FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. CAROLINA FINANCIAL SECURITIES, LLC (CRD No. 41970), and BRUCE VICTOR ROBERTS (CRD No. 1489110), Respondents.	Disciplinary Proceeding No. 2014040295201 Hearing Officer–KBW **EXTENDED HEARING PANEL DECISION** May 26, 2017

Member firm made material misrepresentations and omissions in connection with the sale of securities. While lacking a reasonable basis for the recommendation, the member firm recommended that its customers purchase certain securities. Member firm and its chief executive officer made false and misleading communications to the public and failed to enforce the firm's written supervisory procedures. The member firm is fined $60,000, and this Decision shall serve as a Letter of Caution to both Respondents. Respondents also are jointly and severally assessed hearing costs.

Enforcement did not prove that Respondents made fraudulent misrepresentations and omissions in the sale of securities. Enforcement also did not prove that the firm's chief executive officer negligently made misrepresentations and omissions in connection with the sale of securities or that he recommended that his customers purchase securities while lacking a reasonable basis for his recommendations. These charges are dismissed.

Appearances

For the Complainant: William Brice LaHue, Esq., and Mark J. Fernandez, Esq. Department of Enforcement, Financial Industry Regulatory Authority

For the Respondents: Sylvia Scott, Esq., Holmes, Taylor, Scott & Jones, LLP

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DECISION

I. Introduction

This case arose from the sale of notes ("IMGF Notes") by Carolina Financial Securities, LLC ("Carolina" or "Firm") to accredited investors in February 2014 ("IMGF Offering"). The IMGF Notes were issued by a special purpose entity, International Manufacturing Group Funding, LLC ("IMGF"), for the stated purpose of IMGF's lending money to International Manufacturing Group, Inc. ("IMG"), a medical and dental supply company, to finance certain costs related to setting up a facility to manufacture medical gloves and other supplies. The offering materials prepared and circulated by Carolina ("IMGF Offering Materials") described the IMGF Notes as backed by substantially all of the assets of IMG and guaranteed by Deepal Wannakuwatte ("Wannakuwatte"), IMG's chief executive officer ("CEO") and owner.

On Friday, February 21, 2014, while Carolina was still selling the IMGF Notes, the Federal Bureau of Investigation arrested Wannakuwatte. The FBI suspected that Wannakuwatte was operating a Ponzi scheme.[1]

The following Monday, Carolina informed FINRA of the IMGF Offering and Wannakuwatte's arrest.[2] The subsequent investigation resulted in the filing of the Complaint against Respondents Carolina and Bruce Roberts, Carolina's CEO and chief compliance officer ("CCO").

The Complaint set forth three causes of action that were based on alleged material misrepresentations and omissions in the IMGF Offering Materials. The Complaint charged that Respondents violated Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), Rule 10b-5 thereunder, and FINRA Rules 2020 and 2010 by knowingly or recklessly making material misrepresentations and omissions in the IMGF Offering Materials in that they allegedly failed to respond adequately to red flags that would alert a prudent person to conduct further inquiry. In the alternative, the Complaint charged that Respondents acted in contravention of Section 17(a) of the Securities Act of 1933 ("Securities Act") and thereby violated FINRA Rule 2010 by negligently making the material misrepresentations and omissions in the IMGF Offering Materials. The Complaint also charged that Respondents violated FINRA Rules 2210(d)(1) and 2010 in that the IMGF Offering Materials contained material false statements. The misrepresentations alleged in the Complaint include that: (1) IMG had an accounts receivable balance of $36,685,722 as of November 30, 2013; (2) IMG had a requirements contract with the Department of Veterans Affairs ("Veterans Affairs"), which contemplated the supply of more than $90 million worth of examination gloves; and (3) the IMGF Notes were guaranteed by

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[1] Complaint ("Compl.") ¶¶ 1, 8; Amended Answer ("Ans.") ¶¶ 1, 8; CX-79, at 12-14. "A Ponzi scheme, named for the perpetrator of such a scheme in the 1920s, is an investment fraud that involves the payout of purported earnings to existing investors from funds contributed by new investors." *Bernerd E. Young*, Exchange Act Release No. 10060, 2016 SEC LEXIS 1123, at *4 n.2 (Mar. 24, 2016).

[2] Hearing Transcript ("Tr.") 25-26, 1213; CX-5, at 42; CX-41; CX-48.

Wannakuwatte and will be secured by a first lien position in substantially all of the assets of IMG.

Also, the Complaint set forth two causes of action that were not based on the alleged misrepresentations and omissions. The Complaint charged that Respondents violated FINRA Rules 2111(a) and 2010 by recommending the IMGF Notes to customers without conducting a reasonable investigation of the notes. The Complaint also charged that Respondents violated NASD Rule 3010 and FINRA Rule 2010 by failing to enforce Carolina's written supervisory procedures ("WSPs") with respect to: (1) Carolina's investigation of the IMGF Notes and the representations in the IMGF Offering Materials ("Due Diligence WSPs") and (2) Carolina's determination of whether the IMGF Notes were suitable for investors ("Suitability WSPs").

Respondents do not dispute that the IMGF Offering Materials materially overstated IMG's financial condition and performance, including IMG's accounts receivable balance as of November 30, 2013. Respondents maintain, however, that Carolina conducted a reasonable investigation, which they refer to as "Due Diligence," regarding the IMGF Notes and the disclosures in the IMGF Offering Materials.

Respondents argue that the Extended Hearing Panel should evaluate the reasonableness of Carolina's Due Diligence in light of the nature of the IMGF Offering (one-year, senior secured notes), the size of the initial tranche of the IMGF Offering ($3 million), the history of IMG (in business for more than two decades), and the strength of IMG as reflected in its balance sheet and income statement. Respondents noted that as part of Carolina's Due Diligence, Carolina verified, among other things, that: (1) there were no outstanding Uniform Commercial Code ("UCC") financing statements against either IMG or Wannakuwatte; (2) IMG and Wannakuwatte had never filed for bankruptcy; (3) IMG had been in business for more than two decades, and (4) IMG maintained a warehouse containing stacks of medical supplies, shipped supplies from that warehouse, operated a call center to receive orders, and had active accounts at a number of banks. Respondents maintain that they enforced the Due Diligence WSPs and that the failure to enforce the Suitability WSPs did not result in inadequate supervision.

II. Summary of Findings

In connection with the causes of action charging that the IMGF Offering Materials contained material misrepresentations and omissions, the Panel finds that Enforcement established by a preponderance of the evidence that: (1) the IMGF Offering Materials contained materially false and misleading disclosures; (2) Carolina failed to conduct a reasonable investigation regarding the disclosures in the IMGF Offering Materials; (3) Carolina therefore lacked a reasonable basis for those disclosures; and (4) Carolina therefore acted in contravention of Section 17(a) of the Securities Act and in violation of FINRA Rule 2010 (Second Cause of Action). The Panel further finds that Enforcement established that Carolina: (1) recommended the IMGF Notes to investors without conducting a reasonable investigation to determine if the notes were suitable for at least some investors; and (2) therefore violated FINRA Rules 2111(a) and 2010 (Third Cause of Action). The Panel also finds that Enforcement established that both

Respondents made false statements in violation of FINRA Rules 2210(d)(1) and 2010 (Fourth Cause of Action) and failed to follow and enforce the Firm's Suitability WSPs in violation of NASD Rule 3010 and FINRA Rule 2010 (Fifth Cause of Action).

The remaining causes of action are dismissed. Enforcement did not prove by a preponderance of the evidence that Respondents knowingly or recklessly made materially false or misleading representations or omissions, in violation of Section 10(b) of the Exchange Act, Rule 10b-5 thereunder and FINRA Rules 2020 and 2010. Enforcement did not prove by a preponderance of the evidence that Roberts failed to conduct a reasonable investigation regarding the IMGF Notes and the disclosures in the IMGF Offering Materials. And Enforcement did not prove by a preponderance of the evidence that Respondents failed to enforce the Firm's Due Diligence WSPs.

III. Findings of Fact

A. Respondents and Other Relevant Individuals and Entities

In addition to making findings regarding the two Respondents, the Panel also makes findings regarding other relevant individuals and entities. In order to evaluate Carolina's investigation of the IMGF Notes and the disclosures in the IMGF Offering Materials, the Panel makes findings regarding four Carolina employees who were involved in Carolina's investigation, three other individuals who were involved in bringing to Carolina's attention the financing opportunity that led to the IMGF Offering ("Financing Opportunity"), Wannakuwatte, and two companies that Wannakuwatte owned.

1. Respondent Bruce Victor Roberts

Roberts entered the securities industry in March 1986, after earning a degree in civil engineering and serving for four years as a Naval Special Warfare Officer ("Navy Seal").[3] He was associated with several FINRA member firms between March 1986 and July 1995. Roberts has served as the Firm's CEO since he founded Carolina in 1996 and as its CCO since 2001.[4]

As of January and February 2014, Roberts was registered with Carolina as a general securities representative (Series 7) and a general securities principal (Series 24).[5]

2. Respondent Carolina Financial Services, LLC

Carolina has been a FINRA member firm since 1997. Carolina has approximately 18 registered representatives who operate out of its main office (located in Brevard, North Carolina), or a branch office (located in Raleigh, North Carolina; Irvine, California; and Darien, Connecticut). The Firm derives all of its revenue from private placements for issuer-clients. In

[3] Compl. ¶ 4; Ans. ¶ 4; CX-2, at 32.

[4] CX-1, at 6; CX-2, at 3; Tr. 850, 1428.

[5] Compl. ¶ 4; Ans. ¶ 4; CX-2.

the five years ended December 31, 2015, the Firm placed 106 offerings on behalf of middle market or lower-middle market companies, including 73 current income (mostly debt) offerings. Carolina had a distribution channel consisting of high net-worth individuals, family offices, specialty investment firms, and a select group of independent registered investment advisers.[6] In 2014, Carolina's revenue (net of commissions) was approximately $1 million.[7]

In February 2014, Carolina had approximately five individuals working on the development of private placements.[8] Carolina refers to these individuals as "investment bankers" or "bankers."[9] On each private placement, an investment banker took the lead in maintaining contact with the issuer client, preparing the offering materials, conducting the Firm's investigation of the contemplated security and the representations in the offering materials, and managing the preparation of the closing documents.[10]

IMG formally engaged Carolina to assist IMG, on a best efforts basis, in a Regulation D private placement to raise up to $5 million of "senior secured loan funding." The Firm agreed, among other things, to prepare the offering documentation, contact selected prospective investors, coordinate communications with prospective investors, create IMGF, create initial drafts of all closing documentation, and supervise closing procedures for the financing. IMG agreed to provide the Firm with, among other things, reasonable access to its officers, directors, employees, accountants, counsel and other representatives.[11]

3. Other Carolina Employees

Peter Milhaupt has been Carolina's chairman since he joined the Firm in 2011. Each Carolina transaction required the approval of both Roberts and Milhaupt, and they collaborated in reviewing each prospective Carolina transaction. Before joining Carolina, Milhaupt supervised approximately 300 people as global co-head of debt capital markets for a major investment bank.[12]

Sanjay Raghavan was Carolina's lead investment banker on the IMGF Offering. Raghavan joined the Firm in September 2011 after earning a master of business administration degree from the Wharton School of the University of Pennsylvania and working in a number of finance-related jobs.[13] At Carolina, Raghavan initially assisted Roberts in evaluating projects. In March 2012, Raghavan received his securities licenses and started taking on additional

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[6] Compl. ¶ 3; Ans. ¶ 3; Tr. 1427-37, 1452, 1647; CX-1, at 2, 5; RX-91.

[7] Tr. 1589.

[8] Tr. 1452-53.

[9] Tr. 1452.

[10] Tr. 1452-53.

[11] CX-11.

[12] Tr. 1429-31, 1633-35.

[13] Tr. 970-74; CX-3, at 3.

assignments. Before working on the IMGF Offering, Raghavan worked at the Firm either as the lead banker or as the co-lead banker on more than a dozen transactions.[14] As of January and February 2014, Raghavan was registered with the Firm as both a general securities representative (Series 7) and an investment banking representative (Series 79).[15] During his association with Carolina, Raghavan was based in the San Francisco Bay area.[16]

Craig Gilmore has been Carolina's FINOP since 2006. He directed the LexisNexis background searches that Carolina conducted in connection with private placements.[17]

Alicia Wells was a law school graduate employed by Carolina. Under Gilmore's supervision, she, among other things, performed UCC searches and used LexisNexis to conduct background checks on issuers.[18]

4. Other Individuals Involved in Bringing Financing Opportunity to Carolina's Attention

Richard Kostkas, a certified public accountant, was the head of a factoring company for which Carolina had raised funds. He brought the Financing Opportunity to Raghavan's attention.[19]

Tony Avila was a business broker who, from time to time, sent potential deals to Kostkas's company. He brought the Financing Opportunity to Kostkas's attention.[20]

John Anderson was a consultant whom Wannakuwatte retained to assist in looking for financing. Anderson sent information to Avila regarding the Financing Opportunity. Anderson was also involved in efforts to raise funds for Wannakuwatte through an EB-5 offering.[21] Anderson had known Kostkas for a long time.[22]

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[14] Tr. 29-30, 219, 971-80; CX-3; RX-126.

[15] CX-3.

[16] Tr. 219.

[17] Tr. 548-49, 1697.

[18] Tr. 919, 1094-95, 1728.

[19] Tr. 225, 227-28, 1049.

[20] Tr. 250.

[21] Tr. 230, 1016-17. EB-5 is a federal program to create jobs in economically depressed areas. Under this program, the federal government encouraged foreign nationals to invest capital in U.S. ventures at low interest rates in return for preferential treatment in becoming a permanent legal U.S. resident. Tr. 230, 1022.

[22] Tr. 1015.

5. IMG, Wannakuwatte and Olivehurst Glove Manufacturing LLC

IMG was founded in 1988.[23] IMG was a wholesale and retail medical and dental supply business based in West Sacramento, California. IMG operated a facility there that included a 25,000 square foot warehouse, which was stacked with gloves and other medical and dental supplies, and a call center in which people received orders. IMG marketed its products under the brand name, "RelyAid."[24] Although IMG's financial statements reported net sales of more than $130 million for the first 11 months of 2013, a bankruptcy petition that IMG filed in May 2014 disclosed that IMG's actual gross business revenues for all of 2013 were less than $5 million.[25]

During the relevant period, IMG was owned by Wannakuwatte, who served as IMG's president and CEO from its creation through the period when Carolina sold the IMGF Notes, and his wife, BW. Wannakuwatte also owned a professional tennis team in Sacramento.[26] Wannakuwatte was arrested on February 21, 2014, and charged in a criminal complaint with conspiracy, mail fraud, wire fraud, and bank fraud.[27] In May 2014, Wannakuwatte entered into a plea agreement in which he pled guilty to one count of wire fraud. Wannakuwatte admitted in his plea agreement that he obtained over $150 million by making a variety of material false representations, including overstating the value of a contract with Veterans Affairs and overstating the accounts-receivable balance relating to Veterans Affairs.[28] Wannakuwatte filed for bankruptcy in May 2014.[29]

In addition to IMG, Wannakuwatte owned Olivehurst Glove Manufacturing, LLC ("Olivehurst Glove"). Olivehurst Glove owned and was developing a facility, located in Olivehurst, California, that was to manufacture examination gloves and other disposable medical supplies ("Olivehurst Facility").[30]

B. The IMGF Offering Materials

The IMGF Offering Materials consist of three documents: an eight-page information memorandum; a four-page summary of the terms of the offering ("Term Sheet"); and a one-page chart showing the flow of funds. On February 2, 2014, Raghavan emailed the information

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[23] Compl. ¶ 6; Ans. ¶ 6.

[24] Tr. 909, 1025-26.

[25] CX-20, at 4; CX-85, at 1, 38.

[26] Compl. ¶ 6; Ans. ¶ 6.

[27] Compl. ¶ 8; Ans. ¶ 8; CX-81.

[28] Compl. ¶ 8; Ans. ¶ 8; Tr. 1214.

[29] CX-85, at 2.

[30] RX-40, at 3; Tr. 248.

memorandum to Roberts.[31] Roberts made at least two rounds of minor edits to the information memorandum.[32]

Three days after he initially emailed the information memorandum to Roberts, Raghavan circulated revised IMGF Offering Materials to Carolina's registered representatives, explaining that Roberts had approved this version of the IMGF Offering Materials to be sent to prospective investors.[33] On February 7, 2014, one week before the commencement of the offering, Carolina emailed the IMGF Offering Materials to scores of potential investors, including more than 100 of Roberts' clients.[34] The interest rate was set at 13.5%, which Carolina believed was sufficient to attract investors.[35] In the transmittal email, Carolina stated (among other things) that Wannakuwatte "will personally guarantee the [IMGF] Notes" and his net worth exceeds $10 million outside of his ownership in IMG and Olivehurst Glove and over $70 million inclusive of those corporate investments.[36]

Sometime after February 7, Carolina prepared a private placement memorandum for the IMGF Offering ("IMGF PPM").[37] The information in the IMGF PPM was similar to the information in the IMGF information memorandum.[38] Carolina posted the IMGF PPM on its investor portal, which Carolina investors could access over the Internet. Carolina also posted on the investor portal the IMGF Offering Materials and most of the documents that Carolina had gathered in conducting Due Diligence.[39]

For the purpose of assessing both the materiality of the alleged misrepresentations and omissions and the reasonableness of the investigations conducted by Carolina and Roberts into the IMGF Notes and the disclosures in the IMGF Offering Materials, the Panel makes findings regarding the disclosures in the IMGF Offering Materials relating to six topics: (1) the IMGF Notes and related guarantee and security interest; (2) IMG's financial statements; (3) IMG customers; (4) IMG suppliers; (5) the expected use of proceeds; and (6) the fees and expenses to be paid in connection with the IMGF Offering.

1. IMGF Notes and Related Guarantee and Security Interest

The Term Sheet disclosed that "[u]p to $5,000,000 of senior secured notes . . . are being issued on a continuous basis through a series of tranches . . . having the same security

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[31] CX-36.

[32] CX-36; CX-44.

[33] CX-36; CX-43.

[34] CX-46; CX-53; Tr. 122.

[35] Tr. 595-97.

[36] CX-53, at 2.

[37] CX-5, at 24.

[38] Tr. 110-11.

[39] Tr. 506-07, 623-24, 755-56, 921, 944-45, 1075.

interests."[40] The chart showing the flow of funds disclosed that the initial tranche would be $3 million.[41]

On the first page of the information memorandum, in a sidebar entitled, "Key Offering Terms," Carolina described the IMGF Notes as "Senior Secured Notes of IMG, Inc.," and set forth that the IMGF Notes had a term of one year, bore a 13.5% annual interest rate paid monthly, and all principal was due at maturity.[42] In the sidebar, Carolina described the IMGF Notes as "[s]ecured substantially by all assets of [IMG]. IMG grants to Lenders the right to file a UCC statement to perfect its lien," and stated that "[t]he Loan and its interest is fully guaranteed by . . . Wannakuwatte."[43] Carolina described "closing" as occurring as, "funds are committed by Lenders."[44]

Similarly, under the caption, "Senior secured debt obligation," the information memorandum disclosed that the loan from IMGF to IMG ("the IMG Loan") "will be collateralized by substantially all assets of IMG and will also carry a personal guaranty from the founder and CEO, Deepal Wannakuwatte" ("Wannakuwatte Guarantee").[45]

2. IMG Financial Statements

In the last four pages of the information memorandum, Carolina disclosed financial information regarding IMG including: (1) a graph showing IMG's reported net sales and net income for 2006 through 2012 and estimated net sales and net income for 2013; (2) more detailed information from IMG's income statements, balance sheets, and cash-flow statements for 2010, 2011, 2012, and January through November 2013; and (3) standard financial ratios that Carolina had calculated based on IMG's 2010 through 2012 annual financial statements. The information memorandum disclosed that IMG's net sales and net income grew from about $28 million and $1 million, respectively in 2006 to about $111 million and $4.1 million, respectively, in 2010 to about $149 million and $7.2 million, respectively in 2012, and to about $137 million and $7.1 million for the first eleven months of 2013.[46] The information memorandum showed that as of November 2013, IMG had current assets of about $52 million, which included about $37 million in accounts receivable and about $14 million in inventory (up from about $7 million at December 31, 2012). The information memorandum showed as IMG's other major asset, "Advances to Affiliates + Shareholder Loan" of about $23 million. The information

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[40] CX-53, at 13.

[41] CX-53, at 16.

[42] CX-53, at 3.

[43] CX-53, at 3. The Loan and Security Agreement between IMFG and IMG provided that IMGF's security interest in IMG's assets will be "perfected through the filing of a lien or U.C.C. financing statement (as may be applicable), on behalf of [IMGF] by [an affiliate of Carolina]." CX-41, at 17.

[44] CX-53, at 3.

[45] CX-53, at 6.

[46] CX-53, at 8-11.

memorandum showed current liabilities of about $37 million, no long-term liabilities, and total shareholders' equity of about $38 million at November 30, 2013.[47]

3. IMG Customers

The information memorandum set forth information regarding IMG's customers. In a sidebar, the memorandum set forth a "Major Customer List" purporting to identify IMG's fifty largest customers.[48] In a paragraph captioned, "Long term customers and contracts," Carolina disclosed:

> IMG has several long-term customers and contracts for the supply of gloves and other medical and dental hygiene products. More than 50 local and state dental associations have designated IMG as their preferred glove vendor over the years. Additionally, IMG also holds a requirements contract with the Department of Veterans Affairs which contemplates the supply of more than $90 mm worth of examination gloves for use in 34 VA facilities nationwide. The contract also calls for approximately $38.4 mm of gloves to be made of materials other than latex or vinyl. IMG expects to fill its existing demand for Nitrile gloves with products manufactured by [Olivehurst Glove].[49]

4. IMG Suppliers

The most extensive disclosure regarding an IMG supplier focused on the Aloetouch® Ease glove, a glove distributed by IMG. Under "Business Overview," the information memorandum described the Aloetouch® Ease glove and stated that IMG was the exclusive distributor for the glove in the United States:

> In late 2003, [IMG] partnered with Medline Industries to create Aloetouch® Ease, a glove that is an anatomically correct, left- and right-fitted design, and solves issues arising from wearing powdered, latex, ambidextrous gloves. Through a patented manufacturing technique, the interior of the glove is coated with pure aloe vera gel that penetrates, moisturizes and softens the skin. Aloetouch® Ease gloves are also textured to enhance gripping. IMG is the exclusive distributor of Aloetouch® Ease gloves in the United States.[50]

In a section entitled, "Management," the information memorandum disclosed that Wannakuwatte, "in partnership with Medline Industries, was instrumental in the creation

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[47] CX-53, at 8-9.

[48] CX-53, at 5.

[49] CX-53, at 7.

[50] CX-53, at 3-4. Although the information memorandum refers to the glove as the "Aloetouch® Ease" glove, other exhibits refer to the glove as the Aloe*touch* Ease" glove, the "AloeTouch Ease" glove, or the "Aloetouch Ease" glove.

of the revolutionary anatomically correct left- and right-fitted Aloetouch® Ease glove for the dental industry."[51] Under "Corporate Milestones," the information memorandum disclosed that in 2004 "In partnership with Medline Industries, [IMG began] manufacturing the patented Aloetouch® Ease left- and right-hand fitted gloves, for which it becomes the exclusive U.S. distributor."[52]

The information memorandum contained limited disclosures regarding IMG's other suppliers, including that "[t]hrough Mr. Wannakuwatte's knowledge of the rubber production business . . . and relationships with Asian glove manufacturers, he has built a very successful distribution business with his RelyAid brand of sanitary protective gloves and masks."[53] The information memorandum also disclosed that IMG was a wholesale representative for prominent companies including Medline Industries, McKesson Corporation, and Crosstex International.[54]

5. Expected Use of Proceeds

The Term Sheet disclosed as "Use of Proceeds," extending the IMG Loan from IMGF to IMG to "finance certain costs related to the setting up of [Olivehurst Glove], a new manufacturing affiliate of IMG, being created to manufacture high-end exam gloves and select lines of disposable supplies in the U.S."[55] The information memorandum disclosed additional information regarding the gloves to be manufactured at the Olivehurst Facility:

> Mr. Wannakuwatte is currently involved in setting up a new "Nitrile" glove manufacturing facility in Olivehurst, California. Unlike Latex gloves, Nitrile gloves do not contain any natural rubber latex, so they can be used by anyone with latex allergies. Also Nitrile gloves offer excellent resistance to wear and tear, are puncture resistant and offer superior resistance against many types of chemicals . . . . Due to the superior quality of Nitrile gloves, most U.S. government agencies are now starting to advocate their use. The Olivehurst facility will be the first of its kind in the U.S. . . . [56]

6. Fees and Expenses

The Term Sheet contained disclosures regarding both initial fees and expenses and ongoing fees and expenses. Regarding initial fees and expenses, the Term Sheet disclosed that "6% of the Loan amount is being retained by [IMGF] to pay a 4% placement fee to Carolina . . . for acting as placement Agent for the [IMGF Offering], and a 2% management fee to [Kostkas's

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[51] CX-53, at 7.

