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NASD REGULATION, INC.
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,	:	Disciplinary Proceeding
	:	No. CAF980031
Complainant,	:	
	:	
v.	:	**HEARING PANEL**
	:	**DECISION AS TO**
	:	**RESPONDENT _____**
	:	_____
	:	
	:	Hearing Officer - JN
	:	
	:	February 11, 2000
	:	
	:	
Respondent.	:	
	:	

Digest

The Complaint charged Respondent _____ with fraudulent practices (baseless price predictions, unauthorized transactions, and a tie-in which linked an initial public offering to aftermarket commitments), in violation of Section 10(b) of the Securities Exchange Act of 1934, Rules 10b-5 and 10b-6 promulgated under that Section, and NASD Conduct Rules 2110 and 2120. The Hearing Panel found that the Department of Enforcement failed to carry its burden of proving the allegations by a preponderance of credible evidence and dismissed the Complaint.

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Appearances

Paul D. Taberner, Esq., Washington, DC (Rory C. Flynn, Esq., Chief Litigation Counsel, Washington, DC, of counsel), for the Department of Enforcement.

Respondent _____ appeared *pro se*.

DECISION

I. Introduction

This case began as a disciplinary action against twelve individual respondents, who were formerly associated with the firm of _____. The Chief Hearing Officer denied motions to sever, and an Extended Hearing Panel (the Panel) was appointed. Thereafter, Respondents _____, _____, _____, _____, _____, _____, and _____ settled. Respondent _____ has tendered an Offer of Settlement which is currently being reviewed by the appropriate officials. Respondents _____ and _____ defaulted, and the Hearing Officer will subsequently issue default decisions as to them. Enforcement withdrew its Complaint against Respondent _____.

The proceeding against Respondent _____ went to hearing, and this decision applies only to him. The Panel - an NASD Hearing Officer, a former member of the District Business Conduct Committee for District 10 and a current member of the Committee for District 11 - heard evidence pertaining to Mr. _____ on September 15 and October 29 of 1999. Enforcement presented testimony from two customers (one by telephone and one in person) and introduced four exhibits, marked CX-53 A, CX-53 B, CX-53 C, and CX-55.

Respondent testified and introduced one exhibit, marked R-1. The Panel also received in evidence a series of stipulations, marked Joint Exhibit 1.

The Panel granted the Department's request to file a post-hearing submission concerning one cause on November 15, 1999. At the Panel's request, Enforcement supplemented that submission on November 18, 1999. Respondent filed his post-hearing submission on December 3, 1999.

II. Discussion

A. Allegations Involving Customer M.S.

The Complaint charged _____ with: (1) inducing M.S. to buy units and shares of Xechem International, Inc. by making baseless price predictions about a speculative security; (2) buying Xechem shares for M.S.'s account without authorization; and (3) soliciting M.S. to purchase Xechem shares in the aftermarket before distribution of the initial public offering of units, and requiring that M.S. purchase aftermarket shares as a condition of purchasing the IPO units. The prediction and the unauthorized trade counts (¶¶ 43 and 77 respectively) were grounded in Rules 2110 and 2120. The aftermarket count (¶ 142) was based on Section 10(b) of the Securities Exchange Act, SEC Rules 10b-5 and 10b-6[1], and NASD Rules 2110 and 2120.

[1] Former Rule 10b-6 is now reflected in SEC's Regulation M. The Panel agrees with Enforcement's position that Rule 10b-6, not Regulation M, applies to this case because the conduct in question occurred while the Rule was in effect and before Regulation M was adopted. See Enforcement's Memorandum Regarding the Applicability of Rule 10b-6, filed January 19, 1999.

The Department of Enforcement had the burden of establishing, by a preponderance of the evidence, that _____ committed the alleged violations.[2] To carry this burden, Enforcement was required to establish its case by a "preponderance" of "credible evidence."[3]

In the present case, Enforcement rested on customer M.S.'s testimony that _____ made the predictions, engaged in unauthorized trades and conditioned purchase of the units on purchasing shares in the aftermarket. _____ denied these charges and strongly challenged M.S.'s credibility. Enforcement questioned _____ about two arbitration proceedings involving alleged misrepresentations to others (Tr. 367-374), but never asked about the matters alleged in the instant Complaint.[4] There was no further evidence supporting either side's version, and the case thus reduced itself to a credibility contest. After careful consideration of the record, the Panel concludes that M.S. was not a credible witness, and that Enforcement thus failed to carry its burden as to his allegations of impropriety.

