

This Decision has been published by the NASDR Office of Hearing Officers and should be cited as OHO Redacted Decision C3A000007.

**NASD REGULATION, INC.
OFFICE OF HEARING OFFICERS**

DEPARTMENT OF ENFORCEMENT,	:	
	:	
Complainant,	:	Disciplinary Proceeding
	:	No. C3A000007
v.	:	
	:	Hearing Panel Decision
	:	
	:	Hearing Officer - GAC
	:	
	:	
	:	
	:	
	:	
	:	July 3, 2001
Respondents.	:	

Registered Representatives were each charged with violating NASD Conduct Rule 2110 and NASD Procedural Rule 8210 for providing untruthful information during on-the-record interviews in connection with an NASD Regulation, Inc. investigation. Respondents were also charged with providing written statements containing false information, in violation of NASD Conduct Rule 2110. The Hearing Panel found at the conclusion of Complainant's case-in-chief that Enforcement failed to establish the charges by a preponderance of the evidence. The Hearing Panel therefore granted Respondents' motion for summary disposition, dismissing the Complaint.

Appearances

Jacqueline D. Whelan, Esq., (Rory C. Flynn, Esq., Of Counsel) for the Department of Enforcement.

_____, Esq., for _____.

_____, Esq., for _____.

DECISION

I. Procedural Background

A. Complaint

On March 1, 2000, Enforcement filed a Complaint alleging that each Respondent had violated NASD Conduct Rule 2110 and NASD Procedural Rule 8210 by providing untruthful information to the NASD Regulation, Inc. (“NASDR”) staff during on-the-record interviews. The Complaint also alleged that Respondents violated NASD Conduct Rule 2110 by providing written statements to the NASDR staff that contained false information.

In 1999, both Respondents were registered at _____, Inc. (“_____”). _____ (“_____”), another individual registered at the firm, who was supervised by _____, had his registration deemed inactive on February 9, 1999, for failing to take the Regulatory Element of the continuing education requirements (“Regulatory Element”). The Complaint alleged that Respondents provided “untruthful” and “false” information regarding their dealings with _____ and his customer accounts.

Specifically, the first cause of the Complaint alleged that on August 10, 1999, while participating in on-the-record interviews conducted pursuant to NASD Rule 8210,

[s]ome of [the] information [stated by Respondents] was untruthful, in that:

- [4]a. A. _____ testified that, on or about February 9, 1999, he advised [_____] of his inactive status and instructed him to leave the offices of [_____] , when in fact no such advice or instruction had been given to [_____];
- [4]b. A. _____ testified that [_____] was not present in the offices of [_____] and was not functioning as a registered representative of [_____] during the relevant period, [defined in the Complaint as “from

approximately February 9, 1999 until approximately April 30, 1999],”¹ when in fact [_____] was present in the offices of [_____] and was functioning as a registered representative of [_____] during that period;

[4]c. A. _____ testified that he assigned _____ to function as the registered representative for [_____]’s accounts during the relevant period, when in fact no such assignment was made;

[4]d. _____ testified that he contacted [_____]’s customers at or about the beginning of the relevant period to advise them that he would be handling their accounts during [_____]’s absence, when in fact no such calls were made; and

[4]e. _____ testified that he effected transactions in the accounts of [_____]’s customers during the relevant period, when in fact such transactions were not effected by him.

The Complaint alleged in the second cause that:

_____ and _____ provided written statements to an NASD staff examiner ...[that were] materially untruthful, in that:

[7]a. _____ stated that, on or about February 9, 1999, he had requested that [_____] leave the offices of [_____] and not return until he completed his regulatory element continuing education requirement, when in fact no such request was made;

[7]b. _____ stated that, on February 10, 1999, he informed _____ that _____ “would be appointed to service [_____]’s client base,” when in fact no such communication occurred; and

[7]c. _____ stated that _____ had informed him that [_____] was inactive and that _____ “would be appointed to service [_____]’s client base,” when in fact no such communication occurred.

The Complaint alleged that Respondents “knew or should have known that the written statements would be used by the staff in connection with [an] investigation,” and that “they knew that the information stated therein was materially false.”²

¹ Complaint, ¶ 7. Relevant period is defined in Complaint, ¶ 3.

² Complaint, ¶ 8.

