

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

DEPARTMENT OF ENFORCEMENT,	:	
	:	
Complainant,	:	Disciplinary Proceeding
	:	No. C8A980012
	:	
v.	:	DECISION
	:	
	:	Hearing Panel
	:	
	:	December 2, 1998
	:	
Respondent.	:	

DIGEST

On March 3, 1998, the Department of Enforcement (“Enforcement” or “Complainant”) served a Complaint on Respondent _____ (“Respondent”) asserting two causes of action. Cause One alleged that Respondent violated NASD Conduct Rule IM-2110-1 (the “Free-Riding and Withholding Interpretation”) by opening two brokerage accounts¹ with his sister, DD, in joint tenancy with right of survivorship and permitting the purchase in such accounts of initial public offerings (“IPO”) which traded at a premium in the immediate after-market. Cause Two alleged that Respondent violated NASD Conduct Rules 2110 and 3050(c) by failing to give written notice to his employer, _____ (“_____”), in writing of the Joint Accounts and also by failing to give written notice to _____ and _____ that he was registered with _____.

¹ The accounts were opened at _____ (“_____”) and _____ (“_____”) and collectively are referred to as “the Joint Accounts.”

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The Hearing Panel found no dispute as to the opening of the Joint Accounts by Respondent with DD in joint tenancy with right of survivorship, no dispute that Respondent was aware that IPOs were purchased by DD in the Joint Accounts, no dispute that the securities in the Joint Accounts were traded at an immediate profit in the secondary market, and no dispute that Respondent failed to give written notice either to his employer of the Joint Accounts or to _____ and _____ that he was registered with _____. Thus, the sole issue for determination by the Hearing Panel was whether a side agreement between Respondent and DD which provided that Respondent had no financial interest in the Joint Accounts was sufficient to avoid the alleged violations of NASD Conduct Rules 2110 and 3050(c).

The Hearing Panel found that notwithstanding the side agreement between Respondent and his sister, Respondent had a beneficial interest in the Joint Accounts. Accordingly, the Hearing Panel found that Respondent violated Conduct Rule IM-2110-1. The Hearing Panel also found that Respondent's failure to give written notice to his firm of the Joint Accounts and written notice to _____ and _____ of his registration with _____ violated NASD Conduct Rules 2110 and 3050(c). Taking into consideration all the relevant factors, the Hearing Panel determined that a letter of caution was an appropriate sanction for the violations alleged in both Cause One and Cause Two of the Complaint. The Hearing Panel also assessed the costs of the Hearing against Respondent.

APPEARANCES

Richard S. Schultz, Esq., