

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

DEPARTMENT OF ENFORCEMENT,	:	
	:	
	:	Non-Summary Suspension
Complainant,	:	Proceeding
	:	No. ARB990008
v.	:	
	:	Hearing Officer - Ellen B. Cohn
	:	
	:	DECISION
	:	
	:	June 1, 1999
	:	
Respondent.	:	

Digest

Pursuant to Rule 9513(a), NASD Regulation, Inc. (NASDR) notified Respondent ____ (“____” or “Respondent”) that her registration would be suspended, in accordance with Article VI, Section 3 of the NASD By-Laws and Rule 9510 et seq., for failing to pay an arbitration award. ____ requested a hearing, pursuant to Rule 9514(a), at which she argued, through her counsel and based on documentary evidence, that she is financially unable to pay the award. The Hearing Officer, sitting as the Hearing Panel pursuant to Rule 9514(b), held that ____’s registration should be suspended because she failed to demonstrate a bona fide inability to pay.

Appearances

Lisa J. Henoch, Senior Regional Attorney, Kansas City, Missouri, Nina Schlosser McKenna, Chief Counsel, Kansas City, Missouri, and Rory C. Flynn, Chief Litigation Counsel, Washington, DC, for the Department of Enforcement.

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_____, Esq., _____, Esq., P.C., New York,
NY, for Respondent _____.

DECISION

Introduction

Pursuant to Rule 9513(a), the Office of Dispute Resolution (ODR) of NASDR notified _____, by letter dated February 23, 1999, that her registration would be suspended in accordance with Article VI, Section 3 of the NASD By-Laws and Rule 9510, et seq., as a result of her failure to pay the arbitration award rendered in NASD Arbitration No. 96-01019 (the “Award”). On March 5, 1999 _____, through her counsel, filed a request for a hearing, pursuant to Rule 9514(a), in which counsel asserted that _____ did not have the financial ability to pay the Award. In the request for a hearing, Respondent’s counsel also asked that the matter be decided on the papers, or “in the presence of counsel only,” due to Ms. _____’s inability, as a result of her precarious mental condition, “to participate in a hearing for the next ninety days.”

A hearing was held, by telephone, on April 9, 1999.¹ The Hearing Officer did not require _____ to be present, and she did not testify or otherwise personally participate in the hearing. Prior to the hearing, the Parties filed a stipulation agreeing to certain underlying facts and to the admissibility of certain of Enforcement’s proposed exhibits.² At the hearing, the Department of Enforcement (Enforcement) offered four exhibits, all of which were admitted in evidence, and called one witness, _____, Esq., an Assistant General Counsel at _____. (Tr. Vol. I. 16.) Respondent

¹ References to the transcript of the hearing are cited as “Tr. ____.” References to Enforcement’s and Respondent’s exhibits are cited as “CX ____,” and “RX ____,” respectively.

² References to the “Stipulation as to Facts and Foundation and Admission of Complainant’s Exhibits,” which was filed on April 7, 1999, are cited as “Stip. ¶ ____.”

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offered three exhibits, which were admitted in evidence, in whole or in part.³ At the April 9 hearing, Respondent's counsel requested that the hearing be continued to allow her to adduce testimony from one or more psychiatrists or psychologists to testify about ____'s medical condition and inability to participate in the hearing. The Hearing Officer granted the request over Enforcement's objection. (Tr. Vol. I. 36-37.) On April 12, 1999, at the reconvened hearing, Respondent adduced testimony from two witnesses, _____, Ph.D., a clinical psychologist who has been treating Respondent since the end of October 1998 (Tr. Vol. II. 34), and _____, M.D., a psychiatrist who has been treating Respondent from a psycho-pharmacological perspective and monitoring her medications. (Tr. Vol. II. 17.)

After reviewing the evidence and arguments presented, the Hearing Officer finds that ____ has failed to demonstrate the existence of any valid defense for her failure to pay the Award. Accordingly, ____'s registration is hereby suspended until she provides documentary evidence to NASDR showing the existence of one or more events, as specified in this Decision, that would allow for reinstatement.

