

NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

PATTERSON TRAVIS, INC.
(CRD No. 16540),
Englewood, CO,

DAVID T. TRAVIS
(CRD No. 448950)
Aurora, CO,

ERIC H. DIEFFENBACH
(CRD No. 1833420)
Littleton, CO,

and

MICHEL A. ROOMS
(CRD No. 2187994)
Littleton, CO,

Respondents.

Disciplinary Proceeding
No. C06020003

Hearing Officer—Andrew H. Perkins

HEARING PANEL DECISION

April 25, 2003

Respondents violated penny stock rules SEC Rule 15g-2, 15g-3, and 15g-5, and NASD Conduct Rule 2110 by failing to disclose required information to customers purchasing a penny stock. For this violation, Patterson is expelled, Travis is barred, Rooms is fined \$5,000, and Dieffenbach is fined \$12,000. In addition, Patterson is ordered to offer rescission to the customers. The Respondents also violated NASD Procedural Rule 8210 and NASD Conduct Rule 2110 by obstructing NASD's investigation of the penny stock violations. For these violations, Patterson is expelled, Travis is barred, Rooms is suspended for 30 business days, and Dieffenbach is suspended for six months. Patterson and Travis violated Rule 3010 and 2110 by failing reasonably to

supervise penny stock activities. For this violation, Patterson is expelled and fined \$50,000, and Travis is barred and fined \$50,000. Finally, Patterson and Travis violated NASD Conduct Rule 2110 by failing to abide by the terms of an Order of Settlement entered in a prior NASD disciplinary proceeding. For this violation, Patterson is expelled and Travis is barred. The Hearing Officer dissented as to the sanctions imposed on Rooms and Dieffenbach for obstructing NASD’s investigation.

Appearances

For the Department of Enforcement: Karen E. Whitaker, Senior Regional Attorney, and Mark P. Dauer, Regional Counsel, NASD, Dallas, TX; Rory C. Flynn, NASD Chief Litigation Counsel, Washington, DC, Of Counsel.

For Respondents: Richard C. Kaufman and John W. Kellogg, FRIEDLOB SANDERSON PAULSON & TOURILLOTT, LLC, Denver, CO.

DECISION

I. INTRODUCTION

The Department of Enforcement (“Department”) charged Patterson Travis, Inc. (“Patterson” or the “Firm”), David Travis (“Travis”), Eric Dieffenbach (“Dieffenbach”), and Michael Rooms (“Rooms”) with violations of Section 15(g) of the Securities Exchange Act of 1934 (“Exchange Act”), SEC Rules 15g-2, 15g-3, and 15g-5 (the “Penny Stock Rules”),¹ and NASD Conduct Rule 2110. The Department also charged the Firm, Travis, and Dieffenbach with violations of SEC Rule 15g-9, which the Department withdrew during the hearing. The Department alternatively charged the Firm and Travis, the Firm’s President and owner, with violating NASD Conduct Rules 2110 and 3010 for failing to supervise the activities of Dieffenbach and Rooms in connection with the Penny Stock Rule violations. Moreover, the Department charged each Respondent with violations of NASD Conduct Rule 2110 and NASD

¹ 17 C.F.R. 240.15g-2, 240.15g-3, and 240.15g-5.

Procedural Rule 8210 for attempting to conceal their violations of the Penny Stock Rules and to obstruct NASD's investigation. Finally, the Department charged the Firm and Travis with violating NASD Conduct Rule 2110 for failing to comply with the terms of an NASD Order accepting an offer of settlement entered in a prior disciplinary action.

The Respondents filed an Answer denying the charges and requesting a hearing, which was held in Denver, Colorado, on November 19 and 20, 2002, before an Extended Hearing Panel composed of the Hearing Officer and a current and former member of the District 3 Committee.² The Department called as witnesses: Paul Rash, III, an NASD examiner; Jacqueline D. Whelan, a Department attorney; and four Patterson customers who purchased Turner Group stock from Rooms and Dieffenbach. The Respondents testified on their own behalf.

II. FINDINGS OF FACT AND CONCLUSIONS OF LAW

A. Origin and Nature of the Underlying Investigation

The charges in the Complaint arose from a routine investigation of the Firm in April 1998, which, in part, focused on penny stock³ activities because the Firm had been cited previously for violations of the Penny Stock Rules.⁴ During the investigation, NASD Staff (the "Staff") discovered that some customer files lacked an "Affirmation of Non-Solicitation" ("Non-Solicitation Form")⁵ for transactions in Turner Group, Inc. stock, a penny stock.⁶ The Staff

² References to the November 19, 2002, hearing transcript are cited as "Tr. I ___", and references to the November 20, 2002, hearing transcript are cited as "Tr. II ____." The Department's exhibits are cited as "CX-," and the Respondents' exhibits are cited as "R-."

³ Penny stocks are non-Nasdaq and non-exchange-listed equity securities, currently priced less than \$5 per share, that are issued by companies with less than a specified amount of net tangible assets, continuous operations, or annual revenues. *See* 17 C.F.R. 240.3a51-1 (1998). *See also District Bus. Conduct Comm. v. Gallison*, 1999 NASD Discip. LEXIS 8, *6-7 (NAC Feb. 5, 1999).

⁴ Tr. I, at 198.

⁵ *See* CX-8.

specifically looked at trades in Turner Group stock because Patterson made a market in this security and, therefore, any recommendations the Firm's brokers made in connection with the sales of that security were subject to the Penny Stock Rules.⁷ Ultimately, the Staff determined that Dieffenbach and Rooms contacted their customers for whom Non-Solicitation Forms were missing and asked that they sign and supply backdated forms for the Firm's files. Travis then supplied those forms to the Staff without disclosing that they were postdated. Further, one customer informed the Staff that Dieffenbach had instructed him not to cooperate with NASD's investigation. As a result of the foregoing findings, the Department filed the Complaint instituting this disciplinary proceeding.

B. The Respondents

(a) Patterson Travis

Patterson is a general securities broker-dealer and a member of NASD.⁸ In 1997 and 1998, the Firm had 75 registered representatives in two offices, one in Denver and the other in New York City.⁹ Between 1998 and July 1999, Patterson downsized considerably. The Firm transferred most of its records to the Denver office and reduced the number of brokers in New York to one. The Denver office shrank from nine to four registered representatives.¹⁰

⁶ The Firm's penny stock procedures required a Non-Solicitation Form to be signed by the customer where the customer initiated the stock trade. (CX-22, at 2.)

⁷ Tr. I, at 193.

⁸ CX-1.

⁹ Tr. II, at 123-24.

¹⁰ *Id.* at 124-25.

(b) Travis

Travis, Patterson's President, is registered as a General Securities Representative, a General Securities Principal, and Financial and Operations Principal.¹¹ In 1997 and 1998, Travis oversaw all of the Firm's compliance and supervisory functions.¹² Travis was head of the trading department in the Colorado office where Dieffenbach and Rooms worked, and he was responsible for making a market in Turner Group stock.¹³ Travis was the only principal in the office that approved penny stock trades; he approved each of the Turner Group trades at issue in this case.¹⁴ Significantly, Travis admitted that he was "the principal responsible for obtaining documents that would be required by the Penny Stock Rules in connection with sales out of the Colorado office."¹⁵

(c) Dieffenbach

Dieffenbach is registered as a General Securities Representative and as a General Securities Principal with Jackson National Life Distributors, Inc. in Denver, Colorado.¹⁶ He was associated with Patterson between January 1995 and October 2001.¹⁷ Dieffenbach was registered

¹¹ *Id.*, at 123; CX-2.

