BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD REGULATION, INC.

In the Matter of Department of Enforcement, Complainant, vs. Roger A. Hanson Milwaukee, WI, Respondent.	DECISION Complaint No. C8A000059 Dated: March 28, 2002

Registered representative stipulated that he had engaged in private securities transactions, acknowledged his liability for violating Rules 2110 and 3040, and was suspended for 90 days, ordered to disgorge his commissions to his customers, and fined $5,000. Held, suspension increased to 180 days and monetary sanctions modified.

We called this case for review pursuant to Procedural Rule 9312 to examine the sanctions imposed by the Hearing Panel. After a review of the entire record in this matter, we accept the Hearing Panel's finding that Roger A. Hanson ("Hanson") violated Conduct Rules 2110 and 3040 by participating in private securities transactions for compensation, without prior written notice to and approval by his firm. We modify the Hearing Panel's sanctions and order that Hanson be suspended in all capacities for 180 days, fined $27,050, and ordered to pay costs.

Discussion

In 1996 and 1997, Hanson was registered with Liss Financial Services ("Liss Financial" or "the Firm") as a general securities representative. Hanson is not currently registered with the NASD.

In the proceedings before the Hearing Panel, Hanson stipulated that he had sold securities for compensation without prior written notice to or approval by Liss Financial. The hearing below therefore focused on how to weigh the undisputed facts regarding the violation when assessing sanctions.

Between November 1996 and February 1997, Hanson sold limited partnership units to 15 of his customers for a total amount of $220,500. None of the 15 customers was a customer of Liss Financial. Rather, the 15 customers were long-time clients of Hanson whom he had met while working for other firms. Hanson earned commissions of $22,050 on the limited partnership sales. In addition, Hanson himself purchased $30,000 of limited partnership units. Hanson did not inform the Firm about his sales of the limited partnership units.

The limited partnerships sought to develop the market for pre-paid and other cellular services in the greater metropolitan Los Angeles area. The limited partnerships owned the right to use equipment manufactured for One Stop Wireless of America. As to running a business, however, the limited partnerships failed. The investors eventually lost nearly all of their money. After bankruptcy reorganization, the investors were paid approximately $300 for each $10,000 they had invested.[1]

Enforcement introduced evidence that one of the limited partnerships was a speculative investment because it had no operating history. At the hearing below, Enforcement established that Hanson had not examined the limited partnerships' books and records, including balance sheets or income statements.

Because the parties stipulated that Hanson violated Conduct Rules 3040 and 2110 and because we called this case for review as to sanctions only, we do not review the issue of liability. We accept that Hanson sold securities without prior written notice to or approval by his Firm.

Sanctions

The Hearing Panel imposed sanctions of a 90-day suspension, a $5,000 fine, and $1,122.91 in costs. In addition, the Hearing Panel ordered Hanson to "disgorge" $22,050 of commissions and pay this amount to his customers on a pro rata basis. For a selling away violation, the NASD Sanction Guidelines recommend a fine of $5,000 to $50,000 and a suspension of 10 business days to one year. See NASD Sanction Guidelines ("Guidelines") (2001 ed.) at 19 (Selling Away - Private Securities Transactions). In egregious cases, the Guidelines recommend a suspension of up to two years or a bar.

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1 The investors also received shares of stock, which had no appreciable market at the time of the hearing below.

A. Disgorgement of Commissions

The Hearing Panel ordered that Hanson "disgorge" his total commissions and pay them, on a pro rata basis, to the customers who purchased the limited partnerships. We conclude that the Hearing Panel's order that Hanson pay his customers $22,050 lacks support in the record and we eliminate it. An order that a respondent pay money to his customers is an order of restitution, not disgorgement.[2] Here, the complaint and the Hearing Panel's decision establish that Hanson did not notify the Firm or receive approval from the Firm to sell the limited partnerships to his customers. The record does not establish that the customers' losses were caused by anything other than the poor performance of the investments. Without having adjudicated the issues of whether Hanson made unsuitable recommendations, whether he made misrepresentations about the investments, or similar claims, we do not find it appropriate in this case to sustain the Hearing Panel's order that Hanson pay his commissions to his customers.[3]

Because Hanson earned commissions as a direct result of violating Conduct Rule 3040, we include the amount of his commissions as part of the fine that we impose. Our ruling on this issue is consistent with the Guidelines. The Guideline for private securities

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2 Judge Bassler explained the difference between restitution and disgorgement as follows:

> Disgorgement wrests ill-gotten gains from the hands of a wrongdoer. It is an equitable remedy meant to prevent the wrongdoer from enriching himself by his wrongs. Disgorgement does not seek to compensate the victims of the wrongful acts, as restitution does. Thus, a disgorgement order might be for an amount more or less than that required to make the victim whole. It is not restitution.

