NASD REGULATION, INC.
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. RICHARD F. DAMBAKLY (CRD #2397176) Brooklyn, New York, Respondent.	Disciplinary Proceeding No. C3A980077 Hearing Officer—Andrew H. Perkins **Hearing Panel Decision** September 17, 1999

Digest

The Department of Enforcement filed a Complaint alleging that Respondent Richard F. Dambakly violated NASD Rules 2110 and 3040 by participating in the issuance of four promissory notes without giving his employers prior written notification. Dambakly filed an Answer denying the charge. Prior to the hearing, the Hearing Panel granted Enforcement's motion for summary disposition on the issue of liability and deferred making a finding on sanctions. Following the hearing, the Hearing Panel determined that Dambakly should be fined $25,000, barred in his capacity as a principal, and suspended for one year from associating with any NASD member firm in any capacity. The Hearing Panel also ordered Dambakly to pay costs in the amount of $2,479.25.

Appearances

Roger D. Hogoboom, Jr., Regional Counsel, Denver, Colorado, and Rory C. Flynn, Chief Litigation Counsel, Washington, DC, counsel for the Department of Enforcement.

Leonard C. Aloi, Bronx, New York, counsel for Richard F. Dambakly.

I. Introduction

Enforcement charged Richard F. Dambakly (Dambakly) with violation of NASD Conduct Rules 2110 and 3040, which prohibit associated persons from engaging in private securities transactions without first giving their employer prior written notice of the proposed transaction. Specifically, the Complaint alleges that Dambakly participated in the issuance of four promissory notes by Trigon Corporation (Trigon)[1] while he was associated with Paramount Investments International, Inc. (Paramount), a member of the National Association of Securities Dealers, Inc. ("NASD"), and that he did not give Paramount prior written notice of his proposed participation in their issuance. The Complaint further alleges that after the promissory notes were issued Dambakly left Paramount and established a branch office of Paragon Capital Corporation ("Paragon"), an NASD member, where he used the proceeds from the loans to pay the branch office's operating expenses. The Complaint also alleges that Dambakly failed to give Paragon written notice of the loans.

Enforcement contended that, under Rule 3040, Dambakly was obligated to give both Paramount and Paragon notice of these loans. The Hearing Panel, however, rejected Enforcement's theory that Dambakly was required to give Paragon written notice of the receipt of each loan installment. The Hearing Panel concluded that Dambakly's violation of Conduct Rule

[1] From the documents submitted by Enforcement, it appears that the issuer's name actually is Trigon Incorporated.

3040 was complete when he failed to notify Paramount of the proposed transactions. Therefore, Dambakly did not commit separate violations of Conduct Rule 3040 by not providing Paragon with written notice of his receipt of each loan installment. Instead, the Hearing Panel considered the circumstances surrounding Dambakly's financing of the Paragon branch office as aggravating factors bearing on the issue of sanctions.[2]

II. Procedural Background

On December 11, 1998, Enforcement filed the Complaint in this disciplinary proceeding. Dambakly failed to answer within the time permitted under Rule 9215(f) of the Code of Procedure, and the Hearing Officer issued an order setting a deadline for Enforcement to file for entry of a Default Decision. Dambakly responded to this order and requested leave to file a late answer. The Hearing Officer granted this request following a pre-hearing conference, and Dambakly filed his Answer on March 25, 1999. In his Answer, Dambakly admitted that Trigon issued four promissory notes on January 18, 1996, and that he signed each of the notes as Trigon's President. Dambakly further admitted that he used the loan proceeds to pay the general operating and other expenses associated with Paragon's branch office. He generally denied the remaining allegations in the Complaint.

