NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,	:	
Complainant,	:	Disciplinary Proceeding No. C10020090
v.	:	
	:	Hearing Officer - AWH
JOSEPH ABBONDANTE (CRD #1879052)	:	
	:	**Hearing Panel Decision**
Freehold, NJ	:	
	:	November 7, 2003
Respondent.	:	

Formerly registered representative (1) engaged in private securities transactions, in violation of NASD Conduct Rules 3040 and 2110, (2) failed to disclose outside business activities, in violation of NASD Conduct Rules 3030 and 2110, and (3) made misrepresentations of material facts, in violation of NASD Conduct Rule 2110. Respondent found not liable for (1) making fraudulent misrepresentations and omissions of material facts, in violation of Section 10b of the Securities Exchange Act of 1934, Rule 10b-5 thereunder, and NASD Conduct Rules 2120 and 2110, and (2) issuing fictitious account statements with false information, in violation of NASD Conduct Rule 2110. Respondent fined $96,500, suspended in all capacities for one year, ordered to requalify as a general securities representative, and assessed costs.

Appearances:

Gary A. Chodosh, Esq., and William St. Louis, Esq., for the Department of Enforcement

Louis J. Maione, Esq., for Joseph Abbondante

DECISION

Introduction

On September 19, 2002, the Department of Enforcement ("Enforcement") issued a Complaint in this matter against Joseph Abbondante and Daniel T. Pszanka, alleging that they (1) engaged in private securities transactions, in violation of NASD Conduct Rules 3040 and 2110; (2) used manipulative, deceptive, or other fraudulent devices, in

violation of Section 10(b) of the Securities and Exchange Act of 1934, Rule 10b-5 thereunder, and NASD Conduct Rules 2120 and 2110, (3) failed to disclose outside business activities, in violation of NASD Conduct Rules 3030 and 2110, and (4) issued fictitious account statements with false information, in violation of NASD Conduct Rule 2110.[1] Abbondante filed an Answer to the Complaint on October 17, 2002, denying the alleged violations. A hearing on the allegations against Abbondante was held on May 14 and 15, 2003, in New York , New York, before a hearing panel composed of the Hearing Officer and two current members of the District 10 Committee. The parties filed post-hearing submissions on July 18, 2003.

Pszanka failed to file an Answer to the Complaint, and, on January 23, 2003, Enforcement filed a Motion for Entry of a Default Decision against him. Pszanka did not reply to the Motion. Accordingly, the Hearing Officer granted the Motion and is issuing a separate Default Decision against Pszanka, which is being served concurrently with this Decision.

Findings of Fact[2]

The Respondent

Joseph Abbondante first became registered with NASD as an Investment Company/Variable Contracts Representative through a member firm in October 1988. He was registered as a General Securities Representative through member firm Chemical Investment Service Corp. ("Chemical") in May 1995. In September 1996, Chemical

[1] On February 19, 2003, Enforcement filed an unopposed motion to amend the Complaint to add certain specific allegations. The motion was granted. All references to the Complaint include those allegations in the Amended Complaint that was dated March 11, 2003.

[2] References to Enforcement's exhibits are designated as CX__ (page references are to Bates numbers, e.g. CX__, at C__); Respondent's exhibits, as RX__; Factual Stipulations, as Stip ¶__; and the transcript of the hearing, as Tr. __.

merged into Chase Investment Services Corporation ("CIS"). During the time relevant to the Complaint, Abbondante was registered through CIS as a General Securities Representative, and as an Investment Company/Variable Contracts Representative and Principal. He was last registered with NASD through Worldco, L.L.C. as a General Securities Representative from February 7, 2002, through September 23, 2002, and, accordingly, is subject to NASD's jurisdiction for purposes of this proceeding. CX 1; Stip. ¶¶ 1-5.

Jerry A. Womack and Iris Limited Partnership

As pertinent to this proceeding, from September 1998 through March 1999, Jerry A. Womack ("Womack") offered and sold interests in Iris Limited Partnership ("Iris LP"), a Nevada limited partnership created in July 1997. Womack was the general partner of Iris LP. Among other purposes, Iris LP was formed to trade stocks, bonds, and mutual funds. CX 75; Stip. ¶¶ 7-8.

Womack represented to prospective investors, who would become limited partners, that Iris LP would invest their money using a successful trading strategy that he called the "Womack Dow Principal," or the "Dow Jones Formula." Among other representations, Womack claimed that this trading strategy involved the simultaneous buying and selling of Dow Jones Industrial Average stocks on a daily basis in response to short-term market movements. Stip. ¶¶ 9-10.

In May 2001, in the United States District Court for the Central District of California, Womack was convicted of wire and mail fraud and money laundering in connection with Iris LP. Iris LP was a fraudulent investment scheme. Womack did not invest customers' funds using the alleged successful trading formula; rather he used

investor funds for various personal expenses and paid many investors purported trading profits from funds that were actually contributed to the partnership by other investors. In other words, Iris LP was the quintessential Ponzi scheme. Stip. ¶¶ 11-12. The District Court Judge stated: "I think the Defendant is a classic confidence man who basically played upon the emotions, dreams, and greed of everyone here who invested, including some of the other principals who worked for the Defendant." CX 79, at C404. On July 1, 2003, Womack was sentenced to 188 months (nearly 16 years) in prison and ordered to pay over $6 million in restitution to victims. News Release No. 03-096 (July 1, 2003), *at* http://www.usdoj.gov/usao/cac/pr2003/096.html.

Womack and Iris LP Open Accounts at CIS

S.F. was a co-broker with Abbondante. They shared new business under a joint brokerage code at CIS. On September 18, 1998, a banker at Chase Manhattan Bank ("CMB") (an affiliate of CIS) introduced Womack to S.F., saying that Womack was bringing a million dollars into CMB and was interested in opening a brokerage account at CIS. Tr. 266. S.F. opened an account for Womack, and L.B., a principal at CIS, authorized the account. Tr. 267. On the account application, Womack represented that he had a net worth of $18 million, investment assets of $18 million, and an approximate annual salary of $180,000. CX 62. Womack opened the account by depositing an Iris LP check for $900,000. CX 63, at C195; Tr. 530, 539. Womack told S.F. that he was interested in trading equities and that he had a formula that was a way to generate high returns. Because Abbondante did more trading than S.F. did, she introduced Womack to Abbondante.

