NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. ALVIN W. GEBHART, JR. (CRD #1005905), Fallbrook, CA, and DONNA T. GEBHART (CRD #2708528), Fallbrook, CA, Respondents.	:	Disciplinary Proceeding No. C02020057 **HEARING PANEL DECISION** Hearing Officer - SW Dated: February 9, 2004

For offering and selling unregistered securities, through negligent material omissions, without obtaining prior approval of his employer, in violation of NASD Conduct Rules 2110 and 3040, Respondent Alvin W. Gebhart, Jr. was suspended for 12 months in all capacities and fined $100,000.

For assisting Respondent Alvin W. Gebhart, Jr. to offer and sell unregistered securities, through negligent material omissions, without obtaining prior approval of her employer, in violation of NASD Conduct Rules 2110 and 3040, Respondent Donna T. Gebhart was suspended for 7 months in her capacity as general securities representative and fined $7,500. The Hearing Panel also ordered the Respondents to pay jointly and severally the $5,141.21 costs of the Hearing.

Appearances

Sylvia M. Scott, Esq., Regional Attorney, and David A. Greene, Esq. Regional Counsel, Los Angeles, California, for the Department of Enforcement.

Charles F. Goria, Esq., and John H. L'Estrange, Jr., Esq., San Diego, California, for Respondents Alvin W. Gebhart, Jr. and Donna T. Gebhart.

DECISION

I. Procedural Background

On December 13, 2002, the Department of Enforcement ("Enforcement") filed a four-count Complaint against: (i) Alvin W. Gebhart, Jr. ("Respondent AG"), and his wife, Donna T. Gebhart ("Respondent DG"), (collectively, the "Gebharts" or the "Respondents"); and (ii) John T. Archer ("Mr. Archer"), concerning the sale of promissory notes issued by MHP Conversions, LLC, a California limited liability company ("MHP"). On March 11, 2003, the Hearing Officer held Mr. Archer in default for his failure to participate in a scheduled pre-hearing conference and for his failure to respond to an order to show cause.

Accordingly, the Hearing only addressed the allegations of counts one, two, and three of the Complaint against the Gebharts. Count one of the Complaint alleges that the Gebharts offered and sold unregistered securities, in the form of promissory notes issued by MHP, in violation of NASD Conduct Rule 2110. Count two of the Complaint alleges that the Gebharts sold the MHP promissory notes fraudulently, by failing to disclose material adverse information concerning MHP, in violation of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), SEC Rule 10b-5, and NASD Conduct Rules 2110 and 2120. Count three of the Complaint alleges that the Gebharts failed to obtain prior written approval from their employer, Mutual Service Corporation ("Mutual Service"), before selling the MHP promissory notes, in violation of NASD Conduct Rules 3040 and 2110.

The Gebharts admitted participating in the sales of the MHP promissory notes, from 1997 to 2000, but they denied that the MHP promissory notes were securities. Accordingly, they denied that they sold unregistered securities, as alleged in count one of the Complaint. The Respondents also denied that they fraudulently failed to disclose material information about MHP, as alleged in count two of the Complaint. The Respondents denied that they failed to advise their employers of their activities, as alleged in count three of the Complaint.

On May 28-30, 2003, the Hearing Panel, composed of an NASD Hearing Officer and two current members of the District 2 Committee, held a Hearing on this matter in Los Angeles, California.[1] At the request of the Hearing Panel, the Respondents filed a post-hearing submission on June 10, 2003, which was accepted by the Hearing Panel. Also at the request of the Hearing Panel, Enforcement and the Respondents filed post-hearing briefs on July 16, 2003. The Hearing Panel held deliberations on August 5, 2003 and December 15, 2003.

II. Findings of Fact and Conclusions of Law

A. Jurisdiction

1. Respondent AG

In May 1983, Respondent AG initially registered with NASD as an investment company and variable contracts products representative ("IC representative") with The Prudential Insurance Company of America ("Prudential"). (JX-1, p. 6; Stip. at ¶2). On January 30, 1996, Respondent AG became associated with Mutual Service as an IC

[1] References to the testimony set forth in the transcripts of the Hearing will be designated as "Tr. p." with the appropriate page number. Enforcement exhibits will be designated as "CX-", and the Respondents' exhibits will be designated as "RX-GS-" with the appropriate page number or paragraph number.

representative. (JX-1, p. 4). On December 10, 1997, Respondent AG passed his Series 7 general securities representative qualifying examination and became associated with Mutual Service as a general securities representative. (Stip. at ¶2). On August 11, 2000, Mutual Service terminated the registrations of Respondent AG. (JX-1, p. 4).

2. Respondent DG

On February 13, 1996, Respondent DG initially became registered with NASD through Pacific Mutual as an IC representative. (Tr. p. 509). Subsequently, on February 14, 1996, Respondent DG became associated with Mutual Service as an IC representative. (Stip. at ¶3; JX-2, p. 4). On April 27, 1998, Respondent DG passed her Series 7 general securities representative qualifying examination and became associated with Mutual Service as a general securities representative. (Stip. at ¶3). On August 11, 2000, Mutual Service terminated the registrations of Respondent DG. (JX-2, p. 4).

3. The Respondents

The Respondents registered with Sentra Securities Corporation ("Sentra") as general securities representatives and IC representatives on August 7, 2000. (JX-1, p. 3; JX-2, p. 3). When the Complaint was filed against the Respondents on December 13, 2002, the Respondents were registered as general securities principals, general securities representatives, and IC representatives with Sentra.[2] Accordingly, NASD has jurisdiction over the Respondents.

[2] On June 5, 2001, Respondent AG was registered with Sentra as general securities principal. (JX-1, p. 3). On July 3, 2001, Respondent DG was registered with Sentra as a general securities principal. (JX-2, p. 3).

B. Background

1. Mobile home park conversion program

Community Service Group ("CSG") was formed in the early 1990s to manage mobile home parks and to facilitate conversion of the park from single ownership to multiple ownership by the park's residents.[3] (CX-50, p. 29). CSG initially established a separate entity owned by the principals of CSG, which took title and operated the park until the residents could purchase it. (Tr. pp. 478-479; RX-GS-4). The separate entity obtained financing by selling notes secured by first and second trusts on the property.