B. Answer

Respondents stated that all the testimony they provided “was truthful to the best of their unrefreshed recollection at the time the testimony was provided.”³ Respondents further noted that “if their testimony was in any way inconsistent with a later determined fact, such inconsistency was the result of mistake, not intent.”⁴

As to the written statements, Respondents averred that they informed an NASDR staff member that they had “imperfect recollections and did not know what to write.”⁵ Respondents alleged that the NASDR staff told them what to write, and advised _____ that if he “wrote what [NASDR Compliance Specialist] ____ advised, everything would be fine.”⁶ Respondents claimed that they “told the truth to the best their unrefreshed recollections permitted.”⁷ Respondents also asserted eight affirmative defenses.

C. The Hearing

The Hearing was held in New York, New York on August 2-3, October 11, and December 4, 2000, before a Hearing Panel composed of the Hearing Officer and two current members of the District Committee for District No. 10. Enforcement presented seven witnesses: three customers of _____; _____, an NASDR Compliance Specialist; _____, a former NASDR examiner; and Respondents _____ and _____. The Hearing Officer admitted into evidence all 18 exhibits offered by Enforcement _____.

³ Answer, ¶ 4.

⁴ Answer, ¶ 5.

⁵ Answer, ¶ 7.

⁶ Id.

⁷ Answer, ¶ 8.

This Decision has been published by the NASDR Office of Hearing Officers and should be cited as OHO Redacted Decision C3A000007.

(CX 1-18),⁸ one exhibit offered by Respondent _____, and one exhibit offered by _____.⁹ The Hearing Panel also marked five Hearing Panel exhibits.

Upon completion of Complainant's case-in-chief at the Hearing, both Respondents made motions for directed verdicts. The Hearing Panel considered the motions under Rule 9264(b) as motions for summary disposition. After hearing argument from all Parties, the Hearing Panel deliberated and thereafter granted Respondents' motions, thereby dismissing the allegations in the Complaint.

II. Findings of Fact

A. Respondents' Backgrounds in the Securities Industry

_____ first became registered as a General Securities Representative with a member firm in March 1992.¹⁰ He was employed with two member firms in that capacity until becoming associated with _____ in May 1997.¹¹ _____ became a manager and supervisor of registered representatives at _____ later in 1997.¹² _____ is currently registered with _____ as a General Securities Principal and Representative.¹³

⁸ December Tr., pp. 31-103, 123.

⁹ December Tr., p. 29.

¹⁰ CX 1, p. 6.

¹¹ October Tr., p. 215.

¹² Id.

¹³ CX 1, p. 3.

This Decision has been published by the NASDR Office of Hearing Officers and should be cited as OHO Redacted Decision C3A000007.

_____ first became registered with a member firm as a General Securities Representative in October 1995.¹⁴ In December 1997, _____ became registered as a General Securities Representative with _____, where he remains registered.

B. NASDR's On-Site Examination of _____

NASDR conducted a routine examination of _____, beginning on April 19, 1999.¹⁵ As part of that examination, the NASDR examiners reviewed the firm's compliance with the Regulatory Element of the continuing education requirements under NASD Rule 1120(a).¹⁶ In preparation for the examination, the NASDR staff reviewed NASDR records and determined that there were six registered persons at _____ who had not completed the Regulatory Element, and were thus deemed inactive pursuant to NASD Rule 1120(a).¹⁷

The NASDR staff determined that one registered person, _____, had been deemed inactive by the NASD on February 9, 1999, and from that date to the start of the on-site examination, trades had been executed at the firm using _____'s account executive number. NASDR further determined that during the period _____ was deemed inactive, commission

¹⁴ CX 2, p. 4.

¹⁵ August 2 Tr., p. 140.

¹⁶ Rule 1120(a)(1) provides that a member firm shall not permit an individual to continue to perform duties as a registered person, unless that person has complied with the Rule's continuing education requirements. Rule 1120(a)(1)(A) requires that registered persons complete the Regulatory Element within certain prescribed time periods. Any registered person who fails to complete the Regulatory Element within the prescribed time frames has his or her registration deemed inactive until such time as the continuing education requirement is satisfied.

