures. Hearing Tr. (Cruz) 665-66. When asked who now has responsibility to update the Rule 144 procedures, Cruz testified, "I believe that responsibility now falls on Henry Diekmann as president and also as head of the 144 cert team." Hearing Tr. (Cruz) 584.

[533] Hearing Tr. (Diekmann) 783-86; CX-222a.

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the responsibilities of the Management Committee. The Committee never reconstituted itself again—and yet in May 2014 the Firm put in place the modified WSPs that supposedly gave Rule 144 compliance responsibility to the Management Committee.[534]

Even if the Management Committee had been functioning in May 2014, we find that the modified WSPs were misleading regarding the allocation of responsibilities, and, therefore, not reasonably designed to achieve compliance. They purported to designate a registered principal as responsible for compliance with Rule 144. Rule 3010 requires that supervisory responsibilities be delegated to an appropriately registered principal. But, in fact, the WSPs delegated responsibility for Rule 144 procedures to a group of people. In so doing, the WSPs obscured who had responsibility, making it more difficult to hold anyone accountable for compliance oversight over the bulk of the Firm's business.

This failure to clearly indicate who was responsible for Rule 144 compliance is particularly egregious here. It would have been relatively simple to designate Cruz the responsible principal, since everyone agreed that he was.

It is fundamental that a firm's WSPs must clearly designate responsibilities to appropriately registered persons and must accurately reflect the way a member firm conducts its business. That is why Rule 3010 specifies that supervisory responsibilities be assigned to an appropriately registered principal. The person responsible for supervising a particular line of business must have the appropriate background to do it. That is also why a firm's WSPs must address the particular business and the particular circumstances of a firm. Only then will the WSPs be well designed to reasonably ensure compliance.[535]

ii. The WSPs Did Not Require A Reasonable Inquiry Into Beneficial Ownership

We also find that Scottsdale's WSPs were not reasonably designed to achieve compliance with Section 5 because the WSPs failed to require a reasonable inquiry into the identity of the purported beneficial owners of the stock the Firm was selling. The WSPs do not discuss the concept of nominees, and the Firm's principals responsible for approval of stock deposits did not focus on the potential problem of nominees in conducting their review. The due diligence files for the transactions at issue demonstrate that the Firm's general practice for reviewing stock deposits was inadequate to identify and investigate situations in which nominees might be concealing the identity of the true beneficial owners of securities. Diekmann testified that he knew nothing about the purported beneficial owner of Sky Walker but that the person was a

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[534] Hearing Tr. (DiBlasi) 1973. DiBlasi's testimony that Justine Hurry briefly served as president of the Firm in February 2014 is corroborated by the Firm's Form BD Amendment dated February 13, 2014, which lists Justine Hurry as president, as well as a director, of the Firm. CX-17, at 3. That document identifies Cruz as legal counsel since May 2008. CX-17, at 3.

[535] *See* NASD Notice to Members 99-45 (June 1999), http://www.finra.org/sites/default/files/NoticeDocument/p004311.pdf.

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customer of Unicorn. The lack of focus on the potential use of nominees to conceal the identity of the true beneficial owners is particularly egregious in light of the four prior SEC actions charging that nominees had been used to facilitate fraud and manipulation.

The Firm's listing of every FFI on its red flag list was not sufficient to address beneficial ownership or to ensure that an unlawful distribution was not occurring. The WSPs did not indicate why or what should be done in response to the red flag designation. When asked what additional scrutiny comes from the red flag designation, Diekmann could not think of any. He said that the designation "just reflects the heightened risk."[536] To recognize a heightened risk but provide no guidance for dealing with it is not reasonable. WSPs must provide a "reliable mechanism" for identifying securities sales that should be investigated or halted.[537]

3. Cruz's Violation

The Third Cause of Action charges that Cruz failed to adequately and meaningfully analyze the collected documents and information. Consequently, he and the staff he supervised failed to respond appropriately to red flags strongly indicating that the transactions were not entitled to an exemption. He approved the deposits for resale based on a cursory collection and verification effort. Enforcement proved the charges.

There is no dispute that Cruz supervised the processing of deposits for resale pursuant to Rule 144. He drafted the Firm's procedures for handling restricted stock sold pursuant to Rule 144 and other forms used to process deposits. For each transaction, he also met with the person who had put together the due diligence file to support the Rule 144 exemption. After talking with the person, he gave the final approval that allowed Scottsdale to trade the securities without registration. He was critical to the transactions, and, even though the WSPs did not identify him as the responsible person, everyone at the Firm looked to Cruz as the person responsible for Rule 144 compliance.

Cruz violated his responsibility in two ways.

First, Cruz failed to analyze whether the debt obligations that formed the foundation for tacking were securities. In light of the circumstances, this failure was egregious. Diekmann, who is not a lawyer, was incapable of recognizing and correcting Cruz's error. The members of the Rule 144 team who were lawyers did not have experience with penny stocks before they came to the Firm and were trained by Cruz and the Firm's personnel. Everyone depended on Cruz's analysis and expertise. As an experienced securities lawyer, Cruz should have recognized the problem. But he failed to meaningfully analyze the information in the due diligence packages.

Second, Cruz failed to react appropriately to myriad red flags. As set forth above in connection with each transaction, the stock deposits were rife with discrepancies and suspicious

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[536] Hearing Tr. (Diekmann) 990.

[537] *Midas Sec.*, 2012 SEC LEXIS 199, at *51.

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circumstances that constituted red flags. However, Cruz and his staff did not make the required "searching inquiry" or obtain independent verification.

Cruz's failure is egregious because he knew that the Firm was acting as a gatekeeper,[538] and that broker-dealer firms play a critical role in helping to prevent illegal unregistered resales of restricted securities into the public markets.[539] He also acknowledged that at the time of the events at issue he was aware of the red flags in Regulatory Notice 09-05.[540] It is well established that the "duty of supervision includes the responsibility to investigate 'red flags' that suggest that misconduct may be occurring and to act upon the results."[541]

Cruz argues, however, that he was an effective supervisor. He notes that he created the Rule 144 manual, the due diligence questionnaire, and beneficial ownership declaration, and that the Firm dedicated one-third of its staff to performing due diligence reviews on stock deposits. He states that he inserted himself into the review process as a second set of eyes and additional resource when Scottsdale began accepting stock deposits from customers of sub-FFIs. He also asserts that the due diligence packages at issue contained all the required paperwork and that there is no instance of an issue being brought to Cruz's attention and him ignoring it. Finally, he maintains that the "rigor" of the stock deposit reviews under his leadership is demonstrated by the fact that Scottsdale frequently rejected stock deposits.[542]

All of this is beside the point. Cruz is charged with failing to respond appropriately to specific red flags identified in connection with the transactions at issue. The mere creation of paperwork does not qualify as effective supervision. As FINRA noted in conjunction with Regulatory Notice 09-05, in Rule 144 transactions, representations made by the interested parties have to be evaluated with a skeptical eye. Independent verification may be required. Instead, Cruz guided the staff through a check-the-box exercise.

Even when Cruz acknowledged that something might be a red flag, he indicated that his response would not be to obtain independent verification. Rather, his response would be merely to remind the interested parties of the information that needed to be disclosed. This is a totally inadequate response to a red flag.

Cruz's testimony regarding language on Unicorn's website illustrates the problem. The language on the website indicated that Unicorn would appoint nominees for its customers so that their names would not appear as an officer or director of the company on their account at

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[538] Hearing Tr. (Cruz) 86.

[539] Hearing Tr. (Cruz) 89.

[540] Hearing Tr. (Cruz) 84-90.

[541] *KCD Fin, Inc.*, 2016 FINRA Discip. LEXIS 38, at *70 (quoting *Michael T. Studer*, 57 S.E.C. 1011, 1023-24 (2004), *aff'd*, 260 F. App'x 342 (2d Cir. 2008)). *See also Ronald Pellegrino*, Exchange Act Release No. 59125, 2008 SEC LEXIS 2843, at *33 (Dec. 19, 2008).

[542] Resp. PH Br. 40-41.

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Unicorn. Cruz said he did not recall seeing that language at the time he reviewed Unicorn's deposits, but he agreed that if he had it "could have been" a red flag. In response to that red flag, however, he did not say that he would have sought independent verification of the identity of Unicorn's customers. Rather, he indicated that Scottsdale would merely emphasize to the interested parties that "they needed to – to disclose the underlying beneficial owner."[543] In other words, he would continue to rely on the representations of the interested parties.

Cruz argues that he supervised more actively than did respondents in other disciplinary proceedings in which supervisory violations were found.[544] Even if that were true (which we are not persuaded it is), the fact that other supervisors in other cases did even less than Cruz to respond to red flags is no excuse. The standard for reasonable supervision is not merely something marginally better than bad. Moreover, whether supervision is reasonable depends on the particular circumstances of each case.[545]

Cruz also argues that Enforcement is improperly second-guessing Cruz's exercise of reasoned business judgment, and that Enforcement has failed to provide affirmative evidence that his judgments were incorrect.[546] This argument is erroneous in two regards.

First, the argument ignores the record. The transactions at issue were rife with red flags that could not be ignored, but Cruz did ignore them.

Second, the argument confuses the burden on the Firm when it determined that an exemption existed with the burden of proof in litigation. Cruz, acting on behalf of the Firm, had the burden of developing a reasonable basis for believing that an exemption existed before the securities could be sold without registration. Enforcement proved that he and the Firm did not have a reasonable basis for believing that an exemption existed, but nevertheless Cruz approved the sale of the securities at issue without registration. That is all that Enforcement had to prove for the supervisory violation.

In sum, Cruz did not make sure that the transactions met the legal requirements for an exchange of securities, and he was oblivious to numerous red flags strongly suggesting that the transactions at issue were sham transactions using nominees to effect unlawful distributions of securities without registration. He violated his supervisory duties.

IV. SANCTIONS

In considering the appropriate sanction for a violation, adjudicators in FINRA disciplinary proceedings look to FINRA's Sanction Guidelines ("Guidelines"). The Guidelines

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[543] Hearing Tr. (Cruz) 307-08.

[544] Resp. PH Br. 41 n.236.

[545] *E.g.*, *Dep't of Enforcement v. Wedbush Sec., Inc.*, No. 20070094044, 2014 FINRA Discip. LEXIS 40, at *27-28 (NAC Dec. 11, 2014).

[546] Resp. PH Br. 41.

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contain recommendations for sanctions for many specific violations, depending on the circumstances. They also contain overarching Principal Considerations and General Principles, both of which are applicable in all cases.[547]

The Guidelines are intended to be applied with attention to the regulatory mission of FINRA—to protect investors and strengthen market integrity.[548] The Guidelines caution that sanctions must be significant enough to prevent and discourage future misconduct by a respondent and to deter others from similar misconduct. Sanctions also should encourage improved business practices.[549]

Applying the Guidelines, we first discuss below the appropriate sanctions for the Firm, DiBlasi, and Cruz. We separately discuss the sanction for Hurry.

A. Scottsdale

As authorized by the Guidelines, we aggregate all the Firm's violations.[550] The violations are inextricably intertwined and are the result of a systemic failure at the Firm—the Firm's failure to have procedures in place that would reasonably ensure compliance and the Firm's failure to respond appropriately to red flags led to the Firm's failure to have a reasonable basis for an exemption before selling the securities. Furthermore, as discussed below, the Panel believes stringent sanctions are warranted here, and separately sanctioning the Firm for the different violations, even at the high end of the range of recommended sanctions, would not adequately remediate the Firm's misconduct. We view the Firm's systemic failure to perform its gatekeeping function better addressed as a whole, rather than in piecemeal fashion.

The Firm violated FINRA Rule 2010 because, in connection with the transactions at issue, it did not have a reasonable basis for an exemption. Selling securities without registration and without an exemption violated Section 5. The Guidelines contain specific recommendations for this type of violation. The Guidelines recommend a fine of $2,500 to $73,000, but in egregious cases the fine may be higher. In egregious cases, a firm may also be suspended with respect to any or all activities or functions for up to 30 business days or until procedural deficiencies are remedied.[551]

The Firm, through DiBlasi, failed to have in place WSPs reasonably designed to achieve compliance with Section 5. For deficient WSPs, the Guidelines recommend a fine ranging from $1,000 to $37,000. They also suggest that adjudicators consider suspending a firm with respect

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[547] FINRA Sanction Guidelines (2016) ("Guidelines"), http://www.finra.org/industry/sanction-guidelines.

[548] Guidelines at 1, Overview.

[549] Guidelines at 2, General Principle No. 1.

[550] Guidelines at 4, General Principle No. 4.

[551] Guidelines at 24.

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to any or all relevant activities or functions for up to 30 business days or until the supervisory procedures are amended to conform to the rule requirements.[552]

The Firm, through Cruz, failed to supervise its Rule 144 process appropriately. The Firm, through Cruz, failed to adequately and meaningfully analyze the information collected and thus failed to respond appropriately to red flags that the transactions were unlawful distributions. For a failure to supervise, the Guidelines recommend a fine of $5,000 to $73,000. In egregious cases, they suggest that adjudicators consider suspending a firm with respect to any or all relevant activities or functions for up to 30 business days. An even longer suspension may be imposed, up to two years, or the firm may be expelled, where the case involves systemic supervision failures.[553]

We find the Firm's violations to be egregious. We also find that there are a large number of aggravating factors that increase the need for stringent sanctions. There are no mitigating factors.

1. Aggravating Factors

a. Specific Principal Considerations Related To Section 5 Violations

One of the specific Principal Considerations in a case involving a Section 5 violation is whether the respondent attempted to comply with an exemption.[554] We conclude here that the Firm did not truly attempt to comply. Rather, it created the appearance of compliance. Although the Firm created thick due diligence packages, it did not meaningfully evaluate the information in those packages. If it had, it would have known it could not sell the securities without further investigation and the development of a reasonable basis for an exemption. We further find it aggravating that the Firm expended its resources on creating the appearance of compliance, rather than true compliance, because such conduct is deceptive and displays a lack of regard for the applicable law and regulatory requirements. This aggravating factor applies not only to the Firm but to Cruz, on whom everyone at the Firm depended for Rule 144 compliance.

Another specific Principal Consideration is the share volume and dollar amount of the transactions involved.[555] The transactions at issue involved millions of shares and resulted in

[552] Guidelines at 103.

[553] Guidelines at 102.

[554] Guidelines at 24.

[555] Guidelines at 24. See also Guidelines at 7, General Principal Consideration 18.

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proceeds of more than $1.75 million.[556] The amounts involved are substantial and constitute an aggravating factor.

A third specific Principal Consideration is whether the respondent implemented reasonable procedures to ensure that it did not participate in an unregistered distribution.[557] The Firm's procedures were not reasonable. To the contrary, they seemed designed to obscure who was responsible for Rule 144 compliance and they failed to require specific, reliable evidence to support the application of an exemption. Nor did the Firm implement good practices. Scottsdale's staff uncritically relied on the self-serving representations of the interested parties. When they did notice a discrepancy, the staff assumed an innocent explanation or accepted a plainly unreliable representation from the interested parties, rather than pursuing the "searching inquiry" that was required. This aggravating factor applies to DiBlasi, as the CCO, and to Cruz, as the person ultimately responsible for Rule 144 compliance, as well as the Firm.

A fourth specific Principal Consideration is whether the respondent disregarded red flags suggesting the presence of an unregistered distribution.[558] As discussed above, the Firm repeatedly failed to identify and disregarded numerous red flags indicating that the transactions were unlawful distributions of securities. The multiplicity of red flags is another aggravating factor. This aggravating factor applies to Cruz as well as the Firm.

b. Specific Principal Considerations Related To Deficient WSPs

One of the specific Principal Considerations relating to deficient WSPs is whether those deficiencies allowed violative conduct to occur or to escape detection. We find here that the WSPs allowed violations to occur. The failure to provide guidance on dealing with discrepancies and suspicious circumstances allowed those involved with Rule 144 review to proceed in a rote fashion, without analyzing the information they collected. This aggravating factor applies to both the Firm and DiBlasi.

Another specific Principal Consideration is whether the deficiencies made it difficult to determine the individuals responsible for specific areas of supervision or compliance. We find that the failure to clearly and accurately delineate responsibility lessened transparency and accountability, making regulatory oversight more difficult. It is particularly aggravating that the person designated CCO should disclaim responsibility for the vast majority of the Firm's business. This aggravating factor applies to both the Firm and DiBlasi.

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[556] JX-268 (NHPI-Related Activity in CSCT Account: Total Net Proceeds of $264,711.70); JX-281 (VPLM-Related Activity in CSCT Account: Total Net Proceeds of $1,408,173.39); JX-310 (ORFG-Related Activity in CSCT Account: Total Net Proceeds of $91,408.43).

[557] Guidelines at 24. See also Guidelines at 6, General Principal Consideration 5.

[558] Guidelines at 24.

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c. Specific Principal Considerations Related To Failure To Supervise

One of the specific Principal Considerations in connection with a failure to supervise is whether the respondent ignored red flags warning of the need for additional supervisory scrutiny. Another is the nature, extent, size, and character of the underlying misconduct. Both of these are aggravating factors in this case. The Firm, through Cruz, ignored multiple red flags that the transactions required additional scrutiny. The transactions were substantial and were typical of the bulk of the Firm's business. The supervisory failure was in fact built into the Firm's standard practice for processing Rule 144 stock deposits, which is an aggravating factor. These aggravating factors apply to both the Firm and Cruz.

d. General Principal Considerations

Several general Principal Considerations are relevant to this case.[559] Principal Consideration 1 is a respondent's relevant disciplinary history.[560] Scottsdale has a disciplinary history, and some of that history involves misconduct like the misconduct here. As noted above, in the 2011 AWC the Firm settled charges that it had sold unregistered securities and that it had inadequate supervisory procedures and WSPs to detect and prevent the sale of unregistered securities. The Firm resolved other charges in the 2009, 2012, and 2015 AWCs. Finally, although the Firm was not charged in connection with the four SEC cases, *Ruettiger*, *Gibraltar I*, *Gibraltar II*, and *Tavella*, those cases did involve alleged misconduct through accounts at the Firm. These cases put the Firm on notice of the risk of sham transactions and the use of nominees to conceal beneficial ownership and facilitate unlawful distributions of securities. They heightened the need for the Firm to be alert to red flags. In light of this history, it is aggravating that Scottsdale performed its gatekeeping function so poorly.

Principal Consideration 2 concerns whether a respondent has accepted responsibility for and acknowledged the misconduct prior to detection and intervention. The Firm here has not. It maintains that its procedures are "market-leading" and create an "unfriendly environment" for stock manipulation.[561] The facts do not support that characterization.

Furthermore, in light of the fact that the transactions at issue involved persons who have been indicted for engaging in securities fraud and other crimes, it is particularly aggravating that the Firm's current president, Diekmann, testified that if any of the three deposits at issue were presented to him today—NHPI, VPLM, or ORFG—he would approve it. He expressed no qualms.[562] This means that the person in charge of approving stock deposits as satisfying the Rule 144 exemption is likely to commit the same violations again.

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[559] Guidelines at 6-7.

[560] Guidelines at 6, General Principal Consideration 1.

[561] Resp. PH Br. 37-38.

[562] Hearing Tr. (Diekmann) 1799-80.

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Adding to our concerns in this regard, Cruz echoed Diekmann. Cruz said that, despite the evidence presented to him during his testimony relating to the five certificate deposits charged in the Complaint (three NHPI, one VPLM, and one ORFG), he believed that the Rule 144 exemption applied and the transactions complied with Section 5.[563]

Principal Consideration 8 is whether a respondent engaged in numerous acts or a pattern of misconduct. [564] Principal Consideration 16 is whether the misconduct is aberrant behavior.[565] Scottsdale engaged in a pattern of misconduct and it was not aberrant behavior. Indeed, the Firm institutionalized its misconduct, by papering its files with documents that it did not meaningfully analyze. It is aggravating that the misconduct is actually the standard way the Firm conducts all its business. Moreover, Cruz testified that the pattern of deposits based on buying loan notes and exchanging them for stock was a typical transaction for the Firm. Because it was typical he saw nothing suspicious in it. These aspects of the misconduct are aggravating as to both the Firm and Cruz.

Principal Consideration 13 is whether the misconduct was the result of an intentional act, recklessness or negligence.[566] The Firm's misconduct was not the product of negligence. It acted intentionally when it created and implemented the procedures for reviewing deposits of stock certificates for resale that created a false appearance of compliance. This aggravating factor applies not only to the Firm but to both DiBlasi and Cruz.

Principal Consideration 18 focuses on the number, size, and character of the transactions.[567] The transactions at issue had many red flags indicating that they were schemes to evade the securities laws and the scrutiny that comes with registration. Given that character, it is aggravating that, as a result of Scottsdale's failure to perform its gatekeeping function, millions of dollars of securities were sold to the investing public without the safeguards that accompany registration.

e. General Principles

The Guidelines instruct adjudicators to take into account certain General Principles applicable to all sanction determinations.[568] One of those General Principles is that disciplinary sanctions should be designed to deter misconduct, both by the respondent and by others, and should uphold high standards of business conduct. Adjudicators should impose sanctions that are

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[563] Hearing Tr. (Cruz) 555.

[564] Guidelines at 6, General Principal Consideration 8.

[565] Guidelines at 7, General Principal Consideration 16.

[566] Guidelines at 7, General Principal Consideration 13.

[567] Guidelines at 7, General Principal Consideration 18.

[568] Guidelines at 2-5.

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In the Court of Appeals
For the State of Michigan

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff-Appellee,

v.

MORNINGLIGHTMOUNTAIN, LLC, and MICHAEL GOODE,

Defendants-Appellants,

–and–

DOES 1–10,

Defendants–Not Participating.

Docket No.

Kalamazoo County Circuit Court
Case No.: 18-0153-CZ
HON. ALEXANDER C. LIPSEY

APPLICATION FOR LEAVE TO PURSUE AN INTERLOCUTORY APPEAL

APPELLANT'S APPENDIX VOLUME II

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meaningful and significant enough to accomplish these goals, and the sanctions should reflect the seriousness of the misconduct at issue.[569]

The Firm's business is almost entirely the processing of penny stock deposits for resale into the public marketplace. In light of that fact, it is aggravating that the Firm had a check-the-box approach to its review of the deposits, without meaningful analysis of the multitude of red flags. The confession by Diekmann, the current president of the Firm, that, even after compiling a thick due diligence book, he knew nothing about the beneficial owner of one of the NHPI deposits is disturbing. It suggests that the person who now has authority to give final approval to stock deposits for resale has no understanding of what is required to ensure that the Firm does not participate in an unlawful distribution of securities without registration. The sanctions here must be stringent to deal with the seriousness of the misconduct and to show the Firm that it cannot simply continue with its business in its usual fashion. We believe that only a substantial sanction will deter the Firm from future misconduct.

Another General Principle is that disciplinary sanctions should be more severe for recidivists in order to deter and prevent future misconduct. The imposition of more severe sanctions emphasizes the need for corrective action.[570] As noted above, the Firm has a disciplinary history. It has been disciplined for selling unregistered securities and for other violations. In light of this history, it is appropriate to impose more severe sanctions.

f. Overview

The mission of FINRA's regulatory and disciplinary process is to protect investors and promote market integrity. In fulfilling that mission, adjudicators are not limited to the sanctions recommended in the Guidelines. Based on the facts and circumstances presented in each case, adjudicators may impose sanctions that fall outside the ranges recommended and may consider aggravating and mitigating factors in addition to those listed in the Guidelines.[571]

2. Potential Mitigating Factor

Principal Consideration 3, which is applicable to all sanctions determinations, concerns whether, prior to detection or intervention by a regulator, a firm voluntarily employed corrective measures to avoid recurrence of misconduct. This might be argued to be a mitigating factor.

The Firm maintains that it enhanced its procedures after the SEC filed the complaints in the four cases involving nominees. In particular, it claims that it enhanced its reviews of stock promotions and notes that it ended all commissioned representatives at the Firm. It asserts that its requirement of a beneficial ownership declaration is a "market-leading practice" that has been

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[569] Guidelines at 2, General Principle 1.

[570] Guidelines at 2, General Principle 2.

[571] Guidelines at 1.

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adopted as a recommended method for determining beneficial ownership. It also points to its use of a Red Flag List and a Stock Watch List as enhancements to its reviews.[572]

We find that whatever changes the Firm made in its procedures were insufficient to be mitigating. To some degree, they appear to be more of the same. They created the appearance of compliance without actual compliance. Even with the so-called enhancements, the Firm's procedures were woefully lacking. The record is replete with red flags that the Firm and Cruz ignored.

3. Sanction

In light of the egregious nature of the Firm's violation, the Firm's institutionalization of the misconduct as its standard way of doing business, and the other aggravating factors set forth above, we believe that a stringent sanction is appropriate. Only such a sanction will serve the remedial purposes of the disciplinary process. The Firm must be deterred from similar misconduct in the future. We impose on Scottsdale a fine of $1.5 million.

B. Hurry

Hurry's violation of his duty to observe high standards of commercial honor and just and equitable principles of trade was purposeful and egregious. These two qualities lead us to conclude that Hurry is a threat to investors and the integrity of the markets. Our concern is compounded by our credibility findings. We found that he repeatedly testified falsely, and that there was a pattern of doing so when he thought no contradictory evidence would come to light.

When misconduct is intentional, General Principle 1 provides that adjudicators should assess sanctions that exceed the recommended range in the Guidelines.[573] Principal Consideration 13 also focuses on whether a respondent's misconduct is the result of an intentional act, recklessness, or negligence.[574] When a violation is egregious, the Guidelines often suggest more severe sanctions. In egregious cases in connection with violations of Rule 2010 and Section 5, the specific Guidelines recommend that an individual be suspended for up to two years or barred.

Even though he has no disciplinary history, the devious nature of Hurry's violation evidences disregard for regulatory requirements, an aggravating factor under General Principle 2 and Principal Consideration 10.[575] We have no confidence that if he remained in the securities industry he would not again devise a way to evade the law and regulatory requirements. For this reason also, we believe Hurry is a threat to the investing public.

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[572] Resp. PH Br. 37-38.

[573] Guidelines at 2, General Principle 2.

[574] Guidelines at 7, General Principal Consideration 13.

[575] Guidelines at 2, General Principle 2; Guidelines at 6, General Principal Consideration 10.

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As discussed in connection with the Firm's violation and sanction, the scheme enabled large amounts of stock certificates to be sold in a number of transactions without the protections of registration and without an exemption. Under Principal Consideration 18, the size of the transactions is an aggravating factor.

Finally, we note that Hurry had by far the most to gain financially from setting up CSCT and enabling shares deposited from offshore customers to be shielded from scrutiny. He and his wife own all three entities involved in the process: CSCT, Scottsdale, and Alpine. And although Respondents emphasize that the particular transactions at issue did not generate a huge amount of money, the microcap securities liquidation business as a whole was highly remunerative for Hurry and his wife. We earlier noted that, from Scottsdale alone, in 2014 they received approximately $6.2 million in directors' fees and $1.45 million in net income. The compensation for all other employees and for professional and consulting fees for that year totaled less than half that—approximately $2.7 million. It was to Hurry's financial advantage to facilitate the processing of FFI deposits and to minimize regulatory oversight. The misconduct added to his financial gain and is an aggravating factor under Principal Consideration 17.[576]

We bar Hurry from associating with any FINRA member in any capacity and believe it appropriately remedial to fine him $100,000. In light of the bar, however, we do not impose the fine.

C. DiBlasi

The Guidelines provide with respect to an individual who is responsible for deficient WSPs that in egregious cases he may be suspended in any or all capacities for up to one year. The Guidelines also provide for a fine ranging from $1,000 to $37,000.

In this case we find more stringent sanctions appropriately remedial. DiBlasi's violation was egregious, and there are aggravating factors. The WSPs created the appearance of a set of procedures designed to achieve compliance, but they did not accurately reflect the way the Firm actually handled its Rule 144 deposits. They did not even reflect DiBlasi's true role. Even though he was purportedly the CCO, he claimed that he had nothing to do with the vast majority of the Firm's business. Essentially, he performed back-office functions for the Firm. The result of the deficiencies in the WSPs was that violations occurred and regulatory efforts to determine the persons responsible were hindered.

We suspend DiBlasi from associating with any FINRA member firm in any capacity for two years and fine him $50,000.

D. Cruz

The Guidelines provide with respect to an individual supervisor who fails to respond to red flags that, in egregious cases, an adjudicator should consider suspending the person in any or

[576] Guidelines at 7, General Principal Consideration 17.

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all capacities for up to two years or barring him. A fine of $5,000 to $73,000 also may be imposed.

Cruz's violation was egregious. As a lawyer with considerable background in the securities laws, he had the background that others did not to scrutinize the due diligence packages and identify red flags. Furthermore, as the person at the Firm everyone else depended upon for Rule 144 compliance, he knew that he was critical to the Firm's performance of its gatekeeping duty. He was the principal at the Firm who gave final approval to the sales of deposited securities, signing under a certification that the transactions, to his knowledge, were lawful. In light of these circumstances and the many aggravating factors identified above, Cruz's failure to recognize and appropriately address multiple red flags was inexcusable.

We suspend Cruz from associating with any FINRA member firm in any capacity for two years and fine him $50,000.

E. Respondents' Arguments For Lesser Sanctions Rejected

We reject Respondents' arguments for lesser sanctions. They assert that the relief requested by Enforcement cannot be reconciled with the Guidelines because the sanctions are more stringent than the recommended range.[577] However, the Guidelines are not absolute. They are recommendations. As provided in the Overview, adjudicators may impose sanctions outside the recommended range where the particular facts and circumstances make that appropriate.[578]

We are concerned that the misconduct here is the Firm's standard approach to processing deposits of stock certificates for sale. As long as the Firm continues with that check-the-box approach, without a meaningful evaluation of the information it collects, it is a risk to public investors. More stringent sanctions are necessary to emphasize the necessity for corrective action and to remediate the violation.

Respondents also compare their case to other cases involving Section 5 and supervisory violations, asserting that in those other cases the misconduct was worse and the sanctions less.[579] The appropriateness of sanctions, however, depends on the facts and circumstances of the particular case and cannot be determined by comparison to sanctions in other cases that involve different facts and circumstances.[580] Furthermore, Respondents' misconduct was far more egregious than Respondents acknowledge.

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[577] Resp. PH Br. 47.

[578] Guidelines at 1.

[579] Resp. PH Br. 47-49.

[580] *See, e.g., William Scholander*, Exchange Act Release No. 77492, 2016 SEC LEXIS 1209, at *42 & n.65 (Mar. 31, 2016).

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With respect to disciplinary history, Respondents argue that the individual Respondents have no disciplinary history.[581] It is well established that the absence of a disciplinary history is not mitigating as to sanctions. A wrongdoer should not be rewarded for acting in accord with his duties as a securities professional.[582]

In sum, we find that the sanctions we impose here are necessary, appropriate and remedial. They serve the twin goals of protecting public investors and contributing to market integrity.[583]

V. CONCLUSION

The Firm, Scottsdale Capital Advisors, violated FINRA Rule 2010. Accordingly, it is ordered to pay a fine of $1.5 million. John J. Hurry violated FINRA Rule 2010. For his misconduct he is barred from association with any FINRA member in any capacity. He would be fined $100,000, but, in light of the bar, the fine is not imposed. Timothy B. DiBlasi violated NASD Rules 3010(a) and (b) and FINRA Rule 2010. For his misconduct, he is suspended for two years from association with any FINRA member in any capacity and fined $50,000. D. Michael Cruz violated NASD Rule 3010(b) and FINRA Rule 2010. For his misconduct, he is suspended for two years from association with any FINRA member in any capacity and fined $50,000.

Respondents are also ordered to pay costs in the amount of $22,124.29, which includes a $750 administrative fee and $21,374.29 for the cost of the transcript. If this decision becomes FINRA's final disciplinary action, Hurry's bar will take immediate effect. DiBlasi's and Cruz's suspension will begin with the opening of business on August 21, 2017. The fines and assessed costs shall be due on a date set by FINRA, but not sooner than 30 days after this amended decision becomes FINRA's final disciplinary action in this proceeding.

Lucinda O. McConathy
Hearing Officer
For the Extended Hearing Panel

[581] Resp. PH Br. 47.

[582] *See, e.g., Kenny A. Akindemowo*, Exchange Act Release No. 78352, 2016 SEC LEXIS 2522, at *5 & n.5 (July 18, 2016). *See also* Guidelines at 6 and n.2.

[583] The Hearing Panel has considered and rejects without discussion any other arguments made by the Parties that are inconsistent with this decision.

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Copies to: Scottsdale Capital Advisors (via overnight and first-class mail)
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In the Kalamazoo County Circuit Court
For the State of Michigan

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff,

v.

MORNINGLIGHTMOUNTAIN, LLC, MICHAEL GOODE, and DOES 1-10,

Defendants.

Civil No. 18-0153-CZ

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MOTION FOR SUMMARY DISPOSITION OF FIRST AMENDED COMPLAINT

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Defendants MorningLightMountain, LLC ("MLM") and Michael Goode ask the Court to dismiss the First Amended Complaint with prejudice for failure to state a claim upon which relief can be granted.

Respectfully submitted,

BUTZEL LONG

Dated: JUNE 6, 2018

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SCOTTSDALE CAPITAL ADVISORS CORPORATION,

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MEMORANDUM SUPPORTING MOTION FOR SUMMARY DISPOSITION OF FIRST AMENDED COMPLAINT

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G	*FINRA* v. *Scottsdale Capital Advisors Corp.*, Am. Extended Hr'g Panel Decision (Jun. 20, 2017)

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QUESTIONS PRESENTED

This is a defamation action. As a matter of constitutional law, all torts predicated upon defamation, including invasion-of-privacy claims, must satisfy a special, heightened pleading standard that demands detailed facts supporting each element of the claim.

QUESTION NO. 1: Has Scottsdale satisfied the special, heightened pleading requirements required under constitutional law for its defamation claim?

QUESTION NO. 2: Corporate entities like Scottsdale have no legally cognizable right to privacy. Should the Court dismiss Scottsdale's privacy claim for failure to state a proper claim?

QUESTION NO. 3: If not, has Scottsdale satisfied the special, heightened pleading requirements required under constitutional law for its defamation-based privacy claim?

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Under MCR 2.116(C)(8), MLM and Mr. Goode offer this Memorandum in support of their Motion to dismiss the First Amended Complaint ("Complaint") with prejudice on summary disposition for failure to state a claim upon which relief can be granted.

INTRODUCTION

This is a defamation action. Scottsdale has sued MLM and Mr. Goode for allegedly libelous statements posted in online articles at goodetrades.com, a blog reporting on news about penny-stock trading.

A "penny stock" refers to a security issued by a very small company that trades at less than $5.00 per share.[1] Also known as "microcap stocks," penny stocks are issued by companies, many of which do not file financial reports with the U. S. Securities & Exchange Commission.[2] The SEC describes these securities as "among the most risky," suffering from a scarcity of publicly-available information that allows "fraudsters [to] easily spread false information about microcap companies, making profits while creating losses for unsuspecting investors."[3] They are very speculative investments, and Congress has tightly regulated broker-dealers who facilitate penny-stock trading under the Exchange Act.[4]

One fraud particularly affecting penny stocks is the classic pump-and-dump scheme. The scheme involves touting a company's stock through false and mislead-

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[1] U. S. Secs. & Exch. Comm'n, Penny Stock Rules (May 9, 2013) ("PENNY STOCK RULES") (available at http://bit.ly/SEC-Penny-Stock-Rules).

[2] United States Secs. & Exch. Comm'n, Microcap Stock: A Guide for Investors, Introduction (Sept. 13, 2013) ("Microcap Guide") (available at http://bit.ly/ SEC-Micro cap-Guide).

[3] *Id.*

[4] PENNY STOCK RULES, *supra* at n.1

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ing statements to the marketplace to ignite a buying frenzy that "pumps" the price of a stock (usually a penny stock). The hucksters then sell (or "dump") their stocks at the "pumped" up price, realizing a handsome profit. Once they dump their shares and stop hyping the stock, the price falls and investors lose their money.[5]

MLM and Mr. Goode reported on pump-and-dump schemes, including one involving stock in Biozoom, which was touted as a biomedical technology company. Before April 2013, Biozoom was known as Entertainment Art, Inc., and it produced leather bags. In April 2013, it announced that it was changing its name to Biozoom and exiting the leather-bag business to develop biomedical technology. From March 2013 (the month before the announcement) to June 2013, at least eight people opened accounts with broker-dealers and deposited millions of shares of Biozoom that they (falsely) claimed were purchased from the original shareholders of Entertainment Art in the previous few months and could be freely traded.[6] From May 16, 2013 to June 17, 2013, these people sold 14 million shares yielding almost $34 million, of which nearly $17 million was wired to overseas bank accounts.[7] Eventually, the stock collapsed. The SEC brought an enforcement action, *U.S. Securities & Exchange Comm'n* v. *Tavella*, to recover the ill-gotten gains and make swindled investors whole.[8]

Scottsdale, a broker-dealer that facilitated penny-stock trading and claims to be one of the dominant companies in the microcap securities market for handling

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[5] U.S. Secs. & Exch. Comm'n, "Pump-and-Dumps" and Market Manipulations (Jun. 25, 2013) (available at http://bit.ly/SEC-Pump-and-Dumps).

[6] Answer Exh. A, *U.S. Secs. & Exch. Comm'n* v. *Tavella*, Civ. No. 13-4609 (SDNY), Complaint at 2, ¶¶ 3–5 (Jul. 3, 2013).

[7] *Id.* at 2–3, ¶¶ 6–7.

[8] *See* Answer Exh. C, *Tavella* Biozoom Fair Fund Notice at 2, Plan of Allocation ("The purpose of this distribution is to compensate investors in the [*Tavella*] defendants misrepresentations and omissions in its sale of Biozoom common stock.")

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more than $125 million worth of trades in 2015 alone,[9] accepted Biozoom stocks for deposit and facilitated trading in the microcap market. Many of the trading accounts frozen through the SEC's enforcement action were held at Scottsdale.[10] And, notably, since Scottsdale filed this lawsuit against MLM and Mr. Goode, the SEC entered an order sanctioning Scottsdale's representative Timothy Scarpino for facilitating the sale of 8.2 million Biozoom shares that generated $18.5 million in gains—just over half the shares and half the gains—for the fraudsters.[11] His offense was "fail[ing] to conduct a searching inquiry into facts surrounding the proposed sales" of unregistered Biozoom stock, despite the presence of "significant red flags."[12]

Among other things, it was this same kind of failure to conduct searching inquiries that resulted in the Financial Industry Regulatory Authority taking disciplinary action against Scottsdale.[13] FINRA imposed a $1.5 million fine against Scottsdale for "institutionaliz[ing] misconduct as its standard way of doing business," among other aggravating factors.[14] Part of the institutionalized misconduct included

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[9] Complaint at 3, ¶ 11.

[10] Answer Exh. B, *U. S. Secs. & Exch. Comm'n* v. *Tavella*, Civ. No. 13-4609 (SDNY), Stipulation and Order Granting Prelim. Inj., Asset Freeze, and Other Relief (R. 16, Jul. 16, 2013); Answer Exh. D, Final J. Defs. Graciarena and Loureyro (R. 67, Dec. 8, 2014); Answer Exh. E, Final Default J. and Order Granting Inj. and Other Relief Against Defendants Tavella, Ficicchia, Blaya, Hernando, Lorenzo, Bagattin, Goldman, and Ferrari (R. 69, Jan. 9, 2015).

[11] Answer Exh. F, *In the Matter of Timothy C. Scarpino*, SEC No. 3-18483, Order Instituting Admin. and Cease-and-Desist Proceedings, Making Findings, Imposing Remedial Sanctions, and a Cease-and-Desist Order (May 15, 2018).

[12] *Id.* at 2, Part III, Summary.

[13] Answer Exh. G, *FINRA* v. *Scottsdale Capital Advisors Corp.*, No. 2014041724601, Amended Extended Hr'g Panel Decision (Jun. 20, 2017) (available at http://bit.ly/FINRA-Panel-Decision).

[14] *Id.* at 107, Part IV(A)(3).

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Scottsdale's failure to revise its procedures to focus on potential sham transactions after botching its gatekeeping role in the Biozoom pump-and-dump scheme that led to the SEC's enforcement action.[15]

FINRA had equally harsh words for Scottsdale's owner, John Hurry. FINRA found that he "violat[ed] his duty to observe high standards of commercial honor and just and equitable principles of trade," and it was "purposeful and egregious," which led FINRA to conclude that "[he] is a threat to investors and the integrity of the markets."[16] Worse yet, FINRA found that Mr. Hurry "repeatedly testified falsely, and that there was a pattern of doing so when he thought no contradictory evidence would come to light."[17] FINRA barred Mr. Hurry from associating with any other FINRA member for any reason.[18] Scottsdale and Mr. Hurry are appealing this decision.

Which brings us to this lawsuit. The statements that Scottsdale claims are libelous are contained within two articles written by Mr. Goode and published by MLM about three years after the Biozoom fraud. (The articles are attached to the Complaint, and are therefore "a part of the pleading for all purposes."[19]) Both articles include extensive quotations from FINRA proceedings, SEC press releases, and court records from SEC enforcement actions. They also include links and citations to those source records.

The first article (the "April Article") reported on FINRA's sanctions against Scottsdale and Mr. Hurry. The second article (the "June Article") was a follow-up article about FINRA's 111-page decision and new SEC enforcement action against

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15 *Id.* at 11–12, 101–102, 104.

16 *Id.* at 107, Part IV(B).

17 *Ibid.*

18 *Id.* at 108.

19 *Slater* v. *Ann Arbor Pub. Sch. Bd. of Educ.*, 250 Mich. App. 419, 427 (2002).

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another company with close ties to Scottsdale and Mr. Hurry. Scottsdale doesn't argue that the reporting about the FINRA and SEC actions is inaccurate. Rather, it plucks a few sentences from the articles and claims that they wrongfully accuse it of actively engaging in a pump-and-dump scheme. In context, however, the articles do nothing more than note that penny stocks were illegally traded through Scottsdale brokerage accounts. And the notion that these articles damaged Scottsdale in any way—much less in some way unique and independent of (*a*) FINRA castigating and fining Scottsdale, (*b*) FINRA excommunicating Mr. Hurry from the securities industry, and (*c*) the SEC's Biozoom enforcement actions—is risible.

This lawsuit is about one thing: shutting down free speech. It is commonly known as a "strategic lawsuit against public participation." It is brought with the intent to censor the speaker's message because it is unwanted, not because it is false or defamatory. But the First Amendment no more allows a "litigation veto" than it does a "heckler's veto."

For the reasons that follow, the Court should dismiss the Complaint with prejudice for failing to state a claim upon which relief can be granted.

SPECIAL STANDARD OF REVIEW FOR FIRST AMENDMENT CASES

As in all cases, motions for summary disposition brought under MCR 2.116(C)(8) in defamation actions test the legal sufficiency of the complaint.[20] The Court must limit its review to the pleadings—which by court rule includes both the complaint *and* the answer.[21] The Court must take the well-pleaded factual allegations

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[20] *Singerman* v. *Municipal Serv. Bureau*, 455 Mich. 135, 139 (1997).

[21] MCR 2.116(G)(5) (review of a (C)(8) motion is limited to the pleadings); MCR 2.110(A) (defining a pleading to include complaints and answers).

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as true and construe them in the light most favorable to the nonmoving party.[22]

Importantly, however, under *Bose Corp.* v. *Consumers Union*, courts have a special, heightened duty under the First Amendment to review the sufficiency of the allegations and evidence before them in defamation actions because of the constitutional implications for free speech.[23] Michigan courts take this duty seriously. Recognizing that summary disposition is "an essential tool" to protect against "forbidden intrusions into the field of free expression,"[24] our courts long ago adopted an *Iqbal*-like pleading standard that requires plaintiffs to specifically plead: (1) the defamatory words and the facts that would establish that the words are false; (2) the facts identifying the publication of those words to a third party; (3) the level of fault that must be proved and the facts that would establish that the speaker acted with that level of fault; and (4) the harm suffered by the publication.[25] Pleading specific facts is a "relatively simple requirement"; defendants are entitled to summary disposition under MCR 2.116(C)(8) "on this ground alone" when plaintiffs fail to follow it.[26]

Also important, in *Thomas M. Cooley Law School* v. *Doe 1*, the Michigan Court of Appeals held that the heightened pleading requirement in defamation cases permits courts to resolve several questions of law on the pleadings, including: (1) whether a statement is capable of being defamatory; (2) the nature of the speaker

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[22] *Dalley* v. *Dykema Gossett*, 287 Mich. App. 296, 304–305 (2010).

[23] *Bose Corp.* v. *Consumers Union*, 466 U. S. 485 (1984).

[24] *Kevorkian* v. *American Med. Ass'n*, 237 Mich. App. 1, 5 (1999) (citing *Ireland* v. *Edwards*, 230 Mich. App. 607, 613 and n.4 (1998)).

[25] *Gonyea* v. *Motor Parts Fed. Credit Union*, 192 Mich. App 74, 76–77 (1991). *Accord Ashcroft* v. *Iqbal*, 556 U. S. 662 (2009) (requiring plaintiffs in federal cases to "plausibly" plead claims through specific factual allegations).

[26] *Rouch* v. *Enquirer & News (After Remand)*, 440 Mich. 238, 279 (1992) ("*Rouch II*") (Riley, J., concurring).

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and the level of constitutional protections afforded to the statement; and (3) whether actual malice exists, if the plaintiff is required to show that level of fault.[27] In making these assessments, a court must read the challenged statement in context, fairly and reasonably construing the entire article to determine whether the challenged statement is libelous.[28] A statement "does not become actionable merely because it could be taken out of context."[29]

ARGUMENT

The Complaint does not state a claim under the heightened pleading standard for defamation cases. And, from what is pleaded, the Court can hold that the challenged statements are incapable of a defamatory meaning as a matter of law.

1. *No Defamation*: Scottsdale has not plausibly pleaded the elements for libel as to any of the allegedly defamatory statements.

In Michigan, a libel plaintiff must prove that the defendant: (1) made a false statement, (2) that was defamatory, (3) which was "of and concerning the plaintiff, (4) in the form of an unprivileged publication to a third party, (5) with a level of fault amounting to at least negligence on the part of the publisher, and (6) thereby damaged the plaintiff.[30]

A. *Fault Not Pleaded*: The Complaint fails to plead facts establishing that MLM and Mr. Goode acted negligently.

To adequately plead fault, a plaintiff must identify the level of fault that ap-

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[27] *Thomas M. Cooley Law School* v. *Doe 1*, 300 Mich. App. 245, 342 (2013).

[28] *Sanders* v. *Evening News Ass'n*, 313 Mich. 334, 340 (1946); *Croton* v. *Gillis*, 104 Mich. App. 104, 108 (1981).

[29] *Nehls* v. *Hillsdale Coll.*, 178 F. Supp. 2d 771, 779 (ED Mich. 2001), *aff'd* 65 Fed. Appx. 984 (CA6 2003) (citing Michigan law).

[30] *Northland Wheels Roller Skating Ctr.* v. *Detroit Free Press*, 213 Mich. App. 317, 323 (1995) (citing *Rouch II*).

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plies to the claim *and* allege facts that would establish that level of fault if proved.[31] There are two levels of fault: negligence and actual malice.[32] The negligence standard applies in cases involving private figures; the actual-malice standard applies in cases involving public officials and public figures.[33] Scottsdale alleges that it is a private figure and that MLM and Mr. Goode are the direct and proximate cause of its damages,[34] so it impliedly pleads the level of fault to be negligence.

Negligence is defined as the failure to use the care that an ordinary person would use under the circumstances.[35] Thus, in order to meet the *Iqbal*-like pleading standard, Scottsdale must plead facts as to what a reasonable reporter and publisher would have done under the circumstances and then plead that MLM and Mr. Goode failed to do it. It does not do this for any of the challenged statements in either of the two articles.

To the extent that Scottsdale apparently tries to plead actual malice in the alternative—"notwithstanding [its] status as a private figure, . . . [MLM and Mr. Goode] knew that the [challenged statements] were false and/or acted in reckless disregard of whether [they] were true or false"—the Complaint is likewise devoid of any factual allegations supporting *how* they knew the statements were false or *why* they were reckless in their alleged disregard of the truth.

Under *Rouch II*, a failure to plead both the level of fault that must be proved *and the facts that would establish that the speaker acted with that level of fault* entitles MLM and Mr. Goode to summary disposition under MCR 2.116(C)(8) "on this

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31 *Gonyea*, 192 Mich. App. at 76–77; *Rouch II*, 440 Mich. at 279.

32 *Ibid.*

33 *Ibid.*

34 Complaint at 6, ¶ 25.

35 Mich. Civ. J. Instr. 10.02

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ground alone."[36] The failure to plead any facts supporting negligence or actual malice is fatal to the Complaint.

B. *April Article*: None of the three statements identified in the April Article adequately pleads a claim for libel.

(1) Scottsdale has not pleaded facts sufficient to show that Statement No. 1 is false.

> *If you have followed penny stocks and pump and dumps for a few years then you know Scottsdale Capital Advisors.*

To be actionable, the challenged statement must be false.[37] Scottsdale has not plausibly pleaded that Statement No. 1 in the April Article is false.

Not False. Scottsdale alleges that Statement No. 1 is false because it has "never been involved in any 'pump and dump' schemes, has never been a defendant in any 'pump and dump' lawsuits, and has never been convicted of engaging in 'pump and dump' activity."[38] But, on its face, Statement No. 1 doesn't accuse Scottsdale of any of these things. It simply says that those who have followed pump-and-dumps know about Scottsdale. And that statement is true by Scottsdale's own allegations. It admits that it's a broker-dealer in penny stocks.[39] It also admits that accounts traded through Scottsdale were frozen in connection with the Biozoom pump-and-dump scheme.[40] It is factually accurate to note that observant readers, who have followed news about pump-and-dumps (particularly the "big Biozoom pump") would be familiar with Scottsdale's name.[41]

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36 *Rouch II*, 440 Mich. at 279 (Riley, J., concurring).

37 *Northland Wheels*, 213 Mich. App. at 323.

38 First Am. Compl. at 4, unnumbered paragraph immediately after ¶ 13a.

39 *Id.* at 3, ¶ 11.

40 *Id.* at 4, ¶ 13c and unnumbered paragraph immediately thereafter.

41 *Id.* at Exh. 1, ¶ 1.

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(2) Scottsdale has not pleaded facts sufficient to show that Statement No. 2 is false or capable of defamatory meaning.

> *They are one of the few brokers left that have continued to allow the deposit and sale of shares of illiquid penny stocks. Larger brokers and discount brokers stopped allowing that over five years ago.*

Scottsdale has failed to plausibly plead a claim for libel based on this statement because it is neither false nor defamatory.

Not False. Statement No. 2 says that Scottsdale is one of the few brokers that still allow both the deposit and trade of penny stock. Scottsdale says Statement No. 2 is false because many other brokers still trade in penny stocks.[42] But there is a difference between *trading existing shares* of penny stocks and accepting the *deposit of new shares*. Scottsdale does not allege that any of the brokers it identifies in the Complaint accept the deposit of new penny stocks. Thus, it has not pleaded facts showing that Statement No. 2 is false.

Not Defamatory. In any event, nothing about Statement No. 2 is defamatory. It does not say or imply that there is anything illegal or improper about accepting the deposit of shares of penny stocks. Indeed, the statement acknowledges that a few other brokers do, in fact, accept penny stocks for deposit. It simply notes that most brokers have exited this segment of the securities market. There is nothing defamatory in stating that Scottsdale and a few others continue to serve a niche area.

(3) Scottsdale has not pleaded facts sufficient to show that Statement No. 3 is false or capable of defamatory meaning; and the statement is protected by the fair-report privilege.

> *"When the big Biozoom (BIZM) pump happened back in 2013 many of the frozen accounts were at Scottsdale Capital."*

Scottsdale has likewise failed to plausibly plead a claim for libel based on this statement because it too is neither false nor defamatory. The statement is also pro-

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[42] *Id.* at 4, unnumbered paragraph immediately after ¶ 13b.

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tected under the statutory fair-report privilege.

Not False. Statement No. 3 says that "many of the frozen [Biozoom] accounts" were at Scottsdale. Scottsdale alleges that this is false for two reasons, but both reasons are non-sequiturs.

First, Scottsdale says that "only a handful" of Scottsdale accounts were frozen because of the Biozoom scam.[43] This may well be true—and the Court must accept this allegation as true for purposes of this Motion—but that isn't what MLM and Mr. Goode said. They said that "many of the frozen accounts" were at Scottsdale. While the number of frozen accounts might represent a small percentage of Scottsdale's overall brokerage accounts, they represent "many" of the accounts frozen in the Biozoom enforcement litigation. Tellingly, Scottsdale does not allege otherwise.

Second, Scottsdale says it has "never been a defendant in any lawsuit involving the trading of Biozoom stock."[44] Even accepting this as true, Statement No. 3 doesn't say that Scottsdale was sued in connection with the Biozoom scam. It simply notes that accounts at Scottsdale were frozen.

Not Defamatory. A defamatory communication is one that "tends so to harm the reputation of persons so as to lower them in the estimation of the community or to deter others from associating or dealing with them."[45] Publishing the mere fact that accounts were frozen at Scottsdale is not defamatory. Criminals frequently use third parties to facilitate their wrongdoing. Embezzlers may deposit their ill-gotten gains in bank accounts. When the government learns of the theft, it seizes the funds in the bank accounts for restitution and other purposes. No one would ever

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[43] *Id.* at 4, unnumbered paragraph immediately after ¶ 13c.

[44] *Ibid.*

[45] *Locricchio* v. *Evening News Ass'n*, 438 Mich. 84, 115 (1991).

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credibly argue that a newspaper reporting on such seizures defames *the bank*. Here, the brokerage accounts and the funds acquired from trading Biozoom stocks are like the embezzled funds and Scottsdale is like the bank. Reporting that Biozoom accounts at Scottsdale were frozen in connection with a pump-and-dump scheme no more lowers Scottsdale's reputation in the community than it would lower the bank's reputation.

Privileged Statement. Finally, Statement No. 3 is protected by the statutory fair-report privilege, which provides: "Damages shall not be awarded in a libel action for the publication or broadcast of a fair and true report of *matters of public record* ...."[46] The U.S. District Court for the Southern District of New York froze the defendants' Biozoom accounts in connection with the SEC's enforcement action in *Tavella*.[47] Most of the *Tavella* defendants had trading accounts at Scottsdale for Biozoom stock that were frozen and/or recovered.[48] Accordingly, the statement is a fair and true report of a matter of public record. It is not actionable.

C. *June Article*: The statement identified in the June Article does not support a claim for defamation, either.

> *Lest anyone think that these are just minor paperwork deficiencies with no real consequences, I remind you that one pump and dump alone, Biozoom (BIZM) led to over $17 million in fraudulent profits for manipulators/insiders, and many of their accounts were at Scottsdale Capital.*

Scottsdale plucks this sentence out of a three-page article without regard for its context. As noted earlier, the Court must fairly and reasonably construe the en-

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[46] MCL 600.2911(3) (emphases added).

[47] Answer at 7–8, Answer to Compl. ¶ 13, and Answer Exhs. A–E. (The exhibits are part of the pleadings under MCR 2.113(F)(2)). *See also Slater*, 250 Mich. App. at 427.

[48] Answer at 7–8, Answer to Compl. ¶ 13, and Answer Exhs. A–E.

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tire article to determine whether a statement is libelous.[49]

The challenged statement in the June Article comes after quoting excerpts from FINRA's disciplinary order against Scottsdale and Mr. Hurry for doing an exceedingly poor job at preventing illegal sales by penny-stock insiders.[50] The statement also follows extended excerpts from an SEC press release and the SEC's lawsuit against Scottsdale-affiliate Alpine Securities Corporation, which cleared thousands of suspicious deposits of penny stock introduced by Scottsdale.[51] The Patriot Act requires broker-dealers to monitor and report suspicious trading activity to help crack down on money laundering.[52] Charging Scottsdale's affiliate with thousands of reporting violations, the SEC alleged in its complaint that Scottsdale's affiliate routinely and systematically failed to file Suspicious Activity Reports ("SARs") with the U.S. Treasury Department's Financial Crimes Enforcement Network for stock transactions that the affiliate had internally flagged as suspicious.[53] And, when it did file SARs, the affiliates allegedly omitted the very information that formed the bases for knowing, suspecting, or having reason to suspect that a transaction was suspicious.[54]

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[49] *Sanders*, 313 Mich. at 340; *Croton*, 104 Mich. App. at 108.

[50] Complaint Exh. 2 at 1–2.

[51] *Ibid* (citing *U. S. Secs. & Exch. Comm'n* v. *Alpine Secs. Corp.*, No. 17-04179 (SDNY) (R. 1, Compl., Jun. 5, 2017), and quoting SEC Litig. Release No. 23853 (Jun. 5, 2017) (available at http://bit.ly/SEC-Alpine-Litigation-Release).

[52] 31 U.S.C. §§ 3512(a)(2)(G) and 3518; 31 C.F.R. § 1023.320.

[53] Complaint Exh. 2 at 2.

[54] *Ibid.* Interestingly, although not offered in support of the Motion because it is beyond the pleadings, a federal court has since ruled that the SARs, when filed, were so "woefully inadequate" as a matter of law as to warrant partial summary judgment for the government. *Alpine Secs. Corp.*, No. 17-04179 (SDNY), Order on Mot. for Summ. J., R. 101 at 65 (Mar. 30, 2018).

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The challenged statement must be assessed against this backdrop. By failing to investigate and report suspicious activity, opportunities are lost to prevent criminal activity, including securities fraud. The challenged statement gives an example of how investors lost tens of millions of dollars to securities fraud when a broker-dealer was asleep at the switch. It contains nothing false. Given the FINRA disciplinary action, Scottsdale has an *adjudicated* track record of failing to diligently investigate penny stocks before accepting them for deposit, which in the case of Biozoom permitted fraudsters to steal almost $34 million from investors through trading facilitated by Scottsdale. On this point, it is noteworthy that Scottsdale has *not* alleged that the first sentence in the June Article is false: "As I wrote back in April, FINRA fined Scottsdale Capital Advisors $1.5 million *for doing a really poor job at preventing illegal sales by penny stock insiders.*"[55]

2. *No False Light:* The Complaint does not adequately plead a claim for invasion of privacy by false light.

A. *No Corporate Right to Privacy*. Corporations cannot assert a claim for invasion of privacy because they have no legal right to privacy.

Businesses cannot maintain tort claims for invasion of privacy, by false light or otherwise. In *Booth Newspapers, Inc.* v. *Kent County Treasurer*, the Michigan Court of Appeals held that corporations have no right to privacy under the State constitution or at common-law: "Since the right to privacy is primarily designed to protect the feelings and sensibilities of human beings rather than to safeguard property, business, or other pecuniary interests, the courts have denied this right to corporations and other institutions."[56] Scottsdale is erroneously attempting to assert a right

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[55] Complaint Exh. 2 at 1, ¶ 1 (emphasis added).

[56] *Booth Newspapers, Inc.* v. *Kent County Treas.*, 175 Mich. App. 523, 528–529 (1989). *See also* R. Sack, Defamation § 12:3.5 (5th ed. 2018) (citing Restatement

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it does not have. The Court should not permit it to do so.

B. *No Private Facts.* The challenged statements are all about matters of public record, which cannot support a privacy claim.

Even if corporations could assert privacy claims, it is blackletter law that information already a matter of public knowledge or of public record *cannot* serve as the basis for an invasion of privacy claim.[57] Here, Scottsdale's connection to the Biozoom pump-and-dump is a matter of public record in the SEC enforcement proceedings in *Tavella*, *Villena*, and *Scarpino*, and in the FINRA disciplinary proceeding against Scottsdale and Mr. Hurry. Discussing these matters of public record, *complete with links to the source documents*, defeats any possible privacy claim.

C. *No False Statement.* Scottsdale does not adequately allege that the challenged statements are false.

The heightened First Amendment pleading and proof standards apply equally to privacy torts predicated upon defamation.[58] So, because Scottsdale hasn't adequately pleaded that the challenged statements are false for defamation purposes, it also hasn't adequately pleaded falsity for its privacy claim.

D. *No Actual Malice Pleaded.* Scottsdale does not adequately allege that MLM and Mr. Goode published the challenged statements with actual malice.

Even if corporations could assert privacy claims and the relevant public records did not automatically defeat Scottsdale's claim, it would still fail as pleaded. The elements of this claim are: (1) that the defendant broadcast a communication to the

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(Second) of Torts § 652I Comment *c* (1997), and collecting State and federal cases applying this rule).

[57] *Cf. Doe* v. *Mills*, 212 Mich. App. 73, 82 (1995) (so holding in a case involving a claim for invasion of privacy by public disclosure of embarrassing facts).

[58] *Ireland*, 230 Mich. App. at 624.

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public or a large number of people; and (2) the communication placed the plaintiff in a light that would be highly offensive to a reasonable person; with (3) knowledge that the publicized matter was false or reckless disregard for the false light in which the plaintiff would be placed.[59] The communications at issue are the same challenged statements that Scottsdale relies upon for its defamation claim; there are no new facts offered in support of its privacy claim. Although Scottsdale generically alleges that MLM and Mr. Goode "knew" that the challenged statements were false (or that they recklessly disregarded their falsity), the Complaint is devoid of any facts alleging *how* they knew the statements were false or *why* they recklessly disregarded whether the statements were false. Under *Rouch II*, this automatically dooms the claim.

3. *Dismissal with Prejudice:* Scottsdale cannot cure the flaws in the Complaint by further amendment.

Leave to amend should be withheld when amendment would be futile.[60] Amendment would be futile in this case because: (1) all of the statements are true when considered in light of FINRA's disciplinary proceeding and the SEC's enforcement proceedings; and (2) corporations cannot assert privacy claims. Accordingly, the Court should dismiss this case with prejudice.

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[59] *Early Detection Ctr., P.C.* v. *New York Life Ins. Co.*, 157 Mich. App. 618, 630 (1986).

[60] *Allegheny-Ludlam Corp.* v. *Michigan Dept. of Treas.*, 207 Mich. App. 604, 605 (1994).

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PRAYER FOR RELIEF

For these reasons, MLM and Mr. Goode respectfully request that the Court grant summary disposition in their favor under MCR 2.116(C)(8) and dismiss the Complaint with prejudice.

Respectfully submitted,

BUTZEL LONG

Dated: JUNE 6, 2018

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JUDGE BUCHWALD

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

MAGDALENA TAVELLA, ANDRES HORACIO FICICCHIA, GONZALO GARCIA BLAYA, LUCIA MARIANA HERNANDO, CECILIA DE LORENZO, ADRIANA ROSA BAGATTIN, DANIELA PATRICIA GOLDMAN, MARIANO PABLO FERRARI, MARIANO GRACIARENA, and FERNANDO LOUREYRO,

Defendants.

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CASHIERS

Civil Action No.

Jury Trial Demanded

COMPLAINT

Plaintiff Securities and Exchange Commission (the "Commission") for its Complaint alleges as follows:

1. The Commission brings this civil law enforcement action against Magdalena Tavella, Andres Horacio Ficicchia, Gonzalo Garcia Blaya, Lucia Mariana Hernando, Cecilia De Lorenzo, Adriana Rosa Bagattin, Daniela Patricia Goldman, and Mariano Pablo Ferrari (collectively, the "Selling Defendants") on an emergency basis to prevent millions of dollars of proceeds from unlawful sales of securities being transferred out of the country. Over the past month, the Selling Defendants have sold almost $34 million worth of securities in Biozoom, Inc. ("Biozoom") (f/k/a Entertainment Art, Inc.), a penny stock company traded on the Over-the-Counter Bulletin Board ("OTCBB"), and

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millions more shares are sitting in defendants' brokerage accounts and likely to be sold unlawfully to the public. No registration statement was in effect for the Selling Defendants' resale of securities, thus their sales were in violation of Section 5 of the Securities Act of 1933 (the "Securities Act") [15 U.S.C. § 77e]. Further, almost $17 million of the Selling Defendants' ill-gotten proceeds have been transferred out of the United States. Unless an asset freeze covering the Selling Defendants' Biozoom shares is issued, the unlawful sales of securities and transfer or dissipation of the proceeds from sales of the securities will likely continue.

2. The Commission also brings this civil law enforcement action against Mariano Graciarena and Fernando Loureyro. These defendants recently deposited over a total of approximately 4.4 million shares of Biozoom stock into their respective brokerage accounts. Like the shares sold by the Selling Defendants, there is no registration statement in effect permitting the lawful resale of the Biozoom shares held by Graciarena and Loureyro. Because Graciarena and Loureyro are likely to engage in the sale of securities in violation of Section 5 of the Securities Act, the Commission seeks to enjoin them from offering for resale their Biozoom shares until such time as a registration statement is filed and in effect.

3. From March 2013 to June 2013, defendants opened brokerage accounts at broker-dealers and deposited millions of shares of Biozoom, Inc. (f/k/a Entertainment Art, Inc.) that they claimed did not bear a restrictive legend and were free-trading shares. All of the defendants claimed that they had purchased all or some of their shares from some of the original shareholders of Entertainment Art in transactions between November 2012 and March 2013.

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4. To bolster their claims, each of the defendants submitted stock purchase agreements dated between November 2012 and March 2013 that purportedly evidenced their purchase of Entertainment Art stock from the former Entertainment Art shareholders. Based on these stock purchase agreements and other documentation, the defendants – between March 2013 and June 2013 – deposited a total of 20,130,000 shares of Biozoom into their brokerage accounts.

5. The defendants could not, however, have purchased any of their shares from the original Entertainment Art shareholders as they claimed because those shareholders ceased to have any interest in the company on or around May 2009 –more than *three years* earlier than the defendants' claimed purchases.

6. Almost immediately after defendants deposited shares of Biozoom in their brokerage accounts, Biozoom began issuing a series of press releases and a stock promotional campaign for the company began. Following these press releases and stock promotional campaign, from May 16, 2013 to June 21, 2013, the company's stock price and volume increased dramatically. For example, prior to May 16, 2013, no shares in Biozoom had traded. However, from May 16, 2013 to June 21, 2013, Biozoom's stock price shot past $4 per share, with total volume of more than 87 million shares.

7. During this same period, eight of the defendants sold millions of Biozoom shares into the rising market — reaping millions of dollars in proceeds as a result. In total, over an approximately one month period from May 16, 2013 – June 17, 2013, eight of the defendants sold a total of over 14 million shares of Biozoom stock into the public markets for proceeds of almost $34 million.

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8. None of these sales were made pursuant to an effective registration statement. By engaging in the foregoing conduct, the eight Selling Defendants violated the registration provisions of the federal securities laws, Sections 5(a) and 5(c) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. 15 U.S.C. §§ 77e(a) and 77e(c)].

9. While the remaining two defendants – Graciarena and Loureyro – have yet to sell any of their Biozoom shares, they are likely to do so unless restrained. They recently deposited millions of shares into their respective brokerage accounts, claiming (as the other defendants) that these shares have no restrictive legend and are available for resale to the public. Therefore, the Commission seeks an order pursuant to Securities Act Section 20(b) [15 U.S.C. 77t(b)] to enjoin them from violations of Sections 5(a) and 5(c) of the Securities Act.

JURISDICTION AND VENUE

10. The SEC brings this action pursuant to Section 5 [15 U.S.C. § 77e] and Section 20(b) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. § 77t(b)]. Defendants have directly or indirectly made use of the means or instrumentalities of interstate commerce, or of the mails, or the facilities of a national securities exchange in connection with the acts, practices, transactions, and courses of business alleged in this Complaint.

11. This Court has jurisdiction over this action pursuant to Section 22 of the Securities Act [15 U.S.C. § 77v], and 28 U.S.C. § 1331.

12. Venue is proper in this Court pursuant to Section 22(a) of the Securities Act [15 U.S.C. §77v], because certain acts, practices, and courses of business constituting the violations alleged herein have occurred within the Southern District of New York.

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13. Defendants will, unless restrained and enjoined, continue to engage in the acts, practices, transactions, and courses of business alleged in this Complaint, or in acts, practices, transactions, and courses of business of similar purport and object.

THE DEFENDANTS

14. Defendant Andres Horacio Ficicchia resides in Buenos Aires, Argentina and is an Argentine citizen.

15. Defendant Gonzalo Garcia Blaya resides in Buenos Aires, Argentina, and is an Argentine citizen.

16. Defendant Luciana Mariana Hernando resides in Buenos Aires, Argentina, and is an Argentine citizen.

17. Defendant Cecilia De Lorenzo resides in Buenos Aires, Argentina, and is an Argentine citizen.

18. Defendant Magdalena Tavella resides in Buenos Aires, Argentina, and is an Argentine citizen.

19. Defendant Adriana Rosa Bagattin resides in Buenos Aires, Argentina, and is an Argentine citizen.

20. Defendant Daniela Patricia Goldman resides in Buenos Aires, Argentina, and is an Argentine citizen.

21. Defendant Mariano Pablo Ferrari resides in Buenos Aires, Argentina, and is an Argentine citizen.

22. Defendant Mariano Graciarena resides in Buenos Aires, Argentina, and is an Argentine citizen.

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23. Defendant Fernando Loureyro resides in Buenos Aires, Argentina, and is an Argentine citizen.

OTHER RELEVANT ENTITIES

24. Biozoom, Inc. (f/k/a Entertainment Arts, Inc.) is a Nevada corporation with its principal place of business in Kassel, Germany. Biozoom purports to be in the business of researching, developing, and licensing technologies relating to the mobile remote collection of biomedical data as well as bilateral diagnostic communication. Biozoom's common stock is registered with the Commission pursuant to Section 12 of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. §78l] and is quoted on the Over-the-Counter Bulletin Board ("OTCBB") under the trading symbol "BIZM."

25. Legend Securities ("Legend") is a registered broker-dealer located in New York, New York.

26. Scottsdale Capital Advisors ("Scottsdale") is a registered broker-dealer located in Phoenix, Arizona.

FACTUAL BACKGROUND

A. The Creation of Entertainment Art and Initial Sale of Company

27. On June 15, 2007, Entertainment Art was incorporated under the laws of the state of Nevada. In public filings, Entertainment Art represented that it was a developmental stage company formed to design, produce, and sell a line of leather bags, with offices located in West Hempstead, New York. Entertainment Art was controlled by the three members of company management.

28. From November 2007 through March 2008, Entertainment Art offered and sold a total of 610,000 shares to 34 different investors in private placement transactions.

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A share certificate reflecting Entertainment Art share ownership was issued to each investor.

29. On July 18, 2008, Entertainment Art filed a Form S-1 registration statement with the Commission to register the resale transactions for the 34 shareholders who acquired Entertainment Art stock in these private placements ("the Form S-1 Shareholders"). In particular, of the total 1,810,000 shares outstanding at the time of the Form S-1, Entertainment Art's S-1 covered 610,000, or approximately one-third, of the company's then outstanding shares.

30. The remaining 1,200,000 shares of Entertainment Art stock were held by the three company officers in three identical 400,000 share blocks.

31. On May 1, 2009, Entertainment Art announced, in a public filing with the Commission, that the three Entertainment Art officers sold their total 1,200,000 shares of Entertainment Art to Medford Financial Ltd. ("Medford Financial"), a Belizean entity, for a purchase price of $120,000.

32. Contrary to this disclosure, however, Medford Financial purchased more than 1,200,000 shares of Entertainment Art. In fact, Medford Financial also purchased all of the 610,000 shares that had been purchased by the Form S-1 shareholders. Thus, in this transaction, Medford Financial purchased *all* of the outstanding shares, including the shares then held by the Form S-1 Shareholders.

33. Each of the Form S-1 shareholders received their initial investment back, with an additional, small return on their investment. Thus, by on or around May 2009, each of the Form S-1 shareholders had no remaining shares or other interest in Entertainment Art.

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34. According to company filings, on June 30, 2009, Entertainment Art's board of directors approved the implementation of a 33:1 forward split for Entertainment Art stock without correspondingly increasing the authorized shares of common stock for Entertainment Art. On July 21, 2009, the forward split became effective, and as a result of the forward split, the company had 59,730,000 shares of common stock outstanding – which was ***all*** owned by Medford Financial.

B. Another Sale of Entertainment Art and Acquisition of Biozoom Technology

35. On October 25, 2012, Entertainment Art reported, in a public filing with the Commission, that on October 19 Medford Financial sold 39,600,000 common shares of Entertainment Art in a private transaction with Le Mond Capital for a purchase price of $430,000, which equates to approximately $0.01 per share.

36. Le Mond Capital purports to be a foreign entity based in the British Virgin Islands. As a result of the sale, Entertainment Art disclosed that Le Mond Capital controlled over 66.3% of the Company's issued and outstanding common stock.

37. However, on information and belief, Le Mond Capital purchased the *entire* company from Medford Financial – and all of 59,730,000 outstanding shares.

38. The owner of Le Mond Capital, Sara Deutsch, became Entertainment Art's new President, Chief Executive Officer, Principal Executive Officer, Treasurer, Chief Financial Officer, Secretary, Treasurer, and Director. On information and belief, Deutsch is a resident of Buenos Aires, Argentina.

39. From September 2011 to at least October 2012, Deutsch worked as a manager of Magdalena's Party. According to the business' website, Magdalena's Party is

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a restaurant located in Buenos Aires, Argentina. According to another website describing Magdalena's Party, it is co-owned by Deutsch, defendant Magdalena Tavella, and others.

40. On March 12, 2013, Entertainment Art filed a Form 8-K with the Commission in which it announced a dramatic change in its business operations from a company that developed fashionable leather bags to a company that was involved in the biomedical industry. In particular, Entertainment Art announced a transaction pursuant to which its newly formed subsidiary, Biozoom Technologies, Inc., acquired certain patents, licenses, and related assets from each of three separate companies: Opsolution Spectroscopic Systems, Opsolution NanoPhotonics, and Opsolution GmBH, (the "Opsolution acquisition") in exchange for cash of $50,000 and 39 million shares of Entertainment Art common stock.

41. Entertainment Art described that, through Biozoom, it was now in the business of "researching, developing, and licensing technologies relating to the mobile remote collection of biomedical data as well as bilateral diagnostic communication."

42. Entertainment Art further disclosed that – as of immediately after closing of the Opsolution acquisition and filing of the Form 8-K – Deutsch would step down as CEO and Chief Financial Officer of Entertainment Art, but would stay on as a Director only.

43. As a result of the transaction, the 59,730,000 outstanding shares of Entertainment Art were allocated in the following manner. First, Le Mond Capital returned 39,000,000 shares to the company, and then those 39,000,000 shares were allocated – as shares bearing a restrictive legend – to four entities that were associated with the Opsolution entities.

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44. Thus, after these allocations, 20,730,000 shares of Entertainment Art remained. Le Mond Capital retained 600,000 of these shares bearing a restrictive legend. The remaining 20,130,000 shares – which represented the total shares purchased by the Form S-1 Shareholders (and subsequently sold in the Medford Financial transaction on or around May 2009) – were unallocated.

45. . On April 1, 2013, Entertainment Art changed its name to Biozoom, under the trading symbol "BIZM" on the OTC Bulletin Board.

C. Defendants Deposit Biozoom Shares In Their Newly Opened Brokerage Accounts

46. From January 2013 to May 2013, brokerage accounts were opened at Legend, a registered broker-dealer based in New York, in the name of four of the defendants: Ficicchia, Blaya, Hernando, and De Lorenzo.

47. In May 2013, brokerage accounts were opened at Scottsdale, a registered broker-dealer based in Phoenix, Arizona, in the name of another four defendants: Tavella, Bagattin, Goldman, and Ferrari.

48. According to the account opening documentation – and as reflected in the table below – with one exception, none of the defendants worked in fields related to securities.

Defendant	Profession
Ficicchia	Self-employed music producer
Blaya	Music producer-stock investments
Hernando	Marketing Manager
De Lorenzo	Self-employed marketing specialist

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Defendant	Profession
Tavella	Attorney practicing administrative, political, intellectual property, and patent law
Bagattin	Retired Teacher
Ferrari	Sales and Marketing
Goldman	Delicatessen owner

1. Accounts at Legend

Andres Horacio Ficicchia

49. Defendant Ficicchia opened his account at Legend on or about January 24, 2013 and funded the account with $26,000 cash.

50. On November 30, 2012, Entertainment Art's transfer agent issued an Entertainment Art certificate for 165,000 shares to Ficicchia.

51. On March 13, 2013, Entertainment Art's transfer agent issued an Entertainment Art certificate for 1,237,500 shares to Ficicchia.

52. The certificate for 1,237,500 shares was accompanied by a corporate certification stating that Deutsch certified – at a board meeting of Entertainment Art on March 22, 2013 – the company approved the issuance of that certificate to Ficicchia.

53. In order to deposit the certificate for 1,237,500 shares and the certificate of 165,000 shares of Entertainment Art into his brokerage account at Legend, defendant Ficicchia completed a "Deposit for Securities Request Certificate Questionnaire" that was required by Legend, and provided additional documentation.

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54. The documentation reflected that Ficicchia acquired the 1,237,500 shares pursuant to two private sales that were completed on February 19, 2013: (1) a purchase of 412,500 shares from Investor A and (2) a purchase of 825,000 shares from Investor B. The documentation also reflected that Ficicchia paid a total of approximately $6,300 for these shares, which equals approximately $.005 per share. For the following reasons, the documentation submitted by Ficicchia was false.

55. Investor A was one of the Form S-1 shareholders who had sold his shares of Entertainment Art on or around May 2009 – almost four years before Ficicchia's claimed purchase of shares from Investor A. Investor B was purportedly a shareholder that acquired its shares from some of the Form S-1 shareholders in 2011 – approximately two years after the Form S-1 shareholders actually sold their shares.

56. The documentation further reflected that Defendant Ficicchia acquired the 165,000 shares pursuant to a private sale that was completed on November 30, 2012 with Investor C – shares that he acquired for $24,750, which equals $0.15 per share. Investor C was also one of the Form S-1 Shareholders who had sold his shares of Entertainment Art on or around May 2009 – over three years before Ficicchia's claimed purchase of shares from Investor C.

57. On March 5, 2013, Ficicchia deposited 165,000 shares of Entertainment Art not bearing a restrictive legend into his brokerage account at Legend; and then on March 27, 2013, Ficicchia deposited an additional 1,237,500 shares (again not bearing a restrictive legend) – for a total of 1,402,500 shares.

58. On April 1, 2013, due to the name change of Entertainment Art to Biozoom, these shares became Biozoom shares. Thus, defendant Ficicchia held

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1,402,500 shares of Biozoom that were purportedly available to be sold on the public markets.

Gonzalo Garcia Blaya

59. On or about March 26, 2013, defendant Blaya opened an account at Legend and funded this account with $26,000 cash.

60. On March 22, 2013 – just four days prior to opening this account – Entertainment Art's transfer agent issued a certificate for 1,485,000 Entertainment Art shares to Blaya.

61. In order to deposit his certificate for 1,485,000 shares of Entertainment Art into his brokerage account at Legend, defendant Blaya completed a "Deposit for Securities Request Certificate Questionnaire" that was required by Legend, and provided additional documentation. For the following reasons, the documentation submitted by Blaya was false.

62. The documentation reflected that Blaya acquired the 1,485,000 shares in four separate private sales that were completed on March 4, 2013: (1) a purchase of 165,000 shares from Investor D; (2) a purchase of 495,000 shares from Investor E; (3) a purchase of 165,000 shares from Investor F; and (4) a purchase of 660,000 shares from Investor G. The documentation also reflected that Blaya paid a total of approximately $6,765 for these shares, which equals approximately $.005 per share.

63. Each of Investors D, E, F, and G were Form S-1 Shareholders who had sold their Entertainment Art shares on or around May 2009 – almost four years before Blaya's claimed purchase of shares from these investors.

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64. On April 16, 2013, Blaya deposited 1,485,000 shares of Entertainment Art not bearing a restrictive legend into his brokerage account at Legend. As a result of the business name change on April 1, 2013, these shares became Biozoom shares. Thus, defendant Blaya held 1,485,000 shares of Biozoom that were purportedly available to be sold on the public markets.

Luciana Mariana Hernando

65. On or about March 7, 2013, defendant Hernando opened an account at Legend and funded the account with $50,000 cash.

66. On March 22, 2013, Entertainment Art's transfer agent issued a certificate for 1,815,000 Entertainment Art shares to Hernando.

67. In order to deposit her 1,815,000 shares of Entertainment Art into her brokerage account at Legend, defendant Hernando completed a "Deposit for Securities Request Certificate Questionnaire" that was required by Legend, and provided additional documentation. For the following reasons, the documentation submitted by Hernando was false.

68. The documentation reflected that Hernando acquired the 1,815,000 shares pursuant to two separate private sales that were completed on March 5, 2013: (1) a purchase of 1,650,000 shares from Investor H; and (2) a purchase of 165,000 shares from Investor I. The documentation also reflected that Hernando paid a total of approximately $5,445 for these shares, which equals approximately $.003 per share.

69. Both Investors H and I were Form S-1 shareholders who had sold their Entertainment Art shares on or around May 2009 – almost four years before Hernando's claimed purchase of shares from these investors.

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70. On May 14, 2013, defendant Hernando deposited 1,815,000 shares of Entertainment Art not bearing a restrictive legend into her brokerage account at Legend Securities. As a result of the business name change on April 1, 2013, these shares became Biozoom shares. Thus, defendant Hernando held 1,815,000 shares of Biozoom that were purportedly available to be sold on the public markets.

Cecilia De Lorenzo

71. On or about February 4, 2013, defendant De Lorenzo opened an account at Legend and funded the account with $50,000 cash.

72. On March 13, 2013, Entertainment Art's transfer agent issued a certificate for 2,062,500 shares to De Lorenzo.

73. The certificate was accompanied by a corporate certification stating that Deutsch certified – at a board meeting of Entertainment Art on March 22, 2013 – the company approved the issuance of the above certificate to De Lorenzo.

74. In order to deposit her 2,062,500 shares of Entertainment Art into her brokerage account at Legend, De Lorenzo completed a "Deposit for Securities Request Certificate Questionnaire" that was required by Legend, and provided additional documentation. For the following reasons, the documentation submitted by De Lorenzo was false.

75. The documentation reflected that De Lorenzo acquired the 2,062,500 shares pursuant to two separate private sales that were completed on February 19, 2013 – the same day as the purported purchases of Entertainment Art stock by Ficicchia: (1) a purchase of 1,650,000 shares from Investor J; and (2) a purchase of 412,500 shares from

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Investor K. The documentation also reflected that Defendant De Lorenzo paid a total of approximately $8,300 for these shares, which equals approximately $.004 per share.

76. Both Investors J and K, however, were Form S-1 shareholders who had sold their Entertainment Art shares on or around May 2009 – almost four years before defendant De Lorenzo's claimed purchase of shares from these investors.

77. On March 22, 2013, defendant De Lorenzo deposited 2,062,500 shares of Entertainment Art not bearing a restrictive legend into her brokerage account at Legend. As a result of the business name change on April 1, 2013, these shares became Biozoom shares. Thus, defendant De Lorenzo held 2,062,500 shares of Biozoom that purportedly could be sold on the public markets.

2. Accounts at Scottsdale

Magdalena Tavella

78. On March 22, 2013, Entertainment Art's stock transfer agent issued a certificate for 1,815,000 shares of Entertainment Art to Tavella.

79. On or about May 16, 2013, defendant Tavella opened an account at Scottsdale.

80. In order to deposit her 1,815,000 shares of Entertainment Art into her brokerage account, Scottsdale, using information and documentation provided by Tavella, completed a securities deposit checklist. For the following reasons, the documentation submitted by Tavella was false.

81. The documentation reflected that Tavella acquired the 1,815,000 shares pursuant to three separate private sales that were completed on March 5, 2013 – the same day as the purported purchases of Entertainment Art by defendant Hernando: (1) a

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purchase of 165,000 shares from Investor L; (2) a purchase of 165,000 shares from Investor M; and (3) a purchase of 1,485,000 shares from Investor N. The documentation reflected that Tavella paid a total of approximately $9,075 for these shares, which equals approximately $.006 per share.

82. Investors L and M were two of the Form S-1 shareholders who had sold their shares of Entertainment Art on or around May 2009 – almost four years before Tavella's claimed purchase of shares from them. Investor N was purportedly a shareholder that acquired its shares from some of the Form S-1 shareholders in March 2011 – almost two years after the Form S-1 shareholders sold their shares.

83. On May 22, 2013, defendant Tavella deposited 1,815,000 shares of Entertainment Art not bearing a restrictive legend into her brokerage account at Scottsdale. As a result of the business name change on April 1, 2013, these shares became Biozoom shares. Thus, defendant Tavella held 1,815,000 shares of Biozoom that were purportedly available to be sold on the public markets.

Adriana Rosa Bagattin

84. On March 13, 2013, Entertainment Art's transfer agent issued a certificate for 2,310,000 Entertainment Art shares to defendant Bagattin.

85. On or about May 10, 2013, defendant Bagattin opened an account at Scottsdale.

86. In order to deposit her 2,310,000 shares of Entertainment Art into her brokerage account, Scottsdale, using information and documentation provided by Bagattin, completed a securities deposit checklist. For the following reasons, the documentation submitted by Bagattin was false.

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87. The documentation reflected that Bagattin acquired the 2,310,000 shares pursuant to three private sales that were completed on February 26, 2013: (1) a purchase of 1,650,000 shares from Investor O; (2) a purchase of 330,000 shares from Investor P; and (3) a purchase of 330,000 shares from Investor Q. The documentation reflected that Defendant Bagattin paid approximately $6,930 for these shares, which equals approximately $.003 per share.

88. Each of Investors O, P, and Q, however, were Form S-1 Shareholders who had sold their Entertainment Art shares on or around May 2009 – almost four years before defendant Bagattin's claimed purchase of shares from these persons.

89. On May 22, 2013, Bagattin deposited 2,310,000 shares of Entertainment Art not bearing a restrictive legend into her brokerage account at Scottsdale. As a result of the business name change on April 1, 2013, these shares became Biozoom shares. Thus, defendant Bagattin held 2,310,000 shares of Biozoom that were purportedly available to be sold on the public markets.

Daniela Patricia Goldman

90. On March 22, 2013, Entertainment Art's transfer agent issued a certificate for 2,485,000 Entertainment Art shares to Goldman.

91. On or about May 13, 2013, defendant Goldman opened an account at Scottsdale.

92. In order to deposit her 2,485,000 shares of Entertainment Art into her brokerage account, Scottsdale, using documentation and information provided by Goldman, completed a securities deposit checklist. For the following reasons, the documentation submitted by Goldman was false.

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93. The documentation reflected that Goldman acquired the 2,485,000 shares pursuant to two private sales that were completed on March 4, 2013: (1) a purchase of 1,485,000 shares from Investor R; and (2) a purchase of 1,000,000 shares from Investor S. The documentation also reflected that Goldman paid approximately $7,455 for these shares, which equals approximately $.003 per share.

94. Investor R purportedly obtained its shares from some of the Form S-1 Shareholders in March 2011 – almost two years after the Form S-1 shareholders sold their shares. Investor S was one of the Form S-1 shareholders and sold his shares on or around May 2009 – almost four years before defendant Goldman's claimed purchase of shares from him.

95. On May 22, 2013, Goldman deposited 2,485,000 shares of Entertainment Art not bearing a restrictive legend into her brokerage account at Scottsdale. As a result of the business name change on April 1, 2013, these shares became Biozoom shares. Thus, defendant Goldman held 2,485,000 shares of Biozoom that were purportedly available for sale on the public markets.

Mariano Pablo Ferrari

96. On March 22, 2013, Entertainment Art's transfer agent issued a certificate for 2,310,000 Entertainment Art shares to Ferrari.

97. On or about May 20, 2013, Ferrari opened an account at Scottsdale.

98. In order to deposit his 2,310,000 shares of Entertainment Art into his brokerage account, Scottsdale, using documentation and information provided by Ferrari, completed a securities deposit checklist. For the following reasons, the documentation provided by Ferrari was false.

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99. The documentation reflected that Ferrari acquired the 2,310,000 shares pursuant to two private sales that were completed on March 5, 2013: (1) a purchase of 1,650,000 shares from Investor T; and (2) a purchase of 660,000 shares from Investor U. The documentation also reflected that Goldman paid approximately $9,240 for these shares, or approximately $.004 per share.

100. Investor T was one of the Form S-1 shareholders and sold his shares on or around May 2009 – almost four years before defendant Ferrari's claimed purchase of shares from him. Investor U purportedly obtained its shares from some of the Form S-1 shareholders in September 2009.

101. On May 22, 2013, Ferrari deposited 2,310,000 shares of Entertainment Art not bearing a restrictive legend into his brokerage account at Scottsdale. As a result of the business name change on April 1, 2013, these shares became Biozoom shares. Thus, defendant Ferrari held 2,310,000 shares of Biozoom that were purportedly available for sale on the public markets.

Two Other Accounts in Names of Defendants Graciarena and Loureyro

102. On March 22, 2013, Manhattan Transfer issued a certificate for 2,145,000 Entertainment Art shares to Graciarena and 2,300,000 Entertainment Art shares to Loureyro. Graciarena and Loureyro submitted documentation reflecting that they had obtained their shares in the same manner as the other eight defendants – i.e. – by purportedly purchasing shares from the Form S-1 shareholders.

103. On or about June 14, 2013, Fernando Loureyro and Mariano Graciarena opened separate accounts at Scottsdale. Like the other eight defendants, both stated in brokerage firm documents that they resided in Buenos Aires, Argentina.

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104. On June 18, 2013, these shares were deposited in the brokerage accounts of these two individuals. To date, none of these shares have been sold.

105. In sum, from November 2012 to June 2013, the ten defendant accounts received a total of 20,130,000 shares of Entertainment Art. These shares represented all of the shares that were unallocated after the Opsolution acquisition. Moreover, these shares represented *100%* percent of the total shares without a restrictive legend outstanding in Biozoom at the time, and more than *33%* percent of the total outstanding shares of Biozoom.

D. Defendants Sell Millions of Biozoom Shares

106. Beginning on May 22, 2013 – and after nearly all of the defendants had deposited their Biozoom shares not bearing a restrictive legend in their accounts – Biozoom began issuing a series of press releases in which it claimed it "created the world's first portable, handheld consumer device" to instantly and non-invasively measure certain biomarkers. These claims were also made by other entities, including Global Financial, Inc., Stock Preacher.com, among others.

107. Following these positive claims concerning Biozoom's prospects, the accounts in the name of eight of the selling defendants sold substantial amounts of their Biozoom stock that did not bear a restrictive legend for massive proceeds. In particular, and as reflected in the chart below, eight of the defendants sold 14,078,406 shares of BIZM stock for proceeds of $33,997,152.

Defendant	Shares Sold	Dates Sold	Proceeds	Shares Remaining
Blaya	1,312,053	5/16/13 – 6/13/13	$3,014,965	172,947
De Lorenzo	1,328,000	6/17/13 – 6/18/13	$4,809,836	734,500
Hernando	1,815,000	6/6/13 – 6/17/13	$5,048,217	0

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Defendant	Shares Sold	Dates Sold	Proceeds	Shares Remaining
Ficcichia	1,402,500	5/20/13 – 6/5/13	$1,979,389	272,620[1]
Tavella	1,592,444	6/7/13 – 6/11/13	$3,116,894	382,956[2]
Bagattin	2,176,726	6/10/13 – 6/18/13	$6,223,310	133,724
Ferrari	1,994,038	6/7/13 – 6/19/13	$5,456,690	315,962
Goldman	2,457,645	5/28/13 – 6/6/13	$3,771,761	27,355

108. All of the eight selling defendants placed their orders to sell Biozoom stock in the same manner – via e-mail and instant message to either Legend or Scottsdale.

109. Upon selling shares in Biozoom, several of the defendants instructed their brokerage firms to wire the proceeds of their sales to foreign bank accounts in various countries:

- **Ficicchia**: On June 7, 2013, defendant Ficicchia instructed Legend, to wire $1 million to Alpine Securities, Inc., a registered clearing broker-dealer. Alpine provides clearing services for Scottsdale, and as described earlier, Ficicchia opened an account at Scottsdale on or around June 10, 2013 and funded it with this $1 million. On June 25, 2013 – the same day as the Commission's order suspending trading in Biozoom – Ficicchia instructed Scottsdale to wire $325,000 to a bank account in Cyprus. This wire was not executed. Ficicchia's brokerage account at Legend currently has a cash balance of slightly over $1 million, and Ficicchia's brokerage account at Scottsdale currently has a cash balance of approximately $328,000.

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[1] On or around June 10, 2013, Ficicchia opened an account at Scottsdale and funded this account with $1 million from his account at Legend. Ficicchia's "Shares Remaining" column reflects Biozoom purchases that he has made in his account at Scottsdale.

[2] Tavella's "Shares Remaining" column includes 160,400 Biozoom shares that she purchased in the open market on June 19, 2013.

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- **Blaya**: On June 14, 2013, Blaya instructed Legend to wire "all settled funds except $30,000" to an account held in Geneva, Switzerland. This wire was not executed. This account currently has a cash balance of approximately $3.5 million.
- **Hernando**: On June 13, 2013, Hernando instructed his broker-dealer, Legend, to wire "all available settled cash" in her account, which at the time, was approximately $600,000, to an account held at Hellenic Bank Public Company Limited in Lemesos, Cyprus. This wire was executed. On June 17, 2013, Hernando instructed his broker-dealer, Legend, to wire $2 million, again to an account held at Hellenic Bank Public Company Limited in Lemesos, Cyprus. This wire was not executed by Legend. This account has a cash balance of approximately $4.5 million.
- **De Lorenzo**: De Lorenzo has not yet attempted to wire any money out of her account. De Lorenzo has a bank account in Dar Es Salaam. The account has a cash balance of approximately $4.8 million.
- **Tavella**: On June 25, 2013 – the day of the Commission's order suspending trading in the securities of Biozoom – Tavella attempted to wire approximately $2,450,000 out of her account at Scottsdale to a bank account in St. Vincent and the Grenandines. This wire has not been executed. The current cash balance in Tavella's brokerage account is approximately $2.47 million.
- **Bagattin**: On June 20, 2013, Bagattin instructed Scottsdale to wire approximately $4.33 million to a bank account in Cyprus. This wire was executed. On June 24, 2013, Bagattin instructed Scottsdale to send an additional

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approximately $1.89 million to the same bank account. This wire was also executed. The current cash balance in Bagattin's brokerage account is $3,000.

- **Goldman:** On June 11, 2013, Goldman instructed Scottsdale to wire approximately $3.77 million to an account held at a bank in Geneva, Switzerland – a bank where Blaya also holds an account. This wire was executed. The cash balance in Goldman's account is $0.
- **Ferrari:** On June 19, 2013, Ferrari instructed Scottsdale to wire $500,000 to an account held at a bank in Panama. This wire was executed. On June 24, 2013, Ferrari instructed Scottsdale to wire an additional $4.9 million, this time to a bank in Belize. This wire was also executed. The cash balance in Ferrari's account is $0.

F. No Registration Statement Was In Effect At the Time Defendants Sold Biozoom Shares

110. Section 5 of the Securities Act makes it unlawful for any person, directly or indirectly, to offer or sell securities, using the U.S. mails or interstate commerce, unless such offer or sale is registered with the Commission.

111. No registration statement was in effect for the shares sold by the Selling Defendants.

112. No registration statement is in effect for the Biozoom shares held by defendants Graciarena and Loureyro.

G. Biozoom Is A Penny Stock As Defined By The Securities Exchange Act of 1934 ("Exchange Act")

113. Biozoom's stock is a "penny stock" as defined by the Exchange Act. At times relevant to this Complaint, the stock's shares traded at less than $5.00 per share. During the same time period, Biozoom's stock did not meet any of the exceptions to

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penny stock classification pursuant to Section 3(a)(51) and Rule 3a51-1 of the Exchange Act.

114. For example, the company's stock: (1) did not trade on a national securities exchange; (2) was not an "NMS stock," as defined in 17 C.F.R. § 242.242.600(b)(47); (3) did not have net tangible assets (i.e., total assets less intangible assets and liabilities) in excess of $5,000,000; and (4) did not have average revenue of at least $6,000,000 for the last three years. (*See* Exchange Act, Rule 3a51-1(g).)

COUNT I

VIOLATION OF SECTION 5 OF THE SECURITIES ACT, 15 U.S.C. §77e

(Defendants Tavella, Ficicchia, Blava, Hernando, De Lorenzo, Bagattin, Ferrari, Goldman)

115. Paragraphs 1 through 114 are hereby re-alleged and incorporated by reference.

116. Defendants, by engaging in the conduct described above, directly or indirectly, and without a registration statement in effect as to such securities:

(a) made use of means or instruments of transportation or communication in interstate commerce or of the mails to sell, through the use or medium of a prospectus or otherwise; or

(b) carried or caused to be carried through the mails or in interstate commerce, by any means or instruments of transportation, securities for the purpose of sale or for delivery after sale.

117. Defendants, by engaging in the conduct described above, also directly or indirectly, made use of the means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or

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medium of any prospectus or otherwise securities, without a registration statement having been filed as to those securities.

118. By engaging in the foregoing conduct, Defendants directly or indirectly, violated, and unless restrained and enjoined will continue to violate Sections 5(a) and 5(c) of the Securities Act [15 U.S.C. §§ 77e(a) and 77e(c)].

COUNT II

INJUNCTION PURSUANT TO SECTION 20(b) OF THE SECURITIES ACT

(Defendants Graciarena and Loureyro)

119. Paragraphs 1 through 114 are re-alleged and incorporated by reference herein.

120. Securities Act Section 20(b) provides that "whenever it shall appear to the Commission that any person is engaged in or is about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this title, the Commission may in its discretion, bring an action in district court to enjoin such acts or practices . . ."

121. Defendants Graciarena and Loureyro have deposited shares of Biozoom in their respective brokerage accounts. Those shares do not bear a restrictive legend. However, no registration statement is in effect for the offer of sale of those shares.

122. Unless restrained and enjoined, Graciarena and Loureyro are likely to offer or sell their Biozoom shares to the public in violation of Section 5 of the Securities Act.

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PRAYER FOR RELIEF

WHEREFORE, the Commission respectfully requests that this Court:

I.

Issue findings of fact and conclusions of law that defendants Ficicchia, Blaya, Hernando, De Lorenzo, Tavella, Goldman, Bagattin, and Ferrari committed the violations charged and alleged herein.

II.

Enter an order temporarily restraining and enjoining defendants Ficicchia, Blaya, Hernando, De Lorenzo, Tavella, Goldman, Bagattin, Ferrari, Graciarena, and Loureyro, their officers, agents, servants, employees, attorneys and those persons in active concert or participation with defendants who receive actual notice of the Order, by personal service or otherwise, and each of them from, directly or indirectly, engaging in the transactions, acts, practices or courses of business described above, or in conduct of similar purport and object, in violation of Sections 5(a) and 5(c) of the Securities Act [15 U.S.C. §§ 77e(a) and 77e(c)].

III.

Enter an order freezing the brokerage accounts and any assets of defendants Ficicchia, Blaya, Hernando, De Lorenzo, Tavella, Goldman, Bagattin, and Ferrari derived from the sale of Biozoom stock; and, freezing the brokerage accounts of defendants Graciarena and Loureyro holding Biozoom shares.

IV.

Enter an order requiring defendants Ficicchia, Blaya, Hernando, De Lorenzo, Tavella, Goldman, Bagattin, and Ferrari to return to the United States any proceeds from the sale of Biozoom stock that have been transferred abroad and those proceeds which are

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returned be frozen in a domestic bank during the pendency of this action to preserve such assets for the satisfaction of disgorgement.

V.

Enter an Order of Permanent Injunction restraining and enjoining defendants Ficicchia, Blaya, Hernando, De Lorenzo, Tavella, Goldman, Bagattin, Ferrari, Graciarena, and Loureyro, their officers, agents, servants, employees, attorneys and those persons in active concert or participation with defendants who receive actual notice of the Order, by personal service or otherwise, and each of them from, directly or indirectly, engaging in the transactions, acts, practices or courses of business described above, or in conduct of similar purport and object, in violation of Sections 5(a) and 5(c) of the Securities Act [15 U.S.C. §§ 77e(a) and 77e(c)].

VI.

Enter an Order requiring defendants Ficicchia, Blaya, Hernando, De Lorenzo, Tavella, Goldman, Bagattin, and Ferrari to disgorge the ill-gotten gains received as a result of the violations alleged herein, including prejudgment interest.

VII.

Issue an Order imposing upon defendants Ficicchia, Blaya, Hernando, De Lorenzo, Tavella, Goldman, Bagattin, and Ferrari appropriate civil penalties pursuant to Section 20(d) of the Securities Act [15 U.S.C. §77t(d)].

VIII.

Issue an order permanently and unconditionally barring, pursuant to Section 20(g) of the Securities Act [15 U.S.C. § 77t(g)], the Selling Defendants from participating in an

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offering of penny stock as defined by Exchange Act Section 3(a)(51) [15 U.S.C. § 78c(a)(51)] and Rule 3a51-1 thereunder [17 C.F.R. § 240.3a51-1].

IX.

Retain jurisdiction of this action in accordance with the principles of equity and the Federal Rules of Civil Procedure in order to implement and carry out the terms of all orders and decrees that may be entered or to entertain any suitable application or motion for additional relief within the jurisdiction of this Court.

X.

Grant such other relief as this Court deems appropriate.

Dated: July 3, 2013

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

By: Richard E. Simpson

Richard E. Simpson (RS5859)
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549
Telephone: (202) 551-4420
SimpsonR@sec.gov

Of counsel:

David J. Gottesman
Patrick M. Bryan

Antonia Chion
Ricky Sachar
Deborah J. Tarasevich
Scott M. Lowry
Jennie B. Krasner
U.S. Securities and Exchange Commission
100 F Street, NE

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Washington, DC 20549

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

MAGDALENA TAVELLA, ANDRES HORACIO FICICCHIA, GONZALO GARCIA BLAYA, LUCIA MARIANA HERNANDO, CECILIA DE LORENZO, ADRIANA ROSA BAGATTIN, DANIELA PATRICIA GOLDMAN, MARIANO PABLO FERRARI, MARIANO GRACIARENA, and FERNANDO LOUREYRO,

Defendants.

USDC SDNY
DOCUMENT
ELECTRONICALLY FILED
DOC #:
DATE FILED: 07/17/2013

Civil Action No. 13-CIV-4609 (NRB)

Judge Naomi Reice Buchwald

STIPULATION AND ORDER GRANTING PRELIMINARY INJUNCTION, ASSET FREEZE AND OTHER RELIEF

This cause having come before the Court previously on July 3, 2013, on Plaintiff Securities and Exchange Commission's ("Commission's") Motion for a Temporary Restraining Order and Asset Freeze and For an Order to Show Cause Why a Preliminary Injunction Should Not Be Issued, the Court having considered the Commission's Complaint, motion, supporting memorandum of law, and the exhibits and declarations submitted in support of the Plaintiff's motion, and the Plaintiff and all Defendants by counsel having appeared and, without admitting any wrongdoing, consented to the entry of this Order, this Court finds as follows:

1. On July 3, 2013, this Court entered an order that, among other relief granted, enjoined the disposition, sale, transfer, pledge, encumbrance, assignment, concealment, or other

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disposal of stock of Biozoom, Inc. (hereafter "Biozoom") or the proceeds derived from the sale thereof; froze accounts holding funds or assets of the Defendants; and ordered preservation of documents related to Biozoom, any proceeds from the sale or transfer of Biozoom stock, or related to accounts through which Biozoom stock was traded or proceeds derived from the sale thereof were deposited, and all communications concerning the foregoing. The Order entered on July 3, 2013 also set a hearing for this matter on July 17, 2013 at 11:00 a.m.

2. There is no admission by Defendants that the allegations in the Complaint filed by the Commission are true or accurate.

3. Defendants have consented and stipulated to the entry of this Order, which continues the asset freeze and other relief set forth below, pending final adjudication of this case or until further order of this Court.

IT IS THEREFORE ORDERED:

A. ASSET FREEZE ORDER

IT IS HEREBY ORDERED that, until a final adjudication on the merits may be had, Defendants and each of their agents, servants, employees, attorneys-in-fact, and those persons in active concert or participation with them who receive actual notice of this Order by personal service or otherwise, and each of them, hold and retain within their control, and otherwise prevent any disposition, sale, transfer, pledge, encumbrance, assignment, dissipation, concealment, or other disposal whatsoever of any shares of Biozoom and all proceeds derived from sales of Biozoom stock under their control or over which they exercise actual or apparent investment or other authority, wherever located, in whatever form such assets may presently exist, or in any account whatsoever.

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IT IS FURTHER ORDERED that the freeze described in this Section A, includes but is not limited to all Biozoom stock and all funds in the following accounts (hereafter, "Group A Accounts"):

(i) Andres Horacio Ficicchia's account at Legend Securities, Inc. with account number ending in "CICC".

(ii) Andres Horacio Ficicchia's account at Scottsdale Capital Advisors, Inc. with account number ending 2927.

(iii) Gonzalo Garcia Blaya's account at Legend Securities, Inc. with account number ending in "LAYA".

(iv) Luciana Mariana Hernando's account at Legend Securities, Inc. with account number ending in "ANDO".

(v) Cecilia De Lorenzo's account at Legend Securities, Inc. with account number ending in "ENZO".

(vi) Magdalena Tavella's account Scottsdale Capital Advisors, Inc. with account number ending 3831.

(vii) Adriana Rosa Bagattin's account at Scottsdale Capital Advisors, Inc. with account number ending 5435.

(viii) Daniela Patricia Goldman's account at Scottsdale Capital Advisors, Inc. with account number ending 3536.

(ix) Mariano Pablo Ferrari's account at Scottsdale Capital Advisors, Inc. with account number ending 5327.

IT IS FURTHER ORDERED that the freeze described in this Section A further includes but is not limited to all Biozoom stock, and all proceeds from the sale or disposition of Biozoom

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stock in any other accounts whatsoever, including but not limited to the following accounts (hereafter, "Group B Accounts"), whether deposited directly or transferred from another account:

(i) Luciana Mariana Hernando's account at Hellenic Bank Public Company Limited in Lemesos, Cyprus, with an account number ending in – 13 01.

(ii) Adriana Rosa Bagattin's account at FBME Bank Limited in Nicosia, Cyprus, with an account number ending in – 644.

(iii) Daniela Patricia Goldman's account at CBH Compagnie Bancaire Helvetique SA in Geneva, Switzerland with an account number ending in – 345.

(iv) Mariano Pablo Ferrari's account at HSBC Bank in Panama City, Panama, with an account number ending in – 590.

(v) Mariano Pablo Ferrari's account at Choice Bank Limited in Belize City, Belize, with an account number ending in – 521.

IT IS HEREBY FURTHER ORDERED that any financial or brokerage institution or other person or entity holding any funds or other assets derived or related to the sale of Biozoom stock, in the name of, for the benefit of, or under the control of defendants, their agents, servants, employees, attorneys-in-fact, and those persons in active concert or participation with them, wherever located, shall hold and retain within their control and prohibit the withdrawal, removal, transfer or other disposal of any such funds or other assets except as otherwise ordered by this Court, including all shares of Biozoom held on behalf of Defendants, and including but not limited to: (a) all funds and Biozoom stock in the Group A Accounts; and (b) all funds in the Group B Accounts that are proceeds from the sale of Biozoom stock, whether deposited directly in those accounts or transferred from other accounts.

B. PRELIMINARY INJUNCTION FROM VIOLATIONS OF SECURITIES ACT SECTION 5

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Case 1:13-cv-04609-NRB Document 15-1 Filed 07/16/13 Page 5 of 7

IT IS HEREBY FURTHER ORDERED, ADJUDGED, AND DECREED that Defendants and Defendant's agents, servants, employees, attorneys, and all persons in active concert or participation with them who receive actual notice of this order by personal service or otherwise shall be and are hereby preliminarily restrained and enjoined, pending entry of a Final Judgment in this action, from violating Section 5(a) and 5(c) of the Securities Act [15 U.S.C. § 77e] by, directly or indirectly, in the absence of any applicable exemption:

(a) Unless a registration statement is in effect as to a security, making use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or

(c) Making use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed with the Commission as to such security, or while the registration statement is the subject of a refusal order or stop order or (prior to the effective date of the registration statement) any public proceeding or examination under Section 8 of the Securities Act [15 U.S.C. § 77h].

C. ORDER PROHIBITING DESTRUCTION OF RECORDS

IT IS HEREBY FURTHER ORDERED that Defendants and their agents, servants, employees, attorneys-in-fact, and those persons in active concert or participation with them who receive actual notice of this Order by personal service or otherwise, and each of them, are hereby restrained from destroying, mutilating, concealing, altering, or disposing of any document referring or relating in any manner to any transactions involving or related in any way to Biozoom, any proceeds from the sale or transfer of Biozoom stock, any accounts holding or

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through which Biozoom stock was traded or proceeds derived from sales were deposited, including but not limited to the Group A Accounts and Group B Accounts, and any communications concerning the foregoing. As used in this Order, "document" means the original and all non-identical copies (whether non-identical because of handwritten notation or otherwise) of all written or graphic matter, whether in paper, electronic, or any other form, however produced, and any other tangible record, or electronic data compilation capable of reproduction in tangible form, including, without limitation, correspondence, memoranda, minutes, telephone records, e-mails, reports, studies, telexes, diaries, calendar entries, contracts, letters of agreement, and including any and all existing drafts of all documents.

D. ORDER PROVIDING ALTERNATIVE MEANS OF SERVICE

IT IS HEREBY FURTHER ORDERED that, pursuant to Rule 4 of the Federal Rules of Civil Procedure, service of all pleadings and other papers, this Order and all documents filed in support thereof, and all other documents to be served in this action, may be made personally, by facsimile, by overnight courier, or by electronic mail upon each Defendant, his or her attorney, his or her U.S. agents or his or her foreign agents to the extent permitted by law, or by an alternative provision for service permitted by Rule 4 of the Federal Rules of Civil Procedure, or as this Court may direct by further order.

E. ORDER IS BINDING ON ALL PERSONS WITH ACTUAL NOTICE OF THE ORDER

IT IS HEREBY FURTHER ORDERED, that this Order shall be, and is, binding upon each Defendant, and each of his or her agents, servants, employees, attorneys-in-fact, and those persons in active concert or participation with him or her who receive actual notice of this Order by personal service, facsimile service, or service in accordance with Section D of this Order, or otherwise.

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F. OTHER RELIEF

IT IS HEREBY FURTHER ORDERED, that the United States Marshall in any district in which any Defendant resides, transacts business or may be found is authorized and directed to make service of process upon any Defendant at the request of the Commission.

G. TIME FOR DEFENDANTS TO RESPOND TO COMPLAINT

Defendants shall answer or otherwise respond to the Commission's Complaint on or before August 26, 2013.

IT IS HEREBY FURTHER ORDERED that this Stipulation and Order may be modified for good cause shown, and this Court shall retain jurisdiction of this matter for all purposes.

IT IS HEREBY FURTHER ORDERED that pursuant to Federal Rule of Civil Procedure 65(c), no security is required of the Commission.

SO ORDERED:

Dated this 17th day of July, 2013.

Judge Naomi Reice Buchwald

STIPULATED AND AGREED:

FOR PLAINTIFF:

7/16/2013

Richard E. Simpson (RS5859)
David J. Gottesman (admitted pro hac vice)
Patrick M. Bryan (admitted pro hac vice)
U.S. Securities & Exchange Commission
100 F Street, NE Washington, DC 20549
Telephone: (202) 551-4420
Fax: (202) 772-9245
SimpsonR@sec.gov
GottesmanD@sec.gov
BryanP@sec.gov

FOR DEFENDANTS:

Bruce A. Langer
McLaughlin & Stern, LLP
260 Madison Avenue
New York, NY 10016-2404
Telephone (202) 448-6216
Fax: (202) 448-0066
sschuster@mclaughlinstern.com
blanger@mclaughlinstern.com

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, v. MAGDALENA TAVELLA, ANDRES HORACIO FICICCHIA, GONZALO GARCIA BLAYA, LUCIA MARIANA HERNANDO, CECILIA DE LORENZO, ADRIANA ROSA BAGATTIN, DANIELA PATRICIA GOLDMAN, MARIANO PABLO FERRARI, MARIANO GRACIARENA, and FERNANDO LOUREYRO, Defendants.	Civil Action No. 13-CIV-4609 Judge Naomi Reice Buchwald

BIOZOOM, INC. FAIR FUND NOTICE

The United States Securities and Exchange Commission authorized this Notice.
This is not a solicitation from a lawyer.

If you purchased or otherwise acquired Biozoom, Inc. ("Biozoom"; OTCBB ticker: BIZM; CUSIP: 09072T100) common shares in the United States during the Relevant Period, on or between May 16, 2013 and June 25, 2013, you are eligible for damages if the shares were sold at a loss or continue to be held. Per the Plan of Allocation you may be entitled to receive a monetary payment from the Biozoom Fair Fund ("Fair Fund").

Background

On July 3, 2013, the Securities and Exchange Commission ("SEC" or "Commission") filed a complaint in United States District Court Southern District of New York alleging that Magdalena Tavella, Andres Horacio Ficicchia, Gonzalo Garcia Blaya, Lucia Mariana Hernando, Cecilia De Lorenzo, Adriana Rosa Bagattin, Daniela Patricia Goldman, and Mariano Pablo Ferrari (collectively, the "Defendants") had unlawfully sold to the public almost $34 million worth of securities in Biozoom (f/k/a Entertainment Art, Inc.) a penny stock company traded on the Over-the-Counter Bulletin Board. No registration statement was in effect for the selling Defendants' resale of securities and thus their sales were in violation of Section 5 of the Securities Act. Though the Defendants claimed that they had purchased the stock between November 2012 and March 2013 from the original shareholders, this was impossible because those original shareholders ceased to have any interest in the company more than three years earlier than the selling Defendants' claimed purchases.

From March 2013 to June 2013, Defendants opened brokerage accounts at broker-dealers and deposited millions of shares of Biozoom that they claimed did not bear a restrictive legend and were free-trading shares. All of the Defendants claimed that they had purchased all or some of their shares from some of the original shareholders of Entertainment Art in transactions between November 2012 and March 2013.

On July 9, 2013, a Temporary Restraining Order ("TRO") was granted freezing the brokerage accounts of the Defendants holding Biozoom shares and any accounts held by financial institutions or brokers that have the proceeds of the Biozoom sales on behalf of the Defendants. Pursuant to the Final Judgment, a Fair Fund was

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established to distribute the disgorged funds for the benefit of investors pursuant to the Fair Fund provisions of Section 308(a) of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley"), 15 U.S.C. § 7246(a).

In partial satisfaction of the amounts owed by Defendants, Defendants accounts that were frozen pursuant to the TRO, were ordered to be turned over. To date, the Commission recovered from the frozen assets a total of $16,117,936. The Commission invested $16,022,574 with United States Department of the Treasury at the Bureau of the Fiscal Service ("BFS"). It is doubtful, but possible, that additional funds will be recovered from the Defendants from various foreign sources.

Plan of Allocation

The purpose of this distribution is to compensate investors in the Defendants' misrepresentations and omissions in its sale of Biozoom common stock.

The Net Available Fair Fund for the Biozoom distribution will be allocated to Eligible Claimants according to the Plan of Allocation relative to the total disgorgement. The calculations made pursuant to the Plan of Allocation are not intended to be estimates of the amounts that investors might have been able to recover. Nor are the calculations pursuant to the Plan of Allocation intended to be estimates of the amounts that will be paid to Eligible Claimants. Appendix I to the Distribution Plan details the Plan of Allocation methodology and calculation which is designed to equitably distribute the Fair Fund to those Eligible Investors who suffered economic losses. Appendix I to the Distribution Plan is posted on the Fair Fund website at www.BiozoomFairFund.com.

Preliminary calculations will be made for all Eligible Claimants on a *pro rata* basis determined by an Eligible Claimant's investment in Biozoom common stock divided by the sum of all Eligible Claimants' investments in the Biozoom common stock. After the preliminary calculations have been made, any Eligible Claimant whose preliminary calculation amount is less than the Distribution *De Minimis* Amount of $10 will be removed from the pool of Eligible Claimants.

Final calculations will then be made for all remaining Eligible Claimants on a *pro rata* basis as described above, but excluding Eligible Claimants whose preliminary calculation amounts are less than the Distribution *De Minimis* Amount, to arrive at a Recognized Claim amount. In the event that the number of claims submitted by Eligible Claimant(s) is such that the Eligible Claimant(s) would receive a recovery in excess of their Recognized Claim amount, the recovery per claim is limited to the Recognized Claim. The excess amount in the Fair Fund shall be distributed to the U.S Treasury.

Fund Administration

On August 25, 2015, the Commission issued an Order appointing KCC as the Distribution Agent, to assist in overseeing the administration and distribution of the Fair Fund in coordination with Commission staff, pursuant to the terms of the Distribution Plan.

Fair Fund

The Fair Fund is a "Qualified Settlement Fund" ("QSF") as defined in U.S. Treas. Reg. Sec. 1.468B-1 et seq. The distribution is intended to compensate you for losses incurred with respect to your investment in Biozoom common stock as a result of the conduct described in the Order.

Generally, your distribution is not income to you to the extent of your basis in your investment. However, you must reduce your basis by the amount of your distribution. If your distribution exceeds your tax basis in your investment, then the excess is includable in your income as capital gain. Any such capital gain is long-term capital gain, unless you disposed of your investment before holding it for longer than one year. If you do not have reasonable access to records indicating the tax basis of your

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investment, then you may assume that your tax basis is zero and that the entire losses component of your distribution is includable in your income as capital gain. ***The QSF is not required to – and will not – issue a Form 1099 to you with respect to the losses component of the distribution.***

You should consult your tax advisor or accountant as to the treatment of the payment you are receiving under this Fair Fund, as the Distribution Agent and the SEC cannot provide you with tax advice.

How to Participate

If you believe you are a Potential Claimant and would like to participate, you must follow the enclosed instructions and complete the Proof of Claim Form included in this packet. Fill out the Proof of Claim Form completely, sign it, include copies of all required supporting documentation, and return it in the enclosed envelope to the Distribution Agent's address listed below.

Excluded Parties shall mean Defendants, Biozoom, and all other entities or individuals who improperly helped in establishing a market for, and escalating the price of, Biozoom stock, based on the stock trading of those entities or individuals.

The submission of the Proof of Claim Form and the receipt and acceptance of a distribution by an Eligible Claimant is not intended to be a release of an Eligible Claimant's rights and claims against any party.

Deadline to Submit a Claim	October 31, 2016
More Information	
Website	www.BiozoomFairFund.com
Write	Biozoom Fair Fund Distribution Agent c/o KCC P.O. Box 30233 College Station, TX 77842-3233
Phone	1-855-730-8647
Investor Options for this Fair Fund	
Submit a Claim	The only way to get a payment from the Fair Fund.
Do Nothing	Receive no payment.

Questions

This notice provides only summary information regarding the Fair Fund. We strongly recommend that you read the Distribution Plan, including the Plan of Allocation, and other relevant case documents in their entirety for more complete details. The documents can be found at www.BiozoomFairFund.com.

If you need assistance completing the Proof of Claim Form or if you have any questions about this Fair Fund, you may obtain more information by visiting the Fair Fund website at www.BiozoomFairFund.com, by calling the dedicated toll-free number at 1-855-730-8647 or sending an email inquiry to info@BiozoomFairFund.com.

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Special Notice to Brokers and Nominees

If you purchased or held Biozoom common stock for the beneficial interest of a person or organization other than yourself, within fourteen (14) calendar days of receipt of this Fair Fund Notice you must either: (1) request additional copies of the Fair Fund Notice and Proof of Claim Form from the Distribution Agent, and, within fourteen (14) calendar days of receipt of such copies, send copies by first-class mail directly to beneficial owners; or (2) provide a list of the names and last known addresses of the beneficial owners (preferably in excel format) to the Distribution Agent by email to notifications@Gilardi.com or by mail to the following address:

Biozoom Fair Fund
c/o KCC
P.O. Box 30233
College Station, TX 77842-3233

If you choose to mail the Fair Fund Notice and Proof of Claim Form yourself, you may obtain from the Distribution Agent (without cost to you) as many additional copies of these documents as you will need to complete the mailing. If you choose the second option, KCC will send a copy of the Fair Fund Notice and Proof of Claim Form to the persons and/or entities whose names and address you supply.

In either case, you may obtain reimbursement for reasonable administrative costs actually incurred in connection with forwarding the Fair Fund Notice that would not have been incurred but for the obligation to forward the Fair Fund Notice and Proof of Claim Form, upon submission of appropriate documentation to the Distribution Agent.

Regards,

KCC
Distribution Agent

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, v. MAGDALENA TAVELLA, ANDRES HORACIO FICICCHIA, GONZALO GARCIA BLAYA, LUCIA MARIANA HERNANDO, CECILIA DE LORENZO, ADRIANA ROSA BAGATTIN, DANIELA PATRICIA GOLDMAN, MARIANO PABLO FERRARI, MARIANO GRACIARENA, and FERNANDO LOUREYRO, Defendants.	USDC SDNY DOCUMENT ELECTRONICALLY FILED DOC #: DATE FILED: 12/08/2014 Civil Action No. 13-CIV-4609 (NRB) Judge Naomi Reice Buchwald

FINAL JUDGMENT AS TO DEFENDANTS MARIANO GRACIARENA AND FERNANDO LOUREYRO

The Securities and Exchange Commission ("SEC" or "Plaintiff") having filed a Complaint and Defendants Mariano Graciarena ("Graciarena") and Fernando Loureyro ("Loureyro") (collectively, the "Defendants" for purposes of this Final Judgment), having entered a general appearance; consented to the Court's jurisdiction over Defendants and the subject matter of this action; consented to entry of this Final Judgment without admitting or denying the allegations of the Complaint (except as to jurisdiction); waived findings of fact and conclusions of law; and waived any right to appeal from this Final Judgment:

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I.

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that within three (3) days of service upon him of a copy of this Final Judgment, Graciarena shall provide written instruction in the form attached to Alpine Securities and Scottsdale Capital Advisors to return Entertainment Art, Inc. (currently known as Biozoom, Inc.) stock certificate number 1115, representing 2.145 million shares issued in the name Mariano Augusto Graciarena and deposited into Scottsdale Capital Advisors brokerage account -xxxxx8720 bearing his name, to the company's transfer agent, VStock Transfer, LLC, 18 Lafayette Place, Woodmere, NY 11598, with instructions that the transfer agent cancel the certificates, as "cancellation" is defined in Securities Exchange Act Rule 17Ad-19(a)(1) [17 CFR §240.17Ad-19(a)(1)]. Graciarena shall copy the Plaintiff on all correspondence to or from Alpine Securities or the company's transfer agent concerning cancellation of the foregoing stock certificate.

II.

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that within three (3) days of service upon him of a copy of this Final Judgment, Loureyro shall provide written instruction in the form attached to instruct Alpine Securities and Scottsdale Capital Advisors to return Entertainment Art, Inc. (currently known as Biozoom, Inc.) stock certificate number 1111, representing 2.3 million shares issued in the name Fernando Loureyro and deposited into Scottsdale Capital Advisors brokerage account -xxxxx7518 bearing his name, to the company's transfer agent, VStock Transfer, LLC, 18 Lafayette Place, Woodmere, NY 11598, with instructions that the transfer agent cancel the certificates, as "cancellation" is defined in Securities Exchange Act Rule 17Ad-19(a)(1) [17 CFR §240.17Ad-19(a)(1)]. Loureyro shall

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copy the Plaintiff on all correspondence to or from Alpine Securities or the company's transfer agent concerning cancellation of the foregoing stock certificate.

III.

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that Defendants shall relinquish all claim, title or interest in Entertainment Art, Inc. (currently known as Biozoom, Inc.) stock certificates held in their name, except as necessary to effectuate the cancellations described in paragraphs I and II of this Final Judgment.

IV.

IT IS FURTHER ORDERED, ADJUDGED, AND DECREED that the Consent is incorporated herein with the same force and effect as if fully set forth herein, and that Defendants shall comply with all of the undertakings and agreements set forth therein.

V.

IT IS FURTHER ORDERED, ADJUDGED, AND DECREED that this Court shall retain jurisdiction of this matter for the purposes of enforcing the terms of this Final Judgment.

Dated: December 4, 2014

Hon. Naomi Reice Buchwald
UNITED STATES DISTRICT JUDGE

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EXHIBIT A

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Date: _____, 2014

Alpine Securities
Attn.: Legal – Physical Certificate Deposit
39 Exchange Place
Salt Lake City, UT 84111

Scottsdale Capital Advisors
Attn.: D. Michael Cruz
7170 E. McDonald Drive
Scottsdale, AZ 85253

Re: Entertainment Art, Inc. (currently known as Biozoom, Inc.) stock certificate number 1115 - Alpine Securities brokerage account #[redacted]8720

To Whom It May Concern:

By this letter, I am instructing Alpine Securities and Scottsdale Capital Advisors to return Entertainment Art, Inc. (currently known as Biozoom, Inc.) stock certificate number 1115 (representing 2.145 million shares issued in the name Mariano Augusto Graciarena and deposited into Scottsdale Capital Advisors brokerage account #[redacted]8720 in my name) to the company's transfer agent, VStock Transfer, LLC, 18 Lafayette Place, Woodmere, NY 11598, with instructions that the transfer agent cancel the certificates, as "cancellation" is defined in Securities Exchange Act Rule 17Ad-19(a)(1) [17 CFR §240.17Ad-19(a)(1)].

Enclosed for your information is a copy of an order of the U.S. District Court for the Southern District of New York directing the cancellation of the above-reference certificate.

Sincerely,

Mariano Augusto Graciarena
[redacted]
Buenos Aires, Argentina

cc: Patrick M. Bryan
U.S. Securities and Exchange Commission
100 F. Street, NE
Washington, DC 20005

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Date: _____, 2014

Alpine Securities
Attn.: Legal – Physical Certificate Deposit
39 Exchange Place
Salt Lake City, UT 84111

Scottsdale Capital Advisors
Attn.: D. Michael Cruz
7170 E. McDonald Drive
Scottsdale, AZ 85253

Re: Entertainment Art, Inc. (currently known as Biozoom, Inc.) stock certificate number 1111 - Alpine Securities brokerage account #[redacted]7518

To Whom It May Concern:

By this letter, I am instructing Alpine Securities and Scottsdale Capital Advisors to return Entertainment Art, Inc. (currently known as Biozoom, Inc.) stock certificate number 1111 (representing 2.3 million shares issued in the name Fernando Loureyro and deposited into Scottsdale Capital Advisors brokerage account #[redacted]7518 in my name) to the company's transfer agent, VStock Transfer, LLC, 18 Lafayette Place, Woodmere, NY 11598, with instructions that the transfer agent cancel the certificates, as "cancellation" is defined in Securities Exchange Act Rule 17Ad-19(a)(1) [17 CFR §240.17Ad-19(a)(1)].

Enclosed for your information is a copy of an order of the U.S. District Court for the Southern District of New York directing the cancellation of the above-reference certificate.

Sincerely,

Fernando Loureyro
[redacted]
Buenos Aires, Argentina

cc: Patrick M. Bryan
U.S. Securities and Exchange Commission
100 F. Street, NE
Washington, DC 20005

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

MAGDALENA TAVELLA, ANDRES HORACIO FICICCHIA, GONZALO GARCIA BLAYA, LUCIA MARIANA HERNANDO, CECILIA DE LORENZO, ADRIANA ROSA BAGATTIN, DANIELA PATRICIA GOLDMAN, MARIANO PABLO FERRARI, MARIANO GRACIARENA, and FERNANDO LOUREYRO,

Defendants.

USDC SDNY
DOCUMENT
ELECTRONICALLY FILED
DOC #:
DATE FILED: 1/9/2015

Civil Action No. 13-CIV-4609

Judge Naomi Reice Buchwald

FINAL DEFAULT JUDGMENT AND ORDER GRANTING INJUNCTIVE AND OTHER RELIEF AGAINST DEFENDANTS MAGDALENA TAVELLA, ANDRES HORACIO FICICCHIA, GONZALO GARCIA BLAYA, LUCIA MARIANA HERNANDO, CECILIA DE LORENZO, ADRIANA ROSA BAGATTIN, DANIELA PATRICIA GOLDMAN, AND MARIANO PABLO FERRARI

WHEREAS this matter came before this Court on the Motion of Plaintiff Securities and Exchange Commission ("Commission"), seeking entry of a judgment by default, and providing the relief requested in its Complaint against defendants Magdalena Tavella, Andres Horacio Ficicchia, Gonzalo Garcia Blaya, Lucia Mariana Hernando, Cecilia De Lorenzo, Adriana Rosa Bagattin, Daniela Patricia Goldman, and Mariano Pablo Ferrari (collectively, the "Defaulting Defendants"); and

WHEREAS the Court has entered a Memorandum and Order dated January 6, 2015, in which the Court concluded that the Commission is entitled to a final judgment

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against the Defaulting Defendants that permanently enjoins them from violating Section 5 of the Securities Act of 1933 ("Securities Act") [15 U.S.C. § 77(e)], (2) orders the Defaulting Defendants to individually disgorge ill-gotten gains, and (3) imposes civil penalties; and

WHEREAS the Court deferred judgment to afford the Commission an opportunity to supplement its submission as to the amount of prejudgment interest that should be disgorged; and

WHEREAS the Commission has submitted a proposed order "in lieu of such supplemental submission on prejudgment interest," which the Court interprets as abandoning the Commission's claim to prejudgment interest on the disgorgement amounts; it is hereby

ORDERED THAT:

I.

Defaulting Defendants, their agents, servants, employees, attorneys, and all persons in active concert or participation with them who receive actual notice of this final judgment by personal service or otherwise are permanently restrained and enjoined from violating, directly or indirectly, Section 5(a) and 5(c) of the Securities Act [15 U.S.C. § 77e] by, in the absence of any applicable exemption:

(a) Unless a registration statement is in effect as to a security, making use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise:

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(b) Unless a registration statement is in effect as to a security, carrying or causing to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale; or

(c) Making use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed with the Commission as to such security, or while the registration statement is the subject of a refusal order or stop order or (prior to the effective date of the registration statement) any public proceeding or examination under Section 8 of the Securities Act [15 U.S.C. § 77h].

II.

Defaulting Defendants (Magdalena Tavella, Andres Horacio Ficicchia, Gonzalo Garcia Blaya, Lucia Mariana Hernando, Cecilia De Lorenzo, Adriana Rosa Bagattin, Daniela Patricia Goldman, and Mariano Pablo Ferrari) are permanently barred from participating in an offering of penny stock, including engaging in activities with a broker, dealer, or issuer for purposes of issuing, trading, or inducing or attempting to induce the purchase or sale of any penny stock as defined by Section 3(a)(51) of the Securities Exchange Act of 1934 [15 U.S.C. §78c(a)(51) and Rule 3a51-1 thereunder [17 C.F.R. § 240.3a51-1].

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III.

Defendants are liable for disgorgement (representing profits gained as a result of the conduct alleged in the Complaint), and civil penalties pursuant to Section 20(d) of the Securities [15 U.S.C. § 77t(d)], in the following amounts:

Defendant	Disgorgement Amount	Civil Penalty	Total
Magdalena Tavella	$3,107,819	$160,000	$3,267,819
Andres Horacio Ficicchia	$1,948,339	$160,000	$2,108,339
Gonzalo Garcia Blaya	$3,008,200	$160,000	$3,168,200
Lucia Mariana Hernando	$5,042,771	$160,000	$5,202,771
Cecilia De Lorenzo	$4,801,536	$160,000	$4,961,536
Adriana Rosa Bagattin	$6,216,380	$160,000	$6,376,380
Daniela Patricia Goldman	$3,764,306	$160,000	$3,924,306
Mariano Pablo Ferrari	$5,447,450	$160,000	$5,607,450

Defendants shall satisfy these obligations within ten business days and make payment of all funds to the Commission, which shall provide detailed ACH transfer/Fedwire instructions upon request. The Defendants shall satisfy these obligations from proceeds contained in their various accounts including, but not limited to, the following:

- Andres Horacio Ficicchia's account at Legend Securities, Inc. with account number ending in "CICC".

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- Andres Horacio Ficicchia's account at Scottsdale Capital Advisors, Inc. with account number ending 2927.
- Gonzalo Garcia Blaya's account at Legend Securities, Inc. with account number ending in "LAYA".
- Luciana Mariana Hernando's account at Legend Securities, Inc. with account number ending in "ANDO".
- Luciana Mariana Hernando's account at Hellenic Bank Public Company Limited in Lemesos, Cyprus, with an account number ending in – 1301.
- Cecilia De Lorenzo's account at Legend Securities, Inc. with account number ending in "ENZO".
- Magdalena Tavella's account Scottsdale Capital Advisors, Inc. with account number ending 3831.
- Adriana Rosa Bagattin's account at Scottsdale Capital Advisors, Inc. with account number ending 5435.
- Adriana Rosa Bagattin's account at FBME Bank Limited in Nicosia, Cyprus, with an account number ending in – 644.
- Daniela Patricia Goldman's account at Scottsdale Capital Advisors, Inc. with account number ending 3536.
- Daniela Patricia Goldman's account at CBH Compagnie Bancaire Helvetique SA in Geneva, Switzerland with an account number ending in – 345.
- Mariano Pablo Ferrari's account at Scottsdale Capital Advisors, Inc. with account number ending 5327.

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- Mariano Pablo Ferrari's account at HSBC Bank in Panama City, Panama, with an account number ending in – 590.
- Mariano Pablo Ferrari's account at Choice Bank Limited in Belize City, Belize, with an account number ending in – 521.

IV.

In partial satisfaction of the amounts owed by Defendants pursuant to this Final Judgment, the following entities shall transfer all funds and BIZM shares held in Defaulting Defendants' accounts (including the accounts listed below) and make payment such funds and shares held in Defaulting Defendants' names to the Commission, which shall provide detailed ACH transfer/Fedwire instructions upon request:

A. Legend Securities LLC

1. Gonzalo Garcia Blaya
2. Lucia Mariana Hernando
3. Andres Horacio Ficicchia
4. Cecilia De Lorenzo

B. Scottsdale Capital Advisors

1. Magdalena Tavella
2. Daniela Patricia Goldman
3. Adriana Rosa Bagattin
4. Mariano Pablo Ferrari
5. Andres Horacio Ficicchia

Payment may also be made directly from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm. Payment may also be made by

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certified check, bank cashier's check, or United States postal money order payable to the Securities and Exchange Commission, which shall be delivered or mailed to

Enterprise Services Center
Accounts Receivable Branch
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

and shall be accompanied by a letter identifying the case title, civil action number, and name of this Court; the name of the defendant in this action; and specifying that payment is made pursuant to this Final Judgment. Defaulting Defendant payer shall simultaneously transmit photocopies of each such payment and letter to the Commission's counsel in this action: Patrick M. Bryan, 100 F Street, N.E., Washington, D.C. 20549-4030. Defaulting Defendants relinquish all legal and equitable right, title, and interest in all funds paid pursuant to this Final Judgment, and no part of the funds shall be returned to Defaulting Defendants. The Commission may enforce the Court's judgment for disgorgement by moving for civil contempt (and/or through other collection procedures authorized by law) at any time after ten days following entry of this Final Judgment. In response to any such civil contempt motion by the Commission, Defaulting Defendants may assert any legally permissible defense.

V.

Further to the Stipulation and Order Granting Preliminary Injunction, Asset Freeze, and Other Relief, entered on 7/17/2013 (the "Asset Freeze Order") freezing the assets of Defendants, including those held in the accounts referenced above in Section III and previously enumerated in the Asset Freeze Order, the Court finds that such assets are the proceeds of the violations alleged in the Commission's Complaint. Accordingly, pursuant to the Court's personal jurisdiction over Defaulting Defendants, Defaulting

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Defendants are hereby ordered to repatriate the referenced assets by 30 days after entry of a judgment of default, to the Commission, which shall provide detailed ACH transfer/Fedwire instructions upon request, and to execute any consents, pleadings, or other legal documents as the Commission may require to effect the transfer of such assets in accordance with this Final Judgment, with the understanding that such assets shall be used to satisfy disgorgement only.

VI.

The Commission shall deposit the funds received pursuant to sections III, IV, and V of this Final Judgment into an interest bearing account which, together with any interest and income earned thereon (collectively, the "Fund"), shall be held in the interest bearing account until further order of the Court.

The Commission may by motion propose a plan to distribute the Fund subject to the Court's approval. Such a plan may provide that Fund shall be distributed pursuant to the Fair Fund provisions of Section 308(a) of the Sarbanes-Oxley Act of 2002. Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil penalties pursuant to this Judgment shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Defendants shall not, after offset or reduction of any award of compensatory damages in any Related Investor Action based on any payment of disgorgement in this action, argue that he, she or it is entitled to, nor shall he, she or it further benefit by, offset or reduction of such compensatory damages award by the amount of any part of Defendant's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, the

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Defendant beneficiary of such Penalty Offset shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the United States Treasury or to a Fair Fund, as the Commission directs. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this Judgment. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against a Defendant in this action by or on behalf of one or more investors based on substantially the same facts as alleged in the Complaint in this action. Defendants shall pay post-judgment interest on any delinquent amounts pursuant to 28 USC § 1961.

VII.

IT IS FURTHER ORDERED, ADJUDGED, AND DECREED that this Court shall retain jurisdiction over this matter for the purposes of enforcing the terms of this Final Judgment.

VIII.

RULE 54(b) CERTIFICATION

There being no just reason for delay, pursuant to Rule 54(b) of the Federal Rules of Civil Procedure, the clerk is ordered to enter this Final Judgment forthwith and without further notice.

DATED January 9, 2015.

NAOMI REICE BUCHWALD
UNITED STATES DISTRICT JUDGE

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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 10496 / May 15, 2018

SECURITIES EXCHANGE ACT OF 1934
Release No. 83236 / May 15, 2018

INVESTMENT COMPANY ACT OF 1940
Release No. 33097 / May 15, 2018

ADMINISTRATIVE PROCEEDING
File No. 3-18483

In the Matter of TIMOTHY C. SCARPINO, Respondent.	ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER AND NOTICE OF HEARING

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted against Timothy C. Scarpino ("Scarpino" or "Respondent") pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), and Section 9(b) of the Investment Company Act ("Investment Company Act").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these

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proceedings, which are admitted, and except as provided herein in Section IV, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to 8A of the Securities Act of 1933, Sections 15(b) and 21C of the Securities Exchange Act of 1934, and Section 9(b) of the Investment Company Act, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order and Notice of Hearing ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

Summary

From late May 2013 to mid-June 2013, Timothy Scarpino ("Scarpino"), then a registered representative at registered broker-dealer Scottsdale Capital Advisors ("Scottsdale"), willfully violated Sections 5(a) and 5(c) of the Securities Act when he engaged in the illegal distribution of the securities of Biozoom, Inc. ("Biozoom" or "BIZM") by offering and selling shares of BIZM, which was quoted on the Over-the-Counter Bulletin Board ("OTCBB"), on behalf of four Argentine customers (the "Argentines"). The scope of this illegal distribution was massive, as Scarpino offered and sold approximately 8.2 million BIZM shares, which constituted almost 14% of BIZM's total outstanding shares, and over 40% of BIZM's total number of shares that did not bear a restrictive legend. The Argentines reaped proceeds of over $18.5 million from the less than four weeks of trading activity facilitated by Scarpino.

Sections 5(a) and 5(c) of the Securities Act make it unlawful for any person, directly or indirectly, to offer or sell securities by any means or instruments of transportation or communication in interstate commerce unless a registration statement has been filed with the Commission with respect to Section 5(c) and is in effect with respect to Section 5(a), or an applicable exemption from registration applies. This governs resales of deposited securities, such as Scarpino's sales of the BIZM shares on behalf of the Argentines. No registration statement was in effect as to Scarpino's BIZM offers and sales, and no exemption from registration was applicable to them. Although brokers may rely on an exemption under Section 4(a)(4) of the Securities Act, this exemption would be available to Scarpino for the offers and sales of BIZM only if, after engaging in a reasonable inquiry into the facts surrounding the proposed sales, Scarpino was not aware of facts indicating that the customers would be engaging in an unlawful distribution of securities. Moreover, because Scarpino was presented with red flags of a potential unlawful distribution, he needed to conduct a searching inquiry to determine that the proposed sales were not part of an unlawful distribution of securities. Despite these significant red flags, Scarpino failed to conduct a searching inquiry into facts surrounding the proposed sales, and thereby violated Sections 5(a) and 5(c) of the Securities Act.

Respondent

[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

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1. Timothy Scarpino, 35, resides in Scottsdale, Arizona. Scarpino was, from 2009 until 2013, a registered representative at Scottsdale. Currently, he is not working in the securities industry.

Relevant Entity

2. Scottsdale has been registered with the Commission as a broker-dealer with its principal place of business in Scottsdale, Arizona since May 2002.

Facts

A. Scarpino Opens Foreign Accounts at Scottsdale Based on Referrals from James Benjamin Panther II

3. In or around early May 2013, James B. Panther II ("Panther"), a longtime Scottsdale customer, informed Scarpino and Scottsdale's owner (the "Owner") that Panther planned to refer several individuals to open brokerage accounts and deposit stock certificates at Scottsdale. The Owner told Scarpino that Panther had referred significant business to Scottsdale in the past and that Scarpino should provide special treatment to Panther's referrals because Panther was an important customer.

4. On May 2, 2013, Scarpino emailed an associate of Panther's ("Panther Associate"), writing that Panther had suggested that Scottsdale might be able to assist Panther Associate in "depositing OTC/Pinksheet stocks." Scarpino attached Scottsdale account opening forms for foreign customers to his email.

5. Panther Associate provided Scarpino the names and email addresses of four individuals who Panther was referring to Scottsdale – the Argentines. Scarpino then emailed each of the Argentines offering to assist them in opening accounts and depositing shares at Scottsdale.

6. Starting on May 10, 2013, the Argentines opened accounts at Scottsdale with Scarpino as their registered representative. During the account-opening process, Scarpino learned that the Argentines shared several unusual characteristics, which suggested that they might be acting in concert. In particular, Scarpino knew:

- Each of the Argentines stated that they intended to deposit physical certificates of BIZM stock in significant amounts, ranging from 1.815 million to 2.37 million shares for a total of 8.2 million shares; and
- Each of the Argentines requested the ability to place orders with Scarpino via instant message, which was not a functionality that Scottsdale offered its customers.

7. The initial account opening documents Scarpino received for each of the Argentines listed Panther as the referral source. In response to inquiries from Scarpino and compliance personnel at Scottsdale, however, the Argentines claimed they did not know Panther.

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Ultimately, Panther's name was deleted from each of the account opening documents and the referring source was left blank.

B. Panther Confirms His Connections to Biozoom and the Argentines

8. On May 15, 2013, Scarpino and the Owner flew on the Owner's private jet to meet with Panther in California to discuss the Argentines. During their meeting, Panther told Scarpino that the Argentines planned to deposit share certificates into their respective accounts for trading.

9. Panther explained that he worked with Biozoom and similar start-up companies to maintain their share prices. Panther also told Scarpino and the Owner that the Argentines could bring a good amount of business to Scottsdale.

10. In return for what Panther suggested could be significant trading commissions to Scottsdale, he confirmed specific accommodations for the accounts, several of which he had previously requested. These accommodations included permitting the Argentines to place trades through instant message and significantly reducing commissions for the Argentines. Although some of these requests ran contrary to existing Scottsdale policies, the Owner directed Scarpino to grant them for Panther's referrals.

11. Panther's confirmation that he was connected with both Biozoom and the Argentines was a red flag that the Argentines were potentially affiliates of BIZM.

C. Scarpino Was Aware of Red Flags as He Deposited Substantial Amounts of Penny Stock for the Argentines

12. On May 16, 2013 – the day after Scarpino's meeting with Panther – the Argentines began working with Scarpino to deposit physical certificates of Biozoom stock into their new accounts. Scarpino knew that these certificates had been sent to Scottsdale from another broker-dealer that had rejected the Argentines' attempted deposits of the same certificates.

13. Each Argentine completed a Deposit Securities Request Questionnaire ("DSRQ"), which was necessary for the certificates to be deposited. These DSRQs required the Argentines to, among other things, explain how they obtained their shares and whether they planned to trade the shares in concert with anyone else. The Argentines' completed DSRQs provided no information on Panther's relationship or involvement with the Argentines, even though Scarpino knew that Panther had referred them to Scottsdale and was connected both to them and to BIZM.

14. The Argentines' DSRQs and related documentation raised numerous red flags of a potential unregistered distribution, which Scarpino knew or should have known:

- The Argentines were depositing a large volume of BIZM stock, which had no significant public trading in its history. Collectively, the Argentines' certificates represented 8.92 million BIZM shares, which constituted approximately 15% of BIZM's total outstanding shares, and approximately 44% of BIZM's total shares not bearing a restrictive legend;

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- The Argentines claimed to have purchased their 8.9 million shares of BIZM at prices between $0.003 and $0.005 per share, spending a total of only approximately $33,000; and

- All of the Argentines' certificates had been issued less than two months earlier, and they all purportedly acquired their shares in transactions with investors in Biozoom's predecessor company between February 26 and March 5, 2013.[2]

15. Because, as described above, Scarpino knew that the Argentines were connected to Panther and further knew that Panther had previously discussed Biozoom with Scarpino and the Owner, the numerous and significant red flags raised by the Argentines' share deposits – including the percentage of BIZM shares they controlled, nominal amounts they supposedly paid for the shares, the recent issuance of their share certificates, and other evidence of their connections to one another and to Panther – should have raised significant questions for Scarpino about their possible involvement in an unregistered distribution of BIZM stock coordinated by Panther. Scarpino, however, took no additional steps to investigate this possibility, and did not inform anyone else at Scottsdale about the accumulation of red flags of which he was aware.

D. Scarpino Was Aware of Additional Red Flags During the Unregistered Distribution of BIZM Stock

16. From May 28, 2013 until June 19, 2013, Scarpino offered and sold approximately 8.2 million BIZM shares through the OTCBB for proceeds of nearly $18.6 million on behalf of the Argentines. Given that the Argentines claimed to have paid a total of $32,700 for all of their deposited shares, they realized aggregate returns of more than 56,000% on Scarpino's sales of the shares they had supposedly purchased less than four months earlier.

17. No registration statement was filed or in effect with regards to Scarpino's offers and sales of the BIZM shares and no exemption from the registration requirements was available for those sales. Throughout the trading period, even more red flags of an illegal unregistered distribution appeared:

- The Argentines began liquidating their BIZM shares almost immediately after they were cleared for trading;

- Scarpino's offers and sales occurred amid a dramatic spike in trading of BIZM. Prior to May 16, 2013, the stock of BIZM and its predecessor company had traded once since its inception in 2007, a 300 share trade in November 2012 for $1.02 per share. From May 16, 2013 to June 19, 2013, BIZM's stock price increased from a starting price of $1.10 per share to as high as $4.50 per share. Over the same period, daily volume spiked from 10,000 shares to a high of 11.6 million shares.

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[2] Biozoom came into existence on April 1, 2013 via a reverse merger with a penny stock company named Entertainment Art, Inc. ("EERT"), followed by a name and ticker change. EERT was formed in 2007.

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This market was completely inconsistent with the prior trading history of BIZM and its predecessor company;

- This spike in activity coincided with a promotional campaign touting BIZM in radio, web, and print ads. The promotional campaign also involved mailers put out by third party media sources and was supported by numerous press releases issued by the company; and

- As Scarpino completed liquidating all or substantially all of the BIZM shares on behalf of an Argentine, that Argentine quickly asked Scarpino to wire out the proceeds to offshore accounts. In total, between June 11 and June 24, the four Argentines requested to wire out nearly $17 million, all of which was proceeds from the sale of the recently-deposited and sold BIZM shares.

18. On June 25, 2013, the Commission suspended trading in the BIZM securities. On July 3, 2013, the Commission charged four of the Argentine customers and others with violating Sections 5(a) and (c) of the Securities Act. The Commission obtained default judgments against all defendants in that matter. The Court granted injunctive relief and ordered the Argentines to pay disgorgement of $18,535,955 and penalties of $640,000.

E. Scarpino Did Not Engage in a Reasonable Inquiry

19. Sections 5(a) and 5(c) of the Securities Act prohibit the offer and sale of securities through interstate commerce or the mails, unless a registration statement is filed with the Commission and is in effect, or the offer and sale are subject to an exemption. 15 U.S.C. §§ 77e(a) and (c).

20. Section 4(a)(4) of the Securities Act exempts from the registration requirements of Section 5 "brokers' transactions executed upon customers' orders on any exchange or in the over-the-counter market but not the solicitation of such orders." 15 U.S.C. § 77d(4). Rule 144(g)(4) provides that for a transaction to qualify as a "brokers' transaction" under Section 4(a)(4), the broker must engage in a "reasonable inquiry" prior to the transaction, and after such inquiry he must not be "aware of circumstances indicating that the person for whose account the securities are sold is an underwriter[3] with respect to the securities or that the transaction is a part of a distribution of securities of the issuer." 15 U.S.C. § 77d(a)(4); 17 CFR § 230.144(g)(4).

21. The "reasonable inquiry" should consider, among other factors:

- the length of time the seller has held the securities;

- the nature of the transaction in which the securities were acquired; and

[3] Section 2(a)(11) of the Securities Act defines an underwriter as "any person who has purchased from an issuer, with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking." 15 U.S.C. § 77b(a)(11).

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- the number of shares of the class outstanding or the relevant trading volume. Notes to 17 CFR § 230.144(g)(4).

22. However, certain facts and circumstances surrounding the transaction might require additional inquiry in order for the broker to rely on the Section 4(a)(4) exemption. For example:

> A dealer who is offered a modest amount of a widely traded security by a responsible customer, whose lack of relationship to the issuer is well known to him, may ordinarily proceed with considerable confidence. On the other hand, when a dealer is offered a substantial block of a little-known security, either by persons who appear reluctant to disclose exactly where the securities came from, or *where the surrounding circumstances raise a question* as to whether or not the ostensible sellers may be merely intermediaries for controlling persons or statutory underwriters, then ***searching inquiry*** is called for.

Distribution by Broker-Dealers of Unregistered Securities, Securities Act Rel. No. 4445 (Feb. 2, 1962) (emphasis added). *See also Bloomfield et al.*, Exchange Act Rel. No. 71632, at 5 (Feb. 27, 2014) ("The accounts received large blocks of privately obtained shares of obscure penny stocks. Although the securities initially traded at low prices and in low volumes, the prices of, and trading volume in, these securities quickly escalated around the time of large deposits into the [ ] accounts. The escalation in prices and trading volume was generally associated with coordinated transactions among the various [] accounts and often accompanied by spam email campaigns touting the issuers' prospects. Once prices had risen substantially, the accounts started selling blocks of stocks. Eventually the stocks' prices collapsed. These indicia raised red flags of a possible unlawful distribution and market manipulation."); *Midas Securities, LLC and Jay S. Lee*, Exchange Act Rel. No. 66200, at 14 (Jan. 20, 2012) (holding that because "[t]he amount of inquiry required necessarily varies with the circumstances of the proposed transaction," in certain circumstances, a broker-dealer may need to "conduct a searching inquiry to assure itself that . . . proposed sales [are] exempt from the registration requirements and not part of an unlawful distribution.").

23. When conducting a reasonable inquiry, a registered representative may not rely on others, such as counsel's advice, to fulfill his reasonable inquiry obligation. *Wonsover v. SEC*, 205 F.3d 408, 415-16 (D.C. Cir. 2000) (rejecting registered representative's reliance on clearing firm, the transfer agent, counsel, and reliance on the clearance of sales by the "Restricted Stock Department" of his firm); *see also World Trade Financial Corp. v. SEC*, 739 F.3d 1243, 1249 (9th Cir. 2014) (rejecting argument that duty of reasonable inquiry was satisfied by reliance on third parties in conformity with industry practice and stating "brokers rely on third parties at their own peril, and will not avoid liability through that reliance when the duty of reasonable inquiry rests with the brokers").

24. It is not sufficient "for [the registered representative] merely to accept 'self-serving statements of his sellers and their counsel without reasonably exploring the possibility of contradictory facts.'" *Distribution by Broker-Dealers of Unregistered Securities*, Securities Act Rel. No. 4445 (Feb. 2, 1962) (quoting *SEC v. Culpepper*, 270 F.2d 241, 251 (2d Cir. 1959)). Nor may a broker "rely upon the absence of restrictive legends on the stock certificates when the circumstances surrounding the transaction indicate the need for a thorough investigation."

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Transactions in the Securities of Laser Arms Corporation by Certain Broker-Dealers, Exch. Act Rel. No. 34-28878, 1991 WL 292009 (Feb. 14, 1991).

25. No registration statement was filed or in effect as to Scarpino's offer and sale of the BIZM shares on behalf of the Argentines and no exemption from the registration requirements was available for these sales. Scarpino made use of means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell, sell, and deliver after sale the BIZM shares to the public.

26. Scarpino was presented with numerous and significant red flags raised by the deposits of BIZM shares and subsequent sales of those shares, which should have raised questions as to whether the Argentines were engaged in an unlawful distribution by, for example, acting as underwriters. These red flags included:

- the Argentines opened new accounts and delivered physical certificates representing a large block of thinly traded and low-priced securities;
- the deposited share certificates had been recently issued and represented a large percentage of the float for the security;
- the Argentines had a pattern of depositing physical share certificates, immediately selling the shares and then wiring out the proceeds to offshore accounts;
- there was a sudden spike in volume, coupled with a rising price in, a thinly traded and low-priced security; and
- Scarpino had reason to believe the Argentines were acting in concert with one another and in coordination with an affiliate of the issuer.

27. Throughout the process of opening the Argentines' accounts, depositing their certificates, and then offering and selling those shares into the market on behalf of the Argentines, Scarpino was confronted with red flag after red flag that he was facilitating an unregistered distribution of those shares. Despite the presence of these ample and glaring red flags, Scarpino did not perform a "reasonable inquiry" regarding the facts and circumstances surrounding those transactions, let alone the "searching inquiry" he was required to perform.

Violation

28. As a result of the conduct described above, Scarpino willfully violated Sections 5(a) and 5(c) of the Securities Act.

IV.

Pursuant to this Order, Respondent Scarpino agrees to additional proceedings in this proceeding to determine what, if any, civil penalties pursuant to Section 8A(g) of the Securities Act against Respondent Scarpino are in the public interest. In connection with such additional proceedings: (a) Respondent Scarpino agrees that he will be precluded from arguing that he did not violate the federal securities laws as described in this Order; (b) Respondent Scarpino agrees

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that he may not challenge the validity of this Order; (c) solely for the purposes of such additional proceedings, the allegations of the Order shall be accepted as and deemed true by the hearing officer; and (d) the hearing officer may determine the issues raised in the additional proceedings on the basis of affidavits, declarations, excerpts of sworn deposition or investigative testimony, and documentary evidence.

V.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Scarpino's Offer.

Accordingly, pursuant to Section 8A of the Securities Act, Sections 15(b) and 21C of the Exchange Act, and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent Scarpino shall cease and desist from committing or causing any violations and any future violations of Sections 5(a) or 5(c) of the Securities Act.

B. Respondent Scarpino be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization;

prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter; and

barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock,

with the right to apply for reentry after five (5) years to the appropriate self-regulatory organization, or if there is none, to the Commission.

C. Any reapplication for association by Respondent Scarpino will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory

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organization, whether or not related to the conduct that served as the basis for the Commission order.

D. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Timothy Scarpino as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Antonia Chion, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549.

It is further ORDERED, pursuant to Rule 100(c) of the Commission's Rules of Practice, 17 C.F.R. § 201.100(c), in the interest of justice and without prejudice to any party to the proceedings, that a public hearing for the purpose of taking evidence on the questions set forth in Section IV hereof shall be convened at a time and place to be fixed by, and before, an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110, following the entry of a final judgment against the last remaining defendant(s) in any action(s) arising out of or related to the facts in this Order ("Related Actions").

If Respondent Scarpino fails to appear at a hearing after being duly notified, Respondent Scarpino may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310.

This Order shall be served forthwith upon Respondent Scarpino personally or by certified mail.

It is further ORDERED pursuant to Rule 100(c) of the Commission's Rules of Practice, 17 C.F.R. § 201.100(c), in the interest of justice and without prejudice to any party, that the

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Administrative Law Judge shall issue an initial decision no later than 150 days from the date of the entry of a final judgment in any Related Actions.

VI.

It is further Ordered that, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. § 523, the findings in this Order are true and admitted by Respondent, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent under this Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the violation by Respondent of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. § 523(a)(19).

By the Commission.

Brent J. Fields
Secretary

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FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. SCOTTSDALE CAPITAL ADVISORS CORPORATION (CRD No. 118786), JOHN J. HURRY (CRD No. 2146449), TIMOTHY B. DIBLASI (CRD No. 4623652), and D. MICHAEL CRUZ (CRD No. 2450344), Respondents.	Disciplinary Proceeding No. 2014041724601 Hearing Officer–LOM **AMENDED EXTENDED HEARING PANEL DECISION**[1] June 20, 2017

The Respondent firm violated FINRA Rule 2010 by selling securities without registration and without an exemption, in contravention of Section 5 of the Securities Act of 1933. The firm's owner, Respondent John Hurry, also violated Rule 2010, because he engaged in activities designed to enable the unlawful transactions and evade regulatory scrutiny.

The Respondent firm and its Chief Compliance Officer, Respondent Timothy DiBlasi, violated NASD Rules 3010(a) and (b) and FINRA Rule 2010 by failing to establish and maintain a supervisory system, including written

[1] The original Extended Hearing Panel Decision has been amended to correct a factual error. The amendment does not change the substance of the decision.

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supervisory procedures, reasonably designed to ensure that the firm complied with Section 5 of the Securities Act.

The Respondent firm and its President, Respondent Michael Cruz, violated NASD Rule 3010(b) and FINRA Rule 2010 by failing to supervise and failing to respond appropriately to numerous red flags indicative of unlawful unregistered distributions.

The Respondent firm is fined $1.5 million. Hurry is barred in all capacities. He would also be fined $100,000, but, in light of the bar, the fine is not imposed. DiBlasi is suspended for two years and fined $50,000. Cruz is suspended for two years and fined $50,000. In addition, Respondents are ordered to pay costs, for which they are jointly and severally liable.

Appearances

For the Complainant: Jeffrey D. Pariser, Esq., Gregory R. Firehock, Esq., Laura Leigh Blackston, Esq., and Heather L. Freiburger, Esq., Department of Enforcement, Financial Industry Regulatory Authority.

For the Respondents: Kevin J. Harnisch, Esq., Michael J. Edney, Esq., and Ryan E. Meltzer, Norton Rose Fulbright US LLP.

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DECISION

I. INTRODUCTION

A. The Respondent Firm

The Respondent firm, Scottsdale Capital Advisors Corporation ("Scottsdale" or the "Firm"), is primarily engaged in the business of liquidating penny stocks for its customers without registration. The sale of securities without registration is unlawful unless an exemption exists. In selling securities without registration, Scottsdale usually relies on a "safe harbor" exemption created by the Securities and Exchange Commission ("SEC"), Rule 144. But the securities at issue here did not qualify for the Rule 144 exemption. Thus, the sales were unlawful.

1. The Firm Relied On The Rule 144 Exemption

SEC Rule 144 is highly detailed and technical. It both restricts some transactions and permits others that meet certain conditions. It comes into play where securities have been acquired from the issuer or an affiliate in an unregistered private transaction. Such securities typically are marked with a restrictive legend, and the holder may not sell such securities in the public marketplace unless an exemption applies to the sale.

In determining whether a sale of securities is exempt from registration under Rule 144, a broker-dealer must conduct an inquiry that focuses primarily on identifying the individual who is the beneficial owner of the securities to be sold, analyzing that person's relationship (if any) to the issuer of the securities, investigating the circumstances of that person's acquisition of the securities, and calculating how long the person has held the securities. Rule 144 imposes different holding periods on affiliates and non-affiliates of an issuer before they can resell the issuer's securities. In some circumstances, the holder can "tack" his holding period to that of his predecessor in the chain of holders to meet the applicable holding period.

The purpose of the Rule 144 inquiry is to ensure that the transaction is not a subterfuge for an issuer or its affiliates to distribute securities to the public while evading the disclosure requirements that accompany registration. Representations made by the parties interested in selling the securities must be carefully scrutinized by a broker-dealer firm because of the incentive to misrepresent the circumstances and conceal the true beneficial owners.

2. The Firm Lacked A Basis For "Tacking" To Achieve The Required Holding Period Under SEC Rule 144

In the transactions at issue, the purported beneficial owners claimed that neither they nor their predecessors were affiliates of the issuer. Their lack of affiliate status was critical to their ability to sell the shares pursuant to SEC Rule 144 because of the shorter holding period and fewer restrictions on non-affiliates.

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Even as non-affiliates, however, none of the purported beneficial owners of the shares that Scottsdale accepted for resale had held the shares long enough to qualify for the Rule 144 safe harbor holding period. Each seller therefore claimed that the applicable Rule 144 holding period was satisfied by tacking his holding period to the holding period of a prior holder.

In the transactions at issue, one prior holder claimed that he had forgiven a loan that he had made to the issuer and had exchanged the right to payment on the loan for stock. One of the prior holders forgave a promissory note that the issuer had used to pay him for consulting services. Another prior holder claimed to have extended an oral line of credit to the issuer and then to have accepted shares in satisfaction of a sum owed on the line of credit. A third prior holder forgave a portion of a promissory note extending an open-ended line of credit.

Each of these prior holders received the shares around the same time that he transferred them. Thus, the prior holder did not actually hold the shares long enough for his successor to satisfy the applicable holding period by tacking, creating an impediment to resale.

To overcome that impediment, the sellers of the securities claimed the benefit of another tacking provision under Rule 144. Rule 144 provides that where a holder of a security exchanges that security for another of the same issuer's securities, without any additional compensation, the holder may tack the holding period of the first security to the holding period of the second. The theory is that the exchange of one security for another of the same issuer does not change the nature of the holder's capital at risk, so the holding period for the new security can tack back to the date the old security was acquired. The sellers here characterized their prior holders' exchanges of notes for stock as exchanges of one security for another. On that basis, the sellers claimed that they could tack back to the inception of the prior holders' loans.

Whether the first instrument in the chain was a security is thus a threshold issue. The Firm treated the prior holders' promissory notes and lines of credit as securities and the conversion of that debt into stock as the exchange of one security of the issuer for another security of the same issuer. As a result, the Firm concluded that the sellers were permitted to tack their holding period all the way back to the inception of the prior holders' loans.

The Firm erred. The promissory notes and lines of credit were not securities. Rather, they were ordinary debt liabilities. Accordingly, the purported beneficial owners could not establish the requisite holding period, and the Rule 144 exemption did not exist.

3. The Firm Also Failed To Address Red Flags Signaling Unlawful Distributions

The transactions at issue involved persons seeking to sell large blocks of thinly traded, little-known securities acquired in a chain of private transactions originating with the issuer—generally a red flag that the SEC and FINRA have both said requires a "searching inquiry." The sellers acquired the shares from the prior holders and sought to resell the shares almost immediately. The immediate resale of a large block of stock that has never been the subject of registration disclosures strongly suggests an attempt to distribute securities to the public without

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registration. In addition, there were a large number of discrepancies and suspicious circumstances indicating that sham transactions, false documents, and nominees were being used to evade the securities laws and effect unlawful securities sales without registration. These red flags ought to have been investigated and appropriately resolved before the securities could be sold.

The Firm, however, blinded itself to the multiple red flags signaling that the transactions were unlawful public distributions of securities. It did not conduct the required searching inquiry. It sold the securities without a reasonable basis for a Rule 144 exemption. Because of the suspicious circumstances known to the Firm, it also was not entitled to the so-called "broker's exemption" under Section 4(4) of the Securities Act for ordinary trading.

B. Other Respondents

1. John Hurry

Scottsdale is owned indirectly by Respondent John Hurry and his wife, Justine Hurry, through other entities they own and control. John Hurry also owns the clearing firm that handles Scottsdale's business, Alpine Securities Corporation ("Alpine"), and an off-shore foreign financial institution ("FFI") located in the Cayman Islands, Cayman Securities Clearing and Trading SECZ, Ltd. ("CSCT").

Hurry set up CSCT in 2013 to act as a conduit through which other FFIs could deposit penny stocks at Scottsdale for resale in the U.S. securities market. During the relevant period, December 1, 2013, through June 30, 2014, CSCT deposited billions of shares of penny stocks for resale by Scottsdale. All the transactions at issue were routed through CSCT to Scottsdale.

2. Timothy DiBlasi

Respondent Timothy DiBlasi became Scottsdale's chief compliance officer ("CCO") shortly before the events at issue, and he remains its CCO. He maintains, however, that his responsibilities do not extend to the Firm's Rule 144 business.

3. Michael Cruz

Respondent Michael Cruz was the Firm's president, but now serves as general counsel to the collection of Hurry enterprises. During the relevant period, Cruz had final approval authority over the Rule 144 transactions at issue. In that role, he reviewed the information collected by others and determined whether it was sufficient to approve a deposit of stock certificates for resale. Everyone at the Firm, including Henry Diekmann, who headed the Firm's Rule 144 team at the time of the transactions at issue, and who is now the Firm's president, considered Cruz responsible for Rule 144 compliance.

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C. Parties To The Transactions At Issue

This case concerns Scottsdale's sales of stock issued by three little-known companies—Neuro-Hitech Inc. ("NHPI"), VoipPal.com ("VPLM"), and Orofino Gold Corp. ("ORFG"). CSCT deposited millions of the three issuers' shares in certificate form at Scottsdale for resale. Alpine cleared them, and Scottsdale sold them into the U.S. securities market pursuant to Rule 144 without registration.

In making the deposits of NHPI, VPLM, and ORFG stock, CSCT acted on behalf of three other FFIs: (i) Montage Securities ("Montage"), (ii) Titan International Securities ("Titan"), and (iii) Unicorn International Securities ("Unicorn"). Montage was located in Panama; Titan and Unicorn were in Belize. The FFIs, in turn, purported to act for the benefit of other entities, which were represented to be owned by individuals identified in documents as the beneficial owners of the shares.

II. PROCEDURAL HISTORY

FINRA's Department of Enforcement ("Enforcement") filed the Complaint on May 15, 2015. After an extension of time, Respondents filed an Answer on June 26, 2015. On December 11, 2015, Respondents filed a motion for summary disposition that challenged FINRA's authority to bring a disciplinary action for misconduct associated with the sale of unregistered securities. Briefing on the motion was completed on January 29, 2016. The Hearing Officer issued an Order on February 26, 2016, denying the motion and finding that FINRA has authority to bring this proceeding.

The hearing ran a total of 12 days in two sessions. The first session in Los Angeles, California, was held June 13-24, 2016. The second session in Washington, D.C. was held July 11-12, 2016. Ten witnesses testified at the hearing, including two experts.[2] In addition, the full transcript of an on-the-record interview ("OTR") was admitted into evidence, along with more

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[2] In addition to Hurry, DiBlasi, and Cruz, the following persons testified: Henry Diekmann, the Firm's current president; Jay Noiman, a former Scottsdale employee who served as CCO until DiBlasi took on that responsibility; David Byrne, a FINRA examiner who is a manager of the AML Investigative Unit; Craig D'Mura, a former Scottsdale employee who worked for a couple of months at CSCT; Christopher Frankel, the current CEO of Alpine; Marc Menchel, Respondents' expert; and Brian Underwood, Enforcement's rebuttal expert.

References to hearing testimony are in the following format: "Hearing Tr. (last name of witness), page of transcript." For example, Hurry's testimony is cited as "Hearing Tr. (Hurry) 1542-43."

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than 200 other exhibits.[3] On September 9, 2016, Enforcement and Respondents each filed one post-hearing brief.[4]

III. FINDINGS AND CONCLUSIONS

A. Jurisdiction

FINRA has jurisdiction to bring this proceeding against Scottsdale, Hurry, and DiBlasi because they are currently registered, and the Complaint charges them with misconduct committed while they were registered. FINRA has jurisdiction as to Cruz although he is no longer registered, because the Complaint was filed within two years of the time he was registered and it charges him with misconduct committed while he was registered.[5]

B. Background

We provide substantial background regarding Respondents and others connected to the transactions at issue to provide the context needed to understand the transactions, the Firm's

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[3] Gregory V. Ruzicka, who worked at CSCT during the relevant period, gave an OTR on May 27, 2015. The OTR became an exhibit. Complainant's exhibits are referred to with the prefix "CX" and an identifying number. Respondents' exhibits are referred to with the prefix "RX" and an identifying number. Joint exhibits are referred to with the prefix "JX" and an identifying number. Ruzicka's OTR is CX-178.

[4] References to the post-hearing briefs are as follows: Enf. PH Br. and Resp. PH Br. Respondents attached graphs and other materials to their post-hearing brief that were not offered or admitted into evidence. Respondents apparently created the graphs after the hearing based on exhibits that were admitted into the record. However, the graphs were not subject to any testimony explaining their creation or testing their accuracy. Respondents' post-hearing brief also contained references to website articles that were not admitted into the record. No copies of the articles were attached to the post-hearing brief. Respondents have not asked permission to reopen the record to admit any of these materials. Respondents simply refer and rely on the non-record materials. The Hearing Panel has not considered any of the following items (or assertions made in argument based on them) in formulating its decision:

- Huperzine A in Alzheimer's Disease—website article relating to NHPI (Resp. PH Br. 5, n.9);
- Same (Resp. PH Br. 7, n.20);
- OTCMarkets.com website on VPLM (Resp. PH Br. 7, n.22);
- The Markets OTCQB website article on VPLM (Resp. PH Br. 7, n.23);
- Historical price figures derived from data on OTCMarkets.com (Resp. PH Br. 12, n.58);
- A purported page from a FINRA Continuing Education Module (Resp. PH Br. 17, n.86; Appendix A);
- Graphs generated by Respondents purporting to use data in JX-264 and JX-268 (Resp. PH Br. 19, n.94; Appendix B);
- Graphs generated by Respondents purporting to use data in JX-279 and JX-281 (Resp. PH Br. 25, n.129; Appendix C);
- Graphs generated by Respondents purporting to use data in JX-308 and JX-310 (Resp. PH Br. 29, n.155; Appendix D); and
- Statement about trading volume attributable to CSCT's sales of ORFG (Resp. PH Br. 29, n.156; statement made without reference to source of information or record citation).