Womack told Abbondante that he had been trained as a machinist, but that he had a mathematical aptitude. Womack told Abbondante that he had created a "secret" trading formula based on the volatility of the Dow Jones Index, and that he wanted to experiment with it at CIS. Tr. 531-32. Womack also told Abbondante that he had six traders at a West Coast firm trading for him on the basis of the formula. Tr. 537-38. Abbondante asked Womack for more information on the formula, but Womack asserted that it was secret. Tr. 532-33. Womack wanted to experiment at CIS with a new formula that he was attempting to put together, based on the same premise as his other formula. Tr. 535. Because of the anticipated volume of Womack's unsolicited trades using his formula, Abbondante requested, and received permission, from L.B., who approved the account, to charge Womack reduced commissions on those trades. Tr. 534-35. Womack began trading shortly after he opened his account in September 1998. Over the next three-month period, he made 279 trades, accounting for almost $33,000 in commissions for Abbondante and S.F. RX 33. The account, however, did not generate significant profits. CX 63; Tr. 301.

On November 9, 1998, Womack opened a brokerage account at CIS in the name of Iris LP, with Abbondante as the partnership's broker on the account. Womack transferred money from his personal account at CIS to the Iris LP account. CX 64; Stip. ¶ 15. Abbondante completed the paperwork to open the account, faxed it to the Compliance Department according to CIS procedure, and received approval from the Compliance Department within one hour.[3] Tr. 540-41. From November 18, 1998, through April 20, 1999, Womack made 233 trades in the Iris LP account, accounting for

[3] A principal at CIS did not approve the account until November 24, 1998, several days after trading had begun in the account. CX 64, 65.

over $28,000 in commissions. RX 32.[4] From November 1998 through February 1999, the account netted a trading loss. CX 65.

On December 31, 1998, on his own initiative, Abbondante requested a CMB employee in the Fraud Prevention and Investigation Department to perform another background check on Womack and Iris LP. Using systems at his disposal that would indicate any adverse dealings with financial institutions or the brokerage industry, and any criminal charges or convictions, the employee reported back to Abbondante on January 6, 1999, that he found no adverse information as a result of his inquiry. RX 30; Tr. 619-22. Abbondante spoke to G.B., Womack's office manager, and C.N., an investor in Iris LP. Tr. 538, 556. Both reported making significant amounts of money from their investments in Iris LP. Tr. 554-56. G.B. stated that he had "amassed a fortune," and was able to quit his prior job. C.N. told Abbondante that she had invested approximately $12,000, and had withdrawn $247,000 in distributions. *Id.* From his conversations with Womack, G.B., C.N., and others, Abbondante understood that Iris LP was involved with a number of ventures other than investments in the stock market. He was aware that those ventures included a record company, a golf course, real estate, and art. Tr. 544. On December 31, 1998, Abbondante invested $25,000 of his own money in Iris LP, and on March 30, 1999, he invested an additional $20,000 in Iris LP. CX 66-69; Stip. ¶¶ 20, 23.

The Private Securities Transactions

1. Customer A.C.

A.C. was working as a commodities broker when he met Abbondante at the Commodities Exchange in 1994. They became good friends and used to commute together by train from Middletown, New Jersey, to Wall Street. Tr. 13, 17, 557. In

[4] There were no trades in March 1999 and very few in April 1999.

casual conversation while commuting, Abbondante told A.C. the following information about Womack: (1) he was a high net worth individual; (2) he was a general partner of a limited partnership that traded stocks on the basis of a volatility type of formula, conducive to making superior returns as long as the market stayed volatile; (3) returns from using the formula were "[s]upposed to average eight to ten percent per month;" (4) Womack was successful in trading his own formula; and (5) Chase had done a due diligence background check on Womack. Tr. 18-21, 47. Abbondante told A.C. that he got the information from Womack, but that he did not know how the trading formula worked. Nevertheless, Abbondante told A.C. that he was going to invest his own money with Womack. Tr. 30, 33, 48.

A.C. decided to invest in Iris LP. As a result, he went to Abbondante's office on December 31, 1998, where Abbondante placed a call to G.B. at Iris LP and introduced G.B. to A.C. Tr. 28, 561. G.B. told A.C. that Iris was striving to earn eight to ten percent per month, and that the trading formula was based on the Dow. Tr. 74-76. Abbondante then gave A.C. a wire transfer form and helped A.C. fill it out. A.C. left the form with Abbondante, and within a day or two, $25,000 was transferred from A.C.'s CMB account to an Iris LP account in Nevada. CX 5, 7; Tr. 24-27, 561; Stip ¶ 18. A.C. knew that his investment in Iris was not a CIS approved product. Tr. 78, 91-92. He knew that it was a limited partnership, managed for the investors by Womack. Tr. 95.

On March 22, 1999, A.C. opened a CIS brokerage account with a CIS broker other than Abbondante.[5] CX 8; Tr. 59. On March 30, 1999, A.C. completed another wire transfer form in Abbondante's office to make an additional investment in Iris LP.

[5] Although A.C. opened an account with another broker at CIS, this decision treats A.C. as Abbondante's customer because of Abbondante's participation in A.C.'s transaction with Iris LP.

Abbondante signed the form, and A.C. left it with Abbondante. CX 9; Tr. 34-36. That same day, $25,000 was transferred from A.C.'s CMB account to an Iris LP account in Nevada. Stip. ¶ 22. In February 1999, prior to making his second investment in Iris LP, A.C. had had a conversation with Iris LP investor C.N. who told A.C. that she was pretty happy with her investment, and that it had done quite well. Tr. 76-77, 87.

