

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD REGULATION, INC.

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In the Matter of

District Business Conduct Committee  
For District No. 8,

Complainant,

vs.

Kevin Lee Otto  
Milwaukee, WI,

Respondent.

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DECISION

Complaint No. C8A970015

Dated: June 28, 1999

**Associated person of member firm deposited customer funds in his personal bank account without customer's knowledge or authorization and used the funds for some purpose other than for the benefit of the customer, held, DBCC's findings of violation sustained, but sanctions imposed modified.**

Kevin Lee Otto ("Otto") has appealed the August 7, 1998 decision of the District Business Conduct Committee for District No. 8 ("DBCC") pursuant to Procedural Rule 9310. We find that Otto obtained \$22,000 from customer MSS and used those funds for some purpose other than the benefit of the customer for approximately two years without the customer's knowledge or authorization until he returned her funds to her in approximately November 1994. We order that Otto be censured, barred from associating with any member firm in any capacity, and fined \$35,000.

Background

Otto first became registered with the NASD in 1989 as a general securities representative of Blunt Ellis & Loewi ("Blunt Ellis"). Since his termination from Blunt Ellis in April 1991, Otto has been associated with three other member firms. Otto was registered as a general securities representative with Hamilton Investments, Inc. ("Hamilton") from May 1991 through August 1992, and then with Wellington Investment Services Corporation ("Wellington") from October 1992 to August 1993. In November 1993, Otto was registered as a general securities representative with First Montauk Securities Corporation ("Montauk" or "Firm") until his registration was terminated in December 1996. Otto is not currently registered with a member firm. During all times relevant to the complaint, MSS maintained securities accounts at Hamilton, Wellington, and Montauk, which accounts were handled by Otto.

Facts

MSS opened a securities account with Otto while he was registered at Blunt Ellis and maintained an account with him each time he moved to a new firm. MSS also opened accounts for

her two children, which accounts Otto also handled. Otto testified that he had been friends with MSS before she became his client at Blunt Ellis and that he had become better friends with her once she became a client. The record shows that Otto had socialized with MSS outside of the office on a number of occasions and that her second husband joined them on a few occasions. According to Otto, MSS confided in him that she was having problems in her second marriage and that she wanted to conceal funds from her husband in view of the fact that she had lost a lot of money in a previous divorce. Otto's allegation about MSS' attempts to hide funds from her husband was not corroborated by any other evidence in the record.<sup>1</sup>

The NASD began investigating this matter late in November 1994, as a result of a complaint that MSS had filed regarding Otto's handling of her account.<sup>2</sup> At that time, MSS maintained an account at Montauk that Otto handled. On November 1, 1994, MSS sent a packet of documents to the NASD that included complaint letters written by MSS (dated October 26 and November 1, 1994), copies of account statements and portfolio updates, and copies of other written communications between MSS and Otto.<sup>3</sup> The documents included handwritten notations by MSS questioning Otto's handling of funds that she had given to him for the purpose of investing in what she variously referred to as the "private investment group," "club," "investment group," and "investment club." MSS did not participate in the DBCC hearing.<sup>4</sup>

The record includes a copy of a handwritten letter that MSS received from Otto, dated February 1992, in which Otto described the so-called "investment group":

WBC is a group of people that network and bring to the table business opportunities which enable us to make some cash. These are opportunities that you and I as individuals probably wouldn't see, i.e., industrial equipment that we purchase cheaper and sell, foreclosure of homes or buildings, business ventures and so on. Again as I stated on the phone this is not an investment nor is it offered by any securities company. It has nothing to do with me as a broker or my brokerage firm. This is a private thing. It is kind of fun. I think you'll like it.<sup>5</sup>

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<sup>1</sup> In fact, MSS complained to Montauk in writing (on October 27, 1994) that her account statements did not reflect the investment at issue in this matter.

<sup>2</sup> When MSS initially provided information to the NASD, she had already filed a complaint with the Wisconsin Securities Commissioner and had complained to Montauk.

<sup>3</sup> MSS represented in her November 1, 1994 correspondence to the NASD that the packet of information that she was giving to the NASD was the same information that she had sent to the Wisconsin Commissioner of Securities in late October 1994.

<sup>4</sup> See note 14, *infra*, for a discussion of the contractual agreement that MSS entered into with Otto prior to the issuance of the complaint in this matter.

