BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD

In the Matter of Department of Enforcement, Complainant, vs. Raghavan Sathianathan Montclair, NJ, Respondent.	DECISION Complaint No. C9B030076 Dated: February 21, 2006

Respondent made unsuitable recommendations to two customers and exercised discretion in a customer account without the customer's written authorization. Held, findings and sanctions affirmed.

Appearances

For the Complainant: Leo F. Orenstein, Esq., Michael Newman, Esq., Department of Enforcement, NASD

For the Respondent: Pro Se

DECISION

Pursuant to NASD Procedural Rule 9311(a), Raghavan Sathianathan ("Sathianathan") appeals a November 30, 2004 Hearing Panel decision barring him from associating with any member firm in any capacity. The Hearing Panel found that Sathianathan made unsuitable recommendations to two customers and exercised discretion in a customer account without obtaining the customer's written authorization. The Hearing Panel barred Sathianathan for the violations of NASD's suitability rule but did not impose a separate sanction for the exercise of discretion without written authorization. After a complete review of the record, we affirm the Hearing Panel's findings and its imposition of a bar.

I. Background

A. Raghavan Sathianathan

Sathianathan first entered the securities industry on a full-time basis in August 1998 when he joined Salomon Smith Barney Inc. ("Smith Barney") in its Little Falls, New Jersey branch office.[1] In November 1998, Sathianathan registered with NASD as a general securities representative with Smith Barney. In February 2001, Sathianathan voluntarily left Smith Barney to join Morgan Stanley DW Inc. ("Morgan Stanley") at its flagship office in New York City. Sathianathan was permitted to resign from Morgan Stanley in February 2002. Sathianathan has not been associated with an NASD member firm since he left Morgan Stanley.

B. Procedural History

In late 2001, NASD began an investigation into Sathianathan following Smith Barney's filing of an amended Uniform Termination Notice for Securities Industry Registration ("Form U5") that disclosed a customer arbitration filing involving Sathianathan.[2] On October 24, 2003, NASD's Department of Enforcement ("Enforcement") filed a four-cause complaint against Sathianathan alleging that Sathianathan: (1) made unsuitable recommendations to customer AV in violation of NASD Conduct Rules 2310, IM-2310-2, and 2110; (2) made unsuitable recommendations to customer SS in violation of NASD Conduct Rules 2310, IM-2310-2, and 2110; (3) made fraudulent misrepresentations and omissions of material facts to customers AV and SS in violation of Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rule 10b-5 thereunder and NASD Conduct Rules 2120 and 2110; and (4) exercised discretion in customer AV's account without written authorization in violation of NASD Conduct Rules 2510(b) and 2110.

On December 15, 2003, Sathianathan filed an answer and counter-complaint, in which he denied each of the allegations in the complaint.[3] The Hearing Panel conducted a two-day

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[1] Sathianathan previously worked briefly for another broker-dealer firm for approximately three months in 1995 and passed the investment company products/variable contracts limited representative examination (Series 6). Sathianathan also had worked for approximately three months at another broker-dealer firm in 1987 while he was attending business school. At that time, he passed the general securities representative examination (Series 7).

[2] The record indicates that Smith Barney filed an amended Form U5 for Sathianathan on November 16, 2001. In addition, Morgan Stanley filed an amended Uniform Application for Securities Industry Registration or Transfer ("Form U4") for Sathianathan on December 14, 2001, regarding the same arbitration proceeding.

[3] Sathianathan's "counter-complaint" sought sanctions against both the NASD investigator and regional counsel involved in the proceeding against Sathianathan. On December 18, 2003, Enforcement filed a motion to strike the counter-complaint. The Hearing Officer dismissed the counter-complaint during a pre-hearing conference on January 5, 2004, on the grounds that the

[Footnote continued on next page]

hearing on July 7 and 8, 2004. On November 30, 2004, the Hearing Panel issued a decision finding that Sathianathan made unsuitable recommendations to two customers and exercised discretion in a customer's account without the customer's prior, written authorization, as alleged in the first, second, and fourth causes of the complaint. The Hearing Panel also found, however, that Enforcement failed to prove by a preponderance of the evidence that Sathianathan committed fraud; consequently, the Hearing Panel dismissed the third cause of the complaint. The Hearing Panel barred Sathianathan for his violations of the NASD suitability rule. In light of the bar, the Hearing Panel did not impose a separate sanction for his unauthorized discretionary trading. Sathianathan appealed the Hearing Panel's decision.[4]

II. Facts

A. Sathianathan's Employment at Smith Barney

Smith Barney hired Sathianathan on August 24, 1998. Although Sathianathan had worked briefly in the securities industry on two previous occasions, he testified that he considered his employment as a financial consultant with Smith Barney to be his first real employment in the securities industry. In November 1998, Sathianathan passed the general securities representative examination. Sathianathan also took part in Smith Barney's month-long internal training program. As a new financial consultant at Smith Barney, Sathianathan's compensation was a combination of salary, commissions, and bonuses. Sathianathan was paid a salary for approximately two years. During Sathianathan's second year of employment, however, the salary portion of his compensation incrementally declined to zero. Beginning in October 2000, Sathianathan was no longer being paid a salary, and he relied entirely on commissions and bonuses.[5]

B. Customer AV

1. AV's Account

AV was a systems engineer with Juniper Networks, Inc. ("Juniper"), a California company specializing in telecommunications equipment. While at Juniper, AV's compensation structure included both a salary and the receipt of stock options. In mid-1999, Juniper engaged

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Hearing Panel had no jurisdiction to hear such a claim and lacked the authority to grant the relief that Sathianathan sought.

[4] Enforcement did not file a cross-appeal challenging the Hearing Panel's dismissal of the fraud allegations, and we therefore decline to revisit the Hearing Panel's findings in this respect on appeal.

[5] In September 2000, the last month in which Sathianathan received a salary, his salary for the month was less than $300. When Sathianathan joined Smith Barney in August 1998, his starting salary was $30,000 per year.

in an initial public offering, and by April 2000, the stock was trading at more than $200 per share. In or around April 2000, AV opened an account with Smith Barney at its Menlo Park, California branch office and deposited into the account 13,500 Juniper shares that he had acquired before opening the account through the exercise of Juniper stock options at approximately $1.65 per share. The account application (the "California Application") reflected that AV had a "Moderate" risk tolerance—out of a choice of Aggressive, Moderate, and Conservative—and indicated that AV's investment objectives did not allow for speculation. The California Application also indicated that AV had no investment experience with stocks, bonds, commodities, or options.

Sathianathan's younger brother introduced AV to Sathianathan, and at least as early as September 1999, Sathianathan had been discussing the possibility of AV opening a brokerage account with Sathianathan and referring his Juniper coworkers to Sathianathan for help with their personal finances. For example, on September 24, 1999, Sathianathan sent AV a letter recounting an earlier conversation between Sathianathan and AV in which Sathianathan highlighted his educational and work experience and informed AV that his "aim will be to protect and grow the wealth of [AV's] colleagues using risk management techniques." Similarly, on May 4, 2000, Sathianathan sent AV an e-mail in which he again highlighted his credentials and informed AV that his "immediate focus for [AV] and [his] friends would be to protect your current wealth and then use asset allocation and other more sophisticated techniques to diversify your investment portfolio so as to protect and grow your portfolio in a systematic and controlled manner." In May 2000—less than two months after opening the Menlo Park account—AV moved his account from the Menlo Park branch to Smith Barney's Little Falls, New Jersey branch office so that Sathianathan could serve as AV's financial consultant. At the time of the switch, AV's account included the 13,500 Juniper shares initially deposited into the Menlo Park account.

In contrast to the profile on the California Application, the account application AV signed in May 2000 with Sathianathan lists AV's risk tolerance as "Aggressive" and speculative and represents that AV had been investing in stocks since 1995. While there is nothing in the record to support the proposition that AV had any significant investing experience since 1995, there are indications that, to the contrary, AV had little or no previous investment experience. For example, during his on-the-record interview, Sathianathan testified that, at the time AV opened his Smith Barney account, "[AV] had no prior investment experience" and "[AV's] level of sophistication was almost zero."

