BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of Department of Enforcement, Complainant, vs. Cantone Research, Inc., Anthony Cantone, and Christine Cantone Tinton Falls, NJ, Respondents.	DECISION Complaint No. 2013035130101 Dated: January 16, 2019

Member firm and its president intentionally made material omissions and a misrepresentation in connection with the sale of securities in a series of private placements, and negligently made additional material omissions in connection with the sales of securities. In addition, member firm, through its chief compliance officer, failed to supervise the firm president in connection with the private placements. Held, findings and sanctions modified.

Appearances

For the Complainant: Noel Downey, Esq., John Guild, Esq., Leo Orenstein, Esq., Department of Enforcement, Financial Industry Regulatory Authority

For the Respondents: Michael Gross, Esq., Heidi VonderHeide, Esq.

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This case arose from the sales of over $8 million worth of certificates of participation ("COPs"), which were tied to underlying projects involving the redevelopment of nursing homes, assisted living facilities, and other real estate ventures owned and controlled by Christopher Brogdon ("Brogdon"). COPs are a type of financing where an investor purchases a share of the revenues of a project rather than the bond being secured by those revenues. Primarily at issue in this case is whether Cantone Research, Inc. ("CRI" or the "Firm"), and Anthony Cantone ("Cantone") failed to disclose to investors negative material information that concerned both Brogdon's past financial and legal troubles and financial issues with the COPs at issue in this appeal. Specifically, the crux of the allegations concern that, when marketing the offerings, Cantone and CRI relied on a biography of Brogdon that highlighted his decades of success and his business acumen related to assisted living and nursing home management and redevelopment. However, the biography excluded negative information related to Brogdon's business failures, including two NASD bars, two bankruptcies, criminal fraud charges, substantial liens against a company he controlled, and a judgment against Brogdon in a breach of contract lawsuit.

The complaint also alleges that CRI and Cantone failed to disclose one of their own significant business failings to investors. In addition to their failures to disclose Brogdon's negative financial and legal history, the complaint alleges that Cantone and CRI did not disclose to investors that Brogdon failed to make timely numerous interest payments, which were covered by undisclosed short term "loans" from the Cantones and CRI, as well as significant financial losses sustained by other Brogdon COPs. The complaint also alleges that Cantone and CRI convinced investors to extend two of the COPs beyond their original maturity dates without disclosing the real reason for the extension—that Brogdon was unable to pay. Finally, the complaint alleges that CRI and Cantone misused customer funds and that Christine Cantone ("C. Cantone") failed to reasonably supervise her husband Cantone's conduct related to these deals.

The Extended Hearing Panel ("Hearing Panel") found that CRI and Cantone intentionally made material omissions and a misrepresentation in connection with the sale of securities in a series of private placements, in violation of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), Exchange Act Rule 10b-5 thereunder, and FINRA Rules 2020 and 2010, and negligently made additional material omissions in connection with the sales of securities, in violation of Sections 17(a)(2) and (3) of the Securities Act of 1933 ("Securities Act"), and FINRA Rule 2010. The Extended Hearing Panel suspended Cantone in all capacities for 15 months and fined him and CRI $150,000, jointly and severally. The Extended Hearing Panel also found that CRI and C. Cantone failed to supervise Cantone reasonably, in violation of NASD Rule 3010 and FINRA Rule 2010. The Hearing Panel suspended C. Cantone in all capacities for six months, and it fined her and CRI $75,000, jointly and severally.

The Extended Hearing Panel concluded that Enforcement failed to establish that CRI and Cantone made improper use of customer funds or recommended an unsuitable investment, and it therefore dismissed these charges.

Pursuant to FINRA Rule 9311, CRI, Cantone, C. Cantone, and FINRA's Department of Enforcement ("Enforcement") each appeal the Hearing Panel's decision. After an independent

review of the record, we modify the Hearing Panel's findings of violations and the sanctions it imposed.

I. Background

A. Cantone Research, Inc.

CRI has been a FINRA member since 1990. CRI maintains its main office in Tinton Falls, New Jersey, and has a branch office in Florida. CRI employs approximately 28 registered representatives and engages in a general securities business.

B. Anthony Cantone

Cantone is CRI's majority owner and its president. He first became registered in 1982 as a general securities representative. In 1995, Cantone became registered through CRI as a general securities representative and general securities principal. He later became registered as a research analyst, research principal, and an investment banking representative during the period at issue in this litigation.

C. Christine Cantone

C. Cantone is married to Cantone. She first became registered with FINRA through CRI as a general securities representative in 1996. She subsequently obtained several other registrations. During the relevant period, C. Cantone was a minority owner of CRI and also served the as the Firm's vice-president and chief compliance officer ("CCO").

Under CRI's written supervisory procedures ("WSPs"), C. Cantone's supervisory responsibilities included reviewing emails and correspondence and ensuring that representatives under her supervision, including her husband Cantone, conducted thorough due diligence. She also handled the books for the Brogdon-related COPs. C. Cantone resigned as the Firm's CCO in 2014, but she still works at the Firm in an administrative function.

D. CRI's Esplanade Development, LLC Default

In November 2005, prior to Cantone's sale of the Brogdon COPs, Cantone Office Center, LLC ("COC") issued $2.6 million of COPs in a promissory note that was issued by Esplanade Development, LLC, related to the development of a Florida real-estate project ("Esplanade I"). COC was owned by the Cantones. The offering documents for Esplanade I stated that COC guaranteed the payment of principal and interest on the COP when due. The COPs were due to mature on November 21, 2007, and Cantone sold the COC COPs to customers of CRI.

In February 2007, COC offered another $5.1 million of Esplanade COPs to CRI customers, which included a similar guaranty by COC regarding the payment of principal and interest ("Esplanade II"). These COPs were due to mature on March 1, 2009.

The COPs were unsuccessful. Cantone testified that, while 90 percent of the completed condominiums were sold, many of the buyers walked away from their purchases when the real estate market collapsed. The developer defaulted on both notes. Esplanade I defaulted in November 2007 and Esplanade II defaulted in March 2009. COC failed to honor its guaranty to pay back the investors' principal and interest.[1]

II. Factual Background

A. CRI's Early Deals with Brogdon

Cantone first met Brogdon in 2003, through JF, a registered representative Cantone had hired to work at CRI earlier that year. JF specialized in high-yield municipal bonds, and CRI had not engaged in bond transactions prior to hiring JF. JF knew Brogdon from previous municipal bond deals and vouched for him, affirming that his business dealings with Brogdon had all been positive. JF also introduced Cantone to attorney MG, who prepared the prospectuses for the Brogdon bond deals. Like JF, MG had a prior long-term relationship with Brogdon.

Cantone participated in nine bond offerings with Brogdon that JF brought to CRI from 2003 to 2008, when JF left CRI. Brogdon, his wife, and the Brogdon Family, LLC, guaranteed the bond offerings. For three of the bond offerings, the borrower was National Assistance Bureau, Inc. ("NAB"), a nursing home management company with which Brogdon was associated. The prospectuses MG drafted for the bond offerings disclosed that NAB filed for bankruptcy in 1990. They did not disclose, however, other negative events in Brogdon's background. Cantone testified that these early deals with Brogdon were all successful.

B. Overview of COPs

Beginning in 2008, CRI began offering securities in the form of COPs to its customers. In total, eight COPs were issued.[2] The COPs were issued by limited liability companies ("LLCs") controlled by Cantone and CRI. All of the COPs were tied to underlying real-estate redevelopment projects controlled by Brogdon. Specifically, Cantone and CRI created an LLC that purchased a promissory note from an entity controlled by Brogdon and issued COPs in the purchased note to customers of CRI for each offering. The first seven COP offerings involved nursing homes and assisted living facilities Brogdon acquired, developed, and managed. The eighth involved a residential real estate project on land Brogdon purchased but was operated by a realtor/builder experienced in constructing single-family homes.

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[1] In November 2015, the New Jersey Bureau of Securities filed a complaint against CRI, Cantone, COC, and C. Cantone, alleging, in relevant part, fraudulent misrepresentations. The matter was settled without an admission of liability.

[2] Enforcement alleges misconduct as to five of the eight COPs issued.

The Brogdon-related COPs were substantially similar. The COPs were offered by one of several LLCs controlled by Cantone. The notes earned 10 percent interest annually, payable quarterly. At maturity, the investors were to receive their principal. If and when Brogdon sold or refinanced the project, investors would receive a share of any profit or capital gain realized by Brogdon.

1. The Confidential Disclosure Memorandum and Brogdon Biography

For each offering, Cantone provided investors with a Confidential Disclosure Memorandum ("CDM") that described the features of the offering. Cantone acknowledged that he was ultimately responsible for the content of the CDMs, and he reviewed the CDMs before they were distributed to investors. The CDM for each offering was similar in form and substance. The CDMs noted that the information in the CDM had been provided by Brogdon, and that Cantone's entity had conducted due diligence and believed that the information was accurate and correct. The CDMs were prepared by MG.

The CDMs stated that investors might receive funds in addition to payments of principal and interest. These included contingent semi-annual payments starting after the maturity date of the note, if the facility generated sufficient cash. Furthermore, upon the sale or refinancing of the facility, investors were to receive a proportionate share of any capital gain realized by the sale or refinancing.

The CDMs for the Brogdon-related COPs at issue all contained a section with an exclusively positive biography of Brogdon, with information going back to 1987. The biography touted Brogdon's experience in the nursing home industry, represented that Brogdon had worked in the "assisted living, nursing home and retirement community business for more than 20 years," and stated that he served as Chairman of the Board of Retirement Care Associates ("RCA"), which also operated assisted living and retirement homes, from 1991 to 1998. The CDMs stated that, from 1994 to 1998, Brogdon was chairman of a Nasdaq-listed medical supply company, and from 1998 to 1999, he was the chairman of NewCare Health Corporation ("NHC"), also a Nasdaq-listed company. According to Cantone, the biographical sketches of Brogdon in the CDMs had the same information as those in the offering materials for the municipal bond offerings he had previously conducted with Brogdon.

The CDMs described risks and warned investors they should purchase Brogdon-related COPs only if they were able to bear the risk involved, which was proportionate with the potential for high yield. In the section describing contingent payments, the CDMs had a bold-font paragraph in capital letters warning investors that there was no assurance that cash flow would generate contingent payments.

2. The Brogdon Guaranty

Except for the last offering, each CDM contained a guaranty committing either Brogdon or another entity closely related to Brogdon to make prompt payments of interest and principal (the "Brogdon Guaranty"). This guaranty named Brogdon, his wife, and the Brogdon Family, LLC as guarantors. It stated that the guarantors provided the Brogdon Guaranty as a condition precedent to the purchase of the underlying promissory notes. The Brogdon Guaranty assured

that the guarantors, for the benefit of the issuing LLC and the holders of the COPs, "absolutely and unconditionally" guaranteed the "prompt payment and performance, as and when due, of all . . . obligations" pursuant to the note to the extent the venture succeeded in generating cash flow, achieved capital gains, or successfully refinanced. The guarantors also agreed to pay all expenses, including legal fees the issuing LLC might incur to enforce the Guaranty. Brogdon or another family member signed the CDM personally and as manager of Brogdon Family, LLC.

After the completion of the municipal bond offerings through JF, and before issuing the Brogdon-related COPs, Cantone conducted additional due diligence to evaluate the strength of the Brogdon Guaranty. This included a review of Brogdon's financial statements and tax returns. Cantone represented that he would not have done the Brogdon deals without the guaranty. Cantone required Brogdon to provide the Brogdon Guaranty because he wanted Brogdon to have a personal stake in the deals in case any of the projects collapsed, as well as to make the projects more palatable to potential investors.

C. Brogdon's Undisclosed Financial and Legal Troubles

While Cantone's due diligence involved a review of Brogdon's finances, it did not include any check into Brogdon's background. At the time CRI and Cantone offered these COPs to CRI's customers, there was significant negative financial and legal information concerning Brogdon that was not disclosed to the investors:

- On July 16, 1984, Brogdon was censured, barred, and fined $10,000 by NASD. The hearing committee found that Brogdon engaged in unauthorized transactions in violation of NASD's anti-fraud rule. Specifically, the hearing committee held that "Brogdon effected the unauthorized purchase of transactions in the customer's account for his own nefarious purposes and revealed his scheme to his superior only after the firm had sustained losses of staggering proportions."

- On January 28, 1985, NASD censured, barred, and fined Brogdon $50,000 for net capital and books and records violations, and for failing to file a Form BD amendment.

- In 1990, NAB, a nursing home management company partially controlled by Brogdon, filed for bankruptcy.

- In 1996, the IRS filed multiple tax liens, totaling approximately $4 million, against RCA at the time Brogdon served as Chairman.

- In 1997, while Brogdon was still serving as RCA's Chairman, several securities fraud class action lawsuits were filed against RCA, Brogdon, and others alleging that Brogdon and his co-defendants misrepresented the success and financial condition of RCA, including its operating income and earnings.

- In 1999, Brogdon was indicted for racketeering, elder abuse, grand theft, and Medicaid fraud in Florida. These charges were "nollo prossed" and the case was subsequently closed without disposition.[3]

- In 1999, NHC, a public corporation that managed assisted living facilities and nursing homes, declared bankruptcy. At the time of the bankruptcy, Brogdon was serving as NHC's Chairman.

- In 2003, a Georgia state appellate court affirmed a summary judgment against Brogdon in a civil lawsuit that found, in relevant part, that Brogdon had failed to honor stock repurchase guarantees.

D. CRI's Initial Due Diligence on Brogdon and Early Red Flags

From 2003 through 2008, Cantone relied on information provided by JF concerning Brogdon in connection with the municipal bond transactions. Cantone conducted little to no independent due diligence on Brogdon. Cantone testified that JF informed him in 2003 that NASD had barred Brogdon.[4] Cantone could not recall if he learned all of the information from JF, or if he had learned some from Brogdon. JF informed Cantone of other "red flags" on Brogdon's record, including a 1990 bankruptcy filing by a company Brogdon managed, civil lawsuits, and an indictment in 1999 for Medicaid fraud. Cantone testified that he and JF discussed the materiality of these negative events, and JF told Cantone he had spoken about them with MG. Cantone also testified that JF provided him with a copy of a Forbes article as part of the due diligence process in 2003, which was critical of Brogdon's ethics in municipal bond deals. JF explained away the concerns and vouched for Brogdon's reliability. JF said that his experience with Brogdon was largely positive, and Cantone decided to trust JF's experience over the Forbes article. JF told Cantone that the defaults on municipal bond offerings discussed in the article were false. Cantone stated that he relied on JF and MG, and they advised Cantone that an NASD bar more than 20 years before was not relevant and need not be disclosed.[5]

C. Cantone testified that she had also discussed with MG whether Brogdon's 1984 NASD bar should have been disclosed prior to the first COP deal, but she had no discussions about

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[3] "Nollo prossed" refers to a formal entry in the record of a court made by a prosecutor in a criminal action declaring the discontinuation, and dismissal, of the action.