<sup>5</sup> At the DBCC hearing, Otto described the "business opportunities" that he had referenced in the letter as "anything from a phone company in Tennessee Valley that was doing cell phones that would penetrate the mountainous ranges to a ski lodge out west that I believe it was . . . in the California mountains, . . . Hydrotec Polisher Company, . . . Medical Information Verification, Z-Call, an automotive chemical manufacturing plant right in Milwaukee that she [MSS] was invited to go see herself.

MSS represented in the complaint letter dated October 26, 1994 that Otto had placed approximately \$26,500 of her funds into a "Private Investment Group." She complained that she had been provided no information about the investment subsequent to making the investment, except for verbal and written assurances from Otto that "this group" was "a special opportunity (long term)" for a "very good financial return." In the complaint letter dated November 1, 1994, MSS requested that Otto be investigated for the possible mishandling of investments made by Otto on MSS' behalf. The documents that accompanied the complaint letters show that MSS questioned why the funds that she had given to Otto for the purpose of investing in an entity called "WBC" were not reflected on her Montauk account statements and why none of the other documents that she had received from Otto contained any information, such as "names or places," about the investment group. The documents also show that MSS questioned whether an "investment group," in fact, existed and that she began requesting the return of her funds in April 1994.

Otto testified at hearing, as he had in his investigative testimony, that he had informed MSS of the existence of an investment group that he referred to as "Wisconsin Business Consortium" or "WBC" and that he had received \$22,000 from MSS at or around the time that he had given her the above-referenced note that described the investment. Otto admitted at hearing and in his investigative testimony that, in fact, no investment group by the name of "WBC" existed and that he had used the designation "WBC" to identify MSS' funds.<sup>6</sup> Otto admitted in his investigative testimony that WBC was not a legal entity and that it did not have any business plans, cash flow projections, or accounting documents.<sup>7</sup> Otto maintained that, notwithstanding WBC's status, MSS properly participated in certain business ventures by virtue of having provided money to him.

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<sup>6</sup> At one point in his testimony at the DBCC hearing Otto claimed that WBC was a "very informal" group of investors that consisted of himself, Donna LeBrecht, his one-time partner in PowerSource Battery Corporation ("PowerSource"), and David Schwonek ("Schwonek"), a business partner of Otto's. (Otto and Schwonek were partners in a business by the name of P.S. Holdings, which was set up to look at investment opportunities and acquisitions.) LeBrecht contradicted, and Schwonek failed to corroborate, Otto's claim that they were investors in an entity known as WBC.

<sup>7</sup> Otto equivocated a number of times throughout the proceedings about whether there was, in fact, an investment group. We credit his eventual admission that there was no investment club.

Otto testified that MSS' funds were largely used to pay expenses in connection with PowerSource, a company that he owned and operated with LeBrecht. PowerSource was in the business of distributing batteries and other products during the roughly one-year period of its operation. PowerSource was incorporated on March 21, 1991 and filed for bankruptcy in April 1992. LeBrecht testified that she had financed the company by putting \$25,000 into a stock that was held by Lincoln State Bank as collateral for a \$25,000 loan that was used to finance the start-up cost of the company. LeBrecht testified that shortly after the \$25,000 loan was received, Otto took money out of the company and, over the next few months, periodically paid money back into it.

LeBrecht testified that PowerSource had been "steadily losing money" and that she had approached Otto about selling the assets and splitting the debt, but that Otto had indicated that he wanted to retain the business. According to LeBrecht, Otto suggested that LeBrecht resign, which she did in September 1991. LeBrecht's testimony about the failing financial health of PowerSource is supported by its bankruptcy filing dated April 24, 1992, which reflected that the business had no net income in the two years prior to the bankruptcy.

Otto admitted that he had used the \$22,000 that he had received from MSS for expenses related to the operation of PowerSource and the investigation of other business opportunities, as well as for personal expenses. Otto claimed that he had MSS' authorization to use her money in this manner, and that her complaints to regulators resulted from her desire to assist her father in his dispute with Otto over his handling of her father's account.

Otto testified that he had advised MSS that she would be receiving a return on her WBC funds that would approximate the Treasury bill rate plus "a couple of percentage points." He also testified that he conveyed the value of MSS' WBC funds to her verbally and in writing, in response to her periodic requests. The record demonstrates that Otto sent MSS statements that he entitled "portfolio updates." According to Otto, the portfolio updates were requested by MSS and contained valuations of her securities accounts and her participation in WBC. The portfolio updates did not contain any references to NASD member firms that Otto was associated with during the period relevant to the complaint (Hamilton, Wellington, and Montauk).

