NATIONAL ADJUDICATORY COUNCIL

NASD

DEPARTMENT OF ENFORCEMENT, Complainant, v. ERIC H. DIEFFENBACH Littleton, CO, and MICHEL A. ROOMS Littleton, CO, Respondents.	Decision Complaint No. C06020003 Dated: July 30, 2004

The Hearing Panel found that respondents had violated the SEC's penny stock rules by failing to disclose required information to customers regarding transactions in penny stocks. The Hearing Panel also found that the respondents had obstructed NASD's investigation of the penny stock violations. Held, findings affirmed and sanctions modified.

Appearances

For the Department of Enforcement: Karen E. Whitaker, Senior Regional Attorney, NASD, Dallas, TX; Rory C. Flynn, Chief Litigation Counsel for NASD Department of Enforcement, Washington, DC.

For Respondents: Eric B. Liebman, Esq., Lindquist & Vennum P.L.L.P, Denver, CO.

DECISION

NASD's Department of Enforcement ("Enforcement"), the complainant, appealed and respondents Eric Dieffenbach ("Dieffenbach") and Michel Rooms ("Rooms") cross-appealed an Office of Hearing Officers Hearing Panel decision dated April 25, 2003. The Hearing Panel held that respondents had violated Section 15(g) of the Securities Exchange Act of 1934 ("Exchange Act"), Securities and Exchange Commission ("SEC") Rules 15g-2, 15g-3 and 15g-5 (the "penny

stock rules"), and NASD Conduct Rule 2110 by failing to disclose required information to customers purchasing a penny stock.[1] The Hearing Panel also found that the respondents violated NASD Conduct Rule 2110 and Procedural Rule 8210 by obstructing NASD's investigation of the penny stock violations. The Hearing Panel imposed on Dieffenbach a $12,000 fine for the penny stock violation and a six-month suspension for the obstruction violation. The Hearing Panel imposed on Rooms a $5,000 fine for the penny stock violation and a 30-day suspension for the obstruction violation.

Enforcement appealed the Hearing Panel decision as to the sanctions, which Enforcement argued should be increased to a bar in all capacities for both respondents. The respondents cross-appealed the Hearing Panel's findings and sanctions only as to the obstruction violations, arguing that their conduct did not amount to obstruction of an investigation in violation of Rules 2110 and 8210 and, in the alternative, that we should reduce the sanctions. The respondents did not appeal the findings or sanctions related to the penny stock violations. After a thorough review of the record in this matter, we affirm the Hearing Panel's findings of violations but increase the sanctions to a bar in all capacities as to both respondents. In light of the bars, we eliminate the suspensions and fines. We uphold the Hearing Panel's imposition of costs for the hearing below and impose costs for this appeal proceeding.

I. BACKGROUND

A. Dieffenbach and Rooms Employment History

Dieffenbach first became registered as a general securities representative in 1988. In 1992, he became registered as a general securities principal. Dieffenbach was registered with Patterson Travis, Inc. (the "Firm") in such capacities between January 1995 and October 2001. He is not currently associated with a member firm. Rooms first became registered as a general securities representative in November 1991. He became registered as a general securities principal in August 1994. He was registered with the Firm in such capacities from January 1995 to August 2000.[2] He is currently associated with another member firm.

B. Procedural History

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[1] The definition of "penny stock" is contained in SEC Rule 3a51-1, 17 C.F.R. 240.3a51-1. In general, "[p]enny stocks are non-Nasdaq and non-exchange-listed equity securities, currently priced less than $5 per share, that are issued by companies with less than a specified amount of net tangible assets, continuous operations, or annual revenues." *DBCC for Dist. No. 2 v. Gallison*, Complaint No. C02960001, 1999 NASD Discip. LEXIS 8, at *6–7 (NAC Feb. 5, 1999). In addition to SEC Rules 15g-2, 15g-3 and 15g-5, Enforcement originally charged the respondents with violations of SEC Rule 15g-9. Enforcement, however, subsequently withdrew the Rule 15g-9 charge and the Hearing Panel made no findings regarding that rule.

[2] In 2002, Rooms also became registered as an investment company products/variable contracts representative.

In a complaint dated April 22, 2002, Enforcement charged the Firm, David Travis ("Travis"), Dieffenbach and Rooms with violating Section 15(g) of the Exchange Act, SEC Rules 15g-2, 15g-3 and 15g-5, and NASD Conduct Rule 2110 by failing to provide customers with certain required risk disclosures and other information in connection with penny stock transactions. In addition, Enforcement alleged that the Firm and Travis violated NASD Conduct Rules 2110 and 3010 for failing to supervise the activities of Dieffenbach and Rooms in connection with the penny stock violations. Enforcement also charged each respondent with violations of NASD Conduct Rule 2110 and Procedural Rule 8210 for attempting to conceal their violations of the penny stock rules and attempting to obstruct NASD's examination or investigation. Finally, Enforcement charged the Firm and Travis with violating NASD Conduct Rule 2110 for failing to comply with the terms of an NASD order accepting an offer of settlement entered in a prior disciplinary action.

The respondents filed answers denying that they violated the SEC and NASD rules as alleged in the complaint. They requested a hearing, which was held in Denver, Colorado in November 2002. The Hearing Panel found that the respondents had engaged in the conduct alleged in the complaint. The Hearing Panel imposed the following sanctions on the following respondents: the Firm was expelled from membership in NASD; Travis was barred from associating with any member firm in any capacity; Dieffenbach was suspended for six months and fined $12,000; and Rooms was suspended for 30 days and fined $5,000.

The Firm and Travis did not appeal the Hearing Panel's decision. Enforcement appealed the decision as to the sanctions imposed on Dieffenbach and Rooms. Dieffenbach and Rooms cross-appealed the Hearing Panel's findings and sanctions regarding the obstruction charge. Dieffenbach and Rooms did not appeal the findings and sanctions regarding the violations of the penny stock rules.

C. Factual History

The Firm was a general securities broker-dealer and a member of NASD during the period in question (approximately October 1997 to August 1999).[3] At that time, the Firm had two offices, one in Denver, Colorado, and the other in New York, New York. The Firm made a market in Turner Group, Inc. stock, which was a penny stock. Travis was the Firm's president and owner.[4] Travis oversaw all of the Firm's compliance and supervisory functions. He also was head of the trading department in the Colorado office. Dieffenbach and Rooms worked in the Firm's Colorado office during the relevant period.[5] Dieffenbach sold 21,850 shares of Turner

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[3] As noted above, the Hearing Panel decision expelled the Firm from membership, and it is no longer an NASD member firm.

[4] Travis was registered as a general securities representative, a general securities principal, and a financial and operations principal.

[5] Both Dieffenbach and Rooms started at the Firm's New York office but transferred to its Denver office, where they worked during the relevant period.

