This Decision has been published by the NASDR Office of Hearing Officers and should be cited as OHO Redacted Decision C8A980045.

NASD REGULATION, INC.
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,	:	
Complainant,	:	Disciplinary Proceeding No. C8A980045
v.	:	**HEARING PANEL DECISION**
	:	Hearing Officer - JN
	:	December 23, 1998
Respondent.	:	

Digest

The Department of Enforcement filed a Complaint alleging that Respondent _____ violated NASD Rule 2110 by engaging in two unauthorized trades. The Hearing Panel found that he committed the violations charged in the Complaint. As sanctions, the Hearing Panel imposed a censure for both violations, a fine of $1,000 for one of the trades, and a fine of $1,000, reduced by certain losses and costs, for the other trade. The Panel also ordered _____ to pay costs in the amount of $2,645.20.

Appearances

Daniel P. Moakley, Regional Counsel, Chicago, Ill. (Rory C. Flynn, Chief Litigation Counsel, Washington, DC, of counsel), for the Department of Enforcement.

_____, Chicago, Ill. for the Respondent.

This Decision has been published by the NASDR Office of Hearing Officers and should be cited as OHO Redacted Decision C8A980045.

DECISION

I. Introduction

The Department of Enforcement filed its Complaint against Respondent _____ on July 6, 1998, alleging that he violated NASD Conduct Rule 2110 by engaging in two unauthorized trades. A Hearing Panel, composed of an NASD Hearing Officer and two current members of the District Business Conduct Committee for District 8, conducted hearings in New York and Chicago on October 28, 1998 and November 5, 1998, respectively. The Department presented testimony from two witnesses and Respondent presented testimony from four witnesses, including himself. There were thirteen Joint Exhibits, nine Complainant's Exhibits, and twenty-four Respondent's Exhibits.[1] The parties filed post-hearing briefs on November 23, 1998.[2]

The Panel finds that Respondent committed the unauthorized trades, as alleged in the Complaint. For sanctions, the Panel imposes a censure for each violation, a fine of $1,000 for the transaction involving Mr. W.S., and a fine of $1,000 less $757.86 for the transaction involving Dr. E.G.

II. Facts

A.) The _____ offering

Respondent was associated with the firm of _____, a member firm which was one of the lead underwriters for an initial public offering of shares in _____. (Tr. II, 11, 92, 108-109). The firm designated him as the "primary broker handling incoming accounts for that particular offering"

[1] The transcript of the New York hearings will be cited as "Tr. I", and the transcript of the Chicago hearings will be cited as "Tr. II". Joint Exhibits will be cited as "JX"; Complainant's Exhibits will be cited as "CX"; and Respondent's Exhibits will be cited as "RX".

[2] Respondent's Motion for Leave to File Brief in Excess of 15 Pages was unopposed, and it is hereby granted.

(Tr. II, 12). The projected date for the offering was October 24, 1996 (RX-1). In October of 1996, Respondent (then age 27), although in the securities business for four years, had not come "even remotely close" to the kind of responsibility which the firm gave him in connection with the _____ offering (Tr. II, 137). During September and October of 1996, Respondent received more than 500 names of potential purchasers and sent a preliminary prospectus to most of them (Tr. II, 109-l10, 121-122). _____ branch manager explained that the number of shares in which investors expressed interest "was continually growing. There was a tremendous amount of interest in the stock. And people were calling in on a regular basis" (Tr. II, 13).

The _____ registration statement became effective on October 23, 1996 and the stock began trading the next day (Tr. II, 11-12, 15, 125-126; JX-5). On October 23, 1997, the branch manager unexpectedly informed Respondent that he would receive fewer shares than anticipated. Ultimately, even after several increases in the allocation, Respondent had only about 270,000 shares to satisfy expressions of interest in about 360,000 shares, an amount which was "still significantly below what he had really requested" (Tr II, 16, 129-130). The parties stipulated that "[t]he indications of interest in _____ stock were substantially greater than the number of shares available" (Joint Stipulation, par.6).

On October 23, after learning of the reduced allocation and the price of the stock ($7 per share), _____ spoke with a number of customers, telling them he would have fewer shares than they wanted (Tr. II, 127-128). Some customers called Respondent back several times between October 23 and the start of trading, complaining about his inability to supply the shares (Tr. II, 128). As _____ branch manager stated, Respondent "was disappointed because his clients were disappointed and giving him a hard time in not being able to fill all of his allocations or all of his

indications of interest" (Tr. II, 18). Respondent described "another dilemma" which occurred that day: four or five allotment increases during the afternoon "threw off all of my previous conversations" and required still further communication (Tr. II, 129). On October 23, _____ did not speak to all of the customers he wanted to concerning the lower allocation (Id.).

Respondent explained that he and an assistant began work at 7 or 8 p.m. that evening to prepare paperwork for the offering the next day (Tr. II, 130). The assistant prepared one pile of order tickets for customers with whom Respondent had confirmed purchases of reduced amounts of _____ stock, and another for customers with whom he had not so spoken (Tr. II, 130-131). He left the office at 3 a.m. on October 24 and returned at 6 a.m. that morning (Tr. II, 132).