A.C. received $7,600 from Iris LP as a purported return on his investment. He also recovered $24,000 as a result of a settlement of a claim against CIS arising out of the collapse of Iris LP. As a result, A.C. lost $19,400 of his total investment.[6] Tr. 38-39.

2. Customer K.C.

K.C. is a former New York State Trooper who is currently an advertising account manager for a major metropolitan newspaper. He is a third cousin of Patricia Abbondante, Joseph Abbondante's wife, and he has had a CIS brokerage account with Abbondante since June 1997. Tr. 311-12; Stip. ¶ 28.

In February 1999, K.C. attended a birthday dinner in Manhattan for Patricia Abbondante. During and/or after that dinner, K.C. overheard Abbondante talking to Daniel Pszanka, A.C., and others about Iris LP.[7] Tr. 315, 321-23, 562-63. K.C. then initiated a conversation with Abbondante, asking him "How does this all work, if it does work? How can I be involved?" Tr. 328. Abbondante essentially told K.C. everything he knew about Iris, and that the information had come from Womack, G.B., and C.N. Tr. 568. He told K.C. that (1) Iris LP invested money by trading stocks on the basis of a formula that relied on the volatility of the Dow Jones Industrial 30; (2) the formula had a

[6] In addition to his two $25,000 investments in Iris LP, A.C. lost an additional $1,000 he gave to Womack as a deposit on a trip to Hawaii that Womack supposedly arranged for the limited partners. Tr. 37.

[7] K.C. and Abbondante have different recollections of where the topic of Iris LP was first raised that evening. However, they do not disagree to any material extent as to the substance of what was said.

history of doing very well in volatile markets; (3) he was told by one investor that she had earned returns from Iris LP of a few hundred percent on her investment; (4) at the current time, the minimum return on investment was 10 percent per month; and (5) Womack was a client of his whose background had been looked into by CMB. Tr. 326, 329; Stip. ¶ 39.

K.C. told Abbondante that he wanted to invest in Iris LP. Abbondante called Womack to see if there was room for K.C. as an investor. Womack replied that there was. CX 114, at C790, CX 115, at C861. After discussing the matter with Abbondante, K.C. then transferred $30,000 from his brokerage account to his CMB checking account. He later signed and returned to Abbondante a wire transfer form that Abbondante had filled out and sent to him. Subsequently, $30,000 was transferred from K.C.'s CMB account to an Iris LP account in Nevada. CX 30, CX 115, at C860-61; Tr. 338-40. Abbondante told K.C. that Iris LP was not a CIS product and was separate from his Chase business. Tr. 336, 573. K.C. received $3,660 in purported returns on his $30,000 investment, and $13,500 from settling a claim with CIS on the investment. His net loss on the investment is $12,840. CX 37, at C140; Tr. 358, 361.

3. Customer R.S.

R.S. has been Abbondante's customer since 1995 when he opened a brokerage account at CIS with Abbondante. Stip. ¶ 25; Tr. 574-75. R.S. had inherited wealth and his account was worth approximately $3 million in 1999. He was not employed and was interested in generating income from his portfolio to meet his expenses. Tr. 576, 581-83. R.S. asked Abbondante what types of investments he made. When Abbondante mentioned limited partnerships, among other types of investments, R.S. expressed

interest. Abbondante told R.S. about Iris LP; specifically, that a client of his had a limited partnership in Las Vegas producing some very good returns, according to what other people had told him. Abbondante told R.S. that Iris LP invested its funds based on the volatility of the stock market, and that it was not connected with CIS.[8] Tr. 583-84. As a result of their conversation, R.S. said that he wanted to invest $500,000 in Iris LP. Abbondante responded, "250,000." Tr. 156. Abbondante then called Womack to determine whether there was "room available" for R.S.'s investment. Womack replied that there was. Tr. 585-86. Abbondante had R.S. sign a letter of non-solicitation, indicating that the $250,000 investment was not initiated or solicited by a CIS financial consultant. Tr. 587; CX 24. Abbondante also had R.S. sign an authorization to transfer the money from his bank account to the Iris LP bank account in Nevada. Tr. 587-88. Of his $250,000 investment in Iris LP, R.S. received only two checks totaling $5,975, and has lost $244,025. CX 28, at C101.

4. Pszanka's Customers

Daniel Pszanka was a CIS account representative who worked in a different Manhattan location than did Abbondante. On March 29, 30, and 31, 1999, five of Pszanka's CIS customers invested a total of $725,000 in Iris LP. CX 38, 43, 48, 53, 57; Stip. ¶¶ 31-32. Iris LP used various internal group names to subdivide investor funds. Tr. 241. The investments in Iris LP by CIS customers, with the exception of A.C., were grouped under "DJIA," an acronym, as more fully described below, that stood for Dan

[8] According to R.S., Abbondante "touted" Iris LP, that is, he recommended it. Tr. 145. Abbondante testified that he told R.S. that he didn't think it was an appropriate option for him. Tr. 584. J.W., a nursing supervisor and R.S.'s significant other, was present for the discussion. She testified that Abbondante "thought it would be a good investment" for R.S. Tr. 156. The Hearing Panel finds J.W. to be a credible witness whose testimony was candid and consistent. In investigative testimony, Abbondante stated that he was not "comfortable" about the investment, but didn't know what to say. CX 114, at C806. The Hearing Panel concludes that it is more likely than not that R.S. and J.W. were reasonably convinced, by the tenor of whatever conversation that took place, that Abbondante was recommending Iris LP.

[Pszanka] and Joe [Abbondante] Investment Account, but was thought by one investor to stand for Dow Jones Industrial Average. Tr. 345, 592.

5. Abbondante's Compensation from Iris LP

On or about April 5, 1999, Abbondante received, and deposited into his personal bank account at Nevada State Bank, a check in the amount of $51,500 from Iris LP. Stip. ¶ 33. The check was made out to Abbondante and stated on its face that it was for "referral." CX 102. An Iris LP spreadsheet, seized by the FBI from Iris LP, shows that, in March 1999, Abbondante was credited with bringing in eight deposits totaling $1,030,000 (corresponding to his three CIS customers and Pszanka's five CIS customers), and earning five percent commissions on those deposits, which amounted to $51,500. Tr. 228-29, 231-32, 236-42; CX 101, at C677.

