BEFORE THE NATIONAL BUSINESS CONDUCT COMMITTEE

NASD REGULATION, INC.

In the Matter of District Business Conduct Committee for District No. 3 Complainant, vs. John Holland Mesa, Arizona, Respondent.	DECISION Complaint No. C3A960014 District No. 3 Dated: November 18, 1997

This matter was appealed by respondent John Holland ("Holland") pursuant to Procedural Rule 9310. For the reasons discussed below, we find that Holland engaged in private securities transactions in violation of Article III, Section 40 of the NASD Rules of Fair Practice (now known and hereinafter referred to as "Conduct Rule 3040"), and Article III, Section 1 of the NASD Rules of Fair Practice (now known and hereinafter referred to as "Conduct Rule 2110"). We affirm the censure and $5,000 fine.

Background. Holland entered the securities business in September 1976 as a representative of member firm Merrill Lynch, Pierce, Fenner & Smith, Inc. During the period relevant to the complaint, Holland was associated with member firm Prudential Securities Inc. ("Prudential" or "the Firm"), where he was registered as a general securities representative. Holland is not currently associated with an NASD member firm.

Factual Background. The complaint alleged that, during the period from approximately October 1, 1993 through February 14, 1994, Holland participated in private securities transactions without providing prior written notification to Prudential as required by Conduct Rule 3040, in violation of Conduct Rules 2110 and 3040.

Before Holland commenced his association with Prudential in August 1993, Evan Collins ("Collins"), the Prudential Branch Manager in Mesa, Arizona, requested pre-authorization for

Holland's affiliation with United Medical Network ("UMN")1 in a July 27, 1993, memorandum to the Firm's main office. Collins stated in the memorandum that Holland served as a director of the company and also received compensation for "marketing advice." Collins also stated in the memorandum that UMN expected "to have significant capital needs over the next few years" and that there had been "discussions with [Prudential's] Capital Markets Group about being of assistance." Several days later, Irwin Pronin, an attorney in the Firm's legal department, faxed a memorandum to Collins in which he stated that Holland's UMN affiliation appeared to be "approvable" and that Holland should disclose the affiliation on his Employee Reporting Statement ("Employee Statement") so that final approval could be given. Consistent with that instruction, Holland's Employee Reporting Statement, dated August 13, 1993, disclosed the affiliation and reported that he was paid $3,000 to $5,000 per month for consulting services.2 The Employee Reporting Statement did not request information about the nature of the affiliation and Holland provided none.

At the time of UMN's incorporation in 1992, Holland was a registered representative of Kemper Securities ("Kemper"). In December 1992, Holland advised Kemper in writing that he worked in the evenings and on weekends conducting the company's business plan and developing a matrix of possible investment banking scenarios; that he had received no cash compensation to date and would not for the foreseeable future; and that his compensation had been in the form of the stock that he and the co-founders jointly owned.

In January 1993, Holland provided a written notice to Kemper, stating that he wanted to "update" the firm on his "increased business involvement" with UMN. In this notice, he stated that, among other things, he would be acting as a liaison between the company and the "Investment Banking Area" and advised the Firm that the company would be paying him a consulting fee or other compensation as a result of his increased commitment of time on UMN matters. Kemper responded in February 1993 with a memorandum from the Compliance Department advising Holland that "[t]his memo will serve as the firm's approval for you to participate in an outside business activity involving the offering and sale of shares of [UMN] in a private placement with a minimum investment of 30,000 shares."

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[1] UMN was formed to "create and operate an interactive audio-visual communications network for the global healthcare market." Holland became involved with UMN in 1991 through an entity named Genesis Partners. It was the purpose of Genesis Partners to identify business opportunities in telemedicine and distance learning for continuing medical education and to build a business plan for the successor entity, UMN, which was incorporated in 1992. Holland was one of the founding directors of UMN and a major shareholder and was involved with "strategic as well as tactical planning" for the company.

[2] In May 1993, Holland and UMN entered into a consulting agreement pursuant to which Holland was paid $3,000 to $5,000 per month for performing certain services as described in the agreement, including "[working] with the company to research, interview and contract with domestic and international investment banking firms for the purpose of raising capital for the company."

Kemper conditioned its approval on the execution by each investor of a "hold harmless" letter acknowledging that the investor did not rely on Kemper or on Holland as an agent of the firm in making the investment; that the firm did not perform any due diligence with respect to the offering; and that the investor was able to accept the risk of the investment. The Kemper memo indicated that the firm would prepare the "hold harmless" letter for Kemper investors and that its approval was for the referenced private placement only.

During late 1992 and early 1993, Holland and Collins were having discussions about the possibility of Holland joining the Prudential office in Mesa. Collins testified that those discussions intensified in the Spring of 1993, a time when UMN was engaged in the offering referenced in the Kemper Compliance Department memorandum described above. Collins also testified that in April 1993, he attended a presentation concerning the offering at a Phoenix hotel at which Holland was one of the presenters. Collins further testified that while he clearly knew from his attendance at the April 1993 seminar that Holland had participated in raising capital for UMN, he did not expect that effort to continue because he understood that the Spring offering had met the company's near-term needs for capital and because he expected any future capital-raising activities to be presented to Prudential first.

On September 30, 1993, UMN commenced a private placement of 1,600,000 shares of common stock at $3 per share ("Offering"). According to the private placement memorandum, shares would be offered by the company's officers and directors and potentially through registered broker/dealers. The offering was made to accredited investors and was to terminate on December 31, 1993. The private placement memorandum disclosed that Holland was a director of UMN and the beneficial owner of 12.9% of the company's outstanding shares and referenced his association with Prudential. Holland participated in several presentations to potential investors in the private placement during the Offering.

The record also contains a memorandum dated October 4, 1993, from Collins to Holland in which Collins advised Holland that he was not permitted to participate in the sales process of any private placement that the Firm had not approved. The memorandum further advised Holland that, according to Prudential's legal department, the "hold harmless" letter used by Kemper only partially insulated Kemper from liability to investors. The memorandum also stated that it was more likely that Prudential would approve participation in a public offering than that the Firm would approve participation in a private placement. Collins testified that he prepared the memorandum after a discussion he had with Holland in which Holland had requested clarification as to what he could and could not do. Collins also testified that he had provided the legal department with a copy of the Kemper "hold harmless" letter and that he had delivered the October 4 memorandum to Holland after composing it. Holland testified that he did not receive the memorandum.

In the Fall of 1993, Prudential received an inquiry from the Pennsylvania Securities Commission ("Pennsylvania") asking whether transactions in UMN's offering were reported on the books and records of Prudential and whether Prudential was aware of Holland's participation in the Offering.

The Firm inquired into Holland's participation in the Offering during November 1993 in connection with its response to the inquiry. Richard Platt ("Platt"), the Firm's regional legal counsel, testified that he first learned that Holland had participated in sales activities with respect to UMN when Holland advised him of that fact on November 19, 1993 during a conference call. Collins and Platt testified that it was at that point that the legal department became directly involved. Platt testified that he received a copy of Holland's consulting agreement with UMN for the first time in December 1993.

Platt testified that either he or Collins clearly communicated that Holland should cease all capital-raising for UMN. Collins testified that during a telephone conversation in November 1993, attorneys from Prudential's legal department instructed Holland not to attend a sales presentation he had planned to attend in Ohio the following day and that Holland complied. In a letter to Holland dated February 14, 1994, Prudential formally told Holland to cease all capital-raising for UMN. Platt also testified that Holland had never provided to Prudential a written notice that complied with the requirements of Conduct Rule 3040.