[5] FINRA By-Laws, Art. IV, Section 6; Art. V, Section 4.

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culture, and the Respondents' failure to take reasonable action in response to obvious red flags in connection with the transactions at issue. The background also provides information important in assessing the witnesses' credibility, and in evaluating the Respondents' likely future compliance with the laws and regulations governing Scottsdale's business.

1. Respondents

a. Scottsdale

i. The Firm's Focus On Rule 144 Business

Scottsdale, which is located in Scottsdale, Arizona, has been a FINRA member since 2002.[6] During the relevant period, the Firm had approximately 14 to 20 employees.[7]

Scottsdale's principal business is the deposit and liquidation of penny stocks for its customers.[8] Throughout the proceeding, the penny stocks sold by Scottsdale were also referred to as "microcap" securities.[9] Scottsdale sells most of these securities without registration. The primary exemption that Scottsdale relies on is Rule 144, so it has a dedicated Rule 144 team to review deposits of stock certificates for resale, and its procedures are oriented to Rule 144.[10] Scottsdale obtains customers by advertising in OTC Markets and through referrals.[11]

ii. The Firm's Direct Business With FFIs

Prior to Hurry's creation of CSCT in 2013, Scottsdale did business with FFIs directly. Two of the FFIs involved in this case (Titan and Unicorn) had pre-existing direct relationships with Scottsdale before they started doing business through CSCT.[12]

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[6] CX-1, at 3-9.

[7] Hearing Tr. (Cruz) 116; Hearing Tr. (Diekmann) 1496.

[8] Hearing Tr. (Hurry) 1318; Hearing Tr. (Cruz) 83; Hearing Tr. (Noiman) 1180. DiBlasi acknowledged that during the relevant period penny stock transactions accounted for most of the Firm's revenues, and that over 95% of the transactions that Scottsdale executed for its customers involved penny stocks, most of them unregistered. Hearing Tr. (DiBlasi) 1923.

[9] Microcap securities may be defined as low-priced stock issued by small companies with a market capitalization of $300 million or less. Microcap securities are generally more volatile and less liquid than the stock of larger companies. Most important, because many microcap issuers do not file financial reports with the SEC, it may be difficult for investors to obtain information about the management, products, services, and finances of microcap issuers. https://www.sec.gov/investor/pubs/microcapstock.htm. The SEC has expressed concern that the lack of publicly available information about microcap issuers can enable the spread of false information that misleads investors. *Id.* Many microcap securities trade in the "over-the-counter" ("OTC") market instead of a national exchange such as the New York Stock Exchange or NASDAQ. *Id.*

[10] Hearing Tr. (Cruz) 577, 583; Hearing Tr. (DiBlasi) 1952-54; Hearing Tr. (Diekmann) 818-19, 875-76, 884-86; Hearing Tr. (Hurry) 1600.

[11] Hearing Tr. (Cruz) 116.

[12] Hearing Tr. (Cruz) 192; Hearing Tr. (Diekmann) 727, 817-18; Hearing Tr. (Noiman) 1140-52.

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iii. The Firm's Disciplinary History

Scottsdale has been disciplined previously for selling unregistered securities and having inadequate supervisory procedures and written supervisory procedures ("WSPs") to detect and prevent the sale of unregistered securities. In October 2011, the Firm settled these and other charges, agreeing to a censure and a total fine for all the charges of $125,000 ("2011 Settlement").[13]

The Firm has also settled other types of disciplinary charges against it, which are relevant to the sanctions determinations. In 2009, it agreed to a censure and a $7,500 fine to settle charges that it had bought bonds from customers at unfair prices ("2009 AWC").[14] In August 2012, the Firm settled charges that it had failed to take appropriate action after being on notice that one of its representatives had been using his name and CRD number in stock promotion press releases. The Firm agreed to a censure and a $7,500 fine ("2012 AWC").[15] In 2015, the Firm agreed to a censure and a fine of $10,000 to settle charges that it had submitted reports to FINRA for the Order Audit Trail System that were inaccurate, incomplete, or in the wrong format ("2015 AWC").[16]

iv. The Firm Had Notice That Sham Transactions And The Use Of Nominees Were A Risk In Its Rule 144 Business With FFIs

(a) Four Prior SEC Disciplinary Actions

We find that prior to the events at issue in this case, the Firm was on notice that its business was susceptible to sham transactions and the use of nominees to conceal the true beneficial owners of securities. In four disciplinary actions involving Scottsdale's own employees and customers, the SEC alleged that sham transactions and nominees were used in unlawful sales in violation of Section 5 of the Securities Act of 1933. Those unlawful sales in turn were used to facilitate fraud and manipulation.

In December 2011, two of Scottsdale's registered representatives were named in an SEC complaint ("*Ruettiger*") involving the supposed assignment of portions of a convertible note to satisfy the applicable Rule 144 holding period, the use of nominees to conceal the identity of the true beneficial owners, the use of a "pump-and-dump"[17] scheme to manipulate the market for the stock, and an unlawful distribution of securities without registration. According to the complaint,

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[13] CX-12.

[14] CX-11.

[15] CX-13.

[16] CX-14.

[17] "Pump-and-dump" schemes involve the touting of a company's stock (typically small, so-called "microcap" companies) through false and misleading statements to the marketplace. https://www.sec.gov/answers/pumpdump.htm.

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Scottsdale's registered representatives handled some of the accounts involved in the scheme, and one of them had an interest in an entity that received and sold some of the securities. The complaint alleged that a single person had used 16 Panamanian corporations to conceal his identity and enable him to sell approximately $6 million of stock without registration.[18]

In March 2013, the SEC filed a complaint ("*Gibraltar I*") against a number of people and entities alleging a market manipulation scheme that was facilitated by a Scottsdale customer, Gibraltar. That complaint alleged that individual defendants had secretly sold shares through Gibraltar while simultaneously promoting the stocks and encouraging others to buy. It also alleged that Gibraltar had provided false affidavits and misleading statements that allowed an individual defendant to secretly sell shares of companies he was promoting.[19]

In April 2013, the SEC filed a second complaint against Gibraltar and its owner ("*Gibraltar II*"), alleging that they had facilitated unlawful sales of securities without registration through the use of nominees. According to that complaint, Gibraltar liquidated low-price, thinly traded stocks on behalf of its clients, often during periods of suspicious promotion. Gibraltar assisted its clients to incorporate international business corporations ("IBCs") and encouraged them to use nominee officers and directors so that their identities would remain confidential. The SEC charged that two persons had opened "fake nominee accounts" at Scottsdale.[20]

Gibraltar had been a direct customer of Scottsdale since before the spring of 2010, at least two years before the SEC filed charges against it.[21] It shut down after the filing of the two *Gibraltar* complaints, and some of its customers transferred to Titan, one of the FFIs involved in this case.[22]

In July 2013, the SEC filed an action against ten Argentinians, four of whom had opened accounts at Scottsdale ("*Tavella*"). That complaint alleged that the defendants had submitted false documentation to accompany their securities deposit checklist at Scottsdale, and sold millions of shares into the public markets without registration in violation of Section 5. The defendants claimed that they had purchased their shares from former shareholders, but the former shareholders had already sold their shares years before. Thus, the transactions in which the defendants claimed that they had acquired the shares were a sham.[23]

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[18] *SEC v. Ruettiger*, No. 2:11-cv-2011 (D. Nev. filed Dec. 16, 2011), available at https://www.SEC.gov/litigation/complaints/2011/comp22198.pdf.

[19] Hearing Tr. (Cruz) 195-99; *SEC v. Carrillo Huettel*, No. 13 Civ. 1735 (S.D.N.Y. filed Mar. 15, 2013), available at https://www.SEC.gov/litigation/complaints/2013/comp-pr2013-39.pdf.

[20] Hearing Tr. (Cruz) 185-192; *SEC v. Gibraltar Global Sec., Inc.*, No. 13 Civ. 2575 (S.D.N.Y. filed Apr. 18, 2013), available at https://www.sec.gov/litigation/complaints/2013/comp22683.pdf.

[21] Hearing Tr. (Diekmann) 1912-13.

[22] Hearing Tr. (Diekmann) 727.

[23] *SEC v. Tavella*, No. 13-cv-4609 (S.D.N.Y. filed July 3, 2013), available at https://www.SEC.gov/litigation/complaints/2013/comp-pr2013-122.pdf.

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These regulatory actions should have caused the Firm to take special care when dealing with FFIs, and to revise its procedures to focus on potential sham transactions and the use of nominees. The Firm did not. Its main reaction to *Ruettiger* was to eliminate the branch office involved in the case. Cruz believed that the misconduct identified in the *Gibraltar* cases was "isolated."[24] Scottsdale's current president, Diekmann, who was the head of the Rule 144 team when the *Tavella* complaint was filed, testified that he could not remember if the Firm conducted any investigation of the four Argentinians named in the *Tavella* complaint who had Scottsdale accounts.[25] In Diekmann's view it was "just impossible to know that there was somebody else behind this."[26] Cruz similarly said, "[I]t's almost impossible to detect these nominees, that they're going to be ... misrepresenting the—you know, the true identity of these persons."[27] Although the Firm changed some procedures as a result of *Tavella* (it would not accept more than 9.9% of a security at any one time from its customers and it instituted a stock watch list to monitor trading and promotions), Diekmann could not remember doing anything different to address the problem of nominees.[28]

(b) Respondents' Arguments Minimizing Significance Are Rejected

In their post-hearing brief, Respondents argue that the SEC complaints are not relevant because they were classic pump-and-dump cases, and no charge is made here that the transactions at issue were part of a pump-and-dump fraud. It is not necessary, however, to prove that fraud occurred in order to conclude that Respondents failed to perform their gatekeeping duty adequately. The focus here is on Respondents' failure (i) to recognize as a threshold matter that the transactions lacked a legal underpinning, and (ii) to respond appropriately to an accumulation of red flags and suspicious circumstances, either conducting further investigation to make sure an exemption existed or declining to sell the securities.

Respondents also claim that references in the prior complaints to nominees were "peripheral."[29] To the contrary, the use of nominees was critical to facilitating the fraud and manipulation charged in those cases. We reject Respondents' attempt to brush aside the SEC complaints.

Cruz took a different approach at the hearing to minimizing the significance of the SEC complaints, which we also reject. He insisted on a benign definition of the term "nominee" to mean only someone designated to act on behalf of another. He declined to view the *Ruettiger* complaint as raising a concern about the use of nominees. He said, "I wasn't sure if this is a

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[24] Hearing Tr. (Cruz) 219.

[25] Hearing Tr. (Diekmann) 732-33.

[26] Hearing Tr. (Diekmann) 732.

[27] Hearing Tr. (Cruz) 213-14.

[28] Hearing Tr. (Diekmann) 733-34.

[29] Resp. PH Br. 36-37.

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situation where the—the nominees here that are being listed were purposely hiding their identity. It could be, but … that just was not my takeaway when I was looking at this … Complaint."[30] When asked whether the allegation of "fake nominee entities" gave him pause, Cruz responded, "I have no idea what fake – I mean, if it's an entity – I mean, if it – I don't know what they mean by 'fake.'"[31] Cruz refused to admit that the complaint in *Ruettiger* put him on notice of the possibility of nominees hiding the actual true beneficial owner of securities. He testified, "I would say this is probably not a case that gave me a great concern about the nominee issue, per se …. There might be a nominee issue in there. I guess I don't know the context of that."[32]

We find Cruz's refusal to acknowledge the plain import of the SEC's allegations in *Ruettiger* and the other complaints disingenuous. Even Respondents' expert agreed that Scottsdale was on notice that its customers could be nominees for beneficial owners as of the relevant period in this case.[33]

(c) Later Actions Confirm Risk Of Sham Transactions And Nominees

The risky nature of Scottsdale's Rule 144 business with FFIs became undeniable in the summer of 2014, when the SEC and criminal authorities initiated two new proceedings charging that certain Scottsdale customers and others had used sham transactions and nominees to sell penny stocks unlawfully without registration. These proceedings were brought based on extensive evidence gathered through the use of undercover agents, cooperating witnesses, and recorded conversations. The allegations appeared well founded, and they finally caused Scottsdale and CSCT to react.

The SEC filed a complaint on July 11, 2014 ("*Amogear*"), charging five individuals with using nominee accounts in FFI trading to conceal beneficial ownership and facilitate a pump-and-dump scheme. The SEC alleged that Titan had agreed to assist in the scheme and that Alpine, the clearing firm, was involved in readying shares for trading in connection with the scheme. In reaction to *Amogear*, Scottsdale froze its FFI trading for a couple of months.[34]

On September 8, 2014, prosecutors filed an indictment in federal district court in New York ("*Bandfield*") that charged Titan, Unicorn, and several individuals with whom Scottsdale and CSCT did business with securities fraud, tax fraud, and a money-laundering conspiracy. Those individuals included the following persons, who were also involved in the transactions at issue here: Cem ("Jimmy") Can at Unicorn; Kelvin Leach and Rohn Knowles at Titan; and Robert Bandfield and Andrew Godfrey, who purported to represent customers of Montage,

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[30] Hearing Tr. (Cruz) 191.

[31] Hearing Tr. (Cruz) 192.

[32] Hearing Tr. (Cruz) 184.

[33] Hearing Tr. (Menchel) 2488-89.

[34] Hearing Tr. (Diekmann) 705-12; Hearing Tr. (Cruz) 204-08; CX-250.

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Unicorn, and Titan and appeared in connection with numerous sub-accounts and sub-sub-accounts at Scottsdale. According to the indictment, Robert Bandfield claimed in a recorded conversation that he had created Titan and more than 5000 sham companies. In that conversation, he explained how reporting requirements could be circumvented and beneficial ownership concealed by using nominees.[35] After the indictment was unsealed and became public, CSCT's business substantially diminished.[36]

b. John Hurry

Indirectly, through a trust and a holding company, John Hurry and his wife, Justine Hurry, own Scottsdale.[37] From the Firm's inception in 2002 until December 2012, Respondent Hurry was a registered representative, among other roles.[38] John Hurry again registered with the Firm in October 2014, and remains registered today.[39] Hurry admitted in his Answer to the Complaint that he has been the Firm's director since 2002. However, at the hearing, he claimed that he first became a director of Scottsdale in January 2013. Justine Hurry became its second director in May 2013.[40]

Scottsdale has been highly profitable for Hurry and his wife. According to the Annual Audited Report Form for Scottsdale during the year beginning July 1, 2013, and ending June 30, 2014, the Firm paid $6,222,550 in directors' compensation. Since John and Justine Hurry were the Firm's only directors, this expense presumably was paid to them.[41] The Firm paid other

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[35] CX-244; CX-226; Hearing Tr. (Cruz) 224-30; Hearing Tr. (Diekmann) 1725-26, 1781.

[36] Hearing Tr. (Cruz) 237-38; Hearing Tr. (Hurry) 1529-30.

[37] CX-1, at 7-9; CX-5; Hearing Tr. (Cruz) 81-82.

[38] CX-15, at 11.

[39] CX-15, at 4-5.

[40] CX-1, at 3-9 (showing the Firm's direct owners and directors); CX-17, at 1. In his Answer, Hurry admitted that he had been a director of Scottsdale since 2002. Answer ¶ 16. At the hearing, however, Hurry denied that he had been a director of Scottsdale before January 2013. He did so despite the fact that his signature appeared over the designation "sole director" in a December 2012 document authorizing the creation of the Firm's Management Committee. At the hearing, he claimed that the designation as sole director was a typographical error and that he was acting president prior to January 2013, not sole director. CX-3; Hearing Tr. (Hurry) 1306-09. Cruz testified as to the December 2012 document that Hurry had established the Firm's Management Committee in his capacity as director of the Firm. Hearing Tr. (Cruz) 74-76.

The conflict between the Answer and Hurry's testimony is inexplicable. We find the conflict between Hurry's testimony and the Firm's record of the creation of the Management Committee disturbing, because it reflects a lack of transparency and accountability. We find the typographical error explanation with regard to something as important as corporate authority to designate the responsibilities of senior management—particularly in a simple one-page document—not credible. There is no explanation for the conflict between Hurry's testimony that he was not a director of the Firm in December 2012 and Cruz's testimony that he was. The conflict in the evidence on this point diminishes Hurry's credibility.

[41] RX-42, at 7, 11. When Cruz officially became Scottsdale's president in March 2014, it was by unanimous consent of the Board of Directors, John and Justine Hurry. CX-4.

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compensation of $1,665,574 and professional and consulting fees of $1,138,090. When these payments and other expenses were subtracted from the Firm's gross profit of $11,569,817, the Firm reported net income of $1,446,655. Because Scottsdale is an S corporation, this income flowed through to the shareholders. In the next year, ending June 30, 2015, although the Firm reported only $589 in net income, the Firm paid directors' compensation of $3,255,200.[42]

During the relevant period, Respondent Hurry also was the indirect owner of Scottsdale's clearing firm, Alpine, which is located in Salt Lake City, Utah. Hurry has been its director since March 2011,[43] and has been registered with Alpine since May 15, 2015.[44]

In 2013, Hurry established CSCT, the Cayman Islands broker-dealer through which the securities at issue were deposited at Scottsdale.[45] Hurry owns CSCT,[46] and, as more fully discussed below, he made decisions, both large and small, about how it conducted its business.[47] Despite the highly specialized nature of CSCT's business, Hurry hired Gregory Ruzicka—an out-of-work California real estate attorney who had no prior experience in the securities broker-dealer industry, much less in the specialized business of liquidating microcap securities—to run CSCT.[48] Ruzicka went down to the Cayman Islands in October 2013 to take on his CSCT duties.[49] Hurry then monitored Ruzicka's activities almost daily, right down to his cigarette breaks, and visited the Cayman Islands at least monthly.[50]

Although Hurry attempted to conceal the extent of his involvement in CSCT's business, he admits that he spoke with the three CSCT customers involved in this case (Montage, Titan, and Unicorn), and that he personally visited two of them, Montage in Panama and Unicorn in Belize.[51] He claims that he did not solicit business for CSCT, but, as discussed below, that claim is not credible.

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[42] RX-42, at 27. See also the Firm's FOCUS Reports for 2013-Q4, 2014-Q1, 2014-Q2, 2015-Q3, 2015-Q4, and 2016-Q-1, and the summary of them created by Enforcement. CX-6 through CX-10.

[43] CX-15, at 3, 11; CX-18.

[44] Hearing Tr. (Hurry) 1307.

[45] Hearing Tr. (Hurry) 1329; Hearing Tr. (Noiman) 1117-18; CX-29.

[46] CX-178, at 40-41.

[47] Hearing Tr. (Hurry) 1333-35.

[48] Hearing Tr. (Hurry) 1631; CX-178, at 13-24. Ruzicka had limited experience in the early 1980s with intrastate real estate limited partnership offerings. In that context, he handled post-foreclosure unlawful detainers, relief from automatic bankruptcy stays, and receiverships on commercial properties. CX-178, at 15-18.

[49] CX-178, at 20.

[50] Hearing Tr. (Hurry) 1437-40; CX-178, at 138-41, 151-52; CX-132; CX-133.

[51] Hearing Tr. (Hurry) 1406-08, 1412-14, 1421-22.

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That Hurry was in charge was obvious to his employees and to CSCT customers. Ruzicka referred to him as "the big boss."[52] As noted below, one of the persons at Scottsdale who approved CSCT to become a Scottsdale customer did not even consider rejecting CSCT's application because he knew that Hurry had brought CSCT to the Firm.[53] Similarly, Ruzicka said that CSCT never considered using any broker-dealer except Scottsdale because of Hurry.[54] As Hurry acknowledged, customers also sought direct contact with him because he is "highest on the totem pole."[55]

Respondent Hurry thus owns and controls all three firms involved in the transactions at issue in this proceeding—Scottsdale, Alpine, and CSCT. In fact, the three firms were almost a self-contained system for processing and distributing microcap securities. CSCT did all its business through Scottsdale,[56] and Scottsdale in turn did all its business with Alpine.[57] Alpine's current CEO described Alpine as a small "boutique" clearing firm with a focus on the kind of business brought to it by CSCT.[58] No independent third party was involved in preparing, approving, or clearing the deposits of stock certificates by CSCT at Scottsdale for resale.

c. Timothy DiBlasi

DiBlasi first entered the securities industry in 2002. From December 2002 through March 2012, he was a compliance analyst at First Investors Corporation in New Jersey. DiBlasi has been associated with Scottsdale since April 2012. In June 2012, he became the Firm's anti-money laundering chief officer ("AMLCO"). In October 2013, shortly before the events at issue, DiBlasi became the Firm's CCO, and he remains the Firm's CCO today. Prior to joining the Firm, DiBlasi had limited experience in microcap securities, and he had not handled the type of restricted stock deposits that are the bulk of Scottsdale's business.[59]

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[52] CX-240; Hearing Tr. (Diekmann) 1764-65.

[53] Hearing Tr. (Noiman) 1079, 1103, 1105-06, 1117-18. See also CX-29, at 10, 25 (forms to establish CSCT as a Scottsdale customer listed Hurry as referral or source of the business).

[54] CX-178, at 108.

[55] Hearing Tr. (Hurry) 1432.

[56] Ruzicka testified that CSCT never considered using a firm other than Scottsdale because of Hurry. CX-178, at 108.

[57] Hearing Tr. (Cruz) 143, 306, 382; Hearing Tr. (Diekmann) 759; Hearing Tr. (D'Mura) 2293. The person Hurry hired to run CSCT, Gregory Ruzicka, described CSCT as an "adjunct" of Hurry's operations at Scottsdale. CX-178, at 34.

[58] Hearing Tr. (Frankel) 2342-43. Alpine did do business with other FFIs in addition to CSCT during the relevant period. Hearing Tr. (Frankel) 2343.

[59] Hearing Tr. (DiBlasi) 1919-21; Hearing Tr. (Cruz) 122; CX-19.

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d. Michael Cruz

Cruz entered the securities business in 1994, when he began working at a San Francisco investment banking firm on underwritings, asset-backed securities, and private placements. After approximately six years, he joined FINRA's predecessor, NASD, starting in its San Francisco office as a cause examiner and then moving to New York as a cycle examiner. He then took a job with Citigroup Smith Barney in their central risk group, reporting to the General Counsel and CCO. Subsequently, he moved with his family to Arizona and passed the bar there. In Arizona, he first worked for Wells Fargo in its audit department and then took a similar position at Countrywide in its bank legal department. He left Countrywide when Bank of America acquired it, and he began working at Scottsdale in May 2008.[60]

Cruz has held Series 7, 24, and 63 licenses. However, since January 29, 2015, he has not been registered through Scottsdale. He currently is the general counsel for the holding companies that own Scottsdale and its clearing firm, Alpine.[61]

At the beginning of the relevant period, Cruz was listed on the Firm's Form BD as legal counsel and member of the Management Committee.[62] Cruz officially became the Firm's president by a board resolution dated March 17, 2014. He testified that, at least since December 1, 2013, he had been acting as *de facto* president.[63] The Firm amended its Form BD on March 31, 2014, to disclose that Cruz was the president, as well as legal counsel.[64]

During the relevant period, Cruz approved Rule 144 deposits, including the transactions at issue.[65] Cruz signed the Deposited Securities Checklist ("Checklist") for the transactions at issue under the heading "144 Compliance Approval." Between that heading and his signature is the statement "[B]ased on the information received and reviewed as described in this Deposited Securities Checklist, SCA [Scottsdale] reasonably believes the subject securities are free trading."[66]

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[60] Hearing Tr. (Cruz) 72-73, 557-59, 661; CX-20.

[61] Hearing Tr. (Cruz) 72-73; CX-20.

[62] CX-17, at 1.

[63] Hearing Tr. (Cruz) 78-79; CX-4. Cruz said that the original plan had been for Justine Hurry to be president of the Firm. Hearing Tr. (Cruz) 79. Cruz's testimony that he was the acting president in December is inconsistent with Hurry's testimony that he was president at that time. This conflict concerning who was in charge illustrates the Firm's lack of appropriate supervisory procedures that clearly delegated authority and created accountability.

[64] CX-17, at 7.

[65] Hearing Tr. (Diekmann) 693-94.

[66] RX-1, at 2, 79, 159; RX-2, at 2, 107; RX-3, at 2.

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Cruz acted as the conduit between senior management of the Firm and the board of directors, John and Justine Hurry.[67]

2. Other Key Figures At Scottsdale

a. Henry Diekmann

After graduating from college with a degree in history, Diekmann spent approximately a year as a financial trainee with Morgan Stanley. He then was an insurance salesman for four months. After that, he was unemployed for about a year-and-a-half before he joined Scottsdale in March 2010 as an office assistant. In January 2011, he moved to the Firm's Rule 144 team, where he spent two years before being promoted to head the team. Although many members of the team were lawyers, Diekmann is not. He had no experience with low-priced securities or in clearing unregistered securities for trading before he joined Scottsdale. He was trained to review deposits by Cruz and another person who worked on the Rule 144 team.[68]

During the relevant period, Diekmann focused solely on reviewing CSCT deposits. But he did not have authority to approve a deposit of certificates. Final approval authority rested with Cruz.[69]

Since January 2015, Diekmann has been the Firm's president.[70] As the Firm's current president, Diekmann now has the authority that once belonged to Cruz.[71]

b. Eric Miller

Eric Miller was a Scottsdale salesman. He called potential customers and assisted in conducting due diligence on new accounts.[72] Miller sometimes referred clients to Ruzicka at CSCT.[73]

Although Miller did not testify at the hearing, there is substantial evidence that he was involved with Unicorn's deposits. Miller had a relationship with Unicorn because it had been Scottsdale's direct customer before moving its business to CSCT, and he continued to have contact with Unicorn even after it started doing business with Scottsdale through CSCT, as Diekmann admitted.[74]

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[67] Hearing Tr. (Cruz) 80-82.

[68] Hearing Tr. (Diekmann) 686-90.

[69] Hearing Tr. (Diekmann) 694, 886.

[70] Hearing Tr. (Diekmann) 685; Hearing Tr. (DiBlasi) 1954.

[71] Hearing Tr. (Cruz) 129-30, 583-84; Hearing Tr. (Diekmann) 685-86, 694, 908-09.

[72] Hearing Tr. (Cruz) 116-17; Hearing Tr. (Noiman) 1075-76; CX-29, at 9.

[73] CX-178, at 167-68.

[74] Hearing Tr. (Diekmann) 858, 934-35.

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The fact that Miller continued to have at least some direct contact with Unicorn is significant for the following four reasons:

First, the evidence regarding Miller casts doubt on the effectiveness of the Firm's compliance and supervisory efforts. Diekmann claimed that Miller's direct contact with Unicorn was prohibited and that Miller was "written up" a number of times for corresponding by email with Unicorn. Diekmann did not identify any written prohibition against direct contact with Unicorn, but he said that the prohibition was something that was a matter of business practice at the Firm.[75] The supposed prohibition is inconsistent with the record, which contains a number of emails to and from Unicorn that include Miller as a sender or recipient.[76] Moreover, in some Unicorn emails, Diekmann is a recipient along with Miller.[77] There is no evidence that Diekmann protested Miller's involvement or reprimanded him. If Miller was "written up" a number of times for contact with Unicorn, as Diekmann testified, it apparently had little effect. Diekmann's testimony regarding the supposed prohibition was not credible.

Second, the emails indicate that Miller was a "back door" for Scottsdale in dealing with Unicorn. Although the Unicorn deposits supposedly came through CSCT, Miller and others at Scottsdale corresponded directly with Unicorn personnel and directed Unicorn as to what needed to be done.

For example, Miller engaged in extensive email correspondence with Natalie Bannister at Unicorn in November 2013 about setting up its account with CSCT. Miller instructed her that the stock certificates to be deposited at Scottsdale had to be made out in CSCT's name and sent by CSCT to Scottsdale. Bannister indicated that she did not like transferring ownership to CSCT, "especially with it not in writing." Miller insisted, "These are important details." He said that the account at Scottsdale was in CSCT's name and the "cert[tificate deposit] NEEDS to be in [CSCT's] name, that is all there is to it."[78] Thus, it was Scottsdale—not CSCT—that was making the arrangements and instructing the customer on what had to be done.

Miller shepherded Unicorn's due diligence packages through CSCT. In March 2014, he instructed Unicorn staff and Ruzicka to get together on the telephone to discuss which documents were needed and could be provided for a deposit.[79] Similarly, in May 2014, Miller engaged in email correspondence directly with Unicorn's Back Office Manager, Chinique Lewis, asking her about ORFG, one of the stock deposits at issue in this case. He asked her—not Ruzicka—how the package was coming along. Then Lewis emailed Miller—not Ruzicka—to ask if there was "[a]nything on the [ORFG] as yet?" At that point, Miller emailed her back

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[75] Hearing Tr. (Diekmann) 1664-65.

[76] See CX-216.

[77] See CX-119.

[78] CX-270.

[79] CX-171.

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directing her to call Ruzicka and have him call Miller.[80] Miller's last instruction in the correspondence appears to us to reflect an awareness that Scottsdale should be seen to be dealing only with and through CSCT, when, in fact, Scottsdale, through Miller, was continuing to guide the business with Unicorn.

In April 2014, when Diekmann was unable to obtain the information he needed on a deposit of stock certificates by Unicorn from Ruzicka at CSCT, he emailed Miller a copy of his request to Ruzicka, saying he had not received a response. And Miller, in turn, forwarded the email directly to two persons at Unicorn, Cem Can and Chinique Lewis, asking them to "please address this ASAP."[81] Diekmann denied that he had asked Miller to obtain the information for him, but the correspondence has no other reasonable explanation. Diekmann's testimony in this regard was not credible.[82]

In May 2014, Miller obtained information from Chinique Lewis at Unicorn about the purported beneficial owner of the entity that had deposited VPLM stock through Unicorn for sale by Scottsdale and forwarded that to Diekmann. The email correspondence was included in the VPLM due diligence package.[83]

The degree to which Miller corresponded directly with Unicorn and managed the Unicorn deposits raises the question whether there was any need for CSCT at all. As discussed below in the credibility section, Hurry's decision to route Scottsdale's FFI business through CSCT had little discernible business rationale. His implementation of that decision and staffing of CSCT with Ruzicka, who was unqualified to run CSCT, coupled with the evidence of Miller's continuing role as a "back door" to Scottsdale, demonstrate that CSCT was a façade.

Third, we interpret certain email correspondence between Miller and a client as suggesting that the Firm assisted its clients "all the time" to conceal beneficial ownership of stock. Scottsdale supposedly had a policy not to accept business from Canadian citizens residing in Canada, but, when a client in the Bahamas asked on behalf of a friend whether a Canadian citizen residing in Canada could do business with Scottsdale, Miller suggested that the friend set up a corporation to do the business. Miller called it a "work around." The client responded, "If they get a corporation set up US, Panama, Belize or wherever won[']t your Compliance want to know who is beneficial owner?" Miller responded, "Yes they will but the account holder is the corporation. Trust me on this one, we do it all the time."[84]

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[80] CX-311, at 1.

[81] Hearing Tr. (Diekmann) 1668-71; CX-221.

[82] CX-221; Hearing Tr. (Diekmann) 1665-71. In denying that he intended for Miller to obtain the information from Unicorn that Ruzicka had failed to supply, Diekmann testified that he had no interest whatever in whether he obtained the information. Hearing Tr. (Diekmann) 1665-71. That statement is not credible. If he had no interest, there would have been no reason to send the email to Miller.

[83] RX-3, at 17.

[84] CX-210; Hearing Tr. (Diekmann) 1672-77.

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We are unconvinced by Diekmann's benign reading of this correspondence. He testified that he thought that the client was asking something different, "Won't your compliance know that a Canadian resident owns the LLC and, therefore, won't they reject the deposit or account opening?"[85] Diekmann's interpretation is a rewriting of the client's words. It ignores that Miller's implicit point was that the corporation would be identified as the account holder, not the Canadian owner. That is why the Canadian's deposit would not be rejected. Furthermore, Diekmann's interpretation does not reflect the tone of Miller's comments. When Miller suggested that the shares could be put in the name of the corporation, he treated that as a magical solution to the problem, saying "and wa-la! We get it done that way."[86] Finally, if Diekmann's interpretation of the question were correct, then Miller never answered the question. Miller never explained why the Firm would not reject the deposit if it knew that a Canadian resident owned the LLC.

Fourth, according to Diekmann, after Miller left the Firm in April 2016, the Firm discovered that he had set up his work email to be forwarded to his personal email.[87] This means that Miller could have engaged in communications with FFIs like Unicorn "off the record," avoiding oversight. Although Diekmann testified that all of Scottsdale's emails remained on its system, and were not removed by Miller, Diekmann provided no basis for knowing whether that was true. Diekmann testified that the Firm had asked Miller to confirm he had not removed any emails from the Firm's system but that Miller had not responded.[88]

The inquiry suggests that the Firm in fact does *not* know whether Miller removed emails from the Firm's system. There was no evidence that the Firm employed any technical analysis of its systems to find out if emails or other information had been deleted. There also was no evidence that the Firm made any effort to recover any email correspondence that Miller might have had with customers using only his personal email. Thus, it is undisputed that Miller communicated directly with Unicorn, and it is impossible to know the number or substance of all those communications.

Given the allegations against Unicorn and Cem Can in the *Bandfield* indictment, the inability to review Miller's communications with them is a serious concern. The Firm's reaction—simply to ask Miller to confirm he did not remove any emails from the Scottsdale's system—is an inadequate response. If Miller took emails from Scottsdale's system or deleted them, he would hardly be likely to confess to that wrongdoing. That is particularly so where the emails were with persons subject to a criminal indictment and might place Miller under suspicion. The request to a potential wrongdoer to confirm that he committed no wrongdoing is almost farcical. The inadequacy of the Firm's response mirrors the inadequacy of its checklist

[85] Hearing Tr. (Diekmann) 1673.

[86] CX-210, at 5.

[87] Hearing Tr. (Diekmann) 1662-63.

[88] Hearing Tr. (Diekmann) 1663-64.

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approach to Rule 144 due diligence and contributes to our conclusion that stringent sanctions are required here.

c. Jay Noiman

Jay Noiman joined Scottsdale in September 2011 and left at the end of December 2014.[89] Prior to October 2013, when DiBlasi became CCO, Noiman was the Firm's CCO.[90] He was on the Management Committee from approximately January 2013 through January 2014. He served as vice chairman of the Management Committee and second in command after Cruz. During the relevant period, Noiman was the trading manager and had responsibility for supervising the traders and sales staff. He identified DiBlasi as his supervisor.[91]

Noiman was responsible for reviewing the blotter for restricted stocks. He focused on FFIs,[92] and he approved the account opening documents for CSCT, which was an FFI. Noiman never considered not approving the CSCT account. He knew at the time that it was a referral from Hurry.[93]

Noiman also signed documents in the due diligence packages for the transactions in this case. His signature appears on the Checklist under the heading "Broker Approval." Between the heading and Noiman's signature was the statement that he had carefully reviewed the Checklist and the supporting documents and that to the best of his knowledge "any resale will be made in compliance with firm policy and all applicable laws."[94] By that language, the Checklist makes it appear that Noiman was certifying that he believed that the transaction would comply with the law.

Noiman testified, however, that his signature signified only that all the necessary forms were in the file—a check-the-box function.[95] The parties stipulated that Noiman's signatures on the documents in the three due diligence packages meant the same thing: he checked that the documents were filled out but did not substantively approve or review them.[96] Thus, Noiman's signature on the Checklist created only a façade of compliance and accountability.

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[89] Hearing Tr. (Noiman) 1041-42.

[90] Hearing Tr. (Noiman) 1043.

[91] Hearing Tr. (Cruz) 81, 564; Hearing Tr. (Noiman) 1043-44.

[92] Hearing Tr. (Noiman) 1045-46, 1049-51.

[93] Hearing Tr. (Noiman) 1139-40.

[94] RX-1, at 2; RX-2, at 2; RX-3, at 2.

[95] Hearing Tr. (Noiman) 1156-68, 1171-73.

[96] Hearing Tr. (Noiman) 1172-73.

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During the relevant period, Noiman, like Miller, had contact with one of the FFIs involved in this case, Titan.[97] Noiman talked with Rohn Knowles of Titan at least monthly and sometimes weekly and engaged in email correspondence with Knowles.[98] Both Titan and Knowles were defendants in the *Bandfield* indictment. As discussed below, Noiman obtained information directly from Knowles, which he forwarded to Cruz, to resolve a serious potential problem with a CSCT deposit of VPLM stock. CSCT's staff was not involved.[99] Thus, Noiman was another "back door" to a CSCT customer, raising once again the question why CSCT even existed.

3. CSCT And Its Key Figures

a. Gregory V. Ruzicka

Prior to joining CSCT, Gregory Ruzicka was a real estate attorney in Newport Beach, California. He began his legal career advising exclusively on real estate issues and continued in the real estate field. He did not advise on the federal securities laws.[100] Before beginning work at CSCT, Ruzicka had no experience with Rule 144 or any of the other exemptions from registration under the federal securities laws.[101] Nor did Ruzicka have any prior experience with Cayman Islands law, the Bank Secrecy Act, or anti-money laundering rules and regulations.[102]

Ruzicka met John Hurry in 2002 when Hurry hired him to do some work on a commercial real estate issue. From time to time after that, Ruzicka did work for Hurry, but none of that work involved the securities laws or Hurry's broker-dealer business.[103]

Later, Ruzicka suffered a substantial financial setback that left him out of work and adrift.[104] At this point, Ruzicka asked Hurry to give him a job at a bicycle shop that Hurry owned. Hurry admitted that he was "kind of taken back a little bit."[105] Hurry proposed instead

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[97] Prior to the events at issue, Noiman was involved in the customer due diligence on Titan when it was a direct customer of Scottsdale. On January 18, 2012, Noiman signed a due diligence form as a principal of the Firm representing that to the best of his knowledge the information provided by Titan was true and correct. Noiman also signed the form as the person giving compliance approval. CX-242, at 48.

[98] Hearing Tr. (Noiman) 1185-87. Ruzicka was under the impression that Titan "had a special pipeline to Scottsdale." CX-178, at 110. He spoke of a young woman as being the "private liaison for Titan." CX-178, at 110.

[99] CX-296; CX-294; Hearing Tr. (Noiman) 1187-98. *See infra* at __.

[100] CX-178, at 12-20.

[101] CX-178, at 22-23.

[102] CX-178, at 18-19, 22-24.

[103] CX-178, at 25-29

[104] CX-178, at 14-15, 19-20, 30, 38, 54.

[105] Hearing Tr. (Hurry) 1631, 1635-36. Hurry told D'Mura that Ruzicka had asked, "Would you be able to help me out? Is there any position or something? Could I work at your bike shop or your ice cream shop? You know, you don't have to pay me a lot, but at this point, I don't have anything. I have $50 in my pocket." Hearing Tr. (D'Mura) 2262.

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that Ruzicka go to the Cayman Islands to run Hurry's operation there. According to Ruzicka, Hurry told him that Ruzicka would be running the business and acting as Hurry's lawyer.[106] Ruzicka had been to the Cayman Islands once before to go scuba diving, but he was willing to relocate because he had been through such a hard time and wanted a "change of scenery."[107] Hurry told Ruzicka that he had 30 days to read about Rule 144,[108] so Ruzicka read Rule 144, the Securities Act of 1933, and what he could find on the internet about the Rule 144 exemption.[109]

In mid-October 2013, Hurry flew with Ruzicka in Hurry's private plane to the Cayman Islands so that Ruzicka could begin work.[110] Ruzicka remained with CSCT until mid-October 2014.[111]

Diekmann testified that if CSCT had been his business, Ruzicka would not have been his choice to run the Cayman Islands broker-dealer. Ruzicka lacked securities experience, and he seemed disorganized, sending materials to Scottsdale piecemeal and failing to follow instructions.[112]

Ruzicka never had a securities license or registered with FINRA. Consequently, FINRA had no jurisdiction to compel him to testify. Ruzicka testified voluntarily at an OTR, and he considered testifying voluntarily at the hearing. However, after being contacted by counsel for Respondents, as discussed below in the credibility section, Ruzicka declined to testify. Consequently, Ruzicka's entire OTR was admitted into evidence.

b. Craig D'Mura

Craig D'Mura graduated from Arizona State University in May 2006 and shortly afterward began work at Vanguard Group in the retirement participant services department. After a year and a half, he went to law school at Syracuse University. Although he finished law school, he never took the bar examination and did not become licensed as an attorney. He returned to Phoenix and started a broker training program in 2010. However, he did not feel that being a broker was his "calling."[113]

D'Mura was unemployed in summer of 2011. He responded to an advertisement on Craigslist for an operations position at Scottsdale. In July or August 2011, after an interview with

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[106] CX-178, at 38-40.

[107] CX-178, at 54.

[108] CX-178, at 40.

[109] CX-178, at 22, 62-63.

[110] CX-178, at 37.

[111] CX-178, at 231.

[112] Hearing Tr. (Diekmann) 759-61, 765.

[113] Hearing Tr. (D'Mura) 2246-47.

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Justine Hurry, Scottsdale hired him. Prior to his work at Scottsdale, D'Mura was not even aware of the microcap securities industry.[114]

After two or three weeks in the operations position, D'Mura joined the Rule 144 team. His training was ongoing. By summer of 2013, he was handling more complicated deposits and was able to review files as a principal. However, he did not review deposits by FFIs.[115]

In summer of 2013, Hurry began discussing with Scottsdale staff his plan to open a broker-dealer in the Cayman Islands, and Cruz asked D'Mura if he might be interested in working there. D'Mura began filling out the paperwork necessary if he took the position in the Cayman Islands, and in January 2014, he flew with Hurry in Hurry's private airplane to the Cayman Islands to visit and consider a position with CSCT.[116] D'Mura decided to take the position, returned to Phoenix for a few days, and then went back to the Cayman Islands on January 28, 2014. He stayed with CSCT only about six weeks. After concluding that the situation was intolerable and would never improve, he left on March 14, 2014.[117]

c. CSCT

i. Hurry Set Up CSCT

In early 2013, Hurry set up CSCT in the Cayman Islands.[118] He became its director and intended to have overall management supervision of it and its business.[119] Through a chain of entities, a Hurry family trust owns CSCT, and Hurry and his wife serve as co-trustees of the trust.[120]

Hurry claimed that he set up CSCT because Alpine, his U.S. clearing firm, wanted to be relieved of IRS tax withholding obligations. According to Hurry, Alpine wanted to do business only with FFIs that had agreed with the IRS to take on tax withholding obligations, thereby becoming what is known as a qualified intermediary ("QI").[121] Hurry testified that withholding obligations are complicated and burdensome.[122] He also testified that there are risks in getting

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[114] Hearing Tr. (D'Mura) 2247-48.

[115] Hearing Tr. (D'Mura) 2248-51.

[116] Hearing Tr. (D'Mura) 2252-58.

[117] Hearing Tr. (D'Mura) 2266, 2306-09.

[118] Hearing Tr. (Hurry) 1329, 1333-34.

[119] Hearing Tr. (Hurry) 1394-95; CX-160, at 3.

[120] CX-21, at 2.

[121] Hearing Tr. (Hurry) 1373-74, 1552-61; Hearing Tr. (Frankel) 2345-46, 2349-51. Resp. PH Br. 8.

[122] Hearing Tr. (Hurry) 1554-57.

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the paperwork wrong and incurring penalties, and that there were tax advantages to generating and retaining funds offshore.[123]

Hurry's testimony was at a high level of generality, and there was no corroborating evidence to show the analysis. There was no evidence regarding how Alpine made the decision that it would only do business with QIs, or who made the decision. There was no evidence other than Hurry's testimony to demonstrate that CSCT made business sense. It is unclear how the expense of establishing and staffing a separate offshore office was less burdensome than Alpine's withholding obligations, or why the same goal of eliminating Alpine's withholding obligation could not have been achieved less expensively by requiring the Firm's FFI customers to obtain QI certification in order to do business with Scottsdale and Alpine. Moreover, since Hurry ultimately bore the costs regardless of which entity had the obligation, Alpine or CSCT, we are not persuaded that the claimed reason for creating CSCT made sense.[124]

Nor did the creation of CSCT make sense from the perspective of achieving regulatory compliance. As Cruz agreed, it is easier to spot problems with direct accounts than through an FFI like CSCT that operated as an intermediary for sub-accounts and sub-sub-accounts.[125]

Hurry's intense involvement in CSCT's operations did not abate after he hired Ruzicka in October 2013 to run CSCT's day-to-day operations. Hurry located and rented office space for CSCT before Ruzicka began work and then continued to closely oversee the details of establishing and opening the office after Ruzicka arrived. Hurry obtained a floor plan from Ruzicka, told Ruzicka it was not correct, and asked Ruzicka to take measurements and create a revision.[126] Hurry provided Ruzicka with contact information for shippers to ship furniture Hurry had found for the office.[127] Hurry reviewed the proposed CSCT website design and asked about the costs.[128] Hurry made the final decision on hiring a bookkeeper[129] and all the decisions on entering contracts.[130]

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[123] Hearing Tr. (Hurry) 1554-57.

[124] Hurry testified that he had allocated between $4 and $5 million for the project and had invested well over seven figures in CSCT. Hearing Tr. (Hurry) 1552. When asked what he had taken out of CSCT, he said "Zero." Hearing Tr. (Hurry) 1553.

[125] Hearing Tr. (Cruz) 220.

[126] CX-48; CX-50; CX-52; CX-55; CX-75.

[127] CX-52; CX-53.

[128] CX-49; CX-84.

[129] CX-178, at 43-44.

[130] CX-178, at 46.

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Hurry instructed Ruzicka on fundamental business operations, as well. For example, he explained to Ruzicka that he should open a separate bank account for customer funds to keep their funds separate from CSCT's funds.[131]

Hurry decided that CSCT should be in the Special Economic Zone within the Cayman Islands, and that it should apply to be exempt from regulation by the Cayman Islands Monetary Authority ("CIMA"). In addition, Hurry instructed Ruzicka to apply to the IRS for QI status.[132] Although Ruzicka expressed concerns about the obligations and representations associated with QI status and was reluctant to make the required representations without further study, Hurry insisted that Ruzicka do it.[133]

Hurry determined the fees and commissions CSCT clients would pay. He instructed Ruzicka to take whatever Scottsdale charged CSCT and tack on 200 basis points.[134] Hurry in turn obtained a discount from Scottsdale on its charges to CSCT.[135] By this means, he kept the cost of doing business through CSCT roughly the same as doing business directly with Scottsdale. Otherwise, the rerouting of the FFI business through CSCT would have made no economic sense for the customers. However, there was no evidence that it made economic sense for Hurry to keep customer expenses roughly the same as they would have been working directly with Scottsdale when he was incurring substantial extra expenses setting up and staffing the extra office in the Cayman Islands.[136]

Hurry was intimately involved in setting up CSCT's technical systems. Hurry made the arrangements for computer software for CSCT and instructed Ruzicka to download Office 2010 for two users.[137] Similarly, Hurry selected computer equipment for CSCT and brought it down to the Cayman Islands in mid-January 2014 at the same time that he brought D'Mura to look at joining CSCT. D'Mura testified that Hurry set up the office network for CSCT.[138] When Ruzicka showed Hurry the information he planned to send to clients, Hurry told him he should make it look better and instructed him on how to do that. Hurry told Ruzicka to print to PDF and get a clean file to email customers. He advised Ruzicka that he could do that on his computer.[139]

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[131] CX-83.

[132] CX-178, at 48-53.

[133] CX-105; CX-107; CX-178, at 50-53.

[134] CX-178, at 106-09.

[135] Hearing Tr. (Cruz) 141-43; Hearing Tr. (D'Mura) 2294-95.

[136] Hurry and Diekmann testified that routing the FFI business through CSCT was actually a little less expensive for customers than dealing with Scottsdale directly. Hearing Tr. (Hurry) 1642-44; Hearing Tr. (Diekmann) 1652-53. If true, that testimony further undercuts the business justification for CSCT.

[137] CX-94; Hearing Tr. (Hurry) 1461.

[138] Hearing Tr. (D'Mura) 2263, 2266-68.

[139] CX-77; CX-78.

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Ruzicka, by contrast, was fairly unsophisticated about technology. He was vague on even identifying the programs that he used at CSCT.[140]

ii. Hurry Micro-Managed CSCT's Business

Although Hurry portrayed Ruzicka as being in charge of CSCT,[141] the evidence is otherwise. Hurry micro-managed CSCT, and he bullied Ruzicka and D'Mura to get them to do what he wanted them to do. Hurry also closely tracked CSCT's business with Scottsdale and with its FFI customers.

Ruzicka considered himself to be only an intermediary.[142] Hurry dictated what should be done, and Ruzicka complied. Ruzicka said with respect to Hurry, "You don't discuss; you do as you are ordered."[143] For example, when Ruzicka protested that he was not comfortable with signing off on the QI application, Hurry responded, "Stupid, just do it." Ruzicka said that he "kind of dropped the subject at that point."[144] Ruzicka signed off, despite his discomfort, because he knew if he did not "there is a ticket back to LA coming tomorrow."[145]

Similarly, although Ruzicka thought that Unicorn engaged in some suspicious trading and constant pressure from Cem Can at Unicorn gave him the "creeps," Ruzicka did not think he had authority to terminate the relationship with Unicorn. If he had done so without clear authority from Hurry, he thought that would have been his last day at CSCT.[146] D'Mura confirmed that neither he nor Ruzicka could terminate a client relationship, and, although they hated dealing with Cem Can at Unicorn, they did not consider it an option to turn away the business.[147]

Some of the initial customers of CSCT were pre-existing customers of Scottsdale. When Ruzicka asked the commonsense question why the pre-existing business was going to flow through the new entity, Hurry told him to shut up. After that, Ruzicka just did as he was told.[148]

Ruzicka testified in his OTR, and D'Mura testified at the hearing, that Hurry barraged them with telephone calls while they were working at CSCT. Hurry called Ruzicka almost every day, sometimes multiple times. He called D'Mura less often, probably a couple of times a week.

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[140] CX-77; CX-178, at 24-25.

[141] Hearing Tr. (Hurry) 1433, 1436, 1549-50. Hurry claimed that he hired Ruzicka to fulfill an "executive role." Hearing Tr. (Hurry) 1648.

[142] CX-178, at 46.

[143] CX-178, at 51.

[144] CX-178, at 51-52.

[145] CX-22; CX-178, at 52-53.

[146] CX-178, at 177-80, 188-89.

[147] Hearing Tr. (D'Mura) 2283-86.

[148] CX-178, at 79-80.

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The calls could come at all hours as well.[149] Often the calls were followed by demanding, abrupt, and increasingly impatient emails saying "call me."[150] In one email, Hurry wrote "Your phone is not working TURN IT ON. I need a call."[151] In another he wrote, "Call me in 60 minutes. DO YOU NOT UNDERSTAND THAT?"[152] In another the subject line was "pick up your phone!!!!!!!!"[153]

Hurry developed an Excel spreadsheet to track various aspects of CSCT's business. Although Hurry characterized it in his testimony as an "empowerment tool" that enabled his people to track their work for themselves without his having to keep track of their progress,[154] that characterization is not consistent with the evidence.

The spreadsheet tracked daily gross production, number of trades placed, certificate deposits approved, new certificate deposits received, and number of new accounts. It also tracked Ruzicka's start and finish times.[155] Ruzicka said that in telephone calls Hurry would even ask about how many cigarettes he had smoked during the day.[156] An email from Hurry corroborated Ruzicka's testimony. In the email, Hurry told Ruzicka "Need all the below," including start time, finish time, and "number of cig breaks."[157] Hurry acknowledged that the email included an inquiry about cigarette breaks, but he claimed that he was trying to help Ruzicka get himself organized. He claimed to know that Ruzicka was only in the office for ten minutes in an hour, which meant things were not getting done.[158]

Hurry wanted the numbers prepared every day, even if he did not ask for the information every day. Ruzicka and D'Mura prepared themselves for Hurry's frequent telephone calls and tried to have talking points and updated information ready to go if Hurry should call.[159]

Hurry tracked Ruzicka's and D'Mura's contacts with CSCT customers, including the FFIs involved in the transactions at issue. Ruzicka testified that in their frequent telephone calls Hurry would ask him about whether he had talked to Rohn Knowles at Titan or Cem Can at

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[149] Hearing Tr. (D'Mura) 2301-02; CX-178, at 67-73.

[150] CX-63; CX-68; CX-71; CX-74; CX-118; CX-121; CX-126; CX-127.

[151] CX-121.

[152] CX-127.

[153] CX-118.

[154] Hearing Tr. (Hurry) 1433-39.

[155] CX-131; Hearing Tr. (Hurry) 1433-34.

[156] CX-178, at 140-41.

[157] CX-133; Hearing Tr. (Hurry) 1438-39.

[158] Hearing Tr. (Hurry) 1438-40.

[159] CX-178, at 140-41; Hearing Tr. (D'Mura) 2301-04; Hearing Tr. (Hurry) 1436-40.

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Unicorn or other particular people from the Bahamas, Panama, or Belize.[160] D'Mura testified that Hurry would ask about customers, not particular deposits, but he and Ruzicka did discuss with Hurry how they were doing on specific deposits.[161] For example, in email correspondence and telephone conversations, Ruzicka discussed with Hurry the amount of trading in at least two of the symbols at issue here, NHPI and VPLM.[162]

D'Mura decided to leave CSCT and the Cayman Islands, in part, as a result of Hurry's constant demands. Hurry had called on a day that Ruzicka was attending a wedding as best man and D'Mura was working at his rented condominium instead of the office. Hurry expressed aggravation that neither of them was in the office and spoke of "having a come to Jesus moment" when he arrived in the Cayman Islands in a few days.[163] D'Mura then packed his bag and said good-bye to Ruzicka, who expressed the wish that he could leave, too. However, Ruzicka said he had nowhere to go and no alternative. D'Mura left before Hurry arrived; Ruzicka stayed.[164]

Eventually, in October 2014, Ruzicka also left CSCT. Its business had dwindled in reaction to the SEC complaint in *Amogear* and the *Bandfield* indictment.[165] According to Ruzicka, in October 2014 Hurry offered him other positions back in the United States, but Ruzicka concluded that he "did not want to work any long[er] for that man," referring to Hurry. Ruzicka said, "I don't care what he offered, you know. Incremental value of that last dollar just was not worth it."[166]

iii. Hurry Prospected For CSCT Customers

CSCT did not advertise[167] or engage in cold-calling to try to generate business.[168] Hurry's business plan was for CSCT to develop clients through contacts and referrals,[169] but Ruzicka, who had no prior industry experience, had no network he could cultivate for potential customers.

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[160] CX-178, at 74-77, 84-85.

[161] Hearing Tr. (D'Mura) 2304-05.

[162] CX-132.

[163] Hearing Tr. (D'Mura) 2308-09. Hurry confirmed that he was frustrated that Ruzicka and D'Mura were not in the office. Hearing Tr. (Hurry) 1602-03. When people called CSCT and did not get an answer, they called Alpine trying to find Hurry. Hearing Tr. (Hurry) 1622-23.

[164] Hearing Tr. (D'Mura) 2306-10.

[165] Hearing Tr. (Cruz) 237-38.

[166] CX-178, at 232.

[167] CX-178, at 218. In contrast, even though Scottsdale had been in business for ten years, it advertised for business. Hearing Tr. (Cruz) 116.

[168] Hearing Tr. (D'Mura) 2279-80.

[169] CX-160, at 3; Hearing Tr. (Hurry) 1393.

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Customers simply appeared seeking to establish a business relationship with CSCT. They were referred to CSCT by Hurry or by someone at Scottsdale or Alpine.[170] Ruzicka testified at his OTR that he had an "express representation" that two of the FFIs involved in this case, Titan and Unicorn, were referred by Hurry.[171] Ruzicka did not know how Montage "found" CSCT.[172]

At the hearing, Hurry flatly contradicted Ruzicka's testimony that Hurry had referred Titan and Unicorn to CSCT.[173] We do not credit Hurry's testimony because he gave the testimony only after he knew that Ruzicka would not appear at the hearing to dispute Hurry's statement. To the extent that Hurry means that the referral came from someone at Scottsdale, we do not regard that as proving that Hurry was not the ultimate source of the referral, even if he made the link to CSCT through Scottsdale. Hurry had a pre-existing relationship with Titan while it was a direct customer of Scottsdale,[174] and he admitted talking to existing Scottsdale customers about his plan to establish CSCT.[175] He also admitted, as discussed below, to talking directly to Titan and other customers even after they became CSCT customers.

Hurry admits that he had at least one face-to-face meeting with Montage in Panama[176] and another face-to-face meeting with Unicorn in Belize.[177] He flew to Central America in January 2014 for these meetings, after dropping off D'Mura on his initial visit to CSCT. He did not take Ruzicka with him.[178]

At the hearing, Hurry claimed not to recall discussing business with either Montage or Unicorn during these visits.[179] Hurry claimed that he went to Montage because Ruzicka had asked him to evaluate a back-office system Montage was using to see if it would be suitable for CSCT. Hurry did not identify the nature of the system. He said that in the end they determined that it was not suitable for CSCT. He did not explain why it was unsuitable.[180]

We do not find Hurry's testimony with respect to his visit with Montage credible. Ruzicka was not technologically sophisticated and was too subordinate to suggest such a thing to

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[170] CX-178, at 104, 167-68.

[171] CX-178, at 203-04.

[172] CX-178, at 203.

[173] Hearing Tr. (Hurry) 1410, 1416.

[174] Hurry was listed as the registered representative and financial consultant for Titan when it was a direct customer of Scottsdale. Hearing Tr. (Hurry) 1413-14, 1610-12; CX-242, at 44, 48.

[175] Hearing Tr. (Hurry) 1401-06.

[176] Hearing Tr. (Hurry) 1412-13, 1612-13.

[177] Hearing Tr. (Hurry) 1406, 1422, 1613-14.

[178] Hearing Tr. (D'Mura) 2300-01; Hearing Tr. (Hurry) 1617-19.

[179] Hearing Tr. (Hurry) 1406, 1618-19.

[180] Hearing Tr. (Hurry) 1612-13, 1617-19.

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Hurry. Furthermore, D'Mura testified that he remembered no discussion of evaluating a back office system.[181] Hurry's testimony was vague and lacked specificity, and, again, Hurry gave his testimony only after it was clear that Ruzicka would not appear at the hearing. Hurry knew he would not be contradicted.

Hurry counseled Ruzicka to do business with Montage and, in particular, to do business with a person who was not identified in Montage documents as being connected with it. Ruzicka testified in his OTR that he was unclear about the role of a Montage contact with whom Hurry spoke from time to time. When Ruzicka asked Hurry about the contact, Hurry said to him "Hey, that's fine, you can interface with that guy. He's part of the operation."[182] This evidence shows that Hurry knew more about Montage than Ruzicka did, and that Hurry was instructing Ruzicka with regard to customer dealings.

Hurry claimed at the hearing that he only went to Belize to meet with Cem Can at Unicorn (both named defendants in the *Bandfield* indictment) because Ruzicka asked him to do so. According to Hurry, Ruzicka was trying to open the account and Can had requested a meeting with Hurry. Hurry said it is not uncommon for people to want to meet the owner of a business.[183] However, in somewhat inconsistent testimony, Hurry testified that he did not recall discussing business during his visit with Unicorn.[184]

Hurry's hearing testimony was impeached by his OTR. In his OTR, Hurry testified that Cem Can had asked him whether it would be better to do business with Scottsdale or CSCT. Hurry told him that it might be quicker to go directly to Scottsdale, but there could be "holdups" because of potential withholding there. On the other hand, because CSCT was a QI, Hurry told Can the "holdup" would be eliminated.[185]

There was additional evidence that Hurry discussed business with Unicorn. In late January 2014, Chinique Lewis of Unicorn sent an email to Eric Miller, Diekmann, and Ruzicka asking for Hurry to join a call on the processes and procedures to be used in connection with Unicorn's business with CSCT and Scottsdale. She said from "our personal face to face conversation with Mr. Hurry, I am certain he will not mind getting on a call."[186]

With respect to the request to involve him on a call with Unicorn, Hurry testified that it was no more than the common desire to deal with the person at the head of an organization.[187]

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[181] Hearing Tr. (D'Mura) 2300-01.

[182] CX-178, at 123-24.

[183] Hearing Tr. (Hurry) 1613-14.

[184] Hearing Tr. (Hurry) 1406.

[185] Hearing Tr. (Hurry) 1407-10, 1421-22.

[186] CX-119.

[187] Hearing Tr. (Hurry) 1432

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We find his explanation unconvincing. He traveled to a potential CSCT client without taking Ruzicka, the designated head of CSCT, discussed that client doing business with CSCT, and was viewed by the client as an important participant in the client's business dealings with CSCT.

Although he denied it, Hurry provided other leads and referrals to Ruzicka, too. In an email dated November 17, 2013, for example, Hurry wrote to Ruzicka, "Referrals and Leads call me on them." In the email, Hurry provided a couple of names and telephone numbers. One of those named was an "Andrew Farmer."[188] On November 20, 2013, Ruzicka wrote Hurry that he had tried to call "Andy" at the number Hurry had given him but the call did not go through. That same day Hurry provided another telephone number.[189] Hurry maintained he had identified the people in the email to Ruzicka not as prospects or potential customers but because they knew FFIs.[190]

Hurry revealed that, in fact, he was guiding Ruzicka's customer dealings, when he volunteered that Ruzicka did not in the end talk to the people Hurry had identified in the email. Hurry said that he had afterward found out that they had some "issues" and had told Ruzicka, "Don't bother."[191]

D'Mura testified that while he was at CSCT Hurry and Ruzicka met with another potential customer, Caledonian Securities. CSCT received over 50 Caledonian deposits afterward.[192]

Despite this evidence that Hurry was critical to developing CSCT's business, Hurry portrayed himself as offering only slight help to Ruzicka. He claimed that all he did was to recommend to Ruzicka that he get a book of international financial institutions and prospect for customers using that.[193] This testimony is not credible. Since Ruzicka and D'Mura engaged in no cold calling, they had no use for a book to help them prospect for customers.[194] Furthermore, such an approach to business promotion—cold calling people out of a book—was not likely to be successful. Hurry would certainly have known that, and he would not have been satisfied with

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[188] CX-51.

[189] CX-62.

[190] Hearing Tr. 1401-04; CX-51.

[191] Hearing Tr. (Hurry) 1404.

[192] Hearing Tr. (D'Mura) 2295-97. D'Mura testified that he received the initial documents from Caledonian in the last week before he left Scottsdale and laid them out on a table to review, so he was well aware of the volume submitted to CSCT. The Caledonian-related deposits were not passed on to Scottsdale before he left CSCT. Hearing Tr. (D'Mura) 2317.

[193] Hearing Tr. (Hurry) 1403-04.

[194] Hearing Tr. (D'Mura) 2279.

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that approach to marketing CSCT. He wanted CSCT to be successful and worked hard to make it so.[195]

iv. Hurry Tried To Conceal His Involvement With CSCT

Both Ruzicka and D'Mura had the impression that secrecy was important to Hurry. Ruzicka said that Hurry "flat told me, 'I'm going to Caymans, because that way I don't have to give anything to anybody.'"[196] D'Mura testified that when he first flew down to the Caymans with Hurry, Hurry spent time discussing with him the privacy laws of the Cayman Islands. Hurry noted that some of them were criminal, not just civil.[197] In so doing, Hurry stressed the serious consequences if a person failed to comply.

Hurry denied any particular interest in secrecy.[198] Hurry's denial is not credible. We find that he was intensely concerned with secrecy and concealing his involvement with CSCT's customers and business. His concern was manifested in the following ways.

(a) Use Of Email Address That Hid His Identity

Hurry used an email address that hid his identity. When Ruzicka started working at CSCT, he used as his work email address gr@csct.ky. The address identified him by his initials, the firm by its initials, and the Cayman Islands location by the last two letters. Ruzicka set up a similar email address for Hurry, using Hurry's first initial and last name: jhurry@csct.ky.[199]

Hurry had an extreme reaction to his email address. Ruzicka said that Hurry "just crucified me." Hurry told Ruzicka that the address was too long, and instructed Ruzicka to change the individual identifier to x.[200] Thus, during the relevant period Hurry's email address at CSCT was x@csct.ky, which did not identify Hurry.

At the hearing, Hurry repeated the same explanation for changing his email address. He testified that he wanted an address that was short.[201]

We find Hurry's explanation to be false. He volunteered elsewhere in his testimony that his main email address is JHurry@hurry.com.[202] Thus, Hurry's main email address is constructed in the same way that Ruzicka initially constructed Hurry's address at CSCT. If that construction

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[195] Hearing Tr. (Hurry) 1417-18; CX-178, at 74-75, 135-42.

[196] CX-178, at 36.

[197] Hearing Tr. (D'Mura) 2259.

[198] Hearing Tr. (Hurry) 1361-62, 1364-65.

[199] CX-178, at 146-47.

[200] CX-178, at 146-47.

[201] Hearing Tr. (Hurry) 1459.

[202] Hearing Tr. (Hurry) 1426.

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was not too long for Hurry's main email address, then it was not too long for his CSCT address. Furthermore, we find that the choice of x instead of an identifier such as JH was designed to conceal Hurry's involvement in CSCT business and perhaps give him the possibility of denying that it was his address. Finally, the extreme nature of his reaction to the initial email address—making Ruzicka feel almost "crucified"—strongly suggests that Hurry was concerned with something more important than having a short email address.

(b) Assertion Of Attorney-Client Privilege

Hurry insisted on asserting the attorney-client privilege even where it was not appropriate. Hurry almost always marked his emails with Ruzicka as attorney-client privileged. He did so even when his emails simply asked Ruzicka to call him and when his emails concerned only floor plans and office furniture and the like, which emails neither sought nor received nor reflected any legal advice.[203] In contrast, Ruzicka rarely marked his emails to Hurry as privileged,[204] even though Hurry instructed Ruzicka that he should mark all his email correspondence with Hurry as attorney-client privileged.[205]

Hurry claimed at the hearing that he marked his emails privileged because Ruzicka advised him to use the privilege designation.[206] That claim is not credible in light of Ruzicka's practice of not marking his emails with Hurry as privileged. Nor is Hurry's claim consistent with the written record that it was Hurry who instructed Ruzicka to use the privilege designation, not the other way around. We find that Hurry wanted all his correspondence with Ruzicka marked privileged because he believed that he might be able to shield that correspondence from future regulatory scrutiny or litigation discovery. Similarly, in his hearing testimony, Hurry sometimes used the phrase "on advice of counsel" in his answer, as though it were a talisman against more probing inquiry or criticism.[207]

(c) Avoiding Written Record

Hurry tried to avoid creating a written record. Ruzicka wrote in an email to Diekmann that Hurry had directed him to take a particular deposit, specifying the symbol, SVLE. Diekmann forwarded the email to Hurry and DiBlasi. When Hurry saw the email, he "tore" into Ruzicka

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[203] CX-48; CX-49; CX-50; CX-51; CX-52; CX-55; CX-58; CX-62; CX-63; CX-71; CX-75; CX-77; CX-78; CX-79; CX-83; CX-84; CX-92; CX-94; CX-107; CX-129; CX-151.

[204] CX-53; CX-62; CX-75; CX-77; CX-79; CX-84; CX-151.

[205] CX-53 and CX-84.

[206] Hearing Tr. (Hurry) 1485.

[207] Hearing Tr. (Hurry) 1333-35.

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"like you wouldn't believe."[208] Hurry told Ruzicka something to the effect of "Never put in writing that I am directly involved in business decisions."[209]

Ruzicka said that Hurry did not want any permanent record of his communications.[210] For that reason he communicated with Ruzicka primarily through FaceTime, the iPhone tool for video communications. Hurry called Ruzicka frequently, sometimes as many as four times in a day. He called early in the morning and as late as 9:30 p.m.; he called on weekends as well as business days. Ruzicka viewed the video calls as invasive, but Hurry told him that he used FaceTime because it was free.[211] Notably, emails are similarly "free" communications once you have paid the internet provider, and Hurry would have incurred no additional expense if he had communicated with Ruzicka by email.

Hurry disputed Ruzicka's testimony that he did not want a written record of his communications with CSCT.[212] However, D'Mura confirmed that Hurry did not want a written record of his involvement in CSCT business. D'Mura testified that Hurry expressed to him and Ruzicka both specifically and generally not to send him documents.[213]

(d) Use Of FaceTime To Conceal Contacts With Customers

Hurry also communicated with CSCT customers (including all three FFIs involved in this case) using FaceTime, thereby concealing his contacts with them. Hurry would call Ruzicka at CSCT and ask Ruzicka to call a customer on CSCT's landline. Then Ruzicka would hold his iPhone next to the landline telephone so that Hurry and the customer could talk. Ruzicka did not participate in the calls, although he had to be present to hold the telephones together. This manner of conducting the telephone conversation would avoid a record that Hurry had talked to the customer. To the extent there was any record, it would appear that Hurry had only called CSCT. Ruzicka testified at his OTR that this happened roughly a dozen times and that Hurry had conversations in this manner with Rohn Knowles and Kelvin Leach at Titan, Cem Can at Unicorn, and an individual at Montage.[214]

In hearing testimony, D'Mura similarly described a FaceTime conference call with Caledonian. Caledonian was on the speaker phone in the CSCT office and Hurry was on the iPhone. Ruzicka would hold the telephones next to each other. D'Mura remembered at least one

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[208] CX-178, at 155-61.

[209] CX-178, at 161.

[210] CX-178, at 70.

[211] CX-178, at 67-71.

[212] Hearing Tr. (Hurry) 1540.

[213] Hearing Tr. (D'Mura) 2300.

[214] CX-178, at 118-27.

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other time that such a FaceTime conference happened.[215] D'Mura believed that it was Hurry's idea to conduct the calls this way.[216]

Hurry does not deny that he conducted telephone calls with CSCT customers in this manner. However, he gives the practice an innocent explanation. He claims that he used the iPhone app because it cost less and because he found it difficult to do a conference call on his cell phone. He claimed that Ruzicka was a participant in the call, disputing Ruzicka's OTR testimony after he knew that Ruzicka would not appear at the hearing.[217]

We find Hurry's explanation not credible. Hurry generally did not conduct his business in such a frugal manner. He flew back and forth to the Cayman Islands in his own private airplane, and flew to Panama and Belize from there to meet with Montage and Unicorn.[218] He funded expensive offices for CSCT[219] and provided Ruzicka and D'Mura with housing when they worked there.[220] He instructed Ruzicka to buy Hurry a seven-seat vehicle to use while he was in the Cayman Islands.[221] He liked to tell people how rich he is.[222] It is unlikely that the costs associated with a dozen international telephone calls would trouble him much.

We also find Hurry's assertion that he used FaceTime because he was too technologically challenged to figure out how to do a conference call on his cell phone not credible. Hurry was technologically sophisticated enough to set up CSCT's computer network.[223] He instructed Ruzicka on how to use PDFs and other software, and he created an elaborate Excel spreadsheet.[224] When he was asked whether he was aware that his use of FaceTime to speak with customers would conceal his involvement in a conversation with the customers, Hurry answered evasively, avoiding a direct yes or no.[225]

Hurry testified that he started using FaceTime in February 2014.[226] Coincidentally, his email traffic with Ruzicka and D'Mura at CSCT dropped to nearly nothing.[227] We find a

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[215] Hearing Tr. (D'Mura) 2297-98.

[216] Hearing Tr. (D'Mura) 2302-03.

[217] Hearing Tr. (Hurry) 1540-42.

[218] Hearing Tr. (D'Mura) 2252-58, 2300-01; Hearing Tr. (Hurry) 1412-13, 1613-14, 1617-19.

[219] CX-178, at 35.

[220] Hearing Tr. (Hurry) 1447, 1649-51; Hearing Tr. (D'Mura) 2265, 2316-17.

[221] CX-58.

[222] CX-178, at 26, 70.

[223] Hearing Tr. (Hurry) 1461; Hearing Tr. (D'Mura) 2263, 2266-68; CX-94.

[224] Hearing Tr. (Hurry) 1433-34; CX-178, at 24-25; CX-77; CX-131.

[225] Hearing Tr. (Hurry) 1541.

[226] Hearing Tr. (Hurry) 1540.

[227] Resp. PH Br. 45.

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significant connection between the two events. Hurry's purposeful use of FaceTime enabled him to stop creating a trail of emails.

C. The Firm's General Practice For Reviewing Deposits

Everything that Scottsdale knew about a deposit when the Firm concluded that it could sell the deposited securities pursuant to the Rule 144 exemption is contained in a due diligence package for the deposit.[228] Generally, at the top of the package is a two-page Deposited Securities Checklist ("Checklist"). That is followed by various other documents, including a Beneficial Ownership Declaration signed by the purported beneficial owner of the shares deposited for resale by Scottsdale.[229]

Scottsdale's general process for reviewing and approving a deposit of stock certificates was for a person on the Rule 144 team to assemble the due diligence package, working from the Checklist. Then, the person who had put together the file (sometimes referred to as the first reviewer) would go to Cruz and talk with him about it. Depending on the complexity of the deposit, the talk could take 15 minutes to an hour. Cruz did not review every page in the file. He would read through the Checklist and ask questions. He might ask to see particular documents and conduct Google searches while sitting together with the initial reviewer.[230]

The Firm heavily depended upon the representations made in the Beneficial Ownership Declaration for its conclusion that the purported beneficial owner was not an affiliate of the issuer and was the person who had the economic interest in the shares on deposit. Diekmann initially denied that the persons signing as beneficial owners could be lying. He testified that he saw no reason for them to lie, and he emphasized that the document is very clear about the information it requests. Only upon being pressed did he eventually agree that if someone were acting as a nominee for a secret beneficial owner one would expect them to lie.[231] We find his testimony on this subject evasive.

Cruz similarly focused on the fact that the Beneficial Ownership Declaration was the tool that the Firm used to find out who owned the shares.[232] He stressed that the Declaration was "unequivocal," and that the parties to the transactions understood the Firm's expectations when they made parallel representations regarding the person identified as the beneficial owner.[233] When asked whether language on Unicorn's website offering to appoint nominee officers and directors would be a red flag to him, Cruz responded that it "could have been." He suggested that the way he would deal with that red flag would not be to seek independent verification. Rather,

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[228] Hearing Tr. (Diekmann) 1916-17.

[229] RX-1, at 1-2, 11-12, 78-79, 88-89, 158-59, 169-70; RX-2, at 1-2, 12-13, 106-07, 117-18; RX-3, at 1-2, 11-12.

[230] Hearing Tr. (Diekmann) 694-96; Hearing Tr. (Cruz) 278.

[231] Hearing Tr. (Diekmann) 1895-96.

[232] Hearing Tr. (Cruz) 201-03.

[233] Hearing Tr. (Cruz) 202.

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he would simply emphasize to the interested persons the importance of disclosure. He said that the Firm would "reiterate and make sure they understand the purpose of our forms and … that they need to – to disclose the underlying beneficial owner."[234]

Cruz testified that during the relevant period, from December 2013 through June 30, 2014, the Firm did not conduct a specific search for nominees.[235] Diekmann testified that he thought the Firm's general practice would pick up a problem with nominees, but he could not cite any particular procedures that were geared to do that. He said the "procedures in sum" would address the nominee problem.[236] Cruz confirmed, however, that the term "nominee" appears nowhere in the Firm's policies and procedures.[237]

Given the complexity of the analysis required, and the high potential for interested parties to obfuscate and make misrepresentations, we find the Firm's general process for final approval inadequate. A conversation that may last fifteen minutes and not involve review of all the documents in the file is not enough to analyze the content of the representations and understand whether the business transactions made sense. We also find that the Firm's reliance on the honesty of the interested parties filling out the forms was unreasonable in light of the high potential for the use of nominees.

We are concerned that the Firm's general process for review and approval was so poor when the processing of microcap stock certificates for resale to the public was its primary business. We are further concerned because the transactions at issue here were typical of Scottsdale's business. Cruz testified that the Firm's customers typically were persons who made loans to issuers and then sold the loans to others who then attempted to profit by exchanging them for shares. Thus, the Firm's lack of a good process for review and approval was not a minor aspect of the Firm's business.[238]

D. Transactions

The Firm followed a check-the-box approach to its Rule 144 reviews, without evaluating and independently verifying the information it gathered. This approach is apparent from the following in-depth analysis of the three NHPI deposits. The Firm followed the same approach with the VPLM and ORFG deposits, which we discuss in less detail.

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[234] Hearing Tr. (Cruz) 307-08.

[235] Hearing Tr. (Cruz) 199-202, 211-13; Hearing Tr. (Diekmann) 908-10.

[236] Hearing Tr. (Diekmann) 922.

[237] Hearing Tr. (Cruz) 666-67.

[238] Hearing Tr. (Cruz) 352-53.

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1. NHPI (Three Unicorn deposits derived from Collins promissory note)

a. Due Diligence Package

i. Purported Beneficial Owners

CSCT made three NHPI deposits. They all came from Unicorn, which, in turn, purported to act on behalf of other supposedly independent entities: Sky Walker, Inc. ("Sky Walker"), Swiss National Securities ("Swiss National"), and Ireland Offshore Securities ("Ireland Offshore"). The beneficial owner of Sky Walker is identified on the Checklist as Patrick Gentle; the beneficial owner of Swiss National is identified on a separate Checklist as Talal Fanni (apparently a misspelling, since the person signed documents as Talal Fouani); and the beneficial owner of Ireland Offshore is identified on the third Checklist as Jeff Cox.[239]

Each purported beneficial owner signed a Beneficial Ownership Declaration representing that he was not an affiliate of the issuer, that the issuer was not to his knowledge a shell, and that the securities were free trading, without resale restrictions under Rule 144. The documents were not witnessed or notarized. No address, telephone number or other contact information was given for the purported beneficial owner.[240]

Scottsdale did nothing to identify the purported beneficial owners more specifically. While it did a Google search combining the name of the beneficial owner with the words "securities fraud" and put the first page of the initial index of results in the due diligence package, it did not search for the person's name alone, or the person's name in combination with the name of the entity through which he acquired the shares, or the person's name along with the names of the issuer and issuer's principals.[241]

The purpose of the Google search using the name of the purported beneficial owner with the words securities fraud is unclear in light of the fact that Diekmann testified that a "hit" on such a search indicating that a person was engaged in some sort of securities fraud would be unrelated to beneficial ownership.[242] That testimony demonstrates the check-the-box attitude of the Firm. Diekmann was insensitive to the possibility that if a person was engaged in securities fraud, then the representations made by that person and others connected to a deposit could be false.

As discussed below, the three deposits shared the same origin.

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[239] RX-1, at 1-2, 11-12, 78-79, 88-89, 158-59, 169-70.

[240] RX-1, at 11-12, 88-89, 169-70.

[241] RX-1, at 67, 152, 223. The Firm misspelled Fouani's name when it did the Google search, illustrating its careless approach to conducting due diligence. RX-1, at 67.

[242] Hearing Tr. (Diekmann) 927.

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ii. Prior Holder Transaction

The Checklists for the Sky Walker, Swiss National, and Ireland Offshore deposits state that the issuer, NHPI, gave a $10,000 promissory note dated May 1, 2012, to someone named Thomas Collins. Each NHPI depositor purports to tack back its holding period to that date and that note.[243]

A copy of the May 2012 promissory note is included with the Sky Walker and Ireland Offshore deposits. The note was due and payable no later than July 1, 2012. It provided that if NHPI did not pay the note by the due date, Collins would have the right to convert the debt into common shares. No address or contact information is given for the company or for Collins. Although the note provided that Collins would have a right of conversion upon the company's default, it contained no provision for either party to give notice to the other in the event of a default. The signatures for NHPI and Collins were not witnessed or notarized.[244]

According to the attorney opinion in the due diligence package, the May 2012 note was the company's promise to pay Collins a fee for services.[245] The unaudited financial statements in the due diligence package similarly indicated that the note was for consulting services.[246]

With respect to Collins' identity and possible connection to the issuer, the due diligence package contains a statement signed by Collins declaring that he had never been an affiliate of the issuer. Again, the statement is not witnessed or notarized, and no contact information is provided.[247]

The issuer did provide the stock transfer agent with an address for Collins when it instructed the transfer agent to issue new unrestricted shares to him, as reflected in the instructions to the transfer agent, which are in the due diligence package. Collins had a Texas address.[248] Also in the due diligence package is the transfer agent's list of shareholders, which showed that all active shareholders of NHPI had U.S. addresses.[249]

Scottsdale did not run a Google search on Collins using the address contained in the due diligence package. Nor did it search to see whether Collins had any links to the other persons on the NHPI shareholder list. Rather, it ran a Google search linking Collins' name to the words "securities fraud." Apparently, a person named Thomas Collins had been involved in a securities fraud, but the Firm obtained an SEC litigation release indicating that that person had died prior to

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[243] RX-1, at 1, 78, 158.

[244] RX-1, at 106, 183.

[245] RX-1, at 22, 101, 178.

[246] RX-1, at 40, 122, 198.

[247] RX-1, at 25.

[248] RX-1, at 31.

[249] RX-1, at 37.

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1997. The Firm never determined the identity of the particular Thomas Collins involved in the NHPI deposits.[250]

iii. Acquisition Of Shares By Depositors

Collins gave Sky Walker, Swiss National, and Ireland Offshore each a separate $50,000 note dated September 1, 2013. The notes were to be paid in full by November 7, 2013. The notes specified that in the event of a default the entire sum would become due.[251] Each note was ostensibly secured by a Stock Pledge Agreement pledging 20 million shares of NHPI,[252] which, at the time, Collins did not own. These notes, like the note between Collins and NHPI, contain no address or contact information for any party and no provision for either party to give notice to the other in the event of a default. They are neither witnessed nor notarized.[253]

The next items in the chronology are three Note Satisfaction Agreements dated September 16, 2013. These three identical Agreements indicate that Collins had already defaulted on the $50,000 note, although the due date was not until November 7, 2013. Each depositor declared a desire to take title to the NHPI shares described in the pledge agreement.[254] The Securities Deposit Pre-Review Request Unicorn submitted for Swiss National likewise gives September 16, 2013, as the date of acquisition, referring to the Note Satisfaction Agreement,[255] as does the Deposited Securities Request Form submitted for Ireland Offshore.[256]

On November 15, 2013, more than a year after the due date for the May 2012 note, the issuer and Collins purportedly entered into a note conversion agreement whereby Collins agreed to forgive 90% of the note in return for 90 million shares of NHPI.[257] The Note Conversion Agreement included in the due diligence package, like the May 2012 promissory note, contains no address or contact information for the company or for Collins and is not witnessed or notarized. The Note Conversion Agreement does not explain why the conversion occurred so

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[250] RX-1, at 57-58.

[251] RX-1, at 32, 112, 190.

[252] RX-1, at 113-16, 191-94.

[253] RX-1, at 32, 112, 190.

[254] RX-1, at 33, 117, 195.

[255] RX-1, at 13.

[256] RX-1, at 161. Other documents give conflicting, later dates as the acquisition date. Some documents represent that the three depositors acquired the securities on November 25, 2013, pursuant to a Stock Purchase Agreement. RX-1, at 11, 19, 88, 98, 169. However, the due diligence package for NHPI contains no Stock Purchase Agreement. Another document says that the acquisition date was November 15, 2013, the same date that Collins entered into the Note Conversion Agreement and the shares were issued to him. RX-1, at 81. The Firm did not resolve the discrepancy between the September acquisition date and the November acquisition dates before selling the securities.

[257] RX-1, at 1, 78, 158.

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long after the default or how the remaining unpaid 10% of the May 2012 promissory note was to be treated.[258]

NHPI issued the 90 million shares to Collins on November 15, 2013, the same day as the note conversion agreement.[259]

Although the exact date that Collins assigned the shares to the three beneficial owners is not clear, it was at most a few days after NHPI issued the shares to Collins. Thus, the transaction between the issuer and Collins, the issuance of the stock, and the transactions between Collins and the three purported beneficial owner entities all happened almost simultaneously.

Although the transactions happened almost simultaneously, the value given to the shares differed substantially. There is no evidence of a corporate event or other explanation for the variance. In return for forgiving a debt of $9,000, Collins obtained 90 million shares, but each beneficial owner entity forgave a debt of $50,000 for its 20 million shares. No money actually changed hands in these transactions.

iv. Issuer Filings

Although NHPI had once been a reporting company with the SEC, it stopped being a reporting company in 2009. After that it made less frequent and less regular filings on OTC Markets.[260] On November 20, 2013, a few days after the NHPI shares were issued and around the time that Sky Walker, Swiss National, and Ireland Offshore acquired the shares, the issuer filed an annual report for the year ending December 31, 2012.[261] In the November 20, 2013 report, NHPI mainly discussed its pharmaceutical business and then stated in a single sentence that it had entered into the oil and gas business. It declared that further disclosure related to the oil and gas business was in an Interim Information and Disclosure Statement for the period ended November 20, 2013.[262]

In the annual report filed on November 20, 2013, notes to unaudited financial statements declared that NHPI had given Collins a promissory note for unspecified consulting services.[263] Scottsdale relied upon this disclosure to verify the existence of the May 1, 2012 promissory note, which was critical to the ability of the beneficial owners to sell the securities without registration.

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[258] RX-1, at 26-28, 106-09, 184-86.

[259] RX-1, at 29.

[260] Hearing Tr. (Byrne) 2069-75; CX-255; CX-256; CX-260; CX-261; RX-1, at 130.

[261] CX-256. Diekmann testified that it appeared that the company had had a gap in its reporting prior to its November 2013 filing. Hearing Tr. (Diekmann) 939. However, he did not believe that such a gap would be suspicious, even if it were as long as two-and-a-half years. Hearing Tr. (Diekmann) 1011-13.

[262] CX-256, at 4. One page from the Interim Information and Disclosure Statement was in the due diligence package for the NHPI deposits. But that page did not contain the disclosure relating to the oil and gas business. RX-1 at 39.

[263] RX-1, at 40.

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The only evidence that the note existed, however, was created about the same time as the transactions leading up to the sale of securities into the public markets.

In order to determine that NHPI was not a shell, Scottsdale relied on the representation by the president of NHPI that it was not a shell.[264] It also relied on descriptions of the company's assets and liabilities in unaudited financial statements contained in the annual report filed in November 2013 and in a quarterly report filed about the same time to cover the period ending June 30, 2012. However, those descriptions were vague; they showed mostly unspecific cash assets, not physical assets. In the annual report, for example, the company reported that it had less than $28,000 in a checking account, accounts receivable over $600,000, unspecified inventory over $70,000, and investment assets over $750,000. The financial statements also show that the issuer had incurred some expenses. The financial statements do not provide, however, any indication of the nature of the expenses or the business activities that supposedly gave rise to them. The issuer disclosed no verifiable facts.[265]

The company's public filings created a significant discrepancy between the disclosure in those filings and the NHPI deposits. The interim financial report for the period ending November 20, 2013, states that 981,408,909 shares were outstanding, of which 970,326,182 were restricted.[266] That means that only around 11 million shares were free-trading shares. But the three depositors deposited 60 million for resale to the public. There is no evidence that the Firm investigated this discrepancy.

v. Attorney Opinion Letter

The Firm relied upon an attorney opinion letter stating that the shares could be issued as free trading shares and sold pursuant to Rule 144. However, that opinion made plain that the attorney relied on certifications by the principal officers of NHPI. The attorney assumed that all signatures were genuine and the facts set forth in the certificates were correct.[267] The attorney relied on the company's filings for his conclusion that the company was actively marketing its pharmaceutical products and exploring one or more strategic alliances and licensing arrangements.[268] Similarly, the attorney relied on company filings as showing that NHPI was actively pursuing the acquisition of mineral rights leases.[269] The attorney did not independently verify the facts in his opinion letter.

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[264] RX-1, at 24.

[265] RX-1, at 38-40.

[266] RX-1, at 43.

[267] RX-1, at 20.

[268] RX-1, at 21.

[269] RX-1, at 21.

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vi. Scottsdale Approval And Sales

During the first week of February 2014, Noiman and Cruz approved the first NHPI deposit, Sky Walker, for resale by Scottsdale. At the time, the 20 million shares were given an estimated value of $268,000.[270] Noiman and Cruz approved the Swiss National NHPI deposit on April 9, 2014, which was given a value of $98,000.[271] They approved the Ireland Offshore NHPI deposit at the end of April 2014 with a given value of $82,000.[272]

Sales of NHPI shares began on February 26, 2014, and continued through May 7, 2014. Periodically, Scottsdale would wire out the proceeds of the sales of NHPI and other securities in the CSCT account.[273] As with all transactions conducted with CSCT and its customers, after Scottsdale wired the proceeds of the sales to CSCT's bank account, Scottsdale did not know where the funds flowed after that.[274] Thus, it did not know who received the economic benefit.

vii. Promotional Activity

In December 2013, not long after the series of transactions by which the purported beneficial owners acquired their shares of NHPI, there was promotional activity regarding NHPI, as reflected in the due diligence file for the NHPI deposits. Diekmann testified that he would have looked at the promotional activity but he did not recall doing so. He asserted that promotional activity was not necessarily a red flag, but that he might try to see if there was a link to the customer. He acknowledged, however, that it would be difficult to know if a customer was behind the promotion if a nominee were being used.[275]

In February and March 2014, there also was promotional activity regarding NHPI.[276] In a February 19, 2014 email, Ruzicka wrote to Diekmann that Unicorn was particularly eager to trade NHPI. Diekmann did not remember the email, and did not think it particularly remarkable. He said that no customer wants "to miss an opportunity to trade."[277] Scottsdale sold NHPI shares deposited by CSCT during February and March 2014, when the promotional activity was ongoing.[278]

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[270] RX-1, at 78-79 (Sky Walker).

[271] RX-1, at 1-2.

[272] RX-1, at 158-59.

[273] JX-268.

[274] Hearing Tr. (Cruz) 661-62.

[275] Hearing Tr. (Diekmann) 1014-16; RX-1, at 132-33; CX-262, at 6.

[276] CX-262, at 2-5; CX-263.

[277] Hearing Tr. (Diekmann) 1016-18.

[278] JX-268.

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b. Red Flags Signifying A Scheme To Evade The Securities Laws

Even aside from the fact that the May 2012 promissory note was not a security, as discussed below, the circumstances of the three NHPI deposits raised a number of red flags signaling that the transactions were likely sham transactions using nominees to conceal the identity of the persons actually benefiting from the sale of securities. Some, but not all, of the red flags are listed below.

First, Collins and NHPI entered the agreement to convert the note he held from the company to shares—and NHPI issued the shares—almost simultaneously with his execution of three separate agreements to transfer a portion of those shares to Sky Walker, Swiss National, and Ireland Offshore. The almost simultaneous transactions are compelling evidence that the parties were not truly independent. The suspect nature of the transactions is heightened by the identical terms of the notes to Sky Walker, Swiss National, and Ireland Offshore.

Respondents attempted to rebut any suspicion arising from the timing and identical terms of the Sky Walker, Swiss National, and Ireland Offshore transactions. Diekmann testified that he assumed that one person had put together the loan transactions for Collins, and that was why the three entities had agreed with Collins to the same loan terms. He acknowledged that he did not know who that person might be, but he did not think it was a red flag that Sky Walker, Swiss National, and Ireland Offshore agreed to the same terms or that the same documents were used for the three loan transactions.[279] We find that Diekmann's unverified hypothesis did not excuse the failure to investigate this red flag.

Second, Collins entered into the agreement with the three depositors, along with the agreement pledging NHPI shares as security, before he actually had any shares. However, he represented in the pledge agreement that he held title to them already. It should have been a concern that Collins apparently misrepresented his ownership. It also is suspicious that the depositors would loan him $50,000 each without verifying that he owned the shares. It is even more suspicious that Collins would take on a $150,000 obligation without knowing whether he could obtain the shares. The facts support the conclusion that Collins entered into the agreement with the depositors because he (or whoever was pretending to be Collins) was affiliated with the issuer and knew that the shares could be obtained. Further investigation was required before proceeding to sell the securities.

Third, the documents relating to the NHPI transactions in 2012 lack important elements that would permit verification. For example, the 2012 Collins-NHPI promissory note bears no physical address, telephone number, or other contact information for Collins or NHPI. Similarly, the documents relating to the loan notes Collins gave the three depositors do not include any contact information for Collins or for the depositors. The lack of contact information is odd because there is no provision for where and how payment should be made. It is almost as though there is no expectation of payment.

[279] Hearing Tr. (Diekmann) 1699-1700.

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Fourth, the obviously impossible September date declaring Collins in default on the notes held by the depositors—even before the notes became due on November 7, 2013—should have been investigated. The fact that the identical mistake was made in three separate documents supposedly involving independent parties is suspicious. If the parties were independent, one would have expected someone to notice the mistake. That is particularly so where the error was not a transposition of numbers but, rather, an incorrect month. The error would have been easier to spot.

Diekmann testified that the September 16, 2013 date on the note satisfaction agreement had to be a typographical error. "In all likelihood," he said, "that's supposed to read November 16, 2013."[280] When asked about the fact that the same error appears in all three note satisfaction agreements signed by Sky Walker, Swiss National, and Ireland Offshore, Diekmann said that was not surprising. He noted that the agreements were all executed the same day, and hypothesized that someone must have done a search and replace function to change the words without noticing the mistake.[281] Cruz similarly explained the date as a typographical error. He testified that even though the same mistake occurred in connection with the documentation for three purportedly separate transactions it gave him no pause.[282]

Between hearing days, Respondents obtained a copy of the relevant stock certificate, which was then introduced into evidence. It showed a transfer date of November 21, 2013. They argue that this proves that the September date was a typographical error.[283]

Respondents miss the point. Nothing in the due diligence package shows that the Firm noticed or investigated the discrepancy before selling the securities. Furthermore, if the September date was a typographical error generated by a search and replace function in documents governing supposedly independent transactions, that only increases the appearance of coordination among the parties to those transactions.

Fifth, Diekmann admitted that there was no evidence contemporaneous with the May 2012 note to show that the note existed.[284] The only evidence that the 2012 promissory note from NHPI to Collins existed was created after Collins purported to convert the note to NHPI shares. Rather than confirming the existence of the note, the timing of the late filing suggests the fabrication of false evidence to support the tacking period necessary for the exemption.

Sixth, it is peculiar that Collins did not enforce his right to conversion of the shares at the time if NHPI defaulted in July 2012 on the $10,000 promissory note. There is no explanation why he would have waited more than a year—until November 2013—to do so.

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[280] Hearing Tr. (Diekmann) 949, 1835-37.

[281] Hearing Tr. (Diekmann) 949-52, 956.

[282] Hearing Tr. (Cruz) 365-66, 390-98.

[283] RX-115; Resp. PH Br. 15.

[284] Hearing Tr. (Diekmann) 939.

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Seventh, there were signs that NHPI was a shell. The change from being in the pharmaceutical business to entering the oil and gas business, without any explanation for why, when, and how it had done so, was not consistent with a real business plan. The Firm collected no information regarding the change in business, and the attorney opinion letter, which relied on representations by the interested parties and assumed the asserted facts to be true, was not a sufficient basis for concluding that NHPI was not a shell.

Respondents maintained that the oil and gas business was added to NHPI's pharmaceutical business as a "supplement" to its business line.[285] We reject this characterization. These were radically different businesses that involved different expertise and different business models.

Eighth, the transactions have an air of fantasy. Collins supposedly took the $10,000 note in exchange for unspecified consulting services—no money changed hands. And then he took shares in return for forgiving the note—no money changed hands. When Collins supposedly borrowed $50,000 each from Sky Walker, Swiss National, and Ireland Offshore, nothing in the documents provided how, when, or where he would receive the money. There is no evidence that any money changed hands then either. Collins merely entered into a promissory note with each purported lender in which he pledged to give them stock if he defaulted; and then he defaulted. No money changed hands when Sky Walker, Swiss National, and Ireland Offshore took the pledged shares.[286]

Ninth, there is little evidence to support the value given to the NHPI securities. Within the span of a few months the value of NHPI shares varied substantially without any explanation. In November 2013, Collins received 90 million shares in return for forgiving $9,000 of his loan to NHPI. Simultaneously, he realized $150,000 for 60 million of those shares. By early February 2014, the 20 million shares in the Sky Walker deposit were estimated to have a value of $268,000. There is no evidence of a basis for the increase in value. Then, in April 2014 the value of the shares held by Swiss National and Ireland Offshore declined to less than $100,000—again, without explanation. This is particularly suspicious in light of the promotional activity that occurred in February and March 2014.

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[285] Resp. PH Br. 16 and n.80.

[286] Diekmann testified that the only evidence the Firm had that the September 1, 2013 notes between Collins and the three depositors existed was the notes themselves. He never asked for documentation showing that $50,000 actually was transferred from Sky Walker to Collins. He was satisfied that the document looked like a loan to an individual and not an effort by a small company to raise capital. Hearing Tr. (Diekmann) 943-45.

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2. VPLM (Montage deposit derived from Kipping oral line of credit)

a. Due Diligence Package

i. Purported Beneficial Owner

There was evidence in the record about two VPLM deposits by CSCT. The one included in the allegations of the Complaint was through Montage for the further benefit of VHB International. The Checklist identifies Victor Bretel as the president of VHB International. The deposit was for 9.3 million shares.[287]

ii. Prior Holder Transaction

In the Montage deposit, the prior holder in the VPLM chain was an entity called Locksmith Financial. The Checklist noted that Locksmith Financial was affiliated with Richard Kipping, who was the former president of VPLM. The Checklist stated, however, that Kipping was no longer an affiliate of the issuer because he had resigned more than two years earlier.[288]

In concluding that Kipping was not an affiliate, the Checklist relied on an attorney opinion dated September 6, 2013, stating that Kipping had resigned more than two years before.[289] As discussed below, that attorney opinion was insufficient to support the conclusion that Kipping was no longer an affiliate of VPLM. Cruz testified at the hearing that the Firm also relied on a December 16, 2013 letter signed by VPLM's Chairman, Thomas Sawyer, which made a representation that Locksmith was not an affiliate of the issuer.[290] The Sawyer letter declared that the parties to the sale of securities from Locksmith to VHB International (discussed below) were not affiliates of the issuer.[291]

The Checklist for the VPLM deposit indicated that the depositor had satisfied the Rule 144 holding period by tacking back to a "verbal [oral] line of credit" whereby the prior holder, Locksmith, had loaned the issuer, VPLM, $58,636.24. The Checklist stated that the last advance on the line of credit was made July 6, 2012.[292]

An August 15, 2013 written agreement purported to document and formalize the oral line of credit. According to the 2013 document, Locksmith agreed in 2012 to advance funds as loans

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[287] RX-2, at 1.

[288] RX-2, at 1, 268.

[289] RX-2, at 1, 19-21.

[290] Hearing Tr. (Cruz) 441.

[291] RX-2, at 23-24.

[292] RX-2, at 1.

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against a revolving line of credit and had received the right to demand payment in full or in part at any time.[293]

On the same day, August 15, 2013, a debt settlement agreement was executed between the issuer and Locksmith. In that document, the issuer indicated that it wanted to settle the amount it owed Locksmith by giving stock to Locksmith. The parties agreed to settle the company's $58,636.24 debt as of July 31, 2012.[294]

Although VPLM did not issue the shares to Locksmith until September 2013,[295] the Beneficial Ownership Declaration later signed by Bretel treated the date on which Locksmith acquired the shares as August 1, 2012.[296] The depositor thus relied on tacking his holding period to Locksmith's oral line of credit.

iii. Acquisition Of Shares By Depositor

On August 23, 2013, Locksmith entered into a stock purchase agreement with VHB International. It was roughly a week after Locksmith had memorialized the purported oral line of credit and before the shares were actually issued. The aggregate purchase price for the stock was $240,000.[297] There is no evidence explaining why Locksmith was able to sell the shares for more than four times the value placed on the shares when Locksmith and the issuer entered into the debt settlement agreement only days before.[298] The buyer, VHB International, purported to acquire the shares for investment and not with a view to resale or distribution.[299]

Although Victor Bretel was identified as the beneficial owner of VHB International, Andrew Godfrey signed the Stock Purchase Agreement.[300] The Firm made an inquiry, and Montage responded that Godfrey "handles day to day operations due to Mr. Victor Bretel's travel schedule." Montage represented that Bretel remained the beneficial owner of VHB International.[301] Diekmann testified that the response was, as far as he was concerned, sufficient.[302]

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[293] RX-2, at 26-27.

[294] RX-2, at 28.

[295] RX-2, at 12.

[296] RX-2, at 13.

[297] RX-2, at 33.

[298] RX-2, at 32.

[299] RX-2, at 35.

[300] RX-2, at 37.

[301] RX-2, at 38.

[302] Hearing Tr. (Diekmann) 1744-45.

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iv. Issuer Filings

The Firm relied on public filings for proof of the existence of the oral line of credit. The Firm characterized the oral line of credit as "generally disclosed" in the issuer's annual report for September 30, 2012.[303] The annual report for the period ending September 30, 2013, which was only published on November 6, 2013—*after* the oral line of credit had been memorialized in writing—attached a grid showing that the issuer had settled many of its debts and payments for professional services by issuing VPLM stock. According to the grid, on August 15, 2013, VPLM issued a little over 29.3 million shares to Locksmith Financial as a debt settlement.[304]

The grid actually raised more red flags. It showed that the company regularly followed a practice of compensating affiliates and others with stock. During the period from October 12, 2011, through August 15, 2013, VPLM issued shares to Locksmith three times and shares to Locksmith's owner, the former president of VPLM, Richard Kipping twice. Thus, during the two-year period, Kipping received, either directly or through Locksmith, roughly 80 million shares of VPLM. In fact, according to the grid, during the same period the company issued more than 185 million shares to various persons and entities, including Dennis Chang, the issuer's president, Thomas Sawyer, its Chairman and CEO, and Carl Mattera, an authorized signatory for the issuer.[305]

Curiously, in May 2013 VHB International received directly from the issuer approximately 2.4 million shares of VPLM. This was only a few months before it received the 29 million shares from Locksmith Financial.[306] That VHB had already received shares directly from the issuer raised a red flag that it might be an affiliate or might be coordinating its acquisition and resales of shares with others who were affiliates. There is no evidence that Scottsdale took note of that red flag.

v. Scottsdale Approval And Sales

On February 10, 2014, Noiman and Cruz approved the VPLM shares deposited by VHB International for sale to the public.[307] Sales began on February 20, 2014, and continued through June 5, 2014. Periodically, Scottsdale wired out the proceeds from those and other sales for the account of CSCT.[308]

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[303] RX-2, at 1.

[304] RX-2, at 40.

[305] RX-2, at 40 (excluding an additional 265 million shares issued to consummate an acquisition of another company).

[306] RX-2, at 40.

[307] RX-2, at 2.

[308] JX-281.

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b. Red Flags Signifying A Scheme To Evade The Securities Laws

A number of red flags were raised by this VPLM deposit. Here we discuss two that required the Firm to conduct further inquiry to establish that an exemption existed.

First, the Firm knew that Kipping had been an affiliate of the issuer at some point. This red flag required heightened scrutiny of the transaction. The Firm failed, however, to gather sufficient evidence to conclude that Kipping was no longer an affiliate.

There is no copy of a resignation letter in the due diligence package. Scottsdale did not even have a specific resignation date. It had a vague statement in a legal opinion that Kipping had resigned from the issuer over two years before. The attorney declared that she had reviewed documents filed with the SEC and had determined that Locksmith was not an affiliate or control person of the issuer, but she did not specify the documents she reviewed or explain how she arrived at her conclusion. She did not say she had seen the resignation letter. The attorney further stated that Locksmith and Kipping had represented to her that they were not controlled by any of the officers or directors of the issuer. In making that statement, the attorney was little more than a conduit for representations by the interested parties.[309] Diekmann was unaware of anything that anyone at Scottsdale did to confirm that Kipping no longer had any duties as president of the issuer.[310]

Cruz vaguely testified that he thought the Firm had some sort of resignation or acknowledgement of Kipping's resignation in the file.[311] Cruz may have been referring to the December 16, 2013 letter from VPLM's Chairman, which represented that none of the parties to the sale of the securities to VHB International had been an affiliate of the company within 90 days of the sale.[312] That bare representation provides no detail whatever. It does not indicate when Kipping might have resigned as an officer of VPLM or provide any other verifiable fact. For purposes of ensuring that an issuer is not behind a chain of transactions designed to effect a public distribution without registration, a representation by a principal of the issuer must be viewed more skeptically.

Even more important, from the outset, Scottsdale had affirmative evidence in its due diligence package indicating that Kipping might be affiliated with the issuer regardless of whether he had resigned as president. Under Rule 144, if Locksmith and Kipping held 10% or more of the issuer, they would be affiliates for purposes of the exemption. The grid showed that Kipping, either directly or through Locksmith, had received 80,318,000 shares of VPLM between October 2011 and August 2013.[313] The total outstanding shares of the company at the

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[309] RX-2, at 19-21.

[310] Hearing Tr. (Diekmann) 1719-20.

[311] Hearing Tr. (Cruz) 440-41.

[312] RX-2, at 23-24.

[313] RX-2, at 40.

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time that Scottsdale evaluated the deposit were 730,460,237.[314] Thus, Kipping and Locksmith received at least a 10.996% ownership interest in VPLM and Kipping could have been an affiliate regardless of whether he was still an officer of the company.

There were other signs that Kipping could have been an affiliate. In the due diligence file is the first page of results from a Google search for "Richard Kipping + securities fraud." One of the results dated May 15, 2013, contains a fragment of content apparently referring to VPLM. That fragment says, "So Richard Kipping still has personal interest in this penny scam."[315] Another entry dated May 7, 2013, also refers to VPLM and says, "The next few days will show if the stock can keep its unprecedented … in fraud look at the shareholders Richard kipping pretty much owns the …"[316] The Google search page was filed in the package, apparently without anyone looking at the full stories concerning Kipping or following up on his ownership of VPLM shares.

If Scottsdale had conducted further due diligence, it might have discovered that Kipping was indeed an affiliate of VPLM. During the relevant period, the Board of Directors of VPLM ordered a review of Kipping and Locksmith's debt conversions to VPLM stock. The resulting "forensic audit" dated June 5, 2014, described Kipping as a director and shareholder of VPLM. It indicated that, at the time of the August 15, 2013 stock conversion that was the basis for tacking VHB International's holding period, Kipping had executive responsibilities at both VPLM and Locksmith, including check signing privileges at VPLM.

The accountant who performed the forensic audit opined that many aspects of the August 15, 2013 agreement purporting to memorialize the earlier oral line of credit were problematic. Many of the items that appeared to him to indicate that the arrangement was not a true arms-length transaction were facts known to Scottsdale at the time it approved the sale of VHB International's shares based on tacking to the oral line of credit. Among other things, the accountant noted that the written memorialization was a year after the purported oral line of credit. He also noted that the stock for debt agreement did not specify any particular terms for the conversion, and he viewed Locksmith's right to demand payment in full or part at any time as onerous.[317]

The forensic audit illustrates that an objective analysis of the facts known to Scottsdale would raise strong doubt that Kipping was independent of VPLM at the time of the August 15, 2013 agreement and stock conversion.

Second, the grid attached to the November 2013 public filing shows that the issuer had a pattern of paying for services and its business expenses with stock. It issued much of this stock to

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[314] RX-2, at 1.

[315] RX-2, at 95.

[316] RX-2, at 95.

[317] RX-292, at 6-7.

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company insiders.[318] The pattern suggests that the issuer may have substituted the issuance of stock for compensation to insiders and business partners, leaving them to realize any monetary benefit by selling the stock to others. The constant flow of new issuer stock looks like a two-step process for unlawfully distributing securities into the public marketplace without registration.

This pattern is particularly troubling because all three parties in the chain of holders for the deposit—Kipping, Locksmith, and VHB International—were on the list of persons and entities that had converted debt to shares.[319] This was a red flag that they and the issuer could be coordinating. The Firm should have further investigated before concluding that the transaction was exempt under Rule 144.

3. VPLM (Titan deposit derived from Kipping and Locksmith through the Lees)

a. Due Diligence Package

i. Purported Beneficial Owner

CSCT deposited another 13 million shares of VPLM for the benefit of Titan and for the further benefit of Cumbre Company. The Checklist identified Patrick Gentle as the ultimate beneficial owner of Cumbre and the VPLM stock.[320]

We discuss the evidence regarding this transaction as evidence of other similar conduct for purposes of sanctions and as additional evidence that CSCT was no more than a façade. Scottsdale continued to deal directly with the FFI and to ignore CSCT.

ii. Prior Holder Transactions

This is the one transaction that was not derived from the conversion of a debt liability into shares. However, it also traces back to Kipping and Locksmith in a chain of holders.

The Checklist identified two prior holders, Jung Ju Lee and Soon Deuk (Kang) Lee.[321] Jung Ju Lee acquired 1.5 million shares by a Stock Purchase Agreement dated June 12, 2012, from Richard Kipping. In that Stock Purchase Agreement, Kipping represented that he was not an affiliate of the issuer and had not been an affiliate at least for the previous 90 days. An attachment to the Stock Purchase Agreement indicated that Lee paid Kipping $13,000 for the shares. A copy of a check written to Locksmith for $13,000 was attached. It appears to be written by Brooks K-9 Services Ltd., but it bears a notation saying "re VPLM certs."[322] Nothing in the

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[318] RX-2, at 40.

[319] RX-2, at 40.

[320] RX-2, at 106.

[321] RX-2, at 106.

[322] RX-2, at 126-29.

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due diligence package explains the connection between Brooks K-9 Services and Lee or the nature of Brooks K-9 Services.

Jung Ju Lee acquired another 500,000 shares for $5,000 from Locksmith Financial pursuant to a Stock Purchase Agreement dated October 19, 2012. Locksmith made the same representation that it was not an affiliate of the issuer. Kipping signed on behalf of Locksmith. Another check from Brooks K-9 Services Ltd. was attached.[323]

Soon Deuk (Kang) Lee acquired three million shares of VPLM from Locksmith by a Stock Purchase Agreement dated August 1, 2012, for $20,000. Locksmith represented that it was not an affiliate of the issuer. Kipping signed on behalf of Locksmith.[324]

iii. Acquisition Of Shares By Depositor

Cumbre acquired five million shares of VPLM from Soon Deuk (Kang) Lee on January 10, 2014.[325] In a separate document written to Cumbre, Lee confirmed receipt of $60,000 for the shares.[326] On January 13, 2014, in a separate document, Jung Ju Lee similarly confirmed receipt of $20,000 for 500,000 shares of VPLM.[327]

iv. Scottsdale Approval

On May 29, 2014, Noiman and Cruz signed the Checklist approving the shares of VPLM for sale.[328]

v. Blackout Period On Trading VPLM Shares

On June 5, 2014, Thomas Sawyer, the Chairman of the Board of Directors of VPLM, sent Titan by email a signed declaration notifying it of a blackout period starting June 6, 2014, on trading VPLM stock by certain "covered persons." Covered persons were defined to include directors, officers, and holders of 10% or more of the company's outstanding shares, among others. Richard Kipping (and his assigns) and Locksmith were on the list of covered persons. So was VHB International. The list also included FFIs and broker-dealers. Montage, Titan, Alpine, and Scottsdale were all on the list.[329] Noiman discussed the blackout notice with Titan and requested a copy.[330]

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[323] RX-2, at 136-39.

[324] RX-2, at 147-49.

[325] RX-2, at 160.

[326] RX-2, at 155.

[327] RX-2, at 145.

[328] RX-2, at 107.

[329] CX-294.

[330] RX-104.

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On June 6, 2014, a lawyer named David Wise, who had often done work for Scottsdale, wrote an email to Sawyer claiming to represent unnamed clients on the covered-person list and threatening to sue Sawyer and others for "slow[ing] down or prevent[ing] the transfer of shares by my clients." Wise called the blackout notice an attempt to prevent sales of VPLM stock in order to conduct a promotional campaign to raise the share price. He characterized Sawyer's actions as "clearly illegal" and said he would be calling the SEC.[331]

On June 6, 2014, Wise sent a copy of his email to Sawyer to Kelvin Leach at Titan and to both Noiman and Diekmann at Scottsdale. His cover note to them was breezy: "Hi Guys, See below. David." The tenor of the cover note indicates that Scottsdale and Titan were working closely together to address the problem of the blackout notice.

On June 9, 2014, Titan forwarded the blackout notice to Noiman, and Noiman immediately forwarded it to Cruz.[332] That same day, Noiman also forwarded the Wise email to Cruz.[333] The Firm stopped selling VPLM shares held by VHB International in order to investigate.[334]

On June 11, 2014, Titan received what appears to be an unsigned clarifying memorandum from Sawyer stating that the broker-dealers and FFIs such as Scottsdale and Titan were only on the list because they had been known to trade VPLM stock for covered persons. The memorandum declared that the broker-dealers and FFIs were still free to trade on behalf of *non*-covered persons. Titan forwarded the clarification that same day to Noiman and Diekmann,[335] and Noiman forwarded it to Cruz.[336] The clarifying memorandum did not take Kipping (and his assigns), Locksmith, or VHB International off the list of covered persons. Nor did it explain why they were listed as covered persons. When Noiman forwarded the clarification to Cruz on June 11, 2014, he wrote that "Titan received the attached after David Wise's VPLM notice."[337]

On June 24, 2014, a lawyer claiming to represent VPLM wrote to Noiman as Scottsdale's "Compliance Officer." Scottsdale had requested the transfer of two stock certificates, and the lawyer stated that the stock certificates appeared to be owned by covered persons. Kipping (and his assigns), Locksmith, and VHB International were on the attached list of covered persons. One of the two stock certificates identified, 2985, related to the VPLM deposit by Titan on

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[331] Hearing Tr. (Cruz) 578-79. Wise provided an attorney opinion letter on which the Firm relied in connection with the ORFG stock deposit. RX-3, at 70. Wise also went to the Cayman Islands to assist Ruzicka for a couple of weeks after D'Mura left. Hearing Tr. (Hurry) 1603-04.

[332] CX-294.

[333] Hearing Tr. (Noiman) 1265-67; RX-104.

[334] Hearing Tr. (Cruz) 442-43; JX-281.

[335] CX-295.

[336] CX-296.

[337] CX-296.

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behalf of Cumbre.[338] The other, 2228, may relate to a VPLM deposit not part of the record in this case. The certificate number for the deposit by VHB International is 2525.[339]

Notably, although the Titan deposit on behalf of the Lees nominally came through CSCT, Ruzicka was not included on any of the correspondence about the blackout period.[340] The correspondence reveals that Scottsdale, through Noiman, was continuing to manage FFI deposits without regard to CSCT. CSCT was performing no real function in connection with the VPLM deposit.[341]

b. Red Flags Signifying A Scheme To Evade The Securities Laws

Given what Scottsdale already had in its file on VPLM, it should not have approved the VPLM shares deposited by Cumbre for resale without obtaining better evidence that Kipping was not an affiliate of the issuer. The Lee transactions closely followed the VHB International transaction and revealed a pattern—Kipping was continually acquiring and selling large blocks of VPLM shares. When coupled with the information from the grid showing that VPLM followed a practice of issuing stock to insiders in settlement of its debts, the circumstances raised a strong suspicion that the issuer or an affiliate was unlawfully distributing securities without registration in a two-step process designed to obscure what was actually happening and who was benefiting from the sales of stock.

4. ORFG (Unicorn deposit derived from Forward line of credit)

a. Due Diligence Package

i. Purported Beneficial Owner

In connection with the deposit of approximately 13.2 million shares of ORFG, CSCT acted for Unicorn, and Unicorn acted for an entity called Media Central, which named Geovanni Moh as the beneficial owner.[342] Media Central was identified as a Belize corporation, and Moh

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[338] RX-2, at 106-09.

[339] RX-2, at 3.

[340] When Ruzicka was shown the blackout notice at his OTR, he expressed shock. He testified that he had never seen it, and that if he had he would not have processed the VPLM deposit for resale. He would have expected Scottsdale to treat it as a problem or red flag. CX-178 at 257-60.

[341] In the middle of explaining what he did in connection with investigating the VPLM blackout, Cruz made a half-hearted assertion that CSCT was involved, saying, "I asked or I briefed with CSCT to—to get an explanation if they—if they could." Hearing Tr. (Cruz) 442-43. We do not find that testimony credible. There is no corroborating evidence of any kind, and his testimony about CSCT, in contrast to his detailed testimony about Wise, was vague. Cruz did not say he had a conversation with Ruzicka—who was the only person at CSCT. Rather Cruz referred to CSCT in the abstract. Nor did Cruz say anything about the content of what he "asked" or "briefed" when he supposedly had contact with CSCT.

[342] RX-3, at 1.

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was identified as a citizen of Belize.[343] Media Central was originally incorporated on February 14, 2014, under the name Lock Investments Ltd. Only two weeks later, on February 27, 2014, the name was changed to Media Central.[344] Nothing in the due diligence package explains the reason for the name change or whether there was any change in the identity of the principals of the company.

ii. Prior Holder Transaction

Media Central claimed that it had satisfied the holding period for a non-affiliate by tacking to a prior holder's note as of September 1, 2012.[345] The prior holder was a person named Casey Forward. He purportedly took the issuer's note in return for an open-ended line of credit up to the maximum amount of $600,000. The note provided that the issuer would pay on "loans, advances and debt as of August 31, 2011 … with interest on the principal balance outstanding from time to time" up to a principal amount of $600,000.[346] The note provided Forward with a right to convert any portion of the unpaid principal amount of note to restricted common stock. This right was open-ended and did not specify a particular amount that could be converted or a particular date when the conversion could take place.[347] Furthermore, the note provided that the holder could transfer in whole or in part any portion of the note without the prior consent of the company. Any such transfer was at the discretion of the holder.[348]

Forward subsequently assigned a $50,000 portion of the note to an entity called Anything Media in exchange for shares of Anything Media. As described on the first page of the Deposited Securities List, that transaction was reflected in an Assignment and Modification Agreement dated January 18, 2014, by which ORFG agreed to modify the terms of the original note.[349]

iii. Acquisition Of Shares By Depositor

On April 16, 2014, Anything Media sold 15 million shares of ORFG to Media Central for $75,000 pursuant to a stock purchase agreement. However, at that time, Anything Media did not own the shares. It acquired shares of ORFG only a few days afterward, on April 22, 2014, when it converted a $9,000 portion of the note into 15 million shares of ORFG.[350] There is nothing in the due diligence package to explain why Anything Media sold ORFG shares before it actually owned them. Nor is there anything to explain why the shares could be sold for $75,000 when

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[343] RX-3, at 9, 13.

[344] RX-3, at 15-16.

[345] RX-3, at 36-41.

[346] RX-3, at 36.

[347] RX-3, at 38.

[348] RX-3, at 40.

[349] RX-3, at 1, 42-45.

[350] RX-3, at 1.

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they only had a value of $9,000 when they were converted a few days later. Cruz testified that he did not consider these matters red flags that required further inquiry and that the Firm did not conduct further inquiry based on these matters.[351]

iv. Scottsdale Approval And Sales

On June 5, 2014, Noiman and Cruz signed the Checklist for ORFG approving the sale of securities.[352] Sales began June 11, 2014, and continued through the end of the relevant period on June 30, 2014. Periodically, Scottsdale would wire out the proceeds along with the proceeds from the sales of other securities out of CSCT's account.[353]

v. Promotional Activity

From early May through early July, ORFG was the subject of multiple promotions.[354] Cruz testified that the promotions were consistent with the reviewer's findings on the Checklist. He said he probably would have looked at a couple of pages of printouts showing the existence of promotions. The Firm typically would look to see whether the customer had any involvement and whether the promotions were having any effect on the trading done in the security.[355]

b. Red Flag Signifying A Scheme To Evade The Securities Laws

We discuss here only one of the red flags in the ORFG deposit. The initial transaction underlying the deposit made no business sense. With respect to the original line of credit, no reasonable company would agree to borrow money on a line of credit that permitted the lender to convert the debt to stock at any time in any amount at the holder's discretion. Certainly a company would not agree that the open-ended conversion option could be assigned to an unknown third party without the issuer's prior consent. Under such an agreement the company would not know whether it was going to be required to pay back some or all of the money it borrowed on the line of credit or whether it would be required to issue shares. Nor could it know to whom the conversion option might be assigned. It could not manage its finances or be certain of its shareholder dynamics and corporate control.

As the forensic audit of the Kipping-Locksmith loan found with respect to the open-ended line of credit in that transaction, the onerous terms from the issuer's perspective were a sign that the loan was not an arms-length transaction. Unless the Firm investigated and discovered some sensible explanation, it could not lawfully sell the securities.

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[351] Hearing Tr. (Cruz) 533-34.

[352] RX-3, at 2.

[353] JX-310.

[354] CX-303, at 17-25.

[355] Hearing Tr. (Cruz) 537-38.

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E. Credibility

1. Ruzicka

As noted above, Ruzicka was never registered with FINRA and was never subject to its jurisdiction. He voluntarily testified at an OTR, and considered testifying voluntarily at the hearing. Throughout the first week of the hearing, Enforcement reported at the end of each day on the likelihood of Ruzicka appearing.[356] On Friday of the first week, Enforcement announced that Ruzicka had agreed to appear the following Monday.[357]

However, Ruzicka changed his mind over the weekend and never appeared. He apparently changed his mind because of a text that Respondents' counsel sent to him on the Saturday after the first week of hearing. That text, although portrayed by counsel afterward as nothing more than a request to talk, appears to us to have been an attempt to sow distrust between Ruzicka and Enforcement counsel. It made Ruzicka angry at the way he thought he was being portrayed by Enforcement at the hearing and unwilling to be "put through hell" by appearing.[358]

Respondents' counsel telephoned Ruzicka on Saturday but only received an automated instruction to leave a message or text. Respondents' counsel then left him a text saying the following, which included quotations from Enforcement's opening statement:

> You may want to know how FINRA has been characterizing you during the first week of the hearing. For example, you were "hapless," "malleable," and "bereft of other options." You may want to know the other side of what FINRA is telling you. I would welcome the opportunity to discuss.[359]

After receiving the text from Respondent's counsel, Ruzicka texted Enforcement counsel saying, in part, "If even veracity, I am done."[360] We interpret Ruzicka's response to mean he was offended at the portrayal of him as desperate and easily manipulated, and to mean that he would not appear at the hearing if that was an accurate picture of Enforcement's comments about him.

Enforcement reported at the hearing that it had neither confirmed nor denied to Ruzicka what Respondents' counsel told him in the text. Enforcement took the position that it could not reveal what was said in the proceeding because it was confidential.[361]

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[356] Initially, the discussions of Ruzicka's likely participation were off the record. Later, they were on the record. Hearing Tr. (remarks of counsel) 748, 840-41, 1032, 1275, 1277.

[357] Hearing Tr. (remarks of counsel) 1275, 1277.

[358] Hearing Tr. (counsel reading text into record) 1288.

[359] Hearing Tr. (counsel reading text into record) 1288.

[360] Hearing Tr. (counsel reading text into record) 1287.

[361] Hearing Tr. (remarks of counsel) 1299.

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Enforcement argued that Respondents' counsel had violated at least the spirit of the sequestration order in the case; Respondents' counsel asserted that the sequestration order was about witness testimony and that counsel's quotations from Enforcement's opening statement did not violate the order. The Hearing Officer declined to rule on the charge of misconduct.[362]

Based on legal analysis separate from the alleged misconduct of Respondents' counsel, as laid out at the hearing on the record, the Hearing Officer admitted the entire transcript of Ruzicka's OTR. The Hearing Officer declared that the Hearing Panel would determine the probative value and weight to give the OTR after it had reviewed the OTR in the context of the evidence at the hearing, taking into account the circumstances that led to the admission of the OTR in lieu of live testimony from Ruzicka.[363]

The Hearing Panel now specifically finds that Ruzicka's testimony at his OTR was credible. It was consistent with other evidence in the record and corroborated by D'Mura's testimony. Wherever Ruzicka's testimony is cited here, it is cited because we credit it.

We reject Respondents' arguments for discounting Ruzicka's testimony.

First, Respondents assert that it is unfair to rely upon Ruzicka's testimony because they did not have an opportunity to cross-examine him.[364] The short answer to that argument is that Respondents' counsel was responsible for that lack of opportunity to cross-examine the witness. Respondents cannot complain about it now.

Second, Respondents argue that Ruzicka was angry and biased against Hurry, so his OTR should not be viewed as reliable.[365] After review of the transcript, we conclude that, although Ruzicka evidently did not like the way Hurry treated him, Ruzicka was truthful as to the facts and as to Hurry's intimidating and controlling manner.

Third, Respondents claim that Ruzicka gave inconsistent information in a prior telephone call with FINRA staff.[366] However, the inconsistency was explained by the fact that Ruzicka still felt "beholden" to Hurry at the time of the telephone call. By the time of the OTR he did not feel that way.[367]

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[362] Hearing Tr. (remarks of Hearing Officer) 1302.

[363] Hearing Tr. (remarks of Hearing Officer) 1302-05. There had always been uncertainty about whether Ruzicka would give testimony at the hearing. In light of that uncertainty, the parties had earlier briefed the issue of whether the OTR should be admitted. The Hearing Officer's ruling was informed by that earlier briefing.

[364] Resp. PH Br. 44 and n.253.

[365] Resp. PH Br. 44 and n.253.

[366] Hearing Tr. (remarks of counsel) 1296.

[367] Hearing Tr. (remarks of counsel) 1298.

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Fourth, Respondents claim that Ruzicka gave an affidavit inconsistent with his OTR. They assert that Ruzicka swore that Montage, Titan, and Unicorn came to CSCT through a referral from Scottsdale. However, Ruzicka signed that affidavit at Hurry's request while still working for Hurry.[368] By the time of his OTR, Ruzicka no longer worked for Hurry. For that reason, we credit his OTR testimony that he was told that Titan and Unicorn came to CSCT through Hurry. Moreover, the affidavit saying that the three FFIs were referred by Scottsdale is not inconsistent with Ruzicka's understanding that ultimately Hurry was behind the referral. Even if Hurry persuaded the FFIs to do business with Scottsdale through CSCT, it would be consistent with his desire for secrecy for him to arrange for someone at Scottsdale to make the necessary introductions.

Finally, we observe that although Ruzicka's OTR testimony is valuable, his absence from the hearing deprived the Extended Hearing Panel of what would have been helpful live testimony and the opportunity for the Panel to ask him questions. Ruzicka's absence also encouraged Hurry to dispute the OTR testimony without fear of being contradicted, as discussed below. The distrust sown by Respondents' counsel impeded our adjudicatory process.

2. Hurry

As indicated above in connection with specific testimony, we repeatedly found that Hurry was not credible. Many of Hurry's self-serving explanations were not convincing on their face. His testimony was often inconsistent with other reliable evidence. Much of what he said also conflicted with Ruzicka's OTR testimony, which we find more credible than Hurry's uncorroborated assertions.

Hurry's ostensible purpose for setting up CSCT—to relieve Alpine of IRS withholding obligations—was not supported by any evidence that it made business sense. Rather, we conclude from Cruz's and Diekmann's testimony regarding heightened regulatory scrutiny in the period leading up to the establishment of CSCT, and the filing of the four prior SEC complaints against Scottsdale customers and employees, that Hurry sought to insulate his business from regulatory oversight by moving Scottsdale's FFI business offshore. This conclusion is reinforced by the fact that Scottsdale personnel continued to manage the FFI business with entities such as Unicorn and Titan (through Miller and Noiman). They needed to do that because Ruzicka was not qualified to run a broker-dealer, particularly one in the highly specialized business of liquidating microcap stock pursuant to Rule 144. Moreover, CSCT got its business through Hurry and Scottsdale. CSCT did not, and indeed could not, operate as an independent entity. CSCT served no function that Scottsdale could not have performed without it.

[368] Hearing Tr. (Hurry) 1565-69, 1638-39; RX-110.

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Hurry disputed that Ruzicka was not qualified to run CSCT and emphasized how accomplished Ruzicka was.[369] His testimony in this regard was not credible. It is plain from Ruzicka's inquiry about working in Hurry's bike shop that Ruzicka had no relevant experience and was desperate.[370] D'Mura described trying to educate Ruzicka about the securities industry and the elements for free-trading securities. D'Mura said it was "rough going" and that Ruzicka "wasn't picking it up."[371] D'Mura said that Ruzicka was anxious, stressed, and not capable of handling due diligence on microcap deposits by himself.[372] Even more important for our purposes here, D'Mura testified that he had conversations with Hurry about Ruzicka's difficulties and how Ruzicka was not "getting it."[373] Thus, contrary to his hearing testimony, Hurry knew that Ruzicka was not capable of running CSCT.

Hurry's assertion that he had little to do with CSCT was disproved. D'Mura testified that Hurry frequently bombarded him and Ruzicka with telephone calls about CSCT business and that he and Ruzicka tried to prepare for those calls with updated information about deposits. D'Mura portrayed Hurry as an intense and constant presence in their lives while they worked at CSCT, and emails corroborate that testimony. Emails show that Hurry oversaw every detail of CSCT's business, and Hurry admitted that he traveled to the Cayman Islands at least once a month. He so closely oversaw the CSCT operation that he claimed to know that Ruzicka was in the office only ten minutes out of every hour.

To the extent that Cruz, Diekmann, D'Mura, and Ruzicka all testified that Ruzicka, not Hurry, ran the daily operations of CSCT, as Respondents assert in their post-hearing brief,[374] we do not view that testimony as contradicting the evidence that Hurry was deeply involved in

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[369] Hearing Tr. (Hurry) 1574-77. When asked why he did not hire someone who had broker-dealer experience and who knew about FFIs to run CSCT, Hurry said that he hired Ruzicka to play an "executive role," someone who was "an all-around person, somebody who had some entrepreneurial skills, some management skills, proven to be able to do that." Hearing Tr. (Hurry) 1648.

[370] Hearing Tr. (Hurry) 1631, 1635-36.

[371] Hearing Tr. (D'Mura) 2273-77.

[372] Hearing Tr. (D'Mura) 2277-78.

[373] Hearing Tr. (D'Mura) 2274-77. D'Mura may not have been emphatic about Ruzicka's difficulties—he testified that it was against his self-interest to cause Hurry to fire Ruzicka—but D'Mura did raise concerns with Hurry. Hearing Tr. (D'Mura) 2314-15.

Email correspondence corroborates D'Mura's judgment that Ruzicka did not understand the business. For example, in May 2014, Ruzicka sought Diekmann's approval to consider a deposit of 11 million shares with an ostensible value of two million dollars. Diekmann wrote back that the issuer's shares traded in so little volume—roughly 3,500 per day—that it would take a "bazillion" years to sell the entire deposit. Diekmann said it was inappropriate to set the value that high and the transaction was the kind that should be avoided. CX-241.

This email correspondence also illustrates that CSCT served no real function independent of Scottsdale. Ruzicka sought Diekmann's guidance before even considering the deposit. Ruzicka was not independently vetting deposits before presenting them to Scottsdale. CX-241, at 2.

[374] Resp. PH Br. 45.

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CSCT's business. Ruzicka was responsible for the day-to-day processing of paper, but Hurry was responsible for bringing in business, cultivating the clients, and making all important decisions. Ruzicka, an out-of-work real estate attorney, did not have the background to do more than process the paper as directed. For Hurry to maintain that he left Ruzicka on his own to prospect for customers and manage client relationships defies belief.

Based on D'Mura's testimony and various emails, Hurry's contention that he was not concerned with secrecy was false. D'Mura testified that Hurry emphasized to him the privacy laws of the Cayman Islands, and D'Mura thought Hurry was very concerned about secrecy. Hurry's concern with secrecy was manifested in multiple ways, from his admitted use of FaceTime to confer with Montage, Titan, Unicorn, and other customers, to his obsession with labeling every email to and from Ruzicka as privileged, to his use of an email address that did not reveal its connection to him, to his refusal to use emails to discuss business and insistence on using telephone calls to do that.

Ruzicka's testimony only confirms D'Mura's. Ruzicka testified that Hurry told him that he was moving the FFI business to the Caymans precisely because he would not have to "give anything" to anyone. According to Ruzicka, Hurry was fanatical about not creating a record of his involvement with CSCT.

As for Hurry's efforts to develop business for CSCT, Hurry admitted having telephone calls with principals of Montage, Titan, and Unicorn, and he admitted personally visiting Montage in Panama and Unicorn in Belize. Although he claimed that he discussed a back-office system with Montage at Ruzicka's request, his testimony was vague and unspecific. There was no corroboration for Hurry's assertion, and he only made it when he knew that Ruzicka would not appear at the hearing to contradict him. Similarly, as to Hurry's initial assertion that he did not discuss business with Unicorn when he went to Belize, Hurry was impeached by his own OTR testimony. In his OTR he testified that he discussed pros and cons of doing business with Scottsdale directly or going through CSCT. Emails showed that Hurry provided other leads and referrals to Ruzicka, and D'Mura testified that Hurry was involved in developing Caledonian as a CSCT customer.

We further find Hurry not credible when he testified that he could not remember anything about his meetings with Montage in Panama and Unicorn in Belize. Hurry appeared to have excellent recall of other information and events. He testified in detail about the intricacies of taxation in the Cayman Islands and how it differed for Canadians and U.S. citizens, as well as the way the special economic zone in the Caymans operates.[375] He also testified about the Cayman Islands Monetary Authority, CIMA, and its information sharing agreement with the SEC, noting

[375] Hearing Tr. (Hurry) 1554-65, 1647-48.

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that the original agreement was in 2005 and that it was updated in 2012.[376] He insisted that he knew the exact days on which Ruzicka and D'Mura began at CSCT.[377]

We observe that Hurry appeared to be a canny, sophisticated, controlling, and hard-driving businessman. Hurry's attempt to portray himself as a distant figure, far removed from CSCT's business was not credible. Although he claimed that he likes to empower his people to run their businesses on their own,[378] that is demonstrably untrue.

3. DiBlasi

We find DiBlasi's testimony that he was the CCO—but not in connection with the Firm's Rule 144 business—astonishing.[379] Almost all of the Firm's business involved Rule 144 sales. As explained below in discussing DiBlasi's violation, DiBlasi was responsible for the WSPs, and nothing in the WSPs clearly allocated Rule 144 compliance to Cruz. Indeed, during much of the relevant period, the WSPs assigned the CCO specific responsibilities in connection with Rule 144.[380] DiBlasi's testimony may accurately reflect what he believes his job responsibilities to be, but, if so, his designation as CCO was misleading.

4. Cruz

Cruz's testimony was vague and unreliable. He often said he could not recall whether he had looked at various materials in conducting his due diligence reviews but that he "could" have done so.[381] Cruz also changed his testimony or made it vaguer as he was testifying if he became uncomfortable with his original statement. For example, he said that the change in NHPI's business from pharmaceuticals to oil and gas was not so important because the company's "management team had been stable. It's not the situation where we had a roaming management team."[382] But when asked how he knew that the management team was stable, he could point to nothing in the due diligence package or elsewhere. He ended by denying that he had said that the management team had been stable, saying, "I didn't see any change of – evidence of a change of management. I didn't use 'stable.'"[383] When pressed whether certain items were red flags calling for a searching inquiry about the issuer, Cruz resorted to general statements such as it "depends

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[376] Hearing Tr. (Hurry) 1630.

[377] Hearing Tr. (Hurry) 1620, 1624.

[378] Hearing Tr. (Hurry) 1550.

[379] Hearing Tr. (DiBlasi) 1921-23, 1946-47, 1952-53, 1965-66.

[380] Hearing Tr. (DiBlasi) 1967-73.

[381] Hearing Tr. (Cruz) 279, 284, 292-96, 301-03, 308.

[382] Hearing Tr. (Cruz) 288.

[383] Hearing Tr. (Cruz) 288-91.

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on the facts and the circumstances."[384] He never explained any basis for determining which facts and circumstances would trigger the duty to conduct a searching inquiry.

5. Diekmann

We find Diekmann's testimony vague, evasive, and unreliable. He characterized documents in ways that on their face the documents did not support, such as the Miller email indicating that a Canadian citizen could conceal himself by using a corporate entity as the owner of his Scottsdale account. Diekmann asserted that the Firm's procedures would root out a nominee problem but could point to nothing in the procedures that was designed to do that.[385] He was insensitive to suspicious circumstances such as a Google search that turned up information suggesting that a person was engaged in securities fraud,[386] or the identical terms and circumstances of the three supposedly independent NHPI deposits.[387] He contradicted his own OTR testimony.[388] He repeatedly resisted admitting that inconsistencies and suspicious circumstances could signify that a transaction was a sham until he had to admit what was obvious.[389]

Given Diekmann's position as the Firm's current president, we are concerned about his ability to ensure that the Firm responds appropriately in the future to obvious red flags and suspicious circumstances. This concern bears on the need for stringent sanctions, as discussed below.

Illustrative of the issue is Diekmann's testimony regarding information on Unicorn's website. Unicorn advertised the use of nominees to give customers an "extra level of confidentiality" because the customer's "name will not show up."[390] At his OTR, Diekmann testified that he had not seen this page of the Unicorn website before his OTR, but if he had it would have caused him concern whether the true beneficial owner was being disclosed.[391] At the hearing he testified differently. He said that he would not be concerned about the information on Unicorn's website because he had seen nothing on the website that suggested that Unicorn was offering to affirmatively lie about beneficial ownership.[392] When asked whether Unicorn would

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[384] Hearing Tr. (Cruz) 293.

[385] Hearing Tr. (Diekmann) 737-38.

[386] Hearing Tr. (Diekmann) 927.

[387] Hearing Tr. (Diekmann) 1853-54, 1901-04.

[388] Diekmann testified at his OTR that a print-out from the Unicorn website caused him concern about whether Patrick Gentle was the true beneficial owner of stock deposited at Scottsdale in his name. At the hearing, however, he denied that the information on the Unicorn site was a concern. Hearing Tr. (Diekmann) 925-30.

[389] Hearing Tr. (Diekmann) 1881-84, 1886-87.

[390] Hearing Tr. (Diekmann) 1818-19.

[391] Hearing Tr. (Diekmann) 1875-78.

[392] Hearing Tr. (Diekmann) 1819.

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have had to offer to lie about the beneficial owner before the website language would concern him, Diekmann answered "Yes."[393] That is not consistent with his and the Firm's gatekeeping function.

A second example of Diekmann's insensitivity to suspicious circumstances is his response to questions concerning an email exchange between one of the Rule 144 staff members and Titan. The staff member sent an email to Ryan Mendez at Titan saying that Scottsdale had multiple subaccounts at Scottsdale with Andrew Godfrey as the authorized signer. She requested a statement from Godfrey that explained the purpose for the multiple entities and provided an explanation of "any distinguishing features among the separate entities." She then named the eight entities.[394]

Godfrey provided an astoundingly broad and vague response:

> [The eight companies] are holding company's [sic] that are used to invest in development and exploration stage companies that engage in local, regional, multinational, global, sporting, manufacturing, wholesale, transportation, technology and eco friendly companies, etc., etc. Each investment is placed into a holding company based on investment criteria such as location, industry, long or short-term investment etc., etc.

Godfrey made no distinction among the companies. He provided no facts that could be verified. The response was undated and addressed "To Whom It May Concern." Godfrey provided no address, telephone number, or other contact information for himself or any of the companies. The response was forwarded by email from Titan to Scottsdale.[395]

Diekmann characterized Godfrey's response as reasonable.[396] We do not find it so. It lacks specificity and has no indicia of reliability or authenticity.

Finally, Diekmann displayed a lack of the skepticism, analytic acuity, and ingenuity that are required to perform the broker-dealer's gatekeeping function in the Rule 144 context. He testified that the identical documentation for the NHPI transactions did not trouble him because some unidentified person could have put Collins together with the three parties seeking to sell the NHPI shares they acquired from him. When asked whether that unidentified person could be the secret beneficial owner of the three sub-sub-accounts, he said that there was nothing in the documentation indicating that was so. He further declared that he did not know how you would

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[393] Hearing Tr. (Diekmann) 1875.

[394] CX-247.

[395] CX-248.

[396] Hearing Tr. (Diekmann) 891.

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investigate whether it was so. He seemed content not to know who the unidentified person was and to assume that it was a person who had put the three depositors in touch with Collins.[397]

Diekmann said that "there's always a risk that there could be some puppet master pulling the s[t]rings."[398] But he expressed frustration at the thought that the Firm could and should have done more to ascertain whether a puppet master was at work. As he remarked regarding the Argentinian nominees in the *Tavella* case, "It's just impossible to know that there was somebody else behind this."[399]

For purposes of assessing the Firm's ability to avoid violations in the future and crafting remedial sanctions, his remarks cause us concern. Diekmann said that what happened with NHPI happens all the time.[400]

6. Experts

a. Marc Menchel

We give little weight to the testimony of Respondents' expert, Marc Menchel. Although he opined that Scottsdale's procedures were reasonable and consistent with industry custom and practice, his experience related to Rule 144 was both a long time ago and in a much different context than Scottsdale's business. Menchel ran a Rule 144 desk at a large broker-dealer more than 30 years ago. That desk did not concentrate the way Scottsdale does on large blocks (100,000 shares or more) of microcap stocks.[401]

Furthermore, Menchel did not opine on the sufficiency of Scottsdale's due diligence in the context of the specific transactions at issue. He did not review the exhibits or the investigative testimony. While he did look at all the relevant due diligence packages, he did not review them with the idea of "second guessing" the Firm's handling of the deposits. He merely looked to see whether the due diligence packages contained the sorts of items that one would expect them to contain.[402] Essentially, Respondents' expert, like Respondents, took a check-the-box look at the due diligence packages.

Finally, Menchel's opinion seemed influenced by his admittedly idiosyncratic view that Regulatory Notice 09-05 goes beyond Rule 144, and his claim that many of the red flags listed in the Regulatory Notice are not really red flags for purposes of Rule 144.[403] Menchel's opinion

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[397] Hearing Tr. (Diekmann) 1901-03.

[398] Hearing Tr. (Diekmann) 720.

[399] Hearing Tr. (Diekmann) 732.

[400] Hearing Tr. (Diekmann) 1901, 1903.

[401] Hearing Tr. (Menchel) 2459-61.

[402] Hearing Tr. (Menchel) 2478-80, 2496-98, 2529-33, 2554-65, 2572-73, 2575.

[403] Hearing Tr. (Menchel) 2503-07, 2515-24.

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similarly seemed influenced by his view that FINRA has no authority to charge a broker-dealer firm with a Rule 2010 violation for a Securities Act violation, a view that he admits has no decisional support.[404] Menchel's opinion regarding FINRA's authority is contrary to the Hearing Officer's prior determination in the Order dated February 26, 2016, that FINRA has jurisdiction to bring this case. We decline to accept Menchel's view for the reasons stated in that Order, which we do not repeat here.[405]

b. Brian Underwood

We find the opinion of Enforcement's expert, Brian Underwood, more reliable, more persuasive, and entitled to greater weight than Menchel's. His experience with Rule 144 was more extensive and more recent. Until retiring in 2008, Underwood served as the Chief Compliance Officer of two major broker-dealers for a combined period of almost 20 years. The broker-dealers traded microcap securities on a fairly frequent basis and their Rule 144 desks reported to Underwood through one of his direct reports.[406] He also served on two NASD working groups in the 1990s that reviewed roughly 300 sets of policies and procedures as part of an effort to develop a model set of procedures.[407] Underwood has maintained a consulting practice since he retired, and in that capacity he has more recently seen between 20 and 25 entire policies and procedures of different firms.[408]

Underwood also reviewed more of the materials relating to the particulars of this case, including the pleadings, the parties' memoranda, the exhibits, and the OTRs conducted in connection with the investigation.[409] He, unlike Menchel, evaluated the substance of Scottsdale's due diligence and whether it was consistent with industry custom and practice.[410]

Underwood expressed the following opinions, among others, which we find consistent with our own views and supportive of our conclusions:

(i) In its WSPs, the Firm did not adequately address the risk of nominees being used to conceal the identity of the beneficial owners of the shares—it did not even mention the risk.[411]

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[404] Hearing Tr. (Menchel) 2593-99.

[405] *See also KCD Financial Inc.*, Exchange Act Release No. 80340, slip op. at 5-6 & nn.8-13 (SEC Mar. 29, 2017).

[406] Hearing Tr. (Underwood) 2609, 2615-21.

[407] Hearing Tr. (Underwood) 2711-12.

[408] Hearing Tr. (Underwood) 2712-13.

[409] Hearing Tr. (Underwood) 2619-20.

[410] Hearing Tr. (Underwood) 2651-57, 2665-67, 2669-71, 2673-78, 2685-89, 2691-94.

[411] Hearing Tr. (Underwood) 2682-83.

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(ii) The Firm's practice of placing all FFIs on its red flag list was counterproductive because it did nothing to narrow the focus to the kinds of anomalies that required a searching inquiry.[412]

(iii) The Firm's general practice of accepting the registered agent's address without requiring the physical address of the entities and persons purporting to own the shares was inconsistent with industry custom and practice.[413]

(iv) Even though the Firm gathered large volumes of paper in connection with the transactions, it failed to analyze the information, did not identify issues raised by the files, and did not conduct the type of searching inquiry necessary to resolve those issues.[414] As Underwood testified, a searching inquiry "means asking questions. It means not just assuming an answer that is possible to explain the transaction when there are other answers that might not properly explain or satisfy the question. It means asking and inquiring and doing it independently ...."[415]

(v) Underwood made plain that a broker-dealer cannot go forward with a Rule 144 transaction simply because it finds it too difficult to determine the identity of the beneficial owner. The broker-dealer must have reliable evidence of the identity of the purported beneficial owner. Otherwise it cannot proceed with the transaction.[416]

Underwood also explained that it would be typical in the industry to use other resources in addition to the internet to verify representations by the interested parties and make sure that those parties were not actually participating in an unregistered distribution of securities. With respect to whether the issuer is a shell, for example, it is not enough to obtain a representation from the issuer's principal as to its non-shell status. Underwood said that it would be common in the industry to obtain what is known as a "Bradstreet report." That report "can be quite enlightening in terms both of [the issuer's] operations, revenues, assets, who the key officers and directors are, shareholders—a great deal of information that is not necessarily available simply by going on the internet."[417]

Underwood concluded that a firm engaged in Rule 144 sales would also have more detailed written procedures that "would describe who did what, when, and how."[418] He said that

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[412] Hearing Tr. (Underwood) 2685-86, 2752-55.

[413] Hearing Tr. (Underwood) 2679-80.

[414] Hearing Tr. (Underwood) 2689.

[415] Hearing Tr. (Underwood) 2694.

[416] Hearing Tr. (Underwood) 2734.

[417] Hearing Tr. (Underwood) 2661.

[418] Hearing Tr. (Underwood) 2677-78.

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a firm would "anticipate questions that would be investigated with respect to issuers, with respect to sellers, with respect to the transfers of securities."[419] Furthermore, they would analyze the information collected and would "independently satisfy themselves to clear any red flags that arose. And that did not happen in any of these instances in my opinion."[420] He declared that the Firm did not meet the industry custom and practice for the conduct of this type of business.[421]

F. Law And Regulations Relating to Section 5

1. It Is Unlawful To Sell Securities Without Registration, Unless An Exemption Exists

It is unlawful for a firm to sell securities without an effective registration statement in place unless an exemption applies. Sections 5(a) and 5(c) of the Securities Act prohibit the "sale" and "offer for sale" of securities in interstate commerce unless a registration statement has been filed or is in effect, or an exemption from registration applies.[422] The prohibition applies to "any person,"[423] and the Securities Act defines "person" broadly to include both individuals and entities such as corporations and partnerships.[424] The prohibition also applies to any person who "directly or indirectly" sells or offers to sell securities.[425] Thus, Section 5 may be violated by a person who does not pass title to the securities but who is involved in the process of offering the securities for sale.[426]

The registration requirements are not merely technical—they are the "heart" of the Securities Act.[427] They serve to protect investors by promoting full disclosure of information thought necessary to informed investment decisions.[428] As the preamble to the Securities Act

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[419] Hearing Tr. (Underwood) 2678.

[420] Hearing Tr. (Underwood) 2678.

[421] Hearing Tr. (Underwood) 2689.

[422] 15 U.S.C. § 77e(a), § 77e(c). *See also Ronald S. Bloomfield*, Exchange Act Release No. 71632, 2014 SEC LEXIS 698, at *20-21 (Feb. 27, 2014). A violation of Securities Act Section 5 also is a violation of FINRA Rule 2010, which requires members and associated persons to conduct their business consistent with high standards of commercial honor and just and equitable principles of trade. *Midas Sec.*, Exchange Act Release No. 66200, 2012 SEC LEXIS 199, at *46 n.63 (Jan. 20, 2012); *Dep't of Enforcement v. Padilla*, No. 2006005786501, 2012 FINRA Discip. LEXIS 46, at *1 n.2 (NAC Aug. 1, 2012).

[423] 15 U.S.C. § 77e(a), § 77e(c).

[424] 15 U.S.C. § 77b(a)(2).

[425] 15 U.S.C. § 77e(a), § 77e(c).

[426] *Pinter v. Dahl*, 486 U.S. 622, 642-47 (1988).

[427] *ACAP Fin. Inc.*, Exchange Act Release No. 70046, 2013 SEC LEXIS 2156, at *28 (July 26, 2013) (quoting *Pinter v. Dahl*, 486 U.S. at 638), *aff'd*, 783 F.3d 763 (10th Cir. 2015).

[428] *SEC v. Elliott*, 2012 U.S. Dist. LEXIS 82992, at *1 (June 12, 2012); *Bloomfield*, 2014 SEC LEXIS 698, at *21; *ACAP*, 2013 SEC LEXIS 2156, at *28 (quoting *Pinter*, 486 U.S. at 638); *Dep't of Enforcement v. KCD Fin., Inc.*, No. 2011025851501, 2016 FINRA Discip. LEXIS 38, at *49 (NAC Aug. 3, 2016), *aff'd, KCD Fin. Inc.*, Exchange Act Release No. 80340, slip op. at 5-6 & nn.8-13 (SEC Mar. 29, 2017).

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states, the purpose of the Act is "[t]o provide full and fair disclosure of the character of securities ... and to prevent frauds."[429]

2. Sales Are Not Exempt If They Involve A Distribution By An "Underwriter"

A sale of securities is not exempt from registration if it involves a distribution of securities to the public. The Securities Act distinguishes between a distribution—which requires registration—and ordinary trading, which does not. In general, a distribution involves the sale of a substantial block of securities that is accompanied by sales solicitations, recommendations and other promotional activities that may induce investors to make investment decisions without the benefit of accurate information concerning the issuer, its management, and its plans and prospects. That is the reason registration is required. In contrast, ordinary trading by an individual investor who has little or no influence over the issuer is not accompanied by the same promotional pressures, and, consequently, the same protections are less necessary.[430]

The distinction between a distribution and ordinary trading is reflected in Section 4(a)(1) of the Securities Act, which exempts a securities transaction from registration if it does not involve "an issuer, underwriter, or dealer."[431] In this case, the term "underwriter" is critical. The term is not limited to financial industry professionals. It encompasses individual investors "if they act as links in a chain of transactions through which securities move from an issuer to the public."[432] Section 2(a)(11) of the Securities Act broadly defines the term to include "any person" who has purchased from an issuer "with a view to ... the distribution of any security."[433]

Because it is difficult to know whether a person acquired securities "with a view to" distributing them to the public, the surrounding circumstances and the investor's actions after acquiring the securities must be analyzed. For example, when a person acquires securities from the issuer in a non-public transaction and shortly thereafter resells, the circumstances suggest that the person acquired the securities with a view to distribution, which would make that person an underwriter. The transactions function like a two-step indirect distribution and may be a public offering in disguise.[434]

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[429] Securities Act of 1933, Pub. L. No. 22, § 1, 48 Stat. 74, ch. 38.

[430] *See* the Preliminary Note to Rule 144 ("If any person sells a non-exempt security to any other person, the sale must be registered unless an exemption can be found for the transaction.").

[431] *See generally* Hicks, *Resales of Restricted Securities* at § 2.4, 12-13, § 2:10, 22-23, § 2.11, 23-24 (2015 ed.). *See* the Preliminary Note to Rule 144 ("Section 4(1) of the Securities Act provides one such exemption for a transaction 'by a person other than an issuer, underwriter, or dealer.'").

[432] Preliminary Note to Rule 144.

[433] 15 U.S.C. § 77b(a)(11). *See also SEC v. McNamee*, 481 F.3d 451, 455 (7th Cir. 2007).

[434] *See generally* Hicks, *Resales of Restricted Securities* at § 4:101, 250 (2015 ed.). *See* the Preliminary Note to Rule 144.

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3. Broker-Dealer Has The Burden Of Showing A Reasonable Basis For An Exemption

Once a *prima facie* case is made out, as it was here,[435] a broker-dealer has the burden of showing that it had a reasonable basis at the time it sold the securities for concluding that an exemption from registration existed.[436] Exemptions from the registration requirements are affirmative defenses that must be established by the person claiming the exemption.[437] The Securities Act requires a broker-dealer and its associated persons to act as gatekeepers to prevent unlawful distributions, and the responsibility rests on them to take all steps reasonable in the circumstances to assure themselves that an exemption applies before they sell securities without registration.[438]

A broker-dealer's duty to investigate is not satisfied by simply checking boxes on a checklist. Rather, a firm must examine the information it receives with a skeptical eye because the interested parties have an incentive to mislead and deceive a firm in order to facilitate their sale of securities. A broker-dealer must independently investigate suspicious facts to satisfy itself that an exemption exists. As the SEC has explained,

> A dealer who offers to sell, or is asked to sell a substantial amount of securities must take whatever steps are necessary to be sure that this is a transaction not involving an issuer, person in a control relationship with an issuer[,] or an underwriter. For this purpose, it is not sufficient for him merely to accept "self-serving statements of his sellers and their counsel without reasonably exploring the possibility of contrary facts."[439]

Exemptions from registration requirements are construed narrowly.[440] Accordingly, evidence in support of an exemption must be "explicit, exact, and not built on mere conclusory statements."[441]

It is important to bear in mind that there are two distinct burdens in this case. While it was Enforcement's burden to prove the elements of its claims, it was the Firm's burden before

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[435] *See infra* p. 80.

[436] *Bloomfield*, 2014 SEC LEXIS 698, at *23; *ACAP*, 2013 SEC LEXIS 2156, at *29 (citations omitted); *Dep't of Enforcement v. Midas Sec., LLC*, No. 2005000075703, 2011 FINRA Discip. LEXIS 62, at *11 & n.8 (NAC Mar. 3, 2011), *aff'd*, 2012 SEC LEXIS 199, at *28 & n.36.

[437] *Midas Sec.*, 2011 FINRA Discip. LEXIS 62, at *28 & n.36, *38.

[438] *Padilla*, 2012 FINRA Discip. LEXIS 46, at *29.

[439] *Laser Arms Corp.*, 50 S.E.C. 489, 503 (Feb. 14, 1991) (quoting *Distribution by Broker-Dealers of Unregistered Securities*, Exchange Act Release No. 4445, 1962 SEC LEXIS 74 (Feb. 2, 1962)).

[440] *Midas Sec.*, 2011 FINRA Discip. LEXIS at *11-12 (quoting *SEC v. Blazon*, 609 F. 2d 960, 968 (9th Cir 1979).

[441] *Midas Sec.*, 2011 FINRA Discip. LEXIS at *12 (quoting *Robert G. Weeks*, Exchange Act Release No. 48684, 2003 SEC LEXIS 2572, at *42 n.34 (Oct. 23, 2003).

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selling the securities to establish a reasonable basis for the existence of an exemption from registration.

4. Respondents Claim Two Exemptions

With respect to the transactions at issue, Respondents claim that Rule 144 applied to the transactions, or, failing that, the so-called "broker's exemption" in Section 4(a)(4) of the Securities Act for ordinary unsolicited trading.[442]

a. Securities Act Rule 144

The SEC adopted Rule 144 both to provide a "safe harbor" for certain transactions and to protect against transactions by non-professionals as a means of circumventing the registration requirements. Among other things, Rule 144 restricts the resale of securities acquired directly or indirectly from the issuer or an affiliate in a transaction not involving a public offering. The SEC defines such securities as "restricted securities," and requires an owner of restricted securities to hold them for a length of time before reselling them in another transaction without registration. The holding period and other conditions for resale differ if the holder of the restricted securities is an affiliate or non-affiliate.[443] Thus, the identity of the person selling the securities and the nature of any relationship that person might have to the issuer become important to the exemption analysis.

Rule 144 defines an affiliate of an issuer as a person who directly or indirectly controls or is controlled by or is under common control with the issuer. Although Rule 144 does not define control, it is commonly understood that the definition in SEC Rule 405 of Regulation C applies. It defines control as "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person whether through the ownership of voting securities, by contract, or otherwise." Control depends on the totality of the circumstances and does not turn simply on whether a person is an officer of a company or the holder of a certain amount of stock.[444]

The identity of the issuer is important, too. The Rule 144 safe harbor is not available for shell companies. A shell company is defined as an issuer "with no or nominal operations and no or nominal non-cash assets."[445]

A person who satisfies the applicable conditions of Rule 144 is deemed not to be engaged in a distribution of the securities and therefore not to be an underwriter for purposes of the

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[442] Resp. PH Br. at 2-5.

[443] 17 C.F.R. § 230.144. *See generally* Hicks, *Resales of Restricted Securities* at § 2.4, 12-13, § 2:10, 22-23, § 2.11, 23-24 (2015 ed.).

[444] *SEC v. Zenergy Int'l, Inc.*, 141 F. Supp. 3d 846, 853-54 (N.D. Ill. 2015).

[445] *Id.* at 853.

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Securities Act.[446] The burden is on the person claiming an exemption under Rule 144 to prove that all the applicable conditions have been met.[447]

The provisions of Rule 144(d)(3) relating to tacking are important here because tacking was the only way that the sellers in the transactions at issue could satisfy the required holding period. There are two categories of tacking. One category applies where a person who acquires restricted securities cannot personally meet the applicable holding requirement, but he is able to tack the holding period of another person to his. The other category applies where a person seeks to tack the period of time he has held restricted securities to the time he held other securities of the same issuer.[448]

Both categories are relevant in this case. *First*, to establish the requisite holding period, the purported beneficial owners needed to tack their holding period to that of the prior holders. Their ability to tack depended on the prior holders not being affiliates of the issuer. *Second*, in connection with the transactions charged in the Complaint, the prior holders needed to tack their acquisition of the securities to the earlier inception of the debt obligation exchanged for the securities. In order to do that, the debt obligation had to be a security. Rule 144 permits tacking based on the exchange of a security for another security of the same issuer (as long as no additional consideration is involved).[449]

In this case, Respondents claim that they had sufficient evidence that the sellers of the securities at issue were not affiliates of the issuers, the issuers were not shell companies, and the sellers had met the applicable holding period for the securities. We conclude that they did not.

b. Broker's Exemption Under Section 4(4)

Respondents argue they were entitled to the so-called broker's exemption under Section 4(4) of the Securities Act even if the transactions at issue were not exempt under Rule 144.[450]

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[446] *See generally* Hicks, *Resales of Restricted Securities* at § 4:1, 86 (2015 ed.).

[447] *See* Rule 144(b).

[448] *See generally* Hicks, *Resales of Restricted Securities* at § 4:139, 318 (2015 ed.).

[449] *See generally* Hicks, *Resales of Restricted Securities* at § 4:139, 318-19 (2015 ed.). Rule 144(d)(3) contains the provisions governing tacking. Two provisions are relevant here. Rule 144(d)(3)(iv) provides that securities that are acquired as a result of a default on a bona fide pledge of the securities shall be deemed to have been acquired when they were acquired by the pledger. However, if the securities were pledged without recourse they shall be deemed to have been acquired by the pledgee at the time of the pledge. Rule 144(d)(3)(ii) permits a person to tack the period of time he has held certain restricted securities to the period of time he has held related securities of the same issuer. It provides for tacking where the securities to be sold were acquired from the issuer solely in exchange for other securities of the same issuer.

[450] Resp. PH Br. 4-5.

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Section 4(4) is intended to exempt ordinary trading transactions that a broker may be asked to execute.[451]

As discussed above, a person can be an underwriter within the meaning of the Securities Act if he acquires the securities from an issuer or affiliate of the issuer with a view to distribution. In order to ensure that the person offering restricted securities for resale is not acting as an underwriter, it is necessary for a broker to evaluate the circumstances in which that person acquired restricted securities and offers them for resale. A broker cannot be a mere order taker. It must make whatever inquiries are necessary under the circumstances to ensure that its customer is not an underwriter.[452]

This exemption is not available when the broker "knows or has reasonable ground[s] to believe" that his customer is an underwriter, since in that event the broker would also violate Section 5 by participating in a non-exempt transaction.[453] As FINRA has stated, "[T]his exemption is available only if a broker is not aware, after a reasonable inquiry, of circumstances indicating that the selling customer is participating in a distribution of securities."[454]

Contrary to Respondents' arguments, we conclude that Respondents were confronted by abundant evidence that they were likely participating in unlawful distributions of securities. They cannot claim that they were unaware of facts signifying that possibility or the need to conduct further inquiry.

5. Both Exemptions Required A "Searching Inquiry" To Ensure That No Underwriter Was Involved

Neither the Rule 144 exemption nor the broker's exemption is available if the person selling the securities is an underwriter within the meaning of the Securities Act. Accordingly, where there are red flags indicating the possibility that a person may be acting as an underwriter, both exemptions require that a broker make a "searching inquiry" to satisfy itself that an exemption applies. Only then can a broker ensure that it does not participate in an unlawful distribution of unregistered securities.[455]

The SEC observed over half a century ago, "[W]here the surrounding circumstances raise a question as to whether or not the ostensible sellers may be merely intermediaries for controlling persons or statutory underwriters, then searching inquiry is called for."[456]

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[451] *World Trade Fin. Corp.*, Exchange Act Release No. 66114, 2012 SEC LEXIS 56, at *26 (Jan. 6, 2012).

[452] *Bloomfield*, 2014 SEC LEXIS 698, at *24-25 & nn.35-36.

[453] *Bloomfield*, 2014 SEC LEXIS 698, at *24; *World Trade Financial Corp.*, 2012 SEC LEXIS 56, at *26 & n.31.

[454] CX-197 at 2 (emphasis supplied).

[455] CX-197.

[456] *Bloomfield*, 2014 SEC LEXIS 698, at *26-27.

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6. FINRA Guidance On Red Flags Signaling That Underwriter May Be Involved

In Regulatory Notice 09-05, FINRA published guidance on the specific kinds of facts that give rise to the duty of conducting a searching inquiry.[457] In that guidance, FINRA made plain that "[a]ll firms must have procedures reasonably designed to avoid becoming participants in the potential unregistered distribution of securities."[458] It further explained, "Before selling securities in reliance on an exemption, a firm must take reasonable steps to ensure that the transaction qualifies for the exemption ...."[459]

Regulatory Notice 09-05 identifies a non-exhaustive list of red flags that signal the "possibility of an illegal, unregistered distribution."[460] These red flags are by no means comprehensive. They are merely illustrative. The generally recognized red flags in the Notice include the following: [461]

1. A customer opens a new account and delivers physical certificates that represent a large block of thinly traded or low-priced securities.

2. A customer has a pattern of depositing physical share certificates, immediately selling the shares, and then wiring out the proceeds of the resale.

3. A customer deposits share certificates that are recently issued or represent a large percentage of the float for the security.

4. Share certificates reference a company or customer name that has been changed or that does not match the name on the account.

5. The lack of a restrictive legend on deposited shares seems inconsistent with the date the customer acquired them or the nature of the transaction in which they were acquired.

6. There is a sudden spike in investor demand for a thinly traded or low-priced security, coupled with a rising price.

7. The company was a shell company when it issued the shares.

8. A customer with little or no assets at the firm receives an electronic transfer or journal transactions of large amounts of low-priced unlisted securities.

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[457] CX-197.

[458] CX-197, at 2.

[459] CX-197, at 2.

[460] CX-197, at 1.

[461] CX-197, at 3-4.

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9. The issuer has been through several recent name changes, business combinations or recapitalizations, or the company's officers are also officers of numerous similar companies.

10. The issuer's SEC filings are not current, are incomplete, or are nonexistent.

G. Ethical Violations (First Cause Of Action—Scottsdale And Hurry)

The First Cause of Action charges that Scottsdale and Hurry violated FINRA Rule 2010 by acting in contravention of Section 5 of the Securities Act. It alleges that during the relevant period, Scottsdale sold millions of shares of securities without registration and without an exemption. It further alleges that Hurry was a necessary participant and substantial factor in the unlawful transactions through his close management and control of all the entities involved in the process of depositing, approving, and reselling the securities, and through his prospecting for CSCT customers. The Complaint alleges that Hurry took actions to evade regulatory scrutiny and enable the Firm to make the unlawful sales.

1. Rule 2010

FINRA Rule 2010 requires FINRA members and their associated persons to "observe high standards of commercial honor and just and equitable principles of trade" in the conduct of their business. The Rule requires members of the securities industry not merely to conform to legal and regulatory requirements, but to conduct themselves with integrity, fairness, and honesty.[462]

Scienter is not required for a Rule 2010 violation. Rather, the SEC has established a disjunctive test for a Rule 2010 violation that applies either (i) to intentional or conscious bad conduct or (ii) to a failure to meet ethical norms, regardless of intention. The SEC has held that Rule 2010 may be violated if the respondent has acted either in bad faith or unethically.[463] In the context of a Rule 2010 violation, the SEC has defined bad faith as a dishonest belief or purpose,

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[462] *Robert Marcus Lane*, Exchange Act Release No. 74269, 2015 SEC LEXIS 558, at *22 n.20 (Feb. 13, 2015) (discussing NASD predecessor to FINRA Rule 2010: "[T]his general ethical standard . . . is broader and provides more flexibility than prescriptive regulations and legal requirements. [FINRA Rule 2010] protects investors and the securities industry from dishonest practices that are unfair to investors or hinder the functioning of a free and open market, even though those practices may not be illegal or violate a specific rule or regulation.") (internal quotations omitted).

[463] *Blair Alexander West*, Exchange Act Release No. 74030, 2015 SEC LEXIS 102, at *20 (Jan. 9, 2015); *Thomas W. Heath, III*, Exchange Act Release No. 59223, 2009 SEC LEXIS 14, at *13-17 & nn.9-16 (Jan. 9, 2009), *aff'd*, 586 F.3d 122, 130 (2d Cir. 2009), *cert denied*, 2010 U.S. LEXIS 3029 (Apr. 5, 2010) (discussing NYSE predecessor of Rule 2010); *Dep't of Enforcement v. Shvarts*, No. CAF980029, 2000 NASD Discip. LEXIS 6, at *11-18 (NAC June 2, 2000).

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and unethical conduct as conduct inconsistent with the moral norms or standards of professional conduct.[464]

Because the securities industry is built on trust, any ethical failure damages the industry generally by casting doubt on the integrity of its participants. An ethical failure also casts doubt on the ability of the particular miscreant to conform to ethical norms in the future. Enforcement of FINRA Rule 2010 is therefore fundamental to FINRA's regulatory mission, which, as expressed in FINRA's Sanction Guidelines, "is the building of public confidence in the financial markets."[465]

2. Enforcement Established A *Prima Facie* Case Of A Section 5 Violation

The elements of a *prima facie* case for violation of Section 5 are the following: (i) respondents sold or offered to sell securities; (ii) through use of interstate facilities or the mails (the jurisdictional means); and (iii) when no registration statement was filed or in effect as to those securities. Scienter is not an element.[466] A Section 5 violation does not require a showing that the sale actually facilitated a fraud. A sale without registration and without an exemption is an unlawful distribution of securities regardless of whether it is proven to be connected to a fraud.

Enforcement established a *prima facie* case. It proved that from December 1, 2013, through June 30, 2014, Scottsdale sold shares of three issuers, NHPI, VPLM, and ORFG, using the jurisdictional means and without registration.[467]

Respondents do not dispute these facts. They argue only that the transactions were exempt from registration.[468]

3. The Firm Lacked A Reasonable Basis For An Exemption

Scottsdale failed to have a reasonable basis for an exemption at the time that it sold the securities in the transactions at issue.

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[464] *Edward S. Brokaw*, Exchange Act Release No. 70883, 2013 SEC LEXIS 3583, at *33 (Nov. 15, 2013). *See also Simpson v. Bear, Stearns & Co.*, No. C07950030, 1997 NASD Discip. LEXIS 13, at *27 n.9 (NAC Jan. 29, 1997) ("Term 'bad faith' is not simply bad judgment or negligence, but rather it implies the conscious doing of a wrong because of dishonest purpose or moral obliquity....").

[465] FINRA Sanction Guidelines at 1 (2016) (Overview), https://www.finra.org/industry/sanction-guidelines.

[466] *Bloomfield*, 2014 SEC LEXIS 698, at *22 & n.29. *See also SEC v. Cavanagh*, 445 F.3d 105, 111 n.13 (2d Cir. 2006); *SEC v. Calvo*, 378 F.3d 1211, 1214-15 (11th Cir. 2004).

[467] RX-1; RX-2; RX-3; JX-268; JX-281; JX-310.

[468] Resp. PH Br. 2-5.

