BEFORE THE NATIONAL BUSINESS CONDUCT COMMITTEE

NASD REGULATION, INC.

In the Matter of District Business Conduct Committee For District No. 8 Complainant, vs. Respondent 1, Respondent.	DECISION Complaint No. C8A960074 District No. 8 Dated: August 22, 1997

This matter was appealed by Respondent 1 pursuant to Procedural Rule 9310. For the reasons discussed below, we find that Respondent 1 engaged in an outside business activity in violation of Conduct Rules 2110 and 3030 by distributing "Marketing Programs" issued by Entity A, without having given his employer, Firm A, prompt written notice of his intention to engage in this activity. For this conduct, we censure Respondent 1, fine him $5,000, and require him to qualify (or requalify) by examination before acting in any capacity in which he chooses to act. We also order him to pay restitution to Customer ST in the amount of $1,500, such amount to be reduced by any amount of the $1,000 advanced to Customer ST by Respondent 1 that Respondent 1 can demonstrate that Customer ST has not already repaid.

Background. Respondent 1 entered the securities industry in 1987 as an investment company and variable contracts products representative of PFS. In September 1994, Respondent 1 became registered as an investment company and variable contracts products principal with PFS. PFS suspended Respondent 1's employment on January 4, 1996. Both registrations were terminated in March 1996. Respondent 1 is not currently registered with any NASD member.

Discussion

On March 29, 1995, Respondent 1 signed an "Independent Distributor Agreement" with Entity A, a Canadian, multi-level marketing operation involved in the sale, among other things, of discount travel certificates. Entity A sold the vacation certificates (allegedly worth from $1,200 to $1,700) to its distributors for $62.50 apiece, who then sold them for $500 apiece. Distributors who signed up

additional salespersons also received a portion of the commissions earned by these individuals. The record indicates that Respondent 1 recruited Customer ST as a distributor on April 17, 1995. Customer ST invested a total of $1,500, comprised of $500 of his own funds and $1,000 advanced by Respondent 1.

In response to an NASD Regulation District 8 ("District 8") staff request for information, Firm A's affiliated life insurance company, replied in correspondence dated December 1, 1996, that the company had received a letter from the Customer's wife in which she complained that she and her husband had paid Respondent 1 $1,500 to become affiliated with Entity A, and that she and her husband had some concerns about Entity A. The life insurance company stated that Firm A immediately contacted Respondent 1 regarding his affiliation with Firm A and his recruitment of the Customer, and that Respondent 1 acknowledged his affiliation with Entity A and his recruitment of the Customer. In correspondence to District 8 staff dated April 18, 1996, Firm A stated that Respondent 1 did not seek and/or receive permission from any of the Firm A companies to represent or engage in outside business activities with Entity A.

Respondent 1 admitted in correspondence to District 8 staff that he did not provide any form of notice to Firm A regarding his involvement with Entity A. He contended that he did not deem it necessary to inform Firm A of this activity because he was involved with Entity A as an independent contractor, and the requirement to advise member firms of outside business activities pertained only to "employment and commissions or compensation." Respondent 1 contended that the money that he earned through his Entity A sales was neither commissions nor compensation, but profits -- the difference between the wholesale cost of the certificates and the retail prices at which they were sold, less expenses -- and therefore not within the purview of Conduct Rule 3030.

Respondent 1 did not deny his involvement with Entity A. He asserted that Firm A was fully aware of his "full time income" as a plumbing contractor for 30 years and any income derived from Entity A, which he considered to be a division of "[Respondent 1's] Plumbing." Respondent 1 stated that he became an independent contractor for Entity A on March 29, 1995, and had sold three "Vacation Certificates" (valued at $2,738), which he purchased for $62.50 and sold for $500. Respondent 1 contended that the proceeds derived from these sales constituted the difference between the wholesale and retail price of the certificates, and that his profit should not be viewed as compensation and/or commission. He apologized for his ignorance of Rules 2110 and 3030, and for not giving his firm prompt written notice of this "extra income."

Based on the foregoing, we find that Respondent 1 violated Conduct Rules 2110 and 3030 as alleged. It is undisputed that Respondent 1 engaged in an outside business activity without having first provided prompt written notice to Firm A. We do not credit Respondent 1's contention that he had no obligation to report his Entity A activities to Firm A because they were merely part of his plumbing business, of which Firm A already had notice. We also do not credit Respondent 1's contention that the profits he earned from the sale of vacation certificates were not within the purview of Rule 3030. The

Rule specifically states that its reporting requirement is triggered by the acceptance of compensation from any person other than the member firm as a result of any business activity other than a passive investment.

Sanctions

We affirm the censure and $5,000 fine. As to the restitution requirement, the record indicates that Customer ST invested $1,500 with Entity A, consisting of $500 of his own funds and $1,000 advanced by Respondent 1. There is no evidence in the record regarding the terms of this advance, or whether Customer ST has repaid the $1,000 to Respondent 1. We therefore affirm the order to pay restitution to Customer ST in the amount of $1,500, but we order that this amount be reduced by any portion of the $1,000 advance that Respondent 1 can demonstrate to District 8 staff that Customer ST has not already repaid. This will prevent Customer ST from recovering more than he is actually out-of-pocket. We have considered that the NASD Sanction Guideline for outside business activities does not specifically recommend restitution. Under the particular circumstances of this matter, however, we have concluded that Customer ST should be made whole.

We note that the DBCC ordered Respondent 1 to qualify by examination as a general securities representative before again acting in a capacity requiring registration. We have considered that during his employment in the securities industry, Respondent 1's registration was limited to that of a variable contracts products representative and principal. We therefore modify the qualification order to require Respondent 1 to qualify (or requalify) by examination before acting in any capacity in which he chooses to act.

In sum, we order that Respondent 1 be censured and fined $5,000[1/]; that he pay restitution to Customer ST in the amount of $1,500, to be reduced by any portion of the $1,000 advance that

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[1/] 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 be summarily 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 sanction after seven days' notice in writing will summarily be revoked for non-payment.

Customer ST has not yet repaid to Respondent 1; and that he qualify (or requalify) by examination before acting in any capacity in which he chooses to act.

On Behalf of the National Business Conduct Committee,

Joan C. Conley, Corporate Secretary