BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of Department of Enforcement, Complainant, vs. J. Michael Casas San Antonio, TX, Respondent.	DECISION Complaint No. 2013036799501 Dated: January 13, 2017

Respondent converted customer funds and engaged in securities fraud. Held, findings and sanctions affirmed.

For the Complainant: Leo F. Orenstein, Esq., and Michael P. Manly, Esq., Department of Enforcement, Financial Industry Regulatory Authority

For the Respondent: Pro Se

Decision

An Extended Hearing Panel found that J. Michael Casas ("Casas") fraudulently sold securities issued by his company on the basis of false statements of material fact regarding the use of investor funds, in willful violation of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Exchange Act Rule 10b-5 and in violation of FINRA Rules 2020 and 2010. The Extended Hearing Panel further found that Casas converted investor funds for his personal use, in violation of FINRA Rule 2010. The Extended Hearing Panel barred Casas from association with any FINRA member firm in any capacity, ordered him to pay restitution, and ordered him to pay hearing costs. Casas appeals this decision. We affirm.

I. Factual Background

A. Casas's Background

Casas entered the securities industry in 2001 and registered as a general securities representative.[1] In June 2011, he associated with FINRA member firm RiverStone Wealth Management, Inc. ("RiverStone"). In July 2011, he registered with FINRA as an investment banking representative through RiverStone.

Casas resigned from RiverStone on October 31, 2012.[2] On November 1, 2012, RiverStone filed a Uniform Termination Notice for Securities Industry Registration ("Form U5").

B. MCB Capital Partners, LLC

Casas formed MCB in October 2010 to provide investment banking advisory services. Casas was originally the sole member of MCB, as well as its president and manager. In June 2011, BN, who worked with Casas at RiverStone as an investment banker, joined MCB, while Casas retained majority ownership of MCB.

When BN joined MCB, he provided a temporary bridge loan to Casas. BN loaned Casas $15,000 in June 2011 and $3,000 in December 2011. The purpose of the loan was to enable Casas to devote his time to seeking investment advisory clients for MCB. Although the loan was not memorialized, Casas and BN agreed that any monies that MCB received would be first applied to pay back the loan from BN.

Casas and BN were unsuccessful in securing any investment banking clients, so at the end of September 2011, they changed MCB's business model from investment banking advisory services to an operating company seeking to acquire companies and merge them into MCB. Under this revised business plan, Casas and BN performed different tasks. Casas had all decision-making authority and continued as MCB's president, manager, and majority owner. He also held all of MCB's purse strings. Casas had the only MCB debit card, and only he wrote checks on the MCB bank account. BN was responsible for recordkeeping, and because BN was an attorney, Casas used BN as in-house counsel to provide advice to Casas and MCB.

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[1] Between July 2004 and June 2011, Casas was not in the securities industry.

[2] Casas maintained at the hearing below that FINRA lacked jurisdiction over him because he had resigned from RiverStone long before October 31, 2012. The Hearing Panel found, and we agree, that the record is replete with evidence that Casas was still registered with RiverStone at the time he started MCB Capital Partners, LLC ("MCB") and at the time of the misconduct at issue in this case. Casas does not raise this issue on appeal.

C. The Proposed Reverse Merger

Casas identified Straight Line Construction ("SLC"), a private construction company, for a proposed reverse merger. Casas wanted to merge SLC, MCB, and a publicly traded shell company into one entity. Casas targeted Integrative Health Technologies, Inc. ("IHTI"), a small, development-stage medical technology company, for the publicly traded shell company. In October 2011, MCB entered into letters of intent with SLC and IHTI.[3]

Casas retained the services of an accounting firm and a law firm to conduct the required due diligence. Casas needed approximately $150,000 to $200,000 in "seed capital" to pay for the accounting, legal, and operational expenses for MCB, but he did not have the funds to pay for these expenses. Casas also wanted to raise $40 million prior to closing the reverse merger transaction to capitalize the resulting entity. To acquire the funds, Casas sought investors in MCB and he created an MCB offering. Pursuant to the offering, investors would receive shares in MCB. Casas offered six ownership interest units in MCB to accredited investors for $25,000 per unit.

D. Investor MB

MB was referred to Casas as a potential investor in MCB. MB was interested in the reverse merger, but as a cautious and experienced investor, he performed his own due diligence. Among the steps he took, MB verified that SLC was an actual company and that Casas and RiverStone were registered with FINRA. MB also asked Casas to send him an email describing the terms of the investment. On January 10, 2012, Casas sent MB an email memorializing that MCB was seeking to raise $150,000 in "seed capital to fund the legal, accounting and operating expenses in connection with the [SLC]/IHTI merger." Casas explained that more than 85 percent of the invested funds would go toward the payment of accounting and legal fees, and approximately 15 percent would be applied to operating expenses. Casas further advised that to raise these funds, he intended to sell $25,000 membership units in MCB, each of which would represent a 1.67 percent ownership in his company. He stated that the anticipated return for each membership unit would be $50,000 in cash and $102,000 in stock, a total return of more than 600 percent of the original investment, which would be paid upon consummation of the reverse merger. Casas did not disclose that he would use any of the "seed capital" to pay his personal expenses or to repay the $18,000 bridge loan from BN.

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[3] Casas originally disclosed his MCB outside business activities to RiverStone when he joined the firm. In October 2011, Casas and BN advised their RiverStone supervisor of their plan to pursue the SLC reverse merger as principals rather than as advisors. Because of this change in their anticipated roles, they sought approval from RiverStone to engage in this activity away from the firm. RiverStone's CCO advised Casas and BN that their participation in this transaction was approved in early November 2011. Casas's supervisor at RiverStone, PG, testified that he reviewed MCB's emails, correspondence, and other documents in an effort to exercise supervision of Casas's outside business activities.

On January 27, 2012, MB purchased two membership interests in MCB. He executed a Subscription Agreement, which had been prepared by Casas and signed by him in his capacity as MCB's manager. Pursuant to the Subscription Agreement, MB invested $50,000 in exchange for a 2.5 percent ownership interest in MCB.[4] The Subscription Agreement stated that the investment funds "will be used to fund the transactional and operational expenses of [MCB], to include the payment of accounting fees, legal fees, operational expenses and to provide working capital to [MCB]." The Subscription Agreement did not disclose that the invested funds would be spent on Casas's personal expenses or the repayment of the loan from BN.