M.S. testified that although he authorized Respondent to purchase 20,000 Xechem shares, _____'s subsequent purchase of another 20,000 Xechem shares was unauthorized (Tr. 206, 218, 219). The customer then told Respondent to sell the shares - a transaction

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[2] Steadman v. SEC, 450 U.S. 91, 96 (1981); Wall Street West, Inc. v. SEC, 718 F.2d 973, 974 (10th Cir. 1983); Seaton v. SEC, 670 F.2d 309, 311 (D.C. Cir. 1982); In re First Honolulu Securities, Inc., Exchange Act Rel No. 32933, 1992 SEC LEXIS 2422 at *14 (September 21, 1993); District Business Conduct Committee v. Lawrence P. Bruno, Jr., No. C10970007 (July 8, 1998) slip op. at 4.

[3] District Business Conduct Committee v. Stratton Oakmont, Inc., 1996 NASD Discip. LEXIS 52 at *42 (December 5, 1996); District Business Conduct Committee v. Robert Payne Jackson, 1996 NASD Discip. LEXIS 22 at *10 (January 31, 1996).

[4] Awards were entered against Respondent and several other persons. A third arbitration (with undescribed issues) was pending at the time of the instant hearing (Tr. 370-371). There was no showing that any of those proceedings involved allegations of unauthorized trades, improper price predictions, or tie-ins between an initial public offering and the aftermarket.

which, according to M.S., caused him to lose approximately $23,000, including a commission of $7,500 (Tr. 208, 218, 246).

Although he supposedly sustained a substantial loss, aggravated by a large commission taken by the very person who executed the unauthorized purchase, this customer never complained to NASD about _____ (Tr. 216). Even after the Association contacted him, the customer did not inquire about seeking to recover the loss (Tr. 247)[5]. He also did not complain to compliance, legal personnel, or anyone else at _____ (Tr. 207, 244). Nor did he consult with anyone at Prudential or Kidder Peabody, where he maintained accounts for several years and where he acknowledged he could have gone for advice (Tr. 243, 255). When asked "[y]ou could have also called the Securities and Exchange Commission, which is probably a name that you do recognize," the customer answered "[y]es," while adding "they are not in the _____ phone book, that's for sure" (Tr. 245). When pressed for an explanation as to why he did not call the firm's compliance officer, the NASD, the SEC, or a lawyer - despite claiming that _____ effectively stole substantial sums from him - the customer had no answer (Tr. 218-219).

This customer was a successful businessman, who owned a small manufacturing company in Ohio (Tr. 195). His _____ account reflected various six-figure investments in securities transactions not disputed here (CX-54B). He did not challenge _____'s description of that account as worth "about half a million dollars" at one point (Tr. 235). In addition, for at least four years prior to the events at bar, he maintained securities

[5] The record contains no further details about this contact with NASD.

accounts with Prudential and Kidder Peabody, and engaged in "fairly aggressive" trading activity in one such account. (Tr. 242-244, 255). As one panelist stated, "you sound to be a very sophisticated individual, a man of means" (Tr. 244).

Yet this customer repeatedly claimed that he simply walked away from a $23,000 loss caused by an unauthorized trade. He admitted authorizing the sale of the stock in question, stating "I didn't know any other way to get out …"(Tr. 225). He said "I was so disgusted … all I wanted was out …" (Tr. 226-227). He authorized the sale "to wash my hands of it, cut my losses, and get away from" _____ and _____ (Tr. 233).

In the Panel's view, a person in M.S.'s situation, confronted with a $23,000 loss inflicted by an allegedly unauthorized trade, would not simply walk away silently. On the contrary, he would have made at least one complaint. The Panel concludes that M.S.'s conduct was inconsistent with that of a person claiming to have been cheated out of $23,000.

