

**BEFORE THE NATIONAL ADJUDICATORY COUNCIL**

**NASD REGULATION, INC.**

In the Matter of

Department of Enforcement

Complainant,

vs.

Respondent.

**DECISION**

Complaint No. C01970032

District No. 1 (SF)

Dated: August 12, 1999

**Registered representative's statements on Internet site found to be communications with the public made on behalf of his employer firm. Statement further found to contain promise of specific results without a reasonable basis, in violation of advertising rule. Held: findings of violations and imposition of sanctions modified.**

The National Adjudicatory Council ("NAC") reviewed the 1998 decision of a Hearing Panel ("Hearing Panel") of NASD Regulation, Inc. against the Respondent. The Hearing Panel found that Respondent violated the NASD's advertising rules by recklessly making nine exaggerated, unwarranted, and misleading statements on the Internet. The NAC called the case for review to determine whether a violation occurred and to reassess the sanctions imposed. The Respondent also appealed.

We find that just one of the Respondent's statements violated the advertising rule, and that his conduct was negligent, rather than reckless. We order that this decision serve as a Letter of Caution.

**Factual Background**

The facts of the case are largely undisputed. The Respondent entered the securities industry in 1994. In October 1996, he joined Firm A as a general securities representative. He left Firm A in October 1997 and, since that time, he has not been associated with an NASD member.

In February 1997, NASD Regulation conducted a scheduled examination of Firm A, including a review of material that Firm A published on the Internet. Using an Internet search engine to search for Firm A, the examiner determined that that search phrase was mentioned twice in an Internet site called Site A that

Respondent established and operated. Site A included numerous sub-sites containing content that Respondent wrote, including headline news stories, political analysis, entertainment, business, health, and a variety of advertisements. Each of these sub-sites was connected to Site A's central index.

The NASD examiner identified two sub-sites containing material relevant to this case. The first site that he entered was dedicated to Firm A, and it included descriptions of Firm A's products, services, and rates, stock reports that Respondent wrote, and pictures of Respondent and Firm A's President.<sup>1</sup> Another Site A sub-site, located at Site B described a bond offering with which Firm A was connected.

From the Firm A site, the examiner proceeded to a Stockbroker sub-site located at Site C. The first item on the Stockbroker Site was a picture of Respondent with the caption: "Licensed full time financial consultant. News columnist." This was followed by a table of contents listing three topics: (1) Market Watch; (2) Rules in Investing; and (3) Companies. The Market Watch section, located on the same page, said simply: "As of January 4, 1997 It look bullish for a while."

The statements contained in section two of the Stockbroker Site -- Respondent's so-called Rules in Investing -- are the subject of the complaint in this case. Among the statements that Respondent made, which were cited in the complaint as violative, were:

- (1) "research reports are a license to steal by the issuing firms";
- (2) "buy locally, no need to buy foreign stocks, all markets are up or down almost in unison";
- (3) "the municipalities and governments will default, it is undream [sic] of decades ago";
- (4) "cashless society is coming in around 2005, all buying and selling will be through an all powerful and knowing computer";
- (5) "sell a stock for a loss and still be able to come out with a gain later. E-mail me for this open secret knowledge only after you e-mail me for at least ten different occasions from surfing my site";
- (6) "mutual funds definitely control the market but need the small investors to be the suckers";@;

---

<sup>1</sup> Although Firm A had created an Internet site before the Respondent joined the Firm, Respondent persuaded Firm A's President to give him authority and responsibility for the site shortly after he associated with the Firm. Firm A's President knew that Respondent was operating Firm A's Internet site, but he did not monitor the material that Respondent published there. Nor did the President approve the material that Respondent published on Site A.

- (7) “[when buying small capitalization stocks] you are playing the greater fool theory”;
- (8) “[annuities are] a smart invention to rip off the consumers”; and
- (9) “manipulation, insiders trades, fraud, unfair competition impossible to eradicate totally.”

See Exhibit A attached. Many of Respondent’s 26 Rules in Investing contain similar statements that were not cited in the complaint.

