NASD REGULATION, INC.
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. JOSEPH GAETANO GERACE, (CRD #1060223) St. John's Antigua, West Indies Respondent.	Disciplinary Proceeding No. C02990022 **Hearing Panel Decision** Hearing Officer—SW Dated: August 28, 2000

Digest

The Department of Enforcement filed a Complaint against Respondent Gerace alleging that he violated NASD Conduct Rule 2110, by causing his firm to violate Securities and Exchange Commission ("SEC") Rules 15c2-4 and 10b-9, in connection with a contingency offering, when the firm (i) failed to establish an escrow account to hold investors' funds received pursuant to the contingency offering, and (ii) failed to sell the minimum amount of securities to bona fide public investors prior to delivering the investors' funds to the issuer of the securities. Filing an Answer to the Complaint that denied the allegations, Respondent requested a hearing.

The Hearing Panel found that Respondent violated Conduct Rule 2110 by permitting his firm (i) to fail to establish an escrow account to protect investors' funds in a contingency offering in violation of SEC Rule 15c2-4, and (ii) to fail to refund the investors' funds promptly when the minimum amount of securities were not sold and paid for by bona fide purchasers by the

deadline, in violation of SEC Rules 15c2-4 and 10b-9. Accordingly, the Hearing Panel fined Respondent $10,000 and suspended him in his capacity as a securities principal for one year.

Appearances

Sylvia M. Scott, Esq., Regional Counsel, Los Angeles, CA (Rory C. Flynn, Washington, DC, Of Counsel) for the Department of Enforcement.

Joseph Gaetano Gerace, pro se.

DECISION[1]

I. Procedural History

The NASD Regulation, Inc. Department of Enforcement ("Enforcement") filed a one-count Complaint against Respondent Gerace on April 5, 1999.[2] The Complaint alleged that, in a private placement of securities, between August 1996 and October 1996, Respondent Gerace as the chief operating officer of Interfirst Capital Corporation ("Interfirst")[3] violated NASD Conduct Rule 2110 when Interfirst failed to establish an escrow account to hold investor funds and failed to raise the minimum amount of proceeds from bona fide public investors prior to delivering the investors' funds to the issuer of the securities in violation of SEC Rules 15c2-4 and 10b-9.

---

[1] References to the exhibits submitted by Enforcement at the hearing will be designated as "CX-" with the page number or paragraph number, as appropriate. The Parties also filed a joint stipulation of facts on January 7, 2000; references to the January Stipulation will be designated as "Stip. at ¶"

[2] The record establishes that the investigation that led to the Complaint was based on a routine examination of Interfirst. (Stip. at ¶3).

[3] Interfirst was not named as a respondent in this Complaint because it submitted a Letter of Acceptance, Waiver and Consent on February 23, 1999, which was accepted on April 15, 1999 ("AWC"). (CX-2). At the time of the private placement, Interfirst was known as Baraban Securities Incorporated. (CX-2). The firm changed its name to Interfirst in December 1996. (CX-33, p. 2).

Respondent filed an Answer, admitting Interfirst's violations of SEC Rules 15c2-4 and 10b-9, but denying responsibility for Interfirst's violations. Arguing that Bradford Phillips ("B. Phillips"), the owner of Interfirst, and his father, Gene Phillips ("G. Phillips"), were the responsible parties, Respondent requested a hearing.[4]

A hearing was held in Los Angeles, California, on January 20, 2000, before a Hearing Panel composed of a Hearing Officer and two current members of the District Committee for District No. 2. The Hearing Panel accepted as part of the record Enforcement's 34 exhibits. Respondent did not submit any exhibits. In addition, the Hearing Panel heard the testimony of (i) B. Phillips, (ii) Douglas Wright, the current chief operating officer and compliance officer,[5] and (iii) Respondent.