MHP was created in 1997 to facilitate the financing of multiple conversions. (Tr. p. 678). MHP was to issue notes to obtain funds to acquire mobile home parks. (RX-90, p. 624). MHP would then subdivide the parks into individual lots corresponding to the number of spaces in the park, sell the individual lots to the mobile home park tenants and repay the notes when the lots were sold.[4] (Tr. pp. 836-837; RX-90, p. 624).

2. Chronology

a. The period prior to the Gebharts providing information to Mutual Service about the mobile home park conversion programs of CSG and MHP

Respondent AG began working for Prudential on June 1, 1980. (JX-1, p. 6). On May 16, 1983, Respondent AG became registered with Prudential as an IC representative, and his insurance product line expanded to include variable annuities and mutual funds. (JX-1, p. 6; Tr. pp. 373-375).

[3] A mobile home park conversion was described as being very similar to the conversion of an apartment to a condominium through the formation of a homeowners' association. (Tr. pp. 469-470).

[4] The residents' purchase of the mobile home park was financed by a number of entities, including private financings, municipalities, the State of California, and the U.S. Department of Housing and Urban Development. (Tr. p. 660).

From March 1994 to January 1996, Respondent AG was registered as an IC representative with MONY Securities Corp. ("MONY"). (JX-1, p. 5). At MONY, Respondent AG's business also consisted primarily of insurance products and mutual funds. (Tr. p. 389).

At MONY, Respondent AG met Mr. Archer, an IC representative. (Tr. pp. 417-418). Mr. Archer first became aware of the CSG mobile home park conversion program in 1993, through one of its employees, Mr. Mounier, whom Mr. Archer had known since the 1970s. (RX-GS-90, pp. 301-302). In June 1994, Mr. Archer began selling CSG promissory notes to certain of his clients. (RX-GS-90, p. 93).

In 1995, Mr. Archer discussed with Respondent AG the possibility of Respondent AG's clients investing in promissory notes issued by CSG to finance the purchase of mobile home parks. Mr. Archer explained that CSG would re-sell the land to the parks' residents, thereby converting the mobile home parks to residential ownership. (Tr. p. 420). Mr. Archer reported to Respondent AG that he had discussed the CSG mobile home park conversion program with a MONY compliance officer in 1994, and that the compliance officer had seen no problems with the program. (Tr. p. 827; RX-GS-90, pp. 98-102). Mr. Archer also told Respondent AG that he had several conversations with their MONY agency manager about the CSG program, and the agency manager did not see any problem with the program. (Id.).

Respondent AG had no reason to distrust Mr. Archer, he knew that his MONY agency manager recruited Mr. Archer to join MONY and spoke very highly of Mr. Archer. (Tr. p. 813). Subsequently, Respondent AG introduced three customers to Mr. Archer. (Tr. p. 419; Schedule B to Stip.). Based on Mr. Archer's presentation, the

Respondents, as well as three customers, purchased CSG promissory notes.[5] (Tr. pp. 419-420; Schedule B to Stip.).

On January 30, 1996, Respondent AG became associated with Mutual Service as an IC representative. (JX-1, p. 4). Respondent AG was located in his own office doing business as "Integrated Planning Service." (Tr. p. 562). Mutual Service provided Respondent AG with a number of written documents to assist him in setting up his office; but there was no on-site supervision. (Tr. pp. 279-280).

In June 1995, Respondent DG terminated her 25-year career as a court reporter because of injuries sustained in a 1994 car accident, and began assisting her husband in his business. (Tr. pp. 507-508). In February 1996, she became registered as an IC Representative with Mutual Service, sharing the office with Respondent AG. (Tr. p. 516). After the Gebharts' California office was set up, Mutual Service's home office principals in Florida served as the Respondents' supervising principals; there was no specific individual assigned the responsibility for supervising the Gebharts' office. (Tr. pp. 279-280).

Mutual Service's Policies and Procedures Manual required representatives to disclose all relationships for which they would be remunerated prior to entering into such relationships, and provided that the Firm had the right to approve or disapprove any such activity. (CX-60, p. 2). The Firm's Policies and Procedures Manual discussed the

[5] On January 10, 1996, CSG executed a promissory note to Respondent AG's customer NM for $25,000. (CX-28, p. 3). On April 26, 1996, Respondent AG's customer RD invested $10,000 in the program; on May 10, 1996, Respondent AG's customer CW invested $10,000 in the program; on October 2, 1996, the Gebharts invested $7,000 in the program; and on October 3, 1996, a trust for CW and her husband invested an additional $20,000 in the program. (Schedule B to Stip.).

requirement for approval of private securities transactions but did not provide a definition of a security. (CX-60, pp. 3-4).

In October 1996, Mr. Archer suggested that the Respondents present the CSG notes to their clients as possible investments. (Tr. p. 828). Mr. Archer described the program underlying the notes in greater detail, and again advised the Respondents that MONY had not objected to him selling the notes. (Tr. p. 827; RX-GS-90, pp. 223-224). Mr. Archer had advised the Respondents that the MHP promissory note was not a security. (Tr. p. 555). Mr. Archer, nonetheless, advised the Respondents to contact their employer to avoid selling away problems. (Tr. p. 826).

b. <u>Information concerning mobile home park conversion program provided to Mutual Service</u>

On October 23, 1996, Respondent AG called the Compliance Department of Mutual Service to discuss the CSG program and spoke with Michael Poston, Mutual Service's Compliance Director. (Tr. pp. 96-99, 828-829; CX-72). The Respondents testified that Respondent AG called the Compliance Department specifically to confirm that there was no problem with their participation in the CSG program. (Tr. pp. 792, 828). Mr. Poston testified that he discussed the program with Respondent AG briefly, but it was his understanding that Respondent AG had not participated in, and was not interested in participating in, selling investments in mobile home park conversions.[6] (Tr. p. 361).

On the same day, Respondent AG sent Mr. Poston follow-up correspondence with information concerning the CSG mobile home park conversions that he had received from Mr. Archer. (Tr. p. 832; CX-72). There is no dispute that documents concerning CSG's

[6] Mr. Poston testified "I asked him had he sold the products and he told me 'no,' so I took that as an indication that he again, had no interest in it." (Tr. p. 361).

mobile home program were sent to Mutual Service, but there is some disagreement about what was included.[7] (CX-72).

Although Mr. Poston testified "I didn't know what to make of it," neither Mr. Poston, nor anyone from the Compliance Department, ever contacted the Respondents about the materials that had been sent.[8] (Tr. pp. 108, 290). On the other hand, the Respondents did not call Mutual Service's Compliance Department to follow-up on their correspondence. (Tr. pp. 837-838).

The Respondents erroneously assumed that the approval procedure for the CSG notes would be similar to the approval procedure for their other outside activities, such as insurance. (Tr. pp. 793, 838). In the past, after providing notice of an activity to Mutual Service, Mutual Service would contact the Respondents if there were issues with the activity, but Mutual Service would not contact them if there were no issues. (Tr. pp. 793, 838). Consequently, the Respondents sent in the notice, waited a period of time, and upon hearing nothing from the Firm, they began participating in the sale of the CSG

[7] Both Mr. Poston and Respondent AG agreed that the materials included: (i) local newspaper articles concerning successful trailer park conversions; (ii) favorable "testimonials" representing what former mobile home park owners had allegedly said about CSG; and (iii) single page abstracts of various trailer park deals. (Tr. pp. 101-102, 107-108, 838). Respondent AG testified that the materials also included a description of the conversion process and pro forma financial information, but Mr. Poston denied that the material included those materials. (Tr. p. 837; RX-GS-24). Based on Respondent AG's demeanor, the Hearing Panel believed Respondent AG's testimony that the material he sent to Mr. Poston at Mutual Service included everything that he had received from Mr. Archer, including the conversion process description. Mr. Poston's contrary testimony about the enclosures was based solely on his memory of looking at the material in 1996; Mr. Poston did not have the benefit of a copy of the enclosures in the Firm's files to confirm his memory. (Tr. pp. 292-293).

[8] Mr. Poston testified that he assumed that Respondent AG had heard of mobile home park programs and was calling to find out if the Firm had a position on it. (Tr. p. 99). Mr. Poston testified that the telephone conversation was "just a general conversation." (Tr. p. 358). Mr. Poston had more than 800 representatives under his supervision at the time. (Tr. p. 278).

notes.[9] (Id.). Respondent AG testified that, knowing that Respondent DG had spoken with Mr. Poston about the program, she "relied" on Mr. Poston to advise them if the CSG notes were securities. (Tr. pp. 557-558).

c. The period after documents sent to Mutual Service's compliance department but before the Respondents became general securities representatives

In February 1997, MHP was formed and began issuing all the promissory notes to finance CSG's mobile home park conversion program. (Tr. pp. 678-679). In 1997, the Respondents began to include the MHP notes as one of the investment options that they presented to their customers when proposing a financial plan. (Tr. p. 484).

In August 1997, the Respondents completed the Firm's July 30, 1997 Compliance Survey. (CX-65; CX-66). By executing the survey, among other things, the Respondents represented that they: (i) had notified the Firm in writing of all outside business relationships for which they received compensation; and (ii) had not engaged in private securities transactions, as defined in the Firm's Policies and Procedures Manual, without written approval from the Firm's Compliance Department. (CX-65; CX-66). From January 1, 1997 to August 30, 1997, the Gebharts participated in 11 MHP promissory note transactions raising $378,195, including a $5,939.51 investment from the Respondents. (Schedule B to Stip.). Nevertheless, the Respondents believed their 1997 representations were true, because of their October 1996 communications to Mutual

[9] Mutual Service's outside business activities section of its Manual stated, "These outside business activities must always be reported to the Compliance Department and, in some cases, must be approved by [Mutual Service] in writing before a Representative may proceed." (emphasis added). (CX-76, pp. 51, 124 and 198). There was no definition of the phrase "in some cases," and, therefore, no indication that, after reporting the CSG program as an outside business activity, the Respondents should wait for affirmative written approval from Mutual Service before participating in the sale of CSG notes.

Service regarding the mobile home conversion program, and because they did not believe the MHP promissory notes were securities.

On November 17, 1997, Joshua Helmle, the Firm's compliance auditor, completed the first audit of the Gebharts' office. (RX-GS-25, pp. 1-5). The auditor reviewed the Respondents' business logs, which included the MHP transactions.[10] (RX-GS-26). In connection with the audit, the Respondents each completed the Firm's Representative Questionnaire. (CX-63; CX-64). Among other things, the Questionnaire specifically asked (i) whether the representative had received compensation from sources other than the Firm for initiating or processing a transaction in any type of investment, and (ii) whether the representative had ever participated in any offering of general partnership interests, commercial paper, promissory notes, or joint venture participations other than through the Firm. (CX-63, p. 2; CX-64, p. 2). Respondent AG and Respondent DG each answered "no" to both questions.[11] (Id.). In 1997, the Respondents earned $7,401 in commissions on the MHP promissory notes program. (CX-77, p. 7).

d. The period after the Respondents became general securities representatives

On December 10, 1997, Respondent AG passed the Series 7 qualifying examination and became associated with Mutual Service as a general securities

[10] Mr. Helmle denied that the business logs included the MHP transactions and stated that the business logs were handwritten. (Tr. pp. 610, 612). The Respondents stated that the business logs were computer-generated. (Tr. pp. 568-569, 763). In her deposition testimony, Ms. LP, who was the Gebhart's office manager at the time, testified that the business logs were computed-generated. (RX-GS-72, pp. 26, 45). Ms. LP also confirmed that she input the MHP transactions into the Gebharts' business logs. (RX-GS-72, pp. 45, 64). The Hearing Panel found that Ms. LP had no reason to falsify her testimony in a manner favorable to the Respondents. Customer LT, the brother-in-law of Ms. LP, testified that Ms. LP terminated her relationship with the Gebharts on "less than friendly terms." (Tr. p. 66).