On May 14, 1999, Enforcement moved for summary disposition. In support of its motion, Enforcement filed a Statement Of Undisputed Facts, a Memorandum Of Points And Authorities In Support Of Complainant's Motion For Summary Disposition, and the Declaration Of Donald Lopezi, the staff examiner for NASD Regulation, Inc. ("NASDR") who conducted the

[2] Enforcement did not charge Dambakly's conduct at Paragon as a distinct violation of Conduct Rule 2110, independent of Conduct Rule 3040.

examination that led to the filing of the Complaint. Enforcement also filed 21 exhibits with Lopezi's declaration. Dambakly opposed the motion by filing a document entitled "Affirmation In Opposition Cross Motion To Dismiss" signed by his attorney. The affirmation did not identify any genuine disputed material issues of fact, and the Hearing Panel therefore granted the motion on the issue of liability and continued the case for a hearing on the issue of sanctions. (Order Granting Partial Summary Disposition In Favor Of The Department Of Enforcement And Continuing This Proceeding For Hearing On Sanctions, June 23, 1999.)

A hearing was held in New York City on July 8, 1999, before a panel composed of the Hearing Officer and two current members from the District 10 Committee of the NASD. Enforcement called two witnesses to testify and introduced into evidence the 21 exhibits it had submitted with its motion for summary disposition.[3] Dambakly testified on his own behalf, but he did not offer any other evidence.

III. Findings of Fact

A. Dambakly's Background and Association with Paramount

Dambakly entered the securities industry in June 1993 when he joined A.S. Goldman & Co., Inc. He worked there and later at Joseph Stevens & Company as a General Securities Representative before joining A.T. Brod & Co., Inc. ("Brod") in December 1994. (Ex. C1.) Dambakly worked for Brod until it closed in or about March 1995. (Tr. 128.) Shortly after Brod closed, the President of Paramount, Terrence Butler, approached Dambakly and asked if he

[3] References to Enforcement's exhibits are "Ex. C[number]," and references to the hearing transcript are "Tr. [number]." All transcript references are to the transcript page numbers, not the exhibit page numbers.

would come to work at Paramount. Dambakly agreed, and he joined Paramount as a General Securities Representative in April 1995. (Ex. C1.)

Paramount hired Dambakly to run a new branch office in New York. However, for the first six months, Dambakly worked in Denver, Colorado. (Tr. 130.) While he was there, Paramount opened an office at 120 Wall Street, New York, New York, and Dambakly transferred to that office in late 1995. (Tr. 131.)

When Mr. Butler opened the Paramount branch office at 120 Wall Street, he put the lease in Trigon's name. Mr. Butler had established Trigon as the operating company for the new office. Its purpose was to own the assets, including the lease, and pay the operating expenses for the branch office at 120 Wall Street. (Tr. 185.) Trigon had no other assets or operations, and it was not a registered broker-dealer. Mr. Butler was Trigon's President, and he owned 75% of the company. Dambakly was a Vice President, and he owned the remaining 25%. (Tr. 209.)

1. Dambakly's Association with Paramount

Dambakly managed the 120 Wall Street Office from in or about October 1995 until January 1996. During that time, it appears that the office operated normally. Dambakly testified that the 120 Wall Street Office conducted "business as usual" in December 1995. (Tr. 201.) But shortly after the New Year, Dambakly discovered that they could not call in a trade because the firm was shut down due to regulatory problems. (Tr. 134, 169, 172, 203.) Although Dambakly vacillated on the exact date Paramount closed—and Enforcement did not know the date—the evidence overall supports the Hearing Panel's conclusion that Paramount ceased operations during the first week of January 1996. (Tr. 169, 203.)

Paramount's failure surprised and upset Dambakly because Mr. Butler had given him no indication that the firm was in jeopardy. (Tr. 201.) In fact, Mr. Butler had always assured Dambakly that Paramount was adequately capitalized and that it was going to grow. (Tr. 183-84.) Thus, upon learning that he could no longer place trades, Dambakly immediately flew out to Denver to confront Mr. Butler.

Dambakly's testimony concerning his confrontation with Mr. Butler is conflicting. On the one hand, Dambakly testified that Mr. Butler was "not in Denver, [he was] nowhere in sight." (Tr. 218.) Indeed, Dambakly described Paramount's offices as being in total disarray when he arrived. People were leaving the firm and papers were strewn about. (Tr. 170.) On the other hand, he testified that he confronted Mr. Butler and that they had a "falling out." (Tr. 133, 184.) But Dambakly further testified that he was not in a position to confront Mr. Butler because Dambakly wanted to get the lease for the 120 Wall Street Office so that he could continue in business with another broker-dealer. (Tr. 168, 184.) In his words, he had to "put his tail between his legs" rather than alienate Mr. Butler. (Tr. 184.)

