NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. MICHAEL O'HARE (CRD No. 2522972), 27 Jarman Place Bridgewater, NJ 08807 Respondent.	Disciplinary Proceeding No. C9B030045 Hearing Officer – JN **HEARING PANEL DECISION** May 10, 2004

Respondent violated Rules 2110 and 2310 by engaging in unsuitable excessive trading in a customer's account. For this misconduct, he was fined $7,848.55 (including $5,348.55 in commissions), suspended for ten working days, and assessed hearing costs of $2,744.85.

Appearances

For the Complainant: Michael J. Newman, Esq. and Jonathan M. Prytherch, Esq.

For the Respondent: Richard C. Szuch, Esq.

DECISION

I. Introduction

On July 9, 2003, the Department of Enforcement filed a Complaint against Respondent Michael O'Hare, alleging that he made unsuitable recommendations to a customer and engaged in excessive trading, in violation of NASD Rules 2110 and 2310. The Hearing Panel, composed of an NASD Hearing Officer and two members of NASD District Committee No. 9, conducted a hearing on November 5, 2003 in Woodbridge, New Jersey.

The Department presented two witnesses (the customer and an NASD examiner) and introduced fifteen exhibits (CX-1 through CX-15). The Respondent personally testified,

presented testimony from his branch manager, and introduced eleven exhibits (RX-1 through RX-11). Pages of the hearing transcript are cited with the prefix "Tr." Respondent and Enforcement filed post-hearing briefs on January 2 and January 5, 2004, respectively, and pages from those briefs are cited with the prefix "Br."

II. Background

Respondent is a broker with A.G. Edwards & Sons, Inc.'s ("A.G. Edwards") East Brunswick, New Jersey branch office. He has been employed by that firm since 1995 and has no disciplinary history. In mid 1999, after moving to New Jersey, customer G.D. transferred her account (the "individual account") from A.G. Edwards's Buffalo office to its branch in East Brunswick, where O'Hare became her broker. At his suggestion, she made certain investments, which are not challenged here, and the value of that account increased from $52,000 to $86,000 (Tr. 69).

The instant proceeding involves an IRA account of approximately $16,000, opened with Respondent in November 2000 using money from 401(k) plans (Tr. 11, 25, 160-61). It is undisputed that this customer was 53 years old at the time of the transactions, lived in a mortgage-free home, worked as a senior administrative assistant (with a starting salary of $40,000 per year), and had no dependent children. It is also undisputed that she had no present need for the $16,000 in the IRA account and, accordingly, informed the Respondent that she would not need those funds until retirement, twelve years later.

The new account form, which she signed, listed her primary investment goal as "Growth- Aggressive" and her net worth (excluding residence) as $150,000 (CX-3; RX-1). For the portion of assets in that account, Respondent recommended various purchases and sales of admittedly "volatile" stocks: Broadvision, JDS Uniphase, eSoft, and Netergy Networks

(Tr. 332). These transactions, though profitable at first, ultimately produced a loss of some $5,600 (CX-2).

The Complaint alleged that O'Hare's recommendations were unsuitable because of the nature of the securities, the concentration of funds in one stock at a time, and the frequency of activity in the account (Complaint, pars. 5-7). Under NASD Rule 2310, "a registered representative [must] have reasonable grounds for believing, on the basis of information furnished by the customer, and after reasonable inquiry concerning the customer's investment objectives, financial situation, and needs, that the recommended transaction is not unsuitable for the customer." Dane S. Farber, Exchange Act Release No. 49,216, 2004 SEC LEXIS 277, at *13 (Feb. 10, 2004) (citations omitted). See J. Stephen Stout, Exchange Act Release No. 43,410, 2000 SEC LEXIS 2119, at *43 (Oct. 4, 2000) ("a broker's recommendation must be suitable for a client in light of the client's investment objectives, as determined by the client's financial situation and needs").