Otto testified that MSS knew that she could track the value of her WBC participation under the section of the portfolio update marked "tax deferred." The record shows, however, that only one portfolio update out of a total of five that were included in the record contained any reference to "WBC."<sup>8</sup>

The correspondence provided by MSS to the NASD shows that MSS had been attempting to obtain the return of her funds since at least April 1994, and that Otto had attempted to stall her demands. By letter dated April 1994, Otto advised MSS that the "investment club" had invested "cash" and that it could take "a few weeks to find a replacement" for her position. The letter also warned MSS of the following: "Note: Once we sell your seat, we are out unless another opens up." By letter dated May 13, 1994, Otto again addressed MSS' request for the return of a portion of her funds:

It has been requested that all dividends and or capital gains to date (full & fractional units) be forwarded to you. To date of May 15, 1994 records indicate your account value at \$28,576.24. In order to keep the account active, it is requested that you keep the minimum of \$25,000 on deposit. If this is true and is your intention please verify by your signature below. A draft in the amount of \$3,576.24 shall be forwarded to you within weeks. If you have any questions please contact your club representative.

Please return this acknowledgment in the envelope provided.

The record contains a signed copy of the referenced acknowledgment bearing MSS' signature.

On June 20, 1994, Otto's personal check in the amount of \$3,576.24 was deposited into MSS' personal bank account. It was initially returned for insufficient funds, but ultimately cleared. Although MSS had been provided with a portfolio update dated June 30, 1994, indicating that the tax-deferred portion of her account had been liquidated, the record shows that, in fact, only a portion of MSS' funds had been returned -- the \$3,576.24 that she had received in the form of Otto's

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<sup>8</sup> The portfolio update dated October 12, 1994, was the only portfolio update that referenced "WBC": "WBC (Liquidation) \$26,346.83."

personal check.

MSS indicated in the documents submitted to the NASD that because it had taken so long to receive the \$3,576.24 payment, she had decided to take all of her money out of the WBC investment. In an apparent response to MSS' request to withdraw all of her money from the investment group, Otto advised MSS in a handwritten note dated July 27, 1994 of the following:

I've not yet received our exit papers for the investment club. . . . This is an exclusive club with most people of professional investment background. I pushed to get us in, therefore I can't cause a lot of wave [sic]. (emphasis in original).

Finally, on October 20, 1994, Otto paid MSS \$26,346.33 by personal check. According to Otto, this amount represented the return of MSS' money, with interest. This same amount appeared on the October 12, 1994 portfolio update under the designation "WBC Liquidation." There is no indication in the record that MSS disputed the amount that she was paid by Otto with respect to the funds at issue.

### Discussion

Based on the documentation provided by MSS, including handwritten correspondence signed by Otto, we find that MSS believed that Otto had placed her funds in an investment club called WBC. Further, after reviewing the documentary and testimonial evidence contained in the record, we find that Otto misused the funds that MSS gave to him for the purpose of investing in the so-called investment club by using those funds for his own personal benefit for almost two years, rather than for the benefit of MSS, before he returned MSS' funds to her with interest. Accordingly, we find, as the complaint alleged, that Otto violated Conduct Rule 2110 by not adhering to high standards of commercial honor and just and equitable principles of trade. See In re Bernard D. Gorniak, Exchange Act Rel. No. 35996 (July 20, 1995) (finding that respondent misused customer's funds by retaining customer's funds for seven months and not making requested trades); In re Wheaton D. Blanchard, 46 S.E.C. 365, 366 (1975) (the misuse of customer funds is "patently antithetical to high standards of commercial honor and just and equitable principles of trade").

Otto admitted that he obtained funds from MSS and that he used those funds to pay general operating expenses on behalf of PowerSource and to investigate other business opportunities. Otto said that MSS' funds were used to pay salespersons and vendors in connection with the operation of PowerSource and for expenses associated with due diligence regarding possible investment in other businesses. Otto also admitted using MSS' funds for "whatever [he] had to for personal stuff." We reject as not credible Otto's unsupported claims that MSS had knowledge of the manner in which Otto had used her funds or that she had authorized the use of her funds for Otto's, rather than her own, personal benefit.

