

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD REGULATION, INC.

In the Matter of

District Business Conduct Committee  
For District No. 5

Complainant,

vs.

Respondent.

DECISION

Complaint No. C05960074

District No. 5

Dated: September 18, 1998

This matter was appealed by the Respondent pursuant to NASD Procedural Rule 9311. For the reasons discussed below, we find that Respondent engaged in outside business activity and failed fully and adequately to respond to the Association's requests for information, in violation of NASD Conduct Rules 3030 and 2110 and Procedural Rule 8210. We affirm the October 24, 1997 decision of the District Business Conduct Committee ("DBCC") for District No. 5 which imposed sanctions of a censure, an \$8,000 fine, and \$1,036 in hearing costs.

Factual Background

Respondent served as a state Senator during the conduct at issue. Respondent entered the securities industry in 1983 when Respondent became associated with an NASD member firm ("the Firm"). In May 1987, she qualified as an investment company and variable contracts principal of the Firm, and in October 1995, she resigned from the Firm as a regional vice president. Respondent has not been associated with a member firm since then.

The first cause of the complaint alleged that from March to May 1995, Respondent engaged in outside business activities in that she sold public customers newsletter subscriptions on behalf of Company A, for which she received compensation totaling approximately \$884.64, without providing prior written notice to the Firm, as more fully detailed in Exhibit A to the complaint, in violation of NASD Conduct Rules 2110 and 3030.<sup>1</sup>

The second cause of the complaint alleged that from about February 26, 1996 to the present, Respondent failed fully and adequately to respond to the Association's requests for

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<sup>1</sup> Exhibit A consists of an excerpt of a Company A filing to the Securities and Exchange Commission ("SEC") that reported commission payments.

information, as more fully detailed in Exhibit B to the complaint, in violation of NASD Procedural Rule 8210 and Conduct Rule 2110.

NASD Regulation, Inc. (“NASD Regulation”) staff investigated this matter after having received a Uniform Termination Notice for Securities Industry Registration (“Form U-5”) from the Firm which indicated that the Firm had investigated the Respondent for engaging in outside business activities.<sup>2</sup>

### Facts

Outside Business Activity. In 1994, the Respondent was introduced to Company A and its President, in Respondent’s capacity as a state official and civic leader by a close family friend (“MD”). Company A’s President discussed how membership in Company A could help church communities by giving them access to discounted computers and other products and services, and by increasing their income through the sale of newsletter subscriptions. Company A’s President and the Respondent also discussed, and eventually sponsored, a tennis tournament whose proceeds were used to help disadvantaged youth. The Respondent spoke favorably of Company A’s President to her sisters, brother, and one other acquaintance, all of whom became members of Company A. She also spoke favorably of Company A to her church.

At Company A’s President’s request, the Respondent spoke at two Company A conventions. According to the Respondent, the speeches were “not meant to be promotion pieces for [Company A],” but were “general speeches about self-development and empowerment.” Following the Respondent’s speeches at the Company A conventions, Company A’s President made donations to a number of civic organizations in her senatorial district.

According to the Respondent, MD gave the Respondent and her sisters a gift subscription and a Company A newsletter. The Respondent testified that she later learned that when she received the Company A subscription, Company A also had allocated to her a hierarchy of subscribers. Between February and June of 1995, checks totaling \$884.64 were sent to the Respondent, apparently based on subscription sales made by the hierarchy allocated to her.<sup>3</sup>

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<sup>2</sup> In July 1995, the Firm became aware of the Respondent’s involvement with Company A after receiving Company A documents that included pictures of the Respondent at Company A conventions. The Firm supplied to the NASD an affidavit executed by the Respondent in which she described her role in Company A.

<sup>3</sup> The Respondent failed to provide the staff with copies of the Company A checks as requested by the staff. The DBCC noted that the Respondent received “at least three” checks, but staff was unable to determine the exact number of checks that she received. According to the commission statements that Company A submitted to the SEC, the Respondent received a total of \$884.64 in compensation. The Respondent does not dispute having received that amount, and we therefore find it unnecessary to determine the number of checks that comprised the \$884.64 in compensation.

According to the Respondent, the checks were received by her sister who handled her book-keeping. The Respondent contended that she then donated the checks to her church.

The Respondent also discovered that Company A had photographed her for promotional purposes and had incorrectly described her as a leader of Company A. She telephoned Company A's office and demanded that they not use her picture or describe her in such a manner. On July 17, 1995, at the suggestion of the Firm, the Respondent wrote to Company A to memorialize her earlier request that it not use her photograph or name in any promotional material and she requested that Company A cancel her membership.