[4] Cantone testified that JF informed him that Brogdon's bar for net capital violations was a simple default judgment and was an intentional default as Brogdon was not planning on returning to the industry and "wanted to move on with his life." This characterization is not accurate. In fact, Brogdon did appeal the bar to NASD's Board of Governors, which affirmed the bar.

[5] Cantone testified that he wasn't sure if JF ever informed him that Brogdon was separately barred for making unauthorized transactions in a customer's account.

revisiting the question during the preparation for the subsequent offerings. This was her only testimony about reviewing the CDMs for the Brogdon-related COPs to ensure they contained the necessary disclosures.

Cantone stated that he thought MG was a qualified and competent attorney and as such would have disclosed all required material information about Brogdon's past. In addition, Cantone felt confident enough to go ahead with the Brogdon deals because JF had already conducted research on Brogdon while at previous employers.

Beginning in 2008, after JF's departure, Cantone began conducting due diligence as it related to the specifics of the COP offerings. In addition, Cantone testified that because CRI was about to engage in a new line of business with Brogdon, Cantone wanted additional information and clarification regarding the negative background JF had disclosed to him prior to the municipal bond offerings in 2003, including the criminal charges, the NASD disciplinary proceedings, and the class action suit. In 2008, in response to a request from Cantone, Brogdon provided CRI with a copy of a letter from Brogdon's attorneys, which purported to respond to questions and concerns raised by an unrelated asset management company. The letter explained the details of the Medicaid fraud charges, calling them "utterly groundless" and noting that the prosecutor decided to drop the charges. The letter also claimed that Brogdon had decided to ignore NASD's complaint against him alleging net capital violations because he lacked funds to litigate and had decided not to return to the securities business. The letter went on to note that:

> This matter surfaced again in 1994, when RCA was informed that its application for listing on the NASDAQ would not be approved, in part, because of the NASD Sanctions. On RCA's behalf, we requested and were granted a hearing for an exception to be considered by the Nasdaq Listing and Qualifications Committee (the "Committee"), after which the Committee approved RCA's application. At the time of the hearing, Mr. Brogdon was Chairman and Chief Executive Officer of RCA and its major stockholder. Obviously, the Committee concluded that the NASD Sanctions were insufficient to justify denial of RCA's application.

Cantone testified that he discussed the Medicare fraud charges, the RCA class action, and an NASD proceeding with MG in 2008. MG told him that because the Medicare charges were dropped MG believed they were irrelevant. MG also said that the RCA settlement was not relevant because Brogdon did not have to pay and the action was settled. Cantone testified that, if MG had told him to disclose the fraud charges, the RCA settlement, or NASD action, he would have done so.

E. Cantone and CRI Offered and Sold COPs to CRI Customers

1. Columbia Financial, LLC

In 2009, CRI was presented with a Brogdon project involving the acquisition of an independent and assisted living facility—Richland Pines, in Columbia, South Carolina. At the time of its acquisition, Richland Pines was in foreclosure, and its licenses to operate the facility had lapsed. It had a $6 million mortgage, but its assessed value was only $4 million. Because of

the licensing issues and the depressed real estate market, Brogdon purchased Richland Pines for $3.1, almost $1 million less than the assessed value. The investor funds raised by Cantone were to pay part of the purchase price.

CRI and Cantone conducted due diligence on this proposed deal, including a review of the Brogdon family's financials, the financial information related to the property, real estate appraisals, and operational information on the facility. Cantone and another CRI representative also conducted a site visit to Richland Pines.

Cantone and CRI established Columbia Financial, LLC ("Columbia Financial"), to effect this first of the five Brogdon deals at issue in this matter. On February 1, 2010, Columbia Financial offered $1.7 million of COPs in a promissory note issued by Polo Road Assisted Living, LLC ("Polo Road"). Polo Road was owned by Brogdon's wife and adult son, and it was controlled by Brogdon. The Columbia COP offered 10 percent interest and matured on February 12, 2012 ("Columbia Offering"). The CDM for the Columbia Offering provided that Polo Road would use the net proceeds from the sale of the promissory note to acquire Richland Pines. The CDM for the offering provided that investors' principal and interest would be paid from the following sources: the revenue generated from the ownership and operation of the Richland Pines facility; payments made pursuant to the Brogdon Guaranty; and/or money recovered pursuant to a second lien held by Columbia Financial on the Richland Pines facility.

In addition, the promissory note stated that the failure of Polo Road to make payment of interest or principal within five days after the receipt of notice would constitute a default under the terms of the note. As the payee of the promissory note, Columbia Financial was responsible for enforcing the terms of the note in the event of a default through certain remedial acts, including a demand for immediate payment of the principal and interest. From February 2, 2010, to February 23, 2010, Cantone and CRI raised the $1.7 million for the Columbia Offering from 70 investors, 68 of which were CRI customers.

Under the terms of the Columbia promissory note, Polo Road was obligated to make the first $51,000 payment to Columbia Financial on May 1, 2010, but Brogdon did not make the payment on time. Instead, Brogdon sent a check six days late for $34,000. According to Cantone, Brogdon explained the payment was short because of a "bookkeeping error." On May 10, 2010, C. Cantone wrote a $28,000 check from the Cantones' personal bank account to Columbia Financial, which was then used to pay the investors the outstanding balance of the interest payment. Brogdon reimbursed the Cantones the following month.

The Columbia Offering note matured on February 1, 2012. Polo Road did not repay the principal. On April 3, 2012, Cantone emailed Brogdon and stated that the principal was past due. On April 20, Cantone again emailed Brogdon and complained that Brogdon's failure to pay the principal on time made it difficult to solicit investments in other upcoming Brogdon-related COPs, noting that it was "difficult to have investors send more money for other offerings when they feel insecure based on past offerings," and stating that one investor's "confidence is shaken by all of the above."

On May 12, 2012, Cantone emailed Brogdon that he had failed to make an interest payment that was due on May 1, 2012, and as a result, Polo Road was in default. Cantone's email warned Brogdon:

> It will become increasingly difficult for me to fund projects if we do not keep our commitments on past projects. My salesmanship with investors only goes so far; when you make a guaranty to make a timely payment, you need to make the payment. I do what I can to minimize the damage caused by your late payments []Please make sure that you are not over extending yourself because the trend of late payments is not good for business.

Cantone wired his own funds to Columbia Financial to make this interest payment to investors. When Brogdon missed the next interest payment on August 1, 2012, Cantone again notified Brogdon that he was in default. Cantone provided the funds to Columbia Financial to pay interest to investors for this payment as well.

On October 1, 2012, Cantone agreed to extend the Polo Road note maturity to February 1, 2013 ("First Columbia Extension Agreement"). The First Columbia Extension Agreement stated that Polo Road had been unable to pay principal because the facility had not achieved sufficient occupancy. The agreement increased Brogdon's interest on the note to 14 percent, added $68,000 more in principal, an extension fee of more than $80,000, and attorney's fees of $3,000.

Cantone did not distribute the actual extension agreement to the investors. Cantone sent a letter to Columbia Offering investors to inform them of the extension but did not inform them of Brogdon's missed interest and principal payments or of the additional fees and interest. In addition, the letter did not disclose to investors that Polo Road had defaulted because the facility had not achieved sufficient occupancy or that Brogdon was unable to pay his obligations under the note. Instead, the letter stated that an extension was "granted because the Debtor. . . had a potential buyer for the facility" and "the property will be sold in the near future." When questioned at his on-the-record testimony ("OTR"), Cantone testified that the additional four percent interest was to be paid to him, not to investors, who would continue to receive 10 percent interest.[6] He testified that he did not disclose this to Columbia investors.[7]

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[6] Cantone testified differently at the hearing—that in fact the additional 4 percent was to be paid to the customers and not to him. The Hearing Panel credited Cantone's OTR testimony over his hearing testimony.

[7] Cantone testified at the hearing that, contrary to his earlier testimony, he did disclose the increased interest rate and offered investors the 14 percent interest rate in writing. However, this written disclosure occurred more than a year after the fact, in February 2014, after the 2013 FINRA examination cited him and CRI for their failure to disclose these facts.

On January 21, 2013, Brogdon informed Cantone he would be unable to pay Columbia Offering investors the principal due on February 1 because of the facility's low occupancy. Cantone replied to Brogdon the next day, writing that "without my personal funds to pay off investors, Columbia Financial LLC would have no choice but to bring a lawsuit against you." On February 5, 2013, Cantone told Brogdon he was willing to extend the due date again, postponing the maturity date to February 1, 2014 ("Second Columbia Extension Agreement"). Cantone emailed Brogdon that Brogdon needed to pay an additional $68,000 to cover interest to investors, plus $1,000 in attorney's fees. Cantone testified that he offered to repurchase the Columbia COPs from investors who were not willing to agree to the Second Columbia Extension Agreement. Cantone had to buy out four investors who were unwilling to agree to this one-year extension. Cantone, however, did not disclose to investors that Polo Road had failed to make required interest payments, that CRI and Cantone had covered those missed payments, or that Polo Road was unable to return investors' principal at the time it was due.

After the Second Columbia Extension Agreement, Brogdon continued to miss interest payment deadlines. As a result, Cantone loaned Columbia Financial funds to cover interest payments in May, August, and November 2013, and February 2014.

On November 7, 2014, Columbia Financial sued Polo Road, Brogdon, his wife, and the Brogdon Family, LLC for the unpaid principal, interest, and attorney's fees. On January 4, 2016, the court granted summary judgment in favor of Columbia Financial.

Ultimately, in December 2016, the property sold for $5 million. Columbia Financial received more than $2.8 million from the sale, and it paid investors their principal and all interest due, resulting in a profitable investment.

2. Chestnut Financial, LLC

Cantone created Chestnut Financial, LLC ("Chestnut Financial"), in February 2011 to offer COPs to purchase two notes issued by Brogdon entities to finance the acquisition and development of a campus of assisted living residences—Chestnut Independent Living, LLC, and Highlands Assisted Living, LLC (the "Chestnut Offering"). Located in Highlands, North Carolina, Chestnut Hill is an independent assisted living facility consisting of 36 cottages, and Highlands Assisted Living is a 26-unit assisted living facility.

For his due diligence, Cantone reviewed a 2010 bank appraisal that valued the property at $8.4 million. Cantone also visited the campus as part of his due diligence review. Cantone learned from a local real estate broker that the individual homes, constituting the independent living part of the project, could be sold for $10 million, without including the assisted living apartments and clubhouse. Furthermore, the prior owner had paid $22 million to acquire the facility, while Brogdon had a contract to purchase the property for approximately $7 million. Cantone testified that he was originally concerned about Brogdon's valuation of the facilities because they had a negative cash flow at the time. He asked Brogdon how he expected to be able to pay interest and principal from revenues as the CDM required him to do, given the poor cash flow for 2009 and 2010. Brogdon told Cantone the project would break even when it

achieved 50 percent occupancy. After conducting his due diligence, Cantone concluded that the project was a sensible investment.

According to the CDM dated February 24, 2011, the two entities would use investors' funds to pay part of the cost of buying two senior living facilities. As with the Columbia Offering CDM, the Chestnut Offering CDM provided that investors' principal and interest would be paid from the revenues generated from the ownership and operation of the underlying facilities and payments made pursuant to the Brogdon Guaranty. In addition, Brogdon was to manage the properties and pay principal and interest from revenues realized from the ownership and operation of the living units, or from his own funds as guarantor. The Chestnut Offering CDM stated that Chestnut Financial would purchase the promissory notes from Chestnut Independent Living and Highlands Assisted Living and that Chestnut Financial would issue COPs on those notes to customers of CRI. Further, the CDM specified that the 10 percent annual interest payments were due quarterly on the first day of March, June, September, and December, beginning on June 1, 2011. The notes matured on March 1, 2014. The Chestnut promissory notes defined default as failure to pay within 15 days of a due date.

Between February and March 2011, Cantone solicited investors, sending a number of them an email highlighting the details of the offering—i.e., that it would pay interest quarterly at the rate of 10 percent interest per year for three years, the principal would be repaid in three years, there would be the reassurance of the Brogdon Guaranty, and included equity ownership, entitling investors to additional payments from the cash flow of up to eight percent of each investor's initial investment, and a share of any capital gain realized at the end. Between February 23, and March 4, 2011, 65 investors, some of which were CRI customers, invested in the Chestnut Offering.[8] Cantone and CRI raised approximately $1.8 million.

Both Chestnut Independent Living and Highlands Assistant Living were delinquent in sending the first interest payment that was due on June 1, 2011. On June 13, within the 15-day grace period, Brogdon wired the first quarterly interest payment to Chestnut Financial. However, in the interim, Cantone had reached out to Brogdon to express his concerns over the late interest payment. On June 6, 2011, Cantone reached out to Brogdon's assistant to inform them that three investors had already inquired about the missing interest payments. Cantone stated "This first interest payment is late and this is not good especially since I am trying to convince these same investors to send money to participate in funding for the five nursing homes." On June 7, 2011, Cantone noted that Brogdon's reputation, and Cantone's ability to secure investors for future projects, was harmed by Brogdon's missed and delinquent payments: "It hurts Brogdon's reputation (and my ability to fund future projects) when interest and principal is not paid when due because investors get concerned about his guaranty."

The next interest payment for Chestnut Financial was due on September 1, 2011, and Brogdon failed to pay. On September 23, 2011, the Cantones loaned Chestnut Financial $48,750 so that Chestnut could make the interest payment to investors.

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[8] The Cantone family personally invested $180,000 in the Chestnut Offering.

In February 2012, Cantone sent an email to Brogdon reminding him that an interest payment was due March 1, and expressing concern over whether Brogdon would be able to pay it on time. On March 8, Cantone sent another email to Brogdon, stating that the interest on the Chestnut Offering was one week past due and that "we do not want to cause investors to worry about other projects like Chestnut." On March 13, 2012, Cantone emailed Brogdon a reminder that the interest was now 13 days late, and he threatened that, if payment was not received by March 15, 2012, "the note is in default and the interest rate is reset to 18% instead of [the] current 10%." The Cantones once again loaned money to Chestnut Financial to cover Brogdon's interest payment. On March 29, Brogdon made the interest payment.

The next interest payment was due on June 1, 2012, and again Brogdon failed to pay. On June 8, Cantone loaned the funds to Chestnut Financial to pay investors. On July 12, Cantone sent Brogdon an email reminding him the June interest payment was still outstanding, and the previous quarter's interest had been late enough to give Chestnut Financial the right to declare it in default. The next interest payment was due on September 1, 2012. In an email exchange on September 11 and 12, 2012, Cantone reminded Brogdon he had not made the payments due on June 1 and September 1 despite his personal guaranty. On September 12, Cantone again loaned Chestnut Financial funds for the September interest, which Brogdon did not repay, and again on December 4, 2012, for the December interest. On December 17, Chestnut Financial received a payment from Brogdon for the December interest.

