

No. _____

**In the
Supreme Court of the United States**

ERIC S. SMITH,
Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION, ET AL.,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

The Securities Exchange Act permits “[a] person aggrieved by a final order” of the Securities and Exchange Commission (SEC) to obtain review of the order in a federal court of appeals. 15 U.S.C. § 78y(a)(1). The Act further states that “[n]o objection” to an SEC order or rule “for which review is sought . . . may be considered by the court unless it was urged before the Commission or there was reasonable ground for failure to do so.” *Id.* § 78y(c)(1).

Petitioner sought judicial review of an SEC final order under Section 78y(a)(1), arguing, *inter alia*, that the SEC’s imposition of monetary sanctions against him violated his Seventh Amendment rights under *SEC v. Jarkesy*, 603 U.S. 109 (2024). The Sixth Circuit recognized this claim likely had merit, but refused to consider it because petitioner did not raise the claim before the SEC. In addition, even though the SEC had repeatedly rejected similar jury-trial claims, the court held that exhaustion was not futile because the SEC theoretically could have vacated the sanctions and filed a new action in federal court.

The questions presented—on which the circuits are in conflict—are:

1. Whether a statutory issue-exhaustion requirement bars a court of appeals from considering a constitutional claim challenging the inherent nature of the agency proceeding itself, if the party did not present that claim to the agency.

2. Whether a party may satisfy Section 78y(c)(1)’s issue-exhaustion requirement by showing that presentation of a claim to the agency would have been clearly useless or, instead, must show that the agency was formally powerless to grant the relief requested.

PARTIES TO THE PROCEEDING

Petitioner (petitioner below) is Eric S. Smith.

Respondents are the Securities and Exchange Commission (which was respondent below) and the Financial Industry Regulatory Authority, Inc. (which was intervenor below).

RELATED PROCEEDINGS

United States Court of Appeals (6th Cir.):

Smith v. United States SEC, No. 24-3907 (June 16, 2026), *reh'g denied* (July 16, 2026);

In re: Smith, No. 24-1189 (Aug. 5, 2024) (ordering response to petition for mandamus); and

In re: Smith, No. 24-1189 (Nov. 8, 2024) (denying petition for mandamus).

Securities and Exchange Commission:

In the Matter of the Application of Smith, Exchange Act Release No. 100762, Admin. Proc. File No. 3-20127 (Aug. 19, 2024).

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PETITION FOR A WRIT OF CERTIORARI

Petitioner Eric S. Smith respectfully petitions this Court for a writ of certiorari to review the judgment of the United States Court of Appeals for the Sixth Circuit in this case.

OPINIONS BELOW

The amended opinion of the Sixth Circuit Court of Appeals (App. 1a-23a) is reported at 178 F.4th 312.

JURISDICTION

The court of appeals entered its judgment on March 27, 2026, issued an amended opinion on June 16, 2026 (App. 1a-23a), and denied a timely petition for rehearing on July 16, 2026 (App. 144a-45a). This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

The relevant statutory provisions are reproduced at App. 149a-52a.

INTRODUCTION

Judicial review before an Article III court provides a beacon of liberty for those who find themselves enmeshed in unconstitutional proceedings before the administrative state. This case presents two questions concerning whether, or when, an individual may be deprived of the opportunity for judicial review of his claim that the inherent structure of an agency proceeding violated his constitutional rights because he did not present the claim to the agency first. The circuits are split on both questions. In this case, the Sixth Circuit invoked its precedent to foreclose judicial review of the petitioner’s claims—namely, that he was entitled to a jury trial and, at the very least, to an Article III tribunal—despite explicitly recognizing the likely merit of his jury-trial claim.

Petitioner Eric Smith was embroiled in proceedings before the Securities and Exchange Commission (SEC) and its private adjunct, the Financial Industry Regulatory Authority (FINRA), for more than seven years before he was finally able to reach a federal court—the Sixth Circuit. Before that court, he argued that the agencies’ imposition of a \$130,000 fine against him violated both Article III and his Seventh Amendment right to a jury trial under *SEC v. Jarkesy*, 603 U.S. 109 (2024). *Jarkesy* held that where a suit “is in the nature of an action at common law,” “the matter presumptively concerns private rights, and adjudication by an Article III court is mandatory”—and “with a jury if the Seventh Amendment applies.” *Id.* at 127-28. The Sixth Circuit recognized that Smith’s jury trial claim was “seemingly . . . straightforward” under *Jarkesy*. App. 20a. Yet the court held it was forbidden from

considering that claim because Smith had not presented it to the SEC first. *Id.* at 18a-19a.

The Sixth Circuit pointed to the SEC’s issue-exhaustion statute, which provides that “[n]o objection” to a Commission order “may be considered by the court unless it was urged before the Commission or there was reasonable ground for failure to do so.” 15 U.S.C. § 78y(c)(1). The Sixth Circuit rejected Smith’s arguments that Section 78y(c)(1) does not bar structural constitutional claims challenging the inherent nature of an agency proceeding itself, and that the failure to exhaust should be excused where raising an argument would be clearly useless as a practical matter.

That ruling deepens two circuit conflicts. First, the circuits are split over whether mandatory issue-exhaustion statutes, like 15 U.S.C. § 78y(c)(1), apply to structural constitutional claims challenging the inherent nature of the proceeding itself. The Ninth and Third Circuits hold that such statutes do not withdraw a court’s power to review structural constitutional claims. *See NLRB v. North Mountain Foothills Apartments*, 157 F.4th 1089, 1096-97 (9th Cir. 2025); *Advanced Disposal Servs. E., Inc. v. NLRB*, 820 F.3d 592, 597-98, 600 (3d Cir. 2016). In the decision below, the Sixth Circuit joined the Second, Fifth, Eighth, Tenth, and D.C. Circuits in reading such statutes to bar review of those claims. *See App.* 12a-18a; *Gonnella v. U.S. SEC*, 954 F.3d 536, 544 (2d Cir. 2020); *Harvard Maint., Inc. v. NLRB*, 165 F.4th 886, 897 & n.11 (5th Cir. 2026); *NLRB v. RELCO Locomotives, Inc.*, 734 F.3d 764, 796-98 (8th Cir. 2013); *3484, Inc. v. NLRB*, 137 F.4th 1093, 1112-13 (10th Cir. 2025); *Springsteen-Abbott v. SEC*, 989 F.3d 4, 9 (D.C. Cir. 2021). These courts have acknowledged

that the “circuits are divided on this issue.” *North Mountain*, 157 F.4th at 1096; see *3484, Inc.*, 137 F.4th at 1114 n.8; *Advanced Disposal*, 820 F.3d at 598-600. And, within that conflict, the circuits are specifically divided over treatment of the lead constitutional claim here—the right to a jury trial.

Second, the circuits are divided over the standard for futility under Section 78y(c)(1). All courts recognize that Section 78y(c)(1)—which excuses the failure to exhaust a claim when “there was reasonable ground for failure to do so,” 15 U.S.C. § 78y(c)(1)—incorporates a futility exception. But the circuits are split on what a party must show to establish that presenting a claim to the agency would have been futile. The D.C. and Tenth Circuits ask whether presenting the objection would have been “clearly useless,” a standard satisfied by a settled agency position denying the objection. *Doe v. SEC*, 176 F.4th 32, 40 (D.C. Cir. 2026) (citation omitted); *Malouf v. SEC*, 933 F.3d 1248, 1257 (10th Cir. 2019), *cert. denied*, 589 U.S. 1269 (2020). The Sixth Circuit nonetheless requires that the agency have been formally “powerless to grant the relief requested.” App. 17a (citation omitted). Here, the difference between these standards is critical. The SEC had repeatedly—and in every instance—rejected Seventh Amendment claims like Smith’s. Yet, because the SEC theoretically had the “power” to suddenly reverse its settled position, vacate the administrative case against Smith, and bring a new, SEC-initiated action against him in federal court, the Sixth Circuit held that Smith’s claim was barred.

These questions are important because, as this case illustrates, they can determine whether meritorious structural constitutional claims receive

judicial review at all. Article III review serves as a critical check on the administrative state and the principal protection available to individuals subject to agency proceedings. Forcing litigants to raise these constitutional objections before the agencies themselves does not advance either interest that exhaustion exists to serve. The agency gains nothing, because it has neither the competence nor the authority to grant the relief sought. The courts gain nothing, because no reasoned agency decision follows.

Nor are the stakes confined to the SEC: Comparable exhaustion provisions govern review of orders of the NLRB, the Federal Mine Safety and Health Review Commission (FMSHRC), the Occupational Safety and Health Review Commission (OSHRC), and the Federal Energy Regulatory Commission, among others, and courts construe them interchangeably. Here, the Sixth Circuit itself recognized that petitioner’s Seventh Amendment jury trial claim likely had merit under *Jarkesy*. App. 18a-20a. Yet, the court held that it was unable to hear Smith’s *Jarkesy* claim—allowing a glaring structural constitutional violation to go unremedied. This Court has long insisted that “any seeming curtailment” of the jury-trial right “should be scrutinized with the utmost care.” *Jarkesy*, 603 U.S. at 121 (citation omitted). For individuals like Smith, the decision below forecloses that scrutiny altogether.

The Sixth Circuit’s position is wrong. As this Court has observed, “agency adjudications are generally ill suited to address structural constitutional challenges, which usually fall outside the adjudicators’ areas of technical expertise.” *Carr v. Saul*, 593 U.S. 83, 92 (2021). Thus, it “makes little sense to require litigants to present claims to

adjudicators who are powerless to grant the relief requested,” and such a “vain exercise will rarely protec[t] administrative agency authority or promot[e] judicial efficiency.” *Id.* at 93 (alterations in original) (citation omitted). Those principles at least supply a “reasonable ground” for not presenting a claim to the agency first. 15 U.S.C. § 78y(c)(1). Moreover, the SEC had no expertise or competence to adjudicate Smith’s structural constitutional objections, no power or procedure to empanel a jury, and no reason to reconsider its repeated rejection of similar arguments in published decisions.

Requiring Smith to present the objections in those circumstances would have further delayed review of illegal agency action without producing a meaningful agency decision or record. Because of the glacial pace of the SEC in-house process and the SEC’s unilateral, unexplained extensions of time to render a decision, it took more than five years for Smith’s case finally to reach an Article III court. During that time, Smith’s reputation and ability to make a living were in shambles, because of the professional death sentence that FINRA sought against him and which the SEC sustained. Indeed, most individuals in Smith’s position simply throw in the towel and settle, rather than fight, even if, as in Smith’s case, they strongly contest the allegations and the agency’s processes. There is no basis to close the courthouse doors on individuals like Smith who risk it all in order to expose inherent constitutional flaws in the agency process, simply because they did not take the futile step of allowing the agency to reject the claim first.

The petition should be granted.

STATEMENT OF THE CASE

A. Statutory Background

The Securities Exchange Act of 1934 entrusts the SEC with enforcing the nation’s securities laws. In 1938, the Maloney Act encouraged broker-dealers to organize privately incorporated securities associations and to register those associations with the SEC as self-regulatory bodies. While membership in such an association was voluntary at first, Congress made it mandatory in 1983, barring any person from engaging in the securities business unless he or she joins a registered exchange or securities association. Pub. L. No. 98-38, § 3, 97 Stat. 205, 206-07 (1983) (amending 15 U.S.C. § 78o(b)(8)); *see Alpine Sec. Corp. v. FINRA*, 121 F.4th 1314, 1321 (D.C. Cir. 2024), *cert. denied*, 145 S. Ct. 2751 (2025).

Today, FINRA is the only recognized securities association. FINRA is a private organization whose authority, like that of other private organizations, extends only to its own members and registrants. 15 U.S.C. §§ 78o-3(b)(7), 78s(d)-(e). FINRA writes the rules it enforces, brings the charges, and adjudicates them: A disciplinary complaint is tried before a panel chaired by a FINRA employee and staffed by two industry members. This is done without a jury. An appeal runs to FINRA’s own National Adjudicatory Council. FINRA Rule 9311, <https://www.finra.org/rules-guidance/rulebooks/finra-rules/9311>.

FINRA’s sanctions bite before any government officer reviews them. An application for Commission review does not stay the sanction. 15 U.S.C. § 78s(d)(2); 17 C.F.R. § 201.420(d). And a barred individual also becomes a disqualified “bad actor,” disabling any issuer from raising capital under

Regulation A or Rule 506 so long as he serves as a director or executive officer or beneficially owns 20% or more of the issuer's voting equity. 17 C.F.R. §§ 230.262(a), 230.506(d)(1)(vi). The practical consequence is that a FINRA bar forces the founder of a capital-raising company to surrender his offices and reduce his stake below 20%, or else shut off the company's access to exempt offerings.

A person aggrieved by a FINRA order may seek SEC review of that order. The Commission reviews FINRA's action on the record and without a jury. Its own rule provides that, "[o]rdinarily," a decision "will be issued within eight months from the completion of briefing," extendable to ten months where the issues are complex. *Id.* § 201.900(a)(1)(iii). The Commission may nevertheless extend that period by successive orders of its own, and a respondent has no means to enforce the stated timetable.

A person aggrieved by a final Commission order may then seek review in a federal court of appeals. 15 U.S.C. § 78y(a)(1). Section 78y(c)(1) further provides that "[n]o objection" to the Commission order "may be considered by the court unless it was urged before the Commission or there was reasonable ground for failure to do so." *Id.* § 78y(c)(1). Congress has enacted analogous statutory issue-exhaustion requirements for other agencies as well. *See, e.g.*, 29 U.S.C. § 160(e) (NLRB orders; requiring "extraordinary circumstances"); 30 U.S.C. § 816(a)(1) (FMSHRC; same); 16 U.S.C. § 825l(b) (FERC orders under the Federal Power Act; "reasonable ground").

B. Factual Background

Smith founded and controlled Consulting Services Support Corporation (CSSC), the parent of FINRA

member firm CSSC Brokerage Services, Inc. App. 5a-6a. But Smith himself never registered with FINRA, maintaining that he was exempt from registering as he was not involved in CSSC Brokerage Services, Inc.'s securities business. *Id.* at 6a. FINRA's Department of Enforcement nevertheless filed a disciplinary complaint against Smith on August 4, 2017, asserting what amounts to governmental authority to regulate non-members. *Id.* at 78a-79a.

Smith then faced an eight-day hearing in June 2018 before a FINRA hearing officer and two industry panelists—and no jury. *Id.* at 46a. In January 2019, the FINRA panel found a Rule 10b-5 violation, barred Smith for life from associating with any FINRA member, and ordered him to pay \$130,000 in restitution. *Id.* at 6a-7a. FINRA's National Adjudicatory Council affirmed on September 18, 2020. CA6 No. 24-3907 SEC Br. 20-22, ECF 40.

Smith sought Commission review of FINRA's decision in October 2020 and requested oral argument. No argument was scheduled. Briefing closed in March 2021. A Seventh Amendment objection would have accomplished nothing: The Commission has no procedure for requesting or empaneling a jury, and it had already "repeatedly rejected claims that [its] administrative proceedings violate the Seventh Amendment," *In re John Thomas Cap. Mgmt. Grp. LLC*, Exchange Act Release No. 89775, 2020 WL 5291417, at *27 (Sept. 4, 2020). And although the Commission's own rule directed that its decision would ordinarily issue within eight months after briefing, the Commission granted itself no fewer than ten successive 90-day extensions of the period in which a decision "may be issued," each resting on nothing but the Commission's own "discretion."

17 C.F.R. § 201.900(a)(1)(iii)-(iv). Meanwhile, Smith’s “lifetime bar put[] his individual welfare and reputation at stake, and the ongoing delay hinder[ed] his ability to earn a living.” App. 147a (*In re Smith*, No. 24-1189 (6th Cir. Aug. 5, 2024)).

By March 2024—more than five years after FINRA imposed its sanctions against Smith, three and a half years after Smith sought SEC review, and three years after briefing before the SEC had closed—the Commission *still* had not acted. So, with his case—and fate—hanging in an indefinite limbo before the SEC, Smith petitioned the Sixth Circuit for a writ of mandamus challenging the SEC’s delay and failure to issue a decision. CA6 No. 24-1189 Mandamus Pet. 3, 17-18, ECF 1. The SEC’s idleness was neither isolated nor inadvertent: The Commission had taken four to five and a half years, across 13 to 24 extensions, to resolve comparable appeals, *id.* at 9-10, and its own members had concluded two decades earlier that “[t]here is no justifiable explanation for such delays,” *id.* at 11-12 (citation omitted).

On June 27, 2024, while Smith’s mandamus petition was pending, this Court held in *Jarkesy* that an individual is entitled to a jury trial in an Article III court when the SEC seeks civil penalties against a defendant for securities fraud. 603 U.S. at 140-41. At that point, seven years had elapsed since FINRA’s complaint without any Commission decision, and Smith had spent four of those years subject to a bar—and its devastating consequences—that no government officer had yet reviewed. *Jarkesy* was thus handed down while Smith’s fully briefed case gathered dust on the Commission’s own docket. And Smith had no reason to separately raise *Jarkesy*—the SEC, which had just litigated *Jarkesy*, was obviously

aware of the decision and its significance for Smith’s case. Smith also had reason for concern that a superfluous filing advising the Commission of a decision it necessarily already knew about would furnish yet another occasion for delay.¹

On August 5, 2024, the Sixth Circuit found the SEC’s delay in acting on Smith’s petition unexplained and ordered the Commission to respond to Smith’s mandamus petition. The court noted that briefing had closed “more than 39 months ago,” that Smith’s “lifetime bar . . . hinders his ability to earn a living,” and that “the SEC has granted itself ten discretionary extensions of time totaling more than 900 days.” App. 147a. “Because there is no obvious explanation for the [Commission’s] significant delay,” the court concluded, a response would assist it. *Id.*

Fourteen days later, on August 19, 2024, the SEC issued a decision sustaining FINRA’s sanctions against Smith. It then asked the court to dismiss the mandamus petition as moot. CA6 No. 24-1189 SEC Resp. to Mandamus Pet., ECF 9. The court denied the writ, holding that review under Section 78y(a)(1) was “an adequate alternative notwithstanding that Smith has already waited years for a final decision.” CA6 No. 24-1189 Mandamus Order, ECF 11.

C. Proceedings Below

Smith then petitioned the Sixth Circuit for review. He argued, among other things, that, for the same reasons as in *Jarkesy*, the Commission could not

¹ Nor did the Commission’s rules afford him a right to raise the issue: a party may file a supplemental brief only by leave of the Commission, 17 C.F.R. § 201.421(b), and may seek reconsideration only after a final order has issued, *id.* § 201.470.

impose monetary sanctions against him under the Seventh Amendment without affording him a jury trial before an Article III court. In addition, he argued that he was at least entitled to an Article III tribunal, even if he was not entitled to a jury trial, because Article III vests the “judicial power of the United States” in the courts, not executive agencies. CA6 No. 24-3907 Smith Br. 52-61, ECF 30.²

The Sixth Circuit denied the petition. App. 1a-23a (amended opinion).³ The panel recognized that Smith’s Seventh Amendment jury trial claim likely had merit. It concluded that his case “presents the same ultimate problem as did *Jarkesy*: The SEC is imposing sanctions against Smith (albeit on the recommendation of FINRA) without a jury trial before an Article III judge,” and that he “may well have been entitled to a jury trial in federal court.” *Id.* at 19a-20a. As the panel explained, “[t]he overlap between the cause of action in *Jarkesy* and this case, makes it extremely difficult to distinguish *Jarkesy*.” *Id.* at 22a.

The panel nevertheless held that Section 78y(c)(1) barred it from reaching that claim because Smith had not urged his jury-trial objection before the

² Smith also challenged FINRA’s authority to proceed against him at all, arguing that FINRA is a private organization whose jurisdiction extends only to those who consent to it, and that any contrary rule would violate the private nondelegation doctrine; and that FINRA’s adjudicators were unconstitutionally appointed and insulated from presidential removal. In response, FINRA insisted that it acts only “subordinately” to the Commission, as its “aid,” and the panel thus did not resolve those constitutional claims. App. 7a-8a (citation omitted).

³ The panel amended its opinion, modestly amending the opening paragraph; the remainder of the opinion is unchanged, and citations here are to the amended opinion.

Commission and had no “reasonable ground” for failing to do so. *Id.* at 18a. First, the panel rejected Smith’s argument that the Commission lacked the competence to resolve his structural constitutional claims, reasoning that the agency “has repeatedly adjudicated the merits of Seventh Amendment challenges.” *Id.* at 12a. The panel refused to recognize an exception for structural constitutional claims, and it did not question the Commission’s competence, even though *Jarkesy* showed the Commission had “repeatedly adjudicated the merits of Seventh Amendment challenges” incorrectly. *Id.*

Second, the panel rejected Smith’s argument that raising this objection to the Commission would have been futile because the Commission had repeatedly rejected similar claims. The panel held that futility “targets cases in which the ‘adjudicators . . . are powerless to grant the relief requested.’” *Id.* at 17a (alteration in original) (quoting *Carr*, 593 U.S. at 93). It rejected Smith’s futility argument based on the dubious theory that the Commission could have vacated the sanctions and then sued Smith in a new federal court lawsuit, *id.* at 18a—an argument neither the Commission nor FINRA had made.⁴

The court denied Smith’s petition for rehearing.

REASONS FOR GRANTING THE PETITION

This case presents two questions about when a party must exhaust a constitutional claim before an agency before presenting it to an Article III court.

⁴ Judge Murphy filed a concurring opinion discussing an unconstitutional conditions problem, App. 24a-34a, and Judge Bloomekatz wrote separately to concur in the judgment, saying that she would not have reached the merits of Smith’s jury-trial objection, *id.* at 34a-35a (concurring in the judgment).

Both questions implicate circuit conflicts. Both are important and recurring. And both are cleanly presented here. The Sixth Circuit barred judicial review of a claim that it recognized was likely meritorious under *Jarkesy* solely because the claim was not presented to the agency—even though the agency lacked competence to resolve a constitutional claim challenging the inherent nature of its proceedings, and had repeatedly rejected jury-trial objections in prior cases. If the Sixth Circuit’s decision stands, it will wrongfully shield unconstitutional agency proceedings from judicial review. The petition should be granted.

I. THE DECISION BELOW DEEPENS TWO CIRCUIT SPLITS OVER STATUTORY-ISSUE EXHAUSTION

This case implicates two direct circuit splits concerning statutory issue-exhaustion provisions. The decision below deepens both splits. These conflicts alone warrant this Court’s review.

A. The Courts Of Appeals Are Divided Over Whether The Exhaustion Of Structural Constitutional Claims Is Required

1. The circuits are split 6-2 over whether a party must exhaust a structural constitutional claim challenging the inherent nature of an agency proceeding before raising it in an Article III court when a statute makes exhaustion mandatory.

a. Two circuits—the Ninth and the Third—have held that mandatory statutory exhaustion provisions do not require a party to present a structural constitutional claim to the agency before seeking judicial review of that claim. Their decisions distinguish a challenge to the agency’s authority or

the inherent structure of its proceedings from an ordinary challenge to an agency's decision.

The Ninth Circuit has held that a mandatory exhaustion statute does not bar review of a constitutional challenge to the structure of the agency itself. *NLRB v. North Mountain Foothills Apartments*, 157 F.4th 1089, 1096-97 (9th Cir. 2025). *North Mountain* arose in the context of a challenge to an order by the NLRB. Like SEC orders, NLRB orders are reviewable in Article III courts subject to a provision stating that “[n]o objection that has not been urged before the Board . . . shall be considered by the court, unless the failure or neglect to urge such objection shall be excused because of extraordinary circumstances.” 29 U.S.C. § 160(e). That provision performs the same office as Section 78y(c)(1), but it sets a much more demanding condition for excusing a failure to exhaust—“extraordinary circumstances” as opposed to a “reasonable ground.” *See id.*

Acknowledging that its “sister circuits are divided on this issue,” the court held that the statute did not preclude judicial review of unexhausted Article II, Seventh Amendment, and due process challenges. *North Mountain*, 157 F.4th at 1096-97. The Ninth Circuit reasoned that a court “may decide an issue not raised in an agency action if the agency lacked either the power or the jurisdiction to decide it,” a situation “typified by challenges to the constitutionality of a statute,” *id.* at 1097 (citation omitted). The court distinguished cases involving “an unexhausted challenge to an agency’s decision” and “an unexhausted constitutional challenge to the workings of the agency itself”—the latter need not be exhausted before the agency in order to raise it in court. *Id.* Thus, a claim that the agency’s proceeding is

constitutionally defective need not be presented within the very proceeding being challenged. Having so held, the court decided the unexhausted Seventh Amendment claim on the merits. *Id.* at 1097-1100.

The Third Circuit likewise has held that an objection to the agency’s “authority to act” may be raised for the first time on review. *Advanced Disposal Servs. E., Inc. v. NLRB*, 820 F.3d 592, 597-98, 600 (3d Cir. 2016). Like the Ninth Circuit’s decision in *North Mountain*, the Third Circuit’s decision in *Advanced Disposal* involved Section 160(e) of the NLRA. Construing that provision, the court held that “a challenge like this one, which goes to the authority of the Board to act, constitutes an ‘extraordinary circumstance’ under § 160(e) and can thus be raised for the first time on appeal.” *Id.* at 598. The court reasoned that, far from “a mere procedural technicality” of the sort a litigant may be said to waive, demanding an objection to the structure of the agency proceedings itself would untenably leave “ultra vires agency action . . . insulated from judicial review.” *Id.* at 600 (citation omitted); *see also NLRB v. Starbucks Corp.*, 125 F.4th 78, 87 (3d Cir. 2024) (confirming that the exception preserves objections calling into question “the ALJ’s or the Board’s core authority to act”). Thus, while the court acknowledged the “competing authority” on this issue, it held that such an objection is an “extraordinary circumstance[]” that need not be raised before the agency. *Advanced Disposal*, 820 F.3d at 598-600.

b. By contrast, six circuits, including the Sixth Circuit below, have held that structural constitutional claims are barred under statutory exhaustion requirements. Those courts treat

statutory exhaustion provisions as controlling—even when the claim challenges the agency’s constitutional authority to conduct the proceeding at issue.

The Sixth Circuit held below that Smith had to raise his constitutional claims that he was entitled to a jury trial before an Article III court and (at least) an Article III tribunal, and that the claims’ constitutional character supplied no excuse for not having done so before the SEC. App. 18a-19a.

The Tenth Circuit has likewise held that statutory issue-exhaustion provisions bar judicial review of unexhausted Article III and Seventh Amendment challenges. *See 3484, Inc. v. NLRB*, 137 F.4th 1093, 1112-13 (10th Cir. 2025); *Malouf v. SEC*, 933 F.3d 1248, 1255-56 (10th Cir. 2019), *cert. denied*, 589 U.S. 1269 (2020). In *3484, Inc.*, the court applied that rule in the context of Section 160(e), reasoning that it could not “read a futility exception into the statute.” 137 F.4th at 1112-13. The court acknowledged the conflict, observing that while some courts hear such challenges, “[o]ther circuits . . . have declined to apply the extraordinary-circumstances exception to the identical claim.” *Id.* at 1114 n.8. The Tenth Circuit reached a similar conclusion as to Section 78y(c)(1), refusing to consider an unexhausted Appointments Clause claim. *Malouf*, 933 F.3d at 1255-56.

The D.C. Circuit has likewise applied a mandatory statutory issue-exhaustion provision to structural constitutional claims—including a *Jarkesy* claim. *See Springsteen-Abbott v. SEC*, 989 F.3d 4, 8-9 (D.C. Cir. 2021); *Fleming v. U.S. Dep’t of Agric.*, 987 F.3d 1093, 1102 (D.C. Cir. 2021); *Vermont Info. Processing, Inc. v. NLRB*, 176 F.4th 690, 706-07 (D.C. Cir. 2026); *Stoiber v. SEC*, 161 F.3d 745, 754 (D.C. Cir. 1998), *cert. denied*, 526 U.S. 1069 (1999). In the D.C.

Circuit’s view, such provisions leave “no ‘judicial discretion’” to excuse a failure to exhaust, *Fleming*, 987 F.3d at 1102, and “[a] constitutional argument does not categorically qualify as a ‘reasonable ground’” under Section 78y(c)(1), *Springsteen-Abbott*, 989 F.3d at 9. *See Stoiber*, 161 F.3d at 754 (Section 78y(c)(1)’s requirement “is not inapplicable solely because the objection not urged before the SEC is a constitutional one”). Applying that rule, the court declined to reach an unexhausted Seventh Amendment challenge under *Jarkesy*. *Vermont Info. Processing*, 176 F.4th at 706-07.

The Second, Fifth, and Eighth Circuits have likewise applied statutory issue-exhaustion provisions to structural constitutional claims. *See Gonnella v. U.S. SEC*, 954 F.3d 536, 544 (2d Cir. 2020) (“a litigant who does not object to the constitutionality of an ALJ at any point during the SEC proceedings forfeits that challenge”); *D.R. Horton, Inc. v. NLRB*, 737 F.3d 344, 351 & n.5 (5th Cir. 2013) (declining to reach an unexhausted challenge to the Board’s composition); *NLRB v. RELCO Locomotives, Inc.*, 734 F.3d 764, 796-98 (8th Cir. 2013) (declining to reach a Recess Appointments Clause challenge and explaining that “[c]onstitutional considerations, no matter how important or ‘fundamental,’ can be forfeited”). In these circuits, structural constitutional claims must initially be raised before the agency.

2. The circuits are expressly divided on this question, and the division is sharpest on one of the precise claims at issue here. Four of the decisions discussed above involved a jury-trial claim under *Jarkesy*: the Ninth Circuit reached such a claim and decided it on the merits, while the Sixth, Tenth, and

D.C. Circuits refused to reach it or the Article III argument. Compare *North Mountain*, 157 F.4th at 1096-100, with App. 12a-18a; *3484, Inc.*, 137 F.4th at 1112-13; *Vermont Info. Processing*, 176 F.4th at 706-07. And as noted above, in the case permitting review—*North Mountain*—the exhaustion provision set an even more demanding “extraordinary circumstances” standard. Had this case arisen in the Ninth Circuit, it would have come out differently. Only this Court can resolve the split.

**B. The Courts Of Appeals Are Also Divided
Over The Standard For Futility In Section
78y(c)(1) Cases**

The circuits are also split 2-1 over the standard for establishing futility under Section 78y(c)(1).

1. The D.C. and Tenth Circuits ask whether raising the claim would have been clearly useless. That test looks past the agency’s formal authority to practical realities based on the agency’s settled position and past disposition of similar arguments. If presenting the objection would have accomplished nothing due to the agency’s settled position, then raising it would be futile and there is “reasonable ground” for the court of appeals to consider it in the first instance. 15 U.S.C. § 78y(c)(1).

The D.C. Circuit has taken this position for decades, finding “reasonable ground” for purposes of Section 78y(c)(1) where raising the objection would be “clearly useless.” *Doe v. SEC*, 176 F.4th 32, 40 (D.C. Cir. 2026) (quoting *KPMG, LLP v. SEC*, 289 F.3d 109, 118 (D.C. Cir. 2002)). This standard is satisfied when an argument contradicts “a very clearly articulated agency position.” *KPMG*, 289 F.3d at 118; see also, e.g., *Vermont Info. Processing*, 176 F.4th at 706-07

(applying the same standard under Section 160(e)). The focus is therefore the agency’s established position on the issue and the practical value of presenting the objection, not the agency’s theoretical ability to facilitate a different course.

The Tenth Circuit applies the same test under Section 78y(c)(1). An argument is futile—and thus there is a “reasonable ground” for raising it for the first time in a court of appeals—when raising it in “the administrative process would have been ‘clearly useless.’” *Malouf*, 933 F.3d at 1257 (quoting *Gilmore v. Weatherford*, 694 F.3d 1160, 1169 (10th Cir. 2012)). The inquiry is whether the agency has already settled the question. *Id.* If it has, pressing the objection again would be clearly useless and the litigant may raise it in court; absent such a settled position, as the court found in *Malouf* itself, the litigant must first present the objection to the agency. *Id.*⁵

2. By contrast, the Sixth Circuit now requires a showing that the agency formally lacked power to grant relief. Futility, the panel held, “targets cases in which the ‘adjudicators . . . are powerless to grant the relief requested,’” and a party may not rely on the agency’s settled position with respect to a certain type of claim. App. 17a (alteration in original) (quoting *Carr v. Saul*, 593 U.S. 83, 93 (2021)); see *Joseph Forrester Trucking v. Dir., Off. of Workers’ Comp. Programs*, 987 F.3d 581, 591 (6th Cir. 2021). Under

⁵ The Fifth Circuit has applied a comparable test under Section 160(e), which sets an even more demanding standard, excusing a failure to exhaust only in “extraordinary circumstances.” That court has held that one such “extraordinary circumstance” exists where the Board had already “considered, and rejected,” the argument. *Harvard Maint., Inc. v. NLRB*, 165 F.4th 886, 897 (5th Cir. 2026).

this strict, “powerless to act” test, so long as the agency could theoretically exercise some form of remedial power on paper, futility is unavailable, however certain it is that the agency would refuse to exercise that power based on past practice.

