

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD

In the Matter of

Department of Enforcement,

Complainant,

vs.

Morton Bruce Erenstein

Boca Raton, FL,

Respondent.

DECISION

Complaint No. C9B040080

Dated: December 18, 2006

**Respondent failed to answer a question during an on-the-record interview and did not respond timely to a written request for information. Held, findings affirmed and sanctions modified.**

**Appearances**

For the Complainant: Leo F. Orenstein, Esq., Department of Enforcement, NASD

For the Respondent: John J. Phelan, III, Esq.

**Decision**

Pursuant to NASD Procedural Rule 9311(a), Morton Bruce Erenstein (“Erenstein”) appeals a December 15, 2005 corrected Hearing Panel decision barring him from associating with any member firm in any capacity for failing to answer a question during an on-the-record interview (“OTR”) and failing to timely respond to a written request for information in violation of NASD Procedural Rule 8210 and NASD Conduct Rule 2110. After a complete review of the record, we affirm the Hearing Panel’s liability findings, but we find that the bar imposed by the Hearing Panel is not warranted under the facts of this case and reduce the sanction to a one-year suspension.

I. Factual and Procedural History

A. Morton Bruce Erenstein

Erenstein entered the securities industry in 1964 as a New York Stock Exchange registered representative. He became registered with NASD as a representative when he passed

the Series 1 examination (the predecessor to the Series 7 examination) in 1969. At the time of the alleged violations of NASD Procedural Rule 8210 and Conduct Rule 2110, Erenstein was registered with Cullum & Burks Securities, Inc.

B. NASD's Investigation and Erenstein's Responses

In or around early April 2003, NASD received a letter from an attorney written on behalf of one of Erenstein's former customers, JC. The letter stated that its purpose was "to lodge a complaint against Mr. Erenstein and [two of] his former employers." The letter accused Erenstein of misrepresenting investments, recommending unsuitable transactions, and converting \$10,000.

In May 2003, NASD initiated an investigation based upon the accusations in the letter. On May 30, 2003, NASD staff sent a letter to Erenstein requesting that he provide written responses to several questions. Erenstein, through his counsel, John J. Phelan, III ("Phelan"), responded to the letter on June 20, 2003, and provided the requested information.

On September 12, 2003, NASD made a request pursuant to Procedural Rule 8210 that Erenstein appear for an OTR on September 29, 2003. Erenstein appeared and provided testimony in connection with the investigation on October 3, 2003.<sup>1</sup> During the two-hour interview, NASD staff questioned Erenstein regarding the events that purportedly served as the basis for JC's complaint. Erenstein was responsive throughout his testimony with one exception. With respect to the \$10,000 conversion claim, Erenstein stated that the \$10,000 represented mutually agreed-upon compensation for Erenstein's assistance in helping JC liquidate a large amount of old U.S. savings bonds. When asked whether he reported the \$10,000 in question on his income tax return, Erenstein refused to answer. Because the following exchange serves as the sole basis for the first cause of action, we reproduce it in full:<sup>2</sup>

Q: The \$10,000 that you received from her [JC] for this service, did you declare that money on your income tax returns?

P: Objection. Irrelevant. He won't answer that question.

Q: I think it's relevant. Did you declare that money on your income tax return in 1998, 1999, or 2000?

P: Don't answer the question.

Q: Are you refusing to answer the question?

A: Yes.

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<sup>1</sup> The record does not reflect why the OTR was rescheduled.

<sup>2</sup> In the above exchange, "P" refers to Phelan, "Q" to Department of Enforcement ("Enforcement") staff, and "A" to Erenstein.

P: On the grounds of relevance. Nothing to do with your case.

Q: We would advise [sic.] you – Do you have the advisory for the 8210? I want to readvise you, Mr. Erenstein, that under 8210 the Association has the right to require a member, or person subject to the Association’s jurisdiction to provide information orally, in writing or electronically at a location to be specified by the Association staff. Your failure to provide information as requested by the staff could result in a recommendation for disciplinary action against you. Do you understand that?

A: Yes.

Q: It’s your position you will not answer that question?

A: On advice of counsel, I will not answer it.