The customer's investment objective, though important, is not necessarily decisive. "Even in cases in which a customer affirmatively seeks to engage in highly speculative or otherwise aggressive trading, a representative is under a duty to refrain from making recommendations that are incompatible with the customer's [actual] financial profile."[1]

III. Liability

A. Qualitative Unsuitability

Turning first to the question of G.D.'s investment objectives, the IRA account form listed her primary and secondary investment goals as "Growth - Aggressive" and "Growth - Conservative," respectively (CX-3; RX-1). Respondent believed that those were her goals and he acted accordingly, making recommendations at issue here, which he described as an

[1] Jack H. Stein, Exchange Act Release No. 47,335, 2003 SEC LEXIS 338, at *8 (Feb. 10, 2003) (citations omitted).

“aggressive strategy” involving “volatile” stocks (Tr. 329, 332, 334). The customer, by contrast, said she told O’Hare that she wanted the money invested “safely” for retirement purposes and denied wanting to be aggressive in the account (Tr. 27, 36, 104; CX-9).

The evidence, however, does not support her assertion. Rather, the evidence shows that she engaged in aggressive growth investments *before* opening her account with O’Hare, *while* she invested with O’Hare, and *after* closing her account with O’Hare. The Panel concludes that, despite G.D.’s protestations and conservative pose, her goals were aggressive.

Though she claimed that her investment objectives in Buffalo were “slow to moderate” (CX-8; Tr. 95), the forms for that account, executed long before the events in issue, reflect “Growth - Aggressive” and “Growth - Conservative” objectives (RX-1) – the very same goals set out in the relevant account form here. Similarly, her 401(k) accounts (the source of the IRA money), supposedly involving “safe kind[s] of stuff” (Tr. 26), included investments in funds variously described as “more aggressive than your typical mutual funds.” One of the funds was described as a “speculative fund [with] over-the-counter small cap position stocks,” and another was a “Growth Company Fund” (Tr. 263-64; CX-7, p. 6).

The customer said that she had not read the A.G. Edwards IRA account form for her account with O’Hare, but agreed that the signature on it looked like hers and that the form contained all of its information when she apparently signed it (Tr. 111-12; RX-1). Though she asserted that she was unaware that the account had a Growth - Aggressive objective (CX-9), the January and February account statements she received, which supposedly triggered her concern about trading activity, stated her primary investment objective as “Growth - Aggressive” (Tr. 47, 49; CX-4).

After the transactions at issue here, G.D. left A.G. Edwards and invested the individual account's balance in Sun Microsystems, described by Respondent (without contradiction) as "a growth aggressive technology service company, I think it's a $3 stock" (Tr. 58-59, 345). In making this investment, she told her new broker that she "didn't care" if she lost money, explaining, "I wanted to try to recoup my money" (Tr. 66). In addition she retained the eSoft stock, one of the securities alleged to be unsuitable here (Tr. 59).

The Panel saw and heard the customer at length and concludes that her primary objective was aggressive growth, as set out on the account form.

As noted, however, that finding does not decide the case. The question at issue is whether O'Hare's recommendations were appropriate for her under all of the circumstances. The Panel concludes that they were.

O'Hare understood that the $16,000 in issue reflected only a portion of her $150,000 net worth or of her $100,000 liquid net worth (Tr. 290; RX-1). O'Hare testified that these numbers came from the customer, and G.D. acknowledged they were correct during the hearing (Tr. 33, 106, 112, 289, 330).

O'Hare further knew that the customer would not need the $16,000 until twelve years later, when she planned to retire (Tr. 92-93, 284). She was a senior administrative assistant with a large corporation, who started her job at $40,000 per year (Tr. 24, 107). Respondent also knew that "[s]he did not have large monthly expenses" (Tr. 277), and the customer acknowledged that she received her house as part of a divorce settlement and had no mortgage obligation (Tr. 91). O'Hare also knew that the customer had an older child, and she "didn't have to worry about college, education expenses, anything of that nature" (Tr. 277).

O'Hare's recommendations came at a time (December 2000 through February 2001) of market optimism, reflected in A.G. Edwards's research reports (RX-5; Tr. 285). As O'Hare explained:

> It looked like Bush was getting in. We were going to get our tax cuts requested…Alan Greenspan was talking about his first initial decrease in the interest rates. And everything seemed to be in favor. And our firm was pounding the tables on it is a good time to be in equities, almost to the point where they said there is more risk being out of the market than in the market at this time, because of what they believe of the future. For a customer with a 12-year time horizon, I thought it made sense."

