BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD

In the Matter of Department of Enforcement, Complainant, vs. Dane S. Faber, Sausalito, CA, Respondent.	DECISION Complaint No. CAF010009 Dated: May 7, 2003

Respondent misrepresented and omitted material facts to two customers and made an unsuitable recommendation to one customer. Held, findings affirmed and sanctions modified.

Appearances

For the Complainant Department of Enforcement: Rodney Turner, Esq., and Brian L. Rubin, Esq., NASD Department of Enforcement.

For the Respondent Dane S. Faber: Patrick Baldwin, Esq., and Christine McNamara, Esq., Baldwin and McNamara.

I. Introduction

Dane S. Faber ("Faber") has appealed a May 3, 2002 decision of a Hearing Panel pursuant to NASD Procedural Rule 9311. After reviewing the entire record in this matter, we affirm the Hearing Panel's findings that Faber violated Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), SEC Rule 10b-5, and NASD Conduct Rules 2110 and 2120 by making misrepresentations and omitting material facts to two customers. We also affirm the Hearing Panel's findings that Faber violated Conduct Rules 2110 and 2310 by making an unsuitable recommendation to a customer. We find Faber's conduct to be egregious and bar him from associating with any member firm in all capacities. We order Faber to pay the following restitution: (1) $30,005, plus interest, to customer RK; and (2) $52,215, plus interest, to customer DM.

II. Background

Faber first became an associated person in September 1981. During the time of the alleged violations, Faber was registered as a general securities principal, municipal securities principal, registered options principal, general securities sales supervisor, and general securities representative with Smith Culver, Inc. ("Smith Culver" or the "Firm"), an NASD member firm. Thomas Smith ("Smith") and Wayne Culver ("Culver") were co-owners of Smith Culver, which no longer operates. Faber is currently registered with First Securities USA, Inc.

III. Factual and Procedural History

The Department of Enforcement ("Enforcement") filed the complaint in this matter on April 6, 2001. The complaint alleged three causes of action against three respondents, including two causes of action against Faber.[1] In a decision dated May 3, 2002, the Hearing Panel found that Faber made fraudulent misrepresentations and omissions to two customers in violation of Section 10(b) of the Exchange Act, SEC Rule 10b-5 and NASD Conduct Rules 2110 and 2120. The Hearing Panel further found that Faber made an unsuitable recommendation to one customer in violation of Conduct Rules 2110 and 2310. Faber appealed the Hearing Panel's findings and sanctions. Enforcement cross-appealed the level of sanctions.

A. The Silicon Valley IPO Network

The allegations in the complaint stem from Smith Culver's offering of equity shares of Interbet, Inc. ("Interbet"), which was one of 10 companies that comprised an entity called the Silicon Valley IPO network ("SVIPON"). In 1997, SVIPON, through Smith Culver, sold convertible debentures to investors who later would be entitled to equity shares of each of the 10 companies when such company went public. The purpose of these convertible debentures was to fund the start-up costs of the 10 companies that constituted SVIPON. Edward Durante ("Durante"), through his company Diablo Associates ("Diablo"), organized, controlled and promoted SVIPON. Diablo, however, was not a broker-dealer and Durante was not registered with an NASD member firm.

Smith Culver's main office was in San Francisco, California, but the Firm also maintained branch offices in other locations. In approximately November 1996, Smith, Culver and Durante visited the Firm's office in Beverly Hills and met with Terry Buffalo ("Buffalo"), Smith Culver's President from the middle of 1996 until March 1997, and Jonathan Worley ("Worley"), head of Smith Culver's Bond Trading desk in the Beverly Hills office from the middle of 1996 until March 1997. Smith, Culver and Durante

[1] On November 9, 2001, Grace Stoneham settled with Enforcement. In addition, the Hearing Officer severed one respondent, Monte Myler ("Myler"), from this matter because there were separate allegations that pertained only to Myler that would unduly prolong the hearing as it pertained to the other respondents. Myler also settled with Enforcement.

attempted to persuade Buffalo and Worley to support the Firm's selling of SVIPON's convertible debentures. After hearing a presentation regarding SVIPON and reviewing relevant materials, Buffalo and Worley were skeptical of SVIPON and its promoter, Durante. They both investigated Durante by searching the Internet and contacting NASD. Buffalo and Worley learned that NASD had barred Durante in 1983.[2]

At the hearing below, Buffalo and Worley both testified that they spoke with Faber about Durante's disciplinary history. According to Buffalo's testimony, Faber stated that he had previously worked with Durante, knew that Durante had been barred, and believed that Durante was not "the most upstanding citizen." Worley testified that Faber called Buffalo and Worley to speak about SVIPON and that Worley and Buffalo informed Faber that NASD had barred Durante. Worley further testified that Faber responded that he had worked with Durante, that Durante was a "slick and sleazy person," and that he would not put any money into any deal that involved Durante.

Buffalo and Worley also spoke with Smith and Culver about Durante's bar and insisted that the Firm could not engage in business with Durante. Buffalo and Worley refused to work on or support the SVIPON deal. Over the objection of Buffalo and Worley, the Firm agreed to work with Durante on SVIPON. The Firm fired Buffalo and Worley in March 1997. Thereafter, the Firm and Diablo began a close working relationship, including sharing Smith Culver's San Francisco office with many SVIPON companies.

On June 18, 1997, shortly before the transactions at issue took place, Durante and an associate signed a memo on the Firm's letterhead that was distributed to all Smith Culver brokers, announcing that Faber "has been named Managing Director of Smith Culver Inc." and that "[a]ll brokers should address daily operational issues to Dane [Faber]." After David Cave ("Cave"), the Trading Manager at Smith Culver from March 1997 until August 1997, received a copy of the memo, he spoke with Faber about it. Faber told Cave that Smith and Culver "were not doing a great job of . . . running the company and that he (Faber) was looking at what he could do to improve things." During the conversation between Faber and Cave, Durante entered Faber's office and talked about "how now things were going to get better and Smith Culver was going to become a real player in the OTC market, [and] that he envisioned Smith Culver being a market maker in all 10 of the Silicon Valley companies when they all went public . . . ." Approximately one month later, on July 23, 1997, Faber signed and sent out a letter using the title of Managing Director. At the hearing below, Faber testified that, at the time of the Interbet sales, he believed that Durante had an ownership or controlling interest in Smith Culver.

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[2] NASD barred Durante for publication of manipulative or deceptive quotations, entering into unauthorized transactions, and failing to respond to NASD's requests for information.

B. Interbet

Interbet was one of the first SVIPON companies to transform itself into a publicly traded company. Interbet, which was incorporated in 1996, planned to offer Internet casino gambling to customers, including Internet Bingo. By June 1997, however, none of Interbet's casino gambling games were operational. At this time, the company had generated no revenue, had sustained net losses of approximately $196,552, and held only $3,600 in cash.

Interbet, which was a private company, entered into an agreement to complete a reverse merger with Bio-Chem, Inc. ("Bio-Chem"), a publicly held company. Bio-Chem also had never generated any revenue, but it had $50,000 in cash that it had raised through the sale of 100,000 shares of its stock at $.50 per share. Bio-Chem's stock traded on the Over-the-Counter Bulletin Board ("OTCBB") under the symbol BXLI. Although Bio-Chem's stock price typically had been below one dollar before June 1997, during the month of June 1997 the stock rose to $6.25, even though the company still was not generating any revenue. On June 27, 1997, Bio-Chem's last day of trading under the symbol BXLI, the stock last traded at $6.25 per share.

On June 13, 1997, Interbet's reverse merger with Bio-Chem became effective and, on June 20, 1997, Interbet issued a press release that announced the merger. On June 30, 1997, the stock resumed trading at $6.25 per share on the OTCBB under the new symbol EBET. The sales force at Smith Culver then began to sell shares of Interbet to retail customers. Smith Culver representatives obtained the shares that they were selling from two customers' accounts that were previously opened by Smith. Interbet never received any of the proceeds from the shares sold by Smith Culver.

Faber testified that he believed that the Interbet offering was an IPO and that he was unaware that the Interbet offering was a reverse merger. Cave, Buffalo and Worley, however, all testified that there was readily available information indicating that the offering was a reverse merger.

C. Faber's Investigation of Interbet

Faber testified that before he sold Interbet to his customers, he reviewed Interbet's marketing materials and business plan. Faber did not recall seeing a prospectus, but he testified that the "business plan" was "interchangeable in [his] mind" with a prospectus. In fact, there was no prospectus, and Interbet never filed a registration statement to sell securities.

Faber also spoke with Smith and Culver who represented that the Firm had done due diligence on Interbet, that the Firm had retained attorneys to review Interbet, and that those attorneys who assisted in the due diligence were buying Interbet shares for themselves. Faber testified that he discussed SVIPON with three of his clients, including his father. Faber agreed with his father that SVIPON was a "unique and innovative debtfinancing instrument." Faber further testified that the logo of Brookstreet Securities Corp. ("Brookstreet") appeared on the SVIPON offering memorandum, which he believed lent "a certain credibility to the issue."

Faber testified that he knew that Interbet was a development stage company, but he did not know that it had no business, or that it had lost approximately $200,000 since its inception. He did not recall whether he knew that Interbet had no revenue. Faber did not review publicly available information, such as Interbet's June 24, 1997 Form 8-K, or Bio-Chem's most recent quarterly report. Prior to selling the shares, Faber was not aware if Interbet had filed a Form 8-K or a Form 10-Q. He did not consult a Bloomberg terminal for information regarding Interbet or Bio-Chem.[3] He did not research Interbet or Bio-Chem on the Internet. Further, Faber did no independent research regarding Interbet or Bio-Chem to find any information, news, trading data, public filings, or registration statements.

D. Faber's Sales of Interbet

In June 1997, Faber sold Interbet stock to customers RK and DM. We discuss these sales separately.

1. Customer DM

At the time of the hearing, DM was 56 years old and had been a bookkeeper/office manager for the past 10 years. From 1995 through 1997, her income ranged from approximately $21,000 to $32,000 per year. In February 1996, she opened an IRA rollover account with Smith Culver with approximately $20,500, the proceeds of her pension fund. At the end of 1996, DM also had the following assets: (1) approximately $30,000 in an IRA; (2) approximately $26,000 in a savings account; and (3) an unencumbered house, valued at $175,000.

DM was an inexperienced investor. Prior to February 1996, DM invested all of her savings in certificates of deposit ("CDs") and bank accounts. DM first contacted Faber at her mother's suggestion because her mother was also a client of Faber. During their initial conversation in approximately February 1996, DM explained to Faber that she planned to retire in 12 years and she wanted to purchase bonds so that she would earn higher interest than she was earning through her savings account and CDs. At the hearing, DM did not recall whether Faber asked about her assets or income, and did not recall providing him with that information. Faber did not produce any documents containing that information at the hearing.

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[3] Faber testified that, as a broker, he did not have access to the Smith Culver Bloomberg terminal. The Hearing Panel, however, found that his testimony was inconsistent with the testimony of Grace Stoneham, another broker who worked side-by-side with Faber. She testified that she had access to the Bloomberg terminal.