On October 3, 2003—the same date as the OTR—NASD staff sent Erenstein a written request for information pursuant to Procedural Rule 8210. The letter requested copies of Erenstein’s “complete State and Federal tax returns for calendar years 1998, 1999, and 2000.” The request also stated that, if the \$10,000 in question was reported on any other tax returns, Erenstein must provide copies of those returns to the staff.

On October 31, 2003, Erenstein, through counsel, responded to the staff’s request in a five-page letter. Erenstein did not, however, provide copies of the tax returns. Instead, Erenstein again objected to the staff’s request on the basis of relevance and argued that income tax returns are subject to a heightened standard of relevance. The letter “invite[d] [the staff] to make a showing of relevance” whereupon Erenstein would “reconsider” his position. On November 3, 2003, following a telephone conversation between the staff and Phelan, the staff sent Erenstein a letter informing him that he was “currently in violation of NASD Procedural Rule 8210 for failure to produce the requested tax returns.” The letter also noted that “the fact that either [Erenstein] and/or [his] attorney believes that the requested tax returns are not relevant is no defense for failure to respond to a request made pursuant to NASD Procedural Rule 8210 since staff determines the relevancy of any and all documents that are requested.”

Following the November 3, 2003 letter, there was no correspondence between Erenstein and the staff for seven months. On June 2, 2004, NASD staff sent Erenstein a Wells notice informing him that the staff intended to recommend that a two-cause complaint be filed against him. Both causes of action were to allege violations of Procedural Rule 8210 and Conduct Rule 2110. The first allegation concerned Erenstein’s refusal to answer the question during the OTR regarding whether he had declared the \$10,000 he received from JC on his income tax return. The second allegation concerned Erenstein’s failure to produce the tax returns requested by NASD staff.

On June 21, 2004, Erenstein submitted his response to the Wells notice, and in addition, he produced a copy of his 1998 federal income tax return and an amendment to the 1998 return dated October 2003 that reflected an additional \$10,000 in income for 1998. In the cover letter to the production, Erenstein noted that the production was being made “under protest” and that neither his 1999 nor his 2000 tax return contained any entries relating to the \$10,000 in question.

Erenstein further noted that the 1998 return had been amended in 2003 because the \$10,000 was “initially overlooked . . . since there was, naturally, no 1099 from [JC].”

### C. Procedural History

On August 6, 2004, Enforcement filed a two-cause complaint against Erenstein. The first cause alleged that Erenstein violated Procedural Rule 8210 and Conduct Rule 2110 by failing to respond to a single question during his OTR. The second cause alleged that Erenstein violated Procedural Rule 8210 and Conduct Rule 2110 by failing to timely respond to the staff’s written request for copies of Erenstein’s income tax returns. Erenstein filed an answer denying that he violated Procedural Rule 8210 and Conduct Rule 2110.

A one-day hearing was held on December 14, 2004. On December 8, 2005, the Hearing Panel issued its decision. The Hearing Panel found that Erenstein violated Procedural Rule 8210 and Conduct Rule 2110 and barred him from associating with an NASD member in any capacity. In the decision, the Hearing Panel erroneously stated that Enforcement “argues that a bar is the appropriate sanction in this case.” In fact, Enforcement had consistently sought a one-year suspension.<sup>3</sup> On December 14, 2005, Erenstein’s counsel faxed a letter to the Office of Hearing Officers noting the error and requesting that the Hearing Panel review the sanction in light of the error. The following day, the Hearing Panel issued a “Corrected Hearing Panel Decision.” The corrected decision stated that “[a]fter Respondent’s counsel brought this error to the Hearing Officer’s attention, she consulted with the other Panelists in the proceeding[, and] [t]he Panel confirmed that a bar was the appropriate sanction in this proceeding, regardless of Enforcement’s recommendation.” This appeal followed.

## II. Discussion

### A. Procedural Arguments

Erenstein makes two procedural arguments on appeal. First, Erenstein cites several purported errors in the Hearing Panel decision and argues that the errors evidence either the Hearing Panel’s misunderstanding or its forgetfulness of the facts of the case. Enforcement argues that the errors Erenstein cites are either not errors or are inconsequential. We owe “‘no special deference’ to hearing panel ‘inferences and conclusions that do not hinge upon findings of credibility,’” and none of the purported errors Erenstein raises relate to credibility determinations by the Hearing Panel. *See Dep’t of Enforcement v. Dieffenbach*, Complaint No.

