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**IN THE DISTRICT COURT IN AND
FOR OKLAHOMA COUNTY, OKLAHOMA**

SOUTHEAST INVESTMENTS, N.C. INC.,)
A NORTH CAROLINA CORPORATION; and)
FRANK H. BLACK,)
)
Plaintiffs/Petitioners,)

vs.)

Case No. CV-2015-86.

THE STATE OF OKLAHOMA *ex rel.*)
THE OKLAHOMA SECURITIES COMMISSION)
)
Defendant.)

PETITIONERS' OPENING BRIEF

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PETITIONERS' OPENING BRIEF

In accordance with the Court’s Scheduling Order filed herein on August 11, 2015, Petitioners Southeast Investments, N.C. Inc. and Frank H. Black (collectively “Petitioners” and individually, “Southeast” and “Black”) file this opening brief. For the reasons set forth herein, the order of the Oklahoma Securities Commission dated December 22, 2014 (“OSC Order”), from which this appeal is taken, should be reversed.

I. SUMMARY OF THE RECORD AND SUMMARY OF ARGUMENT

A. APPEAL JURISDICTION OF THIS COURT AND STANDARD OF REVIEW

Jurisdiction

This is an appeal from the OSC Order. Jurisdiction is conferred by 71 O.S. § 1-609(B) because such order affirms a cease and desist order of the OSC Administrator directed to Petitioners. The OSC Order also levies a monetary penalty. An appeal of the monetary penalty has been taken to the Oklahoma Supreme Court, as also provided by § 1-609(B).

Standard of Review

Under the Oklahoma Administrative Procedures Act, 75 O.S. §§ 250 to 323 (“APA”), the reviewing court (whether an appellate court or this Court) may not re-weight the evidence on appeal, but will reverse an agency decision on the factual record if that decision is not supported by “substantial evidence.” *City Of Hugo v. State Ex Rel. Public Emp. Rels. Bd.*, 1994 OK 134 at ¶¶ 9-10, 886 P. 2d 485, 490 (“Substantial evidence is more than a scintilla of evidence. It possesses something of substance and of relevant consequence that induces conviction and may lead reasonable people to fairly differ on whether it establishes a case”). Arbitrary and capricious decisions - decisions that are “willful and unreasonable” or “unreasoning . . . in disregard of facts and circumstances.” – will be reversed. *Glover v. Okla. DOT*, 2011 OK CIV APP 62 at ¶ 10, 259 P.3d 872, 876 (citing cases). Where *facts* are not in dispute (as is largely the case in this appeal), i.e., where the issues are pure issues of law or of the application of law to undisputed facts, this Court’s review is *de novo*. *Id* at ¶ 10, 259 P.3d at 876 (citing multiple cases). Finally, as discussed at length in Proposition II.A *infra*, the APA expressly prohibits an agency from exceeding its constitutional or statutory authority. 75 O.S. § 322(a) and 322(b).

B. ABSTRACT OF PROCEDURAL HISTORY¹

The OSC Order orders Southeast and Black to “cease and desist” from certain practices described therein and discussed in this brief. As discussed in Part I.D below, both Southeast and Black were, as a practical matter, secondary or “vicarious” respondents in the original proceeding brought by the Oklahoma Department of Securities (“ODS” or “the Department”).

¹ To help the Court navigate through the many acronyms and abbreviations contained herein, Petitioners have attached a Glossary of Terms. Such abbreviations and acronyms are also shown parenthetically after the first usage of each in the body of this brief.

The final OSC decision disposing of the third of three related Department recommendations has resulted in this appeal. The first such proceeding was commenced by the ODS on the recommendation of its Enforcement Division on March 29, 2012 styled as: “In the Matter of: Rodney Larry Watkins, Jr.” (the “3-29-12 Recommendation”). *See* Record of Appeal (“ROA”), Tab 61, Ex. 2. The 3-29-12 Recommendation recommended a suspension of Watkins based on his actions while he was employed by Financial Services, Inc. (“AFS”). The original ODS file number (ODS 12-058) was carried forward in all of the proceedings before the ODS Administrator. The proceeding initiated by the 3-29-12 Recommendation culminated in an agreement and six-month suspension of Watkins. ROA, Tab 61 Ex. 3 (agreement) and Ex. 4 (related order).

The Department named Southeast and Black as additional Respondents in its “Supplemental Recommendation” of March 26, 2013 (“the 3-26-13 Recommendation”). ROA Tab 1. The 3-26-13 Recommendation alleged that Watkins had violated the August 29, 2012 agreement by executing securities orders from the State of Oklahoma on behalf of customers in Kansas and Texas. The Department and Watkins settled the issues raised in the 3-26-13 Recommendation on April 30, 2014. ROA, Tab 33.

On June 20, 2014, the Department submitted a third recommendation styled “Supplemental Enforcement Division Recommendation” (the “6-20-14 Recommendation”) seeking (i) permanent suspension of Southeast and Black and (ii) levying of a \$65,000.00 fine. ROA, Tab 41. The 6-20-14 Recommendation alleged, for the first time, system-wide failures by Southeast to supervise its agents adequately and failure to update information to the Central Registration Depository (“CRD”) maintained by the Financial Industry Regulatory Authority (“FINRA”). The ODS Administrator ruled on the 6-20-14 Recommendation in the

Administrator's Final Order of October 10, 2014 ("the Administrator's Final Order"). He ordered Petitioners to "cease and desist from their violations of the [Oklahoma Securities Act]" and levied a \$5,000.00 fine. ROA, Tab 56. The full OSC affirmed the cease-and-desist order contained within the Administrator's Final Order.

C. ISSUES PRESENTED

1. Whether the OSC Order exceeds the Commission's statutory authority and jurisdiction and hence must be reversed under 75 O.S. § 322(1)(b).
2. Whether the OSC Order is affected by error of law within the meaning of 75 O.S. § 322(1)(d) and hence must be reversed.
3. Whether the Final Order was (a) clearly erroneous in view of the reliable, material, probative, and substantial competent evidence presented to the OSC and/or (b) was arbitrary and capricious, and hence must be reversed under 75 O.S. § 322(1)(e) and/or 12 O.S. § 322(1)(f).