Dambakly also testified that he resigned from Paramount during his trip to Denver. However, the evidence regarding Dambakly's resignation is equally contradictory. Dambakly testified that he delivered a written letter of resignation when he went to Paramount's Denver office, but he had no record of the letter. (Tr. 167-70, 201.) He also failed to produce any other corroborating evidence of his claimed resignation. (Tr. 169.) Rather, all of the credible evidence indicates that he remained associated with Paramount until February 1996.

On March 11, 1996, Dambakly filled out and signed a Uniform Application For Securities Industry Registration Or Transfer (Form U-4) in which he represented that he was

associated with Paramount until February 1996. (Ex. C2.) In addition, the Uniform Termination Notice For Securities Industry Registration (Form U-5) filed on his behalf by Paramount on March 5, 1996, reflects that he was associated with Paramount until February 1996. (Ex. C1, at 12.) When asked about the discrepancy between his testimony that he left Paramount in January and the forms indicating that he remained with Paramount until February, Dambakly could only suggest that it resulted from Paramount's disarray. (Tr. 170.) But Paramount had no involvement in completing the Form U-4. Dambakly filled it out himself by hand.

In summary, the Hearing Panel finds Dambakly's conflicting account of his actions in early January 1996 to be unreliable and contradicted by other reliable evidence in the record. Accordingly, from the credible evidence, the Hearing Panel concludes that Paramount was an NASD member until at least early March 1996, and Dambakly was associated with Paramount until February 1996, as reflected on his hand-written Form U-4.

B. Dambakly's Financing and Operation of the 120 Wall Street Office

To continue in the securities business at the 120 Wall Street Office, Dambakly had to do three things: (1) acquire Trigon, which owned the office lease and equipment; (2) obtain financing; and (3) associate with another broker-dealer.

1. Dambakly's Agreement to Acquire Trigon

Sometime in the first two weeks of January 1996, Mr. Butler telephoned Dambakly, and they worked out an agreement by which Dambakly would purchase Mr. Butler's interest in Trigon for $50,000. (Tr. 135, 187-88, 218-19.) Under the agreement, Dambakly was obligated to pay Mr. Butler a down payment of $25,000 (Tr. 219), but to do so he needed to obtain a loan.

2. Dambakly's Financing for the 120 Wall Street Office

Dambakly secured financing through John Chapman. Dambakly had met Mr. Chapman briefly at a Paramount office Christmas party in December 1995 at which Mr. Butler introduced Mr. Chapman as an investment banker or venture capitalist. (Tr. 133, 154-55.) Although Mr. Chapman and Dambakly had no other contact, according to Dambakly, Mr. Chapman called him "out of the clear blue" in early January 1996 and asked Dambakly how he was doing. (Tr. 173-74.) Dambakly told Mr. Chapman that his office was closed and that he would like to get it up and running again, but he did not have the necessary capital. (Id.) Dambakly also told Mr. Chapman that Mr. Butler had the office lease and that he was demanding to be paid to let Dambakly take it over. Mr. Chapman then said that he had a venture capitalist that could help. (Tr. 174.) Mr. Chapman did not supply any details, and Dambakly did not ask any questions. (Tr. 175.) Dambakly understood, however, that Mr. Chapman did not intend to invest any of his own money. (Tr. 178.)

Without further discussion, Mr. Chapman arranged a $400,000 loan, evidenced by four promissory notes of $100,000 each. (Ex. C4.) Except for the lenders, the four promissory notes are identical. Trigon is the borrower, and each has a two year term and bears interest at the rate of 18% per year. In addition, the notes grant the lenders a security interest in Trigon.