[52] CX-53, at 4.

[53] CX-53, at 3.

[54] CX-53, at 3.

[55] CX-53, at 13.

[56] CX-53, at 4.

company]." Regarding ongoing fees and expenses, the Term Sheet disclosed that "IMG will pay to [IMGF] a 1.50% (annualized) fee, payable monthly . . . to pay for [IMGF's] formation, legal fees, bookkeeping, Form D filing, tax preparation, bank fees and other ongoing expenses."[57]

C. Sale of IMGF Notes and Planned Timing of Signing of IMG Closing Documents

In this section, the Panel makes findings regarding Carolina's sale of IMGF Notes. The Panel uses these findings in assessing whether the disclosures in the IMGF Offering Materials regarding the Wannakuwatte Guarantee and the security interest in substantially all of IMG's assets were materially misleading and whether Carolina complied with its Suitability WSPs. The Panel also uses these findings in assessing sanctions.

Between February 14 and 21, 2014, Roberts, Raghavan and three other Carolina registered representatives sold a total of $2,450,000 in IMGF Notes to 18 investors in a continuous, best efforts offering.[58] The 18 investors included three of Roberts' customers, who invested a total of $525,000.[59] As soon as IMGF received funds from an investor, IMGF wired the funds (minus the 6% retained for placement and management fees) to IMG.[60] Between February 14 and February 21, Roberts caused IMGF to wire $2,303,000 to IMG.[61]

Carolina's usual practice in a continuous, best efforts offering was to ask the issuer to sign the closing documents only after the issuer had received all, or almost all, of the offering proceeds.[62] Consistent with this practice, Carolina planned not to ask Wannakuwatte to sign the closing documents relevant to the security interest and the Wannakuwatte Guarantee until IMG had received all, or almost all, the proceeds of the IMGF Offering. Carolina's reasoning for this signing practice was that it was not appropriate to ask Wannakuwatte to sign the closing documents before he was comfortable that he would receive the expected funds.[63] As a result, when Carolina sold the IMGF Notes to the 18 IMGF investors, Wannakuwatte had not signed the the Secured Promissory Note from IMG to IMGF for $3 million ("IMG Promissory Note"), the Wannakuwatte Guarantee, and the Loan and Security Agreement in which IMG granted IMGF a security interest in IMG's assets and granted Carolina the right to perfect the security interest by filing a lien or UCC financing statement on behalf of IMGF ("IMG Loan and Security Agreement") (collectively, "IMG Closing Documents").

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[57] CX-53, at 14. Including the 13.5% interest paid on the notes, the 6% that IMGF would retain for initial fees, and the 1.5% fee that IMGF would receive for its expenses, IMG was paying an effective annual interest rate of more than 22%.

[58] CX-48; CX-49; CX-50; CX-52; Tr. 125-26.

[59] CX-52; Tr. 130.

[60] Tr. 128, 578, 1683.

[61] CX-49; Tr. 943.

[62] Tr. 567-68, 1213-14.

[63] Tr. 567, 570-71.

On February 21, before learning that Wannakuwatte had been arrested the previous evening, Raghavan sent an email to Wannakuwatte transmitting the IMG Closing Documents with a request that he sign and return them.[64]

D. Carolina's Written Supervisory Procedures

The Complaint alleged that Carolina's WSPs "required that the designated principal, in this case, Roberts, conduct due diligence and approve all offerings sold by Carolina" and that in connection with the IMGF Offering Carolina failed to enforce its Due Diligence WSPs and Suitability WSPs.[65] The Panel therefore makes findings interpreting Carolina's WSPs and findings regarding the enforcement by Roberts and Carolina of these WSPs.

1. Due Diligence

Carolina's Due Diligence WSPs defined "due diligence" as "a reasonable investigation conducted by the parties involved in preparing a registration statement (or any offering memo) to form a basis for believing that the statements contained therein are true and that no material facts are omitted."[66] In addition, the WSPs provided that Carolina "has a Due Diligence Checklist as part of its standard offering documents. Always give client companies this checklist, obtain the items and review them carefully before the first on site meeting with management."[67]

Carolina's Due Diligence WSPs also set forth that Roberts, as the "Designated Principal," "is responsible for ensuring that each Private Placement in which the firm participates is conducted, and documents related to the Private Placement are maintained, in accordance with applicable securities rules and regulations."[68]

Carolina's Due Diligence WSPs repeatedly required that Roberts review Due Diligence documents. Under the caption "Supervisory Responsibilities," the Due Diligence WSPs provided:

> The Designated Principal is to review and approve documents related to each Private Placement in which the member participates. Documents and areas to be reviewed include, but are not limited to, subscription documents . . . offering memorandums, correspondence, Form D, financial statements and/or filings of the issuer, all regulatory filings, registration exemptions, *due diligence materials*,

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[64] Tr. 1213; CX-41.

[65] Compl. ¶¶ 107, 110.

[66] CX-77, at 18.

[67] CX-77, at 20 (emphasis deleted).

[68] Tr. 852, 859; CX-77, at 15, 72.

> disclosures to investors, any research and/or analysis, compliance with advertising/solicitation guidelines and accreditation status of investors.[69]

Under the caption, "Due Diligence Requirements," Carolina's Due Diligence WSPs provided:

> The Designated Principal(s) will review and maintain all appropriate documents necessary to demonstrate the fulfillment of the firm's due diligence responsibilities as it relates to each security underwritten . . . . The Designated Principal must review and maintain all due diligence documents in a separate file for each offering.[70]

Under the caption, "Company Procedures," Carolina's Due Diligence WSPs twice instructed Roberts to review Due Diligence documents:

> The Designated Principal(s) and the FINOP will review all prospectuses and/or private placement memorandums for securities sold by the Firm. The review of any potential deal will be conducted at [Carolina's Brevard, North Carolina, office]. This review will encompass:
>
> - registration exemptions
> - disclosures to investors, including any necessary summary disclosures about issuers controlled by or under common control with the Firm, as required by FINRA Rule 2262
> - compensation to underwriters
> - contingencies of the offering
> - escrow requirements
> - *due diligence materials*
>
> * * *
>
> The Designated Principal will review the above noted documents and evidence his/her review by initialing that record.[71]

Enforcement alleged that Carolina's Due Diligence WSPs required that Roberts personally conduct Carolina's Due Diligence on each offering sold by Carolina.[72] The Panel rejects this interpretation of Carolina's Due Diligence WSPs and finds that Carolina's Due Diligence WSPs required Roberts to exercise reasonable judgment regarding the extent to which he reviewed Due Diligence documents.

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[69] CX-77, at 15-16 (emphasis added).

[70] CX-77, at 19.

[71] CX-77, at 20 (emphasis added).

[72] Compl. ¶ 107.

2. Suitability

Carolina's Suitability WSPs prohibited the Firm from authorizing a Carolina registered representative to sell a security unless the representative demonstrated an understanding of the security by passing a quiz:

> [Carolina] has therefore launched a company owned e-learning platform that will be used, among other things, to make sure that each registered representative permitted to sell a particular offering has a sufficient level of understanding of the product and its associated risks to evaluate the appropriateness of a recommendation. To achieve this, representatives will be required to pass a quiz on the e-learning platform with an 80% grade or better for each offering prior to being authorized to distribute offering materials or solicit investors for the offering.[73]

Under Carolina's Suitability WSPs, this requirement applied to all personnel except for the lead banker (who was responsible for overseeing the development of the quiz) and the lead banker's supervisor.[74]

E. Carolina's Due Diligence

Between January 28, 2014 (when Raghavan first reviewed materials relating to the Financing Opportunity) and February 14, 2014 ("Due Diligence Period"), Carolina (1) drafted and executed an engagement letter between Carolina and IMG and drafted a term sheet setting forth key terms of the proposed offering; (2) created offering materials, including (in addition to the term sheet) an information memorandum and a private placement memorandum; (3) conducted an investigation of the IMGF Notes and disclosures in the IMGF Offering Materials, including background checks conducted by Carolina's compliance department and the collection and review of information conducted by Raghavan and others; (4) worked on the preparation of IMG Closing Documents and other closing documents relating to the loans from IMGF investors to IMGF, including the Loan and Security Agreement between the IMGF investors and IMGF ("IMGF Loan and Security Agreement") and the Secured Promissory Notes from IMGF to IMGF investors ("IMGF Promissory Notes").[75]

Raghavan estimates that during the Due Diligence Period he spent approximately 200 hours on Carolina's Due Diligence (more than 11 hours per day), and additional time reviewing the IMGF Offering Materials and other documents relating to the closing (*e.g.*, the IMGF Loan and Security Agreement, the IMGF Promissory Notes). Raghavan estimates that he talked to Wannakuwatte more than 30 times.[76] Also, Roberts reviewed documents gathered during

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[73] CX-77, at 22; Tr. 138.

[74] Tr. 140-41.

[75] Tr. 1052-53; CX-11, at 1; CX-53; CX-55.

[76] Tr. 1061, 1207, 1215.

Carolina's Due Diligence and talked to Wannakuwatte. Other Carolina personnel also spent time working on its Due Diligence.

The Panel finds that Carolina's investigation of the IMGF Offering and the IMFG Offering Materials was unreasonable because Carolina did not exercise reasonable judgment in conducting its investigation. In assessing Carolina's judgment, the Panel considers the totality of the relevant circumstances, including: (1) how Carolina learned of the Financing Opportunity; (2) Carolina's initial investigative steps; (3) eight alleged red flags that—Enforcement contends—would alert a prudent person to conduct further inquiry and Carolina's response to each alleged red flag; and (4) other aspects of Carolina's investigation, including additional investigative steps that Carolina reasonably could have taken, but did not take.[77]

1. Initial Due Diligence Process

a. Raghavan Learns of Opportunity to Provide Financing

Carolina first learned of the Financing Opportunity on January 24, 2014, when Raghavan received a telephone call from Kostkas, the head of a company that specialized in factoring receivables and for which Carolina had issued five tranches of senior secured debt.[78] Kostkas mentioned that there was an opportunity to provide bridge financing for 120 days for a facility that would manufacture medical gloves and that the deal would be collateralized by a future financing.[79] Kostkas stated that this transaction would not work for his company and asked whether Carolina might be interested.[80] Raghavan understood that Carolina's investors were not interested in investing in such short-term debt.[81] Accordingly, Raghavan responded that Carolina was not interested in the Financing Opportunity.[82]

b. Commencement of Due Diligence

Four days later, on January 28, Raghavan visited Kostkas's company to assist Kostkas in evaluating his company's capital needs. During Raghavan's visit, Kostkas mentioned that he had been provided access to a Dropbox folder containing materials relating to the Financing Opportunity and invited Raghavan to review them.[83]

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[77] In assessing the reasonableness of Carolina's investigation, the Panel does not treat findings that Carolina did not take investigative steps that it reasonably could have taken as tantamount to a finding that Carolina did not conduct a reasonable investigation.

[78] Tr. 1007-09; CX-5, at 1.

[79] Tr. 226, 1008.

[80] Tr. 1010-12.

[81] Tr. 225-26, 260-61, 1010-12.

[82] Tr. 1010-12; CX-5, at 1.

[83] CX-5, at 1; Tr. 226-31, 250-51, 1012-13. A dropbox folder is an Internet cloud storage service used for file sharing and collaboration.

Raghavan and Kostkas spent several hours reviewing the materials in the Dropbox folder. The materials included IMG financial statements for each of the three years 2010–2012 and for the first eleven months of 2013 ("IMG financial statements"). The IMG financial statements presented IMG as a financially healthy company. For example, the 2013 IMG financial statements showed that IMG's total stockholder's equity was almost $38 million as of November 30, 2013 and IMG's revenue and net profit for the first eleven months of 2013 were about $137 million and $7 million, respectively.

The Dropbox folder also included a number of other materials, including:

- a document that appeared to be thirteen pages from IMG's federal corporate tax return for 2012 ("IMG Tax Return");
- a document that appeared to be the completed Form 1040 and Schedule A and Schedule B of the joint personal income tax return of Wannakuwatte and BW for 2012 ("Wannakuwatte Tax Return");
- a credit report on Wannakuwatte showing a credit score of 745, no bankruptcy or court judgments, and no negative issues that stood out for Raghavan;
- a document, entitled, "Summary Historical Aged Trial Balance," dated August 31, 2013 ("August A/R Report"), that appeared to show for each IMG customer the accounts receivable balance and the age of that receivable;
- a list of bank and trade references; and
- letters from four companies expressing interest in discussing Olivehurst Glove's production of nitrile gloves in the United States.[84]

After reviewing some of the materials in the Dropbox folder (including the IMG financial statements), Raghavan and Kostkas called Roberts and mentioned that they were in the preliminary stages of speaking with a potential issuer about Carolina working on a private placement of the issuer's securities. Raghavan reported it appeared that the company had solid financials and might be a good fit for Carolina.[85] Raghavan and Roberts discussed what interest rate and term might be appropriate.[86]

On January 28, 2014, Raghavan and Kostkas also called Anderson, a consultant who was helping Wannakuwatte raise funds.[87] Anderson explained that Wannakuwatte was the owner of

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[84] CX-18; RX-1; RX-2; RX-10; RX-31; RX-34; RX-43; Tr. 243-44, 527, 1063, 1142, 1161, 1163-65, 1256, 1288-89.

[85] CX-5, at 1; Tr. 245, 1015-16.

[86] Tr. 1017.

[87] CX-5, at 1; Tr. 230, 250.

IMG and had run it as a family-owned business since founding it in 1989. Anderson stated that IMG sold medical gloves under the RelyAid brand name and distributed medical supplies for companies like McKesson and Medline. Anderson stressed that the only debt that IMG had on its books was a small loan from Wannakuwatte.[88] Raghavan informed Anderson that Carolina was not interested in participating in a transaction with Olivehurst Glove, but would be open to discussing an offering backed by IMG.[89] Anderson responded that Wannakuwatte was in a pinch, needed financing immediately, and was willing to discuss a transaction that was backed by IMG, rather than Olivehurst Glove.[90] Raghavan and Kostkas agreed to drive to IMG's West Sacramento facility the next day to meet Wannakuwatte, look at the facility, meet IMG's accountant, and review financial statements in further detail.[91]

Before traveling to IMG's facility, Raghavan sent an email to Avila ("January 28 Email to Avila") in which Raghavan stated that Carolina's transactions were typically funded through a single-purpose entity (that aggregates funds from investors and loans the funds to the issuer) and proposed that for the IMG transaction the single-purpose entity would be owned by Kostkas's company. Raghavan knew that the Dropbox folder to which Kostkas had been provided access did not contain sufficient materials to satisfy Carolina's Due Diligence requirements, so Raghavan enclosed with the email a checklist that Carolina used as a guideline in conducting investigations relating to fixed income transactions ("Due Diligence Checklist").[92] In the transmittal email, Raghavan stated that he would like to place special emphasis on five topics: (1) the notes receivable reflected on IMG's November 2013 balance sheet, (2) IMG's December 2013 financials, (3) a spike in IMG's reported inventory balance that was not offset by a corresponding increase in IMG's reported accounts payables balance, (4) IMG's accounting system, including who does the bookkeeping and samples of journal entries, and (5) IMG's cash management system, including how IMG handled checks and wire transfers from customers and IMG's internal controls.[93]

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[88] CX-5, at 1.

[89] Tr. 1013-14. In assessing whether to pursue the possibility of participating in an offering backed by IMG, Raghavan considered several factors, including IMG's business, how long IMG had been in business, how IMG made money, the amount of money that Wannakuwatte was seeking, whether IMG made enough money to support the contemplated transaction, IMG's assets and cash flow, the term of the debt at issue, and the plan to secure the debt with substantially all of the assets of IMG. Tr. 1015, 1291-92.

[90] Tr. 247-49, 251-53, 1017-18.

[91] CX-5, at 2.

[92] CX-6. Raghavan testified at the hearing that a Carolina banker typically provides a checklist to the issuer at the beginning of an engagement and asks the issuer to go through the checklist quickly and tell Carolina which items are applicable and what the issuer can deliver. The issuer then marks the checklist up and returns it to Carolina with any documents they might give Carolina at the initial pass. The banker then follows up on outstanding items that the banker considers relevant. Tr. 1191-92.

[93] CX-5, at 3; CX-6; Tr. 262-64; 1019-20.

c. Raghavan's Initial Visit to IMG's Facility

Raghavan and Kostkas visited IMG's facility for about three or four hours on January 29, 2014 ("January 29 Visit").[94] After Raghavan and Kostkas arrived at the IMG facility, they met with Wannakuwatte, Anderson, and Avila.[95] Wannakuwatte indicated that he owned the building and that IMG leased the facility from him.[96]

Wannakuwatte confirmed that he was open to the idea of IMG backing the offering.[97] Wannakuwatte stated that IMG wanted to expand from distributing gloves manufactured in Malaysia to manufacturing gloves in the United States. Wannakuwatte explained that glove manufacturing had moved from the United States 20-30 years ago because most of the gloves were made from rubber found in Asian countries. Wannakuwatte further explained that because nitrile is a petrochemical product, nitrile gloves can be manufactured in the United States efficiently and that some purchasers of medical gloves had a preference for products manufactured in the United States and products manufactured by minority-owned, small businesses.[98]

Wannakuwatte and Raghavan walked through the facility, which included a 25,000 square-foot warehouse. They looked at various boxes of gloves and medical supplies. Wannakuwatte described IMG's background, showed Raghavan a warehouse with stacks of boxes of gloves and other medical supplies, showed Raghavan a forklift that moved the boxes around the warehouse, opened some boxes and showed Raghavan samples, explained the differences between the types of gloves, described how the gloves were made, showed Raghavan pictures of gloves being manufactured in Malaysia, showed Raghavan a call center for receiving orders for the gloves, and showed Raghavan Wannakuwatte's office along with a conference room. Wannakuwatte also showed Raghavan a separate warehouse unit for gloves, needles, and other equipment to be sold to tattoo artists, and brightly-decorated vans that IMG sales people used to market tattoo supplies. Also, Raghavan talked to the individual who ran IMG's tattoo business and looked at an IMG catalogue for that business.[99]

2. Due Diligence Relating to Alleged Red Flags

Enforcement alleged that Carolina knew, or should have known, of eight red flags that would alert a prudent person to conduct further inquiry. As part of the Panel's assessment of the reasonableness of Carolina's Due Diligence, the Panel considers each of the alleged red flags, the investigative steps that Carolina took in connection with the alleged red flags, the documents and

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[94] Tr. 343.

[95] Tr. 302-03.

[96] Tr. 1023-25.

[97] Tr. 1052.

[98] Tr. 1025-27, 1034-37, 1155; CX-5, at 1-2.

[99] Tr. 1023-28, 1034-37, 1155, 1201; CX-5, at 4; CX-6; RX-123; RX-124.

information that Carolina obtained, investigative steps that Carolina reasonably could have taken—but did not take—in response to the alleged red flags, and instances when Wannakuwatte did not provide documents and information that Carolina requested.

a. Need for Immediate Financing

Enforcement alleged that IMG's asserted need for immediate financing was a red flag that would alert a prudent person to conduct further inquiry. Raghavan learned of IMG's asserted need while visiting Kostkas's company on January 28. During the telephone conversation that Raghavan had with Anderson on January 28, Raghavan asked about $23 million of "notes receivable" reflected on IMG's November 30, 2013, balance sheet as current assets, and Anderson responded that Wannakuwatte had borrowed the $23 million from IMG to purchase and repurpose the Olivehurst Facility and was attempting to raise additional funds through an EB-5 offering. Anderson added that the money from the EB-5 offering had not yet come in and Wannakuwatte therefore needed short-term financing to bridge the resulting cash shortfall.[100]

During Raghavan's January 29 Visit, Wannakuwatte explained that he was willing to pay a high interest rate because the Olivehurst Facility was on a tight deadline. If the Olivehurst Facility was not able to produce sample gloves by a deadline, certain Food and Drug Administration licenses would expire and Wannakuwatte's entire plan would be set back by 18 months. Wannakuwatte explained that he had taken out $23 million of IMG's net worth and was unwilling to create further stress on IMG's cash flow by pulling additional funds from IMG.[101] Wannakuwatte further explained that he had expected the EB-5 financing to come through in October 2013, but it had not. Wannakuwatte said that he was optimistic that some EB-5 financing would come through shortly.[102] Raghavan responded that any financing through Carolina would be subject to further due diligence and that he would need to speak with Roberts about various options to expedite the deal.[103]

Thus, Carolina did inquire about IMG's need for financing and its willingness to pay a high cost for the financing. But Carolina did not verify Wannakuwatte's explanation. Although Carolina requested documents relating to the FDA, Carolina did not obtain any documentation corroborating Wannakuwatte's explanation that certain FDA licenses would expire if he did not

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[100] Tr. 236-42, 247-53; CX-5, at 2.

[101] CX-5, at 4; Tr. 303-12.

[102] RX-40; Tr. 250-51, 303-04. In an affidavit that the FBI submitted in support of a sealed application for a search warrant ("FBI affidavit"), the FBI agent stated, in part, "Contact was made with the [United States Citizenship and Immigration Services ("USCIS")]. USCIS confirmed that the California Group Alliance ('CGA'), the Regional Center mentioned by Wannakuwatte in his business plan above, is an approved Regional Center, and that the Olivehurst Facility . . . appears to be a project that was listed on CGA's paperwork as an upcoming project. However, CGA has yet to file the necessary paperwork required before the Olivehurst Facility can be approved to solicit and receive EB-5 funds." CX-79, at 36. Carolina did not obtain any documentation corroborating that CGA had filed the necessary paperwork for Olivehurst Glove to solicit and receive EB-5 funds. RX-105; Tr. 1203-06.

[103] CX-5, at 4; Tr. 290-93, 309-10, 1017.

produce sample gloves by a certain deadline.[104] Indeed, Carolina did not obtain a copy of a FDA permit that licensed IMG or Olivehurst Glove to manufacture gloves.[105]

Carolina's Due Diligence Checklist called for Carolina to obtain "Governmental Regulations And Filings," including documents relating to FDA requirements.[106] Accordingly, on February 3, Raghavan sent an email to Wannakuwatte listing a number of outstanding Due Diligence items, including copies of relevant government certifications.[107] Three days later, Wannakuwatte sent an email to Raghavan stating that he was enclosing, among other things, "FDA test results."[108] However, none of the enclosed documents reflected, "FDA test results."[109] The only enclosed document that related at all to FDA test results was a document from the American Association for Laboratory Accreditations setting forth the tests that a laboratory in Akron, Ohio was accredited to perform, which included tests of gloves.[110] Raghavan testified that Wannakuwatte represented that the Akron laboratory would be able to certify nitrile gloves made at the Olivehurst Facility.[111]

Raghavan also obtained a one-page document entitled, "Device Listings." The document set forth January 25, 1993, as the date of initial registration and bore the legend, "FDA disclosure." The document listed five types of examination gloves as devices, and stated (under the caption, "Activities") "Repackager/Relabeler." Wannakuwatte explained that the document showed that the FDA had approved IMG as a repackager or relabeler of various vinyl, latex, and polymer patient examination gloves.[112] The document, however, did not identify either IMG or Olivehurst Glove by name and did not state that the FDA had approved the listed activities.

Carolina also did not verify Wannakuwatte's claim that funds from an EB-5 financing had been unexpectedly delayed. The only document that Carolina obtained corroborating that Wannakuwatte was pursuing EB-5 financing, much less the delays in the EB-5 financing, was the private placement memorandum for Olivehurst Glove ("Olivehurst PPM") dated "January __, 2014."[113]

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[104] RX-105; Tr. 1203-06.

[105] RX-105; Tr. 1203-06.

[106] CX-6, at 7.

[107] CX-16, at 2.

[108] CX-12, at 1.

[109] CX-12.

[110] CX-12, at 8-12; RX-39; Tr. 1181.

[111] Tr. 1182, 1287.

[112] RX-15; Tr. 1113-15.

[113] RX-40, at 2.

