

**FINANCIAL INDUSTRY REGULATORY AUTHORITY  
OFFICE OF HEARING OFFICERS**

DEPARTMENT OF ENFORCEMENT,

Complainant

v.

Respondent.

Disciplinary Proceeding  
No. 2006006259501

Hearing Officer – RSH

**Hearing Panel Decision**

October 28, 2010

**For engaging in an outside business activity without providing notice to his member firm, in violation of Rules 3030 and 2110, the Respondent is fined \$3,750. Enforcement failed to prove that the Respondent participated in private securities transactions without prior written notice to his member firm, in violation of Rule 3040. Enforcement also failed to prove that the Respondent provided false information about his outside business activity to his member firm, in violation of Rule 2110. Accordingly, those charges are dismissed.**

Appearances

David Utevsky, Senior Regional Counsel, Seattle, WA; Karrin J. Feemster, Senior Regional Counsel, Los Angeles, CA; and Jacqueline D. Whelan, Regional Chief Counsel, San Francisco, CA, for the Department of Enforcement.

Keith A. Ketterling and Jacob S. Gill, of Stoll Stoll Berne Lokting & Schlater, P.C., for Respondent.

## DECISION

### I. PROCEDURAL HISTORY<sup>1</sup>

On May 5, 2009, the FINRA Department of Enforcement filed a three-cause Complaint with the Office of Hearing Officers. The First Cause of Action alleged that Respondent violated Conduct Rules 3040 and 2110 by engaging in private securities transactions without providing prior written notice to his employer, Paulson Investment Company ("Paulson"). The Second Cause of Action alleged that Respondent violated Conduct Rules 3030 and 2110 by engaging in an outside business activity without providing prompt written notice to Paulson. The Third Cause of Action alleged that Respondent violated Conduct Rule 2110 by falsely denying on a firm compliance questionnaire that he had engaged in the outside business activity. The Respondent filed his Answer to the Complaint on June 1, 2009.

The hearing was held on April 28 and 29, 2010, in Portland, Oregon before a Hearing Panel composed of the Hearing Officer and two current members of FINRA's District 3 Committee. Enforcement called two witnesses: Respondent and HS, who was formerly the chief compliance officer at Paulson. Respondent testified on his own behalf, but did not call any other witnesses. The Hearing Panel accepted into evidence 96 exhibits submitted by Enforcement, 119 exhibits submitted by the Respondent, one jointly-submitted exhibit, and the parties' stipulations.<sup>2</sup>

Based upon a review of the entire record, the Hearing Panel makes the following findings of fact and conclusions of law.

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<sup>1</sup> As of July 30, 2007, NASD began operating under a new corporate name, the Financial Industry Regulatory Authority ("FINRA"). References in this decision to FINRA include, where appropriate, NASD. On December 15, 2008, certain consolidated FINRA rules became effective, replacing parallel NASD rules, and in some cases the prior rules were re-numbered and/or revised. *See* Regulatory Notice No. 08-57, FINRA Notices to Members, 2008 FINRA LEXIS 50 (Oct. 2008). This Decision refers to and relies on the NASD rules that were in effect at the time of the Respondent's alleged misconduct and cited in the Complaint as the basis for the charges against him.

<sup>2</sup> In this decision, "Tr." refers to the amended transcript of the hearing; "CX" to Enforcement's exhibits; "RX" to Respondent's exhibits; "JX" to the parties' joint exhibit; and "Stip." to the parties' stipulations.

## **II. FINDINGS OF FACT**

### **A. Respondent**

Respondent has been registered with FINRA as a General Securities Representative through Paulson since February 2004. Since March 2006, he has also been a General Securities Principal.<sup>3</sup> He has been continuously registered with FINRA through other member firms since March 1996.<sup>4</sup> At Paulson, Respondent handles both institutional and retail customer accounts.<sup>5</sup>

### **B. Private Securities Transactions**

Enforcement alleged that Respondent participated in investments made by LE and HH in Wood River Partners, L.P. ("Wood River").

