FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. M. PAUL DE VIETIEN (CRD No. 1121492), Respondent.	Disciplinary Proceeding No. 2006007544401 **HEARING PANEL DECISION** Hearing Officer- SNB December 3, 2009

For participating in private securities transactions without prior written notice to and written permission from his member firm, in violation of Rules 3040 and 2110, and engaging in outside business activities without prior written notice to his member firm, in violation of Rules 3030 and 2110, Respondent is barred in all capacities.

Appearances

Richard March, Esq., and Dale A. Glanzman, Esq., Chicago, IL, for the Department of Enforcement.

Respondent appeared on his own behalf.

DECISION

I. Procedural Background

On December 31, 2008, the Department of Enforcement ("Enforcement") filed a two-count Complaint in this disciplinary proceeding. The first count alleges that, while registered with Citigroup Global Markets, Inc. ("Citigroup" or "Firm"), M. Paul De Vietien ("Respondent") facilitated investor purchases of "Membership Interests" in University Oakwoods, LLC, a limited liability company formed to purchase the majority of condominium units in a Florida condominium project. The Complaint alleges that the Membership Interests were securities, and

that Respondent participated in private securities transactions without providing prior written notice to and receiving written permission from his Firm, in violation of Rules 3040 and 2110. The second count alleges that Respondent failed to give written notice to his Firm that he was engaged in outside business activities – bookkeeping and accounting services for University Oakwoods, LLC – in violation of Rules 3030 and 2110.[1]

On February 2, 2009, Respondent filed an answer. Respondent admitted that he engaged in outside business activities without obtaining written approval from his Firm, but denied engaging in private securities transactions, arguing that the Membership Interests were not securities.

At the initial pre-hearing conference, the parties requested that the hearing be held in Chicago, Illinois.[2] However, during the final pre-hearing conference on June 12, 2009, Respondent asked to participate in the hearing by telephone because he could no longer afford to travel to Chicago. The Hearing Officer granted Respondent's request and arranged for a video conference for the opening statements and Respondent's testimony. Respondent participated by telephone for the remainder of the hearing. The hearing was held from June 23 through 25, 2009, before a Hearing Panel composed of a Hearing Officer and two former members of the

[1] Following the consolidation of NASD and the member regulation, enforcement, and arbitration functions of NYSE Regulation into FINRA, FINRA began developing a new "Consolidated Rulebook" of FINRA Rules. The first phase of the new consolidated rules became effective on December 15, 2008. See FINRA Regulatory Notice 08-57 (Oct. 2008). Because the complaint in this case was filed after December 15, 2008, the procedural rules that apply are the current FINRA Rules. The conduct rules that apply are the NASD Rules that existed at the time of the conduct at issue.

[2] Chicago, IL, is in the District where the witnesses were located and the conduct alleged in the Complaint occurred.

District 8 Committee.[3] Ten witnesses testified at the hearing, including a FINRA examiner, three of the four investors,[4] two of Respondent's former supervisors, the attorney who formed University Oakwoods, LLC, Respondent's daughter, a person who Respondent retained to provide advice on the financing and management of the University Oakwoods condominiums, and Respondent, who testified on his own behalf.

II. Jurisdiction

Respondent was first registered with a FINRA member firm in 1983. Tr. 21; CX-23. From July 1993 through December 2006, Respondent was registered as a general securities representative with Citigroup. From December 20, 2006, through January 4, 2007, he was registered in the same capacity with another member firm. From January 2 through January 26, 2009, he was associated with another member firm as a non-registered fingerprinted associate. Stip. ¶1.

Although Respondent is not currently associated with a member firm, FINRA has jurisdiction to bring this proceeding, pursuant to Art. V, § 4 of FINRA's By-Laws, because (1) the Complaint charges Respondent with misconduct while he was a registered person, and (2) the Complaint was filed within two years of his most recent association with a member firm.

