

This Decision has been published by the NASDR Office of Hearing Officers and should be cited as OHO Redacted Decision C07000023.

Prior to the Hearing, the Hearing Officer held Respondent _____ in default because he failed to respond to the Complaint. Accordingly, the Hearing Panel only considered the allegations of the Complaint relating to Respondents _____ and _____.

Based on the record of the Hearing, the Hearing Panel found that the Department of Enforcement did not prove by a preponderance of the evidence that the transactions executed in PR's account by Respondents _____ and _____ were unauthorized. Accordingly, the Hearing Panel dismissed the Complaint as to Respondents _____ and _____.

Appearances

Gary M. Lisker, Esq., Senior Regional Attorney, Atlanta, Georgia, on behalf of the Department of Enforcement.

_____, Esq., on behalf of Respondents _____ and _____.

DECISION

I. Procedural Background

A. Complaint

Enforcement served the Complaint on Respondents _____ and _____ on March 22, 2000. Respondents _____ and _____ filed Answers to the Complaint on April 28, 2000. Count one of the Complaint alleges that beginning on January 16, 1998 through February 12, 1998, Respondent _____, while registered at _____, Inc. ("_____"), effected or caused to be effected nine securities transactions in PR's securities account, without PR's prior knowledge, consent, or authorization.

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Count two of the Complaint alleges that Respondent _____, while registered at _____, effected one unauthorized purchase in PR's securities account, without PR's prior knowledge, consent, or authorization. According to the Complaint, such actions constitute a violation of NASD Conduct Rule 2110 by Respondents _____ and _____.

B. Answer

The April 28, 2000 Answers of Respondents _____ and _____ admitted that they effected or caused to be effected the securities transactions in PR's securities account as alleged in the Complaint. However, Respondents _____ and _____ stated that all of the subject transactions were effected with PR's knowledge and authorization, except the February 12, 1998 sell out transaction, which, as required by NASD regulations, was initiated after PR failed to pay for the securities.

C. The Hearing

The Hearing was held in Boca Raton, Florida, on October 18 and 19, 2000, before a Hearing Panel composed of the Hearing Officer, and two current members of the District 7 Committee. At the Hearing, Enforcement presented two witnesses, the NASD examiner, Mr. Nellis, and the complaining customer, PR. Respondents _____ and _____ testified on their own behalf and presented the compliance officer for _____, _____, and two additional character witnesses, a long time customer, BC, and a former colleague, RW.

The Hearing Panel admitted into evidence the five exhibits offered by Enforcement and 43 of the exhibits offered by Respondent.¹ The Parties jointly submitted “Stipulations of Relevant, Undisputed Facts,” dated October 13, 2000.²

II. Findings of Fact and Conclusions of Law

A. Jurisdiction

Respondent _____ first became registered with the Association as a general securities representative in November 1986. (Stip. at ¶3). At all times material to the allegations of the Complaint, Respondent _____ was registered as a general securities representative and general securities principal with _____. (Stip. at ¶2).

Respondent _____ first became registered with the Association as a general securities representative in April 1987. (Stip. at ¶5). During the relevant period, January and February 1998, Respondent _____ was registered as a general securities representative with _____. (Stip. at ¶3).

Currently, Respondents _____ and _____ remain registered with _____. (Stip. at ¶1). Accordingly, the Hearing Panel determined that the Association has jurisdiction over them.

B. Background

In December 1997, customer PR’s securities account was transferred from TYM Securities, Inc. (“TYM Securities”) to _____ when Respondent _____ became

¹ The Hearing Officer excluded Respondents’ Exhibits 40, 42, 43, 48, 49, and 50 as unduly repetitious. References to Enforcement’s Exhibits admitted at the Hearing are designated “CX” and references to Respondents Exhibits are designated as “RX,” with the appropriate page or paragraph number.

² The stipulated facts are referenced as “Stip. at” in this Decision.

