NASD REGULATION, INC.
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,	:	
	:	Disciplinary Proceeding
Complainant,	:	No. C3A990050
	:	
v.	:	
	:	Hearing Officer - DMF
JIM NEWCOMB (CRD #1376482),	:	
	:	**HEARING PANEL DECISION**
Fort Collins, CO	:	
	:	
	:	January 13, 2000
Respondent.	:	

Digest

The Department of Enforcement filed a Complaint charging that respondent Jim Newcomb, while registered as a General Securities Representative with NASD member firm Princor Financial Services Corporation, violated NASD Rules 3040 and 2110 by participating in the sale of securities outside the regular course or scope of his association with Princor, for compensation, without giving Princor prior written notice of his intention to participate in the transactions and without obtaining Princor's permission to do so. Newcomb filed an Answer and requested a hearing.

Following a hearing, the Hearing Panel found that Newcomb participated in private securities transactions for compensation without giving Princor adequate notice and without obtaining Princor's permission, in violation of Rules 3040 and 2110. As sanctions, the Hearing Panel ordered that Newcomb be suspended from associating with any member firm in any

capacity for 90 days and fined $32,000. In addition, the Hearing Panel ordered Newcomb to pay costs in the amount of $1,797.25.

Appearances

Jacqueline D. Whelan, Esq., Regional Counsel, Denver, CO (Rory C. Flynn, Chief Litigation Counsel, Washington, DC, Of Counsel) for the Department of Enforcement.

Jim Newcomb, pro se, and Howard Goldman, Esq., Ft. Collins, CO, for respondent.

DECISION

Procedural History

The Department of Enforcement filed the Complaint in this proceeding on August 23, 1999, charging that respondent Jim Newcomb violated NASD Rules 3040 and 2110. Specifically, the Complaint alleged that, during the period from June 5, 1997 until approximately December 30, 1998, Newcomb participated in the sale of debt securities issued by Balanced Assets, Inc., an entity in which he had an economic interest, to approximately 48 members of the public. The Complaint alleged that these transactions were effected outside the regular course or scope of Newcomb's association with the member firm with which he was registered; that Newcomb did not give the firm prior written notice of his intention to participate in the transactions; and that Newcomb did not obtain the firm's written permission to participate in the transactions, which was required, under Rule 3040, because the transactions were for compensation. The Complaint charged that Newcomb thereby violated Rule 3040, and that, by violating Rule 3040, he also violated Rule 2110.

Newcomb filed an Answer to the Complaint on September 20, 1999. Newcomb admitted his association with the member firm during the period in question; that he had participated in

the sale of debt securities issued by Balanced Assets, an entity in which he had an economic interest, to approximately 48 members of the public during the period cited in the Complaint; that those transactions were effected outside the regular course of his association with the member firm with which he was then registered; and that those transactions were private securities transactions within the meaning of Rule 3040. Newcomb denied that he had engaged in these transactions without giving the member firm notice and obtaining its approval prior to participating in the transactions, alleging affirmatively that he "twice gave notice to [the firm] through an amended U-4 and followed the procedures and examples give[n] by [the firm] and the Supervising Registered Representative." Newcomb also admitted receiving a salary from Balanced Assets "in the second year of operation," but denied receiving any commissions or fees from the sale of the securities. Newcomb also asked for a hearing on the charge.

A hearing was held in Denver, Colorado, on November 11, 1999, before a Hearing Panel composed of a Hearing Officer and two former members of the District Committee for District 3. The Department of Enforcement presented the testimony of three witnesses, including Newcomb, and offered 12 exhibits (C1-8, 10-13), which were admitted in evidence. Newcomb presented his own testimony, as well as three other witnesses, and offered seven exhibits (N1-N7), which were admitted in evidence.

Subsequent to the hearing, one of the members of the Hearing Panel withdrew. The Hearing Officer notified the parties of this development and held a conference with the parties, by telephone, on January 11, 2000, to obtain the parties' views as to whether the Chief Hearing Officer should exercise her discretion under Rule 9234 to replace the Panelist, and what procedural steps would be required if the Panelist were replaced. Both parties indicated that they

did not object to the remaining members of the Panel deciding this matter without a replacement Panelist. The Chief Hearing Officer issued a Notice on January 12, 2000, advising the parties that she had decided not to appoint a replacement Panelist. The remaining members of the Hearing Panel have reviewed the case without the participation of the Panelist who withdrew; this Decision reflects only their determinations.

