NASD REGULATION, INC.
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,	:	
Complainant,	:	Disciplinary Proceeding No. C07000033
v.	:	
	:	**HEARING PANEL DECISION**
	:	Hearing Officer - JN
FRANKLYN ROSS MICHELIN (CRD #2459180), Boca Raton, FL	:	
and	:	
LH ROSS & COMPANY, INC. (BD #37920), Boca Raton, FL	:	February 8, 2001
Respondents.	:	

Digest

The Complaint alleged that Respondents failed to implement the supervisory tape recording procedures required by Rule 3010(b)(2), and that such failure constituted violations of that Rule and Rule 2110. The Hearing Panel found that the Respondents were liable as charged in the Complaint. As sanctions, the Panel imposed a fine of $24,000 and a censure. Respondents were also jointly and severally assessed $2,909.70 as costs, including $2,159.70 for transcripts and an administrative fee of $750.

Appearances

Gary M. Lisker, Esq., Atlanta, GA and Rory C. Flynn, Esq., Washington DC, for the Department of Enforcement.

William Nortman, Esq. and Jonathan S. Robbins, Esq., Fort Lauderdale, FL for the Respondents.

DECISION

A. Background

Rule 3010(b)(2) requires that, in certain circumstances, member firms must tape record all telephone conversations between their registered representatives and existing and potential customers. This taping requirement is triggered when the firm employs specified numbers of "registered persons" who had been employed by "Disciplined Firms" within the last three years. "Disciplined Firms" are those whose sales practice violations led to expulsion from self-regulatory organization membership or to revocation of registration by the SEC.

As here relevant, the taping requirement applies to "a firm with at least ten but fewer than twenty registered persons where four or more of its registered persons have been employed by one or more Disciplined Firms within the last three years." Rule 3010(b)(2)(viii). Respondents are LH Ross & Company, Inc., a member firm, and Franklyn R. Michelin, its principal and President. It is undisputed that on July 30, 1999, the date alleged in the Complaint, Ross had "at least ten but fewer than twenty registered persons" and that, as of that time, NASD's Central Registration Depository (CRD) reflected Ross' employment of four registered representatives who were employed by a disciplined firm within the last three years.[1]

[1] The record of the hearing consists of: Stipulations; Hearing Transcript ("Tr."); Joint Exhibits ("JX"); Respondents' Exhibits ("RX"); and Panel Exhibits ("Panel Ex"). As support for the above sentence, see

Enforcement rests on the above facts, arguing that the taping requirement was triggered because four Ross employees, recently employed by a disciplined firm, were registered with the Association on the date in question. Respondents contend that the taping rule does not apply because one of those four resigned from the firm before July 30, 1999 (though the firm failed to file a Form U-5 until many months later) and therefore four registered representatives were not in fact engaged in the firm's securities business on that date.

B. Procedural History

By letter of August 5, 1999, NASD Regulation, Inc. (NASDR) notified the firm that it was in violation of the taping rule as of July 30, 1999. The rule authorizes exemptions and, in a letter written in October of 1999, Ross and Michelin requested such relief. In December of 1999, the Department of Member Regulation denied the request. Respondents appealed the decision to NASDR's Office of General Counsel, which denied the appeal on March 14, 2000. In April of 2000, the Office of General Counsel denied another request in which respondents sought modification of the prior actions.

Enforcement filed the instant Complaint on May 1, 2000, alleging that Respondents failed to implement the taping procedures required by Rule 3010(b)(2). Respondents requested a hearing. In a pre-hearing conference, the parties agreed on a procedural schedule which reserved hearing dates, while enabling Respondents to request the National Adjudicatory Council (NAC) to reconsider the matter. By order issued on September 12, 2000, NAC denied reconsideration and remanded the matter to the Hearing Officer.

Stipulations, pars. 9-13; Tr. 15, 19, 127, 138, 144; JX- 9, 10, 11, and 12; and transcript of pre-hearing conference, June 30, 1999, p. 17.

Enforcement urged before NAC that the prior denials were conclusive as to the Rule's applicability to Respondents (the issue they wished to contest in the disciplinary proceeding). NAC's September 12 order stated that the March 14 denial should not be read as precluding litigation of any factual or legal issue in the instant disciplinary proceeding.

A Hearing Panel, composed of an NASD Regulation Hearing Officer and two current members of District Committee No. 7, conducted hearings in Boca Raton, Florida on November 16 and 17, 2000. Each side presented two witnesses. The record consists of a list of Stipulations, thirteen Joint Exhibits, and twenty-two Respondent's Exhibits. Two documents were admitted as Panel exhibits.