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associated with _____.³ (Stip. at ¶6; RX-1, p. 2). Because Respondent _____ was not registered with _____ at the time of the transfer, Respondents _____ and _____ were listed as PR's account executives. (Stip. at ¶6). At the time of the transfer, PR's account contained 1,500 shares of Hand Brand Distribution, Inc. ("Hand Brand") common stock and 150 shares of Compaq Computer Corp. ("Compaq") common stock.⁴ (RX-52).

It is undisputed that between January 1998, and February 1998, Respondents _____ and _____ effected the following ten transactions in PR's account. (Stip. at ¶¶7-16).

<u>Trade Date</u>	<u>Transaction</u>
January 16, 1998	Sell 1,500 shares of Hand Brand
January 16, 1998	Sell 150 shares of Compaq
January 16, 1998	Purchase 2,500 shares of MEHL/Biophile International Corp. (“MEHL”)
January 20, 1998	Purchase 8 Compaq Put Options
January 21, 1998	Purchase 20 Compaq Put Options
January 26, 1998	Sell 36 Compaq Put Options ⁵
January 27, 1998	Purchase 70 Intel Corporation (“Intel”) Put Options
January 29, 1998	Sell 2,500 shares of MEHL
January 29, 1998	Purchase 70 Intel Put Options

³ PR was introduced to Respondent _____ by WS. (Tr. p. 163). PR testified that he opened the account by writing two checks totaling \$10,000 and giving those checks to WS to give to her boyfriend, Respondent _____. (Tr. p. 164). At the time he gave WS, a Miami Dolphin cheerleader, the \$10,000, PR had known her for five years. (Tr. p. 227).

⁴ At the time of the transfer, the value of Compaq and Hand Brand stock had declined. (Tr. p. 105).

February 12, 1998 Sell 140 Intel Put Options

In February 1998, _____'s clearing agent, Bear Stearns Securities Corp., sent PR margin call letters regarding the purchases of the Intel options. (RX-36). In March 1998, PR telephoned _____'s compliance officer, Mr. _____, and stated that he did not owe _____ any money because the only documents he had ever signed in connection with the securities accounts were the two checks totaling \$10,000. (Tr. p. 289; RX-25).

Subsequently, in an April 23, 1998 complaint letter, PR wrote the Securities and Exchange Commission complaining that Respondent _____ had invested him in high risk options. (RX-24). In May 1999, PR filed an arbitration claim. (Tr. p. 297). The claim was settled and PR received \$6,500 from _____.⁶ (RX-28).

C. Authorization Dispute

The sole issue is whether Respondents _____ and _____ received prior authorization from PR to effect the above transactions. The testimony of the principal witnesses is in direct conflict. PR testified that the ten transactions were effected without his prior consent, knowledge, or authorization. (Tr. pp. 169-171). Respondents _____ and _____ testified that they received PR's authorization prior to effecting the transactions in question, except for the February 12, 1998 sell out of the 140 Intel options. (Tr. pp. 348-349, 448).

In resolving this dispute, the Hearing Panel (i) judged the credibility of each witness in conjunction with other corroborating or conflicting evidence presented, (ii) reviewed the

⁵ The 36 Compaq put options include the two for one split of the 8 Compaq options. (RX-7, p. 2).

⁶ PR received a total settlement of \$10,000; part of the settlement was paid by TYM securities. (Tr. p. 219).

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telephone records of _____, and (iii) noted the lack of other circumstantial evidence of unauthorized trading.

1. Credibility

In a number of instances, PR's testimony at the Hearing was inconsistent both with prior statements made by PR and with other evidence presented at the Hearing. Regardless of whether the inconsistencies were the result of PR's deliberate lies or his inability to accurately recall his market dealings, the Hearing Panel found PR's testimony was not credible.