Facts

Newcomb first became registered as a General Securities Representative in 1985. From November 1993 until January 1999, he was registered with NASD member firm Princor Financial Services Corporation. He is presently registered with another NASD member firm, and is subject to NASD jurisdiction. (Tr. 42, 169; C11.)

The charges in the Complaint concern Newcomb's actions during the period June 1997 to December 1998, while Newcomb was registered with Princor, but earlier events put those actions in context. In July 1995, in accordance with Rule 3030, Newcomb notified Princor, through a Form U-4, that he intended to engaged in outside employment.[1] Specifically, Newcomb advised Princor that, using the business name "Jim Newcomb, CFP, CLU," he would be "[i]mplementing financial plans for fee based advisory services," by "[r]efering clients or prospects to a broker/dealer offering products that integrate to an advisory service." (N2, p. 2.) Newcomb testified he did not receive any express approval from Princor for this outside employment. (Tr. 85-86.) In November 1996, however, Newcomb did receive a copy of a letter from a Princor Compliance Officer to an NASD Compliance Specialist, apparently after the Compliance

[1] Rule 9030, which concerns "Outside Business Activities of an Associated Person," requires that an associated person give prompt notice to his or her employer firm of any outside employment. The employer is not required to give formal approval of the outside employment.

Specialist raised questions about Newcomb having received compensation from another NASD member firm. According to the letter, Princor understood Newcomb's activities as "limited merely to making recommendations as a financial planner .... He in no way participates in the execution of the plan or of the various securities transactions which may take place in execution of the plan." Based on this understanding, in accordance with Notices to Members 94-44 and 96-33, Princor had concluded that Newcomb's "activity falls within Rule 3030…," rather than under Rule 3040, which governs private securities transactions. (N2, pp. 3-4.)

In June 1997, Newcomb, through another Form U-4, notified Princor of his involvement in another business, Balanced Assets, Inc. Newcomb advised Princor that the nature of this business was "[f]inancial advising through a corp. rather than a sole proprietorship"; that he would serve as president of the corporation; and that his duties would be to "[e]valuate investments and transfers." (N5, p. 2.) Newcomb testified that he never received any written approval from Princor of his Balanced Assets activities after he sent the June 1997 Form U-4, but that, based on prior experience, he interpreted Princor's silence as tacit approval. (Tr. 79, 84-88; C12, p. 1.)

Balanced Assets, wholly owned by Newcomb and his wife (C12, p.1), began operations in June 1997, but its business was not as Newcomb had represented it to Princor. Instead, as Balanced Assets explained to potential investors, its business was "to put to work borrowed funds by loaning them out to a factoring company. The factoring company purchases invoices that are short term receivables for small, new or fast growing companies that can make effective use of immediate cash." (C2, p. 2.) To accomplish this, Balanced Assets sold "Demand

Promissory Notes" to members of the public, which paid purchasers 10% interest, compounded quarterly. Balanced Assets then loaned the funds to the factoring firm. Balanced Assets did not disclose to potential investors that when it re-loaned their funds to the factoring firm, it received interest at rates of 16-18%. (C2, pp. 2, 5; C7.)

Newcomb began selling Balanced Assets notes to members of the public, including customers of Newcomb at Princor, in June 1997. (Tr. 44; C2, C7.) By September 30, 1998, Newcomb had made more than 90 sales of Balanced Assets notes (some to repeat purchasers) for a total of more than $700,000. Newcomb made additional sales between October 1 and December 31, 1998. During this entire period, he sold nearly $1 million in notes to approximately 48 members of the public. Newcomb personally solicited each of these customers to buy the notes and made all the sales. (Tr. 44, 49-53, 55; Answer; C2.)