(Tr. 285).

In addition, Respondent had specific reasons for recommending each security. Broadvision was a profitable Internet software provider, which had nationally known clients and was part of the S&P 500 (Tr. 294). JDS Uniphase, in the "high-demand field of fiberoptics," had a large backlog of orders from its customers, including Nortel and Lucent (which then appeared to be strong companies), and its forthcoming merger would rank it first in the fiberoptics market (Tr. 296). Although eSoft could be regarded as speculative, its "revenues had increased about seven-fold in a five-year period of time," and it had relationships with Gateway and Intel (who had also invested in its common stock). Insiders were buying the stock, and A.G. Edwards was recommending purchases (Tr. 298-99). Finally, Netergy Networks was "in talks with AT&T Wireless" concerning testing the firm's semiconductors in new phones; it also had "good revenue growth" and an attractive price, when compared with its recent price range (Tr. 299).

The Panel concludes that O'Hare had reasonable bases for his recommendations, considering the prevailing optimism about the market and the other circumstances he outlined. For this customer, who was investing a relatively small portion of her assets with the goal of aggressive growth over a twelve-year period, and who had no present need for the money, the recommendations were not qualitatively unsuitable.

B. Concentration in One Company

Enforcement further urges that it was unsuitable to invest in one stock at a time, because the various securities were too risky (Br., pp. 8-12). As to the suitability of the particular stocks, the Panel already concluded that O'Hare had a reasonable basis for recommending them, given the customer's overall financial situation. It is true that a "high concentration of investments in one or a limited number of speculative securities is not suitable for investors seeking limited risk" (Faber, supra, at *26, citations omitted). But, as the Panel has found, G.D. was not such a person.[2]

Such concentration would be appropriate "only for an individual who could withstand the loss of the entire principal amount."[3] In the Panel's view, this customer was such an individual. As noted, the entire investment ($16,000) was but a portion of her net worth; she had a steady income, lived rent-free and mortgage-free, and had no dependent children. That she could chance the loss is apparent from her conduct after leaving A.G. Edwards, when she put $13,000 into Sun Microsystems (following another broker's recommendation for an aggressive investment in a single stock). When asked whether she told that broker that she could not afford to lose the money, she answered: "No. At that time I told him I didn't care. I wanted to try to recoup my money" (Tr. 66).

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[2] Enforcement's reliance (Br., pp. 11-12) on James B. Chase, Exchange Act Release No. 47,476, 203 SEC LEXIS 566 (Mar. 10, 2003) is misplaced. Chase recommended that a college student with no income or assets invest all of her money in a start-up company whose parent had a record of operating losses and whose business consisted of selling a new product with no established or tested market. The instant case, by contrast, involved a comparatively small portion of the customer's assets; companies which, though volatile, also had various positive aspects; and a customer who was not comparable to a college student without assets or income. The customers in the Department's other "concentration" cases (Br., p. 12, fn. 64) were widows who were 75 years old and 82 years old, respectively. Clinton Holland, Jr., Exchange Act Release No. 36,621, 1995 SEC LEXIS 3452 (Dec. 21, 1995), aff'd, 105 F.3d 665 (9th Cir. 1997); Gordon Scott Venters, Exchange Act Release No. 31,833, 1993 SEC LEXIS 237 (Feb. 8, 1993). O'Hare's customer, by contrast, was 53 years old, was twelve years from retirement, and had no present need for the portion invested.

[3] Venters, supra, at *4.

This was a customer who had some money to put at risk and was willing to take her chances. Considering the customer's financial situation and her aggressive outlook, the existence of reasonable bases for optimism about each of the companies, and the limited sum involved, the Panel concludes that O'Hare's strategy of short-term concentration in an aggressive stock was not unsuitable.