#### **1. Wood River**

Wood River was a hedge fund that first opened an institutional trading account at Paulson in 2004.<sup>6</sup> On or about October 13, 2005, in an action filed by the Securities and Exchange Commission ("SEC") against Wood River and other defendants, the U.S. District Court for the Southern District of New York ("SDNY") appointed a receiver for Wood River. On or about February 1, 2007, the United States filed an indictment against John H. Whittier ("Whittier"), the founder and manager of Wood River, in the U.S. District Court for the SDNY. Count I of the indictment charged that Whittier had engaged in securities fraud in connection with the sale of Wood River limited partnership interests, in violation of federal securities laws and regulations. Whittier entered a plea of guilty and was found guilty of securities fraud as alleged in Count I of the indictment. Whittier was sentenced to 36 months in prison and was ordered to pay restitution to Wood River investors.<sup>7</sup> The Wood River limited partnership interests were securities.<sup>8</sup>

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<sup>3</sup> Stip. 1.

<sup>4</sup> CX-1, p. 6.

<sup>5</sup> Tr., 44.

<sup>6</sup> Tr., 51.

<sup>7</sup> Stips. 10, 11.

Another broker at Paulson introduced Respondent to Wood River in 2004, and because of Respondent's experience with complex institutional trading, he became a broker on the Wood River account. Respondent was one of the representatives responsible for the Wood River account between June 2004 and January 2006.<sup>9</sup> In calendar year 2005, Respondent received approximately \$13,735.00 in commissions from accounts maintained at Paulson by Wood River and its affiliates.<sup>10</sup> Enforcement did not allege, and there was no evidence presented, that Respondent was aware of or had any involvement in the fraud at Wood River.

## **2. LE's Investment in Wood River**

Respondent met LE in 2001 at a technical trading class. LE was a former registered representative and he told Respondent that he was a retired hedge fund manager.<sup>11</sup> Respondent believed that LE was an experienced investor because of his background and because LE had written a book about investing.<sup>12</sup> LE told Respondent that he was looking for a money manager, and asked who Respondent had worked with and liked. Respondent mentioned Wood River and another fund.<sup>13</sup> LE asked for information about Wood River, so on September 7, 2004, Respondent forwarded Wood River's August 2004 performance summary, which Respondent had received from Wood River.<sup>14</sup> Shortly after receiving Respondent's e-mail, LE responded that he could not open the attachment and asked Respondent to fax the performance summary.<sup>15</sup> LE then sent Respondent an e-mail saying he could not read the fax, and asked Respondent to have Wood River send a prospectus to LE.<sup>16</sup>

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<sup>8</sup> Stip. 6.

<sup>9</sup> Tr., 51-52; Stip. 3.

<sup>10</sup> Stip. 7.

<sup>11</sup> Tr., 81; JX-1, pp. 7-9.

<sup>12</sup> Tr., 83-85; RX-112.

<sup>13</sup> Tr., 82-83.

<sup>14</sup> RX-38.

<sup>15</sup> RX-39.

<sup>16</sup> RX-40.

During the subsequent period, between September 8 and December 8, 2004, Respondent communicated by e-mail with LE, or with Wood River about LE, approximately 15 times. Four of these e-mails involved Respondent forwarding Wood River performance reports to LE, LE responding that he could not open the attachment and asking what the month's performance number was, and Respondent responding with the month's performance number.<sup>17</sup> Four of the e-mails involved Respondent helping LE contact Wood River for more information.<sup>18</sup> Six e-mails involved Respondent attempting to facilitate communications or meetings between LE and Wood River.<sup>19</sup>

On or about November 15, 2004, LE invested \$250,000 in Wood River limited partnership interests. Respondent was not aware of LE's investment when he made it; on December 8, 2004, Respondent wrote to LE, saying, "Have not heard from you in awhile. I hope you had a great Thanksgiving. Take care." LE responded with an email saying that he had invested \$250,000 in Wood River, and wishing Respondent a merry Christmas. As in the earlier e-mails, LE asked for Wood River's November performance number.<sup>20</sup>

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<sup>17</sup> RX-46, 47, 48, 51.

<sup>18</sup> RX-41, 50, 52; CX-65.