E. Casas's Use of MB's Investment Funds

On January 30, 2012, MB wired $50,000 into MCB's bank account, which at the time had a balance of approximately two dollars. Casas immediately began using MB's investment funds for personal expenses and continued to do so until those funds were exhausted. The following are examples of how Casas spent MB's investment funds:

- The day after MB's investment, Casas used $364.38 of MB's investment to purchase a new water heater for his home. At the hearing, Casas justified the hot water heater as a "personal expense in lieu of salary."[5] On that same day, Casas withdrew $200 from an ATM machine to take with him on a visit to SLC. While Casas speculated that he used the cash to purchase beer for SLC, he did not maintain any log of expenses or receipts to document how the cash or other expenses were spent on endeavors related to the reverse merger transaction.

- Casas paid his $2,712 home mortgage for the month of January using MB's investment funds. He admitted that he paid his entire mortgage payment with MCB funds, and not just a portion of the mortgage that could be allocated to the rental of office space out of his home. According to Casas, it did not matter how you categorized the mortgage payment—it was either rent and would therefore qualify as a business expense or it was a personal expense in lieu of salary.

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[4] In addition to his investment, MB agreed to help raise the $40 million necessary to finance the underlying transaction. Over the following months, MB endeavored, without success, to find investors who were willing to invest in SLC. Casas blamed MB for the eventual collapse of the transaction in light of MB's inability to secure any investors in the endeavor.

[5] Casas's testimony at the hearing differed from the testimony he provided FINRA during his on-the-record ("OTR") interview. Casas testified at the OTR that he considered the hot water heater purchase to be a legitimate business expense because it was important for him to have clean clothes and maintain good hygiene.

- Throughout February 2012, Casas continued to use the MCB account to pay his day-to-day expenses, including meals at fast food restaurants, gas, dry cleaning, car washes, and groceries. Again, Casas maintained no supporting documentation to establish that any of the expenses were legitimate business expenses and did not categorize his expenses. Casas maintained that, "if [the accountant] says [a particular expense] is not allowable, then it becomes—then it's a personal expense in lieu of salary."

- On February 7, 2012, Casas wrote a check to BN in the amount of $2,700 in partial repayment of BN's $18,000 loan. Casas acknowledged that he never disclosed the loan to MB, but he argued that he did not need to since the loan was part of MCB's operating expenses. Casas explained that BN needed money to pay his mortgage, and he made the decision as manager of MCB to pay him. Casas claimed that BN was simply providing capital to MCB. He stated that it was characterized as a loan so that BN could avoid paying taxes on it.[6]

- From February through May, Casas used the MCB account to pay for his family's cell phone bill, which exceeded $300 a month.

- Casas used MB's investment funds for medical procedures. On February 17, 2012, Casas spent $1,325 on an "Endodontic Consultation," for a root canal. On March 28, 2012, Casas spent an additional $375 on the same. He also spent $350 at the North Central Baptist Hospital on April 23, 2012 and $213 at a Texas medical clinic on May 7, 2012.

- During March 2012, Casas wrote a $1,500 loan repayment check to BN, spent more than $600 on gas, $285 on automotive repairs, and withdrew $360 from ATM machines.

- By April 2012, the account balance in the MCB bank account was down to less than $10,000. Casas used more than half of the remaining funds to make another $2,700 loan payment to BN and pay his home mortgage payment of $2,712. He spent approximately $1,900 on a trip to New York, purportedly to meet with investment bankers from Merrill Lynch, but provided no supporting documentation.

Casas spent the remainder of the investment funds on cash withdrawals, gas, and restaurants. Casas justified these expenditures by claiming that they were either legitimate business expenses (without any supporting documentation) or were "personal expenses in lieu of salary" that he

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[6] The Hearing Panel did not credit Casas's shifting description of the nature of BN's payment to MCB. During FINRA's investigation, Casas stated that BN's money was a loan to MCB. At the hearing, Casas claimed that BN did not provide a loan to MCB, but rather BN simply provided cash to MCB so it could operate. We agree with the Hearing Panel that BN made a bridge loan to MCB that MCB was obligated to pay back, and that these loan payments should have been disclosed to MCB's investors.

classified as operational expenses. By the end of May 2012, Casas had spent all of MB's $50,000 investment funds, and the account was overdrawn.

Although Casas represented to MB in writing that he intended to spend more than 85 percent of any "seed capital" investment on accounting and legal fees, he spent less than half—only $23,400 of MB's $50,000 investment—on accounting and legal fees. MB had no knowledge of the loan from BN that Casas intended to repay. MB testified that Casas represented that the funds would be used primarily for legal and accounting fees as described in the January 10, 2012 email. MB also testified that Casas never disclosed that he intended to use the investment funds for personal expenses. MB testified that had he known how Casas planned to use his investment funds, he would not have made the investment.

F. Casas's Subsequent Proposed Reverse Merger Transaction

By May, 2012, it became clear that the merger of MCB, SLC, and IHTI, along with the simultaneous raising of $40 million in capital, was no longer viable. IHTI had encountered regulatory issues with the SEC and, as such, Casas needed a new merger partner for SLC.

In May 2012, Casas identified Claimsnet.com as a potential shell company. Casas, on behalf of MCB, and Claimsnet entered into a letter of intent. Casas again needed funds for accounting and legal due diligence. To finance these costs, Casas solicited an additional $50,000 seed capital investment from MB, which MB declined to provide.[7]

G. Investor JPG

In light of MB's refusal to invest any more money in MCB, and Casas's need for additional funds, Casas solicited JPG, SLC's president, to invest in MCB. On May 29, 2012, JPG executed a Subscription Agreement that Casas had created and signed. Casas modified the Subscription Agreement he had used with MB to reflect JPG's investment. The "Proceeds" section contained language identical to the Subscription Agreement that MB signed, and represented that the invested funds would be utilized for accounting fees, legal fees, and the operational expenses and working capital of MCB. Pursuant to the Subscription Agreement, JGP invested a total of $33,000 and agreed to pay certain accounting fees in exchange for a 5 percent ownership interest in MCB.