D. STATEMENT OF FACTS

As noted in Part B above, these proceedings commenced with the filing of the 3-29-12 Recommendation. The background facts that gave rise to that filing and the events that have transpired since are recounted below.

The original Department suspension recommendation

Watkins was registered as a broker-dealer agent and an investment adviser representative with Ameriprise Financial Services, Inc. ("AFS") from March 2009 to October 2011. AFS suspended Watkins for practices that did not involve misappropriation or dishonesty of any kind and that did not involve any customer loss or customer complaint. Watkins resigned from AFS and subsequently was employed by Southeast. On February 24, 2012, he filed an application for

broker-dealer agent registration under the Oklahoma Securities Act of 2004 (“Act”), Okla. Stat. tit. 71 §§ 1-101 through 1-701 (2011). Upon review of Watkins’ application, the ODS Examinations Division discovered the record of Watkins’ suspension by AFS. This review apparently triggered the commencement of the original March, 2012 proceeding, with the ODS Enforcement Division recommending that the Administrator bar Watkins from registration under the Act in any capacity and impose a civil penalty against him. While his application was pending with the ODS, Watkins was approved as a broker-dealer agent by FINRA and the States of California, Kansas and Texas. All of those regulators had access to the same information that the ODS possessed.

The agreed, retroactive suspension

The ODS reinstated Watkins on August 29, 2012. By Agreement entered into that date with the Department, Watkins represented that he had not offered or sold a security or transacted securities business in and/or from the State of Oklahoma “as a broker-dealer, broker-dealer agent, issuer agent, investment adviser, and/or investment adviser representative . . .” ROA, Tab 61, at Exs. 3 and 4 (Agreement and Order incorporating Agreement).

Watkins’ association with Southeast and non-Oklahoma activities

Watkins joined Southeast in the first quarter of 2012. His association with Southeast as its agent received FINRA approval on February 14, 2012, California Securities Commission approval on February 27, 2012, Kansas Securities Commission approval on February 28, 2012, and Texas Securities Commission approval on March 8, 2012. Watkins has never been suspended or disciplined by any state regulators other than the ODS.²

² The facts stated in this paragraph were included in Respondents’ August 29, 2014 filing with the Administrator (ROA, Tab 54 at p. 4), but not verified by affidavit. Respondents understand and believe that the Department does not contest such facts.

Watkins worked out of his sister's home in Texas -- a state where he was duly licensed at all relevant times -- between May 11, 2012 and September 9, 2012. See ROA at Tab 10. During that five-month period, Watkins placed a total of nineteen buy or sell orders for seven clients who resided in either Texas or Kansas. Watkins conducted no securities business anywhere from September 9, 2012 until April 30, 2014, when he was reinstated in Oklahoma. See ROA, Tab 54, Ex. "C," at deposition pages 90-117 (customer Alprin); Vol. 2, pp. 22-28 (customer Lewis); 33-40 (customer Payne); 41-46, 49-50 (customer Walker); 52, line 11 to 53, line 23 (customer Williams); 58-60 (customer Ronica Watkins) and 65-67 (Watkins' affidavit regarding non-Oklahoma customers generally); Record at Tab 10, Exs 2 through 8 (Southeast customer affidavits, showing the latest securities transaction in September, 2012) and Record at Tab 33 (April 30, 2014 Agreement).

In what appears to Petitioners to be a mistaken assumption, the ODS Enforcement Division filed the "supplemental" 3-26-13 Recommendation. The 3-26-13 Recommendation named Southeast and Black as additional Respondents. ROA at Tab 1. The assumption reflected by that ODS action was this: because Watkins resided in Tulsa and maintained a general financial services office there, securities transactions consummated during Mr. Watkins' Oklahoma suspension necessarily occurred in Oklahoma. Watkins, his wife and office-mate Sharmien Watkins, and his Southeast Securities colleague Lamar Guillory all testified that Watkins had transacted no business in Oklahoma during the suspension period. In addition, the record below includes the affidavits of Watkins' customers during this period corroborating that testimony. The record below reflects that the Department proffered no probative evidence to the

contrary.³ Upon that record, the ODS settled its claims with Watkins on April 30, 2014. ROA, Tab 33. *See generally*, ROA, Tabs 10 and 16 (Petitioners' briefs relating to extraterritorial jurisdiction) and Note 6 *infra*.

Almost fourteen months after commencement of the ODS proceeding that alleged that Black and Southeast had failed to supervise Watkins properly, the Department deposed Southeast through its principal, Black. Some three weeks after the Black deposition, the Department filed the 6-20-14 Recommendation (the *third* recommendation in the series of ever-evolving allegations). That filing amounted to an entirely new proceeding against Southeast and Black and the same occurred less than six (6) days before the scheduled evidentiary hearing in No. 12-058. *See* ROA, Tab 38. Over Petitioners' objection, the 6-20-14 Recommendation was allowed by order of the Administrator less than twenty-four hours after that objection was filed with the Administrator. ROA at Tabs 39 (Objection) and 40 (Order).

The Administrator's Final Order

The Administrator's Final Order, all of which was incorporated in the ultimate OSC Order, rejects the ODS Enforcement Division's recommendation in the 6-20-14 Recommendation that the licenses of Southeast and Black be revoked permanently and that Southeast be fined \$65,000.00. The Administrator fined Southeast \$5,000.00 and issued a cease and desist order.

³ Because the OSC proceedings were "individual proceedings," the Department bore the burden of proof. *See* 75 O.S. § 250.3(7)(definition of "individual proceeding") and *Thompson v. State ex rel. Bd. of Trustees of Okla. Pub. Empl. Ret. Sys.*, 264 P.3d 1251, 1255-56 (Okla. 2011).