II. Findings of Fact and Conclusions of Law

A. Jurisdiction

Respondent was associated with Interfirst, from April 8, 1996 through February 14, 1997, as a general securities principal. (CX-1, p. 2). From July 29, 1998 to July 1, 1999, Respondent was employed by NASD member TransGobal Capital Corporation. (CX-1, p. 3). Enforcement filed the Complaint on April 5, 1999 while Respondent was associated with an NASD member firm. The NASD, thus, has jurisdiction over this proceeding.

---

[4] Arguing that it was clear that he was not the controlling owner, Respondent filed a motion for summary disposition on August 2, 1999. Enforcement filed an opposition to Respondent's motion on August 12, 1999. Finding there were issues of fact in dispute, the Hearing Panel denied Respondent's motion in a September 27, 1999 order.

[5] Mr. Wright was the compliance officer of Interfirst from June 1996. (CX-31, p. 3). In November 1997, Mr. Wright also became the chief operating officer of Interfirst. (CX-34, p. 3).

B. Acquisition of Interfirst

In April 1996, B. Phillips, a real estate professional located in Dallas, Texas, became interested in acquiring Interfirst, a broker-dealer with 11 California offices and approximately 700 brokers.[6] (Tr. pp. 24, 105). Using MHK Investment Corporation ("MHK"), an entity 100% owned by him, B. Phillips acquired control of Interfirst in a hostile takeover in April 1996 by purchasing both an Interfirst note receivable and 56% of Interfirst's common stock. (Tr. p. 25). At the time of the acquisition of control, B. Phillips did not have any NASD licenses, had never owned a brokerage firm, and had never been a general securities principal. (Tr. pp. 26-26).

Late in the takeover process, a business associate of B. Phillips recommended Respondent as someone who could manage Interfirst for B. Phillips. (Tr. p. 26). One day before MHK acquired control of Interfirst, B. Phillips and Respondent reached an agreement on April 3, 1996, whereby Respondent would be the chief operating officer of Interfirst. (Tr. p. 27).

When B. Phillips acquired control of Interfirst, he agreed in an April 8, 1996 letter to the NASD "not to participate in the securities business of [Interfirst] until such time that I am properly licensed to do so." (CX-30, p. 2). In June 1996, B. Phillips passed the Series 7 and Series 24 NASD licensing exams. (Tr. p. 29). Although B. Phillips obtained his NASD licenses, Respondent's responsibilities as the chief operating officer of Interfirst did not change.

---

[6] Respondent testified that approximately 50 of the 700 brokers generated approximately 90% of Interfirst's gross revenues. (Tr. p. 108).

(Tr. p. 31). B. Phillips was not on-site and was not involved in the day-to-day operations of Interfirst. (Tr. p. 54).

C. American Realty Trust Inc. Offering

As early as May 1996, B. Phillips suggested to Respondent that Interfirst do an offering for American Realty Trust, Inc. ("ART"), a company based in Dallas, Texas, whose common stock is listed on the New York Stock Exchange. (Tr. p. 32). ART's primary business is investing in equity interests in real estate projects, and financing real estate through investments in mortgage loans. (CX-3, p. 13). B. Phillips testified that he knew ART had an interest in raising capital. (Tr. p. 32; CX-3, p. 3).

The day-to-day real estate operations of ART are managed by Basic Capital Management, Inc. ("BCM"), which is owned by a trust created for the benefit of the children of G. Phillips.[7] (CX-3, p. 17). Ryan T. Phillips and Mickey Ned Phillips, members of the board of directors of BCM, are B. Phillips' brother and uncle, respectively.[8] (CX-3, p. 32). BCM owned approximately 38% of the outstanding shares of ART as of August 16, 1996. (CX-3, p. 17).

Although Respondent expressed reservations about Interfirst undertaking a securities offering for ART so soon after Interfirst's takeover, B. Phillips and Respondent agreed that Interfirst would undertake the private placement of the ART securities. (Tr. p. 33). Respondent

[7] BCM acted as the contractual advisor for ART. (CX-3, p. 28). The stated duties of BCM under the advisory agreement with ART included, among other things, investigating, evaluating, and recommending real property and mortgage loan investment opportunities for ART. (CX-3, p. 28). The advisory agreement automatically renewed from year to year unless terminated. (CX-3, p. 28).

