

**NASD REGULATION, INC.  
OFFICE OF HEARING OFFICERS**

---

DEPARTMENT OF ENFORCEMENT,	:	
	:	
Complainant,	:	Disciplinary Proceeding
	:	No. C01000037
v.	:	
	:	
	:	<b>HEARING PANEL DECISION</b>
PACIFIC ON-LINE TRADING & SECURITIES, INC.	:	
(BD #45737),	:	
San Jose, CA	:	Hearing Officer - SW
	:	
and	:	
	:	
TIMOTHY ALAN MCADAMS	:	
(CRD #2877024),	:	
San Jose, CA	:	December 7, 2001
	:	
	:	
Respondents.	:	

---

**Respondents Pacific On-Line and McAdams were jointly and severally fined \$2,500, and Respondent Pacific On-Line was censured, for violating Rules 2210(c)(3)(A) and 2110 by failing to file Pacific On-Line's active website with the NASD as advertising material when Respondent Pacific On-Line became an NASD member.**

**In addition, Respondents Pacific On-Line and McAdams were jointly and severally fined \$7,500, and Respondent McAdams was ordered to requalify as a general securities principal within 90 days, for violating Rules 2210(d) and 2110 by maintaining a misleading website from January 1999 to March 1999 and on October 5, 1999.**

**Appearances**

David A. Watson, Esq., Regional Counsel, San Francisco, California, for the Department of Enforcement.

M. Van Smith, Esq., San Jose, California, for Respondents Pacific On-Line Trading & Securities, Inc. and Timothy Alan McAdams.

## DECISION

### I. Procedural Background

#### A. Complaint and Answer

The Department of Enforcement filed a three-count Complaint against four respondents concerning a website created for Pacific On-Line Trading & Securities, Inc. (“Pacific On-Line”)<sup>1</sup> in November 1997 (“Original Website”) and used during three separate time periods: (i) from November 1997 to January 7, 1999; (ii) from January 7, 1999 through March 18, 1999; and (iii) on October 5, 1999. This decision involves only two of the four respondents, Respondents Pacific On-Line and McAdams (collectively, the “Respondents”), and two of the three counts of the Complaint.<sup>2</sup>

Count two of the Complaint alleges that Respondent Pacific On-Line, acting through Respondent McAdams, used the Original Website as a website advertisement from January 7, 1999, when Pacific On-Line became a member of the NASD, until March 18, 1999, without filing the website with the NASD’s Advertising Regulation Department (“Advertising Department”), in violation of NASD Rules 2210(c)(3)(A) and 2110.

Count three alleges that the Original Website, used by the Respondents from

---

<sup>1</sup> At the time that the website was initiated and through March 18, 1999, Pacific On-Line was known as Pacific Day Trading, Inc. For purposes of this decision, Pacific On-Line will also refer to Pacific Day Trading, Inc.

<sup>2</sup> Two of the three causes of the Complaint, the second and the third causes, contain allegations against Respondents Pacific On-Line and McAdams. Count one of the Complaint, containing allegations against \_\_\_\_\_, \_\_\_\_ (“\_\_\_\_\_”) and its former president, \_\_\_\_\_, was settled when the National Adjudicatory Council accepted an offer of settlement from \_\_\_\_\_ and \_\_\_\_\_ on September 6, 2001.

January 7, 1999 through March 18, 1999 and on October 5, 1999, was false and misleading because it (i) omitted material information concerning the risks of day-trading, and (ii) contained six exaggerated, unwarranted, and false statements, in violation of Rules 2210(d) and 2110.

In response to count two of the Complaint, the Respondents admitted that they did not file the Original Website with the NASD when Pacific On-Line became registered as an NASD member. However, the Respondents denied liability. The Respondents argued that they had relied on \_\_\_\_\_ to file the Original Website, and, although it was registered as a broker-dealer, Pacific On-Line continued to operate as a branch office of \_\_\_\_\_ prior to March 1999.

In response to count three of the Complaint, the Respondents denied that the Original Website was false and misleading (i) because potential customers were provided with information concerning the risks of on-line trading,<sup>3</sup> and (ii) because Respondents had a reasonable basis for each of the six statements in the Original Website cited as false and misleading. In addition, at the Hearing, the Respondents stated that the availability of the Original Website on October 5, 1999 was inadvertent and due to a mistake by their web host.

## **B. The Hearing**

The Parties presented evidence to a Hearing Panel, consisting of one current and one former member of the District 1 Committee and the Hearing Officer, at a Hearing held in San Francisco, California, on July 17 and 18, 2001.<sup>4</sup> Enforcement presented exhibits labeled

---

<sup>3</sup> The risks of on-line or day trading are defined to include, among other things, risk of loss of investment, risk that trades will not be executed, risk associated with volatile stocks, and risk of high commissions. (Complaint at ¶10).

<sup>4</sup> References to the testimony set forth in the transcript of the July 17 and 18, 2001 Hearing will be designated as “Tr. p.” with the appropriate page number(s).

CX-1 -- CX-20, and the Respondents presented exhibits RX-1 -- RX-26.<sup>5</sup> Enforcement presented the testimony of three witnesses: Christopher LeVasseur, an NASD Supervisor of Examinations for District 1, Leigh Vazquez, a former Associate Examiner for District 1, and Thomas Pappas, the Director of the NASD's Advertising Department. The Respondents presented the testimony of three witnesses: Stuart Townsend,<sup>6</sup> the developer of Pacific On-Line's trading system software, Robert Lowry,<sup>7</sup> an expert concerning broker-dealer regulation, and Respondent McAdams.