Group stock to six customers between October 1997 and March 1998. Rooms sold 2,425 shares of Turner Group stock to five customers between November 1997 and December 1997.

In April 1998, NASD conducted a routine examination of the Firm, which, in part, focused on the Firm's penny stock activities because NASD previously had cited the Firm for violations of the penny stock rules.[6] During the examination, NASD staff discovered that some customer files did not have Affirmation of Non-Solicitation Forms ("Non-Solicitation Forms") indicating that the transactions in Turner Group stock were exempt from the penny stock rules because the Firm or its associated persons had not recommended the transactions. These customer files also did not contain any records of compliance with the penny stock rules.

On May 26, 1998, following the examination, NASD staff sent the Firm a Rule 8210 request, with the heading "Routine Examination," seeking documents and information as to whether the firm had complied with the penny stock rules in effecting sales of Turner Group.[7] In a letter dated June 30, 1998, Travis, responding for the Firm, stated that the trades at issue were exempt from the penny stock rules because they were made "in existing accounts, foreign accounts or unsolicited letters were obtained." Travis produced copies of several Non-Solicitation Forms but claimed that others were missing and that he was trying to locate them.

On July 16, 1998, NASD staff sent a second request for information, asking that the Firm provide the Non-Solicitation Forms that it had not previously produced. In a letter dated August 11, 1998, Travis responded by again claiming that the transactions were exempt. He failed, however, to deliver Non-Solicitation Forms in support of his claim with regard to a number of customer accounts.

On May 28, 1999, NASD sent a third request for information asking, in part, that the Firm state the specific exemption from the penny stock rules that the Firm was claiming for certain transactions. The NASD request also required the Firm to provide documentation in support of each claimed exemption. NASD staff's letter warned that failure to respond completely to the request could result in the imposition of sanctions. By letter dated August 3, 1999, Travis, on the Firm's behalf, sent NASD staff a response to the third request reiterating the Firm's belief, without elaboration, that the transactions were exempt. The Firm also enclosed some of the outstanding Non-Solicitation Forms, including a number related to Dieffenbach's and Rooms's customers.

During the proceeding below, the respondents claimed that the Turner Group transactions were exempt from the penny stock rules because the respondents had not recommended them. In particular, the respondents testified that they believed that they had not recommended the

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6 NASD's examination was conducted at the Firm's New York office.

7 All of the relevant NASD letters to the Firm requesting information used the heading "Routine Examination" and indicated that NASD was requesting the information pursuant to NASD Procedural Rule 8210.

transactions because they did not insist that their customers purchase the stock. The respondents admitted, however, that they brought the stock to their customers' attention and indicated that the customers should consider purchasing the stock.

With regard to their participation in the Firm's production of the Non-Solicitation Forms to NASD, Dieffenbach and Rooms admitted in their answer to the complaint that, after the Firm received NASD's May 28, 1999 request for information, Travis had instructed them to obtain the forms from the customers to whom they had sold the Turner Group stock in 1997 and 1998. They also admitted in their answer that they were aware that NASD staff had requested the information. In addition, Dieffenbach and Rooms testified during the hearing below that they were aware that the Firm intended to provide the Non-Solicitation Forms to NASD. Nonetheless, Dieffenbach and Rooms claimed during the hearing that they did not know that NASD had specifically requested the information via a Rule 8210 request in connection with an investigation.

Dieffenbach and Rooms also admitted that they contacted the eleven customers and that they asked the customers to sign the Non-Solicitation Forms. They acknowledged that they backdated the forms so that the date next to the customer signature line corresponded to the date of the transactions rather than the date when the customers actually signed the forms. The respondents claimed during the hearing that they had backdated the documents because they thought that the signature date should reflect the date of the transactions, even though there was a separate space on the form for the date of the transactions. Rooms, moreover, admitted that he had actually removed a current date that a customer had written next to his signature.

According to various customers, Dieffenbach and Rooms recommended the transactions in Turner Group. These customers also stated that the respondents pressured them to sign the backdated Non-Solicitation Forms regarding the Turner Group transactions and offered them free stock of another company in exchange for the customers' cooperation.

Customer JM testified that Dieffenbach had told him about Turner Group stock and that he purchased shares of the stock based on Dieffenbach's recommendations. The record indicates that customer JM purchased the stock in November 1997 and March 1998. Customer JM also testified that, in June 1999, Dieffenbach called and told him that the Firm was going to give him stock in another company comparable in value to the amount of money he had invested in Turner Group. Customer JM stated that Dieffenbach told him that he would need to sign some documents that he was going to send him. Customer JM testified that he told Dieffenbach at that time that he had spoken to an NASD investigator and had signed a declaration about the Turner Group transactions. He said that Dieffenbach responded by telling him not to return any NASD phone calls in the future and, if asked, to tell NASD that he did not remember the specifics of the Turner Group transactions. In the end, customer JM stated that he had refused to sign the Non-Solicitation Forms that Dieffenbach had sent him because Dieffenbach had backdated the forms and because the forms incorrectly indicated that Dieffenbach had not recommended the Turner Group transactions.

Another of Dieffenbach's customers, customer JS, stated that, in October 1997, Dieffenbach told him that Turner Group was a good short-term investment. Based on

Dieffenbach's recommendation, customer JS purchased Turner Group stock in October 1997 and December 1997. Customer JS also stated that, in June 1999, Dieffenbach had called and asked him if he would sign some papers regarding the Turner Group transactions. Customer JS stated that Dieffenbach had offered him free shares of stock to help him recoup his losses in Turner Group. Customer JS stated that he did not sign the Non-Solicitation Forms because they had been backdated.

Similarly, customer BM testified that Dieffenbach had told him to consider investing in Turner Group. Customer BM purchased shares of Turner Group in December 1997 and January 1998 based on Dieffenbach's recommendations. Dieffenbach subsequently asked customer BM to sign the Non-Solicitation Forms in exchange for free stock. Customer BM signed the forms, which Dieffenbach had backdated.

One of Rooms's customers, customer DH, testified that he first learned of Turner Group in a telephone conversation with Rooms and that, in November 1997, he purchased Turner Group stock from Rooms based on his recommendation. He also testified that, in June 1999, Rooms called him and stated that, if customer DH would sign the Non-Solicitation Form and send it back within two days, the Firm would compensate him with stock equaling the value of what he had invested and lost in Turner Group. Customer DH testified that he had signed the form after writing the current date next to his signature so that the date would accurately represent when he had executed the document. Rooms testified that customer DH had subsequently authorized him to remove the date. Customer DH, however, testified that he never gave Rooms such authority.

During the hearing, Enforcement also introduced as evidence a number of customer questionnaires and declarations, from customers who testified during the hearing and others who did not. The questionnaires and declarations substantially corroborated the customer testimony provided during the hearing.

