

NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF MARKET REGULATION

Complainant,

v.

FLORIDA DISCOUNT SECURITIES, INC.
(BD No. 44859), et al,

Respondents.

Disciplinary Proceeding
No. CMS040094

Hearing Officer – AWH

HEARING PANEL DECISION

August 30, 2005

Five registered representatives barred from associating with any member firm in any capacity, and two ordered to pay restitution to customers, for engaging in fraudulent sales practices, in violation of Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5 thereunder, and NASD Conduct Rules 2110, 2120, 2310, and IM-2310-2. Four of those representatives found liable for failure to update their Form-4 after receiving notice that they were the subject of an NASD investigation, in violation of NASD Rules and By-Laws. In light of the bars, no further sanctions imposed for that violation. All Respondents jointly and severally assessed costs.

Appearances:

James J. Nixon, Esq., and Matthew Campbell, Esq., for
Department of Market Regulation

Delmer C. Gowing III, Esq., for Fernando Fernandez, Adam T. Forman, Kristian F.
Sierp, and Shannon L. Norris

Mark W. Eshleman, *pro se*

DECISION

Introduction

On July 1, 2004, the Department of Market Regulation issued the Complaint in this proceeding against Florida Discount Securities, Inc. (“Florida Discount” or the

“firm”), Bruce E. Rich (“Rich”), Charles P. Celestin (“Celestin”), Fernando Fernandez (“Fernandez”), Adam T. Forman (“Forman”), Mark W. Eshleman (“Eshleman”), Kristian F. Sierp (“Sierp”), Marc C. Kimmel (“Kimmel”), Shannon L. Norris (“Norris”), and Dante F. Calicchio (“Calicchio”). The Complaint alleges that each of those named respondents engaged in fraudulent sales practices involving the solicitation, purchase, and sale of the common stock of two highly speculative over-the-counter (“OTC”) equity securities, in violation of Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5, and NASD Conduct Rules 2110, 2120, 2310, and IM-2310-2. More specifically, the Complaint alleges that, under Rich’s direction, Florida Discount became a “boiler room” that sold the common stock of Combined Professional Services, Inc., (“CPFS”) and BSD Software, Inc., (“BSDS”) through, among other things, an aggressive cold-calling campaign that involved high-pressure sales tactics, misrepresentations and omissions of material facts, baseless performance and price predictions, unauthorized and unsuitable purchases, and an undisclosed no net-selling practice. The Complaint alleges that customers of Florida Discount bought a total of more than \$24 million of CPFS and BSDS stock, eventually sustaining realized losses of more than \$1.1 million, and unrealized losses estimated to exceed \$3.5 million.

The Complaint also alleges that Florida Discount and Rich violated NASD Conduct Rules 2110 and 3010 by egregiously failing to supervise the firm’s registered representatives and associated persons. It alleges that Rich also violated NASD Procedural Rule 8210 by refusing to answer NASD staff’s questions and provide requested information during his investigative testimony. Finally, the Complaint alleges that Fernandez, Forman, Sierp, Kimmel, Norris and Calicchio each failed to update his

Form U-4 to reflect that he was a subject of an NASD investigation into unlawful activities at Florida Discount, in violation of NASD Conduct Rule 2110, IM-1000-1, and Article III, Section 4(f), and Article V, Section 2(c), of NASD By-Laws.

Respondents Rich, Fernandez, Forman, Sierp, Norris, and Eshleman filed answers to the Complaint, denying any violations and requesting a hearing. Respondents Florida Discount, Calicchio, Celestin, and Kimmel failed to respond to the Complaint or a Second Notice of Complaint and Complaint that was sent to them on July 30, 2004. As a result, the Department of Market Regulation was ordered to file a Motion for Entry of Default Decision against those respondents who failed to file answers to the Complaint. The Hearing Officer is issuing a separate Default Decision against Calicchio, Celestin, and Kimmel, granting the Motion and imposing sanctions. That Default Decision is being served concurrently with this Decision.¹

On November 10, 2004, the National Adjudicatory Council (“NAC”) of NASD accepted Offers of Settlement from Respondents Rich and Florida Discount, barring Rich and expelling Florida Discount for engaging in fraudulent sales practices and egregiously failing to supervise registered representatives and associated persons, as charged in the Complaint. In barring Rich, the NAC also found that, as alleged in the Complaint, he refused to provide requested information during his investigative testimony.

A hearing on the Complaint against Respondents Fernandez, Forman, Eshleman, Sierp and Norris was held in Boca Raton, Florida, on February 22 through March 1, 2005, before an Extended Hearing Panel composed of the Hearing Officer and two

¹ The Default Decision bars Calicchio, Celestin, and Kimmel for engaging in fraudulent sales practices, in violation of Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5 thereunder, and NASD Conduct Rules 2110, 2120, 2310, and IM-2310-2. It also finds Calicchio and Kimmel liable for failure to update their Forms U-4, in violation of NASD Rules and By-Laws.

former members of the District 10 Committee, one of whom is a former member of the Board of Governors.² The 1,828 page transcript records the testimony of 23 witnesses and the introduction of 154 exhibits. The parties, with the exception of Respondent Eshleman, filed post-hearing briefs on May 9, 2005.

Findings of Fact³

I. Background

The essential facts that describe the structure of the fraudulent scheme, as they relate to its implementation and operation by Bruce Rich and his business partners, are not in dispute. The nature and extent of participation in that scheme by the individual respondents in this case are at issue.

A. The Investigation of CPFS

In late July 2002, the staff of the Department of Market Regulation (the “staff”) saw an article on the Internet about CPFS. The article asked how a shell company with no cash, no revenues, no business, and no immediate prospects could be selling at prices above six dollars a share. Searching the public filings on the SEC website, the staff learned that CPFS was indeed a shell with no operating history, no revenues, minimal assets, and no financial resources.⁴ The financial statements by its auditors noted that

² Although they had not filed Answers to the Complaint, nor participated in this proceeding in any manner, Respondent Calicchio appeared at the beginning of the hearing, and Respondent Kimmel appeared on the fourth day of the hearing. Because of their prior non-participation, the Department of Market Regulation had not prepared a case against either Calicchio or Kimmel. However, both Calicchio and Kimmel were permitted to testify on their own behalf, but only on the issue of sanctions. Calicchio was called as a witness by the Department of Market Regulation.

³ References to the Department of Market Regulation’s exhibits are designated as C_, followed by the page number (where the exhibit is on-the-record testimony, the transcript page and line numbers are referenced); Respondent Eshleman’s exhibits, as RE_; Respondent Sierp’s exhibits, as RS_; and the transcript of the hearing, as Tr._.

⁴ C7 p. 2; Tr. 1598:21-1599:3.

there was a substantial doubt about the company's ability to continue as a going concern.⁵ CPFS was reportedly looking for a company to acquire or to merge with, although it had not identified any prospects.⁶ There were no current press releases; however, there was a May 2001 press release that announced a new business plan to become a consolidator of a highly fragmented, local and regional brokerage firm industry.⁷ Nevertheless, the public filings made no mention of such a change in CPFS's business plan.⁸ In fact, in subsequent filings the company reiterated that it was still searching for an appropriate target and was not restricting its search to any specific business, industry, or geographical location.⁹

CPFS stock had been dormant until March 2001, when there was a sudden spike in the price and volume of the security. More than 90 percent of the retail buying activity came from one clearing firm, Fiserve, and almost all of that activity was generated by Florida Discount. The staff also noted a connection between Florida Discount and CPFS. According to the public filings, in June 2001, CPFS exchanged 150,000 shares of its common stock for 49 shares of Florida Discount Securities. The transaction was valued at \$3,320. Accordingly, the value of CPFS stock was approximately 2.2 cents per share, while, at the same time, the stock was trading at approximately \$8.75 per share.

B. The Investigation of BSDS

The staff's search of an address for CPFS revealed another public company at that same address: BSDS. The staff saw a pattern in the trading of BSDS that was similar to

⁵ C7 pp. 6, 18, 23; Tr. 1600:15-22.

⁶ C7 p. 3; Tr. 1599:4-8. In addition, CPFS's public filings warned shareholders and potential investors of, among other risks, the possibility that any business combination would likely have a significant diluting effect and would likely depress the market price of CPFS shares. C7 p. 7; Tr. 1599:9-1600:12.

⁷ C19 p. 3; Tr. 1606:5-11.

⁸ C11-C18; Tr. 1606:12-15.

⁹ C14 p. 3, C15 p. 2.

what they had seen in CPFS. The price and volume history showed that the stock was dormant until around November 2001, when, again in this stock, there was a sudden spike in price and volume. Again, more than 90 percent of the retail buy volume was generated by Florida Discount.

The staff's search of the SEC website showed that BSDS was a blank check company whose sole purpose was to acquire or merge with another company. BSDS has minimal assets, negative stockholder equity, no revenues, no operations, and limited financial resources. Its auditor's statement noted a substantial doubt about the company's ability to continue as a going concern. The staff found an announcement that in November 2001, BSDS had acquired a privately held Florida corporation, Benchmark Software Development. Just days before the acquisition, Benchmark Software Development, which had the same address as CPFS and BSDS, had been incorporated by Jeff Spanier. BSDS's public filings with the SEC made no mention of the Benchmark Software acquisition.¹⁰ A copy of the stock purchase agreement between BSDS and Benchmark Software that was in Florida Discount's files showed that BSDS exchanged 1,000 shares of its common stock for all of the shares of Benchmark Software.¹¹ Using the then current market price of BSDS, Benchmark Software was acquired for approximately \$6,500.¹²

On December 11, 2001, BSDS announced that it had entered into a Letter of Intent with an 18 year-old privately held Florida corporation that operated in the software industry.¹³ However, BSDS's Form 10-KSB for the year ended December 31, 2001, and

¹⁰ Tr. 1630:23-1631:4.

¹¹ C40; Tr. 1629:18-1630:13.

¹² Tr. 1630:14-22.

¹³ C39 p. 6.

subsequent filings made no mention of this potential transaction.¹⁴ Moreover, BSDS's public filings disclosed that it had neither identified a target company nor "engaged in any negotiations with any specific entity regarding the possibility of a transaction."¹⁵

C. Principals of CPFS and BSDS

The sole officer and director of both CPFS and BSDS was Jeff Spanier, a person who had worked at Florida Discount as a recruiter of brokers, including Eshleman, Forman, Sierp, and Kimmel.¹⁶ CPFS's public filings, and an August 12, 2002, press release, confirmed that Spanier had become CPFS's sole officer and director on July 18, 2002, and, at that time, was issued 4 million shares, or 60% of the total issued and outstanding shares, of CPFS's common stock.¹⁷

The August 12, 2002, press release also noted both that CPFS held a 4.9 percent interest in PBJ Holdings, the parent company of Florida Discount, and that the beneficial owner of PBJ Holdings owned 300,000 shares of CPFS stock.¹⁸ Bruce Rich owned PBJ Holdings and was the president of Florida Discount. Rich described Paul Harary as a partner and the money behind Florida Discount.¹⁹ The acronym PBJ purportedly stands for Paul [Harary], Bruce [Rich], and Jeff [Spanier].

In addition, the August 12, 2002, press release announced that CPFS had signed a letter of intent to acquire Muni Financial, Inc., a Florida based financial services

¹⁴ C35-C38; Tr. 1631:5-12.

¹⁵ C35 pp. 19, 25; Tr. 1631:13-17.

¹⁶ C160; Tr. 540:9-23.

¹⁷ C17 pp. 1-2, C19 p. 7, C160; Tr. 1610:19-1611:21.

¹⁸ C19 pp. 7-8.

¹⁹ Tr. 970:18-971:2.

company.²⁰ The owner of Muni Financial, was Joseph Muni, a registered representative with Florida Discount.²¹

On September 5, 2002, a press release disclosed that CPFS had signed a letter of intent to acquire the National College Planning Group, Inc. (“NCPG”), a Florida based “financial membership services company.”²² Celestin, a registered representative and principal with Florida Discount, was NCPG’s president.²³

D. Examination of Florida Discount

On September 10, 2002, the staff appeared at the office of Florida Discount to conduct a three-day examination of its trading in CPFS and BSDS. On that same date, Respondents Forman and Fernandez, through counsel, wrote to Bruce Rich, questioning the appropriateness of an announcement by CPFS of a proposed acquisition, and seeking indemnity from any sales they had made of CPFS. Over the course of the next three months, the staff took on-the-record testimony from those involved with CPFS and BSDS at Florida Discount.

II. Setup of a Boiler Room Operation

Bruce Rich, Paul Harary, and Jeff Spanier recruited registered representatives who were high school graduates and relatively new to the securities industry to staff a classic “boiler room” operation, primarily dedicated to selling its two “house stocks,”

²⁰ C19.

²¹ C22; Tr. 1606:17-1607:2. Florida corporation records, which were available on the state’s website, showed that Muni Financial, Inc., was a company owned and operated by Muni and his wife. C21; Tr. 1606:17-1607:9.

²² C19 p. 9.

²³ C24 p. 9; Tr. 1615:9-22.

CPFS and BSDS.²⁴ Eshleman and Forman (both of whom had experience as brokers) were offered signing bonuses, and all brokers were promised various incentives for selling the two house stocks to customers. Rich promised a 100 percent payout on commissions generated from sales of both CPFS and BSDS.²⁵ In addition, he promised bonuses for soliciting those stocks. For example, he offered a \$5,000 bonus to any broker whose client bought 10,000 shares of stock.²⁶ On occasion, he would promise vacations for those who sold large amounts of CPFS or BSDS.²⁷ He also told the “senior brokers”, including Forman, Fernandez, Sierp, Celestin, and Kimmel, that they would receive stock options, the size of which were linked to how well they performed in selling CPFS to their customers.²⁸ With regard to BSDS, Rich told the brokers that they would lock up the stock at Florida Discount and then sell the stock to another branch office that Florida Discount would open in New York.²⁹ The boiler room operation was characterized by the use of misleading sales scripts, unsuitable recommendations, a no net-selling practice, and systematic unauthorized transactions.

A. The Use of Misleading Sales Scripts

Rich, who engineered the fraudulent promotion of CPFS and BSDS, tightly controlled the flow of information about the two stocks by restricting access to that

²⁴ C168 31:8-19. Eshleman is a college graduate, with a degree in chemistry, and had been employed by several firms as a registered representative, including Shochet Securities, Inc., by whom he was employed for 12 years. Tr. 538:1-539:13. Sierp has been a registered representative with several firms since 1994. C51 p. 3.

²⁵ Tr. 1435:22-1436:3; C170 29:13-30:7.

²⁶ C176 29:9-11, 115:21-116:2. Eshleman was told that he could earn the signing bonus he was originally promised, a promise on which Rich reneged, if he sold 10,000 shares of CPFS within a designated time period. C172 42:7-11.

²⁷ Tr. 1226:2-9, 1228:21-25.

²⁸ Tr. 1227:6-1228:17, 1443:2-9, 1790:13-21, 1791:11-1792:7. Fernandez and Forman claimed that it was not clear whether the options would be for CPFS stock or Florida Discount stock. Tr. 1227:24-1228:8, 1443:6-9. Nevertheless, the distinction was immaterial to the brokers. Fernandez thought that the options were going to be from the CPFS merger. C168 61:16-21. Forman wasn't sure: “I don't know if it was going to be Florida Discount or CPFS. I think they could be the same thing, if that matters.” Tr. 1228:5-8.

²⁹ Tr. 1447:10-1449:11.

information and distributing scripted sales pitches he demanded be followed when the brokers solicited their customers.

Generally, the scripts for both CPFS and BSDS followed the same pattern – falsely representing that: (a) the stock was an oversubscribed IPO or other offering that Florida Discount customers had the privilege of purchasing;³⁰ (b) the companies were involved, or about to be involved, in valuable mergers and acquisitions; (c) there were going to be a series of important upcoming events and news announcements; and (d) the price of the stocks would increase significantly.³¹ In addition, the scripts repeatedly asked customers to promise not to sell their shares for a period of time, even though they were expected to increase in value significantly. For example, one script contained the following plea: “all I ask is a gentlemen’s (sic) agreement that when we see the stock up 40-50% in the first few weeks we don’t sell.” Another called for the broker to tell the customer: “Here’s the key: Due to the firm’s relationship with the company I’m privileged to the fact that over the next few weeks there’s going to be a series of news announcements and I’m telling you when that happens.....major buying will come inand the stock will see \$ ____ easy.”³²

Rich distributed the scripts to all the brokers and insisted that they be followed.³³ He required the less experienced brokers to rehearse their pitches.³⁴ More experienced brokers, like Forman and Sierp, would merely peruse a script and then pitch the stock

³⁰ Some brokers compared the CPFS offering to successful “reverse mergers” that were accomplished by Ted Turner and Blockbuster, and they told customers that the opportunity to buy the stock was a “gift.” Tr. 629:25-630:22.

³¹ C1, C30. Rich also told the brokers to tell customers that they could not buy BSDS unless they bought it through Florida Discount. C168 70:9-20.

³² C1 pp. 2, 5.

³³ Tr. 1427:13-24, 1423:21-25; C169 5:19-6:12, 20:14-22.

³⁴ Tr. 1424:1-5.

without the necessity of practicing or reading from it.³⁵ If a broker veered from the script, Rich would “scream from his office say it word for word.”³⁶ Rich also utilized an electronic device to listen in on the pitches to customers and advise the brokers how to respond to customers’ questions or comments. The device prevented customers from hearing Rich’s voice.³⁷

Alfred Evans was a broker-trainee with Florida Discount from approximately March to August 2002.³⁸ He testified that he heard Fernandez, Forman, and Sierp make price predictions that CPFS would go to “ten to twelve,”³⁹ and that it would rise eventually to fifteen dollars.⁴⁰ Evans also confirmed that Fernandez, Forman, and Sierp made specific price predictions for BSDS;⁴¹ that they offered to take limit orders saying “shares at this level are hard to come by;”⁴² and that they represented that BSDS was “in the process of acquiring smaller end software companies around the country generating at least one million dollars a year, one million a year in revenue and consolidating a very fragmented business.”⁴³

B. Unsuitable Recommendations

Florida Discount had due diligence files which contained copies of certain public filings for CPFS and BSDS.⁴⁴ However, Rich did not allow the brokers to see those files.⁴⁵ Instead, the brokers relied upon what Rich told them about CPFS and BSDS.

³⁵ Tr. 1426:12-25, 1424:15-16.

³⁶ C169 20:17-21.

³⁷ Tr. 1427:25-1428:25.

³⁸ Tr. 54:1-4, 96:25-97:1.

³⁹ Tr. 77:24-78:6.

⁴⁰ Tr. 80:17-18.

⁴¹ Tr. 86:2-12.

⁴² Tr. 88:8-13.

⁴³ Tr. 87:13-20.

⁴⁴ Tr. 1619:18-25; C29; Tr. 1633:4-18; C46.

⁴⁵ Tr. 1247:13-24.

Norris never asked to see the public filings for CPFS and BSDS.⁴⁶ He did not know about public filings at the SEC, and he was not familiar with a “going concern” clause in an auditor’s report or what that term meant.⁴⁷ Forman believed that CPFS was a new publicly traded company, and, therefore, he “couldn’t understand how it would have financials.”⁴⁸ When asked whether Rich ever gave him a 10-Q or a 10-K on CPFS or BSDS, Fernandez testified: “If he did, I wouldn’t have known what it was. I remember he would pull us into the office and he would show us certain documents that he got off line and he would ask us if we had any questions and, you know, after hearing him talk for about an hour, I [was] not really understanding too much of it.”⁴⁹ Sierp did some research on the internet and found that CPFS was thinly traded, had lost \$300,000 the previous year, and had no revenues.⁵⁰ Eshleman testified at the hearing that he did not look at the SEC filings on CPFS just prior to joining Florida Discount; however, in his on-the-record interview, he testified as follows:

. . . I went through and I looked and I checked the 10K’s and 10Q’s and I realized that I had jumped from the frying pan into the fire and I was trying to see a process from which I could extricate myself and have nobody damaged. And that’s what – that’s what my thought process was.
Q. All right. And then what happened next, did you begin to solicit customers to purchase CPFS?
A. Yes, I did.⁵¹

The consistent rationale the brokers used to justify their recommendations of CPFS and BSDS was that the prices of those two securities continued to rise when the rest of the market was falling.

⁴⁶ Tr. 880:4-20.

⁴⁷ Tr. 883.

⁴⁸ Tr. 1237:22-23.

⁴⁹ Tr. 1470:9-14. Kimmel also testified that he never looked at SEC filings, and relied on what Rich told him about the stocks. C181 43:23-44:2.

⁵⁰ Tr. 978:3-980:6.

⁵¹ Tr. 547:9-11; C172 82:4-13.

As discussed in more detail below, for their customers' accounts, Respondents purchased excessive concentrations of CPFS and BSDS, stocks that were not qualitatively suitable for those customers. For example, by the end of July 2002, Fernandez' customer JP, who was in his mid-80s and retired, held \$365,007 of CPFS, which accounted for 82 percent of JP's total account value. Norris' customer GW, who was approaching 60, was 100 percent invested in BSDS by the end of August 2002. Sierp's customer RM, who was approaching 80, held a total of \$143,662 of CPFS and BSDS and had no other investments in his account by the end of August 2002. Forman's customer MH, who was also approaching 80, owned \$55,125 of BSDS, which constituted 96 percent of his total account value by the end of August 2002. Eshleman's customer OC, who retired in 1992, held only 350 shares of CPFS in his account, but it was just over 90 percent of his total account value.⁵²

C. The No Net-Selling Practices

Rich insisted that in order to support the price of his two house stocks, there could be no net-selling of either stock; that is, sales of either stock must be offset by buys of the same stock.⁵³ In order to attain that goal, Rich coordinated cross transactions among the customers' accounts and swaps of CPFS and BDS D within each customer's account.