Facts

____ first entered the securities industry in November 1978. From June 1994 through March 1996, ____ was registered with the NASD as a general securities representative through _____, Inc. ("_____"). (CX 1.) ____ is currently registered and associated with _____

³ Two of Respondent's exhibits, RX 1 and RX 3, were admitted in their entirety. And, although page 2 of RX 1 was admitted subject to receiving a more legible copy, the Hearing Officer has determined that the "hard copy" of the exhibit (as opposed to the facsimile copy that Respondent originally filed) is sufficiently legible to admit the entire exhibit. RX 2 was admitted in its entirety at the April 9 hearing, but pages 2-3 of the exhibit, *i.e.*, a letter and note from Dr. _____ to Respondent's counsel about ____'s mental condition, were later stricken because Dr. _____ was unable to authenticate the letters and had no clear recollection of preparing them. (Tr. Vol. II. 12-13, 15, 39-42.) In any event, as discussed below, although Respondent was afforded substantial latitude in being permitted to introduce evidence relating to her present mental condition and inability to testify at the hearing, the Hearing Officer

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(“_____”). (Stip. ¶ 1; CX 1.) In June 1996, _____ filed an arbitration claim (NASD Arbitration No. 96-01019) against _____ and two of its managers, _____ and _____, and _____ and the individuals filed a counterclaim against _____. On or about June 2, 1998, an NASD arbitration panel issued an Award requiring _____ to pay _____ \$93,412, representing reimbursement for various compensation deductions the Firm had made, and requiring _____ to pay _____ \$107,995, representing the amount she owed to _____ on a promissory note, and \$30,000, as a contribution toward settlements _____ had paid to six of _____’s former customers. (CX 2.) Pursuant to the Award, the amount due to _____ was to be offset against the funds _____ owed the Firm. As a result, _____ was required to pay _____ \$44,583. (Stip. ¶ 2; CX 2.)

Respondent received notice of the arbitration panel’s Award (Stip. ¶ 3) and, thereafter, filed a motion in New York State Supreme Court to vacate the Award. By Order dated January 4, 1999, the court denied _____’s motion and granted _____’s cross-motion to confirm the Award. (HX 1.)⁴ By letter, dated January 11, 1999, counsel for _____ advised Respondent’s counsel that the Award had been confirmed and demanded payment of the full amount of the Award. (Stip. ¶ 4; CX 3.)

On February 23, 1999, ODR sent _____ a letter initiating non-summary suspension (CX 5), and _____ filed a timely request for a hearing.⁵ Thereafter, on or about March 29, 1999, _____ (and

has concluded that this evidence is immaterial to determining whether she has demonstrated a bona fide inability to pay the Award.

⁴ The January 4 Order confirming the Award was included in Enforcement’s proposed exhibits (pre-marked as Complainant’s Exhibit 4). Although Enforcement did not introduce the Order as an exhibit at the hearing, it is referred to in another document that Enforcement did introduce (CX 3) and, for the sake of completeness, the Hearing Officer has determined to include the January 4 Order in the record as a Hearing Panel exhibit.

⁵ Because it appeared, based on the date of the Notice of Suspension that _____’s request for a hearing was not timely filed, by Order dated March 8, 1999, the Deputy Chief Hearing Officer dismissed the proceeding. The March 8 Order was vacated, nunc pro tunc, upon information that the Notice of Suspension actually was served on February 26, 1999, not on February 23, 1999. See Order Vacating March 8, 1999 Order Dismissing Proceeding for Want of a Timely Written Request for Hearing, dated March 12, 1999.

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_____ and _____) obtained, from a New York state court, a restraining notice placing a hold for twice the amount of the Award (i.e., \$89,166) on funds in _____'s accounts at The Bank of New York. (Tr. Vol. I. 16-18; RX 1.)⁶ As a result of the restraining notice, approximately \$6,819 of Respondent's funds have been frozen (\$6,628 in one account and \$191 in another account). (Tr. Vol. I. 19, 28.) As of the April 9 hearing, _____ and the individuals had not obtained an order requiring the Bank to turnover the frozen funds to it (id.), and the Firm and individuals had not received any funds, directly or indirectly, from _____ as payment towards the Award. (Tr. Vol. I. 16-18.)

_____ sought to avoid suspension of her registration by claiming that she is financially unable to pay the Award. In support of her claimed inability to pay, _____ offered the following documents: (1) an incomplete financial disclosure form;⁷ (2) incomplete federal tax returns for 1996 and 1997;⁸ (3) a statement for the period ending March 2, 1999 for a loan that _____ obtained from The Bank of New York;⁹ (4) materials purportedly generated by an entity known as "Garden State Consumer Credit Counseling, Inc." (the "credit counseling information");¹⁰ and (5) a redacted "Form 1099-Misc." for the

⁶ _____ obtained the restraining notice pursuant to Section 5222 of the New York Civil Practice Law and Rules. A restraining notice under this provision prohibits a garnishee (in this case, The Bank of New York) from transferring or otherwise disposing of assets of a judgment debtor. The provision allows the garnishee to place a hold on funds in an amount that is twice that owed under the judgment, as The Bank of New York did here, and applies to funds existing at the time the restraining notice is served and to subsequently acquired funds. A restraining notice, such as that obtained by _____, does not, however, include any provision for, or automatically result in, a turnover of funds to the judgment creditor. And, according to Mr. _____, before _____ or the individuals could obtain any of the frozen funds, _____ would be required to obtain an order from a state court in New Jersey (where _____ resides) confirming the Award, and an order from a New Jersey state court directing The Bank of New York to release and turnover the frozen funds to the judgment creditors. (Tr. Vol. I. 28.)