C. Liability

The taping rule turns on a firm's employment of "registered persons" who were alumni of Disciplined Firms. The Rule defines "registered person" as meaning "any person registered with the Association as a representative ... pursuant to the Rule ... 1030 ... Series" (Rule 3010(b)(2)(ix)). Rule 1030 requires the registration of "representatives," a term there defined as "[p]ersons associated with a member ... who are engaged in the ... securities business for the member."

Respondents contend that they are not covered by the taping requirement because one of the four persons (Mr. Siemens) resigned from the firm in June of 1999 and was thus not "engaged in the securities business" for it on July 30, 1999 - although he continued to be registered with NASD until March of 2000, when the firm belatedly filed the pertinent Form U-5 (JX-12, pp. 6-7). Enforcement argues that the purported resignation is immaterial because the taping rule is triggered by a person's registration status, not his or her actual engagement in the securities business (Tr. 213-222).

For purposes of this decision, the Panel assumes that Mr. Siemens did resign on June 21, 1999. Such an assumption is consistent with Siemens' and Michelin's testimony, with Siemens' letter

of resignation, with the expiration of his employment agreement, and with the date submitted to NASD - whose records reflect that Siemens' employment terminated on that date, though his registration did not terminate until March of 2000 when the firm belatedly filed a Form U-5.[2] Enforcement questioned the resignation, noting Michelin's earlier statement that Siemens was on a leave of absence. But despite a thorough investigation, involving seventeen Rule 8210 requests, Enforcement admittedly had no direct evidence that Siemens performed any activity at the firm after June 21, 1999 (Tr. 222, 309). In these circumstances, the Panel assumes that Siemens was no longer a Ross employee on July 30, 1999 and turns to the asserted significance of that resignation for purposes of the taping requirement.

As noted, Rule 3010(b) imposes the taping requirement on firms employing certain numbers of "registered persons" who recently served with disciplined firms. As here relevant, that Rule defines "registered persons" as "any person registered with the Association as a representative ... pursuant to the Rule 1020, 1030, 1040, and 1100 Series" - Rules which refer respectively to principals, representatives, assistant representatives, and foreign associates. Rule 1031, pertaining to representatives like Siemens, requires that persons "engaged in ... the securities business for the member" must register.

Focusing on the "engaged in" language, Respondents argue that "for purposes of this rule, ... a registered person means not only a person registered with the Association, ... but it also means [those] who are engaging the [securities] business ..." (Tr. 259-260). Under this reading, Respondents argue that Siemens - though registered with the Association as a Ross employee on the

[2] Tr. 96, 184-185; RX-32; Panel Ex. 2; Jt. Ex. 12, p. 6. According to Michelin, he delayed the filing, hoping that Siemens would obtain his Florida license and thereby provide a return on Michelin's investment in him (Tr. 97).

day in question - nevertheless was not a "registered person" for taping purposes because he was no longer "engaged in" its securities business.

The Panel agrees with Enforcement that the taping rule is triggered by a person's registration status. The Rule says "four or more of its registered persons." It does not say "four or more of its registered persons who are also engaged in its securities business." The Association could have drafted such a rule and thus added the qualification urged by Respondents, but it did not do so. On its face, the taping rule's language thus supports Enforcement.

Enforcement's construction produces a reasonable result from an administrative viewpoint. It rests on CRD records, showing a firm's employment of the requisite number of "registered persons" who were associated with disciplined firms (Tr. 32-33), and is thus simple to administer. Respondent's approach requires firm-by-firm examinations of each registrant's status, duties, and responsibilities, as a condition precedent to enforcing the taping requirement.

NASD Rule 0113 provides that the Association's Rules "shall be interpreted in such a manner as will aid in effectuating the purposes and business of the Association, and so as to require that all practices in connection with the ... securities business shall be just, reasonable and not unfairly discriminatory." The taping Rule reflects a perceived "need for heightened supervision" and "addresses the particular problems that occur when a firm hires a large number of individuals who formerly worked at a [disciplined] firm ..." (Notice to Members 98-52, July, 1988, p. 393). Respondents' interpretation, requiring on-site inspections of every member whose employment practices otherwise warrant the taping requirement, makes that Rule harder to enforce and does not

"aid in effectuating the purposes and business of the Association." The Panel rejects Respondents' approach and upholds the Department's construction.[3]

Enforcement's focus on Siemen's registration status is also consistent with the NASD regulatory scheme, which creates a two-year period of retained jurisdiction over former representatives (By-Laws, Article 5, Section 4). Under that provision, "[i]t has long been established that the Association's jurisdiction is determined not from the termination of an individual's employment or association with a firm, but from the effective date of termination of the individual's registration, which is the date of the NASD's receipt of a Form U-5."[4] Similarly here, for purposes of the taping requirement, Siemens' status as a Ross representative remained in effect until the firm filed a U-5, notwithstanding his earlier resignation from the firm.