The Panel therefore finds that Carolina could reasonably have conducted further investigative steps to corroborate Wannakuwatte's explanation for why he had an immediate need for financing and was willing to pay a high cost for that financing.

b. Discussion Regarding IMG Accounting System and Request for Bank Statements

In his January 28 Email to Avila, Raghavan expressed special interest in IMG's accounting system, including who did the bookkeeping and samples of journal entries, and in IMG's cash management system, including how IMG handled checks and wire transfers from customers and IMG's internal controls.[114] Accordingly, during the January 29 Visit, Kostkas met with Ursula Klein, the IMG employee who managed IMG's ledger entries and check deposits. Kostkas reported to Raghavan that he had sat down with Klein to look at IMG's accounting system and she had pulled a few general ledger entries. Kostkas told Raghavan that Klein had explained that she handled the retail entries and Wannakuwatte handled the wholesale business, instructing Klein what entries to make with respect to IMG's wholesale business.[115] Kostkas also reported that wholesale orders were shipped directly from the manufacturer to the customer without passing through IMG's warehouse.[116] Thus, during the Due Diligence Period, Raghavan was aware that Klein simply made whatever entries to accounts payable, accounts receivable, inventory, and sales that Wannakuwatte directed her to make for IMG's wholesale business.[117]

After learning of Wannakuwatte's role in the handling of the wholesale account, Kostkas suggested that Raghavan request additional bank statements for the IMG wholesale account. Raghavan then requested bank statements from IMG. The Panel finds that Kostkas made his

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[114] CX-5, at 3; CX-6; Tr. 1019-20.

[115] CX-93, at 1-3; Tr. 322-24, 1049-50. Raghavan learned of this division of labor from Wannakuwatte and then Klein confirmed that division to Kostkas. Tr. 331-32, 336-37. The IMGF Offering Materials state that IMG had four lines of business and that wholesale, dental, government and tribal/tattoo lines account for about 25%, 20%, 45%, and 10% of IMG's revenues, respectively. CX-53, at 5-6. Carolina did not obtain any accounting records corroborating this breakdown. RX-105; Tr. 1203-06.

[116] CX-93, at 3-4. In the FBI affidavit, the FBI agent stated, in litigation involving a bank loan from Bridge Bank, that Klein testified that: (1) the wholesale side of IMG's business had no employees and no operating expenses; (2) IMG did not generate any invoices for wholesale accounts; (3) the sales information, accounts receivable, and cost of goods sold figures for wholesale accounts remained unchanged for years and are often provided by Wannakuwatte verbally or in a note with the sale amount, the cost amount and a freight amount, if appropriate; (4) Klein did not know what bank IMG used for the wholesale transactions; (5) Wannakuwatte handled all of the wholesale deposits and checks; (6) Klein handled the bookkeeping for the government, dental, and tattoo divisions; (7) the government and dental businesses made only "a small profit" and the dental side is "closer to break-even"; and (8) IMG used a separate accounting software system for wholesale transactions because Wannakuwatte believed that information related to wholesale transactions was sensitive and therefore should not be available to everyone in the company. CX-79, at 46-48. As the FBI agent stated in his affidavit, "Although Klein . . . records journal entries relating to the [Veterans Affairs] sales, she receives all of the information from Wannakuwatte directly, and does not rely on underlying source documentation like sales invoices or other documents, which is a generally recognized accounting practice." CX-79, at 63.

[117] Tr. 1249-50.

suggestion because he was concerned by the lack of controls governing IMG's wholesale business and wanted to test the validity of the accounting entries that related to that business.[118]

Following up on the request for bank statements that Raghavan had made at Kostkas's suggestion, Anderson stated, in the email that Anderson sent to Raghavan on the morning of January 30 (the day after Raghavan and Kostkas visited IMG's facility), that he and Wannakuwatte would provide "five months of bank statements" "today" ("Anderson's January 30 Email").

Wannakuwatte did not provide five months of bank statements. Instead, on January 31, Wannakuwatte transmitted to Raghavan the first page of bank statements for the IMG's wholesale account for four months.[119] These pages showed that each month there were numerous deposits and that the deposits/credits in IMG's wholesale account and checks processed totaled over $5 million for the four months.[120] Raghavan was satisfied with receiving the first page of the statements; he testified that the first page was sufficient to serve the purposes for which he

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[118] The Panel recognizes that Raghavan testified at the hearing that his purpose in requesting bank statements was not to verify the entries that Wannakuwatte instructed Klein to make in IMG's accounting system with respect to IMG's wholesale account. Tr. 332, 367, 385-86, 1096-97, 1298-99. Raghavan testified that he requested the bank statements in order to confirm that IMG was a distribution company that was selling gloves. Tr. 336. He also testified that he requested the bank statements because Wannakuwatte had provided certain banks as references, and Raghavan wanted to see that regular transactions happened in the related bank accounts and that the relationships had not just started in November. Tr. 336, 385-86, 448, 1097, 1253, 1325-26.

The Panel's findings that Kostkas specifically suggested requesting bank statements for the wholesale account and that the purpose of his suggestion was to obtain documents that Carolina could use to test the validity of entries in the wholesale account are based on several factors. First, a CPA would likely have been concerned by the lack of controls governing the entries in IMG's accounting system with respect to the wholesale account. Second, Kostkas suggested obtaining the bank statements after meeting with Klein and learning of the lack of accounting controls governing IMG's wholesale business. CX-93; Tr. 334-36. Third, the only account for which Carolina obtained bank statements for multiple months was IMG's wholesale account, which suggests that Kostkas's suggestion was focused on the wholesale account. CX-24. Fourth, Carolina's normal practice was not to look at bank records, and—apart from Kostkas's likely concern regarding the lack of internal controls surrounding IMG's wholesale account—Raghavan identified nothing about IMG that would warrant a departure from Carolina's normal practice. Tr. 336, 359, 362, 381-82, 1096, 1253. In particular, Carolina did not identify any reason why Raghavan or Kostkas would have doubted that IMG had active bank accounts or suspected that IMG had listed as references banks with which it did not have a relationship. Fifth, Raghavan testified at one point that Kostkas's suggestion was to look at the bank statements to confirm that there were both retail and wholesale accounts. Tr. 1326-27. However, Kostkas and Raghavan knew that IMG had already provided bank statements in the Dropbox folder. Tr. 1326-28. In addition, IMG responded to Raghavan's request by stating that they would send five months of bank statements, and the wholesale account was the only bank account for which Carolina obtained bank statements for multiple months. RX-8; Tr. 1331-32.

[119] RX-51; CX-5, at 10-11; CX-24. With access to the Dropbox folder, Raghavan obtained access to the first page of bank statements for December 2013 for three IMG accounts, one of which was IMG's wholesale account. Thus, Carolina obtained bank statements for the IMG wholesale account for a total of five months.

The address on the account statements for the wholesale account is the same as the address on the account statement for the personal bank account of Wannakuwatte and BW. RX-8, at 1, 4. The address on the account statements for the two other IMG bank accounts was the address for IMG's West Sacramento facility. RX-8, at 3, 5.

[120] CX-24.

had requested the bank statements and requesting bank statements was not part of Carolina's typical Due Diligence process.[121]

Enforcement alleged that IMG's provision of incomplete copies of bank account statements was a red flag that would alert a prudent person to conduct further inquiry. The Panel finds that provision of the first page of each of the IMG bank accounts was not a red flag. The Panel further finds, however, that in light of the information that Carolina learned about the weaknesses in the internal accounting controls governing IMG's wholesale business, Carolina could reasonably have taken additional investigative steps to verify that IMG was correctly accounting for that business.

c. Cash Balances Reflected in IMG's Bank Statements

The bank statement pages that IMG provided to Raghavan reflected a substantially lower cash position than the cash balance reflected on IMG's November 2013 financial statements. IMG's November 2013 financial statements showed that the company had a cash position of $1,535,391.69. Yet, the beginning balances in three IMG bank accounts as of December 2, 2013, totaled only $228,899.31, 85% less than the balance reflected on IMG's financial statements.[122]

Raghavan did not attempt to reconcile the cash balances in the bank statements to the cash balance in IMG's November 2013 financial statements.[123] Accordingly, Carolina did not notice that the sum of the cash balances reflected in the bank account statements was substantially less than the cash balance reflected in IMG's November 30, 2013, balance sheet.

Enforcement alleged that the difference between the cash balance reflected in IMG's November 2013 balance sheet and the sum of the cash balances reflected in its bank account statements was a red flag that would alert a prudent person to conduct further inquiry. The Panel disagrees. Enforcement did not establish that IMG ever represented to Carolina that all of its cash was in the three IMG bank accounts reflected in the bank statements.[124] Accordingly, Enforcement did not establish that the bank account statements were inconsistent with IMG's November 2013 financial statements.

The Panel further finds, however, that, as part of testing the reliability of IMG's financial statements, Carolina could reasonably have asked Wannakuwatte to provide records corroborating the cash balance reflected in IMG's November 2013 balance sheet.

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[121] Tr. 362, 381, 449.

[122] Tr. 71-72; CX-20; CX-22, at 3-5; CX-23.

[123] Tr. 1254.

[124] Enforcement did not establish that IMG represented it had only these three bank accounts and did not establish that IMG represented that its cash balance did not reflect any cash equivalents such as treasury bills, commercial paper, and money market funds.

d. Spike in Inventory and Lack of Credit Entry to Offset the Spike

When reviewing IMG's financial statements on January 28, Raghavan noticed that IMG's reported inventory balance had spiked $7 million from December 31, 2012, to November 30, 2013, and that the spike was not offset by a corresponding decrease in accounts receivable. Specifically, IMG's November 2013 financial statements showed an increase in IMG's inventory balance from about $6.7 million at December 31, 2012, to about $13.7 million at November 30, 2013.[125] In his January 28 Email to Avila, Raghavan identified this spike in inventory as a topic on which he would like to place special emphasis.[126]

Enforcement alleged that the spike in inventory reflected in IMG's November 2013 financial statements was a red flag that would alert a prudent person to conduct further inquiry. The Panel finds that Raghavan asked Wannakuwatte about the spike in inventory, and Wannakuwatte explained that IMG had purchased additional inventory because a vendor had offered IMG favorable terms in order to dispose of excess inventory.[127] The Panel further finds that this explanation was plausible.[128]

The Panel finds that Raghavan also asked why there was no offsetting increase in accounts payable, and Wannakuwatte responded that while Klein had, at his direction, made a debit entry to reflect the purchase of the additional inventory, she did not make an offsetting credit entry to accounts payable.[129] Wannakuwatte explained to Raghavan that, with respect to IMG's wholesale business, the practice at IMG was for Wannakuwatte to instruct Klein to make an accounting entry and for her to make the entry as instructed.[130] Although this explanation indicated a weakness in IMG's internal accounting controls, the explanation did not concern Raghavan because he believed such conduct was not unusual for a small company run by the company founder.[131]

Raghavan understood that IMG's failure to make an offsetting credit entry meant that IMG's November 2013 financial statements were misstated.[132] Specifically, Raghavan understood that entry of the offsetting credit would likely reduce IMG's reported net income and shareholder's equity.[133] Wannakuwatte told Raghavan that the offsetting credit entry would be

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[125] Tr. 1045; CX-5, at 3; CX-20, at 2; CX-21, at 3; RX-3, at 3; RX-4, at 2.

[126] CX-6, at 1.

[127] Tr. 317-20, 1241, 1315; CX-5, at 4.

[128] Raghavan never asked for invoices for the additional purchases of inventory. Tr. 1242.

[129] Tr. 317, 320, 322-23, 330, 1241, 1382-86.

[130] Tr. 322-23.

[131] Tr. 1317-19.

[132] Tr. 1045-47, 1316-17, 1406-07.

[133] Tr. 1044-48, 1385-86, 1406-10. Raghavan also testified that he did not know whether IMG would adjust inventory down or accounts payable up. Tr. 1244-45. It is difficult to reconcile this testimony with Wannakuwatte's

reflected in IMG's December 2013 financial statements and that he did not yet have those financial statements available because Ron Rishwain (his accountant in Stockton, California) was working on them.[134]

Wannakuwatte's explanation about the offsetting credit was inconsistent with the November 2013 balance sheet that he had provided to Raghavan. On the balance sheet, the debits (assets) equaled the credits (liabilities and shareholders' equity). If—as Wannakuwatte had represented to Raghavan—Klein had made debit entries to reflect the acquisition of additional inventory without making offsetting credit entries, then the total assets reflected on IMG's balance sheet would have exceeded the sum of the total liabilities and shareholder's equity reflected on IMG's balance sheet.[135] However, Raghavan never questioned why, despite Wannakuwatte's explanation, IMG's November 2013 balance sheet balanced.

The Panel finds that Raghavan could reasonably have followed up on Wannakuwatte's explanation by obtaining detailed information regarding the offsetting credit entry so that Carolina could assess the impact of that entry on IMG's financial statements for January through November 2013. The Panel also finds that Wannakuwatte's explanation (and the information that Kostkas relayed about the accounting for IMG's wholesale business) indicated that the internal accounting controls governing IMG's wholesale business were weak and that it would have been reasonable for Carolina to perform additional investigative steps to verify IMG's accounting for that business.

e. December 2013 IMG Financial Statements

During the Due Diligence Period, Raghavan requested, but did not obtain, IMG's December 2013 financial statements. In his January 28 Email to Avila, Raghavan expressed special interest in IMG's December 2013 financials.[136] In Anderson's January 30 Email, Anderson stated that Raghavan would be provided "today" with IMG's December 2013 financial statements.[137] On February 3, 2014, Raghavan sent an email to Wannakuwatte in which Raghavan stated, "I know you are working on the Dec financials. You can get me the 2013 data when it's ready (in the meantime, if you can estimate the revenue and Net Income for the year, that's helpful as well)."[138] On February 12, Raghavan again asked Wannakuwatte for the December 2013 financial statements if he had them.[139] Raghavan did obtain the estimated

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explanation that the spike in inventory was caused by IMG purchasing additional inventory in order to benefit from favorable terms. Tr. 1315-16. However, like an upward adjustment to accounts payable, a downward adjustment to inventory would decrease both IMG's reported net worth and earnings.

[134] Tr. 318, 320, 1379-80.

[135] Tr. 326-27.

[136] CX-5, at 3; CX-6; Tr. 1019-20.

[137] RX-49.

[138] CX-16, at 1.

[139] RX-58.

revenue and net income for 2013, but never obtained either the preliminary or the final December 2013 financial statements.[140]

Enforcement alleged that Wannakuwatte's failure to provide December 2013 financial information was a red flag that would alert a prudent person to conduct further inquiry.[141] The Panel finds that Raghavan inquired about Wannakuwatte's failure to provide December 2013 financial statements, and Wannakuwatte responded that his accountant in Stockton was working on the annual financial statements and they might not be ready until the end of February.[142] Raghavan testified that it was not unusual that IMG's 2013 financial statements had not been completed as of February 14. His testimony was corroborated by one of the IMGF investors whom Enforcement called as a witness.[143] Enforcement did not establish otherwise.[144] Accordingly, the Panel finds that it was reasonable for Carolina to view Wannakuwatte's explanation as plausible and not to view with suspicion Wannakuwatte's failure to provide the December 2013 financial statements.

However, the Panel finds that Carolina reasonably could have taken additional investigative steps in light of IMG's failure to provide the requested December 2013 financial statements. For example, Raghavan could have, but did not, contact Rishwain to inquire about the December 2013 financial statements and whether Rishwain knew of any adjustments that would be made to IMG's financial statements.

f. Accounts Receivable Aging Report

Enforcement alleged that "99 percent of IMG's accounts receivable remained unchanged from August 31, 2013 to December 31, 2013" and this was a red flag that would alert a prudent person to conduct further inquiry.[145]

The Panel finds that the similarity in accounts receivable balances in IMG's August A/R Report and IMG's Summary History Aged Trial Balance dated December 31, 2013 ("December A/R Report") would, if detected, alert a prudent person to conduct further inquiry. The Panel therefore considers whether it was unreasonable for Carolina not to have detected this similarity.

During the January 29 Visit, Wannakuwatte showed the December A/R Report to Raghavan.[146] Wannakuwatte walked Raghavan through the December A/R Report, identifying

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[140] CX-41, at 1; RX-105; Tr. 1203-06, 1240.

[141] Compl. ¶ 85.

[142] Tr. 1044.

[143] Tr. 816.

[144] Tr. 327, 368, 584, 1046.

[145] Compl. ¶ 85.

[146] Tr. 531; CX-19.

various customers as retail, dental, wholesale, and Veterans Affairs.[147] Raghavan observed that the December A/R Report showed that the listed receivables were current, IMG had multiple customers, and the bulk of IMG's accounts receivable related to the contract with Veterans Affairs.[148] Because the December A/R Report was more current than the August A/R Report, Raghavan requested and later obtained a copy of the December A/R Report.[149]

Although Carolina's Due Diligence Checklist called for Carolina to obtain "[a]ging schedules for accounts receivable for the last three years,"[150] Raghavan only obtained the two aging reports from IMG: the August A/R Report and the December A/R Report.[151]

Raghavan did not look at the August A/R Report and therefore did not compare the August A/R Report to the December A/R Report.[152] As a result, Raghavan did not notice that many of the large balances for individual accounts did not change between the August A/R Report and the December A/R Report.[153] The Panel finds that, because Enforcement did not establish that it was unreasonable for Carolina not to compare the August A/R Report to the December A/R Report, Enforcement did not establish that the similarity between the two reports was a red flag.

Carolina's November 2013 balance sheet showed an accounts receivable balance of about $37 million. Thus, IMG's reported accounts receivable balance approximated its reported shareholder's equity and more than 2/3 of its reported current assets. The Panel finds that—in light of the importance of Carolina's reported accounts receivable balance—Carolina could reasonably have taken additional steps to verify IMG's accounts receivable balance.

g. Veterans Affairs Contract

During Raghavan's January 29 Visit, Wannakuwatte showed Raghavan a 12-page document (or compilation of documents) which Wannakuwatte presented as the contract between IMG and the Department of Veterans Affairs ("VA Contract").[154] The VA Contract referred to itself as a contract. The first page of the VA Contract identified the "Contract Period," as September 15, 2006 through September 14, 2011 and identified IMG as the "Contractor." A page captioned, "Amendment of Solicitation/Modification of Contract," stated, "This unilateral

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[147] Tr. 527-31, 536-37.

[148] Tr. 531-36, 1240; CX-19.

[149] Tr. 1063-64; RX-1; RX-2.

[150] CX-8, at 3.

[151] RX-105, at 1; Tr. 1203-06.

[152] Tr. 531-32, 1063, 1237.

[153] RX-1; RX-2.

[154] CX-26; RX-25; Tr. 1265.

modification is issued to extend the performance period for the above-mentioned contract from September 14, 2011 to September 14, 2016."[155]

Nevertheless, the VA Contract did not include any express obligation for Veterans Affairs to purchase any items, any express obligation for IMG to sell any items, or any price schedule. Accordingly, Enforcement alleged that "IMG failed to provide a complete copy of its VA Contract" and this failure was a red flag that would alert a prudent person to conduct further inquiry.[156] In assessing this allegation, the Panel makes the following findings regarding the VA Contract and Raghavan's review of the VA Contract.

The VA Contract identified the "Point of Production" as "Malaysia," which was consistent with Raghavan's understanding during the Due Diligence Period that the gloves that IMG sold were manufactured in Malaysia.[157] However, on the second page of the VA Contract, under the caption, "Foreign Items," the VA Contract identified only various types of "latex" gloves. The fact that the VA Contract did not list either "vinyl" gloves or "other" gloves as "Foreign Items,"[158] was inconsistent with Wannakuwatte's representation that all three types of gloves were manufactured in Malaysia and IMG sold all three types to Veterans Affairs.

The bulk of the VA Contract consisted of a schedule of items, captioned, "Section I: Continuation of SF-1449, Blocks 19-21, Schedule of Items." Nothing about this schedule indicated that the VA Contract was a requirements contract for all three types of gloves. The schedule set forth information for various classes of medical devices and equipment such as adhesive tape and bandages, sponges, surgical hand instruments, and catheters. Each class was assigned a Special Item Number ("SIN"). The schedule listed SINs A-1 through A-96, plus A-200. For each SIN, the schedule set forth an "FSC Class" number and a description. For many of the SINs, the schedule listed various items and, for each listed item, "estimated annual requirements," and a field for indicating with a check mark whether the item was being offered to Veterans Affairs.[159] The SIN that included examination gloves was SIN A-13. For SIN A-13, the schedule set forth "6515" as "FSC Class," and the following information for the five items listed:

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[155] CX-26, at 1, 4.

[156] Compl. ¶ 85.

[157] CX-5, at 1-2; Tr. 1035-36.

[158] CX-26, at 2.

[159] CX-26, at 5-12; RX-25, at 5-12.

Description Gloves, Medical Supplies and Examinary (Latex and vinyl and other, all sizes)	Estimated Annual Requirements	Check Item Offered
(a) Sterile Latex	$ 14,764,224	(√)
(b) Sterile Vinyl	$ 118,398	(√)
(c) Non-Sterile Latex	$ 22,606,137	(√)
(d) Non-Sterile Vinyl	$ 18,426,216	(√)
(e) Other	$ 38,424,634	(√)[160]

On the copy of the VA Contract that Wannakuwatte showed Raghavan, someone had drawn a rectangle around the information relating to the five items listed under SIN A-13 and typed "$94,339,609"—the sum of the estimated annual requirements for items (a) through (e)—next to an arrow that pointed to the five items. Wannakuwatte showed Raghavan the page with the hand-drawn rectangle and said that IMG had $90 million in contracts with Veterans Affairs.[161] Wannakuwatte explained that the "Other" category was essentially nitrile exam gloves.[162] Raghavan testified at the hearing that he assumed Wannakuwatte, or someone working with Wannakuwatte, had drawn the rectangle around the information for the five listed items and had typed, "$94,339,609."[163]

Raghavan understood that IMG was only selling gloves to Veterans Affairs.[164] However, apart from the hand-drawn rectangle and the typed total, nothing distinguished the entry for SIN A-13 from the scores of entries for the other SINs. The only items on the schedule that are distinguished from the other items on the schedule are the latex gloves listed as A-13(a) and A-13(c)—sterile latex gloves and non-sterile latex gloves. These two types of latex gloves are distinguished from the other items in two respects. First, on the first page, under the caption, "Information For Ordering Officers," the VA Contract provided, "Special Item No. A-13(a) & A-13(c)." Second, a line on the second page of the VA Contract indicated that all of the foreign items were latex gloves: "Latex Exam gloves; Latex Surgical gloves and Latex Chemotherapy gloves."

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[160] CX-26, at 6; RX-25, at 6.

[161] Tr. 423.

[162] Tr. 1266-67.

[163] Tr. 422; CX-26, at 6.

[164] Tr. 515-16.

During the Due Diligence Period, Raghavan noticed the line under the caption, "Information For Ordering Officers," but did not consider its significance.[165] Thus, although Wannakuwatte had represented to Raghavan that IMG was selling not only latex gloves, but also vinyl gloves and "other" gloves, to Veterans Affairs,[166] Raghavan did not consider whether the reference to Items A-13(a) and A-13(c) contradicted Wannakuwatte's representation. Also, there is no evidence Raghavan considered whether the reference to "latex" gloves—but not "vinyl" gloves or "other" gloves—as foreign items also indicated that the VA Contract was limited to latex gloves. The estimated annual requirements for "vinyl" gloves, Items A-13(a) and A-13(c) totaled less than $37 million, about 40% of the $90 million mentioned in the IMGF Offering Materials.

In addition to disclosing that IMG held a requirements contract which contemplated the sale of more than $90 million worth of examination gloves, the IMGF Offering Materials also disclosed, "The contract also calls for approximately $38.4 mm of gloves to be made of materials other than latex or vinyl. IMG expects to fill its existing demand for Nitrile gloves with products manufactured by [Olivehurst Glove]."[167] There is no evidence that Raghavan considered whether the absence of a reference to Item A-13(e) under "Information For Ordering Officers" and of a reference to "other" gloves under "Foreign Items" were indications that the VA Contract did not cover nitrile gloves.

The December A/R Report showed a total of approximately $36 million in accounts receivable, of which $29,084,370.90 related to the contract with Veterans Affairs.[168] Given the apparent importance of the VA Contract to IMG's reported accounts receivable balance and reported revenue and the absence of any clear indication on the VA Contract that IMG had a requirements contract which contemplated the supply of more than $90 million worth of examination gloves, the Panel concludes that Carolina could reasonably have taken additional investigative steps with respect to the VA Contract. For example, Carolina could have asked IMG additional questions about the VA Contract to learn the basis for Wannakuwatte's claim that it was a requirements contract that contemplated the supply of up to $90 million of exam gloves. Carolina could have asked an attorney to review the VA Contract and confirm that Wannakuwatte's representations were supported by the VA Contract. Carolina could have searched the Veterans Affairs website for such confirmation or could have attempted to contact Veterans Affairs. Carolina could have asked IMG for documents reflecting the delivery of gloves to, and corresponding payments by, Veterans Affairs.[169]

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[165] Tr. 1268; CX-26, at 1, 6.

[166] CX-26, at 6; Tr. 422-23, 514.

[167] CX-43, at 13.

[168] RX-2, at 52; Tr. 527-28.

[169] Respondents argue that if Raghavan had questioned Wannakuwatte further he would have lied, that if Carolina had attempted to contact Veterans Affairs, Wannakuwatte would have recruited an imposter to deceive Carolina, and that if Carolina had searched the Veterans Affairs website, Carolina might not have obtained any relevant

Raghavan testified at the hearing that, given that the IMGF Offering was only $3 million, it did not matter from his perspective whether IMG did $90 million in business with Veterans Affairs because there would be sufficient cash flow to cover the financing even without the Veterans Affairs revenue.[170] The Panel rejects this reasoning. First, $90 million represents a majority of IMG's revenue. Second, the accounts receivable attributed to Veterans Affairs is equivalent to IMG's reported shareholder's equity.

h. Litigation Alleging that IMG Had Defaulted on Debts

Shortly after the January 29 Visit, Raghavan performed a Google search to learn additional information regarding Wannakuwatte and IMG and learned that two General Electric entities, General Electric Credit Corporation ("GECC") and GE Equipment Corporate Aircraft Trust 2012-1, LLC ("GE Aircraft"), had filed a lawsuit against Wannakuwatte, IMG, and a company called DBS Air ("GECC/GE Aircraft lawsuit"), but no other details about the nature or status of the lawsuit.[171] Raghavan did not wait to see if Wannakuwatte disclosed the GECC/GE Aircraft lawsuit in response to Carolina's Due Diligence Checklist, which called for Carolina to obtain "[c]opies of any pleadings or correspondence for pending or prior lawsuits involving the Company or the Founders."[172] Raghavan also did not ask Wannakuwatte open-ended questions about recent or pending lawsuits. Rather, Raghavan notified Wannakuwatte that through an Internet search Raghavan had learned that GECC and GE Aircraft had brought a lawsuit against Wannakuwatte, IMG and DBS Air. Raghavan then requested that Wannakuwatte provide a written explanation of the circumstances relating to this lawsuit which, Raghavan said, would enable Raghavan to answer any questions that come up from prospective investors.[173]

Wannakuwatte provided a written explanation, in which he explained that the GECC/GE Aircraft lawsuit involved a loan from Key Equipment Company ("Key Equipment") to RelyAid Global Healthcare ("RelyAid Global"), a stand-alone entity.[174] He stated that originally the loan was to be interest-only for a certain number of months and indicated that it was only when the loan began amortizing that he learned that a GE entity now had the loan:

> I spoke with my banker to keep the loan as interest only for an additional period of six months. At that time he told me that this loan was not a Key Equipment

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information. Respondents' Post-Hearing Br., at 18-20. However, the possibility that the additional steps might have been unsuccessful in uncovering the fraud does not absolve Carolina for its failure to take any of those steps.

[170] Tr. 517, 523.

[171] Tr. 1137, 1140; CX-5, at 10.

[172] CX-5, at 2-3; CX-6; CX-8, at 4. The checklist also called for Carolina to obtain "[a]ll material correspondence with lenders during the last three years, including all compliance reports submitted by the Company or its accountants." CX-6, at 6. Carolina did not obtain any correspondence between IMG and any lender. RX-105; Tr. 1203-06.

[173] CX-5, at 10; Tr. 427-30.

[174] CX-29, at 2.

> loan, but now was a GE loan. Up to this point for over four months, all the interest payments were paid directly to Key Equipment.[175]

Wannakuwatte represented in his written explanation that the loan documents were signed after he received an email from Key Equipment stating that the loan was not a GE loan. He attached an email exchange, in which his representative noted that the documents showed GE as the lender and asked if this was still a Key Equipment deal, and a Key Equipment employee responded it was a Key Equipment loan and GE was Key Equipment's behind-the-scenes partner:

> This is a Key Equipment deal. IMG and Relyaid are Key Equipment Finance clients. Key will be booking this on its system, sending invoices every month and collecting payments. GE is our behind the scenes partner.[176]

In his response, the Key Equipment employee explained that Key Equipment had asked Wannakuwatte if it could use GE documents to keep the deal moving.[177] Raghavan interpreted this attachment as showing that Key Equipment and GECC had misrepresented the respective roles of Key Equipment and GECC.[178]

In his written explanation, Wannakuwatte represented that when GECC refused to extend the interest-only period of the loan and filed a lawsuit, he countersued because "they misrepresented the lender to me" and that "[i]mmediately [after GECC] received the cross complaint, they settled the case in November 2013."[179] The written explanation did not identify the terms of the settlement.[180]

Although the information uncovered by Raghavan's Google search included the fact that two GE entities, GECC and GE Aircraft, were involved in the lawsuit,[181] Wannakuwatte's explanation only addressed GECC's involvement and Carolina did not obtain any written explanation of how or why GE Aircraft was involved in the lawsuit.

In fact, court pleadings show that the GECC/GE Aircraft lawsuit involved two loans, not just one as indicated in Wannakuwatte's written explanation. With respect to one loan ("RelyAid Loan"), GECC and GE Aircraft ("GE Plaintiffs") alleged, among other things, that: (1) as soon

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[175] CX-29, at 2; RX-21, at 2.

[176] CX-29, at 3; RX-21, at 2.

[177] CX-29, at 3; RX-21, at 2. Also, on February 3, Raghavan had a telephone conversation with Wannakuwatte about the GECC/GE Aircraft lawsuit, in which Wannakuwatte indicated that the lawsuit had been settled in November 2013. CX-5, at 13; Tr. 427-30.

[178] CX-5, at 13.

[179] CX-29, at 2; Tr. 1402-03.

[180] CX-29, at 2.

[181] CX-28.

as Key Equipment originated the RelyAid Loan, Key Equipment notified RelyAid that the loan had been assigned; (2) a controversy existed between GECC and RelyAid with respect to the application of the loan monies that had been disbursed; and (3) as of July 30, 2013, the aggregate payment defaults totaled at least $4.4 million. With respect to the second loan ("Aircraft Loan"), the GE Plaintiffs alleged that $3.4 million was due on the Aircraft Loan as of July 30, 2013, and that Wannakuwatte, BW and IMG had guaranteed the Aircraft Loan.[182]

The GECC/GE Aircraft complaint raises a number of questions with respect to the RelyAid Loan that are relevant to the IMGF Offering. First, the GE Plaintiffs alleged that RelyAid Global was provided written notice of the assignment on December 6, 2012, when Key Equipment originated the RelyAid Loan. This allegation conflicts with Wannakuwatte's implication in his written explanation that he did not know of the assignment until the interest-only period of the RelyAid Loan was about to end.[183] Second, the GE Plaintiffs alleged that a controversy existed between RelyAid Global and GECC with respect to the application of the monies that had been disbursed from the RelyAid Loan and that RelyAid Global had not provided an accounting showing how the disbursements had been applied. This allegation raises questions about Wannakuwatte's business methods. Third, the GECC/GE Aircraft complaint was filed on August 15, 2013. The timing of this filing and the allegation that Wannakuwatte, BW, and IMG had guaranteed the RelyAid Loan raise questions as to why IMG's November 2013 financial statements and Wannakuwatte's September 2013 personal financial statements did not refer to the guarantee obligations.

The GECC/GE Aircraft complaint also raises questions with respect to the Aircraft Loan. First, the allegation that IMG, Wannakuwatte, and BW had guaranteed the Aircraft Loan raises a question as to why the guarantee of the Aircraft Loan was not disclosed on the IMG financial statements and the Wannakuwatte financial statements. Second, the fact that the GECC/GE Aircraft lawsuit involved two loans raises a question as to why Wannakuwatte's written explanation only referenced the RelyAid Loan. Third, the allegation that IMG, Wannakuwatte and BW were guarantors of the Aircraft Loan raises a question as to whether this $3.4 million obligation might interfere with IMG's ability to repay the IMG Loan when it matured in one year.

Carolina's Due Diligence Checklist called for "[s]ettlement documentation."[184] Carolina did not obtain either the settlement agreement or the Stipulation and Order Granting A Temporary Stay of All Proceedings, which was filed in court on December 18, 2013. The stipulation indicates that the settlement agreement covered the claim on the RelyAid Loan but not the claim on the Aircraft Loan. Therefore the stipulation raises a question as to why Wannakuwatte did not disclose the part of the lawsuit that was not resolved by the settlement. In addition, because the settlement agreement did not extend to the part of the lawsuit relating to the

[182] CX-31.

[183] Tr. 1416-18.

[184] CX-6, at 6.

Aircraft Loan and the stay was scheduled to expire in April 2014, the stipulation raises questions as to whether Wannakuwatte's need to fund that part of the GECC/GE Aircraft lawsuit and a possible recovery on the lawsuit might interfere with his ability to repay the IMGF Notes.[185]

Carolina's Due Diligence Checklist also called for Carolina to obtain "[c]orrespondence with auditor or accountant regarding threatened or pending litigation, assessment or claims."[186] However, not only did Carolina not obtain copies of any court filings, it did not obtain written representations from any of IMG's attorneys regarding the extent and nature of litigation against IMG and Wannakuwatte, including whether: Wannakuwatte's written explanation fairly described the GECC/GE Aircraft lawsuit, the GECC/GE Aircraft lawsuit was the only lawsuit pending against him and IMG, and any other claims were threatened.[187]

IMG and Wannakuwatte had also been named in a lawsuit brought by another lender, Bridge Bank. In a verified complaint that Bridge Bank had filed in March 2013 against IMG, Wannakuwatte, and others, Bridge Bank alleged that IMG, Wannakuwatte, and BW had guaranteed a $4.3 million loan to IMG that all three had failed to pay.[188] In July 2013, Bridge Bank filed a declaration in which a Bridge Bank employee stated that although IMG had provided an accounts receivable aging report that showed Veterans Affairs owed over $29 million to IMG, Veterans Affairs had told Bridge Bank that no money was owed to either IMG or RelyAid.[189]

Enforcement alleged that the GECC/GE Aircraft lawsuit was a red flag that would alert a prudent person to conduct further inquiry. The Panel finds that Raghavan asked for, and obtained, a written explanation of the lawsuit from Wannakuwatte.

However, the Panel further finds that Carolina could reasonably have made additional inquiries after obtaining Wannakuwatte's written explanation such as: (a) seeking confirmation of Wannakuwatte's explanation; (b) asking whether settlement payments were still pending, when they were due, and how they would be funded; and (c) asking why the settlement obligations were not reflected in the financial statements of either Wannakuwatte or IMG and whether Wannakuwatte or IMG had guaranteed any other loans.

The Panel rejects Carolina's proffered explanations for not having taken such additional investigative steps. Raghavan testified at the hearing that he did not request court pleadings because he believed Wannakuwatte could not provide court filings, or at least the settlement

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[185] CX-33, at 1-3. On February 19, 2014, the Court entered an order granting a motion by the GE Aircraft Trust for a writ of possession directing the levying officer to seize the aircraft that secured the Aircraft Loan, which had an estimated fair market value of $3 million. CX-34.

[186] CX-6, at 6.

[187] RX-105; Tr. 1203-06.

[188] CX-88.

[189] CX-89, at 6.

papers, because they would be privileged.[190] The Panel finds that Raghavan's belief was not reasonable and does not constitute a valid reason for Carolina's decision not to ask for court pleadings and settlement documentation.[191] Raghavan testified at the hearing that he understood that the liability relating to the RelyAid Loan was not reflected on IMG's balance sheet but was not concerned by this because the amount of the liability was de minimis.[192] The Panel finds that the size of the RelyAid Loan, which Raghavan understood to be millions of dollars, did not justify Raghavan's lack of concern. The size of the RelyAid Loan was significant compared to IMG's profitability and the lack of disclosure regarding the guarantees of the RelyAid Loan could reasonably have raised questions about the completeness of the IMG and Wannakuwatte financial statements.

3. Other Due Diligence

In assessing whether Carolina's Due Diligence constituted a reasonable investigation, the Panel considers not only the red flags alleged by Enforcement and Carolina's responses to those alleged red flags, but also other information that Carolina learned during its Due Diligence, investigative steps that Carolina took—or did not take—in response to that information, and instances when Wannakuwatte did not provide documents that Carolina had requested.

a. IMG Notes Receivable

In his initial review of IMG's financial statements, Raghavan formed questions about the $23 million asset that IMG had identified as "Notes Receivable" and had classified as a current asset on the November 2013 balance sheet.

IMG's 2012 balance sheet showed two non-current assets that added up to about $23 million: Advances Receivable-Affiliates of about $11 million and a Shareholder Loan of about $12 million.[193] Accordingly, Raghavan suspected that the $23 million in "Notes Receivable" reflected on IMG's November 2013 balance sheet combined an $11 million loan to Wannakuwatte and $12 million in advances to his affiliates. In addition, Raghavan thought that the $23 million looked like distributions and should only be recorded as an asset if IMG thought

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[190] Tr. 1353.

[191] The offering materials did not contain any disclosures of the GECC/GE Aircraft lawsuit. However, Carolina posted on the investor portal Wannakuwatte's written explanation as well as the email that he had attached to that explanation. Tr. 1400-02. Enforcement argues that Wannakuwatte's representation in his written explanation that the GECC/GE Aircraft litigation was settled was materially false or misleading because the proceeding was merely stayed pending the payment to GECC of the settlement amount. The Panel rejects this contention. The Panel concludes that it is reasonable to consider an action to be settled once the parties have executed a settlement agreement and the action has been stayed pending performance of the settlement agreement. The Panel finds, however, that the representation that the case was settled was false because the settlement did not include the claim relating to the Aircraft Loan.

[192] Tr. 1404.

[193] CX-21, at 3; RX-4, at 2.

that the $23 million would really be repaid and only be recorded as a current asset if IMG expected that amount to be repaid sometime soon.[194]

In his January 28 Email to Avila, Raghavan identified the "Notes Receivable" reflected on IMG's financial statements as one of five topics that Raghavan was especially interested in discussing.[195]

During the January 29 Visit, Wannakuwatte explained that once the EB-5 offering happened, he would take a portion of the proceeds from the EB-5 offering and repay the $23 million reflected on IMG's financial statements as "Notes Receivable." Raghavan concluded that the $23 million had to be reclassified as a non-current asset if there was not a reasonable expectation that IMG would collect money within one year.[196] Also, Wannakuwatte acknowledged that the loans and advances underlying the "Notes Receivable" asset were not documented by notes. According to Raghavan, he was not concerned by the absence of any notes because it was a common practice for an entrepreneur to take money out of a company without recording the transaction with a legal document and Wannakuwatte agreed to sign notes to document the loans.[197]

In the financial statements set forth in the information memorandum, Carolina described the $23 million as "Advances to Affiliates + Shareholder Loans" and classified them as long-term assets.[198]

Wannakuwatte's explanation that he would use the proceeds from the EB-5 offering to repay the notes receivable was inconsistent with the Olivehurst PPM. Raghavan read the Olivehurst PPM when he gained access to the Dropbox folder the day after his January 29 Visit. Raghavan testified at the hearing that when he read the Olivehurst PPM he viewed it as validation that Olivehurst Glove was trying to raise money through an EB-5 offering.[199] The Olivehurst PPM consisted of a 38-page memorandum, dated "January __, 2014,"[200] plus a business plan and other exhibits.[201] The memorandum did not disclose that the purpose of the EB-5 offering was to buy out Wannakuwatte's $23 million equity interest in Olivehurst Glove. Rather, the memorandum disclosed that the purpose of the offering was to raise $25 million to finance a portion of the working capital needed to develop, construct, and begin operating the Olivehurst Facility and, perhaps, to refinance some interim bridge financing:

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[194] CX-20; Tr. 236-43, 1320-21.

[195] CX-5, at 3; CX-6; Tr. 1019-21.

[196] Tr. 1038-40.

[197] Tr. 1037-38, 1042, 1320-25.

[198] CX-53, at 9.

[199] Tr. 352, 397-98, 405-06, 1183-84.

[200] RX-40, at 2.

[201] RX-40.

> The purpose of the Offering is to raise the capital necessary to loan to [Olivehurst Glove] approximately Twenty Five Million Five Hundred Thousand Dollars ($25,500,000) to finance a portion of the working capital needed to develop, construct and begin operating the Project. [Olivehurst Glove] may also use the proceeds of the Loan to refinance interim bridge financing that it obtained prior to the Offering.[202]

The business plan also did not disclose that the offering proceeds would be used to buy out Wannakuwatte's equity in Olivehurst Glove. The business plan identified four sources of funding:

EB-5 funding	$ 25,500,000.00
Developer Equity	$ 22,918,003.14
Bank Loan	$ 9,002,450.00
Private Equity	$ 35,094,518.00

Rather than disclosing that Olivehurst Glove would use the EB-5 funds to buy out "Developer Equity," the business plan disclosed that Olivehurst Glove "will utilize these funds to finance the construction and operation of the manufacturing facility" and included both the $25.5 million in EB-5 funds and the $23 million in "Developer Equity" in calculating how the total $92.5 million cost of the Olivehurst Facility would be financed.[203]

Thus, Raghavan learned early in the Due Diligence Period that IMG's financial statements inappropriately classified IMG's shareholder loan and advances to affiliates as current assets and reported them as, "Notes Receivable." There is no evidence that Raghavan considered whether Wannakuwatte's explanation that he planned to use the proceeds of the EB-5 offering to pay off the loans from IMG was consistent with the disclosures in the Olivehurst PPM.[204] However, if Raghavan had reviewed the Olivehurst PPM carefully, he would have had reason to doubt the veracity of Wannakuwatte's explanation that he intended to use the proceeds to repay IMG's loans to shareholders and advances to affiliates. He also would have had reason to question not only whether the loan to Wannakuwatte and the advances to affiliates were properly classified as current assets, but whether—given the lack of any source of repayment— they should have been reflected at all as assets on IMG's November 2013 financial statements.

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[202] RX-40, at 7.

[203] RX-40, at 118-19.

[204] There also is no evidence that Raghavan considered whether IMG had a business need for a $23 million cash infusion. None of the IMG financial statements in the Dropbox reflected cash balances in excess of $10 million and the 2011, 2012, and November 2013 financial statements reflected cash balances of under $4 million. RX-3.

b. IMG Financial Statements and Wannakuwatte's Financial Statements

Raghavan reasonably could have taken additional steps to verify that the IMG financial statements fairly reflected IMG's financial condition and performance and that the Wannakuwatte financial statements fairly reflected Wannakuwatte's financial condition.

In conducting its Due Diligence and concluding that the IMGF Notes were suitable for its investor clients, Carolina relied heavily on the IMG financial statements that Raghavan reviewed before his January 29 Visit.[205] These statements showed that IMG was profitable and in a strong financial condition.[206] For example, IMG's November 30, 2013, balance sheet showed current assets of about $75 million (including "Notes Receivable" of about $23 million, which Raghavan understood to reflect a loan to Wannakuwatte and advances to his affiliates) compared to current liabilities of about $33 million and total assets of about $75 million compared to total liabilities of about $38 million.[207] Similarly, IMG's income statement for the first eleven months of 2013 showed revenue of about $137 million, cost of goods sold of about $127 million, operating expenses of about $2.5 million, and net profit of about $7 million.[208] Raghavan testified at the hearing that during the Due Diligence Period he noted that the IMG financial statements showed that IMG's cash balance had fallen from over $3 million as of December 31, 2012, to under $900,000 as of November 30, 2013, and that he viewed this decline as consistent with Wannakuwatte's claim that he was in need of cash.[209]

The financial statements provided to Raghavan did not include any representation that a CPA had audited, reviewed, or compiled them. Also, the financial statements did not include any indication whether they had been prepared on the basis of generally accepted accounting principles or any other established accounting principles.[210] In addition, there were no notes to the financial statements.[211]

Raghavan nevertheless believed the IMG financial statements to be reliable based on his tours of IMG's West Sacramento facility, the IMG Tax Return, the Wannakuwatte Tax Return, IMG's having been in business for more than two decades, Raghavan's initial review of the financial statements having triggered only the two questions discussed above (both of which

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[205] Tr. 917, 1291-96, 1414-15. Raghavan did not recall whether he also reviewed the June 2013 income statement that was included in the Dropbox folder. CX-21, at 23; Tr. 234-35.

[206] RX-3; RX-4.

[207] RX-4.

[208] RX-4.

[209] Tr. 1254-55; RX-3, at 3; RX-4, at 2.

[210] Thus, there was no representation that the preparer of the financial statements made any inquiries or used any analytical or other review procedures to evaluate whether the financial statements may be materially misstated.

[211] CX-20; CX-21.

Wannakuwatte answered to his satisfaction), and Raghavan's calculation of ratios and year-over-year comparisons (which did not identify any other questions).[212]

On February 5, Raghavan visited IMG for a second time because, among other things, he wanted to walk around the IMG facility once again and look at some of the people doing their everyday duties.[213] Raghavan observed people packaging inventory and labeling the packages for shipment.[214] Raghavan spoke with a UPS driver who had pulled up while Raghavan was at the IMG facility and asked her how long she had been doing pickups and dropoffs at IMG. She responded that she had been picking up packages at the facility for several years and came fairly regularly. By confirming that IMG was a real company that distributed examination gloves, Raghavan's two visits to IMG's West Sacramento facility gave him some comfort that the IMG financial statements fairly reflected IMG's financial condition and performance.

The IMG Tax Return reflected the revenue, expenses, assets, and liabilities that were set forth in IMG's 2012 financial statements. Rishwain, the Stockton CPA, was identified on the IMG Tax Return as the preparer of the return. The block on the IMG Tax Return for Rishwain's signature was blank, and Raghavan did not contact Rishwain to confirm that the IMG Tax Return was authentic. Raghavan testified that the lack of signatures on the IMG Tax Return did not concern him because most people file their returns electronically.[215]

The IMG Tax Return indicated that IMG was a sub-chapter S corporation so it was taxed as a partnership (that is, IMG was a pass-through entity for federal income tax purposes, and Wannakuwatte and his wife were responsible for the taxes attributable to IMG's ordinary business income). Raghavan took comfort from the fact that the Wannakuwatte Tax Return reflected a personal tax liability of more than $460,000 largely as a result of income from "Rental real estate, royalties, partnerships, S corporations, trusts, etc."[216] Like the IMG Tax

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[212] Tr. 1302, 1307-12, 1387-94. The Due Diligence Checklist called for Carolina to obtain "Federal and state income tax returns for the last three years." CX-6, at 6. The only IMG tax return materials Carolina obtained was a partial federal tax return for 2012 that was in the Dropbox folder on January 28. RX-105, at 7; Tr. 1203-06.

[213] Tr. 1058.

[214] Tr. 1058.

[215] Tr. 243-44, 1100; RX-10. Based on this testimony, the Panel finds that Raghavan never contacted Rishwain to confirm whether the tax returns were genuine, the returns had been filed, or whether Wannakuwatte paid the tax obligation indicated on his personal return. In the FBI affidavit, the FBI agent stated that in litigation involving Bridge Bank, Rishwain testified: he prepared corporate tax returns and compiled financial statements for IMG; he had not compiled the 2011 IMG financial statements provided to Bridge Bank even though the financial statements appeared to be on his company letterhead and signed by him; and there were several differences between the IMG financial statements that he had compiled and the financial statements provided to Bridge Bank. CX-79, at 48.

[216] Tr. 1034, 1094-95; RX-34, at 1-2. The Wannakuwatte Tax Return showed that the salaries and wages of Wannakuwatte and BW totaled $180,000, their income from "Rental real estate, royalties, partnerships, S corporations, trust, etc." totaled $5,061,985, their interest income totaled $97,000 their "Other income" totaled about negative $3.6 million, they had no dividend income, and they owed over $39,000 in taxes at the time of the return. Thus, the Wannakuwatte Tax Return showed millions of dollars of negative income, apart from the taxable income presumably attributed to IMG. The Wannakuwatte Tax Return did not include any backup for the $5,061,985 of income from Rental real estate, royalties, partnerships, S corporations, trust, etc." reflected on the Wannakuwatte Tax Return.

Return, the Wannakuwatte Tax Return identified Rishwain as the preparer but was unsigned. Raghavan did not confirm with Rishwain that the Wannakuwatte Tax Return was authentic and did not confirm whether Wannakuwatte actually paid the tax obligation reflected on the Wannakuwatte Tax Return.[217] As with the IMG Tax Return, Raghavan testified that he was not concerned about the absence of a signature on the Wannakuwatte Tax Return because electronically filed tax returns often are not signed.[218]

Also, Raghavan did not ask why the Wannakuwatte financial statements did not reflect any of the $23 million in notes receivable reflected in IMG's 2013 financial statements.[219] Raghavan testified that his understanding was that the value of Wannakuwatte's corporate investments in IMG and Olivehurst Glove reflected in the Wannakuwatte financial statements was net of the $23 million that Wannakuwatte and affiliates had borrowed from IMG.[220] However, Wannakuwatte did not tell Raghavan that Wannakuwatte had adjusted the value of IMG and Olivehurst Glove to reflect the "Notes Receivable." In addition, Wannakuwatte's financial statements reflect as an asset a $1.8 million loan from Wannakuwatte to IMG.[221]

The Wannakuwatte financial statements indicated that his investments in IMG and Olivehurst Glove were worth about $40 million and that his total net worth, including both commercial and residential real estate, was about $58 million.[222] Although Raghavan noted that the Wannakuwatte Tax Return indicated that Wannakuwatte was a wealthy man, he did not focus on Wannakuwatte's personal financial statements because IMG's cash flows and balance sheet were so strong that he viewed the personal guarantee as not having much significance.[223] Thus, Raghavan did not probe Wannakuwatte regarding the basis of the valuations of IMG, Olivehurst Glove, commercial real estate, personal property, furniture, personal effects, and vehicles.[224]

c. Tax Distributions

In his February 12 email to Wannakuwatte, Raghavan asked whether he had taken any tax distributions in recent years.[225] Raghavan testified at the hearing that he formed an

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[217] Tr. 1257.

[218] Tr. 1100, 1165-66.

[219] RX-4, at 2; Tr. 1345-47.

[220] Tr. 1346.

[221] RX-33.

[222] RX-33; Tr. 374-76. Raghavan testified at the hearing that Carolina's disclosure to potential investors that Wannakuwatte's net worth was "over $70 million inclusive of his company ownership" was based primarily on the Wannakuwatte financial statements. Tr. 374-76, 502-04; CX-53, at 2. The record does not demonstrate why Carolina viewed the Wannakuwatte financial statements, which showed his net worth as $58 million, as corroborating Carolina's disclosure that his net worth was about $70 million.

[223] Tr. 364-67, 1166, 1413-14.

[224] Tr. 374-77, 502-04.

[225] RX-58, at 1.

understanding that Wannakuwatte was able to fund the tax obligations attributable to IMG after he took passive losses.[226] However, Carolina did not obtain documents showing how Wannakuwatte funded his tax obligations.[227]

d. Medline Aloetouch® Ease Glove

Carolina could reasonably have performed additional steps to verify the disclosures regarding the contract with Medline that gave IMG the exclusive right to distribute Aloetouch® Ease gloves in the United States.

During Raghavan's January 29 Visit, Wannakuwatte informed Raghavan that RelyAid was the exclusive distributor in the United States of the Aloetouch® Ease glove. In a February 1 email to Wannakuwatte and Anderson, Raghavan asked for a copy of the contract granting IMG the exclusive right to distribute the Aloetouch® Ease glove made by Medline.[228] On February 3, Raghavan sent an email to Wannakuwatte again asking for the Aloetouch® Ease agreement with Medline.[229]

Although Raghavan had, at least twice, specifically requested a copy of the contract granting IMG the exclusive right to distribute the Aloetouch® Ease glove, IMG never provided the contract. Instead, IMG provided three documents that IMG had prepared. One was a brochure in which IMG represented that "AloeTouch Ease gloves are manufactured by Medline using a patented process and are available to dental professionals exclusively through RelyAid" and that "RelyAid is endorsed and recommended by 33 dental associations throughout the United States."[230] Another was a brochure in which IMG represented that "IMG is the exclusive distributor of Aloe*touch* Ease in the United States."[231] The third was a history of IMG, in which IMG represented that in 2004, "[i]n association with Medline Industries, Inc., RelyAid began manufacturing the patented Aloe*touch* Ease left- and right-hand fitted gloves, for which it became the exclusive distributor."[232]

Raghavan testified at the hearing that he was not concerned by IMG's failure to provide the requested Medline contract because the brochures showed that a relationship existed, he had seen the Aloetouch® Ease gloves at the warehouse, he had viewed a IMG or RelyAid website and had seen that IMG advertised selling the Aloetouch® Ease glove under the RelyAid brand,

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[226] Tr. 1082. This testimony conflicts with a representation that Thom Young, another Carolina registered representative, made to a prospective investor. Young represented that in addition to taking a $180,000 salary from IMG, Wannakuwatte "takes whatever is necessary to pay his tax obligations." CX-71, at 1.

[227] RX-105; Tr. 1203-06.

[228] CX-5, at 11-12; RX-54; Tr. 458-59.

[229] CX-5, at 13.

[230] Tr. 457-60, 475-76, 1154-60, 1274-85; RX-26, at 5; RX-28; RX-54; CX-5, at 12.

[231] RX-27, at 6.

[232] RX-28.

and Wannakuwatte showed Raghavan a Medline catalogue.[233] However, there is a significant distinction between being an authorized seller of a product and being the exclusive distributor of the product. Evidence establishing that IMG sold the Aloetouch® Ease glove did not establish that Medline had granted IMG the exclusive right to distribute that glove.[234]

The Due Diligence Checklist called for documents "pertaining to proprietary technology developed/owned by the Company, including any copyright or patent filings."[235] In his February 3 email to Wannakuwatte and Anderson, Raghavan also asked for "information on Intellectual property (patents etc.)."[236] Carolina did not obtain copies of any patents relating to the Aloetouch® Ease glove.[237]

e. Other Suppliers of Gloves

In his February 1 email to Wannakuwatte asking for the contract with Medline giving IMG exclusive rights to distribute the Aloetouch® Ease glove, Raghavan also asked for "contracts with vendors/partners-e.g., Malaysian Suppliers."[238] In his February 3 email to Wannakuwatte and Anderson, Raghavan asked for material contracts with "Malaysian suppliers."[239]

On February 3, Anderson sent Raghavan the contract with the Malaysian company that was selling glove-manufacturing equipment to IMG, not—as requested—the contract with the Malaysian suppliers of gloves.[240] Raghavan testified that he recognized that the contract related to the purchase of equipment, not of gloves, and that he did not view the equipment contract as relevant to the IMGF Offering.[241] However, despite his requests for contracts with vendors, Carolina also did not obtain contracts between IMG and any other supplier of gloves.[242]

In a February 12, 2014 email to Wannakuwatte, Raghavan asked for a list of manufacturers with which Wannakuwatte had a current relationship, along with a percentage of

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[233] Tr. 359-61, 1154-58, 1196-97, 1274-85.

[234] Based on Raghavan's testimony, it is possible that Wannakuwatte only represented to Raghavan that IMG was the only company granted the right to distribute Medline's Aloetouch® glove under the RelyAid brand, which was IMG's brand, as opposed to being the only company that had the right to distribute Medline's Aloetouch® glove.

[235] CX-6, at 6.

[236] CX-5, at 13.

[237] RX-105; Tr. 1203-06.

[238] CX-5, at 12; RX-54, at 1.

[239] CX-5, at 13.

[240] Tr. 455-59; CX-5, at 12; RX-41; RX-54.

[241] Tr. 455-56, 1185-86. Raghavan obtained a copy of an invoice from the corporation that was selling the glove manufacturing equipment to Olivehurst Glove indicating that a down payment of about $7 million had been made toward the $35 million purchase price of the glove manufacturing equipment. RX-42.

[242] RX-105; Tr. 1203-06.

gloves that came from each, and an accounts payable aging schedule.[243] Carolina did not obtain either document.[244]

f. Market for Gloves

Carolina made a number of requests for information regarding IMG's market for examination gloves and received some responsive documents. On February 3, Raghavan sent an email to Wannakuwatte in which Raghavan mentioned that copies of any endorsements by dental associations or other groups would be helpful but were not mandatory.[245] Although Wannakuwatte provided Carolina with an IMG brochure in which IMG represented that "RelyAid is endorsed and recommended by 33 dental associations throughout the United States,"[246] he did not provide copies of any endorsements.[247]

Raghavan asked Wannakuwatte for information regarding the market for nitrile gloves and obtained a chart showing both the past and the projected total world market for nitrile exam gloves.[248]

Raghavan obtained a list of IMG's 50 top customers.[249] Although Raghavan did not verify the accuracy of the list, he inserted it into the information memorandum.[250]

To understand how IMG priced gloves, Raghavan asked for, and obtained, a schedule of pricing for gloves based on the type of glove and the IMG division that sold the glove. The schedule addressed the pricing for nitrile gloves and for Aloetouch® Ease and other latex gloves, but not for vinyl gloves.[251] Carolina did not obtain any documents that addressed IMG's pricing of vinyl gloves.[252]

g. Wannakuwatte's Authority to Sign Wannakuwatte Guarantee

Raghavan asked Wannakuwatte whether he was authorized to sign the Wannakuwatte Guarantee on behalf of his wife, BW, and he responded that he had that authority.[253] However,

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[243] RX-58, at 2.

[244] RX-105; Tr. 1203-06.

[245] CX-16, at 2; Tr. 472-73.

[246] RX-26, at 5.

[247] RX-105; Tr. 472-73, 1203-06.

[248] RX-44; Tr. 1190-91.

[249] RX-23; Tr. 1144.

[250] Tr. 483, 1262.

[251] RX-24; Tr. 1145-46.

[252] RX-105; Tr. 1203-06.

[253] Tr. 1342-43.

Raghavan did not obtain any document confirming that BW had authorized Wannakuwatte to sign the Wannakuwatte Guarantee on her behalf.[254]

h. Monthly Financial Data

Carolina's Due Diligence Checklist called for Carolina to obtain "[q]uarterly income statements for the last three years and the current year (to date)."[255] On February 1, Raghavan asked Wannakuwatte and Anderson for monthly financials for 2013.[256] The next day, he sent an email to Wannakuwatte explaining that the purpose of this request was to obtain "monthly granularity for [potential investors] who want it."[257] Raghavan repeated this request on February 3, 2014.[258] Carolina never obtained either quarterly income statements for the previous three years or monthly financial statements for 2013.[259]

i. Financial Data for Previous Years

In the email that Raghavan sent to Wannakuwatte and Anderson on February 1, Raghavan also requested annual financial statements for "previous years."[260] Two days later, Raghavan clarified that he only needed the financial statements for a chart and that "topline" information (that is, annual revenue and net income) would suffice.[261] Carolina obtained: (1) revenue and profit information for 2006 through 2010 and (2) estimated revenue and profit for 2013 but did not receive financial statements for these years.[262]

j. Communications with Banks

Wannakuwatte provided a letter from EastWest Bank stating that IMG has been a client of the bank, has maintained deposit accounts at the bank "for a while," and "all the accounts have been handled in an excellent manner."[263]

While discussing with Raghavan the Due Diligence that Carolina was conducting, Milhaupt (Carolina's Chairman) volunteered to contact IMG's banks. He left messages at a number of banks, and an officer of EastWest Bank returned his call. Milhaupt asked her a lot of

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[254] RX-105; Tr. 1203-06.

[255] CX-6, at 4.

[256] CX-5, at 11-12; RX-54.

[257] CX-5, at 14.

[258] CX-16, at 1.

[259] RX-105; Tr. 1203-06.

[260] CX-5, at 11. Given that the Dropbox folder contained annual financial statements beginning 2010, the Panel interprets this request as covering years before 2010.

[261] CX-16, at 1-2.

[262] Tr. 1203-06; RX-5; RX-105.

[263] RX-9.

detailed questions regarding IMG's account, and—as Milhaupt expected—she declined to provide detailed information. She did, however, represent that IMG had an institutional relationship with the bank for eleven years.[264]

k. Calculation of Financial Ratios

At some point before February 5, 2014, Raghavan prepared an excel spreadsheet in which he calculated various standard financial ratios based on the IMG financial statements he had been provided.[265] While Raghavan was calculating financial ratios, Raghavan and Roberts talked to a senior portfolio manager at one of Carolina's investor clients (which managed approximately $500 million) who was running the financial statement numbers through a model and confirmed that his analysis was similar to Raghavan's.[266] Raghavan's calculations did not reveal any abnormalities that, in Raghavan's judgment, warranted further inquiry.[267]

l. Corporate Documents

The Due Diligence Checklist called for Carolina to obtain IMG's corporate documents, including articles of incorporation, bylaws, minutes of meetings of the board of directors, and certificates of good standing for all states and jurisdictions where the issuer is qualified to do business.[268]

In Anderson's January 30 Email, Anderson stated that the documentation to be provided to Raghavan "today" included a corporate certificate of good standing and articles of incorporation.[269] During the Due Diligence Period, Raghavan received copies of: IMG's article of incorporation, which was executed in June 1990 and showed Wannakuwatte as IMG's initial agent for service of process; IMG's "Certificate of Status" from the State of California, which was executed in January 2014; and a business license from the City of West Sacramento for IMG, which described IMG's business as "Medical, Dental, and Hospital Equipment and Supplies Merchan[dise]."[270] In addition, Raghavan received copies of two documents that supported Wannakuwatte's representation that IMG qualified for certain preferential treatment: a certificate from the Northern California Supplier Development Council certifying that IMG met its requirements for certification as a bona fide minority business enterprise and a letter from the U.S. Small Business Administration advising that IMG had been approved as a "qualified

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[264] Tr. 1656, 1660-66.

[265] Tr. 490-96, 1065-66; CX-43; RX-6.

[266] Tr. 1208-10, 1376-77.

[267] Tr. 1068-75.

[268] CX-6, at 5.

[269] RX-49.

[270] RX-11; RX-12; RX-13; Tr. 1105-06.

HUB*Zone* small business concern."[271] Carolina did not obtain copies of IMG's bylaws or board minutes.[272]

m. Background Searches

Wells performed background searches on LexisNexis regarding IMG and Wannakuwatte to ensure that they had not been the subject of any indictments, bankruptcy petitions, convictions, liens, or judgments.[273] The background searches also checked databases to ensure compliance with the Patriot Act, OFAC requirements, and anti-terrorism requirements.[274] Raghavan testified that the searches showed that IMG had been the subject of seven liens over time and each had been terminated, which indicated to him that IMG had repeatedly borrowed money and then repaid the loan.[275]

The comprehensive business report on IMG generated by the LexisNexis search contained information from a business credit database.[276] This information indicated that IMG was started in 1990, had annual sales of $3.4 million, and was located in one rented facility.[277] Raghavan testified at the hearing that Carolina, like much of the finance industry, did not consider that business credit database to be reliable for the purpose of verifying the revenue of private companies.[278] Enforcement did not offer any evidence that contradicted Raghavan's testimony. Accordingly, the Panel finds that Enforcement has not established that it was unreasonable for Carolina to disregard the information from the business credit database.

n. Insurance Documents

Carolina's Due Diligence Checklist called for Carolina to obtain "[s]chedules or copies of all material insurance policies of [IMG]covering property, liabilities and operations, including product liabilities" and a "[s]chedule of all other insurance policies in force such as 'key man' policies or director indemnification policies."[279] In Anderson's January 30 Email, Anderson stated that the documentation to be provided to Raghavan "today" included key insurance policies for IMG, such as liability insurance and worker's compensation insurance.[280] During the Due Diligence Period, Raghavan obtained a liability policy covering IMG, a worker's

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[271] RX-14; Tr. 1110-12.

[272] RX-106; Tr. 1203-06.

[273] RX-7; RX-20; Tr. 1084-85, 1093, 1162, 1742-43.

[274] Tr. 549-51, 1094-95, 1123-25.

[275] Tr. 1125.

[276] Tr. 552-55.

[277] RX-20, at 24; Tr. 552-55, 1123-25.

[278] Tr. 1126, 1130-34.

[279] CX-6, at 7.

[280] RX-49, at 2.

compensation policy, and an insurance policy on Wannakuwatte's life.[281] The liability insurance policy did not identify its beneficiary. Carolina did not obtain any certification that the policies were in effect.[282]

o. Background Information

Carolina's Due Diligence Checklist called for Carolina to obtain a "management organization chart and biographical information, including relevant business success and background."[283] During the Due Diligence Period, Raghavan obtained a one-page biography of Wannakuwatte, which contained most of the biographical information that Raghavan included in the IMGF information memorandum.[284] Raghavan also obtained a one-page history of IMG that contained most of the information set forth in the "Corporate Milestones" of the information memorandum.[285]

p. Olivehurst Facility

During the Due Diligence Period, Carolina obtained documents and information corroborating Wannakuwatte's representation that he was developing a facility in Olivehurst, California to manufacture examination gloves.

In the Google search he performed shortly after his January 29 Visit, Raghavan found articles discussing Wannakuwatte's Olivehurst Facility.[286]

During Raghavan's second visit to IMG's West Sacramento facility, Wannakuwatte explained that he had located his manufacturing facility in Olivehurst because it had high unemployment, he could obtain low-cost EB-5 financing by locating his business in an economically depressed region, and he could obtain various concessions from the local government.[287] During that visit, Raghavan talked with Wannakuwatte's family about IMG's being a small family-owned business and about the Olivehurst Facility.[288] Also during that visit, Wannakuwatte gave Raghavan copies of materials relating to the economically depressed HUBZone in which Olivehurst was located.[289]

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[281] RX-16; RX-17; RX-18; Tr. 1115-20.

[282] RX-105; Tr. 1203-06.

[283] CX-6, at 4.

[284] CX-53, at 7; RX-32; Tr. 1162-63.

[285] RX-28.

[286] Tr. 1137-40.

[287] Tr. 1036-39.

[288] Tr. 1059.

[289] Tr. 1060. Some entities give preferential treatment to small businesses that operate in HUBZones, which are areas that the Small Business Administration has designated as historically underutilized by business. Tr. 1037; RX-14, at 2.

During the Due Diligence Period, Carolina obtained materials relating to the Olivehurst Facility, including an aerial photograph of the facility, a video containing aerial footage of the facility, and two engineering drawings of the manufacturing equipment to be installed in the facility.[290] Raghavan also obtained a preliminary title report regarding the Olivehurst property. Raghavan viewed these materials as corroborating Wannakuwatte's representations regarding the Olivehurst Facility.[291]

In addition, as mentioned above, IMG sent Raghavan a copy of the contract between Olivehurst Glove and a Malaysian company for the purchase of glove manufacturing equipment for the Olivehurst Facility and an invoice for the equipment.[292] Also, during the Due Diligence Period, one of Carolina's investor clients called Raghavan and mentioned that it had been approached about financing the shipment of manufacturing equipment from Malaysia to the United States to be purchased by RelyAid.[293]

In Anderson's January 30 Email, Anderson stated that the documentation to be provided to Raghavan "today" included an expense summary for the $23 million in loans that IMG had advanced to Wannakuwatte in connection with Olivehurst Glove. Raghavan never received the expense summary.[294]

q. Lease Agreement

Carolina's Due Diligence Checklist called for Carolina to obtain "[a]ll outstanding leases with an original term greater than one year for real and personal property . . . ."[295] On February 12, Raghavan sent an email to Wannakuwatte asking for, among other things, a copy of the lease agreement for the warehouse facility.[296] Carolina did not obtain a copy of the lease.[297]

F. Roberts' Involvement in Due Diligence

1. Review of Documents

In this section, the Panel makes findings regarding Roberts' review of Due Diligence documents and other steps that Roberts took in connection with Carolina's Due Diligence. The Panel relies on these findings in assessing whether Roberts conducted a reasonable investigation

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[290] RX-35; RX-36; Tr. 1167-70.

[291] Tr. 1177-80; RX-38.

[292] RX-41; RX-42.

[293] Tr. 740-41, 1168, 1296-97.

[294] Tr. 352, 1203-06; RX-105.

[295] CX-6, at 6.

[296] CX-17, at 2.

[297] RX-105; Tr. 1203-06.

into the IMGF Notes and the disclosures in the IMGF Offering Materials and whether Carolina and Roberts enforced Carolina's Due Diligence WSPs.

a. Roberts' General Approach

Carolina maintained a cloud drive, referred to as the H: drive, that was used by Carolina's investment bankers. Pursuant to Carolina's procedures, Raghavan used the H: drive to store copies of the documents that he gathered in connection with his Due Diligence.[298]

Roberts reviewed Due Diligence documents in Carolina's H: drive, but did not read each document.[299] At the hearing, Roberts explained that he exercised judgment in determining whether and how to review a Due Diligence document,[300] and his approach was to "spot check certain elements which I think are most critical to make in the overall call as to whether this [offering] feels right to me."[301] Roberts explained that Carolina had organized both the Due Diligence process and the H: drive into more than a dozen categories (*e.g.*, company overview, market overview, management, financial information, corporate documents, material contracts, litigation, insurance, and government regulations and filings).[302] Roberts testified that he reviewed "for completeness of the overall diligence file" by looking at what documents were filed in the various categories.[303]

b. Roberts' Review of Specific Due Diligence Documents

The record permits only limited findings regarding the extent to which Roberts reviewed specific Due Diligence documents.

Roberts did not review either the IMG Tax Return or the Wannakuwatte Tax Return, but he was aware that Raghavan had obtained the returns and understood that they were consistent with the 2012 financial statements of Wannakuwatte and IMG.[304]

Roberts took a "cursory look" at the financial analysis that Raghavan performed on IMG's financial statements. In addition, Roberts spoke with the senior portfolio manager of one of Carolina's investor clients about the portfolio manager's analysis of the statements.[305] Roberts

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[298] Tr. 871-72.

[299] Tr. 879, 1502, 1693.

[300] Tr. 879.

[301] Tr. 879; *Accord* Tr. 1502.

[302] CX-6, at 3-7; Tr. 1486.

[303] Tr. 879, 1502.

[304] Tr. 1507-08.

[305] Tr. 911, 1502.

understood that the portfolio manager had discussed his analysis with Raghavan and used in his analysis all of the information on IMG that Carolina had posted to its investor portal.[306]

Roberts reviewed the VA Contract.[307] Having served in the military and having interacted with Veterans Affairs on a personal basis, Roberts thought the VA Contact looked like a standard U.S. government document.[308] Roberts looked at the VA Contract "broadly as evidence that [IMG] had a contractual relationship with Veterans [Affairs] and that [relationship] had continued for some time."[309] He saw on the first page of the VA Contract that the original contract period ran from September 15, 2006 through September 14, 2011, and on the fourth page that the contract period had been extended through September 14, 2016.[310] He did not look "in detail" at the special order information on the first page of the VA Contract.[311]

Roberts reviewed the written explanation that Wannakuwatte provided regarding the GECC/GE Aircraft lawsuit.[312] Roberts, Raghavan, and Gilmore discussed whether Wannakuwatte's written explanation was satisfactory and they concluded that it was.[313]

Roberts did a "quick scan" of the bank statements provided by IMG and confirmed that they showed activity. He was aware that he was not reviewing complete bank statements, but he saw that the portions of the bank statements obtained by Carolina included summaries of activity and believed those were sufficient.[314]

Roberts did not look at either the August A/R Report or the December A/R Report.[315] He discussed the December A/R Report with Raghavan, who informed Roberts that it was consistent with IMG's financial statements.[316]

Roberts looked at the permits that had been issued for the rehabilitation of the Olivehurst Facility.[317]

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[306] Tr. 910-11, 1502-03.

[307] Tr. 893.

[308] Tr. 894-97.

[309] Tr. 898.

[310] Tr. 896-97.

[311] Tr. 898.

[312] Tr. 1354, 1396-97.

[313] Tr. 1396.

[314] Tr. 892-93.

[315] Tr. 910-11, 913.

[316] Tr. 910-12.

[317] Tr. 1558.

Roberts did not read the LexisNexis comprehensive business report "in its entirety."[318] He did, however, ask what the report showed about liens, judgments, and UCC financing statements.[319]

2. Other Steps that Carolina and Roberts Took in Supervising Carolina's Due Diligence on IMGF Offering

By the time of the IMGF Offering, Raghavan had worked as lead or co-lead banker on about a dozen Carolina transactions (some as an understudy to Roberts), and Roberts had developed confidence in Raghavan's competence.[320] Accordingly, for example, Roberts assumed that the disclosure in the IMGF Offering Materials that IMG was "the exclusive distributor of AloeTouch® Ease gloves in the United States," was accurate because Raghavan presented it.[321]

Roberts had a telephone conversation with Wannakuwatte early in Carolina's Due Diligence process. In that conversation, Wannakuwatte provided information regarding his background and his plan to bring the manufacture of examination gloves back to the United States by purchasing a facility at a price well below replacement cost, repurposing the facility, and obtaining a minority preference on government contracts. Roberts formed the impression that Wannakuwatte was energetic, shrewd, and informed.[322]

Roberts, along with some Carolina investor clients and other Carolina registered representatives, participated in a telephone conference on February 11, 2014, in which Wannakuwatte reviewed key aspects of the IMGF offering.[323] The record contains little evidence regarding the content of that telephone conference.

During the Due Diligence Period, Roberts discussed topics relating to the IMGF Offering with Raghavan on multiple telephone calls.[324] The record contains little evidence regarding the content of those discussions.