[8] In addition, G. Phillips served as representative of the trust for the benefit of his children, and, in such capacity, he had substantial contact with the management of BCM and input with respect to BCM's performance of the advisory services for ART. (CX-3, p. 17).

spoke with the sales force to develop an interest in the offering and put together road shows with the various Interfirst brokers.[9] (Tr. p. 33).

In June 1996, Respondent interviewed and, with the approval of B. Phillips, hired Mr. Wright as Interfirst's compliance officer. (Tr. pp. 61-62). When he accepted the position as compliance officer, Mr. Wright explained that he "had no prior experience in offerings," and he "could not come up to speed fast enough to help them on any regulatory problems that may exist" in the proposed ART securities offering. (Tr. pp. 68-69). In response to Mr. Wright's concerns, Respondent indicated that he would handle the ART offering. (Tr. p. 69).

On August 26, 1996, Respondent executed the document entitled the Private Placement Agency and Dealer Manager Agreement ("Dealer Agreement"), which was the agreement between ART and Interfirst to manage the ART offering. (Tr. p. 38; CX-5). Pursuant to the Dealer Agreement, Interfirst undertook the private placement of ART's 11.5% senior subordinated notes due September 30, 1999. (CX-3, p. 1). Interfirst was to offer the securities on a "best efforts" basis subject to a minimum sale of $1,000,000 and a maximum sale of $5,000,000 in principal amount.[10] (CX-3, p. 1). If Interfirst did not sell $1,000,000 of the ART securities by the deadline, all funds received were to be refunded to the investors. (CX-5, p. 5).

---

[9] B. Phillips was "heavily involved" in the preparation of the offering memorandum for the ART offering and testified that Respondent also commented on the offering memorandum. (Tr. p. 36).

[10] A "best efforts" offering contrasts with a "firm commitment" offering in which the underwriter is obligated to purchase the securities to be sold to the public from the issuer and bears the risk of loss on any securities remaining unsold after the distribution is completed.

Beginning August 26, 1996, Interfirst offered and sold the ART securities in reliance upon exemptions from the registration requirements of the Securities Act of 1933 and the applicable State Blue Sky statutes.[11] (CX-3, p. 1). Distribution of the securities was limited to "accredited investors" (as defined in SEC Rule 501 of Regulation D) who were residents of, or domiciled in, the State of California in increments of $10,000.[12] (CX-3, p. 10). Investors in the offering were to deliver completed subscription forms and checks to Interfirst no later than September 30, 1996. (CX-3, p. 11).

1. Lack of Escrow Account

The Dealer Agreement provided that all sales would be conditioned upon the receipt of subscriptions accepted by ART on or before 180 days after the effective date of the offering for a minimum of $1,000,000 in principal amount. (CX-5, p. 5). The Dealer Agreement also provided that, if the minimum sales were not achieved, persons who subscribed for the securities would be refunded their subscription price without interest.[13] (CX-5, p. 5).

Despite the contingent nature of the ART offering, Interfirst did not set up an escrow account to hold investors' funds received during the interim, based on the legal advice provided

---

[11] As part of the AWC, Interfirst offered rescission or early redemption to the ART investors on or before April 30, 1999. (CX-2, p. 3). To the extent that the offer of rescission was accepted by investors, Interfirst provided full and complete restitution. (CX-2, p. 3).

[12] The Private Placement Memorandum stated that the securities would be offered and sold to any individual: (i) whose net worth (or joint net worth together with his spouse) exceeded $1,000,000, or (ii) whose income exceeded $200,000 (or joint income together with his spouse exceeded $300,000) in each of the two most recent years, and the individual reasonably expected such (joint) income to exceed such amount in the current year. (CX-3, p. 11).

