

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

DEPARTMENT OF ENFORCEMENT,	:	
	:	
	:	Disciplinary Proceeding
Complainant,	:	No. CAF980094
	:	
v.	:	
	:	
	:	HEARING PANEL
	:	DECISION
	:	
	:	
	:	Hearing Officer - DMF
	:	
	:	
Respondent.	:	May 7, 1999

Digest

The Department of Enforcement filed a Complaint alleging that respondent _____ violated Section 17(a) of the Exchange Act, SEC Rule 17a-5, and NASD Rule 2110 by failing to file Form BD-Y2K in a timely manner. Form BD-Y2K was promulgated by the SEC to collect information regarding the steps broker-dealers have taken, or plan to take, to address potential Year 2000 computer problems. All NASD member firms were required to file Form BD-Y2K with the SEC and the NASD on or before August 31, 1998.

The Complaint alleged that _____ did not file its Form BD-Y2K until October 2, 1998. _____ filed an Answer to the Complaint in which it admitted that it did not file the Form until October 2, but argued that its late filing should be excused because the delay was attributable to confusion caused by certain communications _____ received from the NASD. _____ requested a hearing in its Answer, but Enforcement and _____ subsequently

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agreed that the case should be submitted to the Hearing Panel based on written submissions, including stipulated facts and briefs of the parties.

Based on the written submissions, the Hearing Panel determined that _____ failed to file its Form BD-Y2K in a timely manner, and thereby violated Rule 2110. The Hearing Panel found, however, that _____ failed to file the Form on time because it believed, based on a mistaken interpretation of communications it received from the NASD, that the NASD had terminated its membership in the Association. The Hearing Panel also found that Enforcement intended to give _____, like other member firms that failed to file Form BD-Y2K on time, a “grace period” within which it could have filed the Form without any disciplinary action, but that _____ did not receive notice of the grace period until after it had expired. The Hearing Panel noted that, once _____ received notice of the grace period and learned that the NASD had not canceled its membership, _____ promptly filed the Form. The Hearing Panel concluded that if _____ had received timely notice of the grace period, it would likely have filed within that period, and therefore would not have been subjected to disciplinary action. In light of all these circumstances, the Hearing Panel concluded that the appropriate sanction for _____ violation was a Letter of Caution, in the form of the Hearing Panel Decision. The Hearing Panel found that a censure and a fine, as sought by Enforcement, were not appropriate to accomplish the NASD’s remedial goals under the facts of this case.

Appearances

Jonathan Golomb, Washington, DC (Rory C. Flynn, Washington, DC, Of Counsel), for the Department of Enforcement.

_____, Newark, NJ,
for Respondent.

DECISION

Introduction

The Department of Enforcement filed its Complaint against respondent _____ on October 20, 1998. The Complaint charges that _____ failed to file its Form BD-Y2K in a timely manner, in violation of Section 17(a) of the Exchange Act, SEC Rule 17a-5, and NASD Rule 2110. Specifically, the Complaint alleged that, although the Form was due on or before August 31, 1998, _____ did not file its Form until October 2, 1998.

_____ filed an Answer to the Complaint in which it admitted that it did not file the Form until October 2, 1998. _____ argued, however, that its delay in filing the Form should be excused because it was attributable to confusion caused by certain communications that _____ received from the NASD. _____ requested a hearing in its Answer, but Enforcement and _____ subsequently agreed that the case should be submitted to the Hearing Panel based on written submissions, including stipulated facts and briefs of the parties.

Accordingly, the Hearing Panel, which was composed of an NASD Hearing Officer and two current members of the District Committee for District 9, considered the charge based on the stipulated facts (“Stip.”) and exhibits (“JX 1-11”), and the briefs of the parties.

Facts

The SEC promulgated Form BD-Y2K, pursuant to Section 17(a) of the Exchange Act and SEC Rule 17a-5, in order to collect data regarding the steps broker-dealers have taken, or

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plan to take, to address potential Year 2000 computer problems. Those problems are potentially serious for the securities industry, and therefore collection of the information is important. NASD member firms were required to submit Form BD-Y2K to both the SEC and the NASD on or before August 31, 1998.

_____ is a broker-dealer, and has been a member of the NASD since 1992. _____ was formed by two partners, _____ and _____. _____ is not a retail broker-dealer servicing public customers, but rather has been primarily involved in offering investment advice to and executing trades for several investment partnerships known as the _____, which invest primarily in distressed properties. As of 1998, the Funds were in the process of winding down, but because the Funds' investments are often illiquid, _____ still had work to do on behalf of the Funds. (Stip. ¶¶ 1-3.)

In March 1998, the NASD began a routine examination of _____, and in April, in connection with the examination, an NASD compliance examiner wrote to _____ asking, among other things, for “[a] legal opinion from your firm’s attorney as to whether _____ needs to remain a registered broker/dealer in order to liquidate the positions in the limited partnerships for which the firm still provides consulting services.” In June, _____ attorney responded with a letter in which he described _____ activities on behalf of the Funds, and concluded that “_____ regular course of business consists in transacting investment banking business within the meaning of the NASD rules.” (Stip. ¶¶ 5-7; JX 1-2.)

In July, the NASD began notifying member firms of their obligation to file Form BD-Y2K. The NASD sent letters dated July 16, 1998, to all member firms; sent a Special Notice to Members on August 3, 1998; and sent a brochure entitled “NASD Year 2000 Member

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Information” to all members along with the August 1998 Notice to Members. All of these were sent to _____ at its business address as listed in the Central Registration Depository. (Stip. ¶¶ 10-11; JX 3-5.) Thus, _____ had clear notice of its obligation to file Form BD-Y2K by August 31.

On August 13, 1998, the NASD examiner wrote to _____ at _____ in response to the June 12 letter from _____ counsel. The examiner stated that the NASD “staff has determined that the firm’s business is limited to advisory work and, therefore, _____ is not required to be registered with the NASD. ... Therefore, unless you can demonstrate to this office no later than August 27, 1998, that the business _____ is conducting meets the guideline of the [NASD’s] By-Law[s], the NASD will initiate steps to cancel your membership.” The parties have stipulated: “At the time _____ received the August 13 letter, _____ understood it to mean that, if it took no action by August 27, four days before the BD-Y2K was due, _____ membership would be canceled before the due date for the form. Based on the NASD’s determination that _____ did not need to be registered to conduct its business, _____ took no action to challenge the cancellation of its registration on or before August 27, 1998.” (Stip ¶¶ 12-13; JX 6.)

In fact, the NASD did not immediately cancel _____ membership in the Association. Instead, an NASD staff supervisor sent _____ a letter dated August 31, 1998 – the date the Form BD-Y2K was due – noting that the NASD had not “received any documentation that you are engaged or intend to engage in a securities business. Therefore, unless we hear from you otherwise and if you can demonstrate within 15 days that your firm is actively engaged in the investment banking or securities business, the firm’s membership in the Association will be

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canceled.” The parties have stipulated that when _____ received this letter, “_____ believed that its NASD registration had either already been canceled as of August 31, 1998 or certainly would be canceled no later than September 15, 1998. _____ never contemplated pursuing an eligibility hearing.” _____ did not file a Form BD-Y2K by August 31, 1998. (Stip. ¶¶ 14-15; JX 7.)

After _____ received the August 31 letter, but before September 15, _____ consulted other attorneys and concluded that it should try to maintain its registration, at least temporarily, in order to fulfill its remaining responsibilities to the Funds while _____ business was wound up. _____ attorneys wrote to the NASD staff supervisor on September 15, 1998, explaining _____ desire to remain registered, and requested a meeting. On October 7, 1998, the NASD examiner sent _____ attorney a letter in response to the September 15 letter, in which the examiner stated: “Based upon the information contained in your letter regarding the past activities and intended businesses to be conducted by _____, the District staff has determined not to cancel the firm’s membership with the Association. Rather, the District staff will recommence its scheduled routine examination of the firm on October 14, 1998.” Thus, _____ NASD membership was never canceled. (Stip. ¶¶ 18, 23; JX 9, 11.)

In the meantime, the August 31 deadline for member firms to file Form BD-Y2K had passed. On September 10, 1998, the NASD’s Year 2000 Program Office sent _____ (as it did every other member firm that had not filed a Form) a letter advising the firm that the NASD had not received the firm’s Form, but telling the firm (as it did every other such member firm) that if _____ filed its Form by September 21, no disciplinary proceeding would be filed

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against the firm. Although the Year 2000 Program Office sent the September 10 letter by Express Mail (next day delivery), the parties have stipulated that _____ received the letter “[o]n or about September 25, 1998” – i.e., after the grace period set forth in the letter had expired. The parties have also stipulated that, when _____ received the letter on or about September 25, “neither of the _____ principals was available; therefore, before even speaking to them, [_____] _____, the [firm’s] part-time secretary, called the NASD. It is believed that _____ spoke to _____ at or about that time. Based on this conversation, it was _____ understanding that _____ membership had not been canceled and that _____ could file the BD-Y2K up until October 2, 1998, subject only to a late fee.” (Stip. ¶¶ 16-17, 19; JX 8.)