The lenders on three of the promissory notes are offshore corporations. Premier Sales Corporation, Ltd. and The China Connection, Ltd. are incorporated in the Isle of Man, and Consolidated Euro Holdings, Ltd. is incorporated in the West Indies. The fourth lender, Oxford Consulting, Inc., is a Nevada corporation. Dambakly had no prior dealings with any of these corporations, and he did not know the identity of any of their principals. (Tr. 156.)

The promissory notes were prepared by an attorney in Utah retained by Mr. Chapman. On or about January 18, 1996, the attorney brought the notes to New York for Dambakly's signature. (Tr. 113, 143, 175.) Although Dambakly had not discussed the terms of the promissory notes before the attorney arrived, Dambakly asked few questions. Dambakly admitted that he was desperate, and he considered the terms of the notes to be non-negotiable. (Tr. 182.) Consequently, he signed the promissory notes on Trigon's behalf without any change.

Dambakly admits that he did not give Paramount written notices of his involvement in the issuance of any of these promissory notes. (Tr. 149.)

3. Dambakly's Association with Paragon and Application of the Loan Proceeds

Dambakly spent his time between January and March 1996 looking for a firm with which to associate. His goal was to retain the existing staff and reopen as a branch office of another firm. Dambakly testified that during this time all of the 20 to 25 brokers at the 120 Wall Street Office came in each day but did not conduct any securities business. (Tr. 134, 212.) Dambakly claimed that all he and his brokers could do was call their clients and tell them to sit tight until they associated with a new firm. (Tr. 214.) According to Dambakly, their accounts had been taken over by Hanifen, Imhoff, Inc., Paramount's clearing firm. (Tr. 212-14.)

By early March 1996, Dambakly was close to closing on a deal to associate with SunPoint Securities when Richard O'Reilly, a principal at Paragon, solicited Dambakly to join Paragon. (Tr. 136-37, 228.) Dambakly suggested that he would be interested in Paragon if he would be permitted to establish and manage an Office of Supervisory Jurisdiction ("OSJ"). (Tr. 138.) Paragon accepted Dambakly's proposal and immediately had an Office Of Supervisory Jurisdiction Agreement ("OSJ Agreement") prepared. (Ex. C8.) Paragon rushed to bring

Dambakly and the other former Paramount brokers on board. It took Paragon less than two weeks to work out the details and finalize the OSJ Agreement. During this time, no one at Paragon asked Dambakly about his finances. (Tr. 44, 72, 74, 88.) Rather, Mr. Argenziano, Paragon's Chief Financial Officer, concluded that Dambakly was adequately capitalized because the office appeared to be fully equipped. (Tr. 105.) Mr. Argenziano conducted no other financial due diligence before signing the OSJ Agreement on March 15, 1996. (Tr. 86-88.) Mr. Argenziano testified that he considered that the office could succeed based on the brokers' anticipated production. (Tr. 88.)

Under the terms of the OSJ Agreement, Dambakly is obligated to pay all of the expenses for the Paragon branch office at 120 Wall Street. Dambakly, however, intended to pay these expenses through a third-party corporation much as Paramount had done. He therefore formed Cyber National, Inc. ("Cyber National"), a Nevada corporation, after discovering that Trigon was heavily indebted. Accordingly, Mr. Argenziano required that Cyber National be a party to the OSJ Agreement so that Paragon could audit its books. (Tr. 81.) As it turned out, Dambakly used Trigon to pay the startup and operational expenses for the office, and Cyber National remained a shell. (Tr. 149, 159.)

Trigon received a total of $387,000 in installments from the lenders Mr. Chapman located. Except for the first installment, when Dambakly needed money, he contacted Mr. Chapman and the funds were wired to Trigon's account. The first installment was advanced before the promissory notes were signed. Around the first of January 1996, Mr. Chapman wired $25,000 directly to Mr. Butler in part payment of the agreed purchase price for his interest in Trigon. (Tr. 136, 157.) The remaining 20 installments totaling $362,000 were all made by wire

transfer to Trigon's account at Marine Midland Bank between March 6 and September 13, 1996. (Ex. C6.) Most of these funds came from sources other than the lenders named in the four promissory notes. One half of the transfers, totaling $240,000, originated with Canaccord Capital Corp., a Canadian broker-dealer; three originated with Union Securities, another Canadian broker-dealer; and one originated with Alan M. Berkun, who at the time was the owner of Marlowe & Company, a registered broker-dealer with the NASD.[4] (Ex. C14, Ex. C18.) The remaining transfers came from Oxford Consulting, one of the named lenders.