Applying its test here, the panel below found futility lacking because the Commission theoretically “was empowered to vacate the sanctions stemming from FINRA’s adjudicative process,” and could then have brought new proceedings against Smith in federal court. App. 18a. Under this position, it does not matter how many times an agency has rejected an argument, or how useless it would be to raise it before an agency yet again. All that matters is that the agency theoretically has the power to act on it.

C. Each Conflict Was Outcome-Determinative Below

1. The first conflict decided the outcome for Smith’s constitutional claims. Indeed, Smith would have received a merits decision in the Ninth Circuit, which reached the merits of an unexhausted Seventh Amendment challenge to agency adjudication just like Smith’s. *North Mountain*, 157 F.4th at 1097-1100. The Sixth, Tenth, and D.C. Circuits refused to reach the identical type of claim. App. 18a; *3484, Inc.*, 137 F.4th at 1112; *Vermont Info. Processing*, 176 F.4th at 706. The geographic location of the proceeding thus determines whether a court will hear the constitutional objection at all.

The decisions permitting review construed Section 160(e), whose “extraordinary circumstances” standard is on its face more demanding than Section 78y(c)(1)’s “reasonable ground.” A claim that satisfies the more demanding standard should satisfy the more

forgiving one. Yet the courts applying the “extraordinary circumstances” standard allowed review, while the Sixth Circuit applying the “reasonable ground” standard refused it.

2. The difference in futility standards also decides cases like this one. Smith prevails under the “clearly useless” standard that applies in the D.C. and Tenth Circuits. The Commission had “repeatedly rejected claims that our administrative proceedings violate the Seventh Amendment,” *John Thomas Cap.*, 2020 WL 5291417, at *27, and the panel below agreed that the agency “has repeatedly adjudicated the merits of Seventh Amendment challenges,” App. 12a. Moreover, before the Sixth Circuit, the SEC renewed its objection to jury trial claims, even in the wake of *Jarkesy*, underscoring just how entrenched the SEC’s position is as to jury trial claims. Raising the objection before the SEC would have been useless. The claim was beaten dead by the SEC—which is exactly why Smith needed an Article III court.

Yet, under the Sixth Circuit’s powerless-to-act test, no respondent in a FINRA or SEC proceeding can ever show that raising a constitutional claim would be futile even if the agency rejected the claim until the end of time because the Commission theoretically always has the formal authority to vacate its order and start over in court. *See* CA6 No. 24-3907, Inv. Choice Advocates Network Amicus Br. 10-11, ECF 85. And, to be clear, this was pure theory—neither the Sixth Circuit nor the government provided examples of the agency taking such action. The Sixth Circuit’s rule therefore turns the statutory exception into a nullity for the very proceedings in which the agency’s answer to a constitutional objection is most likely to be predetermined.

Each of these conflicts warrants certiorari.

II. THE QUESTIONS PRESENTED ARE EXCEPTIONALLY IMPORTANT

The need for this Court’s review is heightened by the importance of the questions presented in ensuring that unconstitutional agency proceedings are not shielded from judicial review. Article III review is the light at the end of the tunnel for individuals enmeshed in agency enforcement proceedings. As this case illustrates, the mere existence of such proceedings imposes severe personal and financial burdens on their subjects. And imposition of the kinds of sanctions meted out here—an industry bar and a monetary sanction—has a crippling effect on their subjects long before any Article III judge reviews them. When an exhaustion rule then forecloses review of the claim that the proceeding was unconstitutional from the start, the promise of eventual judicial review is empty.

1. Judicial review of agency action is critical to the protection of constitutional rights and provides a vital check on abuses by the administrative state. *See, e.g., SEC v. Jarkesy*, 603 U.S. 109, 120-21 (2024) (Seventh Amendment right to a jury trial in an SEC civil-penalty action and an Article III right to an independent judge); *Axon Enter., Inc. v. FTC*, 598 U.S. 175, 195-96 (2023) (district courts may hear structural constitutional challenges to agency proceedings notwithstanding a statutory review scheme); *Lucia v. SEC*, 585 U.S. 237, 243 (2018) (Appointments Clause challenge to SEC ALJs); *Free Enter. Fund v. Public Co. Acct. Oversight Bd.*, 561 U.S. 477, 484 (2010) (multilevel removal protection is contrary to Article II’s vesting of executive power).

That protection matters most when it comes to structural constitutional claims, which challenge an administrative proceeding's inherent structure. Such a claim cannot receive meaningful review if an exhaustion rule prevents any court from hearing it.

Proper interpretation of exhaustion rules is critical because it can determine whether judicial review of unconstitutional agency action exists at all. Smith was subjected to a prolonged proceeding before the SEC that the Sixth Circuit itself recognized was likely unconstitutional under a “straightforward” application of *Jarkesy*. App. 20a. Yet the court held that judicial review of that claim was foreclosed. Indeed, the panel held that Section 78y(c)(1) left it “statutorily barred from reaching Smith’s constitutional arguments,” *id.* at 19a, foreclosing his independent Article III claim along with his jury-trial claim. The result harms Smith directly and creates the same risk for others subject to agency proceedings: A court may identify a likely constitutional violation but decline to decide the issue because the claimant did not first present the objection to the agency. Meanwhile, an agency is free to subject others to its unconstitutional proceedings.

2. This issue is important and recurring. The exhaustion requirements for claims challenging proceedings before the SEC is itself extraordinarily significant. The SEC is one of the most litigious agencies. In fiscal year 2025, the Commission filed 456 enforcement actions, including 69 follow-on administrative proceedings. Press Release, SEC, *SEC Announces Enforcement Results for Fiscal Year 2025* (Apr. 7, 2026), <https://www.sec.gov/newsroom/press-releases/2026-34>. In 2025, FINRA filed 625 new disciplinary actions, barred 187 individuals, and

ordered \$17.1 million in restitution. FINRA, *Key Statistics: Regulatory Operations Key Data*, <https://www.finra.org/media-center/statistics> (last visited Oct. 12, 2026). Each proceeding has the potential to present the same question whether a person must first ask an agency to decide a constitutional objection that the agency lacks authority or competence to remedy and that it has consistently rejected up to that point.

But the questions presented extend beyond the SEC. Numerous agencies subject individuals to in-house proceedings. And Congress has passed similar issue-exhaustion requirements governing review of many agencies' orders, including 29 U.S.C. § 160(e) (National Labor Relations Act; NLRB orders), 30 U.S.C. § 816(a)(1) (Federal Mine Safety and Health Act; FMSHRC orders), 29 U.S.C. § 660(a) (Occupational Safety and Health Act; OSHRC orders), 16 U.S.C. § 825l(b) (Federal Power Act; FERC orders), and 21 U.S.C. § 355(h) (Food, Drug, and Cosmetic Act; FDA drug-approval orders).

And courts have read these statutory exhaustion provisions interchangeably. *See Washington Ass'n for Television & Children v. FCC*, 712 F.2d 677, 682 n.6 (D.C. Cir. 1983) ("Congress meant, in all these statutes, merely to codify the judicial doctrine of exhaustion of administrative remedies."); *Marine Mammal Conservancy, Inc. v. Dep't of Agric.*, 134 F.3d 409, 412 (D.C. Cir. 1998) (reading Sections 78y(c)(1) and 160(e) to express same "general idea"). Courts also draw on cases under one such provision when construing another. The D.C. Circuit, for instance, rejected a futility argument under Section 160(e) by applying the test it had announced in an SEC case under Section 78y(c)(1), asking whether the litigant

could identify “a very clearly articulated agency position” on the question. *Vermont Info. Processing*, 176 F.4th at 707 (quoting *KPMG*, 289 F.3d at 118).

The decision below proves the point: The Sixth Circuit fixed the meaning of Section 78y(c)(1) by reasoning from cases under the Mine Act, the Black Lung Benefits Act, the immigration laws, and the Prison Litigation Reform Act. App. 12a, 17a (citing *Island Creek Coal Co. v. Bryan*, 937 F.3d 738, 746-49 (6th Cir. 2019); *Singh v. Rosen*, 984 F.3d 1142, 1155-56 (6th Cir. 2021); *Jones Bros., Inc. v. Sec’y of Labor*, 898 F.3d 669, 674 (6th Cir. 2018); *Ross v. Blake*, 578 U.S. 632, 639 (2016)). The Court’s resolution of the questions presented would thus impact exhaustion disputes across many different agencies, not only the SEC—including the NLRB, the FMSHRC, the OSHRC, FERC, and the FDA alike.

3. The fact that this case involves a Seventh Amendment claim heightens the petition’s importance. As this Court observed in *Jarkesy*, any “seeming curtailment” of the jury right “should be scrutinized with the utmost care,” and this Court has twice in three Terms decided Seventh Amendment challenges to agency adjudication. 603 U.S. at 121 (citation omitted); see *FCC v. AT&T, Inc.*, 608 U.S. 531 (2026). In this case, moreover, the Sixth Circuit recognized that petitioner’s claim almost certainly had merit. App. 20a-23a. That makes this case an exceptionally strong vehicle to consider the questions presented. Certiorari is warranted to ensure that an Article III court may entertain that claim.⁶

⁶ Unlike the scheme this Court considered last Term in *AT&T*, the Exchange Act affords more limited review—there is no trial de novo and no jury at any stage. 608 U.S. at 540-43. In that

III. THE DECISION BELOW IS WRONG

Finally, certiorari is warranted because the decision below is wrong. An agency defendant is not required to exhaust structural constitutional claims an agency has no competence to resolve or that an agency has repeatedly rejected. As this case underscores, in either instance, the defendant has a “reasonable ground” for not presenting the claim to the agency. 15 U.S.C. § 78y(c)(1).

1. As this Court has stated, “agency adjudications are generally ill suited to address structural constitutional challenges, which usually fall outside the adjudicators’ areas of technical expertise.” *Carr*, 593 U.S. at 92. “Constitutional questions obviously are unsuited to resolution in administrative hearing procedures and, therefore, access to the courts is essential to the decision of such questions.” *Califano v. Sanders*, 430 U.S. 99, 109 (1977). Accordingly, it “makes little sense to require litigants to present claims to adjudicators who are powerless to grant the relief requested,” and such a “vain exercise will rarely ‘protec[t] administrative agency authority or promot[e] judicial efficiency.’” *Carr*, 593 U.S. at 93 (alterations in original) (citation omitted). This is all the more true for the SEC, where the commissioners

case, the FCC’s forfeiture orders created no obligation to pay and reflected no ultimate determination of fact: the statute nowhere gave the agency authority to execute on an order, no penalty attached for nonpayment, and a forfeiture was recoverable exclusively in a later “trial de novo” in which “the jury gets the last word.” *Id.* at 542-43. Section 78y, on the other hand, provides no comparable backstop. FINRA’s sanctions take effect before any government officer reviews them, and the sole avenue of review is appellate review of the Commission’s final order on the administrative record under Section 78y.

are not required to be lawyers, let alone lawyers versed in constitutional law. *See* 15 U.S.C. § 78d.

Given this dynamic, a statutory issue-exhaustion provision should not bar a court from “decid[ing] an issue not raised in an agency action if the agency lacked either the power or the jurisdiction to decide it,” including a “constitutional challenge to the workings of the *agency itself*.” *North Mountain*, 157 F.4th at 1096-97 (citation omitted). Smith’s claims that he was entitled to a jury trial under the Seventh Amendment or at least an Article III tribunal fall on that side of the line because they challenge the constitutionality of the forum’s authority to impose the sanctions at all, not merely the Commission’s application of securities law. *Id.* at 1096-99.

Subjecting structural constitutional claims to mandatory exhaustion exacts a high price for nothing in return. This Court has held time and again that agencies have no special competence over structural constitutional claims. *Axon*, 598 U.S. at 194 (“The Commission knows a good deal about competition policy, but nothing special about the separation of powers.”); *see also Free Enter. Fund*, 561 U.S. at 491-92. This is especially true when, as here, the claims concern a litigant’s right to an Article III forum, whether for a jury trial or otherwise. Presenting such a claim to a body that can neither decide it competently nor remedy it adds delay and expense, yields no useful administrative record, and heightens the risk that the agency’s process will further delay the claimant’s ability to obtain effective review.

2. Section 78y(c)(1) does not require exhaustion when there “was reasonable ground for failure to [exhaust].” 15 U.S.C. § 78y(c)(1). A litigant has reasonable ground to omit an objection that the

agency has no authority to sustain. Such questions lie beyond the agency's institutional competence, *McCarthy v. Madigan*, 503 U.S. 140, 147-48 (1992), and structural claims fall in that category for the reasons explained above. The Commission, which is a creature of Congress, has no competence to resolve constitutional challenges arising from the agency structure created by Congress—in effect, declaring Congress's own action unconstitutional. Moreover, in this instance, the Commission lacks a procedural rule or device by which a respondent can request a jury trial or an Article III tribunal, and it could not itself have empaneled a jury in any event. Smith therefore had a reasonable ground for not presenting his constitutional claims to the Commission first.

Indeed, as discussed above, the Ninth Circuit and Third Circuit have held that a litigant's failure to raise an Appointments Clause challenge—another type of structural constitutional claim—before the agency constitutes “extraordinary circumstances” excusing exhaustion under the NLRB's exhaustion statute (29 U.S.C. § 160(e)). *See North Mountain*, 157 F.4th at 1096-97; *Advanced Disposal*, 820 F.3d at 597-600. It follows *a fortiori* that the failure to exhaust a structural constitutional claim meets the far more forgiving “reasonable ground” standard.

3. There is also reasonable ground for failing to raise a claim when doing so would be futile as a practical matter. This Court recognizes futility where an agency “has otherwise predetermined the issue before it,” *McCarthy*, 503 U.S. at 148, and has called it “unrealistic to expect” an agency to overhaul its procedures “at the behest of a single” litigant, *Mathews v. Eldridge*, 424 U.S. 319, 330 (1976); *see Ross*, 578 U.S. at 643 (relief is unavailable where

officials are “unable or consistently unwilling to provide any relief”). Those principles describe Smith’s circumstances. The SEC had repeatedly rejected similar Seventh Amendment arguments, *see, e.g., John Thomas Cap.*, 2020 WL 5291417, at *27, effectively saying “no, no, a thousand times no,” *Learning Resources, Inc. v. Trump*, 607 U.S. 229, 254 n.6 (2026). The record supplied no reason to expect it to reverse course in response to Smith alone. Indeed, the SEC still fought Smith’s jury-trial claim in the Sixth Circuit even after it lost the *Jarkesy* case.

The Sixth Circuit misread *Carr* to make the absence of remedial power the outer limit of futility. App. 17a (citing *Carr*, 593 U.S. at 93). To begin, *Carr* did not construe a statutory futility exception, and so this Court had no occasion to consider whether the fact that raising an issue would be clearly useless based on past practice provides a “reasonable ground” under Section 78y(c)(1). Rather, the Commissioner there “concede[d] that no statute or regulation obligated petitioners to raise their Appointments Clause challenges in administrative proceedings,” and instead asked this Court “to impose a judicially created issue-exhaustion requirement.” *Carr*, 593 U.S. at 88. The sentence quoted by the panel below was one of the reasons this Court gave for refusing to impose such a requirement in *Carr*. *Id.* at 92-93. But that explanation hardly imposes a ceiling for when exhaustion is excused under Section 78y(c)(1)’s separate “reasonable ground” standard.

The Sixth Circuit’s rule requiring exhaustion unless an agency is formally powerless to act eviscerates the futility exception in enforcement cases, because an enforcement agency can almost always vacate its order and begin again—so a formal

power to start over would defeat futility even where the agency has settled the issue and would predictably reject the objection. That reading detaches the exception from the purpose it has always served: sparing a litigant a submission that would accomplish nothing, and sparing the agency and the courts the delay that submission would entail.

4. Each of the above errors requires reversal. But the totality of the circumstances here, including these errors, gave petitioner a “reasonable ground” for not presenting his constitutional claims to the agency first. The SEC lacked any ability to conduct a jury trial. The SEC lacked competence to decide whether the enforcement proceedings Congress created violate the Constitution. And the SEC had repeatedly rejected jury-trial arguments. *Jarkesy* was decided only 53 days before the Commission ruled, after briefing had been closed for more than three years (with no automatic right to file supplemental briefs, *see* 17 C.F.R. § 201.421(b)). The SEC was itself the losing party in *Jarkesy* and so necessarily knew of the decision. And Smith reasonably feared that a perfunctory filing alerting the Commission to a Supreme Court decision in which it was itself a party would just prompt the Commission to extend its already astonishing delay in resolving Smith’s case, thus postponing the day Smith could, finally, obtain review in an Article III court.

The exhaustion rule should not convert those extenuating circumstances into a forfeiture of a structural constitutional claim that the Sixth Circuit itself recognized was likely meritorious.

CONCLUSION

The petition should be granted.

Respectfully submitted,

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[178 F.4th 312]

**UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT**

Eric S. SMITH, Petitioner,

v.

**UNITED STATES SECURITIES AND
EXCHANGE COMMISSION,**

Respondent,

**Financial Industry Regulatory Authority, Inc.,
Intervenor.**

No. 24-3907

Argued: October 27, 2025

Decided and Filed: June 16, 2026

AMENDED OPINION

READLER, Circuit Judge.

Legendary director Martin Scorsese's highest grossing film, *The Wolf of Wall Street*, features the real-life trials and tribulations of Jordan Belfort, a hard-charging New York City stockbroker. After passing the Series 7 exam and qualifying to buy and sell securities, Belfort amasses enormous wealth as a broker, only to land in hot water with the Securities and Exchange Commission over his suspicious trading activity and other antics. *See generally The Wolf of Wall Street*, Netflix (Paramount Pictures 2013).

For understandable cinematic reasons, the movie glosses over some of the finer points of the securities industry's regulatory structure, including who

administers the Series 7 exam. That job currently belongs to the Financial Industry Regulatory Authority, better known simply as FINRA. Among other securities-related rules FINRA puts forth, one set of regulations requires an applicant interested in taking the Series 7 exam (or a variety of other qualifying securities industry exams) to first register with FINRA or be associated with a FINRA member firm.

Unlike Belfort, petitioner Eric Smith declined to register with the appropriate authorities. But like Belfort, he still ended up in the SEC's crosshairs (albeit for entirely different reasons). Smith now seeks review of the SEC's order upholding sanctions against him for violating a host of securities-related laws and administrative rules. He argues that FINRA lacked jurisdiction over him and that the proceedings before the SEC ran afoul of Article III and the Seventh Amendment. With respect to those latter issues, however, Smith failed to raise his constitutional arguments before the SEC, so we cannot reach them. And as to the threshold jurisdictional question, because FINRA had statutory jurisdiction over Smith despite his refusal to register, we deny his petition for review.

I.

A. To understand this case, it is helpful first to consider the history and structure behind FINRA as well as its relationship with the securities industry. A security is “[a]n instrument that evidences the holder’s ownership rights in a firm (e.g., a stock), . . . creditor relationship with a firm or government (e.g., a bond), or . . . other rights (e.g., an option).” *Security*, *Black’s Law Dictionary* (12th ed. 2024). For centuries, the Anglo-American tradition has relied at

least in part on markets for the sale of securities. John I. Sanders, *Break from Tradition: Questioning the Primacy of Self-Regulation in American Securities Law*, 7 Mich. Bus. & Entrepreneurial L. Rev. 93, 93 (2017). Initially, these exchanges were deeply individualized affairs, with brokers meeting at designated coffee shops to trade securities. *See id.* at 93–94. Over time, however, the number of recorded stockholders increased drastically, making personal dealings infeasible. *See* Elisabeth Keller & Gregory A. Gehlmann, *A Historical Introduction to the Securities Act of 1933 and the Securities Exchange Act of 1934*, 49 Ohio St. L.J. 329, 331 (1988). Those developments put investors at a distance from the entities in which they were investing, elevating the opportunities for fraud in the market stemming from information asymmetries, acts that could have devastating consequences if left unchecked. And in some instances, regrettably, those fears became realities, from scandals in the industry to panics in the markets. *See id.* at 336 (describing the cycle of stock market panics). Those experiences led to reform efforts. Beginning with New York’s “Act to prevent the pernicious practice of stock jobbing, and for regulating sales at public auctions,” 1792 N.Y. Laws 368, rules for who and how one can participate in the securities industry have been a core feature of American securities markets. *See* Sanders, *supra*, at 94–95.

Many of the oversight efforts tied to the securities markets came by way of self-regulation. The New York Stock Exchange, for instance, traces its roots back to a 1792 agreement among private individuals to set rules governing the sale of stock among private brokers. *See id.*; *see also* A.C. Pritchard & Robert B.

Thompson, *A History of Securities Law in the Supreme Court* 25–26 (2023) (detailing the NYSE’s resistance to government regulation). This practice of self-regulation among exchanges continued unimpeded at the federal level until 1933, when Congress began regulating the securities industry. See Howard C. Westwood & Edward G. Howard, *Self-Government in the Securities Business*, 17 Law & Contemp. Probs. 518, 519–20 (1952) (describing historical self-regulatory practices among exchanges); Keller & Gehlmann, *supra*, at 343, 346 (describing, among other initiatives, the introduction of registration statement requirements and the imposition of civil liability for untrue statements in the course of securities sales). Yet Congress’s foray into regulating the securities markets did not spell the end of self-regulation by the exchanges. Spurred on by then-SEC Chair William O. Douglas, Congress soon adopted a self-regulatory organization (SRO) model for the exchanges. See Sanders, *supra*, at 111–13; see also Pritchard & Thompson, *supra*, at 46 (describing Douglas’s efforts). The SRO model required national securities associations to register with the SEC. 15 U.S.C. § 78o–3(a), (b); see also Pritchard & Thompson, *supra*, at 46 (explaining how this regulatory scheme was designed to work). Those associations, as SROs, would promulgate rules subject to SEC approval, *id.* § 78s(b), (c), and, in turn, enforce those rules alongside existing securities laws and regulations against their membership, *id.* § 78s(g). As for individuals interested in selling securities, before they could do so lawfully, they had to choose one of two options: Either join an association or associate with a member of an association. *Id.* § 78o(a)(1).

Only one national securities association has ever existed—the National Association of Securities Dealers. Formed in 1939, the Association would go on to serve as the lone self-regulatory body for nearly seven decades. In 2007, the NASD merged with the New York Stock Exchange’s internal regulatory body to create FINRA. Sanders, *supra*, at 113–14.

FINRA is a private, not-for-profit member organization formed under Delaware law. *Mohlman v. FINRA*, 977 F.3d 556, 557 (6th Cir. 2020). The government plays no role in funding FINRA or choosing its leadership. Instead, FINRA promulgates rules for its members and associated persons, which the SEC reviews and modifies as it sees fit. 15 U.S.C. § 78s(b), (c). FINRA also imposes discipline through its internal adjudicatory process for violations of its rules and federal securities law, again subject to SEC oversight. *Id.* § 78o-3(b)(2), (7), (8). This power to impose disciplinary sanctions, however, is distinct from the power to enforce those sanctions in federal court if a disciplined party does not voluntarily comply; while FINRA has the first power, it lacks the second. *See Fiero v. FINRA*, 660 F.3d 569, 571 (2d Cir. 2011). Thus, to enforce its sanctions, FINRA must once again rely on the SEC, which has the statutory power to go to federal court to bring FINRA discipline to bear. *See* 15 U.S.C. § 78u(d), (e); *SEC v. Mohn*, 465 F.3d 647, 654 (6th Cir. 2006).

B. With this regulatory backdrop in mind, consider the dispute at hand. In 1998, Smith founded Consulting Services Support Corporation (CSSC). As the company’s majority owner, Smith served as its chairman and CEO. Included in CSSC’s corporate structure were several wholly owned subsidiaries that operated out of the company’s Michigan office,

including CSSC Brokerage Services, Inc., a registered FINRA broker-dealer. (The parties refer to this subsidiary as “CSSC-BD” to signify its broker-dealer status.) Acknowledging CSSC-BD’s registration, Smith nonetheless maintained to FINRA that he was exempt from registering so long as he was not actively engaged in managing CSSC-BD’s securities business.

Whether that legal conclusion was true or not, its factual premise was wobbly at best. From 2010 to 2015, Smith played an increasingly hands-on role in the management of CSSC-BD. He directly managed three debt offerings during the period, instructing CSSC-BD representatives to sell bonds to customers based on offering documents he prepared. The last of these offerings contained a number of false or misleading statements about CSSC’s potential revenue opportunities and current financial situation. Smith also personally solicited investors, ultimately garnering \$130,000 from four of them.

A routine FINRA examination of CSSC-BD and investor complaints eventually uncovered these activities. In response, FINRA’s Department of Enforcement filed a complaint against Smith alleging that he violated a host of statutory provisions as well as industry regulations, including § 10(b) of the Exchange Act, SEC Rule 10b–5, §§ 17(a)(2) and (3) of the Securities Act, FINRA Rules 2010 and 2020, and NASD Rules 1021(a) and 1031(a). Following a disciplinary proceeding, FINRA ruled against Smith on all counts. FINRA’s ensuing sanctions order, however, was tied exclusively to Smith’s violations of the Exchange Act and Rule 10(b)–5. As punishment, FINRA ordered Smith to pay \$130,000 in restitution (either to the victims of his fraud or, if they could not be located, to FINRA) and barred him from

associating with any FINRA member. The SEC affirmed FINRA's decision in an opinion that Smith now petitions this Court to review. *See Eric S. Smith*, Exchange Act Release No. 100762, 2024 WL 3875989, at *1 (Aug. 19, 2024).

II.

The SEC's findings of fact are "conclusive" on review "if supported by substantial evidence." 15 U.S.C. § 78y(a)(4). "Substantial evidence," in turn, "is that which a 'reasonable mind' would find sufficient to support the factual finding." *Jones Bros., Inc. v. Sec'y of Lab.*, 68 F.4th 289, 295 (6th Cir. 2023) (citing *KenAmerican Res., Inc. v. U.S. Sec'y of Lab.*, 33 F.4th 884, 891 (6th Cir. 2022)). As to questions of law, including issues of statutory and constitutional interpretation, we conduct de novo review. *Louisville Gas & Elec. Co. v. FERC*, 988 F.3d 841, 846 (6th Cir. 2021) (citing *MISO Transmission Owners v. FERC*, 860 F.3d 837, 841 (6th Cir. 2017); *Cincinnati Gas & Elec. Co. v. FERC*, 724 F.2d 550, 554 (6th Cir. 1984)).

Smith takes a targeted approach in his petition for review. He does not contest the fact that substantial evidence supports the SEC's findings that he controlled a FINRA member firm. Nor does he quarrel with the SEC's conclusion that his conduct violated the Exchange Act, Rule 10(b)–5, and FINRA's internal rules. Instead, Smith contends that the SEC erred as a matter of law in holding that FINRA had regulatory jurisdiction over him, and, further, that the SEC could deprive him of the opportunity to contest the allegations against him before a jury in an Article III court. (Smith also initially made a private nondelegation doctrine and Appointments Clause challenge. FINRA responded, however, that it acts "subordinately" to the SEC as an

“aid,” which it understood to resolve these potential problems. See *Sunshine Anthracite Coal Co. v. Adkins*, 310 U.S. 381, 388, 399–400, 60 S.Ct. 907, 84 L.Ed. 1263 (1940); *Oklahoma v. United States*, 163 F.4th 294, 306 (6th Cir. 2025). Smith withdrew his nondelegation and appointments challenges based on this concession, so we need not resolve them.) We thus turn to Smith’s remaining challenges to the SEC’s determination.

III.

Start with Smith’s statutory argument. Smith, recall, never registered with FINRA. It follows, he says, that FINRA—a private, self-regulatory organization—cannot discipline him. On Smith’s view, he is a member of the public being prosecuted by a non-governmental organization for violating the law, an atypical practice in our American regulatory scheme. See *Oklahoma*, 163 F.4th at 314 (acknowledging that allowing private organizations to enforce federal regulatory schemes “appears to cut against the grain”); *United States v. Ackerman*, 831 F.3d 1292, 1296 (10th Cir. 2016) (Gorsuch, J.) (“[W]hen an actor is endowed with law enforcement powers beyond those enjoyed by private citizens” the actor is typically “a governmental entity.” (citation modified)).

FINRA’s statutory jurisdiction, however, is not so narrowly cabined. As to the threshold question regarding FINRA’s power to regulate, Congress has empowered national securities associations like FINRA to “provide that . . . its members and persons associated with its members shall be appropriately disciplined for violation” of securities laws and regulations. 15 U.S.C. § 78o–3(b)(7); see also *id.* § 78o–3(h)(1) (setting forth the requirements to

discipline a “member or person associated with a member”); *id.* § 78s(g)(1)(B) (requiring registered securities associations to enforce compliance with securities law by “its members and persons associated with its members”). And as to FINRA’s authority over Smith, we note that FINRA has disciplinary power over both members and “persons associated with its members.” *Id.* § 78o–3(b)(7). So even if Smith never became a FINRA member, he still falls under FINRA’s enforcement jurisdiction if he is associated with a member.

All of this raises the question: Was Smith associated with a FINRA member? Helpfully, Congress defined for us the phrase “person associated with a member.” *See id.* § 78c(a)(21). Included within that definition is “any person directly or indirectly controlling . . . such member.” *Id.* As a result, if Smith controlled a FINRA member, he falls within the association’s enforcement ambit. And on that issue, the SEC found that he did exercise such control. As the SEC explained, Smith was the chairman, CEO, and majority owner of CSSC, which wholly owned CSSC-BD, a FINRA member. He personally solicited investments in CSSC and directed CSSC-BD’s registered representatives to do the same. And he was responsible for the recruiting, hiring, and firing of CSSC-BD personnel, whose commissions he also personally determined. On this record, Smith’s argument that FINRA lacks authority to discipline him runs counter to a straightforward reading of the relevant statutory text.

Smith does not offer a contrary reading of the statute. Instead, he takes issue with the notion of a private organization enforcing the law against one who did not consent to its jurisdiction. But whether a

private organization may be afforded such governmental power is primarily a quibble with Congress, which has delineated the scope of FINRA's enforcement jurisdiction. To be sure, Congress's decision to assign this enforcement authority to a private entity theoretically might raise private nondelegation problems, as Judge Walker has previously explained. *See Alpine Sec. Corp. v. FINRA*, 121 F.4th 1314, 1343–45 (D.C. Cir. 2024) (Walker, J., concurring in the judgment in part and dissenting in part) (“[B]ecause [FINRA] enforces federal law and rules that carry the force of law . . . without any initial approval from its supposed supervisor, the SEC[,] . . . [FINRA] transgresses the private nondelegation doctrine.” (citation modified)). *But see Oklahoma*, 163 F.4th at 307 (collecting cases approving of the SEC's SRO model). For today's purposes, it is enough to note that Smith no longer presses his nondelegation challenge because he now agrees that FINRA is simply an adjunct to the SEC, a governmental entity. That leaves only his statutory argument, which is foreclosed by the statute's text.

IV.

Next up is Smith's constitutional argument. He contends he had a right under the Seventh Amendment to a jury trial before an Article III judge based on the logic of *SEC v. Jarkesy*, 603 U.S. 109, 144 S. Ct. 2117, 219 L.Ed.2d 650 (2024), meaning he could not be sanctioned in a proceeding before the SEC without his consent to the forum. But we may not reach the merits of this argument. As Smith never raised this issue before the SEC, we are statutorily barred from resolving the issue. *See* 15 U.S.C. § 78y(c)(1).

A. We begin with a threshold skirmish between the parties over an asserted double omission of sorts on Smith’s part, namely whether on appeal Smith should be faulted for not properly addressing his purported failure to exhaust his constitutional claim before the SEC. In his opening brief, Smith mentioned in a footnote that he did not raise with the SEC his constitutional challenge to the agency proceeding, and committed to addressing the exhaustion issue more fully should the SEC press the matter in its appellate brief. The SEC, in turn, did so. In its brief, the agency claimed that Smith had waived the right to defend his failure to exhaust during his administrative proceeding by foregoing a more full-throated argument in his opening brief.

As a general rule, “a party does not preserve an argument by saying in its opening brief (whether through a footnote or not) that it may raise the issue later, for example, in a reply brief.” *United States v. Huntington Nat’l Bank*, 574 F.3d 329, 331 (6th Cir. 2009) (citation modified). That said, exhaustion requirements—like 15 U.S.C. § 78y(c)(1)—are usually affirmative defenses, meaning that if the agency does not raise the issue, a court may proceed to consider a claim regardless of whether it was raised before the agency. See *K & R Contractors, LLC v. Keene*, 86 F.4th 135, 145 (4th Cir. 2023). For that reason, a party is not required to anticipate affirmative defenses in its opening brief; so long as it responds to those defenses in its reply brief, it preserves its arguments on the issue. See *Overton v. MaCauley*, 822 F. App’x 341, 345 (6th Cir. 2020). Smith did so here, so we therefore turn to the merits of his exhaustion arguments.

B. To preserve an issue for review before the courts of appeals, a party must first exhaust it before the SEC. That much is clear from 15 U.S.C. § 78y(c)(1), which instructs that “[n]o objection to an order or rule of the Commission, for which review is sought under this section, may be considered by the court unless it was urged before the Commission or there was reasonable ground for failure to do so.” As this exhaustion requirement is statutory in nature, *see Island Creek Coal Co. v. Bryan*, 937 F.3d 738, 746 (6th Cir. 2019), we may not excuse a petitioner’s failure to exhaust unless the petitioner qualifies for an exception set out by statute, *see Singh v. Rosen*, 984 F.3d 1142, 1155–56 (6th Cir. 2021) (quoting *Ross v. Blake*, 578 U.S. 632, 639, 136 S.Ct. 1850, 195 L.Ed.2d 117 (2016)).