## **II. Findings of Facts and Conclusions of Law**

### **A. Jurisdiction**

Respondent Pacific On-Line became a member of the NASD on January 7, 1999 and currently is a member of the NASD. (CX-1, p. 3).

During the period from January 7, 1999 through the present, Respondent McAdams has been president, chief executive officer, chief financial officer, chief operating officer, and chief compliance officer of Pacific On-Line, and his registration as a general securities principal of Pacific On-Line remains effective. (CX-2, p. 3).

The NASD thus has jurisdiction over the Respondents.

---

<sup>5</sup> References to exhibits presented by Enforcement will be designated as "CX-." Four of Enforcement's exhibits were also designated as joint exhibits. For purposes of this decision, they will be referenced as "JX-." The Hearing Officer admitted all of Enforcement's exhibits. References to exhibits presented by the Respondents will be designated as "RX-." Twenty-one of the Respondents' 26 exhibits were admitted. The Hearing Officer excluded five of the Respondents' exhibits as irrelevant or duplicative.

<sup>6</sup> Mr. Townsend is the president and owner of Townsend Analytic Limited, a software developer and software provider for the financial industry. (Tr. p. 305).

## B. Background

In 1996, Respondent McAdams became interested in on-line trading.<sup>8</sup> (Tr. p. 175). In May 1997, Respondent McAdams became a registered general securities representative for \_\_\_\_\_, an NASD member. (CX-2, p. 4). In 1997, Respondent McAdams incorporated two entities: (i) Electronic Day Trading Services Incorporated (“EDT”)<sup>9</sup>, a corporation designed to teach people the basic fundamentals of on-line trading, and (ii) Pacific On-Line, a corporation that became registered as a branch of \_\_\_\_\_. (Tr. pp. 183-185).

In November 1997, Respondent McAdams created the Original Website for EDT and Pacific On-Line. (Tr. p. 194). The Original Website was a portal and included two sub-sites, the EDT site and the Pacific On-Line site. (Tr. pp. 185-186, 212). Each of the pages on the EDT sub-site had a hyperlink to the Pacific On-Line sub-site, and each of the pages on the Pacific On-Line sub-site had a hyperlink to the EDT sub-site. (JX-4; Tr. p. 383). Respondent McAdams submitted the Original Website to \_\_\_\_\_ for its approval. (Tr. p. 194). After \_\_\_\_\_ approved the website, the Original website became operational. (Id.).

In April 1998, Pacific On-Line became registered as a branch office of \_\_\_\_\_ and amended the Original Website to reflect its designation as a branch office, but fundamentally the website

---

<sup>7</sup> Mr. Lowry currently provides consulting services to broker-dealers, but previously he was employed at the Securities and Exchange Commission for approximately 30 years in the Division of Market Regulation. (Tr. p. 398).

<sup>8</sup> Respondent McAdams had been a commercial printing company owner for 20 years. (Tr. p. 175).

<sup>9</sup> Electronic Day Trading Services Incorporated is a Nevada S Corporation owned by Respondent McAdams and his spouse. (Tr. pp. 185, 211).

did not change.<sup>10</sup> (Tr. p. 195). From 1997 through 1998, Respondent McAdams relied on \_\_\_\_\_ to meet any NASD compliance obligations. (Tr. p. 197).

In June 1998, Pacific On-Line submitted a broker-dealer application to the NASD. (Tr. p. 195). On or about December 6, 1998, the Respondents were notified that Pacific On-Line's application had been approved and that Pacific On-Line would become a member of the NASD in 30 days. (Tr. p. 200).

In January 1999, Pacific On-Line's registration as a broker-dealer became effective. (CX-1, p. 3). Respondent McAdams testified that, from January 1999 to March 1999, Pacific On-Line maintained the Original Website as operative. (Tr. pp. 339-340).

In March 1999, Mr. LeVasseur of the NASD supervised an examination of Pacific On-Line, including a review of material that Pacific On-Line published on the Internet. (Tr. p. 42). In connection with the examination, Mr. LeVasseur used a search engine to locate and download a copy of Pacific On-Line's Original Website. (Tr. p. 44). Mr. LeVasseur sent the Original Website to the NASD's Advertising Department for review. (Tr. p. 45).

On March 22, 1999, the first day of the NASD examination, Respondent McAdams filed a revised website ("Revised Website") with the NASD's Advertising Department for approval. (JX-1). The Revised Website was substantially different from the Original Website. (JX-1; JX-4). The Revised Website had much greater functionality, included risk disclosures concerning on-line trading, and did not have any of the statements that are the subject of the Complaint. (JX-1, pp. 4-32). In an April 13,

---

<sup>10</sup> Respondent McAdams became registered as a general securities principal with \_\_\_\_\_ on April 29, 1998. (CX-2, p. 4).

1999 letter, the Advertising Department approved the Revised Website for use with minor changes. (JX-5).