Regarding the amount of MSS' funds at issue, Otto testified that MSS gave him a total of \$22,000, in two separate installments, for the purpose of investing in PowerSource. The record contains no documentary evidence, however, showing that the two installments -- a \$12,000 wire transfer from MSS' Hamilton account to an account in the name of PowerSource at Charles Schwab and a \$10,000 deposit to Otto's personal checking account -- were received in the manner that he had described.<sup>9</sup> Otto produced no bank statements showing the funds at issue having been

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<sup>9</sup> At the time that MSS transferred the funds at issue to Otto, Otto was still associated with

deposited into the bank accounts of either PowerSource or Otto. There also is no documentation in the record regarding the \$12,000 wire transfer from MSS' account to the Charles Schwab account. Additionally, MSS did not supply any records showing the specific amount of money that she gave to Otto for the purpose of investing in WBC.<sup>10</sup> The record also does not contain any bank records documenting the contention that MSS made in her October 26, 1994 letter, that Otto had placed "some \$26,500" of her money with the investment group. Further, as noted above, the record does not contain any corroborative evidence that MSS disputed the payment that she had received from Otto that purportedly represented a refund of her money, with interest. In light of the paucity of documentary evidence in the record regarding the amount of money that MSS placed with Otto, we rely on Otto's admissions to establish the amount of funds at issue in this case. In addition we note that Otto had provided a refund to MSS in the amount of \$3,576.24 (on June 20, 1994) and \$26,346.33 in October 1994, which, according to Otto represented MSS' investment plus interest. Thus, based on Otto's admissions and supporting documentation, we find that MSS gave \$22,000 to Otto for the purpose of investing in the investment group that Otto had described in his February 1992 handwritten letter to MSS.

The record demonstrates that Otto was desperate for funds during the relevant period. He admitted that he had used the funds at issue primarily to pay expenses related to the operation of PowerSource. He also admitted that he was not able to pay PowerSource's expenses out of the PowerSource business account essentially because PowerSource was not generating any profits. The evidence also shows that Otto was using MSS' funds for his own personal expenses and that he was obtaining loans from PowerSource and LeBrecht during the relevant period.

Otto's claim that MSS knew that her funds had been invested in PowerSource contradicted the evidence in the record. The documentary evidence provided by MSS shows that she had no knowledge of the manner in which her funds were being utilized by Otto. In addition, Otto's claim that MSS was a "participant" in PowerSource is not supported by the bankruptcy filing, which did not list MSS as either a creditor or equity holder in PowerSource.<sup>11</sup> Further, LeBrecht, Otto's partner in PowerSource, testified that there were no investors in PowerSource other than she and Otto. She also disputed Otto's claim that she was aware of MSS' investment in PowerSource.<sup>12</sup> Based on testimonial and documentary evidence contradicting many of Otto's claims about the operation of PowerSource and his dealings with LeBrecht, we concur with the DBCC's determination to credit LeBrecht's testimony over Otto's.<sup>13</sup> We find no reason, based on the record

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Hamilton.

<sup>10</sup> Otto admitted that he had not supplied MSS with any acknowledgment from PowerSource that she had deposited \$22,000 of her funds in the entity. In addition, Otto admitted that he had not given MSS any evidence of indebtedness on behalf of PowerSource or himself.

<sup>11</sup> The record does not contain information about the date of the discharge in bankruptcy.

<sup>12</sup> We also note that the record shows that Otto's receipt of MSS' funds did not occur until early 1992, approximately four months after LeBrecht had left the company.

<sup>13</sup> Otto claimed that LeBrecht had disappeared after she resigned from PowerSource in September 1991 and that he had no way of reaching her after her departure from the company. LeBrecht disputed Otto's claim. She testified that she had been at the same address since May of 1991 and that Otto had been in contact with her since her departure from PowerSource because he had sent checks to her intermittently (through March 1992) to pay off a \$4,500 loan that she had made to him in August of 1991. In addition, LeBrecht testified that Otto had contacted her sometime early in 1992 in connection with the bankruptcy action that Otto filed with respect to

before us, to disturb the credibility determination of the DBCC subcommittee that heard this case below. The Commission has stated in prior cases that credibility determinations by initial decision makers are entitled to "considerable weight and deference," since such determinations are based on hearing the witnesses' testimony and observing their demeanor. See Charles E. French Exchange Act Rel. No. 37409 (July 8, 1996); Robert E. Gibbs, 51 S.E.C. 482 (1993), aff'd, 25 F.3d 1056 (10th Cir. 1994) (Table); Anthony Ticarico, 51 S.E.C. 457 (1993); Jonathan Garrett Ornstein, 51 S.E.C. 135 (1992).