On that day, he turned to "the pile of people that I had to reconfirm their new allocation with them and people who I had not yet spoken to on the 23rd" (Tr. II, 131), a pile containing 20 to 23 tickets (Tr. II, 203). As he reconfirmed with those customers, he would move the tickets into the "to be executed pile" (Id.). He handed in some of the confirmed tickets at 10 a.m. (the firm's deadline for such records) and obtained an extension from the branch manager, stating: "I still have some people I need to speak to that I haven't spoken to yet …" (Tr. II, 132). The branch manager explained that "we did give him some flexibility because there was such a volume and he was trying to make all the calls and get to all the clients he could" (Tr. II, 19).

Respondent started to make calls, but had to take incoming calls from customers who knew they were getting _____ shares and wanted quotes for the newly-traded issue (Tr. II, 133). Notwithstanding the extension, _____ was under pressure to get the order tickets in; the branch manager said "we have to get them in because the syndicate's pressuring me to make sure all of the orders are in" and the assistant branch manger would say "we got to get those tickets in" (Tr. II, 133).

Respondent's telephone records reflected almost 240 calls over the October 23-24 period, a total which did not include calls referred to his assistant when his lines were busy (Tr. II, 136). _____ records for October 24 show 115 calls, covering 5 hours on the phone; his assistant received 67 calls, covering 3.12 hours (Tr. II, 194). He described the management of the piles and the phone calls as "hectic" and "crazy" (Tr. II, 133). The branch manager testified that the increases in allotments and the number of interested individual clients made the offering "unusual" (Tr. II, 20, 48).

B.) Respondent's Purchase for Customer W.S.

1.) the customer's testimony

Some time in October of 1996, Mr. W.S. spoke with a co-worker and reviewed a preliminary prospectus which Respondent sent to him. W.S. then called Respondent, stating that he was interested in learning more about the _____ offering and would be interested in buying 200 shares (Tr. I, 88-89). W.S. furnished financial information, understood that Respondent was opening an account for him (Tr. I, 91, 93, 107), and told him that an offering price of $7 per share "sounded reasonable to me, and I would be interested in participating, if I could do so" (Tr. I, 91). "I told Mr. _____ that I was interested in purchasing 200 shares and would like to do so" (Tr. I, 107).

The customer said that _____ told him that he would get back to him as to the extent of participation (if any) and the actual offering price, and that Respondent assured him that he would have an opportunity to make a final decision about going ahead with the purchase of a particular number of _____ shares at a particular price (Tr. I, 91-92).

W.S. said that some time thereafter, he received a new account form, along with a confirmation "that I had purchased shares in the _____ offering, which was a surprise to me" (Tr. I, 94). W.S. testified that he called Respondent and told him that although he was not troubled by the price or by the

amount of shares, "the fact that he [Respondent] didn't do what he said he was going to do was the reason I was not going to go ahead with the purchase" (Tr. I, 97). When asked whether _____ initiated the call (rather than the other way around), W.S. said that although he could not so recall, "I wouldn't say that he didn't" (Tr. I, 109).

The customer first testified that Respondent "said I had an obligation to go ahead" (Tr. I, 97), but later explained: "I can't recall that he said that I had an obligation that I had to go ahead with the purchases. He led me to believe that I should go ahead with the purchase, that I had said that I would make the purchase, …" (Tr. I, 124). W.S. said that ultimately he contacted an official in the firm's legal department, who canceled the trade (Tr. I, 97, 98).

The customer testified that although he suffered the "loss of time entailed here and speaking on the phone about the occurrence", the firm canceled the trade as of October 29, and he suffered no financial loss from the transaction (Tr. I, 116, 125, 128). As he put it, "I'm not out of pocket anything, but all of our time is being spent on this, and that's a loss to all of us" (Tr. I, 128). He further acknowledged that if Respondent had called him and said "Do you want them" [the shares], he would have said "fine" (Tr. I, 121). "If he had called me that day, I would have said yes" (Tr. I, 123).

2.) Respondent's testimony

Customer W.S. called him in mid October of 1996, stated that he had seen the co-worker's preliminary prospectus, and "said that he wanted to purchase 250 shares of _____ stock" (Tr. II, 137). _____ said that he might not be able to meet the demand for shares and W.S. replied that "I'd like to buy up to 250 shares of _____ stock when it comes public" (Tr. II, 138). Respondent obtained account opening information and asked the customer to call him on the 23rd or 24th to reconfirm whatever allocation was available.

Respondent testified that W.S. called him a few days before the offering to be sure that the offering was going forward and to ascertain a more definite price. When Respondent told him that the price would be $7 and that "we should speak on the 23rd or 24th so I can give you an allocation", the customer "restated that he wanted to buy up to 250 shares …" (Tr. II, 139).