Smith concedes that he failed to raise his constitutional challenges before the SEC. So he is left to explain why “there was reasonable ground for [his] failure to do so.” 15 U.S.C. § 78y(c)(1). He offers three justifications. One, the SEC lacked the competence to adjudicate his constitutional arguments. Two, *Jarkesy* represents an intervening change in law that excuses his forfeiture of the issue. And three, it would have been futile to raise the issue before the SEC.

1. Smith begins by claiming that the SEC was incompetent to adjudicate his structural constitutional argument. The SEC’s history with these sorts of claims belies that assertion. The agency, we note, has repeatedly adjudicated the merits of Seventh Amendment challenges. *See, e.g., John Thomas Cap. Mgmt. Grp. LLC*, Securities Act Release No. 10834, Exchange Act Release No. 89775, Investment Company Act Release No. 34003, 2020 WL 5291417, at *27 (Sep. 4, 2020), *vacated on the*

merits, Jarkesy v. SEC, 34 F.4th 446 (5th Cir. 2022); *Charles L. Hill, Jr.*, Exchange Act Release No. 79459, 2016 WL 7032731, at *3 (Dec. 2, 2016). The same is true for other constitutional challenges. *See, e.g., Newport Coast Sec., Inc.*, Exchange Act Release No. 88548, 2020 WL 1659292, at *17–18 (Apr. 3, 2020) (Appointments Clause challenge); *John Thomas Cap.*, 2020 WL 5291417, at *25–28 (separation of powers, Appointments Clause, Equal Protection Clause, and Due Process Clause challenges). By all accounts, in other words, the SEC addresses constitutional arguments regarding its structure with some frequency. We see no reason it could not have tackled Smith’s constitutional challenge as well.

Seeing things differently, Smith points to cases that he says suggest that the SEC is unable to adjudicate the validity of its own adjudicatory structure. *See Axon Enters., Inc. v. FTC*, 598 U.S. 175, 143 S. Ct. 890, 905, 215 L.Ed.2d 151 (2023); *Free Enter. Fund v. PCAOB*, 561 U.S. 477, 491, 130 S.Ct. 3138, 177 L.Ed.2d 706 (2010). But fairly read, those decisions address a different point, namely, whether a plaintiff may go to district court before an agency’s adjudication is complete. *Axon*, 143 S. Ct. at 897, 906; *Free Enter. Fund*, 561 U.S. at 489, 130 S.Ct. 3138. Regardless of whether Smith had a strong argument that he could go to federal court during his FINRA and SEC proceedings to challenge the agencies’ adjudicatory structures, he did not do so. And “[w]hen litigants *choose* to use a statutory review mechanism” instead of going to district court, “they must still meet [the exhaustion requirement’s] strictures.” *Heating, Air Conditioning & Refrigeration Distribs. Int’l v. EPA*, 71 F.4th 59, 65 n.2 (D.C. Cir. 2023). That describes Smith’s circumstances. He opted to litigate

his case before the SEC without notifying the agency that he believed he was entitled to a jury trial in an Article III court. Having done so, he cannot now complain on petition from the agency's decision about the competence of those administrative tribunals.

Our decision in *Calcutt v. FDIC* does not change things. 37 F.4th 293 (6th Cir. 2022), *rev'd summarily*, 598 U.S. 623, 143 S. Ct. 1317, 215 L.Ed.2d 557 (2023) (per curiam). Even if *Calcutt's* analysis on exhaustion remains viable following the Supreme Court's summary reversal of that decision on a different basis, it still does not help Smith. Cf. Bryan Garner et al., *The Law of Judicial Precedent* 123–24 (2016) (explaining that under a “strict” view of precedent an opinion's holding that affirms with respect to one issue is no longer binding if the opinion reverses with respect to another issue sufficient to resolve the case, but under a “loose” view of precedent the affirmance on the alternative issue remains binding because it reflects reasoned decisionmaking). There, we held that *Calcutt* had not forfeited his Appointments Clause challenge to the FDIC's board structure because no statute required exhaustion, and because the FDIC had no power to consider *Calcutt's* facial constitutional challenge. See *Calcutt*, 37 F.4th at 312–13. That situation is far afield from the one presented here. All agree that § 78y(c)(1) is a statutory exhaustion requirement. And Smith's challenge is an as-applied one. Accordingly, *Calcutt* is a poor guide for today's dispute.

All told, the SEC's competency is not a fair ground for excusing Smith's failure to raise his Seventh Amendment argument.

2. Next, Smith argues that *Jarkesy* represented an intervening change in law that excused his failure

to raise the issue before the SEC. As applied to this administrative setting, the doctrine invoked by Smith “generally serves to excuse a failure to exhaust when an issue was not available to the party” during an earlier administrative proceeding. *Joseph Forrester Trucking v. Dir., Off. of Workers’ Comp. Programs*, 987 F.3d 581, 592 (6th Cir. 2021) (citing *Hormel v. Helvering*, 312 U.S. 552, 558–59, 61 S.Ct. 719, 85 L.Ed. 1037 (1941)). According to Smith, his Seventh Amendment argument did not become viable until *Jarkesy* announced a change in Supreme Court jurisprudence, meaning the argument was not one he could have raised before the SEC.

Smith’s attempt to excuse his forfeiture, however, has multiple flaws. First and foremost, *Jarkesy* does not represent an intervening change in law. There, the Supreme Court explained that its prior decision in *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 109 S.Ct. 2782, 106 L.Ed.2d 26 (1989), controlled the outcome. *See Jarkesy*, 144 S. Ct. at 2135. Where a prior case effectively dictates a subsequent outcome, there is no intervening change in law. *See Joseph Forrester*, 987 F.3d at 592. Consider *Joseph Forrester*, for example, where we held that *Lucia v. SEC*, 585 U.S. 237, 138 S.Ct. 2044, 201 L.Ed.2d 464 (2018), was not an intervening change in law in the Appointments Clause context because *Lucia* emphasized that “the Supreme Court [in *Freytag v. C.I.R.*, 501 U.S. 868, 111 S.Ct. 2631, 115 L.Ed.2d 764 (1991)] had already said ‘everything necessary to decide th[at] case,’ ” *Joseph Forrester*, 987 F.3d at 592 (quoting *Lucia*, 585 U.S. at 247, 138 S.Ct. 2044). So too in *Jarkesy*. 144 S. Ct. at 2135 (“*Granfinanciera* effectively decides this case.”). In the end, *Jarkesy* was an application of the traditional Article III and Seventh Amendment

analysis, not a departure from it. That leaves Smith without an intervening change in law that would excuse his failure to raise the issue before the SEC.

Even if *Jarkesy* was an intervening departure from precedent, the fact remains that the Supreme Court handed down that decision *before* the SEC decided Smith's case, yet Smith failed to bring the decision to the Commission's attention. Instructive again is *Joseph Forrester*. There, we rejected an intervening change of law excuse when the petitioners "failed to raise that development with the respective ALJs in the wake of" the alleged intervening change. *Joseph Forrester*, 987 F.3d at 592. So too here. Smith opted not to raise *Jarkesy* with the SEC even though his case was still pending before the Commission when *Jarkesy* was decided. Understood that way, *Jarkesy* is not so much an intervening change in law as it is law that Smith neglected to bring to the SEC's attention.

Smith seeks to justify this seeming oversight by claiming that there is no mechanism for informing the SEC of a new decision once briefing on a matter has closed. That is incorrect. Smith could have asked to file a supplemental brief before the matter was resolved. *See* 17 C.F.R. § 201.421(b) (procedure for supplemental briefing). Or he could have filed a motion for reconsideration after the SEC's final order, which did not address *Jarkesy*. *See id.* § 201.470(b) (procedure for reconsideration). Confirming as much, the SEC has in other cases granted motions seeking supplemental briefing on *Jarkesy*'s effect on FINRA adjudications when a party asked the SEC for permission to do so. *See, e.g., Ricky Alan Mantei*, Exchange Act Release No. 101385, 2024 WL 4527340, at *1 (Oct. 18, 2024).

In short, we cannot excuse Smith’s forfeiture of his Seventh Amendment argument because of an intervening change in law.

3. Lastly, Smith claims that raising the Seventh Amendment issue to the SEC would have been futile because the SEC had repeatedly rejected similar claims. To be sure, futility can be a valid justification for failing to exhaust constitutional arguments. *See Carr v. Saul*, 593 U.S. 83, 141 S. Ct. 1352, 1361, 209 L.Ed.2d 376 (2021) (citing *Bethesda Hosp. Ass’n v. Bowen*, 485 U.S. 399, 405–06, 108 S.Ct. 1255, 99 L.Ed.2d 460 (1988); *Mont. Nat’l Bank of Billings v. Yellowstone County*, 276 U.S. 499, 505, 48 S.Ct. 331, 72 L.Ed. 673 (1928)). But the futility exception the Supreme Court recognizes targets cases in which the “adjudicators . . . are powerless to grant the relief requested.” *Id.* Our precedents are to the same end. We view the crucial inquiry as whether the agency can provide the relief requested if the argument succeeds, not whether it is likely to succeed. *See Jones Bros., Inc. v. Sec’y of Lab.*, 898 F.3d 669, 674 (6th Cir. 2018) (citing *McCarthy v. Madigan*, 503 U.S. 140, 147–48, 112 S.Ct. 1081, 117 L.Ed.2d 291 (1992)); *Island Creek*, 937 F.3d at 752–53; *Joseph Forrester*, 987 F.3d at 591 (citing *Peabody Coal Co. v. Greer*, 62 F.3d 801, 806 (6th Cir. 1995)). This rule is designed to afford the agency the opportunity to reconsider its position in the first instance, and to promote efficient litigation. *See Jones Bros.*, 898 F.3d at 673.

Smith misunderstands the futility excuse. He treats it as a preordained result rule: It would be futile to raise his constitutional challenge because everyone knows how the SEC would answer the issue. In so doing, Smith confuses results for remedies. The futility excuse, it bears explaining, concerns whether

the agency can offer an appropriate remedy even if past agency decisions foreclose a successful result before the agency. A party like Smith, it follows, is not excused from making an argument before an agency simply because the argument is destined to lose.

Properly framed, for Smith to prevail on his futility argument, he must show that the SEC did not have the power to remedy the purported Seventh Amendment violation he asserts. He fails to do so. Putting aside the fact that we have traditionally cabined our futility jurisprudence to facial challenges, *see id.* at 674–75, it remains the case that the SEC could have provided Smith a remedy. Namely, the SEC was empowered to vacate the sanctions stemming from FINRA’s adjudicative process, had the agency been persuaded to do so. The SEC would then have had the choice to bring proceedings against Smith in federal court where he could request a jury. *See* 15 U.S.C. § 78u(d). Because the SEC could simply vacate the FINRA sanctions as an appropriate remedy, raising the Seventh Amendment argument before the SEC would not have been futile.

* * *

To sum up, Smith cannot demonstrate a “reasonable ground” for his failure to exhaust his constitutional arguments at the agency level. 15 U.S.C. § 78y(c)(1). The SEC has the competence to adjudicate Smith’s Article III and Seventh Amendment argument. Further, Smith’s argument is not premised on a departure from existing law, so *Jarkesy* (which he never raised to the SEC) is not a reason to excuse his forfeiture. And the SEC could have offered him a remedy for a violation of these

constitutional rights by pursuing enforcement efforts in federal court rather than in an administrative setting, defeating Smith’s futility theory. That leaves us statutorily barred from reaching Smith’s constitutional arguments.

C. All that said, had Smith raised his constitutional challenge before the SEC, he may well have been entitled to a jury trial in federal court. We employ a two-part test for determining when a defendant is due an Article III jury trial. *Jarkesy*, 144 S. Ct. at 2127. First, we ask whether the “action implicates the Seventh Amendment.” *Id.* If so, then second, we determine whether the “public rights” doctrine applies, thereby exempting the case from Article III. *Id.* Within step one, there is a further two-part test for identifying whether the Seventh Amendment attaches. *Tull v. United States*, 481 U.S. 412, 417–18, 107 S.Ct. 1831, 95 L.Ed.2d 365 (1987). To begin, we compare the action at issue to “18th-century actions brought in the courts of England prior to the merger of the courts of law and equity.” *Id.* at 417, 107 S.Ct. 1831 (citing *Pernell v. Southall Realty*, 416 U.S. 363, 378, 94 S.Ct. 1723, 40 L.Ed.2d 198 (1974); *Dairy Queen, Inc. v. Wood*, 369 U.S. 469, 477, 82 S.Ct. 894, 8 L.Ed.2d 44 (1962)). Then, we determine whether the remedy sought is legal or equitable. *Id.* at 417–18, 107 S.Ct. 1831 (citing *Curtis v. Loether*, 415 U.S. 189, 196, 94 S.Ct. 1005, 39 L.Ed.2d 260 (1974); *Ross v. Bernhard*, 396 U.S. 531, 542, 90 S.Ct. 733, 24 L.Ed.2d 729 (1970)).

With respect to the two-part test just described, we note that Smith, FINRA, and the SEC now all agree that FINRA merely acts as an aid to the SEC’s ultimate adjudication. That makes the SEC the relevant adjudicatory body for applying the two-step

framework. And for that reason, this case presents the same ultimate problem as did *Jarkesy*: The SEC is imposing sanctions against Smith (albeit on the recommendation of FINRA) without a jury trial before an Article III judge. See *Jarkesy*, 144 S. Ct. at 2126–27.

Against this backdrop, the analysis seemingly would be straightforward. With respect to the initial inquiry under step one—comparing the SEC’s action at issue here to actions in English courts that predate “the merger of the courts of law and equity”—it is difficult to ignore the similarities between *Jarkesy* and today’s case. *Tull*, 481 U.S. at 417, 107 S.Ct. 1831 (citing *Pernell*, 416 U.S. at 378, 94 S.Ct. 1723; *Dairy Queen*, 369 U.S. at 477, 82 S.Ct. 894). As in *Jarkesy*, the statutes, regulations, and rules that FINRA and the SEC sought to enforce are analogous to common law fraud. In fact, it bears noting that the SEC enforced § 10(b) of the Exchange Act and Rule 10(b)–5 against both Smith and *Jarkesy*. Both target “misrepresenting or concealing material facts,” giving the regulatory framework here “an enduring link” with “its common law ‘ancestor.’” *Jarkesy*, 144 S. Ct. at 2130 (quoting *Foster v. Wilson*, 504 F.3d 1046, 1050 (9th Cir. 2007)). So *Jarkesy*’s conclusion that these are legal actions that date back to the common law is directly controlling. See *id.*

Further, as to the related inquiry—whether the remedy sought by the agency is legal or equitable—all indicators similarly point in favor of the Seventh Amendment’s applicability to Smith’s case. Smith has a strong argument that the restitution order the SEC imposed against him was a legal, not equitable, sanction. Although restitution is frequently “characterize[d] as a form of equitable relief,” *Great-*

West Life & Annuity Ins. Co. v. Knudson, 534 U.S. 204, 212, 122 S.Ct. 708, 151 L.Ed.2d 635 (2002), it has “existed remedially as legal, equitable, and sometimes both,” Caprice L. Roberts, *The Restitution Revival and the Ghosts of Equity*, 68 Wash. & Lee L. Rev. 1027, 1043 (2011). “[F]or restitution to lie in equity, the action generally must seek not to impose personal liability on the defendant, but to restore to the plaintiff particular funds or property in the defendant’s possession.” *Great-West*, 534 U.S. at 214, 122 S.Ct. 708; *see also* Emily Sherwin & Samuel L. Bray, *Ames, Chafee, and Re on Remedies* 759–60 (2d ed. 2018) (discussing the difference between legal and equitable restitution). When a victim cannot point to title to particular property but can show grounds for recovering some money, he has a legal remedy. *Great-West*, 534 U.S. at 213, 122 S.Ct. 708. By contrast, when money can be traced to particular funds in the defendant’s possession, restitution is an equitable remedy (usually in the form of a constructive trust). *Id.*; *see also* Sherwin & Bray, *supra*, at 760.

Here, FINRA’s factual findings suggest that the money was quickly shuffled into the flow of CSSC-BD’s income to keep the firm afloat. As FINRA imposed joint and several liability on Smith and CSSC-BD for the restitution, that action suggests that FINRA and the SEC could not trace where the investors’ money ultimately ended up. Thus, it appears FINRA and the SEC are attempting to impose personal liability. As such, the SEC’s restitution order recognizes the investors’ right to recover—but not from a specific source—making it a legal remedy. *Great-West*, 534 U.S. at 213, 122 S.Ct. 708. Reinforcing this conclusion is FINRA’s willingness to accept payment. Although the

restitution order here was tied to the amount Smith defrauded from investors, which does not go to “the culpability of the defendant and the need for deterrence,” *Jarkesy*, 144 S. Ct. at 2130, the order requires Smith to pay FINRA if he cannot locate a victim. Paying money to FINRA seemingly “does not ‘restore the status quo’ and,” as a result, “can make no pretense of being equitable.” *Id.* (quoting *Tull*, 481 U.S. at 422, 107 S.Ct. 1831). Smith, it follows, has a firm basis for arguing that the remedy sought is legal in nature.

Moving on to the second step of the jury trial right analysis—whether the public rights exception applies—Smith continues to enjoy what would have been a strong claim. Return once more to *Jarkesy*. There, the Supreme Court held that the public rights doctrine did not apply to the SEC’s enforcement of securities law when dealing with many of the same anti-fraud provisions enforced against Smith. *See id.* at 2136. And it is not difficult to see why. After all, at bottom, a statutory cause of action rooted in common law fraud that allows for legal remedies is a private right. *Id.* (quoting *Granfinanciera*, 492 U.S. at 56, 109 S.Ct. 2782). The overlap between the cause of action in *Jarkesy* and this case makes it extremely difficult to distinguish *Jarkesy*. Both cases involve “a suit . . . made of ‘the stuff of the traditional actions at common law tried by the courts at Westminster in 1789,’” so Congress cannot employ the public rights doctrine to remove them from Article III courts. *Stern v. Marshall*, 564 U.S. 462, 484, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011) (quoting *N. Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 90, 102 S.Ct. 2858, 73 L.Ed.2d 598 (1982) (Rehnquist, J., concurring in the judgment)).

The SEC's main response is that there is a long tradition of self-discipline in the securities industry, which exempts these proceedings from Article III. True, a historical tradition of assigning adjudication outside of Article III can be a basis for determining something is a public right. *See N. Pipeline*, 458 U.S. at 68, 102 S.Ct. 2858 (plurality opinion) (citing *Ex parte Bakelite Corp.*, 279 U.S. 438, 458, 49 S.Ct. 411, 73 L.Ed. 789 (1929)). But the longstanding practice that the SEC points to here is one of consenting members regulating themselves. The leniency courts historically have shown to discipline in these organizations was based on the notion that "members [were] parties to a voluntary contract with the exchange." *Westwood & Howard, supra*, at 521. And here, that voluntary relationship is absent. Smith explicitly attempted to avoid becoming a member of FINRA and continues to contest FINRA's jurisdiction over him. And the SEC does not point to any historical tradition allowing SROs to discipline non-consenting non-members. For these reasons, the public rights doctrine does not undermine Smith's weighty assertion to a right to a jury trial before an Article III judge.

For today's purposes, however, these points are all for naught. As Smith failed to make these arguments before the Commission, we cannot reach them, regardless of their strength.

* * * * *

We deny Smith's petition for review.

CONCURRENCE

MURPHY, Circuit Judge, concurring.

I write to highlight an important “unconstitutional conditions” question lurking in the background of this case. Suppose that two parties to a contract agree to arbitrate a federal claim. By doing so, they forgo several procedural protections that they would otherwise enjoy under the U.S. Constitution. To start, Article III grants the “judicial Power” to the Supreme Court and the inferior federal courts. U.S. Const. art. III, § 1. It thus bars Congress from stripping a person of an independent Article III judge in litigation over private rights. *See Stern v. Marshall*, 564 U.S. 462, 483–84, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011). Likewise, the Due Process Clause prohibits the government from “depriv[ing]” a person “of life, liberty, or property, without due process of law[.]” U.S. Const. amend. V. It thus ensures that the government cannot take a person’s money except according to the “settled usages” of common-law courts. *McIntosh v. City of Madisonville*, 126 F.4th 1141, 1150 (6th Cir. 2025) (Murphy, J., concurring) (quoting *Murray’s Lessee v. Hoboken Land & Improvement Co.*, 59 U.S. 272, 277, 18 How. 272, 15 L.Ed. 372 (1856)). Lastly, the Seventh Amendment compels the government to respect “the right of trial by jury” “[i]n Suits at common law[.]” U.S. Const. amend. VII. It thus guarantees that a jury will resolve the factual disputes that a legal claim presents. *SEC v. Jarkesy*, 603 U.S. 109, 121–22, 144 S.Ct. 2117, 219 L.Ed.2d 650 (2024). The hypothetical contracting parties have lost all these rights by agreeing to arbitrate because an arbitrator (not an Article III judge or a jury) will oversee the dispute and find the facts in a private venue (not a court of law).

Next suppose that one of the contracting parties has second thoughts about arbitrating the federal claim when a dispute materializes. Can the party avoid arbitration on the ground that it violates these constitutional rights? Not at all. Parties may presumptively waive any right, including a constitutional right. See *United States v. Mezzanatto*, 513 U.S. 196, 200–01, 115 S.Ct. 797, 130 L.Ed.2d 697 (1995). The validity of a waiver “depends on the nature of the right at issue.” *Kloosterman v. Metro. Hosp.*, 153 F.4th 501, 512 (6th Cir. 2025) (Murphy, J., concurring) (quoting *New York v. Hill*, 528 U.S. 110, 114, 120 S.Ct. 659, 145 L.Ed.2d 560 (2000)). For constitutional waivers, the Supreme Court generally requires “an intentional relinquishment or abandonment of a known right or privilege.” *Brewer v. Williams*, 430 U.S. 387, 404, 97 S.Ct. 1232, 51 L.Ed.2d 424 (1977) (quoting *Johnson v. Zerbst*, 304 U.S. 458, 464, 58 S.Ct. 1019, 82 L.Ed. 1461 (1938)). We have hinted at this standard in the arbitration context. See *Tillman v. Macy’s Inc.*, 735 F.3d 453, 460–61 (6th Cir. 2013); *K.M.C. Co. v. Irving Tr. Co.*, 757 F.2d 752, 755–56 (6th Cir. 1985); but see *Cooper v. MRM Inv. Co.*, 367 F.3d 493, 506–08 (6th Cir. 2004). Yet other courts have followed a less demanding standard. See *IFC Credit Corp. v. United Bus. & Indus. Fed. Credit Union*, 512 F.3d 989, 993–94 (7th Cir. 2008); *Caley v. Gulfstream Aerospace Corp.*, 428 F.3d 1359, 1372 (11th Cir. 2005). And the Supreme Court has suggested that general contract-law principles (including waiver principles) should apply to arbitration agreements. See *Kindred Nursing Ctrs. Ltd. P’ship v. Clark*, 581 U.S. 246, 251–55, 137 S.Ct. 1421, 197 L.Ed.2d 806 (2017). Under any standard, though, a party who voluntarily enters

an arbitration contract (and knowingly waives a jury trial) would likely be out of luck: the party must arbitrate the dispute because it consented to give up the Constitution's procedural protections for the claim at issue. *Cf. Wellness Int'l Network, Ltd. v. Sharif*, 575 U.S. 665, 674–76, 135 S.Ct. 1932, 191 L.Ed.2d 911 (2015); *id.* at 702–03, 135 S.Ct. 1932 (Roberts, C.J., dissenting); *id.* at 718–19, 135 S.Ct. 1932 (Thomas, J., dissenting).

The SEC and FINRA argue that this case is just as easy as my hypothetical arbitration agreement. They point to the history of self-regulation in the securities industry dating back to the early 1790s. *See* Robert Sobel, *The Curbstone Brokers: The Origins of the American Stock Exchange* 10-14 (1970); Stuart Banner, *The Origin of the New York Stock Exchange, 1791–1860*, 27 J. Legal Stud. 113, 114–15 (1998). The founders of the early stock exchanges formed them as voluntary associations (or private clubs). *See* Richard W. Jennings, *Self-Regulation in the Securities Industry: The Role of the Securities and Exchange Commission*, 29 L. & Contemp. Probs. 663, 663 n.2, 667–69 (1964). Courts considering disputes between an exchange and its members concluded that the exchange's governing documents formed a “contract by which each member ha[d] consented to be bound[.]” *Belton v. Hatch*, 109 N.Y. 593, 596, 17 N.E. 225 (1888); *see White v. Brownell*, 4 Abb. Pr. (n.s.) 162, 192–94 (N.Y. C.P. 1868); Howard C. Westwood & Edward G. Howard, *Self-Government in the Securities Business*, 17 L. & Contemp. Probs. 518, 519–21 (1952). And those documents routinely required arbitration. *See* Jill Gross, *The Historical Basis of Securities Arbitration as an Investor Protection Mechanism*, 2016 J. Disp. Resol. 171, 174–76. Indeed,

the New York Stock Exchange would enforce some futures contracts in private adjudications even though New York courts would find those contracts unenforceable in public suits. *See* William A. Birdthistle & M. Todd Henderson, *Becoming a Fifth Branch*, 99 Cornell L. Rev. 1, 14 (2013); Banner, *supra*, at 125. In many ways, then, members who chose to join an exchange *voluntarily* agreed to arbitrate their disputes (and waive their constitutional protections) much like a business might agree to arbitrate a dispute today.

According to the SEC and FINRA, this “unbroken tradition” of self-regulation shows that FINRA can discipline its members (including by taking their money) using an internal process without an Article III judge or a jury. Respondent’s Br. 65 (quoting *Jarkesy*, 603 U.S. at 128, 144 S.Ct. 2117); *see* FINRA Amicus Br. 47–48. In other words, the SEC and FINRA argue that securities brokers accept FINRA’s rules once those brokers decide to become FINRA members. And these rules include a dispute-resolution process in which a hearing panel oversees a case and finds the facts. *See Mohlman v. FINRA*, 977 F.3d 556, 559 (6th Cir. 2020). So the SEC and FINRA analogize today’s FINRA members to yesterday’s exchange members. Just as the exchange members had to abide by their “contract” to follow the exchange’s procedures, *Belton*, 109 N.Y. at 596, 17 N.E. 225-97, so too FINRA members allegedly must adhere to their contract to follow FINRA procedures.

But this analogy breaks down on inspection. For most of the country’s history until the 1930s, securities brokers had a *voluntary* choice over whether to join a securities exchange. They could apply to become an exchange member if they thought

the advantages (such as access to trustworthy trading partners and price information) exceeded the disadvantages (such as the price of admission and, perhaps for some, the rules requiring arbitration). *See* Banner, *supra*, at 120–24. But brokers could also opt not to join an exchange and still operate a brokerage business. In the early 1800s, for example, many brokers who did not join what would become the New York Stock Exchange would regularly “trade in restaurants or coffeehouses,” among other places. Sobel, *supra*, at 14. Many of these individuals even traded securities in the “open air” on “the streets” and so became known as “curbstone brokers.” *Id.* As a result, the exchanges’ self-regulation did not reach “the vast majority of stock transactions” made “over-the-counter” by nonmember brokers. Birdthistle & Henderson, *supra*, at 16; *see* Banner, *supra*, at 118.

Brokers do not have the same choice today. Far from it. Since 1983, Congress has barred Americans from engaging in the securities business unless they join a registered exchange or securities association. *See* Pub. L. 98-38, § 3, 97 Stat. 205, 206–07 (1983) (amending 15 U.S.C. § 78o(b)(8)); *Alpine Sec. Corp. v. FINRA*, 121 F.4th 1314, 1321 (D.C. Cir. 2024). To register, an exchange or association must agree to enforce its rules against its members using “a fair procedure” (presumably one that excludes a court with an Article III judge and jury). *See* 15 U.S.C. §§ 78f(b)(1), (6)–(7); 78o-3(b)(2), (7)–(8). After members exhaust an entity’s internal processes, they may then appeal any punishment to the SEC for fresh review. *See id.* § 78s(d)(2), (e)(1). If the SEC affirms, they may (at long last) seek review in an Article III appellate court. *See id.* § 78y(a)(1). Even then, the

court must defer to the SEC’s factual findings. *Id.* § 78y(a)(4).

In short, unlike in earlier days, brokers today cannot buy and sell securities unless they become a member of a private body that regulates their conduct using procedures that do not include the Constitution’s protections. Congress has thus put aspiring brokers to a choice: consent to forgo those constitutional protections or stay out of the brokerage business.

This government-mandated tradeoff implicates the “unconstitutional conditions” doctrine. *See Sheetz v. County of El Dorado*, 601 U.S. 267, 275, 144 S.Ct. 893, 218 L.Ed.2d 224 (2024); *Bd. of Cnty. Comm’rs, Wabaunsee Cnty. v. Umbehr*, 518 U.S. 668, 674–75, 116 S.Ct. 2342, 135 L.Ed.2d 843 (1996). That doctrine limits the government’s ability to take away constitutional rights by requiring a party to “voluntarily” give up those rights as a condition to receiving some other government benefit. *See Knight v. Metro. Gov’t of Nashville & Davidson Cnty.*, 67 F.4th 816, 824 (6th Cir. 2023). For example, the government does not have unlimited discretion to compel landowners to hand over some of their land (in seeming violation of the Takings Clause) as a condition of receiving a government permit to build on it. *See id.* at 824–27. Nor does it have unlimited discretion to compel parties to express certain viewpoints (in seeming violation of the Free Speech Clause) as a condition to receive public grants or jobs. *See Janus v. Am. Fed’n of State, Cnty., & Mun. Emps., Council 31*, 585 U.S. 878, 902–04, 138 S.Ct. 2448, 201 L.Ed.2d 924 (2018); *Agency for Int’l Dev. v. All. for Open Soc’y Int’l, Inc. (AOSI)*, 570 U.S. 205, 214–15, 133 S.Ct. 2321, 186 L.Ed.2d 398 (2013).

Yet how should courts weed out unconstitutional conditions from constitutional ones? Although the Court has adopted different tests for different constitutional rights, the tests all start with a “generic” inquiry. *Knight*, 67 F.4th at 824. “If the Constitution allows the government to directly compel a private party to” engage in the challenged conduct, “the government may indirectly compel that conduct as a condition on a benefit” that it provides. *Id.* (citing *Rumsfeld v. F. for Acad. & Institutional Rts., Inc.*, 547 U.S. 47, 59–60, 126 S.Ct. 1297, 164 L.Ed.2d 156 (2006)). Take patents that grant monopolies to private parties. Because individuals do not have a private right to patents, the government could directly compel those seeking them to litigate their claim in an administrative venue rather than a court. *See Oil States Energy Servs., LLC v. Greene’s Energy Grp., LLC*, 584 U.S. 325, 335–36, 138 S.Ct. 1365, 200 L.Ed.2d 671 (2018). As a result, the government may also grant a patent on the *condition* that the holder accept this administrative venue in later disputes about the patent’s validity. *See id.* at 341–42 & n.4, 138 S.Ct. 1365.

Applying this “generic” test here, we must ask: Could Congress compel nonconsenting parties to litigate a dispute against them before a FINRA hearing panel (followed by the SEC’s review) rather than a district court with an Article III judge and jury? *Knight*, 67 F.4th at 824. The answer likely depends on the type of claim and remedy at issue. For Article III, due-process, and jury-trial purposes, we would first have to ask if the adjudication would affect public rights (like a patent) or private rights (like a home). *Compare Oil States*, 584 U.S. at 335–36, 138 S.Ct. 1365, *with McIntosh*, 126 F.4th at 1150–51

(Murphy, J., concurring). And for jury-trial purposes, we would also have to ask if the adjudication sought legal or equitable relief. *See Jarquesy*, 603 U.S. at 122–25, 144 S.Ct. 2117. In this case, FINRA investigators pursued what looked like a common-law fraud claim, and they sought what looked like legal relief: a restitution award to be paid by the putative defendant from his own money. So I agree with Judge Readler that this case bears a striking resemblance to *Jarquesy*. Under that precedent, Congress likely could not force a *nonconsenting* party to litigate this claim outside an Article III court without a jury. *See id.* at 120–41, 144 S. Ct. 2117.

I thus see only one possible way to distinguish the FINRA process in this case from the SEC process found unconstitutional in *Jarquesy*. We must ask whether Congress may indirectly require a party to *consent* to waive these constitutional rights as a condition of participating in a brokerage business (what regularly occurs under this FINRA regime) even if Congress could not impose that condition directly on nonconsenting defendants (what apparently occurred in the SEC regime at issue in *Jarquesy*). Apart from the generic first step, the Court has adopted different unconstitutional-condition tests for different rights. *See Knight*, 67 F.4th at 824. In the takings context, for example, the Court has said that any requirement to give up property as a condition to obtain a building permit must have a “nexus” and “rough proportionality” to the land-use harms that the construction will cause. *See Sheetz*, 601 U.S. at 275–76, 144 S.Ct. 893. And in the speech context, the Court has said that Congress can impose speech limits inside a public program that it seeks to subsidize but cannot use that monetary subsidy to

regulate speech outside that program. *See AOSI*, 570 U.S. at 214–15, 133 S.Ct. 2321. As far as I am aware, though, the Court’s cases have yet to develop any sort of test for the procedural rights at issue here. *Cf. Oil States*, 584 U.S. at 341–42 & n.4, 138 S.Ct. 1365.