1. The Policy

Calicchio, Eshleman, Fernandez, Forman, Kimmel, and Norris confirmed that there was a no net-selling policy at Florida Discount.⁵⁴ According to Fernandez, the rule

⁵² C105 p. 42, C146 p. 12, C102 p. 20, C83 p. 53, C69 p. 4.

⁵³ Tr. 879:11-880:3, 1452:9-12; C168 62:25-63:8.

⁵⁴ C168 31:20-32:1, 14-16; C171 113:19-21, C172 80:6-81:7, C181 75:7-8; Tr. 879:11-880:3. As noted previously, the scripts themselves solicited promises from customers not to sell when the stocks' prices increased. C1, C30.

was simple: “No selling.”⁵⁵ Fernandez explained: “... you couldn’t sell to the market. You would have to find a buyer. If not, you would have to hold it in.”⁵⁶ If he tried to sell without finding a buyer, Rich would take away his commissions.⁵⁷ Forman testified that customers were charged extra commissions if they sold either stock,⁵⁸ and, if a broker were only selling and not buying the stock at the same time, the broker would not receive a commission on the sale.⁵⁹

Rich would erupt if there was any selling.⁶⁰ Eshleman often overheard Rich “yelling and screaming and cussing and every four-letter word spoken” about people who wanted to get out of the stock.⁶¹ Rich told the brokers that he did not want to see any selling because it would depress the prices of the stocks. He told them that because CPFS was not a liquid stock, they could not sell it to the open market.⁶² He said that all purchases of BSDS stock were by customers of Florida Discount, and, if those customers maintained their positions, the stock would not go lower.⁶³ Consequently, Rich insisted that the brokers had to find a buyer for any seller in order to support the price of the two house stocks.⁶⁴

2. Coordinated Cross Transactions

After emerging from meetings with Rich in his office, brokers would engage in “cross transactions,” coordinating the sale of CPFS and BSDS at ever higher prices from

⁵⁵ C168 31:23-32:1.

⁵⁶ C168 32:2-5.

⁵⁷ C168 32:17-33:1.

⁵⁸ C171 117:25-118:6.

⁵⁹ C171 118:22-119:5.

⁶⁰ Tr. 1438:14-25.

⁶¹ C172 80:18-22.

⁶² C168 39:8-12.

⁶³ C168 62:20-24.

⁶⁴ Tr. 879:11-880:3, 1452:9-12; C168 62:25-63:8.

one customer's account to another.⁶⁵ Because Florida Discount controlled the whole float, the no net-selling policy assured that the prices would continue to rise.⁶⁶ Rich also controlled the trading by sitting on tickets for weeks, at one point accumulating a stack of tickets a "half a foot high," before executing the orders.⁶⁷

Commission runs and account records show that Forman, Fernandez, Norris, and Sierp coordinated the following customer crosses:⁶⁸

- On August 29, 2002, Forman sold 10,000 shares of CPFS at \$6.15 from customer KS's account, while on the same day Sierp effected a purchase of 10,000 shares of CPFS at \$6.50 in customer RM's account.⁶⁹
- On May 16, 2002, Norris purchased 2,000 shares of CPFS at \$5.77 in GW's account, while on the same day Fernandez sold 6,755 shares of CPFS at \$5.75 in JP's account.⁷⁰
- On August 5, 2002, Fernandez sold 15,185 shares of CPFS at 6.25 in customer RP's account, while on the same day Sierp purchased an identical odd-lot total of 15,185 shares of CPFS in six different customer accounts.⁷¹
- Also on August 5, 2002, Fernandez purchased a total of 12,072 shares of BSDS in three customer accounts.⁷² On the same day, Sierp sold an identical odd-lot total of 12,072 shares of BSDS in the same six customer accounts for which he purchased CPFS.⁷³

Fernandez, Forman, Norris, and Sierp also coordinated crosses using their own customers' accounts. For example:

⁶⁵ Tr. 63:14-25.

⁶⁶ C172 33:20-34:1.

⁶⁷ C168 40:18-41:1, C170 44:13-20, C171 113:9-114:9.

⁶⁸ C52-C60.

⁶⁹ C57 p. 28, C60 p. 55, C102 p. 20; Tr. 772:15-774:3.

⁷⁰ C146 p. 3, C105 p. 32.

⁷¹ C53 p. 126, C117 p. 36, C60 pp. 49, 51-52, 54. Sierp purchased 2,200 shares in PT's account, C60 p. 49; 1,470 shares in AE's account, C60 p. 49; 3,150 shares in H's account, C60 p. 51; 1,700 shares in H's account, C60 p. 52; 3,720 shares in GD's account, C60 p. 54; and 2,945 shares in N's account, C60 p. 54. Sierp had no other purchases of CPFS on this day. C60 pp. 48-57.

⁷² Fernandez purchased 1,122 shares in JP's account, C53 p. 124; 110 shares in PP's account, C53 p. 126; and 10,840 shares in RP's account, C53 p. 126.

⁷³ Sierp sold 1,835 shares in PT's account, C60 p. 49; 1,185 shares in AE's account, C60 p. 49; 2,340 shares in H's account, C60 p. 51; 1,362 shares in H's account, C60 p. 52; 3,000 shares in GD's account, C60 p. 54; and 2,350 shares in N's account, C60 p. 54.

- On May 28, 2002, Fernandez sold 10,000 shares of BSDS at \$7.75 and purchased 12,300 shares of CPFS at \$6.30 in JP’s account.⁷⁴ On the same day, Fernandez purchased 10,000 shares of BSDS at \$8.11 and sold 14,115 shares of CPFS at \$5.75 in RP’s account.⁷⁵
- On August 19, 2002, Forman sold 3,470 shares of CPFS at \$6.30 in RG’s account and purchased 3,470 shares of CPFS at \$6.75 in RS’s account.⁷⁶
- On August 23, 2002, Norris sold 10,000 shares of BSDS in customer M’s account and purchased a total of 10,000 shares of BSDS in three customers’ accounts: 7,000 shares in JB’s account, 1,500 shares in GW’s account, and 1,500 shares in C’s account.⁷⁷ On the same day, Norris purchased 13,500 shares in M’s account and sold a total of 13,500 shares – 9,500 shares in JB’s account, 2,000 shares in GW’s account, and 2,000 shares in C’s account.⁷⁸
- On August 6, 2002, Sierp sold 2,585 shares of BSDS at \$8.39 in RL’s account and purchased 4,450 shares of BSDS at \$8.75 in RM’s account. On the same day, Sierp purchased 4,500 shares of CPFS at \$6.75 in RL’s regular account and sold 6,028 shares of CPFS at \$6.39 in RM’s account.⁷⁹

3. Swapping CPFS and BSDS

In addition to coordinating cross transactions between customers, Fernandez, Forman, Norris, and Sierp repeatedly swapped CPFS and BSDS in their customers’ accounts by selling either CPFS or BSDS, and, at the same time, purchasing the other security with the proceeds. In many instances the swapping was a by-product of the coordinated crosses – swapping made it appear to *customers* that they were realizing gains as the price of each stock increased, while the brokers generated significant commissions for themselves.⁸⁰

Customer account records reflect numerous examples of swapping. For example:

⁷⁴ C105 p. 32.

⁷⁵ C117 p. 25.

⁷⁶ C55 p. 46, C128 p. 40.

⁷⁷ *Id.*

⁷⁸ C59 pp. 17-18.

⁷⁹ C97 p. 23; Tr. 772:4-14; C102 p. 20.

⁸⁰ As Evans testified, Rich would tell Respondents that if they were short on money, they should do a trade in CPFS or BSDS to “make some quick money.” Tr. 63:3-9.

- On April 26, 2002, Fernandez purchased 7,765 shares of BSDS at \$8.40 and sold 12,800 shares of CPFS at \$5.10 in JP's account.⁸¹ Fernandez charged \$6,150.70 for these two transactions.⁸² On the same day, Fernandez also sold 7,765 shares of BSDS (the exact number of shares of BSDS that were purchased in JP's account) at \$7.67 and purchased 10,630 shares of CPFS at \$5.60 in RP's account.⁸³ Fernandez charged RP \$5,006.85 for these two transactions.⁸⁴
- On August 2, 2002, Forman sold \$39,794 of BSDS and purchased \$39,575 of CPFS in RW's account.⁸⁵ Forman charged RW \$1,912 for these two transactions.⁸⁶ On August 30, 2002, Forman purchased \$62,490 of BSDS and sold \$62,533 of CPFS in MH's account. Forman charged MH \$4,296.75 for these two transactions.⁸⁷
- On August 23, 2002, Norris sold \$58,788 of CPFS and purchased \$58,465 of BSDS in JB's account.⁸⁸ Norris charged JB \$5,205 for these two transactions.⁸⁹ On the same day, Norris also sold \$12,524 of CPFS and purchased \$12,540 of BSDS in GW's account.⁹⁰ According to confirms, he charged GW approximately \$945 for the two transactions.⁹¹
- On February 12, 2002, Sierp sold \$27,484 of BSDS and purchased \$27,432 of CPFS in RL's retirement account.⁹² Sierp charged RL \$2,546 for these two transactions.⁹³

⁸¹ C105 p. 27.

⁸² C107 pp. 24, 26.

⁸³ C117 p. 22.

⁸⁴ C119 pp. 10-11.

⁸⁵ C139 p. 17.

⁸⁶ C141 pp. 7-8.

⁸⁷ C83 p. 53, C85 pp. 10-11.

⁸⁸ C62 p. 14.

⁸⁹ C64 pp. 6-7.

⁹⁰ C146 p. 12.

⁹¹ C147 pp. 2-3.

⁹² C95 p. 6; Tr. 244:15-20.

⁹³ C60 p. 22. RL testified that he understood that the "companies were fluctuating and he [Sierp] was buying and selling, or that was his goal, to buy, when they went up a few dollars to sell them, and then if the other one was down, to buy the other one." Tr. 244:23-245:4. However, he did not understand why, on the same date Sierp sold BSDS in his retirement account at \$5.50 per share, Sierp purchased \$2,715 of BSDS in RL's regular account at \$6.00 per share. Tr. 245:5-21; C97 p. 6, C95 p. 6. Sierp charged RL \$99 for that transaction. C98 p. 4.

D. Unauthorized Transactions

A number of order tickets introduced into evidence show cross-outs and changes to the terms and conditions of customers' orders, including price and share amount.⁹⁴ According to Fernandez, Forman, Kimmel, and Sierp, Rich made the changes to the customer tickets.⁹⁵ Both Sierp and Kimmel testified that Rich changed the tickets to use up all available cash in the customers' accounts.⁹⁶ The brokers would then "justify" the changes to the customers.⁹⁷ For example, Sierp would tell his customers that they bought more stock because the price was lower.⁹⁸ While several customers also testified that they did not authorize certain purchases, the Hearing Panel is unable to conclude from the evidence the extent to which Rich effected those unauthorized purchases or whether any were the responsibility of the broker whose name appeared on the account. Forman testified that if a customer complained to him about an unauthorized transaction, he reversed it or broke the trade.⁹⁹

III. The Brokers and Their Customers

A. Fernando (a.k.a. Daniel) Fernandez

After receiving a General Education Diploma and working as a laborer, Fernandez, now 26 years old, first entered the securities industry in July 1999 as a broker-trainee at Emerson Bennett & Associates.¹⁰⁰ Shortly after his license was

⁹⁴ C64, C103, C107; Tr. 1639:20-1642:7.

⁹⁵ C168 41:2-12, 42:5-13, C170 39:13-40:9; Tr. 996:11-16, 1303:6-13, 1797:18-1798:4.

⁹⁶ Tr. 997:21-998:4, 1797:18-24. Their testimony is consistent with the routine use of odd-lot purchases that appear to have been executed for no purpose other than to use up cash in an account.

⁹⁷ Tr. 998:5-999:7; C168 41:17-23, C170 42:1-9.

⁹⁸ Tr. 998:5-999:7.

⁹⁹ Tr. 1304:7-8.

¹⁰⁰ C48 p. 6; Tr. 1415:21-1416:1, 1546:25-1547:1.

approved, Fernandez left Emerson Bennett because of a dispute over a pay check, and then worked as a telemarketer for approximately five months.¹⁰¹

Responding to an advertisement in a local newspaper, Fernandez interviewed at Florida Discount.¹⁰² Fernandez spoke with Rich, who told Fernandez that he would not have a problem registering his license, notwithstanding Fernandez's juvenile criminal history.¹⁰³ On September 13, 2000, Fernandez became registered with NASD through Florida Discount as a general securities representative.¹⁰⁴

Fernandez was one of Florida Discount's top two producers in CPFS and BSDS.¹⁰⁵ He had approximately 120 customers, 100 of whom owned either CPFS or BSDS.¹⁰⁶ Initially, Fernandez was promised a 100 percent payout for selling CPFS.¹⁰⁷ He was also promised stock options.¹⁰⁸ Fernandez made approximately \$175,000 in his two years at Florida Discount.¹⁰⁹

Fernandez admitted that he used the scripts distributed by Rich to take indications of interest and solicit CPFS and BSDS to his customers.¹¹⁰ He did no research of his own on CPFS, and never provided his customers with any negative information about CPFS

¹⁰¹ C48 p. 5; Tr. 1463:23-1464:8, 1464:25-1465:9.

¹⁰² Tr. 1465:17-1466:5.

¹⁰³ Tr. 1465:10-20, 1466:6-8. On January 21, 1997, Fernandez was convicted of discharging a firearm in public, a first-degree felony, for which he was sentenced to one year in the Palm Beach County jail followed by court-authorized work release and house arrest. C48 p. 10. In addition, on September 16, 1999, Fernandez was sentenced to six months of probation after being convicted of the crime of petty theft in Palm Beach County. C48 p. 13.

¹⁰⁴ C48 pp. 4, 6; Tr. 1415:18-20, 1466:9-12.

¹⁰⁵ Tr. 1634:14-1635:1, 1659:19-22.

¹⁰⁶ C158, C168 72:5-11; Tr. 1461:15-1462:5.

¹⁰⁷ Tr. 1435:23-1436:3. Initially, Fernandez's typical payout was 75 percent. C168 49:17-20. As more brokers joined Florida Discount, Rich modified Fernandez's typical payout, which, depending upon production, ranged from 50 to 65 percent. C168 49:5-14, 21-22.

¹⁰⁸ Tr. 1443:2-5.

¹⁰⁹ C168 20:18-21:3, 52:17-53:15.

¹¹⁰ Tr. 1427:13-17, 1444:25-1445:2, 1467:20-1468:3.

when he solicited their purchases of the stock.¹¹¹ He came to believe that the CPFS stock that was being sold to customers was coming from Rich.¹¹² He also realized that the price of BSDS was staying up only because Florida Discount was buying the stock for its customers.¹¹³

Two former customers testified during the hearing about Fernandez's acts and practices in soliciting CPFS and BSDS:

1. Customer RP

Customer RP is a retired, small-business owner from Lantana, Florida.¹¹⁴ Born in 1954, RP was a high school graduate who started a lawnmower shop that expanded into providing lawn maintenance and sweeping services for shopping center parking lots.¹¹⁵ RP sold his business in 1997, and since then, he has cared for his son, who has muscular dystrophy.¹¹⁶ RP had limited investment experience, did not consider himself a sophisticated investor, and was not interested in speculative investments.¹¹⁷

RP learned about Florida Discount from his father who had an account with the firm.¹¹⁸ After he received a phone call from Fernandez, RP decided to open two accounts at Florida Discount, believing it to be a safe place to put some money.¹¹⁹ RP opened a personal account in his own name in March 2001, and a joint account with his wife in April of 2001, with Fernandez as his broker on both accounts.¹²⁰ RP's new account

¹¹¹ C168 27:5-12.

¹¹² Tr. 1442:3-17.

¹¹³ C168 62:15-24, 64:13-65:4.

¹¹⁴ Tr. 173:8-174:21; C116, C120.

¹¹⁵ Tr. 174:3-17; C116, C120.

¹¹⁶ Tr. 174:22-175:3.

¹¹⁷ Tr. 175:23-177:2.

¹¹⁸ Tr. 177:6-9.

¹¹⁹ Tr. 177:9-13; C116, C120.

¹²⁰ Tr. 178:4-182:9; C116, C120.

forms show that his estimated annual income was \$50,000.¹²¹ His estimated net worth, exclusive of primary residence, exceeded one million dollars, and his liquid net worth was \$100,000.¹²²

RP told Fernandez, and his new account forms for both accounts state, that his investment objectives for both accounts were income and trading profits.¹²³ RP also told Fernandez that he was not a “risk taker” or a “gambler” and that he “didn’t take chances.”¹²⁴ Neither account form indicated that RP was interested in speculation.¹²⁵

Initially, Fernandez called RP as much as twice a week, and he frequently discussed CPFS and BSDS with him.¹²⁶ Fernandez referred to CPFS and BSDS as “start-up” companies and claimed that they would be acquired by another company.¹²⁷ Fernandez recommended that RP purchase the stocks and RP, who trusted Fernandez, followed his advice.¹²⁸

In soliciting the purchase of those stocks, Fernandez told RP that CPFS was a holding company that made money every time a stock was bought or sold.¹²⁹ Consistent with the pitches contained in the scripts, Fernandez told RP that CPFS and BSDS each was a “special deal,” and that not everyone could buy them because they were not publicly sold.¹³⁰ Fernandez also told RP to hold the stock for at least three months

¹²¹ C116 p. 1, C120 p. 1.

¹²² *Id.*

¹²³ Tr. 179:18-180:11, 181:15-25; C116, C120.

¹²⁴ Tr. 183:8-22.

¹²⁵ Tr. 180:7-11; C116, C120.

¹²⁶ Tr. 183:23-184:14.

¹²⁷ Tr. 215:14-17, 191:13-192:2.

¹²⁸ Tr. 184:22-185:1, 185:17-186:13, 192:21-193:3; C121 p. 4.

¹²⁹ Tr. 186:14-22. On cross examination, RP acknowledged that Fernandez also sold him Knight Trading Group and that he may have been confused because he was told that Knight made money on trades. Tr. 209:12-19. RP affirmed, however, that Fernandez told him that CPFS made money on the trading of stocks as well. Tr. 209:21-22.

¹³⁰ Tr. 188:14-23, 206:12-16, 207:11-17.

because he predicted that the price would go up to \$12 or \$13.¹³¹ Fernandez also predicted that the price could go to \$15 “if [either stock] went public.”¹³² Likewise, Fernandez said that the price of BSDS would go up once it went public, and that within a few months, its price would rise to \$13 or \$15 per share.¹³³

From time to time, Fernandez would tell RP that he had the opportunity to purchase additional blocks of stock at a certain price, and would give RP deadlines to purchase the stock.¹³⁴ RP would sometimes act on the special opportunity and buy more shares.¹³⁵ Knowing that RP engaged in a hobby of renovating and selling cars, Fernandez would sometimes tell RP that he would hold the special offer open longer to give RP the opportunity to sell a car and raise cash for the deal.¹³⁶ After RP sold the car, he would send the money in to Fernandez to purchase the stock.¹³⁷ Fernandez also convinced RP to sell his other securities and use the proceeds to purchase more CPFS and BSDS.¹³⁸ Fernandez also wanted RP to agree that he would not sell CPFS and BSDS until the stocks hit the prices that Fernandez predicted.¹³⁹

¹³¹ Tr. 187:2-6.

¹³² Tr. 187:5-6.

¹³³ Tr. 191:13-22. Consistent with the remainder of his testimony, RP credibly testified that Fernandez guaranteed profits to him and told him that the stock was not yet public. Tr. 187:5, 13-17.

¹³⁴ Tr. 189:3-13.

¹³⁵ Tr. 189:14-21.

¹³⁶ Tr. 189:22-190:17.

¹³⁷ Tr. 190:15-17.

¹³⁸ Tr. 185:2-12.

¹³⁹ Tr. 188:2-13.

Fernandez never disclosed the risks associated with investing in CPFS or BSDS to RP.¹⁴⁰ Rather, he told RP that CPFS and BSDS were “sure things” and “pretty much guaranteed” that they would go up and make him money.¹⁴¹ Fernandez also did not tell RP that CPFS had an ownership interest in Florida Discount or that Florida Discount had a similar financial interest in CPFS.¹⁴²

Fernandez failed to disclose the financial condition of either company.¹⁴³ For example, he did not disclose that CPFS and BSDS had no relevant operating history, no significant financial resources, and no revenues from operations.¹⁴⁴ RP would not have purchased CPFS or BSDS had Fernandez disclosed such information.¹⁴⁵

RP’s accounts had inordinate concentrations of CPFS and BSDS.¹⁴⁶ By the end of May 2001, his sole equity investment at Florida Discount consisted of \$68,000 of CPFS in his joint account and \$17,000 in his personal account.¹⁴⁷ Fernandez then convinced RP to invest more money in CPFS and BSDS.¹⁴⁸ By the end of August 2002, CPFS and BSDS accounted for \$276,703, or 98.9 percent, of RP’s total personal account value of \$279,792.¹⁴⁹

¹⁴⁰ Tr. 187:7-10, 190:23-25, 191:6-9.