Respondents argue that under Enforcement's view, the taping rule would be triggered when CRD records reflect four registrants from disciplined firms - even if one of those persons had died before the date in question (Tr. 264, 271-272). But these hypotheticals do not undermine Enforcement's theory. Such asserted anomalies would flow from the firm's own failure to file the required Form U-5 on a timely basis. In the instant case, Ross did not file its U-5 pertaining to Siemens until March 16, 2000, eight months after the filing should have occurred.[5] As the Director of NASD Regulation's District Seven office acknowledged, if the firm made that filing within the requisite 30 days, the CRD records would have shown only three registered persons from disciplined firms and Ross would not have been subject to the taping rule (Tr. 53-54). In short, the firm has only

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[3] Administrative efficiency is a legitimate consideration in sustaining the enforcing agency's construction of a regulation. See EEOC v. Commercial Office Products Co., 486 U.S. 107, 124 (1988).

[4] Department of Enforcement v. Ansula Pet Liu, 1999 NASD Discip. LEXIS 32, at *12 (NAC, November 4, 1999)(citations omitted).

[5] Stipulations, paragraph 12; NASD By-Laws, Article 5, Section 3(a).

itself to blame. Circumstances showing that the violation was technical or minimal may be relevant to sanctions (as the Panel finds infra in this Decision) but they do not create defenses to liability.

D. Sanctions

Arguing that the case is egregious, Enforcement seeks expulsion of the firm, or, in the alternative, an order which directs it to install tape recorders and imposes a $100,000 fine (Tr. 241, 246, 250).[6]

Enforcement properly contends argues that Respondents willfully violated the taping rule by waiting for the outcome of this disciplinary proceeding, rather than installing the equipment after their unsuccessful efforts to obtain an exemption and reconsideration from the National Adjudicatory Council (Tr. 235-236, 242-244). It is well settled that associated persons are expected to abide by the Association's rules without forcing the institution of disciplinary proceedings. See e.g. In re Sundra Escott-Russell, 2000 SEC LEXIS 2053 at *9 (September 27, 2000) ("the fact that she waited more than a year to cooperate would be enough to find that she violated NASD Procedural Rule 8210. 'The NASD should not have to bring a disciplinary proceeding and entertain an appeal in order to obtain compliance with its rules ...' " (citations omitted)).

Members and their associated persons cannot choose to violate the Association's rules, while hoping that they will be vindicated in subsequent disciplinary litigation. Having lost in their efforts to obtain an exemption from the taping rule and reconsideration by the Council, and having failed to receive a stay from the Council or an agreement to that effect from Enforcement, Respondents were obligated to install the equipment in compliance with Rule 3010(b)(2). Their failure to do so constitutes an aggravating circumstance.

[6] The argument did not make clear whether the order and fine would run only against the firm, or against the firm and Michelin jointly and severally.

The Department also argues that its receipt of three customer complaints over a seven-month period, during which there was no taping, constitutes an aggravating circumstance (Tr. 238-239). The District Director had no knowledge as to whether any of the complaints were valid, but believed that more than one hundred firms (presumably in his District) had three or more complaints pending against them (Tr. 56). The complaints represented no more than one tenth of a percent of Ross' active accounts (Tr. 85-86). In these circumstances, the Panel is not persuaded that the existence of three unverified complaints constitutes an aggravating factor.

In the Panel's view, the particular circumstances of the violation warrant sanctions which are serious, but not extreme. First, although Ross employed four "registered persons" from disciplined firms, thereby triggering Rule 3010(b)'s taping requirement, their actual involvement in sales was minimal.

Of the four registrants (Ms. Bloom, Mr. Siemens, Mr. Sarmiento, and Ms. Selig), Respondent Michelin testified without contradiction that only Ms. Bloom, a part-time employee, actually contacted customers; that she did not go to work until after July; and that her commissions were less than one percent of the firm's commission base (Tr. 106-107). Siemens, as noted, resigned from the firm well before the date in question, and, as Michelin explained, even while employed by Ross, Siemens never obtained his Florida license and was limited to administrative responsibilities, with no customer contact (Tr. 91-92). Mr. Sarmiento absented himself sometime prior to July 30, 1999, worked for the firm "for a very short time," had an "absenteeism problem" for which he was terminated, and "didn't' do anything" at the firm (Tr. 105-106). Ms. Selig was a sales assistant who never dealt with customers (Tr. 104).[7]

[7] The Department extensively investigated the Respondents, issuing seventeen requests pursuant to Rule 8210 (RX 17 - 31). Yet it introduced no evidence to contradict Michelin's testimony about the absence or inactivity