[13] The Private Placement Memorandum indicated that ART was offering "$5,000,000 in principal amount of 11 1/2% Senior Subordinated Notes (Minimum Offering $1,000,000)." (CX-3, p. 1). Although the Private Placement Memorandum stated that no commissions would be paid and no subscriptions would be accepted until at least $1,000,000 in subscriptions had been received, it did not disclose that the deadline for

by Mr. Metzger, an attorney with a small law firm in Dallas, Texas, who represented ART. (Tr. pp. 34, 36). Mr. Metzger assured B. Phillips that an escrow account was not necessary. (Tr. p. 40). Consequently, the Dealer Agreement stated that no arrangements had been made for placing funds received in any special account with a national bank until the contingency was met. (CX-5, p. 5). The subscription checks were made payable to "American Realty Trust, Inc.," and Interfirst immediately sent them to ART upon receipt. (CX-5, pp. 5, 100).

Respondent did not seek legal advice on behalf of Interfirst on the escrow issue; he signed the Dealer Agreement that failed to include a provision for an escrow account; and he approved the arrangements whereby the investors' checks were immediately forwarded to ART. (Tr. pp. 99, 102, 114-115)

About September 3, 1996, an Interfirst employee, upon review of the Private Placement Memorandum, notified Mr. Wright, the compliance officer, that an escrow had not been established for the ART offering, and, in his view, an escrow was required by the rules. (Tr. p. 74). Mr. Wright relayed this concern to Respondent. (Tr. p. 75). In response to Mr. Wright's concerns, Respondent spoke with Mr. Metzger and advised Mr. Wright that an escrow account was not required based on an attorney's advice. (Tr. p. 76). Respondent admitted that he never asked the NASDR staff whether an escrow account was required for the ART offering, despite the fact that he was in contact with the NASDR staff regarding other matters during this period. (Tr. p. 99).

---

meeting the $1,000,000 minimum amount was 180 days after the offering began, nor that investors' funds would be refunded, if Interfirst failed to sell the $1,000,000 minimum by the deadline. (CX-3, p. 38; CX-5, p. 5).

2. Davister Corp.'s Investment in the ART Offering

B. Phillips testified that investor interest in the ART offering was not as great as Interfirst had anticipated. (Tr. p. 43). After Interfirst received approximately $700,000 in commitments to purchase the ART offering, B. Phillips told Respondent that he knew of a company in Dallas that had a cash balance that could take the remainder of the offering. (Tr. p. 44). B. Phillips testified that he knew that Davister Corp., based in Dallas, Texas, had significant uninvested cash. (Tr. p. 43). Davister Corp., owning approximately 14.2% of ART's common stock through Nanook Partners, L.P. as of March 15, 1996, was an affiliate of ART. (CX-26, pp. 90, 93; Stip. at ¶6). Respondent signed Davister Corp.'s Interfirst account form as its registered representative on July 16, 1996. (CX-23, p. 1; Stip. at ¶6).

The question of whether Davister Corp. could be a bona fide purchaser in the ART offering because of its affiliation to ART was raised, and Mr. Metzger, ART's legal counsel, concluded that there was no issue. (Tr. p. 44). Mr. Metzger explained to B. Phillips and Respondent that, although Davister Corp. was a general partner of a partnership that owned more than 10% of ART's common stock, it did not qualify as a related party because it was a non-managing partner of the partnership. (Tr. pp. 43-44).

On September 27, 1995, Davister Corp. completed subscription forms for the ART offering. (CX-22). Davister Corp. then wrote two checks in the amounts of $350,000 and $40,000 dated September 27, and September 30, 1996, which, although immediately

forwarded to ART, were not deposited into ART's account until a full month later, in October.[14] (Tr. p. 44; Stip. at ¶6).

On September 30, 1996, ART received subscriptions totaling $1,020,000, including Davister Corp.'s $390,000 subscription. (CX-6). Consequently, ART determined that $1,000,000 minimum sale was met, and the private placement was closed on that date. (CX-4; Stip. at ¶5). Beginning September 30, 1996, ART deposited into its bank account the investors' checks it had received previously from Interfirst. (CX-24; Stip. at ¶5).