In August 1999, the Advertising Department called Mr. LeVasseur regarding Pacific On-Line's Original Website, which he had submitted for review in March 1999. (Tr. p. 46). After this call, Mr. LeVasseur used a search engine, located Pacific On-Line's website, and found that it was virtually the same as the Original Website, which he had downloaded in March 1999. (Tr. pp. 46-47). On October 5, 1999, Mr. LeVasseur again visited Pacific On-Line's website, and again, found the website to be virtually the same as the Original Website. (Tr. p. 51).

On October 5, 1999, the Advertising Department, with staff from the NASD District 1 office, called Respondent McAdams and directed him to take his website down within 48 hours.<sup>11</sup> (Tr. p. 98). Respondent McAdams immediately complied with the NASD's request. (Tr. p. 389).

### **C. Respondents should have filed the Original Website before using it after January 1999**

Rule 2210(c) provides that a member of the Association, which has not previously filed advertisements with the Association, shall file its initial advertisement with the Department at least ten days prior to use and shall continue to file its advertisements at least ten days prior to use for a period of one year.<sup>12</sup> (Tr. p. 98).

Enforcement argued that Pacific On-Line became subject to Rule 2210(c) when it became a member of the Association on January 7, 1999. The Respondents argued that because Pacific On-Line

---

<sup>11</sup> Also on October 5, 1999, the staff of the Advertising Department sent a confirming letter to the Respondents, specifically discussing why the staff believed the Original Website failed to comply with Conduct Rule 2210. (CX-19).

<sup>12</sup> Rule 2210(c)(3)(A) states: "Each member of the Association which has not previously filed advertisements with the Association (or with a registered securities exchange having standards comparable to those contained in this Rule)

had not yet received all of its state registrations, during the period from January 1999 to March 1999, Pacific On-Line did not hold itself out as a broker-dealer; rather, it continued to function as a branch office of \_\_\_\_\_ and, accordingly, should not be treated as a member of the Association for purposes of Rule 2210(c). (Tr. pp. 374-375). Respondent McAdams testified that his compliance consultant advised him that Pacific On-Line could maintain its status as a branch office of \_\_\_\_\_, pending receipt of certain state approvals. (Tr. p. 201).

Secondly, the Respondents argued that, believing that the Original Website had been filed with the Advertising Department by \_\_\_\_\_ in 1997, they did not believe that the website had to be refiled. (Tr. p. 376). The Advertising Department has no record that \_\_\_\_\_ filed the Original Website with it. (Tr. p. 102). In any event, the exemption provided for advertising previously filed contained in Rule 2210(c)(1) applies to the requirement that certain advertising material be filed within 10 days of first use. If the advertising was voluntarily filed prior to use, Rule 2210(c)(1) provides that it need not also be filed within 10 days after use.

Article I (q) of the NASD Bylaws defines a member as any “broker or dealer admitted to membership in the NASD.” Accordingly, the Hearing Panel finds that Pacific On-Line was a member of the Association as of January 7, 1999 and therefore was subject to Rule 2210(c)(3)(A).

The Hearing Panel notes that, despite claiming to view Pacific On-Line as a branch office in January 1999, Respondent McAdams, beginning in January 1999, filed focus reports, maintained net

---

shall file its initial advertisement with the Department at least ten days prior to use and shall continue to file its advertisements at least ten days prior to use for a period of one year.”

capital requirements, and executed a membership agreement for the broker-dealer.<sup>13</sup> (Tr. pp. 347-348, 381, 391).

Accordingly, the Hearing Panel finds that the Respondents violated Rules 2210(c)(3)(A) and 2110 by failing to file the Original Website with the NASD when Pacific On-Line became a member of the Association on January 7, 1999.

#### **D. The Respondents Maintained the Original Website**

The Respondents are charged with maintaining a false and misleading website during two separate time periods: (i) from January 1999 to March 1999 and (ii) on October 5, 1999.

The Respondents acknowledged that the Original Website was available from January 1999 to March 1999, but they argued that Pacific On-Line was operating as a branch office of \_\_\_\_\_. (Tr. p. 371). The Hearing Panel has already determined that Pacific On-Line became responsible for the website when it became a member of the Association in January 1999.

The Respondents acknowledged that the Original Website was available for dissemination to the public on October 5, 1999, but they denied responsibility for the website being available, arguing that their web host was the responsible party. (Tr. pp. 215-217). Respondent McAdams testified that, in April 1999, Pacific On-Line began using the Revised Website, which had been approved by the NASD. (Tr. p. 362). Respondent McAdams testified that the Original Website was available on October 5, 1999 only because the web host crashed the weekend of October 2, 1999, and the web

---

<sup>13</sup> The Hearing Panel also noted that, in a September 13, 1999 letter to the NASD staff, Respondent McAdams stated, "In January 1999, [Pacific On-Line] became its own broker/dealer entity and NASD member firm and I stopped forwarding documents to \_\_\_\_\_ for their (sic) approval." (JX-2, p. 1). Respondent McAdams made a similar observation in a November 1, 1999 letter to the NASD staff, stating "From January 1999 to the present, [Pacific On-

host inadvertently used an obsolete backup tape of the Original Website to restore Pacific On-Line's web pages. (Tr. pp. 215-217). The Hearing Panel noted that Respondent McAdams did not adduce any documentary or testimonial evidence (other than his own testimony) to substantiate the web host's inadvertent use of an obsolete backup tape in October 1999.<sup>14</sup>

The Respondents argued that they would not knowingly continue to use the Original Website after receiving approval for use of the Revised Website, which had much more functionality than the Original Website. (Tr. p. 365). The Respondents argued that there was no reasonable explanation, other than a mistake by the web host, for the use of the Original Website after the Revised Website became available.<sup>15</sup> (Tr. pp. 32, 489).

