BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD REGULATION, INC.

In the Matter of Department of Enforcement, Complainant, v. Ryan Mark Reynolds Dallas, Texas Respondent.	DECISION Complaint No. CAF990018 Dated: June 22, 2001

In the proceedings below, the Hearing Panel found that Reynolds assisted in the publication of advertisements, in the form of an eight-page research report and a single-page advertisement, containing misstatements and omissions, exaggerated and unwarranted statements, and unreasonable predictions of price and future performance about an issuer, in violation of the ethical standards, the advertising rules, and the anti-fraud provisions. In addition, the Hearing Panel found that Reynolds failed to disclose that the issuer had paid for the printing and publishing costs of the advertisements and that he had received shares of the issuer's stock as compensation for the advertisement, in violation of the ethical standards, the advertising rules, and the anti-fraud provisions. The Hearing Panel also found that Reynolds improperly shared in customer losses. Held, Hearing Panel's findings sustained in part and reversed in part, and the sanctions are modified.

Respondent Ryan Mark Reynolds ("Reynolds") appealed the September 13, 2000, decision of a Hearing Panel. The Department of Enforcement ("Enforcement") of NASD Regulation, Inc. ("NASD Regulation") cross-appealed the decision. After a review of the entire record in this matter, we affirm in part and reverse in part the Hearing Panel's findings.

We affirm the Hearing Panel's findings as to the first cause of action that Reynolds violated NASD Conduct Rules 2110 and 2210 by making certain exaggerated claims, misrepresentations, and omissions in advertisements. We reverse and dismiss the Hearing Panel's findings as to the first cause of action that Reynolds engaged in fraud regarding those misrepresentations and omissions, in violation of Conduct Rule 2120 and Securities and Exchange Commission ("SEC") Rule 10b-5. We affirm the Hearing Panel's findings as to the second cause of action that Reynolds violated NASD Conduct Rules 2110 and 2210 and Section 17(b) of the Securities Act of 1933 ("Securities Act") by failing to disclose certain consideration received from an issuer for publishing, printing and distributing an advertisement. We reverse and dismiss the Hearing Panel's findings as to the second cause of action that Reynolds committed fraud based on that same conduct. We reverse and dismiss the Hearing Panel's findings as to the third cause of action alleging that, in relation to the advertisements, Reynolds failed to disclose the receipt of stock from the issuer in violation of NASD Conduct Rules 2110 and 2210 and Section 17(b) of the Securities Act. We affirm the Hearing Panel's findings as to the fourth cause of action that Reynolds violated NASD Conduct Rules 2110 and 2330(f) by sharing losses in a customer's account. Finally, we affirm the Hearing Panel's findings as to the fifth cause of action that Reynolds failed to provide the price of a security in a single-page advertisement, in violation of NASD Conduct Rules 2110 and 2210.

We modify the sanctions imposed below to reflect the causes of action that we have reversed and dismissed. The Hearing Panel's imposition of a 720-day suspension is reduced to a 223-day suspension. The Hearing Panel's imposition of a $155,000 fine is reduced to an $85,000 fine. We uphold the Hearing Panel's order of costs, re-qualification, and advance review of advertising requirements. We eliminate the Hearing Panel’s order of restitution and rescission. Our findings and modified sanctions are discussed in detail below.

I. BACKGROUND

Reynolds was first registered as a general securities representative with a member firm in 1996. During the relevant period, he was registered with Premier Capital Management ("Premier") as a general securities representative.

II. FACTUAL AND PROCEDURAL HISTORY

This matter concerns magazine advertisements in the form of an eight-page research report (the "Report") and a single-page advertisement, both of which discussed the stock of Continental Investment Corporation ("Continental"). Continental, a Dallas corporation whose securities traded on the Over-The-Counter Bulletin Board, owned a large parcel of land near Atlanta that it believed eventually could be used as a waste management facility.

Reynolds became familiar with Continental in 1996 after being introduced to Dale Sterritt ("Sterritt"), the CEO of Continental. Sterritt and Reynolds discussed Continental on numerous occasions thereafter. According to Reynolds, Sterritt told him that "Continental was on the verge of becoming one of the major waste companies in the United States and a big part of that was the 229 acre plot of land 10 miles outside of Atlanta that . . . was on the verge of becoming permitted, and that he was going to use that, along with acquisitions that he was going to make in the waste business, to build a major waste company." Reynolds testified that he became interested in Continental and began following the company after his discussions with Sterritt. Reynolds also testified that he believed that Sterritt had the business acumen to accomplish his objectives regarding Continental.

As part of his research of Continental, Reynolds reviewed the company's Forms 10-KSB and 10-QSB that it had filed with the SEC,[1] various press releases, and a study that the company had commissioned regarding the Atlanta property's viability as a waste disposal facility. Reynolds testified that he also spoke with Continental officials in addition to Sterritt, including Oliver Lee, an attorney who served on Continental's Board of Directors, and Barry Roberts ("Roberts"), the company's general counsel.

Reynolds testified that, based on this review, he learned that Continental had hired Steve Lytle, who had 16 years of experience in the waste industry and that Continental was pursuing acquisitions of companies already operating waste facilities.[2] Reynolds also testified that he obtained general information about the waste industry and contacted individuals who operated waste management businesses in the Atlanta area.

In 1997, Reynolds visited Continental's Atlanta property and confirmed that the location of the property was as described in the public filings and that there was a rail line adjacent to the site. While in Atlanta, Reynolds met with Sterritt, Roberts, Stewart Rahr ("Rahr"), who was one of Continental's investors, and AH, who was introduced as a former analyst at Bear Stearns & Co. and was serving as a consultant to Continental. According to Reynolds, Rahr stated that he was going to invest an additional $5 million in Continental. Reynolds also testified that Sterritt and Roberts had told him that Continental was close to obtaining the necessary permits for the landfill. Reynolds stated that, on the basis of the information he had gathered, he believed that Continental had the potential to become a competitive force in the waste disposal industry.

Shortly after Reynolds returned from his trip to Atlanta, Sterritt and AH contacted him and proposed that Premier issue the Report about Continental. Reynolds understood that the Report would be published as a magazine advertisement under Premier's name, with Continental financing the publishing expenses, and using Premier as the vehicle for the payment of money to printers and publishers. Reynolds also understood that his name would be listed on the Report.

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[1] A Form 10-KSB is the General Form of Annual Report for Small Business Issuers filed with the SEC. A Form 10-QSB is the General Form of Quarterly Report for Small Business Issuers filed with the SEC.

[2] Reynolds also learned that Continental had a wholly-owned subsidiary, Fiber-Seal, that had engaged in the cleaning, stain removal and fabric protection business since 1971. According to Reynolds, Fiber-Seal had recently hired John Apple, an individual whom Reynolds knew by reputation and whom he held in high regard, to serve as president of Fiber-Seal. In addition, Reynolds testified that he had learned that Continental planned to franchise its Fiber-Seal operations.

Reynolds received a draft of the Report from Continental several weeks after the Atlanta trip. Reynolds testified that he reviewed the draft and made an initial determination that the Report was accurate. Reynolds also stated that he subsequently spoke with Sterritt and Roberts to verify that Roberts had reviewed and approved the Report and that Rahr had agreed to the inclusion in the Report of his name and of certain comments attributed to him. In addition, Reynolds testified that he questioned AH about certain analyses and calculations discussed in the Report. Reynolds stated that he viewed the information in the Report as truthful based on his knowledge of Continental and the explanations he had received.

Reynolds provided the Report to Bryan James O'Leary ("O'Leary"), Premier's president and a registered general securities principal, for his review and approval. O'Leary was aware that Continental was going to reimburse Premier for the costs of printing and publishing the Report and he did not object to such an arrangement. Nonetheless, after reviewing the Report, O'Leary told Reynolds that he was concerned about some of the representations made in the Report. O'Leary then purportedly contacted an investigator from NASD's District 6 office, who told him that the Report should be sent to NASD Regulation's Advertising Regulation Department ("Advertising Department"). O'Leary indicated to Reynolds that Premier would have to send the Report to NASD Regulation for review. According to Reynolds, O'Leary told him that after the report was received by NASD Regulation there would be a waiting period and that, if they did not hear back from NASD Regulation, Premier could issue the Report.

Reynolds testified that O'Leary instructed an administrative assistant to send the Report to NASD Regulation by Federal Express with a cover letter signed by Reynolds. The record indicates that Premier mailed a package to an NASD Regulation office at or around the time when Reynolds claims Premier sent NASD Regulation a draft copy of the Report. The package was not sent to the NASD Regulation office where the Advertising Department was located, however. It is unclear, moreover, exactly what the package contained and whether anyone at NASD Regulation actually reviewed the contents.[3] The Advertising Department did not have a record of having received the Report at that time. Reynolds and O'Leary admitted that they did not verify with NASD Regulation that the Report had been received by the proper department. Nonetheless, Reynolds testified that, at the time, he believed that the Report had been sent to the correct address and that NASD Regulation had reviewed it.

After some time had passed, Sterritt called Reynolds and asked if the Report could be published. There is some difference of opinion regarding exactly what happened next. Reynolds testified that he directed Sterritt to speak to O'Leary and that he (Reynolds) believed

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[3] Premier's administrative assistant testified that she mailed the Report to the NASD. The record contains a Federal Express airbill confirming that a package from Premier was delivered to the NASD's Rockville, Maryland offices on Piccard Road. The Advertising Department was not located at that office at the time. It was located in downtown Washington, D.C.

that O'Leary gave Sterritt permission to publish the Report. Soon thereafter, the Report was published in "Mutual Funds" magazine. O'Leary testified that he was surprised when Reynolds showed him a copy of "Mutual Funds" magazine containing the Report because he believed (and thought that he had conveyed to both Reynolds and Sterritt) that the advertisement could not "be printed without approval, or at least a critique from the NASD" and did not know that it would appear in a magazine without changes. O'Leary admitted that, notwithstanding his surprise at its publication, he did not tell Reynolds to stop the advertising for lack of NASD Regulation approval.

