BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD REGULATION, INC.

In the Matter of District Business Conduct Committee For District No. 9 Complainant, vs. Maximo J. Guevara Philadelphia, PA, Respondent.	DECISION Complaint No. C9A970018 District No. 9 (PHL) Dated: January 28, 1999

Maximo J. Guevara ("Guevara") appealed the May 6, 1997 decision of the District Business Conduct Committee for District No. 9 ("DBCC") pursuant to NASD Procedural Rule 9310. After a review of the entire record in this matter, we affirm the findings of the DBCC that Guevara made unsuitable recommendations in connection with sales of partnership interests to three retail customers. In addition, we affirm the DBCC's findings that the sales of these partnerships were undertaken in violation of the prohibition against private securities transactions. Based on our independent review, we determine that Guevara should be and hereby is censured, fined $100,000, ordered to pay restitution to customer MD of $13,992 plus 10 percent interest from the date of sale, barred from associating with any member of the NASD in any capacity, and assessed $2,266.50 in DBCC costs.

Background

Guevara was registered as a representative of NASD member firms MetLife Securities Inc. ("MetLife") and Metropolitan Life Insurance Company ("MLIC") from April 1985 to November 1994. He became registered with another member firm from March 1995 through September 1995. Guevara is not currently registered in the securities industry and has no prior securities industry disciplinary history.

Procedural History

The DBCC filed the four-cause complaint against Guevara on April 3, 1997. Causes one through three alleged that Guevara made unsuitable recommendations and sales of general partnership interests to three separate customers (MD, EB, and AK), in violation of Conduct Rules 2110 and 2310; and cause four alleged that such recommendations and sales were effected, in the alternative, as either private securities activities in violation of Conduct Rules 2110 and 3040 or as improper outside business activities in violation of Conduct Rules 2110 and 3030. On April 24, 1997, Guevara filed an answer to the complaint in which he denied the substantive allegations of the complaint.[1]

On April 25, 1997, the District staff provided Guevara a list of the members of the DBCC and explained various aspects of the hearing process. By letter dated May 1, 1997, Guevara alleged, inter alia, that "no current or future member could be impartial in deciding the matter" due to racial and national origin discrimination on the part of the securities industry and the NASD. Guevara enclosed with this letter copies of administrative complaints he had lodged against the NASD and other companies in the Philadelphia area. A hearing before a DBCC hearing panel was thereafter held on November 17 and 18, 1997.[2]

The District staff introduced the testimony of customers MD, EB, and AK during the DBCC hearing. AK testified by telephone. The District staff also introduced the testimony of Guevara and Heinz W. Glassbrenner ("Glassbrenner"), a special investigator with NASD Regulation, Inc. ("NASD Regulation"). Both parties introduced documentary evidence at the hearing.

On May 6, 1998, the DBCC issued a decision. The DBCC found that Guevara had made unsuitable recommendations in the sale of securities to MD, EB, and AK, and that those sales, made without prior written notification to and without prior written permission from his firm, constituted private securities activities.[3]

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[1] Guevara also alleged as "New Matter" that the NASD failed to give him assistance and engaged in discrimination against him.

[2] On the first day of the hearing, Guevara renewed his May 1, 1997 objection to the proceeding. In addition, Guevara objected to the participation of the Chairman of the Hearing Panel, and claimed for the first time that he had been denied employment with that firm as a result of discrimination. Finding no specific grounds for challenge for conflict or bias, the DBCC hearing panel denied the challenge as to the Chairman and proceeded with the hearing.

[3] The DBCC found that Guevara violated Conduct Rule 3040 (the prohibition against private securities transactions), not Conduct Rule 3030 (pertaining to outside business activities).

By letter dated May 20, 1998, Guevara appealed the DBCC's decision. Guevara contests virtually all aspects of the DBCC's decision, including the DBCC's rulings on procedural issues.

After notice of the appeal hearing was provided to the parties and an Opening Statement was transmitted, Guevara waived his right to participate in oral argument. The matter was thus considered on the basis of the written record, as supplemented by the briefs of the parties.

Findings and Conclusions

Following an independent, de novo review of the entire record and the written submissions of the parties, we make the following findings of fact and conclusions of law.

A. The MT3M Units Were Securities

The complaint in this matter covers conduct which occurred between June and October 1994 involving Guevara's recommendation and sales of general partnership interests of Mid-Tennessee Third Mobile Partnership ("MT3M"), a development-stage partnership formed under the laws of the State of Nevada to purchase cellular telephone technology and operate a specialized mobile radio ("SMR") and paging system in Chattanooga, Cookeville, Crossville, Knoxville, and Nashville, Tennessee.

The MT3M offering was sponsored and marketed by Advanced Private Networks, Inc. ("APN"), an entity established in 1994. The offering of 2,600 units of MT3M (priced at $10,000 per unit, with a minimum purchase of two units) commenced on January 3, 1994, with a projected termination date of December 31, 1994. The offering was subject to no suitability limitations and required no special qualifications on the part of purchasers. For each $10,000 unit purchased, investors were required to make two payments: one for $8,625 (86.25 percent of the investment) to APN to cover its purchase of technology and expenses, and another of $1,375 (13.75 percent of the investment) to the MT3M Operating Reserve Account.[4]

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[4] Included in the MT3M general partnership agreement was an "Important Notice" that stated, in pertinent part:

> The purchase of partnership units involves a high degree of risk that could result in a loss of your entire contribution to the partnership.
>
> If all of the 2,600 partnership units are sold, $26,000,000 will be raised. Of the $26,000,000, $22,425,000 will be paid by MT3M to Advanced Private Networks, Inc. ("APN") as the purchase price of the 75% interest in the proposed 62 SMR channels. The remaining $3,575,000 will constitute the Operating Reserve Account and will be used as determined by the general partners of MT3M. The $22,425,000 paid to APN does not represent the price paid by APN for the 62 channels, but, rather, includes among other things,

We agree with the DBCC's determination that the MT3M units constitute securities under applicable law. We find that the units in question are investment contracts, and thus are securities. See 15 U.S.C. § 77b(1) and 15 U.S.C. § 78c(a)(10). The notion of an investment contract "embodies a flexible, rather than a static, principle, on 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." SEC v. W.J. Howey Co., 328 U.S. 293, 299 (1946). In determining whether a particular interest or investment constitutes an "investment contract," the focus is on the "economic realities of the underlying transaction and not on the name it carries." United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 849 (1975).