<sup>19</sup> RX-44, 45, 50, 52; CX-65, 146.

<sup>20</sup> RX-55.

The parties stipulated that when LE purchased the Wood River securities, he was a customer of Paulson, that LE incurred losses as a result of his investments in Wood River, and that as part of Whittier's sentencing agreement in the SDNY, he was ordered to pay restitution to LE.<sup>21</sup> Respondent did not receive any compensation from Wood River as a result of LE's investment.<sup>22</sup>

### **3. HH's Investment in Wood River**

HH had been Respondent's customer at two of his prior brokerage firms; however, HH did not follow Respondent to Paulson. HH was a "very wealthy individual" and active investor. PS, HH's business manager, handled "everything from real estate to picking up things for him;" however, it was not clear that PS was HH's financial advisor.<sup>23</sup> Respondent's interactions with respect to HH were with PS by e-mail or text messages. On November 12, 2004, in response to PS's request, Respondent forwarded Wood River's October performance report to PS, and asked PS to call him with his reaction after he had reviewed the numbers.<sup>24</sup> There was no evidence that PS ever called Respondent to discuss the fund or its performance; instead, Respondent forwarded Wood River's contact information to PS, and also gave PS's contact information to Wood River in subsequent e-mails.<sup>25</sup> As with LE, between December 6, 2004, and February 4, 2005, Respondent forwarded Wood River's financial reports to PS.<sup>26</sup> Several e-mails showed that Respondent tried to help PS call or meet with Wood River representatives when they were having trouble connecting.<sup>27</sup>

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<sup>21</sup> Stips. 4, 9, 11.

<sup>22</sup> Complaint, ¶ 13.

<sup>23</sup> Tr. 114-115.

<sup>24</sup> RX-85; Tr. 125.

<sup>25</sup> RX-91, 94, 95, 96, 98.

<sup>26</sup> RX-86, 88, 93, 100, 101, 102.

<sup>27</sup> RX-94, 95, 96.

The parties stipulated that on or about January 27, 2005, HH invested \$250,000 in Wood River limited partnership interests; that when he purchased the Wood River securities, HH was not a customer of Paulson; that HH incurred losses as a result of his investments in Wood River; and that as part of Whittier's sentencing agreement in the SDNY, he was ordered to pay restitution to HH.<sup>28</sup> Respondent did not receive any compensation from Wood River as a result of HH's investment.<sup>29</sup>

Respondent testified that his main purpose in communicating with LE, PS and Wood River was not to facilitate LE's and HH's investments in Wood River; he was simply trying to serve his clients when they requested information or help. He said, "I have a habit with customers—potential customers—of trying to service them to the best of my ability. I was taught at Merrill Lynch that first year, the second year, that if you want to be meaningful to somebody, you need to be friends with their attorney, their CPAs, anyone they do business with, so that they saw you as someone that they could come to, you know, as a reference."<sup>30</sup>

The Hearing Panel found Respondent's testimony to be credible, and it was corroborated by HS's testimony. HS said, "[Respondent] came from a wire house and those brokers tend to be very relationship oriented. They get very familiar with their customers....So, you know, part of that is being helpful in any way you can with their needs in the hopes they bring assets over to you and invest with you. And so I think when you look at a lot of these e-mails that's what [Respondent] is doing. He is trying to develop or sustain or improve the relationship to hopefully foster, engender, this feeling of—or this bond between them that will allow him to be successful with them as their broker."<sup>31</sup>

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<sup>28</sup> Stips. 5, 9, 11.

<sup>29</sup> Complaint, ¶ 13.

<sup>30</sup> Tr., 91.

<sup>31</sup> Tr. 241-242.

