NASD REGULATION, INC.
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,	:	
Complainant,	:	Disciplinary Proceeding No. C07000090
v.	:	
	:	Hearing Officer - AWH
WALTER REINHARDT (CRD #2468084),	:	**Hearing Panel Decision**
Hillsborough, NC	:	
Capital Investor Group Durham, NC	:	
Respondent.	:	August 2, 2001

Registered representative (1) engaged in private securities transactions for compensation without giving prior written notice to, and without receiving written approval from, the member with which he was associated, in violation of Conduct Rules 2110 and 3040, and (2) forged the signature of a customer on account transfer documents, in violation of Conduct Rule 2110. Respondent barred from associating in any capacity with any member firm for violation of Conduct Rules 2110 and 3040. Respondent fined $20,000, suspended in all capacities for two years, and ordered to requalify before re-entry into the securities industry for forgery in violation of Conduct Rule 2110.

Appearances:

Gary M. Lisker, Esq., for the Department of Enforcement

Michael L. Unti, Esq., and Sharon L. Smith, Esq., for Walter Reinhardt

DECISION

Introduction

On December 1, 2000, the Department of Enforcement ("Enforcement") issued the Complaint in this matter, alleging that Walter Reinhardt ("Reinhardt" or "Respondent") (1) sold certain corporate promissory notes for compensation without giving written notice to, or receiving written permission from, his member firm, and (2) forged a customer's signature on several account transfer documents. On February 6, 2001, Reinhardt filed an Answer to the Complaint, admitting that he sold the notes without giving notice to, or receiving written permission from, his member firm, and that he signed the customer's name to an account transfer form. In his Answer, he also alleged mitigating circumstances with respect to each of the two causes in the Complaint. A hearing was held in Morrisville, North Carolina, on May 22, 2001, before a Hearing Panel composed of the Hearing Officer and two current members of District Committee No. 7.

Findings of Fact

Walter Reinhardt first qualified as an Investment Company and Variable Contracts Products Representative of a member of the NASD in or about April 1994.[1] Stip., ¶ 1. He was registered with member firm PMG Securities Corporation ("PMG") from December 1996 to December 1998, and with member firm Aura Financial Services, Inc., from June 1999 to February 2001. Stip. ¶ 2. He is not currently associated with an NASD member firm. Tr. 14. Because the Complaint in this case was filed within two

[1] References to the parties Stipulations are designated as Stip._; Enforcement's exhibits, as CX_; Respondent's exhibits, as RX_; and the Transcript of the hearing, as Tr._.

years of the effective date of termination of Reinhardt's registration, the NASD has jurisdiction over him for purposes of this proceeding under Article V, Section 4 of the NASD By-Laws.

Sales of Promissory Notes

Reinhardt formed Capital Investor Group, an entity not a member of the NASD, to contract and license securities representatives to sell tax sheltered annuities and certain insurance products. He also used Capital Investor Group to offer commercial paper, including the promissory notes described below, to members of the public.

Through Capital Investor Group, between August 1997 and June 1998, Reinhardt sold corporate promissory notes issued by Public Benefit Consultants to 13 customers, for a total investment of $281,351. A ten-percent commission was charged on each sale, with a two-percent fee paid to the underwriter, and the remaining eight-percent paid to Reinhardt. The 13 customers did not have accounts with PMG. Stip. ¶ 5.

Through Capital Investor Group, between January 1998 and May 1998, Reinhardt sold corporate promissory notes issued by Medical Practice Management to five customers, for a total investment of $65,000. A ten-percent commission was charged on each sale, with half of each commission paid to Daniel Caudell of Raleigh, North Carolina, and half paid to Reinhardt. The five customers were clients of Reinhardt and/or Caudell, and did not have accounts with PMG. Stip. ¶6.

Through Capital Investor Group, between March 1998 and September 1998, Reinhardt sold corporate promissory notes issued by Cybermotion, Inc., to 22 customers, for a total investment of $320,000. A ten-percent commission was charged on each sale, with a

three-percent fee paid to the underwriter, and the remaining seven-percent paid to Reinhardt. The 22 customers did not have accounts with PMG. Stip, ¶ 4.