¹² Tr. II, at 155.

¹³ *Id.* at 156.

¹⁴ *Id.* at 160-61; CX-25.

¹⁵ Tr. II, at 161. Travis' understanding of his responsibilities conforms to the Firm's written supervisory procedures. See CX-22, at 3.

¹⁶ Tr. II, at 79; CX-3, at 2. Dieffenbach first became registered as a General Securities Representative in 1988; in 1992, he became registered as a General Securities Principal.

¹⁷ CX-3, at 3.

as a General Securities Representative and a General Securities Principal while he was associated with Patterson.¹⁸

(d) Rooms

Rooms is registered currently associated with Patterson as a General Securities Representative, a General Securities Principal, and an Investment Company and Variable Contracts Products Representative.¹⁹ Rooms first was associated with Paterson Travis between January 1995 and August 2000, when he voluntarily left to join UBS Painewebber, Inc.²⁰ In May 2002, Painewebber terminated Rooms upon learning of this disciplinary proceeding.²¹ Rooms then rejoined Patterson.

Rooms and Dieffenbach both started their securities careers at Hibbard Brown & Co. in Woodbridge, NJ, and their careers thereafter paralleled each other until they associated with Patterson. They left Hibbard Brown on August 19, 1994, to join H.J. Meyers & Co., Inc. They then left H.J. Meyers and joined Patterson in January 1995.²²

C. Jurisdiction

NASD has jurisdiction of this proceeding.²³ The Firm was an NASD member, and the individual Respondents were registered with NASD, when the alleged violations occurred and when the Department filed the Complaint.

¹⁸ *Id.*

¹⁹ Tr. II 5-6; CX-4, at 3.

²⁰ CX-4, at 4.

²¹ Tr. II, at 5.

²² CX-3; CX-4.

²³ See NASD By-Laws, Article III, Section 3(c), Article IV, Section 6, and Article V, Section 4, < http://www.nasdr.com/pdf-text/nasd_manual.pdf>.

D. Penny Stock Violations by Patterson, Rooms, Dieffenbach, and Travis—Cause One

The Respondents stipulated,²⁴ and the Panel finds, that Turner Group was a penny stock and that sales of the stock were generally subject to the Penny Stock Rules. Further, the Panel finds that, at all times relevant to this disciplinary proceeding, Patterson made a market in Turner Group stock. Accordingly, unless the transactions were exempt, the Respondents were obligated to comply with the Penny Stock Rules.

1. Penny Stock Rules

In summary, the Penny Stock Rules require broker-dealers to provide their penny stock customers with information concerning the general risks of penny stocks, and the specific nature of their penny stock purchases. Unless the transaction is exempt, broker-dealers effecting customer transactions in such defined penny stocks are required to provide their customers with: (1) a Risk Disclosure Document,²⁵ describing the risks of investing in penny stocks;²⁶ (2) oral and written disclosure of current bid and ask quotations, if any;²⁷ (3) disclosure of the compensation of the broker-dealer and its salesperson in the transaction;²⁸ and (4) monthly account statements showing the market value of each penny stock held in their customers' accounts.²⁹ In addition,

²⁴ Ans. ¶ 7; Tr.I, at 111.

²⁵ The Risk Disclosure Document, prepared by the Securities and Exchange Commission (the "Commission"), informs investors of the risky nature of penny stocks and of certain of their rights.

²⁶ SEC Rule 15g-2 also requires the firm to obtain a signed acknowledgment of receipt of the Risk Disclosure Document.

²⁷ SEC Rule 15g-3.

²⁸ SEC Rules 15g-4 and 5.

²⁹ SEC Rule 15g-6.

SEC Rule 15g-9 requires broker-dealers to complete a written suitability statement before effecting a penny stock transaction with a new customer.³⁰

Certain penny stock transactions are exempt from the Penny Stock Rules. SEC Rule 15g-1(e) states that “[t]ransactions that are not recommended by the broker or dealer” are exempt. Commonly referred to as the “non-recommended” exemption, SEC Rule 15g-1(e) “is limited to situations in which a broker-dealer acts as an order taker for the customer, with little or no incentive to engage in manipulative sales tactics.”³¹ Thus, the non-recommended exemption does not apply when a representative brings a penny stock to a customer’s attention because this action usually is intended by a representative, and understood by the customer, as an implicit recommendation to buy the penny stock.³²

Here, Rooms and Dieffenbach concede that they engaged in penny stock transactions and that they failed to make all of the disclosures required by SEC Rules 15g-2, 15g-3, and 15g-5. Nevertheless, Rooms and Dieffenbach claim they did not violate the Penny Stock Rules because the transactions were neither solicited nor recommended. But a representative may not avoid compliance with the Penny Stock Rules by recommending penny stocks when a customer initiates contact, as Rooms and Dieffenbach did. Accordingly, as more fully discussed below, the Panel concludes that Rooms and Dieffenbach did recommend the transactions; therefore, the non-recommended exemption did not apply.

³⁰ See *District Bus. Conduct Comm. v. Gallison*, 1999 NASD Discip. LEXIS 8, *8. See also NASD Notices to Members 92–38, 1992 NASD LEXIS 71 (July 1992).

³¹ Penny Stock Disclosure Rules, Exchange Act Release No. 34-30608, 1992 SEC LEXIS 927 (Apr. 28, 1992).

³² *Id.*

2. Sales of Turner Group Stock

(a) Sales by Respondent Rooms

The underlying facts pertaining to Rooms' transactions in Turner Group stock are largely undisputed. Rooms concedes that he sold 2425 shares of Turner Group stock to five customers³³ between November 21 and December 12, 1997. Rooms also concedes that he failed to provide any of the customers with a copy of the required Risk Disclosure Document.³⁴ In addition, the evidence shows that Rooms failed to provide customers with complete information regarding the inside bid and ask quotations³⁵ and that he did not tell his customers the amount of his compensation.³⁶

The Department called one customer, DH, to testify regarding Rooms' violations of the Penny Stock Rules. DH testified that Rooms failed to give him: (1) a copy of the Risk Disclosure Document; (2) the current bid and ask quotations; and (3) any information regarding the amount of Rooms' compensation.³⁷ DH further testified that he first learned of Turner Group in a telephone call from Rooms and that he purchased Turner Group stock from Rooms based on his recommendation.³⁸ While DH could not recall specific details of the conversation, he stated unequivocally that Rooms brought Turner Group to his attention and suggested it as a potential

³³ The transactions are identified on the attached Schedule A. The identities of the customers who referred to by their initials in this Decision are set forth on the attached Schedule C.

³⁴ Tr. II, at 71.

³⁵ Tr. II, at 36–37.

³⁶ *Id.* at 38.

³⁷ Tr. I, at 26–27.

³⁸ *Id.* at 24–25.

investment that likely would perform well.³⁹ In addition, DH testified that he did not do any independent research into Turner Group before he made his investment.⁴⁰

At the hearing, Rooms challenged DH's credibility by demonstrating that he could not remember the exact wording of his conversation with Rooms. However, the Panel finds DH's testimony credible and consistent with the other evidence. With respect to DH's transaction, the Panel notes that Rooms failed to mark the order ticket "unsolicited"⁴¹ and that he conceded that DH did not know about Turner Group before he brought it to his attention.⁴² Moreover, the Department introduced customer questionnaires⁴³ and declarations⁴⁴ that corroborated DH's testimony.