The Report appeared as an eight-page insert advertisement in the September 1997 issue of "Mutual Funds" magazine, which had over 617,000 paid subscriptions and over 25,000 single copy sales. As discussed below, the Report generally made very positive statements about Continental and included in capitalized lettering a "VERY STRONG BUY/ACCUMULATE" recommendation. Single-page advertisements, which described Continental as "A Stock Whose Time Has Come," and invited readers to contact Premier for a copy of "our research report," appeared in the August and September 1997 issues of "Town & Country" (paid circulation of over 428,000 and 453,000 copies respectively); the September 1997 issue of "Individual Investor" (paid circulation of over 479,000 copies); the August 1997 issue of "Estates International"; and the October 1997 issue of "Leading Estates of the World."

A number of investors testified that they read the Report and contacted Premier to purchase Continental shares as a result of the information contained therein.[4] Customer BO testified that she contacted Premier and purchased 100 shares of Continental in August 1997 after reading the September 1997 issue of "Mutual Funds" magazine, which contained a copy of the Report.[5] She stated that the Report's discussion about Continental, its remark that Continental was "a stock whose time has come," and "[t]he recommendation, very strong buy, buy and accumulate," influenced her decision to purchase the shares. She purchased the stock for $23 per share and later sold it for 25 cents per share.

After reading the Report in the September 1997 issue of "Mutual Funds" magazine, customer LF contacted Premier and purchased 100 shares. He testified that the Report "positively influenced [his] decision to purchase the stock" and that "[t]here were a lot of statements in the magazine that sounded very positive regarding Continental."

Customer SJH testified that she first became aware of Continental after reading the Report in the September 1997 issue of "Mutual Funds" magazine. She contacted Premier at the telephone number listed in the advertisement and purchased 100 shares in August 1997. She

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4 Although the customers discussed herein purchased shares of Continental stock through Premier, there is no evidence that Reynolds effected the transactions or that he received any commissions related to them.

5 The September 1997 issue of the magazine was apparently delivered to subscribers in August 1997.

testified that "[j]ust about everything in the advertisement interested [her] . . . . [She did not] think there was anything that was a downer. [E]verything in the ad influenced [her] to buy it . . . . [B]ecause [the information was] upbeat . . . . [T]here [was] nothing that [indicated that] there [was] any, you know, chance of loss of money . . . . [I]t seemed like a sure thing."

The assistant director of the Advertising Department testified that she became aware of the Report on August 18, 1997, when an Enforcement employee delivered a copy of "Mutual Funds" magazine to her and pointed out the advertisement. She then learned that Premier was a relatively new member firm and that it was subject to the one year new member prefiling requirement. Her review of the Advertising Department's records indicated that the Report had not been filed. She then contacted O'Leary and conveyed her concern that the advertisement raised serious questions regarding regulatory compliance and should be pulled immediately. O'Leary indicated to her that he believed that the Report had been filed with NASD Regulation.

According to Reynolds, once he learned from O'Leary that regulators had expressed concerns about the Report, he immediately notified Sterritt, AH, and Roberts that they could no longer distribute copies of the Report or in any way advertise it. Reynolds stated that, in addition, he asked them which magazines they had contacted so that Premier could prevent any further advertisements from being published. Reynolds testified that they represented that the single-page advertisement was due to be published in "Leading Estates of the World." Reynolds asserted that he called "Leading Estates of the World" and directed them not to run the advertisement. Reynolds, along with another Premier registered representative, also took all of the stand-alone copies of the Report that they had at Premier's offices and disposed of them so that no further copies would be distributed. Reynolds testified that despite his efforts, he subsequently learned that Continental had sent out another copy of the single-page advertisement.

The Advertising Department eventually referred the matter to Enforcement. During the subsequent investigation, Enforcement discovered that Continental had paid Premier for all of the costs of printing and publishing the Report and the single-page advertisement. Enforcement also learned that Reynolds was the person at Premier who dealt with the printers and publishers regarding the Report and the single-page advertisement.[6] In addition, Enforcement discovered that Sterritt had transferred 10,000 shares of Continental stock (then worth over $200,000) to Reynolds' grandfather's account. Reynolds denied that the transfer represented compensation for his role in publishing the Report and single-page advertisement. He testified that the transfer of shares was a loan from Sterritt to help him make up losses which occurred in his grandfather's account.

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[6] For instance, the record contains a letter agreement, dated July 11, 1997, between Reynolds (on behalf of Premier) and "Mutual Funds" magazine, pursuant to which Premier and Reynolds agreed to pay "Mutual Funds" magazine approximately $172,000 to have the report published in the September 1997 issue and to have an advertisement run on the back cover of the magazine. Reynolds' name also appears on other invoices and documents related to payments for the Report and single-page advertisement.

Enforcement's investigation culminated in its filing of the current complaint against Premier, O'Leary, and Reynolds. The complaint contained eight causes of action alleging various violations of the NASD's rules and the federal securities laws stemming from Premier's publication of the Report and single-page advertisement in various magazines. Five of the causes of action pertained to Reynolds. He filed an answer denying the substantive allegations.[7]

After a hearing, the Hearing Panel determined that Reynolds had committed the violations as alleged in the complaint. The Hearing Panel imposed on Reynolds a total suspension of 720 days and a total fine of $155,000, as well as other sanctions. Reynolds appealed and Enforcement cross-appealed.

III. DISCUSSION

As discussed above, the Hearing Panel found that Reynolds had violated the NASD's rules and securities laws as alleged in the complaint. Reynolds contests the Hearing Panel's findings of violation and, alternatively, the sanctions imposed. Enforcement cross-appealed, arguing that the Hearing Panel did not address certain allegations and that the sanctions should be increased. We will discuss each contention in turn.[8]

A. First Cause—Omissions, Misrepresentations, and Exaggerated, Unwarranted or Misleading Statements.

The first cause of action alleged that Reynolds violated NASD Conduct Rules 2110,[9] 2120,[10] and 2210,[11] and SEC Rule 10b-5[12] by his role in the publication of the Report. We

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7 Co-respondents Premier and O'Leary did not appeal the Hearing Panel's decision. Accordingly, the current decision relates only to Reynolds.

8 We note that, in its cross-appeal, Enforcement argued that the Hearing Panel failed to consider all of the facts evidencing Reynolds' misconduct and requested that we impose more severe sanctions. As discussed infra, we agree in part with Enforcement's arguments. We have, for instance, addressed some of the Report's passages that Enforcement asserts are misleading but that were not specifically addressed by the Hearing Panel. Nonetheless, because we ultimately reverse and dismiss one cause of action and aspects of two others, we find that it is appropriate to reduce the sanctions, rather than increase them, as Enforcement requests.

9 Conduct Rule 2110 provides that a registered representative, "in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade." We note that, pursuant to NASD Rule 115, "[p]ersons associated with a member shall have the same duties and obligations as a member under these Rules."

10 NASD Conduct Rule 2120 states that "[n]o member shall effect any transaction in, or induce the purchase or sale of, any security by means of any manipulative, deceptive or other fraudulent device or contrivance."

find that Reynolds violated Conduct Rules 2110 and 2210, and we uphold the Hearing Panel's findings in that regard. We reverse and dismiss, however, the Hearing Panel's findings that Reynolds violated NASD Rule 2120 and SEC Rule 10b-5 in relation to the first cause of action.

1. Omissions

We find that the Report omitted material information and thus failed to present an accurate and balanced picture of the risks and benefits of investing in Continental stock. The Report's executive summary stated:

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[11] NASD Conduct Rule 2210 provides in relevant part:

> All member communications with the public shall be based on principles of fair dealing and good faith and should provide a sound basis for evaluating the facts in regard to any particular security … discussed … No material fact or qualification may be omitted if the omission, in the light of the context of the material presented, would cause the communication to be misleading.
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> Exaggerated, unwarranted or misleading statements or claims are prohibited in all public communications … and no member shall, directly or indirectly, publish, circulate or distribute any public communication that the member knows or had reason to know contained any untrue statement of a material fact or is otherwise false or misleading.
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> Communications with the public must not contain promises of specific results, exaggerated or unwarranted claims or unwarranted superlatives, opinions for which there is no reasonable basis . . . .

[12] SEC Rule 10b-5 states, in pertinent part, that "[i]t shall be unlawful for any person, directly or indirectly, . . . [t]o employ any device, scheme, or artifice to defraud, [t]o make any practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

> As it is perfectly situated to be the site of a massive waste disposal and recycling facility, we believe that [Continental] is potentially in a position to dominate the waste disposal business in the entire southeastern U.S. (and beyond). WE STRONGLY RECOMMEND THAT INVESTORS AGGRESSIVELY ACCUMULATE SHARES OF [CONTINENTAL] AT PRICES UP TO $50 PER SHARE.

In contrast to these optimistic statements, Continental's Form 10-KSB, for the period ending December 31, 1996, detailed the "often unforeseen business risks and certain cost exposures associated with the establishment, ownership and operation of solid waste landfill sites." It further stated that "the Company will be subject to comprehensive federal, state and local environmental, health and safety laws and regulations" and explained that requisite governmental permits are "difficult and time consuming to obtain" and "usually opposed by various local elected officials and citizens' groups." It mentioned particular and potentially costly problems posed by several federal regulatory statutes[13] and expressed the belief "that there will be increased regulation and legislation," even though the waste disposal industry was already "subject to extensive and evolving environmental laws and regulations."

The Report not only minimized or failed to mention many of these environmental and regulatory concerns, but it actually turned some of them into a positive marketing strategy. The Report stated that the environmental laws forced older landfills to close and thus "helped (and will continue to help) create wealth for [Continental's] shareholders! . . . [A]s regards Continental, the environmental issue is a positive, not a negative." As to licensing, "[o]ur concern, however, is not whether Continental will receive the required governmental permits, but rather when Continental will receive them."