SEC v. Hughes Capital Corp., 917 F. Supp. 1080, 1085 (D.N.J. 1996).

3 The Hearing Panel cited a decision of our predecessor, the National Business Conduct Committee ("NBCC"), in which the NBCC ordered a respondent to "disgorge" his commissions and pay them to his customers. See District Bus. Conduct Comm. v. Knepp, 1995 NASD Discip. LEXIS 31, at *31, *33 (NBCC June 9, 1995). The Hearing Panel's reliance on Knepp was misplaced. There, the NBCC based its sanctions on all the violations in the case, which included private securities transactions, selling unregistered securities, failure to exercise due diligence when selling securities, and failing to register as a broker or dealer. See Id. at *2, *31. In a case where a respondent has engaged in private securities transactions and no other violations, adjudicators should start with the approach of the Guidelines, which instruct that a respondent should pay a fine to the NASD that includes a respondent's commissions or other financial benefits.

transactions indicates that adjudicators may increase the fine against a respondent by adding the amount of a respondent's financial benefit to the fine. See Guidelines at 19 n.2. The Guideline for private securities transactions does not recommend that adjudicators consider ordering restitution or partial restitution to customers. Accordingly, we order that Hanson pay a fine of $27,050. See Guidelines at 19 n.2.

B. Hanson's Suspension

On appeal, Enforcement argues that—based on all the circumstances involved in this case—Hanson's misconduct was egregious and he should be barred. Upon careful review, we increase the length of Hanson's suspension, but we do not adopt Enforcement's position that we should bar him. We find that a 180-day suspension is appropriate in this case.

1. Hanson's Intent

Enforcement argues that Hanson's violation was egregious because he intentionally, or at least recklessly, engaged in selling away. At the hearing, Hanson testified that he did not inform the Firm about his sales of the limited partnership units because he believed that they were not securities. Hanson based this belief on discussions with a sales manager of the issuer and on an opinion letter the issuer received from its counsel.

The Hearing Panel concluded that Hanson was believable when he testified that he would have sold the limited partnerships through the Firm if he had known that the units were securities. We find no reason to overturn this credibility determination of the Hearing Panel.[4]

Enforcement further argues that Hanson acted intentionally because, although he had reported to Liss Financial that he operated a separate corporation through which he sold insurance, he did not report his sales of the limited partnerships to the Firm. We find that this fact does not show that Hanson intentionally violated the rule. Moreover, we find that the record is insufficiently developed on this point to draw an inference against Hanson. We do not, however, need to find that Hanson intentionally violated the rule to conclude that his misconduct was a serious offense that warrants a significant suspension. When a registered person fails to give written notice to the firm, the firm loses the opportunity to "evaluate the transaction and … determine whether it will approve the transaction, and if it does, how it will supervise the associated person's participation in the transaction." Department of Enforcement v. Fergus, 2001 NASD Discip. LEXIS 3, at *66 (NAC May 17, 2001).

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[4] The Hearing Panel observed Hanson giving this testimony. We therefore give the Hearing Panel's determination considerable weight. See Frank J. Custable, 51 S.E.C. 643, 648 (1993).

We conclude that Hanson's misconduct was serious, but not egregious. Hanson's conduct fell short of the reasonable care required of a securities professional when he concluded that the limited partnerships were not securities.

2. Advice of Counsel

At the hearing, Hanson testified that he believed that the limited partnerships were not securities, in part, because of an attorney's letter that Hanson received in connection with selling the limited partnership units. The letter was from Arthur J. Frost, LTD, attorney at law, to the issuer, and it stated that the issuer had requested the attorney to prepare the letter. In the letter, the attorney rendered his opinion that the limited partnership units were not "securities" as defined in the Securities Act of 1933, and as interpreted by federal and state administrative and judicial decisions. We find that Hanson's reliance on this letter was not a mitigating factor.

Under the Guidelines, we consider a respondent's claim of reliance on advice of counsel by examining "[w]hether the respondent demonstrated reasonable reliance on competent legal or accounting advice." Guidelines at 9. Here, the issuer's opinion of counsel letter contained an important warning in the final paragraph: "Although I believe that under existing federal law, securities are not being sold by the partnership it would appear that no matter what the facts, some state regulators may attempt to achieve such a determination." Because this paragraph identifies the possibility that the limited partnership units were securities, we find that Hanson's reliance on the letter was not "reasonable reliance," as required under the Guidelines. Once an opinion of counsel letter obtained by an issuer raises the possibility that an investment may be a security, for the purpose of evaluating mitigation under the Guidelines, we find it unreasonable for a respondent to rely on such an opinion.

Moreover, in these circumstances a respondent should not rely solely on a legal opinion letter obtained by the issuer as to whether a financial instrument is a security. We agree that registered persons should not make the assessment of whether a limited partnership, note, or other instrument is a security, but should "give their firms the opportunity to determine whether the sale" involves a security and therefore requires written notice to the firm and firm approval. NASD *Notice to Members* 01-79 (Dec. 2001).