[11] At the time, Respondent DG believed that "no" was a correct answer because he was not receiving income from any entity that he had not already disclosed to Mutual Service. (Tr. pp. 532-533).

representative. (Stip. at ¶2). On April 1998, Respondent DG passed the Series 7 qualifying examination and became associated with Mutual Service as a general securities representative. (JX-2, p. 7).

In July 1998, the Respondents completed the Firm's 1998 Compliance Survey. (CX-68; CX-69). Among other things, the Respondents again represented that: (i) they had notified the Firm in writing of all outside business relationships for which they received compensation; and (ii) they had not engaged in private securities transactions as defined in the Firm's Policies and Procedures Manual, without written approval from the Firm's Compliance Department. (CX-68; CX-69). In making these representations, the Respondents again relied on their disclosure of information in October 1996 and their belief that the notes were not securities, even though from January 1998 to August 1998, the Gebharts had initiated 25 MHP promissory note transactions raising $369,429, including a $6,462.17 investment from the Respondents. (Schedule B to Stip.; CX-68; CX-69).

On September 14, 1998, the Respondents sent an inquiry to the operations department of Mutual Service regarding the appropriateness of MHP promissory notes for a 403(b) account of one their customers. (RX-GS-33). Mutual Service's operations department asked certain questions about the product on September 18, 1998, and ultimately approved the product for inclusion in the 403(b) account on September 24, 1998. (RX-GS-34; RX-GS-35).

On February 1, 1999, Respondent AG and Respondent DG each completed the Firm's 1999 Representative Questionnaires in connection with the 1999 audit of their office. (CX-70; CX-71). Among other things, the Representative Questionnaire

specifically asked whether the representative had ever participated in any offering of general partnership interests, commercial paper, promissory notes, or joint venture participations other than through the Firm. (CX-70, p. 3; CX-71, p. 3). For fiscal year 1998, the Gebharts earned $21,510 from the MHP promissory note program. (CX-77, p. 7). Respondent AG answered "yes" and added the phrase "2nd deeds of trust." (CX-70, p. 2). Respondent DG answered "yes" and added the phrase "2nd deeds of trust / Investment by Rep & Clients."[12] (CX-71, p. 3).

Joshua Helmle, the Firm's compliance auditor, conducted the second audit of the Gebharts' office in February 1999, and reviewed the business logs and the Gebharts' 1999 Representative Questionnaires. (Tr. pp. 598-599). Mr. Helmle testified that, in reviewing the questionnaire, it was his understanding the Respondents had invested in the MHP promissory notes and that their clients had invested in the MHP promissory notes via a mutually known third party.[13] (Tr. pp. 598-599). Respondent DG does not remember what she specifically told Mr. Helmle regarding the second trust deeds during the audit. (Tr. pp. 574). Respondent AG does not remember any discussion about the mobile home park program in the 1999 audit. (Tr. p. 875).

On October 6, 1999, the Respondents completed a Compliance Survey for the Firm on behalf of Gebhart & Associates, the name under which their office did business.

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[12] As explained, the MHP promissory notes were purportedly secured by second deeds of trust on the mobile home parks.

[13] Mr. Helmle initially testified that he "absolutely" reviewed trade tickets during his audit of the Gebharts' office. (Tr. pp. 646-647). Respondent AG testified that they had never worked with trade tickets, they executed transactions on Net Expo through Pershing. (Tr. p. 764). Mr. Helmle admitted that he had done "hundreds and hundreds of audits." (Tr. p. 612). Taking into consideration, the number of audits that Mr. Helmle had performed, the Hearing Panel found it unlikely that Mr. Helmle irrefutably remembered the audit and the conversations that he had with the Respondents. The narrative summaries created by Mr. Helmle for both the 1997 and 1999 audits could not be located. (Tr. p. 301).

(CX-74). Once again, the Respondents represented that they: (i) had notified the Firm in writing of all outside business relationships for which they received compensation; and (ii) had not engaged in private securities transactions as defined in the Firm's Policies and Procedures Manual without the written approval of the Firm's Compliance Department. (Id.).

In November 1999, Mr. Archer received a letter, dated July 28, 1999, from MONY advising him that involvement in the sale of MHP promissory notes would be considered a private securities transaction under NASD Rule 3040. (RX-GS-90, p. 631). Mr. Archer did not advise the Gebharts that he had received the letter from MONY, or that their activities might be covered by Rule 3040. (RX-GS-90, p. 332). The Respondents earned $75,723.40 in commissions through the MHP program for fiscal year 1999. (RX-GS-79).

e. Problems with MHP program revealed

In January 2000, Mr. Scovie, the owner of CSG and indirect owner of MHP, was diagnosed with brain cancer, and in February 2000, Mr. Mounier, Mr. Archer's initial link to CSG, left MHP.[14] (CX-55, p. 75). In April 2000, Mr. Scovie wrote to the MHP note holders to advise them of his health condition, and to indicate that the March 2000 interest payments on the MHP promissory notes would not be paid. (CX-55, p. 79). The Respondents wrote Mr. Scovie to request more specific information concerning liquidation of the parks and payment of the notes. (RX-GS-81).

[14] MHP was owned: (i) 50% by Evicos, Inc., a company owned by Mr. Scovie and his wife; and (ii) 50% by David W. Mounier, Inc., a company owned by Mr. Mounier and his wife. (Tr. pp. 678-679; RX-GS-11).

On May 3, 2000, Mr. Scovie wrote a second letter to the note holders in which he disclosed, among other things, the companies' failures to record the deeds of trust for the MHP promissory notes. (CX-55, p. 75; CX-51, p. 38). The same day, the Gebharts wrote their customers and recommended that they execute and deliver notices of default to MHP. (CX-51, p. 35). The letters included a form for the notice of default.[15] (CX-51, p. 36).