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[7] MB had become wary of Casas and his proposed transactions. Given MB's concerns, he contacted RiverStone to file a complaint against Casas. RiverStone rejected MB's complaint and declined to intervene in MB's dispute with MCB. When RiverStone rejected MB's complaint, MB took his complaints to FINRA, which resulted in the instant action.

H. Casas's Use of JPG's Investment Funds

JPG made his investment in two payments: $15,000 on May 29, 2012, and $18,000 on July 23, 2012, both of which were deposited into MCB's bank account. As he had with MB's investment, Casas immediately began using JPG's investment funds to pay his personal expenses, including the following:

- Casas wrote a check for his home mortgage for May 2012. Casas made additional mortgage payments on June 15, July 15, and August 15 from the MCB account.

- In June and August 2012, Casas wrote checks to BN for $2,700. On June 7, Casas also wrote a check to "Cash" for $2,700, which he gave to BN.

- On June 12, 2012, Casas withdrew $100 in cash for JPG to receive lap dances at a strip club.

- On September 6, 2012, Casas spent $67 for JPG to receive a massage.[8]

Casas also continued using the MCB debit card for other personal expenses, including restaurants, gas for his vehicles, dry cleaning, trips to department and grocery stores, dog grooming services, and the movies.

I. RiverStone's Investigation of Casas

As discussed above, MB made a complaint to RiverStone regarding his investment with MCB. Although RiverStone advised MB that it did not believe that it had any supervisory responsibilities with respect to MB's investment in MCB, RiverStone investigated MB's complaint anyway. PG, Casas's supervisor at RiverStone, conducted surprise audits of BN's and Casas's residences in June 2012. During the course of the audit, PG learned that Casas and BN had been using a previously undisclosed and unauthorized email address (MBCap.co.uk) to communicate with MB and others regarding the reverse mergers. While BN was cooperative and forthcoming during the audit, admitting the existence of the previously undisclosed email account, Casas was not. While Casas disclosed a personal AOL account to PG, he stated that there were no other email accounts that he used for business purposes. PG testified that he concluded that Casas intentionally hid the existence of this email account.

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[8] Even though JPG had already told Casas earlier that night that SLC was not going to close the reverse merger transaction, Casas deemed this massage a business expense to entertain JPG.

In addition, on August 8, 2012, RiverStone requested that Casas provide MCB's bank statements so that it could investigate how Casas spent MB's investment. Casas refused to provide MCB's bank statements to RiverStone, stating that he was relying on BN's legal advice. On August 10, 2012, RiverStone requested that Casas and BN provide a detailed accounting reflecting how MB's $50,000 investment had been spent.

On October 9, 2012, Casas and BN provided RiverStone with a one-page summary of MCB's "expenses" through August 31, 2012. This summary was inaccurate and misleading. First, it overstated MCB's legal expenses by $5,000. Second, it categorized Casas's entire home mortgage payment as "rent expense." Third, it did not reflect the repayments made to BN for his bridge loan. Fourth, it did not disclose the cash that Casas regularly withdrew from the MCB bank account. Finally, the summary failed to disclose the thousands of dollars that Casas spent on personal expenses.

On October 15, 2012, Casas and BN provided to Riverstone a detailed accounting, which much like the expense summary was inaccurate on several key points. Although Casas had spent MB's investment funds by May 25, 2012, the accounting report covered the time period of January 30 through August 31, 2012, and reflected that MCB's expenses were $50,039.62, slightly over MB's $50,000 investment. It included approximately $12,000 in expenses (including more than $7,300 in payments to the accounting and law firms) that were incurred after May 25, 2012. In addition, the accounting report did not disclose the loan repayments to BN; instead, the summary categorized those loan payments as legal expenses. Finally, the accounting report did not reflect any personal expenses in lieu of salary. Instead, those expenses were either omitted or categorized as business expenses.[9]

In reality, of the $83,000 that Casas received from the two investors, he spent only $30,734.60 on legitimate accounting and legal fees (approximately 37 percent), far less than the 85 percent figure he had promised to MB in the January 10, 2012 email.

J. The Reverse Merger Transaction Fails

By the end of September 2012, Casas had again overdrawn MCB's bank account. He was out of money and was unable to find any new investors. Ultimately, SLC elected not to go forward with the reverse merger transaction.

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[9] Casas argued at the hearing that he was unaware of the inaccuracies and blamed BN for the accounting. The Extended Hearing Panel did not find Casas's testimony credible. Casas, as MCB's president and manager, received the request for the accounting from RiverStone and he knew how the investment funds were spent. He had spoken to BN about providing the bank statements, took BN's advice, and refused to provide them. When BN provided the accounting report to RiverStone, he included Casas on the email.

II. Procedural Background

FINRA's Department of Enforcement ("Enforcement") filed a two-cause complaint against Casas on October 6, 2014. Cause one alleged that Casas converted investor funds, in violation of FINRA Rule 2010. The second cause of the complaint alleged that Casas fraudulently misrepresented material facts regarding the use of investor funds when soliciting investors and selling membership interests in MCB, in violation of Section 10(b) of the Exchange Act, Exchange Act Rule 10b-5, and FINRA Rules 2020 and 2010.

A three-day hearing was held from June 15-17, 2015, at which FINRA staff, MB, PG, and Casas testified.[10] The Extended Hearing Panel issued its decision on October 2, 2015, finding that Casas willfully violated Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5, and violated also FINRA Rules 2020 and 2010, by fraudulently selling securities issued by his company on the basis of false statements of material fact regarding the use of investor funds, and that he converted investor funds for his personal use, in violation of FINRA Rule 2010. The Extended Hearing Panel barred Casas from association with any FINRA member firm in any capacity, ordered him to pay restitution to MB, and ordered him to pay hearing costs of $8,886.17.[11] Casas appealed.

III. Discussion

A. Casas Converted Investor Funds

We affirm the Extended Hearing Panel's finding that Casas converted MB's and JPG's funds and thereby violated FINRA Rule 2010.