Perhaps the correct analysis should depend on the proper “baseline” from which to measure this condition. Richard A. Epstein, *Unconstitutional Conditions, State Power, and the Limits of Consent*, 102 Harv. L. Rev. 4, 9–10, 13 (1988). Consider an analogy. Many governments have long allowed a parole board—rather than a court or a jury—to find a parole violation that sends a convicted defendant back to prison. *See United States v. Haymond*, 588 U.S. 634, 651, 139 S.Ct. 2369, 204 L.Ed.2d 897 (2019) (plurality opinion); *Morrissey v. Brewer*, 408 U.S. 471, 477–80, 92 S.Ct. 2593, 33 L.Ed.2d 484 (1972). A parole-violation adjudication does not trigger the Constitution’s normal procedural protections because a parolee’s original conviction permitted the government to detain the parolee during the *entire* parole period. *See Morrissey*, 408 U.S. at 480, 92 S.Ct. 2593; *see also Haymond*, 588 U.S. at 643, 651, 139 S.Ct. 2369 (plurality opinion). And legislatures allowed parolees to serve part of their sentences outside prison “as an ‘act of grace,’ subject to revocation.” *Haymond*, 588 U.S. at 643, 139 S.Ct. 2369 (plurality opinion) (citation omitted). In other words, parolees received a benefit (early release) on the condition that they forgo the Constitution’s usual protections for adjudicating allegations that they violated the terms of their release. Because parolees have only “conditional liberty,” the government has “wide latitude” to put conditions on a departure from the background baseline: imprisonment. *Pa. Bd. of*

Prob. and Parole v. Scott, 524 U.S. 357, 365, 118 S.Ct. 2014, 141 L.Ed.2d 344 (1998) (quoting *Morrissey*, 408 U.S. at 480, 92 S.Ct. 2593). By analogy, suppose that the proper baseline here were that *nobody* could operate a securities business without a similar “act of grace” by Congress. *Haymond*, 588 U.S. at 643, 139 S.Ct. 2369 (plurality opinion) (citation omitted). Maybe Congress would then have “wide latitude” to grant the purported benefit (allowing brokerages) on the condition that brokers forgo the same procedural protections. *Scott*, 524 U.S. at 365, 118 S.Ct. 2014.

But I doubt this is the proper baseline. Indeed, this logic would permit Congress to eviscerate the Constitution’s procedural protections. Wouldn’t it mean that Congress could wield its power over interstate commerce to impose mandatory arbitration on anyone who works (or who hires workers) as a condition of allowing them to do so? One might instead start with the opposite baseline: that “at the common law, no man could be prohibited from working in any lawful trade[.]” *Case of Tailors of Ipswich*, 77 Eng. Rep. 1218, 1219–20 (K.B. 1614); see *Calcutt v. FDIC*, 37 F.4th 293, 348 (6th Cir. 2022) (Murphy, J., dissenting) (quoting 2 Edward Coke, *Institutes of the Laws of England* 47 (1642)). And we should recognize that Congress here has engaged in a form of “regulatory licensing” by first flipping that common-law baseline on its head (with “a background prohibition” of operating a brokerage business) and then imposing conditions on licenses to engage in the business. Philip Hamburger, *Purchasing Submission* 201 (2021). While governments today have broad leeway to regulate in the economic sphere, see *Armour v. City of Indianapolis*, 566 U.S. 673, 680, 132 S.Ct. 2073, 182 L.Ed.2d 998 (2012), perhaps coercing

parties to give up their constitutional rights in order to work can sometimes go a step too far.

In the end, I need not resolve these issues because the majority opinion correctly holds that the petitioner failed to exhaust his constitutional claims. Still, I seek to reiterate two questions for future cases. The first question concerns the SEC's and FINRA's reliance on the history of private self-regulation in the securities industry: Why should this history matter in a changed world in which Congress *forces* brokers to join a private association as a condition of operating a brokerage? The second question concerns the unconstitutional-conditions doctrine: When (if ever) may Congress compel individuals to forgo their rights to an Article III judge and a jury as a condition of operating a business? Leaving these questions for another day, I concur in the majority opinion.

CONCURRENCE

BLOOMEKATZ, Circuit Judge, concurring in the judgment.

As the majority opinion articulates, Eric Smith raises two questions on appeal, one statutory and one constitutional. *First*, as to the statutory question, Smith contests that he fell within FINRA's regulatory jurisdiction. I agree with the majority opinion that, given the record and the statutory text, Smith was "associated with a [FINRA] member," and thus falls within FINRA's regulatory scope. 15 U.S.C. § 78c(a)(21); *id.* § 78o-3(b)(7). *Second*, as to the constitutional question, I also agree with the majority opinion that Smith did not exhaust this claim before the SEC, and that he lacked a "reasonable ground" for failing to do so. *Id.* § 78y(c)(1). Specifically, Smith's constitutional claim stems from the Supreme Court's

decision in *SEC v. Jarkesy*, 603 U.S. 109, 144 S.Ct. 2117, 219 L.Ed.2d 650 (2024), which was decided “before the SEC decided Smith’s case.” Maj. Op. at 324. I agree with the majority opinion that Smith could have raised *Jarkesy* with the SEC, *id.*, and that the SEC had authority to adjudicate his claim, *id.* at 322–24. Thus, there is no basis to excuse Smith’s failure to exhaust.

I depart from the majority opinion because of its dicta opining on the merits of Smith’s constitutional claim. The Securities Act directs that no “objection to an order or rule” of the SEC “may be considered by the court” unless it was exhausted before the agency “or there was reasonable ground for failure to do so.” 15 U.S.C. § 78y(c)(1). *See also Mohlman v. Fin. Indus. Regul. Auth.*, 977 F.3d 556, 560–61 (6th Cir. 2020). Yet the majority opinion spends many pages considering Smith’s constitutional claim and argues in no uncertain terms that the SEC’s adjudicatory process “may well” be unconstitutional, only to lament at the end of its analysis that its “points are all for naught.” Maj. Op. at 325–26, 328. To be sure, we sometimes examine legal issues not squarely presented in a case. But we typically do so by posing questions, highlighting issues that the Supreme Court may want to address, or writing separately. *See, e.g., Island Creek Coal Co. v. Bryan*, 937 F.3d 738, 749 (6th Cir. 2019); *United States v. Morton*, 123 F.4th 492, 497 n.2 (6th Cir. 2024); *Niblock v. Univ. of Kentucky*, 165 F.4th 460, 473 (6th Cir. 2026) (Sutton, C.J., and Murphy, J., concurring). That is not what the majority opinion did here. Because I would not have addressed the merits of the unexhausted constitutional claim, I respectfully concur in the judgment only.

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934

Release No. 100762 / August 19, 2024

Admin. Proc. File No. 3-20127

In the Matter of the Application of ERIC S. SMITH For Review of Disciplinary Action Taken by FINRA

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION —
REVIEW OF DISCIPLINARY PROCEEDING

Applicant appeals from a FINRA disciplinary proceeding finding that he failed to register with FINRA as required and committed antifraud violations of the securities laws and FINRA rules. FINRA barred Smith from association with any member firm and ordered him to pay restitution. *Held*, FINRA's findings of violations and imposition of sanctions are sustained.

* * *

Appeal filed: October 19, 2020

Last brief received: March 11, 2021

Eric S. Smith appeals from FINRA disciplinary action. FINRA found that Smith (i) failed to register as a general securities representative and principal in

violation of NASD Rules 1021 and 1031¹ and FINRA Rule 2010, and (ii) made fraudulent misrepresentations and omissions in securities offering documents in violation of Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5 thereunder, and FINRA Rules 2020 and 2010. FINRA barred Smith from associating with any FINRA member firm in any capacity and ordered him to pay \$130,000 (plus prejudgment interest) in restitution. We sustain FINRA's findings of violations and imposition of sanctions.

I. Background

Smith is the chairman, chief executive officer, and majority owner of Consulting Services Support Corporation ("CSSC"), which Smith founded in 1998. The firm is a financial services firm that provides research, marketing, technology, and administrative services to professionals who provide investment advice to their clients. Among the services it provides is the use of a proprietary "decision-assistance technology" designed to help clients select the best investments for their particular circumstances. CSSC is also the parent company of several wholly owned subsidiaries, including a registered investment adviser and a broker-dealer, CSSC Brokerage Services, Inc. ("CSSC-BD"), formerly a FINRA member firm.²

¹ NASD Rules 1021 and 1031 were in effect at the time of Smith's alleged misconduct. They have been superseded by FINRA Rules 1210 and 1220.

² FINRA also brought a disciplinary proceeding against CSSC-BD, but the firm did not appeal. *See infra* Section I.C. CSSC-BD terminated its FINRA registration in 2018.

A. Smith's control of CSSC and its subsidiaries

During the relevant time (approximately 2010 through 2015), CSSC and its subsidiaries all occupied the same office space in Troy, Michigan. Although formally separate entities, CSSC and its subsidiaries maintained a considerable amount of operational overlap. For example, CSSC had relationships with independent investment professionals around the country with their own client bases, who were called CSSC "affiliates." Affiliate agreements, which Smith signed, required the affiliates to be representatives of CSSC's investment adviser subsidiary and FINRA-registered representatives of CSSC-BD. The agreements also determined the compensation that affiliates would receive from the investment adviser subsidiary and the percentage of commissions they would receive as registered representatives of CSSC-BD.

Smith was responsible for recruiting and signing new CSSC affiliates, and thus also for hiring CSSC-BD's registered representatives, and he decided whether to end an affiliate's relationship with CSSC and its subsidiaries. But Smith himself never registered with FINRA as a representative. Instead, as part of CSSC-BD's application for FINRA membership, Smith submitted a letter to FINRA in July 2006 stating that he was personally exempt from registration. In that letter, he acknowledged that such an exemption would apply only "so long as [he was] not actively engaged in the management of [CSSC-BD's] securities business, including the supervision, solicitation, conduct of business or the securities training of persons associated with the Firm."

Around 2010, after the initial president of CSSC-BD left the firm, Smith appointed Jennifer LaRose and Alex Martin as CSSC-BD's co-presidents. Smith also appointed LaRose as CSSC-BD's Chief Compliance Officer. As more than one witness who worked for CSSC testified, LaRose and Martin were seen as presidents "by title" or "in title only." Indeed, Martin himself testified that he had a "fairly small" role in the "hands-on work" of running the subsidiary.

Smith, by contrast, was extensively involved in running CSSC *and* its subsidiaries. As one CSSC affiliate testified, Smith "maintained absolute ironfisted control over everything that went on in the company [i.e., CSSC]," including "the entities" that were its subsidiaries. For example, when CSSC-BD was in danger of not meeting its minimum net capital requirement in 2014, CSSC's assistant controller spoke directly about the issue with Smith, not LaRose or Martin. Smith directed the assistant controller to prioritize certain payments and directed the investment adviser subsidiary to divert funds to enable CSSC-BD to maintain the required level of net capital. Similarly, when CSSC-BD's auditors had concerns about whether it could continue as a going concern, they contacted Smith.

B. CSSC's debt offerings and revenue initiatives

CSSC struggled financially after the 2008 financial crisis. Most of the firm's revenue came from investment advisory fees based on assets under management, which decreased significantly during this period. To raise money, CSSC pursued three different debt offerings (in 2010, 2014, and 2015), as well as several new business opportunities. FINRA

found that Smith engaged in fraud in connection with the 2015 offering by both misrepresenting CSSC's new business opportunities and not mentioning CSSC's default on its earlier debt offerings.

1. CSSC's 2010 and 2014 offerings

In 2010, CSSC needed funds to retire over one million dollars of short-term debt and to pay deferred salaries and legal fees, so it sought to raise \$5 million through a convertible debenture bond offering (the "2010 Offering"). Smith managed this offering, during which he directed CSSC-BD registered representatives to sell the bonds to their customers using offering documents that Smith provided. Smith also directed CSSC-BD representatives to introduce Smith to their customers and then offered and sold the bonds directly to those customers.

The offering raised \$2.25 million, but CSSC nevertheless continued to struggle to meet its day-to-day obligations, including deferring paying employee salaries and the advisory fees and commissions it owed its affiliates. CSSC therefore conducted another debt offering in 2014 (the "2014 Offering"), in which it sold what it called "bridge loan notes." Smith again managed the offering and used CSSC-BD registered representatives to sell the notes. In doing so, Smith even provided Donald Southwick, a CSSC-BD representative, what Southwick referred to as a "script" to tell his customers when selling the notes. The 2014 Offering ultimately raised approximately \$1.1 million.

2. CSSC's other revenue initiatives

In addition to issuing debt, CSSC pursued several other projects in an effort to improve its finances. These projects are relevant here because Smith would

later misrepresent them when raising money from investors in a 2015 debt offering.

a. Project X

One of the projects--dubbed "Project X"--related to the formation of a special purpose bank. In late 2014, Smith asked Southwick--whom Smith had hired to work for the parent company on such projects--to spearhead Project X, but it faced significant hurdles from the start. Although CSSC hired experienced legal counsel to help form the bank, and Southwick had previous experience setting up a special purpose bank, regulatory approval was far from certain, as was the bank's structure. The initial plan was for a client of Ken Wheeler (a CSSC affiliate) to finance the bank, but questions lingered about obtaining additional financing from private equity firms, as well as the client's role in any newly formed bank.

Although an entity was formed in August 2015 that was intended eventually to provide consulting services to the planned bank, the entity had no employees, board of directors, capital, or operations. Smith fired Southwick in September 2015. At that time, no application to charter the bank had yet been submitted to regulatory authorities, no financing to fund the bank or the consulting entity had been secured, and CSSC had entered into no agreements about advising any such bank.

b. South Dakota Trust Company

In late 2014, around the time it was pursuing Project X, CSSC also sought a relationship with the South Dakota Trust Company ("SDTC"), a national trust administration company that catered to wealthy clients. Smith and Southwick believed that CSSC could help SDTC create a range of new investment

funds for which CSSC could serve as an investment adviser and that SDTC could refer its clients to CSSC for services that SDTC did not offer. In November 2014 and March 2015, Smith and Southwick met with representatives of SDTC to discuss a potential relationship, but no agreement was reached. Southwick attempted to arrange a follow-up meeting with SDTC in 2015 but was unsuccessful. SDTC never entered into a formal relationship with CSSC.

c. City of Jacksonville

CSSC also sought to provide financial advisory services to the City of Jacksonville, Florida. In 2014, Southwick, at Smith's direction, approached the city's treasurer about having CSSC directly manage Jacksonville's investments. City representatives declined the direct management suggestion but were open to having CSSC use its decision-assistance technology to evaluate the investment advice the city was already receiving. In July 2015, Smith submitted a written proposal offering to have CSSC serve as an independent reviewing consultant to the city for a quarterly fee of \$15,000. City representatives never accepted this proposal, however, and never paid CSSC any fees.

3. CSSC's 2015 offering

CSSC's financial troubles continued. In 2014, the company operated at a deficit, with a net loss of approximately one million dollars. It frequently deferred paying compensation to its employees and affiliates and had trouble making credit card payments. Around the end of the year, CSSC-BD was in danger of falling below net capital requirements, and Smith directed the transfer of funds from CSSC's investment adviser subsidiary to CSSC-BD. CSSC

also lacked the funds to repay hundreds of thousands of dollars of principal from the 2010 and 2014 Offerings coming due in May and June 2015. CSSC therefore pursued a bridge loan note offering in 2015 (the “2015 Offering”). Smith drafted the offering documents for the 2015 Offering, including an offering document labeled the “Confidential Report.”

Smith testified that he personally solicited 15 to 25 people to invest in the 2015 Offering and sent them versions of offering documents. These potential investors included both CSSC-BD registered representatives themselves and their customers. Smith also used CSSC-BD registered representatives to find investors. Ultimately, four investors invested \$130,000 in the 2015 Offering between August and November 2015.³

But the 2015 Offering documents that Smith used to solicit investors included many false or misleading representations about the business initiatives described above. For example, although little progress had been made on Project X, and no agreements were ever made for CSSC to advise the future bank, the June 2015 Confidential Report falsely asserted that creation of a special purpose bank was “in the final stages”; that CSSC had already earned and would soon be paid half of a “\$1m consulting fee”; and that the remainder would be paid when the new bank opened, before “the end of the 3rd quarter of 2015.” The report added that CSSC expected to receive an additional \$400,000 in 2015 for creating a second special purpose bank, something

³ Two of the four investors were CSSC-BD registered representatives, and the other two were not CSSC-BD customers.

that was not even contemplated in this timeframe by those working on the project. Smith subsequently acknowledged in a September 2015 update to investors that the receipt of this expected revenue “did not take place as planned,” and baselessly blamed this development on “a plan to deprive [CSSC] of the expected and earned benefit” of the project.

Similarly, although no agreement or formal relationship was ever reached with SDTC, Smith’s June 2015 Confidential Report falsely stated that CSSC had been “active in the formation of an important new strategic alliance” with SDTC. The report touted that this relationship could provide ““substantial” “revenue and profit potential” and that CSSC expected the relationship to be “up and running before the end of calendar year 2015.” September and October 2015 updates to the Confidential Report acknowledged “a hiatus” in the SDTC discussions, but falsely stated that “discussions have recently recommenced.” The updates further stated that the potential fees from the initiative “could be quite large and is expected to provide a growing source of revenue.”⁴ Moreover, Smith continued to highlight a relationship with SDTC in offering documents throughout 2015.

Finally, although no agreement was ever reached with the City of Jacksonville, Smith’s June 2015 Confidential Report highlighted what it described as “a pending engagement” with the city. The report falsely claimed that CSSC was “currently in the final

⁴ Although the September and October 2015 updates to the Confidential Report stated that these discussions had “recently recommenced,” the November 2015 update stated that these “discussions are expected to recommence.”

stages of being engaged as Special Reviewing Consultant with regard to the investment management of Jacksonville's nearly \$1 billion in short-term operating funds." The report asserted that this arrangement would increase CSSC's revenue as well as its "reportable assets under management by nearly \$1 billion—a very significant credentialing plateau." Throughout 2015, Smith's updated disclosure documents continued to highlight a "pending engagement" with Jacksonville, calling the relationship "a real milestone," and claiming that the engagement with the city was "to commence on or about October 1st of this year," and after that date passed, "prior to the end of this calendar year."

The 2015 Offering documents also contained notable omissions, which rendered the statements Smith made in the offering documents misleading. Importantly, they did not disclose that CSSC owed investors hundreds of thousands of dollars in principal payments in connection with the 2010 and 2014 Offerings that was due or coming due. (The 2010 Offering documents, by comparison, had disclosed the company's then-debt.)

C. Procedural History

FINRA began investigating CSSC-BD and Smith after conducting a routine examination in 2015 and receiving complaints from CSSC-BD customers who had invested in CSSC debt offerings. On August 4, 2017, FINRA's Department of Enforcement filed a complaint against Smith and CSSC-BD. The complaint charged Smith and CSSC-BD with fraudulently misrepresenting or omitting material facts in connection with the 2015 Offering and with failing to register Smith as a general securities

representative and principal of CSSC-BD as required by FINRA's rules.

After an eight-day hearing, a hearing panel found that Smith and CSSC-BD engaged in the alleged misconduct. For the fraud violations, the hearing panel barred Smith from associating with any FINRA member firm in any capacity, suspended CSSC-BD from participating in private securities offerings in all capacities for one year, and fined the firm \$100,000. The hearing panel also ordered Smith and CSSC-BD to pay restitution of \$130,000, jointly and severally, to the four investors in the 2015 Offering. For the registration violations, the hearing panel assessed—but in light of the bar for the fraud violations, did not impose--two suspensions in all capacities for one year and two \$50,000 fines on Smith, one for each registration-related cause of action. The hearing panel also imposed a \$20,000 fine on CSSC-BD for the registration violations.

Smith, but not CSSC-BD, appealed to FINRA's National Adjudicatory Council ("NAC"), which affirmed the hearing panel's findings of violations against Smith. The NAC affirmed the hearing panel's imposition of a bar and restitution order for the fraud violations. For acting as an unregistered principal, the NAC increased the hearing panel's sanctions against Smith to a \$75,000 fine and a two-year suspension in all capacities and, for acting as an unregistered representative, increased the sanctions to a \$50,000 fine and a one-year suspension in all capacities. But like the hearing panel, the NAC declined to impose the assessed sanctions for the registration violations because of the bar imposed for the fraud violations.

This appeal followed.

II. Analysis

In reviewing FINRA's action, we determine whether Smith engaged in the conduct FINRA found, whether that conduct violated the statutory provisions or rules specified in FINRA's determination, and whether those provisions and rules are, and were applied in a manner, consistent with the purposes of the Exchange Act.⁵ We base our findings on an independent review of the record and apply a preponderance of the evidence standard.⁶

A. Smith is subject to FINRA's disciplinary authority and violated NASD and FINRA rules by not registering.

1. FINRA has authority to bring a disciplinary action against Smith.

As a threshold matter, we first address Smith's claim that FINRA lacked authority to discipline him. To register as a national securities association, the Exchange Act requires an association to, among other things, have rules providing that "its members and persons associated with its members"—which the Act defines as "any partner, officer, director, or branch manager of such member (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling, controlled by, or under common control with such member, or any employee of such member"⁷—"shall be appropriately disciplined for violation of any provision of" the Act,

⁵ 15 U.S.C. § 78s(e)(1).

⁶ See *Richard G. Cody*, Exchange Act Release No. 64565, 2011 WL 2098202, at *1, *9 (May 27, 2011), *aff'd*, 693 F.3d 251 (1st Cir. 2012).

⁷ 15 U.S.C. § 78c(a)(21).

“the rules or regulations thereunder . . . or the rules of the association.”⁸ The Exchange Act also requires registered securities associations to “enforce compliance” with the Act, the rules and regulations thereunder, and the association’s own rules by members and associated persons.⁹ And the Exchange Act authorizes registered securities associations to initiate disciplinary proceedings against members and associated persons.¹⁰ FINRA is a registered securities association, and its bylaws, in turn, define an associated person as a “natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by a member, *whether or not any such person is registered or exempt from registration.*”¹¹

⁸ *Id.* § 78o-3(b)(7).

⁹ *Id.* § 78s(g)(1)(B); *see also id.* § 78o-3(b)(2) (requiring as a condition of registration with the Commission that a national securities association “be so organized and have the capacity” to “enforce compliance by its members and persons associated with its members” with the federal securities laws and the association’s own rules).

¹⁰ *Id.* § 78o-3(h); *see Louis Ottimo*, Exchange Act Release No. 83555, 2018 WL 3155025, at *14 (June 28, 2018) (noting that FINRA has authority “to discipline all associated persons of a member firm”) (citing *Stephen Grivas*, Exchange Act Release No. 77470, 2016 WL 1238263, at *5 n.15 (Mar. 29, 2016)). FINRA has “the authority to exercise comprehensive oversight over ‘all securities firms that do business with the public.’” *UBS Fin. Servs., Inc. v. W. Va. Univ. Hosps., Inc.*, 660 F.3d 643, 648 (2d Cir. 2011) (quoting 72 Fed. Reg. 42170 (Aug. 1, 2007)). Upon joining FINRA, a member organization agrees to comply with FINRA’s rules. *See* FINRA By-Laws Art. IV, Section 1.

¹¹ FINRA By-Laws, Art. I (rr) (emphasis added); *see also Order Approving Proposed Rule Change Relating to the Definition of “Person Associated with a Member”*, Exchange Act

Smith is an “associated person” of a FINRA member firm because he both controlled a member firm and was engaged in the securities business. Smith does not dispute that he controlled a member firm, CSSC-BD, because he was the chairman, chief executive officer, and majority owner of CSSC, which wholly owned CSSC-BD. As discussed below, Smith also was actively engaged in CSSC-BD’s securities business by acting as both a general securities representative and as a principal. Acting in either capacity makes him an associated person of CSSC-BD under FINRA bylaws. Thus, Smith is properly subject to FINRA’s disciplinary authority.¹²

a. Smith acted as a general securities representative of CSSC-BD.

Smith acted as a general securities representative by offering and selling securities to CSSC-BD’s customers.¹³ He offered and sold CSSC debt

Release No. 42036, 1999 WL 961340 (Oct. 19, 1999) (approving the definition of “person associated with a member” currently in FINRA By-Laws Art. I as consistent with the Exchange Act).

¹² See *Bruce Zipper*, Exchange Act Release No. 90737, 2020 WL 7496222, at *12 (Dec. 21, 2020) (agreeing with FINRA that “activities requiring registration are a subset of those that constitute ‘associating’ with a FINRA member firm”); compare FINRA By-Laws, Art. I (rr) (defining associated person as “natural person *engaged* in the investment banking or securities business . . .”) (emphasis added) with NASD Rule 1060 (exempting from registration “persons associated with a member who are not *actively engaged* in the investment banking or securities business”) (emphasis added).

¹³ See NASD Rule 1031(b) (defining “representatives” as “[p]ersons associated with a member . . . who are engaged in the investment banking or securities business for the member”); cf. *Michael F. Flannigan*, Exchange Act Release No. 47142, 2003 WL 60764, at *4-5 (Jan. 8, 2003) (holding that conducting

securities both personally and by directing CSSC-BD's registered representatives to do so. As part of the 2010, 2014, and 2015 debt offerings, Smith disseminated offering documents that he had prepared to CSSC-BD registered representatives with the intent that they would, in turn, offer and sell the securities to their customers. Smith also had CSSC-BD registered representatives introduce him to their customers so that he could solicit them directly. Through Smith's efforts, CSSC ultimately sold CSSC-BD customers hundreds of thousands of dollars of CSSC's debt securities. Smith thus did not, as he suggests, simply act as a representative of an unrelated issuer (CSSC) reaching out to potential investors. Rather, he used the relationship that CSSC-BD and its representatives had with their customers to solicit those customers, both directly and indirectly, and thereby obtained their investments in CSSC. In doing so, he plainly used CSSC-BD to engage in securities business with the broker-dealer's customers.¹⁴

securities business with a FINRA member's customers requires registration with that firm).

¹⁴ See, e.g., *Flannigan*, 2003 WL 60764, at *3-4 (holding that individuals who solicited and confirmed indications of interest, sent prospectuses, and accepted the orders of a FINRA member's customers were required to register with that firm as its representatives); *First Cap. Funding, Inc.*, Exchange Act Release No. 30819, 1992 WL 150797, at *2-3 (June 17, 1992) (holding that "send[ing] correspondence soliciting securities business," including offering documents, is engaging in the securities business and requires registration); *Bruce Zipper*, Exchange Act Release No. 84334, 2018 WL 4727001, at *5 (Oct. 1, 2018) (holding that emailing customers to recommend securities transactions and speaking with customers on the phone about their investments were functions that "were part of

Smith was thus engaged in the activities of a securities representative with CSSC-BD customers, making him an associated person of the firm subject to FINRA's disciplinary authority.

b. Smith acted as a principal of CSSC-BD.

Smith also acted as a principal of CSSC-BD through his significant role running the broker-dealer's securities operations. NASD Rule 1021(b) defines "principal" as one who is "actively engaged in the management of the member's . . . securities business, including supervision, solicitation, conduct of business or the training of persons associated with a member for any of these functions."¹⁵ The functions that individuals perform, and not their title, determines whether they are acting in a principal capacity.¹⁶ Smith engaged in such functions here.

Smith effectively managed the registered broker-dealer's securities business. Although Martin and

the conduct of a securities business" and thus of an associated person).

¹⁵ NASD Rule 1021(b).

¹⁶ See *Dennis Todd Lloyd Gordon*, Exchange Act Release No. 57655, 2008 WL 1697151, at *6 (Apr. 11, 2008) (holding that "a person who devotes significant time to firm affairs and participates in management decisions is a principal, whether or not the person holds an official firm title"); *Gordon Kerr*, Exchange Act Release No. 43418, 2000 WL 1476174, at *3 (Oct. 5, 2000) (holding that, in determining whether an individual functions as a principal, "we look at the responsibilities assigned to the associated person by the firm and the activities the individual actually performed"); NASD Notice to Members 99-49 (June 1, 1999) ("The registration determination does not depend on the individual's title, but rather on the functions that he or she performs").

LaRose were co-presidents of CSSC-BD, inside CSSC they were seen as such “in title only.” Smith was ultimately responsible for both the hiring and firing of CSSC-BD personnel, including its CCO and registered representatives, and he personally negotiated and determined the registered representatives’ commissions.¹⁷ He made decisions about how the firm met its net capital requirement. He was involved in selecting CSSC-BD’s clearing firm. And when CSSC-BD auditors had concerns about whether the firm could continue as a going concern, they contacted Smith.

Smith disputes that he acted as a principal by virtue of his recruiting CSSC affiliates. He argues that hiring affiliates did not involve him in CSSC’s securities business and there is no evidence that he “played any supervisory role with respect to [CSSC-BD’s] trade execution and collection activity.” Although Smith may not have directly supervised CSSC-BD representatives’ trading activity (beyond hiring and firing CSSC-BD representatives), his overall “authority over a broad range of Firm operations, including recruiting, hiring, and firing of Firm personnel,” demonstrates that he acted as a

¹⁷ See, e.g., *Richard F. Kresge*, Exchange Act Release No. 55988, 2007 WL 1892137, at *13 (June 29, 2007) (finding that an individual who was “actively involved in hiring,” among other things, was “actively engaged in the management of the Firm’s securities business” and was required to register as a principal); *Kirk A. Knapp*, Exchange Act Release No. 30391, 1992 WL 40436, at *3 (Feb. 21, 1992) (finding that applicant actively engaged in the management of the firm’s securities business based on, among other things, his hiring firm personnel).

principal of CSSC-BD and was thus an associated person of the firm.¹⁸

c. Smith's claim that his decision not to register as an associated person exempts him from FINRA's disciplinary authority has no merit.

Smith argues that FINRA should not have authority over any individuals who, like him, have not “voluntarily” registered with FINRA by filing a Form U4,¹⁹ regardless of whether that decision not to do so was proper. For FINRA to exercise authority over him, Smith contends, would undermine the voluntary nature of the self-regulatory system that Congress established when it authorized the creation of organizations like FINRA. But the Exchange Act itself requires that self-regulatory organizations (like FINRA) enforce the federal securities laws and their own rules, including by disciplining the associated persons of its members, and neither the Exchange Act nor FINRA bylaws definitions of an associated person hinges on that person's registration status.²⁰ Moreover, the Commission has repeatedly held that self-regulatory organizations can discipline associated persons of members, regardless of whether those individuals are registered.²¹ Allowing

¹⁸ *Gordon*, 2008 WL 1697151, at *2, *6.

¹⁹ The Form U4 (Uniform Application for Securities Industry Registration or Transfer) is used by firms to register and update the registration information of associated persons with self-regulatory organizations.

²⁰ *See supra* notes 7 through 11 and accompanying text.

²¹ *See, e.g., Vladislav Steven Zubkis*, Exchange Act Release No. 40409, 1998 WL 564562, at *3-4 (Sept. 8 1998) (holding that

associated persons of member firms to avoid FINRA disciplinary action simply by choosing not to register would undermine FINRA's ability to carry out its regulatory function.²²

Smith acknowledges that in *Vladislav Steven Zubkis*, the Commission held that NASD had authority to discipline an individual who was not registered with NASD at the time but was an associated person of a member firm.²³ Smith attempts to distinguish that holding by noting that, in that case, the respondent had previously registered with and obtained securities licenses from NASD. But the holding in *Zubkis* did not turn on that fact; rather, it was based on the respondent's status as an unregistered associated person at the time of his

the NASD had authority to discipline an individual who was unregistered at the time of his alleged misconduct because he was an "associated person" of a member firm based on the facts that he controlled the firm and was engaged in its securities business); *Joseph Patrick Hannan*, Exchange Act Release No. 40438, 1998 WL 611732, at *1 & n.1 (Sept. 14, 1998) (affirming finding of violation and modifying sanction of unregistered administrative assistant whose employment with a NASD member made him a "person associated with a member"); *Stephen M. Carter*, Exchange Act Release No. 26264, 1988 WL 902876, at *1 (Nov. 8, 1988) (holding that the NASD had authority to discipline an unregistered "cashier" of a NASD member firm because he was engaged in "the conduct of a securities business" and was thus an "associated person" of the firm).

²² See *supra* notes 8 through 10; cf. *First Cap. Funding*, 1992 WL 150797, at *3 (holding that NASD's regulation of associated persons and the requirement that they register "before engaging in any securities business provides an important safeguard in protecting public investors").