The Hearing Panel found that there was a slight difference between the Original Website<sup>16</sup> downloaded by Mr. LeVasseur in March 1999 and the Original Website that he downloaded in October 1999. The Original Website downloaded in March 1999 listed seminar dates beginning March 11, whereas the Original Website downloaded in October 1999 listed seminar dates beginning September 10. (Tr. pp. 361-362; JX-4, p. 10; CX-18, p. 10). Accordingly, it is more likely that the

---

Line] has been using the website and all other sales literature referenced as a separate broker/dealer and not as a branch office of \_\_\_\_\_." (JX-3, p. 1).

<sup>14</sup> In an October 8, 1999 letter from EDT to the web host, EDT referenced a "hosting problem" but made no specific reference to a crash or the inadvertent use of an obsolete backup tape. (RX-24).

<sup>15</sup> The Hearing Panel finds that there are a number of other possible reasons, including temporary incompatibility of software and hardware, or the back office costs of supporting the newer website, why the Respondents might not have immediately implemented their more functional website, especially if they believed that the Original Website had already been approved for use.

<sup>16</sup> For purposes of this decision, Original Website refers to Pacific On-Line's website available: (i) from November 1997 to January 7, 1999; (ii) from January 7, 1999 to March 18, 1999, which was downloaded in March 1999; and (iii) on October 5, 1999, which was downloaded in October 1999. Although there were some minor differences, the websites during these periods were substantially the same.

website appearing in October 1999 was an updated version of the Original Website rather than an inadvertent earlier backup version of the Original Website in effect in March 1999.

In addition, Mr. LeVasseur testified that he reviewed Pacific On-Line's website in August 1999, and it was virtually the same as the Original Website that he downloaded in March 1999. (Tr. p. 51). Having observed the demeanor of Mr. LeVasseur, the Hearing Panel finds Mr. LeVasseur to be a credible witness.

Respondent McAdams testified that, after the October 5, 1999 conference call with the NASD staff, he reviewed Pacific On-Line's website and realized that the Original Website, not the Revised Website, was operational. However, in conversations with, and correspondence to, the NASD staff beginning in October 1999, Respondent McAdams did not claim that the wrong website was operational on October 5, 1999, or that there had been a problem with the web host. (Tr. pp. 352, 386; RX-17; RX-18; RX-2). Respondent McAdams testified that he was confused about which website the NASD was referencing.<sup>17</sup> (Tr. p. 366).

It was not until a conversation in June 2000 that Respondent McAdams mentioned the problem with the web host to an NASD staff member. (Tr. p. 28). Furthermore, the Respondents did not allege that there had been a web host problem in their January 2001 Answer to the Complaint. (Tr. p. 358).

The Hearing Panel therefore finds, based on the weight of the credible evidence, that the Respondents, not the web host, were responsible for the Original Website being operational on October 5, 1999.

---

<sup>17</sup> In response to the October 5, 1999 letter from the NASD staff, Respondent McAdams wrote, "We have deleted the statements referenced on Page 3 of your letter." (RX-16, p. 4). The statements referenced in Page 3 of the NASD's letter appeared in the Original Website but did not appear in the Revised Website. (JX-1; CX-19, p. 3).

## **E. The Original Website was Misleading**

### **1. Conduct Rule 2210**

Conduct Rule 2210 prohibits members and associated persons from making exaggerated, unwarranted or misleading statements or claims in their public communications.<sup>18</sup> All public communications must be based upon the principles of fair dealing and good faith, provide a sound basis for evaluating the facts discussed, and not omit material facts or qualifications that would cause the communication to be misleading in light of its context.<sup>19</sup>

Overall, these standards require a full and fair description of any securities product or service, including material information such as risks or costs of the particular product or service.<sup>20</sup> The content must be accurate and must provide sufficient information to evaluate the

---

<sup>18</sup> The 1999 version of NASD Rule 2210(d)(1)(B) provided “Exaggerated, unwarranted or misleading statements or claims are prohibited in all public communications of members. In preparing such literature, members must bear in mind that inherent in investment are the risks of fluctuating prices, and the uncertainty of dividends, rates of return and yield, and no member shall, directly or indirectly, publish, circulate or distribute any public communication that the member knows or has reason to know contains any untrue statement of a material fact or is otherwise false or misleading.”

<sup>19</sup> The 1999 version of NASD Rule 2210(d)(1)(A) provided “All member communications with the public shall be based on principles of fair dealing and good faith and should provide a sound basis for evaluating the facts in regard to any particular security or securities or type of security, industry discussed, or service offered. No material fact or qualification may be omitted if the omission, in the light of the context of the material presented, would cause the advertising or sales literature to be misleading.”

<sup>20</sup> The 1999 version of NASD Rule 2210(d)(1)(D) provided, in part, “In judging whether a communication or a particular element of a communication may be misleading, several factors should be considered, including but not limited to:

(i) the overall context in which the statement or statements are made. A statement made in one context may be misleading even though such a statement could be perfectly appropriate in another context. An essential test in this regard is the balance of treatment of risks and potential benefits.