Failure to Respond Completely.<sup>4</sup> By letter dated November 3, 1995, the District staff requested information from the Respondent by November 17, 1995. On November 16, 1995, the Respondent contacted the staff and agreed to submit a partial response via facsimile by the end of the day, and to submit the remainder of the response via facsimile by the close of business on November 21, 1995. By letter dated November 22, 1995, the District staff sent a second request for information to the Respondent. On that same day, the staff received a letter dated November 21, 1995 via facsimile from the Respondent that responded to the staff's first November 3, 1995 request letter.

By letter dated November 26, 1995, the Respondent informed the staff that she had received the staff's November 22, 1995 second request letter and that she had responded to the request. By letter dated February 13, 1996, the staff requested that she submit additional information by February 26, 1996.<sup>5</sup> On February 26, 1996, the staff received a letter from Respondent's counsel, who stated that the Respondent wished to respond fully, but counsel had advised her not to do so until certain information had been received from the staff. In the letter, Respondent's counsel stated:

[Respondent] and numerous other African-American public officials have recently become targets of an illegal and widely denounced, both publicly and legislatively, 'investigation' by the [State A] Department of Revenue. Admissions of racism by public

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<sup>4</sup> The DBCC erroneously stated that the second cause of the complaint alleged that the Respondent failed "timely" to respond to the staff's requests for information. See DBCC Decision at 4.

<sup>5</sup> For example, the staff's November 3, 1996 letter requested information on whether the Respondent "solicit[ed] family, friends or church members to join [Company A]," and if so to provide "their names, addresses and daytime telephone numbers." In the Respondent's November 21, 1995 response, she indicated that MD had given her and her sisters subscriptions to Company A. She also indicated that her church was involved in a "Building Fund Drive," and that the checks had been donated to the church. The staff's February 13, 1996 letter subsequently requested the name of the church, the names of her siblings, individuals from the church with whom the Respondent discussed Company A and details of those conversations.

officials involved in the investigation have been shocking and now are the subject of additional investigations.

Respondent's counsel requested copies of all complaints made to the District regarding the Respondent, and "the names of any and all persons who have contacted [the staff] orally, personally or in writing regarding this matter, particularly persons acting by or through the [State A] Department of Revenue and/or any other government agency." Counsel stated that after the District produced the information, he also wanted to visit the District, review the District's file, and "discuss fully the matters about which [the staff had] inquired."

On February 27 and 28, 1996, the staff left telephone messages for Respondent's counsel. The staff received no response, and by letter dated February 29, 1996, the staff advised the Respondent that her counsel had not responded to the staff's telephone calls. The staff also advised her that it was "previously unaware of any investigation by the [State A] Department of Revenue, and that [the NASD] matter [had] no relation to [the State A Department of Revenue] investigation." In addition, the staff advised the Respondent that it generally does not produce any documents during the course of an investigation, and that copies of some of the documents that were in the staff's files could be obtained from a District Court for State B.<sup>6</sup> Finally, the staff informed the Respondent of her obligation to respond to the February 13, 1996 request by a new deadline of March 7, 1996.

By letter dated March 13, 1996, the District staff again requested the information specified in its February 13, 1996 letter. By letter dated March 20, 1996, Respondent's counsel responded that he "had yet to receive the materials [he] had requested as a preliminary condition to advising [his] client to participate in [the] investigation."

### Discussion

Outside Business Activity. Rule 3030 prohibits an associated person from being employed by or accepting compensation from any other person as a result of any business activity outside the scope of his relationship with his employer firm, other than passive investment, unless he has provided prompt written notice to the firm.

We find that the Respondent engaged in outside business activity in violation of Rule 3030. Although the Respondent testified that she was unaware that she was receiving compensation from Company A because her sister processed the checks, she stated in her November 21, 1995 response to the Association's first request for information:

[MD] gave me and [my] sisters a gift subscription to the Company A newsletter. However, [w]e did not learn of the gift for several weeks. As I recall, the publication was behind schedule, I only remember receiving one copy. [MD] knew that my Church was

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<sup>6</sup> The Securities and Exchange Commission had filed a complaint involving Company A in that court.

involved in a “Building Fund” drive. She informed me and my sisters that we could generate funds to donate to the Church from the subscriptions. We were placed in a hierarchy beneath [MD] and under each other. [MD] explained that all subscriptions [sic] holders received monthly rebates from the Company’s total subscription sales.

