NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. MARTIN HERBERT MECKLER (CRD# 1203608) Manteca, CA Respondent.	Disciplinary Proceeding No. C01020003 Hearing Officer – DMF **HEARING PANEL DECISION** September 24, 2002

Respondent was suspended in all capacities for six months, barred as a principal and fined $27,550 for failing to make prompt written disclosure of outside business activities, in violation of Rules 3030 and 2110.

Appearances

David A. Watson, Esq., Regional Counsel, San Francisco, CA (Rory C. Flynn, Washington, DC, Of Counsel) for Department of Enforcement.

R. King Prothro, Esq., San Jose, CA, for respondent.

DECISION

I. PROCEDURAL HISTORY

The Department of Enforcement filed a Complaint on March 14, 2002, charging that respondent Martin Herbert Meckler violated NASD Rules 3040 and 2110 by participating in private securities transactions for compensation without providing advance written notice to and obtaining written permission from the NASD member with which he was associated, or, in the alternative, violated NASD Rules 3030 and 2110 by

engaging in outside business activities without giving his firm prompt written notice. Meckler filed an Answer denying the charges and requesting a hearing, which was held on August 13, 2002, before a Hearing Panel composed of a Hearing Officer and two members of the District One Committee.[1]

II. FACTS

From February 1992 until August 2001, Meckler was registered with NASD member Walnut Street Securities, Inc. as an Investment Companies and Variable Contracts Products Limited Representative and Limited Principal. Since August 2001, he has been registered in the same capacities with Day International Securities. (CX 1.)

In late 1999 or early 2000, __________, an insurance and real estate agent with whom Meckler was acquainted, told him about an investment offered by Mobile Cash Systems, LLC in which several of her clients had invested. (CX 6, p. 1; Tr. 26, 35, 59.) Enforcement offered very limited evidence concerning the precise nature of the investment. It appears that, in form, investors purchased "wireless terminal machines" that supposedly would be located in fast food restaurants and other retail establishments, or carried by mobile retail outlets such as pizza delivery persons. Using their ATM debit cards, for a fee, consumers could obtain receipts from the machines that they could exchange for goods or cash from the retailers. For an investment in the machines to be viable, the machines had to be placed with retailers, maintained and connected to a clearing network. Mobile Cash Systems offered to provide or arrange these services for

[1] In this decision, the hearing transcript is cited "Tr." and Enforcement's exhibits are cited "CX."

investors, or the investors could provide or arrange for the services themselves. (Tr. 37-38; CX 4, 6, 10, 12.)[2]

On January 31, 2000, Meckler entered into a Sales Representation Agreement with Mobile Cash Systems. Meckler was to receive a 13% commission on his sales. (Tr. 34-35; CX 6, pp. 6-13.) Meckler submitted the Agreement to Mobile Cash Systems through __________. Other than obtaining some promotional materials from __________, Meckler did no investigation of Mobile Cash Systems.[3] Meckler did not notify Walnut Street of his affiliation with Mobile Cash Systems. (CX 6, p. 1.)

Meckler sold Mobile Cash Systems investments to two customers. In April 2000, HA, a Walnut Street customer, invested $105,000. According to Meckler, HA was an elderly, ill woman, who had been his customer for many years. Early in 2000, it appeared that she needed to enter a nursing home. Her son, who was her only heir, wanted to increase the income from HA's investments by $1,300 per month in order to pay the nursing home costs without invading the principal of his expected inheritance. Because HA's total assets were only $300,000 - $400,000, Meckler advised that it would be impossible to do that through conventional investments; instead, he suggested that HA invest in Mobile Cash Systems machines. Meckler understood that Mobile Cash Systems

[2] During the hearing, it was determined that the agreement form admitted as CX 10 was incomplete. Following the hearing, in accordance with the agreement of the parties at the hearing, Enforcement submitted CX 12, a complete version of the agreement form, which is admitted. Both CX 10 and CX 12 reflect investments by persons who were not customers of Meckler. They were offered and admitted only to show the standard forms employed by Mobile Cash Systems.

[3] During the investigation, Meckler provided certain promotional materials to NASD staff, which are included in CX 6, but they refer to "World Cash Providers, LLC," rather than Mobile Cash Systems. Although the relationship between the two entities is not clear from the record (Tr. 80-82), based on Meckler's testimony, Mobile Cash Systems' purported operations were similar to those described in those promotional materials.

would pay a fixed 13% return on each machine, so HA purchased 21 machines to generate approximately $1,300 per month income. HA did not intend to have any direct involvement in the placement or operation of the machines; at Meckler's advice she simply allowed Mobile Cash Systems to arrange for those services. Mobile Cash Systems paid the commission on the sale to __________, who, in turn, paid Meckler $13,660, using a check drawn on her company's account. (Tr. 26-28, 38-44, 46-47, 67; CX 4, 6, 8, 11.)