### Procedural Issues

Constitutional Claims. Otto claims that he was not afforded rights co-extensive with those mandated under the U.S. Constitution concerning governmental interference with liberty or property interests. Otto's constitutional claims are without merit because the NASD is not a state actor. Numerous courts specifically have rejected claims that the NASD and other securities self-regulatory organizations are state actors. See, e.g., First Jersey Secs., Inc. v. Bergen, 605 F.2d 690, 698, 699 n. 5 (3d Cir. 1979), cert. denied, 444 U.S. 1074 (1980); Desiderio v. NASD, 2 F. Supp. 2d 516, 519 (S.D.N.Y. 1998); Datek Secs. Corp. v. National Ass'n of Secs. Dealers, Inc., 875 F. Supp. 230 (S.D.N.Y. 1995); Shrader v. National Ass'n of Secs. Dealers, Inc., 855 F. Supp. 122, 124 (E.D.N.Y. 1994), aff'd 54 F.3d 744 (4th Cir. 1995); Bahr v. National Ass'n of Secs. Dealers, Inc., 763 F. Supp. 584, 589 (S.D. Fla. 1991).

Hearsay. MSS submitted to the NASD signed complaint letters and copies of account statements and portfolio updates (some of which included her annotations) and copies of correspondence between her and Otto. Otto asserts that MSS' letters of complaint constituted hearsay.

Hearsay is admissible in NASD proceedings, and the Commission has recognized that, in an appropriate case, hearsay statements may constitute the sole basis for findings of fact. In re Michael A. Niebuhr, Exchange Act Rel. No. 36620 (Dec. 21, 1995); In re Gary L. Greenberg, 50 S.E.C. 242 (1990), (citing Richardson v. Perales, 402 U.S. 389 (1971)). Before reliance can be placed on such evidence, however, its reliability and probative value must be assessed by examining: (1) the possible bias of the declarant; (2) whether the statement is contradicted by direct testimony; (3) the type of hearsay at issue (whether the statement is sworn or made under oath and the level of detail); and (4) whether the hearsay is corroborated by independent evidence. Richardson v. Perales, *supra*; Calhoun v. Bailar, 626 F.2d 145 (D.C. Cir. 1980); In re Richard G. Strauss, 50 S.E.C. 1316 (1992). The Commission has found customer complaint letters that were corroborated by other evidence (records of interviews with the customers by NASD examiners) to be reliable and probative evidence. See In re Allen Mansfield, 46 S.E.C. 356 (1976). Although MSS' letters of complaint and annotations constitute hearsay, we conclude that they are reliable and probative because they are corroborated by Otto's own testimony. The record is replete with Otto's admissions that he placed MSS' funds in accounts that he used for his own personal and business purposes.

Otto also argues that he was prejudiced because MSS did not testify before the DBCC. As a starting point, the record demonstrates that Otto entered into a private settlement agreement

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PowerSource. The record includes a copy of the bankruptcy filing, which shows that LeBrecht had signed the document on March 2, 1992. Finally, LeBrecht testified that she also talked to Otto in October 1992 because her attorney had recommended that she file for personal bankruptcy, and that she and Otto thereafter had signed documents relating to a Lincoln State Bank loan in connection with her bankruptcy filing.

("Agreement") with MSS on March 10, 1995, approximately five months after he had provided MSS with a refund in the amount of \$26,346.33. MSS agreed to release Otto from future liability arising out of any investments she had made with Otto.<sup>14</sup> At the time that Otto and MSS entered into the Agreement, Otto was aware that the NASD was conducting an investigation of the misconduct at issue here.<sup>15</sup>

We note that the NASD had no power to compel MSS' testimony since she is a public customer not subject to NASD jurisdiction.<sup>16</sup> The record shows that the regional attorney for District No. 8 attempted to obtain a waiver of the Agreement from Otto in order to help persuade MSS to testify in the DBCC hearing.<sup>17</sup> Despite the staff's efforts to obtain MSS' testimony, MSS

