FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. FOX FINANCIAL MANAGEMENT CORPORATION (CRD No. 134277), BRIAN A. MURPHY (CRD No. 4743164), and JAMES E. ROONEY, JR. (CRD No. 1857754), Respondents.	Disciplinary Proceeding No. 2012030724101 Hearing Officer—DRS **EXTENDED HEARING PANEL DECISION** March 9, 2015

Respondents Fox Financial Management Corporation, James E. Rooney, Jr. and Brian A. Murphy violated: (1) NASD Rules 3040(c)(2) and 2110 and FINRA Rule 2010 by failing to supervise a registered representative's private securities transactions and failing to record the transactions on the firm's books and records; and (2) NASD Rules 3010 and 2110 and FINRA Rule 2010 by failing to establish, maintain, and enforce written supervisory systems and procedures. For this misconduct, Fox Financial Management Corporation is expelled and fined $100,000; James E. Rooney, Jr. is barred in all principal capacities, suspended in all capacities for six months, and fined $50,000; and Brian A. Murphy is barred in all principal capacities, suspended in all capacities for three months, and fined $25,000. Respondents are also jointly and severally ordered to pay hearing costs.

Appearances

For the Department of Enforcement, Complainant, Michael P. Manly, Esq., and Penelope Blackwell, Esq., Dallas, Texas.

For Fox Financial Management Corporation, Brian A. Murphy, and James E. Rooney, Jr., Respondents, Daniel Tapia Esq., Tapia Law Firm, Carrollton, Texas.

DECISION

I. Introduction

Respondents Fox Financial Management Corporation ("Fox" or "Firm"), its President James E. Rooney, Jr., and its Chief Compliance Officer, Brian A. Murphy, failed to reasonably supervise the private securities transaction of one of Fox's registered representatives, JEP. Specifically, Respondents failed to supervise JEP's registered investment adviser ("RIA") or any of the three hedge funds that he managed, and failed to record his private securities transactions on Fox's books and records. Based on this conduct, the Department of Enforcement filed a Complaint against Respondents on December 12, 2013, charging them with violating: (1) NASD Rule 3040(c)(2) by failing to record JEP's private securities transactions on the Firm's books and records and by failing to supervise these transactions as if they were executed through the Firm; and (2) NASD Rule 3010 by failing to establish, maintain, and enforce written supervisory systems and procedures that were reasonably designed to ensure compliance with NASD Rule 3040. As a result of these alleged violations, Enforcement also charged Respondents with failing to observe high standards of commercial honor and just and equitable principles of trade, in violation of NASD Rule 2110 and FINRA Rule 2010.

Respondents filed an Answer denying all charges and requested a hearing. Thereafter, before the hearing, they admitted to liability on all charges.[1] Additionally, the parties stipulated to many of the relevant facts. A hearing limited to sanctions was held on August 25–28, 2014, in Dallas, Texas. In an attempt to mitigate their sanctions, Respondents argued that they committed the violations because they relied to their detriment on their attorney, who advised them that the applicable FINRA Rules did not require that they treat JEP's activities as private securities transactions. The Hearing Panel, however, rejected Respondents' argument, finding that their reliance on advice of counsel was unreasonable and therefore not mitigating. The Extended Hearing Panel[2] finds that Enforcement proved the violations charged in the Complaint and imposes the sanctions set forth herein.

[1] At the final pre-hearing conference held on August 20, 2014, Respondents stipulated to liability on all charges. Final Pre-Hearing Conference Transcript at 6–8. *See also* Hearing Transcript at 33 (Respondents' counsel confirming in opening statement that Respondents had stipulated to liability on all charges) (hereafter "Tr.__").

[2] The Extended Hearing Panel consisted of a Hearing Officer and a current member of FINRA's District 5 Committee and a former member of FINRA's District 3 Committee.

II. Findings of Fact

A. Fox Financial Management Corporation

Fox became a FINRA member firm on August 3, 2005, and withdrew from FINRA membership on December 24, 2013.[3] Fox's primary business was selling private placements in Real Estate Investment Trusts ("REITs") and life settlement funds issued by a Fox affiliate.[4] Although Fox is no longer a FINRA member firm, it remains subject to FINRA's jurisdiction for the purposes of this proceeding, pursuant to Article IV, Section 6 of FINRA's By-Laws, because: (1) the Complaint was filed before the effective date of cancellation of Fox's membership with FINRA; and (2) the Complaint charges the Firm with misconduct committed while it was a FINRA member.[5]

B. James E. Rooney, Jr.

Rooney entered the securities industry in 1988 as a registered representative with a FINRA registered broker-dealer.[6] From May 19, 2005, through December 24, 2013, Rooney was associated with Fox and registered with FINRA as a General Securities Principal and General Securities Representative.[7] From October 19, 2011, until December 24, 2013, Rooney was associated with Fox and registered with FINRA as an Operations Professional.[8] Rooney was also the Firm's President, a position that he held from September 2005 until Fox ceased to be a FINRA member.[9] During his career in the securities industry, Rooney also obtained Series 63 and 65 registrations.[10]

Although Rooney is no longer associated with a FINRA member firm, he remains subject to FINRA's jurisdiction for the purposes of this proceeding, pursuant to Article V, Section 4 of FINRA's By-Laws, because: (1) the Complaint was filed before Rooney ceased to be registered with a FINRA member firm; and (2) the Complaint charges him with misconduct while he was registered with a FINRA member.[11]

---

[3] Joint Agreed Stipulations ¶ 2 (hereafter "Stip. ¶__"); JX-43, at 4.

[4] Stip. ¶ 2.

[5] Stip. ¶ 2.

[6] Stip. ¶ 4; JX-44, at 6.

[7] Stip. ¶ 4.

[8] Stip. ¶ 4.

[9] Stip. ¶ 4.

[10] Stip. ¶ 4; JX-44, at 5.

[11] Stip. ¶ 5 (stipulating that the Complaint was filed before Rooney "ceased to be affiliated with a FINRA member firm" and "the Complaint charges him misconduct committed while he was a FINRA member.").

C. Brian A. Murphy

Murphy entered the securities industry in 2003 as a registered representative of a FINRA registered broker-dealer.[12] From January 2007 through December 24, 2013, Murphy was associated with Fox and registered with FINRA as a General Securities Principal and a General Securities Representative.[13] From October 19, 2011, until December 24, 2013, Murphy was associated with Fox and registered with FINRA as an Operations Professional.[14] Murphy was also Fox's Chief Compliance Officer, a position he held from January 2008 until Fox ceased its FINRA membership.[15] During his career in the securities industry, Murphy also obtained Series 6, 26, 53, 63, and 66 securities registrations.[16]

Although Murphy is no longer associated with a FINRA member firm, he remains subject to FINRA's jurisdiction for the purposes of this proceeding, pursuant to Article V, Section 4 of FINRA's By-Laws, because: (1) the Complaint was filed before Murphy ceased to be registered with a FINRA member firm; and (2) the Complaint charges him with misconduct committed while he was registered with a FINRA member.[17]

D. JEP and his Registered Investment Advisor, JP&A

JEP was associated with Fox and registered with FINRA as a Corporate Securities Representative from May 14, 2008, until October 22, 2012.[18] While associated with Fox, JEP owned JP&A, an RIA.[19] Murphy and Rooney shared supervisory responsibilities for JEP.[20] The gravamen of the Complaint is that Murphy and Rooney made an erroneous decision to treat JEP's RIA and hedge fund activities as outside business activities and not as private securities transactions. This distinction is critical. As discussed below in the Conclusions of Law section, registered representatives must provide written notice to their firm of their outside business activities. If these activities constitute private securities transactions in which the registered representatives are receiving selling compensation, however, then more is required of the firm.

---

[12] Stip. ¶ 6; *but see* JX-45, at 6 (BrokerCheck Report for Murphy reflecting that he first became registered with a FINRA member firm in January 2004).

