BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD

In the Matter of Department of Enforcement, Complainant, vs. Charles A. DaCruz Williston Park, NY, and Thomas J. Linda Queens, NY, Respondents.	DECISION Complaint No. C3A040001 Dated: January 3, 2007

Respondents failed to disclose material information and made baseless price predictions when recommending a security to customers, in violation of the antifraud provisions of the federal securities laws and NASD rules. Held, findings affirmed and sanctions modified.

Appearances

For the Complainant: Leo F. Orenstein, Esq., Department of Enforcement, NASD

For Respondent DaCruz: Lawrence R. Gelber, Esq.
For Respondent Linda: Martin P. Unger, Esq.

Decision

Charles A. DaCruz ("DaCruz") and Thomas J. Linda ("Linda") appeal a September 27, 2005 decision of an NASD Hearing Panel. The Hearing Panel found that DaCruz and Linda violated Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), SEC Rule 10b-5, and NASD Conduct Rules 2120 and 2110 by failing to disclose to customers compensation earned from the sale of Natural Health Trends Corporation ("NHTC") stock and by making baseless price predictions related to this stock. The Hearing Panel suspended DaCruz and Linda

for one year in all capacities, ordered each to requalify as a general securities representative, and fined DaCruz $67,000 and Linda $200,000. After a complete review of the record, we affirm the Hearing Panel's findings of violation but modify the sanctions imposed by barring both respondents in all capacities and requiring disgorgement of ill-gotten gain.

I. Background

DaCruz entered the securities industry in 1994 and first registered as a general securities representative in 1997. Linda entered the securities industry in 1993 and first registered as a general securities representative in 1997. Respondents have been associated with several NASD member firms since each entered the securities industry. Respondents' conduct relevant to this decision occurred during the time when they were associated with First Providence Financial Group, LLC ("First Providence" or the "Firm"). DaCruz was associated with First Providence from June 1998 to June 1999, and Linda was associated with the Firm from June 1998 to June 2000.[1] DaCruz and Linda are currently associated with other NASD member firms as general securities representatives.[2]

II. Procedural History

The Department of Enforcement ("Enforcement") filed separate two-cause complaints against DaCruz and Linda on January 20, 2004, and February 17, 2004, respectively. The complaints alleged that each respondent failed to disclose to customers that he would receive a portion of sales credits ("sales incentive") paid as additional compensation on the sale of NHTC stock and made fraudulent and baseless predictions of the future price of this stock, in violation of the antifraud provisions of the Exchange Act and NASD rules.[3] Respondents denied any wrongdoing. They contended that they did not know that they would receive a portion of the sales incentive when they recommended the purchase of NHTC stock. Respondents admitted that they provided customers with price targets but asserted that a price target differs from a price prediction, and they therefore engaged in no misconduct.

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[1] Throughout his employment with First Providence, DaCruz was subjected to heightened supervision, which was required by the states of Michigan and Colorado. DaCruz's supervisor reviewed his business practices, order tickets, and client trading and communications. DaCruz testified that he could not recall why he was subjected to heightened supervision other than that he had a customer complaint.

[2] DaCruz also has been registered as a general securities principal with his current member firm since January 2004.

[3] The complaint against DaCruz alleged that he engaged in the stated misconduct from October 1, 1998, until approximately June 30, 1999. The complaint against Linda alleged that he engaged in the misconduct from October 1, 1998, until approximately November 30, 1999.

On July 12, 2004, Enforcement filed a motion to consolidate the DaCruz and Linda complaints along with the complaints against three other respondents. DaCruz and Linda opposed the motion. On July 22, 2004, the Chief Hearing Officer ordered the DaCruz and Linda complaints consolidated but denied consolidation of the complaints against the three remaining respondents.

The Hearing Panel held a six-day hearing from November 30, 2004, through December 3, 2004, and March 22 and 23, 2005. Enforcement presented 11 witnesses: an NASD supervisor of examiners, two NASD compliance examiners, three of DaCruz's customers, and five of Linda's customers. DaCruz and Linda each testified on his own behalf. On September 27, 2005, the Hearing Panel issued its decision in which it found that DaCruz and Linda engaged in the misconduct as alleged in the complaints. This appeal followed.

III. Facts

This case arose out of an NASD investigation of First Providence and the Firm's trading activity in NHTC. As of October 1, 1998, NHTC was among the 13 stocks in which the Firm made a market. Through a 2000 examination of the Firm, NASD determined that First Providence accounted for approximately 35 to 76 percent of NHTC's float during the period between October 1998 and April 1999.[4] As of April 30, 1999, the Firm's clearing records showed that the Firm's customers held 4,745,654 of NHTC's float of 6,220,331 shares.[5]

A. NHTC Was a Speculative Security

NHTC was a small-cap company that developed and operated businesses to promote human wellness and was traded on the Nasdaq market. Prior to July 1997, NHTC's operations consisted entirely of medical clinics and vocational schools. In July 1997, NHTC acquired Global Health Alternatives, Inc. and began to market and distribute over-the-counter homeopathic pharmaceutical products. NHTC subsequently ceased operating its medical clinics and sold its vocational schools. In February 1999, NHTC acquired Kaire International, Inc. and began marketing and distributing herbal based dietary supplements and personal care products.

As illustrated by NHTC's periodic reports filed with the SEC for the years 1997, 1998, and 1999, NHTC suffered from chronic financial problems and required capital infusions through private equity offerings of convertible securities to sustain its operations.[6] NHTC's

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[4] A company's float is defined as the total number of shares publicly owned and available for trading.

[5] NHTC's float was reported in its quarterly report for the period ending March 31, 1999.

[6] From October 1998 through November 1999, NHTC's share price fluctuated as follows. On October 1, 1998, the closing price per share of NHTC was $1.9375. By January 1999, the closing share price ranged between $3.50 and $4.00. On March 9, 1999, the share price reached

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1997 annual report showed revenue of $6,992,516, but an operating loss of $4,055,695 and a net loss of $7,725,120. For the year ending December 31, 1998, NHTC reported revenue of $1,191,120, but an operating loss of $2,540,297 and a net loss of $1,288,012. For the third quarter of 1999, NHTC reported year-to-date revenue of $11,826,722, but a year-to-date operating loss of $1,966,502, and year-to-date net loss of $3,122,604. Both the 1997 and 1998 annual reports included a "going concern" opinion by NHTC's auditors. The auditors' opinions noted that NHTC had incurred losses in each of the last two fiscal years, that additional funding would be necessary to sustain operations, and that these conditions raised substantial doubt regarding NHTC's ability to continue as a going concern.

The 1997 and 1998 annual reports also showed that NHTC primarily financed its operations by issuing convertible securities. Despite a 1 to 40 reverse stock split in April 1998, NHTC increased its outstanding and issued shares from 758,136 shares in December 1997 to 6,230,663 at year-end 1998. In both annual reports, NHTC management identified such financings as significant sources of operating capital and stated that additional financing would be required to continue NHTC's operations over the following year.[7]

In the third quarter of 1998, Nasdaq notified NHTC that the company was at risk of being delisted as a result of falling below the net tangible asset requirement. From October 30, 1998, until February 26, 1999, NHTC stock traded with an additional "C" attached to its symbol, signifying a conditional listing on the Nasdaq market.

B. DaCruz and Linda Received Undisclosed Compensation for the Sale of NHTC Stock

Respondents first learned of NHTC from First Providence's owner, Paul Wasserman ("Wasserman"). DaCruz and Linda began recommending and selling NHTC stock to customers on October 1, 1998. First Providence was a market maker in NHTC and sold NHTC stock to customers in principal transactions. The Firm sold the shares at the inside ask price plus a mark-up. Respondents testified that they determined the amount of the mark-up on the NHTC transactions. Linda testified that the mark-up ranged from one to five percent and varied by his relationship with a client. DaCruz testified that he determined the amount of the mark-up by the size of the order, the client relationship (i.e., the length of time the client had been a customer),

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an intra-day high of $6.625 and closed at $5.625. From that point forward, the share price declined. NHTC closed at $3.375 per share on June 30, 1999, and by November 30, 1999, the closing price per share was $2.281.

[7] NHTC management also identified in a quarterly report for the period ending March 31, 1999, that it would require additional financing for the next 12 months largely to fund operations of Kaire International, Inc.

and the frequency with which the customer executed transactions with him. On several NHTC transactions, respondents listed the mark-up as zero. Respondents testified that they disclosed the mark-up to their customers. The mark-up also appeared on the confirmations sent to the customers.

To encourage the purchase of NHTC stock, the Firm paid its representatives, including DaCruz and Linda, a sales incentive in addition to receiving a portion of the mark-up. A member of First Providence's management, routinely Wasserman, advised the Firm's representatives of the availability of the sales incentive at a morning or afternoon staff meeting. When the Firm offered a sales incentive on NHTC purchase transactions, the earning of the incentive was subject to the Firm's representatives' collective achievement of certain sales goals referred to as "break points." Until the customers paid for the transactions, the representatives would not know whether the sales incentive was earned. The representatives did not receive the sales incentive if the customer did not complete the transaction.[8] If the Firm paid a sales incentive for a NHTC transaction, it appeared on the representative's sales commission report. DaCruz and Linda knew they were receiving a sales incentive because they received a detailed commission report with their monthly paychecks from the Firm. The commission reports listed the transactions, commissions, and expenses. One column of the report was labeled "gross." Linda confirmed that if a value was noted in the gross column, a sales incentive was earned.

When processing a customer's NHTC stock purchase, DaCruz and Linda completed an order ticket that included the customer's name, the description of the security, the symbol, the reported share price, whether the transaction was a market or limit order, and the amount of the mark-up. After respondents completed their sections of the order ticket, a Firm principal initialed the ticket and the trading department executed the trade.

The order ticket also included a box labeled "gross credit." The gross credit was expressed on the ticket as a fraction per share in the labeled box and expressed as a dollar value on the bottom section of the order ticket. These amounts were listed on the ticket with the executed price of the order when the representative's sales assistant received the ticket from the trading department.[9] DaCruz and Linda denied reviewing the returned order tickets and stated that they relied on their sales assistants to review the order tickets and record the amounts in their client books. Respondents periodically tracked their compensation by reviewing the postings in their client books. For NHTC transactions, the Firm paid respondents 50 percent of the gross compensation, which consisted of the mark-up plus the sales incentive, less the ticket charges. The gross sales incentive amount that respondents earned from NHTC purchases ranged from $.125 to $.697 per share.

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[8] An NASD investigator testified that if a customer had purchased NHTC stock from another market maker, the customer would have paid the same price assuming simultaneous execution.

[9] Linda testified that the information regarding the gross credit was not entered on the order ticket before the ticket was delivered to the trading department.

With the exception of a sell out or correction, respondents admitted that they earned a sales incentive for every purchase transaction of NHTC stock during the relevant period. DaCruz earned a sales incentive for 96 customer purchases of NHTC stock made by 50 customers between October 1, 1998, and June 30, 1999.[10] The Firm paid him a sales incentive for each of these transactions with the exception of those earned in June 1999.[11] Linda earned and was paid a sales incentive on 161 customer purchases of NHTC stock made by 72 customers between October 1, 1998, and October 31, 1999.[12] Respondents' compensation from First Providence during these periods consisted largely of their payout from NHTC purchase transactions.[13] Linda's total payout earned from NHTC purchase transactions, less the amount

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[10] For example, DaCruz's customer JH purchased 10,000 shares of NHTC on May 19, 1999, at a price of $3.625 per share and a total cost of $36,250. The mark-up per share equaled $.15625, which resulted in a total mark-up of $1,565.50. The customer was advised of the mark-up through the transaction confirmation and by DaCruz. The Firm offered a sales incentive of $.50 per share on this transaction. The Firm paid DaCruz 50 percent of the $6,562.50 gross compensation ($1,562.50 mark-up plus $5,000 sales incentive) less the ticket charge. DaCruz did not disclose to JH that the Firm offered a sales incentive and that he would likely receive a sales incentive on this transaction.

[11] The Firm paid respondents on the 15th day of the month for the prior month's production. In DaCruz's investigative testimony he stated that the Firm did not pay him for the June 1999 transactions. Enforcement provided copies of DaCruz's paychecks reflecting his production through May 1999.

[12] For example, Linda's customer CG purchased 5,000 shares of NHTC on March 9, 1999, at a price of $4.75 per share and a total cost of $23,750. The mark-up per share equaled $.125, which resulted in a total mark-up of $625. The customer was advised of the mark-up through the transaction confirmation and generally by Linda. The Firm offered a $.50 per share sales incentive on this transaction. The Firm paid Linda 50 percent of the $3,125 gross compensation ($625 mark-up plus $2,500 sales incentive) less the ticket charge. Linda did not disclose to CG that the Firm offered a sales incentive and that he would likely receive a sales incentive on this transaction.

[13] During the fourth quarter of 1998, DaCruz's payout was $39,136, of which 81.5 percent ($31,907) was attributable to NHTC transactions. During this same period, Linda's payout was $76,745, of which 89.6 percent ($68,808) resulted from NHTC transactions. DaCruz's payout for the first quarter of 1999 was $50,895 and 80.5 percent ($41,007) of the payout was attributable to NHTC transactions. For this same quarter, Linda earned a payout of $73,485, of which 84.6 percent ($62,162) was derived from NHTC transactions. In the second quarter of 1999, DaCruz's payout was $36,435 and 56.9 percent ($20,761) of the payout resulted from NHTC transactions, while Linda's payout was $78,661, of which 42.9 percent ($33,743) was earned from NHTC transactions. During the third quarter 1999, Linda's payout was $38,155, of which 59.8 percent ($22,837) was attributable to NHTC. In October and November 1999, Linda's payout was $62,315, of which 34.3 percent ($21,395) resulted from NHTC. The record

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earned in November 1999, equaled $203,294. DaCruz's total payout from NHTC purchase transactions during the relevant period, less the amount earned in June 1999, equaled $91,558.

Respondents admitted that at no point did they disclose to any customers to whom they recommended NHTC stock that the Firm offered a sales incentive for purchase transactions on the stock.[14] Linda testified that he never expected to receive a sales incentive on customer purchases of NHTC. He stated, however, that he viewed the additional compensation as "a motivating factor" that encouraged a broker "to look at this company."[15] He admitted that his payout from NHTC transactions was larger than for other stocks. DaCruz also testified that he never expected to earn a sales incentive on NHTC transactions and denied that he ever heard Wasserman offer an incentive. DaCruz stated that the first time he heard about the sales incentive was from Linda's testimony. He acknowledged, however, that he realized he was receiving additional compensation above his percentage of the mark-up after reviewing his commission reports. He stated that he believed the additional compensation was a form of profit sharing by the Firm. DaCruz admitted that after receiving the additional compensation from NHTC over two months, he knew there was "a possibility" of receiving the compensation going forward, but that he did not expect to receive it.

Respondents further admitted that they did not discuss disclosing the NHTC sales incentive to customers with their supervisors at the Firm. DaCruz testified that because he was subjected to heightened supervision, he believed the Firm would have told him to disclose the additional compensation if required. Linda testified that he discussed the issue "of the sales credits in general" with Wasserman but not the "sales credits" that the Firm paid for sales of NHTC.

C. DaCruz's and Linda's Use of Price Targets

DaCruz and Linda admitted that, in soliciting their customers, they regularly offered predictions of the future target price range of NHTC stock that were provided by the Firm.[16] DaCruz testified that he communicated to customers the target price range provided by the

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is unclear, however, as to whether Linda was actually paid for the purchase transactions that earned a sales incentive in November 1999.

[14] The sales incentive paid by the Firm was also not disclosed on the customers' trade confirmations.

[15] Another First Providence representative stated in his investigative testimony that "to really get paid they had to sell Natural Health."

[16] The complaints against DaCruz and Linda alleged that they predicted the future price of NHTC to eight and 16 customers respectively.

Firm's principals of $7 to $8 per share. DaCruz did not conduct independent research, such as reviewing NHTC's SEC filings, to verify the appropriateness of the price targets. Linda testified that he provided customers with a target range of $7 to $10 per share based on his own calculation and the Firm's projections. Linda believed that this target range was reasonable as determined in part by the number of shares outstanding and NHTC's revenue.

As part of NASD's investigation of First Providence, many of DaCruz's and Linda's customers provided information, through written questionnaires and affidavits, regarding the customers' NHTC transactions and their conversations with the Firm's representatives. In addition to providing questionnaires, three of DaCruz's customers (AD, JH, and PL) and five of Linda's customers (PF, DS, CG, SS and GX) also provided telephonic testimony before the Hearing Panel.

1. Statements of DaCruz's Customers

DaCruz's customers made the following statements regarding his use of price predictions when recommending NHTC stock. AD testified that, in enthusiastically recommending NHTC stock, DaCruz indicated that the price would double. AD stated that, in deciding to invest in NHTC, he relied "purely on [DaCruz's] recommendation about the valuation of this stock, and how it was going to go up in the short-term." JH testified that DaCruz would repeatedly call him early in the morning or during the height of JH's business day to recommend to him, with "extensive urgency," that he invest in NHTC. DaCruz would insist that JH "act now" on his recommendation. JH stated that DaCruz told him that NHTC was about to "take off" and that the stock was going to be unattainable for less than $6 to $8 per share. PL testified that DaCruz "guaranteed" that the stock would rise to $11 or $12 per share. Customer SC provided a questionnaire that indicated that DaCruz, in recommending NHTC, stated that the stock was "guaranteed to hit 9 or 10."[17] Customer LJ stated in his questionnaire that DaCruz told him that NHTC's stock price would double in six months.[18]

2. Statements of Linda's Customers

Linda's customers made the following statements regarding the use of price predictions when recommending NHTC stock. PF testified that Linda indicated that NHTC was "destined for bigger and better prices" and "now is the time to strike, now is the time to get into it." PF stated that Linda provided him with a target range for NHTC stock of between $8 and $10 per share. When the stock price began to fall, PF stated that Linda "was insistent on buying more."

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[17] Two years after he submitted the questionnaire, SC stated, in a letter provided by DaCruz, that SC could not recall which broker at the Firm advised him of the price target.

[18] LJ later stated in a letter provided by DaCruz that DaCruz never guaranteed the stock's performance but that DaCruz stated in his professional opinion that the stock could double in six months.

DS testified that Linda solicited him over the phone to purchase NHTC. DS stated that Linda "represented that it was a sure bet [that] it would make a lot of money fast."[19] DS affirmed the statement made in his questionnaire that Linda had "guaranteed" that the value of an investment in NHTC would "double . . . in a few months." CG testified that Linda predicted that NHTC's stock price would rise to $20 per share, but CG had no recollection of Linda providing a time period for when the target price would be attained. CG stated that everything that Linda stated about NHTC was "all positive," and the conversations were "high pressure." SS testified that Linda initiated the contact with him about purchasing NHTC. SS stated that the conversations with Linda were always similar: "you need to purchase more [NHTC] stock and [Linda] was aggressively selling it." SS testified that Linda provided him with a target price of $12 to $15 per share. GX testified that Linda solicited him by telephone to purchase NHTC. According to GX, Linda stated NHTC stock would double in value.

Two of Linda's customers, MK and KK, provided affidavits in addition to their questionnaires. MK stated that Linda told him the price of NHTC was going to "explode soon" and that MK "could at least double his money." KK stated that Linda indicated that the price of NHTC would "doubl[e] quickly," which KK understood to mean within six months. KK further stated that Linda indicated that the price could "triple in a year or so." Four other Linda customers, who provided only questionnaires, stated that he provided price predictions within the $7 to $10 range. Three other customer questionnaires indicated that Linda stated that the price of NHTC would "double," "double or triple," or "hit the sky."

IV. Discussion

After a thorough review of the record, we affirm the Hearing Panel's findings of violation. We conclude that DaCruz and Linda engaged in fraudulent misconduct by failing to disclose that they were receiving a sales incentive in the form of additional compensation from the Firm for customer purchase transactions of NHTC stock and by making baseless predictions of NHTC's share price, in violation of Section 10(b) of the Exchange Act, SEC Rule 10b-5, and Conduct Rules 2120 and 2110.[20] Section 10(b) of the Exchange Act makes it "unlawful for any person . . . to use or employ, in connection with the purchase or sale of any security . . . , any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe." 15 U.S.C. § 78j(b). Among other things, SEC Rule 10b-5 makes it unlawful to "make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under

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[19] DS stated that the term "sure bet" was his, and not Linda's, but that he was led to believe that an investment in NHTC was not risky and that there was a high probability for profit.

[20] NASD Conduct Rule 2110 requires that NASD members shall, in conducting their business, "observe high standards of commercial honor and just and equitable principles of trade." Conduct Rule 115 makes all NASD rules, including Conduct Rule 2110, applicable to both NASD members and all persons associated with NASD members.

which they were made, not misleading."[21] 17 C.F.R. § 240.10b-5. A finding of violation of these antifraud provisions requires a showing that material misrepresentations or omissions were made in connection with the purchase or sale of a security and were made with scienter.[22] *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1467 (2d Cir. 1996); *Dist. Bus. Conduct Comm. v. Euripides*, Complaint No. C9B950014, 1997 NASD Discip. LEXIS 45, at *18 (NBCC July 28, 1997). "[A]ny statement that is reasonably calculated to influence the average investor satisfies the 'in connection with' requirement of Rule 10b-5." *SEC v. Hasho*, 784 F. Supp. 1059, 1106 (S.D.N.Y. 1992).

We discuss the violations in detail below.