In May 2000, the Gebharts advised their customers of their intention to pursue involuntary bankruptcy of CSG and its related entities. (CX-51, p. 41). In May 2000, the Gebharts wrote Mutual Service concerning the problems with the MHP promissory note program. (RX-GS-63). On June 22, 2000, the Federal Bankruptcy Court in San Diego, California approved the involuntary bankruptcy of CSG. (RX-GS-90, p. 136). On August 11, 2000, Mutual Service terminated the registrations of the Gebharts. (JX-1, p. 4; JX-2, p. 4).

Subsequently, the Respondents filed suit against their insurer and the insurer agreed to contribute $925,000 to the note holders. (Tr. p. 890). The Respondents anticipate that note holders will receive 84% of their principal. (Id.).

2. MHP promissory notes were securities

a. MHP

CSG was formed by Mr. Scovie to manage mobile home parks and facilitate their conversion to residential ownership. (CX-50, p. 29). MHP was created in 1997 to issue notes to obtain funds to acquire mobile home parks as the first step of the conversion process. (RX-90, pp. 624, 678). The typical MHP note was one year in duration and paid

[15] Customer LT confirmed that the Gebharts provided him with the notice default. (Tr. p. 70).

11% interest on a monthly basis, with an additional 4-6% accrued on a monthly basis and paid on the maturity date. (Tr. pp. 499-500).

b. Reves analysis

Section 3(a)(10) of the Securities Exchange Act of 1934 ("Exchange Act") includes in its definition of "security," "any note . . . but shall not include . . . any note . . . which has a maturity at the time of issuance of not exceeding nine months." Nevertheless, the courts have held that Congress did not intend that the definition encompass literally "all" notes. To distinguish notes that are securities from those that are not, the courts have developed a test to determine whether a particular note is of the type that Congress wished to encompass within the securities laws.

This "family resemblance" test was adopted by the Supreme Court in Reves v. Ernst & Young, 494 U.S. 56 (1990). It presumes that every note is a security unless, based on a four factor analysis, it either: (1) bears a strong resemblance to certain types of notes recognized as being outside the securities laws; or (2) should be added to that list.

The four factors are:

> (1) the motivations that would prompt a reasonable seller and buyer to enter into the transaction;[16]
> (2) the plan of distribution of the notes;[17]
> (3) the reasonable expectations of the investing public regarding whether the instruments were securities; and

[16] If the seller's purpose is to raise money for the general use of a business enterprise or to finance substantial investments and the buyer is interested primarily in the profit the note is expected to generate, the instrument is likely to be a "security." If the note is exchanged to facilitate the purchase and sale of a minor asset or consumer good, to correct for the seller's cash-flow difficulties, or to advance some other commercial or consumer purpose, on the other hand, the note is less sensibly described as a "security." Reves at 66-67.

[17] The Reves Court held that offer and sale to a "broad segment of the public" would establish the requisite common trading in an instrument. Reves, at 68.

> (4) the presence of any alternative scheme of regulation or other factor that significantly reduces the risk of the instruments so as to make regulation under the securities laws unnecessary.

Considering these factors, the Hearing Panel finds that the MHP promissory notes are securities.

First, MHP entered into the transaction to raise funds for its business of purchasing mobile parks, and the investors loaned the money to MHP with the expectation of earning profits in the form of interest. Thus, the motivations of a reasonable buyer and seller to enter the transaction weigh in favor of a finding that the MHP promissory notes are securities.

Second, it was estimated that millions of dollars worth of MHP promissory notes were sold to numerous customers. The Respondents alone sold over $2.4 million in MHP promissory notes in connection with 117 separate transactions. (Schedule B to Stip.). Accordingly, MHP's plan of distribution was to a "broad segment of the public," demonstrating that there was "common trading for speculation or investment."[18]

Third, the MHP investors reasonably understood that the notes were "investments," rather than consumer or commercial loans. Customer LT testified that he viewed the MHP promissory note as an investment, part of his "investment portfolio." (Tr. p. 58). Respondent DG admitted that she and Respondent AG offered the MHP promissory notes to their clients as an investment vehicle. (Tr. p. 485). Respondent AG also testified that their customers were attracted to the notes because of their short term of maturity and favorable rate-of-return. (Tr. p. 516).

[18] Id. at 66-67.

And finally, there was a clear need for the protection afforded by the federal securities laws, as no other regulatory scheme was in place to reduce the risk of the MHP promissory notes.

Therefore, the Hearing Panel finds that, based on the Reves analysis, the MHP promissory notes do not resemble any one of the enumerated types of notes excluded from the definition of a security,[19] and finds, based on the same analysis, that they should not be added to the category of excluded notes. Accordingly, the MHP promissory notes were securities.

C. The Gebharts Offered and Sold Unregistered Securities in Violation of NASD Conduct Rule 2110

Section 5 of the Securities Act of 1933 prohibits the offer or sale of any security, unless there is a registration statement in effect as to that security, or there is an exemption available for that securities transaction.[20] And it is well settled that the burden of establishing an exemption from registration requirements rests upon those who claim it.[21] Section 5 of the Securities Act of 1933 imposes strict liability on offerors and sellers of unregistered securities; scienter is not a required element of a Section 5 violation.[22]

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[19] The types of notes recognized as being excluded from the definition of a security are notes delivered in consumer financings, notes secured by mortgages on homes, short-term notes secured by liens on small businesses or some of the small businesses' assets, notes evidencing "character " loans from banks, short-term notes secured by an assignment of accounts receivable, notes which simply formalize an open-account debt incurred in the ordinary course of business, and notes evidencing loans by commercial banks for current operations. Stoiber v. SEC, 161 F.3d 745, 749 (D.C. Cir. 1998).

[20] SEC v. Softpoint, Inc., 958 F. Supp. 846, 859 (S.D.N.Y. 1997), aff'd, 159 F.3d 1348 (2d Cir. 1998).

[21] See, e.g., In re First Pittsburgh Securities Corporation, 47 S.E.C 299, 301 (1980). As one court has stated, "[t]he evidence [establishing the exemption] must be . . . explicit, exact, and not built on conclusionary statements of the [respondents]."

[22] SEC v. Current Financial Services, Inc., 100 F. Supp. 2d 1, 5-6 (D.D.C. 2000), 2000 U.S. Dist. LEXIS 8475 (May 18, 2000).

