BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of Department of Enforcement, Complainant, vs. Paul Bryan Zenke, Chicago, IL, Respondent.	DECISION Complaint No. 2006004377701 Dated: December 14, 2009

Finding that respondent violated Rule 2110 by charging commissions for no-load mutual funds without his firm's approval was beyond the scope of complaint's allegations. Held, findings reversed, case dismissed.

Appearances

For the Complainant: Richard A. March, Esq., and Richard S. Schultz, Esq., Department of Enforcement, Financial Industry Regulatory Authority

For the Respondent: Pro Se

Decision

Pursuant to NASD Rule 9311,[1] Paul Bryan Zenke ("Zenke") appeals a May 2, 2008 Hearing Panel decision. In that decision, the Hearing Panel found that Zenke charged impermissible commissions in connection with the sale of no-load mutual funds. The Hearing

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[1] Following the consolidation of NASD and the member regulation, enforcement and arbitration functions of NYSE Regulation into FINRA, FINRA began developing a new "Consolidated Rulebook" of FINRA Rules. The first phase of the new consolidated rules became effective on December 15, 2008. *See* FINRA Regulatory Notice 08-57 (Oct. 2008). Because the complaint in this case was filed before December 15, 2008, the procedural rules that apply are those that existed on December 14, 2008. The conduct rules that apply are those that existed at the time of the conduct at issue.

Panel found that Zenke's conduct violated NASD Rule 2110 ("Rule 2110").[2] For this violation, the Hearing Panel imposed a 20 business-day suspension and $5,000 fine against Zenke. In addition, the Hearing Panel required Zenke to re-qualify in all capacities.

After reviewing the record, we conclude that the Hearing Panel made findings of liability that were beyond the scope of the allegations in the complaint. We therefore reverse the Hearing Panel's finding that Zenke violated Rule 2110 and dismiss the complaint.

I. Background

In December 2000, Zenke became registered with FINRA member Investment Centers of America ("ICA" or the "Firm") as a general securities representative. Zenke resigned from ICA in March 2006, and is currently associated with another FINRA member.[3]

II. Facts

On July 16, 2007, FINRA's Department of Enforcement ("Enforcement") filed a one-cause complaint against Zenke alleging that he violated Rule 2110 by charging commissions in connection with the sale of no-load mutual funds that were prohibited by the funds' prospectuses. The allegations in the complaint cover a period between February 2004 and December 2005. During this period, Zenke sold a total of six no-load mutual funds to seven customers. These sales occurred in nine separate transactions and generated $2,790 in commissions.[4] In each of these transactions, Zenke charged customers what he referred to as a management or consulting "fee" ranging between $75 and $750 in connection with the sale of the no-load mutual funds.

Enforcement filed a complaint alleging that the prospectuses of the mutual funds Zenke sold "provided that no [commissions] would be imposed on the purchases" of the no-load mutual funds and that "[d]espite the prohibition against charging commissions . . . Zenke charged customers fees ranging between 0.5% and 3.0%" in violation of Rule 2110. In his answer to the complaint and throughout the proceeding, Zenke denied that there was any prohibition against charging these fees and further alleged that the prospectuses specifically allowed for additional fees to be charged.

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[2] Rule 2110 requires FINRA members to observe high standards of commercial honor and just and equitable principles of trade. Under Rule 0115, rules such as Rule 2110 that are applicable to FINRA "members" are also applicable to persons associated with a member.

[3] Zenke has been associated with the following firms: (1) Merrill Lynch, Pierce, Fenner & Smith, Inc. from June 1999 to September 2000; and (2) Next Financial Group, Inc., from March 2006 to the present

[4] The following six funds were sold in these transactions: (1) Eaton Vance Floating Rate High Income Fund, (2) Al Frank Fund, (3) Royce Opportunity Fund, (4) Ave Maria Catholic Value Fund, (5) Ave Maria Growth Fund, and (6) Vanguard Short Term Corporate Bond Fund.

