NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,	:	
Complainant,	:	Disciplinary Proceeding No. C01020025
v.	:	Hearing Officer – DMF
BROOKES McINTOSH BENDETSEN (CRD #1374304) Burlingame, CA	:	**HEARING PANEL DECISION**
	:	July 8, 2003
Respondent.	:	

Respondent (1) signed a customer's name to a margin agreement, in violation of Rule 2110; (2) made unsuitable recommendations to the customer, in violation of Rules 2310, 2860(b)(19) and 2110; and (3) created false account statements and provided them to the customer, in violation of Rule 2110. Respondent is barred from associating with any NASD member in any capacity.

Appearances

David A Watson, Esq., San Francisco, CA (Rory C. Flynn, Esq., Washington, DC, Of Counsel) for Complainant.

Respondent Brookes McIntosh Bendetsen, pro se.

DECISION

1. Procedural History

The Department of Enforcement filed a Complaint on December 12, 2002, charging that respondent Brookes McIntosh Bendetsen (1) signed a customer's name to a margin agreement for her account; (2) made unsuitable recommendations to the customer; and (3) created false account statements and provided them to the customer. Bendetsen filed an Answer and requested a hearing, which was held in San Francisco,

CA, on May 28, 2003, before a Hearing Panel that included an NASD Hearing Officer and two members of the District 1 Committee.[1]

2. Facts

Bendetsen has been in the securities industry since 1986. From 1988 to January 2000, he was registered with D.R. Mayo & Co., Inc. as a General Securities Representative and as a General Securities Principal. He is currently registered with Redwood Securities Group, Inc. in the same capacities. (CX 1.)

The charges in the Complaint concern Bendetsen's activities relating to the account of ML, a Mayo customer. ML was born in September 1908.[2] In 1986, a widow, she opened an account with Mayo. According to the account opening form, her investment objective was "conservation of capital with stable income." Beginning in about 1988, Bendetsen became the Mayo registered representative responsible for servicing the account. (CX 4, 5; Tr. 48, 67.)

In 1992, ML opened an account in the name of the ML Trust, with herself as the trustee, and transferred her holdings to that account. Bendetsen completed the account opening form, indicating that ML was 79 years old (in fact, it appears she was 84 at that time), with an annual income of approximately "40K" and an approximate net worth of "1M+," and that her investment objectives were "conservation of capital with stable income" and "long term growth of capital – income secondary," and did not include "short term trading profits" or "speculative capital gains." (CX 6-7; Tr. 48, 71-74.)

[1] The Panel heard testimony from an NASD Compliance Specialist and Bendetsen, and received 28 Complainant's Exhibits (CX). Bendetsen did not offer any separate exhibits.

[2] ML did not testify at the hearing. The NASD Compliance Specialist testified that she had spoken to ML on many occasions, but that ML's memory is poor and she no longer has any recollection of specific transactions in her account. (Tr. 28.)

The account opening form indicated that the ML Trust account would be a margin account. According to Bendetsen, he believes that ML signed a margin agreement when the account was opened, but "somehow it disappeared. Wedbush [Morgan Securities, Inc., Mayo's clearing firm,] caught the discrepancy [in about August 1997]. And I called her, and I said, 'I need a margin agreement.' And she said, 'Why don't you sign it?' So I signed it." The record does not disclose whether the account utilized the margin agreement in 1997, but according to the December 1998 account statement, the ML Trust account paid approximately $1,150 margin interest charge in 1998. In 1999, the account paid more than $14,500 in margin interest. (Tr. 48; CX 4, 6-8, 20.)

According to ML's account statement, as generated by Wedbush, as of December 1, 1998, the net worth of the ML Trust account was approximately $898,000, consisting of about $13,000 in cash, $610,000 in fixed income securities and $275,000 in equities. To that point in time, ML had never made a short sale in the ML Trust account. On December 7, 1998, however, Bendetsen effected a short sale of 300 shares of Amazon.Com, Inc. stock for a total of more than $57,000. The sale was originally made in the account of another of Bendetsen's Mayo customers, but on December 22, 1998, Bendetsen submitted a "Cancel/Rebill" form to Wedbush changing the transaction to a short sale in the ML Trust account. The form indicated that there had been a mistake as to the account number on the original transaction, and therefore it should be re-allocated to the ML Trust account. By December 31, 1998, the negative value of this 300 share Amazon short position in the ML Trust account had increased to approximately $96,000, resulting in a "paper loss" of $39,000 as of that date. (CX 8, 25; Tr. 79, 90-95.)