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<sup>3</sup> On May 4, 2005—before the Hearing Panel had issued its decision—the NASD Office of Hearing Officers was notified that Erenstein had filed a petition for bankruptcy and that, consequently, the NASD disciplinary proceeding was stayed. The petition was discharged on August 24, 2005. On November 8, 2005, Enforcement filed a motion notifying the Hearing Officer that Erenstein’s bankruptcy petition had been discharged and stating that Enforcement was “no longer seeking monetary sanctions against Erenstein in the form of a fine.” Enforcement was, however, still seeking non-monetary relief against Erenstein “in the form of a suspension.”

C06020003, 2004 NASD Discip. LEXIS 10, at \*37 n.16 (NAC July 30, 2004), *aff'd in part*, Exchange Act Rel. No. 51467 (Apr. 1, 2005), *aff'd*, 444 F.3d 1208 (10th Cir. 2006). While we find that Erenstein has identified language in the Hearing Panel's decision that is either erroneous or ambiguous, this is precisely why NASD's procedural rules provide for de novo appellate review. We have carefully reviewed all of the evidence in the record and have considered Erenstein's arguments with respect to each of the purported errors in the Hearing Panel's decision. Our independent review of the record thus cures any drafting deficiencies or errors that may exist in the Hearing Panel decision. *See Dist. Bus. Conduct Comm. v. Guevara*, Complaint No. C9A970018, 1999 NASD Discip. LEXIS 1, \*39 n.16 (NAC Jan. 28, 1999), *aff'd*, 54 S.E.C. 655 (2000).

Erenstein also argues that the delay between the disciplinary hearing and the Hearing Panel's issuance of its decision renders the decision void. There is no rule limiting the time under which a hearing panel must issue a decision. Erenstein argues that NASD Procedural Rule 9268(a) requires hearing panels to render decisions within 60 days. However, "the rule addresses the timing of the Hearing Officer's preparation of a decision (which must then be distributed to other members of the Hearing Panel), and not the issuance of the decision."<sup>4</sup> *Daniel Richard Howard*, 55 S.E.C. 1096, 1104 (2002), *aff'd*, 77 Fed. App'x 2 (1st Cir. 2003).

B. Violations of Procedural Rule 8210

NASD Procedural Rule 8210 "requires persons subject to NASD's jurisdiction to provide information and to testify if requested with respect to, among other things, its investigations." *Toni Valentino*, Exchange Act Rel. No. 49255, 2004 SEC LEXIS 330, at \*9 (Feb. 13, 2004). As has been often observed, because NASD lacks subpoena power, it must rely upon Procedural Rule 8210 "to police the activities of its members and associated persons." *Joseph Patrick Hannan*, 53 S.E.C. 854, 858-59 (1998). The failure to provide information subverts NASD's ability to carry out its self-regulatory functions and is, therefore, a serious violation. *Id.*

There is no question that Erenstein refused to answer the staff's question regarding whether he reported the \$10,000 he received from JC on his tax returns after Phelan objected to the question's relevance. Associated persons, however, "cannot take it upon themselves to determine whether information requested is material to an NASD investigation of their conduct." *Dep't of Enforcement v. Sturm*, Complaint No. CAF000033, 2002 NASD Discip. LEXIS 2, at \*9 (NAC March 21, 2002); *see Hannan*, 53 S.E.C. at 859; *Brian L. Gibbons*, 52 S.E.C. 791, 794 n.12 (1996). And even though Erenstein based his refusal to answer on his counsel's advice, the Commission has held numerous times that "[r]eliance on counsel is immaterial to an associated person's obligation to supply requested information to the NASD." *Michael Markowski*, 51 S.E.C. 553, 557 (1993), *aff'd*, 34 F.3d 99 (2d Cir. 1994); *see Joseph G. Chiulli*, 54 S.E.C. 515,

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<sup>4</sup> Moreover, as Erenstein notes, the proceeding was stayed for over three months because of Erenstein's bankruptcy filing. The record also indicates that, although the discharge order was signed on August 24, 2005, the Hearing Panel was not informed of this fact until November 8, 2005.