There is no evidence that Roberts was aware of the weakness of the internal accounting controls over IMG's wholesale business. There is no evidence that Raghavan or anyone else ever told Roberts about Wannakuwatte's responses to Raghavan's questions about the lack of an entry to offset the spike in IMG's reported inventory. Roberts testified that he does not recall that information being brought to his attention.[325] There is no evidence that Raghavan or anyone else

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[318] Tr. 919.

[319] Tr. 919.

[320] Tr. 1453-54.

[321] Tr. 961-62.

[322] Tr. 1494-95; CX-5, at 8.

[323] CX-47; Tr. 124-25.

[324] Tr. 894.

[325] Tr. 1567.

told Roberts about the information that Kostkas learned from Klein about the accounting for IMG's wholesale business.

The day before Carolina distributed the IMGF Offering Materials to potential investors, Milhaupt sent an email to Raghavan posing four questions. First, Milhaupt asked about the comparative weakness of IMG's reported results for the first eleven months of 2013 and the spike in IMG's inventory. Raghavan responded that Wannakuwatte had mentioned that he expected that revenues and profits for 2013 would exceed 2012 results and relayed Wannakuwatte's explanation that the spike resulted from vendors offering favorable terms.[326] Second, Milhaupt asked about the status of the Olivehurst Facility. Before responding directly to Milhaupt's question, Raghavan explained "the obligor is IMG here" and IMG's "business is not affected by the plant. [Wannakuwatte] imports his gloves from Malaysia today."[327] Third, Milhaupt asked "[h]ow exhaustive is the underwriting of" Wannakuwatte and whether he had sufficient liquid assets to support the guarantee or whether his wealth is in "real estate." In his response, Raghavan did not discuss the limited extent of the Due Diligence he had performed on Wannakuwatte's finances. Rather, Raghavan responded that, in addition to having about $40 million in corporate investments in IMG and Olivehurst Glove, Wannakuwatte had about $750,000 in cash and equivalents and owned $17.5 million in real estate on which the mortgages totaled about $12 million.[328] Fourth, Milhaupt asked whether the deal was too good to be true, and Raghavan responded that Wannakuwatte needed the money urgently so, after talking to Roberts, Raghavan structured the transaction to be attractive to Carolina's investor clients.[329]

Roberts' standard practice was to consult with Milhaupt regarding each prospective Carolina transaction and to not approve the prospective transaction if Milhaupt objected to it.[330] Roberts and Raghavan discussed the IMGF Offering with Milhaupt. They discussed what type of security Carolina should propose to sell (equity or debt), the marketability of the contemplated security, the collateral that was available, the Wannakuwatte Guarantee, and Wannakuwatte's business plans. Milhaupt concluded that IMGF was "conservatively capitalized" and the IMGF Offering was clearly appropriate.[331] Thus, Milhaupt's questions and Raghavan's responses were part of Carolina's supervision of Due Diligence even if no one informed Roberts of Milhaupt's questions and Raghavan's responses.

Roberts approved the IMGF Offering Materials, the IMGF PPM, the Wannakuwatte Guarantee, the IMG Loan and Security Agreement, and the IMGF Loan and Security Agreement.[332] Roberts testified that he approved the IMGF PPM because there was a lot of

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[326] CX-72, at 1-2.

[327] CX-72, at 2.

[328] CX-72, at 2.

[329] CX-72, at 2.

[330] Tr. 1643-44.

[331] Tr. 1658-60, 1670-71.

[332] CX-43; Tr. 497-98, 881, 938, 943-45, 1270.

information confirming that IMG "was a real company, a going concern [and the IMGF Offering] was a de minimis financing relative to the overall reported financial strength of the company."[333]

G. Carolina's Suitability Determination

Raghavan did not prepare, and Carolina's registered representatives therefore did not take, a quiz to test the extent to which a registered representative understood the IMGF Notes. Under Carolina's Suitability WSPs, only Raghavan and Roberts were permitted to sell the IMGF Notes without passing the quiz. Nevertheless, three other Carolina registered representatives sold the IMGF Notes to investor clients.[334]

The purpose of the quiz was to provide a "tangible control" that each registered representative selling a security understood such matters as the nature of the security, the commissions and fees associated with the security, the applicable amortization schedule (if any), and the source of repayment.[335] Roberts allowed Carolina representatives to sell the IMGF Notes without taking the quiz because the IMGF Notes were "plain vanilla."[336]

H. Activity After Commencement of IMGF Offering

The Panel makes findings regarding certain events that occurred after the IMGF Offering began in connection with assessing sanctions against Carolina and evaluating an allegation by Enforcement that the IMGF Offering Materials were materially misleading because they did not disclose that Carolina's Due Diligence continued after the IMGF Offering began.

1. Continuing Communications with IMG

Carolina continued gathering documents and information regarding IMG after February 14, when the IMGF Offering began.[337] Raghavan testified at the hearing that Carolina's practice was to obtain information relating to an offering through the offering period and beyond.[338]

On February 20, 2014, Raghavan and Roberts met with Wannakuwatte and visited the Olivehurst Facility.[339] Wannakuwatte walked them through the facility pointing out the upgrades that had been installed. The three of them then traveled to IMG's facility in West Sacramento where Wannakuwatte gave Roberts and Raghavan a tour of that facility.[340] Wannakuwatte asked

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[333] Tr. 1566.

[334] Tr. 139-40, 1466-67; CX-52; CX-70; CX-71; CX-72; CX-73; CX-74.

[335] Tr. 1466.

[336] Tr. 1466-67.

[337] Tr. 1229.

[338] Tr. 583-84.

[339] CX-5, at 38-39; Tr. 1030-32.

[340] CX-5, at 39.

whether Carolina could sell the remaining $2 million (in a new tranche) so that he could post letters of credit that would allow him to import equipment from Malaysia. Raghavan responded that Wannakuwatte and Carolina should develop a comprehensive financing plan, and Wannakuwatte replied that he would travel to the San Francisco Bay area so that they could review Olivehurst Glove's entire financial plan.[341]

The next day, Raghavan sent two emails to Wannakuwatte. In one email, Raghavan listed the funds Carolina had collected to date ($2,450,000),[342] predicted that the remainder of the $3 million tranche would be collected within the week, and suggested meeting to "iron out the short and intermediate term funding requirements."[343]

In his second email, Raghavan transmitted the IMG Closing Documents to Wannakuwatte and asked him to sign and return the documents to Carolina.[344] The timing of this request was consistent with Carolina's practice in continuous, best efforts offerings of asking the issuer to sign the closing documents only after the issuer had received all, or almost all, of the offering proceeds. However, Wannakuwatte was arrested before he signed the IMG Closing Documents.[345]

In his second email, Raghavan suggested to Wannakuwatte that they "take care of the housekeeping activities next week," including adjusting accounting entries at IMG to correctly reflect short-term and long-term liabilities, making certain adjustments to IMG's general liability insurance policy and key man insurance policy, reclassifying advances to affiliates at IMG as "Loans to Shareholders," getting copies of promissory notes, and obtaining 2013 financial statements that include December data.[346]

2. Discovery of Wannakuwatte's Arrest and Resulting Efforts to Recover Investor Funds

On February 24, 2014, Raghavan saw a Sacramento news article reporting that Wannakuwatte had been arrested the week before. Raghavan immediately informed Gilmore, who informed Roberts.[347]

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[341] CX-5, at 39.

[342] CX-5, at 40; CX-48.

[343] CX-5, at 39.

[344] RX-61.

[345] Compl. ¶ 8; Ans. ¶ 8; Tr. 941-42.

[346] CX-41, at 1.

[347] CX-5, at 42; Tr. 1569-70, 1572.

a. Communications with FINRA and FBI

Within two hours of learning of Wannakuwatte's arrest, Carolina contacted the staff of FINRA's Atlanta office to report that the Firm was in the midst of an offering and had discovered that the owner of the issuer had been arrested for a potential Ponzi scheme.[348] Roberts then contacted the FBI to ensure that the FBI knew that the IMGF investors were victims of Wannakuwatte's fraud.[349]

b. Efforts to Recover Funds for the IMGF Investors

Carolina took other prompt action to protect the IMGF investors. On February 24, 2014, Roberts retained a North Carolina law firm to protect the interests of IMGF and the IMGF investors. That same day, February 24, Carolina filed a UCC statement to perfect IMGF's lien.[350]

Shortly thereafter, Carolina retained a second law firm on behalf of IMGF and the IMGF investors to pursue a civil action against IMG and Wannakuwatte in federal court and to represent those interests in connection with the criminal investigation and prosecution of Wannakuwatte. Later, Carolina retained a third law firm to represent those interests in the IMG bankruptcy.[351]

On February 28, 2014, IMGF filed a lawsuit against Wannakuwatte and IMG asserting various fraud claims and a constructive trust over various IMG assets.[352] Three days later, the court entered a temporary restraining order freezing the assets of IMG and Wannakuwatte.[353] The Court found "good cause [to] believe that [IMG and Wannakuwatte] obtained the investment funds transmitted to them by [IMGF] by means of fraudulent misrepresentations."[354] Subsequently, the Court issued a preliminary injunction extending the asset freeze and again finding, "good cause to believe that [IMG and Wannakuwatte] obtained the investment funds transmitted to them by [IMGF] by means of fraudulent misrepresentations."[355]

After IMG filed for bankruptcy in May 2014, the IMG bankruptcy trustee ("IMG Trustee") disputed the enforceability of the unsigned IMG Loan and Security Agreement, the validity of IMGF's security interest in the IMG business assets, and IMGF's assertion of a constructive trust. Roberts (on behalf of IMGF) and the IMG Trustee reached a settlement agreement that gave IMGF preferential treatment compared to other IMG creditors. This

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[348] Tr. 25-26; CX-5, at 42.

[349] Tr. 1573.

[350] Tr. 1210-11; RX-67.

[351] Tr. 1584-87, 1759-63.

[352] Tr. 1576, 1583-86; RX-68; RX-106.

[353] RX-69, at 3-4.

[354] RX-69, at 1-2.

[355] RX-75, at 1-2.

settlement agreement was approved by the bankruptcy court in December 2014.[356] Pursuant to this agreement, the IMGF investors have received (through IMGF) $1,307,198.03 from the IMG Trustee.[357] The IMG Trustee is continuing to pursue recoveries from third-party litigation. The amount of these additional recoveries is uncertain, and therefore the amount of the ultimate losses of the IMGF investors is not quantifiable at this time.[358]

Carolina spent at least $250,000 on its efforts to recover funds for IMGF investors.[359] Also, in further support of Carolina's efforts to assert a constructive trust over the $1.3 million in IMG's bank accounts, Roberts and other Carolina personnel spent thousands of hours tracing the IMGF funds to those accounts.[360]

c. Return of Placement and Management Fees

On April 1, 2014, Carolina and IMGF returned to the IMGF investors the $147,000 that IMGF had retained to pay placement and management fees.[361]

I. Communications Relating to the Wannakuwatte Guarantee and the IMG Loan and Security Agreement

In order to assess the materiality of the disclosures in the IMGF Offering Materials regarding the Wannakuwatte Guarantee and the collateral interest in substantially all of the assets of IMG, the Panel makes findings regarding communications between Carolina and IMG that relate to this topic.

1. Initial Discussion of Term Sheet

During Raghavan's January 29 Visit, Raghavan shared with Wannakuwatte a term sheet that Raghavan had drafted the previous evening after talking to Roberts and Anderson.[362] The term sheet included the following statements regarding the Wannakuwatte Guarantee and collateral interests:

Guarantee: The Loan and its interest is fully guaranteed by [Wannakuwatte.]

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[356] Tr. 1583-88; RX-78, at 3-7. The Panel does not accept that the unsigned IMG Loan and Security Agreement and Wannakuwatte Guarantee were primary reasons that IMGF was able to obtain preferential treatment. IMG had about $1.3 million in its bank accounts, all of which Carolina traced to wires from IMGF, and Carolina therefore asserted a constructive trust over those funds. Tr. 1579-81, 1584-91.

[357] RX-146, at 3; RX-148, at 2; RX-152, at 8. (The $1,454,198.03 received by IMGF investors minus the $147,000 received in fees returned by Carolina.).

[358] RX-153, at 30-31.

[359] Tr. 1589.

[360] Tr. 1579-80; RX-109.

[361] Tr. 1582-83; RX-106, at 1. Thus, the IMGF investors have recovered a total of $1,454,198.03.

[362] Tr. 292-93, 343-44.

Collateral Interests: The loan will be secured by substantially all assets of [IMG.] IMG grants the Lender[363] the right to file a UCC statement on its behalf.[364]

2. Communications Regarding Draft Term Sheet

The morning after Raghavan's January 29 Visit, Anderson sent an email to Raghavan, copying Avila and Wannakuwatte, stating that IMG and Wannakuwatte "are approving the term sheet as written" and asking Carolina to provide an engagement letter for signature. Raghavan responded that, as he had mentioned during his January 29 Visit, he was going to tweak the term sheet to allow for an extra $2 million to be raised, if needed, and that he would send IMG the engagement letter and background authorization form shortly. Anderson replied that Raghavan's response "sounds great."[365]

3. January 29 Email

On the evening after Raghavan's January 29 Visit, Raghavan sent an email to Wannakuwatte, Anderson, and Avila explaining that because Carolina's "distribution primarily relies on high and ultra-high net-worth individuals, we are able to complete our assignments in a relatively short amount of time" and stating that once he had received Wannakuwatte's approval to proceed, a number of steps would have to be taken, including the execution of an engagement letter.[366]

4. Engagement Letter

On February 3, 2014, Roberts and Wannakuwatte signed the engagement letter, which described the private placement as a "placement to raise up to $5,000,000 of senior secured loan funding."[367] The engagement letter did not specify the security and did not refer to the guarantee.[368]

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[363] RX-47b, at 4. The Term Sheet states that the "Lender" shall be granted this right. IMGF is defined as "the Borrower." The individual investors are defined as the "Lender(s)." RX-47b, at 3. Nevertheless, the Panel finds that the intent was that IMG would grant this right to IMGF, not the individual investors.

[364] RX-47b, at 4; Tr. 292-93, 1017-18.

[365] RX-49; Tr. 1055-57.

[366] RX-50; Tr. 1051-53.

[367] CX-11, at 1; Tr. 1674-75.

[368] CX-11. Technically, the IMGF Notes were secured by all of IMGF's rights under the IMGF Loan and Security Agreement. CX-56, at 4.

5. Conversation Regarding Wannakuwatte's Authority

As discussed above, during the Due Diligence Period, Raghavan asked Wannakuwatte whether he needed permission from BW to sign the Wannakuwatte Guarantee, and Wannakuwatte responded that he was authorized.[369]

6. Information Memorandum

In early February, Raghavan provided Wannakuwatte with a copy of the information memorandum, which contained the following description of the collateral interests: "Secured substantially by all assets of [IMG.] [IMG] grants to Lenders the right to file a UCC statement to perfect its lien." The information memorandum also contained the following description of the Wannakuwatte Guarantee: "The Loan and its interest is fully guaranteed by [Wannakuwatte]."[370] Wannakuwatte sent to Raghavan on February 6 an email that stated that the "memorandum looks good."[371]

7. Investor Call

Raghavan testified that Wannakuwatte agreed on an informational call with potential investors on February 11 that he would sign the Wannakuwatte Guarantee.[372]

8. IMG Closing Documents

On February 12, Raghavan sent an email to Wannakuwatte transmitting the IMG Loan and Security Agreement and the Wannakuwatte Guarantee.[373] In the email, Raghavan stated that he was enclosing the IMG loan documents and would keep Wannakuwatte posted as Carolina starts receiving funds in a day or two.[374] The record does not include any document in which Wannakuwatte responded to Raghavan's February 12, email by accepting or rejecting the IMG Loan and Security Agreement and Wannakuwatte Guarantee.[375]

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[369] Tr. 1342-43.

[370] CX-53, at 3.

[371] Tr. 1368-69; RX-57.

[372] Tr. 1343; CX-73, at 1.

[373] CX-13.

[374] CX-13, at 1.

[375] Tr. 1203-06; RX-105.

IV. Discussion

A. First, Second, and Fourth Causes of Action (Material Misrepresentations and Omissions)

Enforcement brought three causes of action against Respondents based on alleged misrepresentations and omissions in the IMGF Offering Materials. Enforcement alleged that Respondents committed securities fraud by making material misrepresentations and omissions in the IMGF Offering Materials knowingly or recklessly (First Cause of Action) or, alternatively, negligently (Second Cause of Action). Enforcement also alleged that Respondents' misrepresentations and omissions violated FINRA's advertising rule (Fourth Cause of Action).[376]

1. Legal Discussion

"Professional standards in the securities industry require much more than unquestioning reliance on information provided by the issuer."[377] "By recommending a private placement investment, a broker represents to the investor 'that a reasonable investigation has been made and that [the] recommendation rests on the conclusions based on such investigation.'"[378] Thus, when selling securities in a private placement, a broker is "obligated to investigate the . . . securities sold in the private placement in accordance with professional standards." Although a firm selling securities "cannot be expected to possess the same knowledge of [the issuer's] corporate affairs as [the issuer's] insiders, it was required to exercise a 'high degree of care' in investigating and verifying independently [the issuer's] representations."[379] Respondents therefore "may not rely on the self-serving statements" of Wannakuwatte and IMG, but had "a duty to make an adequate independent investigation . . . to ensure that [their] representations to customers have a reasonable basis."[380]

In 2010, FINRA issued a regulatory notice setting forth this standard. FINRA stated that a broker dealer "that prepares the . . . offering document[s] has a duty to investigate securities offered under Regulation D and representations made by the issuer in the . . . offering document[s]" and that "[f]ailure to comply with this duty can constitute a violation of the antifraud provisions of the federal securities laws."[381] Thus, as FINRA explained, in general, a

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[376] The Complaint does not specify whether the fourth cause of action is based on intentional, reckless, or negligent conduct.

[377] *Dep't of Enforcement v. Reynolds*, No. CAF990018, 2001 NASD Discip. LEXIS 17, at *43 (NAC June 25, 2001).

[378] *Dep't of Enforcement v. Luo*, No. 2011026346206, 2017 FINRA Discip. LEXIS 4, at *19 (NAC Jan. 13, 2017) (quoting *Hanly v. SEC*, 415 F.2d 589, 597 (2d Cir. 1969)).

[379] *Everest Sec., Inc.*, 52 S.E.C. 958, 962-63 (1996), *aff'd in pertinent part*, 116 F.3d 1235 (8th Cir. 1997). *See also Kevin D. Kunz*, 55 S.E.C. 551, 564 n.24 (2002), *aff'd*, 64 F. App'x 659 (10th Cir. 2003); *Luo*, 2017 FINRA Discip. LEXIS 4, at *19.

[380] *Dep't of Enforcement v. Rooney*, No. 2009019042402, 2015 FINRA Discip. LEXIS 19, at *83 (NAC July 23, 2015) (quoting *Frank W. Leonesio*, 48 S.E.C. 544, 548 (1986)).

[381] FINRA Regulatory Notice 10-22, 2010 FINRA LEXIS 43, at *6, *15 (Apr. 2010).

broker dealer "'may not rely blindly upon the issuer for information concerning a company' nor may it rely on information provided by the issuer and its counsel in lieu of conducting its own reasonable investigation."[382] "In the course of a reasonable investigation, a BD must note any information that it encounters that could be considered a 'red flag' that would alert a prudent person to conduct further inquiry."[383]

a. First Cause of Action (Scienter Fraud)

In the first cause of action, Enforcement charged that Carolina and Roberts knowingly or recklessly made false and misleading representations and omissions of material fact in connection with the sale of the IMGF Notes and thereby violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. To prove a violation of these antifraud provisions, Enforcement must establish: (1) a false statement or a misleading omission of a material fact; (2) made with scienter; (3) in connection with the purchase or sale of a security; and (4) using jurisdictional means.[384] A failure to establish any element of a Section 10(b) or Rule 10b-5 charge would be fatal to the first cause of action.[385]

Whether information is material "depends on the significance the reasonable investor would place on the . . . information."[386] In the context of Rule 10b-5, "Information is material 'if there is a substantial likelihood that a reasonable [investor] would consider it important in deciding how to [invest] . . . [and] the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available.'"[387] The standard for materiality "is objective -- it asks what a reasonable investor would consider material under the circumstances."[388]

"Scienter is defined as 'a mental state embracing intent to deceive, manipulate, or defraud'"[389] and "is established if a respondent acted intentionally or recklessly."[390] "Reckless

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[382] FINRA Regulatory Notice 10-22, 2010 FINRA LEXIS 43, at *9 (quoting *Hanly v*, 415 F.2d at 597 n.5). *See also Luo*, 2017 FINRA Discip. LEXIS 4, at *23.

[383] FINRA Regulatory Notice 10-22, 2010 FINRA LEXIS 43, at *16.

[384] *Dep't of Enforcement v. Casas*, No. 2013036799501, 2017 FINRA Discip. LEXIS 1, at *24-25, (NAC Jan. 13, 2017); *Luo*, 2017 FINRA Discip. LEXIS 4, at *20.

[385] *In re Fairway Grp. Holdings Corp. Sec. Litig.*, No. 14CV0950(LAK)(AJP), 2015 U.S. Dist. LEXIS 109941, at *25 (S.D.N.Y. Aug. 19, 2015) ("The failure to establish any element is fatal to a § 10(b)/Rule 10b-5 claim.").

[386] *Dep't of Enforcement v. Akindemowo*, No. 2011029619301, 2015 FINRA Discip. LEXIS 58, at *32 (NAC Dec. 29, 2015) (quoting *Basic Inc. v. Levinson*, 485 U.S. 224, 240 (1988)), *aff'd*, Exchange Act Release No. 79007, 2016 SEC LEXIS 3769 (Sept. 30, 2016).

[387] *Dep't of Enforcement v. Fillet*, No. 2008011762801, 2013 FINRA Discip. LEXIS 26, at *29 (NAC Oct. 2, 2013) (quoting *Basic*, 485 U.S. at 231-32), *aff'd in relevant part*, Exchange Act Release No. 75054, 2015 SEC LEXIS 2142 (May 27, 2015).

[388] *Robert Tretiak*, 56 S.E.C. 209, 222 (2003).

[389] *Akindemowo*, 2015 FINRA Discip. LEXIS 58, at *33 (quoting *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976)).

[390] *Id.* (citing *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 n.3 (2007)).

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.'"[391] A reckless action "is one that departs so far from the standards of ordinary care that it is very difficult to believe the [actor] was not aware of what he was doing."[392] Not every failure to investigate constitutes recklessness.[393] Even grossly negligent conduct does not necessarily constitute reckless conduct for the purpose of Section 10(b) and Rule 10b-5 thereunder.[394]

Respondents admit that the IMGF Notes were securities for the purpose of the first cause of action.[395] Thus, Enforcement has satisfied the requirement that the misrepresentations have been made in connection with the purchase or sale of a security. The jurisdictional requirement is satisfied if Respondents used a "means or instrumentality of interstate commerce." Using the Internet, including using email, and inducing wire transfers constitute use of an "instrumentality of interstate commerce."[396] Respondents used the Internet in connection with the IMGF Offering by sending emails and posting information on the investor portal, and Respondents induced wire transfers by the IMGF investors to IMGF.[397] Thus, Enforcement has satisfied the jurisdictional requirement of Section 10(b) and Rule 10b-5 thereunder.

In the first cause of action, Enforcement also charged that Respondents violated FINRA Rule 2020, which is FINRA's anti-fraud rule. "It is similar to Rule 10b-5 and provides that no member shall effect any transactions, or induce the purchase or sale of any security, by means of any manipulative, deceptive or fraudulent device."[398] While similar to Rule 10b-5, FINRA Rule

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[391] *Fillet*, 2013 FINRA Discip. LEXIS 26, at *35 (quoting *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977)) (internal quotation omitted).

[392] *First Commodity Corp. v. CFTC*, 676 F.2d 1, 7 (1st Cir. 1982).

[393] *Donald J. Anthony*, Initial Decisions Release No. 745, 2015 SEC LEXIS 707, at *241-42 (Feb. 25, 2015).

[394] *Reynolds*, 2001 NASD Discip. LEXIS 17, at *44-45 (finding respondent's grossly negligent conduct violated NASD Rule 2110 but lacked the scienter required to render it fraudulent); *Dep't of Enforcement v. Kunz*, No. C3A960029, 1999 NASD Discip. LEXIS 20, at *45 (NAC July 7, 1999) (finding that "respondents' conduct -- albeit negligent and inconsistent with high standards of commercial honor and just and equitable principles of trade -- did not rise to the level of recklessness"), *aff'd*, 55 S.E.C. 551 (2002), *aff'd*, 64 F. App'x 659 (10th Cir. 2003).

[395] Compl. ¶ 62; Ans. ¶ 62.

[396] *Casas*, 2017 FINRA Discip. LEXIS 1, at *29 (holding that use of the internet, including the use of email and the inducing of wire transfers is use of an instrumentality of interstate commerce.); *see also Anthony Fields*, Exchange Act Release No. 74344, 2015 SEC LEXIS 662, at *19 (Feb. 20, 2015).