Newcomb claimed that when he began selling the notes, he did not realize they were securities. In 1998, however, he began to be concerned that the notes might be securities, and consulted an attorney who advised him that the notes were securities and that he should register them with the Securities and Exchange Commission. Balanced Assets subsequently filed with the SEC a Form D Notice of Sale of Securities dated September 10, 1998, which was signed by Newcomb as Balanced Assets' president. (Tr. 42-43, 57-58; C1.)

Also in September 1998, after he filed the Form D with the SEC, Newcomb submitted another Form U-4 to Princor. This Form U-4 described Balanced Assets' business as "lending funds to a factoring company," and Newcomb's duties in connection with that business as "[r]aising funds, monitoring transactions and margins to generate an income to the issuer (Balanced Assets) and the originating lenders. No commissions or fees are incurred or paid."

(N6.) The September 1998 Form U-4 did not disclose that Newcomb was selling notes to members of the public, including Princor customers, to raise funds for Balanced Assets, or that he had determined that the notes were securities, and had filed a Form D with the SEC.

Newcomb testified he never received any approval from Princor after he submitted the September 1998 Form U-4, but he continued to sell the notes. (Tr. 80-81.) Newcomb testified that he discussed Princor's failure to respond with his supervisor, and they decided to "let sleeping dogs lie." (Tr. 92-95.) He testified that in December 1998, during a routine audit, Princor focused on his activities with Balanced Assets and requested details. In January 1999, after Newcomb provided those details, Princor terminated Newcomb for cause and filed a Form U-5 notifying the NASD. (Tr. 81-83; C3.) The NASD thereupon began the investigation that led to the filing of the Complaint.

Discussion

Newcomb is charged with violating Rule 3040, which concerns "Private Securities Transactions of an Associated Person." The Rule requires an associated person, prior to participating in any private securities transaction, to give written notice to the member firm with which he or she is associated "describing in detail the proposed transaction and the person's proposed role therein and stating whether he has or may receive selling compensation in connection with the transaction …." If the associated person has received, or may receive, selling compensation, the member firm must advise the associated person, in writing, whether it approves or disapproves the person's participation in the proposed transactions. If the member firm approves the person's participation, "the transaction shall be recorded on the books and

records of the member and the member shall supervise the person's participation in the transaction as if the transaction were executed on behalf of the member."

A "private securities transaction" is any securities transaction outside the regular course or scope of an associated person's employment with a member, and "selling compensation" is "any compensation paid directly or indirectly from whatever source as a result of the purchase or sale of a security …." The Rule is designed to protect member firms from "exposure to loss and litigation, and investors from the hazards of unmonitored sales." In re William Louis Morgan, Exchange Act Release No. 32744, 54 S.E.C. Docket 1611, 1993 SEC LEXIS 2027, at *8 (Aug. 12, 1993). When an associated person fails to comply with Rule 3040 investors are "deprived of the brokerage firm's oversight and supervision, a protection they have a right to expect." Morgan, 1993 SEC LEXIS 2027, at *20-21.

Newcomb has stipulated that his sales of Balanced Assets notes were private securities transactions, within the meaning of Rule 3040; that he did not provide Princor with prior written notice of his intention to participate in the sales, in the detail specified by Rule 3040(b); and that Princor did not give him written authorization to participate in the sales. (C12, p. 3.) Thus, in effect, Newcomb does not contest the violation of Rule 3040 charged in the Complaint. In any event, the record establishes that Newcomb committed the violation charged.

The first issue under Rule 3040 is whether the Balanced Assets notes were securities. The governing legal principles are set forth in Reves v. Ernst & Young, 494 U.S. 56 (1990), where the Court explained that the "definition of 'security' [is] sufficiently broad to encompass virtually any instrument that might be sold as an investment." The Court also recognized, however, that all "notes" are not securities under this definition, and therefore set out a four-

factor analysis to "distinguish, on the basis of all of the circumstances surrounding the transactions, notes issued in an investment context (which are 'securities') from notes issued in a commercial or consumer context (which are not)."