¹⁴¹ Tr. 187:11-188:1. Fernandez testified that he did no research on CPFS, followed the scripts word for word, and never provided his customers with any negative information about CPFS in his solicitation. He also testified that he told RP’s wife that “just like anything else . . . it could go down to zero, it could go up to a hundred.” C1, C168 27:5-12; Tr. 1478:18-1479:13, 1481:15-17.

¹⁴² Tr. 188:24-189:2.

¹⁴³ Tr. 190:19-22, 215:18-23.

¹⁴⁴ Tr. 191:1-5, 192:8-16.

¹⁴⁵ Tr. 191:10-12, 192:17-20.

¹⁴⁶ C117, C121.

¹⁴⁷ C117 p. 5, C121 p. 7. RP questioned Fernandez about the wisdom of putting so much money into CPFS and BSDS. Fernandez replied that RP should be patient, the stocks would “pay off,” and they both would be rich. Tr. 193:4-12.

¹⁴⁸ Tr. 193:13-20.

¹⁴⁹ C117 p. 36. The staff was able to obtain statements for RP’s joint account only through May 31, 2002. C121 pp. 22-25.

Fernandez failed to follow RP's instructions to sell his holdings.¹⁵⁰ In the summer of 2002, RP needed money to pay bills related to a log cabin he was building in West Virginia.¹⁵¹ RP told Fernandez to sell, but Fernandez stalled him, suggesting that RP wait until October because the mergers would soon be completed, and the stock would go to \$15.¹⁵²

In August 2002, Fernandez conducted a series of unauthorized "swaps" in RP's personal account.¹⁵³ On August 5, 2002, Fernandez sold \$94,888 of CPFS and purchased \$94,865 of BSDS with the proceeds.¹⁵⁴ The next day, on August 6, he sold \$14,372 of CPFS and purchased \$14,233 of BSDS with the proceeds.¹⁵⁵ A couple weeks later on August 23, Fernandez switched course and sold \$33,231 of BSDS and purchased \$33,090 of CPFS.¹⁵⁶ Five days later, Fernandez sold an additional \$96,056 of BSDS and purchased \$96,020 of CPFS.¹⁵⁷ RP, however, was not aware of this activity until he received his August account statements.¹⁵⁸

After he learned about these swap transactions, RP was not able to reach Fernandez.¹⁵⁹ Eventually, he spoke with Rich, who told him that Fernandez had left Florida Discount and that RP would get only \$1.50 a share if he wanted to sell his

¹⁵⁰ Tr. 194:17-195:14.

¹⁵¹ Tr. 194:20-195:5.

¹⁵² Tr. 195:9-14. RP also spoke with Rich about selling his holdings. Rich told RP to be patient. Tr. 218:12-18, 219:12-15.

¹⁵³ C117 p. 36. In addition, Fernandez would often swap CPFS for BSDS and visa versa in RP's accounts. C117, C121. For example, in his joint account on May 28, 2002, Fernandez sold \$81,143 of CPFS and purchased \$81,115 of BSDS with the proceeds. C121 p. 24. Just a few days later on May 31, 2002, Fernandez sold another \$55,413 of CPFS and purchased \$55,415 of BSDS with the proceeds. *Id.* After these transactions, RP held \$155,922 of BSDS and \$69,270 of CPFS and the two stocks accounted for 97 percent of his total account value. *Id.*

¹⁵⁴ *Id.*

¹⁵⁵ *Id.*

¹⁵⁶ *Id.*

¹⁵⁷ *Id.*

¹⁵⁸ Tr. 197:3-21. Fernandez charged RP \$9,465 for these swaps. C119 pp. 19-25.

¹⁵⁹ Tr. 197:22-198:7.

holdings in CPFS and BSDS.¹⁶⁰ RP did not know what to do and thought he would have to sell the log cabin in West Virginia.¹⁶¹

After Fernandez left Florida Discount and associated with LH Ross, he called RP and told him to sell CPFS and BSDS.¹⁶² RP eventually was convinced to transfer his account to Fernandez at LH Ross.¹⁶³ Fernandez then sold the CPFS and BSDS stock and put the proceeds in a stock that Fernandez said was obtained by LH Ross for the purpose of recovering some of the money clients lost from their investments while at Florida Discount.¹⁶⁴ That purchase, however, was also unauthorized by RP.¹⁶⁵

RP testified that, according to his attorney, he lost \$194,000 on his investments in CPFS and BSDS.¹⁶⁶ That loss represented a little more than half of RP's savings.¹⁶⁷

2. Customer JP

JP is 86 years old and has been retired for 15 to 20 years, having worked for many years as a farmer and then as an oil well worker.¹⁶⁸ He opened an account with Fernandez in April 2001, telling him that he wanted to preserve his capital.¹⁶⁹ Over time, he transferred to his Florida Discount accounts \$123,000 in cash, as well as other assets,

¹⁶⁰ Tr. 196:15-23, 198:15-19. RP spoke only on occasion with Rich until after Fernandez left Florida Discount. Tr. 219:16-19.

¹⁶¹ Tr. 196:24-197:2.

¹⁶² Tr. 199:1-10, 205:6-9.

¹⁶³ Tr. 207:23-208:7.

¹⁶⁴ Tr. 225:2-9, 231:17-232:6.

¹⁶⁵ Tr. 231:17-25.

¹⁶⁶ Tr. 199:17-20.

¹⁶⁷ Tr. 199:21-200:5. Through arbitration, RP was awarded approximately \$440,000 against Rich and Florida Discount. Tr. 203:2-18. However, RP has not been able to collect the award. Tr. 204:5-7. Through counsel's advice, RP dismissed his action against Fernandez, who RP believed was young and did not have extensive assets. Tr. 220:23-222:22. He also believed that he needed Fernandez to testify against Rich. Tr. 223:13-16. The dismissal of Fernandez was also part of a settlement relating to another arbitration concerning LH Ross. Tr. 224:12-20.

¹⁶⁸ Tr. 1144:11-14, 1163:6-18; C104 p. 1.

¹⁶⁹ Tr. 1145:21-23.

including \$54,000 in municipal bonds, \$27,759 that was invested in Schwab S&P 500 Fund Investor Shares, and other securities in which he had invested.¹⁷⁰

Fernandez recommended that JP purchase both CPFS and BSDS.¹⁷¹ However, Fernandez did not inform JP that CPFS and BSDS were non-operational shells or blank check companies that had no relevant operating histories, no significant financial resources, and no revenues or earnings from operations.¹⁷² Moreover, Fernandez never disclosed any risks of investing in CPFS or BSDS, nor did he tell JP that the auditors for each company had warned that they may not be able to continue as going concerns.¹⁷³ Finally, Fernandez failed to disclose that there was a no net-selling policy at Florida Discount, that he had been promised incentives for soliciting CPFS or BSDS, and that CPFS had an ownership interest in Florida Discount.¹⁷⁴

JP had excessive concentrations of CPFS and BSDS in his account.¹⁷⁵ By August 31, 2001, JP had deposited a total \$85,010 into his Florida Discount account.¹⁷⁶ However, as of that date, JP's only investment in the account was CPFS, which was valued at \$91,809.¹⁷⁷ By the end of December 2001, JP had transferred his municipal bond holdings and Schwab investments to Florida Discount.¹⁷⁸ On January 16, 2002, Fernandez sold JP's holdings in the Schwab investment, and by the end of April 2002, he sold JP's municipal bond holdings. The proceeds of both sales were used to purchase more CPFS and BSDS. Consequently, at the end of April 2002, JP held approximately

¹⁷⁰ Tr. 1146:5-18; C105 pp. 14-16.

¹⁷¹ Tr. 1146:19-23, 1148:17-19.

¹⁷² Tr. 1147:4-16, 1148:24-1149:7.

¹⁷³ Tr. 1147:17-25, 1149:8-14.

¹⁷⁴ Tr. 1148:1-16, 1149:15-22.

¹⁷⁵ C105, C109.

¹⁷⁶ C105 p. 9.

¹⁷⁷ C105 p. 11.

¹⁷⁸ C105 p. 12.

\$325,000 of CPFS and BSDS, or 73 percent of his total account value.¹⁷⁹ By the end of July 2002, JP's holdings in CPFS alone accounted for 82 percent of JP's total account value.¹⁸⁰

According to JP's account statements, there were approximately 63 transactions in CPFS and BSDS from January through August 2002.¹⁸¹ Notwithstanding Fernandez's testimony that many of the transactions were unsolicited,¹⁸² all but two of the confirmations and all of the order tickets are clearly marked "solicited."¹⁸³

In its post-hearing brief, the Department of Market Regulation avers that account records and testimony by JP that he recouped approximately \$40,000, "supports a very conservative finding that JP lost at least \$253,000 (\$353,000 less \$40,000) (sic) from his investments in CPFS and BSDS." However, there are no account statements in the record between August 2001 and January 2002. Market Regulation infers from the account value at the end of December 2001, which had increased by \$421,000, that the increase was attributed to cash or other deposits, rather than any increase in the market value of the securities in the account. In the absence of those account statements and any other evidence to establish the amount originally invested in the two securities, and the amount JP may have recouped from those investments, the Hearing Panel does not find sufficient reliable evidence upon which a quantifiable loss on the investments in CPFS and BSDS may be ascertained.

¹⁷⁹ C105 p. 26.

¹⁸⁰ C105 p. 42.

¹⁸¹ C105, C109.

¹⁸² C106, C110.

¹⁸³ C107 pp. 54, 58. The two exceptions concerned an August 14, 2002, sale of 651 shares of CPFS and a corresponding buy of 715 shares of BSDS. It is highly unlikely that a customer would place an order for those odd-lot transactions. Accordingly, the Hearing Panel does not credit Fernandez's claim that some of the 63 transactions were unsolicited. C106 pp. 50-51.

B. Adam Forman

Adam Forman, 35, first became registered as a general securities representative in 1996, and was associated with ten firms, before joining Florida Discount in July 2001.¹⁸⁴ Forman joined Florida Discount after answering a newspaper ad and meeting with Spanier.¹⁸⁵ Rich eventually interviewed Forman and hired him.¹⁸⁶

Forman received a \$10,000 signing bonus that was paid to him over a period of several months.¹⁸⁷ He was also offered various incentives for soliciting CPFS, including a vacation and stock options that depended upon how much of the stock he sold.¹⁸⁸ Rich also offered him a full 5 percent commission payout for sales of CPFS and BSDS.¹⁸⁹ Forman made approximately \$220,000 while he was employed with Florida Discount.¹⁹⁰

Rich referred to Forman as his “right hand man.”¹⁹¹ Forman was also one of the firm’s top producers.¹⁹² He opened many accounts and had a large number of clients, including some that he inherited from other brokers who had left the firm.¹⁹³ Forman sold CPFS and BSDS to all of his clients, who he estimated numbered at least 70.¹⁹⁴

From the beginning, Forman knew that CPFS and BSDS were “house stocks.”¹⁹⁵ As noted previously, he needed only to peruse the sales scripts and, because he had a

¹⁸⁴ C49 p. 3.

¹⁸⁵ Tr. 1179:6; C170 20:11-21:3, C160.

¹⁸⁶ Tr. 1179:24-25; C170 20:21-24.

¹⁸⁷ Tr. 1180:8-12, 1185:16-23.

¹⁸⁸ Tr. 1225:22-1226:16, 1228:2-17.

¹⁸⁹ Tr. 1188:7-19.

¹⁹⁰ C170 32:24-33:4.

¹⁹¹ Tr. 1717:14-1718:3. Forman trained new brokers to open accounts, and participated in hiring interviews. Tr. 1220:4-12, 50:21-24, 52:5-6. Rich also asked Forman to help brokers who were struggling. Forman said that he had helped out every broker in the room. C170 32:19-23.

¹⁹² Tr. 1373:12-16.

¹⁹³ Tr. 1212:4-5; C170 25:19-23.

¹⁹⁴ C159, C171 112:8-10.

¹⁹⁵ Tr. 1200:6-11; C171 90:4-6.

good memory, could pitch the stocks without reading or practicing the scripts.¹⁹⁶ Forman confirmed that Rich would listen to the pitches and give instructions over the phone if he did not like what was being said.¹⁹⁷

Consistent with the scripts, Forman told customers that the firm was engaging in investment banking, even though he knew that Florida Discount had no investment-banking department.¹⁹⁸ In pitching CPFS to customers, Forman represented that Florida Discount would become a public company through CPFS; and that the increased value of the assets in the merged company would be reflected in the price of the stock.¹⁹⁹ Forman compared CPFS's planned acquisitions to "major banking consolidations" such as the merger of Dean Witter with Morgan Stanley.²⁰⁰

In soliciting purchases of BSDS, Forman represented that Florida Discount was "successful at investment banking," referring to its purported deal with CPFS.²⁰¹ He represented to customers that BSDS was a small company; and was about to start trading. He claimed that it had a software company, valued at a million dollars, that developed a program used by pawnshops in Florida.²⁰² Forman also told customers that a company named Orca Yachts, with eleven million dollars in assets, was going to buy out the small software company to take it public.²⁰³

¹⁹⁶ Tr. 1279:7-10.

¹⁹⁷ C171 81:11-14.

¹⁹⁸ Tr. 1221:4-10. The promotion of CPFS, however, was not to raise money for the company: it was, according to Forman, "just buying stock" that would be "used as currency to merge, buy and acquire different brokerage firms and businesses related to the brokerage business." Tr. 1221:25-1222:8.

¹⁹⁹ C171 142:13-23.

²⁰⁰ C171 142:23-143:12; Tr. 1263:5-9.

²⁰¹ Tr. 1274:2-3.

²⁰² Tr. 1274:5-8. Forman testified that Rich was his only source for the assertion that BSDS owned a million dollar software company that developed software for Florida pawnshops. Tr. 1275:24-1276:5. He was unable to find any financial information on BSDS and could not explain how a purported shell company could own a million dollar asset. Tr. 1386:9-1388:17.

²⁰³ Tr. 1276:24-1277:1, 11-20.

Forman had no recollection of discussing suitability with two of his customers who testified at the hearing.²⁰⁴ He did not discuss investment objectives with two others.²⁰⁵ As noted before, he engaged in the no net-selling practice at Florida Discount, and was well aware of how Rich would hold order tickets without execution for several days.²⁰⁶ In fact, many of Forman's tickets had multiple alterations, including changes of price, trade date, quantity, markups and commissions, and, in at least one instance, a change in the name of the customer.²⁰⁷ Finally, Forman believed that the rising price of CPFS was attributable to the way Rich traded the stock.²⁰⁸

As noted earlier, Forman engaged in coordinated cross transactions between customer accounts, swapped CPFS and BSDS in his customers' accounts, and engaged in coordinated cross transactions between customer accounts. He continued that activity even after he first noticed signs of trouble and began to feel uncomfortable about CPFS in August 2002 when he saw the news announcement about the Muni Financial acquisition and the appointment of Spanier as president of CPFS.²⁰⁹ Nevertheless, despite his purported "substantial concern," Forman continued to recommend substantial purchases of CPFS and BSDS to his clients.²¹⁰

Four of Forman's customers testified at the hearing: MH, GP, RS and RW:

²⁰⁴ Tr. 1331:11-20.

²⁰⁵ Tr. 1333:6-10, 16-23.

²⁰⁶ C171 113:9-23; Tr. 1260:13-22.

²⁰⁷ For example, a review of customer MH's 11 order tickets shows that 10 have multiple alterations, with portions crossed out, or obliterated, and changed. C85. It is more likely than not that the changes were made by Rich during the period of time he held the tickets.

²⁰⁸ Tr. 1260:1-12.

²⁰⁹ Tr. 1205:7-15, 1288:9-18; C19 p. 7. Forman claimed that he was bothered because, as he told Rich, "if we were waiting all this time for [news of mergers and acquisitions and heard only about] such a small acquisition," his customers would not be satisfied. Tr. 1288:22-24. He knew Muni as an "older guy" who ran a "semi-successful" insurance company." C171 106:14-24. He also knew Spanier as the former recruiter who would "pop in" from time to time and who looked "goofy." Tr. 1218:19-1219:4.

²¹⁰ For example, on August 27, 2002, Forman sold MH's position in BSDS for \$62,550 and purchased CPFS with the proceeds for \$62,475, thereby swapping MH's position in BSDS for CPFS. C84 pp. 12-13. Forman also engaged in a flurry of purchases of CPFS in RS's accounts. C128 p. 40, C129 pp. 12-23.

1. Customer MH

MH is an 82-year-old retiree. After finishing high school, he was employed as an engineer for three years before being drafted into the Army.²¹¹ After the war, he worked for a contractor in Baltimore, Maryland for thirteen years, and then went into business for himself until 1992 when he retired.²¹²

MH first opened his account at Florida Discount with John Heilman.²¹³ Celestin then replaced Heilman as MH's broker but stayed with the account for only a short time.²¹⁴ Forman, who identified himself as a senior vice president at Florida Discount, told MH that he was taking over the account from Celestin.²¹⁵ Forman first told MH that Celestin was in California looking for firms to purchase, and later told him that Celestin had suffered a heart attack.²¹⁶

MH's investment objectives were preservation of capital and reasonable growth; his goal was to provide funds for his retirement.²¹⁷ He made those investment objectives clear to Heilman, Celestin, and Forman.²¹⁸ However, Forman said nothing to MH about the risks of investing in CPFS; he failed to inform him of the financial condition of the company; and he failed to inform him that the investment was not consistent with his stated investment objectives. He strongly recommended CPFS to MH, telling him that it

²¹¹ Tr. 373:3-7.

²¹² Tr. 374:15-375:8.

²¹³ Tr. 377:3-5.

²¹⁴ Tr. 377:10-18.

²¹⁵ Tr. 380:22-23, 381:1-3.

²¹⁶ Tr. 377:25-378:2, 380:3-8. For some time after Forman had become MH's broker, Celestin's name continued to appear on MH's account statements. Tr. 379:5-11. MH asked Forman why Celestin's name was on the account, and eventually Forman's name appeared on the statements as the broker for the account. Tr. 379:12-25.

²¹⁷ Tr. 376:11-23.

²¹⁸ Tr. 382:13-22.

was a good investment, that he was acting in MH's interest, and that he was not charging him commissions.²¹⁹

After successfully urging MH to transfer an account he had at Merrill Lynch to Florida Discount, Forman pressured him to put everything into CPFS. MH told Forman that he was reluctant to do so, he preferred diversification to having all of his money in one place, and he did not know anything about CPFS.²²⁰ Forman told him not to worry because "we have that under control ... we have the ability to know what's going on."²²¹

Although MH did not authorize Forman to invest the entire Merrill Lynch account in CPFS, in April 2002, without informing MH, Forman sold all of the stocks and bonds in that transferred account and bought 10,000 shares of CPFS for \$47,815.²²² MH only learned about these transactions when Forman called him to announce that he had "made" \$15,000 for him.²²³ When MH complained that he had not authorized the transactions, Forman told him to go play golf and let Forman run the account.²²⁴

In August 2002, Forman called MH, proposing to sell MH's position in CPFS and use the proceeds to purchase BSDS.²²⁵ Forman told MH that BSDS was a software company whose stock was good and was going to go up in price. He recommended that MH buy it.²²⁶ Forman promised MH that the transaction would not be a "marriage," but would be short-term; that is, he was just going to "park" the proceeds from the sale of

²¹⁹ Tr. 386:24-387:3, 20-21, 392:14-25. In fact, Forman was charging MH markups and markdowns. C85. Forman told MH that he would start charging commissions only after the account grew in value to \$100,000. Tr. 393:1-4.

²²⁰ Tr. 385:10-386:23.

²²¹ Tr. 386:14-17.

²²² Tr. 389:17-24, 390:10-12. Ten of the transferred stocks and bonds settled on April 24, and an eleventh, on April 25, 2002. C83 p. 37. The order ticket for the purchase of 10,000 shares of CPFS is dated April 24, 2002, is marked solicited, and reflects a markup of .22 for a total of \$2200. C85 p. 3.

²²³ Tr. 389:25-390:9.

²²⁴ Tr. 389:16-19.

²²⁵ Tr. 395:10-19.

²²⁶ Tr. 397:21-398:6.

CPFS for a week, he knew the share price of BSDS would increase, and after MH made five to ten thousand dollars from the transaction, Forman would put him back in CPFS.²²⁷ Despite the recommendation, MH told Forman that he did not want “everything I have in one basket,” and he did not authorize Forman to execute the transaction.²²⁸ MH told Forman he wanted to see his investment in CPFS come to fruition, as Forman had promised.²²⁹

Notwithstanding his instructions, when MH received his August 2002 statement, he discovered that Forman had executed the transaction.²³⁰ On August 30, 2002, Forman sold MH’s position in CPFS for \$62,533 and purchased 7,350 shares of BSDS for a total of \$62,490.²³¹

MH called Florida Discount to discuss these transactions with Forman but was told by Rich that Forman had left the firm.²³² Rich put MH off until October 28, 2002, and when MH called on that date, he learned that Florida Discount had been sold to Indianapolis Securities.²³³ Indianapolis sold part of his BSDS position for approximately \$6,700.²³⁴ Soon thereafter, MH was told that Indianapolis had gone out of business.²³⁵ He estimates his financial loss as a consequence of Forman’s unauthorized trading was

²²⁷ Tr. 396:4-10, 397:1-18.