_____ acknowledged that he did not speak to W.S. on either day, but explained that he tried to reach him on the 23rd, when he called that customer's co-worker about her allocation: "I asked her to transfer me over to [W.S.]. I didn't connect with him at that time. I believe that my phones were ringing, his phone was ringing over probably three or four times, and my phones were ringing, so I jumped off and just grabbed another call with the intention of calling him back" (Tr. II, 140). The co-worker (who is one of Respondent's clients) testified on _____ behalf. When asked about the above conversation, she could not remember his request for transfer to W.S., explaining "… two years ago, I cannot remember whether he asked me to transfer him or if he said 'What's [W.S.'s] phone number? I'm going to call him.' I really can't remember" (Tr. I, 81).

Respondent explained that he did not contact this customer on the 24th because "[I]t was so chaotic at that time. He kind of fell through the cracks" (Tr. II, 141). When asked why he had entered an order for W.S., Respondent said that in the previous conversation, "so close to the offering date, he was extremely adamant that he wanted to invest in _____ and he wanted to own up to 250 shares" and that he intended to call the customer later that afternoon on the 24th but failed to do so (Tr. II, 141-142). _____ did not consider giving W.S.'s 200 shares to someone else, because he had allocated 200 shares to the co-worker, did not want to favor her over W.S., and hoped to build a long-term relationship with them (Tr. II, 142).

A few days after the offering, Respondent called W.S. and left a message asking him to call regarding the _____ stock. The customer called back and stated that although he had no objection to the shares or price, he did not want to participate because Respondent had not spoken to him on the 24th (Tr. II, 141). _____ then explained the situation to the branch manager, who told him to check back and be sure that W.S. did not want the 200 shares. He did so; learned that the customer did not want the shares; and so advised the branch manager, stating "it's my mistake, I thought he wanted them, can you put through a cancel" (Tr. II, 145).

The "Error Transaction Report" pertaining to the shares purchased for W.S. described the error as "my mistake", an entry made by Respondent (RX-22; Tr. II, 201). When asked what his mistake was, _____ replied: "[m]y mistake is I didn't call him on the 24th and reconfirm his receiving 200 shares" (Tr. II, 201).

C.) Respondent's purchase for Dr. E.G.

1.) the customer's testimony

Dr. E.G. first heard of the _____ offering through a dental colleague, who believed that the company was coming out with a revolutionary new toothpaste (Tr. I, 26). He then contacted the issuer's president (who referred him to Respondent's firm), called the firm, and spoke to _____ in October of 1996 (Tr. I, 27). The Doctor told Respondent that he was interested in "probably purchasing some stock; that I would like to see the red herring prospectus…" and that he would be willing to purchase "maybe up to $10,000" of the issue (Tr. I, 28, 30). He told Respondent that he was a dentist, furnished information about his financial situation, and received the prospectus several days later.

After reviewing the prospectus, Dr. E.G. decided not to invest in _____ (Tr. I, 29-30, 32). Thereafter he received a mailgram from Correspondent Services Corporation, a company which was clearing trades for Respondent's firm (Tr. II, 70). Referring to that firm, the document stated that Dr. E.G. owed $3,500 for a trade which occurred on October 24, 1996 (JX-6, p.3). He then called Respondent to inquire why stock was purchased without his approval. The Doctor said that _____ replied "[w]ell, I didn't want you to miss out on this offer, so that was the amount that I could purchase for you" (Tr. I, 35). He asked Respondent to void the transaction, and Respondent told him he would do so or "made it sound that he would be looking into the matter to void it for me" (Tr. I, 36, 57). This customer denied receiving any telephone message from Respondent (Tr. I, 41).

The Doctor continued to receive statements from Respondent's firm showing money due and eventually complained to the NASD, which requested information concerning the order made for him (CX-2). The firm's reply stated inter alia that although Dr. E.G. made a "bona fide order" to purchase the shares (which he denied), it would cancel the purchase and close his account (CX-4).

Finally, Dr. E.G. testified that he suffered no loss from this transaction (Tr. I, 63).

2.) the Respondent's testimony

The Doctor called Respondent on October 1, 1996, stating that he was an orthodontist, who was seeking information about _____ (Tr. II, 146). _____ said that he would send a prospectus and did so. He then obtained account opening information from Dr. E.G. and discussed _____ underlying technology with him (Tr. II, 146-147).

Dr. E.G. thought the technology was revolutionary and "wanted to be involved. He was pretty adamant about wanting to be involved" (Tr. II, 147). Respondent told him to call back later for more precise information as to price and date. The customer said that "he'd like to buy up to $10,000 worth

of _____ stock" (Tr. II, 148). When _____ told him that the price looked like it would be $7 per share, with trading to begin on the 24th, Dr. E.G. "restated I'd like to get up to $10,000 worth of this stock if possible" (Id.).

Respondent testified that at the time, he thought he had called Dr. E.G. on the 24th, but now realizes that he did not do so (Tr. II, 148-149). "I think I made a mistake and confused him with another dentist who wanted to invest because there were just so many conversations going on and so many people" (Tr. II, 149). _____ earlier stated that 25 to 30 dentists had inquired about the offering (Tr. II, 122).