In Howey, the Supreme Court established a three-part definition of "investment contract:"

> An investment contract for the purposes of the Securities Act means a contract, transaction, or scheme whereby a person (1) invests his money in (2) a common enterprise and is led to (3) expect profits solely from the efforts of the promoter or a third party.

328 U.S. 298-99.

The requirement that the profits come "solely" from the efforts of others has been interpreted by the lower courts, and the prevailing view is that a court should examine whether "the efforts made by those other than the investor are the undeniably significant ones, those

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> APN's acquisition cost, marketing expenses, overhead, commissions, legal fees, printing expenses and profit. . . .
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> The $3,575,000 Operating Reserve Account of MT3M (assuming all units are sold) will be available for use by the partnership as it determines. The $3,575,000 will not fund a complete and immediate conversion of the SMR system to a digital system with at least 30,000 end users. There are different vendors that supply SMR enhanced equipment. The cost and capabilities of such equipment may vary. The decision of which SMR enhancement equipment to use will be made by the general partners of MT3M. Substantial additional capital will be necessary to convert the SMR system fully to at least 30,000 end users; these amounts may come from additional capital contributions by the general partners, vendor financing, or other sources determined by the general partners. It is the opinion of APN that $3,575,000 will be sufficient to enable MT3M to begin migration (buildout) to a fully digital system and to allow the partnership to generate increased cash flow from its operations.

essential managerial efforts which affect the failure or success of the enterprise." SEC v. Glenn W. Turner Enterprises, Inc., 474 F.2d 476, 482 (9th Cir. 1973); see Goodwin v. Elkins Co., 730 F.2d 99, 103 (3d Cir. 1984); Odom v. Slavik, 703 F.2d 212, 215 (6th Cir. 1983) (per curiam); Williamson v. Tucker, 645 F.2d 404, 418 (5th Cir. 1981) cert. denied 454 U.S. 897 (1981); Crowley v. Montgomery Ward Co., 570 F.2d 875, 877 (10th Cir. 1975); see also Forman, 421 U.S. at 852 ("The touchstone is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others.").

The first element of the Howey definition is met in this case by the fact that customers MD, EB, and AK made an investment of money in MT3M units. The organization and financing of the MT3M business initiative discussed above establish the second element of the Howey definition, since the creation of the general partnership and its financing by sales of units to numerous general partners established a "common enterprise" among the investors for the purpose of buying and operating an SMR and paging system. The final element of the definition, that is, whether the investors expected to earn profits from the efforts of others, is a question of fact which we decide in the affirmative based on our review of the structure and organization of the general partnership in question, as well as our examination of the expectations of MD, EB, AK, and the other investors in MT3M units, as discussed below.

Interests in general partnerships may be securities if all elements of the Howey definition are satisfied. In Williamson v. Tucker, supra, the Fifth Circuit adopted a three-part test for determining whether a general partnership interest is encompassed within the statutory definition of "investment contract." Under this test, a general partnership interest can be a security under the federal securities laws if it can be shown that: (1) the agreement among the partners leaves so little power in the hands of the partner that the arrangement in fact distributes power as would a limited partnership; (2) the partner is so inexperienced or lacking in knowledge in business affairs that he or she is incapable of intelligently exercising the partnership powers; or (3) the partner is so dependent on some unique entrepreneurial or managerial ability of the promoter that the partner cannot exercise meaningful partnership powers. Under the Williamson test, a primary focus in the analysis concerns "the practical possibility" of the investors' exercising their powers under the partnership agreement.[5]

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[5] Note that the three Williamson factors are presented in the disjunctive, and that satisfaction of one factor is sufficient to conclude that the interest in question is a security. The Williamson test was adopted by the Ninth Circuit in Hocking v. Dubois, 885 F.2d 1449 (9th Cir. 1989), cert. denied, 494 U.S. 1078 (1990). In cases after Hocking, the Ninth Circuit has emphasized that the considerations in the three-factor analysis are not exclusive. Other circumstances, such as the character the instrument is given in promotional materials, the plan of distribution, oral representations given by the promoter and agents of the promoter, and the number of parties, may be considered in the analysis. See, e.g. Koch v. Hankins, 928 F.2d 1471 (9th Cir. 1991); Holden v. Hagopian, 978 F.2d 1115 (9th Cir. 1992).

As to the first of the Williamson factors, an analysis of the terms of the partnership agreement is determinative as to whether the arrangement in fact distributes power as would a limited partnership. The partnership agreement in this matter provides that: (1) management decisions affecting the operation or control of the company must be approved by a majority-in-interest of the members; (2) the partnership agreement may not be amended to alter allocations to partners or to reduce the percentage interest required to approve any company act without the consent of at least two-thirds of both voting and non-voting members; (3) if the members decide to designate a Management Committee of up to five members, it must be agreed to by a majority-in-interest of the partners; (4) individual members and the managing members, if any, must have the consent of two-thirds in interest to enter into long term ground leases, notes, or mortgages, confess a judgment, or amend or otherwise change the Partnership Agreement to modify the obligations of the Partners; (5) individual Partners represent and warrant that they have sufficient experience and knowledge of business affairs to allow them to intelligently exercise their powers as a general partner, inasmuch as "the success of the Partnership's business will depend on the active participation and involvement in Partnership matters of all Partners… and [a Partner] agrees to devote such time and energy as is reasonably necessary to assist in the management of the Partnership's business and use his best efforts to make himself available for Partnership meetings or in actions by written consent;" (6) each member has access to the books of the partnership during business hours.