D. Discussion

In a minimum contingency offering, SEC Rule 15c2-4 requires that funds received by a broker-dealer participating in the offering be properly segregated in a separate trust or agency account or be deposited pursuant to an escrow arrangement until the contingency occurs.[15] In contravention of SEC Rule 15c2-4, Interfirst did not establish an escrow or separate account of any kind for the receipt of the investors' funds pending the satisfaction of the contingency. Instead, checks were made payable to ART and delivered by Interfirst to ART immediately upon receipt.

---

[14] Drew Potera, the treasurer of ART, was also the treasurer of Davister Corp. (CX-3, p. 28; CX-23, p. 1). Mr. Potera was also the vice president and treasurer of BCM, ART's management company. (Stip. at ¶6).

[15] SEC Rule 15c2-4 provides, in relevant part: "It shall constitute a 'fraudulent, deceptive or manipulative act or practice,' … for any broker … participating in any distribution of securities … to accept any part of the sale price of any security being distributed unless: … (b) If the distribution is being made on … any … basis which contemplates that payment is not to be made to the person on whose behalf the distribution is being made until some further event or contingency occurs: … (2) all such funds are promptly transmitted to a bank which has agreed in writing to hold all such funds in escrow for the persons who have the beneficial interests therein and to transmit or return such funds directly to the persons entitled thereto when the appropriate event or contingency has occurred."

SEC Rule 10b-9 provides that it is a deceptive practice to make a representation that an offering is a minimum contingent offering, unless such offering is made on the condition that the investor's purchase price will be refunded promptly if the minimum number of securities offered are not sold at the specified price within the specified period of time. A minimum contingency offering is to be closed only if the contingency occurs, i.e., the minimum amount due the issuer is received by the specified date.[16] This representation gives investors assurance that a contingency offering will go forward only if enough investors demonstrate by their purchases that the risk associated with the offering is worth taking and the price being paid for the securities is fair.[17]

In a 1975 release, the SEC stated that an offering may not be considered "sold" for purposes of the representation unless the securities are sold in bona fide transactions and the purchase prices are fully paid.[18] When an entity with a significant stake in the success of a contingency offering purchases securities in order to meet the contingency and close the offering, without disclosing such possible purchases, a facade of a successful offering is created, and the representation as to the nature of the contingent offering is made false in violation of Rule 10b-9.

---

[16] SEC Rule 10b-9 provides, in relevant part: "It shall constitute a 'manipulative or deceptive device or contrivance" … for any person, directly or indirectly, in connection with the offer or sale of any security, to make any representation: … (2) To the effect that the security is being offered or sold on any … basis whereby all or part of the consideration paid for any such security will be refunded to the purchaser if all or some of the securities are not sold, unless the security is part of an offering … being made on the condition that all or a specified part of the consideration paid for such security will be promptly refunded to the purchaser unless: (A) a specified number of units of the security are sold at a specified price within a specified time …."

[17] District Bus. Conduct Comm. for Dist. No. 1 v. Progressive Asset Management, Inc., Complaint No. C01930037 (NBCC Dec. 7, 1995) ("SEC Rule 10b-9 serves to ensure that investors are given protection in the form of potential return of their funds if the market determines that an offering is too risky or is overvalued").

[18] Exchange Act Rel. No. 11532 (July 11, 1975).

In this case, Davister Corp., owning 14.2% of ART, had a significant stake in the success of ART's contingency offering, and, consequently, was not a bona fide investor. Interfirst's failure to disclose in the Private Placement Memorandum that an affiliate of the issuer could make purchases in order to meet the contingency violated Rule 10b-9. The minimum contingency offering was closed even though minimum amount due the issuer was not received by the specified date. Specifically, $320,000 of the minimum contingency was not met without Davister Corp.'s $390,000 investment in the offering.

