FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. GLENDALE SECURITIES, INC. (CRD No. 123649), GEORGE ALBERTO CASTILLO (CRD No. 1936486), PAUL ERIC FLESCHE (CRD No. 3277904), ALBERT RAYMOND LAUBENSTEIN (CRD No. 303462), JOSE MIGUEL ABADIN (CRD No. 1273345), and HUANWEI HUANG (CRD No. 3268328), Respondents.	Disciplinary Proceeding No. 2016049565901 Hearing Officer—MJD **EXTENDED HEARING PANEL DECISION** April 5, 2019

Respondents Glendale Securities, Inc., and Albert Raymond Laubenstein failed to establish and implement an anti-money laundering ("AML") program reasonably designed to cause the detection and reporting of suspicious transactions under the Bank Secrecy Act. The transactions related to the liquidations by Firm customers of the securities of three low-priced, speculative penny stocks. For this misconduct, Glendale is censured and fined $125,000; Laubenstein is fined $20,000 and suspended from associating with any member firm in any capacity for 18 months.

Glendale and Laubenstein also failed to conduct adequate due diligence and respond to red flags potentially indicative of money laundering activities by a Firm customer—a foreign financial institution—and the institution's customers. For this violation, this Decision shall serve as a Letter of Caution to Glendale and Laubenstein.

Glendale, Laubenstein, and Respondent Paul Eric Flesche failed to reasonably supervise Respondent Huanwei Huang, a Firm registered representative. Glendale is censured and Glendale and Flesche are fined $30,000, jointly and severally. Flesche is also suspended from associating with any member firm in any capacity for 30 business days. Laubenstein is fined $5,000 and suspended from associating with any member firm in any capacity for 15 business days.

Huang shared nonpublic personal information about his customers with third parties in violation of SEC Regulation S-P. For this violation, this Decision shall serve as a Letter of Caution.

Huang also communicated with a customer and another person about securities business using a text messaging service instead of the Firm's approved electronic mail system. Huang is suspended from associating with any member firm in any capacity for 10 business days and fined $5,000.

Enforcement failed to prove that Glendale, acting through Respondent George Alberto Castillo, engaged in fraudulent activities designed to manipulate a security, as alleged in cause one. This charge is therefore dismissed.

A majority of the Panel finds that Enforcement also failed to prove that Glendale, Flesche, and Respondent Jose Miguel Abadin, a Firm registered representative, sold restricted non-exempt securities, as alleged in cause two, and that Glendale, Castillo, and Flesche failed to maintain a reasonable supervisory system, including adequate written supervisory procedures, to prevent the resale of unregistered non-exempt securities, as alleged in cause four. These charges are dismissed.

Enforcement failed to prove that Respondents Castillo, Flesche, Abadin, and Huang engaged in AML-related misconduct associated with customer deposits and liquidations of three low-priced securities, as alleged in cause three. Accordingly, the AML-related charges against these four Respondents are dismissed.

Appearances

For the Complainant: John R. Baraniak, Jr., Esq., and Melissa Turitz, Esq., Department of Enforcement, Financial Industry Regulatory Authority.

For Respondents Glendale Securities, Inc., Albert Raymond Laubenstein, and Jose Miguel Abadin: Jeffrey S. Kob, Esq., Evans & Kob, P.C.

For Respondents George Alberto Castillo and Paul Eric Flesche: Arash Shirdel, Esq., Pacific Premier Law Group.

For Respondent Huanwei Huang: William W. Uchimoto, Esq.

CONTENTS

I. Introduction 1

A. Overview of the Complaint 1

B. Summary of the Hearing Panel's Findings and Sanctions 2

II. Findings of Fact 4

A. Respondents' Backgrounds 4

1. Glendale Securities, Inc. 4

2. George Alberto Castillo 5

3. Eric Paul Flesche 6

4. Albert Raymond Laubenstein 6

5. Jose Miguel Abadin 7

6. Huanwei Huang 7

B. Trading in NuGene International, Inc. (NUGN) at Glendale 8

1. Background of BLMK/NUGN 8

2. The NUGN Lock-Up/Leak-Out Agreement 9

3. Glendale's Procedures for Accepting Securities for Deposit and Approving Their Sale 10

4. Customers BS and ND Trade BLMK/NUGN 14

5. Lock-Up Agreement Restrictions Lifted 21

6. Three Corporate Customers Deposit and Sell NUGN Shares 21

7. NUGN Deposits and Sales by Three Corporate Customers Did Not Raise Red Flags at Glendale 34

8. Laubenstein Reviews Trading in NUGN 35

9. Respondents Were Unaware of Promotional Activity in NUGN 36

C. Trading in Broke Out, Inc. (BRKO) at Glendale 39

1. Background of BRKO 39

2. Customer ECM Deposits 1.3 Million BRKO Shares 40

3. BRKO Engages in a Reverse Merger on January 27, 2016 42

4. ECM Liquidates BRKO Shares (February and March 2016) 42

5. BRKO Promotional Campaign Coincides with ECM's Sales of BRKO (March 2016) 43

6. Glendale Sends ECM a Questionnaire about BRKO Promotional Activity 45

7. The SEC Suspends Trading in BRKO 47
D. Trading of Vitaxel Group Limited (VXEL) at Glendale 47
1. Background of VXEL 47
2. Customer KTO Deposits VXEL 49
3. Other Customers Deposit VXEL Shares 51
4. KTO and Other Customers Sell VXEL Shares 54
5. Huang Used Text Messages to Communicate with KTO and KSC in Malaysia 54
1. Huang Shares Personal Information about VXEL Customers with Third Parties 56
E. Correspondent Accounts Associated with Belize Bank 57
III. Conclusions of Law 59
A. Enforcement Failed to Prove that Glendale and Castillo Manipulated NUGN (Cause One) 59
1. Applicable Law 59
2. The Parties' Arguments 61
3. Conclusion 64
B. Enforcement Failed to Prove that Glendale, Flesche, and Abadin Distributed Unregistered or Non-Exempt NUGN Securities (Cause Two) 66
1. The Applicable Law 67
2. Enforcement Established a *Prima Facie* Case 68
3. Glendale, Flesche, and Abadin Invoke the Broker's Exemption 69
4. Conclusion 70
C. Glendale and Laubenstein Failed to Ensure the Firm Had a Reasonable AML Program (Cause Three) 70
1. The AML Program 71
2. Customer Identification Program 82
3. Due Diligence into Belize Bank 83
D. Supervisory Systems (Cause Four) 86
1. The Applicable Law 86
2. Glendale's Supervisory System in Connection with the Sale of Unregistered Securities Was Reasonable 86
3. Glendale, Flesche, and Laubenstein Failed to Reasonably Supervise Huang in Connection with His Dealings with His Customers 88

E. Huang Violated SEC Regulation S-P (Cause Five) 88
F. Huang Committed Books and Records Violations (Cause Six) 89
IV. Sanctions 90
A. AML Violations (Cause Three) (Glendale and Laubenstein) 91
1. Misconduct Associated with Customer Liquidations of NUGN, BRKO, and VXEL and Customer Identification Program 92
2. Misconduct Related to Belize Bank 94
B. Supervision of Huang (Cause Four) (Glendale, Flesche, and Laubenstein) 94
C. Huang's Violations of SEC Regulation S-P (Cause Five) 96
D. Huang's Books and Records Violation (Cause Six) 96
V. Order 97
DISSENT 100

DECISION

I. Introduction

A. Overview of the Complaint

FINRA's Department of Enforcement filed a six-cause Complaint against Respondents. Cause one charges Glendale Securities, Inc. ("Glendale" or the "Firm"), acting through its President and head trader George Alberto Castillo ("Castillo"), with manipulating the price of NuGene International, Inc. ("NUGN"), to benefit two Firm customers who owned the stock. For this, Glendale and Castillo are charged with violating Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), Exchange Act Rule 10b-5 thereunder, and FINRA Rules 2020 and 2010.

Cause two charges Glendale, Paul Eric Flesche ("Flesche"), the Firm's Chief Compliance Officer ("CCO"), and Jose Miguel Abadin ("Abadin"), a registered representative and trader, with reselling unregistered or non-exempt shares of NUGN on behalf of two customers, in violation of Section 5 of the Securities Act of 1933 ("Securities Act"), which is a violation of FINRA Rule 2010. The Complaint alleges that a portion of the NUGN shares the two customers sold were bought from affiliates of the issuer and accordingly could not be re-sold within six months of acquiring them pursuant to the Securities Act and SEC Rule 144.

Cause three charges each of the Respondents with committing anti-money laundering ("AML") violations of FINRA Rules 3310 and 2010 relating to customer deposits and liquidations of shares of NUGN and two other securities in 2015 and 2016: Broke Out, Inc. ("BRKO") and Vitaxel Group Limited ("VXEL"). It charges Respondents with failing to establish a reasonable AML system to detect and report suspicious activities associated with Firm customers' sales of NUGN, BRKO, and VXEL. Cause three also charges the Firm, Flesche, Laubenstein, and Huang with failing to comply with their obligations under the customer identification program ("CIP") in connection with customers who deposited VXEL shares. Cause three further charges the Firm and Albert Raymond Laubenstein ("Laubenstein"), the Firm's AML Compliance Officer ("AMLCO"), with AML violations for failing to establish and maintain an adequate due diligence program for customer correspondent accounts introduced to the Firm from 2007 to approximately 2011 by a bank based in Belize ("Belize Bank"). Belize Bank did not disclose the identities of approximately 18 customers who opened accounts at Glendale through the bank.

Cause four charges the Firm, Castillo, Flesche, and Laubenstein with supervisory failures in two distinct areas. It charges that Glendale, Castillo, and Flesche failed to establish and maintain a supervisory system, including written supervisory procedures ("WSPs"), reasonably designed to ensure the Firm's compliance with Section 5 of the Securities Act for sales of unregistered, non-exempt securities. Cause four further charges the Firm, Flesche, and Laubenstein with failing to reasonably supervise Respondent Huanwei Huang's ("Huang")

activities, specifically with respect to his Asian customers who deposited and sold BRKO and VXEL shares.

Causes five and six contain allegations only against Huang. Cause five charges Huang with improperly providing nonpublic personal information to third parties about his customers who deposited VXEL in their accounts, in violation of Securities and Exchange Commission ("SEC") Regulation S-P, which constitutes a violation of FINRA Rule 2010. Cause six charges Huang with communicating about VXEL with a customer and another person in Asia via a cell phone text messaging service not approved by Glendale, in violation of FINRA Rules 4511 and 2010. The Complaint charges that Huang's use of the unapproved text messaging service prevented Glendale from being able to preserve securities-related communications among its books and records.

Respondents filed Answers[1] denying the allegations and requesting a hearing. In their Answer, Glendale, Castillo, Flesche, Laubenstein, and Abadin stated that Glendale "occupies a unique niche" in the securities industry because "[f]ew introducing brokers or clearing firms are willing to service the needs of early round investors and founders of microcap companies because of the intense regulatory scrutiny and labor-intensive processes that are required."[2] Glendale "believes that its experience in this type of trading has gotten the firm to the point where it can conduct this business without rule violations."[3]

B. Summary of the Hearing Panel's Findings and Sanctions

After a careful review of the evidence presented at the hearing and the arguments of the parties,[4] the Extended Hearing Panel ("Panel") concludes that Enforcement failed to prove that Glendale and Castillo engaged in a fraudulent manipulation of NUGN, as alleged in cause one. Enforcement alleges that Castillo's NUGN market making activities and his transactions in NUGN on behalf of two customers were calculated to increase the stock's share price so that two other customers would be released from the terms of a lock-up/leak-out agreement ("Lock-Up Agreement"). Specifically, the Panel finds that Enforcement failed to prove that Castillo acted

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[1] Respondents Glendale, Castillo, Flesche, Laubenstein, and Abadin together filed a single Answer and an Amended Answer ("Amended Ans."). Respondent Huang separately filed his own Answer ("Huang Ans.").

[2] Amended Ans. at 2 (Summary).

[3] Amended Ans. at 2 (Summary).

[4] This action arose from a 2015 cycle examination of FINRA member firm Wilson-Davis & Co., Inc. ("Wilson-Davis"), whose customers traded some of the same securities that Glendale's customers traded and are the subject of this Complaint. The investigation into Glendale led to an on-site examination of Huang's New York City branch office in March 2015. Hearing Transcript ("Tr.") 1086-96, 1242, 1981-82. The hearing in this matter was held from July 25 to August 8, 2018, in Los Angeles, California. Enforcement called each of the individual Respondents and two FINRA examiners to testify. Respondents called Castillo, Flesche, and a customer of Huang's who had introduced other customers to Huang and the Firm in connection with deposits of VXEL shares. The parties filed pre-hearing briefs, post-hearing briefs, and post-hearing reply briefs.

with scienter when he entered quotations and engaged in market making in NUGN and executed trades on behalf of two customers. The Panel accordingly dismisses this cause of action.

A majority of the Panel finds that Enforcement failed to prove the allegations in cause two that Glendale, Flesche, and Abadin violated Section 5 of the Securities Act by participating in the unlawful distribution of unregistered or non-exempt shares of NUGN. The shares were sold by two Firm customers who had recently acquired their shares from persons the Complaint alleges were affiliates of the issuer.[5] A majority of the Panel finds that Glendale, Flesche, and Abadin performed adequate due diligence and engaged in a reasonable inquiry into whether the customers had acquired their shares of NUGN from affiliates of the issuer. Accordingly, cause two is dismissed.

With respect to cause three, alleging that all Respondents committed AML violations relating to customer deposits and sales of NUGN, BRKO, and VXEL, the Panel finds that the Firm, acting through Laubenstein, failed to establish a reasonable system to detect and report suspicious activities. The Panel also finds that, as alleged in cause three, Glendale and Laubenstein failed to comply with their AML-related obligations associated with verifying the identifications of Asia-based customers who deposited VXEL shares. The Panel censures Glendale and fines it $125,000 for the AML violations of FINRA Rules 3310 and 2010. The Panel suspends Laubenstein for 18 months years from associating with any member firm in any capacity and fine him $20,000. The Panel dismisses the AML-related charges contained in cause three against the other four individual Respondents— Castillo, Flesche, Abadin, and Huang— because Enforcement failed to meet its burden of proof that their conduct violated FINRA's AML rules.

The Panel also finds that, as alleged in cause three, Glendale and Laubenstein failed to establish an adequate due diligence program to monitor the activities of certain customer accounts introduced to the Firm by Belize Bank. Given the totality of the circumstances— particularly the limited number of customer accounts in question and the absence of evidence of potentially suspicious financial transactions or securities-related activity in the accounts— the Panel finds it appropriate for this Decision to serve as a Letter of Caution to Glendale and Laubenstein concerning the allegations in cause three about Belize Bank's introduction of customer accounts.

A majority of the Panel also finds that Enforcement did not prove that Glendale, Castillo, and Flesche failed to establish and maintain a supervisory system and WSPs reasonably designed

[5] The Hearing Officer dissents from the majority's findings as to cause two and finds that the three Respondents violated Section 5 of the Securities Act.

to achieve compliance with Section 5 of the Securities Act, as alleged in cause four.[6] Accordingly, this portion of cause four is dismissed.

The Panel finds that, as also alleged in cause four, Glendale, Flesche, and Laubenstein failed to reasonably supervise Huang and his dealings with his customers, including communications with the customers. For this violation, Glendale is censured. It is also fined $30,000 jointly and severally with Flesche. Flesche is also suspended from associating with any member firm in any capacity for 30 business days. Laubenstein is fined $5,000 and suspended from associating with any member firm in any capacity for 15 business days.

The Panel determines that, as alleged in cause five, Huang improperly shared personal information belonging to his customers who resided in Asia with third parties without first obtaining the customers' consent, in violation of SEC Regulation S-P, which constitutes a violation of FINRA Rule 2010. Huang provided customer transaction information concerning VXEL and financial information to third parties. After considering all the circumstances, including the nature of the customer information provided and the limited number of violations, the Panel determines that it is appropriate for this Decision to serve as a Letter of Caution to Huang.

Last, the Panel finds that, as alleged in cause six, for about a month, Huang used a text messaging cell phone application popular in Asia to communicate with two persons about securities-related matters, instead of using the Firm's approved email system, in violation of FINRA Rules 4511 and 2010. The two persons acted as representatives of customers they introduced to Glendale and Huang to deposit and sell VXEL shares. One of the two persons was also a customer who deposited VXEL in his Glendale account and sold shares through Huang. For this misconduct, the Panel suspends Huang from associating with any member firm in all capacities for 10 business days and fines him $5,000.

II. Findings of Fact

A. Respondents' Backgrounds

1. Glendale Securities, Inc.

Glendale has been a FINRA member firm since 2003.[7] It is based in Sherman Oaks, California. During the relevant period, from 2014 to 2016, it employed five registered persons and four back office employees in two branch offices: one in Sherman Oaks and the other in

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[6] The Hearing Officer dissents from the majority's findings that Glendale, Castillo, and Flesche engaged in reasonable supervision in connection with ensuring that the Firm does not participate in the unlawful resale of restricted, non-exempt securities.

[7] FINRA has jurisdiction over Glendale pursuant to Article IV of FINRA's By-Laws because it is a current FINRA member and the Complaint charges the Firm with securities-related misconduct committed during its period of membership.

New York City.[8] During the same period, Glendale earned most of its revenue from liquidating microcap securities and penny stocks that its customers deposited and making markets in those securities.[9] The Firm also received referrals asking that it file applications with FINRA to initiate quotations on behalf of issuers.[10] At any given time, Glendale would be engaged in liquidating the securities of about five issuers, while conducting reviews of customers' deposits of the securities of five to ten other issuers. Typically, two or three Glendale customers would be engaged in the liquidation of the securities of the same issuer.[11]

Because of its business model, the Firm and its registered representatives do not make recommendations to customers to purchase or sell securities.[12] In 2014, Glendale had approximately 2,000 accounts (only a few hundred of which were active, according to Castillo). Castillo was the broker of record for about 70 percent of the customer accounts at the Firm. Abadin and Huang were the registered representatives for the remaining accounts.[13]

In a 2010 Letter of Acceptance, Waiver and Consent ("AWC"), Glendale agreed to FINRA's findings that it violated AML rules by failing to identify and analyze numerous securities transactions by Firm customers to determine whether they were suspicious and should be reported. According to the AWC, from 2007 to 2009, the Firm permitted 51 foreign corporate accounts, all of which were controlled by the same person, to deposit and liquidate 279 million shares of low-priced securities. The Firm also failed to have in place an adequate supervisory system and procedures reasonably designed to prevent the distribution of unregistered securities.[14]

2. George Alberto Castillo

Castillo entered the securities industry in 1993. He has been associated with Glendale since 2005, when he and Flesche purchased ownership interests in the Firm. Castillo owns about 22 percent of Glendale. He is the Firm's President and head trader. He described his duties as being responsible for overseeing Glendale's day-to-day business and operations. According to the Firm's WSPs, he is responsible for approving new accounts and reviewing retail customer

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[8] Complaint ("Compl.) ¶ 8 Amended Ans. ¶ 8; Tr. 636-39. The firm has three traders, but only Castillo and Abadin engaged in market making. Tr. 639-40.

[9] Compl. ¶¶ 2, 8; Amended Ans. ¶¶ 2, 8. Castillo estimated that over 75 percent of Glendale's business was from trading penny stocks and about half of the Firm's trading involved market making activity. Castillo also estimated that at one time Glendale made markets in about 250 securities, but at the time of the hearing, the number was down to 80 securities. Tr. 637-38, 2374.

[10] Tr. 2372-73.

[11] Tr. 2391-92.

[12] Tr. 131-32, 2348, 2364.

[13] Tr. 641-42, 815-16, 2390-91.

[14] Complainant's Exhibit ("CX-_") 3. Under the terms of the AWC, the Firm neither admitted nor denied that it violated FINRA rules or federal securities laws and regulations. Glendale agreed to a censure and a $45,000 fine.

securities transactions on a T-plus-1 basis, and is jointly responsible for reviewing activity by accounts the Firm designated as high-risk.[15] Castillo is registered as a general securities representative, general securities principal, equity trader limited representative, and registered options principal.[16]

3. Eric Paul Flesche

Flesche entered the securities industry in 1999 when he associated with a FINRA member firm. He has been registered with Glendale since 2005. He owns approximately 22 percent of Glendale. Flesche is the Firm's CCO and Chief Financial Officer. He is licensed as a general securities representative, general securities principal, financial and operations principal, general securities sales supervisor, municipal securities principal, securities trader representative, and investment banking representative.[17] Flesche supervises everyone at the Firm and is responsible for maintaining the Firm's WSPs.[18] He is also responsible for reviewing customer deposits of microcap securities to determine whether they are eligible for resale.[19]

4. Albert Raymond Laubenstein

Laubenstein entered the securities industry in 1974 when he first associated with a FINRA member firm. He was registered with Glendale as a general securities representative, general securities principal, investment banking representative, municipal securities representative, registered options principal, and equity trader limited representative.[20] Laubenstein was associated with Glendale from February 2010 until December 2016, when he retired from the securities industry. On December 27, 2016, Glendale filed a Uniform Termination Notice for Securities Industry Registration (Form U5) terminating Laubenstein's registration with the Firm.[21]

Glendale hired Laubenstein in 2010 as part of the Firm's plan of corrective action when it consented to FINRA's findings in the AWC that it had committed AML-related violations with respect to its customers' liquidation of low-priced, speculative stocks.[22] Laubenstein was

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[15] Compl. ¶ 10; Amended Ans. ¶ 10; Tr. 77, 139; CX-4, at 8; CX-9, at 26, 133, 170, 395-96.

[16] Compl. ¶ 10; Amended Ans. ¶ 10; Tr. 83-85, 109; CX-4, at 5, 8, 11.

[17] Compl. ¶ 11; Amended Ans. ¶ 11; Tr. 109, 826-27, 1063; CX-5, at 5, 13, 18, 21.

[18] Tr. 853-54; CX-9A, at 26.

[19] Tr. 842-45.

[20] Compl. ¶ 12; Amended Ans. ¶ 12; Tr. 1750; CX-3, at 8; CX-6, at 5, 11, 16-17.

[21] Tr. 1923; CX-6, at 5, 18. FINRA has jurisdiction over Laubenstein under Article V, Section 4(a), of FINRA's By-Laws because the Complaint was filed within two years after the effective date of termination of his registration and the Complaint charges him with misconduct committed while he was registered with FINRA.

[22] Tr. 901, 1763-64; CX-3, at 8-9.

Glendale's AMLCO at all times relevant to this action.[23] He had served as the AMLCO of a clearing firm for five years immediately prior to joining Glendale.[24] Laubenstein was responsible for updating portions of Glendale's WSPs, including its AML-related procedures.[25] Laubenstein also owned a six percent interest in Glendale, which he sold to Castillo when he left the Firm in late 2016.[26]

5. Jose Miguel Abadin

Abadin was first associated with a FINRA member firm in 1988 and has been registered with Glendale since 2006. He owns approximately five percent of the Firm. Abadin is a general securities representative, general securities principal, equity trader limited representative, general securities sales supervisor, and registered options principal.[27] Abadin is an independent broker but he also engages in market making, often in securities that his customers trade. During the relevant period, Abadin had about 150 customers at Glendale, most of whom he said were referred to him by existing customers.[28] As his compensation during the relevant period, Abadin received 80 percent of commissions Glendale charged customers.[29]

6. Huanwei Huang

Huang entered the securities industry in 1999 when he associated with a FINRA member firm. He has been registered with Glendale since 2005 in the Firm's New York City branch office. Huang is registered with Glendale as a general securities representative, general securities principal, registered options principal, and equity trader limited representative.[30] Huang's customer base includes Asian-Americans residing in New York, in addition to customers residing in Asia. In 2015, he had between 200 and 400 customers. Huang speaks Mandarin, Cantonese, and English.[31]

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[23] Compl. ¶ 12; Amended Ans. ¶ 12.

[24] Tr. 1754-56; CX-6, at 6-7. Laubenstein obtained an AML certification from the Association of Certified Anti-Money Laundering Specialists sometime between 2010 and 2012. Tr. 1760.

[25] Tr. 1765-68.

[26] Tr. 1808, 1874.

[27] Compl. ¶ 13; Amended Ans. ¶ 13; CX-7, at 5, 16-19.

[28] Tr. 814-15.

[29] Tr. 2396.

[30] Compl. ¶ 14; Huang Ans. ¶ 14; CX-8, at 4-5, 7-8, 10. Although he has general securities principal and registered options licenses, Huang did not act as a principal at Glendale. Tr. 1454.

FINRA has jurisdiction over individual Respondents Castillo, Flesche, Abadin, and Huang pursuant to Article V, Section 4, of FINRA's By-Laws because they are currently associated with a member firm and the Complaint charges them with misconduct committed while they were registered with FINRA and associated with a member firm.

[31] Tr. 601, 1389-93, 1529.

Consistent with Glendale's policy, Huang did not solicit customer securities transactions. In connection with Glendale's business of filing Forms 211 for issuers, the Firm would refer Chinese-speaking shareholders who wanted to deposit and sell their shares to Huang.[32] According to Huang, Glendale referred "a lot" of issuers to him.[33] During the relevant period, about two-thirds of Huang's customers deposited and liquidated microcap securities.[34]

B. Trading in NuGene International, Inc. (NUGN) at Glendale

The first three causes of action contain allegations involving NUGN. Cause one charges that Glendale, acting through Castillo, participated in the manipulation of NUGN's share price to release two customers (RC and JH) from the terms of the Lock-Up Agreement so that they could liquidate the large number of shares they deposited in their accounts. Cause two charges Glendale, Flesche, and Abadin with participating in the unlawful distribution of restricted or non-exempt securities of NUGN by customers RC and JH, in violation of Section 5 of the Securities Act. Cause three charges that Respondents engaged in AML-related misconduct by failing to ensure that potentially suspicious activity associated with trading in NUGN was investigated and reported. (Cause three also charges all Respondents with AML-related misconduct associated with the deposit and sale of securities of BRKO and VXEL by other customers.)

We first address trading in NUGN at Glendale, which occurred during the first half of 2015. Then we discuss the deposit and sales of BRKO and VXEL shares by Huang's customers, which occurred primarily in early 2016.

1. Background of BLMK/NUGN

NUGN was incorporated in 2006 in California and developed and manufactured skin care and "anti-aging" products. In 2012, NUGN developed a line of products under the NuGene name. In 2013, NUGN had gross revenues of $214,000. During the nine months ended September 30, 2014 (the most recent period before the merger), NUGN had gross revenues of $480,000.[35]

NUGN's predecessor, Bling Marketing, Inc. ("BLMK" or "Bling"), was incorporated in October 2013, in Nevada. It was engaged in the marketing and wholesaling of affordable jewelry through jewelry distributors.[36] In May 2014, a broker-dealer other than Glendale filed a Form

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[32] Tr. 1065-66.

[33] Tr. 1715-18.

[34] Tr. 1368-69.

[35] CX-12, at 7-8; Respondents' Exhibit ("RX-_") 178, at 7-8. Huang did not offer any exhibits into evidence. Respondents Glendale, Castillo, Flesche, Laubenstein, and Abadin submitted their exhibits collectively.

[36] CX-12, at 6; CX-109, at 42.

211 with FINRA seeking authority to enter quotations in BLMK on the OTC Bulletin Board.[37] At the time, BLMK had nominal revenues. It reported sales of $22,025 during the three months ending on June 30, 2014.[38] On September 5, 2014, FINRA cleared the application to quote BLMK.[39]

On December 26, 2014, Bling entered into a reverse merger agreement with NUGN, leaving NUGN as the surviving entity. In connection with the reverse merger, Bling's board of directors approved a stock split in the form of a dividend payable to owners of Bling's common stock. Each stockholder of BLMK stock received 15.04 shares of BLMK for each share of stock owned.[40]

There had been no trading in BLMK before the merger with NUGN. The new company traded under the ticker symbol BLMK until it adopted its new ticker symbol, NUGN, on February 3, 2015.

2. The NUGN Lock-Up/Leak-Out Agreement

In connection with the BLMK/NUGN reverse merger, 30 Bling customers sold approximately 11 million shares of BLMK stock through private transactions to 38 individuals. Seven million of those shares were restricted under the terms of the Lock-Up Agreement, leaving approximately 4 million shares not subject to the Lock-Up Agreement. A Form 8-K filed on January 5, 2015, generally described the terms of the Lock-Up Agreement,[41] but the Lock-Up Agreement itself was not publicly available.[42] Those shareholders who were subject to a Lock-Up Agreement were prohibited from selling any shares of NUGN for 75 days after signing the Agreement. After 75 days, the Lock-Up Agreement permitted a shareholder to "leak out" shares

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[37] Tr. 1104; CX-109. There is no evidence that Respondents were involved in or knew about the BLMK Form 211 at the time of its filing by another broker-dealer or while Firm customers traded the stock. *See* Tr. 1296. Pursuant to Exchange Act Rule 15c2-11 and FINRA Rule 6432, a market maker must complete and submit Form 211 to FINRA to initiate or resume quotations for a security on the OTC Bulletin Board, OTC Markets, or any similar quotation medium. FINRA Rule 6432 requires a member firm to submit a Form 211 application to FINRA's Department of Market Regulation for its review and determination of whether the member firm has demonstrated compliance with SEC Rule 15c2-11 before the member firm initiates or resumes quotation of a non-Nasdaq security in any quotation medium. SEC Rule 15c2-11 makes it unlawful for a broker-dealer to publish any quotations for a security unless the broker-dealer (1) has in its possession specific information regarding the issuer; (2) believes that this information is accurate in all material aspects; and (3) believes that the sources of the information are reliable. *See also* https://www.finra.org/sites/default/files/AppSupportDoc/p126234.pdf.

[38] CX-10, at 2.

[39] RX-106.

[40] CX-12, at 3; RX-178, at 3.

[41] CX-12, at 50. The Form 8-K stated that 30 shareholders sold to 38 persons "an aggregate of 11,099,520 shares of our common stock, of which 7,085,550 shares are subject to a lock-up through February 28, 2015, and thereafter may be leaked out over the ensuing five months." CX-12, at 50.

[42] Tr. 1256.

over a period of 150 days, so long as the shareholder sold no more than 20 percent of the shares the shareholder owned during any 30-day period.[43]

The Lock-Up Agreement also contained a separate provision that limited, or altogether canceled, the 75-day no-sale period and the leak-out restrictions imposed on shareholders in the event NUGN achieved a certain level of market capitalization. Specifically, if NUGN reached a market capitalization of $160 million over three consecutive trading days, 50 percent of a shareholder's shares would be immediately released from the Lock-Up Agreement. If NUGN reached a market capitalization of $200 million over three consecutive trading days, all of a shareholder's shares would be immediately released from the restrictions of the Lock-Up Agreement. The Lock-Up Agreement also stated that a stock certificate covered by the agreement would carry a legend reflecting its terms and that the transfer agent would also maintain records reflecting the resale restrictions.[44]

The existence or applicability of the Lock-Up Agreement is a key issue in this proceeding. According to the allegations in cause one, the Lock-Up Agreement provided the motive for Castillo's alleged manipulation of NUGN's share price. In the event that NUGN's market capitalization reached $200 million, customers RC and JH would be free to sell all of their shares without limitation. To achieve this, NUGN's closing share price would have to be approximately $5.00 per share for three consecutive trading days because NUGN had approximately 41 million shares outstanding (including convertible preferred common shares).

Whether or not Glendale, through Castillo, knew or believed at the time of the alleged manipulation that RC and JH were bound by the Lock-Up Agreement is also key. Respondents, including Castillo, asserted that they believed RC was not subject to the Lock-Up Agreement because the NUGN shares RC had acquired and deposited were free trading, the certificate did not carry a restrictive legend, and the transfer agent confirmed to Glendale that RC's shares were freely tradeable before RC began selling shares.

On the other hand, Respondents acknowledge that they knew JH was bound by the Lock-Up Agreement, chiefly because—unlike RC—it deposited stock certificates with a legend detailing the restrictions in the Lock-Up Agreement.

3. Glendale's Procedures for Accepting Securities for Deposit and Approving Their Sale

Glendale, Castillo, Flesche, Laubenstein, and Abadin stated in their Answer that they "operate on the assumption that assumes that virtually every one of the firm's customers' transactions will trigger the detection of at least one 'Red Flag.'" Because its customers

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[43] CX-19, at 2. FINRA staff obtained a copy of the form of the Lock-Up Agreement from a Wilson-Davis customer who had deposited NUGN shares, not from Glendale. Tr. 1096, 1258.

[44] Tr. 1265-66; CX-19, at 2-3.