We find that the Respondent knew that she was a member of Company A and that she would receive compensation based on that membership. The Respondent’s testimony before the DBCC at times conflicted with the affidavit she had executed for the Firm when it investigated this matter and with her other written statements provided to the Association. We credit her written statements and affidavit over her somewhat vague DBCC hearing testimony which she gave almost two years later, by telephone, without any documents before her. The Respondent’s affidavit confirms that she knew that she was given a subscription to Company A’s newsletter. In the affidavit, the Respondent stated that “[o]ne could only subscribe [to the newsletter] if one was a [Company A ] member,” and that therefore “[she] was given a membership in [Company A ].”<sup>7</sup> The Respondent also admitted in her affidavit that she “cashed” the checks, but she stated that the proceeds had been donated to her church. She failed to substantiate that claim, however, by providing proof as the staff requested. In sum, we disagree with the Respondent’s characterization that she was “involuntarily and unknowingly ‘associated’” with Company A.

The Respondent argued that she never sold customers newsletter subscriptions, as the complaint alleges. Although we agree that the evidence does not support a finding that the Respondent personally sold Company A newsletter subscriptions to customers, we find that the Respondent’s membership and receipt of compensation, as well as her other involvement with Company A, support a finding that she in fact engaged in outside business activity as generally alleged in the complaint.<sup>8</sup> The Respondent not only received checks and a gift membership from

<sup>7</sup> At the DBCC hearing, the Respondent introduced a November 21, 1995 letter from Company A’s President which “certified” that the Respondent “is not a member of [Company A] nor has she ever been.” We place little weight on this letter, which was produced well after the fact, given that the Respondent’s earlier affidavit indicates that she received a membership and compensation from Company A.

<sup>8</sup> The complaint alleged that the Respondent engaged in outside business activity by selling subscriptions, and it alleged that the activity occurred between March and May 1995, which represented the actual time frame that the Respondent received the Company A checks. Although we have made no finding that the Respondent personally sold newsletter subscriptions, we find that she engaged in outside business activity as described above. We note that this activity included not only the receipt of compensation during the dates alleged in the complaint, but also receipt of a membership which occurred prior to that time. We find, however, that the complaint still provided respondent with sufficient notice to allow her to adequately defend the outside business activity allegation. See, e.g., In re James L. Owsley, 51 S.E.C. 524, 528 (1993) (“We recognize that, even if an administrative pleading is defective, the defect can be remedied if the record demonstrates that the respondent understood the issue and was afforded a sufficient opportunity to justify his conduct with respect thereto.”)

Company A, but also spoke at two Company A-sponsored conventions. In addition, she admittedly “spoke favorably” about Company A to family, friends, the church, and one other acquaintance. This involvement with Company A is the sort of activity that should have been reported to her Firm. The compensation the Respondent received from Company A clearly was not received with respect to a “passive investment.” Finally, it is undisputed that the Respondent did not provide notice to the Firm of her receipt of compensation and involvement with Company A.<sup>9</sup>

We recognize that the Respondent may have been involved with Company A as part of her civic and senatorial duties. This does not excuse, however, her obligation as an associated person to comply with Rule 3030’s requirements. We therefore find that the Respondent’s membership and involvement with Company A, and receipt of compensation by virtue of her membership, constituted outside business activity of which she failed to notify her employer in violation of Conduct Rules 3030 and 2110. Cf. DBCC v. Joseph Graf, No. C8A960074 (NBCC Aug. 22, 1997) (finding that respondent’s receipt of profits from sale of vacation certificates as part of multi-level marketing scheme was “compensation” in violation of Conduct Rules 3030 and 2110); DBCC v. Miguel Angel Cruz, No. C8A930048 (NBCC Oct. 31, 1997) (finding that respondent who became an “independent distributor” of NuSkin, gave “motivational speeches to prospective NuSkin clients,” and who claimed to have done “very limited . . . personal retailing,” violated Conduct Rules 3030 and 2110).<sup>10</sup>

Failure to Respond Completely. Procedural Rule 8210 authorizes the Association to require its members to “report, either informally or on the record, orally or in writing with regard to any matter involved in any such investigation.” Because the NASD lacks subpoena power over its members, “a failure to provide information fully and promptly undermines the NASD’s ability to carry out its regulatory mandate.” In re Brian L. Gibbons, Exchange Act Rel. No. 37170 (May 8, 1996), aff’d (9th Cir. 1997) (unpublished decision); In re Michael David Borth, 51 S.E.C. 178, 180 (1992).

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<sup>9</sup> The DBCC found that the Respondent’s affidavit stated that she “had received commission checks from Company A totaling \$884.64 for marketing subscriptions to her friends and family for Company A’s self-help newsletter.” See DBCC Decision at 3. We find, however, that her affidavit makes no such statement and that there is no support for such a finding elsewhere in the record. For the reasons discussed above, however, we still find that the Respondent engaged in outside business activity.