Rash, the lead NASD examiner on the examination that led to the filing of the Complaint, testified that in early 1999 he sent questionnaires⁴⁵ to the Patterson customers who had purchased Turner Group stock because Rash had been unable to determine what exemption Travis claimed applied to the Turner Group transactions.⁴⁶ Specifically, Rash sought to learn if Rooms and Dieffenbach had recommended Turner Group stock to certain of their customers.⁴⁷ Rooms'

³⁹ *Id.* at 24–25, 35–36.

⁴⁰ *Id.* at 25–26.

⁴¹ CX-6, at 4.

⁴² Tr. II, at 64.

⁴³ CX-10.

⁴⁴ CX-11.

⁴⁵ The Commission has approved the use of customer questionnaires as "a necessary and appropriate means of gathering information on members' sales practices" that "furthers the NASD's regulatory objectives." *Robert A. Amato*, 51 S.E.C. 316, 320 (1993).

⁴⁶ Tr. I, at 120–21.

⁴⁷ *Id.* at 121.

customers DH, AC, DR, and HD returned signed questionnaires.⁴⁸ In each case, the customer states that Rooms recommended Turner Group. In 1999, Rash also obtained sworn declarations from each customer except DR. Here also, the customers state: (1) Rooms recommended Turner Group to them; (2) they relied upon Room's recommendation in purchasing the stock; and (3) Rooms did not make all of the disclosures required by the Penny Stock Rules.

3. Sales by Respondent Dieffenbach

The underlying facts pertaining to Dieffenbach's transactions in Turner Group stock also are largely undisputed. Dieffenbach concedes that he sold 21,850 shares of Turner Group stock to six customers⁴⁹ between October 21, 1997, and March 4, 1998. Dieffenbach further admits that he never provided any customer with a copy of the required Risk Disclosure Document.⁵⁰ Indeed, Dieffenbach testified that he was never trained regarding the procedures that applied to penny stock transactions.⁵¹ He explained:

I knew there were a bunch of forms that needed to be filled out, prior to me recommending a customer for a penny stock. But I had never filled out any of these forms. And to this day, I still don't know how to fill them out with what they want.⁵²

In addition, JM, JS, and BM testified that Dieffenbach failed to provide them with complete information regarding the inside bid and ask quotations and the amount of his compensation although he recommended that they purchase Turner Group stock.⁵³ JM, JS, and

⁴⁸ CX-10, at 5, 9, 18, and 38.

⁴⁹ The customers are identified on the attached Schedule B.

⁵⁰ Tr. II, at 111.

⁵¹ *Id.* at 116.

⁵² *Id.* at 117-18.

⁵³ Tr. I, at 52-53, 55-56, 77-78, and 95.

BM further testified that Dieffenbach brought Turner Group to their attention and that they otherwise were unfamiliar with the company. Dieffenbach admits that none of these customers called him about Turner Group.⁵⁴ To corroborate this testimony, the Department also introduced customer questionnaires from AA, CD, JM, LM, and JS, and sworn declarations from JM, LM, and JS. In summary, the questionnaires and declarations state: (1) Dieffenbach recommended that they purchase Turner Group stock; (2) the customers relied on Dieffenbach's recommendation in purchasing the stock; and (3) Dieffenbach failed to provide them with the information required under the Penny Stock Rules.⁵⁵ Taken as a whole, the Panel concludes that the testimony, questionnaires, and declarations comprise compelling evidence that Dieffenbach failed to provide these customers with the information required by the Penny Stock Rules.

4. The Transactions are not Exempt from the Penny Stock Rules

Rooms and Dieffenbach testified that, to the best of their recollection, they did not recommend Turner Group stock to their customers; thus, they believed that they had not violated SEC Rules 15g-2, 15g-3, and 15g-5. Each testified that it was his belief that a recommendation involved more than directing a customer to a particular security or telling a customer that a security was a good idea. Rooms testified that he did not consider it a recommendation unless he was "adamant about a situation."⁵⁶ Rooms explained, "when I recommend a security to somebody, any type of investment, I'm absolutely, 100 percent certain that that recommendation is good for the client . . . I would never say to somebody, this may or may not be a good idea,

⁵⁴ Tr. II, at 83.

⁵⁵ See CX-10, at 1, 13, 22, 30, and 34; CX-11, at 10, 13, and 18.

⁵⁶ Tr. II, at 31.

take a look at it.”⁵⁷ Likewise, Dieffenbach testified that it was his understanding that he was not making a recommendation unless he insisted that the customer buy the security.⁵⁸ Travis testified that he agreed with Rooms and Dieffenbach’s definition.⁵⁹

SEC Rule 15g-1(e) however does not exempt transactions where a broker-dealer brings a penny stock to the attention of investors “because, in most cases, this action is intended, and is understood by the customer, as an implicit recommendation to buy the penny stock.”⁶⁰ To be exempt, “representatives must not advise their clients, either explicitly or implicitly, regarding a penny stock transaction; they must act as mere order takers.”⁶¹ Moreover, application of the non-recommended exemption does not turn solely on whether the customer initiated the contact that led to the transaction; that is, whether the transaction was solicited or unsolicited. In other words, “representatives may not recommend penny stocks simply because a customer initiates contact.”⁶²

Here, the evidence conclusively shows that Rooms and Dieffenbach recommended Turner Group stock to the foregoing customers and that they failed to make all of the required disclosures. Rooms and Dieffenbach brought Turner Group to the attention of their customers.⁶³ The Respondents’ argument that they did not recommend the stock because they did not emphatically push the stock to their customers is unsound. The Commission rejected a nearly identical argument in *Erdos* where the Commission held that a broker made recommendations

⁵⁷ *Id.* at 32.

⁵⁸ *Id.* at 115.

⁵⁹ *Id.* at 165.

⁶⁰ *District Bus. Conduct Comm. v. Gallison*, 1999 NASD Discip. LEXIS 8, *17.

⁶¹ *Id.*

⁶² *Id.* at *18.

⁶³ *See* Tr. II, at 64, 83.

despite his contention that “[a]t all times [he] said to [the customer] if you don’t want to do it, we don’t have to.”⁶⁴

5. Travis and the Firm are Responsible for the Penny Stock Violations

In the First Cause of Complaint, the Department also charged Travis and the Firm with violating SEC Rules 15g-2, 15g-3, and 15g-5, and NASD Conduct Rule 2110. The Panel finds them responsible for these violations for several reasons. First, Travis controlled, and was responsible for, the Firm’s penny stock business. He developed the Firm’s penny stock policies and procedures,⁶⁵ and he approved all penny stock trades in the Colorado office.⁶⁶ In addition, Travis signed each of the order tickets for the transactions in question in this proceeding.

Second, Travis was the Firm’s head trader, and he oversaw the Firm’s market-making activity. Travis made a market in Turner Group.⁶⁷ Each of the violations occurred in the Colorado office where Travis worked and served as the branch manager. As the head of trading in the Colorado office, Travis caused the trades to be executed and was a “central link” in the chain of events that gave rise to the penny stock violations.⁶⁸

Third, Travis was the head sales manager for the Colorado office, and Rooms, himself a sales manager in the Colorado branch office, reported to Travis.⁶⁹ Thus, Travis had ultimate responsibility for every aspect of the penny stock activities in the Colorado office.

⁶⁴ *Erdos*, Exchange Act Release No. 20376, 1983 SEC LEXIS 332, *9 (Nov. 16, 1983).

⁶⁵ CX-22.

⁶⁶ Tr. II, at 156, 160–61; CX-25.

⁶⁷ Tr. II, at 126.

⁶⁸ *See District Bus. Conduct Comm. v. Gallison*, 1999 NASD Discip. LEXIS 8, *24.

⁶⁹ CX-23, at 3.