"predominantly transact in low priced securities," according to Respondents, the Firm "regularly sees" red flags indicative of potentially suspicious activity.[45]

As part of its liquidation business, Glendale had a process for reviewing stock deposits to determine whether a customer's shares could lawfully be resold. The Firm's WSPs addressed the resale of unregistered securities and consisted of less than two pages. Castillo and Flesche shared responsibility for the review of stock deposits, according to the procedures.[46] The review process included the completion by the Firm and customer of required forms and submitting supporting documentation for the provenance of the shares deposited. The procedures called for reviewing the customer's new account application and SEC filings for current financial information about the issuer, and examining the stock certificates to be deposited and any attorney opinion letters.[47]

In connection with a customer's deposit of securities, the Firm created a due diligence package. The package consisted of a series of forms and questionnaires that Firm personnel, including Respondents, had to complete. It also had forms for customers to submit, together with certain necessary documentation.

To deposit physical certificates, or transfer them from an issuer, a customer had to complete and sign a four-page form prepared by Glendale's clearing firm called "Deposit Securities Request for Bulletin Board, Pink Sheet and Unregistered Securities" (or "DSRQ"). The DSRQ asked the customer how the shares were acquired, the purpose of the deposit (for example, safekeeping or resale), the number of shares the customer acquired in the preceding year, and the number of shares the customer currently controlled. It also asked whether the customer was a present or past officer, director, affiliate, control person, or 5 percent owner of the issuer. It further asked if any family member of the customer was a present or past officer, director, employee, control person, insider, or larger shareholder (10 percent or greater) of the issuer.[48]

The DSRQ also asked how and when prior owners had acquired the shares, including how much they paid for them. It also asked if a prior owner was an officer, director, affiliate, control person, or 10 percent holder of the securities at the time of sale or within 90 days of the customer's receipt of the shares. Finally, the form asked the customer whether the securities were restricted from resale, whether they were covered by a registration statement, and whether the issuer was a shell company when shares were issued.[49]

In exchange for accepting the shares for deposit, the clearing firm also required that customers acknowledge that they would abide by applicable securities laws, including

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[45] Amended Ans. at 2 (Summary).

[46] CX-9, at 183-85.

[47] CX-9, at 183-84.

[48] *See, e.g.*, CX-16, at 2.

[49] *See, e.g.*, CX-16, at 3.

specifically those prohibiting the resale of unregistered, non-exempt securities, money laundering, insider trading, stock manipulation, and other forms of securities fraud.[50]

Glendale also required its customers to complete a two-page form called "Client Checklist for Deposit Documentation" ("Client Checklist"). It asked questions similar to those in the DSRQ and identified the supporting documentation the customer would have to provide to Glendale before the Firm would approve the deposit. The Client Checklist required that customers provide the clearing firm with the DSRQ, the stock certificate, and documents associated with the origin of the shares— for example, a promissory note used to buy the shares, a private placement memorandum, or subscription agreement and registration statement.[51]

Glendale also used a "Broker Checklist for Deposit Due Diligence" ("Broker Checklist"), a form that its principals, the account's assigned registered representative, and other administrative employees completed and signed. This nine-page form documented the Firm's internal review of a customer's stock deposit.[52] Among other things, the form asked the current trading price of the security and whether the stock had recently split. It also asked whether the current transfer agent was properly registered with the SEC.[53] A section on "affiliate analysis" tracked whether the customer had submitted all documents supporting the deposit, and asked if the customer was an affiliate of the issuer. The Broker Checklist also asked a series of questions about how the customer acquired the shares and whether the Firm ultimately had determined the shares were tradeable, depending on the applicability of a registration statement or an available exemption.[54]

Additionally, the Firm searched Google, SEC filings, and the database maintained by the U.S. Treasury Department's Office of Foreign Assets Control ("OFAC") for information about persons associated with the customer's deposit. These persons included the sellers, or transferors, of the stock to the customer, and officers of the issuer. If the Firm found nothing negative on Google, an employee checked a box labeled "[n]o derogatory information found." Similarly, if a search of the issuer's SEC filings turned up nothing about the persons, a Glendale employee checked the box "[n]othing found." The Broker Checklist also asked whether searches uncovered any evidence that the issuer was "the subject of civil litigation involving allegations of fraud" or revealed any "evidence that a pump and dump is currently occurring."[55]

The Broker Checklist asked the assigned registered representative on the customer's account whether he "would … recommend that Glendale Securities Inc. accept or reject this

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[50] *See, e.g.*, CX-16, at 4-5.

[51] *See, e.g.*, CX-16, at 7-8.

[52] *See, e.g.*, CX-16, at 9-17; CX-17, at 14-22; CX-52, at 11-19.

[53] *See, e.g.*, CX-16, at 9.

[54] *See, e.g.*, CX-16, at 10-13.

[55] *See, e.g.*, CX-16, at 14-15.

deposit." It also asked whether the broker believed that the information the customer provided in support of the deposit was true and correct and was "made in compliance with" state and federal securities laws.[56]

In his review of deposit-related documentation, Flesche would determine if the shares were properly registered or were entitled to an exemption from registration under SEC Rule 144.[57] Flesche testified that he looked at the chain of owners of the securities since an issuer first distributed the securities.[58] According to Flesche, Laubenstein had the responsibility to review an issuer's press releases, including Internet promotions touting an issuer.[59] Laubenstein in his capacity as AMLCO and Flesche as CCO would also approve and sign the Broker Checklist form.[60]

Finally, Glendale tracked the total number of shares an issuer had outstanding and the floating stock on a one-page form (the "Deposit Analysis"). The Firm then calculated and recorded the percentage of the shares outstanding and the float that the depositing customer's shares constituted. It also calculated, and documented on the Deposit Analysis, the current total of all Firm customers' shares as a percentage of the issuer's shares outstanding and the float. Flesche signed the Deposit Analysis to indicate he had reviewed it.[61]

Once shares were approved for deposit and a customer began selling them, Flesche testified that he reviewed the customer's transactions—including Castillo's and Abadin's trades on behalf of any customers—the next business day, but he also could review trades in real time on his Bloomberg terminal.[62] Flesche looked for "unusual transactions," including transactions involving a large amount of shares or money and large commissions generated for Glendale. Flesche also testified that he looked for suspicious activity associated with changes in a stock's price and trades that are outside the bid and ask price spread for a given security.[63]

The Firm also received over a dozen different exception reports generated by its clearing firm. Laubenstein was responsible for reviewing the exception reports, including a volume concentration report. But this report was not useful, according to Flesche, in instances involving trades of fewer than 10,000 shares.[64]

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[56] *See, e.g.*, CX-16, at 15.

[57] Tr. 842-45.

[58] Tr. 846, 850-52.

[59] Tr. 845, 978.

[60] *See, e.g.*, CX-16, at 15-16; CX-17, at 20-21.

[61] *See, e.g.*, CX-16, at 123. Floating stock is the number of shares that are available for trading.

[62] Tr. 846.

[63] Tr. 846-48.

[64] Tr. 886-87.

4. Customers BS and ND Trade BLMK/NUGN

Enforcement asserts that the circumstances surrounding trading in BLMK/NUGN by two customers—BS's single sale in January 2015 and ND's one purchase followed by sales in February 2015—provide evidence of Castillo's intent to manipulate NUGN. BS's and ND's transactions occurred before customers RC and JH started selling any of their shares. Enforcement points to Castillo's quotations as market maker in NUGN and his trading in the stock on behalf of BS and ND as circumstantial proof that he knowingly manipulated NUGN's price to benefit RC and JH.

a. Customer BS

i. Customer BS Deposits and Sells BLMK/NUGN Shares

BS opened his account at Glendale in 2012 when he referred an issuer to the Firm.[65] In May 2014, Glendale, through Castillo and Laubenstein, had identified BS as a high-risk customer after he liquidated microcap securities that Laubenstein believed he had acquired under suspicious circumstances.[66] Once labeled a high-risk customer, BS's trades were put on the high-risk trade log, which Laubenstein would review for AML purposes.[67] On October 23, 2014, more than two months before the BLMK/NUGN merger announcement, BS deposited 2,000 shares of BLMK into his Glendale account.[68] BS's account was a Firm "house" account for which Castillo was the assigned registered representative.[69]

When BS deposited his BLMK shares in his Glendale account, he completed a DSRQ and Glendale completed the Broker Checklist as part of the process to obtain approval to resell the shares. BS told the Firm in the DSRQ that the purpose of depositing the BLMK shares was to resell them. BS also disclosed that he owned another 50,000 shares of BLMK that he did not deposit in his Glendale account.[70]

As part of his AML review, Laubenstein examined all the documents that were in the deposit package and approved BS's deposit of BLMK shares. Glendale's back office personnel conducted Google, OFAC, and SEC searches of BS and BLMK's current officers and found nothing negative. It was Laubenstein's responsibility and practice to search the Internet for stock

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[65] Tr. 903, 2357; CX-21, at 2.

[66] Tr. 1784-85, 2354-56; CX-25.

[67] Tr. 2630. Laubenstein testified that most trades by any customer identified as high-risk involved the depositing and liquidation of shares. There were about three or four such trades per day, he testified. Tr. 2638.

[68] CX-20; CX-23, at 2.

[69] Compl. ¶ 94; Amended Ans. ¶ 94; Tr. 201-02; CX-21, at 2.

[70] CX-20, at 12. According to the DSRQ, BS acquired 400 shares of BLMK in March 2014 for $100 pursuant to a Form S-1 registration statement. A week later, the issuer approved a 5-to-1 split, which resulted in BS holding 2,000 shares of BLMK. CX-20, at 13, 21-22, 29.

promotion activity.[71] On the Broker Checklist, Laubenstein and Glendale's back office personnel recorded that they found no evidence of a current pump-and-dump scheme.[72] In addition to Laubenstein's review, Flesche approved BS's deposit of BLMK shares and concluded that they were eligible for resale because they were either registered or exempt from registration.[73] Flesche testified that the Firm determined that the activity that caused it to place BS on a list of high-risk customers was unrelated to the type of deposit associated with BS's BLMK shares.[74]

Enforcement presented evidence at the hearing that BS was involved in a Form 211 application for BLMK (that a broker-dealer other than Glendale filed with FINRA in March 2014).[75] According to Enforcement, BS also had acquired real property with two persons (MF and EF) who later acquired BLMK/NUGN shares. In December 2014, MF and EF sold their shares to JH, which a few months later opened an account at Glendale and deposited and sold NUGN.[76] There is no evidence that anyone at Glendale knew of BS's possible connection to the BLMK Form 211 filing and to others who may have later owned BLMK.[77]

On January 6, 2015, BS called Castillo to place an order to sell 500 of his 2,000 BLMK shares. Castillo testified that, to facilitate BS's order, he began making a market in BLMK the same day.[78] Castillo purchased BS's 500 BLMK shares for the Firm's proprietary account, at $0.13 per share. This was the first and only market transaction in BLMK.[79] Castillo acknowledged that he had no obligation on behalf of Glendale to fill BS's sell order, only to display or represent BS's sell order to the market. Castillo disputed that there was anything wrong with buying BS's BLMK shares. He testified that "there was nothing nefarious about" his

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[71] Tr. 1801.

[72] Tr. 1787-90; CX-20, at 6-7.

[73] Tr. 902-03; CX-20, at 8.

[74] Tr. 2548.

[75] Aside from identifying BS as a current BLMK shareholder, documents submitted with the Form 211 show that BS received an email in April 2014 from BLMK's counsel providing him with the CUSIP number recently issued for BLMK. CX-109, at 44; RX-108, at 44.

[76] Tr. 1109-10; CX-38.

[77] Tr. 1106-08; CX-109, at 44.

[78] *See* Compl. ¶ 29; Amended Ans. ¶ 29; Tr. 392-93, 2223-29. By entering quotes, a market maker is announcing its willingness and commitment to buy stock at its bid price and sell stock at its ask price. *See* Section 3(a)(38) of the Exchange Act (defines a "market maker" as "any dealer who, with respect to a security, holds himself out (by entering quotations in an inter-dealer communications system or otherwise) as being willing to buy and sell such security for his own account on a regular or continuous basis"). On March 4, 2015, Abadin took over from Castillo market making responsibilities in BLMK/NUGN, which by February 4 had begun trading as NUGN. Compl. ¶ 46; Amended Ans. ¶ 46. According to Castillo and Flesche, the change occurred because Abadin's customers RC and JH had recently deposited the stock. Castillo testified that it was a "gentleman's decision" as to whether he or Abadin would make a market, and because Castillo recently had sold Glendale's position in NUGN, he had no interest in acting as the market maker. Tr. 1067-68, 2374-75, 2377-78.

[79] Compl. ¶ 30; Amended Ans. ¶ 30.

decision to buy the shares at 13 cents. "The market was initiated. That's all that happened."[80] Castillo added "this is what happens with these markets. Somebody has to be the first one to initiate the trade."[81] Even though BS was on Glendale's high-risk list, Castillo testified that "it never crossed [his] mind that [BS] might be doing something potentially wrong."[82] Castillo did not find it "unusual" that BS decided to sell the NUGN shares for modest net proceeds of about $30.[83]

BS's sale was the first reported market transaction in BLMK. At the time, the inside bid price for BLMK was $0.10. There were no ask quotes for the stock in the market before BS placed his order, suggesting that there was little, if any, demand for BLMK at the time. Castillo testified that he could not route the order to another broker-dealer or market maker for execution because BLMK had not traded before. Castillo said he "briefly read" the company's recent Form 8-K disclosing the expected 15.04-to-1 forward split, which contributed to his decision to buy the shares, which cost Glendale just $65.[84]

Flesche and Laubenstein reviewed BS's 500-share sell transaction and did not consider it suspicious.[85] BS placed no other orders in BLMK/NUGN in his Glendale account. On April 13, 2015, BS transferred all of his BLMK/NUGN shares to an account at another broker-dealer.[86]

ii. Castillo Sells NUGN from Glendale's Proprietary Account Using Shares Bought from BS (February 4, 2015)

By late January 2015, BLMK had completed the 15.04-to-1 stock dividend payment to its shareholders.[87] On February 4, 2015, BLMK began trading under the symbol NUGN. The first trade under the new ticker symbol occurred that day.

Enforcement alleges that Castillo's quotation activity on February 4, 2015, was calculated to help bid up NUGN's price. At 8:19, Castillo placed an opening bid of $0.11 and then increased it three times, to a high bid of $1.01 at 10:56. At 10:24, Castillo placed his first ask quote offering to sell NUGN at $2.00 per share while no other market maker was placing ask

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[80] Tr. 2306-07. *See also* Tr. 2357-58.

[81] Tr. 2358.

[82] Tr. 2380.

[83] Tr. 2358-59. Castillo also did not find it unusual that BS sold on the same day that NUGN's Form 8-K announced the 15.04-to-1 split, which would convert the 500 shares into over 7,500 shares. Tr. 2359.

[84] Tr. 2229-30.

[85] Tr. 908, 1791-92; CX-1A; Compl. ¶¶ 29-30; Amended Ans. ¶¶ 29-30.

[86] Compl. ¶ 31; Amended Ans. ¶ 31; CX-23, at 12; CX-24. After the 500-share BLMK sale on January 6, 2015, and the 15.04-to-1 split went into effect, BS owned 22,560 shares of NUGN (1,500 BLMK shares x 15.04 = 22,560 NUGN shares). CX-23, at 6, 10; CX-24.

[87] Compl. ¶ 32; Amended Ans. ¶ 32; CX-12, at 3-5; CX-23, at 6; RX-178, at 3-5.

quotes.[88] At 10:56, Castillo increased his ask to $2.25, and then at 11:33 he moved his ask to $2.50. Castillo testified that he increased his quotes to see if there was interest in the market, not to manipulate NUGN's price.[89] He also believed the increase in NUGN's share price was supported by events at the company that were reported publicly.[90]

According to Enforcement's investigator, a person identified on NUGN's website as a contact for the company's products placed the first three orders to buy stock under the new ticker symbol using an account at E*Trade Securities LLC ("E*Trade"). In three executions, the person bought 1,000, 450, and 100 shares of NUGN at 10:52, 10:57, and 11:32, on February 4, at $2.00, $2.00, and $2.25 per share, respectively.[91]

Castillo filled two of the buy orders. At 10:57, Castillo sold 450 shares of NUGN at $2.00 per share, using the BLMK/NUGN shares he bought from BS in January. According to Enforcement's investigator, Castillo sent a Pink Link message to Citadel Securities LLC ("Citadel") to sell the shares.[92] Castillo testified that he believed there was nothing unusual about the quote activity or his sale of 450 shares at $2.00 per share because, he said, stock prices can move quickly in the over-the-counter market.[93] After the sale at $2.00, Castillo increased his ask to $2.25 per share.[94]

At 11:32, Castillo sold another 100 NUGN shares, at $2.25 per share, from Glendale's proprietary account. The buyer was again Citadel. Citadel sold the shares to E*Trade, which had bought the shares on behalf of the customer whom Enforcement claimed was associated with NUGN.[95] Right after this execution at $2.25, Castillo entered unpriced ask quotes, and by mid-afternoon dropped his bid quote from $1.01 to $0.25.[96]

Later in the afternoon on February 4, 2015, ND, a customer who had recently opened an account at Glendale, bought NUGN shares from Castillo. According to Enforcement, the only

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[88] CX-1B, at 2. The 500 shares Castillo purchased from BS on behalf of Glendale's proprietary account turned into 7,520 shares after the stock dividend payment (500 NUGN shares x 15.04 = 7,520 NUGN shares).

[89] Tr. 2234-35.

[90] Tr. 634-35. Castillo testified that he wanted to outbid other market makers' NUGN quotations by steadily increasing Glendale's bid to $2.50. Tr. 629.

[91] Tr. 1117-18, 1123; CX-1B, at 1.

[92] Tr. 1117-21; CX-1B, at 1. According to the Pink Sheets website, Pink Link allows market makers and broker-dealers to communicate instantly. Traders can send market makers order messages and the market maker can electronically execute, negotiate, or decline the orders through an execution report message. *See* http://www.otcdealer.com/manuals/plink/main.html. Tr. 1349-51.

[93] Tr. 289-90, 2378-79.

[94] CX-1B, at 2.

[95] Tr. 1123; CX-1B, at 1.

[96] CX-1B, at 2.

two persons who purchased NUGN on the open market on February 4 were the person who allegedly was associated with NUGN and Glendale's new customer, ND.[97]

We next discuss ND and her trading in NUGN at Glendale.

b. Customer ND

On January 16, 2015, ND opened an account at Glendale. According to her account application, ND was self-employed in the real estate industry and had annual income of $500,000, net worth of $4 million, and $2 million in liquid assets. She claimed to have "extensive" investment knowledge and stated that her primary investment objective was "speculation." In her application, ND stated that she had learned of Glendale through a Google search but could not recall the search terms she used that led her to Glendale.[98] Castillo testified that ND opened her account because she had learned that Glendale was making a market in NUGN—perhaps from talking to NUGN shareholders or other persons who followed the stock, he said.[99] Castillo was ND's account representative.[100]

Enforcement presented additional evidence about ND. She had acquired real property in California with a person who, in January 2015, requested that FINRA member firm Wilson-Davis make a market in NUGN. According to Enforcement's investigator, this person had an account at Wilson-Davis that he used to purchase NUGN shares. He also referred customers to Wilson-Davis who deposited NUGN shares for the purpose of selling them.[101] In late November 2014, ND posted photos and statements on her Facebook page referencing NUGN's skin care products and its paid spokesperson, a well-known model.[102] There is no evidence that anyone at Glendale at the time knew of ND's or ND's friend's possible connections to NUGN that Enforcement described.

On February 4, 2015, ND telephoned Castillo to place an order to buy NUGN.[103] ND had engaged in no trading activity in her Glendale account before this date. Castillo placed a day limit order on behalf of ND to purchase 7,500 shares of NUGN at $0.26 per share.[104] At 13:39, Castillo partially filled ND's order by selling her 5,170 shares of NUGN at $0.26 per share from Glendale's proprietary account, which represented the balance of the BLMK shares that

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[97] Tr. 1123; CX-1B, at 1.

[98] CX-26, at 3-5, 17.

[99] Tr. 2361-62.

[100] CX-26, at 13. Laubenstein reviewed the account application. CX-26, at 13.

[101] Tr. 1127-30; CX-75, at 10.

[102] Tr. 1130-32; CX-76.

[103] Tr. 2377-78.

[104] Compl. ¶ 37; Amended Ans. ¶ 37.

Glendale had purchased from BS in January. This set the closing price of NUGN at $0.26 per share.[105]

Castillo testified that he sold Glendale's NUGN shares to ND because he wanted to liquidate the Firm's position in the stock to "lock in my profit." His cost basis in NUGN was negligible, he said, having purchased NUGN from BS at $0.13 per share before the stock split. He said, "I did the math and I figured that it was a good day. And I was done trading [NUGN] in a principal capacity."[106] Castillo was not concerned about ND's interest in buying NUGN, even considering that it had been trading earlier in the day, because it was "not unusual for friends and family or individuals to find out that a market [in a security] is being initiated."[107] Castillo believed that even though NUGN was thinly traded, the market for the stock was "being initiated," or "developed," which supported a potential increase in its share price. Under such circumstances, according to Castillo, it was not unusual for Glendale to represent 100 percent of all sell side transactions in NUGN, as it did on February 4, 2015.[108]

On February 5—the day after buying NUGN shares from Glendale—ND placed a day limit order to sell the NUGN shares at $10.00 per share.[109] Castillo entered ND's order, which expired unfilled at the end of the day.

The following day, February 6, ND placed another day limit order with Castillo—this time at $5.00 per share. This order also expired unfilled at the end of the day. ND repeated this order each day until February 11, 2015, when she instructed Castillo to place a good-til-canceled order to sell 5,000 shares of NUGN at $5.00 per share. There were no trades in NUGN from February 6 to 23, 2015.[110]

On February 24, 2015, at 14:19, ND's $5.00 good-til-canceled order to sell 5,000 NUGN shares, placed on February 11, was partially filled. According to Castillo, a Wilson-Davis trader used Pink Link to "preference" ND's existing sell order by communicating the number of shares he wanted to buy and the price per share. Castillo knew from the message that the request came from Wilson-Davis.[111] Castillo sold 250 NUGN shares on behalf of ND at $5.00 per share.[112]

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[105] Compl. ¶ 37; Amended Ans. ¶ 37; Tr. 2311-12; CX-1B.

[106] Tr. 2312.

[107] Tr. 2312.

[108] Tr. 2309-11, 2315.

[109] Compl. ¶ 38; Amended Ans. ¶ 38.

[110] Compl. ¶¶ 39-40; Amended Ans. ¶¶ 39-40; Tr. 1137.

[111] Tr. 2245-46, 2253, 2266-67. *See also* Tr. 1136-37. The best inside bid price in the market for most of February 24 was $2.25 per share and Glendale was the only market maker asking $5.00 per share. CX-1C.

[112] Tr. 2245; CX-1C; RX-179, at 1. By February 24, 2015, there were about eight market makers entering quotes in NUGN. Tr. 2257; RX-179, at 1.

The next day, February 25, ND sold 1,020 NUGN shares from her outstanding good-til-canceled order at $5.00 per share.[113] She sold 120, 100, and 800 shares, at 9:30, 12:47, and 14:57, respectively. In the first execution, Citadel bought 120 NUGN shares from Castillo and ND on behalf of E*Trade, which had placed a purchase order on behalf of a customer.[114]

In the second execution (for 100 shares, at 12:47) on February 25, according to Castillo, NITE (Knight Securities LLC) "preferenced" Glendale to buy 100 shares at $5.00.[115] NITE had received a limit order to buy 50 shares of NUGN at $5.00 from MLEX (Merrill Lynch, Pierce, Fenner & Smith Incorporated). According to Enforcement's investigator, the 50-share order from MLEX originated from a Wilson-Davis customer.[116] The investigator acknowledged that Glendale and Castillo had no way of knowing the identity of the buyer of the 50 shares or that he was a customer of Wilson-Davis.[117]

The last NUGN execution (for 800 shares) on February 25 occurred at 14:57. According to Castillo, NITE likely "preferenced" Glendale's existing quote to sell at $5.00, which reflected ND's outstanding good-til-canceled order. Castillo sold the 800 shares to NITE, who in turn sold them to National Financial Services LLC (NFSC).[118]

On February 26, ND sold 1,000 shares of NUGN at $5.00 per share.[119] The trade was executed at 15:59:43—just 17 seconds before market close. According to Castillo, NITE bought the shares from Glendale and then sold them to NFSC.[120] According to Enforcement's investigator, the blue sheet records reflected that the NFSC customer who purchased the shares lived in the same city and worked in the same field as another person connected to NUGN.[121] Castillo disputed that he unlawfully marked the close, as Enforcement alleges, by engaging in a transaction with NITE on ND's behalf just before the end of the trading day. He testified that the trade was an execution against ND's open order that had stood since February 11. The trade also

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[113] CX-27, at 1.

[114] Tr. 1142, 2272; CX-1D, at 1; RX-179, at 2.

[115] Tr. 2273-74.

[116] Tr. 1142-43, 1154, 1159; CX-1D, at 1. *See also* Tr. 2273-74. Instead of buying just 50 NUGN shares to fill the order, NITE bought 100 shares and kept the remaining 50 shares. Tr. 1142-43.

[117] Tr. 1334. Enforcement learned the identities of NUGN buyers at other broker-dealers by means of blue sheet requests. "Blue sheets" questionnaires request that broker-dealers identify the buyers and sellers of a particular security during a specified review period. Tr. 1094, 1248-50. Blue sheet information from broker-dealers, generally market makers, set forth a firm's inter-dealer and agency trades by date, size, and contra-party in a given security or securities. *See* Elec. Submission of Sec. Transaction Info. by Exch. Members, Brokers, and Dealers, Exchange Act Release No. 44494, 2001 SEC LEXIS 2802, at *3 (June 29, 2001).

[118] Tr. 2274; CX-1D, at 1; RX-179, at 2.

[119] CX-1D, at 1; CX-27, at 1.

[120] CX-1D.

[121] Tr. 1157.

did not move the market, Castillo said, and the stock would have closed that day at $5.00 without the trade.[122]

ND's sales of 250, 1,020, and 1,000 shares on February 24, 25, and 26, 2015, respectively, constituted 100 percent of NUGN's daily market volume and caused the stock to close at $5.00 per share on each of those days.[123] ND engaged in no other trading in NUGN in her account at Glendale after her sale on February 26, 2015.[124]

Flesche reviewed Castillo's trades in NUGN on behalf of ND. According to Flesche, the $5.00 trade on February 24 generated an exception report from the clearing firm, but he did not find it suspicious because, as he testified, there was news about NUGN. He therefore also did not find it suspicious that ND traded NUGN at $0.26 per share on February 4 and then $5.00 per share beginning February 24. During the investigation, however, Flesche testified he did not look for news about NUGN that could justify a price increase to him.[125]

5. Lock-Up Agreement Restrictions Lifted

Including convertible preferred shares, NUGN had 41,115,120 shares outstanding on February 24–26, 2015.[126] The daily closing price of $5.00 per share for the three consecutive days caused NUGN's market capitalization to exceed $200 million, which released customers RC and JH to trade NUGN, assuming that they were restricted from trading under the Lock-Up Agreement. As a result of the $5.00 per share closing prices on February 24–26, the next day, February 27, any shareholders subject to the Lock-Up Agreement were free to sell all of their NUGN shares.

6. Three Corporate Customers Deposit and Sell NUGN Shares

The Complaint charges that the deposit and liquidation of a large number of NUGN shares by three new corporate customers constituted red flags that should have triggered an investigation. In February 2015, RC, JH, and SEI opened accounts at Glendale through which they sold a volume of NUGN shares and then wired out most of their proceeds. RC sold 2,573,252 shares for proceeds of $7,304,354 from February 27 to August 3, 2015.[127] JH sold

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[122] Tr. 2275-76. Laubenstein testified similarly. He said that the trade at 15:59:43 on February 26 did not unlawfully mark the close because it did not change the price of NUGN that day. Tr. 1911-12. "Marking the close" is a form of market manipulation. It involves attempting to influence the closing price of a security by executing purchase or sale orders at or near the close of trading. The activity can artificially inflate or depress the closing price for the security and can affect the price of "market on close" orders. *See* https://definitions.uslegal.com/m/marking-the-close.

[123] CX-1C; CX-1D, at 1.

[124] CX-27, at 3-16. After buying 5,170 shares of NUGN on February 4, 2015, and selling 2,270 shares on February 24–26, 2015, ND held 2,900 shares of NUGN. CX-27.

[125] Tr. 957-61.

[126] CX-12, at 50.

[127] CX-1F; CX-1G.

247,950 NUGN shares for proceeds of $812,989 from early April to early August 2015.[128] SEI sold 125,140 NUGN shares in June and July for $459,467.[129]

a. Customer RC

i. RC Deposits NUGN Shares

RC was incorporated in Nevada on January 29, 2015. According to its state corporate filings, RC engaged in advertising, marketing, and consulting.[130] On February 4, 2015, RC opened an account at Glendale. RC stated that it had an annual income exceeding $250,000, estimated net worth of $4 million, and liquid assets of $1 million. According to new account documents, RC's primary investment objective was speculation and the main activities of the corporation were described as "investment purposes, appreciation, speculation."[131] Abadin was the account representative.

According to Abadin, an existing customer referred the principal of RC (who served as the company's president, secretary, and treasurer) to him to open an account for RC.[132] Before it opened the account, Abadin understood that RC intended to deposit shares of a low-priced security for resale.[133] According to Flesche, RC came to Glendale because the Firm is one of the few remaining broker-dealers that would accept low-priced securities for deposit.[134]

On February 11, 2015, a week after opening its account, RC deposited a single certificate for 2,899,878 NUGN shares dated February 3 into its account. RC therefore controlled over 7 percent of NUGN's 41 million outstanding shares and approximately 26 percent of NUGN's public float of over 11.1 million shares.[135] Glendale had a policy of not accepting securities representing more than 20 percent of the float of an issuer for the account of any one customer. It also had a policy of not accepting for deposit in more than one customer's account shares that

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[128] Compl. ¶ 57; Amended Ans. ¶ 57; CX-1F.

[129] CX-1F; CX-41, at 8-11.

[130] CX-28, at 32, 36.

[131] CX-28, at 1, 4, 26, 36. Even though it had just been incorporated in Nevada, neither Flesche nor Abadin found it suspicious that RC had such income and assets because it had once been incorporated in California. Tr. 665, 929; CX-28, at 4, 28. RC was previously formed in California in 2008 but the state suspended its corporate registration in 2010. CX-120; CX-121.

[132] Tr. 658, 777, 814, 1067.

[133] Tr. 658-59, 661-62.

[134] Tr. 1067.

[135] Tr. 676, 2627-28; CX-16, at 123; CX-29, at 1; RX-94, at 62-63, 210. The deposit was not reflected in RC's account statement until February 24. CX-29, at 1; RX-94, at 38. On February 11, 2015, RC filed a Schedule 13D "Beneficial Ownership Reporting Requirements Acknowledgment" with the SEC (a copy of which it provided to Glendale) disclosing that the shares it owned constituted 7.4 percent of NUGN's outstanding stock. CX-16, at 21-24.

together totaled more than 40 percent of an issuer's float.[136] Because RC's NUGN shares represented more than 20 percent of the float,[137] Glendale instructed its clearing firm to return 720,000 shares to RC, reducing the number of shares that RC held in the account to 2,179,878 shares, or about 19.5 percent of NUGN's float.

The 720,000 shares were divided into eight 90,000-share stock certificates and debited from RC's account on March 17, 2015.[138] According to Enforcement's investigator, RC sold the 720,000 shares to four persons through private transactions. The purchasers deposited their new NUGN shares in accounts at Wilson-Davis. There is no evidence that anyone at Glendale knew that RC sold the NUGN shares to four persons or that the purchasers deposited the shares in accounts at Wilson-Davis.[139]

ii. The Source of RC's NUGN Shares

In support of its deposit of the NUGN certificate, RC provided Glendale with copies of four identical stock purchase agreements dated December 18, 2014 through which it had acquired 192,811 BLMK shares. RC paid $6,009 for the BLMK shares (just over $0.031 per share)—49,900 shares each from NF, KF, and FF, and 43,111 shares from SF. The four sellers had the same last name. RC paid the sellers with checks dated December 18, 2014, drawn on a bank account in RC's name.[140] RC bought the shares more than a month before its incorporation in Nevada.

According to the Complaint, two of the four persons who sold the BLMK/NUGN shares to RC were affiliates of NUGN because they were related to the company's president by marriage. If they were affiliates of NUGN, as defined under federal securities law, RC's re-sales of the stock it had acquired (irrespective of the applicability of the Lock-Up Agreement) may have been subject to restrictions and limitations. Specifically, the Complaint alleges that BLMK's then President DK was married to NF at the time of the sale to RC, a fact disputed by Respondents.

Based on the weight of the evidence presented at the hearing, the Panel finds that DK and NF were married to each other as of December 18, 2014, the date RC bought its NUGN shares. DK's social network posts referring to the couple's wedding anniversary reflected that they were married in August 2011.[141] DK identified herself using NF's surname on social network

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[136] Tr. 675-76, 2498-2503.