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<sup>14</sup> The record shows that MSS did not provide any additional documentary evidence or testimony after the date that she had entered into the Agreement with Otto. In the Agreement, MSS agreed to "release and forever discharge" Montauk and Otto from any and all future claims arising out of "any activity conducted in or with MSS' brokerage accounts or investments with or through Otto," in exchange for Otto indemnifying her against all tax liability that she had incurred in any and all investments that she had made with or through Otto. The Agreement contains the following language:

In consideration of the indemnification by [Otto] and [Montauk] . . . [MSS] agrees to release and forever discharge [Montauk] and Otto . . . from any and all future claims of every name and nature, both in law and in equity, arising out of any activity conducted in or with [MSS'] brokerage accounts or investments with or through Otto. . . . This release shall apply to all claims, whether known or unknown . . . [and constitutes] a full, binding and final settlement between the parties to the [Agreement]. . . . [MSS] agrees to notify in writing the [NASD], the Wisconsin Division of Securities, and any other governmental authority or self-regulatory agency with which [MSS] has communicated a complaint against Otto that the matters and disputes between them have been resolved and are satisfactorily concluded.

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In consideration of the release set forth above, Otto promises to indemnify [MSS] against and pay [MSS] all tax liability incurred by [MSS] in any and all investments she has made with or through Otto personally and/or through any private investment vehicle.

<sup>15</sup> The complaint was issued on March 14, 1997.

<sup>16</sup> With respect to Otto's argument that the NASD's right to require Otto's investigative testimony pursuant to Procedural Rule 8210 implies that he had an equal right to "depose" MSS, we note that Otto was subject to NASD jurisdiction based on his status as a registered person, whereas MSS, a public customer, was not subject to NASD jurisdiction.

<sup>17</sup> The record also shows that on April 8, 1995 -- the first day of the DBCC hearing -- the regional attorney sought and obtained a waiver from Otto in an effort to obtain MSS' testimony. The waiver was addressed to MSS and advised her of the following:

Kevin Lee Otto hereby agrees to waive all civil actions against [MSS] which may be brought with respect to all testimony or evidence [MSS] has or may give in connection with NASD disciplinary hearing C8A970015. This waiver will include, but is not limited, to any civil actions brought based on any testimony or information provided by [MSS] as any action to void or otherwise challenge the settlement agreement referenced above.

did not testify at the DBCC hearing.

The fact that the parties failed to obtain MSS' participation in the DBCC proceeding does not undermine the probative value of the documentary evidence she provided. This documentation included correspondence written and signed by Otto. In addition, MSS' allegations were corroborated by Otto's own testimony, in which he admitted (in both his investigative testimony and at hearing) that he had used MSS' funds primarily to pay expenses associated with PowerSource. Additionally, Otto admitted at the DBCC hearing that since MSS' funds were in his personal account, he had also used them for his personal expenses. Based on the foregoing, we conclude that use of the documentary evidence provided by MSS was not unfair.

Otto's Requests for Copies of Documents. Otto claims that the Staff refused to furnish him with copies of his investigative testimony and other documents. NASD's Code of Procedure, as then in effect, provided that "[t]he Committee staff . . . shall upon request make available to respondents and their counsel any documentary evidence and the names of any witnesses the staff intends to present at the hearing no later than five (5) business days prior to the hearing."<sup>18</sup> The regional attorney argues that NASD staff made available to Otto its entire non-privileged investigative file and had advised Otto when his investigative testimony was taken that he could purchase a copy of the transcript. Further, the regional attorney represents that Otto's attorney was afforded the opportunity to review a copy of the investigative transcript at no cost at the District office, but that he did not review the transcript or other documents. Moreover, the record shows that Otto personally reviewed the NASD's file in this matter in March 1998, in preparation for the hearing that took place in April 1998. In light of the foregoing, we find that staff's responses to Otto's requests were in compliance with Procedural Rule 9224.

Timeliness of NASD Action. Otto claims that he was prejudiced by a delay in the filing of a complaint in this matter and in setting the matter for hearing because of the deaths of two "key" witnesses, Gene Martin ("Martin") and Harry Pesecki ("Pesecki"), and the alleged memory failure of another witness, Otto's former sales assistant. With respect to the latter witness, Otto did not seek to adduce her testimony at the DBCC hearing, and she apparently became a "key" witness in Otto's estimation only after the issuance of the DBCC decision in this matter. The relevance and materiality of her presumed testimony has not been demonstrated.