6. Conclusion

Accordingly, the Panel finds that Rooms, Dieffenbach, Travis, and the Firm violated SEC Rules 15g-2, 15g-3, and 15g-5, and NASD Conduct Rule 2110,⁷⁰ as alleged, by engaging in penny stock transactions without making the disclosures required under the Penny Stock Rules. Rooms and Dieffenbach are liable for failing to make the required disclosures before making the sales of Turner Group stock,⁷¹ and Rooms, Dieffenbach, and Travis are responsible for causing Patterson to violate the Penny Stock Rules.⁷²

E. Travis' and the Firm's Failure to Supervise Rooms and Dieffenbach—Cause Two

In addition to charging Travis with direct violations of the Penny Stock Rules, in the Second Cause of Complaint the Department charged that Travis and the Firm violated Conduct Rule 3010 by failing reasonably to supervise Rooms and Dieffenbach. Conduct Rule 3010 requires that members establish, maintain, and enforce a set of written supervisory procedures and that these procedures be “reasonably designed to achieve compliance with applicable securities laws and regulations, and with the Rules of [NASD].” Rule 3010 also states that “[f]inal responsibility for proper supervision shall rest with the member.”

Whether supervision was reasonable “is determined based on the particular circumstances of each case. The burden is on the [Department] to show that the respondent’s procedures and

⁷⁰ See *District Bus. Conduct Comm. v. Gallison*, 1999 NASD Discip. LEXIS 8, *29.

⁷¹ See *Deitchman*, Exchange Act Release No. 37325, 1996 SEC LEXIS 1627 (June 19, 1996).

⁷² *M. Rimson & Co.*, Initial Dec. Release No. 106, 1997 SEC LEXIS 486 (Fe. 25, 1997).

conduct were not reasonable. It is not enough to demonstrate that an individual is less than a model supervisor or that the supervision could have been better.”⁷³

In this case, Travis and the Firm presented two defenses to this charge. First, Travis argued that he was not the Firm’s compliance officer. Impliedly, Travis contended that he was not responsible for Rooms and Dieffenbach’s compliance with the Penny Stock Rules. Second, they argued that the small number of transactions shows that the Firm was well managed.⁷⁴ The Panel finds no support for either argument. To the contrary, the Panel finds that Travis had line responsibility for supervising the sales activities in the Colorado branch office, including Rooms and Dieffenbach, and that he was responsible for assuring compliance with the Penny Stock Rules. Travis was the Branch Manager of the Colorado office as well as the President of the Firm. Patterson maintained a schedule of designated supervisory personnel for each area of the Firm’s business.⁷⁵ At the time relevant to the Complaint, Travis was designated as the co-supervisor of trading and market making for the entire firm and the Head Sales Manager for the Colorado branch office.⁷⁶ In addition, Patterson maintained a Supervisory Procedures and Personnel Listing that designated Travis as having the following responsibilities: (1) assuring that the Firm’s supervisory and compliance procedures were adhered to by the office staff; (2) supervising and overseeing the Firm’s Settlement and Operations area; (3) supervising “all aspects of the firm’s compliance efforts including regulatory reporting, monitoring new

⁷³ *District Bus. Conduct Comm. v. Lobb*, 2000 NASD Discip. LEXIS 11, at *16 (NAC Apr. 6, 2000) (citations omitted).

⁷⁴ Respondents’ Post-Hearing Brief at 13.

⁷⁵ CX-23

⁷⁶ *Id.*

regulatory developments, preparation of policies and procedures, monitoring employee's accounts, maintaining customer complaint files, and reviewing all correspondence and promotional material"; (4) supervising the Firm's compliance efforts; and (5) supervising and coordinating the Firm's overall sales and trading efforts.⁷⁷ Travis was also designated a Sales and Trading Supervisor, responsible for overseeing the sales and trading activities of the Colorado branch office.⁷⁸ Significantly, Travis never denied he was Rooms and Dieffenbach's supervisor.

As to Travis' responsibility for ensuring compliance with the Penny Stock Rules, Travis testified at the hearing that he approved penny stock transactions in the Colorado branch office.⁷⁹ He further stated that the compliance officer in the New York office would only assume responsibility when Travis was unavailable.⁸⁰ Moreover, Travis conceded that during 1997 and 1998 "he was the principal responsible for obtaining documents that would be required by the penny stock rules in connection with sales out of the Colorado office."⁸¹ Consistent with his testimony, Travis approved each of the subject order tickets.⁸²

Under these circumstances, the Panel concludes that Travis had a supervisory responsibility to take steps reasonably designed to assure compliance with the Penny Stock Rules and the Firm's penny stock policies and procedures and that he failed to fulfill that responsibility. Travis made no effort to supervise Rooms and Dieffenbach's penny stock activities. The Hearing

⁷⁷ CX-24.

⁷⁸ *Id.*; Tr.II, at 155-56.

⁷⁹ Tr. II, at 160-61.

⁸⁰ *Id.*

⁸¹ *Id.* at 161.

⁸² CX-6; CX-7.

Panel therefore finds that Travis, and the Firm through Travis, failed reasonably to supervise Rooms and Dieffenbach in connection with the sales of Turner Group stock, in violation of Conduct Rules 2110 and 3010.⁸³

F. Obstruction of NASD Investigation by Patterson, Rooms, Dieffenbach, and Travis—Cause Three

In the Third Cause of Complaint, the Department charged all of the Respondents with obstructing NASD’s investigation of the penny stock trading violations. Central to the charge are the Department’s allegations that the Respondents misled the Staff by providing falsified documents in response to the Staff’s requests for information and that the individual Respondents pressured and misled customers to get them to sign false documentation relating to their purchases of Turner Group stock. In addition, the Department alleged that Dieffenbach advised customer JM to refuse to cooperate with, and to lie to, the Staff concerning his purchase.

1. Obtaining False Documents in Response to NASD’s Rule 8210 Information Requests

On May 26, 1998, following the routine examination of Patterson in the New York office, the Staff sent the Firm a formal request that it supply certain documents and information relating to the sales of two penny stocks, Advanced Engine Technology, Inc. (“Advanced Engine”) and

⁸³ The Department charged Travis alternatively with violating the penny stock rules directly and with reasonably failing to supervise Rooms and Dieffenbach. However, the Panel finds that Travis’ direct involvement in the transactions, which fostered and encouraged Rooms and Dieffenbach’s misconduct, permits a finding of supervisory violations and substantive violations. *See Montelbano*, Exchange Act Release No. 47227, 2003 SEC LEXIS 153, at *29 (Jan. 22, 2003) (concluding that “there is [no] inherent inconsistency in finding a respondent both substantively responsible and a deficient supervisor with respect to the same misconduct”). *See also Padgett*, 52 S.E.C. 1257 (1997), *aff’d sub nom. Sullivan v. SEC*, 159 F.3d 637 (D.C. Cir. 1998 (Table) (finding respondents liable for supervisory failures as well as for substantive misconduct). *Cf. R.A. Johnson & Co., Inc.*, 48 S.E.C. 943, 947 n.14 (1988); *Fox Sec. Co., Inc.*, 45 S.E.C. 377, 382–83 (1973); *Silverman*, 45 S.E.C. 328, 331 (1973); and *Market Surveillance Comm. v. Markowski*, No. CMS920091, 1998 NASD Discip. LEXIS 35, at *52–53 (NAC July 13, 1998).