C. The Frequency of the Transactions

The Complaint further alleged that O'Hare engaged in unsuitable trading activity by virtue of the volume of transactions and the resulting concentration of all of her money in one security at a time (pars. 6, 7), conduct which also establishes a violation of NASD's suitability Rule.[4] To establish such liability, Enforcement must prove that (1) O'Hare controlled the account and (2) the trading activity was in fact excessive in light of the customer's financial situation and needs.[5] In the Panel's view, the Department has made that case here.

The first element is satisfied by showing that the representative exercised de facto control, which is established "when the client routinely follows the recommendations of the broker."[6] In the instant case, the client did routinely follow Respondent's recommendations; there was no evidence that she ever differed with (or even questioned) his advice. That he controlled the account is further shown by the telephone records, which suggest that a few of the

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[4] In re Paul C. Kettler, 51 S.E.C. 30, 32 (1992) (footnote omitted); see also, e.g., In re Michael H. Hume, Exchange Act Release No. 35,608, 1995 SEC LEXIS 983, at *5 n.5 (Apr. 17, 1995); In re John M. Reynolds, 50 S.E.C. 805, 806 (1992); IM-2310-2 (2).

[5] See, e.g., In re Stephen Thorlief Rangen, Exchange Act Release No. 38,486, 1997 SEC LEXIS 762, at *13 (Apr. 8, 1997) (NYSE disciplinary proceeding).

[6] Mihara v. Dean Witter & Co., 619 F.2d 814, 821 (9th Cir. 1980); see also, e.g., Erdos v. SEC, 742 F.2d 507, 508 (9th Cir. 1984); In re Donald A. Roche, Exchange Act Release No. 38,742, 1997 SEC LEXIS 1283, n.14, at *14 (June 17, 1997); In re Gerald E. Donnelly, Exchange Act Release No. 36,690, 1996 SEC LEXIS 89, at *10-11 (Jan. 5, 1996).

transactions probably occurred before he spoke to her. O'Hare's testimony did not deny control, and the Panel concludes that it existed here.

There is no precise formula for determining excessive trading, but "the most common" measure is the turnover rate or ratio.[7] As the staff's witness explained:

> "Turnover is a way to measure activity in a customer's account. It's a . . . comparison of the average equity in an account as compared to the total purchases in an account over a given time period. When you compare those two, you come up with a turnover number, number of times the equity has been turned over."

(Tr. 188).

In this case, the turnover ratio for the IRA account alone was 21.358 (CX-2; Tr. 193). When calculated on the combined basis of the customer's two A.G. Edwards accounts, the ratio was 6.9 or 5.3, depending on the transactions counted.[8]

The Panel finds that each of these numbers is troubling. "[C]ourts and commentators have suggested that an annual turnover rate of six reflects excessive trading."[9] But even a 5.3 turnover ratio is also consistent with excessive trading. See Donald A. Roche, Exchange Act Release No. 38,742 (June 17, 1997), 64 SEC Docket 2042, 2047 (turnover ratio of 3.3); Gerald E. Donnelly, Exchange Act Release No. 36,690, 1996 SEC LEXIS 89, at *7 (turnover ratios between 3.1 and 3.8);[10] John M. Reynolds, Exchange Act Release No. 30,036, 50 S.E.C. 805

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[7] Louis Loss & Joel Seligman, Securities Regulation, Section 9-C-4 and cases there cited (3d ed. 2001).

[8] Compare Enforcement's Post-Hearing Submission, pp. 16-17 and Attachment A with Respondent's counsel's February 13, 2004 letter. Enforcement says that all activity should be counted and that the turnover for the two accounts combined is 6.9. Respondent arrives at a rate lower than 6.0 by disregarding a purchase in the individual account because it occurred prior to the activity in issue. The Panel finds that any one of the numbers is indicative of excessive trading and has no occasion to resolve this subsidiary dispute.

[9] Mihara, supra, 619 F.2d at 821; see also Peter C. Bucchieri, Exchange Act Release No. 37,218, 1996 SEC LEXIS 1331, at *11 (May 14, 1996).

[10] In Donnelly, the SEC credited the Respondent's acknowledgement that "an annualized turnover rate of between two and four percent is 'presumptive of churning'" (at *7).