The third section of the Stockbroker Site, entitled “Companies to Watch,” listed 12 stocks and their ticker symbols. The first stock, Cisco Systems, Inc., was followed by the following statement: “Internet explosion growth, intranet, good entry price is \$63, aggressive growth.” The second, Oracle Corporation, was described as a “good buy at \$44.” Following the Companies to Watch list, were hyperlinks (direct Internet connections) to Respondent’s stock market reports and also to Site A’s main menu.

The NASD examiner concluded that several statements contained in Respondent’s Rules for Investing might violate NASD Conduct Rule 2210, which governs associated persons’ communication with the public. An investigator in the NASD Advertising Regulation Department reviewed the statements, prepared a written analysis, and concluded that each of Respondent’s statements violated the NASD’s advertising rule. She testified before the Hearing Panel that Respondent’s statements violated Conduct Rule 2210 as follows:

- (1) Respondent’s statement that “research reports are a license to steal by the issuing firms” was an exaggeration and failed to provide a basis for readers to evaluate his advice;
- (2) Respondent’s statement advising readers to “[b]uy locally, no need to buy foreign stocks, all markets are up or down almost in unison” was unwarranted, failed to provide a reasonable basis for evaluating his advice, and failed to consider readers’ differing investment objectives;
- (3) Respondent’s advice to readers against buying government bonds because “[t]he municipalities and governments will default, it is undream of decades ago,” was an unwarranted exaggeration, failed to present any reasonable basis for evaluation, and was an unlabeled forecast;
- (4) Respondent’s forecast that a “[c]ashless society is coming in around 2005, all buying and selling will be through an all powerful and knowing computer” was an unsupported, unwarranted exaggeration;

- (5) Respondent solicited his readers to contact him to learn how they could “[s]ell any stocks for a loss and still [be] able to come out with a gain later.” This solicitation promised readers a specific result, in violation of Conduct Rule 2210;
- (6) Respondent advised against investing in mutual funds, stating that “[m]utual funds definitely control the market but need the small investors to be the suckers.” This statement contained both an unwarranted claim and an opinion for which he provided no reasonable basis;
- (7) Respondent advised that to buy small capitalization stocks would be to play “the greater fool theory.” This unqualified rejection of an entire category of securities was an exaggeration and a statement for which Respondent provided no reasonable basis;
- (8) Respondent’s claim that annuities are a “smart invention to rip off the consumers” was an unwarranted exaggeration because it failed to consider that annuities, although not appropriate for all investors, can be a valuable investment tool for some; and
- (9) Respondent failed to provide a reasonable basis for his assertion that it is impossible to eradicate “manipulation, insiders trades, fraud, [and] unfair competition.”

The NASD examiner’s analysis triggered the issuance of the complaint in this matter.

### Discussion

Conduct Rule 2210 prohibits associated persons from making exaggerated, unwarranted, or misleading statements or claims in their public communications. All public communications must be based upon the principles of fair dealing and good faith, provide a sound basis for evaluating the facts discussed, and not omit material facts or qualifications that would cause the communication to be misleading in light of its context. In addition, Conduct Rule 2210 prohibits unwarranted forecasts of future events.<sup>2</sup>

---

<sup>2</sup> Conduct Rule 2210(d)(1)(A) states:

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 or securities or type of security, industry discussed, or service offered. No material fact or qualification may be omitted if the omission, in the light of the context of the material presented, would cause the advertising or sales literature to be misleading.

Conduct Rule 2210(d)(1)(B) states:

As a threshold matter, Respondent argues that the NASD cannot regulate Site A's content because he created that site in his capacity as a journalist and not as a registered representative. This argument is not supported by the evidence. As Respondent admitted in a letter to the NASD explaining his actions, he posted the statements on the Internet "to put a little shingle out there." Respondent connected his writings on Site A to his duties as a registered representative by moving Firm A's site to an address within Site A, linking the sites together, and identifying himself as a stockbroker and a licensed financial consultant on the site. There was also similar, often overlapping information on Firm A's site and on Site A. Respondent connected his stock market commentary to his work as a registered representative by printing the Internet address for his stock market commentary on the stock reports published with Firm A's other advertisements. In addition, Respondent printed his Internet site's name on his own Firm A business card. Respondent's conduct establishes that an "essential purpose" of his stock market commentary, and the statements cited in the complaint, was to sell securities. In re Sheen Financial Resources, Inc., 52 S.E.C. 185, 191 (1995).