Although he thought he called on October 24, he said that he did try to reach Dr. E.G. around November 5, after receiving a report listing the customers who had not yet furnished checks; he left a message at the Doctor's office, asking for a return call regarding _____ (Tr. II, 149-150). The customer called back and referred to a mailing saying that he owed $3,500 for 500 _____ shares, which he did not want to buy (Tr. II, 150). When _____ mentioned the customer's prior "strong interest to buy", the Doctor said "I'm only getting this because the stock price is down. If the stock price was up, you guys would have taken back the shares." Respondent (who thought he had called Dr. E.G. on October 24) told the customer that he was able to allocate 500 shares and "you own those 500 shares" (Id.).

The customer told Respondent that he did not want the shares and asked him to void the transaction. Respondent said that he would see what he could do. He discussed the matter with the branch manager, told him that "I made a mistake," and suggested canceling the trade (Tr. II. 152). The branch manager approved the cancellation (Tr. II, 31, 152). Administrative problems (primarily attributable to the clearing firm) caused delays, which, in turn, caused losses and other charges - in

addition to the impact of market decline - to be assessed against the customer's account (Tr. II, 70-78, 80). The branch manager and compliance director explained that Respondent agreed to bear any losses, and _____ testified that he did absorb all expenses associated with the belated cancellation of the trades involving Dr. E.G. (Tr. II, 31, 69, 78, 82, 98, 206-207).

III. Discussion

A.) Respondent's Liability for the Trades

The Complaint alleged that Respondent violated Conduct Rule 2110 in making unauthorized purchases for two customers. The essential facts are undisputed. Before the _____ registration became effective, customers W.S. and Dr. E.G. each reviewed a preliminary prospectus and expressed some interest in the stock. The SEC declared the initial public offering to be effective on October 23, 1996. Trading began on October 24, 1996. On that day, Respondent effectuated the purchase of 200 shares for customer W.S. and 500 shares for Dr. E.G. He did so without having spoken to either customer "by telephone or otherwise, at any time on October 23 or 24, 1996" (Joint Stipulation). Nor did he "have written authorization from [either customer] to exercise discretionary trading authority" (Id.).

Rule 2110 requires adherence to "high standards of commercial honor and just and equitable principles of trade." The undisputed facts established the unauthorized trades and the resulting violation of Rule 2110.

First, Respondent himself recognizes the requirement that brokers selling a stock after a registration becomes effective, cannot enter orders based on earlier expressions of interest, but must contact those who expressed interest and confirm their intent to purchase a given amount of stock at the established price. As Respondent said, "[m]y mistake is I didn't call [customer W.S.] on the 24th and

reconfirm his receiving 200 shares" (Tr. II, 201).

His own witnesses acknowledged the requirement. The firm's branch manager agreed that brokers "have a responsibility to confirm indications of interest prior to submitting an order", and that submitting an order without such confirmation is not "an accepted practice in the securities industry" (Tr. II, 42). The compliance director was even more emphatic, stating that "there is no question that a broker is required to go back and confirm that with the customer when the offering becomes public" and that brokers are "obligated to know that is the rule, that is the policy" (Tr. II, 96, 97). Indeed, the firm's written procedures made that clear (CX-6).

This requirement rests on solid legal and policy bases. Section 5(a) of the Securities Act of 1933 provides in part that "[u]nless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly [to use interstate commerce or the mails] to sell such security through the use or medium of any prospectus or otherwise." As the compliance director explained: a prior expression of interest is "not a firm order until it's confirmed on the date the offering comes out. Things can happen from the time the red herring or the preliminary prospectus comes out till the time it's offered …. Things could happen to the security involved. Things could happen to the brokerage firm. Things could happen to a person's individual economic situation that he may no longer be interested. Conversely he could say he wanted more" (Tr. II, 99).

Respondent admits that he failed to reconfirm the customers' pre-October 23 expressions of interest. He urges that his actions nevertheless did not violate Rule 2110, arguing that he made "[a]n honest mistake"; that he "honestly believed" that the customers wanted the shares; and that an "honest good faith belief that he was doing what his customers wanted" establishes innocence under Rule 2110 (Brief, pp. 12, 14, 15; emphasis in original). The Panel concludes that these arguments, though certainly

relevant to sanctions, do not constitute defenses to the violations alleged.

As Enforcement correctly argues, treating conversations with customers before the effective date as firm orders clashes with Section 5(a)'s policy that trades not occur until registration is declared effective (Brief, pp. 2-3). Indeed, Respondent's own witness (the compliance director) said that a prior expression of interest is "not a firm order until it's confirmed on the date the offering comes out" (Tr. II, 99). Yet _____ "honest mistake" defense, resting heavily on such conversations, inevitably produces the conclusion that expressions of interest nevertheless constitute orders. In the Panel's view, accepting this notion would be inconsistent with the policy reflected in Section 5(a) of the 1933 Act.[3]

Moreover, treating honesty and good faith as defenses under Rule 2110 would effectively impose a scienter requirement on that Rule. But it is well settled that violations of its requirement for "high standards of commercial honor and just and equitable principles of trade" do not require proof of scienter.[4]