The Hearing Panel does not credit Abbondante's testimony that he was told by Womack that the $51,500 check was a "return on your investment" and that the word "refer" on the memo line of the check was merely a "bookkeeping entry." Tr. 613. Iris LP statements show that Abbondante "earned" $2,236 during January 1999 on his $25,000 investment. CX 71. He "earned" $2,342 on that investment during February 1999. CX 72. Four days after he received the $51,500 check, he received a check in the amount of $3,227, which noted that it was for a February distribution. CX 73. Abbondante could not explain the time period for which the $51,500 check purportedly covered, and, in his testimony during the SEC investigation, he could not recall asking Womack why he put the word "refer" on the check, nor did Abbondante know why that word was on the check. CX 114, at C837. The $51,500 check was clearly a referral fee.

6. Lack of Notice or Approval

Abbondante never provided written notice to, nor received written permission from, CIS to participate in Iris LP. He also did not notify CIS that his CIS customers had invested in Iris LP. Tr. 196, 198, 206, 450; Stip. ¶ 41.

Outside Business Activities

On May 12, 1999, Abbondante and Pszanka established DJIA LLC ("DJIA"), a Nevada limited liability company, as a business entity for various ventures, including investments. CX 99; Stip. ¶ 42; Tr. 592-93. Shortly thereafter, Abbondante opened DJIA checking accounts in Nevada.[9] Womack deposited into the DJIA account $39,054 on June 7, 1999, and $29,455 on July 9, 1999. Stip ¶ 43. Abbondante at first thought that those deposits were the result of a mistake by the bank, similar to the one that required him to open an additional account at the bank.[10] When he found that Womack had wired the money to the account, he realized that Womack was using the account to deposit and hold funds belonging to Iris LP investors, including Abbondante and seven of his and Pszanka's CIS customers.[11] He told Womack that the money was not his, but Womack said that he could not help him. Abbondante was also concerned that a wire back to Iris LP would "show up as a reinvestment." CX 114, at C779-80; Stip. ¶¶ 44, 45; Tr. 595-98. From the DJIA account, during June through August 1999, Abbondante and

[9] Abbondante intended to open only one account; however, as a result of a Bank error, two accounts were actually opened. Tr. 593-94. For purposes of this Decision, the two accounts, one of which was eventually closed, will be considered, and referred to, as one.

[10] Womack's distribution of funds to investors was also inconsistent and muddled. He had originally required investors to open accounts at the same Nevada Bank where he had an account so that he would not have to issue checks to investors. A.C. opened such an account and Womack made a deposit to that account. However, he also sent A.C. a check for that same amount. Tr. 68-69.

[11] CIS customers who invested in Iris LP wired money directly from their accounts to Iris LP. The money in the DJIA account that belonged to them represented their purported investment returns. Tr. 596, 599-600.

Pszanka disbursed $19,200 to four of their CIS customers, $16,250 to Pszanka, $6,020 to Abbondante's wife, and $25,000 to Abbondante. Stip. ¶ 45, 47. Pszanka and Abbondante's wife had never invested in Iris LP. Tr. 633-34.

Abbondante did not notify CIS about the establishment or operation of DJIA LLC. CX 115, at C870; Tr. 207, 461-62. He did not tell anyone at CIS that customer funds had been deposited in the DJIA account:

> It would open up a whole can of worms. Now I would have to explain what bank customers' money was doing in my own account, the fact I was invested with this, you should have let us know. There are other people that have broker accounts elsewhere that failed to notify the Company, they get a slap on the wrist. I realized that maybe I should have. I feel to the extent of what I did, that I failed to follow through, but at this point now, this is money in my account, it is money that doesn't belong to me, there is [sic] Chase customers . . .

CX 115, at C872; Tr. 637.

Fictitious Account Statements with False Information

From June 1999 through August 1999, on DJIA letterhead that displayed a Nevada address, Pszanka issued investment account statements concerning Iris LP to seven of his and Abbondante's CIS customers. The statements purported to show the amount of each person's investment in Iris LP and the purported returns on the investment. Stip. ¶¶ 48-49; CX 27, 34-35, 41-42, 46-47, 51-52, 55-56, 59-60. Abbondante provided Pszanka with the information that appeared on the account statements. CX 119, at C998; Tr. 637-38. Abbondante got the information by telephone from Womack. Stip. ¶ 51; CX 116, at C887; Tr. 603-04.

The actual mailing address for DJIA LLC was Abbondante's home address in New Jersey. Stip. ¶ 52; Tr. 638. The account statements were prepared by Pszanka who determined the format for the statements, and mailed them from New York to the CIS

customers. CX 118, at C986.[12] Abbondante and Pszanka wrote checks to some of the investors whose purported returns were deposited in the DJIA account by Womack and who did not want to reinvest those purported returns. Stip. ¶ 55; Tr. 603-04.

Discussion

Private Securities Transactions

Conduct Rule 3040 prohibits any person associated with a member firm from "participat[ing] in any manner in a private securities transaction," unless, prior to participating in the transaction, the associated person provides "written notice to the member with which he is associated describing in detail the proposed transaction and the person's proposed role therein and stating whether he has received or may receive selling compensation in connection with the transaction." The Rule defines a private securities transaction as "any securities transaction outside the regular course or scope of an associated person's employment with a member."

Conduct Rule 3040 also provides that if the associated person has received or may receive compensation for participating in a private securities transaction, the member firm must advise the associated person, in writing, whether the member approves or disapproves the person's participation. If the firm approves participation, it must record the transaction on the firm's books and records and supervise the associated person's participation "as if the transaction were executed on behalf of the member." Finally, the Rule provides that even if the person will not receive compensation, the firm may "require the person to adhere to specified conditions in connection with his participation in the transaction."

