NASD REGULATION, INC.
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. LEONARD VINCENT LOMBARDO (CRD #2401363), Edison, NJ Staten Island, NY Respondent.	Disciplinary Proceeding No. C10000006 Hearing Officer - JN **HEARING PANEL DECISION** June 5, 2001

Formerly registered representative engaged in (1) material misrepresentations and baseless and improper price, profit, and performance predictions; and (2) unauthorized transactions. Respondent found liable, as charged, for violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, and NASD Conduct Rules 2110 and 2120. Respondent barred from associating with any member firm.

Appearances

For the Complainant: Philip A. Rothman, Jay M. Lippman, and Rory C. Flynn.

Leonard Vincent Lombardo, appeared Pro Se.

DECISION

I. Introduction

The Respondent was associated with William Scott & Co., L.L.C., an NASD member firm.

The Department of Enforcement's Complaint, filed on January 11, 2000, alleged that he engaged in (1)

material misrepresentations and baseless and improper price, profit, and performance predictions, involving a number of specific customers, and (2) several unauthorized transactions. Lombardo disputed the charges and requested a hearing.

An Extended Hearing Panel, composed of a current and a former member of the Association's District 10 Committee and an NASDR Hearing Officer, conducted seven days of hearings, beginning on October 26, 2000 and ending on January 31, 2001.[1] Enforcement introduced testimony from seven customers and two staff employees and offered over one hundred exhibits. Respondent testified at length in his defense. Enforcement (at its request) filed a Post-Hearing Memorandum on March 5, 2001. Respondent filed his Post-Hearing Memorandum on April 23, 2001.

II. Liability

A. Misrepresentations and Omissions

It was undisputed that Respondent's sales efforts culminated in five customers' purchases of securities issued by Leasing Edge Corporation, Kushi Macrobiotics Corp., and Innovative Medical Services - transactions which caused four of the customers to sustain losses ranging from $7,429 to $41,766 (CX-96, 98, 100, 101). Each of the five testified that Lombardo made optimistic predictions as to price, profit, and performance, without disclosing any information as to the financial or operating condition or history of these companies (I Tr. 30-32, 112-118; II Tr. 84-87; IV Tr. 18-19, 75, 78-

[1] The proceedings were delayed on several occasions by Mr. Lombardo's decisions concerning counsel. He discharged his first lawyer and hired a law firm to represent him. After obtaining an enlargement of the hearing schedule in order to prepare, the firm discovered a conflict of interest and withdrew from the case. Thereafter, a third lawyer contacted the Office of Hearing Officers, stating that he would be representing Respondent. That lawyer later announced his withdrawal and Mr. Lombardo re-hired his original lawyer, who needed additional time. Lombardo ultimately discharged that lawyer and finished the case by representing himself.

81).[2] Two others testified that Respondent made price and performance predictions in attempting to sell Leasing Edge warrants to them (II Tr. 26-27; V Tr. 200-201).

Lombardo admitted that he recommended the above securities and that each constituted a "speculative" and "risky" investment (V Tr. 238-241, 293-294). He testified that he had no memory of having made the specific representations which the customer witnesses attributed to him (V Tr. 264-270, 379).

The Panel, which had the opportunity to observe most of the customers, accepts their testimony and finds that Respondent made the representations in issue.[3] The testimony of these witnesses, who were from various places in the United States and had never spoken to each other, had common characteristics. As to Leasing Edge, for example, three customers testified that Lombardo told them (falsely, as it turned out) that the issuer was about to sign a large contract with IBM (I Tr. 116; II Tr. 84; V Tr. 200); four testified that he made specific price increase predictions (I Tr. 31; II Tr. 26; IV Tr. 78-79; V Tr. 200); two testified that he said the investment was a "no lose" proposition or a "sure thing" (I Tr. 31; IV Tr. 18); and two said that Lombardo told them that his firm would sell the security out of inventory at a price below market value (I Tr. 30; IV Tr. 47-49). The likelihood that these customers, without ever talking to one another, would invent similar accounts of Lombardo's sales conversations is remote.

[2] The hearing record consists of seven volumes. The transcripts of the hearings of October 26, October 27, November 1, November 2, and November 3 of 2000, and of January 24 and 31 of 2001 are cited with the prefix I, II, III, IV, V, VI, and VII, respectively.