Sathianathan testified that AV's investment objective was preservation of capital and that AV was not interested in speculative trading. Despite this investment objective, Sathianathan testified that he had "no choice" but to mark AV's account forms as aggressive and speculative because Smith Barney required that an account be designated aggressive and speculative to engage in hedging strategies, including the use of options. Thus, Sathianathan designated AV's account as "Aggressive," not because it accurately reflected AV's investment objective, but

because Sathianathan wanted to include a greater variety of potential investment options to use in hedging AV's account.[6]

Steven Torrico ("Torrico"), Sathianathan's branch office manager at Smith Barney, testified that, when Sathianathan originally brought AV's account application to him for approval in May or June 2000, he did not initially approve the application because the form indicated that options strategies were suitable for AV's account. Torrico believed that such strategies were inappropriate for AV and testified that "when [he] originally signed the new account document for [AV] back in June of 2000, [Sathianathan] had checked off most of the options suitability boxes in the options sections of the new account form." Torrico testified that he crossed out the boxes because he believed the use of options was not appropriate for a new account such as AV's, and when Torrico asked Sathianathan why he had checked them off, Sathianathan informed him that he was not intending to use those strategies for AV, he simply wanted AV's account "to be approved for everything." Torrico ultimately approved AV's account except for options trading.

In mid-June 2000, Juniper stock split 2-for-1. In August 2000, AV exercised additional Juniper stock options, and, through that exercise, obtained an additional 20,000 shares of Juniper, which he transferred from the Menlo Park account to the Little Falls account in September 2000.[7]

On September 4, 2000, AV completed yet another Smith Barney account application form (the "September Application"). The September Application indicates that, by this time, AV's estimated liquid net worth had grown to $2 million, and his estimated total net worth was $10 million. The September Application again lists AV's risk tolerance as "Aggressive" and notes that his investment objectives allow for speculation. In addition, the September Application indicates that AV had never previously invested in equity options, debt options, or foreign currency but that the purchase and sale of puts and calls (both covered and uncovered), as well as spreads, were now suitable for AV. Torrico approved the September Application, which approved AV's account for options strategies.

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[6] Sathianathan's use of aggressive and speculative designations on account applications, regardless of the customer's actual investment objectives, was not unique to AV. Sathianathan testified during his on-the-record interview, and again during the Hearing Panel hearing, that he marked most of his accounts as aggressive and speculative regardless of the investor's actual investment objectives to allow the investor to have a broader range of investments available to him. Sathianathan stated that he "didn't realize that the [account opening] form was that important."

[7] AV's exercise of the options in August 2000 resulted in his acquisition of an additional $3 million in Juniper stock. In connection with the June stock split, AV's account was erroneously credited with an additional 13,500 Juniper shares. By mid-September, at the time when Sathianathan made his initial recommendations to AV, Juniper shares were trading at approximately $200 per share. AV had 47,000 Juniper shares in his Little Falls account; however, AV's account statements reflect 60,500 shares because of the erroneous credit.

2. Sathianathan's Recommendations to AV

From the time AV transferred the assets in his account from the Menlo Park branch office to the Little Falls branch office until late September 2000, no steps were taken to hedge the concentrated equity position in AV's account. The price of Juniper shares, however, continued to rise during this time. AV's account value increased from approximately $2 million as of June 30, 2000, to over $10 million in September 2000 due to the increase in the value of the Juniper shares and AV's exercise of additional Juniper stock options.

In August and September 2000, Sathianathan contacted the Smith Barney Global Equity Derivatives department, which specialized in hedging strategies, to price potential ways to protect AV's concentrated equity position in Juniper. Eventually, Sathianathan rejected the options presented by the Global Equity Derivatives department and instead settled on a different strategy for AV's account: AV would hold his Juniper shares until early 2001, at which time they would be eligible for long-term capital gains treatment, and diversify his holdings by purchasing mutual fund shares on margin using the Juniper shares as the collateral for the margin loan.[8]

On September 26, 2000, AV purchased $200,000 of class B shares in each of 14 different mutual funds. AV also invested $500,000 in the Smith Barney Spectrum Fund, a new Smith Barney fund.[9] AV's Smith Barney account was non-discretionary, and each of these purchases was made based on Sathianathan's recommendation. In total, AV invested $3.3 million in 15 different mutual funds, none of which were in the same fund family and almost all of which were growth funds. All of the purchases were effected on margin because Sathianathan had determined to "diversify on margin the account value greater than $10 million."[10] Sathianathan recommended that the concentrated equity position in Juniper stock—which closed at $230.50 per share on September 26, 2000—be used as the sole margin collateral.

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[8] Sathianathan testified that, at the time AV opened his account, AV wanted to liquidate the Juniper holdings. Sathianathan, however, recommended against it because of the tax liability that would be associated with such a liquidation. Moreover, in June 2000, Smith Barney initiated research coverage of Juniper and gave Juniper shares a "buy/speculative" rating.

[9] Sathianathan testified during his on-the-record interview that he recommended the Smith Barney fund because he felt pressure to put some of AV's assets into a Smith Barney investment product. Specifically, Sathianathan stated that he "didn't want to buy Smith Barney funds, but [he] felt obliged to buy one, so [he] bought a new one [for AV's account], a brand new one with no bad record or whatever." Sathianathan stated further that he invested $500,000 of AV's assets in the fund rather than $200,000 because he felt pressured not to make just one $200,000 investment in a Smith Barney fund when there were 14 other funds in which AV had invested $200,000. Consequently, AV invested $500,000 into the Smith Barney fund at Sathianathan's recommendation because it was "like two funds in one shot."

[10] Because AV's account was erroneously credited with 13,500 extra shares, the account was overvalued by approximately $3 million at the time of the recommendations.

Sathianathan testified that, at the time he made the recommendations, he had little experience with mutual fund investments. In making the recommendations, Sathianathan testified that he reviewed the funds' information from Morningstar and reviewed the funds' three-year performance numbers, but he did not compare the funds' securities holdings. Rather, Sathianathan relied principally on the fund family name and reputation. Sathianathan also recommended that AV purchase class B shares of the funds to avoid the front-end sales charges imposed upon purchases of class A shares.[11] Sathianathan recommended that AV limit his purchase in each fund to $200,000 because many fund companies prohibit sales of class B shares in excess of certain amounts.[12] AV's purchase of mutual fund shares in this manner also resulted in an increase in the amount of commissions the investments generated because, in general, the rate of commissions declines as breakpoints in the purchase of class A shares are reached.

In addition to the mutual fund purchases, on September 26, 2000, AV invested, on Sathianathan's recommendation, $1 million in index warrants issued by Smith Barney. The prospectus for the index warrants stated that the warrants involved "a high degree of risk" and that purchasers "should be prepared to sustain a total loss of the purchase price of their warrants." Like the mutual fund purchases, the $1 million purchase of warrants was financed on margin with the use of Juniper shares as the sole collateral for the margin loan. The warrants provided Sathianathan with a six percent commission.

During the three months following these initial recommendations, Sathianathan made no additional recommendations to AV. During that same time, the price of Juniper shares fell from a closing price of $230.50 per share on September 26, 2000, to a closing price of $123.12 per share on December 22, 2000, thus losing almost half of their value.[13] On December 26, 2000, exactly three months after the initial recommendations, AV purchased additional mutual fund shares on Sathianathan's recommendation. Specifically, AV invested $200,000 in each of three

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[11] Many mutual funds offer multiple classes of shares in the same fund. In general, class A shares impose a front-end sales load but charge lower annual fees than the other share classes. The front-end sales load imposed on an investor's investment, however, decreases as the amount invested reaches certain "breakpoints." In general, most mutual funds waive the front-end sales load for investments in A shares of more than $1 million. Many mutual fund families also permit investors to aggregate their investments in multiple funds within the same fund family when calculating whether the investor has reached a breakpoint. By contrast, class B shares impose a contingent deferred sales charge (a "CDSC") rather than a front-end sales load but charge higher fees than class A shares. In addition, the CDSC imposed when class B shares are redeemed typically declines the longer the shareholder holds the shares. Class B shares typically convert to class A shares after six to eight years.

[12] Sathianathan testified that he limited AV's investment in each fund to $200,000 because he "knew there was something about $250,000 that if it was more than $250,000, it was forced to go under A shares."

[13] In addition, in November 2000, Smith Barney corrected the 13,500-share error and removed those shares from AV's account.

different funds (none of which AV had previously invested in), all of which were purchased on margin.[14] Again, Sathianathan recommended using Juniper stock as the margin collateral.

