NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,	
Complainant,	Disciplinary Proceeding No. C06010025
v.	Hearing Officer – JN
ARLIE R. HORN, JR. (CRD #1471308)	**HEARING PANEL DECISION**
Woodlands, TX,	
LINDSAY A. BYRUM (CRD #1263551)	September 13, 2002
Houston, TX,	
Respondents.	

Respondents engaged in private securities transactions in violation of NASD Conduct Rules 3040 and 2110. Respondents fined $10,000, suspended in any and all capacities for six months, and ordered to re-qualify by examination in all capacities.

Appearances

For the Complainant: George C. McGuigan, Jr., Esq., Mark P. Dauer, Esq.

For the Respondent Arlie R. Horn, Jr.: Ruth B. Downes, Esq., Jacks C. Nickens, Esq.

For the Respondent Lindsay A. Byrum: Lindsay A. Byrum, pro se.

Decision

I. Introduction

On September 21, 2001, the Department of Enforcement filed a Complaint against Respondents Arlie R. Horn, Jr. and Lindsay A. Byrum, alleging that they engaged in private securities transactions, in violation of NASD Conduct Rules 3040 and 2110.[1] The Complaint charged that the Respondents sold interests in a "European Leveraged Asset Trading Program" ("Program") without first giving notice to their respective member firms. Because the Respondents expected to receive selling compensation, the Complaint also alleged they did not secure the approval of their respective member firms prior to engaging in these transactions, as required by Rule 3040(c).

A Hearing Panel composed of an NASD Hearing Officer and two members of NASD District Committee No. 6 conducted a hearing on May 2 and 3, 2002, in Houston, Texas. The Respondents admitted the factual allegations in the Complaint (Tr. 31-32, 305-306; Enforcement Br., pp. 1-2; Resp't Horn Br., p. 1). The sole issue on the merits was whether the Program was an investment contract, and, therefore, a security, under SEC v. W. J. Howey Co. et al., 328 U.S. 293 (1946). If so, the remaining issue was to determine the appropriate level of sanctions for the misconduct.

Enforcement and Respondent Horn filed Post-Hearing Briefs on June 17, 2002 and June 28, 2002, respectively. Respondent Byrum declined to make a post-hearing submission.

II. Background

Respondents entered the "financial services" industry in 1986, when they went to work for A. O. Williams, a firm, which, according to Horn, sold term insurance and offered mutual fund investments (Tr. 127). There they met Mr. Randall Garrett, who remained a close friend of Respondent Byrum after Respondent left that firm. Beginning

[1] The Complaint also alleged, in the alternative, that Respondents engaged in outside business activities, in violation of NASD Conduct Rules 3030 and 2110. Given the Hearing Panel's conclusion infra, that Respondents engaged in private securities transactions, there is no need to address that alternative allegation.

in 1996, Horn and Byrum were registered with Intersecurities, Inc. and United Securities Alliance, Inc., respectively, as Investment Company Variable Contacts Products Representatives.

In late 1995, Garrett informed Respondent Byrum about the Program and persuaded him to invest $100,000 in it (Tr. 307, 310-311; JX-16). Byrum then mentioned the Program to Horn (who also knew Garrett) (Tr. 131-132). The Respondents discussed the investment with Garrett, who persuaded Horn to invest $25,000 in the Program (Tr. 132-136, 152-153; JX-4).

According to Garrett, the Program was an investment, which after three to four months, would yield 20% per month (Tr. 134). The monies collected from numerous investors would be aggregated and used to borrow larger sums that would then be used to buy existing notes at deep discounts through European banks (Tr. 137-139; JX-2, p. 8). The notes would then be sold at large profits (JX-2, p. 8). The money was also supposedly guaranteed by a surety bond, held by Garrett (Tr. 134).

Byrum was to receive 10% of the profits earned by every investor he found. He encouraged Horn to solicit investors for the Program, and the two men agreed to divide Byrum's 10% between themselves (Tr. 161-162).