[137] Tr. 817-19.

[138] Tr. 817-20; CX-16, at 1-2, 123; CX-29, at 3; RX-94, at 61, 210. Glendale instructed its clearing firm to generate eight certificates in RC's name, each for 90,000 shares of NUGN.

[139] Tr. 1347-48, 1352-53.

[140] *See* CX-16, at 36-38, 52-54, 68-70, 84-86, 89. After the 15.04-for-1 split, RC's 192,811 shares of BLMK equaled 2,899,878 shares of NUGN, the number of shares it deposited on February 11, 2015.

[141] Tr. 1941-43; CX-117, at 3.

postings.[142] The Panel also concludes that the couple was living together at the same residential address on the date of NF's BLMK sale to RC based on evidence that they had provided common addresses during their marriage.[143]

Respondents rely chiefly on a New York State marriage license issued November 9, 2017, as evidence that the couple was not married as of December 18, 2014. But the document records that "solemnization" occurred on November 17, 2017, and the "type of ceremony" was "religious" and not civil.[144] The Panel therefore concludes that the certificate reflects a religious marriage ceremony that occurred years after the couple's civil marriage ceremony.[145]

At the hearing, Enforcement alleged that another one of the four sellers, SF, was NF's sister, and accordingly a corresponding *pro rata* portion of NUGN's sales at Glendale were also restricted.[146] Because Enforcement did not allege in the Complaint that SF was an affiliate of BLMK by virtue of her relationship to NF,[147] the Panel declines to find that the BLMK/NUGN shares RC acquired from SF were potentially restricted from resale. (The remaining two sellers, KF and FF, were married to each other, according to Enforcement. Their relationship to NF, however, is not known.)[148]

Evidence at the hearing showed that Respondents did not inquire into the relationships among the four sellers and therefore they did not consider that DK and NF were married. Respondents acquired the evidence they presented at the hearing after the customers' NUGN

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[142] Tr. 2519, 2589-90; CX-117; RX-400.

[143] Tr. 2196-97; CX-36, at 1-2, 9; CX-37, at 1, 5; CX-109, at 72-73. The weight of evidence is that the couple lived together at an address in Far Rockaway, New York, at the time of the December 2014 sale. The Form 211 filing in March 2014 contained a list of shareholders showing a Far Rockaway address for DK and NF. CX-109, at 43, 72-73; RX-108, at 19, 43, 72-73, 85. The couple also appears to have shared a telephone number. CX-36, at 1-2; CX-37, at 1-2. Enforcement also relied in part on LexisNexis records in confirming the couple's identities and residential addresses. The records provided date ranges of addresses for both DK and NF, which in some instances were inconsistent or overlapping. Respondents argue this showed that DK and NF did not live at the same addresses. Respondents introduced records from another national database. *See* Tr. 2209-11; RX-5. The Panel did not find Respondents' arguments persuasive. In finding that the couple was married and living together, however, the Panel considered all the circumstances and the nature of all the documentary evidence presented.

[144] CX-34; RX-120. *See also* Compl. ¶¶ 59-60, 66-67; Amended Ans. ¶¶ 59-60, 66-67.

[145] Respondents also relied on the issuer's disclosures about shareholders' relationships in supporting documents for the BLMK Form 211 filed by another broker-dealer (and to which Respondents did not have access when RC deposited its NUGN shares). The list of shareholder relationships did not disclose that NF and DK were married—only that NF and SF were siblings. RX-108, at 91-92. DK, as BLMK's CEO, also represented to FINRA that she was not married. *See* RX-108, at 16, 18, 20, 91. The Panel finds this evidence that DK and NF were not married unpersuasive.

[146] Tr. 2439.

[147] *See* Compl. ¶¶ 58-59, 66-68, 173. The Complaint identified only NF and his parents, MF and EF, as affiliates of BLMK because MF and EF had provided the same residential address that NF provided in connection with selling BLMK to RC. Compl. ¶ 67.

[148] Tr. 2438.

sales and after Respondents learned that FINRA had alleged that some shares sold had been acquired from affiliates of the issuer. At the time of the deposits, Respondents' inquiry into BLMK's officers and the relationships among the persons who sold BLMK/NUGN to RC and JH was limited to Google, OFAC, and SEC searches, as reflected in the due diligence package associated with RC's and JH's deposits.[149]

iii. Glendale Approves RC's NUGN Deposit

In the course of approving the deposit, Flesche reviewed the stock purchase agreements, including the addresses the sellers provided. RC also provided an attorney opinion letter addressed to the transfer agent, dated February 10, 2015, representing that all the shares it bought from the four sellers were freely tradeable.[150]

It was not a red flag for Flesche that the sales took place just 11 days before the BLMK/NUGN reverse merger, on December 29, 2014, because the stock purchase agreements referred to a pending acquisition.[151] It also was not an issue for Flesche that the sellers had the same last name because it was "common" to have "friends and family" involved in transactions with securities of smaller issuers.[152] He also did not consider it suspicious that the sellers were in New York and RC was in California because typically the attorney handling a reverse merger is the person who connects the sellers with the buyers.[153] To Flesche, the fact that shareholders come to Glendale to deposit and liquidate low-priced securities "has never been inherently suspicious" because shareholders refer each other to the Firm.[154] The day RC deposited NUGN shares, Flesche performed the AML review because Laubenstein was unavailable.[155]

Castillo testified that he did not review RC's stock deposit documentation and was unaware it had deposited NUGN shares. He did not sign the Client Checklist associated with RC's stock deposit.[156] Castillo testified that he did not know that RC owned NUGN shares until RC started selling its shares on February 27, 2015.[157]

As part of his review of RC's deposit of NUGN shares, Flesche said he personally performed Google and SEC searches of the individual sellers and NUGN's officers, including

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[149] *See* CX-16; CX-17; CX-18.

[150] CX-16, at 89-91.

[151] Tr. 910-16; CX-16, at 28, 44, 60, 76, 106.

[152] Tr. 918, 2520. Flesche understood that the BLMK shareholders were friends, family members, and business acquaintances of each other. Tr. 2523.

[153] Tr. 2612-14, 2622-24.

[154] Tr. 2624.

[155] Tr. 1794.

[156] Tr. 318-19; CX-16, at 15-16.

[157] Tr. 319.

DK.[158] The Firm's process for reviewing the deposits did not include searches on Facebook.[159] One purpose of the searches was to determine whether the sellers were affiliates of the issuer. Flesche saw nothing that caused him to consider whether NUGN's president and one of the persons who sold shares to RC were married to each other.[160] Abadin did not ask RC's principal what connection, if any, the sellers had to each other because initial investors in small offerings often are friends and family. Like Flesche, Abadin did not consider the common surnames of the four sellers a red flag.[161]

When he approved RC's deposit of NUGN shares, Flesche saw that each stock purchase agreement contained references to the existence of a Lock-Up Agreement associated with the sale. Flesche did not attempt to obtain a copy of the Lock-Up Agreement, but did ask the transfer agent about it. He also asked the issuer's attorney whether there was a Lock-Up Agreement in place. The attorney stated there was not. This satisfied Flesche that RC was not bound by the Lock-Up Agreement.[162] RC's principal told Abadin that the shares it purchased were not restricted from resale and he did not have copies of a Lock-Up Agreement.[163] The stock transfer agent and NUGN's corporate counsel told Glendale that the shares were not restricted.[164] On February 11, 2015, the transfer agent emailed Glendale that all of the NUGN shares that RC deposited were "free-trading & not subject to any lock up agreement."[165]

During its investigation, Enforcement did not contact the transfer agent, NUGN, RC, or RC's attorney to determine if RC was subject to the Lock-Up Agreement.[166] Enforcement's investigator testified that the staff was unable to conclude that RC was in fact subject to the Lock-Up Agreement.[167]

On February 12, 2015, Flesche approved RC's deposit of NUGN shares.[168]

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[158] Tr. 919-21; CX-16, at 14.

[159] Tr. 2517-18.

[160] Tr. 922-24.

[161] Tr. 672-73.

[162] Tr. 931-34.

[163] Abadin testified during the investigation that he believed NUGN had released RC from the Lock-Up Agreement. Tr. 702-03.

[164] Tr. 678-80, 687; CX-16, at 121-22.

[165] CX-16, at 121; RX-100, at 1.

[166] Tr. 1264-65.

[167] Tr. 1253.

[168] Tr. 669-70; CX-16, at 2, 15-16. As the broker on the account, Abadin indicated on the Broker Checklist that he recommended that the Firm accept RC's NUGN shares. CX-16, at 15.

iv. RC Liquidates NUGN Shares

On February 27, 2015, the day after the price of NUGN closed at $5.00 per share for three consecutive days, RC began selling its shares from its Glendale account.[169] From that day through August 2015, RC sold 2,573,252 shares of NUGN for proceeds of over $7.3 million at prices that ranged from $1.37 to $4.38 per share. From early April to mid-August 2015, RC wired out $4,990,595 from its Glendale account.[170]

For a short period, RC also bought NUGN shares. For about three weeks, from late May to mid-June 2015, it bought 577,200 shares of NUGN, for which it paid over $2.5 million.[171] RC traded no other securities besides NUGN in its Glendale account.[172] The Firm earned $193,055 in commissions for liquidating NUGN on RC's behalf.[173]

Flesche testified that he reviewed RC's sales and purchase transactions in NUGN and "didn't see anything specifically suspicious,"[174] including RC's purchases of NUGN in May and June 2015 because they "seem[ed] like normal trading activity."[175]

According to Enforcement's investigator, customers at Wilson-Davis purchased most of the NUGN shares that RC sold. Wilson-Davis customers had also deposited shares of NUGN in their accounts.[176] For example, according to Enforcement's investigator, on March 10, 2015, Glendale sold 37,000 NUGN shares to Wilson-Davis customers in five transactions. Also according to the investigator, Pink Link communications between the two firms preceded the transactions.[177]

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[169] RC's account reflected that the NUGN shares were journaled, or available to trade, on February 24, 2015. *See* CX-29, at 1.

[170] CX-1F; CX-29, at 5-14.

[171] CX-1F; CX-1G; CX-29, at 8-11. Because RC deposited fewer than 2.2 million shares of NUGN, its liquidation of more than 2.5 million NUGN shares necessarily includes a portion of the 577,200 shares it purchased in May and June 2015.

[172] CX-29.

[173] CX-29.

[174] Tr. 938-39.

[175] Tr. 2516.

[176] Tr. 1158-59.

[177] Tr. 1164-65; CX-29, at 3.

b. Customer JH

i. Customer JH Deposits NUGN Shares

Like RC, customer JH sold a large quantity of NUGN shares. JH's principal opened an account at Glendale for JH on February 18, 2015, two weeks after RC opened its account and one week after RC deposited its NUGN certificate.

JH was incorporated in October 2014 in Nevada.[178] According to its new account documents, the corporation's primary investment objective was "speculation" and the source of the funding for the account was "business revenue." It claimed to have an annual income of $500,000, an estimated net worth of $4 million, and liquid assets of $2 million. Its stated business was "investments."[179] Abadin was the representative on JH's account. Abadin had not met JH's principal before he opened an account for JH at Glendale.[180] Flesche approved the opening of the account.

Two days after opening its account, on February 20, 2015, JH's principal emailed Glendale, including Castillo, copies of two stock purchase agreements for BLMK shares, in anticipation of later depositing NUGN shares at Glendale.[181] Beginning February 27, 2015, JH deposited five certificates, each for 272,158 shares of NUGN, totaling 1,360,790 shares, in its Glendale account.[182] Each stock certificate was dated February 3, 2015. On February 27, JH deposited the first certificate; on March 10, it deposited the remaining four certificates.[183]

With its first deposit, JH submitted a signed DSRQ. JH indicated on the form that it intended to deposit another 1,193,632 shares in the account and that it controlled a total of 1,465,790 NUGN shares.[184] JH therefore controlled over 3.5 percent of NUGN's 41 million shares outstanding and 13 percent of the float.

JH provided copies of two stock purchase agreements through which it had obtained all of the BLMK/NUGN shares it would deposit, both of which were dated December 18, 2014, the same date as the stock purchase agreements associated with RC's four purchases of BLMK/NUGN shares. The two stock purchase agreements were identical to the stock purchase

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[178] CX-30, at 32, 36.

[179] CX-30, at 4, 19.

[180] Tr. 709.

[181] Tr. 2594-95; CX-119. The stock purchase agreements attached to the February 20 email to Glendale were signed by JH's principal but were not dated. The attachment included copies of two canceled checks from JH dated December 18, 2014, payable to the sellers. CX-119.

[182] Compl. ¶ 56; Amended Ans. ¶ 56.

[183] CX-17, at 1, 7-13; CX-18, at 1-8, 20-26. JH's first deposit of NUGN appeared in its account on March 2; the second deposit for $1,088,632 shares appeared in the account on March 19, 2015. CX-31, at 2; RX-91, at 41.

[184] CX-17, at 7.

agreements associated with RC's purchases. The two sellers of BLMK/NUGN stock—MF and EF—had the same surname as the four sellers of stock to RC. JH paid MF and EF the same per share price (just over $0.031 per share) that RC paid its four sellers. JH bought 49,900 and 40,578 shares of NUGN for $1,555 and $1,265 from MF and EF, respectively, using checks drawn on a bank account in JH's name.[185] MF and EF had purchased their shares from the issuer in March 2014. Glendale conducted Google, OFAC, and SEC searches of the two sellers and NUGN's officers, and indicated on the Broker Checklist that it found nothing.

As with RC's four stock purchase agreements, JH's two stock purchase agreements stated that the shares JH had acquired were subject to a Lock-Up Agreement. Unlike RC's single certificate (for 2,899,878 NUGN shares), each of JH's five NUGN stock certificates carried a legend stating that the shares were subject to the Lock-Up Agreement.[186] The legend on the certificate deposited February 27, 2015, provided that through March 1 the shareholder could sell 50 percent of the shares represented by the certificate if NUGN's market capitalization reached $160 million for three consecutive trading days, and all the shares if the market capitalization reached $200 million. After March 1, 2015, according to the legend, NUGN shares could be resold without restriction under the Lock-Up Agreement regardless of NUGN's market capitalization.[187]

JH's four other NUGN certificates contained identical restrictive legends except for progressively later leak-out dates of April 1, May 1, June 1, and July 1, 2015.[188] Under the restrictions on the certificates, JH was free to sell 272,158 NUGN shares without restriction beginning March 2 (regardless of NUGN's market capitalization level), another 272,158 shares (represented by the second stock certificate) on April 2, and so on monthly until July 2, 2015, when there would be no restrictions on any of the shares deposited. Stated a little differently, JH

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[185] CX-17, at 37-39, 53-55.

[186] CX-17, at 1-2; CX-18, at 1-8. Flesche testified that he did not try to obtain a copy of the Lock-Up Agreement because he believed its terms were reflected in the legends on JH's five certificates. Tr. 951-52.

[187] The legend on the first certificate (deposited February 27) stated the following:

> Leak Out 3/1/2015. The shares underlying this stock certificate are subject to a lock-up/leak out agreement ("Agreement") that prohibits sale of shares and certain other dispositions thereof through March 1, 2015. In the event of a permitted transfer prior to that date any reissued certificate evidencing the underlying shares must also bear this restrictive legend. In the event the aggregate market capitalization of the company is at least $160 million for three consecutive trading days, 50% of the shares evidenced by this share certificate may be sold or otherwise transferred without any restriction imposed hereby before March 1, 2015. In the event the aggregate market capitalization of the company is at least $200 million for three consecutive trading days, all of the shares evidenced by this share certificate may be sold without any restriction before March 1, 2015. After March 1, 2015, the holder hereof may sell the shares evidenced by this certificate without restrictions under the agreement. Terms of these share transfer restrictions are available from the secretary of the company.

CX-17, at 2.

[188] CX-18, at 2, 4, 6, 8.

was subject to a lock-up of all of its 1,360,790 shares until March 2, when it could leak out 20 percent of the shares it owned. On April 2, it could leak out another 20 percent of the shares each month up to July 2, 2015.[189]

Respondents claim that they were unaware of the terms of the Lock-Up Agreement until JH deposited its first certificate, which occurred on February 27, 2015.[190] In their Answer, Respondents also stated that Castillo remained unaware of the Lock-Up Agreement even after JH's deposit because he did not review JH's deposits.[191]

Flesche and Laubenstein approved JH's first deposit of 272,158 NUGN shares the day of the deposit— February 27, 2015. Abadin recommended that Glendale accept the shares for deposit.[192] This was the day after NUGN's share price closed at $5.00 per share for three consecutive days.

On March 10, 2015, JH deposited the other four stock certificates, totaling 1,088,632 NUGN shares. JH's principal submitted another signed DSRQ. In it, JH again indicated that it controlled 1,465,790 NUGN shares, and stated that it intended to deposit another 105,000 shares.[193] (JH did not deposit any more shares of NUGN after this date.[194])

With this final deposit, JH provided an attorney opinion letter dated March 6, 2015, which addressed only the 1,088,632 shares deposited on March 10. The attorney stated that JH's shares could be freely resold because NUGN's share price had reached a $200 million market capitalization level. The letter did not address whether the sellers of the BLMK shares to JH (MF and EF) were affiliates of NUGN.[195] Flesche checked that the attorney who wrote the opinion was not on a prohibited list. Flesche did not consider it a red flag that the two sellers had the same last name as the four persons who sold NUGN to RC because it was common in reverse mergers to have multiple sales of securities and it did not look to him like anyone was "acting in concert" with others.[196]

As it had for JH's first deposit of NUGN shares, the Firm completed a Broker Checklist for the March 10 deposits. Flesche and Laubenstein approved the deposits on March 11, 2015.

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[189] CX-18, at 2, 4, 6, 8.

[190] *See* CX-17, at 10-11. In their Answer, Respondents mistakenly cite February 29, 2015 (a non-existent date in 2015) as the date of JH's NUGN deposit. *See* Compl. ¶ 22; Amended Ans. ¶ 22.

[191] Compl. ¶ 22; Amended Ans. ¶ 22.

[192] Tr. 1797-99; CX-17, at 20-21.

[193] CX-18, at 20, 23.

[194] *See* CX-31.

[195] *See* Tr. 724-27; CX-18, at 39-40. JH's principal produced no opinion letter concerning the first deposit of 272,158 NUGN shares on February 27, 2015. *See* CX-17.

[196] Tr. 949-50.

As the broker on the account, Abadin indicated on the form his recommendation that Glendale should accept the deposits.[197]

Abadin testified that he understood that JH was subject to the Lock-Up Agreement because its terms were written on the certificates.[198] He also testified that even though JH's five NUGN stock certificates carried the same date, February 3, 2015, they reflected the terms of the Lock-Up Agreement referenced in JH's two December 18, 2014 stock purchase agreements with MF and EF.[199]

ii. JH Sells NUGN Shares

Like RC, customer JH engaged in no other securities transactions in its account at Glendale besides trading NUGN shares. JH did not immediately start liquidating NUGN shares after depositing its first tranche of shares and after the stock's price closed at $5.00 per share for three consecutive days ending February 26. Instead, JH waited more than a month, until April 7, 2015, before making its first sale of NUGN in its Glendale account. That day, it sold 560 shares of NUGN for net proceeds of $1,208.[200]

JH did not sell NUGN again for another two months. On June 9, 2015, it sold 80,000 shares for net proceeds of $349,203. (The next day, June 10, JH made its only purchase of NUGN in its Glendale account; it bought 52,000 shares of NUGN for $233,799.) JH effected no other transactions in NUGN in June 2015.[201]

JH next sold shares of NUGN on July 6, 2015. From that date until the end of July, JH sold 95,880 shares of NUGN.[202] In total, between early April and late July 2015, JH sold 247,950 shares of NUGN for proceeds of $812,989.[203] During this period, the Firm earned commissions of $18,427 from JH's transactions in NUGN.[204] From June to August 2015, JH wired $469,000 out of its Glendale account.[205]

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[197] CX-18, at 33-34.

[198] Tr. 713-14.

[199] Tr. 719-20, 722.

[200] CX-31, at 4.

[201] CX-31, at 8.

[202] CX-31, at 10-11.

[203] CX-1F; CX-31.

[204] CX-31, at 4-11.

[205] CX-31, at 8, 10, 12.

iii. The Source of JH's NUGN Shares

Enforcement alleges that the two persons—MF and EF—from whom JH purchased shares of BLMK/NUGN were affiliates of the issuer because they were the parents of NF, who was BLMK CEO DK's spouse.[206] Enforcement also alleges that MF and EF lived at the same address as NF when they sold their BLMK/NUGN shares to JH on December 18, 2014.[207] Enforcement therefore claims that all the shares that JH sold within six months of their purchase were restricted from resale.

As evidence that MF and EF resided with NF (and DK), Enforcement points to the address MF and EF provided on their respective BLMK stock purchase agreements with JH. NF provided the same address in connection with his sale to RC the same day.[208] Notwithstanding the common address provided on the stock purchase agreements, the Panel declines to find that MF and EF resided with NF and his wife at the time of their sales to JH. They may have provided a common address to facilitate the transactions or for some other logical reason.[209]

c. Customer SEI

A third corporate customer, SEI, deposited and sold a large number of shares of NUGN through Glendale. Enforcement does not allege that SEI was ever subject to the Lock-Up Agreement. SEI opened an account on February 23, 2015. It was formed in Nevada in 1995 and had an address in Las Vegas.[210] In its account application, SEI disclosed income of $200,000, an estimated net worth of $1 million, and $350,000 in liquid assets. Its primary investment objective was "speculation" and it claimed to have "extensive" general investment knowledge.[211]

Abadin was the registered representative for SEI's account. According to Abadin, SEI's principal found Glendale through an Internet search. Abadin did not previously know the principal who opened SEI's account.[212]

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[206] Tr. 1961; CX-34.

[207] Compl. ¶¶ 59-60, 67, 173.

[208] *See* Tr. 349-51, 947-48, 1950-51, 2022; CX-16, at 85, 87; CX-17, at 40-41, 53-54.

[209] Enforcement also relies on information in a LexisNexis report generated for EF. It provides a potential common address for MF and EF that is the same as an address for DK and NF in their LexisNexis reports. *See* Tr. 1949-52; CX-115, at 1-3. LexisNexis may be dependable for certain types of personal information, but the Panel in this instance declines to rely on information in LexisNexis for an element of a potential violation of Section 5 of the Securities Act.

[210] CX-39, at 4, 6, 26-30.

[211] CX-39, at 4-5.

[212] Tr. 728, 814-15.

On March 2, 2015, SEI deposited a certificate dated February 3, 2015, for 216,410 NUGN shares in its Glendale account.[213] Like RC and JH before it, SEI submitted a signed DSRQ to clear the shares for resale. SEI indicated on the DSRQ that it controlled no other NUGN shares than those shares it was depositing.[214]

SEI provided Glendale with copies of two stock purchase agreements dated December 15, 2014, showing that it had acquired BLMK shares from two sellers who had in turn acquired their shares in March 2014 through an S-1 offering by the issuer. The two stock purchase agreements did not refer to a Lock-Up Agreement, and Enforcement does not allege that SEI's shares were subject to a Lock-Up Agreement.[215] SEI bought 1,038 and 13,333 BLMK shares for $32 and $415, respectively, from the sellers, who appear to be husband and wife based on their common last name and address.[216] SEI paid the same price (just over $0.031 per share) that RC and JH paid the six persons who sold them BLMK shares.

Flesche and Laubenstein approved SEI's NUGN deposit on March 2, 2015. As he had for RC's and JH's deposits, Abadin indicated on the Broker Checklist that he recommended that Glendale accept SEI's NUGN shares for deposit.[217] Laubenstein did not ask anyone, including Abadin, how SEI had learned of Glendale.[218]

SEI sold NUGN during periods when RC and JH also sold the stock. SEI made its first sale of NUGN from its Glendale account on June 1, 2015. From June through the end of July 2015, SEI sold 125,140 shares of NUGN for proceeds of $459,467.[219] Glendale earned commissions of $8,987 from SEI's sales of NUGN.[220] On July 15, 2015, SEI wired $360,000 of the proceeds from NUGN sales out of the account.[221] SEI traded no other securities besides NUGN before mid-July 2015.[222]

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[213] CX-40, at 1, 9; CX-41 at 2.

[214] CX-40, at 6-9.

[215] CX-40, at 16, 25-54.

[216] CX-40, at 37-38, 53-54, 56. SEI paid the sellers with checks dated December 15, 2014, drawn on a bank account in its name. CX-40, at 38, 54. After the 15.04-to-1 split, the 14,371 BLMK shares converted to 216,140 NUGN shares.

[217] CX-40, at 19-20.

[218] Tr. 1921.

[219] Compl. ¶ 62; Amended Ans. ¶ 62; CX-1F.

[220] CX-41, at 8-11.

[221] CX-41, at 11.

[222] Tr. 731-32; CX-41. In mid-July 2015, while it was still selling NUGN, SEI purchased 62,400 shares of another security into its account. CX-41, at 10-11.

7. NUGN Deposits and Sales by Three Corporate Customers Did Not Raise Red Flags at Glendale

The total of more than 4.4 million shares of NUGN deposited by RC (2,899,878), JH (1,360,790), and SEI (216,140) constituted over 40 percent of NUGN's float of 11,144,640.[223] Abadin did not view the customers' sales of NUGN, which generated over $8.5 million in proceeds, or their wiring proceeds out, to be red flags because Glendale had already performed due diligence that led to decisions to approve the NUGN deposits.[224] The customers' deposits and sales of NUGN did not concern Abadin because Glendale had performed due diligence when it approved each of the deposits for resale.[225]

Abadin did not consider his three customers' sales of NUGN to be red flags. He testified that he saw NUGN press releases on his Bloomberg system as he was selling NUGN for his customers.[226] The company, Abadin said, had "marketing campaigns that were, you know, being released with news items and, so, the activity and the stock started to pick up as the awareness started to pick up about [what] the company … was doing."[227] Even though there was little trading in NUGN before RC started selling the stock, Abadin did not consider this a red flag because the company had just gone through a reverse merger, noting, "So it's got to start somewhere. It can't stay at zero forever. Or else it would never trade."[228] Abadin added, "It's not like it's trading … zero [shares] one day and 10 million [shares] the next, and there's nothing going on."[229] Abadin was not concerned that RC's sales volume often constituted a large percentage of the daily total trading volume in NUGN because NUGN "was just beginning to trade."[230] He compared the trading in NUGN to market interest in an initial public offering because NUGN was "now basically coming to the market."[231]

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[223] With the last NUGN deposit by one of the three customers (JH's March 10, 2015 deposit of 1,088,632 shares), the Firm calculated that as of March 11 all of its customers' combined holdings amounted to more than 34 percent of NUGN's float. This presumably was because RC had sold a portion of its shares by that date. CX-18, at 103.

[224] Tr. 755-56, 769-70.

[225] Tr. 776. In addition to RC, JH, and SEI (and before them, BS and ND), four other Glendale customers—three individuals (EW, TF, and JL) and a corporate account (BH)—also traded NUGN in market transactions. The other four customers did not deposit NUGN shares in their Glendale accounts. Between April and June 2015, the four customers transferred into their accounts or purchased a total of 4,900 NUGN shares and sold them all. The four customers' sales proceeds totaled less than $16,000. *See* CX-1F; CX-43, at 8, 14; CX-44, at 1, 5; CX-45, at 2, 5; CX-46, at 2-3. Abadin was the assigned broker on three of the four accounts. Tr. 410, 777-78.

[226] Tr. 756.

[227] Tr. 745.

[228] Tr. 746.

[229] Tr. 750.

[230] Tr. 752.

[231] Tr. 752.

No one at the Firm thought RC's and JH's purchases of $2 million in NUGN shares in May and June 2015 were suspicious even though they held approximately 750,000 shares[232] and 1.30 million[233] shares, respectively, in their accounts when they started purchasing shares. Abadin explained that RC's principal "believed in the company," and "hope[d] obviously the stock was going to go higher."[234] He did not believe that the trading pattern looked like RC's principal was trying to support NUGN's price.[235]

Laubenstein had no concerns either. The fact that the three customers deposited and sold NUGN at around the same time did not present a red flag to him because Abadin[236] had a history of "bringing in some big accounts for the firm."[237] As a result, Laubenstein testified, it "[d]idn't occur to [him]" to ask Abadin how it came to be that three new customers—RC, JH, and SEI—deposited large tranches of NUGN shares.[238] Laubenstein testified that he did not monitor how much money RC, JH, and SEI were making from their NUGN sales because "[t]hat just kind of wasn't part of [his] function."[239]

8. Laubenstein Reviews Trading in NUGN

On March 10, 2015, during the period that RC was selling NUGN, Castillo asked Laubenstein to review NUGN trading activity in the market. (This was also the day that customer JH deposited over 1 million shares of NUGN in its account. Castillo testified, however, that the deposit did not cause him to ask Laubenstein to conduct a review.) During its investigation, Enforcement asked Castillo about Laubenstein's review. Castillo explained that he believed

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[232] CX-29, at 7-8. Even during the period that RC was buying NUGN (May 28 to June 18, 2015), it sold over 500,000 shares from its Glendale account. *See* CX-29, at 10-11.

[233] CX-31, at 8. JH sold 80,000 shares of NUGN on June 9, 2015, one day before it made its only purchase of NUGN (52,000 shares).

[234] Tr. 766.

[235] Tr. 767.

[236] Abadin also traded NUGN in his personal account at Glendale. On March 27, 2015, he bought 14,000 shares of NUGN for $25,980 using his margin account. On June 4, 5, and 8, 2015, Abadin sold all of the shares for $57,458, resulting in a $31,478 profit. Tr. 779-80; CX-1F; CX-42, at 3, 9. Laubenstein testified that he was responsible for reviewing Glendale's employees' trading activity by reviewing their monthly account statements for "[a]ny anomalies or anything out of the ordinary." Tr. 1912. He did not find Abadin's trading in NUGN a concern, even though he made a market in the stock and his customers sold large quantities of it, because it was a "common practice for" Abadin to do so. Laubenstein knew that Abadin "often took positions in shares that he was making markets in." Tr. 1913. He would only check to see if Abadin was front-running, or trading ahead of, a customer's orders by going back to look at the trade blotter. Laubenstein could not recall if he did so in this case. Tr. 1912-13.

[237] Tr. 1921-22.

[238] Tr. 1922. There is no evidence in the record that Laubenstein documented any reviews of activity in NUGN. *See* Tr. 2417-18.

[239] Tr. 1924.

NUGN's price was "erratic"[240]— "it was very active and I didn't know what was causing it."[241] Castillo also testified during the investigation that he "personally never found anything" causing activity in the stock.[242]

At the hearing, Castillo said that he "just saw that there was a bunch of activity going on and it was the accounts. You know, [Abadin's] accounts .... not just internally, but outside of us. You know, where the stock was just all over the place."[243] Later in the hearing, he testified that the trading activity in Abadin's customers' accounts—including both the volume of shares they sold and the dollar amount of the proceeds—caused him to talk to Laubenstein.[244] Castillo and Laubenstein decided that Glendale should suspend customer trading in NUGN for one day—on March 11—while Laubenstein conducted his review.[245]

Laubenstein testified that Castillo had "noted that [NUGN's] price was going higher."[246] Laubenstein said that his "impression" was that NUGN had received an "influx of cash" and was marketing new products, which he determined explained the price and volume increases. He further explained that the activity "seemed pretty normal to me" and that it "was just normal market action."[247] Accordingly, he permitted the Firm to resume liquidating NUGN shares on behalf of its customers on March 12, 2015.[248]

Castillo understood from Laubenstein that he "was not able to locate anything that would have alerted [them] regarding any promotion at that point."[249] Therefore, according to Castillo, Laubenstein did not identify any suspicious activity surrounding NUGN.

9. Respondents Were Unaware of Promotional Activity in NUGN

Beginning in March 2015, RC sponsored a promotional campaign that touted NUGN's cosmetic products and urged investors to buy shares of the company. RC paid for a 28-page color brochure and mailer that claimed the price of NUGN—$1.27 on March 9, 2015—could

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[240] After trading at $5.00 per share on February 24–26, 2015, NUGN's share price fell to approximately $2.50 on March 4 and $1.50 on March 9 and 10, 2015. RX-111, at 19-20.

[241] Tr. 2330-31.

[242] Tr. 2332.

[243] Tr. 2383.

[244] Tr. 2398-99. Castillo did not talk to Abadin about RC's and JH's trading in NUGN because Laubenstein was conducting his AML review. Tr. 2405-06.

[245] Tr. 2280.

[246] Tr. 1882.

[247] Tr. 1882. Castillo testified that "there was nothing that [they] could pinpoint that was potentially a problem." *See* Tr. 2367.

[248] Tr. 1882; RX-111, at 19.