Turner Group.⁸⁴ The purpose of the request was to obtain sufficient information to determine if the Firm had complied with SEC Rules 15g-2 through 15g-9. Specifically, the Staff asked whether any of the identified sales had been recommended and requested the Firm to supply copies of documents showing that it had complied with the Penny Stock Rules. Travis responded by letter dated June 30, 1998, in which he stated that all of the trades were exempt from the Penny Stock Rules because they were “in existing accounts, foreign accounts or unsolicited letters were obtained.”⁸⁵ Travis enclosed copies of some Non-Solicitation Forms and indicated that others were “missing,” which he was “trying to locate.”⁸⁶

Confronted with the possibility of a second penny stock violation,⁸⁷ Travis instructed Rooms and Dieffenbach to get signed forms from each customer who did not have a Non-Solicitation Form in his file.⁸⁸ Travis told Rooms and Dieffenbach that he needed the forms for the NASD examination.⁸⁹ Then, without any review of the customers’ files,⁹⁰ Rooms and Dieffenbach called the customers Travis identified and asked that they sign and return postdated Non-Solicitation Forms that Rooms and Dieffenbach prepared. Rooms explained that he and Dieffenbach postdated the Non-Solicitation Forms “because we were told that these letters are to

⁸⁴ CX-26.

⁸⁵ CX-27.

⁸⁶ *Id.*

⁸⁷ In April 1998, Travis and the Firm settled a prior disciplinary proceeding, *District Bus. Conduct Comm. v. Patterson Travis and David T. Travis*, No. C3A950062 (Mar. 25, 1998), that charged, among other violations, that Travis and the Firm had failed to comply with SEC Rules 15g-2, 15g-5, and 15g-9 in connection with a penny stock Initial Public Offering.

⁸⁸ Tr. II, at 13–14, 38–40, 85, 136–37.

⁸⁹ Tr. II, at 40–41, 55, 86, 103.

⁹⁰ Tr. II, at 59.

reflect all details of the transactions that occurred in 1997.”⁹¹ Generally, Rooms and Dieffenbach tried to convey that they gave Travis’ request little thought although they had not been asked to postdate forms before this instance.

JM, JS, and BM testified that Dieffenbach pressured them to sign the postdated Non-Solicitation Forms.⁹² Likewise, DH testified that Rooms pressured him to sign the form and return it within two days.⁹³ Largely, each customer also testified that Rooms and Dieffenbach told them that if they would sign the Non-Solicitation Forms, Patterson would give them stock in another company to compensate them for their losses in Turner Group.⁹⁴ Although each customer’s testimony on the specifics of this offer generally was vague, the Department submitted questionnaires and declarations from other customers that corroborated their testimony. For example, customer CD added a note to his questionnaire that stated that Dieffenbach called him and said that he needed CD to sign a Non-Solicitation Form. When CD received the form, it inaccurately stated that Dieffenbach had not recommended the purchase of Turner Group stock. CD called Dieffenbach to tell him the form was not correct. In response, Dieffenbach said he “would be in a lot of trouble” if CD did not sign the Non-Solicitation Form.⁹⁵ CD also noted that Dieffenbach told him that he would give CD his “next several trades for free” if CD would send back the Non-Solicitation Form.⁹⁶ “After much prodding” by Dieffenbach, CD signed the

⁹¹ *Id.* at 57.

⁹² Tr. I, at 58, 84, 100.

⁹³ *Id.* at 28–30.

⁹⁴ *Id.* at 28–30, 58, 100.

⁹⁵ CX–15, at 4.

⁹⁶ *Id.*

postdated form and sent it by facsimile to Dieffenbach.⁹⁷ Similarly, customer LM submitted a questionnaire in which he stated that Dieffenbach asked LM to help by signing the postdated Non-Solicitation Form. According to LM, Dieffenbach told him that Dieffenbach was “in hot water” regarding Turner Group and that he was trying to work something out so that customers who purchased Turner Group stock could get compensated for their losses and LM would get money only if he signed the form.⁹⁸

2. Alteration of Non-Solicitation Forms by Rooms and Dieffenbach

Some of the customers who signed⁹⁹ the Non-Solicitation Forms returned them by facsimile to Rooms and Dieffenbach, who in turn gave the forms to Travis. Then, before giving the forms to the Staff, Travis cut off the information across the top of each form imprinted by the facsimile machine, which included the date of the facsimile transmission. As such, the Non-Solicitation Forms did not reflect that they had been obtained recently, and Travis did not tell the Staff that the forms were postdated.¹⁰⁰ Thus, Travis gave the Staff the false impression that these were the “missing letters” that had been located among the Firm’s files.

One such customer who signed and returned a postdated Non-Solicitation Form by facsimile was DH. He testified that he signed the form because Rooms promised that, if DH signed, he would “be compensated with stock [equal to] the complete value of what [he] had

⁹⁷ *Id.*

⁹⁸ CX–11, at 14. The Panel could not determine if Dieffenbach was referring to trouble arising from his non-compliance with the Penny Stock Rules or to issues surrounding Turner Group. There were vague references in the testimony that Turner Group may have misled investors about its prospects, but there is no evidence that the Respondents were linked to that alleged wrongdoing.

⁹⁹ A number of customers refused to sign the forms because either their purchases were recommended or because the forms were postdated. *See* CX–10; CX–11.

¹⁰⁰ Tr. II, at 141.

invested in the Turner Group.”¹⁰¹ The form he received from Rooms had the quantity, description, price, and purchase date filled in.¹⁰² In addition, Rooms had inserted the purchase date, 11-21-97, next to the signature line. DH testified that when he signed the Non-Solicitation Form, he added his actual signature date, 6-25-99, under his signature with a note memorializing Rooms’ offer to give him additional stock.¹⁰³ The note, also dated 6-25-99, stated: “Value of stock purchase price will be given in full as stock in an alternate co. 2 days after this form is returned.”¹⁰⁴ DH returned the signed form to Rooms by facsimile with a cover sheet on which he wrote: “Mike please call me after you have received this new stock. Thanks.”¹⁰⁵ Rooms testified that upon receipt of the signed form he removed both of the dates DH had added.¹⁰⁶ He claimed that he did so with DH’s permission,¹⁰⁷ but DH denied this claim. The version of the form Travis provided the Staff lacks DH’s added dates and handwritten note.¹⁰⁸ Rooms and Travis denied any knowledge of how DH’s handwritten note was removed from the Non-Solicitation Form.

3. Undermining Customer Cooperation with NASD by Dieffenbach

In about May 1999, the Staff contacted JM about his purchases of Turner Group stock from Dieffenbach.¹⁰⁹ JM told the Staff that Dieffenbach had recommended the investment. Shortly thereafter, Dieffenbach contacted JM and asked that he sign Non-Solicitation Forms that

¹⁰¹ Tr. I, at 28.

¹⁰² *Id.* at 29.

¹⁰³ *Id.* 30–31; CX–16, at 7.

¹⁰⁴ CX–16, at 7.

¹⁰⁵ *Id.* at 8; Tr. I, at 31.

¹⁰⁶ Tr. II, at 42–43.

¹⁰⁷ *Id.*

¹⁰⁸ CX–16, at 9.

¹⁰⁹ Tr. I, at 56.