[3] Four appeared in person, one testified by video conference, and only two testified by telephone.

Respondent dismissed the customers as “confused” investors, who had been “coached” by the firm and wanted to blame him for their losses (V Tr. 312-313, 338-339, 362-364). The Panel rejects these explanations.

The witnesses were direct and forthright; nothing in their words or demeanor suggested confusion or coaching. Despite ample opportunity to cross-examine the customers, the defense did not probe the so-called coaching. When asked who at the firm was doing the coaching, Lombardo answered that he “was not sure” (V Tr. 314). When asked why he did not present corroborating testimony from the firm (which was still in business), he had no meaningful answer, saying only that “I don’t believe that it would be of any point of substance” because four years had passed, and that he had no reason to bring in his “enemies” (Id.). Despite several adjournments, while changing counsel, he never introduced a shred of evidence to support the asserted “coaching” of the customer witnesses.

Nor were all of the witnesses disgruntled losers. Customer ME achieved some profits through Lombardo’s recommendations and ended up “a little under, break even, somewhere in that range” (IV Tr. 20, 57). He could not remember the losses, and counsel for Enforcement stated that “[w]e’re not going to present any evidence that there was a loss” as to that witness (IV Tr. 61-62). Indeed, it never occurred to ME to sue Lombardo (IV Tr. 39). His testimony that Respondent sold Leasing Edge by representing it as a “sure thing” (IV Tr. 18, 51-52) thus cannot be attributed to bitterness over losses. In any event, “[t]hat a customer has lost money on his investment ... is no basis for rejecting his testimony.”[4]

Lombardo insisted that his statements to clients came solely from materials supplied by the issuers or by his firm (V Tr. 264-270, 291). He never produced copies of any of these materials. The

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[4] In re Gilbert F. Tuffli, Jr., Exchange Actg Rel No. 12534, 1976 SEC LEXIS 1467 at *8 (June 10, 1976).

firm repeatedly denied the existence of any such materials and told the NASDR staff that any documents would have been prepared by the individual brokers for their own use (V Tr. 391). Although the staff discovered some "generic" scripts, none of them contained any of the representations in issue here (V Tr. 292). In any event, representatives must make a reasonable investigation before recommending a security, must have a reasonable basis for their recommendations, cannot rely on issuer-created documents, and must be especially thorough in evaluating the securities of smaller companies of recent origin.[5] Even if Lombardo relied entirely upon such documents, his conduct fell far short of the requisite standard - particularly where, as here, he was recommending investments which he knew to be speculative and risky.

B. Fraud

"To find a violation of Conduct Rule 2120 and Rule 10b-5, there must be a showing that: (1) misrepresentations and/or omissions were made in connection with the purchase or sale of securities; (2) the misrepresentations and/or omissions were material; and (3) they were made with the requisite intent, i.e. scienter." District Business Conduct Committee v. Michael R. Euripides, 1997 NASD Discip. LEXIS 45 at *18 (NBCC, July 28, 1997). These requirements were satisfied here.

It is undisputed that Lombardo's representations involved securities. There were several misrepresentations and omissions. For example, notwithstanding Respondent's statements to customers, due diligence files and press releases pertaining to Leasing Edge contained no information suggesting that the issuer was about to sign, or had signed, any contract with IBM (IV Tr. 111). Lombardo omitted telling the customers anything negative about the companies involved. Yet

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[5] District Business Conduct Committee v. Jacob C. Young, 1994 NASD Discip LEXIS 69 at *48 (June 28, 1994) and cases there cited. See also In re Gilbert F. Tuffli, Jr., 1976 SEC LEXIS 1467 at *12 (June 10, 1976) (reliance on representations from the firm's traders or other salesmen insufficient to satisfy reasonable basis requirement).

documents pertaining to the issuers (CX-77 through CX-94) reflected, as Enforcement stated, "their limited operating history, low price, and precarious financial condition (i.e., at the time of Lombardo's solicitations, each of the companies was losing money)."[6] As noted, Respondent himself acknowledged that the securities in issue were risky and speculative (V Tr. 293-294).