Respondent also claims that his statements are protected by the First Amendment to the United States Constitution. The Respondent's constitutional claim is equally without merit because the NASD is not a government actor and only government actors can violate most constitutional rights. See Cremin v. Merrill Lynch Pierce Fenner and Smith, Inc., 957 F. Supp. 1460 (N.D. Ill. 1997) (private entities cannot violate due process rights). This rule applies to the First Amendment also. Blount v. SEC, 61 F. 3d 938 (D.C. Cir. 1995). In Blount, the court evaluated whether the Municipal Securities Rulemaking Board's ("MSRB") Rule G-37 impermissibly infringed the plaintiff's First Amendment right to unfettered political speech. The court reasoned that if the MSRB is a private entity, then "the rule cannot be found to violate the First and Tenth Amendments, since the Constitution is a 'restriction on governmental action, not that of private persons.'" Id. at 941 (citing CBS v. Democratic National Committee, 412 U.S. 94 (1973)). The court went on to conclude that the MSRB is a state actor, but that MSRB Rule G-37 withstood the plaintiff's challenges.

---

Exaggerated, unwarranted or misleading statements or claims are prohibited in all public communications of members. In preparing such literature, members must bear in mind that inherent in investment are the risks of fluctuating prices and the uncertainty of dividends, rates of return and yield, and no member shall, directly or indirectly, publish, circulate or distribute any public communication that the member knows or has reason to know contains any untrue statement of a material fact or is otherwise false or misleading.

Conduct Rule 2210(d)(2)(C) states:

Claims and Opinions. 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, or forecasts of future events which are unwarranted, or which are not clearly labeled as forecasts.

Contrary to the holding in Blount, numerous courts have ruled that the NASD and other securities self-regulatory organizations are not state actors. See, e.g., Rosenberg v. Merrill Lynch Pierce Fenner and Smith, Inc., 1998 US App. LEXIS 32522 (1st Cir. Dec. 22, 1998) (NYSE not a state actor with regard to arbitration of discrimination claims); First Jersey Secs, Inc. v. Bergen, 605 F.2d 690, 698, 699 n. 5 (3d Cir. 1979), cert. denied, 444 U.S. 1074 (1980); Datek Secs. Corp. v. National Ass'n of Secs. Dealers, Inc., 1995 U.S. Dist. LEXIS 1294 (S.D.N.Y. Feb. 3, 1995) (rejecting due process argument on same grounds); Shrader v. National Ass'n of Secs. Dealers, Inc., 855 F. Supp. 122, 124 (E.D.N.Y. 1994), aff'd, 54 F.3d 744 (2d Cir. 1995); Graman v National Ass'n of Secs. Dealers, Inc., 1998 U.S. Dist. LEXIS 11624 (D.D.C. Apr. 27, 1998) (distinguishing Blount). The court in Desiderio v. NASD, clearly articulated the reasons for this conclusion:

The NASD is a private corporation, does not receive federal funding, and is not subject to any requirement that members of the NASD Board of Governors or members of the NASD Regulation, Inc. Board of Directors be government officials or appointed by a government official. Federal courts consistently have held that the NASD and other self-regulatory agencies are not state actors either in regulating industry pursuant to their statutory duties or in sponsoring arbitration fora that employ rules regulated by the SEC (citing cases).

2 F. Supp. 2d 516, 519 (S.D.N.Y. 1998). Respondent has offered no compelling rationale for concluding that the NASD is a state actor in the First Amendment context, when it has been held to be a private entity in many other contexts.