With regard to competition, Continental's SEC filing recognized that "[t]he solid waste industry is highly competitive and requires substantial amounts of capital;" that the industry was dominated by several large companies, as well as regional and local companies; and that "[a]ll of these companies have significantly larger operations and greater financial resources than [Continental]." But according to the Report, Continental, holding "an insurmountable strategic advantage[,] can potentially achieve complete predominance over significantly larger competitors" and major waste companies might "outbid each other to acquire Continental rather than suffer the potentially irreparable damage that could be caused by a 'price war' in the southeast."

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13 The statutes mentioned were the following: the Resource Conservation and Recovery Act (potentially high cost "of insurance and bonds necessary to meet financial responsibility requirement"); the Federal Water Pollution Control Act (wetlands permitting "likely to affect the construction or expansion of many solid waste disposal sites"); the Comprehensive Environmental Response, Compensation and Liability Act (possible liability for investigatory and clean-up costs); and the Clean Air Act ("[l]andfills located in areas with air pollution problems may be subject to even more extensive air pollution controls and emission limitations").

As to Continental itself, the SEC filing showed a pattern of declining revenues, together with increasing expenses and operating losses. In the last three months of 1996, Continental had an operating loss of $320,702. For the years ending on September 30 of 1996 and 1995, it had operating losses of $909,176 and $559,507 respectively. The company derived its revenues solely from the operations of "Fiber-Seal," a subsidiary specializing in fabric protection. Continental envisioned improvement for the subsidiary, but noted that Fiber-Seal's revenues declined over the period covered by the Form 10-KSB and that, "[h]istorically, revenues from the fabric care operation have not been adequate to fund" Continental's operations.

The Report, however, described Continental as an "undervalued 'asset play,'" noting its ownership of the Atlanta property and of Fiber-Seal, which it described as a potential "cash cow." There was no mention of Continental's pattern of operating losses, Fiber-Seal's declining revenues, or that subsidiary's historic inability to fund the parent's business.

Continental's filing with the SEC concluded that, "[b]ecause of potential political, legal, bureaucratic, and other factors, there can be no assurance that the company will be able to accomplish any of the goals for the Property within a reasonable period of time." The Report, in contrast, described Continental as a "stock whose time has come[,]" and recommended the company as a "very strong" buy, with "extraordinary potential for both short-term and long-term capital appreciation."

On the subjects of regulatory hurdles, competition, financial strength, and overall outlook, the Report thus presented an overly optimistic picture, failing adequately to disclose the risks noted in Continental's SEC filing. The Report therefore lacked a balanced statement of risks and benefits of the investment advertised, in contravention of NASD Conduct Rules 2110 and 2210. <u>See</u>, <u>e.g.</u>, <u>Sheen Financial Resources, Inc.</u>, 52 S.E.C. 185, 190 (1995) (stating that advertisement's failure to discuss risks specifically associated with investment was misleading); <u>Jay Michael Fertman</u>, 51 S.E.C. 943, 950 (1994) (stating that advertisements must "disclose in a balanced way the risks and rewards of the touted investments."); <u>Donald T. Sheldon</u>, 51 S.E.C. 59, 70 (1992) (finding that published materials that "minimized the increasingly significant risks" of certain bonds was misleading), <u>aff'd</u>, 45 F.3d 1515 (11th Cir. 1995); <u>Brian Prendergast</u>, Complaint No. C3A960033, 1999 NASD Discip. LEXIS 19, at *14-18 (July 8, 1999) (finding that respondent violated NASD Conduct Rule 2210 where he sent customers sales literature that failed to present a balanced statement of the benefits and risks of the investment).

2. Predictions of Price and Future Performance

The Report also contained unwarranted predictions of future performance and price. The Report, for instance, made the following claims:

?? "Rarely does an investor have an opportunity to 'get in on the ground floor' of a potential multi-billion dollar enterprise."[14]

?? "[W]e believe that, in the not too distant future, [Continental] will meet the requirements for a New York Stock Exchange listing."[15]

?? "Even if 99% of all stocks are dragged down with the overall market, in our opinion [Continental] will be an extremely profitable exception."

?? "We believe that the discounted net present value of [Continental's] assets and future cash flows is in excess of $250 per share."[16]

?? "[W]e expect to see a tremendous upside 'run' in [Continental's] stock price all the way up to, at least, the mid-fifties."

There is no evidence in the record to support these claims. As to future performance, we note that Continental had no experience in waste management, no profits, and it depended on the earnings of a subsidiary, which were in decline and concededly insufficient to fund Continental's operations. In addition, Continental was merely in the process of evaluating the "potential operation" of a waste facility at the Atlanta site. As discussed above, Continental still had to pursue contested local, state, and federal licensing proceedings to enter a highly competitive industry, where successful operation requires costly compliance with an expanding array of environmental, health, and safety provisions. As Continental itself acknowledged in its SEC filing, "[b]ecause of potential political, legal, bureaucratic, and other factors, there can be no assurance that the Company will be able to accomplish any of its goals for the Property within a reasonable period of time."

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[14] We note that the Hearing Panel did not find that this statement was misleading. Enforcement, however, argues in its cross-appeal that this statement was misleading. We agree. As discussed infra, there was no reasonable basis for this and many other extremely optimistic statements made in the Report about Continental's future performance.

[15] The Hearing Panel did not find that this statement was misleading. We agree with Enforcement, however, that it was misleading in light of Continental's financial condition and operating history at the time when the statement was made. The courts and the SEC, moreover, have specifically noted that false statements that a security could soon be listed on an exchange are misleading. See, e.g., SEC v. Wellshire Secs., Inc., 737 F. Supp. 251, 256 (S.D.N.Y. 1990) (finding unsupported assurances that securities would be listed on exchanges to be misleading).

[16] The Hearing Panel also failed to address this statement. On appeal, Enforcement argued that it was misleading. On the basis of the record before us, we agree.

Specifically with regard to the price prediction, we find such a claim to be inherently misleading. Continental's stock was trading between approximately $23 and $25 per share during the period when the Report was published. Thus, the statement that Continental's stock would rise to, "at least, the mid-fifties" represented an unwarranted prediction that the stock price would increase more than 100 percent.

We concur with the Hearing Panel's finding that Continental's stock was speculative[17] and we find that the Report contained future performance and price projections without a reasonable basis. We also find that the distribution of such material was grossly inconsistent with both just and equitable principles of trade and the advertising standards.[18] See C. James Padgett, 52 S.E.C. 1257, 1265 (1997) (holding that predictions of substantial increases in the price of any security that are made without a reasonable basis are misleading), aff'd, 159 F.3d 637 (D.C. Cir. 1998) (table format), cert. denied, 525 U.S. 1070 (1999); Lester Kuznetz, 48 S.E.C. 551, 553 (1986) (same), aff'd 828 F.2d 844 (D.C. Cir. 1987); Richard Bruce & Co., 43 S.E.C. 777, 782 (1968) (finding that predictions of "a sharp increase in earnings with respect to a speculative stock without disclosure of the uncertainties as well as the known facts upon which a prediction rests [are] inherently misleading"); Richard J. Buck & Co., 43 S.E.C. 998, 1006 (1968) (stating that predictions of a substantial increase in the price of an unseasoned security and predictions of a sharp increase in performance are inherently misleading).

3. Exaggerated Claims

The Report also contained a number of exaggerated claims. The Report, for instance, contained the following language:

- Continental stock "offers extraordinary potential for . . . short-term . . . appreciation";

- "Continental presents a 'textbook case' . . . wherein a small company holding an insurmountable strategic advantage can potentially achieve complete predominance over significantly larger competitors";

- "Unless Bill Gates or the Japanese dig a Grand Canyonesque hole 9 miles from downtown Atlanta, the value of [Continental's] property has no place to go but up";

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17 Continental was in the developmental stage, it had little operating history, and had sustained losses. See Clinton Hugh Holland, 52 S.E.C. 562, 565 n.16 (1995) (holding that securities of "development-stage companies with a limited history of operations and no profitability" are speculative), aff' d, 105 F.3d 665 (9th Cir. 1997) (table format).

18 Although we find that Reynolds acted with gross negligence in this case, it must be emphasized that no such showing is required to find that a respondent has violated Conduct Rules 2110 and 2210.

Reynolds and O'Leary acknowledged that the Report used questionable language. Reynolds described the report as "salesy" or "a little bit fantastic" and O'Leary "thought it was ridiculously written and exaggerated." We find that the Report's unwarranted and exaggerated claims about Continental were misleading.

4. Materiality of the Information

The test of materiality is whether a reasonable investor would consider the information significant. See Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988). In other words, a misstated or omitted fact is material if it would have been viewed by a reasonable investor as having altered the "total mix" of information made available. See TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976). The "reasonable investor" standard is an objective one. Id. at 445.[19] We find that the omissions, misrepresentations, and exaggerated, unwarranted or misleading statements in the Report, discussed above, meet that test.

A reasonable investor, for instance, would certainly consider significant information pertaining to an issuer's financial condition and profitability. See Riedel v. Acutote of Colorado LLP, 773 F. Supp. 1055, 1063 (S.D. Ohio 1991) ("[A] company's 'financial condition, solvency, and profitability' [are] clearly material."); Charles E. French, 52 S.E.C. 858, 863 n.19 (1996) (holding that one cannot successfully challenge the materiality of information about the financial condition, solvency, and profitability of the entity responsible for the success or failure of an enterprise). Yet, in this case, the Report not only failed to disclose, but actually exaggerated, Continental's true financial condition.