For instance, customer CD, who did not testify during the hearing, submitted a questionnaire and stated that Dieffenbach told him in November 1997 that Turner Group "was a great company to invest in, he said that some great things were going on in the company and that the stock was on the rise." Customer CD initially told Dieffenbach that he was not interested in purchasing Turner Group stock. According to customer CD, Dieffenbach responded by saying, "Listen, I have never recommended a stock to you before, this is the first time, that should tell you something. This is a great stock and it is one that you can't go wrong on if you buy it." Customer CD purchased Turner Group in November 1997 based on Dieffenbach's recommendation. Customer CD also noted that Dieffenbach subsequently called him and said that he needed customer CD to sign a Non-Solicitation Form. When customer CD received the form, it inaccurately stated that Dieffenbach had not recommended the purchase of Turner Group stock. Customer CD called Dieffenbach to tell him the form was not correct. In response, Dieffenbach said he "would be in a lot of trouble" if customer CD did not sign the Non-Solicitation Form. Customer CD stated that Dieffenbach also told him that he (customer CD) "might be in trouble" if the form was not on file. Customer CD further noted that Dieffenbach told him that he would give customer CD his "next several trades for free" if customer CD would

execute the Non-Solicitation Form. According to customer CD, he signed the backdated form "after much prodding" by Dieffenbach.

Similarly, customer LM, who also did not testify during the hearing, submitted a questionnaire in which he stated that Dieffenbach recommended Turner Group to him. Customer LM stated that Dieffenbach told him Turner Group was "a good company to invest in and it was going to make me and Eric [Dieffenbach] a lot of money since he had money invested too." Customer LM purchased Turner Group stock in October 1997 and December 1997. In a subsequent declaration that customer LM submitted to NASD, customer LM stated that Dieffenbach called him in June 1999 and asked customer LM to help by signing the backdated Non-Solicitation Forms. Customer LM stated that Dieffenbach had told him that the Firm was "in hot water" regarding Turner Group. According to customer LM, Dieffenbach acknowledged that he had misrepresented Turner Group to him, but claimed he had done so only because the stock had been misrepresented to him. Customer LM also stated that Dieffenbach told him that the Firm was trying to work something out so that the Firm could compensate customers who had lost money by purchasing Turner Group. According to customer LM, Dieffenbach stated that the Firm would only compensate customer LM if he signed the forms. Customer LM did not sign and return the documents because he believed that they were "inaccurate and were lies." Customer LM reiterated that the Turner Group transactions "were definitely solicited and recommended by Dieffenbach."

Customer AC, who did not testify during the hearing, stated in a questionnaire that Rooms recommended Turner Group to him in December 1997. Customer AC stated that Rooms told him that Turner Group was an "up and coming" company "whose profit potential looked very good" and that the Firm was "turning some of [its] better customers onto them." The record indicates that customer AC purchased Turner Group stock in December 1997. In a subsequent declaration that customer AC signed and sent to NASD, customer AC stated that Rooms contacted him in June 1999 and said that the Firm would give customer AC free shares of stock if he would sign the Non-Solicitation Form. Customer AC stated that he noticed that Rooms had backdated the date next to the signature line to December 1997. Customer AC stated that he ultimately refused to sign the Non-Solicitation Form because Rooms had in fact recommended the Turner Group transactions. Customer AC stated, "I would not sign anything that was untrue."

Customer HD, who did not testify during the hearing, stated in his declaration that Rooms told him about Turner Group during a telephone conversation in November 1997. Customer HD said that Rooms recommended Turner Group as an investment, but that he could not recall the specifics of the conversation. In November 1997, Customer HD purchased Turner Group stock. Customer HD also stated that Rooms called him in June 1999 and told him that the Firm was going to give him enough shares of AutoAuction.com, a company that had merged with Turner Group, to roughly equal his original purchase price of Turner Group. According to customer HD, Rooms said that, in return for the stock, customer HD would need to sign the Non-Solicitation Form regarding the original Turner Group transaction. Customer HD stated that he objected "because the document he wanted me to sign was untrue." Customer HD said that he never received the Non-Solicitation Form.

NASD examiner Paul Jones Rash, III ("Rash") testified during the hearing that he conducted a routine examination of the Firm in April 1998. He testified that, during the examination, he reviewed customer account information and noticed that there was a lack of information regarding whether certain Turner Group transactions were unsolicited or in compliance with the penny stock rules. He then sent the Firm a number of Rule 8210 requests for information about the transactions. The Firm provided Non-Solicitation Forms for some, but not all, of the transactions in question. He testified that he was concerned about the Firm's inability to produce all of the forms in a timely manner. As a result, he decided to contact some of the Firm's customers to determine whether the transactions were unsolicited, as the Firm had claimed. He testified that the customers, who were unrelated and did not know each other, indicated that Diffenbach and Rooms had recommended the transactions. Rash also subsequently learned from the customers that Dieffenbach and Rooms had sought to have the customers sign backdated Non-Solicitation Forms in exchange for the stock of AutoAuction.com. He explained that, apparently unbeknownst to some of the customers, AutoAuction.com was the new name of Turner Group. He also testified that the Firm gave some customers free stock of a company called Advanced Engines.

Rash further testified that customer JM had told him that Dieffenbach had encouraged customer JM to be uncooperative with NASD. Rash testified, moreover, that the Firm did not tell NASD that the Non-Solicitation Forms had been backdated. Nor did the Firm advise him that some of the customers had refused to sign the Non-Solicitation Forms. Rash also stated that the fact that the forms had been backdated was important to NASD's investigation because, but for the customers' statements, he would never have known that the forms were not obtained until 1999, long after the 1997 and 1998 transactions in question had actually taken place. Finally, Rash emphasized that whether the transactions were recommended was central to NASD's original inquiry regarding the respondents' compliance with the penny stock rules because, in general, the penny stock disclosure requirements in question apply only to recommended transactions.

Dieffenbach and Rooms asserted that they did not offer stock to customers in order to get them to sign the backdated Non-Solicitation Forms. They claimed that the customers were likely confusing conversations about Turner Group's reverse stock split and name change to AutoAuction.com in May 1999. Dieffenbach and Rooms also asserted that they had not intended to mislead NASD by backdating the documents and emphasized that they were truthful and cooperative when NASD asked them directly about the transactions and Non-Solicitation Forms. In addition, Dieffenbach denied telling customer JM that he should not cooperate with NASD.

II. DISCUSSION

As noted above, the Hearing Panel found that Dieffenbach and Rooms engaged in misconduct by failing to disclose to customers certain information required by the penny stock rules and by obstructing NASD's investigation into the penny stock violations. Enforcement appeals only the sanctions that the Hearing Panel imposed. The respondents cross-appeal the findings and sanctions only with regard to the obstruction violations. The respondents do not contest the findings and sanctions regarding the penny stock violations. Nonetheless, we will

briefly review the findings regarding the penny stock violations before discussing the issues germane to the obstruction charges and sanctions.