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First, in its due diligence the Firm did not even address the question whether the debt obligation was a security, despite having lawyers on its Rule 144 review team and despite Respondent Cruz being a lawyer with significant experience in the securities laws. It had no foundation for the tacking necessary to achieve the required holding period because the promissory notes and lines of credit on which the tacking was based were not securities.

Second, the documentation to support the Rule 144 exemption was rife with discrepancies and suspicious circumstances—all of which raised red flags strongly suggesting that the chain of transactions leading to deposits at Scottsdale were sham transactions using false documents and nominees to conceal the identity of the beneficial owners.

Although the Firm compiled thick due diligence packages for the transactions, it did so with a "check-the-box" attitude. It did not appropriately evaluate the information in the due diligence packages, did not investigate the many red flags, and did not independently verify the information received from the interested parties. The due diligence packages created only the false appearance of due diligence.

The Firm's conduct was unethical and did not meet the industry norms. The persons involved in the Rule 144 review did not obtain any meaningful information about the individuals and entities involved in the transactions. Diekmann confessed that he knew nothing about the purported beneficial owner of one of the deposits other than that the person was a client of CSCT's client. Scottsdale knew little more about any of them. It failed to perform its gatekeeping function. The testimony of Enforcement's expert only confirms our conclusion that the Firm failed to conduct itself in a manner consistent with industry norms.

a. The Prior Holders' Debt Obligations Were Not Securities Available For Tacking

i. *Reves* Governs Whether Note Is A Security

Not every note or debt obligation is a security.[469] The Supreme Court's decision in *Reves* governs the analysis.[470] Any note with a term of more than nine months is presumed to be a security unless it resembles one of the judicially enumerated instruments that are not securities, such as a note delivered in connection with consumer finance or a mortgage. In *Reves*, the Court set the analytic framework for determining whether a note bears a resemblance to one of the enumerated instruments or should be held to be a security. Four factors may be considered in deciding whether a note is a security:

(i) whether the seller's purpose is to raise money for general use of business or to finance substantial investments, and the buyer is motivated by the profit to be

[469] *Reves v. Ernst & Young*, 494 U.S. 56, 65-67 (1990).

[470] *Id.*

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generated, in contrast to a note to facilitate a minor purchase or sale or to correct for cash-flow difficulties;

(ii) whether the note involves an individual transaction or common trading for speculation or investment;

(iii) whether there is a reasonable public expectation that the note would be viewed as security; and

(iv) whether another regulatory scheme applies that would reduce risk of the instrument.[471]

In another case, the Court later summed up the distinguishing characteristic of a security as "any instrument that might be sold as an investment."[472]

As we explain below, we conclude that none of the debt obligations held by the prior holders were securities. That includes the NHPI note in payment for consulting services, the oral line of credit to VPLM, and the outstanding balance on the ORFG line of credit. As a result, when the prior holder accepted stock in satisfaction of the debt, it was not an exchange of securities that would support tacking.

ii. NHPI

It is plain that the note written by NHPI to Collins, the prior holder in the chain of holders, was not a security. We observe at the outset that the note's term was much shorter than the nine months required to presume a note to be a security—roughly two months. But it also fails the test set forth in *Reves*. NHPI did not enter into the note agreement in order to finance its general business or to make a substantial investment. Nor was Collins motivated by some profit to be generated from the note. According to documents in the due diligence package, the note was no more than a promise to pay Collins $10,000 for consulting services. Furthermore, the note was issued in a single transaction. A note that "merely reflects a single transaction" and is "not offered to the public" is not a security.[473] Nor could there be any public expectation that an individual note promising to pay for services was a security. The fourth factor, whether another regulatory scheme applied and diminished the need for treating the instrument as a security, is inapplicable where no other factor supports labeling the note a security.

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[471] *Id.* at 65-67. *See also Bass v. Janney Montgomery Scott, Inc.*, 210 F.3d 577, 583-86 (6th Cir. 2000).

[472] *SEC v. Edwards*, 540 U.S. 389, 393 (2004). *See also Frankfurt v. Mega Entertainment Group II*, 2016 U.S. Dist. LEXIS 73613, at *11 (N.D. Ill. June 7, 2016) (stating that "only those notes that were issued in an investment context" are securities).

[473] *New Earthshell Corp. v. Jobookit Holdings Ltd*, 2015 U.S. Dist. LEXIS 27141, at *10-11 (S.D.N.Y. Mar. 5, 2015)

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As another similar note was aptly described by a federal district court, the note held by Collins was "akin to an 'IOU' for services rendered."[474]

iii. VPLM

With respect to the issue of whether the oral line of credit extended by Locksmith to VPLM was a security, the focus at the hearing was on whether there is any distinction between an oral agreement and a written agreement. Diekmann maintained that there is no difference between an oral line of credit and a written line of credit for purposes of Rule 144 and tacking. He understood that in either case the successor holder could tack back to an advance on the line of credit. He based his understanding on his experience with the treatment of written lines of credit and discussions with legal counsel—who exactly he could not recall.[475]

In their post-hearing brief,[476] Respondents relied on a Seventh Circuit Court of Appeals decision, *Canadian Imperial Bank*.[477] Their reliance is misplaced. The issue in *Canadian Imperial Bank* was whether a private plaintiff had sufficiently pleaded the existence of a security for purposes of establishing subject matter jurisdiction. The plaintiff alleged that a certificate of deposit from a Bahama bank was a security, but no document was attached that could be analyzed for purposes of jurisdiction. The Court held that the complaint did not allege sufficient facts to establish jurisdiction, but it hastened to say that its decision did not mean that only written instruments can be securities, noting that oral promises of participation in a profit sharing plan have been held to be investment contracts even where not evidenced in writing.[478] The Court's remarks regarding oral promises as investment contracts provide no basis for concluding that the oral credit line here was a security.

The oral line of credit, unlike an oral promise of participation in a profit sharing plan, was not represented to be an investment. Nor was it easily tradeable as an investment. There was no means of being certain of the terms, confident of the effective transfer of rights, or sure that those rights might later be enforced. Accordingly, the oral line of credit was not a security.

Moreover, even if written, the line of credit did not meet the *Reves* test. The line of credit was a loan to the issuer by a single individual. Such an individual transaction would not be viewed as a security by the public and would not ordinarily be traded as an investment.

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[474] *SEC v. Garber*, 959 F. Supp. 2d 374, 377 (S.D.N.Y. 2013).

[475] Hearing Tr. (Diekmann) 1711-17.

[476] Resp. PH Br. 22 n.114.

[477] *Canadian Imperial Bank of Commerce Trust Co. v. Fingland*, 615 F. 2d 465 (7th Cir. 1980).

[478] *Id.* at 466-67 & n.5.

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iv. ORFG

The open-ended line of credit extended by Forward to ORFG for $600,000 was not a security. As discussed above in connection with the other debt conversion transactions, it did not meet the *Reves* test. It was an individual transaction that was not designed to trade as an investment. Nor would the public view it as a security.[479]

b. The Firm Ignored Red Flags

Even if the notes had been securities, the transactions were not entitled to the safe harbor of Rule 144. Many of the red flags set forth in Regulatory Notice 09-05[480] existed in the transactions at issue. The following red flags are examples:

- All the stock deposits in the transactions at issue consisted of large blocks of thinly traded, low-priced stocks issued by obscure companies. (Reg. Notice 09-05 Red Flag 1).

- CSCT had a pattern of making large deposits of thinly traded microcap stocks, selling the securities, and immediately wiring out the proceeds. Respondents knew that CSCT was acting on behalf of its FFI customers involved in the transactions and that the FFIs also engaged in the same pattern while acting on behalf of other entities and individuals. Despite the pattern, Scottsdale did nothing to investigate who actually was receiving the funds from the securities sales. Because the only account at Scottsdale was in the name of CSCT, Scottsdale could not and did not track where the proceeds ultimately went. It could not tell if the proceeds went to the different purported beneficial owners or to other persons who were repeatedly engaging in the deposit and immediate resale of securities. (Reg. Notice 09-05 Red Flag 2).

- The deposited shares were recently issued, which suggested that the issuer or its control persons could be initiating a distribution. Nothing in the due diligence packages indicates that Scottsdale took any note of that fact. (Reg. Notice 09-05 Red Flag 3).

- Although the issuer claimed not to be a shell corporation, there was little evidence of ongoing business operations. The Firm mainly relied on a representation by a principal of the issuer that the entity was not a shell. (Reg. Notice 09-05 Red Flag 7).

- Two of the issuers involved in this case had business histories that suggested shell status. Only a few months before the deposit of NHPI securities at Scottsdale, NHPI, a pharmaceutical company, announced it was going into the oil and gas business. ORFG,

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[479] Furthermore, even if the note had been a security, Forward did not transfer the ORFG note for securities of ORFG. He transferred a portion of the note for securities of a different entity, Anything Media. He also did so in connection with an agreement by ORFG to modify the terms of the original line of credit. His exchange involved securities of a different issuer and different consideration. Accordingly, Media Central was not entitled to tack back to Forward's original note.

[480] *See supra* pp. 78-79

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which described itself as an automotive detailing company that used casual part-time labor as required, similarly indicated it was considering going into mineral exploration and set forth an anticipated payment schedule for three unspecified mining concessions. In both cases, the new business venture was radically different from the old line of business, the information regarding either line of business was scant, and the company's purported resources did not appear sufficient to engage in the new line of business. (Reg. Notice 09-05 Red Flags 7 and 9).

Finally, we note that it is critical in a Rule 144 transaction to know the identity of the purported beneficial owners and any relationship they might have to the issuers or affiliates of the issuers of the shares they seek to sell. Even after collecting voluminous documents, the Firm in fact knew nothing about the purported beneficial owners or about the businesses through which they held the securities except their names. Diekmann, who headed the Rule 144 team at the time of the transactions at issue, admitted that he knew nothing about the purported beneficial owner of one of the NHPI deposits other than that the person was a customer of Unicorn.[481] The Firm knew little more than that about any of the other purported beneficial owners involved in the transactions at issue. Diekmann's testimony is a stark confession that the Firm did not perform its gatekeeping function and did not adhere to high standards of commercial honor and just and equitable principles of trade.

c. Respondents' Arguments Are Unavailing

i. NHPI

Respondents' arguments relating to the NHPI deposits rest on treating the representations by the interested parties in the documentation for the NHPI deposits as though they were true. For example, Scottsdale asserts that Collins was not an affiliate of NHPI, and therefore he could freely sell the stock derived from his note in the fall of 2013 regardless of any tacking to the inception of the May 2012 note.[482] Respondents then reason that Collins' transactions with Sky Walker, Ireland Offshore, and Swiss National could not be fake loan transactions, as Enforcement portrays them, because, as a non-affiliate holder for more than a year, Collins could simply have sold the shares to the three depositors. Respondents conclude that there could be no reason to fake the loan transactions. Respondents likewise assert that the beneficial owners of Sky Walker, Ireland Offshore, and Swiss National were not affiliates of NHPI based on the representations to that effect by the interested parties.[483]

In making arguments that depend upon the truth of the representations made by the interested parties, Respondents only demonstrate their continuing lack of appropriate response to

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[481] Hearing Tr. (Diekmann) 911-13, 919.

[482] In so arguing, the Firm abandons the basis on which the deposit was justified at the time Scottsdale sold the shares. On its Checklist for the transaction, the Firm relied on tacking back to the inception of the May 2012 note. RX-1, at 1.

[483] Resp. PH Br. 13-15.

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the suspicious circumstances and glaring red flags raised by the NHPI deposits. As the SEC has noted, a broker-dealer may not rely on representations by interested parties because those interested parties have an incentive to make misrepresentations.[484]

ii. VPLM

Again, Scottsdale's arguments largely assume the truth of the representations by the interested parties. They assert that they reasonably relied on those representations.[485] We reject Respondents' position. Red flags signaled that the transaction could be a scheme to evade the registration requirements while distributing securities to the public. The Firm could not sell the securities unless it investigated further and obtained better support for an exemption.

Scottsdale also argues that Enforcement failed to prove that any proceeds of the sales of VPLM flowed back to the issuer or that there were any links between the issuer and the persons involved in selling VPLM stock through CSCT and Scottsdale.[486] As discussed above, the Firm misunderstands the law. It was not Enforcement's burden to prove who was behind the transactions; rather, it was Respondents' burden to probe the suspicious circumstances and establish that the transaction was entitled to the Rule 144 exemption before the Firm sold the securities.

iii. ORFG

As with the other transactions, Respondents' arguments assume the truth of the representations in the transaction documents. For instance, they argue that the Firm obtained satisfactory evidence that the transaction met the requirements of Rule 144 because the Firm obtained a letter from ORFG's Chairman and CEO dated May 19, 2014, confirming that Media Central and its purported owner were not affiliates of the company.

Given that the underlying transaction—the $600,000 open-ended credit line giving the holder discretion to convert stock at will—made no sense, it was unreasonable to rely on that letter as the only evidence that the seller was not an affiliate. If the chain of transactions were really a series of steps in a distribution for the ultimate benefit of the issuer or those persons controlling the issuer, then such a representation by the issuer's Chairman and CEO would be in service of the unlawful distribution of securities without registration.

4. Hurry's Violation

The First Cause of Action also charges that Hurry was a necessary participant and substantial factor in the unlawful transactions, through his close management and control of all the entities involved in the process of depositing, approving, and reselling the securities, and

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[484] *Laser Arms*, 1991 SEC LEXIS 257, at *36.

[485] Resp. PH Br. 21.

[486] Resp. PH Br. 22.

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through his prospecting for CSCT customers. It expressly alleges that Hurry purposely established CSCT as a means of evading regulatory scrutiny and enabling the Firm to make the unlawful sales. Enforcement proved the charges.

a. Hurry Was A Necessary Participant And Substantial Factor

Section 5 makes it unlawful for a person to offer or sell securities without registration. Liability, however, is not limited to the person or entity that ultimately passes title to the security. Courts have developed the "necessary participant/substantial factor" test as a way of holding other persons involved with the transactions accountable under Section 5 as offerors or sellers.[487] The "necessary participant/substantial factor" test is based on statutory language in Section 5, which imposes liability on persons who "directly or indirectly" offer or sell securities in violation of Section 5.[488]

The "necessary participant/substantial factor" test distinguishes between those persons who have only a *de minimis* or insubstantial role in securities sales in violation of Section 5 and those who should be liable. The test is more than a "but for" test. Even if a person is necessary to the completion of the transaction, such as a transfer agent might be, that does not necessarily mean the person was a substantial factor in the violation. Determining whether someone was a substantial factor in the unlawful sales is a fact issue requiring extensive analysis.[489]

It is not clear that the "necessary participant/substantial factor" test is appropriate here. Hurry is not charged with offering or selling securities in violation of Section 5. He is charged with an ethical violation under Rule 2010. He does not have to be proven to be an offeror or seller in order to be proven to have violated Rule 2010.

The parties briefed Hurry's liability using the "necessary participant/substantial factor" test, however, and we use it to assist in determining whether Hurry was sufficiently linked to the transactions at issue to hold him liable for violating Rule 2010 in connection with them. We also separately apply the more familiar standard for Rule 2010 violations, which we discuss below.

Based on the above factual record and analysis, which we do not repeat in detail here, we conclude that Hurry was a necessary participant and a substantial factor in the transactions. He was sufficiently linked to the transactions to hold him accountable for his conduct in connection with them. His role was not *de minimis* or insubstantial.

We reject Hurry's argument that he cannot be linked to the transactions at issue. He asserts that there is "not a single document relating to the stocks in question with [his] name

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[487] *SEC v. CMKM Diamonds, Inc.*, 729 F.3d 1248, 1255 (9th Cir. 2013).

[488] *SEC v. Boock*, 2011 U.S. Dist. LEXIS 95363, at *47 & n.17 (S.D.N.Y. Aug. 25, 2011).

[489] *CMKM Diamonds*, 729 F.3d at 1255-57; *SEC v. Blackburn*, 2015 U.S. Dist. LEXIS 178325, *8-9 (E.D. La. Sept. 11, 2015).

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anywhere on it."[490] While there was little in the way of a paper trail directly linking Hurry to the particular transactions at issue, the absence of such a direct link was the result of Hurry's own demonstrated obsession with secrecy. He purposely concealed his involvement in CSCT's business. It is not surprising that there is not a single document relating to the deposits at issue with his name on it, because he made sure of it.

In fact, Hurry was the master puppeteer for all the FFI business that flowed through CSCT to Scottsdale and, ultimately, to public investors. CSCT existed only because he established and closely managed it. Given Ruzicka's lack of experience, qualifications, and contacts, CSCT could not have survived without Hurry's active involvement. We reject Hurry's assertion that, because Ruzicka had decades of experience as a real estate lawyer who ran his own law firm, hiring Ruzicka to run CSCT was a reasonable and logical decision.[491]

With respect to the particular transactions at issue, there is sufficient evidence of a link between Hurry and the FFIs that made the deposits. Hurry developed CSCT's business with the three FFIs that engaged in those transactions, Montage, Titan, and Unicorn. As set forth more fully above, Hurry admits that he flew to Panama to see Montage and to Belize to see Unicorn and that he discussed with Unicorn doing its business through CSCT. He admits to talking to the principals of Montage, Titan, and Unicorn multiple times using FaceTime. He admits to creating the spreadsheet that tracked CSCT deposits, including those by Montage, Titan, and Unicorn. D'Mura testified that he and Ruzicka talked about deposits with Hurry, and an email shows that Hurry specifically discussed trading in NHPI and VPLM with Ruzicka. Ruzicka testified that Hurry told him to deal with a specific contact at Montage. Both Ruzicka and D'Mura said they disliked dealing with Cem Can at Unicorn, but that they knew that they had no authority to decline his business without Hurry's consent.

Hurry's direct contact with the three FFIs involved in the transactions at issue made him a substantial factor in their transactions. He did not take Ruzicka with him when he flew to Panama and Belize to talk to Montage and Unicorn, and Ruzicka testified in his OTR that he did not participate in Hurry's FaceTime calls with customers. Hurry was the critical link between CSCT and the three FFIs. Hurry's importance was reflected in Unicorn's demand for Hurry to join a telephone call with Miller, Diekmann, and Ruzicka to discuss the processes and procedures to be used in connection with Unicorn's business with Scottsdale through CSCT. Whenever something beyond paper-pushing was involved, Hurry's input was necessary. We reject Hurry's argument that he merely displayed the normal interest of an owner in the overall financial performance of his firm.[492] His involvement in CSCT's business was intense and pervasive.

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[490] Resp. PH Br. 45.

[491] Resp. PH Br. 43-44.

[492] Resp. PH Br. 46-47.

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Hurry further argues that the case law only imposes liability under Section 5 where the defendant has either sold the unregistered securities himself or has taken concrete steps necessary to effectuate those sales, such as negotiating transactions, issuing opinion letters, or directing the issuance of shares. He contends that he engaged in no such activities here.[493]

We reject the argument. As noted above, Hurry is not charged with a Section 5 violation, but, rather, a Rule 2010 violation. Unethical conduct in violation of Rule 2010 is not constrained by case law defining who is liable as a statutory seller under Section 5. In any event, substantial participation is a broad concept without precise bounds. One who conceives of and plans a scheme, or one who is a substantial motivating factor behind it, can be liable under Section 5.[494] To hold otherwise would allow a person to mastermind a Section 5 violation, and, by directing others to perform the mechanical tasks necessary to effect the sale of securities without registration, escape liability.

b. Hurry Acted In Bad Faith

FINRA Rule 2010 is a broad ethical principle that may be violated either by conduct that fails to meet ethical norms, regardless of intention, or conduct that is undertaken in bad faith. We find here that, in connection with the business he routed through CSCT, Hurry acted in bad faith and violated FINRA Rule 2010. We conclude that he was engaged in a scheme to evade the securities laws, in particular the registration requirements of Section 5.

Hurry claimed that he established CSCT because Alpine wanted to shed its IRS tax withholding obligations, but there was no evidence that it made business sense to set up an office in the Cayman Islands to do that. In fact, the insertion of CSCT into the process of preparing stock certificates for resale to the public made no business sense because, due to the discounts Scottsdale extended to CSCT, Hurry's enterprises as a collective group made no more money than when Scottsdale was handling the business directly—but CSCT imposed additional costs.

That Hurry had no legitimate business reason for setting up CSCT is further apparent from the way the Firm handled the business purportedly routed through CSCT. The Firm, through Miller and Noiman, continued to deal directly with the FFIs and often handled issues that arose with the deposits without involving Ruzicka or CSCT. Rather than independently preparing deposits for submission to Scottsdale, Ruzicka also sought guidance from Diekmann as to what deposits he should consider.

Further casting doubt on the legitimacy of Hurry's reasons for setting up CSCT, Diekmann testified that an individual in Belize or Panama could have a direct account with

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[493] Resp. PH Br. 46 and n.261.

[494] *SEC v. Elliott*, 2011 U.S. Dist. LEXIS 91946, at *20 (S.D.N.Y. Aug. 17, 2011). *See also SEC v. Holschuh*, 694 F. 2d 130, 139-40 (7th Cir. 1982); *SEC v. Friendly Power Co.*, 49 F. Supp. 2d 1363, 1372 (S.D. Fla. 1999) (a person has indirectly sold a security to the public if he has "employed or directed others to sell ... or has conceived of and planned the scheme by which the unregistered securities were offered or sold").

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Scottsdale without going through an FFI like Unicorn or CSCT.[495] Cruz admitted that it would be easier to conduct due diligence on a direct customer of the Firm than a customer who came through an FFI such as CSCT or Unicorn.[496] In fact, the creation of CSCT diminished Scottsdale's access to information about the purported beneficial owners, and neither Scottsdale nor Alpine, Hurry's clearing firm, knew where the proceeds from sales of the securities were flowing.[497] This testimony raises the question of the purpose served by the multiple layers of entities—if not to conceal the identity of the true beneficial owners of the securities.

Hurry's bad faith was amply proven by his elaborate stratagems for concealing his involvement in CSCT's business, including his use of the "x" email address at CSCT, his insistence on using the attorney-client privilege in inappropriate circumstances, and his use of FaceTime to conceal his contacts with customers. He specifically wrote to Ruzicka in an email that there should be no written record of Hurry's involvement, which is powerful evidence of Hurry's scheme to avoid regulatory scrutiny. Ruzicka testified in his OTR that Hurry told him he was going to the Cayman Islands so that he would not have to "give anything to anyone."

Hurry's actions betray an attitude antithetical to the public interest, and his attempt to evade regulatory scrutiny is inconsistent with his duties as a securities professional. He failed to adhere to high standards of commercial honor and just and equitable principles of trade, thereby violating FINRA Rule 2010.

H. Supervisory Violations (Second And Third Causes Of Action—DiBlasi And Cruz)

1. NASD Rule 3010 Imposes Supervisory Duties

NASD Rule 3010(a) mandates that each member firm "shall establish and maintain a system to supervise" the activities of its associated persons. It further mandates that a firm's supervisory system be "reasonably designed to achieve compliance with the applicable securities laws and regulations, and with applicable NASD Rules."

Rule 3010(a)(1) provides that a firm's supervisory system "shall provide, at a minimum," for the "establishment and maintenance of written procedures." Rule 3010(b) details requirements for WSPs. Rule 3010(b)(1) requires that a member firm "shall establish, maintain, and enforce written procedures to supervise the types of business in which it engages." Those WSPs must be "reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable Rules of NASD."

Rule 3010(b)(3) further requires that the WSPs set forth the titles, registration status, locations and responsibilities of each of its supervisory personnel, and that assignments be made

[495] Hearing Tr. (Diekmann) 1675.

[496] Hearing Tr. (Cruz) 220.

[497] Hearing Tr. (Cruz) 661-62; Hearing Tr. (Frankel) 2349-50.

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covering all relevant areas of the firm's business and the applicable securities laws and FINRA Rules. Firms are required to preserve a record of these designations and their effective dates for at least three years. Under Rule 3010(b)(4), a firm is required to amend its WSPs as changes occur in its supervisory system.

Broadly speaking, WSPs are a written set of policies and procedures that describe concrete steps to supervise a firm's activities. They identify who is responsible for taking those steps and set up a system of documentation to allow for review and ensure proper implementation. Every broker-dealer firm must create, maintain, update, and adhere to those policies and procedures.[498] Those policies and procedures contribute to the establishment and maintenance of a supervisory system that is reasonably designed to achieve compliance with the laws, regulations, and rules applicable to the firm's business. To achieve accountability and ensure compliance, the WSPs must be clear and accurate regarding the allocation of supervisory responsibilities.

2. DiBlasi's Violation

a. Charge

The Second Cause of Action charges that Scottsdale and DiBlasi, the Firm's CCO, violated NASD Rules 3010(a) and (b) and FINRA Rule 2010. The Complaint alleges that DiBlasi failed to establish a supervisory system, including WSPs, reasonably designed to ensure compliance with Section 5. This failure occurred even though DiBlasi knew that the Firm had been sanctioned once before in settling prior charges of selling unregistered nonexempt securities. Among other things, the Complaint charges that the Firm's WSPs were deficient because they did not set forth clear responsibilities for its personnel and did not provide for a reasonable inquiry into beneficial ownership. The Complaint alleges that the WSPs did not require that the Firm's personnel take steps to independently verify the self-serving representations made by parties interested in the transactions and did not address the possible use of nominees to obscure the identity of the true beneficial owners of unregistered securities deposited at the Firm for resale. Enforcement proved the charge.

b. DiBlasi Had Responsibility For The Firm's WSPs

Throughout the relevant period, DiBlasi was the Firm's CCO; and he is still the Firm's CCO. DiBlasi contends, however, that he has never had responsibility for the Firm's Rule 144 business. He asserts that he does only what he calls "broker-dealer compliance," and not Rule 144 compliance.[499] According to DiBlasi, the Firm's former president, Cruz, had responsibility

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[498] *Dep't of Enforcement v. Ranni*, No. 20080117243, 2012 FINRA Discip. LEXIS 6, at *15-16 (OHO Mar. 9, 2012).

[499] Hearing Tr. (DiBlasi) 1921-22, 1927, 1952-53, 1976-77. DiBlasi described what he meant by broker-dealer compliance. He makes sure that the Firm's filings, such as the Form BD and the Forms U4 and U5, are done. He maintains records and makes sure correspondence and emails are reviewed. He summed up his work as taking care of all the "back office" tasks. Hearing Tr. (DiBlasi) 1976-77.

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for Rule 144 procedures and everyone deferred to him.[500] DiBlasi agreed that Cruz had a longstanding practice regarding responsibilities for Rule 144 compliance.[501]

We reject DiBlasi's assertion that he had no responsibility for the Firm's procedures in connection with the Firm's Rule 144 business for two reasons. First, in the circumstances of this case, the assertion is inconsistent with his designation as the Firm's Chief Compliance Officer; and, second, the assertion is inconsistent with the WSPs themselves, as is plain from reading them.

First, DiBlasi is the sole person disclosed on the Firm's Form BD as CCO. There is no co-CCO.[502] That means that DiBlasi has been identified to the Firm's regulator as the one person responsible for establishing and maintaining the Firm's WSPs.

The Firm's WSPs were required to cover its Rule 144 business, since the Firm's business is almost entirely the liquidation of unregistered microcap stocks. DiBlasi acknowledged in his testimony that during the relevant period 95% of the transactions Scottsdale did for its customers involved penny stocks, and penny stocks accounted for most of the Firm's revenue.[503] That business required heightened attention to compliance issues, as DiBlasi knew. The Firm had previously settled regulatory charges that it had improperly sold unregistered securities without an applicable exemption.[504]

In these circumstances, the designation CCO carried with it responsibility for the WSPs relating to the Firm's Rule 144 business. DiBlasi's abdication of responsibility as to that business is fundamentally incompatible with what it means to be the Firm's CCO.

We reject DiBlasi's assertion that Enforcement is trying to hold him liable by virtue of his title alone.[505] Rule 3010 requires the designation and disclosure of a person responsible for establishing and maintaining a firm's procedures. By definition under the Rule, the person disclosed as the CCO has responsibility for the Firm's WSPs. The Rule further sets a standard for the design of those procedures, which must be reasonably designed to achieve compliance with the laws and regulations applicable to the firm's business. The designation and disclosure of a firm's CCO is more than a meaningless title. It is one of the building blocks of a supervisory system reasonably designed to achieve compliance, and the CCO designation carries with it

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[500] Hearing Tr. (DiBlasi) 1944-47, 1952-53, 1965-66.

[501] Hearing Tr. (DiBlasi) 1970. According to DiBlasi, his predecessor as CCO had no responsibility for Rule 144 compliance either. *Id.*

[502] Hearing Tr. (DiBlasi) 1981.

[503] Hearing Tr. (DiBlasi) 1923, 1946.

[504] Hearing Tr. (DiBlasi) 1923-24; CX-12.

[505] Resp. PH Br. 38 n.220.

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responsibilities. If DiBlasi is not carrying out those responsibilities, then the disclosure on the Firm's Form BD is false and misleading.[506]

Second, throughout the relevant period the Firm's WSPs expressly provided that the CCO—DiBlasi—had the duty to establish, maintain, and enforce all of the Firm's WSPs. There were two sets of WSPs during the relevant period, the May 2013 WSPs that were in effect in October 2013 when DiBlasi became CCO, and the modified WSPs that became effective in May 2014. The main body of both sets of WSPs expressly assigned to the CCO responsibility to "[e]stablish, maintain and update, as required the firm rules and procedures" and specified that that responsibility included Appendix A and Appendix B to the WSPs.[507] Appendix A to both sets of WSPs listed principals and branches.[508] Appendix B to both sets of WSPs expressly assigned to DiBlasi, by name, the responsibility to "[e]stablish, maintain and update, as required, the firm rules and procedures."[509] Appendix B assigned to Cruz, Diekmann, and others various operational tasks in conducting Rule 144 due diligence, but it did not assign them responsibility for the WSPs.[510]

DiBlasi conceded that there was no written delegation in the 2013 WSPs that gave responsibility for Rule 144 policies and procedures to anyone other than the CCO.[511] Moreover, the 2013 WSPs expressly imposed certain specific responsibilities on the CCO in connection with sales of unregistered securities. The main body of the WSPs included a specific section dealing with Rule 144 stock that was headed "Rule 144 Restricted and Control Stock Sales."[512] In that section, the 2013 WSPs stated that the CCO was responsible for establishing procedures reasonably designed to ensure that a stock certificate was validly issued and owned by the customer.[513] Importantly, the 2013 WSPs also provided that the CCO should establish

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[506] The cases cited by Respondents are not relevant here. The cases did not involve the issue of whether a CCO was responsible for a firm's WSPs. *Dep't of Enforcement v. Mutual Serv. Corp.*, No. EAF0400630001, 2008 FINRA Discip. LEXIS 62, at *90-93 (OHO Dec. 16, 2008) (compliance department subordinates who were told to abandon red flag blotter review did not have supervisory responsibility for that review); *Dep't of Enforcement v. Kemweis*, No. C02980024, 2000 NASD Discip. LEXIS 49, at *67-70 (OHO Feb. 16, 2000) (Director of Compliance held not to have line responsibility for unsuitable trading by registered representatives).

[507] CX-179, at 6 ("The Chief Compliance Officer ('CCO') is responsible for the establishment and maintenance [of Scottsdale's] policies and procedures."), CX-180, at 6 (same).

[508] CX-179, at 158; CX-180, at 151.

[509] Hearing Tr. (DiBlasi) 1930; CX-181, at 2 (DiBlasi assigned to "[e]stablish, maintain and update, as required the firm rules and procedures, includes Appendices A and B"); CX-182, at 2 (same). It appears that Appendix B to the May 2013 WSPs were modified on November 13, 2013, to identify DiBlasi by name as responsible for the WSPs. CX-181, footer bearing date of "11/13/2013."

[510] CX-181, at 8-9; CX-182, at 8-9. For example, Appendix B assigned to Diekmann responsibility for Rule 144 stock deposit due diligence and approval. CX-181, at 9; CX-182, at 9.

[511] Hearing Tr. (DiBlasi) 1933, 1945, 1955-56.

[512] CX-179, at 63-65 (Rule 144 Restricted and Control Stock Sales, 8.18 through 8.18.11).

[513] CX-179, at 64 (8.18.2).

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procedures to ensure that the resale of such a security was made in reasonable reliance on an exemption from registration.[514] The 2013 WSPs further provided that the CCO should be notified and consulted regarding the processing of Rule 144 sales.[515] They also specified that the CCO was responsible for "developing and implementing policies and procedures that provide for the review, approval and resale of Rule 144 transactions."[516]

Nevertheless, DiBlasi argues that he was not responsible for the 2013 WSPs because he inherited them.[517] The fact that the 2013 WSPs already existed when DiBlasi became CCO, however, does not absolve him of responsibility to examine them, and, if necessary, to amend them.[518] As noted above, Rule 3010 contemplates that amendments should be made to WSPs if there are changes in a firm's supervisory processes, so that the WSPs accurately reflect what the firm is doing. Indeed, shortly after DiBlasi became the Firm's CCO, in November 2013, the Firm modified Appendix B to identify DiBlasi by name as the person responsible for establishing, maintaining, and updating the Firm's WSPs, including Appendices A and B.[519] If Cruz had responsibility for WSPs to the extent that they related to its Rule 144 business, the correction could and should have been made in November 2013.

DiBlasi also attempts to explain away aspects of the 2013 WSPs that contradict his position—such as the specific assignment of Rule 144 compliance tasks to the CCO. He testified that the 2013 WSPs "didn't accurately reflect how the division of responsibility was set up throughout the company. And it needed to be corrected."[520] The 2013 WSPs, however, clearly stated that DiBlasi was responsible for the Firm's policies and procedures and made him specifically responsible for policies and procedures relating to the Firm's Rule 144 business. His disclaimer of responsibility cannot override that plain statement.

Approximately six months after DiBlasi became CCO, in May 2014, the WSPs were modified.[521] Even then, however, the WSPs did not clearly reflect the division of responsibility that DiBlasi described in his testimony. The WSPs did not say that Cruz had responsibility for all aspects of Rule 144 compliance, including the WSPs relating to Rule 144.

In place of the CCO, the main body of the modified WSPs designated the "General Principal" as responsible for developing procedures to ensure that a stock certificate was validly issued and owned by the customer, and that the resale of such a security was made in reasonable

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[514] Hearing Tr. (DiBlasi) 1940-41; CX-179, at 64 (8.18.2).

[515] CX-179, at 64 (8.18.3).

[516] CX-179, at 64 (8.18.3).

[517] Hearing Tr. (DiBlasi) 1932-33. See Resp. PH Br. 38-39.

[518] *Ranni*, 2012 FINRA Discip. LEXIS 6, at *27 & n.93.

[519] CX-182, at 2.

[520] Hearing Tr. (DiBlasi) 1969.

[521] Hearing Tr. (DiBlasi) 1921, 1932-33, 1939-42.

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reliance on an exemption.[522] Similarly, the modified WSPs instructed that the General Principal should be consulted in connection with Rule 144 transactions. Under the modified WSPs, the General Principal was responsible for developing and implementing Rule 144 policies and procedures.[523]

Although the title "General Principal" might appear to refer to a single person, the term General Principal was defined in the modified WSPs as the "Management Committee."[524] The WSPs declared that the Management Committee had been set up to serve in the role of president of the Firm.[525] The Management Committee was defined in yet another location to consist of four persons—including DiBlasi.[526] Accordingly, even under the modified WSPs, as a member of the Management Committee, DiBlasi still retained some vaguely defined responsibility for Rule 144 transactions.

DiBlasi relies on the delegation to the Management Committee in arguing that he had no responsibility for compliance matters related to the Firm's Rule 144 business. He maintains that the specific assignment of responsibility for the WSPs to him by name in Appendix B did not "overwrite" the provision in the main body of the WSPs referring to the Management Committee.[527]

Given the ambiguity of the delegation of responsibility in the main body of the WSPs—ostensibly to the General Principal but actually to a committee that included DiBlasi—we think the clear, explicit assignment of responsibility for the WSPs to DiBlasi by name contained in Appendix B forecloses DiBlasi's argument. That conclusion is bolstered by the description in the main body of the WSPs of the CCO's duties, which include responsibility for the Firm's policies and procedures.

DiBlasi's argument also is undermined by the fact that he took actions in connection with certificate deposits. For example, he signed a foreign account application by Unicorn under the label "Compliance Approval."[528] Furthermore, others at the Firm reached out to him in connection with issues regarding certificate deposits. For example, Diekmann had concerns about a deposit because Ruzicka said that the customer was pressing to start trading a stock when

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[522] CX-180, at 64 (8.18.2).

[523] CX-180, at 64 (8.18.3).

[524] CX-180, at 7 (Compliance and Supervision 1.1.2).

[525] Hearing Tr. (DiBlasi) 1972; CX-180, at 7.

[526] Hearing Tr. (DiBlasi) 1933-34, 1939-40, 1942-43. The other members of the Management Committee were Cruz, Jay Noiman, and Elizabeth Arndt. Hearing Tr. (Noiman) 1065-66; Hearing Tr. (DiBlasi) 1972.

[527] Hearing Tr. (DiBlasi) 1974-75.

[528] Hearing Tr. (DiBlasi) 1956-57. DiBlasi maintained that his signature meant nothing more than that a foreign financial institution was involved. Hearing Tr. (DiBlasi) 1957. Whatever it meant, DiBlasi's signature appeared under the heading "Compliance Approval," and it demonstrated that he was involved in some type of compliance review in connection with the Firm's penny stock accounts.

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there was zero market for it, so Diekmann forwarded the correspondence to DiBlasi. Diekmann said that he did so because he thought Ruzicka's comment called into question whether the deposit should have been approved by Scottsdale in the first place. He sent the email to DiBlasi because DiBlasi was the CCO.[529]

c. The Firm's WSPs Were Not Reasonably Designed To Ensure Compliance With Section 5

i. The WSPs Did Not Accurately Reflect The Way The Firm Conducted Its Rule 144 Business

The Firm's WSPs were not reasonably designed to ensure compliance with Section 5 because they did not accurately reflect the way the Firm conducted its Rule 144 business. DiBlasi testified that Cruz was the principal responsible for Rule 144 compliance and the establishment of policies and procedures relating to that business. Cruz testified that DiBlasi never had any role in the Rule 144 review process.[530] Cruz created the procedures for Rule 144 transactions that were in effect during the relevant period, the Firm's OTC Restricted Stock Deposit Procedures, dated November 2012.[531] He testified, however, that during the relevant period DiBlasi had responsibility for updating them.[532]

Accepting Respondents' testimony about the allocation of responsibilities, during the relevant period the WSPs should have clearly said which aspects of the WSPs were Cruz's responsibility and which were DiBlasi's. Neither the 2013 WSPs nor the modified WSPs had any clear indication of who was responsible for what.

DiBlasi admitted that the 2013 WSPs did not accurately reflect the way the Firm was operating its Rule 144 business.[533] We further find that the modified WSPs also did not accurately reflect the way the Firm operated its business.

DiBlasi's testimony revealed that the modified WSPs allocated responsibility to a committee that no longer existed. DiBlasi testified that in January 2014 the Management Committee disbanded. He said that Justine Hurry took on the Committee's responsibilities in February 2014. Then, in March 2014, Cruz officially became president of the Firm and took on

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[529] Hearing Tr. (Diekmann) 782-87; CX-222a.

[530] Hearing Tr. (Cruz) 563-64.

[531] Hearing Tr. (Cruz) 582; RX-27.

[532] Hearing Tr. (Cruz) 665-66; RX-27.

Confusion over who had responsibility for the WSPs apparently is nothing new at the Firm. Cruz did not remember who the CCO was at the time he created the Rule 144 procedures, and he did not recall anyone specifically delegating to him the responsibility for creating the procedures. Hearing Tr. (Cruz) 665-66. When asked who now has responsibility to update the Rule 144 procedures, Cruz testified, "I believe that responsibility now falls on Henry Diekmann as president and also as head of the 144 cert team." Hearing Tr. (Cruz) 584.

[533] Hearing Tr. (Diekmann) 783-86; CX-222a.

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the responsibilities of the Management Committee. The Committee never reconstituted itself again—and yet in May 2014 the Firm put in place the modified WSPs that supposedly gave Rule 144 compliance responsibility to the Management Committee.[534]

Even if the Management Committee had been functioning in May 2014, we find that the modified WSPs were misleading regarding the allocation of responsibilities, and, therefore, not reasonably designed to achieve compliance. They purported to designate a registered principal as responsible for compliance with Rule 144. Rule 3010 requires that supervisory responsibilities be delegated to an appropriately registered principal. But, in fact, the WSPs delegated responsibility for Rule 144 procedures to a group of people. In so doing, the WSPs obscured who had responsibility, making it more difficult to hold anyone accountable for compliance oversight over the bulk of the Firm's business.

This failure to clearly indicate who was responsible for Rule 144 compliance is particularly egregious here. It would have been relatively simple to designate Cruz the responsible principal, since everyone agreed that he was.

It is fundamental that a firm's WSPs must clearly designate responsibilities to appropriately registered persons and must accurately reflect the way a member firm conducts its business. That is why Rule 3010 specifies that supervisory responsibilities be assigned to an appropriately registered principal. The person responsible for supervising a particular line of business must have the appropriate background to do it. That is also why a firm's WSPs must address the particular business and the particular circumstances of a firm. Only then will the WSPs be well designed to reasonably ensure compliance.[535]

ii. The WSPs Did Not Require A Reasonable Inquiry Into Beneficial Ownership

We also find that Scottsdale's WSPs were not reasonably designed to achieve compliance with Section 5 because the WSPs failed to require a reasonable inquiry into the identity of the purported beneficial owners of the stock the Firm was selling. The WSPs do not discuss the concept of nominees, and the Firm's principals responsible for approval of stock deposits did not focus on the potential problem of nominees in conducting their review. The due diligence files for the transactions at issue demonstrate that the Firm's general practice for reviewing stock deposits was inadequate to identify and investigate situations in which nominees might be concealing the identity of the true beneficial owners of securities. Diekmann testified that he knew nothing about the purported beneficial owner of Sky Walker but that the person was a

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[534] Hearing Tr. (DiBlasi) 1973. DiBlasi's testimony that Justine Hurry briefly served as president of the Firm in February 2014 is corroborated by the Firm's Form BD Amendment dated February 13, 2014, which lists Justine Hurry as president, as well as a director, of the Firm. CX-17, at 3. That document identifies Cruz as legal counsel since May 2008. CX-17, at 3.

[535] *See* NASD Notice to Members 99-45 (June 1999), http://www.finra.org/sites/default/files/NoticeDocument/p004311.pdf.

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customer of Unicorn. The lack of focus on the potential use of nominees to conceal the identity of the true beneficial owners is particularly egregious in light of the four prior SEC actions charging that nominees had been used to facilitate fraud and manipulation.

The Firm's listing of every FFI on its red flag list was not sufficient to address beneficial ownership or to ensure that an unlawful distribution was not occurring. The WSPs did not indicate why or what should be done in response to the red flag designation. When asked what additional scrutiny comes from the red flag designation, Diekmann could not think of any. He said that the designation "just reflects the heightened risk."[536] To recognize a heightened risk but provide no guidance for dealing with it is not reasonable. WSPs must provide a "reliable mechanism" for identifying securities sales that should be investigated or halted.[537]

3. Cruz's Violation

The Third Cause of Action charges that Cruz failed to adequately and meaningfully analyze the collected documents and information. Consequently, he and the staff he supervised failed to respond appropriately to red flags strongly indicating that the transactions were not entitled to an exemption. He approved the deposits for resale based on a cursory collection and verification effort. Enforcement proved the charges.

There is no dispute that Cruz supervised the processing of deposits for resale pursuant to Rule 144. He drafted the Firm's procedures for handling restricted stock sold pursuant to Rule 144 and other forms used to process deposits. For each transaction, he also met with the person who had put together the due diligence file to support the Rule 144 exemption. After talking with the person, he gave the final approval that allowed Scottsdale to trade the securities without registration. He was critical to the transactions, and, even though the WSPs did not identify him as the responsible person, everyone at the Firm looked to Cruz as the person responsible for Rule 144 compliance.

Cruz violated his responsibility in two ways.

First, Cruz failed to analyze whether the debt obligations that formed the foundation for tacking were securities. In light of the circumstances, this failure was egregious. Diekmann, who is not a lawyer, was incapable of recognizing and correcting Cruz's error. The members of the Rule 144 team who were lawyers did not have experience with penny stocks before they came to the Firm and were trained by Cruz and the Firm's personnel. Everyone depended on Cruz's analysis and expertise. As an experienced securities lawyer, Cruz should have recognized the problem. But he failed to meaningfully analyze the information in the due diligence packages.

Second, Cruz failed to react appropriately to myriad red flags. As set forth above in connection with each transaction, the stock deposits were rife with discrepancies and suspicious

[536] Hearing Tr. (Diekmann) 990.

[537] *Midas Sec.*, 2012 SEC LEXIS 199, at *51.

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circumstances that constituted red flags. However, Cruz and his staff did not make the required "searching inquiry" or obtain independent verification.

Cruz's failure is egregious because he knew that the Firm was acting as a gatekeeper,[538] and that broker-dealer firms play a critical role in helping to prevent illegal unregistered resales of restricted securities into the public markets.[539] He also acknowledged that at the time of the events at issue he was aware of the red flags in Regulatory Notice 09-05.[540] It is well established that the "duty of supervision includes the responsibility to investigate 'red flags' that suggest that misconduct may be occurring and to act upon the results."[541]

Cruz argues, however, that he was an effective supervisor. He notes that he created the Rule 144 manual, the due diligence questionnaire, and beneficial ownership declaration, and that the Firm dedicated one-third of its staff to performing due diligence reviews on stock deposits. He states that he inserted himself into the review process as a second set of eyes and additional resource when Scottsdale began accepting stock deposits from customers of sub-FFIs. He also asserts that the due diligence packages at issue contained all the required paperwork and that there is no instance of an issue being brought to Cruz's attention and him ignoring it. Finally, he maintains that the "rigor" of the stock deposit reviews under his leadership is demonstrated by the fact that Scottsdale frequently rejected stock deposits.[542]

All of this is beside the point. Cruz is charged with failing to respond appropriately to specific red flags identified in connection with the transactions at issue. The mere creation of paperwork does not qualify as effective supervision. As FINRA noted in conjunction with Regulatory Notice 09-05, in Rule 144 transactions, representations made by the interested parties have to be evaluated with a skeptical eye. Independent verification may be required. Instead, Cruz guided the staff through a check-the-box exercise.

Even when Cruz acknowledged that something might be a red flag, he indicated that his response would not be to obtain independent verification. Rather, his response would be merely to remind the interested parties of the information that needed to be disclosed. This is a totally inadequate response to a red flag.

Cruz's testimony regarding language on Unicorn's website illustrates the problem. The language on the website indicated that Unicorn would appoint nominees for its customers so that their names would not appear as an officer or director of the company on their account at

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[538] Hearing Tr. (Cruz) 86.

[539] Hearing Tr. (Cruz) 89.

[540] Hearing Tr. (Cruz) 84-90.

[541] *KCD Fin, Inc.*, 2016 FINRA Discip. LEXIS 38, at *70 (quoting *Michael T. Studer*, 57 S.E.C. 1011, 1023-24 (2004), *aff'd*, 260 F. App'x 342 (2d Cir. 2008)). *See also Ronald Pellegrino*, Exchange Act Release No. 59125, 2008 SEC LEXIS 2843, at *33 (Dec. 19, 2008).

[542] Resp. PH Br. 40-41.

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Unicorn. Cruz said he did not recall seeing that language at the time he reviewed Unicorn's deposits, but he agreed that if he had it "could have been" a red flag. In response to that red flag, however, he did not say that he would have sought independent verification of the identity of Unicorn's customers. Rather, he indicated that Scottsdale would merely emphasize to the interested parties that "they needed to – to disclose the underlying beneficial owner."[543] In other words, he would continue to rely on the representations of the interested parties.

Cruz argues that he supervised more actively than did respondents in other disciplinary proceedings in which supervisory violations were found.[544] Even if that were true (which we are not persuaded it is), the fact that other supervisors in other cases did even less than Cruz to respond to red flags is no excuse. The standard for reasonable supervision is not merely something marginally better than bad. Moreover, whether supervision is reasonable depends on the particular circumstances of each case.[545]

Cruz also argues that Enforcement is improperly second-guessing Cruz's exercise of reasoned business judgment, and that Enforcement has failed to provide affirmative evidence that his judgments were incorrect.[546] This argument is erroneous in two regards.

First, the argument ignores the record. The transactions at issue were rife with red flags that could not be ignored, but Cruz did ignore them.

Second, the argument confuses the burden on the Firm when it determined that an exemption existed with the burden of proof in litigation. Cruz, acting on behalf of the Firm, had the burden of developing a reasonable basis for believing that an exemption existed before the securities could be sold without registration. Enforcement proved that he and the Firm did not have a reasonable basis for believing that an exemption existed, but nevertheless Cruz approved the sale of the securities at issue without registration. That is all that Enforcement had to prove for the supervisory violation.

In sum, Cruz did not make sure that the transactions met the legal requirements for an exchange of securities, and he was oblivious to numerous red flags strongly suggesting that the transactions at issue were sham transactions using nominees to effect unlawful distributions of securities without registration. He violated his supervisory duties.

IV. SANCTIONS

In considering the appropriate sanction for a violation, adjudicators in FINRA disciplinary proceedings look to FINRA's Sanction Guidelines ("Guidelines"). The Guidelines

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[543] Hearing Tr. (Cruz) 307-08.

[544] Resp. PH Br. 41 n.236.

[545] *E.g.*, *Dep't of Enforcement v. Wedbush Sec., Inc.*, No. 20070094044, 2014 FINRA Discip. LEXIS 40, at *27-28 (NAC Dec. 11, 2014).

[546] Resp. PH Br. 41.

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contain recommendations for sanctions for many specific violations, depending on the circumstances. They also contain overarching Principal Considerations and General Principles, both of which are applicable in all cases.[547]

The Guidelines are intended to be applied with attention to the regulatory mission of FINRA—to protect investors and strengthen market integrity.[548] The Guidelines caution that sanctions must be significant enough to prevent and discourage future misconduct by a respondent and to deter others from similar misconduct. Sanctions also should encourage improved business practices.[549]

Applying the Guidelines, we first discuss below the appropriate sanctions for the Firm, DiBlasi, and Cruz. We separately discuss the sanction for Hurry.

A. Scottsdale

As authorized by the Guidelines, we aggregate all the Firm's violations.[550] The violations are inextricably intertwined and are the result of a systemic failure at the Firm—the Firm's failure to have procedures in place that would reasonably ensure compliance and the Firm's failure to respond appropriately to red flags led to the Firm's failure to have a reasonable basis for an exemption before selling the securities. Furthermore, as discussed below, the Panel believes stringent sanctions are warranted here, and separately sanctioning the Firm for the different violations, even at the high end of the range of recommended sanctions, would not adequately remediate the Firm's misconduct. We view the Firm's systemic failure to perform its gatekeeping function better addressed as a whole, rather than in piecemeal fashion.

The Firm violated FINRA Rule 2010 because, in connection with the transactions at issue, it did not have a reasonable basis for an exemption. Selling securities without registration and without an exemption violated Section 5. The Guidelines contain specific recommendations for this type of violation. The Guidelines recommend a fine of $2,500 to $73,000, but in egregious cases the fine may be higher. In egregious cases, a firm may also be suspended with respect to any or all activities or functions for up to 30 business days or until procedural deficiencies are remedied.[551]

The Firm, through DiBlasi, failed to have in place WSPs reasonably designed to achieve compliance with Section 5. For deficient WSPs, the Guidelines recommend a fine ranging from $1,000 to $37,000. They also suggest that adjudicators consider suspending a firm with respect

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[547] FINRA Sanction Guidelines (2016) ("Guidelines"), http://www.finra.org/industry/sanction-guidelines.

[548] Guidelines at 1, Overview.

[549] Guidelines at 2, General Principle No. 1.

[550] Guidelines at 4, General Principle No. 4.

[551] Guidelines at 24.

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to any or all relevant activities or functions for up to 30 business days or until the supervisory procedures are amended to conform to the rule requirements.[552]

The Firm, through Cruz, failed to supervise its Rule 144 process appropriately. The Firm, through Cruz, failed to adequately and meaningfully analyze the information collected and thus failed to respond appropriately to red flags that the transactions were unlawful distributions. For a failure to supervise, the Guidelines recommend a fine of $5,000 to $73,000. In egregious cases, they suggest that adjudicators consider suspending a firm with respect to any or all relevant activities or functions for up to 30 business days. An even longer suspension may be imposed, up to two years, or the firm may be expelled, where the case involves systemic supervision failures.[553]

We find the Firm's violations to be egregious. We also find that there are a large number of aggravating factors that increase the need for stringent sanctions. There are no mitigating factors.

1. Aggravating Factors

a. Specific Principal Considerations Related To Section 5 Violations

One of the specific Principal Considerations in a case involving a Section 5 violation is whether the respondent attempted to comply with an exemption.[554] We conclude here that the Firm did not truly attempt to comply. Rather, it created the appearance of compliance. Although the Firm created thick due diligence packages, it did not meaningfully evaluate the information in those packages. If it had, it would have known it could not sell the securities without further investigation and the development of a reasonable basis for an exemption. We further find it aggravating that the Firm expended its resources on creating the appearance of compliance, rather than true compliance, because such conduct is deceptive and displays a lack of regard for the applicable law and regulatory requirements. This aggravating factor applies not only to the Firm but to Cruz, on whom everyone at the Firm depended for Rule 144 compliance.

Another specific Principal Consideration is the share volume and dollar amount of the transactions involved.[555] The transactions at issue involved millions of shares and resulted in

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[552] Guidelines at 103.

[553] Guidelines at 102.

[554] Guidelines at 24.

[555] Guidelines at 24. See also Guidelines at 7, General Principal Consideration 18.

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proceeds of more than $1.75 million.[556] The amounts involved are substantial and constitute an aggravating factor.

A third specific Principal Consideration is whether the respondent implemented reasonable procedures to ensure that it did not participate in an unregistered distribution.[557] The Firm's procedures were not reasonable. To the contrary, they seemed designed to obscure who was responsible for Rule 144 compliance and they failed to require specific, reliable evidence to support the application of an exemption. Nor did the Firm implement good practices. Scottsdale's staff uncritically relied on the self-serving representations of the interested parties. When they did notice a discrepancy, the staff assumed an innocent explanation or accepted a plainly unreliable representation from the interested parties, rather than pursuing the "searching inquiry" that was required. This aggravating factor applies to DiBlasi, as the CCO, and to Cruz, as the person ultimately responsible for Rule 144 compliance, as well as the Firm.

A fourth specific Principal Consideration is whether the respondent disregarded red flags suggesting the presence of an unregistered distribution.[558] As discussed above, the Firm repeatedly failed to identify and disregarded numerous red flags indicating that the transactions were unlawful distributions of securities. The multiplicity of red flags is another aggravating factor. This aggravating factor applies to Cruz as well as the Firm.

b. Specific Principal Considerations Related To Deficient WSPs

One of the specific Principal Considerations relating to deficient WSPs is whether those deficiencies allowed violative conduct to occur or to escape detection. We find here that the WSPs allowed violations to occur. The failure to provide guidance on dealing with discrepancies and suspicious circumstances allowed those involved with Rule 144 review to proceed in a rote fashion, without analyzing the information they collected. This aggravating factor applies to both the Firm and DiBlasi.

Another specific Principal Consideration is whether the deficiencies made it difficult to determine the individuals responsible for specific areas of supervision or compliance. We find that the failure to clearly and accurately delineate responsibility lessened transparency and accountability, making regulatory oversight more difficult. It is particularly aggravating that the person designated CCO should disclaim responsibility for the vast majority of the Firm's business. This aggravating factor applies to both the Firm and DiBlasi.

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[556] JX-268 (NHPI-Related Activity in CSCT Account: Total Net Proceeds of $264,711.70); JX-281 (VPLM-Related Activity in CSCT Account: Total Net Proceeds of $1,408,173.39); JX-310 (ORFG-Related Activity in CSCT Account: Total Net Proceeds of $91,408.43).

[557] Guidelines at 24. See also Guidelines at 6, General Principal Consideration 5.

[558] Guidelines at 24.

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c. Specific Principal Considerations Related To Failure To Supervise

One of the specific Principal Considerations in connection with a failure to supervise is whether the respondent ignored red flags warning of the need for additional supervisory scrutiny. Another is the nature, extent, size, and character of the underlying misconduct. Both of these are aggravating factors in this case. The Firm, through Cruz, ignored multiple red flags that the transactions required additional scrutiny. The transactions were substantial and were typical of the bulk of the Firm's business. The supervisory failure was in fact built into the Firm's standard practice for processing Rule 144 stock deposits, which is an aggravating factor. These aggravating factors apply to both the Firm and Cruz.

d. General Principal Considerations

Several general Principal Considerations are relevant to this case.[559] Principal Consideration 1 is a respondent's relevant disciplinary history.[560] Scottsdale has a disciplinary history, and some of that history involves misconduct like the misconduct here. As noted above, in the 2011 AWC the Firm settled charges that it had sold unregistered securities and that it had inadequate supervisory procedures and WSPs to detect and prevent the sale of unregistered securities. The Firm resolved other charges in the 2009, 2012, and 2015 AWCs. Finally, although the Firm was not charged in connection with the four SEC cases, *Ruettiger*, *Gibraltar I*, *Gibraltar II*, and *Tavella*, those cases did involve alleged misconduct through accounts at the Firm. These cases put the Firm on notice of the risk of sham transactions and the use of nominees to conceal beneficial ownership and facilitate unlawful distributions of securities. They heightened the need for the Firm to be alert to red flags. In light of this history, it is aggravating that Scottsdale performed its gatekeeping function so poorly.

Principal Consideration 2 concerns whether a respondent has accepted responsibility for and acknowledged the misconduct prior to detection and intervention. The Firm here has not. It maintains that its procedures are "market-leading" and create an "unfriendly environment" for stock manipulation.[561] The facts do not support that characterization.

Furthermore, in light of the fact that the transactions at issue involved persons who have been indicted for engaging in securities fraud and other crimes, it is particularly aggravating that the Firm's current president, Diekmann, testified that if any of the three deposits at issue were presented to him today—NHPI, VPLM, or ORFG—he would approve it. He expressed no qualms.[562] This means that the person in charge of approving stock deposits as satisfying the Rule 144 exemption is likely to commit the same violations again.

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[559] Guidelines at 6-7.

[560] Guidelines at 6, General Principal Consideration 1.

[561] Resp. PH Br. 37-38.

[562] Hearing Tr. (Diekmann) 1799-80.

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Adding to our concerns in this regard, Cruz echoed Diekmann. Cruz said that, despite the evidence presented to him during his testimony relating to the five certificate deposits charged in the Complaint (three NHPI, one VPLM, and one ORFG), he believed that the Rule 144 exemption applied and the transactions complied with Section 5.[563]

Principal Consideration 8 is whether a respondent engaged in numerous acts or a pattern of misconduct. [564] Principal Consideration 16 is whether the misconduct is aberrant behavior.[565] Scottsdale engaged in a pattern of misconduct and it was not aberrant behavior. Indeed, the Firm institutionalized its misconduct, by papering its files with documents that it did not meaningfully analyze. It is aggravating that the misconduct is actually the standard way the Firm conducts all its business. Moreover, Cruz testified that the pattern of deposits based on buying loan notes and exchanging them for stock was a typical transaction for the Firm. Because it was typical he saw nothing suspicious in it. These aspects of the misconduct are aggravating as to both the Firm and Cruz.

Principal Consideration 13 is whether the misconduct was the result of an intentional act, recklessness or negligence.[566] The Firm's misconduct was not the product of negligence. It acted intentionally when it created and implemented the procedures for reviewing deposits of stock certificates for resale that created a false appearance of compliance. This aggravating factor applies not only to the Firm but to both DiBlasi and Cruz.

Principal Consideration 18 focuses on the number, size, and character of the transactions.[567] The transactions at issue had many red flags indicating that they were schemes to evade the securities laws and the scrutiny that comes with registration. Given that character, it is aggravating that, as a result of Scottsdale's failure to perform its gatekeeping function, millions of dollars of securities were sold to the investing public without the safeguards that accompany registration.

e. General Principles

The Guidelines instruct adjudicators to take into account certain General Principles applicable to all sanction determinations.[568] One of those General Principles is that disciplinary sanctions should be designed to deter misconduct, both by the respondent and by others, and should uphold high standards of business conduct. Adjudicators should impose sanctions that are

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[563] Hearing Tr. (Cruz) 555.

[564] Guidelines at 6, General Principal Consideration 8.

[565] Guidelines at 7, General Principal Consideration 16.

[566] Guidelines at 7, General Principal Consideration 13.

[567] Guidelines at 7, General Principal Consideration 18.

[568] Guidelines at 2-5.

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meaningful and significant enough to accomplish these goals, and the sanctions should reflect the seriousness of the misconduct at issue.[569]

The Firm's business is almost entirely the processing of penny stock deposits for resale into the public marketplace. In light of that fact, it is aggravating that the Firm had a check-the-box approach to its review of the deposits, without meaningful analysis of the multitude of red flags. The confession by Diekmann, the current president of the Firm, that, even after compiling a thick due diligence book, he knew nothing about the beneficial owner of one of the NHPI deposits is disturbing. It suggests that the person who now has authority to give final approval to stock deposits for resale has no understanding of what is required to ensure that the Firm does not participate in an unlawful distribution of securities without registration. The sanctions here must be stringent to deal with the seriousness of the misconduct and to show the Firm that it cannot simply continue with its business in its usual fashion. We believe that only a substantial sanction will deter the Firm from future misconduct.

Another General Principle is that disciplinary sanctions should be more severe for recidivists in order to deter and prevent future misconduct. The imposition of more severe sanctions emphasizes the need for corrective action.[570] As noted above, the Firm has a disciplinary history. It has been disciplined for selling unregistered securities and for other violations. In light of this history, it is appropriate to impose more severe sanctions.

f. Overview

The mission of FINRA's regulatory and disciplinary process is to protect investors and promote market integrity. In fulfilling that mission, adjudicators are not limited to the sanctions recommended in the Guidelines. Based on the facts and circumstances presented in each case, adjudicators may impose sanctions that fall outside the ranges recommended and may consider aggravating and mitigating factors in addition to those listed in the Guidelines.[571]

2. Potential Mitigating Factor

Principal Consideration 3, which is applicable to all sanctions determinations, concerns whether, prior to detection or intervention by a regulator, a firm voluntarily employed corrective measures to avoid recurrence of misconduct. This might be argued to be a mitigating factor.

The Firm maintains that it enhanced its procedures after the SEC filed the complaints in the four cases involving nominees. In particular, it claims that it enhanced its reviews of stock promotions and notes that it ended all commissioned representatives at the Firm. It asserts that its requirement of a beneficial ownership declaration is a "market-leading practice" that has been

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[569] Guidelines at 2, General Principle 1.

[570] Guidelines at 2, General Principle 2.

[571] Guidelines at 1.

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adopted as a recommended method for determining beneficial ownership. It also points to its use of a Red Flag List and a Stock Watch List as enhancements to its reviews.[572]

We find that whatever changes the Firm made in its procedures were insufficient to be mitigating. To some degree, they appear to be more of the same. They created the appearance of compliance without actual compliance. Even with the so-called enhancements, the Firm's procedures were woefully lacking. The record is replete with red flags that the Firm and Cruz ignored.

3. Sanction

In light of the egregious nature of the Firm's violation, the Firm's institutionalization of the misconduct as its standard way of doing business, and the other aggravating factors set forth above, we believe that a stringent sanction is appropriate. Only such a sanction will serve the remedial purposes of the disciplinary process. The Firm must be deterred from similar misconduct in the future. We impose on Scottsdale a fine of $1.5 million.

B. Hurry

Hurry's violation of his duty to observe high standards of commercial honor and just and equitable principles of trade was purposeful and egregious. These two qualities lead us to conclude that Hurry is a threat to investors and the integrity of the markets. Our concern is compounded by our credibility findings. We found that he repeatedly testified falsely, and that there was a pattern of doing so when he thought no contradictory evidence would come to light.

When misconduct is intentional, General Principle 1 provides that adjudicators should assess sanctions that exceed the recommended range in the Guidelines.[573] Principal Consideration 13 also focuses on whether a respondent's misconduct is the result of an intentional act, recklessness, or negligence.[574] When a violation is egregious, the Guidelines often suggest more severe sanctions. In egregious cases in connection with violations of Rule 2010 and Section 5, the specific Guidelines recommend that an individual be suspended for up to two years or barred.

Even though he has no disciplinary history, the devious nature of Hurry's violation evidences disregard for regulatory requirements, an aggravating factor under General Principle 2 and Principal Consideration 10.[575] We have no confidence that if he remained in the securities industry he would not again devise a way to evade the law and regulatory requirements. For this reason also, we believe Hurry is a threat to the investing public.

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[572] Resp. PH Br. 37-38.

[573] Guidelines at 2, General Principle 2.

[574] Guidelines at 7, General Principal Consideration 13.

[575] Guidelines at 2, General Principle 2; Guidelines at 6, General Principal Consideration 10.

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As discussed in connection with the Firm's violation and sanction, the scheme enabled large amounts of stock certificates to be sold in a number of transactions without the protections of registration and without an exemption. Under Principal Consideration 18, the size of the transactions is an aggravating factor.

Finally, we note that Hurry had by far the most to gain financially from setting up CSCT and enabling shares deposited from offshore customers to be shielded from scrutiny. He and his wife own all three entities involved in the process: CSCT, Scottsdale, and Alpine. And although Respondents emphasize that the particular transactions at issue did not generate a huge amount of money, the microcap securities liquidation business as a whole was highly remunerative for Hurry and his wife. We earlier noted that, from Scottsdale alone, in 2014 they received approximately $6.2 million in directors' fees and $1.45 million in net income. The compensation for all other employees and for professional and consulting fees for that year totaled less than half that—approximately $2.7 million. It was to Hurry's financial advantage to facilitate the processing of FFI deposits and to minimize regulatory oversight. The misconduct added to his financial gain and is an aggravating factor under Principal Consideration 17.[576]

We bar Hurry from associating with any FINRA member in any capacity and believe it appropriately remedial to fine him $100,000. In light of the bar, however, we do not impose the fine.

C. DiBlasi

The Guidelines provide with respect to an individual who is responsible for deficient WSPs that in egregious cases he may be suspended in any or all capacities for up to one year. The Guidelines also provide for a fine ranging from $1,000 to $37,000.

In this case we find more stringent sanctions appropriately remedial. DiBlasi's violation was egregious, and there are aggravating factors. The WSPs created the appearance of a set of procedures designed to achieve compliance, but they did not accurately reflect the way the Firm actually handled its Rule 144 deposits. They did not even reflect DiBlasi's true role. Even though he was purportedly the CCO, he claimed that he had nothing to do with the vast majority of the Firm's business. Essentially, he performed back-office functions for the Firm. The result of the deficiencies in the WSPs was that violations occurred and regulatory efforts to determine the persons responsible were hindered.

We suspend DiBlasi from associating with any FINRA member firm in any capacity for two years and fine him $50,000.

D. Cruz

The Guidelines provide with respect to an individual supervisor who fails to respond to red flags that, in egregious cases, an adjudicator should consider suspending the person in any or

[576] Guidelines at 7, General Principal Consideration 17.

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all capacities for up to two years or barring him. A fine of $5,000 to $73,000 also may be imposed.

Cruz's violation was egregious. As a lawyer with considerable background in the securities laws, he had the background that others did not to scrutinize the due diligence packages and identify red flags. Furthermore, as the person at the Firm everyone else depended upon for Rule 144 compliance, he knew that he was critical to the Firm's performance of its gatekeeping duty. He was the principal at the Firm who gave final approval to the sales of deposited securities, signing under a certification that the transactions, to his knowledge, were lawful. In light of these circumstances and the many aggravating factors identified above, Cruz's failure to recognize and appropriately address multiple red flags was inexcusable.

We suspend Cruz from associating with any FINRA member firm in any capacity for two years and fine him $50,000.

E. Respondents' Arguments For Lesser Sanctions Rejected

We reject Respondents' arguments for lesser sanctions. They assert that the relief requested by Enforcement cannot be reconciled with the Guidelines because the sanctions are more stringent than the recommended range.[577] However, the Guidelines are not absolute. They are recommendations. As provided in the Overview, adjudicators may impose sanctions outside the recommended range where the particular facts and circumstances make that appropriate.[578]

We are concerned that the misconduct here is the Firm's standard approach to processing deposits of stock certificates for sale. As long as the Firm continues with that check-the-box approach, without a meaningful evaluation of the information it collects, it is a risk to public investors. More stringent sanctions are necessary to emphasize the necessity for corrective action and to remediate the violation.

Respondents also compare their case to other cases involving Section 5 and supervisory violations, asserting that in those other cases the misconduct was worse and the sanctions less.[579] The appropriateness of sanctions, however, depends on the facts and circumstances of the particular case and cannot be determined by comparison to sanctions in other cases that involve different facts and circumstances.[580] Furthermore, Respondents' misconduct was far more egregious than Respondents acknowledge.

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[577] Resp. PH Br. 47.

[578] Guidelines at 1.

[579] Resp. PH Br. 47-49.

[580] *See, e.g.*, *William Scholander*, Exchange Act Release No. 77492, 2016 SEC LEXIS 1209, at *42 & n.65 (Mar. 31, 2016).

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With respect to disciplinary history, Respondents argue that the individual Respondents have no disciplinary history.[581] It is well established that the absence of a disciplinary history is not mitigating as to sanctions. A wrongdoer should not be rewarded for acting in accord with his duties as a securities professional.[582]

In sum, we find that the sanctions we impose here are necessary, appropriate and remedial. They serve the twin goals of protecting public investors and contributing to market integrity.[583]

V. CONCLUSION

The Firm, Scottsdale Capital Advisors, violated FINRA Rule 2010. Accordingly, it is ordered to pay a fine of $1.5 million. John J. Hurry violated FINRA Rule 2010. For his misconduct he is barred from association with any FINRA member in any capacity. He would be fined $100,000, but, in light of the bar, the fine is not imposed. Timothy B. DiBlasi violated NASD Rules 3010(a) and (b) and FINRA Rule 2010. For his misconduct, he is suspended for two years from association with any FINRA member in any capacity and fined $50,000. D. Michael Cruz violated NASD Rule 3010(b) and FINRA Rule 2010. For his misconduct, he is suspended for two years from association with any FINRA member in any capacity and fined $50,000.

Respondents are also ordered to pay costs in the amount of $22,124.29, which includes a $750 administrative fee and $21,374.29 for the cost of the transcript. If this decision becomes FINRA's final disciplinary action, Hurry's bar will take immediate effect. DiBlasi's and Cruz's suspension will begin with the opening of business on August 21, 2017. The fines and assessed costs shall be due on a date set by FINRA, but not sooner than 30 days after this amended decision becomes FINRA's final disciplinary action in this proceeding.

Lucinda O. McConathy
Hearing Officer
For the Extended Hearing Panel

[581] Resp. PH Br. 47.

[582] *See, e.g., Kenny A. Akindemowo*, Exchange Act Release No. 78352, 2016 SEC LEXIS 2522, at *5 & n.5 (July 18, 2016). *See also* Guidelines at 6 and n.2.

[583] The Hearing Panel has considered and rejects without discussion any other arguments made by the Parties that are inconsistent with this decision.

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Copies to: Scottsdale Capital Advisors (via overnight and first-class mail)
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In the Kalamazoo County Circuit Court
For the State of Michigan

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff,

v.

MORNINGLIGHTMOUNTAIN, LLC, MICHAEL GOODE, and DOES 1–10,

Defendants.

Civil No. 18-0153-CZ

HON. ALEXANDER C. LIPSEY

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PROOF OF SERVICE

Michelle L. Guardiola hereby states that, on June 6, 2018, she served a copy of the Answer to First Amended Complaint, Praecipe, Motion for Summary Disposition of First Amended Complaint and this Proof of Service via Federal Express, addressed to Plaintiff's counsel at the following addresses:

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HARDER LLP Charles J. Harder (CA# 184593) Jordan D. Susman (CA# 246116) 132 South Rodeo Drive, Fourth Floor Beverly Hills, California 90212 **Federal Express** **Tracking No. 7724 1243 5476**	PINSKY, SMITH, FAYETTE & KENNEDY, LLP H. Rhett Pinsky (P18920) 146 Monroe Center St., NW, Suite 805 Grand Rapids, Michigan 49503 **Federal Express** **Tracking No. 7724 1246 8272**

I declare that under the penalty of perjury that the statements above are true to the best of my information, knowledge and belief.

BUTZEL LONG

Michelle L. Guardiola

MICHELLE L. GUARDIOLA

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FILED
AUG 17 2018
9TH CIRCUIT COURT
COUNTY OF KALAMAZOO
KALAMAZOO, MICHIGAN

STATE OF MICHIGAN
KALAMAZOO COUNTY CIRCUIT COURT

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff,

v.

MORNINGLIGHTMOUNTAIN, LLC, MICHAEL GOODE, and DOES 1-10,

Defendants.

File No.: 2018—0153-CZ

Hon. Alexander C. Lipsey

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PLAINTIFF'S RESPONSE IN OPPOSITION TO MOTION FOR SUMMARY DISPOSITION OF FIRST AMENDED COMPLAINT

Plaintiff Scottsdale Capital Advisors Corp. ("SCA"), submits its Response in Opposition to Defendants' MCR 2.116(C)(8) Motion to Dismiss ("Motion").

INTRODUCTION

This action arises from Defendants' online publication of false, defamatory, and highly misleading statements (collectively, the "Defamatory Statements") in two different articles on

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Defendants' website, www.goodetrades.com. As alleged in the operative First Amended Complaint ("FAC"), Defendants published the Defamatory Statements with the intent to smear SCA's reputation. (FAC at ¶ 2). It is therefore not surprising that the Motion begins with a three and a half page vilification of the penny stock industry—including *ad hominin* attacks on SCA and one of its principals—that is better suited for a closing statement than a motion to dismiss. Only on page 4 of the Motion do Defendants begin to discuss the allegations in the FAC. (Motion at p. 4) ("Which brings us to this lawsuit.")

In an effort to escape liability for the Defamatory Statements, Defendants argue that the Defamatory Statements must be read "in context." (Motion at p. 5). SCA agrees. Indeed, it is precisely when one reads the Defamatory Statements in context that their falsity shines through, as they falsely imply that (1) SCA was involved in the pump and dump of penny stocks, (2) SCA was fined for its involvement in the pump and dump of penny stocks, (3) SCA was involved in the pump and dump of Biozoom stock, and (4) SCA is engaged in trading that other, more reputable, brokers do not allow. Even if the Defamatory Statements themselves are true, which they are not, the implications they create are materially false and therefore actionable. *See Hawkins v. Mercy Health Servs., Inc.*, 230 Mich. App. 315, 327 (1998).

LEGAL STANDARD

Ordinarily, one would not quibble with the legal standards alleged in a party's motion. Here, however, Defendants' Motion is rife with misleading legal standards that require correction.

First, "[o]nly the pleadings may be considered" when deciding a motion for summary disposition based upon MCR 2.116(C)(8). MCR 2.116(G)(5). Defendants try to evade this rule by attaching exhibits to their answer and then asking the Court to consider those exhibits. (*See*

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Motion at p. 12, fns. 47, 48). This is improper, because "[a] party may not support a motion under subrule (C)(8) with documentary evidence such as affidavits, depositions, or admissions." *Dalley v. Dykema Gossett*, 287 Mich. App. 296, 305 (2010).

Second, the fact that "only the pleadings may be considered" when deciding a motion for summary disposition does not mean that all of the pleadings are treated equally. In particular, *only the allegations in the complaint should be deemed true* and in the light most favorable to plaintiff. *Dalley*, 287 Mich. App. At 304-05; *Sarkar v. Doe*, 318 Mich. App. 156, 178 (2016) ("all factual allegations *made in the complaint* must be viewed in a light most favorable to the nonmoving party and accepted as true"). Defendants' flout this legal standard by treating the allegations in their answer (including the exhibits thereto) as true. This is improper.

Third, Defendants incorrectly allege that Michigan requires a heightened pleading standard in defamation cases based upon the First Amendment. (Motion at p. 6). In fact, the first case cited by Defendants, *Bose Corp. v. Consumers Union*, 466 U.S. 485 (1984) says nothing about the pleadings in a defamation case. And the other case cited by Defendants, *Gonyea v. Motor Parts Fed. Credit Union*, 192 Mich. App 74 (1991) says nothing about the First Amendment. Defendants are merely playing fast a loose with the holdings in the cases they rely upon.

Fourth, Defendants allege that the Court must read the Defamatory Statements in context to determine whether they are libelous, because they may have been "taken out of context." (Motion at p. 7). Although technically true, Defendants fail to mention that context is a two-way street, as Michigan recognizes claims for defamation by implication. *Hawkins*, 230 Mich. App. at 329–30. In order to determine if a statement is libelous, the "publication is to be considered as a whole, including the character of the display of its headlines when the article is published in a

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newspaper, and the language employed therein." *Sanders v. Evening News Ass'n*, 313 Mich. 334, 340 (1946). Indeed, when one reads the Defamatory Statements in context, their defamatory nature becomes readily apparent.

ARGUMENT

A. The Complaint Sufficiently Alleges The Elements of Libel

A cause of action for libel has four components: (1) a false and defamatory statement concerning the plaintiff; (2) an unprivileged communication to a third party; (3) fault amounting to at least negligence on the part of the publisher; and (4) either actionability of the statement irrespective of special harm or the existence of special harm caused by the publication. *Hawkins*, 230 Mich. App. at 324–26.

Further, a cause of action for defamation by implication if the plaintiff proves that the defamatory implications are materially false, and "that such a cause of action might succeed even without a direct showing of any actual literally false statements." *Hawkins*, 230 Mich. App. at 329–30. Accordingly, "even if defendant's statements were true, if the implications the statements created were false, the question of whether the statements were defamatory must be left up to the jury." *Am. Transmission, Inc. v. Channel 7 of Detroit, Inc.*, 239 Mich. App. 695, 702.

"A communication is defamatory if it tends to harm an individual's reputation so as to lower him in the estimation of the community or deter others from associating with him." *Iacco v. Bohannon*, 70 Mich. App. 463, 466 (1976). "Direct accusations or inferences of criminal conduct or wrongdoing are not protected as opinion. There is no First Amendment protection for a charge which could reasonably be understood as imputing specific criminal conduct or other

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wrongful acts." *Hodgins v. Times Herald Co.*, 169 Mich. App. 245, 253–54 (1988) (internal citations omitted).

1. The False Statements in the April Article are False and Defamatory

Read as a whole, the April Article falsely implies that SCA was wrongfully involved in the pump and dump of certain penny stocks—and fined $1.5 million by FINRA for said involvement. Over and over again, the April Article falsely imputes criminal conduct and wrongdoing to SCA. Even if one concludes that each of three false statements identified in the FAC is true (which SCA strongly contests), the implications created by those statements are false and defamatory.

a. False Statement #1 is False

The headline of the April Article states: "FINRA fines Scottsdale Capital Advisors $1.5 million." This is immediately followed by **False Statement #1**: "**If you have followed penny stocks and pump and dumps for a few years then you know Scottsdale Capital Advisors**." This juxtaposition alone makes it appear that SCA was fined $1.5 million for its involvement in the pump and dump of penny stocks. *See Sanders v. Evening News Ass'n*, 313 Mich. 334, 340, (1946) ("publication is to be considered as a whole, including the character of the display of its headlines when the article is published in a newspaper, and the language employed therein.")

Defendants concede that False Statement #1 is defamatory, but try to escape liability by arguing that False Statement #1 is not false. (Motion at p. 9). Defendants' argument must fail—particularly at the pleadings stage—because False Statement #1 clearly implies something that is materially false: that SCA has been involved in "pump and dump" schemes. Nowhere in the April Article do Defendants inform their readers that SCA has never been involved in any "pump and dump" scheme, has never been a defendant in any "pump and dump" lawsuit, and has never

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been convicted of engaging in "pump and dump" activity. Given the placement of False Statement #1 under a headline regarding a $1.5 million fine by FINRA, a reader could only conclude that SCA was fined for its involvement in a pump and dump. Moreover, the April Article quotes extensively from a FINRA decision that has nothing to do with any pump and dump scheme. Consequently, the implications created by False Statement #1 are false.

b. False Statement #2 is False and Defamatory

False Statement #1 is followed immediately by **False Statement #2**: "**They [SCA] are one of the few brokers left that have continued to allow the deposit and sale of shares of illiquid penny stocks. Larger brokers and discount brokers stopped allowing that over five years ago.**" As Defendants acknowledge, context is everything, and False Statement #2 is false and defamatory when read in context.

False Statement #2 is false because numerous large brokers continue to trade in penny stocks, including without limitation, interactive brokers, Merrill Lynch, Charles Schwab, Scottrade, Cor Clearing, and TradeKing. (FAC ¶ 13). Defendants try to wiggle their way out of the statement's falsity by claiming that the deposit and sale of penny stocks is different than the "trading" of penny stocks. This is a distinction without a difference, as stocks cannot be traded if they are not deposited and sold.

False Statement #2 is clearly defamatory, because it implies that SCA is doing something that "larger brokers and discount brokers stopped allowing" five years earlier. False Statement #2 is preceded by statements that SCA was fined $1.5 million and SCA is involved in the pump and dump of penny stocks. Read in context the implication is clear: unlike larger brokers and discount brokers, SCA is engaged in the illegal pump and dump of penny stocks. Because False Statement #2 paints SCA as a pariah company, engaging in trades that other company do not

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"allow", it lowers SCA in the esteem of the community and deters people from dealing with it, and is therefore defamatory. *See Locricchio v. Evening News Ass'n,* 438 Mich. 84, 115 (1991) (a defamatory statement "tends so to harm the reputation of persons so as to lower them in the estimation of the community or to deter others from associating or dealing with them").

c. False Statement #3 is False, Defamatory, and Not Privileged

False Statement #3 states: "**When the big Biozoom (BIZM) pump happened back in 2013 many of the frozen accounts were at Scottsdale Capital.**" This statement immediately follows False Statements #1 & 2, and it reinforces everything that came before.

The April Article falsely implies that SCA was fined $1.5 million for its involvement in the pump and dump of penny stocks. Between the headline and False Statements #1 & 2, the April Article has already alleged that: (1) FINRA fined SCA $1.5 million; (2) SCA is involved in the pump and dump of penny stocks, and; (3) SCA engages in trades that other more reputable firms do not allow. False Statement #3 ties the forgoing statements together by making it appear that SCA was fined $1.5 million for the pump and dump of Biozoom stock. Indeed, the very next sentence states: "On March 31st FINRA fined Scottsdale Capital $1.5 million."

Read in context, False Statement #3 alleges that SCA did something illegal, because the Biozoom accounts at SCA were frozen and then SCA was fined $1.5 million. It is patently untrue that SCA did anything illegal with regard to the trading of Biozoom stocks. Therefore False Statement #3 is false.

False Statement #3 is also defamatory because it implies that SCA was fined $1.5 million for having accounts that traded in Biozoom. Defendants attempt to escape liability by disingenuously proclaiming that SCA is merely like a bank holding embezzled funds. (Motion at p. 12). Defendants' analogy collapses if the hypothetical bank was (1) accused of allowing

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certain types of accounts and transactions that more reputable banks do not allow, (2) if the article was headlined "Bank fined $1.5 million by FDIC," and (3) if the article stated: "if you follow embezzlement schemes, then you know this bank." In context, False Statement #3 is merely one part in Defendants' scurrilous hit piece on SCA.

Defendants' allegation that False Statement #3 is protected by the fair report privilege misses the point, because it excludes everything that comes before and after it in the April Article. Because of the false statements that precede it, and the misleading statements that follow it, the implications of False Statement #3 are materially false and defamatory. Those false and defamatory implications overcome the fair report privilege. *See Rouch v. Enquirer & News of Battle Creek*, 427 Mich. 157, 175 (1986) (the fair report privilege is a *qualified* privilege, which may be overcome by a showing of malice).

2. The FAC Sufficiently Pleads Fault

Defendants argue that the FAC does not plead facts sufficient to show that Defendants acted negligently because SCA "must plead facts as to what a reasonable reporter and publisher would have done under the circumstances." (Motion at p. 8). This standard has been constructed out of whole cloth, and Defendants do not cite any authority for the proposition that a plaintiff alleging defamation "must plead facts as to what a reasonable reporter and publisher would have done under the circumstances." Indeed, online searches of Michigan case law for the terms "reasonable reporter" and "reasonable publisher" yield no results.

Read as a whole, the FAC contains numerous facts demonstrating that the False Statements were published negligently **and** with malice.

First, as discussed herein, the April Article is a scurrilous hit piece that implies that SCA was fined for its involvement in a pump and dump of penny stocks—allegations that are

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In the Court of Appeals
For the State of Michigan

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff-Appellee,

v.

MORNINGLIGHTMOUNTAIN, LLC, and MICHAEL GOODE,

Defendants-Appellants,

–and–

DOES 1–10,

Defendants–Not Participating.

Docket No.

Kalamazoo County Circuit Court
Case No.: 18-0153-CZ
HON. ALEXANDER C. LIPSEY

APPLICATION FOR LEAVE TO PURSUE AN INTERLOCUTORY APPEAL

APPELLANT'S APPENDIX VOLUME III

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I	6a	Order Denying Mot. Summ. Dispo., First Am. Compl. (Oct. 4, 2018)
I	16a	Register of Actions
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materially false and defamatory. (FAC ¶ 21) ("The Defamatory Statements involve materially false implications.")

Second, the FAC alleges that Defendants refused to retract, correct or apologize for the False Statements even after being given notice of their falsity and ample time to do so. (FAC ¶¶ 16, 23). Consequently, the FAC contains factual allegations showing *how* Defendants knew the False Statements were false, and *why* Defendants were reckless in their disregard of the truth.

Finally, Defendants' reliance on *Rouch,* 427 Mich. 157 is misplaced, because it is based upon dicta in a concurring opinion. In order to be controlling precedent, an opinion must be concurred in by a majority of the court. *Groening v. McCambridge*, 282 Mich. 135, 140 (1937).

3. The False Statement in the June Article is False and Defamatory

False Statement #1 in the June Article states: "**Lest anyone think that these are just minor paperwork deficiencies with no real consequences, I remind you that one pump and dump alone, Biozoom (BIZM) led to over $17 million in fraudulent profits for manipulators / insiders, and many of their accounts were at Scottsdale Capital Advisors.**" Defendants argue that this False Statement has been plucked out of context, and "the Court must fairly and reasonably construe the entire article whether [the] statement is libelous." (Motion at pp. 12-13). SCA wholeheartedly agrees. When False Statement #1 is read in context, it clearly implies that SCA was involved in the pump and dump of Biozoom stock, which it was not.

The June Article begins by saying: "FINRA fined SCA $1.5 million for doing a really poor job at preventing illegal sales by penny stocks insiders." The June Article then quotes extensively from the FINRA Hearing Panel Decision ("FINRA Panel Decision") that fined SCA $1.5 million. This is followed by extensive quotes from a complaint filed by the SEC against Alpine Securities on June 5, 2017 ("SEC Complaint"). Of critical importance, *neither the*

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FINRA Panel Decision, nor the SEC Complaint, accused SCA of any wrongdoing with regard to the trading of Biozoom stock. It is for this reason that the juxtaposition of False Statement #1 with the allegations of wrongdoing by John Hurry and Alpine is so pernicious: it falsely implies that SCA was involved in the pump and dump of Biozoom stock, when SCA has never been involved in any "pump and dump" schemes (including any "pump and dumps" involving Biozoom shares), has never been a defendant in any "pump and dump" lawsuits, and has never been convicted of engaging in "pump and dump" activity.

Instead of acknowledging these truths, Defendants falsely allege that SCA "permitted fraudsters to steal almost $34 million from investors." (Motion at p. 14). Contrary to the allegations in the Motion, SCA does not have a track record—adjudicated or otherwise—of "permit[ting] fraudsters to steal" any money from investors. SCA has never "permitted fraudsters to steal" money from investors. By this accusation in the Motion, Defendants continue to disparage SCA and misrepresent that SCA was involved in the pump and dump of Biozoom stocks.

B. <u>The Complaint Sufficiently Alleges The Elements of False Light</u>

To state a claim for false light in Michigan, a plaintiff must allege: (1) publication of a false statement harmful to plaintiff's interest; (2) the intention that the publication cause harm, recognition of likely harm, or negligence to likely harm; and (3) knowledge that the statement is false or reckless disregard to its veracity. *See Kollenberg v. Ramirez*, 127 Mich. App. 345, 352 (1983); *see also Derderian v. Genesys Health Care Sys.*, 263 Mich. App. 364, 385 (2004) ("In order to maintain an action for false-light invasion of privacy, a plaintiff must show that the defendant broadcast to the public in general, or to a large number of people, information that was unreasonable and highly objectionable by attributing to the plaintiff characteristics, conduct, or

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beliefs that were false and placed the plaintiff in a false position."). All of these elements are present in the FAC.

First, the FAC alleges that Defendants published false statements that harmed SCA. Specifically, Defendants falsely published that SCA is involved in the pump and dump of stocks (FAC ¶¶ 12-15); that SCA engages in suspect trading practices eschewed by other brokers (FAC ¶¶ 12-13); that SCA's involvement in pump and dump schemes has caused harm to third parties (FAC ¶¶ 12-15).

Second, the FAC alleges that Defendants were, at a minimum, negligent to the likely harm of their false publication. (FAC ¶¶ 16, 23, 26, 30).

Third, the FAC alleges, "At the time Defendants published statements, they knew the Defamatory Statements were false and/or acted in reckless disregard as to the falsity of the publicized matter and the false light in which SCA would be placed." (FAC ¶ 30).

1. SCA May Plead A Claim For False Light

Defendants argue that SCA, as a business, is precluded from pleading a claim for false light. Defendants are, at best, confused.

First, no Michigan court has ever held that a business cannot maintain a claim for false light. Indeed, the case cited by Defendant, *Booth Newspapers, Inc. v. Kent County Treas.*, 175 Mich. App. 523 (1989) says nothing about false light.

Second, several business plaintiffs have brought cases for false light in Michigan under Michigan law. In *Thomas M. Cooley Law Sch. v. Kurzon Strauss, LLP*, 978 F. Supp. 2d 849 (W.D. Mich. 2013), *aff'd*, 759 F.3d 522 (6th Cir. 2014), a law school brought claims against a law firm and attorneys for defamation, tortious interference with business relations, breach of contract, and false light. The false light claim was dismissed because the law school was a

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public figure and unable to establish actual malice—not because it was a business asserting a right it did not have. *Id.* at 859–60. And in *Northland Wheels Roller Skating Ctr., Inc. v. Detroit Free Press, Inc.*, 213 Mich. App. 317, 330 (1995), the court dismissed the business-plaintiff's false light claim because the statements at issue were not defamatory—not because it did not have a right to bring the claim.

Third, although characterized as an invasion of privacy tort, false light is, in fact, closely related to defamation. *See Battaglieri v. Mackinac Ctr. For Pub. Policy*, 261 Mich. App. 296, 304 (2004) ("this cause of action [false light] is similar to a defamation claim"). The "gravamen of this tort [false light] is that a defendants publication attributed to the plaintiff characteristics, conduct, or beliefs that were false and placed the plaintiff in a false position." *Id.* at 303-04. As alleged in the FAC, the gravamen of SCA's claim for false light is "Defendants broadcast to the public in general, or to a large number of people, information that was unreasonable and highly objectionable by attributing to SCA characteristics and/or conduct that were false and placed SCA in a false position." (FAC ¶ 29).

Accordingly, SCA is permitted to plead a claim for false light.

2. False Light Is A Different Tort Than Public Disclosure Of Private Facts

Defendants allege that SCA must plead the disclosure of private facts to maintain a claim for false light. Defendants are wrong as a matter of law.

Public disclosure of private facts is a different tort than false light. *See Battaglieri*, 261 Mich. App. at 300 ("The common-law right of privacy is said to protect against four types of invasion of privacy. 1. Intrusion upon the plaintiff's seclusion or solitude, or into his private affairs. 2. Public disclosure of embarrassing private facts about the plaintiff. 3. Publicity which places the plaintiff in a false light in the public eye. 4. Appropriation, for the defendant's

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advantage, of the plaintiff's name or likeness."); *see also Dalley v. Dykema Gossett*, 287 Mich. App. 296, 306 (2010) ("Today, the invasion of privacy tort has evolved into four distinct tort theories: (1) the intrusion upon another's seclusion or solitude, or into another's private affairs; (2) a public disclosure of private facts about the individual; (3) publicity that places someone in a false light in the public eye; and (4) the appropriation of another's likeness for the defendant's advantage.").

Here, SCA's claim against Defendants is for false light—the third theory of invasion privacy—not public disclosure of public facts. Defendants' attempt to impose the elements of a different tort on SCA's false light claim must therefore be rejected.

3. The Defamatory Statements Are False

As discussed extensively above, the Defamatory Statements in the April and June Articles are false. Over and over again, Defendants falsely stated and/or implied that SCA is involved in the pump and dump of penny stocks, that SCA was fined for its involvement in the pump and dump of penny stocks, that SCA was involved in the pump and dump of Biozoom stocks, and that SCA is engaged in trading that "larger brokers and discount brokers stopped allowing" five years earlier. All of the foregoing statements are false.

4. The FAC Sufficiently Pleads Fault

Defendants incorrectly claim that the FAC does not sufficiently plead fault to maintain SCA's claim for false light. (Motion at pp. 15-16) As discussed above, the April Article is a scurrilous hit piece that implies SCA was fined for its involvement in a pump and dump of penny stocks—allegations that are materially false and defamatory. (FAC ¶ 21) ("The Defamatory Statements involve materially false implications.") Second, the FAC alleges that Defendants refused to retract, correct or apologize for the False Statements even after being given notice of

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their falsity and ample time to do so. (FAC ¶¶ 16, 23). Consequently, the FAC contains factual allegations showing *how* Defendants knew the False Statements were false, and *why* Defendants were reckless in their disregard of the truth.

Again, Defendants' reliance on *Rouch*, 427 Mich. 157 is misplaced, because it is based upon dicta in a concurring opinion.

C. Leave To Amend Should Be Granted If Necessary

Leave to amend a pleading "shall be freely given when justice so requires." MCR 2.118(A)(2). "Michigan's court rule regarding the amendment of pleadings provides for a liberal handling of requests to amend." *Clapham v. Yanga*, 102 Mich. App. 47, 52 (1980); *see also Hanon v. Barber*, 99 Mich. App. 851, 859 (1980) (only when amendment would be "futile, or of bad faith, or the result of undue delay or dilatory motive" should leave to amend be denied).

Should the Court determine that the current complaint is somehow lacking, SCA respectfully requests an opportunity to amend.

CONCLUSION

As demonstrated herein, the FAC alleges sufficient facts to state causes of action for Defamation and False Light against Defendants. Therefore, the Motion should be denied.

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Local Counsel for Plaintiff

Dated: August 15, 2018

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FILED
AUG 20 2018
9TH CIRCUIT COURT
COUNTY OF KALAMAZOO
KALAMAZOO, MICHIGAN

In the Kalamazoo County Circuit Court
For the State of Michigan

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff,

v.

MORNINGLIGHTMOUNTAIN, LLC, MICHAEL GOODE, and DOES 1-10,

Defendants.

Civil No. 18-0153-CZ
HON. ALEXANDER C. LIPSEY

REPLY IN SUPPORT OF DEFENDANTS' MOTION FOR SUMMARY DISPOSITION OF FIRST AMENDED COMPLAINT

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INTRODUCTION

Before Defendants reply to SCA's response, it is useful to pause and recap where we are: FINRA ruled that SCA failed to exercise reasonable controls before accepting high-risk penny stocks for deposit, which allowed fraudsters to engage in a pump-and-dump scheme using Biozoom penny stocks. The Securities and Exchange Commission sanctioned an SCA representative for his role in allowing that to happen. SCA doesn't deny any of this.

Rather than spending time and money on rehabilitating its business practices, SCA is wasting a lot of other people's time and money by bullying those who reported on its public discipline with frivolous lawsuits.[1] Its purpose is transparent: to silence critical speech and make a quick buck in the process. This is why SCA works so hard to downplay and obfuscate the heightened standard of review in First Amendment cases. It's also why SCA runs away from the exhibits in Defendants' Answer that show this lawsuit was filed in bad faith. SCA hasn't been defamed or cast in a false light. The real problem is that it has been *fairly*, *accurately*, and *publicly* rapped on the knuckles for bad business practices—and SCA doesn't like it.

The Michigan Supreme Court held in *Locricchio* v. *Evening News Association* that public interest reporting must be protected from frivolous litigation and accorded maximum protection and great latitude.[2] The Court should put an end to SCA's strategic lawsuit against public participation ("SLAPP").

LEGAL STANDARD

SCA spends a good deal of time obfuscating the standard of review so it can justify ignoring the damning exhibits attached to Defendants' Answer. It's wrong for three reasons:

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[1] *See, e.g.*, *Scottsdale Cap. Advisors Corp.* v. *S&P Global, Inc.*, Civ. No. 18-1105 (D Ariz. 2018) (suing four people; motion to dismiss pending); *Scottsdale Cap. Advisors Corp.* v. *The Deal, LLC*, 887 F.3d 17 (CA1 2018) (defamation case dismissed for lack of jurisdiction). ***SCA even sued FINRA to stop its disciplinary proceeding.*** *Scottsdale Cap. Advisors Corp.* v. *FINRA*, 844 F.3d 414 (CA4 2016) (injunctive action dismissed for lack of jurisdiction).

[2] *Locricchio* v. *Evening News Ass'n,* 438 Mich. 84, 113 (1991).

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First, Rule 2.116(G)(5) says that "only the pleadings may be considered when the motion is based on" Rule 2.116(C)(8). At the same time, Rule 2.110(A)(5) defines a pleading to include an answer to a complaint. So, the plain language of the rule says the Court may consider both the complaint and the answer.

Second, SCA says Defendants can't rely on the exhibits to their Answer, citing *Dalley* v. *Dykema Gossett*.[3] But *Dalley* merely states the well-worn rule that the court can't go beyond the pleadings when deciding a motion under Rule 2.116(C)(8): "A motion brought under [Rule 2.116](C)(8) tests the legal sufficiency of the complaint *solely on the basis of the pleadings*."[4] The Michigan Court of Appeals has unambiguously held that "[a]n exhibit attached to or referred to *in a pleading* becomes part of the pleadings *for all purposes*."[5] Thus, the Answer and its exhibits are fair game for this Motion.

Third, SCA complains that considering the Answer and its exhibits would conflict with the rule that "only" the allegations in a complaint should be deemed true and in the light most favorable to it.[6] But the word "only" never appears in the *Dalley* or *Sarkar* cases that SCA cites. Defendants agree that the Court must treat the allegations in SCA's complaint as true, *but* caselaw does *not* require the Court to treat the Answer as *untrue*. Unless the Answer denies or directly conflicts with allegations in the Complaint, the Court should: (1) accept the Answer and exhibits as true; and (2) construe them in the light most favorable to SCA, just like it would for allegations in the Complaint.

HEIGHTENED PLEADING REQUIREMENT

SCA knows it can't meet the heightened pleading standard for First Amendment cases, so it accuses Defendants of making it up. Its protestations do not withstand scrutiny.

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3 SCA's Br. at 2-3 (citing *Dalley* v. *Dykema Gosset*, 287 Mich. App. 296, 305 (2010)).

4 *Dalley*, 287 Mich. App. at 304 (emphasis added).

5 *Slater* v. *Ann Arbor Pub. Schs. Bd. of Educ.*, 250 Mich. App. 419, 427 (2002) (emphases added).

6 SCA's Br. at 3 (citing *Dalley*, 287 Mich. App. at 304–305, and *Sarkar* v. *Doe*, 318 Mich. App. 156, 178 (2016)).

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First, SCA argues *Bose Corp.* does not set is a higher pleading standard.[7] While true, it misses the point. *Bose Corp.* says courts have a heighted duty under the constitution to rigorously review the sufficiency of defamation complaints to make sure pleading requirements are met. In other words, because of the weighty constitutional interests at stake, *Bose Corp.* requires courts to sit up a little straighter and review the pleadings more closely than they would in the run-of-the-mill case.

Second, *Gonyea* recognizes a higher pleading standard for defamation cases. We are a notice-pleading state.[8] Yet a defamation claim "must be specifically pleaded."[9] Why? Because of the First Amendment interests at stake in such cases, as Justice Riley explained in his concurring opinion in *Rouch II*.[10] While SCA says Justice Riley's concurrence is non-binding, the Michigan Court of Appeals long ago adopted his analysis as its own.[11]

ARGUMENT

1. *Substantial Truth:* Invoking defamation "by implication" doesn't avoid the substantial-truth inquiry.

SCA makes a bald assertion that the false statements "involve materially false implications" without identifying the implications and pleading facts as to why the statements give rise to those implications.[12] It claims the freedom to craft those explanations on the fly in its brief.[13] Even assuming SCA could square that argument with it is strict pleading obli-

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7 SCA's Br. at 3 (citing *Bose Corp.* v. *Consumers Union*, 466 U.S. 485 (1984)).

8 *See Dalley*, 287 Mich. App. at 305 (quoting *Roberts* v. *Mecosta County Hosp.*, 470 Mich. 679, 700 n.17 (2004) (the court rules create a "notice pleading environment")).

9 *Gonyea* v. *Motor Parts Fed. Credit Union*, 192 Mich. App 74, 77 (1991).

10 *Rouch* v. *Battle Creek Enquirer* (*On Remand*) (*Rouch II*), 440 Mich. 238, 272 (1992) (Riley, J., concurring). *See also MacGriff* v. *Van Antwerp*, 327 Mich. 200, 204–205 (1950) (Butzel, J.) (specific allegations must be pleaded to avoid immunity or privilege in cases alleging defamation).

11 *See, e.g.*, *Trost* v. *Buckstop Lure Co., Inc.*, 249 Mich. App. 580, 587 n.2 (2002) (where a defamation plaintiff fails to plead his claim with specificity, the proper recourse is to move for summary disposition under Rule 2.116(C)(8), citing Justice Riley's concurrence).

12 First Am. Compl. ("FAC") ¶ 21.

13 SCA Br. at 3–4.

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gations, the substantial-truth doctrine still applies to claims of defamation by implication.[14] When concocting its storyline, SCA never explains how those "implications" withstand a plain reading of the linked FINRA records and other publicly-available information (attached to the Answer), which objectively disprove SCA's fabricated implications.

2. *No Fault:* Nothing in SCA's Response proves fault is pleaded adequately.

Defendants observed in their opening brief that defamation plaintiffs must identify the proper level of fault—either actual malice (if a public figure) or negligence (if a private figure)—and plead facts that would establish that level of fault if proved.[15]

For actual malice, SCA does not plead *how* a defendant knew the statements were false or *why* they were reckless in their alleged disregard of the truth. All it can muster is: we told them the statements were defamatory after publication, and they refused to retract the articles.[16] But fault is assessed *at the time of publication*, not at the time of a retraction demand.[17] Retraction demands are relevant only to a damages analysis.[18]

For negligence, SCA says there is no such thing as a "reasonable reporter" or "reasonable publisher" standard.[19] It missed *Michigan Microtech, Inc.* v. *Federated Publications Inc.*, which specifically mentions both the "reasonably careful publisher" and "reasonably careful journalist" standard.[20] These standards are intertwined with the "reasonable audience" standard.[21] A reasonably careful journalist and publisher can reasonably expect that those who visit goodetrades.com are sophisticated readers—*i.e.*, people familiar with the

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[14] *Collins* v. *Detroit Free Press*, 245 Mich. App. 27, ___ (2001) (citing *Hawkins* v. *Mercy Health Servs., Inc.*, 230 Mich. App. 315, 333–336 (1998); *American Transmission, Inc.* v. *Channel 7 of Detroit, Inc.*, 239 Mich. App. 695, 701–705 (2000)).

[15] Defendants' Br. at 7–8.

[16] SCA Br. at 8–9.

[17] *Peisner* v. *Detroit Free Press*, 104 Mich. App. 59, 64 (1981), *mod. on other grounds*, 421 Mich. 125 (1984).

[18] M.C.L. § 600.2911(2)(b).

[19] SCA Br. at 8.

[20] *Michigan Microtech, Inc.* v. *Federated Publ'ns Inc.*, 187 Mich. App. 178, 186 (1991).

[21] *Air Wis. Airlines Corp.* v. *Hoeper*, 571 U.S. 237, 246–251 (2014).

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microcap market. Those readers, being well versed in the industry, would conclude that SCA was the *means by which* a pump-and-dump was accomplished, not that SCA had itself engaged in illegal activity—particularly with the benefit of links to source documents.

3. *No False Light:* SCA admits its false-light claim is based on a privacy interest it doesn't have.

SCA says Defendants are "confused" about Michigan law on false light.[22] They're not. *Booth Newspapers* held that businesses have no privacy interest.[23] SCA confirms that its false-light claim is "for ... invasion [of] privacy."[24] It seems pretty clear that SCA, a corporate entity, is alleging a claim based on the invasion of a privacy interest it doesn't have.

4. *No Second Amended Complaint:* Leave to amend should not be granted unless SCA presents a meritorious basis for amendment.

After filing two complaints, SCA has still not sufficiently pleaded claims for defamation and false light. Before it gets a third bite at the apple, it should—at a minimum—be required to file a motion with a draft pleading so that the Court can evaluate whether Defendants should be forced to incur more time and expense on this SLAPP suit.

Respectfully submitted,

BUTZEL LONG, P.C.

Dated: August 17, 2018

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22 SCA Br. at 11.

23 *Booth Newspapers, Inc.* v. *Kent County Treas.*, 175 Mich. App. 523 (1989).

24 SCA Br. at 13.

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FILED
AUG 20 2018
9TH CIRCUIT COURT
COUNTY OF KALAMAZOO
KALAMAZOO, MICHIGAN

In the Kalamazoo County Circuit Court
For the State of Michigan

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff,

v.

MORNINGLIGHTMOUNTAIN, LLC, MICHAEL GOODE, and DOES 1–10,

Defendants.

Civil No. 18-0153-CZ

HON. ALEXANDER C. LIPSEY

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PROOF OF SERVICE

Michelle L. Guardiola hereby states that on August 17, 2018, she served a copy of the Reply in Support of Defendants' Motion for Summary Disposition of First Amended Complaint and this Proof of Service via Federal Express, addressed to Plaintiff's counsel at the following addresses:

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HARDER LLP Charles J. Harder (CA# 184593) Jordan D. Susman (CA# 246116) 132 South Rodeo Drive, Fourth Floor Beverly Hills, California 90212 **Federal Express** **Tracking No. 7730 0025 7168**	PINSKY, SMITH, FAYETTE & KENNEDY, LLP H. Rhett Pinsky (P18920) 146 Monroe Center St., NW, Suite 805 Grand Rapids, Michigan 49503 **Federal Express** **Tracking No. 773000274333**

I declare that under the penalty of perjury that the statements above are true to the best of my information, knowledge and belief.

BUTZEL LONG

Michelle L. Guardiola

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FILED
OCT 25 2018
9TH JUDICIAL CIRCUIT
COUNTY OF KALAMAZOO
KALAMAZOO, MICHIGAN

In the Kalamazoo County Circuit Court
For the State of Michigan

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff,

v.

MORNINGLIGHTMOUNTAIN, LLC, MICHAEL GOODE, and DOES 1-10,

Defendants.

Civil No. 18-0153-CZ
HON. ALEXANDER C. LIPSEY

DEFENDANTS' MOTION FOR RECONSIDERATION OF ORDER ON SUMMARY DISPOSITION UNDER RULE 2.116(C)(8)

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DEFENDANTS' MOTION FOR RECONSIDERATION

Under Rule 2.119(F), Defendants MorningLightMountain, LLC, and Michael Goode (jointly, "Defendants") respectfully ask the Court to reconsider its Opinion and Order partially denying their Motion for Summary Disposition under Rule 2.116(C)(8).

JURISDICTION

Motions for reconsideration must be filed within 21 days after the date stamped on the opinion. M.C.R 2.116(F)(1). The Court issued its Opinion on October 4, 2018, making any motion for reconsideration due by October 25, 2018. (Exhibit 1, Opinion.) This Motion was timely filed on October 25, 2018.

LEGAL STANDARD

Motions for reconsideration are governed by Rule 2.119(F)(3). Generally, and without restricting the Court's discretion, a motion for rehearing or reconsideration that merely presents the same issues ruled on by the court, either expressly or by reasonable implication, will not be granted. M.C.R. 2.119(F)(3). The moving party must show a palpable error by which the court and the parties have been misled and show that a different disposition of the motion must result from correction of the error. *Ibid.*

ARGUMENT

1. *Heightened Review:* The Court committed palpable error when it held there is no heightened pleading requirement in defamation cases.

The Court held that it "should not implement a higher standard as the Defendant suggests, but instead maintain a normal course of action regarding MCR 2.116(C)(8) that reviews only pleadings for legal sufficiency in light of the alleged wrongdoing." (Exhibit 1 at 5.) This is a mistake of law. Michigan caselaw imposes a heightened pleading standard for defamation claims.

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To support its holding, the Court explained that Defendants "improperly interpreted" *Bose Corp.* v. *Consumers Union*, 466 U.S. 485 (1984), and *Thomas M. Cooley Law School* v. *Doe 1*, 300 Mich. App. 245 (2013), stating that these cases pertain to public officials and public figures, whereas this is (allegedly) a private-figure case. (Exhibit 1 at 4.) But the distinction between public and private figures is irrelevant to the scrutiny that must be brought to bear when assessing whether a defamation claim is properly pleaded—the distinction goes only to *the level of fault* that applies in a given case. The heightened scrutiny of the pleadings applies to *all* defamation cases, regardless of whether the plaintiff is a public or private figure. *Rouch* v. *Enquirer & News (After Remand)* ("*Rouch II*"), 440 Mich. 238, 272–27 (1992) (Riley, J. concurring) (in a *private-figure case* reviewed on appeal from a (C)(10) ruling, Justice Riley noted that the pleadings in a defamation case are also to be reviewed with heightened scrutiny when challenged under (C)(8)). Although stated in a concurrence, "Justice Riley's position [in his concurring opinion in *Rouch II* is consistent with previous decisions of this Court." *Royal Palace Homes, Inc.* v. *Channel 7 of Detroit, Inc.*, 197 Mich. App. 48, 52–53 (1992) (also apparently a *private-figure case*). *See also Trost* v. *BuckStop Lure Co., Inc.*, 249 Mich. App. 580, 587 n.2 (2002) (observing, in a *private-figure case*, that Justice Riley outlined the proper procedure for (C)(8) challenges).

Thus, the Court made a clear error of law by ruling that it was not required to performed a heightened review of the Complaint to determine whether SCA had pleaded each element of its defamation claims.

2. *SCA's Status:* The Court committed palpable error when it reached the issue of whether SCA is a public or private figure.

When discussing the applicable standard of review, the Court added that it "should not find that the Plaintiff is a public figure, even though neither party has ar-

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gued such." (Exhibit 1 at 4.) The Court explained "[SCA] does not avail itself, intentionally or otherwise, to the public domain. By its nature of investment banking, the average population does not know the company by name and surely does not have a legitimate interest in its affairs." *Ibid.* This reasoning is flawed for five reasons:

First, this was not an issue presented in our motion, and thus beyond the scope of the Court's analysis at this juncture. The Court was limited to the pleadings when rendering its decision. M.C.R. 2.116(G)(5).

Second, SCA is a publicly regulated business subject to oversight from the U.S. Securities & Exchange Commission. The Court offers no legal support for its conclusion of law that the public has no legitimate interest in the business dealings of a publicly regulated company.

Third, the Court has overlooked controlling caselaw that says the "average population" is the wrong cohort for the analysis. As noted in Defendants' Reply, the U.S. Supreme Court has adopted a "reasonable audience" standard. *Air Wis. Airlines Corp.* v. *Hoeper*, 571 U.S. 237, 246–251 (2014). The reasonable audience in this case is not the average population. It is those who visit goodtrades.com, which reports on matters relevant to the microcap market. A reasonably careful journalist and a reasonably careful publisher can reasonably expect that those who visit goodetrades.com are sophisticated readers who are well versed in the industry and that they would conclude that SCA was the means by which illegal activity was implemented—particularly with the benefit of links to source documents.

Fourth, the Court conflates two distinct concepts: public-figure plaintiffs and cases involving matters of public concern. Defendants' Motion addressed the latter, not the former.

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A public figure "attains that status by voluntarily assuming a role of special prominence in the affairs of society, whereas a private figure has not assumed an influential role in society." *Lakeshore Cmty. Hosp., Inc.* v. *Perry*, 212 Mich. App. 396, 403 (1995). There is also the limited-purpose public figure, which is a person who places himself in "the forefront of particular public controversies." *Gertz* v. *Welch*, 418 U.S. 323, 345 (1974). To determine whether someone is a limited-purpose public figure, a "court must look to the nature and extent of the individual's participation in the controversy." *New Franklin Enters.* v. *Sabo*, 192 Mich. App. 219, 222 (1991).

Matters of public concern, on the other hand, are of "legitimate news interest; that is, a subject of general interest and of value and concern to the public at the time of publication." *City of San Diego* v. *Roe*, 543 U.S. 77, 84 (2004).

In every defamation case involving a public figure, a limited-purpose public figure, *or a matter of public concern*, actual malice is a live issue. *New York Times Co.* v. *Sullivan*, 376 U.S. 254, 281–282 (1964) (public officials); *Curtis Publ'g Co.* v. *Butts*, 38 U.S. 130 (1967) (public figures); *Dun & Bradstreet* v. *Greenmoss Builders, Inc.*, 472 U.S. 749, 763 (1985) (limiting private figures to actual damages absent actual malice).

Fifth, and finally, because Defendants moved under Rule 2.116(C)(8), holding that SCA is not a public figure arguably forecloses (impermissibly) Defendants from developing a record to prove that SCA is a general or limited-purpose public figure. While SCA may claim it is a private figure, facts adduced during discovery may prove that it has injected itself into a public controversy, which can be used on a (C)(10) motion brought after the close of discovery.

3. ***Exhibits to Defendants' Pleadings:*** **The Court erroneously held that it could not review Defendants' exhibits.**

At oral argument, the Court stated that it must look to the pleadings—both the Complaint and the Answer—and to the documents attached to those pleadings

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that are necessary to give meaning to the parties' allegations and denials. (Exhibit 2, Motion Tr. 30:3–23 (Aug. 22, 2018).) Yet, in its Opinion, the Court held "the exhibits that were introduced via the Defendants' Motion are not to be reviewed when determining the Motion." (Exhibit 1 at 5.) But the only documents attached to the Motion *are the same documents attached to the Answer.* Thus, the exhibits to Defendants' Motion *are* part of the pleadings. By its own reasoning, the Court was required to view those documents when ruling on this motion. The Court should therefore grant reconsideration of this portion of its Opinion.

4. ***Fault* and *Res Ipsa Loquitur:* The Court erred by applying the doctrine of *res ipsa loquitur*, which cannot be used to prove fault in defamation cases.**

The Court's Opinion conflates falsity and fault, which are two distinct elements that require different proofs. *See Locricchio* v. *Evening News Ass'n*, 438 Mich. 84, 117–123 (1991). Error, alone, is not negligence. Assuming *arguendo* that this is a private-figure case, Statement No. 2 must be provably false *and* Defendants must have failed to exercise the degree of care that a reasonable journalist or publisher would have under the circumstances. The Court ruled, however, that proof of falsity is *ipso facto* proof that Defendants failed to exercise the requisite standard of care: "applying the legal theory of *res ipsa loquitor*, the Defendant's statements were made about a realm that they claim to have a lot of experience in. If the statements prove to be false, then by its very nature they also meet the third element's standard that requires negligence on behalf of the wrongdoer." (Exhibit 1 at 6–7.) This reasoning incorrectly interprets and misapplies the doctrine of *res ipsa loquitur.*

Res ipsa loquitur is a principle of tort law that allows one to infer negligence from the very nature of an injury, despite the absence of direct evidence regarding how any particular person behaved. "The doctrine implies that the court does not know, *and*

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cannot find out, what actually happened in the individual case. Instead, the finding of likely negligence is derived from knowledge of the causes of the type or category of accidents involved." Restatement (Third) of Torts § 17 (2010) (emphasis added). It is applied in negligence cases where there is an injury for which there is no direct evidence that a particular individual caused it, but *the nature of the injury* is such that it *must* have been caused as a result of negligence. Hence *the thing speaks for itself.*

No Michigan court has ever applied this doctrine to a claim of defamation. Indeed, the doctrine cannot apply in defamation cases because a false statement is never automatically the result of actual malice or negligence. Even assuming *arguendo* that this is a private-figure case, at the pleading stage, SCA must plead *how* the reasonable reporter and publisher would have acted differently than Defendants did in this situation. *Rouch II*, 440 Mich. at 279 (Riley, J., concurring) ("The relatively simple requirement of pleading facts to support allegations of material falsity, *negligence, or reckless disregard for the truth* should be followed ... in defamation actions, and, pursuant to MCR 2.116(C)(8), defendant should have been entitled to summary disposition on this ground alone a decade ago." (emphasis added)). But the Complaint does not make any allegations of what a reasonable reporter or publisher would have done differently. Without that connection spelled out in the Complaint, SCA has failed to plead facts establishing *why* Defendants are at fault *if* Statement No. 2 is false. Thus, they have failed to adequately plead a required element with the required specificity as to that statement.

5. *Falsity and Defamatory Meaning:* The Court erred when it held that Statement No. 2 is "likely false and defamatory."

The Court held that Statement No. 2 is "likely" false and defamatory. (Exhibit 1 at 8.) This is erroneous for two reasons.

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First, as to falsity, the Court held: "[w]hile the Defendant[s] claim[] the statement is not false because some large brokers still trade in existing shares of penny stocks, instead of purchasing new penny stocks, this is not asserted in the statement." *Ibid.* This is a facially incorrect statement of fact. Statement No. 2 reads: "They [Plaintiff] are one of the few brokers left that have continued to allow the *deposit and* sale of shares of illiquid penny stock. Larger brokers and discount brokers stopped allowing that over five years ago." *Ibid.* (emphasis added). *Depositing* shares and *selling* shares are two different activities. As written, Statement No. 2 says few brokers still allow *both* activities. The Complaint only identifies brokers who still trade penny stocks. (Compl. ¶ 13(b).) Nowhere in the Complaint does SCA identify *any* other brokers who still accept shares for *deposit*. Thus, it has not sufficiently alleged that the statement as written—"deposit *and* sale"—is false.

Second, as to defamatory meaning, the Court held that Statement No. 2 is "inherently defamatory" by implying that SCA engages in practices not in line with others in its field. *Ibid.* But that is the language of defamation *per se*, and this is a claim for defamation *per quod*. For something to be "inherently defamatory" it must "either hold a person up to contempt, ridicule, or scorn, impute crime, impute unchastity in a woman, or impute a loathsome disease." *Bufalino* v. *Maxon Bros., Inc.*, 368 Mich. 140, 151–152 (1962). Indeed, the Michigan Supreme Court has held that saying someone is in a particular line of business is "not in and of itself defamatory," if it is a "perfectly legitimate business"—*i.e.*, a legal one. *Ibid.* Plainly, a federally regulated business is a lawful business; the Court implicitly acknowledges as much. (*See* Exhibit 1 at 8 ("This statement [about SCA's business practices] ... even if not illegal ...".)

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For these reasons, the Court committed palpable error when it ruled that SCA had adequately pleaded falsity and defamatory meaning with the specificity required for defamation actions. It should therefore reverse these rulings.

RELIEF REQUESTED

For these reasons, the Could should:

(1) HOLD that SCA's defamation claim is subject to heightened pleading requirements, even assuming *arguendo* this is a private-figure case;

(2) HOLD that the Court can review the exhibits attached to Defendants' Answer when considering a motion under MCR 2.116(C)(8);

(3) HOLD that the doctrine of *res ipsa loquitur* cannot be applied in defamation cases as a substitute for pleading fault with the required specificity;

(4) HOLD that SCA has failed to adequately plead falsity, defamatory meaning, or fault with the specificity required in defamation actions; and

(5) GRANT full summary disposition in Defendants' favor, dismissing this action in its entirety under Rule 2.116(C)(8).

Respectfully submitted,

BUTZEL LONG, P.C.

Dated: OCTOBER 25, 2018

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EXHIBIT 1

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OCT 11 2018
JOSEPH E. RICHOTTE

STATE OF MICHIGAN
IN THE CIRCUIT COURT FOR THE COUNTY OF KALAMAZOO
****

SCOTTSDALE CAPITAL ADVISORS CORPORATION

Plaintiff,

v

MORINGLIGHTMOUTAIN, LLC, MICHAEL GOODE AND DOES 1-10,

Defendants.

Circuit Court File No. 2018-0153-CZ

Hon. Alexander C. Lipsey

OPINION AND ORDER

FILED
OCT 04 2018
9TH JUDICIAL CIRCUIT
COUNTY OF KALAMAZOO
KALAMAZOO, MICHIGAN

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At a session of Court in the City and County of Kalamazoo, State of Michigan, on this 4th day of October, 2018.

PRESENT: HONORABLE ALEXANDER C. LIPSEY, Circuit Court Judge

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STATEMENT OF FACTS AND PROCEDURAL HISTORY

Scottsdale Capital Advisors, the Plaintiff, is an investment banking company that partakes in penny stock trading. Penny stocks are smaller, non-SEC regulated stocks. Scottsdale was used by certain investors to perform a pump-and-dump scheme in order to alter the current stock value for a company called Biozoom. The Defendants, MorningLightMountain, Michael Goode, and Does 1-10, report via blog and social media posts about issues facing the trading and investment world.

On April 17, 2017 and June 14, 2017, MorningLightMountain through the website GoodeTrades.com published two articles which Plaintiffs allege were defamatory. Plaintiff claims the April article contains at least three defamatory, false remarks. The Plaintiffs quote the following three:

1. "If you have followed penny stocks and pump and dumps for a few years then you know Scottsdale Capital Advisors."
2. "They [SCA] are one of the few brokers left that have continued to allow the deposit and sale of shares of illiquid penny stocks. Larger brokers and discount brokers stopped allowing that over five years ago."
3. "When the big Biozoom (BIZM) pump happened back in 2013 many of the frozen accounts were at Scottsdale Capital."

The June article contains at least one defamatory, false remark including the following:

1. "Lest anyone think that these are just minor paperwork deficiencies with no real consequences, I remind you that one pump and dump alone, Biozoom, (BIZM) led to over $17 million in fraudulent profits for manipulators / insiders, and many of accounts were at Scottsdale Capital Advisors."

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Based on these alleged defamatory remarks, Plaintiff filed a summons and complaint on April, 16, 2018 in the 9th Circuit Court of Kalamazoo County. The Defendants filed a Motion for Summary Disposition on June 7, 2018. Plaintiffs responded on August 17, 2018 and Defendants replied on August 20, 2018.

STANDARD OF REVIEW

(C)(8)

A motion for summary disposition brought pursuant to MCR 2.116(C)(8) is appropriate when the opposing party has failed to state a claim on which relief can be granted. A Motion for Summary Disposition under MCR 2.116(C)(8) tests the legal sufficiency of the complaint solely on the basis of the pleadings. *Beaudrie v Henderson*, 465 Mich 124, 129 (2001). "[A]ll well pleaded allegations are accepted as true, and construed most favorably to the non-moving party." *Wade v Dep't of Corr*, 439 Mich 158, 162-163 (1992). A mere statement of conclusions, unsupported by factual allegations, is not sufficient to state a cause of action. *ETT Ambulance Svc Corp v Rockford Ambulance, Inc*, 204 Mich App 392, 395 (1994). A motion under MCR 2.116(C)(8) may be granted only where the claims alleged are "so clearly unenforceable as a matter of law that no factual development could possibly justify recovery." *Wade* at 163.

ANALYSIS

Through the parties' filed briefs, there are three issues at bar. First, there is a question regarding the standard of review. Second, there is a question what exhibits and evidence are admissible under review of MCR 2.116(C)(8). Third, there is a question whether the initial and amended complaint (the Complaint) properly give asserted factual basis for all the elements necessary to allege a defamation case.

1. **THE STANDARD OF REVIEW IS NOT ALTERED JUST BECAUSE THE CASE AT BAR INVOLVES AN ALLEGED DEFAMATION.**

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The first issue is whether there is a heightened scrutiny when reviewing defamation cases in the scope of MCR 2.116(C)(8). Defendant, the moving party, claims that there is a heightened scrutiny when reviewing a defamation case for legal sufficiency based on its pleadings. The Plaintiff properly states that this claim is without merit. The two cases the Defendants cite to, *Bose Corp. v Consumers Union* and *Thomas M Cooley Law School v Does 1*, are improperly interpreted. 466 US 485 (1984); 300 Mich App 245 (2013). In *Bose Corp.*, the Supreme Court references decisions made in light of *New York Times Co v Sullivan*. 466 at 487-86. This case pertains to public officials. In defamation cases, most states impart a higher standard for public officials to prove "actual malice" before a proper claim can be made. *New York Times Co v Sullivan*, 376 US 254, 268 (1964).

Furthermore, the Defendant's citation of *Thomas M Cooley Law School v Does 1* also fails to appreciate the different standard between a public official or figure and a private one. The Defendant does not assert that the Plaintiff is a public official or figure, and thus by Michigan law the Plaintiff is not required to prove "actual malice" since proof or assertion of "actual malice" is reserved for defamation cases in which a public figure is the victim of the alleged defamatory remarks. *Peterfish v Frantz*, 168 Mich App 43, 52 (1988).

Further, this Court should not find that the Plaintiff is a public figure, even though neither party has argued such. A public figure is a "person who by his accomplishments, fame, or mode of living, or by adopting a calling which gives the public a legitimate interest in his act ivies, affairs, and character, has become a public personage. *Arber v Sahlin*, 382 Mich 300, n 4 (1969). Scottsdale Capital Advisors Corporation does not avail itself, intentionally or otherwise, to the public domain. By its nature of investment banking, the average population does not know the company by name and surely does not have a legitimate interest in its affairs.

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For these reasons, this Court should not implement a higher standard as the Defendant suggests, but instead maintain a normal course of action regarding MCR 2.116(C)(8) that reviews only pleadings for legal sufficiency in light of the alleged wrongdoing. At bar, only normal defamation is being asserted by a private party.

2. THE EXHIBITS AND EVIDENCE PRODUCED IN THE MOVING PARTY'S ORIGINAL BRIEF FOR SUMMARY DISPOSITION ARE NOT CONSIDERED WHEN REVIEWING WHETHER OR NOT THE ORIGINAL AND AMENDED COMPLAINT SUFFICIENTLY PLEADS A CLAIM IN WHICH RELIEF CAN BE GRANTED.

The second issue is whether the Defendants' attached exhibits to their brief for their Motion for Summary Disposition are reviewable by this Court when deciding on a Motion brought under MCR 2.116(C)(8). The Plaintiff is correct that a Motion for Summary Disposition brought under MCR 2.116(C)(8) allows for the court to review only the pleadings already on file as evidence to support the moving party's Motion. *Dalley v Dykema Gossett*, 287 Mich App 296, 305 (2010). Because of this, the exhibits that were introduced via the Defendant's Motion are not to be reviewed when determining the Motion. This Court should only review the prior pleadings, both the original and the amended complaint, and any documents that were previously, properly submitted to the Court.

3. THE ORIGINAL AND AMENDED COMPLAINT SUFFICIENTLY ASSERT AT LEAST ONE FACTUAL BASIS FOR WHICH THIS COURT CAN GRANT RELIEF THAT IS BEING REQUESTED.

For recovery under MCR 2.116(C)(8), the moving party must prove that the Complaint does not establish the elements of the alleged wrongdoing with proper, factual basis. For a party to succeed in a defamation claim, the complainant must establish and prove that there were (1) false and defamatory statements concerning the plaintiff from an (2) unprivileged communication to a third party from (3) fault amounting at least to negligence on the part of the publisher and (4)

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either actionability of the statement irrespective of the special harm or the existence of special harm caused by publication. *Mitan v Campbell*, 474 Mich 21, 25 (2005).

While the parties may disagree on the some peripheral facts outside of the pleading, the issue before this Court is whether the Complaint by the Plaintiff establishes enough asserted factual basis for the Complaint to be properly pleaded. *Harte-Hanks Communications, Inc v Connaughton*, 491 US 657, 685 (1989). In the Complaint, there are four statements made by the Defendant's publication that the Plaintiff alleges to rise to the level of defamation. Only one of the statements need to be properly pleaded for the Motion for Summary Disposition to be denied.

When analyzing each statement, the question is not whether there is enough evidence to make a legal determination as to whether the Defendant is culpable, but rather the Complaint properly asserts a legal stance in which relief can be granted by this Court. In their brief, the Defendant does not address the second and fourth elements of defamation. Instead, the Defendant claims that either the Plaintiff did not establish in their Complaint that the statements were false or defamatory and/or that the duty of care, negligence, has not been met.

The Plaintiff asserts in the Complaint that the Defendant should have known that the statements were false, or in the least acted in reckless disregard when it published the articles.[1] While this statement does not have alleged evidence to prove directly that the Defendant knew of the claim's falsity, this assertion implies a fact basis. If the Defendants were journalist that work within the realm of the investment banking, as they do, then they would likely know if the statements were intentionally false.

This argument is convincing for two reasons. First, applying the legal theory of res ipsa loquitor, the Defendant's statements were made about a realm that they claim to have a lot of

[1] Amended Complaint, ¶ 26, April 20, 2018.

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experience in. If the statements prove to be false, then by its very nature they also meet the third element's standard that requires negligence on behalf of the wrongdoer. Second, Defendants have refused to retract, correct, or apologize for the statements and thus were on notice about their potential falsity.[2] If this court deems the statements to be false, then it consequently also determines that the Defendant's actions were negligent when reporting false statements. Because of this, only the falsity or defamatory nature will need to be assessed per statement within the Complaint.

A. "If you have followed penny stocks and pump and dumps for a few years then you know Scottsdale Capital Advisors."

The first statement from the April 2017 article implies that Scottsdale is associated with pump and dump schemes. The Court is not currently worried about whether this statement is true or false, but is ONLY worried about whether the Complaint filed by the Plaintiff properly asserts a factual basis that this statement by Defendant is false or defamatory. Defendants argue that this statement is factual because the statement does not explicitly state the Plaintiffs have never been a defendant in any pump and dump lawsuit, but claim that the Plaintiffs are still associated with pump and dump schemes because of their broker-dealer status in penny stocks.

The Plaintiff asserts that this statement implies that Scottsdale Capital Advisors are conducting pump and dump schemes. The Complaint alleges that the Plaintiff has never been a defendant and has never been convicted for engaging in pump and dump schemes. This is a strong argument since the Defendant's statements are not commenting on the Plaintiff's status in legal matters, but instead stating that pump and dump activity has been associated with the Scottsdale Capital Advisors. The Complaint does not properly allege a factual basis to refute this, for this reason the Defendant is correct, the Complaint does not properly give a basis to claim the first statement is false.

[2] Amended Complaint, ¶ 23, April 20, 2018.

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B. "They [SCA] are one of the few brokers left that have continued to allow the deposit and sale of shares of illiquid penny stocks. Larger brokers and discount brokers stopped allowing that over five years ago."

The second statement pertains to the amount of brokers who still partake in transactions of illiquid penny stocks. The Complaint attempts to prove this statement's falsity by asserting many large brokers continue to trade in penny stocks. The Defendant's statement asserts that all large brokers have stopped using this penny stock method. The alleged statements made by Defendants could shed a poor light on the Plaintiff in regards to what is common practice and whether the Plaintiff is following normal standards within the practice.

While the Defendant claims the statement is not false because some large brokers still trade in existing shares of penny stocks, instead of purchasing new penny stocks, this is not asserted in the statement and the Complaint properly asserts a basis to prove that statement #2 is false. Further, the statement is inherently defamatory by implying the practices of Scottsdale Capital Advising is not in line with others in its field. This statement would likely affect the opinions of its viewers, even if not illegal, that the practices by the Plaintiff are unusual and not for the betterment of its clients. For this reason, this statement is likely false and defamatory.

C. "When the big Biozoom (BIZM) pump happened back in 2013 many of the frozen accounts were at Scottsdale Capital."

This last statement from the April 2017 article is not false nor defamatory. The assertion in the Complaint states that "only a handful of accounts at SCA were frozen as a result of Biozoom trading. The difference between "many" and "only a handful" is meritless. Further, the Complaint asserts that SCA has never been a defendant in any lawsuit involving Biozoom stock. Once again, the statement by the Defendants do not declare that the Plaintiff was involved in a Biozoom related lawsuit, and thus the Complaint does not properly assert a factual basis for the claim.

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D. "Lest anyone think that these are just minor paperwork deficiencies with no real consequences, I remind you that one pump and dump alone, Biozoom (BIZM) led to over $17 million in fraudulent profits for manipulators / insiders, and many of their accounts were at Scottsdale Capital Advisors."

The final statement comes from the June 2017 article. Defendant's statement in the June article, unlike statement #2 from the April article, does not imply any wrongdoing by Scottsdale Capital Advisors and only states that the accounts that were wrongfully partaking in the pump and dump scheme were being held through the Plaintiff. The Complaint asserts that this statement by Defendant implies the Plaintiff was handling the trading of Biozoom stock and that it was involved in lawsuits regarding the same matter.

The Complaint seems to be making assertions regarding statements that were never made. The statement from the June 2017 article by the Defendants does not claim the Plaintiff is a party to a lawsuit involving Biozoom stock nor does it state that the Plaintiff was partaking in the pump and dump scheme. The only claim is that many of the accounts that were taking part in pump and dump were held at Scottsdale Capital Advisors. For this reason, this statement is also not properly pleaded in the Complaint to assert that it is factually false.

CONCLUSION

As noted above, all of the legality hinges on the falsity or defamatory nature of each statement and whether the Complaint has properly asserted a basis on which the overall claim can stand. Statement #1, #3, and #4 are not sufficiently pleaded because the Complaint does not assert facts that prove these statements were false. However, Statement #2 likely does meet this standard. Because of this, the overall Complaint is sufficiently pleaded when viewed in light favorable to the non-moving party.

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As to Count II, Invasion of Privacy; False Light, the Court having determined that Plaintiff Corporation would have no expectation of privacy Count II fails to state a claim under MCR 2.116(C)(8).

For the reasons cited above, Defendants' Motion for Summary Disposition is **DENIED**.

IT IS SO ORDERED.

Dated: October 4, 2018

Alexander C Lipsey

Honorable Alexander C. Lipsey
Circuit Court Judge

PROOF OF MAILING

I, Denise Wilson, certify that on this date October 4, 2018 I mailed a copy of this document to the parties in interest at their above stated addresses via first-class mail and/or interoffice mail.

Denise H. Wilson

Denise H. Wilson
Judicial Aide to the Hon. Alexander C. Lipsey

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EXHIBIT 2

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STATE OF MICHIGAN

IN THE 9TH CIRCUIT COURT FOR THE COUNTY OF KALAMAZOO

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff,

v Case No.: 2018-0153-CZ

MORNINGLIGHTMOUNTAIN, LCC
MICHAEL GOODE, and DOES 1-10

Defendant.
_____/

MOTION FOR SUMMARY DISPOSITION

BEFORE THE HONORABLE ALEXANDER C. LIPSEY, CIRCUIT COURT JUDGE

Kalamazoo, Michigan - Wednesday, August 22, 2018

APPEARANCES:

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NONE	

EXHIBITS:	DESCRIPTIONS	IDENTIFIED	ADMITTED
NONE			

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Kalamazoo, Michigan

Wednesday, August 22, 2018 - 9:01:29 a.m.

THE CLERK: All rise.

Kalamazoo County 9th Circuit Court is now in session. The Honorable Alexander C. Lipsey presiding.

Please be seated.

THE COURT: Okay.

THE CLERK: Court calls the case of Scottsdale Capital versus MorningLightMountain, LLC; case number 2018-0153-CZ.

Please state your appearances for the record.

MR. RICHOTTE: Hi. Good morning, your Honor. Joe Richotte appearing on behalf of the defendant.

MR. KURTZ: Good morning, your Honor. Nicholas Kurtz on behalf of the plaintiff.

MR. GOODE: Good morning, your Honor. Michael Goode the defendant and the sole member of the corporate defendant MorningLightMountain, LLC.

THE COURT: Okay.

Good morning. You may be seated.

We are here on kind of a roundabout journey. But, we're here on a Motion for Summary Disposition under 2.116(C)(8), basically dealing with the sufficiency of the plead--pleadings allegation under C8 - alleges that there

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In the Court of Appeals
For the State of Michigan

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff-Appellee,

v.

MORNINGLIGHTMOUNTAIN, LLC, and MICHAEL GOODE,

Defendants-Appellants,

–and–

DOES 1–10,

Defendants–Not Participating.

Docket No.

Kalamazoo County Circuit Court
Case No.: 18-0153-CZ
HON. ALEXANDER C. LIPSEY

APPLICATION FOR LEAVE TO PURSUE AN INTERLOCUTORY APPEAL

APPELLANT'S APPENDIX VOLUME IV

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I	2a	Order Dismissing Second Am. Compl. (Dec. 14, 2018)
I	3a	Order Denying Mot. for Reconsideration (Oct. 25, 2018)
I	6a	Order Denying Mot. Summ. Dispo., First Am. Compl. (Oct. 4, 2018)
I	16a	Register of Actions
I	19a	Motion Hr'g Tr. (Mar. 26, 2019)
I	54a	First Am. Compl. (Apr. 20, 2018)
I–II	69a	Answer, First Am. Compl.(Jun. 7, 2018)
II	273a	Motion Summ. Dispo., First Amended Complaint (June 7, 2018)
II–III	487a	Opp'n, Mot. Summ. Dispo., First Am. Compl. (Aug. 17, 2018)
III	501a	Reply, Mot. Summ. Dispo., First Am. Compl. (Aug. 20, 2018)
III–IV	509a	Motion for Reconsideration of SDO (Oct. 25, 2018)
IV	575a	Second Am. Compl. (Oct. 26, 2018)
IV–V	585a	Answer, Second Am. Compl. (Nov. 15, 2018)
V	757a	Motion Summ. Dispo., Second Am. Compl. (Nov. 15, 2018)
V	777a	Opp'n, Mot. Summ. Dispo., Second Am Compl. (Dec. 3, 2018)
V	789a	Reply, Mot. Summ. Dispo., Second Am. Compl. (Dec. 10, 2018)
VI	799a	Third Am. Compl. (Jan. 11, 2019)
VI–XI	806a	Answer, Third Am. Compl. (Feb. 1, 2019)
XI	990a	Motion Summ. Dispo., Third Am. Compl. (Feb. 1, 2019)
XI	1022a	Opp'n, Mot. Summ. Dispo., Third Am. Compl. (Mar. 20, 2019)
XI	1035a	Reply, Mot. Summ. Dispo., Third Am. Compl. (Mar. 22, 2019)

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is no--no claim on which relief can be granted as a matter of law.

The court has had an opportunity to review the submission of the parties and, I guess, Mr. Richotee it's your motion.

MR. RICHOTTE: Thank you, your Honor.

Your Honor, since you've had an opportunity to review the submissions I'd like to spend oral argument this morning hitting some of the high points in the motion, and seeing if your Honor has any questions for me to answer.

First and foremost, I think, is the disagreement between the parties when it comes to what you can consider on a C8. As we've argued in our briefing papers, the court rule specified that you can consider the pleadings. Pleadings are defined by the court rule to include the answer.

I know there's a disagreement as to materials that are attached to the answer, but we've supplied some case law that demonstrates that you can in fact view anything that's attached to, because it becomes incorporated into the pleadings. So, just like you'd consider the articles that are attached by the plaintiff to their complaint, you can also consider the materials that are attached to our answer.

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In addition, there was a point made in the response brief that the court can only consider the allegations in the complaint. I would respectfully disagree with that.

While, I think it is somewhat unusual on a C8 motion for somebody to have entered an answer and to ask the court to consider that, I think the proper approach would be just as you would with the complaint, view any allegations in there as true, but view them in the light most favorable to the plaintiff, unless, of course, it's a straight out denial and then of course you would have to consider what the--what the complaint alleges.

Turning to the defamations count, your Honor, I think the primary issue that we have is a failure to adequately plead fault. In a defamation action there is either a negligent standard or an actual malice standard, and that depends based on First Amendment law whether you have somebody who is a private figure or a public figure.

Here Scottsdale is alleging that it is a private figure and so is trying to take advantage of the less stringent negligence standard. But, we have a disagreement as to what that standard means.

There is a reasonably careful publisher and a reasonably careful journalist standard that would apply

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here, and there's also, according to a recent Supreme Court decision, U.S. Supreme Court out of 2014, *Air Wisconsin versus Hoeper*, which we've cited in our reply; a reasonable audience standard that also informs that analysis.

So, the question becomes what would a reasonably careful journalist have done given the expected audience of readers or hearers of the statement.

Here there's no allegations in the complaint regarding what we as a publisher or as journalist should have done differently, right. If you're going to argue that a reasonably careful journalist would have done X, you have to plead what that X is and we don't have that here.

What we do have at most in their response brief is an indication that there was a retraction demand, but that retraction demand came after publication. And, the case law is pretty clear that you have to take a look at the statement and the negligence at the time of publication.

Similarly, and I think this more of a corollary, the statute indicates that retraction goes to damages, right, and not to the issue of fault.

If however, actual malice were to apply, and they do appear to plea that in the alternative, and even if they were to tell you at oral argument that they aren't really

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trying to plead actual malice in the alternative it's still relevant to the pleadings on the false like claim. Right. So, we're going to have to talk about actual malice either way.

To--to plead actual malice, you have to allege that the statement was either made knowingly false or made with a reckless disregard for the truth. Right. We have to know how we knew that this was false, or why we were reckless for allegedly disregarding it.

Again, we get back to the same issue of the retraction demand, is really the only issue that they raise, but that is a post-publication analysis that doesn't really apply.

When you talk about reckless disregard you're talking about either a high degree of awareness of the publications probable falsity, or you have to be able to prove that the defendant entertained a serious doubt as to the truth of the publication.

But, here in both articles, Judge, there is a link out to the source documents. So, the question really becomes what more could a reasonable publisher have done under those circumstances. And, certainly if we're citing to underlining litigation documents how we would have a serious doubt that those documents contained falsity or

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errors is certainly not clear from the complaint.

I would also note, Judge, that although we have investigated, even if they were to allege that there was a failure to investigate the accuracy of the information, our courts held in *Smith versus Anonymous Joint Enterprises* that a failure to investigate the accuracy of information, even if a reasonably prudent person would have done so, isn't enough to meet the reckless disregard standard. Of course, again, here we have just an indication just from links and the excessive quote--extensive quotes rather, from those underlining source documents that investigation did in fact occur.

If we get past the fault issue, Judge, which I think is primarily fatal to their claim, we're then going to get into the actual statements themselves. I know that the parties have a disagreement as to how you would read those various statement. We read them, frankly, as not false.

Anyone who has followed penny-stocks for the last few years would know about a company that was, at least, involved in the sense of providing a platform for trading that resulted in about a thirty some odd million dollar fraud that the SEC has been investigating and pursuing vigorously, as has FINRA, which is the self-regulatory

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authority for the securities market.

The second statement is that there are few brokers left who have continued to allow deposit sale of shares of illiquid penny-stocks. Larger brokers and discount brokers stopped allowing that over 5-years ago.

For that, your Honor, it's not false, because there is a distinction, although they try to say, you know, pay no attention to the man behind the curtain when it comes to the difference between the deposit and the trading of stocks.

I think the best way to consider this, Judge, is the concept of grandfathering, right. We're very familiar with that in the law. Something that was prohibited now becomes--or excuse me, was permitted becomes prohibited. You allow the person who was doing something properly to continue on until natural time would--would bring them into compliance.

We're more or less in that kind of situation here. There's no allegations in the complaint that there are any other companies that accepted a deposit of shares for trade. That's step one of the process. If you don't deposit shares as they indicate, you then can't trade them.

These other companies that are identified in the complaint as doing the training, certainly, we'll accept

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that true for purposes of C8; that's their allegation we have to accept it as true. But, there's a difference between those companies allowing shares that are already in the market place that continue to be traded versus bringing new shares in.

Now, it may it be that they'll stand up here and say, Judge, of course, there are other companies that do that, but, that's not pleaded in the complaint. Certainly, since they're making such a big deal of the fact that this apparently niche market carries with it some stigma, then I think it's on them when it comes to the pleading to establish those underlining facts to support their claim.

But, beyond that it's not defamatory for that simple purpose that identifying somebody as working in a niche market is not itself defamatory.

The third statement in the April article is that when the big Biozoom pump happened back in 2013 many of the frozen accounts were at Scottsdale. What we have here is a disagreement in terminology. Right.

Their view of the world is of all of the accounts that we have this is a fraction of the business. Fair enough, but that's not what we alleged. Right.

The articles statement is that many of the accounts involved in that scheme were seized and frozen at

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Scottsdale. I don't think there's any disagreement that that is literally true.

Then they go on to say that Scottsdale has never been a defendant in any lawsuit involving the trading of Biozoom stock. Again, that may very well be, but that's not what the statement says. So, if we're here on an allegation of falsity there's going to have to be some indication that they were--or excuse me, that the statement itself indicated that they were a defendant.

We don't believe that it's defamatory as well, because the fact, again, that something was frozen in the ordinary course of business is not in and of itself defamatory.

Then finally, we have the privilege statement issue. We have the fair-report privilege by statute. I would note, your Honor, that there is going to be some disagreement between the parties on this because they view the fair-report privilege as a qualified privilege and they cite the *Rouch* decision in their response.

I took a look at *Rouch* last night as we were preparing for this morning, and there's act--it's interesting. If you read the opinion there's actually two sections in the *Rouch* opinion - one that discusses the fair-report privilege and one that discusses the common law

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of public interest privilege.

The page that they cite to is actually to the common law qualified public interest privilege; not to the fair-report privilege that we're relying on.

I think when we're talking about the statutory fair-report privilege, the only sense in which it can be qualified is that you have to actually meet the predicate, right, that it is a report on a public proceeding.

Once you get to that point, the question is, is it fair and true, right, which is really just another falsity analysis that we've already just discussed. So, I don't think that there's any dispute, or at least there should be, that the fair-report privilege would certainly immunize that third statement.

Then we move to the June article where there is a reminder that the Biozoom fraud cost 17 million dollars in profits to manipulators and insiders with many of those accounts at Scottsdale.

If you go through the June article you'll see that it's much longer. It contains many more excerpts from the underlining FINRA opinion. We're talking 111 pages that FINRA goes through and details what went wrong at Scottsdale. Right. There's no accusation, contrary to what I suspect you'll hear in oral argument, that we've

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accused Scottsdale of being involved or being part of or a mastermind or anything like that with respect to the pump-and-dump scheme.

But, what we're saying is, FINRA has identified you as having lacks internal controls, and those lacks internal controls allow somebody to commit a fraud through you. Not that you did anything intentionally, but your failure to do your job on the regulatory side is what caused or at least allowed for this fraud to move forward.

So, I think that's a fairly important fact that shouldn't get lost in the--the details of this morning's argument.

The very last issue here, Judge, relates to the False Light complaint. Of everything else that's in our papers, I want to focus this morning only on the fact that *Booth Newspapers* specifies that there is no privacy interest for a corporation.

The response to that is, well nobody has said that a corporation can't bring a False Light claim; that may or may not be true. But, what they tell you later on in their brief is that invasion of privacy is now delineated in four or five different torts.

What that really means is that there's four or five different ways to end a privacy. So, the question is

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do you have an underlining privacy interest that can be protected in that space. The answer is no. Under *Booth Newspapers* it's very clear there's no privacy interest, which reminds me of the old Latin phrase we all learned in law school, right, nemo dat quod non habet - you can't get what you don't have. The corollary being nobody can take from you what you don't have. I can't invade a privacy interest if you don't have one.

So, for that reason we would ask that the False Light count be dismissed, and we do believe that it would be appropriate for the court to dismiss this with prejudice. But, certainly if the court is inclined to give them a third opportunity to plead that they should have to do that by motion so that we can all talk about whether they have met the standard before we have to incur additional time on this file.

Thank you, your Honor, unless you have any questions.

THE COURT: Nope. You covered each of the points. I'll hear what Mr. Kurtz has to say. I'll probably have some questions after that.

So, you may proceed.

MR. KURTZ: Thank you, your Honor.

I may go a little bit in reverse or easiest to

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first.

I just want to point out some--some issues. On the leave to amend issue, I would respectfully disagree that this would not be third bite at the apple if your Honor believes that the complaint does not have sufficient allegations. This is the first amended complaint, but the only allegation that was changed was the location of the defendants. So--so, to suggest a third bite at the apple really isn't fair.

So, again, if your Honor feels that the--the allegations are not sufficient, I believe there are additional allegations that can be alleged, obviously, depending on your Honor's ruling.

First, on the procedural aspect of can we consider these exhibits to an answer. Your Honor's practiced longer than I have. I've only been around, you know, 13-years or so. I've never seen it done. That doesn't mean it can't be done.

But, in--in the legal authority cited every case that's cited by them and even us in considering documents attached to pleadings - the only case as cited show it as a complaint, which makes sense. Because, if the defendants are challenging the sufficiency of a complaint that may only partially refer to documents then the court needs to

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see the document sin whole.

Just like here - if they're challenging that the statement alleged to be defamatory must be read in context then it makes sense. The judge--the court needs to see the entire article.

So, that's just from a common sense practical aspect, otherwise this would be a total end-run around this initial challenge to the pleadings procedure, and you could literally file an answer that basically says whatever you want it to say, attach whatever documents you want and then tell the court - well, you have to assume these are true. You know, as a practical matter it doesn't make sense.

On the--the legal aspect of it, I will point out that MCR 2.13(F) in relation to this issue says that documents attached to the pleadings may be accepted. It refers specifically to written instruments and the cases have interpreted that as, you know, legally binding documents that show an obligation such as a contracted deed, a trust document - some of those things.

I have a couple cases--obviously, these--this was brought up in a reply. I can cite them to you if you want, but I think it's, you know, it's well-laid out in the rule and in the cases that interpreted that, your Honor, should consider really only the pleadings and what is necessary to

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interpret the allegations of the complaint.

Addressing some of counsel's other comments. The standards on fault. I think what is being overlooked here is the allegations of intent where we did allege allegations of malice. You know, from a--from a big picture standpoint this gets into the next issue of falsity and--and whether the statements are defamatory.

As alleged, and from a big picture scenario, what we are alleging is that the defendants acted in a smear campaign to defame my client. Now, within that was this intentional use of juxtaposition and statements created by themselves to infuse these implications into otherwise public facts or public documents.

So, they're kind of a corollary and I'll just point out that, you know, obviously in defamation cases in a lot of tort cases things like intent, malice have to be proved by circumstantial evidence, because the wrong-doers they simply don't stand up and say, you got me, I did it - I'm a bad person. I mean, that's just--that's what happens.

So, it has to be proven through these underlining issues. So, when counsel says, well you shouldn't look at the failure to retract after give--being given notice of the falsity and whey some of the statements are wrong. You

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should only look at that for damages or it shouldn't be considered in--in this intent scenario, because it was after the publication. I don't think that's completely true, because, again, you have to look at the whole picture of what was going on.

Obviously, the intent at the time of publication is important, but this other circumstantial evidence goes on to prove that. The fact that somebody, we're alleging, publishes a lie, is presented with the true, and continues to maintain the lie, I think is relevant to show that intent or malice.

On the--the issue of falsity and whether the statements are defamatory, which I think is really intertwined here. As we point out, and as counsel even referred, this is really something where I think we're both reasonable people. There's a difference of opinion. I think reasonable readers would have a difference of opinion, and this is where there's a question for the jury.

As we point out, our focus and our response is really, and I'll get into it a little more, this kind of implication. So, they don't come out and just say, Scottsdale Crap--Scottsdale Capital are crooks. You know, they just don't come out and say it. It's this kind of innuendo, this implication by piecing together certain

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things that when taken together simply are not true.

So, you have to look at the--the whole article or both of the articles and say what would a reasonable reader really interpret that as meaning. And, if we're having this reasonable debate any common juror is going to have that. So, I think this is truly an issue that can't be decided as a matter of law.

Getting into the specifics, and again, this kind of implication/justification--or juxtaposition, your Honor, may or may not be familiar with, you know, what was commonly referred to these days as "click-bait". I think this is one kind of form of that, which is you create a headline. You create a slogan. You create some kind of issue that's sexy, that drives people to your site. They want to click on the link to get to your article. That's what happened here.

The headlines, the first couple statements, especially in the first article all have different--different points to make, but they present this big picture that supposed to look sexy so that you come and read the article. That is Scottsdale Capital - they've been fined a million and a half dollar. Scottsdale Capital they're involved in pump-and-dump schemes. Scottsdale Capital they're not like everybody else - no one else does this

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stuff - they're--they're doing shady--shady business.

So, when taken into the context--and that's at the beginning, your Honor, and that's all linked at the beginning. That's--that's the "click-bait. That's what's created by defendants. This isn't what counsel was referring to as the FINRA or the SEC articles or statement. This is not any of that. This is specifically created verbiage by the defendant to get you to come to their site.

So, that's also in line with the intent, but also here the juxtaposition and the imposition.

So, if we look at it clear--and the--you know, this goes back to the--to the reasonable debate. Said in isolation, as counsel's pulled out some of these statement that says - well, this context of the statement is not true. He's forgotten that their own argument initially was, well everything needs to be read in context.

So, when we read it in context the fine against Scottsdale Capital has nothing to do with them being involved in a pump-and-dump scheme. But, that's the headline - Scottsdale Capital fined 1.5 million. The very next sentence, if you know pump-and-dump schemes you know Scottsdale Capital.

So, any logical person is going to read those combined and say, well they got fined a million and a half

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dollars for pumping and dumping. That's categorically not true, and I don't think defendants are going to say that that's true. They're just going to say, well each sentence on its own is true. You know, Scottsdale Capital did get fine a million and a half dollars. That's true.

Well, your Honor, come on let's--let's be realistic here. So, I'm kind of beating a dead horse, but it's, you know, obviously, is--as a--an attorney that has spent a lot of work in defamation law and, you know, honestly plaintiff's work. Maybe I'm a little bias.

But, you know, this is--this is something I've seen throughout my years of practice where--when alleged--when defendants have alleged defamation come--come up and say, well it's--it's partially true. I'm giving you some of the--I've giving you the SEC reporter. I'm giving you a link to go look at the documents.

Well, they're not, you know, they're not giving you the whole story because they're creating this "click-bait". They're creating this tag-line. They're creating this slogan to get people to their site and drive in business and then say, well for the real story go somewhere else. I got you here. I'm driving up my numbers. I'm getting advertising revenue. But, if you want the truth, ah go somewhere else. For me that's--that's all

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intertwined in this falsity defamation and intent.

The last--counsel brought up an issue about the fair-report privilege. I'll just add on a procedural statement, they only argue it applies to one statement so it wouldn't knock out the complaint. From a bigger standpoint, I think it's commonly held that First Amendment privileges, whether statutory or not, are all under the backdrop of being a qualified privilege, because First Amendment defenses in general can always be overcome by showing of malice. So, the fair-report privilege, along the lines of the First Amendment, I don't see why it would be any different in this scenario.

So, if your Honor has any questions I'd be happy to--to field them.

THE COURT: Okay.

I don't have any--don't have any questions for today. There are a lot of issues that, depending on my ruling, may weight a later time. But, for today I'm satisfied.

MR. RICHOTTE: I appreciate that, your Honor, and--

THE COURT: Thank you.

MR. RICHOTTE: --thank you so much for your time.

THE COURT: Yep.

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MR. KURTZ: Your Honor, I'm not sure if you're contemplating a brief reply.

THE COURT: You may.

MR. KURTZ: Thank you--

THE COURT: Go ahead.

MR. KURTZ: --your Honor.

Your Honor, I will--I know I promised earlier I would hit the highpoints and then ended up taking a little longer. I--I do plan on only hitting a few highpoints on--on counsel's argument.

With respect to fault. The suggestion that there are allegations of malice in the complaint, I think, don't bear scrutiny if you actually read through the complaint. They alleged that it's an intentional smear campaign and they do allege in a very generic, unsupported way these facts lead to an implication.

What they don't allege in the complaint is what that implication is. We're hearing a lot about it in the briefing, but you don't get to manufacture those implications on the fly to respond to counsel's argument. You have to put them in--into the document themselves.

Counsel also indicates that you typically prove malice by circumstantial evidence, and that's certainly true. I do a lot of criminal defense work and that's how

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prosecutors have to prove their cases in 99-percent of the world.

But, you still have to from a pleading standpoint allege what the facts are that would support that allegation of malice. So, when we get a retraction demand that says, these things aren't true - well, that's just them saying it's not true. It doesn't tell us why they think that it's untrue. I think we're left with, when it comes to falsity, and I'll segue into that, yes we're certainly going to tell you if a particular isn't false, right. Headline - FINRA fines Scottsdale Capital 1.5 million dollars. That's alleged as "click-bait" and yet it's true. Right. There's no question that you can go to a public record and FINRA has fined them 1.5 million dollars.

They keep saying that the articles alleged they were involved, and I emphasize that word "involved" in a pump-and-dump scheme. That's not what we say. What we say is, if you've followed pump-and-dump schemes then you're familiar with this entity. Why? Because, they happen to have lacks controls that have resulted in fraudulent activity being conducted through their platform. Right. That's the essence of FINRA allegations.

So, they want to talk about context and they say,

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we suspect that counsel is going to get up here and forget that he made the argument early about having to consider the totality of the article. Well, you do have to consider the totality of the article, and that includes 111-page opinion that says, Scottsdale you did this wrong. The people at your company were asleep at the switch.

And, if you dig into that 111-pages, Judge, and I--I know you probably don't want too. But, if you--if you dig into it what you will see is allegations that Scottsdale principal John Hur--yeah, John Hurry was essentially ex-communicated from the securities market because of his absolute refusal to acknowledge any wrongdoing, and lies that he reportedly told the FINRA.

Now, I'm sure that there's a disagreement from Mr. Hurry as to whether he lied to FINRA. That's FINRA's finding and I get that. But, that is the context for this article, right. It's that you have a company that has not done its job. It has been fined and here's links out to those underlining articles. So, it's not so much "click-bait" as it's a portal to explain to people.

This isn't something that you're going to necessarily find if you just run a Google search for Scottsdale Capital. But, if you come to Good Trades, which is an online platform that does a lot of news on the penny-

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stock market, right. This is something that's relevant in that market.

And--you know, so when you look at this in--in totality, we can't forget why they were fined 1.5 million. I think that's the point that plaintiffs want to gloss over. I think if you--if you keep in mind the why, you get to this is not a materially false statement.

Very last statement, Judge, is I'm privilege--counsel said that, you know, well First Amendment privileges are qualified. I don't know that I would make that broad of generalization, but if we assume, even just for argument sake, that that were true this is a statutory privilege. We're not alleging when it comes to that privilege that it's based on the First Amendment.

It may have its origins in the First Amendment in the sense that the legislature is looking to protect free speech. But, the legislature is certainly free to bestow an unqualified privilege so long as you fit within its parameters, and that's what we alleged that we do here. So, I would--I would just urge the court to keep that distinction in mind as it considers the privilege analysis.

Thank you, your Honor.

THE COURT: Thank you.

This matter is before the court on a Motion for

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Summary Disposition filed by defendant MorningLightMoutain, LLC, Michael Goode and DOES 1-10.

Under 2.116(C)(8), as the court has indicated C8 motions require the court to look at the pleadings and determine if on C8 motions if the complaint states any cause of action that can be granted relief by the court.

It's designed to establish whether in fact there's a cognoscible legal issue that's being present, as opposed to C10s, which relate to whether there's material facts in dispute requiring a trier of fact to resolve it, or any of the other sections of 2.116(C); statute of limitations, matter having already been adjudicated, etcetera.

In essence, this is, as parties have indicated, this is a defamation action filed by the plaintiff based upon two major--two articles; one on April 17 of 2017, and June 14 of 2017, which MorningLightMoutain on its website published two articles that plaintiff alleges were defamatory.

The April article is alleged to contain three--at least three defamatory or false remarks; specifically, quote, "if you have followed penny-stocks and pump-and-dumps for a few years and you know the Scottsdale Cap advisors". Second was, "they, Scottsdale are one of the

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few holders left that continue--have continued to allow deposit and sale of shares of illiquid penny-stocks. Larger brokers and discount brokers stopped allowing that over 5-years ago." Third, alleged in--item was, "when the big Biozoom pump happened back in 2013 many of the frozen accounts were at Scottsdale."

The June article there's alleged one defamatory or false remark, which was, quote, "lest anyone think that these are just minor paperwork deficiencies with no real consequences, I remind you that one pump-and-dump along, Biozoom led to over 17 million dollars in fraudulent profits for manipulators/insiders, and many of those accounts were at Scottsdale Capital Advisors."

Based upon those alleged defamatory statements plaintiff filed a complaint April 16 of this year. That complaint--the parties actually move these proceedings to federal court, which then by agreement of the parties ended up moving back here with the result in a Motion for Summary Disposition file on June 7 of this year; response filed by plaintiffs on August 17 and a reply to that response filed by the defendants on August 20.

It appears that there are three issues that the parties have argued. First of all, is the question of the standard of review. Second, there's a question of what

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exhibits are admissible under C8 motions. And, third, whether there was--the initial and amendments complaint properly give asserted factual basis for the elements necessary to allege a defamation case.

The question of heightened scrutiny, I believe, while in some ways tempting to side with--with defendants based upon the Bose Corporation and the Thomas Cooley School, the court is not persuaded that simply because the, you know, in this case Scottsdale is a commercial entity that it in fact fits within the standards required to assert that they are a public official, we'll call it the entity that is subject to the higher scrutiny of actual malice as opposed to, quote/unquote, "negligence" defamation.

In fact that were the case, quite frankly, any public entity, any business, would be subject to that heighten scrutiny for any defamation action they chose to file in court. And, I don't believe that the case law or the intent of the legal process is that all commercial entities have to attain that particular standard.

That may ultimately be the direction the process goes, but from our court's perspective I am not willing to extend that further standard of actual malice to this case. Although, as parties have alleged or have argued today

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there is at least whiffs of claims of actual malice throughout this particular process.

This court also in one sense believes that looking at C8 motions, they do require that the court not only look at the allegations, but those attachments that give meaning to the allegations, as opposed to necessarily substantive support, if you will, of the allegations, which I characterize as being more in the line of possible C10 motions at a later time.

The allegations of defamation should in and of themselves establish that there is or is not negligence and should or should not have those specifically set forth in the complaint, and theoretically the--the answer to the complaint such that someone reading those two documents understand at least what the--what the case is about, what the specifics of wrongdoing are alleged in the complaint, and what denies, if any, exist with regard to the answer.

In that regard, I think that the court is bound to look at the actual pleading documents, and only those items that are attached that in fact are necessary to give meaning to the actual allegations and denials that occur within those pleading documents.

At this point, the court is going to address the case with that narrow focus; that narrow reference.

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Looking then at the basics. In order to establish a defamation action, the complainant must establish and the ultimately it must be proof that there were false or defamatory statements concerning the plaintiff. That there was an unprivileged communication to a third party, in this case would be to the public. And, that false amounting to at least negligence on the part of the publisher and actual--and actionability of the statement with respective to the special harm or existence of a special harm caused by the publication. That cites to the *Mitan versus Campbell* case, 476--474 Mich 21.

While the parties may disagree as to some of the peripheral facts outside the pleadings, the issue before the court is whether--by the plaintiff established enough asserted factual basis for the complaint to be properly indicated as pleaded.

Those four statements made by the defendant's publication that plaintiff alleges arises to a level of defamation each can be examined individually. I would simply say that in order for the, quote/unquote, "complaint" to survive just one of them needs to be property pled in order to go forward.

The court notes that defendant has provided the court with the option of--of dismissing the complaint

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without prejudice to the plaintiff refiling once a--and these are not the words of the defendant, but basically once they get their complaint in order. I'll leave it to the ultimate decision in this matter as to whether that avenue needs to be taken.

As you look at each of the--the particular statements, the questions is not whether there's enough evidence to make a legal determination as to whether the defendant is in fact culpable, but rather whether the complaint property asserts a legal stance, which relief can in face be granted by this court.

I would note that in their brief the defendant does not address the second or fourth element of defamation. Instead, they--the claims of either plaintiffs that do not establish a complaint such as the statements were false or defamatory, and that there was a duty of care and negligence have not been met. That was the primary focus.

Plaintiff asserts that the complaint--in the complaint that defendant should have known that the statements were false or at least acted in reckless disregards when it--when it issued the public articles--or published the articles. This statement does not have alleged evidence to prove directly the defendant knew of

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the claims falsity. This certain--assertion is based and applies bias.

If the defendant were journalist that worked within the realm of investigative--investment banking as defendant do, they would likely know the statements were intentionally false. That's, I think a little bit of a stretch given the fact that these rely on, I guess, source information, which would at least lead to statements that would direct a reader to any further inquiry if they in fact desired.

I had some concerns with regard to the question of misleading as opposed to false, which goes, I guess, to the bottom line or early assertions of whether something is--is a false statement or is--in the old terms mere puffery and that the courts have long recognized did not rise to a level of defamation.

But, in this particular case, I think that with at least regard to some of the statements, I--I don't need to go down that particular path.

First statement - "if you have followed penny-stocks and pump-and-dumps for a few years then you know Scottsdale Capital Advisors." That does imply that Scottsdale is associated with pump-and-dumps schemes. However, I'm not worried at this point about whether that

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statement's true or false, but only whether the complaint filed by the plaintiff property asserts a factual basis that the statement by the defense--defendant is false or defamatory.

Defendants argue the statement is factual, because the statement does not explicitly state plaintiffs have--the plaintiffs have never been a defendant in a pump-and-dump lawsuit. But, the claim by the plaintiff is still--are still associate with pump-and-dump schemes, because of their broker/dealer status with regard to penny-stocks.

The plaintiff asserts that this statement implies that Scottsdale Capital advertisement--advertiser--advisors are--are conducting pump-and-dump schemes. And, the complaint alleges that the plaintiff has never been a defendant, has never been convicted for engaged in pump-and-dump schemes, and this clearly is a strong argument since the defendant's statement--statements are not commenting--commenting on the plaintiff's status in legal matters, but instead stating that pump-and-dump activities have been associated with Scottsdale Capital Advisors.

In that context, I do not believe that the complaint states a factual basis to establish a defamatory action.

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As to the second matter - that's SCA is one of the few brokers left that have continued to allow the deposit and sale of shares of illiquid penny-stocks. Larger brokers and discount brokers stopped allowing that over 5-years ago. This basically indicates who still participates in the transactions.

Plaintiff's complaint attempts to prove the statements falsity by asserting that many large broke-- brokers continue to trade in penny-stocks. Defendant's statements assert that all large broker--brokers have stopped using this penny-stock method. The implication that defendant makes--that defendant makes sheds poor light on the defendant (sic) in regards to what is common practice and whether the plaintiff is following normal standards of practice.

While the defendant claims the statement is not false, because some large brokers still trade in existing shares of penny-stocks instead of purchasing new penny-stocks. This is not asserted in the statement and the complaint properly asserts that--on the basis to prove that statement number two, again, isn't false--is false.

Further, the statement is inherently defamatory when applying the practices of Scottsdale Capital is not in line with the others in the field. This statement would

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likely affect the opinion of its viewers even if not illegal. That the practices of the plaintiff are unusual and not for the (inaudible) of its client. Therefore, if proved this could be false and/or defamatory.

As to statement three, that Biozoom happened back in 2013 and that many of the frozen accounts were at Scottsdale. The last--this last statement on April 2017 article is not false or defamatory. Assertion that the complaint states that only a handful of accounts at SCA were frozen as a result of Biozoom trading. The difference, however, between many and only a handful, I think is meritless.

Further, the complaint asserts that SCA has never been a defendant in a lawsuit involving Biozoom stock. Once again that statement the defendant did not declare that plaintiff was involved in the Biozoom related lawsuit, and thus the complaint clearly does not establish a factual basis to allege defamation with regard to that particular claim.

Finally, the lest anyone think - the June 2017 article, "lest anyone think that there are--that these are just minor paperwork deficiencies with no real consequences, I remind you that one pump-and-dump alone, Biozoom, led to over $17 million dollars in fraudulent

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profits for manipulators/insiders, and many of their accounts were at Scottsdale Capital Advisors", closed quote.

That does not imply any wrongdoing on the part of Scottsdale. It only states that the accounts that were wrongfully partaking in the pump-and-dump schemes were being through the plaintiff. The complaint asserts that this statement by the defendant implies that defendant (sic) was handing--handling the trading of Biozoom stock that was involved in lawsuits regarding the same matter.

However, the claim--this complaint seems--making assertions regarding statements that were in fact never made. The statement in the June 2017 article by the defendant does not claim that plaintiff was a party to the lawsuit involving Biozoom, nor does it state that the plaintiff was partic--partaking in the pump-and-dump scheme. The only claim is that many of the accounts that were taking part in this pump-and-dump scheme were held at Scottsdale Capital Advisors.

Based on that, the court does not believe that claim is properly plead in the complaint.

Looking at this as whole, I am not going to dismiss the case under 2.116(C)(8).

However, I would note that statements one, three

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and four have not been sufficiently plead to form a basis for an action in this case.

Number two, at least meets the standard of possibility of a cause of action.

