NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,	:	
Complainant,	:	Disciplinary Proceeding No. C10020075
v.	:	Hearing Officer - AWH
JOSEPH BRIAN SHEVLIN, JR. (CRD #2125060) Bayonne, NJ	:	**PANEL DECISION**
	:	October 2, 2003
Respondent.	:	

Registered Representative (1) made material misrepresentations and omissions in connection with the purchase and sale of securities, in violation of Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5 promulgated thereunder, and NASD Conduct Rules 2110 and 2120; and (2) engaged in unauthorized trading, in violation of NASD Conduct Rules 2110 and 2120. Respondent barred from associating with any member firm in any capacity, ordered to pay restitution in the amount of $12,890.62 plus prejudgment interest, and assessed costs.

Appearances

Rodney W. Turner, Esq., and Edward G. Rosenblatt, Esq., for the Department of Enforcement.

Robert Bertsch, Esq., for Joseph Brian Shevlin, Jr.

DECISION

Background

On August 8, 2002, the Department of Enforcement ("Enforcement") filed the Complaint in this proceeding, alleging that, during the period of April 1998 to September 1998, Joseph B. Shevlin, Jr. ("Shevlin" or "Respondent"): (1) made material misrepresentations and omissions in connection with the purchase and sale of securities, in violation of Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5

thereunder, and NASD Conduct Rules 2110 and 2120; and (2) engaged in unauthorized trading, in violation of NASD Conduct Rules 2110 and 2120. On September 30, 2002, Respondent filed an Answer to the Complaint and requested a hearing. As a result, a hearing was held before a Hearing Panel composed of the Hearing Officer and two members of the District 10 Committee on April 1-2, 2003. Both parties filed post-hearing submissions on July 2, 2003.

Findings of Fact[1]

Respondent

Shevlin began his career in the securities industry in October 1992, and first became registered with NASD through member firm Hanover, Sterling and Company Ltd. ("Hanover") in January 1993. After leaving Hanover, he was registered through three other firms before joining Royal Hutton Securities Corp. ("Royal Hutton") in December 1996. He was terminated as a General Securities Representative by Royal Hutton in July 2001. He is currently registered through member firm Milestone Group Management LLC.[2]

On April 15, 1998, while he was a registered representative in Royal Hutton's New York City office, he was placed on heightened supervision for a period of two months due to a customer complaint that Shevlin had executed an unauthorized trade.[3] The Complaint in this proceeding concerns Shevlin's conduct during the period April through September 1998, which includes the two months he was on heightened supervision. Just over one year later, on May 12, 1999, Royal Hutton suspended Shevlin

[1] References to Enforcement's exhibits are designated as "CX_"; Respondent's exhibits are noted as "RX_"; and the transcript of the hearing is designated as "Tr._."
[2] CX 3A; Tr. 510-12.
[3] CX 3B; Tr. 460-62.

indefinitely, without pay, pending resolution of several customer complaints, including unauthorized trades, that arose out of his conduct both during and after his period of heightened supervision.[4]

Relevant Securities

The allegations in the Complaint involve transactions in the securities of the following three companies:

1. Converse, Inc. ("Converse")

Converse, an athletic footwear and apparel company, lost $5.0 million in 1997, on revenue of $450.2 million.[5] In announcing that loss in February 1998, the company's Chairman and CEO commented that there had been a significant downturn in the market for athletic footwear in 1997, and that such a decline was expected to continue throughout 1998.[6] Shortly thereafter, Converse announced two rounds of job cuts.[7] During the first quarter of 1998, the company's net sales dropped 30% from the previous year's first quarter, and the company lost $1.2 million, whereas it earned $12.7 million for the first quarter in the previous year.[8] Shevlin was aware of the company's poor financial condition in 1998, and he considered Converse stock to be speculative.[9]

2. Ecological Recycling Company, Inc. ("Ecological")

Ecological is a development stage company that had been inactive until 1997 when it acquired a waste removal company called Advanced Waste Services, Inc.[10] Through that acquisition, Ecological acquired net assets worth approximately $63,000

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[4] CX 3C; Tr. 464-65.
[5] Stipulations at ¶ 10.
[6] *See id.* at ¶ 11.
[7] *See id.* at ¶¶ 12-13.
[8] *See id.* at ¶ 14.
[9] Tr. 519, 521.
[10] Stipulations at ¶¶ 15, 17.

and goodwill valued at $337,000.[11] By the end of 1997, Ecological had a net loss of $77,148. From its inception, it had never generated any profits.[12] In June 1998, the company acquired another waste removal business, Grand Sanitation Service, Inc., for $40,000, all of which was allocated to goodwill.[13] For the first six months of 1998, Ecological suffered a net loss of $184,015.[14] Shevlin considered Ecological to be a speculative security, and he was aware that the company had never earned a profit.[15]