[249] Tr. 2280.

increase to over $25 per share by mid-2016.[250] The promoter who distributed the brochure predicted that "[b]ecause NuGene is new to the stock market, decisive action could be the key to unlocking short-term gains of 394% by September or a 887% gain by December [2015]."[251] A disclaimer at the end of the brochure disclosed that RC had paid $4.4 million "to marketing vendors to cover all the costs of creating and distributing this Advertisement, including printing and postage, in an effort to build investor and market awareness."[252] The disclaimer also stated that RC "fully intends to sell [its] shares without notice into this Advertisement/market awareness campaign, including selling into increased volume and share price that may result from this Advertisement/market awareness campaign."[253] There is no evidence that any Respondents saw the brochure during the period that RC sold its NUGN shares.[254]

Also, from early February to mid-July 2015, NUGN issued multiple press releases touting revenue growth, its products and research, industry developments, and other events tied to its business.[255] For example, on February 12, 2015, a press release claimed recent increases in product orders and the number of distribution locations.[256] On February 26, 2015, NUGN announced it had retained a company to handle investor relations and "strategic communications."[257] On March 3 and 5, 2015, respectively, NUGN announced the appointment of a dermatologist to its board of advisors and the launch of an advertising campaign featuring a well-known model.[258] There is no evidence that any Respondent saw the press announcements at or around the time that NUGN released them.

In March and June 2015, certain market observers reported on the Internet their suspicions about trading in NUGN and other activity that suggested to them that NUGN was being promoted despite its limited financial condition. On March 27, 2015, for example, a website called Hot Stocked published an article titled "NuGene … Pushed Up by a Handful of People."[259] On June 1, 2015, a website called Seeking Alpha published a short research report about the 28-page NUGN promotional mailer and pointed out that RC had paid for the promotion. The research report claimed "this large-scale promotion is strictly aimed at inflating

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[250] CX-32, at 3, 27.

[251] CX-32, at 3.

[252] CX-32, at 27.

[253] CX-32, at 27.

[254] Tr. 415-17.

[255] *See* RX-204 through RX-207 and RX-209 through RX-238.

[256] RX-227.

[257] RX-230.

[258] RX-231; RX-232.

[259] CX-114, at 1-3. Hot Stocked is a website that aggregates Internet promotions of stocks. *See* CX-55.

the shares of NUGN so that the 11 [million] shares owned by [RC] could be dumped onto unsuspecting and innocent investors."[260]

There was more Internet activity in June. On June 3 and 13, 2015, a website called Hot Penny Stocks published two articles titled "The Multy-Million [*sic*] Pump for [NUGN] Continues" and "The $2.2 Million Pump for [NUGN] Crashes."[261] The articles described NUGN's stock price increase as having "been influenced by the artificial hype of the promotion," noting that the "pump has been going on for quite a while" but was "coming to an end." These articles also announced that RC had paid for the promotional campaign.[262] There is no evidence that Respondents contemporaneously spotted the articles or posts on the Internet. Laubenstein testified that although he would search the Internet for stock promotion activity about an issuer when a customer deposited securities, he "wouldn't necessarily" look for promotional activity after the Firm had approved the stock deposit.[263]

As a result of the promotional activities and the increase in NUGN's trading volume and price, in early June 2015, the OTC Markets Group asked NUGN to issue a statement. In a press release on June 10, 2015, NUGN disclaimed responsibility for the promotional activities encouraging investors to buy its shares. NUGN stated that, to the company's knowledge, its management, directors, and controlling shareholders were not associated with the promotion and none of them had purchased or sold shares of NUGN in the past 30 days.[264] There is no evidence in the record that any of the Respondents saw the NUGN press announcement around the time of its release.[265]

NUGN's share price increased from $1.27 on March 9, 2015, to $4.31 on June 10, 2015. Afterwards, NUGN's price fluctuated generally between $1.50 and $3.50 until the end of August 2015.[266] During this period, RC's sales of NUGN shares constituted much of the trading volume in NUGN. On March 10, for example, it sold 95,618 NUGN shares, which was 97 percent of market volume; on March 16, it sold 50,900 NUGN shares, which was also 97 percent of the market volume that day.[267]

In September 2015, in the course of the investigation that led to the filing of the Complaint in this proceeding, FINRA informed Glendale that someone was promoting

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[260] Tr. 1971-72; CX-114, at 14-15.

[261] CX-114, at 19-25.

[262] CX-114, at 21, 24-25. According to Enforcement's investigator, he easily found the articles by searching the NUGN stock symbol on Google. Tr. 2215-16.

[263] Tr. 1801-02.

[264] CX-33.

[265] Tr. 414-15, 761-62, 2602-03.

[266] CX-15, at 12-14.

[267] Tr. 1164-66; CX-15, at 14; CX-29, at 3.

NUGN.[268] According to Castillo, this was when Respondents first heard of the promotions, specifically the mailed glossy brochure. Before learning of the promotional activity, no one at Glendale (aside from Castillo's discussions with Laubenstein on March 10) had brought any NUGN trading activity to Laubenstein's attention as potentially suspicious.[269]

C. Trading in Broke Out, Inc. (BRKO) at Glendale

Unrelated to trading in NUGN, ECM, a Malaysian national residing in Malaysia and a new customer of Huang's, deposited and immediately began liquidating shares of another low-priced security, BRKO, in early 2016. As stated above, cause three also charges all Respondents with AML-related misconduct associated with the deposit and sale of securities of BRKO.

1. Background of BRKO

BRKO was in the business of designing, manufacturing, and selling casual wear and gym fitness apparel. The company started as a sole proprietorship in December 2013. It was owned by a person who designed the company's products and website. The sole proprietorship made its first sales in early 2014.[270] According to an SEC Form S-1 registration statement dated April 24, 2015, BRKO was incorporated in Nevada in December 2014. Its wholly owned subsidiary, Broke Out, Ltd., was formed in the United Kingdom in August 2014.[271]

As of December 31, 2014, BRKO had $24,651 in assets and liabilities of $47,269, resulting in a working capital deficit of $22,618. In 2014, it had revenues of $30,714.[272] In 2015, BRKO had two employees who together devoted 30 hours per week to the company's business.[273] The Form S-1 contained a going concern statement about the viability of the company.[274] When customer ECM was liquidating BRKO, the company's common stock was quoted on the OTC Link (previously known as "Pink Sheets") operated by OTC Markets Group.[275]

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[268] Tr. 1803-04, 2282-83, 2505-06.

[269] Tr. 1806.

[270] CX-47, at 5.

[271] CX-47, at 1, 5, 29-30, 66. Under the prospectus, BRKO offered to sell a maximum of 50 million shares of new common stock at a fixed offering price of $0.004 to raise $200,000 to finance the development of additional product designs, the manufacture of additional inventory, and marketing of its products. CX-47, at 5, 21.

[272] CX-47, at 5-8.

[273] CX-47, at 33.

[274] CX-47, at 8.

[275] CX-50, at 2; CX-52, at 11.

2. Customer ECM Deposits 1.3 Million BRKO Shares

On December 2, 2015, Huang received an email from ECM saying he wanted to open an account. ECM said that a Malaysian friend who had recently become Huang's customer had recommended Huang. In his email, ECM told Huang that he wanted to deposit shares of BRKO.[276] Huang did not know ECM and did not know how ECM and his other customer knew each other.[277]

On December 11, 2015, Huang opened an account for ECM. Castillo reviewed the application and Laubenstein signed it as AMLCO.[278] ECM also completed and signed a five-page Glendale "Foreign Account Questionnaire."[279] As proof of identity and residence, ECM provided copies of his Malaysian passport and a utility bill.[280] Laubenstein testified that no one at Glendale authenticated ECM's passport.[281] On his new account documents, ECM represented that he had an annual income of $75,000, an estimated net worth of $1.5 million, and liquid assets of $250,000. He was employed as a production supervisor with a trading company. ECM's primary investment objective was "speculation" and he described his general investment knowledge as "good."[282] ECM stated on the Foreign Account Questionnaire that he intended to deposit BRKO shares. ECM also disclosed an account at CIMB Bank in Malaysia but noted that he would not be transferring money from the United States to a foreign country.[283] No one at Glendale, including Huang, ever met ECM in person.

At the same time that he opened his account, ECM deposited a certificate dated December 7, 2015, for 1,310,000 shares of BRKO.[284] The shares constituted 4.8 percent of the

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[276] Tr. 1403-06; CX-53, at 25-26. Castillo had begun making a market in BRKO by December 4, 2015. On that date, Castillo purchased 2,500 shares of BRKO at $0.50 per share for the Firm's inventory account from another Glendale customer who had deposited BRKO shares. Tr. 497-500, 507-08; CX-1I, at 1; CX-1J, at 1. The customer sold another 2,500 shares of BRKO at $0.50 per share on February 3, 2016, one day before ECM began selling his shares. CX-1I, at 1; CX-1J, at 1.

[277] Tr. 1404-05, 1443, 1731-32. ECM also stated on his new account forms that a friend referred him to Glendale. CX-51, at 19.

[278] Tr. 480-81, 1809-10; CX-51, at 13.

[279] CX-51, at 21-25. ECM also completed Internal Revenue Service Form W-8BEN ("Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding and Reporting (Individuals)"). CX-51, at 20.

[280] The Malaysian utility bill states that it is a "tax invoice," which Enforcement contended was misleading and therefore a red flag because it did not appear to be an actual tax invoice or tax statement. *See* Tr. 1409-13; CX-51, at 31. However, evidence at the hearing indicated that invoices for utility-related services in Malaysia are commonly called "tax invoices." *See* Tr. 2145-46.

[281] Tr. 1813.

[282] CX-51, at 4-5, 19.

[283] Tr. 1419-22; CX-51, at 5, 24. Laubenstein testified that he did not recall whether ECM stated that he would not be transferring money to or from a foreign country. Tr. 1817-18.

[284] CX-52.

27.2 million BRKO shares then outstanding and over 10 percent of the float of 12.2 million shares.[285] ECM submitted a signed DSRQ stating that he had acquired his shares from two individual sellers, both of whom resided in the United Kingdom, and the shares were registered pursuant to Form S-1. The SEC approved the registration on May 11, 2015.[286] According to two "Stock Purchase and Escrow Agreements," both dated November 30, 2015, ECM paid $5,000 for 1 million shares from one seller and $1,550 for 310,000 shares of BRKO from the other seller. When he made his deposit, ECM valued his shares at $200,000 even though he had paid only $6,550 for them just a few weeks earlier.[287] Laubenstein and Flesche did not think it was suspicious that ECM bought his BRKO shares from two persons in the United Kingdom or that an intermediary located in Colorado facilitated the transactions.[288]

ECM also produced a copy of the issuer's bank statement covering a three-month period in 2015 as evidence that the issuer had received payment for the shares issued to the persons who had sold the shares to ECM. Laubenstein, Flesche, and Huang did not find it unusual or suspicious that ECM had obtained a copy of the statement because, they said, it is common for an issuer to produce such a bank statement to assist new shareholders in connection with reverse merger transactions.[289]

The Firm completed the Broker Checklist for the deposit. Laubenstein conducted an AML review and approved the deposit after performing background checks, conducting Google, OFAC, and SEC filing searches, and confirming to himself that ECM was not an affiliate of BRKO.[290] On January 4, 2016, Flesche and Laubenstein approved ECM's deposit of BRKO shares.[291] Flesche assumed ECM understood English or that someone had explained the documents he submitted to Glendale.[292] According to Laubenstein, at the time of the deposit, he searched the Internet for promotions touting BRKO.[293]

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[285] CX-52, at 60.

[286] Tr. 509-10; CX-52, at 6-10. Pursuant to their subscription agreements with the issuer, the two sellers paid a total of $5,240 for the 1.31 million shares (1,310,000 shares x $0.004 per share = $5,240) in May 2015. *See* CX-52, at 43-50.

[287] CX-51, at 24; CX-52, at 22-40.

[288] Tr. 967-69, 1820-21; CX-52, at 22-42.

[289] Tr. 974-75, 1436, 1823-24; CX-52, at 51-52. The bank account statement excerpts covered the period April to June 2015. It showed the issuer received payment for the shares from the two sellers in May 2015. The printout was generated on July 13, 2015. CX-52, at 51-52.

[290] Tr. 1810-12, 1819; CX-52, at 16-17.

[291] Tr. 495, 965; CX-52, at 17-18.

[292] Tr. 965-66. Respondents presumed ECM understood English because his responses to account application documents were in English. *See* Amended Ans. ¶ 107.

[293] Tr. 977-78.

A few weeks after depositing the BRKO shares, ECM submitted a signed form prepared by Glendale, a two-page "Representation Letter for Registered Shareholders," dated January 1, 2016. On the form, ECM affirmed that he was not an affiliate of BRKO and "is not, has not been, and will not be acting in concert" with other persons in connection with his acquisition of BRKO stock or his intended sale of the stock.[294]

On January 20, 2016, Huang emailed ECM that he expected he could begin selling BRKO the next day.[295]

3. BRKO Engages in a Reverse Merger on January 27, 2016

On January 28, 2016, BRKO filed a Form 8-K reporting that the day before it had entered into a share exchange agreement—effectively a reverse merger—with an existing company located in Central America. As a result of the agreement, BRKO switched from the apparel business to developing applications and games for Google and Apple cell phone platforms. The new company was based in Berlin because it purchased the assets of a cell phone application developer in Germany.

According to the Form 8-K, the company into which BRKO merged reported gross revenues of 22,251 Euros and a net profit of 16,306 Euros for the nine-month period ended September 30, 2015. As of September 30, 2015, it had assets of 1,945 Euros and liabilities of 625 Euros.[296] After the agreement, BRKO was controlled by a person residing in Malaysia who also served as BRKO's Chief Executive Officer and a member of its board of directors.[297]

4. ECM Liquidates BRKO Shares (February and March 2016)

Beginning February 4—a week after the reverse merger announcement—and continuing until March 14, 2016, ECM sold 472,782 shares of BRKO at prices ranging from $1.37 to $3.42 per share, for total sales proceeds of $1,279,352. Glendale earned $38,438 in commissions from ECM's sales.[298] There was little trading volume in the stock before ECM began selling the shares he had deposited. Huang, who received ECM's orders to sell BRKO, noticed that ECM's trades constituted a high percentage of the daily trading volume in BRKO.[299] ECM did not deposit shares of any other security or trade any other security in his Glendale account.[300]

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[294] Tr. 2614-15; CX-52, at 20-21.

[295] CX-53, at 7.

[296] CX-48, at 15.

[297] CX-48, at 16-17, 26.

[298] CX-1J.

[299] Tr. 1459-61.

[300] Tr. 1424, 1456.

Flesche reviewed each of ECM's sales of BRKO.[301] On March 3, 11, and 16, 2016, ECM wired out $1,212,000 from his Glendale account to a bank in Singapore that was not the Malaysian bank that he had disclosed on his new account forms.[302] Huang did not consider this a red flag. At that time, no one at the Firm, including Laubenstein, verified who the Singapore bank account holder was or whether the two banks were affiliated.[303]

Laubenstein approved each of ECM's wire requests.[304] He testified that he did not notice that ECM was transferring money to a bank in Singapore that ECM had not identified in his new account documents. Laubenstein did not determine if there was a relationship between the two banks.[305] According to Laubenstein, the chief purpose of his review of wire requests was to ensure that a customer did not try to wire out more money than his account held.[306] He believed that Glendale's clearing firm had the sole responsibility for ensuring that customers did not improperly wire money to unauthorized third parties.[307]

5. BRKO Promotional Campaign Coincides with ECM's Sales of BRKO (March 2016)

By early March 2016, while ECM was still selling his BRKO shares, penny stock promoters made dubious claims about the company. The campaign included newsletters available on stock promotion websites and emailed by promoters. On March 8, 2016, for example, Hot Stocked displayed the contents of an email that it had received, which exclaimed "BRKO leaps up 145% with promise of much more gains to come!"[308] The promoter noted that the stock increased from $1.10 to $2.70 per share in one day and stated that he had "every reason to believe that BRKO will continue going up to 10 dollars this month."[309]

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[301] Tr. 964.

[302] Tr. 523-25, 1827; CX-58; CX-58A, at 6, 8-9, 11, 14, 16. Huang testified that he later learned that the Singapore bank was an affiliate of the Malaysian bank that ECM had disclosed on his new account forms. Tr. 1453, 1725-26.

[303] Tr. 1461-62, 2584.

[304] Tr. 1825-26.

[305] Tr. 1841-42.

[306] Tr. 1827-28. According to Huang, Laubenstein held up ECM's first wire transfer request dated March 3, 2016, for $147,000 until he determined that ECM's BRKO sales had cleared and he had sufficient funds in his account for the transfer. Tr. 1493-94; CX-58A, at 6.

[307] Tr. 1827-28.

[308] Tr. 1976; CX-55, at 2.

[309] CX-55, at 4 (emphasis in original).

ECM made his two biggest sales of BRKO on March 7 and 8, 2016, when he liquidated over 343,000 shares for over $918,000.[310] The proceeds from the two days of sales amounted to over 70 percent of the proceeds from all of ECM's sales of BRKO.

Laubenstein testified that on March 9 he learned—he did not recall how or from whom—of a campaign promoting BRKO. He then searched the Internet for evidence of the promotion.[311] After finding a promotion on the Internet distributed by Finest Penny Stocks, Laubenstein emailed it to Castillo, Flesche, and Huang "so people would see that this was a problem."[312] In his email, Laubenstein noted that the "best line" in the promotion was in a disclaimer warning readers that the promoter's references to names of its "'editor,' 'analyst,' 'copywriter' or any other title or name is purely fictitious and statements by such fictitious characters should not be relied upon."[313] The disclaimer also noted that a third party paid Finest Penny Stocks $110,000 to disseminate the report.[314]

More promotional material appeared on the Internet. On March 11, 2016, for example, Finest Penny Stocks said that BRKO's "potential is truly monstrous" and predicted the stock could go from $3 to $20.[315] On March 14, 2016, Finest Penny Stocks urged investors to "Hold on to BRKO a little longer!" because in a week it "will be trading at upwards of $5 and it will cost you much more to buy shares."[316]

The Hot Stocked website reported that during the month of March 2016 BRKO was one of the 20 most heavily promoted stocks on the Internet and that third parties had paid $315,000 to promote the stock through newsletters, email, and on websites.[317]

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[310] CX-1J, at 2. ECM sold BRKO at $2.54 and $3.00 per share, respectively, on March 7 and 8, 2016. During the preceding month, from the day he started selling BRKO on February 4 to March 6, ECM had sold fewer than 70,000 shares for proceeds of less than $161,000. CX-1J, at 1-2.

[311] Tr. 1828-30.

[312] Tr. 1831; CX-56.

[313] CX-56, at 1, 8.

[314] CX-56, at 8.

[315] Tr. 1977; CX-55, at 10-13. The promotion also disclosed that Finest Penny Stocks was paid $110,000 to distribute information touting BRKO. CX-55, at 15.

[316] CX-55, at 17.

[317] Tr. 1978-79; CX-55, at 19-20.

6. Glendale Sends ECM a Questionnaire about BRKO Promotional Activity

As a result of spotting the promotional activity on the Internet, Glendale wanted to find out if ECM had any role in the activity or knew anything about it. According to Flesche, the Firm asks this of customers "all the time."[318]

On March 9, 2016, the same day he saw the promotional activity about BRKO, Laubenstein instructed Huang to email ECM a customer questionnaire to complete and sign, called a "Stock Promotion Affidavit."[319] The questionnaire's introduction informed customers that "Stock promotion campaigns have become a target for regulators as a potential source of suspicious trading activity, specifically, 'pump and dump' schemes that lead to significant price and volume spikes of issues being promoted."[320] According to Laubenstein, Flesche came up with the idea of having customers sign a Stock Promotion Affidavit. The purpose, Laubenstein testified, was to determine whether a customer was involved in a promotion or had paid for it, even though he had never known of a Glendale customer admitting to participating in a stock promotion campaign.[321]

Huang sent the affidavit to ECM, who returned it the same day. ECM acknowledged that he did not answer all the questions, claiming he did not know what information the promotions contained because he had not seen them. Huang consulted with Laubenstein who told him to email ECM copies of the promotional material.[322] In one of his answers, ECM said that he was not aware of promotional activity about BRKO and he did not know the persons or entities sponsoring the campaign. ECM also wrote that he was "not related to any promotional activity. It was only on speaking to my broker [Huang] that I understand there is currently good activity [in] the stock and that I am able to sell part of my shares.... I am happy that this investment looks to be doing well."[323]

Flesche acknowledged at the hearing that Glendale could not verify ECM's representation that he had no connection to the promotional activity.[324] Huang forwarded ECM's signed affidavit to Laubenstein.[325] Laubenstein testified that Glendale did not "accept" ECM's

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[318] Tr. 982.

[319] Tr. 1465-66, 1470-71; CX-54. Although Glendale called the questionnaire an "Affidavit," it did not require that ECM swear or affirm that his answers and statements were truthful.

[320] CX-54, at 2.

[321] Tr. 1834-36.

[322] Tr. 1467-68, 1473-74; CX-54, at 1.

[323] CX-54, at 3.

[324] Tr. 991-92.

[325] According to Huang, ECM executed another copy of the affidavit after receiving copies of the BRKO promotional material. Huang forwarded the affidavit to Laubenstein. Tr. 1474-75. The second affidavit was not introduced into evidence at the hearing.

affidavit because it was not filled out completely and no Firm principal, including Laubenstein, signed off on it.[326]

On the same day that Huang sent ECM the Stock Promotion Affidavit, Huang also completed and signed an internal Glendale questionnaire called a "Promotion Checklist." According to Laubenstein and Castillo, the Firm uses this form when it identifies promotional activity touting a stock a customer is selling—in this case, the activity of Finest Penny Stocks.[327] One question asks if ECM's name was mentioned in the promotional materials; in this instance, it was not. Another question asks if ECM admitted participating in the stock promotion. Other questions asked if the promotional activity resulted in spikes in price and volume, to which Huang answered "Yes." Huang answered "No" to whether ECM appeared to have acted on the promotion. The Promotion Checklist also asks if a third party is financing the promotion, to which Huang answered "Yes."[328]

Finally, under a section in the Promotion Checklist providing for broker approval, Huang checked the box stating "This does not constitute an illegal 'pump and dump' scheme and should be accepted or permitted to trade." Huang did not check either of the other two options available—(i) the Firm should not accept the stock deposit or permit further trading, and (ii) make a referral to the AMLCO.[329] Because Huang determined that the activity did not constitute an illegal pump and dump, no principal signed off on the form.[330]

Laubenstein testified that he never saw an instance in which someone at Glendale checked the box on the Promotion Checklist recommending that a stock not be accepted for deposit or to halt further trading in the stock.[331] Huang testified that he thought Laubenstein would try to determine who ultimately was behind the promotions.[332] Huang further testified that he believed ECM gained no advantage from the promotional activity because he sold most of his BRKO shares before the promotion began.[333] BRKO's share price increased from $2.00 on March 4 to $14.77 per share on March 16, 2016. Daily trading volume in BRKO ranged from 5,200 shares to a high of 747,000 shares during this period.[334]

After March 9, 2016, the day Huang completed the Promotion Checklist and ECM submitted the signed Stock Promotion Affidavit, Glendale continued to sell BRKO on ECM's

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[326] Tr. 1840-43, 1884, 1901.

[327] Tr. 549-53, 1802; CX-57.

[328] CX-57.

[329] CX-57, at 2.

[330] Tr. 1839-41; CX-57, at 2.

[331] Tr. 1916-17.

[332] Tr. 1480-81.

[333] Tr. 1478.

[334] CX-60.

behalf. ECM sold 42,000 and 8,000 shares of BRKO on March 10 and 14, 2016, respectively, for proceeds of over $170,000.[335] According to Flesche, on or about March 14, the Firm decided that it would no longer accept orders from ECM.[336]

7. The SEC Suspends Trading in BRKO

On March 17, 2016, three days after ECM's last sale, the SEC announced the suspension of trading in BRKO until March 31, 2016, due to "concerns regarding the accuracy and adequacy of information in the marketplace and potentially manipulative transactions in BRKO's common stock."[337] Huang informed ECM about the trading suspension. At the time of the trading halt, ECM had sold 472,782 BRKO shares and therefore still held 837,218 shares of the 1,310,000 shares he had deposited in his Glendale account. On the day of the trading suspension announcement, ECM emailed Huang asking if he would be able to resume liquidating his BRKO shares once the suspension ended or whether he needed to find another broker-dealer to sell the shares.

Huang and ECM did not communicate with each other for two months. On May 23, 2016, Huang emailed ECM, stating that Glendale had determined that ECM needed to close his account and that he could transfer his assets to another broker-dealer. Huang and Glendale never heard from ECM again. ECM effectively abandoned the BRKO shares left in the account.[338]

D. Trading of Vitaxel Group Limited (VXEL) at Glendale

The Complaint charges that Glendale, Castillo, Flesche, Laubenstein and Huang failed to identify and investigate red flags associated with customers' deposits and sales of VXEL stock soon after a reverse merger and business change. They also allegedly failed to investigate the relationship between two persons who acted as intermediaries during the change of ownership and represented the new shareholders who opened accounts at Glendale and deposited VXEL shares. According to cause three, Flesche, Laubenstein, and Huang failed to ensure compliance with the Firm's customer identification program by failing to verify the identities of the customers who deposited VXEL stock.

1. Background of VXEL

Vitaxel Group Limited was previously called Albero Corp. ("Albero"). Albero was formed in Nevada in November 2013. Albero was a development-stage company based in

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[335] Tr. 990-91; CX-1I, at 5-7; CX-1J, at 3. During the period that ECM was selling his BRKO shares, Flesche was not reviewing volume concentration reports and therefore he was not aware what percentage of the trading volume ECM represented. Tr. 993.

[336] Tr. 2557.

[337] Tr. 1496-97; CX-50.

[338] Tr. 1502-04, 1512-14; CX-59. Huang testified that he did not find it unusual or suspicious that ECM left his BRKO shares in the account. Tr. 1514.

Northern Ireland, purportedly in the business of breeding horses.[339] As of early 2015, Albero had no operations and no revenues.[340] It had total assets of $5,254, and net losses of $6,046 for the three months ending January 31, 2015.[341]

Albero's president purportedly learned of Glendale from a Google search in early May 2015.[342] On May 28, 2015, Castillo and Flesche prepared and submitted a Form 211 application to FINRA for authority to begin entering quotations for Albero on the OTC Bulletin Board and OTC Links ATS. According to the Form 211 Glendale prepared, Albero's president bought his shares of Albero in October 2014 in a Regulation S offering, which is available only for offers and sales of U.S. securities made offshore. In materials supporting the Form 211 application, Albero's president gave an address in the United States and provided bank statements showing that he was located in the United States in October 2014.[343] Also according to the Form 211, in May 2015, Albero issued 825,000 common shares to 29 investors, all of whom were persons residing in Northern Ireland and who bought the shares through an SEC Form S-1 registration statement.[344]

Laubenstein reviewed the Form 211 application for Albero to determine whether the Firm should proceed with the filing. He looked at the issuer's SEC filings and whether there was Internet activity promoting Albero at the time of the Form 211 filing. Laubenstein did not review the issuer's financial statements.[345]

On July 27, 2015, FINRA cleared Glendale's request to quote the stock.[346] In December 2015, approximately 30 investors in Asia bought the common stock from the shareholders in Northern Ireland.

On January 8, 2016, Albero changed its name to Vitaxel Group Limited and increased its authorized stock from 75 million shares to 7 billion shares of common stock and 100 million shares of preferred stock. The company's ticker symbol changed to VXEL.[347] Flesche referred VXEL to Globex Transfer, LLC, to retain as its transfer agent. Flesche and Castillo each held a 40 percent ownership interest in Globex Transfer.[348]

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[339] CX-62, at 4-5.

[340] CX-61, at 157; CX-62, at 6-7.

[341] CX-62, at 5-7.

[342] Tr. 1071.

[343] CX-61, at 20, 41.

[344] CX-61, at 14, 20-23, 159.

[345] Tr. 1843-47.

[346] Tr. 574-76, 994; CX-61, at 7, 170; RX-17.

[347] CX-63, at 6.

[348] Tr. 1060, 1070-71, 2636; CX-4, at 10; CX-5, at 17; CX-66, at 85.

On January 18, 2016, VXEL entered into a share exchange agreement with two companies based in Malaysia. Under the agreement, the two companies became wholly owned subsidiaries of VXEL. According to a Form 8-K filed January 22, 2016, VXEL discontinued the horse breeding business and transferred all of its assets and liabilities to the pre-share exchange majority stock holder in return for the cancellation of Albero's sole officer and majority stockholders' 3 million shares of common stock. VXEL then acquired the businesses of the two Malaysian companies, which VXEL described as a "multi-level marketing model with an emphasis on travel, entertainment and lifestyle products and services."[349]

2. Customer KTO Deposits VXEL

On October 30, 2015—two months before the Albero-VXEL reverse merger—KTO submitted an application to open a securities account at Glendale. KTO supposedly was referred to Huang by another of Huang's customers whom Huang had assisted by arranging the filing of a Form 211 for two other issuers. Respondents indicated that KTO contacted Glendale because the Firm had filed the Albero Form 211.[350] The customer told Huang that KTO, through his Malaysia-based company, provided financial services for small cap companies.[351] KTO, who testified at the hearing via telephone, described his employer as a financial and marketing consultant that also assisted companies with initial public offerings and structuring mergers and acquisitions. In early 2015, VXEL retained KTO's employer for the purpose of acquiring Albero.[352] KTO later assisted certain of VXEL's shareholders with opening accounts at Glendale.[353] KTO also represented the 30 purchasers of Albero stock as part of the merger with VXEL.[354]

KTO was the first customer to open an account and deposit VXEL shares. According to KTO's testimony, one reason he opened an account at Glendale was to learn what was involved in establishing a securities account in the United States so that he could help other VXEL shareholders open their own accounts.[355]

On his account application, KTO said he had an annual income of $33,000, an estimated net worth of $200,000, and liquid assets of $50,000. His primary investment objective was

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[349] CX-63, at 8-9. Companies engaged in "multi-level marketing" sell products to the public, typically by word of mouth and through direct sales by their members. Individual distributors earn compensation or commissions, not only for their own sales, but also for sales made by the persons they recruit to sell the products to consumers. *See, e.g.*, https://www.consumer.ftc.gov/articles/0065-multilevel-marketing.

[350] Compl. ¶ 142; Amended Ans. ¶ 142.

[351] Tr. 1517-22, 1582-84.

[352] Tr. 2125-29.

[353] Tr. 1525-26.

[354] CX-66, at 43, 62; CX-67, at 43, 62, 81.

[355] Tr. 2143-44, 2147.

"preservation of capital," while "income" was his next stated objective.[356] KTO told Huang that he opened the account at Glendale for the purpose of depositing and then selling his Albero/VXEL shares.[357] KTO also submitted a Glendale Foreign Account Questionnaire, in which he acknowledged that he had known Glendale and Huang for less than a week.[358] He also submitted copies of his Malaysian passport and driver's license.[359]

Huang had translated portions of the application form by adding typewritten Chinese characters. He did not translate portions of the application form that contained certain disclosures. For example, he did not translate the four-page "Customer Agreement" or the two-page "Conflicts of Interest" disclosures portions of the application.[360] On November 4, 2015, Laubenstein reviewed KTO's account application and authorized the account opening.[361]

Two months later, on January 11, 2016, KTO deposited a certificate for 83,270 shares of VXEL. In connection with the deposit, KTO completed and signed a Client Checklist and a DSRQ.[362] On the DSRQ, KTO disclosed that he had purchased the VXEL shares on December 18, 2015—when the company was still known as Albero—from three persons who in turn had purchased their Albero shares in May 2015 from the issuer, which sold them via an S-1 registration statement. KTO submitted copies of three stock purchase agreements.[363]

The Firm calculated that at that time KTO's 83,270 shares of VXEL constituted slightly more than 10 percent of VXEL's float of 825,000 shares and more than two percent of the more than 3.8 million shares outstanding.[364] The Firm also conducted Google, OFAC, and SEC searches on the three sellers, the company's officers, and the company itself, and determined that there was nothing negative about them.[365] In connection with the stock deposit, KTO also submitted a Glendale "Representation Letter" acknowledging that he owned 2.18 percent of VXEL's outstanding stock and affirming that he was not an affiliate of the issuer, was not acting

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[356] CX-64, at 4-5.

[357] Tr. 1537-38.

[358] CX-64, at 20-24.

[359] CX-64, at 30-31.

[360] Tr. 1529, 1576-77; CX-64, at 3-15, 28-29.

[361] Tr. 1006, 1527; CX-64, at 13. Huang testified that he was not aware at the time that Glendale had filed a Form 211 on behalf of Albero. Tr. 1515.

[362] CX-66, at 4-5. The VXEL certificate was dated January 20, 2016. CX-66, at 1.