We find that a reasonable investor also would view as important the fact that the success of an issuer's primary business venture was contingent on its receiving numerous licenses and permits that had not been obtained.[20] The Report, however, offered no meaningful

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[19] We note as well that, unlike in some private-party actions, proof of customer reliance is not a necessary element in an enforcement action. See Kuznetz, 48 S.E.C. at 554 (1986), aff'd, 828 F.2d 844 (D.C. Cir. 1987) (table format); Alfred Miller, 43 S.E.C. 233, 239 (1966).

[20] See, e.g., Warshaw v. Xoma Corp., 74 F.3d 955 (9th Cir. 1996) (dismissal of action unwarranted where defendant company had made public assurances that FDA approval of a drug crucial to company's success was imminent because company knew approval was unlikely and a reasonable juror could find that such information was materially misleading, notwithstanding company's cautionary statements); Gold Properties Restoration Co., 50 S.E.C. 1236, 1242 (1992) (finding materially misleading statements in an offering document concerning the value of certain gold reserves where inadequate sampling and testing had been performed to support such representations); Thomas J. Fittin, Jr., 50 S.E.C. 544, 546 (1991) (finding the characterization of certain drilling programs as involving developmental wells, when they were actually exploratory, to be materially misleading); Richard J. Buck & Co., 43 S.E.C. 998, 1006 (1968) (company's failure to inform investors that negotiations with electronic companies for the

discussion of the potential obstacles that Continental faced before it could even begin operating a waste disposal facility, let alone operating a profitable one. Instead, the Report touted the purchase of Continental's stock as an investment opportunity of a lifetime.

Indeed, three customer witnesses stressed the enthusiastic tone of the research report as influencing their investment decisions. One customer mentioned "the wording: 'A stock whose time has come.'" A second mentioned that "[t]here were a lot of statements in the magazine that sounded very positive regarding Continental." Another testified that the advertisement influenced her to purchase the stock, explaining "it's all upbeat. I mean there is nothing that tells you that there is any, you know, chance of loss of money. I mean, it seemed like a sure thing." We find that these investors were reasonable in considering this information to be significant in making their determinations to purchase shares of Continental's stock. These investors certainly would have been in a better position to evaluate the Report's "strong buy" recommendation if they had known about Continental's risks and adverse performance record.

As the SEC has explained, the failure to discuss risks specifically associated with an investment and the use of misleading statements violates the advertising rules. See Sheen Financial Resources, 52 S.E.C. at 190-91; Jay Michael Fertman, 51 S.E.C. at 950. The Report's overly optimistic portrayal of Continental was a far cry from the balanced discussion of risks and benefits required by NASD Rules 2110 and 2210.

Nonetheless, Reynolds argues that a finding of materiality cannot be made because there is no proof that the statements contained in Continental's Form 10-KSB filing with the SEC continued to be accurate when the Report was published. We find this argument to be without merit. The Report was first published in or about August 1997.[21] The Form 10-KSB introduced during the hearing below was filed with the SEC on February 11, 1997, it covered Continental's short fiscal year ending December 31, 1996, and it was the most recent such filing available. The record also contains Continental's Form 10-QSB for the period ending March 31, 1997, which was filed with the SEC on May 15, 1997.

Although Form 10-QSBs normally contain less detailed information than do Form 10-KSBs, it is reasonable to expect that if Continental's business had changed significantly for the

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sale or licensing of its product were producing negative results was materially misleading in light of other optimistic statements). See also San Leandro Emerg. Medical Group v. Phillip Morris Cos., 75 F.3d 801, 809-10 (2d Cir. 1996) ("Material facts include not only information disclosing the earnings and distributions of a company but also those facts which affect the probable future of the company and those which may affect the desire of investors to buy, sell, or hold the company's securities.") (citing SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969)).

[21] As discussed previously, although the Report was published in the September 1997 issue of "Mutual Funds" magazine, that issue was apparently distributed to subscribers in August 1997.

better it would have been evidenced in the Form 10-QSB, either through a brief narrative describing the change in circumstances or through improved financial information. Continental's Form 10-QSB, however, did not provide any narrative information indicating that it otherwise had improved its position and the required financial information showed that it continued to operate at a loss. Continental's Form 10-QSB also reiterated as follows:

> In order to satisfy the liquidity needs of the Company for the following twelve months, the Company will be primarily dependent upon proceeds from the sale of the Company's stock and, to a lesser extent, revenues generated from the operation of its fabric care business. Historically, revenues from the fabric care operation have not been adequate to fund the operations of the Company. Because of potential political, legal, bureaucratic, and other possible unforeseen factors unknown to the Company at this time, there can be no assurance that the Company will be able to accomplish any of its goals for the Company's Atlanta property.

Continental's Form 10-QSB, moreover, noted that "it should be read in conjunction with the Form 10-KSB Report of Continental Investment Corporation . . . for the short fiscal year ended December 31, 1996 . . . ." Finally, Reynolds did not introduce any evidence indicating that Continental's circumstances had materially changed. Under these circumstances, we find that the record evidence adequately and fairly represented Continental's financial and business positions at the time when the Report was prepared and published and that the subsequent omission of the cautionary information contained in Continental's SEC filings, in combination with the optimistic representations contained in the Report, made the Report materially misleading. Cf. Fect v. The Price Company, 70 F.3d 1078, 1083-84 (9th Cir. 1995) (holding that the shortness in time, three months, between two contradictory statements was circumstantial evidence that the optimistic statements were false when made), cert. denied, 517 U.S. 1136 (1996); In re Glenfed, Inc. Sec. Litig., 42 F.3d 1541, 1549 (9th Cir. 1994) (en banc) (absence of any indication of an intervening catastrophic event between two contradictory statements was entitled to significant weight in determining whether optimistic statement was false).

Reynolds also argues that the information contained in Continental's periodic filings with the SEC is publicly available and thus the Report did not have to specifically disclose it. As Reynolds points out, there are some cases involving private litigants where the courts have held that the failure to disclose publicly available information was not a material omission. See, e.g., Johnson v. Wiggs, 443 F.2d 803, 806 (5th Cir. 1971) (holding that there was no duty to disclose information which was already in the public domain); Panter v. Marshall Field Co., 646 F.2d 271, 289 (7th Cir.) (holding that the defendant was not obligated to re-emphasize facts already "known to the ordinary investor through papers of general circulation."), cert. denied, 454 U.S. 1092 (1981).

Nevertheless, we decline Reynolds' invitation to apply the same principle to regulatory enforcement actions. The SEC has held that, in the enforcement context, a registered representative may be found in violation of the NASD's rules and the federal securities laws for failure to fully disclose risks to customers even though such risks may have been discussed in a prospectus delivered to the customers. See, e.g., Larry Ira Klein, 52 S.E.C. 1030, 1036 (1996) ("Klein's delivery of a prospectus to Towster does not excuse his failure to inform her fully of the risks of the investment package he proposed."); Robert A. Foster, 51 S.E.C. 1211, 1213 n.2 (1994) ("Notwithstanding Foster's distribution of the prospectuses, he is liable for making untrue statements of material facts and omitting to state material facts . . . . As the Commission has long held, information contained in prospectuses 'furnishes the background against which the salesman's representations may be tested.'") (Order Instituting Proceedings, Making Findings and Imposing Sanctions) (quoting Ross Secs., Inc., 41 S.E.C. 509, 510 (1963)).

In fact, we previously rejected a claim similar to the one advanced by Reynolds here. In Miguel Angel Cruz, Complaint No. C8A930048, 1997 NASD Discip. LEXIS 62 (Oct. 31, 1997), the respondent argued that he could not be found liable for oral misrepresentations because he had supplied a prospectus to the customers that contradicted his alleged statements. Id. We held that "the fact that an unsophisticated customer receives a prospectus disclosing the nature of the product is no defense to allegations of misrepresentation or unsuitability." Id. at *47.

In any event, to the extent that the private litigation cases cited above can be read to stand for the broad proposition that any information filed with the SEC (or other regulator) never has to be disclosed further, we respectfully disagree.[22] The mere fact that information has been made publicly available through a required regulatory filing is not necessarily germane to the issue of whether the omission of the information from a subsequent disclosure document (or advertisement) is immaterial, especially when viewed against other statements made in that subsequent document.

Indeed, Reynolds' argument, taken to its logical end, might produce the incongruous result that an issuer could say one thing in an SEC filing and then say just the opposite in a subsequent document without fear of liability because the truthful statement was in some sense "publicly available." We note, as well, that a number of cases involving private-party plaintiffs appear inconsistent with the notion that publicly available information is always immaterial. See, e.g., United Paperworkers Int'l Union v. International Paper Co., 985 F.2d 1190, 1199-1200 (2d Cir. 1993) (holding that disclosure in a firm's 10-K did not cure incomplete disclosure in a proxy statement); In re Apple Computer Sec. Litig., 886 F.2d 1109, 1114 (9th Cir. 1989) ("Ordinarily, omissions by corporate insiders are not rendered immaterial by the fact that the omitted facts are otherwise available to the public."), cert. denied, 496 U.S. 942 (1990); Kronfeld v. Trans World Airlines, Inc., 832 F.2d 726, 736 (2d Cir. 1987) ("There are serious

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[22] It is far from clear to us that these cases stand for such a broad proposition, as they involved information that was widely disseminated to the public through the mass media.

limitations on a corporation's ability to charge its stockholders with knowledge of information omitted from a document such as a proxy statement or prospectus on the basis that the information is public knowledge and otherwise available to them."), cert. denied, 485 U.S. 1007 (1988).[23] Accordingly, and consistent with our discussion above, we find that the Report made misrepresentations and omissions that a reasonable investor would have found significant.

