

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD REGULATION, INC.

In the Matter of

Department of Enforcement

Complainant,

vs.

John D. Morgan

Dunedin, FL,

Respondent.

DECISION

Complaint No. C07980019

Dated: August 12, 1999

On review of decision by Hearing Officer, findings reversed in part and sanctions modified. Held, respondent effected three unauthorized transactions.

This matter was called for review by the National Adjudicatory Council ("NAC") pursuant to Procedural Rule 9312 to review the September 3, 1998 decision of a Hearing Officer of NASD Regulation, Inc. ("NASD Regulation"). For the reasons discussed below, we reverse the Hearing Officer's findings that respondent John D. Morgan ("Morgan") exercised discretion without written authority and that he guaranteed a customer against loss, in violation of Conduct Rules 2330(e), 2510 and 2110. We affirm the Hearing Officer's finding that Morgan effected unauthorized transactions in violation of Conduct Rule 2110. We impose sanctions of a censure, a \$10,000 fine, and a suspension for 10 business days.

Background

Morgan first became registered with the NASD in 1986. From May through November of 1996, he was associated with Saperston Financial, Inc. ("Saperston" or "the Firm"). On November 19, 1996, Saperston filed a Uniform Termination Notice for Securities Industry Registration ("Form U-5") which stated that the Firm had terminated Morgan's employment for "facilitat[ing] a settlement without informing the home office." NASD Regulation opened an investigation to review the circumstances surrounding Morgan's termination. Morgan has not been associated with a member firm since his employment with Saperston.

Factual and Procedural History

In June of 1996, Halprin Financial, Inc., through its President D.H., established an account with Morgan at Saperston. D.H. opened the account after indicating that he would only trade based on a computer stock tracking program utilized by Morgan's branch manager at Saperston. The computer program did not recommend specific trades, but analyzed the momentum of certain screened stocks. Each morning, Morgan's manager scanned the database for stocks that were overbought, oversold, or unusually quiet in recent price movements to identify potential stock picks. Shortly after the account was opened, D.H. verbally instructed Morgan to "stop calling" and just send him, via facsimile, a list of the daily trades that Morgan had effected in D.H.'s account based on the computer model. D.H., however, never provided formal written authorization for Morgan to execute trades in the account.

From July through September of 1996, Morgan effected numerous securities transactions in D.H.'s account, some of which were not analyzed by the computer model. Among these transactions was an August 22, 1996 purchase of 1,000 shares of Hollywood Showcase TV Network ("HSTV"). Morgan effected this trade without consulting D.H., apparently in reliance on representations made by a stock promoter that HSTV would quickly increase in price. HSTV's share price, however, dropped dramatically and Morgan complained to the stock promoter. As a result of Morgan's complaint, on September 4, 1996, without D.H.'s knowledge, Morgan facilitated the deposit into D.H.'s account of 1,000 additional shares of HSTV free of charge. On September 6, 1996, without consulting D.H., Morgan sold all 2,000 shares of HSTV in D.H.'s account, resulting in an overall profit despite the fact that HSTV's share price had declined.

Hearing Officer Decision. The complaint alleged that Morgan had exercised discretion in D.H.'s account without written authority, that he had effected unauthorized transactions that were not analyzed by the computer model as instructed by D.H., and that he had guaranteed D.H. against loss. Morgan failed to answer the complaint,¹ and on June 25, 1998, the Department of Enforcement ("Enforcement") filed a motion for entry of a default decision pursuant to Procedural Rule 9215(f). Morgan failed to respond to Enforcement's motion.

On September 3, 1998, the Hearing Officer granted Enforcement's motion for entry of a default decision and issued a decision. The Hearing Officer stated that it was deeming the allegations of the complaint admitted pursuant to Procedural Rule 9215 and found that Morgan had violated Rules 2510, 2330(e), and 2110 as alleged in the complaint. The Hearing Officer specifically found, however, that Morgan had exercised discretion when he purchased and sold only the HSTV shares. The Hearing Officer also found that only the HSTV trades were unauthorized. Finally, the Hearing Officer found that Morgan had guaranteed D.H. against loss

¹ Morgan twice had been served with a copy of the complaint in accordance with Procedural Rule 9134.

by facilitating the deposit of the 1,000 additional HSTV shares in D.H.'s account free of charge. The Hearing Officer imposed sanctions of a censure, a \$10,000 fine (\$2,500 for the discretionary trading without written authority; \$5,000 for the unauthorized trading; and \$2,500 for the guarantee against loss), and a three-day suspension (for the guarantee against loss).