[3] References to the testimony at the hearing are designated as "Tr._," with the appropriate page number. References to the exhibits provided by Enforcement are designated as "CX-_." References to stipulations are designated as "Stip. _." Exhibits CX-1-24, CX-25 pp. 5-9 and CX-26 pp. 1-4 were admitted to the record. Tr. 497-502. After the record was closed, but before closing arguments, Respondent attempted to admit an additional document into evidence over Enforcement's objection. The Hearing Officer denied Respondent's request. Tr. 605-09. Pursuant to Rule 9267(b), the document is attached to the record as a supplemental document.

[4] DP appeared in person to testify at the hearing; JL and JB testified by telephone. AP did not testify.

III. Origin of Investigation

The investigation that led to this proceeding was initiated based upon a Form U5 filed by Citigroup reflecting that Respondent was terminated for engaging in outside business activities without his Firm's approval. CX-23 p. 3; Tr. 264.

IV. Discussion

A. Private Securities Transactions

The facts underlying the private securities transactions charge are largely undisputed. Respondent acknowledged that, during 2006, he promoted University Oakwoods, LLC to potential investors, provided investors with marketing materials including a Subscription Agreement, and received over $840,000 from investors. Tr. 48-51, 55, 60-61, 64-65; Stip. ¶7. He also admitted that he retained a real estate expert to obtain financing in connection with University Oakwoods, LLC's purchase of the University Oakwoods condominium units, as well as lawyers to document the transaction. Tr. 29, 358, 542-43. Respondent acknowledged that he did not inform his Firm of these activities, much less obtain his Firm's permission. Stip. ¶2. In defense of the charges, Respondent argued that the investors were not purchasing securities, and, therefore, he did not engage in private securities transactions.[5] Tr. 185. However, as discussed below, the Panel found that the Membership Units were securities.

1. The Membership Units are Securities

The term "security" has been defined to include any "note" or "investment contract." Section 2(a)(1) of the Securities Act of 1933; *SEC v. Edwards*, 540 U.S. 389, 393-94 (2004).

[5] Enforcement did not allege, in the alternative, that Respondent's sale of the Membership Units issued by University Oakwoods, LLC constituted an outside business activity.

The definition of an investment contract has its origin in the U.S. Supreme Court's decision in *SEC v. W.J. Howey Co.*, which held that an investment contract involves an investment of money in a common enterprise, with an expectation of profits solely from the management of others. 328 U.S. 293, 299-300 (1946). Applying the factors in *Howey* to the evidence in this case, the Panel concluded that the Membership Units were securities.

a. An Investment of Money

There is no dispute that there was an investment of money. AP, DP, JL, and JB (the "Investors") invested approximately $844,000 in University Oakwoods, LLC.[6] Stip. ¶7. Specifically, between April and September 2006, the Investors purchased non-voting, Class A Membership Units of University Oakwoods, LLC, a Florida limited liability company formed to purchase 335 condominium units in a 450 unit condominium project located in Tampa, Florida known as "University Oakwoods Apartments."[7] Id.; CX-2 p. 1, CX-8 p. 17; Tr. 333-36, 407, 475-76. Accordingly, the Panel found that there was an investment of money under *Howey*.

b. A Common Enterprise

There also is no dispute that the Investors invested in a common enterprise. A common enterprise under *Howey* is established where there is "horizontal commonality," that is, "the tying of each individual investor's fortunes to the fortunes of the other investors by the pooling of assets, usually combined with the pro-rata distribution of profits." *Revak v. SEC Realty Corp.*, 18

[6] Respondent, his daughter, and son-in-law were co-founders of University Oakwoods, LLC. CX-2, p. 11.

[7] The proceeds of the offering were intended to fund the down payment necessary to purchase the University Oakwoods condominiums, pay closing costs, and fund anticipated reserves required by the lender. The Subscription Agreement disclosed that University Oakwoods, LLC paid a non-refundable deposit of $100,000, which gave it the option to purchase the University Oakwoods condominiums for $8,900,000. Closing on the purchase could be postponed for up to four months, until September 30, 2006, by making monthly $50,000 non-refundable deposits. CX-2 p. 3.