Respondent testified that M.S. did authorize the purchase in question, but could not pay for it because his wife would not allow him to transfer money from a joint account (Tr. 366). According to _____, the customer "wound up fighting with his wife over it, he never got the money ... and then subsequently down the road the stock got sold out" (Id.). Though M.S. denied marital difficulty at the time of the transaction, he admitted receiving "surprise" divorce papers several months thereafter (Tr. 213, 222). The divorce, taken together with the customer's silence in the face of a supposedly costly unauthorized trade, is consistent with _____'s testimony that the purchase was authorized, but came apart in a marital disagreement.

M.S.'s testimony had additional problems. This customer admitted using his grandfather's Florida address because the laws of Ohio, where he lived, restricted certain trades which he wanted to execute (Tr. 205, 248-250). When asked whether he was doing indirectly what he could not do directly, M.S. said "I needed a dual address," and admitted that he did not reside at the Florida address (Tr. 249). This evidence reflected at least a casual attitude toward legal requirements and further weakened his credibility.

His testimony also showed uncertainty and confusion (if not internal inconsistencies) about significant details. He said that the unauthorized Xechem purchase of April 28, 1994 was made on margin, and added that he had not "before or since [done] anything on margin" (Tr. 206-207). But, when confronted with account records reflecting a $165,000 purchase on margin on April 22, 1994, (CX-54B, p. 5), he could not offer any coherent explanation, saying: "[w]ell, you know, what you said, that's maybe where, you know, this margin thing came into play, you know. What I thought, Xechem was on margin, or whatever, you know" (Tr. 240). When asked whether he was really sure that the alleged unauthorized purchase was made on margin, M.S. answered: "Um - I can't remember exactly what Mr. _____ threatened me with at the time. It was something similar to that, you know" (Tr. 239).[6]

Finally, _____'s argument that he would not have jeopardized M.S.'s account, which exceeded half a million dollars, by executing one unauthorized trade involving a comparatively small sum (Tr. 365) was plausible and was never countered.

[6] _____'s statement that the Xechem offer was a new issue and thus not marginable (Tr. 221) was never contradicted.

For all of these reasons, the Panel finds that M.S.'s testimony about the alleged unauthorized trade is not credible. A witness whose testimony is not credible as to an important subject may be regarded as equally unreliable on others.[7] Although the Panel is not required to reject M.S.'s testimony about the alleged predictions and tie-in simply because it finds him unreliable as to the unauthorized trade allegation, such a conclusion is appropriate here.

All of the allegations in this case (the predictions and tie-in, as well as the unauthorized trade) arose out of one transaction involving the same conversations between _____ and M.S. Apart from the customer's version, there was no other evidence of the asserted predictions and tie-in. There is no reasonable basis for concluding that this customer's testimony - rejected as to the unauthorized trade - was nevertheless somehow believable as to the other allegations which also rested on his word.

As to customer M.S., the Panel concludes that Enforcement failed to carry the burden of proving by a preponderance of credible evidence that _____ committed the alleged acts.

B. Allegations Involving Customer R.Y.

The Complaint alleged two offenses as to this customer: that _____ made baseless price predictions about Xechem (¶ 44) and that he engaged in unauthorized transactions when he bought Xechem for R.Y.'s account and sold Waste Management from that account (¶¶ 77, 78).[8] In this aspect of the proceeding, the parties again focused primarily on the alleged unauthorized trade, with the customer insisting that _____ had no permission for the

[7] See, e.g., Bennun v. Rutgers State University, 941 F.2d. 154, 179 (3rd Cir. 1991) (a court, "like any factfinder, [may] assess credibility in light of the maxim 'false in one thing, false in everything'"). Green v. United States Steel Corp., 481 F. Supp. 295, 311 (E.D. Pa., 1979) (that maxim "is as valid in business as it is in law").
[8] There were no tie-in allegations as to this customer.

transactions and Respondent stating that he did have such authority. In addition, the record also contains a tape recorded telephone call between _____ and R.Y., which as shown infra, supports Respondent's testimony that the transactions were authorized.

