

IN THE DISTRICT COURT IN AND  
FOR OKLAHOMA COUNTY, OKLAHOMA

OCT - 8 2015

TIM RHODES  
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SOUTHEAST INVESTMENTS, N.C. INC., )  
 A NORTH CAROLINA CORPORATION; and )  
 FRANK H. BLACK, )  
 )  
 Plaintiffs/Petitioners, )  
 )  
 vs. )  
 )  
 THE STATE OF OKLAHOMA *ex rel.* )  
 THE OKLAHOMA SECURITIES COMMISSION )  
 )  
 Defendant/Respondent. )

Case No. CV-2015-86

**CLOSING ARGUMENT OF THE SECURITIES COMMISSION**

In their reply brief, Petitioners Southeast and Black make arguments that are without merit. First, Petitioners cannot claim, in good faith, that they are not subject to the Respondent's jurisdiction. Petitioner Southeast, when it applied to become a broker-dealer registered under the Oklahoma Uniform Securities Act of 2004 (Act), Okla. Stat. tit. 71, §§ 1-101 through 1-701 (2013), subjected itself to the jurisdiction of the Oklahoma Department of Securities (Department). Accordingly, Petitioner Black, as the control person and director of Southeast, became subject to the jurisdiction of the Department. See § 1-411 of the Act. Further, Petitioner Southeast associated with two agents - Rodney Watkins (Watkins) and Lamar Guillory (Guillory) - who are physically located in Oklahoma and registered under the Act as agents of Petitioner Southeast. Petitioners have duties under the Act and Rules of the Oklahoma Securities Commission and the Administrator of the Department of Securities (Rules) to properly supervise those agents.

Petitioners mock reliance on 660:11-5-42(b)(22) of the Rules in Respondent's enforcement of this matter. Repeatedly, Petitioners argue that Respondent solely relied upon

federal law to “rest its argument.” This is simply untrue. Respondent has been clear that Petitioners are subject to the Act and Rules, specifically citing to 660:11-5-42(b)(22) of the Rules.

The standards of ethical practice set forth in the Rules require a broker-dealer registered under the Act to establish, maintain *and* enforce written supervisory procedures. See 660:11-5-42(b)(22)(A) of the Rules. As specified by the rule, the establishment of policies and procedures alone does not satisfy the broker-dealer’s supervisory obligations. The broker-dealer must also insure compliance with such policies and procedures. In doing so, the broker-dealer must develop a “system for implementing its procedures that [can] reasonably be expected to prevent and detect securities law violations.” *In the Matter of Kirkpatrick, Pettis, Smith, Polian Inc., et. al.*, Release No. 34-48748 (Nov. 5, 2003).

It is stunning that Petitioners admit they do not understand the Commission’s Order. The Administrator’s Order and the Commission’s Order state findings of fact that include a list of violations committed by Petitioners and of which, Petitioners mostly agree, they violated. Where the disagreement really exists between the parties is whether the violations are “material.”

To support their materiality argument, Petitioners cite to FINRA Regulatory Notice 14-10 (March 2014), which was not effective during the time period of the case below. Petitioners use this authority to argue that the firm has discretion in *determining* its supervisory procedures. However, “determining,” that is designing or establishing, supervisory procedures is a separate function from enforcing the procedures once designed. The written supervisory procedures of a broker-dealer are meant to be proactive in preventing future violations and investor abuses. *Id.* The broker-dealer cannot pick and choose the procedures to enforce once the procedures are established.

Petitioner Southeast's written supervisory procedures (WSPs) require agents to complete an order ticket upon taking their customers' orders and to send the order tickets to the Designated Supervisory Principal for review. Contrary to the WSPs, the order tickets are not completed by the customer's agent but instead are called into Petitioner Southeast's main office by the agent and completed by an employee in that office. Petitioners previously admitted that they do not follow the WSPs as to this procedure. See Record at Tab 54, p.14, no. 18.

Amendments to SEC Rule 17a-3 (effective May 2, 2003) clarified and expanded the books and records rules to prevent violations such as those committed by Petitioners. The amendments expanded the types of records that broker-dealers shall maintain and promptly produce at each office to assist securities regulators, particularly state securities regulators, conducting sales practice examinations of broker-dealers, to include examinations of local offices. See 2003 WL 22171211 (SEC No-Action Letter). This allows securities regulators to better focus their examinations and investigations to identify certain types of violative activities and the individuals responsible for those activities.