A. Sales Incentive

It is undisputed that DaCruz and Linda received additional compensation in the form of a sales incentive from NHTC purchase transactions. It is further undisputed that they failed to disclose the likelihood that they would earn additional compensation in connection with their customers' purchases of NHTC stock. Respondents argue that they had no expectation of earning or receiving a sales incentive because receipt depended on the efforts of others; thus, the possibility was not a material fact that they were required to disclose to customers. They also assert that they acted without scienter.[23]

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[21] Conduct Rule 2120 is NASD's antifraud rule and is the equivalent of Section 10(b) and Rule 10b-5. *Mkt. Regulation Comm. v. Shaughnessy*, Complaint No. CMS950087, 1997 NASD Discip. LEXIS 46, at *24 (NBCC June 5, 1997), *aff'd*, 53 S.E.C. 692 (1998).

[22] In addition, there must also be proof that the respondents used "any means or instrumentality of interstate commerce, or of the mails or of any facility of any national security exchange." 17 C.F.R. § 240.10b-5. Respondents satisfied the interstate commerce requirement when they sold NHTC to customers through interstate telephone calls, and they used the mails to send the customers confirmations of the transactions.

[23] Moreover, DaCruz denied ever hearing Wasserman offer a sales incentive on NHTC stock. DaCruz admitted that the Firm typically held twice-daily meetings, one in the morning and one in the afternoon at the market's close to discuss, among other things, market conditions and stock recommendations. It was during these meetings when Wasserman would advise the sales force of the potential sales incentive. DaCruz testified that he often arrived at the Firm late or not at all and frequently wore noise-canceling headphones when he was working. He estimated that he might have been present at 50 percent of the morning meetings at the Firm. The Hearing Panel found that DaCruz's testimony that he was unaware of the offer of a sales incentive "inherently incredible" and did not credit respondents' claims that they did not expect to receive a sales incentive on NHTC purchases given that respondents were paid a sales incentive on nearly every NHTC purchase transaction during the relevant period. The initial fact-finder's credibility determinations are entitled to considerable deference, which may only be overcome by substantial evidence. *Joseph S. Barbera*, 54 S.E.C. 967, 977 n.30 (2000); *see also*

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1. Materiality

Whether information is material "depends on the significance the reasonable investor would place on the . . . information." *Basic Inc. v. Levinson*, 485 U.S. 224, 240 (1988). Information is material "if there is a substantial likelihood that a reasonable [investor] would consider it important in deciding how to [invest] . . . [and] the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[24] *Id.* at 231-32 (*quoting TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)).

When a registered representative recommends a stock to a customer, he must disclose "material adverse facts, including any self-interest that could influence the . . . recommendation." *Richard H. Morrow*, 53 S.E.C. 772, 781 (1998) (finding material that broker failed to disclose to his customers an anticipated "equity kicker" earned from sales of securities and paid by a third party and determining that broker had an obligation to disclose his compensation to customers). If a representative fails to disclose extra compensation that he anticipates earning from a sale, a customer cannot weigh whether the representative may be recommending the stock for the representative's own financial interest, rather than based on the investment value of the security. *Id.* at 782; *see also Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153 (1972) (finding material that sellers had right to know that defendants, who were acting as market makers, would benefit financially from sales); *Chasins v. Smith Barney & Co.*, 438 F.2d 1167 (2d Cir. 1970) (finding material the failure to disclose that the firm was making a market in the recommended stock); *cf. Hasho*, 784 F. Supp. at 1110 (finding material that salespersons falsely stated that they would receive no commissions on the customers' transactions).

Under the facts of this case, we find that the probable receipt of a substantial sales incentive for a stock that generated a sizable portion of DaCruz's and Linda's total compensation was material information that respondents were required to disclose when recommending purchases of NHTC to their customers. Payment by the Firm of additional compensation to respondents when certain sales goals were met would alter the total mix of information available and influence a potential investor's decision to purchase NHTC stock. Many of the respondents' customers believed that a commission or a share of the mark-up for the NHTC transactions

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Dane S. Faber, Exchange Act Rel. No. 49216, 2004 SEC LEXIS 277, at *17-18 (Feb. 10, 2004) (stressing that deference is given to initial decision maker's credibility determination "based on hearing the witnesses' testimony and observing their demeanor"). We find no reason to disturb the Hearing Panel's credibility findings.

[24] The Court stated that no single event or factor is necessarily determinative of the materiality inquiry. *Id.* at 236.

would compensate respondents. None of these customers, however, knew either the nature or the likelihood of the additional compensation that respondents earned. A prospective investor would want to know that a representative recommending a particular security would be compensated by his firm if certain sales targets were achieved regarding this security, and thus that the representative's recommendation might not be wholly disinterested. *See Chasins*, 438 F.2d at 1172 (stating that customers should be given an opportunity to "evaluate the overlapping motivations through appropriate disclosures, especially where one motivation is economic self-interest").

Respondents contend that they were not soliciting customers to purchase NHTC stock because of the possibility of earning additional compensation. Irrespective of respondents' contention, however, they had a significant financial interest in recommending NHTC stock that went undisclosed. Their compensation earned from NHTC transactions exceeded the compensation that they would have earned from the Firm if they had recommended an alternative security and received only a portion of the mark-up. The possibility of earning additional compensation in the form of a sales incentive would have an immediate importance to investors even if no sales incentive was ultimately earned. *See, e.g.*, *Hanly v. SEC*, 415 F.2d 589, 597 (2d Cir. 1969) (requiring a registered representative to disclose material facts that are "reasonably ascertainable"). Although we necessarily make our finding of materiality based on a reasonable investor, we also note that customers considered the sales incentive important. For example, customer JH testified that had he known of the sales incentive, he would have wondered whose interest was being served. Customer AD testified that he would have been suspicious of the additional benefit.

Even if we view the receipt of the sales incentive as a contingency, respondents were required to disclose it. The materiality of contingent or speculative facts depends upon "a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event." *Basic*, 485 U.S. at 238 (internal quotation omitted). The probability that respondents would earn incentive compensation on NHTC purchase transactions was high. Both DaCruz and Linda admitted that that they earned a sales incentive for every purchase transaction of NHTC stock during the relevant period with the exception of sell-outs or corrections. DaCruz earned a sales incentive for 96 customer purchases of NHTC stock made between October 1, 1998, and June 30, 1999.[25] Linda earned a sales incentive on 161 customer purchases of NHTC stock made between October 1, 1998, and October 31, 1999. The regularity with which respondents earned a sales incentive undercuts their assertion that they were uncertain whether they would receive the compensation and therefore did not disclose it.[26] The magnitude of earning a sales incentive was equally high. The respondents' compensation from First Providence during these periods consisted largely of their payout from NHTC purchase transactions—a payout that was greater than from any other stock.

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[25] As previously noted, there is no evidence that the Firm paid DaCruz for the compensation that he earned in June 1999.

[26] Moreover, any uncertainty could have been included in a disclosure.

A preponderance of the evidence supports the finding that it was probable that respondents would earn a sales incentive on NHTC purchase transactions and that this information was material and required disclosure when soliciting customer transactions. We further find that the material omissions were made in connection with the purchase or sale of securities when respondents recommended the purchase of NHTC to their customers and failed to disclose the potential for earning a sales incentive.