In January 1999, Amazon stock split 3 for 1, leaving the account with a 900-share short position, which it maintained until April 1999. The negative value of this position continued to increase, reaching approximately $155,000 as of March 31, resulting in a "paper loss" of $98,000 and a corresponding decrease in the net worth of the account. (CX 9-11.)

Until February 1999, there had never been any options trades in the ML Trust account, and there is no evidence that ML ever executed an options trading agreement for the account. Further, because of her age, she was not eligible to trade options under Mayo's policies. Nevertheless, in February 1999, Bendetsen began trading Amazon options in the account. In February and March he effected only a few options trades that are not the subject of the Complaint. The Complaint does, however, charge that his trading in Amazon options and stock in April 1999 was unsuitable. (CX 10-11, 23; Tr. 38-39.)

In April 1999, Bendetsen made approximately 36 Amazon options trades in the ML Trust account involving a total of about 1,345 contracts. These trades included both writing (selling) and purchasing both puts and calls. For the options it wrote, the account received nearly $326,000 in premiums, but it paid more than $424,000 for the options it purchased, for a net loss of nearly $100,000. Among these trades, the account wrote 160 uncovered calls, which were assigned (exercised) on April 17. To meet its obligations under these calls, the account was forced to sell 16,000 shares of Amazon short on April 19. The account subsequently purchased 16,000 shares of Amazon between April 19 and April 27 to cover the short sale, as well as 900 shares to cover the account's pre-existing short position resulting from the December 1998 short sale. The account received more

than $2.7 million for the premiums on the uncovered calls and the short sales to fill those calls, but it was forced to pay more than $3 million to cover the short positions, for a net loss of nearly $290,000. (CX 12, 22, 27-28; Tr. 25-28.)

These losses, however, were not readily apparent from the account statement for the ML Trust account for the month of April, as generated by Wedbush. In fact, the April statement showed that the net worth of the account increased from about $816,000 at the end of March to nearly $913,000 at the end of April, in spite of the losses resulting from the options trading. This increase was primarily attributable to a single transaction. On April 30, the last day of the month, Bendetsen purchased RDM Sports Group, Inc. bonds having a par value of $600,000 for about 3% of par, or approximately $18,000. In the ML Trust account statement, however, Wedbush valued the bonds at 75% of par, or $450,000.[3] At the hearing, Bendetsen acknowledged that this valuation bore no relationship to the true market value of the bonds, as established by his purchase at 3% of par. Nevertheless, the over-valuation of the bonds on the account statement masked the losses attributable to Bendetsen's options trading. (CX 12; Tr. 111-12.)

Those losses were also not apparent from the May account statement, which indicated that the net worth of the account had remained at about $912,000. The statement shows that on May 11, Bendetsen canceled the April 30 purchase of RDM Sports bonds. On May 28, however, he once again purchased RDM Sports bonds for the ML Trust account. This time he bought bonds with a par value of $625,000 for just 3% of par, or about $18,000, and once again the bonds were over-valued on the account statement, this time at 78% of par, or $487,500. (CX 13; Tr. 112-13.)

[3] According to Wedbush, "all the bonds in the [ML Trust] account except one appear to have been priced by our service vendor BETA or a subcontractor they employ." The lone exception was a bond that is not material to the issues in this proceeding. (CX 25.)

This pattern continued in June. On June 3, Bendetsen canceled the May 30 purchase of RDM Sports bonds, and on June 30 he bought Hechinger Co. bonds having a par value of $700,000 for less than 2% of par, or about $13,000. As with the RDM Sports bonds, the Hechinger bonds were over-valued on the ML Trust account statement, this time at 78% of par, or $546,000. (CX 14; Tr. 113-14.)

The net worth of the ML Trust account decreased substantially on the July statement, from nearly $952,000 at the end of June to just $203,000 as of July 31. As in the prior months, Bendetsen canceled the June 30 Hechinger bond purchase that had inflated the net worth shown on the June statement. He then purchased Hechinger bonds with a par value of $130,000, but this time Wedbush valued them at only 1% of par, or $1,300, on the July statement. According to the monthly account statements prepared by Wedbush, the net worth of the account continued to drop after July; by December 1999 it had diminished to approximately $142,000. (CX 15-20; Tr. 29-31.)