The materiality of the representations and omissions[7] was apparent from the testimony of the customers, who stressed Lombardo's predictions as to price, profit, and performance. Indeed, a balanced presentation, warning the investors of the speculative and risky nature of their commitments, might have prevented substantial losses.[8]

Nor can there be any dispute about scienter, which requires proof that Lombardo intended to deceive, manipulate, or defraud,[9] or acted "with severe recklessness … involving not merely simple or excusable negligence, but an extreme departure from the standards of ordinary care."[10] A respondent acts with scienter when the fraudulent circumstances "were so obvious … that he must have been aware

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[6] Post-Hearing Memorandum, p. 8.

[7] "The test for materiality is whether the reasonable investor would consider a fact important in making his or her investment decision." In re Martin R. Kaiden, Exchange Act Rel. No. 41629, 1999 SEC LEXIS 1396 (July 20, 1999), citing TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 444 (1976).

[8] Lombardo's prior counsel argued that the prosecution was improper because one of the complaining customers had been represented by Mr. Shellenberger, now Chief Counsel of NASDR's New York office, while Shellenberger was in private practice. Respondent's Post-Hearing Memorandum makes no mention of this matter. In any event, the Panel does not believe that this circumstance in any way taints the proceeding. Mr. Shellenberger fully informed the Panel and the parties as to his relevant actions in private practice and after joining the NASDR staff. The staff was already investigating numerous customer complaints against Lombardo when Mr. Shellenberger came to NASDR from private practice. A draft Complaint already existed, and Mr. Shellenberger facilitated the addition of his former client to that pre-existing document. His relationship to the client had ended. There was no fee or other economic arrangement involved. Although the Panel was troubled by the appearance of this matter, it finds no ethical impropriety and no reason to reject the testimony of that customer (who appeared at length by video conference) or to fashion any other relief.

[9] See Aaron v. SEC, 446 U.S. 680, 686-687, fn. 5 (1980); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976).

[10] These principles were recently articulated by the National Adjudicatory Council in Market Regulation Comm. v. Michael B. Jawitz, 1999 NASD Discip. LEXIS 24 at *19-20 (NAC, July 9, 1999), citing Hollinger v. Titan Capital Corp., 914 F.2d 1564 (9th Cir. 1990), cert. denied, 499 U.S. 976 (1991) and cases there cited.

of them."[11] Respondent here made glowing recommendations about securities which he knew were speculative and risky. He made misrepresentations, failed to disclose any of the negative considerations inherent in the investments, and made no investigation to ascertain whether his recommendations had any reasonable basis. As in Tuffli supra, "[t]he record shows a reckless disregard of the standards to which professionals in the securities business must adhere when they recommend the unknown securities of obscure issuers" (1976 SEC LEXIS 1467 at *11).

Finally, Lombardo's price, profit, and performance predictions about admittedly speculative stocks were fraudulent per se. As the SEC has stated, "predictions of specific and substantial increases in the price of a speculative security within a relatively short period of time are fraudulent." In re Donald A. Roche, Exchange Act Rel. No. 38742, 1997 SEC LEXIS 1283 at *5 (June 17, 1997). See also In re Richard Bruce & Co., Exchange Act Rel. No. 8303, 1968 SEC LEXIS 220 at *12-13 (April 30, 1968) (predictions of "a sharp increase in earnings with respect to a speculative stock without disclosure of the uncertainties as well as the known facts upon which a prediction rests [are] inherently misleading"); In re Richard J. Buck & Co., Exchange Act Rel. No. 8482, 1968 SEC LEXIS 272 at *18 (Dec. 31, 1968) ("[P]redictions of a sharp increase in earnings with respect to such a [speculative and unseasoned] security without full disclosure of both the facts on which they are based and the attendant uncertainties are inherently misleading").

C. Unauthorized transactions

Seven customers testified that Lombardo engaged in various unauthorized transactions in their accounts (II Tr. 28-31, 97-99; V Tr. 202-204; I Tr. 81-82, 87-88, 98-99, 109-111; IV Tr. 25, 81-87;). Respondent denied executing any unauthorized transactions (V Tr. 270-271).

[11] Department of Enforcement v. Levitov, No. CAF970011 (NAC, June 28, 2000), at slip op. p. 10.