²³ 1998 WL 564562, at *3-4.

alleged misconduct.²⁴ In any event, Smith does not account for cases, like *Joseph Patrick Hannan* and *Stephen M. Carter*, that involved unregistered associated persons subject to NASD discipline.²⁵

Finally, although Smith may not have registered himself (as he was required to), he agreed to register CSSC-BD, the broker-dealer he controlled. As noted above, the Exchange Act's definition of an associated person does not require registration and FINRA's bylaws explicitly authorize FINRA to discipline all associated persons of member firms "whether or not any such person is registered or exempt from registration."²⁶ At the time CSSC-BD applied for membership, Smith acknowledged to FINRA that he was exempt from registration only "so long as [he was] not actively engaged in the management of [CSSC-BD's] securities business" and that he would "not be permitted to become active in the Firm's securities business" until he registered.²⁷ Even if, as Smith claims, this letter showed his then-intent not to register, his acknowledgement that his active engagement would require registration demonstrates an understanding that he was an associated person of the firm and thus subject to FINRA discipline.

²⁴ *Id.*

²⁵ *See supra* note 21.

²⁶ FINRA By-Laws, Art. I (rr); *see also id.* Articles V and XIII.

²⁷ Smith notes that he unsuccessfully sought to submit evidence during the hearing that NASD had drafted the letter and forwarded it to CSSC-BD staff for Smith's signature. Smith identifies no error, nor can we find any, in FINRA's exclusion of this evidence. Regardless of who drafted the letter, Smith signed it, and its plain terms acknowledge that his active involvement in CSSC-BD's securities business would require his registration.

Moreover, despite his representations in the letter, Smith became actively engaged in CSSC-BD's securities business, triggering registration requirements and reinforcing his associational status.²⁸

Smith also challenges the application of FINRA's bylaws, which define and authorize FINRA to discipline persons "associated with" FINRA member firms. He notes that FINRA is a Delaware corporation and suggests that, under the Delaware corporate code, FINRA's bylaws cannot govern a person "who is not a stockholder/member, director, officer, or employee" of FINRA. But Smith has not shown that FINRA bylaws conflict with the Delaware code, because the section that Smith cites states that corporation bylaws "may contain" provisions relating to not only "the rights or powers of its stockholders, directors, officers or employees," as Smith notes, but also "any provision . . . relating to the business of the corporation, the conduct of its affairs, and its rights or powers."²⁹ In any event, the Delaware code cannot limit or interfere with FINRA's ability to carry out its Exchange Act mandate, as a registered securities association, to discipline its member firms and their

²⁸ NASD Rule 1060, for example, exempts from registration "persons associated with a member who are not actively engaged in the investment banking or securities business," but Smith's active engagement in CSSC-BD securities business negated that exemption.

²⁹ 8 Del. C. § 109(b); see *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934, 951 (Del. Ch. 2013) (Strine, C.) (noting that § 109(b) "has long been understood to allow the corporation to set 'self-imposed rules and regulations [that are] deemed expedient for its convenient functioning'" (citation omitted)).

associated persons.³⁰ And FINRA’s bylaws—in making explicit that its disciplinary authority extends to associated persons (whether or not registered)—give effect to and implement that statutory directive. We thus find no basis for concluding that FINRA lacks the authority to discipline Smith through this proceeding.

2. Smith violated NASD Rules 1021 and 1031 and FINRA Rule 2010 by failing to register.

Smith also violated the registration rules applicable to associated persons of FINRA member firms. NASD Rule 1021(a) requires that “[a]ll persons engaged or to be engaged in the investment banking or securities business of a member who are to function as principals shall be registered as such.” NASD Rule 1031(a) requires that “[a]ll persons engaged or to be engaged in the investment banking or securities business of a member who are to function as representatives shall be registered as such.” By functioning as both a general securities representative and principal, without ever registering with FINRA in any capacity, Smith violated NASD Rules 1021 and 1031 and, in doing so, also violated FINRA Rule 2010.³¹ Accordingly, we affirm FINRA’s finding that Smith violated these registration rules.

³⁰ See *Arizona v. United States*, 567 U.S. 387, 399 (2012) (“[S]tate laws are preempted when they conflict with federal law,” including where state law “stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.”).

³¹ FINRA Rule 2010 states that “[a] member, in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade.” A

3. NASD's and FINRA's rules are, and were applied, consistent with the purposes of the Exchange Act.

The Exchange Act requires that FINRA's rules be designed "to protect investors and the public interest."³² As we have stated, registration requirements "provide an important safeguard in protecting public investors and strict adherence to that requirement is essential, because it serves a significant purpose in the policing of the securities markets and in the protection of the public interest."³³ FINRA's application of the registration requirements was thus consistent with the Exchange Act's purposes because enforcing the registration requirements protects investors.

B. Smith violated antifraud provisions of the securities laws and FINRA's rules.

FINRA found, and we agree, that Smith violated Exchange Act Section 10(b), Rule 10b-5(b) thereunder, and FINRA Rules 2020 and 2010 in connection with the 2015 Offering. Exchange Act Section 10(b) makes it unlawful "[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" Commission rules.³⁴ Rule 10b-5(b) makes it unlawful, "in connection with

violation of another NASD or FINRA rule constitutes a violation of Rule 2010. See *Newport Coast Secs., Inc.*, Exchange Act Release No. 88548, 2020 WL 1659292, at *3 n.8 (Apr. 3, 2020).

³² 15 U.S.C. § 78o-3(b)(6).

³³ *Flannigan*, 2003 WL 60764, at *4 (internal quotation marks omitted).

³⁴ 15 U.S.C. § 78j(b).

the purchase or sale of any security,” to “make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.”³⁵ A violation of Section 10(b) and Rule 10b-5 constitutes a violation of FINRA Rule 2020, which prohibits FINRA members from “effect[ing] any transaction in, or induc[ing] the purchase or sale of, any security by means of any manipulative, deceptive or other fraudulent device or contrivance.”³⁶ And such conduct also violates FINRA Rule 2010, which requires members to observe high standards of commercial honor and just and equitable principles of trade.³⁷

As explained below, Smith violated these provisions by making misrepresentations and omissions of material fact, with scienter, in connection with the 2015 Offering.³⁸ Before the NAC,

³⁵ 17 C.F.R. § 240.10b-5(b).

³⁶ *William Scholander*, Exchange Act Release No. 77492, 2016 WL 1255596, at *4 (Mar. 31, 2016), *pet. denied sub nom. Harris v. SEC*, 712 F. App’x 46 (2d Cir. Oct. 25, 2017).

³⁷ *Id.*

³⁸ *See Aaron v. SEC*, 446 U.S. 680, 691-95 (1980) (holding that a violation of Section 10(b) and Rule 10b-5 requires a finding of scienter). We also find, and Smith does not dispute, that because the 2015 offering involved notes with a one-year maturity, his material misrepresentations and omissions were made in connection with the purchase or sale of a security. *See* 15 U.S.C. § 78c(a)(10) (defining a “security” to include “any note,” except notes with a maturity of less than nine months); *Reves v. Ernst & Young*, 494 U.S. 56, 65, 67 (1990) (adopting a rebuttable “presumption that every note is a security”). A violation of Section 10(b) and Rule 10b-5(b) also requires the use of means or instrumentalities of interstate commerce, and Smith’s

and now in his briefs to the Commission, Smith challenges only the finding that his misstatements and omissions were material.³⁹ Smith has thus forfeited any challenge to other elements of FINRA’s fraud finding on appeal, but we nevertheless review FINRA’s findings of violations on each element consistent with our standard of review.⁴⁰

1. Smith made misrepresentations and omissions in connection with the 2015 Offering.

By writing and disseminating the 2015 Offering documents, Smith made numerous false and misleading representations about CSSC’s revenue

emailing offering documents and accepting payments by wire or check satisfy the interstate commerce requirement. *See, e.g., Grubbs v. Sheakley Grp., Inc.*, 807 F.3d 785, 803 (6th Cir. 2015) (“[T]he very act of sending an e-mail creates the interstate commerce nexus necessary for federal jurisdiction.”); *SEC v. Softpoint, Inc.*, 958 F. Supp. 846, 861, 865 (S.D.N.Y. 1997) (Sotomayor, J.) (finding that wire and mail transfers of funds satisfied interstate commerce requirement of Exchange Act Section 10(b) and Rule 10b-5), *aff’d*, 159 F.3d 1348 (2d Cir. 1998).

³⁹ Smith’s application for review listed other “findings and conclusions” for which he sought Commission review, but we deem these other claims forfeited because he did not brief them. *See* Rule of Practice 420(c), 17 C.F.R. § 201.420(c) (“Any exception to a determination not supported in an opening brief . . . may, at the discretion of the Commission, be deemed to have been waived by the applicant.”); *Anthony Fields*, Exchange Act Release No. 74344, 2015 WL 728005, at *19 & n.115 (Feb. 20, 2015) (explaining that “arguments for reversal not made in the opening brief” are subject to waiver).

⁴⁰ *See* 15 U.S.C. § 78s(e)(1); *Newport Coast Secs.*, 2020 WL 1659292, at *3 (recognizing waiver but reviewing FINRA liability findings consistent with standard of review).

initiatives.⁴¹ He also made several statements about CSSC's solvency and profitability that were misleading by omission. The misrepresentations and omissions in the initial June 2015 Confidential Report included:

- *Project X.* The report stated that CSSC was “in the final stages” of creating a special purpose bank, which was expected to “open . . . for business” by October 2015. But as Southwick and Wheeler both testified, these statements were false; indeed, no request for regulatory approval for the bank had even been submitted to authorities. The report also asserted (among other things) that CSSC had already “earned” \$500,000 for its work associated with the first bank and would receive another \$500,000 when the first bank opened, plus an additional \$400,000 in 2015 for helping to create a second. Yet Southwick testified that there was no revenue agreement in place that would have provided for such payments. Wheeler similarly testified that Project X was not “even remotely close to being able to generate any kind of revenue stream in 2015” and that the statements in the offering documents were “delusional.”

⁴¹ See *SEC v. GenAudio Inc.*, 32 F.4th 902, 924 (10th Cir. 2022) (finding that a CEO made multiple false and misleading statements about his company's potential relationship with a business partner and noting that “no matter how heartfelt their subjective beliefs, corporate executives . . . cannot make material representations to shareholders in disregard or contravention of obvious facts” (citing *Omnicare, Inc. v. Laborers Dist. Council Const. Indus. Pension Fund*, 575 U.S. 175, 188 (2015))).

- *SDTC*. The report falsely represented that CSSC had formed “a new strategic alliance with South Dakota Trust Company,” in particular (i) that CSSC would be “the investment advisor of the common and collective trust funds it [was] helping [SDTC] to create”; and (ii) that CSSC had a “client referral relationship with SDTC.” In fact, at the time that Smith distributed the report to potential investors, he and Southwick had had only a couple of in-person meetings with representatives from SDTC to discuss the ideas, and no agreement had been reached to form such an alliance. Thus, Smith could not have “expect[ed] to have both of these potentially important new revenue sources [from SDTC] up and running before the end of calendar year 2015,” as the report claimed.
- *City of Jacksonville*. The report falsely claimed that CSSC was “currently in the final stages of being engaged as Special Reviewing Consultant” for Jacksonville and that CSSC’s relationship with the city would increase its “reportable assets under management by nearly \$1 billion.” In truth, Southwick had had some initial discussions with Jacksonville, but city representatives had made clear that the city was not interested in CSSC directly managing its money, and CSSC had not yet even submitted an initial written proposal for the work. Moreover, when CSSC did submit a written proposal in July 2015, it was only for CSSC to serve as a reviewing consultant for a fee of \$15,000 per quarter. Thus, even as proposed by CSSC, the relationship would not

have increased CSSC's assets under management at all, let alone by "nearly \$1 billion."

- *Omissions about CSSC's financial health.* Throughout 2015—including in the June 2015 Confidential Report—Smith repeatedly misrepresented CSSC's financial prospects, including his baseless assertion that 2015 "will likely be the most profitable year (so far) in the Company's history," with net earnings "more than double that of our best year to this point." Smith failed to disclose, however, that CSSC had defaulted on hundreds of thousands of dollars in debt and was unable to timely pay its current debt holders, depriving potential investors of crucial information about the company's actual financial situation.⁴²

Smith also wrote and disseminated updates to the Confidential Report throughout the fall of 2015. Those updates reiterated many of the same misstatements and continued to misrepresent important information about CSSC's various revenue initiatives. Those misrepresentations included:

- *Project X.* The September 2015 update acknowledged that the revenue from Project X

⁴² See *Macquarie Infrastructure Corp. v. Moab Partners, L.P.*, 601 U.S. 257, 263 (2024) ("Half-truths," or "representations that state the truth only so far as it goes, while omitting critical qualifying information," are actionable under Rule 10b-5(b).); *SEC v. Johnston*, 986 F.3d 63, 72 (1st Cir. 2021) ("Statements can be misleading if they are materially untrue. They can also be misleading if they are half-truths, painting a materially false picture in what they say because of what they omit." (citations omitted)).

“did not take place as planned” but maintained that CSSC could still “salvage” the project. Smith’s October and November 2015 updates included the same message even though Smith fired Southwick in September 2015—and the project was unlikely to succeed without Southwick’s expertise. And rather than acknowledge that there had never been an agreement for CSSC to receive payments for the project, Smith drafted updates to the Confidential Report that baselessly blamed the lack of revenue on “a plan to deprive [CSSC] of the expected and earned benefit” of the project.

- *SDTC*. In September and October 2015 updates to the Confidential Report, Smith continued to falsely tout a “pending strategic relationship” with SDTC and added that discussions with SDTC had “recently recommenced.” But this statement was belied by the November 2015 update, which replaced “have recently recommenced” with “are expected to recommence (possibly in the first quarter of 2016).” Smith’s updates also continued to misleadingly represent that the SDTC relationship “is expected to provide a growing source of revenue” for CSSC.
- *City of Jacksonville*. In the September 2015 update, Smith continued to falsely claim a “pending engagement with the City of Jacksonville” that was “to commence on or about October 1st of [2015]” and that the relationship would increase CSSC’s assets under management by nearly \$1 billion. When October 1 passed, the October and November 2015 updates falsely claimed that the

engagement would commence “prior to the end of this calendar year.”

- *Omissions about CSSC’s financial health.* In updates to the Confidential Report, Smith claimed that the value of CSSC’s assets “significantly exceed current amounts of Company debt.” But Smith again failed to disclose that CSSC had defaulted on hundreds of thousands of dollars in debt and was unable to timely pay its current debt holders.

2. Smith’s false and misleading representations were material.

A misrepresentation or omission is material “if there is a substantial likelihood that a reasonable person would consider it important in deciding whether to buy or sell securities.”⁴³ Courts and the Commission alike have repeatedly recognized that information about an entity’s financial health—and, in the context of a debt offering, information about the company’s ability to repay that debt—is material.⁴⁴

⁴³ *SEC v. Talbot*, 530 F.3d 1085, 1097, (9th Cir. 2008); *see also Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988) (a misrepresentation or omission is material if there is a substantial likelihood that a reasonable investor would have viewed the misrepresentation or omission “as having significantly altered the ‘total mix’ of information” available in making an investment decision).

⁴⁴ *See, e.g., SEC v. Todd*, 642 F.3d 1207, 1221 (9th Cir. 2011) (“Information regarding a company’s financial condition is material to investment.”); *SEC v. Blavin*, 760 F.2d 706, 711 (6th Cir. 1985) (holding that the materiality of misstatements about “financial condition, solvency, and profitability” is “not subject to serious challenge”); *Fuad Ahmed*, Exchange Act Release No. 81759, 2017 WL 4335036, at *15 (Sept. 28, 2017) (information

Here, Smith’s false and misleading statements about allegedly significant and imminent revenue streams from Project X, SDTC, and Jacksonville were all statements about CSSC’s financial condition that a reasonable investor would find important in deciding whether to participate in the 2015 Offering.⁴⁵ And a reasonable investor in new CSSC debt would find it important that CSSC was at that time unable to make payments on prior debt that were due.⁴⁶

Smith argues that FINRA improperly determined materiality “as a matter of law,” without introducing “actual evidence” of materiality from, for example, affected investors, other fact witnesses, or experts. Smith thus contends that it was “pure speculation” whether the misrepresentations would have been material to investors. But the standard for determining materiality is objective, not subjective, so the testimony of individual investors is not

about financial condition is material to a company’s “ability to repay” its debt).

⁴⁵ See, e.g., *Cooper v. Pickett*, 137 F.3d 616, 626 (9th Cir. 1997) (holding that “substantially overstat[ing]” revenue constitutes “false or misleading statements of material fact”); *In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1421 n.9 (3d Cir. 1997) (“[I]nformation about a company’s past and current earnings is likely to be highly ‘material.’”).

⁴⁶ See, e.g., *Aubrey v. Barlin*, No. A-10-CA-076-SS, 2011 WL 675068, at *9 (W.D. Tex. Feb. 16, 2011) (“[A]ny reasonable investor would want to know if the entity to which they were loaning money was already defaulting on its prior obligations.”); *SEC v. Bravata*, 763 F. Supp. 2d 891, 916 (E.D. Mich. 2011) (finding misrepresentations in offering documents material where “defendants failed to depict the true financial condition of the company, particularly the inevitability that the only way investors would see a return or recovery of principal was if new investors paid money into the company”).

determinative.⁴⁷ Likewise, the Commission has observed that “expert testimony is not necessary” to establish materiality.⁴⁸ In some situations, misrepresentations and omissions can be “so obviously important to an investor” that they are indeed material as a matter of law.⁴⁹ Such representations may include those involving “financial condition, solvency, and profitability,”⁵⁰ and those that “affect the probable future of the company,”⁵¹ both of which are at issue here.

In any event, FINRA properly weighed the total mix of information available to potential investors in the 2015 Offering to conclude that there was ample evidence of materiality.⁵² Smith himself repeatedly

⁴⁷ See *TSC Indus. Inc. v. Northway Inc.*, 426 U.S. 438, 445 (1976).; *Louis Ottimo*, Exchange Act Release No. 95141, 2022 WL 2239146, at *7 (June 22, 2022); *Richmark Capital Corp.*, Securities Act Release No. 8333, 2003 WL 22570712, *5 (Nov. 7, 2003), *aff’d*, 86 F. App’x 744 (5th Cir. 2004).

⁴⁸ *Ottimo*, 2022 WL 2239146, at *7; see also *United States v Mazumder*, 800 F. App’x 392, 395-96 (6th Cir. 2020) (affirming exclusion of expert testimony regarding the materiality of misrepresentations).

⁴⁹ *TSC Indus.*, 426 U.S. at 450.

⁵⁰ *Blavin*, 760 F.2d at 711; see also *Johns Hopkins Univ. v. Hutton*, 422 F.2d 1124, 1129 (4th Cir. 1970) (finding a discrepancy in net revenue projections material as a matter of law).

⁵¹ *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 849 (2d Cir. 1968); see also *GenAudio*, 32 F.4th at 933 (finding a statement regarding the likelihood of a technology acquisition deal material as a matter of law).

⁵² See, e.g., *TSC Indus.*, 426 U.S. at 450 (noting that determining materiality “requires delicate assessments of the inferences a ‘reasonable shareholder’ would draw from a given

emphasized in the offering documents that the new revenue initiatives were “important” to CSSC’s profitability, underscoring his appreciation of the materiality of this information to investors.⁵³ For example, the offering documents emphasized—in bold and underlined text—that the purported \$1.4 million consulting fee for Project X “should ensure that 2015 is not only profitable, but also that it will be the most profitable year in CSSC’s history.” At the same time, as discussed, the offering documents failed to disclose CSSC’s then-current defaulted debt obligations. Such information plainly would have been information that investors would have wanted to know. Moreover, the fact that Smith knowingly included information about

set of facts and the significance of those inferences to him, and these assessments are peculiarly ones for the trier of fact”).

⁵³ See *SEC v. Mayhew*, 121 F.3d 44, 52 (2d Cir. 1997) (“[A] major factor in determining whether information was material is the importance attached to it by those who knew about it.”)

The offering documents stated the following about the initiatives (with emphasis added): “The creation of this new Bank is *very important* to CSSC” (June 2105 Confidential Report); Project X is “a *very important* CSSC Project” (September 2015 Confidential Report) or “an *important* CSSC Project” (October and November 2015 Confidential Reports); Project X is an “*important* initiative” that CSSC is working to get “back on track” (September, October, November, December Important Memorandums); CSSC formed “an *important* new strategic alliance with South Dakota Trust Company” (June 2015 Confidential Report); CSSC “expects to have both of these potentially *important* new revenue sources [from the SDTC relationship] up and running before the end of calendar year 2015” (June Confidential Report); “The *importance* to us of both [CSSC’s program focused on government entities and the special reviewing consultant program] is best illustrated by a pending engagement with the City of Jacksonville” (June, September, October, and November 2015 Confidential Reports).

CSSC's debt obligations in the earlier 2010 bond offering suggests that he thought the information was important.⁵⁴

Smith also claims that the offering documents provided adequate warnings about CSSC's financial condition. But as FINRA found, the offering documents contained only "boilerplate" disclosures, such as "[m]aking an unsecured loan to a company that is experiencing current cash flow shortfalls involves a significant amount of risk"; there is "no guarantee that the loan would be repaid with interest when due"; and "[l]oans of this type should be made only by those financially able and willing to accept the risk that all or part of the loan could be lost." These generic warnings failed to provide investors with meaningful information about CSSC's actual financial condition rather than mere boilerplate.⁵⁵ And "cautionary language does not protect material misrepresentations or omissions when," as here, they are "knowingly false" or misleading.⁵⁶

⁵⁴ *Cf. Mayhew*, 121 F.3d at 52 (noting that information is likely to be material if those who "knew about it" deemed it to be "importan[t]").

⁵⁵ *See, e.g., GenAudio*, 32 F.4th at 928-929 (holding that to negate the materiality of forward-looking statements, "the cautionary statements must be substantive and tailored to the specific future projections, estimates, or opinions" at issue); *SEC v. Merchant Capital, LLC*, 483 F.3d 747, 767 (11th Cir. 2007) (holding that to render alleged omission or misrepresentations immaterial "cautionary language must be meaningful: boilerplate will not suffice").

⁵⁶ *GenAudio*, 32 F.4th at 929 (citation omitted).

3. Smith acted with scienter.

Scienter is “a mental state embracing intent to deceive, manipulate, or defraud”⁵⁷ and may be established by recklessness—conduct representing an “extreme departure from the standards of ordinary care . . . which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.”⁵⁸ One can establish scienter, therefore, by showing an actual knowledge of falsity or a reckless disregard for the truth.⁵⁹

Here, the record shows, and Smith does not dispute, that he knew or must have known that his statements about CSSC’s financial condition and revenue initiatives in the offering documents were false or misleading. For example, as to Project X, Smith knew or must have known that, contrary to what he wrote in the offering documents, CSSC had no agreement in place to earn fees from Project X, and no special purpose bank was anywhere close to opening its doors, let alone a second bank. Although Smith testified that he had relied on Southwick for the information in the June 2015 Confidential Report about Project X, Smith also testified that he would

⁵⁷ *Aaron*, 446 U.S. at 686 n.5 (1980) (internal quotation marks omitted).

⁵⁸ *Dolphin & Bradbury, Inc. v. SEC*, 512 F.3d 634, 639 (D.C. Cir. 2008) (citation omitted); accord *Teamsters Loc. 237 Welfare Fund v. ServiceMaster Glob. Holdings, Inc.*, 83 F.4th 514, 526 (6th Cir. 2023).

⁵⁹ See, e.g., *SEC v. Lyttle*, 538 F.3d 601, 603 (7th Cir. 2008) (holding that scienter means “that the defendants either knew that the representations they made to investors were false or were reckless in disregarding a substantial risk that they were false”).

have had to personally sign any agreement that CSSC entered into to earn the fees claimed in the offering documents, and he knew that he had never done so for any such agreement here.⁶⁰ Smith also knew, or must have known, that he was misleading a potential investor when he sent the June 2015 Confidential Report to that person in September 2015, after he had already written a less optimistic (but still false) update to the report.

Similarly, as to the SDTC and Jacksonville initiatives, Smith knew that CSSC had not entered into any “pending” relationships with these entities as claimed in the offering documents. For example, Smith knew in June 2015 that CSSC had not even submitted a written proposal to Jacksonville. When CSSC finally did submit a proposal, in July 2015, Smith knew, because he drafted the proposal, that it did not contemplate CSSC managing any of Jacksonville’s assets. Smith also knew that Jacksonville never accepted CSSC’s proposal. Yet beginning in June 2015 and through the November 2015 offering documents, Smith continued to include that the Jacksonville relationship would “increase [CSSC’s] reportable assets under management by nearly \$1 billion” and that the engagement would soon commence.

Smith also knew that CSSC was defaulting on debt from prior offerings at the same time he was seeking new debt investments in the 2015 Offering.

⁶⁰ For example, Smith tried to obtain a signed affiliation agreement between CSSC and the consulting entity established as part of Project X to show it to a potential investor in the 2015 Offering. But Smith was unable to secure that investment because CSSC never executed such an agreement.

Smith therefore knew or must have known that it created a substantial risk of misleading investors about CSSC's financial health not to disclose this information to potential investors in CSSC's 2015 debt offering.⁶¹

* * * *

Accordingly, we sustain FINRA's findings that Smith violated Exchange Act Section 10(b), Rule 10b-5 thereunder, and FINRA Rules 2020 and 2010. We also sustain FINRA's findings that Smith willfully violated Exchange Act Section 10(b), Rule 10b-5 thereunder, and FINRA Rules 2020 and 2010.⁶² And because we find that Smith willfully violated Section 10(b) and Rule 10b-5, we also sustain FINRA's finding that he is statutorily disqualified on that ground.⁶³

In sustaining these findings, we find that FINRA's rules were, and were applied in a manner, consistent with the purposes of the Exchange Act. As we have repeatedly recognized, Rules 2020 and 2010, "which are designed to prevent fraud and promote just and equitable principles of trade," are "consistent with the

⁶¹ See *Ottimo*, 2018 WL 3155025, at *12 (holding that "omitting materially adverse information" was "at least reckless" because applicant "must have known that [it] presented a substantial risk of misleading investors").

⁶² See, e.g., *Bennett Grp. Fin. Servs., LLC*, Exchange Act Release No. 80347, 2017 WL 1176053, at *4 n.30 (Mar. 30, 2017) ("Our finding of scienter . . . demonstrates that Bennett's violations were willful."), *abrogated in part on other grounds by Lucia v. SEC*, 138 S. Ct. 2044 (2018).

⁶³ See 15 U.S.C. §§ 78c(a)(39)(F) & 78o(b)(4)(D) (including as a statutory disqualification from the securities industry willful violations of the federal securities laws).

Exchange Act's purposes."⁶⁴ In finding Smith liable for these violations under Exchange Act Section 10(b), Rule 10b-5 thereunder, and FINRA's own rules, FINRA also applied these provisions consistently with the purposes of the Exchange Act.

III. Sanctions

Under Exchange Act Section 19(e)(2), we sustain FINRA sanctions unless we find that, giving due regard to the public interest and the protection of investors, the sanctions are excessive or oppressive or impose an unnecessary or inappropriate burden on competition.⁶⁵ We consider evidence of any aggravating or mitigating factors, as well as whether the sanctions serve remedial rather than punitive purposes.⁶⁶ Although they are not binding on us, FINRA's Sanction Guidelines serve as a benchmark in our review.⁶⁷

Smith does not assert, nor do we find, that FINRA's sanctions—a bar and an order of restitution—are excessive or oppressive or serve a punitive rather than remedial purpose.⁶⁸ At all

⁶⁴ *Ahmed*, 2017 WL 4335036, at *17.

⁶⁵ 15 U.S.C. § 78s(e)(2). Smith does not allege, nor does the record show, that the sanctions imposed create an unnecessary or inappropriate burden on competition.

⁶⁶ See *Saad v. SEC*, 718 F.3d 904, 906 (D.C. Cir. 2013); *PAZ Sec., Inc. v. SEC*, 494 F.3d 1059, 1065 (D.C. Cir. 2007); *McCarthy v. SEC*, 406 F.3d 179, 188-91 (2d Cir. 2005).

⁶⁷ See, e.g., *John Joseph Plunkett*, Exchange Act Release No. 69766, 2013 WL 2898033, at *11 & n.68 (June 14, 2013).

⁶⁸ See, e.g., FINRA Sanction Guidelines, at 89 (2019), finra.org/sites/default/files/2020-10/2019_Sanctions_Guidelines.pdf (recommending bar for intentional or reckless omissions or misrepresentations of material fact unless mitigating factors

events, Smith forfeited any challenge to the sanctions by failing to challenge FINRA's imposition of them or to argue that mitigating factors warrant lesser sanctions.⁶⁹

An appropriate order will issue.⁷⁰

By the Commission (Chair GENSLER and Commissioners PEIRCE, CRENSHAW, UYEDA and LIZÁRRAGA).

Vanessa A. Countryman
Secretary

predominate); *Gopi Krishna Vungarala*, Exchange Act Release No. 90476, 2020 WL 6867617, at *15 (Nov. 20, 2020) (sustaining FINRA bar based on fraudulent misrepresentations and omissions).

⁶⁹ See Rule of Practice 420(c), 17 C.F.R. § 201.420(c) (“Any exception to a determination not supported in an opening brief that complies with [Rule 450(b)] may, at the discretion of the Commission, be deemed to have been waived by the applicant.”).

⁷⁰ Because it would not significantly aid our decisional process, Smith’s motion for oral argument is denied. See Rule of Practice 451(a), 17 C.F.R. § 201.451(a).

BEFORE THE NATIONAL
ADJUDICATORY COUNCIL
FINANCIAL INDUSTRY
REGULATORY AUTHORITY

In the Matter of Department of Enforcement, Complainant, vs. Eric S. Smith Troy, MI, Respondent.

DECISION

Complaint No.
2015043646501

Dated: September 18, 2020

Respondent fraudulently misrepresented and omitted material facts in connection with the sale of securities and failed to register as a general securities representative and principal despite engaging in conduct requiring registration. Held, findings affirmed and sanctions affirmed in relevant part.

* * *

Decision

Eric S. Smith appeals an Extended Hearing Panel (“Hearing Panel”) decision. The Hearing Panel found that Smith fraudulently made material misrepresentations and omissions of fact in offering documents, in willful violation of the federal securities laws and FINRA rules. The Hearing Panel

barred Smith from associating with any FINRA member in any capacity for this misconduct and ordered that he pay, jointly and severally with his firm, \$130,000 in restitution to four investors.

The Hearing Panel also found that Smith actively engaged in the conduct of his firm's securities business in the capacities of a general securities principal and representative without being registered, in violation of NASD and FINRA rules. In light of the bar for Smith's fraud, the Hearing Panel assessed, but did not impose, additional sanctions for Smith's registration violations.

After a thorough review of the record, we affirm the Hearing Panel's liability findings and the bar and restitution ordered for Smith's fraud. We, however, modify the Hearing Panel's assessed sanctions for Smith's registration violations. For acting as an unregistered principal, we increase the fine from \$50,000 to \$75,000 and the suspension in all capacities from one year to two years. For acting as an unregistered general securities representative, we affirm the Hearing Panel's recommended \$50,000 fine and one-year concurrent suspension in all capacities. Like the Hearing Panel, we decline to impose the sanctions for the registration violations in light of the bar imposed for Smith's fraud.

I. Background

Smith founded the financial services company, Consulting Services Support Corporation ("CSSC") in 1998. CSSC is not a FINRA member. Smith is CSSC's chairman, chief executive officer, and majority owner. Prior to founding CSSC, Smith practiced law in private practice and later worked for a broker-dealer named North American Financial, as

its chief operating officer. Smith has never registered with FINRA.

CSSC is the parent company of several wholly owned subsidiaries, including CSSC Brokerage Services, Inc. (“CSSC BD”), as well as a registered investment advisor (“RIA”) and an insurance business. CSSC BD’s registered representatives became affiliated with all the various CSSC entities through an affiliation agreement that Smith required. CSSC and its subsidiaries, including CSSC BD and RIA, occupied the same office suite in Troy, Michigan. CSSC BD leased office space from CSSC.

CSSC BD became a FINRA member in 2006 and terminated its registration in 2018. As part of CSSC BD’s application for FINRA membership, Smith attested that he was exempt from registration pursuant to NASD Rule 1060 because he would not be actively engaged in the management of the firm’s securities business. Keith Frye, who Smith knew from North American Financial, was the initial president and chief compliance officer (“CCO”) of CSSC BD. After Frye left the firm, Smith appointed Jennifer LaRose and Alex Martin as CSSC BD’s co-presidents, and he also made LaRose its CCO.¹

The conduct at issue in this case occurred from 2010 through 2015, while CSSC BD was a FINRA member.

¹ Smith also knew LaRose and Martin from their time working at North American Financial. Martin worked for CSSC RIA before joining CSSC BD as a registered representative. LaRose joined CSSC BD in 2006 as a general securities principal.

II. Procedural History

During a routine examination of CSSC BD in 2015, FINRA's Department of Member Regulation found that Smith appeared to be acting as a general securities representative and principal of the firm without being registered. Around this time, a former CSSC employee, Donald Southwick, complained to FINRA that two of his customers had not received interest and principal payments for certain investments offered through CSSC BD. One of these customers also complained to FINRA directly. These matters were referred to FINRA's Department of Enforcement ("Enforcement") for further investigation.