Respondent does not dispute that Interfirst violated SEC Rules 15c2-4 and 10b-9. The only open question was whether Respondent was responsible for Interfirst's violations of SEC Rules 15c2-4 and 10b-9.

Enforcement argued that Respondent, as the chief operating officer and the general securities principal in charge of the ART offering, was responsible for the violations. In addition, Enforcement noted that Respondent signed the defective Dealer Agreement on behalf of Interfirst, and the firm's written supervisory procedures designated Respondent as the responsible principal for corporate finance, selling group and underwriting activities.

Respondent argued that B. Phillips was the responsible party. Respondent stated that B. Phillips was the controlling and beneficial owner of the holding company that owned Interfirst and was a general securities principal at the time of the ART offering. (Tr. p. 18). Respondent argued that all major decisions concerning the firm were decided by B. Phillips, and B. Phillips was determined to complete the ART offering.[19] (Tr. pp. 20, 110).

[19] Respondent also argued, but provided no evidence, that B. Phillips in pursuing the ART offering was following the instructions of his father, G. Phillips. (Tr. pp. 110, 115).

In addition, Respondent argued that he received an opinion of counsel on the escrow and the affiliation issues on which he relied. (Tr. p. 107). Respondent essentially argued that he simply followed the directions of Mr. Metzger, whom he described as B. Phillips' attorney, and B. Phillips, his boss, and he should not be penalized for doing so.

The Hearing Panel disagrees. First, to establish the defense of reliance on advice of counsel, a respondent must show that he (1) made complete disclosure to counsel; (2) sought counsel's advice as to the legality of his conduct; (3) received advice that the conduct was legal, and (4) relied in good faith on that advice.[20] Respondent admitted that he did not hire Mr. Metzger as Interfirst's counsel.[21]

Second, reliance on B. Phillips was unreasonable in the context of Respondent's extensive experience. Rule 15c2-4 imposes "an obligation on broker/dealers to safeguard investor funds and ensure that they are not disbursed to the issuer before the contingency is met."[22] "Rule 10b-9 requires that a ["part or none"] offering must provide that investor funds will be returned if the required minimum proceeds are not raised by the stated offering deadline."[23] With more than 18 years of securities experience, Respondent should have known of these requirements. (CX-30, p. 4).

---

[20] District Bus. Conduct Comm. for Dist. No. 8 v. Norman E. Mains, Complaint No. C8A950016 (NBCC Jan. 3, 1997).

[21] In any event, reliance on advice of counsel does not serve as a substantive defense in this matter because such a defense serves only to negate the element of scienter, and such defense is unavailable for a violation of Conduct Rule 2110 because scienter is not an element of the violation. Id.

[22] District Bus. Conduct Comm. for Dist. No. 9 v. Covato/Lipsitz, Inc., Complaint No. C9A920043 (NBCC Mar. 15, 1994).

[23] In re Richard H. Morrow, Exchange Act Rel. No. 40392, 1998 SEC LEXIS 1863, *9-10 (Sept. 2, 1998).

Respondent, as the chief operating officer of the firm, had a duty to ensure that Interfirst when soliciting investors in a minimum contingency offering safeguarded the investors' funds until the contingency was met, i.e., by setting up an escrow account. Respondent knew that Mr. Metzger was ART's counsel and could have motivations in connection with the offering that might conflict with a broker-dealer's obligation to its customers. When the escrow issue was raised again on September 3, 1996, Respondent should have made an effort, at a minimum, to obtain legal advice on behalf of Interfirst. Although Respondent's assumption that B. Phillips would insist that Interfirst follow the advice of Mr. Metzger may have been a reasonable assumption, it did not justify Respondent's failure to attempt to obtain legal advice on behalf of Interfirst.