[13] *Cf.* Stip. ¶ 6 (stipulating that Murphy remained associated and registered with Fox through the date of the stipulations, namely, July 25, 2014. Fox's FINRA membership, however, ceased on December 24, 2013, and further, JX-45, at 6, reflects that Murphy's registration with Fox terminated in December 2013).

[14] Stip. ¶ 6.

[15] Stip. ¶ 6.

[16] Stip. ¶ 6; *but see* JX-45, at 5 (which does not reflect the series 53 registration).

[17] Stip. ¶ 7 (stipulating that "the Complaint was filed before Murphy ceased to be affiliated with a FINRA member firm" and "the Complaint charges him with misconduct committed while he was a FINRA member.").

[18] Stip. ¶ 8.

[19] Tr. 38–39.

[20] Stip. ¶ 12.

After the registered representatives provide notice of their activities, the firm must approve or disapprove of those activities in writing. If the firm grants approval, it must record the representatives' private securities transactions on its own books and records and supervise the transactions as if they were executed through the firm.

Consequently, we begin with a description of JEP's outside activity, JP&A, the nature of its business, and how it was compensated. JP&A offered "discretionary direct asset management services to advisory clients."[21] Under an investment advisory agreement, clients gave JP&A "discretionary authority to execute selected investment program transactions."[22] JP&A invested the funds it managed in one of two distinct model portfolios or in one of three affiliated hedge funds.[23] JEP designed and implemented these various portfolios, working with his business partner, AC, to execute the securities trades necessary to create the portfolios for each customer.[24]

In connection with these activities, according to JP&A's brochure, it received the following types of selling compensation: (1) asset management fees calculated on the total assets under management;[25] (2) transaction-based compensation in connection with the sale of certain mutual funds and exchange-traded funds;[26] (3) "solicitor fees" from third-party money managers;[27] (4) a 2% annual advisory fee as a result of its "advisory services" to P&C Partnership, LLC ("P&C"), the general partner of JEP's three hedge funds;[28] and (5) performance-based compensation in connection with the three hedge funds.[29] Fox and JP&A had some overlap in customers. By the time he left Fox, JEP had approximately 300 RIA customers,[30] of which approximately 60 were also Fox customers.[31]

[21] JX-13, at 6.

[22] JX-13, at 6.

[23] Stip. ¶ 14.

[24] Stip. ¶ 14.

[25] Stip. ¶ 15.

[26] Stip. ¶ 16.

[27] Stip. ¶ 19.

[28] Stip. ¶ 17.

[29] Stip. ¶ 18.

[30] Tr. 46.

[31] Tr. 68.

E. Respondents Approve JEP's Continued Association with JP&A as an Outside Business Activity But Do Not Supervise His Related Activities

On or about July 7, 2008, JEP completed a Fox-prepared form entitled: "Outside Activity Approval" regarding JP&A.[32] This form required Fox's registered representatives to document all of their outside business activities and informed them that "[u]pon receipt of a notification of outside business activities by an Associated person, the Firm will approve or disapprove the requested activity and will track all outside business activities."[33] On his response to this form, JEP indicated that: his business, JP&A, was a "Registered Investment Advisor;" he was currently conducting the activity; he received compensation in the form of "client fees and money managers' fees;" the outside activities were "securities related;"[34] his compensation resulted in income of $7,500 to $10,000 a month; and he was contributing 20 to 30 hours of work each week to this RIA.[35]

On that same day, Murphy approved JEP's participation in JP&A, which Murphy documented on the form that JEP had completed.[36] Rooney was also aware of JEP's association with JP&A and had no objection.[37] Before approving JEP's continued association with JP&A, Respondents conducted no independent due diligence regarding that entity.[38] For example, they did not conduct an independent investigation into the types of compensation that JEP was receiving from this business.[39] They did not inquire about JP&A's customers. And they did not ascertain the nature of this business beyond the information JEP included on the "Outside Activity Approval" form.[40]

After approving JEP's outside activities request, Respondents took no action to ensure that JEP's activities with JP&A complied with the federal securities laws and/or applicable FINRA Rules.[41] Specifically, Respondents did not supervise JEP's private securities transactions through JP&A or record JP&A's securities transactions on Fox's books and records.[42] Additionally, they did not review any customer suitability information for JP&A, obtain duplicate account statements and confirmations, review investment advisory agreements or

---

[32] JX-2; Stip. ¶ 9.

[33] JX-2, at 1; Stip. ¶ 9.

[34] JX-2, at 1; Stip. ¶ 10.

[35] JX-2, at 1; Stip. ¶ 10.

[36] JX-2, at 2; Stip. ¶ 10.

[37] Stip. ¶ 11.

[38] Stip. ¶ 20.

[39] Stip. ¶ 20.

[40] Stip. ¶ 20.

[41] Stip. ¶ 22.

[42] Stip. ¶ 21.

correspondence, or review JP&A's advertising and sales literature.[43] In short, both Murphy and Rooney treated JP&A as an outside business activity rather than a private securities transaction.[44]

F. Respondents Authorize JEP's Management of a Hedge Fund as an Outside Business Activity

In or about March 2009, JEP advised Fox that he was creating a hedge fund, P&C Dividend Capture Fund, L.P. ("Dividend Capture Fund"), in which he would invest his own assets as well as the assets of various JP&A customers.[45] Four months later, on July 7, 2009, JEP filled out an "Outside Activity Approval" form seeking approval from Fox to engage in that activity.[46] On the form, JEP wrote that: (1) he had created P&C, which was the general partner of Dividend Capture Fund; (2) this activity, i.e. P&C's role as general partner, was "securities related"; (3) the estimated monthly compensation for this activity exceeded $50,000; and (4) his average weekly time spent on this activity was ten hours.[47]

The investment strategy for the Dividend Capture Fund, according to its Confidential Private Offering Memorandum, was to capitalize on displacements in the credit markets by investing in closed-end bond funds and REITs that were trading at substantial discounts to their net asset value.[48] The Dividend Capture Fund's Investment Manager was JP&A,[49] which was entitled to a 2% annual management fee based on the assets under management.[50] Additionally, the general partner of the fund, P&C, was entitled to an additional 20% of the limited partners' net profits.[51] Collectively, these fees resulted in the payment of hundreds of thousands of dollars in compensation to JP&A and P&C.[52]

Murphy approved JEP's participation in P&C in writing.[53] Murphy approved JEP's activities regarding P&C without verifying JEP's compensation, without reviewing the private placement for the hedge fund, and without requesting any records of P&C.[54] In short, Murphy

[43] Stip. ¶ 21.

[44] Stip. ¶12.

[45] Stip. ¶ 23; JX-3, at 1.

[46] Stip. ¶ 23.

[47] Stip. ¶ 23; JX-3, at 1.

[48] Stip. ¶ 25.

[49] Stip. ¶ 26.

[50] Stip. ¶ 27.

[51] Stip. ¶ 27.

[52] Stip. ¶ 28.

[53] Stip. ¶ 24.

[54] Tr. 273–74.

approved the activity based solely on the outside activities approval form.[55] Rooney was also aware of JEP's association with P&C and had no objection.[56] Both Murphy and Rooney, who shared supervisory responsibilities for JEP,[57] treated P&C and its affiliated hedge funds as outside business activities rather than private securities transactions.[58]

G. JEP Creates Two Additional Hedge Funds

In 2010, JEP created two additional hedge funds, the P&C Global Fund, LP ("Global Fund") and the P&C Value Added Fund, LP ("Value Added Fund").[59] These two hedge funds invested in a relatively small number of securities in order to exploit perceived displacement in international markets (with respect to the Global Fund) and undervalued asset classes (with respect to the Value Added Fund).[60] Both funds provided for a 2% annual management fee to be paid to JP&A and a 20% of net profits incentive fee to be paid to P&C.[61]

Rooney did not consider it important to determine whether JEP had a right to participate in the profits of his hedge funds,[62] Nevertheless, approximately half way through his tenure at Fox, JEP told Rooney that he was participating in the profits of the hedge funds as a general partner in those hedge funds.[63] Specifically, JEP told Rooney that he was receiving, in part, a 20% share in the profits under a so-called "2/20" model.[64] And, at some point, Murphy learned that JEP was receiving profit participation fees from the hedge funds.[65]

---

[55] Tr. 274.