[363] CX-66, at 6-9, 24-79. KTO paid a total of $41,483 for the 83,270 shares of Albero/VXEL. *See* CX-66, at 37, 56, 75.

[364] Tr. 1540-42; CX-66, at 91.

[365] CX-66, at 16-17.

in concert with others in connection with selling or transferring the stock, and did not possess material, nonpublic information about VXEL.[366]

Huang signed the Broker Checklist and recommended that the Firm accept KTO's shares for deposit. On January 26 and 28, 2016, Laubenstein and Flesche approved KTO's deposit of the VXEL shares.[367] Flesche never spoke to KTO but assumed KTO spoke and understood English because he submitted Glendale's new account documents.[368]

3. Other Customers Deposit VXEL Shares

By early November 2015, Huang started receiving requests from new shareholders, all of whom lived in Asia, to open accounts and deposit their recently acquired Albero/VXEL shares. All of the new Asian shareholders were referred to Huang by KTO or his assistant, KSC. They submitted the new customers' account applications via email to Huang. KTO and KSC referred only customers who were VXEL shareholders. If Huang needed more information about a customer, he would ask KTO or KSC for it.[369] Huang described KTO and KSC as "buyers' representatives" and agents helping the shareholders open accounts and deposit their VXEL shares.

VXEL and the company for whom KTO worked shared the same office building address in Kuala Lumpur, although they were located on different floors. Although it was evident in KTO's stock purchase agreements, at the time Laubenstein did not see that KTO, who also deposited his own shares of VXEL into his Glendale account, also had represented the buyers, all of whom were located in Asia, who purchased their shares from sellers, all of whom were located in Northern Ireland.[370]

KTO had served as the representative for all the December 2015 purchasers of VXEL stock who later became Glendale customers.[371] The person who represented all of the sellers of VXEL stock was an existing Glendale customer. As reflected in the documents associated with Glendale's Form 211 filing, he had also invested in Albero in April 2015.[372] In approximately August 2015, the sellers' representative deposited Albero shares into his existing Glendale account. In May 2016, Laubenstein conducted an investigation, which focused on the sellers'

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[366] CX-66, at 21-22.

[367] Tr. 1007-08, 1857; CX-66, at 17-18.

[368] Tr. 1007-08.

[369] Tr. 1570, 1574.

[370] Tr. 1858-59.

[371] Tr. 1009-10, 1549-51. *See also* CX-67, at 24.

[372] CX-61, at 21, 90-92.

representative's deposit of Albero shares in 2015 and did not address any trading in Albero/VXEL after December 18, 2015.[373]

KTO and KSC sent new account applications and share deposit documentation to Huang on behalf of the 29 shareholders (aside from KTO), which Glendale accepted. The customers lived in Malaysia, Singapore, or China.[374] At the time, the Firm did not have powers of attorney or other authorizations from the customers consenting to KTO and KSC acting on their behalf.[375] The VXEL customers provided copies of passports, drivers licenses, utility or telephone bills, and in some cases bank statements in connection with their account applications.[376]

Laubenstein reviewed and approved the account applications of the customers who intended to deposit VXEL shares they had recently acquired. Laubenstein knew that some of the customers were referred by one person—KTO—but Laubenstein did not review his background for AML-related purposes.[377] Laubenstein never talked to any of the VXEL customers and testified that he did not know if Huang or anyone else at Glendale ever spoke to any of them.[378] Laubenstein assumed that all the customers knew English, the language used in the documents, because they resided in Malaysia, and he understood that English is used for business purposes there.[379]

KTO testified that he did not know any of the VXEL shareholders before they acquired VXEL securities. He met some of them in person for the first time when they came to his office in connection with opening their accounts at Glendale.[380] KTO spoke "mainly" Chinese or Malay with the customers, and in some cases English, but he "[didn't] really test if they [knew] English or not."[381] KTO did not know how many of the customers could read English.[382]

To assist its shareholders, VXEL circulated Huang's contact information so that holders of VXEL stock could open an account and then deposit and sell the shares through Glendale.[383] Huang testified that he did not give VXEL permission to circulate his contact information and

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[373] RX-402; RX-403; Hearing Panel Exhibit 1 ("HPX-1"). The parties together prepared HPX-1 at the direction of the Hearing Panel. Tr. 2553.

[374] Amended Ans. ¶ 188.

[375] Tr. 1625-29.

[376] Amended Ans. ¶ 188.

[377] Tr. 1845-46.

[378] Tr. 1848.

[379] Tr. 1848-49.

[380] Tr. 2161-62.

[381] Tr. 2148-49.

[382] Tr. 2164.

[383] Tr. 1560-62; CX-68, at 6-7.

that he asked KTO to have VXEL stop providing his information to shareholders. He assumed that KTO or his assistant, KSC, asked VXEL to stop giving the information to shareholders.[384]

Some months after customers opened accounts at Glendale, Laubenstein had Huang arrange for the customers to execute powers of attorney giving KTO and KSC authority to act on their behalf. Huang sent the powers of attorney to KTO and KSC for the customers to execute. To ensure that the customers—and not someone else—signed the documents, Huang testified that he compared the customers' signatures on the powers of attorney with signatures on other documents he had on file.[385]

Huang spoke to "a few" of the 29 customers[386] but, he testified, he emailed all of them directly their new account numbers and wire instructions for them to use to fund the accounts to cover stock deposit fees imposed by clearing firms. Some of the customers responded to his emails in either English or Chinese. Huang sent the VXEL customers account applications that contained Chinese language translations of portions of the documents because it would "help a little bit more for them to understand[]."[387]

Laubenstein was responsible for reviewing Huang's email communications. He used keyword searches of a sample of emails drawn from Huang's account. However, during the relevant period, the Firm did not have the direct ability to perform searches of Huang's emails using Chinese characters.[388] Occasionally, Laubenstein would translate an email into English himself using Google's translate function.[389]

Even though Flesche and Laubenstein did not determine if the translations were accurate, Glendale approved Huang's use of his Chinese language additions to the account applications.[390] According to Flesche, the Firm believed that it was entitled to assume that a customer understood what he was signing and therefore there was no need to translate the entire application. Flesche assumed that Huang was going over the applications directly with his customers.[391]

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[384] Tr. 1561-65. Huang did not tell anyone at Glendale that Vitaxel was circulating his contact information to its shareholders. Tr. 1719-20.

[385] Tr. 1723-24, 1730-34; RX-325. All but two of the customers' powers of attorney were dated May 18, 2016. Two were dated July 21, 2016. RX-325.

[386] Tr. 1575-76.

[387] Tr. 1575-81, 1626-27, 1630-32, 1644-45.

[388] After FINRA pointed out this potential deficiency, and after the relevant period, Glendale began searching all of Huang's emails using a tool able to read Chinese characters. Tr. 1851-52.

[389] Tr. 1072, 1852-53.

[390] Tr. 1720-21, 1849-50.

[391] Tr. 2610-11.

4. KTO and Other Customers Sell VXEL Shares

The 30 customers (including KTO) deposited more than 63 million shares of VXEL in February and March 2016.[392] Of the 30 customers who opened accounts with Huang, three sold VXEL shares. KTO sold a portion of his VXEL shares[393] by early April 2016 for total proceeds of nearly $39,000.[394] During the same period, two other customers sold 70,000 shares of VXEL for proceeds of $1,685.[395] Glendale earned commissions of $1,343 from the three customers' sales of VXEL.[396]

5. Huang Used Text Messages to Communicate with KTO and KSC in Malaysia

The Complaint charges Huang with using a texting application on his cell phone to communicate with KTO and KSC about securities-related matters. Below we discuss Huang's texts with KTO and KSC, which escaped Glendale's review.

Huang used WeChat, a cell phone application that has a text-like messaging feature, to communicate with KTO and KSC while they represented the Asia-based customers who owned VXEL. FINRA staff discovered Huang's use of WeChat during an unannounced on-site examination of Glendale's New York office in mid-March 2016. The staff asked Huang how he communicated with customers—specifically whether he used the WeChat texting application. Huang admitted to them that he did. Huang showed the staff his WeChat texts he exchanged with KTO and KSC on his cell phone. The staff then took screen shots of all of Huang's texts with KTO and KSC.[397] Huang deleted the WeChat app from his cell phone during the on-site examination so that he would not receive any new texts from KTO and KSC.[398]

According to Huang, WeChat is a popular texting service in Asia.[399] Huang explained that he used the texting service, instead of Firm email, because of the 12-hour time difference between New York and Malaysia. He testified that he could not easily check his Firm email after

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[392] CX-1L.

[393] Although the record is not clear, it appears that by late February 2016 there was a stock split in VXEL, which increased the number of shares KTO had deposited (83,270) a month earlier. VXEL's share price also declined from more than $15 per share in early February to $0.02 and $0.03 per share in late February. *See* CX-1K, at 1; CX-73A, at 41-42.

[394] CX-1K.

[395] CX-1K, at 1, 3.

[396] CX-1K.

[397] Tr. 1992-94; CX-72.

[398] Tr. 1607, 1614-19.

[399] Tr. 1585-86.

work hours, whereas KTO's and KSC's WeChat texts would appear instantly on his cell phone allowing him to respond quickly.[400]

Huang used WeChat with KTO and KSC for about one month—from mid-February to mid-March 2016, when FINRA staff first learned he used the service during their unannounced on-site examination.[401] On WeChat, Huang discussed securities-related matters with KTO and KSC. Huang exchanged about 150 texts, mostly with KSC. The texts with KTO primarily involved KTO's orders to sell his shares of VXEL that he had deposited in his Glendale account, VXEL's share price, and whether KTO could use his Glendale account to buy and sell securities in addition to VXEL.[402]

In response to an email KTO had just sent apparently requesting that Huang execute a VXEL sale at a certain price, Huang texted KTO to "Pls never ever mention what [VXEL] price you want to see." Huang also emailed KTO that "the price is determined by the market, demand and supply."[403] Huang followed up with a text to KTO on WeChat: "You can not [*sic*] send me the email like [the] last one. The [VXEL] price is determined by market."[404]

Huang understood that the Firm's procedures did not permit him to use text messages. In February 2014 and March 2015, Huang signed annual compliance questionnaires acknowledging that he could "use only firm-approved electronic communications systems for communicating with customers."[405] The Firm did not know that Huang had been using WeChat.[406] Although Huang's WeChat texts with KTO and KSC involved securities matters and Glendale's customers, the Firm had no way of reviewing or retaining the text messages, and Huang did not preserve them for the Firm.[407]

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[400] Tr. 1588-90. In a February 26, 2016 email, Huang invited KTO to text him on his cell phone or via WhatsApp, in addition to using WeChat. CX-73A, at 46.

[401] Tr. 1588-90; CX-72.

[402] Tr. 1590-93, 1607; CX-72, at 87-89.

[403] CX-74, at 1.

[404] Tr. 1596-97, 1995-98; CX-72, at 93.

[405] Tr. 1589; RX-318, at 34, 36, 40, 42.

[406] Tr. 1032. Huang called Flesche soon after FINRA staff left his office. Flesche asked to see the WeChat texts. Because he had deleted the app while FINRA staff were in his office, Huang was not able to show them to Flesche. FINRA staff took screen shots of all the texts, copies of which were entered into evidence. Tr. 1619-20; CX-72. In June 2016, Glendale issued Huang a Letter of Caution about his unauthorized use of WeChat. Tr. 2568; RX-58.

[407] Tr. 1032-34, 1612-20, 1872-74.

1. Huang Shares Personal Information about VXEL Customers with Third Parties

The Complaint charges Huang with improperly sharing his VXEL customers' nonpublic personal information with third parties without the customers' consent. Below we discuss the nonpublic information Huang shared with third parties.

Huang began exchanging emails in November 2015 with KTO and KSC about the customers they intended to refer to him to open accounts and deposit VXEL shares. Most of their communications dealt with the logistical and administrative issues surrounding the opening of customer accounts and the VXEL deposits.

The weight of the evidence at the hearing showed that customers provided KTO and KSC with certain personal information to complete their account applications. This information included, for example, a customer's income, net worth, and liquid net worth.[408] The customers also provided KTO and KSC with copies of passports, utility bills, and other identifying documents, which KTO and KSC in turn produced to Huang during the application process.[409] In some instances, customers failed to produce copies of their VXEL share purchase agreements and proof of payment for the shares they deposited, causing Huang to follow up with KTO and KSC.[410] Huang also gave KTO and KSC Glendale's wire instructions to pass on to customers to cover the clearing firm's charges for processing share deposits.[411] In one instance, Huang asked KTO and KSC to clarify the total net worth and liquid net worth amounts a customer had provided in the account application that KTO and KSC had forwarded to Huang.[412] In yet another instance, Huang asked KTO and KSC to clarify the addresses two customers had provided on their account applications.[413]

On at least three occasions, Huang provided KTO and KSC the new customers' account numbers. On January 20, 2016, Huang emailed KSC account numbers belonging to 29 customers.[414] On January 27, 2016, Huang emailed KSC one new customer's account number.[415] On February 22, 2016, he forwarded to KSC the account numbers of three more new customers.[416] At the hearing, Huang testified that he "assumed" the customers had already

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[408] *See* CX-73; CX-73A.

[409] *See, e.g.*, CX-73A, at 3-5.

[410] *See, e.g.*, CX-73, at 1-3, 11.

[411] CX-73, at 16-17; CX-73A, at 17-18.

[412] CX-73, at 18-19.

[413] CX-73A, at 9.

[414] CX-73, at 5-7. Four days later, on January 24, Huang sent another email to KSC with account numbers belonging to two of the customers whose account numbers he had already disclosed. CX-73, at 4.

[415] CX-73A, at 27.

[416] CX-73A, at 32.

separately provided KTO and KSC with their account numbers.[417] Aside from Huang's testimony, there is no evidence in the record that KTO and KSC already had the customers' account numbers.

In some emails, Huang also copied persons not directly affiliated with KTO or KSC or their employer. According to Huang, he sometimes included these other persons on his emails to KTO and KSC because KTO or KSC had included the persons in their initial emails to Huang. Huang would therefore reply to all persons in the original email.[418] Some emails did not refer to any specific customer. Others did, however. On January 12, 2016, for example, Huang sent an email about three customers' share purchase agreements to KSC and three other persons: a person who worked for KTO's employer, a person associated with VXEL, and a person whom Huang did not know. None of these other persons had acted on behalf of Huang's customers before.

On January 26 and 27, 2016, Huang emailed KSC information about the number of VXEL shares a customer had purchased, together with a copy of the customer's share purchase agreement, two stock certificates, and proof the customer had paid for the shares. Huang copied the person who introduced KTO to Huang and Glendale in his email to KSC.[419]

E. Correspondent Accounts Associated with Belize Bank

Enforcement also charges Glendale and Laubenstein with AML violations relating to accounts the Firm opened in 2007 on behalf of Belize Bank. The activity surrounding the bank and its customers pre-dates and is not connected to trading in NUGN, BRKO, and VXEL at Glendale in 2015 and 2016.

In 2007, Glendale acquired customer accounts from another broker-dealer that had gone out of business. The accounts were introduced by Belize Bank. Castillo and Flesche flew to Belize to meet the bank's management. After meeting with bank representatives, Glendale agreed to open accounts for the bank and its customers. As part of their arrangement, Glendale also agreed to share with Belize Bank a portion of the commissions and fees it generated from transactions on behalf of the customers Belize Bank referred.[420]

Belize Bank opened approximately 33 accounts at Glendale beginning in 2007. The identities of the beneficial owners of 18 of the accounts were never disclosed to Glendale.[421] The bank assigned a four-digit number to the 18 accounts (that was different from a securities account number assigned to the customer by Glendale or its clearing firm). At the hearing, only

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[417] Tr. 1707-08.

[418] Tr. 1622-23. *See also, e.g.*, CX-73, at 1-3; CX-73A, at 1-9, 29-30, 37, 41-43.

[419] CX-73, at 10-17; CX-73A, at 28-29.

[420] CX-77, at 9.

[421] Tr. 445, 462-65, 1861-62, 2577; CX-79.

one Glendale customer account application for one of the undisclosed accounts was admitted into evidence, and that application was signed only by a Belize Bank representative, not the customer.[422] Laubenstein testified that the accounts associated with the bank held positions in listed stocks and did not trade speculative penny stocks.[423] According to Castillo, the customers did little trading in the U.S. securities markets.[424]

The bank told Glendale that it would follow AML rules and procedures applicable in its own country. According to Castillo, the bank had also agreed that it would provide information identifying its customers should Glendale want it. As a result, Castillo testified, Glendale "felt comfortable enough" that the bank would provide such information if needed.[425]

There is no evidence in the record that Glendale ever asked for information about the undisclosed customers or that the bank on its own provided such information. Laubenstein, who joined Glendale in early 2010, three years after the accounts were opened, testified that he never asked the bank for the names of the beneficial owners of the accounts.[426] He believed that Glendale was "entitled to regard [the bank] as our customer" (and not the individual customers) because it had provided Glendale a copy of its AML procedures and had demonstrated that it was not a shell.[427] Laubenstein testified that he did not perform any due diligence or review the bank's AML procedures because, he said, he believed that it had been done before he joined Glendale in early 2010.[428]

In 2010, the SEC conducted an examination of the Firm during which it questioned Glendale's relationship with Belize Bank and its customers. It preliminarily determined that Glendale had unreasonably relied on Belize Bank to comply with Glendale's customer identification obligations.[429] As a result of the SEC's examination, in December 2010, Flesche wrote to Belize Bank explaining that Glendale could not rely on the bank's AML program as a substitute for Glendale's knowing the identities of the bank's customers. Flesche offered the bank three options: (i) identify the beneficial owners, (ii) arrange for individual owners to open accounts directly with Glendale, or (iii) close the customers' accounts and return the assets.[430]

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[422] Tr. 439-40, 445. *See* CX-77, at 12-13.

[423] Tr. 1888-89.

[424] Tr. 434-36, 442-43; CX-77. Flesche testified that the customers engaged in little trading activity. Tr. 2572. No party presented documentary evidence about the nature or volume of any of the bank customers' trading activity at Glendale.

[425] Tr. 440, 449.

[426] Tr. 1864.

[427] Tr. 1862.

[428] Tr. 1863-64.

[429] CX-78, at 2.

[430] Tr. 1865-67; CX-78, at 2.

Glendale closed and liquidated the accounts of customers who did not provide identifying information or complete account applications.[431] In early 2012, Laubenstein wrote the bank that Glendale decided it would not open new accounts for the bank's customers in their own names.[432] The remaining Belize Bank customer accounts were closed by 2012.[433]

III. Conclusions of Law

A. Enforcement Failed to Prove that Glendale and Castillo Manipulated NUGN (Cause One)

In cause one, Enforcement charges Glendale, acting through Castillo, with violating Section 10(b) of the Exchange Act, Exchange Act Rule 10b-5 thereunder, and FINRA Rules 2020 and 2010 by manipulating the price of NUGN. The Complaint charges that Castillo placed orders to buy and sell shares of NUGN to inflate its stock price, with the goal of causing the price to close at $5.00 per share for three consecutive trading days, thereby releasing customers RC and JH from the Lock-Up Agreement.[434] This allowed the two customers to sell over $8 million of NUGN shares during a stock promotion campaign funded by RC.

After a thorough review of the record, the Panel determines that there is insufficient evidence that Glendale and Castillo had the requisite scienter, or intent, to manipulate NUGN. The Panel accordingly dismisses cause one.[435]

1. Applicable Law

Section 10(b) of the Exchange Act makes it "unlawful for any person .... [t]o use or employ, in connection with the purchase or sale of any security ..., any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." Exchange Act Rule 10b-5 makes it unlawful, in connection with the purchase or sale of a security, "(a) to employ any device, scheme, or artifice to defraud, ... or (c) to engage in

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[431] Tr. 450-55, 466-67.

[432] Tr. 2576-78; CX-80, at 1.

[433] Tr. 470-71.

[434] *See* Compl. ¶ 161. The Complaint alleges that "Castillo knew, or was reckless in not knowing, that [customer ND's] good until canceled order to sell NUGN at $5.00 was intended to inflate NUGN's price to achieve a level of market capitalization that would nullify the Lock-Up Agreement for [RC and JH]." Compl. ¶ 168.

[435] Enforcement has the burden of proof in FINRA disciplinary actions. Enforcement meets this burden only if it establishes the violation by a preponderance of the evidence. *See Dep't of Enforcement v. Clagett*, No. 2005000631501, 2007 FINRA Discip. LEXIS 2, at *25 (NAC Sept. 28, 2007). The preponderance of evidence standard of proof requires that Enforcement "prove that it [was] more likely than not" that the allegations of the complaint were true. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 390 (1983) (explaining the requirements to meet a preponderance of the evidence standard of proof).

any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person."

Market manipulation is a well-established violation of Section 10(b) of the Exchange Act and Rule 10b-5. The United States Supreme Court has explained that the Exchange Act "was designed to protect investors against the manipulation of stock prices."[436] Manipulation includes practices such as wash sales, cross-trades, matched orders, or rigged prices "that are intended to mislead investors by artificially affecting market activity."[437] "Circumstantial evidence is sufficient to demonstrate a manipulation,"[438] but "a finding of manipulation does not hinge on the presence or absence of any particular device usually associated with a manipulative scheme. Rather, each case must be judged on its own facts."[439] The SEC has described market manipulation as "the creation of deceptive value or market activity for a security, accomplished by an intentional interference with the free forces of supply and demand."[440] The SEC has also explained that when "investors and prospective investors see activity, they are entitled to assume that it is real activity … [and] … that the prices they pay and receive are determined by the unimpeded interaction of real supply and real demand so that those prices are the collective marketplace judgments that they purport to be."[441]

To establish that Castillo violated these provisions, Enforcement must prove by a preponderance of the evidence that, in connection with the purchase or sale of a security,[442] he acted with scienter by engaging in "intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities."[443] In the context of the SEC's antifraud rules, scienter means the "intent to deceive, manipulate, or defraud."[444] "Proof

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[436] *Basic v. Levinson*, 485 U.S. 224, 230 (1988).

[437] *Sante Fe Indus. v. Green*, 430 U.S. 462, 476 (1977).

[438] *Dep't of Enforcement v. Kirlin Sec., Inc.*, No. EAF0400300001, 2009 FINRA Discip. LEXIS 2, at *41 (NAC Feb. 25, 2009) (citing *Pagel, Inc.*, 48 S.E.C. 223, 226 (1985)), *modified*, Exchange Act Release No. 61135, 2009 SEC LEXIS 4168 (Dec. 10, 2009).

[439] *Id.* at *40 (quoting *Patten Sec. Corp.*, 51 S.E.C. 568, 574 (1993)).

[440] *Kirlin Sec., Inc.*, 2009 SEC LEXIS 4168, at *41-42 & n.57 (citing *Swartwood, Hesse, Inc.*, 50 S.E.C. 1301, 1307 (1992) (finding respondent violated Section 10(b) of the Exchange Act and Rule 10b-5 by manipulating the price of a stock that was not dictated by supply and demand)).

[441] *In re Edward J. Mawod & Co.*, 46 S.E.C. 865, 871-72 (1977), *aff'd*, 591 F.2d 588 (10th Cir. 1979).

[442] Enforcement met the "in connection with" element under the federal securities law because Castillo placed ND's trades in NUGN and entered quotations to purchase and sell the securities. Violations of Section 10(b) of the Exchange Act and Rule 10b-5 must also involve the use or the means or instrumentalities of interstate commerce, or the mails, or any facility of any national security exchange. Enforcement satisfied this element because Glendale and Castillo used mail, email, and telephone to communicate with ND and other customers and to place quotations in NUGN in Glendale's capacity as a market maker. *See Dep't of Enforcement v. Casas*, No. 2013036799501, 2017 FINRA Discip. LEXIS 1, at *29 (NAC Jan. 13, 2017).

[443] *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 (1976).

[444] *Id.* at 193.

of scienter need not be direct, but may be a matter of inference from circumstantial evidence."[445] Scienter also connotes knowing or intentional conduct, but it may also be established through a showing of reckless conduct. Conduct is reckless if it is "highly unreasonable" and represents "an extreme departure from the standards of ordinary care."[446] Scienter is not established if the conduct involves "merely simple, or even inexcusable negligence"[447] or "gross negligence."[448]

Enforcement also charges that Glendale, acting through Castillo, violated FINRA Rules 2020 and 2010. Using language similar to Section 10(b) of the Exchange Act, Rule 2020 states that "[n]o member shall effect any transaction in, or induce the purchase or sale of, any security by means of any manipulative, deceptive or other fraudulent device or contrivance." Rule 2010 requires a member to "observe high standards of commercial honor and just and equitable principles of trade." "Committing fraud and other violations of law and FINRA rules is inconsistent with the high standards of ethical conduct required by Rule 2010."[449] A violation of Section 10(b) of the Exchange Act is sufficient to establish violations of FINRA Rules 2020 and 2010.[450]

The issue for the Panel is whether Castillo acted with manipulative intent. In other words, the Panel must determine whether Castillo executed trades in NUGN on behalf of customer ND on February 24–26, 2015, to benefit customers RC and JH, when he knew, or was reckless in not knowing, that they were for a manipulative purpose.

2. The Parties' Arguments

As is the case in many securities enforcement actions, Enforcement bases its case on circumstantial evidence, all of which, it argues, establishes that Castillo acted intentionally. Enforcement states that a factfinder "should infer from the pattern of trading activity in BLMK/NUGN, which made no economic sense, that Glendale and Castillo intentionally manipulated the price of NUGN stock or, at a minimum, were reckless."[451]

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[445] *Wechsler v. Steinberg*, 733 F.2d 1054, 1058 (2d Cir. 1984).

[446] *See SEC v. McNulty*, 137 F.3d 732, 741 (2d. Cir. 1998) (scienter "may be established through a showing of reckless disregard for the truth") (citing *Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38, 46 (2d Cir. 1978), *cert. denied*, 439 U.S. 1039 (1978)), *cert. denied*, 525 U.S. 931 (1998).

[447] *Dep't of Enforcement v. Luo*, No. 2011026346206, 2017 FINRA Discip. LEXIS 4, at *25 (NAC Jan. 13, 2017) (quoting *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977)).

[448] *Dep't of Enforcement v. Reynolds*, No. CAF990018, 2001 NASD Discip. LEXIS 17, at *45 n.28 (NAC June 25, 2001) (citing *Bd. of Cnty. Comm'rs v. Liberty Grp.*, 965 F.2d 879, 883-84 (10th Cir. 1992)).

[449] *Casas*, 2017 FINRA Discip. LEXIS 1, at *25 n.14.

[450] *William Scholander*, Exchange Act Release No. 77492, 2016 SEC LEXIS 1209, at *14-15 (Mar. 31, 2016), *petition for review denied sub nom. Harris v. SEC*, 712 F. App'x 46 (2d. Cir. 2017).

[451] Department of Enforcement's Post-Hearing Brief ("Enforcement's Post-Hearing Br.") 55.

Enforcement argues that many persons played a part in the manipulation of NUGN—in particular, BS, ND, RC (which paid for a promotion campaign), and persons connected to the issuer, and Wilson-Davis, which made a market in NUGN and represented the buy side of NUGN transactions on February 24, 2015.[452] However, as noted above, evidence is lacking that Castillo or other Respondents knew about the purported connections of the other persons to NUGN.

As an initial matter, the Complaint bases Castillo's scienter on his knowing that RC and JH owned NUGN shares when he handled ND's orders and that RC and JH were subject to the terms of the Lock-Up Agreement. Enforcement also argues it is not credible that Castillo did not know about the existence of a Lock-Up Agreement, as he testified at the hearing, because it was referenced in NUGN's filings, which he would have looked at as a market maker in the stock.[453] According to Enforcement, "[i]t defies credibility to assert that Castillo and Glendale did not learn about [RC's] intention to deposit NUGN securities in conversations with [RC's principal] while onboarding [RC's] account and fulfilling the Firm's [know your customer] obligations."[454] At the hearing, Castillo acknowledged looking at an NUGN SEC filing in January 2015 but he denied knowing that RC and JH owned and deposited NUGN shares until later, when he saw RC's trading, at which point he went to Laubenstein to ask him to investigate.

To prove Castillo's scienter, Enforcement starts with Castillo's first trade in BLMK/NUGN. It characterizes Castillo's purchase of BLMK shares from BS in early January 2015 as "suspicious," in part, because BS had been labeled a high-risk customer who had engaged in prior suspicious microcap activity and because Castillo paid a price ($0.13 per share) higher than historic quotation activity in the stock. The stock had never traded before, demonstrating that no one had any interest in owning it, according to Enforcement.[455] Implicit in Enforcement's argument is that by buying BLMK/NUGN from BS, Castillo initiated trading in an obscure stock with no prospects and acquired shares that he could later trade in his capacity as a market maker to help bid up the price.

Enforcement points out that BS also engaged in no other trades in BLMK/NUGN and later transferred his remaining NUGN shares to an account at Wilson-Davis. It also argues that BS was an "architect" of the manipulation scheme from its inception because he had a hand in the BLMK Form 211 application at another broker-dealer in early 2014.[456] Enforcement does not, however, provide evidence that Castillo, or other Respondents, knew that BS may have had

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[452] Enforcement's Post-Hearing Br. 51; Department of Enforcement's Reply Brief to Respondents' Post-Hearing Briefs ("Enforcement's Post-Hearing Reply Br.") 1-2.

[453] Enforcement's Post-Hearing Br. 44-45.

[454] Enforcement's Post-Hearing Reply Br. 4.

[455] Enforcement's Post-Hearing Br. 52.

[456] Enforcement's Post-Hearing Br. 52.

a role in the Form 211 application process, or that BS would later not engage in any other BLMK/NUGN trades.

After BS's trade, Enforcement claims that Castillo quoted NUGN at inflated prices, arguing that the 15.04-to-1 split should have diluted the value of its shares. Beginning on the morning of February 4, 2015, Castillo placed quotes to sell NUGN at $2.00 per share even though no other market makers had placed ask quotes and the only prior activity in the stock was BS's BLMK pre-split sale a month earlier. Further evidence of a scheme to manipulate, Enforcement argues, is that on February 4, prior to ND's purchase from Castillo in the afternoon that day, the buy side was supported solely by orders placed by a person associated with NUGN.[457] However, there is no evidence that at that time Respondents knew that a person who worked for NUGN was buying the stock that day.

To further demonstrate Castillo's scienter, Enforcement points to suspicious circumstances surrounding ND's trading in NUGN. On February 4, ND bought 5,170 NUGN shares from Castillo at $0.26 per share, which occurred after Castillo had quoted the stock for most of the day at $2.00 to $2.50 per share and had sold shares he had bought for the Firm from BS at $2.00 and $2.25. Enforcement says Castillo's motive in selling NUGN to ND at $0.26 per share was not to realize an immediate profit, as he testified at the hearing, but rather ensure that ND had sufficient shares that she could later sell to boost NUGN's price to $5.00 per share.[458] Enforcement also states that ND's order to sell NUGN at $5.00 per share was not economically supportable, and therefore is additional evidence of Castillo's intent to manipulate when he entered the order and then executed trades on her behalf on February 24–26. As Enforcement puts it, "there is no plausible explanation for Castillo's having placed [ND's] good-until-canceled order at the precise level needed for NuGene to reach a market capitalization of $200 million."[459] The Panel considered, however, that it was ND, and not Castillo, who placed the order to sell NUGN at $5.00.

Castillo and other Respondents do not dispute that JH was subject to the terms of the Lock-Up Agreement, chiefly because resale restrictions were recorded on the five NUGN certificates that JH deposited on February 27 and March 10. Castillo argues that it is exculpatory that JH did not take advantage of the alleged manipulation because its sales did not depend on the stock reaching $5.00 per share and the market capitalization reaching at least $200 million. This undercuts the alleged motive for the manipulation, Castillo argues.[460] Enforcement responds that the manipulation provided JH the "ability" to sell NUGN at a "price optimal time,"[461] whether or not it took advantage of the manipulation.

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[457] Enforcement's Post-Hearing Br. 52-53.

[458] Enforcement's Post-Hearing Br. 46.

[459] Enforcement's Post-Hearing Br. 57.

[460] George Castillo and Eric Flesche's Post Trial Brief ("Castillo and Flesche's Post-Hearing Br.") 43-44.

[461] Enforcement's Post-Hearing Reply Br. 5.

Because Enforcement alleges that releasing JH from the Lock-Up Agreement was the motivation behind the manipulative scheme, the Panel is compelled to consider whether JH in fact took advantage of the price movement. JH first sold NUGN more than a month after the alleged manipulation—on April 7—and sold only 560 shares for just over $1,200. Its next sales were in mid-June—132,000 shares for proceeds exceeding $500,000. As Castillo notes, JH could have engaged in the sales regardless of NUGN's market capitalization level.