524 (2000). Erenstein's failure to respond to the staff's question during the OTR constitutes a violation of Procedural Rule 8210 and Conduct Rule 2110.<sup>5</sup>

With respect to the written request for copies of Erenstein's tax returns, Erenstein argues that he made good-faith legal objections to the staff's request and that his counsel sought to negotiate the request with the staff, to no avail. We have found numerous times that, contrary to what may be the case in civil litigation, tax returns must be produced if requested by the staff during the course of an investigation. *See Dep't of Mkt. Regulation v. Ryan & Co.*, Complaint No. FPI040002, 2005 NASD Discip. LEXIS 8, at \*19-20 (NAC Oct. 3, 2005); *Sturm*, 2002 NASD Discip. LEXIS 2, at \*6-10; *Dist. Bus. Conduct Comm. v. Chlowitz*, Complaint No. C02980025, 1999 NASD Discip. LEXIS 31 (NAC Nov. 4, 1999). While Erenstein may make a reasonable argument with respect to the discoverability of tax returns in civil litigation, the law surrounding civil discovery procedure simply is not applicable to an NASD request for information from a registered person. Erenstein's correspondence with the staff essentially states that, until the staff explains the relevance of its request to the investigation, Erenstein will refuse to comply with the request. This is not a demand that a registered person is entitled to make.<sup>6</sup> *See Valentino*, 2004 SEC LEXIS 330, at \*11 & n.7 (NASD "members and associated persons may not impose conditions . . . under which they will respond to NASD requests for information."); *Hannan*, 53 S.E.C. at 859 (same). On November 3, 2003, Erenstein was informed that he was in violation of Procedural Rule 8210, that reliance on counsel was not a defense, and that a dispute as to relevance was also not a defense. While Erenstein may have wanted a more substantive response to his objections, the language of the letter is clear. Because Erenstein did, however, eventually produce the requested tax return, we find, as alleged in the complaint, that he failed to timely respond to Enforcement's written request for information in violation of Procedural Rule 8210 and Conduct Rule 2110.

### C. Sanctions

The NASD Sanction Guidelines ("Guidelines") state that, if a person does not respond to an NASD request for information in any manner, a bar should be the standard sanction.<sup>7</sup> If there

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<sup>5</sup> A violation of Procedural Rule 8210 constitutes a violation of Conduct Rule 2110. *Paz Sec., Inc.*, Exchange Act Rel. No. 52693, 2005 SEC LEXIS 2802, at \*1 n.1 (Oct. 28, 2005), *petition for review filed*, No. 05-1467 (D.C. Cir. Dec. 22, 2005). Conduct Rule 2110 requires that "a member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade." NASD Rule 115 provides that NASD rules apply to all members and persons associated with a member and that such persons have the same duties and obligations as a member under the rules.

<sup>6</sup> NASD is not "required to justify its information requests." *Robert Fitzpatrick*, 55 S.E.C. 419, 425 n.16 (2001), *petition for review denied*, 2003 U.S. App. LEXIS 8767 (2d Cir. May 9, 2003).

<sup>7</sup> *NASD Sanction Guidelines* 35 (2006), [http://www.nasd.com/web/groups/enforcement/documents/enforcement/nasdw\\_011038.pdf](http://www.nasd.com/web/groups/enforcement/documents/enforcement/nasdw_011038.pdf).

are mitigating factors present, or the person did not respond in a timely manner, adjudicators should consider suspending the individual in any or all capacities for up to two years.<sup>8</sup> For failing to respond in a timely manner, the Guidelines also suggest a fine of \$2,500 to \$25,000.<sup>9</sup>

The Guidelines state that aggregation or “batching” of violations may be appropriate for purposes of determining sanctions if, among other things, “the violations resulted from a single systemic problem or cause that has been corrected.”<sup>10</sup> Both the oral request made by the staff during the OTR and the follow-up written request sought the same information. We find that, under these circumstances, it is appropriate to aggregate the two causes of action for purposes of determining sanctions. We further find that, because the requested material was ultimately produced, it is appropriate to sanction Erenstein for a failure to respond timely, rather than for a complete failure to respond.