F.3d 81, 87 (2d Cir. 1994). Here, the Investors' funds were pooled, and they were to share, pro rata, in any profits derived from the operation and sale of the 335 condominium units to be purchased by University Oakwoods, LLC. CX-2. Therefore, the Panel found that there was a common enterprise under *Howey*.

c. Expectation of Profits

Respondent does not dispute that there was an expectation of profits from the enterprise. An expectation of profits exists when an investor anticipates profits either through "capital appreciation resulting from development of the initial investment or a participation in earnings resulting from the use of the investors' funds." *United Housing Foundation v. Forman,* 421 U.S. 837, 852 (1975). Here, both Respondent and the Investors testified at length about their expectation that University Oakwoods, LLC would generate profits for the Investors. For example, Respondent projected profits to the Investors based upon back-up offers on the University Oakwoods condominiums that University Oakwoods, LLC planned to purchase, at "significantly more than our contract price."[8] CX-6 pp.1-3. He also estimated that the annual net cash flows from the project could reach 25% of the investment. CX-6 p. 20. In addition, Respondent presented the investors with comparative market analyses showing the potential for profits. CX-1; Tr. 471-72. The Subscription Agreement also specifically stated that Investors would be allocated a pro rata share of the profits and losses of University Oakwoods, LLC.[9] CX-

[8] Respondent represented that University Oakwoods, LLC had a contract to purchase the University Oakwoods condominiums for $8.9 million, but the seller had four back-up contracts ranging from $9.4 million to $10.2 million. Respondent projected profits based upon the purported $10.2 million back-up contract. CX-6 pp. 1-2; Tr. 330.

[9] Although an unsigned version of the Subscription Agreement was offered into evidence, JL, DP, and JB each testified at the hearing that they had signed it. Tr. 337-38, 403, 467.

2 p. 1. For these reasons, the Panel found that Investors had an expectation of profits under *Howey*.

d. Derived from the Efforts of Others

The Subscription Agreement specifically states that the Managing Members (Respondent, his daughter, his son-in-law, and JM[10]) were "solely responsible for the management of [University Oakwoods, LLC.]" CX-2 p. 8. They, unlike the Investors, received compensation for their services and held 100% of the voting stock of University Oakwoods, LLC. CX-2 pp. 12-13.

However, Respondent argued that he had discussions with one of the investors, DP, about the possibility that she would provide renovation advice for the University Oakwoods condominiums. Tr. 34. Although *Howey* referred to profits derived *solely* from the efforts of others, courts now recognize that it is sufficient that "the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise." *See, SEC v. Glenn W. Turner Enterprises, Inc.*, 474 F.2d 476 (9th Cir.) *cert denied*, 414 U.S. 821 (1973). Here, DP never entered into an agreement to provide services, she received no compensation, she held only non-voting shares, and her interest in University Oakwoods, LLC was identical to the interest held by the other Investors. CX-10; Tr. 417-19. Moreover, the nature of the contemplated activities — undefined renovation advice — does not equate to the "essential managerial efforts which affect the failure or success of the enterprise" required to establish that profits from University Oakwoods, LLC would not be

[10] Respondent retained JM to provide advice on financing the purchase of the University Oakwoods condominiums, and JM was to serve as the Chief Operating Officer of University Oakwoods, LLC. CX-2 p. 8.

derived from the efforts of others. Tr. 417-19. However, even if DP was part of the "essential managerial efforts" for University Oakwoods, LLC, this would not negate a finding that the Membership Units were securities, because none of the other Investors were to provide any services to, or take any role in the management of, University Oakwoods, LLC. Tr. 325, 465-67. For these reasons, the Panel found that, under *Howey*, profits in University Oakwoods, LLC were to be derived from the efforts of others.