Respondent must take part of the responsibility for the firm failing to establish an escrow account. Respondent signed the Dealer Agreement on behalf of Interfirst so he knew that the agreement was defective in not including an escrow provision. Although admitting that he oversaw all the operations of the firm, Respondent made no effort to safeguard the investors' funds when he permitted the checks to be immediately forwarded to ART upon receipt. (Tr. p. 63). Respondent cannot deny responsibility for the ART offering when the NASDR staff was directed to contact Respondent if they had any questions about the ART offering in an August 26, 1996 letter, approved by Respondent, from Mr. Wright to the NASD. (CX-28, p. 1).

With respect to the violation of SEC Rule 10b-9, Respondent knew, prior to the closing, that there was a question of whether the $1,000,000 contingency had been met because of Davister Corp.'s affiliation with ART. Respondent knew, or should have known, that the Private Placement Memorandum had not disclosed the possibility of an affiliated party

purchasing the securities to meet the conditions of the contingency and close the offering. Although Respondent again relied on the advice of Mr. Metzger, Respondent, as the chief operating officer of the firm, was at least reckless in failing to ensure that Interfirst obtain its own legal advice concerning the affiliate issue.

Respondent participated in, and contributed to Interfirst's violation of SEC Rules 15c2-4 and 10b-9. Thus Respondent cannot reasonably argue that the entire blame for the violations should be shifted to B. Phillips.[24] It is well settled that violations of SEC Rules 15c2-4 and 10b-9 constitute violations of NASD Conduct Rule 2110.[25] The Hearing Panel concludes that Respondent violated NASD Conduct Rule 2110 because he was responsible in part for Interfirst violating SEC Rules 15c2-4 and 10b-9.

III. Sanction

For escrow violations of SEC Rule 15c2-4 and Conduct Rule 2110, the Sanction Guidelines recommend a fine between $1,000 to $10,000 and suspension in any or all capacities for up to 30 business days in egregious cases.[26] For violations of SEC Rule 10b-9 and Conduct Rule 2110, the Guidelines recommend a fine between $5,000 to $50,000, and suspension in any or all capacities for up to two years in egregious cases.[27] Because the violations of SEC Rules 15c2-4 and 10b-9 (in this case Conduct Rule 2110) are so closely

[24] Because the Hearing Panel credits Respondent's testimony that there were several revisions to the Supervisory Procedures and the September 13, 1996 version was not authentic, the Hearing Panel does not rely on the Interfirst's Supervisory Procedures dated September 13, 1996 to find that Respondent was the principal in charge of the ART offering. (Tr. p. 117; CX-27, p. 2).

[25] Norman E. Mains, Complaint No. C8A950016 (NBCC Jan. 3, 1997).

[26] NASD Sanction Guidelines, p. 21 (1998).

[27] Id.

related, Enforcement recommended, and the Hearing Panel finds it appropriate, that a single sanction be imposed on Respondent.

In determining the sanctions to be imposed, the Hearing Panel reviewed both the factors that are specifically listed for escrow violations of SEC Rules 15c2-4 and 10b-9 and the general factors that are listed for any violation. In this case, the Hearing Panel found the following specific factors to be aggravating: (1) the funds were released before the contingency occurred; (2) the funds were exposed to substantial risk of loss, and (3) at the deadline, the offering was well short of the minimum stated in the Private Placement Memorandum – in fact, the offering had raised only 66% of the minimum amount from bona fide purchasers by the deadline.[28]

The general factors listed in the Guidelines included: (1) the respondent's relevant disciplinary history; (2) whether the respondent accepted responsibility for and acknowledged the misconduct; (3) whether the respondent engaged in the misconduct over an extended period of time; (4) the number, size, and character of the transactions at issue; (5) whether the respondent's misconduct was the result of an intentional act, recklessness, or negligence; (6) whether the respondent demonstrated reasonable reliance on competent legal advice; and (7) the level of sophistication of the injured or affected customer.[29]

The Hearing Panel found several of the general factors were aggravating. First, Respondent had been the subject of two prior regulatory disciplinary actions. One of the two actions concerned a stock offering and should have sensitized Respondent to the matters

---

[28] Id.