**C. Respondent Engaged in an Outside Business Activity**

Respondent stipulated that during a period of at least one month in 2005, he engaged in an outside business activity without providing prompt written notice to Paulson. Namely, he referred two companies to Voyant Media ("Voyant"), a company that provided marketing services to on-line retailers. Respondent also stipulated that on or about September 1, 2005, he received \$3,750 from Voyant Media as compensation for his referrals of the companies to Voyant.<sup>32</sup> Respondent testified that he entered into a verbal agreement with Voyant to refer businesses to Voyant. He said he needed the income because he was having difficulty earning enough money as a broker.<sup>33</sup>

**D. Enforcement Failed to Prove that the Respondent Answered His Firm's Compliance Summary Falsely**

Respondent stipulated that on or about August 17, 2005, he completed a Registered Representative Compliance Summary ("Compliance Summary") as required by Paulson. The Compliance Summary asked, "Are you engaged in any outside business activity...?" Respondent answered, "No." The Compliance Summary became a part of Paulson's books and records.<sup>34</sup> Enforcement pointed to Voyant's September 1, 2005 payment to Respondent and contended that Respondent's answer on the Compliance Summary was false. Respondent testified that although he received compensation from Voyant on September 1, 2005, the payment was for work he had done during the summer of 2005. He maintained that he had stopped doing referral work for Voyant at the beginning of August. Respondent explained that on August 5, 2005, Paulson promoted him to sales manager, thereby giving him a base salary that eliminated his need for the additional income he hoped to obtain from Voyant. Respondent

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<sup>32</sup> Stips. 12, 13.

<sup>33</sup> Tr., 196-198.

<sup>34</sup> Stip. 14.



testified that he notified Voyant shortly after receiving the promotion that he would no longer be working for them.<sup>35</sup> HS testified that he believed that Voyant's payment to Respondent was made "long after he had discontinued the activity."<sup>36</sup>

After listening to and observing Respondent's testimony, the Hearing Panel found Respondent to be credible, and concluded that he had not answered the Compliance Summary falsely. The Hearing Panel therefore dismisses the Third Cause of Action.

### **III. CONCLUSIONS OF LAW**

#### **A. Enforcement Failed to Prove that Respondent Violated Rule 3040**

Conduct Rule 3040 provides that "[n]o person associated with a member shall participate in any manner in a private securities transaction" unless he provides his employer with prior written notice. Respondent concedes that LE's and HH's investments in Wood River are "private securities transactions," within the meaning of Rule 3040. He argues, however, that his activities in connection with those investments do not amount to "participation." The Hearing Panel agreed with his argument.

Although the SEC has consistently affirmed that the phrase "participate in any manner" should be read broadly,<sup>37</sup> in its most recent decision applying Rule 3040, it stated that "the scope of Rule 3040 is not without some limitation."<sup>38</sup> In delineating the parameters of the rule, the SEC described its precedents finding that brokers had participated in private securities transactions in violation of Rule 3040. All of those cases involved brokers whose activities to facilitate private securities transactions were far more extensive than Respondent's. *Gilbert M. Hair* sent out solicitation letters, referred a customer to a particular instrument, forwarded

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<sup>35</sup> Tr., 207-208, 278-279.

<sup>36</sup> Tr., 244-247.

<sup>37</sup> See, e.g., *Mark H. Love*, Exchange Act Release No. 49248, 2004 SEC LEXIS 318, at \*7 (Feb. 13, 2004); *Stephen J. Gluckman*, Exchange Act Release No. 41628, 1999 SEC LEXIS 1395, at \*17 (Jul. 20, 1999).

<sup>38</sup> *James W. Browne*, Exchange Act Release No. 58916, 2008 SEC LEXIS 3113, at \*25 (Nov. 7, 2008).

paperwork, and received a commission for the sale.<sup>39</sup> *Stephen J. Gluckman* informed an investor that an issuer was seeking funds, provided the investor's contact information to the issuer, helped prepare the purchase agreements, received investor funds, and received a referral fee.<sup>40</sup> *John P. Goldsworthy* signed promissory notes, made arrangements to sell them, received investor checks made payable to him, and accepted funds from the proceeds of the sales of the promissory notes.<sup>41</sup> *Mark H. Love* recommended an investment fund, explained the fund's investment strategy, personally vouched for the fund's operator, and assisted the customers with transferring funds and liquidating their firm accounts to purchase the securities.<sup>42</sup>

In contrast with its earlier decisions, in *James W. Browne*, the SEC found that the brokers had not participated in private securities transactions. The brokers in *Browne* referred customers to an issuer and gave the issuer contact information for at least two individuals who purchased the issuer's securities.<sup>43</sup> The SEC determined that the brokers in *Browne* had not received compensation for the private securities transactions.<sup>44</sup> The Hearing Panel concluded that Respondent's actions in connection with LE's and HH's purchases of Wood River are closer to those of the brokers in the *Browne* case than to those of the brokers in the SEC's earlier decisions.