[56] Stip. ¶ 24; *see also* Tr. 273.

[57] Stip. ¶ 12. At the hearing, Rooney testified that he and Murphy had joint, but different, responsibility for supervising JEP, and that Murphy's authority was limited. Tr. 114–15. This testimony conflicted with Rooney's earlier investigative testimony, during which he stated that supervision was a "joint effort" and that they did not have separate, different, designated supervisory responsibilities regarding JEP. Tr. 116–17. The Panel credited Rooney's investigative testimony, as it was provided earlier in time, and Rooney did not explain the inconsistency between that testimony and his hearing testimony.

[58] Stip. ¶ 24.

[59] Stip. ¶ 30.

[60] Stip. ¶ 31.

[61] Stip. ¶ 32.

[62] Tr. 143.

[63] Tr. 119.

[64] Tr. 119, 145–46.

[65] Tr. 534.

H. Respondents' Lack of Due Diligence Regarding P&C and the Hedge Funds and the Decision to Treat Them as Outside Business Activities

Respondents conducted no independent due diligence regarding P&C or any of the three hedge funds.[66] Specifically, they did not conduct an independent investigation into the types of compensation that JEP received from this business;[67] did not determine whether JEP was receiving an incentive fee comprised of rights to participate in profits except to the extent that any information was provided on the "Outside Activity Approval" form;[68] and did not request or review any of the offering documents in connection with these funds, including the confidential offering memoranda or the subscription agreements.[69] These documents showed, for example, that JEP was responsible for all the investment and trading decisions taken by JP&A on behalf of the funds.[70]

Moreover, Respondents did not: supervise JEP's private securities transactions through P&C and its three affiliated hedge funds; record the securities transactions of these entities on Fox's books and records;[71] review any customer suitability information for the investors in any of the three Funds; obtain duplicate account statements and confirmations; review subscription agreements, accredited investor certifications or other correspondence;[72] take any action to ensure that JEP's activities with P&C and its three affiliated hedge funds complied with the federal securities laws and/or applicable FINRA Rules and regulations;[73] record JEP's transactions through JP&A and the three affiliated hedge funds on the Firm's books and records; and failed to supervise such transactions as if they were executed by Fox.[74]

Rooney made certain key decisions regarding how JEP's outside activities would be treated. He made the decision that JEP's RIA would be treated as an outside business activity;[75] that asset management fees were not selling compensation;[76] and that JEP's hedge fund activities would be treated only as an outside business activity.[77] He testified that he made these decisions

---

[66] Stip. ¶ 35.

[67] Stip. ¶ 35.

[68] Stip. ¶ 35.

[69] Stip. ¶ 36.

[70] JX-16, at 18 (P&C Dividend Capture Fund 1, LP); JX-20, at 18 (P&C Value Added Fund, LP); JX-22, at 18 (P&C Global Fund, LP).

[71] Stip. ¶ 37.

[72] Stip. ¶ 37.

[73] Stip. ¶ 38.

[74] Stip. ¶ 42.

[75] Tr. 118.

[76] Tr. 118.

[77] Tr. 118–19.

based on advice of counsel,[78] and that he hired counsel because he did not understand Rule 3040,[79] which governs private securities transactions. Rooney further testified that his attorney told him that he only had to supervise JEP's outside activities if JEP was charging commissions (as opposed to fees, such as management fees) and was "running" the transactions through Fox's books and records.[80]

I. Fox's Written Supervisory Procedures

During the relevant period, Fox's WSPs, dated August 7, 2008, contained provisions governing outside business activities, but not private securities transactions.[81] Under a section entitled "Outside Activities," the WSPs required representatives, upon employment with the Firm, to provide it with a list of all outside business activities engaged in by the representative.[82] Additionally, the WSPs prohibited representatives from receiving outside compensation in certain instances, unless approved in writing by a Supervisory Principal.[83] Finally, the WSPs generally prohibited registered representatives from engaging in outside investment adviser activities, subject to two exceptions: (1) if the outside activities were with Fox's affiliated investment advisor, FFM Adviser Group,[84] or (2) if the registered representative is the owner or principal of the RIA.[85] The Firm added this second exception to accommodate JEP.[86]

In December 2008, Fox added a section to its WSPs specifically addressing the approval and supervision of outside private securities transactions.[87] The section heading referenced the applicable NASD rules and Notices to Members pertaining to private securities transactions, including NASD Rule 3040 and Notices to Members 85-84, 94-44, and 96-33.[88] The Firm included these references as a resource for the Firm's supervisory principals and registered representatives, and to ensure that they were enforcing the rules properly.[89]

The updated WSPs defined a private securities transaction "as any securities transaction outside the regular course or scope of employment with [the Firm] for which the associated

---

[78] Tr. 118, 120.

[79] Tr. 121, 123.

[80] Tr. 126, 143, 145, 153, 173–74.

[81] JX-9; *see also* Tr. 136.

[82] JX-9, at 21, § 6.2.

[83] JX-9, at 21, § 6.1; *see also* Tr. 136.

[84] JX-9, at 21, § 6.3.

[85] JX-9, at 21, § 6.3.

[86] Tr. 138, 552.

[87] JX-10, at 26–27, § 4.6; Tr. 139.

[88] JX-10, at 26, § 4.6.

[89] Tr. 140, 148.

person receives compensation."[90] The term "compensation" was broadly defined to include "any compensation paid directly or indirectly from whatever source in connection with or as a result of the purchase or sale of a security."[91] "Compensation" specifically included "commissions; finder's fees; securities or rights to acquire securities; right of participation in profits, tax benefits, or dissolution proceeds, as a general partner or otherwise; or expense reimbursements."[92] The definition of private securities transactions did not, however, contain a reference to registered investment advisors. This version of the WSPs included the provision from the earlier versions which limited its registered representatives' outside investment adviser activities to those with FFM Advisor Group or those involving a RIA in which the registered representative is the owner or principal.[93] Murphy made no attempt when the amended WSPs went into effect on December 31, 2008, (or thereafter), to inquire into how JEP was compensated in connection with his RIA.[94]

In October 2011, Fox again revised its WSPs. The heading to the Outside Private Securities Section retained the references to the FINRA Rules and Notices to Members, as well as the same definitions of private securities transactions and compensation.[95] The Outside Business Activities section also retained the same limitations regarding a registered representative's outside investment adviser activities.[96] The revisions, however, added the requirement that the Firm's principal who reviewed any requested outside activities by Fox's registered representatives must "determine, and document in writing …, whether the activity qualifies as an outside business activity or whether it should be treated as an outside securities activity."[97] When the activity is determined to be a private securities transaction and is approved, the WSPs further required that "the transaction will be recorded on the books and records of [the Firm] and the [Chief Compliance Officer] will supervise the Associated Person's participation in transactions to ensure that all the requirements of the NASD Conduct Rule 3040 are met."[98] Additionally, "the Compliance Department at [the Firm] will send a written request to the executing firm requesting duplicate copies of account statements or other information concerning the account or order."[99] The WSPs did not make clear, however, that the receipt of asset

[90] JX-10, at 26, § 4.6.

[91] JX-10, at 26, § 4.6.

[92] JX-10, at 26, § 4.6.

[93] JX-10, at 27, § 4.7.

[94] Tr. 276.

[95] JX-11, at 31, § 4.6.

[96] JX-11, at 32, § 4.7B.

[97] JX-11, at 33; Stip. ¶ 45.

[98] Stip. ¶ 46.