We cannot conclude, based on the agreement alone, that the interests in this case were securities as a matter of law.[6] Koch v. Hankins, supra; Cf. SEC v. Shreveport Wireless Cable Television Partnership, Fed. Secs. L. Rep. (CCH) 90, 332 (D.D.C. October 28, 1998) (ruling denying motions to dismiss or for summary judgment).

The pro forma recitation under (5), supra, appears to confer managerial responsibilities on the partners. As to the second Williamson factor, however, and in contradiction of the pro forma recitations of partnership power in the Partnership Agreement, the customers in this case (MD, EB, and AK) were each so inexperienced or lacking in knowledge in business affairs that they were incapable of exercising the partnership powers, particularly given the highly technical nature of the telecommunications venture at issue.

The facts suggest that investors were targeted for their lack of sophistication and inexperience in business affairs. Customer MD, a high school graduate with 27 college credits, was 62 years old at the time of her purchase of MT3M and was a former teacher's aide who made

[6] Notwithstanding our analysis of the first Williamson factor, which is confined strictly to a review of the Partnership Agreement, the MT3M partnership did not operate throughout its entire existence as a general partnership. See our discussion of the third Williamson factor, infra. Further, notwithstanding our determination as to the first Williamson factor, the knowledge and experience requirement referenced in the Partnership Agreement was illusory. APN did not enforce the knowledge and experience requirement in its sales of MT3M units, and any reliance on this provision for the purpose of negating reliance by investors on the efforts of APN should be considered waived.

a salary of $15,000 per year when she retired in 1993. Customer EB, a high school graduate with about two years' night school college credit, was 65 years old at the time of her purchase of MT3M. She had been retired on medical disability for about 20 years from her job as a secretary, which she had held for approximately five years. Prior to that, she was a domestic worker and worked at a soda fountain. At the time she purchased the MT3M units, she owned her own home and two rental properties, worth a total of about $25,000. Customer AK, a high school graduate with some night school college credits and certifications as a nursing aide and a teacher's aide, was 58 years old at the time of her purchase of MT3M, and was widowed for the second time just before her investment.

The three unsophisticated investors to whom Guevara sold the MT3M units unquestionably did not have the necessary ability or experience -- in the telecommunications industry or in business matters generally -- to be capable of exercising intelligently the partnership powers. For this reason, we find as a matter of law that the investments in this matter were securities.

As to the third Williamson factor, the partners in this case were so dependent on the unique entrepreneurial and managerial abilities of the promoter, APN, that the partners could not exercise meaningful partnership powers.

With respect to this factor, APN performed substantial post-purchase services upon which the future profits of the enterprise depended. Essential managerial decisions were made prior to the time the partners' management committee took control, and the partners were thus precluded from participating in those decisions. The partners never exercised, and could not exercise, their partnership powers until after the MT3M SMR system was delivered by APN, officially the "Interim Managing Partner." Indeed, the investors were virtually powerless to upset the APN/MT3M management team until APN was ready to turn the reins over to the elected management committee of MT3M in or about May 1995. APN controlled the acquisition of the MT3M SMR system and all necessary prerequisites to that acquisition without any input from the investors. APN's promotional materials showcased its technical expertise in organizing and developing the business of MT3M. APN structured the financing to assure an early need for additional financing, thus fostering greater dependency on the part of the investors. Finally, APN's retention of a 25 percent equity stake and its receipt as compensation of 86 percent of the proceeds of each unit sold demonstrates its central entrepreneurial and ongoing management interest in the venture.[7]

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[7] Guevara testified that the MT3M units were sold subject to a 40 percent commission payable to the sales agent, although he was not aware whether his 40 percent commission would be paid by APN, MT3M, or taken from the funds invested by his customers. It would seem to be inconsistent with economic reality for any investor intent on exercising managerial control over the partnership to pay as much as a 40 percent commission for this privilege.

Other factors also suggest that the units constitute securities. The plan of distribution of MT3M units was significant in that it emulated the distribution of a securities offering, without the burdens of compliance and without offering the protections mandated by the scheme of federal securities regulation. The offering was unregistered and was sold through agents like Guevara acting outside the securities industry's oversight structure. The record shows that Guevara presented the units as a passive investment and that the investors had little or no understanding that they would be other than passive investors in the enterprise. Guevara admitted he had learned of the MT3M investment opportunity through a television advertisement, had been given no limitations as to the qualifications of the prospects he might solicit, and did not believe his customers were qualified to act as general partners or to manage the affairs of MT3M. The manner of distribution and the large number of investors to whom they were sold likewise suggests that the instruments are securities.

It is possible for general partnership interests to be securities if so many interests were sold to the general public that there was no "real partnership control." Williamson, 645 F.2d at 423. We find that the number of MT3M units sold nationwide, to as many as 900 investors, diluted each partner's power so that meaningful partnership control was illusory.

As the Fifth Circuit in Williamson aptly stated, "[a] scheme which sells investments to inexperienced and unknowledgeable members of the general public cannot escape the reach of the securities laws merely by labeling itself a general partnership or joint venture. Such investors may be led to expect profits to be derived from the efforts of others in spite of partnership powers nominally retained by them." We thus conclude that the MT3M units were securities under the standards set forth under Howey and Williamson, supra.[8]

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[8] Our determination that the MT3M units are securities is also supported by the reasoning employed in a Memorandum Decision and Order of the United States District Court for the District of Nevada in John R. Clarke, et al. v. Advanced Private Networks, et al., CV-N-95-00751-DWH (Sept. 5, 1997). The court, in connection with its denial of a motion to dismiss a lawsuit by MT3M investors, analyzed the same investment that was recommended and sold by Guevara in this case under the law of the Ninth Circuit. The court applied Williamson, supra, in determining that notwithstanding the general rule that general partnership interests were not securities, "…[certain facts] could well establish that the so-called general partnership interests at issue in this case [MT3M units] are securities within the meaning of the securities laws." The Order pointed out that MT3M units were sold to as many as 900 investors, many of whom (like MD, EB, and AK, the customers in this case) had no knowledge or intention of being involved in the general management of a complex telecommunications business. See also SEC v. Telecom Marketing, Inc. et al., 888 F. Supp 1160 (N. D. Ga. 1995) (investments in wireless cable television business constituted investment contracts rather than general partnership interests).