PR testified at the Hearing that he was not aware until February 1998 that his account had been transferred from TYM Securities to _____, when he received the January _____ statement. (Tr. p. 139). However, _____'s telephone records show that PR made a telephone call to Respondent _____'s _____ 800 number on January 26, 1998, four days before the _____ Statement was issued on January 30, 1998. (RX-20, p. 14; Tr. pp. 139-140).

On June 18, 1998, PR told the NASD examiner, Mr. Nellis, that he was unaware of the unauthorized trades until February 1998 because the account statements and confirmations were sent to his mother's address. (RX-26; Tr. 62). However, at the Hearing, PR admitted that he occasionally spent the night at his mother's home and he regularly picked up his mail from his mother's home. (Tr. 199).

In his August 19, 1998 sworn declaration, PR stated that he had never spoken with Respondents _____ or _____. (RX-23 at ¶10). PR testified that he only spoke with Respondent _____ concerning his securities account. (Tr. pp. 172-173, 229). However, in a telephone conversation on June 18, 1998 with Mr. Nellis, PR indicated that he had spoken with

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Respondent _____ while attempting to locate Respondent _____. (Tr. p. 142). Although Mr. Nellis recorded PR's statement in a contemporaneous memorandum, when asked about the statement, PR testified he "never made that statement" (Tr. p. 207).

PR also testified that Respondent _____ never called him, that he always called Respondent _____. (Tr. p. 228). The telephone records indicate that there were ten calls from _____ to PR during January and February 1998. (RX-52).

In his August 19, 1998 declaration, PR affirmed that he authorized the TYM Securities purchase of 1,500 shares of Hand Brand, which were subsequently transferred to _____ and sold. (RX-23 at ¶5,7). At the Hearing, PR denied that he authorized the original purchase of Hand Brand stock. (Tr. 188). He stated that he was "positive" that he never authorized the purchase of Hand Brand. (Tr. p. 188).

In his May 4, 1998 interview with Mr. Nellis, PR stated that he authorized the purchase of 150 shares of Compaq at Win Capital. (RX-25). In his August 19, 1998 declaration, PR stated that he authorized the purchase of Compaq at TYM Securities. (RX-23 at ¶7). At the Hearing, PR denied that he ever mentioned Win Capital to Mr. Nellis and testified that he did not know through which broker-dealer he had purchased the Compaq securities. (Tr. p. 186).

In his August 19, 1998 declaration, PR stated that there was an unauthorized purchase of 2,500 shares of MEHL on February 3, 1998. (RX-23 at ¶20). There was no purchase or sale of MEHL stock on February 3, 1998. (Stip. at 14; Tr. p. 144).

Mr. Nellis recorded in a June 16, 1999 memorandum that PR told him that he had a net worth of \$10,000 and income of \$1,000 during the year 1997. (RX-27, p. 2). At the Hearing, PR testified that he never told Mr. Nellis that his net worth was \$10,000 or that his income was

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\$1,000 in 1997. (Tr. 217-219). In his August 19, 1998 declaration, PR stated that his annual income was approximately \$20,000. (RX-23 at ¶2).

PR testified that he had 30, maybe 20, telephone conversations with Mr. Nellis. (Tr. p. 202). Mr. Nellis testified that he had approximately a dozen telephone conversations with PR, and he would type a memorandum to record the conversation if substantive issues were discussed.⁷ (Tr. pp. 118-119).

PR stated in the May 4, 1998 interview that he was going through divorce proceedings during the relevant period and consequently his mail was being sent to his mother. (RX-25, p. 1). At the Hearing, PR testified that he had gone through the divorce approximately one year prior to the transactions. (Tr. pp. 165-166).

Respondent _____ and _____ testified that they spoke with PR regarding authorizations of the transactions and specifically in February regarding the margin call for the purchase of the Intel options.⁸ (Tr. pp. 394-396, 438-439, 448). The Hearing Panelists noted that, in their experience, brokers generally contact a customer when an account does not have sufficient funds to pay for securities purchased. Respondent _____ testified that he spoke with PR on the date the account was opened. (Tr. p. 433). The phone records indicate a phone call to PR's office from _____ on December 23, 1997, the day the account was opened. (RX-52; RX-19, p. 1).