5. Reynolds' Liability for the Omissions and Misrepresentations

Reynolds argues that he cannot be held liable for the Report's contents because he is not the author of the Report. Reynolds' argument is unpersuasive. A respondent cannot escape liability merely because he or she did not personally make the misleading statements. See SEC v. First Jersey Secs., Inc., 101 F.3d 1450, 1471 (2d Cir. 1996), cert. denied, 522 U.S. 812 (1997) ("Primary liability may be imposed 'not only on persons who made fraudulent misrepresentations but also on those who had knowledge of the fraud and assisted in its perpetration.'") (citing Azielli v. Cohen Law Offices, 21 F.3d 512, 517 (2d Cir. 1994)).

Here, Reynolds was intimately involved in various aspects of the publication of the Report from the outset. He engaged in the initial discussions with Sterritt regarding Continental's financing of the Report's publication under Premier's name. Reynolds signed the letter agreement for its publication in "Mutual Funds" magazine, received publishing invoices, and negotiated payment with "Town & Country" magazine. He also had discussions with Sterritt about wiring Continental's money to Premier. He closely reviewed a draft of the Report and consulted with Continental's management about several statements in it. He reviewed with AH calculations underlying the Report. Reynolds authorized the appearance of his name on the Report as the contact person and was willing to let readers assume that he was the author. He signed the cover letter which supposedly transmitted the draft Report to NASD Regulation. Indeed, O'Leary testified that, "from start to finish," Reynolds was the "quarterback" who "put [the Report] together, you know, got the money, ran the ads."

In short, Reynolds embraced the Report, allowed his name to be held out as the author, and assisted in its distribution to the public. Under these circumstances, we find that Reynolds endorsed the contents of the Report and that he may be held liable as a direct participant in the publication of the misleading statements contained therein. See Sheen Financial Resources, 52

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23 See also Fisher v. Plessey Co., 559 F. Supp. 442, 446 (S.D.N.Y. 1994) ("[T]here may well be instances in which the offeror's duty to disclose information in offering materials is not relieved by the public availability of the same information."); Dimeling v. Tucker Anthony and R.L. Day, Inc., No. 80-909, 1982 U.S. Dist. LEXIS 13259, at *10, *27 (E.D. Pa. Apr. 8, 1982) (holding that misstatements concerning the taxability of interest on municipal bonds were material even though a Moody's manual disclosed the correct information); Dickey v. Carter, 392 F. Supp. 1055, 1056-57 (D. Mass 1975) (finding material the failure of an issuer, a newly formed mass marketing insurance company, to disclose that a large underwriter of automobile insurance "had already announced its intention to mass market insurance").

S.E.C. at 191 n.25 (finding liability and stating that, "[w]hile some of [the misleading advertising] may have been prepared by entities other than Applicants, Applicants endorsed the contents of these documents when they affixed the Firm's logo and Sheen's name and business address to each document . . . and distributed [them] to seminar attendees"); Everest Secs., Inc., 52 S.E.C. 958, 962-65 (1996) (upholding finding of violation where respondent distributed, but did not participate in the preparation of, a private placement memorandum containing misleading information), aff'd in part and vacated in part, 116 F.3d 1235 (8th Cir. 1997) (table format).

Reynolds also argues that he should not be found liable because he believed, in good faith, that the representations made in the Report were truthful and not misleading, and because he reasonably relied on the representations of Continental's management. We reject his contentions to the extent that he relies on them as a defense to Conduct Rules 2110 and 2210, neither of which requires a showing of scienter.[24]

Reynolds reviewed the Form 10K-SB that Continental filed with the SEC, and he was thus aware of Continental's history of operating losses, its declining revenues, its inability to fund ongoing operations, and its lack of experience in the waste management industry. Similarly, he was aware of the many hurdles underlying entry into that industry—numerous expensive and time-consuming contested regulatory proceedings before local, state, and federal agencies; costly compliance with environmental restrictions; and the "highly competitive" and costly nature of the industry itself. The Report, which Reynolds read closely and discussed with the issuer's General Counsel and with AH, mentioned none of these negatives.

Reynolds had a duty under Conduct Rules 2110 and 2210, which he did not discharge, to make reasonable efforts to ensure that the advertisement did not contain misleading information. We find that Reynolds was grossly negligent in participating in the Report's publication under the facts of this case and that he violated Conduct Rules 2110 and 2210.

The fact that Reynolds purportedly relied on statements made by Continental's management, including its general counsel, does not alter our conclusion. Professional standards in the securities industry require much more than unquestioning reliance on information provided by the issuer. See Everest Secs., 52 S.E.C. at 963 ("When an issuer seeks funds to finance a new and speculative venture, brokers . . . 'must be particularly careful in verifying the issuer's obviously self-serving statements as to its operations and prospects.'") (citing Hamilton Grant &

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24 See, e.g., Eliezer Gurfel, Exchange Act Rel. No. 41229, 1999 SEC LEXIS 640, at *13 (Mar. 30, 1999) ("Proof of scienter is not required to establish a violation of NASD Conduct Rule 2110."); Excel Financial, Inc., Exchange Act Rel. No. 39296, 1997 SEC LEXIS 2292 (Nov. 4, 1997) (noting that NASD Sanction Guidelines for the advertising rules under Conduct Rule 2210 differentiate between intentional or reckless and inadvertent misconduct); Daniel C. Montano, Complaint No. C02950050, 1997 NASD Discip. LEXIS 8 (Jan. 23, 1997) (holding that the fact that respondent did not intend to mislead the public is no defense to advertising rule violation under NASD Conduct Rule 2210).

Co., 48 S.E.C. 788, 794 (1987)).[25] Reliance on the advice of the issuer's counsel is also unavailing. See, e.g., Arthur Lipper Corp. v. SEC, 547 F.2d 171, 182 (2d Cir. 1976) (holding that a broker could not rely on advice of issuer's counsel; to be considered a relevant factor, the advice must come from a wholly disinterested party), cert. denied, 434 U.S. 1009 (1978); Michael Ben Lavigne, 51 S.E.C. 1068, 1071 n.18 (1994) (same), aff'd, 78 F.3d 593 (9th Cir. 1996) (table format).

In light of the aforementioned discussion, we find that Reynolds was grossly negligent in directly participating in the publication of an advertisement containing material misrepresentations, exaggerated and misleading claims, unwarranted price and performance predictions, and omitting material information. This conduct was inconsistent with high standards of commercial honor and just and equitable principles of trade, and therefore violated Conduct Rule 2110. His action also fell far short of the advertising standards set forth in Conduct Rule 2210.

We do not find, however, that the record supports the Hearing Panel's determination that Reynolds engaged in fraud. We therefore reverse and dismiss the Hearing Panel's findings that Reynolds violated Conduct Rule 2120 and SEC Rule 10b-5.

Scienter is an element of an action brought pursuant to Conduct Rule 2120 and SEC Rule 10b-5. Scienter requires proof that a respondent intended to deceive, manipulate, or defraud,[26] or that he acted with severe recklessness involving an extreme departure from the standards of ordinary care.[27] Our review of the evidence indicates that Reynolds' conduct—albeit grossly negligent and inconsistent with just and equitable principles of trade and the standards set forth in the advertising rule—did not rise to the level of scienter required by the anti-fraud provisions.[28]

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[25] See also Jay Houston Meadows, 52 S.E.C. 778, 785 (1996) ("[Meadows] had an obligation to investigate and verify consistently optimistic assertions before repeating them to others."), aff'd, 119 F.3d 1219 (5th Cir. 1997); Robert A. Magnan, Admin. Proc. File No. 3-8370, 1995 SEC LEXIS 1732, at *21-22 (July 5, 1995) ("[A] salesman cannot deliberately ignore that which he has a duty to know and recklessly state facts about matter of which he is ignorant. He must analyze sales literature and must not blindly accept recommendations made therein.") (citing Hanly v. SEC, 415 F.2d 589, 595-96 (2d Cir. 1969)).

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

[27] See Hollinger v. Titan Capital Corp., 914 F.2d 1564 (9th Cir. 1990), cert. denied, 499 U.S. 976 (1991); In re Baesa Secs. Lit., 969 F. Supp. 238, 241 (S.D.N.Y. 1997).

[28] Our findings that Reynolds acted with gross negligence but not recklessly are not inconsistent. Although it is often difficult to draw the line between the two standards, they are not synonymous, and courts have clearly made the distinction in cases involving allegations of fraud. See, e.g., Board of County Commissioners v. Liberty Group, 965 F.2d 879, 883-84

It is important to emphasize that we reject the Hearing Panel's finding of scienter based on the combination of a number of factors not ordinarily present in a fraud action. In this case, Reynolds performed a basic investigation of Continental. For instance, he personally inspected Continental's main asset, held discussions with some of Continental's potential competitors, and reviewed a study and news articles about Continental. He also testified that he believed that Continental's situation had changed for the better from the time when it had filed the Form 10-KSB with the SEC to the time when the Report was prepared because of certain representations made by Continental's management. Furthermore, he made inquiries of and received assurances from Continental's management regarding certain additional information contained in the Report. We find it significant, moreover, that Reynolds had limited experience in the securities industry and he received little guidance or direction from his supervisor, O'Leary. It is also important that Reynolds did not attempt to conceal his actions. He thought that he had cleared the advertisement with his supervisor and believed that NASD Regulation had reviewed and not objected to the Report. We find that, taken together, these facts negate a showing of fraudulent intent or extreme recklessness, notwithstanding that Reynolds' investigation was inadequate, his reliance was unreasonable, and many of his assumptions were mistaken. See Kevin D. Kunz, No. C3A960029, 1999 NASD Discip. LEXIS 20, at *45 n.21 (July 7, 1999) (respondent's reliance on issuer's comments and a misleading audited financial statement, although unreasonable, negated finding of scienter).