That principle applies fully to unauthorized trading violations. In Anthony Tricarico, Exchange Act Rel. No. 32356, 1993 SEC LEXIS 1346 (1996), the respondent (like _____ here) argued that he "reasonably believed that he was authorized" and that his actions were the result of a "misunderstanding or, at worst an error in judgment" (at *5-6). The Commission rejected this defense, stating: "[a]lthough we consider Tricarico's conduct to rise to the level of recklessness, we would sustain the Exchange's finding that Tricarico's conduct in entering these unauthorized trades was inconsistent with just and reasonable principles of trade without evidence of scienter" (footnote, 5, at

[3] Respondent was not charged under Rule 2110 with violating Section 5(a), and the Panel makes no finding of such a violation.

*6). See also District Business Conduct Committee v. Donald Edwin Manuel, No. SF-1343, 1991 NASD Discip. LEXIS 103 (1991), where the NBCC sustained findings of unauthorized trades as violating the "high standards" requirement, even though the respondent "operated under a good faith belief that he possessed legal authority to make the trades" (at *14).

In short, the precedents show that the "honest mistake" defense is not a defense under Rule 2110.[5]

Respondent relies primarily on Lerner & Co., Exchange Act Rel. No. 5538, 1957 SEC LEXIS 379 (1957) (Brief, pp. 12-14), holding that a purchaser's failure to complete a contract to buy securities did not violate the "high standards" rule, when he honestly believed that he did not have to accept delivery because of a material breach by the seller. Using that result, _____ urges that an honest belief in the authority to make a trade constitutes a defense to charges of unauthorized trading. In the Panel's view, Lerner supports no such rule.

That case involved a dispute over the performance of a condition precedent in a contract. In the instant case, there was no contract; there were merely expressions of interest, which, as respondent's own witness agreed, could not constitute a "firm order." Moreover, the Commission's view that a breach of contract came within the NASD rule only when committed "without equitable excuse or justification" cannot apply to unauthorized trades. Such factors may bear on sanctions, but do not create defenses. See, e.g. Tricarico and Manuel, supra.

---

[4] Larry Ira Klein, Exchange Act Rel. No. 37835, 1996 SEC LEXIS 2970 (1996); Gerald E. Donnelly, Exchange Act Rel. No. 36690, 1996 SEC LEXIS 89 (1996); R. B. Webster Investments, Inc., Exchange Act Rel. No. 35754, 1995 SEC LEXIS 1309 (1995); DWS Securities Corporation, Exchange Act Rel No. 33193, 1993 SEC LEXIS 3137 (1993).

[5] As noted, the need for post-effective date confirmation of indications of interest stems from the registration requirement of Section 5 of the 1933 Act, a provision which also does not require proof of scienter. SEC v. National Executive Planners, Ltd., 503 F. Supp. 1066, 1072 (M.D.N.C. 1980) and cases there cited.

The Panel believes that Respondent, though not willful or reckless, could have taken more care - even in the hectic situation in which he found himself. When it became apparent that on-going problems of supply and demand were causing difficulties, _____ could have asked for more help. There is no evidence that he did so. Nor was it clear why, given current computer technology, Respondent had to resort to "piles" of paper, with attendant confusion stemming from possibly placing items in the wrong pile.

To be sure, there was uncontradicted evidence of "unusual" circumstances surrounding the _____ public offering (Tr. II, 20, 48). But Respondent knew that he had to contact customers who earlier expressed interest - he made a separate pile for such purposes. No matter how hectic the situation, he knew that he could not sell stock solely on the basis of preliminary expressions. Respondent's branch manager stated that during the offering periods, "[a]ll reps are reminded" that "[u]pon the pricing of the issue along with the effective date it is the responsibility of the Investment Executive to contact each client to advise them of the issue, price, when it will begin to trade, and obtain a firm order" (CX-6, p.4). The compliance director testified that brokers are "obligated to know that this is the rule, that is the policy" (Tr. II, 97).

On this record, the Panel concludes that Respondent's conceded mistakes, however innocent, could have and should have been avoided, and that his conduct falls short of the mandate for "high standards of commercial honor and just and equitable principles of trade."

B.) Sanctions

1.) The "Principal Considerations"

All NASD Sanction Guidelines begin with an instruction to "See Principal Considerations Listed on Pages 8-9" (see, e.g. NASD Sanction Guidelines (1998), p. 86, pertaining to unauthorized

transactions). The Panel, therefore, begins with those considerations before examining the specific recommendations for unauthorized transactions. Eleven of the nineteen Principal Considerations apply to this case,[6] and the Panel now turns to them.

Consideration 1: disciplinary history

Respondent has no disciplinary history.