Reinhardt admits that the promissory notes issued by Public Benefits Consultants, Medical Practice Management, and Cybermotion, Inc., (collectively, the "Notes") that he sold to his customers are securities. Complaint, ¶ 6; Answer, ¶ 6. The offering materials for the Public Benefits Consultants notes refer to their 36-month duration and their similarity to corporate bonds; and the materials consistently refer to the notes as "securities." CX 3, at 0027, 0032-34, 0038. On the first page of each of the three private Offering Memorandums for the Notes of Public Benefits Consultants, Medical Practice Management, and Cybermotion, Inc., they are specifically referred to as "securities," and two pages later, the following language appears: "TRANSFER OF THE NOTES (WHICH ARE CONSIDERED SECURITIES)…." CX 3, at 0051, 0053; CX 4, at 0091, 0093; CX 5, at 0147, 0149. Reinhardt provided a copy of the offering materials to each of the 40 customers who bought the Notes. Tr. 21.

Reinhardt admits that he did not give written notice to PMG of his participation in the sale of the Notes. Tr. 29, 35. He also admits that he did not receive written permission from PMG to participate in the sale of the Notes. Answer, ¶ 7.

In June and July 1998, an investigator for the North Carolina Securities Division posed as a potential investor for her mother's funds and met with Reinhardt at his office. He gave her offering materials for the Notes, which included information on Cybermotion, Inc., and Public Benefits Consultants, Inc. That information was printed on two sheets of paper containing the letterhead of Capital Investors Group, a business of which Reinhardt was listed as "CEO." At the bottom of the letterhead page that contained information about Cybermotion, the following

notation appeared: "Securities Offered through PMG Securities Corp. _____ New York, NY _____ …." CX 2, at 0010. At the bottom of the letterhead page that contained information about Public Benefits Consulting, Inc., the following notation appeared: "Securities Offered Through Capital Investor Group Member NASD & SIPC…." CX 2, at 0012. Reinhardt testified that each of the two notations appeared because of a mistake made by an intern in his office, and these were the only copies with such notations that were ever sent to a potential customer. Tr. 17, 33. When she was at his office, the investigator picked up one of Reinhardt's business cards that stated at the bottom on the front of the card: "Securities Offered Through PMG Securities." CX 2, at 0017. On the back of the business card the following appears: "Branch Office, _____, New York, NY _____," the address of PMG Securities. CX 2, at 0018.

Forgery of Customer's Signature

In January 2000, Reinhardt signed BG's name to 3 change-of-dealer forms (to Aura Financial Services, Inc.) and a new account application for Aura Financial Services, Inc., without her prior authorization. CX 13. BG had become a client of Reinhardt in or about 1995, but, without informing Reinhardt, she transferred her account away from him approximately two years later. CX 9. After signing BG's name to the change-of-dealer forms, Reinhardt did not attempt to execute any sales or purchases of securities on behalf of BG. Stip. ¶¶ 7, 8.

Discussion

Sales of Promissory Notes

Conduct Rule 3040 prohibits any person associated with a member of the NASD from participating in any manner in a private securities transaction without first providing the member with written notice of the proposed transaction and the person's proposed role in the transaction. If the associated person has received, or may receive selling compensation, the associated person must obtain written notice of the member's approval under Rule 3040(c). A violation of Rule 3040 constitutes a violation of Rule 2110 which provides that "[a] member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade." *See In re Stephen J. Gluckman*, 1998 NASD Discip. LEXIS 8, *15. Notwithstanding Reinhardt's position in his pre-hearing brief that Rule 2110 applies only to members, the ethical standards imposed on members by Rule 2110 apply equally to persons associated with members. NASD Rule 115 states that persons associated with a member shall have the same duties and obligations under the NASD's rules as members.