B. Second Cause—Undisclosed Consideration: Continental's Funding of the Report

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(10th Cir. 1992) (holding that the proper standard for a fraud claim based on SEC Rule 10b-5 is intent or recklessness and not gross negligence, although the line between recklessness and gross negligence is a fine one), cert. denied, 506 U.S. 918 (1992); Reiger v. Altris Software, Inc., No. 98-CV-528 TW (JFS), 1999 U.S. Dist. LEXIS 7949, at *22-23 (S.D. Cal. May 3, 1999) (holding that gross negligence is not sufficient to prove scienter under SEC Rule 10b-5; conduct must have been at least reckless); In re Baesa Secs. Lit., 969 F. Supp. at 2401 (noting that, in relation to actions brought under SEC Rule 10b-5, the Supreme Court left open the issue of "whether 'recklessness'—in the sense, not of gross negligence, but of 'a form of intentional conduct'—could constitute such scienter") (quoting Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193-94 n.12 (1976)). See also Cappello v. Duncan Aircraft, 79 F.3d 1465, 1474 (6th Cir.) (noting distinction between gross negligence and recklessness in tort action), cert. denied, 519 U.S. 980 (1996); King v. Fairman, 997 F.2d 259, 261 (7th Cir. 1993) (noting difference between criminal recklessness and gross negligence); Germany v. Vance, 868 F.2d 9, 27 n.10 (1st Cir. 1989) (stating that for purposes of a section 1983 action based on the denial of constitutional rights, it was "most appropriate to view 'reckless or callous indifference' not as a heightened degree of negligence (akin to 'gross negligence'), but rather as a lesser form of intent").

The second cause of action alleged that Reynolds violated NASD Conduct Rules 2110, 2120, 2210, SEC Rule 10b-5, and Section 17(b) of the Securities Act of 1933 by failing to disclose that Continental funded the printing and publication of the Report and single-page advertisement. The Hearing Panel made findings of violation consistent with the allegations in the complaint. We find that Reynolds violated NASD Conduct Rules 2110 and 2210 and Section 17(b) of the Securities Act, and we uphold the Hearing Panel's findings in that regard. We reverse and dismiss, however, the Hearing Panel's findings that he violated NASD Conduct Rule 2120 and SEC Rule 10b-5.

We find that Continental's payment to Premier of all printing and publication costs associated with the publication of the Report was a material fact that should have been disclosed. The Report purported to contain an independent analysis of Continental's stock. The relationship between the two entities could be viewed as an incentive for Premier to report favorably about and to suppress or tone down negative aspects of Continental's business prospects and financial status. It strains credulity to suggest that a reasonable investor would not have viewed the fact that Continental paid Premier for the costs of printing and publishing the advertisements as having altered the total mix of information. Put another way, a reasonable investor, deciding whether to purchase Continental on the strength of Premier's glowing recommendations, would certainly find significant the fact that Continental had financed such statements. See Kevin Eric Shaughnessy, Exchange Act Rel No. 40244, 1998 SEC LEXIS 1507 (July 22, 1998) (reasonable investor would consider broker's receipt of money from stock promoter as material in deciding whether to purchase that stock based on broker's recommendations).

We find that Reynolds was grossly negligent in participating in the publication of the Report and single-page advertisement under the facts of this case, in violation of Conduct Rules 2110 and 2210. In addition, we find that Reynolds violated Section 17(b) of the Securities Act.[29] That provision "imposes liability on one who publicizes securities for an undisclosed

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[29] Section 17(b) of the Securities Act provides in pertinent part as follows:

> It shall be unlawful for any person . . . to publish, give publicity to, or circulate any . . . advertisement . . . which . . . describes [a] security for a consideration received or to be received, directly or indirectly, from an issuer . . . without fully disclosing the receipt . . . of such consideration and the amount thereof.

We note that this aspect of the second cause of the complaint is charged as a violation of NASD Conduct Rule 2110. See DOE v. Aleksandr Shvarts, Complaint No. CAF980029, 2000 NASD Discip. LEXIS 6 at *12-13 (June 2, 2000) (noting that "violations of federal securities laws and NASD Conduct Rules, are viewed as violations of Conduct Rule 2110 without attention to the surrounding circumstances because members of the securities industry are expected and required to abide by the applicable rules and regulations")(citations omitted). As with Conduct Rules 2110 and 2210, Section 17(b) does not require proof of scienter. See SEC v. Omnigene Development, Inc., 105 F. Supp. 2d 1316, 1320 (S.D. Fla. 2000); SEC v.

compensation, whether received 'directly or indirectly.' This provision is satisfied when the facts show that, in substance, there was a quid pro quo." SEC v. Liberty Capital Group, Inc., 75 F. Supp. 2d 1160, 1162 (W.D. Wash. 1999) (quoting SEC v. Wall Street Pub. Inst., 851 F.2d 365, 376 (D.C. Cir. 1988); United States v. Amick, 439 F.2d 351, 364-65 (7th Cir. 1971)). As courts have noted, moreover, the United States House of Representatives Committee Report explained that this provision was "particularly designed to meet the evils of the 'tipster sheet,' as well as articles in newspapers or periodicals that purport to give an unbiased opinion but which opinions in reality are bought or paid for." SEC v. Wall Street Pub. Institute, Inc., 851 F.2d 365, 369 n.6 (D. D.C. 1988); see also Continental Capital & Equity Corp., Exchange Act Rel. No. 36886 (Feb. 26, 1996).

The conduct at issue here is the very conduct that Section 17(b) was intended to prohibit. The Report was published under the guise of a broker-dealer's unbiased research report when in fact it was a propaganda or marketing piece on behalf of and paid for by the issuer. The quid pro quo test, moreover, is clearly satisfied in this case. Each party gave something and got something in return. Continental gave money and received nationally-circulated advertising in which a brokerage firm touted its stock. Premier and Reynolds gave Continental that imprimatur and received nation-wide publicity, with the potential for contacts with investors. Reynolds told O'Leary that "it would be great for the firm[,]" and believed that the advertisement would "benefit Premier and [himself]" by making new contacts and opening new accounts. O'Leary also explained that Premier did not have the money to run ads and described the advertising arrangement as "more or less an agreement with Continental to get our name in the public." Under these circumstances, Continental's payment of advertising expenses obviously constituted "consideration."[30]

Liberty Capital Group, Inc., 75 F. Supp. 2d 1160, 1163 (N.D. Wash. 1999).

30 See SEC v. Liberty Capital Group, Inc., 75 F. Supp. 2d at 1162 (holding that evidence of a quid pro quo satisfies "consideration" element). See also United States v. Amick, 439 F.2d 351 (7th Cir. 1971) (upholding Section 17(b) violation where issuer did not make outright grants of cash or stock as consideration, but purchased subscriptions to the publication); Paul Page, Jr., Exchange Act Rel. No. 33-7746, 1999 SEC LEXIS 2036 (Sept. 29, 1999) (finding a violation of Section 17(b) where respondents failed to disclose a payment of $30,000, the amount of reimbursement from the issuer for publication and mailing expenses, and the receipt of the right to receive an amount of the issuer's warrants in the event the stock price reached and remained at certain price levels). Reynolds' reliance on dictionary definitions of "consideration" does not excuse him. We agree with the Hearing Panel that judicial construction of this statutory term is authoritative and that, in any event, the present facts meet Reynolds' proffered definitions. See American Heritage Dictionary at 313 (2d ed. 1982) ("Payment given in exchange for a service rendered."); Black's Law Dictionary at 306 (6th ed. 1990) ("The inducement to a contract. The cause, motive, price, or impelling influence which induces a contracting party to enter into a contract . . . some right, interest, profit or benefit accruing to one party . . . ."). Continental paid for Premier's "services," by allowing its name to be used on the Report, to convey the impression that it came from a brokerage firm, not the issuer, and by providing a contact for potential investors to buy the touted stock. Continental's money was the

We reverse and dismiss, however, the Hearing Panel's finding that Reynolds violated NASD Conduct Rule 2120 and SEC Rule 10b-5. Reynolds provided the Report to O'Leary, his supervisor and Premier's principal, for his review and approval. O'Leary was aware that Continental would be reimbursing Premier for the costs of printing and publishing the Report but he did not object to the omission of such information in the advertisement. In addition, Reynolds believed that the Report had been sent to and reviewed by NASD Regulation. Again, these circumstances do not relieve Reynolds from the findings of violation regarding Conduct Rules 2110 and 2210 and Section 17(b) of the Securities Act, which do not require a showing of scienter. Taken together, however, they do negate the scienter element of an action based on the anti-fraud provisions under the unique circumstances of this particular case. See James L. Owsley, 51 S.E.C. 524, 528 (1993) (reversing NASD's finding of fraud where respondent asked a firm official whether it was necessary for him to make certain disclosures and he received a negative response). We therefore dismiss the findings that Reynolds committed fraud in relation to the second cause of action.

C. Third Cause—Reynolds' Nondisclosure of Receipt of Continental Shares

The third cause of action alleged that Reynolds' nondisclosure of receipt of Continental shares of stock in the Report and single-page advertisement violated NASD Conduct Rules 2110, 2120 and 2210, SEC Rule 10b-5, and Section 17(b) of the Securities Act. In October of 1997, a stock transfer agent transferred 10,000 shares of Continental stock, then worth over $200,000, to an account owned by Reynolds' grandfather, over which Reynolds had discretionary authority.[31] Enforcement contended that these shares constituted undisclosed compensation to Reynolds for his activities involving the Report and the single-page advertisement. Reynolds denied that the transfer was a form of compensation, claiming instead that the shares represented a loan from Sterritt, which Reynolds had sought to help him make up losses which occurred in his grandfather's account. The Hearing Panel found that the shares represented compensation and determined that Reynolds had committed the violations alleged in the complaint by failing to disclose such compensation in the Report and single-page advertisement. We disagree and reverse and dismiss the Hearing Panel's findings.

Enforcement has not met its burden of proof in this instance, where "the totality of the evidence suggests an equally or more compelling inference than [Enforcement's] allegation." SEC v. Moran, 922 F. Supp. 867, 892 (S.D.N.Y. 1996). Here, Enforcement offered no direct evidence to support its allegation that the Continental shares were compensation for the

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"inducement" for Premier to enter into the arrangement. This small firm, which could not afford to run ads by itself, now had the means of reaching a national audience of investors, and a valuable "benefit" thus accrued to it.