The parties have also stipulated, however, that “_____ does not specifically recall speaking with _____, although her notes indicate that she had a conversation with someone from _____ in late September 1998. _____ believes that she would not have told _____ that there would be only a late fee if the BD-Y2K was filed by October 2, 1998, because that was not the position of the NASD, and because no firms were being subject to any financial penalty or fee without a censure and disciplinary proceeding. In addition, the only significance to _____ of the date October 2 was that firms which filed by October 2 would be subject to NASD actions, and firms which filed thereafter would be subject to actions by the SEC.” (Stip. ¶ 20.)

In any event, the parties have stipulated that “_____ conveyed her understanding of the conversation to _____. _____, surprised that the NASD, without having contacted _____ at all, had not canceled _____ registration, immediately directed that the BD-Y2K

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be prepared and filed. _____ CFO, _____, completed the Form by September 28, 1998. It was filed and received by the NASD and the Securities and Exchange Commission on October 2, 1998.” (Stip. ¶ 21.) Enforcement subsequently filed this proceeding.

Discussion

There is no dispute that, in fact, the NASD never canceled _____ membership, and that at all relevant times _____ was, in fact, a registered broker/dealer. Therefore, like all other member firms, _____ was required to file a Form BD-Y2K with both the NASD and the SEC on or before August 31, 1998. There is also no dispute that _____ did not file those Forms until October 2. _____, however, offers several arguments against the charges in the Complaint.

First, _____ argues that Enforcement must prove that _____ failure to file on time was “willful” in order to establish that _____ violated Section 17(a) of the Exchange Act and SEC Rule 17a-5, as alleged in the Complaint. _____ contends that the stipulated facts show that _____ failure was not willful, because it was based on _____ mistaken belief that the NASD had canceled its membership before the deadline.

Section 17(a) and Rule 17a-5 impose straightforward reporting requirements. Neither provision states that proof of willfulness is required to establish a violation based on failure to file a required report. In District Business Conduct Committee for District No. 6 v. Toney L. Reed, Complaint No. 06910024 (NBCC Mar. 12, 1993), in the course of affirming the DBCC’s dismissal of a charge that the respondent had failed to maintain records pursuant to SEC Rule 17a-3, the NBCC stated: “We note that willful action is not a requirement ... but is merely one of the aggravating or mitigating factors to consider when assessing sanctions for

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violations in such areas.” The same reasoning applies to _____ failure to file its Form BD-Y2K.

In any event, the stipulated facts establish that _____ failure to file the Form on time was “willful.” In analogous contexts, “the [SEC] has consistently held ... that the term [willfully] does not require proof of evil motive, or intent to violate the law, or knowledge that the law was being violated. . . . All that is required is proof that the broker-dealer acted intentionally in the sense that he was aware of what he was doing.’ 2 Loss, Securities Regulation 1309 (1961). This view has been accorded judicial acceptance.” Arthur Lipper Corp. v. SEC, 547 F.2d 171, 180 (2d Cir. 1976), cert. denied, 434 U.S. 1009 (1978). Accord, Steadman v. SEC, 603 F.2d 1126, 1135 (5th Cir. 1979), aff’d on other grounds, 450 U.S. 91 (1981); Tager v. SEC, 344 F.2d 5, 8 (2d Cir. 1965). Indeed, in cases involving reporting violations, the SEC has held that “the failure to make a required report, even though inadvertent, constitutes a willful violation.” Hammon Capital Management Corp., Investment Advisors Act Release No. 989, 34 S.E.C. Docket 209 (Sept. 24, 1985). Accord, Jesse Rosenblum, Investment Advisors Act Release No. 913, 30 S.E.C. Docket 692 (May 17, 1984); Oppenheimer & Co., Exchange Act Release No. 16817, 20 S.E.C. Docket 58 (May 19, 1980); Haight & Co., 44 S.E.C. 481, 507 (1971), aff’d without opinion, (D.C. Cir. June 30, 1971), cert. denied, 404 U.S. 1058 (1972).