The decline in Juniper's stock price continued into early 2001. In February 2001, when Juniper shares had fallen below $100 per share, AV's account began to be subject to margin calls. On February 8, 2001, based on Sathianathan's recommendation, AV sold the Smith Barney warrants for approximately $925,000 (realizing a loss of approximately $75,000) to cover the margin call. On February 14, 2001, AV redeemed approximately $470,000 in shares of the Smith Barney Spectrum Fund (realizing a loss of almost $30,000). Two days later, on February 16, AV redeemed $75,000 in each of 17 different funds: a total redemption of $1,275,000 (realizing a loss on the shares of approximately $680,000 and paying approximately $44,000 in CDSCs). That same day, Sathianathan voluntarily left Smith Barney and joined Morgan Stanley. Despite Sathianathan's departure, throughout March, AV's assets were continually sold to cover the margin balance at Smith Barney. To cover the margin calls, AV was eventually forced to sell the warrants, redeem all of the mutual funds, and liquidate a portion of his Juniper stock. Ultimately, AV paid over $100,000 in CDSCs and almost $200,000 in margin interest. On April 12, 2001, approximately $2.6 million in Juniper shares were transferred from AV's Little Falls account to Morgan Stanley.

C. Customer SS

Like AV, SS was also an engineer at Juniper, having started at Juniper in late 1998. In or around May 2000, SS met Sathianathan, and, following their meeting, transferred his existing Smith Barney account to the Little Falls branch office so that Sathianathan could serve as his financial consultant. When SS discussed his account with Sathianathan, he informed Sathianathan that his objectives were to diversify his account holdings and protect his net worth. Despite these representations, the account opening application indicates that SS's risk tolerance was "Aggressive" and that his investment objectives included speculation. By December 2000, SS had transferred all of his assets in other Smith Barney accounts to his Little Falls account, which then held approximately $3 million in assets, a large portion of which was in Juniper stock.

With the exception of assets transferred into the Little Falls account, there was essentially no investment activity in SS's account from the time he opened the account in May 2000 until December 2000. According to SS's declaration, in the third quarter of 2000, SS and Sathianathan discussed the possibility of placing a collar around SS's Juniper shares to protect

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[14] For two of the funds, AV invested in class B shares. For one fund, AV invested in class C shares. Class C shares, like class B shares, typically impose higher costs than class A shares. However, unlike class B shares, class C shares generally do not convert to class A shares. Sathianathan testified during his on-the-record interview that the class C share purchase was an error, and he intended to purchase class B shares in the fund for AV's account. Despite the error, Sathianathan testified that he never considered correcting it because he thought the error was "harmless."

the value of the stock.[15] SS's declaration states that, following this discussion, he asked Sathianathan to place a collar around the Juniper shares; however, Sathianathan chose to ignore the instruction because he believed that the price of Juniper shares would rise in late 2000.

In or around October 2000, SS had a conversation with AV during which they discussed Sathianathan's management of their accounts. AV told SS that Sathianathan was not selling any of his Juniper shares, and AV asked SS whether Sathianathan was providing him with the same advice. According to SS's declaration, "[AV] told [SS] that Mr. Sathianathan had assured him that the price of Juniper shares would appreciate significantly in subsequent months because a new President would be elected in November and the stock market would rally in January 2001."

In December 2000, Sathianathan made the same recommendation to SS that he made to AV; to wit, purchase class B share mutual funds on margin using Juniper stock as collateral. This was the first transaction that Sathianathan recommended to SS, and he made the recommendation with the knowledge that the previous three months had witnessed an almost 50 percent decline in the price of Juniper shares. While SS followed Sathianathan's recommendation regarding the mutual fund purchases, SS did not want to use margin to fund the purchases. Instead, SS instructed Sathianathan to liquidate a portion of his Juniper stock. On December 26 and 28, 2000, SS sold 11,000 shares of Juniper stock and applied the proceeds to purchase class B shares in 11 different mutual funds. SS purchased $150,000 of Class B shares in each of nine of the funds and $200,000 of Class B shares in each of the other two funds. No two funds were in the same fund family. By his own admission, in making the recommendations to SS, Sathianathan performed no independent analysis. Rather, Sathianathan simply selected a subset of the funds he had already recommended to AV.[16] At SS's request, however, Sathianathan also invested a portion of SS's assets in two bond funds.

D. Transactions in Customer AV's Account at Morgan Stanley

As noted above, in February 2001, Sathianathan voluntarily left Smith Barney to join Morgan Stanley. Both AV and SS transferred their accounts from Smith Barney to Morgan Stanley. In April 2001, Sathianathan recommended that AV sell 25,000 of his Juniper shares at a time when the stock price had rebounded from a low of approximately $30 per share.[17] Following the sale, AV was upset because the share price of Juniper continued to rise, and two days later, at Sathianathan's urging, AV sold an additional 8,000 shares that were held in another

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[15] A collar involves both the sale and purchase of stock options to limit the risk in a stock's price fluctuations on both the upside and downside.

[16] During his on-the-record testimony, when asked what type of research he performed to determine which funds to recommend to SS, Sathianathan stated that he "was picking what [he] thought were good funds out of the funds that [he] bought [for AV's account] in September."

[17] AV's Morgan Stanley account statement for April 2001 indicates that 15,000 shares were sold on April 20, 2001, for $50.34 per share, and an additional 10,000 shares were sold on April 23, 2001, for $55.70 per share.

of AV's accounts at another firm.[18] A later e-mail from Sathianathan indicates that AV was unhappy with the price at which the shares were sold. According to Sathianathan's on-the-record testimony, he and AV discussed a general strategy "to sell [Juniper shares] when the price of the stock was high and then to buy it back when it was lower and to do this over the next few years (if need be) by trying to time the market rallies in summer and January."

In May 2001, AV sent Sathianathan an e-mail in which he relayed a rumor to Sathianathan that Juniper would be added to the S&P 500. Based on the general strategy they had discussed and this rumor, Sathianathan decided to buy back a portion of the 33,000 shares sold in April based on his belief that, if the rumor proved to be correct, Juniper's stock price would go up.[19] Sathianathan testified that he and AV, both in discussions and in an e-mail, did not discuss specific times or prices for the purchases; they discussed only general strategy.[20] On May 29, 2001, while AV was out of the country on vacation, Sathianathan purchased 13,000 Juniper shares for AV's account for approximately $47 per share. On June 8, 2001, Sathianathan purchased an additional 10,000 shares of Juniper stock for AV's account for approximately $38

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[18] The record does not establish the price at which the 8,000 shares were sold; however, Sathianathan stated in an e-mail that the shares were sold for "around $58" per share. The record supports this figure. On April 25, 2001, Juniper shares closed at $57.86 per share with a high of $59.47 per share and a low of $52.30 per share.

[19] Sathianathan testified that AV had previously passed along a rumor that Juniper would be added to the Nasdaq 100. This rumor, unlike the S&P 500 rumor, turned out to be correct. Sathianathan testified that, following Juniper's addition to the Nasdaq 100, its stock price increased.

[20] While the record does not include May 2001 e-mail correspondence between Sathianathan and AV, Sathianathan maintains that a May 2001 e-mail from AV to Sathianathan resulted in AV granting Sathianathan price and time discretion. Based upon Sathianathan's numerous descriptions of the contents of this e-mail, it is clear that no such discretion was granted. On appeal, Sathianathan requested that the subcommittee of the National Adjudicatory Council empanelled to consider this appeal (the "Subcommittee") reissue a discovery request to Morgan Stanley to search for the e-mail in light of then-recent press reports indicating that Morgan Stanley's previous representations to various regulators and arbitration claimants concerning the extent of Morgan Stanley's e-mail records following September 11, 2001, may have been incorrect. The Subcommittee denied Sathianathan's request, instead informing him it would credit his testimony and representations concerning the content of the e-mail and would provide him with another opportunity to address, in writing, the contents of the e-mail for the record. Sathianathan provided the Subcommittee with a brief written description, in which he also noted that he did not recall the precise language used in the e-mail. It is clear from Sathianathan's various descriptions that the transactions were not made based on price and time discretion.

per share. It is the repurchase of these 23,000 shares that is the subject of the unauthorized discretionary trading allegation.[21]

On August 2, 2001, AV sent an e-mail to Sathianathan in which he stated: "In June, no transaction was authorized by me at all. When I came back from my vacation, I found out that you had proceeded to buy 23,000 shares while clearly knowing my investment objectives and the loan that I had to repay. The resulting loss from this unauthorized trade is about $400,000." In his response to AV's complaint e-mail, Sathianathan represented that his decision to purchase the shares was "purely based on what [Sathianathan] thought was a strong family relationship" and that he "felt a strong responsibility for the management of the 33,000 shares."[22] The e-mail contains no mention of AV's granting of time and price discretion to Sathianathan.