¹⁷ August 2 Tr., pp. 142-143. Upon arriving at the firm, the NASDR staff concluded, through a review of firm records, that four of the six registered persons had not conducted any securities business during the period in which they were deemed inactive. Id. For a fifth registered person, SK, the NASDR staff determined that he had conducted a securities business for a period of weeks and that the firm had simply forgotten to inform the individual of the need to take the examination for the Regulatory Element. Consequently, the firm arranged for SK to sit for the examination the next day. August Tr., p. 208.

This Decision has been published by the NASDR Office of Hearing Officers and should be cited as OHO Redacted Decision C3A000007.

checks had been issued payable to him.¹⁸ Although the firm had twice scheduled _____ to take the continuing education examination, he failed to sit for it.¹⁹

During the course of the on-site examination, _____ informed NASDR examiner _____ (“_____”) that _____ did not handle any trades, and that _____ was handling _____’s customer accounts during his inactive period.²⁰

Based on those oral representations, _____ instructed the firm to confirm its position in writing regarding _____’s activities.²¹ In May 1999, in response to the request from

_____, _____ prepared a written statement for himself, and a separate statement for _____. In preparing the statements, _____ testified

that he wrote them based on _____’s instructions. In so doing, he said that he relied on, and adopted the dates he was provided regarding _____’s inactive period.²² Each

Respondent signed his respective statement, which was provided to _____.²³

After receiving the written statements, the NASDR staff conducted an on-the-record interview with each Respondent in accordance with NASD Rule 8210. The written statements by _____ and _____, and statements made by Respondents during the on-the-record interviews, formed the basis of the charges in this case.

¹⁸ The Parties stipulated that _____ was paid by the firm during the period he was inactive. August 2 Tr., p. 146. CX 14.

¹⁹ August 2 Tr., pp. 143-144.

²⁰ October Tr., pp. 52-53.

²¹ August 2 Tr., p. 151.

²² October Tr., p. 231.

²³ October Tr., p. 230; December Tr., pp. 7, 16-17, 25. CX 16, pp. 1-2. The firm also provided _____ with a written statement signed by _____, that was consistent with the written statements signed by Respondents. CX 16, p. 3.

C. Findings as to the Specific Alleged Untruthful Statements

- (1) _____'s communications with _____ regarding his inactive status

The Complaint alleges at paragraph 4a, that Respondent _____ provided false testimony during the on-the-record interview when he stated that on or about February 9, 1999, he advised _____ of his inactive status and instructed him to leave _____. The Complaint alleges at paragraph 7a that the same false information was contained in his written statement provided to the NASDR staff.

_____’s testimony during the on-the-record interview was that, in February 1999, he learned from the firm’s Compliance Officer that _____ had failed to complete his continuing education requirement.²⁴ He stated that he thereafter informed _____ of his inactive status and of his need to leave the firm.²⁵

Other than _____’s single reference to having heard about _____’s continuing education status in February, the NASDR staff asked no other date-related questions about _____ during the interview until just prior to the conclusion. At that point, the NASDR staff read _____’s written statement into the record. A portion of the written statement included the language that _____ had such communications with _____ “on or about February 9, 1999.”²⁶ _____ then confirmed that the statement was true, to the best of his present recollection.²⁷

²⁴ CX 4, pp. 15-18.

²⁵ CX 4, p. 18.

²⁶ CX 16, p. 1.

²⁷ CX 4, p. 52.

At the Hearing, _____ stated he could not recall the date he learned that _____ was deemed inactive or when he instructed _____ to leave the firm. He speculated that he may have first learned about _____'s inactive status at the "end of February, March, somewhere in there. Could have been in the beginning, I don't know."²⁸

The Hearing Panel found that _____'s testimony regarding how he learned of _____'s status, as well as his subsequent conversation with _____ was reasonable and credible. The Hearing Panel also found his inability to recall the exact dates of such conversations to be reasonable, given the circumstances under which they occurred.

_____ had no reason to record the date that he spoke with _____. In 1999, the procedure at _____ was for an individual in the firm's Operations Department to remind registered representatives of their obligation to complete the Regulatory Element and to facilitate completion of the obligation by setting appointments to take the exam.²⁹ During the interview, _____ was unable to explain whether there was a "normal practice" for handling continuing education problems, explaining that "[it's] never happened before."³⁰

In an attempt to prove that _____ did not speak with _____ about his inactive status, Enforcement offered a transcript of an on-the-record interview of _____, but did not call _____ as a witness.³¹ The Hearing Panel was therefore unable to evaluate

²⁸ October Tr., p. 225. He subsequently testified that it could have been "[s]ometime in March." December Tr., p. 9.