[31] The shares bore some kind of restriction. The record does not contain details as to the nature of the restriction or its economic impact, if any, on the shares' value. In any event, the account statement valued them at $205,630.

Report. Enforcement simply pointed to two facts, the publication of the Report itself and the transfer of the shares.

Reynolds, on the other hand, testified that he had arranged for the transfer of the shares because of the decline in value in his grandfather's account. Reynolds explained that he sought help from Sterritt because Sterritt was one of the few people he knew who had the resources to help him. Reynolds also believed that he lacked the collateral for a bank loan. Reynolds stated that Sterritt did not personally have sufficient funds to lend Reynolds, but agreed to lend restricted Continental stock to his grandfather's account. During the proceedings below, Reynolds submitted Sterritt's sworn affidavit corroborating his assertion that the transaction was a loan.

The sequence of events also lends credence to Reynolds' version of events. The stock transfer occurred long after the time when Premier agreed to issue the Report, the advertising arrangements had been made, and the Report had been published, but just after Reynolds' grandfather's account had suffered significant losses.[32]

One could infer that the stock transfer represented compensation, but one could also reasonably accept that it was a loan in light of the evidence introduced during the proceedings below. We therefore find that Enforcement did not meet its burden of proof. See Moran, 922 F. Supp. at 892 (noting that equally compelling inferences do not suffice to prove cause of action by a preponderance of the evidence); Thomas D. Coldicutt, Complaint No. C07950054, at 8 (April 7, 1999) (same). Accordingly, we reverse and dismiss the third cause of action.

D. Fourth Cause—Reynolds' Sharing of Customer Losses

The fourth cause of action alleged that Reynolds violated NASD Conduct Rule 2330(f) by sharing in customer losses. We find that the evidence supports the allegations of the fourth cause and we uphold the Hearing Panel's finding of violation.

Conduct Rule 2330(f) provides that no associated person "shall share directly or indirectly in the profits or losses in any account of a customer" held with a member firm. Reynolds does not dispute that he arranged the transfer of some $200,000 worth of Continental stock to his grandfather's Premier account to restore losses. Reynolds stated, "I had lost some money in my granddad's account, and I felt bad and I wanted to put something back in it. "

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32 Premier agreed to issue the Report in May 1997. Most of the arrangements with the various publishers were made in July 1997. The Report and one-page advertisement were published in late August and early September 1997. The loss in Reynolds' grandfather's account occurred in October 1997. The stock was transferred into Reynolds' grandfather's account on October 23, 1997.

Reynolds argues that he did not violate the rule because there was no underlying sharing agreement between him and the customer, because he was not attempting to hide misconduct, and because there was a family relationship between him and the customer. Such factors, while perhaps mitigating for purposes of sanctions, do not excuse the violation. The rule contains no requirement for an antecedent agreement or for any particular motive. Nor does it create an exception for grandsons. Conduct Rule 2330(f) contains a flat ban on "directly or indirectly" sharing losses in a customer's account. A broker who contributes his own assets (whether received as compensation or a loan) because he wants "to put something back in" to offset trading losses is "sharing" those losses in any sense of the word. Accordingly, we find that Reynolds shared his grandfather's losses, in violation of Rules 2330(f) and 2110.

E. Fifth Cause—Omitted Price

The fifth cause alleged that Reynolds violated Rule 2210(d)(2)(B)(ii)'s requirement that "[r]ecommendations on behalf of corporate equities must provide the price at the time the recommendation is made." The Hearing Panel found that Reynolds violated this provision. We concur.

This cause of action relates to Premier's single-page advertisement that appeared in "Town & Country," "Individual Investor," "Estates International," and "Leading Estates of the World" magazines. The advertisement described Continental as "A Stock Whose Time Has Come" but failed to provide any price for the security. These ads thus violated the above advertising rule and Rule 2110's ethical standard. Having previously found that Reynolds was directly involved in all of the advertising at issue, we hold him in violation of Conduct Rules 2110 and 2210(d)(2)(B)(ii).

F. Evidentiary and Procedural Matters

Reynolds argues that the Hearing Panel below erred by admitting into evidence investigative transcripts of Reynolds' testimony because Enforcement did not give Reynolds notice of the specific matters about which Enforcement sought testimony prior to the taking of such testimony, in violation of the notice requirements of Section 15A(h)(1) of the Securities Exchange Act of 1934. We reject Reynolds' argument. Section 15A(h)(1) provides: "In any proceeding by [the NASD] to determine whether a . . . person associated with a member should be disciplined . . . , the association shall bring specific charges, notify such . . . person of, and give him an opportunity to defend against, such charges, and keep a record."

Contrary to Reynolds' argument, this provision relates to the formal filing of an action against an associated person—namely, the filing of a complaint—and not to requests for on-the-record testimony. In this case, the requirements of Section 15A(h)(1) were clearly followed. Enforcement provided notice to Reynolds of the complaint, which contained specific charges, and gave him an opportunity to defend himself. Reynolds answered the complaint and defended against this action, with the assistance of counsel, during the hearing below.

NASD Procedural Rule 8210, which was subject to public comment and approval by the SEC, relates to requests for on-the-record testimony. Subsection (a)(1) of Rule 8210 provides Enforcement with the authority to "require . . . a person associated with a member . . . to provide information orally . . . and to testify . . . under oath or affirmation . . . with respect to any matter involved in the investigation, complaint, examination, or proceeding." Subsection (d) of the rule states simply that "[a] notice under this Rule shall be deemed received by the member or person to whom it is directed by mailing or otherwise transmitting the notice to the last known business address of the member or the last known residential address of the person as reflected in the Central Registration Depository."[33] The rule does not require that Enforcement give an associated person advance notice of the matters about which he or she will be examined and we do not find that the Hearing Panel erred in admitting the transcripts in this case.[34]

IV. SANCTIONS

The Hearing Panel imposed the following sanctions on Reynolds: 720-day suspension; $155,000 fine; re-qualification requirement; and a three year pre-filing of advertisement and sales literature requirement. Reynolds was also required to pay customer BO $2,329.86 in restitution, jointly and severally with O'Leary, with interest running from August 7, 1997. (Such interest to be calculated at the rate prescribed in 26 U.S.C. §6621(a)(2).) In addition, for a period of 30 days from the effective date of the Hearing Panel's decision, customers LF and SJH could sell the Continental shares (which they purchased on August 18, 1997 and August 25, 1997, respectively) to O'Leary or Reynolds, who were obliged, jointly and severally, to pay

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[33] In essence, Rule 8210(d) merely sets forth the circumstances under which a person will be considered to have received the request for on-the-record testimony.

[34] In this regard, we note that NASD Regulation is a private self-regulatory organization that is not subject to the same procedural due process requirements that are applicable to government agencies. See Larry Ira Klein, 52 S.E.C. at 1039 n.36 (1996). Evidence is generally admissible if it is probative and reliable. In this case, the transcript of Reynolds' on-the-record testimony satisfies these requirements. The transcript represented Reynolds own testimony (admissions of a party opponent) about matters central to the case. Moreover, Reynolds was represented by counsel during the on-the-record interview and the hearing. Reynolds also was able to testify about (and clarify) his previous testimony during the hearing. Finally, Reynolds was aware, at least in a general sense, that NASD Regulation was reviewing the circumstances surrounding the Report's publication as a result of his conversation with O'Leary about the Advertising Department's concern over the contents of the Report and certain statements made by NASD Regulation examiners during an on-site examination of Premier. Accordingly, we find no error in the Hearing Panel's admitting the transcript into evidence.

those customers the original purchase price. In the case of LF, that price was $24 3/8 per share. In the case of SJH, that price was $23 3/8 per share. Such payments also were to include interest, calculated at the rate described above, from August 18, 1997 (for customer LF) and from August 25, 1997 (for customer SJH).

Because we have dismissed various causes of action, we modify the sanctions imposed by the Hearing Panel. We discuss the sanctions imposed for each cause of action separately below. We note as a threshold matter, however, that in determining appropriate sanctions we have reviewed and considered the parties' arguments on appeal, the NASD Sanction Guidelines ("Guidelines"), and all of the relevant facts in this case. We also are mindful of the principle that sanctions may be tailored to impress upon respondents and others in the securities industry the need to comply with the federal securities laws and the NASD's rules, as well as to deter similar misconduct in the future. See Daniel Joseph Alderman, 52 S.E.C. 366, 370 (1995), aff'd, 104 F.3d 285 (9th Cir. 1997).

A. Sanctions Specific to the First Cause of Action

The Hearing Panel imposed a $20,000 fine and a 60-day suspension for violating the advertising rules, and a $30,000 fine and a 180-day suspension for violating the anti-fraud provisions of the securities laws in relation to publication of the Report under the first cause of action. The Hearing Panel did not separately impose sanctions for Reynolds' violation of Conduct Rule 2110.

The relevant guideline for the advertising rules recommends fining the responsible person $1,000 to $20,000 and, in egregious cases, suspending him or her in any or all capacities for up to 60 days.[35] We concur with the Hearing Panel's sanction for the advertising rule violation, which falls within the guideline. Reynolds' actions, although not fraudulent, were grossly negligent and egregious.[36] He was responsible for the publication of an advertisement that contained material omissions and exaggerated, unwarranted and misleading statements. He was aware, moreover, that the Report would be widely circulated to the public. We uphold the

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35 See Sanction Guidelines for Advertising Rule (1998 ed.) at 76.