From October 1996 through February 1997, while registered with Intersecurities, Horn sold the Program to seven individuals, four of whom were customers of the firm (Compl., ¶ 1; Answer of Resp't Horn, ¶ 1; Tr. 165; JX-2, p. 9). Their investments totaled $345,000 (JX-2, p. 9). The investor received a "Project Funding/Joint Venture Agreement" signed by the customer and Horn, and a letter agreement, signed by the customer, spelling out the promised return, and other terms (JX-5).

Horn did not provide his firm with any notice of this activity (Tr. 186; JX-2, p. 2). Intersecurities became aware of the transactions when one of the customers filed an arbitration claim against the firm seeking the return of her investment (Tr. 51-52, 70-72, 116-117).[2]

Though Byrum did not make the sales in issue here, he nonetheless played an active role in them. As noted, he originally brought the Program to Horn's attention and urged him to solicit investors. Thereafter, he provided Horn with all the necessary contracts and paperwork (Tr. 245-246). Byrum was also the conduit for the Program customers' funds. Horn would turn their money over to Byrum, who would then transmit it to Garrett (Tr. 159-160, 240, 308).

Byrum, a registered representative of United Securities during the first four of Horn's seven sales, failed to provide his firm with any notice of those four transactions (Tr. 317-319).

Meanwhile, the seven customers did not receive any return on their investments, let alone the promised 20% per month, and all lost their original investments (Tr. 189-190). Horn lost his $25,000 and Byrum lost $80,000 of his $100,000 investment (Tr. 310-311). Garrett and others were indicted in federal court for their activities involving the Program; they were found guilty, and sentenced to jail (Tr. 143; JX-16, p. 3; JX-18). Federal criminal authorities enabled the customers to recover 15% to 20% of their investments (Tr. 189).

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[2] Intersecurities paid the customer $50,000 in settlement of that arbitration claim (Tr. 71-73, 113).

III. Discussion

A. The Leveraged Asset Program Was a Security

Under Section 2(1) of the Securities Act of 1933, the term "security" includes an "investment contract." In SEC v. W. J. Howey et al., 328 U.S. 293 (1946), the Supreme Court explained that "an investment contract for purposes of the Securities Act means 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" (Id. at 298-99).

In the instant case, the parties agreed that the Program was a contract, under which persons expected profits solely from the efforts of a third party (Enforcement Br., p. 2; Resp't Horn Br., p. 1). The only issue as to liability is whether the Program involved a "common enterprise."

1. Horizontal Commonality

"Horizontal" commonality involves the participation of more than one investor, and a "pooling" of investor funds, where all investors are tied to the overall venture. See, e.g., Revak v. SEC Realty Corp., 18 F.3d 81, 87 (2d Cir. 1994); Wals v. Fox Hills Development Corp., 24 F.3d 1016, 1018 (7th Cir. 1994); Commonwealth Bank & Trust Co. v. Spectrum Leasing Corp., 719 F. Supp. 346, 349 (M.D. Penn. 1989). The instant Program meets that definition. As the Respondents told customers, the Program involved the aggregation of funds from many investors, which money would be used to purchase deeply discounted bank notes overseas (Tr. 74-75, 265-266, 420). Customers CM, TJ, and SL explained that they were aware other people were participating in the Program, and that their money would be pooled with others (Tr. 74-75, 265-266, 420). Respondent Horn himself (who invested $25,000) understood that his money would be aggregated with other customers' funds and the sum used to purchase the notes (Tr. 137-138). The record thus establishes that the Program involved the pooling of investor funds to be managed by third parties – i.e., horizontal commonality.

Horn quotes language from SEC v. Life Partners, Inc., et al., 87 F.3d 536, 544 (D.C. Cir. 1996) (dictum), concerning the need for a "threshold percentage" of investors for purposes of commonality (Resp't Horn Br., pp. 3-4). The absence of such a threshold here is not fatal to Howey's commonality requirement. Life Partners involved purchases of fractional interests in underlying life insurance policies. The instant case, by contrast, does not involve investments in portions of a specified whole and presents no predicate for any "threshold percentage" of ownership. Moreover, wholly apart from any "threshold," Life Partners went on to find the presence of horizontal commonality, highlighting the pooling of investors' money, the combining of those monies by the promoter, and the investors' sharing in profits and losses (Id. at 544) – the very factors present here.