[12] The statements included the amount of each customer's initial investment, but noted the initial investment as the customer's "DJIA" position. As stated in note 10, each initial investment was wired directly to Iris LP. None of the customers actually had DJIA "positions." Tr. 638.

The purpose of Conduct Rule 3040 is to ensure that member firms adequately supervise the suitability and due diligence responsibilities of their associated persons. *See Dep't of Enforcement v. Carcaterra*, No. C10000165, 2001 NASD Discip. LEXIS 39, at *8 (NAC Dec. 13, 2001). The Rule also serves to "protect employers against investor claims arising from an associated person's private transactions and to prevent customers from being misled as to the employing firm's sponsorship of the transactions." *Id.* at **8-9.

Under Section 3(a)(10) of the Securities Exchange Act of 1934, the term "security" includes an "investment contract." The United States Supreme Court has held that there is an investment contract, and hence, a security, when "a person invests money in a common enterprise and is led to expect profits" to be derived "solely from the efforts of others." *SEC v. W.J. Howey Co*., 328 U.S. 293 (1946).[13] A limited partnership interest, such as the one involved in this proceeding, is a security because it involves a common enterprise with profits that are derived from the efforts of persons other than the limited partners who are passive investors. *See, e.g., Jeanne Piaubert, S.A., v. Sefrioui,* No. 97056131, 2000 U.S. App. LEXIS 2462, **11, 12 (9th Cir. 2000) (a limited partnership interest is generally a security because, by definition, it involves an investment in a common enterprise with profits to come solely from the effort of others) (quoting *SEC v. Murphy*, 626 F.2d 633, 640-41 (9th Cir. 1980)). Abbondante argues on brief that Iris LP was not a security because it returned profits based on the "endeavors of a number of individual components, including a golf course, two record companies, real estate, fine art, and investments in the stock market by use of a [sic] undisclosed

[13] Although *Howey* dealt with the definition of "security" under § 2(1) (now 2(a)(1)) of the Securities Act of 1933, the 1933 Act and the 1934 Act are to be construed together, and the definition of the term under both Acts has been deemed identical. *See Tcherepnin v. Knight*, 389 U.S. 332, 335-36 (1967)

formula." (emphasis in original). Respondent's Post-Hearing Submission, at 36. That argument misses the mark. The critical question is not the type of common enterprise in which money is invested; it is whether the investors are actively involved in the enterprise, and not merely passive. Here, the investors had absolutely no control over the use of their funds. They were relying solely on the efforts of Womack to generate profits on their investments.

Abbondante's activities with regard to Iris LP were outside the scope of his employment with CIS, and there is no question that he did not give CIS written notice of those activities, or that he never received written approval from CIS to engage in those activities. Abbondante argues that he was not required to give notice because he did not participate in any manner in the sale of interests of Iris LP to customers. The SEC and NASD have interpreted the phrase "participate in any manner" broadly, to further the purposes of Conduct Rule 3040. Those purposes include not only protecting investors, but also protecting employers from the adverse consequences of an employee's improper conduct. Accordingly, even very limited involvement by an associated person is sufficient to trigger the requirement that the person give notice to the employer. *See, e.g.*, *Stephen J. Gluckman*, Exch. Act Rel. No. 41,628, 1999 SEC LEXIS 1395, at **14-15 (July 20, 1999) (finding that referral of customers to an investment and collecting a finder's fee violated Conduct Rules 3040 and 2110); *DBCC v. Mohn*, No. C8A960063 1999 NASD Discip. LEXIS 2 (NAC Jan. 22, 1999) (representative brought limited partnership investment to customers' attention, completed portions of subscription documents for customers, and determined suitability of limited partnerships as investments for customers); *James L. Owsley*, Exch. Act Rel. No. 32,187, 1993 SEC

LEXIS 1525 (June 18, 1993) (representative arranged a meeting between customer and person who sold customer stock in his company, and received a finder's fee).

Abbondante's involvement with his customers' investments in Iris LP was sufficient to trigger the requirement that he notify CIS in writing. None of the customers had heard of Womack or Iris LP before Abbondante mentioned them. He told them everything he knew about Womack, Iris LP, and the "secret formula," and, by informing them of his own investment in Iris LP, he tacitly endorsed investing with Womack. By suggesting to R.S. that he invest only $250,000, and not $500,000, in Iris LP, at a minimum, he implied that the investment would be appropriate for R.S.'s portfolio. According to R.S., Abbondante "touted," i.e., recommended the investment. Abbondante may not distance himself from the customers' decision to invest by telling them that they were on their own and would have to do their own due diligence. *Dep't. of Enforcement v. Mark H. Love*, No. C3A010009, 2003 NASD Discip. LEXIS 17 (NAC May 19, 2003), *appeal docketed*, No. 3-11164 (SEC June 20, 2003).

Abbondante received at least $51,500 from Womack for his referral of both his and Pszanka's customers.[14] By failing to give CIS prior written notice of his participation in the customers' transactions with Iris LP, and by participating in those transactions for compensation without the written approval of CIS, Abbondante violated Conduct Rules 3040 and 2110. CIS had no opportunity to impose conditions that might have protected the customers from their losses, and to protect itself from the claims of those customers arising out of their losses.

[14] As noted in the findings of fact, Abbondante also received approximately $33,000 as purported returns on his investment in Iris LP, and his wife, who had not invested in Iris LP, received more than $6,000 from Iris LP, for some unspecified purpose.