A. Penny Stock Violations

In general, the penny stock rules require broker-dealers to provide customers with information concerning the risks of penny stocks and the specific nature of their penny stock purchases. Unless the transactions are exempt, broker-dealers effecting customer transactions in penny stocks must provide their customers with the following information pertinent to this case: (1) a disclosure document describing the risks of investing in penny stocks;[8] (2) oral and written disclosure of current bid and ask quotations;[9] and (3) the salesperson's compensation for the transaction.[10] Among a number of exemptions, SEC Rule 15g-1(e) states that "[t]ransactions that are not recommended by the broker or dealer" are exempt from the penny stock disclosure requirements in question.

Rooms and Dieffenbach admitted during the proceedings below that they brought the Turner Group penny stock to their customers' attention and suggested to the customers that they might want to consider making a purchase. They also admitted that they had failed to provide the customers with the required disclosures and information about penny stocks. They had argued, however, that the SEC Rule 15g-1(e) exemption to the penny stock rules applied because they had not "recommended" the Turner Group transactions. Each testified that it was his belief that a recommendation involved more than directing a customer to a particular security or telling a customer that a security was a good idea. Rooms testified that he did not consider it a recommendation unless he was "adamant about a situation." Likewise, Dieffenbach testified that it was his understanding that he was not making a recommendation unless he insisted that the customer buy the security.

The Hearing Panel rejected the respondents' arguments, finding that the SEC Rule 15g-1(e) exemption did not apply because the respondents had recommended the transactions to their customers. The Hearing Panel noted that the respondents' arguments were based on an erroneous view of what types of communications or actions constitute a recommendation for purposes of the penny stock rules. Moreover, numerous customers stated that the respondents

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[8] SEC Rule 15g-2. This rule also requires the firm to obtain a signed acknowledgment of receipt of the risk disclosure document.

[9] SEC Rule 15g-3.

[10] SEC Rule 15g-5. The penny stock rules also require firms to provide customers with disclosure of the firm's compensation, *see* SEC Rule 15g-4, monthly account statements showing the market value of each penny stock held in the customer's account, *see* SEC Rule 15g-6, and a written suitability statement (when the transaction involves a non-established customer), *see* SEC Rule 15g-9. Enforcement, however, did not allege in the complaint that the respondents violated SEC Rules 15g-4 and 6, and Enforcement withdrew its charge that the respondents violated SEC Rule 15g-9.

had recommended the Turner Group transactions to them.[11] The Hearing Panel concluded that Dieffenbach and Rooms had recommended Turner Group and had violated the penny stock rules by failing to provide their customers with the proper disclosures and other required information.

The respondents do not contest the Hearing Panel's findings of violations in this regard. After reviewing the record, we agree with the Hearing Panel and the parties that the respondents violated the penny stock rules by failing to provide their customers with the required disclosures. We emphasize that, where, as here, the brokers bring the penny stock to their customers' attention and tell them that they should consider purchasing the stock, a recommendation clearly exists under the penny stock rules and the SEC Rule 15g-1(e) exemption does not apply. As the SEC emphasized in its order approving the pertinent penny stock rules, the exemption "is limited to situations in which a broker-dealer acts as an order taker for the customer . . . . The rule does not exempt situations in which a broker-dealer brings a penny stock to the attention of an investor. . . . " SEC Order Adopting Penny Stock Rules Regarding Disclosure Requirements, Exchange Act Rel. No. 30608, 1992 SEC LEXIS 927, *75-76 (April 20, 1992); *see also DBCC for Dist. No. 2 v. Gallison*, Complaint No. C02960001, 1999 NASD Discip. LEXIS 8, at *17 (NAC Feb. 5, 1999) ("The crux of the exemption is that representatives must not advise their clients, either explicitly or implicitly, regarding a penny stock transaction; they must act as mere order takers.").

We also agree that the respondents violated the ethical principles in Conduct Rule 2110 by violating the penny stock rules. *See Gallison*, 1999 NASD Discip. LEXIS 8, at *29 (finding that respondents violated Conduct Rule 2110 by engaging in penny stock transactions without making the disclosures required under the penny stock rules).

B. Obstruction of NASD Examination or Investigation

The Hearing Panel held that Dieffenbach and Rooms violated Conduct Rule 2110 and Procedural Rule 8210 by obstructing NASD's examination or investigation regarding the Turner Group transactions. The Hearing Panel found that, after receiving NASD's Rule 8210 requests,

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[11] As noted above, a number of customers testified during the earlier proceedings. Many customers also provided questionnaires and declarations. The SEC has approved the use of customer questionnaires as "a necessary and appropriate means of gathering information on members' sales practices" that "furthers the NASD's regulatory objectives." *Robert A. Amato*, 51 S.E.C. 316, 321 (1993). The SEC also has upheld the use of affidavits and declarations to support findings in self-regulatory organization disciplinary proceedings. *See Harry Gliksman*, Exchange Act Rel. No. 42255, 1999 SEC LEXIS 2685, at *15-16 (Dec. 20, 1999) (finding customer's affidavit to be probative, reliable and admissible), *aff'd*, No. 00-70141, 2001 U.S. App. LEXIS 25479 (9th Cir. Nov. 26, 2001); *Charles D. Tom*, 50 S.E.C. 1142, 1145 (1992) (holding that written declaration was admissible). While live testimony is preferred and used when available, we find that the questionnaires and declarations in this case are relevant and trustworthy, particularly in light of the live testimony that was consistent with, and supportive of, the information provided by the questionnaires and declarations.

Travis had instructed Dieffenbach and Rooms to get signed Non-Solicitation Forms from their customers. The Hearing Panel also found that "Travis told Rooms and Dieffenbach that he needed the forms for the NASD examination." The Hearing Panel, moreover, found that Dieffenbach and Rooms attempted to persuade their customers to sign the backdated forms, in part, by telling their customers that the Firm would give them free stock if they signed the forms. The Hearing Panel concluded that Dieffenbach and Rooms "obstructed NASD's investigation by providing false documentation to the [NASD] staff and that Dieffenbach further obstructed NASD's investigation by telling [customer] JM to refuse to cooperate with NASD and to lie regarding the facts and circumstances regarding his purchases of Turner Group stock."

On appeal, the respondents argue that they should not be held in violation of Conduct Rule 2110 and Procedural Rule 8210 because the Rule 8210 requests were not specifically addressed to them and they did not know that NASD was investigating their sales of Turner Group. Although they admit that they backdated the forms (and Rooms admits that he actually removed the correct date that had been written by one of his customers next to his signature), the respondents argue that they did not intend to mislead NASD by backdating the documents. They also claim that they did not pressure their customers to sign the forms. We reject the respondents' contentions and uphold the Hearing Panel's findings regarding the obstruction violations.