3. Other Considerations Under the Sanction Guidelines

As to the five considerations specifically listed in the Guidelines for selling away violations, we find that Hanson's conduct was contrary to one of these considerations. Hanson failed to give the Firm at least verbal notice of his selling away. Hanson's conduct was not contrary to the other four considerations. First, Hanson did not have a proprietary or beneficial interest in the issuer. Second, Hanson did not create any impression that the Firm approved of the limited partnerships. Third, Hanson did not sell the limited partnerships to customers of the Firm. Lastly, Hanson's Firm had not given a prior warning against selling limited partnerships.

Enforcement argues that Hanson showed no remorse toward his customers. The Hearing Panel, however, determined that Hanson "showed some remorse." After a careful review of the record, we find no basis for overturning the Hearing Panel's credibility-based determination.

Enforcement contends that Hanson's failure to investigate the business prospects of the limited partnerships is an aggravating factor here. We disagree. Enforcement did not allege that Hanson violated NASD rules by failing to use the requisite diligence when selling limited partnerships to customers. Rather, Enforcement alleged that Hanson engaged in private securities transactions in violation of Conduct Rule 3040. As a general matter, if Enforcement alleges and proves that a respondent both sold a security in an unlawful private securities transaction and recommended such a sale when it was unsuitable, we would consider such misconduct to be more serious than either violation standing alone. In this case, however, we base our sanctions on the factors contained in the Guidelines for private securities transactions violations. We do not consider whether Hanson's efforts, or alleged lack thereof, in assessing the business prospects of the limited partnerships is an aggravating factor because such misconduct was not alleged in the complaint.

4. Comparisons with Other Cases

We have long recognized the principle that appropriate sanctions depend on the facts and circumstances of each particular case and cannot be determined precisely by broad comparison with actions taken in other proceedings or against other individuals in the same proceeding. See Butz v. Glover Livestock Comm'n Co., 411 U.S. 182, 187 (1973); David A. Gingras, 50 S.E.C. 1286, 1293-94 (1992). Our decision regarding what sanctions to impose on a respondent is a fact-bound endeavor that involves the careful weighing of numerous different factors.

Without acknowledging the difficulty of broad comparisons, Enforcement argues that two recent private securities transaction decisions should guide our assessment of the seriousness of this case. See Department of Enforcement v. Newcomb, 2000 NASD Discip. LEXIS 15 (Nov. 16, 2000); District Bus. Conduct Comm. v. Goldsworthy, 2000 NASD Discip. LEXIS 13 (Oct. 16, 2000). First, we are satisfied that the sanctions we impose on Hanson reflect the particular circumstances of this case. Second, the two recent cases that Enforcement relies on are significantly different from this case. In Newcomb, where we imposed a two-year suspension, we found aggravating that the respondent was selling promissory notes in his own company and that—during the 18-month period of his selling away—respondent learned that he needed to report his securities sales to his firm but chose not to do so. The critical differences between Newcomb's and Hanson's cases are: (1) Newcomb was President of the issuer, while Hanson had no relation to the issuer;

(2) Newcomb sold $1,000,000 of promissory notes to 48 customers, while Hanson sold $220,500 to 15 customers; and (3) Newcomb knew that he was violating the rule, while we have found that Enforcement did not prove that Hanson committed an intentional violation.

The Goldsworthy case is also significantly different from Hanson's. In Goldsworthy, the respondent had a disciplinary history, was the President of the issuer, and refused to accept responsibility for his misconduct. Goldsworthy, 2000 NASD Discip. LEXIS 13, at *39. None of these aggravating factors is present in this case. Consequently, even if we accepted Enforcement's argument, which we do not, that we should compare this case to other cases, we do not agree that Newcomb and Goldworthy are the appropriate cases.

Conclusion

We consider a private securities transaction violation to be a serious breach of a registered representative's duty to his member firm and to the investing public. See Fergus, 2001 NASD Discip. LEXIS 3, at *66. The sanctions that we impose reflect our conclusion that Hanson's misconduct was serious.

Accordingly, we order that Hanson be suspended in all capacities for 180 days, fined $27,050, and ordered to pay costs of $1,122.91.[5]

On Behalf of the National Adjudicatory Council,

Barbara Z. Sweeney
Senior Vice President and Corporate Secretary

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[5] We have also considered and reject without discussion all other arguments advanced by Enforcement.

Pursuant to NASD Procedural Rule 8320, any member that fails to pay any fine, costs, or other monetary sanction imposed in this decision, after seven days' notice in writing, will summarily be suspended or expelled from membership for non-payment. Similarly, the registration of any person associated with a member who fails to pay any fine, costs, or other monetary sanctions, after seven days' notice in writing, will summarily be revoked for non-payment.