When DM opened her account, she instructed Faber to buy bonds. In accordance with those instructions, Faber purchased corporate bonds. DM testified that Faber "was always very knowledgeable, very nice to me," and she "trusted him to do good for me." Pleased with the performance of the bonds in her rollover IRA account, DM opened a second account with Faber in May 1997, using the proceeds from a recently matured CD in a non-qualified account of approximately $29,000. She told Faber that she wanted to buy bonds in her new account. Accordingly, Faber recommended, and DM purchased, Wickes Lumber Company ("Wickes") bonds. DM held the Wickes bonds until they were sold out of her account approximately one month later, on June 27, 1997.

In late June or early July 1997, Faber explained to DM that he had a great opportunity for her to purchase an IPO stock that could triple her money in a short period of time. Because she did not know what an "IPO" was, Faber explained the concept to her and, at that time, she wrote down the words "Initial Public Offering" on a piece of paper. DM, however, did not recall whether Faber mentioned Interbet's name. DM testified that she subsequently received both her IRA rollover account statement and her non-qualified investment account statement. She then learned that Interbet was the name of the IPO company. In total, DM purchased 8,700 shares of Interbet stock.

Faber did not disclose to DM that Interbet had not generated any revenue since its inception and that it had only incurred losses. Faber also did not disclose the speculative nature of Interbet. DM testified that had these facts been disclosed, she would have directed Faber not to purchase shares of Interbet.

DM never sold Interbet, now known as Virtual Gaming, despite its decline in value, because Faber encouraged her to hold the stock, and because subsequently it became nearly worthless. As the price was falling precipitously, Faber continuously encouraged DM to keep the stock by making optimistic statements about Interbet.[4] Due to a reverse stock split, DM now owns 178 shares of Virtual Gaming. DM lost a total of $52,215 on her Interbet purchases.

2. Customer RK

RK, a retired federal government employee and attorney, began investing with Faber prior to Faber's arrival at Smith Culver. RK originally held municipal bonds in his Smith Culver account with Faber. According to RK, he and Faber had established a "friendship" over the phone, and RK relied upon Faber's recommendations.

In June 1997, Faber telephoned RK and recommended that he purchase an Internet "IPO opportunity." Faber presented Interbet as a different type of investment from RK's previous purchases with Faber. RK testified that "it was presented to me as an

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[4] For example, among other statements, Faber compared Interbet to Netscape and told DM, when Interbet's price was less than $1, "I wouldn't advise anyone to sell for less than $7 a share, at this point."

opportunity, as something different and something perhaps a little more volatile, in the sense of making more money and probably in a shorter time frame than municipal bonds." Faber told him that he thought, "it was a chance for us to double our money."

RK believed that the company was issuing common stock to expand its operations. Faber did not tell him that the transaction was a reverse merger and that proceeds from the sale would not go to Interbet. RK never received a prospectus for Interbet. RK testified that Interbet's involvement in a reverse merger would have been an important factor that he would have considered in deciding whether to purchase shares of Interbet.

RK testified that—after Faber's recommendation—he had a positive impression of Interbet, thinking it was a good investment opportunity and, ultimately, he purchased the stock because he had "faith and confidence" in Faber. On July 8, 1997, RK purchased 5,000 shares of Interbet for a total cost of $30,005.

While soliciting RK to purchase Interbet, Faber did not disclose to RK that Interbet had not generated any revenue since its inception and that it had only incurred losses. Faber further did not disclose the speculative nature of Interbet. According to RK, knowledge of Interbet's losses and its lack of revenue would have been important factors that he would have considered in deciding whether to purchase shares of Interbet.

RK still owns his Interbet stock, now known as Virtual Gaming. He has not sold the shares because he believes that they are worthless. RK still has an account for which Faber is his registered representative, but there has been no activity in it since Faber sold Interbet shares to RK. RK lost a total of $30,005 on his Interbet purchase.

IV. Discussion

Faber appeals the findings of the Hearing Panel and seeks to have the allegations in the complaint dismissed. We decline to dismiss the complaint's allegations. Instead, we affirm the Hearing Panel's findings that Faber fraudulently misrepresented and omitted material facts to two customers and that he made an unsuitable recommendation to one customer.

A. The Suitability of Faber's Recommendation to Customer DM

Conduct Rule 2310 states that "[i]n recommending to a customer the purchase, sale, or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs."

We begin by determining whether Faber recommended shares of Interbet to DM. We agree with the Hearing Panel that Faber recommended Interbet to DM. First, the Hearing Panel found DM's testimony to be credible and Faber's testimony on this issue not credible. Faber has failed to show why this credibility determination was incorrect.

Faber's claim that he acted solely as an order taker and that he did not recommend the security to DM was contradicted by DM's testimony.[5] Second, the Interbet confirmation notice does not carry a notation that the purchase of Interbet by DM was unsolicited. Third, in Faber's Opposition to Enforcement's Motion for Summary Disposition/Motion to Strike, Faber claimed that "NASD failed to properly and timely investigate any wrongdoing in connection with Interbet, even though it received complaint letters from [another customer] long before *Respondent recommended Interbet* to [RK and DM]" and that Faber "*recommended* Interbet in reliance on Smith Culver." (emphasis added). Accordingly, we conclude that Faber recommended Interbet.

We next examine whether Faber's recommendation that DM purchase shares of Interbet was unsuitable. We find that it was. DM had liquid assets of approximately $76,500. Her income was $21,000 to $32,000, and she was an inexperienced investor. Although the record does not contain a new account form indicating DM's investment objectives, DM's goal of retiring in 12 years, her previous investments in CDs, and her goal of earning more than what she earned on CDs and saving accounts lead us to conclude that DM's investment objectives were conservative.