²²⁸ Tr. 395:24-396:3, 398:10-11.

²²⁹ Tr. 395:20-23.

²³⁰ Tr. 398:11-14.

²³¹ C83 p. 53. When asked if he recommended the transaction to MH, Forman testified: “I’m not saying I didn’t do it ... I don’t recall. I definitely don’t remember anything about parking. I may have.” Tr. 1362:18-25. Later, when questioned by a panel member, Forman claimed MH had lied. Tr. 1369:8-11. Forman’s commissions on the transaction totaled \$4212 . C85 pp. 10-11.

²³² Tr. 398:15-16, 399:18-401:4.

²³³ Tr. 402:1-4.

²³⁴ Tr. 402:10-11.

²³⁵ Tr. 402:14-21.

approximately \$55,000.²³⁶ However, the Hearing Panel notes that the value of the account transferred from Merrill Lynch was only \$47,815, and, if MH recouped \$6,700 from Indianapolis, his net loss would have been \$41,115.

2. Customer GP

Customer GP, 82 years of age, served in the U.S. Navy in World War II.²³⁷ After the war, he took courses at night to learn air conditioning and refrigeration engineering, and made a career in sales.²³⁸ He retired in 1987 and relocated from Massachusetts to Florida.²³⁹

After he acquired enough savings, GP began to make conservative investments in the stock market.²⁴⁰ Eventually his investments grew to the extent that, on advice from lawyers, he put his assets into two trusts.²⁴¹ His investment objectives were to provide for the education of his children, provide for his retirement, and build an estate for his heirs.²⁴²

GP learned of Florida Discount through a call from Celestin.²⁴³ He visited Florida Discount's office to meet with Celestin personally, and was introduced to Rich, who assured him that he would oversee Celestin's recommendations.²⁴⁴ GP told Celestin and Rich that he was a conservative investor, and that the money he invested came from his

²³⁶ MH bases this on the value of the BSDS position that was sent to Indianapolis Securities, which according to his statements was \$62,490, minus the \$6,700 he received for the sale of a block of BSDS by Indianapolis.

²³⁷ Tr. 483:10-14, 484:25.

²³⁸ Tr. 484:2-5.

²³⁹ Tr. 484:22-23, 485:7-9.

²⁴⁰ Tr. 486:17-20.

²⁴¹ Tr. 487:24-488:3.

²⁴² Tr. 488:16-24.

²⁴³ Tr. 489:19-25.

²⁴⁴ Tr. 490:2-3, 21-23.

earnings and that he put his savings into his trust.²⁴⁵ His account opening application describes his investment objectives as income and growth.²⁴⁶

When Celestin and Rich told him about CPFS, GP understood it was a speculative investment, but Celestin and Rich talked him into investing in the company.²⁴⁷ Relying on the strong recommendations made by Rich and Celestin, GP authorized purchases of both CPFS and BSDS.²⁴⁸ He did not recall much of what they told him about the companies other than that they were going to buy other companies and their stock would appreciate in value.²⁴⁹ They gave GP the impression that the stock would double in value in a year.²⁵⁰

At sometime around April 2002, Forman took over GP's account and told him that he was filling in for Celestin who was in California on business, opening a branch office.²⁵¹ By the end of April, GP's account was worth almost \$105,000, and, with the exception of about \$70, consisted entirely of CPFS and BSDS. On May 2, Forman sold 8,050 shares of BSDS for \$61,565.64 and purchased 10,340 shares of CPFS for \$60,814.20.²⁵² On July 26, Forman swapped the stocks again by selling 10,000 shares of

²⁴⁵ Tr. 491:4-9, 16-23.

²⁴⁶ C112 p. 1; Tr. 494:4-10.

²⁴⁷ Tr. 496:8-14.

²⁴⁸ Tr. 497:8-10. GP was surprised when he later reviewed his records and saw how much CPFS had been purchased. Tr. 496:21-23.

²⁴⁹ Tr. 497:16-22.

²⁵⁰ Tr. 498:2-3.

²⁵¹ Tr. 498:21-24. Forman's name first appears on GP's April 2002 monthly statement next to Celestin's name in the space for "Rep name." C113 p. 37.

²⁵² C113 p. 39. Forman charged GP \$4,907.70 for stock swap. C115 pp. 3-4.

CPFS for \$61,983.13 and purchasing 7,350 shares of BSDS for \$62,490.²⁵³ By the end of August, CPFS and BSDS accounted for GP's total account value of just over \$140,000.²⁵⁴

GP estimated that he lost more than \$100,000 as a consequence of his purchases of CPFS and BSDS.²⁵⁵ His account records show that at least \$67,637 was invested in CPFS when Celestin was the broker on his account.²⁵⁶

3. Customer RS

RS, 79, attended school through the seventh grade, worked for a year at Wright Patterson Air Force Base, and then served in the Navy until 1946.²⁵⁷ He returned to Wright Patterson where he began a 39-year career testing hydraulic mechanisms, before retiring in Ohio. His investment experience has generally been in certificates of deposit and utilities. His objective has been long-term growth.²⁵⁸

RS learned of Florida Discount when Celestin called him in January 2001.²⁵⁹ Celestin eventually recommended CPFS to RS, representing that the company dealt with mergers and could make him a lot of money.²⁶⁰ Celestin also strongly recommended the purchase of BSDS; which he said also would be a good investment and make money for him.²⁶¹ Celestin never told RS anything about the financial condition of either company, the risks of investing in them, or that CPFS was non-operational.²⁶² By the end of August 2001, RS had deposited \$36,104.50 in his account; \$33,330 of the account value of

²⁵³ C113 p. 48. Forman charged GP \$3,690.50 for this swap. C15 pp. 5-6. Forman admitted that he did not discuss GP's investment objectives because he claimed this was a small account with which GP told him he wanted "to have a little bit of fun." Tr. 1333:12-23. Forman even suggested GP had referred to it as play money in his testimony at the hearing; in fact, GP did not.

²⁵⁴ C113 p. 52.

²⁵⁵ Tr. 518:10-11.

²⁵⁶ C113 pp. 5, 21, 28.

²⁵⁷ Tr. 722:14-25, 723:14-20.

²⁵⁸ Tr. 725:23-726:8.

²⁵⁹ Tr. 727:1-6.

²⁶⁰ Tr. 729:4-9, 15-17.

²⁶¹ Tr. 731:2-8.

²⁶² Tr. 731:9-11, 17-23.

\$38,755.44 was invested in CPFS.²⁶³ By the end of February 2002, the two stocks comprised all but \$1,488 of the account which was valued at \$59,023.95.²⁶⁴

Sometime around April 2002, RS began to deal with Forman who told RS that Celestin was on the West Coast doing “investment banking.”²⁶⁵ From that time forward, his contact with Florida Discount was Forman.²⁶⁶

In or about July 2002, Forman convinced RS to transfer an account he had at Smith Barney to Florida Discount.²⁶⁷ RS told Forman that the money he had put into his Smith Barney account over the years represented his life savings, and that he was worried about having too much of his account invested in two stocks.²⁶⁸ However, Forman recommended that his money be used to purchase CPFS and BSDS.²⁶⁹ RS told Forman that he did not want “all the money put in those two particular stocks,” and that he “wasn’t diversified enough.”²⁷⁰ Nevertheless, between August 13 and 30, 2002, Forman effected eight transactions for that very purpose; by the end of the month, the two stocks comprised almost \$124,000 of RS’s \$129,170.42 account value.²⁷¹

RS was unaware of what was happening to his account. From September 5 through 12, RS tried to reach Forman, who, in the meantime, had left a message on RS’s

²⁶³ C128 pp. 17, 19. RS’s account records are incomplete. C128 contains account statements dating from January through August 2001 for one account (pages 1 to 19), and for another, from January 2001 through September 2002 (pages 20-46). There are no statements for an additional IRA account.

²⁶⁴ C128 p. 25.

²⁶⁵ Tr. 732:6-13.

²⁶⁶ Tr. 732:18-21. Forman had no idea whether RS knew anything about CPFS or BSDS. Tr. 1308:19-24. Although he was “pretty sure” RS’s “account had a sizable position” in CPFS and BSDS, Forman surmised that he “may not have said too much to him [RS] thinking he already” had the information “he needed to make him take the position he was taking.” Tr. 1309:3-9.

²⁶⁷ Tr. 733:1-20; C128 p. 37.

²⁶⁸ Tr. 733:16-734:1, 741:9-12, 735:4-22.

²⁶⁹ Tr. 750:3-6.

²⁷⁰ Tr. 735:25-736:12.

²⁷¹ C128 p. 40. All but one of these transactions occurred after August 12, the date of the news release that caused Forman “substantial concern” about CPFS.

telephone saying that the account was fine.²⁷² RS finally succeeded in reaching Forman on September 12. Forman told RS that he had been too busy to return his calls but would call him back the next day. However, Forman did not make that call.²⁷³ Eventually, RS reached Rich who told him Forman had left the firm.²⁷⁴ Forman subsequently called RS to inform him that he had left Florida Discount and to advise him to sell his positions in CPFS and BSDS. When RS expressed his fear that he would lose all his money as a result of selling those shares, Forman assured him that he would be able to recover his money as a result of a lawsuit Forman claimed he and the other brokers were filing against Florida Discount.²⁷⁵ Not knowing whom to believe, RS left his account with Florida Discount and Bruce Rich as his broker.²⁷⁶

RS's account was transferred to Indianapolis Securities after it purchased Florida Discount. Later, on the advice of his daughter, RS moved the account to Schwab.²⁷⁷ RS estimated that he lost "practically everything" he had in his life savings.²⁷⁸ His daughter, NG, is an accountant who works for an investment firm. She testified that RS ultimately lost \$106,317.58 from his investments in CPFS and BSDS.²⁷⁹ However, she did not break out the amount of money that was invested with Forman as the broker of record, nor did she calculate the amount that could have been recovered had RS sold his positions at the time Forman recommended that he do so.

²⁷² Tr. 736:22-737:12

²⁷³ Tr. 737:15-22.

²⁷⁴ Tr. 738:9-16.

²⁷⁵ Tr. 738:22-739:8.

²⁷⁶ Tr. 739:9-24.

²⁷⁷ Tr. 740:2-3, 21-23.

²⁷⁸ Tr. 741:3-8.

²⁷⁹ Tr. 752:5-16, 753:1-20.

4. Customer RW

RW, 84, lives in Denver, Colorado, where he builds houses and does engineering and architectural consulting.²⁸⁰ He holds degrees in mechanical engineering and architecture.²⁸¹ He first invested in the stock market in the nineteen-fifties, and has relied on the advice of brokers because he is not a sophisticated investor.²⁸² In the beginning, his investment objective was growth, in order to build an estate for his children and grandchildren.²⁸³ At the outset of his involvement with Forman, RW's net worth was approximately three million dollars.²⁸⁴

A person with whom he was acquainted through a charitable organization told RW that Florida Discount had acquired a shell corporation and was offering an opportunity to buy CPFS stock below market price with a guaranteed profit within 45 to 90 days.²⁸⁵ Accordingly, in early April 2002, RW sent \$25,125 to Florida Discount to invest.²⁸⁶ Shortly thereafter, Forman called RW and confirmed what RW had been told about CPFS.²⁸⁷ Forman, either on that occasion or later, predicted that CPFS would go up in price to eight or eight and a half dollars per share within a short period of time. The cost to RW was three dollars and thirty-five cents.²⁸⁸

Forman also sent RW an account application that was marked up for RW to fill out.²⁸⁹ RW indicated that he had limited investment knowledge, and that growth and

²⁸⁰ Tr. 795:10-19.

²⁸¹ Tr. 791:22-792:5, 794:11-14.

²⁸² Tr. 796:23-797-11. With blunt candor, RW described himself as a "stupid" investor.

²⁸³ Tr. 797:15-23.

²⁸⁴ Tr. 833:9-12.

²⁸⁵ Tr. 798:7-800:4.

²⁸⁶ Tr. 800:12-19, 801:14-16.

²⁸⁷ Tr. 810:5-8.

²⁸⁸ Tr. 803:15-804:3.

²⁸⁹ Tr. 802:17-21, 804:12-17; C138 p. 1.

speculation were his investment objectives.²⁹⁰ RW felt that limited speculation would be permissible in light of his net worth.²⁹¹ His practice was to instruct his broker with a stop loss order to sell when the price falls eight to ten percent below his cost.²⁹² RW was certain that he gave a stop loss instruction to Forman.²⁹³

Forman called RW frequently, sometimes daily, to discuss the account.²⁹⁴ RW's first purchase was for 7,000 shares of CPFS for \$25,125.²⁹⁵ Soon, however, on the recommendation of Forman, RW made additional purchases of CPFS and BSDS.²⁹⁶ RW deposited an additional \$50,000 in the account, and, by the end of August 2002, the two stocks comprised practically all of the account which was valued at \$78,419.50.²⁹⁷

Forman also learned that RW had a personal IRA account at Schwab and had RW transfer it to Florida Discount.²⁹⁸ Almost immediately, Forman sold the securities in the account and purchased BSDS and CPFS.²⁹⁹ Forman told RW that BSDS and CPFS would go to eight and a half dollars per share, and, at one time, predicted the prices would rise to ten dollars per share.³⁰⁰

After Forman left Florida Discount, he called RW to advise him to sell his positions in CPFS and BSDS, and he said that Rich had not exercised the stop-loss orders on those shares.³⁰¹ RW decided to keep his accounts at Florida Discount, rather than

²⁹⁰ Tr. 805:8-23.

²⁹¹ Tr. 806:1-6.

²⁹² Tr. 806:10-14.

²⁹³ Tr. 806:22-807:11.

²⁹⁴ Tr. 808:13-21. Dante Calicchio's name also appeared for a time alongside Forman's as the account's registered representatives; RW believed Calicchio to be Forman's assistant. Tr. 808:9-13.

²⁹⁵ Tr. 809:2-8.

²⁹⁶ Tr. 810:9-22. In soliciting RW's purchase of BSDS, Forman said nothing about the financial condition of the company or the risks associated with investing in it. Tr. 813:10-15.

²⁹⁷ C139 p. 17.

²⁹⁸ Tr. 815:22-816:20.

²⁹⁹ Tr. 823:1-9.

³⁰⁰ Tr. 820:14-21.

³⁰¹ Tr. 825:8-15.

transfer them to Forman at another firm.³⁰² RW calculated that he lost \$51,370 from his investments in BSDS and CPFS in his original Florida Discount account and an additional \$25,033 in his rolled-over IRA account, for a total loss of \$76,403.³⁰³

C. Shannon Norris

Norris first entered the securities industry in 1997, and was employed by six member firms before becoming associated with Florida Discount on April 22, 2002.³⁰⁴ Norris learned about Florida Discount from Fernandez, with whom he had worked at Emerson Bennett.³⁰⁵ Rich offered Norris a \$25,000 signing bonus and told him that his payout would be between 65 to 75 percent of commissions, depending on the amount of business he did.³⁰⁶

Although he was with Florida Discount for only about four and one-half months, Norris was one of Florida Discount's top producers.³⁰⁷ Of his approximately 50 customers, half purchased CPFS or BSDS in large amounts.³⁰⁸ Norris made approximately \$40,000 during the short time he was with Florida Discount.³⁰⁹

When he solicited his customers to purchase CPFS and BSDS, Rich would listen in on Norris's conversations, without the customers' knowledge, and instruct Norris on

³⁰² Tr. 825:16-21.

³⁰³ Tr. 827:7-13.

³⁰⁴ Tr. 848:14-19, 850:11-13, 21-24; C50 p. 3, 5.

³⁰⁵ Tr. 851:4-18. Fernandez told Norris that Paul Harry was the primary boss of Florida Discount. Tr. 857:6-17.

³⁰⁶ Tr. 852:2-8, 854:2-6; C173 42:23-43:13.

³⁰⁷ Tr. 1634:23-1635:2, 1659:19-1660:1.

³⁰⁸ Tr. 858:4-6, 860:3-18, 861:16-23.

³⁰⁹ Tr. 864:15-22, 904:11-14.

what to say.³¹⁰ Norris also used Rich's office to call customers from whom he was soliciting a large order.³¹¹ He gave all of his tickets to Rich.³¹²

Norris knew that CPFS was just a shell company which, according to Rich, had a small ownership interest in Florida Discount.³¹³ Norris was not aware of any due diligence file on CPFS at Florida Discount.³¹⁴ His own due diligence on CPFS consisted of searching the Internet for price and performance charts on the stock.³¹⁵ He was not aware of any news that was disseminated by CPFS while he was with Florida Discount, although he attended the bi-weekly broker meetings during which Rich would discuss BSDS and CPFS and possible news announcements about them.³¹⁶

Norris solicited the purchase CPFS on the basis that its price was rising, when the rest of the market was down 80 percent.³¹⁷ He also told customers that news announcements about the company were soon to be released; that CPFS would be consolidating failing brokerage businesses; and that eventually Florida Discount would become a public company through CPFS.³¹⁸ However, he did not know the basis upon which the price of the stock was rising, and he did not know that value of Florida Discount or how its value might affect the price of CPFS.³¹⁹

Norris was aware that BSDS was a shell company, but he was not aware of any due diligence file on BSDS at Florida Discount, and he did no research on BSDS

³¹⁰ C173 32:4-13.

³¹¹ C173 31:20-25.

³¹² Tr. 947:11-17.

³¹³ Tr. 868:4-6, 867:22-25; C173 37:9-15.

³¹⁴ Tr. 869:25-870:4.

³¹⁵ Tr. 868:16-869:2.

³¹⁶ Tr. 865:8-15, 871:9-13.

³¹⁷ Tr. 866:3-11, 867:17-19.

³¹⁸ Tr. 868:1-3, 892:1-11.

³¹⁹ Tr. 867:20-25, 870:5-14, 893:19-21.

himself.³²⁰ Although Rich told Norris that there were going to be numerous acquisitions concerning BSDS, they never materialized.³²¹

Norris pitched the stock on the basis of its rising price, in the same manner as he pitched CPFS. As with CPFS, he was not aware of the reason that the price was increasing.³²² Norris also told his customers that BSDS was a software company that would be consolidating a fragmented software industry.³²³ Norris had access to the Internet while he was at Florida Discount and had the ability to pull up information on CPFS and BSDS.³²⁴

In soliciting CPFS and BSDS, Norris never told his customers that the companies had limited financial resources, minimal assets, and no revenues.³²⁵ He never disclosed that the companies' auditors had issued going concern clauses, which raised doubts about their continuing viability.³²⁶ He never informed customers that any acquisition by CPFS or BSDS would likely result in the issuance of additional shares of stock that would have a diluting effect on the stock's price and value to existing shareholders.³²⁷ Finally, he failed to tell customers that he never looked at the companies' public filings.³²⁸ As he put it, his customers "pretty much just went with my better judgment. So I told them whatever they needed to hear pretty much."³²⁹

As noted previously, Norris participated in the no net-selling practice at Florida Discount, engaged in coordinated cross transactions with other brokers, crossed stock

³²⁰ Tr. 872:14-16, 19-22, 873:4-12; C173 35:22-23.

³²¹ Tr. 875:15-22, 877:17-878:6.

³²² Tr. 874:7-875:10.

³²³ Tr. 893:22-894:2.

³²⁴ Tr. 926:11-927:4.

³²⁵ Tr. 884:12-19.

³²⁶ Tr. 884:20-23.

³²⁷ Tr. 892:1-14, 894:7-13.

³²⁸ Tr. 897:7-16.

³²⁹ Tr. 874:21-23.

between his own customers' accounts, and swapped the stocks in his customers' accounts.³³⁰ Furthermore, consistent with Forman's explanation that Rich manipulated prices by holding tickets to ensure that he had buyers for any sellers, Norris's order tickets also reflect changes to the trade dates, price, quantity, markup, and commission.³³¹

Two former customers testified at the hearing about Norris's acts and practices in soliciting CPFS and BSDS:

1. Customer JB

JB is a 55-year-old, self-employed fishing captain in Key West, Florida.³³² While Norris was associated with First Union, he phoned JB who, eventually, opened an account at First Union with Norris as the representative.³³³ When Norris left First Union to go to Florida Discount, JB transferred his account, as Norris had requested.³³⁴ Norris guaranteed JB that he would make more money at Florida Discount, and promised him that he would not charge JB any commissions until JB recouped his losses that had occurred in his First Union account.³³⁵

JB's investment objective was to make money for retirement.³³⁶ He told Norris that he did not want to take big risks with his money, but he told Norris that he was interested in growth and speculation.³³⁷ When JB opened his Florida Discount account in May 2002, Norris immediately purchased \$54,915 of CPFS in JB's account, and

³³⁰ Tr. 878:12-879:24; C59 pp. 17-18, C62 p. 14, C146 p. 12.

³³¹ Tr. 1639:20-1641:20; C64 pp. 1, 3-8, C148 pp. 2-3.

³³² Tr. 441:1-20.

³³³ Tr. 442:10-443:6, 463:5-8.