Cantone testified that, by March 2013, he was growing more concerned by Brogdon's missed and delinquent interest payments, and that Brogdon was "overstretched." On March 19, 2013, Brogdon sent Cantone an email saying he was searching for funds to cover the Chestnut interest payment that was past due. The next day, Cantone confronted Brogdon in an email, noting that he had gotten "many phone calls from investors about the quarterly interest they expected by now. Technically, you now owe 18% instead of 10% because you did not pay on time." Brogdon responded, "I guess you have nothing to do but bug me." In an email response, Cantone asked "What would you do if you loaned me money and I did not pay back the principal back in accordance to our agreement?" Cantone went on to complain:

> The problem is even worse because I have about 100 investors that can file a lawsuit against me for not enforcing the terms of the agreements on the various projects we financed. <u>You</u> guaranteed the prompt payment of interest and principal. Yet <u>I</u> had to pay back the principal to five investors who did not want to extend the Polo Road/Columbia Note to avoid complaints to FINRA. I paid the quarterly interest on Chestnut several times because you could not come up with the money.

On May 24, 2013, Chestnut Financial sent an invoice to Brogdon that reflected unpaid interest payments for March, June, and September 2012, and March 2013, and interest that would be due on June 1, 2013, plus administrative fees, for a total of approximately $350,000.

In December 2013 and March 2014, Cantone again loaned the funds to Chestnut Financial to make interest payments to investors that Brogdon should have paid. Principal was

due on March 1, 2014. On June 24, 2014, Chestnut notified Brogdon that the note was in default and demanded payment. On August 12, 2014, Chestnut filed suit to enforce the Brogdon Guaranty. Chestnut Financial obtained a judgment against Brogdon. At the time of the hearing below, the property was on the market, the Chestnut project remained in default, and investors had not yet received full interest or principal payments from Brogdon.

3. Oklahoma Financial, LLC

Cantone created Oklahoma Financial, LLC ("Oklahoma Financial"), in or around June 2011 to offer COPs to purchase a promissory note issued by Oklahoma Operating, LLC ("Oklahoma Operating"), a Brogdon entity, to finance the acquisition of five separate nursing home facilities in Enid, Oklahoma and Grove, Oklahoma (the "Oklahoma Offering"). The Oklahoma Offering CDM contained terms that were similar to those of the earlier offerings: 10 percent interest payable quarterly, maturity in two years, semiannual equity payments to be generated by operating proceeds, and a proportionate share of any capital gains earned when the properties were sold or refinanced. As with the Chestnut Offering, the Oklahoma Offering provided for a 15-day grace period from the due date of interest and principal payments before a missed payment would be considered a default. The risk warnings in the CDM stated that there was no assurance that the homes would generate sufficient revenues to pay investors the semi-annual contingent payments, or that investors would receive capital gains.

Unlike the previous deals, Cantone did not visit the Oklahoma nursing homes as part of his due diligence. The facilities were operating successfully, and he was satisfied with the appraisals, the facilities' cash flows, their financial statements, and Brogdon's documentation of his finances. Cantone did, however, collect information similar to that he reviewed in the due diligence for the previous COP offerings, including environmental assessments, appraisals, and operating agreements for all five of the nursing homes. Brogdon also sent Cantone eight months of financial statements from the previous owner of the five nursing homes. Cantone was impressed by the fact that the purchase price of each of the nursing homes was significantly below the appraised value of the homes.

Cantone solicited investors for the Oklahoma Offering from June 2011 to August 2011 and raised $2.8 million to purchase the note from Oklahoma Operating.[9] In some communications with prospective investors, Cantone identified the Brogdon Guaranty as a selling point, and touted Brogdon's accomplishments. At the time of these solicitations, however, Cantone was separately expressing his concerns about Brogdon's reputation and ability to pay, noting in an email dated June 7, 2011, that "it hurts Brogdon's reputation (and my ability to fund future projects) when interest and principal is not paid when due because investors get concerned about his guaranty. There is an indication that Brogdon is stretched too far and that his guaranty is no longer reliable."

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[9] Cantone and C. Cantone invested $100,000 in the Oklahoma Offering, and family members invested another $120,000 based on Cantone's recommendations.

The Oklahoma Offering CDM provided that the offering was to raise $2.8 million to assist a Brogdon entity to purchase five nursing homes. Oklahoma Financial purchased the note at a discount, and was to send Brogdon $2,547,500. However, on July 28, 2011, Cantone wired $2,483,000 to Brogdon—$64,500 less than the full amount owed. An entry in Oklahoma Financial's books stated $64,500 "held for amt Brogdon owes Hoover." This was a reference to another Brogdon COP offering that was unrelated to Oklahoma. Under the Hoover CDM, Brogdon's entity was obligated to make a semi-annual equity payment of $64,500, which was due on July 1, 2011, but not paid.

In an August 15, 2011 email to Brogdon, Cantone referred to a need to "settle up on Hoover" and went on to state that "we still have $64,500 in the escrow account" for the Oklahoma Offering "that you had me withhold at the time of closing. We can use these funds to make the monthly payments you suggest below." The bank records for Brogdon Family, LLC show that, on August 17, 2011, Brogdon Family LLC received two deposits of $64,500—one deposit from the Oklahoma Offering and the other from another Brogdon entity. On the same day, the Brogdon account wired $64,500 to Hoover. Once the wire was received, Cantone issued checks to Hoover investors.

Brogdon managed to make interest payments to Oklahoma investors in a relatively timely matter. However, Brogdon did not pay the principal when it came due in July 2013. On July 10, 2013, Oklahoma Financial and Oklahoma Operating entered into an agreement, extending the maturity date of the note to January 15, 2014 ("Oklahoma Extension Agreement"). Under the terms of the Oklahoma Extension Agreement, Brogdon agreed to increase the interest rate from 10 percent to 14 percent, make an additional interest payment of $56,000, and pay an "extension fee" of $56,000. The increased interest resulted in the previous $84,000 interest payment being increased to $112,000, payable on July 15, 2013, October 15, 2013, and January 15, 2014.[10] While Cantone admitted that he did not mail a copy of the Oklahoma Extension Agreement to his investors, he testified that he "fully disclosed" the increase in the interest rate.[11]

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[10] Under the terms of the extension agreement, Brogdon was obligated to pay interest and fees of $112,000. However, Brogdon paid only $84,000, the amount due prior to the extension. Cantone did not inform Oklahoma investors of this underpayment.

[11] Cantone's testimony is contradicted by the record. In a letter Cantone sent to Oklahoma investors describing the Oklahoma Extension Agreement, Cantone wrote that Brogdon had agreed to continue paying 10 percent interest. The letter does not disclose the increase to 14 percent. When asked about this in his OTR, Cantone testified that investors would not be interested in the 4 percent Cantone was to receive—they just wanted assurances they would continue to receive the promised 10 percent. Cantone later acknowledged, in response to the 2014 FINRA letter summarizing the findings of the 2013 FINRA examination that Cantone's letter to investors "contained an error of fact regarding the actual interest rate the borrower agreed to pay."

Brogdon defaulted on the principal payment that was due on January 15, 2014. Cantone then filed suit against Brogdon, his wife, and the Brogdon Family LLC, and obtained a judgment for return of principal and interest. Cantone testified at the hearing below that the nursing homes were listed for sale for $14 million and that two potential buyers have shown interest. Since Brogdon paid $11.5 million, and did not need to invest in any significant capital improvements, Cantone believes investors will realize a substantial capital gain if the nursing homes are sold for the asking price.

4. Cedars Financial, LLC

Cantone created Cedars Financial, LLC ("Cedars Financial") to offer COPs to purchase a promissory note, issued by Cedala, LLC, an entity owned by Brogdon's wife but controlled by Brogdon ("Cedars Offering"). Cedala was the "equitable owner" of a 61-unit assisted living facility in Montgomery, Alabama. On August 15, 2011, in an email to Cantone regarding the deal, Brogdon explained: "[Cantone and CRI] would be buying a 25 percent interest in an assisted living building that is very profitable for $550,000. The building is worth $6,000,000." Brogdon wrote that he intended to sell or refinance the facility the following year. Cantone responded the same day, asking Brogdon for ownership history, including financial statements, Cedala's 2010 tax return, and other information about the condition of the facility.

On August 19, 2011, Brogdon provided Cantone with income statements for Cedala that revealed that Cedala had sustained the following net losses for the years 2008, 2009, and 2010—($109,735.73), ($232,349.04), and ($127,525.92.13), respectively. Cantone questioned Brogdon about his estimate of the value of the property in another email, asking "How can you justify a value of $6 million on Cedala when the income statement and tax return show an operating loss of $240,000 in 2009?" Brogdon provided an income statement for the first six months of 2011, which showed increased revenues and profitability. While the information concerning Cedala's recent profitably provided Cantone with sufficient confidence to go forward with the deal, he nevertheless failed to disclose the previous years' losses to investors.

Cantone testified that his due diligence for the Cedars Offering was similar to the due diligence he conducted for the other offerings. He did not ask for a new appraisal but obtained a 2004 appraisal, and he sought information on sales of comparable properties, in addition to the income statements discussed above.

The COPs offered 10 percent annual interest and matured in two years, on September 15, 2013. As with the prior CDMs, the Cedars CDM provided that investors' principal and interest would be paid solely from revenues generated from the facility or by payments made by the Brogdons pursuant to the Cedars Guaranty Agreement. If Cedars Financial did not receive principal and interest within fifteen days, it would be an "Event of Default." The CDM did not disclose the facility's losses in 2008, 2009, and 2010.

From August 22 through August 24, 2011, CRI and Cantone solicited investors, including CRI customers, to purchase Cedars COPs. During that period, 24 investors invested approximately $550,000.

As with prior deals, Cedala failed to make the interest payments in a timely manner. In December 2012, June 2013, and September 2013, Cedala failed to make its interest payments to Cedars Financial. On each occasion, Cantone "loaned" Cedars Financial funds from his joint account with C. Cantone, which were then used to pay interest to investors.

The promissory note matured in September 2013. In a February 2013 email, noting that Brogdon needed extensions to repay principal on two other projects, Cantone warned Brogdon that if he failed to repay principal when due, Cantone would "have no choice" but to sue. Brogdon defaulted on the promissory note, and in June 2014, Cedars Financial sued Brogdon as Cantone had promised. The court granted summary judgment, awarding Cedars Financial almost $700,000 in principal, interest, and costs, and investors received their principal and outstanding interest. In May 2015, Cedars Financial returned the outstanding principle to investors.

After the Cedars Offering, Cantone decided that he would conduct no further offerings containing the Brogdon Guaranty.

5. Cherokee Financial, LLC

Cherokee was the final Brogdon-related COP. Cantone created Cherokee Financial, LLC ("Cherokee Financial") to offer COPs in a promissory note issued by Arcadia Partners, LLC ("Arcadia"), an entity owned and managed by Brogdon (the "Cherokee Offering").[12] The promissory note was secured by a deed, subordinate to a senior deed held by participants in a bond issue by Brogdon's entity, Chelsea Investments, LLC ("Chelsea"), which raised the funds for the purchase of the land.

Brogdon had purchased land, below market value, located next to a retirement facility in Conyers, Georgia, on which he planned to build age-restricted townhomes with a clubhouse and other common areas. Brogdon's partner was a real estate developer, BA, who worked with him at RCA and on the Chestnut facilities renovations. As Brogdon's expertise was in the assisted living industry, not building and selling homes, BA was tasked with managing the project. Arcadia planned to use the proceeds from the Cherokee Offering for constructing the first phase of the project. With the note purchase, the Cherokee Offering and its investors acquired an ownership interest in Arcadia. Arcadia was to retain BA's company to construct the homes and manage the project.

The Cherokee offering resembled the previous Brogdon-related COPs, except the note was to mature in five years, not two. Arcadia was to pay Cherokee investors 10 percent in

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[12] Brogdon first approached Cantone in April 2012 about land located next to a retirement facility in Conyers, Georgia that he had previously developed. Cantone was initially uninterested in the deal as the real estate market at the time did not look favorable. By January 2013, however, Cantone heard reports that home sales nationally were rebounding, and he decided to take another look at the project.

quarterly payments and a share of profits generated by sales of the homes. The minimum share of profits for investors was to be $5,000 per home, and after the first 15 were sold, the minimum profit was to increase to $9,000. The Cherokee promissory note defined a default as occurring if an interest payment was not made within 15 days of the due date.

Cantone testified that his due diligence included reviewing the certificate of organization for Arcadia, documentation for the first mortgage on the property, and the money Brogdon borrowed to develop infrastructure. He asked Brogdon for details on the finances of the project, including Brogdon's expected cash flow and projected profits, as well as information on nearby comparable home sales, documentation of the bank's willingness to discount the mortgage, and financial statements for 2012 for the other Brogdon-related COPs. Those statements showed net losses for the Cedars, Chestnut, and Columbia Offerings.

Cantone also made a site visit and reviewed a personal financial statement for BA that showed BA's net worth in excess $8 million. In addition, during this time period, Cantone had worked successfully with BA on another project, and the fact that BA was not only the builder but was also a real estate agent with an existing network to market and sell the homes appealed to Cantone. Cantone testified that he reviewed a real estate appraisal giving the property a market value of $3.6 million, significantly more than what Brogdon planned to pay for it.

Between April 22, 2013, and June 11, 2013, CRI and Cantone solicited investors, including CRI customers, to invest in the Cherokee Offering. During this period, 53 investors invested approximately $1,825,000 with CRI and Cantone. The CDM, dated May 28, 2013, did not mention the Brogdon Guaranty. Instead, Chelsea guaranteed the prompt payment of interest and principal (the "Chelsea Guaranty"). The CDM for the Cherokee Offering provided that investors' principal and interest would be paid solely from the revenues of the underlying real estate development project, and its sale of the individual property units, and payments made pursuant to the "Guaranty Agreement." [13] Regardless of the name change, the guarantying entity, Chelsea Investments, was still controlled by Brogdon, with the CDM noting:

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[13] Cantone testified he lost confidence in Brogdon's guarantee since Brogdon had failed on multiple occasions to make interest payments on time and defaulted in previous offerings. Cantone also testified that, when MG began drafting the Cherokee CDM, he told Cantone if he included the Brogdon Guaranty, he would have to disclose Brogdon's "multiple failures to perform under previous guaranties." Therefore, Cantone and MG agreed not to include a Brogdon Guaranty in the Cherokee CDM. Cantone testified that he also instructed MG to "de-emphasize the [Chelsea] guaranty" in the Cherokee CDM. As requested, MG included a warning in the CDM in bold, capital letters stating, "**POTENTIAL INVESTORS SHOULD MAKE THEIR INVESTMENT DECISION BASED UPON THEIR EVALUATION OF THE DEVELOPMENT PROJECT, AND NOT IN RELIANCE UPON THE CHELSEA GUARANTY AGREEMENT.**"

> Christopher F. Brogdon is the central participant in the transactions described in this Confidential Disclosure Memorandum . . . . Chelsea Investments, L.L.C. ("Chelsea") is wholly-owned by Brogdon Family, L.L.C. ("Brogdon Family"). Chelsea is managed by Mr. Brogdon. Brogdon Family is also controlled by Mr. Brogdon. Mr. Brogdon owns all of the equity interests in Arcadia Lender, and 35% of the equity interests in Arcadia Partners.