Whether the offeror or seller knows that it is selling an unregistered security is irrelevant.[23] And "[t]here is no requirement that the actor also be aware that he is violating any Acts or Rules."[24]

It is undisputed that no registration statement under the Securities Act of 1933 had been filed or was in effect as to the MHP promissory notes. (Stip. at ¶7). There is no evidence that transactions were exempt.

Consequently, although the Respondents did not realize that the MHP promissory notes were securities, or that the MHP promissory notes should have been registered, their ignorance is not relevant to a finding of liability. Therefore, the Hearing Panel finds that the Gebharts violated NASD Conduct Rule 2110 by offering and selling securities that were not exempt from registration, and for which no registration statement had been filed, in violation of Section 5 of the Securities Act of 1933.

D. The Gebharts Omitted Material Information in Connection with the Offer and Sale of the MHP Promissory Notes, in Violation of NASD Conduct Rule 2110, but Fraud was not Proven

1. Fraud not proven

In order to establish a violation of the anti-fraud provisions of Section 10(b) of the Exchange Act, SEC Rule 10b-5, and NASD Conduct Rule 2120, Enforcement was required to prove, by a preponderance of the evidence, that:

(i) the Respondents made misrepresentations and/or omissions;

(ii) the misrepresentations and/or omissions were material;

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[23] Id.

[24] In re Kolar, 1999 SEC LEXIS 2300, at *70 (Oct. 28, 1999).

(iii) the Respondents made the misrepresentations and/or omissions with scienter; and

(iv) the Respondents made the misrepresentations and/or omissions in connection with the purchase or sale of securities.[25]

In addition, the duty of fair dealing requires that stock brokers have an adequate basis for their recommendations, and those recommendations should be based on reasonable investigation.[26] As registered representatives, the Respondents, therefore, had an obligation to employ due diligence to discover material information about the investment they were selling.

The Gebharts failed to conduct a reasonable investigation of MHP or CSG. In fact, the Gebharts obtained all of the information they reported to their customers concerning the mobile home conversion program from Mr. Archer. The Gebharts had no substantial direct contact with the principals of MHP until after MHP had defaulted. The Gebharts knew nothing about the financial condition or the workforce of MHP or CSG.

The Gebharts disclosed that the MHP promissory notes were to be secured by second deeds of trusts, but they failed to disclose that they had done no due diligence to confirm independently that MHP was actually completing and recording second deeds of trust, which, in fact, MHP was not doing.

The Hearing Panel finds, however, that the Gebharts did not act with scienter. They did not omit the information intentionally, nor were their omissions reckless.

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[25] See DBCC v. Euripides, No. C9B950014, 1997 NASD Discip. LEXIS 45, at *18 (NBCC July 28, 1997).

[26] Hanly v. SEC, 415 F.2d 589, 597 (2d Cir. 1969); Steven D. Goodman, Exch. Act. Rel. No. 43,889, 2001 SEC LEXIS 144, at *12 (Jan. 26, 2001).

Recklessness is defined as an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious the actor must have been aware of it.[27]

The Respondents truly believed that they had fulfilled their responsibilities to assure that MHP and CSG were appropriate investments, based on: (i) the information they received from Mr. Archer, whom they believed to be reliable; (ii) the general information that they gathered about mobile home conversions from HUD and other municipal and state agencies; (iii) their one-year personal payment history with the MHP promissory note; and (iv) Mutual Service's lack of response to the information concerning the mobile home conversion provided to it. Enforcement has proven that the Respondents' conduct was negligent, perhaps even grossly negligent, but not reckless.

2. The Respondents' omissions violated NASD Conduct Rule 2110

Although the Gebharts' omissions were not fraudulent, they did violate NASD Conduct Rule 2110. NASD Conduct Rule 2110 does not require scienter; negligent omissions violate that Rule.[28] Consequently, although the Respondents did not intend to mislead their customers, their reliance on Mr. Archer's representations about how MHP operated was unreasonable, and their omissions did mislead their customers, and constituted negligent behavior.

[27] See Tuchman v. DSC Communications Corp., 14 F.3d 1061, 1067 (5th Cir. 1994), 1994 U.S. App. LEXIS 3326, at *14 (5th Cir. Feb. 24, 1994).

[28] See Dep't of Enforcement v. Reynolds, No. CAF990018, 2001 NASD Discip. LEXIS 17, at *47 (NAC June 25, 2001) (finding a Rule 2110 violation, but not fraud, where representative's investigation was inadequate, his reliance on issuer's representations was unreasonable, and his assumptions mistaken).

The Hearing Panel finds that the Gebharts' negligent failure to disclose material information to their customers, in connection with their recommendations to purchase the MHP promissory notes, violated NASD Conduct Rule 2110.

E. The Respondents Failed to Obtain Prior Written Approval from their Employer, Mutual Service, Before Selling Securities, in Violation of NASD Conduct Rules 3040 and 2110

NASD Conduct Rule 3040 requires that an associated person who intends to participate in a private securities transaction "provide written notice to the member with which he is associated describing in detail the proposed transaction and the person's proposed role therein and stating whether he has received or may receive selling compensation in connection with the transaction . . . ." Further, if the transaction is for compensation, the member firm must approve or disapprove of the proposed transaction in writing.

Rule 3040 defines a "private securities transaction" as "any securities transaction outside the regular course or scope of an associated person's employment with a member, including, though not limited to, new offerings of securities which are not registered with the Commission." Proof of scienter is not required to establish a violation of Conduct Rule 3040. Consequently, although Respondents did not realize that the MHP promissory notes were securities, their ignorance is not a defense to a finding of liability.

Mutual Service did not sell the MHP promissory notes and they were not on the Firm's approved product list. (Tr. pp. 105-106). The MHP promissory note transactions also were not supervised by Mutual Service, or recorded on the Firm's books and records. As such, the sales of MHP promissory notes were sales outside the regular course and scope of the Gebharts' employment with the Firm.