<sup>10</sup> As its basis for finding that the Respondent “received” compensation even though her sister as the bookkeeper had apparently received the checks, the DBCC found that “[g]iven the duration of payments being made to her, the Respondent had an obligation to both monitor and report the payments to her employer firm.” See DBCC Decision at 4. We think that the DBCC’s finding -- that an associated person has an obligation to monitor his or her accounts in order to detect the receipt of any unsolicited compensation that might need to be reported to an employer -- is unnecessary here. As we discussed above, we find that the Respondent knew that her membership in Company A would entitle her to compensation.

We find that the Respondent failed fully and adequately to respond to the staff's requests for information. Although she provided an initial response to the staff's first request for information, she subsequently hired counsel who advised her not to respond until the staff provided counsel with certain information. The Respondent thereafter failed to respond to the staff's two additional requests for information, which were made on February 13, 1996 (and due by February 26, 1996),<sup>11</sup> and on February 29, 1996.<sup>12</sup> An associated person who has relied on advice of counsel in refusing to respond to an NASD request for information has no substantive defense to an allegation of failure adequately to respond to requests for information. See, e.g., In re Michael Markowski, 51 S.E.C. 553, 557 (1993), aff'd, 34 F.3d 99 (2d Cir. 1994) ("reliance on counsel is immaterial to an associated person's obligation to supply requested information"); In re Darrell Jay Williams, 50 S.E.C. 1070, 1072 (1992) (associated person's failure to respond to NASD request for information about a transaction not excused where person, acting on advice of counsel, informed NASD he would cooperate fully only when litigation related to the transaction was resolved). When a respondent registers with the NASD, he or she agrees to abide by the NASD rules, which are "unequivocal with respect to the obligation to cooperate with the NASD." See, e.g. In re Michael Markowski, 51 S.E.C. at 557.<sup>13</sup>

### Sanctions

The DBCC imposed a censure, a \$1,000 fine for the Respondent's outside business activity, and a \$7,000 fine for her failure to respond completely. In assessing the sanctions, the DBCC considered that the Respondent has been out of the securities industry for more than two years, and that she therefore is subject to requalification by examination prior to becoming registered again. The DBCC imposed a fine of \$1,000, an amount at the lower end of the range recommended by the 1996 Sanction Guideline,<sup>14</sup> for the Respondent's outside business activity, because the DBCC found that the Respondent appeared not to have had a significant role with

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<sup>11</sup> In determining that the Respondent failed to provide complete responses to the staff's requests, we have considered only her conduct during the period on or after February 26, 1996, as alleged in the complaint.

<sup>12</sup> In respondent's brief, she claims that the Association failed to give notice under Procedural Rule 8221. Rule 8221, however, provides that the National Adjudicatory Council ("NAC") may provide written notice to a member when it has grounds for suspending that member due to a failure to provide requested information. That rule is not obligatory and specifically applies only to suspension proceedings initiated by the NAC; it does not apply to a disciplinary proceeding such as this one brought by the District.

<sup>13</sup> In addition, we find that the staff acted properly in denying counsel's requests for documents from the staff's files and that the Respondent improperly conditioned her response to the staff's requests for information on access to the staff's files. See, e.g., In re John F. Fiero, Exchange Act Rel. No. 39544 (Jan. 13, 1998) ("[M]embers and their associated persons may not impose conditions on their obligation to supply requested information."); In re Richard J. Rouse, 51 S.E.C. 581, 585 (1993) (same); In re Michael David Borth, 51 S.E.C. 178, 181 (1992) (same).

<sup>14</sup> See Guidelines (1996 ed.) at 36 (Outside Business Activities).

Company A. We agree. We note that the Respondent's activities did not relate to her business with the Firm or its customers in any way. We find that a fine at the lower end of the Sanction Guideline range is appropriate in this instance.

We also affirm the DBCC's imposition of a \$7,000 fine for the Respondent's failure to respond completely to the staff's requests for information.<sup>15</sup> We note that although this amount is below the recommended fine amount under the Sanction Guidelines, we find that the Respondent initially cooperated with the staff. She responded to the staff's first request for information and made efforts to follow up on the second request by communicating to staff via facsimile. She thereafter hired counsel, and subsequently refused to respond completely to the staff's information requests. Finally, we agree with the DBCC's decision not to impose a suspension because the Respondent has been out of the industry for two years and will be required to requalify prior to reentering the industry.

Accordingly, the Respondent is censured, fined \$8,000, and ordered to pay \$1,036 in DBCC hearing costs and \$750 in NAC hearing costs.

Behalf of the National Business Conduct Committee,

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Joan C. Conley, Corporate Secretary

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<sup>15</sup> This fine is below the 1996 applicable Sanction Guideline. See Guidelines (1996 ed.) at 22 (Failure to Respond or Failure to Respond Truthfully, Completely, or Timely).