³³⁴ Tr. 444:17-19.

³³⁵ Tr. 443:24-444:16, 464:13-20.

³³⁶ Tr. 444:20-22.

³³⁷ Tr. 445:3-8, 472:17-21; C61 p. 2.

subsequently purchased \$15,255 of BSDS.³³⁸ The next month, Norris sold JB's holdings in a mutual fund and some options, and purchased an additional \$19,065 of BSDS.³³⁹ By the end of June 2002, JB's investments in CPFS and BSDS constituted 99.9 percent of his account value.³⁴⁰

Again, at Norris' urging, JB transferred \$46,469.18 from an annuity he owned at Hartford Life.³⁴¹ On September 4, 2002, the day after the funds were received, Norris purchased for JB, in two separate transactions, \$41,537.50 of CPFS.³⁴²

JB purchased both CPFS and BSDS upon Norris' recommendation.³⁴³ Norris represented that CPFS and BSDS were "good investments" and told JB that he needed to get as much money as he could into them.³⁴⁴ He said that they were getting in "on the ground floor," and JB would make a lot of money.³⁴⁵ In making his recommendations of CPFS and BSDS to JB, Norris did not disclose that CPFS and BSDS were non-operational shells or blank check companies, with no relevant operating histories, no significant financial resources, and no revenues or earnings from operations.³⁴⁶ Norris

³³⁸ C62 p. 3. Contrary to his promise that he would not charge JB commissions until he got JB's money back, Norris charged \$3,300 for the two transactions. C64 pp. 1-2. The confirmations for the transactions did not disclose the charges as commissions. Instead, they only indicated that mark ups were associated with the transactions. The mark-up for each trade, however, was incorporated into the trade reported price and there was no separate disclosure of the price to JB or the difference between the reported price and the price to the customer. C63 pp. 1-2.

³³⁹ C62 p. 7. Again, Norris charged \$775 for the transaction. C64 p. 3.

³⁴⁰ C62 p. 7.

³⁴¹ Tr. 445:9-447:11, 455:19-456:8; C61 pp. 9-17, C62 pp. 16, 18. JB had attempted to transfer funds from an account at Prudential Securities, but it did not go through. Tr. 445:23-446:4.

³⁴² C62 p. 18. Norris charged \$1,200 for these transactions. C64 pp. 8-9.

³⁴³ Tr. 447:24-448:15, 450:21-451:3, 861:24-862:8.

³⁴⁴ Tr. 451:4-7, 475:4-6.

³⁴⁵ Tr. 466:1-4, 465:17-20.

³⁴⁶ Tr. 448:16-449:8, 451:8-24. Norris claimed that he told JB that CPFS was a start up, shell type company that was just getting off its feet and was going to acquire other brokerage firms. Tr. 901:24-902:8. However, JB, who the Hearing Panel finds to be a credible witness, denied that Norris ever told him that the companies were shells or even start up companies. In fact, JB never heard the term "shell company" before. Tr. 448:20-23, 451:12-14, 466:8-14.

failed to disclose that auditors for each company had warned that they may not be able to continue as going concerns.³⁴⁷

Norris did not disclose any of the risks involved in investing in CPFS or BSDS; that there was a no net-selling policy at Florida Discount; that he had been promised incentives for soliciting CPFS and BSDS; that CPFS and Florida Discount had financial interests in each other; or that there was no significant demand for CPFS outside of that being generated at Florida Discount.³⁴⁸

Norris usually effected the transactions in CPFS and BSDS without JB's advanced knowledge.³⁴⁹ Norris called JB after the transactions were completed.³⁵⁰ Finally, as noted previously, JB had unreasonable concentrations of CPFS and BSDS in his account.³⁵¹

After he left Florida Discount in mid-September 2002, Norris called JB, telling him that Rich had lied to him (Norris), and he asked JB to transfer his account to him at LH Ross where he was then associated.³⁵² Norris also represented that he would institute a class action suit on behalf of all his clients, and that he was attempting to obtain \$30,000 to \$40,000 of JB's money back.³⁵³ JB transferred his account to Norris at LH Ross because he believed Norris would try to get his money back.³⁵⁴ After transferring his account to LH Ross, his account value initially rose a bit, but then continuously

³⁴⁷ Tr. 449:13-16, 452:4-7. Norris did not claim that he told JB that CPFS and BSDS were speculative ventures, instead he asserted that JB understood that the stocks were speculative. Tr. 902:9-19.

³⁴⁸ Tr. 449:17-25, 450:9-20, 452:8-11, 452:22-453:4.

³⁴⁹ Tr. 456:9-23. For example, JB identified the \$58,788 sale of CPFS and corresponding purchase of \$58,465 of BSDS on August 23, 2002, as transactions that Norris did without JB's advanced knowledge. Tr. 479:23-480:17; C62 p. 14.

³⁵⁰ Tr. 456:21-23, 481:4-6. JB never signed a document giving Norris the authority to buy or sell securities in his account without first consulting him. Tr. 480:18-481:3.

³⁵¹ C62.

³⁵² Tr. 457:24-458:8.

³⁵³ Tr. 458:9-13, 469:16-18.

³⁵⁴ Tr. 469:18-21. Norris said that he would "buy and sell stocks as much as [he] could, [to] try and make as much money as [he] could" for JB. Tr. 912:7-12.

declined.³⁵⁵ JB's lost at least \$89,229.50 from his investments in CPFS and BSDS while his account was at Florida Discount.³⁵⁶

2. Customer GW

GW is a 63-year-old, self-employed livestock farmer from Lindsay, Nebraska.³⁵⁷ Norris cold-called GW, who eventually opened an account with Norris at Florida Discount.³⁵⁸ GW discussed his investment objectives with Norris, who told GW that he could make some money with CPFS and BSDS.³⁵⁹

GW purchased CPFS and BSDS on Norris's recommendations.³⁶⁰ Norris admitted that he based his recommendations on the fact that the prices of those stocks were rising.³⁶¹ However, as noted above, he did not know the basis upon which the prices were rising.³⁶²

In recommending CPFS and BSDS to GW, Norris failed to disclose any negative information about either company.³⁶³ He failed to disclose that CPFS and BSDS were shells or blank check companies, with no relevant operating histories.³⁶⁴ He failed to disclose that BSDS had no significant financial resources, and no revenues or earnings

³⁵⁵ Tr. 470:15-20.

³⁵⁶ JB's account statements show that he transferred approximately \$123,940.27 into his Florida Discount account, of which \$111,707.50 was invested in CPFS and BSDS. C62 pp. 4, 18. At the end of September 2002, his total account value was \$27,746.49, of which \$22,478 was the value of CPFS and BSDS. C62 p. 16. Accordingly, JB lost a minimum of \$89,229.50 on his investments in CPFS and BSDS while his account was with Norris at Florida Discount.

³⁵⁷ Tr. 1391:21-23, 1392:3-11. GW's income in 2002 was approximately \$60,000 to \$70,000. Tr. 1392:12-15. His liquid assets were in the same range, although he had a significant investment in livestock. Tr. 1392:16-20.

³⁵⁸ Tr. 1392:24-1393:15.

³⁵⁹ Tr. 1393:20-1394:1. Norris claimed that GW was a speculative, wildcat-oil investor. Tr. 1761:16-21. Norris admitted, however, that he did not know basic information about GW, such as his age, the type of farming in which he engaged, or his liquid net worth. Tr. 1765:8-1766:11. Moreover, contrary to Norris's assertion that GW was a wildcatter, GW denied that he had any investments in oil wells. Tr. 1408:21-22. He did invest, however, in Phillips Petroleum. Tr. 1409:3-4.

³⁶⁰ Tr. 1394:2-16, 1396:20-1397:11.

³⁶¹ Tr. 1762:17-21.

³⁶² Tr. 1766:12-19.

³⁶³ Tr. 1394:17-21, 1397:7-11.

³⁶⁴ Tr. 1394:22-1395:5, 1397:12-20.

from operations.³⁶⁵ He failed to disclose that he had done little research on CPFS and BSDS.³⁶⁶

Norris never discussed any specific risks of investing in CPFS or BSDS.³⁶⁷ He did not disclose that each company's auditors had warned that they may not be able to continue as a going concerns.³⁶⁸

Norris did not disclose to GW the no net-selling policy at Florida Discount or that he had been promised incentives for soliciting CPFS and BSDS.³⁶⁹ He did not tell GW that CPFS had an ownership interest in Florida Discount or that Florida Discount had a similar financial interest in CPFS.³⁷⁰

Had Norris disclosed the negative financial information about them, the risks that were associated with investing in them, or the no net-selling practice at Florida Discount, GW never would have purchased either CPFS or BSDS.³⁷¹ GW testified that disclosure that CPFS had an ownership interested in Florida Discount would have raised a "red flag" for him.³⁷²

GW funded his account at Florida Discount by depositing two checks that totaled \$18,557.71.³⁷³ GW's first deposit of \$11,550 was used in its entirety to cover a purchase of 2,000 shares of CPFS on May 16, 2002.³⁷⁴ His second deposit of \$7,007.01 was used

³⁶⁵ Tr. 1397:21-24.

³⁶⁶ Tr. 1396:4-8, 1398:12-14.

³⁶⁷ Tr. 1395:6-16, 1397:25-1398:3.

³⁶⁸ Tr. 1395:18-22, 1398:4-7.

³⁶⁹ Tr. 1395:23-1396:3, 1396:9-11, 1398:8-11, 1398:15-18.

³⁷⁰ Tr. 1396:12-19.

³⁷¹ Tr. 1394:17-21, 1395:23-1396:3, 1397:7-11, 1397:25-1398:3.

³⁷² Tr. 1396:12-16.

³⁷³ Tr. 1398:19-1399:21; C146 pp. 3, 6. Norris was aware that GW had another brokerage account at another firm. Tr. 1403:12-17.

³⁷⁴ C146 p. 3.

to cover the purchase of 1,000 shares of BSDS on June 20, 2002.³⁷⁵ On August 23, 2002, on the recommendation of Norris, GW sold the 2,000 shares of CPFS and purchased another 1,500 shares of BSDS with the proceeds.³⁷⁶ As a result, GW was 100 percent invested in BSDS by the end of August.³⁷⁷ CPFS and BSDS were the only investments GW ever held in his Florida Discount account.³⁷⁸

After he left Florida Discount, Norris called GW and asked him to transfer his account to LH Ross, where Norris had become associated.³⁷⁹ GW did so.³⁸⁰ After the prices of CPFS and BSDS declined precipitously, GW was able to recoup only a small amount of his original investment.³⁸¹ GW estimated that he recovered less than \$3,000. Accordingly, GW lost a minimum of \$15,557.71.³⁸²

D. Kristian Sierp

In 1993, Sierp entered the securities industry in a non-registered position.³⁸³ He became registered as a general securities representative in March 1994 while employed at Gruntal & Co., where he worked until August 1994.³⁸⁴ Between August 1994 and August 2001, Sierp was employed at eight other broker-dealers.³⁸⁵

After answering an advertisement in a local newspaper, Sierp joined Florida Discount as a general securities representative on August 15, 2001.³⁸⁶ He initially

³⁷⁵ C146 p. 6.

³⁷⁶ Tr. 1399:25-1400:18; C146 p. 12.

³⁷⁷ C146 p. 12.

³⁷⁸ C146.

³⁷⁹ Tr. 1401:12-1402:5.

³⁸⁰ Tr. 1402:2-11. GW denied that Norris had called him in mid-September 2002 to tell him to sell his holdings. Tr. 1406:5-9. GW testified that had Norris done so, he probably would have sold. *Id.*

³⁸¹ Tr. 1400:25-1401:4.

³⁸² Tr. 1401:8-11. GW's recollection is consistent with his September 2002 account statement, which shows that his investment of \$18,557.71 had declined to \$2,625. C146 p. 15.

³⁸³ Tr. 969:5-7; C51 pp. 3, 12-13.

³⁸⁴ Tr. 1027:21-25; C51 p. 3.

³⁸⁵ C51 p. 3.

³⁸⁶ Tr. 969:15-22; C51 p. 5.

interviewed with Rich and Spanier, and then met Harary at a second interview. During a third interview, Harary and Rich told Sierp that the brokers were moving on CPFS. They told him that they were planning to split the stock to make it more marketable, and that there would be some significant announcements about mergers, acquisitions, and letters of intent, within the upcoming three to six months.³⁸⁷ Rich told Sierp that Harary was very close with the directors of CPFS, and that he had firsthand knowledge of the company.³⁸⁸

After the interview, Sierp looked into CPFS and saw that it had no trading volume and little trading history.³⁸⁹ He checked the company profile on Yahoo Finance and its prices over the prior 12 months.³⁹⁰ Sierp reviewed the company's financials and saw that CPFS had no revenues and had lost \$3,000 the previous year.³⁹¹ He found little other information on the online services that he used.³⁹² Sierp again spoke with Rich, who told him that there was not much public information on CPFS, that CPFS was a shell company anticipating a reverse merger, and that Florida Discount was going to go public through CPFS.³⁹³ Rich said that the float of CPFS was two million shares, and that he was holding 1.2 million shares.³⁹⁴ Sierp did not know whether Rich personally owned the 1.2 million shares or whether they were held by Rich's clients.³⁹⁵

³⁸⁷ Tr. 974:12-22, 976:14-19.

³⁸⁸ Tr. 976:3-12.

³⁸⁹ Tr. 978:6-17.

³⁹⁰ Tr. 979:20-24. Accordingly, Sierp would have seen the sudden spike in CPFS's price in mid-February 2001, and the spike in volume that occurred in mid-March 2001. C25.

³⁹¹ Tr. 979:25-980:6.

³⁹² Tr. 980:19-24.

³⁹³ C174 46:22-47:2; Tr. 981:5-10, 983:19-23.

³⁹⁴ Tr. 985:22-987:11.

³⁹⁵ Tr. 987:15-23.

Sierp was promised a \$40,000 signing bonus when he joined Florida Discount.³⁹⁶ After joining Florida Discount, Sierp became one of the firm's top producers in CPFS and BSDS.³⁹⁷ He earned at least \$60,000 in the year he was with Florida Discount.³⁹⁸

Rich showed Sierp a performance chart for CPFS and told Sierp that the firm had “been able to support the stock” and make money for clients during a down market.³⁹⁹ Sierp then recommended that his customers purchase CPFS because of the increases in volume and price, although he was unaware of the cause of those increases.⁴⁰⁰ Sierp told his customers that CPFS was set up for mergers and acquisitions in the investment banking field; that the performance for the past couple of years had been very good on the upside; that, in his opinion, the stock was undervalued; and that there were possible letters of intent that the company was going to be signing.⁴⁰¹ Sierp also predicted that CPFS could be a “big winner” in their portfolio if they held on to the stock from the date of purchase forward.⁴⁰² Sierp's top selling point was that the customer would be able to own another company, referring to Florida Discount, that was going to be publicly traded after merging with CPFS.⁴⁰³ As a result of his efforts, approximately 70 to 75 percent of his 40 to 60 customers eventually owned CPFS.⁴⁰⁴

³⁹⁶ Tr. 1022:13-17.

³⁹⁷ Tr. 1634:14-1635:11. Sierp was the third largest producer, just behind Forman and Fernandez. Tr. 1659:19-24.

³⁹⁸ C174 56:18-57:4.

³⁹⁹ Tr. 991:4-992:18.

⁴⁰⁰ Tr. 992:20-23, 993:5-13, 1070:16-20. Sierp claimed that he tried to call CPFS a couple of times to request its recent public filings. Tr. 983:24-984:24. Sierp left messages with CPFS requesting such information but he never received anything from the company. Tr. 984:18-24. Although Sierp was told that Harary was close to the directors of CPFS and had firsthand information on the company, Sierp never asked Harary if he could obtain the public filings for him. Tr. 985:4-13.

⁴⁰¹ Tr. 993:17-994:11.

⁴⁰² Tr. 994:14-19.

⁴⁰³ Tr. 994:21-25.

⁴⁰⁴ Tr. 995:1-4, 990:13-25.

Sierp saw the news announcement, dated August 12, 2002, stating that Spanier had become the CEO of CPFS and had received shares of restricted CPFS stock.⁴⁰⁵ As noted above, the announcement also stated that CPFS had signed a letter of intent to acquire Muni Financial Inc., which Sierp knew was owned by another Florida Discount registered representative. According to Sierp, the brokers were happy when they saw this announcement; he said they were happy to see any announcement.⁴⁰⁶ However, whenever Spanier came by the offices of Florida Discount after he became CEO of CPFS, everyone would joke about Spanier, the former recruiter, rising to the position of a CEO.⁴⁰⁷

Although Sierp testified that he became concerned about CPFS when he saw the Spanier and Muni announcements, he continued to recommend the stock to his customers.⁴⁰⁸ For example, Sierp purchased \$98,180 of CPFS in customer RM's account and \$3,695 of CPFS in RL's account after he was aware of the Spanier and Muni announcements.⁴⁰⁹ Moreover, during this same time period, Calicchio, who had left Florida Discount on August 8, 2002, called Sierp and warned him about staying at Florida Discount.⁴¹⁰ Calicchio told Sierp that Florida Discount was "going down," and that Rich was not going to get away with what he was doing.⁴¹¹ In response, Sierp told him not to worry because he was going to get out of Florida Discount in his own due

⁴⁰⁵ Tr. 986:20-23, 987:25-986:2, 1039:22-1040:10.

⁴⁰⁶ Tr. 1065:23-1066:4. Rich told Sierp that the deal with Muni's company was "all part of the plan." Tr. 1040:1-5. Rich also said that Spanier had earned the CEO position. Tr. 988:3-7.

⁴⁰⁷ Tr. 988:8-16, 989:20-990:2.

⁴⁰⁸ Tr. 1038:14-1039:8, 1067:18-20, 1101:14-24.

⁴⁰⁹ C102 p. 20, C97 p. 27

⁴¹⁰ Tr. 308:2-17, 1068:16-23; C166 p. 9.

⁴¹¹ Tr. 308:5-9, 1069:16-1070:2.

time.⁴¹² Sierp continued on at Florida Discount until NASD staff began its unannounced, on-site examination of Florida Discount on the morning of September 10, 2002.⁴¹³

Sierp researched BSDS on Yahoo and confirmed Rich's representation that BSDS was a shell, looking for a company with which to merge or acquire.⁴¹⁴ Because Sierp did not find other information about BSDS from his on-line service, he went by what Rich told him about the company.⁴¹⁵

Sierp told his customers that, based upon Florida Discount's track record and its participation in CPFS, Florida Discount was able to get another stock called BSDS, which was another reverse merger similar to CPFS.⁴¹⁶ Sierp predicted to his customers that the price performance for BSDS could do the same or better than CPFS, given a good market.⁴¹⁷ Approximately 25 percent of his customers bought BSDS.⁴¹⁸

Sierp testified that he sent "risk trading letters" to his customers that disclosed that they were aware that the stock of CPFS and BSDS could go to zero, based upon the speculative nature of the investment.⁴¹⁹ However, Sierp was not able to produce copies of such letters to the staff, none was produced to the staff during their on-site examination of the firm in September 2002, and none of Sierp's customers who testified at the hearing received one.⁴²⁰

⁴¹² C176 113:9-11.

⁴¹³ Tr. 1074:17-23, 1561:4-9, 1683:22-1684:9, 1685:3-5.

⁴¹⁴ Tr. 1006:6-11.

⁴¹⁵ Tr. 1006:12-15; C174 155:8-15. Sierp claimed he tried calling BSDS to get information on the company but received no response. Tr. 1008:19-21. Sierp also claimed that there was no due diligence file on BSDS at Florida Discount. Tr. 1008:22-1009:6.

⁴¹⁶ Tr. 1009:10-18.

⁴¹⁷ Tr. 1009:19-22.

⁴¹⁸ Tr. 1016:23-25.

⁴¹⁹ Tr. 1015:5-9.

⁴²⁰ Tr. 244:3-6, 356:8-11, 767:19-22, 1017:1-15, 1571:5-9, 1691:19-1692:9.

Sierp participated in the no net-selling practices at Florida Discount, and engaged in coordinated cross transactions between customer accounts at Florida Discount, including crosses between his own customers' accounts.⁴²¹ On February 12, 2002, Sierp sold BSDS in RL's IRA account, while, on the same day, he purchased BSDS in RL's regular account.⁴²² On numerous occasions he swapped CPFS and BSDS in GD's account, RL's accounts, and RM's account.⁴²³

Sierp was also fully aware of Rich's practice of holding customer market orders, including those for Sierp's customers, for days without execution.⁴²⁴ Sierp knew that Rich would very often change the prices and share amounts on Sierp's tickets.⁴²⁵ In doing so, Rich would expend any money in the customer's account without the customer's authorization.⁴²⁶ Rich told Sierp that he changed the share amounts and prices on customer tickets because there was no reason to leave any cash in customers' accounts.⁴²⁷ However, Sierp told his customers that he bought more shares because the price was lower.⁴²⁸ Sierp would have an unauthorized transaction reversed only if a client complained, but he had only one or two of those transactions reversed.⁴²⁹

⁴²¹ On May 17, 2002, Sierp sold shares of CPFS in GD's account, while, on the same day, he purchased shares of that same stock in RL's regular account. C73 p. 13, C97 p. 13. Sierp testified that he sold CPFS and purchased BSDS in GD's account on May 17, 2002, because he made GD a profit on CPFS and thought that BSDS "was in play and had the potential to go higher." Tr. 1042:11-12. Yet, rather than purchase BSDS in RL's account, Sierp purchased more CPFS in an account that at the time only held CPFS stock. C97 p. 13.