(ii) the audience to which the communication is directed. Different levels of explanation or detail may be necessary depending on the audience to which a communication is directed, and the ability of the member given the nature of the media used, to restrict the audience appropriately. If the statements made in a

facts with respect to the securities products or services discussed.

The Complaint alleged that the Original Website violated Rule 2210 because it (i) omitted material information concerning the risks of day trading and (ii) contained six exaggerated, unwarranted, and false statements.

## **2. Absence of Disclosure of Risks of On-Line Trading**

Mr. Pappas, the Director of the Advertising Department,<sup>21</sup> testified that because the Original Website contained no risk disclosures about day trading, or investing in general, in his opinion, it violated Rule 2210(d)(1)(A). (Tr. pp. 107-108). The Respondents acknowledged that potential investors first received information concerning the risks of on-line trading when they either attended the EDT seminars or opened an account, whichever occurred first. (Tr. pp. 450-451). The Respondents argued that they complied with the advertising rule by notifying their customers of the risks of on-line trading, subsequently, in a separate document. In any event, the Respondents argued that the NASD

---

communication would be applicable only to a limited audience, or if additional information might be necessary for other audiences, it should be kept in mind that it is not always possible to restrict the readership of a particular communication.

(iii) the overall clarity of the communication. A statement or disclosure made in an unclear manner obviously can result in a lack of understanding of the statement, or in a serious misunderstanding. A complex or overly technical explanation may be worse than too little information. Likewise material disclosure relegated to legends or footnotes realistically may not enhance the reader's understanding of the communication."

<sup>21</sup> Mr. Pappas joined the Advertising Department in 1984 and has held progressively more responsible positions in the department over the years. (Tr. p. 94). Mr. Pappas was promoted to Director of the Advertising Department three years ago. (Id.).

first required specific disclosure regarding risks of on-line trading when it adopted Day Trading Rules 2360 and 2361, effective October 16, 2000, subsequent to the date of the alleged violation.<sup>22</sup>

The Hearing Panel rejects the Respondents' argument that the phrase "in the context" in Rule 2210(d)(1)(D)(i) means that the advertisement should be judged in light of the subsequent disclosures that were provided to the customers. The case law is clear that advertisements are to be judged in "the context of" material provided in the advertisement itself.<sup>23</sup> The subsequent dissemination of appropriate disclosures is not sufficient to correct a false or misleading advertisement.<sup>24</sup>

Even prior to the adoption of the Day Trading Rules, Rule 2210 required a full, fair, and balanced description of services provided by the broker-dealer, including the risks associated with such services. The Hearing Panel finds that, for the Respondents to present a full, fair, and balanced discussion of on-line trading, the Original Website should have included disclosure of the risks of on-line trading.

Accordingly, the Hearing Panel finds that the Original Website was misleading in describing the supposed benefits of on-line trading without also disclosing the risk of such trading or investing in general.

### **3. Specific Statements Deemed Misleading**

The Original Website contained the following six statements:

---

<sup>22</sup> In Notice to Members 00-62, the NASD adopted Day Trading Rules 2360 and 2361, which require broker-dealers promoting day-trading strategy to furnish a risk disclosure statement to customers prior to opening an account.

<sup>23</sup> In re Sheen Financial Resources, et al, Exchange Act Rel. 35477, 1995 SEC LEXIS 613 (March 13, 1995) (Defects in advertisements cannot be cured through subsequent detailed explanations. Advertisements must stand on their own.).

<sup>24</sup> Id.

1. “With Pacific Day Trading there is less risk because you control your own buy and sell by the second.” (“Statement 1”). (JX-4, p. 25).
2. “Do the math  
1 Point on 1000 shares=\$1000.00  
1 Point average per day=[\$]240,000.00 Annually” (“Statement 2”). (JX-4, p. 25).
3. “8 Hours of Professional Instruction, Supervised by NASD Series 24 Registered Principal.” (“Statement 3”). (JX-4, p. 7).
4. “The fastest Access to the Market today.” (“Statement 4”). (JX-4, p. 21).
5. “Stock Brokers and Market Makers have made money doing this for years, many times at your expense.” (“Statement 5”). (JX-4, p. 25).
6. “Pacific Day Trading, Inc. is a branch of \_\_\_\_\_ Trading, LLC.” (“Statement 6”). (JX-4, p. 4).

***a. Enforcement’s Exposition on the Six Statements***

At the Hearing, Mr. Pappas testified that, in his opinion, the above-statements violated NASD Rule 2210.

Mr. Pappas stated that Statement 1 “Less Risk” implied that “because you put your order in, make your own decisions on when you want to buy and sell, that you will have less risks with your investment.” (Tr. p. 113). Mr. Pappas stated that “investment risk is the same; it does not change.” (Id.). Accordingly, Mr. Pappas opined that Statement 1 was not a true statement, and it violated Rule 2210(d)(1)(D). (Id.).

Mr. Pappas testified that Statement 2 “Do the Math” was false and misleading because it was promissory. (Tr. pp. 112-113). Mr. Pappas argued that Statement 2 was placed in such a way to

imply that “all an investor needs to do is make one point per day on a trade and they will net \$240,000.” (Tr. p. 112). However, there was no disclosure about commission fees or any fees, which would impact what an investor would earn. (Tr. p. 113).