[99] Stip. ¶ 46.

management fees constitutes "selling compensation" in accordance with the definition of that term contained in NASD Rule 3040(e)(2) and Notices to Members 94-44 and 96-33.[100]

Throughout the relevant period, Fox, acting through Rooney and Murphy, failed to enforce the Firm's supervisory system and written supervisory procedures regarding their registered representatives' participation in private securities transactions.[101]

J. FINRA and SEC Notified Respondents that Fox's Supervisory Systems and Procedures were Deficient

While JEP was associated with Fox, both FINRA and the SEC notified the Firm that its supervisory systems and procedures regarding private securities transactions, including their implementation, were deficient. Each time, in responses prepared by counsel[102] and signed by Murphy, the Firm disputed that it was in non-compliance.

On May 28, 2010, FINRA sent Rooney a copy of its report based on an examination of the Firm. The report notified Rooney that the staff had concluded that, contrary to its obligations under Rule 3010(a), Fox had "failed to establish and maintain a system to supervise the activities of each registered representative, registered principal, and other associated person that is reasonably designed to achieve compliance with the applicable securities law and regulations." Among other things, according to FINRA, the Firm failed to adequately supervise its registered representatives' outside business activities to ensure that they did not engage in private securities transactions and to ensure that such activity was free of conflicts of interest with the Firm or the investors. This conclusion rested, in part, on JEP's employment with JP&A (and the outside employment of two persons associated with Fox).[103]

Through Murphy, the Firm responded to FINRA on July 7, 2010. Fox's counsel prepared most of the response, though Murphy testified that he did perform some of "the light lifting" in connection with it,[104] including drafting the portion regarding the supervision of private securities transactions.[105] That specific response consisted of two sentences: "All of the [persons mentioned] own their own RIA firms. All were exempted from the Firm contractual paperwork which forbids association with an RIA that is not FFM Advisor Group."[106]

---

[100] Stip. ¶ 47.

[101] Stip. ¶ 43.

[102] Tr. 163, 222.

[103] JX-25, at 12.

[104] Tr. 279–82. *But see* Tr. 185 (Rooney testifying that Murphy played no role in drafting the responses).

[105] Tr. 512.

[106] JX-26, at 49.

Additional regulatory warnings followed in 2011 and 2012. Fox received communications from the SEC in July 2011 and from FINRA in June 2012, informing it that pursuant to NASD Rule 3040, it was required to record JEP's outside securities transactions on its books and records and to supervise JEP's participation in these transactions.[107] On July 25, 2011, the SEC notified Fox that it had identified certain "deficiencies and weaknesses" based on its examination of the Firm's Fort Worth branch office, including a failure to supervise transactions for compensation under Rule 3040.[108] Specifically, the SEC stated that it had learned that JEP's "investment advisory business includes his participation in the execution of customer transactions to purchase Private Funds interests and possibly the execution of Private Funds portfolio transactions for which he earns advisory fees through entities he owns." The SEC further noted that JEP's "participation in customer transactions for compensation subject Fox to the requirement that it record and supervise the transactions pursuant to Rule 3040; however, Fox has failed to do so." The SEC's notification directed Fox to correct the deficiencies and weaknesses immediately, and to inform the staff of what steps they took or intended to take to do so.[109]

Fox, however, did not correct these deficiencies. Instead, on August 22, 2011, the Firm, through Murphy, responded by letter to the SEC. In the letter, Murphy defended Fox's decision not to supervise JEP's activities, arguing that Notice to Members ("NTM") 96-33 did not impose a "requirement that each hedge fund trade be supervised when it is routed through another broker-dealer."[110] Again, counsel prepared most of this response.[111]

In June 2012, FINRA sent Rooney and Murphy its examination report of the Firm.[112] The report identified certain exceptions, including Fox's failure to comply with NASD Rule 3040. Specifically, FINRA notified the Firm that a review of JEP's activities showed that "he had participated in the execution of securities transactions for advisory and hedge fund accounts away from the firm through his outside [investment adviser]." Additionally, the staff discovered that he "had received asset and performance-based fee compensation from this activity." Nevertheless, FINRA noted, Fox "had not recorded these transactions on the firm's books and records, and there was no documentation of any supervisory review by a principal of the firm for this activity."[113]

---

[107] Stip. ¶ 39.

[108] JX-28, at 5.

[109] JX-28, at 9.

[110] JX-29, at 6.

[111] Tr. 286. *See also* Tr. 171 (Rooney testifying that counsel wrote JX-29); Tr. 329 (prior counsel testifying that he believed he drafted the August 22, 2011 response to the SEC as well as the June 26, 2012 response to FINRA).

[112] Stip. ¶ 39; JX-30.

[113] JX-30, at 3.

The Firm, through Murphy, responded to the exam report on June 26, 2012. The response, also written primarily by prior counsel, acknowledged that this item "had been covered in detail during other exams," but maintained that the Firm had complied with Rule 3040(b) and (d) because it had been notified of, and had approved, JEP's registered investment adviser as an outside business activity.[114] Further, Fox asserted that JEP received "fees" and not "profit participation interests." These fees, Fox contended, "are costs to the fund, and are not tied to any pro rata profit participation based on the interest in in the fund." Fox concluded that JEP did not receive "selling compensation" under Rule 3040(c), and, therefore, the supervisory and books and records provisions of that rule did not apply.[115] Murphy did not prepare this portion of the response. Rather, it was prepared by counsel.[116] Murphy took no steps to verify the accuracy of the response, testifying that he was "in no position to second-guess my counsel."[117] At the time he signed the letter, however, Murphy knew that JEP was receiving profit participation fees in addition to his management fees for the hedge funds.[118]

Notwithstanding the above communications from FINRA and the SEC, Respondents did not change their business practices regarding the supervision of JEP's RIA and hedge fund activities.[119] As a result, JEP continued to engage in these activities without supervision until he left the Firm in October 2012.[120] In December 2013, the SEC brought an action against JEP and JP&A, which JEP and JP&A settled without admitting or denying the charges. Under the settlement, the SEC found that between 2009 and 2011, JP&A, at JEP's direction, improperly charged three private funds that it managed performance fees totaling $610,762 for clients who did not satisfy the requirements of a "qualified client" under the Investment Advisers Act of 1940.[121] Recognizing that JP&A had repaid the affected clients, the SEC entered a cease and desist order censuring JP&A and JEP and imposed a civil money penalty against them in the amount of $35,000.

[114] JX-31, at 25.

[115] JX-31, at 25.

[116] Tr. 293–94, 520–21.

[117] Tr. 294–95.

[118] Tr. 294.

[119] Stip. ¶ 40.

[120] Stip. ¶ 41.

[121] JX-35, at 2, ¶ 1.

III. Conclusions of Law

A. Respondents Violated NASD Rules 3040(c)(2) and 2110 and FINRA Rule 2010 by Failing to Supervise JEP's Private Securities Transactions and Failing to Record the Transactions on Fox's Books and Records (First Cause of Action)

Enforcement charged Respondents with violating NASD Rules 3040(c)(2) and 2110 and FINRA Rule 2010. "The purpose of NASD Conduct Rule 3040 is to protect 'investors from unsupervised sales and securities firms from exposure to loss and litigation from transactions by associated persons outside the scope of their employment.'"[122] Under Rule 3040, before participating in any private securities transaction, an associated person must provide written notice to his FINRA registered broker-dealer employer.[123] The Rule defines a "private securities transaction" as "any securities transaction outside the regular course or scope of an associated person's employment with member."[124] The notice must describe in detail the proposed transaction and the person's proposed role in connection with it, and state whether he has received or may receive "selling compensation."[125] "Selling compensation" is defined under the Rule as "any compensation paid directly or indirectly from whatever source in connection with or as a result of the purchase or sale of a security, including, though not limited to, commissions; finder's fees; securities or rights to acquire securities; rights of participation in profits, tax benefits or dissolution proceeds, as a general partner or otherwise; or expense reimbursements."[126]

Where an associated person has received or may receive selling compensation in connection with the private securities transaction, the Rule 3040(c)(1) requires the member to provide the associated person with written approval or disapproval of the associated person's participation in the private securities transaction. When a member elects to approve the registered representative's private securities transaction, it is then required under Rule 3040(c)(2) to record the transaction on its books and records. Additionally, the member must also "supervise the person's participation in the transaction as if the transaction were executed on behalf of the member."