Enforcement traced the source of the funds from the two Canadian broker-dealers and discovered that the funds originated from five accounts at those firms: East-West Trading Corporation ("East-West"), Karston Electronics Limited ("Karston"), Tamarisk Enterprises, Ltd. ("Tamarisk"), World Financial Corporation ("World Financial"), and Lexington Sales Corporation Limited ("Lexington"). (Ex. C14.) Each of these firms is also a foreign corporation.

Records obtained from the Vancouver Stock Exchange indicate that East-West and Karston are owned by Gordon Heywood, a resident of the United Kingdom. East-West lists its principal place of business as Nevis, West Indies, and Karston lists its principal place of business as Tortola, British Virgin Islands. (Ex. C15, Ex. C16.) East-West had accounts at both Canaccord and Union Securities, and Mr. Chapman is designated as their representative on the account information forms. (Id.) Mr. Chapman had authority to trade in Karston's account.

The next two companies, Tamarisk and World Financial, have a number of common factors. Each has its principal place of business in the United Kingdom, and the Secretary of

[4] Among other sanctions, Mr. Berkun was barred from associating with any member firm under the terms of a settlement with the NASD dated September 16, 1998. (Ex. C18, at 13.)

Tamarisk is the President of World Financial. (Ex. C16, at 62.) Also, Alan Wolfson set up their accounts at Canaccord. (Ex. C16, at 62, 84.) Mr. Wolfson was a stock promoter who, in October 1996, was charged jointly with Mr. Chapman by the Securities and Exchange Commission in an administrative proceeding with violating the securities laws. (Tr. 145-46; Ex. C18.)

The final account that lent money to Trigon is Lexington, which has its principal place of business in the Isle of Man. The account documentation shows that Mr. Chapman was designated to receive the account statements and that he had trading authority in the account. (Ex. C16, at 146.)

A Field Supervisor with NASDR testified that he gathered the foregoing information about the persons lending money to Trigon because NASDR staff had detected an overlap between the securities Dambakly was trading at Paragon and the securities listed on the account statements for four account holders at Canaccord. (Tr. 115-16.) Many of the securities those companies invested in were securities that Dambakly and his brokers were trading at Paragon. Moreover, the NASDR staff learned that Dambakly and Paragon had entered into an arrangement with Cyber America, a company Mr. Wolfson was promoting. (Tr. 146, 237-38.) However, no direct evidence of wrongdoing was uncovered in this portion of the investigation. (Tr. 116.)

In or about October 1996, the NASD requested Dambakly to supply information about, among other matters, any private securities transactions he had engaged in since January 1995. (Ex. C5.) Mr. Argenziano reviewed Dambakly's response before it went to the NASD, at which point he claims that he discovered that Dambakly had borrowed money from non-family

members to finance the operations of the 120 Wall Street branch office.[5] Mr. Argenziano testified that as a result of this discovery he called Dambakly into his office for questioning. When Dambakly told Mr. Argenziano about the four promissory notes, Mr. Argenziano terminated the OSJ Agreement and closed the 120 Wall Street office on November 11, 1996. (Tr. 33-34; Ex. C12, at 1.)

Dambakly partially disputes Mr. Argenziano's testimony. Dambakly contends that he informed officials at Paragon about his loans right from the start. Dambakly also claims that at the time he signed the OSJ Agreement he told Alex Cherepakhov, the manager at Paragon, about the loans. (Tr. 144, 237.) Nevertheless, Dambakly concedes that he did not notify Paragon about his participation in the issuance of the four Trigon promissory notes, the identity of the lenders, or his use of the loan proceeds to pay the operating expenses of the 120 Wall Street Office. (Tr. 149.)