Mr. Pappas stated that Statement 3 was false and misleading because the NASD was identified in such a way to lend credibility to the service being provided.<sup>25</sup> (Tr. p. 109). Mr. Pappas argued that Statement 3 could easily be misinterpreted to mean that “this is actually an NASD person” who is providing the service. (Id.).

Mr. Pappas testified that Statement 4 “Fastest Access” was misleading because there was no basis for that statement provided in the website. (Tr. pp. 110-111, 140). Specifically, Mr. Pappas testified that the website contained no information that would allow an investor to evaluate whether or not Statement 4 was accurate. (Tr. p. 140).

Mr. Pappas testified that Statement 5 was false and misleading because it implied that customers were abused by stockbrokers and market-makers who used electronic systems. (Tr. p. 111). Mr. Pappas argued that this was an exaggeration because it failed to disclose that some stockbrokers and market-makers had been losing money using electronic systems and it failed to disclose that customers could also lose money using electronic systems. (Tr. pp. 111-112).

Mr. Pappas opined that Statement 6 was false because Pacific On-Line was a broker-dealer as of January 7, 1999, not a branch office of a broker-dealer. (Tr. p. 109).

***b. The Respondents’ Exposition on the Six Statements***

---

<sup>25</sup> Specifically, Mr. Pappas testified that Statement 3 is a violation of Rule 2210(D)(2)(J), which “states that members may not use the Association name or the name of any regulatory, other regulatory body to imply approval or

The Respondents argued that, in the context in which these statements were made, i.e., primarily to solicit customers for EDT's training services, they had a reasonable basis for each of the statements; therefore, the statements were not exaggerated, unwarranted, or misleading. Statements 1 through 3 and 5 appear on EDT's sub-site. (JX-4, pp. 7, 25). Only Statements 4 and 6 appear on Pacific On-Line's sub-site. (JX-4, pp. 4, 21).

With regard to Statement 1, "Less Risk," Respondent McAdams testified that he was referring to the "risk of not possibly being able to contact a broker" in a timely manner. (Tr. pp. 327-328). Accordingly, the Respondents claimed they reasonably believed that, compared with customers who use a broker, the risk of failure to execute was less. (Id.). Mr. Lowry, Respondent's expert, also testified that he believed that customers would view Statement 1 solely as a reference to the risk of execution. (Tr. p. 404). Because there is less risk of failure of execution with the RealTick system, in his opinion, Statement 1 was not exaggerated, unwarranted, or misleading. (Tr. p. 405).

Respondent McAdams stated that Statement 2, "Do the Math," referred to the costs of trading, not to possible trading profits. (Tr. pp. 328-329). Mr. Lowry also believed that customers would read Statement 2 as referring to costs. (Tr. pp. 407-408). Mr. Lowry testified that, with real time information, an investor has the ability to execute the trade closer to the quoted price, reducing the costs of execution, and that "Do the Math" referred to the increased costs incurred by customers who do not have real time information. (Id.).

Respondent McAdams testified that Statement 3, regarding instruction by a Series 24, was not intended to imply that the NASD endorsed the service provided by EDT, but was simply meant to state

---

endorsement by the Association." (Tr. p. 109). Mr. Pappas also testified "there is nothing in the Series 24 exam that

a fact--that the person supervising the class had a Series 24 license. (Tr. p. 331). Mr. Lowry testified that, in his opinion, because Statement 3 was made in the context of services for EDT and was surrounded by information that would only be useful to someone “pretty knowledgeable with the security industry,” it would not have been viewed by such an individual as suggesting that the NASD approved the service. (Tr. p. 410).

With regard to Statement 4, “Fastest access,” Respondent McAdams argued that he made the statement based on the information that was provided to him by Mr. Townsend<sup>26</sup> concerning the software, and based on the configuration of the hardware that he provided to his customers. (Tr. pp. 301-303). Mr. Lowry testified that he compared the access provided by Pacific On-Line’s program with his previous experience with a Level II machine, and, based on his comparison, Statement 4 was not exaggerated. (Tr. pp. 402-403).

With respect to Statement 5, concerning market makers, Respondent McAdams testified that he intended customers to understand that he was providing a system that was similar to the one that market makers had used for years to make money. (Tr. p. 334).

With respect to Statement 6, Respondent McAdams reiterated that he believed the statement was true because he was operating Pacific On-Line as a branch office of \_\_\_\_\_ during the period from January 1999 to March 1999. (Tr. p. 335). Respondent admitted that as of October 5, 1999, Statement 6 was false. (Tr. p. 335).

### *c. Discussion*

---

prepares the candidates to teach day trading strategies.” (Tr. p. 110).

After primarily reviewing the Original Website, the six statements therein, and the positions of the statements on the sub-sites, then also reviewing the testimony of Mr. Pappas, Mr. Lowry,<sup>27</sup> and Respondent McAdams, the Hearing Panel finds that each of the six statements is misleading.

Respondent McAdams may only have meant to imply in Statement 1 that the risk of failure of execution is less, but Statement 1 does not expressly refer to execution risk. As drafted Statement 1 reads “less risk,” which customers might reasonably interpret as referring to less market risk, less risk of volatility, etc., none of which would be true. Accordingly, Statement 1 is misleading.