The Panel credits the customers' testimony for several reasons. There can be no dispute that the various transactions occurred; the prosecution established them by documentary evidence. Although the seven customers were from various parts of the country and did not know each other, their complaints had similarities. Four of the seven complained of unauthorized purchases of Leasing Edge warrants; two complained of sales and purchases of Innovative Medical Services warrants; two testified to unauthorized sales of GK Intelligent Systems (GKIS). The transactions in issue occurred over the same four-month time period, from September of 1996 to January of 1997. Each of the unauthorized sales involved additional purchases of securities, which the customer had previously purchased on Lombardo's recommendation. Three of the customers testified that when they challenged the unauthorized transactions, Lombardo or his colleague told them (falsely) that tape recordings would verify the authorization.[12] The likelihood that seven customers who did not know each other would invent similar stories of unauthorized transactions is remote at best. The Panel, which had the opportunity to observe most of the seven customers, finds that Lombardo engaged in unauthorized transactions as alleged in the Complaint.

III. Sanctions

The NASD Sanction Guidelines (2001 ed.) for misrepresentations and material omissions state that adjudicators should consider a bar in egregious circumstances (at p. 96). The Panel believes that such circumstances are present here. Lombardo made numerous misrepresentations and omissions; his misconduct involved seven customers; and it occurred over a four-month period. He admitted that the securities involved were "speculative and risky," and the record shows that his sales efforts caused significant losses to several customers. Lombardo describes himself as a "youngster to the industry"

[12] NASD's investigation revealed no tape recording systems during the time in question (IV Tr. 129-130).

when the events occurred in 1996;[13] but his CRD reflects employment by Stratton Oakmont dating back to 1993 (CX-110). His own testimony acknowledged a period of prior sales experience with Stratton and A. S. Goldmen (V Tr. 322-323). In the Panel's view, he had sufficient experience to know better. His current professions of remorse come late in the day and are inconsistent with his attempt during the hearing to shift blame to his firm. In the Panel's view, these recent expressions do not counterbalance his flagrant misconduct. The case is egregious and a bar shall be imposed.

A bar is similarly appropriate for the unauthorized transactions. The Guidelines recommend a bar in egregious cases - i. e. those where the unauthorized transactions are qualitatively and quantitatively egregious (Guidelines, supra, p. 102). Those standards are met here. The prosecution's evidence was strong; the transactions in question were corroborated by documents, and customers who did not know each other were making similar complaints about Respondent's unauthorized conduct. Virtually all of the unauthorized purchases and sales involved speculative and risky securities, which Lombardo himself was recommending. The unauthorized conduct involved seven customers, some of whom suffered significant losses, and the activity went on over a period of several months. Here, again, a bar is appropriate.

Enforcement seeks orders requiring restitution of some $100,000 to five customers; the imposition of a $50,000 fine for the misrepresentations and omissions and another $50,000 fine for the unauthorized transactions; and disgorgement of commissions. The Panel believes that as a practical matter, such sanctions would be empty remedies, which would provide no meaningful relief to customers, the Association, or the securities industry. In these circumstances, the Panel exercises its discretion by declining to enter such orders.

[13] Post-Hearing Memorandum, p. 4.

IV. Conclusion

Respondent's fraudulent misrepresentations and omissions violated Section 17(a) of the Securities Act of 1933, and thereby NASD Rule 2110; Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder; and NASD Rules 2110 and 2120. For that misconduct, Respondent is barred from associating with any member of the Association in any capacity.

Respondent engaged in unauthorized transactions, in violation of Rule 2110. For that misconduct, Respondent is barred from associating with any member of the Association in any capacity.

Respondent shall pay costs of $8,418.50, reflecting $7,668.50 for transcripts, plus the standard administrative fee of $750.

The bar shall become effective immediately upon this Decision becoming the final disciplinary action of the NASD.[14]

HEARING PANEL

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Jerome Nelson
Hearing Officer

Dated: Washington, D.C.
June 5, 2001

Copies to: Leonard Vincent Lombardo (via overnight and first class mail)
Philip A. Rothman, Esq. (via electronic and first class mail)
Jay M. Lippman, Esq. (via electronic and first class mail)
Rory C. Flynn, Esq. (via electronic and first class mail)

[14] The Hearing Panel considered all of the arguments of the parties. All arguments are rejected or sustained to the extent they are inconsistent with or in accord with the views expressed here.