The Administrator's Dispositive Findings of Fact

The Administrator's Final Order, again adopted by the full OSC, makes four fact findings that are said to support the Administrator's conclusions that Black and Southeast violated Oklahoma securities laws and regulations: (1) Southeast failed to report timely and accurately the ODS proceedings themselves to FINRA's CRD; (2) Southeast failed to timely report change of address information to the CRD; (iii) Southeast permits its agents to call in orders to Southeast rather than "complet[ing]" and "submit[ting]" written orders to Southeast for approval; and (iv) Southeast failed to show the Administrator that it conducted compliance interviews with Watkins and agent Lamar Guillory. ROA, Tab 56 and Ex. A hereto (OSC Order).

The Administrator's Conclusions of Law

The Administrator's Final Order and the OSC Order find generally that "Southeast and Black willfully failed to comply with the Act and with a rule adopted under the Act" and states three conclusions of law: (1) "Southeast failed to establish, maintain and/or enforce supervisory procedures," citing Okla. Dept. of Securities Rule 660:11-5-42(b)(22); (2) "Black failed to enforce supervisory procedures to assure compliance with applicable securities laws," citing Rule 660:11-5-42(b)(22); and (3) "Southeast and Black failed to promptly file a correcting amendment of Watkin's change of address and the filing of the 2013 Recommendation on March 26, 2013," citing no authority. ROA, Tab 56 and Ex. A hereto (OSC Order).

II. ARGUMENT AND AUTHORITIES

A. THE OSC ORDER EXCEEDS THE COMMISSION'S STATUTORY AUTHORITY AND JURISDICTION AND EXCEEDS ITS FEDERAL CONSTITUTIONAL AUTHORITY.

1. The power to enforce FINRA rules is vested exclusively in FINRA itself and in the United States Securities and Exchange Commission.

As discussed at length in the briefing below, the Department did not so much purport to enforce Oklahoma law (including statutorily-authorized OSC regulations) as it purported to enforce rules promulgated by FINRA. (Proposition II.B below addresses the question of whether the record before the OSC is sufficient to show any FINRA rule violation). FINRA is a self-regulating organization ("SRO") under federal law. The National Association of Securities Dealers ("NASD"), FINRA's predecessor SRO, was "a non-profit, self-regulatory organization registered with the Securities and Exchange Commission as a national securities association." *See Knights of Columbus Council v. KFS Bd, Inc.*, 791 N.W.2d 317 (Neb. 2010). "NASD, now FINRA, 'is the primary regulatory body for the broker-dealer industry,' subject to control of the Securities and Exchange Commission (SEC)." *Id.*, citing federal authorities that in turn cite the Securities and Exchange Act of 1934 ("the 1934 Act"). "Congress has delegated to it authority 'to promulgate and enforce rules governing the conduct of its members,' also subject to SEC's approval and changes." *Id.* Under its broad authority from the SEC, the NASD (and now FINRA) developed a comprehensive set of rules regulating broker-dealers. These rules "govern virtually every aspect of broker-dealer regulation: registration requirements, *supervision requirements*, record-keeping requirements, and . . . standards regarding broker-dealer duties to customers." *Note: The Flawed State of Broker-Dealer Regulation and the Case for an Authentic*

Federal Fiduciary Standard For Broker-Dealers, 16 Fordham J. Corp. & Fin. L. 203, 205 (2010)(emphasis added).

FINRA also *enforces* its own rules, with the SEC acting as an appeal tribunal. Indeed the 1934 Act, on its face, authorizes the SEC to “make such investigations as it deems necessary to determine whether any person has violated, is violating, or is about to violate any provision of . . . the rules of a national securities exchange *or registered securities association* of which such person is a member.” 15 U.S.C. § 78u (emphasis added). “In addition to serving in an appellate role over NASD actions, the SEC may also directly enforce national securities laws and NASD rules by filing complaints against alleged violators in district court pursuant to Exchange Act § 21(d), 15 U.S.C. § 78u(d).” *SEC v. Mohr*, 465 F.3d 647 (6th Cir. 2006). But the SEC may *not* exercise such authority “unless it appears to the [SEC] that [FINRA] is unable or unwilling to take appropriate action against such person in the public interest and for the protection of investors, or (2) such action is otherwise necessary or appropriate in the public interest or for the protection of investors.” *Id.*, quoting 15 U.S.C. § 78u(f)(first bracketed material by the Court; second bracket added).

2. The OSC record establishes that FINRA was not “unable or unwilling to act” against Southeast or Black.

The record below shows that FINRA here was not “unwilling or unable to act” against Petitioners. FINRA regularly audited Southeast. ROA, Tab 54, Ex. “F” (Affidavit of Frank Black). Of course Petitioners cannot “prove a negative” (i.e., prove that FINRA made an affirmative decision not to act, as opposed to engaging in some “unwillingness” or “inability” to act). “Acting” against a member broker-dealer when a review indicates that action is necessary is the entire purpose of the FINRA review. Such reviews are a core reason for FINRA’s very

existence.⁴ The *SEC itself* could not have taken action against Southeast under the cited statute absent some public interest or investor protection “need.” If the SEC could not do so, Petitioners respectfully (if rhetorically) ask, how could the OSC? And if FINRA *had* taken action against Southeast, then Southeast could have sought review from the SEC *only*. Plainly the federal system preempts state enforcement of *the FINRA rules* as such. That does not mean, and Petitioners do not argue, that federal regulation (which includes the “deputizing of FINRA as described hereinabove) preempts state regulation of broker-dealers completely.