In this case, there is no need for a prolonged Reves analysis, because Newcomb conceded that the notes were securities when he filed the Form D with the SEC, and he also admitted that in his Answer and at the hearing. Furthermore, it is clear that both Newcomb and the purchasers understood the notes to be investments, not commercial or consumer loans. The notes were sold to members of the public in order to provide working capital for Balanced Assets. Newcomb himself called a purchaser as a witness and elicited testimony that the purchaser was a Princor customer; that the relationship between Newcomb and the customer was that "[Newcomb was] a registered rep salesman and [the purchaser was his] client"; that the notes were "clearly identified [by Newcomb] as an investment"; and that the purchaser regarded the note as a small part of his investment portfolio. (Tr. 138-143.) Finally, with regard to each of the four key factors identified in Reves, the Balanced Assets demand notes were very similar to the demand notes that the Supreme Court held were securities in Reves.

The Hearing Panel also found that Newcomb received "selling compensation" for these transactions within the Rule's broad definition. Newcomb and his wife owned Balanced Assets, which received the funds generated by the sale of the notes, then loaned the funds to a factoring firm at substantially higher interest rates. While the record does not disclose Balanced Assets' total earnings, Newcomb admitted that by the end of 1998 Balanced Assets had paid him $12,000 for his services, using funds generated through this process. These benefits to Newcomb as an

owner of Balanced Assets constituted selling compensation to Newcomb for sale of the notes, within the meaning of Rule 3040.[2]

There is no dispute that Newcomb's sale of the Balanced Assets notes was outside the regular scope or course of his employment with Princor, and it is also clear that Newcomb did not provide the written notice to Princor required under the Rule. To comply with the Rule, Newcomb was required to describe the proposed transaction and his role in detail, and to disclose whether he would receive any selling compensation. The June 1997 Form U-4 that Newcomb gave Princor was misleading, not simply inadequate. Newcomb had previously notified Princor of his financial planning outside business activities, and, having received a copy of the November 1996 letter from Princor's Compliance Officer to the NASDR Compliance Specialist, Newcomb was on notice that Princor understood his activities were "limited merely to making recommendations as a financial planner." By describing Balanced Assets' business as "[f]inancial advising through a corp. rather than a sole proprietorship" in the June 1997 Form U-4, Newcomb clearly implied he would be engaged in the same type of business Princor had previously approved, rather than Balanced Assets' actual business.

When Newcomb sent Princor the September 1998 Form U-4 he provided a more accurate description of Balanced Assets' business, but he failed to disclose critical information. While he told Princor that Balanced Assets was loaning money to a factoring company, he did not tell

[2] Notice to Members 85-84, which was issued when what is now Rule 3040 went into effect, explained that "the definition of 'selling compensation' is deliberately broad in its scope. … Certain examples are provided, including … rights of participation in profits … as a general partner or otherwise. While these examples include some of the most common forms of compensation, the definition is not restricted to these examples. It includes any item of value received or to be received directly or indirectly." (C8, p. 3.)

Princor that in order to finance those loans he was selling notes, which he had registered as securities, to members of the public, including Princor customers. As a result, he effectively disguised from Princor that he was engaged in private securities transactions. Finally, Newcomb admits that, even though he had determined the notes were securities, he continued to sell them without receiving any written approval from Princor.

Therefore, the Hearing Panel has determined that Newcomb violated Rule 3040, as alleged in the Complaint. By violating Rule 3040, Newcomb also violated Rule 2110. See, e.g., Department of Enforcement v. Liu, No. C04970050 (NAC Nov. 4, 1999) (private securities transactions in violation of Rule 3040 constitute a failure to observe high standards of commercial honor in violation of Rule 2110).

Sanctions

Although Newcomb did not seriously contest the charge that he violated Rule 3040, he argued that the Hearing Panel should impose minimal sanctions for his violation, including no suspension and a fine at or near the very bottom of the range recommended in the Sanction Guidelines. On the other hand, Enforcement requests that the sanctions include "some period of suspension" and a fine "above the minimum" set forth in the Sanction Guidelines, which Enforcement urges should be increased by the $12,000 that Newcomb received as compensation from Balanced Assets.[3]

[3] Prior to the hearing, Newcomb submitted a contested offer of settlement, pursuant to Rule 9270(f). Enforcement opposed Newcomb's offer and the Hearing Panel, after deferring consideration of the offer, advised Newcomb at the outset of the hearing that it would not approve the offer. (Tr. 7.) In accordance with Rule 9270(h), Newcomb's offer was deemed withdrawn and it does not constitute a part of the record of this proceeding, and was not considered by the Hearing Panel in reaching its decision.

