

**NASD REGULATION, INC.  
OFFICE OF HEARING OFFICERS**

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DEPARTMENT OF ENFORCEMENT,	:	
	:	
Complainant,	:	Disciplinary Proceeding
	:	No. C01970033
v.	:	
	:	<b>DECISION</b>
REYNOLD BRADFORD KERN	:	
(CRD #2478632),	:	Hearing Officer - DMF
	:	
Scottsdale, AZ	:	
	:	May 14, 1998
	:	
Respondent.	:	

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*Digest*

The Department of Enforcement filed a complaint alleging that a registered representative violated NASD Rules 2110 and 3040 by engaging in two private securities transactions without giving his employer prior written notification. The respondent submitted an answer to the complaint in which he acknowledged failing to give his employer written notification of the transactions and waived a hearing on the charges. Based on the complaint, the answer, and a written submission of the Department of Enforcement, to which the respondent did not reply, the Hearing Panel held that the respondent violated NASD Rules 2110 and 3040 by engaging in two private securities transactions without giving his employer prior written notification, as alleged in the complaint. The Hearing Panel censured the respondent, suspended him for 10 business days, and fined him \$5,000.

## *Appearances*

David A. Watson, Regional Counsel, San Francisco, California (Rory C. Flynn, Washington, DC, of counsel), for the Department of Enforcement.

Reynold Bradford Kern pro se.

## **DECISION**

### **Procedural Background**

The Department of Enforcement filed the Complaint in this proceeding against respondent Reynold Bradford Kern on December 29, 1997. Kern's Answer was filed on January 20, 1998.<sup>1</sup> In Kern's Answer, he said he was "waiving a hearing on this matter." He also said: "I admit as stated that I failed to provide [my employer] with written notification."

On February 25, 1998, the Hearing Officer issued an order directing Enforcement to file and serve its case against Kern by March 18, 1998, including "all evidence ... that Enforcement wishes the Hearing Panel to consider in support of the Complaint." The order provided that Enforcement's submission "should address both liability and sanctions . . . ." In the same order, the Hearing Officer gave Kern until April 1, 1998, within which to file and serve "any argument or evidence that [Kern] wishes the Hearing Panel to consider in response to the Complaint. Respondent's submission should address both liability and sanctions."

Enforcement served its submission on Kern on March 13, 1998, and filed it on March 16, 1998. The submission included 10 documentary exhibits (CX 1-10). Kern filed nothing in response to Enforcement's submission. Accordingly, the Hearing Panel, composed of one current and one former member of the District Committee for District 1 and the Hearing Officer,

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<sup>1</sup> Kern sent his handwritten Answer, dated January 18, 1998, to counsel for the Department of Enforcement, who forwarded it to the Office of Hearing Officers for filing.

considered this matter on the basis of the Complaint, Kern's Answer, and Enforcement's submission.

### **Findings**

The underlying facts in this case are not in dispute. Kern became registered with the NASD as a General Securities Representative in April 1994. From April 1994 to March 28, 1996, Kern was employed by NASD member firm W.B. McKee Securities, Inc.<sup>2</sup> Kern was subsequently employed by another NASD member until November 1997. His registration with the NASD was terminated on November 5, 1997. He is not currently employed in the industry.<sup>3</sup>

On May 1, 1995, Kern purchased 250,000 shares of The Tracker Corporation of America from the issuer for \$1 per share.<sup>4</sup> On or about June 15, 1995, Respondent Kern agreed to sell public customer DS 5,000 of his Tracker shares, and accepted \$5,000 from DS for the stock.<sup>5</sup> Kern did not give McKee any prior notification of these transactions. On February 2, 1996, DS contacted McKee asking for documentation of his purchase of Tracker stock.<sup>6</sup> McKee investigated and discovered the transactions, which Kern freely admitted. He acknowledged that he had purchased the Tracker stock in a private placement, and that he had agreed to sell 5,000 shares to DS, his family's orthodontist. Kern canceled the sale and repaid DS the \$5,000. DS

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<sup>2</sup> CX 3; CX 4 pp. 18-19.

<sup>3</sup> CX 3.

<sup>4</sup> CX 4 pp. 21-26.

<sup>5</sup> CX 4 p. 46.

<sup>6</sup> CX 4 p. 10.

wrote to McKee saying that he was “satisfied with [Kern’s] explanation and actions” and that he “consider[ed] the matter resolved.”<sup>7</sup>

### **Conclusions**

Article IV, Section 4 of the NASD’s By-laws provides: “A person whose association with any member has been terminated and is no longer associated with any member of the Corporation ... shall continue to be subject to the filing of a complaint under the Code of Procedure based upon conduct which commenced prior to the termination ... but any such complaint shall be filed within ... two (2) years after the effective date of the termination ....” The Complaint is based on Kern’s conduct while he was associated with McKee and it was filed within two years after Kern’s last association with a member firm. Therefore, the NASD has jurisdiction over this disciplinary proceeding.

Rule 3040 provides that “no person associated with an NASD member firm shall participate in any manner in a private securities transaction except in accordance with the requirements of this rule.”

The Rule defines a “private securities transaction” as:

any securities transaction outside the regular course or scope of an associated person’s employment with a member, including, though not limited to, new offerings of securities which are not registered with the Commission, provided however that transactions subject to the notification requirements of Rule 3050, transactions among immediate family members (as defined by IM-2110-1, “Free-riding and Withholding”), for which no associated person receives any selling compensation, and personal transactions in investment company and variable annuity securities, shall be excluded.