2. Vertical Commonality

Respondent Horn suggests that the Program fails to meet the "vertical" commonality requirement, employed by some courts (Resp't Horn Br., pp. 2-3). This contention lacks merit.

First, such a standard may have no significance for this proceeding. The SEC and the National Adjudicatory Council (NAC) have held that where, as here, horizontal commonality is present, the common enterprise element of an "investment contract" has been proved. See, e.g., Ronald Gibbs, 1995 SEC LEXIS 1824, at *12 (July 20, 1995) ("Howey's second prong, a common enterprise, is satisfied by showing horizontal commonality, that is, investors' funds are pooled and their fortunes are interrelated."); Dist. Bus. Conduct Comm. v. Kevin Kunz, et al., 1999 NASD Discip. LEXIS 20 (July 7, 1999); Dist. Bus. Conduct Comm. v. Bruce McNabb, 1999 NASD Discip. LEXIS 13, at *36 (Mar. 31, 1999). A finding of horizontal commonality may thus be sufficient to establish the "common enterprise" element, without any need to explore "vertical" commonality.

In any event, there are two tests for vertical commonality ("strict" and "broad"), and each is satisfied here. Under "strict" vertical commonality, the fortunes of the investor and the promoter are tied; they rise or fall together. See, e.g., Brodt v. Bache & Co., 595 F.2d 459, 461 (9th Cir. 1978). Under "broad" vertical commonality, the investors are dependent solely on the promoter's expertise, irrespective of whether their fortunes are completely interdependent. See, e.g., SEC v. Koscot Interplanetary, Inc., 497 F.2d 473, 478-79 (5th Cir. 1974); SEC v. Continental Commodities Corp., 497 F.2d 516, 522 (5th Cir. 1974); Long v. Shultz Cattle Co., 881 F.2d 129, 140-141 (5th Cir. 1989).

Strict vertical commonality exists here. The Program's investors were completely dependent on the traders' ability to execute trades in the discounted notes (Tr. 138-139). Horn and Byrum were to receive a share of the investors' profits (Tr. 161-162). If there were no profits, the investors and the Respondents would receive nothing. If there were profits, the investors and the Respondents would benefit. This tying of the profits between investor and promoter demonstrates strict vertical commonality.

Broad vertical commonality (dependence upon promoter expertise) also existed here. The money went from the customer to Horn to Byrum to Garrett to "traders" (Tr. 138, 159-160). The customers looked to Garrett and to those traders as the persons who would manage their money (Tr. 81, 138, 271, 421). They testified that all they had to do was give their money to Horn, who started it up the chain (Tr. 75, 156, 265-266). No one would ask for an individual investor's advice or input (Tr. 237, 266, 420). As Horn himself recognized, what happened to the money after it left his hands was completely up to Garrett and the traders, with no involvement by individual investors (Tr. 237). The customers were dependent upon the Respondents, who, in turn, were dependent upon Garrett (JX-2, p. 3). In short, every investor (including Horn and Byrum themselves) was wholly dependent on a promoter's expertise.

B. Respondents Participated In Private Securities Transactions

Conduct Rule 3040 provides that no person associated with a member shall participate in a private securities transaction without first providing written notice to the member. Additionally, if the associated person has, or may receive, "selling compensation" (any compensation, either direct or indirect, paid in connection with the sale of securities, including commissions, or rights to participate in profits), the member must approve the advance written notice prior to each transaction (Rules 3040(c) and 3040(e)(2)).

As noted, from October 1996 through February 1997, Respondents persuaded seven individuals to invest a total of $345,000 in the Program (Tr. 165; JX-2, p. 9).[3]

[3] The last three of the seven transactions occurred after Byrum was terminated from employment with his firm and while he was unaffiliated with any member firm. As Enforcement noted (Enforcement Br., p. 3 n. 3), Rule 3040 was inapplicable to him as to those three sales. These three customers were MH ($50,000); DE/MH ($50,000); and SR ($50,000) (JX-6).