3. Number Nine Visual Technology Corp. ("Number Nine")

Number Nine was a company that designed and supplied computer accessories and software. Its revenue decreased about 60% in 1997, and it suffered a net loss of over $20 million.[16] Number Nine had lost its largest customer, Dell Computers, and was unable to reduce costs and expenses as fast as its revenues decreased.[17] Moreover the company's total assets decreased by nearly 50% from the previous year.[18] In March 1998, Number Nine's auditor reported that the company would likely not be able to continue as a going concern. The auditor cited the factors above, plus the company's inability to comply with its lenders' covenants, its unresolved class action lawsuits, and its need for additional financing to continue operations.[19] In 1998, Shevlin was aware of the company's poor outlook because he had reviewed its annual reports, quarterly reports,

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[11] *See id.* at ¶ 17.
[12] *See id.* at ¶ 18.
[13] *See id.* at ¶ 19.
[14] CX 11 at 6; Stipulations at ¶ 19.
[15] Tr. 523-24.
[16] Stipulations at ¶ 21.
[17] Tr. 526.
[18] *See id.* at ¶ 22.
[19] *See id.* at ¶ 23.

and press releases. He considered Number Nine to be a low-priced, speculative security.[20]

Misrepresentations and Omissions

1. Customer R.G.

R.G. is a 74-year-old engineer who had had about four years of experience investing in individual stocks by the time Shevlin initiated phone calls to him in late 1997 or early 1998.[21] He was not interested in particularly risky investing and initially resisted Shevlin's solicitations, during which Shevlin claimed that he normally produced 40 percent profits per year for his clients.[22]

R.G. eventually opened an account with Shevlin in March 1998. On April 2, 1998, on Shevlin's recommendation, he purchased 1,000 shares of Converse stock at $6.75 per share, for a total cost of approximately $6,873.[23] During his sales pitch, Shevlin informed R.G. that Leon Black was in the process of obtaining a controlling interest in Converse, and as a result, R.G. could "make a great deal of money by buying into the companies that [Black] was interested in."[24] He described Black as a Wall Street financier who specialized in obtaining control of, and rehabilitating, distressed companies to sell them for a profit.[25] Shevlin did not disclose to R.G. that the CEO of Converse attributed its financial losses to a significant slowdown in the athletic footware market and expected a sluggish year in the industry in 1998. Nor did he disclose to R.G. that

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[20] Tr. 524-527.
[21] Tr. 393, 395-96.
[22] Tr. 395-397.
[23] Tr. 397, 400; Stipulations at ¶¶ 27-28.
[24] Tr. 398-99.
[25] *Id.*

Leon Black had already owned 65 percent of Converse for at least a year prior to Shevlin's recommendation of the stock to R.G. [26]

On April 13, 1998, Shevlin recommended that R.G. also purchase shares of Ecological, noting that a secondary offering of that company's stock was imminent and would likely result in a tripling of R.G.'s money.[27] Shevlin suggested that R.G. either send him more money or purchase the stock on margin.[28] When R.G. said he would do neither, Shevlin recommended that he sell his Converse stock to buy Ecological, explaining that Converse's deal was taking longer than expected and that R.G. would still have enough time to repurchase the Converse stock later.[29] R.G. followed this advice and sold his Converse shares at $6.31 per share on April 21, 1998, resulting in a loss of approximately $733.72.[30] He then purchased 710 shares of Ecological, using the net proceeds from his sale of Converse.[31] In fact, Ecological was not preparing for, nor contemplating, a secondary offering of stock.[32] Shevlin did not disclose to R.G. that Ecological had a limited operational history or that it never earned a profit.[33]

Soon after his purchase of Ecological, R.G. became concerned that he was losing money on that investment.[34] When he contacted Shevlin to discuss his concern, Shevlin reassured him that he was looking out for R.G.'s best interests, reiterated that

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[26] Tr. 403-05.
[27] Tr. 408.
[28] Tr. 408-09.
[29] *Id.*
[30] Stipulations at ¶ 28.
[31] Tr. 409, 411.
[32] Tr. 495-96.
[33] Tr. 414-416.
[34] Tr. 417.