2. Scienter

DaCruz and Linda also dispute the Hearing Panel's finding that they acted with scienter when they failed to disclose the probable receipt of a sales incentive as additional compensation. We disagree and affirm the Hearing Panel's finding that respondents acted with the requisite scienter.

The Supreme Court has defined scienter for purposes of securities fraud cases as "a mental state embracing intent to deceive, manipulate, or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976). Scienter is established if the respondents acted recklessly. *See Makor Issues & Rights, Ltd. v. Tellabs, Inc.*, 437 F.3d 588, 600 (7th Cir. 2006). Reckless conduct includes "a highly unreasonable omission, involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it." *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977); *see Meadows v. SEC*, 119 F.3d 1219, 1226 (5th Cir. 1997). Proof of scienter may be "a matter of inference from circumstantial evidence." *Herman & MacLean v. Huddleston*, 459 U.S. 375, 390 n.30 (1983).

Respondents contend that because the payment of a sales incentive is common in the securities industry and there is no NASD rule or established practice requiring disclosure, they lacked scienter. For support, respondents cite *Platsis v. E.F. Hutton & Co.*, 946 F.2d 38 (6th Cir. 1991) and *Shivangi v. Dean Witter Reynolds, Inc.*, 825 F.2d 885 (5th Cir. 1987). In *Platsis*, the court determined that E.F. Hutton and an associate of the firm did not violate SEC Rule 10b-5 when the associate failed to disclose the mark-up earned on utility bond purchases made from the firm's inventory in 1980 and 1981. 946 F.2d at 40-41. The associate explained to a customer that the firm did not charge commissions on inventory transactions, but failed to disclose the mark-up. *Id.* at 40. In concluding that defendants did not act with scienter, the court stated that

> [s]ince very few brokers disclosed these credits at the time these events took place and there was no established regulatory duty to disclose these items, an intent to deceive or "an extreme departure from the standards of ordinary care" could not be established merely by the omission of this information in the absence of special circumstances.

Id. at 41. In *Shivangi*, the court determined that the record did not establish that defendants acted with scienter when they failed to disclose that the firm's account executives received higher

compensation for principal transactions in which the firm was a market maker. 825 F.2d at 887, 889. The court determined that defendants showed no intent to deceive and did not recommend the stock based on the attendant compensation structure. *Id.* at 889.

We disagree with respondents that *Platsis* and *Shivangi* are controlling here. Engaging in a purportedly common industry practice does not shield respondents from liability. "Even a universal industry practice may still be fraudulent." *Newton v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 135 F.3d 266, 274 (3d Cir. 1998) (*citing Chasins*, 438 F.2d at 1171-72 (holding nondisclosure of widespread industry practice may constitute fraudulent nondisclosure of material fact)). Given the particular circumstances of this case, we find, by a preponderance of the evidence, that respondents acted recklessly when they failed to disclose that it was probable that they would earn a sales incentive from NHTC stock. The NHTC sales incentive, which was paid over an extended period of time, amounted to a substantial portion of respondents' compensation. Although DaCruz and Linda both claimed that they were not motivated to recommend NHTC based on the sales incentive, the evidence in this case makes such a contention implausible. Between October 1998 and June 1999, DaCruz executed more NHTC purchase transactions than purchase transactions in any other security with the exception of April and May 1999. In April 1999, 23 percent of DaCruz's executed purchase transactions involved NHTC stock, but equaled more than 55 percent of his net compensation. In May 1999, 29 percent of DaCruz's executed purchase transactions involved NHTC, but equaled more than 67 percent of his net compensation. DaCruz testified that between 30 to 50 percent of his customers purchased NHTC and acknowledged that he recommended NHTC to most of his clients. And while Linda's executed NHTC purchase transactions equaled approximately 26 percent of his total purchase transactions between October 1998 and November 1999, when measured by dollar amount, Linda earned 67 percent of his net compensation during this time period from his customers' NHTC transactions. In addition, respondents' recommendations to purchase NHTC and omissions of the potential sales incentive were accompanied by high-pressure sales tactics such as making persistent telephone calls, urging the customers to act quickly, and pushing customers to amass larger positions of NHTC stock. Notably, Linda admitted that a customer could view receipt of a sales incentive as evidence of Linda's bias based on compensation earned from the purchase of the stock.[27] "Omitting to disclose a broker's financial or economic incentive in connection with a stock recommendation constitutes a violation of the anti-fraud provisions." *Hasho*, 784 F. Supp. at 1110.

DaCruz contends that scienter is absent because the receipt of incentive compensation did not affect the customers' price. DaCruz, ignores, however, that the sales incentive influenced

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[27] Indeed, First Providence at times paid respondents a sales incentive that was in excess of the mark-up, and respondents periodically determined that the mark-up on certain customers' NHTC transactions was zero. In those instances where the mark-up was zero, respondents earned their sole compensation on these trades via the undisclosed sales incentive.

what particular stocks were recommended to customers.[28] Respondents, as securities professionals, should have viewed the compensation in excess of the mark-up as a red flag and were reckless in not knowing that disclosure of the sales incentive was required to avoid misleading their customers.[29] *See Hasho*, 784 F. Supp. at 1110 (failing to disclose own financial interest in connection with stock recommendation is misleading and deprives the customer of knowledge that representative might be recommending security based on financial incentive rather than investment value); *see also Joseph J. Barbato*, 53 S.E.C. 1259, 1274-75 (1999) (failing to disclose compensation earned from selling employer's house stocks was a fraudulent omission that misled customers); *see, e.g.*, Louis Loss, *The SEC and the Broker-Dealer*, 1 Vand. L. Rev. 516, 522 (1948) (stating that a registered representative "must not bring his own interests into conflict with his client's. If he does, he must explain in detail what his own self-interest in the transaction is in order to give his client an opportunity to make up his own mind whether to employ an agent who is riding two horses").

DaCruz also contends that because he was subjected to heightened supervision, he believed that his supervisor would have told him to disclose the sales incentive to customers if it was required and that this further evidences DaCruz's lack of scienter. Linda similarly contends that Wasserman did not tell him to disclose the sales incentive to customers during his discussion with Wasserman of "sales credits in general." Respondents may not shift all responsibility to a supervisor. *See Hasho*, 784 F. Supp. at 1107; *Thomas C. Kocherhans*, 52 S.E.C. 528, 531 (1995) (dismissing as meritless respondent's assertion that he was never warned by his manager that his conduct was inappropriate and therefore he had no way to know that his conduct was wrong); *Willard G. Berge*, 46 S.E.C. 690, 694 (1976) ("Compliance with the antifraud provisions cannot be shifted entirely to a salesman's superior."), *aff'd sub nom. Feeney v. SEC*, 564 F.2d 260 (8th Cir. 1977). In addition, "it is no defense that others in the industry may have been operating in a similarly illegal or improper manner." *Patricia H. Smith*, 52 S.E.C. 346, 348 (1995); *see, e.g.*, *Bison Sec., Inc.*, 51 S.E.C. 327, 330 n.10 (1993) ("[O]ne dealer's improper pricing practices cannot legitimize another's.").

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[28] There is evidence in the record that respondents earned a sales incentive on other securities in addition to NHTC, but the payout on NHTC was the largest.