They expected to receive selling compensation in the form of 10% of the investors' profits (Tr. 161-162). At no point did Horn or Byrum notify their member firms of such transactions, and at no point did their member firms provide them with approval to engage in such sales (Tr. 102, 186, 319). Respondents thus participated in private securities transactions, in violation of Rule 3040. Such misconduct also constitutes a violation of Rule 2110's ethical mandate. See Stephen J. Gluckman, Exchange Act Rel. No. 41628, 1999 SEC LEXIS 1395, at *22 (July 20, 1999).

IV. Sanctions

A. Enforcement's Theory of Egregiousness: the "prime bank instrument" contention

For "selling away," the NASD Sanction Guidelines recommend a fine of $5,000 to $50,000, along with a suspension in any and all capacities for ten business days to one year (NASD Sanction Guidelines, p. 19 (2001 ed.)). In egregious cases, the suspension period may be increased up to two years, or may become a bar (Id.).

The parties differ as to an appropriate suspension. Enforcement sees this case as egregious and requests that Respondents be suspended for eighteen months (Enforcement Br., p. 11). Respondent Horn argues for a six-month suspension, if liable (Resp't Horn Br., p. 4). Respondent Byrum did not present his view of an appropriate sanction.

Enforcement's case for egregiousness rests almost entirely on the contention – presented for the first time in its post-hearing brief – that investments in the Program resembled "Prime Bank Instruments," fraudulent devices prosecuted aggressively by the SEC and other government agencies (Enforcement Br., pp. 12-17, 20). Indeed, the Department's "Conclusion" as to sanctions begins by arguing that "Prime bank instrument schemes have plagued investors for more than 10 years now" (Enforcement Br., p. 20).

Sanctions must be imposed "fairly" (Guidelines, p. 1), and the Panel believes it unfair to impose lengthy suspensions on a ground never addressed during the hearing.

This is especially so here. The Complaint did not allege fraud and did not mention "Prime Bank Instruments." Respondents had no way of anticipating or preparing for the contention that their conduct was egregious because the Program supposedly looked like the Prime Bank Instruments. Moreover, the extent to which the Program did or did not resemble those fraudulent Instruments was a fact-driven question which could have and should have been litigated during the hearing. If Respondents' sales are to be treated as "egregious" for sanctions purposes, that characteristic must be based on the hearing record, which, in this case, is silent concerning the Prime Bank Instrument/fraud theory. For these reasons, the Panel gives no weight to the claim that the Program resembles fraudulent Prime Bank Instruments.

B. The Principal Considerations for Sanctions in Selling Away Cases

The Guidelines list five "principal considerations" applicable to sanctions in selling away cases: (1) whether the respondents had a proprietary or beneficial interest in the selling enterprise or issuer; (2) whether the respondents attempted to create the impression that their employer sanctioned the activity; (3) whether the respondents sold away to customers of the member firm; (4) whether the respondents provided the member firm with verbal notice; and (5) whether the respondents sold the securities after a prior rejection or warning by the member firm (Guidelines, p. 19). On this record, the Panel concludes that two of the five factors do apply to Respondents' misconduct, two others do not, and one is inapplicable.

1. Respondents Did Not Have a Proprietary or Beneficial Interest in the Issuer

Enforcement argues that the Respondents had a proprietary interest in the Program because they were to receive a share of the investors' profits (Enforcement Br., p. 19). The Hearing Panel disagrees.[4] The Respondents' arrangement is far from the ownership or management roles found to constitute proprietary interests for selling away sanctions purposes. See, e.g., Dep't of Enforcement v. George M. Goritz, No. C10000037, 2002 NASD Discip. LEXIS 7, at *2, 9-10 (NAC Apr. 26, 2002) (respondent was one of three co-owners and operators); Dep't of Enforcement v. Jim Newcomb, No. C3A990050, 2000 NASD Discip. LEXIS 15, at *2 (NAC Nov. 16, 2000), aff'd, Exchange Act Release No. 44945, 2001 SEC LEXIS 2172 (Oct. 18, 2001) (Respondent and his wife owned and controlled the issuer); Dep't of Enforcement v. Ansula Pet Hwa Liu, No. C04970050, 1999 NASD Discip. LEXIS 32, at *22 (NAC Nov. 4, 1999) (Respondent served as CEO of the issuer). Horn and Byrum, by contrast, owned no part of the selling enterprise, did not control it, held no office in it, and had no power to make decisions for it.