Ecological's secondary offering would soon take place, and predicted that it would bump the stock's price up to $11 per share.[35]

In June of 1998, because he had lost confidence in Shevlin and Ecological, R.G. transferred the shares of Ecological to another brokerage firm and closed his Royal Hutton account.[36] He then promptly complained to Royal Hutton and NASD about Shevlin's Converse and Ecological solicitations.[37] On July 10, 1998, he sold his shares of Ecological at a loss of $1,924.95.[38]

2. Customer J.R.

J.R., a 54-year-old power plant training coordinator, received an unsolicited phone call from Shevlin in February 1998.[39] He did not open an account with Shevlin until April 20, 1998, when he purchased shares of Converse.[40] Shevlin told J.R. of a pending deal between Converse and Nike that would cause Converse's stock to increase from $6.50 to $8.00 per share or higher.[41] Following this sales pitch, and after informing Shevlin that his investment objective was preservation of capital, J.R. purchased 500 shares of Converse stock at $6.50 per share, for a total of $3,273.00.[42] In May, Shevlin recommended that J.R. purchase additional shares of Converse stock in order to "average down" his cost and increase his profits by purchasing the stock at a lower price. Shevlin reiterated his representations regarding a deal pending between Converse and Nike.[43]

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[35] Tr. 418; CX 17H at 2.
[36] Tr. 419, 423; CX 17H at 3.
[37] Tr. 423-24; CX 17H at 3.
[38] Stipulations at ¶ 32.
[39] Tr. 26.
[40] Stipulations at ¶ 34; Tr. 28.
[41] Tr. 33; CX 7 at 5, CX 18A at 1.
[42] Tr. 34; Stipulations at ¶ 34.
[43] Tr. 37-38.

J.R. purchased an additional 500 shares of Converse at $5.4375 per share on May 13, 1998, at a total cost of $2,816.75.[44]

There was no pending deal between Converse and Nike, and Shevlin never told J.R about Converse's financial losses, job cuts, or expectations for a sluggish year in the footware industry.[45] On August 25, 1998, J.R. sold his 1,000 shares of Converse for $3,296.38, leaving him with a net loss of approximately $2,793.37.[46]

On June 8, 1998, Shevlin contacted J.R. to recommend that he purchase stock in Number Nine.[47] Shevlin claimed that the company's innovative products and a deal that would soon be announced would rapidly push the stock price up from $3.00 per share to $5.00 or more, enough to cover the losses on J.R.'s Converse stock.[48] Following Shevlin's recommendation, J.R. purchased 1,000 shares of Number Nine on June 8, 1998, at $3.125 per share, for a total of $3,223.00.[49]

Shevlin swiftly followed up with another solicitation on June 11, 1998, urging J.R. to purchase more shares of Number Nine.[50] Shevlin reiterated that Number Nine's deal would soon be completed and the stock price would rise.[51] J.R. purchased an additional 1,000 shares that day at $2.625 per share, for a total cost of $2,723.00.[52] J.R. made this purchase with a cash advance from his credit card because Shevlin assured him

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[44] Stipulations at ¶ 35.
[45] Tr. 36-37, 495.
[46] Tr. 43-44; CX 18M, 18N; Stipulations at ¶ 36.
[47] *Id.* at ¶ 37.
[48] Tr. 45-46; CX 18A at 2.
[49] Stipulations at ¶ 38.
[50] Tr. 55-56, 58; CX 18 L.
[51] Tr. 55-56; CX 18 at 2-3.
[52] Stipulations at ¶ 39.

that he would realize a profit on the stock before he received his next credit card statement.[53]

With regard to each purchase, Shevlin did not disclose to J.R. any risks associated with investing in Number Nine, including its declining revenues, decreasing assets, mounting losses, or auditor's "going concern" opinion.[54] He transferred his entire account to E*Trade and, on November 30, 1998, sold his stock in Number Nine at a net loss of $2,946.00.[55] On December 28, 1998, he sent complaint letters to both Royal Hutton and NASD, alleging that Shevlin had misrepresented the stocks he recommended.[56]

3. Customers D.P. and D.M.

D.P. is a 58-year-old retired, power plant warehouse employee who learned about Shevlin in June 1998 through her discussions with J.R. who was her coworker at the power plant.[57] D.P. told her husband, D.M., that J.R. had heard about an investment opportunity about which he was enthusiastic. D.P. later contacted Shevlin and, during their initial discussion, Shevlin explained that Number Nine was merging with another company and its stock would double within a week.[58] When D.P. requested that Shevlin send her more information about the company, he told her that she would not receive it in time to purchase the stock before completion of the deal.[59] Shevlin did not disclose any risks associated with investing in Number Nine, and he never sent her any information on

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[53] Tr. 59-60; CX 18J.
[54] Tr. 52-53, 55.
[55] Tr. 62-64.
[56] CX 19K at 64-65.
[57] Tr. 181-82.
[58] Tr. 183-84.
[59] Tr. 189.