Additionally, NASD provided members with guidance regarding their obligations under Rule 3040 (including its predecessor, Article III, Section 40) by issuing two notices to members. In Notice to Members 94-44, issued in 1994, NASD advised that "the receipt of compensation as a result of investment advisory activities constituted the receipt of selling compensation as

---

[122] *Michael Frederick Siegel*, Exchange Act Release No. 58737, 2008 SEC LEXIS 2459, at *46 (Oct. 6, 2008) (quoting *Chris Dinh Hartley*, 57 S.E.C. 767, 775 n.17 (2004)).

[123] NASD Rule 3040(b).

[124] NASD Rule 3040(e)(1).

[125] NASD Rule 3040(b).

[126] NASD Rule 3040(e)(2).

defined by [Rule 3040's predecessor]."[127] The Notice made it clear that "[t]his would be the case whether the RR/RIA received transactionally-related, commission-type compensation, asset-based management fees, wrap fees, hourly, yearly, or per-plan fees, as long as fees paid include execution services by the RR/RI."[128] The Notice also informed members that the requirements of the Rule 3040's predecessor applied "to all investment advisory activities conducted by [individuals dually registered as registered representatives and RIAs] that result in the purchase or sale of securities by the associated person's advisory clients, with the exception of their activities on behalf of the member."[129]

Two years later, in 1996, NASD issued Notice to Member 96-33. This Notice reminded members that when a registered investment adviser participates in the execution of securities transactions away from the member firm, the member firm must comply with the recordkeeping and supervision requirements set forth in the predecessor to NASD Rule 3040(c)(2). Specifically, it noted that "[i]n all circumstances, . . . recordkeeping and supervision must be adequate to ensure that full and complete transaction information is captured, and be reasonably designed to detect and/or prevent misconduct that could violate the federal securities laws and NASD Rules."[130]

JEP engaged in private securities transactions and received selling compensation (both transaction-based compensation and profit participation interests). Nevertheless, Respondents neither supervised his private securities transactions as required by the Rule, nor did they comply with its recordkeeping provisions. Accordingly, Respondents violated NASD Rule 3040(c)(2).[131]

The Complaint also charges Respondents with violating NASD Rule 2110 and FINRA Rule 2010. NASD Rule 2110, FINRA's ethical standards rule, states that "[a] member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade." Effective December 15, 2008, NASD Rule 2110 was codified, without change, as FINRA Rule 2010.[132] "A violation of any FINRA rule, including NASD Rule 3040, violates NASD Rule 2110 and FINRA Rule 2010."[133] Accordingly by virtue of their violation of Rule 3040, Respondents also violated NASD Rule 2110 (during the period from July 2008, to

---

[127] JX-40; NTM 94-44, at 2. The predecessor to NASD Conduct Rule 3040 was known as Article III, Section 40 of the NASD Rules of Fair Practice. *See D.B.C.C., v. Mohn*, No. C8A960063, 1999 NASD Discip. LEXIS 2, at *32 (NAC Jan. 22, 1999).

[128] JX-40; NTM 94-44, at 2.

[129] JX-40; NTM 94-44, at 2.

[130] JX-41; NTM 96-33, at 2–3.

[131] Rooney and Murphy's violations are imputed to Fox. *See Quest Capital Strategies, Inc.*, Initial Decisions Release No. 141, 1999 SEC LEXIS 727, at *54 (Apr. 12, 1999) (holding that failures of firm's owner and president to reasonably supervise are imputed to his firm).

[132] *See FINRA Regulatory Notice 08-57*, 2008 FINRA LEXIS 50, at *32–33 (Oct. 2008).

[133] *Dep't of Enforcement v. Mielke*, No. 2009019837302, 2014 FINRA Discip. LEXIS 24, at *8 (NAC July 18, 2014). NASD Rule 0115 subjects associated persons to NASD Rule 2110, and FINRA Rule 0140 subjects associated persons to FINRA Rule 2010. *Id*. at *9.

December 14, 2008) and FINRA Rule 2010 (during the period from December 15, 2008, to October 2012).

B. Respondents Violated NASD Rule 3010 and 2110 and FINRA Rule 2010 by Failing to Establish, Maintain, and Enforce Written Supervisory Systems and Procedures (Second Cause of Action)

NASD Rule 3010(a) requires member firms to establish and maintain a supervisory system that is reasonably designed to achieve compliance with applicable securities laws and regulations. Rule 3010(b) further requires that member firms establish, maintain, and enforce WSPs reasonably designed to supervise their associated persons. Respondents violated Rule 3010 in two ways. First, the Firm's written supervisory procedures were deficient. Second, Respondents failed to enforce their procedures.

The WSPs were deficient because, as charged in the Complaint, they specifically provided that investment advisory activities by registered representatives would be permitted and treated as outside business activities and thus would not be subject to the requirements of NASD Rule 3040. The procedures were also deficient because they failed to make clear that the receipt of asset management fees constituted "selling compensation" in accordance with the definition of that term provided by NASD Rule 3040(e)(2) (as explained, further, in Notices to Members 94-44 and 96-33).

Respondents also failed to enforce Fox's WSPs. They failed to conduct a reasonable inquiry into JEP's RIA and hedge fund businesses and make a determination, documented in writing, as to whether such businesses constituted "outside business activity or outside securities activity." Further, they failed to enforce the Firm's procedures by failing to "ensure that all the requirements of NASD Rule 3040 are met" and to request copies of duplicate statements from the executing broker-dealer with respect to JEP's registered investment adviser and hedge fund activities. The Panel also finds that Fox's supervisory failures were systemic in nature. Accordingly, Respondents violated NASD Rules 3010, 2110 (during the period from July 2008 to December 14, 2008) and FINRA Rule 2010 (during the period from December 15, 2008, to October 2012).[134]

IV. Sanctions

A. Applicable Sanctions Guidelines

In considering the appropriate sanctions to impose on Respondents, the Panel looked to FINRA's Sanction Guidelines ("Guidelines"). The Guidelines contain General Principles Applicable to All Sanctions Determinations ("General Principles"), overarching Principal

[134] A violation of NASD Rule 3010 is also a violation of NASD Rule 2110 and FINRA Rule 2010. *Ronald Pellegrino*, Exchange Act Release No. 59125, 2008 SEC LEXIS 2843, at *2 n.2 (Dec. 19, 2008).

Considerations, as well as guidelines for specific violations.[135] Among the General Principles are the following: "Disciplinary sanctions are remedial in nature and should be designed to deter future misconduct and to improve overall business standards in the securities industry." Additionally, "[t]he overall purposes of FINRA's disciplinary process and FINRA's responsibility in imposing sanctions are to remediate misconduct by preventing the recurrence of misconduct, improving overall standards in the industry, and protecting the investing public." The General Principles further state that "[t]oward this end, Adjudicators should design sanctions that are significant enough to prevent and discourage misconduct by a respondent, to deter others from engaging in similar misconduct, and to modify and improve business practices."[136]

Also, in assessing sanctions, the Hearing Panel was mindful that "Conduct Rule 3040 plays a crucial role in the regulatory scheme, and its abuse calls for significant sanctions,"[137] and that violations of the Rule "are serious, 'depriv[ing] investors of a member firm's oversight and due diligence, protections they have a right to expect.'"[138] Finally, the Panel recognized that "'[a]ssuring proper supervision is a critical component of broker-dealer operations.'"[139]

The Guidelines contain a specific sanction guideline for violations of NASD Rule 3040.[140] That guideline, however, does not specifically address sanctions for supervisory violations under Rule 3040(c)(2). Rather, it pertains to selling away by associated persons and the failure by a member firm to provide written notice of approval, disapproval, or acknowledgment of the activities. For a member firm's failure to supervise the selling away activity, as here, the guideline directs the Adjudicators to also consider the failure to supervise sanction guideline.[141]

The Guidelines include separate guidelines for failure to supervise and deficient WSPs.[142] Both apply here. For failure to supervise, the guideline recommends that Adjudicators consider imposing fines of $5,000 to $50,000 independently (rather than jointly and severally). Additionally it recommends individual supervisory suspensions for up to 30 business days. In egregious cases, it recommends suspending the firm with respect to any or all activities or

---

[135] FINRA Sanction Guidelines at 1 (Overview) & 2 (General Principle No. 1) (2013) ("Guidelines"), *available at* www.finra.org/sanctionguidelines.