Cantone testified at the hearing that six homes had been sold, the clubhouse was finished, and two other homes were under construction. Investors have received their interest payments in addition to their profit shares from the sales. The note's maturity date was May 2018.

III. Procedural History

A. Origins of the Investigation

This case originated with a 2013 routine FINRA cycle examination of CRI. FINRA staff conducted its opening interview with CRI on June 17, 2013. In response to FINRA staff's questions, Cantone represented that that there had been no defaults, late payments, or extensions in any of the Brogdon-related COPs. FINRA later learned that Cantone's initial representations were inaccurate as FINRA examined the bank records for the LLCs and saw that many of the payments were made by Cantones or an entity which with they were affiliated rather than by the Brogdon entities. FINRA reviewed emails that corroborated that the payments were being made by the Cantones. The emails also included many communications where Cantone was requesting that Brogdon make the payments to investors as directed by the offerings. FINRA staff then conducted internet searches of Brogdon. The searches revealed the negative financial and legal information discussed above, none of which was a part of CRI's files.

B. Enforcement's Complaint

On November 20, 2015, Enforcement filed a five-cause complaint against CRI, Cantone, and C. Cantone, four of which are at issue in this appeal.[14] The first cause of action alleged that CRI and Cantone knowingly or recklessly made fraudulent misrepresentations and omissions of material facts in connection with the offer and sale of five Brogdon-related COPs from 2010 to April 2013, in willful violation of Section 10(b) of the Exchange Act, Exchange Act Rule 10b-5, and FINRA Rules 2020 and 2010. In the alternative, Enforcement alleged in cause two of the complaint that Cantone and CRI made these alleged misrepresentations or omissions negligently, violating Sections 17(a)(2) and (3) of the Securities Act, and thereby violating FINRA Rule

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[14] Enforcement did not appeal the Hearing Panel's dismissal of the fourth cause of action, which alleged that in, recommending the Cherokee Offering, CRI and Cantone failed to conduct reasonable due diligence into the underlying real estate project and ignored multiple "red flags" related to Brogdon, and therefore lacked a reasonable basis for believing that the offering was suitable for any investor.

2010. Enforcement alleged that CRI, acting through Cantone, misrepresented and failed to disclose the following information in connection with the sale and related extension agreements of the COP offerings to its investors:

- Brogdon had twice been barred by NASD;
- Brogdon had been indicted for fraud;
- A Georgia appellate court had affirmed a judgment filed against Brogdon in a civil lawsuit that found that Brogdon had failed to honor a stock repurchase guaranty agreement;
- Several entities controlled by Brogdon had filed for bankruptcy, had tax liens filed against them, and/or were sued for fraud and misrepresentation;
- Cantone, through COC, had issued approximately $7.7 million worth of COPs in the COC COP offering—Esplanade—which defaulted;
- The Brogdon entities' late and missed interest payments in the Columbia Financial, Chestnut Financial, and Cedars Financial Offerings;
- The Brogdon entities' failure to make required principal payments in the Columbia Financial Offering in February 2012, August 2012, and February 2013;
- Cantone's and C. Cantone's coverage of interest payments in the Columbia Financial, Chestnut Financial, and Cedars Financial Offerings, in contravention of the CDMs;
- Cantone's negotiation of secret terms in the extension agreements, including "extension fees" and increased interest rates on the underlying promissory notes in the Columbia Financial and Oklahoma Financial Offerings;
- In or about May 2013, Chestnut Independent Living and Highlands Assisted Living owed Chestnut Financial approximately $350,000 for past due payments, interest, and late fees;
- Cedala had sustained the following net losses for the years 2008, 2009, and 2010, respectively: $109,735.73; $232,349.04; and $127,525.92;
- In 2012, Polo Road, Chestnut Independent Living, Highlands Assisted Living, and Cedala collectively lost more than $2 million; and
- That $64,500 of investor funds from the Oklahoma Financial Offering were used to pay investors' interest on a separate COP offering.

The third cause of action alleged that CRI and Cantone made improper use of customer funds, in violation of FINRA Rules 2150 and 2010. The fifth and final cause of action alleged that CRI and C. Cantone were responsible for Cantone's supervision, and while aware of the negative facts material to the Brogdon-related COP offerings, failed to supervise Cantone, in violation of NASD Rule 3010 and FINRA Rule 2010.

C. Hearing Panel Decision and Appeal

The Hearing Panel issued its decision on May 12, 2017, after an eight-day hearing. The Hearing Panel determined that three events in Brogdon's history were material and should have been disclosed to investors in all five of the private placements: (1) the approximately $4 million in federal tax liens filed in 1996 against RCA while Brogdon was its chairman; (2) the 1999 NHC bankruptcy filing while Brogdon was its chairman; and (3) the 2003 Georgia state appellate court decision concerning Brogdon's failure to honor a personal guaranty that he had originally proposed to induce a stock sale. The Hearing Panel concluded that CRI and Cantone's failures to disclose these three events were negligent, in contravention of Sections 17(a)(2) and (3) of the Securities Act, thereby violating FINRA Rule 2010.

The Hearing Panel also found that Brogdon's undisclosed and increasingly frequent missed payments of interest and principal, the undisclosed increase in the interest rate, and the additional fees Cantone charged Brogdon for the extensions were material to Columbia and Oklahoma Offering investors who were presented with the option of agreeing to extensions of the maturity dates of the notes in those offerings. The Hearing Panel further concluded that the misrepresentation made in the letter to Oklahoma Offering investors regarding the interest rate Cantone charged Brogdon was material and should have been disclosed. The Hearing Panel also concluded that CRI and Cantone should have disclosed to prospective Cherokee Offering investors that: (1) Brogdon had missed or made late interest payments to investors in the previous offerings; (2) Brogdon's arrearage of more than $350,000 owed to the Chestnut Offering; (3) and the financial problems facing the facilities Brogdon was managing for the Columbia, Chestnut, and Cedars Offerings. The Hearing Panel determined that CRI and Cantone acted with scienter, and willfully violated Section 10(b) of the Exchange Act, Exchange Act Rule 10b-5, and FINRA Rules 2020 and 2010, as charged in the complaint's first cause of action.

The Hearing Panel also concluded that C. Cantone and CRI failed to supervise Cantone reasonably, in violation of NASD Rule 3010(a) and FINRA Rule 2010.

However, the Hearing Panel determined that CRI and Cantone were not required to disclose that Brogdon was twice barred by NASD, Brogdon had been indicted for fraud, Brogdon's NAB bankruptcy and class action suits, or CRI's failed Esplanade deal. The Hearing Panel further ruled that CRI and Cantone were also not required to disclose the missed interest payments in the Columbia, Chestnut, and Cedars Offerings. The Hearing Panel also dismissed the charges that CRI and Cantone misused customer funds and made unsuitable recommendations to investors in the Cherokee Offering. This appeal followed.

Both Enforcement and respondents appeal the Hearing Panel's findings. Respondents argue that the Hearing Panel erred in the following ways:

- Finding that the $4 million in federal tax liens, the 1999 NHC bankruptcy filing, and the 2003 Georgia state appellate court decision were material;

- Finding that Brogdon's financial troubles in the earlier COPs were material to the investors in the Cherokee Offering;

- Finding that CRI and Cantone omitted and misrepresented material facts in connection with the extension agreements for the Columbia and Oklahoma Offerings;

- Concluding that Cantone and CRI acted fraudulently or negligently;

- Finding no reasonable reliance on counsel;

- Finding that CRI and C. Cantone failed to supervise Cantone; and

- The severity of the sanctions imposed on all respondents.

Conversely, Enforcement appeals the following aspects of the Hearing Panel Decision:

- Finding that CRI and Cantone were not required to disclose that Brogdon was twice barred by NASD, Brogdon had been indicted for fraud, Brogdon's NAB bankruptcy and class action suits, or CRI's failed Esplanade deal;

- Finding that CRI and Cantone were not required to disclose the missed interest payments in the Columbia Financial, Chestnut Financial and Cedars Financial Offerings; and

- Dismissal of the charges that CRI and Cantone misused customer funds.

Enforcement also requests that Cantone be barred, CRI expelled, and restitution awarded.

IV. Discussion

A. Fraud and Negligent Misrepresentation Charges

A central issue of this appeal involves an assessment of the information that CRI and Cantone did not disclose to investors. CRI and Cantone failed to inform investors of Brogdon's history of financial and legal troubles, his numerous late payments of interest and principal, Cantone's loans to cover those payments, the details of Cantone's extensions of note maturity dates, the significant financial losses sustained by the offerings, and respondents' failed Esplanade deal.

Enforcement contends that CRI's and Cantone's omissions and misrepresentations constitute fraud, or at a minimum, negligent omissions and misrepresentations. Respondents maintain that none of the information that they failed to disclose to investors was material, and that with respect to the allegations related to Brogdon's late or missed payments and other

financial problems with the private placements, the misrepresentations were not made in connection with the purchase or sale of a security.

1. Legal Standard

a. Fraudulent Misrepresentations or Omissions

Exchange Act Section 10(b) makes it unlawful "to use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of" Commission rules. 15 U.S.C. § 78j(b). Exchange Act Rule 10b-5 makes it unlawful, "in connection with the purchase or sale of any security," to "make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." 17 C.F.R. § 240.10b-5(b). As the Commission has recently noted:

> Rule 10b-5 imposes a duty to disclose material facts that are necessary to make disclosed statements, whether mandatory or volunteered, not misleading. That duty is a general one, and arises whenever a disclosed statement would be 'misleading' in the absence of the disclosure of additional material facts needed to make it *not* misleading.

Louis Ottimo, Exchange Act Release No. 83555, 2018 SEC LEXIS 1588, at *31 (June 28, 2018), *appeal docketed*, No. 18-2534 (2d Cir filed Aug. 24, 2018).

To establish a violation under Exchange Act Section 10(b) and Exchange Act Rule 10b-5, a preponderance of the evidence must demonstrate that CRI and Cantone misrepresented a material fact (or omitted a material fact which they had a duty to disclose), with scienter, in connection with the purchase or sale of securities.[15] *See Fuad Ahmed*, Exchange Act Release No. 81759, 2017 SEC LEXIS 3078, at *25 (Sept. 28, 2017).

Enforcement also contends that Cantone's and CRI's violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder were willful. A violation is deemed willful if "the person charged with the duty knows what he is doing." *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000). To find that Cantone and CRI acted willfully, the adjudicator need only find that they "voluntarily committed the act that constituted the violation." *Dep't of Enforcement v. Gallagher*, Complaint No. 2008011701203, 2012 FINRA Discip. LEXIS 61, at *25 (FINRA NAC Dec. 12, 2012).

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[15] Violations of these provisions also must involve the use of any means or instrumentalities of communication in interstate commerce, the mails, or of any national security exchange. *See* 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5. Respondents CRI and Cantone do not dispute that they employed instrumentalities of interstate commerce to solicit investments in the Brogdon-related COPs. Cantone solicited and communicated with customers via email and telephone, and used interstate wires to send and receive investors' funds.

FINRA Rule 2020 is FINRA's anti-fraud rule. It prohibits FINRA members and their associated persons from "effect[ing] any transaction in, or induc[ing] the purchase or sale of, any security by means of any manipulative, deceptive or other fraudulent device or contrivance." Such misconduct also violates FINRA Rule 2010. *William Scholander*, Exchange Act Release No. 77492, 2016 SEC LEXIS 1209, at *15 (Mar. 31, 2016), *aff'd sub nom. Harris v. SEC*, 712 F. App'x 46 (2d Cir. 2017). "Conduct that violates the Commission's or FINRA's rules, including the antifraud rules, is inconsistent with 'high standards of commercial honor and just and equitable principles of trade' and violates FINRA Rule 2010." *Dep't of Enforcement v. Ahmed*, 2015 FINRA Discip. LEXIS 45, at *89 n.83 (FINRA NAC Sept. 25, 2015), *aff'd*, Exchange Act Release No. 81759, 2017 SEC LEXIS 3078 (2017).

b. Scienter

"Scienter is defined as 'a mental state embracing intent to deceive, manipulate, or defraud.'" *Dep't of Enforcement v. Akindemowo*, Complaint No. 2011029619301, 2015 FINRA Discip. LEXIS 58, at *33 (FINRA NAC Dec. 29, 2015) (quoting *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976), *aff'd*, Exchange Act Release No. 79007, 2016 SEC LEXIS 3769 (Sept. 30, 2016). Scienter "is established if a respondent acted intentionally or recklessly." *Id.* (citing *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 n.3 (2007)). "Reckless conduct includes 'a highly unreasonable omission, involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.'" *Dep't of Enforcement v. Fillet*, Complaint No. 2008011762801, 2013 FINRA Discip. LEXIS 26, at *35 (FINRA NAC Oct. 2, 2013) (*quoting Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977)), *aff'd*, Exchange Act Release No. 75054, 2015 SEC LEXIS 2142 (May 27, 2015).

c. Materiality

"Whether information is material 'depends on the significance the reasonable investor would place on the . . . information.'" *Dep't of Enforcement v. Akindemowo*, 2015 FINRA Discip. LEXIS 58, at *32 (quoting *Basic Inc. v. Levinson*, 485 U.S. 224, 240 (1988)). In the context of Exchange Act Rule 10b-5, a fact is material if a reasonable investor would view the disclosure of the omitted information as "significantly alter[ing] the total mix of information made available." *Levinson*, 485 U.S. at 232.

d. Negligent Misrepresentations or Omissions

As an alternative to the scienter-based fraud charges, the complaint alleges that CRI and Cantone violated FINRA Rule 2010 by acting in contravention of Section 17(a) of the Securities Act. Section 17(a)(2) of the Securities Act makes it unlawful in the offer or sale of securities "to obtain money or property by means of any untrue statement" or omission of a material fact. Section 17(a)(3) prohibits, in the offer or sale of any securities, engaging "in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser." Sections 17(a)(2) and (3) do not require a showing of scienter; negligence is sufficient. *U.S. v. Aaron*, 446 U.S. 680, 686-87 n.6 (1980). Negligent conduct under Sections

17(a)(2) and (a)(3) is a failure "to use the degree of care and skill that a reasonable person of ordinary prudence and intelligence would be expected to exercise in the situation." *SEC v. True North Fin. Corp.*, 909 F. Supp. 2d 1073, 1122 (D. Minn. 2012). This standard of care imposes a duty to take reasonable steps to become informed about a recommended security, and to do much more than rely unquestioningly on information an issuer provides. *Dep't of Enforcement v. Reynolds*, Complaint No. CAF990018, 2001 NASD Discip. LEXIS 17, at *42-43 (NASD NAC June 25, 2001). Negligent misrepresentations violate Rule 2010. *See Dep't of Enforcement v. Pellegrino*, Complaint No. C3B050012, 2008 FINRA Discip. LEXIS 10, at *13-14 n.13 (FINRA NAC Jan. 4, 2008), *aff'd*, Exchange Act Release No. 59125, 2008 SEC LEXIS 2483 (Dec. 19, 2008) (citing *Reynolds*, 2001 NASD Discip. LEXIS 17, at *44, *47).