The Hearing Panel finds that Dambakly did not disclose the loans or his receipt of the loan proceeds to Paragon before he was questioned in November 1996.

IV. Conclusions of Law

A. Jurisdiction

The NASD has jurisdiction over Dambakly and this proceeding. Dambakly was registered with the NASD at the time of the alleged rule violations and at the time Enforcement filed the Complaint. His registration with the NASD terminated on December 23, 1998, and Enforcement filed the Complaint on December 11, 1998. (Ex. C1, at 1.)

[5] Mr. Argenziano testified that on his first visit to the 120 Wall Street Office, after the OSJ Agreement was signed, Dambakly told him that his father had lent him the money to get the office started. Mr. Argenziano admitted that he did not question Dambakly about the terms of the financing.

B. The Promissory Notes Are Securities

Conduct Rule 3040 prohibits any person associated with a member firm from participating in any manner in a private securities transaction outside the regular course of employment unless that person provides prior written notice to the member "describing in detail the proposed transaction and the person's proposed role therein and stating whether he has received or may receive compensation in connection with the transaction." Accordingly, the threshold question is whether the four promissory notes are securities. For the reasons below, the Hearing Panel concludes that they are.

Under the "family resemblance" test adopted by the Supreme Court in Reves v. Ernst & Young, 494 U.S. 56 (1990), a note is presumed to be a security as defined in Section 3(a)(10) of the Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(10), unless (1) it bears a strong resemblance to certain types of notes recognized, based on four factors, as being outside the investment market regulated under the securities laws, or (2) it should be added, based on a balancing of the same four factors, to that list of excluded notes.[6] The presumption is only rebutted when this analysis leads to the conclusion that the note is not a security.[7] "This reflects Congress's intent to define the term "security" with sufficient breadth to encompass virtually any instrument that might be sold as an investment."[8]

[6] The four factors are: (1) the motivations that would prompt a reasonable borrower and lender to enter into the transaction; (2) the plan of distributing the notes; (3) the reasonable expectations of the investing public regarding whether the instruments were securities; and (4) the presence of any alternative scheme of regulation or other factor that significantly reduces the risk of the instrument so as to make regulation under the securities laws unnecessary. Reves, 494 U.S. at 66-67.

[7] See, e.g., Stoiber v. S.E.C., 161 F.3d 745, 752 (D.C. Cir. 1998).

[8] In re Stephen J. Gluckman, Exchange Act Release No. 41628, 1999 SEC LEXIS 1395, at *10 (July 20, 1999).

The four Trigon notes do not resemble any of the certain types of commercial or consumer notes that are excluded from the definition of a security. Trigon's notes were sold to members of the general public as investments.[9] The notes' favorable interest rate indicates that profit was the lenders' primary objective.[10]

The remaining factors in Reves also indicate that the Trigon notes are securities and that they should not be added to the list of instruments excluded from coverage by the securities laws.[11] First, the plan of distribution extended beyond the immediate lenders. Several others invested through Canadian broker-dealers. Second, the manner in which the investors were approached on Trigon's behalf indicate that the investors would expect that the notes were investments.[12] All of the investors were located by broker-dealers or investment advisors, and none of the investors knew Dambakly. Finally, the investments were not insured, and there was no other factor present that reduced the investors' risk.[13]

C. Dambakly's Violation Of Rules 2110 and 3040—Private Securities Transactions

The Hearing Panel finds that Dambakly violated Rules 2110 and 3040 when he failed to give Paramount notice of his proposed involvement in the issuance of the four promissory notes on January 18, 1996. This violation is clearly established. Dambakly participated in the sale of

[9] See In re William Louis Morgan, Exchange Act Release No. 32744, 54 S.E.C. Docket 1611, 1993 SEC LEXIS 2027 (Aug. 12, 1993) (notes sold to finance branch office of broker-dealer held to be securities).

[10] See Stoiber, 161 F.3d at 750.