In addition, on March 22, 1995, the Pennsylvania Securities Commission issued a Summary Order to Cease and Desist with respect to the offering of units of MT3M by APN, on the basis that the interests in MT3M constituted securities and that the offering and sale of such securities was not registered in Pennsylvania and was unlawful.

B. Findings of Violations

Unsuitable Recommendations (Causes One through Three). The DBCC found that Guevara made unsuitable recommendations in connection with sales of MT3M units to customers MD, EB, and AK. We concur in these findings.

Conduct Rule 2310 requires associated persons to have reasonable grounds for believing that recommendations are suitable for a customer based on the facts, if any, disclosed by the customer as to his or her other security holdings and financial situation and needs. See In re Larry Ira Klein, Exchange Act Rel. No. 37835, at 10 (Oct. 17, 1996). Even where a customer affirmatively seeks to engage in highly speculative or otherwise aggressive trading, a representative is under a duty to refrain from making recommendations that are incompatible with the customer's financial profile. See In re John M. Reynolds, 50 S.E.C. 805 (1992) (regardless whether the customers wanted to engage in aggressive and speculative trading, the representative was obligated to abstain from making recommendations that were inconsistent with their financial situation); In re Gordon Scott Venters, 51 S.E.C. 292, 294-95 (1993) (same).

Guevara claims that he did not recommend the purchase of MT3M to his customers, but instead represents that he merely presented the product to them, and they made the decision to invest. We find that Guevara's actions with respect to each customer involved the recommendation of investment in MT3M. The record is clear that the customers learned of the opportunity from Guevara and based their decision to purchase on his representations that it was a good investment.

Customer MD (Cause One). Customer MD, a high school graduate with 27 college credits, was 62 years old at the time of her purchase of MT3M and was a former teacher's aide who made a salary of $15,000 per year when she retired in 1993. Her husband had been disabled with blindness since 1987 and was retired from his work as a stevedore. Their combined monthly income in 1994 was $2,200 per month: $1,300 from his disability, and $900 from her retirement and Social Security benefits. They had no investment experience with stocks or bonds, other than U. S. Savings Bonds, and had perhaps $1,000 in savings. Their main assets consisted of a principal residence and an inherited rental property, both unencumbered, worth $56,000 in total. MD had an Individual Retirement Account ("IRA") holding a Metropolitan Life Insurance Company annuity she had purchased with some of her teacher's aide retirement funds from Guevara in 1991 for $30,000.[9] At the time of that investment, she indicated that the purpose of

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[9] This annuity was characterized as a fixed annuity in the DBCC decision. On appeal, Guevara contends that it was a variable annuity with "diversified investor privileges" which MD "enjoyed and exercised." Although there is a paucity of evidence below tending to prove or disprove either characterization, there is no evidence demonstrating that MD was an

the annuity was retirement income, and that her general investment objective was "growth and income." By 1994, when the funds from that IRA account were transferred to purchase MT3M units, the investment had appreciated to approximately $38,000.

On August 30, 1994, MD purchased four units of MT3M from Guevara for $38,061.14.[10] MD's source of funds was her IRA held through MetLife. MD testified that she could not afford to lose the money she invested with Guevara in MT3M.

MD testified that Guevara presented her with the idea of investing in MT3M and that she made the investment on his recommendation. MD did not understand the extent to which her principal was at risk or the mechanics of how her investment in MT3M or profits therefrom would actually be returned to her. Although she admitted that she did receive some documents that did contain risk disclosures, she did not receive them until after she made the MT3M investment, and the extent of the risk was never explained to her by Guevara. Guevara did not disclose how he was being compensated on the MT3M transaction, and MD was not told that Guevara's recommendation and sale of MT3M were not related to his employment with MetLife or MLIC. In about August 1995, she learned from her new insurance agent that she risked losing not only her investment in MT3M, but her home and other property, because her investment was in the form of a general partnership. She thereafter sought to get her money back from MT3M, without success, and later contacted an attorney and filed an arbitration action.[11]

The DBCC credited MD's testimony in reaching its findings, and we have no reason to disturb that determination. We conclude that Guevara's recommendation of MT3M units to MD was wholly unsuitable because of the speculative, illiquid nature of the investment; the limited means and the conservative investment objectives of MD; the size of MD's investment as compared to her liquid assets and net worth; and the fact that Guevara knew that MD would be using retirement funds for her purchase. Contrary to Guevara's view that MD's purchase came out of "discretionary funds" that were appropriate for speculative investment as long as the investment did not risk "keeping food off her table," we find that the suitability doctrine requires

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active and sophisticated investor, and we do not consider the characterization particularly material to our analysis.

[10] Documentation from APN showed that MD apparently was credited with an investment of $40,000, and that the shortfall was deducted from Guevara's $16,000 commission, leaving him a net commission of $13,992.14.

[11] Entered into the record were two versions of a letter dated April 16, 1996, from MD to Glasbrenner. While identical in content, one was signed, and the other was not. Based on MD's testimony that she did not recollect having signed the letter, Guevara questioned whether the letter was a forgery. MD did not contend that the signature was not hers. Based on our examination of the documents and our review of exemplars of MD's signature, we find no basis for a forgery determination. In addition, we observe that MD adopted the content of the April 16, 1996 letter during her DBCC hearing testimony.

a higher standard of care and somewhat more realistic appraisal of the circumstances and needs of the customer. For these reasons, we find that Guevara made an unsuitable recommendation in his sale to MD, as alleged in cause one, in violation of Conduct Rules 2110 and 2310.