2. Analysis of Alleged Misrepresentations and Omissions

The central questions raised regarding the alleged omissions and misrepresentations are whether the information was material, whether CRI and Cantone acted with scienter, and in the case of the alleged disclosure violations related to the Columbia and Oklahoma extension agreements, whether the misrepresentations or omissions were made in connection with the purchase or sale of a security. We review each individual alleged omission and misrepresentation to determine whether the information was material, and if it was, whether the failure to disclose rose to the level of fraud under Section 10(b)(5) of the Exchange Act or was negligent under Section 17(a) of the Securities Act.

a. Brogdon's Financial and Legal Issues

i. NASD Bars

The Hearing Panel found that Brogdon's 1984 and 1985 NASD bars were not material due to their temporal remoteness and because, in 1994, the NASDAQ approved RCA's listing application while Brogdon was RCA's Chairman and CEO. Enforcement appealed this determination, arguing that Brogdon's bars are material events that required disclosure. We find the bars material and therefore reverse the Hearing Panel's findings.

As a general guiding principal, we agree with respondents and the Hearing Panel that the temporal remoteness of an event can abate its materiality. As the Hearing Panel noted, "[c]ommon sense suggests that a reasonable investor would consider . . . recent adverse events more significant than similar events occurring a quarter century before. Facts weighed for materiality must be viewed in context. That is part of the rationale leading courts to consider the passage of time as a relevant factor in making materiality determinations involving undisclosed facts." On the other hand, we also agree with the Hearing Panel that "the age of an event is not the only factor to consider." Taking into account the age of the bars, in addition to other factors discussed below, we find the bars to be material.

A bar is the most significant sanction NASD could impose on Brogdon. The 1984 NASD decision specifically took Brogdon to task for his misconduct, commenting on Brogdon's "cavalier attitude . . . toward the [NASD's] disciplinary process" and noting that "Brogdon effected the unauthorized purchase of transactions in the customer's account for his own

nefarious purposes and revealed his scheme to his superior only after the firm had sustained losses of staggering proportions." The bars imposed on Brogdon also remain in effect. We find that a reasonable investor would want to know that the person integrally involved in a deal in which they were considering investing, and guarantying the financial solvency and success of that deal, engaged in misconduct so egregious that a self-regulatory organization determined him unfit to be in the industry—twice. However, rather than divulging any aspects of Brogdon's checkered past, respondents chose to highlight only the successes that Brogdon achieved over the last three decades.

We conclude that the significance placed on the "temporal remoteness" of Brogdon's misconduct, which resulted in these bars, is misplaced. First, as noted above, while the bars may have been imposed some time ago, they remain in effect. In addition, CRI and Cantone rely on the nearly equally temporally remote positive descriptions of Brogdon business acumen. They cannot tout Brogdon's decades' old successes and then cry foul when taken to task for not including his decades' old failures. Respondents were selling Brogdon's experience and integrity, and as such they had an obligation to investors to include factual information that reflected business misconduct. Furthermore, the language in the CDMs touted Brogdon's responsibility for obtaining NASDAQ Market listing for RCA but neglected to mention a glaring impediment to that listing. The information pendulum swings both ways—investors are entitled to a balanced account of Brogdon's history, and while an investor may still decide to invest in a COP notwithstanding the bars, that does not render that information immaterial.[16]

Neither are we persuaded that the NASDAQ's 1994 intervening approval of RCA's listing application renders the bars immaterial. Whether to allow a company to list involves an analysis and consideration of information that is distinct from FINRA's or the Commission's analysis of materiality under the Exchange Act.[17] For example, a factor that the Qualifications Committee considered whether granting the application would "pose a threat to the public interest." This consideration is distinct from whether a reasonable investor would consider the bars when making his or her investment decision. Thus, we find the fact that Brogdon was twice barred by NASD to be material.

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[16] Respondents provided testimony and affidavits from CRI customers who stated that, even if they had known of Brogdon's bars, they still would have chosen to make their investments. On the other hand, Enforcement witnesses testified that they would have wanted to know about Brogdon's bars when deciding whether to invest. While each investor's statements regarding his personal views concerning materiality may be true, such views are not dispositive on the issue of materiality. Although each of these investors may very well be "reasonable," the reasonable investor we look to is an objective standard paradigm rather than a particular real person.

[17] The decision by the Nasdaq Listing Qualifications Committee to permit RCA's listing is not part of the record. Therefore, any reliance on why the NASDAQ chose to approve, or any weight it assigned to the bars, is purely speculative.

Next, we examine whether CRI and Cantone's failures to disclose were made with scienter or negligently. We do not believe the record supports a finding that CRI and Cantone acted with scienter when they omitted the bars from Brogdon's biography. CRI and Cantone relied exclusively, and unreasonably, on JF's information regarding the NASD bars and the 2008 attorney letter from Brogdon's outside counsel and conducted no independent research. In fact, Cantone is unsure if even knew of the bar involving Brogdon's unauthorized trading. Furthermore, the details JF provided respondents surrounding Brogdon's bar for net capital violations were not accurate. Had respondents conducted their own research, they would have learned that the nature of the bars was much more troubling than represented to them. Respondents failed "to exercise the standard of care that a reasonably prudent person would have exercised in a similar situation . . . [Negligence] connotes culpable carelessness." *John P. Flannery*, Initial Decisions Release No. 438, 2011 SEC LEXIS 3835, at *104 (Oct. 28, 2011) (quoting Black's Law Dictionary, 1056 (7th ed. 1999)), *rev'd in part,*Exchange Act Release No. 73840, 2014 SEC LEXIS 4981 (Dec. 15, 2014), *rev'd on other grounds*, 810 F.3d 1 (1st Cir. 2015). Respondents had a duty to more than rely unquestioningly on the information provided by JF. CRI and Cantone should have acted independently and further investigated the information concerning Brogdon's past financial and legal troubles about which they were already aware. *See Reynolds*, 2001 NASD Discip. LEXIS 17, at *42-43. Instead, they conducted unreasonably little due diligence with regards to Brogdon's past, despite the red flags. Therefore, we conclude that respondents CRI and Cantone negligently omitted material facts in contravention of Section 17(a) of the Securities Act, in violation of FINRA Rule 2010.

ii. Criminal Indictment

The Hearing Panel determined that Brogdon's 1999 criminal indictment concerning, among other things, elder abuse and Medicare fraud, was not material because there was no admission of guilt or an adjudication of the facts alleged in the indictment and because the indictment was temporally remote. Enforcement argues that the indictment is material, and should have been disclosed, maintaining that case law supports their position of disclosure. We disagree with Enforcement and affirm the Hearing Panel's findings as to the criminal indictment.

The cases relied on by Enforcement are distinguishable on the grounds that they involve actual criminal convictions or failures to disclose pending indictments or guilty pleas, not—as is the case here—an indictment that had been dismissed years prior to the drafting of Brogdon's CDM biography. *See, e.g, SEC v. Electrics Warehouse, Inc.*, 689 F. Supp. 53, 67 (D. Conn. 1988) ("Thus, there is no genuine issue of fact but that . . . Calvo knew of the indictment, *that it had not been dismissed*, and that it had not been disclosed to investors in the prospectus or the amended registration statement. In the failure to disclose material facts, those documents were misleading.") (emphasis added)

We find that Enforcement has not met its burden of showing that the criminal indictment is material in this instance. The fact that Brogdon was indicted, and the charges dropped, is not analogous to a criminal conviction, guilty plea, or pending indictment. We therefore affirm the Hearing Panel's findings.

iii. NAB Bankruptcy

In 1990, NAB filed for bankruptcy. The Hearing Panel concluded that the temporal remoteness of the NAB bankruptcy, combined with the fact that it was neither a personal bankruptcy filing by Brogdon, nor a bankruptcy of a company partially controlled by Brogdon, made it non-material. We agree that it is not material.

Brogdon's CDM biography makes no mention of Brogdon's association with NAB. "That duty [to disclose] is a general one, and arises whenever a disclosed statement would be 'misleading' in the absence of the 'disclos[ure] of [additional] material facts' needed to make it *not* misleading." *SEC v. Fehn,* 97 F.3d 1276, 1290 n. 12 (9th Cir. 1996) (*quoting Hanon v. Dataproducts Corp.*, 976 F.2d 497, 504 (9th Cir. 1992)). Therefore, investors were not subject to an unbalanced assessment of Brogdon's business acumen as it related to his time with NAB. "Under these circumstances the failure to disclose negative information [concerning the individual at issue] did not affirmatively create an impression of a state of affairs that differs in a material way from the one that actually exists." *Ottimo*, 2018 SEC LEXIS 1588, at *47. Thus, we conclude a reasonable investor would not find information concerning the NAB bankruptcy material.

iv. RCA Liens

In 1996, while Brogdon was Chairman of RCA, the Internal Revenue Service filed liens against RCA for approximately $4 million. We agree with the Hearing Panel that the liens are material and should have been disclosed to investors.

We find that a reasonable investor would consider millions of dollars in tax liens against RCA, under Brogdon's chairmanship, significant, with the potential to alter the total mix of information available relating to Brogdon's ability to manage the businesses underlying the COPs sold by CRI and Cantone. This information becomes more significant in light of the statements in the CDMs touting Brogdon's business savvy and success managing similar retirement, assisted living, and nursing home facilities and projects. Respondents put RCA's failures at issue by touting Brogdon's success at RCA as a reason for investing in projects that are under Brogdon's control. The CDMs used by Cantone and CRI to promote the COPs highlighted Brogdon's Chairmanship of RCA, but they failed to disclose this important negative information relating to RCA. Once Cantone and CRI voluntarily undertook to sell COPs on the premise that Brogdon's success at RCA was a reason to trust his business acumen, it was incumbent on them to disclose any facts that would have significantly altered the total mix of information concerning that chairmanship, including these large tax liens. The biographical information omitted from the CDM was material and misleading in light of the information disclosed. CRI and Cantone were "required to provide additional information because [their] representations painted a misleading picture of [Brogdon's] management acumen given the company's undisclosed problems." *Ottimo*, 2018 SEC LEXIS 1588, at *32.

Respondents argue that the tax liens were not material because $4 million was relatively insubstantial in relation to the size and value of RCA, and may not have threatened RCA's viability. This, however, is not the standard for materiality. Cantone and CRI chose to focus on Brogdon's supposed success at RCA, in addition to his purported success over twenty-five years

in the nursing home industry, and they were required to disclose negative information that would significantly affect investors' views of those supposed successes.

We also agree with the Hearing Panel that respondents' failure to disclose the tax liens was negligent, in contravention of Section 17(a) of the Securities Act. Cantone and CRI unreasonably failed to conduct any due diligence regarding Brogdon's background, instead relying on the incomplete rosy picture painted by JF and MG.

v. RCA Class Action Lawsuits

In 1997, while Brogdon was still Chairman of RCA, multiple securities fraud class action lawsuits were filed against RCA, Brogdon, and others, alleging that defendants misrepresented the success and financial condition of RCA, including its operating income and earnings. The lawsuits were settled in July 1999. The Hearing Panel determined that these settled class action suits were not material. We affirm.

With regard to the class actions filed in 1997 against RCA, Brogdon and others, 13 years before the Columbia offering, we find that they are not material and Cantone and CRI were not required to disclose them. First, we note their temporal remoteness. Second, the suits were settled. We agree with the Hearing Panel that unadjudicated allegations should not automatically be deemed material and find that a reasonable investor in the Brogdon-related COPs would not "place much stock in the bald, untested allegations in a civil complaint" unrelated to the COPs. *GAF Corp. v. Heyman*, 724 F.2d 727, 739-40 (2d Cir. 1983).

vi. NHC Bankruptcy

In 1999, while Brogdon served as its chairman, NHC filed for Chapter 11 bankruptcy. We agree with the Hearing Panel that this bankruptcy is material.

Cantone and CRI argue that there is no evidence in the record that the bankruptcy was the result of Brogdon's stewardship, and because Enforcement failed to prove any connection, the bankruptcy is not material. Here, the underlying cause of the bankruptcy is not the linchpin for materiality, but rather respondents' reliance on Brogdon's chairmanship of NHC as evidence of his nursing home business-related expertise that matters. Cantone and CRI represented in each of the CDMs that, "[i]n 1998 and 1999, Mr. Brogdon was also Chairman of NewCare Health Corporation, a Nasdaq-listed company in the assisted living and nursing home business." However, not included in the CDMs are the facts that NHC filed bankruptcy in June 1999, and the NHC board fired Brogdon shortly thereafter. By emphasizing Brogdon's chairmanship of a company that was a part of the same industry as the COPs Cantone and CRI were selling, without disclosing negative contemporaneous events, respondents omitted material facts. *See SEC v. Carriba Air*, 681 F.2d 1318, 1320, 1323-24 (11th Cir. 1982) (defendants selling stock in a new airline were required to disclose that the principals had been involved in a string of airline company failures including a nearly identical venture, an airline that declared bankruptcy only one month before the formation of the new venture, with the same routes, and employees); *SEC v. Merch. Capital*, 483 F.3d 747, 770-71 (11th Cir. 2007) (holding that "failure to disclose the bankruptcy of a similar predecessor company is a material omission" particularly when the

defendant "put his experience in issue" by touting his past business successes and the bankruptcy was "very recent").

We also reject Cantone's and CRI's argument that we should look to the Form U4 disclosure obligations for guidance. They argue that, because the Form U4 does not require disclosure of bankruptcies more than ten years old, we should also conclude that the NHC bankruptcy is not material here. First, the Form U4 serves a regulatory purpose that is distinct from the materiality analysis here. In addition, while we agree, as previously stated, that the age of an event is related to its materiality—the older an event is the less material it becomes—this is not the only consideration. Cantone and CRI cannot omit contemporaneous, material, negative biographical information, particularly, as is the case here, when the absence of the negative information paints an incomplete and misleading portrait of Brogdon's time at NHC.

Cantone's and CRI's omissions were negligent, in violation of Section 17 of the Securities Act and FINRA Rule 2010. While Cantone was apparently unaware of the NHC bankruptcy, he had an obligation to conduct his own investigation into Brogdon's background.

vii. Breach of Contract Lawsuit

In 1998, Brogdon was NHC's CEO and a stockholder in the company. To induce another entity to purchase a significant number of shares of NHC, Brogdon agreed to buy back the shares if the purchaser requested he do so within one year. Before the year ended, the purchaser invoked the repurchase agreement, but Brogdon refused to honor it. The purchaser sued for breach of contract, and moved for summary judgment. The court granted the motion and enforced the agreement. Brogdon appealed, claiming the repurchase agreement was legally unenforceable. In March 2003, the Georgia Court of Appeals upheld the lower court decision. The court found that Brogdon, to induce the purchase of NHC stock, had created "essentially a personal guaranty" and, having benefitted from the agreement, held that he could not renege by later claiming it was unenforceable. The Hearing Panel found that this information was material, and we agree.

Cantone and CRI maintain that the Georgia court decision is not material, because the repurchase agreement was "not a straightforward personal guaranty," and that because there is no evidence that Brogdon failed to honor his obligations under the contract after the court ruled against him. We do not find either argument persuasive.