Dieffenbach would send him by facsimile. JM testified that he told Dieffenbach that he already had been contacted by NASD and that he had provided a declaration to NASD, which stated that Dieffenbach had recommended the purchases of Turner Group stock.¹¹⁰ JM testified that when JM told Dieffenbach about NASD's inquiry, Dieffenbach said: "[D]on't worry about it. Just don't return any phone calls to them in the future. You can say you didn't remember signing [the postdated Non-Solicitation Forms]."¹¹¹ JM immediately called Rash at NASD and told him what Dieffenbach had said and that Dieffenbach had faxed to him two postdated Non-Solicitation Forms.¹¹² Thereafter, JM sent Rash a copy of the letters and signed a supplemental declaration memorializing his conversation with Dieffenbach.¹¹³

4. Conclusion

Based upon the foregoing findings of fact, the Panel determines that Rooms, Dieffenbach, Travis, and the Firm, acting through Travis, obstructed NASD's investigation by providing false documentation to the Staff and that Dieffenbach further obstructed NASD's investigation by telling JM to refuse to cooperate with NASD and to lie regarding the facts and circumstances regarding his purchases of Turner Group stock. Accordingly, the Panel concludes that the Respondents violated NASD Conduct Rule 2110 and NASD Procedural Rule 8210, as alleged in the Complaint.

¹¹⁰ Tr. I, at 60–62; CX–17, at 6.

¹¹¹ Tr. I, at 58–59.

¹¹² *Id.* at 62.

¹¹³ *Id.*; CX–17, at 5.

G. Failure to Comply with NASD Order of Settlement by Travis and the Firm—Cause Four

In 1998, Patterson settled a prior disciplinary proceeding¹¹⁴ alleging violations of the Penny Stock Rules by the Firm, Travis, and others.¹¹⁵ The Decision and Order of Acceptance of Respondent’s Settlement Offer (“Settlement Order”) required the Firm to retain an independent consultant to review the Firm’s policies, practices, and procedures with respect to the sale of penny stocks and to provide the Staff with a copy of the consultant’s report, together with documentation of the changes implemented by the Firm as a result of the consultant’s review.¹¹⁶ Patterson was required to retain the consultant on or about March 15, 1999.¹¹⁷ Travis signed the Offer of Settlement on the Firm’s behalf.¹¹⁸

In connection with NASD’s examination of Patterson in 1998, the Staff sought to verify the Firm’s compliance with the Order of Settlement.¹¹⁹ Among other documents, the Staff requested Travis to provide the following: (1) a copy of the consulting agreement; (2) copies of all invoices received from the consultant; (3) a copy of the consultant’s report; (4) documentary evidence that Patterson filed a copy of the consultant’s report with NASD; and (5) documentation of any changes Patterson implemented as a result of the consultant’s review.¹²⁰ In response, on January 26, 2000, Travis wrote that Patterson’s New York office had handled

¹¹⁴ *District Bus. Conduct Comm. v. Patterson Travis and David T. Travis*, No. C3A950062 (Mar. 25, 1998).

¹¹⁵ CX–33.

¹¹⁶ *Id.* at 4.

¹¹⁷ Tr. I, at 207.

¹¹⁸ CX–34.

¹¹⁹ Tr. I, at 153.

¹²⁰ CX–35, at 2–3.

retention of the consultant, which office had since closed, and Travis was unable to locate a copy of the consultant's report. Travis further stated that HB, the attorney that handled the matter for the Firm, was no longer in business and could not be contacted because he had entered the "witness protection program."¹²¹ Travis and the Firm have never been able to produce documentary evidence that they hired HB or any other consultant.¹²² In addition, Rooms testified that none of the Firm's procedures governing penny stock transactions had changed because of the settlement of the prior disciplinary proceeding.¹²³

At the hearing, Travis testified that the extent of his knowledge regarding compliance with the Order of Settlement was that HB had told Travis that he had "taken care of" the consultant issue.¹²⁴ Travis understood this to mean that HB was acting as the consultant and that he would file the needed report with NASD. Travis further testified that HB told him that the Statement of Corrective Action¹²⁵ that Patterson submitted with its Offer of Settlement was the required report.¹²⁶ Travis admitted that Patterson did not have a written agreement with HB to conduct the review required by the Order of Settlement.¹²⁷

Based on the foregoing, the Panel finds that Travis and the Firm failed to comply with the terms of the Order of Settlement. Indeed, Travis could not point to any action he or the Firm took

¹²¹ CX-36, at 1.

¹²² Tr. I, at 154-60; Tr. II, at 177-79.

¹²³ Tr. II, at 68.

¹²⁴ Tr. II, at 148-49, 175.

¹²⁵ CX-39.

¹²⁶ Tr. II, at 175.

¹²⁷ *Id.* at 178-79.

to comply with the Order of Settlement. Accordingly, the Panel finds that Travis and the Firm violated NASD Conduct Rule 2110, as alleged in the Complaint.¹²⁸

III. SANCTIONS

A. Travis and the Firm

1. Penny Stock Violations

The applicable Sanction Guidelines for violations of the Penny Stock Rules recommend different sanctions depending on whether the misconduct was negligent or willful.¹²⁹ For negligent misconduct, the Sanction Guidelines recommend imposition of a fine of \$5,000 to \$100,000. For willful cases, on the other hand, the Sanction Guidelines recommend imposition of a fine of the greater of \$100,000 or \$5,000 per transaction. In either case, the Sanction Guidelines further suggest consideration of a suspension in any or all capacities for up to two years. In addition, for egregious misconduct the Sanction Guidelines recommend barring the responsible individual and expelling the member firm.

The Panel determined that the Firm and Travis willfully violated the Penny Stock Rules. In making this determination, the Panel considered the Principal Considerations set forth in the Sanction Guidelines. Specifically, the Panel notes that Travis and the Firm had settled the first disciplinary proceeding involving allegations of violations of the penny stock rules pertaining to penny stock initial public offerings at about the same time as the occurrence of these violations. Nevertheless, Travis and the Firm took no steps to review and correct the Firm's handling of

¹²⁸ Cf., *Hayes*, NYSE Disc. Action LEXIS 49 (Apr. 4, 2001) (NYSE imposed additional sanctions against respondent for failure to comply with sanctions imposed by a hearing panel); *Department of Enforcement v. Josephthal & Co.*, No. CAF000015, 2002 NASD Discip. LEXIS 8 (NAC May 6, 2002) (firm violated Conduct Rule 2110 by failing to comply with an order of an NASD arbitration panel).

¹²⁹ NASD Sanction Guidelines 97 (2002 ed.).

penny stock transactions. The Panel also notes that Travis engaged in deliberate conduct to circumvent the Penny Stock Rules. He encouraged Rooms and Dieffenbach to obtain Non-Solicitation Forms from customers purchasing penny stocks regardless of the fact that they had recommended the transactions. Travis, and the Firm acting through Travis, also deliberately attempted to circumvent the Penny Stock Rules by making capricious claims that the transactions were “non-recommended.” In addition, Travis and the Firm failed to make any efforts to comply with the Firm’s written supervisory procedures applicable to penny stocks. Finally, Travis and the Firm steadfastly refuse to acknowledge their wrongdoing and have made no effort to mitigate the injury suffered by the purchasing customers. The Panel finds no mitigating factors applicable to Travis’ and the Firm’s misconduct.

Applying these factors, the Panel finds that the violations by Travis and the Firm were willful and egregious. Accordingly, the Panel determines that Travis should be barred from associating with any member firm in any capacity and that the Firm should be expelled from NASD. In addition, the Panel determines that Travis and the Firm shall be required to offer rescission to the customers involved in the violative transactions identified in Schedules A and B to this Decision.¹³⁰

2. Failure to Supervise

Travis, and the Firm acting through Travis, are at the center of the violations found in this proceeding. By failing to exercise any supervisory responsibility over Rooms’ and Dieffenbach’s penny stock activities, Travis permitted Rooms and Dieffenbach to negligently violate the Penny

¹³⁰ The Panel exercised its discretion not to impose a fine because it is barring Travis and expelling the Firm. *See* Sanction Guidelines 13–14.