⁷ There were four memoranda in the NASD investigative file regarding telephone conferences between PR and Mr. Nellis, dated May 4, 1998, June 18, 1998, January 28, 1999, and June 16, 1999. (RX-25; RX-26; RX-27, pp. 1-2).

⁸ Respondent _____ testified that he received a phone call from PR, who indicated he had spoken with Respondent _____ and wanted to purchase 42,000 shares of MEHL. (Tr. p. 348).

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BC, a customer of Respondents _____ and _____ for approximately seven years with accounts totaling between \$350,000 and \$500,000, testified that Respondents _____ and _____ were truthful and honest, that he has recommended them to his family and friends in the past, and that he would recommend them in the future. (Tr. pp. 249-254). RW, a former colleague of Respondents _____ and _____ who knew the Respondents for five years, testified that both Respondent _____ and _____ were known in the brokerage community as “straight up, honest, by the book people.” (Tr. pp. 257-261).

The compliance officer for _____, Mr. _____, testified that he has had no problems with Respondents _____ and _____ and that feedback from their clients has been excellent. (Tr. pp. 278-280). Mr. _____ further testified that unauthorized trading would be totally out of character for either of them. (Tr. p. 280).

On the whole, the Hearing Panel found that Respondents _____’s and _____’s recitation of events was much more credible than PR’s recitation of events.

2. Telephone Records

PR reported to Mr. Nellis that he telephoned Respondent _____ at _____ only from his office telephone (305) 662-6410 (“office phone”). (Tr. p. 72; RX-27). Relying on that statement, Mr. Nellis concluded that no calls had been made from PR’s office phone to _____ at a time and of a duration that might suggest authorization of the transactions. (Tr. p. 41).

However, the opening account forms for PR listed PR's cell phone number as a contact number. (RX-1, p. 2). At the Hearing, PR confirmed that one of the contact numbers on the opening account form was his cell phone.⁹ (Tr. p. 200).

The telephone records indicate that on January 15 and 16, 1998 there were two telephone calls made to PR's cell phone from _____. (RX-19, p. 5; RX-52). On January 16, 1998 at 10:13 a.m., a telephone call was made from _____ to PR's office phone. (RX-19, p. 5; RX-52). Subsequently, on January 16, 1998, the Hand Brand and Compaq shares were sold, and the MEHL shares were purchased. (RX-2; RX-3; RX-4; RX-52). The Compaq options purchased on January 20 and 21, 1998 were executed as limit orders, rather than market orders, subsequent to the January 16, 1998 phone call. (RX-5; RX-6; RX-52).

On January 26, 1998, a telephone call from _____ was made to the cell phone at 2:38 p.m. (RX-19, p. 6; RX-52). At 2:39 p.m., 36 Compaq put options were sold. (RX-7; RX-52). On January 26, 1998 at 4:00 p.m. a phone call was made from PR's office phone to _____'s 800 number. (RX-20, p. 14; RX-52). Subsequently, on January 27, 1998 and January 29, 1998, 140 Intel options were purchased. (RX-8; RX-9; RX-52). On January 29, 1998, 2,500 shares of MEHL were sold. (RX-10; RX-52).

On February 3, 1998, an eight minute telephone call was made to PR's office phone from _____. (RX-52; RX-19, p. 8). Respondent _____ testified that he spoke with customer PR regarding his failure to pay for the Intel options (Tr. p. 448). Respondent _____ confirmed that he overheard the conversations regarding the payment for the Intel options. (Tr. pp. 360, 395).

⁹ The cell phone number was (xxx) xxx-xxxx.

Mr. Nellis admitted that, prior to the Hearing, he was not aware that PR's cell phone appeared on the _____ telephone records. (Tr. p. 73). Mr. Nellis testified that the fact that telephone calls were made at or about the time that certain transactions were executed was inconsistent with what PR had told him. (Tr. pp. 84-85).