Customer EB (Cause Two). Customer EB, a high school graduate with about two years' night school college credit, was 65 years old at the time of her purchase of MT3M. She had been retired on medical disability for about 20 years from her job as a secretary, which she had held for approximately five years. Prior to that, she was as domestic worker and worked at a soda fountain. At the time she purchased the MT3M units, she owned her own home and two rental properties, worth a total of about $25,000. Her sources of income were $539 per month from Social Security, and monthly income of $1,140 from rents. She had approximately $28,000 in the bank. A customer profile compiled by Guevara two years earlier in connection with an unspecified mutual fund investment (identified by Guevara as the MetLife State Street Fund) listed her annual income as less than $40,000 and her savings and investments as less than $40,000, as well as a main investment objective of "aggressive growth." She had no investment experience with securities before meeting Guevara.

EB purchased two units of MT3M for $20,000 on October 5, 1994. EB's source of funds was her $28,000 in savings. EB testified that she felt at the time that she could not afford to lose this money.

EB testified that Guevara recommended the purchase of MT3M units as a good investment for her and stated that she wouldn't lose "all of her money" and said "now, of course, nothing is certain but it looks good." EB did not understand the extent to which her principal was at risk or the mechanics of how her investment in MT3M or profits therefrom would actually be returned to her. EB testified that Guevara did tell her that the investments would be in the form of a partnership, but that he didn't identify whether it was a limited or general partnership, or what level of risk it would entail. EB did not recall whether she received disclosure documents prior to investing in MT3M.

The DBCC credited EB's testimony in reaching its findings, and we have no reason to disturb that determination. We conclude that Guevara's recommendation of MT3M units to EB was wholly unsuitable because of the speculative, illiquid nature of the investment; EB's limited means and, notwithstanding Guevara's indication of her investment objectives, the conservative nature of those objectives, given her age and disability retirement; the size of EB's investment as compared to her liquid assets and net worth; and the fact that Guevara knew that EB would be using funds saved for retirement for her purchase. Contrary to Guevara's view that EB's purchase came out of "discretionary funds" that were appropriate for speculative investment, we find that the suitability doctrine requires a higher standard of care and a somewhat more realistic appraisal of the circumstances and needs of the customer. For these reasons, we find that Guevara made an unsuitable recommendation in his sale to EB, as alleged in cause two, in violation of Conduct Rules 2110 and 2310.

Customer AK (Cause Three). Customer AK, a high school graduate with some night school college credits and certifications as a nursing aide and a teacher's aide, was 58 years old at the time of her purchase of MT3M, and was widowed for the second time just before her investment. When she purchased the MT3M units, she owned her home subject to a home equity loan of unspecified amount and two automobiles (a questionnaire she completed indicated that the home and automobiles were worth about $150,000, offset by short-term liabilities of $10,000 and long-term liabilities of $37,000; the home was sold in 1996 for $90,000). She had a checking account worth approximately $1,000, but no retirement accounts. Her income at the time of the purchase consisted of survivor's income from a previous husband's employer consisting of approximately $647 per month. She had previously purchased insurance from Guevara, but had no experience investing in securities or any other investments. AK indicated in an investigatory questionnaire that her investment objective at the time of the purchase was "growth."

AK purchased two units of MT3M on June 24, 1994 for $20,000. AK's source of funds was her second husband's death benefit of $50,000 from an insurance policy. She testified that she could not afford to lose the entire investment that she made in MT3M.

AK testified that Guevara introduced her to MT3M, and that she relied on Guevara's recommendation "100 percent." The only communication to her regarding risk was when Guevara warned her that if she needed the money within the next two or three years, she should not invest, and that "you have to give it a chance to work." AK testified that if she had ever been told that there was a possibility that she could lose the entire investment, she never would have invested.

The DBCC credited AK's testimony in reaching its findings, and we have no reason to disturb that determination. We conclude that Guevara's recommendation of MT3M units to AK was wholly unsuitable because of the speculative, illiquid nature of the investment; AK's limited means and her current and future needs; the size of AK's investment compared to her liquid assets and net worth; and the fact that Guevara knew that AK had made no provision for retirement and would be using insurance proceeds for her purchase. Contrary to Guevara's view that AK's purchase came out of "discretionary funds" that were appropriate for speculative investment, we find that the suitability doctrine requires a higher standard of care and a somewhat more realistic appraisal of the circumstances and needs of the customer. For these reasons, we find that Guevara made an unsuitable recommendation in his sale to AK, as alleged in cause three, in violation of Conduct Rules 2110 and 2310.

Guevara had good reason to be motivated to sell MT3M units. Guevara testified that he learned about MT3M through a television advertisement and placed a telephone call through its toll-free number to offer his services as a representative. Guevara explained that he was told he would receive a commission on each sale of 40 per cent of the purchase price. When asked whether it struck him that this commission rate was high, Guevara responded that it did not, particularly in comparison with his experience with insurance commissions "as high as 125 per cent." Guevara did not disclose his commission rate to his customers.

It is well established that a broker cannot recommend any security to a customer "unless there is an adequate and reasonable basis for such recommendation." See e.g. Hanly v. SEC, 415 F.2d 589, 597 (2d Cir. 1969); Berko v. SEC, 316 F.2d 137 (2d Cir. 1963) ("[T]he making of recommendations to prospective purchasers without a reasonable basis, couched in terms of either opinion or fact designed to induce purchases, is contrary to the basic obligation of fair dealing borne by those who engage in the sale of securities to the public."). Although Guevara attended seminars, read materials pertaining to the telecommunications industry, and called the Federal Trade Commission to ascertain whether there had been any complaints about MT3M, he conducted no further investigation of the entity and apparently engaged in no financial analysis of its marketing materials.[12] Guevara testified that he considered the investment "well worth the risk" and stated that he would have invested if he had had the money. Guevara was not aware whether his 40 percent commission would be paid by APN, MT3M, or taken from the funds invested by his customers, information pivotal to the customers' expected rate of return. While Guevara could not necessarily foresee that the investors in MT3M would later file a lawsuit alleging fraud and breach of fiduciary duty, he should have known that the investment was illiquid and highly speculative on legal, financial, and business grounds. We thus conclude that Guevara did not have a reasonable basis for recommending the purchase of MT3M units to the three customers in this case.