After concluding its investigation, Enforcement began disciplinary proceedings on August 4, 2017, when it filed a five-cause complaint alleging that Smith and CSSC BD engaged in misconduct for which FINRA should impose sanctions. The first three causes of action involve a bridge loan note offering that Smith issued in 2015 ("2015 Bridge Loan Note Offering") to address CSSC's deteriorating financial condition. Cause one alleged that Smith and CSSC BD fraudulently misrepresented or omitted material facts in connection with the 2015 Bridge Loan Note Offering, in willful violation of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), Exchange Act Rule 10b-5, and FINRA Rules 2020 and 2010.² Enforcement pleaded the second and third causes of action as alternatives to cause one. Cause two alleged that Smith and CSSC BD acted negligently when they made the fraudulent

² The conduct rules that apply in this case are those that existed at the time of the conduct at issue.

misrepresentations and omissions, in violation of Sections 17(a)(2) and (a)(3) of the Securities Act of 1933 (“Securities Act”), and FINRA Rule 2010. Cause three alleged that Smith and CSSC BD violated FINRA Rule 2010 because they failed to adhere to just and equitable principles of trade by making unethical misrepresentations and omitting to disclose material facts to investors.

Causes four and five of the complaint involve Smith’s active involvement in CSSC BD’s securities business without maintaining the proper securities registrations. Enforcement alleged that Smith and CSSC BD violated NASD Rules 1021 and 1031 and FINRA Rule 2010 by failing to register Smith as a general securities representative and principal of CSSC BD.

In their answer, CSSC BD denied all involvement in the 2015 Bridge Loan Note Offering, and Smith denied making any false statements or omissions in the 2015 Bridge Loan Note Offering documents. Smith and CSSC BD also denied violating the registration rules, asserting that FINRA does not have jurisdiction over Smith and therefore he was never required to be registered as a representative or a principal. As discussed in detail below, we agree with the Hearing Panel’s findings that FINRA has jurisdiction over Smith to bring this disciplinary action against him and that Smith was required to register.

After conducting an eight-day hearing, the Hearing Panel found that Smith and CSSC BD engaged in the alleged misconduct. For knowingly or recklessly misrepresenting and failing to disclose material facts in connection with the sales of securities, in willful violation of Section 10(b) of the

Exchange Act and Exchange Act Rule 10b-5, as alleged in cause one, the Hearing Panel barred Smith from associating with any FINRA member firm in any capacity. The Hearing Panel suspended CSSC BD from participating in private securities offerings in all capacities for one year and fined the firm \$100,000. The Hearing Panel also ordered that Smith and CSSC BD be held jointly and severally liable for paying \$130,000 in restitution to four affected investors.

For Smith's acting in the capacities of a principal and a representative without being registered, in violation of NASD Rules 1021 and 1031, and FINRA Rule 2010, as alleged in the fourth and fifth causes of action, the Hearing Panel assessed, but declined to impose, any additional sanctions in light of the bar already imposed. For CSSC BD's failure to register Smith as a representative and principal, the Hearing Panel fined the firm \$20,000.

Smith timely appealed the Hearing Panel's decision. CSSC BD did not appeal, and the Hearing Panel's decision is final with respect to the firm.

III. Facts

A. CSSC's Efforts to Raise Cash Through Offerings in 2010 and 2014

In the wake of the 2008 financial crisis, CSSC's revenues dropped because of a reduction in investment advisory fees earned by its RIA subsidiary. Smith and CSSC undertook multiple efforts to raise cash to bolster CSSC's faltering financial condition. In 2010, Smith and CSSC issued a convertible debenture bond offering ("2010 Bond Offering"), hoping to raise \$5 million to satisfy financial obligations. The offering raised only \$2.45 million. In 2014, Smith and CSSC began offering

“bridge loan notes” (“2014 Bridge Loan Note Offering”) to garner additional funds to cover operational losses. This offering raised approximately \$1.1 million. That amount proved insufficient as CSSC continued losing money. To address CSSC’s ongoing financial decline, Smith initiated CSSC’s issuance of the 2015 Bridge Loan Note Offering, which is the subject of the first three causes of action in Enforcement’s complaint.

1. The 2010 Bond Offering and Smith’s Role

It was Smith’s decision to conduct the 2010 Bond Offering. The intended use of the proceeds was to retire short-term debt of \$1.4 million, including \$480,000 in short-term promissory notes that were due. CSSC also needed money to pay \$160,000 in deferred salaries and \$140,000 in legal fees. The offering document stated that the bonds were unsecured, had a five-year maturity date, offered an annual interest rate of eight percent, and permitted buyers to convert the bonds to CSSC common stock.

The offering document stated that CSSC had “no plans to use the services of registered representatives to act as agents of [CSSC] in selling the Bonds,” and no brokerage commissions or fees would be paid to them. Because it was assumed that CSSC BD would not be marketing or selling the 2010 Bond Offering, the firm established no parameters for its registered representatives’ marketing or selling of this investment. CSSC BD’s representatives, however, did sell the 2010 Bond Offering to their customers, and Smith provided these representatives with the offering documents in order to do so. CSSC BD’s representatives also introduced Smith directly to their customers for him to sell the 2010 Bond Offering directly to those customers.

For example, Martin introduced customer SK to the 2010 Bond Offering, but Smith finalized the \$375,000 investment. Southwick also introduced Smith to several of his CSSC BD customers, who then invested in the 2010 Bond Offering. These customers included: JM who was approximately 88 years old at the time she invested \$300,000; DN who invested \$400,000; PK who invested \$100,000; DG who invested \$200,000; and SM who invested \$20,000. Some investors in the 2010 Bond Offering used funds from their CSSC BD accounts to invest in the 2010 Bond Offering.

From March 2010 through March 2014, CSSC and Smith raised a total of \$2.45 million through the 2010 Bond Offering.

2. The 2014 Bridge Loan Note Offering and Smith's Role

After conducting the 2010 Bond Offering, CSSC's business continued to struggle; the firm lost approximately \$803,000 in 2012 and \$883,000 in 2013. CSSC could not meet its day-to-day obligations without additional outside funding. As CSSC had done in the past, it deferred payments of salaries, commissions, and advisory fees to employees and affiliates. To cover ongoing losses, CSSC conducted the 2014 Bridge Loan Note Offering. This offering consisted of one-year, unsecured promissory notes bearing simple interest at eight percent. Buyers were promised 1,000 shares of CSSC common stock from Smith's holdings for every \$100,000 invested.

Smith made Southwick aware of the 2014 Bridge Loan Note Offering, and Southwick then sold it to his customers, including SM and JM, who also had invested in the 2010 Bond Offering. Smith

specifically asked Southwick whether JM, who had invested \$300,000 in the 2010 Bond Offering, would also invest in the 2014 Bridge Loan Note Offering. Southwick testified that Smith told him not to recommend the investment, but rather to make his customers “aware” of the offering and to tell them he would “see if it could be made available,” which Southwick referred to as his “script.” CSSC and Smith raised approximately \$1.1 million in the 2014 Bridge Loan Note Offering, including \$550,000 from JM, who was approximately 90 years-old at the time.³ JM initially invested \$100,000 in the 2014 offering, but made subsequent investments after Smith asked Southwick whether JM would invest more. Southwick “made her aware” that more notes were available, which led to her additional \$450,000 investment.

CSSC and Smith raised most of the money in the 2014 Bridge Loan Note Offering from Southwick’s CSSC BD customers. While Southwick received no compensation for these sales, Smith expressed their importance to him. Southwick knew the offering’s success was integral to whether Smith could pay Southwick his salary as CSSC continued to suffer financial difficulties.

B. CSSC’s Ongoing Financial Instability in
Advance of the 2015 Bridge Loan Note Offering

³ In April 2017, Southwick settled a disciplinary action with FINRA. Southwick consented to findings that he made unsuitable recommendations to his customers to invest in the 2010 Bond Offering and 2014 Bridge Loan Note Offering without conducting reasonable due diligence and by relying upon a sales script that CSSC provided. Southwick was suspended from FINRA membership for six months in all capacities.

CSSC's financial problems persisted into 2015 following the 2014 Bridge Loan Note Offering. Indeed, CSSC had a net loss of \$944,000 in 2014. Smith was keenly aware of the company's financial struggles at the time of the 2015 offering.

For example, in December 2014, American Express started declining charges on the CSSC company credit card after four successive months in which the company's payments were more than thirty days past due. Smith and Southwick were traveling on business at the time, and Smith was worried that he and Southwick might be "stranded" because American Express was declining the charges that they had incurred. While traveling, Smith emailed CSSC's assistant controller, MD, about the immediacy of the financial strain facing CSSC. MD informed Smith that CSSC BD "desperately needs to be paid the \$20,000 that it is owed from the RIA for December." MD highlighted that CSSC BD was "only \$874 over the notification threshold" when it would fall below its minimum net capital requirement. MD explained that because CSSC BD owed CSSC more than \$83,000 for the December 2014 rent, CSSC BD would fail to maintain its required level of net capital unless CSSC offset the rent with other revenue. Smith acknowledged that CSSC already had "missed payroll" and that offsetting the rent payment would leave CSSC unable to make payroll again. MD further explained to Smith that she was unable to make an \$11,000 past due payment that Smith had asked her to send Ken Wheeler, a CSSC affiliate with CSSC BD and RIA, who needed the funds to pay insurance premiums.

In addition, in February 2015, CSSC's auditor alerted Smith that the company's accumulated deficit

had surpassed \$10 million at the end of 2014. The auditor also questioned whether CSSC BD could continue as a going concern and noted that CSSC BD would have been net capital deficient without the monthly \$20,000 “stipends” it received from CSSC RIA. The auditor noted that CSSC’s group of entities suffered losses of \$803,000, \$883,000, and \$944,000 in 2012, 2013, and 2014, respectively. The auditor highlighted that CSSC “continues to experience difficulty in meeting its day-to-day obligations without significant outside funding.”

In May and June 2015, principal began to become due to investors in the 2010 Bond Offering and the 2014 Bridge Loan Note Offering. When Smith began the 2015 Bridge Loan Note Offering, CSSC owed \$635,000 to investors in the prior offerings. Smith knew that CSSC was unable to pay these investors. Smith, however, believed that CSSC would be current on its obligations to these investors by August 2015, and he did not disclose in the 2015 Bridge Loan Note Offering materials CSSC’s inability to pay its investors in these prior offerings.

At the end of June 2015, CSSC BD’s co-president, Martin, recognized CSSC’s need for cash and extended to CSSC a loan of \$50,000 at eight percent interest to be paid back in 30 days. CSSC, however, did not repay Martin when the principal became due. In August 2015, Martin demanded at least partial payment from CSSC. While CSSC repaid Martin approximately \$7,500 by August 10, 2015, the balance remained unpaid as of the date of the hearing in this matter.

C. The 2015 Bridge Loan Note Offering

Smith sought to address CSSC's financial woes by issuing more debt securities, in the form of the 2015 Bridge Loan Note Offering. The terms of this offering were essentially the same as those of the 2014 Bridge Loan Note Offering, including Smith's promise to give investors 1,000 shares of his own CSSC stock for every \$100,000 invested.⁴ The offering documents, which Smith drafted and disseminated, consisted of a "Confidential Report" and an "Important Memorandum," each of which went through several

⁴ Regarding the stock, the 2015 Bridge Loan Note terms stated that investors

will also receive 1,000 shares of CSSC common stock for every \$100,000 loaned (and proportionally more and less for greater and lesser loan amounts). These shares will **not** be coming from the Company, but from the personal holdings of Eric Smith, CSSC's Founder, Chairman, and Chief Executive Officer. He is giving these shares as an expression of his gratitude for the important help being provided by these loans. Although the value of CSSC's common stock has not been professionally evaluated, the latest Company transaction involving such shares occurred on April 30, 2012, when 11 CSSC Bondholders converted their Bonds to common stock at \$20 per share.

Although these bridge loan Notes are not "convertible," the Company is currently planning an offering of CSSC common stock to provide an opportunity for the holders of CSSC debt instruments, including these bridge loan Notes and CSSC Bonds (from a prior offering), to acquire CSSC common stock in exchange for all or part of their CSSC Bonds or bridge loan Notes. The Company plans to initiate this new Offering sometime within the third quarter of 2015.

iterations. Smith's omissions and misrepresentations in the 2015 Bridge Loan Note Offering documents form the basis of the Hearing Panel's findings that Smith committed fraud.

1. Smith's Failure to Disclose CSSC's Inability to Pay Prior Investors

Smith failed to disclose in the 2015 Bridge Loan Note Offering documents that CSSC was unable to pay substantial sums to the investors in the 2010 Bond Offering and 2014 Bridge Loan Note Offering. When Smith commenced the 2015 Bridge Loan Note Offering in June 2015, CSSC owed more than \$200,000 to the 2010 investors and \$300,000 to the 2014 investors. Smith admittedly was aware that CSSC was unable to pay those investors what they were owed. Smith acknowledged in his hearing testimony that, when he was soliciting investments in the 2015 Bridge Loan Note Offering, he was aware of CSSC's financial condition at the time and that he knew CSSC was unable to pay interest and principal to investors in the 2010 Bond Offering and 2014 Bridge Loan Note Offering.

2. Smith Misrepresented Facts Related to Project X

In November 2014, CSSC affiliate and registered representative Wheeler was looking for novel investment ideas to present to SB, a wealthy client and cardiologist who had a large network of contacts with other physicians. Wheeler, who also was an estate planner in Florida, provided estate planning services for SB. Wheeler approached Southwick for advice on what investments he might recommend. Southwick suggested he could "build a bank" in which SB could invest. Southwick had a background in

commercial banking and previously had participated in the creation of a nationally chartered special purpose bank. Southwick understood SB to have enough wealth to provide the necessary capital to enable a new bank to obtain regulatory approval.

Wheeler told Southwick that SB had expressed “extreme excitement” and was “very interested in building a bank.” SB insisted on keeping the project confidential, and they referred to the undertaking as “Project X.” Wheeler informed Southwick that he alone would handle contact with SB.

Southwick told Smith about Project X soon after he and Wheeler began discussing it. Wheeler made clear that he did not want Smith participating in Project X, but Southwick continued to inform Smith about what was happening. Southwick explained that the Office of the Comptroller of the Currency (“OCC”), as well as other bank regulators, would have to approve the bank’s charter. Southwick contacted a lawyer with whom he had worked to establish a special purpose bank in 1996 to ask for legal guidance. On November 9, 2014, Southwick informed Wheeler that he would soon send him “work product” from the law firm, the OCC, and a major private equity firm, that he hoped to involve in financing the bank.

On November 11, 2014, Southwick made a presentation regarding Project X to CSSC affiliates in a weekly meeting held at CSSC’s office in Michigan, and Southwick shared all this information with Smith. In the presentation, Southwick described Project X in broad terms and provided a lengthy list of tasks that would have to be completed to form a national bank. The presentation described Project X as creating a nationally chartered private purpose

bank that would produce consulting fees for CSSC and provide an opportunity for CSSC to obtain equity in the bank. Southwick testified that all of this information, including a consulting fee for CSSC of \$1 million “initially paid up front with [equity firm] funds,” was “[p]rospective” and there were “no [p]lans or agreements,” “assets under management,” or any “entity created.”

Southwick and Wheeler both testified that, at the time, they understood that chartering the bank would be a long and arduous process and that success was far from assured. Southwick explained that virtually everything with Project X was suppositional, “not firm.” Southwick had no idea if bank regulators would allow CSSC or the private equity firm to share ownership in the bank; he had no information on whether OCC would approve the project; he had not spoken to any of the OCC representatives; and had not yet attempted to contact individuals at the private equity firm nor made a proposal to them. Importantly, no consulting agreement ever existed. Southwick testified that sometime around March 2015, he contacted the private equity firm, and it was not interested in Project X. According to Southwick, getting approval for the bank would be a “huge, monumental task,” and would take one to two years.

Notwithstanding the tentative and inconclusive status of Project X, Smith featured it prominently in the offering materials for the 2015 Bridge Loan Notes Offering. In the June 15, 2015 Confidential Report, Smith represented that **“CSSC is being paid a \$1 million consulting fee for its work on the design and formation of this new Bank, the payment of which will ensure CSSC’s profitability in 2015.”** He further wrote:

One-half of that fee has now been earned and should be received very soon. The remainder will be due and payable when this new bank opens its doors for business, an event we expect to occur prior to the end of the 3rd quarter of 2015. For each additional bank of this type that CSSC helps to create, CSSC will receive an additional consulting fee, declining by \$200,000 for each new bank created, with consulting fees ending with the 5th such Special Purpose Bank formed. CSSC expects to receive the full consulting fee for the first Bank during 2015, plus at least one half of the consulting fee for the second Special Purpose Bank amounting to \$400,000 during 2015, for a total bank design-related consulting fee-income to CSSC of \$1.4 million in 2015.

Smith went on to state in the offering materials that CSSC's receipt of the \$1.4 million consulting fees "should ensure that 2015 is not only profitable, but also that it will be the most profitable year in CSSC's history."

In the July 12, 2015 Important Memorandum, Smith highlighted the special purpose bank as foremost among several CSSC's "important new initiatives." Specifically, in the section "Important Disclosures in the Accompanying 'Confidential Report,'" Smith again represented that **"CSSC is being paid a \$1 million consulting fee for its work on the design and formation of this new Bank, the payment of which will ensure CSSC's profitability in 2015."** He added that this project would **"likely make 2015 CSSC's most profitable year so far."**

Wheeler testified that contrary to Smith's representations in the offering documents as of June 2015, the special purpose bank was far from being in the final stages. The project organizers were "nowhere close" to creating a special-purpose bank. CSSC had no arrangement in place to be paid a consulting fee for the project nor was there work done or contemplated toward a second bank. Wheeler described Smith's representations about Project X in the offering materials as "delusional." When asked at the hearing whether he believed, at the time of the 2015 Bridge Loan Note Offering, that the bank would be opening its doors for business in the third quarter of 2015, Wheeler answered, "Absolutely not." Wheeler explained that they first had to form the financial services entity and prove the concept to the regulators. They then had to apply for the bank's charter, which may not have been granted. Wheeler surmised that they "were looking probably at a year or more in June of 2015 to accomplish all of that."

When Smith made these representations in the offering documents, he was aware of challenges involved with Project X coming to fruition. At the hearing, Smith admitted that he knew when he drafted the offering documents that only three banks in the previous five years had received national charters. Smith also admitted he never reviewed or approved any consulting agreement. He also never saw any evidence of an agreement by which CSSC would be paid a \$1 million consulting fee. And despite his representation in the offering documents that "[o]ne-half" of the \$1 million fee "had been earned and should be received very soon," Smith admitted "[w]e did not know exactly the triggering event of when the payment" would be made. Smith testified that it was

his “expectation” that CSSC would be paid based on what Southwick had told him. Smith admitted, however, that he never received any documentation from Southwick evidencing that CSSC would be paid any fee. Smith also had no conversations with the private equity firm purportedly involved with Project X about the payment of the consulting fee.

3. Smith Misrepresented CSSC’s Business
with the South Dakota Trust Company

In the June 15, 2015 Confidential Report, Smith claimed that he and Southwick were working on establishing an “important new strategic alliance with South Dakota Trust Company (SDTC).” Smith claimed that CSSC was helping SDTC create a range of new investment funds for which CSSC “will be the investment advisor” and for which CSSC “will earn a fee based on a percentage of the assets under management.” Smith also claimed he was forming “a client referral relationship with SDTC” whereby SDTC clients “would be referred to CSSC for a range of financial services that SDTC does not currently offer.” Smith further asserted in the Confidential Report:

With over \$80 Billion of investment assets of wealthy families across the country in SDTC administered trust accounts, the revenue and profit potential from client referrals to CSSC could be quite substantial. . . . [T]he Company [CSSC] expects to have both of these potentially important new revenue sources up and running before the end of calendar year 2015.

These representations, however, were largely baseless. In March 2015, based on an introduction provided by a CSSC affiliate who was on SDTC’s

board of directors, Southwick and Smith had met with representatives of SDTC to discuss a possible referral agreement. At the meeting, SDTC emphasized that CSSC was not to disclose the prospective relationship to avoid jeopardizing SDTC's relationships with other investment professionals. As of June 2015, Smith knew there was no client referral agreement in place between CSSC and SDTC and that CSSC was not about to become the advisor for any SDTC funds. Nevertheless, Smith disregarded SDTC's request for confidentiality and touted the prospective relationship with SDTC in the offering documents for the 2015 Bridge Loan Note Offering.

In July 2015, a planned follow-up meeting with SDTC's chief executive officer never materialized.⁵ And, in reality, CSSC never became the investment advisor to any SDTC funds, nor did it enter into a client referral agreement with SDTC.

4. Smith Misrepresented the Status of CSSC's Business with the City of Jacksonville

Smith also misrepresented in the June 15, 2015 Confidential Report the status of CSSC's business with Jacksonville, Florida. Smith stated in the Report:

We are currently in the final stages of being engaged as Special Reviewing Consultant with regard to the investment management of Jacksonville's nearly \$1 billion in short-term operating funds. . . . In addition to the revenue this case will generate, it will also increase our reportable assets under management by nearly

⁵ Southwick unsuccessfully attempted to meet with SDTC representatives until Smith fired him in September 2015.

\$1 billion — a very significant credentialing plateau.

Southwick was primarily responsible for pursuing the city as a client. When Smith made this representation in June 2015, CSSC had not yet sent the city a proposal. When it did so on July 27, 2015, the proposal was confined to CSSC's providing a quarterly performance review of the city's investment portfolio, not managing its investments. For providing this review, CSSC proposed a \$15,000 quarterly fee. The city did not agree to CSSC's proposal.

Even after Smith terminated Southwick in September 2015, Smith continued falsely representing to investors in an "October 2015 Important Update" offering document that CSSC had a pending engagement with Jacksonville that would result in an additional \$1 billion in assets under management, and that the engagement was expected to begin by the end of 2015. In fact, as Smith acknowledged at hearing, the city of Jacksonville never engaged CSSC to serve as a reviewing consultant. Even if the city had accepted the proposal, CSSC's acting as "special reviewing consultant" would not have increased its assets under management at all, let alone by \$1 billion.

D. Investors in the 2015 Bridge Loan Note Offering

Smith personally solicited between 15 and 25 people to invest in the 2015 Bridge Loan Note Offering and succeeded in raising \$130,000 from four of them: TL, Thomas Scotto, BB, and Gavin

Clarkson.⁶ Scotto and Clarkson were registered representatives of CSSC BD.

TL and Scotto were the first two investors in the 2015 Bridge Loan Note Offering and made their investments in August 2015, after receiving the offering materials that included the July 12, 2015 version of the Important Memorandum to potential investors. On September 9, 2015, Smith revised the Important Memorandum and Confidential Report related to Project X. Smith stated in the revised documents that progress on Project X had been “unexpectedly interrupted,” the revenue he previously had represented as already having been earned “may not materialize until 2016, if at all,” and that the interruption, caused by a “plan to deprive” CSSC of “an expected \$2.15 million,” meant that the special purpose bank revenue “now appears unlikely to take place within the 4th quarter of 2015. Consequently, it now appears unlikely that, unless other revenue sources are secured, 2015 will be profitable and the best year in the Company’s history.” Despite these revisions made a few days earlier, Smith, on September 12, 2015, sent investor BB a package of materials that included the June 15, 2015 Confidential Report, which described the likely receipt of revenue from Project X, as follows: **“CSSC is being paid a \$1 million consulting fee for its work on the design and formation of this new Bank, the payment of which will ensure CSSC’s profitability in 2015.”**

⁶ Investors BB and TL are identified in Enforcement’s Schedule of Abbreviations and References filed with its complaint in this matter.

In October and November 2015, Smith sent emails to Clarkson soliciting him and his connections to invest in the 2015 Bridge Loan Note Offering. Although Smith attached updated offering materials to the emails, including the disclosure that Project X had been “unexpectedly interrupted and revenue from it now is doubtful in 2015,” the materials continued to make other false claims about projected large increases in revenues to CSSC related to the SDTC and engagement with the city of Jacksonville. Smith’s emails to Clarkson also failed to disclose that CSSC was unable to pay the investors from the 2010 Bond Offering and the 2014 Bridge Loan Note Offering.

1. Investor TL

JC, who was affiliated with CSSC, referred Smith to TL. On July 21, 2015, Smith emailed TL promoting the 2015 Bridge Loan Note Offering. The email, with the subject line “CSSC’s ‘Bridge Loan Note’ Offering -explanation/package,” stated that Smith was sending TL “the complete package” of offering documents. Smith represented that the offering was a “great deal” that “really was originally designed for friends and family and for those doing business with CSSC.” Smith told TL that he had been “introducing this to one person at a time” but had “recently changed that approach” and now was “expanding the range of those to whom this is being made available.” Smith represented to have “successfully placed” \$1.35 million in notes and hoped to complete the \$3 million offering by placing \$1.65 million “within the next 30 days.” Smith said he was “not anticipating doing anything like this (individual offerings) again.” Smith invited TL to meet him later that week in New

York City, where they discussed the 2015 Bridge Loan Note Offering. Smith stayed in contact and spoke again with TL about the offering by phone in August 2015.

On August 17, 2015, Smith followed-up with TL via email. To that email Smith attached the July 12, 2015 Important Memorandum to prospective investors, which Smith described as “[a] summary discussion of why we are seeking bridge financing, the new initiatives and changes being implemented, and important financial information/disclosures.” TL had asked Smith whether he would rescind the offer of promised CSSC stock if TL exercised an early payoff of the note. Smith assured TL that he would not and promised to send a stock certificate and the note by overnight mail. On August 24, 2015, TL invested \$50,000 in the 2015 Bridge Loan Note Offering.

Smith did not send the stock certificate to TL until November 2015. TL complained to JC in email about the delay, indicating that he had been waiting for weeks for Smith to send him the paperwork. TL told JC that his “trust has been seriously shaken” and that he would refuse to accept delivery of the certificate and wanted a refund from Smith. JC did not respond and forwarded the email to Smith. Smith informed TL that he had “no present ability” to refund his investment and promised he would “be paying off the Notes at the earliest opportunity.” Smith highlighted that TL’s investment was “earning interest at 8%” and Smith had gifted him CSSC common stock. TL has not been repaid his \$50,000 investment.

2. Investor Scotto

Scotto, a CSSC registered representative and an employee of CSSC RIA, previously had invested

\$215,000 in bond and note purchases with CSSC. Smith made Scotto aware of the 2015 Bridge Loan Note Offering to enable him to solicit prospective investors. In July 2015, Smith sent Scotto an email directing him to replace the June 2015 version of the “Important Memorandum” in the offering documents that Smith sent earlier with the updated July 12, 2015 version.⁷ Smith directed Scotto to send the updated memorandum to anyone to whom he had given the earlier version. Smith explained that the June memorandum “did not give an accurate or balanced view of what we are doing and why . . . someone might consider it beneficial (to them) to participate in the Offering.” He also attached a copy of a PowerPoint presentation he thought “should provide a quick way to introduce us to prospective new investors and others that you think might be good fits for a relationship with us.”

In response to Smith’s email, Scotto sent \$20,000 of his personal funds to CSSC on August 31, 2015. Smith claimed during the hearing that the \$20,000 was not an investment in the 2015 Bridge Loan Note Offering but was instead a short-term loan to CSSC. In an email exchange on November 18, 2015, between CSSC’s controller, DW and Smith, however, DW informed Smith that Scotto’s \$20,000 was one of several “notes” that “[t]erms have not been specified for.” In response, Smith wrote that Scotto’s funds were “in the Bridge Loan Note Offering.” Scotto has not been repaid his \$20,000 investment.

⁷ The record does not detail their prior conversations.

3. Investor BB

In September 2015, Smith solicited BB, a college classmate, to invest in the 2015 Bridge Loan Note Offering and encouraged BB to solicit other investors in the offering. Smith emailed BB on September 12, 2015, with the subject line “FW: CSSC’s ‘Bridge Loan Note Offering’ - explanation/package.” In the email, Smith referred to a conversation he and BB had earlier that day and referenced their prior discussion that the offering was not “applicable in [BB’s] case.” Smith stated that they should “consider some alternatives” for BB to become “involved” in the offering. Smith attached to this email various offering documents, including the June 15, 2015 version of the “Confidential Report.” Smith encouraged BB to let him know if he thought the offering would be a “fit” for him or “others that you believe we should consider including that would be good for us to ‘have in the family.’”

On September 29, 2015, BB sent \$10,000 to Smith. Smith indicated to CSSC’s controller that BB’s investment was a “6 month Note.” BB has not been repaid his \$10,000 investment.

4. Investor Clarkson

In October 2015, Smith solicited Clarkson to invest in the 2015 Bridge Loan Note Offering. Clarkson was a licensed investment advisor and broker who had been registered with affiliates of CSSC since 2012. Smith sent Clarkson an email on October 29, 2015, attaching the “Confidential Report,” the “Important Update,” a version of the “Memorandum to Those Considering Making a Bridge Loan” that Smith had revised four days earlier, and a promissory note and certificate. Smith encouraged

Clarkson to invest personally and to solicit his contacts for investments. Smith knew that Clarkson also worked with Native American tribes attempting to facilitate release of tribal funds held by the Bureau of Indian Affairs. Smith referenced CSSC's "current short-term cash needs," and stated that he hoped the 2015 offering "might indeed be a good 'fit' with you and possibly one or more of your tribal connections—that you and/or some of them will be able to take advantage of the opportunity." Smith told Clarkson that it would be "good [to] have some new folks 'on the team'—especially in the tribal world, and if you are the one recommending them."

On November 2, 2015, Smith sent Clarkson another email with updates to "two of the principal [offering] documents" that Smith had revised that day, and asked Clarkson to "dispose of the earlier versions in the package(s)" and "replace with these." Smith emailed wiring instructions to Clarkson on November 12, 2015, and wrote that he would soon "resend the rest of the disclosure package." In a subsequent email sent 14 minutes later, Smith attached the 2015 Bridge Loan Note Offering documents and the wiring instructions. The following day, Clarkson invested \$50,000. In an email to CSSC's controller, Smith characterized Clarkson's investment as a "6 month Note." Clarkson has not been repaid his \$50,000 investment.

IV. Discussion

We affirm the Hearing Panel's findings that Smith engaged in fraud when he failed to disclose material facts and made material misrepresentations in connection with the 2015 Bridge Loan Notes Offering. We further affirm the findings that Smith acted in the

capacities of a general securities representative and principal without being registered. We discuss the violations in detail below.

A. Smith Committed Fraud When He Omitted and Misrepresented Material Facts

Exchange Act Section 10(b) makes it “unlawful for any person, directly or indirectly . . . [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 Commission rules. 15 U.S.C. § 78j(b). Exchange Rule 10b-5(b) makes it unlawful for any person “directly or indirectly” to “make any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made . . . not misleading.”⁸ 17 C.F.R. §240.10b-5(b). Thus, under Section 10(b) and Rule 10b-5, “one who elects to disclose material facts must speak fully and truthfully, and provide complete and non-misleading information with respect to the subjects on which he undertakes to speak.” *Louis Ottimo*, Exchange Act Release No. 83555, 2018 SEC LEXIS 1588, at *31 (June 28, 2018) (internal quotation marks omitted). “That duty is a general one, and arises whenever a disclosed statement would be misleading in the absence of the disclosure of additional material facts needed to make it *not* misleading.” *Id.* (internal quotation marks omitted).

⁸ Smith, as the drafter of the 2015 Bridge Loan Notes Offering documents with the ultimate authority over these documents and their contents, was the maker of the misstatements and omissions contained within them for purposes of liability under Exchange Act Rule 10(b)-(5)(b). See *Janus Capital Grp., Inc. v. First Derivative Traders*, 564 U.S. 135, 142-43 (2011).

A violation of Section 10(b) and Rule 10b-5 constitutes a violation of FINRA's antifraud rule, FINRA Rule 2020, which prohibits FINRA members and their associated persons from effecting "any transaction in, or induce [ing] the purchase or sale of, any security by means of any manipulative, deceptive or other fraudulent device or contrivance." *William Scholander*, Exchange Act Release No. 77492, 2016 SEC LEXIS 1209, at *15 (Mar. 31, 2016), *aff'd sub nom. Harris v. SEC*, 712F. App'x 46 (2d Cir. Oct. 25, 2017). Proof of scienter is required to establish a violation of each of the foregoing provisions.⁹ See *Dept. of Enforcement v. Luo*, Complaint No. 2011026346206, 2017 FINRA Discip. LEXIS 4, at *20 (FINRA NAC Jan. 13, 2017). Such conduct also violates FINRA Rule 2010. *Scholander*, 2016 SEC LEXIS 1209, at *14-15.