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[10] JPG did not testify at the hearing, but Casas presented an affidavit that he drafted and JPG signed. The affidavit stated that JPG authorized Casas to use his investment funds in Casas's sole discretion, including on "personal expenses in-lieu-of salary." The Hearing Panel did not credit the self-serving affidavit because Casas's OTR testimony contradicted the affidavit. Casas testified at the OTR that he did not think he discussed with JPG whether he would be using his funds to pay personal or out-of-pocket expenses, but that Casas did not think JPG would care. We agree with the Extended Hearing Panel and assign no evidentiary weight to the affidavit.

[11] The Extended Hearing Panel declined to award restitution to JPG. After the reverse merger collapsed, JPG hired Casas to work for him. Based on the record and JPG's refusal to testify at the hearing, the Hearing Panel was unable to determine if JPG recouped any of his losses when negotiating Casas's salary prior to employing him.

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."[12] The rule encompasses "a wide variety of conduct that may operate as an injustice to investors or other participants" in the securities markets. *Edward S. Brokaw*, Exchange Act Release No. 70883, 2013 SEC LEXIS 3583, at *33 (Nov. 15, 2013) (quoting *Daniel Joseph Alderman*, Exchange Act Release No. 35997, 52 SEC 366, 1995 SEC LEXIS 1823, at *7 (July 20, 1995), *petition denied*, 104 F.3d 285 (9th Cir. 1997)). FINRA Rule 2010 "applies when the misconduct reflects on the associated person's ability to comply with the regulatory requirements of the securities business and to fulfill his fiduciary duties in handling other people's money." *Daniel D. Manoff*, 55 S.E.C. 1155, 1162 (2002).

"Conversion generally is an intentional and unauthorized taking of and/or exercise of ownership over property by one who neither owns the property nor is entitled to possess it."[13] Conversion violates FINRA Rule 2010, even if the person from whom the funds are converted is not a customer of the firm with which the respondent was associated. *See Stephen Grivas*, Exchange Act Release No. 77470, 2016 SEC LEXIS 1173, at *11 (Mar. 29, 2016); *see also Dep't of Enforcement v. Olson*, Complaint No. 2010023349601, 2014 FINRA Discip. LEXIS 7 (FINRA Bd. of Governors. May 9, 2014) (finding that respondent violated just and equitable principles of trade for submitting false expense reimbursement claim), *aff'd*, Exchange Act Release No. 75838, 2015 SEC LEXIS 3629 (Sept. 3, 2015); *Ernest A. Cipriani*, 51 S.E.C. 1004 (1994) (finding that a respondent violated just and equitable principles of trade by keeping funds remitted to him by non-securities customers for the purchase of insurance).

Here, Casas took and improperly used MB's and JPG's funds for his own benefit. MB and JPG provided Casas with investment funds for the explicit purpose of providing "seed capital" to MCB in order to finance the reverse merger. Casas told both MB and JPG that their investments would be used to facilitate the reverse merger transaction, particularly with respect to the payment of accounting fees and legal fees, as well as other operational expenses of MCB. In fact, Casas explicitly represented to MB that more than 85 percent of the funds would be directed to accounting and legal fees. Instead, Casas paid less than $31,000 to accounting and legal firms, which amounted to approximately 37 percent of the total amount invested. At no time did Casas disclose that he intended to use the funds for his personal expenses. Although the Subscription Agreement warned investors that the securities were risky and an investment in MCB could result in losses, the Subscription Agreement did not notify potential investors that Casas intended to use investor funds for his personal expenses. Casas's unauthorized use of MB's and JPG's funds was conversion.

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[12] FINRA Rule 2010 applies also to persons associated with a member under FINRA Rule 0140(a), which provides that "[p]ersons associated with a member shall have the same duties and obligations as a member under the Rules."

[13] *FINRA Sanction Guidelines* (2015), at 36 n.2 [hereinafter *Guidelines*].

During oral argument, Casas defended his actions by arguing that his use of investor funds was permitted under the terms of the Subscription Agreement because personal expenses in lieu of salary are considered permissive operational expenses. We disagree. Casas provides no evidence that the terms of the Subscription Agreement authorized him to use the investor funds to pay his personal expenses. In fact, if he had been entitled to use the investor funds to pay his personal expenses in lieu of being paid a salary, he would have had no reason to withhold disclosure of that intended use from his investors. Casas's own testimony demonstrates his conflicting and shifting justifications for the expenses. During his OTR, he attempted to claim that all of his personal expenses had some nexus with legitimate operations of the business entity. Then at the hearing and at oral argument he stated that the expenses were permissible "personal expenses in lieu of salary."

In addition, if in fact Casas had actually intended to use the invested funds as personal expenses in lieu of salary, he should have reported these personal expenses as income to IRS, which he did not. Furthermore, had Casas been authorized to use the investor funds as he claimed, there would have been no reason to hide the personal expenses when submitting the accounting report of MB's investment to RiverStone. Instead, not only did Casas fail to disclose to RiverStone some personal expenses and improperly categorize others, he refused to disclose the existence of an unauthorized email account to RiverStone that he had used to communicate with MB. Casas was aware that his use of investor funds to pay for his personal expenses was impermissible and went out of his way to hide his malfeasance.

We therefore agree with the Extended Hearing Panel that Casas converted to his own use investor funds to which he was not entitled, in violation of FINRA Rule 2010.

B. Casas Engaged in Fraud, in Violation of the Exchange Act and FINRA's Rules

The Extended Hearing Panel found that Casas made material misrepresentations concerning how he intended to use investor funds when selling the MCB membership interests. It concluded that Casas's material misrepresentations constituted securities fraud, and that it was a willful violation of Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5 and a violation of FINRA Rules 2020 and 2010. We affirm the Extended Hearing Panel's findings.

Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5 prohibit fraudulent and deceptive acts and practices in connection with the purchase or sale of a security. Section 10(b) of the Exchange Act makes it "unlawful for any person ... [t]o use or employ, in connection with the purchase or sale of any security ..., any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe." 15 U.S.C. § 78j(b).