III. Discussion

In addition to the issues raised in the complaint, Sathianathan has raised numerous procedural and other arguments throughout the course of these proceedings. We first address the allegations in the complaint before turning to Sathianathan's other motions and objections.

A. Complaint Allegations

1. Suitability

The complaint alleged that Sathianathan made unsuitable recommendations to both customer AV and customer SS. Regarding AV, the complaint alleged that Sathianathan's unsuitable recommendations involved both the purchase—effected on margin and using only Juniper shares as collateral—of B shares in multiple mutual funds of different fund families, rather than A shares in fewer fund families, and the purchase of approximately $1 million in Smith Barney index warrants. With respect to SS, the allegations in the complaint were limited to the recommendation by Sathianathan that SS purchase B shares, rather than A shares, in multiple mutual funds in different fund families.[23]

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[21] The record indicates that an additional 10,000 Juniper shares were purchased in AV's account on or around June 27, 2001, for approximately $30 per share. Enforcement did not allege that Sathianathan violated NASD rules with respect to this final purchase.

[22] Sathianathan's response e-mail indicates that the loan referenced in AV's e-mail was for $750,000, which AV was forced to take out to cover an error in his tax liability for 2000.

[23] On numerous occasions, Sathianathan sought to introduce evidence into the record regarding the use of margin in SS's account. While the complaint does allege that the use of margin in AV's account was unsuitable, there is no allegation in the complaint that the use of margin in SS's account was unsuitable. Moreover, the Hearing Panel did not base its determination of unsuitable recommendations to SS on the use of margin. Consequently, the Subcommittee denied Sathianathan's requests, and we affirm those decisions.

NASD Conduct Rule 2310(a) requires that "[i]n recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs."[24] Thus, "a representative may make only such recommendations . . . as would be consistent with the customer's financial situation and needs." *Dep't of Enforcement v. Stein*, Complaint No. C07000003, 2001 NASD Discip. LEXIS 38, at *10 (NAC Dec. 3, 2001), *aff'd*, Exchange Act Rel. No. 47335 (Feb. 10, 2003). As we have noted, "most often, the [suitability] rule is violated based on the quality of the recommended transactions when compared to the customer's financial situation and needs."[25] *Dep't of Enforcement v. Howard*, Complaint No. C11970032, 2000 NASD Discip. LEXIS 16, at *15-16 (NAC Nov. 16, 2000), *aff'd*, Exchange Act Rel. No. 46269 (July 26, 2002), *aff'd*, *Howard v. SEC*, 2003 U.S. App. LEXIS 19454 (1st Cir. Sept. 19, 2003) (per curiam).

The recommendations Sathianathan made to AV and SS were deficient in numerous ways. Despite the contrary indications on AV's account forms, Sathianathan stated on multiple occasions that AV's investment objective was the preservation of his newly acquired wealth. Indeed, Sathianathan testified that one of the primary reasons AV moved his account to Little Falls was to engage in hedging transactions and protect his wealth. In addition, Sathianathan admitted that the investment objectives and trading strategies he marked on AV's account opening documents did not reflect AV's objectives; rather, the answers were used as a means to allow Sathianathan to recommend the broadest possible range of investments. The record reflects that Sathianathan requested pricing models on various hedging strategies to protect AV's account, which was concentrated entirely in one highly volatile stock. Ultimately, rather than pursue such a strategy or sell any of the Juniper stock, Sathianathan instead recommended that AV purchase over $3 million in class B shares of 15 different mutual funds on margin using the concentrated equity position as collateral.

Fundamental to a representative's suitability obligation is the requirement that recommendations be personalized and specific to each customer. *See, e.g.*, *F.J. Kaufman & Co.*, 50 S.E.C. 164, 168 (1989). In addition to the obligation that recommendations be personalized,

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[24] NASD Rule 115 provides that NASD rules apply to all members "and persons associated with a member" and that such persons have the same duties and obligations as a member under the rules.

[25] Of course, the fact that a recommendation is ultimately unprofitable or proves to have been unwise does not, in and of itself, make the recommendation unsuitable any more than the fact that a recommendation is profitable makes the recommendation suitable. *See Dist. Bus. Conduct Comm. v. Bruff*, Complaint No. C01960005, 1997 NASD Discip. LEXIS 41, at *11 (NBCC Aug. 11, 1997), *aff'd*, 53 S.E.C. 880 (1998), *aff'd*, 1999 U.S. App. LEXIS 27405 (9th Cir. 1999). Profitability and suitability are not synonymous; rather, the appropriate inquiry is whether the recommendations were appropriate for a particular client given that client's financial situation, investment objectives, and risk tolerance.

"a registered representative's suitability obligation encompasses the requirement to minimize the sales loads that a customer pays for mutual fund shares, when consistent with the customer's investment objectives." *Dep't of Enforcement v. Belden*, Complaint No. C05010012, 2002 NASD Discip. LEXIS 12, at *13 (NAC Aug. 13, 2002), *aff'd*, Exchange Act Rel. No. 47859 (May 14, 2003).

Sathianathan purchased (or intended to purchase) all of the mutual fund shares in class B even though, with the size of the investment, he could have saved AV thousands of dollars in fees and expenses by using fewer fund families and availing the client of breakpoint discounts available with class A shares. Sathianathan gave no serious review as to whether similar diversification in AV's account could have been achieved by investing in multiple funds in the same fund family, thereby taking advantage of breakpoint discounts. *See id.* at *13-19 (discussing the unsuitability of a recommendation of class B shares rather than class A shares and noting that, among other reasons, "because Class A shares with similar investment objectives and performance were available in the same mutual fund family, the purchase of Class B shares was unsuitable"). Instead, Sathianathan relied on the fund family reputation and his own limited, general knowledge of mutual funds. In one instance, he recommended a Smith Barney fund because he felt "pressure" to do so, rather than because he thought it was a suitable investment for AV's account.[26]

Throughout the course of the proceedings, Sathianathan has attempted to demonstrate why he believes that the recommendation of class B shares was suitable. In essence, Sathianathan contends that, on a present value basis, class B shares are superior to class A shares on certain investments. Sathianathan's arguments are premised on general financial theory and ignore the actual facts of this case. While class B shares may be preferable to some investors who invest up to certain amounts, AV was investing several million dollars, which could have qualified him for breakpoint discounts if he invested in class A shares in fewer fund families. Moreover, Sathianathan made the recommendation to purchase class B shares with the knowledge that the shares were being purchased on margin, and the collateral on the margin loan was a concentrated, volatile equity position. Sathianathan, by his own admission, failed to consider the consequences if a margin call were to occur, likening that eventuality to the chances of "a meteorite hitting New York City tomorrow."

The record demonstrates that Sathianathan failed in his obligation to provide AV with recommendations that were suitable based on his individual investment objectives and needs. The Hearing Panel found that Sathianathan made his recommendations based largely on general market trends rather than on the specific financial situation and needs of his customers. As discussed above, the record supports this finding. Sathianathan's recommendations to AV of the purchase of class B shares in multiple different fund companies were unsuitable.

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[26] When Sathianathan was asked during his on-the-record interview whether he recommended the Smith Barney fund even though he did not believe it was the most beneficial recommendation for the customer, he replied that he "didn't think it would hurt the guy [AV] and Smith Barney is a good name anyways."

The recommendations of class B shares to AV were made all the more unsuitable given Sathianathan's recommended manner of financing the purchases using margin. As the Commission has observed: "Trading on margin increases the risk of loss to a customer for two reasons. First, the customer is at risk to lose more than the amount invested if the value of the security depreciates sufficiently . . . . Second, the client is required to pay the interest on the margin loan, adding to the investor's cost of maintaining the account and increasing the amount by which his investment must appreciate before the customer realizes a net gain." *Stephen Thorlief Rangen*, 52 S.E.C. 1304, 1307-08 (1997). The possibility that CDSCs would be incurred if, as ultimately happened, the class B shares had to be redeemed to cover a margin call added yet another level of risk to an account that, despite the indications on the account application, was not aggressive or intended for speculation. In December 2000, Sathianathan again recommended that class B shares be purchased on margin using a concentrated position in a highly volatile stock as the sole margin collateral, even after the stock had lost almost half of its value and the 13,500-share error had been corrected. When the stock price declined and margin calls were issued, AV was forced to redeem the mutual fund shares and incur thousands of dollars in CDSCs.[27] We agree with the Hearing Panel's findings that Sathianathan did not provide AV with suitable mutual fund recommendations.