In addition, Petitioners have admitted in their briefs that they failed to turn over the interview notes of annual interviews conducted of their Oklahoma agents pursuant to discovery requests sent by the Department. Because no interview notes were produced during discovery, it is reasonable for Respondent to deduce they do not exist. Contrary to Petitioners' pronouncements, compliance training, distribution of compliance materials and self-serving agent declarations do not satisfy the annual interview requirement of the WSPs.

Furthermore, Petitioners incorrectly assert that Watkins was given a "clean bill of health" by the Department. Contrary to this assertion, Watkins entered into an agreement on April 30, 2014, with the Department to settle the matter. Watkins agreed, *inter alia*, to hire an independent

compliance consultant to perform monthly reviews of his activities for three (3) years and to not exercise discretionary authority over customer accounts for five (5) years. See Record at Tab 33. This agreement superseded the August 29, 2012 Order that required Watkins to be under a heightened supervision plan approved by the Department. Petitioners' footnote 3 asserts the Department required Watkins to be supervised by Guillory. On the contrary, the Department never approved the heightened supervision plan proposed by Petitioner Southeast, *i.e.*, for Watkins to be supervised by Guillory.

Finally, Petitioners rehash their argument that FINRA has not taken an action against them. See Petitioners' Reply Brief, p.5 and Petitioners' Opening Brief, fn 5. Admittedly this Court's review is limited to the record. However, Respondent refutes Petitioners' continued representation that FINRA has "passed" Southeast's practices during the periods under review.

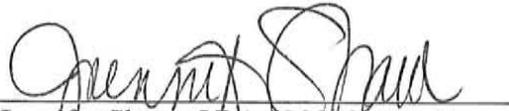
It is clear that the Petitioners were ordered to cease and desist from their violations of failing to establish, maintain and enforce supervisory procedures. The basis of the orders issued by the Administrator and Respondent is firmly established in the record. The Commission's Order includes a finding that it is the public interest to direct the Petitioners to take the necessary steps to come into compliance with the Act and Rules. The Administrator has been entrusted by the Oklahoma Legislature to determine the appropriate sanction or sanctions in order to achieve the protection of the investing public. Such responsibility is appropriately, and by necessity, a matter for administrative competence. The Oklahoma Supreme Court has summarized the standard of review for appealed administrative cases as follows: "A court of review may not substitute its own judgment for that of an agency, particularly in the area of expertise which the agency supervises." See *Denney v. Scott*, 1992 OK 134, 848 P.2d 1142. Further, if the administrative agency facts are supported by substantial evidence and free of error, the decision

of the agency must be affirmed. *Id.* at 1143-1144 (citing *Tulsa Area Hosp. Council, Inc. v. Oral Roberts Univ.*, 626 P.2d 316, 320 (Okla. 1981).

In *Black Diamond Fund, LLLP v. Joseph*, 211 P.3d 727, 738 (2009), the Colorado Court of Appeals stated that it was self-evident that an order to cease further violations of the Colorado Securities Act (CSA) is predicated on the conclusion that violations of the CSA had happened. Further, the court found that compliance with the CSA is in the public interest and that passage of laws by the legislature establishes the public interest underlying those laws. *Id.* Moreover, the court found nothing arbitrary or capricious in the terms of a cease and desist order that mandates compliance with those laws. *Id.*

Petitioners, throughout the entire proceeding, have admitted to clear violations of the Act and Rules – violations that warrant the imposition of sanctions ordered by the Administrator and the Commission acting in the public interest. The Commission’s Order should be affirmed.

Respectfully Submitted,

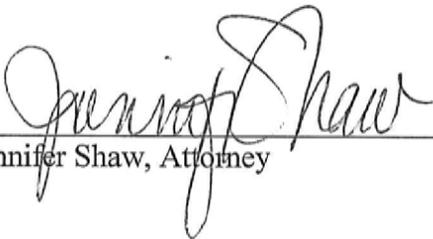


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CERTIFICATE OF SERVICE

The undersigned hereby certifies that on the 8<sup>th</sup> day of October, 2015, a true and correct copy of the above and foregoing *Closing Argument of the Securities Commission* was mailed with postage prepaid thereon, addressed to:

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