Here the OSC, without any prior FINRA action or any FINRA finding of failure to supervise, purported to engage in direct enforcement of FINRA rules.⁵ The salient point is that the OSC apparently could not find any of *its own rules* (to say nothing of any *statute*) that were violated, and so resorted to a putative finding that FINRA rules were violated -- this in the face of (in effect) a FINRA finding to the contrary. *See*, in this connection, *Symposium: Financial Compliance, Regulation, and Risk Management: Wasn't My Broker Always Looking out for my Best Interests? The Road to Become a Fiduciary*, 12 Duq. Bus. L.J. 41 (2009). The authors note that the SEC has delegated rulemaking authority to FINRA completely, but that “[b]roker-dealers must *also* abide by applicable state laws” (emphasis added). The record makes clear that (i) Southeast has “abided by” FINRA rules because Southeast has routinely “passed” FINRA’s

⁴ *See* <http://www.finra.org/about>. There FINRA itself lists its principal functions and objectives, as follows (emphasis added):

- writing and enforcing rules governing the activities of more than 4,030 securities firms with approximately 638,320 brokers;
- *examining firms for compliance with those rules*;
- fostering market transparency; and
- educating investors.

⁵ At a status conference with the Court on July 15, 2015, counsel for the OSC suggested that the OSC may present “evidence” of some FINRA inquiry or action that *postdates* the OSC Order. Such evidence is de hors the record, of course, and hence inadmissible in this appeal proceeding. The appeal review is confined to the record in the OSC. 75 O.S. § 319.

tests and (ii) that the OSC has not even found any failure to “abide by applicable state laws” *other than* allegedly “incorporated” FINRA rules.

Petitioners’ preemption argument is buttressed by holdings that “the NASD rules do not provide a basis for liability” of a broker-dealer to a customer because it “is well established that violation of an exchange rule will not support a private claim.” *Oravec v. New York Life Ins. Co.*, 2009 Cal. App. LEXIS 7890 (Sept. 9, 2009), citing *Asplund v. Selected Invs. in Fin. Equities*, 86 Cal. App. 4th 26 (2000). If, as *Oravec* holds, the NASD rules are not “a source of federal law” upon which a private right of action can be founded, such rules surely are not a “source” of *state* law upon which legal action against Southeast could be based. In sum, it is difficult to see how FINRA rules, standing alone, may be the basis for a state enforcement action.

Finally, on the issue of federal sovereignty, it cannot be disputed on the OSC record that the OSC has purported to review and make orders relating to Southeast’s practices and procedures in North Carolina and throughout the other forty-nine states of the United States. It is no accident, Petitioners submit, that Congress has vested *nationwide* rule-making and enforcement authority in the SEC and, by delegation, FINRA. Plainly a fifty-state patchwork of regulations governing *system-wide* practices would not and does not make sense. The OSC has overstepped its bounds here and should be reined in by this Court.⁶

⁶ This attempt to exercise extraterritorial jurisdiction has plagued the Department proceedings since the filing of the 3-26-13 Recommendation. The Department purported to exercise jurisdiction over Watkins’ activities in other states by which he was duly licensed *and in good standing*. See discussion at ROA, Tabs 10, 16 (showing that the OSC may not exercise extraterritorial jurisdiction as a matter of law under the United States Constitution or even under the express provisions of the Oklahoma Securities Act).

B. THE OSC FINAL ORDER -- INSOFAR AS IT MERELY ADOPTS THE ADMINISTRATOR'S FINAL ORDER -- (1) IS AFFECTED BY ERROR OF LAW, (2) IS NOT SUPPORTED BY SUBSTANTIAL EVIDENCE, AND/OR (3) IS ARBITRARY AND CAPRICIOUS.

The parties to the proceedings below (Petitioners and the Department) submitted the facts relating to Southeast/Black's supervision of broker-dealers on the deposition testimony in the OSC proceeding and on admissible documents produced by both parties in discovery.

Petitioners showed the OSC, and show below, that the uncontroverted facts so adduced do not establish a violation of law by any "substantial evidence" measure. That is true *even if* the FINRA rules that formed the basis for the 6-20-14 Recommendation (and, ultimately for the OSC Order) in fact constitute *Oklahoma law*.

1. Southeast's delay in reporting address information and the pendency of the OSC proceeding did not violate any statute or regulation.

The OSC's Conclusions of Law cite no specific Oklahoma statute, but the "Authorities" section of the OSC Order quotes verbatim § 1-406 of the Act, 71 O.S. § 1-406. The OSC Order relies *directly*, however, upon Rule 660:11-5-42(22) only. According to the Department's brief of July 23, 2014 (apparently relied upon by the Administrator and the OSC appeals panel), § 1-406(B) of the Act provides that "if any information filed in a registrant's application becomes inaccurate, he shall promptly file a correcting amendment." *See* Record at Tab 43, p. 15. Here is what the cited statute *actually* provides:

If the information contained in an application that is filed under subsection A of this section is or becomes inaccurate or incomplete *in any material respect*, the registrant shall promptly file a correcting amendment.

(emphasis added). It is easy to understand why the Department chose to omit the italicized language in its brief to the Administrator. It undercuts the Department's hypertechnical basis for

disciplinary action. Nevertheless the Administrator and the full OSC proceeded to take action against the Petitioners, albeit less drastic action than the Department sought.

Like the similar FINRA rule,⁷ § 1-406(B) on its face incorporates a materiality condition. Perhaps one reason the Legislature included that condition was to prevent the rule's use as a cudgel by overzealous regulators. Southeast's violations of the quoted statute, according to the Department, the Administrator, and the OSC were these: (i) it failed to update Watkins' CRD office address and (ii) it failed to report the instant proceedings to the CRD "promptly." Both eventually were reported.⁸ In the meantime, the OSC record shows, no customer or anyone else was deprived of any information that would, by any realistic assessment, influence any customer. (The OSC record discloses no customer complaint against Watkins, Southeast or Black). Indeed the Department never so much as *alleged* in the OSC proceedings that any customer was ever misled, harmed or even made unhappy. The CRD filings were not inaccurate or incomplete *in any material respect*. The record showing those facts is uncontroverted. Hence, as a matter of law, the OSC Order was legally erroneous if not indeed "arbitrary and capricious," i.e. "willful and unreasonable." *See* cases cited in Part I.A above (Standard of Review).

⁷ The Department quoted FINRA Rule 1122 as follows: "No member or person associated with a member shall file with FINRA information with respect to membership or registration which is incomplete or inaccurate *so as to be misleading*, or which could in any way tend to mislead, or fail to correct such filing after notice thereof" (emphasis added). ROA at Tab 43, p. 15.