In addition to the mutual fund recommendations to AV, Enforcement alleged, and the Hearing Panel found, that Sathianathan's recommendation to AV to invest $1 million in speculative Smith Barney index warrants was unsuitable. AV's investment objective was to preserve his newly acquired wealth by diversifying his account holdings, and the purchase of the warrants did not advance AV's investment objectives. The warrants had the potential to expire worthless and, according to the prospectus, involved "a high degree of risk." When questioned during his on-the-record interview as to why he thought this investment would further AV's investment goals, Sathianathan was unable to articulate a meaningful response. In essence, Sathianathan testified that he "thought we could defer all those protection of net worth questions" until the Juniper shares would be eligible for long-term capital gains treatment. Sathianathan failed to adequately consider the risk of this investment and whether it was appropriate for AV's account. We affirm the Hearing Panel's finding that Sathianathan's recommendation that AV purchase $1 million in the Smith Barney index warrants was unsuitable.

Sathianathan's recommendations to SS were also unsuitable. When Sathianathan made similar mutual fund recommendations to SS in December 2000, by his own admission, he merely picked from among the funds he had previously recommended to AV without any consideration of SS's personal circumstances. The suitability rule "requires a broker to make a customer-specific determination of suitability and to tailor his recommendations to the customer's financial profile and investment objectives." *F.J. Kaufman & Co.*, 50 S.E.C. at 168 (citations omitted).

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[27] Throughout the proceedings, Sathianathan has argued that the sales charges and margin interest AV was forced to pay were de minimis amounts in relation to the overall size of AV's account. This position is unavailing. Sathianathan cannot isolate portions of the customers' total losses that resulted from his recommendations to the exclusion of others.

Sathianathan failed on this fundamental tenet. In addition, and like his recommendations to AV, Sathianathan failed to adequately consider whether class B shares were appropriate for SS, relying instead on his general knowledge of financial theory rather than the specifics of SS's investment objectives.

We affirm the Hearing Panel's finding that Sathianathan made unsuitable recommendations to AV and SS in violation of NASD Conduct Rules 2310 and 2110.[28]

2. Discretionary Trading

NASD Conduct Rule 2510(b) provides that no registered representative "shall exercise any discretionary power in a customer's account unless such customer has given prior written authorization to a stated individual or individuals" and the account has been accepted in writing by the member. Paragraph (d)(1) of Rule 2510 excepts from this prohibition "discretion as to the price at which or the time when an order given by a customer for the purchase or sale of a definitive amount of a specified security shall be executed."[29]

There is no dispute that Sathianathan exercised discretion in AV's account by purchasing 23,000 shares of Juniper while AV was out of the country on vacation. There is also no dispute that AV did not know of and consent to the specific terms of the trades before Sathianathan made the purchases. Finally, there is no dispute that AV's Morgan Stanley account was not discretionary; indeed, Morgan Stanley did not permit registered representatives to exercise discretion in customer accounts at that time.

Sathianathan asserts that he had price and time discretion to make the trades. It is clear from Sathianathan's testimony and representations, however, that he did not. According to Sathianathan's on-the-record testimony, he and AV discussed a general strategy of repurchasing these 33,000 shares over time with an approach of buying low and selling high by timing the market based on broad, historical market trends. Based on the general strategy they had discussed and the rumor concerning the possibility of Juniper being added to the S&P 500, Sathianathan chose to buy back a portion of the 33,000 shares while AV was out of the country. These sorts of general strategy discussions are not sufficient to establish price and time discretion, particularly when, by Sathianathan's own admission, there were no discussions involving an appropriate price range (other than buy low and sell high) or any sort of time limitation on the alleged discretionary authority. Thus, we find that the purchases Sathianathan made for AV's account, while based on general discussions of strategy, were unauthorized discretionary trades by Sathianathan, effected without price and time discretion. This conduct violates NASD Conduct Rules 2510(b) and 2110.

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[28] "A violation of NASD's suitability rule is also a violation of Conduct Rule 2110 which requires members to observe high standards of commercial honor and just and equitable principles of trade." *Belden*, 2002 NASD Discip. LEXIS 12, at *13 (citations omitted).

[29] Rule 2510(d)(1) was amended effective January 31, 2005. *See NASD Notice to Members 04-71*. We review the allegations under the rules in effect at the time of the alleged misconduct.

B. Sanctions

The Hearing Panel barred Sathianathan from associating with any member firm for the violations of NASD's suitability rule. In light of the bar, the Hearing Panel declined to sanction Sathianathan for the exercise of discretion in AV's account without written authorization. We affirm the sanctions and the assessed costs.

1. Unsuitable Recommendations

The NASD Sanction Guidelines ("Guidelines") for unsuitable recommendations suggest a fine of $2,500 to $75,000 and a suspension in any or all capacities for a period of 10 business days to one year.[30] In egregious cases, the Guidelines state that adjudicators should consider a longer suspension (of up to two years) or a bar for an individual respondent.[31]

There are no principal considerations specific to a suitability violation; rather, the Guidelines instruct adjudicators to review the principal considerations for all violations, in addition to the General Principles that are applicable to all sanction determinations. After a review of these considerations and principles, we find that there are numerous aggravating factors present that support barring Sathianathan.[32] Perhaps most obviously, Sathianathan's recommendations brought about adverse financial consequences for his customers, who were both inexperienced investors.[33] The principal considerations include as factors both the nature and extent of any injury to customers[34] and the level of sophistication of the injured customers.[35]

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30 Guidelines (2001 ed.) at 99 (Suitability—Unsuitable Recommendations).

31 *Id.*

32 One of Sathianathan's objections was that the Hearing Panel decision included in its discussion of sanctions a statement that AV and SS were Sathianathan's two largest accounts. Sathianathan contends that SS was not his second-largest account and that the Hearing Panel erroneously considered this as an aggravating factor. Sathianathan also sought to adduce evidence on appeal to demonstrate that SS was his third—rather than his second—largest client, which the Subcommittee considering the case denied. We find that the Hearing Panel's statement was immaterial to the Hearing Panel's decision, and we do not consider this fact in our determination of appropriate sanctions. Consequently, we affirm the Subcommittee's decision not to allow Sathianathan to adduce additional evidence on this point. Moreover, Sathianathan also included this statement by the Hearing Panel as an example to support his contention that the Hearing Panel was biased against him. We note that the Hearing Panel's apparent source for the statement was Sathianathan's own on-the-record testimony and in no way demonstrates bias.

33 Sathianathan notes that much of AV's losses occurred during the period after he left Smith Barney and before the assets were transferred to Morgan Stanley. While this may be true, Sathianathan still bears responsibility for his recommendations to AV.

34 *See* Guidelines at 10 (Principal Considerations in Determining Sanctions, No. 11).

In addition, Sathianathan repeated the recommendations in December 2000—after Juniper shares had lost almost half of their value.

While Sathianathan's recommendations resulted in financial losses for his customers, they generated substantial commissions.[36] For instance, the recommendations Sathianathan made to AV in September 2000 alone generated $180,000 in commissions and resulted in a payout to Sathianathan of $66,600. Rather than focusing on the need to recommend suitable investments, Sathianathan focused instead on his own financial gain. On multiple occasions, Sathianathan represented that his unsuitable recommendations were based, if not entirely, at least in part, on his personal need to receive higher commissions and increase his assets under management.[37] For example, on July 28, 2002, in connection with the arbitration filed against Smith Barney, Morgan Stanley, and Sathianathan by AV, Sathianathan sent a letter to AV's counsel, among other people, so that the attorney could "have full knowledge of the facts."[38] In that letter, Sathianathan made the following comments (emphasis added):[39]

(1) When explaining why he recommended that AV invest in mutual funds rather than private accounts, Sathianathan stated that "[m]utual funds would have been preferred because: (1) to have diversification in privately managed accounts, as per [Smith Barney] procedures, entails opening up several new accounts which is very cumbersome; and (2) *more importantly, immediate commissions which were important to me at that time*."

[cont'd]

[35] *See id.* (Principal Considerations in Determining Sanctions, No. 19).

[36] *See id.* (Principal Considerations in Determining Sanctions, No. 17) (requiring adjudicators to consider "[w]hether the respondent's misconduct resulted in the potential for respondent's monetary or other gain").

[37] Torrico, Sathianathan's former branch manager, testified that after a financial consultant's initial two-year salary had expired, he or she would rely on both commission payouts and various types of bonus payments for income. One of the bonus payments was based on the attainment of certain asset levels.

[38] Sathianathan argues that the letter should not be used as evidence because it is covered by the "litigation privilege." The Hearing Officer permitted Enforcement to enter the letter into the record and held that it was not covered by any applicable privilege. We affirm that ruling.