1.) The Unauthorized Trades

It is undisputed that on May 13, 1994, Respondent _____ purchased 1,500 Xechem shares for R.Y.'s account at a price of $8 ¾ (Jt. Ex. 1, ¶ 16). The customer stated that this purchase was unauthorized (Tr. 288-289; CX-53A), while _____ urged that it was authorized (Tr. 366-367). Enforcement did not question _____ about the details involving R.Y.[9]

_____ relied primarily on a recorded telephone conversation between himself and the customer, which occurred after the customer discovered the alleged unauthorized purchase and complained to Respondent's supervisor (Tr. 288-292).[10] Respondent urges that the customer's conduct during this conversation, after learning of the supposed unauthorized purchase, was inconsistent with that of a person claiming to have been victimized. The Panel agrees.

The conversation lasted for ten to fifteen minutes (Tr. 290), and despite several opportunities, reflects no suggestion by the customer that the Xechem purchase was unauthorized (Tr. 290, 338-350). _____ began by saying: "Let me give you a quick update. 1,500 shares of Xechem at $8 3/4. Stock is trading now at $7 a share" (Tr. 338). The customer said nothing, even though these shares reflected the very purchase which he

[9] _____'s investigative testimony was mentioned (Tr. 373-374), but not offered in evidence.

already knew about and had complained of (Tr. 288-289). After telling the customer that he expected the stock to go up because many shares had been sold short and his firm held a large inventory (Tr. 339-343), _____ said "[b]ut the bottom line is, you bought 1,500 shares here at $8 ¾" (Tr. 343). The customer again remained silent.

_____ reiterated his statement about the short positions and told the customer: "[w]e own 1,500 shares here at $8 ¾. …, I know you are sensitive about the market, but the bottom line is, the only way we are going to make money is by getting involved in cheap stock. At $7 a share, how much can you put into the situation"? R.Y. answered "I am not going to put any more into the situation. I want to see some work first" (Tr. 343-344). When thus confronted with the very acquisition which he claims to have been unauthorized, the customer - far from showing outrage or protest of any kind - replied that he wanted to watch his existing holdings before deciding about purchasing more.

Respondent then urged R.Y. to purchase an additional 1,500 shares. The customer again did not protest, saying instead "[w]ell, I am telling you that you are trying to get me divorced" (Tr. 345). Following further sales efforts, the customer said: "[w]ell, like I told you before, uh, you know, I bought the Waste Management, it went down; you said it would come back up. I bought this, it's down. You know, I don't understand this" (Tr. 347-348). Taken in context, the acknowledgment that "I bought this, it's down"
refers precisely to the 1,500 Xechem shares and completely belies the assertion that such purchase was unauthorized.

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[10] _____'s firm made the tape, which Enforcement produced in discovery. The tape is Exhibit R-1 (Tr. 350); the conversation is transcribed at pages 338 through 350 of the transcript.

Finally, the customer then declined _____'s request to buy "an additional 1,500 shares," stating "I can't do it. I just can't. My wife –" (Tr. 349). Respondent told R.Y. that "I'll be in touch. If you need anything, you give me a buzz. Bye-bye." The customer ended the conversation, saying "Okay" (Tr. 350).

Although the now-disputed holding was mentioned three times, the customer never said a word which remotely suggested that it had been acquired without authority. On the contrary, he said "I bought this, it's down" which, in context, could only refer to the supposed unauthorized Xechem purchase. He thus spoke of the stock as his purchase, articulated reasons why he did not then want to buy more, and agreed to call the Respondent if he needed anything. The Panel believes that this conversation, an amiable disagreement over whether to invest more, is utterly inconsistent with what would be expected from a customer claiming to be the victim of an unauthorized purchase.

R.Y. said that because he had already complained to the firm (which promised to undo the transaction), it "didn't really matter what I said" to _____ and the call "made no difference" (Tr. 354-355). He also said that he had been brought up to be "polite" and that since he already persuaded the firm to void the transaction, "[t]here was no need to be disrespectful or anything else to somebody on the phone at that point in time" (Tr. 356).

The Panel, which saw and heard R.Y. and listened to the tape recording, rejects these explanations. R.Y. is a successful entrepreneur, who owns his own trucking company. The Panel believes it unlikely that he would spend ten to fifteen minutes on the telephone without caring about what he said to a wrongdoer who supposedly cheated him. The theory that R.Y. would not care what he said on the telephone about any subject, especially investments, is

inconsistent with the Panel's perception of this careful businessman. The Panel cannot accept the notion that R.Y., who says that he was wronged by a broker and succeeded in getting the transaction undone, would conduct a lengthy conversation with that very broker, let alone admit making the disputed investment, speak of wanting to hold and watch the position, and express concern about his wife's opposition to further investment.