Beginning in August, however, Bendetsen provided ML with conflicting information, in the form of falsified account statements that indicated the net worth of the account remained substantial. For example, although the Wedbush-generated statement showed that the account's net value was about $194,000 as of August 31, Bendetsen created and provided to ML a statement indicating that the account's value as of that date was about $816,000. As of the end of September, according to the Wedbush-generated statement, the net worth of the ML Trust account was about $169,000, but Bendetsen prepared and gave to ML a statement indicating that the net worth of the account was approximately $791,000. Bendetsen created similar falsified account statements for the months ending October 31, November 30 and December 31, 1999, each of which

indicated that the net value of ML's account was far greater than shown on the corresponding Wedbush-generated statement. (CX 4, 16-20, 26; Tr. 36-38, 51.)

In format, the statements Bendetsen created were indistinguishable from the statements generated by Wedbush. Bendetsen created them by cutting and pasting portions of prior Wedbush-generated statements for the account. The August statement that he created, for example, incorporated the account holdings and values reflected on the Wedbush generated statement for March 1999. According to Bendetsen, he created these statements and gave them to ML because he believed the statements generated by Wedbush undervalued some of ML's bonds. In fact, however, the August statement that Bendetsen created included securities that the ML Trust no longer held as of August, and included information about the account's cash position, equity holdings and values, and the amount of margin interest that the account had paid that differed substantially from the corresponding values on the Wedbush-generated statement.[4] It is unclear which old account statements Bendetsen used to fabricate the statements he provided to ML for the months of September, October and December 1999. In each case, however, the statement that Bendetsen provided differed from the corresponding Wedbush-generated statement not only as to the value of the fixed income securities in the account, but also as to the

[4] For example, on August 31, 1999, according to the statement generated by Wedbush, the ML Trust account's money balance was a negative $253,327.27, but the statement that Bendetsen created showed that the account's money balance was a positive $120,302.39 – the correct money balance for the account as of March 31. The Wedbush-generated statement for August showed that as of August 31 the account had fixed income securities with a value of $235,357 and equities valued at $212,525.05, while the statement Bendetsen prepared showed that the account's fixed income securities were worth $560,539.50 and its equities were worth $135,663.99, which were the values shown on the Wedbush-generated account statement for March 1999. The statement generated by Bendetsen also showed that the account had a number of holdings that the account had held in March, but had sold by August to meet its margin obligations. And although the Wedbush-generated statement for August showed the account had incurred margin interest charges, year to date, of $8,229.66, according to the statement that Bendetsen prepared, the account's margin interest charge for the year had been only $1,106.09.

account's money balance and the value of its equities holdings. (CX 4, 17-20; Tr. 33, 35-38, 57.)

3. Discussion

The first charge in the Complaint is that by signing ML's name to the margin agreement for the ML Trust account, Bendetsen violated Rule 2110, which requires that NASD members and associated persons "observe high standards of commercial honor and just and equitable principles of trade." As the National Adjudicatory Council has explained:

> Conduct Rule 2110 "is not limited to rules of legal conduct but rather … it states a broad ethical principle." … Disciplinary hearings under Conduct Rule 2110 are ethical proceedings, and one may find a violation of the ethical requirements where no legally cognizable wrong occurred. … The NASD has authority to impose sanctions for violations of "moral standards" even if there was no "unlawful" conduct. … The concepts of excuse, justification, and "bad faith" may be employed to determine whether conduct is unethical [when it does not violate some specific statute, rule or regulation].

Department of Enforcement v. Shvartz, 2000 NASD Discip. LEXIS 6 at *11-13 (NAC June 2, 2000) (citations omitted).

Bendetsen's actions were plainly unethical, even if they were not illegal. He admits that he signed ML's name to the margin agreement. He claims that ML authorized him to do so, but even accepting that testimony as true, Bendetsen certainly knew or should have known that it was inappropriate to sign her name to the margin agreement, and there was no excuse or justification for him doing so. He had no written authorization to sign; he placed no notation on the agreement to indicate that he had signed on ML's behalf; and he does not claim to have advised Mayo that he was signing ML's name, or to have obtained the firm's permission.

The Hearing Panel, therefore, finds that Bendetsen violated Rule 2110, as charged. See, e.g., Charles E. Kautz, 52 S.E.C. 730, 734, 1996 SEC LEXIS 994 (April 5, 1996) ("it is a violation of NASD Rules to enter false information on official Firm records. The entry of accurate information on official Firm records is a predicate to the NASD's regulatory oversight of its members. It is critical that associated persons, as well as firms, comply with this basic requirement.") (footnote omitted); John G. Abruscato, 43 S.E.C. 209, 1966 SEC LEXIS 198 (Dec. 14, 1996).