[39] Sathianathan asserts that his representations in the letter should not be given significant weight because he drafted the letter and e-mail "in the heat of litigation," and because of that, he portrayed his actions "in the worst possible light." Even if we were to adopt this interpretation, which we do not, other evidence in the record demonstrates that Sathianathan's recommendations were improperly influenced by considerations of his own financial gain.

(2) When listing the various reasons for his recommendations, Sathianathan included the fact that "by diversifying on margin, in any case, I would be able to purchase some mutual funds for [AV] *and get some commissions*."

(3) Sathianathan admitted that "instead of implementing [AV's] wishes to sell [Juniper] stock and use the proceeds from his account to hedge his $40 million net worth, *I was heavily incentivized by the [Smith Barney] compensation plan* . . . to recommend other strategies for [AV]."

(4) Sathianathan admitted that he "cannot tell you that the incentives created by the [Smith Barney] compensation plan (when it came to assets under management) were not a factor in [his] recommendations."

(5) Finally, Sathianathan stated that "[his] recommendations, *while based on flawed conflicts of interest*, were not intended in any way to intentionally inflict harm on [AV]."

At his on-the-record testimony, Sathianathan reaffirmed that his focus was largely on his personal gain. When asked why he did not discuss breakpoints with SS, for instance, Sathianathan stated: "I wasn't focused on breakpoints. My focus was on bringing in assets. I know I may sound whatever, but commissions were important to me but not that important. Assets were much more important to me." Sathianathan testified that his bonuses were based, in part, on assets under management and that "from day one when [he] started, everyone told [him] that assets are very important because, you know, if you have the assets, then you can survive in the business." Moreover, purchases made on margin were included in the calculation of assets under management.

The record is replete with strong indications that Sathianathan's recommendations to both AV and SS were motivated by his own interests and financial gain and were given without respect to the investment objectives and risk tolerance of AV and SS and without any real investigation or analysis as to appropriate investments.

In addition, Sathianathan made these recommendations and caused the injuries after having received a written probation letter shortly after he joined Smith Barney that alerted Sathianathan to some of the same deficiencies present in this case, such as the excessive use of margin and an excessive focus on commissions. Torrico, Sathianathan's former branch manager at Smith Barney, testified that in 1999 he and Sathianathan initially discussed concerns that arose involving several of Sathianathan's client accounts. Ultimately, these issues led to the issuance of a "Warning/Probation Letter" from Torrico to Sathianathan on September 27, 1999. The letter stated that it served as a "formal probation letter beginning [September 27, 1999] for a period of 4 months (1/27/00)" and included a reference to the previous issues, noting that "[a]s we have discussed on several occasions, you have not shown a consistent pattern of meeting these levels of acceptable behavior." The letter also listed seven "guidelines/goals/standards" that Sathianathan "must adhere to in order to continue [his] employment as a Financial Consultant." One of the seven items was "Proper Portfolio Management," and included in that item was a separate list of six examples, including "Proper Asset Allocation/Diversification," "Limited/no use of margin," and "Eliminate excessive trading/commissions." Torrico testified that he gave

this letter to Sathianathan to "get [Sathianathan's] attention and remind him of [Torrico's] expectations of him" and that such letters were not typically given to trainees. Thus, when Sathianathan made the recommendations to AV and SS, Sathianathan had previously been warned about excessive use of margin and an excessive focus on commissions.

Finally, we agree with the Hearing Panel that Sathianathan has failed to take responsibility for his actions. Sathianathan levied blame on his former supervisor, his former firm, and the brokerage industry in general for presenting conflicts of interest. Sathianathan's attempt to shift blame to Smith Barney by noting that the Smith Barney research department had rated Juniper a "buy" during the relevant time period is unavailing. As the Commission has noted, a registered representative is "obligated not only to consider [the firm's] recommendations, but his clients' investment objectives and financial situations." *Rangen*, 52 S.E.C. at 1309. While Sathianathan may have believed that Juniper shares would increase in value, he also knew of their volatility and that the entirety of AV's margin balance would be collateralized by this single volatile security. Sathianathan cannot focus on the "buy" portion of the rating to the exclusion of the risk portion, particularly given the fact that one of AV's primary investment objectives was to preserve his newfound wealth. Moreover, when, in December, Sathianathan recommended to SS, and reaffirmed his recommendation to AV, that they use Juniper shares—and only Juniper shares—as margin collateral for the purchase of class B shares of mutual funds, Juniper shares had already lost almost half of their value.

We find that there are multiple aggravating factors present and that Sathianathan's conduct was egregious. Sathianathan's actions evidence a total disregard for his customers' best interests. His pattern of conduct—including misrepresenting information on customer account forms, ignoring the instructions of his clients and their investment objectives, evading the investment limits imposed by mutual funds on class B shares, and placing his own financial interests above those of his customers—demonstrates a profound lack of understanding and appreciation of NASD rules and compliance procedures in general. Consequently, we affirm the Hearing Panel's decision to bar Sathianathan in all capacities. Sathianathan is barred for violating NASD Rules 2310 and 2110 with respect to the unsuitable recommendations he provided to AV. Sathianathan's violations of NASD Rules 2310 and 2110 with respect to the unsuitable recommendations he provided to SS also warrant a separate bar.

2. Exercising Discretion Without Written Authorization

The Guidelines for violations of NASD Conduct Rules 2510 and 2110 recommend fining respondents between $2,500 and $10,000 and, in egregious cases, considering suspending the respondent in any or all capacities for 10 to 30 business days.[40] The Guidelines instruct adjudicators to consider whether the customer's grant of discretion was express or implied and whether the respondent's firm had policies and/or procedures prohibiting discretionary trading. In this case, Sathianathan did not have any type of grant of discretion from the customer. In addition, Morgan Stanley had explicit procedures prohibiting its representatives from exercising

[40] *See* Guidelines at 94 (Discretion—Exercise Of Discretion Without Customer's Written Authority).

discretion in customer accounts, even if the customer had provided the representative with price and time discretion. In light of the bars imposed above, however, we do not impose a separate fine or suspension for this violation.

C. Procedural Issues

Sathianathan has raised a host of procedural objections to the disciplinary proceedings against him. We have reviewed each of the objections and find all of them to be without merit. While we need not address every issue individually in detail, we specifically address several recurrent objections.

1. Misconduct and Bias of NASD Enforcement Staff

In multiple filings, Sathianathan alleged misconduct and bias on the part of Enforcement and various members of the NASD staff. After a thorough review of the record, we find no evidence of any such misconduct or bias. Even if a member of the staff were biased, that would not, without more, make the Hearing Panel decision biased. *See Bruff*, 1997 NASD Discip. LEXIS 41, at *17 n.9; *see also Maximo Justo Guevara*, 54 S.E.C. 655, 665 n.21 (2000) ("[I]t is the NASD, not the staff that makes decisions. 'Even if a member of the staff were biased, that would not mean that the NASD decision is biased.'") (*quoting Frank J. Custable, Jr.*, 51 S.E.C. 855, 862 n.22 (1993)); *Stephen Russell Boadt*, 51 S.E.C. 683, 685 (1993). Moreover, de novo review of Hearing Panel decisions by the NAC further ensures that the proceedings are conducted fairly and without bias. *See Bruff*, 1997 NASD Discip. LEXIS 41, at *18-19; *Dist. Bus. Conduct Comm. v. Guevara*, Complaint No. C9A970018, 1999 NASD Discip. LEXIS 1, *39 n.16 (NAC Jan. 28, 1999), *aff'd*, 54 S.E.C. 655 (2000). Thus, we reject Sathianathan's unsubstantiated assertions of staff bias and misconduct.

2. The Fairness of the Proceedings Below

Before the hearing below, Sathianathan requested that the hearing be held in a "neutral location" and that the two industry panelists come from the "San Francisco/Silicon Valley Region" because the "local Primary District Committee in New Jersey has minimal experience with concentrated technology stock positions." Despite these requests, the hearing was held in New Jersey, and the two panelists were then-current members of the District 9 and District 11 Committees of NASD, neither of which covers California. As to Sathianathan's request to hold the hearing in California, there is nothing in the record to support Sathianathan's contentions that the location of the hearing in any way resulted in prejudice.