As an initial matter, we note that, at various times during these proceedings, the respondents attempted to somehow distinguish between an NASD examination and investigation. We emphasize that Procedural Rule 8210 makes no distinction regarding an associated person's obligations based on whether NASD is conducting an examination or investigation. The rule's requirements apply equally and explicitly to NASD examinations and investigations.

We next address whether, as a matter of law, a respondent can be found in violation of Conduct Rule 2110 and Procedural Rule 8210 for obstructing an examination or investigation even though the Rule 8210 request was not addressed to the respondent in question. In their appellate briefs, respondents argued that an adjudicator could not find a respondent in violation of Rules 2110 and 8210 if NASD did not specifically direct the request to that respondent. Under questioning from the National Adjudicatory Council Subcommittee during oral argument on appeal, respondents' counsel acknowledged that there is no bright line rule. Respondents' counsel stated that, hypothetically, an adjudicator appropriately could find a respondent in violation of the rules if the respondent was aware of the Rule 8210 request, notwithstanding that the request was not specifically addressed to the respondent. For the reasons discussed below, we hold that the appropriate analysis does not hinge on whether NASD addressed the Rule 8210 request to the particular respondent. Nor does it matter whether the Firm or a supervisor used the words "Rule 8210 request" in directing a respondent to gather information for production to NASD. Rather, the appropriate focus is whether the respondent had reasonable notice that his or her conduct regarding a document production to NASD would be inconsistent with Conduct Rule 2110 and Procedural Rule 8210.

Conduct Rule 2110 and Procedural Rule 8210 are crucial components of NASD's examinations and investigations. Procedural Rule 8210 gives NASD the right to require a

member or person associated with a member to provide information, orally or in writing, in connection with an examination or investigation. The rule further states that no member or person shall fail to provide such information. It is axiomatic that Procedural Rule 8210 prohibits an associated person from providing false or misleading information to NASD in connection with an examination or investigation. *See John Montelbano*, Exchange Act Rel. No. 47227, 2003 SEC LEXIS 153, at *36-38 (Jan. 22, 2003) (upholding NASD's finding that respondents violated Procedural Rule 8210 by giving false testimony during an on-the-record interview).

Conduct Rule 2110 states that a "member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade." A refusal to cooperate with an NASD examination or investigation is conduct inconsistent with just and equitable principles of trade and violative of Conduct Rule 2110. *See Stratton Oakmont, Inc*., 52 S.E.C. 1170, 1174 (1997) (finding that attempts to impede NASD investigation violated Conduct Rule 2110); *John J. Fiero*, 53 S.E.C. 434, 438 n.12 (1998) ("Fiero impeded an investigation into his business activities. That conduct must be viewed as a violation of his obligation to conduct those activities in accordance with ethical standards."). Providing false or misleading information to NASD also is conduct inconsistent with just and equitable principles of trade. *See Brian L. Gibbons*, 52 S.E.C. 791, 795 (1996) ("Providing misleading and inaccurate information to the NASD is conduct contrary to high standards of commercial honor and is inconsistent with just and equitable principles of trade.").

It is, of course, impractical to try to anticipate and enumerate every type of specific conduct that could violate these important principles. A respondent has sufficient notice of the breadth of a rule, however, if a reasonable person would understand that the rule prohibited the conduct at issue. *See Mark H. Love*, Exchange Act Rel. No. 49248, 2004 SEC LEXIS 318, at *12 (Feb. 13, 2004) (noting, in context of a vagueness challenge to NASD Rule 3040, that the rule must give fair guidance to firms, their associated persons and NASD decision makers with respect to the type of activities that are subject to its restrictions); *Richard Kwiatkowski*, Exchange Act Rel. No. 48707, 2003 SEC LEXIS 2568, at *18 n.15 (Oct. 28, 2003) ("Due process requires that 'laws give the person of ordinary intelligence a reasonable opportunity to know what is prohibited.'") (quoting *Upton v. SEC*, 75 F.3d 92, 98 (2d Cir. 1996)). While the reaches of Conduct Rule 2110 and Procedural Rule 8210 are not without boundaries, the respondents' positions assign to them far too limited a scope.

We find that a reasonable person would understand and have fair notice that Conduct Rule 2110 and Procedural Rule 8210 prohibit an associated person from falsifying information knowing that the information will be produced to NASD as part of an NASD examination or investigation. The fact that a Rule 8210 request does not specifically name all of the persons who ultimately participate in a firm's document production to NASD is not dispositive. We hold that adjudicators must consider the facts and circumstances of the particular case to determine

whether a respondent who was not named in a Rule 8210 request nonetheless would understand that Conduct Rule 2110 and Procedural Rule 8210 prohibited the conduct at issue.[12]

We now address the respondents' factual arguments. We reiterate that the credibility determinations of the initial trier of fact are entitled to deference and may be overturned only if there is substantial evidence to contradict such determinations. *See Dane S. Faber*, Exchange Act Rel. No. 49216, 2004 SEC LEXIS 277, at *17-18 (Feb. 10, 2004) (emphasizing that the credibility determinations of initial fact-finder are entitled to considerable weight and deference); *Jonathan Garrett Ornstein*, 51 S.E.C. 135, 137 (1992) (same). Here, the Hearing Panel found credible the customers' testimony that the respondents recommended Turner Group and subsequently attempted to persuade the customers to sign the backdated Non-Solicitation Forms. The Hearing Panel also found credible the customers' testimony that the respondents offered them free stock in exchange for their signatures on the backdated forms. The Hearing Panel did not find the respondents' contrary testimony to be credible. In addition, the Hearing Panel found that the respondents' testimony was not credible regarding their claim that they did not know that the Firm intended to produce the forms to NASD in connection with an NASD examination or

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[12] The respondents argue in their appellate brief that the decision in *General Bond & Share Co. v. SEC*, 39 F.3d 1451 (10th Cir. 1994), supports their position that a respondent cannot be found in violation of Conduct Rule 2110 and Procedural Rule 8210 unless the Rule 8210 request was directed to the respondent. We disagree with respondents' analysis of *General Bond & Share*. In that case, the United States Court of Appeals for the Tenth Circuit held that an NASD Notice to Members had established a new standard of conduct and was a rule change that required NASD to seek SEC approval prior to taking disciplinary action against a respondent under the standard. *Id*. at 1459. The Tenth Circuit determined that a market maker's acceptance of issuer paid compensation was conduct that "reasonable persons could disagree as to whether" it was prohibited by Article III, Section I (now Conduct Rule 2110). *Id*. at 1460 n.4. The court stated that the market maker's conduct was not so "inherently deceptive" that it was clearly prohibited by NASD's mandate that members observe "just and equitable principles of trade." *Id*. at 1460.