Outside Business Activities

Conduct Rule 3030 provides that no person registered with a member "shall be employed by, or accept compensation from, any other person as a result of any business activity . . . outside the scope of his relationship with his employer firm, unless he has provided prompt written notice to the member . . . in the form required by the member." The purpose of Conduct Rule 3030 is to provide member firms with an opportunity to raise any objections to such activities at a meaningful time and to exercise appropriate supervision as necessary under applicable law. *Proposed Rule Change by NASD Relating to Outside Business Activities of Associated Persons*, Exch. Act Rel. No. 26,063, 1988 SEC LEXIS 1841 (Sept. 6, 1988), adopted at Exch. Act Rel. No 26,178, 1988 SEC LEXIS 2032 (Oct. 13 1988). Rule 3030 requires disclosure of all outside business activity, not just securities-related activity. *DBCC v. Cruz*, No. C8A930048, 1997 NASD Discip. LEXIS 62, at *96 (NBCC Oct. 31, 1997).

Abbondante and Pszanka established DJIA LLC to engage in various business ventures, including "laundromats, investing in washing machines, dryers and putting them in apartment buildings, contracting, and just working together and in different avenues." Tr. 592-93. Abbondante argues that DJIA LLC was a "passive" shell, not an active business, and that its checking account was not utilized until Abbondante experienced difficulties with his personal account in Nevada. However, the Rule excepts only passive investments, those in which the investor does not materially participate.

Here, Abbondante and Pszanka intended to be the active participants in whatever ventures their limited liability company pursued. The DJIA checking account was funded by Abbondante. The checking account received deposits by Womack, and funds

were disbursed from it to CIS customers, as well as to Abbondante, Pszanka, and Abbondante's wife. Abbondante and Pszanka were the active participants who created a business entity, funded its initial capitalization, and received and disbursed Iris LP funds through that entity. Their business activity included obtaining the investor information from Womack that Pszanka used to create account statements on DJIA LLC letterhead, and to mail those statements to the CIS customers who invested in Iris LP.

Because it had no notice of the establishment and operation of DJIA LLC, CIS had no opportunity to raise any objections to such activities at a meaningful time and to exercise appropriate supervision as necessary under applicable law. In Abbondante's opinion, to have given CIS such notice would have opened up "a whole can of worms." However, under Rule 3030, CIS was entitled to receive notice *before* any associated person became employed by, or accepted compensation from, an outside business. Here, the activity of establishing DJIA as a business entity, opening checking accounts, receiving and disbursing funds, and preparing and disseminating account statements all took place without *any* notice to CIS, and thereby precluded the firm from protecting itself from potential liability. By engaging in that activity without appropriate notice to CIS, Abbondante violated Conduct Rules 3030 and 2110.

Misrepresentation and Omission of Material Facts

To establish that Abbondante violated Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5 thereunder, and NASD Conduct Rule 2120, Enforcement must prove that: (1) he made misrepresentations or omissions in connection with the purchase

or sale of securities; (2) his misrepresentations or omissions were material; [15] and (3) he made them with the requisite intent, i.e., scienter.[16] *See DBCC v. Euripides*, No. C9B950014, 1997 NASD Discip. LEXIS 45, at *18 (NBCC July 28, 1997). In addition, the duty of fair dealing requires that stock brokers have an adequate basis for their recommendations, and those recommendations should be based on reasonable investigation. *Hanly v. SEC*, 415 F.2d 589, 597 (2d Cir. 1969); *Steven D. Goodman*, Exch. Act. Rel. No. 43,889, 2001 SEC LEXIS 144, at *12 (Jan. 26, 2001).

The Complaint alleges that Abbondante falsely represented to customers that Womack invested by using a formula based on the volatility of the thirty Dow Jones stocks, that the formula was conducive to making better than average returns in a volatile market, and that returns were as large as ten percent per month. Womack's conviction for fraud demonstrates that there was, in fact, no secret formula he was using to buy and sell stocks using investors funds. Any returns that investors received, or were credited with, came from the funds of newer investors. The false information about the existence of the formula and the reputed returns on investment came from Womack, the perpetrator of the "Ponzi" scheme. That false information was conveyed to CIS customers by Abbondante. By conveying that false information, he misrepresented the true facts to his

[15] The test for materiality is "whether the reasonable investor would consider a fact important" in making an investment decision, or whether disclosure would "significantly alter…the 'total mix' of information made available." *Martin R. Kaiden*, Exch. Act Rel. No. 41,629, 1999 SEC LEXIS 1396, at * 18 n. 25 (July 20. 1999); *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

[16] Scienter is "a mental state embracing intent to deceive, manipulate, or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976). To prove scienter there must be a showing that the respondent acted intentionally or with severe recklessness. *See M. Rimson & Co., Inc.*, 1997 SEC LEXIS 486, at *95 (Feb. 25, 1997). Recklessness has been defined as highly unreasonable conduct involving not merely simple or excusable negligence but an extreme departure from the standards of ordinary care. *See Market Regulation Committee v. Michael B. Jawitz*, No. CMS960238, 1999 NASD Discip. LEXIS 24, at **19-20 (NAC July 9, 1999) (citing *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1568-69 (9th Cir. 1990), *cert. denied*, 499 U.S. 976 (1991) and cases there cited). A respondent may not plead ignorance as a defense to recklessness if a reasonable investigation would have revealed the truth to the respondent. *See SEC v. Infinity Group*, 993 F. Supp. 324, 330 (E.D. Pa. 1998).

customers, although he relayed the same information that he had gotten from Womack, Womack's employees, and some other investors in Iris LP. Clearly, had the truth been known to CIS customers, they would not have invested in a fraudulent enterprise that was designed to bilk anyone who did not get out of it before it collapsed.

By investing in Iris LP himself, Abbondante became a victim of the fraudulent scheme. He was never charged in the criminal case; neither were Womack's associate, G.B., or C.N., an investor from whom Abbondante received information about the performance of Iris LP. As the district court judge said at Womack's sentencing hearing, "dreams and greed" drove the people who were taken in by Womack, including those who worked for him. Abbondante was not an active participant in the scheme; he was one of those upon whose emotions Womack, the confidence man, played, and who invested in something he should have known was too good to be true.