HA obtained the funds for the Mobile Cash Systems investment from a Franklin Mutual Fund held in her Walnut Street account, utilizing a Letter of Instruction that was processed through Day International Securities, an NASD member owned by __________'s husband.[4] Meckler had no reasonable explanation for this procedure. (Tr. 53-58; CX 8.)

In March 2000, PS and ES, a married couple who were Walnut Street customers, invested $30,000 in Mobile Cash Systems machines, for which Meckler received a $3,900 commission. PS and ES were in their seventies; PS was a retired truck driver and they were living on his pension and social security. They were looking for an additional $300 per month income, but Meckler told them, "For what you've got, there isn't a whole lot of places to get a whole lot of income." On Meckler's recommendation that they could receive a 13% return, they invested in Mobile Cash Systems. Like HA, they wanted a passive investment and, on Meckler's recommendation, allowed Mobile Cash

[4] __________ does not have a securities license and, to Meckler's knowledge, she was not associated with Day International. (Tr. 58-59.)

Systems to select the firms that would provide the necessary services. (Tr. 28-29, 47-48; CX 4, 6, 8, 11.)

PS and ES obtained the funds for their Mobile Cash Systems investment from an Oppenheimer Mutual Fund held in their Walnut Street account. Once again, the funds were cleared through Day International en route to Mobile Cash Systems for reasons that Meckler could not adequately explain. (Tr. 52-57; CX 8.)

The customers received monthly checks from Mobile Cash Systems for five to six months, but have received no return on their investments since then. PS and ES received a total of approximately $1,950, and HA a total of approximately $6,825. Meckler testified, "As it turned out, [the investments] were a scam." (Tr. 29; CX 8.)

Walnut Street's compliance manual provided that "[Registered Representatives] are not permitted to engage in private securities transactions …. [Registered Representatives] are expected to conduct all securities transactions through [Walnut Street]." (CX 4, p. 22.) Meckler, however, could not recall ever having consulted the manual, even though he admitted he "probably did" receive a copy. (Tr. 62-63.) In any event, Meckler did not believe the Mobile Cash Systems investments were securities, because __________ told him no license of any kind was required to sell them. (Tr. 36.)

Walnut Street's compliance manual also provided that "[Registered Representatives] are required to disclose to [Walnut Street], in writing, any **outside business activities** prior to engaging in such activity." (CX 4, p. 21 (emphasis in original).) Although Meckler did not recall consulting the manual, he knew of his

general obligation to report outside business activities promptly, but he admitted that he failed to disclose his affiliation with Mobile Cash Systems. He could offer no reasonable explanation for his failure – "I just never did." (Tr. 86.)

On September 19, 2000, several months after the sales, Meckler completed a "2000 Report of Outside Business/Employment Activities" form for Walnut Street. On the form, he disclosed that he had outside business activities involving life insurance sales and home mortgages. He did not, however, disclose his affiliation with Mobile Cash Systems. (Tr. 63-64, 75-76; CX 4, pp. 1-2, 16.)

On the same date, he also had a compliance interview with his supervisor and completed a "2000 Compliance Interview" form. On that form, he responded "yes" to the question, "For 2000, have you disclosed all outside occupations, employment or business ventures to [Walnut Street] by completing an Outside Business Activities form in advance of beginning the activity?" He responded "yes" to the question, "Have you obtained prior written approval from [Walnut Street] before engaging in any outside business activity?" He responded "yes" to the question, "Do you understand the definition of a security?" And he responded "no" to the question, "Have you distributed, or gotten paid for distributing any security except as approved by [Walnut Street]?" Meckler's only explanation for failing to disclose his involvement in the sale of Mobile Cash Systems investments in response to these questions was, "I just didn't think it was necessary." (Tr. 88-89; CX 4, pp. 1-2, 17-19.)

In July 2001, Walnut Street received a letter from the California Department of Corporations indicating that it was "reviewing securities transaction[s] effected by

[Meckler] for compliance with the state securities law," citing the investments offered by Mobile Cash Systems. Walnut Street sent a compliance investigator to Meckler's office on a surprise visit. The investigator discovered the sales to HA and to PS and ES, and Meckler admitted his involvement with Mobile Cash Systems. (CX 4.) Walnut Street terminated Meckler in August, and approximately 10 days later, Meckler became associated with Day International Securities. (CX 1.) Based upon an Amended Form U-5 filed by Walnut Street, indicating that it had terminated Meckler for "selling away," NASD staff began the investigation that led to the Complaint. (CX 3.)