Faber's recommendation to purchase Interbet, however, was not conservative and was not suitable for DM, given her financial situation and needs. Interbet stock was a speculative security of a company that had never generated any revenue and had only experienced losses. In light of DM's limited income, net worth and her goal of using these funds for retirement, Faber's commitment of approximately $50,000 of DM's assets to Interbet stock was plainly not suitable. See Klein, 52 S.E.C. at 1030, 1037-38 (1996) (finding that high-risk investments were unsuitable when customers could not afford to risk principal and were unsophisticated).

Faber argues that DM somehow ratified the unsuitable transactions because she never complained or instructed Faber to sell her Interbet shares. As the Commission has stated, "[t]he proper inquiry is not whether [the customer] viewed [the broker's] recommendations as suitable, but whether [the broker] fulfilled his obligations to his client." Paul F. Wickswat, 50 S.E.C. 785, 786-87 (1991). For the purpose of the suitability rule, the proper focus therefore is on Faber's actions, not the acquiescence or nonaction of his customers. Moreover, in this instance, DM did not understand the

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[5] Faber also argues that DM wanted to and should be able to purchase speculative securities. For support, Faber cites to an interview of former SEC Commissioner Unger, in which the Commissioner stated that customers should be able to speculate. We reject this argument. First, the record does not support the conclusion that Faber acted strictly as an order taker. Second, even if a client wanted to purchase speculative securities, a representative must refrain from making recommendations that are not consistent with the client's financial needs and situation. See John M. Reynolds, 50 S.E.C. 805, 809 (1991) (stating that regardless of whether the customer wanted to engage in aggressive and speculative trading, a broker is obligated to abstain from making recommendations that are inconsistent with a customer's financial situation).

riskiness of her purchase and Faber recommended that she not sell Interbet. DM followed Faber's advice to "keep the faith" and did not sell the stock. We reject Faber's argument that DM's failure to sell Interbet provides a valid defense to the suitability violation.

Accordingly, we find that Faber's recommendation of Interbet to DM was unsuitable and violated Conduct Rules 2110 and 2310.

B. Misrepresentations and Omissions of Material Facts

Section 10(b) of the Exchange Act forbids any person from "us[ing] or employ[ing], in connection with the purchase of sale of any security . . . , any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe . . . ." Among other things, SEC Rule 10b-5 makes it unlawful to "make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading." NASD Conduct Rule 2120 has requirements similar to Section 10(b) of the Exchange Act.[6]

To show a violation of Section 10(b) of the Exchange Act, SEC Rule 10b-5, and NASD Conduct Rule 2120, Enforcement must prove that: (1) the misrepresentations or omissions were made in connection with the purchase or sale of securities; (2) the misrepresentations or omissions were material; and (3) the misrepresentations or omissions were made with the requisite intent, i.e. scienter. See SEC v. First Jersey Sec., Inc., 101 F.3d 1450, 1467 (2d Cir. 1996); District Bus. Conduct Comm. v. Euripides, Complaint No. C9B950014, 1997 NASD Discip. LEXIS 45, at *18 (NBCC July 28, 1997).

The Hearing Panel below found that Faber had misrepresented that Interbet was an IPO and that he had made baseless price predictions and generalized assurances of success regarding the stock. The Hearing Panel also found that Faber had failed to inform DM and RK of negative financial information about the issuer and had failed to disclose fully the speculative nature of the security. Based upon a complete review of the record, we agree.[7]

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6 Conduct Rule 2120 states, "No member shall effect any transaction in, or induce the purchase or sale of, any security by means of any manipulative, deceptive, or other fraudulent device or contrivance."

7 Faber does not dispute that his representations were made in connection with the purchase or sale of securities. We find that they were. See SEC v. Hasho, 784 F. Supp. 1059, 1106 (S.D.N.Y. 1992)

1. Materiality

We find that Faber misrepresented and omitted material facts to two customers. A fact is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision. See Basic, Inc. v. Levinson, 485 U.S. 224, 232 (1988).

We find that Faber's omissions—that Interbet had not generated any revenue, that Interbet had only incurred losses, and that Interbet was a speculative security—were material and rendered misleading his statements about Interbet. The fact that an issuer has never generated revenue and has only incurred losses is undoubtedly material. See Hanley, 415 F.2d 589, 595-97 (2d Cir. 1969); see also Hasho, 784 F. Supp. at 1109; Department of Enforcement v. Golub, Complaint No. C10990024, 2000 NASD Discip. LEXIS 14, at *21 n.14 (NAC Nov. 17, 2000). The speculative nature of a security is also material. See Hasho, 784 F. Supp. at 1109 ("Failure to disclose the speculative nature of securities recommended . . . violate[s] the antifraud provisions."); Golub, 2000 NASD Discip. LEXIS 14, at *21 n.14.[8] Here, Faber's omissions regarding Interbet were misleading because he failed to disclose adverse information about Interbet at the same time that he was pitching the stock as a money-making opportunity.

Faber also told RK that the stock could double in price and told DM that the stock could triple in price. A price prediction, such as Faber's, is material. The SEC has consistently held that a specific price prediction regarding a speculative security is material. Charles P. Lawrence, 43 S.E.C. 607, 610 (1967) ("We have repeatedly held that a specific prediction of the future value of a speculative or unseasoned security is inherently fraudulent"), aff'd, 398 F.2d 276 (1st Cir. 1968). We therefore find Faber's prediction of a substantial increase in the price of Interbet—a speculative security—to be material. See Hasho, 784 F. Supp. at 1109; Lawrence, 43 S.E.C. at 610.