Based on that evidence, the Hearing Panel does not find that Abbondante made misrepresentations with scienter. He was the only CIS employee who did any due diligence on Womack and Iris LP. He received no adverse information on either after requesting a background check on both. Furthermore, the accounts for both Womack and Iris LP were approved by CIS supervisors, without hesitation and without any thought to due diligence. Had Abbondante sought more information from Womack or those who claimed to be successful in their investments with him, Womack, as the architect of the scheme, would not have advised Abbondante of the truth, and the early investors had no way of knowing that their purported profits came only from later investors' funds. Abbondante was negligent in recommending an investment based on a secret formula, especially when Womack's experiments in trading at CIS did not provide superior or

even positive returns. However, the facts do not demonstrate that he intended to defraud his customers or that he was reckless in relaying information he received from Womack and his early investors. *See Ryan Mark Reynolds*, No. CAF990018, 2001 NASD Discip. LEXIS 17, at *47 (NAC June 25, 2001) (finding no fraudulent intent although representative's investigation was inadequate, his reliance on issuer's representations was unreasonable, and his assumptions mistaken). Because Iris LP was nothing more than a Ponzi scheme, it is highly doubtful that Abbondante, who was not a co-conspirator, could have discovered the true facts, regardless of any greater due diligence he might have performed. However, because the Hearing Panel concludes that, under the circumstances, Abbondante acted negligently in misrepresenting that an investment made its returns by trading stocks on the basis of a secret formula, he failed to adhere to the "high standards of commercial honor and just and equitable principles of trade" mandated by NASD Conduct Rule 2110.

The Complaint alleges that Abbondante omitted to tell customers that (1) he had no verifiable evidence that Womack invested money through a trading formula; (2) Womack refused to provide details of the trading formula; (3) he had no reliable evidence that Womack's investments generated any positive returns; (4) he knew that Womack's and Iris LP's accounts at CIS were not always successful; (5) he never read the Iris limited partnership agreement because it did not make any sense to him; and (6) he did not perform any bona fide due diligence on Womack and/or Iris LP. Complaint ¶ 27(d). The Hearing Panel concludes that Enforcement did not prove by a preponderance of the evidence that Abbondante omitted to tell customers material information.

Womack opened his personal account at CIS with a third party $900,000 check and represented that he had investment assets of $18 million. The account was approved by Abbondante's CIS supervisor, and no one at CIS questioned the propriety or bona fides of Womack's or Iris LP's account. To the contrary, because of Womack's anticipated trading volume, he was granted discounted brokerage fees by CIS. Abbondante asked for a background check on Womack and Iris LP. Enforcement does not suggest what more Abbondante could have done to do greater due diligence on either.

Abbondante told investors that Womack traded stocks using a formula based on the volatility of the Dow Jones stocks. He told his supervisor at CIS that Womack would be trading stocks, based on that formula. Tr. 195. No one asked for details of that formula, nor did the investors state that the details of the formula were important to their investment decision. Moreover, because, in truth, there was no formula, any "details" of the formula that Womack might have revealed to Abbondante would have been fictitious. Finally, even had there been a real formula, there has been no showing that investors would find any detail useful, beyond knowing that volatility in the market dictated buy and sell decisions. Accordingly, the Hearing Panel concludes that Enforcement did not demonstrate by a preponderance of the evidence that details of the formula would have been material to the investors' decision to invest in Iris LP.

Abbondante told investors about returns other investors were purportedly making, based on oral statements by G.B. and C.N. In addition, C.N. gave Abbondante a copy of what appeared to be an EXCEL spreadsheet tracking the "returns" she was getting from her investment in Iris LP. Tr. 601-02. Pszanka showed that spreadsheet to some of his CIS customers. *Id*. Abbondante also received checks that were purported to be returns

on his investment, and other funds were deposited in the DJIA account that purportedly represented customers' returns on their investments. Enforcement has not specified any other information that could have been available to Abbondante to verify the returns that investors were receiving. Because of the fraudulent nature of Iris LP, there could not have been any reliable information on investment returns because there were no real returns, and Abbondante was not aware of the fraud until the scheme collapsed.

Abbondante was aware that Womack's and Iris LP's accounts at CIS were not always successful. However, Womack told Abbondante that he was experimenting with those accounts at CIS, and that he had accounts at other firms where he was using his secret formula. For example, Womack's initial trades were not in individual stocks; rather they were in "Diamonds," shares traded on the American Stock Exchange and which mirror the Dow Jones Industrial Average. Tr. 536-37. His trading in the Iris LP account likewise was completely different from his purported formula trading. Tr. 542. Investors were not making their decisions to invest based on Womack's experimental trading at CIS.

Finally, although Abbondante did not read the entire Iris LP limited partnership agreement because he found it to contain "legalese" that made no sense to him, the Hearing Panel finds that the agreement itself was a "vanilla" document that contained provisions applicable to any limited partnership, but nothing that would be material to investors in any particular limited partnership. CX 75; Tr. 630-31. Enforcement has pointed to no specific information in that document that would affect a customer's decision to invest in Iris LP.

Issuance of Fictitious Account Statements with False Information

On brief, Enforcement argues that Abbondante was responsible for creating fictitious account statements, and, because Abbondante knew or should have known that the information contained on DJIA account statements was false, deceptive, and misleading, he violated Conduct Rule 2110 that requires associated persons to "observe high standards of commercial honor, and just and equitable principles of trade." Complainant's Post-Hearing Submission, at 32. However, the evidence demonstrates that Pszanka created the statements to accompany checks that were drawn on funds Womack deposited in the DJIA account. Abbondante and Pszanka did not solicit those deposits and were attempting to dispose of funds in that account that did not belong to them, but to other investors. The account statements were based on information Abbondante received from Womack. As a victim of the Ponzi-type scheme, there was no way Abbondante could have, or should have, known that the purported returns on investors' funds were not what Womack represented them to be. Accordingly, the Hearing Panel concludes that Enforcement has not shown by a preponderance of the evidence that Abbondante violated Conduct Rule 2110 as alleged in causes six and seven of the Complaint.