the company.[60] On June 12, 1998, D.P. and D.M. purchased 500 shares of Number Nine, at a total cost of $1,363.63.[61]

After D.P. and D.M.'s initial purchase, Shevlin made numerous follow-up calls to them, touting Number Nine stock and recommending that they purchase additional shares.[62] Shevlin said that the stock would double or triple very quickly. D.M. spurned Shevlin's entreaties because the stock continued to decline.[63]

In September 1998, D.M. contacted Shevlin about selling the Number Nine stock.[64] However, Shevlin encouraged him to buy more shares, stating that he had recently met with people who worked at Number Nine who said that the deal would happen soon, and that the stock would double or triple as soon as the deal was announced.[65] D.P. and D.M. discussed this development and, with Shevlin's encouragement, they borrowed from D.P.'s 401(k) retirement account to buy 4,500 additional shares of Number Nine stock.[66] They purchased the stock for $1.75 per share, at a total cost of $8,061.00.[67]

On November 10, 1998, D.P. and D.M. sold all 5,000 shares of Number Nine, at a loss of $1,882.48.[68] Subsequently, they sent a complaint letter to NASD, dated January 4, 1999.[69] Their letter reiterated that Shevlin never disclosed any information regarding the risks associated with the securities he recommended.[70]

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[60] Tr. 188-89.
[61] Tr. 185, Stipulations at ¶ 42; CX 22C.
[62] Tr. 146, 189.
[63] Tr. 146-47.
[64] Tr. 147-49.
[65] Tr. 147-48.
[66] Tr. 148-49.
[67] Stipulations at ¶ 43; CX 22E.
[68] *Id.* at ¶ 44.
[69] CX 22F; Tr. 155.
[70] *Id;* Tr. 156.

4. Customer J.L.

In June 1998, J.L. first learned about Shevlin from his then father-in-law, D.M.[71] He contacted Shevlin to inquire about the stock that his in-laws purchased.[72] Shevlin represented that a reliable source had told him that Number Nine would soon be bought out by another company and that its stock would jump from $3.00 per share to about $5.00 or $6.00 per share.[73] Shevlin did not disclose to J.L. any risks associated with investing in Number Nine stock. Based upon these representations, J.L. bought 1,000 shares of Number Nine at a total cost of $2,535.50.[74]

In September 1998, J.L. talked to Shevlin about selling the stock, due to its poor performance.[75] Shevlin told him that the pending deal was going to be completed over that weekend, and he recommended that J.L. purchase more stock, even if it meant borrowing money to do so.[76] Shevlin represented that the stock would return a profit before his credit card statement arrived.[77] On September 23, 1998, J.L. took a cash advance on his credit card to purchase an additional 1,000 shares of Number Nine stock at a cost of $2,723.00.[78]

By December 4, 1998, J.L. was unhappy with the performance of Number Nine stock and could no longer afford to finance the purchase on his credit card. As a result,

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[71] Tr. 211.
[72] *Id.*
[73] Tr. 212-13; CX 23A.
[74] Stipulations at ¶ 46; Tr. 213; CX 23A.
[75] Tr. 219-20.
[76] *Id.*
[77] Tr. 224.
[78] Tr. 225; Stipulations at ¶ 47.

he sold the stock at a net loss of $2,610.10.[79] He closed his Royal Hutton account and complained to NASD about Shevlin's misconduct.[80]

Unauthorized Transactions

1. W.G.

In February 1998, Shevlin made numerous unsolicited phone calls to W.G. and his wife at their home. Shevlin also called W.G., a dentist, at his office.[81] W.G. who invested primarily in mutual funds, not individual stocks, told Shevlin that he had no interest in purchasing any stocks from him.[82] Nevertheless, Shevlin continued to call W.G. once or twice a week, touting the performance of stocks he had previously recommended to W.G.[83] Because of Shevlin's persistent calls, W.G. bought a caller ID system to screen the calls at home. W.G. never authorized Shevlin to open an account in his name.[84]

On June 16, 1998, W.G. and his wife went on vacation and did not return home until June 24, 1998.[85] During that time, W.G. did not speak to Shevlin or anyone else at Royal Hutton. However, on June 16, Shevlin purchased 500 shares of Number Nine stock for an account that he opened in W.G.'s name.[86] Before W.G. became aware of the purchase, the stock had been sold on June 23, the day before W.G. returned from vacation.[87] W.G. discovered the existence of the account and the purchase transaction when he returned to his office on June 25, 1998, where he found a Federal Express