### **1. LE's Investment**

Respondent's e-mails related to LE's investment showed Respondent to have been primarily an intermediary passing contact information between the two parties. While Respondent forwarded Wood River's financial information to LE, each time was in response to LE's request. There were no e-mails or any other evidence that Respondent had any substantive

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<sup>39</sup> Exchange Act Release No. 32187, 1993 SEC LEXIS 883 (Apr. 21, 1993).

<sup>40</sup> *Stephen J. Gluckman*, at \*15-18.

<sup>41</sup> Exchange Act Release No. 45926, 2002 SEC LEXIS 1279, at \*29.

<sup>42</sup> *Mark H. Love*, at \*3, 8.

<sup>43</sup> *James W. Browne*, at \*11-12.

<sup>44</sup> *Id.* at \*34.

involvement in LE's investment. The Hearing Panel found it significant that Respondent did not receive any compensation, directly or indirectly in connection with LE's investment in Wood River.

## **2. HH's Investment**

As in the situation with LE, the Hearing Panel found that Respondent did little more than make a referral and forward financial and contact information. In HH's case, however, Respondent was even more removed from the transaction, since all of his e-mails were with PS. There was no evidence presented that PS forwarded any of Respondent's e-mails to HH before HH invested in Wood River. It is therefore questionable whether Respondent's e-mails had any connection to HH's investment in Wood River at all. The Hearing Panel found it significant that Respondent did not receive any compensation in connection with HH's investment in Wood River.

Enforcement's theory of this case seemed to be that because Respondent exchanged more than one e-mail with LE and PS, and because the e-mails contained more than simple contact information, he participated in securities transactions within the meaning of Rule 3040. The Hearing Panel was not persuaded by this argument. Although Respondent exchanged numerous e-mails with LE and PS, they amounted to little more than referrals.

The Hearing Panel finds that Respondent did not participate in LE's and HH's purchases of Wood River securities in violation of Rule 3040, and therefore dismissed the First Cause of Action.

### **B. The Respondent Violated Rules 3030 and 2110**

Rule 3030 provides that no member or person associated with a member "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.”

Respondent stipulated that he had engaged in an outside business activity without notifying his firm, and the Hearing Panel therefore finds that Respondent violated Rules 3030 and 2110.

#### **IV. SANCTION**

##### **Violation of Rules 3030 and 2110**

In determining sanctions, the Hearing Panel considered the FINRA Sanction Guidelines (“Guidelines”). For violations of Rule 3030, the Guidelines recommend a fine of \$2,500 to \$50,000, and a suspension of up to 30 business days.<sup>45</sup> Because Respondent’s conduct did not involve firm customers, occurred over a short amount of time, and resulted in a relatively minor amount of compensation to him, the Hearing Panel finds that a suspension would not serve any remedial purpose in this case. Accordingly, Respondent will be ordered to pay \$3,750.00, which is the amount of compensation he received from Voyant.

#### **V. ORDER**

For violating Rules 3030 and 2110, Respondent is fined \$3,750.00. The Respondent is also ordered to pay costs in the amount of \$2,665.68, which includes a \$750.00 administrative fee and the cost of the hearing transcript. The fine and costs shall be payable on a date set by FINRA, but not less than 30 days after this decision becomes FINRA’s final disciplinary action in this matter.<sup>46</sup>

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Rochelle S. Hall

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<sup>45</sup> Guidelines, at 14.

<sup>46</sup> The Hearing Panel has considered and rejects without discussion all other arguments of the parties.

**This Decision has been published by FINRA's Office of Hearing Officers and should be cited as OHO Redacted Decision 2006006259501.**

Hearing Officer  
For the Hearing Panel