⁴²² C95 p. 6, C97 p. 6.

⁴²³ C73 pp. 6, 13, 19, C95 pp. 6, 14, 17, 23, C97 pp. 13, 17, 23, C102 pp. 10, 20.

⁴²⁴ Tr. 999:9-12. Rich told Sierp that he was holding the tickets because he was waiting for the "right price." Tr. 999:13-16.

⁴²⁵ Tr. 996:11-16. The order tickets for RM's and RL's accounts confirm that there were numerous changes made to Sierp's tickets, including changes to prices, including limit prices and executed prices, quantities, and commissions or mark ups. Tr. 1639:20-1640:11; C99 pp. 1, 4-6, 8-9, 11, C100 pp. 2, 4-5, 9-12, 14, C103 pp. 1-2, 4-5, 8, 12-15.

⁴²⁶ Tr. 996:18-21. Sierp did not have discretionary authority over his customers' accounts, and he knew that Rich had not contacted the customers before making changes to their orders. Tr. 996:6-9, 997:11-20.

⁴²⁷ Tr. 997:21-998:4.

⁴²⁸ Tr. 998:5-999:7.

⁴²⁹ Tr. 1033:16-21.

Three former customers testified during the hearing about Sierp's acts and practices in soliciting CPFS and BSDS:

1. Customer RM

Customer RM is an 80-year-old, self-employed farmer and equipment dealer from Baltimore, Ohio.⁴³⁰ After a cold call by Sierp and several more phone conversations with him, at some time before February 2002, RM opened an account with Sierp at Florida Discount.⁴³¹ RM's investment objective was to earn income, "something better than interest."⁴³² Sierp opened RM's account with a purchase of Office Max stock, made some money on the stock, and thereby gained RM's trust.⁴³³ By February 13, 2002, on Sierp's recommendation, RM sold the Office Max stock and invested the funds solely in CPFS.⁴³⁴ Beginning in May 2002, Sierp began recommending that RM purchase BSDS. On May 7, 2002, Sierp had RM sell almost 4,000 shares of CPFS for \$20,638.77, and buy almost 2,500 shares of BSDS for a nearly identical \$20,721.⁴³⁵

In recommending CPFS and BSDS to RM, Sierp did not disclose any negative information about those companies.⁴³⁶ He did not disclose that they were non-operational shells or blank check companies, with no relevant operating histories, no significant financial resources, and no revenues or earnings from operations.⁴³⁷ Sierp failed to inform RM that he had done little research on CPFS and BSDS or that there was

⁴³⁰ Tr. 759:14-760:2. His annual income in 2001 was approximately \$65,000 to \$75,000 and his net worth was over \$2 million. Tr. 760:3-12. Most of RM's net worth was in real estate and equipment. Tr. 776:13-18.

⁴³¹ Tr. 760:13-761:6.

⁴³² Tr. 761:7-12. Sierp initially challenged RM's testimony that he had never seen his new account card, which Sierp admitted he filled out. Tr. 1048:15-1049:13. On further questioning by the Panel, however, Sierp admitted that the new account card was not sent to his clients. Tr. 1108:1-7.

⁴³³ Tr. 777:6-17.

⁴³⁴ C102 p. 3.

⁴³⁵ C102 p. 10.

⁴³⁶ Tr. 763:5-10, 766:1-4.

⁴³⁷ Tr. 763:11-764:1, 766:5-16.

a lack of available information on BSDS.⁴³⁸ Sierp generally informed RM that there are risks associated with investing in any securities, but he did not disclose that each company's auditors had warned that they may not be able to continue as going concerns.⁴³⁹ RM would not have purchased CPFS or BSDS had Sierp disclosed such negative information about them.⁴⁴⁰

Sierp did not inform RM of the no net-selling policy at Florida Discount, or that he had been promised incentives for soliciting CPFS and BSDS.⁴⁴¹ Neither did Sierp tell RM that CPFS had an ownership interest in Florida Discount, and that Florida Discount had a similar financial interest in CPFS.⁴⁴²

There were unreasonable concentrations of CPFS and BSDS in RM's account.⁴⁴³ In April 2002, Sierp sold RM's holdings in Knight Trading Group and purchased additional shares of CPFS.⁴⁴⁴ As a result, at the end of April 2002, CPFS accounted for 99.9 percent of RM's total account value.⁴⁴⁵ On May 7, 2002, Sierp sold the CPFS at \$5.20 and purchased BSDS with the proceeds.⁴⁴⁶ Just 11 days later, Sierp purchased 2,500 shares of CPFS at \$5.77, after RM deposited another \$15,000 into his account.⁴⁴⁷ At the end of May, CPFS and BSDS still constituted RM's only stock holdings in the account.⁴⁴⁸ On August 6, 2002, Sierp swapped almost \$39,000 of RM's CPFS stock for

⁴³⁸ Tr. 764:22-25, 767:8-11, 15-18.

⁴³⁹ Tr. 764:7-17, 766:17-767:2.

⁴⁴⁰ Tr. 763:8-10, 774:19-22. RM received no written information from Sierp on CPFS or BSDS or the risks of investing in them. Tr. 767:19-22, 785:6-10.

⁴⁴¹ Tr. 764:18-21, 765:1-5, 767:3-7, 767:12-14.

⁴⁴² Tr. 765:6-14.

⁴⁴³ C102 pp. 3, 6, 10, 14, 17, 20.

⁴⁴⁴ C102 p. 6.

⁴⁴⁵ *Id.*

⁴⁴⁶ Tr. 770:3-9; C102 p. 10.

⁴⁴⁷ Tr. 770:10-24; C102 p. 10.

⁴⁴⁸ C102 p. 10.

almost the same amount of BSDS.⁴⁴⁹ By the end of August 2002, RM held \$142,662 of CPFS and BSDS in his account and had a cash deficit of \$58,891.⁴⁵⁰

On August 29, 2002, there was an unauthorized purchase of 10,000 shares of CPFS for \$65,015 in RM's account.⁴⁵¹ Prior to the purchase, Sierp recommended this transaction, even though he was aware of, and concerned about, the CPFS announcements concerning Spanier as CEO and the acquisition of Muni's company.⁴⁵² RM told Sierp that he was not ready to make such a purchase, and he wanted to think about it over the weekend.⁴⁵³ Nevertheless, a week to 10 days after his conversation with Sierp, Rich called RM and insisted that RM send in \$60,000 to cover the transaction that had been effected without RM's authorization. The account statement shows that the check was received on September 6, 2002.⁴⁵⁴

RM was not aware that Sierp had left Florida Discount.⁴⁵⁵ Eventually, RM transferred his account to Advest at which time he learned that the price of CPFS and BSDS had fallen.⁴⁵⁶ RM testified that he lost \$137,437 from his investments in CPFS and BSDS.⁴⁵⁷ However, some statements are missing from the record, and it is not possible to determine how gains and losses from securities in the account other than CPFS and BSDS affected his estimate of loss, or whether Sierp or Rich were ultimately responsible for the final purchases of CPFS that occurred on August 29 and 30, 2002, and which totaled \$98,180.

⁴⁴⁹ Tr. 771:22-772:14; C102 p. 20.

⁴⁵⁰ C102 p. 20.

⁴⁵¹ Tr. 772:15-774:3; C102 p. 20.

⁴⁵² Tr. 1067:18-20, 1101:14-24.

⁴⁵³ Tr. 772:20-773:3, 17-22.

⁴⁵⁴ Tr. 773:23-774:3, 786:13-787:6, 789:11-790:8; C102 p. 24.

⁴⁵⁵ Tr. 781:19-25.

⁴⁵⁶ Tr. 782:1-783:21.

⁴⁵⁷ Tr. 774:4-10.

2. Customer RL

Customer RL, 72 years old, lives in St. Paul, Minnesota.⁴⁵⁸ He has been semi-retired since 2001, when he sold his scaffold business.⁴⁵⁹ After a cold call from Sierp, RL opened two accounts, a regular account and an IRA account, with Sierp as his broker at Florida Discount.⁴⁶⁰ Citing his age, RL told Sierp that all he “wanted to do was to hit singles and try to make some money.”⁴⁶¹ He said he was not interested in speculative securities, and he was not looking to “hit any home runs.”⁴⁶²

RL purchased CPFS and BSDS on Sierp’s recommendation.⁴⁶³ Sierp told RL that Wall Street had not paid attention to CPFS, which had a low profile, was making money, and was going to start acquiring some named companies.⁴⁶⁴ Sierp told RL that BSDS was a software company that was also a growth company.⁴⁶⁵

In recommending CPFS and BSDS to RL, Sierp did not disclose any negative information about either company.⁴⁶⁶ He did not inform RL that CPFS and BSDS were non-operational shells or blank check companies, with no relevant operating histories, no significant financial resources, and no revenues or earnings from operations.⁴⁶⁷ He did not tell RL that he had done little research on CPFS and BSDS or that there was a lack of

⁴⁵⁸ Tr. 235:1-2,19-20.

⁴⁵⁹ Tr. 235:7-16. His income in 2001 was approximately \$100,000 and his net worth was approximately \$1.5 million. Tr. 235:21-236:1.

⁴⁶⁰ Tr. 236:5-7, 236:22-237:1, 9-11; C94, C95, C97. The IRA account was opened in October 2001. C94. The first statement for the regular account shows activity as of December 2001. C97.

⁴⁶¹ Tr. 237:17-23.

⁴⁶² Tr. 237:17-238:1 RL opened his IRA account at Florida Discount by transferring an account he had with UBS PaineWebber. Tr. 237:12-16. However, the PaineWebber account statement is for the month of September 2001, and the first Florida Discount statement in evidence is for the month of January 2002. C94 pp. 4-7, C95 p.1. Accordingly, there is no way to determine the amount of money or the value of any securities transferred to Florida Discount to open the IRA account.

⁴⁶³ Tr. 238:21-239:7, 242:1-11, 995:11-22, 996:2-5, 1047:3-5.

⁴⁶⁴ Tr. 238:24-239:5.

⁴⁶⁵ Tr. 242:4-6.

⁴⁶⁶ Tr. 239:12-15, 242:12-15.

⁴⁶⁷ Tr. 239:16-240:5, 242:16-243:4.

available information on either company.⁴⁶⁸ He did not inform RL of the risks involved in investing in CPFS or BSDS, nor did he disclose that each company's auditors had warned that they may not be able to continue as going concerns.⁴⁶⁹

Sierp did not tell RL about the no net-selling policy at Florida Discount or that he had been promised incentives for soliciting CPFS and BSDS.⁴⁷⁰ Moreover, Sierp did not disclose that CPFS had an ownership interest in Florida Discount and that Florida Discount had a similar financial interest in CPFS.⁴⁷¹

RL had inordinate concentrations of CPFS and BSDS in his accounts.⁴⁷² On July 31, 2002, BSDS accounted for 99.9 percent of RL's total IRA account value.⁴⁷³ After swapping all of the BSDS for CPFS, on August 7, 2002, CPFS accounted for 99.9 percent of his total account value.⁴⁷⁴ The concentration levels in RL's regular account were similar. By August 31, 2002, CPFS, which was the only stock RL held in this account, accounted for 93 percent of RL's total account value.⁴⁷⁵

On one occasion, Sierp swapped CPFS for BSDS without RL's knowledge and authorization. He called RL after effecting the transactions, and told RL that he had made him some money, but that RL had to send him another check before the transaction could go through.⁴⁷⁶

⁴⁶⁸ Tr. 240:23-241:11, 243:15-24.

⁴⁶⁹ Tr. 240:12-18, 243:5-11.

⁴⁷⁰ Tr. 240:19-22, 241:12-17, 243:12-14, 243:25-244:2.

⁴⁷¹ Tr. 241:19-25.

⁴⁷² C95, C97.

⁴⁷³ C95 p. 20.

⁴⁷⁴ C95 p. 23.

⁴⁷⁵ C97 p. 23.

⁴⁷⁶ Tr. 250:20-24, 251:1-9.

Sierp called RL after he had left Florida Discount and told him that there was a problem at Florida Discount.⁴⁷⁷ Sierp convinced RL to transfer his account from Florida Discount to Sierp's new firm, LH Ross.⁴⁷⁸ RL estimated that he lost approximately \$30,000 from his investments in CPFS and BSDS.⁴⁷⁹

3. Customer GD

Customer GD is a 63-year-old software consultant from Framingham, Massachusetts.⁴⁸⁰ After repeated calls from Sierp, GD eventually opened an account with Florida Discount because Sierp kept offering him great stock opportunities that were going to make him money.⁴⁸¹ GD was interested in investing in established tech stocks that would provide growth.⁴⁸²

GD purchased CPFS and BSDS on Sierp's recommendation.⁴⁸³ Sierp told GD that CPFS was an existing group that was being joined by three other groups from around the country providing security services.⁴⁸⁴ Sierp told GD that CPFS was a good investment that would be profitable and make money.⁴⁸⁵

In recommending CPFS and BSDS to GD, Sierp did not disclose any negative information about either company.⁴⁸⁶ GD acknowledged that it was difficult for him to

⁴⁷⁷ Tr. 260:8-15.

⁴⁷⁸ Tr. 251:17-253:1.

⁴⁷⁹ Tr. 251:10-16. Because of missing account statements, the Hearing Panel cannot determine the amount of RL's initial investments, nor the gains and losses in the accounts attributable to other securities, nor the amount of recovery, if any, he may have received from any sale of CPFS or BSDS. Accordingly, the Hearing Panel cannot determine the amount of his loss on the two securities.

⁴⁸⁰ Tr. 347:10-11, 18-21. His annual income in 2001-2002 was approximately \$119,000 and his net worth was approximately \$800,000 to \$900,000. Tr. 347:22-348:4. GD's liquid net worth was approximately \$300,000. Tr. 348:5-7. GD held most of his liquid assets at another brokerage account. Tr. 362:21-363:3.

⁴⁸¹ Tr. 348:12-19, 348:23-349: 5.

⁴⁸² Tr. 349:9-19.

⁴⁸³ Tr. 350:18-19, 354:12-13, 356:17-357:4, 995:8-10, 14-17, 996:2-5.

⁴⁸⁴ Tr. 350:8-12, 351:11-15, 353:1-6, 367:10-21.

⁴⁸⁵ Tr. 350:8-17, 351:11-15.

⁴⁸⁶ Tr. 350:20-23, 354:14-18, 367:1-6.

recall what Sierp said and did not say about CPFS and BSDS.⁴⁸⁷ However, he definitely recalled that Sierp did not inform him that the auditors for both companies had warned that they may not be able to continue as going concerns.⁴⁸⁸ He also firmly recalled that Sierp did not disclose that CPFS and BSDS were non-operational shells or blank check companies.⁴⁸⁹

Sierp did not disclose to GD that he had been promised incentives for soliciting CPFS and BSDS.⁴⁹⁰ Nor did Sierp tell GD that CPFS had an ownership interest in Florida Discount and that Florida Discount had a similar financial interest in CPFS.⁴⁹¹ Moreover, he failed to tell GD that there was no significant demand for CPFS other than what was being generated at Florida Discount.⁴⁹² GD received no written information or correspondence from Sierp that disclosed any risks of investing in CPFS or BSDS or provided any other information on the two companies.⁴⁹³

GD had excessive concentrations of CPFS and BSDS in his account.⁴⁹⁴ For example, by the end of February 2002, CPFS accounted for \$19,707 of GD's total account value of \$19,712.⁴⁹⁵ At the end of August 2002, CPFS accounted for \$22,766 of his total account value of \$30,514, the balance being held in cash⁴⁹⁶

⁴⁸⁷ Tr. 361:7-15.

⁴⁸⁸ Tr. 351:22-25, 355:9-12.

⁴⁸⁹ Tr. 350:24-351:4, 354:19-25.

⁴⁹⁰ Tr. 353:10-13, 356:4-7.

⁴⁹¹ Tr. 353:14-354:1.

⁴⁹² Tr. 353:7-9.

⁴⁹³ Tr. 356:8-11, 364:16-18, 366:20-25. GD is a self-described "pack rat" and would have kept any such documents had he received them from Sierp. Tr. 370:7-14.

⁴⁹⁴ C73 pp. 3, 6, 10, 13, 16, 19.

⁴⁹⁵ C73 p. 6.

⁴⁹⁶ C73 p.19.

After Sierp left Florida Discount, he asked GD to transfer his account to Sierp at LH Ross, but GD refused.⁴⁹⁷ GD believed he lost approximately \$13,000 to \$15,000 from his investments in CPFS and BSDS.⁴⁹⁸

E. Mark Eshleman

A self-described experienced broker, Eshleman entered the securities industry as a general securities representative with Shochet Securities in 1988.⁴⁹⁹ While with Shochet, Eshleman was encouraged by Spanier to join Florida Discount.⁵⁰⁰ Eshleman interviewed with Harary and Rich, who gave Eshleman a \$25,000 check as a “down payment” to induce him to join Florida Discount.⁵⁰¹ Eshleman initially did not intend to take Rich’s offer because he felt that Florida Discount “wasn’t really my kind of place.”⁵⁰² Consequently, he never cashed the \$25,000 check because, if he had, he would “have to work for them,”⁵⁰³ and, at the time, he was negotiating for a job with another firm that was offering him a signing bonus of \$75,000.⁵⁰⁴ However, Eshleman changed his mind about Rich’s offer. As he put it, the “lure of the money” overcame his misgivings about Florida Discount.⁵⁰⁵ He signed an employment contract in June 2001 to become “senior

⁴⁹⁷ Tr. 358:25-359:10.

⁴⁹⁸ Tr. 358:21-24. The Hearing Panel cannot determine the extent of GD’s loss. The account records are incomplete, and, therefore, there is no evidence of the total amount that GD invested in the two stocks. There is evidence only of two deposits. The first was a \$7,000 deposit on January 30, 2002, that was apparently used to cover the purchase of Digital Lightwave stock that, in turn, was sold for \$5,015 in February. The proceeds were used for part of the purchase of CPFS, along with the sale of BSDS and other shares of Digital Litewave. C73 pp. 3, 6. The second was on August 16, 2002, when GD deposited \$4,935 to cover the purchase of Metris Company stock on August 13. Metris was sold on August 27, for a profit of \$2,800. C73 p. 19. It appears that the profit was held in cash, at least until the end of September, when the account value of his position in CPFS was worth \$5,952, and Rich was the representative named on the account. C73 p. 23.

⁴⁹⁹ Tr. 546:24-547:1; C47 pp.3-4.

⁵⁰⁰ Tr. 540:9-19.

⁵⁰¹ Tr. 540:23-541:2, 703:12-15.

⁵⁰² C172 29:2-6.

⁵⁰³ Tr. 703:15-20.

⁵⁰⁴ Tr. 704:18-21.

⁵⁰⁵ Tr. 697:24-698:1, 704:6-8.

vice president” at Florida Discount for \$150,000 in bonuses, stock options in CPFS, and a guarantee that he would have his own private office.⁵⁰⁶

After resigning from Shochet on July 24, 2001, and before leaving for vacation, Eshleman went to Florida Discount because he had learned that his license had cleared and, therefore, according to the terms of his employment contract, he was entitled to collect his signing bonus of \$50,000.⁵⁰⁷ Rich, however, would not give him the bonus check and told Eshleman that he would have to wait for Harary to return to the office.⁵⁰⁸ When Eshleman returned from his vacation, Rich and Harary refused to pay him the bonus because, according to Rich, not enough of his clients were following him from Shochet to Florida Discount.⁵⁰⁹ They told Eshleman that he might be able to earn the bonus by selling 10,000 shares of CPFS.⁵¹⁰

Eshleman was familiar with CPFS because he had looked at the firm’s filings before joining Florida Discount.⁵¹¹ Rich and Harary told Eshleman that CPFS was going to buy up other brokerage companies, that “they controlled the whole float;” and they were going to “take this thing much higher.”⁵¹² At that point, Eshleman concluded that Rich and Harary were not reliable, and that there was a high probability that everything he had been told was a lie.⁵¹³ Eshleman protested to Rich that he knew CPFS was “just a

⁵⁰⁶ Tr. 698:12-13, 544:7-545:1, 5-7; C172 29:6-10, 18-19. Eshleman heard about CPFS in his initial interview with Rich and Harary. They told him he was being recruited because “they needed more marketing power” for CPFS. C172 33:10-13. In addition to the stock options, Eshleman was also promised that in “a couple of years . . . [he] would definitely be on the board and could quite probably be the president of the company.” C172 46:9-13.

⁵⁰⁷ Tr. 545:2-4, 566:7-22. Eshleman’s \$150,000 in bonuses was to be paid in three installments: \$50,000 when his “number cleared,” \$50,000 in three months, and \$50,000 based on the percentage of his “book that came over.” C172 29:24-30:4, Tr. 544:7-19.

⁵⁰⁸ Tr. 567:13-18.

⁵⁰⁹ Tr. 570:5-12.

⁵¹⁰ C172 42:8-11.

⁵¹¹ C172 213:5-9.

⁵¹² C172 42:11-18.