The offering memoranda describe the Notes as securities, the parties have stipulated that they are securities, and they are clearly securities under the standards set forth in *Bob Reves, et al. v. Ernst & Young*, 494 U.S. 56 (1990). As noted in the findings of fact, Reinhardt admits that he did not give written notice to, nor receive written approval from, PMG prior to selling the notes. Accordingly, by selling those Notes for compensation, he violated Conduct Rules 2110 and 3040.

Forgery of Customer's Signature

BG, a middle school teacher, became a client of Reinhardt in 1995, but approximately two years later, she transferred her account to another representative and firm without informing Reinhardt. CX 9. He had not spoken to her for some time, and thinking that she was still his customer, he called her in January 2000 to arrange the transfer of her account to his new broker dealer. Answer, at ¶ 9; CX 10.

In his testimony, Reinhardt claims that he called BG during a snow storm and spoke to her husband who said that she "was walking somewhere to pick up some groceries, or something like that." Tr. 56-58. Reinhardt then testified that he told BG's husband that he "was going to change her registration, and if there was any objection to let [him] know." Tr. 58. He never heard back from BG. In a letter of complaint to NASDR, dated February 16, 2000, BG described the discovery of her forged signatures and her efforts to change the accounts back to her chosen representative. The letter contains the following comments:

> …Rinehardt (sic) agreed that I had not signed the papers but that he had spoken to my husband to get the permission to change advisors. I assured him that this was not true. My husband has not spoken with Mr. Rinehardt. Even if Mr. Rinehardt had called my home and spoken with my husband, he would not have gotten authorization from him. My husband does not interfere with or have knowledge of my financial matters. In fact, I find it somewhat amusing that during the time Mr. Rinehardt was supposedly speaking with my husband, I was at home. This was the week that Durham had 20 inches of snow and school was closed for more than a week.

CX 9.

The Hearing Panel concludes that it is not likely that BG was walking outside on an errand when Reinhardt called, or that her husband would so claim during a blizzard with a 20-inch snowfall. Reinhardt testified that BG was the last person on a long list of people he had

been trying to contact to change broker dealers. Tr. 56, 57. In view of Reinhardt's testimony that "these teachers don't return telephone calls, and that's my job to be persistent," the Hearing Panel concludes that it is more likely that Reinhardt just went ahead and signed her name to the documents. Even if the Hearing Panel were to accept his story on its face, he had no basis for signing the forms. He admits that he never spoke to the customer, nor obtained her authorization to sign the forms. Frustrated by his inability to contact her directly, he spoke to her husband (whom she had not designated as her agent for purposes of the account) and, through him, gave her a negative option to veto the transfer of the accounts. He had no authority to do that, and so was acting improperly when he went ahead and signed the forms.

Sanctions

For violations of NASD Conduct Rules 2110 and 3040, NASD Sanction Guidelines recommend fines of from $5,000 to $50,000, and consideration of suspensions in any and all capacities for up to one year. In egregious cases, the Guidelines provide for consideration of a longer suspension (of up to two years) or a bar. NASD Sanction Guidelines 19 (2001 ed.). Enforcement contends that given the aggravating circumstances of the violation, the dollar amounts of the transactions, the commissions earned, and the number of customers involved, this is an egregious case that calls for a bar. The Hearing Panel agrees that a bar is warranted.

The violations are clearly egregious based on the number of products sold, the number of customers involved, the total sales amount, the period of time over which the sales took place, and the amount of commissions earned from those sales. Reinhardt sold the Notes over a period of 10 months to 40 customers who invested approximately $666,000 and generated roughly $48,000 in commissions for himself.