⁷ RX 3, pp. 1-10.

⁸ RX 3, pp. 18-21.

⁹ RX 3, pp. 11-12.

¹⁰ RX 3, pp. 13-16.

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year ending 1998, only showing ____'s compensation from ____.¹¹ Among other things, the financial disclosure form was not accompanied by a schedule of liabilities prepared by ____ (RX 3, p. 6); nor did she respond to that portion of the financial disclosure form requiring information about disbursements (of \$1,000 or more) or the transfer of assets (with a fair market value of \$2,000 or more) she has made since the Award was issued. (RX 3, p. 7.) And, although Respondent's federal tax returns for 1996 and 1997 show that she filed Schedules A, C, and D with the Form 1040s, she did not include any schedules in the exhibit submitted in this proceeding. (RX 3, pp. 18-21.)

In addition to these obvious deficiencies, the financial information ____ provided is replete with internal inconsistencies or contradicted by other evidence in the record. For example, Respondent represented, on the financial disclosure form, that her income for the past 12 months was \$27,000 and that she did not anticipate any unusual income in the coming 12 months. (RX 3, p. 4.) However, the credit counseling information, which was prepared on or about March 27, 1999, shows that ____ has a monthly income of \$5,500, or \$66,000 per year. (RX 3, p. 14.)¹² Further, the Hearing Officer notes that during the past 12 months – when her income was purportedly only \$27,000 – she managed to pay \$48,000 on outstanding loans and \$68,521 in legal fees. (RX 3, p. 5.) ____ also assigned inconsistent values to one of her assets: in Part II., Section B of the financial disclosure form, ____ valued her IRA at \$10,000, but on a schedule of assets she prepared in response to Part II., Section G of the financial

¹¹ RX 3, p. 17.

¹² The Hearing Officer also notes that ____'s reported adjusted gross income for 1996 and 1997 was substantially higher than her claimed income for 1998. According to her Form 1040s, in 1996 and 1997, she reported adjusted gross income of \$132,222.59 and \$79,379.95, respectively. (RX 3, pp. 18-21.)

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disclosure form, she valued her IRA at \$17,245. (RX 3, pp. 2, 10.)¹³ Finally, _____ represented, on the financial disclosure form, that she has cash on hand in the amount of \$500 (RX 3., p. 2.); however, more than ten times that amount, i.e., \$6,819, was frozen in her accounts at The Bank of New York. (Tr. Vol. I. 19, 28.)

These inconsistencies not only cast doubt on the overall accuracy of the financial information _____ provided, but prevent the Hearing Officer from making any conclusive findings regarding Respondent's current financial condition. Nonetheless, even assuming the bleakest possible financial picture, although _____ has a negative net worth, she has a steady stream of income, between \$27,000 and \$66,000, at least \$10,000 in an IRA, and \$6,819 in cash that is now subject to the New York state court restraining notice.

Discussion

Arbitration proceedings are designed to settle disputes efficiently and avoid expensive litigation. See, e.g., In re Peter Thompson Higgins, 51 S.E.C. 865 (1993). To ensure compliance with arbitration awards, the NASD has promulgated rules to allow it to initiate non-summary suspension proceedings against members and associated person for failing to abide by such awards. To foster the goals of arbitration, these proceedings necessarily are limited in scope. If a valid award has been rendered and the respondent has received notice of the award, the respondent's registration will be suspended, absent a showing that: (1) the award has been paid in full; (2) the parties have agreed to settle the award; (3) the award has been modified or vacated by a court; (4) an action to vacate or modify the award is

¹³ The Hearing Officer also notes that _____'s 1996 tax return shows an IRA rollover of \$99,221.29 and her 1997 tax return shows an IRA rollover of \$34,000. During closing argument, Respondent's counsel explained the dwindling value of _____'s IRA by stating that _____ was making periodic withdrawals from her IRA to support herself. (Tr. Vol. II. 51.) Of course, counsel's statements do not constitute evidence and _____ introduced no evidence to explain the dramatic reductions in the value of her IRA over the past three years.