Therefore, the complaint is not dismissed at this particular point. However, I do believe that unless there is an amendment as to ones--statements one, three and four that those alleged allegations are not sufficient under C8 to go forward and that they will not be allowed to go forward on that basis.

Ultimately, I guess, that means plaintiff has, at least opportunity, if they believe they have something that will in fact provide a factual basis, at least allegations, as to one, three and four - they may choose to amend. Otherwise, we will simply go forward on Count--on the statement number two with regard to any further litigation in this matter.

Mr--I guess, Mr. Richotte--

MR. RICHOTTE: Yes.

THE COURT: --if you could prepare the order on this.

MR. RICHOTTE: Your Honor, I'd be happy to do that.

If I can also ask if the court has a ruling today

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on the False Light count?

THE COURT: Yes.

On the False Light count, I believe that--. Well, my ruling would be that the False Light count is not viable under C8. In essence, for the reasons argued by the defendant; mainly that this is no expectation privacy in-- in a corporation. This is certainly a public corporation.

MR. RICHOTTE: I will be happy to prepare that order and work opposing counsel to get that submitted to your Honor.

THE COURT: Thank you.

MR. RICHOTTE: If I may have just a moment to confer?

THE COURT: You may.

MR. RICHOTTE: I may have one question for the court after this.

THE COURT: Sure.

(At 9:58:21 a.m., sidebar conversation between Attorney Richotte and Michael Goode)

MR. RICHOTTE: Thank you, your Honor. It turns out I don't have an additional question.

THE COURT: That's fine.

MR. KURTZ: Your Honor, if I may pose some logistical question--

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THE COURT: Yes.

MR. KURTZ: --if you'll entertain those.

My interpretation is if we want to amend on those other statements we can. Do we want to send some kind of deadline or--or have that--

THE COURT: Yeah.

MR. KURTZ: --as part of the order as well?

THE COURT: I--I think--yeah, I think that probably makes some sense.

I--I--. Well, yeah, we getting--we getting the end of vacation seasons.

So, we'll do 14-days to amend, and then if you do amend the defendant has, under the rules, a period of time to respond--to file an answer.

MR. KURTZ: And, to be somewhat (inaudible) it sounds like you had to prepare a written something--

THE COURT: Something--something written--

MR. KURTZ: --or--

THE COURT: --I will--. What I can do is--I can whip this up. Technically, as this is a business court case you're entitled to have a document prepared and I will so prepare it and issue that opinion.

MR. KURTZ: I--I really appreciate that, because we didn't have the forethought of having a court recorder

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and my note taking is not the best.

THE COURT: No, that's fine. That's fine.

I mean, technically it is recorded, but by the same token that doesn't really give you a whole flavor in my--my transcriptionist regularly admonishes me that I mumble too much, so a written document probably is a better one for you anyway.

MR. KURTZ: Fair enough.

And, do we want to--. I'm a logistical guy.

THE COURT: Sure.

MR. KURTZ: Do we want to do a time frame on the--doing the order?

MR. RICHOTTE: Sure.

Your Honor, perhaps if you're going to issue the opinion does it make sense for the court to issue or you still want us to have a separate order to that effect?

THE COURT: I think a--I think a separate order just from the standpoint of you guys indicating what it is that you understand in terms of direct.

I will--I will issue the opinion and then give you, I think, a week to fashion the order after you get the opinion.

MR. KURTZ: Really appreciate it, your Honor. That works nicely.

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THE COURT: Okay.

We'll do that. I'll make a note to myself before I forget.

MR. RICHOTTE: Any other logistics?

MR. KURTZ: I'm done.

MR. RICHOTTE: No. No. That's all right. I just wanted to make sure we--we got everything covered. All right.

THE COURT: Okay.

MR. RICHOTTE: Your Honor, we'll wait for the opinion--

THE COURT: Yep.

MR. RICHOTTE: --and then get crafting an order after that.

THE COURT: Okay.

No problem. Court will stand in recess.

MR. KURTZ: Thank you.

MR. RICHOTTE: Thank you.

(At 10:02:18 a.m., proceedings concluded)

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STATE OF MICHIGAN)
)
COUNTY OF KALAMAZOO)

I certify that this transcript consisting of 43 pages, is a complete, true, and correct transcript of the MOTION FOR SUMMARY DISPOSITION to the best of my ability, of the proceedings held in this case on Wednesday, August 22, 2018, before the Honorable Alexander C. Lipsey.

October 17, 2018

Date

Rebecca Abbs-Kucks CER #7921
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In the Kalamazoo County Circuit Court
For the State of Michigan

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff,

v.

MORNINGLIGHTMOUNTAIN, LLC, MICHAEL GOODE, and DOES 1–10,

Defendants.

Civil No. 18-0153-CZ

HON. ALEXANDER C. LIPSEY

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PROOF OF SERVICE

Michelle L. Guardiola hereby states that on August 17, 2018, she served a copy of the Defendants' Motion for Reconsideration of Order on Summary Disposition Under Rule 2.116(C)(8) and this Proof of Service via Federal Express, addressed to Plaintiff's counsel at the following addresses:

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HARDER LLP Charles J. Harder (CA# 184593) Jordan D. Susman (CA# 246116) 132 South Rodeo Drive, Fourth Floor Beverly Hills, California 90212	PINSKY, SMITH, FAYETTE & KENNEDY, LLP H. Rhett Pinsky (P18920) 146 Monroe Center St., NW, Suite 805 Grand Rapids, Michigan 49503

I declare that under the penalty of perjury that the statements above are true to the best of my information, knowledge and belief.

BUTZEL LONG

Michelle L. Guardiola

MICHELLE L. GUARDIOLA

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STATE OF MICHIGAN
IN THE CIRCUIT COURT FOR THE COUNTY OF KALAMAZOO

SCOTTSDALE CAPITAL ADVISORS CORP., an Arizona corporation,

Plaintiff,

v.

MORNINGLIGHTMOUNTAIN, LLC, a Michigan limited liability company d/b/a GoodeTrades.com; MICHAEL GOODE, an individual; and DOES 1-10, inclusive,

Defendants.

CASE NO. 2018—0153-CZ

Hon. Alexander C. Lipsey

PLAINTIFF'S SECOND AMENDED COMPLAINT AND JURY DEMAND

Plaintiff Scottsdale Capital Advisors Corp., for its Complaint against MorningLightMountain, LLC d/b/a GoodeTrades.com and Michael Goode, alleges as follows:

INTRODUCTION

1. Plaintiff Scottsdale Capital Advisors Corp. ("SCA") is a successful securities broker-dealer.

2. In an effort to smear SCA's reputation, MorningLightMountain, LLC d/b/a GoodeTrades.com and Michael Goode (collectively, "Defendants") published an article on their website, www.goodetrades.com, which contained false, defamatory, and highly misleading statements of and concerning SCA. Among other things, the articles falsely alleged that SCA is involved in penny stock "pump and dump" schemes and improperly permits the trading of penny stocks.

3. By this action, SCA seeks to clear its good name and hold Defendants liable for

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the harm caused by their misconduct.

THE PARTIES

4. Plaintiff Scottsdale Capital Advisors Corp. is, and at all times relevant hereto was, a corporation organized under the laws of the State of Arizona, with its principal place of business in Maricopa County, Arizona.

5. SCA is informed and believes and based thereon alleges that Defendant MorningLightMountain, LLC d/b/a GoodeTrades.com ("MorningLightMountain") is, and at all times relevant hereto was, a corporation organized under the laws of the Michigan, with its principal place of business in Eaton County, Michigan. SCA is informed and believes and based thereon alleges that MorningLightMountain owns and operates the website goodetrades.com.

6. SCA is informed and believes and based thereon alleges that Defendant Michael Goode ("Goode") is an individual who resides in Kalamazoo County, Michigan. Upon information and belief, Goode is the sole owner and officer of Defendant MorningLightMountain.

7. SCA is informed and believes and based thereon alleges that the fictitiously-named defendants sued herein as Does 1 through 10, and each of them, are in some manner responsible or legally liable for the actions, events, transactions and circumstances alleged herein. The true names and capacities of such fictitiously-named defendants, whether individual, corporate, or otherwise, are presently unknown to SCA, and SCA will seek leave of Court to amend this Complaint to assert the true names and capacities of such fictitiously-named defendants when the same have been ascertained. For convenience, each reference to a named defendant herein shall also refer to Does 1 through 10. All defendants, including MorningLightMountain, LLC d/b/a GoodeTrades.com, Michael Goode, and those referred to herein as Does 1 through 10, are collectively referred to herein as "Defendants."

JURISDICTION AND VENUE

8. This Court has personal jurisdiction over Defendants because they have minimum contacts with the State of Michigan, and defendant Goode is a domiciliary of the State of

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Michigan.

9. Venue in Kalamazoo County is proper because Defendant Goode resides in Kalamazoo County.

10. The amount in controversy exceeds Twenty Five Thousand Dollars ($25,000.00) exclusive of interest, costs, and attorney fees and the matter is otherwise within the jurisdiction of this Court.

FACTS COMMON TO ALL CAUSES OF ACTION

11. Founded in 2002, SCA is a full service broker-dealer focused on serving the microcap securities market, often referred to as the OTC market. In this time, SCA has grown to become one of the dominant companies in the OTC market, with more than $125 million worth of trades in 2015.

12. On April 17, 2017, Defendants published an article written by Goode on the website goodettrades.com, entitled "FINRA fines Scottsdale Capital Advisors $1.5 million" (the "Article"): https://www.goodetrades.com/2017/04/finra-fines-scottsdale-capital-advisors-1-5-million/. A true and correct copy of the Article is attached hereto as **Exhibit 1** and incorporated by this reference.

13. The Article contained statements that are defamatory and outright false, including:

a. **False Statement #1:** "If you have followed penny stocks and pump and dumps for a few years then you know Scottsdale Capital Advisors."

False Statement #1 is immediately preceded by the headline: "FINRA fines Scottsdale Capital Advisors $1.5 million." This juxtaposition makes it appear that SCA was fined $1.5 million for its involvement in the pump and dump of penny stocks. Given the placement of False Statement #1 under a headline regarding a $1.5 million fine by FINRA, a reader could only conclude that SCA was fined for its involvement in a pump and dump. Moreover, the Article quotes extensively from a FINRA decision that has nothing to do with any pump and dump scheme. In addition, False Statement #1 falsely alleges and/or implies that SCA is so heavily

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involved in the illegal pump and dump of penny stocks that it is identified and known by the association. This is false. Because SCA has never been involved in any "pump and dump" schemes, has never been a defendant in any "pump and dump" lawsuits, has never been charged by FINRA or any regulatory agency with involvement in a "pump and dump" scheme, and has never been fined for its involvement in a "pump and dump", the implications created by False Statement #1 in the context of the Article are false and defamatory.

b. **False Statement #2:** "They [SCA] are one of the few brokers left that have continued to allow the deposit and sale of shares of illiquid penny stocks. Larger brokers and discount brokers stopped allowing that over five years ago."

In truth, numerous large brokers continue to trade in penny stocks, including without limitation, interactive brokers, Merrill Lynch, Charles Schwab, Scottrade, Cor Clearing, and TradeKing.

14. On September 21, 2017, SCA's counsel sent a letter to Defendants identifying the foregoing false statements in the Article, and demanding that Defendants remove each one and publish a retraction, correction, and apology as to each of those statements. Defendants have failed and refused to comply with SCA's demand.

15. The false, defamatory, and highly misleading statements written and published by Defendants have caused and are continuing to cause SCA economic harm and damage to its reputation. Accordingly, SCA has no alternative but to file this lawsuit for compensatory damages, punitive damages, and injunctive relief, as explained more fully herein.

COUNT ONE

(Against All Defendants)

(Defamation)

16. SCA incorporates by reference all of the preceding paragraphs as though fully restated herein.

17. Defendants wrote and published the defamatory statements of fact about SCA referred to in Paragraph 13 herein (collectively, the "Defamatory Statements").

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18. The Defamatory Statements, whether by themselves or by implication, are false. Moreover, the statements, individually and jointly, tend to harm the reputation of Plaintiff as to lower its reputation in the community or deter third persons from associating or dealing with it.

19. The Defamatory Statements involve materially false implications.

20. The Defamatory Statements have caused SCA to be damaged.

21. Defendants have refused to retract, correct or apologize for the Defamatory Statements after being given notice and ample time to do so.

22. As a direct and proximate result of Defendants' conduct, SCA has suffered damages to its reputation and business interests in an amount to be determined at trial, and in an amount not less than the jurisdictional minimum of this Court. SCA's damages may also be presumed because the Defamatory Statements impute to SCA offenses regarded by public opinion as involving moral turpitude, and unfitness for the proper conduct of its lawful business, trade, and profession.

23. SCA is a private figure for purposes of a defamation analysis.

24. Notwithstanding SCA's status as a private figure, at the time the Defamatory Statements were published, Defendants knew the Defamatory Statements were false and/or acted in reckless disregard of whether the Defamatory Statements were true or false. As such, in addition to compensatory damages and/or presumed damages, SCA is entitled to an award of punitive damages in an amount to be determined at trial.

JURY TRIAL DEMAND

SCA hereby demands a jury trial of all issues in this case.

PRAYER FOR RELIEF

WHEREFORE, SCA requests that judgment be entered against the Defendants, and each of them, as follows:

A. For compensatory, consequential, exemplary, and punitive damages in an amount to be determined at trial;

B. For pre- and post-judgment interest on the foregoing sum at the highest lawful

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rate from entry of judgment until paid in full;

C. For an injunction enjoining further publication of the Defamatory Statements;

D. For SCA's costs of suit; and

E. For all other relief the Court deems appropriate.

RESPECTFULLY SUBMITTED this 26th day of October, 2018.

PINSKY, SMITH, FAYETTE & KENNEDY, LLP
Local Counsel for Plaintiff

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EXHIBIT 1

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GOODE TRADES
The Best Source for Stock Promotion & Penny Stock News and Insight

FINRA fines Scottsdale Capital Advisors $1.5 million

April 17, 2017 | By Michael Goode | All Categories, Fraud, Microcap, SEC actions

If you have followed penny stocks and pump and dumps for a few years then you know Scottsdale Capital Advisors (hereafter referred to as Scottsdale Capital). They are one of the few brokers left that have continued to allow the deposit and sale of shares in illiquid penny stocks. Larger brokers and discount brokers stopped allowing that over five years ago. When the big Biozoom (BIZM) pump happened back in 2013 many of the frozen accounts were at Scottsdale Capital.

On March 31st, FINRA fined Scottsdale Capital $1.5 million. Unfortunately I cannot find any public posting of that news so the prior link is to a Stockwatch article (full article only available to subscribers; see this copy if not a subscriber). In addition to the fine, John Hurry, owner of Scottsdale Capital, was permanently banned from working in the securities industry.

The full 111-page FINRA decision can be found on their website. Unfortunately FINRA prevents direct-linking so you need to go to http://disciplinaryactions.finra.org/Search/ and then enter "John Hurry" as the name. I have downloaded a copy of the decision in case they delete it.

Excerpt from the decision:

> Hurry's violation of his duty to observe high standards of commercial honor and just and equitable principles of trade was purposeful and egregious. These two qualities lead us to conclude that Hurry is a threat to investors and the integrity of the markets. Our concern is compounded by our credibility findings. We found that he repeatedly testified falsely, and that there was a pattern of doing so when he thought no contradictory evidence would come to light.

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> When misconduct is intentional, General Principle 1 provides that adjudicators should 572 assess sanctions that exceed the recommended range in the Guidelines. Principal Consideration 13 also focuses on whether a respondent's misconduct is the result of an intentional act, recklessness, or negligence.573 When a violation is egregious, the Guidelines often suggest more severe sanctions. In egregious cases in connection with violations of Rule 2010 and Section 5, the specific Guidelines recommend that an individual be suspended for up to two years or barred.
>
> Even though he has no disciplinary history, the devious nature of Hurry's violation evidences disregard for regulatory requirements, an aggravating factor under General Principle 2 and Principal Consideration 10.574 We have no confidence that if he remained in the securities industry he would not again devise a way to evade the law and regulatory requirements. For this reason also, we believe Hurry is a threat to the investing public.

The decision also shows just how remunerative running Scottsdale Capital has been for Hurry — in 2014 he and his wife made "approximately $6.2 million in directors' fees and $1.45 million in net income."

Disclaimer. No position in any stocks mentioned and I have no relationship with anyone mentioned in this post. This blog has a *terms of use* ***that is incorporated by reference into this post; you can find all my disclaimers and disclosures there as well.***

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STATE OF MICHIGAN
KALAMAZOO COUNTY CIRCUIT COURT

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff,

v.

MORNINGLIGHTMOUNTAIN, LLC, MICHAEL GOODE, and DOES 1-10,

Defendants.

File No.: 2018—0153-CZ

Hon. Alexander C. Lipsey

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PROOF OF SERVICE

Erika Dech, Legal Assistant at Pinsky, Smith, Fayette & Kennedy LLP, states that on October 26, 2018, she served PLAINTIFF'S SECOND AMENDED COMPLAINT AND JURY DEMAND upon Joseph E. Richotte, BUTZEL LONG, PC, 41000 Woodward Avenue, Bloomfield Hills, MI 48304 and Jordan D. Susman, HARDER LLP, 132 South Rodeo Dr., 4th Floor, Beverly Hills, CA 90212 via first class mail, postage prepaid.

Erika Dech

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FILED
NOV 15 2018
9TH CIRCUIT COURT
COUNTY OF KALAMAZOO
KALAMAZOO, MICHIGAN

In the Kalamazoo County Circuit Court
For the State of Michigan

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff,

v.

MORNINGLIGHTMOUNTAIN, LLC, MICHAEL GOODE, and DOES 1–10,

Defendants.

Civil No. 18-0153-CZ

HON. ALEXANDER C. LIPSEY

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ANSWER TO PLAINTIFF'S FIRST AMENDED COMPLAINT WITH AFFIRMATIVE AND OTHER DEFENSES

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Under MCR 2.108, Defendants MorningLightMountain, LLC ("MLM"), and Michael Goode jointly answer Plaintiff Scottsdale Capital Advisors Corp.'s Second Amended Complaint as follows:

INTRODUCTION

1. Plaintiff Scottsdale Capital Advisors Corp. ("SCA") is a successful securities broker-dealer.

ANSWER: MLM and Goode admit that SCA is a broker-dealer of securities. They deny the allegation that SCA is a "successful" broker-dealer for lack of knowledge or information sufficient to form a belief about whether it is true.

2. In an effort to smear SCA's reputation, MorningLightMountain, LLC d/b/a GoodTrades.com and Michael Goode (collectively, "Defendants") published an article on their website, www.goodetrades.com, which contained false, defamatory, and highly misleading statements of and concerning SCA. Among other things, the articles falsely alleged that SCA is involved in penny stock "pump and dump" schemes and improperly permits the trading of penny stocks.

ANSWER: MLM admits that it operates the website www.goodetrades.com (the "Website"). MLM admits that it published, and Goode admits that he caused MLM to publish, an article on the Website. MLM and Goode deny the rest of the allegations in Paragraph 2 as untrue.

3. By this action, SCA seeks to clear its good name and hold Defendants liable for the harm caused by their misconduct.

ANSWER: Denied as untrue. SCA's primary purpose in initiating this strategic lawsuit against public participation is to harass or injure MLM and Goode; SCA has no reasonable basis to believe that the facts underlying its legal position are true;

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and/or SCA's legal position is devoid of arguable merit.

THE PARTIES

4. Plaintiff Scottsdale Capital Advisors Corp. is, and at all times relevant hereto was, a corporation organized under the laws of the State of Arizona, with its principal place of business in Maricopa County, Arizona.

ANSWER: MLM and Goode deny these allegations for lack of knowledge or information sufficient to form a belief about whether they are true.

5. SCA is informed and believes and based thereon alleges that Defendant MorningLightMountain, LLC d/b/a GoodeTrades.com ("MorningLightMountain") is, and at all times relevant hereto was, a corporation organized under the laws of the [State of] Michigan, with its principal place of business in Eaton County, Michigan. SCA is informed and believes and based thereon alleges that MorningLightMountain owns and operates the website goodtrades.com.

ANSWER: Denied. In the interest of judicial economy, however, MLM admits the following: (1) it is a limited liability corporation organized under the laws of the State of Michigan; (2) its principal place of business is Kalamazoo County; and (3) it operates the Website.

6. SCA is informed and believes and based thereon alleges that Defendant Michael Goode ("Goode") is an individual who resides in Kalamazoo County, Michigan. Upon information and belief, Goode is the sole owner and officer of Defendant MorningLightMountain.

ANSWER: MLM and Goode admit these allegations.

7. SCA is informed and believes and based thereon alleges that the fictitiously-named defendants sued herein as Does 1 through 10, and each of them, are

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in some manner responsible or legally liable for the actions, events, transactions and circumstances alleged herein. The true names and capacities of such fictitiously-named defendants, whether individual, corporate, or otherwise, are presently unknown to SCA, and SCA will seek leave of Court to amend this Complaint to assert the true names and capacities of such fictitiously-named defendants when the same have been ascertained. For convenience, each reference to a named defendant herein shall also refer to Does 1 through 10. All defendants, including MorningLightMountain, LLC d/b/a GoodeTrades.com, Michael Goode, and those referred to herein as Does 1 through 10, are collectively referred to herein as "Defendants."

ANSWER: MLM and Goode lack knowledge or information sufficient to form a belief about whether the Doe defendants exist or have engaged in any acts giving rise to liability. For purposes of answering the First Amended Complaint, MLM and Goode treat the term *Defendants* as applying only to them. None of their answers shall be construed to admit the existence or liability of the Doe defendants or to in any way answer for the Doe defendants.

JURISDICTION AND VENUE

8. This Court has personal jurisdiction over Defendants because they have minimum contacts with the State of Michigan, and defendant Goode is a domiciliary of the State of Michigan.

ANSWER: MLM and Goode submit to the personal jurisdiction of the Court without objection.

9. Venue in Kalamazoo County is proper because Defendant Goode resides in Kalamazoo County.

ANSWER: MLM and Goode admit this allegation.

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10. The amount in controversy exceeds Twenty Five Thousand Dollars ($25,000.00) exclusive of interest, costs, and attorney fees and the matter is otherwise within the jurisdiction of this Court.

ANSWER: MLM and Goode admit that SCA seeks to recover an amount in excess of $25,000, but they deny that SCA is entitled to any recovery.

FACTS COMMON TO ALL CAUSES OF ACTION

11. Founded in 2002, SCA is a full service broker-dealer focused on serving the microcap securities market, often referred to as the OTC market. In this time, SCA has grown to become one of the dominant companies in the OTC market, with more than $125 million worth of trades in 2015.

ANSWER: MLM and Goode admit that SCA is a broker-dealer that services the microcap securities market, which is often referred to as the OTC [over-the-counter] market. MLM and Goode deny the rest of the allegations in Paragraph 11 for lack of knowledge or information sufficient to form a belief about whether they are true.

12. On April 17, 2017, Defendants published an article written by Goode on the website goodtrades.com, entitled "FINRA fines Scottsdale Capital Advisors $1.5 million" (the "Article"): https://goodetrades.com/2017/04/finra-fines-scottsdale-capital-advisors-1-5-million/. A true and correct copy of the Article is attached hereto as Exhibit 1 and incorporated by this reference.

ANSWER: MLM admits that it published, and Goode admits that he caused MLM to publish the Article on the Website. They deny that Exhibit 1 is a true and correct copy of the Article because it omits the materials linked or otherwise incorporated into the Article. A true and correct copy of the Article with the linked materials are attached to this Answer as Exhibit A. Together, Exhibit 1 and Exhibit A

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constitute the Article.

13. The Article contained statements that are defamatory and outright false, including:

a. **False Statement #1:** "If you have followed penny stocks and pump and dumps for a few years then you know Scottsdale Capital Advisors."

False Statement #1 is immediately preceded by the headline: "FINRA fines Scottsdale Capital Advisors $1.5 million." This juxtaposition makes it appear that SCA was fined $1.5 million for its involvement in the pump and dump of penny stocks. Given the placements of False Statement #1 under a headline regarding a $1.5 million fine by FINRA, a reader could only conclude that SCA was fined for its involvement in a pump and dump. Moreover, the Article quotes extensively from a FINRA decision that has nothing to do with any pump and dump scheme. In addition, False Statement #1 falsely alleges and/or implies that SCA is so heavily involved in the illegal pump and dump of penny stocks that it is identified and known by the association. This is false. Because SCA has never been involved in any "pump and dump" schemes, has never been a defendant in any "pump and dump" lawsuits, has never been charged by FINRA or any regulatory agency with involvement in "pump and dump" scheme, and has never been fined for its involvement in a "pump and dump", the implications created by False Statement #1 in the context of the Article are false and defamatory.

b. **False Statement #2:** "They [SCA] are one of the few brokers left that have continued to allow the deposit and sale of shares of illiquid penny stocks. Larger brokers and discount brokers stopped allowing that over five years ago."

In truth, numerous large brokers continue to trade in penny stocks, including

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without limitation, interactive brokers, Merrill Lynch, Charles Schwab, Scottrade, Cor Clearing, and TradeKing.

ANSWER: MLM and Goode admit that the Article contains the two quoted statements in Paragraphs 13a and 13b. They deny SCA's characterization of those statements as false and defamatory as untrue. Finally, MLM and Goode deny the rest of the allegations in Paragraph 13, including each of its subparts, for lack of knowledge or information sufficient to form a belief about whether they are true.

14. On September 21, 2017, SCA's counsel sent a letter to Defendants identifying the foregoing false statements in the Article, and demanding that Defendants remove each one and publish a retraction, correction, and apology as to each of those statements. Defendants have failed and refused to comply with SCA's demand.

ANSWER: MLM and Goode admit that SCA's counsel sent a letter to them on September 12, 2017 demanding, among other things, that they remove the two statements identified in Paragraphs 13a and 13b, and publish a retraction, correction, and apology. A true and correct copy of this letter is attached to this Answer as Exhibit B. MLM and Goode responded on September 13, 2017. A true and correct copy of their response is attached to this Answer as Exhibit C. MLM and Goode admit that they did not remove the statements or publish a retraction, correction, or apology. They deny that the statements are false or that they had any duty to comply with SCA's demand. MLM and Goode deny the rest of the allegations in Paragraph 14 as untrue in the manner and form stated.

15. The false, defamatory, and highly misleading statements written and published by Defendants have caused and are continuing to cause SCA economic harm and damage to its reputation. Accordingly, SCA has no alternative but to file

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this lawsuit for compensatory damages, punitive damages, and injunctive relief, as explained more fully herein.

ANSWER: MLM and Goode deny that the statements identified in Paragraphs 13a and 13b are false, defamatory, or highly misleading. They deny the rest of the allegations in Paragraph 15 for lack of knowledge or information sufficient to form a belief about whether they are true.

COUNT 1
DEFAMATION

16. SCA incorporates by reference all of the preceding paragraphs as though fully restated herein.

ANSWER: MLM and Goode incorporate by reference all of their answers to the preceding paragraphs as though fully restated herein.

17. Defendants wrote and published the defamatory statements of fact about SCA referred to in Paragraph 13 herein (collectively, the "Defamatory Statements").

ANSWER: Goode admits to writing, and MLM admits to publishing the statements identified in Paragraphs 13a and 13b, but they deny that the statements are defamatory. They also deny that either of the statements is a "statement of fact" in the manner and form stated. MLM and Goode deny the rest of the allegations in Paragraph 17 for lack of knowledge or information sufficient to form a belief about whether they are true.

18. The Defamatory Statements, whether by themselves or by implication, are false. Moreover, the statements, individually and jointly, tend to harm the reputation of Plaintiff as to lower its reputation in the community or deter third persons from associating or dealing with it.

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ANSWER: MLM and Goode deny these allegations as untrue.

19. The Defamatory Statements involve materially false implications.

ANSWER: MLM and Goode deny these allegations as untrue.

20. The Defamatory Statements have caused SCA to be damaged.

ANSWER: MLM and Goode deny that the statements identified in Paragraphs 13a and 13b are defamatory. They deny that the statements have caused SCA damages for lack of knowledge or information sufficient to form a belief about whether it is true.

21. Defendants have refused to retract, correct or apologize for the Defamatory Statements after being given notice and ample time to do so.

Answer: MLM and Goode admit that they did not retract the two statements identified in Paragraphs 13a and 13b. They deny that the statements are incorrect, false, or defamatory. The law does not require an apology. MLM and Goode deny that SCA gave them "ample time" to respond to SCA's demands; SCA demanded a response within 24 hours. MLM and Goode deny the rest of the allegations in Paragraph 21 as untrue in the manner and form stated.

22. As a direct and proximate result of Defendants' conduct, SCA has suffered damages to its reputation and business interests in an amount to be determined at trial, and in an amount not less than the jurisdictional minimum of this Court. SCA's damages may also be presumed because the Defamatory Statements impute to SCA offenses regarded by public opinion as involving moral turpitude, and unfitness for the proper conduct of its lawful business, trade, and profession.

ANSWER: MLM and Goode deny the allegations as untrue.

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23. SCA is a private figure for purposes of a defamation analysis.

ANSWER: MLM and Goode deny this allegation as untrue.

24. Notwithstanding SCA's status as a private figure, at the time the Defamatory Statements were published, Defendants knew the Defamatory Statements were false and/or acted in reckless disregard of whether the Defamatory Statements were true or false. As such, in addition to compensatory damages and/or presumed damages, SCA is entitled to an award of punitive damages in an amount to be determined at trial.

ANSWER: MLM and Goode deny the allegations as untrue.

AFFIRMATIVE AND OTHER DEFENSES

Under MCR 2.111(F), MLM and Goode assert the following special, affirmative, and other defenses that may apply in whole or in part to the claims that SCA purports to assert in the Second Amended Complaint, without assuming the burden of proof on any matters where the burden rests with SCA or any other party.

MLM and Goode give notice that they lack knowledge or information sufficient to form a belief as to the truth of many of the allegations in the Second Amended Complaint. Until they avail themselves of their rights to discovery, they cannot determine which, if any, of the following defenses will be asserted at trial or by dispositive motion. These defenses are pleaded to preserve MLM and Goode's right to assert them at trial or by motion, to give fair notice of their intention to assert these defenses, and to avoid a waiver of any defenses.

MLM and Goode reserve the right to assert all special, affirmative, and other defenses that may appear or become available during discovery in this case. They also reserve the right to amend their Answer under MCR 2.118(A)(1), or to seek

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leave from the Court to amend their Answer under MCR 2.118(A)(2) if necessary, to assert such defenses.

Subject to the foregoing, SCA's claims and requests for relief are barred in whole or in part for one or more of the following reasons:

1. The Complaint fails to state a claim upon which relief can be granted.

2. The challenged statements are not actionable because they are statements of opinion, not statements of fact.

3. The challenged statements are not materially false.

4. The challenged statements are not defamatory.

5. The challenged statements are not "of and concerning" SCA.

6. SCA has failed to plead fault with the specificity required by law.

7. SCA is a public figure for purposes of this lawsuit.

8. If SCA is a public figure, the challenged statements are not actionable because MLM and Goode did not know any of the statements were false.

9. If SCA is a public figure, the challenged statements are not actionable because MLM and Goode did not act with reckless disregard for whether they were false (*i.e.*, with "actual malice").

10. If SCA is a public figure, the challenged statements are not actionable because SCA cannot prove, with clear and convincing evidence, that MLM and Goode published the statements with actual malice.

11. If SCA is a private figure, the challenged statements are not actionable because MLM and Goode did not negligently publish them.

12. The challenged statements are privileged under the statutory fair-report privilege codified at MCL 600.2911.

13. None of the challenged statements give rise to any defamatory inference or innuendo because of the omission of material facts.

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14. The challenged statements are matters of legitimate public interest and concern and received from reliable and official sources, and are privileged under (*a*) the common law and statutes of Michigan; (*b*) Article I, Section 5 of the Michigan Constitution of 1963; and (*c*) the First Amendment to the U.S. Constitution.

15. SCA is libel-proof.

16. The incremental-harm doctrine prevents SCA from recovering damages.

17. MLM and Goode are not the proximate cause of any damages SCA claims to have suffered; SCA or persons other than MLM and Goode caused SCA's damages.

18. SCA is barred from recovering punitive and/or exemplary damages because that would violate Article I, Section 5 of the Michigan Constitution of 1963 and the First Amendment to the United States Constitution.

19. SCA cannot sue on the challenged statements under the doctrine of judicial estoppel.

20. SCA cannot sue on the challenged statements under the doctrine of collateral estoppel.

21. SCA has suffered no damages.

22. If SCA was damaged as alleged, then SCA is limited to its actual damages because it has failed to plead and prove that Defendants acted with actual malice.

23. If SCA was damaged as alleged, then SCA failed to reasonably mitigate its damages.

24. All special, affirmative, and other defenses asserted by a Doe defendant who becomes identified or by any other defendant later added to this action, which MLM and Goode adopt and incorporate as additional defenses.

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RELIANCE ON JURY DEMAND

MLM and Goode rely on SCA's demand for a jury trial on all issues that can be tried to a jury, but object to SCA's demand for a jury trial on its request for injunctive relief. There is no right to a trial by jury on equitable issues. *Smith* v. *University of Detroit*, 145 Mich. App. 468 (1985).

RELIEF REQUESTED

WHEREFORE, MLM and Goode respectfully request that the Court:

1. DISMISS the Second Amended Complaint with prejudice;

2. DECLARE this lawsuit "frivolous" within the meaning of MCR 2.114(F), MCR 2.625(A)(2), and MCL 600.2591, and AWARD Defendants their reasonable attorney fees and costs. SCA's primary purpose in initiating this strategic lawsuit against public participation is to harass or injure MLM and Goode; SCA has no reasonable basis to believe that the facts underlying its legal position are true; and/or SCA's legal position is devoid of arguable merit.

3. Grant such other and further relief as it deems appropriate.

Respectfully submitted,

BUTZEL LONG, P.C.

Dated: November 14, 2018

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GOODE TRADES
The Best Source for Stock Promotion & Penny Stock News and Insight

FINRA fines Scottsdale Capital Advisors $1.5 million

April 17, 2017 | By Michael Goode | All Categories, Fraud, Microcap, SEC actions

If you have followed penny stocks and pump and dumps for a few years then you know Scottsdale Capital Advisors (hereafter referred to as Scottsdale Capital). They are one of the few brokers left that have continued to allow the deposit and sale of shares in illiquid penny stocks. Larger brokers and discount brokers stopped allowing that over five years ago. When the big Biozoom (BIZM) pump happened back in 2013 many of the frozen accounts were at Scottsdale Capital.

On March 31st, FINRA fined Scottsdale Capital $1.5 million. Unfortunately I cannot find any public posting of that news so the prior link is to a Stockwatch article (full article only available to subscribers; see this copy if not a subscriber). In addition to the fine, John Hurry, owner of Scottsdale Capital, was permanently banned from working in the securities industry.

The full 111-page FINRA decision can be found on their website. Unfortunately FINRA prevents direct-linking so you need to go to http://disciplinaryactions.finra.org/Search/ and then enter "John Hurry" as the name. I have downloaded a copy of the decision in case they delete it.

Excerpt from the decision:

> Hurry's violation of his duty to observe high standards of commercial honor and just and equitable principles of trade was purposeful and egregious. These two qualities lead us to conclude that Hurry is a threat to investors and the integrity of the markets. Our concern is compounded by our credibility findings. We found that he repeatedly testified falsely, and that there was a pattern of doing so when he thought no contradictory evidence would come to light.

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> When misconduct is intentional, General Principle 1 provides that adjudicators should 572 assess sanctions that exceed the recommended range in the Guidelines. Principal Consideration 13 also focuses on whether a respondent's misconduct is the result of an intentional act, recklessness, or negligence.573 When a violation is egregious, the Guidelines often suggest more severe sanctions. In egregious cases in connection with violations of Rule 2010 and Section 5, the specific Guidelines recommend that an individual be suspended for up to two years or barred.
>
> Even though he has no disciplinary history, the devious nature of Hurry's violation evidences disregard for regulatory requirements, an aggravating factor under General Principle 2 and Principal Consideration 10.574 We have no confidence that if he remained in the securities industry he would not again devise a way to evade the law and regulatory requirements. For this reason also, we believe Hurry is a threat to the investing public.

The decision also shows just how remunerative running Scottsdale Capital has been for Hurry — in 2014 he and his wife made "approximately $6.2 million in directors' fees and $1.45 million in net income."

Disclaimer. No position in any stocks mentioned and I have no relationship with anyone mentioned in this post. This blog has a *terms of use* ***that is incorporated by reference into this post; you can find all my disclaimers and disclosures there as well.***

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SEC Freezes accounts used in illegal sales of unregistered shares of Biozoom $BIZM

July 3, 2013 | By Michael Goode | All Categories, All Categories, Fraud, Microcap, Stock Promotions, Very Important Posts

Earlier today the SEC announced that it froze accounts of eight different Argentinians who had illegally sold unregistered shares of Biozoom (BIZM). Two others who had not yet sold shares also had their accounts frozen. A week ago the SEC suspended trading in Biozoom. See my original post on the Biozoom promotion as well as the Promotion Stock Secrets post on the individuals behind the promotion.

SEC press release
SEC complaint

The sheer number of shares sold and the profits involved are impressive. Here is a good description of what transpired from the SEC press release:

> The SEC's complaint alleges that from March to June 2013, the ten defendants received more than 20 million shares of Entertainment Art, which was one-third of the company's total outstanding shares. In a one-month period beginning in mid-May, eight of them sold more than 14 million shares. The sales yielded almost $34 million, of which almost $17 million was wired to overseas bank accounts. Their U.S. brokerage accounts, which include approximately $16 million in cash, are subject to the asset freeze.

The ten defendants in the litigation are: Magdalena Tavella, Andres Horacio Ficicchia, Gonzalo Garcia Blaya, Lucia Mariana Hernando, Cecilia De Lorenzo, Adriana Rosa Bagattin, Daniela Patricia Goldman and Mariano Pablo Ferrari

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(Mariano Graciarena and Fernando Loureyro are also named but had not yet sold shares). The defendants claimed to have purchased shares in Biozoom (then known as Entertainment Art Inc.) from the company's original seed shareholders between November 2012 and March 2013, but those shareholders had already sold all their shares back in 2009.

Despite the SEC's quick action, over $17m in illicit profits were already wired overseas and are now beyond the reach of American authorities. Most likely none of the individuals whose names appeared on the accounts were behind the fraud. It is believed by many that Francisco Abellan has controlled scheme from the start.

The US brokerages used by the defendants are well-known to everyone who is familiar with the penny stock world: Legend Securities and Scottsdale Capital Advisors.

For further details, I suggest reading Promotion Stock Secret's post on this litigation (same post as here).

Disclaimer: I am net long 1700 shares of BIZM (long 11,700 shares in one account and short 10,000 shares in another account); I have no positions in any other stock mentioned and no relationship with any parties mentioned above. This blog has a *terms of use* ***that is incorporated by reference into this post; you can find all my disclaimers and disclosures there as well.***

4 thoughts on "SEC Freezes accounts used in illegal sales of unregistered shares of Biozoom $BIZM"

Michael Goode says:

July 21, 2013 at 5:41 pm

BIZM got a DTC/ DTCC global lock. Read more about that here: http://promotionstocksecrets.com/what-are-dtc-chills-and-locks-and-how-can-they-affect-me/

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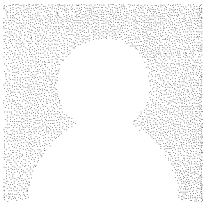


xerty says:

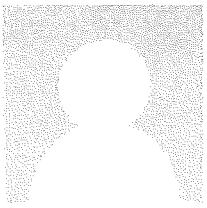
July 22, 2013 at 3:37 am

Do you know who gets stuck holding the bag for these illegal/unregistered stock sales? Clearly these guys walked with $17M, but is it their trade counter parties, the brokers who accepted the shares, or someone else who gets stiffed?

Michael Goode says:

July 22, 2013 at 11:48 am

That is a good question. In this case the shares they sold did exist (share counterfeiting happens sometimes) although they were not free-trading. So the trades stand and whoever bought those shares still has them. It is too late to go back and bust the trades made days or weeks ago.



xerty says:

July 24, 2013 at 11:40 am

So I guess it's the average shareholder of the company who lost, since they just got diluted by the addition of these new, duplicate shares. In fact, they got diluted for the full $34M amount, not just the $17M amount the criminals escaped with, since the funds seized by the SEC tend to go to the Treasury if they can't figure out a directly harmed party to reimburse. With 60M shares outstanding, this scam resulted in a 1/3 loss of value for prior shareholders.

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Press Release

SEC Obtains Freeze on Proceeds from Unlawful Distribution of Biozoom Securities

FOR IMMEDIATE RELEASE
2013-122

Washington, D.C., July 3, 2013 — The Securities and Exchange Commission today announced charges against eight Argentine citizens who unlawfully sold millions of shares of Biozoom, Inc. in unregistered transactions. The SEC also obtained an emergency order to freeze assets in the U.S. brokerage accounts of the eight defendants and two other Argentine citizens who had Biozoom shares but had not yet sold them. The action follows last week's suspension of trading in Biozoom due to concerns that some shareholders may be unlawfully distributing its securities.

Biozoom, formerly Entertainment Art, Inc., announced in April that it was changing its name and moving from producing leather bags to developing biomedical technology. The SEC's complaint alleges that from March to June 2013, the ten defendants received more than 20 million shares of Entertainment Art, which was one-third of the company's total outstanding shares. In a one-month period beginning in mid-May, eight of them sold more than 14 million shares. The sales yielded almost $34 million, of which almost $17 million was wired to overseas bank accounts. Their U.S. brokerage accounts, which include approximately $16 million in cash, are subject to the asset freeze.

The SEC's complaint, filed in U.S. District Court in Manhattan, charges the eight defendants — Magdalena Tavella, Andres Horacio Ficicchia, Gonzalo Garcia Blaya, Lucia Mariana Hernando, Cecilia De Lorenzo, Adriana Rosa Bagattin, Daniela Patricia Goldman and Mariano Pablo Ferrari — along with two others, Mariano Graciarena and Fernando Loureyro, who received shares but have yet to sell them.

"Today's action, along with the SEC's trading suspension order last week, demonstrate the SEC's ability and commitment to act swiftly to halt ongoing illegal conduct and preserve assets," said Antonia Chion, Associate Director in the SEC's Division of Enforcement.

According to the SEC's complaint, when the defendants deposited the Biozoom stock into their U.S. brokerage accounts, they claimed to have acquired the bulk of the shares in March 2013 from Entertainment Art shareholders who purchased them in private placements that began in 2007. Each of the defendants provided stock purchase agreements between them and the former shareholders purportedly signed by the defendants and those shareholders. The SEC alleges that the documents were false because the Entertainment Art investors had sold all of their stock in the company in 2009, almost four years earlier. The defendants' shares of Biozoom were deposited into their accounts as shares that purportedly could be freely traded and the defendants sold them even though no registration statement was filed with the SEC for any of the sales transactions, in violation of U.S. law.

In addition to the temporary restraining order and asset freeze granted by the court, the SEC is seeking preliminary and permanent injunctions, return of the selling defendants' allegedly ill-gotten sale proceeds, and civil penalties. The SEC also seeks preliminary and permanent injunctions against the non-selling defendants, Graciarena and Loureyro, because of the likelihood that both defendants will offer or sell their Biozoom shares to the public in violation of the registration requirements of U.S. securities law.

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Ricky Sachar, Scott Lowry, Deborah Tarasevich, Jennie Krasner, and Robert Nesbitt conducted the SEC's investigation, which is continuing. Patrick M. Bryan will lead the litigation. The SEC acknowledges the assistance of the Financial Industry Regulatory Authority (FINRA).

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Related Materials

- SEC Complaint

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JUDGE BUCHWALD

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, v. MAGDALENA TAVELLA, ANDRES HORACIO FICICCHIA, GONZALO GARCIA BLAYA, LUCIA MARIANA HERNANDO, CECILIA DE LORENZO, ADRIANA ROSA BAGATTIN, DANIELA PATRICIA GOLDMAN, MARIANO PABLO FERRARI, MARIANO GRACIARENA, and FERNANDO LOUREYRO, Defendants.	Civil Action No. Jury Trial Demanded

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COMPLAINT

Plaintiff Securities and Exchange Commission (the "Commission") for its Complaint alleges as follows:

1. The Commission brings this civil law enforcement action against Magdalena Tavella, Andres Horacio Ficicchia, Gonzalo Garcia Blaya, Lucia Mariana Hernando, Cecilia De Lorenzo, Adriana Rosa Bagattin, Daniela Patricia Goldman, and Mariano Pablo Ferrari (collectively, the "Selling Defendants") on an emergency basis to prevent millions of dollars of proceeds from unlawful sales of securities being transferred out of the country. Over the past month, the Selling Defendants have sold almost $34 million worth of securities in Biozoom, Inc. ("Biozoom") (f/k/a Entertainment Art, Inc.), a penny stock company traded on the Over-the-Counter Bulletin Board ("OTCBB"), and

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millions more shares are sitting in defendants' brokerage accounts and likely to be sold unlawfully to the public. No registration statement was in effect for the Selling Defendants' resale of securities, thus their sales were in violation of Section 5 of the Securities Act of 1933 (the "Securities Act") [15 U.S.C. § 77e]. Further, almost $17 million of the Selling Defendants' ill-gotten proceeds have been transferred out of the United States. Unless an asset freeze covering the Selling Defendants' Biozoom shares is issued, the unlawful sales of securities and transfer or dissipation of the proceeds from sales of the securities will likely continue.

2. The Commission also brings this civil law enforcement action against Mariano Graciarena and Fernando Loureyro. These defendants recently deposited over a total of approximately 4.4 million shares of Biozoom stock into their respective brokerage accounts. Like the shares sold by the Selling Defendants, there is no registration statement in effect permitting the lawful resale of the Biozoom shares held by Graciarena and Loureyro. Because Graciarena and Loureyro are likely to engage in the sale of securities in violation of Section 5 of the Securities Act, the Commission seeks to enjoin them from offering for resale their Biozoom shares until such time as a registration statement is filed and in effect.

3. From March 2013 to June 2013, defendants opened brokerage accounts at broker-dealers and deposited millions of shares of Biozoom, Inc. (f/k/a Entertainment Art, Inc.) that they claimed did not bear a restrictive legend and were free-trading shares. All of the defendants claimed that they had purchased all or some of their shares from some of the original shareholders of Entertainment Art in transactions between November 2012 and March 2013.

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4. To bolster their claims, each of the defendants submitted stock purchase agreements dated between November 2012 and March 2013 that purportedly evidenced their purchase of Entertainment Art stock from the former Entertainment Art shareholders. Based on these stock purchase agreements and other documentation, the defendants – between March 2013 and June 2013 – deposited a total of 20,130,000 shares of Biozoom into their brokerage accounts.

5. The defendants could not, however, have purchased any of their shares from the original Entertainment Art shareholders as they claimed because those shareholders ceased to have any interest in the company on or around May 2009 –more than ***three years*** earlier than the defendants' claimed purchases.

6. Almost immediately after defendants deposited shares of Biozoom in their brokerage accounts, Biozoom began issuing a series of press releases and a stock promotional campaign for the company began. Following these press releases and stock promotional campaign, from May 16, 2013 to June 21, 2013, the company's stock price and volume increased dramatically. For example, prior to May 16, 2013, no shares in Biozoom had traded. However, from May 16, 2013 to June 21, 2013, Biozoom's stock price shot past $4 per share, with total volume of more than 87 million shares.

7. During this same period, eight of the defendants sold millions of Biozoom shares into the rising market — reaping millions of dollars in proceeds as a result. In total, over an approximately one month period from May 16, 2013 – June 17, 2013, eight of the defendants sold a total of over 14 million shares of Biozoom stock into the public markets for proceeds of almost $34 million.

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8. None of these sales were made pursuant to an effective registration statement. By engaging in the foregoing conduct, the eight Selling Defendants violated the registration provisions of the federal securities laws, Sections 5(a) and 5(c) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. 15 U.S.C. §§ 77e(a) and 77e(c)].

9. While the remaining two defendants – Graciarena and Loureyro – have yet to sell any of their Biozoom shares, they are likely to do so unless restrained. They recently deposited millions of shares into their respective brokerage accounts, claiming (as the other defendants) that these shares have no restrictive legend and are available for resale to the public. Therefore, the Commission seeks an order pursuant to Securities Act Section 20(b) [15 U.S.C. 77t(b)] to enjoin them from violations of Sections 5(a) and 5(c) of the Securities Act.

JURISDICTION AND VENUE

10. The SEC brings this action pursuant to Section 5 [15 U.S.C. § 77e] and Section 20(b) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. § 77t(b)]. Defendants have directly or indirectly made use of the means or instrumentalities of interstate commerce, or of the mails, or the facilities of a national securities exchange in connection with the acts, practices, transactions, and courses of business alleged in this Complaint.

11. This Court has jurisdiction over this action pursuant to Section 22 of the Securities Act [15 U.S.C. § 77v], and 28 U.S.C. § 1331.

12. Venue is proper in this Court pursuant to Section 22(a) of the Securities Act [15 U.S.C. §77v], because certain acts, practices, and courses of business constituting the violations alleged herein have occurred within the Southern District of New York.

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13. Defendants will, unless restrained and enjoined, continue to engage in the acts, practices, transactions, and courses of business alleged in this Complaint, or in acts, practices, transactions, and courses of business of similar purport and object.

THE DEFENDANTS

14. Defendant Andres Horacio Ficicchia resides in Buenos Aires, Argentina and is an Argentine citizen.

15. Defendant Gonzalo Garcia Blaya resides in Buenos Aires, Argentina, and is an Argentine citizen.

16. Defendant Luciana Mariana Hernando resides in Buenos Aires, Argentina, and is an Argentine citizen.

17. Defendant Cecilia De Lorenzo resides in Buenos Aires, Argentina, and is an Argentine citizen.

18. Defendant Magdalena Tavella resides in Buenos Aires, Argentina, and is an Argentine citizen.

19. Defendant Adriana Rosa Bagattin resides in Buenos Aires, Argentina, and is an Argentine citizen.

20. Defendant Daniela Patricia Goldman resides in Buenos Aires, Argentina, and is an Argentine citizen.

21. Defendant Mariano Pablo Ferrari resides in Buenos Aires, Argentina, and is an Argentine citizen.

22. Defendant Mariano Graciarena resides in Buenos Aires, Argentina, and is an Argentine citizen.

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23. Defendant Fernando Loureyro resides in Buenos Aires, Argentina, and is an Argentine citizen.

OTHER RELEVANT ENTITIES

24. Biozoom, Inc. (f/k/a Entertainment Arts, Inc.) is a Nevada corporation with its principal place of business in Kassel, Germany. Biozoom purports to be in the business of researching, developing, and licensing technologies relating to the mobile remote collection of biomedical data as well as bilateral diagnostic communication. Biozoom's common stock is registered with the Commission pursuant to Section 12 of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. §78l] and is quoted on the Over-the-Counter Bulletin Board ("OTCBB") under the trading symbol "BIZM."

25. Legend Securities ("Legend") is a registered broker-dealer located in New York, New York.

26. Scottsdale Capital Advisors ("Scottsdale") is a registered broker-dealer located in Phoenix, Arizona.

FACTUAL BACKGROUND

A. The Creation of Entertainment Art and Initial Sale of Company

27. On June 15, 2007, Entertainment Art was incorporated under the laws of the state of Nevada. In public filings, Entertainment Art represented that it was a developmental stage company formed to design, produce, and sell a line of leather bags, with offices located in West Hempstead, New York. Entertainment Art was controlled by the three members of company management.

28. From November 2007 through March 2008, Entertainment Art offered and sold a total of 610,000 shares to 34 different investors in private placement transactions.

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A share certificate reflecting Entertainment Art share ownership was issued to each investor.

29. On July 18, 2008, Entertainment Art filed a Form S-1 registration statement with the Commission to register the resale transactions for the 34 shareholders who acquired Entertainment Art stock in these private placements ("the Form S-1 Shareholders"). In particular, of the total 1,810,000 shares outstanding at the time of the Form S-1, Entertainment Art's S-1 covered 610,000, or approximately one-third, of the company's then outstanding shares.

30. The remaining 1,200,000 shares of Entertainment Art stock were held by the three company officers in three identical 400,000 share blocks.

31. On May 1, 2009, Entertainment Art announced, in a public filing with the Commission, that the three Entertainment Art officers sold their total 1,200,000 shares of Entertainment Art to Medford Financial Ltd. ("Medford Financial"), a Belizean entity, for a purchase price of $120,000.

32. Contrary to this disclosure, however, Medford Financial purchased more than 1,200,000 shares of Entertainment Art. In fact, Medford Financial also purchased all of the 610,000 shares that had been purchased by the Form S-1 shareholders. Thus, in this transaction, Medford Financial purchased *all* of the outstanding shares, including the shares then held by the Form S-1 Shareholders.

33. Each of the Form S-1 shareholders received their initial investment back, with an additional, small return on their investment. Thus, by on or around May 2009, each of the Form S-1 shareholders had no remaining shares or other interest in Entertainment Art.

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34. According to company filings, on June 30, 2009, Entertainment Art's board of directors approved the implementation of a 33:1 forward split for Entertainment Art stock without correspondingly increasing the authorized shares of common stock for Entertainment Art. On July 21, 2009, the forward split became effective, and as a result of the forward split, the company had 59,730,000 shares of common stock outstanding – which was ***all*** owned by Medford Financial.

B. Another Sale of Entertainment Art and Acquisition of Biozoom Technology

35. On October 25, 2012, Entertainment Art reported, in a public filing with the Commission, that on October 19 Medford Financial sold 39,600,000 common shares of Entertainment Art in a private transaction with Le Mond Capital for a purchase price of $430,000, which equates to approximately $0.01 per share.

36. Le Mond Capital purports to be a foreign entity based in the British Virgin Islands. As a result of the sale, Entertainment Art disclosed that Le Mond Capital controlled over 66.3% of the Company's issued and outstanding common stock.

37. However, on information and belief, Le Mond Capital purchased the ***entire*** company from Medford Financial – and all of 59,730,000 outstanding shares.

38. The owner of Le Mond Capital, Sara Deutsch, became Entertainment Art's new President, Chief Executive Officer, Principal Executive Officer, Treasurer, Chief Financial Officer, Secretary, Treasurer, and Director. On information and belief, Deutsch is a resident of Buenos Aires, Argentina.

39. From September 2011 to at least October 2012, Deutsch worked as a manager of Magdalena's Party. According to the business' website, Magdalena's Party is

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a restaurant located in Buenos Aires, Argentina. According to another website describing Magdalena's Party, it is co-owned by Deutsch, defendant Magdalena Tavella, and others.

40. On March 12, 2013, Entertainment Art filed a Form 8-K with the Commission in which it announced a dramatic change in its business operations from a company that developed fashionable leather bags to a company that was involved in the biomedical industry. In particular, Entertainment Art announced a transaction pursuant to which its newly formed subsidiary, Biozoom Technologies, Inc., acquired certain patents, licenses, and related assets from each of three separate companies: Opsolution Spectroscopic Systems, Opsolution NanoPhotonics, and Opsolution GmBH, (the "Opsolution acquisition") in exchange for cash of $50,000 and 39 million shares of Entertainment Art common stock.

41. Entertainment Art described that, through Biozoom, it was now in the business of "researching, developing, and licensing technologies relating to the mobile remote collection of biomedical data as well as bilateral diagnostic communication."

42. Entertainment Art further disclosed that – as of immediately after closing of the Opsolution acquisition and filing of the Form 8-K – Deutsch would step down as CEO and Chief Financial Officer of Entertainment Art, but would stay on as a Director only.

43. As a result of the transaction, the 59,730,000 outstanding shares of Entertainment Art were allocated in the following manner. First, Le Mond Capital returned 39,000,000 shares to the company, and then those 39,000,000 shares were allocated – as shares bearing a restrictive legend – to four entities that were associated with the Opsolution entities.

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44. Thus, after these allocations, 20,730,000 shares of Entertainment Art remained. Le Mond Capital retained 600,000 of these shares bearing a restrictive legend. The remaining 20,130,000 shares – which represented the total shares purchased by the Form S-1 Shareholders (and subsequently sold in the Medford Financial transaction on or around May 2009) – were unallocated.

45. On April 1, 2013, Entertainment Art changed its name to Biozoom, under the trading symbol "BIZM" on the OTC Bulletin Board.

C. Defendants Deposit Biozoom Shares In Their Newly Opened Brokerage Accounts

46. From January 2013 to May 2013, brokerage accounts were opened at Legend, a registered broker-dealer based in New York, in the name of four of the defendants: Ficicchia, Blaya, Hernando, and De Lorenzo.

47. In May 2013, brokerage accounts were opened at Scottsdale, a registered broker-dealer based in Phoenix, Arizona, in the name of another four defendants: Tavella, Bagattin, Goldman, and Ferrari.

48. According to the account opening documentation – and as reflected in the table below – with one exception, none of the defendants worked in fields related to securities.

Defendant	Profession
Ficicchia	Self-employed music producer
Blaya	Music producer-stock investments
Hernando	Marketing Manager
De Lorenzo	Self-employed marketing specialist

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Defendant	Profession
Tavella	Attorney practicing administrative, political, intellectual property, and patent law
Bagattin	Retired Teacher
Ferrari	Sales and Marketing
Goldman	Delicatessen owner

1. Accounts at Legend

Andres Horacio Ficicchia

49. Defendant Ficicchia opened his account at Legend on or about January 24, 2013 and funded the account with $26,000 cash.

50. On November 30, 2012, Entertainment Art's transfer agent issued an Entertainment Art certificate for 165,000 shares to Ficicchia.

51. On March 13, 2013, Entertainment Art's transfer agent issued an Entertainment Art certificate for 1,237,500 shares to Ficicchia.

52. The certificate for 1,237,500 shares was accompanied by a corporate certification stating that Deutsch certified – at a board meeting of Entertainment Art on March 22, 2013 – the company approved the issuance of that certificate to Ficicchia.

53. In order to deposit the certificate for 1,237,500 shares and the certificate of 165,000 shares of Entertainment Art into his brokerage account at Legend, defendant Ficicchia completed a "Deposit for Securities Request Certificate Questionnaire" that was required by Legend, and provided additional documentation.

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54. The documentation reflected that Ficicchia acquired the 1,237,500 shares pursuant to two private sales that were completed on February 19, 2013: (1) a purchase of 412,500 shares from Investor A and (2) a purchase of 825,000 shares from Investor B. The documentation also reflected that Ficicchia paid a total of approximately $6,300 for these shares, which equals approximately $.005 per share. For the following reasons, the documentation submitted by Ficicchia was false.

55. Investor A was one of the Form S-1 shareholders who had sold his shares of Entertainment Art on or around May 2009 – almost four years before Ficicchia's claimed purchase of shares from Investor A. Investor B was purportedly a shareholder that acquired its shares from some of the Form S-1 shareholders in 2011 – approximately two years after the Form S-1 shareholders actually sold their shares.

56. The documentation further reflected that Defendant Ficicchia acquired the 165,000 shares pursuant to a private sale that was completed on November 30, 2012 with Investor C – shares that he acquired for $24,750, which equals $0.15 per share. Investor C was also one of the Form S-1 Shareholders who had sold his shares of Entertainment Art on or around May 2009 – over three years before Ficicchia's claimed purchase of shares from Investor C.

57. On March 5, 2013, Ficicchia deposited 165,000 shares of Entertainment Art not bearing a restrictive legend into his brokerage account at Legend; and then on March 27, 2013, Ficicchia deposited an additional 1,237,500 shares (again not bearing a restrictive legend) – for a total of 1,402,500 shares.

58. On April 1, 2013, due to the name change of Entertainment Art to Biozoom, these shares became Biozoom shares. Thus, defendant Ficicchia held

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1,402,500 shares of Biozoom that were purportedly available to be sold on the public markets.

Gonzalo Garcia Blaya

59. On or about March 26, 2013, defendant Blaya opened an account at Legend and funded this account with $26,000 cash.

60. On March 22, 2013 – just four days prior to opening this account – Entertainment Art's transfer agent issued a certificate for 1,485,000 Entertainment Art shares to Blaya.

61. In order to deposit his certificate for 1,485,000 shares of Entertainment Art into his brokerage account at Legend, defendant Blaya completed a "Deposit for Securities Request Certificate Questionnaire" that was required by Legend, and provided additional documentation. For the following reasons, the documentation submitted by Blaya was false.

62. The documentation reflected that Blaya acquired the 1,485,000 shares in four separate private sales that were completed on March 4, 2013: (1) a purchase of 165,000 shares from Investor D; (2) a purchase of 495,000 shares from Investor E; (3) a purchase of 165,000 shares from Investor F; and (4) a purchase of 660,000 shares from Investor G. The documentation also reflected that Blaya paid a total of approximately $6,765 for these shares, which equals approximately $.005 per share.

63. Each of Investors D, E, F, and G were Form S-1 Shareholders who had sold their Entertainment Art shares on or around May 2009 – almost four years before Blaya's claimed purchase of shares from these investors.

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64. On April 16, 2013, Blaya deposited 1,485,000 shares of Entertainment Art not bearing a restrictive legend into his brokerage account at Legend. As a result of the business name change on April 1, 2013, these shares became Biozoom shares. Thus, defendant Blaya held 1,485,000 shares of Biozoom that were purportedly available to be sold on the public markets.

Luciana Mariana Hernando

65. On or about March 7, 2013, defendant Hernando opened an account at Legend and funded the account with $50,000 cash.

66. On March 22, 2013, Entertainment Art's transfer agent issued a certificate for 1,815,000 Entertainment Art shares to Hernando.

67. In order to deposit her 1,815,000 shares of Entertainment Art into her brokerage account at Legend, defendant Hernando completed a "Deposit for Securities Request Certificate Questionnaire" that was required by Legend, and provided additional documentation. For the following reasons, the documentation submitted by Hernando was false.

68. The documentation reflected that Hernando acquired the 1,815,000 shares pursuant to two separate private sales that were completed on March 5, 2013: (1) a purchase of 1,650,000 shares from Investor H; and (2) a purchase of 165,000 shares from Investor I. The documentation also reflected that Hernando paid a total of approximately $5,445 for these shares, which equals approximately $.003 per share.

69. Both Investors H and I were Form S-1 shareholders who had sold their Entertainment Art shares on or around May 2009 – almost four years before Hernando's claimed purchase of shares from these investors.

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70. On May 14, 2013, defendant Hernando deposited 1,815,000 shares of Entertainment Art not bearing a restrictive legend into her brokerage account at Legend Securities. As a result of the business name change on April 1, 2013, these shares became Biozoom shares. Thus, defendant Hernando held 1,815,000 shares of Biozoom that were purportedly available to be sold on the public markets.

Cecilia De Lorenzo

71. On or about February 4, 2013, defendant De Lorenzo opened an account at Legend and funded the account with $50,000 cash.

72. On March 13, 2013, Entertainment Art's transfer agent issued a certificate for 2,062,500 shares to De Lorenzo.

73. The certificate was accompanied by a corporate certification stating that Deutsch certified – at a board meeting of Entertainment Art on March 22, 2013 – the company approved the issuance of the above certificate to De Lorenzo.

74. In order to deposit her 2,062,500 shares of Entertainment Art into her brokerage account at Legend, De Lorenzo completed a "Deposit for Securities Request Certificate Questionnaire" that was required by Legend, and provided additional documentation. For the following reasons, the documentation submitted by De Lorenzo was false.

75. The documentation reflected that De Lorenzo acquired the 2,062,500 shares pursuant to two separate private sales that were completed on February 19, 2013 – the same day as the purported purchases of Entertainment Art stock by Ficicchia: (1) a purchase of 1,650,000 shares from Investor J; and (2) a purchase of 412,500 shares from

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Investor K. The documentation also reflected that Defendant De Lorenzo paid a total of approximately $8,300 for these shares, which equals approximately $.004 per share.

76. Both Investors J and K, however, were Form S-1 shareholders who had sold their Entertainment Art shares on or around May 2009 – almost four years before defendant De Lorenzo's claimed purchase of shares from these investors.

77. On March 22, 2013, defendant De Lorenzo deposited 2,062,500 shares of Entertainment Art not bearing a restrictive legend into her brokerage account at Legend. As a result of the business name change on April 1, 2013, these shares became Biozoom shares. Thus, defendant De Lorenzo held 2,062,500 shares of Biozoom that purportedly could be sold on the public markets.

2. Accounts at Scottsdale

Magdalena Tavella

78. On March 22, 2013, Entertainment Art's stock transfer agent issued a certificate for 1,815,000 shares of Entertainment Art to Tavella.

79. On or about May 16, 2013, defendant Tavella opened an account at Scottsdale.

80. In order to deposit her 1,815,000 shares of Entertainment Art into her brokerage account, Scottsdale, using information and documentation provided by Tavella, completed a securities deposit checklist. For the following reasons, the documentation submitted by Tavella was false.

81. The documentation reflected that Tavella acquired the 1,815,000 shares pursuant to three separate private sales that were completed on March 5, 2013 – the same day as the purported purchases of Entertainment Art by defendant Hernando: (1) a

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purchase of 165,000 shares from Investor L; (2) a purchase of 165,000 shares from Investor M; and (3) a purchase of 1,485,000 shares from Investor N. The documentation reflected that Tavella paid a total of approximately $9,075 for these shares, which equals approximately $.006 per share.

82. Investors L and M were two of the Form S-1 shareholders who had sold their shares of Entertainment Art on or around May 2009 – almost four years before Tavella's claimed purchase of shares from them. Investor N was purportedly a shareholder that acquired its shares from some of the Form S-1 shareholders in March 2011 – almost two years after the Form S-1 shareholders sold their shares.

83. On May 22, 2013, defendant Tavella deposited 1,815,000 shares of Entertainment Art not bearing a restrictive legend into her brokerage account at Scottsdale. As a result of the business name change on April 1, 2013, these shares became Biozoom shares. Thus, defendant Tavella held 1,815,000 shares of Biozoom that were purportedly available to be sold on the public markets.

Adriana Rosa Bagattin

84. On March 13, 2013, Entertainment Art's transfer agent issued a certificate for 2,310,000 Entertainment Art shares to defendant Bagattin.

85. On or about May 10, 2013, defendant Bagattin opened an account at Scottsdale.

86. In order to deposit her 2,310,000 shares of Entertainment Art into her brokerage account, Scottsdale, using information and documentation provided by Bagattin, completed a securities deposit checklist. For the following reasons, the documentation submitted by Bagattin was false.

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87. The documentation reflected that Bagattin acquired the 2,310,000 shares pursuant to three private sales that were completed on February 26, 2013: (1) a purchase of 1,650,000 shares from Investor O; (2) a purchase of 330,000 shares from Investor P; and (3) a purchase of 330,000 shares from Investor Q. The documentation reflected that Defendant Bagattin paid approximately $6,930 for these shares, which equals approximately $.003 per share.

88. Each of Investors O, P, and Q, however, were Form S-1 Shareholders who had sold their Entertainment Art shares on or around May 2009 – almost four years before defendant Bagattin's claimed purchase of shares from these persons.

89. On May 22, 2013, Bagattin deposited 2,310,000 shares of Entertainment Art not bearing a restrictive legend into her brokerage account at Scottsdale. As a result of the business name change on April 1, 2013, these shares became Biozoom shares. Thus, defendant Bagattin held 2,310,000 shares of Biozoom that were purportedly available to be sold on the public markets.

Daniela Patricia Goldman

90. On March 22, 2013, Entertainment Art's transfer agent issued a certificate for 2,485,000 Entertainment Art shares to Goldman.

91. On or about May 13, 2013, defendant Goldman opened an account at Scottsdale.

92. In order to deposit her 2,485,000 shares of Entertainment Art into her brokerage account, Scottsdale, using documentation and information provided by Goldman, completed a securities deposit checklist. For the following reasons, the documentation submitted by Goldman was false.

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93. The documentation reflected that Goldman acquired the 2,485,000 shares pursuant to two private sales that were completed on March 4, 2013: (1) a purchase of 1,485,000 shares from Investor R; and (2) a purchase of 1,000,000 shares from Investor S. The documentation also reflected that Goldman paid approximately $7,455 for these shares, which equals approximately $.003 per share.

94. Investor R purportedly obtained its shares from some of the Form S-1 Shareholders in March 2011 – almost two years after the Form S-1 shareholders sold their shares. Investor S was one of the Form S-1 shareholders and sold his shares on or around May 2009 – almost four years before defendant Goldman's claimed purchase of shares from him.

95. On May 22, 2013, Goldman deposited 2,485,000 shares of Entertainment Art not bearing a restrictive legend into her brokerage account at Scottsdale. As a result of the business name change on April 1, 2013, these shares became Biozoom shares. Thus, defendant Goldman held 2,485,000 shares of Biozoom that were purportedly available for sale on the public markets.

Mariano Pablo Ferrari

96. On March 22, 2013, Entertainment Art's transfer agent issued a certificate for 2,310,000 Entertainment Art shares to Ferrari.

97. On or about May 20, 2013, Ferrari opened an account at Scottsdale.

98. In order to deposit his 2,310,000 shares of Entertainment Art into his brokerage account, Scottsdale, using documentation and information provided by Ferrari, completed a securities deposit checklist. For the following reasons, the documentation provided by Ferrari was false.

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99. The documentation reflected that Ferrari acquired the 2,310,000 shares pursuant to two private sales that were completed on March 5, 2013: (1) a purchase of 1,650,000 shares from Investor T; and (2) a purchase of 660,000 shares from Investor U. The documentation also reflected that Goldman paid approximately $9,240 for these shares, or approximately $.004 per share.

100. Investor T was one of the Form S-1 shareholders and sold his shares on or around May 2009 – almost four years before defendant Ferrari's claimed purchase of shares from him. Investor U purportedly obtained its shares from some of the Form S-1 shareholders in September 2009.

101. On May 22, 2013, Ferrari deposited 2,310,000 shares of Entertainment Art not bearing a restrictive legend into his brokerage account at Scottsdale. As a result of the business name change on April 1, 2013, these shares became Biozoom shares. Thus, defendant Ferrari held 2,310,000 shares of Biozoom that were purportedly available for sale on the public markets.

Two Other Accounts in Names of Defendants Graciarena and Loureyro

102. On March 22, 2013, Manhattan Transfer issued a certificate for 2,145,000 Entertainment Art shares to Graciarena and 2,300,000 Entertainment Art shares to Loureyro. Graciarena and Loureyro submitted documentation reflecting that they had obtained their shares in the same manner as the other eight defendants – i.e. – by purportedly purchasing shares from the Form S-1 shareholders.

103. On or about June 14, 2013, Fernando Loureyro and Mariano Graciarena opened separate accounts at Scottsdale. Like the other eight defendants, both stated in brokerage firm documents that they resided in Buenos Aires, Argentina.

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104. On June 18, 2013, these shares were deposited in the brokerage accounts of these two individuals. To date, none of these shares have been sold.

105. In sum, from November 2012 to June 2013, the ten defendant accounts received a total of 20,130,000 shares of Entertainment Art. These shares represented all of the shares that were unallocated after the Opsolution acquisition. Moreover, these shares represented *100%* percent of the total shares without a restrictive legend outstanding in Biozoom at the time, and more than *33%* percent of the total outstanding shares of Biozoom.

D. Defendants Sell Millions of Biozoom Shares

106. Beginning on May 22, 2013 – and after nearly all of the defendants had deposited their Biozoom shares not bearing a restrictive legend in their accounts – Biozoom began issuing a series of press releases in which it claimed it "created the world's first portable, handheld consumer device" to instantly and non-invasively measure certain biomarkers. These claims were also made by other entities, including Global Financial, Inc., Stock Preacher.com, among others.

107. Following these positive claims concerning Biozoom's prospects, the accounts in the name of eight of the selling defendants sold substantial amounts of their Biozoom stock that did not bear a restrictive legend for massive proceeds. In particular, and as reflected in the chart below, eight of the defendants sold 14,078,406 shares of BIZM stock for proceeds of $33,997,152.

Defendant	Shares Sold	Dates Sold	Proceeds	Shares Remaining
Blaya	1,312,053	5/16/13 – 6/13/13	$3,014,965	172,947
De Lorenzo	1,328,000	6/17/13 – 6/18/13	$4,809,836	734,500
Hernando	1,815,000	6/6/13 – 6/17/13	$5,048,217	0

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Defendant	Shares Sold	Dates Sold	Proceeds	Shares Remaining
Ficcichia	1,402,500	5/20/13 – 6/5/13	$1,979,389	272,620[1]
Tavella	1,592,444	6/7/13 – 6/11/13	$3,116,894	382,956[2]
Bagattin	2,176,726	6/10/13 – 6/18/13	$6,223,310	133,724
Ferrari	1,994,038	6/7/13 – 6/19/13	$5,456,690	315,962
Goldman	2,457,645	5/28/13 – 6/6/13	$3,771,761	27,355

108. All of the eight selling defendants placed their orders to sell Biozoom stock in the same manner – via e-mail and instant message to either Legend or Scottsdale.

109. Upon selling shares in Biozoom, several of the defendants instructed their brokerage firms to wire the proceeds of their sales to foreign bank accounts in various countries:

- **Ficicchia:** On June 7, 2013, defendant Ficicchia instructed Legend, to wire $1 million to Alpine Securities, Inc., a registered clearing broker-dealer. Alpine provides clearing services for Scottsdale, and as described earlier, Ficicchia opened an account at Scottsdale on or around June 10, 2013 and funded it with this $1 million. On June 25, 2013 – the same day as the Commission's order suspending trading in Biozoom – Ficicchia instructed Scottsdale to wire $325,000 to a bank account in Cyprus. This wire was not executed. Ficicchia's brokerage account at Legend currently has a cash balance of slightly over $1 million, and Ficicchia's brokerage account at Scottsdale currently has a cash balance of approximately $328,000.

---

[1] On or around June 10, 2013, Ficicchia opened an account at Scottsdale and funded this account with $1 million from his account at Legend. Ficicchia's "Shares Remaining" column reflects Biozoom purchases that he has made in his account at Scottsdale.

[2] Tavella's "Shares Remaining" column includes 160,400 Biozoom shares that she purchased in the open market on June 19, 2013.

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- **Blaya:** On June 14, 2013, Blaya instructed Legend to wire "all settled funds except $30,000" to an account held in Geneva, Switzerland. This wire was not executed. This account currently has a cash balance of approximately $3.5 million.
- **Hernando:** On June 13, 2013, Hernando instructed his broker-dealer, Legend, to wire "all available settled cash" in her account, which at the time, was approximately $600,000, to an account held at Hellenic Bank Public Company Limited in Lemesos, Cyprus. This wire was executed. On June 17, 2013, Hernando instructed his broker-dealer, Legend, to wire $2 million, again to an account held at Hellenic Bank Public Company Limited in Lemesos, Cyprus. This wire was not executed by Legend. This account has a cash balance of approximately $4.5 million.
- **De Lorenzo:** De Lorenzo has not yet attempted to wire any money out of her account. De Lorenzo has a bank account in Dar Es Salaam. The account has a cash balance of approximately $4.8 million.
- **Tavella:** On June 25, 2013 – the day of the Commission's order suspending trading in the securities of Biozoom – Tavella attempted to wire approximately $2,450,000 out of her account at Scottsdale to a bank account in St. Vincent and the Grenandines. This wire has not been executed. The current cash balance in Tavella's brokerage account is approximately $2.47 million.
- **Bagattin:** On June 20, 2013, Bagattin instructed Scottsdale to wire approximately $4.33 million to a bank account in Cyprus. This wire was executed. On June 24, 2013, Bagattin instructed Scottsdale to send an additional

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approximately $1.89 million to the same bank account. This wire was also executed. The current cash balance in Bagattin's brokerage account is $3,000.

- **Goldman:** On June 11, 2013, Goldman instructed Scottsdale to wire approximately $3.77 million to an account held at a bank in Geneva, Switzerland – a bank where Blaya also holds an account. This wire was executed. The cash balance in Goldman's account is $0.
- **Ferrari:** On June 19, 2013, Ferrari instructed Scottsdale to wire $500,000 to an account held at a bank in Panama. This wire was executed. On June 24, 2013, Ferrari instructed Scottsdale to wire an additional $4.9 million, this time to a bank in Belize. This wire was also executed. The cash balance in Ferrari's account is $0.

F. No Registration Statement Was In Effect At the Time Defendants Sold Biozoom Shares

110. Section 5 of the Securities Act makes it unlawful for any person, directly or indirectly, to offer or sell securities, using the U.S. mails or interstate commerce, unless such offer or sale is registered with the Commission.

111. No registration statement was in effect for the shares sold by the Selling Defendants.

112. No registration statement is in effect for the Biozoom shares held by defendants Graciarena and Loureyro.

G. Biozoom Is A Penny Stock As Defined By The Securities Exchange Act of 1934 ("Exchange Act")

113. Biozoom's stock is a "penny stock" as defined by the Exchange Act. At times relevant to this Complaint, the stock's shares traded at less than $5.00 per share. During the same time period, Biozoom's stock did not meet any of the exceptions to

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penny stock classification pursuant to Section 3(a)(51) and Rule 3a51-1 of the Exchange Act.

114. For example, the company's stock: (1) did not trade on a national securities exchange; (2) was not an "NMS stock," as defined in 17 C.F.R. § 242.242.600(b)(47); (3) did not have net tangible assets (i.e., total assets less intangible assets and liabilities) in excess of $5,000,000; and (4) did not have average revenue of at least $6,000,000 for the last three years. (*See* Exchange Act, Rule 3a51-1(g).)

COUNT I

VIOLATION OF SECTION 5 OF THE SECURITIES ACT, 15 U.S.C. §77e

(Defendants Tavella, Ficicchia, Blaya, Hernando, De Lorenzo, Bagattin, Ferrari, Goldman)

115. Paragraphs 1 through 114 are hereby re-alleged and incorporated by reference.

116. Defendants, by engaging in the conduct described above, directly or indirectly, and without a registration statement in effect as to such securities:

(a) made use of means or instruments of transportation or communication in interstate commerce or of the mails to sell, through the use or medium of a prospectus or otherwise; or

(b) carried or caused to be carried through the mails or in interstate commerce, by any means or instruments of transportation, securities for the purpose of sale or for delivery after sale.

117. Defendants, by engaging in the conduct described above, also directly or indirectly, made use of the means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or

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medium of any prospectus or otherwise securities, without a registration statement having been filed as to those securities.

118. By engaging in the foregoing conduct, Defendants directly or indirectly, violated, and unless restrained and enjoined will continue to violate Sections 5(a) and 5(c) of the Securities Act [15 U.S.C. §§ 77e(a) and 77e(c)].

COUNT II

INJUNCTION PURSUANT TO SECTION 20(b) OF THE SECURITIES ACT

(Defendants Graciarena and Loureyro)

119. Paragraphs 1 through 114 are re-alleged and incorporated by reference herein.

120. Securities Act Section 20(b) provides that "whenever it shall appear to the Commission that any person is engaged in or is about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this title, the Commission may in its discretion, bring an action in district court to enjoin such acts or practices . . ."

121. Defendants Graciarena and Loureyro have deposited shares of Biozoom in their respective brokerage accounts. Those shares do not bear a restrictive legend. However, no registration statement is in effect for the offer of sale of those shares.

122. Unless restrained and enjoined, Graciarena and Loureyro are likely to offer or sell their Biozoom shares to the public in violation of Section 5 of the Securities Act.

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PRAYER FOR RELIEF

WHEREFORE, the Commission respectfully requests that this Court:

I.

Issue findings of fact and conclusions of law that defendants Ficicchia, Blaya, Hernando, De Lorenzo, Tavella, Goldman, Bagattin, and Ferrari committed the violations charged and alleged herein.

II.

Enter an order temporarily restraining and enjoining defendants Ficicchia, Blaya, Hernando, De Lorenzo, Tavella, Goldman, Bagattin, Ferrari, Graciarena, and Loureyro, their officers, agents, servants, employees, attorneys and those persons in active concert or participation with defendants who receive actual notice of the Order, by personal service or otherwise, and each of them from, directly or indirectly, engaging in the transactions, acts, practices or courses of business described above, or in conduct of similar purport and object, in violation of Sections 5(a) and 5(c) of the Securities Act [15 U.S.C. §§ 77e(a) and 77e(c)].

III.

Enter an order freezing the brokerage accounts and any assets of defendants Ficicchia, Blaya, Hernando, De Lorenzo, Tavella, Goldman, Bagattin, and Ferrari derived from the sale of Biozoom stock; and, freezing the brokerage accounts of defendants Graciarena and Loureyro holding Biozoom shares.

IV.

Enter an order requiring defendants Ficicchia, Blaya, Hernando, De Lorenzo, Tavella, Goldman, Bagattin, and Ferrari to return to the United States any proceeds from the sale of Biozoom stock that have been transferred abroad and those proceeds which are

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returned be frozen in a domestic bank during the pendency of this action to preserve such assets for the satisfaction of disgorgement.

V.

Enter an Order of Permanent Injunction restraining and enjoining defendants Ficicchia, Blaya, Hernando, De Lorenzo, Tavella, Goldman, Bagattin, Ferrari, Graciarena, and Loureyro, their officers, agents, servants, employees, attorneys and those persons in active concert or participation with defendants who receive actual notice of the Order, by personal service or otherwise, and each of them from, directly or indirectly, engaging in the transactions, acts, practices or courses of business described above, or in conduct of similar purport and object, in violation of Sections 5(a) and 5(c) of the Securities Act [15 U.S.C. §§ 77e(a) and 77e(c)].

VI.

Enter an Order requiring defendants Ficicchia, Blaya, Hernando, De Lorenzo, Tavella, Goldman, Bagattin, and Ferrari to disgorge the ill-gotten gains received as a result of the violations alleged herein, including prejudgment interest.

VII.

Issue an Order imposing upon defendants Ficicchia, Blaya, Hernando, De Lorenzo, Tavella, Goldman, Bagattin, and Ferrari appropriate civil penalties pursuant to Section 20(d) of the Securities Act [15 U.S.C. §77t(d)].

VIII.

Issue an order permanently and unconditionally barring, pursuant to Section 20(g) of the Securities Act [15 U.S.C. § 77t(g)], the Selling Defendants from participating in an

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offering of penny stock as defined by Exchange Act Section 3(a)(51) [15 U.S.C. § 78c(a)(51)] and Rule 3a51-1 thereunder [17 C.F.R. § 240.3a51-1].

IX.

Retain jurisdiction of this action in accordance with the principles of equity and the Federal Rules of Civil Procedure in order to implement and carry out the terms of all orders and decrees that may be entered or to entertain any suitable application or motion for additional relief within the jurisdiction of this Court.

X.

Grant such other relief as this Court deems appropriate.

Dated: July 3, 2013

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

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John Hurry

The sanctions are contained in a 111-page decision that FINRA released on March 31, 2017. The decision is a loss for Mr. Hurry and for Scottsdale, which had claimed that it was simply the broker on the sales. The firm also said that it had adequate procedures in place to detect insider activity, and would not accept deposits that involved more than 10 per cent of a company's shares.

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FINRA fines Scottsdale Capital $1.5-million (U.S.)

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by Mike Caswell
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John Hurry
The sanctions are contained in a 111-page decision that FINRA released on March 31, 2017. The decision is a loss for Mr. Hurry and for Scottsdale, which had claimed that it was simply the broker on the sales. The firm also said that it had adequate procedures in place to detect insider activity, and would not accept deposits that involved more than 10 per cent of a company's shares.
FINRA, however, has found that Scottsdale ignored many indications that it was selling shares for insiders in unregistered transactions. The firm allowed sellers to operate through nominees and through an entity incorporated in the Cayman Islands. Its way of doing business amounted to "institutionalization of the misconduct," FINRA has found. Scottsdale's procedures only created the appearance of compliance.
The sanctions stem from Scottsdale's sale of shares in three companies, including Voip Pal.com, in 2013

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U.S. Stocks Open Higher Amid Volatile Oil Moves

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and 2014. According to FINRA, the sales generated $1.7-million in proceeds. It should have been clear to Scottsdale that the share transactions leading to those sales required some investigation, the decision states. Insiders (who would normally be subject to heightened reporting requirements) looked to be connected to the selling, according to FINRA.

With Voip Pal.com, most of the shares were initially issued to an entity controlled by the company's former president, Vancouver resident Richard Kipping. (Mr. Kipping is not a respondent in FINRA's case, and the regulator has not made any finding against him.) In accepting the shares for deposit and subsequent sale, Scottsdale made little effort to determine if Mr. Kipping was an insider, FINRA says. The firm knew that he had been Voip Pal.com's president, but it did nothing to determine if he remained an insider. It did not obtain his resignation letter or even a date for his resignation, according to FINRA.

Even more important, Scottsdale ignored indications that Mr. Kipping remained an insider through his ownership of more than 10 per cent of the company's shares, FINRA says. Documents in Scottsdale's possession showed that Mr. Kipping had received 80 million shares of Voip Pal.com in the two years prior to that date. That amounted to 10.99 per cent of the company's total issued shares. The circumstances raised a strong suspicion that Voip Pal.com was "unlawfully distributing securities without registration in a two-step process designed to obscure what was actually happening and who was benefiting from the sales of stock," the decision states.

While FINRA's decision mostly cites Mr. Hurry and Scottsdale for selling shares in Voip Pal.com and two other companies, the decision indicates that Mr. Hurry was engaged in other dubious dealings. In 2013, he set up an entity in the Cayman Islands that he named Cayman Securities Clearing and Trading SECZ Ltd. According to FINRA, he formed Cayman Securities to act as a conduit for offshore institutions to deposit shares at Scottsdale for eventual sale into the U.S. markets. Over a seven-month period, Cayman Securities deposited billions of shares with Scottsdale, FINRA says.

The risky nature of those dealings was exposed in the summer of 2014, according to the decision. The U.S. Securities and Exchange Commission and criminal authorities began proceedings against some customers of Scottsdale and Cayman Securities. After those charges became public, the business of Cayman Securities substantially declined, FINRA says.

(Included in those actions was an indictment filed in New York on Sept. 8, 2014, against an Oregon man named Bob Bandfield. Prosecutors claimed that Mr. Bandfield ran a massive money laundering operation that contributed to the manipulations of over 40 publicly traded companies. He set up an offshore system that allowed insiders of U.S. companies to hide their share positions and launder

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and is now serving six years in jail. His co-defendants included West Vancouver's Gregg Mulholland and Kelowna's Phil Kueber. Both also pleaded guilty, with Mr. Mulholland receiving 12 years in jail and Mr. Kueber awaiting sentencing.)

Meanwhile Mr. Hurry and his wife were profiting substantially, according to FINRA's decision. In the year ended June 30, 2014, the firm paid $6.2-million in compensation to its directors. Since Mr. Hurry and his wife were the only directors, this money must have gone to them, FINRA says.

While much of the decision deals with violations of securities rules, it also contains a few snippets that show Mr. Hurry's relationship with his employees was not always a fond one. Two of those employees stated that he would contact them at all times of the day and on weekends. If he could not reach them, he would start to send demanding, abrupt and increasingly impatient e-mails. In one e-mail, he wrote: "Your phone is not working TURN IT ON. I need a call." Another read: "Call me in 60 minutes. DO YOU NOT UNDERSTAND THAT?" Mr. Hurry also maintained a spreadsheet that detailed much of their activity, including the amount of time that they spent on cigarette breaks.

The ban for Mr. Hurry prevents him from associating with any FINRA member in any capacity. In effect, he can no longer be a brokerage employee. FINRA also fined two Scottsdale employees, Timothy DeBlasi and Michael Cruz. They each must pay $50,000 and serve a two-year ban.

Voip Pal.com remains an active company, listing an address in Bellevue, Wash. The stock closed at four cents Monday. The company was not a respondent in the case or in any other action.

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FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. SCOTTSDALE CAPITAL ADVISORS CORPORATION (CRD No. 118786), JOHN J. HURRY (CRD No. 2146449), TIMOTHY B. DIBLASI (CRD No. 4623652), and D. MICHAEL CRUZ (CRD No. 2450344), Respondents.	Disciplinary Proceeding No. 2014041724601 Hearing Officer–LOM **AMENDED EXTENDED HEARING PANEL DECISION**[1] June 20, 2017

The Respondent firm violated FINRA Rule 2010 by selling securities without registration and without an exemption, in contravention of Section 5 of the Securities Act of 1933. The firm's owner, Respondent John Hurry, also violated Rule 2010, because he engaged in activities designed to enable the unlawful transactions and evade regulatory scrutiny.

The Respondent firm and its Chief Compliance Officer, Respondent Timothy DiBlasi, violated NASD Rules 3010(a) and (b) and FINRA Rule 2010 by failing to establish and maintain a supervisory system, including written

[1] The original Extended Hearing Panel Decision has been amended to correct a factual error. The amendment does not change the substance of the decision.

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supervisory procedures, reasonably designed to ensure that the firm complied with Section 5 of the Securities Act.

The Respondent firm and its President, Respondent Michael Cruz, violated NASD Rule 3010(b) and FINRA Rule 2010 by failing to supervise and failing to respond appropriately to numerous red flags indicative of unlawful unregistered distributions.

The Respondent firm is fined $1.5 million. Hurry is barred in all capacities. He would also be fined $100,000, but, in light of the bar, the fine is not imposed. DiBlasi is suspended for two years and fined $50,000. Cruz is suspended for two years and fined $50,000. In addition, Respondents are ordered to pay costs, for which they are jointly and severally liable.

Appearances

For the Complainant: Jeffrey D. Pariser, Esq., Gregory R. Firehock, Esq., Laura Leigh Blackston, Esq., and Heather L. Freiburger, Esq., Department of Enforcement, Financial Industry Regulatory Authority.

For the Respondents: Kevin J. Harnisch, Esq., Michael J. Edney, Esq., and Ryan E. Meltzer, Norton Rose Fulbright US LLP.

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DECISION

I. INTRODUCTION

A. The Respondent Firm

The Respondent firm, Scottsdale Capital Advisors Corporation ("Scottsdale" or the "Firm"), is primarily engaged in the business of liquidating penny stocks for its customers without registration. The sale of securities without registration is unlawful unless an exemption exists. In selling securities without registration, Scottsdale usually relies on a "safe harbor" exemption created by the Securities and Exchange Commission ("SEC"), Rule 144. But the securities at issue here did not qualify for the Rule 144 exemption. Thus, the sales were unlawful.

1. The Firm Relied On The Rule 144 Exemption

SEC Rule 144 is highly detailed and technical. It both restricts some transactions and permits others that meet certain conditions. It comes into play where securities have been acquired from the issuer or an affiliate in an unregistered private transaction. Such securities typically are marked with a restrictive legend, and the holder may not sell such securities in the public marketplace unless an exemption applies to the sale.

In determining whether a sale of securities is exempt from registration under Rule 144, a broker-dealer must conduct an inquiry that focuses primarily on identifying the individual who is the beneficial owner of the securities to be sold, analyzing that person's relationship (if any) to the issuer of the securities, investigating the circumstances of that person's acquisition of the securities, and calculating how long the person has held the securities. Rule 144 imposes different holding periods on affiliates and non-affiliates of an issuer before they can resell the issuer's securities. In some circumstances, the holder can "tack" his holding period to that of his predecessor in the chain of holders to meet the applicable holding period.

The purpose of the Rule 144 inquiry is to ensure that the transaction is not a subterfuge for an issuer or its affiliates to distribute securities to the public while evading the disclosure requirements that accompany registration. Representations made by the parties interested in selling the securities must be carefully scrutinized by a broker-dealer firm because of the incentive to misrepresent the circumstances and conceal the true beneficial owners.

2. The Firm Lacked A Basis For "Tacking" To Achieve The Required Holding Period Under SEC Rule 144

In the transactions at issue, the purported beneficial owners claimed that neither they nor their predecessors were affiliates of the issuer. Their lack of affiliate status was critical to their ability to sell the shares pursuant to SEC Rule 144 because of the shorter holding period and fewer restrictions on non-affiliates.

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Even as non-affiliates, however, none of the purported beneficial owners of the shares that Scottsdale accepted for resale had held the shares long enough to qualify for the Rule 144 safe harbor holding period. Each seller therefore claimed that the applicable Rule 144 holding period was satisfied by tacking his holding period to the holding period of a prior holder.

In the transactions at issue, one prior holder claimed that he had forgiven a loan that he had made to the issuer and had exchanged the right to payment on the loan for stock. One of the prior holders forgave a promissory note that the issuer had used to pay him for consulting services. Another prior holder claimed to have extended an oral line of credit to the issuer and then to have accepted shares in satisfaction of a sum owed on the line of credit. A third prior holder forgave a portion of a promissory note extending an open-ended line of credit.

Each of these prior holders received the shares around the same time that he transferred them. Thus, the prior holder did not actually hold the shares long enough for his successor to satisfy the applicable holding period by tacking, creating an impediment to resale.

To overcome that impediment, the sellers of the securities claimed the benefit of another tacking provision under Rule 144. Rule 144 provides that where a holder of a security exchanges that security for another of the same issuer's securities, without any additional compensation, the holder may tack the holding period of the first security to the holding period of the second. The theory is that the exchange of one security for another of the same issuer does not change the nature of the holder's capital at risk, so the holding period for the new security can tack back to the date the old security was acquired. The sellers here characterized their prior holders' exchanges of notes for stock as exchanges of one security for another. On that basis, the sellers claimed that they could tack back to the inception of the prior holders' loans.

Whether the first instrument in the chain was a security is thus a threshold issue. The Firm treated the prior holders' promissory notes and lines of credit as securities and the conversion of that debt into stock as the exchange of one security of the issuer for another security of the same issuer. As a result, the Firm concluded that the sellers were permitted to tack their holding period all the way back to the inception of the prior holders' loans.

The Firm erred. The promissory notes and lines of credit were not securities. Rather, they were ordinary debt liabilities. Accordingly, the purported beneficial owners could not establish the requisite holding period, and the Rule 144 exemption did not exist.

3. The Firm Also Failed To Address Red Flags Signaling Unlawful Distributions

The transactions at issue involved persons seeking to sell large blocks of thinly traded, little-known securities acquired in a chain of private transactions originating with the issuer—generally a red flag that the SEC and FINRA have both said requires a "searching inquiry." The sellers acquired the shares from the prior holders and sought to resell the shares almost immediately. The immediate resale of a large block of stock that has never been the subject of registration disclosures strongly suggests an attempt to distribute securities to the public without

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registration. In addition, there were a large number of discrepancies and suspicious circumstances indicating that sham transactions, false documents, and nominees were being used to evade the securities laws and effect unlawful securities sales without registration. These red flags ought to have been investigated and appropriately resolved before the securities could be sold.

The Firm, however, blinded itself to the multiple red flags signaling that the transactions were unlawful public distributions of securities. It did not conduct the required searching inquiry. It sold the securities without a reasonable basis for a Rule 144 exemption. Because of the suspicious circumstances known to the Firm, it also was not entitled to the so-called "broker's exemption" under Section 4(4) of the Securities Act for ordinary trading.

B. Other Respondents

1. John Hurry

Scottsdale is owned indirectly by Respondent John Hurry and his wife, Justine Hurry, through other entities they own and control. John Hurry also owns the clearing firm that handles Scottsdale's business, Alpine Securities Corporation ("Alpine"), and an off-shore foreign financial institution ("FFI") located in the Cayman Islands, Cayman Securities Clearing and Trading SECZ, Ltd. ("CSCT").

Hurry set up CSCT in 2013 to act as a conduit through which other FFIs could deposit penny stocks at Scottsdale for resale in the U.S. securities market. During the relevant period, December 1, 2013, through June 30, 2014, CSCT deposited billions of shares of penny stocks for resale by Scottsdale. All the transactions at issue were routed through CSCT to Scottsdale.

2. Timothy DiBlasi

Respondent Timothy DiBlasi became Scottsdale's chief compliance officer ("CCO") shortly before the events at issue, and he remains its CCO. He maintains, however, that his responsibilities do not extend to the Firm's Rule 144 business.

3. Michael Cruz

Respondent Michael Cruz was the Firm's president, but now serves as general counsel to the collection of Hurry enterprises. During the relevant period, Cruz had final approval authority over the Rule 144 transactions at issue. In that role, he reviewed the information collected by others and determined whether it was sufficient to approve a deposit of stock certificates for resale. Everyone at the Firm, including Henry Diekmann, who headed the Firm's Rule 144 team at the time of the transactions at issue, and who is now the Firm's president, considered Cruz responsible for Rule 144 compliance.

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C. Parties To The Transactions At Issue

This case concerns Scottsdale's sales of stock issued by three little-known companies—Neuro-Hitech Inc. ("NHPI"), VoipPal.com ("VPLM"), and Orofino Gold Corp. ("ORFG"). CSCT deposited millions of the three issuers' shares in certificate form at Scottsdale for resale. Alpine cleared them, and Scottsdale sold them into the U.S. securities market pursuant to Rule 144 without registration.

In making the deposits of NHPI, VPLM, and ORFG stock, CSCT acted on behalf of three other FFIs: (i) Montage Securities ("Montage"), (ii) Titan International Securities ("Titan"), and (iii) Unicorn International Securities ("Unicorn"). Montage was located in Panama; Titan and Unicorn were in Belize. The FFIs, in turn, purported to act for the benefit of other entities, which were represented to be owned by individuals identified in documents as the beneficial owners of the shares.

II. PROCEDURAL HISTORY

FINRA's Department of Enforcement ("Enforcement") filed the Complaint on May 15, 2015. After an extension of time, Respondents filed an Answer on June 26, 2015. On December 11, 2015, Respondents filed a motion for summary disposition that challenged FINRA's authority to bring a disciplinary action for misconduct associated with the sale of unregistered securities. Briefing on the motion was completed on January 29, 2016. The Hearing Officer issued an Order on February 26, 2016, denying the motion and finding that FINRA has authority to bring this proceeding.

The hearing ran a total of 12 days in two sessions. The first session in Los Angeles, California, was held June 13-24, 2016. The second session in Washington, D.C. was held July 11-12, 2016. Ten witnesses testified at the hearing, including two experts.[2] In addition, the full transcript of an on-the-record interview ("OTR") was admitted into evidence, along with more

[2] In addition to Hurry, DiBlasi, and Cruz, the following persons testified: Henry Diekmann, the Firm's current president; Jay Noiman, a former Scottsdale employee who served as CCO until DiBlasi took on that responsibility; David Byrne, a FINRA examiner who is a manager of the AML Investigative Unit; Craig D'Mura, a former Scottsdale employee who worked for a couple of months at CSCT; Christopher Frankel, the current CEO of Alpine; Marc Menchel, Respondents' expert; and Brian Underwood, Enforcement's rebuttal expert.

References to hearing testimony are in the following format: "Hearing Tr. (last name of witness), page of transcript." For example, Hurry's testimony is cited as "Hearing Tr. (Hurry) 1542-43."

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than 200 other exhibits.[3] On September 9, 2016, Enforcement and Respondents each filed one post-hearing brief.[4]

III. FINDINGS AND CONCLUSIONS

A. Jurisdiction

FINRA has jurisdiction to bring this proceeding against Scottsdale, Hurry, and DiBlasi because they are currently registered, and the Complaint charges them with misconduct committed while they were registered. FINRA has jurisdiction as to Cruz although he is no longer registered, because the Complaint was filed within two years of the time he was registered and it charges him with misconduct committed while he was registered.[5]

B. Background

We provide substantial background regarding Respondents and others connected to the transactions at issue to provide the context needed to understand the transactions, the Firm's

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[3] Gregory V. Ruzicka, who worked at CSCT during the relevant period, gave an OTR on May 27, 2015. The OTR became an exhibit. Complainant's exhibits are referred to with the prefix "CX" and an identifying number. Respondents' exhibits are referred to with the prefix "RX" and an identifying number. Joint exhibits are referred to with the prefix "JX" and an identifying number. Ruzicka's OTR is CX-178.

[4] References to the post-hearing briefs are as follows: Enf. PH Br. and Resp. PH Br. Respondents attached graphs and other materials to their post-hearing brief that were not offered or admitted into evidence. Respondents apparently created the graphs after the hearing based on exhibits that were admitted into the record. However, the graphs were not subject to any testimony explaining their creation or testing their accuracy. Respondents' post-hearing brief also contained references to website articles that were not admitted into the record. No copies of the articles were attached to the post-hearing brief. Respondents have not asked permission to reopen the record to admit any of these materials. Respondents simply refer and rely on the non-record materials. The Hearing Panel has not considered any of the following items (or assertions made in argument based on them) in formulating its decision:

- Huperzine A in Alzheimer's Disease—website article relating to NHPI (Resp. PH Br. 5, n.9);
- Same (Resp. PH Br. 7, n.20);
- OTCMarkets.com website on VPLM (Resp. PH Br. 7, n.22);
- The Markets OTCQB website article on VPLM (Resp. PH Br. 7, n.23);
- Historical price figures derived from data on OTCMarkets.com (Resp. PH Br. 12, n.58);
- A purported page from a FINRA Continuing Education Module (Resp. PH Br. 17, n.86; Appendix A);
- Graphs generated by Respondents purporting to use data in JX-264 and JX-268 (Resp. PH Br. 19, n.94; Appendix B);
- Graphs generated by Respondents purporting to use data in JX-279 and JX-281 (Resp. PH Br. 25, n.129; Appendix C);
- Graphs generated by Respondents purporting to use data in JX-308 and JX-310 (Resp. PH Br. 29, n.155; Appendix D); and
- Statement about trading volume attributable to CSCT's sales of ORFG (Resp. PH Br. 29, n.156; statement made without reference to source of information or record citation).

[5] FINRA By-Laws, Art. IV, Section 6; Art. V, Section 4.

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culture, and the Respondents' failure to take reasonable action in response to obvious red flags in connection with the transactions at issue. The background also provides information important in assessing the witnesses' credibility, and in evaluating the Respondents' likely future compliance with the laws and regulations governing Scottsdale's business.

1. Respondents

a. Scottsdale

i. The Firm's Focus On Rule 144 Business

Scottsdale, which is located in Scottsdale, Arizona, has been a FINRA member since 2002.[6] During the relevant period, the Firm had approximately 14 to 20 employees.[7]

Scottsdale's principal business is the deposit and liquidation of penny stocks for its customers.[8] Throughout the proceeding, the penny stocks sold by Scottsdale were also referred to as "microcap" securities.[9] Scottsdale sells most of these securities without registration. The primary exemption that Scottsdale relies on is Rule 144, so it has a dedicated Rule 144 team to review deposits of stock certificates for resale, and its procedures are oriented to Rule 144.[10] Scottsdale obtains customers by advertising in OTC Markets and through referrals.[11]

ii. The Firm's Direct Business With FFIs

Prior to Hurry's creation of CSCT in 2013, Scottsdale did business with FFIs directly. Two of the FFIs involved in this case (Titan and Unicorn) had pre-existing direct relationships with Scottsdale before they started doing business through CSCT.[12]

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[6] CX-1, at 3-9.

[7] Hearing Tr. (Cruz) 116; Hearing Tr. (Diekmann) 1496.

[8] Hearing Tr. (Hurry) 1318; Hearing Tr. (Cruz) 83; Hearing Tr. (Noiman) 1180. DiBlasi acknowledged that during the relevant period penny stock transactions accounted for most of the Firm's revenues, and that over 95% of the transactions that Scottsdale executed for its customers involved penny stocks, most of them unregistered. Hearing Tr. (DiBlasi) 1923.

[9] Microcap securities may be defined as low-priced stock issued by small companies with a market capitalization of $300 million or less. Microcap securities are generally more volatile and less liquid than the stock of larger companies. Most important, because many microcap issuers do not file financial reports with the SEC, it may be difficult for investors to obtain information about the management, products, services, and finances of microcap issuers. https://www.sec.gov/investor/pubs/microcapstock.htm. The SEC has expressed concern that the lack of publicly available information about microcap issuers can enable the spread of false information that misleads investors. *Id.* Many microcap securities trade in the "over-the-counter" ("OTC") market instead of a national exchange such as the New York Stock Exchange or NASDAQ. *Id.*

[10] Hearing Tr. (Cruz) 577, 583; Hearing Tr. (DiBlasi) 1952-54; Hearing Tr. (Diekmann) 818-19, 875-76, 884-86; Hearing Tr. (Hurry) 1600.

[11] Hearing Tr. (Cruz) 116.

[12] Hearing Tr. (Cruz) 192; Hearing Tr. (Diekmann) 727, 817-18; Hearing Tr. (Noiman) 1140-52.

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iii. The Firm's Disciplinary History

Scottsdale has been disciplined previously for selling unregistered securities and having inadequate supervisory procedures and written supervisory procedures ("WSPs") to detect and prevent the sale of unregistered securities. In October 2011, the Firm settled these and other charges, agreeing to a censure and a total fine for all the charges of $125,000 ("2011 Settlement").[13]

The Firm has also settled other types of disciplinary charges against it, which are relevant to the sanctions determinations. In 2009, it agreed to a censure and a $7,500 fine to settle charges that it had bought bonds from customers at unfair prices ("2009 AWC").[14] In August 2012, the Firm settled charges that it had failed to take appropriate action after being on notice that one of its representatives had been using his name and CRD number in stock promotion press releases. The Firm agreed to a censure and a $7,500 fine ("2012 AWC").[15] In 2015, the Firm agreed to a censure and a fine of $10,000 to settle charges that it had submitted reports to FINRA for the Order Audit Trail System that were inaccurate, incomplete, or in the wrong format ("2015 AWC").[16]

iv. The Firm Had Notice That Sham Transactions And The Use Of Nominees Were A Risk In Its Rule 144 Business With FFIs

(a) Four Prior SEC Disciplinary Actions

We find that prior to the events at issue in this case, the Firm was on notice that its business was susceptible to sham transactions and the use of nominees to conceal the true beneficial owners of securities. In four disciplinary actions involving Scottsdale's own employees and customers, the SEC alleged that sham transactions and nominees were used in unlawful sales in violation of Section 5 of the Securities Act of 1933. Those unlawful sales in turn were used to facilitate fraud and manipulation.

In December 2011, two of Scottsdale's registered representatives were named in an SEC complaint ("*Ruettiger*") involving the supposed assignment of portions of a convertible note to satisfy the applicable Rule 144 holding period, the use of nominees to conceal the identity of the true beneficial owners, the use of a "pump-and-dump"[17] scheme to manipulate the market for the stock, and an unlawful distribution of securities without registration. According to the complaint,

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[13] CX-12.

[14] CX-11.

[15] CX-13.

[16] CX-14.

[17] "Pump-and-dump" schemes involve the touting of a company's stock (typically small, so-called "microcap" companies) through false and misleading statements to the marketplace. https://www.sec.gov/answers/pumpdump.htm.

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Scottsdale's registered representatives handled some of the accounts involved in the scheme, and one of them had an interest in an entity that received and sold some of the securities. The complaint alleged that a single person had used 16 Panamanian corporations to conceal his identity and enable him to sell approximately $6 million of stock without registration.[18]

In March 2013, the SEC filed a complaint ("*Gibraltar I*") against a number of people and entities alleging a market manipulation scheme that was facilitated by a Scottsdale customer, Gibraltar. That complaint alleged that individual defendants had secretly sold shares through Gibraltar while simultaneously promoting the stocks and encouraging others to buy. It also alleged that Gibraltar had provided false affidavits and misleading statements that allowed an individual defendant to secretly sell shares of companies he was promoting.[19]

In April 2013, the SEC filed a second complaint against Gibraltar and its owner ("*Gibraltar II*"), alleging that they had facilitated unlawful sales of securities without registration through the use of nominees. According to that complaint, Gibraltar liquidated low-price, thinly traded stocks on behalf of its clients, often during periods of suspicious promotion. Gibraltar assisted its clients to incorporate international business corporations ("IBCs") and encouraged them to use nominee officers and directors so that their identities would remain confidential. The SEC charged that two persons had opened "fake nominee accounts" at Scottsdale.[20]

Gibraltar had been a direct customer of Scottsdale since before the spring of 2010, at least two years before the SEC filed charges against it.[21] It shut down after the filing of the two *Gibraltar* complaints, and some of its customers transferred to Titan, one of the FFIs involved in this case.[22]

In July 2013, the SEC filed an action against ten Argentinians, four of whom had opened accounts at Scottsdale ("*Tavella*"). That complaint alleged that the defendants had submitted false documentation to accompany their securities deposit checklist at Scottsdale, and sold millions of shares into the public markets without registration in violation of Section 5. The defendants claimed that they had purchased their shares from former shareholders, but the former shareholders had already sold their shares years before. Thus, the transactions in which the defendants claimed that they had acquired the shares were a sham.[23]

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[18] *SEC v. Ruettiger*, No. 2:11-cv-2011 (D. Nev. filed Dec. 16, 2011), available at https://www.SEC.gov/litigation/complaints/2011/comp22198.pdf.

[19] Hearing Tr. (Cruz) 195-99; *SEC v. Carrillo Huettel*, No. 13 Civ. 1735 (S.D.N.Y. filed Mar. 15, 2013), available at https://www.SEC.gov/litigation/complaints/2013/comp-pr2013-39.pdf.

[20] Hearing Tr. (Cruz) 185-192; *SEC v. Gibraltar Global Sec., Inc.*, No. 13 Civ. 2575 (S.D.N.Y. filed Apr. 18, 2013), available at https://www.sec.gov/litigation/complaints/2013/comp22683.pdf.

[21] Hearing Tr. (Diekmann) 1912-13.

[22] Hearing Tr. (Diekmann) 727.

[23] *SEC v. Tavella*, No. 13-cv-4609 (S.D.N.Y. filed July 3, 2013), available at https://www.SEC.gov/litigation/complaints/2013/comp-pr2013-122.pdf.

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These regulatory actions should have caused the Firm to take special care when dealing with FFIs, and to revise its procedures to focus on potential sham transactions and the use of nominees. The Firm did not. Its main reaction to *Ruettiger* was to eliminate the branch office involved in the case. Cruz believed that the misconduct identified in the *Gibraltar* cases was "isolated."[24] Scottsdale's current president, Diekmann, who was the head of the Rule 144 team when the *Tavella* complaint was filed, testified that he could not remember if the Firm conducted any investigation of the four Argentinians named in the *Tavella* complaint who had Scottsdale accounts.[25] In Diekmann's view it was "just impossible to know that there was somebody else behind this."[26] Cruz similarly said, "[I]t's almost impossible to detect these nominees, that they're going to be ... misrepresenting the—you know, the true identity of these persons."[27] Although the Firm changed some procedures as a result of *Tavella* (it would not accept more than 9.9% of a security at any one time from its customers and it instituted a stock watch list to monitor trading and promotions), Diekmann could not remember doing anything different to address the problem of nominees.[28]

(b) Respondents' Arguments Minimizing Significance Are Rejected

In their post-hearing brief, Respondents argue that the SEC complaints are not relevant because they were classic pump-and-dump cases, and no charge is made here that the transactions at issue were part of a pump-and-dump fraud. It is not necessary, however, to prove that fraud occurred in order to conclude that Respondents failed to perform their gatekeeping duty adequately. The focus here is on Respondents' failure (i) to recognize as a threshold matter that the transactions lacked a legal underpinning, and (ii) to respond appropriately to an accumulation of red flags and suspicious circumstances, either conducting further investigation to make sure an exemption existed or declining to sell the securities.

Respondents also claim that references in the prior complaints to nominees were "peripheral."[29] To the contrary, the use of nominees was critical to facilitating the fraud and manipulation charged in those cases. We reject Respondents' attempt to brush aside the SEC complaints.

Cruz took a different approach at the hearing to minimizing the significance of the SEC complaints, which we also reject. He insisted on a benign definition of the term "nominee" to mean only someone designated to act on behalf of another. He declined to view the *Ruettiger* complaint as raising a concern about the use of nominees. He said, "I wasn't sure if this is a

[24] Hearing Tr. (Cruz) 219.

[25] Hearing Tr. (Diekmann) 732-33.

[26] Hearing Tr. (Diekmann) 732.

[27] Hearing Tr. (Cruz) 213-14.

[28] Hearing Tr. (Diekmann) 733-34.

[29] Resp. PH Br. 36-37.

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situation where the—the nominees here that are being listed were purposely hiding their identity. It could be, but … that just was not my takeaway when I was looking at this … Complaint."[30] When asked whether the allegation of "fake nominee entities" gave him pause, Cruz responded, "I have no idea what fake – I mean, if it's an entity – I mean, if it – I don't know what they mean by 'fake.'"[31] Cruz refused to admit that the complaint in *Ruettiger* put him on notice of the possibility of nominees hiding the actual true beneficial owner of securities. He testified, "I would say this is probably not a case that gave me a great concern about the nominee issue, per se …. There might be a nominee issue in there. I guess I don't know the context of that."[32]

We find Cruz's refusal to acknowledge the plain import of the SEC's allegations in *Ruettiger* and the other complaints disingenuous. Even Respondents' expert agreed that Scottsdale was on notice that its customers could be nominees for beneficial owners as of the relevant period in this case.[33]

(c) Later Actions Confirm Risk Of Sham Transactions And Nominees

The risky nature of Scottsdale's Rule 144 business with FFIs became undeniable in the summer of 2014, when the SEC and criminal authorities initiated two new proceedings charging that certain Scottsdale customers and others had used sham transactions and nominees to sell penny stocks unlawfully without registration. These proceedings were brought based on extensive evidence gathered through the use of undercover agents, cooperating witnesses, and recorded conversations. The allegations appeared well founded, and they finally caused Scottsdale and CSCT to react.

The SEC filed a complaint on July 11, 2014 ("*Amogear*"), charging five individuals with using nominee accounts in FFI trading to conceal beneficial ownership and facilitate a pump-and-dump scheme. The SEC alleged that Titan had agreed to assist in the scheme and that Alpine, the clearing firm, was involved in readying shares for trading in connection with the scheme. In reaction to *Amogear*, Scottsdale froze its FFI trading for a couple of months.[34]

On September 8, 2014, prosecutors filed an indictment in federal district court in New York ("*Bandfield*") that charged Titan, Unicorn, and several individuals with whom Scottsdale and CSCT did business with securities fraud, tax fraud, and a money-laundering conspiracy. Those individuals included the following persons, who were also involved in the transactions at issue here: Cem ("Jimmy") Can at Unicorn; Kelvin Leach and Rohn Knowles at Titan; and Robert Bandfield and Andrew Godfrey, who purported to represent customers of Montage,

[30] Hearing Tr. (Cruz) 191.

[31] Hearing Tr. (Cruz) 192.

[32] Hearing Tr. (Cruz) 184.

[33] Hearing Tr. (Menchel) 2488-89.

[34] Hearing Tr. (Diekmann) 705-12; Hearing Tr. (Cruz) 204-08; CX-250.

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Unicorn, and Titan and appeared in connection with numerous sub-accounts and sub-sub-accounts at Scottsdale. According to the indictment, Robert Bandfield claimed in a recorded conversation that he had created Titan and more than 5000 sham companies. In that conversation, he explained how reporting requirements could be circumvented and beneficial ownership concealed by using nominees.[35] After the indictment was unsealed and became public, CSCT's business substantially diminished.[36]

b. John Hurry

Indirectly, through a trust and a holding company, John Hurry and his wife, Justine Hurry, own Scottsdale.[37] From the Firm's inception in 2002 until December 2012, Respondent Hurry was a registered representative, among other roles.[38] John Hurry again registered with the Firm in October 2014, and remains registered today.[39] Hurry admitted in his Answer to the Complaint that he has been the Firm's director since 2002. However, at the hearing, he claimed that he first became a director of Scottsdale in January 2013. Justine Hurry became its second director in May 2013.[40]

Scottsdale has been highly profitable for Hurry and his wife. According to the Annual Audited Report Form for Scottsdale during the year beginning July 1, 2013, and ending June 30, 2014, the Firm paid $6,222,550 in directors' compensation. Since John and Justine Hurry were the Firm's only directors, this expense presumably was paid to them.[41] The Firm paid other

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[35] CX-244; CX-226; Hearing Tr. (Cruz) 224-30; Hearing Tr. (Diekmann) 1725-26, 1781.

[36] Hearing Tr. (Cruz) 237-38; Hearing Tr. (Hurry) 1529-30.

[37] CX-1, at 7-9; CX-5; Hearing Tr. (Cruz) 81-82.

[38] CX-15, at 11.

[39] CX-15, at 4-5.

[40] CX-1, at 3-9 (showing the Firm's direct owners and directors); CX-17, at 1. In his Answer, Hurry admitted that he had been a director of Scottsdale since 2002. Answer ¶ 16. At the hearing, however, Hurry denied that he had been a director of Scottsdale before January 2013. He did so despite the fact that his signature appeared over the designation "sole director" in a December 2012 document authorizing the creation of the Firm's Management Committee. At the hearing, he claimed that the designation as sole director was a typographical error and that he was acting president prior to January 2013, not sole director. CX-3; Hearing Tr. (Hurry) 1306-09. Cruz testified as to the December 2012 document that Hurry had established the Firm's Management Committee in his capacity as director of the Firm. Hearing Tr. (Cruz) 74-76.

The conflict between the Answer and Hurry's testimony is inexplicable. We find the conflict between Hurry's testimony and the Firm's record of the creation of the Management Committee disturbing, because it reflects a lack of transparency and accountability. We find the typographical error explanation with regard to something as important as corporate authority to designate the responsibilities of senior management—particularly in a simple one-page document—not credible. There is no explanation for the conflict between Hurry's testimony that he was not a director of the Firm in December 2012 and Cruz's testimony that he was. The conflict in the evidence on this point diminishes Hurry's credibility.

[41] RX-42, at 7, 11. When Cruz officially became Scottsdale's president in March 2014, it was by unanimous consent of the Board of Directors, John and Justine Hurry. CX-4.

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compensation of $1,665,574 and professional and consulting fees of $1,138,090. When these payments and other expenses were subtracted from the Firm's gross profit of $11,569,817, the Firm reported net income of $1,446,655. Because Scottsdale is an S corporation, this income flowed through to the shareholders. In the next year, ending June 30, 2015, although the Firm reported only $589 in net income, the Firm paid directors' compensation of $3,255,200.[42]

During the relevant period, Respondent Hurry also was the indirect owner of Scottsdale's clearing firm, Alpine, which is located in Salt Lake City, Utah. Hurry has been its director since March 2011,[43] and has been registered with Alpine since May 15, 2015.[44]

In 2013, Hurry established CSCT, the Cayman Islands broker-dealer through which the securities at issue were deposited at Scottsdale.[45] Hurry owns CSCT,[46] and, as more fully discussed below, he made decisions, both large and small, about how it conducted its business.[47] Despite the highly specialized nature of CSCT's business, Hurry hired Gregory Ruzicka—an out-of-work California real estate attorney who had no prior experience in the securities broker-dealer industry, much less in the specialized business of liquidating microcap securities—to run CSCT.[48] Ruzicka went down to the Cayman Islands in October 2013 to take on his CSCT duties.[49] Hurry then monitored Ruzicka's activities almost daily, right down to his cigarette breaks, and visited the Cayman Islands at least monthly.[50]

Although Hurry attempted to conceal the extent of his involvement in CSCT's business, he admits that he spoke with the three CSCT customers involved in this case (Montage, Titan, and Unicorn), and that he personally visited two of them, Montage in Panama and Unicorn in Belize.[51] He claims that he did not solicit business for CSCT, but, as discussed below, that claim is not credible.

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[42] RX-42, at 27. See also the Firm's FOCUS Reports for 2013-Q4, 2014-Q1, 2014-Q2, 2015-Q3, 2015-Q4, and 2016-Q-1, and the summary of them created by Enforcement. CX-6 through CX-10.

[43] CX-15, at 3, 11; CX-18.

[44] Hearing Tr. (Hurry) 1307.

[45] Hearing Tr. (Hurry) 1329; Hearing Tr. (Noiman) 1117-18; CX-29.

[46] CX-178, at 40-41.

[47] Hearing Tr. (Hurry) 1333-35.

[48] Hearing Tr. (Hurry) 1631; CX-178, at 13-24. Ruzicka had limited experience in the early 1980s with intrastate real estate limited partnership offerings. In that context, he handled post-foreclosure unlawful detainers, relief from automatic bankruptcy stays, and receiverships on commercial properties. CX-178, at 15-18.

[49] CX-178, at 20.

[50] Hearing Tr. (Hurry) 1437-40; CX-178, at 138-41, 151-52; CX-132; CX-133.

[51] Hearing Tr. (Hurry) 1406-08, 1412-14, 1421-22.

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That Hurry was in charge was obvious to his employees and to CSCT customers. Ruzicka referred to him as "the big boss."[52] As noted below, one of the persons at Scottsdale who approved CSCT to become a Scottsdale customer did not even consider rejecting CSCT's application because he knew that Hurry had brought CSCT to the Firm.[53] Similarly, Ruzicka said that CSCT never considered using any broker-dealer except Scottsdale because of Hurry.[54] As Hurry acknowledged, customers also sought direct contact with him because he is "highest on the totem pole."[55]

Respondent Hurry thus owns and controls all three firms involved in the transactions at issue in this proceeding—Scottsdale, Alpine, and CSCT. In fact, the three firms were almost a self-contained system for processing and distributing microcap securities. CSCT did all its business through Scottsdale,[56] and Scottsdale in turn did all its business with Alpine.[57] Alpine's current CEO described Alpine as a small "boutique" clearing firm with a focus on the kind of business brought to it by CSCT.[58] No independent third party was involved in preparing, approving, or clearing the deposits of stock certificates by CSCT at Scottsdale for resale.

c. Timothy DiBlasi

DiBlasi first entered the securities industry in 2002. From December 2002 through March 2012, he was a compliance analyst at First Investors Corporation in New Jersey. DiBlasi has been associated with Scottsdale since April 2012. In June 2012, he became the Firm's anti-money laundering chief officer ("AMLCO"). In October 2013, shortly before the events at issue, DiBlasi became the Firm's CCO, and he remains the Firm's CCO today. Prior to joining the Firm, DiBlasi had limited experience in microcap securities, and he had not handled the type of restricted stock deposits that are the bulk of Scottsdale's business.[59]

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[52] CX-240; Hearing Tr. (Diekmann) 1764-65.

[53] Hearing Tr. (Noiman) 1079, 1103, 1105-06, 1117-18. See also CX-29, at 10, 25 (forms to establish CSCT as a Scottsdale customer listed Hurry as referral or source of the business).

[54] CX-178, at 108.

[55] Hearing Tr. (Hurry) 1432.

[56] Ruzicka testified that CSCT never considered using a firm other than Scottsdale because of Hurry. CX-178, at 108.

[57] Hearing Tr. (Cruz) 143, 306, 382; Hearing Tr. (Diekmann) 759; Hearing Tr. (D'Mura) 2293. The person Hurry hired to run CSCT, Gregory Ruzicka, described CSCT as an "adjunct" of Hurry's operations at Scottsdale. CX-178, at 34.

[58] Hearing Tr. (Frankel) 2342-43. Alpine did do business with other FFIs in addition to CSCT during the relevant period. Hearing Tr. (Frankel) 2343.

[59] Hearing Tr. (DiBlasi) 1919-21; Hearing Tr. (Cruz) 122; CX-19.

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d. Michael Cruz

Cruz entered the securities business in 1994, when he began working at a San Francisco investment banking firm on underwritings, asset-backed securities, and private placements. After approximately six years, he joined FINRA's predecessor, NASD, starting in its San Francisco office as a cause examiner and then moving to New York as a cycle examiner. He then took a job with Citigroup Smith Barney in their central risk group, reporting to the General Counsel and CCO. Subsequently, he moved with his family to Arizona and passed the bar there. In Arizona, he first worked for Wells Fargo in its audit department and then took a similar position at Countrywide in its bank legal department. He left Countrywide when Bank of America acquired it, and he began working at Scottsdale in May 2008.[60]

Cruz has held Series 7, 24, and 63 licenses. However, since January 29, 2015, he has not been registered through Scottsdale. He currently is the general counsel for the holding companies that own Scottsdale and its clearing firm, Alpine.[61]

At the beginning of the relevant period, Cruz was listed on the Firm's Form BD as legal counsel and member of the Management Committee.[62] Cruz officially became the Firm's president by a board resolution dated March 17, 2014. He testified that, at least since December 1, 2013, he had been acting as *de facto* president.[63] The Firm amended its Form BD on March 31, 2014, to disclose that Cruz was the president, as well as legal counsel.[64]

During the relevant period, Cruz approved Rule 144 deposits, including the transactions at issue.[65] Cruz signed the Deposited Securities Checklist ("Checklist") for the transactions at issue under the heading "144 Compliance Approval." Between that heading and his signature is the statement "[B]ased on the information received and reviewed as described in this Deposited Securities Checklist, SCA [Scottsdale] reasonably believes the subject securities are free trading."[66]

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[60] Hearing Tr. (Cruz) 72-73, 557-59, 661; CX-20.

[61] Hearing Tr. (Cruz) 72-73; CX-20.

[62] CX-17, at 1.

[63] Hearing Tr. (Cruz) 78-79; CX-4. Cruz said that the original plan had been for Justine Hurry to be president of the Firm. Hearing Tr. (Cruz) 79. Cruz's testimony that he was the acting president in December is inconsistent with Hurry's testimony that he was president at that time. This conflict concerning who was in charge illustrates the Firm's lack of appropriate supervisory procedures that clearly delegated authority and created accountability.

[64] CX-17, at 7.

[65] Hearing Tr. (Diekmann) 693-94.

[66] RX-1, at 2, 79, 159; RX-2, at 2, 107; RX-3, at 2.

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Cruz acted as the conduit between senior management of the Firm and the board of directors, John and Justine Hurry.[67]

2. Other Key Figures At Scottsdale

a. Henry Diekmann

After graduating from college with a degree in history, Diekmann spent approximately a year as a financial trainee with Morgan Stanley. He then was an insurance salesman for four months. After that, he was unemployed for about a year-and-a-half before he joined Scottsdale in March 2010 as an office assistant. In January 2011, he moved to the Firm's Rule 144 team, where he spent two years before being promoted to head the team. Although many members of the team were lawyers, Diekmann is not. He had no experience with low-priced securities or in clearing unregistered securities for trading before he joined Scottsdale. He was trained to review deposits by Cruz and another person who worked on the Rule 144 team.[68]

During the relevant period, Diekmann focused solely on reviewing CSCT deposits. But he did not have authority to approve a deposit of certificates. Final approval authority rested with Cruz.[69]

Since January 2015, Diekmann has been the Firm's president.[70] As the Firm's current president, Diekmann now has the authority that once belonged to Cruz.[71]

b. Eric Miller

Eric Miller was a Scottsdale salesman. He called potential customers and assisted in conducting due diligence on new accounts.[72] Miller sometimes referred clients to Ruzicka at CSCT.[73]

Although Miller did not testify at the hearing, there is substantial evidence that he was involved with Unicorn's deposits. Miller had a relationship with Unicorn because it had been Scottsdale's direct customer before moving its business to CSCT, and he continued to have contact with Unicorn even after it started doing business with Scottsdale through CSCT, as Diekmann admitted.[74]

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[67] Hearing Tr. (Cruz) 80-82.

[68] Hearing Tr. (Diekmann) 686-90.

[69] Hearing Tr. (Diekmann) 694, 886.

[70] Hearing Tr. (Diekmann) 685; Hearing Tr. (DiBlasi) 1954.

[71] Hearing Tr. (Cruz) 129-30, 583-84; Hearing Tr. (Diekmann) 685-86, 694, 908-09.

[72] Hearing Tr. (Cruz) 116-17; Hearing Tr. (Noiman) 1075-76; CX-29, at 9.

[73] CX-178, at 167-68.

[74] Hearing Tr. (Diekmann) 858, 934-35.

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The fact that Miller continued to have at least some direct contact with Unicorn is significant for the following four reasons:

First, the evidence regarding Miller casts doubt on the effectiveness of the Firm's compliance and supervisory efforts. Diekmann claimed that Miller's direct contact with Unicorn was prohibited and that Miller was "written up" a number of times for corresponding by email with Unicorn. Diekmann did not identify any written prohibition against direct contact with Unicorn, but he said that the prohibition was something that was a matter of business practice at the Firm.[75] The supposed prohibition is inconsistent with the record, which contains a number of emails to and from Unicorn that include Miller as a sender or recipient.[76] Moreover, in some Unicorn emails, Diekmann is a recipient along with Miller.[77] There is no evidence that Diekmann protested Miller's involvement or reprimanded him. If Miller was "written up" a number of times for contact with Unicorn, as Diekmann testified, it apparently had little effect. Diekmann's testimony regarding the supposed prohibition was not credible.

Second, the emails indicate that Miller was a "back door" for Scottsdale in dealing with Unicorn. Although the Unicorn deposits supposedly came through CSCT, Miller and others at Scottsdale corresponded directly with Unicorn personnel and directed Unicorn as to what needed to be done.

For example, Miller engaged in extensive email correspondence with Natalie Bannister at Unicorn in November 2013 about setting up its account with CSCT. Miller instructed her that the stock certificates to be deposited at Scottsdale had to be made out in CSCT's name and sent by CSCT to Scottsdale. Bannister indicated that she did not like transferring ownership to CSCT, "especially with it not in writing." Miller insisted, "These are important details." He said that the account at Scottsdale was in CSCT's name and the "cert[tificate deposit] NEEDS to be in [CSCT's] name, that is all there is to it."[78] Thus, it was Scottsdale—not CSCT—that was making the arrangements and instructing the customer on what had to be done.

Miller shepherded Unicorn's due diligence packages through CSCT. In March 2014, he instructed Unicorn staff and Ruzicka to get together on the telephone to discuss which documents were needed and could be provided for a deposit.[79] Similarly, in May 2014, Miller engaged in email correspondence directly with Unicorn's Back Office Manager, Chinique Lewis, asking her about ORFG, one of the stock deposits at issue in this case. He asked her—not Ruzicka—how the package was coming along. Then Lewis emailed Miller—not Ruzicka—to ask if there was "[a]nything on the [ORFG] as yet?" At that point, Miller emailed her back

[75] Hearing Tr. (Diekmann) 1664-65.

[76] See CX-216.

[77] See CX-119.

[78] CX-270.

[79] CX-171.

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directing her to call Ruzicka and have him call Miller.[80] Miller's last instruction in the correspondence appears to us to reflect an awareness that Scottsdale should be seen to be dealing only with and through CSCT, when, in fact, Scottsdale, through Miller, was continuing to guide the business with Unicorn.

In April 2014, when Diekmann was unable to obtain the information he needed on a deposit of stock certificates by Unicorn from Ruzicka at CSCT, he emailed Miller a copy of his request to Ruzicka, saying he had not received a response. And Miller, in turn, forwarded the email directly to two persons at Unicorn, Cem Can and Chinique Lewis, asking them to "please address this ASAP."[81] Diekmann denied that he had asked Miller to obtain the information for him, but the correspondence has no other reasonable explanation. Diekmann's testimony in this regard was not credible.[82]

In May 2014, Miller obtained information from Chinique Lewis at Unicorn about the purported beneficial owner of the entity that had deposited VPLM stock through Unicorn for sale by Scottsdale and forwarded that to Diekmann. The email correspondence was included in the VPLM due diligence package.[83]

The degree to which Miller corresponded directly with Unicorn and managed the Unicorn deposits raises the question whether there was any need for CSCT at all. As discussed below in the credibility section, Hurry's decision to route Scottsdale's FFI business through CSCT had little discernible business rationale. His implementation of that decision and staffing of CSCT with Ruzicka, who was unqualified to run CSCT, coupled with the evidence of Miller's continuing role as a "back door" to Scottsdale, demonstrate that CSCT was a façade.

Third, we interpret certain email correspondence between Miller and a client as suggesting that the Firm assisted its clients "all the time" to conceal beneficial ownership of stock. Scottsdale supposedly had a policy not to accept business from Canadian citizens residing in Canada, but, when a client in the Bahamas asked on behalf of a friend whether a Canadian citizen residing in Canada could do business with Scottsdale, Miller suggested that the friend set up a corporation to do the business. Miller called it a "work around." The client responded, "If they get a corporation set up US, Panama, Belize or wherever won[']t your Compliance want to know who is beneficial owner?" Miller responded, "Yes they will but the account holder is the corporation. Trust me on this one, we do it all the time."[84]

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[80] CX-311, at 1.

[81] Hearing Tr. (Diekmann) 1668-71; CX-221.

[82] CX-221; Hearing Tr. (Diekmann) 1665-71. In denying that he intended for Miller to obtain the information from Unicorn that Ruzicka had failed to supply, Diekmann testified that he had no interest whatever in whether he obtained the information. Hearing Tr. (Diekmann) 1665-71. That statement is not credible. If he had no interest, there would have been no reason to send the email to Miller.

[83] RX-3, at 17.

[84] CX-210; Hearing Tr. (Diekmann) 1672-77.

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We are unconvinced by Diekmann's benign reading of this correspondence. He testified that he thought that the client was asking something different, "Won't your compliance know that a Canadian resident owns the LLC and, therefore, won't they reject the deposit or account opening?"[85] Diekmann's interpretation is a rewriting of the client's words. It ignores that Miller's implicit point was that the corporation would be identified as the account holder, not the Canadian owner. That is why the Canadian's deposit would not be rejected. Furthermore, Diekmann's interpretation does not reflect the tone of Miller's comments. When Miller suggested that the shares could be put in the name of the corporation, he treated that as a magical solution to the problem, saying "and wa-la! We get it done that way."[86] Finally, if Diekmann's interpretation of the question were correct, then Miller never answered the question. Miller never explained why the Firm would not reject the deposit if it knew that a Canadian resident owned the LLC.

Fourth, according to Diekmann, after Miller left the Firm in April 2016, the Firm discovered that he had set up his work email to be forwarded to his personal email.[87] This means that Miller could have engaged in communications with FFIs like Unicorn "off the record," avoiding oversight. Although Diekmann testified that all of Scottsdale's emails remained on its system, and were not removed by Miller, Diekmann provided no basis for knowing whether that was true. Diekmann testified that the Firm had asked Miller to confirm he had not removed any emails from the Firm's system but that Miller had not responded.[88]

The inquiry suggests that the Firm in fact does *not* know whether Miller removed emails from the Firm's system. There was no evidence that the Firm employed any technical analysis of its systems to find out if emails or other information had been deleted. There also was no evidence that the Firm made any effort to recover any email correspondence that Miller might have had with customers using only his personal email. Thus, it is undisputed that Miller communicated directly with Unicorn, and it is impossible to know the number or substance of all those communications.

Given the allegations against Unicorn and Cem Can in the *Bandfield* indictment, the inability to review Miller's communications with them is a serious concern. The Firm's reaction—simply to ask Miller to confirm he did not remove any emails from the Scottsdale's system—is an inadequate response. If Miller took emails from Scottsdale's system or deleted them, he would hardly be likely to confess to that wrongdoing. That is particularly so where the emails were with persons subject to a criminal indictment and might place Miller under suspicion. The request to a potential wrongdoer to confirm that he committed no wrongdoing is almost farcical. The inadequacy of the Firm's response mirrors the inadequacy of its checklist

[85] Hearing Tr. (Diekmann) 1673.

[86] CX-210, at 5.

[87] Hearing Tr. (Diekmann) 1662-63.

[88] Hearing Tr. (Diekmann) 1663-64.

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approach to Rule 144 due diligence and contributes to our conclusion that stringent sanctions are required here.

c. Jay Noiman

Jay Noiman joined Scottsdale in September 2011 and left at the end of December 2014.[89] Prior to October 2013, when DiBlasi became CCO, Noiman was the Firm's CCO.[90] He was on the Management Committee from approximately January 2013 through January 2014. He served as vice chairman of the Management Committee and second in command after Cruz. During the relevant period, Noiman was the trading manager and had responsibility for supervising the traders and sales staff. He identified DiBlasi as his supervisor.[91]

Noiman was responsible for reviewing the blotter for restricted stocks. He focused on FFIs,[92] and he approved the account opening documents for CSCT, which was an FFI. Noiman never considered not approving the CSCT account. He knew at the time that it was a referral from Hurry.[93]

Noiman also signed documents in the due diligence packages for the transactions in this case. His signature appears on the Checklist under the heading "Broker Approval." Between the heading and Noiman's signature was the statement that he had carefully reviewed the Checklist and the supporting documents and that to the best of his knowledge "any resale will be made in compliance with firm policy and all applicable laws."[94] By that language, the Checklist makes it appear that Noiman was certifying that he believed that the transaction would comply with the law.

Noiman testified, however, that his signature signified only that all the necessary forms were in the file—a check-the-box function.[95] The parties stipulated that Noiman's signatures on the documents in the three due diligence packages meant the same thing: he checked that the documents were filled out but did not substantively approve or review them.[96] Thus, Noiman's signature on the Checklist created only a façade of compliance and accountability.

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[89] Hearing Tr. (Noiman) 1041-42.

[90] Hearing Tr. (Noiman) 1043.

[91] Hearing Tr. (Cruz) 81, 564; Hearing Tr. (Noiman) 1043-44.

[92] Hearing Tr. (Noiman) 1045-46, 1049-51.

[93] Hearing Tr. (Noiman) 1139-40.

[94] RX-1, at 2; RX-2, at 2; RX-3, at 2.

[95] Hearing Tr. (Noiman) 1156-68, 1171-73.

[96] Hearing Tr. (Noiman) 1172-73.

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During the relevant period, Noiman, like Miller, had contact with one of the FFIs involved in this case, Titan.[97] Noiman talked with Rohn Knowles of Titan at least monthly and sometimes weekly and engaged in email correspondence with Knowles.[98] Both Titan and Knowles were defendants in the *Bandfield* indictment. As discussed below, Noiman obtained information directly from Knowles, which he forwarded to Cruz, to resolve a serious potential problem with a CSCT deposit of VPLM stock. CSCT's staff was not involved.[99] Thus, Noiman was another "back door" to a CSCT customer, raising once again the question why CSCT even existed.

3. CSCT And Its Key Figures

a. Gregory V. Ruzicka

Prior to joining CSCT, Gregory Ruzicka was a real estate attorney in Newport Beach, California. He began his legal career advising exclusively on real estate issues and continued in the real estate field. He did not advise on the federal securities laws.[100] Before beginning work at CSCT, Ruzicka had no experience with Rule 144 or any of the other exemptions from registration under the federal securities laws.[101] Nor did Ruzicka have any prior experience with Cayman Islands law, the Bank Secrecy Act, or anti-money laundering rules and regulations.[102]

Ruzicka met John Hurry in 2002 when Hurry hired him to do some work on a commercial real estate issue. From time to time after that, Ruzicka did work for Hurry, but none of that work involved the securities laws or Hurry's broker-dealer business.[103]

Later, Ruzicka suffered a substantial financial setback that left him out of work and adrift.[104] At this point, Ruzicka asked Hurry to give him a job at a bicycle shop that Hurry owned. Hurry admitted that he was "kind of taken back a little bit."[105] Hurry proposed instead

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[97] Prior to the events at issue, Noiman was involved in the customer due diligence on Titan when it was a direct customer of Scottsdale. On January 18, 2012, Noiman signed a due diligence form as a principal of the Firm representing that to the best of his knowledge the information provided by Titan was true and correct. Noiman also signed the form as the person giving compliance approval. CX-242, at 48.

[98] Hearing Tr. (Noiman) 1185-87. Ruzicka was under the impression that Titan "had a special pipeline to Scottsdale." CX-178, at 110. He spoke of a young woman as being the "private liaison for Titan." CX-178, at 110.

[99] CX-296; CX-294; Hearing Tr. (Noiman) 1187-98. *See infra* at __.

[100] CX-178, at 12-20.

[101] CX-178, at 22-23.

[102] CX-178, at 18-19, 22-24.

[103] CX-178, at 25-29

[104] CX-178, at 14-15, 19-20, 30, 38, 54.

[105] Hearing Tr. (Hurry) 1631, 1635-36. Hurry told D'Mura that Ruzicka had asked, "Would you be able to help me out? Is there any position or something? Could I work at your bike shop or your ice cream shop? You know, you don't have to pay me a lot, but at this point, I don't have anything. I have $50 in my pocket." Hearing Tr. (D'Mura) 2262.

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that Ruzicka go to the Cayman Islands to run Hurry's operation there. According to Ruzicka, Hurry told him that Ruzicka would be running the business and acting as Hurry's lawyer.[106] Ruzicka had been to the Cayman Islands once before to go scuba diving, but he was willing to relocate because he had been through such a hard time and wanted a "change of scenery."[107] Hurry told Ruzicka that he had 30 days to read about Rule 144,[108] so Ruzicka read Rule 144, the Securities Act of 1933, and what he could find on the internet about the Rule 144 exemption.[109]

In mid-October 2013, Hurry flew with Ruzicka in Hurry's private plane to the Cayman Islands so that Ruzicka could begin work.[110] Ruzicka remained with CSCT until mid-October 2014.[111]

Diekmann testified that if CSCT had been his business, Ruzicka would not have been his choice to run the Cayman Islands broker-dealer. Ruzicka lacked securities experience, and he seemed disorganized, sending materials to Scottsdale piecemeal and failing to follow instructions.[112]

Ruzicka never had a securities license or registered with FINRA. Consequently, FINRA had no jurisdiction to compel him to testify. Ruzicka testified voluntarily at an OTR, and he considered testifying voluntarily at the hearing. However, after being contacted by counsel for Respondents, as discussed below in the credibility section, Ruzicka declined to testify. Consequently, Ruzicka's entire OTR was admitted into evidence.

b. Craig D'Mura

Craig D'Mura graduated from Arizona State University in May 2006 and shortly afterward began work at Vanguard Group in the retirement participant services department. After a year and a half, he went to law school at Syracuse University. Although he finished law school, he never took the bar examination and did not become licensed as an attorney. He returned to Phoenix and started a broker training program in 2010. However, he did not feel that being a broker was his "calling."[113]

D'Mura was unemployed in summer of 2011. He responded to an advertisement on Craigslist for an operations position at Scottsdale. In July or August 2011, after an interview with

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[106] CX-178, at 38-40.

[107] CX-178, at 54.

[108] CX-178, at 40.

[109] CX-178, at 22, 62-63.

[110] CX-178, at 37.

[111] CX-178, at 231.

[112] Hearing Tr. (Diekmann) 759-61, 765.

[113] Hearing Tr. (D'Mura) 2246-47.

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Justine Hurry, Scottsdale hired him. Prior to his work at Scottsdale, D'Mura was not even aware of the microcap securities industry.[114]

After two or three weeks in the operations position, D'Mura joined the Rule 144 team. His training was ongoing. By summer of 2013, he was handling more complicated deposits and was able to review files as a principal. However, he did not review deposits by FFIs.[115]

In summer of 2013, Hurry began discussing with Scottsdale staff his plan to open a broker-dealer in the Cayman Islands, and Cruz asked D'Mura if he might be interested in working there. D'Mura began filling out the paperwork necessary if he took the position in the Cayman Islands, and in January 2014, he flew with Hurry in Hurry's private airplane to the Cayman Islands to visit and consider a position with CSCT.[116] D'Mura decided to take the position, returned to Phoenix for a few days, and then went back to the Cayman Islands on January 28, 2014. He stayed with CSCT only about six weeks. After concluding that the situation was intolerable and would never improve, he left on March 14, 2014.[117]

c. CSCT

i. Hurry Set Up CSCT

In early 2013, Hurry set up CSCT in the Cayman Islands.[118] He became its director and intended to have overall management supervision of it and its business.[119] Through a chain of entities, a Hurry family trust owns CSCT, and Hurry and his wife serve as co-trustees of the trust.[120]

Hurry claimed that he set up CSCT because Alpine, his U.S. clearing firm, wanted to be relieved of IRS tax withholding obligations. According to Hurry, Alpine wanted to do business only with FFIs that had agreed with the IRS to take on tax withholding obligations, thereby becoming what is known as a qualified intermediary ("QI").[121] Hurry testified that withholding obligations are complicated and burdensome.[122] He also testified that there are risks in getting

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[114] Hearing Tr. (D'Mura) 2247-48.

[115] Hearing Tr. (D'Mura) 2248-51.

[116] Hearing Tr. (D'Mura) 2252-58.

[117] Hearing Tr. (D'Mura) 2266, 2306-09.

[118] Hearing Tr. (Hurry) 1329, 1333-34.

[119] Hearing Tr. (Hurry) 1394-95; CX-160, at 3.

[120] CX-21, at 2.

[121] Hearing Tr. (Hurry) 1373-74, 1552-61; Hearing Tr. (Frankel) 2345-46, 2349-51. Resp. PH Br. 8.

[122] Hearing Tr. (Hurry) 1554-57.

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the paperwork wrong and incurring penalties, and that there were tax advantages to generating and retaining funds offshore.[123]

Hurry's testimony was at a high level of generality, and there was no corroborating evidence to show the analysis. There was no evidence regarding how Alpine made the decision that it would only do business with QIs, or who made the decision. There was no evidence other than Hurry's testimony to demonstrate that CSCT made business sense. It is unclear how the expense of establishing and staffing a separate offshore office was less burdensome than Alpine's withholding obligations, or why the same goal of eliminating Alpine's withholding obligation could not have been achieved less expensively by requiring the Firm's FFI customers to obtain QI certification in order to do business with Scottsdale and Alpine. Moreover, since Hurry ultimately bore the costs regardless of which entity had the obligation, Alpine or CSCT, we are not persuaded that the claimed reason for creating CSCT made sense.[124]

Nor did the creation of CSCT make sense from the perspective of achieving regulatory compliance. As Cruz agreed, it is easier to spot problems with direct accounts than through an FFI like CSCT that operated as an intermediary for sub-accounts and sub-sub-accounts.[125]

Hurry's intense involvement in CSCT's operations did not abate after he hired Ruzicka in October 2013 to run CSCT's day-to-day operations. Hurry located and rented office space for CSCT before Ruzicka began work and then continued to closely oversee the details of establishing and opening the office after Ruzicka arrived. Hurry obtained a floor plan from Ruzicka, told Ruzicka it was not correct, and asked Ruzicka to take measurements and create a revision.[126] Hurry provided Ruzicka with contact information for shippers to ship furniture Hurry had found for the office.[127] Hurry reviewed the proposed CSCT website design and asked about the costs.[128] Hurry made the final decision on hiring a bookkeeper[129] and all the decisions on entering contracts.[130]

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[123] Hearing Tr. (Hurry) 1554-57.

[124] Hurrry testified that he had allocated between $4 and $5 million for the project and had invested well over seven figures in CSCT. Hearing Tr. (Hurry) 1552. When asked what he had taken out of CSCT, he said "Zero." Hearing Tr. (Hurry) 1553.

[125] Hearing Tr. (Cruz) 220.

[126] CX-48; CX-50; CX-52; CX-55; CX-75.

[127] CX-52; CX-53.

[128] CX-49; CX-84.

[129] CX-178, at 43-44.

[130] CX-178, at 46.

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Hurry instructed Ruzicka on fundamental business operations, as well. For example, he explained to Ruzicka that he should open a separate bank account for customer funds to keep their funds separate from CSCT's funds.[131]

Hurry decided that CSCT should be in the Special Economic Zone within the Cayman Islands, and that it should apply to be exempt from regulation by the Cayman Islands Monetary Authority ("CIMA"). In addition, Hurry instructed Ruzicka to apply to the IRS for QI status.[132] Although Ruzicka expressed concerns about the obligations and representations associated with QI status and was reluctant to make the required representations without further study, Hurry insisted that Ruzicka do it.[133]

Hurry determined the fees and commissions CSCT clients would pay. He instructed Ruzicka to take whatever Scottsdale charged CSCT and tack on 200 basis points.[134] Hurry in turn obtained a discount from Scottsdale on its charges to CSCT.[135] By this means, he kept the cost of doing business through CSCT roughly the same as doing business directly with Scottsdale. Otherwise, the rerouting of the FFI business through CSCT would have made no economic sense for the customers. However, there was no evidence that it made economic sense for Hurry to keep customer expenses roughly the same as they would have been working directly with Scottsdale when he was incurring substantial extra expenses setting up and staffing the extra office in the Cayman Islands.[136]

Hurry was intimately involved in setting up CSCT's technical systems. Hurry made the arrangements for computer software for CSCT and instructed Ruzicka to download Office 2010 for two users.[137] Similarly, Hurry selected computer equipment for CSCT and brought it down to the Cayman Islands in mid-January 2014 at the same time that he brought D'Mura to look at joining CSCT. D'Mura testified that Hurry set up the office network for CSCT.[138] When Ruzicka showed Hurry the information he planned to send to clients, Hurry told him he should make it look better and instructed him on how to do that. Hurry told Ruzicka to print to PDF and get a clean file to email customers. He advised Ruzicka that he could do that on his computer.[139]

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[131] CX-83.

[132] CX-178, at 48-53.

[133] CX-105; CX-107; CX-178, at 50-53.

[134] CX-178, at 106-09.

[135] Hearing Tr. (Cruz) 141-43; Hearing Tr. (D'Mura) 2294-95.

[136] Hurry and Diekmann testified that routing the FFI business through CSCT was actually a little less expensive for customers than dealing with Scottsdale directly. Hearing Tr. (Hurry) 1642-44; Hearing Tr. (Diekmann) 1652-53. If true, that testimony further undercuts the business justification for CSCT.

[137] CX-94; Hearing Tr. (Hurry) 1461.

[138] Hearing Tr. (D'Mura) 2263, 2266-68.

[139] CX-77; CX-78.

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Ruzicka, by contrast, was fairly unsophisticated about technology. He was vague on even identifying the programs that he used at CSCT.[140]

ii. Hurry Micro-Managed CSCT's Business

Although Hurry portrayed Ruzicka as being in charge of CSCT,[141] the evidence is otherwise. Hurry micro-managed CSCT, and he bullied Ruzicka and D'Mura to get them to do what he wanted them to do. Hurry also closely tracked CSCT's business with Scottsdale and with its FFI customers.

Ruzicka considered himself to be only an intermediary.[142] Hurry dictated what should be done, and Ruzicka complied. Ruzicka said with respect to Hurry, "You don't discuss; you do as you are ordered."[143] For example, when Ruzicka protested that he was not comfortable with signing off on the QI application, Hurry responded, "Stupid, just do it." Ruzicka said that he "kind of dropped the subject at that point."[144] Ruzicka signed off, despite his discomfort, because he knew if he did not "there is a ticket back to LA coming tomorrow."[145]

Similarly, although Ruzicka thought that Unicorn engaged in some suspicious trading and constant pressure from Cem Can at Unicorn gave him the "creeps," Ruzicka did not think he had authority to terminate the relationship with Unicorn. If he had done so without clear authority from Hurry, he thought that would have been his last day at CSCT.[146] D'Mura confirmed that neither he nor Ruzicka could terminate a client relationship, and, although they hated dealing with Cem Can at Unicorn, they did not consider it an option to turn away the business.[147]

Some of the initial customers of CSCT were pre-existing customers of Scottsdale. When Ruzicka asked the commonsense question why the pre-existing business was going to flow through the new entity, Hurry told him to shut up. After that, Ruzicka just did as he was told.[148]

Ruzicka testified in his OTR, and D'Mura testified at the hearing, that Hurry barraged them with telephone calls while they were working at CSCT. Hurry called Ruzicka almost every day, sometimes multiple times. He called D'Mura less often, probably a couple of times a week.

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[140] CX-77; CX-178, at 24-25.

[141] Hearing Tr. (Hurry) 1433, 1436, 1549-50. Hurry claimed that he hired Ruzicka to fulfill an "executive role." Hearing Tr. (Hurry) 1648.

[142] CX-178, at 46.

[143] CX-178, at 51.

[144] CX-178, at 51-52.

[145] CX-22; CX-178, at 52-53.

[146] CX-178, at 177-80, 188-89.

[147] Hearing Tr. (D'Mura) 2283-86.

[148] CX-178, at 79-80.

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The calls could come at all hours as well.[149] Often the calls were followed by demanding, abrupt, and increasingly impatient emails saying "call me."[150] In one email, Hurry wrote "Your phone is not working TURN IT ON. I need a call."[151] In another he wrote, "Call me in 60 minutes. DO YOU NOT UNDERSTAND THAT?"[152] In another the subject line was "pick up your phone!!!!!!!!"[153]

Hurry developed an Excel spreadsheet to track various aspects of CSCT's business. Although Hurry characterized it in his testimony as an "empowerment tool" that enabled his people to track their work for themselves without his having to keep track of their progress,[154] that characterization is not consistent with the evidence.

The spreadsheet tracked daily gross production, number of trades placed, certificate deposits approved, new certificate deposits received, and number of new accounts. It also tracked Ruzicka's start and finish times.[155] Ruzicka said that in telephone calls Hurry would even ask about how many cigarettes he had smoked during the day.[156] An email from Hurry corroborated Ruzicka's testimony. In the email, Hurry told Ruzicka "Need all the below," including start time, finish time, and "number of cig breaks."[157] Hurry acknowledged that the email included an inquiry about cigarette breaks, but he claimed that he was trying to help Ruzicka get himself organized. He claimed to know that Ruzicka was only in the office for ten minutes in an hour, which meant things were not getting done.[158]

Hurry wanted the numbers prepared every day, even if he did not ask for the information every day. Ruzicka and D'Mura prepared themselves for Hurry's frequent telephone calls and tried to have talking points and updated information ready to go if Hurry should call.[159]

Hurry tracked Ruzicka's and D'Mura's contacts with CSCT customers, including the FFIs involved in the transactions at issue. Ruzicka testified that in their frequent telephone calls Hurry would ask him about whether he had talked to Rohn Knowles at Titan or Cem Can at

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[149] Hearing Tr. (D'Mura) 2301-02; CX-178, at 67-73.

[150] CX-63; CX-68; CX-71; CX-74; CX-118; CX-121; CX-126; CX-127.

[151] CX-121.

[152] CX-127.

[153] CX-118.

[154] Hearing Tr. (Hurry) 1433-39.

[155] CX-131; Hearing Tr. (Hurry) 1433-34.

[156] CX-178, at 140-41.

[157] CX-133; Hearing Tr. (Hurry) 1438-39.

[158] Hearing Tr. (Hurry) 1438-40.

[159] CX-178, at 140-41; Hearing Tr. (D'Mura) 2301-04; Hearing Tr. (Hurry) 1436-40.

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Unicorn or other particular people from the Bahamas, Panama, or Belize.[160] D'Mura testified that Hurry would ask about customers, not particular deposits, but he and Ruzicka did discuss with Hurry how they were doing on specific deposits.[161] For example, in email correspondence and telephone conversations, Ruzicka discussed with Hurry the amount of trading in at least two of the symbols at issue here, NHPI and VPLM.[162]

D'Mura decided to leave CSCT and the Cayman Islands, in part, as a result of Hurry's constant demands. Hurry had called on a day that Ruzicka was attending a wedding as best man and D'Mura was working at his rented condominium instead of the office. Hurry expressed aggravation that neither of them was in the office and spoke of "having a come to Jesus moment" when he arrived in the Cayman Islands in a few days.[163] D'Mura then packed his bag and said good-bye to Ruzicka, who expressed the wish that he could leave, too. However, Ruzicka said he had nowhere to go and no alternative. D'Mura left before Hurry arrived; Ruzicka stayed.[164]

Eventually, in October 2014, Ruzicka also left CSCT. Its business had dwindled in reaction to the SEC complaint in *Amogear* and the *Bandfield* indictment.[165] According to Ruzicka, in October 2014 Hurry offered him other positions back in the United States, but Ruzicka concluded that he "did not want to work any long[er] for that man," referring to Hurry. Ruzicka said, "I don't care what he offered, you know. Incremental value of that last dollar just was not worth it."[166]

iii. Hurry Prospected For CSCT Customers

CSCT did not advertise[167] or engage in cold-calling to try to generate business.[168] Hurry's business plan was for CSCT to develop clients through contacts and referrals,[169] but Ruzicka, who had no prior industry experience, had no network he could cultivate for potential customers.

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[160] CX-178, at 74-77, 84-85.

[161] Hearing Tr. (D'Mura) 2304-05.

[162] CX-132.

[163] Hearing Tr. (D'Mura) 2308-09. Hurry confirmed that he was frustrated that Ruzicka and D'Mura were not in the office. Hearing Tr. (Hurry) 1602-03. When people called CSCT and did not get an answer, they called Alpine trying to find Hurry. Hearing Tr. (Hurry) 1622-23.

[164] Hearing Tr. (D'Mura) 2306-10.

[165] Hearing Tr. (Cruz) 237-38.

[166] CX-178, at 232.

[167] CX-178, at 218. In contrast, even though Scottsdale had been in business for ten years, it advertised for business. Hearing Tr. (Cruz) 116.

[168] Hearing Tr. (D'Mura) 2279-80.

[169] CX-160, at 3; Hearing Tr. (Hurry) 1393.

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Customers simply appeared seeking to establish a business relationship with CSCT. They were referred to CSCT by Hurry or by someone at Scottsdale or Alpine.[170] Ruzicka testified at his OTR that he had an "express representation" that two of the FFIs involved in this case, Titan and Unicorn, were referred by Hurry.[171] Ruzicka did not know how Montage "found" CSCT.[172]

At the hearing, Hurry flatly contradicted Ruzicka's testimony that Hurry had referred Titan and Unicorn to CSCT.[173] We do not credit Hurry's testimony because he gave the testimony only after he knew that Ruzicka would not appear at the hearing to dispute Hurry's statement. To the extent that Hurry means that the referral came from someone at Scottsdale, we do not regard that as proving that Hurry was not the ultimate source of the referral, even if he made the link to CSCT through Scottsdale. Hurry had a pre-existing relationship with Titan while it was a direct customer of Scottsdale,[174] and he admitted talking to existing Scottsdale customers about his plan to establish CSCT.[175] He also admitted, as discussed below, to talking directly to Titan and other customers even after they became CSCT customers.

Hurry admits that he had at least one face-to-face meeting with Montage in Panama[176] and another face-to-face meeting with Unicorn in Belize.[177] He flew to Central America in January 2014 for these meetings, after dropping off D'Mura on his initial visit to CSCT. He did not take Ruzicka with him.[178]

At the hearing, Hurry claimed not to recall discussing business with either Montage or Unicorn during these visits.[179] Hurry claimed that he went to Montage because Ruzicka had asked him to evaluate a back-office system Montage was using to see if it would be suitable for CSCT. Hurry did not identify the nature of the system. He said that in the end they determined that it was not suitable for CSCT. He did not explain why it was unsuitable.[180]

We do not find Hurry's testimony with respect to his visit with Montage credible. Ruzicka was not technologically sophisticated and was too subordinate to suggest such a thing to

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[170] CX-178, at 104, 167-68.

[171] CX-178, at 203-04.

[172] CX-178, at 203.

[173] Hearing Tr. (Hurry) 1410, 1416.

[174] Hurry was listed as the registered representative and financial consultant for Titan when it was a direct customer of Scottsdale. Hearing Tr. (Hurry) 1413-14, 1610-12; CX-242, at 44, 48.

[175] Hearing Tr. (Hurry) 1401-06.

[176] Hearing Tr. (Hurry) 1412-13, 1612-13.

[177] Hearing Tr. (Hurry) 1406, 1422, 1613-14.

[178] Hearing Tr. (D'Mura) 2300-01; Hearing Tr. (Hurry) 1617-19.

[179] Hearing Tr. (Hurry) 1406, 1618-19.

[180] Hearing Tr. (Hurry) 1612-13, 1617-19.

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Hurry. Furthermore, D'Mura testified that he remembered no discussion of evaluating a back office system.[181] Hurry's testimony was vague and lacked specificity, and, again, Hurry gave his testimony only after it was clear that Ruzicka would not appear at the hearing. Hurry knew he would not be contradicted.

Hurry counseled Ruzicka to do business with Montage and, in particular, to do business with a person who was not identified in Montage documents as being connected with it. Ruzicka testified in his OTR that he was unclear about the role of a Montage contact with whom Hurry spoke from time to time. When Ruzicka asked Hurry about the contact, Hurry said to him "Hey, that's fine, you can interface with that guy. He's part of the operation."[182] This evidence shows that Hurry knew more about Montage than Ruzicka did, and that Hurry was instructing Ruzicka with regard to customer dealings.

Hurry claimed at the hearing that he only went to Belize to meet with Cem Can at Unicorn (both named defendants in the *Bandfield* indictment) because Ruzicka asked him to do so. According to Hurry, Ruzicka was trying to open the account and Can had requested a meeting with Hurry. Hurry said it is not uncommon for people to want to meet the owner of a business.[183] However, in somewhat inconsistent testimony, Hurry testified that he did not recall discussing business during his visit with Unicorn.[184]

Hurry's hearing testimony was impeached by his OTR. In his OTR, Hurry testified that Cem Can had asked him whether it would be better to do business with Scottsdale or CSCT. Hurry told him that it might be quicker to go directly to Scottsdale, but there could be "holdups" because of potential withholding there. On the other hand, because CSCT was a QI, Hurry told Can the "holdup" would be eliminated.[185]

There was additional evidence that Hurry discussed business with Unicorn. In late January 2014, Chinique Lewis of Unicorn sent an email to Eric Miller, Diekmann, and Ruzicka asking for Hurry to join a call on the processes and procedures to be used in connection with Unicorn's business with CSCT and Scottsdale. She said from "our personal face to face conversation with Mr. Hurry, I am certain he will not mind getting on a call."[186]

With respect to the request to involve him on a call with Unicorn, Hurry testified that it was no more than the common desire to deal with the person at the head of an organization.[187]

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[181] Hearing Tr. (D'Mura) 2300-01.

[182] CX-178, at 123-24.

[183] Hearing Tr. (Hurry) 1613-14.

[184] Hearing Tr. (Hurry) 1406.

[185] Hearing Tr. (Hurry) 1407-10, 1421-22.

[186] CX-119.

[187] Hearing Tr. (Hurry) 1432

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We find his explanation unconvincing. He traveled to a potential CSCT client without taking Ruzicka, the designated head of CSCT, discussed that client doing business with CSCT, and was viewed by the client as an important participant in the client's business dealings with CSCT.

Although he denied it, Hurry provided other leads and referrals to Ruzicka, too. In an email dated November 17, 2013, for example, Hurry wrote to Ruzicka, "Referrals and Leads call me on them." In the email, Hurry provided a couple of names and telephone numbers. One of those named was an "Andrew Farmer."[188] On November 20, 2013, Ruzicka wrote Hurry that he had tried to call "Andy" at the number Hurry had given him but the call did not go through. That same day Hurry provided another telephone number.[189] Hurry maintained he had identified the people in the email to Ruzicka not as prospects or potential customers but because they knew FFIs.[190]

Hurry revealed that, in fact, he was guiding Ruzicka's customer dealings, when he volunteered that Ruzicka did not in the end talk to the people Hurry had identified in the email. Hurry said that he had afterward found out that they had some "issues" and had told Ruzicka, "Don't bother."[191]

D'Mura testified that while he was at CSCT Hurry and Ruzicka met with another potential customer, Caledonian Securities. CSCT received over 50 Caledonian deposits afterward.[192]

Despite this evidence that Hurry was critical to developing CSCT's business, Hurry portrayed himself as offering only slight help to Ruzicka. He claimed that all he did was to recommend to Ruzicka that he get a book of international financial institutions and prospect for customers using that.[193] This testimony is not credible. Since Ruzicka and D'Mura engaged in no cold calling, they had no use for a book to help them prospect for customers.[194] Furthermore, such an approach to business promotion—cold calling people out of a book—was not likely to be successful. Hurry would certainly have known that, and he would not have been satisfied with

[188] CX-51.

[189] CX-62.

[190] Hearing Tr. 1401-04; CX-51.

[191] Hearing Tr. (Hurry) 1404.

[192] Hearing Tr. (D'Mura) 2295-97. D'Mura testified that he received the initial documents from Caledonian in the last week before he left Scottsdale and laid them out on a table to review, so he was well aware of the volume submitted to CSCT. The Caledonian-related deposits were not passed on to Scottsdale before he left CSCT. Hearing Tr. (D'Mura) 2317.

[193] Hearing Tr. (Hurry) 1403-04.

[194] Hearing Tr. (D'Mura) 2279.

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that approach to marketing CSCT. He wanted CSCT to be successful and worked hard to make it so.[195]

iv. Hurry Tried To Conceal His Involvement With CSCT

Both Ruzicka and D'Mura had the impression that secrecy was important to Hurry. Ruzicka said that Hurry "flat told me, 'I'm going to Caymans, because that way I don't have to give anything to anybody.'"[196] D'Mura testified that when he first flew down to the Caymans with Hurry, Hurry spent time discussing with him the privacy laws of the Cayman Islands. Hurry noted that some of them were criminal, not just civil.[197] In so doing, Hurry stressed the serious consequences if a person failed to comply.

Hurry denied any particular interest in secrecy.[198] Hurry's denial is not credible. We find that he was intensely concerned with secrecy and concealing his involvement with CSCT's customers and business. His concern was manifested in the following ways.

(a) Use Of Email Address That Hid His Identity

Hurry used an email address that hid his identity. When Ruzicka started working at CSCT, he used as his work email address gr@csct.ky. The address identified him by his initials, the firm by its initials, and the Cayman Islands location by the last two letters. Ruzicka set up a similar email address for Hurry, using Hurry's first initial and last name: jhurry@csct.ky.[199]

Hurry had an extreme reaction to his email address. Ruzicka said that Hurry "just crucified me." Hurry told Ruzicka that the address was too long, and instructed Ruzicka to change the individual identifier to x.[200] Thus, during the relevant period Hurry's email address at CSCT was x@csct.ky, which did not identify Hurry.

At the hearing, Hurry repeated the same explanation for changing his email address. He testified that he wanted an address that was short.[201]

We find Hurry's explanation to be false. He volunteered elsewhere in his testimony that his main email address is JHurry@hurry.com.[202] Thus, Hurry's main email address is constructed in the same way that Ruzicka initially constructed Hurry's address at CSCT. If that construction

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[195] Hearing Tr. (Hurry) 1417-18; CX-178, at 74-75, 135-42.

[196] CX-178, at 36.

[197] Hearing Tr. (D'Mura) 2259.

[198] Hearing Tr. (Hurry) 1361-62, 1364-65.

[199] CX-178, at 146-47.

[200] CX-178, at 146-47.

[201] Hearing Tr. (Hurry) 1459.

[202] Hearing Tr. (Hurry) 1426.

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was not too long for Hurry's main email address, then it was not too long for his CSCT address. Furthermore, we find that the choice of x instead of an identifier such as JH was designed to conceal Hurry's involvement in CSCT business and perhaps give him the possibility of denying that it was his address. Finally, the extreme nature of his reaction to the initial email address—making Ruzicka feel almost "crucified"—strongly suggests that Hurry was concerned with something more important than having a short email address.

(b) Assertion Of Attorney-Client Privilege

Hurry insisted on asserting the attorney-client privilege even where it was not appropriate. Hurry almost always marked his emails with Ruzicka as attorney-client privileged. He did so even when his emails simply asked Ruzicka to call him and when his emails concerned only floor plans and office furniture and the like, which emails neither sought nor received nor reflected any legal advice.[203] In contrast, Ruzicka rarely marked his emails to Hurry as privileged,[204] even though Hurry instructed Ruzicka that he should mark all his email correspondence with Hurry as attorney-client privileged.[205]

Hurry claimed at the hearing that he marked his emails privileged because Ruzicka advised him to use the privilege designation.[206] That claim is not credible in light of Ruzicka's practice of not marking his emails with Hurry as privileged. Nor is Hurry's claim consistent with the written record that it was Hurry who instructed Ruzicka to use the privilege designation, not the other way around. We find that Hurry wanted all his correspondence with Ruzicka marked privileged because he believed that he might be able to shield that correspondence from future regulatory scrutiny or litigation discovery. Similarly, in his hearing testimony, Hurry sometimes used the phrase "on advice of counsel" in his answer, as though it were a talisman against more probing inquiry or criticism.[207]

(c) Avoiding Written Record

Hurry tried to avoid creating a written record. Ruzicka wrote in an email to Diekmann that Hurry had directed him to take a particular deposit, specifying the symbol, SVLE. Diekmann forwarded the email to Hurry and DiBlasi. When Hurry saw the email, he "tore" into Ruzicka

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[203] CX-48; CX-49; CX-50; CX-51; CX-52; CX-55; CX-58; CX-62; CX-63; CX-71; CX-75; CX-77; CX-78; CX-79; CX-83; CX-84; CX-92; CX-94; CX-107; CX-129; CX-151.

[204] CX-53; CX-62; CX-75; CX-77; CX-79; CX-84; CX-151.

[205] CX-53 and CX-84.

[206] Hearing Tr. (Hurry) 1485.

[207] Hearing Tr. (Hurry) 1333-35.

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"like you wouldn't believe."[208] Hurry told Ruzicka something to the effect of "Never put in writing that I am directly involved in business decisions."[209]

Ruzicka said that Hurry did not want any permanent record of his communications.[210] For that reason he communicated with Ruzicka primarily through FaceTime, the iPhone tool for video communications. Hurry called Ruzicka frequently, sometimes as many as four times in a day. He called early in the morning and as late as 9:30 p.m.; he called on weekends as well as business days. Ruzicka viewed the video calls as invasive, but Hurry told him that he used FaceTime because it was free.[211] Notably, emails are similarly "free" communications once you have paid the internet provider, and Hurry would have incurred no additional expense if he had communicated with Ruzicka by email.