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[79] CX 23K; Stipulations at ¶ 48.
[80] CX 24K; Tr. 229-30.
[81] Tr. 276, 281-83.
[82] Tr. 278-81.
[83] Tr. 281-82.
[84] Tr. 321, 283-84.
[85] Tr. 296, 305.
[86] Tr. 305-06; CX 25J, CX 26C.
[87] Tr. 303-05; CX 25L.

package containing account opening forms and documentation reflecting the purchase of Number Nine in his name.[88] W.G. never signed any of the forms or sent them back to Royal Hutton or its clearing firm.[89] He did, however, call Royal Hutton to complain, and he filed written complaints about Shevlin's conduct with Royal Hutton, the Wisconsin Division of Securities and NASD.[90]

2. S.G.

S.G., a sales manager, first received a cold call from Shevlin in 1996 or 1997, at which time he declined Shevlin's solicitation to invest a minimum of $10,000.[91] Shevlin again called S.G. on June 15, 1998, recommending the purchase of Number Nine stock and predicting that S.G. would make a profit on his investment in a matter of days.[92] S.G. told him that he had an interest in investing in technology stocks, that he would do some internet research on the company, and that he would call Shevlin back to let him know whether or not he was interested.[93] S.G. reviewed Number Nine's product on its web site and called Shevlin the next day, June 16, to request account opening documents for him to review and return, if he chose to purchase the stock.[94] Shevlin sent the materials via overnight delivery; however, that same day, Shevlin also purchased 500 shares of Number Nine stock for an account he opened in S.G.'s name.[95]

When S.G. received the account opening documents, he reviewed them and decided against opening an account because he did not approve of language in the margin

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[88] Tr. 284-87, 295-96, 305; CX 25C, CX 25J.
[89] Tr. 288-93; CX 25D, CX 25E, CX 25F, CX 25G.
[90] Tr. 307-19; CX 25P, CX 25Q, CX 25R.
[91] Tr. 331-32.
[92] Tr. 332-34, 346-47.
[93] Tr. 334-35.
[94] Tr. 336-38, 347.
[95] Tr. 342-43, 352; CX 27I.

account agreement.[96] He never signed or returned any of the materials, and he did not authorize an account to be opened on his behalf.[97] Instead, S.G. called Shevlin on June 18 to notify him of his decision not to invest with him.[98] Because he could not reach Shevlin, S.G. left a message for him. Shevlin did not return his call.[99] Accordingly, S.G. sent Shevlin a letter, via facsimile, advising him of his decision not to open an account with him.[100]

From a confirmation statement he received on June 20, 1998, S.G. learned that an account had been opened in his name and that Number Nine stock had been purchased without his consent.[101] He attempted to call Royal Hutton and Shevlin to resolve the matter.[102] He never paid for the stock, which Royal Hutton sold on June 23, 1998.[103] S.G. also sent a letter to Shevlin and to Royal Hutton management notifying them of his concern that he would be taxed for a transaction that he did not authorize. He also sent a complaint letter to NASD regarding Shevlin's unauthorized transactions.[104]

Discussion

Material Misrepresentations and Omissions

In order to establish a violation of Section 10(b) of the Securities Act of 1934, Rule 10b-5 promulgated thereunder, and NASD Conduct Rule 2120,[105] in connection with the purchase or sale of a security, a party must show: (a) a misrepresentation or

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[96] Tr. 343.
[97] Tr. 349-50, 360-61, 364; CX 27D, CX 27E, CX 27F, CX 27G.
[98] Tr. 343-46.
[99] *Id.*
[100] *Id.*; CX 27H.
[101] Tr. 350-52; CX 27I.
[102] Tr. 353.
[103] Tr. 356; CX 27K.
[104] Tr. 356-59, 362-63; CX 27L, CX 27N, CX 28I.
[105] A violation of Rule 10b-5 or NASD Conduct Rule 2120 constitutes a violation of NASD Conduct Rule 2110. *Stephen J. Gluckman*, 1999 SEC LEXIS 1395, at *22 (July 20, 1999).

omission (b) of a material fact, (c) made with the requisite intent, i.e., scienter. *See DBCC v. Euripides*, 1997 NASD Discip. LEXIS 45, at *18 (NBCC July 28, 1997).

a. Misrepresentations and Omissions

Shevlin failed to give his customers a full or accurate picture of the risks of investing in the speculative stocks he was recommending. In addition, he compounded that failure by predicting substantial short-term price increases for those stocks without a reasonable basis. As a result, his customers were prevented from making informed investment decisions and were induced to purchase stock solely on the basis of unwarranted promises of profits.