To establish a violation of these antifraud provisions, a preponderance of the evidence must demonstrate: (1) a false statement or a misleading omission; (2) of a material fact; (3) made with the requisite state of mind; (4) using the jurisdictional means; (5) in connection with the purchase or sale of a security.[14]

1. Casas Made Misrepresentations to MB and JPG

Casas misrepresented to MB and JPG how he intended to use their invested funds. Casas told both MB and JPG that their investments would be used to facilitate the reverse merger transaction, particularly with respect to the payment of accounting fees and legal fees, and operational expenses of MCB. In an email to MB, Casas further represented that more than 85 percent of the funds would be directed to accounting and legal fees. Instead, Casas paid less than $31,000 to accounting and legal firms, which amounted to approximately 37 percent of the total amount invested.

In reality, Casas used the funds for his own personal expenses. Although the Subscription Agreement warned investors of the risks associated with an investment in MCB, the Subscription Agreement did not notify potential investors of Casas's intention to use investor funds for his personal expenses.

Casas argues that he did not make any misrepresentations to the investors because the use of the investment proceeds for personal expenses in lieu of salary was a permissible operating expense. As previously discussed, Casas provides no evidence that the Subscription Agreement permitted that the invested funds could be used to pay personal expenses. Moreover, had Casas been entitled to use the investor funds to pay his personal expenses in lieu of being paid a salary, he would have had no reason to withhold disclosure of that intended use from his investors or misrepresent to RiverStone how MB's funds were spent.

2. Casas's Misrepresentations Were Material

The evidence also supports the finding that Casas's representations regarding the use of the investment funds were material. "Whether information is material 'depends on the significance the reasonable investor would place on the . . . information.'" *Dep't of Enforcement v. Akindemowo*, Complaint No. 2011029619301, 2015 FINRA Discip. LEXIS 58, at *32 (NAC Dec. 29, 2015), *aff'd*, Exchange Act Release No. 79007, 2016 SEC LEXIS 3769 (Sept. 30, 2016)

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[14] FINRA Rule 2020 proscribes fraud in language similar to Exchange Act Section 10(b), stating: "no member shall effect any transaction in, or induce the purchase or sale of, any security by means of any manipulative, deceptive or other fraudulent device or contrivance." "A violation of Exchange Act Section 10(b) also constitutes a violation of FINRA Rule 2020." *William Scholander*, Exchange Act Release No. 77492, 2016 SEC LEXIS 1209, at *15 (Mar. 31, 2016). Committing fraud and other violations of law and FINRA rules is inconsistent with the high standards of ethical conduct required by Rule 2010.

(quoting *Basic Inc. v. Levinson*, 485 U.S. 224, 240 (1988)). In the context of Exchange Act Rule 10b-5, a fact is material if a reasonable investor would view the disclosure of the omitted information as "significantly alter[ing] the total mix of information made available." *Levinson*, at 232.

In deciding whether to invest in MCB, a reasonable investor would consider it important that Casas, contrary to the representations made in the Subscription Agreement and the January 10, 2012 email, would use the majority of the investments for his own personal use. Thus, we affirm the Extended Hearing Panel's finding that Casas's misrepresentations about his intended use of the funds were material.

3. Casas Acted with Scienter

We also find that Casa acted with scienter. "Scienter is defined as 'a mental state embracing intent to deceive, manipulate, or defraud.'" *Akindemowo*, 2015 FINRA Discip. LEXIS 58, at *33 (quoting *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976)). "Scienter is established if a respondent acted intentionally or recklessly." *Id.* (citing *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 n.3 (2007)). Casas does not deny that he was responsible for the content of the January 10, 2012 email and the Subscription Agreement, both of which indicated that the investment funds would be used for legal, accounting, and operational expenses of the company. Moreover, there is no evidence that Casas took any steps to inform or update the investors that he was in fact using their funds to pay his personal expenses. In addition, Casas deliberately hid his use of investor funds when he provided RiverStone with inaccurate account statements. Casas's concealment from RiverStone bolsters our finding that he intended to deceive MB and JPG regarding the use of their funds. Casas's actions reflect an intent to deceive or defraud that satisfy the scienter requirement.

4. Jurisdictional Means

Liability under Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5 also requires proof that Casas used "means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange." 17 C.F.R. § 240.10b-5. The jurisdictional element of the case is satisfied because Casas emailed MB and JPG to discuss terms of the investment. *See SEC v. Levin*, No. 12-21917-CIV, 2013 U.S. Dist. LEXIS 20027, *31-32 (S.D. Fla. Feb. 14, 2013) ("[T]he Internet, which necessarily includes email, is an 'instrumentality of interstate commerce.' Because the interstate communications prong of Section 5 is broadly construed, allegations of Preve's email use are sufficient to withstand a motion to dismiss.") (citations omitted). In addition, MB sent his funds to Casas via a wire transfer, which also satisfies the jurisdictional element. *See Shepherd v. S3 Partners, LLC*, No. C-09-01405 RMW, 2011 U.S. Dist. LEXIS 117957 (N.D. Cal. Oct. 12, 2011) (inducing other party to deposit funds via wire transfer constitutes use of a means of interstate commerce in furtherance of the alleged fraud).

5. The MCB Interests Are Securities

We agree with the Extended Hearing Panel that the MCB membership interests that MB and JPG purchased are securities under the Exchange Act.[15] To determine whether a particular investment product is a security, a preponderance of the evidence must demonstrate that the investment product involved: (1) "an investment of money;" (2) "in a common enterprise;" (3) "with a reasonable expectation by the investors of profits;" (4) "to be derived from the managerial efforts of others." *See SEC v. W. J. Howey Co.*, 328 U.S. 293, 301 (1946); *see also Warfield v. Alaniz*, 453 F. Supp. 2d 1118, 1124 (D. Ariz. 2006) (enumerating the *Howey* factors), *aff'd*, 569 F.3d 1015 (9th Cir. 2009). When applying *Howey*, the Supreme Court cautioned that the test should be "broadly construed by [] courts so as to afford the investing public a full measure of protection [, and that form should be] disregarded for substance and emphasis was placed upon economic reality." *Howey*, 328 U.S. at 298. The Supreme Court noted that the term, security, "embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits." *Id*. at 299. Applying these factors, we find that the MCB membership interests were securities.