Stock Rules. But Travis' misconduct was far from mere negligence, as is evidenced by his complete disregard of the applicable rules and his total failure to take any steps to comply with the 1998 Order of Settlement. Accordingly, as more fully discussed below, the Panel determines that Travis should be barred and Patterson expelled from membership in NASD. The Panel finds no mitigating factors that would permit these Respondents to remain in the securities industry.

Travis' and the Firm's supervisory failures cannot be viewed in isolation from their prior disciplinary record with regard to compliance with the penny stock rules. In 1998, they settled a prior case that alleged certain violations of the rules governing penny stock initial public offerings.¹³¹ Under the terms of the Order of Settlement entered in that disciplinary proceeding, Travis and the Firm were required to retain an outside consultant to review the Firm's policies and procedures regarding penny stock transactions. Travis took no steps to comply, and he steadfastly refuses to accept responsibility for this failure. This conduct evidences contempt for the regulatory system and total disregard for their obligation to protect the investing public.

Upon consideration of all of the factors bearing on Travis' and the Firm's supervisory failures, the Panel concludes that their misconduct was egregious, representing a systemic supervisory failure. Essentially, Travis' and the Firm's supervision of penny stock activities was non-existent. In addition, the Panel took particular note of Travis' total lack of explanation for his and the Firm's supervisory failures and their failure to offer rescission to the customers.¹³² Accordingly, the Panel will bar Travis from associating with any member firm in any capacity and fine him \$50,000, and the Panel will expel Patterson from membership in NASD and fine it

¹³¹ CX-33.

¹³² Cf. *Gallison*, 1999 NASD Discip. LEXIS 8, at *67.

\$50,000. These sanctions are the maximum recommended by the applicable NASD Sanction Guidelines.¹³³

3. Failure to Comply with Order of Settlement

The Panel concludes that Travis and the Firm also should be severely sanctioned for their misconduct in failing to comply with the requirements of the Settlement Order. As discussed above, Travis made no effort whatsoever to comply with the terms of the settlement, and he refuses to acknowledge his responsibility to do so. Under these circumstances, the Panel concludes that Travis should be barred from associating with any member firm in any capacity and the Firm should be expelled from membership in NASD.¹³⁴

4. Obstructing an NASD Investigation

Finally, the Panel determines that Travis should be barred and the Firm expelled for their role in obstructing NASD's investigation of the penny stock violations. Travis willfully violated NASD Procedural Rule 8210 by falsifying the Firm's records in an effort to conceal Rooms' and Dieffenbach's penny stock violations. Knowing that the proper documentation was never obtained from the customers, Travis misrepresented to the Staff that certain Non-Solicitation Forms were "missing." Then, to cover up the violations, he instructed Rooms and Dieffenbach to have the subject customers sign postdated forms that Travis then gave to the Staff without disclosing that they were postdated. Moreover, when the signed forms arrived, Travis admitted that he cut off the facsimile transmission dates. The Panel concludes that he did so to conceal the fact that the letters were postdated. Travis' explanation that he always removes such information from all

¹³³ NASD Sanction Guidelines 108 (2002 ed.).

¹³⁴ There is no recommended sanction in the Guidelines for this violation.

correspondence to avoid confusion is unconvincing. In short, the Panel finds Travis' conduct to be egregious, warranting the severest of sanctions to protect the investing public and deter similar misconduct by others. Accordingly, the Panel will bar Travis from associating with any member firm in any capacity and will expel the Firm from membership in NASD. These sanctions are consistent with the recommended sanctions under the Guidelines for impeding regulatory investigations where no mitigation exists.¹³⁵

B. Rooms and Dieffenbach

1. Penny Stock Violations

The evidence amply exhibits that Rooms and Dieffenbach violated SEC Rules 15g-2, 15g-3, and 15g-5. Neither Rooms nor Dieffenbach presented any evidence of their compliance with the Penny Stock Rules. On the other hand, the Panel disagrees with the Department's assertion that Rooms' and Dieffenbach's violations were willful; rather, the Panel finds that they were negligent. As discussed above, the Panel concluded that the core of the penny stock violations in the Colorado office was the absence of training and supervision. For example, Dieffenbach testified that he had never had any training on the Firm's policies and procedures governing penny stock transactions,¹³⁶ and neither of them demonstrated any familiarity with the Penny Stock Rules or the Firm's policies and procedures pertaining to penny stock transactions.

The Panel further notes that none of the customers complained about Rooms' and Dieffenbach's conduct. Indeed, some of the customers were quite pleased with Rooms and Dieffenbach and continued to do business with them even after they learned that Rooms and

¹³⁵ Sanction Guidelines at 39.

¹³⁶ Tr. II, at 116.

Dieffenbach had not supplied all of the required penny stock disclosures. In summary, the Department presented no evidence that Rooms and Dieffenbach intentionally violated the penny stock rules when they recommended Turner Group stock to their customers. Accordingly, the Panel will assess a \$5,000 fine against Rooms and a \$12,000 fine against Dieffenbach. The fine assessed against Rooms is smaller because he participated in fewer transactions than Dieffenbach.

2. Obstructing an NASD Investigation

The Sanction Guideline for failing to respond truthfully to a request for information made pursuant to NASD Procedural Rule 8210 provides for a fine of \$25,000 to \$50,000 and, where mitigation exists, a suspension of up to two years.¹³⁷ Here, a majority of the Panel finds sufficient mitigating factors to justify substantially less severe sanctions than those imposed on the Firm and Travis.

Although Rooms and Dieffenbach knew from Travis that he intended to supply the postdated Non-Solicitation Forms to NASD in connection with its routine examination of the Firm, the Rule 8210 requests were not directed to them, and there is no other evidence that Rooms and Dieffenbach were informed of the context of the information requests. Thus, the Panel cannot conclude by a preponderance of the evidence that Rooms and Dieffenbach understood the significance of Travis' request to obtain the postdated forms. There was no direct evidence that Travis told Rooms and Dieffenbach about his effort to mislead the Staff. Accordingly, Rooms and Dieffenbach may have seen their involvement as nothing more than an administrative effort to assist in correcting the Firm's records. In other words, the majority of the Panel concludes that Rooms and Dieffenbach were pawns used by Travis to deceive the Staff.

¹³⁷ Sanction Guidelines 39.

In determining the appropriate sanctions for these violations, the Panel also reviewed the Principal Considerations set forth in the Sanction Guidelines.¹³⁸ Specifically, the Panel notes: (1) neither Rooms nor Dieffenbach has a disciplinary history; (2) the misconduct did not result in customer loss or injury; (3) Rooms and Dieffenbach cooperated in the investigation and never denied that they postdated the forms; (4) the number and size of the underlying transactions were small, resulting in minimal financial gain; and (5) none of the customer's complained and each that testified indicated that they understood the risky nature of the investment.

Taking all of the foregoing factors into consideration, the majority of the Panel finds that a downward departure from the Sanction Guidelines is justified. Accordingly, the Panel will order that Rooms be suspended for 30 business days from associating with any member firm in any capacity and that Dieffenbach be suspended for six months from associating with any member firm in any capacity.

IV. ORDER

Therefore, having considered all the evidence,¹³⁹ the Hearing Panel orders that sanctions be imposed as follows:

A. Penny Stock Violations—First Cause of Complaint

1) Patterson is expelled from membership in NASD and ordered to offer rescission to the customers identified on the attached Schedules within 60 days of the date this Decision becomes the final disciplinary action of NASD.

2) Travis is barred from associating with any member firm in any capacity.