Similarly, at the initial pre-hearing conference, Zenke indicated that he reviewed the prospectuses and he found that each of them allowed the broker-dealer to add "all kinds of different fees and costs" in connection with the sale of the funds. Later, in his pre-hearing brief, Zenke argued that "[a]ll 'no-load' funds allow the adding of costs by [a] prospectus" and pointed to language in the Al Frank Fund, Ave Maria Catholic Value Fund, Royce Opportunity Fund and Eaton Vance Floating Rate Fund prospectuses that supported his position.[5] In response, Enforcement introduced a modified theory of liability in its pre-hearing brief. Under this theory, Enforcement argued that the language in the prospectuses did not grant Zenke the authority to charge additional fees because the language only suggested that ICA as *an organization* had power to charge such fees. In addition, Enforcement asserted that guidance posted on ICA's website established what amounted to a "firm policy" prohibiting the collection of any charges on sales of no-load mutual funds. At this point, however, Enforcement made no attempt to amend the complaint to comport with its modified theory of liability.

At the hearing, Enforcement tried to establish that Zenke violated ICA's policy by asking Zenke about a section of ICA's website that offered guidance on what fees the Firm charged in connection with the sale of no-load mutual funds.[6] Zenke objected on the grounds that any violation of ICA's internal rules was not within the scope of the complaint. The Hearing Panel sustained Zenke's objection after the Hearing Officer noted that there was no reference to the Firm's website or procedures in the one-cause complaint.

Later at the hearing, Zenke objected to Enforcement's questions to Jon P. Desmidt, a manager of ICA's Investment Review Department, who provided testimony on ICA's purported policy against imposing sales charges for no-load mutual fund transactions. Again, these questions related to ICA's website and the website's guidance on what fees ICA allowed in connection with the sale of no-load funds. Immediately following Zenke's objection, Enforcement sought to amend the complaint to add that Zenke: (1) charged commissions on no-load funds without the knowledge or consent of his firm, and (2) violated ICA's policy by charging such commissions. The Hearing Officer, however, denied Enforcement's motion and sustained Zenke's objection to the question directed to Mr. Desmidt regarding ICA's policy. In

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[5] For example, Zenke identified language in the Ave Maria Catholic Value Fund prospectus stating that "[brokerage firms] may charge you transaction fees on purchases of fund shares and may impose other charges or restrictions or account options that differ from those applicable to shareholders who purchase shares directly through the Funds." Similarly, the Eaton Vance Floating Rate High Income Fund prospectus stated that "an investment dealer . . . may charge you a fee for executing the purchase for you."

[6] At the hearing, Enforcement claimed that ICA prohibited the collection of commissions or any charges on sales of no-load mutual funds and that the Firm's website had a "frequently asked questions" section that supported this assertion. In Enforcement's post-hearing brief, however, it concedes that "ICA's written policies did not, during the time period of the events at issue, expressly prohibit representatives from adding loads to no-load fund sales . . . ."

ruling in favor of Zenke, the Hearing Officer indicated that Zenke would have "reasonably concluded that the charges relate to whether his conduct violated the terms of the prospectus, not whether there was a firm policy . . . on the point."

The Hearing Panel nevertheless issued a decision finding that Zenke violated Rule 2110 by charging commissions for no-load mutual funds without seeking and receiving ICA's approval.

III. Discussion

Exchange Act Section 15A(h)(1) ensures fairness in [FINRA] proceedings by requiring that specific charges be brought, that notice be given of such charges, that an opportunity to defend against such charges be given, and that a record be kept. 15 U.S.C. § 78o-3(h)(1). *See also James L. Owsley,* 51 S.E.C. 524, 528 (1993) (dismissing "findings of misconduct on matters that have not been charged and which respondents [did not have] a fair chance to rebut."). Similarly, NASD Rule 9212(a) provides that in FINRA's disciplinary proceedings, "[t]he complaint shall specify in reasonable detail the conduct alleged to constitute the violative activity and the rule, regulation, or statutory provision the Respondent is alleged to be violating or have violated."

Here, the sole theory of liability alleged in the complaint was that the prospectuses of the mutual funds prohibited *any* fees to be charged in connection with the sale of the funds. This theory was incorrect. In fact, the prospectuses contained provisions that allowed a broker-dealer to impose additional unspecified fees when selling the funds. As early as in his answer to the complaint, Zenke presented this information to Enforcement. Curiously, Enforcement did not attempt to amend the complaint until *after* the hearing began and was near the end of its case in chief.

FINRA procedure allows Enforcement to amend a complaint to "conform to the evidence presented" after a showing of good cause for the amendment and that the amendment does not prejudice the respondent. *See* Rule 9212(b). The Hearing Panel denied Enforcement's motion to amend the complaint, finding that Enforcement had not shown good cause for the delay and that the amendment would be prejudicial to Zenke's defense. We agree.