The second charge in the Complaint is that Bendetsen made unsuitable recommendations in connection with the ML Trust account's short sale of Amazon stock in December 1998 and its trading of Amazon options in April 1999. Rule 2310 provides that in recommending to a customer the purchase of a security, a member or associated person must have reasonable grounds for believing that the recommendation is suitable for the customer based on the facts, if any, disclosed by the customer as to her other security holdings and as to her financial situation and needs. Rule 2860(b)(19) provides more specifically that a member or associated person must have reasonable grounds, based on the information furnished by the customer concerning her investment objectives, financial situation and needs, to believe that any recommended options purchase or sale is suitable for the customer.

There is no dispute that Bendetsen recommended the December 1998 short sale of Amazon stock and the April 1999 options transactions. He claimed that generally he and ML "actively discussed the trades" and that he "outlined the strategy with her" (Tr. 55), but even if that is true, it would not excuse him from his obligation to recommend only suitable transactions. As the SEC recently reiterated, "a broker's recommendations must

be consistent with his customer's best interests. The test for whether [the broker's] recommended investments were suitable is not whether [the customer] acquiesced in them, but whether [the broker's] recommendations … were consistent with [the customer's] financial situation and needs." Wendell D. Belden, Exch. Act Rel. No. 47859, 2003 SEC LEXIS 1154 (May 14, 2003) (footnotes omitted).

According to the account opening documents that Bendetsen filled out for the ML Trust account, ML was elderly, had an income of just $40,000 per year and assets of "$1M+," and her investment objectives were "conservation of capital with stable income" and "long term growth of capital – income secondary," and did not include "short term trading profits" or "speculative capital gains." Further, Bendetsen admits that the ML Trust account, which was opened in 1992, had never before engaged in short selling or options trading. Indeed, there is no evidence that ML had ever completed the various forms required by Mayo to permit options trading in a customer account, and in fact ML was ineligible for options trading under Mayo's supervisory procedures because of her age.

Bendetsen contends, however, that ML "had a long history in the high-yield bond market [so he] assumed she had a certain level of sophistication." He also testified that he "probably mischaracterized" ML's objectives on the account opening form for the ML Trust account, and that she had substantial assets, including holdings in Pacific Gas & Electric and General Motors and Certificates of Deposit, apart from the ML Trust account. But he also stated that when he effected the challenged trades he was "desperately attempting to get [ML] whole. And, if anything, I'm guilty of bad

judgment, in that I employed high-volatility options to, in fact, recover part of her losses in high-yield bonds." (Tr. 50, 53-54.)

Notwithstanding Bendetsen's attempt to justify his actions, the short sale of Amazon stock in December 1998 was clearly unsuitable for the ML Trust account. The transaction was inconsistent with the history of the account, and was effected under suspicious circumstances. The sale was initially in the account of another of Bendetsen's customers, before Bendetsen moved it to the ML Trust account several days later. Even assuming that the trade was originally intended as the first short sale in the account, which had never before made a short sale, it represented a substantial and highly speculative investment, with a very substantial downside risk, as shown by the steady increase in the negative value of the short position in the account. Even assuming that Bendetsen's testimony about her holdings outside the ML Trust account is correct, such a trade was not suitable for a customer of her age and circumstances.

The April options transactions, including, in particular, the writing of uncovered calls, were even more clearly speculative. Engaging in speculation in a "desperate attempt" to recoup losses incurred from other investments is highly unsuitable for a customer such as this customer. Bendetsen put her account at great risk, leading ultimately to the loss of a substantial portion of the net worth of the account.

The Hearing Panel finds, therefore, that in connection with the December 1998 short sale Bendetsen violated Rules 2310 and 2110, and that in connection with the April options trading he violated Rules 2860(b)(19) and 2110, as charged.[5]

[5] The unsuitability allegations in the Complaint also refer to the April stock transactions, but those transactions were not discretionary trades recommended by Bendetsen. The account was compelled to make the April short sales to satisfy its obligations under the uncovered calls, and the subsequent purchases were made to fill the account's short positions. The suitability rule, however, "applies only to securities

The third charge against Bendetsen is that he prepared false account statements and provided them to ML, in violation of Rule 2110. Bendetsen admits that he created the false statements and gave them to ML. He contends that he did so because Mayo's clearing firm, Wedbush, under-valued some of the account's bond holdings on the account statements it generated. Bendetsen did not, however, identify any particular holdings that he believed were undervalued, or explain how he had arrived at the correct values for those bonds. Further, his actions were inconsistent with his contention: he did not increase the value of some of the bonds in the ML Trust account's portfolio, but rather falsified information concerning the account's money balance, the value of its equities, the amount the account had paid in margin interest, and the account's holdings. In fact, it is apparent that Bendetsen created the false statements in order to conceal the losses in the account.