²⁹ October Tr., pp. 28, 104, 222.

³⁰ CX 4, p. 17.

³¹ According to Enforcement, _____ is currently enlisted in the U.S. Armed Forces and was not available to participate.

This Decision has been published by the NASDR Office of Hearing Officers and should be cited as OHO Redacted Decision C3A000007.

_____’s credibility in person or consider his testimony when subject to cross-examination.

In that interview, _____ stated that when his second extension to take the examination expired on February 9, 1999, no one told him that he was deemed inactive, that he could not be in the offices, or that he could not accept orders from customers.³² According to _____, he continued to function normally at the firm.³³

The Hearing Panel found that _____’s testimony was replete with explicit statements of self-interest, asking the NASDR staff, “[w]hat’s in it for me,”³⁴ indicating that he was appearing only because he was trying to get back into the securities industry,³⁵ and asking for NASDR to provide a letter to his prospective employer as a result of his testimony.³⁶ The Hearing Panel also found that the NASDR staff’s manner of conducting the questioning during the interview left an unreliable record. This was even noted by _____ who at one point stated, “You guys are trying to put words in my mouth.”³⁷ The Hearing Panel therefore found that _____’s testimony was neither credible nor reliable and therefore determined not to give it weight in evaluating the evidence in the case.

Enforcement also offered the testimony of JH, a customer and relative of _____. JH testified that _____ executed approximately 40 transactions for him during the inactive period, including approximately 20 trades in a single security, Hauppauge. JH also testified that he contacted _____ by telephone at the firm during that period. A review of JH’s account

³² CX 3, pp. 14-16.

³³ Id.

³⁴ CX 6, p. 25.

³⁵ CX 6, p. 29.

³⁶ CX 6, p. 22. _____ asked that the letter indicate that his testimony should have no effect on whether he receives the job at the new employer.

This Decision has been published by the NASDR Office of Hearing Officers and should be cited as OHO Redacted Decision C3A000007.

statements for the relevant period, however, showed only six transactions during that period, none of which involved Hauppauge. The Hearing Panel therefore found that JH was mistaken as to the time period he recalled speaking to _____ by telephone in the office.

Due to the lack of credible evidence to the contrary, the Hearing Panel could not determine whether or not _____ informed _____ of his need to leave the firm at or about the time he learned of _____'s inactive status. The Hearing Panel, therefore, finds that there was insufficient evidence to show that _____ provided false information as alleged at paragraphs 4a and 7a of the Complaint.

(2) _____’s testimony that _____ was not in the office during his inactive period, and was not functioning as a registered representative

The Complaint alleges at paragraph 4b, that _____ testified that _____ was not in the offices of _____ and *was not functioning as a registered representative of _____* during the relevant period. The Hearing Panel found that Enforcement presented no credible evidence that _____ was working in the _____ offices during the inactive period. The Hearing Panel also found that _____ never testified in the on-the-record interview that _____ did not function as a registered representative during the relevant period. Although he testified that to the best of his knowledge _____ was not *in the office* while inactive, _____ acknowledged signing forms for _____’s commission checks during March and April and stated that he probably spoke to _____ by telephone during that period.³⁸ Respondents also acknowledged that

³⁷ CX 6, p. 39.

³⁸ CX 4, pp. 18-19, 29-30.

This Decision has been published by the NASDR Office of Hearing Officers and should be cited as OHO Redacted Decision C3A000007.

_____ transacted business during the time that he was inactive.³⁹ The Hearing Panel found, however, that _____'s transacting business while physically out of the office was not necessarily inconsistent with _____'s testimony during the on-the-record interview:

Q: When [the Compliance Officer] told you that [_____] had a problem and he was inactive, what was your understanding what he could and couldn't do at that point?

A: My understanding, to the best of my ability, he was not to be in the office.

Q: Was he not to talk to customers?

A: That was unclear. I mean that was never made clear to me. It wasn't anything specific.

Q: So did [the Compliance Officer] tell you he was not supposed to be actually physically be in the office? Is that what she told you?