Finally, Faber informed customers RK and DM that shares of Interbet were being sold pursuant to an IPO. This was not an accurate statement because Interbet obtained publicly traded shares by completing a reverse merger with Bio-Chem. We find that this fact would have been material to a reasonable investor. See James D. Lang, 46 S.E.C. 461, 464 (1976) (finding that a failure to disclose that a purchaser would not be receiving original issue shares with the proceeds going to the issuer was material), aff'd sub. nom., Sartain v. SEC, 601 F.2d 1366 (9th Cir. 1979).[9]

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[8] Interbet was a typical speculative stock because the company was only in its developmental stage and had only incurred losses since its inception. See, e.g., Department of Enforcement v. Golub, Complaint No. C10990024, 2000 NASD Discip. LEXIS 14, at *18-19 (NAC Nov. 17, 2000).

[9] Faber argues that, under District Business Conduct Committee v. Gregory, Complaint No. C06940002, 1995 NASD Discip. LEXIS 203 (NBCC Apr. 6, 1995), the distinction between an IPO and a reverse merger is not a material misrepresentation. We reject Faber's argument. Although it is true that the broker in Gregory failed to disclose

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2. Scienter

Scienter is defined as "a mental state embracing intent to deceive, manipulate, or defraud." Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976). Numerous courts have found that recklessness satisfies the scienter requirement of SEC Rule 10b-5. See Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1569-70 (9th Cir. 1990) (noting that 10 United States Circuit Courts of Appeal have found that recklessness satisfies the scienter requirement).[10] We find that Faber acted with scienter.

Reckless conduct may be defined as a highly unreasonable misrepresentation or omission, "involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers and sellers that is either known to the defendant or is so obvious that the actor must have been aware of it." Hollinger, 914 F.2d at 1569. Further, "the danger of misleading buyers must be actually known or so obvious that any reasonable man would be legally bound as knowing." Id. at 1569-70 (citations omitted).

The facts and circumstances of this case show that Faber's omissions—that Interbet had not generated any revenue, had only incurred losses, and that Interbet was a speculative security—were reckless. Faber knew Interbet's financial condition. Even though Faber testified that he did not review a prospectus, Faber acknowledged reviewing a business plan of Interbet. The business plan included a balance sheet, which listed Interbet's accumulated deficit of almost $200,000 and total liabilities of $140,000. The business plan also contained a statement of operations, which listed Interbet's revenue in 1997 as zero, and its net loss of almost $200,000. Finally, the business plan continuously referred to Interbet's business as in a "development stage." Faber also

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to his customer that the company issued public stock via a reverse merger, the company registered the offering, the customer was told that the offering was completed, and the stock was being traded in the secondary market. Here, Faber did not disclose that the offering was completed, the offering was not registered (although it appears to us that it should have been), and the two customers did not know that they were purchasing shares in the secondary market. More importantly, in Gregory, the National Business Conduct Committee ("NBCC") (the predecessor to the NAC) did not find the customer's claim that he thought he was buying shares in an IPO to be credible. In the case before us, the customers' testimony was credible.

[10] Although some courts use the term severe recklessness, not recklessness, the distinction is not relevant. As the United States Court of Appeals for the Eleventh Circuit stated, "Although the [Fifth Circuit] used the modifier 'severe' in its characterization of what kind of reckless conduct can satisfy [Rule] 10b-5's scienter requirement, its definition of severe recklessness is identical to that used by other courts to describe what conduct they considered reckless." Woods v. Barnett Bank, 765 F.2d 1004, 1011 n.9 (11th Cir. 1985).

testified that he knew that Interbet was a development stage company. Under the circumstances, we find Faber's failure to disclose that Interbet had not generated any revenue, had only incurred losses, and was a speculative security was an extreme departure from the ordinary standards of care.

With regard to Faber's price predictions, we find Faber's prediction of a substantial increase in the price of Interbet to be reckless. See Hasho, 784 F. Supp. at 1109; Charles P. Lawrence, 43 S.E.C. 607, 610 (1967) ("We have repeatedly held that a specific prediction of the future value of a speculative or unseasoned security is inherently fraudulent"), aff'd, 398 F.2d 276 (1st Cir. 1968). There can be no doubt that Interbet was a speculative security, and therefore a price prediction that it would double or triple is inherently fraudulent. Faber argues that he did not commit fraud because he merely stated that the stock "could" double. Conditional language, however, does not lessen or negate the misconduct. See Hasho, 784 F. Supp. at 1109 ("The fraud is not ameliorated where the positive prediction about the future performance of securities is cast as opinion or possibility rather than as a guarantee"); Mac Robbins & Co., Inc., 41 S.E.C. 116, 119 (1962), aff'd sub nom., Berko v. SEC, 316 F.2d 137 (2d Cir. 1963). Accordingly, we find that under the circumstances, Faber was reckless to predict that Interbet's price would double or triple.

We find that Faber's misrepresentation of Interbet's transaction as an IPO was intentional or, at a minimum, reckless. The record shows that Faber knew that the Interbet offering was a reverse merger, and his denials in this regard are not credible. Worley testified that he had mentioned the reverse merger to Faber; Faber responded that he knew about it, and that he "wasn't going to do any of it." In spite of his response to Worley, Faber represented to DM and RK that Interbet was conducting an IPO. Faber's admission to Worley is consistent with the knowledge of other Firm employees that the Interbet offering was a reverse merger. Cave testified that Durante, in a meeting before Smith Culver brokers, specifically stated that the offering was a reverse merger. Further, Buffalo testified that prior to his leaving the firm in March 1997, he learned that Durante, Smith and Culver were working on a reverse merger.