Having determined that the NASD can regulate the Respondent's conduct, two questions remain: (1) does the advertising rule apply to Respondent's statements, and (2) do his statements violate the rule. Based on the totality of the circumstances, we find that the advertising rule applies to Respondent's statements because those statements were communications with the public on behalf of Firm A. The first section of the Stockbroker Site, the Market Watch, stated 'Respondent's bullish outlook for the market, indicating a positive bias toward purchasing securities. The second section, the Rules in Investing, evaluated the types of securities and securities vehicles that investors might consider in determining which securities to buy and when to buy them. The third section, Companies to Watch, specifically instructed readers which securities to buy and, for two of them, at what price to buy them. Respondent identified himself as a licensed financial consultant and titled the page Respondent.stockbroker, further demonstrating that the communication was made in his capacity as an Firm A registered representative.

We find that one of Respondent's statements on the Stockbroker Site violated the advertising rule. Respondent stated that readers could "sell a stock for a loss and still be able to come out with a gain later. E-mail me for this open secret knowledge only after you e-mail me for at least ten different occasions from surfing my site." This statement contains a promise of specific results for which there is no reasonable basis, in violation of subsection (d)(2)(C) of Conduct Rule 2210.

We find that the remainder of Respondent's statements, however, do not violate the advertising rule. Respondent's statements that it is impossible to eradicate fraud and manipulation from the market, and that a cashless society is coming in 2005 are, on their face, best understood as Respondent's view of market conditions. Although these statements are perhaps unsupported, we do not believe that they are so unbalanced that they rise to the level of a violation of the advertising rule. Respondent's claim that research reports are a "license to steal," viewed in context, appears more to be a statement of opinion that is not so unbalanced as to violate Rule 2210:

The stock markets are guessing games. You can do some homework and reduce your risk. The markets are always being manipulated by everyone. The Internet hype chat groups and listserv lists. The buy, hold, sell research reports are a license to steal by the issuing firms. There are always inside information used by inside and outsiders....

This is Respondent's first Rule in Investing and is intended to set forth Respondent's understanding of the markets and the factors that drive prices and behaviors. In the context in which these statements appear in the Stockbroker Site, the advertising rule does not prohibit them.

Respondent's statements regarding municipal securities, annuities, mutual funds, and small-capitalization and foreign stocks, while unbalanced, also do not rise to the level of violations of Rule 2210. Respondent's claim that municipalities and governments will default, and that "it is undream [sic] of decades ago," is difficult to comprehend due to its misspellings and grammatical errors. Thus, it is unlikely that investors would be misled by this statement. Given the unique facts of this case, Respondent's statements about annuities, mutual funds, and small-capitalization and foreign stocks are statements that, while unbalanced, are too general to mislead the investing public. For these reasons, we do not believe that these statements violated Rule 2210.

Accordingly, we find that just one of the nine statements cited in the complaint violated Conduct Rule 2210. We separately find that Respondent violated Conduct Rule 2110 because his conduct failed to uphold the high standards of commercial honor to which associated persons are held.

### Sanctions

The NASD Sanction Guideline ("guideline") for improper communications with the public separates such violations into two categories: (1) violations of the standards set forth in Conduct Rule 2210; and (2) intentional or reckless use of misleading public communications. The Guideline recommends a fine of between \$1,000 and \$20,000 for the first category, and a fine of between \$10,000 and \$100,000 for the second. The Guideline also recommends considering a suspension of up to 60 days for egregious examples of the first type of violation, and of up to two years for the second.<sup>3</sup> The Hearing Panel concluded that

---

<sup>3</sup> See NASD Sanction Guidelines 76 - 77 (1998 ed.) (Communications With The Public). The sanctions imposed are consistent with that Guideline.

Respondent's violation was reckless and therefore applied the Guideline with respect to the second category of violations. The Hearing Panel then departed downward from the recommended range of fines because it found no evidence of actual harm to investors, and also because the firm President's conduct misled Respondent.

Having concluded that only one of Respondent's statements violated Rule 2210, we will reduce the sanctions that the Hearing Panel imposed and order that this decision serve as a Letter of Caution. This sanction is remedial because Respondent's violation was negligent, was limited in scope, and there is no evidence that it harmed the investing public.

Accordingly, we order that this decision serve as a Letter of Caution to Respondent.<sup>4</sup>

On Behalf of the National Adjudicatory Council,

---

Joan C. Conley, Corporate Secretary

---

<sup>4</sup> 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.