The Respondents intended for the October 23, 1996 letter to put Mutual Service on notice of their intent to participate in the MHP promissory note program, but it did not meet the requirements of NASD Conduct Rule 3040. The letter did not describe in detail the proposed transaction, the Respondents' roles in the transactions, or whether the Respondents would receive compensation for the transactions. Moreover, the Respondents never received the required written approval from the Firm.

Therefore, the Hearing Panel finds that Respondents violated NASD Conduct Rules 3040 and 2110.

III. Sanctions

"Although SEC case law and NASD practice strongly suggest that sanctions generally be assessed per cause, where multiple, related violations arise as a result of a single underlying problem, a single set of sanctions may be more appropriate to achieve NASD's remedial goals."[29] In this case, the Hearing Panel concludes that a single set of sanctions is appropriate because the sale of unregistered securities, the negligent omissions of material information, and the private securities transactions all arose from the Respondents' involvement in the sale of the MHP notes, and their failure to obtain approval from the Firm for that involvement.

The NASD Sanction Guidelines for sales of unregistered securities provide for fines ranging from $2,500 to $50,000, and in egregious cases a suspension of up to two years or a bar.[30] The Guidelines for negligent misrepresentations or material omissions of fact recommend a fine ranging from $2,500 to $50,000, and suspension for up to 30

[29] Dep't of Enforcement v. Investment Management, Inc., No. C3A010045 (NAC Dec. 15, 2003).

[30] NASD Sanction Guidelines, p. 30 (2001).

business days.[31] The Guidelines for Private Securities Transactions, effective December 2003, suggest fines ranging from $5,000 to $50,000, which the adjudicator may increase by the amount of respondent's financial benefit. The Guideline, as revised, also suggests suspensions, ranging from 10 business days for sales activities involving sales of up to $100,000, to a 12 month suspension, or a bar, for sales activities involving sales in excess of $1,000,000, which suspensions the adjudicator may increase or decrease after considering other applicable aggravating or mitigating factors.[32] Arguing that the Respondents' actions were especially egregious, Enforcement recommended that the Respondents be barred.

The Hearing Panel considered the following factors in arriving at specific sanctions:

A. Extent of the Selling Away

1. Dollar Volume of Sales

The dollar volume of sales was in excess of $1,000,000.[33]

2. Number of Customers

The selling away activity involved 45 customers.

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[31] Id. at 96.

[32] Special NASD Notice to Members 03-65 (Oct. 2003). The Guidelines, as revised, recommend that adjudicators first assess the extent of the selling away, including the dollar amount of sales, the number of customers, and the length of time over which the selling away occurred. Following the assessment of the extent of the selling away, adjudicators are advised to consider the ten other factors listed in the Guideline, which includes six of the general considerations listed in the introductory section of the Guidelines.

[33] In assessing the extent of the selling away, the Hearing Panel noted that the Respondents waited approximately three months after providing the October 1996 disclosure about mobile home park conversions to Mutual Service before they began soliciting customers. The Hearing Panel also noted that more than one-half of the $2.4 million in sales originated by the Respondents occurred after the Respondents put the Firm on specific notice of the activity by listing 2nd deeds of trust on their 1999 Representative questionnaires.

3. Length of Time

The Respondents were engaged in the offer and sale of the MHP promissory notes for more than three years, beginning in 1997 and continuing through February of 2000.

B. Other Private Securities Considerations

4. Whether product sold away involved a violation of federal or state securities laws, or federal, state or SRO rules

The sales of MHP promissory notes involved the sale of unregistered securities, which the Hearing Panel considered an aggravating factor.

5. Whether the Respondents had a proprietary interest in the issuer of the promissory notes

The Respondents did not have the aggravating factor of having a proprietary or ownership interest in MHP or CSG.

6. Whether the Respondents created the impression that the Firm sanctioned their activity

The Respondents put correspondence relating to the MHP promissory notes on letterhead with "Gebhart & Associates" on the top and "Securities offered through Mutual Service Corporation" on the bottom. (Tr. pp. 430-431). The Respondents also told their customers of the MHP promissory notes mainly during their routine conversations with existing customers. (Tr. p. 483).

Generally, creating an impression for customers that the Firm sanctioned the sales of the product would be considered a serious aggravating factor. However, in this case, because the Respondents sincerely believed that Mutual Service was aware of their

participation in the MHP program, the creation of the impression of approval was deemed by the Hearing Panel to be a minor aggravating factor.[34]

7. Whether the Respondents' activity resulted in injury to the investing public

The Respondents' misconduct indirectly resulted in substantial injury to the investing public.[35] Although the Respondents' customers and the Respondents invested $2.4 million in the program over the three year period, only those customers who invested after March 1999 were subject to a loss, and due to the Respondents' efforts the customers are expected to recoup approximately 84% of their investments.

8. Whether the Respondents sold away to customers of the employer

Some of the customers to whom the MHP promissory notes were sold were customers of Mutual Service. The Respondents offered and sold the MHP promissory notes from their Mutual Service office, primarily to their existing customers in their capacity as their Mutual Service adviser.

9. Whether the Respondents provided their employer firm with verbal notice of the proposed transactions

The Respondents not only provided oral notice to the Firm of the mobile home park program, but they also provided written information about the program to the Firm's compliance department. The notice that the Respondents provided was not sufficient to meet the requirements of Conduct Rule 3040; however, the Hearing Panel finds that the notice provided was a substantial mitigating factor.

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[34] The Respondents believed that Mutual Service did not object to them selling MHP promissory notes. (Tr. p. 876).

[35] MHP's failure to record properly the deeds of trusts on the mobile home parks was the direct cause of the Respondents' customers' injuries.

10. Whether the Respondents sold away after being instructed not to do so

The Respondents did not continue to sell the MHP promissory notes after being instructed not to do so. Although Mr. Archer was advised by MONY that the MHP promissory notes should not be sold in November 1999, he admitted that he did not relay that information to the Respondents.