First, Shevlin omitted pertinent negative information about the companies he was touting. He never disclosed information about Converse's poor financial condition, job cuts, or unfavorable projections for 1998. He never disclosed Ecological's limited operational history, limited revenue, or its failure ever to earn a profit. He never disclosed Number Nine's declining revenues, diminishing assets, escalating financial losses, and unfavorable auditor's opinion.

Second, Shevlin misrepresented what information he did give to his customers. He told customers that Leon Black was interested in obtaining a controlling interest in Converse; however, this was not a new development. Black had had a 65% interest in Converse for at least a year prior to the customers' purchase of the stock, and, notwithstanding that interest, the company's financial condition continued to deteriorate and its prospects for the following year were dim. Contrary to Shevlin's assertion, there was no imminent deal between Converse and Nike. Likewise, Ecological had no plans

for a "secondary offering," nor was there a merger in the offing for Number Nine, contrary to what Shevlin represented to customers.

Finally, Shevlin made baseless predictions about the prices of Converse, Ecological, and Number Nine stock, all speculative securities. He told customers that they would make "a great deal of money" in Converse, and that its price would rise $1.50 or more after a non-existent deal with Nike was consummated. He predicted to one customer that Ecological's stock would probably "triple" after a secondary offering that Shevlin knew was fictitious. Similarly, he represented to customers that Number Nine's stock would "double" after a merger that he knew was also fictitious took place.

Shevlin made those predictions of specific and substantial increases in the prices of speculative securities within a relatively short period of time, without any reasonable basis for so doing. Those predictions were false and inherently misleading. *See C. James Padgett*, Exch. Act Rel. No. 38,423, 1997 SEC LEXIS 634, at **23-24 (Mar. 20, 1997) (finding that predictions of sizeable stock price increases that are made without any reasonable basis are fraudulent); *Richard Bruce & Co., Inc.*, Exch. Act Rel. No. 8,303, 1968 SEC LEXIS 220, at **12-13 (Apr. 30, 1968) (concluding that predictions of "a sharp increase in earnings with respect to a speculative stock without disclosure of the uncertainties as well as the known facts upon which a prediction rests [are] inherently misleading") (citation omitted). *See also Clinton Hugh Holland*, Exch. Act Rel. No. 36,621, 1995 SEC LEXIS 3452, at *8 n.16 (Dec. 21, 1995) (implying that the performance of stock of development-stage companies with a limited history of operations and no profitability is unpredictable). The SEC has repeatedly held that "predictions of specific and substantial increases in the price of a speculative security

within a relatively short period of time are fraudulent." *Donald A. Roche*, 1997 SEC LEXIS 1283, at *5 (June 17, 1997).

b. Materiality

The standard for materiality is an objective one, requiring consideration of "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. 41629, 1999 SEC LEXIS 1396, at * 18 n. 25 (July 20. 1999); *TCS Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976). Material facts include not only earnings of a company, but also those facts that affect the probable future of a company and that may affect the desires of investors to buy, sell, or hold the securities. *See SEC v. Hasho*, 784 F. Supp. 1059, 1108 (S.D.N.Y. 1992). Failure to disclose the speculative nature of a recommended security or negative financial information about the issuer violates the anti-fraud provisions of the securities laws and NASD Rules. *Id.* at 1109. Furthermore, 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. 43889, 2001 SEC LEXIS 144, at *12 (Jan. 26, 2001).

Here, Shevlin withheld negative information about the performance and outlook for these companies, misrepresented and fabricated information bearing on the probable future of those companies, and predicted price increases in their stock without any reasonable basis. Reasonable investors would find these misrepresentations, omissions, and price predictions relevant to their decisions to invest in a company. In this case, all

of Shevlin's customers stated that his enthusiastic promotion of the securities and his assurance of their short-term earning potential influenced their decisions to invest. Had he given them a true and accurate picture of the companies' financial condition, solvency, and profitability, they stated that the information would likely have dissuaded them from investing.[106]

c. Scienter

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).

Shevlin admitted that, at the time he recommended the securities at issue, he understood his obligations as a registered representative to investigate a security, to disclose material facts about a security before recommending it to a customer, and to have a reasonable basis for predicting any substantial increase in the price of a security.[107] He also admitted that, prior to recommending the securities at issue, he reviewed publicly available financial information and reports on the companies, and he was aware of their declining revenues and poor financial prospects.[108] As a result, Shevlin was fully aware that he omitted to inform his customers of negative financial information and that his rosy predictions for their future performance and the prices of their securities were fabricated and had no basis in fact. Accordingly, the Hearing Panel concludes that Shevlin acted intentionally when he made misrepresentations and omissions of material fact to his customers in the course of recommending securities to

[106] Tr. 53-55, 150-52, 186-88, 216-19, 403-405, 414-416.
[107] Tr. 516-17.
[108] Tr. 519, 521, 524, 527.

them. In so doing, he violated Section 10(b) of the Securities Act of 1934, Rule 10b-5 promulgated thereunder, and NASD Conduct Rules 2120 and 2110.