[29] DaCruz contends that he did not act with scienter because his customers were sophisticated. Even if his customers were sophisticated, which the record does not support, it does not remedy the fraud and is no defense. *See Joseph Abbondante*, Exchange Act Rel. No. 53066, 2006 SEC LEXIS 23, at *43-44 & n.65 (Jan. 6, 2006) (determining that a customer's sophistication is no defense to fraud), *petition for review denied*, No. 06-0558-ag, 2006 U.S. App. LEXIS 20982 (2d Cir. Dec. 12, 2006); *Jay Houston Meadows*, 52 S.E.C. 778, 785 (1996) (rejecting argument that antifraud provisions do not apply to sophisticated investors), *aff'd*, 119 F.3d 1219 (5th Cir. 1997); *see also James E. Cavallo*, 49 S.E.C. 1099, 1102 (1989) ("[T]he fact[] that customers initiated a transaction or are sophisticated or aware of speculative risks [does not] justify making misstatements to them."), *aff'd*, 993 F.2d 913 (D.C. Cir. 1993) (table decision).

We conclude that DaCruz and Linda engaged in fraudulent misconduct by recklessly failing to disclose to customers that it was probable that respondents would earn a sales incentive on NHTC purchase transactions when the amount of the sales incentive was substantial, respondents' misconduct took place over a lengthy period of time, the respondents earned sizable portions of their net compensation from the sales of NHTC (DaCruz 55 and 67 percent in two months and Linda 67 percent over 13 months), and respondents employed high-pressure sales tactics related to a speculative security. In doing so, DaCruz and Linda violated Section 10(b) of the Exchange Act, SEC Rule 10b-5, and NASD Rules 2120 and 2110.

B. Price Predictions

We also affirm the Hearing Panel's findings that respondents violated Section 10(b) of the Exchange Act, SEC Rule 10b-5, and NASD Rules 2120 and 2110 by making baseless price predictions when recommending NHTC stock to customers.

It is undisputed that respondents provided customers with the target price of NHTC stock provided by the Firm. DaCruz testified that he communicated to customers the target price range of $7 to $8. Linda testified that he provided customers with a target range of $7 to $10 based on his independent calculation and the projection provided by the Firm. In addition, DaCruz's and Linda's customers provided additional evidence that respondents made price predictions regarding NHTC. The customer statements were corroborative of this point.[30] The Hearing Panel determined that the customers' testimony that DaCruz provided them with price targets was credible and that a preponderance of the evidence supported a finding that respondents provided price targets when recommending NHTC stock. We will not disturb these findings.[31] *See Faber*, 2004 SEC LEXIS 277, at *17-18.

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[30] For example, AD testified that DaCruz indicated that the price of NHTC would double. JH testified that DaCruz told him that NHTC was about to "take off" and that the stock was going to be unattainable for less than $6 to $8 per share. PL testified that DaCruz "guaranteed" that the stock would rise to $11 or $12 per share. LJ stated that DaCruz opined that the stock could double in six months. PF testified that Linda provided him with a target range for NHTC stock between $8 and $10 per share. In his hearing testimony, DS affirmed the statement made in his questionnaire that Linda had "guaranteed" that the value of an investment in NHTC would "double . . . in a few months." CG testified that Linda predicted that NHTC's stock price would rise to $20 per share. SS testified that Linda provided him with a target price of $12 to $15 per share. GX testified that Linda stated that NHTC stock would double in value. MK stated that Linda told him that the price of NHTC was going to "explode soon" and that MK "could at least double his money." KK stated that Linda indicated that the price of NHTC would "doubl[e] quickly" or could "triple in a year or so."

[31] Respondents object to the use of customer questionnaires and affidavits rather than live testimony. As previously noted, a number of customers also testified before the Hearing Panel. 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

[Footnote continued on next page]

The SEC has consistently held that a specific price prediction regarding a speculative security is material. *Faber*, 2004 SEC LEXIS 277, at *16; *Charles P. Lawrence*, 43 S.E.C. 607, 610 (1967) ("We have repeatedly held that a specific prediction of the future value of a speculative or unseasoned security is inherently fraudulent."), *aff'd*, 398 F.2d 276 (1st Cir. 1968). We therefore find respondents' predictions of a substantial increase in the price of NHTC, which was a speculative security, to be material.[32] *See Hasho*, 784 F. Supp. at 1109; *Lawrence*, 43 S.E.C. at 610.

We further find that respondents had no reasonable basis for these predictions and were reckless in making them. *See Hasho*, 784 F. Supp. at 1109; *Lawrence*, 43 S.E.C. at 610. Unquestionably, NHTC was a speculative security, and therefore rendering any prediction that it would appreciate significantly in value is inherently fraudulent. DaCruz admits that he conducted no independent research, such as reviewing NHTC's SEC filings, to verify the

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[cont'd]

objectives." *Robert A. Amato*, 51 S.E.C. 316, 321 (1993), *aff'd*, 18 F.3d 1281 (5th Cir. 1994). The SEC also has upheld the use of affidavits to support findings in self-regulatory organization disciplinary proceedings. *See Harry Gliksman*, 54 S.E.C. 471, 480-81 (1999) (finding customer's affidavit to be probative, reliable, and admissible), *aff'd*, No. 00-70258, 2001 U.S. App. LEXIS 25479 (9th Cir. Nov. 26, 2001). While live testimony is preferred and used when available, we find that the questionnaires and affidavits in this case are relevant and were supportive of the point that respondents made future predictions of the value of NHTC stock as provided by the live testimony.

Respondents also object to the use of live testimony provided telephonically. We believe that respondents were not prejudiced by the telephonic testimony, which was accepted from eight customer witnesses. The SEC has consistently held that telephonic testimony is acceptable, as long as the respondent is afforded a full and fair opportunity to cross-examine the witnesses. *See, e.g., Alderman v. SEC*, 104 F.3d 285, 288 (9th Cir. 1997) (rejecting argument that credibility determinations made during NASD proceedings were undermined because the testimony was provided over the telephone); *Howard Alweil*, 51 S.E.C. 14, 17 (1992) (upholding the use of telephonic testimony in NASD proceeding). We note that respondents and their counsel received such an opportunity and questioned each witness at length. We also note that the witnesses were from Oregon, Texas, Montana, Nevada, Rhode Island, South Carolina, and California—each a considerable distance from the New York City site of the hearing.

[32] NHTC was a speculative security because it had little operating history and had operated historically at a deficit. *See Clinton Hugh Holland*, 52 S.E.C. 562, 565 n.16 (1995) (holding that securities of companies "with a limited history of operations and no profitability" are speculative), *aff'd*, 105 F.3d 665 (9th Cir. 1997) (table decision). Moreover, First Providence listed NHTC on its approved stock list as a "speculative buy," and Linda admitted that he knew NHTC was speculative.

appropriateness of the price targets, but argues that he relied on the Firm's representations about NHTC, that the Firm's stock picks usually did well, and that the market was at a high and virtually all stocks at the time "went to gold." Such reasons do not constitute a reasonable basis for recommending NHTC in light of its financial condition. Moreover, statements made by NHTC's management about the company are not an adequate basis for representations to customers. *See Steven D. Goodman*, 54 S.E.C. 1203, 1210 (2001).