A: Correct.

Q: But she didn't tell you what he could do or couldn't do out of the office with his customers?

A: Not that I recall.⁴⁰

It appears from the interview that _____ did not fully understand the restrictions imposed on an individual with an "inactive" status either at the time when he instructed _____ to leave the firm, when he prepared the written statement, or when he participated in the on-the-record interview. _____ informed the NASDR staff during the interview that he had never before been involved in dealing with someone with an inactive status.⁴¹ While as a General Securities Representative and Principal he may be presumed to know that an inactive person cannot transact any business, his testimony before the NASDR staff evidenced a lack of knowledge about the rules on inactive status. Although a lack of knowledge of NASD rules is generally not a defense for failure to comply with such rules, the Hearing Panel deemed it appropriate to consider Respondent _____'s

³⁹ August 2 Tr., p. 175.

⁴⁰ CX 4, pp. 45-46.

lack of knowledge in determining whether he committed a violation for providing untruthful testimony. The Hearing Panel, therefore, finds that there was insufficient evidence to show that _____ provided false information as alleged at paragraph 4b of the Complaint.

(3) _____'s assignment of the _____ customer accounts to _____

The Complaint alleges at paragraph 4c that _____ provided false information to the NASDR staff when he testified that he assigned _____ to function as the registered representative for _____'s accounts during the relevant time period.

Paragraph 7b similarly alleges that _____'s written statement was false where it stated that on February 10, 1999, _____ informed _____ that he would be appointed to service _____'s client base. According to the Complaint, no such communication occurred. Finally, paragraph 7c alleges that _____ provided false information in his written statement where it stated that _____ informed him that _____ was inactive and that _____ would be appointed to service _____'s client base. The Complaint again alleges that no such communication occurred.

The Hearing Panel found that _____ did, in fact, contact _____'s customers during _____'s inactive period. This was evidenced through testimony from customers that recalled being contacted by _____. Enforcement produced no credible direct or circumstantial evidence that the conversation between _____ and _____ did not take place. The Hearing Panel therefore finds that _____ and _____ did not provide false information as alleged in paragraphs 4c, 7b and 7c of the Complaint.

(4) _____'s contact with _____ customers

_____ is alleged in paragraph 4d of the Complaint to have stated falsely that at about the beginning of _____'s inactive period, he contacted _____'s customers to advise them that he would be handling their accounts. According to the Complaint, "no such calls were made."⁴² (Emphasis added.) _____ is also charged under paragraph 4e with testifying falsely that he effected transactions in the accounts of _____ customers during the relevant period.

Initially, the Hearing Panel found that _____ did not testify during the on-the-record interview that he contacted such customers "at or about the beginning of the relevant period," or words to that effect, as alleged in the Complaint.⁴³ Further, the evidence adduced through _____, _____ and two customers established that, during the relevant period, _____ spoke with at least two of _____'s customers and executed trades on behalf of at least one customer.

JM, a _____ customer, told _____ that, during the relevant period, _____ executed approximately two trades for him, and spoke to him twice.⁴⁴ _____, conversation with JM was consistent with a handwritten statement of JM which read: "Between the months of March and May I executed trades with _____ and [_____ registered representative] _____. _____ spoke to me about my account several times."⁴⁵

⁴¹ CX 4, p. 17.

⁴² Complaint ¶ 4d.

⁴³ CX 5.

⁴⁴ August 2 Tr., p. 226.

⁴⁵ _____ Ex. 1

This Decision has been published by the NASDR Office of Hearing Officers and should be cited as OHO Redacted Decision C3A000007.

_____ customer MS testified that he, too, was called by _____, but could not recall if that occurred during the relevant period.⁴⁶ _____ testified that when he spoke to MS prior to the Hearing, the customer stated that he did speak to _____ a couple of times during the relevant period.⁴⁷ _____ confirmed that he spoke to MS during _____'s absence.⁴⁸

Beyond the evidence that *was* presented, which showed _____'s contact with _____ customers, the Hearing Panel also considered the *lack* of sufficient evidence to establish a violation. Enforcement only offered evidence as to a limited number of _____ customers and acknowledged that it had not contacted all of _____'s customers to determine whether _____ had contacted them at any time during the relevant period.⁴⁹

Thus, the Hearing Panel found, contrary to the allegations at paragraphs 4d and 4e of the Complaint, that _____ had contact with at least two customers, and transactions with one during _____'s inactive period.