Similarly, Otto's attorney claimed in a March 16, 1998 letter to the regional attorney that two investors (Martin and Pesecki) would have given highly relevant testimony but had recently died (Martin in late 1996 and Pesecki in February 1998). Otto claimed in his investigative testimony that he discussed WBC with Martin on one occasion, and that Martin never gave him any money. The record is devoid of evidence, however, about how, when, or to what extent Martin and Pesecki were involved in WBC, or how they would have had knowledge of Otto's dealings with MSS. Based on these facts, there is no support for Otto's argument that he was prejudiced because of the deaths of two witnesses and the alleged loss of memory of a third witness.

With respect to Otto's allegation that there was a delay in the filing of a complaint in this matter, we note that there were numerous requests for information filed by the NASD prior to the

It is unclear from the record whether or not the waiver was ever received by MSS during the course of the hearing. It is similarly unclear as to what efforts, if any, Otto took to persuade MSS to testify at the DBCC hearing.

<sup>18</sup> Procedural Rule 9224 (NASD Manual, 1996 ed.)

filing of the complaint. The NASD commenced its investigation of Otto upon receipt of MSS' complaint to the NASD in late 1994. The NASD sent a request for information to Otto on December 20, 1994, to which Otto responded on January 21, 1995. On September 28, 1995, NASD sent a request for additional information. On October 11, 1995, Otto responded by stating that he was gathering the requested documents and that he would be available to meet with the NASD sometime after October 19, 1995. On March 8, 1996, the NASD sent a request for information asking for copies of documents relevant to WBC and copies of bank records. Otto asked for more time to respond via letter dated March 11, 1996. Based on Otto's assurances that the requested documents were available for his review at Otto's office, the examiner arranged to travel from Chicago, Illinois to Otto's office in Milwaukee, Wisconsin to retrieve the requested documents and information. When the examiner arrived at Otto's office, however, Otto still did not make available to him the requested documents. An additional request for information was sent in March 1996, and Otto responded on March 25, 1996 by supplying some, but not all, of the requested documents.

By letter dated June 21, 1996, NASD staff requested that Otto appear for investigative testimony on July 9, 1996. Subsequent to the investigative testimony, which was delayed to August 1996 at Otto's request, additional information was requested and obtained from third parties during October and November 1996. Disciplinary action against Otto was authorized in January 1997 and the complaint was filed in March 1997. We find no excessive delay based on the foregoing.

With respect to Otto's claim of delay in setting this matter for hearing, we note that subsequent to the filing of the complaint on March 14, 1997, the parties engaged in settlement negotiations. Otto rejected an Offer of Settlement on January 28, 1998, and a Notice of Hearing was sent to Otto on March 12, 1998, setting the matter for hearing on April 8 and 9, 1998.<sup>19</sup> There is no evidence that the staff or the DBCC did not comply with the applicable Procedural Rules (see Procedural Rules (NASD Manual, July 1996) 9211 (issuance of complaints by DBCC); 9221 (request for hearing); and 9226 (settlement procedure)).

### Sanctions

Otto's misuse of MSS' funds was inexcusable. His misconduct, coupled with his total refusal to acknowledge that he had misused his client's funds by using her money for his own personal and business benefit, makes him a danger to the investing public. We therefore affirm the DBCC's decision that Otto be censured and barred from association with any member in all capacities. In addition, we modify the \$110,000 fine imposed by the DBCC by reducing it to a fine of \$35,000. We will first discuss our reasons for imposing a bar and then discuss the analysis we used to calculate an appropriate monetary sanction.

We have concluded that a bar is essential based on the egregious nature of Otto's misconduct.<sup>20</sup> In addition to his misuse of customer funds, Otto engaged in a series of lies and deceptions -- through telephone calls, letters, and false account information in the form of portfolio

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<sup>19</sup> Procedural Rule 9221(a) (NASD Manual, July 1996 ed.) requires that a notice of hearing date be mailed to respondent at least 10 calendar days before the hearing. In this matter, adequate notice is not an issue since the hearing notice was mailed to Otto well before the 10-day advance notice period.

<sup>20</sup> The Sanction Guideline for improper use of funds does not recommend a bar for such misconduct, however, we have concluded that a bar is essential based on the egregious nature of Otto's actions.

updates -- to cover up the fact that he had completely dissipated MSS' funds. We consider these efforts to conceal his misconduct as an aggravating factor.