Unlike the conduct discussed in *General Bond & Share*, which the court did not find inherently deceptive, the Hearing Panel in the instant case found that respondents attempted to persuade customers to sign falsified documents that the respondents knew the Firm would produce to NASD in order to obstruct NASD's examination or investigation. Moreover, the respondents offered their customers free stock to induce the customers to sign the misleading forms. In addition, on at least one occasion, Dieffenbach attempted to persuade a customer not to cooperate with NASD. We find that it is self evident that altering documents and coercing customers in an effort to frustrate NASD's performance of its regulatory function is inherently deceptive, and that a securities professional has fair notice that such conduct would violate NASD's rules. *Cf. Stratton Oakmont, Inc.*, 52 S.E.C. 1170, 1174-75 (1997) (distinguishing *General Bond & Share* and holding that Article III, Section I, now Conduct Rule 2110, and the Exchange Act inherently obligate NASD members to cooperate with NASD investigations and accordingly respondent had ample notice that its conduct would violate NASD rules).

investigation. We find no evidence, let alone convincing evidence, that the Hearing Panel's credibility determinations and other factual findings regarding the violations are in error. To the contrary, we find that the evidence overwhelmingly supports the Hearing Panel's findings of violations.

A number of unrelated customers testified at the hearing (and many other customers submitted questionnaires or declarations) to the effect that Dieffenbach and Rooms recommended the Turner Group transactions and later attempted to persuade them to sign the backdated Non-Solicitation Forms. They also testified that Dieffenbach and Rooms offered them free stock in exchange for their agreement to sign and send back the forms. The customers' testimony and written statements were, in relevant part, consistent. The customers, moreover, lived in different geographic areas and there is no indication that any of them knew each other. Finally, there is no evidence that any of the customers had motive to lie. We find untenable the respondents' claim that all of these customers told the same mistaken story about the respondents' conduct.

We find equally untenable the respondents' claim that they did not know that the Firm, via Travis, intended to provide NASD the false Non-Solicitation Forms. In their answer to the complaint, the respondents admitted that Travis had told them that NASD had requested the information. Moreover, Dieffenbach and Rooms testified that Travis had directed them to get the forms because of an NASD examination.[13] Rooms's testimony also suggested at one point

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[13] The following testimony by Rooms during cross-examination is instructive:

> Question: Your prior testimony was you believed that the NASD investigation prompted the search for the non-solicitation letters?
>
> Answer: At that point, that's what I said, yes.
>
> Question: In other words, the reason you were looking for these letters that had been requested by Mr. Travis was because of the NASD investigation or examination?
>
> Answer: That's correct.
>
> Question: You knew the NASD requested this information?
>
> Answer: From David Travis, yes.

At another point, Rooms stated, "I'm sure I was aware there was an NASD examination going on in the firm, and that's what they [the Non-Solicitation Forms] were being requested for." Similarly, Dieffenbach testified on direct examination as follows:

> Question: Did you know why he asked you to [get the forms]? You know now. But I'm talking about '97, '98. What was your impression then as to why you were asked to do that?

[Footnote continued on next page]

that he had actually reviewed NASD's Rule 8210 requests to the Firm.[14] In addition, at least one customer had told Dieffenbach that NASD was investigating the Turner Group transactions. We find, as did the Hearing Panel, that Dieffenbach and Rooms were aware that NASD had requested the information as part of its examination or investigation and that the respondents knew that the Firm intended to produce the falsified forms to NASD.

Under these circumstances, we find that Dieffenbach and Rooms violated Conduct Rule 2110 and Procedural Rule 8210. Perhaps the most important component of self-regulation is NASD's ability to effectively police member firms' compliance with the federal securities laws and NASD rules. Here, the respondents attempted to undermine NASD's regulatory function by pressuring their customers to sign inaccurate and backdated Non-Solicitation Forms.[15] The respondents clearly acted inconsistently with just and equitable principles, in violation of Conduct Rule 2110. Their actions also run contrary to Rule 8210's fundamental requirement that members and their associated persons cooperate fully with NASD examinations and investigations.

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> Answer: My impression then was at the time we were missing some of these forms from the files. And there was an investigation or an examination by the NASD. And we needed those for the files.
>
> Question: You were aware of the NASD examination?
>
> Answer: Yes.

[14] During the hearing below, for example, Rooms attempted to explain his statement that he was unaware of any NASD "investigation" by testifying as follows: "My understanding from when I read the correspondence, they all referred to a routine examination. . . . Well, I'd reviewed all the documents. And they all said, examination, which is, that's the only problem I had, was that all correspondence said, routine examination. That's what I'm saying. Everything I got said, from the NASD said, routine examination. Nothing referred to an investigation." As noted above, the NASD Rule 8210 requests had a heading that stated "Routine Examination."

[15] We find most disturbing that the respondents backdated the Non-Solicitation Forms, knowing that the Firm would produce them to NASD. However, we also find that they acted improperly in attempting to persuade customers to sign the Non-Solicitation Forms when they knew or were reckless in not knowing that they had recommended the transactions.

C. Sanctions

As discussed above, the Hearing Panel unanimously found that the respondents violated NASD Rule 2110 and the SEC's penny stock rules by failing to provide customers with certain required disclosures. The Hearing Panel also unanimously found that the respondents violated Conduct Rule 2110 and Procedural Rule 8210 by obstructing NASD's examination or investigation. In this regard, the Hearing Panel specifically found that the respondents attempted to pressure their customers to sign falsified documents central to an NASD examination or investigation knowing that the Firm would produce those falsified documents to NASD. The Hearing Panel also unanimously found that Rooms removed an accurate date that a customer had written next to his signature (without the customer's authorization) and that Dieffenbach encouraged a customer to be uncooperative with NASD. We agree with these unanimous Hearing Panel findings.

After making these unanimous findings, however, the Hearing Panel majority imposed lenient sanctions. The majority imposed on Dieffenbach a six-month suspension for the obstruction violation and a $12,000 fine for the penny stock violation. The majority imposed on Rooms a 30-day suspension for the obstruction violation and a $5,000 fine for the penny stock violation. The Hearing Officer, in a dissenting opinion, disagreed with the sanctions imposed by the majority. The Hearing Officer found the respondents' misconduct regarding the obstruction charge to have been egregious, requiring a bar in all capacities as to both respondents. We agree with the Hearing Officer's dissent. We find the respondents' misconduct to be extremely serious and egregious.[16] Indeed, the type of misconduct at issue here threatens the self-regulatory system.