Hurry disputed Ruzicka's testimony that he did not want a written record of his communications with CSCT.[212] However, D'Mura confirmed that Hurry did not want a written record of his involvement in CSCT business. D'Mura testified that Hurry expressed to him and Ruzicka both specifically and generally not to send him documents.[213]

(d) Use Of FaceTime To Conceal Contacts With Customers

Hurry also communicated with CSCT customers (including all three FFIs involved in this case) using FaceTime, thereby concealing his contacts with them. Hurry would call Ruzicka at CSCT and ask Ruzicka to call a customer on CSCT's landline. Then Ruzicka would hold his iPhone next to the landline telephone so that Hurry and the customer could talk. Ruzicka did not participate in the calls, although he had to be present to hold the telephones together. This manner of conducting the telephone conversation would avoid a record that Hurry had talked to the customer. To the extent there was any record, it would appear that Hurry had only called CSCT. Ruzicka testified at his OTR that this happened roughly a dozen times and that Hurry had conversations in this manner with Rohn Knowles and Kelvin Leach at Titan, Cem Can at Unicorn, and an individual at Montage.[214]

In hearing testimony, D'Mura similarly described a FaceTime conference call with Caledonian. Caledonian was on the speaker phone in the CSCT office and Hurry was on the iPhone. Ruzicka would hold the telephones next to each other. D'Mura remembered at least one

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[208] CX-178, at 155-61.

[209] CX-178, at 161.

[210] CX-178, at 70.

[211] CX-178, at 67-71.

[212] Hearing Tr. (Hurry) 1540.

[213] Hearing Tr. (D'Mura) 2300.

[214] CX-178, at 118-27.

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other time that such a FaceTime conference happened.[215] D'Mura believed that it was Hurry's idea to conduct the calls this way.[216]

Hurry does not deny that he conducted telephone calls with CSCT customers in this manner. However, he gives the practice an innocent explanation. He claims that he used the iPhone app because it cost less and because he found it difficult to do a conference call on his cell phone. He claimed that Ruzicka was a participant in the call, disputing Ruzicka's OTR testimony after he knew that Ruzicka would not appear at the hearing.[217]

We find Hurry's explanation not credible. Hurry generally did not conduct his business in such a frugal manner. He flew back and forth to the Cayman Islands in his own private airplane, and flew to Panama and Belize from there to meet with Montage and Unicorn.[218] He funded expensive offices for CSCT[219] and provided Ruzicka and D'Mura with housing when they worked there.[220] He instructed Ruzicka to buy Hurry a seven-seat vehicle to use while he was in the Cayman Islands.[221] He liked to tell people how rich he is.[222] It is unlikely that the costs associated with a dozen international telephone calls would trouble him much.

We also find Hurry's assertion that he used FaceTime because he was too technologically challenged to figure out how to do a conference call on his cell phone not credible. Hurry was technologically sophisticated enough to set up CSCT's computer network.[223] He instructed Ruzicka on how to use PDFs and other software, and he created an elaborate Excel spreadsheet.[224] When he was asked whether he was aware that his use of FaceTime to speak with customers would conceal his involvement in a conversation with the customers, Hurry answered evasively, avoiding a direct yes or no.[225]

Hurry testified that he started using FaceTime in February 2014.[226] Coincidentally, his email traffic with Ruzicka and D'Mura at CSCT dropped to nearly nothing.[227] We find a

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[215] Hearing Tr. (D'Mura) 2297-98.

[216] Hearing Tr. (D'Mura) 2302-03.

[217] Hearing Tr. (Hurry) 1540-42.

[218] Hearing Tr. (D'Mura) 2252-58, 2300-01; Hearing Tr. (Hurry) 1412-13, 1613-14, 1617-19.

[219] CX-178, at 35.

[220] Hearing Tr. (Hurry) 1447, 1649-51; Hearing Tr. (D'Mura) 2265, 2316-17.

[221] CX-58.

[222] CX-178, at 26, 70.

[223] Hearing Tr. (Hurry) 1461; Hearing Tr. (D'Mura) 2263, 2266-68; CX-94.

[224] Hearing Tr. (Hurry) 1433-34; CX-178, at 24-25; CX-77; CX-131.

[225] Hearing Tr. (Hurry) 1541.

[226] Hearing Tr. (Hurry) 1540.

[227] Resp. PH Br. 45.

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significant connection between the two events. Hurry's purposeful use of FaceTime enabled him to stop creating a trail of emails.

C. The Firm's General Practice For Reviewing Deposits

Everything that Scottsdale knew about a deposit when the Firm concluded that it could sell the deposited securities pursuant to the Rule 144 exemption is contained in a due diligence package for the deposit.[228] Generally, at the top of the package is a two-page Deposited Securities Checklist ("Checklist"). That is followed by various other documents, including a Beneficial Ownership Declaration signed by the purported beneficial owner of the shares deposited for resale by Scottsdale.[229]

Scottsdale's general process for reviewing and approving a deposit of stock certificates was for a person on the Rule 144 team to assemble the due diligence package, working from the Checklist. Then, the person who had put together the file (sometimes referred to as the first reviewer) would go to Cruz and talk with him about it. Depending on the complexity of the deposit, the talk could take 15 minutes to an hour. Cruz did not review every page in the file. He would read through the Checklist and ask questions. He might ask to see particular documents and conduct Google searches while sitting together with the initial reviewer.[230]

The Firm heavily depended upon the representations made in the Beneficial Ownership Declaration for its conclusion that the purported beneficial owner was not an affiliate of the issuer and was the person who had the economic interest in the shares on deposit. Diekmann initially denied that the persons signing as beneficial owners could be lying. He testified that he saw no reason for them to lie, and he emphasized that the document is very clear about the information it requests. Only upon being pressed did he eventually agree that if someone were acting as a nominee for a secret beneficial owner one would expect them to lie.[231] We find his testimony on this subject evasive.

Cruz similarly focused on the fact that the Beneficial Ownership Declaration was the tool that the Firm used to find out who owned the shares.[232] He stressed that the Declaration was "unequivocal," and that the parties to the transactions understood the Firm's expectations when they made parallel representations regarding the person identified as the beneficial owner.[233] When asked whether language on Unicorn's website offering to appoint nominee officers and directors would be a red flag to him, Cruz responded that it "could have been." He suggested that the way he would deal with that red flag would not be to seek independent verification. Rather,

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[228] Hearing Tr. (Diekmann) 1916-17.

[229] RX-1, at 1-2, 11-12, 78-79, 88-89, 158-59, 169-70; RX-2, at 1-2, 12-13, 106-07, 117-18; RX-3, at 1-2, 11-12.

[230] Hearing Tr. (Diekmann) 694-96; Hearing Tr. (Cruz) 278.

[231] Hearing Tr. (Diekmann) 1895-96.

[232] Hearing Tr. (Cruz) 201-03.

[233] Hearing Tr. (Cruz) 202.

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In the Court of Appeals
For the State of Michigan

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff-Appellee,

v.

MORNINGLIGHTMOUNTAIN, LLC, and MICHAEL GOODE,

Defendants-Appellants,

–and–

DOES 1–10,

Defendants–Not Participating.

Docket No.

Kalamazoo County Circuit Court
Case No.: 18-0153-CZ
HON. ALEXANDER C. LIPSEY

APPLICATION FOR LEAVE TO PURSUE AN INTERLOCUTORY APPEAL

APPELLANT'S APPENDIX VOLUME V

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he would simply emphasize to the interested persons the importance of disclosure. He said that the Firm would "reiterate and make sure they understand the purpose of our forms and … that they need to – to disclose the underlying beneficial owner."[234]

Cruz testified that during the relevant period, from December 2013 through June 30, 2014, the Firm did not conduct a specific search for nominees.[235] Diekmann testified that he thought the Firm's general practice would pick up a problem with nominees, but he could not cite any particular procedures that were geared to do that. He said the "procedures in sum" would address the nominee problem.[236] Cruz confirmed, however, that the term "nominee" appears nowhere in the Firm's policies and procedures.[237]

Given the complexity of the analysis required, and the high potential for interested parties to obfuscate and make misrepresentations, we find the Firm's general process for final approval inadequate. A conversation that may last fifteen minutes and not involve review of all the documents in the file is not enough to analyze the content of the representations and understand whether the business transactions made sense. We also find that the Firm's reliance on the honesty of the interested parties filling out the forms was unreasonable in light of the high potential for the use of nominees.

We are concerned that the Firm's general process for review and approval was so poor when the processing of microcap stock certificates for resale to the public was its primary business. We are further concerned because the transactions at issue here were typical of Scottsdale's business. Cruz testified that the Firm's customers typically were persons who made loans to issuers and then sold the loans to others who then attempted to profit by exchanging them for shares. Thus, the Firm's lack of a good process for review and approval was not a minor aspect of the Firm's business.[238]

D. Transactions

The Firm followed a check-the-box approach to its Rule 144 reviews, without evaluating and independently verifying the information it gathered. This approach is apparent from the following in-depth analysis of the three NHPI deposits. The Firm followed the same approach with the VPLM and ORFG deposits, which we discuss in less detail.

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[234] Hearing Tr. (Cruz) 307-08.

[235] Hearing Tr. (Cruz) 199-202, 211-13; Hearing Tr. (Diekmann) 908-10.

[236] Hearing Tr. (Diekmann) 922.

[237] Hearing Tr. (Cruz) 666-67.

[238] Hearing Tr. (Cruz) 352-53.

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1. NHPI (Three Unicorn deposits derived from Collins promissory note)

a. Due Diligence Package

i. Purported Beneficial Owners

CSCT made three NHPI deposits. They all came from Unicorn, which, in turn, purported to act on behalf of other supposedly independent entities: Sky Walker, Inc. ("Sky Walker"), Swiss National Securities ("Swiss National"), and Ireland Offshore Securities ("Ireland Offshore"). The beneficial owner of Sky Walker is identified on the Checklist as Patrick Gentle; the beneficial owner of Swiss National is identified on a separate Checklist as Talal Fanni (apparently a misspelling, since the person signed documents as Talal Fouani); and the beneficial owner of Ireland Offshore is identified on the third Checklist as Jeff Cox.[239]

Each purported beneficial owner signed a Beneficial Ownership Declaration representing that he was not an affiliate of the issuer, that the issuer was not to his knowledge a shell, and that the securities were free trading, without resale restrictions under Rule 144. The documents were not witnessed or notarized. No address, telephone number or other contact information was given for the purported beneficial owner.[240]

Scottsdale did nothing to identify the purported beneficial owners more specifically. While it did a Google search combining the name of the beneficial owner with the words "securities fraud" and put the first page of the initial index of results in the due diligence package, it did not search for the person's name alone, or the person's name in combination with the name of the entity through which he acquired the shares, or the person's name along with the names of the issuer and issuer's principals.[241]

The purpose of the Google search using the name of the purported beneficial owner with the words securities fraud is unclear in light of the fact that Diekmann testified that a "hit" on such a search indicating that a person was engaged in some sort of securities fraud would be unrelated to beneficial ownership.[242] That testimony demonstrates the check-the-box attitude of the Firm. Diekmann was insensitive to the possibility that if a person was engaged in securities fraud, then the representations made by that person and others connected to a deposit could be false.

As discussed below, the three deposits shared the same origin.

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[239] RX-1, at 1-2, 11-12, 78-79, 88-89, 158-59, 169-70.

[240] RX-1, at 11-12, 88-89, 169-70.

[241] RX-1, at 67, 152, 223. The Firm misspelled Fouani's name when it did the Google search, illustrating its careless approach to conducting due diligence. RX-1, at 67.

[242] Hearing Tr. (Diekmann) 927.

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ii. Prior Holder Transaction

The Checklists for the Sky Walker, Swiss National, and Ireland Offshore deposits state that the issuer, NHPI, gave a $10,000 promissory note dated May 1, 2012, to someone named Thomas Collins. Each NHPI depositor purports to tack back its holding period to that date and that note.[243]

A copy of the May 2012 promissory note is included with the Sky Walker and Ireland Offshore deposits. The note was due and payable no later than July 1, 2012. It provided that if NHPI did not pay the note by the due date, Collins would have the right to convert the debt into common shares. No address or contact information is given for the company or for Collins. Although the note provided that Collins would have a right of conversion upon the company's default, it contained no provision for either party to give notice to the other in the event of a default. The signatures for NHPI and Collins were not witnessed or notarized.[244]

According to the attorney opinion in the due diligence package, the May 2012 note was the company's promise to pay Collins a fee for services.[245] The unaudited financial statements in the due diligence package similarly indicated that the note was for consulting services.[246]

With respect to Collins' identity and possible connection to the issuer, the due diligence package contains a statement signed by Collins declaring that he had never been an affiliate of the issuer. Again, the statement is not witnessed or notarized, and no contact information is provided.[247]

The issuer did provide the stock transfer agent with an address for Collins when it instructed the transfer agent to issue new unrestricted shares to him, as reflected in the instructions to the transfer agent, which are in the due diligence package. Collins had a Texas address.[248] Also in the due diligence package is the transfer agent's list of shareholders, which showed that all active shareholders of NHPI had U.S. addresses.[249]

Scottsdale did not run a Google search on Collins using the address contained in the due diligence package. Nor did it search to see whether Collins had any links to the other persons on the NHPI shareholder list. Rather, it ran a Google search linking Collins' name to the words "securities fraud." Apparently, a person named Thomas Collins had been involved in a securities fraud, but the Firm obtained an SEC litigation release indicating that that person had died prior to

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[243] RX-1, at 1, 78, 158.

[244] RX-1, at 106, 183.

[245] RX-1, at 22, 101, 178.

[246] RX-1, at 40, 122, 198.

[247] RX-1, at 25.

[248] RX-1, at 31.

[249] RX-1, at 37.

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1997. The Firm never determined the identity of the particular Thomas Collins involved in the NHPI deposits.[250]

iii. Acquisition Of Shares By Depositors

Collins gave Sky Walker, Swiss National, and Ireland Offshore each a separate $50,000 note dated September 1, 2013. The notes were to be paid in full by November 7, 2013. The notes specified that in the event of a default the entire sum would become due.[251] Each note was ostensibly secured by a Stock Pledge Agreement pledging 20 million shares of NHPI,[252] which, at the time, Collins did not own. These notes, like the note between Collins and NHPI, contain no address or contact information for any party and no provision for either party to give notice to the other in the event of a default. They are neither witnessed nor notarized.[253]

The next items in the chronology are three Note Satisfaction Agreements dated September 16, 2013. These three identical Agreements indicate that Collins had already defaulted on the $50,000 note, although the due date was not until November 7, 2013. Each depositor declared a desire to take title to the NHPI shares described in the pledge agreement.[254] The Securities Deposit Pre-Review Request Unicorn submitted for Swiss National likewise gives September 16, 2013, as the date of acquisition, referring to the Note Satisfaction Agreement,[255] as does the Deposited Securities Request Form submitted for Ireland Offshore.[256]

On November 15, 2013, more than a year after the due date for the May 2012 note, the issuer and Collins purportedly entered into a note conversion agreement whereby Collins agreed to forgive 90% of the note in return for 90 million shares of NHPI.[257] The Note Conversion Agreement included in the due diligence package, like the May 2012 promissory note, contains no address or contact information for the company or for Collins and is not witnessed or notarized. The Note Conversion Agreement does not explain why the conversion occurred so

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[250] RX-1, at 57-58.

[251] RX-1, at 32, 112, 190.

[252] RX-1, at 113-16, 191-94.

[253] RX-1, at 32, 112, 190.

[254] RX-1, at 33, 117, 195.

[255] RX-1, at 13.

[256] RX-1, at 161. Other documents give conflicting, later dates as the acquisition date. Some documents represent that the three depositors acquired the securities on November 25, 2013, pursuant to a Stock Purchase Agreement. RX-1, at 11, 19, 88, 98, 169. However, the due diligence package for NHPI contains no Stock Purchase Agreement. Another document says that the acquisition date was November 15, 2013, the same date that Collins entered into the Note Conversion Agreement and the shares were issued to him. RX-1, at 81. The Firm did not resolve the discrepancy between the September acquisition date and the November acquisition dates before selling the securities.

[257] RX-1, at 1, 78, 158.

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long after the default or how the remaining unpaid 10% of the May 2012 promissory note was to be treated.[258]

NHPI issued the 90 million shares to Collins on November 15, 2013, the same day as the note conversion agreement.[259]

Although the exact date that Collins assigned the shares to the three beneficial owners is not clear, it was at most a few days after NHPI issued the shares to Collins. Thus, the transaction between the issuer and Collins, the issuance of the stock, and the transactions between Collins and the three purported beneficial owner entities all happened almost simultaneously.

Although the transactions happened almost simultaneously, the value given to the shares differed substantially. There is no evidence of a corporate event or other explanation for the variance. In return for forgiving a debt of $9,000, Collins obtained 90 million shares, but each beneficial owner entity forgave a debt of $50,000 for its 20 million shares. No money actually changed hands in these transactions.

iv. Issuer Filings

Although NHPI had once been a reporting company with the SEC, it stopped being a reporting company in 2009. After that it made less frequent and less regular filings on OTC Markets.[260] On November 20, 2013, a few days after the NHPI shares were issued and around the time that Sky Walker, Swiss National, and Ireland Offshore acquired the shares, the issuer filed an annual report for the year ending December 31, 2012.[261] In the November 20, 2013 report, NHPI mainly discussed its pharmaceutical business and then stated in a single sentence that it had entered into the oil and gas business. It declared that further disclosure related to the oil and gas business was in an Interim Information and Disclosure Statement for the period ended November 20, 2013.[262]

In the annual report filed on November 20, 2013, notes to unaudited financial statements declared that NHPI had given Collins a promissory note for unspecified consulting services.[263] Scottsdale relied upon this disclosure to verify the existence of the May 1, 2012 promissory note, which was critical to the ability of the beneficial owners to sell the securities without registration.

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[258] RX-1, at 26-28, 106-09, 184-86.

[259] RX-1, at 29.

[260] Hearing Tr. (Byrne) 2069-75; CX-255; CX-256; CX-260; CX-261; RX-1, at 130.

[261] CX-256. Diekmann testified that it appeared that the company had had a gap in its reporting prior to its November 2013 filing. Hearing Tr. (Diekmann) 939. However, he did not believe that such a gap would be suspicious, even if it were as long as two-and-a-half years. Hearing Tr. (Diekmann) 1011-13.

[262] CX-256, at 4. One page from the Interim Information and Disclosure Statement was in the due diligence package for the NHPI deposits. But that page did not contain the disclosure relating to the oil and gas business. RX-1 at 39.

[263] RX-1, at 40.

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The only evidence that the note existed, however, was created about the same time as the transactions leading up to the sale of securities into the public markets.

In order to determine that NHPI was not a shell, Scottsdale relied on the representation by the president of NHPI that it was not a shell.[264] It also relied on descriptions of the company's assets and liabilities in unaudited financial statements contained in the annual report filed in November 2013 and in a quarterly report filed about the same time to cover the period ending June 30, 2012. However, those descriptions were vague; they showed mostly unspecific cash assets, not physical assets. In the annual report, for example, the company reported that it had less than $28,000 in a checking account, accounts receivable over $600,000, unspecified inventory over $70,000, and investment assets over $750,000. The financial statements also show that the issuer had incurred some expenses. The financial statements do not provide, however, any indication of the nature of the expenses or the business activities that supposedly gave rise to them. The issuer disclosed no verifiable facts.[265]

The company's public filings created a significant discrepancy between the disclosure in those filings and the NHPI deposits. The interim financial report for the period ending November 20, 2013, states that 981,408,909 shares were outstanding, of which 970,326,182 were restricted.[266] That means that only around 11 million shares were free-trading shares. But the three depositors deposited 60 million for resale to the public. There is no evidence that the Firm investigated this discrepancy.

v. Attorney Opinion Letter

The Firm relied upon an attorney opinion letter stating that the shares could be issued as free trading shares and sold pursuant to Rule 144. However, that opinion made plain that the attorney relied on certifications by the principal officers of NHPI. The attorney assumed that all signatures were genuine and the facts set forth in the certificates were correct.[267] The attorney relied on the company's filings for his conclusion that the company was actively marketing its pharmaceutical products and exploring one or more strategic alliances and licensing arrangements.[268] Similarly, the attorney relied on company filings as showing that NHPI was actively pursuing the acquisition of mineral rights leases.[269] The attorney did not independently verify the facts in his opinion letter.

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[264] RX-1, at 24.

[265] RX-1, at 38-40.

[266] RX-1, at 43.

[267] RX-1, at 20.

[268] RX-1, at 21.

[269] RX-1, at 21.

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vi. Scottsdale Approval And Sales

During the first week of February 2014, Noiman and Cruz approved the first NHPI deposit, Sky Walker, for resale by Scottsdale. At the time, the 20 million shares were given an estimated value of $268,000.[270] Noiman and Cruz approved the Swiss National NHPI deposit on April 9, 2014, which was given a value of $98,000.[271] They approved the Ireland Offshore NHPI deposit at the end of April 2014 with a given value of $82,000.[272]

Sales of NHPI shares began on February 26, 2014, and continued through May 7, 2014. Periodically, Scottsdale would wire out the proceeds of the sales of NHPI and other securities in the CSCT account.[273] As with all transactions conducted with CSCT and its customers, after Scottsdale wired the proceeds of the sales to CSCT's bank account, Scottsdale did not know where the funds flowed after that.[274] Thus, it did not know who received the economic benefit.

vii. Promotional Activity

In December 2013, not long after the series of transactions by which the purported beneficial owners acquired their shares of NHPI, there was promotional activity regarding NHPI, as reflected in the due diligence file for the NHPI deposits. Diekmann testified that he would have looked at the promotional activity but he did not recall doing so. He asserted that promotional activity was not necessarily a red flag, but that he might try to see if there was a link to the customer. He acknowledged, however, that it would be difficult to know if a customer was behind the promotion if a nominee were being used.[275]

In February and March 2014, there also was promotional activity regarding NHPI.[276] In a February 19, 2014 email, Ruzicka wrote to Diekmann that Unicorn was particularly eager to trade NHPI. Diekmann did not remember the email, and did not think it particularly remarkable. He said that no customer wants "to miss an opportunity to trade."[277] Scottsdale sold NHPI shares deposited by CSCT during February and March 2014, when the promotional activity was ongoing.[278]

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[270] RX-1, at 78-79 (Sky Walker).

[271] RX-1, at 1-2.

[272] RX-1, at 158-59.

[273] JX-268.

[274] Hearing Tr. (Cruz) 661-62.

[275] Hearing Tr. (Diekmann) 1014-16; RX-1, at 132-33; CX-262, at 6.

[276] CX-262, at 2-5; CX-263.

[277] Hearing Tr. (Diekmann) 1016-18.

[278] JX-268.

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b. Red Flags Signifying A Scheme To Evade The Securities Laws

Even aside from the fact that the May 2012 promissory note was not a security, as discussed below, the circumstances of the three NHPI deposits raised a number of red flags signaling that the transactions were likely sham transactions using nominees to conceal the identity of the persons actually benefiting from the sale of securities. Some, but not all, of the red flags are listed below.

First, Collins and NHPI entered the agreement to convert the note he held from the company to shares—and NHPI issued the shares—almost simultaneously with his execution of three separate agreements to transfer a portion of those shares to Sky Walker, Swiss National, and Ireland Offshore. The almost simultaneous transactions are compelling evidence that the parties were not truly independent. The suspect nature of the transactions is heightened by the identical terms of the notes to Sky Walker, Swiss National, and Ireland Offshore.

Respondents attempted to rebut any suspicion arising from the timing and identical terms of the Sky Walker, Swiss National, and Ireland Offshore transactions. Diekmann testified that he assumed that one person had put together the loan transactions for Collins, and that was why the three entities had agreed with Collins to the same loan terms. He acknowledged that he did not know who that person might be, but he did not think it was a red flag that Sky Walker, Swiss National, and Ireland Offshore agreed to the same terms or that the same documents were used for the three loan transactions.[279] We find that Diekmann's unverified hypothesis did not excuse the failure to investigate this red flag.

Second, Collins entered into the agreement with the three depositors, along with the agreement pledging NHPI shares as security, before he actually had any shares. However, he represented in the pledge agreement that he held title to them already. It should have been a concern that Collins apparently misrepresented his ownership. It also is suspicious that the depositors would loan him $50,000 each without verifying that he owned the shares. It is even more suspicious that Collins would take on a $150,000 obligation without knowing whether he could obtain the shares. The facts support the conclusion that Collins entered into the agreement with the depositors because he (or whoever was pretending to be Collins) was affiliated with the issuer and knew that the shares could be obtained. Further investigation was required before proceeding to sell the securities.

Third, the documents relating to the NHPI transactions in 2012 lack important elements that would permit verification. For example, the 2012 Collins-NHPI promissory note bears no physical address, telephone number, or other contact information for Collins or NHPI. Similarly, the documents relating to the loan notes Collins gave the three depositors do not include any contact information for Collins or for the depositors. The lack of contact information is odd because there is no provision for where and how payment should be made. It is almost as though there is no expectation of payment.

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[279] Hearing Tr. (Diekmann) 1699-1700.

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Fourth, the obviously impossible September date declaring Collins in default on the notes held by the depositors—even before the notes became due on November 7, 2013—should have been investigated. The fact that the identical mistake was made in three separate documents supposedly involving independent parties is suspicious. If the parties were independent, one would have expected someone to notice the mistake. That is particularly so where the error was not a transposition of numbers but, rather, an incorrect month. The error would have been easier to spot.

Diekmann testified that the September 16, 2013 date on the note satisfaction agreement had to be a typographical error. "In all likelihood," he said, "that's supposed to read November 16, 2013."[280] When asked about the fact that the same error appears in all three note satisfaction agreements signed by Sky Walker, Swiss National, and Ireland Offshore, Diekmann said that was not surprising. He noted that the agreements were all executed the same day, and hypothesized that someone must have done a search and replace function to change the words without noticing the mistake.[281] Cruz similarly explained the date as a typographical error. He testified that even though the same mistake occurred in connection with the documentation for three purportedly separate transactions it gave him no pause.[282]

Between hearing days, Respondents obtained a copy of the relevant stock certificate, which was then introduced into evidence. It showed a transfer date of November 21, 2013. They argue that this proves that the September date was a typographical error.[283]

Respondents miss the point. Nothing in the due diligence package shows that the Firm noticed or investigated the discrepancy before selling the securities. Furthermore, if the September date was a typographical error generated by a search and replace function in documents governing supposedly independent transactions, that only increases the appearance of coordination among the parties to those transactions.

Fifth, Diekmann admitted that there was no evidence contemporaneous with the May 2012 note to show that the note existed.[284] The only evidence that the 2012 promissory note from NHPI to Collins existed was created after Collins purported to convert the note to NHPI shares. Rather than confirming the existence of the note, the timing of the late filing suggests the fabrication of false evidence to support the tacking period necessary for the exemption.

Sixth, it is peculiar that Collins did not enforce his right to conversion of the shares at the time if NHPI defaulted in July 2012 on the $10,000 promissory note. There is no explanation why he would have waited more than a year—until November 2013—to do so.

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[280] Hearing Tr. (Diekmann) 949, 1835-37.

[281] Hearing Tr. (Diekmann) 949-52, 956.

[282] Hearing Tr. (Cruz) 365-66, 390-98.

[283] RX-115; Resp. PH Br. 15.

[284] Hearing Tr. (Diekmann) 939.

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Seventh, there were signs that NHPI was a shell. The change from being in the pharmaceutical business to entering the oil and gas business, without any explanation for why, when, and how it had done so, was not consistent with a real business plan. The Firm collected no information regarding the change in business, and the attorney opinion letter, which relied on representations by the interested parties and assumed the asserted facts to be true, was not a sufficient basis for concluding that NHPI was not a shell.

Respondents maintained that the oil and gas business was added to NHPI's pharmaceutical business as a "supplement" to its business line.[285] We reject this characterization. These were radically different businesses that involved different expertise and different business models.

Eighth, the transactions have an air of fantasy. Collins supposedly took the $10,000 note in exchange for unspecified consulting services—no money changed hands. And then he took shares in return for forgiving the note—no money changed hands. When Collins supposedly borrowed $50,000 each from Sky Walker, Swiss National, and Ireland Offshore, nothing in the documents provided how, when, or where he would receive the money. There is no evidence that any money changed hands then either. Collins merely entered into a promissory note with each purported lender in which he pledged to give them stock if he defaulted; and then he defaulted. No money changed hands when Sky Walker, Swiss National, and Ireland Offshore took the pledged shares.[286]

Ninth, there is little evidence to support the value given to the NHPI securities. Within the span of a few months the value of NHPI shares varied substantially without any explanation. In November 2013, Collins received 90 million shares in return for forgiving $9,000 of his loan to NHPI. Simultaneously, he realized $150,000 for 60 million of those shares. By early February 2014, the 20 million shares in the Sky Walker deposit were estimated to have a value of $268,000. There is no evidence of a basis for the increase in value. Then, in April 2014 the value of the shares held by Swiss National and Ireland Offshore declined to less than $100,000—again, without explanation. This is particularly suspicious in light of the promotional activity that occurred in February and March 2014.

[285] Resp. PH Br. 16 and n.80.

[286] Diekmann testified that the only evidence the Firm had that the September 1, 2013 notes between Collins and the three depositors existed was the notes themselves. He never asked for documentation showing that $50,000 actually was transferred from Sky Walker to Collins. He was satisfied that the document looked like a loan to an individual and not an effort by a small company to raise capital. Hearing Tr. (Diekmann) 943-45.

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2. VPLM (Montage deposit derived from Kipping oral line of credit)

a. Due Diligence Package

i. Purported Beneficial Owner

There was evidence in the record about two VPLM deposits by CSCT. The one included in the allegations of the Complaint was through Montage for the further benefit of VHB International. The Checklist identifies Victor Bretel as the president of VHB International. The deposit was for 9.3 million shares.[287]

ii. Prior Holder Transaction

In the Montage deposit, the prior holder in the VPLM chain was an entity called Locksmith Financial. The Checklist noted that Locksmith Financial was affiliated with Richard Kipping, who was the former president of VPLM. The Checklist stated, however, that Kipping was no longer an affiliate of the issuer because he had resigned more than two years earlier.[288]

In concluding that Kipping was not an affiliate, the Checklist relied on an attorney opinion dated September 6, 2013, stating that Kipping had resigned more than two years before.[289] As discussed below, that attorney opinion was insufficient to support the conclusion that Kipping was no longer an affiliate of VPLM. Cruz testified at the hearing that the Firm also relied on a December 16, 2013 letter signed by VPLM's Chairman, Thomas Sawyer, which made a representation that Locksmith was not an affiliate of the issuer.[290] The Sawyer letter declared that the parties to the sale of securities from Locksmith to VHB International (discussed below) were not affiliates of the issuer.[291]

The Checklist for the VPLM deposit indicated that the depositor had satisfied the Rule 144 holding period by tacking back to a "verbal [oral] line of credit" whereby the prior holder, Locksmith, had loaned the issuer, VPLM, $58,636.24. The Checklist stated that the last advance on the line of credit was made July 6, 2012.[292]

An August 15, 2013 written agreement purported to document and formalize the oral line of credit. According to the 2013 document, Locksmith agreed in 2012 to advance funds as loans

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[287] RX-2, at 1.

[288] RX-2, at 1, 268.

[289] RX-2, at 1, 19-21.

[290] Hearing Tr. (Cruz) 441.

[291] RX-2, at 23-24.

[292] RX-2, at 1.

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against a revolving line of credit and had received the right to demand payment in full or in part at any time.[293]

On the same day, August 15, 2013, a debt settlement agreement was executed between the issuer and Locksmith. In that document, the issuer indicated that it wanted to settle the amount it owed Locksmith by giving stock to Locksmith. The parties agreed to settle the company's $58,636.24 debt as of July 31, 2012.[294]

Although VPLM did not issue the shares to Locksmith until September 2013,[295] the Beneficial Ownership Declaration later signed by Bretel treated the date on which Locksmith acquired the shares as August 1, 2012.[296] The depositor thus relied on tacking his holding period to Locksmith's oral line of credit.

iii. Acquisition Of Shares By Depositor

On August 23, 2013, Locksmith entered into a stock purchase agreement with VHB International. It was roughly a week after Locksmith had memorialized the purported oral line of credit and before the shares were actually issued. The aggregate purchase price for the stock was $240,000.[297] There is no evidence explaining why Locksmith was able to sell the shares for more than four times the value placed on the shares when Locksmith and the issuer entered into the debt settlement agreement only days before.[298] The buyer, VHB International, purported to acquire the shares for investment and not with a view to resale or distribution.[299]

Although Victor Bretel was identified as the beneficial owner of VHB International, Andrew Godfrey signed the Stock Purchase Agreement.[300] The Firm made an inquiry, and Montage responded that Godfrey "handles day to day operations due to Mr. Victor Bretel's travel schedule." Montage represented that Bretel remained the beneficial owner of VHB International.[301] Diekmann testified that the response was, as far as he was concerned, sufficient.[302]

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[293] RX-2, at 26-27.

[294] RX-2, at 28.

[295] RX-2, at 12.

[296] RX-2, at 13.

[297] RX-2, at 33.

[298] RX-2, at 32.

[299] RX-2, at 35.

[300] RX-2, at 37.

[301] RX-2, at 38.

[302] Hearing Tr. (Diekmann) 1744-45.

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iv. Issuer Filings

The Firm relied on public filings for proof of the existence of the oral line of credit. The Firm characterized the oral line of credit as "generally disclosed" in the issuer's annual report for September 30, 2012.[303] The annual report for the period ending September 30, 2013, which was only published on November 6, 2013—*after* the oral line of credit had been memorialized in writing—attached a grid showing that the issuer had settled many of its debts and payments for professional services by issuing VPLM stock. According to the grid, on August 15, 2013, VPLM issued a little over 29.3 million shares to Locksmith Financial as a debt settlement.[304]

The grid actually raised more red flags. It showed that the company regularly followed a practice of compensating affiliates and others with stock. During the period from October 12, 2011, through August 15, 2013, VPLM issued shares to Locksmith three times and shares to Locksmith's owner, the former president of VPLM, Richard Kipping twice. Thus, during the two-year period, Kipping received, either directly or through Locksmith, roughly 80 million shares of VPLM. In fact, according to the grid, during the same period the company issued more than 185 million shares to various persons and entities, including Dennis Chang, the issuer's president, Thomas Sawyer, its Chairman and CEO, and Carl Mattera, an authorized signatory for the issuer.[305]

Curiously, in May 2013 VHB International received directly from the issuer approximately 2.4 million shares of VPLM. This was only a few months before it received the 29 million shares from Locksmith Financial.[306] That VHB had already received shares directly from the issuer raised a red flag that it might be an affiliate or might be coordinating its acquisition and resales of shares with others who were affiliates. There is no evidence that Scottsdale took note of that red flag.

v. Scottsdale Approval And Sales

On February 10, 2014, Noiman and Cruz approved the VPLM shares deposited by VHB International for sale to the public.[307] Sales began on February 20, 2014, and continued through June 5, 2014. Periodically, Scottsdale wired out the proceeds from those and other sales for the account of CSCT.[308]

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[303] RX-2, at 1.

[304] RX-2, at 40.

[305] RX-2, at 40 (excluding an additional 265 million shares issued to consummate an acquisition of another company).

[306] RX-2, at 40.

[307] RX-2, at 2.

[308] JX-281.

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b. Red Flags Signifying A Scheme To Evade The Securities Laws

A number of red flags were raised by this VPLM deposit. Here we discuss two that required the Firm to conduct further inquiry to establish that an exemption existed.

First, the Firm knew that Kipping had been an affiliate of the issuer at some point. This red flag required heightened scrutiny of the transaction. The Firm failed, however, to gather sufficient evidence to conclude that Kipping was no longer an affiliate.

There is no copy of a resignation letter in the due diligence package. Scottsdale did not even have a specific resignation date. It had a vague statement in a legal opinion that Kipping had resigned from the issuer over two years before. The attorney declared that she had reviewed documents filed with the SEC and had determined that Locksmith was not an affiliate or control person of the issuer, but she did not specify the documents she reviewed or explain how she arrived at her conclusion. She did not say she had seen the resignation letter. The attorney further stated that Locksmith and Kipping had represented to her that they were not controlled by any of the officers or directors of the issuer. In making that statement, the attorney was little more than a conduit for representations by the interested parties.[309] Diekmann was unaware of anything that anyone at Scottsdale did to confirm that Kipping no longer had any duties as president of the issuer.[310]

Cruz vaguely testified that he thought the Firm had some sort of resignation or acknowledgement of Kipping's resignation in the file.[311] Cruz may have been referring to the December 16, 2013 letter from VPLM's Chairman, which represented that none of the parties to the sale of the securities to VHB International had been an affiliate of the company within 90 days of the sale.[312] That bare representation provides no detail whatever. It does not indicate when Kipping might have resigned as an officer of VPLM or provide any other verifiable fact. For purposes of ensuring that an issuer is not behind a chain of transactions designed to effect a public distribution without registration, a representation by a principal of the issuer must be viewed more skeptically.

Even more important, from the outset, Scottsdale had affirmative evidence in its due diligence package indicating that Kipping might be affiliated with the issuer regardless of whether he had resigned as president. Under Rule 144, if Locksmith and Kipping held 10% or more of the issuer, they would be affiliates for purposes of the exemption. The grid showed that Kipping, either directly or through Locksmith, had received 80,318,000 shares of VPLM between October 2011 and August 2013.[313] The total outstanding shares of the company at the

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[309] RX-2, at 19-21.

[310] Hearing Tr. (Diekmann) 1719-20.

[311] Hearing Tr. (Cruz) 440-41.

[312] RX-2, at 23-24.

[313] RX-2, at 40.

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time that Scottsdale evaluated the deposit were 730,460,237.[314] Thus, Kipping and Locksmith received at least a 10.996% ownership interest in VPLM and Kipping could have been an affiliate regardless of whether he was still an officer of the company.

There were other signs that Kipping could have been an affiliate. In the due diligence file is the first page of results from a Google search for "Richard Kipping + securities fraud." One of the results dated May 15, 2013, contains a fragment of content apparently referring to VPLM. That fragment says, "So Richard Kipping still has personal interest in this penny scam."[315] Another entry dated May 7, 2013, also refers to VPLM and says, "The next few days will show if the stock can keep its unprecedented … in fraud look at the shareholders Richard kipping pretty much owns the …"[316] The Google search page was filed in the package, apparently without anyone looking at the full stories concerning Kipping or following up on his ownership of VPLM shares.

If Scottsdale had conducted further due diligence, it might have discovered that Kipping was indeed an affiliate of VPLM. During the relevant period, the Board of Directors of VPLM ordered a review of Kipping and Locksmith's debt conversions to VPLM stock. The resulting "forensic audit" dated June 5, 2014, described Kipping as a director and shareholder of VPLM. It indicated that, at the time of the August 15, 2013 stock conversion that was the basis for tacking VHB International's holding period, Kipping had executive responsibilities at both VPLM and Locksmith, including check signing privileges at VPLM.

The accountant who performed the forensic audit opined that many aspects of the August 15, 2013 agreement purporting to memorialize the earlier oral line of credit were problematic. Many of the items that appeared to him to indicate that the arrangement was not a true arms-length transaction were facts known to Scottsdale at the time it approved the sale of VHB International's shares based on tacking to the oral line of credit. Among other things, the accountant noted that the written memorialization was a year after the purported oral line of credit. He also noted that the stock for debt agreement did not specify any particular terms for the conversion, and he viewed Locksmith's right to demand payment in full or part at any time as onerous.[317]

The forensic audit illustrates that an objective analysis of the facts known to Scottsdale would raise strong doubt that Kipping was independent of VPLM at the time of the August 15, 2013 agreement and stock conversion.

Second, the grid attached to the November 2013 public filing shows that the issuer had a pattern of paying for services and its business expenses with stock. It issued much of this stock to

[314] RX-2, at 1.

[315] RX-2, at 95.

[316] RX-2, at 95.

[317] RX-292, at 6-7.

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company insiders.[318] The pattern suggests that the issuer may have substituted the issuance of stock for compensation to insiders and business partners, leaving them to realize any monetary benefit by selling the stock to others. The constant flow of new issuer stock looks like a two-step process for unlawfully distributing securities into the public marketplace without registration.

This pattern is particularly troubling because all three parties in the chain of holders for the deposit—Kipping, Locksmith, and VHB International—were on the list of persons and entities that had converted debt to shares.[319] This was a red flag that they and the issuer could be coordinating. The Firm should have further investigated before concluding that the transaction was exempt under Rule 144.

3. VPLM (Titan deposit derived from Kipping and Locksmith through the Lees)

a. Due Diligence Package

i. Purported Beneficial Owner

CSCT deposited another 13 million shares of VPLM for the benefit of Titan and for the further benefit of Cumbre Company. The Checklist identified Patrick Gentle as the ultimate beneficial owner of Cumbre and the VPLM stock.[320]

We discuss the evidence regarding this transaction as evidence of other similar conduct for purposes of sanctions and as additional evidence that CSCT was no more than a façade. Scottsdale continued to deal directly with the FFI and to ignore CSCT.

ii. Prior Holder Transactions

This is the one transaction that was not derived from the conversion of a debt liability into shares. However, it also traces back to Kipping and Locksmith in a chain of holders.

The Checklist identified two prior holders, Jung Ju Lee and Soon Deuk (Kang) Lee.[321] Jung Ju Lee acquired 1.5 million shares by a Stock Purchase Agreement dated June 12, 2012, from Richard Kipping. In that Stock Purchase Agreement, Kipping represented that he was not an affiliate of the issuer and had not been an affiliate at least for the previous 90 days. An attachment to the Stock Purchase Agreement indicated that Lee paid Kipping $13,000 for the shares. A copy of a check written to Locksmith for $13,000 was attached. It appears to be written by Brooks K-9 Services Ltd., but it bears a notation saying "re VPLM certs."[322] Nothing in the

[318] RX-2, at 40.

[319] RX-2, at 40.

[320] RX-2, at 106.

[321] RX-2, at 106.

[322] RX-2, at 126-29.

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due diligence package explains the connection between Brooks K-9 Services and Lee or the nature of Brooks K-9 Services.

Jung Ju Lee acquired another 500,000 shares for $5,000 from Locksmith Financial pursuant to a Stock Purchase Agreement dated October 19, 2012. Locksmith made the same representation that it was not an affiliate of the issuer. Kipping signed on behalf of Locksmith. Another check from Brooks K-9 Services Ltd. was attached.[323]

Soon Deuk (Kang) Lee acquired three million shares of VPLM from Locksmith by a Stock Purchase Agreement dated August 1, 2012, for $20,000. Locksmith represented that it was not an affiliate of the issuer. Kipping signed on behalf of Locksmith.[324]

iii. Acquisition Of Shares By Depositor

Cumbre acquired five million shares of VPLM from Soon Deuk (Kang) Lee on January 10, 2014.[325] In a separate document written to Cumbre, Lee confirmed receipt of $60,000 for the shares.[326] On January 13, 2014, in a separate document, Jung Ju Lee similarly confirmed receipt of $20,000 for 500,000 shares of VPLM.[327]

iv. Scottsdale Approval

On May 29, 2014, Noiman and Cruz signed the Checklist approving the shares of VPLM for sale.[328]

v. Blackout Period On Trading VPLM Shares

On June 5, 2014, Thomas Sawyer, the Chairman of the Board of Directors of VPLM, sent Titan by email a signed declaration notifying it of a blackout period starting June 6, 2014, on trading VPLM stock by certain "covered persons." Covered persons were defined to include directors, officers, and holders of 10% or more of the company's outstanding shares, among others. Richard Kipping (and his assigns) and Locksmith were on the list of covered persons. So was VHB International. The list also included FFIs and broker-dealers. Montage, Titan, Alpine, and Scottsdale were all on the list.[329] Noiman discussed the blackout notice with Titan and requested a copy.[330]

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[323] RX-2, at 136-39.

[324] RX-2, at 147-49.

[325] RX-2, at 160.

[326] RX-2, at 155.

[327] RX-2, at 145.

[328] RX-2, at 107.

[329] CX-294.

[330] RX-104.

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On June 6, 2014, a lawyer named David Wise, who had often done work for Scottsdale, wrote an email to Sawyer claiming to represent unnamed clients on the covered-person list and threatening to sue Sawyer and others for "slow[ing] down or prevent[ing] the transfer of shares by my clients." Wise called the blackout notice an attempt to prevent sales of VPLM stock in order to conduct a promotional campaign to raise the share price. He characterized Sawyer's actions as "clearly illegal" and said he would be calling the SEC.[331]

On June 6, 2014, Wise sent a copy of his email to Sawyer to Kelvin Leach at Titan and to both Noiman and Diekmann at Scottsdale. His cover note to them was breezy: "Hi Guys, See below. David." The tenor of the cover note indicates that Scottsdale and Titan were working closely together to address the problem of the blackout notice.

On June 9, 2014, Titan forwarded the blackout notice to Noiman, and Noiman immediately forwarded it to Cruz.[332] That same day, Noiman also forwarded the Wise email to Cruz.[333] The Firm stopped selling VPLM shares held by VHB International in order to investigate.[334]

On June 11, 2014, Titan received what appears to be an unsigned clarifying memorandum from Sawyer stating that the broker-dealers and FFIs such as Scottsdale and Titan were only on the list because they had been known to trade VPLM stock for covered persons. The memorandum declared that the broker-dealers and FFIs were still free to trade on behalf of *non*-covered persons. Titan forwarded the clarification that same day to Noiman and Diekmann,[335] and Noiman forwarded it to Cruz.[336] The clarifying memorandum did not take Kipping (and his assigns), Locksmith, or VHB International off the list of covered persons. Nor did it explain why they were listed as covered persons. When Noiman forwarded the clarification to Cruz on June 11, 2014, he wrote that "Titan received the attached after David Wise's VPLM notice."[337]

On June 24, 2014, a lawyer claiming to represent VPLM wrote to Noiman as Scottsdale's "Compliance Officer." Scottsdale had requested the transfer of two stock certificates, and the lawyer stated that the stock certificates appeared to be owned by covered persons. Kipping (and his assigns), Locksmith, and VHB International were on the attached list of covered persons. One of the two stock certificates identified, 2985, related to the VPLM deposit by Titan on

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[331] Hearing Tr. (Cruz) 578-79. Wise provided an attorney opinion letter on which the Firm relied in connection with the ORFG stock deposit. RX-3, at 70. Wise also went to the Cayman Islands to assist Ruzicka for a couple of weeks after D'Mura left. Hearing Tr. (Hurry) 1603-04.

[332] CX-294.

[333] Hearing Tr. (Noiman) 1265-67; RX-104.

[334] Hearing Tr. (Cruz) 442-43; JX-281.

[335] CX-295.

[336] CX-296.

[337] CX-296.

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behalf of Cumbre.[338] The other, 2228, may relate to a VPLM deposit not part of the record in this case. The certificate number for the deposit by VHB International is 2525.[339]

Notably, although the Titan deposit on behalf of the Lees nominally came through CSCT, Ruzicka was not included on any of the correspondence about the blackout period.[340] The correspondence reveals that Scottsdale, through Noiman, was continuing to manage FFI deposits without regard to CSCT. CSCT was performing no real function in connection with the VPLM deposit.[341]

b. Red Flags Signifying A Scheme To Evade The Securities Laws

Given what Scottsdale already had in its file on VPLM, it should not have approved the VPLM shares deposited by Cumbre for resale without obtaining better evidence that Kipping was not an affiliate of the issuer. The Lee transactions closely followed the VHB International transaction and revealed a pattern—Kipping was continually acquiring and selling large blocks of VPLM shares. When coupled with the information from the grid showing that VPLM followed a practice of issuing stock to insiders in settlement of its debts, the circumstances raised a strong suspicion that the issuer or an affiliate was unlawfully distributing securities without registration in a two-step process designed to obscure what was actually happening and who was benefiting from the sales of stock.

4. ORFG (Unicorn deposit derived from Forward line of credit)

a. Due Diligence Package

i. Purported Beneficial Owner

In connection with the deposit of approximately 13.2 million shares of ORFG, CSCT acted for Unicorn, and Unicorn acted for an entity called Media Central, which named Geovanni Moh as the beneficial owner.[342] Media Central was identified as a Belize corporation, and Moh

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[338] RX-2, at 106-09.

[339] RX-2, at 3.

[340] When Ruzicka was shown the blackout notice at his OTR, he expressed shock. He testified that he had never seen it, and that if he had he would not have processed the VPLM deposit for resale. He would have expected Scottsdale to treat it as a problem or red flag. CX-178 at 257-60.

[341] In the middle of explaining what he did in connection with investigating the VPLM blackout, Cruz made a half-hearted assertion that CSCT was involved, saying, "I asked or I briefed with CSCT to—to get an explanation if they—if they could." Hearing Tr. (Cruz) 442-43. We do not find that testimony credible. There is no corroborating evidence of any kind, and his testimony about CSCT, in contrast to his detailed testimony about Wise, was vague. Cruz did not say he had a conversation with Ruzicka—who was the only person at CSCT. Rather Cruz referred to CSCT in the abstract. Nor did Cruz say anything about the content of what he "asked" or "briefed" when he supposedly had contact with CSCT.

[342] RX-3, at 1.

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was identified as a citizen of Belize.[343] Media Central was originally incorporated on February 14, 2014, under the name Lock Investments Ltd. Only two weeks later, on February 27, 2014, the name was changed to Media Central.[344] Nothing in the due diligence package explains the reason for the name change or whether there was any change in the identity of the principals of the company.

ii. Prior Holder Transaction

Media Central claimed that it had satisfied the holding period for a non-affiliate by tacking to a prior holder's note as of September 1, 2012.[345] The prior holder was a person named Casey Forward. He purportedly took the issuer's note in return for an open-ended line of credit up to the maximum amount of $600,000. The note provided that the issuer would pay on "loans, advances and debt as of August 31, 2011 ... with interest on the principal balance outstanding from time to time" up to a principal amount of $600,000.[346] The note provided Forward with a right to convert any portion of the unpaid principal amount of note to restricted common stock. This right was open-ended and did not specify a particular amount that could be converted or a particular date when the conversion could take place.[347] Furthermore, the note provided that the holder could transfer in whole or in part any portion of the note without the prior consent of the company. Any such transfer was at the discretion of the holder.[348]

Forward subsequently assigned a $50,000 portion of the note to an entity called Anything Media in exchange for shares of Anything Media. As described on the first page of the Deposited Securities List, that transaction was reflected in an Assignment and Modification Agreement dated January 18, 2014, by which ORFG agreed to modify the terms of the original note.[349]

iii. Acquisition Of Shares By Depositor

On April 16, 2014, Anything Media sold 15 million shares of ORFG to Media Central for $75,000 pursuant to a stock purchase agreement. However, at that time, Anything Media did not own the shares. It acquired shares of ORFG only a few days afterward, on April 22, 2014, when it converted a $9,000 portion of the note into 15 million shares of ORFG.[350] There is nothing in the due diligence package to explain why Anything Media sold ORFG shares before it actually owned them. Nor is there anything to explain why the shares could be sold for $75,000 when

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[343] RX-3, at 9, 13.

[344] RX-3, at 15-16.

[345] RX-3, at 36-41.

[346] RX-3, at 36.

[347] RX-3, at 38.

[348] RX-3, at 40.

[349] RX-3, at 1, 42-45.

[350] RX-3, at 1.

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they only had a value of $9,000 when they were converted a few days later. Cruz testified that he did not consider these matters red flags that required further inquiry and that the Firm did not conduct further inquiry based on these matters.[351]

iv. Scottsdale Approval And Sales

On June 5, 2014, Noiman and Cruz signed the Checklist for ORFG approving the sale of securities.[352] Sales began June 11, 2014, and continued through the end of the relevant period on June 30, 2014. Periodically, Scottsdale would wire out the proceeds along with the proceeds from the sales of other securities out of CSCT's account.[353]

v. Promotional Activity

From early May through early July, ORFG was the subject of multiple promotions.[354] Cruz testified that the promotions were consistent with the reviewer's findings on the Checklist. He said he probably would have looked at a couple of pages of printouts showing the existence of promotions. The Firm typically would look to see whether the customer had any involvement and whether the promotions were having any effect on the trading done in the security.[355]

b. Red Flag Signifying A Scheme To Evade The Securities Laws

We discuss here only one of the red flags in the ORFG deposit. The initial transaction underlying the deposit made no business sense. With respect to the original line of credit, no reasonable company would agree to borrow money on a line of credit that permitted the lender to convert the debt to stock at any time in any amount at the holder's discretion. Certainly a company would not agree that the open-ended conversion option could be assigned to an unknown third party without the issuer's prior consent. Under such an agreement the company would not know whether it was going to be required to pay back some or all of the money it borrowed on the line of credit or whether it would be required to issue shares. Nor could it know to whom the conversion option might be assigned. It could not manage its finances or be certain of its shareholder dynamics and corporate control.

As the forensic audit of the Kipping-Locksmith loan found with respect to the open-ended line of credit in that transaction, the onerous terms from the issuer's perspective were a sign that the loan was not an arms-length transaction. Unless the Firm investigated and discovered some sensible explanation, it could not lawfully sell the securities.

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[351] Hearing Tr. (Cruz) 533-34.

[352] RX-3, at 2.

[353] JX-310.

[354] CX-303, at 17-25.

[355] Hearing Tr. (Cruz) 537-38.

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E. Credibility

1. Ruzicka

As noted above, Ruzicka was never registered with FINRA and was never subject to its jurisdiction. He voluntarily testified at an OTR, and considered testifying voluntarily at the hearing. Throughout the first week of the hearing, Enforcement reported at the end of each day on the likelihood of Ruzicka appearing.[356] On Friday of the first week, Enforcement announced that Ruzicka had agreed to appear the following Monday.[357]

However, Ruzicka changed his mind over the weekend and never appeared. He apparently changed his mind because of a text that Respondents' counsel sent to him on the Saturday after the first week of hearing. That text, although portrayed by counsel afterward as nothing more than a request to talk, appears to us to have been an attempt to sow distrust between Ruzicka and Enforcement counsel. It made Ruzicka angry at the way he thought he was being portrayed by Enforcement at the hearing and unwilling to be "put through hell" by appearing.[358]

Respondents' counsel telephoned Ruzicka on Saturday but only received an automated instruction to leave a message or text. Respondents' counsel then left him a text saying the following, which included quotations from Enforcement's opening statement:

> You may want to know how FINRA has been characterizing you during the first week of the hearing. For example, you were "hapless," "malleable," and "bereft of other options." You may want to know the other side of what FINRA is telling you. I would welcome the opportunity to discuss.[359]

After receiving the text from Respondent's counsel, Ruzicka texted Enforcement counsel saying, in part, "If even veracity, I am done."[360] We interpret Ruzicka's response to mean he was offended at the portrayal of him as desperate and easily manipulated, and to mean that he would not appear at the hearing if that was an accurate picture of Enforcement's comments about him.

Enforcement reported at the hearing that it had neither confirmed nor denied to Ruzicka what Respondents' counsel told him in the text. Enforcement took the position that it could not reveal what was said in the proceeding because it was confidential.[361]

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[356] Initially, the discussions of Ruzicka's likely participation were off the record. Later, they were on the record. Hearing Tr. (remarks of counsel) 748, 840-41, 1032, 1275, 1277.

[357] Hearing Tr. (remarks of counsel) 1275, 1277.

[358] Hearing Tr. (counsel reading text into record) 1288.

[359] Hearing Tr. (counsel reading text into record) 1288.

[360] Hearing Tr. (counsel reading text into record) 1287.

[361] Hearing Tr. (remarks of counsel) 1299.

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Enforcement argued that Respondents' counsel had violated at least the spirit of the sequestration order in the case; Respondents' counsel asserted that the sequestration order was about witness testimony and that counsel's quotations from Enforcement's opening statement did not violate the order. The Hearing Officer declined to rule on the charge of misconduct.[362]

Based on legal analysis separate from the alleged misconduct of Respondents' counsel, as laid out at the hearing on the record, the Hearing Officer admitted the entire transcript of Ruzicka's OTR. The Hearing Officer declared that the Hearing Panel would determine the probative value and weight to give the OTR after it had reviewed the OTR in the context of the evidence at the hearing, taking into account the circumstances that led to the admission of the OTR in lieu of live testimony from Ruzicka.[363]

The Hearing Panel now specifically finds that Ruzicka's testimony at his OTR was credible. It was consistent with other evidence in the record and corroborated by D'Mura's testimony. Wherever Ruzicka's testimony is cited here, it is cited because we credit it.

We reject Respondents' arguments for discounting Ruzicka's testimony.

First, Respondents assert that it is unfair to rely upon Ruzicka's testimony because they did not have an opportunity to cross-examine him.[364] The short answer to that argument is that Respondents' counsel was responsible for that lack of opportunity to cross-examine the witness. Respondents cannot complain about it now.

Second, Respondents argue that Ruzicka was angry and biased against Hurry, so his OTR should not be viewed as reliable.[365] After review of the transcript, we conclude that, although Ruzicka evidently did not like the way Hurry treated him, Ruzicka was truthful as to the facts and as to Hurry's intimidating and controlling manner.

Third, Respondents claim that Ruzicka gave inconsistent information in a prior telephone call with FINRA staff.[366] However, the inconsistency was explained by the fact that Ruzicka still felt "beholden" to Hurry at the time of the telephone call. By the time of the OTR he did not feel that way.[367]

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[362] Hearing Tr. (remarks of Hearing Officer) 1302.

[363] Hearing Tr. (remarks of Hearing Officer) 1302-05. There had always been uncertainty about whether Ruzicka would give testimony at the hearing. In light of that uncertainty, the parties had earlier briefed the issue of whether the OTR should be admitted. The Hearing Officer's ruling was informed by that earlier briefing.

[364] Resp. PH Br. 44 and n.253.

[365] Resp. PH Br. 44 and n.253.

[366] Hearing Tr. (remarks of counsel) 1296.

[367] Hearing Tr. (remarks of counsel) 1298.

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Fourth, Respondents claim that Ruzicka gave an affidavit inconsistent with his OTR. They assert that Ruzicka swore that Montage, Titan, and Unicorn came to CSCT through a referral from Scottsdale. However, Ruzicka signed that affidavit at Hurry's request while still working for Hurry.[368] By the time of his OTR, Ruzicka no longer worked for Hurry. For that reason, we credit his OTR testimony that he was told that Titan and Unicorn came to CSCT through Hurry. Moreover, the affidavit saying that the three FFIs were referred by Scottsdale is not inconsistent with Ruzicka's understanding that ultimately Hurry was behind the referral. Even if Hurry persuaded the FFIs to do business with Scottsdale through CSCT, it would be consistent with his desire for secrecy for him to arrange for someone at Scottsdale to make the necessary introductions.

Finally, we observe that although Ruzicka's OTR testimony is valuable, his absence from the hearing deprived the Extended Hearing Panel of what would have been helpful live testimony and the opportunity for the Panel to ask him questions. Ruzicka's absence also encouraged Hurry to dispute the OTR testimony without fear of being contradicted, as discussed below. The distrust sown by Respondents' counsel impeded our adjudicatory process.

2. Hurry

As indicated above in connection with specific testimony, we repeatedly found that Hurry was not credible. Many of Hurry's self-serving explanations were not convincing on their face. His testimony was often inconsistent with other reliable evidence. Much of what he said also conflicted with Ruzicka's OTR testimony, which we find more credible than Hurry's uncorroborated assertions.

Hurry's ostensible purpose for setting up CSCT—to relieve Alpine of IRS withholding obligations—was not supported by any evidence that it made business sense. Rather, we conclude from Cruz's and Diekmann's testimony regarding heightened regulatory scrutiny in the period leading up to the establishment of CSCT, and the filing of the four prior SEC complaints against Scottsdale customers and employees, that Hurry sought to insulate his business from regulatory oversight by moving Scottsdale's FFI business offshore. This conclusion is reinforced by the fact that Scottsdale personnel continued to manage the FFI business with entities such as Unicorn and Titan (through Miller and Noiman). They needed to do that because Ruzicka was not qualified to run a broker-dealer, particularly one in the highly specialized business of liquidating microcap stock pursuant to Rule 144. Moreover, CSCT got its business through Hurry and Scottsdale. CSCT did not, and indeed could not, operate as an independent entity. CSCT served no function that Scottsdale could not have performed without it.

[368] Hearing Tr. (Hurry) 1565-69, 1638-39; RX-110.

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Hurry disputed that Ruzicka was not qualified to run CSCT and emphasized how accomplished Ruzicka was.[369] His testimony in this regard was not credible. It is plain from Ruzicka's inquiry about working in Hurry's bike shop that Ruzicka had no relevant experience and was desperate.[370] D'Mura described trying to educate Ruzicka about the securities industry and the elements for free-trading securities. D'Mura said it was "rough going" and that Ruzicka "wasn't picking it up."[371] D'Mura said that Ruzicka was anxious, stressed, and not capable of handling due diligence on microcap deposits by himself.[372] Even more important for our purposes here, D'Mura testified that he had conversations with Hurry about Ruzicka's difficulties and how Ruzicka was not "getting it."[373] Thus, contrary to his hearing testimony, Hurry knew that Ruzicka was not capable of running CSCT.

Hurry's assertion that he had little to do with CSCT was disproved. D'Mura testified that Hurry frequently bombarded him and Ruzicka with telephone calls about CSCT business and that he and Ruzicka tried to prepare for those calls with updated information about deposits. D'Mura portrayed Hurry as an intense and constant presence in their lives while they worked at CSCT, and emails corroborate that testimony. Emails show that Hurry oversaw every detail of CSCT's business, and Hurry admitted that he traveled to the Cayman Islands at least once a month. He so closely oversaw the CSCT operation that he claimed to know that Ruzicka was in the office only ten minutes out of every hour.

To the extent that Cruz, Diekmann, D'Mura, and Ruzicka all testified that Ruzicka, not Hurry, ran the daily operations of CSCT, as Respondents assert in their post-hearing brief,[374] we do not view that testimony as contradicting the evidence that Hurry was deeply involved in

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[369] Hearing Tr. (Hurry) 1574-77. When asked why he did not hire someone who had broker-dealer experience and who knew about FFIs to run CSCT, Hurry said that he hired Ruzicka to play an "executive role," someone who was "an all-around person, somebody who had some entrepreneurial skills, some management skills, proven to be able to do that." Hearing Tr. (Hurry) 1648.

[370] Hearing Tr. (Hurry) 1631, 1635-36.

[371] Hearing Tr. (D'Mura) 2273-77.

[372] Hearing Tr. (D'Mura) 2277-78.

[373] Hearing Tr. (D'Mura) 2274-77. D'Mura may not have been emphatic about Ruzicka's difficulties—he testified that it was against his self-interest to cause Hurry to fire Ruzicka—but D'Mura did raise concerns with Hurry. Hearing Tr. (D'Mura) 2314-15.

Email correspondence corroborates D'Mura's judgment that Ruzicka did not understand the business. For example, in May 2014, Ruzicka sought Diekmann's approval to consider a deposit of 11 million shares with an ostensible value of two million dollars. Diekmann wrote back that the issuer's shares traded in so little volume—roughly 3,500 per day—that it would take a "bazillion" years to sell the entire deposit. Diekmann said it was inappropriate to set the value that high and the transaction was the kind that should be avoided. CX-241.

This email correspondence also illustrates that CSCT served no real function independent of Scottsdale. Ruzicka sought Diekmann's guidance before even considering the deposit. Ruzicka was not independently vetting deposits before presenting them to Scottsdale. CX-241, at 2.

[374] Resp. PH Br. 45.

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CSCT's business. Ruzicka was responsible for the day-to-day processing of paper, but Hurry was responsible for bringing in business, cultivating the clients, and making all important decisions. Ruzicka, an out-of-work real estate attorney, did not have the background to do more than process the paper as directed. For Hurry to maintain that he left Ruzicka on his own to prospect for customers and manage client relationships defies belief.

Based on D'Mura's testimony and various emails, Hurry's contention that he was not concerned with secrecy was false. D'Mura testified that Hurry emphasized to him the privacy laws of the Cayman Islands, and D'Mura thought Hurry was very concerned about secrecy. Hurry's concern with secrecy was manifested in multiple ways, from his admitted use of FaceTime to confer with Montage, Titan, Unicorn, and other customers, to his obsession with labeling every email to and from Ruzicka as privileged, to his use of an email address that did not reveal its connection to him, to his refusal to use emails to discuss business and insistence on using telephone calls to do that.

Ruzicka's testimony only confirms D'Mura's. Ruzicka testified that Hurry told him that he was moving the FFI business to the Caymans precisely because he would not have to "give anything" to anyone. According to Ruzicka, Hurry was fanatical about not creating a record of his involvement with CSCT.

As for Hurry's efforts to develop business for CSCT, Hurry admitted having telephone calls with principals of Montage, Titan, and Unicorn, and he admitted personally visiting Montage in Panama and Unicorn in Belize. Although he claimed that he discussed a back-office system with Montage at Ruzicka's request, his testimony was vague and unspecific. There was no corroboration for Hurry's assertion, and he only made it when he knew that Ruzicka would not appear at the hearing to contradict him. Similarly, as to Hurry's initial assertion that he did not discuss business with Unicorn when he went to Belize, Hurry was impeached by his own OTR testimony. In his OTR he testified that he discussed pros and cons of doing business with Scottsdale directly or going through CSCT. Emails showed that Hurry provided other leads and referrals to Ruzicka, and D'Mura testified that Hurry was involved in developing Caledonian as a CSCT customer.

We further find Hurry not credible when he testified that he could not remember anything about his meetings with Montage in Panama and Unicorn in Belize. Hurry appeared to have excellent recall of other information and events. He testified in detail about the intricacies of taxation in the Cayman Islands and how it differed for Canadians and U.S. citizens, as well as the way the special economic zone in the Caymans operates.[375] He also testified about the Cayman Islands Monetary Authority, CIMA, and its information sharing agreement with the SEC, noting

[375] Hearing Tr. (Hurry) 1554-65, 1647-48.

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that the original agreement was in 2005 and that it was updated in 2012.[376] He insisted that he knew the exact days on which Ruzicka and D'Mura began at CSCT.[377]

We observe that Hurry appeared to be a canny, sophisticated, controlling, and hard-driving businessman. Hurry's attempt to portray himself as a distant figure, far removed from CSCT's business was not credible. Although he claimed that he likes to empower his people to run their businesses on their own,[378] that is demonstrably untrue.

3. DiBlasi

We find DiBlasi's testimony that he was the CCO—but not in connection with the Firm's Rule 144 business—astonishing.[379] Almost all of the Firm's business involved Rule 144 sales. As explained below in discussing DiBlasi's violation, DiBlasi was responsible for the WSPs, and nothing in the WSPs clearly allocated Rule 144 compliance to Cruz. Indeed, during much of the relevant period, the WSPs assigned the CCO specific responsibilities in connection with Rule 144.[380] DiBlasi's testimony may accurately reflect what he believes his job responsibilities to be, but, if so, his designation as CCO was misleading.

4. Cruz

Cruz's testimony was vague and unreliable. He often said he could not recall whether he had looked at various materials in conducting his due diligence reviews but that he "could" have done so.[381] Cruz also changed his testimony or made it vaguer as he was testifying if he became uncomfortable with his original statement. For example, he said that the change in NHPI's business from pharmaceuticals to oil and gas was not so important because the company's "management team had been stable. It's not the situation where we had a roaming management team."[382] But when asked how he knew that the management team was stable, he could point to nothing in the due diligence package or elsewhere. He ended by denying that he had said that the management team had been stable, saying, "I didn't see any change of – evidence of a change of management. I didn't use 'stable.'"[383] When pressed whether certain items were red flags calling for a searching inquiry about the issuer, Cruz resorted to general statements such as it "depends

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[376] Hearing Tr. (Hurry) 1630.

[377] Hearing Tr. (Hurry) 1620, 1624.

[378] Hearing Tr. (Hurry) 1550.

[379] Hearing Tr. (DiBlasi) 1921-23, 1946-47, 1952-53, 1965-66.

[380] Hearing Tr. (DiBlasi) 1967-73.

[381] Hearing Tr. (Cruz) 279, 284, 292-96, 301-03, 308.

[382] Hearing Tr. (Cruz) 288.

[383] Hearing Tr. (Cruz) 288-91.

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on the facts and the circumstances."[384] He never explained any basis for determining which facts and circumstances would trigger the duty to conduct a searching inquiry.

5. Diekmann

We find Diekmann's testimony vague, evasive, and unreliable. He characterized documents in ways that on their face the documents did not support, such as the Miller email indicating that a Canadian citizen could conceal himself by using a corporate entity as the owner of his Scottsdale account. Diekmann asserted that the Firm's procedures would root out a nominee problem but could point to nothing in the procedures that was designed to do that.[385] He was insensitive to suspicious circumstances such as a Google search that turned up information suggesting that a person was engaged in securities fraud,[386] or the identical terms and circumstances of the three supposedly independent NHPI deposits.[387] He contradicted his own OTR testimony.[388] He repeatedly resisted admitting that inconsistencies and suspicious circumstances could signify that a transaction was a sham until he had to admit what was obvious.[389]

Given Diekmann's position as the Firm's current president, we are concerned about his ability to ensure that the Firm responds appropriately in the future to obvious red flags and suspicious circumstances. This concern bears on the need for stringent sanctions, as discussed below.

Illustrative of the issue is Diekmann's testimony regarding information on Unicorn's website. Unicorn advertised the use of nominees to give customers an "extra level of confidentiality" because the customer's "name will not show up."[390] At his OTR, Diekmann testified that he had not seen this page of the Unicorn website before his OTR, but if he had it would have caused him concern whether the true beneficial owner was being disclosed.[391] At the hearing he testified differently. He said that he would not be concerned about the information on Unicorn's website because he had seen nothing on the website that suggested that Unicorn was offering to affirmatively lie about beneficial ownership.[392] When asked whether Unicorn would

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[384] Hearing Tr. (Cruz) 293.

[385] Hearing Tr. (Diekmann) 737-38.

[386] Hearing Tr. (Diekmann) 927.

[387] Hearing Tr. (Diekmann) 1853-54, 1901-04.

[388] Diekmann testified at his OTR that a print-out from the Unicorn website caused him concern about whether Patrick Gentle was the true beneficial owner of stock deposited at Scottsdale in his name. At the hearing, however, he denied that the information on the Unicorn site was a concern. Hearing Tr. (Diekmann) 925-30.

[389] Hearing Tr. (Diekmann) 1881-84, 1886-87.

[390] Hearing Tr. (Diekmann) 1818-19.

[391] Hearing Tr. (Diekmann) 1875-78.

[392] Hearing Tr. (Diekmann) 1819.

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have had to offer to lie about the beneficial owner before the website language would concern him, Diekmann answered "Yes."[393] That is not consistent with his and the Firm's gatekeeping function.

A second example of Diekmann's insensitivity to suspicious circumstances is his response to questions concerning an email exchange between one of the Rule 144 staff members and Titan. The staff member sent an email to Ryan Mendez at Titan saying that Scottsdale had multiple subaccounts at Scottsdale with Andrew Godfrey as the authorized signer. She requested a statement from Godfrey that explained the purpose for the multiple entities and provided an explanation of "any distinguishing features among the separate entities." She then named the eight entities.[394]

Godfrey provided an astoundingly broad and vague response:

> [The eight companies] are holding company's [sic] that are used to invest in development and exploration stage companies that engage in local, regional, multinational, global, sporting, manufacturing, wholesale, transportation, technology and eco friendly companies, etc., etc. Each investment is placed into a holding company based on investment criteria such as location, industry, long or short-term investment etc., etc.

Godfrey made no distinction among the companies. He provided no facts that could be verified. The response was undated and addressed "To Whom It May Concern." Godfrey provided no address, telephone number, or other contact information for himself or any of the companies. The response was forwarded by email from Titan to Scottsdale.[395]

Diekmann characterized Godfrey's response as reasonable.[396] We do not find it so. It lacks specificity and has no indicia of reliability or authenticity.

Finally, Diekmann displayed a lack of the skepticism, analytic acuity, and ingenuity that are required to perform the broker-dealer's gatekeeping function in the Rule 144 context. He testified that the identical documentation for the NHPI transactions did not trouble him because some unidentified person could have put Collins together with the three parties seeking to sell the NHPI shares they acquired from him. When asked whether that unidentified person could be the secret beneficial owner of the three sub-sub-accounts, he said that there was nothing in the documentation indicating that was so. He further declared that he did not know how you would

[393] Hearing Tr. (Diekmann) 1875.

[394] CX-247.

[395] CX-248.

[396] Hearing Tr. (Diekmann) 891.

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investigate whether it was so. He seemed content not to know who the unidentified person was and to assume that it was a person who had put the three depositors in touch with Collins.[397]

Diekmann said that "there's always a risk that there could be some puppet master pulling the s[t]rings."[398] But he expressed frustration at the thought that the Firm could and should have done more to ascertain whether a puppet master was at work. As he remarked regarding the Argentinian nominees in the *Tavella* case, "It's just impossible to know that there was somebody else behind this."[399]

For purposes of assessing the Firm's ability to avoid violations in the future and crafting remedial sanctions, his remarks cause us concern. Diekmann said that what happened with NHPI happens all the time.[400]

6. Experts

a. Marc Menchel

We give little weight to the testimony of Respondents' expert, Marc Menchel. Although he opined that Scottsdale's procedures were reasonable and consistent with industry custom and practice, his experience related to Rule 144 was both a long time ago and in a much different context than Scottsdale's business. Menchel ran a Rule 144 desk at a large broker-dealer more than 30 years ago. That desk did not concentrate the way Scottsdale does on large blocks (100,000 shares or more) of microcap stocks.[401]

Furthermore, Menchel did not opine on the sufficiency of Scottsdale's due diligence in the context of the specific transactions at issue. He did not review the exhibits or the investigative testimony. While he did look at all the relevant due diligence packages, he did not review them with the idea of "second guessing" the Firm's handling of the deposits. He merely looked to see whether the due diligence packages contained the sorts of items that one would expect them to contain.[402] Essentially, Respondents' expert, like Respondents, took a check-the-box look at the due diligence packages.

Finally, Menchel's opinion seemed influenced by his admittedly idiosyncratic view that Regulatory Notice 09-05 goes beyond Rule 144, and his claim that many of the red flags listed in the Regulatory Notice are not really red flags for purposes of Rule 144.[403] Menchel's opinion

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[397] Hearing Tr. (Diekmann) 1901-03.

[398] Hearing Tr. (Diekmann) 720.

[399] Hearing Tr. (Diekmann) 732.

[400] Hearing Tr. (Diekmann) 1901, 1903.

[401] Hearing Tr. (Menchel) 2459-61.

[402] Hearing Tr. (Menchel) 2478-80, 2496-98, 2529-33, 2554-65, 2572-73, 2575.

[403] Hearing Tr. (Menchel) 2503-07, 2515-24.

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similarly seemed influenced by his view that FINRA has no authority to charge a broker-dealer firm with a Rule 2010 violation for a Securities Act violation, a view that he admits has no decisional support.[404] Menchel's opinion regarding FINRA's authority is contrary to the Hearing Officer's prior determination in the Order dated February 26, 2016, that FINRA has jurisdiction to bring this case. We decline to accept Menchel's view for the reasons stated in that Order, which we do not repeat here.[405]

b. Brian Underwood

We find the opinion of Enforcement's expert, Brian Underwood, more reliable, more persuasive, and entitled to greater weight than Menchel's. His experience with Rule 144 was more extensive and more recent. Until retiring in 2008, Underwood served as the Chief Compliance Officer of two major broker-dealers for a combined period of almost 20 years. The broker-dealers traded microcap securities on a fairly frequent basis and their Rule 144 desks reported to Underwood through one of his direct reports.[406] He also served on two NASD working groups in the 1990s that reviewed roughly 300 sets of policies and procedures as part of an effort to develop a model set of procedures.[407] Underwood has maintained a consulting practice since he retired, and in that capacity he has more recently seen between 20 and 25 entire policies and procedures of different firms.[408]

Underwood also reviewed more of the materials relating to the particulars of this case, including the pleadings, the parties' memoranda, the exhibits, and the OTRs conducted in connection with the investigation.[409] He, unlike Menchel, evaluated the substance of Scottsdale's due diligence and whether it was consistent with industry custom and practice.[410]

Underwood expressed the following opinions, among others, which we find consistent with our own views and supportive of our conclusions:

(i) In its WSPs, the Firm did not adequately address the risk of nominees being used to conceal the identity of the beneficial owners of the shares—it did not even mention the risk.[411]

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[404] Hearing Tr. (Menchel) 2593-99.

[405] *See also KCD Financial Inc.*, Exchange Act Release No. 80340, slip op. at 5-6 & nn.8-13 (SEC Mar. 29, 2017).

[406] Hearing Tr. (Underwood) 2609, 2615-21.

[407] Hearing Tr. (Underwood) 2711-12.

[408] Hearing Tr. (Underwood) 2712-13.

[409] Hearing Tr. (Underwood) 2619-20.

[410] Hearing Tr. (Underwood) 2651-57, 2665-67, 2669-71, 2673-78, 2685-89, 2691-94.

[411] Hearing Tr. (Underwood) 2682-83.

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(ii) The Firm's practice of placing all FFIs on its red flag list was counterproductive because it did nothing to narrow the focus to the kinds of anomalies that required a searching inquiry.[412]

(iii) The Firm's general practice of accepting the registered agent's address without requiring the physical address of the entities and persons purporting to own the shares was inconsistent with industry custom and practice.[413]

(iv) Even though the Firm gathered large volumes of paper in connection with the transactions, it failed to analyze the information, did not identify issues raised by the files, and did not conduct the type of searching inquiry necessary to resolve those issues.[414] As Underwood testified, a searching inquiry "means asking questions. It means not just assuming an answer that is possible to explain the transaction when there are other answers that might not properly explain or satisfy the question. It means asking and inquiring and doing it independently ...."[415]

(v) Underwood made plain that a broker-dealer cannot go forward with a Rule 144 transaction simply because it finds it too difficult to determine the identity of the beneficial owner. The broker-dealer must have reliable evidence of the identity of the purported beneficial owner. Otherwise it cannot proceed with the transaction.[416]

Underwood also explained that it would be typical in the industry to use other resources in addition to the internet to verify representations by the interested parties and make sure that those parties were not actually participating in an unregistered distribution of securities. With respect to whether the issuer is a shell, for example, it is not enough to obtain a representation from the issuer's principal as to its non-shell status. Underwood said that it would be common in the industry to obtain what is known as a "Bradstreet report." That report "can be quite enlightening in terms both of [the issuer's] operations, revenues, assets, who the key officers and directors are, shareholders—a great deal of information that is not necessarily available simply by going on the internet."[417]

Underwood concluded that a firm engaged in Rule 144 sales would also have more detailed written procedures that "would describe who did what, when, and how."[418] He said that

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[412] Hearing Tr. (Underwood) 2685-86, 2752-55.

[413] Hearing Tr. (Underwood) 2679-80.

[414] Hearing Tr. (Underwood) 2689.

[415] Hearing Tr. (Underwood) 2694.

[416] Hearing Tr. (Underwood) 2734.

[417] Hearing Tr. (Underwood) 2661.

[418] Hearing Tr. (Underwood) 2677-78.

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a firm would "anticipate questions that would be investigated with respect to issuers, with respect to sellers, with respect to the transfers of securities."[419] Furthermore, they would analyze the information collected and would "independently satisfy themselves to clear any red flags that arose. And that did not happen in any of these instances in my opinion."[420] He declared that the Firm did not meet the industry custom and practice for the conduct of this type of business.[421]

F. Law And Regulations Relating to Section 5

1. It Is Unlawful To Sell Securities Without Registration, Unless An Exemption Exists

It is unlawful for a firm to sell securities without an effective registration statement in place unless an exemption applies. Sections 5(a) and 5(c) of the Securities Act prohibit the "sale" and "offer for sale" of securities in interstate commerce unless a registration statement has been filed or is in effect, or an exemption from registration applies.[422] The prohibition applies to "any person,"[423] and the Securities Act defines "person" broadly to include both individuals and entities such as corporations and partnerships.[424] The prohibition also applies to any person who "directly or indirectly" sells or offers to sell securities.[425] Thus, Section 5 may be violated by a person who does not pass title to the securities but who is involved in the process of offering the securities for sale.[426]

The registration requirements are not merely technical—they are the "heart" of the Securities Act.[427] They serve to protect investors by promoting full disclosure of information thought necessary to informed investment decisions.[428] As the preamble to the Securities Act

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[419] Hearing Tr. (Underwood) 2678.

[420] Hearing Tr. (Underwood) 2678.

[421] Hearing Tr. (Underwood) 2689.

[422] 15 U.S.C. § 77e(a), § 77e(c). *See also Ronald S. Bloomfield*, Exchange Act Release No. 71632, 2014 SEC LEXIS 698, at *20-21 (Feb. 27, 2014). A violation of Securities Act Section 5 also is a violation of FINRA Rule 2010, which requires members and associated persons to conduct their business consistent with high standards of commercial honor and just and equitable principles of trade. *Midas Sec.*, Exchange Act Release No. 66200, 2012 SEC LEXIS 199, at *46 n.63 (Jan. 20, 2012); *Dep't of Enforcement v. Padilla*, No. 2006005786501, 2012 FINRA Discip. LEXIS 46, at *1 n.2 (NAC Aug. 1, 2012).

[423] 15 U.S.C. § 77e(a), § 77e(c).

[424] 15 U.S.C. § 77b(a)(2).

[425] 15 U.S.C. § 77e(a), § 77e(c).

[426] *Pinter v. Dahl*, 486 U.S. 622, 642-47 (1988).

[427] *ACAP Fin. Inc.*, Exchange Act Release No. 70046, 2013 SEC LEXIS 2156, at *28 (July 26, 2013) (quoting *Pinter v. Dahl*, 486 U.S. at 638), *aff'd*, 783 F.3d 763 (10th Cir. 2015).

[428] *SEC v. Elliott*, 2012 U.S. Dist. LEXIS 82992, at *1 (June 12, 2012); *Bloomfield*, 2014 SEC LEXIS 698, at *21; *ACAP*, 2013 SEC LEXIS 2156, at *28 (quoting *Pinter*, 486 U.S. at 638); *Dep't of Enforcement v. KCD Fin., Inc.*, No. 2011025851501, 2016 FINRA Discip. LEXIS 38, at *49 (NAC Aug. 3, 2016), *aff'd, KCD Fin. Inc.*, Exchange Act Release No. 80340, slip op. at 5-6 & nn.8-13 (SEC Mar. 29, 2017).

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states, the purpose of the Act is "[t]o provide full and fair disclosure of the character of securities … and to prevent frauds."[429]

2. Sales Are Not Exempt If They Involve A Distribution By An "Underwriter"

A sale of securities is not exempt from registration if it involves a distribution of securities to the public. The Securities Act distinguishes between a distribution—which requires registration—and ordinary trading, which does not. In general, a distribution involves the sale of a substantial block of securities that is accompanied by sales solicitations, recommendations and other promotional activities that may induce investors to make investment decisions without the benefit of accurate information concerning the issuer, its management, and its plans and prospects. That is the reason registration is required. In contrast, ordinary trading by an individual investor who has little or no influence over the issuer is not accompanied by the same promotional pressures, and, consequently, the same protections are less necessary.[430]

The distinction between a distribution and ordinary trading is reflected in Section 4(a)(1) of the Securities Act, which exempts a securities transaction from registration if it does not involve "an issuer, underwriter, or dealer."[431] In this case, the term "underwriter" is critical. The term is not limited to financial industry professionals. It encompasses individual investors "if they act as links in a chain of transactions through which securities move from an issuer to the public."[432] Section 2(a)(11) of the Securities Act broadly defines the term to include "any person" who has purchased from an issuer "with a view to … the distribution of any security."[433]

Because it is difficult to know whether a person acquired securities "with a view to" distributing them to the public, the surrounding circumstances and the investor's actions after acquiring the securities must be analyzed. For example, when a person acquires securities from the issuer in a non-public transaction and shortly thereafter resells, the circumstances suggest that the person acquired the securities with a view to distribution, which would make that person an underwriter. The transactions function like a two-step indirect distribution and may be a public offering in disguise.[434]

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[429] Securities Act of 1933, Pub. L. No. 22, § 1, 48 Stat. 74, ch. 38.

[430] *See* the Preliminary Note to Rule 144 ("If any person sells a non-exempt security to any other person, the sale must be registered unless an exemption can be found for the transaction.").

[431] *See generally* Hicks, *Resales of Restricted Securities* at § 2.4, 12-13, § 2:10, 22-23, § 2.11, 23-24 (2015 ed.). *See* the Preliminary Note to Rule 144 ("Section 4(1) of the Securities Act provides one such exemption for a transaction 'by a person other than an issuer, underwriter, or dealer.'").

[432] Preliminary Note to Rule 144.

[433] 15 U.S.C. § 77b(a)(11). *See also SEC v. McNamee*, 481 F.3d 451, 455 (7th Cir. 2007).

[434] *See generally* Hicks, *Resales of Restricted Securities* at § 4:101, 250 (2015 ed.). *See* the Preliminary Note to Rule 144.

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3. Broker-Dealer Has The Burden Of Showing A Reasonable Basis For An Exemption

Once a *prima facie* case is made out, as it was here,[435] a broker-dealer has the burden of showing that it had a reasonable basis at the time it sold the securities for concluding that an exemption from registration existed.[436] Exemptions from the registration requirements are affirmative defenses that must be established by the person claiming the exemption.[437] The Securities Act requires a broker-dealer and its associated persons to act as gatekeepers to prevent unlawful distributions, and the responsibility rests on them to take all steps reasonable in the circumstances to assure themselves that an exemption applies before they sell securities without registration.[438]

A broker-dealer's duty to investigate is not satisfied by simply checking boxes on a checklist. Rather, a firm must examine the information it receives with a skeptical eye because the interested parties have an incentive to mislead and deceive a firm in order to facilitate their sale of securities. A broker-dealer must independently investigate suspicious facts to satisfy itself that an exemption exists. As the SEC has explained,

> A dealer who offers to sell, or is asked to sell a substantial amount of securities must take whatever steps are necessary to be sure that this is a transaction not involving an issuer, person in a control relationship with an issuer[,] or an underwriter. For this purpose, it is not sufficient for him merely to accept "self-serving statements of his sellers and their counsel without reasonably exploring the possibility of contrary facts."[439]

Exemptions from registration requirements are construed narrowly.[440] Accordingly, evidence in support of an exemption must be "explicit, exact, and not built on mere conclusory statements."[441]

It is important to bear in mind that there are two distinct burdens in this case. While it was Enforcement's burden to prove the elements of its claims, it was the Firm's burden before

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[435] *See infra* p. 80.

[436] *Bloomfield*, 2014 SEC LEXIS 698, at *23; *ACAP*, 2013 SEC LEXIS 2156, at *29 (citations omitted); *Dep't of Enforcement v. Midas Sec., LLC*, No. 2005000075703, 2011 FINRA Discip. LEXIS 62, at *11 & n.8 (NAC Mar. 3, 2011), *aff'd*, 2012 SEC LEXIS 199, at *28 & n.36.

[437] *Midas Sec.*, 2011 FINRA Discip. LEXIS 62, at *28 & n.36, *38.

[438] *Padilla*, 2012 FINRA Discip. LEXIS 46, at *29.

[439] *Laser Arms Corp.*, 50 S.E.C. 489, 503 (Feb. 14, 1991) (quoting *Distribution by Broker-Dealers of Unregistered Securities,* Exchange Act Release No. 4445, 1962 SEC LEXIS 74 (Feb. 2, 1962)).

[440] *Midas Sec.*, 2011 FINRA Discip. LEXIS at *11-12 (quoting *SEC v. Blazon*, 609 F. 2d 960, 968 (9th Cir 1979).

[441] *Midas Sec.*, 2011 FINRA Discip. LEXIS at *12 (quoting *Robert G. Weeks*, Exchange Act Release No. 48684, 2003 SEC LEXIS 2572, at *42 n.34 (Oct. 23, 2003).

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selling the securities to establish a reasonable basis for the existence of an exemption from registration.

4. Respondents Claim Two Exemptions

With respect to the transactions at issue, Respondents claim that Rule 144 applied to the transactions, or, failing that, the so-called "broker's exemption" in Section 4(a)(4) of the Securities Act for ordinary unsolicited trading.[442]

a. Securities Act Rule 144

The SEC adopted Rule 144 both to provide a "safe harbor" for certain transactions and to protect against transactions by non-professionals as a means of circumventing the registration requirements. Among other things, Rule 144 restricts the resale of securities acquired directly or indirectly from the issuer or an affiliate in a transaction not involving a public offering. The SEC defines such securities as "restricted securities," and requires an owner of restricted securities to hold them for a length of time before reselling them in another transaction without registration. The holding period and other conditions for resale differ if the holder of the restricted securities is an affiliate or non-affiliate.[443] Thus, the identity of the person selling the securities and the nature of any relationship that person might have to the issuer become important to the exemption analysis.

Rule 144 defines an affiliate of an issuer as a person who directly or indirectly controls or is controlled by or is under common control with the issuer. Although Rule 144 does not define control, it is commonly understood that the definition in SEC Rule 405 of Regulation C applies. It defines control as "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person whether through the ownership of voting securities, by contract, or otherwise." Control depends on the totality of the circumstances and does not turn simply on whether a person is an officer of a company or the holder of a certain amount of stock.[444]

The identity of the issuer is important, too. The Rule 144 safe harbor is not available for shell companies. A shell company is defined as an issuer "with no or nominal operations and no or nominal non-cash assets."[445]

A person who satisfies the applicable conditions of Rule 144 is deemed not to be engaged in a distribution of the securities and therefore not to be an underwriter for purposes of the

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[442] Resp. PH Br. at 2-5.

[443] 17 C.F.R. § 230.144. *See generally* Hicks, *Resales of Restricted Securities* at § 2.4, 12-13, § 2:10, 22-23, § 2.11, 23-24 (2015 ed.).

[444] *SEC v. Zenergy Int'l, Inc.*, 141 F. Supp. 3d 846, 853-54 (N.D. Ill. 2015).

[445] *Id.* at 853.

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Securities Act.[446] The burden is on the person claiming an exemption under Rule 144 to prove that all the applicable conditions have been met.[447]

The provisions of Rule 144(d)(3) relating to tacking are important here because tacking was the only way that the sellers in the transactions at issue could satisfy the required holding period. There are two categories of tacking. One category applies where a person who acquires restricted securities cannot personally meet the applicable holding requirement, but he is able to tack the holding period of another person to his. The other category applies where a person seeks to tack the period of time he has held restricted securities to the time he held other securities of the same issuer.[448]

Both categories are relevant in this case. *First*, to establish the requisite holding period, the purported beneficial owners needed to tack their holding period to that of the prior holders. Their ability to tack depended on the prior holders not being affiliates of the issuer. *Second*, in connection with the transactions charged in the Complaint, the prior holders needed to tack their acquisition of the securities to the earlier inception of the debt obligation exchanged for the securities. In order to do that, the debt obligation had to be a security. Rule 144 permits tacking based on the exchange of a security for another security of the same issuer (as long as no additional consideration is involved).[449]

In this case, Respondents claim that they had sufficient evidence that the sellers of the securities at issue were not affiliates of the issuers, the issuers were not shell companies, and the sellers had met the applicable holding period for the securities. We conclude that they did not.

b. Broker's Exemption Under Section 4(4)

Respondents argue they were entitled to the so-called broker's exemption under Section 4(4) of the Securities Act even if the transactions at issue were not exempt under Rule 144.[450]

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[446] *See generally* Hicks, *Resales of Restricted Securities* at § 4:1, 86 (2015 ed.).

[447] *See* Rule 144(b).

[448] *See generally* Hicks, *Resales of Restricted Securities* at § 4:139, 318 (2015 ed.).

[449] *See generally* Hicks, *Resales of Restricted Securities* at § 4:139, 318-19 (2015 ed.). Rule 144(d)(3) contains the provisions governing tacking. Two provisions are relevant here. Rule 144(d)(3)(iv) provides that securities that are acquired as a result of a default on a bona fide pledge of the securities shall be deemed to have been acquired when they were acquired by the pledger. However, if the securities were pledged without recourse they shall be deemed to have been acquired by the pledgee at the time of the pledge. Rule 144(d)(3)(ii) permits a person to tack the period of time he has held certain restricted securities to the period of time he has held related securities of the same issuer. It provides for tacking where the securities to be sold were acquired from the issuer solely in exchange for other securities of the same issuer.

[450] Resp. PH Br. 4-5.

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Section 4(4) is intended to exempt ordinary trading transactions that a broker may be asked to execute.[451]

As discussed above, a person can be an underwriter within the meaning of the Securities Act if he acquires the securities from an issuer or affiliate of the issuer with a view to distribution. In order to ensure that the person offering restricted securities for resale is not acting as an underwriter, it is necessary for a broker to evaluate the circumstances in which that person acquired restricted securities and offers them for resale. A broker cannot be a mere order taker. It must make whatever inquiries are necessary under the circumstances to ensure that its customer is not an underwriter.[452]

This exemption is not available when the broker "knows or has reasonable ground[s] to believe" that his customer is an underwriter, since in that event the broker would also violate Section 5 by participating in a non-exempt transaction.[453] As FINRA has stated, "[T]his exemption is available only if a broker is not aware, after a reasonable inquiry, of circumstances indicating that the selling customer is participating in a distribution of securities."[454]

Contrary to Respondents' arguments, we conclude that Respondents were confronted by abundant evidence that they were likely participating in unlawful distributions of securities. They cannot claim that they were unaware of facts signifying that possibility or the need to conduct further inquiry.

5. Both Exemptions Required A "Searching Inquiry" To Ensure That No Underwriter Was Involved

Neither the Rule 144 exemption nor the broker's exemption is available if the person selling the securities is an underwriter within the meaning of the Securities Act. Accordingly, where there are red flags indicating the possibility that a person may be acting as an underwriter, both exemptions require that a broker make a "searching inquiry" to satisfy itself that an exemption applies. Only then can a broker ensure that it does not participate in an unlawful distribution of unregistered securities.[455]

The SEC observed over half a century ago, "[W]here the surrounding circumstances raise a question as to whether or not the ostensible sellers may be merely intermediaries for controlling persons or statutory underwriters, then searching inquiry is called for."[456]

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[451] *World Trade Fin. Corp.*, Exchange Act Release No. 66114, 2012 SEC LEXIS 56, at *26 (Jan. 6, 2012).

[452] *Bloomfield*, 2014 SEC LEXIS 698, at *24-25 & nn.35-36.

[453] *Bloomfield*, 2014 SEC LEXIS 698, at *24; *World Trade Financial Corp.*, 2012 SEC LEXIS 56, at *26 & n.31.

[454] CX-197 at 2 (emphasis supplied).

[455] CX-197.

[456] *Bloomfield*, 2014 SEC LEXIS 698, at *26-27.

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6. FINRA Guidance On Red Flags Signaling That Underwriter May Be Involved

In Regulatory Notice 09-05, FINRA published guidance on the specific kinds of facts that give rise to the duty of conducting a searching inquiry.[457] In that guidance, FINRA made plain that "[a]ll firms must have procedures reasonably designed to avoid becoming participants in the potential unregistered distribution of securities."[458] It further explained, "Before selling securities in reliance on an exemption, a firm must take reasonable steps to ensure that the transaction qualifies for the exemption ...."[459]

Regulatory Notice 09-05 identifies a non-exhaustive list of red flags that signal the "possibility of an illegal, unregistered distribution."[460] These red flags are by no means comprehensive. They are merely illustrative. The generally recognized red flags in the Notice include the following: [461]

1. A customer opens a new account and delivers physical certificates that represent a large block of thinly traded or low-priced securities.

2. A customer has a pattern of depositing physical share certificates, immediately selling the shares, and then wiring out the proceeds of the resale.

3. A customer deposits share certificates that are recently issued or represent a large percentage of the float for the security.

4. Share certificates reference a company or customer name that has been changed or that does not match the name on the account.

5. The lack of a restrictive legend on deposited shares seems inconsistent with the date the customer acquired them or the nature of the transaction in which they were acquired.

6. There is a sudden spike in investor demand for a thinly traded or low-priced security, coupled with a rising price.

7. The company was a shell company when it issued the shares.

8. A customer with little or no assets at the firm receives an electronic transfer or journal transactions of large amounts of low-priced unlisted securities.

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[457] CX-197.

[458] CX-197, at 2.

[459] CX-197, at 2.

[460] CX-197, at 1.

[461] CX-197, at 3-4.

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9. The issuer has been through several recent name changes, business combinations or recapitalizations, or the company's officers are also officers of numerous similar companies.

10. The issuer's SEC filings are not current, are incomplete, or are nonexistent.

G. Ethical Violations (First Cause Of Action—Scottsdale And Hurry)

The First Cause of Action charges that Scottsdale and Hurry violated FINRA Rule 2010 by acting in contravention of Section 5 of the Securities Act. It alleges that during the relevant period, Scottsdale sold millions of shares of securities without registration and without an exemption. It further alleges that Hurry was a necessary participant and substantial factor in the unlawful transactions through his close management and control of all the entities involved in the process of depositing, approving, and reselling the securities, and through his prospecting for CSCT customers. The Complaint alleges that Hurry took actions to evade regulatory scrutiny and enable the Firm to make the unlawful sales.

1. Rule 2010

FINRA Rule 2010 requires FINRA members and their associated persons to "observe high standards of commercial honor and just and equitable principles of trade" in the conduct of their business. The Rule requires members of the securities industry not merely to conform to legal and regulatory requirements, but to conduct themselves with integrity, fairness, and honesty.[462]

Scienter is not required for a Rule 2010 violation. Rather, the SEC has established a disjunctive test for a Rule 2010 violation that applies either (i) to intentional or conscious bad conduct or (ii) to a failure to meet ethical norms, regardless of intention. The SEC has held that Rule 2010 may be violated if the respondent has acted either in bad faith or unethically.[463] In the context of a Rule 2010 violation, the SEC has defined bad faith as a dishonest belief or purpose,

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[462] *Robert Marcus Lane*, Exchange Act Release No. 74269, 2015 SEC LEXIS 558, at *22 n.20 (Feb. 13, 2015) (discussing NASD predecessor to FINRA Rule 2010: "[T]his general ethical standard . . . is broader and provides more flexibility than prescriptive regulations and legal requirements. [FINRA Rule 2010] protects investors and the securities industry from dishonest practices that are unfair to investors or hinder the functioning of a free and open market, even though those practices may not be illegal or violate a specific rule or regulation.") (internal quotations omitted).

[463] *Blair Alexander West*, Exchange Act Release No. 74030, 2015 SEC LEXIS 102, at *20 (Jan. 9, 2015); *Thomas W. Heath, III*, Exchange Act Release No. 59223, 2009 SEC LEXIS 14, at *13-17 & nn.9-16 (Jan. 9, 2009), *aff'd*, 586 F.3d 122, 130 (2d Cir. 2009), *cert denied*, 2010 U.S. LEXIS 3029 (Apr. 5, 2010) (discussing NYSE predecessor of Rule 2010); *Dep't of Enforcement v. Shvarts*, No. CAF980029, 2000 NASD Discip. LEXIS 6, at *11-18 (NAC June 2, 2000).

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and unethical conduct as conduct inconsistent with the moral norms or standards of professional conduct.[464]

Because the securities industry is built on trust, any ethical failure damages the industry generally by casting doubt on the integrity of its participants. An ethical failure also casts doubt on the ability of the particular miscreant to conform to ethical norms in the future. Enforcement of FINRA Rule 2010 is therefore fundamental to FINRA's regulatory mission, which, as expressed in FINRA's Sanction Guidelines, "is the building of public confidence in the financial markets."[465]

2. Enforcement Established A *Prima Facie* Case Of A Section 5 Violation

The elements of a *prima facie* case for violation of Section 5 are the following: (i) respondents sold or offered to sell securities; (ii) through use of interstate facilities or the mails (the jurisdictional means); and (iii) when no registration statement was filed or in effect as to those securities. Scienter is not an element.[466] A Section 5 violation does not require a showing that the sale actually facilitated a fraud. A sale without registration and without an exemption is an unlawful distribution of securities regardless of whether it is proven to be connected to a fraud.

Enforcement established a *prima facie* case. It proved that from December 1, 2013, through June 30, 2014, Scottsdale sold shares of three issuers, NHPI, VPLM, and ORFG, using the jurisdictional means and without registration.[467]

Respondents do not dispute these facts. They argue only that the transactions were exempt from registration.[468]

3. The Firm Lacked A Reasonable Basis For An Exemption

Scottsdale failed to have a reasonable basis for an exemption at the time that it sold the securities in the transactions at issue.

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[464] *Edward S. Brokaw*, Exchange Act Release No. 70883, 2013 SEC LEXIS 3583, at *33 (Nov. 15, 2013). *See also Simpson v. Bear, Stearns & Co.*, No. C07950030, 1997 NASD Discip. LEXIS 13, at *27 n.9 (NAC Jan. 29, 1997) ("Term 'bad faith' is not simply bad judgment or negligence, but rather it implies the conscious doing of a wrong because of dishonest purpose or moral obliquity....").

[465] FINRA Sanction Guidelines at 1 (2016) (Overview), https://www.finra.org/industry/sanction-guidelines.

[466] *Bloomfield*, 2014 SEC LEXIS 698, at *22 & n.29. *See also SEC v. Cavanagh*, 445 F.3d 105, 111 n.13 (2d Cir. 2006); *SEC v. Calvo*, 378 F.3d 1211, 1214-15 (11th Cir. 2004).

[467] RX-1; RX-2; RX-3; JX-268; JX-281; JX-310.

[468] Resp. PH Br. 2-5.

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First, in its due diligence the Firm did not even address the question whether the debt obligation was a security, despite having lawyers on its Rule 144 review team and despite Respondent Cruz being a lawyer with significant experience in the securities laws. It had no foundation for the tacking necessary to achieve the required holding period because the promissory notes and lines of credit on which the tacking was based were not securities.

Second, the documentation to support the Rule 144 exemption was rife with discrepancies and suspicious circumstances—all of which raised red flags strongly suggesting that the chain of transactions leading to deposits at Scottsdale were sham transactions using false documents and nominees to conceal the identity of the beneficial owners.

Although the Firm compiled thick due diligence packages for the transactions, it did so with a "check-the-box" attitude. It did not appropriately evaluate the information in the due diligence packages, did not investigate the many red flags, and did not independently verify the information received from the interested parties. The due diligence packages created only the false appearance of due diligence.

The Firm's conduct was unethical and did not meet the industry norms. The persons involved in the Rule 144 review did not obtain any meaningful information about the individuals and entities involved in the transactions. Diekmann confessed that he knew nothing about the purported beneficial owner of one of the deposits other than that the person was a client of CSCT's client. Scottsdale knew little more about any of them. It failed to perform its gatekeeping function. The testimony of Enforcement's expert only confirms our conclusion that the Firm failed to conduct itself in a manner consistent with industry norms.

a. The Prior Holders' Debt Obligations Were Not Securities Available For Tacking

i. *Reves* Governs Whether Note Is A Security

Not every note or debt obligation is a security.[469] The Supreme Court's decision in *Reves* governs the analysis.[470] Any note with a term of more than nine months is presumed to be a security unless it resembles one of the judicially enumerated instruments that are not securities, such as a note delivered in connection with consumer finance or a mortgage. In *Reves*, the Court set the analytic framework for determining whether a note bears a resemblance to one of the enumerated instruments or should be held to be a security. Four factors may be considered in deciding whether a note is a security:

(i) whether the seller's purpose is to raise money for general use of business or to finance substantial investments, and the buyer is motivated by the profit to be

[469] *Reves v. Ernst & Young*, 494 U.S. 56, 65-67 (1990).

[470] *Id.*

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generated, in contrast to a note to facilitate a minor purchase or sale or to correct for cash-flow difficulties;

(ii) whether the note involves an individual transaction or common trading for speculation or investment;

(iii) whether there is a reasonable public expectation that the note would be viewed as security; and

(iv) whether another regulatory scheme applies that would reduce risk of the instrument.[471]

In another case, the Court later summed up the distinguishing characteristic of a security as "any instrument that might be sold as an investment."[472]

As we explain below, we conclude that none of the debt obligations held by the prior holders were securities. That includes the NHPI note in payment for consulting services, the oral line of credit to VPLM, and the outstanding balance on the ORFG line of credit. As a result, when the prior holder accepted stock in satisfaction of the debt, it was not an exchange of securities that would support tacking.

ii. NHPI

It is plain that the note written by NHPI to Collins, the prior holder in the chain of holders, was not a security. We observe at the outset that the note's term was much shorter than the nine months required to presume a note to be a security—roughly two months. But it also fails the test set forth in *Reves*. NHPI did not enter into the note agreement in order to finance its general business or to make a substantial investment. Nor was Collins motivated by some profit to be generated from the note. According to documents in the due diligence package, the note was no more than a promise to pay Collins $10,000 for consulting services. Furthermore, the note was issued in a single transaction. A note that "merely reflects a single transaction" and is "not offered to the public" is not a security.[473] Nor could there be any public expectation that an individual note promising to pay for services was a security. The fourth factor, whether another regulatory scheme applied and diminished the need for treating the instrument as a security, is inapplicable where no other factor supports labeling the note a security.

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[471] *Id.* at 65-67. *See also Bass v. Janney Montgomery Scott, Inc.*, 210 F.3d 577, 583-86 (6th Cir. 2000).

[472] *SEC v. Edwards*, 540 U.S. 389, 393 (2004). *See also Frankfurt v. Mega Entertainment Group II*, 2016 U.S. Dist. LEXIS 73613, at *11 (N.D. Ill. June 7, 2016) (stating that "only those notes that were issued in an investment context" are securities).

[473] *New Earthshell Corp. v. Jobookit Holdings Ltd*, 2015 U.S. Dist. LEXIS 27141, at *10-11 (S.D.N.Y. Mar. 5, 2015)

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As another similar note was aptly described by a federal district court, the note held by Collins was "akin to an 'IOU' for services rendered."[474]

iii. VPLM

With respect to the issue of whether the oral line of credit extended by Locksmith to VPLM was a security, the focus at the hearing was on whether there is any distinction between an oral agreement and a written agreement. Diekmann maintained that there is no difference between an oral line of credit and a written line of credit for purposes of Rule 144 and tacking. He understood that in either case the successor holder could tack back to an advance on the line of credit. He based his understanding on his experience with the treatment of written lines of credit and discussions with legal counsel—who exactly he could not recall.[475]

In their post-hearing brief,[476] Respondents relied on a Seventh Circuit Court of Appeals decision, *Canadian Imperial Bank*.[477] Their reliance is misplaced. The issue in *Canadian Imperial Bank* was whether a private plaintiff had sufficiently pleaded the existence of a security for purposes of establishing subject matter jurisdiction. The plaintiff alleged that a certificate of deposit from a Bahama bank was a security, but no document was attached that could be analyzed for purposes of jurisdiction. The Court held that the complaint did not allege sufficient facts to establish jurisdiction, but it hastened to say that its decision did not mean that only written instruments can be securities, noting that oral promises of participation in a profit sharing plan have been held to be investment contracts even where not evidenced in writing.[478] The Court's remarks regarding oral promises as investment contracts provide no basis for concluding that the oral credit line here was a security.

The oral line of credit, unlike an oral promise of participation in a profit sharing plan, was not represented to be an investment. Nor was it easily tradeable as an investment. There was no means of being certain of the terms, confident of the effective transfer of rights, or sure that those rights might later be enforced. Accordingly, the oral line of credit was not a security.

Moreover, even if written, the line of credit did not meet the *Reves* test. The line of credit was a loan to the issuer by a single individual. Such an individual transaction would not be viewed as a security by the public and would not ordinarily be traded as an investment.

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[474] *SEC v. Garber*, 959 F. Supp. 2d 374, 377 (S.D.N.Y. 2013).

[475] Hearing Tr. (Diekmann) 1711-17.

[476] Resp. PH Br. 22 n.114.

[477] *Canadian Imperial Bank of Commerce Trust Co. v. Fingland*, 615 F. 2d 465 (7th Cir. 1980).

[478] *Id.* at 466-67 & n.5.

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iv. ORFG

The open-ended line of credit extended by Forward to ORFG for $600,000 was not a security. As discussed above in connection with the other debt conversion transactions, it did not meet the *Reves* test. It was an individual transaction that was not designed to trade as an investment. Nor would the public view it as a security.[479]

b. The Firm Ignored Red Flags

Even if the notes had been securities, the transactions were not entitled to the safe harbor of Rule 144. Many of the red flags set forth in Regulatory Notice 09-05[480] existed in the transactions at issue. The following red flags are examples:

- All the stock deposits in the transactions at issue consisted of large blocks of thinly traded, low-priced stocks issued by obscure companies. (Reg. Notice 09-05 Red Flag 1).

- CSCT had a pattern of making large deposits of thinly traded microcap stocks, selling the securities, and immediately wiring out the proceeds. Respondents knew that CSCT was acting on behalf of its FFI customers involved in the transactions and that the FFIs also engaged in the same pattern while acting on behalf of other entities and individuals. Despite the pattern, Scottsdale did nothing to investigate who actually was receiving the funds from the securities sales. Because the only account at Scottsdale was in the name of CSCT, Scottsdale could not and did not track where the proceeds ultimately went. It could not tell if the proceeds went to the different purported beneficial owners or to other persons who were repeatedly engaging in the deposit and immediate resale of securities. (Reg. Notice 09-05 Red Flag 2).

- The deposited shares were recently issued, which suggested that the issuer or its control persons could be initiating a distribution. Nothing in the due diligence packages indicates that Scottsdale took any note of that fact. (Reg. Notice 09-05 Red Flag 3).

- Although the issuer claimed not to be a shell corporation, there was little evidence of ongoing business operations. The Firm mainly relied on a representation by a principal of the issuer that the entity was not a shell. (Reg. Notice 09-05 Red Flag 7).

- Two of the issuers involved in this case had business histories that suggested shell status. Only a few months before the deposit of NHPI securities at Scottsdale, NHPI, a pharmaceutical company, announced it was going into the oil and gas business. ORFG,

[479] Furthermore, even if the note had been a security, Forward did not transfer the ORFG note for securities of ORFG. He transferred a portion of the note for securities of a different entity, Anything Media. He also did so in connection with an agreement by ORFG to modify the terms of the original line of credit. His exchange involved securities of a different issuer and different consideration. Accordingly, Media Central was not entitled to tack back to Forward's original note.

[480] *See supra* pp. 78-79.

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which described itself as an automotive detailing company that used casual part-time labor as required, similarly indicated it was considering going into mineral exploration and set forth an anticipated payment schedule for three unspecified mining concessions. In both cases, the new business venture was radically different from the old line of business, the information regarding either line of business was scant, and the company's purported resources did not appear sufficient to engage in the new line of business. (Reg. Notice 09-05 Red Flags 7 and 9).

Finally, we note that it is critical in a Rule 144 transaction to know the identity of the purported beneficial owners and any relationship they might have to the issuers or affiliates of the issuers of the shares they seek to sell. Even after collecting voluminous documents, the Firm in fact knew nothing about the purported beneficial owners or about the businesses through which they held the securities except their names. Diekmann, who headed the Rule 144 team at the time of the transactions at issue, admitted that he knew nothing about the purported beneficial owner of one of the NHPI deposits other than that the person was a customer of Unicorn.[481] The Firm knew little more than that about any of the other purported beneficial owners involved in the transactions at issue. Diekmann's testimony is a stark confession that the Firm did not perform its gatekeeping function and did not adhere to high standards of commercial honor and just and equitable principles of trade.

c. Respondents' Arguments Are Unavailing

i. NHPI

Respondents' arguments relating to the NHPI deposits rest on treating the representations by the interested parties in the documentation for the NHPI deposits as though they were true. For example, Scottsdale asserts that Collins was not an affiliate of NHPI, and therefore he could freely sell the stock derived from his note in the fall of 2013 regardless of any tacking to the inception of the May 2012 note.[482] Respondents then reason that Collins' transactions with Sky Walker, Ireland Offshore, and Swiss National could not be fake loan transactions, as Enforcement portrays them, because, as a non-affiliate holder for more than a year, Collins could simply have sold the shares to the three depositors. Respondents conclude that there could be no reason to fake the loan transactions. Respondents likewise assert that the beneficial owners of Sky Walker, Ireland Offshore, and Swiss National were not affiliates of NHPI based on the representations to that effect by the interested parties.[483]

In making arguments that depend upon the truth of the representations made by the interested parties, Respondents only demonstrate their continuing lack of appropriate response to

[481] Hearing Tr. (Diekmann) 911-13, 919.

[482] In so arguing, the Firm abandons the basis on which the deposit was justified at the time Scottsdale sold the shares. On its Checklist for the transaction, the Firm relied on tacking back to the inception of the May 2012 note. RX-1, at 1.

[483] Resp. PH Br. 13-15.

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the suspicious circumstances and glaring red flags raised by the NHPI deposits. As the SEC has noted, a broker-dealer may not rely on representations by interested parties because those interested parties have an incentive to make misrepresentations.[484]

ii. VPLM

Again, Scottsdale's arguments largely assume the truth of the representations by the interested parties. They assert that they reasonably relied on those representations.[485] We reject Respondents' position. Red flags signaled that the transaction could be a scheme to evade the registration requirements while distributing securities to the public. The Firm could not sell the securities unless it investigated further and obtained better support for an exemption.

Scottsdale also argues that Enforcement failed to prove that any proceeds of the sales of VPLM flowed back to the issuer or that there were any links between the issuer and the persons involved in selling VPLM stock through CSCT and Scottsdale.[486] As discussed above, the Firm misunderstands the law. It was not Enforcement's burden to prove who was behind the transactions; rather, it was Respondents' burden to probe the suspicious circumstances and establish that the transaction was entitled to the Rule 144 exemption before the Firm sold the securities.

iii. ORFG

As with the other transactions, Respondents' arguments assume the truth of the representations in the transaction documents. For instance, they argue that the Firm obtained satisfactory evidence that the transaction met the requirements of Rule 144 because the Firm obtained a letter from ORFG's Chairman and CEO dated May 19, 2014, confirming that Media Central and its purported owner were not affiliates of the company.

Given that the underlying transaction—the $600,000 open-ended credit line giving the holder discretion to convert stock at will—made no sense, it was unreasonable to rely on that letter as the only evidence that the seller was not an affiliate. If the chain of transactions were really a series of steps in a distribution for the ultimate benefit of the issuer or those persons controlling the issuer, then such a representation by the issuer's Chairman and CEO would be in service of the unlawful distribution of securities without registration.

4. Hurry's Violation

The First Cause of Action also charges that Hurry was a necessary participant and substantial factor in the unlawful transactions, through his close management and control of all the entities involved in the process of depositing, approving, and reselling the securities, and

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[484] *Laser Arms*, 1991 SEC LEXIS 257, at *36.

[485] Resp. PH Br. 21.

[486] Resp. PH Br. 22.

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through his prospecting for CSCT customers. It expressly alleges that Hurry purposely established CSCT as a means of evading regulatory scrutiny and enabling the Firm to make the unlawful sales. Enforcement proved the charges.

a. Hurry Was A Necessary Participant And Substantial Factor

Section 5 makes it unlawful for a person to offer or sell securities without registration. Liability, however, is not limited to the person or entity that ultimately passes title to the security. Courts have developed the "necessary participant/substantial factor" test as a way of holding other persons involved with the transactions accountable under Section 5 as offerors or sellers.[487] The "necessary participant/substantial factor" test is based on statutory language in Section 5, which imposes liability on persons who "directly or indirectly" offer or sell securities in violation of Section 5.[488]

The "necessary participant/substantial factor" test distinguishes between those persons who have only a *de minimis* or insubstantial role in securities sales in violation of Section 5 and those who should be liable. The test is more than a "but for" test. Even if a person is necessary to the completion of the transaction, such as a transfer agent might be, that does not necessarily mean the person was a substantial factor in the violation. Determining whether someone was a substantial factor in the unlawful sales is a fact issue requiring extensive analysis.[489]

It is not clear that the "necessary participant/substantial factor" test is appropriate here. Hurry is not charged with offering or selling securities in violation of Section 5. He is charged with an ethical violation under Rule 2010. He does not have to be proven to be an offeror or seller in order to be proven to have violated Rule 2010.

The parties briefed Hurry's liability using the "necessary participant/substantial factor" test, however, and we use it to assist in determining whether Hurry was sufficiently linked to the transactions at issue to hold him liable for violating Rule 2010 in connection with them. We also separately apply the more familiar standard for Rule 2010 violations, which we discuss below.

Based on the above factual record and analysis, which we do not repeat in detail here, we conclude that Hurry was a necessary participant and a substantial factor in the transactions. He was sufficiently linked to the transactions to hold him accountable for his conduct in connection with them. His role was not *de minimis* or insubstantial.

We reject Hurry's argument that he cannot be linked to the transactions at issue. He asserts that there is "not a single document relating to the stocks in question with [his] name

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[487] *SEC v. CMKM Diamonds, Inc.*, 729 F.3d 1248, 1255 (9th Cir. 2013).

[488] *SEC v. Boock*, 2011 U.S. Dist. LEXIS 95363, at *47 & n.17 (S.D.N.Y. Aug. 25, 2011).

[489] *CMKM Diamonds*, 729 F.3d at 1255-57; *SEC v. Blackburn*, 2015 U.S. Dist. LEXIS 178325, *8-9 (E.D. La. Sept. 11, 2015).

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anywhere on it."[490] While there was little in the way of a paper trail directly linking Hurry to the particular transactions at issue, the absence of such a direct link was the result of Hurry's own demonstrated obsession with secrecy. He purposely concealed his involvement in CSCT's business. It is not surprising that there is not a single document relating to the deposits at issue with his name on it, because he made sure of it.

In fact, Hurry was the master puppeteer for all the FFI business that flowed through CSCT to Scottsdale and, ultimately, to public investors. CSCT existed only because he established and closely managed it. Given Ruzicka's lack of experience, qualifications, and contacts, CSCT could not have survived without Hurry's active involvement. We reject Hurry's assertion that, because Ruzicka had decades of experience as a real estate lawyer who ran his own law firm, hiring Ruzicka to run CSCT was a reasonable and logical decision.[491]

With respect to the particular transactions at issue, there is sufficient evidence of a link between Hurry and the FFIs that made the deposits. Hurry developed CSCT's business with the three FFIs that engaged in those transactions, Montage, Titan, and Unicorn. As set forth more fully above, Hurry admits that he flew to Panama to see Montage and to Belize to see Unicorn and that he discussed with Unicorn doing its business through CSCT. He admits to talking to the principals of Montage, Titan, and Unicorn multiple times using FaceTime. He admits to creating the spreadsheet that tracked CSCT deposits, including those by Montage, Titan, and Unicorn. D'Mura testified that he and Ruzicka talked about deposits with Hurry, and an email shows that Hurry specifically discussed trading in NHPI and VPLM with Ruzicka. Ruzicka testified that Hurry told him to deal with a specific contact at Montage. Both Ruzicka and D'Mura said they disliked dealing with Cem Can at Unicorn, but that they knew that they had no authority to decline his business without Hurry's consent.

Hurry's direct contact with the three FFIs involved in the transactions at issue made him a substantial factor in their transactions. He did not take Ruzicka with him when he flew to Panama and Belize to talk to Montage and Unicorn, and Ruzicka testified in his OTR that he did not participate in Hurry's FaceTime calls with customers. Hurry was the critical link between CSCT and the three FFIs. Hurry's importance was reflected in Unicorn's demand for Hurry to join a telephone call with Miller, Diekmann, and Ruzicka to discuss the processes and procedures to be used in connection with Unicorn's business with Scottsdale through CSCT. Whenever something beyond paper-pushing was involved, Hurry's input was necessary. We reject Hurry's argument that he merely displayed the normal interest of an owner in the overall financial performance of his firm.[492] His involvement in CSCT's business was intense and pervasive.

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[490] Resp. PH Br. 45.

[491] Resp. PH Br. 43-44.

[492] Resp. PH Br. 46-47.

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Hurry further argues that the case law only imposes liability under Section 5 where the defendant has either sold the unregistered securities himself or has taken concrete steps necessary to effectuate those sales, such as negotiating transactions, issuing opinion letters, or directing the issuance of shares. He contends that he engaged in no such activities here.[493]

We reject the argument. As noted above, Hurry is not charged with a Section 5 violation, but, rather, a Rule 2010 violation. Unethical conduct in violation of Rule 2010 is not constrained by case law defining who is liable as a statutory seller under Section 5. In any event, substantial participation is a broad concept without precise bounds. One who conceives of and plans a scheme, or one who is a substantial motivating factor behind it, can be liable under Section 5.[494] To hold otherwise would allow a person to mastermind a Section 5 violation, and, by directing others to perform the mechanical tasks necessary to effect the sale of securities without registration, escape liability.

b. Hurry Acted In Bad Faith

FINRA Rule 2010 is a broad ethical principle that may be violated either by conduct that fails to meet ethical norms, regardless of intention, or conduct that is undertaken in bad faith. We find here that, in connection with the business he routed through CSCT, Hurry acted in bad faith and violated FINRA Rule 2010. We conclude that he was engaged in a scheme to evade the securities laws, in particular the registration requirements of Section 5.

Hurry claimed that he established CSCT because Alpine wanted to shed its IRS tax withholding obligations, but there was no evidence that it made business sense to set up an office in the Cayman Islands to do that. In fact, the insertion of CSCT into the process of preparing stock certificates for resale to the public made no business sense because, due to the discounts Scottsdale extended to CSCT, Hurry's enterprises as a collective group made no more money than when Scottsdale was handling the business directly—but CSCT imposed additional costs.

That Hurry had no legitimate business reason for setting up CSCT is further apparent from the way the Firm handled the business purportedly routed through CSCT. The Firm, through Miller and Noiman, continued to deal directly with the FFIs and often handled issues that arose with the deposits without involving Ruzicka or CSCT. Rather than independently preparing deposits for submission to Scottsdale, Ruzicka also sought guidance from Diekmann as to what deposits he should consider.

Further casting doubt on the legitimacy of Hurry's reasons for setting up CSCT, Diekmann testified that an individual in Belize or Panama could have a direct account with

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[493] Resp. PH Br. 46 and n.261.

[494] *SEC v. Elliott*, 2011 U.S. Dist. LEXIS 91946, at *20 (S.D.N.Y. Aug. 17, 2011). *See also SEC v. Holschuh*, 694 F. 2d 130, 139-40 (7th Cir. 1982); *SEC v. Friendly Power Co.*, 49 F. Supp. 2d 1363, 1372 (S.D. Fla. 1999) (a person has indirectly sold a security to the public if he has "employed or directed others to sell ... or has conceived of and planned the scheme by which the unregistered securities were offered or sold").

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Scottsdale without going through an FFI like Unicorn or CSCT.[495] Cruz admitted that it would be easier to conduct due diligence on a direct customer of the Firm than a customer who came through an FFI such as CSCT or Unicorn.[496] In fact, the creation of CSCT diminished Scottsdale's access to information about the purported beneficial owners, and neither Scottsdale nor Alpine, Hurry's clearing firm, knew where the proceeds from sales of the securities were flowing.[497] This testimony raises the question of the purpose served by the multiple layers of entities—if not to conceal the identity of the true beneficial owners of the securities.

Hurry's bad faith was amply proven by his elaborate stratagems for concealing his involvement in CSCT's business, including his use of the "x" email address at CSCT, his insistence on using the attorney-client privilege in inappropriate circumstances, and his use of FaceTime to conceal his contacts with customers. He specifically wrote to Ruzicka in an email that there should be no written record of Hurry's involvement, which is powerful evidence of Hurry's scheme to avoid regulatory scrutiny. Ruzicka testified in his OTR that Hurry told him he was going to the Cayman Islands so that he would not have to "give anything to anyone."

Hurry's actions betray an attitude antithetical to the public interest, and his attempt to evade regulatory scrutiny is inconsistent with his duties as a securities professional. He failed to adhere to high standards of commercial honor and just and equitable principles of trade, thereby violating FINRA Rule 2010.

H. Supervisory Violations (Second And Third Causes Of Action—DiBlasi And Cruz)

1. NASD Rule 3010 Imposes Supervisory Duties

NASD Rule 3010(a) mandates that each member firm "shall establish and maintain a system to supervise" the activities of its associated persons. It further mandates that a firm's supervisory system be "reasonably designed to achieve compliance with the applicable securities laws and regulations, and with applicable NASD Rules."

Rule 3010(a)(1) provides that a firm's supervisory system "shall provide, at a minimum," for the "establishment and maintenance of written procedures." Rule 3010(b) details requirements for WSPs. Rule 3010(b)(1) requires that a member firm "shall establish, maintain, and enforce written procedures to supervise the types of business in which it engages." Those WSPs must be "reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable Rules of NASD."

Rule 3010(b)(3) further requires that the WSPs set forth the titles, registration status, locations and responsibilities of each of its supervisory personnel, and that assignments be made

[495] Hearing Tr. (Diekmann) 1675.

[496] Hearing Tr. (Cruz) 220.

[497] Hearing Tr. (Cruz) 661-62; Hearing Tr. (Frankel) 2349-50.

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covering all relevant areas of the firm's business and the applicable securities laws and FINRA Rules. Firms are required to preserve a record of these designations and their effective dates for at least three years. Under Rule 3010(b)(4), a firm is required to amend its WSPs as changes occur in its supervisory system.

Broadly speaking, WSPs are a written set of policies and procedures that describe concrete steps to supervise a firm's activities. They identify who is responsible for taking those steps and set up a system of documentation to allow for review and ensure proper implementation. Every broker-dealer firm must create, maintain, update, and adhere to those policies and procedures.[498] Those policies and procedures contribute to the establishment and maintenance of a supervisory system that is reasonably designed to achieve compliance with the laws, regulations, and rules applicable to the firm's business. To achieve accountability and ensure compliance, the WSPs must be clear and accurate regarding the allocation of supervisory responsibilities.

2. DiBlasi's Violation

a. Charge

The Second Cause of Action charges that Scottsdale and DiBlasi, the Firm's CCO, violated NASD Rules 3010(a) and (b) and FINRA Rule 2010. The Complaint alleges that DiBlasi failed to establish a supervisory system, including WSPs, reasonably designed to ensure compliance with Section 5. This failure occurred even though DiBlasi knew that the Firm had been sanctioned once before in settling prior charges of selling unregistered nonexempt securities. Among other things, the Complaint charges that the Firm's WSPs were deficient because they did not set forth clear responsibilities for its personnel and did not provide for a reasonable inquiry into beneficial ownership. The Complaint alleges that the WSPs did not require that the Firm's personnel take steps to independently verify the self-serving representations made by parties interested in the transactions and did not address the possible use of nominees to obscure the identity of the true beneficial owners of unregistered securities deposited at the Firm for resale. Enforcement proved the charge.

b. DiBlasi Had Responsibility For The Firm's WSPs

Throughout the relevant period, DiBlasi was the Firm's CCO; and he is still the Firm's CCO. DiBlasi contends, however, that he has never had responsibility for the Firm's Rule 144 business. He asserts that he does only what he calls "broker-dealer compliance," and not Rule 144 compliance.[499] According to DiBlasi, the Firm's former president, Cruz, had responsibility

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[498] *Dep't of Enforcement v. Ranni*, No. 20080117243, 2012 FINRA Discip. LEXIS 6, at *15-16 (OHO Mar. 9, 2012).

[499] Hearing Tr. (DiBlasi) 1921-22, 1927, 1952-53, 1976-77. DiBlasi described what he meant by broker-dealer compliance. He makes sure that the Firm's filings, such as the Form BD and the Forms U4 and U5, are done. He maintains records and makes sure correspondence and emails are reviewed. He summed up his work as taking care of all the "back office" tasks. Hearing Tr. (DiBlasi) 1976-77.

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for Rule 144 procedures and everyone deferred to him.[500] DiBlasi agreed that Cruz had a longstanding practice regarding responsibilities for Rule 144 compliance.[501]

We reject DiBlasi's assertion that he had no responsibility for the Firm's procedures in connection with the Firm's Rule 144 business for two reasons. First, in the circumstances of this case, the assertion is inconsistent with his designation as the Firm's Chief Compliance Officer; and, second, the assertion is inconsistent with the WSPs themselves, as is plain from reading them.

First, DiBlasi is the sole person disclosed on the Firm's Form BD as CCO. There is no co-CCO.[502] That means that DiBlasi has been identified to the Firm's regulator as the one person responsible for establishing and maintaining the Firm's WSPs.

The Firm's WSPs were required to cover its Rule 144 business, since the Firm's business is almost entirely the liquidation of unregistered microcap stocks. DiBlasi acknowledged in his testimony that during the relevant period 95% of the transactions Scottsdale did for its customers involved penny stocks, and penny stocks accounted for most of the Firm's revenue.[503] That business required heightened attention to compliance issues, as DiBlasi knew. The Firm had previously settled regulatory charges that it had improperly sold unregistered securities without an applicable exemption.[504]

In these circumstances, the designation CCO carried with it responsibility for the WSPs relating to the Firm's Rule 144 business. DiBlasi's abdication of responsibility as to that business is fundamentally incompatible with what it means to be the Firm's CCO.

We reject DiBlasi's assertion that Enforcement is trying to hold him liable by virtue of his title alone.[505] Rule 3010 requires the designation and disclosure of a person responsible for establishing and maintaining a firm's procedures. By definition under the Rule, the person disclosed as the CCO has responsibility for the Firm's WSPs. The Rule further sets a standard for the design of those procedures, which must be reasonably designed to achieve compliance with the laws and regulations applicable to the firm's business. The designation and disclosure of a firm's CCO is more than a meaningless title. It is one of the building blocks of a supervisory system reasonably designed to achieve compliance, and the CCO designation carries with it

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[500] Hearing Tr. (DiBlasi) 1944-47, 1952-53, 1965-66.

[501] Hearing Tr. (DiBlasi) 1970. According to DiBlasi, his predecessor as CCO had no responsibility for Rule 144 compliance either. *Id.*

[502] Hearing Tr. (DiBlasi) 1981.

[503] Hearing Tr. (DiBlasi) 1923, 1946.

[504] Hearing Tr. (DiBlasi) 1923-24; CX-12.

[505] Resp. PH Br. 38 n.220.

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responsibilities. If DiBlasi is not carrying out those responsibilities, then the disclosure on the Firm's Form BD is false and misleading.[506]

Second, throughout the relevant period the Firm's WSPs expressly provided that the CCO—DiBlasi—had the duty to establish, maintain, and enforce all of the Firm's WSPs. There were two sets of WSPs during the relevant period, the May 2013 WSPs that were in effect in October 2013 when DiBlasi became CCO, and the modified WSPs that became effective in May 2014. The main body of both sets of WSPs expressly assigned to the CCO responsibility to "[e]stablish, maintain and update, as required the firm rules and procedures" and specified that that responsibility included Appendix A and Appendix B to the WSPs.[507] Appendix A to both sets of WSPs listed principals and branches.[508] Appendix B to both sets of WSPs expressly assigned to DiBlasi, by name, the responsibility to "[e]stablish, maintain and update, as required, the firm rules and procedures."[509] Appendix B assigned to Cruz, Diekmann, and others various operational tasks in conducting Rule 144 due diligence, but it did not assign them responsibility for the WSPs.[510]

DiBlasi conceded that there was no written delegation in the 2013 WSPs that gave responsibility for Rule 144 policies and procedures to anyone other than the CCO.[511] Moreover, the 2013 WSPs expressly imposed certain specific responsibilities on the CCO in connection with sales of unregistered securities. The main body of the WSPs included a specific section dealing with Rule 144 stock that was headed "Rule 144 Restricted and Control Stock Sales."[512] In that section, the 2013 WSPs stated that the CCO was responsible for establishing procedures reasonably designed to ensure that a stock certificate was validly issued and owned by the customer.[513] Importantly, the 2013 WSPs also provided that the CCO should establish

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[506] The cases cited by Respondents are not relevant here. The cases did not involve the issue of whether a CCO was responsible for a firm's WSPs. *Dep't of Enforcement v. Mutual Serv. Corp.*, No. EAF0400630001, 2008 FINRA Discip. LEXIS 62, at *90-93 (OHO Dec. 16, 2008) (compliance department subordinates who were told to abandon red flag blotter review did not have supervisory responsibility for that review); *Dep't of Enforcement v. Kemweis*, No. C02980024, 2000 NASD Discip. LEXIS 49, at *67-70 (OHO Feb. 16, 2000) (Director of Compliance held not to have line responsibility for unsuitable trading by registered representatives).

[507] CX-179, at 6 ("The Chief Compliance Officer ('CCO') is responsible for the establishment and maintenance [of Scottsdale's] policies and procedures."); CX-180, at 6 (same).

[508] CX-179, at 158; CX-180, at 151.

[509] Hearing Tr. (DiBlasi) 1930; CX-181, at 2 (DiBlasi assigned to "[e]stablish, maintain and update, as required the firm rules and procedures, includes Appendices A and B"); CX-182, at 2 (same). It appears that Appendix B to the May 2013 WSPs were modified on November 13, 2013, to identify DiBlasi by name as responsible for the WSPs. CX-181, footer bearing date of "11/13/2013."

[510] CX-181, at 8-9; CX-182, at 8-9. For example, Appendix B assigned to Diekmann responsibility for Rule 144 stock deposit due diligence and approval. CX-181, at 9; CX-182, at 9.

[511] Hearing Tr. (DiBlasi) 1933, 1945, 1955-56.

[512] CX-179, at 63-65 (Rule 144 Restricted and Control Stock Sales, 8.18 through 8.18.11).

[513] CX-179, at 64 (8.18.2).

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procedures to ensure that the resale of such a security was made in reasonable reliance on an exemption from registration.[514] The 2013 WSPs further provided that the CCO should be notified and consulted regarding the processing of Rule 144 sales.[515] They also specified that the CCO was responsible for "developing and implementing policies and procedures that provide for the review, approval and resale of Rule 144 transactions."[516]

Nevertheless, DiBlasi argues that he was not responsible for the 2013 WSPs because he inherited them.[517] The fact that the 2013 WSPs already existed when DiBlasi became CCO, however, does not absolve him of responsibility to examine them, and, if necessary, to amend them.[518] As noted above, Rule 3010 contemplates that amendments should be made to WSPs if there are changes in a firm's supervisory processes, so that the WSPs accurately reflect what the firm is doing. Indeed, shortly after DiBlasi became the Firm's CCO, in November 2013, the Firm modified Appendix B to identify DiBlasi by name as the person responsible for establishing, maintaining, and updating the Firm's WSPs, including Appendices A and B.[519] If Cruz had responsibility for WSPs to the extent that they related to its Rule 144 business, the correction could and should have been made in November 2013.

DiBlasi also attempts to explain away aspects of the 2013 WSPs that contradict his position—such as the specific assignment of Rule 144 compliance tasks to the CCO. He testified that the 2013 WSPs "didn't accurately reflect how the division of responsibility was set up throughout the company. And it needed to be corrected."[520] The 2013 WSPs, however, clearly stated that DiBlasi was responsible for the Firm's policies and procedures and made him specifically responsible for policies and procedures relating to the Firm's Rule 144 business. His disclaimer of responsibility cannot override that plain statement.

Approximately six months after DiBlasi became CCO, in May 2014, the WSPs were modified.[521] Even then, however, the WSPs did not clearly reflect the division of responsibility that DiBlasi described in his testimony. The WSPs did not say that Cruz had responsibility for all aspects of Rule 144 compliance, including the WSPs relating to Rule 144.

In place of the CCO, the main body of the modified WSPs designated the "General Principal" as responsible for developing procedures to ensure that a stock certificate was validly issued and owned by the customer, and that the resale of such a security was made in reasonable

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[514] Hearing Tr. (DiBlasi) 1940-41; CX-179, at 64 (8.18.2).

[515] CX-179, at 64 (8.18.3).

[516] CX-179, at 64 (8.18.3).

[517] Hearing Tr. (DiBlasi) 1932-33. See Resp. PH Br. 38-39.

[518] *Ranni*, 2012 FINRA Discip. LEXIS 6, at *27 & n.93.

[519] CX-182, at 2.

[520] Hearing Tr. (DiBlasi) 1969.

[521] Hearing Tr. (DiBlasi) 1921, 1932-33, 1939-42.

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reliance on an exemption.[522] Similarly, the modified WSPs instructed that the General Principal should be consulted in connection with Rule 144 transactions. Under the modified WSPs, the General Principal was responsible for developing and implementing Rule 144 policies and procedures.[523]

Although the title "General Principal" might appear to refer to a single person, the term General Principal was defined in the modified WSPs as the "Management Committee."[524] The WSPs declared that the Management Committee had been set up to serve in the role of president of the Firm.[525] The Management Committee was defined in yet another location to consist of four persons—including DiBlasi.[526] Accordingly, even under the modified WSPs, as a member of the Management Committee, DiBlasi still retained some vaguely defined responsibility for Rule 144 transactions.

DiBlasi relies on the delegation to the Management Committee in arguing that he had no responsibility for compliance matters related to the Firm's Rule 144 business. He maintains that the specific assignment of responsibility for the WSPs to him by name in Appendix B did not "overwrite" the provision in the main body of the WSPs referring to the Management Committee.[527]

Given the ambiguity of the delegation of responsibility in the main body of the WSPs—ostensibly to the General Principal but actually to a committee that included DiBlasi—we think the clear, explicit assignment of responsibility for the WSPs to DiBlasi by name contained in Appendix B forecloses DiBlasi's argument. That conclusion is bolstered by the description in the main body of the WSPs of the CCO's duties, which include responsibility for the Firm's policies and procedures.

DiBlasi's argument also is undermined by the fact that he took actions in connection with certificate deposits. For example, he signed a foreign account application by Unicorn under the label "Compliance Approval."[528] Furthermore, others at the Firm reached out to him in connection with issues regarding certificate deposits. For example, Diekmann had concerns about a deposit because Ruzicka said that the customer was pressing to start trading a stock when

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[522] CX-180, at 64 (8.18.2).

[523] CX-180, at 64 (8.18.3).

[524] CX-180, at 7 (Compliance and Supervision 1.1.2).

[525] Hearing Tr. (DiBlasi) 1972; CX-180, at 7.

[526] Hearing Tr. (DiBlasi) 1933-34, 1939-40, 1942-43. The other members of the Management Committee were Cruz, Jay Noiman, and Elizabeth Arndt. Hearing Tr. (Noiman) 1065-66; Hearing Tr. (DiBlasi) 1972.

[527] Hearing Tr. (DiBlasi) 1974-75.

[528] Hearing Tr. (DiBlasi) 1956-57. DiBlasi maintained that his signature meant nothing more than that a foreign financial institution was involved. Hearing Tr. (DiBlasi) 1957. Whatever it meant, DiBlasi's signature appeared under the heading "Compliance Approval," and it demonstrated that he was involved in some type of compliance review in connection with the Firm's penny stock accounts.

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there was zero market for it, so Diekmann forwarded the correspondence to DiBlasi. Diekmann said that he did so because he thought Ruzicka's comment called into question whether the deposit should have been approved by Scottsdale in the first place. He sent the email to DiBlasi because DiBlasi was the CCO.[529]

c. The Firm's WSPs Were Not Reasonably Designed To Ensure Compliance With Section 5

i. The WSPs Did Not Accurately Reflect The Way The Firm Conducted Its Rule 144 Business

The Firm's WSPs were not reasonably designed to ensure compliance with Section 5 because they did not accurately reflect the way the Firm conducted its Rule 144 business. DiBlasi testified that Cruz was the principal responsible for Rule 144 compliance and the establishment of policies and procedures relating to that business. Cruz testified that DiBlasi never had any role in the Rule 144 review process.[530] Cruz created the procedures for Rule 144 transactions that were in effect during the relevant period, the Firm's OTC Restricted Stock Deposit Procedures, dated November 2012.[531] He testified, however, that during the relevant period DiBlasi had responsibility for updating them.[532]

Accepting Respondents' testimony about the allocation of responsibilities, during the relevant period the WSPs should have clearly said which aspects of the WSPs were Cruz's responsibility and which were DiBlasi's. Neither the 2013 WSPs nor the modified WSPs had any clear indication of who was responsible for what.

DiBlasi admitted that the 2013 WSPs did not accurately reflect the way the Firm was operating its Rule 144 business.[533] We further find that the modified WSPs also did not accurately reflect the way the Firm operated its business.

DiBlasi's testimony revealed that the modified WSPs allocated responsibility to a committee that no longer existed. DiBlasi testified that in January 2014 the Management Committee disbanded. He said that Justine Hurry took on the Committee's responsibilities in February 2014. Then, in March 2014, Cruz officially became president of the Firm and took on

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[529] Hearing Tr. (Diekmann) 782-87; CX-222a.

[530] Hearing Tr. (Cruz) 563-64.

[531] Hearing Tr. (Cruz) 582; RX-27.

[532] Hearing Tr. (Cruz) 665-66; RX-27.

Confusion over who had responsibility for the WSPs apparently is nothing new at the Firm. Cruz did not remember who the CCO was at the time he created the Rule 144 procedures, and he did not recall anyone specifically delegating to him the responsibility for creating the procedures. Hearing Tr. (Cruz) 665-66. When asked who now has responsibility to update the Rule 144 procedures, Cruz testified, "I believe that responsibility now falls on Henry Diekmann as president and also as head of the 144 cert team." Hearing Tr. (Cruz) 584.

[533] Hearing Tr. (Diekmann) 783-86; CX-222a.

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the responsibilities of the Management Committee. The Committee never reconstituted itself again—and yet in May 2014 the Firm put in place the modified WSPs that supposedly gave Rule 144 compliance responsibility to the Management Committee.[534]

Even if the Management Committee had been functioning in May 2014, we find that the modified WSPs were misleading regarding the allocation of responsibilities, and, therefore, not reasonably designed to achieve compliance. They purported to designate a registered principal as responsible for compliance with Rule 144. Rule 3010 requires that supervisory responsibilities be delegated to an appropriately registered principal. But, in fact, the WSPs delegated responsibility for Rule 144 procedures to a group of people. In so doing, the WSPs obscured who had responsibility, making it more difficult to hold anyone accountable for compliance oversight over the bulk of the Firm's business.

This failure to clearly indicate who was responsible for Rule 144 compliance is particularly egregious here. It would have been relatively simple to designate Cruz the responsible principal, since everyone agreed that he was.

It is fundamental that a firm's WSPs must clearly designate responsibilities to appropriately registered persons and must accurately reflect the way a member firm conducts its business. That is why Rule 3010 specifies that supervisory responsibilities be assigned to an appropriately registered principal. The person responsible for supervising a particular line of business must have the appropriate background to do it. That is also why a firm's WSPs must address the particular business and the particular circumstances of a firm. Only then will the WSPs be well designed to reasonably ensure compliance.[535]

ii. The WSPs Did Not Require A Reasonable Inquiry Into Beneficial Ownership

We also find that Scottsdale's WSPs were not reasonably designed to achieve compliance with Section 5 because the WSPs failed to require a reasonable inquiry into the identity of the purported beneficial owners of the stock the Firm was selling. The WSPs do not discuss the concept of nominees, and the Firm's principals responsible for approval of stock deposits did not focus on the potential problem of nominees in conducting their review. The due diligence files for the transactions at issue demonstrate that the Firm's general practice for reviewing stock deposits was inadequate to identify and investigate situations in which nominees might be concealing the identity of the true beneficial owners of securities. Diekmann testified that he knew nothing about the purported beneficial owner of Sky Walker but that the person was a

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[534] Hearing Tr. (DiBlasi) 1973. DiBlasi's testimony that Justine Hurry briefly served as president of the Firm in February 2014 is corroborated by the Firm's Form BD Amendment dated February 13, 2014, which lists Justine Hurry as president, as well as a director, of the Firm. CX-17, at 3. That document identifies Cruz as legal counsel since May 2008. CX-17, at 3.

[535] *See* NASD Notice to Members 99-45 (June 1999), http://www.finra.org/sites/default/files/NoticeDocument/p004311.pdf.

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customer of Unicorn. The lack of focus on the potential use of nominees to conceal the identity of the true beneficial owners is particularly egregious in light of the four prior SEC actions charging that nominees had been used to facilitate fraud and manipulation.

The Firm's listing of every FFI on its red flag list was not sufficient to address beneficial ownership or to ensure that an unlawful distribution was not occurring. The WSPs did not indicate why or what should be done in response to the red flag designation. When asked what additional scrutiny comes from the red flag designation, Diekmann could not think of any. He said that the designation "just reflects the heightened risk."[536] To recognize a heightened risk but provide no guidance for dealing with it is not reasonable. WSPs must provide a "reliable mechanism" for identifying securities sales that should be investigated or halted.[537]

3. Cruz's Violation

The Third Cause of Action charges that Cruz failed to adequately and meaningfully analyze the collected documents and information. Consequently, he and the staff he supervised failed to respond appropriately to red flags strongly indicating that the transactions were not entitled to an exemption. He approved the deposits for resale based on a cursory collection and verification effort. Enforcement proved the charges.

There is no dispute that Cruz supervised the processing of deposits for resale pursuant to Rule 144. He drafted the Firm's procedures for handling restricted stock sold pursuant to Rule 144 and other forms used to process deposits. For each transaction, he also met with the person who had put together the due diligence file to support the Rule 144 exemption. After talking with the person, he gave the final approval that allowed Scottsdale to trade the securities without registration. He was critical to the transactions, and, even though the WSPs did not identify him as the responsible person, everyone at the Firm looked to Cruz as the person responsible for Rule 144 compliance.

Cruz violated his responsibility in two ways.

First, Cruz failed to analyze whether the debt obligations that formed the foundation for tacking were securities. In light of the circumstances, this failure was egregious. Diekmann, who is not a lawyer, was incapable of recognizing and correcting Cruz's error. The members of the Rule 144 team who were lawyers did not have experience with penny stocks before they came to the Firm and were trained by Cruz and the Firm's personnel. Everyone depended on Cruz's analysis and expertise. As an experienced securities lawyer, Cruz should have recognized the problem. But he failed to meaningfully analyze the information in the due diligence packages.

Second, Cruz failed to react appropriately to myriad red flags. As set forth above in connection with each transaction, the stock deposits were rife with discrepancies and suspicious

[536] Hearing Tr. (Diekmann) 990.

[537] *Midas Sec.*, 2012 SEC LEXIS 199, at *51.

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circumstances that constituted red flags. However, Cruz and his staff did not make the required "searching inquiry" or obtain independent verification.

Cruz's failure is egregious because he knew that the Firm was acting as a gatekeeper,[538] and that broker-dealer firms play a critical role in helping to prevent illegal unregistered resales of restricted securities into the public markets.[539] He also acknowledged that at the time of the events at issue he was aware of the red flags in Regulatory Notice 09-05.[540] It is well established that the "duty of supervision includes the responsibility to investigate 'red flags' that suggest that misconduct may be occurring and to act upon the results."[541]

Cruz argues, however, that he was an effective supervisor. He notes that he created the Rule 144 manual, the due diligence questionnaire, and beneficial ownership declaration, and that the Firm dedicated one-third of its staff to performing due diligence reviews on stock deposits. He states that he inserted himself into the review process as a second set of eyes and additional resource when Scottsdale began accepting stock deposits from customers of sub-FFIs. He also asserts that the due diligence packages at issue contained all the required paperwork and that there is no instance of an issue being brought to Cruz's attention and him ignoring it. Finally, he maintains that the "rigor" of the stock deposit reviews under his leadership is demonstrated by the fact that Scottsdale frequently rejected stock deposits.[542]

All of this is beside the point. Cruz is charged with failing to respond appropriately to specific red flags identified in connection with the transactions at issue. The mere creation of paperwork does not qualify as effective supervision. As FINRA noted in conjunction with Regulatory Notice 09-05, in Rule 144 transactions, representations made by the interested parties have to be evaluated with a skeptical eye. Independent verification may be required. Instead, Cruz guided the staff through a check-the-box exercise.

Even when Cruz acknowledged that something might be a red flag, he indicated that his response would not be to obtain independent verification. Rather, his response would be merely to remind the interested parties of the information that needed to be disclosed. This is a totally inadequate response to a red flag.

Cruz's testimony regarding language on Unicorn's website illustrates the problem. The language on the website indicated that Unicorn would appoint nominees for its customers so that their names would not appear as an officer or director of the company on their account at

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[538] Hearing Tr. (Cruz) 86.

[539] Hearing Tr. (Cruz) 89.

[540] Hearing Tr. (Cruz) 84-90.

[541] *KCD Fin, Inc.*, 2016 FINRA Discip. LEXIS 38, at *70 (quoting *Michael T. Studer*, 57 S.E.C. 1011, 1023-24 (2004), *aff'd*, 260 F. App'x 342 (2d Cir. 2008)). *See also Ronald Pellegrino*, Exchange Act Release No. 59125, 2008 SEC LEXIS 2843, at *33 (Dec. 19, 2008).

[542] Resp. PH Br. 40-41.

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Unicorn. Cruz said he did not recall seeing that language at the time he reviewed Unicorn's deposits, but he agreed that if he had it "could have been" a red flag. In response to that red flag, however, he did not say that he would have sought independent verification of the identity of Unicorn's customers. Rather, he indicated that Scottsdale would merely emphasize to the interested parties that "they needed to – to disclose the underlying beneficial owner."[543] In other words, he would continue to rely on the representations of the interested parties.

Cruz argues that he supervised more actively than did respondents in other disciplinary proceedings in which supervisory violations were found.[544] Even if that were true (which we are not persuaded it is), the fact that other supervisors in other cases did even less than Cruz to respond to red flags is no excuse. The standard for reasonable supervision is not merely something marginally better than bad. Moreover, whether supervision is reasonable depends on the particular circumstances of each case.[545]

Cruz also argues that Enforcement is improperly second-guessing Cruz's exercise of reasoned business judgment, and that Enforcement has failed to provide affirmative evidence that his judgments were incorrect.[546] This argument is erroneous in two regards.

First, the argument ignores the record. The transactions at issue were rife with red flags that could not be ignored, but Cruz did ignore them.

Second, the argument confuses the burden on the Firm when it determined that an exemption existed with the burden of proof in litigation. Cruz, acting on behalf of the Firm, had the burden of developing a reasonable basis for believing that an exemption existed before the securities could be sold without registration. Enforcement proved that he and the Firm did not have a reasonable basis for believing that an exemption existed, but nevertheless Cruz approved the sale of the securities at issue without registration. That is all that Enforcement had to prove for the supervisory violation.

In sum, Cruz did not make sure that the transactions met the legal requirements for an exchange of securities, and he was oblivious to numerous red flags strongly suggesting that the transactions at issue were sham transactions using nominees to effect unlawful distributions of securities without registration. He violated his supervisory duties.

IV. SANCTIONS

In considering the appropriate sanction for a violation, adjudicators in FINRA disciplinary proceedings look to FINRA's Sanction Guidelines ("Guidelines"). The Guidelines

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[543] Hearing Tr. (Cruz) 307-08.

[544] Resp. PH Br. 41 n.236.

[545] *E.g.*, *Dep't of Enforcement v. Wedbush Sec., Inc.*, No. 20070094044, 2014 FINRA Discip. LEXIS 40, at *27-28 (NAC Dec. 11, 2014).

[546] Resp. PH Br. 41.

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contain recommendations for sanctions for many specific violations, depending on the circumstances. They also contain overarching Principal Considerations and General Principles, both of which are applicable in all cases.[547]

The Guidelines are intended to be applied with attention to the regulatory mission of FINRA—to protect investors and strengthen market integrity.[548] The Guidelines caution that sanctions must be significant enough to prevent and discourage future misconduct by a respondent and to deter others from similar misconduct. Sanctions also should encourage improved business practices.[549]

Applying the Guidelines, we first discuss below the appropriate sanctions for the Firm, DiBlasi, and Cruz. We separately discuss the sanction for Hurry.

A. Scottsdale

As authorized by the Guidelines, we aggregate all the Firm's violations.[550] The violations are inextricably intertwined and are the result of a systemic failure at the Firm—the Firm's failure to have procedures in place that would reasonably ensure compliance and the Firm's failure to respond appropriately to red flags led to the Firm's failure to have a reasonable basis for an exemption before selling the securities. Furthermore, as discussed below, the Panel believes stringent sanctions are warranted here, and separately sanctioning the Firm for the different violations, even at the high end of the range of recommended sanctions, would not adequately remediate the Firm's misconduct. We view the Firm's systemic failure to perform its gatekeeping function better addressed as a whole, rather than in piecemeal fashion.

The Firm violated FINRA Rule 2010 because, in connection with the transactions at issue, it did not have a reasonable basis for an exemption. Selling securities without registration and without an exemption violated Section 5. The Guidelines contain specific recommendations for this type of violation. The Guidelines recommend a fine of $2,500 to $73,000, but in egregious cases the fine may be higher. In egregious cases, a firm may also be suspended with respect to any or all activities or functions for up to 30 business days or until procedural deficiencies are remedied.[551]

The Firm, through DiBlasi, failed to have in place WSPs reasonably designed to achieve compliance with Section 5. For deficient WSPs, the Guidelines recommend a fine ranging from $1,000 to $37,000. They also suggest that adjudicators consider suspending a firm with respect

[547] FINRA Sanction Guidelines (2016) ("Guidelines"), http://www.finra.org/industry/sanction-guidelines.

[548] Guidelines at 1, Overview.

[549] Guidelines at 2, General Principle No. 1.

[550] Guidelines at 4, General Principle No. 4.

[551] Guidelines at 24.

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to any or all relevant activities or functions for up to 30 business days or until the supervisory procedures are amended to conform to the rule requirements.[552]

The Firm, through Cruz, failed to supervise its Rule 144 process appropriately. The Firm, through Cruz, failed to adequately and meaningfully analyze the information collected and thus failed to respond appropriately to red flags that the transactions were unlawful distributions. For a failure to supervise, the Guidelines recommend a fine of $5,000 to $73,000. In egregious cases, they suggest that adjudicators consider suspending a firm with respect to any or all relevant activities or functions for up to 30 business days. An even longer suspension may be imposed, up to two years, or the firm may be expelled, where the case involves systemic supervision failures.[553]

We find the Firm's violations to be egregious. We also find that there are a large number of aggravating factors that increase the need for stringent sanctions. There are no mitigating factors.

1. Aggravating Factors

a. Specific Principal Considerations Related To Section 5 Violations

One of the specific Principal Considerations in a case involving a Section 5 violation is whether the respondent attempted to comply with an exemption.[554] We conclude here that the Firm did not truly attempt to comply. Rather, it created the appearance of compliance. Although the Firm created thick due diligence packages, it did not meaningfully evaluate the information in those packages. If it had, it would have known it could not sell the securities without further investigation and the development of a reasonable basis for an exemption. We further find it aggravating that the Firm expended its resources on creating the appearance of compliance, rather than true compliance, because such conduct is deceptive and displays a lack of regard for the applicable law and regulatory requirements. This aggravating factor applies not only to the Firm but to Cruz, on whom everyone at the Firm depended for Rule 144 compliance.

Another specific Principal Consideration is the share volume and dollar amount of the transactions involved.[555] The transactions at issue involved millions of shares and resulted in

[552] Guidelines at 103.

[553] Guidelines at 102.

[554] Guidelines at 24.

[555] Guidelines at 24. See also Guidelines at 7, General Principal Consideration 18.

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proceeds of more than $1.75 million.[556] The amounts involved are substantial and constitute an aggravating factor.

A third specific Principal Consideration is whether the respondent implemented reasonable procedures to ensure that it did not participate in an unregistered distribution.[557] The Firm's procedures were not reasonable. To the contrary, they seemed designed to obscure who was responsible for Rule 144 compliance and they failed to require specific, reliable evidence to support the application of an exemption. Nor did the Firm implement good practices. Scottsdale's staff uncritically relied on the self-serving representations of the interested parties. When they did notice a discrepancy, the staff assumed an innocent explanation or accepted a plainly unreliable representation from the interested parties, rather than pursuing the "searching inquiry" that was required. This aggravating factor applies to DiBlasi, as the CCO, and to Cruz, as the person ultimately responsible for Rule 144 compliance, as well as the Firm.

A fourth specific Principal Consideration is whether the respondent disregarded red flags suggesting the presence of an unregistered distribution.[558] As discussed above, the Firm repeatedly failed to identify and disregarded numerous red flags indicating that the transactions were unlawful distributions of securities. The multiplicity of red flags is another aggravating factor. This aggravating factor applies to Cruz as well as the Firm.

b. Specific Principal Considerations Related To Deficient WSPs

One of the specific Principal Considerations relating to deficient WSPs is whether those deficiencies allowed violative conduct to occur or to escape detection. We find here that the WSPs allowed violations to occur. The failure to provide guidance on dealing with discrepancies and suspicious circumstances allowed those involved with Rule 144 review to proceed in a rote fashion, without analyzing the information they collected. This aggravating factor applies to both the Firm and DiBlasi.

Another specific Principal Consideration is whether the deficiencies made it difficult to determine the individuals responsible for specific areas of supervision or compliance. We find that the failure to clearly and accurately delineate responsibility lessened transparency and accountability, making regulatory oversight more difficult. It is particularly aggravating that the person designated CCO should disclaim responsibility for the vast majority of the Firm's business. This aggravating factor applies to both the Firm and DiBlasi.

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[556] JX-268 (NHPI-Related Activity in CSCT Account: Total Net Proceeds of $264,711.70); JX-281 (VPLM-Related Activity in CSCT Account: Total Net Proceeds of $1,408,173.39); JX-310 (ORFG-Related Activity in CSCT Account: Total Net Proceeds of $91,408.43).

[557] Guidelines at 24. See also Guidelines at 6, General Principal Consideration 5.

[558] Guidelines at 24.

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c. Specific Principal Considerations Related To Failure To Supervise

One of the specific Principal Considerations in connection with a failure to supervise is whether the respondent ignored red flags warning of the need for additional supervisory scrutiny. Another is the nature, extent, size, and character of the underlying misconduct. Both of these are aggravating factors in this case. The Firm, through Cruz, ignored multiple red flags that the transactions required additional scrutiny. The transactions were substantial and were typical of the bulk of the Firm's business. The supervisory failure was in fact built into the Firm's standard practice for processing Rule 144 stock deposits, which is an aggravating factor. These aggravating factors apply to both the Firm and Cruz.

d. General Principal Considerations

Several general Principal Considerations are relevant to this case.[559] Principal Consideration 1 is a respondent's relevant disciplinary history.[560] Scottsdale has a disciplinary history, and some of that history involves misconduct like the misconduct here. As noted above, in the 2011 AWC the Firm settled charges that it had sold unregistered securities and that it had inadequate supervisory procedures and WSPs to detect and prevent the sale of unregistered securities. The Firm resolved other charges in the 2009, 2012, and 2015 AWCs. Finally, although the Firm was not charged in connection with the four SEC cases, *Ruettiger*, *Gibraltar I*, *Gibraltar II*, and *Tavella*, those cases did involve alleged misconduct through accounts at the Firm. These cases put the Firm on notice of the risk of sham transactions and the use of nominees to conceal beneficial ownership and facilitate unlawful distributions of securities. They heightened the need for the Firm to be alert to red flags. In light of this history, it is aggravating that Scottsdale performed its gatekeeping function so poorly.

Principal Consideration 2 concerns whether a respondent has accepted responsibility for and acknowledged the misconduct prior to detection and intervention. The Firm here has not. It maintains that its procedures are "market-leading" and create an "unfriendly environment" for stock manipulation.[561] The facts do not support that characterization.

Furthermore, in light of the fact that the transactions at issue involved persons who have been indicted for engaging in securities fraud and other crimes, it is particularly aggravating that the Firm's current president, Diekmann, testified that if any of the three deposits at issue were presented to him today—NHPI, VPLM, or ORFG—he would approve it. He expressed no qualms.[562] This means that the person in charge of approving stock deposits as satisfying the Rule 144 exemption is likely to commit the same violations again.

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[559] Guidelines at 6-7.

[560] Guidelines at 6, General Principal Consideration 1.

[561] Resp. PH Br. 37-38.

[562] Hearing Tr. (Diekmann) 1799-80.

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Adding to our concerns in this regard, Cruz echoed Diekmann. Cruz said that, despite the evidence presented to him during his testimony relating to the five certificate deposits charged in the Complaint (three NHPI, one VPLM, and one ORFG), he believed that the Rule 144 exemption applied and the transactions complied with Section 5.[563]

Principal Consideration 8 is whether a respondent engaged in numerous acts or a pattern of misconduct. [564] Principal Consideration 16 is whether the misconduct is aberrant behavior.[565] Scottsdale engaged in a pattern of misconduct and it was not aberrant behavior. Indeed, the Firm institutionalized its misconduct, by papering its files with documents that it did not meaningfully analyze. It is aggravating that the misconduct is actually the standard way the Firm conducts all its business. Moreover, Cruz testified that the pattern of deposits based on buying loan notes and exchanging them for stock was a typical transaction for the Firm. Because it was typical he saw nothing suspicious in it. These aspects of the misconduct are aggravating as to both the Firm and Cruz.

Principal Consideration 13 is whether the misconduct was the result of an intentional act, recklessness or negligence.[566] The Firm's misconduct was not the product of negligence. It acted intentionally when it created and implemented the procedures for reviewing deposits of stock certificates for resale that created a false appearance of compliance. This aggravating factor applies not only to the Firm but to both DiBlasi and Cruz.

Principal Consideration 18 focuses on the number, size, and character of the transactions.[567] The transactions at issue had many red flags indicating that they were schemes to evade the securities laws and the scrutiny that comes with registration. Given that character, it is aggravating that, as a result of Scottsdale's failure to perform its gatekeeping function, millions of dollars of securities were sold to the investing public without the safeguards that accompany registration.

e. General Principles

The Guidelines instruct adjudicators to take into account certain General Principles applicable to all sanction determinations.[568] One of those General Principles is that disciplinary sanctions should be designed to deter misconduct, both by the respondent and by others, and should uphold high standards of business conduct. Adjudicators should impose sanctions that are

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[563] Hearing Tr. (Cruz) 555.

[564] Guidelines at 6, General Principal Consideration 8.

[565] Guidelines at 7, General Principal Consideration 16.

[566] Guidelines at 7, General Principal Consideration 13.

[567] Guidelines at 7, General Principal Consideration 18.

[568] Guidelines at 2-5.

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meaningful and significant enough to accomplish these goals, and the sanctions should reflect the seriousness of the misconduct at issue.[569]

The Firm's business is almost entirely the processing of penny stock deposits for resale into the public marketplace. In light of that fact, it is aggravating that the Firm had a check-the-box approach to its review of the deposits, without meaningful analysis of the multitude of red flags. The confession by Diekmann, the current president of the Firm, that, even after compiling a thick due diligence book, he knew nothing about the beneficial owner of one of the NHPI deposits is disturbing. It suggests that the person who now has authority to give final approval to stock deposits for resale has no understanding of what is required to ensure that the Firm does not participate in an unlawful distribution of securities without registration. The sanctions here must be stringent to deal with the seriousness of the misconduct and to show the Firm that it cannot simply continue with its business in its usual fashion. We believe that only a substantial sanction will deter the Firm from future misconduct.

Another General Principle is that disciplinary sanctions should be more severe for recidivists in order to deter and prevent future misconduct. The imposition of more severe sanctions emphasizes the need for corrective action.[570] As noted above, the Firm has a disciplinary history. It has been disciplined for selling unregistered securities and for other violations. In light of this history, it is appropriate to impose more severe sanctions.

f. Overview

The mission of FINRA's regulatory and disciplinary process is to protect investors and promote market integrity. In fulfilling that mission, adjudicators are not limited to the sanctions recommended in the Guidelines. Based on the facts and circumstances presented in each case, adjudicators may impose sanctions that fall outside the ranges recommended and may consider aggravating and mitigating factors in addition to those listed in the Guidelines.[571]

2. Potential Mitigating Factor

Principal Consideration 3, which is applicable to all sanctions determinations, concerns whether, prior to detection or intervention by a regulator, a firm voluntarily employed corrective measures to avoid recurrence of misconduct. This might be argued to be a mitigating factor.

The Firm maintains that it enhanced its procedures after the SEC filed the complaints in the four cases involving nominees. In particular, it claims that it enhanced its reviews of stock promotions and notes that it ended all commissioned representatives at the Firm. It asserts that its requirement of a beneficial ownership declaration is a "market-leading practice" that has been

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[569] Guidelines at 2, General Principle 1.

[570] Guidelines at 2, General Principle 2.

[571] Guidelines at 1.

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adopted as a recommended method for determining beneficial ownership. It also points to its use of a Red Flag List and a Stock Watch List as enhancements to its reviews.[572]

We find that whatever changes the Firm made in its procedures were insufficient to be mitigating. To some degree, they appear to be more of the same. They created the appearance of compliance without actual compliance. Even with the so-called enhancements, the Firm's procedures were woefully lacking. The record is replete with red flags that the Firm and Cruz ignored.

3. Sanction

In light of the egregious nature of the Firm's violation, the Firm's institutionalization of the misconduct as its standard way of doing business, and the other aggravating factors set forth above, we believe that a stringent sanction is appropriate. Only such a sanction will serve the remedial purposes of the disciplinary process. The Firm must be deterred from similar misconduct in the future. We impose on Scottsdale a fine of $1.5 million.

B. Hurry

Hurry's violation of his duty to observe high standards of commercial honor and just and equitable principles of trade was purposeful and egregious. These two qualities lead us to conclude that Hurry is a threat to investors and the integrity of the markets. Our concern is compounded by our credibility findings. We found that he repeatedly testified falsely, and that there was a pattern of doing so when he thought no contradictory evidence would come to light.

When misconduct is intentional, General Principle 1 provides that adjudicators should assess sanctions that exceed the recommended range in the Guidelines.[573] Principal Consideration 13 also focuses on whether a respondent's misconduct is the result of an intentional act, recklessness, or negligence.[574] When a violation is egregious, the Guidelines often suggest more severe sanctions. In egregious cases in connection with violations of Rule 2010 and Section 5, the specific Guidelines recommend that an individual be suspended for up to two years or barred.

Even though he has no disciplinary history, the devious nature of Hurry's violation evidences disregard for regulatory requirements, an aggravating factor under General Principle 2 and Principal Consideration 10.[575] We have no confidence that if he remained in the securities industry he would not again devise a way to evade the law and regulatory requirements. For this reason also, we believe Hurry is a threat to the investing public.

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[572] Resp. PH Br. 37-38.

[573] Guidelines at 2, General Principle 2.

[574] Guidelines at 7, General Principal Consideration 13.

[575] Guidelines at 2, General Principle 2; Guidelines at 6, General Principal Consideration 10.

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As discussed in connection with the Firm's violation and sanction, the scheme enabled large amounts of stock certificates to be sold in a number of transactions without the protections of registration and without an exemption. Under Principal Consideration 18, the size of the transactions is an aggravating factor.

Finally, we note that Hurry had by far the most to gain financially from setting up CSCT and enabling shares deposited from offshore customers to be shielded from scrutiny. He and his wife own all three entities involved in the process: CSCT, Scottsdale, and Alpine. And although Respondents emphasize that the particular transactions at issue did not generate a huge amount of money, the microcap securities liquidation business as a whole was highly remunerative for Hurry and his wife. We earlier noted that, from Scottsdale alone, in 2014 they received approximately $6.2 million in directors' fees and $1.45 million in net income. The compensation for all other employees and for professional and consulting fees for that year totaled less than half that—approximately $2.7 million. It was to Hurry's financial advantage to facilitate the processing of FFI deposits and to minimize regulatory oversight. The misconduct added to his financial gain and is an aggravating factor under Principal Consideration 17.[576]

We bar Hurry from associating with any FINRA member in any capacity and believe it appropriately remedial to fine him $100,000. In light of the bar, however, we do not impose the fine.

C. DiBlasi

The Guidelines provide with respect to an individual who is responsible for deficient WSPs that in egregious cases he may be suspended in any or all capacities for up to one year. The Guidelines also provide for a fine ranging from $1,000 to $37,000.

In this case we find more stringent sanctions appropriately remedial. DiBlasi's violation was egregious, and there are aggravating factors. The WSPs created the appearance of a set of procedures designed to achieve compliance, but they did not accurately reflect the way the Firm actually handled its Rule 144 deposits. They did not even reflect DiBlasi's true role. Even though he was purportedly the CCO, he claimed that he had nothing to do with the vast majority of the Firm's business. Essentially, he performed back-office functions for the Firm. The result of the deficiencies in the WSPs was that violations occurred and regulatory efforts to determine the persons responsible were hindered.

We suspend DiBlasi from associating with any FINRA member firm in any capacity for two years and fine him $50,000.

D. Cruz

The Guidelines provide with respect to an individual supervisor who fails to respond to red flags that, in egregious cases, an adjudicator should consider suspending the person in any or

[576] Guidelines at 7, General Principal Consideration 17.

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all capacities for up to two years or barring him. A fine of $5,000 to $73,000 also may be imposed.

Cruz's violation was egregious. As a lawyer with considerable background in the securities laws, he had the background that others did not to scrutinize the due diligence packages and identify red flags. Furthermore, as the person at the Firm everyone else depended upon for Rule 144 compliance, he knew that he was critical to the Firm's performance of its gatekeeping duty. He was the principal at the Firm who gave final approval to the sales of deposited securities, signing under a certification that the transactions, to his knowledge, were lawful. In light of these circumstances and the many aggravating factors identified above, Cruz's failure to recognize and appropriately address multiple red flags was inexcusable.

We suspend Cruz from associating with any FINRA member firm in any capacity for two years and fine him $50,000.

E. Respondents' Arguments For Lesser Sanctions Rejected

We reject Respondents' arguments for lesser sanctions. They assert that the relief requested by Enforcement cannot be reconciled with the Guidelines because the sanctions are more stringent than the recommended range.[577] However, the Guidelines are not absolute. They are recommendations. As provided in the Overview, adjudicators may impose sanctions outside the recommended range where the particular facts and circumstances make that appropriate.[578]

We are concerned that the misconduct here is the Firm's standard approach to processing deposits of stock certificates for sale. As long as the Firm continues with that check-the-box approach, without a meaningful evaluation of the information it collects, it is a risk to public investors. More stringent sanctions are necessary to emphasize the necessity for corrective action and to remediate the violation.