Collins testified that he did not learn of the private placement until the Firm received the request from Pennsylvania and did not know of Holland's involvement until the Firm's inquiry in response to that request in November. He also stated that he had not seen a completed private placement memorandum until preparing for the hearing, although he had reviewed the pages disclosing Holland's affiliation with UMN during the process of responding to the Pennsylvania request. Collins testified that he had sought approval of the affiliation from the Firm based on his understanding that Holland's involvement with UMN after associating with Prudential was limited to serving on the Board of Directors and providing consulting services in the marketing area.

Moira Johnson ("Johnson"), Holland's former sales assistant, testified that Collins must have been aware of Holland's involvement with UMN because of his attendance at the April 1993 sales presentation and because Collins understood that if Holland came to work for Prudential Johnson would work solely for Holland for at least one year because of the time that Holland would be devoting to UMN. She also stated that she provided Collins with the Kemper UMN due diligence file and that she did not recall Holland receiving the October 4, 1993 memorandum concerning the limitations on his ability to participate in the UMN private placement. Johnson testified that it was well-known in the office that Holland was assisting UMN in raising capital and that she used the office facilities to send out offering documents for Holland. Richard Johnson ("Johnson"), who worked down the hall from Holland, also testified that it was common knowledge in the Mesa office that Holland was raising money for UMN. Johnson testified that she had discussed Holland's UMN activities with Collins and that he had never advised her that Holland was violating any Prudential policies.

Ronald Buness ("Buness"), formerly the chief financial officer of UMN, testified that Holland was not specifically compensated for his participation in the private placement. Buness also testified that Holland's compensation had been paid pursuant to the consulting agreement, which specified his duties. With respect to those duties, Buness indicated that Holland had undertaken the

enumerated responsibilities, including those pertaining to raising capital. Buness also testified that Holland performed duties that were not specifically listed in the consulting agreement.

Michael O'Connor ("O'Connor"), the former CEO of UMN, testified that Holland's role in the sales presentations consisted of bringing in potential investors that Holland had suggested might be interested in purchasing UMN securities and responding to inquiries from potential investors in the areas in which he had responsibility at UMN. O'Connor further stated that he had sent faxes and engaged in telephone conversations with Holland about UMN's financing efforts while Holland was at the Prudential office; that Holland had made no effort to hide his involvement; and that no one from Prudential had ever communicated to him in September or October 1993 that Holland's work for UMN violated any policies or rules to which Holland was subject.

Discussion. Conduct Rule 3040(a) states that no associated person shall participate in any manner in a "private securities transaction" except in accordance with the requirements of the rule. It is undisputed that the sale of UMN units in connection with the Offering in 1993 constituted private securities transactions as contemplated by the rule. Conduct Rule 3040(b) requires an associated person to provide written notice to the member with which he is associated, before participating in any private securities transaction, describing in detail the proposed transaction and the person's proposed role in the transaction and whether the person has received or may receive selling compensation in connection with the transaction. In the case of a series of related transactions in which no selling compensation has been or will be received, an associated person may provide a single written notice.

On the basis of the evidence in the record, we find that Holland participated in private securities transactions without providing the required prior written notice to Prudential, in violation of Conduct Rules 3040 and 2110.3 It is undisputed that Holland was very involved in fund raising activities for UMN. Specifically, Holland brought prospective investors to offering meetings and participated in sales presentations at those meetings. Based on this evidence, we conclude that such activity constituted participation in a private securities transaction.

We reject Holland's argument that the Kemper due diligence file and the private placement memorandum for the Offering satisfied the prior written notice requirement of Conduct Rule

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[3] We have accepted into the record on appeal two exhibits that Holland requested be adduced as additional evidence. As to the first exhibit (a list of individuals who worked at the company where Collins' son was employed (Hambrecht & Quest) and to whom UMN private placement memoranda had been sent), the Subcommittee determined that the document previously had been included in the record as "Exhibit K." With respect to the second exhibit, which is a group of documents showing that a Prudential employee bought a UMN promissory note through his IRA account at the Firm, the Subcommittee determined to admit these documents into the record to assure that the record was complete. We ratify and adopt the Subcommittee's rulings. We have not accepted into the record Holland's 1994 Employee Reporting Statement that Holland requested be adduced as additional evidence. Our decision not to accept into evidence this additional document is based on the fact that the respondent failed to satisfy the requirements in Procedural Rule 9312 that notice of the intention to introduce such evidence be made no later than 10 business days prior to the date of the hearing and be material to the proceeding.