Consideration 2: acceptance of responsibility prior to detection and intervention by firm or regulator

The record shows that Respondent went to the branch manager on his own motion, promptly after customers W.S. and Dr. E.G. complained. The branch manager described his first conversation concerning W.S: "I remember [Respondent] coming into my office and telling me that [W.S.] was … not going to accept the shares;" he further testified that at no time did Respondent object to taking responsibility for the W.S. trade (Tr. II, 22, 27). As to the Dr. E.G. trade, the branch manager said that Respondent came to him with the complaint, that he (the branch manager) had not asked _____ to come to his office, and that no one had raised a problem about the Doctor's account until Respondent came in (Tr. II, 29-30).

Consideration 4: voluntarily attempting, prior to detection or intervention, to pay restitution or otherwise remedy the misconduct

As noted, Respondent promptly brought W.S.'s complaint to the attention of the branch manager, who gave directions to cancel the trade. When asked if _____ said anything about absorbing a loss, the branch manager said: "regarding accepting the loss? He understood. I mean, it

[6] Considerations 5, 6, 14, and 16 apply to the firm, not the individual. Neither side introduced evidence pertaining to subsequent corrective measures; claimed reliance on legal or accounting advice; injury to "other parties," including

was, okay, fine, let's cancel the trade" (Tr. II, 25). As to Dr. E.G., the branch manger stated that Respondent "again understood that he would have to accept the responsibility for any losses. And he did, and the trade was canceled" (Tr. II, 31). The compliance director said in the first conversation following Dr. E.G's call, Respondent said that "it was a misunderstanding and that if there was a problem he'd take the loss, the monetary loss" (Tr. II, 98). Respondent's testimony that he absorbed all expenses associated with the Doctor's account was uncontradicted.

Consideration 8: numerous acts and/or a pattern

There were two unauthorized trades, one for W.S. and the other for Dr. E.G. Respondent began with a list of more than 500 persons who might be interested in the offering. During the October 23-24 period, he received or made 230 to 240 phone calls, not counting those referred to his assistant. He had customers for 360,000 shares; thirty-six particular customers took over 89,000 shares. The record contains no other complaints. In these circumstances, the Panel concludes that two unauthorized trades, involving 200 and 500 shares respectively, do not reflect either "numerous acts" or "a pattern of misconduct."

Consideration 9: extended period of time

The events occurred over two days (October 23 and 24 of 1996) at most. Respondent did not, therefore, engage in misconduct "over an extended period of time."

Consideration 10: attempts to conceal misconduct or to deceive a customer, regulatory authority, or member firm

Respondent promptly and candidly admitted his errors to the firm. As to customer

---

the investing public or market participants; or action despite prior warnings (Considerations 3, 7, 11, and 15).

W.S., he wrote "my mistake" on the firm's correction notice, which canceled the trade (Tr. II, 201). After Dr. E.G. told _____ that he did not want the shares, Respondent told his branch manager and compliance director "[i]t's my responsibility. I made a mistake" (Tr. II, 151-152).

As to communications with customers, Respondent told Dr. E.G. that he (_____) had purchased the shares because he did not want the customer to "miss out" on the offer (Tr. I, 35). When the doctor objected to the purchase, Respondent said he "would void the transaction" or "made it sound that he would be looking into the matter to void it for me" (Tr. I, 57). Far from deception, Respondent's comments reflected candor and a prompt attempt to correct the matter.

Customer W.S. first testified that _____ told him he "had an obligation to go ahead," but later modified his account, stating: "I can't recall that he said that I had an obligation to go ahead with the purchases. He led me to believe that I should go ahead with the purchase, that I had said that I would make the purchase" (Tr. I, 97, 124). Respondent and the branch manager explained that because W.S. was otherwise satisfied with the trade, _____ had to re-check his request to void the transaction. Respondent said that he told the customer "… you said that you wanted the 200 shares and seven bucks is fine but because we didn't speak you're not going ahead. I said before a cancellation takes place, I just want to be clear in my mind that you don't want these shares. He said I don't want the shares. I said fine, we understand each other, hung up" (Tr. II, 144). Viewed in this context, W.S. could easily have understood the conversation as urging him to go through with a purchase with which he had no other objection. On this record, the Panel cannot find that the description ("led me to believe that I should go forward") rises to the level of attempted deception.

There were no communications with any regulatory authority other than NASD, a subject discussed next.

Consideration 12: extent of cooperation with NASD

In certain respects, Respondent's investigative response to NASD's review of Dr. E.G.'s complaint was inconsistent with - or failed to mention matters included in - his testimony at the hearing. Standing alone, the existence of these defects is an aggravating factor, but its significance is offset by Respondent's explanation of the surrounding circumstances.

When he received NASD's inquiries, Respondent, who had "never received anything like this before," prepared a response and sent it to the compliance department (Tr. II, 160- 161). He there had "cursory discussions" with _____ who furnished "overall concept" suggestions ("overall brush strokes and not like specific lines") as to the content of the response (Tr. II, 164, 179). He knows that compliance made certain changes in his draft; he specifically recalled that _____ inserted the adjective "bona fide" in reference to Dr. E.G.'s "order" (Tr. II, 181). Ultimately, _____ gave him the statement to sign, and he did so (Tr. 163). He did not then consult with counsel, explaining that the firm told him that the response was a "kind of routine thing" following a customer letter to NASD and "[s]o, you know, it's not a big issue" (Tr. II, 164). He added: "at the time this letter was done, I really didn't understand what was going on with the NASD's question, so there may have been something I could have included that could have been important that I didn't include. So I didn't know really what was important and what wasn't important" (Tr. II, 171).