Reinhardt argues, in mitigation of the violations, that he believed, in good faith, that the Notes were not securities and that therefore he could sell them. The Hearing Panel does not find that argument persuasive. The offering materials explicitly stated that the Notes were securities, and Reinhardt had an obligation to read those materials. Either he knew that the Notes were securities, or he abrogated his responsibility to read the offering materials. In either case, he cannot claim that he was acting in good faith. Reindhardt's due diligence in determining whether the Notes were securities consisted of reading advertisements for corporate notes in life and health trade journals and concluding from them that such notes could be sold by "life and health licensed agents." Tr. 27. Slightly more rigorous efforts at due diligence using the internet have been found to be "both minimal and ineffectual," and not sufficient to mitigate sanctions. *DOE v. Fergus et al.*, No. C8A990025 (NAC May 17, 2001) *at* http://www.nasdr.com/pdf-text/nac0501_02.pdf, at 23. In any event, because the offering materials expressly referred to the Notes as securities, his "good faith" argument is untenable, regardless of what advertisements for notes he may have read in journals. He should have sought guidance from his employer, and he should have recognized the continual references in the offering materials to the Notes as "securities" as a red flag and checked with PMG. *Id*.

Reinhardt also argues, in mitigation of the violations, that he gave PMG verbal notice of his involvement with the Notes. Paragraph 7 of the Answer states:

> Further answering, Respondent states that he notified PMG of his desire to sell the Notes and that an officer of PMG, Robert Houck, advised Respondent: (1) that PMG was not interested in selling corporate notes as part of its business, (2) that Respondent could proceed as an independent broker, (3) that he should not hold himself out as an agent of PMG during the course of such transactions, and (4) that if any problems develop with such transactions, Respondent would no longer be allowed to work with PMG.

Had Reinhardt given written notice of his participation in these private securities transactions, there would be no need to resolve the conflict in the evidence, described in the paragraphs below, regarding whether he gave PMG some form of oral notice. At the hearing, Reinhardt initially testified that he did not remember speaking to Robert Houck (the correct name is Hock). He later testified that he might have spoken to him because he assumed the person to whom he spoke was Hock, although he did not have a specific recollection that it was Hock. Tr. 30, 31. However, he testified that the substance of the conversation he had with someone in the Compliance Department of PMG was accurately stated in his Answer. Tr. 32.

Robert Hock, currently employed by PMG and, until March 2000, its owner and active in its Compliance Department, testified by telephone that he had never met Reinhardt and has never had a conversation with him such as was alleged in the above quotation from the Answer to the Complaint. Tr. 70, 71, 73. In the period 1997 through 1999, the other corporate officers were Laura Cognetti, Walter McVey, and Justin Shu. Tr. 75. Since 1997, all compliance questions have been referred to Laura Cognetti. Tr. 76, 79.

Laura Cognetti, Vice-President and Chief Compliance Officer of PMG since 1997, testified by telephone that she never had any conversation with Reinhardt in which he either expressed an interest in selling corporate promissory notes or stated his intention to sell corporate promissory notes and asked if PMG would be involved or permit it. Tr. 80. Walter McVey, Senior Vice-President and Chief Operating Officer of PMG, testified by telephone that he recalled speaking to Reinhardt about a tax

shelter annuity program, but that he could recall no conversations with him regarding corporate notes or any other investment businesses with which Reinhardt may have been involved. Tr. 83, 84. Justin Shu is no longer with PMG. Tr. 74.

The Hearing Panel concludes that Reinhardt never had any discussions with anyone from PMG about his intention to sell the Notes. Three of the four officers of PMG during the time at issue denied that they had such a discussion with Reinhardt, and it is more likely than not that the one officer who is no longer with PMG did not have such a conversation, because all compliance issues were to be referred to Laura Cognetti, who knew nothing about the matter. Moreover, the allegation that an officer of PMG said that Reinhardt "could proceed as an independent broker" makes no logical sense. First, there is no such thing as an independent broker of securities. Securities can only be sold by an NASD member or a person registered with a member, which PMG surely knew. Second, since Reinhardt was registered with PMG, any securities sales by him might well subject PMG to liability to injured customers. Indeed, the risk of such liability is one of the key justifications for Rule 3040's requirements. PMG would surely have recognized this risk, and, because it did not stand to gain anything from allowing the sales, it would not likely have allowed Reinhardt to expose the firm to such risk. Finally, because PMG knew that Reinhardt was registered only as an Investment Company and Variable Contract Products Limited Representative (Series 6), the firm knew that he was not allowed to sell securities such as the Notes under any circumstances. For all these reasons, the Hearing Panel finds that Reinhardt did not give verbal notice to PMG of his sales of the Notes.