[11] The list of notes not considered securities consists of: notes delivered in consumer financing; notes secured by a mortgage on a home; short-term notes secured by a lien on a small business or some of its assets; notes evidencing a "character" loan to a bank customer; short-term notes secured by an assignment of accounts receivable; notes that simply formalizes an open-account debt incurred in the ordinary course of business; and notes evidencing a loan by a commercial bank for current operations. Reves, 494 U.S. at 65.

[12] See Gluckman, 1999 SEC LEXIS at *13.

[13] Id.

the four promissory notes issued by Trigon, and he admits that he failed to give Paramount written notice prior to their issuance.

Enforcement, however, contends that Dambakly also violated Rule 3040 by failing to give Paragon written notice before he received the loan proceeds while he was associated with Paragon. (Tr. 247-48.) In Enforcement's view, the receipt of the loan proceeds is inseparable from the original violation, and therefore each time Dambakly received money under the promissory notes without giving Paragon written notice of his participation in the transactions, he violated Conduct Rule 3040. On the other hand, Enforcement concedes that Dambakly would not have been obligated under Rule 3040 to give Paragon written notice of his participation in the loans if the original issuance of the notes had not been in violation of the Rule. (Tr. 248-49.) In other words, if Dambakly had given proper notice to Paramount or had not been associated with a broker-dealer when the notes were issued, he would not have been obligated to give Paragon written notice of the loans and his receipt of the loan proceeds.

The Hearing Panel rejects Enforcement's construction of Rule 3040. Not only has Enforcement offered no authority to support its view, but such a construction contradicts the plain language of the Rule. Conduct Rule 3040 requires that notice of a proposed private securities transaction be given before the broker participates in the transaction.[14] The violation is complete when the broker participates in the private securities transaction without having provided the required notice. The offense centers on the requirement to provide notice, not the various acts comprising the broker's participation in the private securities transaction.

[14] Morgan, 1993 SEC LEXIS at *8.

The purposes underlying the Rule also support the Hearing Panel's conclusion. The Rule is designed to protect the broker's firm from "exposure to loss and litigation, and investors from the hazards of unmonitored sales."[15] By failing to give written notice of the proposed private securities transaction investors are "deprived of the brokerage firm's oversight and supervision, a protection they have a right to expect."[16] These prophylactic purposes are best achieved by requiring notice before the broker participates in any manner in a proposed private securities transaction.

V. Sanctions

For violations of Rule 3040, the applicable NASD Sanction Guideline recommends a fine ranging from $5,000 to $50,000 and provides that "Adjudicators may increase the recommended fine amount by adding the amount of a respondent's financial benefit." The Guideline also recommends that the Adjudicator consider suspending a respondent for up to two years, and, in egregious cases, consider barring the respondent.[17]

In addition to the general factors that should be considered whenever imposing sanctions,[18] the Guideline directs Adjudicators to consider the following factors for violations of Rule 3040: (1) whether the respondent had a proprietary or beneficial interest in, or was affiliated with, the selling enterprise or issuer; (2) whether respondent attempted to create the impression that the employer member firm sanctioned the activity, for example, by using the employer's premises, facilities, name and/or goodwill for private transactions or by selling a product similar

[15] Morgan, 1993 SEC LEXIS at *8.

[16] Id. 1993 SEC LEXIS at *20-21.

[17] NASD Sanction Guidelines 15 (2d ed. 1998).

[18] NASD Sanction Guidelines 8-9 (2d ed. 1998).

to the products that the employer member firm sells; (3) whether the selling away involved customers of the employer member firm; and (4) whether the individual provided the employer with verbal notice of all relevant factors and, if so, the firm's verbal or written response, if any.

The Hearing Panel begins its analysis under the Guideline with the recognition that failure to give notice of private securities transactions is a serious offense. Investors are exposed to significant risk and loss where there is no oversight and supervision, and the NASD loses its ability to regulate sales practices when transactions are not disclosed. The Hearing Panel notes that the investors in this case lost their entire investment, a total of $382,000. Furthermore, the Hearing Panel finds that Dambakly had a proprietary or beneficial interest in Trigon, the issuer of the promissory notes. These factors warrant serious sanctions.