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pending in court; (5) there is a pending bankruptcy petition in a United States Bankruptcy court or the award has been discharged by a United States Bankruptcy Court; or (6) a bona fide inability to pay exists.¹⁴

It is axiomatic that a respondent claiming inability to pay bears the burden of proving, through credible evidence, the bona fides of such a defense. E.g., In re Toney L. Reed, Exchange Act Release No. 37572, n.12, 62 S.E.C. Docket 1543, 1996 SEC LEXIS 2208, at * 7 (Aug. 14, 1996) (“Reed, like any respondent raising the issue of his or her personal financial circumstances as they affect ability to pay . . . , has the burden of producing evidence in support of the claim and of proving bona fide insolvency); Bruce M. Zipper, Exchange Act Release No. 33376, 55 S.E.C. Docket 2002, 1993 SEC LEXIS 3525, at * 8 (Dec. 23, 1993) (“[b]ecause the scope of his assets is particularly within Zipper’s knowledge, we think Zipper should properly bear the burden of adducing evidence with respect to those assets.”). The Hearing Officer thus rejects, as impermissible burden shifting, Respondent’s contention that Enforcement, when faced with inconsistent financial information, must come forward with independent evidence of Respondent’s financial condition. (Tr. Vol. II. 56.)¹⁵ Further, an inability to pay defense may be rejected if it appears that the respondent has the ability to divert funds from other expenditures to pay the award, or could borrow the funds, or could make some meaningful payment toward the award from available assets or income, even if he could not pay the full award.¹⁶

¹⁴ Although this is not a disciplinary proceeding to impose sanctions, a respondent’s bona fide inability to pay is a factor to be considered in determining whether the respondent’s registration should be suspended or canceled for failure to pay an arbitration award. Department of Member Regulation v. Bronzino, Non-Summary Suspension Proceeding (NASD Regulation Bd. June 29, 1998).

¹⁵ The Hearing Officer also notes that the NASD does not have the power to compel banks and credit card companies to provide information to it.

¹⁶ Herbert Garrett Frey, Exchange Act Release No. 39007; In re Michael H. Novick, Exchange Act Release No. 37503, 62 S.E.C. Docket 1129, 1996 SEC LEXIS 1994, at *4-6 (July 31, 1996); District Business Conduct Committee for District

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_____ simply has failed to satisfy her burden of proof. The evidence she submitted is not sufficiently reliable to document her present financial condition or to base a finding that she is financially unable to pay the Award. Further, even if the Hearing Officer disregarded the fact that Respondent has failed to satisfy her burden of proof and viewed the financial information in the record in the light most favorable to her, _____ has not shown that she is incapable of making meaningful payments to satisfy the Award. Pursuant to the Award, _____ is now required to pay _____ \$44,583. (CX 2.) Although _____ has a negative net worth, she has a steady stream of income of \$27,000 to \$66,000, an IRA valued at least \$10,000, and cash of \$6,819 that is now frozen. Further, she has not shown that she is incapable of borrowing the funds necessary to satisfy the Award or diverting funds from other expenses.¹⁷

Accordingly, it is hereby ordered, pursuant to Article VI, Section 3 of the NASD By-Laws and Rule 9514(g), that _____'s registration shall be suspended effective as of the date of the issuance of this decision, and that such suspension shall continue until she provides documentary evidence to NASD Regulation showing: (1) she has made full payment of the Award; (2) _____ has agreed to a

No. 8 v. Miguel Angel Cruz, Complaint No. C8A930048, 1997 NASD Discip. LEXIS 62, at *108-12 (NBCC Oct. 31, 1997); District Business Conduct Committee for District No. 7 v. Bruce M. Zipper, Complaint No. C07910138, 1994 NASD Discip. LEXIS 194 (NBCC Oct. 31, 1994), aff'd, Exchange Act Release No. 35606, 58 S.E.C. Docket 235 (April 17, 1995).

¹⁷ Because the documentary evidence in the record does not substantiate _____'s claimed inability to pay, whether her mental condition prevented her from testifying at the hearing is irrelevant. Thus, the Hearing Officer has not reached any conclusion regarding Respondent's mental condition or how it may curtail her activities; nor has the Hearing Officer considered the testimony of either Dr. _____ or Dr. _____ (or any letters prepared by them) in determining that _____ has failed to demonstrate a bona fide inability to pay the Award. Accordingly, that counsel for Enforcement and the Hearing Officer did not have an opportunity to complete their questioning of Dr. _____ is inconsequential.

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settlement of the Award; or (3) she has filed a bankruptcy petition in a United States Bankruptcy Court or that the Award has been discharged by a United States Bankruptcy Court.¹⁸

Ellen B. Cohn
Hearing Officer

¹⁸ The other events that might allow for reinstatement are inapplicable. _____ already filed an application to modify or vacate the Award and, in this decision, the Hearing Officer has found that she has the present financial ability to pay the Award.

The Hearing Officer considered all of the arguments of the Parties. They are rejected or sustained to the extent they are inconsistent or in accord with the views expressed herein.