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<sup>7</sup> CX 4 pp. 20, 30-33, 34-35; CX 8. When Kern repaid DS for the stock, Tracker was trading at only \$.50 per share. CX 4 p. 10.

The two transactions at issue were clearly outside the regular course and scope of Kern's employment with McKee, and they did not fit within any of the exclusions described in Rule 3040. They were, therefore, covered by Rule 3040.<sup>8</sup>

Rule 3040 requires that an associated person who intends to participate in a private securities transaction, prior to the transaction, must "provide written notice to the member with which he is associated describing in detail the proposed transaction and the person's role therein and stating whether he has received or may receive selling compensation in connection with the transaction . . . ." Kern admits that he did not give McKee any such notice of either his purchase of the Tracker stock or his agreement to sell 5,000 of his shares to DS.

Accordingly, the Hearing Panel concludes that Kern violated Rule 3040 by purchasing the Tracker stock and by agreeing to sell 5,000 shares to DS. The Hearing Panel also concludes that, by violating Rule 3040, Kern failed to "observe high standards of commercial honor and just and equitable principles of trade," and so violated Rule 2110.

### **Sanctions**

The NASD Sanction Guidelines recommend a monetary sanction for violations of Rule 3040 that includes "any commissions, concessions, and other benefits" the respondent received

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<sup>8</sup> Rule 3040 applies to "any securities transaction," which includes both sales and purchases. In Jay Frederick Keeton, 50 S.E.C. 1128 (1992), the SEC stated that the associated person's "sales activities . . . as well as his own purchases . . . violated Article III, Section 40 of the NASD's Rules of Fair Practice [now Rule 3040]." The SEC explained the rationale underlying the notice requirement of Rule 3040: "A securities firm, through which salesmen are registered for the protection of the public, must protect investors as well as itself through supervisory measures that impose conditions on a salesman's employment. To implement and enforce those measures, the firm must be apprised of any associated person's outside involvement in securities transactions." These concerns apply to private purchases of securities, such as Kern's purchase of the Tracker stock, as well as private sales, such as his agreement to sell 5,000 of his shares to DS.

as a result of his violations, plus an additional \$5,000 to \$50,000.<sup>9</sup> The Guidelines also provide that “[a] suspension or a bar should be considered.” The “Principal Considerations” listed in the Guidelines for setting sanctions in a specific case include: (1) prior or similar misconduct; (2) number of transactions and customers involved, as well as the duration of the activity; (3) whether the respondent had a proprietary or beneficial interest in the underlying enterprise; (4) whether the violation reflects willful disregard of known requirements; (5) whether the respondent used the employer’s offices or facilities for private transactions; (6) whether the respondent attempted to conceal the private transactions; (7) the amount of commissions or benefits to the respondent; and (8) other aggravating or mitigating factors.

In this case, (1) there is no evidence of prior or similar misconduct by Kern; (2) the violations involved only two transactions and a single customer, over a short period; (3) Kern’s 250,000 shares did represent a substantial interest in Tracker; (4) Kern says he did not realize he was required to notify McKee of his transactions, and Kern had been registered for only a little over a year at the time of these transactions; (5) Kern does not appear to have used McKee’s facilities to conduct these transactions; and (6) Kern does not appear to have attempted to conceal the transactions. In fact, he readily admitted them to McKee and has admitted them in his Answer.

The \$5,000 that DS paid Kern for Tracker stock would constitute a “commission, concession or other benefit” to Kern that would have to be included in the monetary sanction, if Kern had retained the money. The Sanction Guidelines specifically provide: “Where respondent is affiliated with the issuer or has a beneficial interest in the transaction other than a commission, also include all sales proceeds received by the respondent directly or indirectly (possibly by

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<sup>9</sup> NASD Sanction Guidelines 45 (1996 ed.).

requiring [respondent to offer rescission] of the entire contract amount to the investors).”

Because Kern has already rescinded the sale and refunded DS’s money, however, there is no need to increase the sanction to deprive Kern of any benefit from his violation.<sup>10</sup>

The Hearing Panel concludes that, on balance, the relevant factors suggest that a censure, a fine at the bottom of the range recommended in the Sanction Guidelines, and a relatively brief suspension are appropriate sanctions in this case. Enforcement suggests a \$5,000 fine and a 10 business day suspension. The Hearing Panel agrees.

Therefore, Kern is censured, suspended for 10 business days, and fined \$5,000. These sanctions shall become effective on a date set by the Association, but not before the expiration of 45 days after the date of this decision.<sup>11</sup>

#### **HEARING PANEL**

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By: David M. FitzGerald  
Hearing Officer

Dated: Washington, DC  
May 14, 1998

Copies to:

Reynold Bradford Kern (by certified and first class mail)  
Rory C. Flynn (by first class mail)  
David A. Watson (by first class mail)

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<sup>10</sup> Enforcement argues that the \$250,000 Kern paid for the Tracker stock does not represent a “commission, concession, or other benefit” to Kern that should increase the monetary sanction under the Sanction Guidelines. The Hearing Panel agrees with Enforcement, under the facts presented.

<sup>11</sup> The Hearing Panel has considered all of the arguments of the parties. They are rejected or sustained to the extent that they are inconsistent or in accord with the views expressed herein.