To the contrary, we conclude that these facts would have been material to investors. Despite touting Brogdon's personal guaranty in the offerings, Cantone and CRI did not disclose that Brogdon was found to have violated what a Georgia appellate court described as "essentially a personal guaranty" in a case involving NHC. Given the importance of the Brogdon Guaranty and the fact that Brogdon controlled every entity obligated on the notes, there is little doubt that a reasonable investor deciding whether to purchase Brogdon COPs would consider the court's decision that Brogdon refused to honor a similar personal guaranty to be an important fact that could alter the total mix of available information. The lawsuit involved both NHC and a guaranty, both components which figured prominently in respondents' efforts to encourage investors to purchase the Brogdon COPs. The fact that Brogdon's refusal to honor the

repurchase agreement, forcing investors to litigate is a fact that a reasonable investor would want to know. Indeed, the same scenario played out with the Brogdon COPs. Cantone and CRI were forced to sue Brogdon to enforce his guaranty.

We also agree with the Hearing Panel that Cantone's and CRI's omissions were negligent, in violation of Section 17 of the Securities Act. Cantone and CRI were negligent in their failure to conduct any meaningful due diligence into Brogdon's background, and instead continued to rely on JF and MG's representations about Brogdon's past. Cantone does not recall whether he even was aware of this lawsuit. However, regardless of whether JF told Cantone, Cantone and CRI should have conducted an independent search into Brogdon's background, and their failure to do so resulted in negative material information being shielded from investors.

b. Misrepresentations and Omissions Involving the COPs

Both Cantone and CRI and Enforcement appeal the Hearing Panel's findings with respect to what information concerning Brogdon's payment issues and other offering-related financial issues respondents were obligated to disclose to investors.

i. Late Interest Payments are Not Material to the Columbia, Chestnut, Oklahoma, and Cedars Offerings

Enforcement alleges that CRI and Cantone failed to disclose numerous late interest payments and that these were material facts that should have been disclosed to investors. Specifically, Enforcement contends that interest payments first missed in the Columbia, Chestnut, and Cedars offerings were events of default under the terms of the CDM and therefore material to investors. The Hearing Panel concluded otherwise, as do we.

As to the first late Columbia Offering interest payment, under the terms of the Columbia Offering promissory note, Polo Road was obligated to make the first $51,000 payment to Columbia Financial on May 1, 2010, but Brogdon did not make the payment on time. Instead, Brogdon sent a check six days late for $34,000—less than the full amount due. According to Cantone, Brogdon explained the payment was short because of a "bookkeeping error." On May 10, 2010, C. Cantone wrote a check from the Cantones' personal bank account to Columbia Financial, to cover the outstanding balance of the interest payment and Brogdon reimbursed the Cantones the following month. The Hearing Panel found credible Cantone's testimony that this first late interest payment was a bookkeeping error and not an event of default that would have obligated CRI and Cantone to disclose the late payment to investors in the COP offerings that followed.[18] The lack of materiality made it unnecessary for CRI and Cantone to disclose the tardy payment to investors in the COP offerings that followed Columbia: Country Club,

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18 While we review de novo the Hearing Panel's decision on appeal, its findings concerning credibility are entitled to deference absent substantial evidence to the contrary. *See, e.g., Daniel D. Manoff*, 55 S.E.C. 1155, 1161-62 & n.6 (2002).

Chestnut, Cedars, and Cherokee. We find no reason to disturb the Hearing Panel's credibility findings as to the first Columbia interest payment and conclude, like the Hearing Panel, that it is not material.

As to the Chestnut Offering late payment, while Enforcement is correct that the first interest payment was due on June 1, 2011, and Brogdon did not pay until June 13, they are incorrect that this late payment is material. Brogdon did not default because he made the payment within the 15-day grace period as prescribed by the Chestnut Offering CDM. Therefore, we agree with Hearing Panel that this late payment was not material.

We also agree with the Hearing Panel that the Cedars Offering's first late interest payment is not material. The first Cedars interest payment was due on December 15, 2011. On December 27, the Cantones paid the interest. Brogdon's payment, by check dated December 24, was subsequently deposited into the Cedars account on December 31. Like the Chestnut Offering, the Cedars Offering promissory note set a 15-day grace period for payments of interest, so the Brogdon check, dated within and deposited one day after the grace period, was not significantly late, and we do not deem the late payment to be material. Therefore, we do not agree with Enforcement's argument that Cantone was required to disclose it to the Cedar Offering investors and prospective investors in the last offering at issue, the Cherokee Offering.

We find that there were no material late interest payments that needed to be disclosed to investors in the CDMs for the Columbia, Chestnut, Oklahoma, or Cedars Offerings. Columbia was the first deal, with a CDM dated February 1, 2010. As such, there were no late payments to be disclosed. At the time of the Chestnut (CDM dated 2/24/11), Oklahoma (CDM dated 7/22/11), and Cedars (CDM dated 8/24/11) Offerings, the only late payments to occur during this time frame were the first late interest payments for the Columbia and Chestnut Offerings, which were not material.

ii. Omissions and a Misrepresentation Related to Columbia and Oklahoma Extension Agreements Were Made in Connection with the Sale of a Security and Are Material

Respondents appeal the Hearing Panel's finding that Cantone's and CRI's failure to inform investors in the Columbia and Oklahoma offerings—to whom they proposed extending the maturity dates of their notes—of Brogdon's missed and late payments and the changes in the interest rate and other fees assessed against Brogdon constituted material omissions. Respondents argue that the extensions do not satisfy the "in connection with the sale of a security" requirement of Section 17(a) of the Securities Act or Exchange Act Rule 10(b)(5). In addition, respondents maintain that Enforcement did not prove that Brogdon's late payments were not disclosed or that the late payments were material. We affirm the Hearing Panel's findings.

First, the extension agreements do satisfy the "in connection with" prong. By inviting investors to agree to the extension agreements, Cantone gave investors a choice. They could continue to participate in the offerings or he would buy them out to let them redeem their investments. In giving investors this choice, Cantone and CRI should have provided investors

with the information needed to appropriately asses the risks and make an educated decision. Misrepresentations concerning previously purchased securities that included "lulling statements about [] delayed interest payments as well as misrepresentations intended to induce delayed redemptions" of investment certificates, were sufficiently in connection with securities purchases to fall within the scope of Section 10(b) and Rule 10b-5. *United States. v. Durham*, 766 F.3d 672, 683 (7th Cir. 2014). In addition, the "reliable payment of interest...would have played a large role in an investor's decision to cash out." *Id. See also Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 85 (2006) (holding that when the Court has interpreted "in connection with" in the context of Section 10(b), it has espoused a broad interpretation, stating that "[u]nder our precedents, it is enough that the fraud alleged 'coincide' with a securities transaction"); *accord McGee v. SEC*, 733 F. Appx. 571, 575 (2d Cir. 2018); *SEC v. Zandford*, 535 U.S. 813, 819 (2002) (holding that Section 10(b) should be construed flexibly and adopting the SEC's broad reading of the phrase "in connection with"); *Dep't of Enforcement v. Ortiz*, Complaint No. 2014041319201, 2017 FINRA Discip. LEXIS 5, at *23-26 (FINRA NAC Jan. 4, 2017) (holding that misrepresentations and omissions that prevented customers from making an informed decision as to whether to hold or sell their investments were in connection with the purchase or sale of a security).

CRI and Cantone failed to disclose to Columbia and Oklahoma Offering investors that Brogdon had failed to make or made untimely interest payments, the Cantones were covering the missed and late payments, and that the terms of the extension agreements had changed. This information would have been critical to their decision whether to accept Cantone's offer to buy back their securities or to hold them through the extended term.[19]

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[19] In a brief footnote, the Hearing Panel concluded that, even though the CDMs identified the "sole sources" of the payments of interest and principal, nothing in the CDMs expressly prohibited Cantone from covering the interest payments, rendering that information immaterial to investors. We disagree with the Hearing Panel and find that CRI and Cantone should have disclosed to the investors in the Columbia and Oklahoma offerings that the Cantone's were loaning Brogdon funds to cover some of the interest payments when considering the proposed extension agreements, and potential Cherokee investors.

The CDMs provided that investors in each of the offerings would be paid solely from: (1) revenues from the underlying facility/projects; (2) payments made by Brogdon and his wife pursuant to relevant Guaranty Agreement; and/or (3) money recovered pursuant to a second lien. Although it does not explicitly prohibit the Cantones from making payments, we believe that reasonable investors would find the fact that Brogdon was unable to make his contractually obligated payments a significant factor in determining whether or not to consent to a proposed extension agreement in the Columbia or Oklahoma offerings, or whether to participate at all in the Cherokee Offering. *See, e.g., Dep't of Enforcement v. Donner Corp. Int'l*, Complaint No. CAF020048, 2006 NASD Discip. LEXIS 4, at *34 (NASD NAC Mar. 9, 2006) (finding that "[a] reasonable investor . . . would consider significant information pertaining to an issuer's financial condition, profitability, solvency, and potential for success"), *aff'd in relevant part*, Exchange Act Release No. 55313, 2007 SEC LEXIS 334 (Feb. 20, 2007); *Kunz v. SEC*, 64 F. App'x 659,

[Footnote continued on next page]

We also conclude that the evidence does not support Cantone's assertion that he informed Columbia and Oklahoma investors of Brogdon's failures to make interest payments on time, or that Cantone was covering these interest payments. While three customers testified at the hearing that Cantone discussed Brogdon's late payments with them, there is no documentary evidence that Cantone informed all interested investors that Brogdon missed payments in other offerings before extending the maturity dates for the Columbia and Oklahoma notes. Rather, FINRA concluded after its 2013 cycle examination that CRI and Cantone "did not disclose to investors of Columbia that [Brogdon] failed to make several timely interest payments." Respondents agreed with the examiners "that Columbia ought to have made disclosures to investors" of these failures. Furthermore, in his OTR, when asked if he informed Columbia investors that he had made interest payments that Brogdon missed, Cantone testified, "I don't know the answer to that question, but I don't think it's that pertinent." He also testified he "probably did not mention . . . that I was lending the money to Columbia out of my pocket. I'm not sure that I did." When asked during the OTR to explain what he told clients about having paid interest to COP investors, Cantone replied: "It was irrelevant. I don't think I discussed it with too many people. Maybe one or two people that asked."

Finally, we agree with the Hearing Panel that the information was material. There is a substantial likelihood that reasonable Columbia and Oklahoma investors, when deciding whether to continue to participate in the offerings, would consider Brogdon's late and missed payments, the terms of the extension agreements that Cantone failed to disclose (and misrepresented to Oklahoma investors), to significantly alter the total mix of available information. The First Columbia Extension Agreement stated that Brogdon was unable to make required payments, but Cantone did not circulate that extension agreement to investors. Instead, he sent them a letter after the fact stating only that he had granted the extension because Brogdon had a prospective purchaser for the underlying facility. The First Columbia Extension Agreement charged additional fees to Brogdon and increased the interest rate from 10 to 14 percent, and Cantone determined the additional 4 percent would go to him, not to the investors. Cantone did not disclose these changes to the investors.

The Oklahoma Extension Agreement made similar changes, increasing the interest rate from 10 to 14 percent and charging Brogdon additional fees. As with the Columbia Offering extensions, Cantone did not send the extension agreement to investors. In the letter he sent to them, he falsely stated the 10 percent interest rate would continue and did not disclose the additional four percent he was charging.

[cont'd]

665 (10th Cir. 2003) (holding that "the materiality of information relating to financial condition, solvency and profitability is not subject to serious challenge").

* * *

We therefore affirm the Hearing Panel's findings that Cantone and CRI made material omissions and a misrepresentation to investors regarding Brogdon's missed and late payments and the changes in the interest rate and other fees assessed in connection with Columbia and Oklahoma extension agreements. We further find that Cantone and CRI made material omissions to these investors by not informing them that Brogdon was at times unable to make the offerings interest payments and that the Cantones covered those payments.

iii. Omissions Related to the Cherokee Offering Are Material

Respondents contend that the Hearing Panel erred when it determined that they were obligated to disclose Brogdon's late and missed payments that occurred after the Cedar Offering, as well the other financial problems with the preceding deals to investors in the Cherokee Offering. Specifically they argue that, unlike the prior COP offerings that were personally guaranteed by Brogdon, his wife, and Brogdon Family, LLC, in the Cherokee CDM, Chelsea Investments, Inc., a Brogdon-controlled entity, guaranteed the prompt payment of principal and interest. We agree with the Hearing Panel that the absence of the Brogdon Guaranty did not relieve CRI and Cantone of their disclosure obligations and affirm the Hearing Panels findings.

At the time of the Cherokee Offering, Polo Road, Chestnut and Highlands Independent Living, and Cedala, all Brogdon-controlled entities, failed to make required interest payments, which Cantone covered, or failed to make required principal payments. Cantone had also negotiated undisclosed interest rate increases and fees in the First and Second Columbia Extension Agreements. Moreover, Cantone had reviewed Cedala's income statements that indicated that Cedala had sustained net losses for the years 2008, 2009, and 2010, and just four days prior to the date of the Cherokee CDM, Chestnut Financial generated an invoice showing that Brogdon owed $350,000 in unpaid interest and administration fees for that offering. CRI and Cantone failed to disclose any of this information to prospective investors in the Cherokee Offering.

Respondents maintain that Brogdon's history was entirely irrelevant to the Cherokee Offering, effectively taking the position that investors would not be concerned about Brogdon's involvement since he was not guaranteeing the promissory notes. On the contrary, it is irrelevant that Brogdon was not personally guarantying the notes. It is undisputed that the entity that was giving the guaranty was owned by and entirely under Brogdon's control. This means that Brogdon's financial problems and lack of personal and business integrity would just as significantly influence the purchasers of the COPs as would a personal guaranty. The Cherokee CDM clearly emphasized the importance of Brogdon's role in the Cherokee offering:

> Christopher F. Brogdon is the central participant in the transactions described in this [CDM]...Chelsea Investments, LLC ("Chelsea"), is wholly-owned by Brogdon Family LLC (Brogdon Family"). Chelsea is managed by Mr. Brogdon. Brogdon Family is also controlled by Mr. Brogdon. Mr. Brogdon owns all of the equity interests in Arcadia Lender, and 35% of the equity interests in Arcadia Partners.

Therefore, the Hearing Panel correctly concluded that Brogdon was sufficiently central to the Cherokee Offering that prior late payments and defaults in other Brogdon offerings, and material changes to the terms of those offerings providing Cantone additional fees and interest, should have been disclosed to purchasers of the Cherokee COPs.

iv. CRI and Cantone's Omissions and Misrepresentation Constitute Fraud

We agree with the Hearing Panel that CRI and Cantone intentionally omitted Brogdon's missed and late payments, and the changes to the interest rate, to Columbia and Oklahoma Offering investors, and misrepresented the changed interest rate to be paid after the extension to Oklahoma Offering, thereby depriving the investors of material facts when deciding whether to continue to participate in the offerings with extended maturity dates.[20] We also affirm the Hearing Panel's finding that CRI and Cantone acted with scienter when they failed to inform prospective Cherokee investors of Brogdon's growing number of missed interest and principal payments and Brogdon's substantial debt of the proceeding offerings. CRI's and Cantone's misconduct with respect to these omissions and misrepresentations violate Section 10(b) of the Exchange Act, Exchange Act Rule 10b-5, and FINRA Rules 2020 and 2010.