Private Securities Transactions (Cause Four). The DBCC found that Guevara engaged in private securities transactions in violation of Conduct Rule 3040 in connection with sales of MT3M units to customers MD, EB, and AK. We concur in those findings.

Conduct Rule 3040 prohibits any person associated with a member firm from participating in any manner in a private securities transaction outside the regular course or scope of his or her employment without providing prior written notice to the member. The Securities and Exchange Commission outlined the importance of the prohibition on private securities transactions in In re Anthony J. Amato, et al., 45 S.E.C. 282, 285 (1973):

> The regulatory scheme under the Exchange Act, in which the NASD is assigned a vital role, imposes on broker-dealer entities and NASD member firms the responsibility to exercise appropriate supervision over their personnel for the protection of investors. Where employees effect transactions for customers outside of the normal channels and without disclosure to the employer, the public is deprived of protection which it is entitled to expect. Moreover, the employer may also thus be exposed to risks to which it should

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[12] As a securities professional, Guevara had a duty to investigate the investment before recommending it to his customers. That duty was particularly important because no broker/dealer was involved in the offering, and there was no due diligence file available. See In re Richard H. Morrow, Exchange Act Rel. No. 40392 (September 2, 1998).

> not be exposed. Thus, such conduct is not only potentially harmful to public investors, but inconsistent with the obligation of an employee to serve his employer faithfully . . . . There is always a possibility in these situations that some improper conduct may be involved or that the employer's interests may be adversely affected. At the least, the employer should be enabled to make that determination. (Footnotes omitted).

The NASD's records and the Form U-5 filed by MetLife confirm that Guevara was registered with MetLife when the sales of MT3M were made to the three customers. Guevara admitted that when he recommended and sold interests in MT3M to his three customers, he was (and considered himself to be) an employee of both MT3M and MetLife. He also admitted that he concealed his activities on behalf of MT3M from MetLife, and that he knew that if MetLife had discovered his sales position with MT3M, it would have resulted in immediate termination. He stated that he ". . . didn't know of anyone who quits a job to go find another."

Guevara claims that he relied on his own judgment and the representations of the issuer that the units were not securities. Reliance by a registered representative on an issuer's bare representations is not sufficient. See e.g., In re Frank W. Leonesio, 48 S.E.C. 544, 548 (1986) (salesman may not rely on self-serving statements of an issuer). A registered representative's reliance on sources other than an official opinion by appropriate firm personnel is an insufficient basis for concluding that a transaction is not subject to Conduct Rule 3040. In re Gilbert M. Hair, 51 S.E.C. 374 (1993). Based on the forgoing, we find that Guevara's sale of MT3M units to each of the customers in this case violated Conduct Rules 2110 and 3040 as alleged in cause four.

C. Procedural Issues

On appeal, Guevara reiterates numerous arguments about perceived procedural improprieties or conspiracies against him. Although these contentions were properly addressed in the DBCC decision, we have made an independent, de novo review of each of them.[13]

First, Guevara claims that he was the subject of selective prosecution. No showing of this has been made. To establish selective prosecution, one must show both that he was singled out for enforcement action while others similarly situated were not, and that the action was motivated by arbitrary or unjust considerations, such as race, religion, or the desire to prevent the exercise of a constitutionally-protected right. U.S. v. Huff, 959 F.2d 731 (8th Cir. 1992); C.E. Carlson, Inc. v. S.E.C., 859 F.2d 1429, 1437 (10th Cir. 1988). Neither showing has been made here.

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[13] Guevara questions whether the National Adjudicatory Council is the appropriate venue to address complaints about the District staff, the NASD Office of the Ombudsman, and the financial services industry in general. We address those complaints only to the extent that they are relevant to the fairness of the DBCC proceedings.

In a similar vein, Guevara contends that the DBCC's complaint should never have been initiated because no customer ever complained about him. This argument is without merit. The initial information in this matter came from another registered representative acting on behalf of customer MD. As a result of this information, Guevara supplied District staff with the names of AK and EB in response to a staff inquiry. There was nothing unusual or unethical about the way in which NASD Regulation obtained information about, or from, these customers. See In re Bernard D. Gorniak, Exchange Act Rel. No. 35996, at 3 n.5 (July 20, 1995) ("The NASD's power to enforce its rules is independent of a customer's decision not to complain, which may be influenced by many factors."); In re Ronald J. Gogul, Exchange Act Rel. No. 35824, at 8 n.20 (June 8, 1995) (finding the lack of any customer complaints to be irrelevant); In re Joseph H. O'Brien, 51 S.E.C. 1112, 1115 (1994) (finding "immaterial" a late-filed letter from a customer seeking "unconditionally" to withdraw her complaint against respondent). Finally, the record fails to show that Guevara asked the DBCC hearing panel to call any witnesses within the jurisdiction of the NASD to clarify the initiation of MD's complaint.

Guevara also contends that the NASD Regulation counsel who presented the matter to the DBCC deliberately left documents out of evidence. The DBCC observed that there appeared to be "some confusion" about the process involved in compiling the hearing record. We attribute some of this confusion to Guevara, who was not aware that documents compiled during the staff's investigation did not automatically become part of the record at the DBCC hearing. We also note the representation on the part of NASD Regulation counsel that "all post-complaint correspondence between the parties automatically constitutes part of the case record" in the DBCC proceeding, a statement that was at odds with the staff's initial treatment of Guevara's correspondence questioning the qualifications of DBCC members to render a decision against him and forwarding discrimination complaints that he had filed. We find, however, that Guevara experienced no disadvantage because the DBCC hearing panel admitted all documents he desired to place into evidence upon request. In addition, we find no support in the record for Guevara's contention that NASD Regulation counsel engaged in ex parte contact with the DBCC hearing panel or that testimony was taken during the DBCC hearing outside the presence of the respondent.