[397] CX-50; Tr. 127-28.

[398] *Dep't of Enforcement v. The Dratel Grp., Inc.*, No. 2008012925001, 2014 FINRA Discip. LEXIS 6, at *26 (NAC May 2, 2014), *aff'd*, Exchange Act Release No. 77396, 2016 SEC LEXIS 1035 (Mar. 17, 2016).

2020 "captures a broader range of activity."[399] However, like a violation of Rule 10b-5, a violation of FINRA Rule 2020 requires a showing of scienter.[400]

A violation of Section 10(b) and Rule 10b-5 thereunder and of FINRA Rule 2020 is also a violation of FINRA Rule 2010.[401]

b. Second Cause of Action (Negligence Fraud)

In the second cause of action, as an alternative to the first cause of action, Enforcement charged that Carolina and Roberts negligently made material misrepresentations and omissions in the sale of the IMGF Notes and thereby 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.[402] No scienter requirement exists for violations of Section 17(a)(2) of the Securities Act;[403] negligence alone is sufficient.[404] Thus, a broker acts in contravention of Section 17(a) by making a false representation about a security that is being offered or sold if the representative has "no adequate reason to believe such representations to be true."[405]

Respondents admit that the IMGF Notes were securities for the purpose of the second cause of action.[406] Thus, Enforcement has satisfied the requirement that the misrepresentations have been made in the offer or sale of securities.

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[399] *Fillet*, 2013 FINRA Discip. LEXIS 26, at *38.

[400] *Dep't of Enforcement v. Davidofsky*, No. 2008015934801, 2013 FINRA Discip. LEXIS 7, at *31 n.31 (NAC Apr. 26, 2013).

[401] *Dep't of Enforcement v. Ahmed*, No. 2012034211301, 2015 FINRA Discip. LEXIS 45, at *89 n.83 (NAC Sept. 25, 2015) ("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."), *appeal docketed*, SEC Admin. Proc. No. 3-16900 (Oct. 13, 2015).

[402] *See KCD Fin. Inc.*, Exchange Act Release No. 80340, 2017 SEC LEXIS 986, at *13-14 & n.11 (Mar. 29, 2017) (a violation of the Securities Act violates Rule 2010) (citing *Scottsdale Capital Advisors Corp. v. FINRA*, 844 F.3d 414, 422 (4th Cir. 2016)) (finding plausible FINRA's view that "grounding violations of the Securities Act in its Rule 2010 is an exercise of its statutory authority to 'promote just and equitable principles of trade'").

[403] *Dennis Navarra*, Administrative Proceeding No. 3-17355, 2016 SEC LEXIS 3008, at *8 (July 21, 2016) (citing *Aaron v. SEC*, 446 U.S. 680, 697, 701-02 (1980)); Department of Enforcement's Post-Hearing Br., at 31.

[404] *Anthony*, 2015 SEC LEXIS 707, at *265. Enforcement concedes that "[v]iolations of Sections 17(a)(2) and 17(a)(3) require a showing of negligence." Department of Enforcement's Post-Hearing Br., at 31.

[405] *Daniel R. Lehl*, 55 S.E.C. 843, 872 n.54 (May 17, 2002) (quoting *Feeney v. SEC*, 564 F.2d 260, 262 (8th Cir. 1977)).

[406] Compl. ¶ 74; Ans. ¶ 74.

c. Fourth Cause of Action (Advertising)

In the fourth cause of action, Enforcement charged that Carolina and Roberts made false and misleading statements in the IMGF Offering Materials and thereby violated FINRA Rules 2210(d)(1) and 2010. FINRA Rule 2210(d)(1)(B) provides:

> No member may make any false, exaggerated, unwarranted, promissory or misleading statement or claim in any communication. No member may publish, circulate or distribute any communication that the member knows or has reason to know contains any untrue statement of a material fact or is otherwise false or misleading.

FINRA Rule 2210 generally governs communications by a FINRA member with the public and includes certain content standards that apply to all member communications. It is undisputed that the IMGF Offering Materials are communications for the purpose of FINRA Rule 2210.

The parties dispute whether establishing a violation of FINRA Rule 2210(d)(1)(B) requires a showing that Respondents acted unreasonably. In resolving this dispute, the Panel relies primarily on two decisions by the National Adjudicatory Council ("NAC") and one opinion by the Securities and Exchange Commission ("SEC"). In the first of the NAC decisions, the NAC held that the advertising rule did not require a showing that the respondent acted with scienter or even with gross negligence.[407] In the second of the NAC decisions, the NAC reaffirmed this holding and rejected the respondent's "suggestion that a violation of Rule 2210(d)(1)(B) requires a showing of motive."[408] The NAC stated, "Rule 2210(d)(1)(B) precludes the making of misleading statements for any reason."[409]

In 2011, the SEC interpreted a New York Stock Exchange ("Exchange") Rule, Exchange Rule 472.30, that prohibited the use of "any communication which contains . . . any untrue statement or omission of material fact or is otherwise misleading."[410] The Exchange had broadly construed Exchange Rule 472.30 "as applying to any misleading communication by an Exchange member to the public, regardless of the member's state of mind."[411] The applicants argued that they could not be held liable under Exchange Rule 472.30 because they did not act with scienter.[412] The SEC upheld the Exchange's interpretation, observing that a "plain reading of the

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[407] *Reynolds*, 2001 NASD Discip. LEXIS 17, at *27 n.18.

[408] *Dep't of Enforcement v. Asensio Brokerage Servs., Inc.*, No. CAF030067, 2006 NASD Discip. LEXIS 20, at *32 (NAC July 28, 2006).

[409] *Id.* at *32.

[410] *Philip L. Spartis*, Exchange Act Release No. 64489, 2011 SEC LEXIS 1693, at *28 (May 13, 2011).

[411] *Id.* at *40-41.

[412] *Id.* at *40.

Rule supports the Exchange's interpretation" and that "[n]owhere in the language of the Rule is there an indication that scienter is required."[413]

Although Respondents correctly note that the second sentence of FINRA Rule 2210(d)(1)(A) explicitly embodies a negligence standard,[414] the plain language of the first sentence does not impose any limit on the prohibition against a member making a false or misleading statement or claim in any communication. Rather than indicating that the prohibition in the first sentence is limited to statements and claims that are made at least negligently, the second sentence of the rule demonstrates that the drafters of the rule knew how to insert a negligence standard into a prohibition when they intended to do so. The Panel therefore declines to infer that the prohibition set forth in the first sentence of FINRA Rule 2210(d)(1)(A) includes a negligence standard that the drafters did not insert into first sentence. The Panel thus concludes that Enforcement can establish a violation of FINRA Rule 2210(d)(1)(A) without establishing that Respondents acted unreasonably.

2. Analysis

Enforcement alleged that the IMGF Offering Materials falsely disclosed that: (1) IMG had a contract with Veterans Affairs valued at more than $90 million; (2) IMG had an accounts receivable balance of $36,685,772 as of November 30, 2013; (3) the IMG Loan was secured by a first lien on substantially all of the assets of IMG; and (4) the IMGF Notes were fully guaranteed by Wannakuwatte.[415] Enforcement also alleged that the IMGF Offering Materials omitted the following material facts: (1) IMG's financial statements were falsified and overstated accounts receivable; (2) during the course of Carolina's Due Diligence, Carolina was provided with bank statements that—Enforcement contends—were inconsistent with IMG's financial statements and were incomplete; (3) Carolina's due diligence relating to the IMGF Offering was ongoing; and (4) IMG, Wannakuwatte, and IMG affiliate RelyAid Global were being sued by GECC in connection with RelyAid Global's default on a loan related to the Olivehurst Facility.[416] Enforcement further alleged that Respondents were reckless or, in the alternative, negligent in making these misrepresentations and omissions.

As set forth below, the Panel analyzes these allegations in two stages. First, the Panel considers whether the Respondents made the alleged misrepresentations and whether they were material. The Panel finds that two of the alleged misrepresentations both were made by Respondents and were materially false and misleading. Second, the Panel considers whether Respondents acted knowingly or recklessly or (in the alternative) negligently in making these material misrepresentations. The Panel finds that Enforcement established that Carolina did not conduct a reasonable investigation, but not that Carolina acted recklessly. The Panel further finds

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[413] *Id.* at *41.

[414] Respondents' Post-Hearing Br., at 35.

[415] Compl. ¶¶ 46, 100-02.

[416] Compl. ¶ 85.

that Enforcement did not establish that Roberts acted either recklessly or negligently in making the two material misrepresentations.

a. Alleged Misrepresentations and Omissions

i. VA Contract

Enforcement alleged that the IMGF Offering Materials falsely represented that IMG had a contract with the Veterans Affairs valued at more than $90 million.[417] In the information memorandum, Carolina disclosed that "IMG . . . holds a requirements contract with [Veterans Affairs] which contemplates the supply of more than $90 mm worth of examination gloves for use in 34 VA facilities nationwide."[418] Carolina included this disclosure in a paragraph describing, "Long term customers and contracts."[419] Ninety million dollars is more than half of the $159 million in revenue that IMG estimated for 2013.[420]

Based primarily on the FBI affidavit, the Panel finds that the disclosure in the IMGF Offering Materials regarding the VA Contract was false.[421] In that affidavit, the FBI agent states that the Veterans Affairs Office of Inspector General, Criminal Investigations Division informed him that: IMG had a contract with Veterans Affairs that originally ran for the five years ended September 14, 2011; the contract was extended for five years to September 14, 2016; for the new five-year period the value of IMG's contract with Veterans Affairs totaled only $125,000; and when the contract was extended, the Veterans Affairs contract specialist noted that IMG's annual sales had been $25,000 and that it "is reasonable to forecast that sales would continue as such."[422] This finding is also supported by information that a FINRA staff member obtained from the Veterans Affairs website in May 2014, which shows that IMG's sales to Veterans Affairs in 2013 totaled about $24,000 and were limited to Items A-13A and A-13C.[423]

Respondents argue that this disclosure was not material because the disclosure specified that the VA Contract was a "requirements contract" and because "[r]equirements contracts are variable quantity term agreements under which the buyer's actual requirements constitute the basic measure of quantity," the disclosure communicates that the VA Contract "imposed no fixed obligation on [Veterans Affairs] to purchase $90 million worth of gloves."[424]

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[417] Compl. ¶ 98.

[418] CX-53, at 7.

[419] CX-53, at 7.

[420] RX-5.

[421] CX-79, at 10-88.

[422] CX-79, at 31.

[423] Tr. 81-83; CX-27, at 5. The VA Contract indicates that Item A-13A and Item A-13C refer to "Sterile Latex" and "Non-Sterile Latex" gloves, respectively, and the estimated annual requirements in the VA Contract for these two items total less than $40 million. CX-26, at 6.

[424] Respondents' Post-Hearing Br., at 17.

The Panel finds that the disclosure regarding IMG's contract with Veterans Affairs was materially false and misleading. The disclosure assured investors that the majority of IMG's revenues from 2013 were locked in until 2016 by a contract unless there was an unanticipated decline in the quantity of examination gloves that Veterans Affairs required. The Panel finds that there is a substantial likelihood that a reasonable investor would have considered this assurance important given that the IMGF Notes were scheduled to mature in 2015.

ii. Accounts Receivable Balance

Enforcement alleged that the IMGF Offering Materials falsely represented that IMG had an accounts receivable balance of $36,685,772 as of November 30, 2013.[425] This balance was included in the financial statements contained in the information memorandum. As with all of the other financial statement balances included in the information memorandum, Raghavan extracted this balance from the IMG financial statements that were in the Dropbox folder.

The Panel finds that this reported accounts receivable balance was materially false and misleading. The balance of the Veterans Affairs accounts receivable, and therefore of IMG's total reported accounts receivable balance, was overstated by more than $29 million.[426] IMG's accounts receivable balance as of November 30, 2013 therefore was no more than about $7,685,722 (the $36,685,722 reflected in IMG's 2013 financial statements minus the $29 million overstatement).[427]

The Panel finds that this overstatement of IMG's November 2013 accounts receivable balance was material. Because of this overstatement of accounts receivable, the IMGF Offering Materials overstated both IMG's reported total current assets and its reported shareholders' equity by more than more than 300%. As disclosed in the information memorandum, IMG's current assets exceeded its current liabilities by more than $14.5 million. As adjusted, IMG's current assets were $14.5 million less than IMG's disclosed current liabilities.

iii. Guarantee and Security Interest

Enforcement alleged that the IMGF Offering Materials falsely disclosed that the loan from IMGF to IMG was secured by a first lien on substantially all of the assets of IMG and the IMGF Notes were fully guaranteed by Wannakuwatte.[428] The information memorandum and the Term Sheet each disclosed, "The Loan and its interest is fully guaranteed by [Wannakuwatte]."[429] The Term Sheet included in the offering materials described "Collateral

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[425] Compl. ¶ 100.

[426] RX-1, at 66; RX-2, at 52. The Panel calculated the overstatement as more than $29 million by subtracting $24,000 (IMG's actual 2013 sales to Veterans Affairs) from the $29,084,371 accounts receivable balance that the August A/R Report and December A/R Report attributed to Veterans Affairs.

[427] RX-4, at 2. Enforcement did not offer other evidence directly demonstrating that any of IMG's other accounts receivable were overstated.

[428] Compl. ¶ 102.

[429] CX-53, at 3, 14.

Interests" as, "The loan will be secured by a first lien position in substantially all assets of [IMG]. IMG grants to Lender the right to perfect its first lien position."[430]

Citing North Carolina, California, and Florida law, Respondents argue that "loan was in fact secured and guaranteed, despite the absence of a signature, because [Wannakuwatte] and IMG agreed to the deal on multiple occasions, both through email communications and verbally in front of multiple parties, and accepted the loan proceeds."[431] Enforcement counters by arguing that, in light of the absence of Wannakuwatte's signature, the loan was not in fact secured by IMG's assets and guaranteed by Wannakuwatte.[432]

The Panel considers the parties' arguments and concludes that they do not address the controlling question. The controlling question is whether Enforcement established that there is a substantial likelihood that a reasonable investor would consider it important that Carolina planned to delay signing the IMG Closing Documents until IMG had received all or almost all of the proceeds from the IMGF Offering ("Signing Plans").

In support of its position that the IMGF Offering Materials were materially misleading, Enforcement offered testimony from investors that they considered the Wannakuwatte Guarantee and the first lien important and would not have purchased the IMGF Notes if they had known that Wannakuwatte had not signed the IMG Loan and Security Agreement and the Wannakuwatte Guarantee.[433] For two reasons, the Panel placed limited weight on this testimony. First, the standard for materiality "is objective."[434] Second, the Panel believes that it is very difficult for the investor witnesses to accurately assess what their reactions would have been if the information memorandum had disclosed Carolina's Signing Plans. An investor's current assessment is inevitably tainted by the knowledge that Wannakuwatte never signed the IMG Closing Documents and never made the interest and principal payments called for by the IMGF Notes.

In assessing whether the Signing Plans were material, the Panel focuses on the impact that disclosure of Carolina's Signing Plans would have had—prior to Wannakuwatte's arrest—on the assessment by a reasonable investor of the likelihood that: (1) Wannakuwatte would sign the IMG Closing Documents as planned; (2) IMG would timely make the interest and principal payments on the IMGF Notes; and (3) the IMGF investors would collect on the IMGF Notes if Wannakuwatte did not sign the IMG Closing Documents and IMG did not make timely interest and principal payments.

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[430] CX-53, at 14.

[431] Respondents' Post-Hearing Br., at 20.

[432] Department of Enforcement Post-Hearing Br., at 20-23.

[433] Tr. 703, 731-32, 832-33.

[434] *Tretiak*, 56 S.E.C. at 222.

For a number of reasons, the Panel finds that it was reasonable—prior to Wannakuwatte's arrest—to expect that he would sign the IMG Closing Documents as planned. In January 2013, Anderson sent an email to Raghavan, copying Wannakuwatte, stating that Wannakuwatte approved the term sheet as written, and the term sheet specified that Wannakuwatte would fully guarantee principal and interest and that the loan from IMGF to IMG would be secured by substantially all the assets of IMG. The draft information memorandum that Raghavan provided to Wannakuwatte described the security interest and the Wannakuwatte Guarantee, and on February 6, Wannakuwatte sent an email to Raghavan stating that the "memorandum looks good." Also on February 6, Wannakuwatte signed an engagement letter that described the IMGF Offering as a "senior secured loan funding." After Raghavan emailed the IMG closing papers to Wannakuwatte on February 12, Wannakuwatte accepted the wire transfers without communicating any objection to the closing documents.[435] In contrast, Enforcement has not identified any reason, barring his arrest, why Wannakuwatte would have refused to sign the IMG closing papers as planned.

While Enforcement contends that the IMG Loan and Security Agreement and the Wannakuwatte Guarantee were not legally binding in the absence of his signature, Enforcement appears to concede that IMG was nevertheless obligated to make interest and principal payments on the $3 million loan. Based on the disclosed financial statements, it appeared likely that IMG would have the ability to make the payments. Accordingly, the Panel finds that, prior to Wannakuwatte's arrest, it was reasonable to expect IMG to make timely interest and principal payments on the loan from IMGF to IMG.

The Panel considers the importance a reasonable person would place on the absence of a signature on the IMG Loan and Security Agreement and the Wannakuwatte Guarantee if, as happened here, IMG did not make timely interest and principal payments. Enforcement has not established the impact that a reasonable investor, prior to Wannakuwatte's arrest, would expect a refusal by Wannakuwatte to sign the IMG Closing Documents would have on the ability of IMGF or Carolina to file a lien against IMG's assets and the effect of such a lien.[436] Similarly, Enforcement has not established the impact that a reasonable investor, prior to Wannakuwatte's arrest, would expect the absence of a signed IMG Loan and Security Agreement would have on the ability of IMGF to collect the principal and interest from IMG. And Enforcement has not demonstrated that a reasonable investor would expect that a guarantee from Wannakuwatte would have significantly facilitated collection of principal and interest, especially given that Wannakuwatte's ownership interest in IMG appeared to constitute the bulk of Wannakuwatte's net worth, his real estate holdings were subject to mortgages, and IMGF had a claim against IMG even without Wannakuwatte's having signed the IMG Closing Documents.

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[435] Tr. 1349-52.

[436] Here, even though Wannakuwatte had not signed the IMG Loan and Security Agreement, Carolina filed a UCC financing statement against all of IMG's assets on February 24, 2014, promptly after learning that he had been arrested. Tr. 1210-11. The IMG bankruptcy then challenged the validity of the lien based on the absence of the signature. Tr. 1777-78.

Accordingly, the Panel finds that Enforcement has not established that there is a substantial likelihood that, in deciding whether to purchase the IMGF Notes, a reasonable investor would have considered Carolina's Signing Plans to be important. Thus, Enforcement has not established the materiality of the disclosures that the IMGF Notes were guaranteed by Wannakuwatte and the IMG Loan was secured by substantially all of the assets of IMG.

iv. IMG Financial Statements

Enforcement alleged that the IMGF Offering Materials did not disclose that IMG's financial statements were falsified and accounts receivable overstated.[437] The misstatement of IMG's financial condition and performance and overstatement of IMG's accounts receivable balance are better analyzed as the making of misleading disclosures rather than as a failure to disclose that IMG's financial statements did not fairly reflect IMG's financial condition and performance. The Panel has already addressed this issue as the making of misleading disclosures. Accordingly, the Panel declines to analyze this issue as an omission.

v. Documents Collected During Due Diligence

Enforcement alleged that Carolina was provided with incomplete and inconsistent financial documentation during its Due Diligence. This allegation is similar to Enforcement's allegation that bank statements were red flags both because Wannakuwatte only provided the first page of the statements and because the cash balance reflected in IMG's November 2013 balance sheet greatly exceeded the sum of the cash balances reflected in the account statements.[438]

Enforcement did not establish that this information was material. Because Enforcement did not establish that IMG ever represented to Carolina that all of its cash was in the three accounts reflected in the bank statements, Enforcement never established that the bank account statements were inconsistent with IMG's November 2013 financial statements. Enforcement also did not establish that there was a substantial likelihood that an investor would consider it important that Carolina obtained the first page of the bank statements—but not the remainder—of the bank statements.

vi. Carolina Due Diligence was Ongoing

Enforcement alleged that the IMGF Offering Materials did not disclose that Carolina's Due Diligence relating to the IMGF Offering was ongoing. The Panel finds that Enforcement did not establish that it was inappropriate for Carolina to continue to gather documents and information while the IMGF Offering was in progress or that the omission of this information made the IMGF Offering Materials materially false or misleading.

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[437] Compl. ¶ 65.

[438] Compl. ¶ 65.

vii. GECC/GE Aircraft Lawsuit

Enforcement alleged that the IMGF Offering Materials did not disclose that IMG, Wannakuwatte, and RelyAid Global were being sued by GECC in connection with RelyAid's default on a loan related to the Olivehurst Facility.[439] Enforcement argues that there is a substantial likelihood that a reasonable investor would have considered it important that Wannakuwatte and IMG had failed to perform on guarantees that they made in connection with a loan related to the Olivehurst Facility. In response, Respondents note that at least one of the three IMGF investors whom Enforcement called as witnesses testified that he was aware of the GECC/GE Aircraft lawsuit before investing and did not consider it material.[440]

The Panel concludes that the mere existence of a lawsuit against IMG, Wannakuwatte, and IMG affiliate RelyAid Global in connection with RelyAid's default on a loan related to the Olivehurst Facility was not material and therefore did not have to be disclosed.[441]

viii. Conclusion

The Panel finds that two of the alleged misrepresentations were materially false and misleading. The disclosure regarding the financial condition of IMG was materially false and misleading because of the overstated accounts receivable balance. The disclosure regarding the VA Contract was materially false and misleading because the VA Contract contemplated the supply of about $25,000 worth of examination gloves annually. The Panel therefore evaluated whether the investigations conducted by Respondents were reasonable and provided an adequate basis for the disclosures in the IMGF Offering Materials.

b. Carolina's Investigation of Disclosures in the IMGF Offering Materials

Rather than address whether Carolina's response, or lack of a response, to any of the alleged red flags was sufficient by itself to warrant a finding that Carolina lacked a reasonable basis for the representations in the IMGF Offering Materials, the Panel considers the totality of the relevant circumstances in evaluating Carolina's investigation.

In taking this approach, the Panel considers several factors. The Panel considers the overall context of the IMGF Offering, including the timing and size of the IMGF Offering and how Carolina learned of the Financing Opportunity. The Panel also considers the investigative steps that Carolina took, including the discussions Raghavan and Roberts had with Wannakuwatte, Raghavan's visits to IMG's facility, the LexisNexis background searches, Raghavan's Google search, the conversations that Raghavan and Roberts had with

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[439] Compl. ¶ 65.

[440] Tr. 770-71.

[441] Enforcement did not allege that the other information alleged in the GECC/GE Aircraft complaint was material. The Panel therefore does not address the materiality of that information.

Wannakuwatte, the discussion Kostkas had with Klein, the discussion that Raghavan had with the UPS driver, and the materials received by Raghavan. Also, the Panel considers the results of Raghavan's initial review of IMG's financial statements. The Panel also considers investigative steps that Carolina reasonably could have taken, but did not take, including Carolina's failure to obtain: additional information regarding the credit entry that Wannakuwatte said would be reflected in IMG's December 2013 financial statements; additional confirmation with respect to IMG's contract with Veterans Affairs; and additional information regarding the GECC/GE Aircraft lawsuit. And the Panel considers the instances in which Carolina requested, but did not receive, a document.

During Raghavan's initial review of IMG's financial statements, he identified questions regarding two topics. When Raghavan questioned Wannakuwatte on these topics, his responses indicated that IMG's financial statements might not fairly reflect the financial condition and performance of IMG.

Wannakuwatte's response regarding why the spike in inventory was not offset by a corresponding increase in accounts payable indicated that IMG's accounts payable and shareholder's equity were understated as of November 2013 and that IMG's net income for the first eleven months of 2013 might be overstated. The explanation also indicated a significant weakness in IMG's internal accounting controls. In addition, upon examination, his explanation is not consistent with the fact that on IMG's November 2013 financial statements the sum of IMG's reported liabilities and total shareholder's equity equaled IMG's reported total assets.

Wannakuwatte's response regarding the notes receivable and the classification of the notes receivable as a current asset indicated that the IMG November 2013 balance sheet in the Dropbox folder did not fairly reflect the financial condition of IMG. The loan to Wannakuwatte and advances to his affiliates were not documented in any notes and were improperly classified as current assets. Carolina adjusted IMG's balance sheet so that the advances and loan were not classified as current assets and renamed the assets so as to not refer to any note. However, this mistake in the November 2013 financial statements, coupled with the explanations that Wannakuwatte provided in connection with the spike in inventory, raised doubt about whether there were issues regarding the validity of IMG's financial statements that were not apparent upon an initial review.