III. VIOLATION

Enforcement charged, in the alternative, that Meckler violated either Rule 3040 or 3030. Rule 3040 requires associated persons to provide prior written notice to the member firm with which they are associated before they participate in any private securities transactions. Rule 3030 requires, more generally, that associated persons provide prompt written notice to their firm of any outside business activity in which they engage.

In this case, it is clear that Meckler violated one rule or the other; which rule he violated depends on whether the Mobile Cash Systems investments were securities. Enforcement contends that they were "investment contracts," and thus securities, under the standards established in SEC v. W.J. Howey Co., 328 U.S. 293 (1946). In Howey, the Supreme Court held that an investment contract is "a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits

solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise." Id. at 298-99.

The Howey test has been applied in many subsequent cases, and many types of arrangements have been held to be investment contract securities. But the analysis under Howey is not mechanical. "It embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits." Id. at 299. Application of such a test requires a reasonably clear picture of the underlying investment.

A clear understanding of the investment is particularly helpful when considering the "common enterprise" element of the Howey test. Substantial disagreement has developed as to whether that element requires "horizontal commonality" – meaning "the pooling of assets from multiple investors so that all share in the profits and risks of the enterprise" – or "vertical commonality" – meaning that "an investor's fortunes are tied to the promoter's success rather than to the fortunes of his or her fellow investors." Some courts accept both types of commonality; others accept only one or the other. The "disarray" is further complicated by two variants of the vertical commonality standard. One requires "that the well-being of all investors be dependent upon the promoter's expertise," while the other requires only that "the investors' fortunes be 'interwoven with and dependent upon the efforts and success of those seeking the investment or third parties.'" SEC v. SG Ltd., 265 F.3d 42, 49-50 (1st Cir. 2001) (citation omitted). The National Adjudicatory Council has applied the horizontal commonality standard. See,

e.g., District Bus. Cond. Comm. v. Kunz, No. C3A960029, 1999 NASD Discip. LEXIS 20, at *21 (NAC July 7, 1999). The NAC might, or might not, accept vertical commonality; if it did, it is uncertain which version it would follow.

According to the terms of Mobile Cash Systems' Equipment Sales Agreement offered by Enforcement, investors were "solely responsible for the management and operation of the Equipment, and [Mobile Cash Systems was] not under any obligation … to provide for such management or operation in any particular form or by any particular party, including [Mobile Cash Systems] or its affiliates." Attached to the Agreement was a Memorandum of Understanding to be initialed by the investor, indicating, among other things, that the investor understood that he or she was purchasing equipment that would "produce anticipated actual business revenue from the operation of said equipment." The investor "acknowledge[d] that this revenue is not interest, a dividend, guaranteed or any other type of 'fixed income.'" In another attachment to the Agreement, investors were required to indicate whether they would service and install the machines themselves, or wished to enter into contracts with specifically identified third party firms for those services, as well as "transaction handling" and "monitoring" services. (CX 10, 12.)

These terms are relevant to a Howey analysis, but not controlling, if they do not reflect the true nature of the investment.[5] Enforcement, however, failed to offer sufficient admissible evidence to provide a clear picture of the way it actually operated. Enforcement apparently intended to rely primarily on CX 9, an undated "Notice of

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[5] Cf. Department of Enforcement v. Baxter, No. C07990016, 2000 NASD Discip. LEXIS 3, at *18 (NAC Apr. 19, 2000) ("In determining whether investors intend to control the management of an LLC or whether they intend to rely on the management of a third party to derive profits [for purposes of applying the Howey test], courts have considered the wording of the operating agreement, but also have focused on how the LLC actually operated.").

Opportunity for Hearing Regarding Proposed Order to Cease and Desist, for Restitution, for Administrative Penalties, and for Other Affirmative Action" that an NASD examiner apparently downloaded from the Arizona Corporation Commission's web site. This document appeared to be, in essence, an administrative complaint filed by the Arizona Securities Division with the Corporation Commission. It contains a number of allegations against Mobile Cash Systems and various other companies and individuals, but Enforcement offered nothing to substantiate the allegations, or to show if or how the Corporation Commission resolved them. Complaint allegations, without more, are not probative; if they were, Enforcement could rest on the allegations in its own Complaint. Therefore, the Hearing Officer sustained Meckler's objection to CX 9, and excluded it pursuant to Rule 9263(a) as "unduly prejudicial."