In response to numerous objections raised by Guevara, we find no evidence of prosecutorial or staff misconduct or bias. Even if evidence of bias existed, it would not, as a matter of law, necessarily impugn the fairness of the DBCC proceedings. The alleged bias of an NASD investigator is insufficient to invalidate an entire decision, because under the NASD's collegial, self-regulatory process, "the staff does not decide cases [and] allegations of staff bias . . . do not suggest that the fairness of the hearing itself was compromised." In re Frank J. Custable, 51 S.E.C. 643, 650 (1993); see also In re Joseph H. O'Brien, 51 S.E.C. 1112 (1994); In re Dillon Securities, Inc., 51 S.E.C. 142 (1992).

Guevara reiterates his claim that the Chairman of the DBCC hearing panel, and indeed the DBCC and the NASD, should have been disqualified from this case on the grounds that they were interested parties in pending employment discrimination cases he filed. As noted above,

Guevara alleged that he had been denied employment with the Chairman's firm as a result of discrimination. Guevara was given an opportunity to connect his general allegations to specific individuals in this case. Guevara failed to substantiate the particular bias or interest of the Chairman or to establish that he had ever lodged a complaint against the Chairman's firm. Finding no specific grounds for challenge for conflict or bias, the DBCC hearing panel denied the challenge as to the Chairman and proceeded with the hearing.[14] Guevara's challenge to the DBCC as a whole was thus tacitly denied.

We affirm the DBCC's rejection of Guevara's recusal motions. Guevara has failed to substantiate that any individual associated with the decisional process was biased or prejudiced against him. Further, we do not accept the contention that Guevara's mere accusation of discrimination, without more, is sufficient to evoke a disqualifying bias or interest on the part of all individuals associated with firms so accused or to establish that such persons' participation in any subsequent disciplinary action is per se retaliatory.[15] In our view, a purported conflict established by such means by a respondent falls far short of an actual pecuniary or other disqualifying interest in the outcome of a proceeding. Cf. In re Datek Securities Corporation, 51 S.E.C. 542 (1993).

As to other objections raised by Guevara, we find that the DBCC hearing panel was properly constituted, and that the respondent was not prejudiced by the fact that it was not designated an Extended Hearing Panel. A respondent does not have a right to the appointment of an Extended Hearing Panel or to dictate the qualifications of the panel members. See In re Thomas R. Alton, Exchange Act Rel. No. 36058 (Aug. 4. 1995) (rejecting challenge for failure to empanel an attorney as member), aff'd, 94-16589 (9th Cir. 1996) (unpublished opinion); In re

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[14] We note that Guevara had not filed a complaint against the Chairman's firm. In addition, Guevara did not challenge the remaining member of the DBCC hearing panel, and had not filed a complaint against that panel member's firm. As to the DBCC, Guevara had filed complaints against member firms employing three of the twelve members of the DBCC.

[15] Rule 9131 of the Code of Procedure applicable to this proceeding provides the test for disqualification:

> 9131. Grounds for Disqualification to Participate in Proceedings
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> No member of the Board, National Business Conduct Committee, any Committee or other committee of subcommittee governed by this Code shall in any manner, directly or indirectly, participate in the determination of any matter substantially affecting his interest or the interests of any person in whom he is directly or indirectly interested. In any such case the particular member shall disqualify himself, or shall be disqualified by the Chairman of the Board, National Business Conduct Committee, or any such Committee or other committee or subcommittee governed by this Code.

Keith L. DeSanto Exchange Act Rel. No. 35860 (June 19, 1995), aff'd, 101 F. 3d 108 (2d Cir. 1996) (table) (no entitlement to a three-person panel).

We further find no evidence of unfairness on the part of the DBCC hearing panel. In particular, we find no evidence that the DBCC hearing panel's questioning of witnesses and the respondent was inappropriate or motivated by bias. See In re Brooklyn Capital & Securities Trading, Inc., Exchange Act Rel. No. 38454 (Mar. 31, 1997) (panel member's questions were directed at clarifying witness' answers); In re U.S. Securities Clearing Corp, Exchange Act Rel. No. 35066 (Dec. 8, 1994) (same); In re Michael A. Leeds 51 S.E.C. 500, 506 (1993) (panel has right to question witness to elicit testimony). Indeed, we find that the staff, the DBCC hearing panel and the attorney-advisor who advised the DBCC hearing panel went out of their way to assure a fair and orderly proceeding.

In sum, we find no evidence of unfairness on the part of the DBCC. We observe that the DBCC, and not the staff or the DBCC hearing panel, decided this case below, and the collegial decision it rendered fairly addresses the issues raised by the parties. [16] Although Guevara appears to be convinced that he has been the victim of bias on the part of the NASD and the securities industry, the DBCC properly found that these claims were unsubstantiated and thus of no relevance to the instant proceeding. We thus reject Guevara's conspiracy theory. See, e.g., In re Mayer A. Amsel, Exchange Act Rel. No. 37092, at 8-9 (April 10, 1996) (rejecting unsubstantiated claims of bias); In re Dan Adlai Druz, Exchange Act Rel. No. 36306 (Sept. 29, 1995) (rejecting myriad unsubstantiated accusations of impropriety involving fraud, corruption, and collusion by the hearing officer, enforcement division and firm), aff'd, 103 F.3d 112 (3d Cir. 1996). [17]