3. Conclusion

Based on the evidence presented at the hearing, the Panel finds insufficient evidence showing that during the alleged manipulation Castillo knew that RC and JH owned NUGN shares, believed that they were subject to the Lock-Up Agreement, and knew the terms of the Lock-Up Agreement. Without this evidence, the Panel is unable to conclude that Castillo acted knowingly when he placed ND's order to sell NUGN at $5.00 and traded the stock on her behalf at that price on February 24–26, 2015.

Enforcement did not present evidence that Castillo (or anyone else at Glendale) reasonably believed that a Lock-Up Agreement possibly restricted RC's and JH's resales of NUGN when he entered ND's good-til-canceled order to sell at $5.00 per share on February 11 and continuing until February 26. RC opened its account on February 4. On February 11, it deposited its sole NUGN stock certificate, which had no restrictive legend, along with four stock purchase agreements that referred to a Lock-Up Agreement but did not include a copy. Glendale relied at least in part on the attorney opinion letter and the transfer agent's representations in concluding that RC's shares were free trading and not subject to a Lock-Up Agreement.

JH opened its account on February 18 and deposited its first tranche of NUGN shares on February 27. Enforcement points to an email on February 20 from JH's principal to Glendale's back office personnel and Castillo attaching copies of two stock purchase agreements for the BLMK shares it bought.[462] Like the stock purchase agreements that RC executed, JH's stock purchase agreements refer to a Lock-Up Agreement, but the email did not include a copy of any NUGN certificate with a restrictive legend or other evidence setting forth the terms of the Lock-Up Agreement.

No Respondent, including Castillo, saw the terms of the Lock-Up Agreement, according to the evidence presented at the hearing, until February 27, when JH deposited its first NUGN stock certificate. By then, the alleged manipulation had already occurred. Before February 27, as Enforcement concedes, the available SEC filings just "described generally" the terms of the Lock-Up Agreement and references to it in the stock purchase agreements provided no details,

[462] CX-119. Enforcement did not ask Castillo questions about this email, only Flesche.

such as market capitalization levels and leak-out dates.[463] Given the reasonable bases for Glendale and Castillo to have concluded that RC's shares were not restricted, the Panel finds the circumstantial evidence insufficient to support a finding that Castillo acted with scienter.

Enforcement relies in part on purported inconsistencies in Castillo's testimony but the Panel finds that he gave a credible explanation about the apparent discrepancies. During the investigation, Castillo told FINRA staff he did not know about the existence of a Lock-Up Agreement until the date of his first investigative interview.[464] At the hearing, he explained that during the investigative testimony, when asked whether he knew of the existence of a Lock-Up Agreement, he understood the question to ask whether he was familiar with its "specifics"[465] and if he knew that RC and JH were subject to the Lock-Up Agreement when he engaged in trades for ND. Based on the totality of the evidence, including passages from Castillo's investigative testimony used at the hearing, the Panel finds that Castillo's investigative and hearing testimony were generally consistent on material issues concerning what Castillo knew about the Lock-Up Agreement and when he learned about it.

After applying the legal standards set forth above, the Panel finds that Enforcement failed to establish that Castillo acted with scienter when he traded NUGN on behalf of ND and entered quotations. Even Enforcement's investigator was unable to determine that RC was indeed subject to the Lock-Up Agreement. The evidence did not show that when Castillo traded NUGN he intended to increase the stock's price to achieve the required market capitalization to release RC and JH from the Lock-Up Agreement.[466]

Having found that Castillo did not act with scienter, the Panel next considers whether he acted with recklessness. While the line distinguishing recklessness from gross negligence is a fine one,[467] the Panel finds that Castillo did not act recklessly. Rather, the Panel finds that, at most, Castillo acted negligently by failing to question ND's $5.00 order to sell NUGN, which later was followed by RC depositing NUGN shares.

After carefully weighing the totality of the evidence, the Panel finds that Glendale and Castillo did not act recklessly in trading NUGN allegedly to manipulate its price. Accordingly, they did not act with scienter. Enforcement thus failed to establish a required element of a

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[463] *See* Compl. ¶ 24. The BLMK Form 8-K dated January 5, 2015, announcing the BLMK/NUGN merger, referred to certain existing NUGN shareholders being subject to lock-up agreements. It noted that over seven million NUGN shares were subject to a lock-up agreement for a period, and that thereafter a shareholder could leak them out. CX-12, at 5, 50.

[464] *See* Tr. 274-78; Enforcement's Post-Hearing Br. 44 & n.275.

[465] Tr. 274.

[466] There is also no evidence that persons behind the possible manipulation (including BS, ND, RC, JH, and others associated with the issuer) ever disclosed to any Respondent their scheme to manipulate NUGN's price so that it would result in a market capitalization level that would free RC and JH from the Lock-Up Agreement.

[467] *See Reynolds*, 2001 NASD Discip. LEXIS 17, at *45 n.28.

securities fraud claim. The Panel therefore dismisses the allegations against Glendale and Castillo in cause one.

B. Enforcement Failed to Prove that Glendale, Flesche, and Abadin Distributed Unregistered or Non-Exempt NUGN Securities (Cause Two)

Cause two charges Glendale, Flesche, and Abadin with violating Section 5 of the Securities Act, which constitutes a violation of FINRA Rule 2010, by participating in the resale of unregistered and non-exempt NUGN shares. Customers RC and JH acquired their shares on December 18, 2014, from three of the six persons who sold them BLMK shares. The Complaint charges that RC's resales of NUGN shares it acquired from NF (NUGN President DK's husband) and JH's resales of shares it acquired from NF's parents (MF and EF) constituted unregistered non-exempt resales of a restricted security. The Complaint alleges that NF, MF, and EF were affiliates of BLMK through their family relationship with DK and by virtue of sharing a common residential address.[468]

As discussed above, based on the evidence presented at the hearing, the Panel determined that Enforcement failed to prove that MF and EF lived with DK and NF, and therefore they were not affiliates of the issuer pursuant to SEC Rule 144. Accordingly, the Panel did not consider whether any of JH's sales of NUGN shares (all of which were acquired from MF and EF) were restricted.[469]

The Complaint alleges that no registration statement was in effect concerning the NUGN shares originating from NF that RC resold, and no exemption from registration applied to any of the resale transactions. Therefore, according to Enforcement, a *pro rata* portion of the shares that RC[470] resold during the six-month holding period under SEC Rule 144, ending June 17, 2015,

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[468] Compl. ¶¶ 173-75. *See also* Compl. ¶¶ 66-71. In its pre-hearing brief, at 17-19, Enforcement identified SF as NF's sister, alleging that the BLMK shares she sold to RC were restricted. At the hearing, Enforcement presented evidence that SF was NF's sister and that she shared a residential address with him and DK. Department of Enforcement's Pre-Hearing Brief ("Enforcement's Pre-Hearing Br.") 17-19. The Complaint, however, did not identify SF as an affiliate of BLMK—only NF, MF, and EF. Compl. ¶¶ 171-75. Accordingly, the Panel did not consider SF's sales as potentially being the source of unregistered non-exempt shares that RC sold.

[469] According to Enforcement, because JH bought all of its 1,360,790 BLMK/NUGN shares from MF and EF, all of its sales within six months of the purchase, or before June 18, 2015, constituted unlawful resales. JH sold 80,560 shares of NUGN before June 18, 2015, for $350,412. CX-118, at 3.

[470] According to Enforcement's calculations, RC earned *pro rata* proceeds of $894,315 from the sale of NUGN before June 18, 2015, attributable to NF. NF's 49,900 BLMK shares, pre-split, represented 25.8803 percent of the total of 2,899,878 NUGN shares that RC deposited. RC sold 1,552,599 NUGN shares from February 27 to June 17, 2015, of which the *pro rata* share from NF was 401,817 shares (1,552,599 shares x 25.8803% = 401,817 shares). During this period, RC earned proceeds of $3,455,582. RC's *pro rata* proceeds from shares it bought from NF equal $894,315 ($3,455,599 x 25.8803% = $894,315). CX-118, at 1.

and attributable to NF, constituted unregistered non-exempt resales of securities in violation of Section 5 of the Securities Act.[471]

A majority of the Panel finds that Enforcement failed to prove that Respondents participated in the unlawful resale of restricted securities.[472]

1. The Applicable Law

Sections 5(a) and (c) of the Securities Act prohibit the "sale" and "offer for sale" of any security unless a registration statement is in effect or there is an applicable exemption from registration requirements. The purpose of the registration requirement is to "protect investors by promoting full disclosure of information thought necessary to informed investment decisions."[473] A violation of Section 5 of the Securities Act constitutes a violation of FINRA Rule 2010.[474]

Prima facie proof of a Section 5 violation requires a showing that (1) no registration statement was in effect as to securities; (2) Respondent sold the securities; and (3) interstate transportation or communications were used in connection with the sale.[475] Proof of scienter is not required because "[t]he Securities Act of 1933 imposes strict liability on offerors and sellers of unregistered securities."[476]

Liability under Section 5 extends not only to those who engage in the actual sale of securities, but also those who engage in significant steps in the distribution process. Anyone who is a "necessary participant" or a "substantial factor" in the unlawful transaction, including a

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[471] Compl. ¶¶ 173-74.

[472] As set forth below, the hearing officer dissents from the majority and finds that Glendale, Flesche, and Abadin participated in the resale of restricted NUGN shares, in violation of Section 5 of the Securities Act, which constitutes a violation of FINRA Rule 2010.

[473] *SEC v. Ralston Purina Co.*, 346 U.S. 119, 124 (1953).

[474] *Alvin W. Gebhart, Jr.*, 58 S.E.C. 1133, 1165 & n.75 (2006), *rev'd and remanded in part on other grounds*, 255 F. App'x 254 (9th Cir. 2007), *aff'd*, Exchange Act Release No. 58951, 2008 SEC LEXIS 3142 (Nov. 14, 2008), *petition for review denied*, 595 F.3d 1034 (2010), *cert. denied*, 561 U.S. 1008 (2010); *Stephen J. Gluckman*, 54 S.E.C. 175, 185 (1999); *see William H. Gerhauser, Sr.*, 53 S.E.C. 933, 941-42 (1998).

[475] *Rodney R. Schoemann*, Securities Act Release No. 9076, 2009 SEC LEXIS 3939, at *20-21 (Oct. 23, 2009), *aff'd*, 398 F. App'x 603 (D.C. Cir. 2010); *SEC v. Cavanagh*, 1 F. Supp. 2d 337, 361 (S.D.N.Y. 1998), *aff'd*, 155 F.3d 129 (2d Cir. 1998); *Gebhart*, 58 S.E.C. at 1165. The interstate instrumentalities requirement is met because the NUGN transactions were effected in the over-the-counter market. *See Dep't of Enforcement v. Merrimac Corp. Sec., Inc.*, No. 2011027666902, 2017 FINRA Discip. LEXIS 16, at *27-28 (NAC May 26, 2017) (use of over-the-counter market satisfies the interstate instrumentalities requirement), *appeal docketed*, SEC Admin. Proc. No. 3-18045 (June 26, 2017).

[476] *Schoemann*, 2009 SEC LEXIS 3939, at *21 n.13 (citing *Swenson v. Engelstad*, 626 F.2d 421, 424 (5th Cir. 1980)); *SEC v. Calvo*, 378 F.3d 1211, 1215 (11th Cir. 2004).

selling broker, violates Section 5 of the Securities Act.[477] The Complaint charges that in addition to Glendale, Flesche and Abadin were necessary participants because Flesche accepted and approved RC's deposits of restricted NUGN shares for resale. Abadin was the registered representative on the accounts who facilitated the deposit and liquidation of NUGN shares.

2. Enforcement Established a *Prima Facie* Case

The facts here sufficiently establish a *prima facie* case—Glendale, through Flesche and Abadin, sold unregistered non-exempt shares of NUGN on behalf of customer RC using means or instruments of transportation or communication in interstate commerce without a registration statement or an exemption in effect. RC acquired NUGN shares from NF. As the Complaint alleges and the Panel has determined, NF was the spouse of BLMK's then CEO, DK, and they lived together at the time of the sale.[478]

Pursuant to Rule 144(a)(3)(i), "restricted securities" are "[s]ecurities acquired directly or indirectly from the issuer, or from an affiliate of the issuer, in a transaction or chain of transactions not involving any public offering." Under Rule 144(a)(1), an "affiliate" of an issuer is defined as a "person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, such issuer." DK meets the definition of an affiliate because as BLMK's CEO she controlled the company. Rule 144(a)(2) defines "person" to include "[a]ny relative or spouse of such person, or any relative of such spouse, any one of whom has the same home as such person." Because NF was DK's spouse and they had the same home, NF was an affiliate of BLMK/NUGN.

No valid registration statement was in effect concerning RC's resales of NUGN. The issuer, BLMK, was a reporting company for at least 90 days immediately before NF's sale to RC on December 18, 2014. Pursuant to Rule 144(d)(1)(i), six months must elapse between the acquisition of the securities of a reporting company and any resale. Therefore, Enforcement argues, a *pro rata* portion of the resales by RC before June 18, 2015, that are attributable to NF constituted unregistered, non-exempt resales of NUGN in violation of Section 5 of the Securities Act.

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[477] *Zacharias v. SEC*, 569 F.3d 458, 467 (D.C. Cir. 2009) (finding broker who accepted customer orders, completed Rule 144 forms, and ensured that proceeds were wired to clients was a "substantial factor" in Section 5 violation), *reh'g denied*, 584 F.3d 1073 (D.C. Cir. 2009); *see also Calvo*, 378 F.3d at 1215; *SEC v. Murphy*, 626 F.2d 633, 649-52 (9th Cir. 1980).

[478] As discussed above, Glendale, Flesche, and Abadin devoted considerable effort to disproving that DK and NF were married as of December 18, 2014, and argued the issue in their post-hearing briefs. *See* George Castillo and Eric Flesche's Post Trial Brief ("Castillo and Flesche's Post-Hearing Br.") 44-54; George Castillo and Eric Flesche's Post Trial Reply Brief ("Castillo and Flesche Post-Hearing Reply Br.") 22-23; Post Hearing Brief of Respondents Glendale Securities, Inc., Albert Laubenstein and Jose Abadin ("Glendale, Laubenstein, and Abadin's Post-Hearing Br.") 19-23. For the reasons cited above, the Panel rejects their arguments.

3. Glendale, Flesche, and Abadin Invoke the Broker's Exemption

Once Enforcement establishes *prima facie* proof of a violation, the burden shifts to Glendale, Flesche, and Abadin to demonstrate that the disputed transactions qualify for an exemption.[479] "Exemptions from registration are affirmative defenses that must be established by the person claiming the exemption."[480] An exemption must be "construed narrowly 'in order to further the purpose of the Act: To provide full and fair disclosure of the character of the securities, and to prevent frauds in the sale thereof.'"[481] Evidence supporting a claimed exemption must be "explicit, exact, and not built on mere conclusory statements."[482]

Glendale, Flesche, and Abadin contended at the hearing that RC's unsolicited NUGN sales were exempt under Rule 144.[483] Rule 144 creates a safe harbor from the definition of "underwriter" in Section 2(a)(11) of the Securities Act. A person who satisfies the conditions of the Rule 144 safe harbor is deemed not to be engaged in a distribution of the securities and therefore not an underwriter of the securities.

Glendale, Flesche, and Abadin argue that they facilitated RC's sales as brokers pursuant to the exemption in Section 4(a)(4) of the Securities Act for "brokers' transactions executed upon customers' orders on any exchange or in the over-the-counter market but not the solicitation of such orders." The Section 4(a)(4) exemption, designed to exempt ordinary brokerage transactions, "is not available to a registered representative if he knows or has reasonable grounds to believe that the selling customer's part of the transaction is not exempt from Section 5 of the Securities Act."[484] The exemption is available only if the broker conducts an inquiry adequate to determine if the securities may be sold lawfully. The SEC explained a broker's duty to investigate in a widely cited 1962 release:

> The amount of inquiry called for necessarily varies with the circumstances of particular cases. A dealer who is offered a modest amount of a widely traded security by a responsible customer, whose lack of relationship to the issuer is well known to him, may ordinarily proceed with considerable confidence. On the other

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[479] *Gebhart*, 58 S.E.C. at 1165; *Cavanagh*, 1 F. Supp. 2d at 361-63; *John A. Carley*, Initial Decision Release No. 292, 2005 SEC LEXIS 1745, at *87 (July 18, 2005) (citing *Swenson*, 626 F.2d at 425), *aff'd*, Exchange Act Release No. 57246, 2008 SEC LEXIS 222 (Jan. 31, 2008), *aff'd in part and rev'd in part sub nom. Zacharias v. SEC*, 569 F.3d 458 (D.C. Cir. 2009), *reh'g denied*, 584 F.3d 1073 (2009).

[480] *Carley*, 2008 SEC LEXIS 222, at *24.

[481] *SEC v. Platforms Wireless Int'l Corp.*, No. 07-56542, 2010 U.S. App. LEXIS 15328, at *16 (9th Cir. July 27, 2010) (citing *Murphy*, 626 F.2d at 641).

[482] *Robert G. Weeks*, 56 S.E.C. 1297, 1322 (2003).

[483] Glendale Securities, Inc., George Albert Castillo, [Paul Flesche, Albert Laubenstein, and Jose Abadin's] Pretrial Brief ("Glendale, Castillo, Flesche, Laubenstein, and Abadin's Pre-Hearing Br.") 23-26; Castillo and Flesche's Post-Hearing Br. 44-45.

[484] *Carley*, 2008 SEC LEXIS 222, at *34; *Jacob Wonsover*, 54 S.E.C. 1, 13 (1999), *petition for review denied*, 205 F.3d 408 (D.C. Cir. 2000).

> hand, when a dealer is offered a substantial block of a little-known security, either by persons who appear reluctant to disclose exactly where the securities came from, or where the surrounding circumstances raise a question as to whether or not the ostensible sellers may be merely intermediaries for controlling persons or statutory underwriters, then searching inquiry is called for.[485]

Glendale, Flesche, and Abadin claim that they met their burden under Section 4(a)(4) by conducting a reasonable inquiry: "Glendale conducted a reasonable investigation relying upon industry recognized and available tools for the task of determining relationship status."[486] The inquiry, they argue, included generating the Broker Checklist and obtaining supporting documentation during the process of accepting RC's shares for deposit.[487] They also reasonably relied, considering all the circumstances, on transfer agent representations that RC's NUGN shares were freely tradeable. They point out that Enforcement searched materials and records not available to Glendale. For example, the Firm did not have access to the BLMK Form 211 application (that another broker-dealer submitted to FINRA) and supporting documents that Enforcement used to help tie NF to DK. Respondents also claim they were not required to use Facebook or LexisNexis records, other sources that Enforcement relied on.[488]

4. Conclusion

A majority of the Panel finds—based on all the circumstances, including considering the sources and nature of the evidence that Enforcement presented linking NF and DK—that Glendale, Flesche, and Abadin met their obligation of reasonable inquiry under the special broker exemption in Section 4(a)(4) of the Securities Act. Accordingly, the allegations in cause two against Glendale, Flesche, and Abadin are dismissed.

As discussed below, the Hearing Officer respectfully dissents from the majority's conclusions.

C. Glendale and Laubenstein Failed to Ensure the Firm Had a Reasonable AML Program (Cause Three)

Cause three charges all Respondents with violating FINRA Rules 3310 and 2010 by failing to detect and report suspicious activity associated with Glendale customers' deposit and liquidation of NUGN, BRKO, and VXEL. As an initial matter, the Panel dismisses the AML-related allegations contained in cause three against Castillo, Flesche, Abadin, and Huang. The Panel rejects Enforcement's arguments that their conduct violated FINRA Rule 3310 because

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[485] *Wonsover v. SEC*, 205 F.3d 408, 415 (D.C. Cir. 2000) (quoting *Distribution by Broker-Dealers of Unregistered Securities*, Securities Act Release No. 4445, 1962 SEC LEXIS 74 (Feb. 2, 1962)).

[486] Glendale, Laubenstein, and Abadin's Post-Hearing Br. 23.

[487] Glendale, Laubenstein, and Abadin's Post-Hearing Br. 20-21.

[488] Glendale, Laubenstein, and Abadin's Post-Hearing Br. 23.

they allegedly failed to report potentially suspicious activities to Laubenstein. There is no evidence that they withheld material information about customers and their trading in NUGN, BRKO, and VXEL from Laubenstein that undercut his ability to identify, investigate, and report potentially suspicious activity.[489]

Cause three also charges Glendale, Flesche, and Laubenstein with failing to comply with their customer identification obligations in connection with Huang's Asia-based customers who deposited shares of VXEL, and Glendale with failing to conduct due diligence into the Belize Bank and the unidentified customers it introduced to the Firm.

Below we discuss cause three in three parts: the AML program, the customer identification obligations, and the due diligence into Belize Bank.

1. The AML Program

a. The Applicable Law

FINRA Rule 3310 obligates each member to "develop and implement a written anti-money laundering program reasonably designed to achieve and monitor the member's compliance with the requirements of the Bank Secrecy Act (31 U.S.C. 5311 *et seq.*), and the implementing regulations promulgated thereunder by the Department of the Treasury." FINRA Rule 3310(a) requires that, at a minimum, AML programs "[e]stablish and implement policies and procedures that can be reasonably expected to detect and cause the reporting of transactions required under 31 U.S.C. 5318(g) [of the Bank Secrecy Act] and the implementing regulations thereunder." FINRA Rule 3310(b) requires that member firms "[e]stablish and implement policies, procedures, and internal controls reasonably designed to achieve compliance with the Bank Secrecy Act and the implementing regulations thereunder." WSPs are a critical component of an overall AML system. Compliance with FINRA Rule 3310 "requires *both* adequate systems and written procedures."[490]

Broker-dealers must report a transaction "conducted or attempted by, at, or through a broker/dealer" that "involves or aggregates funds or other assets of at least $5,000, and … the broker-dealer knows, suspects or has reason to suspect that the transaction (or a pattern of transactions of which the transaction is a part)" involves funds "derived from illegal activity" or that are "intended or conducted to hide or disguise funds or assets derived from illegal activity," or that involve "use of the broker/dealer to facilitate criminal activity."[491] A broker-dealer must

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[489] The Panel declines to find that as a matter of law a person other than a Firm's AMLCO cannot be found liable for violations of FINRA Rule 3310.

[490] *Dep't of Enforcement v. Lek Sec. Corp.*, No. 2009020941801, 2016 FINRA Discip. LEXIS 63, at *20 (NAC Oct. 11, 2016) (citations omitted and emphasis in original); *aff'd*, Exchange Act Release No. 82981, 2018 SEC LEXIS 830 (Apr. 2, 2018).

[491] NASD Notice to Members 02-47 at 458-59 (Aug. 2002), http://finra.org/industry/notices/02-47 (citing 31 C.F.R. § 103.19(a)(2) (re-numbered 31 C.F.R. § 1023.320(a)(2), effective March 1, 2011)).

file a suspicious activity report ("SAR") within 30 days of becoming aware of the suspicious transaction.[492]

In 2001, Congress passed the USA PATRIOT Act,[493] which imposed certain added obligations on broker-dealers under the AML provisions and amendments to the Bank Secrecy Act.[494] In 2002, the SEC approved NASD Rule 3011, now FINRA Rule 3310, setting forth the minimum standards for a member firm's AML compliance program.[495]

FINRA issued guidance to firms on AML issues in April 2002 in NASD Notice to Members ("Notice") 02-21. Notice 02-21 defines "money laundering" as "engaging in acts designed to conceal or disguise the true origin of criminally derived proceeds so that the unlawful proceeds appear to have derived from legitimate origins or constitute legitimate assets."[496] Notice 02-21 instructs members on how they should structure their AML programs. To be effective, FINRA advised, a broker-dealer's AML program must be risk-based so that its AML program is tailored to its "business model and customer base."[497] The obligation to develop and implement an AML compliance program, FINRA told members, "is not a 'one-size-fits-all' requirement."[498] Member firms were cautioned that "in developing an appropriate AML program ... , [a firm] should consider facts such as its ... business activities, the types of accounts it maintains, and the types of transactions in which its customers engage."[499]

Notice 02-21 also advised firms to monitor for red flags. Red flags of suspicious activity by customers could indicate money laundering activities. A firm must conduct due diligence to determine whether or not to report suspicious activity to law enforcement authorities when a red flag is detected.[500] Notice 02-21 contains examples of red flags that could indicate suspicious activity in connection with money laundering. Glendale incorporated the list of red flags into its AML procedures.[501] The most relevant red flags applicable to this case are the following:

- The customer, for no apparent reason or in conjunction with other red flags, engages in transactions involving certain types of securities, such as penny stocks.

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[492] NASD Notice to Members 02-47 at 460.

[493] USA PATRIOT Act of 2001, Pub. L. No. 107-56, 115 Stat. 272.

[494] *See* 31 U.S.C. §§ 5311 *et seq.*

[495] *See* Order Approving Proposed Rule Changes Relating to Anti-Money Laundering Compliance Programs, Exchange Act Release No. 45798, 2002 SEC LEXIS 1047 (Apr. 22, 2002).

[496] NASD Notice to Members 02-21 at 1 (Apr. 2002), http://www.finra.org/industry/notices/02-21.

[497] NASD Notice to Members 02-21 at 4.

[498] NASD Notice to Members 02-21 at 4.

[499] NASD Notice to Members 02-21 at 4.

[500] NASD Notice to Members 02-21 at 10-11.

[501] CX-9, at 47-49.

- The customer engages in transactions that lack business sense or apparent investment strategy, or are inconsistent with the customer's stated business strategy.

- The customer (or a person publicly associated with the customer) has a questionable background or is the subject of news reports indicating possible criminal, civil, or regulatory violations.[502]

Notice 02-21 cautions that its enumerated red flags are "not exhaustive" and a firm should describe red flags appropriate to its business in its WSPs and AML compliance procedures.[503]

Later in 2002, FINRA released another Notice to Members about AML compliance. In NASD Notice to Members 02-47, FINRA advised members that the U.S. Department of the Treasury's Financial Crimes and Enforcement Network ("FinCEN") had adopted new rules concerning the filing of a SAR for certain suspicious transactions. FINRA reminded broker-dealers of their duty to file a SAR in accordance with the regulations issued by FinCEN. The SAR identifies "market manipulation" as a type of "suspicious activity" that broker-dealers are required to report to FinCEN. It also identifies "microcap securities" as a type of product more likely to be subject to suspicious activity.[504]

FINRA noted that broker-dealers must determine whether activities surrounding certain transactions "appear[] to serve no business or apparent lawful purpose or [are] not the sort of transactions in which the particular customer would be expected to engage and for which the broker/dealer knows of no reasonable explanation after examining the available facts."[505] Notice 02-47 also referred to the red flags in Notice 02-21. It informed members that they should be alert to patterns of transactions and not view individual transactions in isolation. Citing FinCEN's guidance, FINRA noted that "if a broker/dealer determines that a series of transactions that would not independently trigger the suspicion of the broker/dealer, but that taken together, form a suspicious pattern of activity, the broker/dealer must file a suspicious transaction report."[506]

In January 2009, FINRA issued Regulatory Notice 09-05 reminding firms of their obligation to determine whether unregistered securities are eligible for public sale. The Notice told firms that they must ensure their AML compliance programs address red flags that may be

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[502] CX-9, at 47-49.

[503] NASD Notice to Members 02-21 at 11.

[504] *See Lek Sec. Corp.*, 2016 FINRA Discip. LEXIS 63, at *18. *See also* https://bsaefiling.fincen.treas.gov/main.html.

[505] NASD Notice to Members 02-47 at 459. *See* 31 C.F.R. § 1023.320(a)(2)(iii).

[506] NASD Notice to Members 02-47 at 459.

associated with unregistered resales conducted through the firm, including the sale of restricted securities under Rule 144.[507]

b. Glendale and Laubenstein Failed to Tailor the Firm's AML Program to Its Penny Stock Business

Glendale's WSPs included AML procedures and a separate AML Program, which the Firm incorporated by reference into its procedures.[508] During the relevant period, the Firm's procedures and AML Program designated Laubenstein as the Firm's AMLCO.[509] The Firm gave Laubenstein the responsibility "for developing policies and procedures and oversight of the Firm's [AML] program" and vested in him "full responsibility and authority to enforce the firm's AML program."[510] This included investigating suspected money laundering activities and taking corrective action, including filing SARs when required by the circumstances after conducting an appropriate investigation.[511]

The AML Program required that the Firm, through Laubenstein, monitor customer account activity "to permit [the] identification of patterns of unusual size, volume, pattern or type of transactions" or whether other red flags identified in its procedures are triggered. The procedures further stated that the Firm would "look at transactions, including trading and wire transfers, in the context of other account activity to determine if a transaction lacks financial sense or is suspicious because it is an unusual transaction or strategy for that customer."[512]

Glendale also required that its employees report suspicious activity to the AMLCO and instructed them to know their customers as a means to help prevent money laundering. The obligation to know a customer begins with the opening of an account and includes being familiar with the customer's financial resources, business activities, and sources of funds, according to the Firm's AML program.[513]

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[507] FINRA Regulatory Notice 09-05 at 4-5, 7, 9 (Jan. 2009), http://www.finra.org/industry/notices/09-05.

[508] CX-9, at 222, 397-432.

[509] CX-9, at 26, 222-23, 397-98.

[510] CX-9, at 223, 398.

[511] CX-9, at 50, 223, 398, 417.

[512] CX-9, at 410.

[513] CX-9, at 46-47.

The Firm's AML Program, which appeared to have been based on FINRA's small firm AML template,[514] identified 42 red flags that could signal the presence of possible money laundering activities. Glendale included the red flags in its AML Program. A handful of the 42 listed red flags are relevant to Glendale's business and the allegations in this proceeding.[515] These include:

- Customer transactions that include a pattern of receiving stock in physical form or the incoming transfer of shares, selling the position and wiring out proceeds.
- Two or more customers trade an illiquid stock suddenly and simultaneously.
- The penny stock company whose securities a customer is selling has no business, no revenues, and no product.
- The issuer has experienced frequent or continuous changes in its business structure.
- The issuer undergoes frequent material changes in business strategy or its line of business.

The Firm and Laubenstein also relied on Glendale's clearing firm's exception reports. However, they were not suited to Glendale's stock liquidation business. In early 2015, the Firm maintained a monthly log that Laubenstein used to document that he had reviewed certain types of activity. The review log included customer incoming and outgoing wire transfers, short positions,[516] and high commissions charged to customers whose trading generated commissions exceeding $3,000 in a month.[517] Laubenstein testified that the high commission report was intended to detect churning of customer accounts by a broker. This report, he acknowledged, was more appropriate for much larger broker-dealers than Glendale, which handled fewer trades and did not solicit customer transactions.[518] Even though RC's sales of NUGN generated considerably more than $3,000 in commissions per month, this did not arouse suspicions because the customer was expected to sell large dollar amounts of stock.

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[514] *See* Anti-Money Laundering (AML) Template for Small Firms ("AML Template"), http://www.finra.org/industry/anti-money-laundering-template-small-firms. FINRA cautioned firms that "following this template does not guarantee compliance with AML Program requirements or provide a safe harbor from regulatory responsibility." FINRA added, "Your firm's AML program should be 'risk-based.' That means that the program's AML policies, procedures and internal controls should be designed to address the risk of money laundering specific to your firm." AML Template at 1.

[515] AML Template at 37-40.

[516] Flesche testified that most of the Firm's customers had cash accounts and Glendale and its customers did not engage in short trading. Tr. 2535-39.

[517] Tr. 2542-43; RX-406; RX-407.

[518] Tr. 2639-40, 2648.

The log also reflected that Laubenstein reviewed trades by customers designated as high-risk and monitored them for potential "mini-manipulations,"[519] "spoofing,"[520] and wash trades.[521] Given Glendale's business, mini-manipulations and spoofing were not a particularly high risk compared to the underlying liquidation business.[522] Glendale's clearing firm also generated a volume concentration report. Flesche conceded this report was of little use because the Firm's customers traded low-volume stocks. This meant a customer's liquidation of a thinly traded, low-priced stock would often constitute a large percentage of the stock traded in a given period.[523]

The Panel finds that Glendale and Laubenstein failed to employ monitoring appropriate to the Firm's liquidation business.

c. Glendale and Laubenstein Failed to Detect and Investigate Red Flags of Suspicious Activity

Glendale's primary line of business was liquidating speculative, low-priced securities for its customers. Liquidations of penny stocks on behalf of customers presented a heightened risk for Glendale because such securities are easily manipulated. Penny stocks are often subject to promotional campaigns that circulate exaggerated or false claims about their prospects. A customer that acquires a large block of shares can benefit by selling the stock at a price that is higher than it otherwise would be without the promotional activity. Promotions that take place around the time that a customer is selling its shares are a red flag.[524]

The deposit and trading activity involving NUGN, BRKO, and VXEL was suspicious given the issuers' background, the manner in which the customers acquired their shares, the number of shares acquired, and the proceeds they earned from the sales. Information about the securities was publicly available and readily accessible. This included, for example, SEC filings, promotional activity on the Internet (for NUGN and BRKO), and multiple press releases that

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[519] "Mini-manipulation" involves trading in the underlying security of an option contract in order to manipulate its price so the option will become in-the-money. *See* https://www.nasdaq.com/investing/glossary/m/mini-manipula tion. An option is "in-the-money" if exercising the option under current market conditions would be favorable to its holder. Conversely, an option is "out-of-the-money" if exercising it under current market conditions would not be favorable to its holder. *See* https://www.nasdaq.com/investing/glossary/i/in-the-money.