The VA Contract and the conversation that Raghavan had with Wannakuwatte about the VA Contract were significant factors in the Panel's finding that Carolina did not conduct a reasonable investigation. The VA Contract was important both because $90 million is a large share of IMG's reported net sales and because the Veterans Affairs accounts receivable balance constituted a large share of IMG's reported current assets and shareholder's equity. The VA Contract did not contain any provision explicitly setting forth any obligation by Veterans Affairs to purchase gloves from IMG, any obligation by IMG to sell gloves to Veterans Affairs, or any price schedule. The absence of such provisions could reasonably have raised questions about whether the VA Contract constituted a requirements contract contemplating the supply of $90 million of examination gloves.

The Panel also considers Raghavan's response to learning about the GECC/GE Aircraft lawsuit in a Google search. Raghavan did not take steps to verify Wannakuwatte's explanation of the lawsuit even though Raghavan's Google search indicated that the lawsuit had been brought by GECC and GE Aircraft and Wannakuwatte's explanation referred only to GECC. In addition, Raghavan did not ask Wannakuwatte follow-up questions such as why the financial statements of IMG and Wannakuwatte did not reflect the guaranty obligations and whether any settlement payments were pending and, if so, how Wannakuwatte expected to fund those payments. Raghavan also did not contact the attorney who represented IMG and Wannakuwatte to confirm Wannakuwatte's explanation and whether there were other lawsuits against IMG or Wannakuwatte.

The documents that Carolina requested but did not obtain include: monthly financial statements for 2013; a summary of the expenses funded by the $23 million advanced by IMG; the contract in which Medline gave IMG the exclusive right to distribute Aloetouch® Ease gloves in the United States; other contracts with the companies that supplied gloves to IMG; the patent protecting the Aloetouch® Ease gloves; a list of manufacturers with which Wannakuwatte had a current relationship along with the percentage of gloves that came from each, an accounts payable aging schedule; a copy of the lease agreement for the warehouse facility; FDA test results and the FDA permit for the Olivehurst Facility; and endorsements by dental associations or other groups.

In arguing that Carolina conducted a reasonable investigation, Respondents point to the evidence that Carolina obtained which indicated that IMG had a facility in West Sacramento that included a warehouse with stacks of boxes of gloves, shipped merchandise from that facility, operated a forklift at that facility, operated a call center at that facility, had been in business for more than two decades, was led by a CEO who could talk knowledgeably about the examination glove business, maintained active bank accounts, was not the subject of any liens, had never filed for bankruptcy, had never been convicted of a crime, and had communicated with potential customers about their purchasing domestically manufactured nitrile gloves. The offering materials, however, contain other important disclosures, including disclosures regarding IMG's financial condition and financial performance, contract with Veterans Affairs, and contracts with vendors. Accordingly, the Panel focuses on whether Carolina conducted a reasonable investigation that resulted in Carolina having a reasonable basis for these disclosures.

Respondents argue that because the Dropbox folder materials included the IMG Tax Return and the Wannakuwatte Tax Return, Carolina obtained corroboration of the financial statement information in the IMGF Offering Materials. Carolina did not, however, obtain confirmation from Rishwain (Wannakuwatte's CPA) that the tax returns were filed and did not obtain any evidence that Wannakuwatte paid the tax obligation reflected on his return. The Panel concludes that, in the context of Carolina's overall investigation, these unauthenticated tax returns did not constitute adequate verification of Carolina's disclosures regarding IMG's financial condition and performance.

Based on the Panel members' experience in private placements and the foregoing considerations, the Panel finds that Carolina's investigation of the representations in the IMG offering materials did not meet applicable professional standards. As noted above, not every failure to conduct a reasonable investigation in accordance with professional standards constitutes recklessness. The Panel finds, in light of the steps that Carolina did take to verify disclosures in the IMGF Offering Materials, that Carolina did not act knowingly or recklessly in making material misrepresentations regarding IMG and the IMGF Notes. Accordingly, the Panel finds that Carolina did not conduct a reasonable investigation but was not reckless and did not knowingly make material omissions or misrepresentations.

c. Roberts' Investigation of Disclosures in the IMGF Offering Materials

In evaluating the quality of Roberts' investigation of the IMGF Notes and the disclosures in the IMGF Offering Materials, the Panel considers that Roberts had worked closely with Raghavan on previous offerings and had confidence in Raghavan's competence. The Panel also considers that Roberts had provided Raghavan guidance, in the form of the checklist and Carolina's WSPs, regarding the purpose and conduct of Due Diligence.

The Panel also considers that although Roberts did not read every Due Diligence document gathered by Carolina, he reviewed the H: drive for completeness by looking at the documents that Raghavan had filed in more than a dozen categories. Also, during the Due Diligence Period, Roberts spoke by telephone with Wannakuwatte about IMG and formed a favorable impression. Roberts also spoke with a senior portfolio manager at an investor client about the analyses that the manager and Raghavan had performed on IMG's financial statements. In addition, Roberts knew that Carolina had performed a comprehensive background search on IMG and Wannakuwatte and had not found any exceptions. Although Roberts had frequent discussions with Raghavan during the Due Diligence Period, Enforcement did not establish the content of those discussions.

Enforcement established that Roberts did not thoroughly review the VA Contract but not that it was unreasonable for Roberts to rely on Raghavan to review the VA Contract appropriately and relay to Roberts any questions raised by Raghavan's review of the contract. Enforcement did not establish what, if anything, Raghavan told Roberts about IMG's accounting controls and the response that Wannakuwatte gave Raghavan about why the spike in inventory was not offset by an increase in IMG's accounts payable. Enforcement also did not establish that Raghavan informed Roberts about the instances when Raghavan requested, but did not receive, documents from IMG.

Enforcement established that Raghavan informed Roberts of the GECC/GE Aircraft lawsuit.[442] Enforcement did not, however, establish that Raghavan informed Roberts that

[442] It is not clear whether Raghavan informed Roberts that he had not seen any of the pleadings in the GECC/GE Aircraft lawsuit. However, Roberts could have inferred from his review of the H: drive that—at a minimum—Raghavan had not obtained copies of any of the pleadings.

Raghavan's Google search had indicated that GE Aircraft, as well as GECC, had brought the lawsuit. In addition, Roberts testified, without contradiction, that his experience was that GECC was a litigious lender and this experience might have influenced his conclusion that Wannakuwatte's explanation was satisfactory.

Based on the Panel members' experience in private placements, the Panel concludes that Enforcement did not establish that Roberts had acted either recklessly or negligently in investigating the representations made in the offering materials.

3. Conclusion

Enforcement established that Carolina violated FINRA Rule 2010 by making misrepresentations in contravention of Section 17(a)(2) of the Securities Act (Second Cause of Action) and violated FINRA Rules 2210(d)(1) and 2010 by making false statements in the IMGF Offering Materials and by distributing IMGF Offering Materials that it should have known contained untrue statements of material fact (Fourth Cause of Action). Also, Enforcement established that Roberts violated FINRA Rules 2210(d)(1) and 2010 by making false statements in the IMGF Offering Materials (Fourth Cause of Action).

Enforcement did not establish that Carolina knowingly or recklessly made misrepresentations in violation of Section 10(b) of the Exchange Act, Rule 10b-5 thereunder, and FINRA Rules 2020 and 2010 (First Cause of Action). Also, Enforcement did not establish that Roberts knowingly or recklessly made misrepresentations in violation of Section 10(b) of the Exchange Act, Rule 10b-5 thereunder, and FINRA Rules 2020 and 2010 (First Cause of Action) or violated FINRA Rule 2010 by negligently making misrepresentations in contravention of Section 17(a) of the Securities Act (Second Cause of Action).

B. Third Cause of Action (Reasonable-Basis Suitability)

1. Legal Standard

In the third cause of action, Enforcement charged that Carolina and Roberts recommended the IMGF Notes to investors without conducting a reasonable investigation, thereby violating FINRA Rule 2111(a). Rule 2111(a) provides that "[a] member or an associated person must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile."

FINRA Rule 2111 calls for two types of analysis. A broker must conduct a reasonable investigation and conclude that the recommendation would be suitable for at least some investors.[443] This suitability is referred to as "reasonable-basis" suitability and differs from

[443] *Luo*, 2017 FINRA Discip. LEXIS 4, at *27-28.

"customer-specific" suitability, which turns on the particular facts and circumstances of the customer's situation and is not an issue in this proceeding.

2. Analysis

For the reasons set forth above with respect to the second cause of action, the Panel concludes that Enforcement established that Carolina failed to conduct an investigation sufficient to provide a reasonable basis for concluding that the IMGF Notes were suitable for at least some customers and did not establish that Roberts failed to conduct such an investigation.

3. Conclusion

Thus, the Panel finds that Carolina, but not Roberts, violated FINRA Rule 2111(a) by recommending the IMGF Notes to investors without conducting an investigation sufficient to provide a reasonable basis for determining that the IMGF Notes were suitable for any investor. Because a violation of this Rule also constitutes a violation of FINRA Rule 2010, which requires all persons associated with a FINRA member firm to "observe high standards of commercial honor and just and equitable principles of trade," Carolina also violated Rule 2010.[444]

C. Fifth Cause of Action (Enforcement of WSPs)

1. Legal Standard

The fifth cause of action alleged that Carolina and Roberts failed to enforce Carolina's WSPs and thereby violated NASD Rule 3010 and FINRA Rule 2010.[445] NASD Rule 3010(b) provided that "[e]ach member shall establish, maintain, and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of registered representatives . . . that are reasonably designed to achieve compliance with the applicable Rules of NASD."

2. Analysis

The Panel analyzes this cause of action in two parts. First, the Panel considers whether Respondents enforced Carolina's Due Diligence WSPs and finds that they did. Second, the Panel considers whether Respondents enforced Carolina's Suitability WSPs and finds that they did not.

a. Due Diligence

As set forth above, Carolina's WSPs did not require Roberts to conduct the Due Diligence for all offerings sold by Carolina. Rather, Carolina's Due Diligence WSPs required Roberts to exercise reasonable judgment in determining the extent to which he reviewed Due

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[444] *Richard G. Cody*, Exchange Act Release No. 64565, 2011 SEC LEXIS 1862, at *26 (May 27, 2011), *aff'd*, 693 F.3d 251 (1st Cir. 2012).

[445] NASD Rule 3010 has been superseded by FINRA Rule 3110.

Diligence documents. In exercising his judgment, Roberts could reasonably consider the following factors, among others:

- Roberts had implemented procedures to ensure that Carolina hired individuals who were competent;[446]

- Roberts had developed confidence in Raghavan's competence after Raghavan had worked as lead or co-lead banker on a number of Carolina transactions, some as an understudy to Roberts;[447]

- The information that Roberts obtained during the multiple telephone calls that Roberts had with Raghavan on topics relating to the IMGF Offering during the Due Diligence Period;[448]

- The favorable impression that Roberts formed of Wannakuwatte as energetic, shrewd, and informed based on a January 30, 2014 telephone call that Raghavan had arranged between Roberts and Wannakuwatte;[449]

- A senior portfolio manager of one of Carolina's investor clients, reviewed Raghavan's financial analysis of IMG; and

- The information that Roberts received from an investor client that, by coincidence, had been approached about financing the purchase of glove-making equipment by IMG.[450]

Based on the Panel's experience in private placements, the Panel concludes that Enforcement did not establish that Roberts' judgment regarding the extent to which he reviewed Due Diligence Documents was unreasonable in light of these factors and therefore did not establish that Respondents violated NASD Rule 3010 by failing to follow and enforce Carolina's Due Diligence WSPs.

b. Suitability

Under Carolina's Suitability WSPs, all Carolina registered representative other than Roberts and Raghavan were prohibited from selling the IMGF Notes unless they demonstrated their understanding of the IMGF Notes by scoring 80% or better on a quiz designed to test their understanding of the notes. Carolina did not develop, and therefore Carolina registered representatives did not take, such a quiz. Nevertheless, Carolina and Roberts permitted other

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[446] Tr. 899.

[447] Tr. 1453-54.

[448] Tr. 894.

[449] Tr. 1494-95; CX-5, at 8.

[450] Tr. 740-41.

Carolina representatives to sell the IMGF Notes. Thus, Enforcement established that Carolina and Roberts violated NASD Rule 3010(b) by failing to follow and enforce Carolina's Suitability WSPs.

3. Conclusion

Enforcement established that Carolina and Roberts violated NASD Rule 3010(b) and FINRA Rule 2010 by permitting Carolina registered representatives—other than Roberts and Raghavan—to sell the IMGF Notes even though the representatives had not passed the required quiz. Enforcement did not establish that either Carolina or Roberts violated NASD Rule 3010 and FINRA Rule 2010 by failing to enforce Carolina's Due Diligence WSPs.

V. Sanctions

The Panel applies FINRA's Sanction Guidelines in considering the appropriate sanctions to impose on Carolina and Roberts.[451] The Guidelines explain that "sanctions should be designed to protect the investing public by deterring misconduct and upholding high standards of business conduct."[452] Adjudicators are therefore instructed to "design sanctions that are meaningful and significant enough to prevent and discourage future misconduct by a respondent and deter others from engaging in similar misconduct."[453]

The Guidelines instruct adjudicators to "always consider a respondent's relevant disciplinary history in determining sanctions and should ordinarily impose progressively escalating sanctions on recidivists."[454] In April 2014, Carolina entered into a Letter of Acceptance, Waiver, and Consent ("AWC") in which Carolina accepted a censure and a fine of $50,000 based on a finding that Carolina had failed to follow its procedures for the review and verification of disclosures in offering materials for a private placement and had failed to conduct an adequate investigation.[455] The Panel considers the 2014 AWC to be relevant.

A. Second Cause of Action (Negligence Fraud), Third Cause of Action (Reasonable-Basis Suitability), and Fourth Cause of Action (Advertising)

Carolina's liability under both the second and fourth causes of action involves the same material misrepresentations, and its liability under both the second and third causes of action involves a failure to conduct a reasonable investigation. Thus, these violations are related and

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[451] FINRA Sanction Guidelines (2017), http://finra.org/industry/sanction-guidelines.

[452] Guidelines at 2 (General Principles, No. 1).

[453] Guidelines at 2 (General Principles, No. 1).

[454] Guidelines at 2 (General Principles, No. 2).

[455] CX-87.

arise from the same underlying misconduct. The Panel therefore aggregates these three causes of action for purposes of sanctions, as authorized by the Guidelines.[456]

For fraud, misrepresentations, or material omissions of fact involving negligent misconduct, the Guidelines recommend that adjudicators consider imposing a fine of $2,500 to $73,000 and suspending the firm with respect to a limited set of activities for up to 90 days.[457] For unsuitable recommendations, the Guidelines recommend that adjudicators impose fines of $2,500 to $110,000 and consider suspending the firm with respect to a limited set of activities for up to 90 days.[458] For misleading communications with the public, the Guidelines recommend that adjudicators impose fines of $1,000 to $29,000 and (in cases involving inadvertent use of misleading communications) consider suspending the firm with respect to any and all communications for up to six months, and thereafter imposing for a definite period, a "pre-use" filing requirement to obtain a FINRA Regulation staff "no objection" letter on proposed communications with the public.[459]

The Guidelines contain no principal considerations specifically tailored to material misrepresentations and unsuitable recommendations and refer to the Principal Considerations in Determining Sanctions.[460] For the second and third causes of action, the Panel therefore applies the Principal Considerations in Determining Sanctions.[461] The Guidelines for communications with the public advises that the Panel consider in determining the appropriate sanction whether violative communications with the public were circulated widely. For the fourth cause of action, the Panel therefore also considers the extent to which Carolina and Roberts circulated the IMGF Offering Materials.

Given the particular facts and circumstances of this case, the Panel finds that Carolina's violations of FINRA Rules 2010, 2111(a), and 2210(d)(1) warrant a $60,0000 fine. This sanction is appropriately remedial under the circumstances, reflects the 2014 AWC and the instruction in the Guidelines to ordinarily impose escalating sanctions on recidivists, the nature of the violation, the brief duration of the misconduct in February 2014, the circulation of the IMGF Offering Materials to scores of Carolina's investor clients, the risk of loss suffered by the IMGF investors, and the steps taken by Carolina to help the IMGF investors recoup their losses (including the money and effort that Carolina expended on their behalf).[462]

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[456] Guidelines at 4 (General Principles, No. 4).

[457] Guidelines at 89.

[458] Guidelines at 95.

[459] Guidelines at 80.

[460] Guidelines at 89, 95.

[461] Guidelines at 7-8.

[462] The Panel also considers Enforcement's argument that Respondents have not accepted responsibility for their misconduct. Guidelines at 6 (Principal Considerations, No. 2). The Panel agrees that it is aggravating when a respondent refuses to accept responsibility for their misconduct, but does not find that Respondents refused to accept responsibility for their role in the IMGF Offering. In a real sense, Respondents accepted responsibility for the IMGF

The Panel concludes that imposing a monetary fine or suspension on Roberts for his violation of FINRA Rules 2210(d)(1) and 2010 would serve no remedial purpose, but would only be punitive. In reaching this conclusion, the Panel considers the brief duration of the misconduct in February 2014, the circulation of the IMGF Offering Materials to more than 100 of Roberts' investor clients, the risk of loss suffered by the three clients of Roberts who purchased IMGF Notes, and the steps taken by Roberts to help the IMGF investors recoup their losses (including the money and effort that Carolina expended on their behalf). Accordingly, the Panel concludes that, with respect to Roberts's violation of FINRA Rules 2210(d)(1) and 2010, a Letter of Caution suffices to meet the remedial goals of FINRA sanctions, as set forth in the Guidelines.

The Panel also considers whether to order Carolina to pay restitution to the IMGF investors. The Guidelines provide, "Where appropriate to remediate misconduct, Adjudicators should order restitution and/or rescission."[463] The Guidelines add that "[a]djudicators may order restitution when an identifiable person, member firm or other party has suffered a quantifiable loss proximately caused by respondent's misconduct."[464] In light of the uncertainty regarding the outcome of the IMG Trustee's pending litigation to recover funds from third parties, the losses suffered by the IMGF investors are not quantifiable. Accordingly, the Panel does not order restitution.[465]

B. Failure to Supervise

In determining the appropriate sanction, if any, for Respondents' failure to enforce Carolina's WSPs, the Panel considered the Guidelines for failure to supervise. The Guidelines for failure to supervise recommend that adjudicators impose a fine of $5,000 to $73,000,

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offering; immediately upon learning of Wannakuwatte's arrest, Respondents acted to recover funds for the IMGF investors. Although Respondents argued at the hearing that Carolina's investigation of the IMGF Notes and the disclosures in the IMGF Offering was reasonable, we do not hold this argument against the Respondents. *See Clinger & Co.*, 51 S.E.C. 924, 926 n.7 (1993) ("Persons charged with violations are entitled to pursue the procedural and substantive remedies provided by [FINRA] and the Commission rules."); *Dep't of Enforcement v. Bullock*, No. 2005003437102, 2011 FINRA Discip. LEXIS 14, at *60-61 (NAC May 6, 2011) (holding that Respondent was entitled under FINRA rules to fully defend himself against the allegations against him and declining to characterize his "hearty defense" as a refusal to accept responsibility).

[463] Guidelines at 4 (General Principles, No. 5).

[464] Guidelines at 4 (General Principles, No. 5).

[465] In deciding not to order restitution, the Panel also considers whether equity demands that Carolina bear all losses resulting from the purchase of IMGF Notes. The Panel recognizes that "the appropriate amount of restitution 'may exceed the amount by which the wrongdoer was unjustly enriched, if equity would demand that the wrongdoer, rather than the customer, bear the loss.'" *Dep't of Mkt. Regulation v. Yankee Fin. Grp., Inc.*, No. CMS030182, 2006 NASD Discip. LEXIS 21, at *84-85 (NAC Aug. 4, 2006) (quoting *Toney L. Reed*, 51 S.E.C. 1009, 1013-14 & n.22 (1994)), *rev'd on other grounds sub nom. Richard Kresge*, Exchange Act Release No. 55988, 2007 SEC LEXIS 1407 (June 29, 2007). *See also Dep't of Enforcement v. Siegel*, No. C05020055, 2007 NASD Discip. LEXIS 20, at *59 (NAC May 11, 2007), *aff'd*, Exchange Act Release No. 58737, 2008 SEC LEXIS 2459 (Oct. 6, 2008). However, in light of the nature of Carolina's violation and the money and effort that Carolina expended helping IMGF investors recover funds from the IMG trustee, the Panel concludes that equity does not demand that Carolina bear all of the loss resulting from the purchase of the IMGF Notes.

consider suspending a responsible individual for up to 30 business days, and limiting activities of the appropriate branch office or department for up to 30 business days.[466] The Guidelines set forth three principal considerations specific to failures to supervise: (1) whether respondent ignored "red flag" warnings that should have resulted in additional supervisory scrutiny and whether individuals responsible for underlying misconduct attempted to conceal misconduct from Respondents; (2) the nature, extent, size and character of the underlying misconduct; and (3) the quality and degree of supervisor's implementation of the firm's supervisory procedures and controls.[467]

The Panel considered these three principal considerations. Although the underlying violations are serious, the Panel considered that enforcement of the WSPs relating to the suitability quiz probably would not have prevented the underlying violations. The Panel also considered that the preponderance of the evidence establishes that, given the terms of the IMGF Notes, it was reasonable for Carolina and Roberts to believe that a quiz was not necessary to ensure that the Carolina registered representatives selling the IMGF Notes sufficiently understood the topics a quiz ordinarily would address (*e.g.*, the nature of the IMGF Notes, the commission and fees associated with the IMGF Notes, and the sources of repayment).

The Panel therefore concludes that imposing a monetary fine or suspension on Respondents for their violations of NASD Rule 3010 and FINRA Rule 2010 would serve no remedial purpose, but would only be punitive. Accordingly, the Panel concludes that, with respect to Respondents' violation of NASD Rule 3010 and FINRA Rule 2010, a letter of caution suffices to meet the remedial goals of FINRA sanctions, as set forth in the Guidelines.

VI. Order

Respondent Carolina Financial Securities, LLC, is fined $60,000 for: (1) making material misrepresentations in the IMGF Offering Materials in contravention of Section 17(a) of the Securities Act and therefore in violation of FINRA Rule 2010; (2) making material misrepresentations in the IMGF Offering Materials in violation of FINRA Rules 2210(d)(1) and 2010; and (3) recommending unsuitable securities in violation of FINRA Rules 2111(a) and 2010.

In addition, Respondent Bruce Victor Roberts made material misrepresentations in the IMGF Offering Materials in violation of FINRA Rules 2210(d)(1) and 2010 and both Respondent Carolina Financial Securities, LLC and Respondent Bruce Victor Roberts failed to enforce Carolina WSPs by permitting Carolina representatives to sell IMGF Notes without taking a quiz required by the WSPs, in violation of NASD Rule 3010 and FINRA Rule 2010. For these violations, this Decision will serve as a Letter of Caution.

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[466] Guidelines at 104.

[467] Guidelines at 104.

The following charges are dismissed: (1) Carolina and Roberts knowingly or recklessly made material misrepresentations or omissions in the IMGF Offering Materials in violation of Section 10(b) of the Exchange Act, Rule 10b-5 thereunder and FINRA Rules 2010 and 2020; (2) Roberts negligently made material misrepresentations in the IMGF Offering Materials in contravention of Section 17(a) of the Securities Act and in violation of FINRA Rule 2010; (3) Roberts recommended unsuitable securities in violation of FINRA Rules 2111(a) and 2010; and (4) Carolina and Roberts failed to enforce Carolina's WSPs in connection with the supervision of Carolina's Due Diligence on the IMGF Notes.

Carolina and Roberts are jointly and severally ordered to pay hearing costs of $8,202.10, which includes a $750 administrative fee.

If this decision becomes FINRA's final disciplinary action, the fine and assessed costs shall be due on a date set by FINRA, but not sooner than 30 days after this decision becomes FINRA's final disciplinary action in this proceeding.[468]

Kenneth Winer
Hearing Officer
For the Extended Hearing Panel

Copies to: Carolina Financial Securities, LLC (via overnight courier and first-class mail)
Bruce V. Roberts (via overnight courier and first-class mail)
Sylvia M. Scott, Esq. (via electronic mail and first-class mail)
William Brice LaHue, Esq. (via electronic mail and first-class mail)
Mark J. Fernandez, Esq. (via electronic mail)
David B. Klafter, Esq. (via electronic mail)
Jeffrey Pariser, Esq. (via electronic mail)

[468] The Panel has considered and rejected any other arguments made by the Parties that are inconsistent with this Decision.