Linda testified that he believed the $7 to $10 per share target range was reasonable as determined in part by the number of shares outstanding; NHTC's new CEO who Linda described as a turnaround specialist; the company's potential ability to meet its objective of $100 million in revenue; discussing NHTC with the Firm's research analyst and NHTC's CEO; and attending two NHTC road shows. In Linda's hearing testimony, however, he was unable to articulate what a turnaround specialist does, and he had no understanding of convertible securities, which NHTC used to finance its operations through successive offerings. NHTC's financial condition was quite tenuous as documented in its SEC filings and as reflected in its conditional listing on the Nasdaq market. Irrespective of Linda's "honest belief in an issuer's prospects[, it] does not warrant his making exaggerated and unfounded representations and predictions to others" and does not therefore diminish the reckless nature of his misconduct. *Cavallo*, 49 S.E.C. at 1102.

Respondents argue that they did not commit fraud because they merely stated, as an opinion or possibility, that the stock could reach the target range that they provided and that providing a price target is not the equivalent of a price prediction. The baseless predictions of the future value of a speculative security, whether expressed as a range or otherwise, are inherently fraudulent. *See Hasho*, 784 F. Supp. at 1109. The fraud, moreover, is not remedied where the positive predictions about the future performance of securities are cast as conditional opinion or possibilities rather than as guarantees. *Id.*; *Mac Robbins & Co.*, 41 S.E.C. 116, 119 (1962), *aff'd sub nom. Berko v. SEC*, 316 F.2d 137 (2d Cir. 1963). Further, the record does not include any information about NHTC's prospects that would support the price predictions that respondents made. Accordingly, we find that under the circumstances, respondents' predictions of a substantial increase in the price of NHTC were reckless.

Respondents violated Section 10(b) of the Exchange Act, SEC Rule 10b-5, and Conduct Rules 2120 and 2110 by making baseless predictions of the future value of NHTC's stock.

* * *

In considering the totality of respondents' actions, we find that they committed fraud because their statements that the price of this speculative security would substantially increase were misrepresentations and—in connection with a recommendation to purchase NHTC—it was misleading for respondents to fail to disclose the substantial sales incentives that they were striving to collect.

V. Procedural Arguments

Respondents argue that we should reject Enforcement's appellate brief because it was not timely served upon them.[33] We find that any delay in service was not material, respondents have shown no prejudice, and exclusion of Enforcement's brief would be an extreme penalty for any minimal delay in service that may have occurred. *See, e.g.*, *David I. Cassuto*, Exchange Act Rel. No. 48087, 2003 SEC LEXIS 1496, at *13 (June 25, 2003) (declining to strike brief for de minimis filing defect); *Jeffrey D. Field*, 51 S.E.C. 1074, 1074 n.1 (1994) (accepting brief received three days after due date and rejecting argument to reject brief as untimely filed).

In this case, Enforcement was due to file its brief and correspondingly serve it upon respondents by February 9, 2006. Enforcement's counsel attested in his certificate of service that he sent Enforcement's brief via facsimile and by first class mail to respondents' counsel on February 9, 2006. Respondents contend that their counsel received Enforcement's brief on February 10, 2006, via facsimile and therefore Enforcement's counsel falsely certified timely

[33] In addition, DaCruz argues that Enforcement's brief should be stricken because it argued that the NAC should reverse the Hearing Officer's refusal to admit certain evidence related to a settlement between NASD and the Firm and the Firm's owners. We find that the Hearing Officer's ruling was correct and that settlement of a related matter is not relevant or material. *See, e.g.*, *Dep't of Mkt. Regulation v. Geraci*, Complaint No. CMS020143, 2004 NASD Discip. LEXIS 19, at *50-51 (NAC Dec. 9, 2004) (rejecting respondent's argument that sanction received in related settled matter was relevant or material to current disciplinary proceeding). We reject, however, DaCruz's assertion that Enforcement's argument forms a basis for striking its brief.

DaCruz further argues in favor of striking Enforcement's brief that Enforcement failed to provide DaCruz with copies of the pleadings in connection with its motion to consolidate the proceedings against him, Linda, and three others as required by Procedural Rule 9214. DaCruz and Linda objected to Enforcement's motion before the Hearing Officer. The Chief Hearing Officer ordered the DaCruz and Linda matters consolidated and attached copies of the complaints against DaCruz and Linda to the order. DaCruz and Linda again objected to the consolidation, citing the lack of receipt of the relevant pleadings. In response, the Hearing Officer issued a "Notice of Deadline for Filing Motions for Reconsideration of the Order Consolidating Proceedings" and attached the DaCruz and Linda pleadings. Respondents declined to move for reconsideration. The Hearing Officer subsequently issued an order in which she found that Enforcement's failure to provide copies of the complaints and answers constituted harmless error and that respondents waived any further objection to the Chief Hearing Officer's consolidation order. We conclude that DaCruz's argument for striking Enforcement's brief is without merit.

service.[34] We agree that service made on February 10, 2006, was not timely. Procedural Rule 9134, however, does not provide facsimile as a method for service. Respondents assert that Enforcement's brief was also postmarked February 10, 2006. Procedural Rule 9134(b)(3) provides that service by mail is complete upon mailing. The rule does not state that the date of service is synonymous with the postmark. Respondents set forth no argument evidencing how they were prejudiced, and we find none. We reject respondents' argument to disregard Enforcement's appellate brief.[35]

VI. Sanctions

For DaCruz's and Linda's violations of Section 10(b) of the Exchange Act, SEC Rule 10b-5, and NASD Conduct Rules 2120 and 2110, the Hearing Panel suspended each respondent in all capacities for one year and ordered each to requalify as a general securities representative before again acting in that capacity. The Hearing Panel also fined DaCruz $67,000 and Linda $200,000, which the Hearing Panel determined represented the approximate amount each respondent received from the NHTC transactions.[36] A confluence of factors leads us to the conclusion that DaCruz's and Linda's misconduct was egregious and that in order to protect the investing public, the appropriate sanction is a bar imposed against both respondents. We further find it appropriate to require respondents to disgorge their ill-gotten gains. We modify the sanctions for the reasons set forth below.

The Hearing Panel found that the fraudulent omissions and baseless price predictions stemmed from a common underlying cause (i.e., the respondents' sale of NHTC stock) and imposed a unitary sanction for both violations per respondent. We agree with the Hearing Panel's determination that a single set of sanctions is appropriate for the violations alleged in causes one and two of the complaints, and prior precedent supports this approach to sanctions as

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[34] DaCruz's counsel states in a reply brief that he received Enforcement's brief at 12:19 a.m. on February 10, 2006.

[35] On February 28, 2006, Enforcement submitted a document captioned "Memorandum in Opposition to Respondents' Motions to Strike Enforcement's Brief" in response to respondents' arguments made in their reply briefs. DaCruz and Linda objected to the filing, arguing that they made no such motion. The National Adjudicatory Council subcommittee ("Subcommittee") empanelled to consider this appeal determined that the above referenced filing by Enforcement would not be made part of the record before it in this appellate proceeding. We adopt the Subcommittee's ruling as our own.

[36] *NASD Sanction Guidelines* 5 (2006), http://www.nasd.com/web/groups/enforcement/documents/enforcement/nasdw_011038.pdf (requiring disgorgement of financial benefit derived from ill-gotten gain appropriate in certain instances) [hereinafter *Guidelines*].

appropriately remedial. *See Dep't of Enforcement v. Inv. Mgmt. Corp.*, Complaint No. C3A010045, 2003 NASD Discip. LEXIS 47, at *27-28 (NAC Dec. 15, 2003).