Moreover, the cordial tone of the conversation (even for a "polite" victim) was not consistent with that of a person talking to a broker whom he described at the hearing as the equivalent of a "low life" who "would lie to me and steal from me" (Tr. 355). Even the most decorous customer could have explained that his complaint had already been addressed, or made clear that the Xechem holding should not have been there in the first place, or simply told _____ "I am sorry, I do not wish to speak with you." The Panel cannot accept the witness' explanations for the telephone call.

As to the alleged unauthorized trade involving customer R.Y., the Panel thus finds that Enforcement has failed to carry the burden of proving its case by a preponderance of credible evidence.

2.) The Price Predictions

It is well settled, as the Complaint alleges, that: "[I]t is a fraudulent practice to make price predictions for any speculative securities, or to make predictions as to any security, without a reasonable basis" (¶ 24).[11] As to Respondent _____, the Complaint alleged that he improperly predicted to R.Y. that "Xechem common, which was then trading at $7 a

[11] See, e.g. In re Joseph J. Barbato, Exchange Act Rel No. 41034, 1999 SEC LEXIS 276, at *29-30 and cases there cited (February 10, 1999).

share, would be trading at between $11 and $13 a share in the next five days because Kensington was going to orchestrate a short squeeze" (¶ 44).

The recording of the _____-R.Y. telephone conversation shows that Respondent used substantially those words in attempting to persuade the customer to purchase additional Xechem shares (Tr. 341-343). The fact that he followed the prediction by saying "I can't guarantee anything" (Tr. 343) is of no consequence. Expressing the prediction as a statement of opinion, rather than a guarantee, does not cure it.[12]

Enforcement, as noted, has the burden of proving that the alleged violation did occur (see authorities cited in footnote 2, supra). An element of the "prediction" offense is that _____ had no reasonable basis for his prediction, or that the prediction was necessarily improper because Xechem was a speculative stock. After review of the record, the Panel concludes that Enforcement failed to carry its burden as to these matters.

The record contains almost nothing about the nature of Xechem International, Inc. That its units were listed on the Nasdaq SmallCap Market (Jt. Ex. 1, ¶ 9) does not tend to prove that they or the shares were "speculative" or that _____ lacked a reasonable basis for his prediction. The share prices reflected in this record ($7 and $8.75) do not themselves suggest a speculative quality. Indeed, by SEC rule, stock priced at over $5 is excluded from the definition of "penny stock," a term which "generally refers to low-priced, speculative securities …" (Penny Stock Disclosure Rules, 1991 SEC LEXIS 716, at *12 (April 17, 1991). See SEC Rule 3a51-1.

[12] In re Joseph J. Barbato, supra. Nor can improper price predictions be cured by general disclaimers. District Business Conduct Committee v. Pendergast, 1999 NASD Discip. LEXIS 19, at *25-26, and cases there cited (July 8, 1999).

Nor does the record contain evidence about the company, which might enable the Panel to conclude that Xechem was a speculative security. Cf. District Business Conduct Committee v. Stevens, 1998 NASD Discip. LEXIS 58 at *8-9 (NAC, June 10, 1998), where a Form 10-K and prospectuses - together with evidence concerning products, a "development stage," profit-loss records, and ability to make debt payments - demonstrated the speculative nature of a particular investment. Nothing of that kind appears in the present record.

There was similar dearth of evidence concerning Respondent's lack of a reasonable basis for his predictions. _____'s announced basis for the predictions (the so-called "short squeeze") stood unchallenged on this record. There was no evidence that such a reason was manufactured or was otherwise unreasonable - a showing which could have led the Panel to infer that Respondent had no basis for his claims. Nor was there evidence of investigative testimony which might have shown that _____'s predictions were baseless. The Panel simply found no evidence supporting the alleged lack of reasonable basis for the predictions.

III. Conclusion

The Department of Enforcement failed to carry its burden of proving the Complaint's allegations by a preponderance of credible evidence as to Respondent _____.[13] The Complaint is, therefore, dismissed.

HEARING PANEL

_____
By: Jerome Nelson
Hearing Officer

[13] 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.