The record demonstrates that the focus of Zenke's defense was on whether the mutual fund *prospectuses* prohibited such charges rather than whether ICA had a specific policy that would not allow its representatives to impose charges with or without ICA's authorization. Indeed, Zenke objected on multiple occasions to Enforcement's attempt to prove that his actions violated ICA policy. *See James W. Browne and Kevin Calandro*, Exchange Act Release No. 58916, 2008 SEC LEXIS 3113, at *38 (Nov. 7, 2008) (dismissing allegation where applicant "objected repeatedly to [the] disparity between the complaint and the evidence" offered to prove the complaint's allegation).

The Hearing Panel appropriately limited the action to the initial allegations in the complaint. As a result, Enforcement's modified theory of liability was not alleged in the complaint. Nevertheless, by finding Zenke liable for charging commissions without ICA's authorization, the Hearing Panel improperly made a finding of liability for misconduct that was not alleged in the complaint. *See Owlsley*, 51 S.E.C. at 527-28 (refusing to affirm findings of

liability for purported fraudulent misconduct that had not been charged in the complaint and where applicant did not have a fair chance to rebut charges). Moreover, the Hearing Panel's findings essentially embraced the theory of liability it had *rejected* in denying Enforcement's motion to amend the complaint. *Cf. Browne*, 2008 SEC LEXIS 3113, at *38 (dismissing an allegation in the complaint after concluding that confusion caused in part by Hearing Officer's failure to rule on a motion to amend the complaint left the scope of the allegation in the complaint unclear).

We find that the Hearing Panel improperly found Zenke liable for misconduct that was beyond the scope of the allegations in the complaint. Specifically, we find that the complaint alleged that Zenke violated Rule 2110 by charging fees that were prohibited by the prospectuses, but did not allege that the basis for Zenke's violation was that he imposed these fees without ICA's authorization. We recognize that the Commission has held that "a complaint need not specify all details regarding a case against a respondent,"[7] and that a complaint will be "sufficient if the respondent 'understood the issue' and 'was afforded full opportunity' to justify its conduct during the course of the litigation."[8]

In this case, however, the Hearing Panel's finding that Zenke could not impose additional costs without ICA's permission was central to their finding of liability against him. In contrast, Zenke's defense centered on the specific allegation in the complaint, namely, that the prospectuses of the no-load mutual funds he sold prohibited the imposition of any sales charges. Consequently, we find that Zenke did not have a sufficient opportunity to defend himself in the proceedings below. Under these circumstances, we reverse the Hearing Panel's findings of liability and dismiss the complaint. *See D.E. Wine Investments, Inc.*, 54 S.E.C. 1213, 1221 (2001) (finding that a theory of misconduct that was "neither initially charged nor fairly litigated at the hearing" must be dismissed).

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[7] *Wanda P. Sears*, Exchange Act. Rel. 58075, 2008 SEC LEXIS 1521, at *11 (July 1, 2008) (citation omitted); *see also Fox & Co. Invs. Inc.*, Exchange Act Rel. No. 52697, 2005 SEC LEXIS 2822, at *32 n.34 (Oct. 28, 2005) (affirming applicant's liability for recordkeeping violations where applicant's failure to book an arbitration award as a liability was one of the inaccuracies supporting the alleged recordkeeping violation, but the complaint did not specifically allege applicant's failure to book the award was a violation).

[8] *Aloha Airlines, Inc. v. Civil Aeronautics Bd.*, 598 F.2d 250, 262 (D.C. Cir. 1979) (quoting *NLRB v. Mackay Radio & Tel. Co.*, 304 U.S. 333, 350 (1938)). *See also Thomas E. Warren, III*, 51 S.E.C. 1015, 1019 n.18 (1994), *aff'd*, 69 F.3d 549 (10th Cir. 1995) (table format) (stating that "even if an administrative pleading is defective, the defect can be remedied if the record demonstrates that the respondent understood the issue and was afforded a sufficient opportunity to justify his conduct with respect thereto.") (citation omitted).

IV. Conclusion

We conclude that the Hearing Panel's finding that Zenke violated Rule 2110 by charging commissions for no-load mutual funds without his firm's approval was beyond the scope of the complaint. Accordingly, we reverse the Hearing Panel's finding and dismiss the complaint.

On Behalf of the National Adjudicatory Council,

Marcia E. Asquith

Marcia E. Asquith, Senior Vice President and Corporate Secretary