⁵¹³ Tr. 574:20-25.

shell company” that was not appropriate for his clients “at these kind of elevated prices.”⁵¹⁴ Eshleman also believed that “Bruce Rich was a con artist and Paul Harary was his partner and that ultimately people were going to get hurt.”⁵¹⁵

Eshleman knew that remaining at Florida Discount was wrong.⁵¹⁶ Nonetheless, he stayed to collect his promised bonus by selling CPFS. Believing that Rich and Harary were engaged in a “two-year plan,” and that they “had the ability ... to make this thing happen,” Eshleman concluded that, eventually, he would be able to get out of CPFS, “get [his] bonus and get out of this place.”⁵¹⁷ Accordingly, Eshleman began to recommend CPFS to his clients.⁵¹⁸ In doing so, Eshleman counted on the trust of clients who he knew would listen to, and follow, his recommendations.⁵¹⁹

Eshleman called at least ten clients to recommend and sell them CPFS, often using the scripts prepared specially for him by Rich. For example, Eshleman sold CPFS to a married couple, SN and FN, whose ages he estimated to be between 75 and 85 years old.⁵²⁰ He also sold 1,000 shares of CPFS to HR and his wife; she was blind, they were both over 75 years of age, and they lived in an adult living center. The funds in their joint trust account, from which the purchase of CPFS was paid, were to last them the rest of their lives.⁵²¹ Eshleman also recalled using the script to induce RC to purchase 2,000

⁵¹⁴ C172 48:1-12.

⁵¹⁵ Tr. 600:4-7.

⁵¹⁶ Tr. 601:14-15, 598:10-11, 600:22-601:4.

⁵¹⁷ C172 50:7-18.

⁵¹⁸ His first CPFS sales pitch to a customer, JH, appears to have occurred on August 16, 2001. C172 187:16-21. Eshleman’s trade blotter confirms that the first settlement date for trades in CPFS for customer JH was on August 21, 2001. C52 p. 1.

⁵¹⁹ C172 82:13-23.

⁵²⁰ C172 115:20-116:6.

⁵²¹ C172 114:5-115:4. HR died before the date of the hearing, but his wife is still living at the adult living center. Tr. 635:5-20.

shares of CPFS.⁵²² In making the sale to RC, Eshleman did not discuss the fundamental condition of CPFS nor tell RC anything beyond the confines of the script.⁵²³ RC ultimately sold at a loss.⁵²⁴

Although within his first month at Florida Discount, Eshleman knew that CPFS was a shell, he did not disclose that fact to his customers, nor did he disclose its weak financial condition.⁵²⁵ Moreover, Eshleman did not disclose that he was promised a \$150,000 bonus and stock options for soliciting CPFS.⁵²⁶

Eshleman claimed that at one point he “just couldn’t go any further;” at which time, Rich offered to contact his clients for him, and Eshleman agreed.⁵²⁷ According to Eshleman, Rich solicited four of his clients to purchase CPFS: HC, MD, JD and OC.⁵²⁸ Eshleman, however, participated in the calls and assisted Rich by introducing the clients to Rich over the phone.⁵²⁹ Rich pitched them using the language that was taken from the scripts, while Eshleman remained with him.⁵³⁰

Eshleman was employed as a registered representative at Florida Discount from July to November 2001.⁵³¹ During that time, he received a \$10,000 signing bonus and a \$5,000 bonus for meeting his “interim quotas on CPFS.”⁵³² Adding these bonuses to his

⁵²² Tr. 616:11-13; C172 129:16-130:4.

⁵²³ C172 95:23-96:4.

⁵²⁴ C172 98:11-12. Other customers Eshleman admitted soliciting CPFS include JH, SA, AF, ES, GN, and SR. C172 187:17-21, 189:1-4, 130:19-22, 116:7-11, 113:23-114:3; Tr. 619:1-10.

⁵²⁵ Tr. 565:15-20; C172 95:23-96:4, 103:1-10.

⁵²⁶ Tr. 621:21-622:19. He claimed that he didn’t disclose the incentives because he didn’t think they were germane and didn’t think there was any reason to tell his customers. Tr. 626:16-19.

⁵²⁷ C172 90:3-7.

⁵²⁸ C172 90:15-91:7, 99:11-12.

⁵²⁹ Tr. 600:8-13, 596:1-4.

⁵³⁰ Tr. 595:22-24, 602:24-603:11. One client, HC, who Eshleman claimed was a “good friend and client for 22 years” was in his seventies. C172 99:5-6; Tr. 603:21-22.

⁵³¹ His registration with Florida Discount was terminated on December 13, 2001. C47 p. 4. He has been registered at vFinance Investments, Inc., another Boca Raton-based broker-dealer, since November 2001. C47 p. 3.

⁵³² C172 67:13-17.

commission checks, Eshleman earned a total of \$21,894.35 while he was at Florida Discount.⁵³³

One of Eshleman's clients, OC, a retired physician who was in his 70s, testified at the hearing.⁵³⁴

Customer OC

OC originally invested in the stock market to help pay for the education of his children and to save money for retirement.⁵³⁵ He did not consider himself to be a sophisticated investor, making only conservative investments in blue-chip stocks.⁵³⁶ He was introduced to Eshleman through a friend.⁵³⁷ OC invested in Pfizer with Eshleman and received a call from Eshleman when he moved from Shochet to Florida Discount.⁵³⁸ Eshleman then persuaded OC to sell 100 shares of Pfizer in order to purchase 350 shares of CPFS for \$3,602.50.⁵³⁹

OC and Eshleman disagree about whether it was Eshleman or Rich who persuaded OC to sell his shares of Pfizer and purchase 350 shares of CPFS. OC testified that he was "pretty sure" that it was Eshleman who spoke with him, because OC was familiar with his voice.⁵⁴⁰ OC also took contemporaneous notes, and, referring to them, he recalled being told that CPFS was a good company; was trading at ten and a quarter;

⁵³³ Tr. 553:5-554:23.

⁵³⁴ C172 104:23-25; Tr. 148:4-5, 149:3-4.

⁵³⁵ Tr. 149:11-25.

⁵³⁶ Tr. 151:7-22.

⁵³⁷ Tr. 151:23-152:3.

⁵³⁸ Tr. 153:12-16.

⁵³⁹ Tr. 604:9-18; C69 p. 4.

⁵⁴⁰ Tr. 155:5-9,167:25-168:19. OC recalled hearing Eshleman talking to someone else during the conversation, but could not tell who it was or what was said. Tr. 164:14-23.

and would give him a 15% return in a few months.⁵⁴¹ OC's account records confirm he purchased 350 shares of CPFS at \$10.25 per share.⁵⁴² Based on the consistency between OC's testimony and his contemporary notes, in addition to Eshleman's testimony that he believes that he received the commissions on the trades, the Hearing Panel credits OC's testimony.⁵⁴³ OC was not familiar with the term "shell company," and Eshleman failed to tell him that CPFS had no operating history or revenues, that it had minimal assets, and was unlikely to continue to stay in business unless it could obtain additional financial resources.⁵⁴⁴ OC would not have purchased the stock had he known the truth about CPFS.⁵⁴⁵ His shares are now virtually worthless.⁵⁴⁶

IV. Failures to Update Form U-4

Fernandez, Forman, Norris, and Sierp were each notified by letter that he was the subject of an investigation relating to his activity while associated with Florida Discount, and was further advised of his obligation to update his Form U-4 to disclose that he was the subject of such investigation.⁵⁴⁷ All of them understood that it was their obligation to ensure that their Forms U-4 were properly updated.⁵⁴⁸ However, each failed to update and amend his Form U-4 within 30 days of learning of the facts and circumstances giving rise to the amendment.⁵⁴⁹

⁵⁴¹ Tr. 154:6-12. The note stated: "Mark, CPFS, buy, trading at ten and a quarter, a thousand shares, 15% return, five hundred at ten dollars, four thousand dollars sell, will send one thousand in the middle of October." Tr. 161:17-21.

⁵⁴² Tr. 156:21-157:12.

⁵⁴³ Tr. 669:14-23.

⁵⁴⁴ Tr. 158:22-159:20.

⁵⁴⁵ Tr. 159:21-24.

⁵⁴⁶ When he left Florida Discount, Eshleman tried to persuade OC to move his account with him. He told OC that there was a problem with the company and that he was not recommending the shares. Tr. 660:6-16. At the end of November 2001, when Eshleman left Florida Discount, OC's shares in CPFS were worth almost \$300 more than he paid for them. C69 p. 8.

⁵⁴⁷ C150, C152, C154, C156; Tr. 881:11-882:1, 1021:24-1022:4, 1364:12-18, 1416:1-1417:8.

⁵⁴⁸ Tr. 923:16-25, 1366:1-3, 1737:18-21.

⁵⁴⁹ C48 pp. 7-8, C50 pp. 12-13, C51 pp. 16-17, C49 pp. 16-17; Tr. 1592:13-18, 1592:23-1593:3.

Each Respondent testified that he provided a copy of his Wells submission to LH Ross, with the expectation that the firm would update the Form U-4 to reflect receipt of the Wells letter notifying him that he was the subject of an investigation.⁵⁵⁰ However, they all failed to verify that their CRD records were properly updated.⁵⁵¹

Forman never disclosed the investigation on his CRD records.⁵⁵² Fernandez did not disclose this matter on his Form U-4 until August 25, 2004, almost a year after receiving the Wells letter and almost two months after the Complaint had been filed in this matter.⁵⁵³ Norris did not disclose this matter on his Form U-4 until September 8, 2004, more than a year after receiving the Wells letter and more than two months after the Complaint had been filed in this matter.⁵⁵⁴ Sierp never disclosed NASD's investigation, even though he amended his Form U-4 eight times from October 10, 2003, through his departure from the industry in June 2004.⁵⁵⁵

⁵⁵⁰ Tr. 900:20-901:6, 1023:7-21, 1364:12-1366:8, 1736:3-9. Norris also claimed that he disclosed his receipt of his Wells letter to GunnAllen after he joined the firm in November 2003. Tr. 924:24-925:4.

⁵⁵¹ Tr. 922:25-923:6, 1064:15-1065:5, 1368:5-9, 1741:11-15. Fernandez claimed that he checked to see if his Form U-4 was updated after speaking with his counsel and "watching this whole thing develop."

Tr. 1739:24-1740:6. Although Fernandez could not recall when he made the inquiry, whether it was before or after the Complaint in this matter was filed, LH Ross's compliance personnel told him that they did not have a copy of his Wells submission. Tr. 1740:10-1741:7. Fernandez provided LH Ross with another copy, but never verified whether his Form U-4 had been updated. Tr. 1741:11-15.

⁵⁵² C49 pp. 61-69.

⁵⁵³ C48 p. 8. CRD records show that Fernandez amended his Form U-4 11 times after receiving the Wells letter, but failed to disclose the investigation in any of the amendments. C48 pp. 44-117.

⁵⁵⁴ C50 pp. 38-44. CRD records show that Norris amended his Form U-4 11 times after receiving the Wells letter, but failed to disclose the investigation in any of the amendments. C50 p. 35.

⁵⁵⁵ C51 pp. 47-96.

Discussion and Conclusions

I. Respondents Engaged in Fraudulent Sales Practices, in Violation of Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5 thereunder, and NASD Conduct Rules 2110, 2120, 2310, and IM-2310.

To establish a violation of Section 10(b) of the Exchange Act⁵⁵⁶ and Rule 10b-5,⁵⁵⁷ the evidence must show that in connection with the purchase or sale of a security, a respondent, acting with scienter,⁵⁵⁸ either: (a) employed a device, scheme or artifice to defraud, or (b) made untrue statements of material fact or omitted to state material facts necessary, or (c) engaged in acts, practices or a course of business that operated or would operate as a fraud or deceit upon persons.⁵⁵⁹ Recklessness suffices to show scienter.⁵⁶⁰ Here, the Complaint alleges that Respondents violated each subpart of SEC Rule 10b-5.

NASD Conduct Rule 2120 is the functional equivalent of Rule 10b-5.⁵⁶¹ Accordingly, the analysis concerning Rule 10b-5 also applies to Conduct Rule 2120. In addition, Rule 2110 is violated whenever a respondent engages in unethical conduct.⁵⁶²

⁵⁵⁶ 15 U.S.C. §78j (2003).

⁵⁵⁷ 17 C.F.R. 240.10b-5 (2003).

⁵⁵⁸ Scienter is "a mental state embracing intent to deceive, manipulate, or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976).

⁵⁵⁹ *SEC v. Alliance Leasing Corp.*, 2000 U.S. Dist. Lexis 5227, at *24-24 (S.D. Cal. 2000, *aff'd.*, 2000 U.S. App. Lexis 153 (9th Cir. 2002)). There is also a jurisdictional element that the transaction involved the use of interstate commerce or the mails. *Id.*

⁵⁶⁰ *See, e.g., Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1568-69 (9th Cir. 1990), *cert. denied*, 499 U.S. 976 (1991); *Kevin Eric Shaughnessy*, Exchange Act Rel. 40244, 1998 SEC Lexis 1507, *9 (July 22, 1998). Recklessness has been defined as highly unreasonable conduct involving not merely simple or excusable negligence but an extreme departure from the standards of ordinary care. *See Market Regulation Committee v. Jawitz*, No. CMS960238, 1999 NASD Discip. Lexis 24, at **19-20 (NAC July 9, 1999) (citing *Hollinger*, 914 F.2d at 1568-69 and cases there cited), *aff'd*, *Michael B. Jawitz*, Exchange Act Rel. 44357, 2001 SEC Lexis 1042 (May 29, 2001).

⁵⁶¹ *Market Reg. Comm. v. Shaughnessy*, No. CMS950087, 1997 NASD Discip. Lexis 46, *24 (NBBC June 5, 1997), *aff'd.*, Exchange Act. Rel. 40244, 1998 Lexis 1507 (July 22, 1998).

⁵⁶² *Department of Enf. v. Timberlake*, No. C07010099, 2004 NASD Discip. Lexis 11, *16 (NAC Aug. 6, 2004) ("It is axiomatic that a broker who makes material misrepresentations and omissions to customers is engaging in unethical conduct.").

Conduct violative of Rule 10b-5 and Conduct Rule 2120 also violates Conduct Rule 2110.⁵⁶³

A. Participation in the Scheme to Defraud

Eshleman, Fernandez, Forman, Norris, and Sierp knowingly participated in an unlawful, fraudulent, and deceptive scheme, orchestrated by Rich, to solicit the purchase and sale of the common stock of CPFS and BSDS by unsuspecting members of the public. From March 2001 to September 2002, Florida Discount was a boiler room operation in which the Respondents engaged in a variety of fraudulent and deceptive sales practices that included using misleading sales scripts, making misrepresentations and omissions of material facts, making unsuitable recommendations, engaging in a no net-selling practice, and effecting unauthorized transactions in customer accounts. In so doing, they disregarded their fiduciary duties to, and obligations of fair dealing with, their customers, while at the same time, they profited from ill-gotten gains through commissions and incentives they received.

“No express ‘agreement’ is necessary to establish the existence of a scheme to defraud. It is enough that each of the individual respondents knowingly joined or participated in a common undertaking that he knew or should have known was fraudulent.”⁵⁶⁴ There also is no requirement that an individual be involved in every stage of a manipulative or fraudulent scheme to sustain a violation under Section 10(b) and

⁵⁶³ See generally *DBCC v. Euripides*, No. C9B950014, 1997 NASD Discip. Lexis 45, at *16-23 (NBCC July 28, 1997); *Shaughnessy*, 1997 NASD Discip. Lexis 46, at *24-27.

⁵⁶⁴ *Haight & Co.*, 44 S.E.C. 481, 497 (1971); see also *Leslie A. Arouh*, Exchange Act Rel. No. 50889, 2004 SEC Lexis 3015, at * 20 (Dec. 20, 2004) (“[A] person who directly or indirectly engages in a manipulative or deceptive act as part of a scheme to defraud can be a primary violator of Section 10(b) and Rule 10b-5 (a.)”); *Hamilton Waters & Co.*, 42 S.E.C. 784, 789 (1965) (finding respondents engaged in a scheme to defraud involving the sale of a speculative security of an unseasoned company by means of a high-pressure sales campaign).

Rule 10b-5.⁵⁶⁵ Nor does a co-schemer have to be familiar with every facet of the scheme.⁵⁶⁶

Respondents attempted to shift responsibility for their misconduct to Rich, the mastermind of the scheme. However, regardless of any regulatory violations by Rich, these Respondents are not excused from their own obligations to comply with regulatory requirements.⁵⁶⁷ The evidence demonstrates that each Respondent knowingly and recklessly participated in the fraudulent scheme. As Eshleman put it, he knew from the beginning that Rich was a “con artist” and that “people were going to get hurt.”

B. Material Misrepresentations and Omissions

The purpose of Section 10(b)-5(b) is to “substitute a philosophy of full disclosure for the philosophy of caveat emptor, and thus to ensure that investors obtain disclosure of material facts in connection with their investment decisions regarding the purchase or sale of securities.”⁵⁶⁸ The standard for materiality is an objective one, requiring consideration of “whether the reasonable investor would consider a fact important” in making an investment decision,⁵⁶⁹ or whether disclosure would “significantly alter...the ‘total mix’ of information made available.”⁵⁷⁰ Material facts

⁵⁶⁵ See *Department of Enf. v. Galasso*, No. C10970145, 2001 NASD Discip. Lexis 2, *36 (NAC Feb. 5, 2001), *aff’d sub nom, John Montelbano*, Exchange Act Rel. No. 47227, 2003 SEC Lexis 153, *24 (Jan. 22, 2003).

⁵⁶⁶ See *John Montelbano*, 2003 SEC Lexis 153, at *24 (“Whether or not applicants were familiar with every facet of the scheme is immaterial.”).

⁵⁶⁷ See *Euripides*, 1997 NASD Discip. Lexis 45, at *21 (finding that respondent's defense was meritless because he could not pass off his responsibilities to his firm) (citations omitted). See also *Frank W. Leonesio*, Exch. Act Rel. No. 23,524, 1986 SEC Lexis 1009, at *11 (Aug. 11, 1986) (“A salesperson has a duty to make an adequate independent investigation in order to ensure that his representations to customers have a reasonable basis.”).

⁵⁶⁸ *SEC v. Hasho*, 784 F. Supp. 1059, at 1106 (quoting *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 186 (1963)).

⁵⁶⁹ See *Basic, Inc. v. Levinson*, 485 U.S. 224, 232 (1988).

⁵⁷⁰ *Martin R. Kaiden*, Exch. Act Rel. No. 41629, 1999 SEC Lexis 1396, at *18 n. 25 (July 20, 1999); *TCS Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976); *Time Warner, Inc., Sec. Lit.*, 9 F.3d 259, 267-268 (2d Cir. 1993).

include not only earnings of a company, but also those facts that affect the probable future of a company and that may affect the desires of investors to buy, sell, or hold the securities.⁵⁷¹ The speculative nature of a security and the risks associated with it, as well as information about the financial condition of a company are all material facts.⁵⁷² The SEC has consistently held that a specific price prediction regarding a speculative security is material.⁵⁷³ Finally, undisclosed payments to brokers are material facts that should be disclosed to investors due to an actual or potential conflict of interest.⁵⁷⁴ Any failure to disclose such payments violates the antifraud provisions of the federal securities laws.⁵⁷⁵

The duty of fair dealing requires that stock brokers have an adequate basis for their recommendations, and those recommendations should be based on reasonable investigation.⁵⁷⁶ Accordingly, a respondent cannot plead ignorance as a defense to recklessness if a reasonable investigation would have revealed the truth to the respondent.⁵⁷⁷ Registered representatives have an affirmative duty to investigate the securities they recommend to customers to ensure that they have an adequate basis for their recommendations and statements made to customers to support their

⁵⁷¹ See *Hasho*, 784 F. Supp. at 1108.

⁵⁷² See *SEC v. Murphy*, 626 F.2d 633, 653 (9th Cir. 1980); *Hanly v. SEC*, 415 F.2d 589, 595-597 (2d Cir. 1969); *SEC v. Texas Gulph & Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 404 U.S. 1005 (1971); *Hasho*, 784 F. Supp. at 1109; *Department of Enf. v. Golub*, 2000 NASD Discip. Lexis 14, at *21 n.14 (NAC Nov. 17, 2000).

⁵⁷³ See *Department of Enf. v. Faber*, No. CAF010009, 2003 NASD Discip. Lexis 3, at *22-23 (NAC May 7, 2003), *aff'd*, *Dane Faber*, Exchange Act Rel. No. 49216, 2004 SEC Lexis 277, at *16 (Feb. 10, 2004).

⁵⁷⁴ *Timothy J. Brannon*, Exchange Act Rel. No. 39949, 1998 SEC Lexis 840, *7 (May 4, 1998).

⁵⁷⁵ *Id.*; see also *Hasho*, 784 F. Supp. at 1110.

⁵⁷⁶ See *Hanly v. SEC*, 415 F.2d at 597; *Steven D. Goodman*, Exch. Act. Rel. No. 43,889, 2001 SEC Lexis 144, at *12 (Jan. 26, 2001).