In the alternative, we find that Faber's promotion of Interbet as an IPO was, at a minimum, reckless. Faber encountered significant red flags surrounding the offering that should have alerted him to the fact that the offering of Interbet shares was by means of a reverse merger, not an IPO. See Voss v. SEC, 222 F.3d 994, 1006 (D.C. Cir. 2000) ("Registered representatives are 'under a duty to investigate,' and 'red flags and suggestions of irregularities demand inquiry as well as adequate follow up and review'" (internal citations omitted)). First, Faber never received or reviewed a prospectus for Interbet. In fact, there was no prospectus. The lack of a prospectus when selling an IPO is undoubtedly a red flag. The Securities Act of 1933 requires an issuer to file a prospectus[11] and the rules promulgated under the Exchange Act require registered

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[11] Section 5(b)(2) of the Securities Act of 1933; 15 U.S.C. § 77e(b)(2) (2003).

representatives such as Faber to deliver a prospectus to their customers.[12] Faber claims, however, that he reviewed a business plan which was the same as a prospectus. We reject this claim. In particular, among other sections, a prospectus includes a description of the "use of proceeds" that would have shown that Interbet was not issuing shares pursuant to an IPO. See Regulation S-K, Item 504. Especially in light of Faber's prior dealings with IPOs and his lengthy tenure in the industry, his failure to have a prospectus when selling Interbet was reckless. We also conclude that Faber's statement that Interbet was an IPO was unsupported by any relevant documents. Second, a memorandum addressed to Faber on Smith Culver letterhead, which described the incentive package he was to receive for selling SVIPON, was a further red flag. The memorandum stated that free trading stock would be derived from, among other sources, "full reporting publicly traded shells." Faber chose to ignore this obvious warning sign that the Interbet transaction was not an IPO.[13] Moreover, Faber did not perform any research on Interbet, even though a Bloomberg terminal and Internet access were available. In light of the red flags that Interbet was not an IPO, Faber's lack of investigation into the irregularities of the transaction was reckless.

In sum, the combination of Faber's actions was more significant than the isolated parts. Faber seriously misled his customers by touting an IPO stock that could double or triple in price. In fact, Faber sold them a speculative stock of a company that had never generated any revenues and had only incurred losses. We conclude that Faber knew what he was doing or—given his experience in the business and the red flags that he ignored—that he was reckless in not knowing that he was misleading his customers.

Faber argues that he did not act recklessly because he relied on the due diligence conducted by his employer. Faber does not provide any legal support for this contention; rather, he asserts that if his position is incorrect, every individual representative will be required to investigate for him or herself the accuracy of every report, opinion, analysis, or recommendation made by a firm.[14] Faber overstates his argument and we disregard it.

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[12] Exchange Act Rule 15c2-8; 17 C.F.R. § 240.15c2-8 (2003).

[13] Faber's statement that the appearance of the Brookstreet logo on the SVIPON offering memorandum lent credibility to the Interbet offering is not relevant since his representations involved Interbet, not SVIPON. Nevertheless, the presence of the logo provides no justification for his representations.

[14] Faber's argument can only address his misrepresentation that the offering was an IPO, and not his price predictions or omissions because Faber offered no evidence that his Firm predicted that Interbet's price would double or triple, or concluded that Interbet was not a speculative security.

With regard to the merit of Faber's argument, the only support Faber provides is the testimony of Allen Rockler, whom he tendered as an "expert." The Hearing Panel gave Rockler's testimony no weight. We agree with this assessment. Rockler's testimony was, at best, speculative because: (1) he never read any SEC cases on the issue; (2) he read only some NASD decisions, but stated that they are not to be relied upon as

[Footnote continued on next page…]

First, our finding is that—given the red flags that confronted him—Faber acted recklessly in representing that the Interbet transaction was an IPO. Our finding is consistent with applicable case law. See Richard H. Morrow, 53 S.E.C. 772, 779 n. 10 (1998); see also Hasho, 784 F. Supp. at 1107 ("Registered representatives have certain duties that they cannot avoid by reliance on either their employer or an issuer"); Donald T. Sheldon, 51 S.E.C. 59, 71 (1992) aff'd, 45 F.3d 1515 (11th Cir. 1995) (material misstatements and omissions by registered representatives are not excused by a representative's reliance on information from his broker or dealer); William G. Berge, 46 S.E.C. 690, 694 (1976) ("Compliance with the antifraud provisions cannot be shifted entirely to a salesman's supervisor"), aff'd sub nom, Feeney v. SEC, 564 F.2d 260 (8th Cir. 1977). Second, Faber did not show that the Firm's due diligence concluded that the Interbet transaction was an IPO. We therefore reject Faber's argument that he relied on Smith Culver's due diligence.

Faber also argues that several of his actions prove that he acted in good faith, a fact that would negate a finding of intentional or reckless conduct. In support of this claim, Faber states that he purchased shares of Interbet for his own account and the account of his father. Faber also contends that he stopped a large trade of Interbet shares once he learned that Durante was arrested in Smith Culver's Walnut Creek, California office. As to Faber's purchase of Interbet, this fact does not demonstrate that he acted with good faith when he misrepresented and omitted material facts to his customers. A registered representative's "willingness to speculate with his own funds despite his knowledge of adverse financial information cannot justify recommending the purchase or retention of such stock by customers without disclosure of that information so that the customers can make their own informed decision." Richard J. Buck & Co., 43 S.E.C. 998, 1008 (1968), aff'd sub. nom., Hanley v. SEC, 415 F.2d 589 (2d Cir. 1969). In addition, we give Faber's father's purchase of Interbet no weight because the record is devoid of any proof that his father actually purchased Interbet. The record does not contain an account statement for his father, an affidavit from his father, or any testimony at the hearing by his father. In any event, his father's alleged purchase of Interbet would not demonstrate that Faber acted with good faith as to his customers. We also find no evidence in the record, including Faber's own testimony, to support Faber's claim that he stopped a trade involving Interbet. In fact, Faber's testimony on the subject was that he stopped a trade involving SVIPON, not Interbet. We therefore give this claim no weight.