When the NASD inquiry began, "I didn't know what I was doing or what I was involved in. I thought that I was going to be, you know, kind of taken care of the by the people I was working for" (Tr. II, 175). When he went to the compliance department after the Association made another request for information, "[t]hey weren't very responsive" (Tr. II, 186). Respondent was not "happy with how I was kind of being handled and treated" in the firm's responses to NASD (Tr. II, 199). He could not

communicate with a law firm that was handling the matter; intermediaries would tell him that they had questions about his response, but he had to file with NASD on short notice (Tr. II, 199). Finally, he retained counsel, realizing that "I needed my own help and to be able to tell my story and what really occurred" (Tr. II, 200). His hearing testimony followed consultation with that attorney: "[b]eing able to finally speak to someone who was further challenging me to think hard about what really happened and what went on. And … talking more and more and more through, okay, take me through this step and take me through this step ... and that's where I remembered things I didn't remember before" (Tr. II, 189).

To be sure, Respondent should have taken the matter more seriously than he did at the outset. But the Panel finds that Respondent's description of the circumstances surrounding the statement was credible, and, on balance, offsets any adverse implication. In the circumstances of this case, the matters mentioned in sanctions Consideration 12 thus constitute neither aggravation nor mitigation.

Consideration 13: intent, recklessness, or negligence

The Panel believes that Respondent's acts resulted from negligence. He was careless in not asking for help - particularly when he faced the opening of trading on less than three hours sleep - and when he tried to perform his obligations through piles of orders, where papers could easily slip into the wrong stack. The acts were not intentional or reckless. The circumstances were not consistent with intentional misconduct or an "extreme departure from the standards of ordinary care."[7] There was no reason for such conduct or departures. The two trades would have earned Respondent a total of only about $95 in commissions (Tr. II, 26). The fact that _____ earned an after-tax total of

[7] Recklessness has been defined as "a lesser form of intent" or "an extreme departure from the standards of ordinary care" (Sanders v. John Nuveen & Co., Inc., 554 F.2d 790, 793 (7th Cir. 1977).

approximately $20,000 in commissions through this offering (Tr. II, 210), together with the existence of other customers demanding more shares than available, also highlights the absence of a motive to cut corners for $95. The Panel accepts Respondent's uncontradicted account of the hectic situation involved in this offering and concludes that his mistakes were, at the most, the result of negligence.

Consideration 17: potential for monetary or other gain

As to commissions, there was, as noted, a potential for monetary gain of some $95 to Respondent. In the Panel's view, this amount is insignificant, compared with the total net commissions of about $20,000 which _____ earned through the _____ offering. As to customer W.S., Respondent did testify that he allocated shares to that customer (believing that W.S. wanted them) because he had done so for a co-worker, did not want to show favoritism to her, and hoped this would build a long term relationship" (Tr. II, 142). But this hoped-for "gain" had validity as a motive only if _____ believed that W.S. wanted the shares. To stick the customer with unwanted shares could not have built any long-term relationship. If this motive has significance here, it corroborates Respondent's testimony that he was doing what he thought W.S. wanted, and certainly does not create a circumstance in aggravation.

Consideration 18: number, size and character of the transaction

There were two unauthorized trades - one for 200 shares and one for 500 shares. These were small amounts, considering that Respondent had requests for about 360,000 shares (Tr. II, 130). The commissions from these two trades would have totaled about $95, a small sum, compared with $20,000 after taxes which Respondent earned from the offering.

Consideration 19: level of sophistication of customers

Each customer was a professional, a dentist and a lawyer. The dentist had several years of investment experience (some of it through a childhood friend who was a broker), and used the term "red herring" in referring to the preliminary prospectus (Tr. I, 28). The lawyer had ten to twelve years experience in dealing with securities (Tr. I, 87). As the prosecutor recognized in his closing statement, the customers in this case were not "widows and orphans" (Tr. II, 289).

On balance, these considerations weigh in Respondent's favor. He has no disciplinary history. He accepted responsibility before detection or intervention by the firm and did not attempt to deceive the firm. He brought the trades to the attention of his branch manager, acknowledged his errors, and bore losses and costs associated with cancellation of the trades.

Respondent promptly acknowledged his responsibility to Dr. E.G. Although W.S. said that Respondent "led me to believe that I should go ahead with the purchase," this inference occurred in the context of _____ re-checking to be sure that W.S. - who had no objection to the number of shares or the price - really wanted to cancel the order. Respondent testified that he replied "fine" when W.S. said that he did not want the shares. In any event, the Panel believes that W.S.'s conclusory description of unquoted words does not create an aggravating circumstance. Under any view, neither customer sustained any financial loss as a result of the trades.