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[16] Our de novo review, which is independent from the proceedings below, is intended to insulate the proceedings from procedural unfairness. See, e.g., In re Curtis I. Wilson, Exchange Act Rel. No. 26425 (Jan. 6, 1989), aff'd sub nom., Wilson v. SEC, 902 F.2nd 1580 (9th Cir. 1990). In re Dillon Sec., Inc., 51 S.E.C. 142, 150 n.29 (1992); In re Jonathan Garrett Ornstein, 51 S.E.C. 135, 138 n.5 (1992); In re Charles L. Campbell, 49 S.E.C. 1047 (1989). Furthermore, unsubstantiated assertions of bias are an insufficient basis to invalidate NASD proceedings. See In re Rita H. Malm, Exchange Act Rel. No. 35000 (Nov. 23, 1994); In re David A. Gingras, 51 S.E.C. 622 (1992); In re Cal Caulfield & Co., 48 S.E.C. 452 (1986); In re Robert E. Gibbs, 51 S.E.C. 1131 (1993); In re Arthur J. Lewis, 50 S.E.C. 1487, 1489 (1991).

[17] Guevara objects to his receipt of an notification that his appeal had been dismissed as abandoned. This notification, which was in fact transmitted to Guevara in error, was immediately corrected with notification to the respondent that his appeal was still pending. We find that this admittedly erroneous notification had no bearing on fairness of the instant proceedings.

Sanctions

The DBCC imposed a censure and a fine of $33,992, consisting of a $10,000 fine, inclusive, for causes one through three (unsuitable recommendations); a $10,000 fine for cause four (private securities transactions), plus $13,992 representing commissions received by Guevara. The DBCC also required Guevara to offer rescission of the sales, or to make restitution to the customers in the total amount of $78,000, plus interest at a rate of 10 per cent from the respective date of the investment, barred Guevara in all capacities, and imposed costs of $2,266.50. We modify those sanctions.

In imposing sanctions on Guevara, we have independently considered the factors enumerated in the NASD Sanction Guidelines ("Guidelines") for unsuitable recommendations and private securities transactions and the aggravating and mitigating factors present in this particular case.[18] We have also considered Guevara's lack of disciplinary history.

The Guideline for unsuitable recommendations states that in cases involving "numerous recommendations of clearly unsuitable securities and no prior similar misconduct, [we should] consider suspending the respondent in all capacities for 10 to 30 business days" and impose a fine amounting to the respondent's commissions plus $5,000 to $50,000. We find that a fine totaling $50,000 for the three unsuitable recommendation under causes one through three, which falls in the middle of the recommended range, is sufficiently remedial.

We find that the unsuitable transactions alone support the imposition of a bar, notwithstanding the fact that Guevara has no prior record of similar misconduct. The three violations in this regard involved unsuitable recommendations to inexperienced, unsophisticated customers in or approaching retirement, living on low fixed incomes, in transactions involving large monetary amounts resulting in what may well be large customer losses. In addition, we observe that Guevara attempted to avoid detection of his recommendations by keeping his sales activities a secret.

Similarly, the Guidelines for private securities transactions specify a monetary sanction including the amount of the respondent's commission, plus $5,000 to $50,000. We find that a fine of $50,000 for the three private securities violations, which also fall at the middle of the recommended Guideline range, is sufficiently remedial. In addition, in order to remediate the harm that his unsuitable recommendations and private securities transactions violations have caused to his customers, the requirement of restitution is appropriate. Because Guevara received $13,992 in commissions from the sale of MT3M to customer MD, even though he admitted only

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[18] NASD Sanction Guidelines, 1996 ed. at 52 (Suitability) and at 45 (Private Securities Transactions).

to receiving approximately $3,200, we impose the requirement of restitution of $13,992 to customer MD, plus interest at a rate of 10 per cent per annum from the date of the sale.[19]

The Guidelines state that for "serious cases" of private securities transactions involving situations that include numerous sales or attempts to conceal the activity, "a bar should be standard." The principal considerations under the relevant Guideline also include the use of the employer's offices or facilities for the private securities transactions. MD, EB, and AK were MetLife customers, and Guevara utilized the firm’s office to receive communication from APN. An additional aggravating factor is Guevara's deliberate action in participating in the sales knowing that he would probably be fired if they came to the attention of MetLife. These circumstances support the imposition of a bar under cause four alone, consistent with the relevant Guideline.

We find that Guevara's alleged ignorance of the requirements of Conduct Rules 2310 and 3040 is no excuse for his misconduct. Indeed, Guevara was aware of the need to avoid detection by his supervising member firm, and he conformed his activities to frustrate such supervision. In violating the foregoing rules, Guevara breached requirements intended to protect investors and to maintain high standards of responsibility in the securities industry.

Guevara's misconduct in this case was serious. In violation of the prohibitions against private securities transactions, he engaged in blatantly unsuitable recommendations with regard to three customer accounts, resulting in what may well be the loss of the customers' entire investments. Moreover, he has never taken responsibility for his conduct, instead maintaining throughout this disciplinary action that even though the alleged transactions took place, he should be excused from their consequences because he is the victim of certain unsubstantiated conspiracies. There can be no doubt that Guevara is unfit to remain associated with the securities industry.

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[19] We note that Guevara was given an opportunity to correct or clarify the amount of his compensation, but he did not explain the discrepancy.

For the foregoing reasons, we have determined to impose upon Guevara the remedial sanctions of a censure; $100,000 fine; the requirement to make restitution to customer MD in the amount of $13,992, plus interest at a rate of 10 per cent from the date of the investment; a bar in all capacities; and $2,266.50 in DBCC costs.[20] The bar is effective upon the date of this decision.

On Behalf of the National Adjudicatory Council,

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Joan C. Conley, Corporate Secretary

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[20] We have considered all of the arguments of the parties. They are rejected or sustained to the extent that they are inconsistent or in accord with the views expressed herein.

Pursuant to NASD Procedural Rule 8320, any member who 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, any person associated with a member who fails to pay any fine, costs, or other monetary sanction, after seven days' notice in writing, will be summarily revoked for non-payment.