We are also particularly troubled by Otto's utter failure to accept responsibility for his actions. Throughout the disciplinary process Otto refused to acknowledge that his use of MSS' funds for his own benefit was in any way improper.<sup>21</sup> Otto would have us believe that the use of MSS' funds for his own benefit was entirely appropriate because, according to Otto, he felt responsible for MSS' money and had planned on paying her a return on her so-called "participation" in his personal business ventures. In fact, MSS' funds were at risk for the entire period during which Otto exerted control over them (approximately two years). Although Otto did eventually return MSS' funds to her with interest, he did not do so promptly or voluntarily.<sup>22</sup> Through his misconduct, Otto placed his own interests above those of his client.

Additionally, we note that Otto has attempted to lay blame on others during these proceedings. He claimed: (1) that MSS had used the complaint in this case as leverage to obtain a favorable settlement for her father's complaint;<sup>23</sup> and (2) that the NASD examiner had not clearly advised him which documents needed to be produced.<sup>24</sup> The record demonstrates that these claims are entirely baseless.

Although the DBCC decision did not specify the Sanction Guideline ("Guideline") that the DBCC used to calculate the \$110,000 fine, it appears from the Department of Enforcement's brief that it used the Guideline for conversion, which recommends a fine of five times the amount

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<sup>21</sup> In his briefs on appeal, Otto primarily attacked the sanctions that were imposed by the DBCC and requested that the bar be eliminated and alternatively that a 30- or 60-day suspension be imposed. In support of his request that the bar be eliminated, Otto's attorney argues in his reply brief on appeal that while "Otto deeply regrets the incident, . . . it is not uncommon . . . for a securities agent to fail to recognize the serious nature of attempting to enter into this type of transaction." We do not consider such statement to be mitigative.

<sup>22</sup> It took Otto six months to return MSS' funds, during which time he continued to stall and delay by advising MSS that it was difficult to obtain her funds from the "group." Ultimately, the repayment to MSS occurred only after Otto had been made aware that MSS and her father were close to filing their respective complaints with the Wisconsin Commissioner of Securities and with Montauk. See note 23, *infra*, for a discussion of the complaint filed by MSS' father.

<sup>23</sup> The record shows that MSS and her father had separate complaints regarding the manner in which Otto was handling their respective accounts. The case that MSS filed with the Wisconsin Commissioner of Securities, which was based on the same misconduct at issue in this case, resulted in a settlement order that imposed a six-month suspension on Otto, which was effective on May 26, 1995. The record also shows that MSS' father entered into a settlement agreement with Montauk and Otto that required Montauk and Otto to pay MSS' father \$60,000 for alleged losses sustained by MSS' father through investments in his securities account handled by Otto at Montauk.

<sup>24</sup> With respect to Otto's claim that the NASD examiner did not make it clear to him which documents were being sought, we note that the requests for information were detailed and specific as to the information being sought. We also note that there is evidence that Otto attempted to delay the investigation. Otto consistently failed to produce all of the requested documents, to the point that the examiner was forced to drive to Otto's office, located in another city, in an attempt to obtain the requested information, which Otto still did not produce.

converted.<sup>25</sup> The complaint, however, did not charge conversion, nor did the DBCC make a finding of conversion. We have found that Otto misused MSS' funds and that the Sanction Guideline for Improper Use of Funds or Securities is therefore more analogous to this case.<sup>26</sup> The Guideline for improper use of funds recommends a fine in the range of \$2,500 to \$20,000. We have concluded that a fine above the recommended \$20,000 maximum is necessary in view of the particular facts of this case. Importantly, Otto did not "mistakenly" believe that he had authority to use MSS' funds for his own benefit, inasmuch as he affirmatively misrepresented to her that her funds would be invested on her behalf, and there is no credible evidence that MSS knew that Otto was using her money largely for operating expenses for his unsuccessful business (PowerSource).

Accordingly, Otto is censured, fined \$35,000, barred in all capacities, and assessed \$3,110.75 in DBCC hearing costs. Pursuant to Rule 9360, the bar shall be effective upon service of this decision.<sup>27</sup>

On Behalf of the National Adjudicatory Council,

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Joan C. Conley, Senior Vice President and Corporate Secretary

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<sup>25</sup> See Guidelines (1996 ed.) at 13.

<sup>26</sup> See Guidelines (1996 ed.) at 13.

<sup>27</sup> We have considered all of the arguments of the parties. They are rejected or sustained to the extent that they are inconsistent or in accord with the views expressed herein.

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