The NASD Sanction Guidelines ("Guidelines") for intentional or reckless misrepresentations or omissions of material facts under NASD Rules 2120 and 2110 recommend a fine of $10,000 to $100,000, and a suspension of 10 business days to two years.[37] A fine may be increased by the amount of a respondent's financial benefit.[38] In an egregious case, the Guidelines recommend a bar.[39]

In determining the proper remedial sanction, the Guidelines for misrepresentations or omissions of material facts advise that adjudicators consider the "Principal Considerations in Determining Sanctions."[40] We find DaCruz's and Linda's misconduct to be egregious. As we detailed in our findings, respondents recklessly failed to disclose the sales incentive to their customers and made fraudulent price predictions of the future value of NHTC stock.[41] Respondents engaged in these fraudulent sales practices over an extended period of time through which they each obtained a sizable monetary benefit.[42] The majority of respondents' total compensation during the review period stemmed from the substantial payout that respondents received from NHTC sales. In addition, DaCruz's and Linda's misconduct involved a voluminous number of transactions involving many customers.[43] DaCruz and Linda willingly accepted the sales incentives, provided the baseless price predictions to customers, and "totally ignored their general duty of fair dealing" to their customers. *Cf. Affiliated Ute Citizens*, 406 U.S. at 151. We conclude that a bar is necessary to prevent DaCruz and Linda from inflicting similar harm to customers in the future.

In determining sanctions, the Hearing Panel considered mitigating that DaCruz and Linda did not attempt to conceal their misconduct from First Providence, the Firm did not direct them to disclose the incentive compensation, and the Firm provided them with the price targets to share with customers and determined that because the respondents did not act intentionally, a bar was not warranted. We disagree that these facts mitigate the respondents' egregious misconduct in this case. The extraordinary compensation that the Firm made available to respondents for

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37 *Guidelines*, at 93.

38 *Id.* at 5 (General Principles Applicable to All Sanction Determinations, No. 6).

39 *Id.* at 93.

40 *Id.* at 6-7 (Principal Considerations in Determining Sanctions).

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

42 *Id.* at 6-7 (Principal Considerations in Determining Sanctions, Nos. 9 and 17).

43 *Id.* (Principal Considerations in Determining Sanctions, Nos. 11 and 18).

selling NHTC was a red flag that demanded a high degree of skepticism on the part of respondents. Linda argues that his discussion with Wasserman of the "sales credits in general" should be viewed as mitigating because Wasserman did not advise Linda to disclose the NHTC sales incentive, and Wasserman led Linda to believe that disclosure to customers was not required. We do not view Linda's reliance on Wasserman as mitigating given the circumstances of this case. Moreover, as we discussed in our findings, "registered representatives have certain duties that they cannot avoid by reliance on either their employer or an issuer." *Hasho*, 784 F. Supp. at 1107; *see Kocherhans*, 52 S.E.C. at 531. Linda further contends that we should impose a reduced sanction based on his independent investigation to determine the target price of NHTC combined with the fact that he opined to customers that the target price could fluctuate over time depending on the success of NHTC's turnaround. Linda's belief in the future value of NHTC is not mitigating and there is nothing in the record to support the baseless predictions of the future value of NHTC that were provided to customers.

Respondents also argue in favor of lesser sanctions that they have not been found to have engaged in misconduct after the current action. Subsequent compliance with the federal securities laws and NASD's rules is not mitigating, but conduct consistent with a registered representative's obligations as an associated person. *Dep't of Enforcement v. Balbirer*, Complaint No. C07980011, 1999 NASD Discip. LEXIS 29, at *10-11 (NAC Oct. 18, 1999) ("We are not compelled to reward a respondent because he has acted in the manner in which he agreed (and was required) to act when entering this industry . . . ."). Linda also argues that his lack of disciplinary history is mitigating. We disagree. While the existence of a disciplinary history is an aggravating factor when determining the appropriate sanction, its absence is not mitigating. *See Rooms v. SEC*, 444 F.3d 1208, 1214-15 (10th Cir. 2006) (determining the lack of disciplinary history is not mitigating and representative "was required to comply with the NASD's high standards of conduct at all times"); *Dep't of Enforcement v. Fergus*, Complaint No. C8A990025, 2001 NASD Discip. LEXIS 3, at *58-59 (NAC May 17, 2001) (holding the absence of disciplinary history is not considered part of "relevant disciplinary history" under the Guidelines for purposes of reducing sanctions). Moreover, the Commission and at least one federal court of appeals have rejected arguments that a lack of a disciplinary record is a factor mitigating the sanction of a bar. *See Rooms*, 444 F.3d at 1215; *Daniel D. Manoff*, 55 S.E.C. 1155, 1165-66 & n.15 (2002).

DaCruz's and Linda's customers placed their trust and confidence in them to recommend stocks without secret inducements for those recommendations and without baseless predictions of future value. DaCruz and Linda violated that trust. Respondents engaged in fraudulent sales tactics in complete disregard of their obligations to their customers. Respondents' complete lack of understanding of their duties as registered persons, such as the duty to disclose all material facts to customers, warrants consequential sanctions. Accordingly, we bar respondents from acting in any capacity. We also require DaCruz and Linda to disgorge their ill-gotten gains in the amount of $67,000 and $165,000, respectively.[44]

[44] We determined these amounts from the gross sales incentives attributed to DaCruz's and Linda's respective brokerage accounts during the relevant period as an estimate of the sales

[Footnote continued on next page]

VII. Conclusion

We affirm the Hearing Panel's findings that DaCruz and Linda made material omissions and baseless price predictions when recommending NHTC stock to customers in violation of Section 10(b) of the Exchange Act, SEC Rule 10b-5, and NASD Rules 2120 and 2110. Accordingly, we bar each respondent in all capacities. The bars are effective upon service of this decision. We also order DaCruz and Linda to disgorge the financial benefit from their misconduct as a fine to NASD in the amount of $67,000 and $165,000, respectively. We affirm the Hearing Panel's imposition of hearing costs against each respondent in the amount of $8,837.88. We impose appeal costs and transcript costs of $1,388 per respondent.[45]

On Behalf of the National Adjudicatory Council,

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Barbara Z. Sweeney, Senior Vice President
and Corporate Secretary

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incentive that they were paid on NHTC purchase transactions. DaCruz and Linda testified that they received 50 percent of the gross sales incentive. Accordingly, we took 50 percent of the gross sales incentive to determine the appropriate amount of disgorgement. We have not included any amounts that DaCruz and Linda were paid as a percentage of the mark-up. With respect to DaCruz, we have not included any amounts earned in June 1999. With respect to Linda, we have not included any amounts earned in November 1999.

Although the record includes customer testimony about losses that they incurred, we determine that an order of restitution would be inappropriate here because the record is insufficient regarding the customers' quantifiable loss.

[45] We also have considered and reject without discussion all other arguments of the parties.

Pursuant to NASD Procedural Rule 8320, any member that fails to pay any fine, costs, or other monetary sanction imposed in this decision, after seven days' notice in writing, will summarily be suspended or expelled from membership for nonpayment. 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 nonpayment.