Respondents also compare their case to other cases involving Section 5 and supervisory violations, asserting that in those other cases the misconduct was worse and the sanctions less.[579] The appropriateness of sanctions, however, depends on the facts and circumstances of the particular case and cannot be determined by comparison to sanctions in other cases that involve different facts and circumstances.[580] Furthermore, Respondents' misconduct was far more egregious than Respondents acknowledge.

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[577] Resp. PH Br. 47.

[578] Guidelines at 1.

[579] Resp. PH Br. 47-49.

[580] *See, e.g., William Scholander*, Exchange Act Release No. 77492, 2016 SEC LEXIS 1209, at *42 & n.65 (Mar. 31, 2016).

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With respect to disciplinary history, Respondents argue that the individual Respondents have no disciplinary history.[581] It is well established that the absence of a disciplinary history is not mitigating as to sanctions. A wrongdoer should not be rewarded for acting in accord with his duties as a securities professional.[582]

In sum, we find that the sanctions we impose here are necessary, appropriate and remedial. They serve the twin goals of protecting public investors and contributing to market integrity.[583]

V. CONCLUSION

The Firm, Scottsdale Capital Advisors, violated FINRA Rule 2010. Accordingly, it is ordered to pay a fine of $1.5 million. John J. Hurry violated FINRA Rule 2010. For his misconduct he is barred from association with any FINRA member in any capacity. He would be fined $100,000, but, in light of the bar, the fine is not imposed. Timothy B. DiBlasi violated NASD Rules 3010(a) and (b) and FINRA Rule 2010. For his misconduct, he is suspended for two years from association with any FINRA member in any capacity and fined $50,000. D. Michael Cruz violated NASD Rule 3010(b) and FINRA Rule 2010. For his misconduct, he is suspended for two years from association with any FINRA member in any capacity and fined $50,000.

Respondents are also ordered to pay costs in the amount of $22,124.29, which includes a $750 administrative fee and $21,374.29 for the cost of the transcript. If this decision becomes FINRA's final disciplinary action, Hurry's bar will take immediate effect. DiBlasi's and Cruz's suspension will begin with the opening of business on August 21, 2017. The fines and assessed costs shall be due on a date set by FINRA, but not sooner than 30 days after this amended decision becomes FINRA's final disciplinary action in this proceeding.

Lucinda O. McConathy
Hearing Officer
For the Extended Hearing Panel

[581] Resp. PH Br. 47.

[582] *See, e.g., Kenny A. Akindemowo*, Exchange Act Release No. 78352, 2016 SEC LEXIS 2522, at *5 & n.5 (July 18, 2016). *See also* Guidelines at 6 and n.2.

[583] The Hearing Panel has considered and rejects without discussion any other arguments made by the Parties that are inconsistent with this decision.

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9TH CIRCUIT COURT
COUNTY OF KALAMAZOO
KALAMAZOO, MICHIGAN

In the Kalamazoo County Circuit Court
For the State of Michigan

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff,

v.

MORNINGLIGHTMOUNTAIN, LLC, MICHAEL GOODE, and DOES 1–10,

Defendants.

Civil No. 18-0153-CZ

HON. ALEXANDER C. LIPSEY

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MOTION FOR SUMMARY DISPOSITION OF SECOND AMENDED COMPLAINT

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Defendants MorningLightMountain, LLC, and Michael Goode ask the Court to dismiss the First Amended Complaint with prejudice for failure to state a claim upon which relief can be granted.

Respectfully submitted,

BUTZEL LONG

Dated: November 14, 2018

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MEMORANDUM SUPPORTING MOTION FOR SUMMARY DISPOSITION OF SECOND AMENDED COMPLAINT

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Under MCR 2.116(C)(8), MLM and Goode offer this Memorandum in support of their Motion to dismiss the Second Amended Complaint ("Complaint") with prejudice on summary disposition for failure to state a claim upon which relief can be granted.

INTRODUCTION

This is a defamation action. Scottsdale has sued MLM and Goode for allegedly libelous statements posted in an online article at goodetrades.com, a blog reporting on news about penny-stock trading.

A "penny stock" refers to a security issued by a very small company that trades at less than $5.00 per share.[1] Also known as "microcap stocks," penny stocks are issued by companies, many of which do not file financial reports with the U.S. Securities & Exchange Commission.[2] The SEC describes these securities as "among the most risky," suffering from a scarcity of publicly-available information that allows "fraudsters [to] easily spread false information about microcap companies, making profits while creating losses for unsuspecting investors."[3] They are very speculative investments, and Congress has tightly regulated broker-dealers who facilitate penny-stock trading under the Exchange Act.[4]

One fraud particularly affecting penny stocks is the classic pump-and-dump scheme. The scheme involves touting a company's stock through false and misleading statements to the marketplace to ignite a buying frenzy that "pumps" the price of

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1 U.S. Secs. & Exch. Comm'n, Penny Stock Rules (May 9, 2013) ("PENNY STOCK RULES") (available at http://bit.ly/SEC-Penny-Stock-Rules).

2 U.S. Secs. & Exch. Comm'n, Microcap Stock: A Guide for Investors, Introduction (Sept. 13, 2013) (available at http://bit.ly/ SEC-Microcap-Guide).

3 *Id.*

4 PENNY STOCK RULES, *supra* at n.1

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a stock (usually a penny stock). The hucksters then sell (or "dump") their stocks at the "pumped" up price, realizing a handsome profit. Once they dump their shares and stop hyping the stock, the price falls and investors lose their money.[5]

MLM and Mr. Goode reported on pump-and-dump schemes, including one involving stock in Biozoom, which was touted as a biomedical technology company. Before April 2013, Biozoom was known as Entertainment Art, Inc., and it produced leather bags. In April 2013, it announced that it was changing its name to Biozoom and exiting the leather-bag business to develop biomedical technology. From March 2013 (the month before the announcement) to June 2013, at least eight people opened accounts with broker-dealers and deposited millions of shares of Biozoom that they (falsely) claimed were purchased from the original shareholders of Entertainment Art in the previous few months and could be freely traded.[6] From May 16, 2013 to June 17, 2013, these people sold 14 million shares yielding almost $34 million, of which nearly $17 million was wired to overseas bank accounts.[7] Eventually, the stock collapsed. The SEC brought an enforcement action, *U.S. Securities & Exchange Comm'n* v. *Tavella*, to recover the ill-gotten gains and make swindled investors whole.

Scottsdale, a broker-dealer that facilitated penny-stock trading and claims to be one of the dominant companies in the microcap securities market for handling more than $125 million worth of trades in 2015 alone,[8] accepted Biozoom stocks for deposit and facilitated trading in the microcap market. Many of the trading accounts frozen

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[5] U. S. Secs. & Exch. Comm'n, "Pump-and-Dumps" and Market Manipulations (Jun. 25, 2013) (available at http://bit.ly/SEC-Pump-and-Dumps).

[6] *U.S. Secs. & Exch. Comm'n* v. *Tavella*, Civ. No. 13-4609 (SDNY), Complaint at 2, ¶¶ 3-5 (Jul. 3, 2013).

[7] *Id.* at 2-3, ¶¶ 6-7.

[8] Complaint at 3, ¶ 11.

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through the SEC's enforcement action were held at Scottsdale.[9] And, notably, since Scottsdale filed this lawsuit against MLM and Mr. Goode, the SEC entered an order sanctioning Scottsdale's representative Timothy Scarpino for facilitating the sale of 8.2 million Biozoom shares that generated $18.5 million in gains—just over half the shares and half the gains—for the fraudsters.[10] His offense was "fail[ing] to conduct a searching inquiry into facts surrounding the proposed sales" of unregistered Biozoom stock, despite the presence of "significant red flags."[11]

Among other things, it was this same kind of failure to conduct searching inquiries that resulted in the Financial Industry Regulatory Authority taking disciplinary action against Scottsdale.[12] FINRA imposed a $1.5 million fine against Scottsdale for "institutionaliz[ing] misconduct as its standard way of doing business," among other aggravating factors.[13] Part of the institutionalized misconduct included Scottsdale's failure to revise its procedures to focus on potential sham transactions after botching its gatekeeping role in the Biozoom pump-and-dump scheme that led to the SEC's enforcement action.[14]

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[9] *Tavella*, Civ. No. 13-4609 (SDNY), Stipulated Order Granting Prelim. Inj., Asset Freeze, and Other Relief (R. 16, Jul. 16, 2013); Final J. Defs. Graciarena and Loureyro (R. 67, Dec. 8, 2014); Final Default J., Order Granting Inj. & Other Relief Against Tavella [and Others] (R. 69, Jan. 9, 2015).

[10] *In re Timothy C. Scarpino*, SEC No. 3-18483, Order Instituting Admin. and Cease-and-Desist Proceedings, Making Findings, Imposing Remedial Sanctions, and a Cease-and-Desist Order (May 15, 2018).

[11] *Id.* at 2, Part III, Summary.

[12] Answer Exh. A, *FINRA* v. *Scottsdale Capital Advisors Corp.*, No. 2014041724601, Amended Extended Hr'g Panel Decision (Jun. 20, 2017) (available at http://bit.ly/FINRA-Panel-Decision) ("FINRA PANEL DEC.")

[13] *Id.* at 107, Part IV(A)(3).

[14] *Id.* at 11-12, 101-102, 104.

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FINRA had equally harsh words for Scottsdale's owner, John Hurry. FINRA found that he "violat[ed] his duty to observe high standards of commercial honor and just and equitable principles of trade," and it was "purposeful and egregious," which led FINRA to conclude that "[he] is a threat to investors and the integrity of the markets."[15] Worse yet, FINRA found that Hurry "repeatedly testified falsely, and that there was a pattern of doing so when he thought no contradictory evidence would come to light."[16] FINRA barred Hurry from associating with any other FINRA member for any reason.[17]

Which brings us to this lawsuit. The statements that Scottsdale claims are libelous are contained within an article written by Goode and published by MLM about three years after the Biozoom fraud. (The article is attached to the Complaint, and is part of the pleading for all purposes. *Slater* v. *Ann Arbor Pub. Sch. Bd. of Educ.*, 250 Mich. App. 419, 427 (2002).) The article include extensive quotations from FINRA's enforcement decision. It also include a link to the decision.

Scottsdale doesn't argue that the reporting about the FINRA action is inaccurate. Rather, it plucks a few sentences from the articles and claims that they wrongfully accuse it of actively engaging in a pump-and-dump scheme. In context, however, the articles do nothing more than note that penny stocks were illegally traded through Scottsdale brokerage accounts. And the notion that these articles damaged Scottsdale in any way—much less in some way unique and independent of (*a*) FINRA castigating and fining Scottsdale, or (*b*) FINRA excommunicating Mr. Hurry from the securities industry—is risible.

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[15] *Id.* at 107, Part IV(B).

[16] *Ibid.*

[17] *Id.* at 108. The FINRA National Adjudicatory Council affirmed this ruling. *FINRA* v. *Scottsdale Capital Advisors Corp.*, No. 2014041724601 (FINRA Dec. Jul. 20, 2018) at 104, Part V (available at http://bit.ly/FINRA-National-Decision).

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This lawsuit is about one thing: shutting down free speech. It is commonly known as a "strategic lawsuit against public participation." It is brought with the intent to censor the speaker's message because it is unwanted, not because it is false or defamatory. But the First Amendment no more allows a "litigation veto" than it does a "heckler's veto."

For the reasons that follow, the Court should dismiss the Complaint with prejudice for failing to state a claim upon which relief can be granted.

SPECIAL STANDARD OF REVIEW FOR FIRST AMENDMENT CASES

Motions for summary disposition brought under MCR 2.116(C)(8) in defamation actions test the legal sufficiency of the complaint. *Singerman* v. *Municipal Serv. Bureau*, 455 Mich. 135, 139 (1997). The Court must limit its review to the pleadings—which by court rule includes both the complaint *and* the answer. MCR 2.116(G)(5) (review of a (C)(8) motion is limited to the pleadings); MCR 2.110(A) (defining a pleading to include complaints and answers). The Court must take the well-pleaded factual allegations as true and construe them in the light most favorable to the non-moving party. *Dalley* v. *Dykema Gossett*, 287 Mich. App. 296, 304–305 (2010).

Importantly, however, courts have a special, heightened duty under the First Amendment to review the sufficiency of defamation complaints to make sure that pleading requirements are met. *Bose Corp.* v. *Consumers Union*, 466 U. S. 485 (1984). Although *Bose Corp.* involved a public figure and this case (allegedly) involves a private figure, the distinction between public and private figures is irrelevant to the scrutiny that must be brought to bear when assessing whether a defamation claim is properly pleaded—the distinction goes only to *the level of fault* that applies in a given case. The heightened scrutiny of the pleadings applies to *all* defamation cases, regardless of whether the plaintiff is a public or private figure. *Rouch* v. *Enquirer & News (After Remand)*

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("*Rouch II*"), 440 Mich. 238, 272–27 (1992) (Riley, J. concurring) (in a *private-figure case* reviewed on appeal from a (C)(10) ruling, Justice Riley noted that the pleadings in a defamation case are also to be reviewed with heightened scrutiny when challenged under (C)(8)). Although stated in a concurrence, "Justice Riley's position [in his concurring opinion in *Rouch II* is consistent with previous decisions of this Court." *Royal Palace Homes, Inc.* v. *Channel 7 of Detroit, Inc.*, 197 Mich. App. 48, 52–53 (1992) (also apparently a *private-figure case*). *See also Trost* v. *BuckStop Lure Co., Inc.*, 249 Mich. App. 580, 587 n.2 (2002) (observing, in a *private-figure case*, that Justice Riley outlined the proper procedure for (C)(8) challenges).

Michigan courts take this duty seriously. Recognizing that summary disposition is "an essential tool" to protect against "forbidden intrusions into the field of free expression," *Kevorkian* v. *American Med. Ass'n*, 237 Mich. App. 1, 5 (1999) (citing *Ireland* v. *Edwards*, 230 Mich. App. 607, 613 and n.4 (1998)), our courts long ago adopted an *Iqbal*-like pleading standard that requires plaintiffs to specifically plead: (1) the defamatory words and the facts that would establish that the words are false; (2) the facts identifying the publication of those words to a third party; (3) the level of fault that must be proved and the facts that would establish that the speaker acted with that level of fault; and (4) the harm suffered by the publication. *Gonyea* v. *Motor Parts Fed. Credit Union*, 192 Mich. App 74, 76–77 (1991). *Accord Ashcroft* v. *Iqbal*, 556 U.S. 662 (2009) (requiring plaintiffs in federal cases to "plausibly" plead claims through specific factual allegations). Pleading specific facts is a "relatively simple requirement"; defendants are entitled to summary disposition under MCR 2.116(C)(8) "on this ground alone" when plaintiffs fail to follow it. *Rouch II*, 440 Mich. at 279.

Also important, the heightened pleading requirement in defamation cases permits courts to resolve several questions of law on the pleadings, including: (1) whether a statement is capable of being defamatory; (2) the nature of the speaker and the level

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of constitutional protections afforded to the statement; and (3) whether actual malice exists, if the plaintiff is required to show that level of fault. *Thomas M. Cooley Law School* v. *Doe 1*, 300 Mich. App. 245, 342 (2013). In making these assessments, a court must read the challenged statement in context, fairly and reasonably construing the entire article to determine whether the challenged statement is libelous. *Sanders* v. *Evening News Ass'n*, 313 Mich. 334, 340 (1946); *Croton* v. *Gillis*, 104 Mich. App. 104, 108 (1981). A statement "does not become actionable merely because it could be taken out of context." *Nehls* v. *Hillsdale Coll.*, 178 F. Supp. 2d 771, 779 (ED Mich. 2001), *aff'd* 65 Fed. Appx. 984 (CA6 2003) (citing Michigan law).

ARGUMENT

In Michigan, a libel plaintiff must prove that the defendant: (1) made a false statement, (2) that was defamatory, (3) which was "of and concerning the plaintiff, (4) in the form of an unprivileged publication to a third party, (5) with a level of fault amounting to at least negligence on the part of the publisher, and (6) thereby damaged the plaintiff. *Northland Wheels Roller Skating Ctr.* v. *Detroit Free Press*, 213 Mich. App. 317, 323 (1995) (citing *Rouch II*).

I. FAULT NOT PLEADED: The Complaint fails to plead facts establishing that MLM and Goode acted negligently.

To adequately plead fault, a plaintiff must identify the level of fault that applies to the claim *and* allege facts that would establish that level of fault if proved. *Gonyea*, 192 Mich. App. at 76–77; *Rouch II*, 440 Mich. at 279. There are two levels of fault: negligence and actual malice. *Ibid.* The negligence standard applies in cases involving private figures; the actual-malice standard applies in cases involving public officials, public figures, and limited-purpose public figures. *Ibid.* Scottsdale alleges that it is a private figure and that MLM and Goode are the direct and proximate cause of its damages, Compl. ¶ 23, so it impliedly pleads the level of fault to be negligence.

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Negligence is defined as the failure to use the care that an ordinary person would use under the circumstances. MICH. CIV. J. INSTR. 10.02. Thus, in order to meet the *Iqbal*-like pleading standard, Scottsdale must alleged what a reasonably careful reporter and reasonably careful publisher would have done under the circumstances, and then plead facts alleging that MLM and Goode failed to do those things. *Michigan Microtech, Inc.* v. *Federated Publ'ns, Inc.*, 187 Mich. App. 178, 186 (1991). These standards are intertwined with the "reasonable audience" standard. *Air Wis. Airlines Corp.* v. *Hoeper*, 71 U.S. 237, 246–251 (2014). The Complaint does not satisfy these pleading requirements for either of the two statements. A reasonably careful journalist and publisher can reasonably expect that those who visit the Website are sophisticated readers—*i.e.*, people familiar with the microcap market. Those readers, being well versed in the industry, would conclude that Scottsdale was the *means* by which a pump-and-dump was accomplished, not that Scottsdale had itself engaged in illegal activity—particularly with the benefit of links to source documents.[18]

Under *Rouch II*, a failure to plead both the level of fault that must be proved *and the facts that would establish the speaker acted with that level of fault* entitles MLM and Goode to summary disposition under MCR 2.116(C)(8) "on this ground alone." *Rouch II*, 440 Mich. at 279 (Riley, J., concurring). The failure to plead any facts supporting negligence (or actual malice) is fatal to the Complaint.

Previously, the Court applied the doctrine of *res ipsa loquitur* to conclude that fault is adequately pleaded if the Complaint adequately pleads the challenged statements to be

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[18] To the extent that Scottsdale apparently tries to plead actual malice in the alternative—"notwithstanding [its] status as a private figure, . . . [MLM and Goode] knew that the [challenged statements] were false and/or acted in reckless disregard of whether [they] were true or false"—the Complaint is likewise devoid of any factual allegations supporting *how* they knew the statements were false or *why* they were reckless in their alleged disregard of the truth.

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false. But error alone is not negligence. "The doctrine implies that the court does not know, *and cannot find out*, what actually happened in the individual case. Instead, the finding of likely negligence is derived from knowledge of the causes of the type or category of accidents involved." RESTATEMENT (THIRD) OF TORTS § 17 (2010) (emphasis added). It is applied in negligence cases where there is an injury for which there is no direct evidence that a particular individual caused it, but *the nature of the injury* is such that it *must* have been caused as a result of negligence. Hence *the thing speaks for itself.*

No Michigan court has ever applied this doctrine to a claim of defamation. Indeed, the doctrine cannot apply in defamation cases because a false statement is never automatically the result of actual malice or negligence. Scottsdale must plead *how* the reasonable reporter and publisher would have acted differently than Defendants did in this situation. *Rouch II*, 440 Mich. at 279 (Riley, J., concurring) ("The relatively simple requirement of pleading facts to support allegations of material falsity, *negligence, or reckless disregard for the truth* should be followed ... in defamation actions, and, pursuant to MCR 2.116(C)(8), defendant should have been entitled to summary disposition on this ground alone a decade ago." (emphasis added)). The Complaint does not allege what a reasonable reporter or publisher would have done differently in this case. Without that connection spelled out in the Complaint, Scottsdale has failed to plead facts establishing *why* Defendants are at fault *if* the challenged statements are false. Thus, they have failed to adequately plead a required element with the required specificity.

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II. STATEMENT NO. 1: Scottsdale has not pleaded facts sufficient to show that this statement is actionable.

> *If you have followed penny stocks and pump and dumps for a few years then you know Scottsdale Capital Advisors.*

A. Statement No. 1 is an opinion; opinions are not actionable.

To be actionable, the challenged statement must be provably false. *Ireland*, 230 Mich. App. 607 (citing *Milkovich* v. *Lorain Journal Co.*, 497 U.S. 1, 17–22 (1990)). In other words, the statement must state "actual, objectively verifiable facts." *Milkovich*, 497 U.S. at 17–21. Nonfactual hyperbole is not provably false. As noted in Part II.B, *infra*, Scottsdale has been connected to at least two pump-and-dump schemes in the years preceding publication of the Article. The challenged statement thus amounts to "everyone knows" about the connection—which is classic rhetorical hyperbole that is not actionable. *See, e.g.*, *Komarov* v. *Advance Magazine Publ'rs, Inc.*, 691 N.Y.S.2d 298, 301–302 (NY Sup. Ct. 1999) (plaintiff was as "well known" in the community as notorious mobster John Gotti was rhetorical hyperbole that cannot be proven false and not actionable). Scottsdale cannot objectively prove that those who followed penny stock pump-and-dump schemes did *not* know of Scottsdale.

B. Statement No. 1 is not false.

If the Court holds that Statement No. 1 is not an opinion, it should still find that Scottsdale has failed to plead facts sufficient to show that Statement No. 1 is false. Scottsdale says Statement No. 1 is false because it has "never been involved in any 'pump and dump' schemes, has never been a defendant in any 'pump and dump' lawsuits, and has never been convicted of engaging in 'pump and dump' activity." (Compl. ¶ 13.) On its face, Statement No. 1 doesn't accuse Scottsdale of these things, as the Court previously held in dismissing this statement from the First Amended Complaint.

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C. Statement No. 1 is not defamatory.

Undeterred, Scottsdale alleges that the juxtaposition of the headline "FINRA fines Scottsdale Capital Advisors $1.5 million" implies that FINRA fined Scottsdale for its involvement in the pump and dump of penny stocks—and that this the *only* conclusion that a "reader" could make. (Compl. ¶ 13a.) In the context of the substantial truth defense, a defamation defendant "is not responsible for every defamatory implication a reader might draw from his report of true facts, absent evidence that he intended the defamatory implication." *Royal Palace Homes, Inc.* v. *Channel 7 of Detroit, Inc.*, 197 Mich. App 48, 56. A statement "does not become actionable merely because it could be taken out of context." *Nehls* v. *Hillsdale Coll.*, 178 F. Supp. 2d 771, 779 (ED Mich. 2001), *aff'd* 65 Fed. Appx. 984 (CA6 2003). There are no facts pleaded that would establish Defendants intended to imply that Scottsdale was committing pump-and-dump schemes, as opposed to the means by which such schemes were accomplished.

As noted earlier, the Court must read the challenged statement in context, fairly and reasonably construing the entire article to determine whether the challenged statement is libelous. *Sanders*, 313 Mich. at 340; *Croton*, 104 Mich. App. at 108. The linked FINRA decision provides the context. It details how Scottsdale's business is susceptible to sham transactions. For example, among Scottsdale's many shortcomings, FINRA noted that the SEC had previously sued two of Scottsdale's registered representatives in case involving a pump-and-dump scheme. (Answer, Exhibit A, FINRA PANEL DEC. at 11, Part III.B(1)(a)(iv) (citing Compl., *SEC* v. *Ruettiger*, Civ. No. 11-2011 (D Nev. 2011)). FINRA fined Scottsdale in part because FINRA directly tied the success of the $34 million Biozoom pump-and-dump scheme to Scottsdale's lax anti-fraud safeguards, which it never improved despite being on notice that its existing safeguards were inadequate to detect and prevent fraud. (Answer, Exhibit A, FINRA PANEL DEC. at 107, Part IV.A(3).)

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Of course, even if the Court were to conclude that the statement is capable of a defamatory implication, the alleged implication is substantially true. Substantial truth is an absolute defense to a defamation claim. *Collins* v. *Detroit Free Press*, 245 Mich. App. 27, 33 (2001). The doctrine precludes liability if the gist or sting of the statement is true; a statement is not considered false unless the literal truth would have produced a different effect in the mind of the reader. *Ibid.*

Scottsdale's claim rests on the distinction between actively committing fraud and being used as a tool for fraudsters. Although these are concededly two different things, a person who followed pump-and-dump schemes—*i.e.*, the reasonable audience—would know the difference between these two things *and* understand from the linked FINRA report that Scottsdale was involved in pump and dumps *as a tool*. Moreover, the linked FINRA report shows that regulators found Scottsdale to effectively be a *willing* tool because it "institutionalized misconduct as its standard way of doing business." (*Ibid.*) Anyone who followed pump-and-dump schemes would know of Scottsdale. Anyone who read the entire article (including the linked FINRA report)—as the Court must under *Sanders*—would also understand *how* Scottsdale was involved. Thus, Statement No. 2 is substantially true.

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III. STATEMENT NO. 2: Scottsdale has not pleaded facts sufficient to show that this statement is false or capable of defamatory meaning.

> *They are one of the few brokers left that have continued to allow the deposit and sale of shares of illiquid penny stocks. Larger brokers and discount brokers stopped allowing that over five years ago.*

A. Statement No. 2 is not false.

Scottsdale says Statement No. 2 is false because many other brokers still trade in penny stocks. (Compl. ¶ 13b.) But the statement is conjunctive. *Depositing* shares and *selling* shares are two different activities. As written, Statement No. 2 says few brokers still allow *both* activities. The Complaint only identifies brokers who still *sell* penny stock. (Compl. ¶ 13b.) Nowhere in the Complaint does SCA identify *any* other brokers who still accept shares for *deposit*. Therefore, it has not sufficiently alleged that the statement as written—"deposit *and* sale"—is false.

B. Statement No. 2 is not defamatory.

Scottsdale alleges that Statement No. 2 is *per se* defamatory. (Compl. ¶ 22.) For something to be "inherently defamatory" it must "either hold a person up to contempt, ridicule, or scorn, impute crime, impute unchastity in a woman, or impute a loathsome disease." *Bufalino* v. *Maxon Bros., Inc.*, 368 Mich. 140, 151–152 (1962). Statement No. 2 does not say or imply that there is anything illegal about accepting penny stocks for deposit. Indeed, the statement acknowledges that a few other brokers do so. It simply notes that most brokers have exited this segment of the securities market.

As a matter of law, there is nothing defamatory about stating that Scottsdale serves a niche area. In *Bufalino*, the Court held that saying someone is in a particular line of business is "not in and of itself defamatory," if it is a "perfectly legitimate business"—*i.e.*, a legal one. *Ibid.* Plainly, a federally regulated business is a lawful business. *See* Penny Stock Reform Act of 1990, 104 Stat. 931, 951–958 (subjecting penny-stock broker-dealers to enhanced regulatory oversight).

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IV. DISMISSAL WITH PREJUDICE: Scottsdale cannot cure the flaws in the Complaint by further amendment.

Leave to amend should be withheld when amendment would be futile. *Allegheny-Ludlam Corp.* v. *Michigan Dept. of Treas.*, 207 Mich. App. 604, 605 (1994). Amendment would be futile in this case. Statement No. 1 is nonactionable opinion, and no amount of re-pleading will change that. Both of the statements are substantially true when considered in light of FINRA's disciplinary decision. And Statement No. 2 is not defamatory as a matter of law.

PRAYER FOR RELIEF

For these reasons, MLM and Goode respectfully request that the Court grant summary disposition in their favor under MCR 2.116(C)(8) and dismiss the Complaint with prejudice.

Respectfully submitted,

BUTZEL LONG, P.C.

Dated: NOVEMBER 14, 2018

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KALAMAZOO, MICHIGAN

STATE OF MICHIGAN 9TH CIRCUIT COURT KALAMAZOO COUNTY	PRAECIPE	CASE NO. 18-0153-CZ

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Plaintiff's Name(s)	v	Defendant's Name(s)
Scottsdale Capital Advisors Corporation, et al.		MorningLightMountain, LLC, et al.
Plaintiff's Attorney, Bar No., Address & Telephone No. Jordan D. Susman (CA# 246116) 132 South Rodeo Drive, Fourth Floor Beverly Hills, California 90212 (424) 203-1600 – Telephone *Counsel for Scottsdale Capital Advisors* *Pro Hac Vice Pending*		Defendant's Attorney, Bar No., Address & Telephone No. BUTZEL LONG, P.C. Joseph E. Richotte (P70902) Stoneridge West, 41000 Woodward Avenue Bloomfield Hills, Michigan 48304 (248) 258-1616 – Telephone *Counsel for MLM and Michael Goode*

Additional names and addresses may be added at the bottom of this form or as an attachment.

Please schedule this case for: [Title of motion(s) or other matter(s)]
Defendants' Motion for Summary Disposition of Second Amended Complaint

Moving party: Defendants

The estimated amount of time for hearing this matter is: 30 Minutes

Dated: November 14, 2018

Signature of Requesting Attorney/Pro Per Party

Additional names/addresses:
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Counsel for Scottsdale Capital Advisors

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FILED
NOV 15 2018
9TH CIRCUIT COURT
COUNTY OF KALAMAZOO
KALAMAZOO, MICHIGAN

In the Kalamazoo County Circuit Court
For the State of Michigan

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff,

v.

MORNINGLIGHTMOUNTAIN, LLC, MICHAEL GOODE, and DOES 1–10,

Defendants.

Civil No. 18-0153-CZ

HON. ALEXANDER C. LIPSEY

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PROOF OF SERVICE

Michelle L. Guardiola hereby states that on November 14, 2018, she served a copy of the Motion for Summary Disposition of Second Amended Complaint, Answer to Plaintiff's First Amended Complaint with Affirmative and Other Defenses and this Proof of Service via Federal Express, addressed to Plaintiff's counsel at the following addresses:

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I declare that under the penalty of perjury that the statements above are true to the best of my information, knowledge and belief.

BUTZEL LONG

Michelle L. Guardiola

MICHELLE L. GUARDIOLA

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DEC 03 2018
9TH JUDICIAL CIRCUIT
COUNTY OF KALAMAZOO
KALAMAZOO, MICHIGAN

STATE OF MICHIGAN
KALAMAZOO COUNTY CIRCUIT COURT

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff,

v.

MORNINGLIGHTMOUNTAIN, LLC, MICHAEL GOODE, and DOES 1-10,

Defendants.

File No.: 2018—0153-CZ

Hon. Alexander C. Lipsey

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PLAINTIFF'S RESPONSE IN OPPOSITION TO MOTION FOR SUMMARY DISPOSITION OF SECOND AMENDED COMPLAINT

Plaintiff Scottsdale Capital Advisors Corp. ("Scottsdale"), submits its Response in Opposition to Defendants' MCR 2.116(C)(8) Motion for Summary Disposition of Second Amended Complaint ("Current Motion").

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INTRODUCTION AND RELEVANT PROCEDURAL BACKGROUND

This action arises from Defendants' online publication of false, defamatory, and highly misleading statements on Defendants' website, www.goodetrades.com.

On April 16, 2018, Scottsdale filed its First Amended Complaint ("FAC") that alleged four defamatory statements made by Defendants.

On June 7, 2018, Defendants filed a Motion for Summary Disposition of the FAC (the "Previous Motion").

On October 4, 2018, the Court entered its Opinion and Order on Defendants' Previous Motion (the "October 4 Order") and held that one of the four defamatory statements (Statement #2) was sufficiently pleaded, but the other three defamatory statements (Statements #1, #3, and #4) were not sufficiently pleaded.

Subsequently, Defendants filed a Motion for Reconsideration, alleging palpable errors by the Court.

On October 25, 2018, the Court entered an Order Denying Defendants' Motion for Reconsideration (the "October 25 Order").

On November 8, 2018, Scottsdale filed its operative Second Amended Complaint ("SAC") that alleged two defamatory statements by Defendants: Statement #2, the statement already deemed sufficiently pleaded by the Court, and Statement #1. The SAC alleged additional facts concerning Statement #1 that demonstrate its defamatory nature.

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On November 14, 2018, Defendants filed their Current Motion, which is substantially identical to their Previous Motion,[1] alleging that Statements #1 and #2 are insufficiently pleaded. Defendants' Current Motion should be denied.

Regarding Statement #2, the Court has already held on two separate occasions that it sufficiently pleads a claim for defamation. Defendants' current attempt to dismiss the statement is legally unjustified and sanctionable. *See Ortega v. Trudel*, No. 239744, 2003 WL 22018391, at *1 (Mich. Ct. App. Aug. 26, 2003).

Regarding Statement #1, Scottsdale has supplemented and bolstered the allegations against Defendants, demonstrating that the statement, when read in context, falsely implies that Scottsdale was fined $1.5 million for its involvement in the pump and dump of penny stocks. Statement #1 also falsely alleges and/or implies that Scottsdale is so deeply entrenched in the illegal pump and dump of penny stocks that it is identified and known by the association.

LEGAL STANDARD

As with their Previous Motion, Defendants again allege that there is a heightened scrutiny for reviewing defamation case for legal sufficiency based on the pleadings. (Current Motion at pp.5-7). The Court already rejected these arguments in the October 4 Order and October 25 Order. Defendants' claim of a heightened pleading standard "is without merit." (October 4 Order at p.4). Moreover, the cases cited by Defendants in the Current Motion, *Bose Corp. v. Consumers Union* and *Thomas M. Cooley Law School v. Doe 1* "are improperly interpreted" by Defendants. (*Id.*).

"[T]his Court should not implement a higher standard as the Defendant suggests, but

[1] The Current Motion even begins with the exact same three and a half-page vilification of the penny stock industry and *ad hominin* attacks on Scottsdale, and one of its principals, as the Previous Motion.

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instead maintain a normal course of action regarding MCR 2.116(C)(8) that reviews only pleadings for legal sufficiency in light of the alleged wrongdoing." (*Id.* at p.5).

ARGUMENT

A. Statement #2 Sufficiently Pleads A Claim For Defamation

False Statement #2 states: "They [Scottsdale] are one of the few brokers left that have continued to allow the deposit and sale of shares of illiquid penny stocks. Larger brokers and discount brokers stopped allowing that over five years ago."

1. The Court Has Already Held That Statement #2 Is Sufficiently Pleaded

In its ruling on Defendants' Previous Motion, the Court held:

> [Statement #2] is inherently defamatory by implying the practices of Scottsdale Capital Advisors is not in line with others in its field. The statement would likely affect the opinions of its viewers, even if not illegal, that the practices by the Plaintiff are unusual and not for the betterment of its clients. For this reason, this statement is likely false and defamatory.

(October 4 Order at p.8). The Court affirmed its ruling in the October 25 Order, holding that there was no palpable error by the Court. The Court should therefore deny Defendants' **third attempt** to have Statement #2 dismissed.

2. The Current Motion Should Be Denied Because It Seeks The Same Relief Based Upon The Same Facts As The Previous Motion

MCR 2.612(C) provides limited bases for challenging a court's order, such as fraud, mistake, or newly discovered facts. *See Moore v. Vines*, No. 221846, 2001 WL 684561, at *1 (Mich. Ct. App. June 15, 2001) ("The doctrine of *res judicata* generally precludes relitigation of matters already decided absent certain compelling circumstances, such as those specified in MCR 2.612(C)."). Similarly, MCR 2.119(F) allows for reconsideration of an order based upon a

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showing of "palpable error by which the court and parties have been misled and that a different disposition would result from correction of the error." *Burda Bros, Inc. v. Wayne Cty. Prosecutor*, No. 250487, 2005 WL 156621, at *3 (Mich. Ct. App. Jan. 25, 2005).

Michigan courts routinely deny motions that seek the same relief based upon the same facts as an earlier motion. In *Burda Bros, Inc.*, the Court of Appeals upheld a trial court's denial of a plaintiff's third motion for attorney fees, stating:

> Plaintiffs' third motion for attorney fees pleaded virtually identical facts and requested the same substantive relief as plaintiffs' second motion for attorney fees, when the court ruled against them. We, therefore, agree with the trial court's treatment of plaintiffs' third motion for attorney fees as a motion for reconsideration of the court's decision on their second motion for attorney fees.

No. 250487, 2005 WL 156621, at *3 (Mich. Ct. App. Jan. 25, 2005).

In *Ortega v. Trudel*, the defendant brought a motion to remove a court-appointed counselor and to reinstate certain parenting time. After that motion was denied, the defendant filed a second motion seeking the same relief. The trial court awarded sanctions pursuant to MCR 2.114(D)(3) and (E) (holding that the motion was interposed for an improper purpose, such as "to harass or to cause unnecessary delay or needless increase in the cost of litigation"). After the defendant appealed, the Court of Appeals upheld the sanctions, stating, "Under the circumstances, we conclude that the court's action was proper." No. 239744, 2003 WL 22018391, at *1 (Mich. Ct. App. Aug. 26, 2003).

The Current Motion seeks the same relief based upon the same facts as Defendants' Previous Motion. Because the Court already ruled that there was no palpable error with its earlier ruling, the purpose of the Current Motion is clearly to harass and needlessly increase the cost of litigation. Consequently, in denying Defendants' Current Motion, the Court should also award sanctions pursuant to MCR 2.114.

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3. Statement #2 Is False And Defamatory

Lest there be any mistake, Statement #2 is, in fact, false and defamatory.

As stated in Scottsdale's Opposition to the Previous Motion, Statement #2 is false because numerous large brokers continue to trade in penny stocks, including without limitation, interactive brokers, Merrill Lynch, Charles Schwab, Cor Clearing, and TradeKing. (SAC ¶ 13).

Statement #2 is defamatory because it implies that Scottsdale is doing something that "larger brokers and discount brokers stopped allowing" five years earlier. Statement #2 paints Scottsdale as a pariah company, engaging in trades that other company do not "allow." The statement therefore lowers Scottsdale in the esteem of the community and deters people from dealing with it. *See Locricchio v. Evening News Ass'n*, 438 Mich. 84, 115 (1991) (a defamatory statement "tends so to harm the reputation of persons so as to lower them in the estimation of the community or to deter others from associating or dealing with them").

The Court should therefore deny the Current Motion regarding Statement #2.

B. Statement #1 Sufficiently Pleads A Claim For Defamation

Statement #1 states: "If you have followed penny stocks and pump and dumps for a few years then you know Scottsdale Capital Advisors." Scottsdale alleges that this statement is false and defamatory when read in context:

> False Statement #1 is immediately preceded by the headline: "FINRA fines Scottsdale Capital Advisors $1.5 million." This juxtaposition makes it appear that SCA [Scottsdale] was fined $1.5 million for its involvement in the pump and dump of penny stocks. Given the placement of False Statement #1 under a headline regarding a $1.5 million fine by FINRA, a reader could only conclude that SCA was fined for its involvement in a pump and dump. Moreover, the Article quotes extensively from a FINRA decision that has nothing to do with any pump and dump scheme. In addition, False Statement #1 falsely alleges and/or implies that SCA is so heavily involved in the illegal pump and dump of penny stocks that it is identified and known by the association. This is

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> false. Because SCA has never been involved in any "pump and dump" schemes, has never been a defendant in any "pump and dump" lawsuits, has never been charged by FINRA or any regulatory agency with involvement in a "pump and dump" scheme, and has never been fined for its involvement in a "pump and dump", the implications created by False Statement #1 in the context of the Article are false and defamatory.

SAC ¶ 13(a).

A cause of action for defamation by implication occurs when the defamatory implications of a statement are materially false, and "that such a cause of action might succeed even without a direct showing of any actual literally false statements." *Hawkins v. Mercy Health Servs., Inc.*, 230 Mich. App. 315, 329-30, 583 N.W.2d 725, 731 (1998). "[E]ven if defendant's statements were true, if the implications the statements created were false, the question of whether the statements were defamatory must be left up to the jury." *Am. Transmission, Inc. v. Channel 7 of Detroit, Inc.*, 239 Mich. App. 695, 702 (2000). "Direct accusations or inferences of criminal conduct or wrongdoing are not protected as opinion. There is no First Amendment protection for a charge which could reasonably be understood as imputing specific criminal conduct or other wrongful acts." *Hodgins v. Times Herald Co.*, 169 Mich. App. 245, 253-54 (1988) (internal citations omitted).

1. Statement #1 Is Not Mere "Opinion"

Defendants attempt to evade liability by claiming that Statement #1 is mere "opinion," when it clearly is not.

Statement #1 is immediately preceded by the headline: "FINRA fines Scottsdale Capital Advisors $1.5 million." This juxtaposition can "reasonably be understood as imputing specific criminal conduct" to Scottsdale, namely: that Scottsdale was fined $1.5 million for its involvement in the pump and dump of penny stocks. In fact, **Scottsdale has never been fined for its involvement in a pump and dump scheme**.

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Defendant's inference of criminal conduct is not protected opinion, and its Current Motion should be denied.

2. Statement #1 Implies Something False

Defendants next try to evade liability by arguing that Statement #1 is not false. Defendants' argument must fail because Statement #1 falsely implies that Scottsdale was fined $1.5 million for its involvement in the pump and dump of penny stocks. Given the placement of Statement #1 under a headline regarding a $1.5 million fine by FINRA, a reader could reasonably conclude that Scottsdale was fined for its involvement in a pump and dump. Consequently, the implications created by Statement #1 are false.

3. Statement #1 Is Defamatory

Defendants' final argument—that Statement #1 is not defamatory—is a strawman argument that ignores the controlling legal standard.

First, as stated above, "There is no First Amendment protection for a charge which **could reasonably be understood** as imputing specific criminal conduct or other wrongful acts." *Hodgins*, 169 Mich. App. at 253-54 (emphasis added). Instead of addressing this legal standard, Defendants dispute Scottsdale's allegation in the SAC that, "Given the placement of False Statement #1 under a headline regarding a $1.5 million fine by FINRA, a reader could only conclude that [Scottsdale] was fined for its involvement in a pump and dump." Although Scottsdale genuinely believes that a reader "could only conclude" something defamatory, the standard for defamation by implication is much more lax, and Defendants fail to address this more lax standard. Put simply, because of the placement of Statement #1 under a headline regarding a $1.5 million fine by FINRA, a reader **could reasonably conclude** that Scottsdale was fined for its involvement in a pump and dump, when in fact, it was not.

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Second, Defendants misconstrue defamation by implication. When Statement #1 is read in context, it falsely implies that Scottsdale was fined $1.5 million for its involvement in a pump and dump. Statement #1 is immediately followed by Statement #2, which the Court already held "is inherently defamatory by implying the practices of Scottsdale Capital Advisors is not in line with others in its field." Defendants argue that a link to a 111-page FINRA ruling later in the article "provides the context" for their false and defamatory statements. However, by the time a reader arrives at that link, the damage has been done: Defendants have already falsely accused Scottsdale of being fined $1.5 million for its involvement in a pump and dump and of engaging in practices not in line with others in its field.

Third, Defendants mischaracterize the FINRA ruling to which the article linked. The 111-page FINRA ruling concerned a purported violation of Section 5 of the Securities Act relating to the sale of unregistered securities—not Scottsdale's involvement in a pump and dump scheme.[2]

In sum, Statement #1 is false, defamatory, and not mere opinion. The Court should therefore not dismiss Statement #1.

C. The SAC Sufficiently Pleads Fault

Defendants argue that the SAC does not plead facts sufficient to show that Defendants acted negligently. Defendants are wrong.

The Court already addressed this argument in the October 4 Order, holding:

> If the Defendants were journalist[s] that work within the realm of the investment banking, as they do, then they would likely know if the statements were intentionally false. . . . If this court deems the statements to be false, then it consequently also determines that the

[2] Defendants argue that Scottsdale conflates committing fraud with being a tool of fraud. (Current Motion at p.12). Defendants are grasping at straws, as Statement #1 falsely implies that Scottsdale was fined $1.5 million for its involvement in a pump and dump scheme.

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> Defendant's actions were negligent when reporting false statements. Because of this, only the falsity or defamatory nature will need to be assessed per statement within the Complaint.

(October 4 Order at pp.6-7).

The Court gave two reasons for its holding: (1) the doctrine of *res ipsa loquitor*, and (2) Defendants' refusal to retract, correct, or apologize for the statements. (*Id.*)

In their Current Motion, Defendants do not dispute that their refusal to retract, correct, or apologize for the false statements demonstrates fault, thereby conceding that the SAC sufficiently pleads fault on that basis.

Defendants' claim that "no Michigan court has ever applied *res ipsa loquitor* to a claim for defamation" ignores the fact that the Court already ruled on this exact same argument in the October 4 Order. Further, in the October 25 Order, the Court held that its application of *res ipsa loquitor* was not palpable error. The Court should therefore deny Defendants' **third attempt** to argue that the SAC insufficiently pleads fault.[3]

D. Leave To Amend Should Be Granted If Necessary

Leave to amend a pleading "shall be freely given when justice so requires." MCR 2.118(A)(2). "Michigan's court rule regarding the amendment of pleadings provides for a liberal handling of requests to amend." *Clapham v. Yanga*, 102 Mich. App. 47, 52 (1980).

Should the Court determine that the SAC is somehow lacking, Scottsdale respectfully requests an opportunity to amend.

CONCLUSION

As demonstrated herein, the SAC alleges sufficient facts to state causes of action for Defamation against Defendants. Therefore, the Current Motion should be denied.

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[3] Defendants' request for the exact same relief based on the exact same facts as before is sanctionable per MCR 2.114. *See Ortega*, 2003 WL 22018391, at *1.

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Local Counsel for Plaintiff

Dated: November 29, 2018

By:

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9TH JUDICIAL CIRCUIT
COUNTY OF KALAMAZOO
KALAMAZOO, MICHIGAN

STATE OF MICHIGAN
KALAMAZOO COUNTY CIRCUIT COURT

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

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v.

MORNINGLIGHTMOUNTAIN, LLC, MICHAEL GOODE, and DOES 1-10,

Defendants.

File No.: 2018—0153-CZ

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PROOF OF SERVICE

Erika Dech, Legal Assistant at Pinsky, Smith, Fayette & Kennedy LLP, states that on November 29, 2018, she served PLAINTIFF'S RESPONSE IN OPPOSITION TO MOTION FOR SUMMARY DISPOSITION OF SECOND AMENDED COMPLAINT upon Joseph E. Richotte, BUTZEL LONG, PC, 41000 Woodward Avenue, Bloomfield Hills, MI 48304 and Jordan D. Susman, HARDER LLP, 132 South Rodeo Dr., 4th Floor, Beverly Hills, CA 90212 via first class mail, postage prepaid.

Erika Dech

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FILED
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9TH JUDICIAL CIRCUIT
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KALAMAZOO, MICHIGAN

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DEFENDANTS' REPLY IN SUPPORT OF MOTION FOR SUMMARY DISPOSITION OF SECOND AMENDED COMPLAINT

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I. SANCTIONS GAMESMANSHIP: Scottsdale is hoping the Court will reflexively apply its earlier rulings without carefully reviewing the new legal arguments raised in support of Defendants' arguments.

Scottsdale notes that Defendants raise arguments similar to those raised in their motion to dismiss the original complaint. Looking to avoid the new dimensions of those arguments, Scottsdale pronounces them to be "the same" and therefore worthy of sanctions.[1] Defendants explain *infra* the nuances that Scottsdale missed, showing Scottsdale's position to be meritless. While Scottsdale accuses Defendants of "clearly" trying to harass it by re-raising these arguments, Defendants are offering the Court an opportunity to correct errors of law and supplying the bases to do so.

Of course, even if Defendants had raised the exact same arguments without adding to them, doing so would have been proper to preserve the arguments for appeal. The new complaint *supersedes* the original complaint. MCR 2.118(A)(4). The original complaint is "abandoned and withdrawn." *Grzesick* v. *Cepela*, 237 Mich. App. 554, 562 (1999). Thus, the Court's earlier rulings are of no practical effect *for appellate purposes*. Any appeal would review the Court's ruling on the new complaint. So, in order to preserve their challenges to the Court's earlier rulings, Defendants must re-raise them here. *Cf. id.* at 562–563.

Regardless, Scottsdale's request is just poor form. It missed the 14-day deadline the Court imposed to file its new complaint. (Exhibit 1, Motion Hr'g Tr. 40:13–15 (Aug. 22, 2018).) Rather than force Scottsdale to file a motion to explain why it missed the deadline, Defendants consented to the filing as a matter of professional courtesy. Asking for sanctions over a matter of issue preservation is an exercise in repaying mercy with malice.

---

[1] Scottsdale erroneously contends that Rule 2.612(C) applies to bar Defendants from raising "the same" arguments. The Rule "applies only to *final* judgments and *final* orders," not interlocutory orders like the one the Court previously entered that do not dispose of the entire case. *McDaniel* v. *Jackson*, 78 Mich. App. 218, 223 (1977).

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II. SPECIAL STANDARD OF REVIEW: Scottsdale ignores the new points raised in support of Defendants' contention that a special standard applies to defamation cases.

Although the Court previously ruled that the special standard of review in defamation cases is limited to cases involving public officials and public figures, (Order at 4), Defendants offer case law proving that the special standard also applies in private-figure cases. (Motion at 6, citing *Rouch II*, 440 Mich. at 272–27 (1992) (in a private-figure case reviewed on appeal from a (C)(10) ruling, Justice Riley noted that the pleadings in a defamation case are also to be reviewed with heightened scrutiny when challenged under (C)(8)); *Trost* v. *BuckStop Lure Co., Inc.*, 249 Mich. App. 580, 587 n.2 (2002) (observing, in a private-figure case, that Justice Riley out-lined the proper procedure for (C)(8) challenges); *Royal Palace Homes, Inc.* v. *Channel 7 of Detroit, Inc.*, 197 Mich. App. 48, 52–53 (1992) (in another apparently private-figure case: "Justice Riley's position is consistent with previous decisions of this Court.") Scottsdale offers no critique of these cases.

III. STATEMENT NO. 1: Scottsdale has not responded to Defendants' arguments.

Falsity. Defendants argue that Statement No. 1 is opinion in the form of rhetorical hyperbole that cannot be proven false. Scottsdale does not deny that it was connected to two other pump-and-dump schemes in the years preceding publication of the Article. Indeed, the 111-page FINRA report specifically identifies those other schemes, a Panamanian-based pump-and-dump in 2008–2012 and Bahamian-based pump-and-dump in 2008. (Answer Exh. A, FINRA Rpt. at 11–12 and nn. 18 and 20, with links to Securities & Exchange Commission enforcement actions concerning those schemes in *Ruettiger*, *Gibraltar*, and *Tavella*.) The report explains that, in accepting penny stocks for deposit in those schemes, Scottsdale failed to exercise its gatekeeping role to safeguard against being used by its customers as a means to execute a pump-and-dump fraud.[2] So, anyone

[2] Scottsdale's failure to adequately police the Biozoom transaction and halt the pump-and-dump scheme through vigorous due diligence—as it was required to have done by law under SEC Rule 17a-8, the Bank Secrecy Act ("BSA"), and its implementing regulations, *see* BSA, 31 U.S.C. § 5311, *et seq.*; 31 C.F.R. § 1023.320(a)(2) ("SAR Rule"); and 17 C.F.R. 240.17a-8 (SEC regulation requiring brokers to follow the BSA and its rules) (for a convenient summary with links to applic-

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following pump-and-dump schemes over the previous years would be familiar with Scottsdale. As noted in Defendants' opening briefs, the challenged statement thus amounts to "everyone knows" about the connection—which is classic rhetorical hyperbole that is not actionable. (Defs.' Br. at 10 (citing *Komarov* v. *Advance Magazine Publ'rs, Inc.*, 691 N.Y.S.2d 298, 301-302 (NY Sup. Ct. 1999)). Scottsdale doesn't deny that it lacks the ability to objectively prove that those who followed such schemes did *not* know of Scottsdale.

Defamatory Meaning. Scottsdale harps on the juxtaposition between the headline and the first sentence. It essentially concedes that anyone reading the linked FINRA report would understand the context of the challenged statement, but that the "damage is done" before the reader gets to the FINRA report. (Opp'n at 9.) That's like saying the reader can't be expected to read the entire text if the article is too long. *But that isn't the law.* In making these assessments, a court must read the challenged statement in context, fairly and reasonably construing *the entire article* to determine whether the challenged statement is libelous. *Sanders* v. *Evening News Ass'n*, 313 Mich. 334, 340 (1946); *Croton* v. *Gillis*, 104 Mich. App. 104, 108 (1981).

Although Scottsdale wants to emphasize the "could reasonably be understood" standard, it ignores that a person is not responsible for every defamatory implication a reader might draw from his report of true facts, *absent evidence that he intended the defamatory implication.*" *Royal Palace Homes,*

---

able law, visit https://www.sec.gov/about/offices/ocie/amlsourcetool.htm)—signaled to FINRA that Scottsdale had not heeded lessons of its earlier roles in pump-and-dump schemes. It considered this an aggravating factor, which formed a basis for the $1.5 million fine:

> Finally, although [Scottsdale] was not charged in ... *Ruettiger*, *Gibraltar I*, *Gibraltar II*, and *Tavella*, those cases did involve alleged misconduct through accounts at [Scottsdale]. These cases put [Scottsdale] on notice of the risk of sham transactions and the use of nominees to conceal beneficial ownership and facilitate unlawful distributions of securities. They heightened the need for [Scottsdale] to be alert to red flags. *In light of this history, it is aggravating that Scottsdale performed its gatekeeping function so poorly.*

(Answer Exh. A, FINRA Rpt. 104 at §IV.A(1)(d) (emphasis supplied). Accordingly, it is Scottsdale that mischaracterizes the FINRA report by suggesting the report and the fine have nothing to do with Scottsdale's role in pump-and-dump schemes. (*See* Opp'n at 9 and n.2.)

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Inc. v. *Channel 7 of Det., Inc.*, 197 Mich. App 48, 56 (1992). A statement "does not become actionable merely because it could be taken out of context." *Nehls* v. *Hillsdale Coll.*, 178 F. Supp. 2d 771, 779 (ED Mich. 2001), *aff'd* 65 Fed. Appx. 984 (CA6 2003). The new complaint alleges no facts that show Goode intended the defamatory implication Scottsdale has pleaded.

IV. STATEMENT NO. 2: Scottsdale has not responded to Defendants' arguments.

Defendants argue that Scottsdale has failed to sufficiently plead that Statement No. 2 is false because: (1) the statement says Scottsdale is one of the few remaining brokers that both accept *deposits* of penny stocks *and trade* them; but (2) Scottsdale only identifies brokers who *trade* in penny stocks. (Compl. ¶13b.) In its opposition, Scottsdale does not dispute Defendants' argument that *depositing* shares and *selling* shares are distinct activities. Nowhere in the new complaint does SCA identify *any* other brokers who still accept shares for *deposit*. Therefore, it has not sufficiently alleged that the statement as written—"deposit *and* sale"—is false.

In addition, Scottsdale alleges that Statement No. 2 is *per se* defamatory because it implies Scottsdale engages in business activities that are not allowed. (Compl. ¶ 22; Opp'n Br. at 6, § A.3) In their opening brief, Defendants cited *Bufalino*, in which the Supreme Court held that saying someone is in a particular line of business is not defamatory, if it is a "perfectly legitimate business"—*i.e.*, a legal one. (Defs.' Br. at 13 (citing *Bufalino* v. *Maxon Bros., Inc.*, 368 Mich. 140, 151–152 (1962)). Scottsdale does not dispute that it operates a business authorized by law. Thus, *Bufalino* is fatal to its claim for defamation by implication. Rather than acknowledge this, or make any attempt to distinguish *Bufalino*, Scottsdale merely emphasizes the alleged "implication" that it serves a niche market that others have chosen to abandon.

V. FAULT: It is still improper for Scottsdale to rely on its retraction demand to plead fault, and Scottsdale admits no other court has ever applied *res ipsa loquitur*.

The only fact that Scottsdale purportedly pleads in support of its fault allegation is that the Article remains on the website after Scottsdale served a retraction demand. (Opp'n at 9.) Fault is assessed *at the time of the publication*. *Peisner* v. *Detroit Free Press*, 104 Mich. App. 59, 64 (1981), mod.

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on other grounds, 421 Mich. 125 (1984). For Scottsdale's pleading to sufficiently allege fault, each new day the Article remains on the website would have to constitute a republication of the Article—that way, Goode could be negligent for republishing the article after receiving the retraction demand. *But that is not the law.* Michigan follows the single-publication rule for Michigan. *Mitan* v. *Campbell*, 474 Mich. 21, 24–25 (2005). Applying the single-publication rule, the Michigan Court of Appeals has held that leaving allegedly defamatory material on a website is *not* a new publication each day it remains online. *Roberts* v. *Detroit Pub. Schs.*, No. 269414, 2007 WL 127791, at *3 (Mich. App. Jan. 18, 2007) (unpublished).

On the issue of *res ipsa loquitur*, Scottsdale has not pointed to any other court that has applied this doctrine in a defamation case. Nor has it disputed Defendants' explanation for why it is improper to do so. It simply asks the Court to unthinkingly apply its earlier, incorrect ruling. The Court should take this opportunity to revisit this legal issue.

CONCLUSION

For these reasons, and those in their opening brief, Defendants respectfully request that the Court dismiss the new complaint with prejudice.

Respectfully submitted,

BUTZEL LONG, P.C.

Dated: December 7, 2018

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THE COURT: Yes.

MR. KURTZ: --if you'll entertain those.

My interpretation is if we want to amend on those other statements we can. Do we want to send some kind of deadline or--or have that--

THE COURT: Yeah.

MR. KURTZ: --as part of the order as well?

THE COURT: I--I think--yeah, I think that probably makes some sense.

I--I--. Well, yeah, we getting--we getting the end of vacation seasons.

So, we'll do 14-days to amend, and then if you do amend the defendant has, under the rules, a period of time to respond--to file an answer.

MR. KURTZ: And, to be somewhat (inaudible) it sounds like you had to prepare a written something--

THE COURT: Something--something written--

MR. KURTZ: --or--

THE COURT: --I will--. What I can do is--I can whip this up. Technically, as this is a business court case you're entitled to have a document prepared and I will so prepare it and issue that opinion.

MR. KURTZ: I--I really appreciate that, because we didn't have the forethought of having a court recorder

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FILED
DEC 10 2018
8TH JUDICIAL CIRCUIT
COUNTY OF KALAMAZOO
KALAMAZOO, MICHIGAN

In the Kalamazoo County Circuit Court
For the State of Michigan

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff,

v.

MORNINGLIGHTMOUNTAIN, LLC, MICHAEL GOODE, and DOES 1–10,

Defendants.

Civil No. 18-0153-CZ

HON. ALEXANDER C. LIPSEY

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PROOF OF SERVICE

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Michelle L. Guardiola hereby states that on December 7, 2018, she served a copy of Defendants' Reply in Support of Motion for Summary Disposition of Second Amended Complaint and this Proof of Service via Federal Express, addressed to Plaintiff's counsel at the following addresses:

HARDER LLP Charles J. Harder (CA# 184593) Jordan D. Susman (CA# 246116) 132 South Rodeo Drive, Fourth Floor Beverly Hills, California 90212 jsusman@harderllp.com Tracking No. 7739 0922 1559	PINSKY, SMITH, FAYETTE & KENNEDY, LLP H. Rhett Pinsky (P18920) 146 Monroe Center St., NW, Suite 805 Grand Rapids, Michigan 49503 hrpinsky@sbcglobal.net Tracking No. 7739 0922 7730

I declare that under the penalty of perjury that the statements above are true to the best of my information, knowledge and belief.

BUTZEL LONG

Michelle L. Guardiola

MICHELLE L. GUARDIOLA

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In the Court of Appeals
For the State of Michigan

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff-Appellee,

v.

MORNINGLIGHTMOUNTAIN, LLC, and MICHAEL GOODE,

Defendants-Appellants,

–and–

DOES 1–10,

Defendants–Not Participating.

Docket No.

Kalamazoo County Circuit Court
Case No.: 18-0153-CZ
HON. ALEXANDER C. LIPSEY

APPLICATION FOR LEAVE TO PURSUE AN INTERLOCUTORY APPEAL

APPELLANT'S APPENDIX VOLUME VI

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STATE OF MICHIGAN
IN THE CIRCUIT COURT FOR THE COUNTY OF EATON

SCOTTSDALE CAPITAL ADVISORS CORP., an Arizona corporation, Plaintiff, v. MORNINGLIGHTMOUNTAIN, LLC, a Michigan limited liability company d/b/a GoodeTrades.com; MICHAEL GOODE, an individual; and DOES 1-10, inclusive, Defendants.	CASE NO. 2018—0153-CZ Hon. Alexander C. Lipsey

PLAINTIFF'S THIRD AMENDED COMPLAINT AND JURY DEMAND

Plaintiff Scottsdale Capital Advisors Corp., for its Complaint against MorningLightMountain, LLC d/b/a GoodeTrades.com and Michael Goode, alleges as follows:

INTRODUCTION

1. Plaintiff Scottsdale Capital Advisors Corp. ("SCA") is a successful securities broker-dealer.

2. In an effort to smear SCA's reputation, MorningLightMountain, LLC d/b/a GoodeTrades.com and Michael Goode (collectively, "Defendants") published an article on their website, www.goodetrades.com, which contained false, defamatory, and highly misleading statements of and concerning SCA. Among other things, the articles falsely alleged that SCA is involved in penny stock "pump and dump" schemes and improperly permits the deposit and sale of penny stocks.

3. By this action, SCA seeks to clear its good name and hold Defendants liable for

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the harm caused by their misconduct.

THE PARTIES

4. Plaintiff Scottsdale Capital Advisors Corp. is, and at all times relevant hereto was, a corporation organized under the laws of the State of Arizona, with its principal place of business in Maricopa County, Arizona.

5. SCA is informed and believes and based thereon alleges that Defendant MorningLightMountain, LLC d/b/a GoodeTrades.com ("MorningLightMountain") is, and at all times relevant hereto was, a corporation organized under the laws of the Michigan, with its principal place of business in Eaton County, Michigan. SCA is informed and believes and based thereon alleges that MorningLightMountain owns and operates the website goodetrades.com.

6. SCA is informed and believes and based thereon alleges that Defendant Michael Goode ("Goode") is an individual who resides in Kalamazoo County, Michigan. Upon information and belief, Goode is the sole owner and officer of Defendant MorningLightMountain.

7. SCA is informed and believes and based thereon alleges that the fictitiously-named defendants sued herein as Does 1 through 10, and each of them, are in some manner responsible or legally liable for the actions, events, transactions and circumstances alleged herein. The true names and capacities of such fictitiously-named defendants, whether individual, corporate, or otherwise, are presently unknown to SCA, and SCA will seek leave of Court to amend this Complaint to assert the true names and capacities of such fictitiously-named defendants when the same have been ascertained. For convenience, each reference to a named defendant herein shall also refer to Does 1 through 10. All defendants, including MorningLightMountain, LLC d/b/a GoodeTrades.com, Michael Goode, and those referred to herein as Does 1 through 10, are collectively referred to herein as "Defendants."

JURISDICTION AND VENUE

8. This Court has personal jurisdiction over Defendants because they have minimum contacts with the State of Michigan, and defendant Goode is a domiciliary of the State of

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Michigan.

9. Venue in Kalamazoo County is proper because Defendant Goode resides in Kalamazoo County.

10. The amount in controversy exceeds Twenty Five Thousand Dollars ($25,000.00) exclusive of interest, costs, and attorney fees and the matter is otherwise within the jurisdiction of this Court.

FACTS COMMON TO ALL CAUSES OF ACTION

11. Founded in 2002, SCA is a full service broker-dealer focused on serving the microcap securities market, often referred to as the OTC market. In this time, SCA has grown to become one of the dominant companies in the OTC market, with more than $125 million worth of trades in 2015.

12. On April 17, 2017, Defendants published an article written by Goode on the website goodettrades.com, entitled "FINRA fines Scottsdale Capital Advisors $1.5 million" (the "Article"): https://www.goodetrades.com/2017/04/finra-fines-scottsdale-capital-advisors-1-5-million/. A true and correct copy of the Article is attached hereto as **Exhibit 1** and incorporated by this reference.

13. The Article contained statements that are defamatory and outright false, including: "If you have followed penny stocks and pump and dumps for a few years then you know Scottsdale Capital Advisors" (False Statement #1")

14. False Statement #1 is immediately preceded by the headline: "FINRA fines Scottsdale Capital Advisors $1.5 million." To a reasonable reader, this juxtaposition makes it appear that SCA was fined $1.5 million for its involvement in the pump and dump of penny stocks. This is false. In fact, FINRA fined SCA $1.5 million for allegedly violating FINRA Rule 2010 by selling securities without registration and without an exemption – this fine is presently being appealed. The Article disingenuously quotes extensively from the FINRA decision, which has nothing to do with any pump and dump scheme, further giving the impression that SCA was fined for its involvement in a pump and dump.

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15. In addition, False Statement #1 falsely alleges and/or implies that SCA is so heavily involved in the illegal pump and dump of penny stocks that it is identified and known by the association. This is also demonstratively false. If people who "followed penny stocks and pump and dumps for a few years" were polled, most respondents would not be aware of SCA. Because SCA has never been involved in any "pump and dump" schemes, has never been a defendant in any "pump and dump" lawsuits, has never been charged by FINRA or any regulatory agency with involvement in a "pump and dump" scheme, has never been fined for its involvement in a "pump and dump", and has never been either identified or known as being involved in the illegal pump and dump of penny stocks, the implications created by False Statement #1 in the context of the Article are false and defamatory.

16. On September 21, 2017, SCA's counsel sent a letter to Defendants identifying the foregoing false statements in the Article, and demanding that Defendants remove each one and publish a retraction, correction, and apology as to each of those statements. Defendants have failed and refused to comply with SCA's demand.

17. The false, defamatory, and highly misleading statements written and published by Defendants have caused and are continuing to cause SCA economic harm and damage to its reputation. Accordingly, SCA has no alternative but to file this lawsuit for compensatory damages, punitive damages, and injunctive relief, as explained more fully herein.

COUNT ONE

(Against All Defendants)

(Defamation)

18. SCA incorporates by reference all of the preceding paragraphs as though fully restated herein.

19. Defendants wrote and published False Statement #1.

20. False Statement #1, whether by itself or by implication, is false or involves materially false implications.

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21. Moreover, the statement, individually and jointly, tends to harm the reputation of Plaintiff as to lower its reputation in the community or deter third persons from associating or dealing with it. Specifically, False Statement #1 accuses SCA of illegal, unsavory, and unusual business activity – engaging in the pump and dump of penny stocks.

22. At a minimum, Defendants were negligent in creating the implication in False Statement #1 that FINRA fined SCA $1.5 million for participating in illegal pump and dump schemes. In the Article, Defendants cite to a Stockwatch article and a 111-page FINRA decision as support for False Statement #1, but a plain reading of both of these documents indicates that FINRA fined SCA for selling securities without registration and without an exemption, as required by FINRA Rule 2010, and not for participating in illegal pump and dump schemes. A reasonable journalist reads the documents he cites and would not report, or imply that, a fine for procedural noncompliance is the equivalent of a fine for intentional pump and dump activity.

23. Defendants intended, or acted with reckless disregard for the truth, to cause the reasonable reader to read False Statement #1 and conclude that FINRA fined SCA $1.5 million for participating in illegal pump and dump schemes by juxtaposing certain facts together and by purposefully omitting that the FINRA fine was for SCA "violat[ing] FINRA Rule 2010 by selling securities without registration and without an exemption."

24. Defendants were also negligent in making False Statement #1. Defendants, as journalists in the penny stock industry, knew or should have known that SCA has not been charged by any regulatory agency with involvement in a "pump and dump" scheme, has never been fined for its involvement in a "pump and dump", and has never been either identified or known as being involved in the illegal pump and dump of penny stocks. Defendants had no reason to conclude that followers of penny stock pump and dumps would have any knowledge of SCA, yet published a statement specifically to that affect.

25. Defendants intended, or acted with careless disregard for the truth, to cause the reasonable reader to read False Statement #1 and conclude that SCA is such a major player in penny stock pump and dumps that it is commonly associated with such activity.

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26. False Statement #1 has caused SCA to be damaged.

27. Defendants have refused to retract, correct or apologize for False Statement #1 after being given notice and ample time to do so.

28. As a direct and proximate result of Defendants' conduct, SCA has suffered damages to its reputation and business interests in an amount to be determined at trial, and in an amount not less than the jurisdictional minimum of this Court. SCA's damages may also be presumed because False Statement #1 imputes to SCA offenses regarded by public opinion as involving moral turpitude, and unfitness for the proper conduct of its lawful business, trade, and profession.

29. SCA is a private figure for purposes of a defamation analysis.

30. Notwithstanding SCA's status as a private figure, at the time False Statement #1 was published, Defendants knew the False Statement #1 was false and/or acted in reckless disregard of whether False Statement #1 was true or false. As such, in addition to compensatory damages and/or presumed damages, SCA is entitled to an award of punitive damages in an amount to be determined at trial.

JURY TRIAL DEMAND

SCA hereby demands a jury trial of all issues in this case.

PRAYER FOR RELIEF

WHEREFORE, SCA requests that judgment be entered against the Defendants, and each of them, as follows:

A. For compensatory, consequential, exemplary, and punitive damages in an amount to be determined at trial;

B. For pre- and post-judgment interest on the foregoing sum at the highest lawful rate from entry of judgment until paid in full;

C. For an injunction enjoining further publication of False Statement #1;

D. For SCA's costs of suit; and

E. For all other relief the Court deems appropriate.

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RESPECTFULLY SUBMITTED this 11th day of January 2019.

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In the Kalamazoo County Circuit Court
For the State of Michigan

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff,

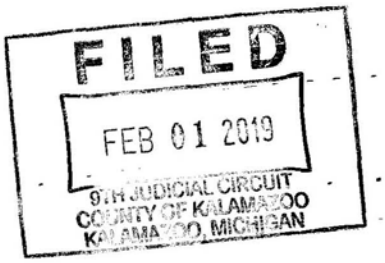
v.

MORNINGLIGHTMOUNTAIN, LLC, MICHAEL GOODE, and DOES 1-10,

Defendants.

Civil No. 18-0153-CZ

HON. ALEXANDER C. LIPSEY



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DEFENDANTS' JOINT ANSWER TO THIRD AMENDED COMPLAINT

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Under MCR 2.108, Defendants MorningLightMountain, LLC ("MLM"), and Michael Goode jointly answer Plaintiff Scottsdale Capital Advisors Corp.'s Third Amended Complaint as follows:

INTRODUCTION

1. Plaintiff Scottsdale Capital Advisors Corp. ("SCA") is a successful securities broker-dealer.

ANSWER: MLM and Goode admit that SCA is a broker-dealer of securities. They deny the allegation that SCA is a "successful" broker-dealer for lack of knowledge or information sufficient to form a belief about whether it is true.

2. In an effort to smear SCA's reputation, MorningLightMountain, LLC d/b/a GoodTrades.com and Michael Goode (collectively, "Defendants") published an article on their website, www.goodetrades.com, which contained false, defamatory, and highly misleading statements of and concerning SCA. Among other things, the articles falsely alleged that SCA is involved in penny stock "pump and dump" schemes and improperly permits the trading of penny stocks.

ANSWER: MLM admits that it operates the website www.goodetrades.com (the "Website"). MLM admits that it published, and Goode admits that he caused MLM to publish, an article on the Website. MLM and Goode deny the rest of the allegations in Paragraph 2 as untrue.

3. By this action, SCA seeks to clear its good name and hold Defendants liable for the harm caused by their misconduct.

ANSWER: Denied as untrue. SCA's primary purpose in initiating this strategic lawsuit against public participation is to harass or injure MLM and Goode; SCA has no reasonable basis to believe that the facts underlying its legal position are true; and/or SCA's legal position is devoid of arguable merit.

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THE PARTIES

4. Plaintiff Scottsdale Capital Advisors Corp. is, and at all times relevant hereto was, a corporation organized under the laws of the State of Arizona, with its principal place of business in Maricopa County, Arizona.

ANSWER: MLM and Goode deny these allegations for lack of knowledge or information sufficient to form a belief about whether they are true.

5. SCA is informed and believes and based thereon alleges that Defendant MorningLightMountain, LLC d/b/a GoodeTrades.com ("MorningLightMountain") is, and at all times relevant hereto was, a corporation organized under the laws of the [State of] Michigan, with its principal place of business in Eaton County, Michigan. SCA is informed and believes and based thereon alleges that MorningLightMountain owns and operates the website goodtrades.com.

ANSWER: MLM and Goode deny these allegations as untrue. In the interest of judicial economy, however, MLM admits the following: (1) it is a limited liability corporation organized under the laws of the State of Michigan; (2) its principal place of business is Kalamazoo County; and (3) it operates the Website.

6. SCA is informed and believes and based thereon alleges that Defendant Michael Goode ("Goode") is an individual who resides in Kalamazoo County, Michigan. Upon information and belief, Goode is the sole owner and officer of Defendant MorningLightMountain.

ANSWER: MLM and Goode admit these allegations, except the allegation that Goode is an officer of MLM. As a limited liability company, MLM does not have officers.

7. SCA is informed and believes and based thereon alleges that the fictitiously-named defendants sued herein as Does 1 through 10, and each of them, are in some manner responsible or legally liable for the actions, events, transactions and circumstances alleged

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herein. The true names and capacities of such fictitiously-named defendants, whether individual, corporate, or otherwise, are presently unknown to SCA, and SCA will seek leave of Court to amend this Complaint to assert the true names and capacities of such fictitiously-named defendants when the same have been ascertained. For convenience, each reference to a named defendant herein shall also refer to Does 1 through 10. All defendants, including MorningLightMountain, LLC d/b/a GoodeTrades.com, Michael Goode, and those referred to herein as Does 1 through 10, are collectively referred to herein as "Defendants."

ANSWER: MLM and Goode lack knowledge or information sufficient to form a belief about whether the Doe defendants exist or have engaged in any acts giving rise to liability. For purposes of answering the Third Amended Complaint, MLM and Goode treat the term *Defendants* as applying only to them. None of their answers shall be construed to admit the existence or liability of the Doe defendants or to in any way answer for the Doe defendants.

JURISDICTION AND VENUE

8. This Court has personal jurisdiction over Defendants because they have minimum contacts with the State of Michigan, and defendant Goode is a domiciliary of the State of Michigan.

ANSWER: Denied as pleaded, but in the interest of judicial economy, MLM and Goode submit to the personal jurisdiction of the Court without objection.

9. Venue in Kalamazoo County is proper because Defendant Goode resides in Kalamazoo County.

ANSWER: MLM and Goode admit this allegation.

10. The amount in controversy exceeds Twenty Five Thousand Dollars ($25,000.00) exclusive of interest, costs, and attorney fees and the matter is otherwise

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within the jurisdiction of this Court.

ANSWER: MLM and Goode admit that SCA seeks to recover an amount in excess of $25,000, but they deny that SCA is entitled to any recovery.

FACTS COMMON TO ALL CAUSES OF ACTION

11. Founded in 2002, SCA is a full service broker-dealer focused on serving the microcap securities market, often referred to as the OTC market. In this time, SCA has grown to become one of the dominant companies in the OTC market, with more than $125 million worth of trades in 2015.

ANSWER: MLM and Goode admit that SCA is a broker-dealer that services the microcap securities market, which is often referred to as the OTC [over-the-counter] market. MLM and Goode deny the rest of the allegations in Paragraph 11 for lack of knowledge or information sufficient to form a belief about whether they are true.

12. On April 17, 2017, Defendants published an article written by Goode on the website goodtrades.com, entitled "FINRA fines Scottsdale Capital Advisors $1.5 million" (the "Article"): https://goodetrades.com/2017/04/finra-fines-scottsdale-capital-advisors-1-5-million/. A true and correct copy of the Article is attached hereto as Exhibit 1 and incorporated by this reference.

ANSWER: MLM admits that it published, and Goode admits that he caused MLM to publish the Article on the Website. They deny that Exhibit 1 is a true and correct copy of the Article because it was not served upon them with the Complaint; they therefore cannot assess its content. In the interest of judicial economy, however, MLM and Goode attach a true and correct copy of the Article as Exhibit A.

13. The Article contained statements that are defamatory and outright false, including: "If you have followed penny stocks and pump and dumps for a few years then you know Scottsdale Capital Advisors." ("False Statement #1").

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ANSWER: MLM and Goode admit that the Article contained the quoted sentence. They deny SCA's characterization of the quoted sentence as false and defamatory as untrue. They also deny SCA's allegation that other statements in the Article are false and defamatory as untrue.

14. False Statement #1 is immediately preceded by the headline: "FINRA fines Scottsdale Capital Advisors $1.5 million." To a reasonable reader, this juxtaposition makes it appear that SCA was fined $1.5 million for its involvement in the pump and dump of penny stocks. This is false. In fact, FINRA fined SCA $1.5 million for allegedly violating FINRA Rule 2010 by selling securities without registration and without an exemption—this fine is presently being appealed. The Article disingenuously quotes extensively from the FINRA decision, which has nothing to do with any pump and dump scheme, further giving the impression that SCA was fined for its involvement in a pump and dump.

ANSWER: MLM and Goode admit that the Article contained the quoted headline, that the Article quoted from the FINRA decision, and that SCA—after the Article was published and after filing this lawsuit—appealed the $1.5 million fine that FINRA imposed for selling securities without registration and without an exemption, which appeal remains pending before the U.S. Securities & Exchange Commission. MLM and Goode deny as untrue the rest of the allegations in Paragraph 14.

15. In addition, False Statement #1 falsely alleges and/or implies that SCA is so heavily involved in the illegal pump and dump of penny stocks that it is identified and known by the association. This is also demonstratively false. If people who "followed penny stocks and pump and dumps for a few years" were polled, most respondents would not be aware of SCA. Because SCA has never been involved in any "pump and dump" schemes, has never been a defendant in any "pump and dump" lawsuits, has never been charged by FINRA or any regulatory agency with involvement in "pump and dump"

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scheme, and has never been fined for its involvement in a "pump and dump", and has never been either identified or known as being involved in the illegal pump and dump of penny stocks, the implications created by False Statement #1 in the context of the Article are false and defamatory.

ANSWER: MLM and Goode deny as untrue SCA's characterization of the challenged statement at issue as false and defamatory or that it creates a false and defamatory implication. MLM and Goode also deny as untrue SCA's allegation that most people who have followed penny stock pump-and-dump schemes would deny being aware of SCA if polled. MLM and Goode deny the rest of the allegations in Paragraph 15 for lack of knowledge or information sufficient to form a belief as to whether they are true.

16. On September 21, 2017, SCA's counsel sent a letter to Defendants identifying the foregoing false statements in the Article, and demanding that Defendants remove each one and publish a retraction, correction, and apology as to each of those statements. Defendants have failed and refused to comply with SCA's demand.

ANSWER: MLM and Goode admit that SCA's counsel sent a letter to them on September 12, 2017 demanding, among other things, that they remove the certain statements, including the challenged statement identified in Paragraph 13, and publish a retraction, correction, and apology. A true and correct copy of this letter is attached to this Answer as Exhibit B.

MLM and Goode responded on September 13, 2017. A true and correct copy of their response is attached to this Answer as Exhibit C.

MLM and Goode admit that they did not remove the statements or publish a retraction, correction, or apology. They deny that the statements are false or that they had any duty to comply with SCA's demand. MLM and Goode deny the rest of the allegations in Paragraph 16 as untrue in the manner and form stated.

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17. The false, defamatory, and highly misleading statements written and published by Defendants have caused and are continuing to cause SCA economic harm and damage to its reputation. Accordingly, SCA has no alternative but to file this lawsuit for compensatory damages, punitive damages, and injunctive relief, as explained more fully herein.

ANSWER: MLM and Goode deny as untrue all of the allegations in Paragraph 17. Answering further, SCA has admitted in answers to Interrogatories that it has suffered no actual economic harm or compensatory damages and cannot identify a single customer it has lost because of the challenged statement identified in Paragraph 13.

COUNT 1
DEFAMATION

18. SCA incorporates by reference all of the preceding paragraphs as though fully restated herein.

ANSWER: MLM and Goode incorporate by reference all of their answers to the preceding paragraphs as though fully restated herein.

19. Defendants wrote and published False Statement #1.

ANSWER: Goode admits to writing, and MLM admits to publishing the challenged statement identified in Paragraph 13, but they deny that the statement is false. MLM and Goode deny as untrue the rest of the allegations in Paragraph 19.

20. False Statement #1, whether by itself or by implication, is false or involves materially false implications.

ANSWER: MLM and Goode deny as untrue all of the allegations in Paragraph 20.

21. Moreover, the statement, individually and jointly, tends to harm the reputation of Plaintiff as to lower its reputation in the community or deter third persons

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from associating or dealing with it. Specifically, False Statement #1 accuses SCA of illegal, unsavory, and unusual business activity—engaging in the pump and dump of penny stocks.

ANSWER: MLM and Goode deny as untrue all of the allegations in Paragraph 21.

22. As a minimum, Defendants were negligent in creating the implication in False Statement #1 that FINRA fined SCA $1.5 million for participating in illegal pump and dump schemes. In the Article, Defendants cite to a Stockwatch article and a 111-page FINRA decision as support for False Statement #1, but a plain reading of both of these documents indicates that FINRA fined SCA for selling securities without registration and without an exemption, as required by FINRA Rule 2010, and not for participating in illegal pump and dump schemes. A reasonable journalist reads the documents he cites and would not report, or imply that, a fine for procedural noncompliance is the equivalent of a fine for intentional pump and dump activity.

ANSWER: MLM admit that the Article cites to a Stockwatch article and a 111-page FINRA decision as support for the challenged statement identified in Paragraph 13. They deny as untrue that the challenged statement implies FINRA fined SCA $1.5 million for participating in illegal pump-and-dump schemes, much less negligently so. SCA's allegation about what a reasonable journalist would or would not do is an allegation of law that requires no response. If the Court determines that a response is required to that allegation, MLM and Goode deny that it is an accurate statement of the governing legal standard.

23. Defendants intended, or acted with reckless disregard for the truth, to cause the reasonable reader to read False Statement #1 and conclude that FINRA fined SCA $1.5 million for participating in illegal pump and dump schemes by juxtaposing certain facts together any by purposefully omitting that the FINRA fine was for SCA "violat[ing] FINA Rule 2010 by selling securities without registration and without an exemption."

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ANSWER: MLM and Goode deny as untrue all of the allegations in Paragraph 23. Answering further, the Article does disclose that the FINRA fine concerned violations of Rule 2010 and Section 5 of the Securities Act. (*See* Exhibit A at 1, Excerpt ¶ 2.)

24. Defendants were also negligent in making False Statement #1. Defendants, as journalists in the penny stock industry, knew or should have known that SCA has not been charged by an regulatory agency with involvement in a "pump and dump" scheme, has never been fined for its involvement in a "pump and dump," and has never been either identified or known as being involved in the illegal pump and dump of penny stocks. Defendants had no reason to conclude that followers of penny stock pump and dumps would have any knowledge of SCA, yet published a statement specifically to that affect [sic].

ANSWER: MLM and Goode deny as untrue that they negligently made the challenged statement identified in Paragraph 13. They admit that Goode is a journalist who writes about the penny-stock industry. MLM and Goode deny as untrue the rest of allegations in Paragraph 24.

25. Defendants intended, or acted with careless disregard for the truth, to cause the reasonable reader to read False Statement #1 and conclude that SCA is such a major player in penny stock pump and dumps that it is commonly associated with such activity.

ANSWER: MLM and Goode deny as untrue all of the allegations in Paragraph 25.

26. False Statement #1 has caused SCA to be damaged.

ANSWER: MLM and Goode deny as untrue the allegation in Paragraph 26.

27. Defendants have refused to retract, correct, or apologize for False Statement #1 after being given notice and ample time to do so.

ANSWER: MLM and Goode admit that they did not retract the challenged statement identified in Paragraph 13. They deny that the statement is incorrect, false, or

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defamatory. The law does not require an apology. MLM and Goode deny that SCA gave them "ample time" to respond to SCA's demands. SCA demanded a response within 24 hours.

28. As a direct and proximate result of Defendants' conduct, SCA has suffered damages to its reputation and business interests in an amount to be determined at trial, and in an amount not less than the jurisdictional minimum of this Court. SCA's damages may also be presumed because False Statement #1 imputes to SCA offenses regard by public opinion as involving moral turpitude, and unfitness for the proper conduct of its lawful business, trade, and profession.

ANSWER: MLM and Goode deny as untrue all of the allegations in Paragraph 28.

29. SCA is a private figure for purposes of a defamation analysis.

ANSWER: MLM and Goode deny as untrue the allegation in Paragraph 29.

30. Notwithstanding SCA's status as a private figure, at the time False Statement #1 was published, Defendants knew the False Statement #1 was false and/or acted in reckless disregard of whether False Statement #1 was true or false. As such, in addition to compensatory damages and/or presumed damages, SCA is entitled to an award of punitive damages in an amount to be determined at trial.

ANSWER: MLM and Goode deny as untrue all of the allegations in Paragraph 30.

AFFIRMATIVE AND OTHER DEFENSES

Under MCR 2.111(F), MLM and Goode assert the following special, affirmative, and other defenses that may apply in whole or in part to the claims that SCA purports to assert in the Third Amended Complaint, without assuming the burden of proof on any matters where the burden rests with SCA or any other party.

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MLM and Goode give notice that they lack knowledge or information sufficient to form a belief as to the truth of many of the allegations in the Third Amended Complaint. Until they avail themselves of their rights to discovery, they cannot determine which, if any, of the following defenses will be asserted at trial or by dispositive motion. These defenses are pleaded to preserve MLM and Goode's right to assert them at trial or by motion, to give fair notice of their intention to assert these defenses, and to avoid a waiver of any defenses.

MLM and Goode reserve the right to assert all special, affirmative, and other defenses that may appear or become available during discovery in this case. They also reserve the right to amend their Answer under MCR 2.118(A)(1), or to seek leave from the Court to amend their Answer under MCR 2.118(A)(2) if necessary, to assert such defenses.

Subject to the foregoing, SCA's claims and requests for relief are barred in whole or in part for one or more of the following reasons:

1. The Complaint fails to state a claim upon which relief can be granted.

2. The challenged statement is not actionable because it is hyperbole or otherwise a statement of opinion, not a statement of fact.

3. The challenged statement is not materially false.

4. The challenged statement is not defamatory.

5. The challenged statement is not "of and concerning" SCA.

6. SCA has failed to plead fault with the specificity required by law.

7. SCA is a public figure for purposes of this lawsuit.

8. If SCA is a public figure, the challenged statement is not actionable because MLM and Goode did not know the statement was false.

9. If SCA is a public figure, the challenged statement is not actionable because MLM and Goode did not act with reckless disregard for whether it was false (*i.e.*, with "actual malice").

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10. If SCA is a public figure, the challenged statement is not actionable because SCA cannot prove, with clear and convincing evidence, that MLM and Goode published the statement with actual malice.

11. If SCA is a private figure, the challenged statement is not actionable because MLM and Goode did not negligently publish it.

12. The challenged statement is privileged under the statutory fair-report privilege codified at M.C.L. § 600.2911.

13. The challenged statement is privileged under the common-law fair-comment privilege.

14. The challenged statement does not give rise to any defamatory inference or innuendo because of the omission of material facts.

15. The challenged statement is a matter of legitimate public interest and concern and received from reliable and official sources, and is privileged under (*a*) the common law and statutes of Michigan; (*b*) Article I, Section 5 of the Michigan Constitution of 1963; and (*c*) the First Amendment to the U. S. Constitution.

16. SCA is libel-proof.

17. The incremental-harm doctrine prevents SCA from recovering damages.

18. MLM and Goode are not the proximate cause of any damages SCA claims to have suffered; SCA or persons other than MLM and Goode caused SCA's damages.

19. SCA is barred from recovering punitive and/or exemplary damages because that would violate Article I, Section 5 of the Michigan Constitution of 1963 and the First Amendment to the United States Constitution.

20. SCA cannot sue on the challenged statement under the doctrine of judicial estoppel.

21. SCA cannot sue on the challenged statement under the doctrine of collateral estoppel.

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22. SCA is not entitled to presumed damages.

23. SCA has suffered no damages.

24. If SCA was damaged as alleged, then SCA is limited to its actual damages because it has failed to plead and prove that Defendants acted with actual malice.

25. If SCA was damaged as alleged, then SCA failed to reasonably mitigate its damages.

26. All special, affirmative, and other defenses asserted by a Doe defendant who becomes identified or by any other defendant later added to this action, which MLM and Goode adopt and incorporate as additional defenses.

RELIANCE ON JURY DEMAND

MLM and Goode rely on SCA's demand for a jury trial on all issues that can be tried to a jury, but object to SCA's demand for a jury trial on its request for injunctive relief. There is no right to a trial by jury on equitable issues. *Smith* v. *University of Detroit*, 145 Mich. App. 468 (1985).

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RELIEF REQUESTED

WHEREFORE, MLM and Goode respectfully request that the Court:

1. DISMISS the Third Amended Complaint with prejudice;

2. DECLARE this lawsuit "frivolous" within the meaning of MCR 2.114(F), MCR 2.625(A)(2), and MCL 600.2591, and AWARD Defendants their reasonable attorney fees and costs. SCA's primary purpose in initiating this strategic lawsuit against public participation is to harass or injure MLM and Goode; SCA has no reasonable basis to believe that the facts underlying its legal position are true; and/or SCA's legal position is devoid of arguable merit.

3. Grant such other and further relief as it deems appropriate.

Respectfully submitted,

BUTZEL LONG, P.C.

Dated: JANUARY 29, 2019

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FINRA fines Scottsdale Capital Advisors $1.5 million

April 17, 2017 | By Michael Goode | All Categories, Fraud, Microcap, SEC actions

If you have followed penny stocks and pump and dumps for a few years then you know Scottsdale Capital Advisors (hereafter referred to as Scottsdale Capital). They are one of the few brokers left that have continued to allow the deposit and sale of shares in illiquid penny stocks. Larger brokers and discount brokers stopped allowing that over five years ago. When the big Biozoom (BIZM) pump happened back in 2013 many of the frozen accounts were at Scottsdale Capital.

On March 31st, FINRA fined Scottsdale Capital $1.5 million. Unfortunately I cannot find any public posting of that news so the prior link is to a Stockwatch article (full article only available to subscribers; see this copy if not a subscriber). In addition to the fine, John Hurry, owner of Scottsdale Capital, was permanently banned from working in the securities industry.

The full 111-page FINRA decision can be found on their website. Unfortunately FINRA prevents direct-linking so you need to go to http://disciplinaryactions.finra.org/Search/ and then enter "John Hurry" as the name. I have downloaded a copy of the decision in case they delete it.

Excerpt from the decision:

> Hurry's violation of his duty to observe high standards of commercial honor and just and equitable principles of trade was purposeful and egregious. These two qualities lead us to conclude that Hurry is a threat to investors and the integrity of the markets. Our concern is compounded by our credibility findings. We found that he repeatedly testified falsely, and that there was a pattern of doing so when he thought no contradictory evidence would come to light.

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> When misconduct is intentional, General Principle 1 provides that adjudicators should 572 assess sanctions that exceed the recommended range in the Guidelines. Principal Consideration 13 also focuses on whether a respondent's misconduct is the result of an intentional act, recklessness, or negligence.573 When a violation is egregious, the Guidelines often suggest more severe sanctions. In egregious cases in connection with violations of Rule 2010 and Section 5, the specific Guidelines recommend that an individual be suspended for up to two years or barred.
>
> Even though he has no disciplinary history, the devious nature of Hurry's violation evidences disregard for regulatory requirements, an aggravating factor under General Principle 2 and Principal Consideration 10.574 We have no confidence that if he remained in the securities industry he would not again devise a way to evade the law and regulatory requirements. For this reason also, we believe Hurry is a threat to the investing public.

The decision also shows just how remunerative running Scottsdale Capital has been for Hurry — in 2014 he and his wife made "approximately $6.2 million in directors' fees and $1.45 million in net income."

Disclaimer. No position in any stocks mentioned and I have no relationship with anyone mentioned in this post. This blog has a *terms of use* ***that is incorporated by reference into this post; you can find all my disclaimers and disclosures there as well.***

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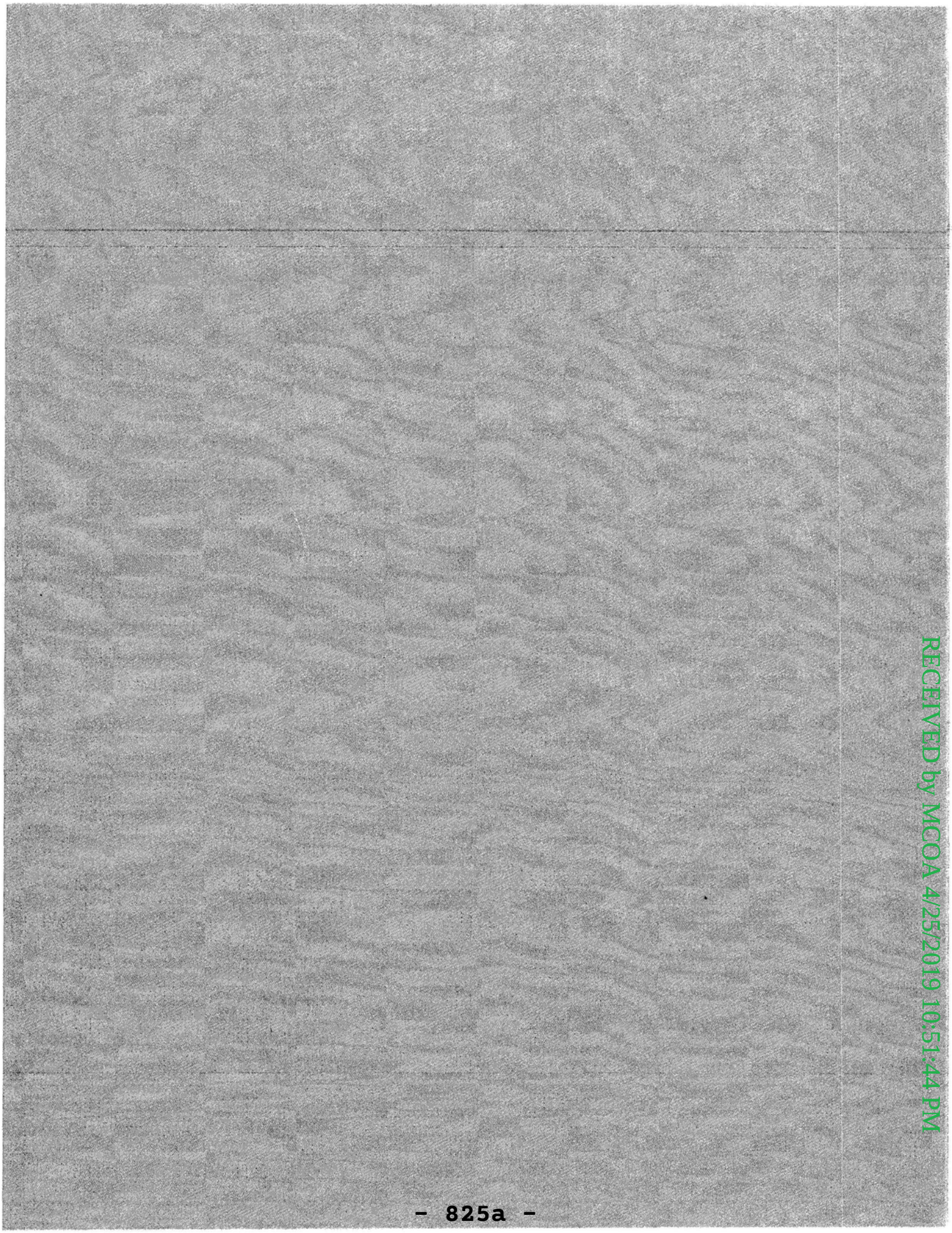

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SEC Freezes accounts used in illegal sales of unregistered shares of Biozoom $BIZM

July 3, 2013 | By Michael Goode | All Categories, All Categories, Fraud, Microcap, Stock Promotions, Very Important Posts

Earlier today the SEC announced that it froze accounts of eight different Argentinians who had illegally sold unregistered shares of Biozoom (BIZM). Two others who had not yet sold shares also had their accounts frozen. A week ago the SEC suspended trading in Biozoom. See my original post on the Biozoom promotion as well as the Promotion Stock Secrets post on the individuals behind the promotion.

SEC press release
SEC complaint

The sheer number of shares sold and the profits involved are impressive. Here is a good description of what transpired from the SEC press release:

> The SEC's complaint alleges that from March to June 2013, the ten defendants received more than 20 million shares of Entertainment Art, which was one-third of the company's total outstanding shares. In a one-month period beginning in mid-May, eight of them sold more than 14 million shares. The sales yielded almost $34 million, of which almost $17 million was wired to overseas bank accounts. Their U.S. brokerage accounts, which include approximately $16 million in cash, are subject to the asset freeze.

The ten defendants in the litigation are: Magdalena Tavella, Andres Horacio Ficicchia, Gonzalo Garcia Blaya, Lucia Mariana Hernando, Cecilia De Lorenzo, Adriana Rosa Bagattin, Daniela Patricia Goldman and Mariano Pablo Ferrari

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(Mariano Graciarena and Fernando Loureyro are also named but had not yet sold shares). The defendants claimed to have purchased shares in Biozoom (then known as Entertainment Art Inc.) from the company's original seed shareholders between November 2012 and March 2013, but those shareholders had already sold all their shares back in 2009.

Despite the SEC's quick action, over $17m in illicit profits were already wired overseas and are now beyond the reach of American authorities. Most likely none of the individuals whose names appeared on the accounts were behind the fraud. It is believed by many that Francisco Abellan has controlled scheme from the start.

The US brokerages used by the defendants are well-known to everyone who is familiar with the penny stock world: Legend Securities and Scottsdale Capital Advisors.

For further details, I suggest reading Promotion Stock Secret's post on this litigation (same post as here).

Disclaimer: I am net long 1700 shares of BIZM (long 11,700 shares in one account and short 10,000 shares in another account); I have no positions in any other stock mentioned and no relationship with any parties mentioned above. This blog has a *terms of use* ***that is incorporated by reference into this post; you can find all my disclaimers and disclosures there as well.***

4 thoughts on "SEC Freezes accounts used in illegal sales of unregistered shares of Biozoom $BIZM"

Michael Goode says:

July 21, 2013 at 5:41 pm

BIZM got a DTC/ DTCC global lock. Read more about that here: http://promotionstocksecrets.com/what-are-dtc-chills-and-locks-and-how-can-they-affect-me/

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xerty says:

July 22, 2013 at 3:37 am

Do you know who gets stuck holding the bag for these illegal/unregistered stock sales? Clearly these guys walked with $17M, but is it their trade counter parties, the brokers who accepted the shares, or someone else who gets stiffed?

Michael Goode says:

July 22, 2013 at 11:48 am

That is a good question. In this case the shares they sold did exist (share counterfeiting happens sometimes) although they were not free-trading. So the trades stand and whoever bought those shares still has them. It is too late to go back and bust the trades made days or weeks ago.

xerty says:

July 24, 2013 at 11:40 am

So I guess it's the average shareholder of the company who lost, since they just got diluted by the addition of these new, duplicate shares. In fact, they got diluted for the full $34M amount, not just the $17M amount the criminals escaped with, since the funds seized by the SEC tend to go to the Treasury if they can't figure out a directly harmed party to reimburse. With 60M shares outstanding, this scam resulted in a 1/3 loss of value for prior shareholders.

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Press Release

SEC Obtains Freeze on Proceeds from Unlawful Distribution of Biozoom Securities

FOR IMMEDIATE RELEASE
2013-122

Washington, D.C., July 3, 2013 — The Securities and Exchange Commission today announced charges against eight Argentine citizens who unlawfully sold millions of shares of Biozoom, Inc. in unregistered transactions. The SEC also obtained an emergency order to freeze assets in the U.S. brokerage accounts of the eight defendants and two other Argentine citizens who had Biozoom shares but had not yet sold them. The action follows last week's suspension of trading in Biozoom due to concerns that some shareholders may be unlawfully distributing its securities.

Biozoom, formerly Entertainment Art, Inc., announced in April that it was changing its name and moving from producing leather bags to developing biomedical technology. The SEC's complaint alleges that from March to June 2013, the ten defendants received more than 20 million shares of Entertainment Art, which was one-third of the company's total outstanding shares. In a one-month period beginning in mid-May, eight of them sold more than 14 million shares. The sales yielded almost $34 million, of which almost $17 million was wired to overseas bank accounts. Their U.S. brokerage accounts, which include approximately $16 million in cash, are subject to the asset freeze.

The SEC's complaint, filed in U.S. District Court in Manhattan, charges the eight defendants — Magdalena Tavella, Andres Horacio Ficicchia, Gonzalo Garcia Blaya, Lucia Mariana Hernando, Cecilia De Lorenzo, Adriana Rosa Bagattin, Daniela Patricia Goldman and Mariano Pablo Ferrari — along with two others, Mariano Graciarena and Fernando Loureyro, who received shares but have yet to sell them.

"Today's action, along with the SEC's trading suspension order last week, demonstrate the SEC's ability and commitment to act swiftly to halt ongoing illegal conduct and preserve assets," said Antonia Chion, Associate Director in the SEC's Division of Enforcement.

According to the SEC's complaint, when the defendants deposited the Biozoom stock into their U.S. brokerage accounts, they claimed to have acquired the bulk of the shares in March 2013 from Entertainment Art shareholders who purchased them in private placements that began in 2007. Each of the defendants provided stock purchase agreements between them and the former shareholders purportedly signed by the defendants and those shareholders. The SEC alleges that the documents were false because the Entertainment Art investors had sold all of their stock in the company in 2009, almost four years earlier. The defendants' shares of Biozoom were deposited into their accounts as shares that purportedly could be freely traded and the defendants sold them even though no registration statement was filed with the SEC for any of the sales transactions, in violation of U.S. law.

In addition to the temporary restraining order and asset freeze granted by the court, the SEC is seeking preliminary and permanent injunctions, return of the selling defendants' allegedly ill-gotten sale proceeds, and civil penalties. The SEC also seeks preliminary and permanent injunctions against the non-selling defendants, Graciarena and Loureyro, because of the likelihood that both defendants will offer or sell their Biozoom shares to the public in violation of the registration requirements of U.S. securities law.

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Ricky Sachar, Scott Lowry, Deborah Tarasevich, Jennie Krasner, and Robert Nesbitt conducted the SEC's investigation, which is continuing. Patrick M. Bryan will lead the litigation. The SEC acknowledges the assistance of the Financial Industry Regulatory Authority (FINRA).

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Related Materials

- SEC Complaint

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13 CIV 4609

JUDGE BUCHWALD

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

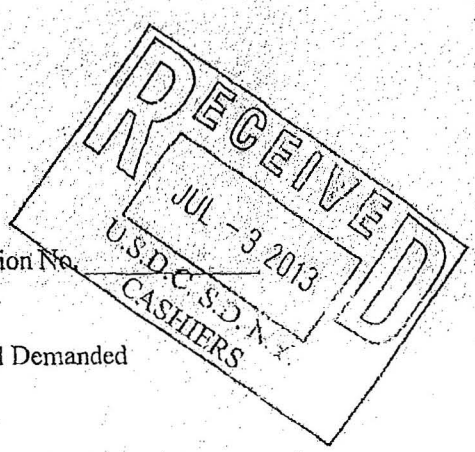
SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

MAGDALENA TAVELLA, ANDRES HORACIO FICICCHIA, GONZALO GARCIA BLAYA, LUCIA MARIANA HERNANDO, CECILIA DE LORENZO, ADRIANA ROSA BAGATTIN, DANIELA PATRICIA GOLDMAN, MARIANO PABLO FERRARI, MARIANO GRACIARENA, and FERNANDO LOUREYRO,

Defendants.



Civil Action No.

Jury Trial Demanded

COMPLAINT

Plaintiff Securities and Exchange Commission (the "Commission") for its Complaint alleges as follows:

1. The Commission brings this civil law enforcement action against Magdalena Tavella, Andres Horacio Ficicchia, Gonzalo Garcia Blaya, Lucia Mariana Hernando, Cecilia De Lorenzo, Adriana Rosa Bagattin, Daniela Patricia Goldman, and Mariano Pablo Ferrari (collectively, the "Selling Defendants") on an emergency basis to prevent millions of dollars of proceeds from unlawful sales of securities being transferred out of the country. Over the past month, the Selling Defendants have sold almost $34 million worth of securities in Biozoom, Inc. ("Biozoom") (f/k/a Entertainment Art, Inc.), a penny stock company traded on the Over-the-Counter Bulletin Board ("OTCBB"), and

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millions more shares are sitting in defendants' brokerage accounts and likely to be sold unlawfully to the public. No registration statement was in effect for the Selling Defendants' resale of securities, thus their sales were in violation of Section 5 of the Securities Act of 1933 (the "Securities Act") [15 U.S.C. § 77e]. Further, almost $17 million of the Selling Defendants' ill-gotten proceeds have been transferred out of the United States. Unless an asset freeze covering the Selling Defendants' Biozoom shares is issued, the unlawful sales of securities and transfer or dissipation of the proceeds from sales of the securities will likely continue.

2. The Commission also brings this civil law enforcement action against Mariano Graciarena and Fernando Loureyro. These defendants recently deposited over a total of approximately 4.4 million shares of Biozoom stock into their respective brokerage accounts. Like the shares sold by the Selling Defendants, there is no registration statement in effect permitting the lawful resale of the Biozoom shares held by Graciarena and Loureyro. Because Graciarena and Loureyro are likely to engage in the sale of securities in violation of Section 5 of the Securities Act, the Commission seeks to enjoin them from offering for resale their Biozoom shares until such time as a registration statement is filed and in effect.

3. From March 2013 to June 2013, defendants opened brokerage accounts at broker-dealers and deposited millions of shares of Biozoom, Inc. (f/k/a Entertainment Art, Inc.) that they claimed did not bear a restrictive legend and were free-trading shares. All of the defendants claimed that they had purchased all or some of their shares from some of the original shareholders of Entertainment Art in transactions between November 2012 and March 2013.

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4. To bolster their claims, each of the defendants submitted stock purchase agreements dated between November 2012 and March 2013 that purportedly evidenced their purchase of Entertainment Art stock from the former Entertainment Art shareholders. Based on these stock purchase agreements and other documentation, the defendants – between March 2013 and June 2013 – deposited a total of 20,130,000 shares of Biozoom into their brokerage accounts.

5. The defendants could not, however, have purchased any of their shares from the original Entertainment Art shareholders as they claimed because those shareholders ceased to have any interest in the company on or around May 2009 –more than ***three years*** earlier than the defendants' claimed purchases.

6. Almost immediately after defendants deposited shares of Biozoom in their brokerage accounts, Biozoom began issuing a series of press releases and a stock promotional campaign for the company began. Following these press releases and stock promotional campaign, from May 16, 2013 to June 21, 2013, the company's stock price and volume increased dramatically. For example, prior to May 16, 2013, no shares in Biozoom had traded. However, from May 16, 2013 to June 21, 2013, Biozoom's stock price shot past $4 per share, with total volume of more than 87 million shares.

7. During this same period, eight of the defendants sold millions of Biozoom shares into the rising market — reaping millions of dollars in proceeds as a result. In total, over an approximately one month period from May 16, 2013 – June 17, 2013, eight of the defendants sold a total of over 14 million shares of Biozoom stock into the public markets for proceeds of almost $34 million.

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8. None of these sales were made pursuant to an effective registration statement. By engaging in the foregoing conduct, the eight Selling Defendants violated the registration provisions of the federal securities laws, Sections 5(a) and 5(c) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. 15 U.S.C. §§ 77e(a) and 77e(c)].

9. While the remaining two defendants – Graciarena and Loureyro – have yet to sell any of their Biozoom shares, they are likely to do so unless restrained. They recently deposited millions of shares into their respective brokerage accounts, claiming (as the other defendants) that these shares have no restrictive legend and are available for resale to the public. Therefore, the Commission seeks an order pursuant to Securities Act Section 20(b) [15 U.S.C. 77t(b)] to enjoin them from violations of Sections 5(a) and 5(c) of the Securities Act.

JURISDICTION AND VENUE

10. The SEC brings this action pursuant to Section 5 [15 U.S.C. § 77e] and Section 20(b) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. § 77t(b)]. Defendants have directly or indirectly made use of the means or instrumentalities of interstate commerce, or of the mails, or the facilities of a national securities exchange in connection with the acts, practices, transactions, and courses of business alleged in this Complaint.

11. This Court has jurisdiction over this action pursuant to Section 22 of the Securities Act [15 U.S.C. § 77v], and 28 U.S.C. § 1331.

12. Venue is proper in this Court pursuant to Section 22(a) of the Securities Act [15 U.S.C. §77v], because certain acts, practices, and courses of business constituting the violations alleged herein have occurred within the Southern District of New York.

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13. Defendants will, unless restrained and enjoined, continue to engage in the acts, practices, transactions, and courses of business alleged in this Complaint, or in acts, practices, transactions, and courses of business of similar purport and object.

THE DEFENDANTS

14. Defendant Andres Horacio Ficicchia resides in Buenos Aires, Argentina and is an Argentine citizen.

15. Defendant Gonzalo Garcia Blaya resides in Buenos Aires, Argentina, and is an Argentine citizen.

16. Defendant Luciana Mariana Hernando resides in Buenos Aires, Argentina, and is an Argentine citizen.

17. Defendant Cecilia De Lorenzo resides in Buenos Aires, Argentina, and is an Argentine citizen.

18. Defendant Magdalena Tavella resides in Buenos Aires, Argentina, and is an Argentine citizen.

19. Defendant Adriana Rosa Bagattin resides in Buenos Aires, Argentina, and is an Argentine citizen.

20. Defendant Daniela Patricia Goldman resides in Buenos Aires, Argentina, and is an Argentine citizen.

21. Defendant Mariano Pablo Ferrari resides in Buenos Aires, Argentina, and is an Argentine citizen.

22. Defendant Mariano Graciarena resides in Buenos Aires, Argentina, and is an Argentine citizen.

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23. Defendant Fernando Loureyro resides in Buenos Aires, Argentina, and is an Argentine citizen.

OTHER RELEVANT ENTITIES

24. Biozoom, Inc. (f/k/a Entertainment Arts, Inc.) is a Nevada corporation with its principal place of business in Kassel, Germany. Biozoom purports to be in the business of researching, developing, and licensing technologies relating to the mobile remote collection of biomedical data as well as bilateral diagnostic communication. Biozoom's common stock is registered with the Commission pursuant to Section 12 of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. §78l] and is quoted on the Over-the-Counter Bulletin Board ("OTCBB") under the trading symbol "BIZM."

25. Legend Securities ("Legend") is a registered broker-dealer located in New York, New York.

26. Scottsdale Capital Advisors ("Scottsdale") is a registered broker-dealer located in Phoenix, Arizona.

FACTUAL BACKGROUND

A. The Creation of Entertainment Art and Initial Sale of Company

27. On June 15, 2007, Entertainment Art was incorporated under the laws of the state of Nevada. In public filings, Entertainment Art represented that it was a developmental stage company formed to design, produce, and sell a line of leather bags, with offices located in West Hempstead, New York. Entertainment Art was controlled by the three members of company management.

28. From November 2007 through March 2008, Entertainment Art offered and sold a total of 610,000 shares to 34 different investors in private placement transactions.

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In the Court of Appeals
For the State of Michigan

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff-Appellee,

v.

MORNINGLIGHTMOUNTAIN, LLC, and MICHAEL GOODE,

Defendants-Appellants,

–and–

DOES 1–10,

Defendants–Not Participating.

Docket No.

Kalamazoo County Circuit Court
Case No.: 18-0153-CZ
HON. ALEXANDER C. LIPSEY

APPLICATION FOR LEAVE TO PURSUE AN INTERLOCUTORY APPEAL

APPELLANT'S APPENDIX VOLUME VII

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A share certificate reflecting Entertainment Art share ownership was issued to each investor.

29. On July 18, 2008, Entertainment Art filed a Form S-1 registration statement with the Commission to register the resale transactions for the 34 shareholders who acquired Entertainment Art stock in these private placements ("the Form S-1 Shareholders"). In particular, of the total 1,810,000 shares outstanding at the time of the Form S-1, Entertainment Art's S-1 covered 610,000, or approximately one-third, of the company's then outstanding shares.

30. The remaining 1,200,000 shares of Entertainment Art stock were held by the three company officers in three identical 400,000 share blocks.

31. On May 1, 2009, Entertainment Art announced, in a public filing with the Commission, that the three Entertainment Art officers sold their total 1,200,000 shares of Entertainment Art to Medford Financial Ltd. ("Medford Financial"), a Belizean entity, for a purchase price of $120,000.

32. Contrary to this disclosure, however, Medford Financial purchased more than 1,200,000 shares of Entertainment Art. In fact, Medford Financial also purchased all of the 610,000 shares that had been purchased by the Form S-1 shareholders. Thus, in this transaction, Medford Financial purchased *all* of the outstanding shares, including the shares then held by the Form S-1 Shareholders.

33. Each of the Form S-1 shareholders received their initial investment back, with an additional, small return on their investment. Thus, by on or around May 2009, each of the Form S-1 shareholders had no remaining shares or other interest in Entertainment Art.

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34. According to company filings, on June 30, 2009, Entertainment Art's board of directors approved the implementation of a 33:1 forward split for Entertainment Art stock without correspondingly increasing the authorized shares of common stock for Entertainment Art. On July 21, 2009, the forward split became effective, and as a result of the forward split, the company had 59,730,000 shares of common stock outstanding – which was ***all*** owned by Medford Financial.

B. Another Sale of Entertainment Art and Acquisition of Biozoom Technology

35. On October 25, 2012, Entertainment Art reported, in a public filing with the Commission, that on October 19 Medford Financial sold 39,600,000 common shares of Entertainment Art in a private transaction with Le Mond Capital for a purchase price of $430,000, which equates to approximately $0.01 per share.

36. Le Mond Capital purports to be a foreign entity based in the British Virgin Islands. As a result of the sale, Entertainment Art disclosed that Le Mond Capital controlled over 66.3% of the Company's issued and outstanding common stock.

37. However, on information and belief, Le Mond Capital purchased the ***entire*** company from Medford Financial – and all of 59,730,000 outstanding shares.

38. The owner of Le Mond Capital, Sara Deutsch, became Entertainment Art's new President, Chief Executive Officer, Principal Executive Officer, Treasurer, Chief Financial Officer, Secretary, Treasurer, and Director. On information and belief, Deutsch is a resident of Buenos Aires, Argentina.

39. From September 2011 to at least October 2012, Deutsch worked as a manager of Magdalena's Party. According to the business' website, Magdalena's Party is

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a restaurant located in Buenos Aires, Argentina. According to another website describing Magdalena's Party, it is co-owned by Deutsch, defendant Magdalena Tavella, and others.

40. On March 12, 2013, Entertainment Art filed a Form 8-K with the Commission in which it announced a dramatic change in its business operations from a company that developed fashionable leather bags to a company that was involved in the biomedical industry. In particular, Entertainment Art announced a transaction pursuant to which its newly formed subsidiary, Biozoom Technologies, Inc., acquired certain patents, licenses, and related assets from each of three separate companies: Opsolution Spectroscopic Systems, Opsolution NanoPhotonics, and Opsolution GmBH, (the "Opsolution acquisition") in exchange for cash of $50,000 and 39 million shares of Entertainment Art common stock.

41. Entertainment Art described that, through Biozoom, it was now in the business of "researching, developing, and licensing technologies relating to the mobile remote collection of biomedical data as well as bilateral diagnostic communication."

42. Entertainment Art further disclosed that – as of immediately after closing of the Opsolution acquisition and filing of the Form 8-K – Deutsch would step down as CEO and Chief Financial Officer of Entertainment Art, but would stay on as a Director only.

43. As a result of the transaction, the 59,730,000 outstanding shares of Entertainment Art were allocated in the following manner. First, Le Mond Capital returned 39,000,000 shares to the company, and then those 39,000,000 shares were allocated – as shares bearing a restrictive legend – to four entities that were associated with the Opsolution entities.

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44. Thus, after these allocations, 20,730,000 shares of Entertainment Art remained. Le Mond Capital retained 600,000 of these shares bearing a restrictive legend. The remaining 20,130,000 shares – which represented the total shares purchased by the Form S-1 Shareholders (and subsequently sold in the Medford Financial transaction on or around May 2009) – were unallocated.

45. On April 1, 2013, Entertainment Art changed its name to Biozoom, under the trading symbol "BIZM" on the OTC Bulletin Board.

C. Defendants Deposit Biozoom Shares In Their Newly Opened Brokerage Accounts

46. From January 2013 to May 2013, brokerage accounts were opened at Legend, a registered broker-dealer based in New York, in the name of four of the defendants: Ficicchia, Blaya, Hernando, and De Lorenzo.

47. In May 2013, brokerage accounts were opened at Scottsdale, a registered broker-dealer based in Phoenix, Arizona, in the name of another four defendants: Tavella, Bagattin, Goldman, and Ferrari.

48. According to the account opening documentation – and as reflected in the table below – with one exception, none of the defendants worked in fields related to securities.

Defendant	Profession
Ficicchia	Self-employed music producer
Blaya	Music producer-stock investments
Hernando	Marketing Manager
De Lorenzo	Self-employed marketing specialist

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Defendant	Profession
Tavella	Attorney practicing administrative, political, intellectual property, and patent law
Bagattin	Retired Teacher
Ferrari	Sales and Marketing
Goldman	Delicatessen owner

1. Accounts at Legend

Andres Horacio Ficicchia

49. Defendant Ficicchia opened his account at Legend on or about January 24, 2013 and funded the account with $26,000 cash.

50. On November 30, 2012, Entertainment Art's transfer agent issued an Entertainment Art certificate for 165,000 shares to Ficicchia.

51. On March 13, 2013, Entertainment Art's transfer agent issued an Entertainment Art certificate for 1,237,500 shares to Ficicchia.

52. The certificate for 1,237,500 shares was accompanied by a corporate certification stating that Deutsch certified – at a board meeting of Entertainment Art on March 22, 2013 – the company approved the issuance of that certificate to Ficicchia.

53. In order to deposit the certificate for 1,237,500 shares and the certificate of 165,000 shares of Entertainment Art into his brokerage account at Legend, defendant Ficicchia completed a "Deposit for Securities Request Certificate Questionnaire" that was required by Legend, and provided additional documentation.

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54. The documentation reflected that Ficicchia acquired the 1,237,500 shares pursuant to two private sales that were completed on February 19, 2013: (1) a purchase of 412,500 shares from Investor A and (2) a purchase of 825,000 shares from Investor B. The documentation also reflected that Ficicchia paid a total of approximately $6,300 for these shares, which equals approximately $.005 per share. For the following reasons, the documentation submitted by Ficicchia was false.

55. Investor A was one of the Form S-1 shareholders who had sold his shares of Entertainment Art on or around May 2009 – almost four years before Ficicchia's claimed purchase of shares from Investor A. Investor B was purportedly a shareholder that acquired its shares from some of the Form S-1 shareholders in 2011 – approximately two years after the Form S-1 shareholders actually sold their shares.

56. The documentation further reflected that Defendant Ficicchia acquired the 165,000 shares pursuant to a private sale that was completed on November 30, 2012 with Investor C – shares that he acquired for $24,750, which equals $0.15 per share. Investor C was also one of the Form S-1 Shareholders who had sold his shares of Entertainment Art on or around May 2009 – over three years before Ficicchia's claimed purchase of shares from Investor C.

57. On March 5, 2013, Ficicchia deposited 165,000 shares of Entertainment Art not bearing a restrictive legend into his brokerage account at Legend; and then on March 27, 2013, Ficicchia deposited an additional 1,237,500 shares (again not bearing a restrictive legend) – for a total of 1,402,500 shares.

58. On April 1, 2013, due to the name change of Entertainment Art to Biozoom, these shares became Biozoom shares. Thus, defendant Ficicchia held

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1,402,500 shares of Biozoom that were purportedly available to be sold on the public markets.

Gonzalo Garcia Blaya

59. On or about March 26, 2013, defendant Blaya opened an account at Legend and funded this account with $26,000 cash.

60. On March 22, 2013 – just four days prior to opening this account – Entertainment Art's transfer agent issued a certificate for 1,485,000 Entertainment Art shares to Blaya.

61. In order to deposit his certificate for 1,485,000 shares of Entertainment Art into his brokerage account at Legend, defendant Blaya completed a "Deposit for Securities Request Certificate Questionnaire" that was required by Legend, and provided additional documentation. For the following reasons, the documentation submitted by Blaya was false.

62. The documentation reflected that Blaya acquired the 1,485,000 shares in four separate private sales that were completed on March 4, 2013: (1) a purchase of 165,000 shares from Investor D; (2) a purchase of 495,000 shares from Investor E; (3) a purchase of 165,000 shares from Investor F; and (4) a purchase of 660,000 shares from Investor G. The documentation also reflected that Blaya paid a total of approximately $6,765 for these shares, which equals approximately $.005 per share.

63. Each of Investors D, E, F, and G were Form S-1 Shareholders who had sold their Entertainment Art shares on or around May 2009 – almost four years before Blaya's claimed purchase of shares from these investors.

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64. On April 16, 2013, Blaya deposited 1,485,000 shares of Entertainment Art not bearing a restrictive legend into his brokerage account at Legend. As a result of the business name change on April 1, 2013, these shares became Biozoom shares. Thus, defendant Blaya held 1,485,000 shares of Biozoom that were purportedly available to be sold on the public markets.

Luciana Mariana Hernando

65. On or about March 7, 2013, defendant Hernando opened an account at Legend and funded the account with $50,000 cash.

66. On March 22, 2013, Entertainment Art's transfer agent issued a certificate for 1,815,000 Entertainment Art shares to Hernando.

67. In order to deposit her 1,815,000 shares of Entertainment Art into her brokerage account at Legend, defendant Hernando completed a "Deposit for Securities Request Certificate Questionnaire" that was required by Legend, and provided additional documentation. For the following reasons, the documentation submitted by Hernando was false.

68. The documentation reflected that Hernando acquired the 1,815,000 shares pursuant to two separate private sales that were completed on March 5, 2013: (1) a purchase of 1,650,000 shares from Investor H; and (2) a purchase of 165,000 shares from Investor I. The documentation also reflected that Hernando paid a total of approximately $5,445 for these shares, which equals approximately $.003 per share.

69. Both Investors H and I were Form S-1 shareholders who had sold their Entertainment Art shares on or around May 2009 – almost four years before Hernando's claimed purchase of shares from these investors.

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70. On May 14, 2013, defendant Hernando deposited 1,815,000 shares of Entertainment Art not bearing a restrictive legend into her brokerage account at Legend Securities. As a result of the business name change on April 1, 2013, these shares became Biozoom shares. Thus, defendant Hernando held 1,815,000 shares of Biozoom that were purportedly available to be sold on the public markets.

Cecilia De Lorenzo

71. On or about February 4, 2013, defendant De Lorenzo opened an account at Legend and funded the account with $50,000 cash.

72. On March 13, 2013, Entertainment Art's transfer agent issued a certificate for 2,062,500 shares to De Lorenzo.

73. The certificate was accompanied by a corporate certification stating that Deutsch certified – at a board meeting of Entertainment Art on March 22, 2013 – the company approved the issuance of the above certificate to De Lorenzo.

74. In order to deposit her 2,062,500 shares of Entertainment Art into her brokerage account at Legend, De Lorenzo completed a "Deposit for Securities Request Certificate Questionnaire" that was required by Legend, and provided additional documentation. For the following reasons, the documentation submitted by De Lorenzo was false.

75. The documentation reflected that De Lorenzo acquired the 2,062,500 shares pursuant to two separate private sales that were completed on February 19, 2013 – the same day as the purported purchases of Entertainment Art stock by Ficicchia: (1) a purchase of 1,650,000 shares from Investor J; and (2) a purchase of 412,500 shares from

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Investor K. The documentation also reflected that Defendant De Lorenzo paid a total of approximately $8,300 for these shares, which equals approximately $.004 per share.

76. Both Investors J and K, however, were Form S-1 shareholders who had sold their Entertainment Art shares on or around May 2009 – almost four years before defendant De Lorenzo's claimed purchase of shares from these investors.

77. On March 22, 2013, defendant De Lorenzo deposited 2,062,500 shares of Entertainment Art not bearing a restrictive legend into her brokerage account at Legend. As a result of the business name change on April 1, 2013, these shares became Biozoom shares. Thus, defendant De Lorenzo held 2,062,500 shares of Biozoom that purportedly could be sold on the public markets.

2. Accounts at Scottsdale

Magdalena Tavella

78. On March 22, 2013, Entertainment Art's stock transfer agent issued a certificate for 1,815,000 shares of Entertainment Art to Tavella.

79. On or about May 16, 2013, defendant Tavella opened an account at Scottsdale.

80. In order to deposit her 1,815,000 shares of Entertainment Art into her brokerage account, Scottsdale, using information and documentation provided by Tavella, completed a securities deposit checklist. For the following reasons, the documentation submitted by Tavella was false.

81. The documentation reflected that Tavella acquired the 1,815,000 shares pursuant to three separate private sales that were completed on March 5, 2013 – the same day as the purported purchases of Entertainment Art by defendant Hernando: (1) a

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purchase of 165,000 shares from Investor L; (2) a purchase of 165,000 shares from Investor M; and (3) a purchase of 1,485,000 shares from Investor N. The documentation reflected that Tavella paid a total of approximately $9,075 for these shares, which equals approximately $.006 per share.

82. Investors L and M were two of the Form S-1 shareholders who had sold their shares of Entertainment Art on or around May 2009 – almost four years before Tavella's claimed purchase of shares from them. Investor N was purportedly a shareholder that acquired its shares from some of the Form S-1 shareholders in March 2011 – almost two years after the Form S-1 shareholders sold their shares.

83. On May 22, 2013, defendant Tavella deposited 1,815,000 shares of Entertainment Art not bearing a restrictive legend into her brokerage account at Scottsdale. As a result of the business name change on April 1, 2013, these shares became Biozoom shares. Thus, defendant Tavella held 1,815,000 shares of Biozoom that were purportedly available to be sold on the public markets.

Adriana Rosa Bagattin

84. On March 13, 2013, Entertainment Art's transfer agent issued a certificate for 2,310,000 Entertainment Art shares to defendant Bagattin.

85. On or about May 10, 2013, defendant Bagattin opened an account at Scottsdale.

86. In order to deposit her 2,310,000 shares of Entertainment Art into her brokerage account, Scottsdale, using information and documentation provided by Bagattin, completed a securities deposit checklist. For the following reasons, the documentation submitted by Bagattin was false.

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87. The documentation reflected that Bagattin acquired the 2,310,000 shares pursuant to three private sales that were completed on February 26, 2013: (1) a purchase of 1,650,000 shares from Investor O; (2) a purchase of 330,000 shares from Investor P; and (3) a purchase of 330,000 shares from Investor Q. The documentation reflected that Defendant Bagattin paid approximately $6,930 for these shares, which equals approximately $.003 per share.

88. Each of Investors O, P, and Q, however, were Form S-1 Shareholders who had sold their Entertainment Art shares on or around May 2009 – almost four years before defendant Bagattin's claimed purchase of shares from these persons.

89. On May 22, 2013, Bagattin deposited 2,310,000 shares of Entertainment Art not bearing a restrictive legend into her brokerage account at Scottsdale. As a result of the business name change on April 1, 2013, these shares became Biozoom shares. Thus, defendant Bagattin held 2,310,000 shares of Biozoom that were purportedly available to be sold on the public markets.

Daniela Patricia Goldman

90. On March 22, 2013, Entertainment Art's transfer agent issued a certificate for 2,485,000 Entertainment Art shares to Goldman.

91. On or about May 13, 2013, defendant Goldman opened an account at Scottsdale.

92. In order to deposit her 2,485,000 shares of Entertainment Art into her brokerage account, Scottsdale, using documentation and information provided by Goldman, completed a securities deposit checklist. For the following reasons, the documentation submitted by Goldman was false.

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93. The documentation reflected that Goldman acquired the 2,485,000 shares pursuant to two private sales that were completed on March 4, 2013: (1) a purchase of 1,485,000 shares from Investor R; and (2) a purchase of 1,000,000 shares from Investor S. The documentation also reflected that Goldman paid approximately $7,455 for these shares, which equals approximately $.003 per share.

94. Investor R purportedly obtained its shares from some of the Form S-1 Shareholders in March 2011 – almost two years after the Form S-1 shareholders sold their shares. Investor S was one of the Form S-1 shareholders and sold his shares on or around May 2009 – almost four years before defendant Goldman's claimed purchase of shares from him.

95. On May 22, 2013, Goldman deposited 2,485,000 shares of Entertainment Art not bearing a restrictive legend into her brokerage account at Scottsdale. As a result of the business name change on April 1, 2013, these shares became Biozoom shares. Thus, defendant Goldman held 2,485,000 shares of Biozoom that were purportedly available for sale on the public markets.

Mariano Pablo Ferrari

96. On March 22, 2013, Entertainment Art's transfer agent issued a certificate for 2,310,000 Entertainment Art shares to Ferrari.

97. On or about May 20, 2013, Ferrari opened an account at Scottsdale.

98. In order to deposit his 2,310,000 shares of Entertainment Art into his brokerage account, Scottsdale, using documentation and information provided by Ferrari, completed a securities deposit checklist. For the following reasons, the documentation provided by Ferrari was false.

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99. The documentation reflected that Ferrari acquired the 2,310,000 shares pursuant to two private sales that were completed on March 5, 2013: (1) a purchase of 1,650,000 shares from Investor T; and (2) a purchase of 660,000 shares from Investor U. The documentation also reflected that Goldman paid approximately $9,240 for these shares, or approximately $.004 per share.

100. Investor T was one of the Form S-1 shareholders and sold his shares on or around May 2009 – almost four years before defendant Ferrari's claimed purchase of shares from him. Investor U purportedly obtained its shares from some of the Form S-1 shareholders in September 2009.

101. On May 22, 2013, Ferrari deposited 2,310,000 shares of Entertainment Art not bearing a restrictive legend into his brokerage account at Scottsdale. As a result of the business name change on April 1, 2013, these shares became Biozoom shares. Thus, defendant Ferrari held 2,310,000 shares of Biozoom that were purportedly available for sale on the public markets.

Two Other Accounts in Names of Defendants Graciarena and Loureyro

102. On March 22, 2013, Manhattan Transfer issued a certificate for 2,145,000 Entertainment Art shares to Graciarena and 2,300,000 Entertainment Art shares to Loureyro. Graciarena and Loureyro submitted documentation reflecting that they had obtained their shares in the same manner as the other eight defendants – i.e. – by purportedly purchasing shares from the Form S-1 shareholders.

103. On or about June 14, 2013, Fernando Loureyro and Mariano Graciarena opened separate accounts at Scottsdale. Like the other eight defendants, both stated in brokerage firm documents that they resided in Buenos Aires, Argentina.

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104. On June 18, 2013, these shares were deposited in the brokerage accounts of these two individuals. To date, none of these shares have been sold.

105. In sum, from November 2012 to June 2013, the ten defendant accounts received a total of 20,130,000 shares of Entertainment Art. These shares represented all of the shares that were unallocated after the Opsolution acquisition. Moreover, these shares represented *100%* percent of the total shares without a restrictive legend outstanding in Biozoom at the time, and more than *33%* percent of the total outstanding shares of Biozoom.

D. Defendants Sell Millions of Biozoom Shares

106. Beginning on May 22, 2013 -- and after nearly all of the defendants had deposited their Biozoom shares not bearing a restrictive legend in their accounts – Biozoom began issuing a series of press releases in which it claimed it "created the world's first portable, handheld consumer device" to instantly and non-invasively measure certain biomarkers. These claims were also made by other entities, including Global Financial, Inc., Stock Preacher.com, among others.

107. Following these positive claims concerning Biozoom's prospects, the accounts in the name of eight of the selling defendants sold substantial amounts of their Biozoom stock that did not bear a restrictive legend for massive proceeds. In particular, and as reflected in the chart below, eight of the defendants sold 14,078,406 shares of BIZM stock for proceeds of $33,997,152.

Defendant	Shares Sold	Dates Sold	Proceeds	Shares Remaining
Blaya	1,312,053	5/16/13 – 6/13/13	$3,014,965	172,947
De Lorenzo	1,328,000	6/17/13 – 6/18/13	$4,809,836	734,500
Hernando	1,815,000	6/6/13 – 6/17/13	$5,048,217	0

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Defendant	Shares Sold	Dates Sold	Proceeds	Shares Remaining
Ficcichia	1,402,500	5/20/13 – 6/5/13	$1,979,389	272,620[1]
Tavella	1,592,444	6/7/13 – 6/11/13	$3,116,894	382,956[2]
Bagattin	2,176,726	6/10/13 – 6/18/13	$6,223,310	133,724
Ferrari	1,994,038	6/7/13 – 6/19/13	$5,456,690	315,962
Goldman	2,457,645	5/28/13 – 6/6/13	$3,771,761	27,355

108. All of the eight selling defendants placed their orders to sell Biozoom stock in the same manner – via e-mail and instant message to either Legend or Scottsdale.

109. Upon selling shares in Biozoom, several of the defendants instructed their brokerage firms to wire the proceeds of their sales to foreign bank accounts in various countries:

- **Ficicchia**: On June 7, 2013, defendant Ficicchia instructed Legend, to wire $1 million to Alpine Securities, Inc., a registered clearing broker-dealer. Alpine provides clearing services for Scottsdale, and as described earlier, Ficicchia opened an account at Scottsdale on or around June 10, 2013 and funded it with this $1 million. On June 25, 2013 – the same day as the Commission's order suspending trading in Biozoom – Ficicchia instructed Scottsdale to wire $325,000 to a bank account in Cyprus. This wire was not executed. Ficicchia's brokerage account at Legend currently has a cash balance of slightly over $1 million, and Ficicchia's brokerage account at Scottsdale currently has a cash balance of approximately $328,000.

[1] On or around June 10, 2013, Ficicchia opened an account at Scottsdale and funded this account with $1 million from his account at Legend. Ficicchia's "Shares Remaining" column reflects Biozoom purchases that he has made in his account at Scottsdale.

[2] Tavella's "Shares Remaining" column includes 160,400 Biozoom shares that she purchased in the open market on June 19, 2013.

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- **Blaya:** On June 14, 2013, Blaya instructed Legend to wire "all settled funds except $30,000" to an account held in Geneva, Switzerland. This wire was not executed. This account currently has a cash balance of approximately $3.5 million.
- **Hernando:** On June 13, 2013, Hernando instructed his broker-dealer, Legend, to wire "all available settled cash" in her account, which at the time, was approximately $600,000, to an account held at Hellenic Bank Public Company Limited in Lemesos, Cyprus. This wire was executed. On June 17, 2013, Hernando instructed his broker-dealer, Legend, to wire $2 million, again to an account held at Hellenic Bank Public Company Limited in Lemesos, Cyprus. This wire was not executed by Legend. This account has a cash balance of approximately $4.5 million.
- **De Lorenzo:** De Lorenzo has not yet attempted to wire any money out of her account. De Lorenzo has a bank account in Dar Es Salaam. The account has a cash balance of approximately $4.8 million.
- **Tavella:** On June 25, 2013 – the day of the Commission's order suspending trading in the securities of Biozoom – Tavella attempted to wire approximately $2,450,000 out of her account at Scottsdale to a bank account in St. Vincent and the Grenandines. This wire has not been executed. The current cash balance in Tavella's brokerage account is approximately $2.47 million.
- **Bagattin:** On June 20, 2013, Bagattin instructed Scottsdale to wire approximately $4.33 million to a bank account in Cyprus. This wire was executed. On June 24, 2013, Bagattin instructed Scottsdale to send an additional

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approximately $1.89 million to the same bank account. This wire was also executed. The current cash balance in Bagattin's brokerage account is $3,000.

- **Goldman:** On June 11, 2013, Goldman instructed Scottsdale to wire approximately $3.77 million to an account held at a bank in Geneva, Switzerland – a bank where Blaya also holds an account. This wire was executed. The cash balance in Goldman's account is $0.
- **Ferrari:** On June 19, 2013, Ferrari instructed Scottsdale to wire $500,000 to an account held at a bank in Panama. This wire was executed. On June 24, 2013, Ferrari instructed Scottsdale to wire an additional $4.9 million, this time to a bank in Belize. This wire was also executed. The cash balance in Ferrari's account is $0.

F. No Registration Statement Was In Effect At the Time Defendants Sold Biozoom Shares

110. Section 5 of the Securities Act makes it unlawful for any person, directly or indirectly, to offer or sell securities, using the U.S. mails or interstate commerce, unless such offer or sale is registered with the Commission.

111. No registration statement was in effect for the shares sold by the Selling Defendants.

112. No registration statement is in effect for the Biozoom shares held by defendants Graciarena and Loureyro.

G. Biozoom Is A Penny Stock As Defined By The Securities Exchange Act of 1934 ("Exchange Act")

113. Biozoom's stock is a "penny stock" as defined by the Exchange Act. At times relevant to this Complaint, the stock's shares traded at less than $5.00 per share. During the same time period, Biozoom's stock did not meet any of the exceptions to

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penny stock classification pursuant to Section 3(a)(51) and Rule 3a51-1 of the Exchange Act.

114. For example, the company's stock: (1) did not trade on a national securities exchange; (2) was not an "NMS stock," as defined in 17 C.F.R. § 242.242.600(b)(47); (3) did not have net tangible assets (i.e., total assets less intangible assets and liabilities) in excess of $5,000,000; and (4) did not have average revenue of at least $6,000,000 for the last three years. (*See* Exchange Act, Rule 3a51-1(g).)

COUNT I

VIOLATION OF SECTION 5 OF THE SECURITIES ACT, 15 U.S.C. §77e

(Defendants Tavella, Ficicchia, Blaya, Hernando, De Lorenzo, Bagattin, Ferrari, Goldman)

115. Paragraphs 1 through 114 are hereby re-alleged and incorporated by reference.

116. Defendants, by engaging in the conduct described above, directly or indirectly, and without a registration statement in effect as to such securities:

(a) made use of means or instruments of transportation or communication in interstate commerce or of the mails to sell, through the use or medium of a prospectus or otherwise; or

(b) carried or caused to be carried through the mails or in interstate commerce, by any means or instruments of transportation, securities for the purpose of sale or for delivery after sale.

117. Defendants, by engaging in the conduct described above, also directly or indirectly, made use of the means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or

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medium of any prospectus or otherwise securities, without a registration statement having been filed as to those securities.

118. By engaging in the foregoing conduct, Defendants directly or indirectly, violated, and unless restrained and enjoined will continue to violate Sections 5(a) and 5(c) of the Securities Act [15 U.S.C. §§ 77e(a) and 77e(c)].

COUNT II

INJUNCTION PURSUANT TO SECTION 20(b) OF THE SECURITIES ACT

(Defendants Graciarena and Loureyro)

119. Paragraphs 1 through 114 are re-alleged and incorporated by reference herein.

120. Securities Act Section 20(b) provides that "whenever it shall appear to the Commission that any person is engaged in or is about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this title, the Commission may in its discretion, bring an action in district court to enjoin such acts or practices . . ."

121. Defendants Graciarena and Loureyro have deposited shares of Biozoom in their respective brokerage accounts. Those shares do not bear a restrictive legend. However, no registration statement is in effect for the offer of sale of those shares.

122. Unless restrained and enjoined, Graciarena and Loureyro are likely to offer or sell their Biozoom shares to the public in violation of Section 5 of the Securities Act.

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PRAYER FOR RELIEF

WHEREFORE, the Commission respectfully requests that this Court:

I.

Issue findings of fact and conclusions of law that defendants Ficicchia, Blaya, Hernando, De Lorenzo, Tavella, Goldman, Bagattin, and Ferrari committed the violations charged and alleged herein.

II.

Enter an order temporarily restraining and enjoining defendants Ficicchia, Blaya, Hernando, De Lorenzo, Tavella, Goldman, Bagattin, Ferrari, Graciarena, and Loureyro, their officers, agents, servants, employees, attorneys and those persons in active concert or participation with defendants who receive actual notice of the Order, by personal service or otherwise, and each of them from, directly or indirectly, engaging in the transactions, acts, practices or courses of business described above, or in conduct of similar purport and object, in violation of Sections 5(a) and 5(c) of the Securities Act [15 U.S.C. §§ 77e(a) and 77e(c)].

III.

Enter an order freezing the brokerage accounts and any assets of defendants Ficicchia, Blaya, Hernando, De Lorenzo, Tavella, Goldman, Bagattin, and Ferrari derived from the sale of Biozoom stock; and, freezing the brokerage accounts of defendants Graciarena and Loureyro holding Biozoom shares.

IV.

Enter an order requiring defendants Ficicchia, Blaya, Hernando, De Lorenzo, Tavella, Goldman, Bagattin, and Ferrari to return to the United States any proceeds from the sale of Biozoom stock that have been transferred abroad and those proceeds which are

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returned be frozen in a domestic bank during the pendency of this action to preserve such assets for the satisfaction of disgorgement.

V.

Enter an Order of Permanent Injunction restraining and enjoining defendants Ficicchia, Blaya, Hernando, De Lorenzo, Tavella, Goldman, Bagattin, Ferrari, Graciarena, and Loureyro, their officers, agents, servants, employees, attorneys and those persons in active concert or participation with defendants who receive actual notice of the Order, by personal service or otherwise, and each of them from, directly or indirectly, engaging in the transactions, acts, practices or courses of business described above, or in conduct of similar purport and object, in violation of Sections 5(a) and 5(c) of the Securities Act [15 U.S.C. §§ 77e(a) and 77e(c)].

VI.

Enter an Order requiring defendants Ficicchia, Blaya, Hernando, De Lorenzo, Tavella, Goldman, Bagattin, and Ferrari to disgorge the ill-gotten gains received as a result of the violations alleged herein, including prejudgment interest.

VII.

Issue an Order imposing upon defendants Ficicchia, Blaya, Hernando, De Lorenzo, Tavella, Goldman, Bagattin, and Ferrari appropriate civil penalties pursuant to Section 20(d) of the Securities Act [15 U.S.C. §77t(d)].

VIII.

Issue an order permanently and unconditionally barring, pursuant to Section 20(g) of the Securities Act [15 U.S.C. § 77t(g)], the Selling Defendants from participating in an

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offering of penny stock as defined by Exchange Act Section 3(a)(51) [15 U.S.C. § 78c(a)(51)] and Rule 3a51-1 thereunder [17 C.F.R. § 240.3a51-1].

IX.

Retain jurisdiction of this action in accordance with the principles of equity and the Federal Rules of Civil Procedure in order to implement and carry out the terms of all orders and decrees that may be entered or to entertain any suitable application or motion for additional relief within the jurisdiction of this Court.

X.

Grant such other relief as this Court deems appropriate.

Dated: July 3, 2013

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

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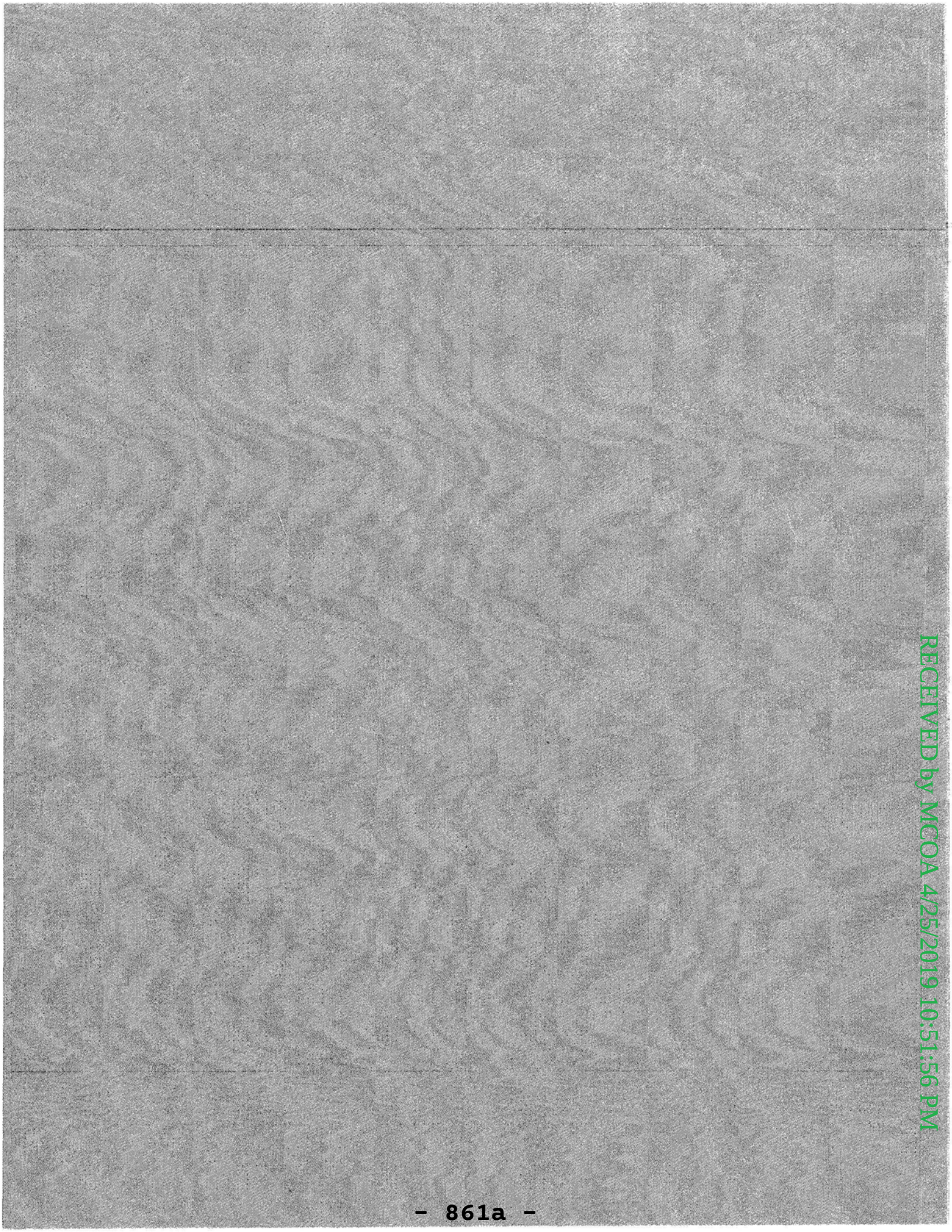

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FINRA fines Scottsdale Capital $1.5-million (U.S.)

2017-04-12 10:42 ET - Street Wire

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by Mike Caswell

The Financial Industry Regulatory Authority has imposed a $1.5-million penalty on Arizona brokerage Scottsdale Capital Advisors Corp. and has permanently banned its owner, John Hurry. (All figures are in U.S. dollars.) FINRA found that Scottsdale facilitated the sale of tens of millions of unregistered shares in penny stocks while ignoring indications that insiders were behind the sales. The shares that it sold included those of a Vancouver-linked OTC Markets company, Voip Pal.com Inc.

John Hurry

The sanctions are contained in a 111-page decision that FINRA released on March 31, 2017. The decision is a loss for Mr. Hurry and for Scottsdale, which had claimed that it was simply the broker on the sales. The firm also said that it had adequate procedures in place to detect insider activity, and would not accept deposits that involved more than 10 per cent of a company's shares.

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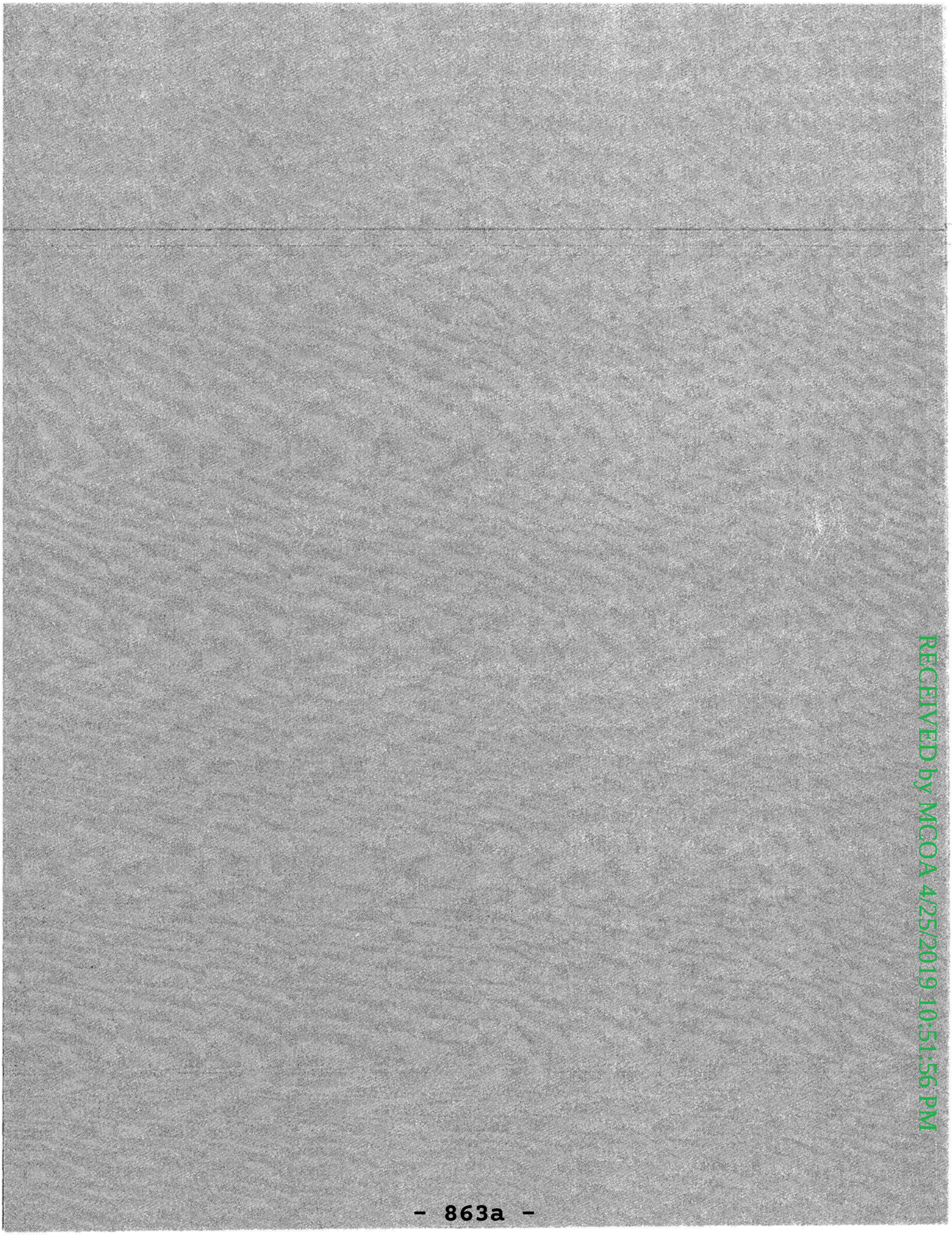

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FINRA fines Scottsdale Capital $1.5-million (U.S.)

2017-04-12 10:42 ET - Street Wire
Also Street Wire (U-VPLM) Voip Pal.com Inc
by Mike Caswell
The Financial Industry Regulatory Authority has imposed a $1.5-million penalty on Arizona brokerage Scottsdale Capital Advisors Corp. and has permanently banned its owner, John Hurry. (All figures are in U.S. dollars.) FINRA found that Scottsdale facilitated the sale of tens of millions of unregistered **shares** in penny stocks while ignoring indications that insiders were behind the sales. The shares that it sold included those of a Vancouver-linked OTC Markets company, Voip Pal.com Inc.LINKED IN
John Hurry
The sanctions are contained in a 111-page decision that FINRA released on March 31, 2017. The decision is a loss for Mr. Hurry and for Scottsdale, which had claimed that it was simply the broker on the sales. The firm also said that it had adequate procedures in place to detect insider activity, and would not accept deposits that involved more than 10 per cent of a company's shares.
FINRA, however, has found that Scottsdale ignored many indications that it was selling shares for insiders in unregistered transactions. The firm allowed sellers to operate through nominees and through an entity incorporated in the Cayman Islands. Its way of doing business amounted to "institutionalization of the misconduct," FINRA has found. Scottsdale's procedures only created the appearance of compliance.
The sanctions stem from Scottsdale's sale of shares in three companies, including Voip Pal.com, in 2013

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U.S. Stocks Open Higher Amid Volatile Oil Moves

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and 2014. According to FINRA, the sales generated $1.7-million in proceeds. It should have been clear to Scottsdale that the share transactions leading to those sales required some investigation, the decision states. Insiders (who would normally be subject to heightened reporting requirements) looked to be connected to the selling, according to FINRA.

With Voip Pal.com, most of the shares were initially issued to an entity controlled by the company's former president, Vancouver resident Richard Kipping. (Mr. Kipping is not a respondent in FINRA's case, and the regulator has not made any finding against him.) In accepting the shares for deposit and subsequent sale, Scottsdale made little effort to determine if Mr. Kipping was an insider, FINRA says. The firm knew that he had been Voip Pal.com's president, but it did nothing to determine if he remained an insider. It did not obtain his resignation letter or even a date for his resignation, according to FINRA.

Even more important, Scottsdale ignored indications that Mr. Kipping remained an insider through his ownership of more than 10 per cent of the company's shares, FINRA says. Documents in Scottsdale's possession showed that Mr. Kipping had received 80 million shares of Voip Pal.com in the two years prior to that date. That amounted to 10.99 per cent of the company's total issued shares. The circumstances raised a strong suspicion that Voip Pal.com was "unlawfully distributing securities without registration in a two-step process designed to obscure what was actually happening and who was benefiting from the sales of stock," the decision states.

While FINRA's decision mostly cites Mr. Hurry and Scottsdale for selling shares in Voip Pal.com and two other companies, the decision indicates that Mr. Hurry was engaged in other dubious dealings. In 2013, he set up an entity in the Cayman Islands that he named Cayman Securities Clearing and Trading SECZ Ltd. According to FINRA, he formed Cayman Securities to act as a conduit for offshore institutions to deposit shares at Scottsdale for eventual sale into the U.S. markets. Over a seven-month period, Cayman Securities deposited billions of shares with Scottsdale, FINRA says.

The risky nature of those dealings was exposed in the summer of 2014, according to the decision. The U.S. Securities and Exchange Commission and criminal authorities began proceedings against some customers of Scottsdale and Cayman Securities. After those charges became public, the business of Cayman Securities substantially declined, FINRA says.

(Included in those actions was an indictment filed in New York on Sept. 8, 2014, against an Oregon man named Bob Bandfield. Prosecutors claimed that Mr. Bandfield ran a massive money laundering operation that contributed to the manipulations of over 40 publicly traded companies. He set up an offshore system that allowed insiders of U.S. companies to hide their share positions and launder

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and is now serving six years in jail. His co-defendants included West Vancouver's Gregg Mulholland and Kelowna's Phil Kueber. Both also pleaded guilty, with Mr. Mulholland receiving 12 years in jail and Mr. Kueber awaiting sentencing.)

Meanwhile Mr. Hurry and his wife were profiting substantially, according to FINRA's decision. In the year ended June 30, 2014, the firm paid $6.2-million in compensation to its directors. Since Mr. Hurry and his wife were the only directors, this money must have gone to them, FINRA says.

While much of the decision deals with violations of securities rules, it also contains a few snippets that show Mr. Hurry's relationship with his employees was not always a fond one. Two of those employees stated that he would contact them at all times of the day and on weekends. If he could not reach them, he would start to send demanding, abrupt and increasingly impatient e-mails. In one e-mail, he wrote: "Your phone is not working TURN IT ON. I need a call." Another read: "Call me in 60 minutes. DO YOU NOT UNDERSTAND THAT?" Mr. Hurry also maintained a spreadsheet that detailed much of their activity, including the amount of time that they spent on cigarette breaks.

The ban for Mr. Hurry prevents him from associating with any FINRA member in any capacity. In effect, he can no longer be a brokerage employee. FINRA also fined two Scottsdale employees, Timothy DeBlasi and Michael Cruz. They each must pay $50,000 and serve a two-year ban.

Voip Pal.com remains an active company, listing an address in Bellevue, Wash. The stock closed at four cents Monday. The company was not a respondent in the case or in any other action.

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ALYI • Nov 14, 2018 11:51 AM

Puration 2019 Growth Acceleration Anticipated After 400% Revenue Increase Reported Q3 Toward $1 Million In 2018 Annual Revenue

PURA • Nov 14, 2018 10:30 AM

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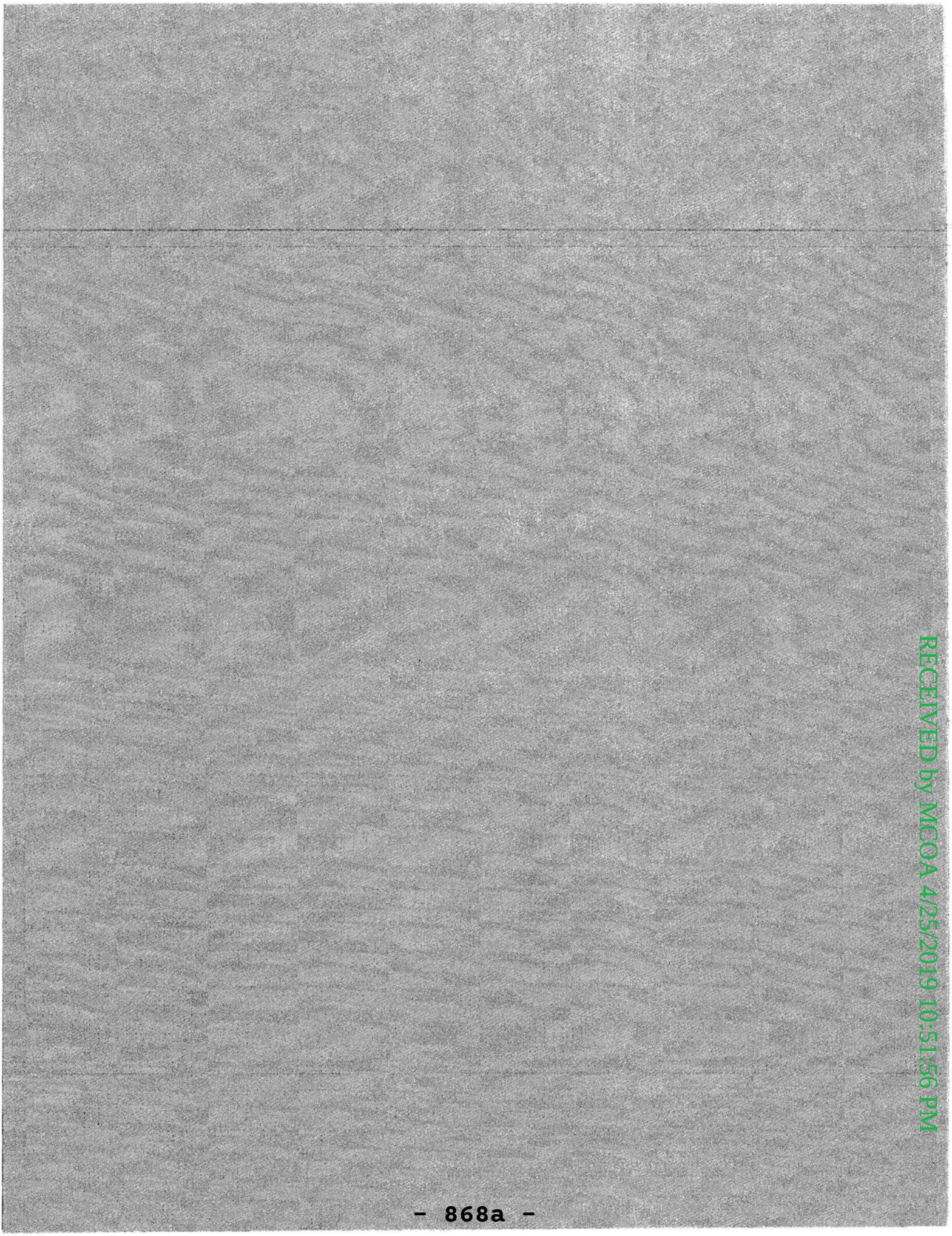

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FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. SCOTTSDALE CAPITAL ADVISORS CORPORATION (CRD No. 118786), JOHN J. HURRY (CRD No. 2146449), TIMOTHY B. DIBLASI (CRD No. 4623652), and D. MICHAEL CRUZ (CRD No. 2450344), Respondents.	Disciplinary Proceeding No. 2014041724601 Hearing Officer–LOM **AMENDED EXTENDED HEARING PANEL DECISION**[1] June 20, 2017

The Respondent firm violated FINRA Rule 2010 by selling securities without registration and without an exemption, in contravention of Section 5 of the Securities Act of 1933. The firm's owner, Respondent John Hurry, also violated Rule 2010, because he engaged in activities designed to enable the unlawful transactions and evade regulatory scrutiny.

The Respondent firm and its Chief Compliance Officer, Respondent Timothy DiBlasi, violated NASD Rules 3010(a) and (b) and FINRA Rule 2010 by failing to establish and maintain a supervisory system, including written

[1] The original Extended Hearing Panel Decision has been amended to correct a factual error. The amendment does not change the substance of the decision.

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supervisory procedures, reasonably designed to ensure that the firm complied with Section 5 of the Securities Act.

The Respondent firm and its President, Respondent Michael Cruz, violated NASD Rule 3010(b) and FINRA Rule 2010 by failing to supervise and failing to respond appropriately to numerous red flags indicative of unlawful unregistered distributions.

The Respondent firm is fined $1.5 million. Hurry is barred in all capacities. He would also be fined $100,000, but, in light of the bar, the fine is not imposed. DiBlasi is suspended for two years and fined $50,000. Cruz is suspended for two years and fined $50,000. In addition, Respondents are ordered to pay costs, for which they are jointly and severally liable.

Appearances

For the Complainant: Jeffrey D. Pariser, Esq., Gregory R. Firehock, Esq., Laura Leigh Blackston, Esq., and Heather L. Freiburger, Esq., Department of Enforcement, Financial Industry Regulatory Authority.

For the Respondents: Kevin J. Harnisch, Esq., Michael J. Edney, Esq., and Ryan E. Meltzer, Norton Rose Fulbright US LLP.

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DECISION

I. INTRODUCTION

A. The Respondent Firm

The Respondent firm, Scottsdale Capital Advisors Corporation ("Scottsdale" or the "Firm"), is primarily engaged in the business of liquidating penny stocks for its customers without registration. The sale of securities without registration is unlawful unless an exemption exists. In selling securities without registration, Scottsdale usually relies on a "safe harbor" exemption created by the Securities and Exchange Commission ("SEC"), Rule 144. But the securities at issue here did not qualify for the Rule 144 exemption. Thus, the sales were unlawful.

1. The Firm Relied On The Rule 144 Exemption

SEC Rule 144 is highly detailed and technical. It both restricts some transactions and permits others that meet certain conditions. It comes into play where securities have been acquired from the issuer or an affiliate in an unregistered private transaction. Such securities typically are marked with a restrictive legend, and the holder may not sell such securities in the public marketplace unless an exemption applies to the sale.

In determining whether a sale of securities is exempt from registration under Rule 144, a broker-dealer must conduct an inquiry that focuses primarily on identifying the individual who is the beneficial owner of the securities to be sold, analyzing that person's relationship (if any) to the issuer of the securities, investigating the circumstances of that person's acquisition of the securities, and calculating how long the person has held the securities. Rule 144 imposes different holding periods on affiliates and non-affiliates of an issuer before they can resell the issuer's securities. In some circumstances, the holder can "tack" his holding period to that of his predecessor in the chain of holders to meet the applicable holding period.

The purpose of the Rule 144 inquiry is to ensure that the transaction is not a subterfuge for an issuer or its affiliates to distribute securities to the public while evading the disclosure requirements that accompany registration. Representations made by the parties interested in selling the securities must be carefully scrutinized by a broker-dealer firm because of the incentive to misrepresent the circumstances and conceal the true beneficial owners.

2. The Firm Lacked A Basis For "Tacking" To Achieve The Required Holding Period Under SEC Rule 144

In the transactions at issue, the purported beneficial owners claimed that neither they nor their predecessors were affiliates of the issuer. Their lack of affiliate status was critical to their ability to sell the shares pursuant to SEC Rule 144 because of the shorter holding period and fewer restrictions on non-affiliates.

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Even as non-affiliates, however, none of the purported beneficial owners of the shares that Scottsdale accepted for resale had held the shares long enough to qualify for the Rule 144 safe harbor holding period. Each seller therefore claimed that the applicable Rule 144 holding period was satisfied by tacking his holding period to the holding period of a prior holder.

In the transactions at issue, one prior holder claimed that he had forgiven a loan that he had made to the issuer and had exchanged the right to payment on the loan for stock. One of the prior holders forgave a promissory note that the issuer had used to pay him for consulting services. Another prior holder claimed to have extended an oral line of credit to the issuer and then to have accepted shares in satisfaction of a sum owed on the line of credit. A third prior holder forgave a portion of a promissory note extending an open-ended line of credit.

Each of these prior holders received the shares around the same time that he transferred them. Thus, the prior holder did not actually hold the shares long enough for his successor to satisfy the applicable holding period by tacking, creating an impediment to resale.

To overcome that impediment, the sellers of the securities claimed the benefit of another tacking provision under Rule 144. Rule 144 provides that where a holder of a security exchanges that security for another of the same issuer's securities, without any additional compensation, the holder may tack the holding period of the first security to the holding period of the second. The theory is that the exchange of one security for another of the same issuer does not change the nature of the holder's capital at risk, so the holding period for the new security can tack back to the date the old security was acquired. The sellers here characterized their prior holders' exchanges of notes for stock as exchanges of one security for another. On that basis, the sellers claimed that they could tack back to the inception of the prior holders' loans.

Whether the first instrument in the chain was a security is thus a threshold issue. The Firm treated the prior holders' promissory notes and lines of credit as securities and the conversion of that debt into stock as the exchange of one security of the issuer for another security of the same issuer. As a result, the Firm concluded that the sellers were permitted to tack their holding period all the way back to the inception of the prior holders' loans.

The Firm erred. The promissory notes and lines of credit were not securities. Rather, they were ordinary debt liabilities. Accordingly, the purported beneficial owners could not establish the requisite holding period, and the Rule 144 exemption did not exist.

3. The Firm Also Failed To Address Red Flags Signaling Unlawful Distributions

The transactions at issue involved persons seeking to sell large blocks of thinly traded, little-known securities acquired in a chain of private transactions originating with the issuer—generally a red flag that the SEC and FINRA have both said requires a "searching inquiry." The sellers acquired the shares from the prior holders and sought to resell the shares almost immediately. The immediate resale of a large block of stock that has never been the subject of registration disclosures strongly suggests an attempt to distribute securities to the public without

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In the Court of Appeals
For the State of Michigan

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff-Appellee,

v.

MORNINGLIGHTMOUNTAIN, LLC, and MICHAEL GOODE,

Defendants-Appellants,

–and–

DOES 1–10,

Defendants–Not Participating.

Docket No.

Kalamazoo County Circuit Court
Case No.: 18-0153-CZ
HON. ALEXANDER C. LIPSEY

APPLICATION FOR LEAVE TO PURSUE AN INTERLOCUTORY APPEAL

APPELLANT'S APPENDIX VOLUME VIII

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registration. In addition, there were a large number of discrepancies and suspicious circumstances indicating that sham transactions, false documents, and nominees were being used to evade the securities laws and effect unlawful securities sales without registration. These red flags ought to have been investigated and appropriately resolved before the securities could be sold.

The Firm, however, blinded itself to the multiple red flags signaling that the transactions were unlawful public distributions of securities. It did not conduct the required searching inquiry. It sold the securities without a reasonable basis for a Rule 144 exemption. Because of the suspicious circumstances known to the Firm, it also was not entitled to the so-called "broker's exemption" under Section 4(4) of the Securities Act for ordinary trading.

B. Other Respondents

1. John Hurry

Scottsdale is owned indirectly by Respondent John Hurry and his wife, Justine Hurry, through other entities they own and control. John Hurry also owns the clearing firm that handles Scottsdale's business, Alpine Securities Corporation ("Alpine"), and an off-shore foreign financial institution ("FFI") located in the Cayman Islands, Cayman Securities Clearing and Trading SECZ, Ltd. ("CSCT").

Hurry set up CSCT in 2013 to act as a conduit through which other FFIs could deposit penny stocks at Scottsdale for resale in the U.S. securities market. During the relevant period, December 1, 2013, through June 30, 2014, CSCT deposited billions of shares of penny stocks for resale by Scottsdale. All the transactions at issue were routed through CSCT to Scottsdale.

2. Timothy DiBlasi

Respondent Timothy DiBlasi became Scottsdale's chief compliance officer ("CCO") shortly before the events at issue, and he remains its CCO. He maintains, however, that his responsibilities do not extend to the Firm's Rule 144 business.

3. Michael Cruz

Respondent Michael Cruz was the Firm's president, but now serves as general counsel to the collection of Hurry enterprises. During the relevant period, Cruz had final approval authority over the Rule 144 transactions at issue. In that role, he reviewed the information collected by others and determined whether it was sufficient to approve a deposit of stock certificates for resale. Everyone at the Firm, including Henry Diekmann, who headed the Firm's Rule 144 team at the time of the transactions at issue, and who is now the Firm's president, considered Cruz responsible for Rule 144 compliance.