36 It must be emphasized that the guideline for the advertising rules has different sections for failure to comply with rule standards or inadvertent use of misleading communications, on the one hand, and for intentional and reckless conduct, on the other. Compare Sanction Guidelines (1998 ed.) at 76 (recommending fine of $1,000 to $20,000 and suspension of up to 60 days for failure to comply or inadvertent conduct) with id. at 77 (recommending fine of $10,000 to $100,000 and suspension of up to two years or a bar). Here, we have applied the former. It should further be noted that the guideline recognizes that a respondent can be found to have engaged in egregious misconduct even though he or she did not act intentionally or recklessly. See id. at 76 (recommending suspension of up to 60 days in egregious cases notwithstanding that the conduct was inadvertent).

Hearing Panel's imposition of a $20,000 fine and a 60-calendar-day suspension in all capacities for Reynolds' violation of the advertising rules.

We dismiss the Hearing Panel's imposition of a $30,000 fine and a 180-day suspension for violating the anti-fraud provisions, as we have dismissed those causes of action. We did, however, find that Reynolds acted with gross negligence in causing the publication of an advertisement containing material misrepresentations and omissions. Where statements or omissions were made negligently, the guideline suggests imposing a fine of $2,500 to $50,000 and suspending the individual in any or all capacities for up to 30 business days.[37] Here, the misrepresentations and omissions were material, bordered on being fraudulent, and were publicized to numerous potential investors. We therefore impose a $20,000 fine and a 42-calendar-day suspension in all capacities as a result of this conduct.[38]

The total sanctions for cause one are as follows: $40,000 fine and a 102-calendar-day suspension in all capacities, to be served consecutively with the other suspensions.

B. Sanctions Specific to the Second Cause of Action

The Hearing Panel imposed a $20,000 fine and a 60-day suspension for violating the advertising rules, and a $30,000 fine and a 180-day suspension for violating the anti-fraud provisions of the securities laws in relation to the publication of the Research Report and the single-page advertisements. The Hearing Panel did not separately impose sanctions for Reynolds' violation of Conduct Rule 2110.

As discussed above, the relevant guideline for the advertising rules states that an adjudicator should consider fining the responsible person $1,000 to $20,000 and suspending him or her in any or all capacities for up to 60 days.[39] We concur with the Hearing Panel's sanction for the advertising rule violation, which falls within the guideline. We again find Reynolds' misconduct to be egregious, but not fraudulent. Reynolds was responsible for the publication of advertisements that purported to contain an independent analysis of an issuer's stock. In reality, the advertisements were bought and paid for by the issuer and they were thus

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[37] See Sanction Guidelines for Misrepresentations and Omissions (1998 ed.) at 80.

[38] Note that the guideline suggests a suspension of up to 30-business days, which equals 6 weeks or 42 calendar days. See Sanction Guidelines for Misrepresentations and Omissions (1998 ed.) at 80. See also id., "Technical Matters," at 11 (stating that "a suspension of 30 or fewer days be measured in business days . . . ."). Our imposition of a 42-calendar-day suspension, therefore, is within the range recommended by the relevant guideline and remedial under the facts of this case.

[39] See Sanction Guidelines for Advertising Rules (1998 ed.) at 76.

extremely misleading. The advertisements also were widely circulated to the public. We uphold the Hearing Panel's imposition of a $20,000 fine and a 60-calendar-day suspension in all capacities for Reynolds' violation of the advertising rules.

We dismiss the Hearing Panel's imposition of a $30,000 fine and a 180-day suspension for violating the anti-fraud provisions, as we have dismissed those causes of action. We did, however, find that Reynolds acted with gross negligence in failing to disclose the issuer's role in the advertisements and in misrepresenting that the advertisements contained an independent analysis of the issuer's stock. Again, the guideline for such conduct recommends imposing a fine of $2,500 to $50,000 and a suspension of the individual in any or all capacities for up to 30 business days.[40] We impose a $20,000 fine and a 42-calendar-day suspension in all capacities.[41]

The total sanctions for cause two are as follows: $40,000 fine and a 102-calendar-day suspension in all capacities, to be served consecutively with the other suspensions.[42]

C. Sanctions Specific to the Third Cause of Action

The Hearing Panel imposed a $20,000 fine and a 60-day suspension for violating the advertising rules, and a $30,000 fine and a 180-day suspension for violating the anti-fraud provisions. We have dismissed all of the Hearing Panel's findings of violation for cause three. Accordingly, we eliminate the sanctions imposed for that cause of action.

D. Sanctions Specific to the Fourth Cause of Action

The Hearing Panel imposed a fine of $2,500 and a five-day suspension for sharing customer losses in relation to cause four. The most analogous guideline for sharing customer losses is the guideline for guaranteeing a customer against loss. That guideline recommends imposing a fine of $2,500 to $25,000 and suspending the individual for up to 30 business days.[43]

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[40] See Sanction Guidelines for Misrepresentations and Omissions (1998 ed.) at 80.

[41] See supra note 38.

[42] We have aggregated or "batched" the sanction for Reynolds' violation of Section 17(b) with the sanctions for his violations under Rules 2110 and 2210 in relation to the nondisclosure issuer payments under the second cause of action. See Sanction Guidelines (1998 ed.) at 5.

[43] See Sanction Guidelines for Guaranteeing a Customer Against Loss (1998 ed.) at 79.

The Hearing Panel found several mitigating factors in relation to this cause of action. For instance, Reynolds' sharing did not involve the inducement of a customer to trade or an attempt to hide trading misconduct. Although we agree that these are mitigating factors, we differ from the Hearing Panel in that we hold that the relatively lenient suspension for this cause, as with the other causes, must be served consecutively (and not concurrently) with the other suspensions.

Accordingly, we impose a fine of $2,500 and a 5-day suspension in all capacities, to be served consecutively with the other suspensions, for sharing customer losses in relation to cause four.

E. Sanctions Specific to Fifth Cause of Action

The Hearing Panel imposed a $2,500 fine and a 10-day suspension for omitting the price of a security in an advertisement, as alleged in the fifth cause of action, in relation to the single-page advertisements. As previously noted, the relevant guideline for advertising violations recommends imposition of a fine of $1,000 to $20,000 and a suspension of up to 60 days. We note, as did the Hearing Panel, that this violation was less serious than the findings that Reynolds failed to disclose the issuer's payment of costs associated with the advertisements and many of the other incidents of misconduct involved in this case. We also concur with the Hearing Panel's imposition of sanctions at the low end of those recommended in the relevant guideline.

Nonetheless, Reynolds violated the rule without any true mitigation and we thus differ from the Hearing Panel in that we hold that the suspension must be served consecutively (and not concurrently) with those imposed for the other causes of action. Furthermore, the guideline states that "a suspension of 30 or fewer days be measured in business days . . . ."[44] We thus imposed a 14-calendar-day suspension in all capacities to reflect the recommendation in the Guidelines and because we find that such a suspension is warranted and remedial in this case.

Accordingly, we impose a $2,500 fine and a 14-calandar-day suspension in all capacities, to be served consecutively with the suspensions imposed for the other causes of action.

F. Other Sanctions

The Hearing Panel imposed additional sanctions as well. Under the facts of this case, we find the imposition of most of these additional sanctions to be fully warranted and remedial and we uphold their use here. We dismiss the Hearing Panel’s imposition of restitution and rescission, however. A discussion of each additional sanction is provided below.

1. Re-Qualification

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44 See Sanction Guidelines, Technical Matters (1998 ed.) at 11.

Reynolds took a casual approach toward NASD advertising standards and he disregarded his duty as a registered representative to perform a reasonable investigation of the accuracy of statements made in publicly available materials. To impress upon Reynolds the significance of the rules violated here and of his responsibilities, we require him to re-qualify by examination in all capacities prior to associating with a member firm.

2. Advance Review of Advertising

This case involves numerous and serious advertising violations. As an additional remedial measure, we order that for a period of three years following the expiration of suspensions imposed herein, Reynolds must file any advertising and sales literature on which his name appears with the NASD Regulation Advertising Regulation Department and obtain a "no objection" response prior to use. Such a sanction is consistent with the Sanction Guidelines for serious advertising violations and is appropriate for Reynolds.[45]

3. Restitution and Rescission

The Hearing Panel's decision required Reynolds to pay restitution to one investor and offer rescission to two others. We do not find the imposition of such sanctions to be necessary where, as here, the undisputed evidence indicates that none of the three investors were customers of Reynolds, he did not receive any commissions in relation to their purchases, and the Hearing Panel ordered O'Leary, Premier's President and Reynolds' supervisor, to pay restitution and make offers of rescission to the customers in question. Accordingly, we eliminate the requirement that Reynolds pay restitution to customer BO and offer rescission to customers LF and SJH.

4. Costs of Hearing Below

The Hearing Panel imposed costs of the proceeding below in the amount of $5,241, reflecting $4,491 for transcripts plus the standard administrative fee of $750. We affirm the imposition of such costs.

V. CONCLUSION

In summary, we find that Reynolds violated NASD Conduct Rules 2110 and 2210 in relation to the first, second, and fifth causes of action. We also find that he violated Section 17(b) of the Securities Act in relation to the second cause of action and NASD Conduct Rules 2110 and 2330(f) in relation to the fourth cause of action. We dismiss the findings that Reynolds violated NASD Conduct Rule 2120 and SEC Rule 10b-5 in relation to the first and

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[45] See Sanction Guidelines for Advertising Rules (1998 ed.) at 76; id. "General Considerations" at 4.

second causes of action. We dismiss the third cause of action in its entirety. We impose on Reynolds a total suspension of 223 calendar days in all capacities[46] and a total fine of $85,000. We also impose the following requirements: pre-filing of advertising for a period of three years; and re-qualification by examination in all capacities before associating with a member firm. Finally, we uphold the Hearing Panel's imposition of costs of the proceeding below in the amount of $5,241.

On Behalf of the National Adjudicatory Council,

Barbara Z. Sweeney, Senior Vice President
and Corporate Secretary

[46] The suspension commences on the date noted in the cover letter accompanying this decision. We also note that we have 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.