Discussion

We called this case for review to examine the appropriateness of the sanctions imposed. After our thorough review of the record, we modify the Hearing Officer's findings and increase the sanctions as discussed below.

Exercising Discretion Without Written Authority. Conduct Rule 2510 prohibits a registered representative from exercising discretionary power in a customer's account without prior written authorization from the customer and the firm. As noted above, the customer verbally authorized Morgan to trade based on the computer model but did not provide any writing documenting his grant of authority. Enforcement alleged that "nearly all" of the trading in the customer's account was discretionary. The Hearing Officer found, however, that Enforcement "[did] not provide an analysis of the circumstances surrounding [the] trades or the weight that should be given to them." The Hearing Officer determined that Morgan exercised discretion only when he purchased and sold the HSTV shares. We agree with the Hearing Officer that Enforcement did not provide sufficient support for its allegation that "nearly all" of the trading in the account was discretionary, but we reverse the Hearing Officer's finding that Morgan exercised discretionary power without written authority as to the HSTV trades.

We are aware that in response to the Association's request for information, Morgan admitted that he had engaged in discretionary trading in D.H.'s account. Morgan maintained, however, that not all of the trading in D.H.'s account was discretionary.² The complaint alleged that "nearly all" of the trades were discretionary, but did not set forth which trades were discretionary. Nor does the record contain any evidence from which we might discern which trades were discretionary. Thus, even though this is a default decision, which permits us to deem the allegations of the complaint admitted under Rule 9269, we are unable to determine based on the complaint or any evidence before us the number of discretionary trades effected. See, e.g., In re James M. Russen, 51 S.E.C. 675, 678 n.12 (1993) (Even when the allegations of the complaint are deemed admitted, there must be an evidentiary basis in the record to support the allegations.); Nancy H. Martin, Complaint No. C02970027 (July 28, 1998) (default decision remanded by NAC

² The record contains no statement from the customer, other than the customer's complaint letter to the Firm and certain brief memoranda that memorialized conversations between the NASD Regulation examiner and the customer. The compliance examiner's affidavit submitted in support of the motion for entry of a default decision merely stated: "According to [D.H.], most, if not all, of the trades in his account were the result of Morgan exercising the discretion [D.H.] had given him."

due to evidentiary problems under Russen standard).³

Finally, although the complaint alleged (under the cause relating to guaranteeing a customer against loss) that the HSTV trades were executed at Morgan's discretion, the complaint also alleged that the trades were made "without consulting" D.H. The Hearing Officer found that the purchase and sale of HSTV shares were unauthorized, in that these trades exceeded the scope of the oral discretion granted to Morgan to trade based on the analysis provided by the computer model. We agree that the HSTV trades were unauthorized, as discussed below. Because the HSTV trades were wholly unauthorized, rather than being executed pursuant to any oral discretionary authority, we find that Rule 2510 does not apply. Accordingly, we reverse the Hearing Officer's finding that Morgan exercised discretion without written authority.⁴

Unauthorized Trading. The complaint alleged that from July through September 1996, Morgan effected securities transactions without D.H.'s "prior knowledge or authorization in that none of the securities was identified by Saperston's computer model." The complaint alleged that the unauthorized transactions were listed on Exhibit A, but Exhibit A was not attached to the complaint nor was it part of the record before the Hearing Officer.⁵ The Hearing Officer determined that Morgan effected unauthorized transactions only in the purchase and sale of HSTV. We affirm this finding.

We are aware that the record contains some evidence that Morgan may have effected additional unauthorized trades in stocks that were not analyzed by the computer model. For example, the record contains letters from both the Firm and the customer that describe an October 1997 meeting between D.H., Morgan and the branch manager, in which the customer's account was reviewed and it was determined that some of the purchases were in stocks not analyzed by

³ We also note that the account was not opened as a discretionary account.

⁴ Although we are unable to discern which discretionary trades Morgan effected without written authority and we therefore dismiss that cause, we nevertheless emphasize that we in no way condone discretionary trading without written authority.