¹³⁸ Sanction Guidelines 9–10.

¹³⁹ The Hearing Panel has considered all of the arguments of the Parties. They are rejected or sustained to the extent they are inconsistent or in accord with the views expressed herein.

- 3) Rooms is fined \$5,000.
- 4) Dieffenbach is fined \$12,000.

B. Failure to Supervise—Second Cause of Complaint

- 1) Patterson is expelled from membership in NASD and fined \$50,000.
- 2) Travis is barred from associating with any member firm in any capacity and fined \$50,000.

C. Obstruction of NASD Investigation—Third Cause of Complaint

- 1) Patterson is expelled from NASD.
- 2) Travis is barred from associating with any member firm in any capacity.
- 3) Rooms is suspended for 30 business days from associating with any member firm in any capacity.
- 4) Dieffenbach is suspended for six months from associating with any member firm in any capacity.

D. Failure to Comply with Order of Settlement—Fourth Cause of Complaint

- 1) Patterson is expelled from NASD.
- 2) Travis is barred from associating with any member firm in any capacity.

In addition, the Respondents, jointly and severally, are ordered to pay the costs of this proceeding in the total amount of \$2,294.50, which include an administrative fee of \$750 and hearing transcript costs of \$3,044.50.

These sanctions shall become effective on a date set by the NASD, but not earlier than 30 days after this Decision becomes the final disciplinary action of the NASD; except, if this Decision becomes the final disciplinary action of the NASD, the suspension of Rooms and Dieffenbach

shall commence as follows: (1) Rooms' suspension shall commence with the opening of business on June 16, 2003, and end at the close of business on July 28, 2003; and (2) Dieffenbach's suspension shall commence on June 16, 2003, and end on December 16, 2003.

Andrew H. Perkins
Hearing Officer
For the Extended Hearing Panel

DISSENT

Hearing Officer Perkins, dissenting, in part:

I respectfully dissent as I would impose far harsher sanctions on Rooms and Dieffenbach for their misconduct in obstructing NASD's investigation. I concur with the remainder of the majority's decision.

As the majority indicates, Travis willfully violated Procedural Rule 8210 by falsifying the Firm's records and providing those false records to the Staff to conceal the Respondents' Penny Stock violations. The majority, however, in large part excuses Rooms and Dieffenbach's knowing participation in Travis' scheme to mislead the Staff because they were secondary actors to Travis. In the majority's view, Rooms and Dieffenbach should not be held to the same level of responsibility because they were following Travis' lead. According to the majority, substantially all of the violations addressed in this proceeding spawned from Travis' supervisory failures. In addition, the majority reasons that the lack of direct customer harm and Rooms' and Dieffenbach's clean disciplinary history are sufficiently mitigating to warrant relatively light

sanctions. In so doing, the majority overlooks the fundamental importance of Rule 8210 to NASD's ability to meet its regulatory obligations under the Exchange Act and the well-established precedent that registered representatives may not excuse their misconduct by placing the ultimate responsibility for securities violations on their superiors.

Procedural Rule 8210 authorizes NASD, in the course of an investigation, to require persons associated with an NASD member to "provide information orally [or] in writing... with respect to any matter involved in the investigation." It is well settled that, because NASD lacks subpoena power over its members, a failure to provide information fully and promptly undermines NASD's ability to carry out its regulatory mandate.¹⁴⁰ For the same reason, the Commission has consistently rejected attempts by members and associated persons to impose conditions on compliance with NASD requests for information.¹⁴¹ Members and associated persons must "cooperate fully and assist [NASD's] regulatory and investigatory functions";¹⁴² otherwise, NASD would be stymied in carrying out its regulatory responsibilities.

Because compliance with Rule 8210 is central to NASD's mission, the Sanction Guidelines treat failures to respond and failures to respond truthfully as egregious violations of Rule 8210 and NASD Conduct Rule 2110. The Sanction Guidelines provide that absent

¹⁴⁰ See, e.g., *Joseph G. Chiulli*, Exchange Act Release No. 42359, 2000 SEC LEXIS 112, at *8 (Jan. 28, 2000).

¹⁴¹ See, e.g., *Mark Allen Elliott*, 51 S.E.C. 1148, 1150–51 (1994); *Richard J. Rouse*, 51 S.E.C. 581, 586–87 (1993); *Michael David Borth*, 51 S.E.C. 178, 180–81 (1992) ("[t]he Rules do not permit second guessing the NASD's request"). See also *Markowski v. SEC*, 34 F.3d 99 (2d Cir. 1994) (member may not dictate the terms under which it will provide access to its books and records).

¹⁴² *District Bus. Conduct Comm. V. Donald Clyde Bozzi*, No. C10970003, 1999 NASD Discip. LEXIS 5, at *13 (NAC Jan. 13, 1999).

mitigating factors a “bar should be standard.”¹⁴³ The Sanction Guidelines also recommend a minimum fine of \$25,000.

The aggravating circumstances presented by the facts of this case require that Rooms and Dieffenbach be barred from the securities industry. First, in applying the principal considerations in the Sanction Guidelines for false responses to NASD requests for information, I find that the requested documentation was of material importance to the Staff’s efforts to determine if the Respondents had violated the Penny Stock Rules. Travis and the Firm had represented that the Penny Stock Rules did not apply to the Turner Group transactions because they had not been recommended. The Staff sought to verify this claim by requesting copies of the Non-Solicitation Forms that Travis had said were misplaced. These documents were key to Travis’ and the Firm’s assertion that they had not violated the Penny Stock Rules. Further, I note that Rooms and Dieffenbach did not come forward and admit that they falsified the Firm’s records until after the Staff exerted considerable regulatory pressure on the Respondents. These facts are evidence in aggravation.¹⁴⁴

In addition, I find that the following aggravating factors should be considered: (1) Rooms and Dieffenbach knowingly and willfully falsified the Firm’s records; (2) the Respondents willfully impeded NASD’s investigation; (3) Rooms and Dieffenbach lacked a reasonable explanation for their actions; (4) they engaged in a concerted pattern of conduct to conceal their violations of the Penny Stock Rules; and (5) they refused to accept responsibility for their misconduct. On balance,

¹⁴³ Sanction Guidelines 39.

¹⁴⁴ See *Department of Enforcement v. Manuel M. Bello*, No. CAF000030, 2002 NASD Discip. LEXIS 10, at *12 (NAC June 3, 2002).

I find no mitigating factors. The fact that neither Rooms nor Dieffenbach had engaged in similar misconduct in the past is of no consequence.¹⁴⁵

Accordingly, I conclude that Rooms and Dieffenbach knowingly and willfully participated in a scheme to deceive the Staff and hide their violations of the Penny Stock Rules. They falsified documents that they knew were to be produced to the Staff. No excuse can justify this conduct. Unlike the majority, I find no mitigation in their explanation that Travis asked that they collect the documents. Both Rooms and Dieffenbach were experienced securities professionals; each was registered as a principal, and Rooms was a sales manager in the Colorado office. Thus, I would bar both of them from associating with any member firm in any capacity.

Copies to:

Patterson Travis, Inc. (by overnight courier and first-class mail)
David T. Travis (by overnight courier and first-class mail)
Eric H. Dieffenbach (by overnight courier and first-class mail)
Michael A. Rooms (by overnight courier and first-class mail)
Mark P. Dauer, Esq. (by first-class and electronic mail)
Richard C. Kaufman, Esq. (by facsimile and first-class mail)
Rory C. Flynn, Esq. (by first-class and electronic mail)

¹⁴⁵ *Bozzi*, 1999 NASD Discip. LEXIS at *14.