Shevlin asserts that, in their testimony, his former customers either must have been mistaken or were lying.[109] However, after listening to that testimony and observing their demeanor, the Hearing Panel concludes that the customers' testimony was unambiguous, candid, and credible. Although J.R., D.P., D.M., and J.L. knew each other at the time they dealt with Shevlin, their testimony did not appear to be scripted, nor did the Hearing Panel find any reason to believe that they had colluded in preparing to testify. Moreover, their testimony was corroborated by customer R.G., who was not acquainted with them, and whose testimony portrayed the same pattern of conduct by Shevlin.

Shevlin also tried to shift responsibility for his misconduct to Royal Hutton and NASD.[110] However, regardless of any regulatory violations by Royal Hutton, Shevlin is not excused from his own obligations to comply with regulatory requirements. *See DBCC v. Euripides*, 1997 NASD Discip. LEXIS 45, at *21 (July 28, 1997) (finding that respondent's defense was meritless because he could not pass off his responsibilities to his firm) (citations omitted). *See also Frank W. Leonesio*, Exch. Act Rel. No. 23,524, 1986 SEC LEXIS 1009, at *11 (Aug. 11, 1986) ("A salesperson has a duty to make an adequate independent investigation in order to ensure that his representations to customers have a reasonable basis."). Nor can Shevlin shift responsibility to NASD for complying with relevant rules and regulations. *DBCC No. 8 v. Freedom Investors Corp.*, No C8A950011 (NBCC Jan. 27, 1997).

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[109] Tr. 541. Shevlin suggests that the customers were acting in collusion. *See* Respondent's Post-Hearing Brief, at 4.
[110] *See, e.g.,* Tr. 504-05; Respondent's Post-Hearing Brief, at 15 ("NASD is seeking an easy mark against a defenseless broker, who was employed with a non-compliant NASD member firm.").

Unauthorized Trading

The SEC and NASD have repeatedly held that "unauthorized trading in a customer's account violates Conduct Rule 2110." *Jeffrey B. Hodde*, 2002 NASD Discip. LEXIS 4, at **13-14 (NAC Mar. 27. 2002); *See also Robert Lester Gardner*, Exch. Act Rel. No. 35,899, 1995 SEC LEXIS 1532, at *1 n.1, 5 (June 27, 1995) (sustaining the NASD's finding that the respondent had violated just and equitable principles of trade by engaging in unauthorized trading). Further, where scienter is established, unauthorized trading is a violation of Conduct Rule 2120. *See DBCC v. Granath*, 1998 NASD Discip. LEXIS 19, at **10-11 (NAC March 6, 1998).

The evidence clearly establishes that Shevlin intentionally effected securities transactions against the expressed wishes of individuals who were neither his customers nor Royal Hutton's. There is no evidence showing that either W.G. or S.G. signed any document purporting to open an account at Royal Hutton. Shevlin claims that he had no reason to effect unauthorized transactions because he would suffer personal financial loss from any "busted" trade.[111] However, the Hearing Panel finds it more likely that Shevlin was willing to take the chance that potential customers would not complain, and that he could retain them as customers. Moreover, the Hearing Panel finds the testimony of W.G. and S.G. to be consistent and credible. They both refused to execute account opening forms sent to them by Shevlin, and they promptly complained in writing about the transactions. Accordingly, the Hearing Panel concludes that Shevlin violated NASD Conduct Rules 2110 and 2120 by intentionally engaging in unauthorized transactions.

[111] Respondent's Post-Hearing Brief, at 11.

Sanctions

Material Misrepresentations and Omissions

The NASD Sanction Guidelines for misrepresentations or material omissions of fact recommend a fine of $10,000 to $100,000 for intentional or reckless misconduct. NASD SANCTION GUIDELINES, p. 96 (2001). Additionally, the Guidelines recommend a suspension in any or all capacities for a period of 10 business days to two years, or a bar in egregious cases. *Id.*

Contending that Shevlin's misconduct was egregious, Enforcement requests that he be barred for his actions. The Hearing Panel agrees. Shevlin's misrepresentations and omissions occurred while he was under heightened supervision by Royal Hutton for earlier misconduct. Instead of conforming his conduct to standards appropriate for a registered representative, after he was placed under that heightened supervision, he intentionally engaged in a pattern of misconduct that resulted in financial injury to his clients. Instead of acknowledging and accepting responsibility for his misconduct, Shevlin suggested that his customers were colluding and mistaken or lying; he attempted to blame his employer for his misconduct; and he portrayed himself as a "defenseless broker" who is an "easy mark" for NASD enforcement action. His disciplinary history, lack of remorse, and failure to accept responsibility for his actions are significant aggravating factors that militate in favor of a bar. The Hearing Panel finds no mitigating factors that would warrant a lesser sanction. In light of the bar, no fine will be imposed.