The first factor is satisfied because MB and JPG invested money. There is an "investment of money" when an investor provides "some tangible and definable consideration in return for an interest that had substantially the characteristics of a security." *Dep't of Enforcement v. v. Bernard G. McGee*, Complaint No. 2012034389202, 2016 FINRA Discip. LEXIS 33, at *43 (NAC Jul.18, 2016) (*citing Int'l Bhd. of Teamsters v. Daniel*, 439 U.S. 551, 559-560 (1979)), *appeal docketed*, SEC Admin. Proceeding No. 3-17402 (Sept. 21, 2016); *see also Warfield v. Alaniz*, 569 F.3d 1015, 1021 (9th Cir. 2009). MB invested $50,000 and JPG invested $33,000.

Second, we find that MB and JPG were investing in a common enterprise.[16] The "pooling of interests among more than one investor is the clearest example of a common enterprise." *Id.* (internal quotation marks omitted). Here, Casas specifically represented to MB and JPG that the investment in MCB involved the pooling of investor funds—thus establishing evidence of a common enterprise. This form of a "common enterprise" is known as "horizontal commonality," which the majority of circuit courts recognize as satisfying the *Howey* common enterprise requirement. *See, e.g.*, *SEC v. SG Ltd.*, 265 F.3d 42, 50 (1st Cir. 2001); *Revak v. SEC Realty Corp.*, 18 F.3d 81, 87-88 (2d Cir. 1994); *SEC v. Infinity Grp. Co.*, 212 F.3d 180, 188 (3d

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[15] Casas did not argue below, nor does he argue on appeal, that the MCB interests were not securities.

[16] The SEC has held that a "common enterprise" is "not a distinct requirement for an investment contract under *Howey*." *Johnny Clifton*, Exchange Act Release No. 69982, 2013 SEC LEXIS 2022, at *32 n.55 (July 12, 2013).

Cir. 2000); *Teague v. Bakker*, 35 F.3d 978, 987 n.8 (4th Cir. 1994); *Newmyer v. Philatelic Leasing, Ltd.*, 888 F.2d 385, 394 (6th Cir. 1989); *SEC v. Lauer*, 52 F.3d 667, 670 (7th Cir. 1995); *SEC v. Banner Fund Int'l*, 211 F.3d 602, 614 (D.C. Cir. 2000).

Third, MB and JPG expected to receive profits from their investments once the reverse merger was complete. To gauge whether there was such an expectation, we employ an objective test "based on what the purchasers were lead to expect." *See Warfied*, 569 F.3d at 1021. The January 10, 2012 email to MB stated that (1) Casas was selling six membership interests in MCB, and (2) assuming the reverse merger transaction was successful, MB could expect to receive a 600 percent return on his investment. The Subscription Agreements, prepared by Casas and executed by MB and JPG, described the membership interests as securities and noted that the investor could only sell them pursuant to an exemption from the registration requirements under the federal securities laws.

Finally, the profits that Casas promised were based on the efforts of Casas, not the investors. As detailed above, MB and JPG invested in MCB with the expectation of earning profits solely from the efforts of Casas. MB and JPG had no involvement in the management of MCB.

Therefore, we find, based on the satisfaction of the Howey investment contracts test, that the products Casas sold were securities, and we conclude that Casas made material misrepresentations concerning how he intended to use investor funds when selling the MCB membership interests, in willful violation of Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5 and in violation of FINRA Rules 2020 and 2010.[17]

C. Casas's Arguments on Appeal Lack Merit

In his briefs and at oral argument, Casas makes several arguments challenging jurisdiction, venue, as well as the fundamental fairness of FINRA's proceedings. We find each argument unavailing.

First, Casas argues that FINRA has no jurisdiction to resolve a private contract dispute with his investors and maintains that FINRA does not have jurisdiction because he was not

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[17] Although not addressed in the Extended Hearing Panel Decision, Casas is subject to statutory disqualification. Casas's willful violation of Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5 results in his statutory disqualification. *See Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) ("'[W]illfully" in [the Exchange Act] means intentionally committing the act which constitutes the violation," not that "the actor [must] also be aware that he is violating one of the Rules or Acts."); *Robert Marcus Lane*, Exchange Act Release No. 74269, 2015 SEC LEXIS 558, at *3 n.2 (Feb. 13, 2015); *see also* Sections 3(a)(39)(F) (15 U.S.C. § 78c(a)(39)(F)) and 15(b)(4)(D) (15 U.S.C. § 78o(b)(4)(D)) of the Exchange Act; Article III, Section 4 of FINRA's By-Laws.

acting in the capacity of a registered Series 79 limited investment banking representative in his dealings with MB and JPG. Casas is mistaken. As a registered person and a person associated with a member firm, Casas's business-related conduct is subject to discipline in accordance with FINRA rules. *See, e.g.*, *Grivas*, 2016 SEC LEXIS at *16-17 (respondent converted funds invested in limited liability corporation of which he was manager); *Keilen Dimone Wiley*, Exchange Act Release No. 76558, 2015 SEC LEXIS 4952, at *10–13 (Dec. 4, 2015) (respondent converted insurance premiums and used money to pay personal and business expenses); *Mullins*, 2012 SEC LEXIS 464 (respondent converted wine and gift certificates); *Akindemowo*, 2015 FINRA Discip. LEXIS 58 (NAC Dec. 29, 2015) (respondent converted funds entrusted to him for investment in a purported loan-pooling business and used money for, among other things, mortgage payments). "[W]hether misconduct is within Rule 2010's scope is ultimately a question of whether the conduct raises concerns that the associated person will not comply with the regulatory requirements of the securities business and will not fulfill [his or her] fiduciary duties in handling other people's money." *Grivas*, 2016 SEC LEXIS 1173 at *17 (internal quotations omitted). Casas's argument that FINRA Rule 2010 does not allow FINRA "to adjudicate contract disputes for business activities not regulated by FINRA" is also misplaced. FINRA is not adjudicating a contract dispute; it is adjudicating Casas's egregious violations of SEC and FINRA rules. *Cf. Wiley*, 2015 SEC LEXIS 4952, at *14 ("[I]t is Wiley's violation of FINRA Rule 2010, not his violation of any contract, that is at issue here"). Therefore, Casas's argument that FINRA lacks jurisdiction fails.