Based upon the foregoing, the Panel found that the University Oakwoods, LLC Membership Units purchased by the Investors were securities.

2. Respondent Continues to Solicit Additional Investments From the Investors After He Had Concerns About the Investment

On October 16, 2006, Respondent wrote a letter to the attorney, JG, stating, "I feel as though we have been swindled," because of seller misrepresentations, including fictitious back-up offers and operating expenses, and the related refusal of lenders to finance the project. CX-6 pp. 26-27. Respondent did not share his concerns with the Investors. Instead, in what appeared to the Panel to be a desperate attempt to salvage the transaction at the Investors' expense, Respondent continued to press for additional funds. On the same day, Respondent wrote one of the Investors, JL, stating, "I feel confident that … we have the ability to make this property work …. We still have a chance of making this thing work and closing the transaction. We need your support and [AP's] support to make it happen." CX-6 pp. 24-25.

However, when the Investors failed to make additional investments and requested that Respondent liquidate University Oakwoods, LLC and return what was left of their investments, Respondent refused. Tr. 352. The Investors were therefore required to retain counsel, ultimately

settling their claims for approximately $500,000—a cumulative loss of approximately $350,000. CX-10; Tr. 353.

3. Respondent Did Not Notify Citigroup of His Sale of University Oakwoods, LLC Securities

There is no dispute that Respondent failed to notify Citigroup of his promotion and sale of the University Oakwoods, LLC Membership Units to the Investors.[11] Stip. ¶2. The Panel found that this omission was intentional. Based upon his earlier conversation with his supervisor at Citigroup, Respondent knew that such activity would not have been permitted. Specifically, during Respondent's unexplained two-week absence from the office in early 2006, his supervisor, CS, learned that Respondent was taking the Florida real estate license examination. Tr. 192-93, 369, 371, 395. When Respondent returned, CS told him that he would not be permitted to receive compensation for real estate services while employed by the Firm. Tr. 395-96. Moreover, Respondent indicated that he knew his promotion of University Oakwoods, LLC was not permitted when he advised an investor that sending correspondence to his Firm would jeopardize his employment. CX-6 p. 23.

Nevertheless, in May 2006, while in the midst of promoting University Oakwoods, LLC Membership Units to investors, Respondent answered "no" to questions asking whether he participated in outside business activities or private placements away from his Firm. CX-20 pp. 29-30.

[11] Respondent also violated Firm policies which required him to provide notification and obtain approval from his Firm, prior to engaging in sales of University Oakwoods, LLC units. CX-19 pp. 3, 6.

4. Respondent's Activities Were Uncovered and He Was Terminated

Respondent's supervisor learned of his promotion and sale of University Oakwoods, LLC Membership Units in late November 2006, when DP, one of the Investors, called Respondent's office to request information about her investment. Tr. 369-70; CX-18. When the supervisor asked Respondent about this, he claimed ignorance. Tr. 377-78; CX-18. However, after Respondent's supervisor gathered additional information from DP, the supervisor suspended Respondent pending a determination of further action. In a later conversation, Respondent was forthcoming. On December 18, 2006, Respondent was terminated for failure to follow Firm policy. CX-18; Tr. 368.

B. Respondent Engaged in Related Outside Business Activities

Respondent does not dispute that, between June and November 2006, he received $16,000 in compensation for bookkeeping and accounting services to University Oakwoods, LLC. Stip. ¶5. He also acknowledges that he failed to give written notice to his firm about these outside business activities. Stip. ¶6. Again, by doing so, Respondent violated Firm policies prohibiting outside business activities without the Firm's prior approval. CX-19 pp. 3, 6.

V. Violations

A. Respondent Engaged in Private Securities Transactions without Prior Written Notice to and Approval from His Firm

As noted above, the Panel found that the University Oakwoods, LLC Membership Units were securities. The Complaint alleges that Respondent promoted and sold these securities to the Investors without prior written notice to and written permission from his firm, in violation of Rules 3040 and 2110.