The applicable Sanction Guidelines recommend that the Hearing Panel consider suspending the respondent in any or all capacities for up to two years, or, in egregious cases, consider barring the respondent. In addition, the Guidelines recommend a fine of $5,000 to $50,000, and also suggest that adjudicators may increase the fine by the amount of the respondent's financial benefit. NASD Sanction Guidelines 15 (1998 ed.). The Guidelines list as principal considerations in setting sanctions for violations of Rule 3040: (1) whether the respondent had a proprietary interest in the selling enterprise; (2) whether the respondent attempted to create the impression that the member firm sanctioned the activity; (3) whether the selling away involved customers of the member firm; and (4) whether the respondent provided the member firm with verbal notice of all relevant factors.

In this case, the Hearing Panel finds Newcomb had a proprietary interest in the selling enterprise; at least some, but not all, of the purchasers were Princor customers; and Newcomb did not give Princor verbal notice of all relevant factors.[4] All of these factors weigh in favor of

[4] At the hearing, Newcomb called his former supervisor at Princor as a witness. During his testimony, the supervisor, who is no longer employed at Princor, stated that sometime prior to September 1998 (he was not certain exactly when), without Newcomb's knowledge, he discussed Newcomb's Balanced Assets activities with Princor compliance, but did not receive any guidance or any objections to Newcomb's activities. (Tr. 112-130.) The Hearing Panel did not give this testimony substantial weight in determining the appropriate sanctions. The supervisor's testimony was vague about when this occurred, what he knew about Newcomb's Balanced Assets activities, and what information he provided to Princor compliance about those activities. He could not even give a satisfactory explanation for why he contacted Princor compliance, particularly since he claimed he did not view the Balanced Assets notes as securities, and therefore did not believe Newcomb might be engaged in private securities transactions. Therefore, the Hearing Panel did not find the testimony credible. Furthermore, Newcomb did not claim he relied on any discussions he had with the supervisor, or any discussions that the supervisor may have had with Princor compliance, as affording notice to Princor of his Balanced Assets activities. He could not reasonably have made such a claim, because Princor's 1998 Manual, which was in effect at the time, advised representatives to contact Princor compliance, not their supervisors, about selling away issues, and because Newcomb indicated that until the hearing he did not know the supervisor had discussed his Balanced Assets activities with Princor compliance. (Tr. 132; C4, p. 5.)

substantial sanctions. On the other hand, there is no evidence that Newcomb attempted to create the impression that Princor sanctioned his sale of the notes.

In support of his argument for minimal sanctions, Newcomb contends that his violations of Rule 3040 were largely the fault of Princor, for failing to make clear to him his responsibilities under Rule 3040 and failing to object when he notified it of his activities on behalf of Balanced Assets; that, initially, he did not know that the Balanced Assets notes were securities; that his violations of Rule 3040 were essentially technical and did not pose any risk of injury to members of the public or Princor; and that he deserves credit for acknowledging, at this late date, that he violated the Rule. The Hearing Panel did not find any of these arguments persuasive.

In support of his first contention, Newcomb points to the relevant provisions of Princor's Registered Representative Manual in 1997, when he first notified Princor of his involvement with Balanced Assets. At that time, the Manual advised:

> Princor Registered Representatives Will Not: ... Maintain employment by, or accept compensation from, any person as a result of outside business activity ... unless previously approved by Princor. The Registered Representative must provide prompt written notice of all outside business interests. ... The written notice shall describe in detail the proposed interest, and whether the representative may receive selling compensation in connection with the outside interest.

The Manual also directed that representatives report their outside business activity on a Form U-4, and include a description of the "nature of the business" and a "brief description of [the representative's] duties." (C10 [emphasis in original.])