Respondent's investigative response to NASD was not what it should have been. But _____, a youthful and relatively inexperienced broker, acted without counsel, relying entirely on a compliance officer, who told him that the inquiry was "routine" and not a "big issue," made suggestions as to what he should say, re-wrote his draft, and presented him with the statement for his signature.

Respondent's conduct was neither intentional nor reckless, and at the most reflected negligence. The misconduct had minimal dimensions: two trades, occurring over two days, without any "pattern" of

violations. Any potential monetary gain from the trades was insignificant: a total of $95 in commissions. The purchases involved $1,400 and $3,500 respectively. The demand for shares in this offering vastly exceeded the supply, and the stock in question could easily have gone to other persons. There was no plausible reason - other than honest error - for Respondent to have conducted unauthorized trades.

2.) Additional considerations

These customers came to Respondent; he did not "cold call" them or otherwise solicit their business. It was undisputed that Respondent faced a hectic and unusual situation during the period October 23 and 24 of 1996. The interest in the shares and the ever-changing allocations created serious administrative difficulties for this one young broker and an assistant, whom the firm left with sole responsibility. The Panel believes that the firm should have supplied help and shared some of the responsibility for the errors. As to Respondent himself, the branch manager, who had over twenty-five years experience in the securities industry and testified in this proceeding, nevertheless believed that _____ was a person of integrity. Indeed, the branch manager asked Respondent to join him in a new firm, after _____ went out of business (Tr. II, 57).

3.) The Guidelines Recommendations

For unauthorized trades, the NASD Sanction Guidelines (1998) recommend fines of $5,000 to $75,000 (at p. 86). In addition, "in cases involving customer losses, [adjudicators should] consider suspending individual respondent in any or all capacities for 10 to 30 business days" (Id.). The Guidelines recognize that "[a]djudicators may determine that no remedial purpose is served by imposing a sanction within the range recommended … i.e., that a sanction below the recommended range … is appropriate" (Id., at 5).

As to fines, the Panel believes that this is such a case. Almost all of the Principal Considerations point toward mitigation. As noted, the shares and amounts involved are small. There were only two trades for customers who sustained no financial injuries. As Enforcement's counsel acknowledged, while arguing that Respondent had failed to live up to his responsibilities, "[t]his is not a guy who's coming in here with 25 widows and orphans that he's been running dozens of unauthorized trades to, I'll grant you that" (Tr. II, 289). Certainly _____ knew that he had to reconfirm expressions of interest; in this regard, he made (and acknowledged) errors which, while violative, were understandable in the hectic circumstances confronting him on October 23 and 24 of 1996.

In addition, the presence or absence of prospective commissions is an important consideration in determining sanctions for unauthorized trades. See District Business Conduct Committee v. Goldberg, No. C3A960040, 1998 NASD Discip. LEXIS 25 (NAC, 1998) at *7, where the absence of commissions was mitigating, making the proceeding "unlike a typical unauthorized trading case, in which the registered representative profits from an unauthorized trade." See also District Business Conduct Committee v. Columbia, No. C10970029, NAC, September 11, 1998, where "a sizeable commission" on the unauthorized trade was an aggravating circumstance in considering sanctions (slip op. at 8). In the present case, that factor cuts sharply the Respondent's way. _____ would have earned a total of $95 in commissions from the two trades. But in a case where Respondent netted $20,000 in _____ commissions and had other customers seeking far more shares than he had, the Panel cannot accept that the prospect of $95 in commissions somehow influenced his purchases for the two customers. In the Panel's view, the small size of the prospective commissions is a mitigating factor.

For all of these reasons, the Panel believes that the appropriate fine should be $1,000 for each of the trades. In the case of Dr. E.G., that fine should be reduced by $757.86, reflecting the losses and

expenses which Respondent bore in connection with the firm's undoing of the trade (JX-6, pp. 6-8). He promptly and candidly admitted his mistake to the firm, and did not quarrel with its demands that he cover the loss; moreover, some of that money ($41.93) reflects late charges, the incurrence of which was not his fault. In these circumstances, the Panel believes that he should not effectively pay this money again, albeit in the form of a fine.

As noted, the Guideline for unauthorized trades suggests that adjudicators consider suspensions of 10 to 30 business days "[i]n cases involving customer losses, …" (Guidelines, supra., at 86). Here there were no customer losses. Considering this factor, together with all of the mitigating circumstances discussed above, the Panel concludes that no suspension should be imposed.

IV. Conclusion

Respondent committed the unauthorized trades as alleged in the Complaint. These acts constituted violations of Conduct Rule 2110.

For the trade involving customer W.S., Respondent is censured and fined $1,000. For the trade involving Dr. E.G., Respondent is fined $1,000, but such fine shall be reduced by $757.86 in losses and costs associated with this trade, which Respondent has already absorbed.

In addition, Respondent is ordered to pay costs of $2,645.20, which includes an administrative fee of $300 and the hearing transcript cost of $2,345.20.

HEARING PANEL

_____

BY: Jerome Nelson
Hearing Officer

Dated: Washington, DC
December 23, 1998