[136] Guidelines at 2 (General Principle No. 1).

[137] *Dep't of Enforcement v. Keyes*, No. C02040016, 2005 NASD Discip. LEXIS 9, at *31 (NAC Dec. 28, 2005) (citing *Ronald W. Gibbs*, 52 S.E.C. 358, 365 (1995)).

[138] *Dep't of Enforcement v. Vietien*, No. 2006007544401, 2010 FINRA Discip. LEXIS 45, at *41 (NAC Dec. 28, 2010) (quoting *Philippe N. Keyes*, Exchange Act Release No. 54723, 2006 SEC LEXIS 2631, at *14–15 (Nov. 8, 2006)).

[139] *Midas Securities, LLC*, Exchange Act Release No. 66200, 2012 SEC LEXIS 199, at *46 (Jan. 20, 2012) (quoting *Pellegrino*, 2008 SEC LEXIS 2843, 12641).

[140] Guidelines at 14–15.

[141] Guidelines at 15 n.2.

[142] Guidelines at 103–04.

functions for up to 30 business days; suspending the responsible individual in any or all capacities for up to two years or a bar; and, in cases of systemic supervision failures, a longer suspension of the firm with respect to any or all activities or functions of up to two years or expulsion.

With respect to deficient WSPs, the guideline recommends a fine of $1,000 to $25,000. In egregious cases, the guideline provides for a suspension of the responsible individual in any or all capacities for up to one year and a suspension of the firm in any or all relevant activities or functions for up to 30 business days and thereafter until the supervisory procedures are amended to conform to the rule requirements. Finally, the Hearing Panel took into account the relevant principal considerations contained in the supervision guidelines.

As to each Respondent the Hearing Panel imposes the sanctions detailed below. The Hearing Panel finds that Respondents' violations are related and that the sanctions imposed should be designed and tailored to deter the same underlying misconduct. Accordingly, the Hearing Panel imposes a unitary sanction on Respondents for their violations.[143]

B. Fox is expelled and fined $100,000; Rooney is barred in all principal capacities, suspended in all capacities for six months, and fined $50,000; and Murphy is barred in all principal capacities, suspended in all capacities for three months, and fined $25,000

Because Fox engaged in the violative conduct through Rooney and Murphy, we begin our sanctions discussion with the individual Respondents. In applying the Guidelines and imposing sanctions, the Hearing Panel considered the overlapping, but different, roles that Rooney and Murphy played at the Firm. Rooney was the primary decision-maker at the Firm, and it was Rooney who decided, in his capacity as President and as JEP's supervisor, that the Firm would not supervise JEP's RIA and hedge fund activities.

Murphy, as Fox's Chief Compliance Officer, was responsible for supervising and approving the outside activities of the Firm's registered representatives, including JEP. He specifically approved, in writing, each of JEP's businesses as outside business activities without first determining that they involved the execution of private securities transactions. He also signed each of the Firm's responses to FINRA and the SEC that rejected their warnings that Fox was not complying with Rule 3040. Rooney, however, was more culpable than Murphy, because he was the final decision-maker regarding the misconduct at issue. Notwithstanding these

---

[143] *Mielke*, 2014 FINRA Discip. LEXIS 24, at *55 (citing *Dep't of Enforcement v. Fox & Co. Inv., Inc*., No. C3A030017, 2005 NASD Discip. LEXIS 5, at *37 (NAC Feb. 24, 2005) (finding that "where multiple, related violations arise as a result of a single underlying problem, a single set of sanctions may be more appropriate to achieve NASD's remedial goals . . . "), *aff'd*, Exchange Act Release No. 52697, 2005 SEC LEXIS 2822, at *36 (Oct. 28, 2005)).

differences in culpability, the Hearing Panel concluded that their misconduct was egregious, based on a number of aggravating factors.

1. Respondents Ignored Regulatory Warnings

Respondents failed to comply with Rule 3040, notwithstanding two warnings from FINRA and one from the SEC that the Firm was violating FINRA rules by not supervising JEP's private securities transactions and recording them on its books and records.[144] The Panel concluded that Respondents made a calculated and knowing decision not to comply with those warnings. At the hearing, Murphy was blunt in his reasoning: "It didn't take me long to figure it out---. . . . just because FINRA says something doesn't necessarily mean that it's correct."[145] Murphy elaborated that over the years there had been a number of issues that FINRA and the Firm disagreed about and "eventually FINRA stopped disagreeing."[146] On the issue of supervising JEP's RIA and hedge fund activities, he hoped FINRA would eventually relent.[147]

Similarly, at least through 2012, Rooney also assumed that eventually FINRA would abandon the issue. [148] As Rooney explained at the hearing: "[what] we're guilty of most is digging our heels in . . . We never backed off our position, because in some cases, you know, we've heard them cry wolf so many times on other issues that they weren't backing off from that we got a little numb to it."[149] Rooney was not only numb, he was unconcerned: "I don't even want to make this seem like this was something we revisited every day. I mean, this wasn't weighing on us at all. This was something we thought was disposed of. We thought . . . okay, it comes up every two years, but so does three other things."[150] Even a referral of the matter by the FINRA examination staff to FINRA's Department of Enforcement[151] did not prompt Respondents to supervise JEP's activities. Rooney testified that "the presence of a referral to enforcement by [the examination staff] is not sufficient to change the way you're doing business," because in the past, the Department of Enforcement had not prosecuted certain matters that the examination staff had referred to it.[152]

In short, Respondents refused to supervise JEP's RIA and hedge fund activities after receiving regulatory warnings from both the SEC and FINRA that they must do so. Instead, they

---

[144] *Guidelines*, at 7 (Principal Considerations in Determining Sanctions, No. 15); *Cf. Guidelines*, at 6 (Principal Considerations in Determining Sanctions, No. 3).

[145] Tr. 546.

[146] Tr. 547.

[147] Tr. 547–48.

[148] Tr. 639–42

[149] Tr. 581–82.

[150] Tr. 588.

[151] JX-48.

[152] Tr. 266–67; *see also* Tr. 260.

stubbornly reasserted that they were not required to supervise these activities, expecting, or at least hoping, that FINRA would eventually stop pressing the issue. This is not how member firms and associated persons—especially the President and Chief Compliance Officer of a firm—are expected to conduct themselves when dealing with regulators. Respondents' response to the regulatory warnings was wholly unacceptable and a highly aggravating factor in assessing sanctions against them.

2. Respondents Failed to Take Responsibility for Their Misconduct

Until shortly before the hearing, Respondents failed to accept responsibility for their misconduct.[153] But even after stipulating to liability, they tried to minimize their responsibility. by attempting to shift blame for their non-compliance to FINRA and the SEC (notwithstanding that the regulators had warned them that they were in non-compliance). Respondents argue that they wrote to the SEC and FINRA explaining that they disagreed with the regulators' interpretation of Rule 3040, and did not receive a response.[154] As a result, according to Rooney, he concluded that they "must have been right."[155] Rooney went on to say that when he had not heard anything from FINRA after a year or two, the matter was probably no longer "front and center" with him[156] and he took "comfort" in the fact that FINRA had not taken regulatory action against him.[157] Although he took comfort in the regulatory silence, he nonetheless complained at the hearing that it was unfair that once a matter is referred to Enforcement, there was no mechanism to let him know whether Enforcement had accepted or rejected his arguments.[158] These arguments carry no weight. The SEC has repeatedly rejected attempts to shift responsibility to the staff for associated persons' compliance obligations.[159] And, more specifically, associated persons cannot rely on a regulator's silence to justify their non-

[153] Respondents' post-complaint admission of liability is not mitigative. The Guidelines treat acceptance of responsibility as a mitigating factor when it occurs "prior to [the firm's or regulator's] detection and investigation." *Mielke*, 2014 FINRA Discip. LEXIS 24, at *69 (emphasis in original) (quoting *Guidelines*, at 6 (Principal Considerations in Determining Sanctions, No. 2)).