Horn described the share-the-profit arrangement as a form of "override" or "compensation" for his solicitation efforts (Tr. 288, 298). Such selling compensation is more like a commission, the presence of which does not create a proprietary interest for sanctions purposes. See, e.g., Dep't of Enforcement v. Roger A. Hanson, No.

[4] During the hearing, the Panel expressed a tentative and preliminary view that the arrangement did constitute the requisite interest (Tr. 353). On review of the record and after considering the briefs and examining the cases, the Panel concludes to the contrary.

C8A000059, 2002 NASD Discip. LEXIS 5, at *2, 12-13 (NAC Mar. 28, 2002) (Respondent received commissions, but did not have a proprietary or beneficial interest); Dep't of Enforcement v. Timothy James Fergus et al., No. C8A990025, 2001 NASD Discip. LEXIS 3, at *5 (NAC May 17, 2001) (Respondents received selling compensation for soliciting customers, but did not have a proprietary interest in the issuer).

If selling compensation were enough to constitute proprietary interest in the issuer, this consideration would apply in virtually all selling away cases. Such a construction could justify more serious sanctions in every proceeding, rendering case-by-case application of the Guidelines difficult. The Panel declines to adopt this rigid construction of the Guideline's language.

It is true that some of the contracts between Respondents and the investors referred to Horn or Byrum as "managing partners" (JX-5). But that label had no basis in reality. In fact, neither Respondent "managed" anything. When asked about being a "managing director," Horn testified that he never managed any money and never told any investors that he was managing their funds (Tr. 155). His role was to turn the customer's funds over to Byrum, who then turned them over to Garrett. Horn and Byrum were merely conduits for the investors' money (Tr. 75, 155, 156, 266). They had no part in determining how the money was used or traded; they neither had nor exercised any control over the money (Tr. 75, 156, 237, 266, 420). Indeed, they themselves ended up as victims (Tr. 189-190, 310-311). The Hearing Panel finds that Respondents, notwithstanding the "managing" label on the documents, had no proprietary or beneficial interest in the Program.

2. Respondents Did Not Create the Impression that the Firms Were Authorizing the Activity

There was no evidence that Respondents created the impression that their respective firms somehow approved of investments in the Program (Tr. 165-166, 263, 408, 423). Each Respondent denied any such activity, and customers testified that they had no such impressions (Tr. 165-166, 263, 267-268, 316, 408, 423). Despite seeking such information in Rule 8210 requests, Enforcement introduced no evidence on the point, and its post-hearing brief was silent on this consideration (JX-1, JX-16, JX-17). The Panel finds that Respondent did not create, or even attempt to create, the impression that their firms were behind the sales.

3. Some of Respondent Horn's Customers Were Also Customers of the Member Firm

The Hearing Panel finds that four of Respondent Horn's seven Program customers were also customers of his member firm (Tr. 165).

4. Respondents Did Not Provide Verbal Notice to Their Firms

Each Respondent admitted that he did not provide his member firm with any sort of notice of the Program sales (Tr. 102, 186, 319).

5. Respondents Did Not Sell After Prior Warnings

Respondents' firms issued no prior rejections or warnings as to the transactions in issue. But that was because Respondents' conduct prevented the firm from knowing about the sales. That the sales were made in the absence of prior warnings thus has no significance one way or the other in this case.

C. Other Circumstances

Respondents engaged in the sale of securities to seven customers over a five-month period of time, in an amount totaling $345,000 (Tr. 165; JX-2, p. 9). There were several characteristics of the Program that should have served as red flags: (1) the promise of a rate of return of 20% per month (Tr. 134); (2) the guarantee of the investor's principal in the form of a surety bond (Id.); (3) the element of secrecy associated with the solicitation of investors (Tr. 135-136); and (4) the unwillingness of the promoters to explain how the Program worked (Id.).