There are also the following mitigating factors. The Hearing Panel finds that there is no evidence that Dambakly attempted to create the impression that Paramount or Paragon sanctioned the transactions, nor is there evidence that any of the investors were Paramount or Paragon customers. In addition, Dambakly does not have a disciplinary history. Moreover, the Hearing Panel finds that some of the circumstances surrounding the issuance of the Trigon notes are mitigating. First, Paramount was no longer operating at the time Trigon issued the promissory notes. Thus, one of Rule 3040's primary purposes—to protect the firm from exposure to loss and litigation—is not implicated at the time the notes were issued. Second, Mr. Butler, the President and owner of Paramount, knew about the notes before they were issued. This is the equivalent of oral notice, a mitigating factor under the Guideline.[19] These factors would be substantially

[19] The Hearing Panel also notes that since Mr. Butler stood to benefit from the issuance of the notes through Dambakly's purchase of Trigon, it is unlikely that he would have questioned the transactions or provided much oversight of the transactions.

mitigating in the usual case. However, the Hearing Panel cannot ignore Dambakly's conduct after he left Paramount. He secured this financing for the express purpose of financing branch office operations at his next firm. Under these circumstances, the Hearing Panel considers Dambakly's failure to fully and accurately disclose the existence of the loans, the source of the borrowed funds, and Mr. Chapman's involvement to Paragon to be aggravating factors that warrant more than minimal sanctions. Although Dambakly's conduct while he was associated with Paragon did not violate Rule 3040 directly, his conduct raises significant regulatory concern. By not disclosing the existence and details concerning his operating loans, Dambakly insulated that aspect of Paragon's branch office from oversight by Paragon and the NASD.

Despite Paragon's apparent lax supervision and Mr. Argenziano's failure to make reasonable inquiry about the finances for Paragon's branch office at 120 Wall Street, as the managing principal, Dambakly should have realized that his failure to disclose the details concerning the financing violated the spirit of Rule 3040 and generally accepted standards of conduct regarding branch office operations. Dambakly knew or should have known that Paragon would have a substantial supervisory interest in knowing that he had developed a working relationship with Mr. Chapman, a stock promoter or consultant who was involved with investing in some of the same securities that were traded by the brokers under Dambakly's supervision. Dambakly also knew or should have known that it was important for Paragon to know that at least one of the lenders, Mr. Berkun, was also a registered person and that the lenders had a security interest in the assets that comprised the 120 Wall Street Office. However, Dambakly testified that he did not care where the money came from because he "needed the money to survive." (Tr. 241.)

In the Hearing Panel's opinion, these loans were highly unusual. Except for one, all of the lenders were offshore companies, and the source of funds were from yet other offshore companies. These factors, combined with the careless manner the loans were originated, should have raised red flags for Dambakly and—at a minimum—caused him to fully disclose the details concerning the financing of Paragon's branch office. Without this information, Paragon's ability to adequately supervise the branch's operations and protect itself from the potential of loss or litigation was impaired.

Balancing these various factors in light of the remedial purposes of sanctions in NASD disciplinary proceedings, including the improvement of overall business standards in the industry, the Hearing Panel finds that Dambakly should be fined $25,000, suspended in all capacities for one year, and barred as a principal.

VI. Order

Therefore, having considered all of the evidence, Respondent Richard F. Dambakly is fined $25,000, suspended for one year from associating with any member firm in any capacity, and barred as a principal.[20]

Richard F. Dambakly is further ordered to pay the costs of this proceeding in the amount of $2,479.25, which includes an administrative fee of $750 and hearing transcript costs of $1,729.25

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

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

Association; provided, however, that the bar shall become effective on the date this Decision becomes a final disciplinary action.

_____
Andrew H. Perkins
Hearing Officer
For the Hearing Panel

Copies to:

Richard F. Dambakly. (by FedEx, overnight delivery, and first class mail)
Leonard C. Aloi, Esq. (by FedEx, overnight delivery, and first class mail)
Roger D. Hogoboom, Jr., Esq. (by first class and electronic mail)
Rory C. Flynn, Esq. (by first class and electronic mail)