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C. Parties To The Transactions At Issue

This case concerns Scottsdale's sales of stock issued by three little-known companies—Neuro-Hitech Inc. ("NHPI"), VoipPal.com ("VPLM"), and Orofino Gold Corp. ("ORFG"). CSCT deposited millions of the three issuers' shares in certificate form at Scottsdale for resale. Alpine cleared them, and Scottsdale sold them into the U.S. securities market pursuant to Rule 144 without registration.

In making the deposits of NHPI, VPLM, and ORFG stock, CSCT acted on behalf of three other FFIs: (i) Montage Securities ("Montage"), (ii) Titan International Securities ("Titan"), and (iii) Unicorn International Securities ("Unicorn"). Montage was located in Panama; Titan and Unicorn were in Belize. The FFIs, in turn, purported to act for the benefit of other entities, which were represented to be owned by individuals identified in documents as the beneficial owners of the shares.

II. PROCEDURAL HISTORY

FINRA's Department of Enforcement ("Enforcement") filed the Complaint on May 15, 2015. After an extension of time, Respondents filed an Answer on June 26, 2015. On December 11, 2015, Respondents filed a motion for summary disposition that challenged FINRA's authority to bring a disciplinary action for misconduct associated with the sale of unregistered securities. Briefing on the motion was completed on January 29, 2016. The Hearing Officer issued an Order on February 26, 2016, denying the motion and finding that FINRA has authority to bring this proceeding.

The hearing ran a total of 12 days in two sessions. The first session in Los Angeles, California, was held June 13-24, 2016. The second session in Washington, D.C. was held July 11-12, 2016. Ten witnesses testified at the hearing, including two experts.[2] In addition, the full transcript of an on-the-record interview ("OTR") was admitted into evidence, along with more

[2] In addition to Hurry, DiBlasi, and Cruz, the following persons testified: Henry Diekmann, the Firm's current president; Jay Noiman, a former Scottsdale employee who served as CCO until DiBlasi took on that responsibility; David Byrne, a FINRA examiner who is a manager of the AML Investigative Unit; Craig D'Mura, a former Scottsdale employee who worked for a couple of months at CSCT; Christopher Frankel, the current CEO of Alpine; Marc Menchel, Respondents' expert; and Brian Underwood, Enforcement's rebuttal expert.

References to hearing testimony are in the following format: "Hearing Tr. (last name of witness), page of transcript." For example, Hurry's testimony is cited as "Hearing Tr. (Hurry) 1542-43."

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than 200 other exhibits.[3] On September 9, 2016, Enforcement and Respondents each filed one post-hearing brief.[4]

III. FINDINGS AND CONCLUSIONS

A. Jurisdiction

FINRA has jurisdiction to bring this proceeding against Scottsdale, Hurry, and DiBlasi because they are currently registered, and the Complaint charges them with misconduct committed while they were registered. FINRA has jurisdiction as to Cruz although he is no longer registered, because the Complaint was filed within two years of the time he was registered and it charges him with misconduct committed while he was registered.[5]

B. Background

We provide substantial background regarding Respondents and others connected to the transactions at issue to provide the context needed to understand the transactions, the Firm's

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[3] Gregory V. Ruzicka, who worked at CSCT during the relevant period, gave an OTR on May 27, 2015. The OTR became an exhibit. Complainant's exhibits are referred to with the prefix "CX" and an identifying number. Respondents' exhibits are referred to with the prefix "RX" and an identifying number. Joint exhibits are referred to with the prefix "JX" and an identifying number. Ruzicka's OTR is CX-178.

[4] References to the post-hearing briefs are as follows: Enf. PH Br. and Resp. PH Br. Respondents attached graphs and other materials to their post-hearing brief that were not offered or admitted into evidence. Respondents apparently created the graphs after the hearing based on exhibits that were admitted into the record. However, the graphs were not subject to any testimony explaining their creation or testing their accuracy. Respondents' post-hearing brief also contained references to website articles that were not admitted into the record. No copies of the articles were attached to the post-hearing brief. Respondents have not asked permission to reopen the record to admit any of these materials. Respondents simply refer and rely on the non-record materials. The Hearing Panel has not considered any of the following items (or assertions made in argument based on them) in formulating its decision:

- Huperzine A in Alzheimer's Disease—website article relating to NHPI (Resp. PH Br. 5, n.9);
- Same (Resp. PH Br. 7, n.20);
- OTCMarkets.com website on VPLM (Resp. PH Br. 7, n.22);
- The Markets OTCQB website article on VPLM (Resp. PH Br. 7, n.23);
- Historical price figures derived from data on OTCMarkets.com (Resp. PH Br. 12, n.58);
- A purported page from a FINRA Continuing Education Module (Resp. PH Br. 17, n.86; Appendix A);
- Graphs generated by Respondents purporting to use data in JX-264 and JX-268 (Resp. PH Br. 19, n.94; Appendix B);
- Graphs generated by Respondents purporting to use data in JX-279 and JX-281 (Resp. PH Br. 25, n.129; Appendix C);
- Graphs generated by Respondents purporting to use data in JX-308 and JX-310 (Resp. PH Br. 29, n.155; Appendix D); and
- Statement about trading volume attributable to CSCT's sales of ORFG (Resp. PH Br. 29, n.156; statement made without reference to source of information or record citation).

[5] FINRA By-Laws, Art. IV, Section 6; Art. V, Section 4.

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culture, and the Respondents' failure to take reasonable action in response to obvious red flags in connection with the transactions at issue. The background also provides information important in assessing the witnesses' credibility, and in evaluating the Respondents' likely future compliance with the laws and regulations governing Scottsdale's business.

1. Respondents

a. Scottsdale

i. The Firm's Focus On Rule 144 Business

Scottsdale, which is located in Scottsdale, Arizona, has been a FINRA member since 2002.[6] During the relevant period, the Firm had approximately 14 to 20 employees.[7]

Scottsdale's principal business is the deposit and liquidation of penny stocks for its customers.[8] Throughout the proceeding, the penny stocks sold by Scottsdale were also referred to as "microcap" securities.[9] Scottsdale sells most of these securities without registration. The primary exemption that Scottsdale relies on is Rule 144, so it has a dedicated Rule 144 team to review deposits of stock certificates for resale, and its procedures are oriented to Rule 144.[10] Scottsdale obtains customers by advertising in OTC Markets and through referrals.[11]

ii. The Firm's Direct Business With FFIs

Prior to Hurry's creation of CSCT in 2013, Scottsdale did business with FFIs directly. Two of the FFIs involved in this case (Titan and Unicorn) had pre-existing direct relationships with Scottsdale before they started doing business through CSCT.[12]

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[6] CX-1, at 3-9.

[7] Hearing Tr. (Cruz) 116; Hearing Tr. (Diekmann) 1496.

[8] Hearing Tr. (Hurry) 1318; Hearing Tr. (Cruz) 83; Hearing Tr. (Noiman) 1180. DiBlasi acknowledged that during the relevant period penny stock transactions accounted for most of the Firm's revenues, and that over 95% of the transactions that Scottsdale executed for its customers involved penny stocks, most of them unregistered. Hearing Tr. (DiBlasi) 1923.

[9] Microcap securities may be defined as low-priced stock issued by small companies with a market capitalization of $300 million or less. Microcap securities are generally more volatile and less liquid than the stock of larger companies. Most important, because many microcap issuers do not file financial reports with the SEC, it may be difficult for investors to obtain information about the management, products, services, and finances of microcap issuers. https://www.sec.gov/investor/pubs/microcapstock.htm. The SEC has expressed concern that the lack of publicly available information about microcap issuers can enable the spread of false information that misleads investors. *Id.* Many microcap securities trade in the "over-the-counter" ("OTC") market instead of a national exchange such as the New York Stock Exchange or NASDAQ. *Id.*

[10] Hearing Tr. (Cruz) 577, 583; Hearing Tr. (DiBlasi) 1952-54; Hearing Tr. (Diekmann) 818-19, 875-76, 884-86; Hearing Tr. (Hurry) 1600.

[11] Hearing Tr. (Cruz) 116.

[12] Hearing Tr. (Cruz) 192; Hearing Tr. (Diekmann) 727, 817-18; Hearing Tr. (Noiman) 1140-52.

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iii. The Firm's Disciplinary History

Scottsdale has been disciplined previously for selling unregistered securities and having inadequate supervisory procedures and written supervisory procedures ("WSPs") to detect and prevent the sale of unregistered securities. In October 2011, the Firm settled these and other charges, agreeing to a censure and a total fine for all the charges of $125,000 ("2011 Settlement").[13]

The Firm has also settled other types of disciplinary charges against it, which are relevant to the sanctions determinations. In 2009, it agreed to a censure and a $7,500 fine to settle charges that it had bought bonds from customers at unfair prices ("2009 AWC").[14] In August 2012, the Firm settled charges that it had failed to take appropriate action after being on notice that one of its representatives had been using his name and CRD number in stock promotion press releases. The Firm agreed to a censure and a $7,500 fine ("2012 AWC").[15] In 2015, the Firm agreed to a censure and a fine of $10,000 to settle charges that it had submitted reports to FINRA for the Order Audit Trail System that were inaccurate, incomplete, or in the wrong format ("2015 AWC").[16]

iv. The Firm Had Notice That Sham Transactions And The Use Of Nominees Were A Risk In Its Rule 144 Business With FFIs

(a) Four Prior SEC Disciplinary Actions

We find that prior to the events at issue in this case, the Firm was on notice that its business was susceptible to sham transactions and the use of nominees to conceal the true beneficial owners of securities. In four disciplinary actions involving Scottsdale's own employees and customers, the SEC alleged that sham transactions and nominees were used in unlawful sales in violation of Section 5 of the Securities Act of 1933. Those unlawful sales in turn were used to facilitate fraud and manipulation.

In December 2011, two of Scottsdale's registered representatives were named in an SEC complaint ("*Ruettiger*") involving the supposed assignment of portions of a convertible note to satisfy the applicable Rule 144 holding period, the use of nominees to conceal the identity of the true beneficial owners, the use of a "pump-and-dump"[17] scheme to manipulate the market for the stock, and an unlawful distribution of securities without registration. According to the complaint,

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[13] CX-12.

[14] CX-11.

[15] CX-13.

[16] CX-14.

[17] "Pump-and-dump" schemes involve the touting of a company's stock (typically small, so-called "microcap" companies) through false and misleading statements to the marketplace. https://www.sec.gov/answers/pumpdump.htm.

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Scottsdale's registered representatives handled some of the accounts involved in the scheme, and one of them had an interest in an entity that received and sold some of the securities. The complaint alleged that a single person had used 16 Panamanian corporations to conceal his identity and enable him to sell approximately $6 million of stock without registration.[18]

In March 2013, the SEC filed a complaint ("*Gibraltar I*") against a number of people and entities alleging a market manipulation scheme that was facilitated by a Scottsdale customer, Gibraltar. That complaint alleged that individual defendants had secretly sold shares through Gibraltar while simultaneously promoting the stocks and encouraging others to buy. It also alleged that Gibraltar had provided false affidavits and misleading statements that allowed an individual defendant to secretly sell shares of companies he was promoting.[19]

In April 2013, the SEC filed a second complaint against Gibraltar and its owner ("*Gibraltar II*"), alleging that they had facilitated unlawful sales of securities without registration through the use of nominees. According to that complaint, Gibraltar liquidated low-price, thinly traded stocks on behalf of its clients, often during periods of suspicious promotion. Gibraltar assisted its clients to incorporate international business corporations ("IBCs") and encouraged them to use nominee officers and directors so that their identities would remain confidential. The SEC charged that two persons had opened "fake nominee accounts" at Scottsdale.[20]

Gibraltar had been a direct customer of Scottsdale since before the spring of 2010, at least two years before the SEC filed charges against it.[21] It shut down after the filing of the two *Gibraltar* complaints, and some of its customers transferred to Titan, one of the FFIs involved in this case.[22]

In July 2013, the SEC filed an action against ten Argentinians, four of whom had opened accounts at Scottsdale ("*Tavella*"). That complaint alleged that the defendants had submitted false documentation to accompany their securities deposit checklist at Scottsdale, and sold millions of shares into the public markets without registration in violation of Section 5. The defendants claimed that they had purchased their shares from former shareholders, but the former shareholders had already sold their shares years before. Thus, the transactions in which the defendants claimed that they had acquired the shares were a sham.[23]

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[18] *SEC v. Ruettiger*, No. 2:11-cv-2011 (D. Nev. filed Dec. 16, 2011), available at https://www.SEC.gov/litigation/complaints/2011/comp22198.pdf.

[19] Hearing Tr. (Cruz) 195-99; *SEC v. Carrillo Huettel*, No. 13 Civ. 1735 (S.D.N.Y. filed Mar. 15, 2013), available at https://www.SEC.gov/litigation/complaints/2013/comp-pr2013-39.pdf.

[20] Hearing Tr. (Cruz) 185-192; *SEC v. Gibraltar Global Sec., Inc.*, No. 13 Civ. 2575 (S.D.N.Y. filed Apr. 18, 2013), available at https://www.sec.gov/litigation/complaints/2013/comp22683.pdf.

[21] Hearing Tr. (Diekmann) 1912-13.

[22] Hearing Tr. (Diekmann) 727.

[23] *SEC v. Tavella*, No. 13-cv-4609 (S.D.N.Y. filed July 3, 2013), available at https://www.SEC.gov/litigation/complaints/2013/comp-pr2013-122.pdf.

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These regulatory actions should have caused the Firm to take special care when dealing with FFIs, and to revise its procedures to focus on potential sham transactions and the use of nominees. The Firm did not. Its main reaction to *Ruettiger* was to eliminate the branch office involved in the case. Cruz believed that the misconduct identified in the *Gibraltar* cases was "isolated."[24] Scottsdale's current president, Diekmann, who was the head of the Rule 144 team when the *Tavella* complaint was filed, testified that he could not remember if the Firm conducted any investigation of the four Argentinians named in the *Tavella* complaint who had Scottsdale accounts.[25] In Diekmann's view it was "just impossible to know that there was somebody else behind this."[26] Cruz similarly said, "[I]t's almost impossible to detect these nominees, that they're going to be … misrepresenting the—you know, the true identity of these persons."[27] Although the Firm changed some procedures as a result of *Tavella* (it would not accept more than 9.9% of a security at any one time from its customers and it instituted a stock watch list to monitor trading and promotions), Diekmann could not remember doing anything different to address the problem of nominees.[28]

(b) Respondents' Arguments Minimizing Significance Are Rejected

In their post-hearing brief, Respondents argue that the SEC complaints are not relevant because they were classic pump-and-dump cases, and no charge is made here that the transactions at issue were part of a pump-and-dump fraud. It is not necessary, however, to prove that fraud occurred in order to conclude that Respondents failed to perform their gatekeeping duty adequately. The focus here is on Respondents' failure (i) to recognize as a threshold matter that the transactions lacked a legal underpinning, and (ii) to respond appropriately to an accumulation of red flags and suspicious circumstances, either conducting further investigation to make sure an exemption existed or declining to sell the securities.

Respondents also claim that references in the prior complaints to nominees were "peripheral."[29] To the contrary, the use of nominees was critical to facilitating the fraud and manipulation charged in those cases. We reject Respondents' attempt to brush aside the SEC complaints.

Cruz took a different approach at the hearing to minimizing the significance of the SEC complaints, which we also reject. He insisted on a benign definition of the term "nominee" to mean only someone designated to act on behalf of another. He declined to view the *Ruettiger* complaint as raising a concern about the use of nominees. He said, "I wasn't sure if this is a

[24] Hearing Tr. (Cruz) 219.

[25] Hearing Tr. (Diekmann) 732-33.

[26] Hearing Tr. (Diekmann) 732.

[27] Hearing Tr. (Cruz) 213-14.

[28] Hearing Tr. (Diekmann) 733-34.

[29] Resp. PH Br. 36-37.

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situation where the—the nominees here that are being listed were purposely hiding their identity. It could be, but … that just was not my takeaway when I was looking at this … Complaint."[30] When asked whether the allegation of "fake nominee entities" gave him pause, Cruz responded, "I have no idea what fake – I mean, if it's an entity – I mean, if it – I don't know what they mean by 'fake.'"[31] Cruz refused to admit that the complaint in *Ruettiger* put him on notice of the possibility of nominees hiding the actual true beneficial owner of securities. He testified, "I would say this is probably not a case that gave me a great concern about the nominee issue, per se …. There might be a nominee issue in there. I guess I don't know the context of that."[32]

We find Cruz's refusal to acknowledge the plain import of the SEC's allegations in *Ruettiger* and the other complaints disingenuous. Even Respondents' expert agreed that Scottsdale was on notice that its customers could be nominees for beneficial owners as of the relevant period in this case.[33]

(c) Later Actions Confirm Risk Of Sham Transactions And Nominees

The risky nature of Scottsdale's Rule 144 business with FFIs became undeniable in the summer of 2014, when the SEC and criminal authorities initiated two new proceedings charging that certain Scottsdale customers and others had used sham transactions and nominees to sell penny stocks unlawfully without registration. These proceedings were brought based on extensive evidence gathered through the use of undercover agents, cooperating witnesses, and recorded conversations. The allegations appeared well founded, and they finally caused Scottsdale and CSCT to react.

The SEC filed a complaint on July 11, 2014 ("*Amogear*"), charging five individuals with using nominee accounts in FFI trading to conceal beneficial ownership and facilitate a pump-and-dump scheme. The SEC alleged that Titan had agreed to assist in the scheme and that Alpine, the clearing firm, was involved in readying shares for trading in connection with the scheme. In reaction to *Amogear*, Scottsdale froze its FFI trading for a couple of months.[34]

On September 8, 2014, prosecutors filed an indictment in federal district court in New York ("*Bandfield*") that charged Titan, Unicorn, and several individuals with whom Scottsdale and CSCT did business with securities fraud, tax fraud, and a money-laundering conspiracy. Those individuals included the following persons, who were also involved in the transactions at issue here: Cem ("Jimmy") Can at Unicorn; Kelvin Leach and Rohn Knowles at Titan; and Robert Bandfield and Andrew Godfrey, who purported to represent customers of Montage,

[30] Hearing Tr. (Cruz) 191.

[31] Hearing Tr. (Cruz) 192.

[32] Hearing Tr. (Cruz) 184.

[33] Hearing Tr. (Menchel) 2488-89.

[34] Hearing Tr. (Diekmann) 705-12; Hearing Tr. (Cruz) 204-08; CX-250.

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Unicorn, and Titan and appeared in connection with numerous sub-accounts and sub-sub-accounts at Scottsdale. According to the indictment, Robert Bandfield claimed in a recorded conversation that he had created Titan and more than 5000 sham companies. In that conversation, he explained how reporting requirements could be circumvented and beneficial ownership concealed by using nominees.[35] After the indictment was unsealed and became public, CSCT's business substantially diminished.[36]

b. John Hurry

Indirectly, through a trust and a holding company, John Hurry and his wife, Justine Hurry, own Scottsdale.[37] From the Firm's inception in 2002 until December 2012, Respondent Hurry was a registered representative, among other roles.[38] John Hurry again registered with the Firm in October 2014, and remains registered today.[39] Hurry admitted in his Answer to the Complaint that he has been the Firm's director since 2002. However, at the hearing, he claimed that he first became a director of Scottsdale in January 2013. Justine Hurry became its second director in May 2013.[40]

Scottsdale has been highly profitable for Hurry and his wife. According to the Annual Audited Report Form for Scottsdale during the year beginning July 1, 2013, and ending June 30, 2014, the Firm paid $6,222,550 in directors' compensation. Since John and Justine Hurry were the Firm's only directors, this expense presumably was paid to them.[41] The Firm paid other

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[35] CX-244; CX-226; Hearing Tr. (Cruz) 224-30; Hearing Tr. (Diekmann) 1725-26, 1781.

[36] Hearing Tr. (Cruz) 237-38; Hearing Tr. (Hurry) 1529-30.

[37] CX-1, at 7-9; CX-5; Hearing Tr. (Cruz) 81-82.

[38] CX-15, at 11.

[39] CX-15, at 4-5.

[40] CX-1, at 3-9 (showing the Firm's direct owners and directors); CX-17, at 1. In his Answer, Hurry admitted that he had been a director of Scottsdale since 2002. Answer ¶ 16. At the hearing, however, Hurry denied that he had been a director of Scottsdale before January 2013. He did so despite the fact that his signature appeared over the designation "sole director" in a December 2012 document authorizing the creation of the Firm's Management Committee. At the hearing, he claimed that the designation as sole director was a typographical error and that he was acting president prior to January 2013, not sole director. CX-3; Hearing Tr. (Hurry) 1306-09. Cruz testified as to the December 2012 document that Hurry had established the Firm's Management Committee in his capacity as director of the Firm. Hearing Tr. (Cruz) 74-76.

The conflict between the Answer and Hurry's testimony is inexplicable. We find the conflict between Hurry's testimony and the Firm's record of the creation of the Management Committee disturbing, because it reflects a lack of transparency and accountability. We find the typographical error explanation with regard to something as important as corporate authority to designate the responsibilities of senior management—particularly in a simple one-page document—not credible. There is no explanation for the conflict between Hurry's testimony that he was not a director of the Firm in December 2012 and Cruz's testimony that he was. The conflict in the evidence on this point diminishes Hurry's credibility.

[41] RX-42, at 7, 11. When Cruz officially became Scottsdale's president in March 2014, it was by unanimous consent of the Board of Directors, John and Justine Hurry. CX-4.

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compensation of $1,665,574 and professional and consulting fees of $1,138,090. When these payments and other expenses were subtracted from the Firm's gross profit of $11,569,817, the Firm reported net income of $1,446,655. Because Scottsdale is an S corporation, this income flowed through to the shareholders. In the next year, ending June 30, 2015, although the Firm reported only $589 in net income, the Firm paid directors' compensation of $3,255,200.[42]

During the relevant period, Respondent Hurry also was the indirect owner of Scottsdale's clearing firm, Alpine, which is located in Salt Lake City, Utah. Hurry has been its director since March 2011,[43] and has been registered with Alpine since May 15, 2015.[44]

In 2013, Hurry established CSCT, the Cayman Islands broker-dealer through which the securities at issue were deposited at Scottsdale.[45] Hurry owns CSCT,[46] and, as more fully discussed below, he made decisions, both large and small, about how it conducted its business.[47] Despite the highly specialized nature of CSCT's business, Hurry hired Gregory Ruzicka—an out-of-work California real estate attorney who had no prior experience in the securities broker-dealer industry, much less in the specialized business of liquidating microcap securities—to run CSCT.[48] Ruzicka went down to the Cayman Islands in October 2013 to take on his CSCT duties.[49] Hurry then monitored Ruzicka's activities almost daily, right down to his cigarette breaks, and visited the Cayman Islands at least monthly.[50]

Although Hurry attempted to conceal the extent of his involvement in CSCT's business, he admits that he spoke with the three CSCT customers involved in this case (Montage, Titan, and Unicorn), and that he personally visited two of them, Montage in Panama and Unicorn in Belize.[51] He claims that he did not solicit business for CSCT, but, as discussed below, that claim is not credible.

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[42] RX-42, at 27. See also the Firm's FOCUS Reports for 2013-Q4, 2014-Q1, 2014-Q2, 2015-Q3, 2015-Q4, and 2016-Q-1, and the summary of them created by Enforcement. CX-6 through CX-10.

[43] CX-15, at 3, 11; CX-18.

[44] Hearing Tr. (Hurry) 1307.

[45] Hearing Tr. (Hurry) 1329; Hearing Tr. (Noiman) 1117-18; CX-29.

[46] CX-178, at 40-41.

[47] Hearing Tr. (Hurry) 1333-35.

[48] Hearing Tr. (Hurry) 1631; CX-178, at 13-24. Ruzicka had limited experience in the early 1980s with intrastate real estate limited partnership offerings. In that context, he handled post-foreclosure unlawful detainers, relief from automatic bankruptcy stays, and receiverships on commercial properties. CX-178, at 15-18.

[49] CX-178, at 20.

[50] Hearing Tr. (Hurry) 1437-40; CX-178, at 138-41, 151-52; CX-132; CX-133.

[51] Hearing Tr. (Hurry) 1406-08, 1412-14, 1421-22.

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That Hurry was in charge was obvious to his employees and to CSCT customers. Ruzicka referred to him as "the big boss."[52] As noted below, one of the persons at Scottsdale who approved CSCT to become a Scottsdale customer did not even consider rejecting CSCT's application because he knew that Hurry had brought CSCT to the Firm.[53] Similarly, Ruzicka said that CSCT never considered using any broker-dealer except Scottsdale because of Hurry.[54] As Hurry acknowledged, customers also sought direct contact with him because he is "highest on the totem pole."[55]

Respondent Hurry thus owns and controls all three firms involved in the transactions at issue in this proceeding—Scottsdale, Alpine, and CSCT. In fact, the three firms were almost a self-contained system for processing and distributing microcap securities. CSCT did all its business through Scottsdale,[56] and Scottsdale in turn did all its business with Alpine.[57] Alpine's current CEO described Alpine as a small "boutique" clearing firm with a focus on the kind of business brought to it by CSCT.[58] No independent third party was involved in preparing, approving, or clearing the deposits of stock certificates by CSCT at Scottsdale for resale.

c. Timothy DiBlasi

DiBlasi first entered the securities industry in 2002. From December 2002 through March 2012, he was a compliance analyst at First Investors Corporation in New Jersey. DiBlasi has been associated with Scottsdale since April 2012. In June 2012, he became the Firm's anti-money laundering chief officer ("AMLCO"). In October 2013, shortly before the events at issue, DiBlasi became the Firm's CCO, and he remains the Firm's CCO today. Prior to joining the Firm, DiBlasi had limited experience in microcap securities, and he had not handled the type of restricted stock deposits that are the bulk of Scottsdale's business.[59]

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[52] CX-240; Hearing Tr. (Diekmann) 1764-65.

[53] Hearing Tr. (Noiman) 1079, 1103, 1105-06, 1117-18. See also CX-29, at 10, 25 (forms to establish CSCT as a Scottsdale customer listed Hurry as referral or source of the business).

[54] CX-178, at 108.

[55] Hearing Tr. (Hurry) 1432.

[56] Ruzicka testified that CSCT never considered using a firm other than Scottsdale because of Hurry. CX-178, at 108.

[57] Hearing Tr. (Cruz) 143, 306, 382; Hearing Tr. (Diekmann) 759; Hearing Tr. (D'Mura) 2293. The person Hurry hired to run CSCT, Gregory Ruzicka, described CSCT as an "adjunct" of Hurry's operations at Scottsdale. CX-178, at 34.

[58] Hearing Tr. (Frankel) 2342-43. Alpine did do business with other FFIs in addition to CSCT during the relevant period. Hearing Tr. (Frankel) 2343.

[59] Hearing Tr. (DiBlasi) 1919-21; Hearing Tr. (Cruz) 122; CX-19.

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d. Michael Cruz

Cruz entered the securities business in 1994, when he began working at a San Francisco investment banking firm on underwritings, asset-backed securities, and private placements. After approximately six years, he joined FINRA's predecessor, NASD, starting in its San Francisco office as a cause examiner and then moving to New York as a cycle examiner. He then took a job with Citigroup Smith Barney in their central risk group, reporting to the General Counsel and CCO. Subsequently, he moved with his family to Arizona and passed the bar there. In Arizona, he first worked for Wells Fargo in its audit department and then took a similar position at Countrywide in its bank legal department. He left Countrywide when Bank of America acquired it, and he began working at Scottsdale in May 2008.[60]

Cruz has held Series 7, 24, and 63 licenses. However, since January 29, 2015, he has not been registered through Scottsdale. He currently is the general counsel for the holding companies that own Scottsdale and its clearing firm, Alpine.[61]

At the beginning of the relevant period, Cruz was listed on the Firm's Form BD as legal counsel and member of the Management Committee.[62] Cruz officially became the Firm's president by a board resolution dated March 17, 2014. He testified that, at least since December 1, 2013, he had been acting as *de facto* president.[63] The Firm amended its Form BD on March 31, 2014, to disclose that Cruz was the president, as well as legal counsel.[64]

During the relevant period, Cruz approved Rule 144 deposits, including the transactions at issue.[65] Cruz signed the Deposited Securities Checklist ("Checklist") for the transactions at issue under the heading "144 Compliance Approval." Between that heading and his signature is the statement "[B]ased on the information received and reviewed as described in this Deposited Securities Checklist, SCA [Scottsdale] reasonably believes the subject securities are free trading."[66]

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[60] Hearing Tr. (Cruz) 72-73, 557-59, 661; CX-20.

[61] Hearing Tr. (Cruz) 72-73; CX-20.

[62] CX-17, at 1.

[63] Hearing Tr. (Cruz) 78-79; CX-4. Cruz said that the original plan had been for Justine Hurry to be president of the Firm. Hearing Tr. (Cruz) 79. Cruz's testimony that he was the acting president in December is inconsistent with Hurry's testimony that he was president at that time. This conflict concerning who was in charge illustrates the Firm's lack of appropriate supervisory procedures that clearly delegated authority and created accountability.

[64] CX-17, at 7.

[65] Hearing Tr. (Diekmann) 693-94.

[66] RX-1, at 2, 79, 159; RX-2, at 2, 107; RX-3, at 2.

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Cruz acted as the conduit between senior management of the Firm and the board of directors, John and Justine Hurry.[67]

2. Other Key Figures At Scottsdale

a. Henry Diekmann

After graduating from college with a degree in history, Diekmann spent approximately a year as a financial trainee with Morgan Stanley. He then was an insurance salesman for four months. After that, he was unemployed for about a year-and-a-half before he joined Scottsdale in March 2010 as an office assistant. In January 2011, he moved to the Firm's Rule 144 team, where he spent two years before being promoted to head the team. Although many members of the team were lawyers, Diekmann is not. He had no experience with low-priced securities or in clearing unregistered securities for trading before he joined Scottsdale. He was trained to review deposits by Cruz and another person who worked on the Rule 144 team.[68]

During the relevant period, Diekmann focused solely on reviewing CSCT deposits. But he did not have authority to approve a deposit of certificates. Final approval authority rested with Cruz.[69]

Since January 2015, Diekmann has been the Firm's president.[70] As the Firm's current president, Diekmann now has the authority that once belonged to Cruz.[71]

b. Eric Miller

Eric Miller was a Scottsdale salesman. He called potential customers and assisted in conducting due diligence on new accounts.[72] Miller sometimes referred clients to Ruzicka at CSCT.[73]

Although Miller did not testify at the hearing, there is substantial evidence that he was involved with Unicorn's deposits. Miller had a relationship with Unicorn because it had been Scottsdale's direct customer before moving its business to CSCT, and he continued to have contact with Unicorn even after it started doing business with Scottsdale through CSCT, as Diekmann admitted.[74]

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[67] Hearing Tr. (Cruz) 80-82.

[68] Hearing Tr. (Diekmann) 686-90.

[69] Hearing Tr. (Diekmann) 694, 886.

[70] Hearing Tr. (Diekmann) 685; Hearing Tr. (DiBlasi) 1954.

[71] Hearing Tr. (Cruz) 129-30, 583-84; Hearing Tr. (Diekmann) 685-86, 694, 908-09.

[72] Hearing Tr. (Cruz) 116-17; Hearing Tr. (Noiman) 1075-76; CX-29, at 9.

[73] CX-178, at 167-68.

[74] Hearing Tr. (Diekmann) 858, 934-35.

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The fact that Miller continued to have at least some direct contact with Unicorn is significant for the following four reasons:

First, the evidence regarding Miller casts doubt on the effectiveness of the Firm's compliance and supervisory efforts. Diekmann claimed that Miller's direct contact with Unicorn was prohibited and that Miller was "written up" a number of times for corresponding by email with Unicorn. Diekmann did not identify any written prohibition against direct contact with Unicorn, but he said that the prohibition was something that was a matter of business practice at the Firm.[75] The supposed prohibition is inconsistent with the record, which contains a number of emails to and from Unicorn that include Miller as a sender or recipient.[76] Moreover, in some Unicorn emails, Diekmann is a recipient along with Miller.[77] There is no evidence that Diekmann protested Miller's involvement or reprimanded him. If Miller was "written up" a number of times for contact with Unicorn, as Diekmann testified, it apparently had little effect. Diekmann's testimony regarding the supposed prohibition was not credible.

Second, the emails indicate that Miller was a "back door" for Scottsdale in dealing with Unicorn. Although the Unicorn deposits supposedly came through CSCT, Miller and others at Scottsdale corresponded directly with Unicorn personnel and directed Unicorn as to what needed to be done.

For example, Miller engaged in extensive email correspondence with Natalie Bannister at Unicorn in November 2013 about setting up its account with CSCT. Miller instructed her that the stock certificates to be deposited at Scottsdale had to be made out in CSCT's name and sent by CSCT to Scottsdale. Bannister indicated that she did not like transferring ownership to CSCT, "especially with it not in writing." Miller insisted, "These are important details." He said that the account at Scottsdale was in CSCT's name and the "cert[tificate deposit] NEEDS to be in [CSCT's] name, that is all there is to it."[78] Thus, it was Scottsdale—not CSCT—that was making the arrangements and instructing the customer on what had to be done.

Miller shepherded Unicorn's due diligence packages through CSCT. In March 2014, he instructed Unicorn staff and Ruzicka to get together on the telephone to discuss which documents were needed and could be provided for a deposit.[79] Similarly, in May 2014, Miller engaged in email correspondence directly with Unicorn's Back Office Manager, Chinique Lewis, asking her about ORFG, one of the stock deposits at issue in this case. He asked her—not Ruzicka—how the package was coming along. Then Lewis emailed Miller—not Ruzicka—to ask if there was "[a]nything on the [ORFG] as yet?" At that point, Miller emailed her back

[75] Hearing Tr. (Diekmann) 1664-65.

[76] See CX-216.

[77] See CX-119.

[78] CX-270.

[79] CX-171.

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directing her to call Ruzicka and have him call Miller.[80] Miller's last instruction in the correspondence appears to us to reflect an awareness that Scottsdale should be seen to be dealing only with and through CSCT, when, in fact, Scottsdale, through Miller, was continuing to guide the business with Unicorn.

In April 2014, when Diekmann was unable to obtain the information he needed on a deposit of stock certificates by Unicorn from Ruzicka at CSCT, he emailed Miller a copy of his request to Ruzicka, saying he had not received a response. And Miller, in turn, forwarded the email directly to two persons at Unicorn, Cem Can and Chinique Lewis, asking them to "please address this ASAP."[81] Diekmann denied that he had asked Miller to obtain the information for him, but the correspondence has no other reasonable explanation. Diekmann's testimony in this regard was not credible.[82]

In May 2014, Miller obtained information from Chinique Lewis at Unicorn about the purported beneficial owner of the entity that had deposited VPLM stock through Unicorn for sale by Scottsdale and forwarded that to Diekmann. The email correspondence was included in the VPLM due diligence package.[83]

The degree to which Miller corresponded directly with Unicorn and managed the Unicorn deposits raises the question whether there was any need for CSCT at all. As discussed below in the credibility section, Hurry's decision to route Scottsdale's FFI business through CSCT had little discernible business rationale. His implementation of that decision and staffing of CSCT with Ruzicka, who was unqualified to run CSCT, coupled with the evidence of Miller's continuing role as a "back door" to Scottsdale, demonstrate that CSCT was a façade.

Third, we interpret certain email correspondence between Miller and a client as suggesting that the Firm assisted its clients "all the time" to conceal beneficial ownership of stock. Scottsdale supposedly had a policy not to accept business from Canadian citizens residing in Canada, but, when a client in the Bahamas asked on behalf of a friend whether a Canadian citizen residing in Canada could do business with Scottsdale, Miller suggested that the friend set up a corporation to do the business. Miller called it a "work around." The client responded, "If they get a corporation set up US, Panama, Belize or wherever won[']t your Compliance want to know who is beneficial owner?" Miller responded, "Yes they will but the account holder is the corporation. Trust me on this one, we do it all the time."[84]

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[80] CX-311, at 1.

[81] Hearing Tr. (Diekmann) 1668-71; CX-221.

[82] CX-221; Hearing Tr. (Diekmann) 1665-71. In denying that he intended for Miller to obtain the information from Unicorn that Ruzicka had failed to supply, Diekmann testified that he had no interest whatever in whether he obtained the information. Hearing Tr. (Diekmann) 1665-71. That statement is not credible. If he had no interest, there would have been no reason to send the email to Miller.

[83] RX-3, at 17.

[84] CX-210; Hearing Tr. (Diekmann) 1672-77.

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We are unconvinced by Diekmann's benign reading of this correspondence. He testified that he thought that the client was asking something different, "Won't your compliance know that a Canadian resident owns the LLC and, therefore, won't they reject the deposit or account opening?"[85] Diekmann's interpretation is a rewriting of the client's words. It ignores that Miller's implicit point was that the corporation would be identified as the account holder, not the Canadian owner. That is why the Canadian's deposit would not be rejected. Furthermore, Diekmann's interpretation does not reflect the tone of Miller's comments. When Miller suggested that the shares could be put in the name of the corporation, he treated that as a magical solution to the problem, saying "and wa-la! We get it done that way."[86] Finally, if Diekmann's interpretation of the question were correct, then Miller never answered the question. Miller never explained why the Firm would not reject the deposit if it knew that a Canadian resident owned the LLC.

Fourth, according to Diekmann, after Miller left the Firm in April 2016, the Firm discovered that he had set up his work email to be forwarded to his personal email.[87] This means that Miller could have engaged in communications with FFIs like Unicorn "off the record," avoiding oversight. Although Diekmann testified that all of Scottsdale's emails remained on its system, and were not removed by Miller, Diekmann provided no basis for knowing whether that was true. Diekmann testified that the Firm had asked Miller to confirm he had not removed any emails from the Firm's system but that Miller had not responded.[88]

The inquiry suggests that the Firm in fact does *not* know whether Miller removed emails from the Firm's system. There was no evidence that the Firm employed any technical analysis of its systems to find out if emails or other information had been deleted. There also was no evidence that the Firm made any effort to recover any email correspondence that Miller might have had with customers using only his personal email. Thus, it is undisputed that Miller communicated directly with Unicorn, and it is impossible to know the number or substance of all those communications.

Given the allegations against Unicorn and Cem Can in the *Bandfield* indictment, the inability to review Miller's communications with them is a serious concern. The Firm's reaction—simply to ask Miller to confirm he did not remove any emails from the Scottsdale's system—is an inadequate response. If Miller took emails from Scottsdale's system or deleted them, he would hardly be likely to confess to that wrongdoing. That is particularly so where the emails were with persons subject to a criminal indictment and might place Miller under suspicion. The request to a potential wrongdoer to confirm that he committed no wrongdoing is almost farcical. The inadequacy of the Firm's response mirrors the inadequacy of its checklist

[85] Hearing Tr. (Diekmann) 1673.

[86] CX-210, at 5.

[87] Hearing Tr. (Diekmann) 1662-63.

[88] Hearing Tr. (Diekmann) 1663-64.

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approach to Rule 144 due diligence and contributes to our conclusion that stringent sanctions are required here.

c. Jay Noiman

Jay Noiman joined Scottsdale in September 2011 and left at the end of December 2014.[89] Prior to October 2013, when DiBlasi became CCO, Noiman was the Firm's CCO.[90] He was on the Management Committee from approximately January 2013 through January 2014. He served as vice chairman of the Management Committee and second in command after Cruz. During the relevant period, Noiman was the trading manager and had responsibility for supervising the traders and sales staff. He identified DiBlasi as his supervisor.[91]

Noiman was responsible for reviewing the blotter for restricted stocks. He focused on FFIs,[92] and he approved the account opening documents for CSCT, which was an FFI. Noiman never considered not approving the CSCT account. He knew at the time that it was a referral from Hurry.[93]

Noiman also signed documents in the due diligence packages for the transactions in this case. His signature appears on the Checklist under the heading "Broker Approval." Between the heading and Noiman's signature was the statement that he had carefully reviewed the Checklist and the supporting documents and that to the best of his knowledge "any resale will be made in compliance with firm policy and all applicable laws."[94] By that language, the Checklist makes it appear that Noiman was certifying that he believed that the transaction would comply with the law.

Noiman testified, however, that his signature signified only that all the necessary forms were in the file—a check-the-box function.[95] The parties stipulated that Noiman's signatures on the documents in the three due diligence packages meant the same thing: he checked that the documents were filled out but did not substantively approve or review them.[96] Thus, Noiman's signature on the Checklist created only a façade of compliance and accountability.

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[89] Hearing Tr. (Noiman) 1041-42.

[90] Hearing Tr. (Noiman) 1043.

[91] Hearing Tr. (Cruz) 81, 564; Hearing Tr. (Noiman) 1043-44.

[92] Hearing Tr. (Noiman) 1045-46, 1049-51.

[93] Hearing Tr. (Noiman) 1139-40.

[94] RX-1, at 2; RX-2, at 2; RX-3, at 2.

[95] Hearing Tr. (Noiman) 1156-68, 1171-73.

[96] Hearing Tr. (Noiman) 1172-73.

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During the relevant period, Noiman, like Miller, had contact with one of the FFIs involved in this case, Titan.[97] Noiman talked with Rohn Knowles of Titan at least monthly and sometimes weekly and engaged in email correspondence with Knowles.[98] Both Titan and Knowles were defendants in the *Bandfield* indictment. As discussed below, Noiman obtained information directly from Knowles, which he forwarded to Cruz, to resolve a serious potential problem with a CSCT deposit of VPLM stock. CSCT's staff was not involved.[99] Thus, Noiman was another "back door" to a CSCT customer, raising once again the question why CSCT even existed.

3. CSCT And Its Key Figures

a. Gregory V. Ruzicka

Prior to joining CSCT, Gregory Ruzicka was a real estate attorney in Newport Beach, California. He began his legal career advising exclusively on real estate issues and continued in the real estate field. He did not advise on the federal securities laws.[100] Before beginning work at CSCT, Ruzicka had no experience with Rule 144 or any of the other exemptions from registration under the federal securities laws.[101] Nor did Ruzicka have any prior experience with Cayman Islands law, the Bank Secrecy Act, or anti-money laundering rules and regulations.[102]

Ruzicka met John Hurry in 2002 when Hurry hired him to do some work on a commercial real estate issue. From time to time after that, Ruzicka did work for Hurry, but none of that work involved the securities laws or Hurry's broker-dealer business.[103]

Later, Ruzicka suffered a substantial financial setback that left him out of work and adrift.[104] At this point, Ruzicka asked Hurry to give him a job at a bicycle shop that Hurry owned. Hurry admitted that he was "kind of taken back a little bit."[105] Hurry proposed instead

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[97] Prior to the events at issue, Noiman was involved in the customer due diligence on Titan when it was a direct customer of Scottsdale. On January 18, 2012, Noiman signed a due diligence form as a principal of the Firm representing that to the best of his knowledge the information provided by Titan was true and correct. Noiman also signed the form as the person giving compliance approval. CX-242, at 48.

[98] Hearing Tr. (Noiman) 1185-87. Ruzicka was under the impression that Titan "had a special pipeline to Scottsdale." CX-178, at 110. He spoke of a young woman as being the "private liaison for Titan." CX-178, at 110.

[99] CX-296; CX-294; Hearing Tr. (Noiman) 1187-98. *See infra* at __.

[100] CX-178, at 12-20.

[101] CX-178, at 22-23.

[102] CX-178, at 18-19, 22-24.

[103] CX-178, at 25-29

[104] CX-178, at 14-15, 19-20, 30, 38, 54.

[105] Hearing Tr. (Hurry) 1631, 1635-36. Hurry told D'Mura that Ruzicka had asked, "Would you be able to help me out? Is there any position or something? Could I work at your bike shop or your ice cream shop? You know, you don't have to pay me a lot, but at this point, I don't have anything. I have $50 in my pocket." Hearing Tr. (D'Mura) 2262.

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that Ruzicka go to the Cayman Islands to run Hurry's operation there. According to Ruzicka, Hurry told him that Ruzicka would be running the business and acting as Hurry's lawyer.[106] Ruzicka had been to the Cayman Islands once before to go scuba diving, but he was willing to relocate because he had been through such a hard time and wanted a "change of scenery."[107] Hurry told Ruzicka that he had 30 days to read about Rule 144,[108] so Ruzicka read Rule 144, the Securities Act of 1933, and what he could find on the internet about the Rule 144 exemption.[109]

In mid-October 2013, Hurry flew with Ruzicka in Hurry's private plane to the Cayman Islands so that Ruzicka could begin work.[110] Ruzicka remained with CSCT until mid-October 2014.[111]

Diekmann testified that if CSCT had been his business, Ruzicka would not have been his choice to run the Cayman Islands broker-dealer. Ruzicka lacked securities experience, and he seemed disorganized, sending materials to Scottsdale piecemeal and failing to follow instructions.[112]

Ruzicka never had a securities license or registered with FINRA. Consequently, FINRA had no jurisdiction to compel him to testify. Ruzicka testified voluntarily at an OTR, and he considered testifying voluntarily at the hearing. However, after being contacted by counsel for Respondents, as discussed below in the credibility section, Ruzicka declined to testify. Consequently, Ruzicka's entire OTR was admitted into evidence.

b. Craig D'Mura

Craig D'Mura graduated from Arizona State University in May 2006 and shortly afterward began work at Vanguard Group in the retirement participant services department. After a year and a half, he went to law school at Syracuse University. Although he finished law school, he never took the bar examination and did not become licensed as an attorney. He returned to Phoenix and started a broker training program in 2010. However, he did not feel that being a broker was his "calling."[113]

D'Mura was unemployed in summer of 2011. He responded to an advertisement on Craigslist for an operations position at Scottsdale. In July or August 2011, after an interview with

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[106] CX-178, at 38-40.

[107] CX-178, at 54.

[108] CX-178, at 40.

[109] CX-178, at 22, 62-63.

[110] CX-178, at 37.

[111] CX-178, at 231.

[112] Hearing Tr. (Diekmann) 759-61, 765.

[113] Hearing Tr. (D'Mura) 2246-47.

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Justine Hurry, Scottsdale hired him. Prior to his work at Scottsdale, D'Mura was not even aware of the microcap securities industry.[114]

After two or three weeks in the operations position, D'Mura joined the Rule 144 team. His training was ongoing. By summer of 2013, he was handling more complicated deposits and was able to review files as a principal. However, he did not review deposits by FFIs.[115]

In summer of 2013, Hurry began discussing with Scottsdale staff his plan to open a broker-dealer in the Cayman Islands, and Cruz asked D'Mura if he might be interested in working there. D'Mura began filling out the paperwork necessary if he took the position in the Cayman Islands, and in January 2014, he flew with Hurry in Hurry's private airplane to the Cayman Islands to visit and consider a position with CSCT.[116] D'Mura decided to take the position, returned to Phoenix for a few days, and then went back to the Cayman Islands on January 28, 2014. He stayed with CSCT only about six weeks. After concluding that the situation was intolerable and would never improve, he left on March 14, 2014.[117]

c. CSCT

i. Hurry Set Up CSCT

In early 2013, Hurry set up CSCT in the Cayman Islands.[118] He became its director and intended to have overall management supervision of it and its business.[119] Through a chain of entities, a Hurry family trust owns CSCT, and Hurry and his wife serve as co-trustees of the trust.[120]

Hurry claimed that he set up CSCT because Alpine, his U.S. clearing firm, wanted to be relieved of IRS tax withholding obligations. According to Hurry, Alpine wanted to do business only with FFIs that had agreed with the IRS to take on tax withholding obligations, thereby becoming what is known as a qualified intermediary ("QI").[121] Hurry testified that withholding obligations are complicated and burdensome.[122] He also testified that there are risks in getting

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[114] Hearing Tr. (D'Mura) 2247-48.

[115] Hearing Tr. (D'Mura) 2248-51.

[116] Hearing Tr. (D'Mura) 2252-58.

[117] Hearing Tr. (D'Mura) 2266, 2306-09.

[118] Hearing Tr. (Hurry) 1329, 1333-34.

[119] Hearing Tr. (Hurry) 1394-95; CX-160, at 3.

[120] CX-21, at 2.

[121] Hearing Tr. (Hurry) 1373-74, 1552-61; Hearing Tr. (Frankel) 2345-46, 2349-51. Resp. PH Br. 8.

[122] Hearing Tr. (Hurry) 1554-57.

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the paperwork wrong and incurring penalties, and that there were tax advantages to generating and retaining funds offshore.[123]

Hurry's testimony was at a high level of generality, and there was no corroborating evidence to show the analysis. There was no evidence regarding how Alpine made the decision that it would only do business with QIs, or who made the decision. There was no evidence other than Hurry's testimony to demonstrate that CSCT made business sense. It is unclear how the expense of establishing and staffing a separate offshore office was less burdensome than Alpine's withholding obligations, or why the same goal of eliminating Alpine's withholding obligation could not have been achieved less expensively by requiring the Firm's FFI customers to obtain QI certification in order to do business with Scottsdale and Alpine. Moreover, since Hurry ultimately bore the costs regardless of which entity had the obligation, Alpine or CSCT, we are not persuaded that the claimed reason for creating CSCT made sense.[124]

Nor did the creation of CSCT make sense from the perspective of achieving regulatory compliance. As Cruz agreed, it is easier to spot problems with direct accounts than through an FFI like CSCT that operated as an intermediary for sub-accounts and sub-sub-accounts.[125]

Hurry's intense involvement in CSCT's operations did not abate after he hired Ruzicka in October 2013 to run CSCT's day-to-day operations. Hurry located and rented office space for CSCT before Ruzicka began work and then continued to closely oversee the details of establishing and opening the office after Ruzicka arrived. Hurry obtained a floor plan from Ruzicka, told Ruzicka it was not correct, and asked Ruzicka to take measurements and create a revision.[126] Hurry provided Ruzicka with contact information for shippers to ship furniture Hurry had found for the office.[127] Hurry reviewed the proposed CSCT website design and asked about the costs.[128] Hurry made the final decision on hiring a bookkeeper[129] and all the decisions on entering contracts.[130]

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[123] Hearing Tr. (Hurry) 1554-57.

[124] Hurrry testified that he had allocated between $4 and $5 million for the project and had invested well over seven figures in CSCT. Hearing Tr. (Hurry) 1552. When asked what he had taken out of CSCT, he said "Zero." Hearing Tr. (Hurry) 1553.

[125] Hearing Tr. (Cruz) 220.

[126] CX-48; CX-50; CX-52; CX-55; CX-75.

[127] CX-52; CX-53.

[128] CX-49; CX-84.

[129] CX-178, at 43-44.

[130] CX-178, at 46.

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Hurry instructed Ruzicka on fundamental business operations, as well. For example, he explained to Ruzicka that he should open a separate bank account for customer funds to keep their funds separate from CSCT's funds.[131]

Hurry decided that CSCT should be in the Special Economic Zone within the Cayman Islands, and that it should apply to be exempt from regulation by the Cayman Islands Monetary Authority ("CIMA"). In addition, Hurry instructed Ruzicka to apply to the IRS for QI status.[132] Although Ruzicka expressed concerns about the obligations and representations associated with QI status and was reluctant to make the required representations without further study, Hurry insisted that Ruzicka do it.[133]

Hurry determined the fees and commissions CSCT clients would pay. He instructed Ruzicka to take whatever Scottsdale charged CSCT and tack on 200 basis points.[134] Hurry in turn obtained a discount from Scottsdale on its charges to CSCT.[135] By this means, he kept the cost of doing business through CSCT roughly the same as doing business directly with Scottsdale. Otherwise, the rerouting of the FFI business through CSCT would have made no economic sense for the customers. However, there was no evidence that it made economic sense for Hurry to keep customer expenses roughly the same as they would have been working directly with Scottsdale when he was incurring substantial extra expenses setting up and staffing the extra office in the Cayman Islands.[136]

Hurry was intimately involved in setting up CSCT's technical systems. Hurry made the arrangements for computer software for CSCT and instructed Ruzicka to download Office 2010 for two users.[137] Similarly, Hurry selected computer equipment for CSCT and brought it down to the Cayman Islands in mid-January 2014 at the same time that he brought D'Mura to look at joining CSCT. D'Mura testified that Hurry set up the office network for CSCT.[138] When Ruzicka showed Hurry the information he planned to send to clients, Hurry told him he should make it look better and instructed him on how to do that. Hurry told Ruzicka to print to PDF and get a clean file to email customers. He advised Ruzicka that he could do that on his computer.[139]

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[131] CX-83.

[132] CX-178, at 48-53.

[133] CX-105; CX-107; CX-178, at 50-53.

[134] CX-178, at 106-09.

[135] Hearing Tr. (Cruz) 141-43; Hearing Tr. (D'Mura) 2294-95.

[136] Hurry and Diekmann testified that routing the FFI business through CSCT was actually a little less expensive for customers than dealing with Scottsdale directly. Hearing Tr. (Hurry) 1642-44; Hearing Tr. (Diekmann) 1652-53. If true, that testimony further undercuts the business justification for CSCT.

[137] CX-94; Hearing Tr. (Hurry) 1461.

[138] Hearing Tr. (D'Mura) 2263, 2266-68.

[139] CX-77; CX-78.

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Ruzicka, by contrast, was fairly unsophisticated about technology. He was vague on even identifying the programs that he used at CSCT.[140]

ii. Hurry Micro-Managed CSCT's Business

Although Hurry portrayed Ruzicka as being in charge of CSCT,[141] the evidence is otherwise. Hurry micro-managed CSCT, and he bullied Ruzicka and D'Mura to get them to do what he wanted them to do. Hurry also closely tracked CSCT's business with Scottsdale and with its FFI customers.

Ruzicka considered himself to be only an intermediary.[142] Hurry dictated what should be done, and Ruzicka complied. Ruzicka said with respect to Hurry, "You don't discuss; you do as you are ordered."[143] For example, when Ruzicka protested that he was not comfortable with signing off on the QI application, Hurry responded, "Stupid, just do it." Ruzicka said that he "kind of dropped the subject at that point."[144] Ruzicka signed off, despite his discomfort, because he knew if he did not "there is a ticket back to LA coming tomorrow."[145]

Similarly, although Ruzicka thought that Unicorn engaged in some suspicious trading and constant pressure from Cem Can at Unicorn gave him the "creeps," Ruzicka did not think he had authority to terminate the relationship with Unicorn. If he had done so without clear authority from Hurry, he thought that would have been his last day at CSCT.[146] D'Mura confirmed that neither he nor Ruzicka could terminate a client relationship, and, although they hated dealing with Cem Can at Unicorn, they did not consider it an option to turn away the business.[147]

Some of the initial customers of CSCT were pre-existing customers of Scottsdale. When Ruzicka asked the commonsense question why the pre-existing business was going to flow through the new entity, Hurry told him to shut up. After that, Ruzicka just did as he was told.[148]

Ruzicka testified in his OTR, and D'Mura testified at the hearing, that Hurry barraged them with telephone calls while they were working at CSCT. Hurry called Ruzicka almost every day, sometimes multiple times. He called D'Mura less often, probably a couple of times a week.

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[140] CX-77; CX-178, at 24-25.

[141] Hearing Tr. (Hurry) 1433, 1436, 1549-50. Hurry claimed that he hired Ruzicka to fulfill an "executive role." Hearing Tr. (Hurry) 1648.

[142] CX-178, at 46.

[143] CX-178, at 51.

[144] CX-178, at 51-52.

[145] CX-22; CX-178, at 52-53.

[146] CX-178, at 177-80, 188-89.

[147] Hearing Tr. (D'Mura) 2283-86.

[148] CX-178, at 79-80.

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The calls could come at all hours as well.[149] Often the calls were followed by demanding, abrupt, and increasingly impatient emails saying "call me."[150] In one email, Hurry wrote "Your phone is not working TURN IT ON. I need a call."[151] In another he wrote, "Call me in 60 minutes. DO YOU NOT UNDERSTAND THAT?"[152] In another the subject line was "pick up your phone!!!!!!!!"[153]

Hurry developed an Excel spreadsheet to track various aspects of CSCT's business. Although Hurry characterized it in his testimony as an "empowerment tool" that enabled his people to track their work for themselves without his having to keep track of their progress,[154] that characterization is not consistent with the evidence.

The spreadsheet tracked daily gross production, number of trades placed, certificate deposits approved, new certificate deposits received, and number of new accounts. It also tracked Ruzicka's start and finish times.[155] Ruzicka said that in telephone calls Hurry would even ask about how many cigarettes he had smoked during the day.[156] An email from Hurry corroborated Ruzicka's testimony. In the email, Hurry told Ruzicka "Need all the below," including start time, finish time, and "number of cig breaks."[157] Hurry acknowledged that the email included an inquiry about cigarette breaks, but he claimed that he was trying to help Ruzicka get himself organized. He claimed to know that Ruzicka was only in the office for ten minutes in an hour, which meant things were not getting done.[158]

Hurry wanted the numbers prepared every day, even if he did not ask for the information every day. Ruzicka and D'Mura prepared themselves for Hurry's frequent telephone calls and tried to have talking points and updated information ready to go if Hurry should call.[159]

Hurry tracked Ruzicka's and D'Mura's contacts with CSCT customers, including the FFIs involved in the transactions at issue. Ruzicka testified that in their frequent telephone calls Hurry would ask him about whether he had talked to Rohn Knowles at Titan or Cem Can at

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[149] Hearing Tr. (D'Mura) 2301-02; CX-178, at 67-73.

[150] CX-63; CX-68; CX-71; CX-74; CX-118; CX-121; CX-126; CX-127.

[151] CX-121.

[152] CX-127.

[153] CX-118.

[154] Hearing Tr. (Hurry) 1433-39.

[155] CX-131; Hearing Tr. (Hurry) 1433-34.

[156] CX-178, at 140-41.

[157] CX-133; Hearing Tr. (Hurry) 1438-39.

[158] Hearing Tr. (Hurry) 1438-40.

[159] CX-178, at 140-41; Hearing Tr. (D'Mura) 2301-04; Hearing Tr. (Hurry) 1436-40.

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Unicorn or other particular people from the Bahamas, Panama, or Belize.[160] D'Mura testified that Hurry would ask about customers, not particular deposits, but he and Ruzicka did discuss with Hurry how they were doing on specific deposits.[161] For example, in email correspondence and telephone conversations, Ruzicka discussed with Hurry the amount of trading in at least two of the symbols at issue here, NHPI and VPLM.[162]

D'Mura decided to leave CSCT and the Cayman Islands, in part, as a result of Hurry's constant demands. Hurry had called on a day that Ruzicka was attending a wedding as best man and D'Mura was working at his rented condominium instead of the office. Hurry expressed aggravation that neither of them was in the office and spoke of "having a come to Jesus moment" when he arrived in the Cayman Islands in a few days.[163] D'Mura then packed his bag and said good-bye to Ruzicka, who expressed the wish that he could leave, too. However, Ruzicka said he had nowhere to go and no alternative. D'Mura left before Hurry arrived; Ruzicka stayed.[164]

Eventually, in October 2014, Ruzicka also left CSCT. Its business had dwindled in reaction to the SEC complaint in *Amogear* and the *Bandfield* indictment.[165] According to Ruzicka, in October 2014 Hurry offered him other positions back in the United States, but Ruzicka concluded that he "did not want to work any long[er] for that man," referring to Hurry. Ruzicka said, "I don't care what he offered, you know. Incremental value of that last dollar just was not worth it."[166]

iii. Hurry Prospected For CSCT Customers

CSCT did not advertise[167] or engage in cold-calling to try to generate business.[168] Hurry's business plan was for CSCT to develop clients through contacts and referrals,[169] but Ruzicka, who had no prior industry experience, had no network he could cultivate for potential customers.

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[160] CX-178, at 74-77, 84-85.

[161] Hearing Tr. (D'Mura) 2304-05.

[162] CX-132.

[163] Hearing Tr. (D'Mura) 2308-09. Hurry confirmed that he was frustrated that Ruzicka and D'Mura were not in the office. Hearing Tr. (Hurry) 1602-03. When people called CSCT and did not get an answer, they called Alpine trying to find Hurry. Hearing Tr. (Hurry) 1622-23.

[164] Hearing Tr. (D'Mura) 2306-10.

[165] Hearing Tr. (Cruz) 237-38.

[166] CX-178, at 232.

[167] CX-178, at 218. In contrast, even though Scottsdale had been in business for ten years, it advertised for business. Hearing Tr. (Cruz) 116.

[168] Hearing Tr. (D'Mura) 2279-80.

[169] CX-160, at 3; Hearing Tr. (Hurry) 1393.

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Customers simply appeared seeking to establish a business relationship with CSCT. They were referred to CSCT by Hurry or by someone at Scottsdale or Alpine.[170] Ruzicka testified at his OTR that he had an "express representation" that two of the FFIs involved in this case, Titan and Unicorn, were referred by Hurry.[171] Ruzicka did not know how Montage "found" CSCT.[172]

At the hearing, Hurry flatly contradicted Ruzicka's testimony that Hurry had referred Titan and Unicorn to CSCT.[173] We do not credit Hurry's testimony because he gave the testimony only after he knew that Ruzicka would not appear at the hearing to dispute Hurry's statement. To the extent that Hurry means that the referral came from someone at Scottsdale, we do not regard that as proving that Hurry was not the ultimate source of the referral, even if he made the link to CSCT through Scottsdale. Hurry had a pre-existing relationship with Titan while it was a direct customer of Scottsdale,[174] and he admitted talking to existing Scottsdale customers about his plan to establish CSCT.[175] He also admitted, as discussed below, to talking directly to Titan and other customers even after they became CSCT customers.

Hurry admits that he had at least one face-to-face meeting with Montage in Panama[176] and another face-to-face meeting with Unicorn in Belize.[177] He flew to Central America in January 2014 for these meetings, after dropping off D'Mura on his initial visit to CSCT. He did not take Ruzicka with him.[178]

At the hearing, Hurry claimed not to recall discussing business with either Montage or Unicorn during these visits.[179] Hurry claimed that he went to Montage because Ruzicka had asked him to evaluate a back-office system Montage was using to see if it would be suitable for CSCT. Hurry did not identify the nature of the system. He said that in the end they determined that it was not suitable for CSCT. He did not explain why it was unsuitable.[180]

We do not find Hurry's testimony with respect to his visit with Montage credible. Ruzicka was not technologically sophisticated and was too subordinate to suggest such a thing to

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[170] CX-178, at 104, 167-68.

[171] CX-178, at 203-04.

[172] CX-178, at 203.

[173] Hearing Tr. (Hurry) 1410, 1416.

[174] Hurry was listed as the registered representative and financial consultant for Titan when it was a direct customer of Scottsdale. Hearing Tr. (Hurry) 1413-14, 1610-12; CX-242, at 44, 48.

[175] Hearing Tr. (Hurry) 1401-06.

[176] Hearing Tr. (Hurry) 1412-13, 1612-13.

[177] Hearing Tr. (Hurry) 1406, 1422, 1613-14.

[178] Hearing Tr. (D'Mura) 2300-01; Hearing Tr. (Hurry) 1617-19.

[179] Hearing Tr. (Hurry) 1406, 1618-19.

[180] Hearing Tr. (Hurry) 1612-13, 1617-19.

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Hurry. Furthermore, D'Mura testified that he remembered no discussion of evaluating a back office system.[181] Hurry's testimony was vague and lacked specificity, and, again, Hurry gave his testimony only after it was clear that Ruzicka would not appear at the hearing. Hurry knew he would not be contradicted.

Hurry counseled Ruzicka to do business with Montage and, in particular, to do business with a person who was not identified in Montage documents as being connected with it. Ruzicka testified in his OTR that he was unclear about the role of a Montage contact with whom Hurry spoke from time to time. When Ruzicka asked Hurry about the contact, Hurry said to him "Hey, that's fine, you can interface with that guy. He's part of the operation."[182] This evidence shows that Hurry knew more about Montage than Ruzicka did, and that Hurry was instructing Ruzicka with regard to customer dealings.

Hurry claimed at the hearing that he only went to Belize to meet with Cem Can at Unicorn (both named defendants in the *Bandfield* indictment) because Ruzicka asked him to do so. According to Hurry, Ruzicka was trying to open the account and Can had requested a meeting with Hurry. Hurry said it is not uncommon for people to want to meet the owner of a business.[183] However, in somewhat inconsistent testimony, Hurry testified that he did not recall discussing business during his visit with Unicorn.[184]

Hurry's hearing testimony was impeached by his OTR. In his OTR, Hurry testified that Cem Can had asked him whether it would be better to do business with Scottsdale or CSCT. Hurry told him that it might be quicker to go directly to Scottsdale, but there could be "holdups" because of potential withholding there. On the other hand, because CSCT was a QI, Hurry told Can the "holdup" would be eliminated.[185]

There was additional evidence that Hurry discussed business with Unicorn. In late January 2014, Chinique Lewis of Unicorn sent an email to Eric Miller, Diekmann, and Ruzicka asking for Hurry to join a call on the processes and procedures to be used in connection with Unicorn's business with CSCT and Scottsdale. She said from "our personal face to face conversation with Mr. Hurry, I am certain he will not mind getting on a call."[186]

With respect to the request to involve him on a call with Unicorn, Hurry testified that it was no more than the common desire to deal with the person at the head of an organization.[187]

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[181] Hearing Tr. (D'Mura) 2300-01.

[182] CX-178, at 123-24.

[183] Hearing Tr. (Hurry) 1613-14.

[184] Hearing Tr. (Hurry) 1406.

[185] Hearing Tr. (Hurry) 1407-10, 1421-22.

[186] CX-119.

[187] Hearing Tr. (Hurry) 1432

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We find his explanation unconvincing. He traveled to a potential CSCT client without taking Ruzicka, the designated head of CSCT, discussed that client doing business with CSCT, and was viewed by the client as an important participant in the client's business dealings with CSCT.

Although he denied it, Hurry provided other leads and referrals to Ruzicka, too. In an email dated November 17, 2013, for example, Hurry wrote to Ruzicka, "Referrals and Leads call me on them." In the email, Hurry provided a couple of names and telephone numbers. One of those named was an "Andrew Farmer."[188] On November 20, 2013, Ruzicka wrote Hurry that he had tried to call "Andy" at the number Hurry had given him but the call did not go through. That same day Hurry provided another telephone number.[189] Hurry maintained he had identified the people in the email to Ruzicka not as prospects or potential customers but because they knew FFIs.[190]

Hurry revealed that, in fact, he was guiding Ruzicka's customer dealings, when he volunteered that Ruzicka did not in the end talk to the people Hurry had identified in the email. Hurry said that he had afterward found out that they had some "issues" and had told Ruzicka, "Don't bother."[191]

D'Mura testified that while he was at CSCT Hurry and Ruzicka met with another potential customer, Caledonian Securities. CSCT received over 50 Caledonian deposits afterward.[192]

Despite this evidence that Hurry was critical to developing CSCT's business, Hurry portrayed himself as offering only slight help to Ruzicka. He claimed that all he did was to recommend to Ruzicka that he get a book of international financial institutions and prospect for customers using that.[193] This testimony is not credible. Since Ruzicka and D'Mura engaged in no cold calling, they had no use for a book to help them prospect for customers.[194] Furthermore, such an approach to business promotion—cold calling people out of a book—was not likely to be successful. Hurry would certainly have known that, and he would not have been satisfied with

[188] CX-51.

[189] CX-62.

[190] Hearing Tr. 1401-04; CX-51.

[191] Hearing Tr. (Hurry) 1404.

[192] Hearing Tr. (D'Mura) 2295-97. D'Mura testified that he received the initial documents from Caledonian in the last week before he left Scottsdale and laid them out on a table to review, so he was well aware of the volume submitted to CSCT. The Caledonian-related deposits were not passed on to Scottsdale before he left CSCT. Hearing Tr. (D'Mura) 2317.

[193] Hearing Tr. (Hurry) 1403-04.

[194] Hearing Tr. (D'Mura) 2279.

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that approach to marketing CSCT. He wanted CSCT to be successful and worked hard to make it so.[195]

iv. Hurry Tried To Conceal His Involvement With CSCT

Both Ruzicka and D'Mura had the impression that secrecy was important to Hurry. Ruzicka said that Hurry "flat told me, 'I'm going to Caymans, because that way I don't have to give anything to anybody.'"[196] D'Mura testified that when he first flew down to the Caymans with Hurry, Hurry spent time discussing with him the privacy laws of the Cayman Islands. Hurry noted that some of them were criminal, not just civil.[197] In so doing, Hurry stressed the serious consequences if a person failed to comply.

Hurry denied any particular interest in secrecy.[198] Hurry's denial is not credible. We find that he was intensely concerned with secrecy and concealing his involvement with CSCT's customers and business. His concern was manifested in the following ways.

(a) Use Of Email Address That Hid His Identity

Hurry used an email address that hid his identity. When Ruzicka started working at CSCT, he used as his work email address gr@csct.ky. The address identified him by his initials, the firm by its initials, and the Cayman Islands location by the last two letters. Ruzicka set up a similar email address for Hurry, using Hurry's first initial and last name: jhurry@csct.ky.[199]

Hurry had an extreme reaction to his email address. Ruzicka said that Hurry "just crucified me." Hurry told Ruzicka that the address was too long, and instructed Ruzicka to change the individual identifier to x.[200] Thus, during the relevant period Hurry's email address at CSCT was x@csct.ky, which did not identify Hurry.

At the hearing, Hurry repeated the same explanation for changing his email address. He testified that he wanted an address that was short.[201]

We find Hurry's explanation to be false. He volunteered elsewhere in his testimony that his main email address is JHurry@hurry.com.[202] Thus, Hurry's main email address is constructed in the same way that Ruzicka initially constructed Hurry's address at CSCT. If that construction

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[195] Hearing Tr. (Hurry) 1417-18; CX-178, at 74-75, 135-42.

[196] CX-178, at 36.

[197] Hearing Tr. (D'Mura) 2259.

[198] Hearing Tr. (Hurry) 1361-62, 1364-65.

[199] CX-178, at 146-47.

[200] CX-178, at 146-47.

[201] Hearing Tr. (Hurry) 1459.

[202] Hearing Tr. (Hurry) 1426.

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was not too long for Hurry's main email address, then it was not too long for his CSCT address. Furthermore, we find that the choice of x instead of an identifier such as JH was designed to conceal Hurry's involvement in CSCT business and perhaps give him the possibility of denying that it was his address. Finally, the extreme nature of his reaction to the initial email address—making Ruzicka feel almost "crucified"—strongly suggests that Hurry was concerned with something more important than having a short email address.

(b) Assertion Of Attorney-Client Privilege

Hurry insisted on asserting the attorney-client privilege even where it was not appropriate. Hurry almost always marked his emails with Ruzicka as attorney-client privileged. He did so even when his emails simply asked Ruzicka to call him and when his emails concerned only floor plans and office furniture and the like, which emails neither sought nor received nor reflected any legal advice.[203] In contrast, Ruzicka rarely marked his emails to Hurry as privileged,[204] even though Hurry instructed Ruzicka that he should mark all his email correspondence with Hurry as attorney-client privileged.[205]

Hurry claimed at the hearing that he marked his emails privileged because Ruzicka advised him to use the privilege designation.[206] That claim is not credible in light of Ruzicka's practice of not marking his emails with Hurry as privileged. Nor is Hurry's claim consistent with the written record that it was Hurry who instructed Ruzicka to use the privilege designation, not the other way around. We find that Hurry wanted all his correspondence with Ruzicka marked privileged because he believed that he might be able to shield that correspondence from future regulatory scrutiny or litigation discovery. Similarly, in his hearing testimony, Hurry sometimes used the phrase "on advice of counsel" in his answer, as though it were a talisman against more probing inquiry or criticism.[207]

(c) Avoiding Written Record

Hurry tried to avoid creating a written record. Ruzicka wrote in an email to Diekmann that Hurry had directed him to take a particular deposit, specifying the symbol, SVLE. Diekmann forwarded the email to Hurry and DiBlasi. When Hurry saw the email, he "tore" into Ruzicka

[203] CX-48; CX-49; CX-50; CX-51; CX-52; CX-55; CX-58; CX-62; CX-63; CX-71; CX-75; CX-77; CX-78; CX-79; CX-83; CX-84; CX-92; CX-94; CX-107; CX-129; CX-151.

[204] CX-53; CX-62; CX-75; CX-77; CX-79; CX-84; CX-151.

[205] CX-53 and CX-84.

[206] Hearing Tr. (Hurry) 1485.

[207] Hearing Tr. (Hurry) 1333-35.

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"like you wouldn't believe."[208] Hurry told Ruzicka something to the effect of "Never put in writing that I am directly involved in business decisions."[209]

Ruzicka said that Hurry did not want any permanent record of his communications.[210] For that reason he communicated with Ruzicka primarily through FaceTime, the iPhone tool for video communications. Hurry called Ruzicka frequently, sometimes as many as four times in a day. He called early in the morning and as late as 9:30 p.m.; he called on weekends as well as business days. Ruzicka viewed the video calls as invasive, but Hurry told him that he used FaceTime because it was free.[211] Notably, emails are similarly "free" communications once you have paid the internet provider, and Hurry would have incurred no additional expense if he had communicated with Ruzicka by email.

Hurry disputed Ruzicka's testimony that he did not want a written record of his communications with CSCT.[212] However, D'Mura confirmed that Hurry did not want a written record of his involvement in CSCT business. D'Mura testified that Hurry expressed to him and Ruzicka both specifically and generally not to send him documents.[213]

(d) Use Of FaceTime To Conceal Contacts With Customers

Hurry also communicated with CSCT customers (including all three FFIs involved in this case) using FaceTime, thereby concealing his contacts with them. Hurry would call Ruzicka at CSCT and ask Ruzicka to call a customer on CSCT's landline. Then Ruzicka would hold his iPhone next to the landline telephone so that Hurry and the customer could talk. Ruzicka did not participate in the calls, although he had to be present to hold the telephones together. This manner of conducting the telephone conversation would avoid a record that Hurry had talked to the customer. To the extent there was any record, it would appear that Hurry had only called CSCT. Ruzicka testified at his OTR that this happened roughly a dozen times and that Hurry had conversations in this manner with Rohn Knowles and Kelvin Leach at Titan, Cem Can at Unicorn, and an individual at Montage.[214]

In hearing testimony, D'Mura similarly described a FaceTime conference call with Caledonian. Caledonian was on the speaker phone in the CSCT office and Hurry was on the iPhone. Ruzicka would hold the telephones next to each other. D'Mura remembered at least one

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[208] CX-178, at 155-61.

[209] CX-178, at 161.

[210] CX-178, at 70.

[211] CX-178, at 67-71.

[212] Hearing Tr. (Hurry) 1540.

[213] Hearing Tr. (D'Mura) 2300.

[214] CX-178, at 118-27.

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other time that such a FaceTime conference happened.[215] D'Mura believed that it was Hurry's idea to conduct the calls this way.[216]

Hurry does not deny that he conducted telephone calls with CSCT customers in this manner. However, he gives the practice an innocent explanation. He claims that he used the iPhone app because it cost less and because he found it difficult to do a conference call on his cell phone. He claimed that Ruzicka was a participant in the call, disputing Ruzicka's OTR testimony after he knew that Ruzicka would not appear at the hearing.[217]

We find Hurry's explanation not credible. Hurry generally did not conduct his business in such a frugal manner. He flew back and forth to the Cayman Islands in his own private airplane, and flew to Panama and Belize from there to meet with Montage and Unicorn.[218] He funded expensive offices for CSCT[219] and provided Ruzicka and D'Mura with housing when they worked there.[220] He instructed Ruzicka to buy Hurry a seven-seat vehicle to use while he was in the Cayman Islands.[221] He liked to tell people how rich he is.[222] It is unlikely that the costs associated with a dozen international telephone calls would trouble him much.

We also find Hurry's assertion that he used FaceTime because he was too technologically challenged to figure out how to do a conference call on his cell phone not credible. Hurry was technologically sophisticated enough to set up CSCT's computer network.[223] He instructed Ruzicka on how to use PDFs and other software, and he created an elaborate Excel spreadsheet.[224] When he was asked whether he was aware that his use of FaceTime to speak with customers would conceal his involvement in a conversation with the customers, Hurry answered evasively, avoiding a direct yes or no.[225]

Hurry testified that he started using FaceTime in February 2014.[226] Coincidentally, his email traffic with Ruzicka and D'Mura at CSCT dropped to nearly nothing.[227] We find a

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[215] Hearing Tr. (D'Mura) 2297-98.

[216] Hearing Tr. (D'Mura) 2302-03.

[217] Hearing Tr. (Hurry) 1540-42.

[218] Hearing Tr. (D'Mura) 2252-58, 2300-01; Hearing Tr. (Hurry) 1412-13, 1613-14, 1617-19.

[219] CX-178, at 35.

[220] Hearing Tr. (Hurry) 1447, 1649-51; Hearing Tr. (D'Mura) 2265, 2316-17.

[221] CX-58.

[222] CX-178, at 26, 70.

[223] Hearing Tr. (Hurry) 1461; Hearing Tr. (D'Mura) 2263, 2266-68; CX-94.

[224] Hearing Tr. (Hurry) 1433-34; CX-178, at 24-25; CX-77; CX-131.

[225] Hearing Tr. (Hurry) 1541.

[226] Hearing Tr. (Hurry) 1540.

[227] Resp. PH Br. 45.

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significant connection between the two events. Hurry's purposeful use of FaceTime enabled him to stop creating a trail of emails.

C. The Firm's General Practice For Reviewing Deposits

Everything that Scottsdale knew about a deposit when the Firm concluded that it could sell the deposited securities pursuant to the Rule 144 exemption is contained in a due diligence package for the deposit.[228] Generally, at the top of the package is a two-page Deposited Securities Checklist ("Checklist"). That is followed by various other documents, including a Beneficial Ownership Declaration signed by the purported beneficial owner of the shares deposited for resale by Scottsdale.[229]

Scottsdale's general process for reviewing and approving a deposit of stock certificates was for a person on the Rule 144 team to assemble the due diligence package, working from the Checklist. Then, the person who had put together the file (sometimes referred to as the first reviewer) would go to Cruz and talk with him about it. Depending on the complexity of the deposit, the talk could take 15 minutes to an hour. Cruz did not review every page in the file. He would read through the Checklist and ask questions. He might ask to see particular documents and conduct Google searches while sitting together with the initial reviewer.[230]

The Firm heavily depended upon the representations made in the Beneficial Ownership Declaration for its conclusion that the purported beneficial owner was not an affiliate of the issuer and was the person who had the economic interest in the shares on deposit. Diekmann initially denied that the persons signing as beneficial owners could be lying. He testified that he saw no reason for them to lie, and he emphasized that the document is very clear about the information it requests. Only upon being pressed did he eventually agree that if someone were acting as a nominee for a secret beneficial owner one would expect them to lie.[231] We find his testimony on this subject evasive.

Cruz similarly focused on the fact that the Beneficial Ownership Declaration was the tool that the Firm used to find out who owned the shares.[232] He stressed that the Declaration was "unequivocal," and that the parties to the transactions understood the Firm's expectations when they made parallel representations regarding the person identified as the beneficial owner.[233] When asked whether language on Unicorn's website offering to appoint nominee officers and directors would be a red flag to him, Cruz responded that it "could have been." He suggested that the way he would deal with that red flag would not be to seek independent verification. Rather,

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[228] Hearing Tr. (Diekmann) 1916-17.

[229] RX-1, at 1-2, 11-12, 78-79, 88-89, 158-59, 169-70; RX-2, at 1-2, 12-13, 106-07, 117-18; RX-3, at 1-2, 11-12.

[230] Hearing Tr. (Diekmann) 694-96; Hearing Tr. (Cruz) 278.

[231] Hearing Tr. (Diekmann) 1895-96.

[232] Hearing Tr. (Cruz) 201-03.

[233] Hearing Tr. (Cruz) 202.

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he would simply emphasize to the interested persons the importance of disclosure. He said that the Firm would "reiterate and make sure they understand the purpose of our forms and … that they need to – to disclose the underlying beneficial owner."[234]

Cruz testified that during the relevant period, from December 2013 through June 30, 2014, the Firm did not conduct a specific search for nominees.[235] Diekmann testified that he thought the Firm's general practice would pick up a problem with nominees, but he could not cite any particular procedures that were geared to do that. He said the "procedures in sum" would address the nominee problem.[236] Cruz confirmed, however, that the term "nominee" appears nowhere in the Firm's policies and procedures.[237]

Given the complexity of the analysis required, and the high potential for interested parties to obfuscate and make misrepresentations, we find the Firm's general process for final approval inadequate. A conversation that may last fifteen minutes and not involve review of all the documents in the file is not enough to analyze the content of the representations and understand whether the business transactions made sense. We also find that the Firm's reliance on the honesty of the interested parties filling out the forms was unreasonable in light of the high potential for the use of nominees.

We are concerned that the Firm's general process for review and approval was so poor when the processing of microcap stock certificates for resale to the public was its primary business. We are further concerned because the transactions at issue here were typical of Scottsdale's business. Cruz testified that the Firm's customers typically were persons who made loans to issuers and then sold the loans to others who then attempted to profit by exchanging them for shares. Thus, the Firm's lack of a good process for review and approval was not a minor aspect of the Firm's business.[238]

D. Transactions

The Firm followed a check-the-box approach to its Rule 144 reviews, without evaluating and independently verifying the information it gathered. This approach is apparent from the following in-depth analysis of the three NHPI deposits. The Firm followed the same approach with the VPLM and ORFG deposits, which we discuss in less detail.

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[234] Hearing Tr. (Cruz) 307-08.

[235] Hearing Tr. (Cruz) 199-202, 211-13; Hearing Tr. (Diekmann) 908-10.

[236] Hearing Tr. (Diekmann) 922.

[237] Hearing Tr. (Cruz) 666-67.

[238] Hearing Tr. (Cruz) 352-53.

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1. NHPI (Three Unicorn deposits derived from Collins promissory note)

a. Due Diligence Package

i. Purported Beneficial Owners

CSCT made three NHPI deposits. They all came from Unicorn, which, in turn, purported to act on behalf of other supposedly independent entities: Sky Walker, Inc. ("Sky Walker"), Swiss National Securities ("Swiss National"), and Ireland Offshore Securities ("Ireland Offshore"). The beneficial owner of Sky Walker is identified on the Checklist as Patrick Gentle; the beneficial owner of Swiss National is identified on a separate Checklist as Talal Fanni (apparently a misspelling, since the person signed documents as Talal Fouani); and the beneficial owner of Ireland Offshore is identified on the third Checklist as Jeff Cox.[239]

Each purported beneficial owner signed a Beneficial Ownership Declaration representing that he was not an affiliate of the issuer, that the issuer was not to his knowledge a shell, and that the securities were free trading, without resale restrictions under Rule 144. The documents were not witnessed or notarized. No address, telephone number or other contact information was given for the purported beneficial owner.[240]

Scottsdale did nothing to identify the purported beneficial owners more specifically. While it did a Google search combining the name of the beneficial owner with the words "securities fraud" and put the first page of the initial index of results in the due diligence package, it did not search for the person's name alone, or the person's name in combination with the name of the entity through which he acquired the shares, or the person's name along with the names of the issuer and issuer's principals.[241]

The purpose of the Google search using the name of the purported beneficial owner with the words securities fraud is unclear in light of the fact that Diekmann testified that a "hit" on such a search indicating that a person was engaged in some sort of securities fraud would be unrelated to beneficial ownership.[242] That testimony demonstrates the check-the-box attitude of the Firm. Diekmann was insensitive to the possibility that if a person was engaged in securities fraud, then the representations made by that person and others connected to a deposit could be false.

As discussed below, the three deposits shared the same origin.

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[239] RX-1, at 1-2, 11-12, 78-79, 88-89, 158-59, 169-70.

[240] RX-1, at 11-12, 88-89, 169-70.

[241] RX-1, at 67, 152, 223. The Firm misspelled Fouani's name when it did the Google search, illustrating its careless approach to conducting due diligence. RX-1, at 67.

[242] Hearing Tr. (Diekmann) 927.

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ii. Prior Holder Transaction

The Checklists for the Sky Walker, Swiss National, and Ireland Offshore deposits state that the issuer, NHPI, gave a $10,000 promissory note dated May 1, 2012, to someone named Thomas Collins. Each NHPI depositor purports to tack back its holding period to that date and that note.[243]

A copy of the May 2012 promissory note is included with the Sky Walker and Ireland Offshore deposits. The note was due and payable no later than July 1, 2012. It provided that if NHPI did not pay the note by the due date, Collins would have the right to convert the debt into common shares. No address or contact information is given for the company or for Collins. Although the note provided that Collins would have a right of conversion upon the company's default, it contained no provision for either party to give notice to the other in the event of a default. The signatures for NHPI and Collins were not witnessed or notarized.[244]

According to the attorney opinion in the due diligence package, the May 2012 note was the company's promise to pay Collins a fee for services.[245] The unaudited financial statements in the due diligence package similarly indicated that the note was for consulting services.[246]

With respect to Collins' identity and possible connection to the issuer, the due diligence package contains a statement signed by Collins declaring that he had never been an affiliate of the issuer. Again, the statement is not witnessed or notarized, and no contact information is provided.[247]

The issuer did provide the stock transfer agent with an address for Collins when it instructed the transfer agent to issue new unrestricted shares to him, as reflected in the instructions to the transfer agent, which are in the due diligence package. Collins had a Texas address.[248] Also in the due diligence package is the transfer agent's list of shareholders, which showed that all active shareholders of NHPI had U.S. addresses.[249]

Scottsdale did not run a Google search on Collins using the address contained in the due diligence package. Nor did it search to see whether Collins had any links to the other persons on the NHPI shareholder list. Rather, it ran a Google search linking Collins' name to the words "securities fraud." Apparently, a person named Thomas Collins had been involved in a securities fraud, but the Firm obtained an SEC litigation release indicating that that person had died prior to

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[243] RX-1, at 1, 78, 158.

[244] RX-1, at 106, 183.

[245] RX-1, at 22, 101, 178.

[246] RX-1, at 40, 122, 198.

[247] RX-1, at 25.

[248] RX-1, at 31.

[249] RX-1, at 37.

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1997. The Firm never determined the identity of the particular Thomas Collins involved in the NHPI deposits.[250]

iii. Acquisition Of Shares By Depositors

Collins gave Sky Walker, Swiss National, and Ireland Offshore each a separate $50,000 note dated September 1, 2013. The notes were to be paid in full by November 7, 2013. The notes specified that in the event of a default the entire sum would become due.[251] Each note was ostensibly secured by a Stock Pledge Agreement pledging 20 million shares of NHPI,[252] which, at the time, Collins did not own. These notes, like the note between Collins and NHPI, contain no address or contact information for any party and no provision for either party to give notice to the other in the event of a default. They are neither witnessed nor notarized.[253]

The next items in the chronology are three Note Satisfaction Agreements dated September 16, 2013. These three identical Agreements indicate that Collins had already defaulted on the $50,000 note, although the due date was not until November 7, 2013. Each depositor declared a desire to take title to the NHPI shares described in the pledge agreement.[254] The Securities Deposit Pre-Review Request Unicorn submitted for Swiss National likewise gives September 16, 2013, as the date of acquisition, referring to the Note Satisfaction Agreement,[255] as does the Deposited Securities Request Form submitted for Ireland Offshore.[256]

On November 15, 2013, more than a year after the due date for the May 2012 note, the issuer and Collins purportedly entered into a note conversion agreement whereby Collins agreed to forgive 90% of the note in return for 90 million shares of NHPI.[257] The Note Conversion Agreement included in the due diligence package, like the May 2012 promissory note, contains no address or contact information for the company or for Collins and is not witnessed or notarized. The Note Conversion Agreement does not explain why the conversion occurred so

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[250] RX-1, at 57-58.

[251] RX-1, at 32, 112, 190.

[252] RX-1, at 113-16, 191-94.

[253] RX-1, at 32, 112, 190.

[254] RX-1, at 33, 117, 195.

[255] RX-1, at 13.

[256] RX-1, at 161. Other documents give conflicting, later dates as the acquisition date. Some documents represent that the three depositors acquired the securities on November 25, 2013, pursuant to a Stock Purchase Agreement. RX-1, at 11, 19, 88, 98, 169. However, the due diligence package for NHPI contains no Stock Purchase Agreement. Another document says that the acquisition date was November 15, 2013, the same date that Collins entered into the Note Conversion Agreement and the shares were issued to him. RX-1, at 81. The Firm did not resolve the discrepancy between the September acquisition date and the November acquisition dates before selling the securities.

[257] RX-1, at 1, 78, 158.

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long after the default or how the remaining unpaid 10% of the May 2012 promissory note was to be treated.[258]

NHPI issued the 90 million shares to Collins on November 15, 2013, the same day as the note conversion agreement.[259]

Although the exact date that Collins assigned the shares to the three beneficial owners is not clear, it was at most a few days after NHPI issued the shares to Collins. Thus, the transaction between the issuer and Collins, the issuance of the stock, and the transactions between Collins and the three purported beneficial owner entities all happened almost simultaneously.

Although the transactions happened almost simultaneously, the value given to the shares differed substantially. There is no evidence of a corporate event or other explanation for the variance. In return for forgiving a debt of $9,000, Collins obtained 90 million shares, but each beneficial owner entity forgave a debt of $50,000 for its 20 million shares. No money actually changed hands in these transactions.

iv. Issuer Filings

Although NHPI had once been a reporting company with the SEC, it stopped being a reporting company in 2009. After that it made less frequent and less regular filings on OTC Markets.[260] On November 20, 2013, a few days after the NHPI shares were issued and around the time that Sky Walker, Swiss National, and Ireland Offshore acquired the shares, the issuer filed an annual report for the year ending December 31, 2012.[261] In the November 20, 2013 report, NHPI mainly discussed its pharmaceutical business and then stated in a single sentence that it had entered into the oil and gas business. It declared that further disclosure related to the oil and gas business was in an Interim Information and Disclosure Statement for the period ended November 20, 2013.[262]

In the annual report filed on November 20, 2013, notes to unaudited financial statements declared that NHPI had given Collins a promissory note for unspecified consulting services.[263] Scottsdale relied upon this disclosure to verify the existence of the May 1, 2012 promissory note, which was critical to the ability of the beneficial owners to sell the securities without registration.

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[258] RX-1, at 26-28, 106-09, 184-86.

[259] RX-1, at 29.

[260] Hearing Tr. (Byrne) 2069-75; CX-255; CX-256; CX-260; CX-261; RX-1, at 130.

[261] CX-256. Diekmann testified that it appeared that the company had had a gap in its reporting prior to its November 2013 filing. Hearing Tr. (Diekmann) 939. However, he did not believe that such a gap would be suspicious, even if it were as long as two-and-a-half years. Hearing Tr. (Diekmann) 1011-13.

[262] CX-256, at 4. One page from the Interim Information and Disclosure Statement was in the due diligence package for the NHPI deposits. But that page did not contain the disclosure relating to the oil and gas business. RX-1 at 39.

[263] RX-1, at 40.

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In the Court of Appeals
For the State of Michigan

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff-Appellee,

v.

MORNINGLIGHTMOUNTAIN, LLC, and MICHAEL GOODE,

Defendants-Appellants,

–and–

DOES 1–10,

Defendants–Not Participating.

Docket No.

Kalamazoo County Circuit Court
Case No.: 18-0153-CZ
HON. ALEXANDER C. LIPSEY

APPLICATION FOR LEAVE TO PURSUE AN INTERLOCUTORY APPEAL

APPELLANT'S APPENDIX VOLUME IX

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The only evidence that the note existed, however, was created about the same time as the transactions leading up to the sale of securities into the public markets.

In order to determine that NHPI was not a shell, Scottsdale relied on the representation by the president of NHPI that it was not a shell.[264] It also relied on descriptions of the company's assets and liabilities in unaudited financial statements contained in the annual report filed in November 2013 and in a quarterly report filed about the same time to cover the period ending June 30, 2012. However, those descriptions were vague; they showed mostly unspecific cash assets, not physical assets. In the annual report, for example, the company reported that it had less than $28,000 in a checking account, accounts receivable over $600,000, unspecified inventory over $70,000, and investment assets over $750,000. The financial statements also show that the issuer had incurred some expenses. The financial statements do not provide, however, any indication of the nature of the expenses or the business activities that supposedly gave rise to them. The issuer disclosed no verifiable facts.[265]

The company's public filings created a significant discrepancy between the disclosure in those filings and the NHPI deposits. The interim financial report for the period ending November 20, 2013, states that 981,408,909 shares were outstanding, of which 970,326,182 were restricted.[266] That means that only around 11 million shares were free-trading shares. But the three depositors deposited 60 million for resale to the public. There is no evidence that the Firm investigated this discrepancy.

v. Attorney Opinion Letter

The Firm relied upon an attorney opinion letter stating that the shares could be issued as free trading shares and sold pursuant to Rule 144. However, that opinion made plain that the attorney relied on certifications by the principal officers of NHPI. The attorney assumed that all signatures were genuine and the facts set forth in the certificates were correct.[267] The attorney relied on the company's filings for his conclusion that the company was actively marketing its pharmaceutical products and exploring one or more strategic alliances and licensing arrangements.[268] Similarly, the attorney relied on company filings as showing that NHPI was actively pursuing the acquisition of mineral rights leases.[269] The attorney did not independently verify the facts in his opinion letter.

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[264] RX-1, at 24.

[265] RX-1, at 38-40.

[266] RX-1, at 43.

[267] RX-1, at 20.

[268] RX-1, at 21.

[269] RX-1, at 21.

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vi. Scottsdale Approval And Sales

During the first week of February 2014, Noiman and Cruz approved the first NHPI deposit, Sky Walker, for resale by Scottsdale. At the time, the 20 million shares were given an estimated value of $268,000.[270] Noiman and Cruz approved the Swiss National NHPI deposit on April 9, 2014, which was given a value of $98,000.[271] They approved the Ireland Offshore NHPI deposit at the end of April 2014 with a given value of $82,000.[272]

Sales of NHPI shares began on February 26, 2014, and continued through May 7, 2014. Periodically, Scottsdale would wire out the proceeds of the sales of NHPI and other securities in the CSCT account.[273] As with all transactions conducted with CSCT and its customers, after Scottsdale wired the proceeds of the sales to CSCT's bank account, Scottsdale did not know where the funds flowed after that.[274] Thus, it did not know who received the economic benefit.

vii. Promotional Activity

In December 2013, not long after the series of transactions by which the purported beneficial owners acquired their shares of NHPI, there was promotional activity regarding NHPI, as reflected in the due diligence file for the NHPI deposits. Diekmann testified that he would have looked at the promotional activity but he did not recall doing so. He asserted that promotional activity was not necessarily a red flag, but that he might try to see if there was a link to the customer. He acknowledged, however, that it would be difficult to know if a customer was behind the promotion if a nominee were being used.[275]

In February and March 2014, there also was promotional activity regarding NHPI.[276] In a February 19, 2014 email, Ruzicka wrote to Diekmann that Unicorn was particularly eager to trade NHPI. Diekmann did not remember the email, and did not think it particularly remarkable. He said that no customer wants "to miss an opportunity to trade."[277] Scottsdale sold NHPI shares deposited by CSCT during February and March 2014, when the promotional activity was ongoing.[278]

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[270] RX-1, at 78-79 (Sky Walker).

[271] RX-1, at 1-2.

[272] RX-1, at 158-59.

[273] JX-268.

[274] Hearing Tr. (Cruz) 661-62.

[275] Hearing Tr. (Diekmann) 1014-16; RX-1, at 132-33; CX-262, at 6.

[276] CX-262, at 2-5; CX-263.

[277] Hearing Tr. (Diekmann) 1016-18.

[278] JX-268.

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b. Red Flags Signifying A Scheme To Evade The Securities Laws

Even aside from the fact that the May 2012 promissory note was not a security, as discussed below, the circumstances of the three NHPI deposits raised a number of red flags signaling that the transactions were likely sham transactions using nominees to conceal the identity of the persons actually benefiting from the sale of securities. Some, but not all, of the red flags are listed below.

First, Collins and NHPI entered the agreement to convert the note he held from the company to shares—and NHPI issued the shares—almost simultaneously with his execution of three separate agreements to transfer a portion of those shares to Sky Walker, Swiss National, and Ireland Offshore. The almost simultaneous transactions are compelling evidence that the parties were not truly independent. The suspect nature of the transactions is heightened by the identical terms of the notes to Sky Walker, Swiss National, and Ireland Offshore.

Respondents attempted to rebut any suspicion arising from the timing and identical terms of the Sky Walker, Swiss National, and Ireland Offshore transactions. Diekmann testified that he assumed that one person had put together the loan transactions for Collins, and that was why the three entities had agreed with Collins to the same loan terms. He acknowledged that he did not know who that person might be, but he did not think it was a red flag that Sky Walker, Swiss National, and Ireland Offshore agreed to the same terms or that the same documents were used for the three loan transactions.[279] We find that Diekmann's unverified hypothesis did not excuse the failure to investigate this red flag.

Second, Collins entered into the agreement with the three depositors, along with the agreement pledging NHPI shares as security, before he actually had any shares. However, he represented in the pledge agreement that he held title to them already. It should have been a concern that Collins apparently misrepresented his ownership. It also is suspicious that the depositors would loan him $50,000 each without verifying that he owned the shares. It is even more suspicious that Collins would take on a $150,000 obligation without knowing whether he could obtain the shares. The facts support the conclusion that Collins entered into the agreement with the depositors because he (or whoever was pretending to be Collins) was affiliated with the issuer and knew that the shares could be obtained. Further investigation was required before proceeding to sell the securities.

Third, the documents relating to the NHPI transactions in 2012 lack important elements that would permit verification. For example, the 2012 Collins-NHPI promissory note bears no physical address, telephone number, or other contact information for Collins or NHPI. Similarly, the documents relating to the loan notes Collins gave the three depositors do not include any contact information for Collins or for the depositors. The lack of contact information is odd because there is no provision for where and how payment should be made. It is almost as though there is no expectation of payment.

[279] Hearing Tr. (Diekmann) 1699-1700.

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Fourth, the obviously impossible September date declaring Collins in default on the notes held by the depositors—even before the notes became due on November 7, 2013—should have been investigated. The fact that the identical mistake was made in three separate documents supposedly involving independent parties is suspicious. If the parties were independent, one would have expected someone to notice the mistake. That is particularly so where the error was not a transposition of numbers but, rather, an incorrect month. The error would have been easier to spot.

Diekmann testified that the September 16, 2013 date on the note satisfaction agreement had to be a typographical error. "In all likelihood," he said, "that's supposed to read November 16, 2013."[280] When asked about the fact that the same error appears in all three note satisfaction agreements signed by Sky Walker, Swiss National, and Ireland Offshore, Diekmann said that was not surprising. He noted that the agreements were all executed the same day, and hypothesized that someone must have done a search and replace function to change the words without noticing the mistake.[281] Cruz similarly explained the date as a typographical error. He testified that even though the same mistake occurred in connection with the documentation for three purportedly separate transactions it gave him no pause.[282]

Between hearing days, Respondents obtained a copy of the relevant stock certificate, which was then introduced into evidence. It showed a transfer date of November 21, 2013. They argue that this proves that the September date was a typographical error.[283]

Respondents miss the point. Nothing in the due diligence package shows that the Firm noticed or investigated the discrepancy before selling the securities. Furthermore, if the September date was a typographical error generated by a search and replace function in documents governing supposedly independent transactions, that only increases the appearance of coordination among the parties to those transactions.

Fifth, Diekmann admitted that there was no evidence contemporaneous with the May 2012 note to show that the note existed.[284] The only evidence that the 2012 promissory note from NHPI to Collins existed was created after Collins purported to convert the note to NHPI shares. Rather than confirming the existence of the note, the timing of the late filing suggests the fabrication of false evidence to support the tacking period necessary for the exemption.

Sixth, it is peculiar that Collins did not enforce his right to conversion of the shares at the time if NHPI defaulted in July 2012 on the $10,000 promissory note. There is no explanation why he would have waited more than a year—until November 2013—to do so.

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[280] Hearing Tr. (Diekmann) 949, 1835-37.

[281] Hearing Tr. (Diekmann) 949-52, 956.

[282] Hearing Tr. (Cruz) 365-66, 390-98.

[283] RX-115; Resp. PH Br. 15.

[284] Hearing Tr. (Diekmann) 939.

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Seventh, there were signs that NHPI was a shell. The change from being in the pharmaceutical business to entering the oil and gas business, without any explanation for why, when, and how it had done so, was not consistent with a real business plan. The Firm collected no information regarding the change in business, and the attorney opinion letter, which relied on representations by the interested parties and assumed the asserted facts to be true, was not a sufficient basis for concluding that NHPI was not a shell.

Respondents maintained that the oil and gas business was added to NHPI's pharmaceutical business as a "supplement" to its business line.[285] We reject this characterization. These were radically different businesses that involved different expertise and different business models.

Eighth, the transactions have an air of fantasy. Collins supposedly took the $10,000 note in exchange for unspecified consulting services—no money changed hands. And then he took shares in return for forgiving the note—no money changed hands. When Collins supposedly borrowed $50,000 each from Sky Walker, Swiss National, and Ireland Offshore, nothing in the documents provided how, when, or where he would receive the money. There is no evidence that any money changed hands then either. Collins merely entered into a promissory note with each purported lender in which he pledged to give them stock if he defaulted; and then he defaulted. No money changed hands when Sky Walker, Swiss National, and Ireland Offshore took the pledged shares.[286]

Ninth, there is little evidence to support the value given to the NHPI securities. Within the span of a few months the value of NHPI shares varied substantially without any explanation. In November 2013, Collins received 90 million shares in return for forgiving $9,000 of his loan to NHPI. Simultaneously, he realized $150,000 for 60 million of those shares. By early February 2014, the 20 million shares in the Sky Walker deposit were estimated to have a value of $268,000. There is no evidence of a basis for the increase in value. Then, in April 2014 the value of the shares held by Swiss National and Ireland Offshore declined to less than $100,000—again, without explanation. This is particularly suspicious in light of the promotional activity that occurred in February and March 2014.

[285] Resp. PH Br. 16 and n.80.

[286] Diekmann testified that the only evidence the Firm had that the September 1, 2013 notes between Collins and the three depositors existed was the notes themselves. He never asked for documentation showing that $50,000 actually was transferred from Sky Walker to Collins. He was satisfied that the document looked like a loan to an individual and not an effort by a small company to raise capital. Hearing Tr. (Diekmann) 943-45.

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2. VPLM (Montage deposit derived from Kipping oral line of credit)

a. Due Diligence Package

i. Purported Beneficial Owner

There was evidence in the record about two VPLM deposits by CSCT. The one included in the allegations of the Complaint was through Montage for the further benefit of VHB International. The Checklist identifies Victor Bretel as the president of VHB International. The deposit was for 9.3 million shares.[287]

ii. Prior Holder Transaction

In the Montage deposit, the prior holder in the VPLM chain was an entity called Locksmith Financial. The Checklist noted that Locksmith Financial was affiliated with Richard Kipping, who was the former president of VPLM. The Checklist stated, however, that Kipping was no longer an affiliate of the issuer because he had resigned more than two years earlier.[288]

In concluding that Kipping was not an affiliate, the Checklist relied on an attorney opinion dated September 6, 2013, stating that Kipping had resigned more than two years before.[289] As discussed below, that attorney opinion was insufficient to support the conclusion that Kipping was no longer an affiliate of VPLM. Cruz testified at the hearing that the Firm also relied on a December 16, 2013 letter signed by VPLM's Chairman, Thomas Sawyer, which made a representation that Locksmith was not an affiliate of the issuer.[290] The Sawyer letter declared that the parties to the sale of securities from Locksmith to VHB International (discussed below) were not affiliates of the issuer.[291]

The Checklist for the VPLM deposit indicated that the depositor had satisfied the Rule 144 holding period by tacking back to a "verbal [oral] line of credit" whereby the prior holder, Locksmith, had loaned the issuer, VPLM, $58,636.24. The Checklist stated that the last advance on the line of credit was made July 6, 2012.[292]

An August 15, 2013 written agreement purported to document and formalize the oral line of credit. According to the 2013 document, Locksmith agreed in 2012 to advance funds as loans

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[287] RX-2, at 1.

[288] RX-2, at 1, 268.

[289] RX-2, at 1, 19-21.

[290] Hearing Tr. (Cruz) 441.

[291] RX-2, at 23-24.

[292] RX-2, at 1.

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against a revolving line of credit and had received the right to demand payment in full or in part at any time.[293]

On the same day, August 15, 2013, a debt settlement agreement was executed between the issuer and Locksmith. In that document, the issuer indicated that it wanted to settle the amount it owed Locksmith by giving stock to Locksmith. The parties agreed to settle the company's $58,636.24 debt as of July 31, 2012.[294]

Although VPLM did not issue the shares to Locksmith until September 2013,[295] the Beneficial Ownership Declaration later signed by Bretel treated the date on which Locksmith acquired the shares as August 1, 2012.[296] The depositor thus relied on tacking his holding period to Locksmith's oral line of credit.

iii. Acquisition Of Shares By Depositor

On August 23, 2013, Locksmith entered into a stock purchase agreement with VHB International. It was roughly a week after Locksmith had memorialized the purported oral line of credit and before the shares were actually issued. The aggregate purchase price for the stock was $240,000.[297] There is no evidence explaining why Locksmith was able to sell the shares for more than four times the value placed on the shares when Locksmith and the issuer entered into the debt settlement agreement only days before.[298] The buyer, VHB International, purported to acquire the shares for investment and not with a view to resale or distribution.[299]

Although Victor Bretel was identified as the beneficial owner of VHB International, Andrew Godfrey signed the Stock Purchase Agreement.[300] The Firm made an inquiry, and Montage responded that Godfrey "handles day to day operations due to Mr. Victor Bretel's travel schedule." Montage represented that Bretel remained the beneficial owner of VHB International.[301] Diekmann testified that the response was, as far as he was concerned, sufficient.[302]

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[293] RX-2, at 26-27.

[294] RX-2, at 28.

[295] RX-2, at 12.

[296] RX-2, at 13.

[297] RX-2, at 33.

[298] RX-2, at 32.

[299] RX-2, at 35.

[300] RX-2, at 37.

[301] RX-2, at 38.

[302] Hearing Tr. (Diekmann) 1744-45.

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iv. Issuer Filings

The Firm relied on public filings for proof of the existence of the oral line of credit. The Firm characterized the oral line of credit as "generally disclosed" in the issuer's annual report for September 30, 2012.[303] The annual report for the period ending September 30, 2013, which was only published on November 6, 2013—*after* the oral line of credit had been memorialized in writing—attached a grid showing that the issuer had settled many of its debts and payments for professional services by issuing VPLM stock. According to the grid, on August 15, 2013, VPLM issued a little over 29.3 million shares to Locksmith Financial as a debt settlement.[304]

The grid actually raised more red flags. It showed that the company regularly followed a practice of compensating affiliates and others with stock. During the period from October 12, 2011, through August 15, 2013, VPLM issued shares to Locksmith three times and shares to Locksmith's owner, the former president of VPLM, Richard Kipping twice. Thus, during the two-year period, Kipping received, either directly or through Locksmith, roughly 80 million shares of VPLM. In fact, according to the grid, during the same period the company issued more than 185 million shares to various persons and entities, including Dennis Chang, the issuer's president, Thomas Sawyer, its Chairman and CEO, and Carl Mattera, an authorized signatory for the issuer.[305]

Curiously, in May 2013 VHB International received directly from the issuer approximately 2.4 million shares of VPLM. This was only a few months before it received the 29 million shares from Locksmith Financial.[306] That VHB had already received shares directly from the issuer raised a red flag that it might be an affiliate or might be coordinating its acquisition and resales of shares with others who were affiliates. There is no evidence that Scottsdale took note of that red flag.

v. Scottsdale Approval And Sales

On February 10, 2014, Noiman and Cruz approved the VPLM shares deposited by VHB International for sale to the public.[307] Sales began on February 20, 2014, and continued through June 5, 2014. Periodically, Scottsdale wired out the proceeds from those and other sales for the account of CSCT.[308]

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[303] RX-2, at 1.

[304] RX-2, at 40.

[305] RX-2, at 40 (excluding an additional 265 million shares issued to consummate an acquisition of another company).

[306] RX-2, at 40.

[307] RX-2, at 2.

[308] JX-281.

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b. Red Flags Signifying A Scheme To Evade The Securities Laws

A number of red flags were raised by this VPLM deposit. Here we discuss two that required the Firm to conduct further inquiry to establish that an exemption existed.

First, the Firm knew that Kipping had been an affiliate of the issuer at some point. This red flag required heightened scrutiny of the transaction. The Firm failed, however, to gather sufficient evidence to conclude that Kipping was no longer an affiliate.

There is no copy of a resignation letter in the due diligence package. Scottsdale did not even have a specific resignation date. It had a vague statement in a legal opinion that Kipping had resigned from the issuer over two years before. The attorney declared that she had reviewed documents filed with the SEC and had determined that Locksmith was not an affiliate or control person of the issuer, but she did not specify the documents she reviewed or explain how she arrived at her conclusion. She did not say she had seen the resignation letter. The attorney further stated that Locksmith and Kipping had represented to her that they were not controlled by any of the officers or directors of the issuer. In making that statement, the attorney was little more than a conduit for representations by the interested parties.[309] Diekmann was unaware of anything that anyone at Scottsdale did to confirm that Kipping no longer had any duties as president of the issuer.[310]

Cruz vaguely testified that he thought the Firm had some sort of resignation or acknowledgement of Kipping's resignation in the file.[311] Cruz may have been referring to the December 16, 2013 letter from VPLM's Chairman, which represented that none of the parties to the sale of the securities to VHB International had been an affiliate of the company within 90 days of the sale.[312] That bare representation provides no detail whatever. It does not indicate when Kipping might have resigned as an officer of VPLM or provide any other verifiable fact. For purposes of ensuring that an issuer is not behind a chain of transactions designed to effect a public distribution without registration, a representation by a principal of the issuer must be viewed more skeptically.

Even more important, from the outset, Scottsdale had affirmative evidence in its due diligence package indicating that Kipping might be affiliated with the issuer regardless of whether he had resigned as president. Under Rule 144, if Locksmith and Kipping held 10% or more of the issuer, they would be affiliates for purposes of the exemption. The grid showed that Kipping, either directly or through Locksmith, had received 80,318,000 shares of VPLM between October 2011 and August 2013.[313] The total outstanding shares of the company at the

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[309] RX-2, at 19-21.

[310] Hearing Tr. (Diekmann) 1719-20.

[311] Hearing Tr. (Cruz) 440-41.

[312] RX-2, at 23-24.

[313] RX-2, at 40.

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time that Scottsdale evaluated the deposit were 730,460,237.[314] Thus, Kipping and Locksmith received at least a 10.996% ownership interest in VPLM and Kipping could have been an affiliate regardless of whether he was still an officer of the company.

There were other signs that Kipping could have been an affiliate. In the due diligence file is the first page of results from a Google search for "Richard Kipping + securities fraud." One of the results dated May 15, 2013, contains a fragment of content apparently referring to VPLM. That fragment says, "So Richard Kipping still has personal interest in this penny scam."[315] Another entry dated May 7, 2013, also refers to VPLM and says, "The next few days will show if the stock can keep its unprecedented … in fraud look at the shareholders Richard kipping pretty much owns the …"[316] The Google search page was filed in the package, apparently without anyone looking at the full stories concerning Kipping or following up on his ownership of VPLM shares.

If Scottsdale had conducted further due diligence, it might have discovered that Kipping was indeed an affiliate of VPLM. During the relevant period, the Board of Directors of VPLM ordered a review of Kipping and Locksmith's debt conversions to VPLM stock. The resulting "forensic audit" dated June 5, 2014, described Kipping as a director and shareholder of VPLM. It indicated that, at the time of the August 15, 2013 stock conversion that was the basis for tacking VHB International's holding period, Kipping had executive responsibilities at both VPLM and Locksmith, including check signing privileges at VPLM.

The accountant who performed the forensic audit opined that many aspects of the August 15, 2013 agreement purporting to memorialize the earlier oral line of credit were problematic. Many of the items that appeared to him to indicate that the arrangement was not a true arms-length transaction were facts known to Scottsdale at the time it approved the sale of VHB International's shares based on tacking to the oral line of credit. Among other things, the accountant noted that the written memorialization was a year after the purported oral line of credit. He also noted that the stock for debt agreement did not specify any particular terms for the conversion, and he viewed Locksmith's right to demand payment in full or part at any time as onerous.[317]

The forensic audit illustrates that an objective analysis of the facts known to Scottsdale would raise strong doubt that Kipping was independent of VPLM at the time of the August 15, 2013 agreement and stock conversion.

Second, the grid attached to the November 2013 public filing shows that the issuer had a pattern of paying for services and its business expenses with stock. It issued much of this stock to

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[314] RX-2, at 1.

[315] RX-2, at 95.

[316] RX-2, at 95.

[317] RX-292, at 6-7.

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company insiders.[318] The pattern suggests that the issuer may have substituted the issuance of stock for compensation to insiders and business partners, leaving them to realize any monetary benefit by selling the stock to others. The constant flow of new issuer stock looks like a two-step process for unlawfully distributing securities into the public marketplace without registration.

This pattern is particularly troubling because all three parties in the chain of holders for the deposit—Kipping, Locksmith, and VHB International—were on the list of persons and entities that had converted debt to shares.[319] This was a red flag that they and the issuer could be coordinating. The Firm should have further investigated before concluding that the transaction was exempt under Rule 144.

3. VPLM (Titan deposit derived from Kipping and Locksmith through the Lees)

a. Due Diligence Package

i. Purported Beneficial Owner

CSCT deposited another 13 million shares of VPLM for the benefit of Titan and for the further benefit of Cumbre Company. The Checklist identified Patrick Gentle as the ultimate beneficial owner of Cumbre and the VPLM stock.[320]

We discuss the evidence regarding this transaction as evidence of other similar conduct for purposes of sanctions and as additional evidence that CSCT was no more than a façade. Scottsdale continued to deal directly with the FFI and to ignore CSCT.

ii. Prior Holder Transactions

This is the one transaction that was not derived from the conversion of a debt liability into shares. However, it also traces back to Kipping and Locksmith in a chain of holders.

The Checklist identified two prior holders, Jung Ju Lee and Soon Deuk (Kang) Lee.[321] Jung Ju Lee acquired 1.5 million shares by a Stock Purchase Agreement dated June 12, 2012, from Richard Kipping. In that Stock Purchase Agreement, Kipping represented that he was not an affiliate of the issuer and had not been an affiliate at least for the previous 90 days. An attachment to the Stock Purchase Agreement indicated that Lee paid Kipping $13,000 for the shares. A copy of a check written to Locksmith for $13,000 was attached. It appears to be written by Brooks K-9 Services Ltd., but it bears a notation saying "re VPLM certs."[322] Nothing in the

[318] RX-2, at 40.

[319] RX-2, at 40.

[320] RX-2, at 106.

[321] RX-2, at 106.

[322] RX-2, at 126-29.

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due diligence package explains the connection between Brooks K-9 Services and Lee or the nature of Brooks K-9 Services.

Jung Ju Lee acquired another 500,000 shares for $5,000 from Locksmith Financial pursuant to a Stock Purchase Agreement dated October 19, 2012. Locksmith made the same representation that it was not an affiliate of the issuer. Kipping signed on behalf of Locksmith. Another check from Brooks K-9 Services Ltd. was attached.[323]

Soon Deuk (Kang) Lee acquired three million shares of VPLM from Locksmith by a Stock Purchase Agreement dated August 1, 2012, for $20,000. Locksmith represented that it was not an affiliate of the issuer. Kipping signed on behalf of Locksmith.[324]

iii. Acquisition Of Shares By Depositor

Cumbre acquired five million shares of VPLM from Soon Deuk (Kang) Lee on January 10, 2014.[325] In a separate document written to Cumbre, Lee confirmed receipt of $60,000 for the shares.[326] On January 13, 2014, in a separate document, Jung Ju Lee similarly confirmed receipt of $20,000 for 500,000 shares of VPLM.[327]

iv. Scottsdale Approval

On May 29, 2014, Noiman and Cruz signed the Checklist approving the shares of VPLM for sale.[328]

v. Blackout Period On Trading VPLM Shares

On June 5, 2014, Thomas Sawyer, the Chairman of the Board of Directors of VPLM, sent Titan by email a signed declaration notifying it of a blackout period starting June 6, 2014, on trading VPLM stock by certain "covered persons." Covered persons were defined to include directors, officers, and holders of 10% or more of the company's outstanding shares, among others. Richard Kipping (and his assigns) and Locksmith were on the list of covered persons. So was VHB International. The list also included FFIs and broker-dealers. Montage, Titan, Alpine, and Scottsdale were all on the list.[329] Noiman discussed the blackout notice with Titan and requested a copy.[330]

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[323] RX-2, at 136-39.

[324] RX-2, at 147-49.

[325] RX-2, at 160.

[326] RX-2, at 155.

[327] RX-2, at 145.

[328] RX-2, at 107.

[329] CX-294.

[330] RX-104.

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On June 6, 2014, a lawyer named David Wise, who had often done work for Scottsdale, wrote an email to Sawyer claiming to represent unnamed clients on the covered-person list and threatening to sue Sawyer and others for "slow[ing] down or prevent[ing] the transfer of shares by my clients." Wise called the blackout notice an attempt to prevent sales of VPLM stock in order to conduct a promotional campaign to raise the share price. He characterized Sawyer's actions as "clearly illegal" and said he would be calling the SEC.[331]

On June 6, 2014, Wise sent a copy of his email to Sawyer to Kelvin Leach at Titan and to both Noiman and Diekmann at Scottsdale. His cover note to them was breezy: "Hi Guys, See below. David." The tenor of the cover note indicates that Scottsdale and Titan were working closely together to address the problem of the blackout notice.

On June 9, 2014, Titan forwarded the blackout notice to Noiman, and Noiman immediately forwarded it to Cruz.[332] That same day, Noiman also forwarded the Wise email to Cruz.[333] The Firm stopped selling VPLM shares held by VHB International in order to investigate.[334]

On June 11, 2014, Titan received what appears to be an unsigned clarifying memorandum from Sawyer stating that the broker-dealers and FFIs such as Scottsdale and Titan were only on the list because they had been known to trade VPLM stock for covered persons. The memorandum declared that the broker-dealers and FFIs were still free to trade on behalf of *non*-covered persons. Titan forwarded the clarification that same day to Noiman and Diekmann,[335] and Noiman forwarded it to Cruz.[336] The clarifying memorandum did not take Kipping (and his assigns), Locksmith, or VHB International off the list of covered persons. Nor did it explain why they were listed as covered persons. When Noiman forwarded the clarification to Cruz on June 11, 2014, he wrote that "Titan received the attached after David Wise's VPLM notice."[337]

On June 24, 2014, a lawyer claiming to represent VPLM wrote to Noiman as Scottsdale's "Compliance Officer." Scottsdale had requested the transfer of two stock certificates, and the lawyer stated that the stock certificates appeared to be owned by covered persons. Kipping (and his assigns), Locksmith, and VHB International were on the attached list of covered persons. One of the two stock certificates identified, 2985, related to the VPLM deposit by Titan on

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[331] Hearing Tr. (Cruz) 578-79. Wise provided an attorney opinion letter on which the Firm relied in connection with the ORFG stock deposit. RX-3, at 70. Wise also went to the Cayman Islands to assist Ruzicka for a couple of weeks after D'Mura left. Hearing Tr. (Hurry) 1603-04.

[332] CX-294.

[333] Hearing Tr. (Noiman) 1265-67; RX-104.

[334] Hearing Tr. (Cruz) 442-43; JX-281.

[335] CX-295.

[336] CX-296.

[337] CX-296.

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behalf of Cumbre.[338] The other, 2228, may relate to a VPLM deposit not part of the record in this case. The certificate number for the deposit by VHB International is 2525.[339]

Notably, although the Titan deposit on behalf of the Lees nominally came through CSCT, Ruzicka was not included on any of the correspondence about the blackout period.[340] The correspondence reveals that Scottsdale, through Noiman, was continuing to manage FFI deposits without regard to CSCT. CSCT was performing no real function in connection with the VPLM deposit.[341]

b. Red Flags Signifying A Scheme To Evade The Securities Laws

Given what Scottsdale already had in its file on VPLM, it should not have approved the VPLM shares deposited by Cumbre for resale without obtaining better evidence that Kipping was not an affiliate of the issuer. The Lee transactions closely followed the VHB International transaction and revealed a pattern—Kipping was continually acquiring and selling large blocks of VPLM shares. When coupled with the information from the grid showing that VPLM followed a practice of issuing stock to insiders in settlement of its debts, the circumstances raised a strong suspicion that the issuer or an affiliate was unlawfully distributing securities without registration in a two-step process designed to obscure what was actually happening and who was benefiting from the sales of stock.

4. ORFG (Unicorn deposit derived from Forward line of credit)

a. Due Diligence Package

i. Purported Beneficial Owner

In connection with the deposit of approximately 13.2 million shares of ORFG, CSCT acted for Unicorn, and Unicorn acted for an entity called Media Central, which named Geovanni Moh as the beneficial owner.[342] Media Central was identified as a Belize corporation, and Moh

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[338] RX-2, at 106-09.

[339] RX-2, at 3.

[340] When Ruzicka was shown the blackout notice at his OTR, he expressed shock. He testified that he had never seen it, and that if he had he would not have processed the VPLM deposit for resale. He would have expected Scottsdale to treat it as a problem or red flag. CX-178 at 257-60.

[341] In the middle of explaining what he did in connection with investigating the VPLM blackout, Cruz made a half-hearted assertion that CSCT was involved, saying, "I asked or I briefed with CSCT to—to get an explanation if they—if they could." Hearing Tr. (Cruz) 442-43. We do not find that testimony credible. There is no corroborating evidence of any kind, and his testimony about CSCT, in contrast to his detailed testimony about Wise, was vague. Cruz did not say he had a conversation with Ruzicka—who was the only person at CSCT. Rather Cruz referred to CSCT in the abstract. Nor did Cruz say anything about the content of what he "asked" or "briefed" when he supposedly had contact with CSCT.

[342] RX-3, at 1.

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was identified as a citizen of Belize.[343] Media Central was originally incorporated on February 14, 2014, under the name Lock Investments Ltd. Only two weeks later, on February 27, 2014, the name was changed to Media Central.[344] Nothing in the due diligence package explains the reason for the name change or whether there was any change in the identity of the principals of the company.

ii. Prior Holder Transaction

Media Central claimed that it had satisfied the holding period for a non-affiliate by tacking to a prior holder's note as of September 1, 2012.[345] The prior holder was a person named Casey Forward. He purportedly took the issuer's note in return for an open-ended line of credit up to the maximum amount of $600,000. The note provided that the issuer would pay on "loans, advances and debt as of August 31, 2011 … with interest on the principal balance outstanding from time to time" up to a principal amount of $600,000.[346] The note provided Forward with a right to convert any portion of the unpaid principal amount of note to restricted common stock. This right was open-ended and did not specify a particular amount that could be converted or a particular date when the conversion could take place.[347] Furthermore, the note provided that the holder could transfer in whole or in part any portion of the note without the prior consent of the company. Any such transfer was at the discretion of the holder.[348]

Forward subsequently assigned a $50,000 portion of the note to an entity called Anything Media in exchange for shares of Anything Media. As described on the first page of the Deposited Securities List, that transaction was reflected in an Assignment and Modification Agreement dated January 18, 2014, by which ORFG agreed to modify the terms of the original note.[349]

iii. Acquisition Of Shares By Depositor

On April 16, 2014, Anything Media sold 15 million shares of ORFG to Media Central for $75,000 pursuant to a stock purchase agreement. However, at that time, Anything Media did not own the shares. It acquired shares of ORFG only a few days afterward, on April 22, 2014, when it converted a $9,000 portion of the note into 15 million shares of ORFG.[350] There is nothing in the due diligence package to explain why Anything Media sold ORFG shares before it actually owned them. Nor is there anything to explain why the shares could be sold for $75,000 when

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[343] RX-3, at 9, 13.

[344] RX-3, at 15-16.

[345] RX-3, at 36-41.

[346] RX-3, at 36.

[347] RX-3, at 38.

[348] RX-3, at 40.

[349] RX-3, at 1, 42-45.

[350] RX-3, at 1.

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they only had a value of $9,000 when they were converted a few days later. Cruz testified that he did not consider these matters red flags that required further inquiry and that the Firm did not conduct further inquiry based on these matters.[351]

iv. Scottsdale Approval And Sales

On June 5, 2014, Noiman and Cruz signed the Checklist for ORFG approving the sale of securities.[352] Sales began June 11, 2014, and continued through the end of the relevant period on June 30, 2014. Periodically, Scottsdale would wire out the proceeds along with the proceeds from the sales of other securities out of CSCT's account.[353]

v. Promotional Activity

From early May through early July, ORFG was the subject of multiple promotions.[354] Cruz testified that the promotions were consistent with the reviewer's findings on the Checklist. He said he probably would have looked at a couple of pages of printouts showing the existence of promotions. The Firm typically would look to see whether the customer had any involvement and whether the promotions were having any effect on the trading done in the security.[355]

b. Red Flag Signifying A Scheme To Evade The Securities Laws

We discuss here only one of the red flags in the ORFG deposit. The initial transaction underlying the deposit made no business sense. With respect to the original line of credit, no reasonable company would agree to borrow money on a line of credit that permitted the lender to convert the debt to stock at any time in any amount at the holder's discretion. Certainly a company would not agree that the open-ended conversion option could be assigned to an unknown third party without the issuer's prior consent. Under such an agreement the company would not know whether it was going to be required to pay back some or all of the money it borrowed on the line of credit or whether it would be required to issue shares. Nor could it know to whom the conversion option might be assigned. It could not manage its finances or be certain of its shareholder dynamics and corporate control.

As the forensic audit of the Kipping-Locksmith loan found with respect to the open-ended line of credit in that transaction, the onerous terms from the issuer's perspective were a sign that the loan was not an arms-length transaction. Unless the Firm investigated and discovered some sensible explanation, it could not lawfully sell the securities.

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[351] Hearing Tr. (Cruz) 533-34.

[352] RX-3, at 2.

[353] JX-310.

[354] CX-303, at 17-25.

[355] Hearing Tr. (Cruz) 537-38.

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E. Credibility

1. Ruzicka

As noted above, Ruzicka was never registered with FINRA and was never subject to its jurisdiction. He voluntarily testified at an OTR, and considered testifying voluntarily at the hearing. Throughout the first week of the hearing, Enforcement reported at the end of each day on the likelihood of Ruzicka appearing.[356] On Friday of the first week, Enforcement announced that Ruzicka had agreed to appear the following Monday.[357]

However, Ruzicka changed his mind over the weekend and never appeared. He apparently changed his mind because of a text that Respondents' counsel sent to him on the Saturday after the first week of hearing. That text, although portrayed by counsel afterward as nothing more than a request to talk, appears to us to have been an attempt to sow distrust between Ruzicka and Enforcement counsel. It made Ruzicka angry at the way he thought he was being portrayed by Enforcement at the hearing and unwilling to be "put through hell" by appearing.[358]

Respondents' counsel telephoned Ruzicka on Saturday but only received an automated instruction to leave a message or text. Respondents' counsel then left him a text saying the following, which included quotations from Enforcement's opening statement:

> You may want to know how FINRA has been characterizing you during the first week of the hearing. For example, you were "hapless," "malleable," and "bereft of other options." You may want to know the other side of what FINRA is telling you. I would welcome the opportunity to discuss.[359]

After receiving the text from Respondent's counsel, Ruzicka texted Enforcement counsel saying, in part, "If even veracity, I am done."[360] We interpret Ruzicka's response to mean he was offended at the portrayal of him as desperate and easily manipulated, and to mean that he would not appear at the hearing if that was an accurate picture of Enforcement's comments about him.

Enforcement reported at the hearing that it had neither confirmed nor denied to Ruzicka what Respondents' counsel told him in the text. Enforcement took the position that it could not reveal what was said in the proceeding because it was confidential.[361]

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[356] Initially, the discussions of Ruzicka's likely participation were off the record. Later, they were on the record. Hearing Tr. (remarks of counsel) 748, 840-41, 1032, 1275, 1277.

[357] Hearing Tr. (remarks of counsel) 1275, 1277.

[358] Hearing Tr. (counsel reading text into record) 1288.

[359] Hearing Tr. (counsel reading text into record) 1288.

[360] Hearing Tr. (counsel reading text into record) 1287.

[361] Hearing Tr. (remarks of counsel) 1299.

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Enforcement argued that Respondents' counsel had violated at least the spirit of the sequestration order in the case; Respondents' counsel asserted that the sequestration order was about witness testimony and that counsel's quotations from Enforcement's opening statement did not violate the order. The Hearing Officer declined to rule on the charge of misconduct.[362]

Based on legal analysis separate from the alleged misconduct of Respondents' counsel, as laid out at the hearing on the record, the Hearing Officer admitted the entire transcript of Ruzicka's OTR. The Hearing Officer declared that the Hearing Panel would determine the probative value and weight to give the OTR after it had reviewed the OTR in the context of the evidence at the hearing, taking into account the circumstances that led to the admission of the OTR in lieu of live testimony from Ruzicka.[363]

The Hearing Panel now specifically finds that Ruzicka's testimony at his OTR was credible. It was consistent with other evidence in the record and corroborated by D'Mura's testimony. Wherever Ruzicka's testimony is cited here, it is cited because we credit it.

We reject Respondents' arguments for discounting Ruzicka's testimony.

First, Respondents assert that it is unfair to rely upon Ruzicka's testimony because they did not have an opportunity to cross-examine him.[364] The short answer to that argument is that Respondents' counsel was responsible for that lack of opportunity to cross-examine the witness. Respondents cannot complain about it now.

Second, Respondents argue that Ruzicka was angry and biased against Hurry, so his OTR should not be viewed as reliable.[365] After review of the transcript, we conclude that, although Ruzicka evidently did not like the way Hurry treated him, Ruzicka was truthful as to the facts and as to Hurry's intimidating and controlling manner.

Third, Respondents claim that Ruzicka gave inconsistent information in a prior telephone call with FINRA staff.[366] However, the inconsistency was explained by the fact that Ruzicka still felt "beholden" to Hurry at the time of the telephone call. By the time of the OTR he did not feel that way.[367]

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[362] Hearing Tr. (remarks of Hearing Officer) 1302.

[363] Hearing Tr. (remarks of Hearing Officer) 1302-05. There had always been uncertainty about whether Ruzicka would give testimony at the hearing. In light of that uncertainty, the parties had earlier briefed the issue of whether the OTR should be admitted. The Hearing Officer's ruling was informed by that earlier briefing.

[364] Resp. PH Br. 44 and n.253.

[365] Resp. PH Br. 44 and n.253.

[366] Hearing Tr. (remarks of counsel) 1296.

[367] Hearing Tr. (remarks of counsel) 1298.

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Fourth, Respondents claim that Ruzicka gave an affidavit inconsistent with his OTR. They assert that Ruzicka swore that Montage, Titan, and Unicorn came to CSCT through a referral from Scottsdale. However, Ruzicka signed that affidavit at Hurry's request while still working for Hurry.[368] By the time of his OTR, Ruzicka no longer worked for Hurry. For that reason, we credit his OTR testimony that he was told that Titan and Unicorn came to CSCT through Hurry. Moreover, the affidavit saying that the three FFIs were referred by Scottsdale is not inconsistent with Ruzicka's understanding that ultimately Hurry was behind the referral. Even if Hurry persuaded the FFIs to do business with Scottsdale through CSCT, it would be consistent with his desire for secrecy for him to arrange for someone at Scottsdale to make the necessary introductions.

Finally, we observe that although Ruzicka's OTR testimony is valuable, his absence from the hearing deprived the Extended Hearing Panel of what would have been helpful live testimony and the opportunity for the Panel to ask him questions. Ruzicka's absence also encouraged Hurry to dispute the OTR testimony without fear of being contradicted, as discussed below. The distrust sown by Respondents' counsel impeded our adjudicatory process.

2. Hurry

As indicated above in connection with specific testimony, we repeatedly found that Hurry was not credible. Many of Hurry's self-serving explanations were not convincing on their face. His testimony was often inconsistent with other reliable evidence. Much of what he said also conflicted with Ruzicka's OTR testimony, which we find more credible than Hurry's uncorroborated assertions.

Hurry's ostensible purpose for setting up CSCT—to relieve Alpine of IRS withholding obligations—was not supported by any evidence that it made business sense. Rather, we conclude from Cruz's and Diekmann's testimony regarding heightened regulatory scrutiny in the period leading up to the establishment of CSCT, and the filing of the four prior SEC complaints against Scottsdale customers and employees, that Hurry sought to insulate his business from regulatory oversight by moving Scottsdale's FFI business offshore. This conclusion is reinforced by the fact that Scottsdale personnel continued to manage the FFI business with entities such as Unicorn and Titan (through Miller and Noiman). They needed to do that because Ruzicka was not qualified to run a broker-dealer, particularly one in the highly specialized business of liquidating microcap stock pursuant to Rule 144. Moreover, CSCT got its business through Hurry and Scottsdale. CSCT did not, and indeed could not, operate as an independent entity. CSCT served no function that Scottsdale could not have performed without it.

[368] Hearing Tr. (Hurry) 1565-69, 1638-39; RX-110.

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Hurry disputed that Ruzicka was not qualified to run CSCT and emphasized how accomplished Ruzicka was.[369] His testimony in this regard was not credible. It is plain from Ruzicka's inquiry about working in Hurry's bike shop that Ruzicka had no relevant experience and was desperate.[370] D'Mura described trying to educate Ruzicka about the securities industry and the elements for free-trading securities. D'Mura said it was "rough going" and that Ruzicka "wasn't picking it up."[371] D'Mura said that Ruzicka was anxious, stressed, and not capable of handling due diligence on microcap deposits by himself.[372] Even more important for our purposes here, D'Mura testified that he had conversations with Hurry about Ruzicka's difficulties and how Ruzicka was not "getting it."[373] Thus, contrary to his hearing testimony, Hurry knew that Ruzicka was not capable of running CSCT.

Hurry's assertion that he had little to do with CSCT was disproved. D'Mura testified that Hurry frequently bombarded him and Ruzicka with telephone calls about CSCT business and that he and Ruzicka tried to prepare for those calls with updated information about deposits. D'Mura portrayed Hurry as an intense and constant presence in their lives while they worked at CSCT, and emails corroborate that testimony. Emails show that Hurry oversaw every detail of CSCT's business, and Hurry admitted that he traveled to the Cayman Islands at least once a month. He so closely oversaw the CSCT operation that he claimed to know that Ruzicka was in the office only ten minutes out of every hour.

To the extent that Cruz, Diekmann, D'Mura, and Ruzicka all testified that Ruzicka, not Hurry, ran the daily operations of CSCT, as Respondents assert in their post-hearing brief,[374] we do not view that testimony as contradicting the evidence that Hurry was deeply involved in

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[369] Hearing Tr. (Hurry) 1574-77. When asked why he did not hire someone who had broker-dealer experience and who knew about FFIs to run CSCT, Hurry said that he hired Ruzicka to play an "executive role," someone who was "an all-around person, somebody who had some entrepreneurial skills, some management skills, proven to be able to do that." Hearing Tr. (Hurry) 1648.

[370] Hearing Tr. (Hurry) 1631, 1635-36.

[371] Hearing Tr. (D'Mura) 2273-77.

[372] Hearing Tr. (D'Mura) 2277-78.

[373] Hearing Tr. (D'Mura) 2274-77. D'Mura may not have been emphatic about Ruzicka's difficulties—he testified that it was against his self-interest to cause Hurry to fire Ruzicka—but D'Mura did raise concerns with Hurry. Hearing Tr. (D'Mura) 2314-15.

Email correspondence corroborates D'Mura's judgment that Ruzicka did not understand the business. For example, in May 2014, Ruzicka sought Diekmann's approval to consider a deposit of 11 million shares with an ostensible value of two million dollars. Diekmann wrote back that the issuer's shares traded in so little volume—roughly 3,500 per day—that it would take a "bazillion" years to sell the entire deposit. Diekmann said it was inappropriate to set the value that high and the transaction was the kind that should be avoided. CX-241.

This email correspondence also illustrates that CSCT served no real function independent of Scottsdale. Ruzicka sought Diekmann's guidance before even considering the deposit. Ruzicka was not independently vetting deposits before presenting them to Scottsdale. CX-241, at 2.

[374] Resp. PH Br. 45.

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CSCT's business. Ruzicka was responsible for the day-to-day processing of paper, but Hurry was responsible for bringing in business, cultivating the clients, and making all important decisions. Ruzicka, an out-of-work real estate attorney, did not have the background to do more than process the paper as directed. For Hurry to maintain that he left Ruzicka on his own to prospect for customers and manage client relationships defies belief.

Based on D'Mura's testimony and various emails, Hurry's contention that he was not concerned with secrecy was false. D'Mura testified that Hurry emphasized to him the privacy laws of the Cayman Islands, and D'Mura thought Hurry was very concerned about secrecy. Hurry's concern with secrecy was manifested in multiple ways, from his admitted use of FaceTime to confer with Montage, Titan, Unicorn, and other customers, to his obsession with labeling every email to and from Ruzicka as privileged, to his use of an email address that did not reveal its connection to him, to his refusal to use emails to discuss business and insistence on using telephone calls to do that.

Ruzicka's testimony only confirms D'Mura's. Ruzicka testified that Hurry told him that he was moving the FFI business to the Caymans precisely because he would not have to "give anything" to anyone. According to Ruzicka, Hurry was fanatical about not creating a record of his involvement with CSCT.

As for Hurry's efforts to develop business for CSCT, Hurry admitted having telephone calls with principals of Montage, Titan, and Unicorn, and he admitted personally visiting Montage in Panama and Unicorn in Belize. Although he claimed that he discussed a back-office system with Montage at Ruzicka's request, his testimony was vague and unspecific. There was no corroboration for Hurry's assertion, and he only made it when he knew that Ruzicka would not appear at the hearing to contradict him. Similarly, as to Hurry's initial assertion that he did not discuss business with Unicorn when he went to Belize, Hurry was impeached by his own OTR testimony. In his OTR he testified that he discussed pros and cons of doing business with Scottsdale directly or going through CSCT. Emails showed that Hurry provided other leads and referrals to Ruzicka, and D'Mura testified that Hurry was involved in developing Caledonian as a CSCT customer.

We further find Hurry not credible when he testified that he could not remember anything about his meetings with Montage in Panama and Unicorn in Belize. Hurry appeared to have excellent recall of other information and events. He testified in detail about the intricacies of taxation in the Cayman Islands and how it differed for Canadians and U.S. citizens, as well as the way the special economic zone in the Caymans operates.[375] He also testified about the Cayman Islands Monetary Authority, CIMA, and its information sharing agreement with the SEC, noting

[375] Hearing Tr. (Hurry) 1554-65, 1647-48.

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that the original agreement was in 2005 and that it was updated in 2012.[376] He insisted that he knew the exact days on which Ruzicka and D'Mura began at CSCT.[377]

We observe that Hurry appeared to be a canny, sophisticated, controlling, and hard-driving businessman. Hurry's attempt to portray himself as a distant figure, far removed from CSCT's business was not credible. Although he claimed that he likes to empower his people to run their businesses on their own,[378] that is demonstrably untrue.

3. DiBlasi

We find DiBlasi's testimony that he was the CCO—but not in connection with the Firm's Rule 144 business—astonishing.[379] Almost all of the Firm's business involved Rule 144 sales. As explained below in discussing DiBlasi's violation, DiBlasi was responsible for the WSPs, and nothing in the WSPs clearly allocated Rule 144 compliance to Cruz. Indeed, during much of the relevant period, the WSPs assigned the CCO specific responsibilities in connection with Rule 144.[380] DiBlasi's testimony may accurately reflect what he believes his job responsibilities to be, but, if so, his designation as CCO was misleading.

4. Cruz

Cruz's testimony was vague and unreliable. He often said he could not recall whether he had looked at various materials in conducting his due diligence reviews but that he "could" have done so.[381] Cruz also changed his testimony or made it vaguer as he was testifying if he became uncomfortable with his original statement. For example, he said that the change in NHPI's business from pharmaceuticals to oil and gas was not so important because the company's "management team had been stable. It's not the situation where we had a roaming management team."[382] But when asked how he knew that the management team was stable, he could point to nothing in the due diligence package or elsewhere. He ended by denying that he had said that the management team had been stable, saying, "I didn't see any change of – evidence of a change of management. I didn't use 'stable.'"[383] When pressed whether certain items were red flags calling for a searching inquiry about the issuer, Cruz resorted to general statements such as it "depends

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[376] Hearing Tr. (Hurry) 1630.

[377] Hearing Tr. (Hurry) 1620, 1624.

[378] Hearing Tr. (Hurry) 1550.

[379] Hearing Tr. (DiBlasi) 1921-23, 1946-47, 1952-53, 1965-66.

[380] Hearing Tr. (DiBlasi) 1967-73.

[381] Hearing Tr. (Cruz) 279, 284, 292-96, 301-03, 308.

[382] Hearing Tr. (Cruz) 288.

[383] Hearing Tr. (Cruz) 288-91.

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on the facts and the circumstances."[384] He never explained any basis for determining which facts and circumstances would trigger the duty to conduct a searching inquiry.

5. Diekmann

We find Diekmann's testimony vague, evasive, and unreliable. He characterized documents in ways that on their face the documents did not support, such as the Miller email indicating that a Canadian citizen could conceal himself by using a corporate entity as the owner of his Scottsdale account. Diekmann asserted that the Firm's procedures would root out a nominee problem but could point to nothing in the procedures that was designed to do that.[385] He was insensitive to suspicious circumstances such as a Google search that turned up information suggesting that a person was engaged in securities fraud,[386] or the identical terms and circumstances of the three supposedly independent NHPI deposits.[387] He contradicted his own OTR testimony.[388] He repeatedly resisted admitting that inconsistencies and suspicious circumstances could signify that a transaction was a sham until he had to admit what was obvious.[389]

Given Diekmann's position as the Firm's current president, we are concerned about his ability to ensure that the Firm responds appropriately in the future to obvious red flags and suspicious circumstances. This concern bears on the need for stringent sanctions, as discussed below.

Illustrative of the issue is Diekmann's testimony regarding information on Unicorn's website. Unicorn advertised the use of nominees to give customers an "extra level of confidentiality" because the customer's "name will not show up."[390] At his OTR, Diekmann testified that he had not seen this page of the Unicorn website before his OTR, but if he had it would have caused him concern whether the true beneficial owner was being disclosed.[391] At the hearing he testified differently. He said that he would not be concerned about the information on Unicorn's website because he had seen nothing on the website that suggested that Unicorn was offering to affirmatively lie about beneficial ownership.[392] When asked whether Unicorn would

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[384] Hearing Tr. (Cruz) 293.

[385] Hearing Tr. (Diekmann) 737-38.

[386] Hearing Tr. (Diekmann) 927.

[387] Hearing Tr. (Diekmann) 1853-54, 1901-04.

[388] Diekmann testified at his OTR that a print-out from the Unicorn website caused him concern about whether Patrick Gentle was the true beneficial owner of stock deposited at Scottsdale in his name. At the hearing, however, he denied that the information on the Unicorn site was a concern. Hearing Tr. (Diekmann) 925-30.

[389] Hearing Tr. (Diekmann) 1881-84, 1886-87.

[390] Hearing Tr. (Diekmann) 1818-19.

[391] Hearing Tr. (Diekmann) 1875-78.

[392] Hearing Tr. (Diekmann) 1819.

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have had to offer to lie about the beneficial owner before the website language would concern him, Diekmann answered "Yes."[393] That is not consistent with his and the Firm's gatekeeping function.

A second example of Diekmann's insensitivity to suspicious circumstances is his response to questions concerning an email exchange between one of the Rule 144 staff members and Titan. The staff member sent an email to Ryan Mendez at Titan saying that Scottsdale had multiple subaccounts at Scottsdale with Andrew Godfrey as the authorized signer. She requested a statement from Godfrey that explained the purpose for the multiple entities and provided an explanation of "any distinguishing features among the separate entities." She then named the eight entities.[394]

Godfrey provided an astoundingly broad and vague response:

> [The eight companies] are holding company's [sic] that are used to invest in development and exploration stage companies that engage in local, regional, multinational, global, sporting, manufacturing, wholesale, transportation, technology and eco friendly companies, etc., etc. Each investment is placed into a holding company based on investment criteria such as location, industry, long or short-term investment etc., etc.

Godfrey made no distinction among the companies. He provided no facts that could be verified. The response was undated and addressed "To Whom It May Concern." Godfrey provided no address, telephone number, or other contact information for himself or any of the companies. The response was forwarded by email from Titan to Scottsdale.[395]

Diekmann characterized Godfrey's response as reasonable.[396] We do not find it so. It lacks specificity and has no indicia of reliability or authenticity.

Finally, Diekmann displayed a lack of the skepticism, analytic acuity, and ingenuity that are required to perform the broker-dealer's gatekeeping function in the Rule 144 context. He testified that the identical documentation for the NHPI transactions did not trouble him because some unidentified person could have put Collins together with the three parties seeking to sell the NHPI shares they acquired from him. When asked whether that unidentified person could be the secret beneficial owner of the three sub-sub-accounts, he said that there was nothing in the documentation indicating that was so. He further declared that he did not know how you would

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[393] Hearing Tr. (Diekmann) 1875.

[394] CX-247.

[395] CX-248.

[396] Hearing Tr. (Diekmann) 891.

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investigate whether it was so. He seemed content not to know who the unidentified person was and to assume that it was a person who had put the three depositors in touch with Collins.[397]

Diekmann said that "there's always a risk that there could be some puppet master pulling the s[t]rings."[398] But he expressed frustration at the thought that the Firm could and should have done more to ascertain whether a puppet master was at work. As he remarked regarding the Argentinian nominees in the *Tavella* case, "It's just impossible to know that there was somebody else behind this."[399]

For purposes of assessing the Firm's ability to avoid violations in the future and crafting remedial sanctions, his remarks cause us concern. Diekmann said that what happened with NHPI happens all the time.[400]

6. Experts

a. Marc Menchel

We give little weight to the testimony of Respondents' expert, Marc Menchel. Although he opined that Scottsdale's procedures were reasonable and consistent with industry custom and practice, his experience related to Rule 144 was both a long time ago and in a much different context than Scottsdale's business. Menchel ran a Rule 144 desk at a large broker-dealer more than 30 years ago. That desk did not concentrate the way Scottsdale does on large blocks (100,000 shares or more) of microcap stocks.[401]

Furthermore, Menchel did not opine on the sufficiency of Scottsdale's due diligence in the context of the specific transactions at issue. He did not review the exhibits or the investigative testimony. While he did look at all the relevant due diligence packages, he did not review them with the idea of "second guessing" the Firm's handling of the deposits. He merely looked to see whether the due diligence packages contained the sorts of items that one would expect them to contain.[402] Essentially, Respondents' expert, like Respondents, took a check-the-box look at the due diligence packages.

Finally, Menchel's opinion seemed influenced by his admittedly idiosyncratic view that Regulatory Notice 09-05 goes beyond Rule 144, and his claim that many of the red flags listed in the Regulatory Notice are not really red flags for purposes of Rule 144.[403] Menchel's opinion

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[397] Hearing Tr. (Diekmann) 1901-03.

[398] Hearing Tr. (Diekmann) 720.

[399] Hearing Tr. (Diekmann) 732.

[400] Hearing Tr. (Diekmann) 1901, 1903.

[401] Hearing Tr. (Menchel) 2459-61.

[402] Hearing Tr. (Menchel) 2478-80, 2496-98, 2529-33, 2554-65, 2572-73, 2575.

[403] Hearing Tr. (Menchel) 2503-07, 2515-24.

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similarly seemed influenced by his view that FINRA has no authority to charge a broker-dealer firm with a Rule 2010 violation for a Securities Act violation, a view that he admits has no decisional support.[404] Menchel's opinion regarding FINRA's authority is contrary to the Hearing Officer's prior determination in the Order dated February 26, 2016, that FINRA has jurisdiction to bring this case. We decline to accept Menchel's view for the reasons stated in that Order, which we do not repeat here.[405]

b. Brian Underwood

We find the opinion of Enforcement's expert, Brian Underwood, more reliable, more persuasive, and entitled to greater weight than Menchel's. His experience with Rule 144 was more extensive and more recent. Until retiring in 2008, Underwood served as the Chief Compliance Officer of two major broker-dealers for a combined period of almost 20 years. The broker-dealers traded microcap securities on a fairly frequent basis and their Rule 144 desks reported to Underwood through one of his direct reports.[406] He also served on two NASD working groups in the 1990s that reviewed roughly 300 sets of policies and procedures as part of an effort to develop a model set of procedures.[407] Underwood has maintained a consulting practice since he retired, and in that capacity he has more recently seen between 20 and 25 entire policies and procedures of different firms.[408]

Underwood also reviewed more of the materials relating to the particulars of this case, including the pleadings, the parties' memoranda, the exhibits, and the OTRs conducted in connection with the investigation.[409] He, unlike Menchel, evaluated the substance of Scottsdale's due diligence and whether it was consistent with industry custom and practice.[410]

Underwood expressed the following opinions, among others, which we find consistent with our own views and supportive of our conclusions:

(i) In its WSPs, the Firm did not adequately address the risk of nominees being used to conceal the identity of the beneficial owners of the shares—it did not even mention the risk.[411]

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[404] Hearing Tr. (Menchel) 2593-99.

[405] *See also KCD Financial Inc.*, Exchange Act Release No. 80340, slip op. at 5-6 & nn.8-13 (SEC Mar. 29, 2017).

[406] Hearing Tr. (Underwood) 2609, 2615-21.

[407] Hearing Tr. (Underwood) 2711-12.

[408] Hearing Tr. (Underwood) 2712-13.

[409] Hearing Tr. (Underwood) 2619-20.

[410] Hearing Tr. (Underwood) 2651-57, 2665-67, 2669-71, 2673-78, 2685-89, 2691-94.

[411] Hearing Tr. (Underwood) 2682-83.

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(ii) The Firm's practice of placing all FFIs on its red flag list was counterproductive because it did nothing to narrow the focus to the kinds of anomalies that required a searching inquiry.[412]

(iii) The Firm's general practice of accepting the registered agent's address without requiring the physical address of the entities and persons purporting to own the shares was inconsistent with industry custom and practice.[413]

(iv) Even though the Firm gathered large volumes of paper in connection with the transactions, it failed to analyze the information, did not identify issues raised by the files, and did not conduct the type of searching inquiry necessary to resolve those issues.[414] As Underwood testified, a searching inquiry "means asking questions. It means not just assuming an answer that is possible to explain the transaction when there are other answers that might not properly explain or satisfy the question. It means asking and inquiring and doing it independently ...."[415]

(v) Underwood made plain that a broker-dealer cannot go forward with a Rule 144 transaction simply because it finds it too difficult to determine the identity of the beneficial owner. The broker-dealer must have reliable evidence of the identity of the purported beneficial owner. Otherwise it cannot proceed with the transaction.[416]

Underwood also explained that it would be typical in the industry to use other resources in addition to the internet to verify representations by the interested parties and make sure that those parties were not actually participating in an unregistered distribution of securities. With respect to whether the issuer is a shell, for example, it is not enough to obtain a representation from the issuer's principal as to its non-shell status. Underwood said that it would be common in the industry to obtain what is known as a "Bradstreet report." That report "can be quite enlightening in terms both of [the issuer's] operations, revenues, assets, who the key officers and directors are, shareholders—a great deal of information that is not necessarily available simply by going on the internet."[417]

Underwood concluded that a firm engaged in Rule 144 sales would also have more detailed written procedures that "would describe who did what, when, and how."[418] He said that

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[412] Hearing Tr. (Underwood) 2685-86, 2752-55.

[413] Hearing Tr. (Underwood) 2679-80.

[414] Hearing Tr. (Underwood) 2689.

[415] Hearing Tr. (Underwood) 2694.

[416] Hearing Tr. (Underwood) 2734.

[417] Hearing Tr. (Underwood) 2661.

[418] Hearing Tr. (Underwood) 2677-78.

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a firm would "anticipate questions that would be investigated with respect to issuers, with respect to sellers, with respect to the transfers of securities."[419] Furthermore, they would analyze the information collected and would "independently satisfy themselves to clear any red flags that arose. And that did not happen in any of these instances in my opinion."[420] He declared that the Firm did not meet the industry custom and practice for the conduct of this type of business.[421]

F. Law And Regulations Relating to Section 5

1. It Is Unlawful To Sell Securities Without Registration, Unless An Exemption Exists

It is unlawful for a firm to sell securities without an effective registration statement in place unless an exemption applies. Sections 5(a) and 5(c) of the Securities Act prohibit the "sale" and "offer for sale" of securities in interstate commerce unless a registration statement has been filed or is in effect, or an exemption from registration applies.[422] The prohibition applies to "any person,"[423] and the Securities Act defines "person" broadly to include both individuals and entities such as corporations and partnerships.[424] The prohibition also applies to any person who "directly or indirectly" sells or offers to sell securities.[425] Thus, Section 5 may be violated by a person who does not pass title to the securities but who is involved in the process of offering the securities for sale.[426]

The registration requirements are not merely technical—they are the "heart" of the Securities Act.[427] They serve to protect investors by promoting full disclosure of information thought necessary to informed investment decisions.[428] As the preamble to the Securities Act

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[419] Hearing Tr. (Underwood) 2678.

[420] Hearing Tr. (Underwood) 2678.

[421] Hearing Tr. (Underwood) 2689.

[422] 15 U.S.C. § 77e(a), § 77e(c). *See also Ronald S. Bloomfield*, Exchange Act Release No. 71632, 2014 SEC LEXIS 698, at *20-21 (Feb. 27, 2014). A violation of Securities Act Section 5 also is a violation of FINRA Rule 2010, which requires members and associated persons to conduct their business consistent with high standards of commercial honor and just and equitable principles of trade. *Midas Sec.*, Exchange Act Release No. 66200, 2012 SEC LEXIS 199, at *46 n.63 (Jan. 20, 2012); *Dep't of Enforcement v. Padilla*, No. 2006005786501, 2012 FINRA Discip. LEXIS 46, at *1 n.2 (NAC Aug. 1, 2012).

[423] 15 U.S.C. § 77e(a), § 77e(c).

[424] 15 U.S.C. § 77b(a)(2).

[425] 15 U.S.C. § 77e(a), § 77e(c).

[426] *Pinter v. Dahl*, 486 U.S. 622, 642-47 (1988).

[427] *ACAP Fin. Inc.*, Exchange Act Release No. 70046, 2013 SEC LEXIS 2156, at *28 (July 26, 2013) (quoting *Pinter v. Dahl*, 486 U.S. at 638), *aff'd*, 783 F.3d 763 (10th Cir. 2015).

[428] *SEC v. Elliott*, 2012 U.S. Dist. LEXIS 82992, at *1 (June 12, 2012); *Bloomfield*, 2014 SEC LEXIS 698, at *21; *ACAP*, 2013 SEC LEXIS 2156, at *28 (quoting *Pinter*, 486 U.S. at 638); *Dep't of Enforcement v. KCD Fin., Inc.*, No. 2011025851501, 2016 FINRA Discip. LEXIS 38, at *49 (NAC Aug. 3, 2016), *aff'd, KCD Fin. Inc.*, Exchange Act Release No. 80340, slip op. at 5-6 & nn.8-13 (SEC Mar. 29, 2017).

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states, the purpose of the Act is "[t]o provide full and fair disclosure of the character of securities ... and to prevent frauds."[429]

2. Sales Are Not Exempt If They Involve A Distribution By An "Underwriter"

A sale of securities is not exempt from registration if it involves a distribution of securities to the public. The Securities Act distinguishes between a distribution—which requires registration—and ordinary trading, which does not. In general, a distribution involves the sale of a substantial block of securities that is accompanied by sales solicitations, recommendations and other promotional activities that may induce investors to make investment decisions without the benefit of accurate information concerning the issuer, its management, and its plans and prospects. That is the reason registration is required. In contrast, ordinary trading by an individual investor who has little or no influence over the issuer is not accompanied by the same promotional pressures, and, consequently, the same protections are less necessary.[430]

The distinction between a distribution and ordinary trading is reflected in Section 4(a)(1) of the Securities Act, which exempts a securities transaction from registration if it does not involve "an issuer, underwriter, or dealer."[431] In this case, the term "underwriter" is critical. The term is not limited to financial industry professionals. It encompasses individual investors "if they act as links in a chain of transactions through which securities move from an issuer to the public."[432] Section 2(a)(11) of the Securities Act broadly defines the term to include "any person" who has purchased from an issuer "with a view to ... the distribution of any security."[433]

Because it is difficult to know whether a person acquired securities "with a view to" distributing them to the public, the surrounding circumstances and the investor's actions after acquiring the securities must be analyzed. For example, when a person acquires securities from the issuer in a non-public transaction and shortly thereafter resells, the circumstances suggest that the person acquired the securities with a view to distribution, which would make that person an underwriter. The transactions function like a two-step indirect distribution and may be a public offering in disguise.[434]

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[429] Securities Act of 1933, Pub. L. No. 22, § 1, 48 Stat. 74, ch. 38.

[430] *See* the Preliminary Note to Rule 144 ("If any person sells a non-exempt security to any other person, the sale must be registered unless an exemption can be found for the transaction.").

[431] *See generally* Hicks, *Resales of Restricted Securities* at § 2.4, 12-13, § 2:10, 22-23, § 2.11, 23-24 (2015 ed.). *See* the Preliminary Note to Rule 144 ("Section 4(1) of the Securities Act provides one such exemption for a transaction 'by a person other than an issuer, underwriter, or dealer.'").

[432] Preliminary Note to Rule 144.

[433] 15 U.S.C. § 77b(a)(11). *See also SEC v. McNamee*, 481 F.3d 451, 455 (7th Cir. 2007).

[434] *See generally* Hicks, *Resales of Restricted Securities* at § 4:101, 250 (2015 ed.). *See* the Preliminary Note to Rule 144.

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3. Broker-Dealer Has The Burden Of Showing A Reasonable Basis For An Exemption

Once a *prima facie* case is made out, as it was here,[435] a broker-dealer has the burden of showing that it had a reasonable basis at the time it sold the securities for concluding that an exemption from registration existed.[436] Exemptions from the registration requirements are affirmative defenses that must be established by the person claiming the exemption.[437] The Securities Act requires a broker-dealer and its associated persons to act as gatekeepers to prevent unlawful distributions, and the responsibility rests on them to take all steps reasonable in the circumstances to assure themselves that an exemption applies before they sell securities without registration.[438]

A broker-dealer's duty to investigate is not satisfied by simply checking boxes on a checklist. Rather, a firm must examine the information it receives with a skeptical eye because the interested parties have an incentive to mislead and deceive a firm in order to facilitate their sale of securities. A broker-dealer must independently investigate suspicious facts to satisfy itself that an exemption exists. As the SEC has explained,

> A dealer who offers to sell, or is asked to sell a substantial amount of securities must take whatever steps are necessary to be sure that this is a transaction not involving an issuer, person in a control relationship with an issuer[,] or an underwriter. For this purpose, it is not sufficient for him merely to accept "self-serving statements of his sellers and their counsel without reasonably exploring the possibility of contrary facts."[439]

Exemptions from registration requirements are construed narrowly.[440] Accordingly, evidence in support of an exemption must be "explicit, exact, and not built on mere conclusory statements."[441]

It is important to bear in mind that there are two distinct burdens in this case. While it was Enforcement's burden to prove the elements of its claims, it was the Firm's burden before

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[435] *See infra* p. 80.

[436] *Bloomfield*, 2014 SEC LEXIS 698, at *23; *ACAP*, 2013 SEC LEXIS 2156, at *29 (citations omitted); *Dep't of Enforcement v. Midas Sec., LLC*, No. 2005000075703, 2011 FINRA Discip. LEXIS 62, at *11 & n.8 (NAC Mar. 3, 2011), *aff'd*, 2012 SEC LEXIS 199, at *28 & n.36.

[437] *Midas Sec.*, 2011 FINRA Discip. LEXIS 62, at *28 & n.36, *38.

[438] *Padilla*, 2012 FINRA Discip. LEXIS 46, at *29.

[439] *Laser Arms Corp.*, 50 S.E.C. 489, 503 (Feb. 14, 1991) (quoting *Distribution by Broker-Dealers of Unregistered Securities*, Exchange Act Release No. 4445, 1962 SEC LEXIS 74 (Feb. 2, 1962)).

[440] *Midas Sec.*, 2011 FINRA Discip. LEXIS at *11-12 (quoting *SEC v. Blazon*, 609 F. 2d 960, 968 (9th Cir 1979).

[441] *Midas Sec.*, 2011 FINRA Discip. LEXIS at *12 (quoting *Robert G. Weeks*, Exchange Act Release No. 48684, 2003 SEC LEXIS 2572, at *42 n.34 (Oct. 23, 2003).

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selling the securities to establish a reasonable basis for the existence of an exemption from registration.

4. Respondents Claim Two Exemptions

With respect to the transactions at issue, Respondents claim that Rule 144 applied to the transactions, or, failing that, the so-called "broker's exemption" in Section 4(a)(4) of the Securities Act for ordinary unsolicited trading.[442]

a. Securities Act Rule 144

The SEC adopted Rule 144 both to provide a "safe harbor" for certain transactions and to protect against transactions by non-professionals as a means of circumventing the registration requirements. Among other things, Rule 144 restricts the resale of securities acquired directly or indirectly from the issuer or an affiliate in a transaction not involving a public offering. The SEC defines such securities as "restricted securities," and requires an owner of restricted securities to hold them for a length of time before reselling them in another transaction without registration. The holding period and other conditions for resale differ if the holder of the restricted securities is an affiliate or non-affiliate.[443] Thus, the identity of the person selling the securities and the nature of any relationship that person might have to the issuer become important to the exemption analysis.

Rule 144 defines an affiliate of an issuer as a person who directly or indirectly controls or is controlled by or is under common control with the issuer. Although Rule 144 does not define control, it is commonly understood that the definition in SEC Rule 405 of Regulation C applies. It defines control as "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person whether through the ownership of voting securities, by contract, or otherwise." Control depends on the totality of the circumstances and does not turn simply on whether a person is an officer of a company or the holder of a certain amount of stock.[444]

The identity of the issuer is important, too. The Rule 144 safe harbor is not available for shell companies. A shell company is defined as an issuer "with no or nominal operations and no or nominal non-cash assets."[445]

A person who satisfies the applicable conditions of Rule 144 is deemed not to be engaged in a distribution of the securities and therefore not to be an underwriter for purposes of the

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[442] Resp. PH Br. at 2-5.

[443] 17 C.F.R. § 230.144. *See generally* Hicks, *Resales of Restricted Securities* at § 2.4, 12-13, § 2:10, 22-23, § 2.11, 23-24 (2015 ed.).

[444] *SEC v. Zenergy Int'l, Inc.*, 141 F. Supp. 3d 846, 853-54 (N.D. Ill. 2015).

[445] *Id.* at 853.

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Securities Act.[446] The burden is on the person claiming an exemption under Rule 144 to prove that all the applicable conditions have been met.[447]

The provisions of Rule 144(d)(3) relating to tacking are important here because tacking was the only way that the sellers in the transactions at issue could satisfy the required holding period. There are two categories of tacking. One category applies where a person who acquires restricted securities cannot personally meet the applicable holding requirement, but he is able to tack the holding period of another person to his. The other category applies where a person seeks to tack the period of time he has held restricted securities to the time he held other securities of the same issuer.[448]

Both categories are relevant in this case. *First*, to establish the requisite holding period, the purported beneficial owners needed to tack their holding period to that of the prior holders. Their ability to tack depended on the prior holders not being affiliates of the issuer. *Second*, in connection with the transactions charged in the Complaint, the prior holders needed to tack their acquisition of the securities to the earlier inception of the debt obligation exchanged for the securities. In order to do that, the debt obligation had to be a security. Rule 144 permits tacking based on the exchange of a security for another security of the same issuer (as long as no additional consideration is involved).[449]

In this case, Respondents claim that they had sufficient evidence that the sellers of the securities at issue were not affiliates of the issuers, the issuers were not shell companies, and the sellers had met the applicable holding period for the securities. We conclude that they did not.

b. Broker's Exemption Under Section 4(4)

Respondents argue they were entitled to the so-called broker's exemption under Section 4(4) of the Securities Act even if the transactions at issue were not exempt under Rule 144.[450]

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[446] *See generally* Hicks, *Resales of Restricted Securities* at § 4:1, 86 (2015 ed.).

[447] *See* Rule 144(b).

[448] *See generally* Hicks, *Resales of Restricted Securities* at § 4:139, 318 (2015 ed.).

[449] *See generally* Hicks, *Resales of Restricted Securities* at § 4:139, 318-19 (2015 ed.). Rule 144(d)(3) contains the provisions governing tacking. Two provisions are relevant here. Rule 144(d)(3)(iv) provides that securities that are acquired as a result of a default on a bona fide pledge of the securities shall be deemed to have been acquired when they were acquired by the pledger. However, if the securities were pledged without recourse they shall be deemed to have been acquired by the pledgee at the time of the pledge. Rule 144(d)(3)(ii) permits a person to tack the period of time he has held certain restricted securities to the period of time he has held related securities of the same issuer. It provides for tacking where the securities to be sold were acquired from the issuer solely in exchange for other securities of the same issuer.

[450] Resp. PH Br. 4-5.

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Section 4(4) is intended to exempt ordinary trading transactions that a broker may be asked to execute.[451]

As discussed above, a person can be an underwriter within the meaning of the Securities Act if he acquires the securities from an issuer or affiliate of the issuer with a view to distribution. In order to ensure that the person offering restricted securities for resale is not acting as an underwriter, it is necessary for a broker to evaluate the circumstances in which that person acquired restricted securities and offers them for resale. A broker cannot be a mere order taker. It must make whatever inquiries are necessary under the circumstances to ensure that its customer is not an underwriter.[452]

This exemption is not available when the broker "knows or has reasonable ground[s] to believe" that his customer is an underwriter, since in that event the broker would also violate Section 5 by participating in a non-exempt transaction.[453] As FINRA has stated, "[T]his exemption is available only if a broker is not aware, after a reasonable inquiry, of circumstances indicating that the selling customer is participating in a distribution of securities."[454]

Contrary to Respondents' arguments, we conclude that Respondents were confronted by abundant evidence that they were likely participating in unlawful distributions of securities. They cannot claim that they were unaware of facts signifying that possibility or the need to conduct further inquiry.

5. Both Exemptions Required A "Searching Inquiry" To Ensure That No Underwriter Was Involved

Neither the Rule 144 exemption nor the broker's exemption is available if the person selling the securities is an underwriter within the meaning of the Securities Act. Accordingly, where there are red flags indicating the possibility that a person may be acting as an underwriter, both exemptions require that a broker make a "searching inquiry" to satisfy itself that an exemption applies. Only then can a broker ensure that it does not participate in an unlawful distribution of unregistered securities.[455]

The SEC observed over half a century ago, "[W]here the surrounding circumstances raise a question as to whether or not the ostensible sellers may be merely intermediaries for controlling persons or statutory underwriters, then searching inquiry is called for."[456]

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[451] *World Trade Fin. Corp.*, Exchange Act Release No. 66114, 2012 SEC LEXIS 56, at *26 (Jan. 6, 2012).

[452] *Bloomfield*, 2014 SEC LEXIS 698, at *24-25 & nn.35-36.

[453] *Bloomfield*, 2014 SEC LEXIS 698, at *24; *World Trade Financial Corp.*, 2012 SEC LEXIS 56, at *26 & n.31.

[454] CX-197 at 2 (emphasis supplied).

[455] CX-197.

[456] *Bloomfield*, 2014 SEC LEXIS 698, at *26-27.

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6. FINRA Guidance On Red Flags Signaling That Underwriter May Be Involved

In Regulatory Notice 09-05, FINRA published guidance on the specific kinds of facts that give rise to the duty of conducting a searching inquiry.[457] In that guidance, FINRA made plain that "[a]ll firms must have procedures reasonably designed to avoid becoming participants in the potential unregistered distribution of securities."[458] It further explained, "Before selling securities in reliance on an exemption, a firm must take reasonable steps to ensure that the transaction qualifies for the exemption ...."[459]

Regulatory Notice 09-05 identifies a non-exhaustive list of red flags that signal the "possibility of an illegal, unregistered distribution."[460] These red flags are by no means comprehensive. They are merely illustrative. The generally recognized red flags in the Notice include the following: [461]

1. A customer opens a new account and delivers physical certificates that represent a large block of thinly traded or low-priced securities.

2. A customer has a pattern of depositing physical share certificates, immediately selling the shares, and then wiring out the proceeds of the resale.

3. A customer deposits share certificates that are recently issued or represent a large percentage of the float for the security.

4. Share certificates reference a company or customer name that has been changed or that does not match the name on the account.

5. The lack of a restrictive legend on deposited shares seems inconsistent with the date the customer acquired them or the nature of the transaction in which they were acquired.

6. There is a sudden spike in investor demand for a thinly traded or low-priced security, coupled with a rising price.

7. The company was a shell company when it issued the shares.

8. A customer with little or no assets at the firm receives an electronic transfer or journal transactions of large amounts of low-priced unlisted securities.

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[457] CX-197.

[458] CX-197, at 2.

[459] CX-197, at 2.

[460] CX-197, at 1.

[461] CX-197, at 3-4.

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9. The issuer has been through several recent name changes, business combinations or recapitalizations, or the company's officers are also officers of numerous similar companies.

10. The issuer's SEC filings are not current, are incomplete, or are nonexistent.

G. Ethical Violations (First Cause Of Action—Scottsdale And Hurry)

The First Cause of Action charges that Scottsdale and Hurry violated FINRA Rule 2010 by acting in contravention of Section 5 of the Securities Act. It alleges that during the relevant period, Scottsdale sold millions of shares of securities without registration and without an exemption. It further alleges that Hurry was a necessary participant and substantial factor in the unlawful transactions through his close management and control of all the entities involved in the process of depositing, approving, and reselling the securities, and through his prospecting for CSCT customers. The Complaint alleges that Hurry took actions to evade regulatory scrutiny and enable the Firm to make the unlawful sales.