As the SEC has emphasized, compliance with Conduct Rule 2110 and Procedural Rule 8210 is essential to enable NASD to carry out its self-regulatory functions. *See Michael David Borth*, 51 S.E.C. 178, 180 (1992). In recognition of the importance of Rules 2110 and 8210 to the regulatory scheme, the NASD Sanction Guidelines ("Sanction Guidelines") treat a failure to respond and a failure to respond truthfully as egregious violations. The Sanction Guidelines provide that, absent mitigating factors, "a bar should be standard."[17] Here, we find the respondents' conduct to be egregious, and we do not find any facts in mitigation. We thus determine that the standard sanction of a bar is appropriate.

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[16] As Enforcement correctly points out, on *de novo* review, we owe "no special deference" to hearing panel "inferences and conclusions that do not hinge upon findings of credibility." *Local 259, United Automobile, Aerospace and Agricultural Implement Workers v. NLRB*, 776 F.2d 23, 27 (2d Cir. 1985). We may make our "own findings based on a review of all material in the record." *Keith Springer*, Exchange Act Rel. No. 45944, 2002 SEC LEXIS 1295, at *4 n.4 (May 16, 2002).

[17] The Sanction Guidelines state that, "[i]f the individual did not respond in any manner, a bar should be standard. Where mitigation exists, or the person did not respond in a timely manner, consider suspending the individual in any or all capacities for up to two years." NASD Sanction Guidelines (2001 ed.) at 39.

The Sanction Guidelines list two principal considerations for such violations: (1) the nature of the information requested; and (2) whether the requested information has been provided and, if so, consider the number of requests made, the time respondent took to respond, and the degree of regulatory pressure required to obtain a response. We find that these considerations support imposition of a bar.

The Non-Solicitation Forms that NASD requested were material to NASD's investigation of whether the respondents violated the penny stock rules. Travis and the Firm had claimed that the penny stock rules did not apply because the respondents had not recommended the Turner Group transactions. NASD staff sought to verify that claim by requesting copies of the Non-Solicitation Forms that Travis claimed were misplaced. The documents were thus crucial to NASD's investigation.

Furthermore, we view the respondents' action in this case to be as egregious as (and, perhaps, more egregious than) a complete failure to respond. The respondents, who were experienced securities professionals, willfully attempted to affirmatively mislead NASD. Knowing that the Firm intended to produce the Non-Solicitation Forms to NASD in connection with NASD's examination or investigation, the respondents falsified the forms so that they would not reflect that the Firm had obtained them recently. Thus, the documents gave NASD staff the false impression that they were the missing Non-Solicitation Forms that the Firm had located among its files and that the customers had signed the forms at the time of the Turner Group transactions. If it is to fulfill its regulatory obligations, NASD cannot tolerate this type of deception. NASD staff only learned that the transactions had been recommended and that the forms had been falsified as a result of NASD staff's independent discussions with the respondents' customers. There is no excuse for the respondents' egregious actions, and we find no mitigating factors under the circumstances of this case.[18] We order that the respondents be

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[18] The respondents argue that we should affirm the Hearing Panel majority's finding that their lack of a disciplinary history is mitigating. In general, NASD does not consider a lack of disciplinary history to be mitigating. *See Dep't of Enforcement v. Balbirer*, Complaint No. C07980011, 1999 NASD Discip. LEXIS 29, at *10 (NAC Oct. 18, 1999) ("We are not compelled to reward a respondent because he has acted in the manner in which he . . . was required to act . . . as a registered person. We . . . do not find that the absence of a disciplinary history should mitigate . . . the severity of the sanctions imposed."). We need not resolve in this case, moreover, whether or to what extent there may be limited exceptions to this general proposition. We find that, under the facts of this case and considering the seriousness of the misconduct, the respondents' lack of disciplinary history is not mitigating.

We also reject the respondents' contention that we should uphold the Hearing Panel majority's finding that the respondents' cooperation with NASD's investigation was mitigating. The Hearing Panel majority's finding was based on respondents' truthful admissions during their on-the-record testimony in December 1999 that they had attempted to (and, in fact, did in some instances) persuade their customers to sign the backdated Non-Solicitation Forms in June 1999. We note that NASD took respondents' on-the-record testimony after NASD staff had learned from customers that the respondents had sought to have the customers sign the backdated Non-

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barred in all capacities for intentionally attempting to mislead NASD during its examination or investigation, in violation of Rules 2110 and 8210.[19]

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Solicitation Forms (a fact generally known to the respondents at the time of their on-the-record testimony). Capitulation after NASD staff learned of the misconduct from customer statements is hardly mitigating considering respondents' attempts to keep NASD staff from learning the truth in the first instance. *Cf. Brian L. Gibbons*, 52 S.E.C. at 794 n.10 ("Gibbons' offers to confess after his actions were discovered do not mitigate his offense."). Moreover, we do not view the respondents' decision to refrain from giving perjured testimony to be mitigating.

Furthermore, under the facts of this case, we reject the Hearing Panel majority's view that the lack of customer harm is a mitigating factor regarding the obstruction violation. As an initial matter, adjudicators consider customer harm to be an aggravating factor but they normally do not consider the lack of customer harm to be mitigating (although there are some exceptions to this general rule). More to the point, however, is that customer harm or lack thereof usually is irrelevant to a charge of obstruction of an examination or investigation. It is rare that a respondent's obstruction of an examination or investigation would directly result in financial harm to a customer. The harm in such instances, as here, is to the self-regulatory process and to investors' confidence in that process. We find that the Hearing Panel majority erred in determining that a lack of customer harm regarding the respondents' misconduct for the obstruction violations was mitigating.

Finally, we reject the Hearing Panel majority's findings of mitigation regarding the respondents' obstruction violations based on the majority's assertion that "the number and size of the underlying transactions were small, resulting in minimal financial gain" and that "none of the customers complained and each that testified indicated that they understood the risky nature of the investment." We do not find the Hearing Panel majority's observations to be mitigating in relation to a determination of appropriate sanctions for respondents' obstruction of an examination or investigation.

[19] We impose the bars in this case because we find that the respondents intentionally sought to obstruct NASD's examination or investigation by attempting to persuade customers to sign the backdated Non-Solicitation Forms, knowing that the Firm would provide those forms to NASD. We note, however, that we would be troubled by the respondents' actions even if they had not backdated the Non-Solicitation Forms because the respondents clearly had recommended the transactions. As discussed *infra*, the respondents' actions—both at the time of the transactions and during the period when they attempted to have customers sign the forms—evidence a reckless disregard of their duties to know and abide by the securities laws and rules, particularly the penny stock rules. Moreover, the respondents' conversations with some of their customers in 1999 should have alerted them that, at that point, they needed to investigate further whether their prior communications would be treated as "recommendations" under the penny stock rules and interpretations thereof. For instance, customer JM testified that he told Dieffenbach that he had signed a declaration for NASD indicating that Dieffenbach had recommended the Turner Group

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We also disagree with the lenient sanctions that the Hearing Panel imposed for the respondents' violations of the penny stock rules. Violations of the penny stock rules are serious. As the SEC has emphasized, the penny stock rules "are part of a comprehensive effort by the Congress and the Commission to reduce fraud and manipulation in the penny stock market and to provide investors with important information concerning that market." SEC Order Adopting Penny Stock Rules Regarding Disclosure Requirements, 1992 SEC LEXIS 927, at *13. In recognition of the importance of the penny stock rules, the Sanction Guidelines recommend suspending the individual in any or all capacities for up to two years in cases involving negligent misconduct. *See* Sanction Guidelines (2001 ed.) at 97. For those involving egregious misconduct, the Sanction Guidelines recommend a bar. *Id*.