3040. The Securities and Exchange Commission ("SEC") has held that the requirement in Conduct Rule 3040 to describe the proposed transaction "in detail" requires at the very minimum that the identity of the investor and the amount involved be provided. In re William Louis Morgan, 51 S.E.C. 622, 627, n.19 (1993). Although it is unclear from the record whether Collins ever received the Kemper due diligence file that contained the "hold harmless" letter or the private placement memorandum for the Offering from Holland or his assistant, we conclude that in any event such documents do not satisfy the requirement in the rule that an associated person describe "in detail" the proposed transaction and his or her role in it.4

We further reject Holland's argument that the onus was on Prudential to advise him that any notice that he did provide to the firm was inadequate.5 As a registered representative, Holland was charged with having knowledge of the rules regarding the private sales of securities. See Carter v. S.E.C., 726 F.2d 472 (9th Cir. 1983). Accordingly, it was Holland's responsibility to provide the Firm with written notice meeting the requirements of Conduct Rule 3040. The Employee Reporting Statement that Holland completed and signed on August 13, 1993, provided no details about his participation or role in the Offering;6 therefore, it cannot be considered as evidence of prior written notice.7

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[4] Johnson testified that she had given Collins a copy of the Kemper due diligence file. Holland argued at both the DBCC hearing and the appeal hearing that Collins had been given copies of both the Kemper due diligence file and the private placement memorandum for the Offering. Collins testified, however, that he had never received the documents from either Johnson or Holland. Collins testified that he had not seen the documents at issue until they had been provided to him by the Firm sometime in late October or early November 1993 in connection with the Pennsylvania inquiry. Notwithstanding that testimony, we note that Collins also testified that he had provided Prudential's legal department with a copy of the "hold harmless" letter prior to preparing the October 4, 1993 memorandum to Holland. In fact, Collins referenced the letter in the memorandum. Although Collins contended at the DBCC hearing that he had not received a copy of the Kemper due diligence file, the foregoing demonstrates that he, in fact, had obtained a copy of the "hold harmless" letter prior to being given the Kemper due diligence file by the Firm. We note that there is record evidence that the "hold harmless" letter was contained in the Kemper due diligence file. We further note that there is no explanation in the record for the seemingly inconsistent statements made by Collins about when he received the Kemper due diligence file that contained a copy of the "hold harmless" letter. In any event, the due diligence file did not constitute sufficient notice to satisfy the requirements of Rule 3040.

[5] Holland argued that the UMN memorandum, which listed names of persons that had received UMN offering memoranda between January 1 and January 14, 1994, was probative of Collins' knowledge about Holland's sales activities because it shows that he sent UMN offering memoranda to two individuals who worked for the same firm (Hambrecht & Quest) as Collins' son. Holland also argued that documents related to a purchase of a UMN promissory note in a Prudential IRA account showed that Collins and Platt knew of his activities with respect to UMN. We find that these documents do not prove that Collins and Platt knew the extent of Holland's involvement in UMN. Furthermore, Collins' and Platt's knowledge here is irrelevant because Rule 3040 placed the duty on Holland to provide the Firm with prior written notice about his activities.