These provisions of the Manual addressed the disclosure of associated persons' outside business activities, as required by Rule 3030; they did not specifically mention Rule 3040 or

"private securities transactions," and there is no suggestion that any other portions of Princor's 1997 Manual addressed those topics. As a result, it appears that Princor's 1997 Manual gave Newcomb no express warnings or compliance guidance about private securities transactions. That does not mean, however, that Princor, rather than Newcomb, bears primary responsibility for his violations of Rule 3040. In 1997, Newcomb had been a registered person for more than 10 years. He was responsible for knowing his obligations and complying with them.[5]

In addition, Newcomb argues that, because Princor had not affirmatively approved his prior notifications to the firm of his outside employment activities, when the firm did not respond to his 1997 Form U-4 notifying it of his Balanced Assets activities he interpreted Princor's silence as tacit approval. Newcomb's prior notifications, however, concerned outside employment under Rule 3030, for which Princor's express approval was not required. As explained above, Newcomb's activities for Balanced Assets involved private securities transactions for compensation, and required written approval.

Nevertheless, in setting sanctions the Hearing Panel might have considered the absence of guidance in Princor's 1997 Manual and its failure to respond to the 1997 Form U-4 as mitigating facts if Newcomb had clearly and accurately disclosed Balanced Assets' intended business in the Form U-4. Instead, Newcomb told Princor that Balanced Assets' business would be "financial advising through a corp. rather than a sole proprietorship" and that he would be "evaluat[ing] investments and transfers." (N5.)

[5] See, e.g., Carter v. S.E.C., 726 F.2d 472, 473-74 (9th Cir. 1983) (rejecting representatives' defense that they were unaware of requirements of NASD rules, stating "[a]s employees, [the representatives] are assumed as a matter of law to have read and have knowledge of these rules and requirements").

During his testimony, Newcomb admitted that "this particular disclosure does not in detail represent what I did in raising funds, and loaning to a factoring company, lending to a factoring company." (Tr. 156.) Newcomb attempted to justify his misleading description of Balanced Assets' business activities by stating that when he organized Balanced Assets he "was not quite sure what I was doing with it," but he admitted that when he filed the 1997 Form U-4 he "thought it would be a good possibility" that he would be selling notes on behalf of Balanced Assets. In spite of this, Newcomb failed to disclose that Balanced Assets would be selling notes in the 1997 Form U-4, and he also failed to amend the Form U-4 promptly when he began conducting activities on behalf of Balanced Assets that were significantly different than had been represented in the 1997 Form U-4. (Tr. 157-158.)

Furthermore, even though Princor's 1997 Manual did not give Newcomb clear advice about his obligations under Rule 3040, Newcomb did receive such advice when Princor issued a revised Manual in January 1998. The 1998 Manual contained a specific, detailed section addressing "Private Securities Transactions" in which Princor clearly stated:

> The Compliance Department must be informed in writing of the Registered Representative's intention to become involved before the Registered Representative discusses, solicits, or participates in any securities transaction that is not transacted directly through Princor. Permission for these transactions, if given, must be in writing.

(C4, p. 5. (emphasis in original).) Princor's 1998 Manual also warned:

> The definition of "security" is broadly defined by the SEC and may include any number of items, contracts, or relationships not traditionally viewed as securities. ... This definition could be applied to situations that an individual may not normally deem to be "selling away." Before a Registered Representative becomes

> involved in any business deal or raises capital for any entity that could lead an investor to satisfy the definition stated above, they should contact Princor Compliance to discuss the situation.

Id.

Newcomb admits that he received and read the revised Manual. He testified that, at the time, he specifically noted the new provision regarding private securities transactions and "wonder[ed] is this thing going to apply to me or not." Yet he did not immediately amend his prior Form U-4 regarding Balanced Assets and seek written approval from Princor, or even call Princor compliance for guidance. Instead, he testified, he continued to rely on Princor's failure to respond to his June 1997 Form U-4 (which did not accurately describe Balanced Assets' business) as tacit approval of his activities, even though the 1998 Manual emphasized that approval for private securities transactions "must be in writing." (Tr. 56-59, 66-67, 75-79, 91; C5.) The Hearing Panel found that this was unreasonable and aggravating for purposes of setting sanctions.