Here, the respondents recommended and sold penny stocks to eleven customers without providing the required disclosures to them. The respondents' justification for these failures was that they did not believe that they were "recommending" the stocks because they did not actually insist that the customers make the purchases. The respondents, however, admitted that they brought the penny stocks to their customers' attention and told the customers that they should consider purchasing the stocks. Moreover, various customers stated that the respondents had recommended the transactions. We find it hard to believe that experienced securities professionals (registered as general securities representatives and principals) were so obviously mistaken about whether they were recommending the penny stocks. However, even assuming, *arguendo*, that the respondents accurately depicted during the hearing their mistaken belief at the time of the transactions, their utter lack of understanding of what constitutes a recommendation for purposes of the penny stock rules nonetheless would evidence a reckless disregard for their obligations as registered representatives and principals.[20]

We reject the Hearing Panel's conclusion that the Firm's inadequate training and supervision mitigates the respondents' failures in this regard. Respondents were experienced

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transaction. Similarly, customer HD stated in his declaration that he told Rooms that he would not sign the Non-Solicitation Form because Rooms had recommended the Turner Group transaction. Yet, the respondents again failed to seek clarification of the penny stock rules to determine whether, under those rules, they had recommended the trades.

[20] The CRD records introduced as evidence below clearly indicate that the respondents were registered with the Firm as general securities representatives and general securities principals. On appeal, the respondents claimed that they were not acting in a principal capacity at the Firm. The respondents did not elaborate on their claim, but we presume that they intended to assert that they had not acted in a supervisory capacity at the Firm. Our reasons for noting that the respondents were registered as general securities principals does not hinge on whether the respondents acted in a supervisory capacity. Instead, we note the respondents' registration status because we find it inexcusable for experienced securities professionals, registered as principals, who intended to (and, in fact, did) sell penny stocks to numerous customers, to be so completely unaware of the correct application of the penny stock rules.

securities professionals and they either should have been, or should have made efforts to become, aware of the appropriate requirements before recommending and selling penny stocks to customers. Moreover, NASD and the SEC, on several occasions and in various settings, have rejected arguments similar to those relied on by the Hearing Panel. For instance, in *Patricia H. Smith*, Exchange Act Rel. No. 35898, 1995 SEC LEXIS 1531 (June 27, 1995), the respondent argued in mitigation that her misconduct had resulted from inadequate training. *Id*. at *5 n.8. The SEC rejected the contention, stating that "ignorance of NASD requirements is no excuse for violative behavior." *Id.* Similarly, in *Thomas C. Kocherhans*, 52 S.E.C. 528 (1995), the respondent argued that he should not be held responsible for the misconduct because his manager had failed to warn him that his actions violated NASD's rules. He also argued that the firms at which he had previously worked did not properly supervise or train him. Again, the SEC rejected the arguments, emphasizing that "[p]articipants in the securities industry must take responsibility for compliance with regulatory requirements and cannot be excused for lack of knowledge, understanding, or appreciation of these requirements." *Id*. at 531. The SEC also rejected the respondent's claim that the firm's failure to adequately supervise him was mitigating for purposes of sanctions. *Id*. at 534.[21]

The penny stock rules and interpretations thereof make very clear that the SEC Rule 15g-1(e) exemption for non-recommended transactions does not apply when an associated person brings a penny stock to the attention of a customer because such action, without more, constitutes a "recommendation" for purposes of the penny stock rules. *See* SEC Order Adopting Penny Stock Rules Regarding Disclosure Requirements, 1992 SEC LEXIS 927, at *75-76 (emphasizing that the exemption for non-recommended transactions "is limited to situations in which a broker-dealer acts as an order taker for the customer. . . . The rule does not exempt situations in which a broker-dealer brings a penny stock to the attention of an investor. . . . "). There is no excuse for the respondents' failures to adhere to the rules under the facts of this case. But for the bars we have already imposed regarding the violations for obstructing NASD's examination or investigation, we would impose suspensions on respondents for their penny stock violations.[22] In light of the bars, however, we eliminate the fines and need not determine the appropriate length of suspensions for the penny stock violations.

III. CONCLUSION

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[21] *See also Carter v. SEC*, 726 F.2d 472, 474 (9th Cir. 1983) (stating that respondents are "assumed as a matter of law to have read and have knowledge of the [NASD's] rules and requirements"); *Ernest A. Cipriani, Jr.*, 51 S.E.C. 1004, 1007 (1994) ("Cipriani would not be relieved of his responsibilities even if he had received inadequate supervision.").

[22] We also note that a number of customers testified that their Turner Group investments performed very poorly and that they lost money on the investments, suggesting that the respondents' misconduct may have resulted in customer harm. However, this issue was not sufficiently developed below and we do not rely on it in finding that, but for the bars regarding the obstruction violations, we would impose on the respondents suspensions for their penny stock violations.

We uphold the Hearing Panel's findings of violations. A preponderance of the evidence proves that Dieffenbach and Rooms violated the penny stock rules and attempted to obstruct NASD's examination or investigation. We disagree with the sanctions imposed by the Hearing Panel majority. We find that the respondents' misconduct was egregious. Accordingly, we order that Dieffenbach and Rooms be barred in all capacities.[23] The bars will become effective upon issuance of this decision. In light of our imposition of the bars, we eliminate the fines and suspensions. Finally, we uphold the Hearing Panel's imposition of $2,294.50 in hearing costs, as directed by the Hearing Panel decision (joint and several as to the Firm, Travis, Dieffenbach and Rooms), and impose $1,446.57 in appeal costs, joint and several as to Dieffenbach and Rooms.[24]

On Behalf of the National Adjudicatory Council,

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Barbara Z. Sweeney, Senior Vice President
and Corporate Secretary

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[23] During the current appeal, the respondents objected to Enforcement's use of a quote in its opening appellate brief that negatively reflected on one of the respondents' former employers. The quote was from the SEC Director of Enforcement's Congressional testimony years after the respondents had worked at the firm referenced in the quote and years after the conduct at issue in this case had occurred. We have not relied on this information in any way in making findings and determining appropriate sanctions in this case.

[24] We have considered and reject without discussion all other arguments advanced by the respondents and Enforcement.