The taping Rule reflects a need for heightened supervision when a percentage of a firm's "sales force" consists of registered persons from disciplined firms; it is "designed to prevent a reoccurrence of sales practice abuse or other customer harm" underlying the Disciplined Firm's history.[8] The registered persons who triggered the Rule here were barely part of the firm's "sales force" - on the day in question or at any other time - and were hardly in a position to perpetuate sales practice abuse or to inflict customer harm. Two of the registrants, Siemens and Sarmiento, had resigned from or been terminated by the firm before the date in question and in any event, had no customer contact when they were employed there. Ms. Bloom, though registered, did not begin work until after the date in question, when she became a minimal part-time producer. The fourth registrant, Ms. Selig, never dealt with customers.

In addition to the limited sales and customer involvement of the four registrants, Michelin testified that he now keeps a "close eye" on the employment of representatives from Disciplined Firms and that, since July 30, 1999, the firm has not "been remotely close to this [four registrant] threshold" (Tr. 144-145). Finally, he accepted responsibility for Siemens' late-filed U-5, which led to the instant Complaint, and did not try to shift that responsibility to anyone else (Tr. 96).

The taping requirement, involving a form of "heightened supervision, is part of Rule 3010, dealing with supervisory responsibilities. For violations of that Rule, the NASD Sanction Guidelines (1998) recommend fines of $5,000 to $50,000 (at p. 89). The Guideline also recommends suspending a firm for up to 30 days in egregious cases, or a longer suspension or expulsion where the firm has

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of the four persons. Indeed, it made no argument whatsoever as to three of the four and, as to Siemens, contended only that Michelin's prior descriptions (e.g., leave of absence) were inconsistent with resignation.

[8] "Self-Regulatory Organizations; Order Granting Approval of Proposed Rule Change ...", Exchange Act Rel No. 39883 (April 17, 1998), 63 Fed. Reg. at 20233-20235 (April 23, 1998); NASD Notice to Members 98-52 (July, 1998).

"systemic supervision failures" (Id.). For individuals, the Guideline recommends consideration of suspension for up to thirty days, or, in egregious cases, suspensions of up to two years or a bar (Id.).

The Panel has weighed the aggravating circumstance (Respondents' refusal to install the equipment, even after losing before the National Adjudicatory Council). It also considered certain mitigating factors. The four registrants did not create (or even pose the potential for) the kind of conduct at which the Rule was aimed. Moreover, Michelin's present attitude reflected care in avoiding hiring alumni of Disciplined Firms and acceptance of responsibility for the underlying late-filed U-5. Finally, there was no evidence of "systemic" supervisory failures at Ross. Weighing all of the circumstances, the Panel concludes, on balance, that this was a serious - but not an egregious case - and imposes a fine of $24,000, an amount slightly above the midpoint of the recommended range for supervisory violations.[9] In addition, pursuant to Notice to Members 99-91 (November, 1999), the Panel censures each Respondent.

The reasonableness of this result is also confirmed by the Guideline recommendation for late filing of a Form U-5 - the conduct which led to the instant complaint. That provision suggests fining the firm and/or responsible principal $5,000 to $50,000 and, in egregious cases, suspending or barring the individual and suspending the firm (Id., at 65-66). The delayed U-5 here involved none of the egregious characteristics mentioned there. The delay did not conceal customer complaints or disqualifying information; did not inflict harm on another registered person or firm; and did not hamper regulatory investigations or examinations. The delay was, however, lengthy and intentional, as Michelin waited for Siemens to obtain a Florida license and thereby produce a return on the money invested in him.

For Respondents' failure to institute the requisite tape recording (a violation of Rules 3010(b)(2) and 2210), the Panel concludes that the appropriate sanctions are: (1) the imposition of a fine of $24,000, for which Respondents shall be jointly and severally liable and (2) censures for each Respondent. Respondents are also jointly and severally liable for $2,909.70 in costs, reflecting $2,159.70 for transcripts and a $750 administrative fee.[10]

HEARING PANEL

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Jerome Nelson
Hearing Officer

Dated: Washington, DC
February 8, 2001

Copies to: Jonathan S. Robbins, Esq. (via facsimile and first class mail)
Franklyn Ross Michelin (via overnight and first class mail)
LH Ross & Company, Inc. (via overnight and first class mail)
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Rory C. Flynn, Esq. (via electronic and first class mail)

[9] The Guideline for supervisory violations also suggests that adjudicators consider suspending the responsible individual for thirty days. The Panel concluded that suspending Michelin would be unwarranted because of the mitigating circumstances noted above.

[10] 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.