Enforcement alleged, and the Hearing Panel found, that Smith committed securities fraud when he failed to disclose and made material misstatements of fact when he solicited investors to

⁹ Section 10(b) and Rule 10b-5 include jurisdictional elements that prohibit fraud by "any means or instrumentality of interstate commerce." See 15 U.S.C. § 78j; 17 C.F.R. 240.10b-5. Smith's conduct in this case occurred by means or instrumentality of interstate commerce, such as communicating through telephone calls, email, or the U.S. mail service, thereby satisfying the interstate commerce requirement. See *Grubbs v. Sheakley Grp., Inc.*, 807 F.3d 785, 803 (6th Cir. 2015) ("[T]he very act of sending an e-mail creates the interstate commerce nexus necessary for federal jurisdiction."); *SEC v. Softpoint, Inc.*, 958 F. Supp. 846, 865 (S.D.N.Y. 1997) (determining that the jurisdictional requirements of the federal antifraud provisions are interpreted broadly and are satisfied by intrastate telephone calls or the use of the U.S. mail), *aff'd*, 159 F.3d 1348 (2d Cir. 1998).

purchase the 2015 Bridge Loan Notes. Enforcement's fraud allegations stemmed from: (1) Smith's failure to disclose CSSC's inability to pay previous investors in CSSC's 2010 Bond and 2014 Bridge Note Loan Offerings; and (2) Smith's representations related to Project X and CSSC's business with the SDTC and the city of Jacksonville. We agree with the Hearing Panel that Smith committed securities fraud.

1. The 2015 Bridge Loan Notes Were Securities

We agree with the Hearing Panel's determination that the 2015 Bridge Loan Notes were securities. The offering documents describe the 2015 Bridge Loan Notes as unsecured with a 12-month maturity, earning eight percent interest, with an additional "gift" of CSSC common stock. The Exchange Act defines a "security" to include "any note," except notes with maturities of less than nine months. 15 U.S.C. § 78c(a)(10); see *Reves v. Ernst & Young*, 494 U.S. 56, 65-66 (1990). The Supreme Court in *Reves* adopted the "family resemblance" test, along with four factors, to consider in determining whether a note is a security under Section 3(a)(10) of the Exchange Act. 494 U.S. at 66-67. The *Reves* four factors determine whether the transaction nonetheless involves a security by evaluating: (1) the motivations of the buyer and seller (i.e., whether the seller is raising money for general use of a business enterprise and whether the buyer is interested in the profit the note is expected to generate); (2) the plan of distribution (i.e., whether the note is an instrument in which there is a common trading for speculation or investment); (3) the reasonable expectation of the investing public; and (4) the existence of another regulatory scheme

that makes oversight by federal securities laws unnecessary. *Id.* Under the *Reves* test, a note is presumed to be a security. *Id.* That presumption may be rebutted only by demonstrating that the note bears a strong resemblance to one of the enumerated categories of instrument that are deemed as non-securities when considering the four factors of the *Reves* test.¹⁰ *Id.* at 66-67. If a note is not sufficiently similar to the enumerated categories of non-securities, the family resemblance test requires an examination, based on the same four factors, of whether another category should be added. *Id.*

The 2015 Bridge Loan Note Offering documents show that CSSC issued the short-term notes to raise capital for its general business operations and that the notes were crafted to appeal to investors seeking profit. The 2015 Bridge Loan Note Offering Confidential Report stated that CSSC was “covering its operating deficits” with the note proceeds. In the “Important Memorandum,” Smith wrote that “funds raised will be used to smooth out Company cash flows and cover any operating deficits until the revenue expected from” pending “new initiatives begins to be received.”

Furthermore, the evidence reflects that Smith drafted the offering documents to emphasize the

¹⁰ The categories of notes that are not securities are notes that are: (1) delivered in consumer financing; (2) secured by a mortgage on a home; (3) short-term notes secured by a lien on a small business or some of its assets; (4) evidencing a character loan to a bank customer; (5) short-term notes secured by an assignment of accounts receivable; or (6) which simply formalize an open-account debt incurred in the ordinary course of business (particularly if, as in the case of the customer of a broker, it is collateralized). *Id.* at 65.

potential profit to note purchasers. Indeed, Smith acknowledged that he drafted the offering documents with the offer of an eight percent return and gifts of CSSC stock to make the offering attractive to potential investors. The 2015 Bridge Loan Notes provided its holders an attractive interest rate of eight percent; thus, the investing public reasonably would view them as “securities.” See *Stoiber v. SEC*, 161 F.3d 745, 750 (D.C. Cir. 1998) (explaining that notes with a favorable interest rate indicate that profit was the lender’s primary goal). In addition, the notes were uninsured and not subject to the federal banking laws and therefore would otherwise escape federal regulatory oversight if they were deemed non-securities. Based on these considerations, we conclude that the 2015 Bridge Loan Notes were securities. The notes did not bear a strong family resemblance to the notes listed as non-securities, and there is no basis for adding a new category considering the *Reves* factors.

While Smith conceded that customer TL invested \$50,000 in the 2015 Bridge Loan Note Offering, he asserted that Scotto, Clarkson, and BB merely loaned money to CSSC. In evaluating the 2015 Bridge Loan Notes under the *Reves* factors, however, we conclude that the notes were securities that Smith offered to TL, Scotto, Clarkson, and BB, who were investors in the securities offering. Smith offered the notes for investment purposes and not in commercial or consumer contexts with a standard maturity date of one year from purchase. While Smith was willing to shorten the maturity date to less than one year for some note holders, he did so only after investors negotiated a shorter term for the notes’ maturity in exchange for their investment. For example, Smith

testified that Scotto said he would participate in the offering, but needed his principal returned by the end of the year. Smith accommodated Scotto by agreeing to “[d]o it differently.” Thus, Smith was willing to adjust the terms to satisfy those who wanted to participate in the offering, but with terms that differed from its original terms. It was only after Smith solicited Scotto with emails and sent him the package of offering documents for prospective investors that Scotto sent Smith \$20,000. As the Hearing Panel found, these circumstances show that Smith solicited Scotto to invest in the 2015 Bridge Loan Note Offering, and Scotto invested in the offering only after negotiating a shorter term for maturity than the standard one year.

Similarly, with respect to BB, Smith in September 2015 sent BB the offering materials for the 2015 Bridge Loan Note Offering, including the June 15, 2015 version of the “Confidential Report.” Smith stated in an accompanying email that if BB wished “to get involved,” Smith would “consider some alternatives,” and invited BB to let Smith know if he decided “to get involved.” When BB reviewed the offering documents, he said he wanted to participate, but asked if he could do so with only a \$10,000 “loan” and that he was interested in receiving CSSC stock to have “a stake in the company.” Smith again agreed to vary from the original terms and shorten the offering’s standard one-year maturity, referring to it as a “6 month Note,” in order to obtain BB’s \$10,000. Like he did with Scotto, Smith solicited BB to invest in the 2015 Bridge Loan Note Offering and obtained BB’s investment only after modifying the offering’s standard terms. Smith also encouraged BB to introduce the offering to his connections in

investment banking and venture capital circles to obtain more investors.

While Smith admitted in his hearing testimony that he solicited Clarkson to invest in the 2015 Bridge Loan Note Offering, Smith contends that Clarkson instead made a shorter-term loan. Smith, however, sent the 2015 Bridge Loan Note Offering documents and wiring instructions to Clarkson hoping he would purchase a Bridge Loan Note and solicit other potential investors among his Native American tribal contacts. In October 2015, Smith emailed Clarkson that he was “finishing the placement of the remaining \$1.6 million available in our current Bridge Loan Note Offering,” and described it as “a great opportunity” that he hoped would “be a good ‘fit’” for Clarkson and his “tribal connections—that you and/or some of them will be able to take advantage of the opportunity.” Smith’s willingness to make individual modifications to the terms of the offering to obtain certain investors does not alter that the 2015 Bridge Loan Note Offering was a securities offering under the Exchange Act and *Reves* analysis. See 15 U.S.C. § 78c(a)(10); *Reves*, 494 U.S. at 65-66.

In addition, CSSC records describe the note transactions in terms of investments rather than loans in a document titled, “Bridge Loan note holders.” In this document, TL and Scotto were listed by name as “Bridge Loan note holders,” with the amounts of their investments, August 2016 maturity dates of their notes, and total interest due at eight percent upon maturity for each investor. Investor BB’s name appears on another CSSC document titled, “Other note holders,” and lists his \$10,000 investment with a September 2016 maturity date, which was one

year after his investment, and \$799.99 interest due at maturity.

As the Hearing Panel found, other evidence supports the conclusion that the four transactions at issue were purchases of securities in the 2015 Bridge Loan Note Offering rather than short-term unaffiliated loans to CSSC. In November 2015, when CSSC's controller emailed Smith to inform him that "[t]erms have not been specified for the following notes," he included the notes at issue here: Scotto's \$20,000; BB's \$10,000; TL's \$ 50,000; and Clarkson's \$50,000 investments. Smith then identified Scotto's and TL's funds as "in the Bridge Loan Note Offering," and BB's and Clarkson's funds as "6 month Note[s]."

2. Smith's Omissions and Misstatements of Fact Were Material

The information that Smith omitted to disclose and misstated in the 2015 Bridge Loan Note Offering documents was material. Whether information is material "depends on the significance the reasonable investor would place on the . . . information." *Basic Inc. v. Levinson*, 485 U.S. 224, 240 (1988). Information is material "if there is a substantial likelihood that a reasonable [investor] would consider it important in deciding how to [invest] . . . [and] the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Id.* at 231-32 (quoting *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)).

When soliciting investments in the 2015 Bridge Loan Notes, Smith failed to disclose that CSSC was unable to pay the investors in CSSC's 2010 Bond Offering and 2014 Bridge Loan Note Offering. Smith

does not dispute that he failed to disclose CSSC's inability to satisfy its pre-existing debt obligations. He in fact admitted that when he was soliciting investments in the 2015 Bridge Loan Note Offering, he was aware of CSSC's deteriorating financial condition at the time and knew CSSC was unable to pay interest and principal to investors in the 2010 and 2014 offerings. Indeed, when Smith was soliciting investors in the 2015 offering, CSSC owed a combined \$635,000 to the 2010 and 2014 investors. A reasonable investor would have considered the fact that CSSC was unable to pay investors in its prior debt offerings an important factor when evaluating whether an investment in the 2015 Bridge Loan Note Offering was prudent. *See SEC v. Todd*, 642 F.3d 1207, 1221 (9th Cir. 2011) (holding a company's financial condition is material to investments); *Dep't of Enforcement v. McGee*, Complaint No. 2012034389202, 2016 FINRA Discip. LEXIS 33, at *33 (FINRA NAC July 18, 2016), *aff'd*, 2017 SEC LEXIS 987 (Mar. 27, 2017), *aff'd*, 733 F. App'x 571 (2d Cir. 2018); *see, e.g., Aubrey v. Barlin*, No. A-10-CA-076-SS, 2011 U.S. Dist. LEXIS 15332, at *23 (W.D. Tex. Feb. 16, 2011) (finding "the omitted facts material, as any reasonable investor would want to know if the entity to which they were loaning money was already defaulting on its prior obligations"). This omission was material.

Smith also made false material representations regarding CSSC's anticipated revenue from Project X, SDTC, and the city of Jacksonville. Smith misrepresented the status of these significant revenue events in the 2015 offering documents and concluded that 2015 likely would be CSSC's most profitable year so far. For example, he stated that

CSSC was being paid \$1.4 million in consulting fees for its work on the design and formation of Project X, and that the payment “will ensure CSSC’s profitability in 2015.” Smith also stated without support that CSSC had already earned \$500,000 from this project. Smith claimed that CSSC would be the investment advisor for a range of new investment funds that CSSC was helping SDTC create, that CSSC would earn a fee based on a percentage of the assets under management, and that CSSC was forming “a client referral relationship” with SDTC for a range of financial services that SDTC does not currently offer. Smith claimed that “the revenue and profit potential from client referrals to CSSC could be quite substantial.”

As of June 2015, Smith knew that CSSC had not earned anything from Project X, that there was no client referral agreement in place between CSSC and SDTC, and that CSSC was not about to become the advisor for any SDTC funds. Smith further misrepresented in the offering documents that CSSC would increase its assets under management by nearly \$1 billion through its engagement with the city of Jacksonville. These statements, which were demonstrably false when Smith made them, were at the heart of his sales pitch to potential investors. “[T]he materiality of information relating to financial condition, solvency and profitability is not subject to serious challenge.” *SEC v. Murphy*, 626 F.2d 633, 653 (9th Cir. 1980); *see also SEC v. USA Real Estate Fund 1, Inc.*, 30 F. Supp. 3d 1026, 1034 (E.D. Wash. 2014) (“False claims of substantial unearned revenue, or the substantial overstatement of revenue, are ‘material’ to reasonable investors.”); *Dep’t of Enforcement v. Gomez*, Complaint No. 2011030293503, 2018 FINRA

Discip. LEXIS 10, at *44 (FINRA NAC Mar. 28, 2018) (“The truth that Praetorian and the Praetorian G entities did not own pre-IPO shares of Groupon or Zynga, and that U.S. Coal had no plans to pursue an IPO, would have undoubtedly been material to the investors Gomez solicited. Gomez’s false statements to the contrary significantly altered the total mix of information available to these investors and any reasonable investor.”). The statements that Smith included in the 2015 Bridge Loan Note Offering documents about CSSC’s financial prospects related to Project X, SDTC, and the city of Jacksonville were information that “altered the total mix of information made available” to the investors for the 2015 offering, and any reasonable investor would consider this information important to an investment decision in the offering. *See Basic*, 485 U.S. at 231-32; *Ottimo*, 2018 SEC LEXIS 1588, at *33.

Smith argues that the Hearing Panel erroneously decided materiality “as a matter of law,” and failed to consider evidence of whether any of the specific investors relied on the information in making their investment decisions. Moreover, he states that one investor, Scotto, continued “loaning” CSSC money in 2015 despite having “loaned” CSSC money earlier that the firm had not yet repaid. The Commission and the courts, however, have rejected arguments mirroring Smith’s, and we do so here. As the Supreme Court has explained in the context of deciding materiality as a matter of law:

The determination [of materiality] requires delicate assessments of the inferences a reasonable shareholder would draw from a given set of facts and the significance of those inferences to him. and these assessments are

peculiarly ones for the trier of fact. Only if the established omissions are so obviously important to an investor, that reasonable minds cannot differ on the question of materiality is the ultimate issue of materiality appropriately resolved as a matter of law by summary judgment.

TSC Indus., 426 U.S. at 450 (internal quotation marks omitted).¹¹ The Hearing Panel, as the trier of fact, decided materiality correctly as a mixed question of law and the relevant facts of this case. *See id.* Relevant precedent also does not require that Enforcement present evidence of an individual investor relying upon a misstatement or omission when deciding to invest. “[T]o be material, a fact need not be outcome-determinative—that is, it need not be important enough that it would necessarily cause a reasonable investor to change his investment decision.” *SEC v. Meltzer*, 440 F. Supp. 2d 179, 190 (E.D.N.Y. 2006). And the reasonableness of an investor’s reliance is not an element of a FINRA enforcement action for fraud. *See Dep’t of*

¹¹ Smith also objects to Enforcement’s failure to call an expert to offer testimony on materiality. Smith, however, could have filed his own motion before the Hearing Officer to permit expert testimony. *See* FINRA Rule 9242(a)(5). Regardless, expert testimony is not necessary for the Hearing Panel or the NAC to assess what Smith omitted and disclosed to investors and whether those disclosures were false and misleading in light of the circumstances of this case. *See Fuad Ahmed*, Exchange Act Release No. 81759, 2017 SEC LEXIS 3078, at *79 (Sept. 28, 2017) (“Rather, the relevant evidence concerned the representations that Respondents made in offering the STI notes. Both FINRA and the Commission . . . have the expertise to evaluate such evidence without expert testimony.” (internal quotation marks omitted)).

Enforcement v. Kaweske, Complaint No. C07040042, 2007 NASD Discip. LEXIS 5, at *21 n.16 (NASD NAC Feb. 12, 2007). The “reaction of individual investors is not determinative of materiality, since the standard is objective, not subjective.” *Ottimo*, 2018 SEC LEXIS 1588, at *38; *see also Kenny Akindemowo*, Exchange Act Release No. 79007, 2016 SEC LEXIS 3769, at *17 (Sept. 30, 2016) (finding misstatements material “because a reasonable investor would want to know how their funds were actually being used”).

Smith further contends that the “total mix of information” that he provided to prospective investors included “stark warnings” of CSSC’s “financial losses and its then-current inability to pay its debts from operating revenues.” Smith overstates these purported disclosures, which do not serve to counteract his omissions and misstatements. “Materiality is not judged in the abstract, but in light of the surrounding circumstances.” *Rosenzweig v. Azurix Corp.*, 332 F.3d 854, 866 (5th Cir. 2003); *see also ZPR Inv. Mgmt. v. SEC*, 861 F.3d 1239, 1251-52 (11th Cir. 2017) (explaining that it is “well-established principle that a statement or omission must be considered in context”), *cert. denied*, 138 S. Ct. 756 (2018); *United States v. Rigas*, 490 F.3d 208, 231 (2d Cir. 2007) (“Analysis of the misrepresentations must be in the context in which they were made.”).

While the 2015 Confidential Report referred to CSSC’s ongoing financial difficulties, it did so in the context of how CSSC was overcoming those struggles through its new initiatives including Project X, its business with SDTC, and its business with the city of Jacksonville. The “warnings” that Smith highlights were boilerplate risk-disclosure language in the 2015

Important Memorandum, which stated, “[m]aking an unsecured loan to a company that is experiencing current cash flow shortfalls involves a significant amount of risk,” “that there was no guarantee that the loan would be repaid with interest when due,” “[l]oans of this type should be made only by those financially able and willing to accept the risk that all or part of the loan could be lost.” Smith’s warnings, however, were offset by his statement that, “we believe that the measures described and discussed in the accompanying Confidential Report (which you are urged to read) will restore the Company to sustainable and growing profitability, and could result in significant appreciation in the value of CSSC’s common stock.” Here, Smith’s numerous falsehoods and his omission of key financial information that CSSC was unable to pay its prior investors were made to portray the 2015 Bridge Loan Note Offering as an ostensibly profitable investment. *See, e.g., Gould v. Am. Hawaiian S.S. Co.*, 331 F. Supp. 981, 997 (D. Del. 1971) (finding aggregate effect of numerous falsehoods most clearly evidenced materiality).

The NAC moreover rejected arguments like Smith’s in *Department of Enforcement v. Escarcega*, Complaint No. 2012034936005, 2017 FINRA Discip. LEXIS 32 (FINRA NAC July 20, 2017). The NAC found unpersuasive Escarcega’s argument that because he provided written material that described risks of an investment in detail, such as the prospectus, any alleged misrepresentations that he made cannot be considered material in the context of the total mix of information. *Id.* at *36-37; *see also Dep’t of Enforcement v. Brookstone Sec., Inc.*, Complaint No. 2007011413501, 2015 FINRA Discip.

LEXIS 3, at *81 (FINRA NAC Apr. 16, 2015) (rejecting respondents' argument that a broker's misrepresentations are rendered immaterial when written risk disclosures are made available to customers).

We conclude that the information that Smith failed to disclose and misrepresented was material.

3. Smith Acted with Scienter

We also find that Smith acted with scienter when he omitted material facts and made material misrepresentations to investors. Scienter is defined as "a mental state embracing intent to deceive, manipulate, or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976). Scienter is established if a respondent acted intentionally or recklessly. See *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 n.3 (2007). Scienter includes recklessness, which is defined as conduct that is "an extreme departure from the standards of ordinary care . . . which presents a danger [of deceiving investors that] is either known to the [respondent] or is so obvious that the [respondent] must have been aware of it." *Dolphin & Bradbury, Inc. v. SEC*, 512 F.3d 634, 639 (D.C. Cir. 2008) (internal quotation marks and emphasis omitted). Recklessness may be inferred from circumstantial evidence suggesting an obvious risk of misleading investors that is so great that it is simply implausible that a respondent did not know about it. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 390-91 n.30 (1983); *Vernazza v. SEC*, 327 F.3d 851, 860-61 & n.8 (9th Cir. 2003).

In the case of a material omission, "scienter is satisfied where . . . the [respondent] had actual knowledge of the material information." *Brookstone*,

2015 FINRA Discip. LEXIS 3, at *78-79. Smith knew when he drafted the 2015 Bridge Loan Note Offering documents that CSSC was experiencing extreme financial difficulties. In March 2015, CSSC's controller informed Smith that \$635,000 was coming due to prior investors by the end of June 2015. Smith knew that CSSC was unable to pay these investors but failed to disclose that fact in the 2015 offering documents that he drafted.

We also find as additional evidence of scienter that Smith had disclosed in the 2010 Bond Offering documents that short-term notes CSSC issued in 2009 had become due, and it was "fortunate" to secure agreements to exchange the notes for new notes. Smith disclosed in the 2010 offering documents that "serious consequences," including CSSC being unable to continue as a going concern, could result if the note holders did not continue to agree to similar exchanges. Smith included no similar language in the 2015 offering documents. While Smith stated in the 2015 documents that CSSC had conducted previous offerings, he did not disclose that those investors were not being paid. This omission served to mislead new investors and furthered Smith's self interest in obtaining much needed capital infusions from these investors.¹² *See, e.g., Warwick Capital Mgmt., Inc.,*

¹² In further support of Smith's scienter, we note that Smith initiated the 2015 Bridge Loan Note Offering in the wake of extreme financial pressure on CSSC. For example, in December 2014, American Express had been declining charges on the CSSC company credit card for nonpayment, and Smith was worried that he and Southwick might be "stranded" while traveling as a result. In February 2015, CSSC's auditor alerted Smith that the company's accumulated deficit had surpassed \$10 million at the end of 2014. The auditor also questioned

Investment Advisers Act Release No. 2694, 2008 SEC LEXIS 96, at *29 (Jan. 16, 2008) (“His self-interest in providing inaccurate information about Warwick is apparent.”). The evidence unquestionably reflects that Smith knew these adverse facts and intentionally withheld them.

Smith also misled investors about the status of Project X and CSSC’s purported agreements with SDTC and the city of Jacksonville. Affirmative statements concerning the purchase or sale of a security come with the “ever-present duty not to mislead.” *See Basic*, 485 U.S. at 240 n. 18. Smith lacked a reasonable basis for his statements concerning these initiatives and the circumstances reveal it was implausible that he did not know or was extremely reckless in not knowing the truth when he made these statements. *See Gebhart v. SEC*, 595 F.3d 1034, 1041 (9th Cir. 2010) (“Scienter may be established, therefore, by showing that the [respondents] knew their statements were false, or by showing that [respondents] were reckless as to the truth or falsity of their statements.”).

Smith represented in the multiple iterations of the 2015 Bridge Loan Note Offering documents that CSSC was set to receive \$1.4 million in total consulting fees in 2015 from Project X alone, consisting of \$1 million for creating the first bank and \$400,000 for creating the second bank. Smith represented that Project X would make 2015 the “most profitable year in CSSC’s history.” Smith

whether CSSC BD could continue as a going concern. The auditor highlighted that CSSC “continues to experience difficulty in meeting its day-to-day obligations without significant outside funding.”

stated that half of the \$1 million consulting fee had already “been earned and should be received very soon.” Smith went on to explain that he expected CSSC would receive the other half of the fee when the bank began operating, and that he expected this would be accomplished prior to the third quarter of 2015. Smith represented that CSSC then was slated to be paid additional fees for replicating the banks. None of this was remotely accurate.

Smith made these representations without reviewing or approving a consulting agreement or reviewing an application to bank regulators for the special purpose bank. And the evidence shows that Smith knew (or was extremely reckless in not knowing) that there was no consulting agreement in place when he made these statements. For example, in July 2015, a wealthy potential investor LC, with whom Smith was trying to place \$ 1.6 million in 2015 Bridge Loan Notes, insisted that Smith produce a copy of a written commitment reflecting that CSSC would be providing financial services for the special purpose bank. On July 28, Smith wrote to LC that the “bank is nearing completion,” and the document confirming that CSSC would provide “the investment advisory and brokerage platform” would be executed “very soon since meetings with the [prospective] investors began, financial services introductions have already been set.” Smith then asked Southwick for the documentation. When Southwick said he did not have any, Smith had Southwick, in Smith’s presence, call the lawyer who Southwick knew was advising on the project and ask him for the agreement. The lawyer replied that there was no agreement, and that the financial services entity had not been formed. On July 31, 2015, Smith informed LC “that the document

that establishes that CSSC will be providing the investment advisory and brokerage platform for the . . . banks, has not yet been signed.” Despite knowing that there was no agreement, Smith continued to assure LC that written confirmation of the commitment was forthcoming: “I was told that they expected that agreement to be finalized and executed within the next 7-14 days.”¹³

Moreover, both Southwick and Wheeler testified there was no work being done yet on a second special purpose bank. Wheeler also had no knowledge of a \$1 million consulting fee owed to CSSC. Southwick, when asked whether Smith’s representations regarding the purported \$1.4 million consulting fees were accurate, repeatedly answered, “No.” In short, Smith’s representations regarding the status of Project X and its imminent beneficial effects on CSSC’s finances were uniformly baseless.

CSSC BD’s co-presidents, LaRose and Martin, also testified about that status of Project X. LaRose first learned the details of Project X around August 2015 when Southwick submitted an outside business activity approval form to her when there were discussions of doing a capital raise for the initiative. LaRose referred to Project X as “a fluid project,” which was not sufficiently underway for her to even review it as an outside business activity for Martin, who was supposed to take a significant position in the financial services company that would provide brokerage and advisory services to the banking clients. Martin testified that when Smith asked him in the spring of

¹³ In September 2015, LC informed Smith that he would “pass” on the 2015 Bridge Loan Note Offering and requested that Smith not contact him again.

2015 if he had seen any documentation regarding the Project X consulting fee, he told Smith he had not seen anything.

Smith contends that he relied on Southwick for updates on Project X and that Southwick misled him about the progress and imminent earning of consulting fees. Smith's claims are unpersuasive and do not negate his scienter. Smith first made the representations about Project X in the June 2015 offering documents without any confirmation of their truth. After Southwick could not produce any documentation that Smith requested in July 2015 to provide to LC, Smith knew from his and Southwick's conversation with the lawyer on Project X that no agreement existed. Nonetheless, Smith continued to misrepresent the status of Project X to investors. Contrary to his assertions, Smith must have known that, when he made his misrepresentations, his actions presented an unacceptable danger of misleading investors. *See Alvin W. Gebhart*, Exchange Act Release No. 58951, 2008 SEC LEXIS 3142, at *35 (Nov. 14, 2008) ("A respondent's asserted good faith belief is not plausible if he ignores facts that place him on notice of a risk of misleading clients."), *aff'd*, 595 F.3d 1034 (9th Cir. 2010). In addition, Southwick's employment contract precluded him from committing CSSC to "any project, contract or engagement" without "conferring in advance with" Smith and "securing his prior advice and consent." Smith also cannot shift to others his responsibility to refrain from committing fraud. *See Dane S. Faber*, 57 S.E.C. 297, 309-10 (2004) (rejecting argument that respondent did not possess the scienter necessary to establish liability for fraudulent misrepresentations

and omissions when respondent argued that he relied on information provided by his firm).

We have no difficulty in finding that the requisite scienter existed here considering Smith's statements to investors about the supposed consulting agreement and its purported financial benefits to CSSC when there was no actual consulting agreement in place. It is simply implausible that Smith, who is CSSC's chairman, chief executive officer, majority owner, and a lawyer, did not know that he was deceiving investors. *See Vernazza*, 327 F.3d 851 at 860-61 & n.8. These circumstances go beyond mere recklessness and indicate a deliberate intent to defraud investors. *See John Edward Mullins*, Exchange Act Release No. 66373, 2012 SEC LEXIS 464, at *38 (Feb. 10, 2012) (finding that circumstantial evidence in the record lends further support to the conclusion individual acted with intent).

We also find Smith acted with scienter regarding his statements in the 2015 Bridge Loan Note Offering documents about CSSC's business with SDTC and the city of Jacksonville. Smith knew that CSSC had formed no "strategic alliance" with SDTC or client referral relationship and that there was no agreement in place for CSSC to be the investment advisor for SDTC's new investment funds. Instead, Smith had direct knowledge that discussions with SDTC had stalled. Likewise, in June 2015, when Smith first represented that CSSC was in the final stages of engagement with the city of Jacksonville to manage its \$ 1 billion in assets, CSSC had not sent the city such a proposal. When Smith drafted a proposal for the city in July 2015, CSSC's role was limited to providing a performance review of the city's

investment portfolio—a service that did not increase CSSC’s assets under management at all—for a \$15,000 quarterly fee. And as Smith acknowledged, the city never engaged CSSC.

We conclude that Smith failed to disclose material information and made material misrepresentations in connection with the offer and sale of the 2015 Bridge Loan Notes and he did so with scienter. As a result, Smith violated Exchange Act Section 10(b), Exchange Act Rule 10b-5, and FINRA Rules 2020 and 2010.¹⁴

4. Smith Acted Willfully and Is Statutorily Disqualified

We also affirm the Hearing Panel’s findings that Smith acted willfully when he made material misrepresentations and omissions with scienter, in violation of the Exchange Act and the rules promulgated thereunder. “A willful violation under the federal securities laws simply means ‘that the person charged with the duty knows what he is doing.’” *Robert D. Tucker*, Exchange Act Release No. 68210, 2012 SEC LEXIS 3496, at *41 (Nov. 9, 2012) (quoting *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000)); see also *Mathis v. SEC*, 671 F.3d 210, 216-18 (2d Cir. 2012) (explaining that “willfulness” does not require awareness that one “is violating one of the Rules or Acts,” and holding that a person may be subject to statutory disqualification under Section 3(a)(39) as long as he “intentionally submitted an application to register with a FINRA member knowing that the application contained

¹⁴ We decline to make any findings with respect to the alternative allegations in causes two and three of the complaint related to violations of Sections 17(a)(2) and (a)(3) of the Securities Act and FINRA Rule 2010.

material false information”); *Allen Holeman*, Exchange Act Release No. 86523, 2019 SEC LEXIS 1903, at *38 (July 31, 2019) (requiring “subjective intent” for a willful violation), *appeal docketed*, No. 19-1251 (D.C. Cir. Nov. 26, 2019).

Smith knew that CSSC was unable to pay investors in CSSC’s prior offerings but failed to disclose this key fact in the 2015 Bridge Loan Note Offering documents. He also was at least extremely reckless when he represented the imminent finalization of lucrative contracts with SDTC and the city of Jacksonville and that CSSC had earned a \$500,000 consulting fee through Project X. Consequently, Smith is subject to statutory disqualification. *See* Exchange Act Section 3(a)(39)(F) (incorporating by reference Exchange Act Section 15(b)(4)(D), which together provide that a person is subject to statutory disqualification if he has willfully violated any provision of, among other things, the Exchange Act and its rules and regulations); FINRA By-Laws, Article III Section 4 (providing that a person is subject to statutory disqualification if he is disqualified pursuant to Exchange Act Section 3(a)(39)).

B. Smith Acted as an Unregistered General Securities Representative and Principal

We also find that Smith violated FINRA’s registration rules because he acted as an unregistered general securities representative and principal while associated with CSSC BD, as alleged in causes four and five of Enforcement’s complaint. Smith has argued throughout these proceedings that FINRA lacks jurisdiction to bring this enforcement action

against him, asserting that he was not a “person associated with a member.” We disagree.

1. Smith Was an Associated Person Who Acted as an Unregistered General Securities Representative

NASD Rule 1031 provides that any person engaged in the securities business of a FINRA member firm and functioning as a “representative” must register with FINRA. NASD Rule 1031(b) defines a representative as a person “associated with a member . . . who [is] engaged in the investment banking or securities business for the member including the functions of supervision, solicitation or conduct of business in securities.” FINRA By-Laws define an associated person as a “natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by a member, whether or not any such person is registered or exempt from registration.” FINRA By-Laws, Art. I (rr). “FINRA has jurisdiction to discipline all associated persons of a member firm,” including Smith. *See Ottimo*, 2018 SEC LEXIS 1588, at *49; *see also Stephen Grivas*, Exchange Act Release No. 77470, 2016 SEC LEXIS 1173, at *14 n.15 (Mar. 29, 2016) (“There is no dispute that FINRA has jurisdiction over a registered representative associated with a member firm or that FINRA has jurisdiction to discipline associated persons.” (citing 15 U.S.C. § 78o-3(b), (h); FINRA By-Laws Articles V and XIII)); *Keilen Dimone Wiley*, Exchange Act Release No. 76558, 2015 SEC LEXIS 4952, at *11 (Dec. 4, 2015) (finding that FINRA has jurisdiction to discipline a person associated with a member firm and that an associated person’s “unethical

business-related conduct, even while performing insurance-related activities, falls under FINRA's jurisdiction"), *aff'd*, 663 F. App'x 353 (5th Cir. 2016).

Under FINRA's By-Laws, "investment banking or securities business" includes "the business, carried on by a broker . . . of underwriting or distributing issues of securities." FINRA By-Laws, Art. I(u). The Commission has interpreted the definition of associated person broadly, and has held that "FINRA has the authority to discipline associated persons who engage in misconduct in connection with their management of an investment fund where the misconduct is 'business-related . . . , even if that management was not of a FINRA member firm.'" *Ottimo*, 2018 SEC LEXIS 1588, at *49-50. Even clerical staff are included in the category of an associated person if their duties are part of the conduct of a firm's securities business. *See, e.g., Stephen M. Carter*, 49 S.E.C. 988, 989 (1988) (employee who worked as a "dealer cashier" was an associated person because he received checks and securities and entered them in the firm's computer system, prepared firm checks for signature in payment of customer balances, prepared deposit slips, and furnished account balances and other information to customers).