[520] Spoofing is the manipulation of stock prices, typically using high-frequency trading algorithms, by placing orders in a stock to generate interest in it but with the intent to cancel the orders before they are filled. It is also defined as "bidding or offering with the intent to cancel the bid or offer before execution." *See* 7 U.S.C. § 6c(a)(5)(C).

[521] Tr. 2535-36, 2540; RX-406. *See also* RX-407.

[522] *See* Tr. 2539-40, 2586-87.

[523] Tr. 2587.

[524] *See, e.g., Microcap Stock: A Guide for Investors*, https://www.sec.gov/reportspubs/investor-publications/investorpubsmicrocapstockhtm.html.

NUGN issued with exaggerated claims about its business. Laubenstein's own efforts never uncovered any evidence of the suspicious activities that Glendale's customers were engaged in.

The Complaint charges that Glendale's AML program relied on individual registered representatives to identify potentially suspicious activity in their customers' accounts, which they then were supposed to refer to Laubenstein. Enforcement alleges that the Firm's AML procedures failed to describe how this was to be accomplished. For the cases that were brought to Laubenstein's attention, the Complaint alleges that he failed to document or otherwise memorialize the substance of his reviews.[525]

The principal allegations are that Glendale, through Laubenstein, failed to identify and investigate red flags indicative of potentially suspicious activity related to the customer accounts that deposited and sold NUGN, BRKO, and VXEL. As a result, they failed to consider whether to file a SAR with respect to the accounts and the trading activity, as required by the Bank Secrecy Act and implementing regulations. The Panel finds that there were ample red flags surrounding Glendale's customers' deposits and sales of shares of NUGN, BRKO, and VXEL that should have triggered a timely investigation by AMLCO Laubenstein.

i. NUGN

NUGN's history should have attracted Laubenstein's attention. NUGN was the result of a reverse merger with BLMK, which had had virtually no business history. Although NUGN's revenues were not negligible, in its January 2015 Form 8-K, it acknowledged that sales of its cosmetics products had begun only recently, in March 2014, it had earned "limited revenues" from its operations since inception, and prospects for future sales of its products were "uncertain."[526] In the Form 8-K, NUGN stated that an investment in the company "involve[d] a high degree of risk."[527]

As described above, Glendale customer sales of NUGN presented ample red flags. The three most active customers (RC, JH, and SEI) opened accounts at the Firm within a few weeks of each other and quickly deposited nearly 4.5 million shares of the stock. The customers were not known to the Firm until they opened their accounts. The only activity RC and JH engaged in was liquidating NUGN shares. Together, the three customers' shares amounted to over 40 percent of NUGN's float of 11.1 million shares and over 11 percent of the more than 41 million shares outstanding. RC alone deposited nearly 2.9 million shares, 720,000 of which the Firm returned to the customer because they exceeded Glendale's internal concentration guidelines.

Those three customers sold a large volume of NUGN shares at around the same time. According to Glendale's AML Program, it is a red flag when two or more customers trade an

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[525] Compl. ¶ 181.

[526] CX-12, at 28-29.

[527] CX-12, at 19.

illiquid stock "suddenly and simultaneously."[528] Combined, the customers sold over 2.9 million shares for proceeds of more than $8.5 million in less than five months, with RC earning the lion's share—more than $7.3 million. The customers' exorbitant returns on investment resulted from the extreme price increase in NUGN stock, which had just begun trading on February 4, 2015. This alone was indicative of potentially suspicious activity.

How RC, JH, and SEI had acquired their shares was also potentially suspicious. It suggested the possibility that they were acting in concert with others or with each other. RC and JH bought their NUGN shares in private transactions from six persons with the same surname, all on the same date. SEI bought its shares from two other persons (with different last names), but also within days of RC's and JH's purchases. They each paid virtually nothing for their shares (together less than $9,000[529]) in comparison to the lucrative proceeds they derived from the liquidations, which began less than three months after the purchases. RC promptly began wiring out the proceeds of its sales. RC and JH traded no other securities besides NUGN and SEI engaged in limited trading in other securities. It was also suspicious that RC and JH purchased NUGN while holding a significant number of shares in their Glendale accounts, even as they sold shares. Laubenstein failed to consider whether this was an effort to prop up NUGN's price.

High-risk customer BS's single sale of BLMK in January 2015, when viewed in isolation, may not have been suspicious. However, Laubenstein failed to follow Glendale's procedures regarding high-risk customers and apply heightened scrutiny to his activities. BS disclosed that he owned another 50,000 NUGN shares that he did not deposit into his account. Despite BS's history, the focus of Laubenstein's review of the deposit was whether BS's NUGN shares were tradable and not his trading history.[530]

As FINRA has cautioned, member firms should look at transactions in the context of other trading activity. It was also unreasonable for Laubenstein to ignore BS's NUGN sale once ND opened an account at Glendale, then bought NUGN shares and promptly placed orders to sell NUGN at much higher prices. And ND traded no other securities besides NUGN.

ND's activity in NUGN, quickly followed by RC's large NUGN deposit, should have triggered an investigation by Laubenstein. Laubenstein also failed to act once JH deposited its first NUGN certificate on February 27, 2015, bearing the terms of the Lock-Up Agreement. By this date, NUGN had just closed at $5.00 per share for three consecutive trading days.

As a result of owning such a large volume of NUGN shares, RC's sales often constituted a high percentage of daily volume. This aroused no one's suspicions, not even AMLCO Laubenstein's. Laubenstein viewed RC's, JH's, and SEI's trading as part of the market initiating

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[528] CX-9, at 412.

[529] RC paid a total of $6,009 for the pre-split shares it bought from the four sellers on December 18, 2014; JH paid $2,820 for the pre-split shares it bought from two sellers. CX-16, at 36-38, 52-54, 68-70, 84-86, 89; CX-17, at 37-39, 53-55.

[530] Tr. 2547-48; CX-20, at 12. *See also* Glendale, Laubenstein, and Abadin's Post-Hearing Br. 35-36.

trading in NUGN. Laubenstein did not even think of asking Abadin, the broker on the three accounts, how he had acquired the customers. This could have helped lead him to question whether RC, JH, and SEI were coordinating their deposits and sales of NUGN.

Even though Castillo asked Laubenstein on March 10, 2015, to look into trading in NUGN, Laubenstein spotted nothing suspicious. He investigated, but did not document his review or conclusions. As of that date, RC already had sold nearly 180,000 shares of NUGN for proceeds of more than $245,000. On March 10, RC sold its largest number of shares to date (over 95,000) for proceeds exceeding $128,000. RC still had more than 2 million shares in its account as of March 10.[531]

As of March 10, JH and SEI already had opened accounts at the Firm and deposited NUGN shares, even though they had not sold any yet. On March 10, JH deposited the balance of its NUGN shares (four certificates for just over 1 million shares). The next day, Laubenstein approved JH's NUGN deposits. SEI had deposited all of its shares, which Laubenstein (and Flesche) had approved for resale. (JH and SEI did not start selling NUGN until April 7 and June 1, 2015, respectively.)

Even assuming Laubenstein, as the AMLCO, had investigated and found nothing on March 10, 2015, he should have been monitoring all trading activity in NUGN for AML purposes. On March 12, RC started liquidating NUGN again, selling 25,000 shares for more than $39,000. RC then accelerated its liquidation. By the end of March 2015, RC had sold about a third of all the NUGN shares it had deposited, for about $1.1 million. On April 6, RC made its first funds transfer by wiring $1,098,000 out of its account.[532] By mid-August 2015, RC wired out $4,990,595 from its account. (By August 2015, JH wired out $469,000 and SEI $360,000.) This notwithstanding, Laubenstein testified that he never found anything suspicious about RC's trading from February to June 2015.[533]

After his review on March 10, 2015, Laubenstein did not conduct another investigation into NUGN trading by RC, JH, and SEI until September 2015, about two months after customers ceased selling the stock. He did so only because FINRA brought the promotional activity to Glendale's attention.[534]

The Panel rejects Glendale's and Laubenstein's arguments that NUGN trading was not suspicious. They argue that the trading reflected "a new company whose market is just being inititiated[,] incrementally increasing in price with a similar incrementally increasing daily volume."[535] They explain that Laubenstein did not spot promotional activity because one of the

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[531] CX-1G, at 1; CX-29, at 3.

[532] CX-29, at 3-5.

[533] Tr. 2650-51.

[534] *See* Glendale, Laubenstein, and Abadin's Post-Hearing Br. 40.

[535] Glendale, Laubenstein, and Abadin's Post-Hearing Br. 40.

items, the 28-page glossy brochure— was a mailing, and no one at Glendale received it. They point to the many press releases NUGN issued which announced purportedly significant news about the company's produces and business prospects.[536]

The Panel finds that the press releases were evidence of an effort to manipulate the stock, not a true reflection of significant company developments. Also, Laubenstein did not see the press releases at the time. Laubenstein testified that looking for NUGN's press releases was "not really relevant to what I was doing." He would only look at press releases on the Internet, if any existed, on the day a customer deposited stock.[537]

ii. BRKO

The circumstances surrounding ECM's acquisition of and trading in BRKO was also suspicious. ECM bought his BRKO shares in late November 2015, paying two sellers in the United Kingdom less than $7,000 through private stock transactions. A week later, in early December 2015, he opened an account at Glendale through Huang, and simultaneously deposited a certificate for 1.3 million BRKO shares, representing all the shares he had just purchased. ECM disclosed that the purpose of opening an account was to sell BRKO shares.

In late January 2016, less than two months later, BRKO announced that it had changed its line of business and ownership and merged with another company. Within a week of the merger announcement, ECM started selling his shares of BRKO. From early February to mid-March 2016, he sold over 472,000 BRKO shares for proceeds of more than $1.25 million. ECM wired out of his account over $1 million that he earned from the sales of just over a third of the shares he deposited. ECM transferred the money to a bank that was not in the country where he lived.

It was not until early March 2016 that Laubenstein reviewed ECM's trading in BRKO. Rather than uncovering suspicious activity on his own, Laubenstein learned from someone else that BRKO was the subject of promotional activity. By this time, ECM had made over $1 million from his BRKO sales.[538] Laubenstein's investigation led to his identifying a potentially suspicious development— the BRKO promotional activity. This caused him to have Huang send ECM the Stock Promotion Affidavit, while Huang filled out the Promotion Checklist. Glendale and Laubenstein allowed ECM to engage in two more sales of BRKO based on ECM's representations that he did not know about or participate in the promotion.

Even before learning of the BRKO promotion, ECM's acquisition of and trading in BRKO at Glendale presented ample red flags that should have compelled Laubenstein to conduct an investigation.

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[536] Glendale, Laubenstein, and Abadin's Post-Hearing Br. 40.

[537] Tr. 2650-51.

[538] *See* HPX-1.

iii. VXEL

Like NUGN and BRKO, VXEL had just gone through a business, ownership, and name change. As a result of a reverse merger, an entirely new class of shareholders took over the company. New shareholders in Malaysia replaced shareholders based mostly in Northern Ireland. VXEL was thinly capitalized and was located in yet a third foreign country, far away from where the new shareholders were located. The process constituted an orchestrated effort to transfer ownership of one company to another, followed immediately by the new shareholders depositing VXEL shares at Glendale with the ultimate of liquidating them.

A third-party consultant (KTO) represented the buyers in the transaction that resulted in the change in VXEL's ownership and business. Soon after the transaction, KTO and an assistant (KSC) acted as agents for 29 new VXEL shareholders located in Southeast Asia. KTO and KSC helped the customers by dealing with Huang on their behalf to open accounts and deposit VXEL shares. KTO and KSC acted on behalf of the foreign VXEL shareholders even though the Firm had no documented authorization for them to do so. The stated purpose of opening the accounts was to sell the recently acquired VXEL shares. The Firm and Huang did not know KTO or any of the other foreign customers.

KTO himself owned a significant amount of VXEL shares. After depositing them in his new Glendale account, he sold a portion of his holdings. Although only two other customers sold any VXEL shares during the relevant period, the VXEL shareholders deposited a significant number of shares into their Glendale accounts. Huang communicated with the 29 customers primarily through KTO and KSC. He communicated directly only with a handful of the customers, and he never met any of them.

d. Conclusion

The Panel finds that Laubenstein failed to ensure that Glendale's AML program was adequately tailored to reduce the risks posed by the Firm's penny stock liquidation business. As a result, Glendale and Laubenstein failed to detect and investigate red flags indicative of potentially suspicious trading activity by customers who deposited and sold NUGN, BRKO, and VXEL. This enabled the suspicious activity to continue without an adequate evaluation of the customers' trading in those stocks. For these reasons, the Panel finds that Glendale, acting through Laubenstein, violated FINRA Rules 3310 and 2010 by failing to establish and implement reasonable AML policies and procedures to detect, investigate, and report, where appropriate, suspicious activity.[539]

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[539] *See Dep't of Enforcement v. Domestic Sec., Inc.*, No. 2005001819101, 2008 FINRA Discip. LEXIS 44, at *14 (NAC Oct. 2, 2008) (firm "did not establish AML policies and procedures to monitor, analyze, and investigate suspicious activity associated with [its business]"); *Lek Sec. Corp.*, 2016 FINRA Discip. LEXIS 63, at *24 (firm failed to tailor is AML procedures to its business); *Merrimac Corp. Sec.*, 2017 FINRA Discip. LEXIS 16, at *41 (firm "failed to detect, investigate, and document red flags in penny stock trading, including patterns of large deposits and liquidations of penny stocks").

The Panel dismisses the AML-related allegations contained in cause three against the other four Respondents—Castillo, Flesche, Abadin, and Huang. The Panel rejects Enforcement's argument that their conduct violated FINRA Rule 3310. None was Glendale's designated AMLCO and, accordingly, they were not responsible for Glendale's AML program during the relevant period.

2. Customer Identification Program

Cause three also charges Glendale, acting through Flesche, Laubenstein, and Huang, with failing to comply with the Firm's customer identification program, in violation of FINRA Rules 3310 and 2010.[540] FINRA Rule 3310(b) requires member firm to establish and implement a written AML program reasonably designed to achieve and monitor the member's compliance with the requirements of the Bank Secrecy Act, and its implementing regulations, including 31 C.F.R. § 1023.220 (Customer Identification Programs for Broker-Dealers).

This regulation requires that broker-dealers "establish, document, and maintain a written Customer Identification Program ("CIP") appropriate for its size and business."[541] A firm's CIP, which must be part of a firm's AML compliance program, "must include risk-based procedures for verifying the identity of each customer to the extent reasonable and practicable." A firm's procedures must be based on an assessment of the "relevant risks, including those presented by the various types of accounts maintained" by the firm, among other considerations.[542] The regulation provides that to verify an individual's identification using documentary means, the customer must provide unexpired government-issued identification evidencing nationality or residence and bearing a photograph, such as a driver's license or passport. A failure to establish a reasonable CIP violates FINRA Rule 3310(b).[543]

The CIP contained in Glendale's WSPs provides that the Firm will use non-documentary methods of verifying identity when the customer and Glendale "do not have fact-to-face contact" or when "there are other circumstances that increase the risk that the firm will be unable to verify the true identity of the customer through documentary means," among other circumstances.[544] Huang dealt primarily with KTO and KSC, who acted on behalf of the VXEL shareholders including providing documents to help verify the customers' identities. Huang did not meet the customers and communicated with only a few of them via email. Given the totality of the

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[540] Compl. ¶¶ 188-89.

[541] 31 C.F.R. § 1023.220(a)(1).

[542] 31 C.F.R. § 1023.220(a)(2).

[543] *Dep't of Enforcement v. Dratel Group, Inc.*, No. 2008012925001, 2014 FINRA Discip. LEXIS 6, at *88 (NAC May 2, 2014), *aff'd*, Exchange Act Release No. 77396, 2016 SEC LEXIS 1035 (Mar. 17, 2016).

[544] CX-9, at 403. *See also* 31 C.F.R. § 1023.220(a)(2)(ii)(B)(2) and NASD Notice to Members 03-34, at 353-54 (June 2003), https://www.finra.org/industry/notices/03-34. Non-documentary methods of verifying customer identification include contacting a customer, independently verifying the customer's identity through comparison of the information the customer provides with information from a consumer reporting agency, checking references with a financial institution, or obtaining a financial statement. *See* CX-9, at 403; 31 C.F.R. § 1023.220(a)(2)(ii)(B)(1).

circumstances surrounding the manner in which the customers acquired their VXEL shares and opened accounts at Glendale, the Firm was presented with the risk that it could not adequately verify the customers' identities through documentary means alone. It accordingly should have used non-documentary means, as set forth in its CIP and the AML regulations.

The Panel finds that Glendale, through Laubenstein, failed to employ non-documentary means of verifying Huang's customers' identities, in violation of FINRA Rules 3310(b) and 2010. The Panel dismisses the allegations against Flesche and Huang on the grounds that Laubenstein, as Glendale's AMLCO, had primary responsibility for implementing the CIP as part of the Firm's overall AML program and that Flesche and Huang did not engage in misconduct that impeded Laubenstein from performing his AML-related duties.

3. Due Diligence into Belize Bank

Cause three further charges Glendale, acting through Laubenstein, with failing to conduct due diligence into Belize Bank and the unidentified customers it introduced to the Firm. The Complaint charges Respondents with failing to comply with 31 C.F.R. § 1010.610, implementing the Bank Secrecy Act, which constitutes a violation of FINRA Rules 3310(b) and 2010.[545]

Cause three also charges that Glendale and Laubenstein failed to "ascertain the type, purpose and anticipated activity of" the correspondent accounts introduced by Belize Bank. Therefore they "could not assess the money laundering risks presented" by the accounts or "conduct periodic review of the correspondent account activity to determine whether the activity was consistent with its stated purpose."[546] As a result, according to Enforcement, the Firm and Laubenstein failed to "establish and implement an adequate due diligence program for correspondent accounts for foreign financial institutions ... [and] risk-based AML procedures and controls designed to detect and report suspicious activity within correspondent accounts."[547]

Section 312 of the USA PATRIOT Act, as implemented by 31 C.F.R. § 1010.610, requires that broker-dealers exercise due diligence when accepting correspondent accounts for a foreign financial institution ("FFI").[548] An FFI includes a bank organized under foreign law. The term "FFI" means any entity "organized under foreign law (other than a branch or office of such person in the United States) that, if it were located in the United States, would be a covered

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[545] Compl. ¶¶ 178, 190.

[546] Compl. ¶ 190.

[547] Compl. ¶ 190.

[548] Publ. L. No. 107-56 (codified at 31 U.S.C. § 5318(i)).

financial institution,"[549] as defined by statute. This includes a "broker or dealer in securities registered, or required to be registered" with the SEC.[550]

A broker-dealer's due diligence program for an FFI must include "appropriate, specific, risk-based, and, where necessary, enhanced policies, procedures, and controls that are reasonably designed to enable the covered financial institution to detect and report, on an ongoing basis, any known or suspected money laundering activity conducted through or involving any correspondent account."[551] Broker-dealers that handle FFI accounts must implement policies, procedures, and controls that "assess[] the money laundering risk presented by [an FFI] correspondent account, based on a consideration of all relevant factors, which shall include, as appropriate:"

- The nature of the FFI's business and the markets it serves.
- The type, purpose, and anticipated activity of such correspondent account.
- The nature and duration of the covered financial institution's relationship with the FFI (and any of its affiliates).
- The AML and supervisory regime of the jurisdiction that issued the charter or license to the FFI.
- Information known or reasonably available to the covered financial institution about the FFI's AML record.[552]

A broker-dealer must adopt risk-based procedures and controls that are reasonably designed to detect and report known or suspected money laundering activity, including "a periodic review of the correspondent account activity sufficient to determine consistency with information obtained about the type, purpose, and anticipated activity of the account."[553]

Belize Bank was an FFI, as defined by the Bank Secrecy Act, because it was organized and domiciled in Belize. Accordingly, Glendale and Laubenstein were obligated to perform risk-based due diligence into the bank's business when it opened accounts, and conduct periodic reviews of its activities. They failed to do so. Glendale and Laubenstein failed to conduct their own separate due diligence into the bank's customers and deferred to the bank the responsibility of performing AML-related supervision of its customers.

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[549] 31 C.F.R. § 103.175(h)(1)(iii) (re-numbered 31 C.F.R. § 1010.605(f)(iii) effective March 1, 2011).

[550] 31 C.F.R. § 103.175(f)(1)(viii) (re-numbered 31 C.F.R. § 1010.605(e)(1)(viii) effective March 1, 2011).

[551] 31 C.F.R. § 103.176(a) (re-numbered 31 C.F.R. § 1010.610(a) effective March 1, 2011).

[552] 31 C.F.R. § 103.176(a)(2) (re-numbered 31 C.F.R. § 1010.610(a)(2) effective March 1, 2011).

[553] 31 C.F.R. § 103.176(a)(3) (re-numbered 31 C.F.R. § 1010.610(a)(3) effective March 1, 2011).

Glendale relied on Belize Bank to satisfy Glendale's customer identification obligations concerning the 18 undisclosed customers. Pursuant to 31 C.F.R. § 103.122(b)(6) (re-numbered 31 C.F.R. §1023.220(b)(6)), a broker-dealer may rely on another financial institution under certain conditions. First, the reliance must be reasonable under the circumstances. Second, the other financial institution must be subject to the AML compliance program of the USA PATRIOT Act and be regulated by a federal functional regulator. Third, the other financial institution must enter into a contract requiring it to certify annually to the broker-dealer that it has implemented an AML program and will perform specified requirements of the broker-dealer's CIP.[554] Given that customer identities were not disclosed to Glendale, reliance on Belize Bank was not reasonable. The bank also was not subject to the USA PATRIOT Act and it was not contractually bound to Glendale to perform customer identification requirements.

In their Answer to the Complaint, Glendale and Laubenstein acknowledged that Glendale had opened two types of accounts associated with Belize Bank. One type was for accounts in the name of the bank itself and the other was for accounts the bank introduced to the Firm. Glendale and Laubenstein argue that they did not have an obligation to conduct know-your-customer due diligence on the undisclosed customer accounts.[555] For this proposition, they rely on a June 2015 statement, or interpretation, by the Financial Action Task Force ("FATF") purportedly clarifying that its existing AML recommendations did not require financial institutions "to perform, as a matter of course, normal customer due diligence on the customers of their respondent banks when establishing and maintaining correspondent banking relationships."[556] Respondents' reliance on the FATF is misplaced. First, it does not reflect requirements contained in the BSA. Second, the FATF statement just refers to persons who are customers only of the correspondent bank, not bank customers who are also customers of a broker-dealer.

Glendale and Laubenstein failed to conduct reasonable due diligence into the nature of Belize Bank's undisclosed customers' activities, as required by the Bank Secrecy Act's implementing regulations. Glendale and Laubenstein also failed to respond to red flags associated with the undisclosed customers and their accounts. The Panel therefore finds that Glendale and Laubenstein violated FINRA Rules 3310(b) and 2010.

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[554] 31 C.F.R. § 103.122(b)(6) (re-numbered 31 C.F.R. §1023.220(b)(6), effective March 1, 2011). *See also* NASD Notice to Members 03-34 at 353.

[555] Amended Ans. ¶ 150. *See also* Glendale, Castillo, Flesche, Laubenstein, and Abadin's Pre-Hearing Br. 40-41. They also argue that because the SEC took no formal action against the Firm, the Panel should dismiss allegations against Glendale and Laubenstein associated with Belize Bank. Glendale, Laubenstein, and Abadin's Post-Hearing Br. 42-43.

[556] Amended Ans. ¶ 150 (citing http://www.fatf-gafi.org/documents/news/derisking-goes-beyond-amlcft.html.) *See also* Tr. 1038-39. FATF is an intergovernmental body established in 1989 for the purpose of setting standards and promoting effective measures to combat money laundering and other threats to the international financial system.

D. Supervisory Systems (Cause Four)

Cause four charges supervision-related violations of FINRA Rules 3110(a) and (b)[557] and 2010 in two areas. First, it charges the Firm, through Castillo and Flesche, with supervisory deficiencies relating to the sale of unregistered non-exempt securities. Second, it charges the Firm, acting through Flesche and Laubenstein, with failing to reasonably supervise Huang.

1. The Applicable Law

FINRA Rule 3110(a) requires members to "establish and maintain a system" that is "reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules." Rule 3110(b) requires members to "establish, maintain, and enforce written procedures to supervise the types of business in which it engages and the activities of its associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations and with applicable FINRA rules." FINRA Rule 3110(b)(4) requires a firm to have supervisory procedures, which are appropriate for its business, size, structure, and customers, to review incoming and outgoing written (including electronic) correspondence and internal communications relating to its investment banking and securities business.

It is well recognized that "[a]ssuring proper supervision is a critical component of broker-dealer operations."[558] "Proper supervision is the touchstone to ensuring that broker-dealer operations comply with the securities laws and [FINRA] rules."[559] "The duty of supervision includes the responsibility to investigate 'red flags' that suggest that misconduct may be occurring and to act upon the results of such investigation."[560]

2. Glendale's Supervisory System in Connection with the Sale of Unregistered Securities Was Reasonable

The Complaint charges that the Firm, through Castillo and Flesche, failed to establish and maintain a supervisory system, including WSPs, reasonably designed to achieve compliance with Section 5 of the Securities Act. It alleges that the Firm's supervisory system was not adequate to ensure that its customers sold microcap securities pursuant to an effective registration statement or a valid exemption from the registration requirement. More specifically, the Complaint charges that the WSPs did not set forth a standardized procedure for Firm personnel to conduct an inquiry to ensure that customer transactions qualified for available exemptions from registration.

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[557] FINRA Rule 3110, effective December 1, 2014, superseded NASD Rule 3010. *See* FINRA Regulatory Notice 14-10 (Mar. 2014), http://www.finra.org/industry/notices/14-10.

[558] *Richard F. Kresge*, Exchange Act Release No. 55988, 2007 SEC LEXIS 1407, at *27 (June 29, 2007).

[559] *Dennis S. Kaminski*, Exchange Act Release No. 65347, 2011 SEC LEXIS 3225, at *35 (Sept. 16, 2011).

[560] *Dep't of Enforcement v. Newport Coast Sec., Inc.*, No. 2012030564701, 2018 FINRA Discip. LEXIS 14, at *166-67 (NAC May 23, 2018) (quoting *Michael T. Studer*, 57 S.E.C. 1011, 1023-24 (2004)), *appeal docketed*, SEC Admin. Proc. No. 3-18555 (June 22, 2018).

It further charges that the WSPs merely contained general instructions and action items to ensure that a sale of securities qualifies for an exemption, but failed to describe the purpose of the reviews and the risks associated with each action item.[561]

Flesche's broad supervisory authority over the Firm's microcap liquidation business included approving or rejecting customer deposits of microcap securities for resale. Flesche accordingly reviewed supporting documentation customers provided that purportedly established that securities were eligible for resale.[562] In connection with RC's and JH's deposits and resales of NUGN shares, according to the Complaint, neither Castillo nor Flesche took action to determine whether there was a relationship between RC and JH and the persons from whom they acquired the shares to ensure that NUGN shares were eligible for resale. As a result, the Complaint charges, the Firm failed to determine that RC and JH received their shares from affiliates of NUGN, and therefore some of the NUGN shares they deposited were not eligible for immediate resale into the market.[563]

A majority of the Panel finds that Glendales's procedures were adequate, including the process Glendale, Castillo, and Flesche established and maintained of reviewing customer stock deposits. The Panel majority's conclusion is dictated in part by its finding that Glendale, Flesche, and Abadin did not commit underlying violations of Section 5 of the Securities Act in connection with RC's and JH's sales of NUGN, as alleged in cause two.

A majority of the Panel notes that the process for reviewing customer stock deposits, as discussed above, involved compiling a due diligence package. The due diligence package included forms (the DSRQ, Client Checklist, Broker Checklist, and Deposit Analysis) that customers and Firm principals and administrative personnel completed and signed approving or rejecting stock deposits. The Firm also required customers to submit documents evidencing the chain of ownership of the shares from the date of issuance. These documents included, for example, stock purchase agreements, evidence of payment for the security from the customer and from persons from whom the shares were acquired, relevant SEC filings by the issuer, attorney opinion letters, and transfer agent records.

A majority of the Panel therefore finds that Glendale's supervisory system and WSPs were reasonable. Accordingly, the Panel dismisses the allegations in cause four that Glendale, acting through Castillo and Flesche, failed to establish and implement a reasonable supervisory system to ensure compliance with Section 5 of the Securities Act.

As discussed below, the Hearing Officer respectfully dissents from the majority's conclusions.

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[561] Compl. ¶¶ 195-98.

[562] Compl. ¶ 199; Amended Ans. ¶ 199.

[563] Compl. ¶ 200.

3. Glendale, Flesche, and Laubenstein Failed to Reasonably Supervise Huang in Connection with His Dealings with His Customers

The Complaint charges that the Firm, acting through Flesche and Laubenstein, failed to supervise Huang's communications with his customers in Asia. Even though Flesche knew that Huang opened accounts and engaged in transactions with customers based in Asia, Enforcement alleges, he failed to inquire how Huang communicated with his customers generally or ensure that customers understood the substance of his communications.[564] These included Huang's Chinese language translations of portions of Glendale's new account documents and the VXEL customers' powers of attorney.

Laubenstein was responsible for reviewing Huang's emails.[565] The Complaint charges that his reviews were limited to periodic English-language word searches of emails contained in the Firm's email archive and he therefore failed to identify red flags of suspicious activity in Huang's emails with customers about VXEL. Enforcement contends that Laubenstein's review was also unreasonable because he took no steps to adopt search terms for Huang's non-English written communications even though he knew that Huang sent customers Chinese-language translations of Firm documents.[566]

The Panel finds that Flesche's and Laubenstein's supervision of Huang's communications was unreasonable given the number of Huang's customers, the customers' relationship with KTO and KSC, and the fact that the customers lived overseas. The Panel finds that Glendale, Flesche, and Laubenstein violated FINRA Rules 3110 and 2010.

E. Huang Violated SEC Regulation S-P (Cause Five)

Cause five charges that Huang shared his VXEL customers' nonpublic personal information with third persons without the customers' consent, in violation of SEC Regulation S-P, which is a violation of FINRA Rule 2010.

Regulation S-P requires broker-dealers to "adopt written policies and procedures that address administrative, technical, and physical safeguards for the protection of customer records and information."[567] It also prohibits broker dealers from "disclos[ing] any nonpublic personal information about a consumer to a nonaffiliated third party unless" the consumer receives proper

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[564] Compl. ¶ 201.

[565] Compl. ¶ 154; Amended Ans. ¶ 154.

[566] Compl. ¶¶ 202-03.

[567] 17 C.F.R. § 248.30(a). Regulation S-P also requires that a firm's policies and procedures be "reasonably designed to: (1) Insure the security and confidentiality of customer records and information; (2) Protect against any anticipated threats or hazards to the security or integrity of customer records and information; and (3) Protect against unauthorized access to or use of customer records or information that could result in substantial harm or inconvenience to any customer." 17 C.F.R. § 248.30(a).

notice and a "reasonable opportunity" to opt out of the disclosure.[568] FINRA has reminded members of their obligation to protect confidential customer information.[569]

Under Regulation S-P, "[n]onpublic personal information" means "[p]ersonally identifiable financial information."[570] "Personally identifiable financial information" includes information that a consumer provides to a broker-dealer to obtain a financial product or service. It also includes information about a consumer resulting from a transaction involving a financial product or service between a broker-dealer and a consumer. Another category is information a broker-dealer otherwise obtains about a consumer in connection with providing a financial product or service to the consumer.[571]

In January 2016, Huang provided the brokerage account numbers for 29 of his customers to KSC after KSC asked for them.[572] A customer's brokerage account number constitutes personally identifiable financial information because it is information associated with a financial product or service between Glendale and a customer. He also shared customers' financial information with third parties other than KTO and KSC.

The Panel therefore finds that Huang improperly disclosed confidential customer information by providing to a third party "nonpublic personal information" under Regulation S-P, in violation of FINRA Rule 2010.[573]

F. Huang Committed Books and Records Violations (Cause Six)

Cause six charges Huang with using a texting service on his cell phone to communicate with KTO and KSC instead of the Firm's email system, causing Glendale to keep inaccurate books and records.

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[568] 17 C.F.R. § 248.10(a)(1).