With respect to Statement 2, “Do the Math,” the Respondents may have intended customers to interpret the statement as a reference to costs of transactions. However, the Hearing Panel finds that potential investors would reasonably interpret Statement 2 to refer to trading profits, especially because on the website, Statement 2 immediately follows Statement 5, which indicates that stockbrokers “have made money doing this for years.” The Hearing Panel finds that a customer reasonably would view Statement 2 as promising profits for those engaging in on-line trading through Pacific On-Line. Accordingly, the Hearing Panel agrees with Mr. Pappas that such a statement is promissory and misleading.

With respect to Statement 3, the Hearing Panel finds that there is an inference that because Respondent McAdams is registered as an NASD Series 24, he is more qualified than someone else to

---

<sup>26</sup> Mr. Townsend testified that based on tests of his software system, his RealTick system provided the fastest access to the market. (Tr. p. 315). RealTick is a windows application that allows the user to see market data, news, and order entry in real time. (Tr. p. 308).

<sup>27</sup> The Hearing Panel noted that Mr. Pappas evaluates advertising claims within the context of Rule 2210 as a regular part of his duties. In contrast, Mr. Lowry did not “claim to be an expert specifically on Rule 2210.” (Tr. p. 413). Nor had Mr. Lowry ever testified as an expert in a case on the issue of advertising. (Tr. p. 424). Accordingly, the Hearing Panel finds Mr. Lowry’s opinions about the statements less persuasive than those of Mr. Pappas.

provide market training. Respondent McAdams testified that he wanted the potential EDT customers to know that the course was “being taught by somebody who basically understands something of the stock market.” (Tr. p. 395). However, taking the NASD Series 24 supervisory exam does not necessarily qualify anyone to teach a course about trading. Accordingly, the Hearing Panel finds that Statement 3 was misleading in that it carried an implied indication of NASD approval for the service being discussed in the advertisement.

The Hearing Panel finds that Statement 5 is misleading because it implies that customers will have the same access to the market as stockbrokers and market makers. Respondent McAdams admitted that, even using Pacific On-Line’s system, on-line trading customers would not have the same capability as that of market makers and stockbrokers. (Tr. p. 334).

The Hearing Panel specifically considered whether the position of Statements 1 through 3 and 5 on EDT’s sub-site, rather than on Pacific On-Line’s sub-site, altered its conclusions. The Hearing Panel found that the Pacific On-Line sub-site and the EDT sub-site were hyperlinked to each other on every page; both sub-sites were designed to tout the advantages of on-line trading; EDT’s sub-site specifically touted the services of Pacific On-Line;<sup>28</sup> the sub-sites were both created by Respondent McAdams; and Respondent McAdams treated the sub-sites as one advertisement by filing them both with \_\_\_\_\_. Accordingly, in this instance, the Hearing Panel finds that the sub-sites were so interrelated that the position of the statements on EDT’s sub-site, rather than Pacific On-Line’s sub-site, did not alter the misleading character of the statements.

---

<sup>28</sup> The EDT sub-site stated, in part, “[W]ith the click of your mouse or stroke of a key, Pacific Day Trading enables the investors to take advantage of short swing moves in the market.” (CX-4, p. 25).

Statements 4 and 6 appeared on Pacific On-Line's sub-site. With respect to Statement 4, Pacific On-Line's access to the market may have been one of the fastest available at the time,<sup>29</sup> but, the Respondents confused two separate issues: (i) whether the Respondents provided viewers with a sound basis for evaluating Statement 4; and (ii) whether the Respondents had a reasonable basis for making Statement 4. Even if Respondents had a reasonable basis, Subsection (d)(1)(A) of Conduct Rule 2210 requires the communication to provide "a sound basis for evaluating the facts." This provision was designed to ensure that members of the public have sufficient independent information to evaluate claims made in an advertisement.<sup>30</sup> The Respondents' Original Website did not provide readers with a sound basis to evaluate Statement 4. Accordingly, the Hearing Panel finds that Statement 4 is misleading.

The Respondents acknowledged that Statement 6 was misleading as of October 5, 1999. The Hearing Panel also finds that Statement 6 was misleading for the period January 1999 through March 1999.

The Hearing Panel finds that the Respondents did not intentionally disseminate misleading statements, but intent is not required to establish violations of the advertising rules.<sup>31</sup> Furthermore, although they did not intend to mislead investors, the Respondents should have realized, for example, that investors might reasonably interpret Statement 2 to mean trading profits; that their references to

---

<sup>29</sup> Mr. Townsend testified that he had licensed his RealTick software to approximately five other firms during the relevant time period. (Tr. p. 324).

<sup>30</sup> District Business Conduct Committee for District No. 2 v. Daniel C. Montano, Complaint No. C02950050, 1997 NASD Discip. LEXIS 8 (NBCC, Jan. 23, 1997).

<sup>31</sup> Id.

“less risk” might be interpreted as meaning less market risk; and that reasonable investors might interpret Statement 5 as meaning that they would have the same capability as professional traders.

There is no evidence that any customers relied on the statements to their detriment. However, disciplinary proceedings are instituted to protect the public interest, not to redress private wrongs. Accordingly, to find a violation, it is unnecessary to show customers relied on the misleading statements.<sup>32</sup>

Publishing an advertisement that fails to conform to the general standards of Conduct Rule 2210 is inconsistent with high standards of commercial honor and just and equitable principles of trade. Accordingly, the Hearing Panel finds the Respondents violated Rules 2210 and 2110.