[6] The Employee Reporting Statement indicates that Holland's affiliation with UMN would require one hour of his time per day, yet the record testimony shows that it was common knowledge in the Mesa office that Holland was spending considerably more time on UMN matters than one hour per day. The record testimony indicates that Holland was spending virtually all of his time on UMN matters. Considering the testimony about the importance of UMN to Holland and the fact that he would be devoting a lot of time to UMN his first year with Prudential, it

Unlike the DBCC, we decline to decide whether Holland's participation in the private placement offering was for compensation. Conduct Rule 3040(b) provides that the requisite written notice by an associated person prior to participating in a private securities transaction should state whether that person has or will receive selling compensation in connection with the transaction. Transactions for compensation require the firm to advise the associated person in writing whether it approves or disapproves of the person's participation in the proposed transaction, while transactions not for compensation require the firm to provide the associated person with written acknowledgment of the notice.8 Therefore, although the issue of selling compensation is determinative of the type of notice that a firm must give to an associated person who provides written notice prior to participating in a transaction, it is irrelevant for purposes of determining whether or not an associated person has violated Conduct Rule 3040. Accordingly, we need not reach the issue of whether the compensation that Holland received under the consulting agreement was related to his participation in UMN's second offering.

Sanctions

We affirm the sanctions imposed by the DBCC. With respect to the principal considerations listed in the Sanction Guidelines ("Guidelines") for selling away (private securities transactions), we find that: (1) Holland participated in several presentations to potential investors during the period of the offering, which was from September 30 through December 31, 1993; (2) Holland held a 12.9% beneficial interest in UMN; (3) to the extent Holland thought that certain documents had been provided to Collins and that those documents were sufficient notice, it does not appear that he wilfully disregarded the requirements of Conduct Rule 3040; and (4) Holland did not attempt to conceal the "selling away" activity. For the above reasons, we believe that the minimum monetary sanction under the applicable Guidelines is an appropriate remedial measure and that a suspension therefore is not necessary.9

Based on the following facts, we conclude that it is likely that Collins knew that Holland was participating in sales efforts with respect to UMN: (1) the testimony of Holland, Collins, Holland's assistant, and another employee who all worked in Prudential's Mesa, Arizona office, about the extent of Holland's involvement with UMN; (2) the evidence in the record that Holland

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appears to us that, at a minimum, Collins had a duty to alert Prudential to the fact that Holland was spending much more time than the one hour per day on UMN matters that he had noted on the form.

[7] It appears that the Employee Reporting Statement was designed to satisfy the requirements of Conduct Rule 3030, which provides that an associated person must give written notice to a member about outside business activities for which the person is compensated. The Employee Statement did not ask about Holland's proposed role with UMN and Holland provided no such information.

[8] See Subsections (c) and (d) of Conduct Rule 3040, respectively.

[9] See NASD Sanction Guidelines (1996 ed.) at 45 (Selling Away (Private Securities Transactions)).

was not spending much time on Prudential-related activities; (3) testimony from Holland's assistant that UMN private placement memoranda were kept in a visible place on her desk, in light of evidence in the record that the Mesa office was a relatively small branch office; and (4) testimony from Collins and Holland that Collins knew Holland was involved with sales in connection with the first offering, and that there would be another offering because UMN only had raised one third of the necessary capital in the first offering. Although Holland had reasonable grounds to believe that Prudential knew about his sales efforts in connection with UMN, we find that such belief did not obviate Holland's duty to provide the Firm with the proper written notice.

Conclusion

In summary, we affirm the findings of the DBCC and the sanctions imposed. Thus, Holland is censured, fined $5,000, and assessed $1,985.25 in hearing costs.[10] In addition, Holland is assessed NBCC hearing costs of $750.

On Behalf of the National Business Conduct Committee,

Joan C. Conley, Corporate Secretary

[10] We have considered all of the arguments of the parties. Such arguments are rejected or sustained to the extent that they are inconsistent or in accord with the views expressed herein.

Pursuant to NASD Procedural Rule 8320, any member who fails to pay any fine, costs, or other monetary sanction imposed in this decision, after seven days' notice in writing, will be summarily suspended or expelled from membership for non-payment. Similarly, the registration of any person associated with a member who fails to pay any fine, costs, or other monetary sanction, after seven days' notice in writing, will be summarily revoked for non-payment.