The Guidelines list two principal considerations for adjudicators to assess in determining appropriate sanctions for violations of Procedural Rule 8210 in addition to the principal considerations applicable to all violations.<sup>11</sup> First, adjudicators are instructed to consider the nature of the information requested. Here, the information sought by the staff was circumstantial evidence as to whether Erenstein may have converted his customer’s funds. Because JC refused to cooperate with NASD’s investigation, the staff’s ability to assess the veracity of her allegation was limited to the use of circumstantial evidence and Erenstein’s testimony. Because Erenstein’s treatment of the \$10,000 on his personal tax returns could evidence whether Erenstein considered the funds compensation or whether the \$10,000 was ill-gotten, this additional circumstantial evidence was of some importance to the staff’s investigation.

Second, adjudicators are advised to consider whether the information was provided and, if so, the number of requests made, the time it took the respondent to respond, and the degree of regulatory pressure required to obtain a response.<sup>12</sup> In this case, Erenstein ultimately provided the requested information, but only after he received a Wells notice informing him that the staff intended to recommend disciplinary action. Erenstein had been alerted seven months earlier that the staff considered him to be in violation of Procedural Rule 8210 because of his refusal to provide copies of his tax returns. While Erenstein is correct that he produced the information before a complaint was filed, he did not produce it until the staff already considered him to be in violation of Procedural Rule 8210 and had notified him of the staff’s intention to recommend disciplinary action. While we do give some consideration to the fact that the information was produced before the initiation of formal disciplinary action, it is of limited weight because the

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<sup>8</sup> *Id.*

<sup>9</sup> *Id.*

<sup>10</sup> *Id.* at 4 (General Principles Applicable To All Sanction Determinations, No. 4).

<sup>11</sup> *Id.* at 35.

<sup>12</sup> *Id.*

information was not produced until after the receipt of a Wells notice.<sup>13</sup> *See Dist. Bus. Conduct Comm. v. Goldstein*, Complaint No. C02950053, 1997 NASD Discip. LEXIS 50, at \*22-30 (NBCC Aug. 28, 1997). A Wells notice, while not the initiation of formal disciplinary action, is nonetheless significant regulatory pressure.

Erenstein argues that, given the facts of this case, the sanction of a bar is excessive. We agree. His refusal to answer one question during the OTR, while a violation of Procedural Rule 8210, was based on his counsel's apparently good-faith objection, and, most importantly, Erenstein ultimately produced the requested document.<sup>14</sup> Given these factors, the importance of the information requested, and the fact that Erenstein did not produce the information until he received a Wells notice, we find that a one-year suspension is appropriately remedial.<sup>15</sup>

### III. Conclusion

We affirm the Hearing Panel's finding that Erenstein violated Procedural Rule 8210 and Conduct Rule 2110 by failing to respond to a question during an on-the-record interview and by failing to timely respond to a written request for information. We find, however, that the Hearing Panel's imposition of a bar in this case was not warranted. Accordingly, we suspend Erenstein from associating with any NASD member in any capacity for one year.<sup>16</sup>

On behalf of the National Adjudicatory Council,

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Barbara Z. Sweeney,  
Senior Vice President and Corporate Secretary

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<sup>13</sup> One of the purported errors Erenstein raises on appeal is the statement in the Hearing Panel's corrected decision that "the NASD should not have to initiate disciplinary proceedings to obtain a response to a request for information under Rule 8210." Erenstein argues that a Wells notice "is NOT the commencement of a proceeding." While Erenstein is correct that the filing of a complaint, rather than the issuance of a Wells notice, marks the initiation of a formal disciplinary proceeding, the broader point made by the Hearing Panel is nonetheless true: registered persons are expected to comply with NASD requests without the need for the staff to resort to the threat of disciplinary action.

<sup>14</sup> Although, as stated above, reliance on counsel is not a defense to liability under Procedural Rule 8210, we have recently noted that "even if a respondent cannot meet the requirements necessary to invoke reliance on counsel as an affirmative defense, adjudicators may still consider reasonable reliance on counsel as a mitigating factor." *Dep't of Enforcement v. Respondent Firm*, Complaint No. 01040001, 2005 NASD Discip. LEXIS 47, at \*31 (Sept. 6, 2005).

<sup>15</sup> As noted above, Enforcement sought a one-year suspension.

<sup>16</sup> We also have considered and reject without discussion all other arguments of the parties.