In Department of Enforcement v. Ryan Mark Reynolds, Complaint No. CAF990018, 2001 NASD Discip. LEXIS 17 (NAC June 25, 2001), we held that a respondent acted with gross negligence, but not recklessness in making misrepresentations because he conducted an adequate investigation. We also found that Reynolds did not act recklessly in omitting material facts in a document because he attempted to correct the omissions prior to the release of the document. Relying on our decision in Reynolds, Faber argues that his actions were not reckless. We disagree. The

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[cont'd]
precedent; (3) he has never conducted studies on the issue; and (4) he has never been published.

facts in Reynolds were markedly different from the facts in this case. Reynold's investigation of the issuer included personally inspecting the issuer's main asset, discussing the company with some of the issuer's potential competitors, and reviewing news articles and a study about the issuer. In contrast, Faber conducted no investigation of Interbet; rather he reviewed its marketing materials and business plan, but he relayed none of the negative information contained in them to his customers. In addition, Reynolds had limited experience in the securities industry. Considering Faber's significantly longer tenure in the securities industry, his actions were not comparable to Reynolds.

Faber argues that DM and RK ratified these transactions because they never complained or instructed Faber to sell their Interbet shares. We reject Faber's attempt to shift fault to his customers. Because Faber made misrepresentations and omissions, his customers were deprived of material facts regarding the investment. See Eichler v. SEC, 757 F.2d 1066, 1070 (9th Cir. 1985). Again, the proper focus is on Faber's conduct, not the non-action or acquiescence of his customers because customer reliance is not an element of a fraud claim when brought by NASD. We therefore reject this claim.

Accordingly, we find that Faber violated Section 10(b) of the Exchange Act, SEC Rule 10b-5, and Conduct Rules 2110 and 2120.

C. Credibility Determinations

Faber encourages us to reverse numerous findings of fact that were made by the Hearing Panel and that were based on the Hearing Panel's credibility determinations. We find no reason to reverse. First, the "credibility determination of the initial decision maker is entitled to considerable weight and deference, since it is based on hearing the witnesses' testimony and observing their demeanor." Jonathan Garrett Ornstein, 51 S.E.C. 135, 137 (1992). The Hearing Panel found the testimony of Buffalo, Worley, RK and DM to be credible. Further, the Hearing Panel found that much of Faber's testimony was contradicted by documents, inconsistent with other credible witnesses, and inconsistent with his previous testimony. The only rationale that Faber advances for overturning many of the Hearing Panel's credibility determinations is that the determinations are inconsistent with his testimony. This does not meet the burden required for us to overturn the Hearing Panel's credibility determinations.[15]

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[15] For example, the Hearing Panel made a finding of fact that Faber did not learn that DM could be receiving an inheritance from her mother until after he recommended that DM purchase Interbet. The Hearing Panel credited DM's testimony that a discussion regarding inheritance took place several months after the purchase of Interbet. The Hearing Panel observed both witnesses give their testimony on this issue and we uphold its finding.

D. Procedural Issue

Respondent argues that he was prejudiced by his inability to subpoena DM's documents "regarding suitability," including any other brokerage accounts that DM may have held. Faber explains that because Smith Culver ceased operations and many of its documents were in the custody of the Federal Bureau of Investigation and the SEC, the documents were not available to him. We find that Faber suffered no undue prejudice. First, DM testified that her account with Faber was her first account with a broker/dealer and that she had previously only invested in CDs and savings accounts. DM therefore did not hold any other brokerage accounts. Second, Enforcement provided Faber with all of the exhibits that it presented at the hearing. Enforcement did not introduce DM's account opening agreement or any suitability questionnaires. Moreover, Enforcement made available for inspection and copying by Faber all documents, other than documents that can be withheld,[16] that Enforcement obtained during the investigation of this case. See Procedural Rule 9251(a). Enforcement therefore had no unfair advantage. Third, although respondents in NASD disciplinary proceedings cannot request subpoenas, the SEC has held that NASD's disciplinary proceedings are fair. See James Elderidge Cartwright, 50 S.E.C. 1174, 1179 (1992).[17] Accordingly, we find no undue prejudice and no violation of due process.

V. **Sanctions**

For the unsuitable recommendation, the Hearing Panel ordered a one-year suspension, a $15,000 fine, and restitution of $52,215, plus interest. For the material misrepresentations and omissions, the Hearing Panel imposed a one-year suspension, a $20,000 fine, and restitution of $82,220, plus interest, and assessed hearing costs. The Hearing Panel ordered that the suspensions be served concurrently, which would have resulted in a total suspension of one year. Faber appealed the imposition of sanctions and Enforcement cross-appealed the amount of the fine imposed by the Hearing Panel.

The NASD Sanction Guideline ("Guideline") for an unsuitable recommendation suggests a fine of $2,500 to $75,000.[18] In addition, the Guideline recommends a suspension of 10 business days to one year. For egregious cases, the adjudicator should consider a longer suspension of up to two years or a bar. The Guideline for misrepresentations or omissions of a material fact suggests a fine of $10,000 to $100,000

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[16] See Procedural Rule 9251(b).

[17] Faber further states that these documents are discoverable under NASD's Arbitration Discovery Guide. The rules for NASD Arbitrations, however, are not applicable in NASD disciplinary cases.