⁸ The Department's complaint about the late change of Watkins' address is especially trivial and technical. As the record reveals, Watkins did not conduct any securities business at all between September 19, 2012 and his reinstatement in the spring of 2014. *See* Record at Tab 1 (3-26-13 Recommendation) at p. 4, ¶ 24 *and* Record at Tab 54, Exhibits "C" (Watkins testimony concerning sales activities) and "D" (customer affidavits). Plainly the address information could not have affected any customer during the year and a half that Watkins was not engaged in the transaction of securities business.

2. Southeast's supervisory procedures do not violate any statute, regulation, or NASD/FINRA rule.

a. *No Oklahoma statute or regulation sets forth specific requirements regarding supervision of agents or the contents of written supervisory procedures.*

The Administrator's Final Order and the OSC Order cite a single regulation, Rule 660:11-5-42(b)(22). According to the Department, that regulation "specifically requires a broker-dealer to establish, maintain, and enforce written procedures to supervise the activities of each of its registered agents and associated persons." Record at Tab 43, page 7. But it was undisputed in the OSC proceedings that Southeast has adopted written procedures. To the extent that the stringency of those procedures exceed legal requirements (including even "incorporated" requirements of FINRA/NASD rules), "violations" of Southeast's own "written supervisory procedures" ("WSPs") have no legal effect. The reality, however, is that Southeast complied with its WSPs in every *material* respect during the period examined by the Department and with the statutes and regulations in all respects. See Record at Tab 42 (Respondents' July 15, 2014 brief and attached exhibits).

Overwhelmingly, the procedural requirements upon which the Department based the 6-20-14 Recommendation for suspension of Petitioners are contained in FINRA/NASD requirements putatively incorporated by reference in the statutes and regulations. See Record at Tab 43, p. 7 (where the Department invokes NASD/FINRA rules alleged to be incorporated in Commission Rule 660:11-5-42(b)(1)).⁹ But the OSC record shows that FINRA itself, to say

⁹ Again Rules 660:11-5-42(b)(1), (b)(22)(A) and (b)(22)(B) contain no real specifics. The last cited regulation provides that "responsibility for proper supervision shall rest with the broker-dealer . . . to carry out the supervisory responsibilities assigned to that office by the . . . rules and regulations of the NASD."

nothing of the SEC, had never found any actionable violation by Southeast or Black at any time prior to December 22, 2014. See, in this regard, ROA at Tab 54, Ex. “F” (uncontroverted affidavit of Frank Black).

- b. *Respondents have complied with the applicable FINRA rules relating to supervision generally and to review of broker-submitted securities transactions.*

The NASD/FINRA rules that form the basis for the 6-20-14 Recommendation’s complaints about Southeast’s supervision generally and about its order procedures are discussed below. The Department’s allegations plainly form the bases for the Administrator’s Final Order and for the OSC Order. Tellingly, those orders (apparently mindful of the preemption problem discussed in Proposition II.A *supra*) carefully avoid mention of the FINRA rules upon which the Department’s entire, moving-target prosecution was based.

- (i). Agent supervision generally: NASD Rule 3010(a)(3)

The Department informed the Administrator that “NASD [now FINRA] Rule 3010 specifies the minimum requirements of an acceptable supervisory system” Record at Tab 43, p 7. But the FINRA rule is not cookie cutter. Rather, it has the flexibility to take into account the particular scope and peculiarities of a particular broker-dealer’s operations. The Department’s central criticism of Southeast (which apparently forms the basis of the OSC’s Conclusion of Law No. 3) appears to be this: Southeast cannot possibly keep up with its far-flung network of agents without additional OSJs¹⁰ and additional day-to-day supervisors.¹¹ It

¹⁰ An “OSJ” is an “office of supervisory jurisdiction,” as defined in FINRA Rule 3110. That lengthy definition is set forth in the attached Glossary of Terms.

¹¹ Given the broad generality of the Administrator’s conclusion that “Southeast failed to establish, maintain and/or enforce supervisory procedures to enable the firm to assist compliance with applicable securities laws,” it is hard to know what exactly is encompassed in the alleged

ignores the facts on the ground: by far the majority of Southeast's brokers are financial advisors that sell insurance products and provide other services besides securities trading. Indeed, the majority of these brokers engage in only a handful of securities transactions annually. See ROA Tab 54, Ex. "E" (deposition testimony of Frank Black at pp. 24-25). All securities transactions are in fact reviewed by Black or others in Charlotte, North Carolina (Southeast's home office) and the supervisors are not overwhelmed or even "whelmed." The Department proffered no evidence to the contrary.

The applicable NASD [now FINRA] rule – Rule 3010(a)(3) -- actually sets forth a series of nonexclusive factors that the broker-dealer should consider in determining whether multiple OSJs are needed:

. . . Each member shall also designate such other OSJs *as it determines to be necessary* in order to supervise its registered representatives, registered principals, and other associated persons in accordance with the standards set forth in this Rule, taking into consideration the following factors:

- (A) whether registered persons at the location engage in retail sales or other activities involving regular contact with public customers;
- (B) whether a substantial number of registered persons conduct securities activities at, or are otherwise supervised from, such location;
- (C) whether the location is geographically distant from another OSJ of the firm;
- (D) whether the member's registered persons are geographically dispersed; and

failure to supervise. Southeast complied with that directive by requiring Watkins to report through Lamar Guillory until the settlement agreement between Watkins and the Department of April 30, 2014 (ROA at Tab 33) took effect. Under that agreement, Watkins' activities are monitored by an independent consulting firm approved by the Department. There is no allegation in the record that Watkins has failed to honor the settlement agreement or that Southeast has committed any violation of any kind related to that agreement.

- (E) whether the securities activities at such location are diverse and/or complex.

(emphasis added).