11. Whether the Respondents participated in the sale by referring customers or selling the product directly to customers

The Respondents participated in the sale of the MHP promissory notes by selling the product directly to their customers. The Hearing Panel viewed this as more of an aggravating factor for Respondent AG than for Respondent DG. Although both Respondents testified that they were equally responsible for the sales to their customers, based on their testimony concerning who made the presentations to the customers, it is clear that Respondent AG was the primary promoter of the MHP promissory notes. It was Respondent AG who had the initial conversation with Mr. Archer, who instigated the telephone call with Mr. Poston to discuss the product, and who was Respondent DG's mentor.

12. Whether the Respondents recruited other registered individuals to sell the product

Respondent AG was responsible, in part, for Respondent DG becoming involved in selling the MHP promissory notes. Nevertheless, the Hearing Panel finds that this factor will not be deemed as aggravating because the customers were viewed as joint customers.

13. Whether the Respondents misled their employer or otherwise concealed the selling away activity

Contrary to Enforcement's argument, the Hearing Panel finds that the Respondents did not deliberately attempt to conceal the MHP promissory note transactions from their employer. The Respondents did not intentionally conceal their participation in the MHP program from the Firm's compliance auditor. (Tr. pp. 760-761, 924). The Respondents' failure to disclose the MHP program on the pre-1999 surveys and questionnaires involved a series of misunderstandings, rather than a deliberate attempt to mislead.

The Respondents interpreted the questions on the compliance surveys as soliciting information about new programs. The Respondents did not perceive the MHP program as a new program because they were under the impression that Mutual Service was aware of their activities based on the October 1996 telephone conversation and mailing. Partly because of their interactions with the Firm concerning their insurance activities, and partly because of their unfamiliarity with securities products concepts, with each subsequent contact with Mutual Service, including their interaction with the operations department of Mutual Service and the auditor's review of their business logs, reinforced the Respondents' misimpression that Mutual Service had specifically considered the MHP program and determined that there were no compliance issues.

C. Other Factors

14. The Respondents undertook voluntary efforts to assist their customers to recover their investments

The Respondents immediately took action when they realized there was a problem with the MHP program. Their efforts in initiating the involuntary bankruptcy of CSG and

in pursuing their insurer for additional funds are expected to result in reimbursement of at least 84% of the MHP note holders' principal.

Although not listed as a consideration in the Sanction Guidelines for private securities transactions, consistent with the NAC's reasoning in Dep't of Enforcement v. Fergus, No. C10990025 (NAC May 17, 2001), the Hearing Panel finds that the Respondents' voluntary and proactive efforts to assist their customers in recovering their funds, which were undertaken prior to discovery by the Firm or NASD, should be encouraged and constitutes a mitigating factor.

The Hearing Panel was favorably impressed with the Respondents' remorse and sincerity. The Hearing Panel finds that the Respondents did not recommend the MHP promissory notes primarily because of the commissions that they expected to earn on the product. The Respondents were attempting to meet their clients desire for a fixed rate, short-term financial instrument. In fact, the Respondents had personally invested in the program almost a year before they made an initial presentation to a customer. The Hearing Panel is convinced that the Respondents will not engage in similar misconduct in the future and will not be a danger to the investing public.

15. Unregistered Securities/Negligent Omissions

In addition to reviewing the factors applicable to private securities transactions, the Hearing Panel considered whether there were any additional factors listed in the Sanction Guidelines for unregistered securities and negligent omissions that needed to be considered. There were no additional factors. The applicable principal consideration in determining the sanctions for the sale of unregistered securities is the share volume and dollar amount of the transactions. The applicable factors for determining the sanctions for

negligent omissions are the factors listed in the introductory section, including whether the respondent voluntarily and reasonably attempted to remedy the misconduct, whether the respondent engaged in numerous acts, whether the respondent engaged in the misconduct over an extended period of time, whether the respondent attempted to conceal his or her misconduct, etc. Accordingly, the Hearing Panel has already considered the factors listed in the Sanction Guidelines for unregistered securities and negligent omissions.

D. Sanctions to be Imposed

After applying each of the factors listed above to the two Respondents, and determining that as between Respondent AG and Respondent DG, Respondent AG was primarily responsible for the activity, the Hearing Panel determined that the following sanctions should be imposed:

1. Respondent AG

For violating NASD Conduct Rules 3040 and 2110, by offering and selling unregistered securities by means of material omissions, without providing prior written notice to, and approval of, his employer, Respondent Alvin W. Gebhart, Jr. is suspended for 12 months in all capacities and fined $100,000.

2. Respondent DG

For violating NASD Conduct Rules 3040 and 2110, by assisting Respondent AG in offering and selling unregistered securities by means of material omissions, without providing prior written notice to, and approval of, her employer, Respondent Donna T. Gebhart is suspended for seven months in her capacity as a general securities representative and fined $7,500.

3. The Respondents

The Hearing Panel also orders the Respondents to pay jointly and severally the $5,141.21 costs of the Hearing.

IV. Conclusion

For violating NASD Conduct Rules 3040 and 2110, by offering and selling unregistered securities by means of material omissions, without providing prior written notice to, and approval of, his employer, Respondent Alvin W. Gebhart, Jr. is suspended for 12 months in all capacities and fined $100,000.

For violating NASD Conduct Rules 3040 and 2110, by offering and selling unregistered securities by means of material omissions, without providing prior written notice to, and approval of, her employer, Respondent Donna T. Gebhart is suspended for seven months in her capacity as a general securities representative and fined $7,500.

The Hearing Panel also orders the Respondents jointly and severally to pay the $5,141.21 costs of the Hearing, which include an administrative fee of $750 and Hearing transcript costs of $4,391.21.

If this Decision becomes the final disciplinary action of NASD, the suspension of Respondent Alvin W. Gebhart, Jr. in all capacities shall commence with the opening of business on Monday, April 5, 2004, and end at the close of business on April 4, 2005; Respondent Donna T. Gebhart's suspension in her capacity as a general securities representative shall commence with the opening of business on Monday, April 5, 2004, and end at the close of business on November 4, 2004.

The Respondents' fines and costs shall become due and payable upon their re-entry into the securities industry.[36]

HEARING PANEL

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By: Sharon Witherspoon
Hearing Officer

Dated: Washington, DC
February 9, 2004

Copies to:
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[36] The Hearing Panel has 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.