[154] Tr. 34–35 (Respondents' Opening Statement).

[155] Tr. 131–32; 146–48.

[156] Tr. 169.

[157] Tr. 181.

[158] Tr. 247–48

[159] *See, e.g.*, *Hans N. Beerbaum*, Exchange Act Release No. 55731, 2007 SEC LEXIS 971, at *19 & n.22 (May 9, 2007) ("We have repeatedly held that members and their associated persons cannot shift their burden of compliance to the NASD") (internal quotation omitted); *Cf. Kent M. Houston*, Exchange Act of 1934 Release No. 71589, 2014 SEC LEXIS 614, at *27–28 (Feb. 20, 2014) (finding respondent's acceptance of responsibility "unconvincing because of his attempts to shift blame for his misconduct").

compliance.[160] In summary, the Hearing Panel finds that their attempt to shift blame demonstrates that they fail to appreciate the seriousness of their misconduct[161] and serves to aggravate their misconduct.[162]

3. Rooney and Fox Have Disciplinary Histories

Rooney and Fox have disciplinary histories that include supervisory violations and a principal suspension and fine against Rooney.[163] In May 2009, Fox consented to NASD's imposition of a censure, a $7,500 fine, and to the entry of findings that it had violated NASD advertising rules related to the Firm's distribution of sales literature and/or correspondence.[164] In February 2010, Fox and Rooney consented to an order issued by the Texas Securities Board finding that they had, among other things, made omissions in the sale of securities; made unsuitable sales of Fox Life Settlement Bonds; and had failed to establish and enforce written supervisory procedures. The order reprimanded Fox and Rooney; ordered them to cease and desist from violations of the Texas Securities Act; and provided for the establishment of a supplemental premiums account for the protection of investors and other undertakings regarding the sale and supervision of Fox Life Settlement offerings.[165] Finally, in October 2010, Fox and Rooney consented, without admitting or denying, to the entry of findings by FINRA that they negligently failed to disclose various material facts in connection with the sale of zero coupon bonds secured by interests in life insurance policies; that they violated escrow requirements pertaining to the holding of customer funds; that the Firm's system of supervisory controls was flawed because it failed to include a review of the Firm's private placement business; and that the Firm failed to appropriately supervise Rooney's private placement sales. For this misconduct, FINRA censured and imposed a $40,000 fine against Fox and suspended Rooney for 15 business days in any principal capacity and fined him $20,000.[166]

---

[160] *Leslie A. Arough*, Exchange Act Release No. 62898, 2010 SEC LEXIS 2977, at *57 (Sept. 13, 2010) (rejecting, as an attempt to shift blame to NASD, the argument that respondent's attorney disclosed his activities "to . . . NASD, and that he thereafter reasonably relied on the lack of any response in assuming that NASD found his activities unobjectionable."); *Apex Fin. Corp.*, 47 S.E.C. 265, 267 (1980) (finding that "applicants were not justified in relying on the agencies' silence" where applicant contended that he "asked for these agencies' comments on the offerings, none were forthcoming, and he therefore assumed that no regulatory provisions were being violated").

[161] *See Scott Epstein*, Exchange Act Release No. 59328, 2009 SEC LEXIS 217, at *73 (Jan. 30, 2009) (finding that respondent's blame-shifting arguments demonstrate failure to accept responsibility for own actions), *aff'd, Michael G. Keselica*, 52 S.E.C. 33, 37 (1994) (stating that "attempts to blame others for his misconduct . . . demonstrate that [respondent] fails to understand the seriousness of [the] violations.").

[162] See *Dep't of Enforcement* v. *Eplboim*, No. 2011025674101, 2014 FINRA Discip. LEXIS 8, at *45 (NAC May 14, 2014) (finding that respondent's continued denial of responsibility and attempts to blame others including the FINRA staff was "troubling and serves to aggravate his misconduct.").

[163] Indeed, Rooney described his regulatory record as "disgraceful," adding: "I wouldn't hire me." Tr. 566.

[164] JX-43, at 22–23.

[165] JX-36.

[166] JX-37.

Although these regulatory actions occurred while JEP was associated with the Firm, they did not cause Rooney and Fox to focus on their obligations to supervise JEP. Rooney and Fox's continued failure to comply with their regulatory obligations, coupled with their disciplinary history, demonstrates their complete disregard for the regulatory process.[167]

4. Additional Aggravating Factors

There are additional aggravating factors the Hearing Panel considered in assessing sanctions. First, Respondents engaged in the misconduct over a considerable period of time, namely, four years.[168] Second, in light of the regulators' warnings and the clear statements in the offering memoranda regarding JEP's activities, Respondents' refusal to comply with Rule 3040 exhibited a high degree of recklessness, bordering on intentional misconduct.[169] Third, the regulatory warnings and JEP's disclosure on the outside activities forms that his activities were securities-related were clear red flags that should have resulted in additional supervisory scrutiny.[170] Fourth, at the time of its Rule 3040 supervisory failures, the Firm had not developed reasonable supervisory, operational, and/or technical procedures or controls that were properly implemented.[171] Fifth, during the period that Respondents failed to supervise JEP, he engaged in private securities transactions involving millions of dollars that resulted in a disciplinary action against him by the SEC.[172]

5. Respondents Failed to Establish any Mitigating Factors

There are no mitigating factors. Respondents' primary mitigation argument was that they reasonably relied on their attorney's advice that they were not required to supervise JEP's outside activities as private securities transactions.[173] To establish that advice of counsel is mitigating for sanctions purposes, Respondents must demonstrate "'reasonable reliance on

---

[167] *Guidelines*, at 2, 6 (General Principles Applicable to All Sanction Determinations, No. 2; Principal Considerations in Determining Sanctions, No. 1).

[168] *Guidelines*, at 6 (Principal Considerations in Determining Sanctions, No. 9).

[169] *Guidelines*, at 7 (Principal Considerations in Determining Sanctions, No. 13).

[170] *Guidelines*, at 103 (Principal Considerations in Determining Sanctions, Failure to Supervise, No. 1).

[171] *Guidelines*, at 6 (Principal Considerations in Determining Sanctions, No. 5).

[172] *Guidelines*, at 103 (Principal Considerations in Determining Sanctions, Failure to Supervise, No. 2); *Guidelines*, at 7 (Principal Considerations in Determining Sanctions, No. 18). On a related point, Enforcement argues that an additional aggravating factor is that the supervisory failure resulted in injury to the investing public. Enforcement's Pre-Hearing Brief at 32; *Guidelines*, at 6 (Principal Considerations in Determining Sanctions, No. 11) & 104 (Principal Considerations in Determining Sanctions, Deficient Written Supervisory Procedures, No. 1). But this argument is not supported by the record and is speculative.