Southeast has shown that it in fact considered these factors, particularly factor (B), in conjunction with the closely-related fact that the “registered persons” at each nonbranch office themselves engage in only a few securities transactions per year. ROA at Tab 54, Ex. E (Black deposition testimony) at pp. 23-24. Southeast has not violated Rule 3010(a). It has instead run afoul of the Department’s unilateral conclusion, now enshrined in the OSC Order, about how Southeast ought to run its business.

- (ii). Review of transactions: NASD Rule 3010(d)(1)

According to the Department, NASD [now FINRA] Rule 3010(d) “specifically requires a broker-dealer to make provisions for the review of all transactions.” Record at Tab 43, p. 12. The Department suggests that, in order to comply with the FINRA/NASD rule, the broker-dealer must adhere to its own WSPs to the letter. Again it is helpful to consult the actual language of the rule invoked. FINRA Rule 3010(d)(1) provides in pertinent part:

Each member shall establish procedures for the review and endorsement by a registered principal in writing, on an internal record, of all transactions . . . of its registered representatives with the public relating to the investment banking or securities business of such member. Such procedures should be in writing *and be designed to reasonably supervise each registered representative*. Evidence that these supervisory procedures have been implemented and carried out must be maintained and made available to the Association upon request.

(emphasis added).

The truth is that Southeast’s transaction review protocol is far more stringent than most SEC/FINRA-regulated firms. Southeast’s president and principal owner reviews every single

order request and the firm itself actually places the order only after review by the President, the Chief Compliance Officer and the Designated Supervisory Principal.

The OSC's Conclusions of Law Nos. 2 and 3 (adopting the Administrator's conclusions verbatim) find no substantial evidentiary support in the record. Indeed the record refutes those conclusions, rendering them arbitrary and capricious.

- c. *Southeast has conducted regular and adequate compliance training and reviews.*

Regarding compliance reviews, the Administrator's Final Order and the OSC Order find:

The WSPs provide that Southeast will conduct annual compliance interviews with each of its agents and maintain a record of all interviews. Respondents have not submitted any record of compliance interviews with Watkins and Guillory even though there were two separate discovery requests for such records.

Administrator's Final Order (ROA, Tab 56) at p.3, ¶ 14.

The Administrator's fact findings do not support his Conclusions of Law Nos. 1 and 2 (Conclusions No. 2 and 3 of the OSC Order). Both FINRA itself and Southeast provide compliance training to Southeast representatives. Southeast distributes many compliance materials throughout the year. That is scarcely a basis for *criticism* of Southeast. But Southeast also requires bi-annual representative written declarations. *See* Record at Tab 54, appendix to Respondents' brief of Aug. 29, 2014 at Ex. "H" (Guillory bi-annual declaration) and Ex. "I" (Watkins bi-annual declaration). Southeast also conducts an annual compliance meeting as required by FINRA rules. *Id* at Ex. "E" (Depo of Frank Black at pp. 75-76).

NASD/FINRA Rule 3010(a) provides that "the member shall establish and maintain a system to supervise the activities of each registered representative . . . and other associated persons that is *reasonably designed to achieve compliance* with applicable securities laws and regulations . . ." (emphasis added). No fair assessment of Southeast's compliance-review

procedures would conclude that Respondents have not met the “reasonably-designed-to-achieve-compliance” test that permeates all of the FINRA procedural rules. Hence the OSC’s Conclusions of Law (again adopting the Administrator’s conclusions verbatim) find no substantial evidentiary support in the record.

C. OSC CONCLUSION OF LAW NO. 1 IS A NON-SEQUITER.

The OSC Order adopts the Administrator’s Final Order lock, stock and barrel except for the OSC’s added Conclusion of Law No.1:

Associating with an agent who should be under heightened supervision requires a higher standard of oversight and supervision by the broker-dealer and its principals.

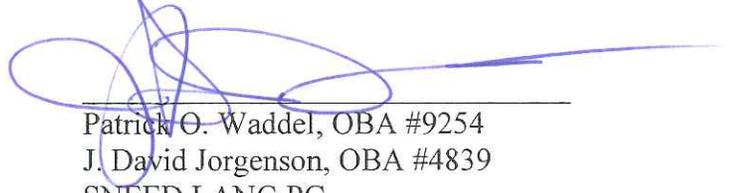
The foregoing would appear to be either a “footless conclusion of law” (if it intends to imply that Watkins was *not* under “heightened supervision” at all relevant times) or simply gratuitous. The OSC record shows that Watkins was at all relevant times, *and remains today*, under “heightened supervision.” ROA at Tab 54, Exs. B and C. *See also* Note 11 *supra* at pp. 16-17 (describing the terms of Watkins’ supervision under his agreement with the Department and as prescribed by the Department itself).

III. CONCLUSION

For that reasons set forth herein, the OSC Order’s cease and desist directive should be set aside in all particulars and this matter should be remanded to the OSC with instructions to withdraw the cease and desist order.

[signature lines on next page]

Respectfully submitted,

A handwritten signature in blue ink, consisting of several loops and a long horizontal stroke extending to the right.

Patrick O. Waddel, OBA #9254

J. David Jorgenson, OBA #4839

SNEED LANG PC

One West Third Street, Suite 1700

Tulsa, OK 74103

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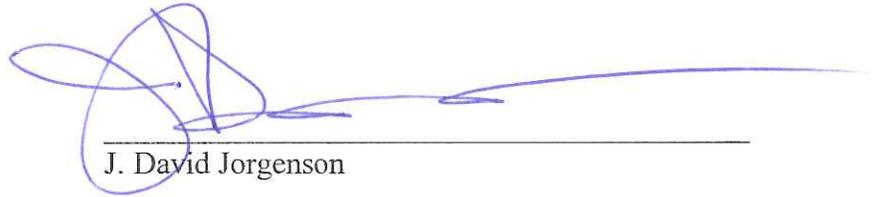
(918) 588-1314 Facsimile

*Counsel for Frank H. Black and Southeast
Investments, N.C. Inc.*

Certificate of Mailing

I, the undersigned, do hereby certify that on this 17th day of August, 2015, a true and correct copy of the above and foregoing *Petitioner's Opening Brief* was sent by U.S. Mail, postage prepaid, to:

Jennifer Shaw/Amanda Cornmesser
OK Dept. of Securities
204 North Robinson, Suite 400
Oklahoma City, OK 73102-7001



J. David Jorgenson

GLOSSARY
OF
TERMS

**SOUTHEAST INVESTMENTS, N.C. INC., et al v.
THE OKLAHOMA SECURITIES COMMISSION
Case No. CV-2015-86**

GLOSSARY OF TERMS

3-29-12 Recommendation – the Oklahoma Securities Department Enforcement Division recommendation filed March 29, 2012 and styled as: “In the Matter of: Rodney Larry Watkins, Jr.”