Unauthorized Trading

For unauthorized trading, the Guidelines recommend a fine of $5,000 to $75,000 and a suspension in any or all capacities for ten business days to one year. GUIDELINES,

p. 102. In egregious cases, the suspension may be increased up to two years or a bar may be imposed. *Id.* The Guidelines list two principal considerations: (1) a determination of whether or not respondent misunderstood his authority or the terms of the cutomer's order; and (2) whether the unauthorized trading was egregious. The Guidelines recognize that unauthorized trading may be (a) quantitatively egregious, (b) egregious because it is accompanied by aggravating factors, and/or (c) qualitatively egregious.

Enforcement submits that Shevlin did not misunderstand his authority or the terms of his interactions with the potential customers. Describing his misconduct as qualitatively egregious, Enforcement requests that Shevlin be suspended for 18 months and fined $50,000. The Hearing Panel agrees that Shevlin's misconduct was qualitatively egregious, but finds that under the circumstances, he should be barred for that misconduct.

The two factors that determine whether unauthorized trading is qualitatively egregious are (1) the strength of the evidence, and (2) the respondent's motives, i.e., whether the respondent acted in bad faith or as a result of a reasonable misunderstanding. *See, e.g., Daniel S. Hellen*, No C3A970031, 1999 NASD Discip. LEXIS 22, at **15-17 (NAC June 15, 1999). The evidence that the trades were unauthorized is particularly strong. Both W.G. and S.G. testified credibly and unequivocally that they were not interested in purchasing Number Nine stock or in opening an account with Shevlin. Not only is their testimony uncontradicted, but it is corroborated by account opening forms that do not contain their signatures. There is no evidence that Shevlin misunderstood their intentions or his lack of authority to act on their behalf. Finally, the Hearing Panel finds that Shevlin did not act in good faith. The unauthorized trades occurred on the

same day, the day after his heightened supervision ended. That heightened supervision had been initiated as a result of a complaint for precisely the same conduct. The unauthorized transactions were clearly qualitatively egregious and merit the sanction of a bar. In light of the bar, no fine will be imposed.

Restitution and Costs

Enforcement requests that Shevlin be ordered to pay restitution to the customers who purchased Converse, Ecological, and Number Nine as a result of his fraudulent recommendations. The Guidelines recognize restitution as a proper remedy to return victims to the financial positions they were in prior to the misconduct. Customers R.G., J.R., D.P. and D.M., and J.L. were unable to make informed investment decisions as a result of Shevlin's misrepresentations and omissions. Accordingly, restitution is appropriate and will be ordered in the total amount of $12,890.62, plus pre-judgment interest, calculated in accordance with 26 U.S.C. § 6621(a)(2) from the date of each purchase, as set forth in the addendum to this Decision.[112] Shevlin will also be ordered to pay costs of $4,327.78, consisting of a $750 administrative fee and a $3,577.78 transcript fee.

Conclusion

Joseph B. Shevlin is barred from association with any NASD member firm in any capacity for (1) making material misrepresentations and omissions in connection with the purchase and sale of securities, in violation of Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5 promulgated thereunder, and NASD Conduct Rules 2110 and 2120; and (2) engaging in unauthorized trading, in violation of NASD Conduct Rules 2110 and 2120. He is further ordered to pay restitution in the total amount of $12,890.62,

[112] *See* Enforcement's post-hearing brief, at 32 nn.19-20 for precise calculations.

plus pre-judgment interest, and costs of $4,327.78, consisting of a $750 administrative fee and a $3,577.78 transcript fee. The bars shall become effective immediately if this Decision becomes the final disciplinary action of NASD.

SO ORDERED.

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Alan W. Heifetz
Hearing Officer
For the Hearing Panel

Copies to:
Via First Class Mail & Overnight Courier
Joseph Brian Shevlin, Jr.

Via First Class Mail & Facsimile
Robert Bertsch, Esq.

Via First Class & Electronic Mail
Rodney W. Turner, Esq.
Edward G. Rosenblatt, Esq.
Rory C. Flynn, Esq.