Under these standards, _____ failure to file on time was plainly willful. _____ knew about the obligation of broker-dealers to file Form BD-Y2K, and intentionally failed to file the Form by the August 31 deadline. Under the principles discussed above, _____

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mistaken belief that it did not have an obligation to file does not prevent a finding that the failure was willful, but it does bear upon the issue of sanctions.

Second, _____ argues that to establish a violation of NASD Rule 2110, Enforcement must prove that its failure to file the Form on time was in “bad faith.” This contention is also incorrect. In District Business Conduct Committee for District No. 7 v. William H. Gerhauser, Complaint No. C07960014 (NBCC Nov. 20, 1997), the NBCC explained: “The [SEC] has required a demonstration of bad faith under Conduct Rule 2110 only where the misconduct alleged does not constitute the violation of another SEC or NASD rule or regulation and does not involve the respondent’s activities as a registered person.” Here, the misconduct charged – failure to file the Form BD-Y2K on time – is a violation of a specific SEC rule. Therefore, proof of bad faith is not required to establish this violation of Rule 2110. Once again, however, “good faith” is relevant to the issue of sanctions.

Finally, _____ argues that the NASD should be estopped from finding a violation in this case because the NASD staff caused _____ to file its Form late. _____ contends that the various communications from the NASD were “confusing and conflicting.” _____ contends that, in light of those communications, it was reasonable for it to conclude that it did not have to file its Form, because “the NASD had advised _____ that its registration was being revoked before the Form was due.” _____ also points to (1) the delay in its receipt of the letter from Enforcement advising _____ that it had a “grace period” within which it could file the Form without penalty; (2) the delay in _____ receipt of notice that the NASD would not terminate its membership; and (3) _____ confusion regarding the advice it received about

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filing the Form by October 2 as additional facts that should estop the NASD from finding a violation.

The stipulated facts do not, however, establish a basis for estopping the NASD from proceeding against _____, or from finding that _____ failed to file the Form in a timely manner. _____ received the same notices of its obligation to file Form BD-Y2K as every other member firm, and those notices made it clear that all member firms were required to file by August 31. The parties have stipulated that, based on the August 13 letter from the NASD examiner, _____ believed its membership in the NASD would be terminated before August 31. The letter, however, simply said that, if _____ did not respond by August 27, “the NASD will initiate steps to cancel your membership.” (JX 6 (emphasis added).) From this statement, _____ jumped to the mistaken conclusion that the NASD would complete those steps within a four day period, which included a weekend, prior to the August 31 deadline for filing the Form BD-Y2K. Nothing in the letter said or implied that _____ membership would be canceled so quickly.

All of the other communications between the NASD staff and _____ occurred after August 31. By that time, _____ had already missed the deadline for filing the Form, and, therefore, had already violated Section 17(a) and SEC Rule 17a-5. While those communications are relevant to sanctions, they do not provide a defense to the charge that by missing the August 31 deadline, _____ violated Rule 2110.

The Hearing Panel finds, therefore, that _____ failed to file Form BD-Y2K by August 31, 1998, as required by Section 17(a) of the Exchange Act and SEC Rule 17a-5, and thereby violated NASD Rule 2110.

Sanctions

Enforcement asks that _____ be censured and fined \$3,200. As noted above, the collection of BD-Y2K data is of great importance to the securities industry, both to ensure that the industry is prepared for the Year 2000 and to maintain investor confidence. Member firms must take seriously their obligation to complete and file Form BD-Y2K in a timely manner, as well as their obligation to anticipate and address potential Year 2000 problems. In appropriate cases, censures and substantial fines may be required to signal the importance of these obligations, and to ensure that the member firms comply with them. One of the overall “General Principles Applicable to all Sanctions Determinations,” however, is that, “[s]ince sanctions in disciplinary proceedings are intended to be remedial, Adjudicators should impose sanctions tailored to address the misconduct involved in each particular case.” NASD Sanctions Guidelines pp. 4, ¶ 3.