⁵⁷⁷ See, e.g., *SEC v. Infinity Group*, 993 F. Supp. 324, 330 (E.D. Pa. 1998).

recommendations.⁵⁷⁸ Consequently, registered representatives cannot ignore their duty to investigate and avoid liability for fraud by relying on what their employers tell them.⁵⁷⁹

Each of the Respondents used the scripts, whether verbatim or as guidance, to misrepresent to customers that CPFS and BSDS (1) were oversubscribed securities that were available to customers of Florida Discount on a privileged basis, (2) about to merge with or acquire other valuable companies, (3) about to announce important events, and (4) sure to increase in price significantly. Each of the Respondents either knew, or should have known, and did not inform his customers, that CPFS and BSDS had no relevant operating history, no significant financial resources, and their auditors questioned their ability to continue as going concerns. Each of the Respondents failed to inform his customers that he could not, or did not, do any due diligence on either company, but that he was relying on what Bruce Rich told him about CPFS and BSDS, and, therefore, had no adequate basis upon which to recommend those stocks or to predict their price performance. Each of the Respondents failed to inform his customers of any risks of investing in those two issues, or that there would be difficulty in selling those shares because the float was controlled by Florida Discount which had a no net-selling policy to which he was, in fact, adhering. Finally, each of the Respondents failed to inform his customers that he was promised bonuses, stock options, and other incentives for selling CPFS and BSDS to them.

⁵⁷⁸ See, e.g., *Hasho*, 784 F. Supp. at 1110.

⁵⁷⁹ *Richard H. Morrow*, 53 S.E.C. 772, 779 n.10 (1998) (“[E]ven if Morrow had had access to a broker-dealer’s due diligence file on the offering, that fact alone would not have relieved Morrow of his duty to investigate.”); see also *Steven D. Goodman*, 2001 SEC Lexis 144, at *14 (statements by a registered representative’s superiors are “not an adequate basis for representations to customers.”); *Donald T. Sheldon*, 51 S.E.C. 59, 71 (1992) (material misstatements and omissions by registered representatives are not excused by reliance on information from his broker or dealer), *aff’d*, 45 F.3d 1515 (11th Cir. 1995); *William G. Berge*, 46 S.E.C. 690, 694 (1976) (“Compliance with the antifraud provisions cannot be shifted entirely to a salesman’s supervisor.”).

The foregoing misrepresentations and omissions were clearly material; they altered the total mix of information made available to customers, and were critical to the customers' decisions to invest in the two securities. Each Respondent recommended the purchase of those two securities solely on the basis that the prices were rising, although they had no idea why the prices were rising. The NASD investigation was prompted by the question raised in an Internet article: how can a shell company with no cash, no revenues, no business, and no immediate prospects be selling at prices above six dollars a share? Either the Respondents knew the answer to that question – Florida Discount controlled the float and was responsible for almost all of the trading activity that pumped up the price – and intentionally deceived their customers, or they were reckless in not answering that question before soliciting purchases of stock from their customers.

C. Fraudulent and Deceitful Acts and Practices

1. Unauthorized Trading

Unauthorized trading in a customer's account is illegal and violates Rule 10b-5 when committed with "deception, misrepresentation or nondisclosure."⁵⁸⁰ The SEC and NASD have consistently held that unauthorized trading in a customer's account violates Conduct Rule 2110.⁵⁸¹

Here, Fernandez, Forman, Norris, and Sierp effected unauthorized transactions in their customers' accounts. In addition to effecting those unauthorized transactions, they also knew that Rich was altering tickets in order to use all remaining cash in their

⁵⁸⁰ *Hasho*, 784 F. Supp. at 1110; *J.W. Barclay*, 2003 SEC Lexis 2529, *33-34 (Oct. 23, 2003); *see also*, *DBCC v. Granath*, 1998 NASD Discip. Lexis 19, *10-11 (NAC March 6, 1998) (when scienter is established, unauthorized trading violates Conduct Rule 2120).

⁵⁸¹ *Jeffrey B. Hodde*, No. C10010005, 2002 NASD Discip. LEXIS 4, at *13-14 (NAC Mar. 27, 2002) (citations omitted); *see also Robert Lester Gardner*, Exchange Act Rel. No. 35899, 1995 SEC LEXIS 1532, at *1 n.1 (1995).

customers' accounts. They either merely acquiesced in the practice of buying more shares than were ordered by the customer, or, when confronted by the customer, attempted to justify the larger purchase. In no case was the customer told that the tickets were altered, that Rich was using up available cash, or that any justification for the unauthorized trade was merely a pretext.

2. Coordinated Cross Transactions and Swapping

By participating in coordinated cross transactions and swapping CPFS and BSDS in their customers' accounts, Fernandez, Forman, Norris, and Sierp insured that the price of those two securities would rise, consistent with the no net-selling policy at Florida Discount. Shares that one of them bought or sold for a customer would be bought or sold by another for one or more of his customers. Moreover, each of them sold either CPFS or BSDS in one of his customers' accounts on the same day he bought the same stock for another of his customers. These practices were fraudulent and deceptive because they gave the appearance of making money for their customers as the prices were rising, while they were generating significant commissions for themselves.

3. Unsuitable Transactions

Conduct Rule 2310(a) provides that, in recommending a purchase of a security to a customer, a broker "shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and his financial situation

and needs." Unsuitable trading can also violate the antifraud provisions of the federal securities laws.⁵⁸²

When, as here, a broker is recommending that customers purchase low-priced securities, the broker has a heightened duty of ascertaining the suitability of the investment for each customer.⁵⁸³ Even if a customer seeks to engage in highly speculative or otherwise aggressive trading, a broker is under a duty to refrain from making recommendations that are incompatible with the customer's financial profile.⁵⁸⁴ Moreover, representatives must not recommend purchases that lead to unsuitably high concentrations in the customer's account of a particular security or group of securities that are speculative.⁵⁸⁵

In this case, because CPFS and BSDS were worth, at most, pennies a share, and were being pushed so hard by Rich and his partners that the prices were rising to \$14 for CPFS and almost \$9 for BSDS, the two stocks were clearly unsuitable for any customer. There was no reasonable basis upon which any of the Respondents could have recommended either stock. They either knew, or were reckless in not knowing, that the prices were rising only because they were being pumped up by the activity at Florida Discount. In fact, the only positive factor that any of the Respondents could cite for

⁵⁸² See *Clark v. John Lamula Investors, Inc.*, 583 F.2d 594, 599-601 (2d Cir. 1978) (holding that Rule 10b-5 was violated where defendant recommended unsuitable securities that he knew or reasonably believed were unsuitable); *Laurie Jones Canady*, Exchange Act Rel. No. 41250, 1999 SEC Lexis 669 (Apr. 5, 1999) (holding that a sales agent's securities recommendations violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 where she knew that the transactions were unsuitable for customers and failed to disclose associated risks); see also *Banca Cremi, S.A. v. Alex Brown & Sons, Inc.*, 132 F.3d 1017, 1032 (4th Cir. 1997) (collecting appellate cases).

⁵⁸³ *Eugene J. Erdos*, 47 S.E.C. 985, 989 (1983) (a salesperson violated NASD's suitability rule because the recommendations were inconsistent with the customer's financial situation and needs); *Douglas Jerome Hellie*, 50 S.E.C. 611, 613 n.8 (1991) (a broker's "duties respecting suitability are heightened in the context of ... low-priced stock transactions.").

⁵⁸⁴ *Id.*; *Department of Enf. v. Jack H. Stein*, No. C07000003, 2001 NASD Discip. Lexis 38, *10 (NAC Dec. 3, 2001), *aff'd*, 2003 SEC Lexis 338 (Feb. 10, 2003).

⁵⁸⁵ See, e.g., *Clinton Hugh Holland*, 52 S.E.C. 562, 564 (Dec. 21, 1995), *aff'd*, 105 F.3d 665 (9th Cir. 1997) (table).

recommending either stock was that the price was rising, although they claimed that they did not know the reason for the rise. Nevertheless, as account records in evidence demonstrate, they recommended that their customers sell “blue-chip” stocks, large-cap stocks, tax-free and corporate bonds, annuities, and other assets, – in many cases, investments that were made to secure their retirements or provide for their heirs – to buy shares of CPFS and BSDS. Those purchases resulted in inordinate concentrations of those stocks in their customers’ accounts, exposing those customers to extreme risk of loss. Each Respondent knew, or had reason to know, that their recommendations to buy CPFS and BSDS were unsuitable for their customers, both qualitatively and quantitatively, and they failed to inform those customers of the risks involved in investing in them.

By virtue of the foregoing activities and practices, the Extended Hearing Panel concludes that Fernandez, Forman, Norris, Sierp, and Eshleman engaged in fraudulent sales practices, in violation of Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5 thereunder, and NASD Conduct Rules 2110, 2120, 2310, and IM-2310.

II. Fernandez, Forman, Norris, and Sierp Each Failed to Update and Amend His Form U-4 After Receiving Notice That He Was a Subject of an NASD Investigation, in Violation of NASD Conduct Rule 2110, IM-1000-1, and Article V, Section 2(c), of NASD By-Laws

Fernandez, Forman, Norris, and Sierp each failed to update his Form U-4 to reflect that he had received a Wells notice that he was a subject of the investigation that led to the filing of the Complaint in this matter.⁵⁸⁶ Article V, Section 2(c), of NASD’s By-Laws obligates registered representatives to keep their application for registration

⁵⁸⁶ *Department of Enf. v. Daniel Richard Howard*, No. C11970032, 2000 NASD Discip. Lexis 16, *31 (NAC Nov. 16, 2000) (failure to amend Form U-4 after receipt of Wells letter constitutes a violation of Rule 2110).

current by filing supplementary amendments. Form U-4 notifies registered persons to “update this form by causing an amendment to be filed on a timely basis whenever changes occur to answers previously reported.”⁵⁸⁷ Such amendments shall be filed with NASD within 30 days after learning of the facts or circumstances giving rise to the amendment.⁵⁸⁸

By early September 2003, Fernandez, Forman, Norris, and Sierp each received a Wells notice that reminded him of his obligation to disclose on his Form U-4 his status as a subject of NASD’s investigation. Each of them responded in writing to the Wells notice. However, each failed to update his Form U-4 to disclose that he was the subject of an investigation.

Fernandez, Forman, Norris, and Sierp testified that they provided a copy of their Wells notices to LH Ross, expecting that firm to update their Forms U-4. However, merely providing a copy of a Wells notice to a representative’s firm is not a defense to the failure to update a Form U-4. Both the SEC and NASD have stated that the responsibility for maintaining the accuracy of the Form U-4, by updating the information as necessary, lies with the registered representative.⁵⁸⁹ That responsibility cannot be shifted to the firm or a supervisor.⁵⁹⁰ Moreover, none of those Respondents verified that his Form U-4 was updated. Consequently, by failing to update their Forms U-4,

⁵⁸⁷ See NTM 98-27, at p. 167 (March 1998) (obligation to amend U-4 arises upon receipt of a Wells notice.).

⁵⁸⁸ Article V, Section 2(c), NASD By-Laws.

⁵⁸⁹ *Frank R. Rubba*, Exchange Act Release No. 40238, 1998 SEC LEXIS 1499, at *8 (July 21, 1998); *Dep’t of Enforcement v. Howard*, 2000 NASD Discip. LEXIS 16, at **31-32 (NAC Nov. 16, 2000) *aff’d*. 2002 SEC LEXIS 1909 (July 26, 2002).

⁵⁹⁰ *Guang Lu*, Exchange Act Release No. 51047, 2005 SEC LEXIS 117, at *22 (Jan. 14, 2005); *Dep’t of Enforcement v. Knight*, No. C10020060, 2003 NASD Discip. LEXIS 27, at *7 (June 5, 2003), *aff’d*. 2004 NASD Discip. LEXIS 5 (NAC Apr. 24, 2004).

Fernandez, Forman, Norris, and Sierp violated Registration Rule IM-1000-1, Conduct Rule 2110, and Article V, Section 2(c), of NASD's By-Laws.⁵⁹¹

Sanctions

For intentional or reckless misrepresentations or material omissions of fact, the NASD Sanction Guidelines recommend a fine of \$10,000 to \$100,000 and a suspension for a period of 10 business days to two years.⁵⁹² In egregious cases, the Guidelines recommend a bar.⁵⁹³ For unsuitable recommendations, the Guidelines recommend a fine of \$2,500 to \$75,000, and a suspension for a period of 10 business days to one year.⁵⁹⁴ In egregious cases, the Guidelines recommend consideration of a longer suspension or a bar.⁵⁹⁵ For unauthorized trading, the Guidelines recommend a fine of \$5,000 to \$75,000 and a suspension in any or all capacities for ten business days to one year.⁵⁹⁶ In egregious cases, the suspension may be increased up to two years or a bar may be imposed.⁵⁹⁷

The violations all arise out of a common underlying cause – knowing and/or reckless participation in a scheme to defraud customers by inducing them, by means of misrepresentation and omissions of material facts, and other fraudulent sales practices, to

⁵⁹¹ Although the Complaint alleges a violation of Article III, Section 4(f) of the By-Laws (stating that a willful omission of a material fact in a report to be filed with NASD subjects a person to disqualification with respect to membership), there is no evidence that Respondents' failure to update their Forms U-4 was willful. The fact that they provided a copy of their Wells notices to their then current employer firm tends to negate that proposition. On brief, the willfulness argument has not been advanced, and the Extended Hearing Panel considers the charge to have been abandoned.

⁵⁹² NASD SANCTION GUIDELINES, at 94 (2004).

⁵⁹³ *Id.*

⁵⁹⁴ *Id.* at 97.

⁵⁹⁵ *Id.*

⁵⁹⁶ *Id.* at 100.

⁵⁹⁷ *Id.*

purchase shares of CPFS and BSDS. Accordingly, the Extended Hearing Panel aggregates the misconduct for purposes of imposing severe sanctions.⁵⁹⁸

Violations of Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5 thereunder, and NASD Conduct Rules 2110, 2120, 2310, and IM-2310

Each of the Respondents actively participated in the scheme to defraud, a scheme that was masterminded by Rich and his associates. Each knew that (1) information on CPFS and BSDS was scant, (2) Rich would not allow them access to whatever information he had in his “due diligence” files, (3) no significant news occurred which would justify the increases in the prices of the stocks, (4) they were promised bonuses and other incentives for pushing the stocks on customers, (5) Rich would not stand for any sales of stock without corresponding purchases of the same stock by other customers, (6) they facilitated the no net-selling policy by engaging in cross-transactions and swapping one stock for the other, (7) sales to their clients were unsuitable for them, (8) their clients had unreasonable concentrations of the two stocks in their accounts, (9) they made those sales by use of misrepresentations and omissions of material facts, and, (10) either they or Rich caused unauthorized transactions in those stocks to be effected in their customers’ accounts.

The evidence of their individual culpability is strong. Eshleman, who hoped eventually to receive his promised bonuses, testified that he was in too deep to get out. He said that although he saw the financial reports, and realized the stock was a sham, he continued to convince customers to transfer stock to Florida Discount in order to buy CPFS. He characterized his conduct as a “moral lapse.” Forman could not explain how a shell company such as BSDS could purportedly own a software company valued at \$1

⁵⁹⁸ See *Dep’t of Enforcement v. J. Alexander Securities, Inc., et al.*, No. CAF010021, 2004 NASD Discip. LEXIS 16, at *69 (NAC Aug. 16, 2004).

million, as he represented to his customers. Fernandez testified that he wouldn't know what a 10-K or 10-Q was. He said it was "Greek to me." Norris never saw any financial filings for CPFS or BSDS, and never asked to see any. Sierp knew that Rich was using up all funds in customers' accounts.

Each of these Respondents engaged in egregious conduct. They were motivated by the potential of significant monetary gain, to the detriment of the interests of their clients. They never questioned why there had been a run up in the price of the shares of CPFS and BSDS stock in the absence of any favorable news, and they disregarded a myriad of "red flags" that made Eshleman, and would have made any rational observer, highly suspicious of the circumstances, and question what was taking place.

Forman, Fernandez, Norris, and Sierp attempted to portray themselves as whistleblowers who alerted the NASD to the activities at Florida Discount. However, regardless of whether they retained their counsel a week before the NASD examination of Florida Discount on September 10, 2002 (as they claim), or at any other time before, or during, the staff examination, the NASD staff had begun its investigation into CPFS and Florida Discount in late July 2002, and there is no evidence that these Respondents provided any information to NASD staff that influenced the investigation in any way that had a material effect on its nature, scope, or direction. Accordingly, the Extended Hearing Panel does not find that they "blew the whistle" on Rich and the scheme to defraud. Their retention of counsel was intended to protect their own interests and limit their liability for customer trading losses. As registered representatives, their cooperation in the investigation was obligatory.

Given the circumstances, and the absence of any mitigating factors, the Extended Hearing Panel concludes that, in order to protect the investing public, each of the Respondents should be barred from associating with any member firm in any capacity. In light of the bars, no fines will be imposed.

In the penultimate paragraph of the Department of Market Regulation's brief, it seeks an order of restitution in the total amount of more than \$1 million, plus interest, for the benefit of 12 customers, to be assessed jointly and severally against the five named Respondents, in addition to the defaulting Respondents, Callichio, Celestin, and Kimmel. However, although the Department of Market Regulation seeks specific amounts for each customer, for all except two customers, there is insufficient evidence upon which the Extended Hearing Panel can determine a "quantifiable loss" by the customer.⁵⁹⁹ There are a variety of deficiencies in the evidence: the amount invested in CPFS and/or BSDS cannot be determined because a number of account statements are missing; the amount of any recoupment, as a result of the sale of the two stocks or a settlement with another broker-dealer, is not supplied; there is no evidence that certain customers mitigated their losses by selling stock when the Respondents informed them of events at Florida Discount and recommended that they sell; some calculations of loss are based on the increased value of the stock as a result of rising prices, rather than based on the amount of money or the value of securities the customers deposited in order to buy the stocks; and the bases for some calculations are supported only by the customers' unsupported estimates of loss.

The Extended Hearing Panel will order restitution to the following two customers who have demonstrated a quantifiable loss:

⁵⁹⁹NASD SANCTION GUIDELINES, at 6 (2004).

1. Customer MH

MH bought some stock in CPFS and BSDS from John Heilman and Charles Celestin before he began buying them from Forman. While Forman may not be held accountable for losses on those shares, it is clear that Forman was responsible for the unauthorized sale of \$47,815 in stocks and bonds that were transferred from MH's Merrill Lynch account in order to purchase 10,000 shares of CPFS.⁶⁰⁰ Subtracting the amount he recouped from the sale of those shares, \$6,700, his quantifiable loss amounts to \$41,115. Forman will be ordered to pay that amount to MH, plus interest, calculated in accordance with Section 6621 of the Internal Revenue Code, 26 U.S.C. § 6621(a)(2), from September 16, 2002, Forman's last day at Florida Discount, until paid.

2. Customer GW

GW opened his account with Norris at Florida Discount by depositing \$11,555 on May 16, 2002. He made another deposit, in the amount of \$7,007, on June 24, 2002. Those deposits were invested only in CPFS and BSDS.⁶⁰¹ After GW transferred his account from Florida Discount to Norris at LH Ross, he was able to recoup less than \$3,000. Accordingly, GW lost at least \$15,557.71. Norris will be ordered to pay that amount to GW, plus interest, calculated in accordance with Section 6621 of the Internal Revenue Code, 26 U.S.C. § 6621(a)(2), from September 16, 2002, Norris's last day at Florida Discount, until paid.

The Extended Hearing Panel declines to order restitution on a joint and several basis because no one Respondent has been shown to have been responsible for the actions

⁶⁰⁰ C83 p. 37.

⁶⁰¹ C146 pp. 3, 6.

of the others. Moreover, some Respondents were not employed at Florida Discount when transactions were effected by other Respondents in their customers' accounts.

Violations of NASD Conduct Rule 2110, IM-1000-1, and Article V,
Section 2(c), of NASD By-Laws

In light of the bars, the imposition of further sanctions for failures by Fernandez, Forman, Norris, and Sierp to update their Forms U-4 after receiving notice that they were the subjects of an NASD investigation would be redundant.⁶⁰²

Conclusion

Mark W. Eshleman, Fernando Fernandez, Adam T. Forman, Shannon L. Norris, and Kristian F. Sierp are barred from associating with any member firm in any capacity, for engaging in fraudulent sales practices, in violation of Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5 thereunder, and NASD Conduct Rules 2110, 2120, 2310, and IM-2310-2. Adam T. Forman is also ordered to pay \$41,115 to customer MH, plus interest, calculated in accordance with Section 6621 of the Internal Revenue Code, 26 U.S.C. § 6621(a)(2), from September 16, 2002, until paid. Shannon L. Norris is ordered to pay \$15,557.71 to customer GW, plus interest, calculated in accordance with Section 6621 of the Internal Revenue Code, 26 U.S.C. § 6621(a)(2), from September 16, 2002, until paid. In light of the bars, no fines will be imposed, nor will Fernandez, Forman, Norris, or Sierp be sanctioned for failure to update their Forms U-4 as charged.

⁶⁰² *Dep't of Enforcement v. Jeffrey B. Hodde*, No. C10010005, 2002 NASD Discip. LEXIS 4, at *17 (NAC Mar. 27, 2002).

Eshleman, Fernandez, Forman, Norris, and Sierp are assessed, jointly and severally, total costs of \$11,317, consisting of an administrative fee of \$750, plus a transcript fee of \$10,567.

SO ORDERED.

Alan W. Heifetz
Hearing Officer

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