1. Rule 2010

FINRA Rule 2010 requires FINRA members and their associated persons to "observe high standards of commercial honor and just and equitable principles of trade" in the conduct of their business. The Rule requires members of the securities industry not merely to conform to legal and regulatory requirements, but to conduct themselves with integrity, fairness, and honesty.[462]

Scienter is not required for a Rule 2010 violation. Rather, the SEC has established a disjunctive test for a Rule 2010 violation that applies either (i) to intentional or conscious bad conduct or (ii) to a failure to meet ethical norms, regardless of intention. The SEC has held that Rule 2010 may be violated if the respondent has acted either in bad faith or unethically.[463] In the context of a Rule 2010 violation, the SEC has defined bad faith as a dishonest belief or purpose,

[462] *Robert Marcus Lane*, Exchange Act Release No. 74269, 2015 SEC LEXIS 558, at *22 n.20 (Feb. 13, 2015) (discussing NASD predecessor to FINRA Rule 2010: "[T]his general ethical standard . . . is broader and provides more flexibility than prescriptive regulations and legal requirements. [FINRA Rule 2010] protects investors and the securities industry from dishonest practices that are unfair to investors or hinder the functioning of a free and open market, even though those practices may not be illegal or violate a specific rule or regulation.") (internal quotations omitted).

[463] *Blair Alexander West*, Exchange Act Release No. 74030, 2015 SEC LEXIS 102, at *20 (Jan. 9, 2015); *Thomas W. Heath, III*, Exchange Act Release No. 59223, 2009 SEC LEXIS 14, at *13-17 & nn.9-16 (Jan. 9, 2009), *aff'd*, 586 F.3d 122, 130 (2d Cir. 2009), *cert denied*, 2010 U.S. LEXIS 3029 (Apr. 5, 2010) (discussing NYSE predecessor of Rule 2010); *Dep't of Enforcement v. Shvarts*, No. CAF980029, 2000 NASD Discip. LEXIS 6, at *11-18 (NAC June 2, 2000).

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and unethical conduct as conduct inconsistent with the moral norms or standards of professional conduct.[464]

Because the securities industry is built on trust, any ethical failure damages the industry generally by casting doubt on the integrity of its participants. An ethical failure also casts doubt on the ability of the particular miscreant to conform to ethical norms in the future. Enforcement of FINRA Rule 2010 is therefore fundamental to FINRA's regulatory mission, which, as expressed in FINRA's Sanction Guidelines, "is the building of public confidence in the financial markets."[465]

2. Enforcement Established A *Prima Facie* Case Of A Section 5 Violation

The elements of a *prima facie* case for violation of Section 5 are the following: (i) respondents sold or offered to sell securities; (ii) through use of interstate facilities or the mails (the jurisdictional means); and (iii) when no registration statement was filed or in effect as to those securities. Scienter is not an element.[466] A Section 5 violation does not require a showing that the sale actually facilitated a fraud. A sale without registration and without an exemption is an unlawful distribution of securities regardless of whether it is proven to be connected to a fraud.

Enforcement established a *prima facie* case. It proved that from December 1, 2013, through June 30, 2014, Scottsdale sold shares of three issuers, NHPI, VPLM, and ORFG, using the jurisdictional means and without registration.[467]

Respondents do not dispute these facts. They argue only that the transactions were exempt from registration.[468]

3. The Firm Lacked A Reasonable Basis For An Exemption

Scottsdale failed to have a reasonable basis for an exemption at the time that it sold the securities in the transactions at issue.

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[464] *Edward S. Brokaw*, Exchange Act Release No. 70883, 2013 SEC LEXIS 3583, at *33 (Nov. 15, 2013). *See also Simpson v. Bear, Stearns & Co.*, No. C07950030, 1997 NASD Discip. LEXIS 13, at *27 n.9 (NAC Jan. 29, 1997) ("Term 'bad faith' is not simply bad judgment or negligence, but rather it implies the conscious doing of a wrong because of dishonest purpose or moral obliquity....").

[465] FINRA Sanction Guidelines at 1 (2016) (Overview), https://www.finra.org/industry/sanction-guidelines.

[466] *Bloomfield*, 2014 SEC LEXIS 698, at *22 & n.29. *See also SEC v. Cavanagh*, 445 F.3d 105, 111 n.13 (2d Cir. 2006); *SEC v. Calvo*, 378 F.3d 1211, 1214-15 (11th Cir. 2004).

[467] RX-1; RX-2; RX-3; JX-268; JX-281; JX-310.

[468] Resp. PH Br. 2-5.

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First, in its due diligence the Firm did not even address the question whether the debt obligation was a security, despite having lawyers on its Rule 144 review team and despite Respondent Cruz being a lawyer with significant experience in the securities laws. It had no foundation for the tacking necessary to achieve the required holding period because the promissory notes and lines of credit on which the tacking was based were not securities.

Second, the documentation to support the Rule 144 exemption was rife with discrepancies and suspicious circumstances—all of which raised red flags strongly suggesting that the chain of transactions leading to deposits at Scottsdale were sham transactions using false documents and nominees to conceal the identity of the beneficial owners.

Although the Firm compiled thick due diligence packages for the transactions, it did so with a "check-the-box" attitude. It did not appropriately evaluate the information in the due diligence packages, did not investigate the many red flags, and did not independently verify the information received from the interested parties. The due diligence packages created only the false appearance of due diligence.

The Firm's conduct was unethical and did not meet the industry norms. The persons involved in the Rule 144 review did not obtain any meaningful information about the individuals and entities involved in the transactions. Diekmann confessed that he knew nothing about the purported beneficial owner of one of the deposits other than that the person was a client of CSCT's client. Scottsdale knew little more about any of them. It failed to perform its gatekeeping function. The testimony of Enforcement's expert only confirms our conclusion that the Firm failed to conduct itself in a manner consistent with industry norms.

a. The Prior Holders' Debt Obligations Were Not Securities Available For Tacking

i. *Reves* Governs Whether Note Is A Security

Not every note or debt obligation is a security.[469] The Supreme Court's decision in *Reves* governs the analysis.[470] Any note with a term of more than nine months is presumed to be a security unless it resembles one of the judicially enumerated instruments that are not securities, such as a note delivered in connection with consumer finance or a mortgage. In *Reves*, the Court set the analytic framework for determining whether a note bears a resemblance to one of the enumerated instruments or should be held to be a security. Four factors may be considered in deciding whether a note is a security:

(i) whether the seller's purpose is to raise money for general use of business or to finance substantial investments, and the buyer is motivated by the profit to be

[469] *Reves v. Ernst & Young*, 494 U.S. 56, 65-67 (1990).

[470] *Id.*

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generated, in contrast to a note to facilitate a minor purchase or sale or to correct for cash-flow difficulties;

(ii) whether the note involves an individual transaction or common trading for speculation or investment;

(iii) whether there is a reasonable public expectation that the note would be viewed as security; and

(iv) whether another regulatory scheme applies that would reduce risk of the instrument.[471]

In another case, the Court later summed up the distinguishing characteristic of a security as "any instrument that might be sold as an investment."[472]

As we explain below, we conclude that none of the debt obligations held by the prior holders were securities. That includes the NHPI note in payment for consulting services, the oral line of credit to VPLM, and the outstanding balance on the ORFG line of credit. As a result, when the prior holder accepted stock in satisfaction of the debt, it was not an exchange of securities that would support tacking.

ii. NHPI

It is plain that the note written by NHPI to Collins, the prior holder in the chain of holders, was not a security. We observe at the outset that the note's term was much shorter than the nine months required to presume a note to be a security—roughly two months. But it also fails the test set forth in *Reves*. NHPI did not enter into the note agreement in order to finance its general business or to make a substantial investment. Nor was Collins motivated by some profit to be generated from the note. According to documents in the due diligence package, the note was no more than a promise to pay Collins $10,000 for consulting services. Furthermore, the note was issued in a single transaction. A note that "merely reflects a single transaction" and is "not offered to the public" is not a security.[473] Nor could there be any public expectation that an individual note promising to pay for services was a security. The fourth factor, whether another regulatory scheme applied and diminished the need for treating the instrument as a security, is inapplicable where no other factor supports labeling the note a security.

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[471] *Id.* at 65-67. *See also Bass v. Janney Montgomery Scott, Inc.*, 210 F.3d 577, 583-86 (6th Cir. 2000).

[472] *SEC v. Edwards*, 540 U.S. 389, 393 (2004). *See also Frankfurt v. Mega Entertainment Group II*, 2016 U.S. Dist. LEXIS 73613, at *11 (N.D. Ill. June 7, 2016) (stating that "only those notes that were issued in an investment context" are securities).

[473] *New Earthshell Corp. v. Jobookit Holdings Ltd*, 2015 U.S. Dist. LEXIS 27141, at *10-11 (S.D.N.Y. Mar. 5, 2015)

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In the Court of Appeals
For the State of Michigan

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff-Appellee,

v.

MORNINGLIGHTMOUNTAIN, LLC, and MICHAEL GOODE,

Defendants-Appellants,

–and–

DOES 1–10,

Defendants–Not Participating.

Docket No.

Kalamazoo County Circuit Court
Case No.: 18-0153-CZ
HON. ALEXANDER C. LIPSEY

APPLICATION FOR LEAVE TO PURSUE AN INTERLOCUTORY APPEAL

APPELLANT'S APPENDIX VOLUME X

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As another similar note was aptly described by a federal district court, the note held by Collins was "akin to an 'IOU' for services rendered."[474]

iii. VPLM

With respect to the issue of whether the oral line of credit extended by Locksmith to VPLM was a security, the focus at the hearing was on whether there is any distinction between an oral agreement and a written agreement. Diekmann maintained that there is no difference between an oral line of credit and a written line of credit for purposes of Rule 144 and tacking. He understood that in either case the successor holder could tack back to an advance on the line of credit. He based his understanding on his experience with the treatment of written lines of credit and discussions with legal counsel—who exactly he could not recall.[475]

In their post-hearing brief,[476] Respondents relied on a Seventh Circuit Court of Appeals decision, *Canadian Imperial Bank*.[477] Their reliance is misplaced. The issue in *Canadian Imperial Bank* was whether a private plaintiff had sufficiently pleaded the existence of a security for purposes of establishing subject matter jurisdiction. The plaintiff alleged that a certificate of deposit from a Bahama bank was a security, but no document was attached that could be analyzed for purposes of jurisdiction. The Court held that the complaint did not allege sufficient facts to establish jurisdiction, but it hastened to say that its decision did not mean that only written instruments can be securities, noting that oral promises of participation in a profit sharing plan have been held to be investment contracts even where not evidenced in writing.[478] The Court's remarks regarding oral promises as investment contracts provide no basis for concluding that the oral credit line here was a security.

The oral line of credit, unlike an oral promise of participation in a profit sharing plan, was not represented to be an investment. Nor was it easily tradeable as an investment. There was no means of being certain of the terms, confident of the effective transfer of rights, or sure that those rights might later be enforced. Accordingly, the oral line of credit was not a security.

Moreover, even if written, the line of credit did not meet the *Reves* test. The line of credit was a loan to the issuer by a single individual. Such an individual transaction would not be viewed as a security by the public and would not ordinarily be traded as an investment.

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[474] *SEC v. Garber*, 959 F. Supp. 2d 374, 377 (S.D.N.Y. 2013).

[475] Hearing Tr. (Diekmann) 1711-17.

[476] Resp. PH Br. 22 n.114.

[477] *Canadian Imperial Bank of Commerce Trust Co. v. Fingland*, 615 F. 2d 465 (7th Cir. 1980).

[478] *Id.* at 466-67 & n.5.

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iv. ORFG

The open-ended line of credit extended by Forward to ORFG for $600,000 was not a security. As discussed above in connection with the other debt conversion transactions, it did not meet the *Reves* test. It was an individual transaction that was not designed to trade as an investment. Nor would the public view it as a security.[479]

b. The Firm Ignored Red Flags

Even if the notes had been securities, the transactions were not entitled to the safe harbor of Rule 144. Many of the red flags set forth in Regulatory Notice 09-05[480] existed in the transactions at issue. The following red flags are examples:

- All the stock deposits in the transactions at issue consisted of large blocks of thinly traded, low-priced stocks issued by obscure companies. (Reg. Notice 09-05 Red Flag 1).

- CSCT had a pattern of making large deposits of thinly traded microcap stocks, selling the securities, and immediately wiring out the proceeds. Respondents knew that CSCT was acting on behalf of its FFI customers involved in the transactions and that the FFIs also engaged in the same pattern while acting on behalf of other entities and individuals. Despite the pattern, Scottsdale did nothing to investigate who actually was receiving the funds from the securities sales. Because the only account at Scottsdale was in the name of CSCT, Scottsdale could not and did not track where the proceeds ultimately went. It could not tell if the proceeds went to the different purported beneficial owners or to other persons who were repeatedly engaging in the deposit and immediate resale of securities. (Reg. Notice 09-05 Red Flag 2).

- The deposited shares were recently issued, which suggested that the issuer or its control persons could be initiating a distribution. Nothing in the due diligence packages indicates that Scottsdale took any note of that fact. (Reg. Notice 09-05 Red Flag 3).

- Although the issuer claimed not to be a shell corporation, there was little evidence of ongoing business operations. The Firm mainly relied on a representation by a principal of the issuer that the entity was not a shell. (Reg. Notice 09-05 Red Flag 7).

- Two of the issuers involved in this case had business histories that suggested shell status. Only a few months before the deposit of NHPI securities at Scottsdale, NHPI, a pharmaceutical company, announced it was going into the oil and gas business. ORFG,

[479] Furthermore, even if the note had been a security, Forward did not transfer the ORFG note for securities of ORFG. He transferred a portion of the note for securities of a different entity, Anything Media. He also did so in connection with an agreement by ORFG to modify the terms of the original line of credit. His exchange involved securities of a different issuer and different consideration. Accordingly, Media Central was not entitled to tack back to Forward's original note.

[480] *See supra* pp. 78-79.

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which described itself as an automotive detailing company that used casual part-time labor as required, similarly indicated it was considering going into mineral exploration and set forth an anticipated payment schedule for three unspecified mining concessions. In both cases, the new business venture was radically different from the old line of business, the information regarding either line of business was scant, and the company's purported resources did not appear sufficient to engage in the new line of business. (Reg. Notice 09-05 Red Flags 7 and 9).

Finally, we note that it is critical in a Rule 144 transaction to know the identity of the purported beneficial owners and any relationship they might have to the issuers or affiliates of the issuers of the shares they seek to sell. Even after collecting voluminous documents, the Firm in fact knew nothing about the purported beneficial owners or about the businesses through which they held the securities except their names. Diekmann, who headed the Rule 144 team at the time of the transactions at issue, admitted that he knew nothing about the purported beneficial owner of one of the NHPI deposits other than that the person was a customer of Unicorn.[481] The Firm knew little more than that about any of the other purported beneficial owners involved in the transactions at issue. Diekmann's testimony is a stark confession that the Firm did not perform its gatekeeping function and did not adhere to high standards of commercial honor and just and equitable principles of trade.

c. Respondents' Arguments Are Unavailing

i. NHPI

Respondents' arguments relating to the NHPI deposits rest on treating the representations by the interested parties in the documentation for the NHPI deposits as though they were true. For example, Scottsdale asserts that Collins was not an affiliate of NHPI, and therefore he could freely sell the stock derived from his note in the fall of 2013 regardless of any tacking to the inception of the May 2012 note.[482] Respondents then reason that Collins' transactions with Sky Walker, Ireland Offshore, and Swiss National could not be fake loan transactions, as Enforcement portrays them, because, as a non-affiliate holder for more than a year, Collins could simply have sold the shares to the three depositors. Respondents conclude that there could be no reason to fake the loan transactions. Respondents likewise assert that the beneficial owners of Sky Walker, Ireland Offshore, and Swiss National were not affiliates of NHPI based on the representations to that effect by the interested parties.[483]

In making arguments that depend upon the truth of the representations made by the interested parties, Respondents only demonstrate their continuing lack of appropriate response to

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[481] Hearing Tr. (Diekmann) 911-13, 919.

[482] In so arguing, the Firm abandons the basis on which the deposit was justified at the time Scottsdale sold the shares. On its Checklist for the transaction, the Firm relied on tacking back to the inception of the May 2012 note. RX-1, at 1.

[483] Resp. PH Br. 13-15.

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the suspicious circumstances and glaring red flags raised by the NHPI deposits. As the SEC has noted, a broker-dealer may not rely on representations by interested parties because those interested parties have an incentive to make misrepresentations.[484]

ii. VPLM

Again, Scottsdale's arguments largely assume the truth of the representations by the interested parties. They assert that they reasonably relied on those representations.[485] We reject Respondents' position. Red flags signaled that the transaction could be a scheme to evade the registration requirements while distributing securities to the public. The Firm could not sell the securities unless it investigated further and obtained better support for an exemption.

Scottsdale also argues that Enforcement failed to prove that any proceeds of the sales of VPLM flowed back to the issuer or that there were any links between the issuer and the persons involved in selling VPLM stock through CSCT and Scottsdale.[486] As discussed above, the Firm misunderstands the law. It was not Enforcement's burden to prove who was behind the transactions; rather, it was Respondents' burden to probe the suspicious circumstances and establish that the transaction was entitled to the Rule 144 exemption before the Firm sold the securities.

iii. ORFG

As with the other transactions, Respondents' arguments assume the truth of the representations in the transaction documents. For instance, they argue that the Firm obtained satisfactory evidence that the transaction met the requirements of Rule 144 because the Firm obtained a letter from ORFG's Chairman and CEO dated May 19, 2014, confirming that Media Central and its purported owner were not affiliates of the company.

Given that the underlying transaction—the $600,000 open-ended credit line giving the holder discretion to convert stock at will—made no sense, it was unreasonable to rely on that letter as the only evidence that the seller was not an affiliate. If the chain of transactions were really a series of steps in a distribution for the ultimate benefit of the issuer or those persons controlling the issuer, then such a representation by the issuer's Chairman and CEO would be in service of the unlawful distribution of securities without registration.

4. Hurry's Violation

The First Cause of Action also charges that Hurry was a necessary participant and substantial factor in the unlawful transactions, through his close management and control of all the entities involved in the process of depositing, approving, and reselling the securities, and

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[484] *Laser Arms*, 1991 SEC LEXIS 257, at *36.

[485] Resp. PH Br. 21.

[486] Resp. PH Br. 22.

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through his prospecting for CSCT customers. It expressly alleges that Hurry purposely established CSCT as a means of evading regulatory scrutiny and enabling the Firm to make the unlawful sales. Enforcement proved the charges.

a. Hurry Was A Necessary Participant And Substantial Factor

Section 5 makes it unlawful for a person to offer or sell securities without registration. Liability, however, is not limited to the person or entity that ultimately passes title to the security. Courts have developed the "necessary participant/substantial factor" test as a way of holding other persons involved with the transactions accountable under Section 5 as offerors or sellers.[487] The "necessary participant/substantial factor" test is based on statutory language in Section 5, which imposes liability on persons who "directly or indirectly" offer or sell securities in violation of Section 5.[488]

The "necessary participant/substantial factor" test distinguishes between those persons who have only a *de minimis* or insubstantial role in securities sales in violation of Section 5 and those who should be liable. The test is more than a "but for" test. Even if a person is necessary to the completion of the transaction, such as a transfer agent might be, that does not necessarily mean the person was a substantial factor in the violation. Determining whether someone was a substantial factor in the unlawful sales is a fact issue requiring extensive analysis.[489]

It is not clear that the "necessary participant/substantial factor" test is appropriate here. Hurry is not charged with offering or selling securities in violation of Section 5. He is charged with an ethical violation under Rule 2010. He does not have to be proven to be an offeror or seller in order to be proven to have violated Rule 2010.

The parties briefed Hurry's liability using the "necessary participant/substantial factor" test, however, and we use it to assist in determining whether Hurry was sufficiently linked to the transactions at issue to hold him liable for violating Rule 2010 in connection with them. We also separately apply the more familiar standard for Rule 2010 violations, which we discuss below.

Based on the above factual record and analysis, which we do not repeat in detail here, we conclude that Hurry was a necessary participant and a substantial factor in the transactions. He was sufficiently linked to the transactions to hold him accountable for his conduct in connection with them. His role was not *de minimis* or insubstantial.

We reject Hurry's argument that he cannot be linked to the transactions at issue. He asserts that there is "not a single document relating to the stocks in question with [his] name

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[487] *SEC v. CMKM Diamonds, Inc.*, 729 F.3d 1248, 1255 (9th Cir. 2013).

[488] *SEC v. Boock*, 2011 U.S. Dist. LEXIS 95363, at *47 & n.17 (S.D.N.Y. Aug. 25, 2011).

[489] *CMKM Diamonds*, 729 F.3d at 1255-57; *SEC v. Blackburn*, 2015 U.S. Dist. LEXIS 178325, *8-9 (E.D. La. Sept. 11, 2015).

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anywhere on it."[490] While there was little in the way of a paper trail directly linking Hurry to the particular transactions at issue, the absence of such a direct link was the result of Hurry's own demonstrated obsession with secrecy. He purposely concealed his involvement in CSCT's business. It is not surprising that there is not a single document relating to the deposits at issue with his name on it, because he made sure of it.

In fact, Hurry was the master puppeteer for all the FFI business that flowed through CSCT to Scottsdale and, ultimately, to public investors. CSCT existed only because he established and closely managed it. Given Ruzicka's lack of experience, qualifications, and contacts, CSCT could not have survived without Hurry's active involvement. We reject Hurry's assertion that, because Ruzicka had decades of experience as a real estate lawyer who ran his own law firm, hiring Ruzicka to run CSCT was a reasonable and logical decision.[491]

With respect to the particular transactions at issue, there is sufficient evidence of a link between Hurry and the FFIs that made the deposits. Hurry developed CSCT's business with the three FFIs that engaged in those transactions, Montage, Titan, and Unicorn. As set forth more fully above, Hurry admits that he flew to Panama to see Montage and to Belize to see Unicorn and that he discussed with Unicorn doing its business through CSCT. He admits to talking to the principals of Montage, Titan, and Unicorn multiple times using FaceTime. He admits to creating the spreadsheet that tracked CSCT deposits, including those by Montage, Titan, and Unicorn. D'Mura testified that he and Ruzicka talked about deposits with Hurry, and an email shows that Hurry specifically discussed trading in NHPI and VPLM with Ruzicka. Ruzicka testified that Hurry told him to deal with a specific contact at Montage. Both Ruzicka and D'Mura said they disliked dealing with Cem Can at Unicorn, but that they knew that they had no authority to decline his business without Hurry's consent.

Hurry's direct contact with the three FFIs involved in the transactions at issue made him a substantial factor in their transactions. He did not take Ruzicka with him when he flew to Panama and Belize to talk to Montage and Unicorn, and Ruzicka testified in his OTR that he did not participate in Hurry's FaceTime calls with customers. Hurry was the critical link between CSCT and the three FFIs. Hurry's importance was reflected in Unicorn's demand for Hurry to join a telephone call with Miller, Diekmann, and Ruzicka to discuss the processes and procedures to be used in connection with Unicorn's business with Scottsdale through CSCT. Whenever something beyond paper-pushing was involved, Hurry's input was necessary. We reject Hurry's argument that he merely displayed the normal interest of an owner in the overall financial performance of his firm.[492] His involvement in CSCT's business was intense and pervasive.

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[490] Resp. PH Br. 45.

[491] Resp. PH Br. 43-44.

[492] Resp. PH Br. 46-47.

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Hurry further argues that the case law only imposes liability under Section 5 where the defendant has either sold the unregistered securities himself or has taken concrete steps necessary to effectuate those sales, such as negotiating transactions, issuing opinion letters, or directing the issuance of shares. He contends that he engaged in no such activities here.[493]

We reject the argument. As noted above, Hurry is not charged with a Section 5 violation, but, rather, a Rule 2010 violation. Unethical conduct in violation of Rule 2010 is not constrained by case law defining who is liable as a statutory seller under Section 5. In any event, substantial participation is a broad concept without precise bounds. One who conceives of and plans a scheme, or one who is a substantial motivating factor behind it, can be liable under Section 5.[494] To hold otherwise would allow a person to mastermind a Section 5 violation, and, by directing others to perform the mechanical tasks necessary to effect the sale of securities without registration, escape liability.

b. Hurry Acted In Bad Faith

FINRA Rule 2010 is a broad ethical principle that may be violated either by conduct that fails to meet ethical norms, regardless of intention, or conduct that is undertaken in bad faith. We find here that, in connection with the business he routed through CSCT, Hurry acted in bad faith and violated FINRA Rule 2010. We conclude that he was engaged in a scheme to evade the securities laws, in particular the registration requirements of Section 5.

Hurry claimed that he established CSCT because Alpine wanted to shed its IRS tax withholding obligations, but there was no evidence that it made business sense to set up an office in the Cayman Islands to do that. In fact, the insertion of CSCT into the process of preparing stock certificates for resale to the public made no business sense because, due to the discounts Scottsdale extended to CSCT, Hurry's enterprises as a collective group made no more money than when Scottsdale was handling the business directly—but CSCT imposed additional costs.

That Hurry had no legitimate business reason for setting up CSCT is further apparent from the way the Firm handled the business purportedly routed through CSCT. The Firm, through Miller and Noiman, continued to deal directly with the FFIs and often handled issues that arose with the deposits without involving Ruzicka or CSCT. Rather than independently preparing deposits for submission to Scottsdale, Ruzicka also sought guidance from Diekmann as to what deposits he should consider.

Further casting doubt on the legitimacy of Hurry's reasons for setting up CSCT, Diekmann testified that an individual in Belize or Panama could have a direct account with

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[493] Resp. PH Br. 46 and n.261.

[494] *SEC v. Elliott*, 2011 U.S. Dist. LEXIS 91946, at *20 (S.D.N.Y. Aug. 17, 2011). *See also SEC v. Holschuh*, 694 F. 2d 130, 139-40 (7th Cir. 1982); *SEC v. Friendly Power Co.*, 49 F. Supp. 2d 1363, 1372 (S.D. Fla. 1999) (a person has indirectly sold a security to the public if he has "employed or directed others to sell ... or has conceived of and planned the scheme by which the unregistered securities were offered or sold").

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Scottsdale without going through an FFI like Unicorn or CSCT.[495] Cruz admitted that it would be easier to conduct due diligence on a direct customer of the Firm than a customer who came through an FFI such as CSCT or Unicorn.[496] In fact, the creation of CSCT diminished Scottsdale's access to information about the purported beneficial owners, and neither Scottsdale nor Alpine, Hurry's clearing firm, knew where the proceeds from sales of the securities were flowing.[497] This testimony raises the question of the purpose served by the multiple layers of entities—if not to conceal the identity of the true beneficial owners of the securities.

Hurry's bad faith was amply proven by his elaborate stratagems for concealing his involvement in CSCT's business, including his use of the "x" email address at CSCT, his insistence on using the attorney-client privilege in inappropriate circumstances, and his use of FaceTime to conceal his contacts with customers. He specifically wrote to Ruzicka in an email that there should be no written record of Hurry's involvement, which is powerful evidence of Hurry's scheme to avoid regulatory scrutiny. Ruzicka testified in his OTR that Hurry told him he was going to the Cayman Islands so that he would not have to "give anything to anyone."

Hurry's actions betray an attitude antithetical to the public interest, and his attempt to evade regulatory scrutiny is inconsistent with his duties as a securities professional. He failed to adhere to high standards of commercial honor and just and equitable principles of trade, thereby violating FINRA Rule 2010.

H. Supervisory Violations (Second And Third Causes Of Action—DiBlasi And Cruz)

1. NASD Rule 3010 Imposes Supervisory Duties

NASD Rule 3010(a) mandates that each member firm "shall establish and maintain a system to supervise" the activities of its associated persons. It further mandates that a firm's supervisory system be "reasonably designed to achieve compliance with the applicable securities laws and regulations, and with applicable NASD Rules."

Rule 3010(a)(1) provides that a firm's supervisory system "shall provide, at a minimum," for the "establishment and maintenance of written procedures." Rule 3010(b) details requirements for WSPs. Rule 3010(b)(1) requires that a member firm "shall establish, maintain, and enforce written procedures to supervise the types of business in which it engages." Those WSPs must be "reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable Rules of NASD."

Rule 3010(b)(3) further requires that the WSPs set forth the titles, registration status, locations and responsibilities of each of its supervisory personnel, and that assignments be made

[495] Hearing Tr. (Diekmann) 1675.

[496] Hearing Tr. (Cruz) 220.

[497] Hearing Tr. (Cruz) 661-62; Hearing Tr. (Frankel) 2349-50.

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covering all relevant areas of the firm's business and the applicable securities laws and FINRA Rules. Firms are required to preserve a record of these designations and their effective dates for at least three years. Under Rule 3010(b)(4), a firm is required to amend its WSPs as changes occur in its supervisory system.

Broadly speaking, WSPs are a written set of policies and procedures that describe concrete steps to supervise a firm's activities. They identify who is responsible for taking those steps and set up a system of documentation to allow for review and ensure proper implementation. Every broker-dealer firm must create, maintain, update, and adhere to those policies and procedures.[498] Those policies and procedures contribute to the establishment and maintenance of a supervisory system that is reasonably designed to achieve compliance with the laws, regulations, and rules applicable to the firm's business. To achieve accountability and ensure compliance, the WSPs must be clear and accurate regarding the allocation of supervisory responsibilities.

2. DiBlasi's Violation

a. Charge

The Second Cause of Action charges that Scottsdale and DiBlasi, the Firm's CCO, violated NASD Rules 3010(a) and (b) and FINRA Rule 2010. The Complaint alleges that DiBlasi failed to establish a supervisory system, including WSPs, reasonably designed to ensure compliance with Section 5. This failure occurred even though DiBlasi knew that the Firm had been sanctioned once before in settling prior charges of selling unregistered nonexempt securities. Among other things, the Complaint charges that the Firm's WSPs were deficient because they did not set forth clear responsibilities for its personnel and did not provide for a reasonable inquiry into beneficial ownership. The Complaint alleges that the WSPs did not require that the Firm's personnel take steps to independently verify the self-serving representations made by parties interested in the transactions and did not address the possible use of nominees to obscure the identity of the true beneficial owners of unregistered securities deposited at the Firm for resale. Enforcement proved the charge.

b. DiBlasi Had Responsibility For The Firm's WSPs

Throughout the relevant period, DiBlasi was the Firm's CCO; and he is still the Firm's CCO. DiBlasi contends, however, that he has never had responsibility for the Firm's Rule 144 business. He asserts that he does only what he calls "broker-dealer compliance," and not Rule 144 compliance.[499] According to DiBlasi, the Firm's former president, Cruz, had responsibility

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[498] *Dep't of Enforcement v. Ranni*, No. 20080117243, 2012 FINRA Discip. LEXIS 6, at *15-16 (OHO Mar. 9, 2012).

[499] Hearing Tr. (DiBlasi) 1921-22, 1927, 1952-53, 1976-77. DiBlasi described what he meant by broker-dealer compliance. He makes sure that the Firm's filings, such as the Form BD and the Forms U4 and U5, are done. He maintains records and makes sure correspondence and emails are reviewed. He summed up his work as taking care of all the "back office" tasks. Hearing Tr. (DiBlasi) 1976-77.

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for Rule 144 procedures and everyone deferred to him.[500] DiBlasi agreed that Cruz had a longstanding practice regarding responsibilities for Rule 144 compliance.[501]

We reject DiBlasi's assertion that he had no responsibility for the Firm's procedures in connection with the Firm's Rule 144 business for two reasons. First, in the circumstances of this case, the assertion is inconsistent with his designation as the Firm's Chief Compliance Officer; and, second, the assertion is inconsistent with the WSPs themselves, as is plain from reading them.

First, DiBlasi is the sole person disclosed on the Firm's Form BD as CCO. There is no co-CCO.[502] That means that DiBlasi has been identified to the Firm's regulator as the one person responsible for establishing and maintaining the Firm's WSPs.

The Firm's WSPs were required to cover its Rule 144 business, since the Firm's business is almost entirely the liquidation of unregistered microcap stocks. DiBlasi acknowledged in his testimony that during the relevant period 95% of the transactions Scottsdale did for its customers involved penny stocks, and penny stocks accounted for most of the Firm's revenue.[503] That business required heightened attention to compliance issues, as DiBlasi knew. The Firm had previously settled regulatory charges that it had improperly sold unregistered securities without an applicable exemption.[504]

In these circumstances, the designation CCO carried with it responsibility for the WSPs relating to the Firm's Rule 144 business. DiBlasi's abdication of responsibility as to that business is fundamentally incompatible with what it means to be the Firm's CCO.

We reject DiBlasi's assertion that Enforcement is trying to hold him liable by virtue of his title alone.[505] Rule 3010 requires the designation and disclosure of a person responsible for establishing and maintaining a firm's procedures. By definition under the Rule, the person disclosed as the CCO has responsibility for the Firm's WSPs. The Rule further sets a standard for the design of those procedures, which must be reasonably designed to achieve compliance with the laws and regulations applicable to the firm's business. The designation and disclosure of a firm's CCO is more than a meaningless title. It is one of the building blocks of a supervisory system reasonably designed to achieve compliance, and the CCO designation carries with it

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[500] Hearing Tr. (DiBlasi) 1944-47, 1952-53, 1965-66.

[501] Hearing Tr. (DiBlasi) 1970. According to DiBlasi, his predecessor as CCO had no responsibility for Rule 144 compliance either. *Id.*

[502] Hearing Tr. (DiBlasi) 1981.

[503] Hearing Tr. (DiBlasi) 1923, 1946.

[504] Hearing Tr. (DiBlasi) 1923-24; CX-12.

[505] Resp. PH Br. 38 n.220.

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responsibilities. If DiBlasi is not carrying out those responsibilities, then the disclosure on the Firm's Form BD is false and misleading.[506]

Second, throughout the relevant period the Firm's WSPs expressly provided that the CCO—DiBlasi—had the duty to establish, maintain, and enforce all of the Firm's WSPs. There were two sets of WSPs during the relevant period, the May 2013 WSPs that were in effect in October 2013 when DiBlasi became CCO, and the modified WSPs that became effective in May 2014. The main body of both sets of WSPs expressly assigned to the CCO responsibility to "[e]stablish, maintain and update, as required the firm rules and procedures" and specified that that responsibility included Appendix A and Appendix B to the WSPs.[507] Appendix A to both sets of WSPs listed principals and branches.[508] Appendix B to both sets of WSPs expressly assigned to DiBlasi, by name, the responsibility to "[e]stablish, maintain and update, as required, the firm rules and procedures."[509] Appendix B assigned to Cruz, Diekmann, and others various operational tasks in conducting Rule 144 due diligence, but it did not assign them responsibility for the WSPs.[510]

DiBlasi conceded that there was no written delegation in the 2013 WSPs that gave responsibility for Rule 144 policies and procedures to anyone other than the CCO.[511] Moreover, the 2013 WSPs expressly imposed certain specific responsibilities on the CCO in connection with sales of unregistered securities. The main body of the WSPs included a specific section dealing with Rule 144 stock that was headed "Rule 144 Restricted and Control Stock Sales."[512] In that section, the 2013 WSPs stated that the CCO was responsible for establishing procedures reasonably designed to ensure that a stock certificate was validly issued and owned by the customer.[513] Importantly, the 2013 WSPs also provided that the CCO should establish

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[506] The cases cited by Respondents are not relevant here. The cases did not involve the issue of whether a CCO was responsible for a firm's WSPs. *Dep't of Enforcement v. Mutual Serv. Corp.*, No. EAF0400630001, 2008 FINRA Discip. LEXIS 62, at *90-93 (OHO Dec. 16, 2008) (compliance department subordinates who were told to abandon red flag blotter review did not have supervisory responsibility for that review); *Dep't of Enforcement v. Kemweis*, No. C02980024, 2000 NASD Discip. LEXIS 49, at *67-70 (OHO Feb. 16, 2000) (Director of Compliance held not to have line responsibility for unsuitable trading by registered representatives).

[507] CX-179, at 6 ("The Chief Compliance Officer ('CCO') is responsible for the establishment and maintenance [of Scottsdale's] policies and procedures."); CX-180, at 6 (same).

[508] CX-179, at 158; CX-180, at 151.

[509] Hearing Tr. (DiBlasi) 1930; CX-181, at 2 (DiBlasi assigned to "[e]stablish, maintain and update, as required the firm rules and procedures, includes Appendices A and B"); CX-182, at 2 (same). It appears that Appendix B to the May 2013 WSPs were modified on November 13, 2013, to identify DiBlasi by name as responsible for the WSPs. CX-181, footer bearing date of "11/13/2013."

[510] CX-181, at 8-9; CX-182, at 8-9. For example, Appendix B assigned to Diekmann responsibility for Rule 144 stock deposit due diligence and approval. CX-181, at 9; CX-182, at 9.

[511] Hearing Tr. (DiBlasi) 1933, 1945, 1955-56.

[512] CX-179, at 63-65 (Rule 144 Restricted and Control Stock Sales, 8.18 through 8.18.11).

[513] CX-179, at 64 (8.18.2).

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procedures to ensure that the resale of such a security was made in reasonable reliance on an exemption from registration.[514] The 2013 WSPs further provided that the CCO should be notified and consulted regarding the processing of Rule 144 sales.[515] They also specified that the CCO was responsible for "developing and implementing policies and procedures that provide for the review, approval and resale of Rule 144 transactions."[516]

Nevertheless, DiBlasi argues that he was not responsible for the 2013 WSPs because he inherited them.[517] The fact that the 2013 WSPs already existed when DiBlasi became CCO, however, does not absolve him of responsibility to examine them, and, if necessary, to amend them.[518] As noted above, Rule 3010 contemplates that amendments should be made to WSPs if there are changes in a firm's supervisory processes, so that the WSPs accurately reflect what the firm is doing. Indeed, shortly after DiBlasi became the Firm's CCO, in November 2013, the Firm modified Appendix B to identify DiBlasi by name as the person responsible for establishing, maintaining, and updating the Firm's WSPs, including Appendices A and B.[519] If Cruz had responsibility for WSPs to the extent that they related to its Rule 144 business, the correction could and should have been made in November 2013.

DiBlasi also attempts to explain away aspects of the 2013 WSPs that contradict his position—such as the specific assignment of Rule 144 compliance tasks to the CCO. He testified that the 2013 WSPs "didn't accurately reflect how the division of responsibility was set up throughout the company. And it needed to be corrected."[520] The 2013 WSPs, however, clearly stated that DiBlasi was responsible for the Firm's policies and procedures and made him specifically responsible for policies and procedures relating to the Firm's Rule 144 business. His disclaimer of responsibility cannot override that plain statement.

Approximately six months after DiBlasi became CCO, in May 2014, the WSPs were modified.[521] Even then, however, the WSPs did not clearly reflect the division of responsibility that DiBlasi described in his testimony. The WSPs did not say that Cruz had responsibility for all aspects of Rule 144 compliance, including the WSPs relating to Rule 144.

In place of the CCO, the main body of the modified WSPs designated the "General Principal" as responsible for developing procedures to ensure that a stock certificate was validly issued and owned by the customer, and that the resale of such a security was made in reasonable

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[514] Hearing Tr. (DiBlasi) 1940-41; CX-179, at 64 (8.18.2).

[515] CX-179, at 64 (8.18.3).

[516] CX-179, at 64 (8.18.3).

[517] Hearing Tr. (DiBlasi) 1932-33. See Resp. PH Br. 38-39.

[518] *Ranni*, 2012 FINRA Discip. LEXIS 6, at *27 & n.93.

[519] CX-182, at 2.

[520] Hearing Tr. (DiBlasi) 1969.

[521] Hearing Tr. (DiBlasi) 1921, 1932-33, 1939-42.

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reliance on an exemption.[522] Similarly, the modified WSPs instructed that the General Principal should be consulted in connection with Rule 144 transactions. Under the modified WSPs, the General Principal was responsible for developing and implementing Rule 144 policies and procedures.[523]

Although the title "General Principal" might appear to refer to a single person, the term General Principal was defined in the modified WSPs as the "Management Committee."[524] The WSPs declared that the Management Committee had been set up to serve in the role of president of the Firm.[525] The Management Committee was defined in yet another location to consist of four persons—including DiBlasi.[526] Accordingly, even under the modified WSPs, as a member of the Management Committee, DiBlasi still retained some vaguely defined responsibility for Rule 144 transactions.

DiBlasi relies on the delegation to the Management Committee in arguing that he had no responsibility for compliance matters related to the Firm's Rule 144 business. He maintains that the specific assignment of responsibility for the WSPs to him by name in Appendix B did not "overwrite" the provision in the main body of the WSPs referring to the Management Committee.[527]

Given the ambiguity of the delegation of responsibility in the main body of the WSPs—ostensibly to the General Principal but actually to a committee that included DiBlasi—we think the clear, explicit assignment of responsibility for the WSPs to DiBlasi by name contained in Appendix B forecloses DiBlasi's argument. That conclusion is bolstered by the description in the main body of the WSPs of the CCO's duties, which include responsibility for the Firm's policies and procedures.

DiBlasi's argument also is undermined by the fact that he took actions in connection with certificate deposits. For example, he signed a foreign account application by Unicorn under the label "Compliance Approval."[528] Furthermore, others at the Firm reached out to him in connection with issues regarding certificate deposits. For example, Diekmann had concerns about a deposit because Ruzicka said that the customer was pressing to start trading a stock when

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[522] CX-180, at 64 (8.18.2).

[523] CX-180, at 64 (8.18.3).

[524] CX-180, at 7 (Compliance and Supervision 1.1.2).

[525] Hearing Tr. (DiBlasi) 1972; CX-180, at 7.

[526] Hearing Tr. (DiBlasi) 1933-34, 1939-40, 1942-43. The other members of the Management Committee were Cruz, Jay Noiman, and Elizabeth Arndt. Hearing Tr. (Noiman) 1065-66; Hearing Tr. (DiBlasi) 1972.

[527] Hearing Tr. (DiBlasi) 1974-75.

[528] Hearing Tr. (DiBlasi) 1956-57. DiBlasi maintained that his signature meant nothing more than that a foreign financial institution was involved. Hearing Tr. (DiBlasi) 1957. Whatever it meant, DiBlasi's signature appeared under the heading "Compliance Approval," and it demonstrated that he was involved in some type of compliance review in connection with the Firm's penny stock accounts.

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there was zero market for it, so Diekmann forwarded the correspondence to DiBlasi. Diekmann said that he did so because he thought Ruzicka's comment called into question whether the deposit should have been approved by Scottsdale in the first place. He sent the email to DiBlasi because DiBlasi was the CCO.[529]

c. The Firm's WSPs Were Not Reasonably Designed To Ensure Compliance With Section 5

i. The WSPs Did Not Accurately Reflect The Way The Firm Conducted Its Rule 144 Business

The Firm's WSPs were not reasonably designed to ensure compliance with Section 5 because they did not accurately reflect the way the Firm conducted its Rule 144 business. DiBlasi testified that Cruz was the principal responsible for Rule 144 compliance and the establishment of policies and procedures relating to that business. Cruz testified that DiBlasi never had any role in the Rule 144 review process.[530] Cruz created the procedures for Rule 144 transactions that were in effect during the relevant period, the Firm's OTC Restricted Stock Deposit Procedures, dated November 2012.[531] He testified, however, that during the relevant period DiBlasi had responsibility for updating them.[532]

Accepting Respondents' testimony about the allocation of responsibilities, during the relevant period the WSPs should have clearly said which aspects of the WSPs were Cruz's responsibility and which were DiBlasi's. Neither the 2013 WSPs nor the modified WSPs had any clear indication of who was responsible for what.

DiBlasi admitted that the 2013 WSPs did not accurately reflect the way the Firm was operating its Rule 144 business.[533] We further find that the modified WSPs also did not accurately reflect the way the Firm operated its business.

DiBlasi's testimony revealed that the modified WSPs allocated responsibility to a committee that no longer existed. DiBlasi testified that in January 2014 the Management Committee disbanded. He said that Justine Hurry took on the Committee's responsibilities in February 2014. Then, in March 2014, Cruz officially became president of the Firm and took on

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[529] Hearing Tr. (Diekmann) 782-87; CX-222a.

[530] Hearing Tr. (Cruz) 563-64.

[531] Hearing Tr. (Cruz) 582; RX-27.

[532] Hearing Tr. (Cruz) 665-66; RX-27.

Confusion over who had responsibility for the WSPs apparently is nothing new at the Firm. Cruz did not remember who the CCO was at the time he created the Rule 144 procedures, and he did not recall anyone specifically delegating to him the responsibility for creating the procedures. Hearing Tr. (Cruz) 665-66. When asked who now has responsibility to update the Rule 144 procedures, Cruz testified, "I believe that responsibility now falls on Henry Diekmann as president and also as head of the 144 cert team." Hearing Tr. (Cruz) 584.

[533] Hearing Tr. (Diekmann) 783-86; CX-222a.

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the responsibilities of the Management Committee. The Committee never reconstituted itself again—and yet in May 2014 the Firm put in place the modified WSPs that supposedly gave Rule 144 compliance responsibility to the Management Committee.[534]

Even if the Management Committee had been functioning in May 2014, we find that the modified WSPs were misleading regarding the allocation of responsibilities, and, therefore, not reasonably designed to achieve compliance. They purported to designate a registered principal as responsible for compliance with Rule 144. Rule 3010 requires that supervisory responsibilities be delegated to an appropriately registered principal. But, in fact, the WSPs delegated responsibility for Rule 144 procedures to a group of people. In so doing, the WSPs obscured who had responsibility, making it more difficult to hold anyone accountable for compliance oversight over the bulk of the Firm's business.

This failure to clearly indicate who was responsible for Rule 144 compliance is particularly egregious here. It would have been relatively simple to designate Cruz the responsible principal, since everyone agreed that he was.

It is fundamental that a firm's WSPs must clearly designate responsibilities to appropriately registered persons and must accurately reflect the way a member firm conducts its business. That is why Rule 3010 specifies that supervisory responsibilities be assigned to an appropriately registered principal. The person responsible for supervising a particular line of business must have the appropriate background to do it. That is also why a firm's WSPs must address the particular business and the particular circumstances of a firm. Only then will the WSPs be well designed to reasonably ensure compliance.[535]

ii. The WSPs Did Not Require A Reasonable Inquiry Into Beneficial Ownership

We also find that Scottsdale's WSPs were not reasonably designed to achieve compliance with Section 5 because the WSPs failed to require a reasonable inquiry into the identity of the purported beneficial owners of the stock the Firm was selling. The WSPs do not discuss the concept of nominees, and the Firm's principals responsible for approval of stock deposits did not focus on the potential problem of nominees in conducting their review. The due diligence files for the transactions at issue demonstrate that the Firm's general practice for reviewing stock deposits was inadequate to identify and investigate situations in which nominees might be concealing the identity of the true beneficial owners of securities. Diekmann testified that he knew nothing about the purported beneficial owner of Sky Walker but that the person was a

[534] Hearing Tr. (DiBlasi) 1973. DiBlasi's testimony that Justine Hurry briefly served as president of the Firm in February 2014 is corroborated by the Firm's Form BD Amendment dated February 13, 2014, which lists Justine Hurry as president, as well as a director, of the Firm. CX-17, at 3. That document identifies Cruz as legal counsel since May 2008. CX-17, at 3.

[535] *See* NASD Notice to Members 99-45 (June 1999), http://www.finra.org/sites/default/files/NoticeDocument/p004311.pdf.

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customer of Unicorn. The lack of focus on the potential use of nominees to conceal the identity of the true beneficial owners is particularly egregious in light of the four prior SEC actions charging that nominees had been used to facilitate fraud and manipulation.

The Firm's listing of every FFI on its red flag list was not sufficient to address beneficial ownership or to ensure that an unlawful distribution was not occurring. The WSPs did not indicate why or what should be done in response to the red flag designation. When asked what additional scrutiny comes from the red flag designation, Diekmann could not think of any. He said that the designation "just reflects the heightened risk."[536] To recognize a heightened risk but provide no guidance for dealing with it is not reasonable. WSPs must provide a "reliable mechanism" for identifying securities sales that should be investigated or halted.[537]

3. Cruz's Violation

The Third Cause of Action charges that Cruz failed to adequately and meaningfully analyze the collected documents and information. Consequently, he and the staff he supervised failed to respond appropriately to red flags strongly indicating that the transactions were not entitled to an exemption. He approved the deposits for resale based on a cursory collection and verification effort. Enforcement proved the charges.

There is no dispute that Cruz supervised the processing of deposits for resale pursuant to Rule 144. He drafted the Firm's procedures for handling restricted stock sold pursuant to Rule 144 and other forms used to process deposits. For each transaction, he also met with the person who had put together the due diligence file to support the Rule 144 exemption. After talking with the person, he gave the final approval that allowed Scottsdale to trade the securities without registration. He was critical to the transactions, and, even though the WSPs did not identify him as the responsible person, everyone at the Firm looked to Cruz as the person responsible for Rule 144 compliance.

Cruz violated his responsibility in two ways.

First, Cruz failed to analyze whether the debt obligations that formed the foundation for tacking were securities. In light of the circumstances, this failure was egregious. Diekmann, who is not a lawyer, was incapable of recognizing and correcting Cruz's error. The members of the Rule 144 team who were lawyers did not have experience with penny stocks before they came to the Firm and were trained by Cruz and the Firm's personnel. Everyone depended on Cruz's analysis and expertise. As an experienced securities lawyer, Cruz should have recognized the problem. But he failed to meaningfully analyze the information in the due diligence packages.

Second, Cruz failed to react appropriately to myriad red flags. As set forth above in connection with each transaction, the stock deposits were rife with discrepancies and suspicious

[536] Hearing Tr. (Diekmann) 990.

[537] *Midas Sec.*, 2012 SEC LEXIS 199, at *51.

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circumstances that constituted red flags. However, Cruz and his staff did not make the required "searching inquiry" or obtain independent verification.

Cruz's failure is egregious because he knew that the Firm was acting as a gatekeeper,[538] and that broker-dealer firms play a critical role in helping to prevent illegal unregistered resales of restricted securities into the public markets.[539] He also acknowledged that at the time of the events at issue he was aware of the red flags in Regulatory Notice 09-05.[540] It is well established that the "duty of supervision includes the responsibility to investigate 'red flags' that suggest that misconduct may be occurring and to act upon the results."[541]

Cruz argues, however, that he was an effective supervisor. He notes that he created the Rule 144 manual, the due diligence questionnaire, and beneficial ownership declaration, and that the Firm dedicated one-third of its staff to performing due diligence reviews on stock deposits. He states that he inserted himself into the review process as a second set of eyes and additional resource when Scottsdale began accepting stock deposits from customers of sub-FFIs. He also asserts that the due diligence packages at issue contained all the required paperwork and that there is no instance of an issue being brought to Cruz's attention and him ignoring it. Finally, he maintains that the "rigor" of the stock deposit reviews under his leadership is demonstrated by the fact that Scottsdale frequently rejected stock deposits.[542]

All of this is beside the point. Cruz is charged with failing to respond appropriately to specific red flags identified in connection with the transactions at issue. The mere creation of paperwork does not qualify as effective supervision. As FINRA noted in conjunction with Regulatory Notice 09-05, in Rule 144 transactions, representations made by the interested parties have to be evaluated with a skeptical eye. Independent verification may be required. Instead, Cruz guided the staff through a check-the-box exercise.

Even when Cruz acknowledged that something might be a red flag, he indicated that his response would not be to obtain independent verification. Rather, his response would be merely to remind the interested parties of the information that needed to be disclosed. This is a totally inadequate response to a red flag.

Cruz's testimony regarding language on Unicorn's website illustrates the problem. The language on the website indicated that Unicorn would appoint nominees for its customers so that their names would not appear as an officer or director of the company on their account at

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[538] Hearing Tr. (Cruz) 86.

[539] Hearing Tr. (Cruz) 89.

[540] Hearing Tr. (Cruz) 84-90.

[541] *KCD Fin, Inc.*, 2016 FINRA Discip. LEXIS 38, at *70 (quoting *Michael T. Studer*, 57 S.E.C. 1011, 1023-24 (2004), *aff'd*, 260 F. App'x 342 (2d Cir. 2008)). *See also Ronald Pellegrino*, Exchange Act Release No. 59125, 2008 SEC LEXIS 2843, at *33 (Dec. 19, 2008).

[542] Resp. PH Br. 40-41.

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Unicorn. Cruz said he did not recall seeing that language at the time he reviewed Unicorn's deposits, but he agreed that if he had it "could have been" a red flag. In response to that red flag, however, he did not say that he would have sought independent verification of the identity of Unicorn's customers. Rather, he indicated that Scottsdale would merely emphasize to the interested parties that "they needed to – to disclose the underlying beneficial owner."[543] In other words, he would continue to rely on the representations of the interested parties.

Cruz argues that he supervised more actively than did respondents in other disciplinary proceedings in which supervisory violations were found.[544] Even if that were true (which we are not persuaded it is), the fact that other supervisors in other cases did even less than Cruz to respond to red flags is no excuse. The standard for reasonable supervision is not merely something marginally better than bad. Moreover, whether supervision is reasonable depends on the particular circumstances of each case.[545]

Cruz also argues that Enforcement is improperly second-guessing Cruz's exercise of reasoned business judgment, and that Enforcement has failed to provide affirmative evidence that his judgments were incorrect.[546] This argument is erroneous in two regards.

First, the argument ignores the record. The transactions at issue were rife with red flags that could not be ignored, but Cruz did ignore them.

Second, the argument confuses the burden on the Firm when it determined that an exemption existed with the burden of proof in litigation. Cruz, acting on behalf of the Firm, had the burden of developing a reasonable basis for believing that an exemption existed before the securities could be sold without registration. Enforcement proved that he and the Firm did not have a reasonable basis for believing that an exemption existed, but nevertheless Cruz approved the sale of the securities at issue without registration. That is all that Enforcement had to prove for the supervisory violation.

In sum, Cruz did not make sure that the transactions met the legal requirements for an exchange of securities, and he was oblivious to numerous red flags strongly suggesting that the transactions at issue were sham transactions using nominees to effect unlawful distributions of securities without registration. He violated his supervisory duties.

IV. SANCTIONS

In considering the appropriate sanction for a violation, adjudicators in FINRA disciplinary proceedings look to FINRA's Sanction Guidelines ("Guidelines"). The Guidelines

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[543] Hearing Tr. (Cruz) 307-08.

[544] Resp. PH Br. 41 n.236.

[545] *E.g.*, *Dep't of Enforcement v. Wedbush Sec., Inc.*, No. 20070094044, 2014 FINRA Discip. LEXIS 40, at *27-28 (NAC Dec. 11, 2014).

[546] Resp. PH Br. 41.

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contain recommendations for sanctions for many specific violations, depending on the circumstances. They also contain overarching Principal Considerations and General Principles, both of which are applicable in all cases.[547]

The Guidelines are intended to be applied with attention to the regulatory mission of FINRA—to protect investors and strengthen market integrity.[548] The Guidelines caution that sanctions must be significant enough to prevent and discourage future misconduct by a respondent and to deter others from similar misconduct. Sanctions also should encourage improved business practices.[549]

Applying the Guidelines, we first discuss below the appropriate sanctions for the Firm, DiBlasi, and Cruz. We separately discuss the sanction for Hurry.

A. Scottsdale

As authorized by the Guidelines, we aggregate all the Firm's violations.[550] The violations are inextricably intertwined and are the result of a systemic failure at the Firm—the Firm's failure to have procedures in place that would reasonably ensure compliance and the Firm's failure to respond appropriately to red flags led to the Firm's failure to have a reasonable basis for an exemption before selling the securities. Furthermore, as discussed below, the Panel believes stringent sanctions are warranted here, and separately sanctioning the Firm for the different violations, even at the high end of the range of recommended sanctions, would not adequately remediate the Firm's misconduct. We view the Firm's systemic failure to perform its gatekeeping function better addressed as a whole, rather than in piecemeal fashion.

The Firm violated FINRA Rule 2010 because, in connection with the transactions at issue, it did not have a reasonable basis for an exemption. Selling securities without registration and without an exemption violated Section 5. The Guidelines contain specific recommendations for this type of violation. The Guidelines recommend a fine of $2,500 to $73,000, but in egregious cases the fine may be higher. In egregious cases, a firm may also be suspended with respect to any or all activities or functions for up to 30 business days or until procedural deficiencies are remedied.[551]

The Firm, through DiBlasi, failed to have in place WSPs reasonably designed to achieve compliance with Section 5. For deficient WSPs, the Guidelines recommend a fine ranging from $1,000 to $37,000. They also suggest that adjudicators consider suspending a firm with respect

[547] FINRA Sanction Guidelines (2016) ("Guidelines"), http://www.finra.org/industry/sanction-guidelines.

[548] Guidelines at 1, Overview.

[549] Guidelines at 2, General Principle No. 1.

[550] Guidelines at 4, General Principle No. 4.

[551] Guidelines at 24.

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to any or all relevant activities or functions for up to 30 business days or until the supervisory procedures are amended to conform to the rule requirements.[552]

The Firm, through Cruz, failed to supervise its Rule 144 process appropriately. The Firm, through Cruz, failed to adequately and meaningfully analyze the information collected and thus failed to respond appropriately to red flags that the transactions were unlawful distributions. For a failure to supervise, the Guidelines recommend a fine of $5,000 to $73,000. In egregious cases, they suggest that adjudicators consider suspending a firm with respect to any or all relevant activities or functions for up to 30 business days. An even longer suspension may be imposed, up to two years, or the firm may be expelled, where the case involves systemic supervision failures.[553]

We find the Firm's violations to be egregious. We also find that there are a large number of aggravating factors that increase the need for stringent sanctions. There are no mitigating factors.

1. Aggravating Factors

a. Specific Principal Considerations Related To Section 5 Violations

One of the specific Principal Considerations in a case involving a Section 5 violation is whether the respondent attempted to comply with an exemption.[554] We conclude here that the Firm did not truly attempt to comply. Rather, it created the appearance of compliance. Although the Firm created thick due diligence packages, it did not meaningfully evaluate the information in those packages. If it had, it would have known it could not sell the securities without further investigation and the development of a reasonable basis for an exemption. We further find it aggravating that the Firm expended its resources on creating the appearance of compliance, rather than true compliance, because such conduct is deceptive and displays a lack of regard for the applicable law and regulatory requirements. This aggravating factor applies not only to the Firm but to Cruz, on whom everyone at the Firm depended for Rule 144 compliance.

Another specific Principal Consideration is the share volume and dollar amount of the transactions involved.[555] The transactions at issue involved millions of shares and resulted in

[552] Guidelines at 103.

[553] Guidelines at 102.

[554] Guidelines at 24.

[555] Guidelines at 24. See also Guidelines at 7, General Principal Consideration 18.

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proceeds of more than $1.75 million.[556] The amounts involved are substantial and constitute an aggravating factor.

A third specific Principal Consideration is whether the respondent implemented reasonable procedures to ensure that it did not participate in an unregistered distribution.[557] The Firm's procedures were not reasonable. To the contrary, they seemed designed to obscure who was responsible for Rule 144 compliance and they failed to require specific, reliable evidence to support the application of an exemption. Nor did the Firm implement good practices. Scottsdale's staff uncritically relied on the self-serving representations of the interested parties. When they did notice a discrepancy, the staff assumed an innocent explanation or accepted a plainly unreliable representation from the interested parties, rather than pursuing the "searching inquiry" that was required. This aggravating factor applies to DiBlasi, as the CCO, and to Cruz, as the person ultimately responsible for Rule 144 compliance, as well as the Firm.

A fourth specific Principal Consideration is whether the respondent disregarded red flags suggesting the presence of an unregistered distribution.[558] As discussed above, the Firm repeatedly failed to identify and disregarded numerous red flags indicating that the transactions were unlawful distributions of securities. The multiplicity of red flags is another aggravating factor. This aggravating factor applies to Cruz as well as the Firm.

b. Specific Principal Considerations Related To Deficient WSPs

One of the specific Principal Considerations relating to deficient WSPs is whether those deficiencies allowed violative conduct to occur or to escape detection. We find here that the WSPs allowed violations to occur. The failure to provide guidance on dealing with discrepancies and suspicious circumstances allowed those involved with Rule 144 review to proceed in a rote fashion, without analyzing the information they collected. This aggravating factor applies to both the Firm and DiBlasi.

Another specific Principal Consideration is whether the deficiencies made it difficult to determine the individuals responsible for specific areas of supervision or compliance. We find that the failure to clearly and accurately delineate responsibility lessened transparency and accountability, making regulatory oversight more difficult. It is particularly aggravating that the person designated CCO should disclaim responsibility for the vast majority of the Firm's business. This aggravating factor applies to both the Firm and DiBlasi.

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[556] JX-268 (NHPI-Related Activity in CSCT Account: Total Net Proceeds of $264,711.70); JX-281 (VPLM-Related Activity in CSCT Account: Total Net Proceeds of $1,408,173.39); JX-310 (ORFG-Related Activity in CSCT Account: Total Net Proceeds of $91,408.43).

[557] Guidelines at 24. See also Guidelines at 6, General Principal Consideration 5.

[558] Guidelines at 24.

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c. Specific Principal Considerations Related To Failure To Supervise

One of the specific Principal Considerations in connection with a failure to supervise is whether the respondent ignored red flags warning of the need for additional supervisory scrutiny. Another is the nature, extent, size, and character of the underlying misconduct. Both of these are aggravating factors in this case. The Firm, through Cruz, ignored multiple red flags that the transactions required additional scrutiny. The transactions were substantial and were typical of the bulk of the Firm's business. The supervisory failure was in fact built into the Firm's standard practice for processing Rule 144 stock deposits, which is an aggravating factor. These aggravating factors apply to both the Firm and Cruz.

d. General Principal Considerations

Several general Principal Considerations are relevant to this case.[559] Principal Consideration 1 is a respondent's relevant disciplinary history.[560] Scottsdale has a disciplinary history, and some of that history involves misconduct like the misconduct here. As noted above, in the 2011 AWC the Firm settled charges that it had sold unregistered securities and that it had inadequate supervisory procedures and WSPs to detect and prevent the sale of unregistered securities. The Firm resolved other charges in the 2009, 2012, and 2015 AWCs. Finally, although the Firm was not charged in connection with the four SEC cases, *Ruettiger*, *Gibraltar I*, *Gibraltar II*, and *Tavella*, those cases did involve alleged misconduct through accounts at the Firm. These cases put the Firm on notice of the risk of sham transactions and the use of nominees to conceal beneficial ownership and facilitate unlawful distributions of securities. They heightened the need for the Firm to be alert to red flags. In light of this history, it is aggravating that Scottsdale performed its gatekeeping function so poorly.

Principal Consideration 2 concerns whether a respondent has accepted responsibility for and acknowledged the misconduct prior to detection and intervention. The Firm here has not. It maintains that its procedures are "market-leading" and create an "unfriendly environment" for stock manipulation.[561] The facts do not support that characterization.

Furthermore, in light of the fact that the transactions at issue involved persons who have been indicted for engaging in securities fraud and other crimes, it is particularly aggravating that the Firm's current president, Diekmann, testified that if any of the three deposits at issue were presented to him today—NHPI, VPLM, or ORFG—he would approve it. He expressed no qualms.[562] This means that the person in charge of approving stock deposits as satisfying the Rule 144 exemption is likely to commit the same violations again.

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[559] Guidelines at 6-7.

[560] Guidelines at 6, General Principal Consideration 1.

[561] Resp. PH Br. 37-38.

[562] Hearing Tr. (Diekmann) 1799-80.

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Adding to our concerns in this regard, Cruz echoed Diekmann. Cruz said that, despite the evidence presented to him during his testimony relating to the five certificate deposits charged in the Complaint (three NHPI, one VPLM, and one ORFG), he believed that the Rule 144 exemption applied and the transactions complied with Section 5.[563]

Principal Consideration 8 is whether a respondent engaged in numerous acts or a pattern of misconduct. [564] Principal Consideration 16 is whether the misconduct is aberrant behavior.[565] Scottsdale engaged in a pattern of misconduct and it was not aberrant behavior. Indeed, the Firm institutionalized its misconduct, by papering its files with documents that it did not meaningfully analyze. It is aggravating that the misconduct is actually the standard way the Firm conducts all its business. Moreover, Cruz testified that the pattern of deposits based on buying loan notes and exchanging them for stock was a typical transaction for the Firm. Because it was typical he saw nothing suspicious in it. These aspects of the misconduct are aggravating as to both the Firm and Cruz.

Principal Consideration 13 is whether the misconduct was the result of an intentional act, recklessness or negligence.[566] The Firm's misconduct was not the product of negligence. It acted intentionally when it created and implemented the procedures for reviewing deposits of stock certificates for resale that created a false appearance of compliance. This aggravating factor applies not only to the Firm but to both DiBlasi and Cruz.

Principal Consideration 18 focuses on the number, size, and character of the transactions.[567] The transactions at issue had many red flags indicating that they were schemes to evade the securities laws and the scrutiny that comes with registration. Given that character, it is aggravating that, as a result of Scottsdale's failure to perform its gatekeeping function, millions of dollars of securities were sold to the investing public without the safeguards that accompany registration.

e. General Principles

The Guidelines instruct adjudicators to take into account certain General Principles applicable to all sanction determinations.[568] One of those General Principles is that disciplinary sanctions should be designed to deter misconduct, both by the respondent and by others, and should uphold high standards of business conduct. Adjudicators should impose sanctions that are

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[563] Hearing Tr. (Cruz) 555.

[564] Guidelines at 6, General Principal Consideration 8.

[565] Guidelines at 7, General Principal Consideration 16.

[566] Guidelines at 7, General Principal Consideration 13.

[567] Guidelines at 7, General Principal Consideration 18.

[568] Guidelines at 2-5.

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meaningful and significant enough to accomplish these goals, and the sanctions should reflect the seriousness of the misconduct at issue.[569]

The Firm's business is almost entirely the processing of penny stock deposits for resale into the public marketplace. In light of that fact, it is aggravating that the Firm had a check-the-box approach to its review of the deposits, without meaningful analysis of the multitude of red flags. The confession by Diekmann, the current president of the Firm, that, even after compiling a thick due diligence book, he knew nothing about the beneficial owner of one of the NHPI deposits is disturbing. It suggests that the person who now has authority to give final approval to stock deposits for resale has no understanding of what is required to ensure that the Firm does not participate in an unlawful distribution of securities without registration. The sanctions here must be stringent to deal with the seriousness of the misconduct and to show the Firm that it cannot simply continue with its business in its usual fashion. We believe that only a substantial sanction will deter the Firm from future misconduct.

Another General Principle is that disciplinary sanctions should be more severe for recidivists in order to deter and prevent future misconduct. The imposition of more severe sanctions emphasizes the need for corrective action.[570] As noted above, the Firm has a disciplinary history. It has been disciplined for selling unregistered securities and for other violations. In light of this history, it is appropriate to impose more severe sanctions.

f. Overview

The mission of FINRA's regulatory and disciplinary process is to protect investors and promote market integrity. In fulfilling that mission, adjudicators are not limited to the sanctions recommended in the Guidelines. Based on the facts and circumstances presented in each case, adjudicators may impose sanctions that fall outside the ranges recommended and may consider aggravating and mitigating factors in addition to those listed in the Guidelines.[571]

2. Potential Mitigating Factor

Principal Consideration 3, which is applicable to all sanctions determinations, concerns whether, prior to detection or intervention by a regulator, a firm voluntarily employed corrective measures to avoid recurrence of misconduct. This might be argued to be a mitigating factor.

The Firm maintains that it enhanced its procedures after the SEC filed the complaints in the four cases involving nominees. In particular, it claims that it enhanced its reviews of stock promotions and notes that it ended all commissioned representatives at the Firm. It asserts that its requirement of a beneficial ownership declaration is a "market-leading practice" that has been

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[569] Guidelines at 2, General Principle 1.

[570] Guidelines at 2, General Principle 2.

[571] Guidelines at 1.

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adopted as a recommended method for determining beneficial ownership. It also points to its use of a Red Flag List and a Stock Watch List as enhancements to its reviews.[572]

We find that whatever changes the Firm made in its procedures were insufficient to be mitigating. To some degree, they appear to be more of the same. They created the appearance of compliance without actual compliance. Even with the so-called enhancements, the Firm's procedures were woefully lacking. The record is replete with red flags that the Firm and Cruz ignored.

3. Sanction

In light of the egregious nature of the Firm's violation, the Firm's institutionalization of the misconduct as its standard way of doing business, and the other aggravating factors set forth above, we believe that a stringent sanction is appropriate. Only such a sanction will serve the remedial purposes of the disciplinary process. The Firm must be deterred from similar misconduct in the future. We impose on Scottsdale a fine of $1.5 million.

B. Hurry

Hurry's violation of his duty to observe high standards of commercial honor and just and equitable principles of trade was purposeful and egregious. These two qualities lead us to conclude that Hurry is a threat to investors and the integrity of the markets. Our concern is compounded by our credibility findings. We found that he repeatedly testified falsely, and that there was a pattern of doing so when he thought no contradictory evidence would come to light.

When misconduct is intentional, General Principle 1 provides that adjudicators should assess sanctions that exceed the recommended range in the Guidelines.[573] Principal Consideration 13 also focuses on whether a respondent's misconduct is the result of an intentional act, recklessness, or negligence.[574] When a violation is egregious, the Guidelines often suggest more severe sanctions. In egregious cases in connection with violations of Rule 2010 and Section 5, the specific Guidelines recommend that an individual be suspended for up to two years or barred.

Even though he has no disciplinary history, the devious nature of Hurry's violation evidences disregard for regulatory requirements, an aggravating factor under General Principle 2 and Principal Consideration 10.[575] We have no confidence that if he remained in the securities industry he would not again devise a way to evade the law and regulatory requirements. For this reason also, we believe Hurry is a threat to the investing public.

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[572] Resp. PH Br. 37-38.

[573] Guidelines at 2, General Principle 2.

[574] Guidelines at 7, General Principal Consideration 13.

[575] Guidelines at 2, General Principle 2; Guidelines at 6, General Principal Consideration 10.

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As discussed in connection with the Firm's violation and sanction, the scheme enabled large amounts of stock certificates to be sold in a number of transactions without the protections of registration and without an exemption. Under Principal Consideration 18, the size of the transactions is an aggravating factor.

Finally, we note that Hurry had by far the most to gain financially from setting up CSCT and enabling shares deposited from offshore customers to be shielded from scrutiny. He and his wife own all three entities involved in the process: CSCT, Scottsdale, and Alpine. And although Respondents emphasize that the particular transactions at issue did not generate a huge amount of money, the microcap securities liquidation business as a whole was highly remunerative for Hurry and his wife. We earlier noted that, from Scottsdale alone, in 2014 they received approximately $6.2 million in directors' fees and $1.45 million in net income. The compensation for all other employees and for professional and consulting fees for that year totaled less than half that—approximately $2.7 million. It was to Hurry's financial advantage to facilitate the processing of FFI deposits and to minimize regulatory oversight. The misconduct added to his financial gain and is an aggravating factor under Principal Consideration 17.[576]

We bar Hurry from associating with any FINRA member in any capacity and believe it appropriately remedial to fine him $100,000. In light of the bar, however, we do not impose the fine.

C. DiBlasi

The Guidelines provide with respect to an individual who is responsible for deficient WSPs that in egregious cases he may be suspended in any or all capacities for up to one year. The Guidelines also provide for a fine ranging from $1,000 to $37,000.

In this case we find more stringent sanctions appropriately remedial. DiBlasi's violation was egregious, and there are aggravating factors. The WSPs created the appearance of a set of procedures designed to achieve compliance, but they did not accurately reflect the way the Firm actually handled its Rule 144 deposits. They did not even reflect DiBlasi's true role. Even though he was purportedly the CCO, he claimed that he had nothing to do with the vast majority of the Firm's business. Essentially, he performed back-office functions for the Firm. The result of the deficiencies in the WSPs was that violations occurred and regulatory efforts to determine the persons responsible were hindered.

We suspend DiBlasi from associating with any FINRA member firm in any capacity for two years and fine him $50,000.

D. Cruz

The Guidelines provide with respect to an individual supervisor who fails to respond to red flags that, in egregious cases, an adjudicator should consider suspending the person in any or

[576] Guidelines at 7, General Principal Consideration 17.

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all capacities for up to two years or barring him. A fine of $5,000 to $73,000 also may be imposed.

Cruz's violation was egregious. As a lawyer with considerable background in the securities laws, he had the background that others did not to scrutinize the due diligence packages and identify red flags. Furthermore, as the person at the Firm everyone else depended upon for Rule 144 compliance, he knew that he was critical to the Firm's performance of its gatekeeping duty. He was the principal at the Firm who gave final approval to the sales of deposited securities, signing under a certification that the transactions, to his knowledge, were lawful. In light of these circumstances and the many aggravating factors identified above, Cruz's failure to recognize and appropriately address multiple red flags was inexcusable.

We suspend Cruz from associating with any FINRA member firm in any capacity for two years and fine him $50,000.

E. Respondents' Arguments For Lesser Sanctions Rejected

We reject Respondents' arguments for lesser sanctions. They assert that the relief requested by Enforcement cannot be reconciled with the Guidelines because the sanctions are more stringent than the recommended range.[577] However, the Guidelines are not absolute. They are recommendations. As provided in the Overview, adjudicators may impose sanctions outside the recommended range where the particular facts and circumstances make that appropriate.[578]

We are concerned that the misconduct here is the Firm's standard approach to processing deposits of stock certificates for sale. As long as the Firm continues with that check-the-box approach, without a meaningful evaluation of the information it collects, it is a risk to public investors. More stringent sanctions are necessary to emphasize the necessity for corrective action and to remediate the violation.

Respondents also compare their case to other cases involving Section 5 and supervisory violations, asserting that in those other cases the misconduct was worse and the sanctions less.[579] The appropriateness of sanctions, however, depends on the facts and circumstances of the particular case and cannot be determined by comparison to sanctions in other cases that involve different facts and circumstances.[580] Furthermore, Respondents' misconduct was far more egregious than Respondents acknowledge.

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[577] Resp. PH Br. 47.

[578] Guidelines at 1.

[579] Resp. PH Br. 47-49.

[580] *See, e.g., William Scholander*, Exchange Act Release No. 77492, 2016 SEC LEXIS 1209, at *42 & n.65 (Mar. 31, 2016).

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With respect to disciplinary history, Respondents argue that the individual Respondents have no disciplinary history.[581] It is well established that the absence of a disciplinary history is not mitigating as to sanctions. A wrongdoer should not be rewarded for acting in accord with his duties as a securities professional.[582]

In sum, we find that the sanctions we impose here are necessary, appropriate and remedial. They serve the twin goals of protecting public investors and contributing to market integrity.[583]

V. CONCLUSION

The Firm, Scottsdale Capital Advisors, violated FINRA Rule 2010. Accordingly, it is ordered to pay a fine of $1.5 million. John J. Hurry violated FINRA Rule 2010. For his misconduct he is barred from association with any FINRA member in any capacity. He would be fined $100,000, but, in light of the bar, the fine is not imposed. Timothy B. DiBlasi violated NASD Rules 3010(a) and (b) and FINRA Rule 2010. For his misconduct, he is suspended for two years from association with any FINRA member in any capacity and fined $50,000. D. Michael Cruz violated NASD Rule 3010(b) and FINRA Rule 2010. For his misconduct, he is suspended for two years from association with any FINRA member in any capacity and fined $50,000.

Respondents are also ordered to pay costs in the amount of $22,124.29, which includes a $750 administrative fee and $21,374.29 for the cost of the transcript. If this decision becomes FINRA's final disciplinary action, Hurry's bar will take immediate effect. DiBlasi's and Cruz's suspension will begin with the opening of business on August 21, 2017. The fines and assessed costs shall be due on a date set by FINRA, but not sooner than 30 days after this amended decision becomes FINRA's final disciplinary action in this proceeding.

Lucinda O. McConathy
Hearing Officer
For the Extended Hearing Panel

[581] Resp. PH Br. 47.

[582] *See, e.g., Kenny A. Akindemowo*, Exchange Act Release No. 78352, 2016 SEC LEXIS 2522, at *5 & n.5 (July 18, 2016). *See also* Guidelines at 6 and n.2.

[583] The Hearing Panel has considered and rejects without discussion any other arguments made by the Parties that are inconsistent with this decision.

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Copies to: Scottsdale Capital Advisors (via overnight and first-class mail)
John J. Hurry (via overnight and first-class mail)
Timothy B. DiBlasi (via overnight and first-class mail)
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HARDER MIRELL & ABRAMS LLP

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September 12, 2017

VIA E-MAIL AND U.S. MAIL

Mr. Michael Goode
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Eaton Rapids, MI 48827
michael.goode@gmail.com

Re: Scottsdale Capital Advisors – Demand for Retraction and Apology

Dear Mr. Goode:

This law firm is litigation counsel for Scottsdale Capital Advisors and John Hurry (collectively, "Scottsdale Capital"). We write in connection with the many libelous statements in the article published on or about April 17, 2017, at GoodeTrades.com bearing the headline, "FINRA fines Scottsdale Capital Advisors $1.5 million"[1] (the "April Article") and the article published on or about June 14, 2017 bearing the headline "SEC Sues Alpine Securities, continuing a run of bad news for owner John Hurry"[2] (the "June Article") (collectively the "Articles").

The following statements in the Articles, among others, are false, defamatory and/or portray my clients in a false light. *See Morganroth v. Whitall*, 411 N.W.2d 859, 863-64 (Mich. Ct. App. 1987) (discussing defamation and the tort of false light in Michigan). We therefore demand that you **immediately and permanently** remove each of these statements from the Articles, and print a full and complete retraction and apology, with as prominent placement as the original Articles:

April Article:

False Statement #1: "If you have followed penny stocks and pump and dumps for a few years then you know Scottsdale Capital Advisors." In truth, Scottsdale Capital has never been

[1] Available at https://www.goodetrades.com/2017/04/finra-fines-scottsdale-capital-advisors-1-5-million/.
[2] Available at https://www.goodetrades.com/2017/06/sec-sues-alpine-securities-continuing-a-run-of-bad-news-for-owner-john-hurry/.

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involved in any "pump and dump" schemes, has never been a defendant in any "pump and dump" lawsuits, and it has never been convicted of engaging in "pump and dump" activity.

False Statement #2: "They [Scottsdale Capital] are one of the few brokers left that have continued to allow the deposit and sale of shares in illiquid penny stocks. Larger brokers and discount brokers stopped allowing that over five years ago." In truth, numerous large brokers continue to trade in penny stocks, including without limitation, interactive brokers, Merrill Lynch, Charles Schwab, Scottrade, Cor Clearing, and TradeKing.

False Statement #3: "When the big Biozoom (BIZM) pump happened back in 2013 many of the frozen accounts were at Scottsdale Capital." In truth, only a handful of accounts at Scottsdale Capital were frozen as a result of Biozoom trading. Moreover, Scottsdale Capital has not been a defendant in any lawsuit involving the trading of Biozoom stock.

June Article:

False Statement #1: "Lest anyone think that these are just minor paperwork deficiencies with no real consequences, I remind you that one pump and dump alone, Biozoom (BIZM), led to over $17 million in fraudulent profits for manipulators / insiders, and many of their accounts were at Scottsdale Capital Advisors." In truth, other than hosting a handful of accounts that traded in Biozoom shares, Scottsdale Capital had nothing to do with the trading of Biozoom shares. Moreover, as discussed above, Scottsdale Capital has never been involved in any "pump and dump" schemes (including any "pump and dumps" involving Biozoom shares), has never been a defendant in any "pump and dump" lawsuits, and it has never been convicted of engaging in "pump and dump" activity.

Your publication of the false and defamatory statements listed above, among others, constitutes libel *per quod*, false light, intentional infliction of emotional distress, and tortious interference with business relations, among other claims. Actual malice easily can be proven given the Articles total disregard for the truth. In addition, this letter constitutes direct notice of the false and defamatory nature of the foregoing statements, and actual malice can be proven should you fail to comply with the demands herein to remove and retract, and instead continue to publish the false and defamatory statements discussed above.

Remedies for your legal violations include, among others, actual damages, special damages, punitive damages, and temporary and permanent injunctive relief. *See* Mich. Comp. Laws Ann. § 600.2911; *Lothschuetz v. Carpenter*, 898 F.2d 1200, 1209 (6th Cir. 1990). As you should know, the individual and company you have defamed have very substantial net worth, and damages in this matter are massive.

Please confirm in writing **within twenty-four (24) hours** of the transmission of this letter that the foregoing demands will be, and are being, fully complied with. Failure to do so will leave my clients with no alternative but to evaluate their legal options which could include

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immediate legal proceedings against you. Should that occur, my clients would pursue all available causes of action and seek all available legal remedies to the maximum extent permitted by law.

You are officially on notice of this dispute and therefore you are required to undertake steps to affirmatively preserve, and not delete, any and all physical and electronic documents, materials, information, and data, including without limitation all emails, text messages, instant messages (IMs), letters, memoranda, handwritten notes, typewritten notes, charts, summaries, financial information, audio and/or video footage etc. that pertain in any way to John Hurry, Scottsdale Capital, and/or might otherwise be relevant or related to the foregoing matters. All sources of documents, materials, information, and data should be preserved, including without limitation, physical files, electronic and digital files, computer servers, email servers, backup tapes, cloud storage, personal computers, hard drives, smart phones, tablets, and other types of storage devices including external drives, thumb drives, zip drives, disks and DVDs.

Please govern yourselves accordingly.

This letter is not intended as a full or complete statement of all relevant facts or applicable law, and nothing herein is intended as, nor should it be deemed to constitute, a waiver or relinquishment of any of my clients' rights, remedies, claims or causes of action, all of which are hereby expressly reserved.

Very truly yours,

CHARLES J. HARDER Of
HARDER MIRELL & ABRAMS LLP

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September 13, 2017

VIA ELECTRONIC MAIL
charder@hmafirm.com

Charles J. Harder
Harder Mirell & Abrams LLP
132 S. Rodeo Drive, Fourth Floor
Beverly Hills, CA 90212

Dear Mr. Harder:

We represent Michael Goode, MorningLightMountain LLC, and goodetrades.com. We have received and reviewed your September 12, 2017 demand letter. We do not agree with your allegations that Mr. Goode's publications of April 17, 2017 or June 14, 2017 that you referenced would support a defamation or false light privacy claim, nor do we conclude that the statements in the articles are false. We also question the supposed urgency that requires a response within twenty-four hours as the statements were all published months ago. Regardless, we are willing to discuss the articles with you, with a goal of attempting to address your clients' concerns as an alternative to litigation.

As a preliminary matter, Scottsdale and Mr. Hurry have been publicly sanctioned in connection with their involvement in the securities business, specifically in connection with their mishandling of microcap stock registrations and sales. This means that each of the statements to which your clients object implicate matters of public concern, and likely renders both of your clients public figures for this purpose. Any claim by your clients would, consequently, have to prove actual malice to succeed. Given the public record about your clients, we respectfully submit they would never be able to provide proof our client made any statement with the intent that satisfies the actual malice standard.

Regarding the first statement you identified in your demand letter, from the April 2017 publication, there is nothing false about the statement. It does not accuse your client of engaging in a 'pump and dump' scheme, nor does it say your client has been sued or convicted of anything in connection with such a scheme. The statement is true because, as your demand letter concedes, your client had multiple accounts that were identified in a complaint filed by the SEC in connection with a microcap stock fraud scheme. As your letter also concedes, the SEC made a sufficient factual showing to successfully freeze those Scottsdale Capital Advisors ("Scottsdale") trading accounts. Therefore, merely saying that readers would "know" Scottsdale in connection with pump and dump schemes is factually true. In addition, whether readers would 'know'

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Scottsdale is a matter of opinion and not actionable under either defamation or false light privacy theories.

In addition, your clients have no privacy concerns with respect to the manner in which they operate in the securities business. It is a matter of public record that both the SEC and FINRA have investigated your clients in connection with violations of U.S. securities laws, and FINRA sanctioned both Scottsdale and John Hurry. Needless to say, Michigan's Fair Report privilege would cover reporting about your clients as a result of these public proceedings.

Regarding the second statement you identified, also from the April 2017 publication, the statement that few brokers allow the deposit of penny stock shares is true, and our client has made the same statement in the past. While various brokers might still engage in *trading* of penny stocks, that is a different issue than accepting the *deposit of shares*. Other brokers in the industry acknowledge that few brokers and market makers will accept the *deposit* of penny stock share certificates. In any event, there is nothing about this statement that defamed your clients, as nothing in the statement says or implies that there is anything illegal or improper about accepting the deposit of shares of penny stocks. We fail to see how your client's reputation in the business of handling or trading penny stocks could be harmed by this statement, given the manner in which FINRA excoriated your clients' compliance practices in conducting that business when FINRA sanctioned your clients.

Regarding the third statement you identified from the April 2017 publication, that statement is also true. According to a complaint filed by the SEC, eight trading accounts were implicated in the scheme, and half of those accounts were with Scottsdale. Because these facts have been the subject of public litigation, the Fair Report privilege would protect our client from allegations related to this statement as well. In addition, public reports about the investigation of Biozoom from 2013 clearly stated that Scottsdale was being investigated by the FBI and 'securities officials.' The statement simply does not say your clients were sued or convicted of anything in connection with Biozoom, and it accurately states that Scottsdale accounts were used in that pump and dump scheme.

Regarding the fourth statement you identified, from the June 2017 publication, the statement contains no false statements and does not harm your clients' respective reputations. It does not accuse your clients of being involved in any pump and dump scheme, and it does not say your clients were sued or convicted of anything in connection with Biozoom. It accurately states that "many" (half, to be precise) of the trading accounts that were implicated in the trading of Biozoom stock in a 'pump and dump scheme' were trading accounts opened with Scottsdale. Indeed, the compliance failures for which your clients were sanctioned concerned compliance failures that would allow such misuse of trading accounts.

It is a matter of public record that the SEC ultimately proved its allegations regarding Biozoom in *SEC v. Magdalena Tavella*, so as we already observed, the statements are covered by the Fair Report Privilege.

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In the Court of Appeals
For the State of Michigan

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff-Appellee,

v.

MORNINGLIGHTMOUNTAIN, LLC, and MICHAEL GOODE,

Defendants-Appellants,

–and–

DOES 1–10,

Defendants–Not Participating.

Docket No.

Kalamazoo County Circuit Court
Case No.: 18-0153-CZ
HON. ALEXANDER C. LIPSEY

APPLICATION FOR LEAVE TO PURSUE AN INTERLOCUTORY APPEAL

APPELLANT'S APPENDIX VOLUME XI

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As we indicated at the outset, we are open to discussing ways to address your clients' concerns. Please contact either of the undersigned at your convenience.

Sincerely,

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In the Kalamazoo County Circuit Court
For the State of Michigan

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff,

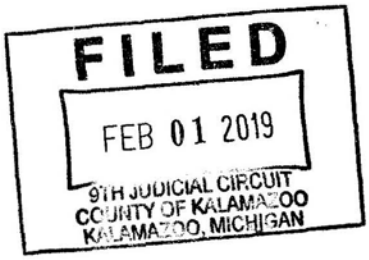
v.

MORNINGLIGHTMOUNTAIN, LLC, MICHAEL GOODE, and DOES 1-10,

Defendants.

Civil No. 18-0153-CZ

HON. ALEXANDER C. LIPSEY



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MOTION FOR SUMMARY DISPOSITION OF THIRD AMENDED COMPLAINT

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Defendants MorningLightMountain, LLC, and Michael Goode ask the Court to dismiss the Third Amended Complaint with prejudice for failure to state a claim upon which relief can be granted.

Respectfully submitted,

BUTZEL LONG, P.C.

Dated: JANUARY 29, 2019

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In the Kalamazoo County Circuit Court
For the State of Michigan

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff,

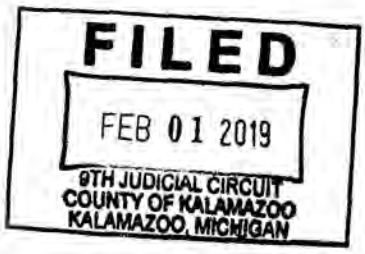
v.

MORNINGLIGHTMOUNTAIN, LLC, MICHAEL GOODE, and DOES 1-10,

Defendants.

Civil No. 18-0153-CZ

HON. ALEXANDER C. LIPSEY



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MEMORANDUM SUPPORTING MOTION FOR SUMMARY DISPOSITION OF THIRD AMENDED COMPLAINT

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Under Rule 2.116(C)(8), MLM and Goode offer this Memorandum in support of their Motion to dismiss the Third Amended Complaint ("Complaint") with prejudice on summary disposition for failure to state a claim upon which relief can be granted.

INTRODUCTION

This is a defamation action. Scottsdale has sued MLM and Goode for allegedly libelous statements posted in an online article at goodetrades.com, a blog reporting on news about penny-stock trading.

A "penny stock" refers to a security issued by a very small company that trades at less than $5.00 per share.[1] Also known as "microcap stocks," penny stocks are issued by companies, many of which do not file financial reports with the U. S. Securities & Exchange Commission.[2] The SEC describes these securities as "among the most risky," suffering from a scarcity of publicly-available information that allows "fraudsters [to] easily spread false information about microcap companies, making profits while creating losses for unsuspecting investors."[3] They are very speculative investments, and Congress has tightly regulated broker-dealers who facilitate penny-stock trading under the Exchange Act.[4]

One fraud particularly affecting penny stocks is the classic pump-and-dump scheme. The scheme involves touting a company's stock through false and mislead-ing statements to the marketplace to ignite a buying frenzy that "pumps" the price of a stock (usually a penny stock). The hucksters then sell (or "dump") their stocks at the "pumped" up price, realizing a handsome profit. Once they dump their shares and stop hyping the stock, the

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[1] United States Secs. & Exch. Comm'n ("SEC"), Penny Stock Rules (May 9, 2013) ("PENNY STOCK RULES") (available at http://bit.ly/SEC-Penny-Stock-Rules).

[2] SEC, Microcap Stock: A Guide for Investors, Introduction (Sept. 13, 2013) (available at http://bit.ly/ SEC-Microcap-Guide).

[3] *Ibid.*

[4] PENNY STOCK RULES, *supra* at n.1

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price falls and investors lose their money.[5]

MLM and Mr. Goode reported on pump-and-dump schemes, including one involving stock in Biozoom, which was touted as a biomedical technology company. Before April 2013, Biozoom was known as Entertainment Art, Inc., and it produced leather bags. In April 2013, it announced that it was changing its name to Biozoom and exiting the leather-bag business to develop biomedical technology. From March 2013 (the month before the announcement) to June 2013, at least eight people opened accounts with broker-dealers and deposited millions of shares of Biozoom that they (falsely) claimed were purchased from Entertainment Art's original shareholders in the previous few months and could be freely traded.[6] From May 16–July 17, 2013, these people sold 14 million shares yielding almost $34 million, of which nearly $17 million was wired to overseas bank accounts.[7] Eventually, the stock collapsed. The SEC brought an enforcement action, *U. S. Securities & Exchange Comm'n* v. *Tavella*, to recover the ill-gotten gains and make swindled investors whole.

Scottsdale, a broker-dealer that facilitated penny-stock trading and claims to be one of the dominant companies in the microcap securities market for handling more than $125 million worth of trades in 2015 alone,[8] accepted Biozoom stocks for deposit and facilitated trading in the microcap market. Many of the trading accounts frozen through the SEC's enforcement action were held at Scottsdale.[9] And, notably, since Scottsdale filed this lawsuit against MLM and Mr. Goode, the SEC entered an order sanctioning Scottsdale's

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[5] SEC, "Pump-and-Dumps" and Market Manipulations (Jun. 25, 2013) (available at http://bit.ly/SEC-Pump-and-Dumps).

[6] *SEC* v. *Tavella*, Civ. No. 13-4609 (SDNY), Complaint at 2, ¶¶ 3–5 (Jul. 3, 2013).

[7] *Id.* at 2–3, ¶¶ 6–7.

[8] Compl. at 3, ¶ 11.

[9] *Tavella*, Civ. No. 13-4609 (SDNY), Stipulated Order Granting Prelim. Inj., Asset Freeze, and Other Relief (R. 16, Jul. 16, 2013); Final J. Defs. Graciarena & Loureyro (R. 67, Dec. 8, 2014); Final Default J. Against Tavella [and Others] (R. 69, Jan. 9, 2015).

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representative Timothy Scarpino for facilitating the sale of 8.2 million Biozoom shares that generated $18.5 million in gains—just over half the shares and half the gains—for the fraudsters.[10] His offense was "fail[ing] to conduct a searching inquiry into facts surrounding the proposed sales" of unregistered Biozoom stock, despite the presence of "significant red flags."[11]

Among other things, it was this same kind of failure to conduct searching inquiries that resulted in the Financial Industry Regulatory Authority ("FINRA") taking disciplinary action against Scottsdale.[12] FINRA imposed a $1.5 million fine against Scottsdale for "institutionaliz[ing] misconduct as its standard way of doing business," among other aggravating factors.[13] Part of the institutionalized misconduct included Scottsdale's failure to revise its procedures to focus on potential sham transactions after botching its gatekeeping role in the Biozoom pump-and-dump scheme that led to the SEC's enforcement action.[14]

FINRA had equally harsh words for Scottsdale's owner, John Hurry. FINRA found that he "violat[ed] his duty to observe high standards of commercial honor and just and equitable principles of trade," and it was "purposeful and egregious," which led FINRA to conclude that "[he] is a threat to investors and the integrity of the markets."[15] Worse yet, FINRA found that Hurry "repeatedly testified falsely, and that there was a

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[10] *In re Timothy C. Scarpino*, SEC No. 3-18483, Order Instituting Admin. and Cease-and-Desist Proceedings, Making Findings, Imposing Remedial Sanctions, and a Cease-and-Desist Order (May 15, 2018).

[11] *Id.* at 2, Part III, Summary.

[12] Answer Exh. A, *FINRA* v. *Scottsdale Capital Advisors Corp.*, No. 2014041724601, Am. Extended Hr'g Panel Dec. (Jun. 20, 2017) (available at http:// bit.ly/FINRA-Panel-Decision) ("FINRA PANEL DEC.")

[13] *Id.* at 107, Part IV(A)(3).

[14] *Id.* at 11-12, 101-102, 104.

[15] *Id.* at 107, Part IV(B).

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pattern of doing so when he thought no contradictory evidence would come to light."[16] FINRA barred Hurry from associating with any other FINRA member for any reason.[17]

Which brings us to this lawsuit. The statement that Scottsdale claims is libelous is contained within an article written by Goode and published by MLM about three years after the Biozoom fraud. The article includes extensive quotations from FINRA's enforcement decision. It also include a link to the decision.

Scottsdale doesn't argue that the reporting about the FINRA action is inaccurate. Rather, it plucks a few sentences from the articles and claims that they wrongfully accuse it of actively engaging in a pump-and-dump scheme. In context, however, the articles do nothing more than note that penny stocks were illegally traded through Scottsdale brokerage accounts. And the notion that these articles damaged Scottsdale in any way—much less in some way unique and independent of (*a*) FINRA castigating and fining Scottsdale, or (*b*) FINRA excommunicating Mr. Hurry from the securities industry—is risible.

After four attempts at pleading a sufficient claim, Scottsdale has now conceded it is one of a few remaining brokers that still allow the deposit and sale of penny stocks,[18] and

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[16] *Ibid.*

[17] *Id.* at 108. The FINRA National Adjudicatory Council affirmed this ruling. *FINRA* v. *Scottsdale Capital Advisors Corp.*, No. 2014041724601 (FINRA Dec. Jul. 20, 2018) at 104, Part V (available at http://bit.ly/FINRA-National-Decision). Scottsdale has appealed to the SEC, which has stayed the fine until pending its decision. The appeal is irrelevant to this action, however, since the Court must assess the Statement at the time of publication, not based on later developments. *Peisner* v. *Detroit Free Press*, 104 Mich. App. 59, 64 (1981), *mod. on other grounds*, 421 Mich. 125 (1984).

[18] On December 17, 2018, Scottsdale sued FINRA in the U.S. District Court for the District of Columbia. It alleged: "At this point, only a handful of firms are still willing and able to process and clear sales of microcap securities, and those firms are under intense pressure to cease their participation in the market." R. 1, Compl. ¶ 6, *Scottsdale Capital Advisors Corp.* v. *FINRA.*, Civil No. 18-02973 (DDC Dec. 17, 2018). What Scottsdale claimed was false and defamatory is now so true that it supports a lawsuit against FINRA.

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that most of the accounts frozen in the Biozoom pump-and-dump were at Scottsdale. So, what started as a defamation claim over four statements across two articles is now down to just one statement—a statement the court has already ruled is not defamatory:

> *If you have followed penny stocks and pump and dumps for a few years then you know Scottsdale Capital Advisors.*

(the "Statement," which appeared in an article on goodetrades.com (the "Website") in April 2017 (the "Article")).

One must question Scottsdale's motives for continuing to press this claim. Although irrelevant for (C)(8) purposes, Scottsdale has admitted in discovery that: (1) none of its clients has mentioned the Statement; (2) it has lost no customers; and (3) it has suffered no lost revenue.[19] Even assuming Scottsdale could prevail on a theory of defamation *per se*,[20] a plaintiff is only entitled to nominal damages, unless he can prove that the defendant acted maliciously. *Burden* v. *Elias Bros. Big Boy Restaurants*, 240 Mich. App. 723, 727–728 (2000). Having accused Goode and MLM of acting only negligently, carelessly, or recklessly,[21] and having suffered no actual losses,[22] the only apparent reason for continuing this lawsuit is to gain editorial control over unfavorable news coverage.[23] In other words, this lawsuit is about one thing: shutting down free speech. It is commonly known as a "strategic lawsuit against public participation." It is brought with the intent to

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[19] Exhibit 1, Scottsdale Interrog. Answers 27–30.

[20] Goode and MLM argue, *infra*, that this is not a case of defamation *per se* because: (1) the challenged statement does not accuse Scottsdale of a crime; and (2) no reasonable reader—a sophisticated person familiar with the penny stock market and Scottsdale's role in that market as a broker (not as a depositor-seller of the stock)—reading the article in its entirety (including the linked FINRA article) could reasonably conclude otherwise.

[21] Compl. ¶¶ 22–25.

[22] *Id.* at ¶ 17. Allegations about economic losses, like all others, must be pleaded in good faith and not for an improper purpose. MCR 1.109(E)(5)).

[23] *See* Compl., Prayer for Relief ¶ C.

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censor the speaker's message because it is unwanted, not because it is false or defamatory. Fortunately, the First Amendment no more allows a "litigation veto" than it does a "heckler's veto."

For the reasons that follow, the Court should dismiss the Complaint with prejudice for failing to state a claim upon which relief can be granted.

SPECIAL STANDARD OF REVIEW FOR FIRST AMENDMENT CASES

Motions for summary disposition brought under MCR 2.116(C)(8) in defamation actions test the legal sufficiency of the complaint. *Singerman* v. *Municipal Serv. Bureau*, 455 Mich. 135, 139 (1997). The Court must limit its review to the pleadings—which by court rule includes both the complaint *and* the answer. MCR 2.116(G)(5) (review of a (C)(8) motion is limited to the pleadings); MCR 2.110(A) (defining a pleading to include complaints and answers). The Court must take the well-pleaded factual allegations as true and construe them in the light most favorable to the nonmoving party. *Dalley* v. *Dykema Gossett*, 287 Mich. App. 296, 304–305 (2010).

Importantly, however, courts have a special, heightened duty under the First Amendment to review the sufficiency of defamation complaints to make sure that pleading requirements are met. *Bose Corp.* v. *Consumers Union*, 466 U. S. 485 (1984). Although *Bose Corp.* involved a public figure and this case (allegedly) involves a private figure, the distinction between public and private figures is irrelevant to the scrutiny that must be brought to bear when assessing whether a defamation claim is properly pleaded—the distinction goes only to *the level of fault* that applies in a given case. The heightened scrutiny of the pleadings applies to *all* defamation cases, regardless of whether the plaintiff is a public or private figure. *Rouch* v. *Enquirer & News (After Remand)* ("*Rouch II*"), 440 Mich. 238, 272–27 (1992) (Riley, J. concurring) (in a private-figure case reviewed on appeal from a (C)(10) ruling, Justice Riley noted that the pleadings in a defamation case are also to be

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reviewed with heightened scrutiny when challenged under (C)(8)). Although stated in a concurrence, "Justice Riley's position [in his concurring opinion in *Rouch II* is consistent with previous decisions of this Court." *Royal Palace Homes, Inc.* v. *Channel 7 of Detroit, Inc.*, 197 Mich. App. 48, 52–53 (1992) (also apparently a private-figure case). *See also Trost* v. *BuckStop Lure Co., Inc.*, 249 Mich. App. 580, 587 n.2 (2002) (observing, in a private-figure case, that Justice Riley outlined the proper procedure for (C)(8) challenges).

Michigan courts take this duty seriously. Recognizing that summary disposition is "an essential tool" to protect against "forbidden intrusions into the field of free expression," *Kevorkian* v. *American Med. Ass'n*, 237 Mich. App. 1, 5 (1999) (citing *Ireland* v. *Edwards*, 230 Mich. App. 607, 613 and n.4 (1998)), our courts long ago adopted an *Iqbal*-like pleading standard that requires plaintiffs to specifically plead: (1) the defamatory words and the facts that would establish that the words are false; (2) the facts identifying the publication of those words to a third party; (3) the level of fault that must be proved and the facts that would establish the speaker acted with that level of fault; and (4) the harm suffered by the publication. *Gonyea* v. *Motor Parts Fed. Credit Union*, 192 Mich. App 74, 76–77 (1991). *Accord Ashcroft* v. *Iqbal*, 556 U. S. 662 (2009) (federal plaintiffs must "plausibly" plead claims through specific factual allegations). Pleading specific facts is a "relatively simple requirement"; defendants are entitled to summary disposition under MCR 2.116(C)(8) "on this ground alone" when plaintiffs fail to follow it. *Rouch II*, 440 Mich. at 279.

Also important, the heightened pleading requirement allows courts to resolve several questions of law on the pleadings, including: (1) whether a statement is capable of being defamatory; (2) the nature of the speaker and the level of constitutional protections afforded to the statement; and (3) whether actual malice exists, if the plaintiff is required to show that level of fault. *Thomas M. Cooley Law School* v. *Doe 1*, 300 Mich. App. 245, 342 (2013). In making these assessments, a court must read the challenged statement in context, fairly and reasonably construing the entire article to determine whether the

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challenged statement is libelous. *Sanders* v. *Evening News Ass'n*, 313 Mich. 334, 340 (1946); *Croton* v. *Gillis*, 104 Mich. App. 104, 108 (1981). A statement "does not become actionable merely because it could be taken out of context." *Nehls* v. *Hillsdale Coll.*, 178 F. Supp. 2d 771, 779 (ED Mich. 2001), *aff'd* 65 Fed. Appx. 984 (CA6 2003) (citing Michigan law).

ARGUMENT

Scottsdale has again failed to sufficiently plead a claim for defamation. In Michigan, a libel plaintiff must prove that the defendant: (1) made a false statement of fact, (2) that was defamatory, (3) which was "of and concerning the plaintiff, (4) in the form of an unprivileged publication to a third party, (5) with a level of fault amounting to at least negligence on the part of the publisher, and (6) thereby damaged the plaintiff. *Northland Wheels Roller Skating Ctr.* v. *Detroit Free Press*, 213 Mich. App. 317, 323 (1995) (citing *Rouch II*). As an initial matter, the Statement is nonactionable hyperbole. Even if it were a statement of fact, it is not neither false nor defamatory. The Statement is also subject to the fair-comment privilege. The Complaint does not plead a claim in avoidance of the privilege. Finally, Scottsdale's most recent amendments have not cured its failure to adequately plead the level of fault with the required factual support.

I. HYPERBOLE: The Statement is not a false material statement *of fact* because it is nonactionable hyperbole.

To be actionable, the challenged statement must be provably false. *Ireland*, 230 Mich. App. 607 (citing *Milkovich* v. *Lorain Journal Co.*, 497 U.S. 1, 17–22 (1990)). In other words, the statement must state "actual, objectively verifiable facts." *Milkovich*, 497 U.S. at 17–21. Nonfactual hyperbole is not provably false. As noted in Part III, *infra*, Scottsdale has been connected to at least two pump-and-dump schemes in the years preceding publication of the Article. The Statement thus amounts to "everyone knows" about the connection—which is classic rhetorical hyperbole that is not actionable. *See, e.g.*, *Komarov* v. *Advance Magazine Publ'rs, Inc.*, 691 N.Y.S.2d 298, 301–302 (NY Sup. Ct. 1999) (plaintiff was as

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"well known" in the community as notorious mobster John Gotti was rhetorical hyperbole that cannot be proven false and not actionable).[24] Scottsdale cannot objectively prove that those who followed penny stock pump-and-dump schemes did *not* know of Scottsdale. It says that it could do so through a poll, (Compl. ¶ 15), but we do not try cases by polling the community. Trials are not gameshows where people "text their vote" to the jury. The absence of any legal mechanism to conduct and admit such a poll into evidence only underscores that this is *Komarov*-style hyperbole, not a provable statement of fact.

II. TRUTH: The Statement is not actionable because it is not materially false.

If the Court holds that the Statement is not an opinion, it should still find that Scottsdale has failed to plead facts sufficient to show that the Statement is false. Scottsdale says the Statement is false because it has "never been involved in any 'pump and dump' schemes, has never been a defendant in any 'pump and dump' lawsuits, and has never been convicted of engaging in 'pump and dump' activity." (Compl. ¶ 15.) But, on its face, the Statement doesn't accuse Scottsdale of these things, as the Court previously held in dismissing this statement from the First Amended Complaint. (Op. 7 (Oct. 4, 2018).)

[24] *See also Hogan* v. *Winder*, 762 F.3d 1096, 1107-1108 (CA10 2014) (accusing someone of blackmail for threatening to sue a former employer was not actionable because, in context, it was nonactionable hyperbole); *Fasi* v. *Gannett Co.*, 930 F. Supp. 1403 (D Haw. 1995) ("Frank 'the Extortionist' Fasi is at it again" was hyperbole, not a true accusation of criminal activity); *Haberstroh* v. *Crain Publ'ns, Inc.*, 189 Ill. App. 3d 267 (1989) (saying a professor was on an "acid trip" was not an accusation of illegal drug use); *McGilvray* v. *Springett*, 68 Ill. App. 275 (1896) (statement that the plaintiff had stolen money from the town treasury "and everybody knows it" was not slanderous; bystanders understood this was not an accusation of larceny, but allegedly overbilling the town for services).

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III. NOT LIBELOUS: The Statement is not actionable because it is not reasonably capable of a defamatory meaning.

Undeterred, Scottsdale alleges that the juxtaposition of the headline "FINRA fines Scottsdale Capital Advisors $1.5 million" implies that FINRA fined Scottsdale for its involvement in the pump and dump of penny stocks—and that this the *only* conclusion that a "reader" could make. (Compl. ¶ 14.)

In a lengthy and strongly worded opinion in *Locricchio* v. *Evening News Association*, 438 Mich. 84 (1991), the Michigan Supreme Court placed severe restrictions on "libel by implication." Relying on *Sanders* v. *Evening News Association*, 313 Mich. 334 (1946), the Court held that, under Michigan law, "imposing liability on a media defendant for facts it publishes accurately and without material factual omissions about public affairs" is prohibited. *Locricchio*, 434 Mich. at 117. Noting that defamation by implication was not so "analytically distinct" as to "require a departure from the guiding principles of general libel and First Amendment libel law," *id.* at 132, the Court emphasized the "severe constitutional" burden of proving falsity that a plaintiff must carry. *Id.* at 122. *Locricchio* renders it extremely difficult, if not practically impossible, to advance a defamation by implication claim under Michigan law. This is as it should be. The falsity requirement should be construed and applied in a manner that assures true speech will not be punished.

The courts look with extreme skepticism upon any theory that threatens to soften the requirement that a libel plaintiff plead and prove a specific false statement of fact. Emphasizing the principles articulated *Locricchio*, the Michigan Court of Appeals has held that a libel defendant "is not responsible for every defamatory implication a reader might draw from his report of true facts, absent evidence that he intended the defamatory implication." *Royal Palace Homes, Inc.* v. *Channel 7 of Det., Inc.*, 197 Mich. App 48, 56 (1992). A statement "does not become actionable merely because it could be taken out of context." *Nehls* v. *Hillsdale Coll.*, 178 F. Supp. 2d 771, 779 (ED Mich. 2001), *aff'd* 65 Fed. Appx. 984 (CA6 2003). There are no facts pleaded that, if proven, would establish that

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MLM and Goode intended to imply that Scottsdale was *committing* pump-and-dump schemes, as opposed to serving as the means by which such schemes were accomplished.

As noted earlier, the Court must read the Statement in context, fairly and reasonably construing the entire article to determine whether the challenged statement is libelous. *Sanders*, 313 Mich. at 340; *Croton*, 104 Mich. App. at 108. The linked FINRA decision provides the context. It details how Scottsdale's business is susceptible to sham transactions.

FINRA noted, among Scottsdale's many shortcomings, that the SEC had previously sued two of Scottsdale's registered representatives in a case involving a pump-and-dump scheme: a Panamanian-based pump-and-dump in 2008–2012 and Bahamian-based pump-and-dump in 2008. FINRA PANEL DEC. at 11–12 and nn. 18 and 20. FINRA fined Scottsdale in part because FINRA directly tied the success of the $34 million Biozoom pump-and-dump scheme to Scottsdale's lax anti-fraud safeguards, which it never improved despite being on notice that its existing safeguards were inadequate to detect and prevent fraud. *Id.* at 107, Part IV.A(3). FINRA explained that, in accepting penny stocks for deposit in the earlier schemes, Scottsdale failed to exercise its gatekeeping role to safeguard against being used by its customers as a means to execute a pump-and-dump fraud. Scottsdale's subsequent failure to adequately police transactions—as it was required to do under SEC Rule 17a-8, the Bank Secrecy Act ("BSA"), and its implementing regulations, *see* BSA, 31 U.S.C. § 5311, *et seq.*; 31 C.F.R. § 1023.320(a)(2); and 17 C.F.R. 240.17a-8 (SEC regulation requiring brokers to follow the BSA and its rules)—signaled to FINRA that Scottsdale had not heeded the lessons of its earlier roles in pump-and-dump schemes. It considered this an aggravating factor, which formed a basis for the $1.5 million fine:

> Finally, although [Scottsdale] was not charged in … *Ruettiger*, *Gibraltar I*, *Gibraltar II*, and *Tavella*, those cases did involve alleged misconduct through accounts at [Scottsdale]. These cases put [Scottsdale] on notice of the risk of sham transactions and the use of nominees to conceal beneficial ownership and facilitate unlawful distributions of

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> securities. They heightened the need for [Scottsdale] to be alert to red flags. *In light of this history, it is aggravating that Scottsdale performed its gatekeeping function so poorly.*

FINRA PANEL DEC. 104 at Part IV.A(1)(d) (emphasis supplied). Accordingly, Scottsdale grossly mischaracterizes the FINRA report by suggesting the report and the fine have "nothing to do" with Scottsdale's role in pump-and-dump schemes. (*See* Compl. ¶ 14.)

Under Section 5 of the Securities Act, the sale of securities without registration is unlawful unless an exemption exists. 15 U.S.C. § 77e(a)(1). In selling penny stocks without registration, Scottsdale "usually relie[d] on a 'safe harbor' exemption created by the [SEC], Rule 144." FINRA PANEL DEC. 5 at Part I.A. When a securities transaction involves "large blocks of thinly traded, little-known securities acquired in a chain of private transactions," like the Biozoom stock, it is "a red flag that the SEC and FINRA have both said requires a 'searching inquiry.'" *Id.* at 6, Part I.A(3). "These red flags ought to have been investigated and properly resolved *before* the securities could be sold. [Scottsdale], however, *blinded itself* to the multiple red flags signaling that the transactions were unlawful public distributions of securities. It did not conduct the required searching inquiry. It [therefore] sold the securities without a reasonable basis for a Rule 144 exemption." *Id.* at 7, Part I.A(3) (emphasis added).

Explaining Scottsdale's willful blindness, FINRA noted that "[Scottsdale] was on notice that its business was susceptible to sham transactions and the use of nominees to conceal the true beneficial owners of securities. *In four disciplinary actions* involving Scottsdale's own employees and customers, the SEC alleged that sham transactions and nominees were used in unlawful sales in violation of Section 5 of the Securities Act. Those unlawful sales in turn were used to facilitate fraud and manipulation." FINRA PANEL DEC. 11, Part III.B(1)(a)(iv)(a) (emphasis added). FINRA identified the nature of the fraud and manipulation, two of which involved pump-and-dump schemes. *Id.* at 11–12, Part III.B(1)(a)(iv)(a). After detailing Scottsdale's shortcomings in each of the earlier regulatory actions—

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including the Biozoom fraud—FINRA held that those actions "should have caused [Scottsdale] to take special care . . . to revise its procedures to focus on potential sham transactions and the use of nominees. [Scottsdale] did not." *Id.* at 13, Part III.B(1)(a)(iv)(a).

Scottsdale attempted to minimize the significance of its gatekeeping function, arguing that it was unfair to look back to the pump-and-dump schemes because no formal accusation had been made in the current disciplinary case that the challenged transactions were part of a pump-and-dump fraud. *Id.* at 13, Part III.B(1)(a)(iv)(b). FINRA was unmoved: "It is not necessary, however, to prove that fraud occurred in order to conclude that [Scottsdale and other respondents] failed to perform their gatekeeping duty adequately." *Ibid.* In trying to make the same argument here, (Compl. ¶ 14), Scottsdale ignores the central thrust of the Article: a company with a history of being used by third parties as a tool to execute pump-and-dump schemes because of its repeated failure to take its gatekeeping function seriously was fined $1.5 million for yet again not doing its job to adequately safeguard the investing public.

In its last brief on this subject, Scottsdale essentially conceded that anyone reading the linked FINRA report would understand this context, but argued that the "damage is done" before the reader gets to the FINRA report. (Opp'n at 9, Mot. Summ. Dispo., Second Am. Compl.) This is just another way of saying the reader can't be expected to read the entire text if the article is too long. *But that isn't the law*. In making these assessments, a court must read the challenged statement in context, fairly and reasonably construing *the entire article* to determine whether the challenged statement is libelous. *Sanders*, 313 Mich. at 340; *Croton* v. *Gillis*, 104 Mich. App. 104, 108 (1981). In context, the Statement is not libelous.

Even if the Court were to conclude that the Statement is capable of a defamatory implication, the alleged implication is substantially true. Substantial truth is an absolute defense to a defamation claim. *Collins* v. *Detroit Free Press*, 245 Mich. App. 27, 33 (2001).

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The doctrine precludes liability if the gist or sting of the statement is true; a statement is not considered false unless the literal truth would have produced a different effect in the mind of the reader. *Ibid.*

Scottsdale's claim rests on the distinction between actively committing fraud and being used as a tool for fraudsters. A person who followed pump-and-dump schemes—*i.e.*, the reasonable audience—would know the difference between these two things *and* understand from the linked FINRA report that Scottsdale was involved in pump and dumps *as a tool*. Moreover, the linked FINRA report shows that regulators found Scottsdale to be a *willing* tool because it "institutionalized misconduct as its standard way of doing business." FINRA PANEL DEC. 105 at Part IV.A(1)(d). Anyone who followed pump-and-dump schemes would know of Scottsdale. Anyone who read the entire article (including the linked FINRA report)—as the Court must under *Sanders*—would also understand *how* Scottsdale was involved. Thus, the Statement is substantially true.

IV. PRIVILEGED: The Article addresses a matter of public concern—enforcement of securities regulations to guard against frauds on the market— making the Statement privileged under Michigan's common law fair-comment privilege.

A news story about any matter of public interest or concern is protected under Michigan's common law fair-comment privilege. *Lawrence* v. *Fox*, 357 Mich. 134 (1954). There is no requirement that the publication deal with a "public controversy," a term of art that applies in other contexts in First Amendment cases. *Bichler* v. *Union Bank & Trust*, 745 F.2d 1006, 1011 (CA 9184) (applying Michigan common law). The fair-comment privilege is a qualified privilege that exists based upon the circumstances surrounding the publication, not the publication's content. *Lawrence*, 357 Mich. at 140. The privilege also applies regardless of whether the plaintiff is a public or private figure. *Peisner* v. *Detroit Free Press, Inc.*, 82 Mich. App. 153, 161 (1978). "Everyone, citizen and reporter, has the right to comment on matters of public importance, and expressions of opinion and even

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misstatements of fact are not actionable in a libel suit unless made maliciously for the purpose of damaging another's reputation." *Orr* v. *Argus-Press Co.*, 586 F.2d 1108, 1113 (CA6 1978) (applying Michigan law). "Negligence on the part of the newspaper *is not sufficient to establish liability*. Scienter is required. If the statement is honestly believed to be true and published in good faith, there is no scienter and no liability." *Ibid.* (internal quotations omitted) (emphasis added). "The burden is on *the plaintiff* to prove the untruth of the statements *and actual malice*." *Dadd* v. *Mount Hope Church*, 486 Mich. 857 n.1 (2010) (quoting *Van Vliet* v. *Vander Naald*, 290 Mich. 365, 371 (1939)) (emphases added).

The source of the content bears on the privilege's application: "If the source of the publisher's information is a person or organization of probity and good repute, the jury would have warrant to find that he honestly believed that what he published was the truth … On the other hand, if his sources were notably mendacious, there might well be warrant to find otherwise." *Lawrence*, 357 Mich. at 143. Although the reliability of the source is often a question for the jury, that is not the case here. The source that Goode and MLM relied upon here is a detailed legal decision from a licensing authority empowered to act as the frontline regulator of securities brokers like Scottsdale. (FINRA is a self-regulatory organization that is responsible under the Exchange Act of 1934 for policing enforcement of federal securities laws by its members. *See* 15 U.S.C. § 78f.) As a matter of law, no reasonable juror could conclude that the functional equivalent of a court decision is "mendacious" or otherwise of bad repute; a reasonable juror could only conclude that reliance on a *de facto* judicial decision is a trustworthy source. *Cf. Sherwood* v. *Evening News Ass'n*, 256 Mich. 318, 321 (1931) ("fair and impartial reports of judicial, executive, legislative, or other official public proceedings are considered qualifiedly privileged."); M.C.L. § 600.2911(3) (more or less codifying the *Sherwood* privilege).

A plaintiff can overcome the fair-comment privilege only by pleading and proving that the defendant abused the privilege by recklessly disregarding the truth—*i.e.*, by

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entertaining serious doubts about the truth of the publication. *Schultz* v. *Newsweek, Inc.*, 668 F.2d 911, 918 (CA6 1982) (applying Michigan law and recognizing that Michigan has replaced the old definition of "actual malice," meaning spite or ill will, with the new "actual malice" standard articulated in *New York Times Co.* v. *Sullivan*, 376 U.S. 254 (1964)). Michigan requires plaintiffs to allege facts in the complaint that would establish actual malice. *Gonyea*, 192 Mich. App. at 76–77; *Rouch II*, 440 Mich. at 279. It is not enough to offer conclusory allegations that the defendant entertained serious doubt—the plaintiff must plead facts that, if proved, would allow a jury to make that finding.

Scottsdale alleges that Goode and MLM "purposefully omitted" that FINRA fined Scottsdale for rule violations instead of its involvement in pump-and-dump activity. (Compl. ¶ 23.) Not only is this a conclusory allegation entitled to no weight, but it is contradicted by the Article, which includes a reference to FINRA Rule 2010 and Section 5 of the Securities Act, and the FINRA report, which *is part of the article*. Moreover, the report explained that FINRA fined Scottsdale in part for failing to remedy lax procedures that had proven to be inadequate to prevent pump-and-dump schemes, including the Biozoom fraud. FINRA PANEL DEC. 107 at Part IV.A(3). On a pleadings-based motion to dismiss, a court needn't accept as true allegations that are plainly contradicted by an exhibit to a pleading. *Sprewell* v. *Golden State Warriors*, 266 F.3d 979, 988 (CA9 2001) (applying Fed. Rule Civ. Proc. 12(b)(6), the equivalent of M.C.R. 2.116(C)(8)).

In short, Scottsdale is displeased that Goode and MLM published an Article stating that FINRA tied its $1.5 million fine to rule violations that had previously allowed pump-and-dump schemes to succeed. But since that is exactly what the FINRA report says, Scottsdale has failed to plead facts from which the jury could find that they entertained serious doubt correctness of the conclusion they drew from the report. At most, Scottsdale has alleged that Goode and MLM failed to adequately investigate and understand the legal issues in the FINRA report before reporting on it. But allegations of inadequate

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investigation are insufficient to constitute malice. *Beckley Newspapers Corp.* v. *Hanks*, 389 U.S. 81 (1967). And nonlawyers are not held liable for technical errors in reporting on legal matters, as long as the gist or sting of the legal report is substantially true. *Rouch II*, 440 Mich. at 249–265 (collecting authorities and offering in detail as an example the case of a Wisconsin judge who could not sue a newspaper for libel over a story mischaracterizing his remarks—in which he wondered aloud if a 15-year-old convicted of sexual assault should receive a more lenient sentence having grown up in a sexually permissive society—as a "ruling," which story led to his recall from office).

V. FAULT: The Complaint does not adequately plead negligence.

To adequately plead fault, a plaintiff must identify the level of fault that applies to the claim *and* allege facts that would establish that level of fault if proved. *Gonyea*, 192 Mich. App. at 76–77; *Rouch II*, 440 Mich. at 279. There are two levels of fault: negligence and actual malice. *Ibid.* The negligence standard applies in cases involving private figures; the actual-malice standard applies in cases involving public officials, public figures, and limited-purpose public figures. *Ibid.* Scottsdale alleges that it is a private figure and that MLM and Goode are the direct and proximate cause of its damages, Compl. ¶ 29, so it impliedly pleads the level of fault to be negligence.

Negligence is defined as the failure to use the care that an ordinary person would use under the circumstances. MICH. CIV. J. INSTR. 10.02. Thus, in order to meet the *Iqbal*-like pleading standard, Scottsdale must allege what a reasonably careful reporter and reasonably careful publisher would have done under the circumstances, and then plead facts alleging that MLM and Goode failed to do those things. *Michigan Microtech, Inc.* v. *Federated Publ'ns, Inc.*, 187 Mich. App. 178, 186 (1991). These standards are intertwined with the "reasonable audience" standard. *Air Wis. Airlines Corp.* v. *Hoeper*, 71 U.S. 237, 246–251 (2014). The Complaint does not satisfy these pleading requirements.

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Scottsdale alleges that a reasonably careful reporter "reads the documents he cites and would not report, or imply that a fine for procedural noncompliance is the equivalent of a fine for intentional pump and dump activity." (Compl. ¶ 24.) Scottsdale would presumably have the Court draw an inference that Goode did not read the FINRA report. Yet the Article in which the Statement appears quotes from the report at length. Thus, the Article itself precludes this from being a *reasonable* inference. *Lakeside Oakland Dev.* v. *H&J Beef Co.*, 249 Mich. App. 517, 530 n4 (2002) ("[w]hen considering a motion under MCR 2.116(C)(8), … any *reasonable* inferences or conclusions that can be drawn from the facts, are accepted as true." (cleaned up) (emphasis added)).

Alleging that Goode did not read the FINRA report is also a rather odd allegation to make. Essentially, Scottsdale's position is that a reasonable journalist would take the time to read source material, but: (1) a reasonable reader would not do so, even though the material forms part of the article; and (2) the Court should not do so when assessing the sufficiency of the Complaint. Not only does the law presume that the reasonable reader reads the entire story, but in this case the law also presumes they're sophisticated readers. Under *Air Wisconsin*, Goode and MLM can reasonably expect that the reasonable audience of visitors to the Website are people familiar with the microcap market, including the players in the market and their roles (*e.g.*, depositor-sellers, broker-dealers, and buyers, etc.). Those readers, being versed in the industry, would conclude that Scottsdale was the *means* by which a pump-and-dump was accomplished, not that Scottsdale had itself engaged in illegal activity—particularly with the benefit of links to source documents.[25]

Under *Rouch II*, a failure to plead *both* the level of fault that must be proved *and the facts* that would establish the speaker acted with that level of fault entitles MLM and Goode

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[25] Indeed, this probably explains why Scottsdale hasn't suffered any loss of business. (Goode and MLM do not rely on the absence of damages for this Motion; it is merely an observation.)

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to summary disposition under MCR 2.116(C)(8). *Rouch II*, 440 Mich. at 279 (Riley, J., concurring). Scottsdale's failure to plead facts adequately supporting a claim of negligence is fatal to the Complaint.

VI. DISMISSAL WITH PREJUDICE: Scottsdale cannot cure the flaws in the Complaint by further amendment.

Leave to amend should be withheld when amendment would be futile. *Allegheny-Ludlam Corp.* v. *Michigan Dept. of Treas.*, 207 Mich. App. 604, 605 (1994). Amendment would be futile in this case. The Statement is nonactionable hyperbole, and no amount of re-pleading will change that. Even if could be construed as a statement of fact, it is substantially true when considered in light of FINRA's disciplinary decision, it is not capable of defamatory meaning, and it is privileged. After four failed attempts at a proper pleading, it is time to bring this case to a close.

PRAYER FOR RELIEF

MLM and Goode respectfully request that the Court grant summary disposition in their favor under Rule 2.116(C)(8) and dismiss the Complaint with prejudice.

Respectfully submitted,

BUTZEL LONG, P.C.

Dated: JANUARY 29, 2019

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JOSEPH E. RICHOTTE

STATE OF MICHIGAN
KALAMAZOO COUNTY CIRCUIT COURT

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff,

v.

MORNINGLIGHTMOUNTAIN, LLC, MICHAEL GOODE, and DOES 1-10,

Defendants.

File No.: 2018—0153-CZ

Hon. Alexander C. Lipsey

Charles J. Harder (CA #184593) (pro hac vice to be filed)
Jordan Susman (CA #246116) (pro hac vice to be filed)
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PLAINTIFF'S ANSWER TO DEFENDANTS' FIRST SET OF INTERROGATORIES

Under Rule 2.309(B), Plaintiff Scottsdale Capital Advisors, Corporation ("Plaintiff"), answers Defendants MorningLightMountain, LLC, and Michael Goode (collectively "Defendants") First Set of Interrogatories as follows:

RESERVATION OF RIGHT TO SUPPLEMENT

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Interrogatory to the extent that it is ambiguous, overbroad as to time, burdensome, and harassing. In light of the foregoing objections, Plaintiff will not respond to this Interrogatory.

25. Identify every act, fact, and event that supports SCA's answer to Interrogatory No.24.

OBJECTION: Plaintiff objects to this Request to the extent that it is not reasonably calculated to lead to the discovery of relevant evidence in light of the fact that Plaintiff is not seeking special damages for specific lost business relationships. Plaintiff further objects to this Interrogatory to the extent that it is ambiguous, overbroad as to time, burdensome, and harassing. In light of the foregoing objections, Plaintiff will not respond to this Interrogatory.

26. Identify each person and business that SCA knows, believes, or suspects has factual information supporting SCA's answers to Interrogatory Nos. 24 and 25, providing the full name of the person or business. For each person, provide their business address, business telephone number, business email, personal address, personal telephone number, and personal email. For each business, provide their state of incorporation; resident agent's name, business address, business telephone, and business email; and chief executive's name, business address, business telephone, and business email.

OBJECTION: Plaintiff objects to this Request to the extent that it is not reasonably calculated to lead to the discovery of relevant evidence in light of the fact that Plaintiff is not seeking special damages for specific lost business relationships. Plaintiff further objects to this Interrogatory to the extent that it is ambiguous, overbroad as to time, burdensome, and harassing. In light of the foregoing objection, Plaintiff will not respond to this Interrogatory.

27. Identify each person and business that declined to enter into, or declined to renew, a business relationship with SCA because of the Statement in the April Article, providing the full legal name of the person or business. For each person, provide their business address, business telephone number, business email, personal address, personal telephone number, and personal email. For each business, provide their state of incorporation; resident agent's name, business

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address, business telephone, and business email; and chief executive's name, business address, business telephone, and business email.

OBJECTION: Plaintiff objects to this Interrogatory to the extent that it is not reasonably calculated to lead to the discovery of relevant evidence in light of the fact that Plaintiff is not seeking special damages for specific lost business relationships. Plaintiff further objects to this Interrogatory to the extent that it is ambiguous, overbroad as to time, burdensome, and harassing. In light of the foregoing objection, Plaintiff will not respond to this Interrogatory.

28. Identify every act, fact, and event that supports SCA's answer to Interrogatory No. 27.

OBJECTION: Plaintiff objects to this Interrogatory to the extent that it is not reasonably calculated to lead to the discovery of relevant evidence in light of the fact that Plaintiff is not seeking special damages for specific lost business relationships. In light of the foregoing objection, Plaintiff will not respond to this Interrogatory.

29. Identify each person and business that SCA knows, believes, or suspects has factual information supporting SCA's answers to Interrogatory No. 27 and 28, providing the full name of the person or business. For each person, provide their business address, business telephone number, business email, personal address, personal telephone number, and personal email. For each business, provide their state of incorporation; resident agent's name, business address, business telephone, and business email; and chief executive's name, business address, business telephone, and business email.

OBJECTION: Plaintiff objects to this Interrogatory to the extent that it is not reasonably calculated to lead to the discovery of relevant evidence in light of the fact that Plaintiff is not seeking special damages for specific lost business relationships. In light of the foregoing objection, Plaintiff will not respond to this Interrogatory.

30. Identify all damages that SCA claims as a result of the Statement in the April Article, itemized by the type of damages, monetary value, and the date(s) the damages were incurred.

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OBJECTION: Plaintiff objects to this Interrogatory to the extent that it is not reasonably calculated to lead to the discovery of relevant evidence in light of the fact that Plaintiff is not seeking special damages.

ANSWER: Without waiving the foregoing objection, Plaintiff states that it is seeking general damages for the harm the Statement in the April Article has caused to its business reputation. This harm is ongoing.

31. Identify every act, fact, and event that supports SCA's answer to Interrogatory No.30.

OBJECTION: Plaintiff objects to this Interrogatory to the extent that it requests information not fully available to Plaintiff because those who have formed negative opinions of Plaintiff are unlikely to voice those opinions of Plaintiff.

ANSWER: Without waiving the foregoing objection, Plaintiff states that the Statement in the April Article directly calls Plaintiff's business reputation into question by insinuating that it engages in practices that typical brokers do not do. This has damaged Plaintiff's business reputation by making it appear to be a sub-par brokerage that is engaging in questionable, non-standard, potentially illegal business practices.

32. Identify each person and business that SCA or any of its Agents knows, believes, or suspects has factual information supporting SCA's answer to Interrogatory Nos. 30 and 31, providing the full name of the person or business. For each person, provide their business address, business telephone number, business email, personal address, personal telephone number, and personal email. For each business, provide their state of incorporation; resident agent's name, business address, business telephone, and business email; and chief executive's name, business address, business telephone, and business email.

OBJECTION: Plaintiff objects to this Interrogatory to the extent that it is not reasonably calculated to lead to the discovery of relevant evidence in light of the fact that Plaintiff is not seeking special damages.

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In the Kalamazoo County Circuit Court
For the State of Michigan

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff,

v.

MORNINGLIGHTMOUNTAIN, LLC, MICHAEL GOODE, and DOES 1–10,

Defendants.

Civil No. 18-0153-CZ

HON. ALEXANDER C. LIPSEY

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PROOF OF SERVICE

Michelle L. Guardiola hereby states that on January 29, 2019, she served a copy of Defendants' Joint Answer to Third Amended Complaint, Motion for Summary Disposition of Third Amended Complaint, Memorandum in Support and this Proof of Service via U.S. First Class Mail, addressed to Plaintiff's counsel at the following addresses:

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HARDER LLP Charles J. Harder (CA# 184593) Jordan D. Susman (CA# 246116) 132 South Rodeo Drive, Fourth Floor Beverly Hills, California 90212	PINSKY, SMITH, FAYETTE & KENNEDY, LLP H. Rhett Pinsky (P18920) 146 Monroe Center St., NW, Suite 805 Grand Rapids, Michigan 49503

I declare that under the penalty of perjury that the statements above are true to the best of my information, knowledge and belief.

BUTZEL LONG

Michelle L. Guardiola

MICHELLE L. GUARDIOLA

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RECEIVED
MAR 25 2019
JOSEPH E. RICHOTTE

March 18, 2019

Clerk of the Court
Kalamazoo County Circuit Court
150 East Crosstown Parkway
Kalamazoo, MI 49001

Re: Scottsdale Capital Advisors Corp. v. MorningLightMountain, LLC, et al
Case No.: 2018-0153-CZ

Dear Clerk:

Enclosed please find an original and "Judge's Copy" of Plaintiff's Response in Opposition to Motion for Summary Disposition of Third Amended Complaint, together with Proof of Service.

If you have any questions, please contact me.

Very truly yours,

PINSKY, SMITH, FAYETTE & KENNEDY, LLP

H. Rhett Pinsky

HRP/esd
Enclosures
c: Jordan D. Susman, Esq. (w/o encs)
Joseph E. Richotte, Esq. (w/encs)

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STATE OF MICHIGAN
KALAMAZOO COUNTY CIRCUIT COURT

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff,

v.

MORNINGLIGHTMOUNTAIN, LLC, MICHAEL GOODE, and DOES 1-10,

Defendants.

File No.: 2018—0153-CZ

Hon. Alexander C. Lipsey

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PROOF OF SERVICE

Erika Dech, Legal Assistant at Pinsky, Smith, Fayette & Kennedy LLP, states that on **March 18, 2019**, she served **PLAINTIFF'S RESPONSE IN OPPOSITION TO MOTION FOR SUMMARY DISPOSITION OF THIRD AMENDED COMPLAINT** upon Joseph E. Richotte, BUTZEL LONG, PC, 41000 Woodward Avenue, Bloomfield Hills, MI 48304 and Jordan D. Susman, HARDER LLP, 132 South Rodeo Dr., 4th Floor, Beverly Hills, CA 90212 via first class mail, postage prepaid.

Erika Dech

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STATE OF MICHIGAN
KALAMAZOO COUNTY CIRCUIT COURT

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff,

v.

MORNINGLIGHTMOUNTAIN, LLC, MICHAEL GOODE, and DOES 1-10,

Defendants.

File No.: 2018—0153-CZ

Hon. Alexander C. Lipsey

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PLAINTIFF'S RESPONSE IN OPPOSITION TO MOTION FOR SUMMARY DISPOSITION OF THIRD AMENDED COMPLAINT

Plaintiff Scottsdale Capital Advisors Corp. ("Scottsdale"), submits its Response in Opposition to Defendants' MCR 2.116(C)(8) Motion for Summary Disposition of Third Amended Complaint ("Current Motion").

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INTRODUCTION AND RELEVANT PROCEDURAL BACKGROUND

This action arises from Defendants' publication on www.goodetrades.com of a false, defamatory, and highly misleading article (the "Article"). The Article, titled "FINRA fines Scottsdale Capital Advisors $1.5 million," opened with the sentence "If you have followed penny stocks and pump and dumps for a few years then you know Scottsdale Capital Advisors," thus leading the reader to immediately conclude that Scottsdale was fined by FINRA for pump and dump activity.

On November 8, 2018, Scottsdale filed its Second Amended Complaint ("SAC"), which alleged two defamatory statements by Defendants, including Statement #1: **"If you have followed penny stocks and pump and dumps for a few years then you know Scottsdale Capital Advisors."**

On November 14, 2018, Defendants filed a Motion for Summary Disposition of the SAC (the "SAC Motion").

During the December 14, 2018, hearing on the SAC Motion, the Court held that Scottsdale had adequately amended its complaint "to specifically allege those two statements as defamatory," but granted Defendants' SAC Motion because Scottsdale had not pleaded "the necessary elements of negligence in their pleadings." (Transcript at 20:13-20; 24:3-8). The Court granted Scottsdale leave to "fashion a complaint that does comport with this Court's rulings relating to establishing at least some factual basis for negligence that can be explored in the litigation process." (Transcript at 24:9-18)

On January 16, 2019, Scottsdale filed its operative Third Amended Complaint ("TAC"). Per the Court's order, Scottsdale alleged additional facts to establish that Defendants negligently published Statement #1.

On January 29, 2019, Defendants filed the Current Motion, which (1) alleges Scottsdale has failed to plead the requisite fault standard, (2) realleges that Scottsdale has failed to state a claim for defamation and (3) alleges for the first time that Scottsdale's defamation claim is barred as a matter of law based on the substantial truth defense and public interest privilege.

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The Current Motion should be denied because (1) Scottsdale has sufficiently alleged that Defendants were negligent in publishing Statement #1, (2) the Court already held that Scottsdale sufficiently pleaded a claim for defamation, and (3) neither the substantial truth defense nor the public interest privilege bar Scottsdale's claim.

LEGAL STANDARD

As with their SAC Motion, Defendants again allege that there is a heightened scrutiny for reviewing a defamation case for legal sufficiency based on the pleadings. (Current Motion at pp.5-7). The Court already rejected these arguments in its October 4, 2018 Order on Defendants' motion to dismiss the First Amended Complaint. (October 4, 2018 Order at p.5). ("[T]his Court should not implement a higher standard as the Defendant suggests, but instead maintain a normal course of action regarding MCR 2.116(C)(8) that reviews only pleadings for legal sufficiency in light of the alleged wrongdoing."). The Court further held that Defendants' claim of a heightened pleading standard "is without merit" and "improperly interpreted" the cases cited by Defendants, *Bose Corp. v. Consumers Union* and *Thomas M. Cooley Law School v. Doe 1.* (October 4, 2018 Order at p.4).

The proper standard of review for a MCR 2.116(C)(8) motion is to test the legal sufficiency of the pleadings. *Ben-Tech Indus. Automation v. Oakland Univ.*, No. 247471, 2005 WL 50131, at *2 (Mich. Ct. App. Jan. 11, 2005). "All factual allegations in support of the claim are accepted as true" and "any reasonable inferences or conclusions which can be drawn from the facts" must be "construed in the light most favorable to the nonmoving party." *Id.* A MCR 2.116(C)(8) motion should only be granted if "the claim is so clearly unenforceable as a matter of law that no factual development could possibly justify recovery." *Id.*

ARGUMENT

A. The TAC Sufficiently Pleads Fault

"The negligence standard under Michigan law is understood to measure whether a defendant's actions were those of a 'reasonably careful journalist' or 'reasonably careful publisher.'" *Compuware Corp. v. Moody's Inv'rs Servs., Inc.*, 371 F. Supp. 2d 898, 902 (E.D.

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Mich. 2005) (*citing Michigan Microtech, Inc. v. Federated Publ'ns, Inc.*, 187 Mich. App. 178, 466 N.W.2d 717, 722 (1991)). The TAC easily satisfies this standard.

The TAC states, "Defendants were negligent in creating the implication in False Statement #1 that FINRA fined SCA $1.5 million for participating in illegal pump and dump schemes." (TAC ¶ 22). The TAC further alleges that although the Article references a Stockwatch article and a 111-page FINRA decision as support for False Statement #1, a plain reading of both of those documents indicates that FINRA fined SCA for selling securities without registration and without an exemption, as required by FINRA Rule 2010—**not** for participating in illegal pump and dump schemes. (*Id.*) Defendants acted negligently because "**a reasonable journalist reads the documents he cites and would not report, or imply that, a fine for procedural noncompliance is the equivalent of a fine for intentional pump and dump activity**." (*Id.*) (emphasis added).

Accordingly, the TAC clearly states that Defendants were negligent because their actions were not those of a reasonably careful journalist or publisher. Stated differently, Defendants were negligent because they failed to give "a full and accurate account of the relevant facts" regarding the decision upon which they claimed to reporting. *In re Thompson*, 162 B.R. 748, 770 (Bankr. E.D. Mich. 1993).

Accordingly, there is no dispute that the TAC sufficiently pleads negligence, and the Current Motion should be denied.

B. <u>The Court Already Held That Statement #1 Sufficiently Pleads Defamation</u>

In ruling on Defendants' SAC Motion, the Court held: "plaintiffs amended their complaint to specifically allege [Statement #1] as defamatory." (December 14, 2018 Transcript at 20:13-20). Despite the Court's unambiguous holding, Defendants improperly try to relitigate the Court's earlier order and argue the TAC does not sufficiently allege Statement #1 is defamatory.

Michigan courts routinely deny motions that seek the same relief based upon the same facts as an earlier motion. *See Moore v. Vines*, No. 221846, 2001 WL 684561, at *1 (Mich. Ct.

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App. June 15, 2001) ("The doctrine of *res judicata* generally precludes relitigation of matters already decided absent certain compelling circumstances, such as those specified in MCR 2.612(C)."). In *Burda Bros, Inc.*, the Court of Appeals upheld a trial court's denial of a plaintiff's third motion for attorney fees, stating:

> Plaintiffs' third motion for attorney fees pleaded virtually identical facts and requested the same substantive relief as plaintiffs' second motion for attorney fees, when the court ruled against them. We, therefore, agree with the trial court's treatment of plaintiffs' third motion for attorney fees as a motion for reconsideration of the court's decision on their second motion for attorney fees.

No. 250487, 2005 WL 156621, at *3 (Mich. Ct. App. Jan. 25, 2005).

Because the Current Motion seeks the exact same relief based upon the exact same facts as Defendants' SAC Motion, it should be denied.[1]

C. Statement #1 Sufficiently Pleads a Claim for Defamation

Statement #1 states: "If you have followed penny stocks and pump and dumps for a few years then you know Scottsdale Capital Advisors." Scottsdale alleges that this statement is false and defamatory when read in context:

> False Statement #1 is immediately preceded by the headline: "FINRA fines Scottsdale Capital Advisors $1.5 million." This juxtaposition makes it appear that SCA [Scottsdale] was fined $1.5 million for its involvement in the pump and dump of penny stocks. Given the placement of False Statement #1 under a headline regarding a $1.5 million fine by FINRA, a reader could only conclude that SCA was fined for its involvement in a pump and dump. Moreover, the Article quotes extensively from a FINRA decision that has nothing to do with any pump and dump scheme. In addition, False Statement #1 falsely alleges and/or implies that SCA is so heavily involved in the illegal pump and dump of penny stocks that it is identified and known by the association. This is false. Because SCA has never been involved in any "pump and dump" schemes, has never been a defendant in any "pump and dump" lawsuits, has never been charged by FINRA or any

[1] Because the Court already ruled that there was no palpable error with its earlier ruling, the purpose of the Current Motion is clearly to harass and needlessly increase the cost of litigation. Consequently, in denying Defendants' Current Motion, the Court should also award sanctions pursuant to MCR 2.114.

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> regulatory agency with involvement in a "pump and dump" scheme, and has never been fined for its involvement in a "pump and dump", the implications created by False Statement #1 in the context of the Article are false and defamatory.

SAC ¶ 13(a).

A cause of action for defamation by implication occurs when the defamatory implications of a statement are materially false, and "that such a cause of action might succeed even without a direct showing of any actual literally false statements." *Hawkins v. Mercy Health Servs., Inc.*, 230 Mich. App. 315, 329-30, 583 N.W.2d 725, 731 (1998). "[E]ven if defendant's statements were true, if the implications the statements created were false, the question of whether the statements were defamatory must be left up to the jury." *Am. Transmission, Inc. v. Channel 7 of Detroit, Inc.*, 239 Mich. App. 695, 702 (2000). "Direct accusations or inferences of criminal conduct or wrongdoing are not protected as opinion. There is no First Amendment protection for a charge which could reasonably be understood as imputing specific criminal conduct or other wrongful acts." *Hodgins v. Times Herald Co.*, 169 Mich. App. 245, 253-54 (1988) (internal citations omitted).

Statement #1 is defamatory because it falsely alleges and/or implies that Scottsdale is so heavily involved in the illegal pump and dump of penny stocks that it is identified and known by the association. Consequently, the Current Motion should be denied.

1. Statement #1 Is Not "Nonactionable Hyperbole"

Defendants attempt to evade liability by claiming that Statement #1 is mere "hyperbole," when it clearly is not. Defendants falsely accused Scottsdale of being fined $1.5 million for its purported involvement in criminal pump and dump schemes, when, in fact, Scottsdale was fined for mere regulatory violations. Statement #1 is not hyperbolic; it is simply false.

The one case that Defendants rely upon, *Komarov v. Advance Magazine Publ'rs, Inc.*, 691 N.Y.S.2d 298 (NY Sup. Ct. 1999), is easily distinguished. In *Komarov*, the court held that an author's comment during an interview about the plaintiff being as "well known" in his community as John Gotti, "especially read in the context of the article [at issue], where the

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author was clearly trying to elicit a response from [a close associate of the plaintiff about his relationship with the plaintiff]," was "clearly understood as conjecture."

Statement #1, when read in context, is not mere conjecture and it does not merely convey that "everyone knows" there is a connection between pump and dumps and Scottsdale as Defendants claim. Rather, Statement #1 leads the reader to understand that Scottsdale is actively involved in pump and dumps and **was recently fined by FINRA for such involvement**. This is provably false, because Scottsdale has never been fined for its involvement in a pump and dump scheme.

Defendants' inference of criminal conduct is not protected hyperbole, and the Current Motion should be denied.

2. Statement #1 Is False

Defendants next try to evade liability by arguing that Statement #1 is not false. Defendants' argument must fail because Statement #1 falsely implies that Scottsdale was fined $1.5 million for its involvement in the pump and dump of penny stocks. Given the placement of Statement #1 under a headline regarding a $1.5 million fine by FINRA, a reader could reasonably conclude that Scottsdale was fined for its involvement in a pump and dump. Consequently, the implications created by Statement #1 are false.

3. Statement #1 Is Defamatory

Defendants' final argument—that Statement #1 is not defamatory—is a strawman argument that ignores the controlling legal standard.

First, as stated above, "There is no First Amendment protection for a charge which **could reasonably be understood** as imputing specific criminal conduct or other wrongful acts." *Hodgins*, 169 Mich. App. at 253-54 (emphasis added). Instead of addressing this legal standard, Defendants dispute Scottsdale's allegation in the **SAC** (not the operative TAC) that, "Given the placement of False Statement #1 under a headline regarding a $1.5 million fine by FINRA, a reader could only conclude that [Scottsdale] was fined for its involvement in a pump and dump." (*See* Current Motion at p.10 citing SAC ¶14). Although Scottsdale genuinely believes that a

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reader "could only conclude" something defamatory, the standard for defamation by implication is much more lax (i.e., "could reasonably be understood" as defamatory). Defendants fail to address this more lax standard. Because Defendants placed Statement #1 under a headline regarding a $1.5 million fine by FINRA, a reader **could reasonably conclude** that Scottsdale was fined for its involvement in a pump and dump, when in fact, it was not.

Second, Defendants misconstrue defamation by implication. While a media defendant is not "liable for the reader's possible inferences, speculations, or conclusions, where the defendant has not made or directly implied any provably false factual assertion," a media defendant is liable if it has "by selective omission of crucial relevant facts, misleadingly conveyed any false factual implication." *Locricchio v. Evening News Ass'n*, 438 Mich. 84, 144, 476 N.W.2d 112, 139 (1991) (Cavanaugh, C.J., concurring).

When Statement #1 is read in context, it falsely implies that Scottsdale was fined $1.5 million for engaging in illegal pump and dump practices. At no point in the Article do Defendants mention that Scottsdale was fined for selling securities without registration and without an exemption, and **not for engaging in pump and dump schemes**.

Defendants argue that a link to a 111-page FINRA ruling later in the Article "provides the context" for their false and defamatory statements. (Current Motion at p.11). However, "context" for the purposes of determining defamatory meaning is limited to the four corners of the publication. the alleged defamatory statements must be construed only in the context of the document in which they are contained. *Nucor Corp. v. Prudential Equity Grp., LLC*, 189 N.C. App. 731, 736, 659 S.E.2d 483, 487 (2008); *Mandel v. O'Connor*, 99 S.W.3d 33, 36 (Mo. Ct. App. 2003) ("When considering a writing, it is to be interpreted from its four corners and given its ordinary meaning."). Further, by the time a reader arrives at that link and reviews the FINRA decision, the damage has been done: Defendants have already falsely accused Scottsdale of being fined $1.5 million for its involvement in pump and dumps and of engaging in practices shunned by others in its field.

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In sum, Statement #1 is false, defamatory, and not hyperbole. The Court should therefore deny the Current Motion.

D. Statement #1 Is Not Protected by the Substantial Truth Defense

Defendants attempt to evade liability by claiming that the implication created by Statement #1 is substantially true. Defendants are wrong.

A substantial truth defense requires that the gist or sting of the statement be true. *Collins v. Detroit Free Press*, 245 Mich. App. 27, 33 (2001). Here, the gist of Statement #1—that Scottsdale was fined $1.5 million for its involvement in a pump and dump scheme—is demonstrably false.

Defendants argue that Scottsdale conflates committing fraud with being a tool of fraud. (Current Motion at p.12). Defendants are grasping at straws, as Statement #1 falsely implies that Scottsdale was fined $1.5 million for its involvement in a pump and dump scheme. And the FINRA decision to which the Article contains a hyperlink does not provide context for the false and defamatory statement nor evidence that the statement is substantially true. The 111-page FINRA ruling concerned a purported violation of Section 5 of the Securities Act relating to the sale of unregistered securities—not Scottsdale's involvement in a pump and dump scheme.

Hawkins v. Mercy Health Servs., Inc., 230 Mich. App. 315, 335, 583 N.W.2d 725, 734 (1998), is instructive. In *Hawkins*, the court held that a news release stating that a nurse had been terminated for her involvement in administering an overdose was not substantially true because the nurse had actually been terminated for denying that she participated in a conversation criticizing a doctor's standard of care. "Looking at the evidence in a light most favorable to [the nurse] it was erroneous to conclude as a matter of law that the implication created by the [news] release would have the same effect on the mind of the audience as would a statement accurately identifying the reasons underlying the discharge." *Id.*

Hawkins is similar to the fact pattern here, as Defendants stated that Scottsdale was punished for actions that were worse than what actually occurred. Defendants falsely wrote and published that Scottsdale was fined for affirmative intentional actions (pump and dump schemes)

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when it was actually fined for administrative negligence (believing it qualified for an exemption to the requirement to be registered to sell securities). When the allegations in the TAC are viewed in a light most favorable to Scottsdale, it would be erroneous to conclude as a matter of law that the implication created by Statement #1 would have the same effect on the mind as would a statement that accurately identified the reasons for FINRA's fine. Consequently, the Current Motion should be denied.

E. Statement #1 Is Not Protected by the Public Interest Privilege[2]

Defendants' final argument, that Statement #1 is protected by the "fair-comment privilege", is baseless.

Michigan's common law public concern privilege does not require private-figure plaintiffs to allege actual malice. *Rouch v. Enquirer & News of Battle Creek*, 427 Mich. 157, 182, 398 N.W.2d 245, 256 (1986). In *Rouch*, the Michigan Supreme Court questioned whether the common law public concern privilege, which requires the plaintiff to prove both falsity and actual malice if the statements at issue are of a matter of public concern, equally applied to both public figure and private figure plaintiffs. In reviewing cases where the privilege had been applied, including *Lawrence v. Fox,* 357 Mich. 134, 97 N.W.2d 719 (1959), *Peisner v. Detroit Free Press,* 82 Mich. App. 153, 266 N.W.2d 693 (1978), the Supreme Court held that Michigan had "never applied the privilege in a case involving a strictly private-person plaintiff." *Id.* After considering recent constitutional changes to libel law, including the United States Supreme Court decision in *Gertz v. Robert Welch,* the Michigan Supreme Court held that the heightened fault

[2] Michigan has both a fair comment privilege and a qualified public-interest privilege. "Although federal courts applying Michigan law have sometimes confused the fair-comment privilege with the qualified public-interest privilege, the fair-comment privilege is involved only where the matter complained of is comment, as distinguished from statement of fact." *Rouch v. Enquirer & News of Battle Creek,* 427 Mich. 157, 180, 398 N.W.2d 245, 255 (1986) (internal quotes and citations omitted). While Defendants' moving papers use the term "fair comment privilege," the arguments made and cases cited demonstrate that Defendants' are actually referring to the "public-interest privilege."

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requirement would apply to libel cases involving public figures.[3] This decision was affirmed by the Michigan Supreme Court in *Locricchio v. Evening News Ass'n,* 438 Mich. 84, 114, 476 N.W.2d 112, 125 (1991).

Defendants' arguments based upon the public interest privilege are fatally defective.

First, the fine levied on Scottsdale by FINRA is not a matter of public interest. "There is an important distinction between matters which truly promote the public interest and matters which are merely interesting to the public." *Rouch*, 427 Mich. at 163, at 247 (citing 3 Restatement Torts, 2d, § 598, comment [b]). Criminal matters, while interesting, are not always matters of public interest. *Rouch v. Enquirer & News of Battle Creek,* 137 Mich. App. 39, 49, 357 N.W.2d 794, 800 (1984), *aff'd and remanded,* 427 Mich. 157, 398 N.W.2d 245 (1986). Articles meant to update the public on "a continuing violation of the law, like a police burglary ring" have been held as matters of public interests. *Id.* (citing *Stice v. Beacon Newspaper Corp., Inc.,* 185 Kan. 61, 340 P.2d 396, 76 A.L.R.2d 687 (1959)). Similarly, articles about crime by government officials or judicial misconduct when prosecuting crimes have been held as matters of public interest. *Id.* (citing *Miner v. The Detroit Post & Tribune Co.,* 49 Mich. 358, 364, 13 N.W. 773 (1882)); *Lawrence v. Fox,* 357 Mich. 134, 97 N.W.2d 719 (1959) (publication reported that plaintiff, a deputy superintendent of police, had engaged in fraud, corruption, and protection of criminals.); *Peisner v. Detroit Free Press,* 82 Mich. App. 153, 266 N.W.2d 693 (1978) (article accused plaintiff of failing to raise the issue of judicial misconduct on appeal of an indigent defendant's criminal conviction because the plaintiff was the judge's longtime friend and former campaign manager).

Comparatively, publications that simply report that a private-figure previously committed a crime are not necessarily matters of public interest. *Rouch*, 137 Mich. App. at 54-55, 357

[3] *Gertz v. Robert Welch, Inc.*, 418 U.S. 323, 347, 94 S. Ct. 2997, 3010, 41 L. Ed. 2d 789 (1974), held that the *New York Times v. Sullivan* heightened fault standard must be used for actions involving public figures, but "States may define for themselves the appropriate standard of liability for a publisher or broadcaster of defamatory falsehood injurious to a private individual."

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N.W.2d at 802 (citing *McAllister v. The Detroit Free Press Co.*, 76 Mich. 338, 43 N.W. 431 (1889); *Lancour v. Herald & Globe Ass'n.*, 111 Vt. 371, 17 A.2d 253, 132 A.L.R. 486 (1941); *Hornby v. Hunter*, 385 S.W.2d 473 (Tex. Civ. App. 1964); *Phillips v. The Evening Star Newspaper Co.*, 424 A.2d 78 (D.C. App. 1980). *Rouch* concerned a news article reporting the arrest of a man for allegedly raping his ex-wife's teenage babysitter. The Court of Appeal found, and the Supreme Court affirmed that "the details of plaintiff's alleged crime were merely matters that the public would find generally interesting and not matters deserving of robust public debate." *Rouch*, 137 Mich. App. at 58, 357 N.W.2d at 804 ("The fact that plaintiff had been arrested for raping his ex-wife's teenage baby sitter and cutting off the baby sitter's clothes with a knife does not contribute to the public's interest in reducing or detecting crime.").

Here, Defendants allegedly reported on the outcome of a FINRA proceeding in which Scottsdale was fined (although the Article misconstrued the subject of Scottsdale's violation). The Article did not contribute to the reduction or detection of FINRA violations nor report on the wrongdoing of a government officer. *Rouch*, 137 Mich. App. at 58, 357 N.W.2d at 804. Rather, the Article simply reported that a proceeding occurred and on the outcome of the proceeding (albeit, it grossly misstated the outcome).

Even if the Article concerned a matter of public interest (it didn't), the public interest privilege would still not apply because Scottsdale adequately pleaded that Defendants were, at a minimum, negligent in the publication. (*See* Section A, herein).

This instant matter is strikingly similar to the facts in *McAllister v. Detroit Free Press Co.*, 76 Mich. 338, 355, 43 N.W. 431, 437 (1889), in which a newspaper accused the plaintiff of being arrested for felony post office burglary, and the Court found the article to be unprivileged defamation because the plaintiff had actually been arrested for the misdemeanor sale of stamps without a license. The Court held that there was a lack of care on the part of the author and newspaper because they had a copy of the plaintiff's arrest complaint, which stated the charges.

Here, Defendants had access to the FINRA ruling against Scottsdale for violation of Section 5 of the Securities Act but falsely reported that Scottsdale was fined for its involvement

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in pump and dump schemes. Consequently, Statement #1 is not privileged, and the Current Motion should be denied.

F. Leave To Amend Should Be Granted If Necessary

Leave to amend a pleading "shall be freely given when justice so requires." MCR 2.118(A)(2). "Michigan's court rule regarding the amendment of pleadings provides for a liberal handling of requests to amend." *Clapham v. Yanga*, 102 Mich. App. 47, 52 (1980).

Should the Court determine that the TAC is somehow lacking, Scottsdale respectfully requests an opportunity to amend.

CONCLUSION

As demonstrated herein, the TAC alleges sufficient facts to state a cause of action for Defamation against Defendants. Therefore, the Current Motion should be denied.

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Dated: March 19, 2019

By: _____

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In the Kalamazoo County Circuit Court
For the State of Michigan

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff,

v.

MORNINGLIGHTMOUNTAIN, LLC, MICHAEL GOODE, and DOES 1–10,

Defendants.

Civil No. 18-0153-CZ

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DEFENDANTS' REPLY IN SUPPORT OF MOTION FOR SUMMARY DISPOSITION OF THIRD AMENDED COMPLAINT

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I. SPECIAL STANDARD OF REVIEW: Scottsdale ignores the new points raised in Defendants' opening brief that the special standard applies in private-figure cases.

Although the Court previously ruled that the special standard of review in defamation cases is limited to cases involving public officials and public figures, (Op. 4 (Oct. 4, 2018)), Defendants have offered caselaw proving that the special standard also applies in private-figure cases. (Br. 6–8 (citing *Rouch II*, *Trost*, and *Royal Palace Homes*).) Scottsdale offered no critique of these cases when opposing the last motion for summary disposition, and it has failed to do so again. The Court should treat this as a concession that Defendants' analysis is correct.

II. THE STATEMENT: Scottsdale has not addressed Defendants' core arguments.

A. ***Hyperbole.*** As noted in Defendants' opening brief, a challenged statement is not actionable unless it is *provably* false. (Br. 8.) In opposition, Scottsdale simply says the facts of this case are different than the *Komorov* example cited in the opening brief. (Opp'n 6–7.) (Notably, Scottsdale ignores *Hogan*, *Fasi*, *Haberstroh*, or *Springett*. (Br. 9, n. 24.)) Of course, the factual differences are irrelevant; the legal principle is the same. Statements of the "everyone knows" variety are not *provably* false. Scottsdale cannot "poll" the community for its proofs. (Br. 9.) Scottsdale does not dispute this; it offers not a single case where "polling the community" was recognized as a viable means of proving an "everybody knows" statement. (*See* Opp'n 6–7.) Indeed, Scottsdale just ignores the impossibility of its proofs altogether.

B. ***Substantial Truth.*** Scottsdale does not dispute that the actual words of the challenged statement are true. The Court has already agreed with Defendants that the statements are true, too. (Op. 7.)

Instead, Scottsdale argues that the statement falsely implies that FINRA fined it $1.5 million for its involvement in a penny stock pump-and-dump scheme, which it says is an "inference of criminal conduct." (Opp'n 7, Part C.1.) This is unpersuasive for three reasons.

First, FINRA is a *civil* regulatory authority that would have no authority to punish Scottsdale for *criminal* conduct. Keeping in mind that *Air Wisconsin* requires the Court to assess

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the challenged statement from the perspective of the reasonable audience—here, sophisticated consumers of news concerning the penny-stock market—the implication Scottsdale wishes to read into the statement is not reasonable. The reasonable audience for the Article would understand that FINRA fines are civil in nature.

Second, even if the reasonable audience made that unreasonable inference, Scottsdale refuses to acknowledge that a libel defendant "is not responsible for every defamatory implication a reader might draw from his report of true facts, absent evidence that he *intended* the defamatory implication." *Royal Palace Homes, Inc.* v. *Channel 7 of Det., Inc.*, 197 Mich. App. 48, 56 (1992) (emphasis added). Scottsdale has not pleaded any facts from which the Court could reasonably infer that Defendants *intended* the implication that Scottsdale tries to read into the statement. Tellingly, Scottsdale does not cite a single fact *pleaded in the complaint* to establish this intent element. (*See* Opp'n 7–9.)

Third, the implication of which Scottsdale complains is substantially true. "[A] statement is not considered false unless it would have a different effect on the mind of the reader from that which the pleaded truth would have produced." *Hawkins* v. *Mercy Health Servs.*, 230 Mich. App. 315, 332 n.12 (1998) (cleaned up). Here, the pleaded truth is that Scottsdale was fined for selling securities without a registration or an exemption from registration, not for engaging in pump-and-dump schemes. (Compl. ¶ 22; Opp'n 8.) Yet Scottsdale *does not dispute* Defendants' analysis of the FINRA panel's decision, which details how and why FINRA tied the fine to Scottsdale's failure to properly police transactions susceptible to pump-and-dump frauds. (Br. 11–14). FINRA held that shares sold through Scottsdale were not exempt from registration because the exemption required Scottsdale *to properly police transactions*, which it did not do. (*Id.* at 12–13.) Thus, in FINRA's estimation, Scottsdale was partly responsible for the pump-and-dump schemes. Had Scottsdale done its job properly, innocent people would not have lost money. The reasonable audience—sophisticated consumers of news concerning the penny-stock market—would detect no meaningful difference between "engaging in" behavior and

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"being responsible for" that behavior. In both cases, the reasonable audience would understand Scottsdale was culpable for frauds perpetrated on the market.

C. ***Defamatory Meaning.***[1] Scottsdale argues that the FINRA report is not part of the Article that must be reviewed when assessing context. (Opp'n 8.) It cites *Nucor Corp.* and *Mandel*, cases from North Carolina and Missouri, for the proposition that defamatory meaning is judged by the content within the "four corners of the publication." (*Ibid.*) Defendants do not quarrel with that statement of the law conceptually, but the four corners of a publication includes documents attached to the publication, *Service Employees Int'l Union Local 5* v. *Professional Janitorial Serv. of Houston, Inc.*, 415 S.W.3d 387, 402–403 (Tex. App. 2013), just like attachments to a complaint are part of the complaint, *cf. Slater* v. *Ann Arbor Pub. Schs. Bd. of Educ.*, 250 Mich. App. 419, 427 (2002). Neither *Nucor Corp.* nor *Mandel* involved online publications or publications with attachments.[2] Links embedded in online articles are the functional equivalent of attachments. Scottsdale can't complain that the Article omits relevant information about the FINRA report, but then ignore that the Article links the audience to the report, making it available in 10 keystrokes and a few clicks of a mouse—the digital equivalent of turning to a motion's index of exhibits, finding the right exhibit number, and then flipping to the correct tab. *See Adelson* v. *Harris*, 973 F. Supp. 2d 467 (SDNY 2013), *affirmed* 876 F.3d 413 (CA2 2017); *Adelson* v. *Harris*, 402 P.2d 665 (Nev. 2017).

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[1] Scottsdale renews its request for sanctions, arguing the Court has already held the challenged statement to be defamatory. (Opp'n 5, n.1.) Scottsdale misinterprets the Court's statement. (*See* Part II.B, *supra*.) Otherwise, it is dictum; any ruling on the element of truth was not germane to the Court's ruling on the element of fault. Regardless, earlier rulings have no effect *for appellate purposes* because the new complaint *supersedes* the previous complaint, which is "abandoned and withdrawn." MCR 2.118(A)(4); *Grzesick* v. *Cepela*, 237 Mich. App. 554, 562 (1999). Defendants must re-raise their arguments here to preserve their challenges to any earlier rulings. *Cf. id.* at 562–563. This was explained in Defendants' reply brief in support of its last motion. Yet here Scottsdale is again asking for sanctions, recycling the same argument and caselaw, without any effort to rebut *Grzesick*.

[2] The challenged statements were in an email, *Nucor Corp.* v. *Prudential Equity Group*, 659 S.E.2d 483, 485 (N.C. App. 2008), and a letter written to members of a city council. *Mandel* v. *O'Connor*, 99 S.W.3d 33, 37 (Mo. App. 2003).

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Scottsdale also renews its argument that the damage is done by the time the audience reads the FINRA report. This isn't the law. The whole article, including attachments, must be considered. (Br. 13.)

D. ***Fair-Comment Privilege.*** The challenged statement is privileged from liability under Michigan's fair-comment privilege. Rather than address this privilege, Scottsdale argues why the largely defunct public-interest privilege does not apply. *Rouch II*, 427 Mich. 157, 180–182 n.13 (1986) (observing that the public-interest privilege has been largely subsumed under the *New York Times* test). The fair-comment privilege remains and has more recently been called the "qualified privilege," *Dadd* v. *Mount Hope Church*, 486 Mich. 857 (2010). In that *private-figure* case, the Supreme Court held that plaintiffs must prove untruth *and* actual malice" when the privilege applies. *Id.* at 857, n.1. In a partial concurrence, Justice Markman traced the contours of the privilege. *See also*, *id.* at 860–862, 864–867 (Markman, J., dissenting in part).[3]

"The principle of 'fair comment' affords legal immunity for the honest expression of opinion on matters of legitimate public interest when based upon a true or privileged statement of fact." *Deitz* v. *Wometco West Mich. TV*, 160 Mich. App. 367, 376 (1987).[4] Here, the statement is fair comment by a media defendant about disciplinary action taken against a regulated entity whose willful nonfeasance facilitated pump-and-dump frauds, according to a trustworthy source. Scottsdale says that "criminal matters" are not always matters of public interest, (Opp'n 11), but that confuses the real issues of interest to the public in two respects. First, as noted in Part II.B, *supra*, the FINRA fine is a *civil* matter. Second, Defendants provide news to investors, including warnings about stock manipulation schemes to prevent them from being fleeced. The

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[3] Justice Markman's discussion of the qualified privilege is consistent with the majority opinion. The Court differed over whether the jury was properly instructed. The majority did not believe it reversible error for the instructions to omit a reference to "actual malice," finding the use of "reckless disregard" to be sufficient under the circumstances.

[4] *Deitz* says the fault standard is negligence, but that holding is inconsistent with *Dadd*, a subsequent Supreme Court decision that plainly holds to the contrary. *Dadd* 486 Mich. at 857 n.1.

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public has an interest in understanding how pump-and-dump schemes work, how they succeed (in part through companies like Scottsdale failing to police transactions), whether a scheme has been detected or is suspected (so that investors can protect themselves), and whether they have been victimized by a scheme (so they can seek redress), among other interests. To overcome the privilege, Scottsdale must plead and prove actual malice under *Dadd*, even if it claims to be a private figure. It has not done so. (*See* Br. 14–17.)

E. ***Fault.*** Scottsdale alleges that a reasonable journalist "reads the documents he cites." (Compl. ¶ 22.) The Article in which the Statement appears quotes from the FINRA report at length. The only reasonable inference is that Mr. Goode read the report. (Br. 18.)

Scottsdale also alleges that a reasonable journalist would not report or imply that a fine for procedural noncompliance is the equivalent of a fine for intentional pump-and-dump activity. (Compl. ¶ 22.) As noted in Part II.B, the Court has already ruled that Defendants did not report this. Proceeding on a defamation-by-implication theory requires Scottsdale to plead facts from which the Court can infer that Defendants *intended* the implication. In their opening brief, and in Part II.B, *supra*, Defendants observed that Scottsdale has pleaded no such facts. (Br. 17–19.) Scottsdale does not dispute this. (Opp'n 3–4.) Instead, it merely points to its conclusory allegation that Defendants "acted negligently." (*Ibid.*) This is inadequate to state a claim upon which relief can be granted.

Respectfully submitted,

BUTZEL LONG, P.C.

Dated: MARCH 25, 2019

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In the Kalamazoo County Circuit Court
For the State of Michigan

SCOTTSDALE CAPITAL ADVISORS CORPORATION,

Plaintiff,

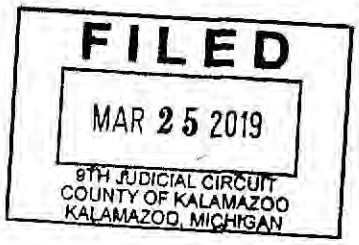
v.

MORNINGLIGHTMOUNTAIN, LLC, MICHAEL GOODE, and DOES 1–10,

Defendants.

Civil No. 18-0153-CZ

HON. ALEXANDER C. LIPSEY



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PROOF OF SERVICE

Michelle L. Guardiola hereby states that on March 25, 2019, she served a copy of Defendants' Reply in Support of Motion for Summary Disposition of Third Amended Complaint and this Proof of Service via ***Federal Express and E-mail,*** addressed to Plaintiff's counsel at the following addresses:

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I declare that under the penalty of perjury that the statements above are true to the best of my information, knowledge and belief.

BUTZEL LONG

Michelle L. Guardiola

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