[173] Tr. 35 (Respondents' Opening Statement); Tr. 172–73.

competent legal . . . advice.'"[174] If Respondents' reliance was unreasonable, they are not entitled to mitigation based on advice of counsel.[175]

In evaluating Respondents' advice of counsel argument, the Hearing Panel examined all the attendant facts and circumstances and concluded that Respondents' reliance was unreasonable.[176] Respondents were aware of the relevant notices to members explaining the types of compensation encompassed within the term "selling compensation." Nevertheless, they chose not to investigate the types of compensation JEP was receiving. Although JEP eventually informed them of the nature of his compensation, had they performed reasonable due diligence regarding JEP's RIA and hedge fund activities, they would have learned earlier that JEP was receiving selling compensation and that their counsel's advice was incorrect. At the hearing, Rooney conceded as much, testifying that he probably afforded counsel "too much credibility based on his credentials and performed an inadequate amount of due diligence."[177]

Further, Respondents received several regulatory warnings that their failure to supervise JEP violated Rule 3040,[178] yet they persisted in making the same arguments that they did not have supervisory responsibility for JEP's activities. Moreover, despite the notices they received from both the SEC and FINRA, there is no evidence that they even considered seeking a second opinion from another attorney.[179] Additionally, these circumstances, coupled with Rooney's extensive industry experience, rendered his reliance on their counsel's advice especially unreasonable.[180]

---

[174] *Mielke*, 2014 FINRA Discip. LEXIS 24, at *66–67 (quoting *Fergus*, 2001 NASD Discip. LEXIS 3, at *48); *Fergus*, 2001 NASD Discip. LEXIS 3, at *46–47 ("Under the Sanction Guidelines, the appropriate test is 'whether the respondent demonstrated reasonable reliance on competent legal or accounting advice.'"); *Guidelines*, at 6 (Principal Considerations in Determining Sanctions, No. 7).

[175] *Fergus*, 2001 NASD Discip. LEXIS 3, at *46–47 (rejecting respondent's argument that his reliance on counsel was a mitigating factor because the reliance was not reasonable), *aff'd sub nom., Frank Thomas Devine*, Exchange Act Release No. 46746, 2002 SEC LEXIS 2780, at *1 (Oct. 30, 2002).

[176] *Dep't of Enforcement v. Steinhart*, No. FPI020002, 2003 NASD Discip. LEXIS 23, at *11 (NAC August 11, 2003) ("In order to determine whether Steinhart's reliance was reasonable, we must examine the facts and circumstances surrounding his reliance."); *Fergus*, 2001 NASD Discip. LEXIS 3, at *47–48 (NAC "examined all the facts and circumstances of this case to determine whether the respondents reasonably relied on competent legal advice for purposes of assessing whether mitigation of sanctions is warranted").

[177] Tr. 188. *Cf. Steinhart*, 2003 NASD Discip. LEXIS 23, at *11 ("Reliance on advice to engage in conduct that is a violation of NASD rules cannot be considered reasonable, especially when the legal counsel or client has knowledge that the advice violates the applicable rule").

[178] *Toni Valentino*, Exchange Act Release No. 49255, 2004 SEC LEXIS 330, at *14 (Feb. 13, 2004) (rejecting argument that respondent's reliance on counsel should be mitigating, where respondent had agreed to comply with NASD rules and where NASD staff repeatedly warned that failing to appear could result in a bar).

[179] Tr. 315–16; *see also* Tr. 123.

[180] *Dep't of Enforcement v. Berger*, No. C9B040069, 2006 NASD Discip. LEXIS 19, at *30 (NAC July 28, 2006) ("Given Berger's agreement to comply with NASD's rules, his extensive experience in the industry, and the warnings from NASD staff, any purported reliance on counsel was not reasonable.").

In addition to reliance on advice of counsel, Rooney also argued in mitigation that "there isn't a string of carnage from investors that typically are associated with a failure to supervise; that all these transactions happened away from the firm."[181] It is not clear, however, that the violations did not result in customer harm. But, regardless, lack of customer harm is not mitigating.[182]

6. Conclusion

The Hearing Panel finds that Respondents' misconduct was egregious. Both Rooney and Murphy are registered securities principals and, as such, are "the person[s] at the broker dealer to whom [FINRA] looks to ensure compliance with regulatory requirements."[183] They did not, however, ensure that the Firm complied with its regulatory requirements regarding JEP's private securities transactions. Moreover, Rooney and Murphy did not simply evidence ignorance of the applicable Rules governing private securities transactions.[184] Rather, their misconduct and hearing testimony "demonstrated insouciance and indifference towards their regulatory responsibilities under NASD rules [and] poses a serious risk to the investing public."[185] They abdicated the supervisory decision-making expected of securities principals and deferred completely, and unreasonably, to their prior attorney.[186]

In short, Rooney and Murphy's conduct demonstrates that they appreciate neither the importance of the rules they violated nor their obligations as securities principals to enforce them. Accordingly, the Panel concludes that merely suspending Rooney and Murphy "in a principal capacity for a limited duration of time would be insufficient to ensure that [they] fully understand[] the need to comply with the obligations and responsibilities that principals shoulder . . . [T]o permit [them] to be entrusted with supervisory responsibilities again would place

---

[181] Tr. 645.

[182] *Dep't of Enforcement v. Blum*, No. 20090209629-01, 2013 FINRA Discip. LEXIS 38, at *53 n.117 (NAC Dec. 12, 2013) (finding that "[w]hile the presence of harm or the potential for gain may be aggravating . . . the absence of these factors is not mitigating.") (citing *Howard Braff*, Exchange Act Release No. 66467, 2012 SEC LEXIS 620, at *26 (Feb. 24, 2012)); *Cf. Dep't of Enforcement v. Cohen*, No. EAF0400630001, 2010 FINRA Discip. LEXIS 12, at *47 n.29 (NAC Aug. 18, 2010) ("Although the evidence does not demonstrate that Kaminski's supervisory failures resulted in his pecuniary gain or customer loss, they potentially could have, which militates against considering lack of customer harm and pecuniary gain as mitigating.").

[183] *Beerbaum*, 2007 SEC LEXIS 971, at *14.

[184] In any event, ignorance of FINRA rules is not a basis for mitigation. *See Gilbert M. Hair*, 51 S.E.C. 374, 378 n.12 (1993).

[185] *See Dep't of Enforcement v. Evansen*, No. 2010023724601, 2014 FINRA Discip. LEXIS 10, at *55 (NAC June 3, 2014) (quoting *Epstein*, 2009 SEC LEXIS 217, at *75 (affirming FINRA's finding that that Epstein's "demonstrated insouciance and indifference towards his responsibilities under NASD rules poses a serious risk to the investing public.")).

[186] For example, when asked at the hearing if he understood everything in the letters that he sent to the regulators, Murphy answered: "Not even close." Murphy explained that this did not disturb him, however, because he viewed himself merely as the "transmitter" of counsel's advice. Tr. 313.

customers at too great a risk."[187] Therefore, in light of the egregiousness and systematic nature of the violations, the Firm is expelled from FINRA membership, and Rooney and Murphy are barred as securities principals. Additionally, all-capacities suspensions and substantial fines are necessary to impress upon Respondents the seriousness of their violations and to deter others from engaging in similar misconduct.

V. Order

Fox Financial Management Corporation is expelled and fined $100,000; James E. Rooney, Jr. is barred in all principal capacities, suspended in all capacities for six months, and fined $50,000; and Brian A. Murphy is barred in all principal capacities, suspended in all capacities for three months, and fined $25,000 for violating: (1) NASD Rules 3040(c)(2) and 2110 and FINRA Rule 2010 by failing to supervise a registered representative's private securities transactions and failing to record the transactions on its books and records; and (2) NASD Rules 3010 and 2110 and FINRA Rule 2010 by failing to establish, maintain, and enforce written supervisory systems and procedures.

Respondents are also ordered jointly and severally to pay the costs of the hearing in the amount of $6,596.22, which includes a $750 administrative fee and the cost of the hearing transcript.[188]

_____

David R. Sonnenberg
Hearing Officer
For the Extended Hearing Panel

[187] *See Dep't of Enforcement v. Pellegrino*, No. C3B050012, 2008 FINRA Discip. LEXIS 10, at *77 (NAC Jan. 4, 2008), *aff'd*, 2008 SEC LEXIS 2843 (barring Pellegrino from serving in a principal capacity for failing to establish, maintain, and implement a supervisory system, in violation of NASD Rules 3010 and 2110).

[188] The Extended Hearing Panel considered and rejected without discussion all other arguments by the parties.