Respondents' misconduct resulted in harm to the customers (Guidelines, p. 10), each of whom lost significant sums. Though one customer recovered through an arbitration claim, the other six received only 15 to 20 cents per dollar through the efforts of the federal criminal authorities (Tr. 71-73, 113, 189).

Both men disregarded their own firm's safeguards. The questionnaire for Horn's firm asked representatives to disclose whether they had sold any unapproved securities product or any "non-securities" investment products (JX-2, pp. 34-35). Horn falsely answered in the negative, thereby preventing Intersecurities from discovering his activity in the Program sooner (Tr. 187-188; JX-2, pp. 34-35). Byrum admitted that he violated his firm's prohibition on accepting checks made payable to a "d/b/a" (doing business as) (Tr. 322-324). In fact, he set up "The Byrum Agencies," as a d/b/a and accepted the investors' checks payable to that entity, activity which he knew was contrary to his firm's policies (Tr. 323-325).

Respondents acknowledged their wrongdoing and accepted full responsibility for it (Tr. 278-282, 305-306; Horn Br., p. 11). Each responded cooperatively to the various staff inquiries, and the Complaint contains no allegations of Rule 8210 violations (JX-1 – JX-2; JX-16 – JX-18; Guidelines, p. 10). Nor did it allege fraud. In the Panel's view, Respondents did not intentionally cheat the investors; rather, each naively convinced himself that the Program would produce financial success for all involved. Indeed, Respondents were victims themselves, losing substantial sums of money to the Program (Tr. 189-190, 310-311).

The Panel rejects Horn's argument that his conversations with others produced a mitigating good faith belief that the Program was not a security (Resp't Horn Br., p. 12; Tr. 142-150). A person affiliated with a similar investment (one of his conferees) certainly would not be an objective source. An accountant (who later invested in the Program) with no special expertise in determining what is a "security" also should not be treated as a significant influence (Tr. 250-252, 292). Although "reasonable reliance on competent legal or accounting advice" may be mitigating (Guidelines, p. 9), the Panel concludes that Horn's conversations with two attorneys did not constitute such reliance. One lawyer was connected to another similar investment (Tr. 144, 149-150). Just as consulting an issuer's counsel does not constitute reasonable reliance, conversations with counsel for a similar issuer should not create any different result. (See Hanson, 2002 NASD Discip. LEXIS 5, at *9-10). The second attorney, Horn's partner in teaching retirement planning, was not a securities lawyer but "more of an estate planning attorney," who offered no legal theory or reason for concluding that the Program did not involve securities (Tr. 252, 292-293).

D. Sanctions Previously Approved by the National Adjudicatory Council (NAC)

The Panel recognizes that the appropriateness of sanctions depends upon the facts of each case and "cannot be determined precisely by broad comparison with actions taken in other proceedings" Dep't of Enforcement v. Roger Hanson, 2002 NASD Discip. LEXIS 5 at *12 (Mar. 28, 2002). The Panel notes, however, that Enforcement's argument for "[l]ong suspensions and even bars" (Enforcement Br., pp. 19-20) relies on cases, which, as in Hanson, are "significantly different" from ours. Hanson, 2002 NASD Discip. LEXIS at *12.

Department of Enforcement v. Jim Newcomb, 2000 NASD Discip. LEXIS 15 (Nov. 16, 2000), aff'd, Exchange Act Rel. No. 44945, 2001 SEC LEXIS 2172 (Oct. 18, 2001), involved a two-year suspension for selling away to forty-seven customers, including many from the Respondent's firm, who invested over one million dollars over an eighteen-month period in an enterprise owned by the Respondent.

Although Department of Enforcement v. Ansula Pet Hwa Liu, 1999 NASD Discip. LEXIS 32 (Nov. 4, 1999) sustained a bar for selling away to four customers who lost a total of $50,000, its circumstances were far more aggravated than those presented here. Ms. Liu, the CEO of the issuer, "never accepted responsibility for or acknowledged her misconduct," which went on over a two-year period (Id. at *23). Moreover, she "delayed and frustrated the investigation, by providing evasive, incomplete, and nonresponsive answers to the first request for information and then by failing to respond at all to the second and third requests" (Id. at *23-24). Finally, she engaged in the selling away "notwithstanding prior warnings" from her firm (Id. at *24).