Smith asserts that he was not associated and "never knowingly consented to FINRA jurisdiction." Regardless of Smith's intentions, the evidence shows that he was associated with CSSC BD. In July 2006, as part of CSSC BD's new member application form ("Form NMA"), Smith acknowledged that he was

exempt from registration, and therefore an associated person, under NASD Rule 1060 when he stated:¹⁵

I understand that I will be permitted to be exempt from NASD securities registration requirements, without having to register either as a registered representative or as a principal, so long as I am not actively engaged in the management of the Firm's (CSSC Brokerage Services, Inc.) securities business, including the supervision, solicitation, conduct of business or the securities training of persons associated with the Firm. I understand that I will not be permitted to become active in the Firm's securities business until such time as I

¹⁵ NASD Rule 1060 stated:

(a) The following persons associated with a member are not required to be registered with the Association:

- (1) persons associated with a member whose functions are solely and exclusively clerical or ministerial;
- (2) persons associated with a member who are not actively engaged in the investment banking or securities business;
- (3) persons associated with a member whose functions are related solely and exclusively to the member's need for nominal corporate officers or for capital participation; and
- (4) persons associated with a member whose functions are related solely and exclusively to:
 - (A) effecting transactions on the floor of a national securities exchange and who are registered as floor members with such exchange;
 - (B) transactions in municipal securities;
 - (C) transactions in commodities; or
 - (D) transactions in security futures, provided that any such person is registered with a registered futures association.

have completed the registration as both an appropriately registered representative and principal as outlined in NASD Rules 1020-1032.

We find that Smith participated in the firm's securities business, evidencing that he was associated. "[O]ne whose functions are part of the conduct of a securities business is an associated person engaged in that business." *Bruce Zipper*, Exchange Act Release No. 84334, 2018 SEC LEXIS 2709, at *14 (Oct. 1, 2018) (internal quotation marks omitted). Smith contends that he did not conduct any securities business on behalf of CSSC BD and his participation in any securities sales was solely to raise money for CSSC as its chairman and chief executive officer. We reject Smith's unrealistic view of his activities. It is undisputed that Smith solicited CSSC BD's customers to invest in CSSC's debt offerings and sold these securities to some of these customers. Smith also created and distributed the offering documents to CSSC BD customers directly and through the firm's brokers, including Southwick for whom Smith prepared scripted solicitations. Southwick also introduced Smith to CSSC BD's customers for purposes of soliciting their investments in CSSC's offerings. *See Dep't of Enforcement v. Hedge Fund Capital Partners, LLC*, Complaint No. 2006004122402, 2012 FINRA Discip. LEXIS 42, at *24-25 (FINRA NAC May 1, 2012) (contacting potential investors and marketing hedge funds to them constituted investment banking or securities business requiring FINRA registration).

We also find that Smith's activities are part of the conduct of a securities business and made him not only an associated person, but that his active

participation required FINRA registration. “Activities requiring registration are a subset of those that constitute ‘associating’ with a FINRA member firm.” *Dep’t of Enforcement v. Dakota Sec. Int’l, Inc.*, Complaint No. 2016047565702, 2019 FINRA Discip. LEXIS 11, at *16-17 (FINRA NAC Mar. 18, 2019), *appeal docketed*, SEC Admin. Proceeding No. 3-19138 (Apr. 5, 2019). By engaging in these activities without proper FINRA registration, Smith violated NASD Rule 1031.

The functions of a registered representative include communicating with members of the public to determine their interest in making investments, discussing the nature or details of particular securities or investment vehicles, recommending the purchase or sale of securities, and accepting orders for the purchase or sale of securities. *Dist. Bus. Conduct Comm. v. Gallison*, Complaint No. C02960001, 1999 NASD Discip. LEXIS 8, at *52 (NASD NAC Feb. 5, 1999). Smith claims that he “had precluded CSSC-BD from becoming involved in the private offerings made by CSSC-Parent.” But the evidence shows that Smith orchestrated and directed the involvement of CSSC BD brokers and their customers in CSSC’s private offerings. For example, Martin introduced CSSC BD customer SK to the 2010 Bond Offering, but Smith finalized the \$375,000 investment. Smith also specifically asked Southwick whether CSSC BD customer JM, who had invested \$300,000 in the 2010 Bond Offering, would also invest in the 2014 Bridge Loan Note Offering. Smith directed Southwick not to recommend the investment outright, but rather to make his customers “aware” of the offering and to tell them he would “see if it could be made available.” Smith solicited CSSC BD customers to invest in

CSSC's offerings, disseminated the offering documents to CSSC BD brokers whom he directed to sell the securities, and obtained customer introductions from CSSC BD brokers in order to solicit the customers personally. Smith's activities fell within the definition of a representative and required appropriate registration. *See Zipper*, 2018 SEC LEXIS 2709, at *14; *Michael F. Flannigan*, 56 S.E.C. 8, 17-18 (2003) (affirming finding that firm and its president violated FINRA's registration rules by permitting unregistered individuals to solicit customers and confirm indications of interest for an initial public offering); *First Capital Funding, Inc.*, 50 S.E.C. 1026, 1028-30 (1992) (finding that member firm and its president violated FINRA's registration rules by permitting an unregistered individual to send pre-qualification forms with information regarding an investment to potential investors and that firm was "engaged at least in an 'attempt to induce' the purchase or sale of securities").

We affirm the Hearing Panel's finding that Smith participated in CSSC BD's securities business as a general securities representative and therefore violated NASD Rule 1031 and FINRA Rule 2010 by acting in this capacity without registration. "FINRA is empowered to bring disciplinary actions and impose sanctions to enforce its members' compliance with federal securities laws, SEC regulations, and FINRA's own rules and regulations." *Birkelbach v. SEC*, 751 F.3d 472, 475 (7th Cir. 2014). Thus, FINRA has the authority to discipline Smith for violating the antifraud provisions of the securities laws and FINRA's registration rules—regardless of whether he believed he was not associated at the time of the

misconduct. *See Ottimo*, 2018 SEC LEXIS 1588, at *49.

2. Smith Acted as an Unregistered Principal

In addition, Smith engaged in activities that required principal registration. NASD Rule 1021(a) requires that all individuals acting as principals register. The rule defines “principal” as an associated person who is “actively engaged in the management of the member’s . . . securities business, including supervision, solicitation, conduct of business or the training of persons associated with a member for any of these functions.” NASD Rule 1021(b). The definition of principal includes not only officers and directors of corporations who “actively engage[] in the management of the member’s investment banking or securities business,” but applies equally to others who engage in management or supervision. *NASD Notice to Members 99-49*, 1999 NASD LEXIS 24, at *2 (June 1999). An individual must register as a principal, when the individual is involved in the “day-to-day conduct of the member’s securities business and the implementation of corporate policies related to such business.” *Id.* (explaining that registration determination turns on the functions that an individual performs).

The evidence establishes that Smith was actively engaged in the management of CSSC BD’s securities business, which required Smith to register as a principal. *See, e.g., Gordon Kerr*, 54 S.E.C. 930, 938 (2000) (“[A] person acting in a supervisory capacity must be registered as a general securities principal.”). First, Smith recruited and hired registered representatives and officers of CSSC BD. Smith made the decisions to appoint LaRose and Martin as

co-presidents of CSSC BD and elevate LaRose as the firm's CCO. The NAC has found the selection and hiring of firm employees such as principals to reflect active management of a broker dealer. *Dep't of Enforcement v. Harvest Capital Invs., LLC*, Complaint No. 2005001305701, 2008 FINRA Discip. LEXIS 45, at *26-27 (FINRA NAC Oct. 2008); *see also Kirk A. Knapp*, 50 S.E.C. 858, 861 (1992) (considering that the applicant hired individuals in determining that applicant acted in a principal capacity).

Smith was central to the hiring and firing of registered representatives at the firm. When individuals became registered representatives, they also affiliated with all the various CSSC entities because Smith required them to sign an affiliation agreement. For example, Smith recruited, hired, and negotiated employment terms for CSSC BD representatives Wheeler, Ken Bryant, and Southwick. LaRose testified that she never hired or fired a CSSC BD registered representative without first discussing it with Smith. The affiliation agreement gave Smith the authority to terminate the employment relationship if an employee willfully failed to comply with Smith's directive. And it was Smith who fired Southwick. The hiring and firing of a firm's personnel are activities that favor principal registration. *See Dennis Todd Lloyd Gordon*, Exchange Act Release No. 57655, 2008 SEC LEXIS 819, at *28-29 (Apr. 11, 2008) (determining that employee's hiring and firing of firm's registered representatives supports that employee acted as unregistered principal); *Richard F. Kresge*, Exchange Act Release No. 55988, 2007 SEC LEXIS 1407, at *50 (June 29, 2007) (finding that employee's active

involvement in firm's hiring demonstrates that employee acted as unregistered principal).

And it was Smith who made financial decisions for CSSC BD, including directing the maintenance of its minimum net capital and controlling the payments of salaries and commissions to firm personnel. Smith controlled when CSSC BD would receive money from CSSC. LaRose testified that if an employee of the broker-dealer had a question about a salary deferral, she directed the employee to Smith. When CSSC BD needed money in order to meet its net capital requirement, CSSC's assistant controller, MD communicated with Smith—not Martin or LaRose. She told Smith that CSSC BD “desperately needs to be paid the \$20,000 that it is owed from the RIA for December” and was “only \$874 over the notification threshold” when it would fall below its minimum net capital requirement. MD explained that because CSSC BD owed CSSC more than \$83,000 for the December 2014 rent, CSSC BD would fail to maintain its required level of net capital unless Smith offset the rent with other revenue. Smith told MD which bill payments to prioritize and Smith ensured that CSSC RIA diverted funds to enable the broker dealer to maintain minimum net capital. When the firm's auditors had concerns about whether CSSC BD could continue as a going concern, they contacted Smith. Control of a firm's finances is an activity that suggests that an associated person is actively engaged in a firm's securities business and should register as a principal. *See Kresge*, 2007 SEC LEXIS 1407, at *50 (finding that employee's “substantial role” in firm's finances supports that employee acted as unregistered principal); *Vladislav Steven Zubkis*, 53 S.E.C. 794, 799-800 (1998) (explaining that

applicant's financial support of firm, including payment of firm expenses such as rent, telephone charges, and compensation of brokers, evidences need for principal registration); *Harvest*, 2008 FINRA Discip. LEXIS 45, at *27 (controlling firm checking account and making financial decisions for firm is an example of activities requiring principal registration). Smith also was involved in selecting CSSC BD's clearing firm. *Cf. Harvest*, 2008 FINRA Discip. LEXIS 45, at *27-28 (negotiating potential clearing agreements on behalf of firm was activity that demonstrated that an individual acted in a principal capacity).

LaRose and Martin as co-presidents answered directly to Smith and acted on behalf of CSSC BD at Smith's direction. *See Harvest*, 2008 FINRA Discip. LEXIS 45, at *27. Martin testified that his "hands-on work" as co-president was "fairly small."¹⁶ Martin admitted that he "relied on other people to do a lot of the hands-on work," and that "people might have" seen his role as "in title only." Smith's wide-ranging involvement even included suitability reviews of CSSC BD customers' purchases of CSSC's offerings and the handling of broker dealer customer complaints. LaRose testified that when CSSC BD customer, SM, complained to the broker dealer about her investment in one of the CSSC offerings, LaRose consulted with Smith. Smith informed LaRose that SM's principal was due but unpaid and that he would speak with SM. LaRose informed SM that she should work with CSSC directly to resolve her complaint.

¹⁶ In addition to co-president of the broker dealer, Martin was president of CSSC's insurance subsidiary and a senior consultant for CSSC RIA.

Smith told LaRose that he had prepared a memo in anticipation of additional complaints that would be sent to the other broker dealer customers who had invested in CSSC's offerings.

Smith argues that he was engaged in these activities solely in his capacity as chairman and chief executive officer of CSSC. The evidence shows, however, that he was deeply involved in CSSC BD's securities business and does not support Smith's limited view of his activities. While, for example, an officer of a broker-dealer's parent corporation who sits on the board of directors of the broker-dealer and is not actively engaged in the management of the broker-dealer is considered an outside director and does not need to be registered, that is not the case here. The ⁶ In addition to co-president of the broker dealer, Martin was president of CSSC's insurance subsidiary and a senior consultant for CSSC RIA. record shows that although Smith was not registered as a principal, he controlled CSSC BD and was actively engaged in the management of the firm's securities business. *See Dep't of Enforcement v. Gallagher*, Complaint No. 2008011701203, 2012 FINRA Discip. LEXIS 61, at *10-11 (FINRA NAC Dec. 12, 2012) (finding respondent acted as unregistered principal through his activities including hiring, firing, and supervision and his ownership and control of the broker-dealer's parent company).

Consequently, we find that Smith engaged in activities requiring principal registration, and that he violated NASD Rule 1021 and FINRA Rule 2010.

V. Sanctions

For Smith's fraudulent omission and misrepresentations of material facts, the Hearing Panel barred Smith and ordered that he pay \$130,000 in restitution (joint and several with CSSC BD) to the four investors in the 2015 Bridge Loan Note Offering. The Hearing Panel recommended, but declined to impose, additional sanctions for Smith's registration violations, in light of the bar. For the reasons set forth below, we affirm the bar and restitution order. We also assess, but do not impose, additional sanctions for Smith's violations of FINRA's registration rules.

A. Fraudulent Omissions and Misrepresentations of Material Facts

In assessing sanctions, we consider FINRA's Sanction Guidelines ("Guidelines"), including the Principal Considerations in Determining Sanctions and any other case-specific factors. Fraud violations are "especially serious and subject to the severest of sanctions under the securities laws." *See Marshall E. Melton*, 56 S.E.C. 695, 713 (2003). The Guidelines for intentional or reckless omissions or misrepresentations of material fact therefore recommend that we strongly consider barring an individual respondent, unless mitigating factors predominate.¹⁷

We conclude that there are numerous aggravating factors, and no mitigating factors, that support a decision to bar Smith for his fraud. Smith engaged in

¹⁷ *See FINRA Sanction Guidelines* 89 (2019), http://www.finra.org/sites/default/files/Sanctions_Guidelines.pdf [hereinafter *Guidelines*]. They also recommend a fine of \$10,000 to \$155,000. *Id.*

numerous acts of fraud over an extended period involving several investors who lost the entirety of their investments.¹⁸ By his own admission, Smith solicited a minimum of 15 people to invest in the 2015 Bridge Loan Note Offering. Of those, four people invested \$130,000 in the offering in which Smith misrepresented and failed to disclose the material facts. Smith intentionally failed to disclose the critical fact that CSSC owed prior investors hundreds of thousands of dollars that it could not repay.¹⁹ The evidence shows that Smith was desperate to raise funds for CSSC, which was struggling to pay its employees and remain viable.

In addition, Smith knew or was reckless in not knowing that his representations about CSSC's financial prospects resulting from Project X and CSSC's business with the SDTC and the city of Jacksonville were unfounded and would persuade investors to purchase the 2015 Bridge Loan Note Offering.²⁰ See, e.g., *Mitchell H. Fillet*, Exchange Act Release No. 75054, 2015 SEC LEXIS 2142, at *14-15 (May 27, 2015) (finding respondent acted recklessly, which served to aggravate sanctions, when drafting an offering term sheet knowing that it contained inaccurate descriptions subject to contingencies that had not yet occurred and failing to alert investors to the contingencies); *Gomez*, 2018 FINRA Discip. LEXIS 10, at *51 ("Under these circumstances, Gomez's "refusal to see the obvious, or to investigate

¹⁸ See *Guidelines*, at 7 (Principal Considerations in Determining Sanctions Nos. 8, 9, 11).

¹⁹ See *id.* at 8 (Principal Considerations in Determining Sanctions, No. 13).

²⁰ See *id.*

the doubtful,’ gives rise to an inference of reckless misconduct.”). Even after Smith fired Southwick in September 2015, Smith continued to solicit investors when it was obvious that his claims in the offering materials touting Project X and the purportedly pending engagements with SDTC and the city of Jacksonville were false.

In November 2015, one of the four investors, TL, requested a refund from Smith of his \$50,000 investment after he had not received documents related to his investment that he made in August 2015. TL stated that his “trust has been seriously shaken.” Smith told TL that he had “no present ability” to refund his money and attempted to assuage TL’s concerns by claiming without support that CSSC’s assets “far exceed” CSSC’s total debt. Smith’s fraudulent omission and misrepresentations resulted not only in the potential for monetary gain, but \$130,000 in actual gain for Smith and CSSC for his sales to the four investors.²¹

We are also troubled by Smith’s blaming of others for his own misrepresentations related to the 2015 Bridge Loan Note Offering.²² *See also John B. Busacca, III*, Exchange Act Release No. 63312, 2010 SEC LEXIS 3787, at *63 (Nov. 12, 2010) (aggravating for purposes of sanctions that representative blamed others for his own misconduct), *aff’d*, 449 F. App’x 886 (11th Cir. 2011); *Janet Gurley Katz*, Exchange Act Release No. 61449, 2010 SEC LEXIS 994, at *69 (Feb. 1, 2010) (“Katz cannot shift the blame for her

²¹ *See Guidelines*, at 8 (Principal Considerations in Determining Sanctions, No. 16).

²² *See id.* at 7 (Principal Considerations in Determining Sanctions, No. 2).

violations to others or claim that others' misconduct somehow excuses her own misdeeds"), *aff'd*, 647 F.3d 1156 (D.C. Cir. 2011). Throughout these proceedings, Smith blamed Southwick and denied his own responsibility despite ample evidence of Smith's direct involvement and control over the offering. Smith ignored the high standards of conduct that FINRA expects in the sale of privately placed securities. *See FINRA Regulatory Notice 10-22*, 2010 FINRA LEXIS 43, at *4-5 (Apr. 2010). Smith defrauded investors and his "conduct demonstrates a fundamental unfitness for association in the securities industry." *See Akindemowo*, 2016 SEC LEXIS 3769, at *39.

We also determine that restitution is an appropriate remedy in this case. Restitution may be appropriate when an "identifiable person" otherwise would unjustly suffer "quantifiable loss proximately caused by a respondent's misconduct."²³ "An order requiring restitution . . . seeks primarily to return customers to their prior positions by restoring the funds of which they were wrongfully deprived." *Newport Coast Sec. Inc.*, Exchange Act Release No. 88548, 2020 SEC LEXIS 911, at *37 (Apr. 3, 2020). Although the Commission and courts have not adopted a single approach to proximate causation, we agree with the Hearing Panel's determination that the losses suffered by the four investors in the form of the full amount of their investment in the 2015 Bridge Loan Note Offering were the foreseeable, direct, and proximate result of Smith's fraud. *See id.*; *McGee*, 2016 FINRA Discip. LEXIS 33, at *79. Smith used

²³ *Guidelines*, at 4 (General Principles Applicable to All Sanction Determinations, No. 5).

CSSC BD as one way to obtain investors and the firm shared liability with Smith for the fraudulent misconduct. We therefore order Smith to pay restitution, jointly and severally, with CSSC BD, to the four investors in the amounts set forth below in footnote 24 plus prejudgment interest until paid in full.²⁴ See *Newport*, 2020 SEC LEXIS 911, at *38 n.112 (finding when “there are multiple parties liable for misconduct, it was appropriate to impose that obligation on respondents jointly and severally”).

Accordingly, we bar Smith from associating with any FINRA member in any capacity for violating Exchange Act Section 10(b), Exchange Act Rule 10b-5, and FINRA Rules 2020 and 2010 and order that he pay restitution to the four purchasers of the 2015 Bridge Loan Notes.

²⁴ Prejudgment interest shall be paid at the rate established for the underpayment of income taxes in Section 6621(a) of the Internal Revenue Code, 26 U.S.C. § 6621(a). *Guidelines*, at 11; see *McGee*, 2016 FINRA Discip. LEXIS 33 at *80. The restitution amount for each investor is as follows: TL, \$50,000, with interest accruing from August 24, 2015; Thomas Scotto, \$20,000, with interest accruing from August 31, 2015; BB, \$10,000, with interest accruing from September 29, 2015; and Gavin Clarkson, \$50,000, with interest accruing from November 13, 2015. If Smith is unable to locate an investor, he must provide Enforcement with proof that he has made a bona fide attempt to locate the investor. The Hearing Panel ordered that if Smith cannot locate an investor, Smith is to pay the restitution owed to FINRA as fine. We disagree with this approach and order instead that if investors cannot be located, unpaid restitution should be paid to the appropriate escheat, unclaimed property, or abandoned property fund for the states of the investors’ last known residences. See *Guidelines*, at 11.

B. Registration Violations

For registration violations, the Guidelines recommend imposing a fine of \$2,500 to \$77,000 and suspending the individual in any or all capacities for up to six months.²⁵ In egregious cases, the Guidelines recommend a lengthier suspension of up to two years, or a bar.²⁶ In assessing sanctions for registration violations, the Guidelines advise adjudicators to consider whether the respondent has filed an application for registration and the nature and extent of the unregistered respondent's responsibilities.²⁷

Smith's registration violations were egregious. Smith actively engaged in a multitude of activities as a principal and representative despite his lack of registration. Smith deliberately ignored the requirements of the registration rules.²⁸ Smith knew that he was required to register as a principal in order to manage CSSC BD's day-to-day securities business. Smith acknowledged in the Form NMA that he was exempt from registration *only if* he was not actively engaged in the firm's management. The record shows, however, that Smith was active in most every aspect of firm management: the hiring and firing of firm staff; appointing officers; overseeing and unilaterally controlling the firm's finances; channeling money from the RIA to the firm to maintain minimum net capital; responding to firm auditors about the broker dealer's ability to continue

²⁵ *Guidelines*, at 45.

²⁶ *Id.*

²⁷ *Id.*

²⁸ *Id.* at 8 (Principal Considerations in Determining Sanctions, No. 13).

as a going concern; conducting suitability reviews; and responding to firm customer complaints. Smith appointed Martin and LaRose as co-presidents largely in name only when it was Smith who actively managed the firm and its employees. Smith's misconduct spanned the duration of the review period, occurring for more than five years.²⁹

Smith also acted as a representative without oversight when he directly, and through other CSSC BD representatives, solicited firm customers to invest in CSSC's debt offerings. These solicitations resulted in some firm customers investing in CSSC offerings and provided CSSC with much needed cash infusions. Thus, Smith had the potential for monetary gain from these investments that served to keep his business afloat.³⁰

As the Hearing Panel found, Smith chose not to register in order to conduct business through CSSC BD while attempting to avoid the appearance of doing so. At every turn, Smith has refused to accept any responsibility for his conduct.³¹ *See Hans N. Beerbaum*, Exchange Act Release No. 55731, 2007 SEC LEXIS 971, at *18 (May 9, 2007) (explaining respondent's "conduct and statements raise significant uncertainty about his willingness to comply with registration and other regulatory requirements in the future"). FINRA's "registration requirement provides an important safeguard in protecting public investors

²⁹ *Id.* at 7 (Principal Considerations in Determining Sanctions, No. 9).

³⁰ *Id.* at 8 (Principal Considerations in Determining Sanctions, No. 16).

³¹ *Id.* at 7 (Principal Considerations in Determining Sanctions, No. 2).

and strict adherence to that requirement is essential.” See *Flannigan*, 56 S.E.C. at 17 (internal quotation marks omitted). We are particularly troubled by Smith’s wide-ranging actions as an unregistered principal. As the Commission has observed, “the registered principal is the person at a broker-dealer to whom [FINRA] looks to ensure compliance with regulatory requirements.” *Beerbaum*, 2007 SEC LEXIS 971, at *14 (internal quotation marks omitted); see *Douglas Conrad Black*, 51 S.E.C. 791, 794 (1993). And that “regulatory compliance is dependent, to a significant degree, on the qualifications of the principal, and those qualifications are assessed through the examination process,” a process that Smith conveniently and impermissibly circumvented. See *Beerbaum*, 2007 SEC LEXIS 971, at *14.

Accordingly, we modify the Hearing Panel’s sanctions for Smith’s registration violations to reflect the seriousness and degree of Smith’s activities as an unregistered principal.³² For acting as an unregistered principal, we fine Smith \$75,000 and suspend him in all capacities for two years. For acting as an unregistered representative, we fine Smith an additional \$50,000 and concurrently suspend him for one year in all capacities. In light of the bar for fraud, however, we decline to impose these additional sanctions for Smith’s registration violations.

³² For acting as an unregistered principal, the Hearing Panel assessed a \$50,000 fine and a one-year suspension in all capacities. For acting as an unregistered general securities representative, the Hearing Panel assessed a \$50,000 fine and a one-year concurrent suspension in all capacities.

VI. Conclusion

We find that Smith fraudulently failed to disclose and misrepresented material facts to investors, in violation of Section 10(b) of the Exchange Act, Exchange Act Rule 10b-5, and FINRA Rules 2020 and 2010. We also find that Smith acted as an unregistered representative and principal, in violation of NASD Rules 1021 and 1031 and FINRA Rule 2010. Accordingly, we bar Smith from associating with any FINRA member in any capacity for his fraud and order that he shall pay to the affected investors as set forth in footnote 24 above, restitution totaling \$130,000, jointly and severally with CSSC BD. The bar is effective immediately upon issuance of this decision. In light of the bar, we assess but do not impose additional sanctions for Smith's registration violations. We also affirm the Hearing Panel's order that Smith pay hearing costs, jointly and severally with CSSC BD, of \$12,107.09 and impose appeal costs of \$1,283.

On behalf of the National
Adjudicatory Council,

/s/ Jennifer Piorko Mitchell

Jennifer Piorko Mitchell, Vice
President and Deputy Corporate
Secretary

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No. 24-3907

FILED Jul 16, 2026 KELLY L. STEPHENS, Clerk

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

ERIC S. SMITH,	)	
Petitioner,	)	
v.	)	
UNITED STATES	)	ORDER
SECURITIES AND	)	
EXCHANGE	)	
COMMISSION,	)	
Respondent,	)	
FINANCIAL INDUSTRY	)	
REGULATORY	)	
AUTHORITY, INC.,	)	
Intervenor.	)	
	)	

BEFORE: READLER, MURPHY, and
BLOOMEKATZ, Circuit Judges.

The court received a petition for rehearing en banc. The original panel has reviewed the petition for rehearing and concludes that the issues raised in the petition were fully considered upon the original submission and decision of the case. The petition then

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was circulated to the full court.* No judge has requested a vote on the suggestion for rehearing en banc.

Therefore, the petition is denied.

**ENTERED BY ORDER OF THE
COURT**

s/ *Kelly L. Stephens*
Kelly L. Stephens, Clerk

* Judge Larsen is recused in this case.

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No. 24-1189

FILED Aug 5, 2024 KELLY L. STEPHENS, Clerk
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UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

In re: ERIC S. SMITH,	)	
Petitioner.	)	<u>O R D E R</u>
	)	

BEFORE: STRANCH, BUSH, and MATHIS,
Circuit Judges.

Eric S. Smith petitions for a writ of mandamus directing the Securities and Exchange Commission to rule on his October 2020 appeal from a September 2020 decision by the Financial Industry Regulatory Authority (“FINRA”) National Adjudicatory Counsel (“NAC”). That decision affirmed a FINRA hearing panel’s decision to bar Smith from the industry for life because it determined he violated Section 10(b) of the Securities and Exchange Act of 1934.

“[We have] jurisdiction under the All Writs Act to issue writs, including writs of mandamus, in aid of our jurisdiction.” *In re Sutton*, 652 F.3d 678, 679 (6th Cir. 2011) (per curiam) (citing 28 U.S.C. § 1651). That jurisdiction includes the authority to compel the SEC to act. 5 U.S.C. § 706(1); *see also* 15 U.S.C. § 78y(a)(1) (providing for direct review by the courts of appeals of SEC decisions on applications for review); *In re Howard*, 570 F.3d 752, 756 (6th Cir. 2009)

(recognizing the authority to compel agency action when such action would be reviewable in this court). Indeed, federal law mandates that courts “compel agency action unlawfully withheld or unreasonably delayed.” 5 U.S.C. § 706(1).

When examining an agency’s delay, we consider, among other things, whether the agency has been given reasonable time to make decisions, whether “human health and welfare are at stake,” and “the nature and extent of the interests prejudiced by delay[.]” *Barrios Garcia v. U.S. Dep’t of Homeland Sec.*, 25 F.4th 430, 451–52 (6th Cir. 2022) (quoting *Telecomms. Rsch. & Action Ctr. v. FCC*, 750 F.2d 70, 80 (D.C. Cir. 1984)). These considerations support Smith.

SEC Rule of Practice 900 presumes that decisions on applications for review from FINRA decisions “will be issued within eight months from the completion of briefing,” or ten months “[i]f the Commission determines that the complexity of the issues presented . . . warrants additional time.” 17 C.F.R. § 201.900(a)(1)(iii). The parties completed briefing on Smith’s application more than 39 months ago. Smith’s lifetime bar puts his individual welfare and reputation at stake, and the ongoing delay hinders his ability to earn a living. Meanwhile, the SEC has granted itself ten discretionary extensions of time totaling more than 900 days. Because there is no obvious explanation for the significant delay, a response from the SEC would assist the court in resolving this mandamus petition.

Accordingly, Respondent Securities and Exchange Commission is **ORDERED** to respond to the petition within thirty (30) days of the date of this order. Fed.

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R. App. P. 21(a)(1), (b)(1). Thereafter, the mandamus petition will be resubmitted to the court.

ENTERED BY ORDER OF THE
COURT

s/ *Kelly L. Stephens*
Kelly L. Stephens, Clerk

15 U.S.C. § 78y

§ 78y. Court review of orders and rules**(a) Final Commission orders; persons aggrieved; petition; record; findings; affirmance, modification, enforcement, or setting aside of orders; remand to adduce additional evidence**

(1) A person aggrieved by a final order of the Commission entered pursuant to this chapter may obtain review of the order in the United States Court of Appeals for the circuit in which he resides or has his principal place of business, or for the District of Columbia Circuit, by filing in such court, within sixty days after the entry of the order, a written petition requesting that the order be modified or set aside in whole or in part.

(2) A copy of the petition shall be transmitted forthwith by the clerk of the court to a member of the Commission or an officer designated by the Commission for that purpose. Thereupon the Commission shall file in the court the record on which the order complained of is entered, as provided in section 2112 of title 28 and the Federal Rules of Appellate Procedure.

(3) On the filing of the petition, the court has jurisdiction, which becomes exclusive on the filing of the record, to affirm or modify and enforce or to set aside the order in whole or in part.

(4) The findings of the Commission as to the facts, if supported by substantial evidence, are conclusive.

(5) If either party applies to the court for leave to adduce additional evidence and shows to the satisfaction of the court that the additional evidence

is material and that there was reasonable ground for failure to adduce it before the Commission, the court may remand the case to the Commission for further proceedings, in whatever manner and on whatever conditions the court considers appropriate. If the case is remanded to the Commission, it shall file in the court a supplemental record containing any new evidence, any further or modified findings, and any new order.

* * *

**(c) Objections not urged before Commission;
stay of orders and rules; transfer of
enforcement or review proceedings**

(1) No objection to an order or rule of the Commission, for which review is sought under this section, may be considered by the court unless it was urged before the Commission or there was reasonable ground for failure to do so.

* * *

29 U.S.C. § 160**§ 160. Prevention of unfair labor practices**

* * *

(e) Petition to court for enforcement of order; proceedings; review of judgment

The Board shall have power to petition any court of appeals of the United States, or if all the courts of appeals to which application may be made are in vacation, any district court of the United States, within any circuit or district, respectively, wherein the unfair labor practice in question occurred or wherein such person resides or transacts business, for the enforcement of such order and for appropriate temporary relief or restraining order, and shall file in the court the record in the proceedings, as provided in section 2112 of title 28. Upon the filing of such petition, the court shall cause notice thereof to be served upon such person, and thereupon shall have jurisdiction of the proceeding and of the question determined therein, and shall have power to grant such temporary relief or restraining order as it deems just and proper, and to make and enter a decree enforcing, modifying and enforcing as so modified, or setting aside in whole or in part the order of the Board. No objection that has not been urged before the Board, its member, agent, or agency, shall be considered by the court, unless the failure or neglect to urge such objection shall be excused because of extraordinary circumstances. The findings of the Board with respect to questions of fact if supported by substantial evidence on the record considered as a whole shall be conclusive. If either party shall apply to the court for leave to adduce additional evidence and shall show to the satisfaction of the court that

such additional evidence is material and that there were reasonable grounds for the failure to adduce such evidence in the hearing before the Board, its member, agent, or agency, the court may order such additional evidence to be taken before the Board, its member, agent, or agency, and to be made a part of the record. The Board may modify its findings as to the facts, or make new findings by reason of additional evidence so taken and filed, and it shall file such modified or new findings, which findings with respect to questions of fact if supported by substantial evidence on the record considered as a whole shall be conclusive, and shall file its recommendations, if any, for the modification or setting aside of its original order. Upon the filing of the record with it the jurisdiction of the court shall be exclusive and its judgment and decree shall be final, except that the same shall be subject to review by the appropriate United States court of appeals if application was made to the district court as hereinabove provided, and by the Supreme Court of the United States upon writ of certiorari or certification as provided in section 1254 of title 28.

* * *