Enforcement correctly argued that the phone records are only circumstantial evidence because they do not show who was speaking on the phone or the subject matter of the conversation. However, contrary to Enforcement's original theory that the circumstantial evidence of the telephone records, without reference to PR's cell phone, supported the testimony of customer PR, the Hearing Panel finds that the complete telephone records support the testimony of Respondents _____ and _____.

3. Other Circumstantial Markers

In addition, the Hearing Panel noted the absence of other circumstantial markers of unauthorized trading, such as financial motive, pattern of similar complaints, and attempts to conceal the transactions. In this case, the commissions earned on PR's trades were de minimis. (RX-37). Respondents _____ and _____ have no disciplinary history. (Stip. at ¶¶3, 5). The confirmations and statement accounts were sent to the address provided by the customer. (Tr. p. 97).

Mr. Nellis testified that, generally, the motive for unauthorized trading is to increase the amount of the brokers' commissions and their financial rewards. (Tr. p. 93). Respondents _____ and _____ jointly made over \$882,000 in gross commissions in 1997. (RX-35, p. 1; Tr. p. 94). The commissions on the alleged unauthorized transactions totaled \$1,720. (RX-37). Brokers that engage in unauthorized trading have an incentive to conduct such trades as

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principal in order to a gain a larger spread. (Tr. p. 100). None of the alleged unauthorized trades involved a _____ house stock; they were all agency transactions. (Tr. pp. 111, 389).

Mr. Nellis testified that, generally, brokers that effect unauthorized trades do not effect unauthorized trades in an account that has no money. (Tr. p. 95). PR's account did not have sufficient funds to pay for all the transactions. (Tr. p. 95). Respondents _____ and _____ individually paid approximately \$5,000 for the losses incurred on the sell out of the 140 Intel Corp. options. (Tr. p. 95; RX-37).

Generally, brokers executing unauthorized purchases do not enter limit orders but rather market orders for the trades. (Tr. p. 108). All of the disputed purchase orders were limit orders. (Tr. p. 367). The purchase of 2,500 shares of MEHL was the result of a limit order for 42,000 shares at \$1 15/32 per share. (RX-4; Tr. p. 356). Only 2,500 shares were able to be filled at the limit price. (RX-4; Tr. p. 357).

Generally, brokers engaged in unauthorized trading do not lower the commission on a trade. The \$100 commission on the MEHL purchase was lowered from \$100 to \$70. (RX-4). Respondent _____ testified that the commission was lowered at the request of PR. (Tr. p. 358).

Finally, there was no pattern of similar behavior in other customer accounts, and, in fact, Respondents _____ and _____, generally, did not execute purchases of options in their other customer accounts because of the costs involved.¹⁰ (Tr. p. 392).

¹⁰ Respondent _____ described the cost of two dollars a contract and thirty-one dollars a ticket to execute options as a very "hefty charge" and not worth the bother. (Tr. p. 392).

4. Enforcement Failed to Meet its Burden

Considering the foregoing: (i) the credibility of the witnesses, (ii) the circumstantial evidence of the telephone records, and (iii) the absence of other circumstantial evidence, the Hearing Panel concluded that Enforcement did not prove by a preponderance of the evidence that the transactions, as specified in the Complaint, were executed without the prior knowledge, consent, or authorization of customer PR.

III. Conclusion

The Hearing Panel finds that Enforcement did not prove by a preponderance of the credible evidence that Respondents _____ and _____ effected unauthorized transactions in customer PR's _____ account between January and February 1998. Consequently, the Hearing Panel dismisses the proceeding as to Respondents _____ and _____.¹¹

SO ORDERED.

Hearing Panel

by: _____

Sharon Witherspoon

Hearing Officer

Dated: Washington, D.C.

January 30, 2001

¹¹ The Hearing Panel 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.