There is similarly no indication in the record that the Hearing Panel was biased or deficient in any way. In his Notice of Appeal, Sathianathan alleges that the Hearing Officer "was looking for a NASD Hearing Panel who would accept his influence and which would not understand the dynamics of the Silicon Valley area where the customer [AV] and his friend [SS] were based (and, therefore, the NASD Hearing Officer filled the NASD Hearing Panel with young, around 40 years [sic] Panel members)." Sathianathan also alleges that his request to hold the hearing in California was denied because the Hearing Officer "had presided over and had been outvoted by a NASD Hearing Panel in Northern California." NASD Procedural Rules 9231 and 9233 provide that the Chief Hearing Officer, who was not the Hearing Officer in this case,

designates a Primary District Committee based on a number of factors and appoints the panelists. Even if the Hearing Officer was "looking for a NASD Hearing Panel who would accept his influence," which is entirely unsupported in the record, he had no ability to select the panelists. That authority rests solely with the Chief Hearing Officer, and a thorough review of the record demonstrates that he followed the procedures for hearing panel appointments set forth in NASD's Procedural Rules.

We also reject Sathianathan's assertions that the composition of the Hearing Panel was deficient. In general, "[a] respondent does not have a right . . . to dictate the qualifications of the panel members." *Guevara*, 1999 NASD Discip. LEXIS 1, at *38. Moreover, Sathianathan has not shown that the Hearing Panel lacked the proper expertise to consider his arguments. *See Bruff*, 1997 NASD Discip. LEXIS 41, at *18-19. While Sathianathan asserts that the Hearing Panel could not understand concentrated equity positions without a physical connection to California, the suitability allegations in the complaint concern the recommendation of class B shares in multiple mutual funds and the use of margin in AV's account, not an inappropriate concentration in Juniper stock. Furthermore, appellate review of the matter ensures the application of additional industry expertise. *See id.* at *19.

Sathianathan further alleges that one of the Hearing Panelists was biased. Sathianathan argues that because, at the time of the hearing, the panelist's firm was under investigation by NASD, the panelist had an incentive to find against Sathianathan to gain favor with NASD staff. We reject this allegation for numerous reasons. First, assertions of bias that are wholly unsubstantiated, which a review of the record demonstrates these are, "are an insufficient basis to invalidate NASD proceedings." *See Guevara*, 1999 NASD Discip. LEXIS 1, at *39 n.16. Second, as we noted above, our de novo review of the record assures that respondents are given a fair proceeding. *See id.* While there is not a scintilla of evidence to support Sathianathan's assertions beyond his mere suppositions, the record indicates that, to the contrary, the Hearing Panel was fair and, in many instances, gave Sathianathan extra leeway. Finally, taken to its logical conclusion, Sathianathan essentially challenges the legitimacy of self-regulation; under his view, persons associated with member firms would always have the incentive to "vote with" NASD, if not to influence ongoing investigations, then to potentially stave them off or ingratiate themselves to NASD staff. [41]

Finally, Sathianathan objects to the manner in which the proceedings below were conducted. First, Sathianathan argues that some of his motions were not decided by the entire Hearing Panel in violation of NASD Procedural Rules. We reject this argument. The entire Hearing Panel considered and denied an initial motion to dismiss filed by Sathianathan.

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[41] On appeal, Sathianathan objected to the participation of one of the Subcommittee members because the Subcommittee member served as an adjunct professor of law at the same law school where both a Morgan Stanley lawyer and a Smith Barney lawyer also served as adjunct professors. The Chairman of the NAC reviewed the objection pursuant to NASD Procedural Rule 9332 and determined that there was no conflict of interest. We affirm the Chairman's decision.

Subsequent to that denial, however, Sathianathan filed multiple motions making the same arguments. The entire Hearing Panel need not reconsider identical arguments multiple times that they have previously rejected. Moreover, we have reviewed each of Sathianathan's arguments de novo and conclude that they are without merit.

Second, Sathianathan argues that the Hearing Officer improperly interrupted his testimony during the hearing. The Hearing Officer's attempt to limit the hearing to issues relevant to the case was not unfair. *See Bruff*, 1997 NASD Discip. LEXIS 41, at *18 (finding that the hearing panel "acted properly within its discretion to limit [the respondent's] presentation of evidence on points irrelevant to the main issues in [the] case"). Indeed, a Hearing Officer is expressly charged with "regulating the course of the hearing." NASD Procedural Rule 9235(a)(2). The record demonstrates that, both before the Hearing Panel and on appeal, Sathianathan has been given multiple opportunities to present his case.

3. Timing of the Hearing Panel Decision

Sathianathan argues on appeal that the Hearing Panel's decision "was prepared late and was served late in violation of NASD Rule 9268(a) and NASD Rule 9268(c)." This argument is of no moment. There is no NASD procedural rule providing a time limitation for the service of a Hearing Panel decision. Rather, Rule 9268(a) provides that "[w]ithin 60 days after the final date allowed for filing proposed findings of fact, conclusions of law, and post-hearing briefs . . . the Hearing Officer shall *prepare* a written decision that reflects the views of the Hearing Panel . . . as determined by majority vote." (Emphasis added.) "[T]he rule addresses the timing of the Hearing Officer's preparation of a decision (which must then be distributed to other members of the Hearing Panel), and not the issuance of the decision." *Daniel Richard Howard*, Exchange Act Rel. No. 46269, 2002 SEC LEXIS 1909, at *13 (July 26, 2002). Moreover, even if the decision was initially prepared later than 60 days—an allegation for which there is no evidence—Sathianathan has not demonstrated either a lack of diligence by NASD or that he was prejudiced as a result of the alleged delay.[42] *See id.*

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[42] Sathianathan filed a motion to adduce additional evidence on May 11, 2005, that requested "proof from the NASD that the NASD Hearing Officer had issued, at least, a draft version of the NASD written decision to, at least, the NASD Panel within the 60 days mandated by the NASD Rules." In denying that request, the Subcommittee noted that Sathianathan failed to demonstrate that he was prejudiced by any alleged delay. On July 20, 2005, Sathianathan submitted a letter to the NAC arguing that he was prejudiced because the Hearing Panel decision imposed a bar on him and adversely affected his employment in other industries. Sathianathan confuses prejudice caused by the delay with the effect of the decision. Clearly, the adverse decision barring Sathianathan from the industry imposes harm upon him; however, what is required is that Sathianathan demonstrate harm resulting from the alleged delay, not harm resulting from the sanctions imposed in the decision. *Cf. Howard*, 2002 SEC LEXIS 1909, at *13 (noting that "to succeed on a claim of laches, [a respondent] must show both a lack of diligence by the NASD and prejudice resulting from the NASD's delay") (citations omitted). We affirm the Subcommittee's denial of the motion.

Finally, we note that the 60-day time period is measured, not from the date the hearing is completed, but, rather, from the date the last post-hearing papers are allowed to be filed, which here was August 23, 2004. *See* NASD Procedural Rule 9268(a). Here, Sathianathan filed at least nine post-hearing motions, several of which were filed after August 23, 2004, despite the Hearing Officer's order.

In sum, we find that, throughout these proceedings, Sathianathan has been given multiple opportunities to present all facts and arguments relevant to the issues of liability and sanctions. The proceedings have been conducted fairly and in accordance with NASD rules, without bias or prejudice.

D. Evidentiary Issues

On appeal, Sathianathan challenges the Hearing Officer's ruling with respect to each exhibit Sathianathan offered into evidence that the Hearing Officer rejected.[43] Sathianathan offered 347 exhibits into evidence before the Hearing Panel.[44] Of these, 215 were admitted into evidence.[45] We have reviewed the Hearing Officer's decision with respect to each exhibit that was not admitted—the majority of which were not admitted on relevancy grounds—and find that, with three exceptions, the Hearing Officer correctly decided to exclude those exhibits. After our review, we find that it is appropriate to admit respondent's exhibits 25, 101, and 164.[46] Enforcement objected to the admission of all three exhibits on the grounds that each was duplicative of an exhibit offered by Enforcement. A review of the record indicates that the Hearing Officer excluded exhibit 25 on the grounds that it was duplicative. The record does not indicate why the Hearing Officer excluded exhibits 101 and 164. A close review of the three exhibits establishes that they are relevant, and while they are similar to other exhibits, they are not identical. Consequently, all three exhibits will be admitted into the record. With respect to

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[43] Before the Subcommittee, Sathianathan sought to introduce the exhibits that the Hearing Officer ruled were not admissible. The Subcommittee properly determined to treat that request as a challenge to the Hearing Officer's initial decision not to admit those exhibits rather than as a motion to adduce additional evidence. We affirm the Subcommittee's decision.

[44] The Hearing Panel decision states that Sathianathan submitted 349 exhibits; however, two of these "exhibits" were intentionally left blank.