Casas next argues that a FINRA hearing panel is not the appropriate "venue" to adjudicate this matter.[18] He maintains that the matter should have been brought in federal or state court, where his due process concerns would be protected, a court's subpoena could be exercised, and fairness issues under the Administrative Procedure Act ("APA") could be resolved.[19] Casas believes that he was prejudiced in part because of FINRA's lack of subpoena power and its inability to compel the testimony of individuals who are not subject to FINRA jurisdiction, particularly JPG. But state and federal courts do not offer alternative forums for the adjudication of FINRA disciplinary proceedings. The SEC has also expressly rejected the argument that FINRA disciplinary proceedings are unfair because they do not confer on

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[18] Casas misunderstands the concept of venue. For civil cases, venue is usually the district or county which is the residence of a principal defendant, where a contract was executed or is to be performed, or where an accident took place.

[19] We construe Casas's arguments to take exception to FINRA as the appropriate forum for this dispute. His arguments fail. Casas seemingly argues that FINRA proceedings are subject to constitutional standards such as due process and that they are governed by the APA. But constitutional standards have no application to FINRA because FINRA is not a state actor. *Gregory Evan Goldstein*, Exchange Act Release No. 71970, 2014 SEC LEXIS 1350, at *26 and *26–27 nn.33, 34 (Apr. 17, 2014). Nor does the APA apply to FINRA; it applies only to "agencies" as that term is defined in the statute and FINRA is not an "agency." *See* 5 USCS § 551.

respondents the right to subpoena witnesses. *See James Elderidge Cartwright*, Exchange Act Release No. 31087, 1992 SEC LEXIS 2009, at *12 (Aug. 25, 1992).

Casas also argues that "[a]nother key issue regarding the proper venue to adjudicate this matter is the application of Section 10(b) of the Exchange Act." The argument appears to be based on an erroneous belief that, if FINRA were to assert its claims against Casas in federal court, it would have to prove reliance, economic loss, and loss causation. In support of the argument, Casas cites *Dura Pharmaceuticals, Inc. v. Broudo*, a 2005 Supreme Court decision addressing the sufficiency of the manner in which the plaintiff in that private action for damages under Exchange Act Rule 10b-5 pleaded loss causation. *See Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336 (2005). The decision has no application here. Reliance, economic loss, and loss causation must be proved by a plaintiff seeking damages pursuant to the implied private right of action under Rule 10b-5; they are not required elements of proof in a regulatory action enforcing Rule 10b-5. *See, e.g.*, *Fillet*, 2013 FINRA Discip. LEXIS 26, at *19; *SEC v. Rana Research*, 8 F.3d 1358, 1364 (9th Cir. 1993).

Finally, Casas contends that FINRA was biased against him and that the entire process was unfair.[20] The record is devoid of evidence supporting any of Casas's allegations. Casas makes the unsupported claim that Enforcement "initiated the complaint against [him] based on a false allegation by [MB] that [he] was a client of RiverStone and that Casas was acting under his Series 79." We reject this argument. Whatever allegations MB may have made to FINRA, the complaint does not allege that MB was a RiverStone customer, nor is the fact that MB was not a RiverStone customer relevant to the misconduct at issue. *See Akindemowo*, 2015 FINRA Discip. LEXIS 58, at *18–19 (citing *Manoff*, 55 S.E.C. at 1163 (20002) ("Rule 2010 prohibits conversion even when the victim is not a customer of the firm with whom the registered representative is associated"). Even if the record demonstrated that Enforcement had an improper basis for investigating and filing a complaint against Casas, which we find it does not, "[a]bsent a showing of selective enforcement, the motives behind [Enforcement's decision to initiate an investigation and commence disciplinary proceedings] are irrelevant." *Dep't of Enforcement v. Epstein*, Complaint No. C9B040098, 2007 FINRA Discip. LEXIS 18, at *78 (FINRA NAC Dec. 20, 2007), *aff'd*, Exchange Act Release No. 59328, 2009 SEC LEXIS 217 (Jan. 30, 2009), *aff'd*, *Epstein v. SEC*, 416 F. App'x 142 (3d Cir. 2010); *see also Frank J. Custable, Jr.*, 51 S.E.C. 855, 862 n.22 (1993) (concluding that bias on the part of a FINRA staff member does not mean the FINRA decision is biased). Casas has not demonstrated that FINRA

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[20] Again, Casas maintains that FINRA's lack of impartiality violates the APA. As we have previously noted, the APA does not apply to FINRA's actions. Moreover, even if there were evidence of bias (which there is not), our de novo review, in which we have carefully considered all of the evidence in the case and the transcripts of the proceedings below, "dissipates even the possibility of unfairness." *Robert Tretiak*, 56 S.E.C. 209, 232 (2003); *see also Robert E. Gibbs*, 51 S.E.C. 482, 484-85 (1993) (discussing how de novo review by the NASD Board during NASD disciplinary proceedings insulates against bias), *aff'd*, 25 F.3d 1056 (10th Cir. 1994) (table).

has engaged in selective prosecution. *See Terrance Yoshikawa*, Exchange Act Release No. 53731, 2006 SEC LEXIS 948, at *28-29 (Apr. 26, 2006) (holding that respondents must demonstrate that they were singled out for enforcement while others similarly situated were not and that such prosecution was motivated by arbitrary or unjust considerations (e.g., race, religion, or the desire to prevent the exercise of a constitutionally protected right)). Consequently, we reject Casas's argument.

Section 15A(b)(8) of the Exchange Act provides that FINRA disciplinary proceedings must be conducted in accordance with fair procedures. *See Scott Epstein*, 2009 SEC LEXIS 217, at *51 (holding that FINRA must provide fair procedures for its disciplinary actions). Section 15A(h)(1) of the Exchange Act requires that FINRA, in a disciplinary proceeding, "bring specific charges, notify such member or person of and give him an opportunity to defend against, such charges, and keep a record." Here, we find that the proceedings before the Extended Hearing Panel were fair and conducted in accordance with FINRA rules. Enforcement commenced its investigation of Casas after it received MB's complaint concerning possible misconduct by Casas. Following its investigation and after taking Casas's investigative testimony, Enforcement filed a complaint against Casas. We find that Casas had ample notice of the allegations against him, access to FINRA's documents,[21] and had an opportunity to defend himself throughout the underlying proceedings.