[18] See NASD Sanction Guideline (Suitability – Unsuitable Recommendations) (2001 ed.), at 99.

when the conduct is intentional or reckless.[19] The Guideline recommends that for egregious cases, an adjudicator should consider a bar.

We find Faber's misconduct to be egregious and order that he be barred in all capacities. As we stated in our findings, the totality of Faber's actions are the focus of our assessment. Faber engaged in fraudulent sales tactics in complete disregard of his obligations to his customers. Faber's complete lack of understanding of his duties as a registered person, including his duty to disclose all material facts to his customers and ensure that investments are suitable for his customers, warrant severe sanctions. By omitting and misrepresenting material facts, and blatantly ignoring the financial situation and needs of DM, Faber caused DM to lose $52,215 that she intended to use during retirement. Faber also caused RK to make an investment without material information.

In addition, after examining Faber's conduct in light of the Principal Considerations contained in the Guidelines, we find numerous aggravating factors.[20] The Principal Considerations indicate that relevant disciplinary history is an aggravating factor. In a 1995 settlement, Faber was previously sanctioned for a violation of the suitability rule in which he made unsuitable recommendations to an elderly customer. <u>District Bus. Conduct Comm. v. Faber</u>, Complaint No. C01940043 (1995). We consider Faber's repeat violation of the suitability rule to be an aggravating factor.

Faber also has failed to accept responsibility for his misconduct, and his misconduct resulted in significant losses to customers DM and RK. Following the Principal Considerations, we find these facts aggravating. We are particularly concerned with Faber's evasiveness and lack of candor in his testimony regarding accepting responsibility. Faber's testimony—that his past disciplinary history included a violation of the suitability rule with a client that died unexpectedly—was less than forthcoming because the customer was more than 100 years old at the time of her death. Consistent with his failure to take responsibility for his actions, throughout this proceeding Faber has attempted to shift his duties and responsibilities as a registered person to his superiors. Moreover, we question whether any sanction short of a bar would affect Faber's future conduct. As part of his 1995 settlement, Faber was required to take certain corrective action, including a requirement that he provide written evidence of the basis for each recommendation made in all customer accounts and a brief statement regarding the suitability of the recommendation for the customer and how it compares with the stated account objectives. Faber failed to take this corrective action. Faber's flagrant disregard for the rules of the securities industry and his continuous attempts to avoid taking responsibility for his actions demonstrate the threat that his continued employment in the industry holds. We therefore bar Faber to prevent his further disregard of the standards that govern the securities industry.

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[19] <u>See</u> <u>id.</u> (Misrepresentations or Material Omissions of Fact), at 96.

[20] <u>See</u> Sanction Guidelines, Principal Considerations (2001 ed.), at 9.

Enforcement urges us to increase Faber's $35,000 fine because it argues that the Hearing Panel improperly discounted the amount of the fine. The Hearing Panel declined to impose a higher fine because it believed that such a fine might affect Faber's ability to pay restitution.[21] We require, however, that a respondent assert and prove an inability to pay defense. See Daniel J. Avant, 52 S.E.C. 442, 446 (1995). At the hearing below, Faber did not claim or prove an inability to pay and the Hearing Panel therefore should not have decreased Faber's fine. Fines serve an important regulatory function because they deter respondents from engaging in similar misconduct in the future. Although we would increase Faber's fine to $25,000 for the fraudulent misrepresentations and omissions, and $25,000 for the unsuitable recommendations, we do not impose these fines in light of the bar. We, however, order restitution in this case because both customers suffered a quantifiable loss as a result of Faber's misconduct.[22]

Faber cites two cases that he contends are similar to this case in which the NBCC ordered lesser sanctions. We find that the circumstances of this case are different from those cited by Faber. Moreover, it is well established that the appropriateness of sanctions is dependent on the facts and circumstances of each particular case and cannot be precisely determined by comparing the facts in any one individual case with the sanctions imposed in another proceeding. See Butz v. Glover Livestock Commission, Co., 411 U.S. 182, 187 (1973); Hiller v. SEC, 429 F.2d 856, 858-859 (2d Cir. 1970).[23]

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21 Enforcement argues that there was no evidence presented that would indicate that a higher fine would prevent Faber from paying full restitution.

22 See Sanction Guidelines, General Principals, at 6. The Hearing Panel ordered restitution to customer DM in the amount of $52,215 for each violation and stated that the order of restitution would be decreased to only one order of $52,215 if the decision became the final decision of NASD. We disapprove of the Hearing Panel's conditional order that Faber pay double restitution under certain circumstances. We therefore impose one order of restitution, but note that either violation constitutes an appropriate basis.

23 Respondent also argues that the Hearing Panel imposed separate sanctions for his violation of Conduct Rule 2110. There is no support for this claim. The Hearing Panel ordered sanctions for Faber's fraudulent misrepresentations and omissions and his unsuitable recommendations.

Accordingly, we order that Faber be barred from associating with any member firm in all capacities.[24] We order Faber to pay restitution totaling $52,215, plus interest, to DM, and $30,005, plus interest, to RK.[25] Finally, we order Faber to pay appeal transcript fees of $512.18, appeal costs of $1,000, and the hearing costs for the proceeding below.

On Behalf of the National Adjudicatory Council,

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Barbara Z. Sweeney, Senior Vice President and
Corporate Secretary

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[24] We also have considered and rejected without discussion all other arguments advanced by the respondent.

Pursuant to Procedural Rule 8320, the registration of any person associated with a member who fails to pay any fine, cost, or other monetary sanction imposed in this decision, after seven days' notice in writing, will summarily be revoked for non-payment.

[25] Interest is calculated at the rate established for the underpayment of income taxes in Section 6621(a) of the Internal Revenue Code, 26 U.S.C. § 6621(a).