Rule 3040 requires that an associated person who intends to participate in a private securities transaction must "provide written notice to the member with which he is associated describing in detail the proposed transaction and the person's proposed role therein and stating whether he has received or may receive selling compensation in connection with the transaction …." Further, if the transaction is for compensation, the associated member may not engage in the transaction unless the employer gives its prior approval in writing.[12] Rule 3040 defines a "private securities transaction" as "any securities transaction outside the regular course or scope of an associated person's employment with a member."

Here, Respondent participated in securities transactions when he offered and sold University Oakwoods, LLC Membership Units to the Investors. In addition, Respondent stipulated that his participation in these sales was outside the regular course and scope of his employment with Citigroup. Stip. ¶3.

Rule 3040 and Citigroup's procedures required Respondent to obtain permission from Citigroup before promoting University Oakwoods, LLC to investors. CX-19 pp. 3, 6, CX-20 p. 29; Tr. 298-301. Respondent does not dispute that he failed to do so. Stip. ¶2. Respondent also failed to disclose these activities in his Annual Regulatory Questionnaire and his Outside Business Activity Request Form. Tr. 385-87.

Respondent claimed that he received legal advice that the Membership Units were not securities. However, the attorney who purportedly provided the advice did not support Respondent's account. Tr. 588-90. Consistent with the attorney's testimony, the front page of the Subscription Agreement that the attorney prepared, and which Respondent reviewed and

[12] *Alvin W. Gebhart, Jr.*, Exchange Act Release No. 53,136, 2006 SEC LEXIS 93, at *55, *57 (Jan. 18, 2006).

provided to investors, expressly stated in capital letters and bold text that the investments were securities. Accordingly, the Panel did not credit Respondent's claim of reliance upon counsel.

Accordingly, the Panel found that Respondent engaged in private securities transactions, in violation of Rules 3040 and 2110. [13]

B. Respondent Engaged in Outside Business Activities

The Complaint also alleges that Respondent engaged in outside business activities in violation of Rule 3030 and 2110. Rule 3030 provides that "[n]o person associated with a member in any registered capacity shall be employed by, or accept compensation from, any other person as a result of any business activity … outside the scope of his relationship with his employer firm, unless he has provided prompt written notice to the member … in the form required by the member." The purpose of Rule 3030 is to provide member firms with an opportunity to raise any objections to such activities at a meaningful time and to exercise appropriate supervision as necessary under applicable law.[14] Rule 3030 requires disclosure of all outside business activity, not just securities-related activity. Respondent's violation of Rule 3030 is also a violation of Rule 2110.

Here, Respondent stipulated that he received $16,000 in compensation from University Oakwoods, LLC for accounting and bookkeeping services. Stip. ¶5. He also stipulated that he failed to give written notice to his Firm of these outside business activities. Stip. ¶6.

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[13] Respondent's violation of Rule 3040 is also a violation of Rule 2110. *District Bus. Conduct Comm. v. Cruz*, No. C8A930048, 1997 NASD Discip. LEXIS 62, at *96 (N.B.C.C. Oct. 31, 1997).

[14] *Proposed Rule Change by NASD Relating to Outside Business Activities of Associated Persons*, Exchange Act Release No. 26,063, 1988 SEC LEXIS 1841 (Sept. 6, 1988), adopted at Exchange Act Release No. 26,178, 1988 SEC LEXIS 2032 (Oct. 13, 1988).

Accordingly, the Hearing Panel finds that Respondent engaged in outside business activities, in violation Rules 3030 and 2110.