In the panel's view, a six-month suspension, as opposed to Enforcement's proposed eighteen months, is more nearly harmonious with recent NAC decisions in a variety of selling away cases. See Dep't of Enforcement v. George M. Goritz, 2002 NASD Discip. LEXIS 7 (Apr. 26, 2002) (six months where respondent sold away to six customers, totaling $425,000, had a proprietary interest in issuer, but no customers were of the member firm, and no investors were harmed); Dep't of Enforcement v. Roger A. Hanson, 2002 NASD Discip. LEXIS 5 (Mar. 28, 2002) (six months for selling away to fifteen customers for $220,000, but where respondent showed remorse and the panel believed he would not have sold away if he knew the instruments were securities); Dep't of Enforcement v. Stephen D. Carcaterra, No. C10000165, 2001 NASD Discip. LEXIS 39 (Dec. 13, 2001) (thirty days for selling away to one customer of member firm); Dep't of Enforcement v. Luther A. Hanson, No. C9A000027, 2001 NASD Discip. LEXIS 41 (Dec. 13, 2001) (six months where respondent sold away to thirty-three customers of the member firm, for $2.6 million, but panel impressed by respondent's contrition and his pursuing legal action against issuer on behalf of his customers); Dep't of Enforcement v. Timothy James Fergus, et. al., 2001 NASD Discip. LEXIS 3 (May 17, 2001) (three respondents suspended for 60, 90, and 180 days for violations respectively involving three customers and $132,950.15; five customers and $898,479; and twenty customers who invested $1.7 million).

E. The Panel's Sanctions Choices

As the SEC has explained, "Rule 3040 protects investors from the hazards of unmonitored sales, while protecting the member firm from exposure to loss and litigation." Stephen J. Gluckman, Exchange Act Release No. 41628, 1999 SEC LEXIS

1395, at *38-39 (July 20, 1999). Respondents' violation resulted in precisely what Rule 3040 was designed to prevent – investors lost their money and a member firm settled an arbitration initiated by one of them. This risky "investment" might well have been prevented if the member firms had advance notice, as the Rule requires, that Horn and Byrum were intending to solicit purchasers for shares in the Program.

Respondents' violations of Rule 3040 were, therefore, serious and require significant sanctions. At the same time, the Panel believes that the mix of circumstances in this case warrants some modification from the high end of the scale. On balance, the Panel concludes that each Respondent should be fined $10,000 (a sum upon which Enforcement and Horn agree) and suspended in all capacities for six months.[5] Finally, as in Hanson and Fergus, in order to emphasize the importance of adhering to all applicable requirements, the Panel also directs that Horn and Byrum be required to re-qualify by examination in all capacities prior to associating with a member firm. See Hanson, 2002 NASD Discip. LEXIS 5; Fergus, 2001 NASD Discip. LEXIS 3.

V. Conclusion

It is hereby ordered, pursuant to Article VI, Section 3 of the NASD By-Laws and Rule 9514(g), that Respondents Horn and Byrum are each fined $10,000, and shall be suspended in any and all capacities for six months for engaging in private securities transactions in violation of Rule 3040 and Rule 2110. In addition, each Respondent is ordered to re-qualify by examination in all capacities before associating with a member firm. Respondents also shall be jointly and severally responsible for $3,395.10 in costs, reflecting $2,645.10 for hearing transcripts and the standard $750 administrative fee.

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[5] Enforcement does not request restitution. Nor does the record identify the net losses with sufficient precision to warrant that remedy.

These sanctions shall become effective on a date set by NASD, but not earlier than thirty days after this Decision becomes the final disciplinary action of NASD, except that if this Decision becomes the final disciplinary action of NASD, the suspensions shall become effective with the opening of business on Monday, November 4, 2002, and end on Sunday, May 4, 2003.

SO ORDERED.

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Jerome Nelson
Hearing Officer

Dated: Washington, DC
September 13, 2002

Copies to: Lindsay A. Byrum (via overnight delivery and first class mail)
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