⁵ The Hearing Officer's initial decision did not address whether Exhibit A had been considered. Accordingly, on February 24, 1999, the Review Subcommittee of the NAC ("RSC") remanded this case for the limited purpose of determining whether Exhibit A had been served on the respondent and whether Exhibit A should be added to the record. The RSC directed that the remand be effected without reconsideration of the Hearing Officer's findings or the sanctions. On remand, the Hearing Officer held a conference to inquire whether Exhibit A had been served with the complaint, and Enforcement reported that it had not. The Hearing Officer nevertheless concluded that Enforcement had met the general pleading requirements of Rule 9212(a), and that Exhibit A need not be added to the record. Consequently, we have considered only the HSTV trading as alleged in the complaint in analyzing Morgan's unauthorized trading activity, as discussed above.

the computer model. The letters, however, do not identify which stocks were or were not computer-analyzed picks. The record also contains some evidence that the Firm paid D.H. \$4,500 in settlement for losses to his account, apparently based on unauthorized transactions; the record does not identify, however, the trades for which the Firm reimbursed D.H. Nor does the record contain any evidence for us to decipher which stocks were analyzed by the computer model; we thus cannot determine which trades might have been effected in contravention of the customer's instructions. Accordingly, like the Hearing Officer, we find that Morgan engaged in unauthorized trading only with respect to the HSTV trades.

The complaint (as set forth in the guarantee against customer loss allegation) clearly alleged that D.H. did not authorize the HSTV trades. The record also contains statements from D.H. and the Firm that indicate that HSTV was not a stock analyzed by the computer model, and that the trades were unauthorized. Accordingly, we affirm the Hearing Officer's finding that Morgan engaged in the unauthorized purchase and sale of HSTV. We also find that the additional deposit of HSTV shares into D.H.'s account was unauthorized, in violation of Conduct Rule 2110.

Guaranteeing A Customer Against Loss. Rule 2330(e) states that "[n]o member or person associated with a member shall guarantee a customer against loss in any securities account . . . or in any securities transaction effected by the member with or for such customer." The complaint alleged that Morgan guaranteed D.H. against loss by facilitating the deposit into D.H.'s account of 1,000 additional shares of HSTV free of charge after Morgan had complained to HSTV's promoter of the stock's decline in price. Although we recognize that Rule 2330(e) applies "broadly to any guarantee against loss in connection with a securities transaction as well as any such guarantee in connection with a customer's account," see, e.g., In re Curtis I. Wilson, 49 S.E.C. 1020, 1024 (1989), in this instance there was no evidence of an agreement between Morgan and the customer that could be construed as a "guarantee." Rather, we view Morgan's additional deposit of HSTV shares, which was effected without any communication with the customer, as an unauthorized transaction. Accordingly, we reverse the Hearing Officer's finding that Morgan guaranteed the customer against loss.

Sanctions

The Hearing Officer imposed sanctions at the low end of the range recommended by the NASD Sanction Guidelines. The Unauthorized Transactions Guideline recommends a monetary sanction of \$5,000 to \$75,000, and in cases involving customer loss, a suspension for 10 to 30 business days. The Hearing Officer, after acknowledging that the customer suffered no losses due to the HSTV trading, imposed only a \$5,000 fine and no suspension. Because we find that the customer clearly instructed that Morgan trade only based on the computer model, and HSTV was not one of the stocks analyzed by the computer model, we find that Morgan executed the HSTV trades in deliberate disregard of the customer's instructions. Based on the representations of the stock promoter that the price of HSTV would rise, Morgan effected an unauthorized purchase of HSTV in his customer's account. When the price declined, Morgan deposited additional shares provided by the promoter into the customer's account. Although Morgan did not attempt to

induce the customer to purchase based on a guarantee, we view Morgan's unauthorized deposit of additional shares of HSTV, in an apparent attempt to cover losses to the account without the customer's or his Firm's knowledge, as an aggravating factor that warrants a suspension.⁶ We also conclude that a fine greater than the minimum recommended by the Guidelines is warranted. We impose a fine of \$10,000 and a 10-business-day suspension.⁷

Accordingly, Morgan is censured, fined \$10,000, and suspended from association with any member in any capacity for ten business days.⁸

On Behalf of the National Adjudicatory Council,⁹

Joan C. Conley, Senior Vice-President and Corporate Secretary

⁶ Our decision to impose a 10-business-day suspension is consistent with our other recent decisions involving unauthorized trading, even though we imposed more severe sanctions in some of those cases when a respondent's conduct was considered egregious. In Daniel S. Hellen, Complaint No. C3A970031 (NAC June 15, 1999), we delineated the circumstances in which conduct may be considered "egregious" for purposes of determining sanctions in unauthorized trading cases. Here, the record is devoid of facts that would lead us to conclude that respondent's actions were egregious. In particular, we note that the record contains virtually no evidence of respondent's motives. Accordingly, we conclude that a 10-business-day suspension is appropriate in this instance.

⁷ The sanctions imposed are consistent with the Guidelines. See Guidelines (1998 ed.) (Unauthorized Transactions) at 86.

⁸ The suspension shall begin 30 days from the date of this decision.

⁹ 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.