Ultimately, however, Bendetsen's motives are immaterial. Even if the values shown on the account statements generated by Mayo's clearing firm did not accurately reflect the market value of certain bonds in the account, that could not justify creating false account statements and providing them to the customer. Account statements are critically important documents; the creation of false statements "is the antithesis of a registered representative's upholding high standards of commercial honor." DBCC No. 10 v. Mangan, 1998 NASD Discip. LEXIS 33 at *16 (NAC July 29, 1998).

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that the broker 'recommends' to customers." Department of Enforcement v. Chase, 2001 NASD Discip. LEXIS 30 at *15 (NAC Aug. 15, 2001). Therefore, although these trades were occasioned by Bendetsen's unsuitable short sale in December 1998 and options trading in April 1999, they did not violate the suitability rule.

4. Sanctions

Turning first to the unsuitable recommendations, the Sanction Guidelines recommend that for such violations, in egregious cases, adjudicators should consider a suspension of up to two years or a bar, and indicate that in setting specific sanctions adjudicators should look to the general considerations set forth in the Guidelines. NASD Sanction Guidelines at 9-10, 99 (2001 ed.). At least with respect to the April options trading, if not the December short sale, applying the considerations in the Guidelines leads inevitably to the conclusion that this is a highly egregious case. The customer was elderly and vulnerable, and the trading was highly speculative and patently unsuitable for her. Bendetsen's actions were intentional; the unsuitable options trading involved a large number of trades; they caused very substantial losses to the customer; and he attempted to conceal those losses. Therefore, the Hearing Panel concludes that a bar is warranted for this violation.

Turning next to the false account statements, the NASD Sanction Guidelines provide that for falsification of records, adjudicators should consider suspending the respondent in any or all capacities for up to two years where mitigating factors exist, and should consider a bar in egregious cases. In setting specific sanctions, adjudicators should consider the nature of the documents falsified and whether the respondent had a good faith, but mistaken, belief of express or implied authority, as well as the more general considerations set forth in the Guidelines. NASD Sanction Guidelines at 43. In this case, the falsified documents were account statements, which are critically important, and Bendetsen had no good faith belief that he had authority to create such false statements and provide them to ML. Further, Bendetsen created false statements for five

months, for August through December 1999; his conduct was intentional; and the false statements were directed to an elderly customer and had the effect of concealing large losses in her account occasioned by Bendetsen's unsuitable trades. The Panel finds that the violation was highly egregious, that there are no mitigating facts, and, therefore, that a bar is warranted.

Finally, the Hearing Panel concludes that Bendetsen's signing of ML's name to the margin agreement was also a serious violation that would warrant significant sanctions, but not necessarily a bar. In light of the bars imposed for the other violations, however, additional sanctions for this violation would be redundant. Therefore, no additional sanctions will be imposed.[6]

5. Conclusion

Respondent Brookes McIntosh Bendetsen (1) signed a customer's name to a margin agreement, in violation of Rule 2110; (2) made unsuitable recommendations to the customer, in violation of Rules 2310, 2860(b)(19) and 2110; and (3) created false account statements and provided them to the customer, in violation of Rule 2110. He is barred from associating with any NASD member in any capacity for the unsuitable recommendations and false account statements. In light of the bar, no separate sanctions are imposed for signing the margin agreement. In addition, he is ordered to pay costs in the total amount of $1,624.62, which includes a $750 administrative fee and hearing transcript costs of $874.62. These sanctions shall become effective on a date set by NASD, but not sooner than 30 days after this decision becomes the final disciplinary

[6] In light of the bars, the Panel will not impose a fine. Further, because ML has already obtained restitution for her losses from Mayo and Bendetsen, the Panel will not order it. (Tr. 50-51, 67, 90.)

action of NASD, except that if this decision becomes NASD's final disciplinary action, the bar shall become effective immediately.[7]

HEARING PANEL

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By: David M. FitzGerald
Hearing Officer

Copies to:

Brookes McIntosh Bendetsen (via overnight and first class mail)
David A. Watson, Esq. (electronically and via first class mail)
Rory C. Flynn, Esq. (electronically and via first class mail)

[7] The Hearing Panel has considered all of the arguments of the parties. They are rejected or sustained to the extent they are inconsistent or in accord with the views expressed herein.