[45] The Hearing Panel decision states that the Hearing Officer admitted 203 exhibits; however, our review of the record indicates that 215 were admitted.

[46] When Sathianathan offered his exhibits, he used exhibit numbers multiple times, and on October 13, 2004, the Hearing Officer issued an order renumbering the exhibits in order. The numbers used above correlate to those used in the Hearing Officer's order. We note that, while we find the Hearing Officer's decision not to admit these three exhibits was an error, none of these exhibits—either individually or cumulatively—is sufficiently material or probative to warrant a remand.

the other exhibits, we affirm the Hearing Officer's rulings. We also affirm the Subcommittee's rulings regarding Sathianathan's multiple motions to adduce additional evidence on appeal.

E. Affirmative Defenses

Sathianathan has maintained throughout the course of this litigation that he is a "whistleblower" and, as such, is entitled to protection—including immunity from NASD disciplinary action—under various federal laws, including 18 U.S.C. § 1513, as amended by Section 1107 of the Sarbanes Oxley Act of 2002 (the "Sarbanes Oxley Act"), and 18 U.S.C. § 241, which is a federal criminal conspiracy provision. Sathianathan argues that his "whistleblower" status arises because he informed federal law enforcement authorities (as well as NASD) about alleged violations of federal law, namely, alleged false sworn declarations provided in an arbitration filed by AV against Smith Barney, Morgan Stanley, and Sathianathan.[47] As we describe below, the federal statutes Sathianathan cites do not provide him with an affirmative defense to an NASD disciplinary proceeding.

1. The Sarbanes Oxley Act

Section 1107 of the Sarbanes Oxley Act added paragraph (e) to 18 U.S.C. § 1513, the federal criminal statute for retaliating against a witness, victim, or informant. That paragraph establishes criminal penalties for a person who "knowingly, with the intent to retaliate, takes any action harmful to any person . . . for providing to a law enforcement officer any truthful information relating to the commission or possible commission of any Federal offense . . . ."

This provision is not relevant to these proceedings. The statutory language on which Sathianathan relies is a criminal provision that provides no recourse to an individual who may find himself on the receiving end of retaliatory conduct. Rather, the provision provides a punishment for those found to have violated its dictates. Sathianathan cannot himself enforce this criminal provision or twist it into an "affirmative defense" to the misconduct at issue in this case based on his perceived public policy rationale for the statute's enactment.

To the extent Sathianathan argues that NASD initiated proceedings against him in violation of federal law, we reject this argument.[48] Sathianathan has failed to establish any

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[47] Sathianathan points to allegedly false declarations provided by a Smith Barney employee and a Morgan Stanley employee during the course of the arbitration. Sathianathan claims to have informed the Securities and Exchange Commission, the New York Attorney General's Office, and NASD about the alleged violations of federal perjury statutes.

[48] Sathianathan argues, as a separate ground for appeal, that he was the subject of selective prosecution. To establish a claim of selective prosecution, Sathianathan must establish "that he was singled out for enforcement action while others similarly situated were not, and that the action was motivated by arbitrary or unjust considerations, such as race." *See Robert Tretiak*, Exchange Act Rel. No. 47534, 2003 SEC LEXIS 653, at *34 (Mar. 19, 2003) (citations omitted). The facts do not support such a claim. Indeed, NASD brought an enforcement action against Torrico, Sathianathan's branch office manager at Smith Barney, based on the same underlying

[Footnote continued on next page]

retaliatory intent on the part of NASD. Instead, Sathianathan links a series of events to impute an alleged retaliatory intent from Smith Barney onto NASD's Enforcement staff.[49] Moreover, Sathianathan first brought his allegations to the attention of NASD examiners in or around September 2002—almost one year after NASD began its investigation into Sathianathan's conduct.

Second, "NASD disciplinary proceedings are treated as an exercise of prosecutorial discretion," and, as such, "are given wide latitude." *Schellenbach v. SEC*, 989 F.2d 907, 912 (7th Cir. 1993). Generally, "courts will not inquire into a prosecutor's ill motive unless there is a showing of selective enforcement or an attempt to discriminate by arbitrary classification." *Id.* (citations omitted). Here, the facts belie either of these motives.

Finally, we note that Sathianathan's arguments demonstrate a misunderstanding of whistleblower protection. In general, whistleblower provisions are intended to protect employees from adverse employment decisions made by an employer about which an employee has notified legal authorities of wrongdoing.[50] These provisions do not serve to absolve the whistleblower from his or her previous misconduct or serve as immunity from suit.

[cont'd]

facts. Sathianathan cannot reasonably allege that NASD selectively initiated proceedings against only him, and there is nothing in the record to support an assertion that Enforcement's actions were motivated by arbitrary or unjust considerations.

[49] Sathianathan argues that Enforcement began its investigation of him based on an alleged "retaliatory" filing by Smith Barney of an amended Form U5 for Sathianathan. Smith Barney, however, amended Sathianathan's Form U5 in November 2001 because of AV's arbitration claim naming Sathianathan as a respondent, an event triggering Form U5 amendments under NASD rules. *See* NASD By-Laws, Art. V, Sec. 3(b) (requiring amendments to a Form U5 "in the event that the member learns of facts or circumstances causing any information set forth in said notice to become inaccurate or incomplete"); *see also* NASD Form U5, Question 7E(1) ("In connection with events that occurred while the individual was employed by or associated with your firm, was the individual named as a respondent/defendant in an investment-related, consumer-initiated arbitration or civil litigation which alleged that the individual was involved in one or more sales practice violations . . . ."). Thus, rather than establish retaliatory intent, the record merely evidences Smith Barney's compliance with NASD rules.

[50] For example, the civil whistleblower statute added by the Sarbanes Oxley Act—which is separate from the provision Sathianathan raises here—provides a civil remedy for employees of publicly-traded companies who are subject to retaliatory conduct by the company "or any officer, employee, contractor, subcontractor, or agent" of such a company. *See* 18 U.S.C. § 1514A(a).

2. Section 241 of Title 18 of the U.S. Code

Title 18, Section 241 of the U.S. Code ("Section 241") is a criminal conspiracy provision that provides that "[i]f two or more persons conspire to injure, oppress, threaten, or intimidate any person in any State . . . in the free exercise or enjoyment of any right or privilege secured to him by the Constitution or laws of the United States, or because of his having exercised the same . . . [t]hey shall be fined under this title or imprisoned not more than ten years, or both . . . ." At the outset we note that, like the Sarbanes Oxley Act provision discussed above, Section 241 is a purely criminal provision and does not give rise to a civil cause of action. *Lewis v. Green*, 629 F. Supp. 546, 554 (D.D.C. 1986). Sathianathan acknowledges that he has no ability to "enforce" the provision; however, he again seeks to use it as an affirmative defense by claiming he is protected by the statute as it relates to this proceeding. Thus, in essence, Sathianathan argues that, by proceeding against him, NASD and/or NASD staff (and possibly employees of Smith Barney or Morgan Stanley) are conspiring against him to injure, oppress, threaten, or intimidate him.

Once again, Sathianathan seeks to transform his self-proclaimed title as whistleblower into a complete immunity from disciplinary action by invoking a federal criminal statute. While it is no doubt true that multiple individuals were involved in various stages of this disciplinary proceeding, from the investigation stage through the litigation below, and the outcome was adverse to Sathianathan, it is erroneous to conclude that this violates Section 241. We find that, for the reasons set forth in the previous section, Section 241 is inapplicable to this case and does not provide Sathianathan with an affirmative defense or cloak him with immunity from disciplinary proceedings for his misconduct.

IV. Conclusion

We affirm the Hearing Panel's finding that Sathianathan provided AV and SS with unsuitable recommendations in violation of NASD Conduct Rules 2310 and 2110. We also affirm the Hearing Panel's finding that Sathianathan exercised discretion in AV's account without prior written authorization in violation of NASD Conduct Rules 2510 and 2110.

Accordingly, we affirm the Hearing Panel's imposition of a bar for each of the suitability violations. In light of the bars, we do not impose a separate sanction for the unauthorized exercise of discretion. We also affirm the Hearing Panel's imposition of hearing costs against Sathianathan in the amount of $4,198.30. We impose appeal costs of $1,000 and transcript costs of $491.15. The bars will be effective immediately upon service of this decision.[51]

On behalf of the National Adjudicatory Council,

Barbara Z. Sweeney, Senior Vice President and Corporate Secretary

[51] We also have considered and reject without discussion all other arguments of the parties.