IV. Sanctions

The Extended Hearing Panel barred Casas for conversion and imposed a separate bar for his fraud. For the reasons set forth below, we affirm these sanctions.

A. Conversion

The Guidelines governing sanctions for conversion direct us to consider the Principal Considerations in Determining Sanctions and "[b]ar the respondent regardless of amount

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[21] Casas claims bias is evidenced by Enforcement's "dumping over 1,500 documents" on him "days before the hearing," and the Hearing Officer's decision to decline to impose sanctions for Enforcement's failure to produce the documents earlier. Casas's argument grossly misstates the events. Early in the proceeding, Enforcement timely produced to Casas what it then believed to be its entire investigative file. Then, just short of two months before the hearing, Enforcement discovered that attachments to RiverStone's response to FINRA's Rule 8210 request, including 165 pages of documents as well as emails to and from Casas or his business partner, had been misplaced and, consequently, had not been produced to Casas. Enforcement produced those documents and emails less than two days after discovery of the production deficiency. Casas moved for sanctions against Enforcement, including having Enforcement counsel removed from the case. The Hearing Officer denied this motion, finding that Enforcement's error was inadvertent and that, in any event, Casas already had access to and reviewed most of the information at issue since he was either the sender of the emails or the recipient.

converted."[22] We find that there are numerous aggravating factors associated with Casas's conversion and no mitigating factors that could lead us to conclude that a sanction less than a bar is in order. We find it aggravating that Casas's conversion harmed his investors,[23] while at the same time resulting in his monetary gain.[24] Casas attempted to conceal his misconduct by failing to disclose to RiverStone his personal expenses and improperly categorized others, and through his refusal to acknowledge the existence of an unauthorized email account that he had used to communicate with MB.[25] We note that the amount of money converted was substantial, representing a majority of the funds that should have been invested with MCB.[26] We also find it aggravating that Casas's conversion was intentional as he immediately began spending MB's and JPG's invested funds to pay his personal expenses.[27]

In light of the numerous aggravating factors, and considering that a bar is the standard sanction in conversion cases, we hereby bar Casas in all capacities for the conversion of MB's and JPG's funds.

B. Fraud

The Guidelines for misrepresentations of fact recommend that we strongly consider imposing a bar for intentional or reckless misconduct, and a fine of $10,000 to $146,000.[28] When mitigating factors are present, the Guidelines recommend suspending an individual for six months to two years.[29]

Casas's misrepresentations were egregious and, with no mitigating factors present, warrant a bar. The aggravating factors articulated for conversion apply equally to this cause of action. Casas's misconduct was intentional, not merely negligent.[30] Casas was responsible for the creation of the Subscription Agreement that both investors received. He also drafted the January 10, 2012 email to MB. Immediately after receiving the investors' funds, he began using the money for his personal expenses. He concealed his misconduct from RiverStone through his use of an unauthorized email account and with false and misleading accounting reports.[31] In

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22 *Guidelines*, at 36.

23 *Id*. at 6 (Principal Considerations in Determining Sanctions, No. 11).

24 *Id*. at 7 (Principal Considerations in Determining Sanctions, No. 17).

25 *Id.* at 6 (Principal Considerations in Determining Sanctions, No. 10).

26 *Id*. at 7 (Principal Considerations in Determining Sanctions, No. 18).

27 *Id*. at 7 (Principal Considerations in Determining Sanctions, No. 13).

28 *Id.* at 88.

29 *Id.*

30 *Id*. at 7 (Principal Considerations in Determining Sanctions, No. 13).

31 *Id.* at 6 (Principal Considerations in Determining Sanctions, No. 10).

addition, Casas refuses to accept responsibility for his misconduct.[32] He continues to argue that he did not misrepresent anything to the investors. Rather than accept responsibility, he blames others. He blames MB for complaining to FINRA and BN for creating the false accounting reports. Casas's refusal to admit wrongdoing and his continued finger-pointing only heightens our concern that he may engage in similar misconduct in the future. *See Manoff*, 55 S.E.C. at 1165 ("Manoff has not shown any remorse or admitted wrongdoing . . . .").

Therefore, after carefully reviewing the facts and circumstances surrounding Casas's misrepresentations, and finding no mitigating factors, we affirm the Extended Hearing Panel's conclusion that a bar in all capacities from associating with any FINRA member is the appropriate remedial sanction for this violation.

C. Restitution

The Extended Hearing Panel ordered that Casas make restitution to MB in the amount of $50,000. The Guidelines instruct adjudicators to order restitution where it is appropriate to remediate misconduct and necessary to "restore the status quo ante for victims who would otherwise unjustly suffer loss."[33] We may order restitution "when an identifiable person . . . has suffered a quantifiable loss proximately caused by a respondent's misconduct."[34] On appeal, we affirm the Hearing Panel's restitution order.

MB invested $50,000 in MBC as a direct result of the Casas's material misrepresentations concerning the use of the investment funds, and Casas proceeded to convert those invested funds for his personal use. Casas's payment of restitution shall include prejudgment interest, which shall accrue from January 27, 2012 (the date MB's investment), until paid. The prejudgment interest rate shall be the rate established for the underpayment of income taxes in Section 6621(a) of the Internal Revenue Code, 26 U.S.C. § 6621(a).[35]

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32 *Id*. at 6 (Principal Considerations in Determining Sanctions, No. 2).

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

34 *Id.*

35 *Id.* at 9 (Technical Matters).

V. Conclusion

Casas converted MB and JPG's funds in violation of FINRA Rule 2010, and fraudulently sold securities on the basis of false statements of material fact regarding the use of investor funds, in willful violation of Exchange Act Section 10(b) and Exchange Act Rule 10b-5 and in violation of FINRA Rules 2020 and 2010. We bar Casas in all capacities for his conversion and impose a separate bar in all capacities for his fraud, effective upon service of this decision. We affirm the Extended Hearing Panel's award of restitution in the amount of $50,000 to MB. We also affirm the order that Casas pay $8,886.17 in hearing costs and order him to pay $1,514.77 in appeal costs.

On Behalf of the National Adjudicatory Council,

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Marcia E. Asquith, Senior Vice President
and Corporate Secretary