VI. Sanctions

The FINRA Sanction Guidelines ("Guidelines") for private securities transactions recommend a fine ranging from $5,000 to $50,000. In cases involving sales of $500,000 to $1,000,000, the Guidelines recommend a suspension of 6 to 12 months, or a greater sanction if aggravating factors are present.[15] The Guidelines for outside business activities recommend a fine ranging from $2,500 to $50,000 and a suspension of up to 30 business days in cases without aggravating factors, up to a one-year suspension in cases involving aggravating factors, or a bar in egregious cases.[16] Enforcement requested a bar. Respondent did not take a position on sanctions. Because both violations are related to the same misconduct, and the Guideline's Principal Considerations overlap, the Hearing Panel decided to impose a unitary sanction.

As the starting point for its consideration, the Panel observed that failing to give notice of private securities transactions is a serious offense. Investors are exposed to significant risk and loss where there is no oversight and supervision, and FINRA loses its ability to regulate sales practices when transactions are not disclosed.

The Guidelines provide a number of Principal Considerations to guide the Panel in its determination of whether there are mitigating or aggravating factors that would raise or lower the sanctions.[17] Those applicable to this case include: (l) the dollar volume of sales; (2) the number of customers; (3) the length of time over which the selling away activity occurred; (4) whether

[15] *Sanction Guidelines*, p. 15 (2007).

[16] *Sanction Guidelines*, p. 14 (2007).

the respondent had a beneficial interest in the issuer; and (5) whether the respondent attempted to create the impression that his or her member firm sanctioned the activity; (6) whether the investors were injured; (7) whether the respondent gave his firm verbal notice of the selling away activity; (8) whether respondent sold away after being instructed not to do so; (9) whether respondent's actions were through referrals or direct sales; and (10) whether respondent concealed his selling away activity from his firm.[18]

Applying these factors, the Panel found as mitigating that Respondent did not attempt to create the impression that his Firm sanctioned the sales. Tr. 347, 360-61. The Panel also appreciated Respondent's remorse at the hearing. However, the Panel found that the balance of the factors were aggravating. First, the Panel considered that the dollar volume of the sales was large; Respondent sold $844,000 in University Oakwoods, LLC Membership Units to four investors. Moreover, two of the Investors were Respondent's longtime customers at the Firm, with whom he had developed a strong relationship of trust and confidence. Tr. 32, 401, 443-46. Further, Respondent had a significant beneficial interest in University Oakwoods, LLC; he held 41% of the voting Membership Units, and options to purchase additional units. He was also entitled to a management fee and compensation for bookkeeping and accounting services. CX-2 pp. 12-13. In addition, the investors suffered substantial losses, approaching $350,000 in the aggregate. Furthermore, the misconduct occurred over a nine-month period, and continued even after Respondent's supervisor specifically reiterated the firm's policy that such activities would

[17] *Sanction Guidelines*, pp. 15-16 (2007).

[18] *Sanction Guidelines*, pp. 15-16 (2007).

not be permitted. Finally, Respondent concealed his private securities transactions from his Firm, and initially denied the activity when confronted by his supervisor.

In addition to the Principal Considerations noted above, the Panel also considered that Respondent continued to solicit investments in University Oakwoods, LLC at a time when he had serious concerns that the sellers of University Oakwoods condominiums had defrauded him. This callous disregard of the Investors' best interests was particularly troubling to the Panel. Balancing these various factors, the Hearing Panel finds that a bar is warranted.

VII. Conclusion

For participating in private securities transactions without prior written notice to and written permission from his member firm, in violation of Rules 3040 and 2110, and engaging in outside business activities without prior written notice to his member firm, in violation of Rules 3030 and 2110, Respondent is barred in all capacities.[19] This bar shall become effective immediately if this Hearing Panel Decision becomes the final disciplinary action of FINRA.

HEARING PANEL

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By: Sara Nelson Bloom
Hearing Officer

Copies: M. Paul De Vietien *(via first-class mail, electronic mail & overnight courier)*
Richard A. March, Esq. *(via first-class mail & electronic mail)*
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Mark Dauer, Esq. *(via electronic mail)*
David R. Sonnenberg, Esq. *(via electronic mail)*

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