3-26-13 Recommendation -- the Oklahoma Securities Department Enforcement Division “Supplemental Recommendation” of March 26, 2013

6-20-14 Recommendation -- the Oklahoma Securities Department “Supplemental Enforcement Division Recommendation” of March 26, 2013

The Act – the Oklahoma Securities Act of 2004, 71 O.S. §§ 1-101 through 1-701

APA – the Oklahoma Administrative Procedures Act, 75 O.S. §§ 250 to 323

The Administrator – the Administrator of the Oklahoma Securities Department

Administrator’s Final Order – the Final Order of October 10, 2014 filed by the Administrator of the Oklahoma Securities Department

Black – Petitioner (Appellant) Frank H. Black

CRD – the Central Registration Depository maintained by the Financial Industry Regulatory Authority

The Department -- the Oklahoma Department of Securities

FINRA – the Financial Industry Regulatory Authority, the successor of the National Association Of Securities Dealers

NASD -- the National Association of Securities Dealers

ODS -- the Oklahoma Department of Securities

ODS Administrator – the Administrator of the Oklahoma Securities Department

OSC -- the Oklahoma Securities Commission

OSC Order – the final order of the Oklahoma Securities Commission dated December 22, 2014, the order appealed from herein

OSJ – Office of Supervisory Jurisdiction, defined by FINRA as follows:

Any office of a member at which any one or more of the following functions take place:

- (A) order execution or market making;
- (B) structuring of public offerings or private placements;
- (C) maintaining custody of customers' funds or securities;
- (D) final acceptance (approval) of new accounts on behalf of the member;
- (E) review and endorsement of customer orders, pursuant to paragraph (b)(2) above;
- (F) final approval of retail communications for use by persons associated with the member, pursuant to Rule 2210(b)(1), except for an office that solely conducts final approval of research reports; or
- (G) responsibility for supervising the activities of persons associated with the member at one or more other branch offices of the member.

Petitioners (Appellants) -- Southeast Investments, N.C. Inc. and Frank H. Black

ROA -- Record of Appeal filed by the OSC clerk on April 6, 2015

Southeast – Petitioner Southeast Investments, N.C. Inc.

SEC – The United States Securities and Exchange Commission

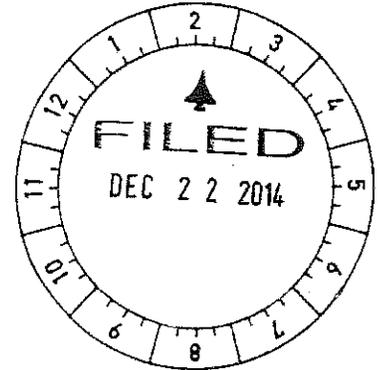
SRO – Self-Regulating Organization

Watkins -- Rodney Larry Watkins, Jr.

WSPs – Written Supervisory Procedures

EXHIBIT A

STATE OF OKLAHOMA
OKLAHOMA SECURITIES COMMISSION
THE FIRST NATIONAL CENTER
120 NORTH ROBINSON, SUITE 860
OKLAHOMA CITY, OKLAHOMA 73102



IN THE MATTER OF:

SOUTHEAST INVESTMENTS, N.C. INC. and
FRANK H. BLACK,

Appellants,

v.

OSC 15-001

OKLAHOMA DEPARTMENT OF SECURITIES
ex rel. IRVING L. FAUGHT, ADMINISTRATOR,

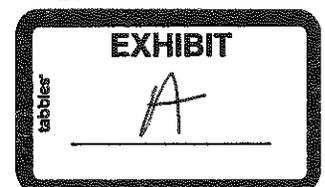
Appellee.

COMMISSION'S FINAL ORDER

On March 26, 2013, the Enforcement Division of the Oklahoma Department of Securities (Department) filed a recommendation under the Oklahoma Uniform Securities Act of 2004 (Act), Okla. Stat. tit. 71, §§ 1-101 through 1-701 (2011), alleging that Rodney Larry Watkins, Jr. (Watkins) violated a previous order of the Administrator of the Department (Administrator) by transacting business in and/or from the state of Oklahoma as an agent without the benefit of registration under the Act and that Frank H. Black (Black) and Southeast Investments, N.C. Inc. (Southeast) failed to supervise Watkins in violation of 660:11-5-42 of the Rules of the Oklahoma Securities Commission and the Administrator of the Department of Securities (Rules), Okla. Admin. Code §§ 660:1-1-1 through 660:25-7-1 (2013 Recommendation).

On June 20, 2014, the Department supplemented its 2013 Recommendation to allege that Southeast failed to establish, maintain and enforce written procedures that enable Southeast to properly supervise the activities of Southeast's registered agents and associated persons to assure compliance with applicable securities laws, rules, and regulations.

On October 10, 2014, the Administrator issued a final order against Southeast and Black (Administrator's Order). The Administrator ordered Southeast and Black to cease and desist from violations of the Act, to wit: failing to establish, maintain and/or enforce supervisory procedures to enable Southeast to assure compliance with applicable



securities laws. The Administrator further ordered Southeast and Black to pay a monetary penalty in the amount of \$5,000 to the Department within ninety (90) days of the date of the Administrator's Order.