Apart from the Arizona administrative complaint, the only description of Mobile Cash Systems' actual operations came from Meckler, whose testimony was vague and incomplete. He indicated that his customers intended to make passive investments and therefore allowed Mobile Cash Systems to make all the arrangements for the placement and servicing of the machines. The record, however, does not clearly establish the relationship between Mobile Cash Systems and the companies that were to provide those services, or place the actions of Meckler's customers in any broader context of Mobile Cash Systems' operations. Meckler indicated that he understood that his customers would receive a fixed 13% rate of return on their investments, regardless of the "actual business revenue" generated by the machines, but also suggested that the company might have based that figure on "a track record of each machine would generate so much

revenue per month." (Tr. 70-71.) Further, his understanding of the investment seems to have come largely from __________, rather than directly from Mobile Cash Systems. Above all, the evidence is unclear as to the existence or precise nature of either horizontal or vertical commonality, an essential element of any Howey analysis.

If the Hearing Panel had a clear picture of the Mobile Cash Systems investments, it might well find that they were securities. But it was incumbent upon Enforcement to offer sufficient evidence to allow the Panel to reach that conclusion with a reasonable degree of confidence. In the absence of such evidence, the Hearing Panel finds that Enforcement failed to establish that the Mobile Cash Systems investments were securities, and therefore it failed to prove that Meckler violated Rule 3040.[6]

On the other hand, it is clear that Meckler violated Rule 3030. He was engaged in outside business activity and admits he failed to give Walnut Street prompt (or indeed any) notice of it. By violating Rule 3030, he also violated Rule 2110.

IV. SANCTIONS

For outside business activities violations, the NASD Sanction Guidelines recommend a fine of $2,500 to $50,000, plus the amount of financial benefit the respondent enjoyed as a result of the violation. In addition, "[w]here [the] outside activity is similar to the employing firm's business," the Guidelines recommend a suspension of up to one year, and in egregious cases, "including those involving sales of financial products," the Guidelines recommend consideration of a longer suspension of up to two years, or a bar. NASD Sanction Guidelines at 18 (2001 ed.).

[6] Cf. Department of Enforcement v. Baxter, at *21 ("In light of the dearth of evidence regarding the LLC investors and the actual operation of the LLCs, we cannot find that the LLC interests at issue were securities. [W]e simply do not have evidence sufficient to make a determination in this regard.")

Enforcement suggested that the Hearing Panel suspend Meckler in all capacities for three months and fine him $5,000, plus an additional $17,550, representing the commissions that he earned on the transactions. Meckler, on the other hand, suggested that he, himself, had been "as much a victim as the clients were," and he urged the Panel to impose neither a suspension nor a fine. (Tr. 31, 103-08.)

The Hearing Panel viewed the violations in this case as very serious. Some of the specific considerations listed in the Guidelines for outside business activities violations are applicable here as aggravating factors. The persons to whom he sold the investments were customers of Walnut Street; although Meckler said they had been his customers before he became associated with Walnut Street, he admitted that "they knew I was a representative of Walnut Street." (Tr. 50.) Further, the Mobile Cash Systems investments were unquestionably "financial products," whether or not they were securities.

In addition, some of the general considerations applicable to determining sanctions are applicable here as aggravating factors. Meckler failed to accept responsibility for the misconduct prior to detection, and in fact attempted to conceal it by lying when specifically asked, on the Compliance Interview form, whether he had disclosed all outside business activities. His misconduct caused substantial injury to his customers. His misconduct in failing to notify Walnut Street of his affiliation with Mobile Cash Systems was at least reckless, if not intentional. In that regard, Meckler's use of another broker/dealer to facilitate these transactions, while failing to disclose them to Walnut Street, is particularly troubling. And he enjoyed substantial gain from his misconduct in the form of 13% commissions. See Sanction Guidelines, pp. 9-10.

Both Enforcement and Meckler pointed to the fact that he sold the investment to only two customers. In addition, both HA's son (HA having passed away), and PS and ES provided letters of support to Meckler. The letters, however, are more troubling than mitigating. The letter from HA's son indicates that he believes that Meckler's "personal integrity and honesty is above reproach. I believe that Martin Meckler researched this investment and did not cause this unfortunate occurrence." PS and ES likewise expressed their "confidence in the programs [Meckler] presents to us for our income investments to best fit our interests." (CX 11, pp. 4-5.) In fact, however, Meckler did no research on this investment. He merely accepted whatever __________ told him, and what he read in promotional brochures. He had no reasonable basis for evaluating whether this investment was viable or would achieve the investors' goals. (Tr. 77-78.) Although the customers trusted him, he did little to justify that trust.