CRI and Cantone knew of Brogdon's missed and late payments of interest and principal prior to the date of the extension agreements, and prior to the issuance of the Cherokee offering, and they knew of Brogdon's substantial financial losses and the changes to the terms of the loans, specifically the additional fees and higher interest rate they charged Brogdon. *See Dep't of Mkt. Regulation v. Field*, Complaint No. CMS040202, 2008 FINRA Discip. LEXIS 63 at *31-32 (FINRA NAC Sept. 23, 2008) (affirming Rule 10b-5 fraud findings against a respondent who sold municipal bonds to investors without disclosing that the underlying developer had failed to make payments on prior bond issues). As Cantone acknowledged that he was ultimately responsible for the contents of the CDMs, he had an obligation to include this material information to his investors.

There is also no question that Cantone understood the import of Brogdon's missed and late payments, as Cantone repeatedly and explicitly stated that the late and missed payments of the Brogdon-controlled entities would affect his ability to sell future Brogdon COPs to investors. On June 6, 2011, Cantone wrote to Brogdon's assistant that three investors already had inquired about the missing interest payment. Cantone stated, "This first interest payment is late and this is not good especially since I am trying to convince these same investors to send money to participate in funding for the five [Oklahoma] nursing homes." On June 7, 2011, Cantone added "It hurts Brogdon's reputation (and my ability to fund future projects) when interest and principal is not paid when due because investors get concerned about his guaranty." In an April

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[20] We also find, unlike the Hearing Panel, that CRI and Cantone intentionally omitted the fact that the Cantones were loaning money to the offerings to cover Brogdon's late and missed payments.

20, 2012 email Cantone noted "it was "difficult to have investors send more money for other offerings when they feel insecure based on past offerings." In a May 16, 2012 email, Cantone stated, "It will become increasingly difficult for me to fund projects if we do not keep our commitments on past projects. My salesmanship with investors only goes so far; when you make a guaranty to make a timely payment, you need to make the payment. I do what I can to minimize the damage caused by the late payments. . ." In late March 2013, Cantone wrote to Brogdon:

> The problem is even worse because I have about 100 investors that can file a lawsuit against me for not enforcing the terms of the agreements on the various projects we financed. You guaranteed the prompt payment of interest and principal. Yet I had to pay back the principal to five investors who did not want to extend the Polo Road/Columbia Note to avoid complaints to FINRA. I paid the quarterly interest on Chestnut several times because you could not come up with the money.

Cantone was acutely aware of Brogdon's late and missed payments, and other financial ills, and covered these payments to keep the deals afloat and to keep investors satisfied. Cantone also acknowledged on several occasions that this information would be important to investors. These facts establish that, in the offers to Columbia and Oklahoma Offering investors to continue participating in offerings with extended note maturity dates, and the offer and sale of the Cherokee COPs, Cantone, and through him CRI, willfully violated Section 10(b) of the Exchange Act, Exchange Act Rule 10b-5, and FINRA Rules 2020 and 2010.[21]

c. Cantone's Esplanade Default

Enforcement has appealed the Hearing Panel's determination that CRI and Cantone's default in Esplanade was not material, and thus did not need to be disclosed. Enforcement alleges that Cantone and CRI were required to disclose this failure in the subject COP offerings because those offerings are structured similarly to Esplanade and because Cantone painted a positive picture of his own business success in the biography disturbed to investors. We do not

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[21] Because CRI and Cantone acted willfully, we agree with the Hearing Panel's conclusion that CRI and Cantone are statutorily disqualified. *See* Section 15 U.S.C. 78c (a)(39)(F) of the Exchange Act. A willful violation of the securities laws means "intentionally committing the act which constitutes the violation" and does not require that the actor "also be aware that he is violating one of the Rules or Acts." *Wonsover*, 205 F.3d at 414. The record firmly establishes that, in the offers to Columbia and Oklahoma investors to continue participating in offerings with extended note maturity dates, and the offer and sale of the Cherokee COPs, Cantone, and through him CRI, willfully violated Section 10(b) of the Exchange Act and Rule 10b-5. As these violations were willful, CRI and Cantone are statutorily disqualified by operation of the Exchange Act.

think this alone makes the failure of the Esplanade deal material and affirm the Hearing Panel's findings.

Although Esplanade and the offerings at issue in this appeal were structured as COPs, Cantone's business failure with Esplanade does not mean it was material to later, unrelated ventures, and does not support a conclusion that Cantone was obligated to disclose this business failure to prospective investors in the Brogdon-related COPs. Esplanade was not a nursing home or assisted living facility, nor was Brogdon involved with it. Here, the failure to disclose information related to one of CRI and Cantone's failed business ventures did not "'affirmatively create an impression of a state of affairs that differs in a material way from the one that actually exists.'" *Retail Wholesale & Dep't Store Union Local 338 Ret.Fund v. Hewlett-Packard Co.*, 845 F.3d 1268, 1278 (9th Cir. 2017) (quoting *Brody v. Transitional Hosps. Corp.*, 280 F.3d 997, 1006 (9th Cir. 2002)). Not every failed business venture in a person's background must be disclosed. *See Fisher v. Ross*, No. 93-0275, 1996 U.S. Dist. LEXIS 15091, at *31-33 (S.D.N.Y. Sept. 30, 1996) (six-year-old bankruptcy of prior employer of directors of company making an offering held immaterial absent evidence that the executives had committed wrongdoing, and no evidence the bankruptcy had any bearing on financial prospects of offering company); *Feinberg v. Leighton*, No. 80-4398, 1987 U.S. Dist. LEXIS 580, at *32 (S.D.N.Y. Jan. 30, 1987) (omission by defendant to disclose he was involved in a company, with no connection to the business at issue, that went bankrupt nine years earlier, was not material).

* * *

In sum, we conclude that the NASD bars, the Georgia appellate court decision, the RCA tax lien, and the NHC bankruptcy should have been disclosed to investors in all five of the offerings, and that CRI and Cantone's omissions were negligent, in violation of Sections 17(a)(2) and (3) of the Securities Act, and FINRA Rule 2010.

We also conclude that the missed and late payments should have been disclosed to investors when Cantone and CRI agreed to the extension agreements in Columbia and Oklahoma. In addition, the late and missed interest and principal payments and the substantial debt that Brogdon incurred in the proceeding offerings should have been disclosed to the Cherokee investors. We find that the evidence supports that CRI and Cantone acted with scienter, and their willful omissions and misrepresentation violate Section 10(b) of the Exchange Act, Exchange Act Rule 10b-5, and FINRA Rules 2020 and 2010.

B. Failure to Supervise

The Hearing Panel found that C. Cantone and CRI failed to supervise Cantone's activities related to the COPs. We agree and affirm.

1. Legal Standard

NASD Rule 3010(a) requires that a member "establish and maintain a supervisory system that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with [FINRA Rules]." *Pellegrino*, 2008 SEC LEXIS 2843, at *32-33. In

addition to an adequate supervisory system, "[t]he duty of supervision includes the responsibility to investigate 'red flags' that suggest that misconduct may be occurring and to act upon the results of such investigation." *Michael T. Studer*, 57 S.E.C. 1011, 1023-24 (2004). "Once indications of irregularity arise, supervisors must respond appropriately." *La Jolla Capital Corp.*, 54 S.E.C. 275, 285 (1999).

2. C. Cantone and CRI Failed to Supervise Cantone

The record demonstrates that C. Cantone failed to supervise Cantone in violation of NASD Rule 3010(a) and FINRA Rule 2010. Under CRI's written supervisory procedures ("WSPs"), C. Cantone's responsibilities included reviewing emails and correspondence, maintaining CRI's written supervisory procedures, and ensuring that representatives under her supervision conducted thorough due diligence. C. Cantone also supervised her husband and handled the books for the Brogdon-related COPs.

C. Cantone was required to review Cantone's emails on a daily basis to ensure his messages were truthful and balanced, and to make sure that Cantone performed his due diligence with respect to the COP offering. Furthermore, C. Cantone was aware of numerous red flags concerning Cantone's and CRI's sales and extensions of the COP offerings. Through her review of Cantone's emails and her discussions with him, C. Cantone knew when Brogdon failed to make timely interest payments in the Columbia, Chestnut, and Cedars offerings, and missed principal payments in the Columbia offering. She also participated with Cantone in directing funds from their joint bank account to make interest payments when Brogdon failed to do so in Columbia, Chestnut, and Cedars. C. Cantone herself wrote the checks to cover the Brogdon's deficient payments. She knew when Cantone extended the maturity dates of the notes in the Columbia and Oklahoma offerings and changed the terms by increasing the interest rate Brogdon was to pay and assessing him additional costs. C. Cantone also knew that Cedala, the Brogdon entity involved in the Cedars offering, sustained losses in 2008, 2009, and 2010; that by May 2013, Brogdon owed more than $350,000 in interest to investors in the Chestnut offering; and that by the end of 2012, the Brogdon entities involved in the Chestnut and Cedars offerings had sustained losses of more than $2 million. Notwithstanding her knowledge of these red flags, C. Cantone failed to take any steps to address them. She was obligated to exercise her supervisory authority by directing Cantone to inform appropriate investors of the financial issues with Brogdon and the offerings. By not doing so, she failed in her supervisory obligations as designated by the WSPs. Therefore she, and through her, CRI, violated NASD Rule 3010 and FINRA Rule 2010.

C. Improper Use of Customer Funds

Enforcement contends that the Hearing Panel erred in dismissing the charge that CRI and Cantone made improper use of customer funds, in violation for FINRA Rules 2150 and 2010. Enforcement alleges that CRI and Cantone caused $64,500 of Oklahoma investor funds to be wired to a bank account controlled by Brogdon, who subsequently wired those funds to pay

investors in a separate COP offering, the Hoover Offering. For the reasons discussed below, we affirm the Hearing Panel's dismissal.[22]

1. Legal Standard

FINRA Rule 2150 states that "[n]o member or person associated with a member shall make improper use of a customer's securities or funds." "[M]isuse of customer funds is 'patently antithetical to the high standards of commercial honor and just and equitable principles of trade that [FINRA] seeks to promote.'" *Henry E. Vail*, 52 S.E.C. 339, 342 n. 12 (1995) (*quoting Wheaton D. Blanchard*, 46 S.E.C. 365, 366 (1976)), *aff'd*, 101 F.3d 37 (5th Cir. 1996); *see also Janet Gurley Katz*, Exchange Act Release No. 61449, 2010 SEC LEXIS 994, at *47-48 (Feb. 1, 2010), *aff'd*, 647 F.3d 1156 (D.C. Cir. 2011).

2. CRI and Cantone Did Not Misuse Customer Funds

We agree with the Hearing Panel that the evidence does not support a finding that CRI and Cantone made improper use of customer funds. Respondents did not send the $64,500 to Hoover but rather wired the funds to the Brogdon SunTrust Bank account Brogdon designated. Cantone testified the funds were "leftover money in the escrow account that needed to be wired to Brogdon . . . [f]or the Oklahoma project." Indeed, the wire transfer from the Oklahoma account reflects the transfer to the Brogdon Family, LLC Sun Trust Bank account with a notation "FBO [for benefit of] Oklahoma Financial." Moreover, when Oklahoma transferred the $64,500 to Brogdon's designated account, that account had nearly $90,000 and thus had sufficient funds to cover the other deal.

It was not CRI or Cantone, but an individual with control over the Brogdon account, who directed $64,500 to Hoover. The evidence does not establish, as required to prove misuse of customer funds, that the funds sent from Brogdon's account to the other offering were the same dollars that originated in the Oklahoma escrow account or that, if they were, it was CRI or Cantone who transferred the funds to that other offering. Therefore, we affirm the Hearing Panel's dismissal of this cause.

D. Respondents' Defenses Fail

1. Reliance on Counsel

Cantone and CRI argued before the Hearing Panel, and again on appeal, that they reasonably relied on the advice of counsel with regard to the disclosures set forth in the offering documents. They contend that by virtue of this reliance, Cantone and CRI cannot be found to have acted negligently, or with scienter, with respect to their failures to disclose and the charges

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[22] Since we have dismissed the improper use of customer funds cause of action, we conclude that the facts underlying the cause of action were not material to investors, as alleged in the complaint.

should be dismissed. Enforcement maintains that respondents did not meet their burden to prove reliance on counsel and that the Hearing Panel's determination with respect to this issue should be upheld. We agree with the Hearing Panel and conclude that respondents did not meet their burden of proof.

Reliance on counsel is an affirmative defense. To establish a reliance on counsel claim, respondents must demonstrate that they: (1) made complete disclosure of the relevant facts of the intended conduct to counsel; (2) sought advice on the legality of the intended conduct; (3) received advice that the intended conduct was legal; and (4) relied in good faith on counsel's advice. *See Markowski v. SEC*, 34 F.3d 99, 105 (2d Cir. 1994). The Commission has noted that "it isn't possible to make out an advice-of-counsel claim without producing the actual advice from an actual lawyer." *Howard Brett Berger*, Exchange Act Release No 58950, 2008 SEC LEXIS 3141, at *40-41 (Nov. 14, 2008) (internal quotations omitted), *aff'd*, 347 F. App'x 692 (2d. Cir. 2009).

CRI and Cantone have not met this burden. As an initial matter, MG's association with Brogdon pre-dated CRI's and Cantone's. Cantone represented that he relied on MG's and JF's years of familiarity with Brogdon and his background. When asked about the drafting of the contents of the biographical background information in the CDMs, Cantone testified he had taken "a hands-off policy." Cantone testified that he delegated the responsibility for ensuring that CRI and Cantone complied with securities laws and FINRA rules to MG, and that MG would have made all necessary disclosures of material facts in connection with the sales of the COPs. "Compliance with federal securities laws cannot be avoided simply by retaining outside counsel to prepare required documents." *SEC v. Savoy Indus. Inc.*, 665 F.2d 1310, 1314 n.28 (D.C. Cir. 1981) (citations omitted). It is not enough for respondents to retain counsel to prepare offering documents and then argue they reasonably relied on competent legal advice with regard to the contents. The record establishes that Cantone read and approved the biographical description of Brogdon in the CDMs. Respondents, not their attorney, were ultimately responsible for the material omissions.

Furthermore, Cantone failed to provide any evidence regarding what advice he sought from, or what advice was "affirmatively provided" by, MG.[23] Respondents' contention that, "at no point during the entirety of the relationship did Attorney [MG] ever raise any issue, question,

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[23] There were only three communications MG sent relating to advice concerning Brogdon's background, none of which support respondents' claims of evidence of their reasonable reliance on counsel. First is an email MG wrote to JF in 2002, relating to a municipal bond offering, suggesting that Brogdon's 1990 bankruptcy was "well beyond any period of relevancy." In a 2008 email in connection with an uncharged offering, MG opined that the NASD bar imposed on Brogdon for net capital violations was not relevant. The final email concerns whether or not to include the Brogdon Guaranty in the Cherokee Offering, on which MG warned that if Cantone wanted to include the Brogdon Guaranty, the CDM would have to recite all the prior Brogdon failures to pay promised interest and principal when due.

or concern regarding the ultimate disclosures regarding Brogdon in the offering documents," is not "legal advice" upon which Respondents could reasonably rely.