Newcomb also admitted that after reading the new Manual in January 1998, he "was not sure" whether the notes were securities. (Tr. 57.) The 1998 Manual gave him clear guidance that under such circumstances he "should contact Princor Compliance to discuss the situation," (C4, p. 5), but Newcomb did not do so. Instead, he consulted an attorney and, based on the attorney's advice, filed the Form D with the SEC in September 1998. Thus, by September 1998, Newcomb unquestionably knew that the Balanced Assets notes were securities, and he filed a new Form U-4 with Princor. But although the September 1998 Form U-4 described Balanced Assets' lending business more accurately, it did not disclose that Balanced Assets was raising funds for that

business by selling securities to the public, including Princor customers. By omitting this information, Newcomb deprived Princor of adequate notice that he was participating in private securities transactions. Furthermore, after he sent the September Form U-4, Newcomb did not halt his sales of the notes pending receipt of written permission from Princor to continue them. Newcomb testified he decided to "let sleeping dogs lie," in reliance upon Princor's prior silent approval of his outside business activities. The Hearing Panel concluded that this was unreasonable and aggravating, for purposes of setting sanctions, because Newcomb's prior outside business activities that Princor did not expressly approve did not involve Newcomb in the sale of securities. The 1998 Manual warned Newcomb that before he became involved in the sale of securities away from Princor, he would have to have Princor's written permission.

The Hearing Panel also rejects Newcomb's argument that his violations of Rule 3040 were technical and posed no threat to members of the public or Princor. The sale of securities is closely regulated to protect the investing public. By selling Balanced Assets' notes away from Princor, Newcomb effectively deprived the purchasers of those protections. There was no one but Newcomb, who owned Balanced Assets, to determine whether the notes were suitable investments for the purchasers; to determine whether the purchasers received adequate and accurate disclosures about Balanced Assets' business and the risks associated with purchasing the notes; or to provide any of the other protections routinely afforded customers who purchase securities through member firms.

On the other hand, Princor customers who purchased notes through Newcomb were entitled to assume that Newcomb was disclosing the sales to Princor, as required by Rule 3040,

and that Princor was supervising Newcomb's sale of the notes, as required under Rule 3040 whenever a member firm approves an associated person's participation in private securities transactions. Based on those assumptions, they might have asserted claims against Princor for any losses they incurred on Balanced Assets' notes. Because Newcomb did not comply with Rule 3040, Princor was unaware of this potential exposure.

Finally, the Hearing Panel rejects Newcomb's argument that only minimal sanctions should be imposed because he now admits he violated Rule 3040. As the foregoing discussion makes clear, although Newcomb admits a "technical" violation of Rule 3040, he accepts no genuine responsibility for his actions in failing to disclose his activities to Princor, or for the resulting risks to members of the public and Princor. Therefore, the Hearing Panel concludes that substantial sanctions are required to accomplish the NASD's remedial goals. The minimal sanctions requested by Newcomb would simply reinforce his failure to acknowledge the seriousness of his violations of Rule 3040.

Conclusion

Therefore, the Hearing Panel orders that Newcomb be suspended from association with any member firm in any capacity for a period of 90 days, and that he be fined a total of $32,000, which includes a base fine of $20,000 plus the $12,000 that he was paid by Balanced Assets. In addition, the Hearing Panel orders that Newcomb pay costs in the amount of $1,797.25, which includes an administrative fee of $750 and the hearing transcript costs of $1,047.25. These

sanctions shall become effective on a date set by the Association, but not earlier than 30 days after this decision becomes the final disciplinary action of the Association.[6]

HEARING PANEL

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By: David M. FitzGerald
Deputy Chief Hearing Officer

Dated: Washington, DC
January 13, 2000

Copies to:

Jim Newcomb (via overnight delivery and first class mail)
Howard Goldman, Esq. (via overnight delivery and first class mail)
Jacqueline D. Whelan, Esq. (electronically and via first class mail)
Rory C. Flynn, Esq. (electronically and via first class mail)

[6] 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.