On October 24, 2014, Southeast and Black (collectively, the "Appellants") filed a petition for review by the Oklahoma Securities Commission (Commission) of the Administrator's Order pursuant to Section 1-609 of the Act and 660:1-5-1 of the Rules (Petition). On November 20, 2014, Appellants filed their brief in support of their petition and requested oral argument before the Commission. The Administrator filed his brief on December 5, 2014. With proper notice having been given, the Commission heard oral argument by Appellants and the Administrator commencing at 10:00 a.m. on December 18, 2014.

After reviewing the Petition, the record on which the Administrator's Order was issued, and the written briefs submitted by the Appellants and the Administrator, the Commission makes the following Findings of Fact and Conclusions of Law:

FINDINGS OF FACT

1. Southeast became registered under the Act as a broker-dealer on May 8, 2009, and has been a member of the Financial Industry Regulation Authority (FINRA) since July 1, 1997.

2. Black, a South Carolina resident, is the owner and control person of Southeast. In addition to these duties, Black is Southeast's Chief Compliance Officer, Financial and Operations Principal, and "Designated Supervisory Principal" (the title used to designate particular authority and responsibilities in Southeast's written supervisory procedures dated August 2013 (WSPs)). Black is not and has not been registered under the Act in any capacity.

3. Watkins was first registered as an agent under the Act in December 1998. From March 2009 until October 2011, Watkins was registered as an agent of Ameriprise Financial Services, Inc. (AFS). Watkins was allowed to resign as a result of an internal AFS investigation. AFS filed a Uniform Termination Notice for Securities Industry Registration (Form U-5) with the Central Registration Depository (CRD) stating that Watkins had violated the firm's policies relating to "discretionary power; unacceptable activities/transactions; pre-signed forms and applications; forgery, signature stamps and other signature issues; [and] annuity overview." Watkins became an agent of Southeast in February of 2012 and designated an address in Tulsa, Oklahoma, as his business address.

4. Southeast's principal place of business located in Charlotte, North Carolina, is designated as Watkins' office of supervisory jurisdiction.

5. Black is responsible for directly supervising all of Southeast's approximately one hundred and forty-five (145) agents as well as its associated persons from Southeast's principal place of business.

6. The Southeast agents are geographically dispersed throughout the United States, mostly in one or two-agent offices. Many of the agents are held out to be independent contractors who conduct outside business activities.

7. For purposes of supervision, Southeast does not maintain a system of branch offices or regional offices of supervisory jurisdiction, but instead relies entirely on Black, individually, to supervise all agents other than himself.

8. The WSPs provide that Southeast and Black must report to CRD any disclosable event, including administrative actions, within ten (10) days of the event.

9. Southeast and Black did not timely report the proceeding on the 2013 Recommendation on CRD with regards to Watkins.

10. When Southeast and Black did report the 2013 Recommendation, the filing was inaccurate as to the date, the basis and the conditions of the action.

11. In June 2013, Watkins directed Southeast to update his business and residential addresses on CRD. Neither Southeast nor Black updated Watkins' business and residential addresses until November 2013, leaving Watkins' CRD profile inaccurate during this period.

12. The WSPs provide that Southeast's agents shall complete order tickets and submit them to Black for approval.

13. Contrary to the WSPs, Southeast's agents do not complete order tickets, but instead call in orders over the phone to one or more of Southeast's employees in the firm's Charlotte, North Carolina office.

14. The WSPs provide that Southeast will conduct annual compliance interviews with each of its agents and maintain a record of all interviews. Appellants have not submitted any record of compliance interviews with Watkins and Lamar Guillory, a Southeast agent located in Oklahoma, even though there were two separate discovery requests for such records.

15. Watkins should have been under heightened supervision during the period in which Southeast and Black failed to enforce the WSPs as to: (a) the timely update of business and residential addresses on CRD; (b) the timely and accurate disclosure of administrative actions on CRD; (c) the completion of order tickets; and (d) the annual compliance interviews.

CONCLUSIONS OF LAW

1. Associating with an agent who should be under heightened supervision requires a higher standard of oversight and supervision by the broker-dealer and its principals.

2. Southeast failed to establish, maintain and/or enforce supervisory procedures to enable the firm to assure compliance with applicable securities laws in violation of 660:11-5-42(b)(22) of the Rules.

3. Black failed to enforce supervisory procedures to assure compliance with applicable securities laws in violation of 660:11-5-42(b)(22) of the Rules.

4. Southeast and Black failed to promptly file a correcting amendment of Watkins' change of address and the filing of the 2013 Recommendation on March 26, 2013.

5. Southeast and Black willfully failed to comply with the Act and with a rule adopted under the Act. Such conduct constitutes dishonest and unethical practices in the securities business.

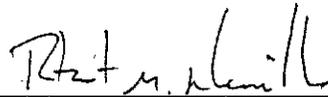
6. It is proper, just and equitable that Southeast and Black be required to take the necessary steps to come into compliance with the Act and Rules.

7. It is proper, just and equitable that a civil penalty be imposed against Southeast and Black.

ORDER

IT IS HEREBY ORDERED under Section 1-609 of the Act that Southeast and Black cease and desist from their violations of failing to establish, maintain and/or enforce supervisory procedures to enable the firm to assure compliance with applicable securities laws, and that Southeast and Black jointly pay a monetary penalty in the amount of \$5,000 to the Department, by cashier's check or money order within ninety (90) days of the date of the Administrator's Order.

WITNESS My Hand and the Official Seal of the Oklahoma Securities Commission this 22nd day of December, 2014.



Robert M. Neville, Chairperson
Oklahoma Securities Commission

CERTIFICATE OF SERVICE

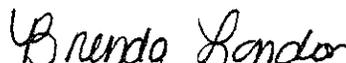
The undersigned hereby certifies that on the 22nd day of December, 2014, true and correct copies of the above and foregoing *Commission's Final Order* were sent in the following manner to the specified individuals:

By electronic mail, and by mail with postage prepaid thereon, to:

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