(1996) (turnover ratio of 4); and Samuel B. Franklin & Co., Exchange Act Release No. 7407, 42 S.E.C. 330 (1964) (turnover rates of 3.5 and 4.4).

As a further measure of excessive activity, Enforcement relied on the cost-equity ratio, which "compares the average equity in a customer's account over a given time as compared to any costs incurred in the account during that same time period, which can be commission, margin interest, any other costs" (Tr. 189). This customer's costs included over $5,300 in commissions (CX-2). The resulting cost equity ratio for the period involved was 35, which meant that the account would have had to generate a 35% return over the time of the transactions just to break even (CX-2; Tr. 194). Such a number also evidences excessive trading. See Robert H. Wolfson, Exchange Act Release No. 41,831, 1999 SEC LEXIS 1761, at **5, 10-11 (Sept. 2, 1999) (cost equity ratio of 16.5%); Jeffrey B. Bukantz, Exchange Act Release No. 41,827, 1999 SEC LEXIS 1780, at *8 (Sept. 2, 1999) (over 27%); Peter C. Bucchieri, Exchange Act Release No. 37,218, 1996 SEC LEXIS 1331, at *11 (May 14, 1996) (20% to 30%); Michael D. Sweeney, Exchange Act Release No. 29,884, 1991 SEC LEXIS 2455, at *10 (Oct. 30, 1991) (22%, 27%, 37%, and 44%).

Enforcement also showed that the securities were held for relatively brief periods of time – three, five, five, fourteen, and twenty-two days – and that two of the four securities involved were purchased, sold, and re-purchased within a short time (CX-2; Tr. 191). The short holding periods and the "in and out" trading are also suggestive of excessive trading.[11]

That the customer's investment goal was "growth aggressive" does not justify the extent of the activity here. As the SEC said in Sweeney, supra: "[e]ven if we were to assume that the customers authorized the Sweeneys to manage their accounts aggressively, they did not authorize

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[11] Note, Churning by Securities Dealers, 80 Harv. L. Rev. 869, 876-77 (1967) (and cases there cited); Bucchieri, supra; Daniel Richard Howard, Exchange Act Release No. 46,269, 2002 SEC LEXIS 1909, at *8 (July 26, 2002).

them to deplete those accounts through commissions. . . . There is a difference between aggressive investing and excessive trading" (1991 SEC LEXIS 2455, at **9-10).

IV. Sanctions

For unsuitable recommendations, the Sanction Guidelines recommend fines of $2,500 to $75,000 and suspensions of ten days to one year or, if egregious, a longer suspension or bar. NASD Sanction Guidelines (2001 ed.), p. 99. Enforcement urges a fine of $10,000, restitution of the $5,600 loss attributable to O'Hare's activity, and (treating the misconduct as not egregious) a nine-month suspension (Br., p. 17).[12] Respondent argues that any sanction should be limited to a minor fine or a censure (Br., p. 10).

This case presents a mix of circumstances. O'Hare's excessive trading was clearly established by the evidence summarized above. This was not a borderline case. Moreover, it resulted in a loss to the customer and in significant commission costs. But in the Panel's view, there were also countervailing considerations.

As shown above, O'Hare had a plausible basis for recommending each security. Second, the record suggests that the customer likely authorized or approved many of the transactions, as suggested by telephone records that show that Respondent communicated with her shortly before or after each transaction.

There was no evidence that Respondent intentionally engaged in the transactions in order to generate commissions. In the Panel's view, the frequency of trading was the product of the strategy involving short-term investments, and not bad faith, recklessness, or a desire for commissions. As noted, O'Hare thought he was executing an agreed-upon strategy. Certainly his judgment was poor. He should have realized that the frequency of the transactions was

[12] Enforcement's suggested sanctions assume Respondent's liability for recommending unsuitable securities and for excessive trading (Br., pp. 17-20). The Panel found liability only under the latter allegation.

inappropriate, especially in an IRA account. But, in the Panel's view, this error was the product of negligence, not willfulness or recklessness.