In this case, the parties have stipulated that “_____ understood [the August 13 letter from the NASD examiner] to mean that if it took no action by August 27, ... _____ membership would be canceled before the due date for the form.” (Stip. ¶13.) As a result, the Hearing Panel concludes that _____ failed to file it Form BD-Y2K on time because it misunderstood its status, and its obligation to file, rather than because it disregarded its filing obligations.¹

¹ Enforcement argues that even if _____ believed the NASD had terminated its membership, “[t]here is no evidence that Respondent took any steps to withdraw its SEC registration, or was subject to any proceeding by that agency.” The stipulated facts, however, do not address _____ relationship with the SEC, so the Hearing Panel cannot reach any conclusions about what _____ did or did not do about its SEC registration. The Hearing Panel notes, however, that, pursuant to Section 15(b)(8) of the Exchange Act, if _____ membership in the NASD had been terminated, as _____ believed, _____ would have been precluded from functioning as a broker-dealer.

Furthermore, the Hearing Panel notes that Enforcement elected to give all member firms that missed the deadline a “grace period” within which they could file without having any disciplinary action being taken against them. According to the stipulated facts, Enforcement sent _____ a letter advising it of the grace period on September 10, by “Express Mail (next day delivery).” The letter advised _____: “If the completed report is received no later than Monday, September 21, 1998, no enforcement action will be taken.” (JX 8.) Thus, it appears that Enforcement intended to give _____ an additional 10 days, from the date Enforcement expected _____ would receive the letter, within which it could file its Form. Enforcement must have determined that giving member firms this additional grace period was appropriate and consistent with the NASD’s goals and policies.

_____, however, never had an opportunity to take advantage of the grace period. The parties have stipulated that _____ did not receive the letter until “on or about September 25, 1998,” after the grace period had expired. (Stip. ¶17.) There is no explanation in the record for the cause of this delay, so it is not possible to blame it on Enforcement, _____, the Postal Service, or some third party, but the result was that, unlike other member firms that did not file by August 31, _____ did not have any grace period within which it could file the Form and avoid disciplinary action.²

² Enforcement argues that _____ failure to receive the letter until on or about September 25 “appears to be the result of _____ failure to regularly staff the office it designated for receipt of correspondence from the NASD (its CRD address). The firm should not be rewarded for not being in a position to receive its mail by avoiding sanctions.” The parties stipulated that “[i]t was not uncommon for many days to go by without any of [_____ employees] having been at _____ offices during 1998,” but the parties have not stipulated that these circumstances caused or contributed to the delay in _____ receiving the grace period letter, and the Hearing Panel cannot leap to that conclusion. Furthermore, the fact that _____ office was not always staffed is understandable in light of the stipulated fact that, at the time, _____ believed the NASD had terminated its membership, so it was no longer lawful for _____ to operate as a broker-dealer.

The Hearing Panel believes that if _____ had received the September 10 letter on or about September 11, as Enforcement intended, _____ would likely have filed the Form within the grace period. Once _____ received the letter, it took prompt action. “When the September 10, 1998, letter was received on or about September 25, neither of the _____ principals was available; therefore, before even speaking with them, _____, the part-time secretary, called the NASD.” (Stip. ¶19.) According to the stipulated facts, _____ learned from this call that the NASD had not canceled its membership. _____ thereupon completed and filed the Form with the NASD and the SEC on October 2, approximately seven days after _____ received the September 10 letter. (Stip. ¶21.) These facts lead the Hearing Panel to conclude that if _____ had received the September 10 letter on September 11, as Enforcement intended, it would likely have proceeded with equal dispatch, would have learned that its NASD membership had not been canceled, and would have filed the completed Form within the grace period.

_____ says that it would have no objection to paying a “late fee,” but expresses grave concern about a censure. The Hearing Panel has no power to impose a late fee, even if that were justified. The Hearing Panel can impose a fine, but under NASD practice any fine is accompanied automatically by a censure, and a censure and fine are serious sanctions that could have far-reaching effects on _____ future activities. Of course, that would not deter the Hearing Panel from imposing such sanctions if they were required to achieve the NASD’s remedial goals, but the stipulated facts in this case establish that _____ missed the original filing deadline because it misunderstood its status, and missed the grace period deadline because of an unexplained delay in receiving the letter announcing the grace period. Under those

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circumstances, the Hearing Panel has determined that the censure and fine requested by Enforcement are too severe, and do not properly address _____ misconduct.

Therefore, the Hearing Panel finds that a Letter of Caution will satisfy the NASD's remedial goals under the particular circumstances of this case. Accordingly, the Hearing Panel orders that this Decision shall constitute a Letter of Caution to _____.³

HEARING PANEL

By: David M. FitzGerald
Hearing Officer

Dated: Washington, DC
May 7, 1999

³ 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.