There also was insufficient evidence that MG was provided with complete information about Brogdon's indictment and disciplinary history. Cantone testified that he emailed MG a copy of a May 2008 letter from Brogdon's attorney that only addresses three of the multiple legal and financial issues that should have been disclosed to investors. CRI could not, however, produce either a copy of this email or any reply from MG. Cantone testified that he discussed the indictment with MG; he did not testify that he discussed the NASD bars with MG—only with JF. There is no evidence establishing that he sought MG's advice specifically on whether to disclose Brogdon's 1996 tax liens, the 1999 NHC bankruptcy, the 2003 Georgia appellate decision, Brogdon's failures to pay interest and principal, the changes in the interest rate and fees he charged Brogdon for the extensions, and arrearages Brogdon owed to Chestnut investors. C. Cantone testified that she discussed at least one of the NASD bars with MG; she did not testify that she discussed the indictment with him. Neither Cantone nor C. Cantone gave any of the details of these alleged conversations and MG did not reduce his advice, if any, to writing. In fact, the only attorney opinion letter concerning Brogdon in the record is the May 2008 letter from Brogdon's counsel. Cantone's testimony and scant documentary evidence are insufficient to establish a reliance on counsel defense. *See SEC v. McNamee*, 481 F.3d 451, 456 (7th Cir. 2007) (rejecting a defendant's argument that reliance on advice of counsel exculpates his conduct because the defendant "offered nothing other than his say-so").

Therefore, we agree with the Hearing Panel that absent proof of the actual advice given, either through testimony or written documentation of the advice, Respondents did not satisfy any of the elements of their defense of advice of counsel.

2. The Cantones' Personal Investments in the Offerings Is Not a Defense

Cantone and CRI maintain that they could not have acted with scienter because Cantone and his family also invested in the COPs. The Cantones testified that they would never have sold the investments to their family members if they did not have faith in the offering. Their personal beliefs in the soundness of the offerings did not relieve respondents of their obligation to disclose material information to investors. The Hearing Panel did not afford this defense any weight, and Respondents argue this was in error. We agree with the Hearing Panel.

3. Respondents' Purported Due Diligence Is Insufficient

Respondents contend that CRI and Cantone conducted extensive due diligence on each project and offering, and that this due diligence negates a finding of scienter. As an initial matter, we have concluded that CRI and Cantone acted negligently with respect to their review of Brogdon's background, and as such there is no scienter requirement to negate. Moreover, there is no real dispute on appeal that respondents engaged in meaningful due diligence to determine the viability of the projects and whether or not they would be good investments. This due diligence included reviewing property appraisals and financial data, environmental assessments, and site visits. However, the due diligence Cantone and others conducted concerning the economics of the underlying projects is not relevant here. Rather, it is the failure

to conduct any meaningful due diligence concerning Brogdon and his background that is relevant in this appeal. Cantone has admitted he did little investigation into Brogdon's background, instead relying on JF's and MG's knowledge of Brogdon from their past association with Brogdon. Therefore, this defense fails.

V. Sanctions

A. CRI's and Cantone's Fraudulent and Negligent Misrepresentations and Omissions

For Cantone's and CRI's fraudulent misrepresentations and omission related to their failure to disclosures Brogdon's missed and late payments and negative material financial information related to Brogdon's projects, the Hearing Panel suspended Cantone for one year, and fined Cantone and CRI $100,000, jointly and severally. For negligently failing to disclose to investors in all five of the offerings Brogdon's negative financial and legal history, the Hearing Panel imposed an additional three-month suspension on Cantone in all capacities, and an additional joint and several fine on Cantone and CRI of $50,000. We affirm.

For an individual charged with intentional or reckless omissions of material fact in the sales of securities, the Sanction Guidelines strongly recommend considering a bar.[24] If there are mitigating circumstances, the Guidelines recommend a suspension in any or all capacities for six months to two years, and a fine of $10,000 to $146,000.[25] For a firm, the Guidelines recommend suspension of any or all activities for up to two years, and strong consideration of expulsion from FINRA membership if there are aggravating circumstances.[26] For negligent misrepresentations and omissions, the Guidelines recommend suspension of an individual in any or all capacities for 31 days to two years, a fine of $2,500 to $73,000, and, for a firm, considering suspension with respect to a limited set of activities for 90 days.[27] Finally, the Guidelines direct us to consider the Principle Considerations in Determining Sanctions that apply to all sanction determinations in our assessment of the severity of respondents' violations.[28]

Enforcement maintains that CRI's and Cantone's misconduct was egregious, and it argues that expelling CRI and barring Cantone are the appropriate sanctions. CRI and Cantone counter that no sanctions should be imposed, and if the NAC determines that sanctions are

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24 *See FINRA Sanction Guidelines* 90 (2017) http://www.finra.org/sites/default/files/2017_Sanctions_Guidelines.pdf [hereinafter *Guidelines*].

25 *Id.*

26 *Id.*

27 *Id.*

28 *Id.*

appropriate, that a bar would be punitive. Respondents contend it is mitigating that they acted as best they could to ensure the accuracy of the CDMs and reasonably relied on the advice of counsel. Thus, they assert there is no misconduct to deter by imposing sanctions. Respondents also argue that mitigating factors exist, including Cantone's offer to repurchase COPs from investors when he extended note maturity dates, paying interest when Brogdon was late, and obtaining judgments against Brogdon. Respondents also maintain that the sophistication of the investors weighs against the imposition of severe sanctions. Respondents note that the investors were all sophisticated, accredited investors who understood the potential risks and rewards and decided to invest only after reviewing the offering documents. Furthermore, each investor represented and warranted that they understood and appreciated the risks involved with investments in the offering. Respondents argue further that they intended no harm, should not be faulted for failing to accept responsibility simply because they defended themselves in this proceeding, and demonstrated their desire to improve by changing their policies in response to FINRA staff's examination findings.

The Hearing Panel determined that of CRI's and Cantone's violations of Section 10(b) of Exchange Act and Rule 10b-5 thereunder were serious, and we agree. While the intentional nature of the CRI's and Cantone's misconduct is an aggravating factor, we note that CRI and Cantone's intentional material misrepresentations and omissions was limited to the extensions of the Columbia and Oklahoma Offering notes and the solicitation of investments in the Cherokee offering.[29] It is aggravating that CRI's and Cantone's fraudulent conduct involved numerous acts, constituting a pattern, and occurred over a significant period of time.[30] It is also aggravating that Cantone has not acknowledged responsibility for his misconduct, even though he did not conduct any independent due diligence with respect any investigation into Brogdon's background.[31] We finally find Cantone's lack of candor with FINRA examiners during the June 2013 FINRA examination aggravating.[32] The examiners asked him if there had been any defaults or late payments in the private placements during the review period, and he said no. However, by that point in time Brogdon had made a number of late interest payments and had failed to pay the Columbia note principal when due, and Cantone had extended the maturity date twice.

Finally, we do not believe that the record supports the Hearing Panel's conclusion that Cantone believed he was acting to protect his investors by keeping the deals viable, and find this

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29 *Guidelines*, at 8 (Principal Considerations in Determining Sanctions, No. 13).

30 *Id.* at 7 (Principal Considerations in Determining Sanctions, No. 8).

31 *Id.* (Principal Considerations in Determining Sanctions, No. 2).

32 *Id.* (Principal Considerations in Determining Sanctions, No. 10).

factor neither aggravating nor mitigating.[33] While we acknowledge the presence of aggravating factors, we have concluded based on the facts and circumstances of this case that a sanction less than a bar is appropriate.

Therefore, we agree that a one-year suspension in all capacities for Cantone, and for Cantone and CRI a joint and several fine of $100,000, are appropriately remedial sanctions for their knowing, material omissions and misrepresentation in connection with the Columbia and Oklahoma extensions and the sales of Cherokee COPs.[34]

As for CRI's and Cantone's negligent misrepresentations, we also find the misconduct serious. Respondents lack of due diligence was negligent.[35] While respondents did not demonstrate reasonable reliance on counsel, they did seek outside advice on what events in Brogdon's past needed to be disclosed, albeit rather perfunctorily.

For Cantone and CRI's negligent failures to disclose to investors in all five of the offerings the NASD bars, the federal tax liens, the NHC bankruptcy, and the court decision finding Brogdon failed to honor a guaranty, we agree that it is appropriate to impose an additional three-month suspension on Cantone in all capacities, and an additional joint and several fine on Cantone and CRI in the amount of $50,000. Cantone's suspensions will run consecutively.

B. Failure to Supervise

The Hearing Panel suspended C. Cantone for six months in all capacities for her failures to supervise Cantone, and fined C. Cantone and CRI $75,000, jointly and severally. We have, however, determined that a lengthier suspension is warranted and impose a two-year suspension in all principal and supervisory capacities with a requirement to requalify. We have also reduced the fine imposed to $73,000 to comport with the Guidelines.

The Sanction Guidelines recommend for a failure to supervise a fine in the range of $5,000 to $73,000, and suspending the responsible individual in all supervisory capacities for up to 30 business days and limiting the activities of the appropriate branch office or department for

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[33] We disagree with respondents' characterization of Cantone's actions as mitigating under Principal Consideration No. 4 (whether the respondent voluntarily and reasonably attempted, prior to detection and intervention, to pay restitution or otherwise remedy the misconduct).

[34] We impose joint and several fines on CRI and Cantone because it was through Cantone that the misconduct for which CRI is liable occurred. *See id.* at 9.

[35] *Id.* at 8 (Principal Considerations in Determining Sanctions, No. 13).

up to 30 business days.[36] In egregious cases, the Guidelines direct the adjudicator to consider limiting the activities of the branch office or department for a longer period or suspending the firm with respect to any or all activities or functions for up to 30 business days.[37] The adjudicator is also directed to consider suspending the responsible individual in any or all capacities for up to two years or barring the responsible individual.[38]

Notably, this is not the first supervisory violation for C. Cantone and CRI. In February 2012, C. Cantone and CRI entered into an Offer of Settlement with FINRA in which C. Cantone was suspended for three months in any principal capacity, fined $10,000 jointly and severally with CRI, and ordered to pay $200,000 in partial restitution to customers jointly and severally with CRI. Without admitting or denying the allegations, C. Cantone and CRI consented to the entry of findings that C. Cantone failed to reasonably supervise a CRI registered representative who sold fraudulent investments to firm customers and misappropriated approximately $1.6 million of customers' funds. The Guidelines direct the imposition of progressively escalating sanctions on recidivists and require a lengthier suspension here.[39]

The supervision failures in this case are troubling. CRI, acting through C. Cantone failed to adequately supervise CRI and Cantone's conduct related to the Brogdon-related COPs. CRI, through C. Cantone, ignored red numerous flags, particularly with respect to numerous late and missed payments by Brogdon, that CRI, through C. Cantone, covered. C. Cantone testified that she was aware of these issues, but was also responsible for signing the checks to cover Brogdon's late and missed payments. "Assuring proper supervision is a critical component of broker-dealer operations." *Dep't of Enforcement v. Rooney*, Complaint No. 2009019042402, 2015 FINRA Discip. LEXIS 19, at *59 (FINRA NAC Jul. 23, 2015) (*quoting Pellegrino*, 2008 SEC LEXIS 2843, at *33). Given that the supervisory violations in this case are serious, the absence of any mitigating factors, and that C. Cantone is a recidivist, we find that CRI and C. Cantone should be fined, jointly and severally, $73,000 and that C. Cantone should be suspended in all supervisory capacities for two years, with the requirement that she requalify after the completion of her suspension.

C. Restitution

Enforcement asks that we order respondents to pay restitution. Adjudicators may order restitution "when an identifiable person . . . has suffered a quantifiable loss proximately caused by a respondent's misconduct." Further, "[a]djudicators should calculate orders of restitution

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36 *Id.* at 104.

37 *Id.*

38 *Id.*

39 *Guidelines*, at 2 (Disciplinary sanctions should be more severe for recidivists).

based on the actual amount of the loss sustained by a person . . . as demonstrated by the evidence . . . Restitution orders must include a description of the adjudicator's method of calculation."[40]

Enforcement argues that the Hearing Panel erred in finding that it abandoned its claim for restitution. Indeed, while Enforcement's complaint requests restitution or disgorgement, Enforcement made no arguments in its briefs or at the hearing, nor did it provide the adjudicator with any meaningful evidence that would support either form of relief. While we agree that Enforcement abandoned its claim for restitution, the NAC still retains the ability to order restitution or disgorgement where appropriate.

Here, Enforcement has not successfully established a claim for restitution. There is no quantifiable loss suffered by the investors. Enforcement's broad claim that the investors in Brogdon-related COPs lost $4 million is inaccurate. Enforcement looks only to the amount of investor's outstanding principal as the quantifiable loss, without providing any additional information or calculations. Therefore, we are unable to award restitution.

VI. Conclusion

CRI and Cantone intentionally made material omissions and a misrepresentation in connection with the sales of securities in a series of private placements, in willful violation of Section 10(b) of the Exchange Act, Rule 10b-5 thereunder, and FINRA Rules 2020 and 2010. For these violations, Anthony Cantone is suspended in all capacities for one year and fined, jointly and severally with CRI, $100,000. CRI and Cantone also negligently made additional material omissions in connection with the sales of securities, in violation of Sections 17(a)(2) and (3) of the Securities Act, and FINRA Rule 2010. For these violations, Cantone is suspended in all capacities for three months and fined, jointly and severally with CRI, $50,000. The suspensions will run consecutively. For their willful violations of the Exchange Act, CRI and Cantone are statutorily disqualified.

C. Cantone and CRI violated NASD Rule 3010(a) and FINRA Rule 2010 by failing to reasonably supervise Cantone. For these violations, C. Cantone is suspended for two years in any principal and supervisory capacities, and fined $73,000, jointly and severally with CRI. C. Cantone is also ordered to requalify as a securities principal upon the completion of her suspension.

We affirm the Hearing Panel's dismissal of the charge that CRI and Cantone misused customer funds.

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40 *Guidelines*, at 4.

We also affirm the Hearing Panel's imposition of hearing costs in the amount of $17,201.27, jointly and severally among Cantone, C. Cantone, and CRI, and impose appeal costs in the amount of $1,572.61, jointly and severally among Cantone, C. Cantone, and CRI.[41]

On Behalf of the National Adjudicatory Council,

Jennifer Piorko Mitchell,
Vice President and Deputy Corporate Secretary

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41 Pursuant to FINRA Rule 8320, the membership of any firm that fails to pay any fine, costs, or other monetary sanction, after seven days' notice in writing, will summarily be revoked for non-payment. Similarly, the registration of any person associated with a member who fails to pay any fine, costs, or other monetary sanction, after seven days' notice in writing, will summarily be revoked for non-payment.