III. Legal Discussion

A. Jurisdiction

The NASD has jurisdiction over this proceeding. Respondents were registered with the NASD at the time of the alleged violations and at the time Enforcement filed the Complaint.

⁴⁶ August 2 Tr., pp. 267-268, 275.

⁴⁷ August 2 Tr., pp. 240-241.

⁴⁸ CX 5, p. 83.

⁴⁹ August 3 Tr., pp. 167, 202.

This Decision has been published by the NASDR Office of Hearing Officers and should be cited as OHO Redacted Decision C3A000007.

B. Providing Untruthful Information Pursuant to NASD Procedural Rule 8210

NASD Procedural Rule 8210(a)(1) authorizes the NASD to require an associated person “to provide information orally, in writing, or electronically . . . with respect to any matter involved in [an] investigation” The Rule provides a means for the NASD to carry out its regulatory mandate in the absence of subpoena power. As such, the Rule is a “key element in the NASD’s effort to police its members.”⁵⁰ The SEC has held that “[p]roviding the NASD with inaccurate and misleading information is a serious violation. To allow an associated person to mislead the NASD without sanction would hinder the NASD’s ability to carry out its regulatory responsibility.”⁵¹

The Complaint alleged that the written statements were “materially untruthful” and that the Respondents “knew that the information was materially false.”⁵² According to the Complaint, Respondents were also “untruthful” in their on-the-record interviews.

As discussed above, the Hearing Panel found that Respondents’ statements as alleged in the Complaint were either not false or that insufficient evidence was presented to determine their falsity. Specifically, the Hearing Panel found that _____ did, in fact, contact some _____ customers, and effected at least one transaction on behalf of a customer, which serves to imply that _____ did assign some of _____’s accounts to _____. _____ effected some securities business during the time he was inactive, but there was no credible evidence that such business was conducted in the office. Finally, although

⁵⁰ In re Richard J. Rouse, 51 S.E.C. 581, 1993 SEC LEXIS 1831, at *7 (1993).

⁵¹ In re Brian L. Gibbons, Exchange Act Rel. No. 37170 (May 8, 1996), *citing* Jonathan G. Ornstein, 51 S.E.C. 135, 141 (1992).

⁵² Complaint, ¶¶ 7-8.

This Decision has been published by the NASDR Office of Hearing Officers and should be cited as OHO Redacted Decision C3A000007.

the record failed to establish the date upon which these events occurred, and there is some evidence that such events may not have occurred on the dates when Respondents stated they occurred, the Hearing Panel found that such misstatements were not material.

Consequently, the Hearing Panel found that Enforcement failed to show, by a preponderance of the evidence, that Respondents provided untruthful information to NASDR as alleged.

C. Summary Disposition Standard

Code of Procedure Rule 9264(e) provides that the Hearing Panel “may grant the motion for summary disposition if there is no genuine issue with regard to any material fact and the Party that files the motion is entitled to summary disposition as a matter of law.” In this case, Respondents each made a motion for a directed verdict at the conclusion of Enforcement’s case-in-chief. The Hearing Panel considered the motions as motions for summary disposition under Rule 9264(b). The Hearing Panel thereafter deliberated and granted Respondents’ motions. The Hearing Panel found, based on the credible evidence presented, that Enforcement failed to meet its burden to establish any of the violations alleged by a preponderance of the evidence. In reaching that conclusion, the Hearing Panel determined that there was no genuine issue with regard to any material fact, and that Respondents were entitled to summary disposition as a matter of law.

IV. Order

Having found that Enforcement failed to prove the violations alleged in the Complaint by a preponderance of the evidence, the Hearing Panel granted the motions for summary

This Decision has been published by the NASDR Office of Hearing Officers and should be cited as OHO Redacted Decision C3A000007.

disposition and dismissed the Complaint as to both Respondents.⁵³ This decision shall constitute the final disciplinary action of the Association unless timely appealed pursuant to Rule 9311 or timely called for review pursuant to Rule 9312.

Hearing Panel

by: _____

Gary A. Carleton
Hearing Officer

⁵³ The Hearing Panel 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.