[29] NASD Sanction Guidelines, Principal Consideration Nos. 1, 2, 7, 9, 13, 18, and 19, pp. 8-9 (1998).

surrounding stock offerings. The stock offering violation involved a violation of Section 5 of the Securities Act of 1933 when Respondent sold shares of stock without a final registration statement being in effect, i.e., "gunjumping." (Tr. p. 97). Respondent was censured, fined $5,175, and ordered to requalify as a general securities principal on October 10, 1997 pursuant to an offer of settlement. (Stip. at ¶2). In the second disciplinary action, the American Stock Exchange sanctioned Respondent for making unsuitable recommendations to a customer in 1991.[30] (Tr. p. 99).

Second, the Hearing Panel noted as an aggravating factor, Respondent's refusal to shoulder any responsibility for Interfirst's violations although he was the chief operating officer at the time and had been hired to run the firm.

Third, the Hearing Panel noted that the misconduct continued for approximately a month, and the misconduct put at risk approximately $700,000 in proceeds from bona fide purchasers.

Fourth, the Hearing Panel particularly noted that, in the absence of an escrow account, Respondent appeared to have made no arrangements to safeguard the investors' funds during the interim when Interfirst was attempting to sell the minimum number of securities. (Tr. p. 100). He did not appear to know what, if any, arrangements had been made by ART to safeguard the funds pending the closing. (Tr. p. 102).

Fifth, although the Hearing Panel found that Respondent did not intend to violate the SEC rules, the Hearing Panel found that his conduct was reckless. Respondent has been in the

[30] On June 27, 1991, Respondent consented to a finding by the American Stock Exchange that he executed options transactions in a customer's account that were unsuitable, and he used discretion in a customer's

securities business for eighteen years since 1982. (CX-30, p. 4; Stip. at ¶1). During the eighteen years, he owned his own securities firm for two years and, more recently, was a managing director of another NASD member. (CX-30, p. 4). The Hearing Panel was deeply concerned that someone with Respondent's substantial securities experience did not question the advice given that an escrow account was not required and that Davister Corp., owning more than 10% of ART, was not an ART affiliate. At a minimum, Respondent should have requested B. Phillips's approval to obtain legal counsel for Interfirst on the issues.

The Hearing Panel considered the following general factors as slightly mitigative. Respondent relied on an attorney who appeared to Respondent to understand and address the issues. Because of B. Phillips' close relationship to the management of ART and B. Phillips' confidence in ART's counsel, Respondent may have been less skeptical than he should have been regarding the advice of ART's counsel. Finally, the affected customers were accredited investors and, therefore, were fairly sophisticated.

However, after weighing the aggravating specific factors and the aggravating and mitigating general factors, the Hearing Panel determines that this is an egregious case, and the violations warrant substantial sanctions. Enforcement requested that Respondent be fined $10,000 and suspended for one year as a securities principal. The Hearing Panel finds that Enforcement's recommended sanctions are appropriate and, consequently, fines Respondent $10,000 and suspends him for one year in the capacity of a securities principal.

---

account without obtaining written authorization or prior approval of a registered options principal. (Stip. at ¶2). Respondent agreed to a censure and a fine of $10,000 in that matter. (Stip. at ¶2).

IV. Order

Therefore, based on the evidence submitted, the Hearing Panel fines Respondent $10,000 and suspends him for one year in the capacity of a securities principal. These sanctions shall become effective on a date set by the Association, but not earlier than 30 days after the date this decision becomes the final disciplinary decision of the Association.[31] If this Decision becomes the final disciplinary decision of the Association, without an appeal or call for review, the suspension shall become effective on October 16, 2000 and shall end on October 16, 2001.

SO ORDERED.

Hearing Panel

____

by: Sharon Witherspoon
Hearing Officer

Dated: Washington, DC
August 28, 2000

Copies to:
Joseph G. Gerace (Airborne Express, first class mail, and electronic mail)
Sylvia M. Scott, Esq. (electronic mail and first class mail)
Rory C. Flynn, Esq. (electronic mail and first class mail)

[31] 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.