The misconduct did not involve "numerous acts and/or a pattern of misconduct," nor did it occur over "an extended period of time," two of the Guidelines' principal considerations (at p. 9). The trading involved one customer and occurred over a brief period of a few weeks. The losses in the account ($5,614.68),[13] while not insignificant, reflect less than 4% of the customer's net worth.[14]

On balance, the Panel concludes that appropriate sanctions for the excessive trading that occurred here should be drawn from the low end of the recommended range. Accordingly, the Panel suspends Respondent in all capacities for ten working days. As to monetary sanctions for suitability violations, the Guidelines recommend that adjudicators increase the fine "by adding the amount of a respondent's financial benefit" (at p. 99, fn. 2). In this case, the Panel imposes a fine of $2,500. O'Hare's commissions were $5,348.55 (CX-2), and this money must also be paid as a fine. The total fine is, therefore, $7,848.55.

The Panel declines to order restitution of the commissions to the customer. It found her unreliable. In addition to weaknesses already mentioned, her testimony reflected further problems. Although she previously stated that she "did not sign" an agreement that the money was to be in an "aggressive growth account" (CX-6), she reluctantly admitted during the hearing that the signature on a form that so described her goal looked like hers (Tr. 111).[15] G.D. said that she had no reason for testifying other than to obtain "satisfaction" and did not know that she

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[13] See Enf. Br., p. 17, fn. 70 and CX-2, Schedule A.

[14] The Panel may not consider the absence of disciplinary history as mitigating. Dep't of Enforcement v. Mark S. Balbirer, Complaint No. C07980011, 1999 NASD Discip. LEXIS 29 (NAC Oct. 18, 1999).

[15] As noted, her handwriting sample appears identical to that on the form (compare RX-11 with RX-1).

could get restitution in this proceeding (Tr. 61-62). The NASD examiner, however, had told her that restitution, though unlikely, was "a possible outcome" (Tr. 206).

She claimed not to know the meaning of "stock" (Tr. 29), but went on to describe one of the investments as "just stock" and later used the term "tech stocks" (Tr. 31, 41). She said that O'Hare went off on "tangents" when she wanted to discuss financial matters, but when asked whether she could recall an instance when he did so instead of answering a financial question, she said, "I can't say he did during a specific question" (Tr. 35, 78-79). Finally, she admitted that her complaint letter to A.G. Edwards concerning Respondent's conduct perhaps contained an "exaggeration" and that she "may have exaggerated" certain statements (Tr. 136, 138, 140).

The Panel believes that she knew and approved much of what occurred. The first three buy-and-sell transactions were profitable, and increased the value of her account (CX-2, p. 1). G.D. received and opened monthly statements and confirmation slips, and she did not complain at that time. It was not until *after* losses occurred that she complained. Respondent's branch manager said that she had a "level of sophistication and experience where she understood what was happening" and was "perfectly aware of what was happening" (Tr. 233). O'Hare described her as a person who, though "not at the highest level of the spectrum . . . was well beyond the halfway mark as far as sophistication of investments" (Tr. 276-77). The Panel agrees with those descriptions. It concludes that in the particular circumstances of this case, G.D. was not a victim who "otherwise would unjustly suffer loss," and restitution is thus not required (Guidelines, supra, p. 6).

Finally, the Panel assesses $2,744.85 in hearing costs, consisting of $1,994.85 in transcript costs and the standard $750 administrative fee.[16]

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[16] The Hearing Panel considered all of the arguments of the parties. They are rejected or sustained to the extent that they are inconsistent or in accord with the views expressed herein.

V. Conclusion

Respondent violated Rules 2110 and 2310 by engaging in excessive trading in customer G.D.'s account. For that violation, he is suspended in all capacities for ten working days, fined $7,848.55, and assessed costs of $2,744.85. These sanctions shall become effective on a date set by NASD, but not earlier than 30 days after this decision becomes the final disciplinary action of NASD, except that if this decision becomes the final disciplinary action of NASD, the suspensions shall become effective with the opening of business on Tuesday, July 6, 2004 and end at the close of business on Monday, July 19, 2004.

HEARING PANEL

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Jerome Nelson
Hearing Officer

Dated: May 10, 2004
Washington, DC

Copies to: Michael O'Hare (*via overnight and first class mail*)
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