[569] *See* NASD Notice to Members 05-49 (July 2005), http://www.finra.org/industry/notices/05-49.

[570] 17 C.F.R. § 248.3(t). As defined in Regulation S-P, a "consumer" is "an individual who obtains or has obtained a financial product or service from [a broker-dealer] that is to be used primarily for personal, family, or household purposes, or that individual's legal representative." 17 C.F.R. § 248.3(g)(1). A "customer" is a consumer who has a continuing relationship with a broker-dealer under which the broker-dealer provides one or more financial products or services that are to be used primarily for personal, family, or household purposes. A consumer has a "continuing relationship" with a broker-dealer if the consumer has a brokerage account with the broker-dealer." 17 C.F.R. §§ 248.3(j), (k)(1), (k)(2)(i)(A).

[571] 17 C.F.R. §§ 248.3(u)(1)(i)-(iii).

[572] CX-73, at 5-7.

[573] A violation of Regulation S-P constitutes a violation of FINRA Rule 2010. *See Dep't of Enforcement v. Tomlinson*, No. 2009017527501, 2014 FINRA Discip. LEXIS 4, at *15 (NAC Mar. 5, 2014) (violating privacy requirements in Regulation S-P supports a finding that respondent violated his ethical obligations under the predecessor to FINRA Rule 2010), *petition for review denied*, Exchange Act Release No. 73825, 2014 SEC LEXIS 4982 (Dec. 11, 2014).

FINRA Rule 4511(a) requires FINRA members to "make and preserve" books and records as required under FINRA rules, the Exchange Act and applicable Exchange Act rules. Causing a firm to violate the SEC's recordkeeping requirements is a violation of Rule 4511.[574] A member firm's responsibility to retain electronic records, including emails relating to its business is well established.[575] Section 17(a)(1) of the Exchange Act provides that a broker-dealer "shall make and keep for prescribed periods such records, [and] furnish copies thereof, … as the Commission, by rule, prescribes as necessary or appropriate in the public interest for the protection of investors, or otherwise in furtherance of this Act." Exchange Act Rule 17a-4(b)(4) requires that a broker-dealer retain originals of all communications received or sent by the broker-dealer relating to its business for at least three years, the first two years in an easily accessible place. The requirement applies to all electronic communications relating to the firm's business, including emails.[576] Causing a firm to maintain false books and records violates FINRA Rules 4511 and 2010.[577]

Huang engaged in approximately 150 WeChat texts to communicate with KTO and KSC between mid-February and mid-March 2015. Huang's use of WeChat instead of the Firm's email system prevented Glendale from being able to capture his communications with KTO in its email archives, causing the Firm's records to be incomplete. The Panel therefore finds that Huang violated FINRA Rules 4511 and 2010.

IV. Sanctions

The Panel imposes sanctions against Respondents Glendale, Flesche, Laubenstein, and Huang for violations of causes three through six of the Complaint. In considering the appropriate sanctions to impose on these Respondents, the Panel consulted FINRA's Sanction Guidelines ("Guidelines"),[578] specifically, the General Principles Applicable to All Sanction Determinations ("General Principles"),[579] overarching Principal Considerations in Determining Sanctions ("Principal Considerations"),[580] as well as guidelines for specific violations. The General Principles explain that disciplinary sanctions "should be designed to protect the investing public

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[574] *See, e.g., Fox & Co. Invs., Inc.*, 58 S.E.C. 873, 891-94 (2005); *Wedbush Sec., Inc.*, Exchange Act Release No. 78568, 2016 SEC LEXIS 2794, at *35 n.36 (Aug. 12, 2016) (stating that a violation of FINRA's recordkeeping rules is also a violation of FINRA Rule 2010), *aff'd*, 719 F. App'x. 724 (9th Cir. 2018).

[575] *Dep't of Enforcement v. Dratel Group, Inc.*, No. 2009016317701, 2015 FINRA Discip. LEXIS 10, at *26 (NAC May 6, 2015) (citing *Dep't of Enforcement v. Legacy Trading Co.*, No. 2005000879302, 2009 FINRA Discip. LEXIS 12, at *54-55 (OHO Mar. 12, 2009), *aff'd*, 2010 FINRA Discip. LEXIS 20 (NAC Oct. 8, 2010)).

[576] *See* NASD Notice to Members 03-33 (July 2003), http://www.finra.org/industry/notices/03-33.

[577] *Dep't of Enforcement v. Escarcega*, No. 2012034936005, 2017 FINRA Discip. LEXIS 32, at *63-64 & n.37 (NAC July 20, 2017).

[578] FINRA Sanction Guidelines (2019), http://www.finra.org/industry/sanction-guidelines.

[579] Guidelines at 2-6.

[580] Guidelines at 7-8.

by deterring misconduct and upholding high standards of business conduct."[581] 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."[582] Sanctions should also be "more than a cost of doing business." They should be "a meaningful deterrent and reflect the seriousness of the misconduct at issue."[583] Adjudicators should impose sanctions "tailored to address the misconduct involved in each particular case."[584]

In determining sanctions for Glendale's supervision and AML-related violations of causes three and four of the Complaint, the Panel also considered that the Firm has relevant disciplinary history involving similar misconduct, which is an aggravating factor for determining sanctions. The Guidelines provide for imposing progressively escalating sanctions on recidivists beyond those outlined in the Guidelines. The Firm was disciplined by FINRA in 2010 for AML violations relating to a customer's liquidation of billions of shares of multiple speculative securities and failing to have in place a reasonable supervisory system to prevent the resale of unregistered securities.[585] Glendale consented to a $45,000 fine and censure.[586] The Panel finds that the prior action involved similar misconduct by the Firm. The Guidelines state that "[s]anctions imposed on recidivists should be more severe because a recidivist, by definition, already has demonstrated a failure to comply with FINRA's rules or the securities laws."[587] The Guidelines further note that imposing more severe sanctions "emphasizes the need for corrective action after a violation has occurred, discourages future misconduct by the same respondent, and deters others from engaging in similar misconduct."[588]

A. AML Violations (Cause Three) (Glendale and Laubenstein)

There is no specific Guideline for failing to establish and implement AML procedures. Because FINRA's rules requiring firms to implement AML programs are in substance supervisory requirements, the most analogous Guideline is the one for deficient supervision. Given the nature and duration of Glendale's and Laubenstein's AML-related misconduct, including their failures concerning customer identification, the Panel finds that the Guideline for

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

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

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

[584] Guidelines at 3 (General Principles, No. 3).

[585] Guidelines at 2-3 (General Principles, No. 2) (explaining that adjudicators should consider imposing more severe sanctions when the respondent's disciplinary history includes past misconduct that is similar to the misconduct at issue).

[586] The Panel rejects Glendale's argument that the 2010 disciplinary action cannot be considered as a prior action for sanctions determination purposes because it was not "exactly the same" violation. Glendale, Laubenstein, and Abadin's Post-Hearing Br., at 46. The prior misconduct was similar to the AML-related misconduct present in this case.

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

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

systemic supervisory failures is appropriate. Adjudicators should use this Guideline "when a supervisory failure is significant and is widespread or occurs over an extended period of time." The Guideline further instructs that, while "systemic supervisory failures typically involve failures to implement or use supervisory procedures that exist, systemic supervisory failures also may involve supervisory systems that have both ineffectively designed procedures and procedures that are not implemented."[589]

The Guideline for a firm's systemic supervisory failures instructs adjudicators to consider a fine between $10,000 and $310,000. Where aggravating factors predominate, consideration should be given to imposing a higher fine and ordering restitution or disgorgement in appropriate cases and suspending a firm with respect to any or all relevant activities or functions for a period of 10 business days to two years, or expelling the firm. Adjudicators may also consider imposing an undertaking, ordering a firm to revise its supervisory systems and procedures, or ordering a firm to engage an independent consultant to recommend changes to the firm's supervisory systems and procedures.

For a responsible individual, the Guidelines instruct adjudicators to consider a fine between $10,000 and $77,000, and, where aggravating factors predominate, suspending the person in any or all capacities for a period of 10 business days to two years, or barring the individual.[590]

1. Misconduct Associated with Customer Liquidations of NUGN, BRKO, and VXEL and Customer Identification Program

The Guideline for systemic supervisory failures contains eight principal considerations, each of which is relevant here in connection specifically with Glendale's liquidation business. Accordingly, the Panel finds the presence of multiple aggravating factors and determines that Glendale's and Laubenstein's misconduct was egregious. There are no mitigating factors present.

One principal consideration is whether the deficiencies allowed the violative conduct to occur or escape detection. Another is whether Glendale and Laubenstein failed to timely correct or address deficiencies once identified or failed to respond reasonably to "red flag" warnings. Respondents never critically questioned the liquidations by RC and JH and never conducted a meaningful investigation into NUGN, whose securities they were selling. As a result, they did not detect multiple red flags indicative of suspicious activity. Glendale, acting through Laubenstein, instead permitted RC, JH, and SEI to sell NUGN without probing whether the sales were part of a pump-and-dump scheme or timed to coincide with stock promotion efforts. The same applied to ECM's lucrative sales of BRKO, which resulted in proceeds exceeding $1.2 million after making a miniscule investment of less than $7,000 to buy the BRKO shares just a few months earlier.

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[589] Guidelines at 105-06.

[590] Guidelines at 105-06.

Other principal considerations are the number and dollar value of the transactions not adequately supervised as a result of the deficiencies and the nature, extent, size, character, and complexity of the activities or functions not adequately supervised. All of these considerations are aggravating factors here. The misconduct covered approximately one year.[591] In the first half of 2015, RC, JH, and SEI sold over 2.9 million shares of NUGN, which generated proceeds of more than $8.5 million.[592] In just six weeks during February and March 2016, ECM sold over 470,000 shares of BRKO for over $1.25 million. Within a few months, 30 customers deposited a large tranche of VXEL shares at Glendale.

Additional principal considerations include the number and type of customers, investors or market participants affected by the deficiencies and the extent to which the deficiencies affected market integrity or market transparency. The Panel finds that RC's, JH's, and SEI's liquidations of NUGN and ECM's sales of BRKO created a significant risk of harm to the investing public.

The Panel is mindful that adjudicators should impose sanctions that are remedial in nature and not punitive. Sanctions should protect the investing public, not penalize brokers, and prevent the violating firm and individuals from causing additional harm to the public. The Panel also fashioned sanctions to deter Glendale, Laubenstein, and others from engaging in this serious misconduct. The Guidelines also require that the Panel take into account a firm's size to ensure that sanctions are remedial and not punitive. Factors to consider in connection with assessing a firm's size are its financial resources, the nature of its business, the number of persons associated with it, and the level of trading activity.[593] The Panel believes that a significant fine and a censure are necessary to impress upon Glendale and other firms the importance of an adequate AML program.

Glendale also gained financially from its misconduct. The Panel took into consideration the commissions it earned from its customers' sales of NUGN ($220,103), BRKO ($38,438), and VXEL ($1,343), which amount to nearly $260,000.

After careful consideration of the principal considerations and the facts and circumstances of this case, the Panel concludes that the appropriate remedial sanction for the Firm's AML violations charged in cause three is a $125,000 fine. When determining this sanction, the Panel considered Glendale's prior disciplinary history.

Applying the same principal considerations to Laubenstein's misconduct, the Panel determines that the appropriate sanction for his AML violations, including misconduct associated with the Firm's CIP in connection with Huang's VXEL customers, as charged in cause three, is a

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[591] Guidelines at 7 (Principal Considerations, Nos. 8, 9) (whether respondent engaged in numerous acts and/or a pattern of misconduct and whether the respondent engaged in the misconduct over an extended period of time).

[592] Guidelines at 8 (Principal Considerations, No. 17) (the number, size and character of the transactions at issue).

[593] Guidelines at 2-3 (General Principles, Nos. 1, 2).

$20,000 fine and a two-year suspension from associating with any FINRA member firm in any capacity.

2. Misconduct Related to Belize Bank

The Panel finds that Glendale and Laubenstein failed to understand their obligations with respect to foreign financial institutions under the Bank Secrecy Act and FINRA rules. Thus they did not comprehend the nature of Belize Bank's business and its relationships with its customers. The Panel notes that Enforcement presented no evidence indicating the presence of aggravating factors—for example, potentially suspicious trading activity or suspicious money movements by the undisclosed customers.

The Panel carefully considered the facts and circumstances involving Glendale's relationship with Belize Bank. The Panel finds that it would not serve a remedial purpose to impose a monetary fine on Glendale or Laubenstein or suspend Laubenstein for their failure to perform proper due diligence on the bank and its customers.[594]

For these reasons, the Panel concludes that a Letter of Caution will prevent future misconduct by Glendale and Laubenstein and serve as a general deterrent against other member firms and registered persons considering similar activities involving foreign financial institutions and their customers.[595] Accordingly, this Decision will constitute a Letter of Caution as to Glendale and Laubenstein.[596]

B. Supervision of Huang (Cause Four) (Glendale, Flesche, and Laubenstein)

For a failure to supervise, the Guidelines recommend a fine in the range of $5,000 to $77,000, suspending the responsible individual in all supervisory capacities for up to 30 business days, and limiting the activities of the appropriate branch office or department for up to 30 business days. In egregious cases, the Guidelines direct adjudicators to consider limiting the activities of the branch office or department for a longer period or suspending the firm with respect to any or all activities or functions for up to 30 business days. Adjudicators should also

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[594] Guidelines at 3-4 (General Principles, No. 3) (adjudicators should tailor sanctions to respond to the misconduct at issue).

[595] Guidelines at 2 (General Principles, No. 1) (disciplinary sanctions should be designed to protect the investing public by deterring misconduct and upholding high standards of business conduct).

[596] *See Dep't of Enforcement v. Mutual Servs. Corp.*, No. EAF0400630001, 2008 FINRA Discip. LEXIS 62, at *136-37 & n.314 (OHO Dec. 16, 2008) (considering mitigating factors, a Letter of Caution is sufficient to remediate misconduct and protect the investing public) (citing *Dist. Bus. Conduct Comm. v. Greenberg*, No. C9B9200008, 1993 WL 968256, at *5 (NBCC Aug. 3, 1993)) (considering the nature of the offense, among other mitigating factors, a Letter of Caution in place of censure and fine is appropriate because censure and fine "would not serve any remedial purpose"), *modified sub nom. Department of Enforcement v. Kaminski*, No. EAF0400630001, 2010 FINRA Discip. LEXIS 12 (NAC Aug. 18, 2010), *aff'd*, Exchange Act Release No. 65347, 2011 SEC LEXIS 3225 (Sept. 16, 2011).

consider suspending the responsible individual in any or all capacities for up to two years or barring the responsible individual.[597]

The principal considerations that adjudicators must evaluate include whether a respondent ignored "red flag" warnings that should have resulted in additional supervisory scrutiny and whether the individual responsible for the underlying misconduct attempted to conceal misconduct from the respondent. Adjudicators must also consider the nature, extent, size, and character of the underlying misconduct and the quality and degree of the supervisor's implementation of the firm's procedures and controls.[598]

Flesche and Laubenstein knew that Huang opened accounts and engaged in securities transactions for customers in Asia, and that some of the customers likely did not speak English. These are red flags that required them to consider more supervisory measures. They nonetheless failed to learn how Huang communicated with the customers. Laubenstein was given the responsibility of reviewing Huang's incoming and outgoing emails. He failed to follow up on the emails that Huang had with KTO and KSC about the customers who deposited shares of VXEL. Laubenstein used only English language word searches to review Huang's email communications with customers. Both Flesche and Laubenstein knew that Huang had translated portions of the Firm's account application and related forms but they did not confirm that the translations were accurate and complete. They each failed to take reasonable measures to ensure that Huang's customers understood his email communications and Glendale's documents.

Proper supervision is critical to the securities industry's self-regulatory system.[599] The Panel is troubled by the supervisory failures. Given that Huang was in New York, and Flesche and Laubenstein were in California, these deficiencies allowed Huang to conduct business with a number of his customers without consistent and reasonable oversight. It is also a concern for the Panel that—like Glendale's other customers—Huang and his customers were involved in trading microcap securities, a business that presents significant risks to the investing public.

The Panel finds it appropriate to censure the Firm and fine the Firm and Flesche $30,000, jointly and severally, for their failure to reasonably supervise Huang. The fine is near the middle of the recommended fine range in the Guidelines. The Panel finds it appropriate also to suspend Flesche, who had primary responsibility for supervising Huang, from associating with any member firm in any capacity for 30 business days. The Panel also finds that the appropriate sanctions for Laubenstein's supervisory deficiencies are a $5,000 fine and a suspension from associating with any member firm in any capacity for 15 business days. This suspension will run concurrently with the 18-month suspension for AML-related misconduct alleged in cause three.

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[597] Guidelines at 104.

[598] Guidelines at 104.

[599] *Ronald Pellegrino*, Exchange Act Release No. 59125, 2008 SEC LEXIS 2843, at *33 (Dec. 19, 2008) ("Assuring proper supervision is a critical component of broker-dealer operations.").

C. Huang's Violations of SEC Regulation S-P (Cause Five)

The Guidelines do not contain recommended sanctions for violating Regulation S-P. The Panel therefore considered the recommendations contained in the Principal Considerations in Determining Sanctions and other relevant factors in imposing remedial sanctions.[600]

The Panel considered that Huang acted intentionally, or at least recklessly, by including third persons in his emails to KTO and KSC that provided customers' information without the customers' consent.[601] The Panel however also considered that Huang's misconduct did not involve numerous acts or reflect a pattern of misconduct. Nor did he engage in the misconduct over an extended period.[602]

After considering all the circumstances, the Panel determines that it is not appropriate, nor would it not serve remedial purpose, to fine or suspend Huang for this misconduct. Instead, the Panel finds it appropriate to caution Huang about his misconduct. Accordingly, this Decision shall serve as a Letter of Caution.

D. Huang's Books and Records Violation (Cause Six)

For recordkeeping violations, the Guidelines instruct adjudicators to consider imposing a fine between $1,000 and $16,000 and suspending the responsible individual in any or all capacities for a period of 10 business days to three months. Where aggravating factors predominate, adjudicators should consider a fine of $10,000 to $155,000 and a longer suspension (of up to two years) or a bar. The principal considerations for determining sanctions for recordkeeping violations are (i) the nature and materiality of the inaccurate or missing information; (ii) the nature, proportion, and size of the firm's records that are at issue; (iii) whether inaccurate or missing information was entered or omitted intentionally, recklessly, or as the result of negligence; (iv) whether the violations occurred during two or more examination or review periods or over an extended period of time, or involved a pattern of misconduct; and (v) whether the violations allowed other misconduct to occur or escape detection.[603]

The Panel found that Huang's use of WeChat instead of the Firm's email system was intentional. It was primarily motivated by a desire to accommodate his customers' preference to communicate via a texting platform widely used in Asia and was occasioned by the time

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[600] *Tomlinson*, 2014 FINRA Discip. LEXIS 4, at *24-25 (applying the Guidelines' Principal Considerations in Determining Sanctions for violations of Regulation S-P); *Dep't of Enforcement v. DiFrancesco*, No. 2007009848801, 2010 FINRA Discip. LEXIS 37, at *19-20 (NAC Dec. 17, 2010) (same), *aff'd*, Exchange Act Release No. 66113, 2012 SEC LEXIS 54 (Jan. 6, 2012).

[601] Guidelines at 8 (Principal Considerations, Nos. 13, 17) (whether respondent's misconduct was the result of an intentional act, recklessness, or negligence) (the number, size, and character of the transactions at issue).

[602] Guidelines at 7 (Principal Considerations, Nos. 8, 9) (whether the respondent engaged in numerous acts and/or a pattern of misconduct) (whether the respondent engaged in the misconduct over an extended period of time).

[603] Guidelines at 29.

difference. The Panel considered that Huang communicated with KTO and KSC for about a month, during which time he exchanged about 150 texts—a relatively short time and involving a limited number of communications. The Panel also considered that most of the texts addressed administrative or logistical issues surrounding the 29 customers that KTO and KSC had introduced to the Firm.

Some of Huang's texts with KTO and KSC, however, were troubling. He used WeChat in a few instances to respond to emails from KTO that contained potentially inappropriate requests about securities trades. Instead of emailing his responses, he turned to WeChat, thereby concealing his communications with KTO and KSC from Glendale. This deprived the Firm of the opportunity to surveil Huang's complete conversations with KTO. Huang did not tell Glendale he was using WeChat, so the Firm was unaware he was communicating with KTO and KSC via text instead of Firm email.

When fashioning appropriate sanctions, the Guidelines instruct adjudicators to consider whether the employer disciplined the respondent by imposing a fine or a suspension.[604] Here, Huang received only a Letter of Caution from Glendale. Accordingly, the Panel gave this no mitigative weight in determining sanctions.

Considering all the circumstances, the Panel finds it appropriately remedial to suspend Huang from associating with any FINRA member firm in any capacity for ten business days and fine him $5,000.

V. Order

As set forth above, the Hearing Panel dismisses causes one and two of the Complaint because Enforcement failed to meet its burden of proof. Enforcement failed to prove by a preponderance of the evidence that Glendale and Castillo violated Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5 thereunder, and FINRA Rules 2020 and 2010 by manipulating the price of NUGN.

A majority of the Panel also finds that Enforcement failed to prove by a preponderance of the evidence that Glendale, Flesche, and Abadin participated in the unlawful resale by customers RC and JH of NUGN shares, in violation of Section 5 of the Securities Act, which constitutes a violation of FINRA Rule 2010. These charges are therefore also dismissed.

As for the remaining causes of action in the Complaint, Respondents are sanctioned as follows:

[604] Guidelines at 5 (General Principles, No. 7).

Glendale Securities Inc.:

- Censured and fined $125,000 for the AML-related violations of FINRA Rules 3310 and 2010 associated with its customers' deposit and liquidation of NUGN, BRKO, and VXEL (Cause Three).

- Censured and fined $30,000 jointly and severally with Paul Eric Flesche for failing to reasonably supervise Huanwei Huang, in violation of FINRA Rules 3110 and 2010 (Cause Four).

- This Decision shall serve as a Letter of Caution for the failure to conduct proper due diligence on Belize Bank and its customer accounts, in violation of FINRA Rules 3310 and 2010 (Cause Three).

Respondent Paul Eric Flesche:

- Suspended from associating with any FINRA member firm in any capacity for 30 business days and fined $30,000, jointly and severally with Glendale Securities, Inc., for failing to supervise Huanwei Huang, in violation of FINRA Rules 3110 and 2010 (Cause Four).

Respondent Albert Raymond Laubenstein:

- Suspended from associating with any FINRA member firm in any capacity for 18 months and fined $20,000 for AML-related violations of FINRA Rules 3310 and 2010 associated with the liquidations of NUGN, BRKO, and VXEL (Cause Three).

- Suspended from associating with any FINRA member firm in any capacity for 15 business days and fined $5,000 for failing to supervise Huang, in violation of FINRA Rules 3110 and 2010 (Cause Four). This suspension will run concurrently with the 18-month suspension imposed for misconduct alleged in cause three.

- This Decision shall serve as a Letter of Caution for the failure to conduct proper due diligence on Belize Bank and its customer accounts, in violation of FINRA Rules 3310 and 2010 (Cause Three).

Respondent Huanwei Huang:

- For sharing customers' nonpublic personal information with third parties in violation of Regulation S-P, which is a violation of FINRA Rule 2010, this Decision shall serve as a Letter of Caution (Cause Five).

- Suspended from associating with any FINRA member firm in any capacity for ten business days and fined $5,000 for books and records violations of FINRA Rules 4511 and 2010 associated with engaging in securities-related communications with a customer and a third party via text instead of Firm email (Cause Six).

Respondents Glendale, Flesche, Laubenstein, and Huang are ordered to pay the costs of the hearing in the amount of $22,289.23, which includes a $750 administrative fee and the cost of the hearing transcript, $21,539.38. Their responsibility to pay these costs is apportioned as follows: Glendale is ordered to pay $12,289.23; Laubenstein is ordered to pay $5,500; Flesche is ordered to pay $2,500; and Huang is ordered to pay $2,000.[605]

If this decision becomes FINRA's final disciplinary action, the suspensions shall become effective with the opening of business on Monday, June 3, 2019. Respondent Laubenstein's suspension of 15 business days for the misconduct alleged in cause four is to run concurrently with the 18-month suspension for the misconduct alleged in cause three. Respondent Huang's suspension of ten business days shall end at the close of business on Friday, June 14, 2019. Respondent Flesche's suspension of 30 business days shall end at the close of business on Monday, July 15, 2019.

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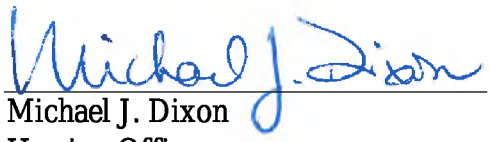
[605] Unless "equity otherwise dictates," responsibility for costs is generally imposed jointly and severally on multiple parties found liable for misconduct. *Newport Coast Sec. Inc.*, 2018 FINRA Discip. LEXIS 14, at *223-24 (citing *Concord Boat Corp. v. Brunswick Corp.*, 309 F.3d 494, 497 (8th Cir. 2002)). There is precedent in this forum for apportioning costs between respondents. *See, e.g., Dist. Bus. Conduct Comm. v. Equity One Corp.*, No. DEN-659, 1988 NASD Discip. LEXIS 30, at *114-15 (Bd. of Governors Aug. 29, 1988) (imposing costs on a per capita basis because "respondents ... had differing degrees of involvement in the facts underlying the allegations of the complaint," their hearing presentations "varied considerably in length and complexity," and it was not "appropriate to burden any one of these respondents with the entire cost of the ... proceeding in order to remain in the securities business").

In this case, the Panel finds that equity dictates the imposition of costs on an apportioned basis given the different degrees of responsibility and liability among Respondents Glendale, Flesche, Laubenstein, and Huang for the misconduct alleged in the Complaint. Also, if all of the costs were imposed jointly and severally, and one or more Respondents failed to pay them, it would be unfair for one or more of the other Respondent(s) to shoulder all the costs in order to re-associate with a member firm.

The fines and assessed costs shall be due on a date set by FINRA, but not sooner than 30 days after this decision becomes FINRA's final disciplinary action in this proceeding.[606]



Michael J. Dixon
Hearing Officer
For the Extended Hearing Panel

DISSENT

Hearing Officer dissenting, in part, from the majority of the Panel regarding the following two causes of the Complaint:

Cause Two

I am unable to join in the Panel majority's conclusion that Enforcement failed to prove that Glendale, Flesche, and Abadin violated Section 5 of the Securities Act, which constitutes a violation of FINRA Rule 2010. The majority determined that Respondents discharged their duty of reasonable inquiry under the broker's exemption set forth in Section 4(a)(4) of the Securities Act. I respectfully disagree with their conclusion.

As an initial matter, I note that in the Broker Checklist prepared simultaneously with RC's deposit of 2.9 million shares of NUGN on February 11, 2015, Glendale and Flesche stated that the shares were registered pursuant to an S-1 registration statement declared effective by the SEC in March 2014. The DSRQ also recorded at the time that RC's deposit constituted 7.4 percent of the total NUGN shares outstanding. Abadin indicated on the Broker Checklist his recommendation that Glendale accept the shares the same day that RC deposited them; Flesche formally approved the deposit the next day. In their Answer to the Complaint, Glendale, Flesche, and Abadin also claimed that the shares acquired by RC (and JH) "were *registered* securities."[607] Accordingly, I cannot conclude that Glendale, Flesche, and Abadin conducted a reasonable or "searching" inquiry at the time of RC's deposit.

The courts have held that a broker may claim the Section 4(a)(4) exemption only if "after reasonable inquiry [the broker] is not aware of circumstances indicating that the person for whose account the securities are sold is an underwriter with respect to the securities or that the transaction is a part of a distribution of securities of the issuer."[608] A broker may not act merely

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[606] The Extended Hearing Panel considered and rejected without discussion all other arguments of the parties.

[607] Amended Ans. ¶ 71 (emphasis in original).

[608] *Wonsover*, 205 F.3d at 415 (quoting SEC Rule 144(g)(4)).

as an "order taker," and must conduct a reasonable inquiry into the circumstances surrounding the transaction before the broker may claim the exemption.

The circumstances surrounding RC's purchases of NUGN contained numerous red flags that should have triggered a true "searching inquiry," as the SEC has instructed. RC deposited a substantial number of NUGN shares. NUGN was a little-known company with modest prospects at the time, according to its own SEC filings, and had just recently been involved in a reverse merger. The persons from whom RC bought NUGN had the same surname. RC, including its principal, were not familiar to Respondents. They were new Glendale customers who had not established a track record at the Firm that Flesche and Abadin could otherwise have relied on to ensure that they had been given all necessary information to adequately conduct a review of the deposit.

Additional factors were suspicious. The stock had traded just once as BLMK (in January 2015) and only recently (a week earlier, February 4) had begun trading as NUGN. RC opened its account solely for the purpose of liquidating its recently acquired NUGN shares. Also, relying on the transfer agent, as Respondents did, is insufficient to discharge a duty of reasonable inquiry.[609] Furthermore, conducting Google, OFAC, and SEC searches was inadequate considering all the circumstances and the presence of so many red flags. Such searches are not likely to uncover potential relationships among parties to a security transaction.

JH's deposit of another large tranche of NUGN shares on February 27 (which also was the day that RC started liquidating its shares), followed by SEI's deposit on March 2 and JH's second and much larger deposit on March 10, should also have raised red flags concerning RC's deposit two weeks earlier. The three customers had purchased their BLMK shares nearly at the same time, and paid little for them. RC was able to generate enormous revenues from its sales as a result of NUGN's dramatic price increase. Even assuming Respondent's inquiry into RC's deposit was reasonable at the time, JH's and SEI's deposits should have caused Respondents to reconsider whether RC's deposit was part of a distribution of the issuer's securities.

I therefore would have found that Glendale, through Flesche and Abadin, violated Section 5 of the Securities Act, which is a violation of FINRA Rule 2010, by participating in RC's sales of NUGN shares (before June 18, 2015) that it had acquired from NF. I would also have imposed appropriately remedial sanctions as follows: (i) a censure and a $20,000 fine against Glendale, (ii) a suspension from associating with any FINRA member firm in any capacity for one month and a $10,000 fine against Flesche, and (iii) a suspension from associating with any FINRA member firm in any capacity for one month and a $5,000 fine against Abadin.[610]

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[609] *Wonsover*, 205 F.3d at 415-16 ("If a broker relies on others to make the inquiry called for in any particular circumstances, it does so at its peril.").

[610] *See* Guidelines at 24.

Cause Four

I also dissent from the majority's conclusion that Enforcement failed to prove by a preponderance of the evidence that Glendale, Castillo, and Flesche failed to establish and maintain a reasonable supervisory system, including WSPs, to ensure compliance with Section 5 of the Securities Act, as alleged in cause four. The Complaint charges them with violating FINRA Rules 3110 and 2010. Both Castillo and Flesche were given the responsibility in the Firm's procedures of ensuring compliance with Section 5. Flesche also specifically reviewed customer stock deposits and supporting documentation. He signed the various forms that made up the Firm's due diligence package to evidence his approval of deposits.

As Glendale, Castillo, and Flesche noted in their Answer, the Firm's customers predominantly traded in low-priced securities, and accordingly they expect "virtually every one" of their customers to trigger at least one red flag. The Firm's procedures do not reflect this view. Instead, the Firm's procedures for compliance with Section 5 consisted of just over one page that provided general statements and a list of bullet points identifying the categories of documents to obtain and examine when reviewing a stock deposit. The procedures stated that before selling securities in reliance on an exemption the Firm "must take reasonable steps to ensure that the transaction qualifies for the exemption." The procedures also required "taking whatever steps [are] necessary to ensure that the sale does not involve an issuer, a person in a control relationship with an issuer, or an underwriter with a view to offer or sell the securities in connection with an unregistered distribution."

The procedures, in my view, failed to describe the specific purpose of the reviews and the risks associated with each bullet point listed in the WSPs under "resources" and "action" as part of a review of a stock deposit. As implemented in practice, the Firm employed a "check-the-box" process for completing required forms and obtaining documents that it used to review a customer's stock deposits. This process failed to identify for Firm personnel examples of red flags that could be indicative of an unlawful distribution of restricted securities.

In summary, I would have found that Glendale, acting through Castillo and Flesche, failed to have in place a reasonable supervisory system, including WSPs, to ensure compliance with Section 5 of the Securities Act, in violation of FINRA Rules 3110 and 2010. I would also have imposed appropriately remedial sanctions as follows: (i) a censure and a $20,000 fine against Glendale, (ii) a suspension from associating with any FINRA member firm in any capacity for one month and a $10,000 fine against Castillo, and (iii) a suspension from associating with any FINRA member firm in any capacity for one month and a $10,000 fine against Flesche.[611]

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[611] *See* Guidelines at 104, 107.

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