For forgery of documents, the Guidelines call for a fine of from $5,000 to $100,000, a suspension for up to two years where mitigating circumstances exit, and a bar in egregious

cases. NASD Sanction Guidelines 43 (2001 ed.). The principal considerations in determining sanction are (1) the nature of the documents forged, and (2) whether the respondent had a good-faith, but mistaken, belief of express or implied authority.

The Hearing Panel concludes that Reinhardt has failed to show that he had a good faith, but mistaken, belief of express or implied authority. The facts clearly demonstrate that he never spoke to BG about the change of dealer forms or the new account application. Clearly then, there was no express authority for Reinhardt to sign her name, and there is no factual predicate for concluding that he had implied authority from her to sign on her behalf. Even if he had spoken to BG's husband (a finding the Hearing Panel declines to make), there is no evidence that her husband had any authority over her accounts. Finally, Reinhardt tried to make the forgery look like her signature. Tr. 40. Had he truly been under the impression that he had some kind of authority from her to sign, he would not have had to be concerned that the signature looked like hers.

On October 29, 1999, four months after becoming registered with Aura Financial Services, Inc., Reinhardt responded in writing to an NASDR compliance examiner who had requested certain information. In that letter, Reinhardt included a "general statement" concerning the consequences of his "failure to properly disclose outside business activity and/or have my previous broker dealer review and approve these corporate notes…." The letter concluded by referring to his employment with Aura Financial Services, and stating: "There is no question that all business activities will be reviewed and approved, and that all matters of compliance will be handled by the book." CX 8, at 2. Because the forgery took place just three months after Reinhardt made this assurance to the NASDR compliance examiner, the

Hearing Panel concludes that his failure to adhere to his promise to handle everything by the book shows his tendency to ignore the rules and proper business practices whenever it suits him.

With regard to the nature of the documents forged, the three change-of-dealer forms transferred three mutual fund accounts to Reinhardt at Aura Financial Services, Inc. Although he did not execute any sales or purchases of securities after signing BG's name to the forms, his misconduct was not so benign. After she had purposefully moved her accounts away from Reinhardt, he moved them to where she clearly did not want them to be. Accordingly, his misconduct was injurious to BG because it encroached on her rights as a customer. *See DBCC v. Kirschbaum*, No. C07960069, 1998 NASD Discip. LEXIS 36, at *12 (NBCC August 25, 1998).

Having considered the nature of the documents forged, the intent of the Respondent, the fact that only one customer was involved, and the fact that there is no evidence that Reinhardt benefited financially from the forgeries, the Hearing Panel concludes that this is not an egregious case warranting a bar. However, forgery is a serious offense that cannot be tolerated and warrants a fine and suspension significant enough to deter Reinhardt from engaging in future misconduct and encourage the use of care and sound judgment in all aspects of his employment in the securities industry. His explanation of what he did, even taken at face value, displays an apparent disregard for his clients' rights and the applicable rules and regulations, which leads to the reasonable conclusion that he presents a danger to investors, and that strong sanctions are necessary to impress upon him the need to follow the rules. Accordingly the Hearing Panel will impose a fine of $20,000, and a suspension for two years from associating with any member

firm in any capacity, and ordered to requalify as an Investment Company and Variable Contracts Products Representative before re-entering the securities industry.

The fine for forgery in violation of Conduct Rule 2110 shall become due and payable upon his re-entry into the securities business. The bar for violation of Conduct Rules 2110 and 3040 shall become effective immediately if this Decision becomes the final disciplinary action of the NASD.

SO ORDERED.

_____

Alan W. Heifetz
Hearing Officer
For the Hearing Panel

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