Sanctions

The private securities transactions, outside business activity, and misrepresentations all arose from a single course of conduct arising out of the investment of customer funds in Iris LP. Under such circumstances a single set of sanctions may be appropriate and effective to achieve NASD's remedial goals. *See, e. g., Dep't. of Enforcement v. Respondent Firm 1*, No., C8A990071, 2001 NASD Discip. LEXIS 6, at

**30-31 (NAC Apr. 19, 2001). Accordingly, the Hearing Panel has considered the totality of Abbondante's conduct in assessing sanctions.

For selling away, NASD Sanction Guidelines call for a fine of $5,000 to $50,000 and a suspension for a period of 10 business days to one year. NASD SANCTION GUIDELINES, at 19. The Guidelines for outside business activities call for the same fine, and, where the outside activity is similar to the employing firm's business, or it presents a conflict of interest for the employing firm, the same suspension. *Id.*, at 18. The principal considerations in determining the appropriate sanctions are similar and are addressed below. For negligent misrepresentations, the Guidelines call for a fine of $2,500 to $50,000, and a suspension for up to 30 business days. *Id.*, at 96.

The Hearing Panel finds several aggravating circumstances surrounding Abbondante's conduct. Although Abbondante sought to distance himself and Iris LP from CIS by stressing that Iris LP was not a CIS product, and by obtaining from R.S. a letter of nonsolicitation, he nevertheless created the appearance that CIS, as an affiliate of CMB, had sanctioned Womack, if not Iris LP, as an investment because he (1) used CIS facilities to introduce R.S. to the Iris LP investment, to introduce A.C. to an Iris LP employee, and to facilitate the transfer of R.S.'s, A.C.'s, and K.C.'s funds from CMB to Iris LP in Nevada, and (2) told those investors that Womack's background had been checked by CMB. In addition, R.S., A.C., and K.C. were all customers of CIS at the time they invested in Iris LP.[17]

[17] A.C. was a CMB customer at the time of his first investment in Iris LP, and he opened a brokerage account at CIS before his second investment in Iris LP. CX 8; Tr. 59.

Other facts show that Abbondante's conduct was not egregious. Abbondante's private securities transactions involved only three customers of CIS.[18] Of the three, Abbondante actually recommended the investment only to R.S., although he arranged for the transfer of funds to Iris LP for all three. His outside business activity with DJIA LLC involved his three customers, in addition to Pszanka's five. However, the outside business activity regarding those investors would not have taken place, but for the unsolicited action of Womack, who deposited funds into the DJIA account that belonged to those investors, and not to Abbondante and Pszanka. Abbondante sought promptly to forward those funds to the investors when he could not reverse the deposits and send the funds back to Womack. Abbondante was not a participant in the fraudulent scheme, and he had no proprietary interest in Iris LP; nor, as a limited partner who invested in it, could he control, or exert any influence over, the limited partnership.

In light of the circumstances, the Hearing Panel concludes that Abbondante's misconduct was serious, but not egregious. To remediate that misconduct and to protect the investing public, the Hearing Panel will fine Abbondante a total of $96,500, an amount that includes the $51,500 he received in referral fees, and suspend him in all capacities for a period of one year. In addition, he will be ordered to requalify by examination as a general securities representative. Abbondante will also be assessed costs of $5,415.82, consisting of a $750 administrative fee and a $4,665.82 transcript fee.

Enforcement also requests that Abbondante be ordered to pay restitution to R.S., A.C. and K.C. However, the Hearing Panel declines to do so. All three were fully aware

[18] There is no evidence linking Abbondante to the purchase of Iris LP interests by Pszanka's customers. Under the circumstances of this case, the fact that Abbondante received referral fees for their investments does not, by itself, prove that he had anything to do with their decisions to invest. The determination to pay Abbondante the referral fees for investors grouped under DJIA LLC was Womack's.

of the same information that Abbondante had about the investment. They knew that they were investing in a highly speculative venture, based on a "secret" trading strategy, and they hoped to receive enormous returns on those investments. Their losses were not caused by Abbondante's actions. They were the direct result of Womack's fraudulent activity. A.C. and K.C. have settled claims against CIS for their losses, and the Guideline for private securities transactions does not recommend that adjudicators consider ordering restitution or partial restitution to customers. *See Dep't. of Enforcement v. Roger A. Hanson*, No. C8A000059, 2002 NASD Discip. LEXIS 5, at *6 (NAC Mar. 28, 2002).

Conclusion

Joseph Abbondante is fined $96,500, suspended in all capacities for one year, and ordered to requalify by examination as a general securities representative, for engaging in private securities transactions, in violation of NASD Conduct Rules 3040 and 2110; failing to disclose outside business activities, in violation of NASD Conduct Rules 3030 and 2110; and making negligent misrepresentations of material facts, in violation of NASD Conduct Rule 2110. He is found not liable for (1) making fraudulent misrepresentations and omissions of material facts, in violation of Section 10b of the Securities Exchange Act of 1934, Rule 10b-5 thereunder, and NASD Conduct Rules 2120 and 2110, as alleged in the Third Cause of the Complaint; and (2) issuing fictitious account statements with false information, in violation of NASD Conduct Rule 2110, as alleged in the Sixth and Seventh Causes of the Complaint. Accordingly, the Third Cause of the Complaint is *dismissed* to the extent that it alleges a violation of Section 10b of the Securities Exchange Act of 1934, Rule 10b-5 thereunder, and NASD Conduct Rule 2120; and the Sixth and Seventh Causes of the Complaint are *dismissed* in their entirety.

Abbondante is assessed costs in the total amount of $5,415.82. The monetary sanctions shall be payable if and when Abbondante re-enters the securities industry.

The sanctions shall become effective on a date determined by NASD, but not sooner than 30 days from the date this Decision becomes the final disciplinary action of NASD, except that, if this Decision becomes the final disciplinary action of NASD, the suspension shall become effective with the opening of business on Monday, January 5, 2004, and end at the close of business on January 5, 2005.

SO ORDERED.

_____
Alan W. Heifetz
Hearing Officer
For the Hearing Panel

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