### **III. Sanctions**

The NASD Sanction Guidelines governing communications with the public provide that failure to file an advertisement warrants a fine ranging from \$1,000 to \$15,000.<sup>33</sup> The principal considerations in setting the fine are: (i) whether the failure to file was inadvertent; (ii) whether the communication with the public was widely circulated; and (iii) whether an individual respondent failed to notify a supervisor of the communication with the public.

The Guidelines governing communications with the public also provide for a fine ranging from \$1,000 to \$20,000 for inadvertent use of misleading communications or a fine ranging from \$10,000 to

---

<sup>32</sup> Wall Street West, Inc. v. SEC, 718 F.2d 973, 1983 U.S. App. LEXIS 16129 (Oct. 12, 1983) (The court held that there is no evidence that anyone was actually misled by the stationery in question is legally irrelevant.)

<sup>33</sup> NASD Sanction Guidelines, p. 87 (2001).

\$100,000 for intentional or reckless use of misleading communications.<sup>34</sup> The principal consideration listed for setting the fine is whether violative communications with the public were circulated widely.

Without distinguishing between the failure to file and the use of misleading communications, Enforcement recommended that Respondent Pacific On-Line be censured and fined a total of \$50,000. Enforcement also recommended that Respondent McAdams be suspended for two weeks and fined a total of \$25,000 for both the failure to file, and the use of misleading communications.

In arriving at appropriate sanctions, the Hearing Panel considered several important mitigating circumstances. First, it was the responsibility of \_\_\_\_\_, as the NASD member firm, to file the Original Website advertisement in 1997. Respondent McAdams reasonably believed that \_\_\_\_\_ had filed the Original Website with the NASD, and that the NASD had approved it. Second, the Respondents' compliance consultant advised Respondent McAdams that Pacific On-Line could continue to operate as a branch office in January 1999, after it became an NASD member. (Tr. pp. 196, 201). Respondent relied on that advice.

In light of these factors, the Hearing Panel concludes that, for failing to file Pacific On-Line's active website with the NASD as advertising material when Respondent Pacific On-Line became registered as an NASD member, a fine at the low end of the Guidelines is appropriate. Accordingly, for violating Rules 2210(c)(3)(A) and 2110, the Respondents are jointly and severally fined \$2,500, and Respondent Pacific On-Line is censured.

The Hearing Panel also considered Respondent McAdams' reasonable belief that the Original Website had been previously approved by the NASD and his belief that Pacific On-Line could continue

---

<sup>34</sup> Id. at 88, 89.

to operate as a branch office as mitigative for the Respondents having used the misleading website from January 1999 to March 1999 and on October 5, 1999. In addition, the Hearing Panel considered the subsequent distribution of risk disclosures as mitigative for purposes of sanctions.<sup>35</sup> Further, the Hearing Panel concluded that the Respondents' use of misleading statements was not intentional or reckless, and that the violation involved statements that had misleading implications, rather than outright falsehoods.

However, the Hearing Panel also considered as aggravating the seriousness of the omissions and the misleading information included in the website, which had the potential to be widely viewed. The Hearing Panel also considered Respondent McAdams' continued failure to appreciate that the Original Website as drafted was misleading. Accordingly, for violating Rules 2210(d) and 2110, the Respondents are jointly and severally fined \$7,500, and Respondent McAdams is required to requalify as a general securities principal within 90 days.

#### **IV. Conclusion**

The Hearing Panel, jointly and severally, fines the Respondents \$2,500 and censures Respondent Pacific On-Line for violating Rules 2210(c)(3)(A) and 2110 by failing to file Pacific On-Line's active website with the NASD as advertising material when Respondent Pacific On-Line became an NASD member in January 1999.

The Hearing Panel jointly and severally fines the Respondents \$7,500, and Respondent McAdams is required to requalify as a general securities principal within 90 days for violating Rules 2210(d) and 2110 by using a misleading website from January 1999 to March 1999 and on October 5, 1999.

---

<sup>35</sup> In the Matter of Thomas S. Foti, Exchange Act Rel. 31646, 1992 SEC LEXIS 3329 (Dec. 23, 1992).

In addition, the Respondents are jointly and severally ordered to pay the \$3,612 hearing cost, which includes an administrative fee of \$750 and hearing transcript costs of \$2,862.

These sanctions shall become effective on a date set by the Association, but not earlier than 30 days after the date this decision becomes the final disciplinary decision of the Association.<sup>36</sup>

**HEARING PANEL**

---

By: Sharon Witherspoon  
Hearing Officer

Dated: Washington, DC  
December 7, 2001

Copies to:

Pacific On-Line Trading & Securities, Inc. (via Airborne Express and first class mail)  
Timothy Alan MacAdams (via Airborne Express and first class mail)  
M. Van Smith, Esq. (via facsimile and first class mail)  
David A. Watson, Esq. (via electronic and first class mail)  
Rory C. Flynn, Esq. (via electronic and first class mail)

---

<sup>36</sup> The Hearing Panel considered all of the arguments of the parties. They are rejected or sustained to the extent they are inconsistent or in accord with the views expressed herein.