Other factors offered by Meckler as "mitigating" reflect simply the absence of additional aggravating facts, rather than true mitigation. These include the facts that Meckler did not sell the investments to even more customers; that he had no proprietary interest in Mobile Cash Systems; and that he has no prior disciplinary history. The Hearing Panel also rejects Meckler's argument that he should be given some sort of sanctions credit because California did not approve his registration promptly after he left Walnut Street in August 2001 and became associated with Day International Securities. According to Meckler, "At first they said yes, then they relinquished [sic] because the NASD was still in the investigation. Then they said, 'Okay, you can go with this other broker-dealer, but we want the broker-dealer to scrutinize your business to make sure you are not doing anything and just watching you very closely, what you are doing.'" (Tr.

91.) Thus, California's delay in approving Meckler's registration was based on its need to assure itself that the investing public was adequately protected. It was not a disciplinary sanction for which Meckler might have been given some credit under the Guidelines.[7] See Department of Enforcement v. Greer, No. C05990035, 2001 NASD Discip. LEXIS 34, at *12 (NAC Aug. 6, 2001).

To achieve NASD's remedial goals and to impress upon Meckler the significance of his violation, the Hearing Panel concludes that sanctions significantly greater than those recommended by Enforcement are required. First, Meckler's actions show that he is not qualified to serve as a principal, supervising others. He will therefore be barred from associating with any NASD member in any principal capacity. Second, he will be suspended in all other capacities for six months. In addition, the Hearing Panel believes a base fine of $10,000, rather than the $5,000 suggested by Enforcement, is needed to emphasize the seriousness of the violation in this case.

With regard to the $17,550 in commissions earned by Meckler from these transactions, the Hearing Panel has sought guidance from two recent National Adjudicatory Council decisions. In Department of Enforcement v. Luther A. Hanson, No. C9A000027, 2001 NASD Discip. LEXIS 41, at *1 (Dec. 13, 2001), NAC "order[ed] that Hanson be fined $79,105.62, [for private securities transaction violations] to be reduced by any amounts paid in disgorgement of commissions to identified customers within six months of the date of this decision." Shortly thereafter, however, in Department of Enforcement v. Roger A. Hanson, No. C8A000059, 2002 NASD Discip. LEXIS 5, at *4-5 (March 28, 2002), NAC overturned a Hearing Panel sanction requiring

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[7] Meckler testified that while his registration was pending, he continued to conduct his insurance and mortgage broker business. (Tr. 94.)

that the respondent "'disgorge' his total commissions and pay them, on a pro rata basis, to the customers," explaining that "adjudicators should start with the approach of the Guidelines, which instruct that a respondent should pay a fine to the NASD that includes a respondent's commissions or other financial benefits."

Based on these two decisions, the Hearing Panel concludes that it is appropriate to increase Meckler's fine by the amount of his commissions, but to allow him to claim any commissions that he pays to the injured customers, within a relatively brief period, as a credit against that element of the fine.

V. CONCLUSION

The Hearing Panel finds that respondent Meckler violated NASD Rules 3030 and 2110 by failing to give Walnut Street prompt written notification of outside business activities. The charge that he violated Rule 3040 by participating in private securities transactions without providing proper notice is dismissed.

As sanctions, Meckler is barred from associating with any member firm in any principal capacity, suspended from associating with any member firm in any other capacity for six months, and fined $27,550. Meckler shall receive a credit of not more than $17,550 toward payment of the fine for any amounts that he pays to customer HA's son or to customers PS and ES within 60 days after the issuance of this decision.[8] In addition, Meckler is ordered to pay costs in the amount of $1,403.98, which includes an administrative fee of $750 and hearing transcript costs of $653.98.

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[8] These individuals are fully identified in the record. To obtain credit, Meckler must provide proof of the payments to the District 1 staff within the 60 day period. See Luther A. Hanson, at *23.

These sanctions shall become effective on a date set by NASD, but not sooner than 30 days after this decision becomes the final disciplinary action of NASD, except that if this decision becomes NASD's final disciplinary action, the bar shall be effective immediately and Meckler's suspension shall become effective with the opening of business on Monday, November 18, 2002, and end on May 17, 2003.[9]

HEARING PANEL

____
By: David M. FitzGerald
Hearing Officer

Copies to:

David A. Watson, Esq. (electronically and via first class mail)
Rory C. Flynn, Esq. (electronically and via first class mail)
Martin Herbert Meckler (via overnight delivery and first class mail)
R. King Prothro, Esq. (via facsimile and first class mail)

[9] 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.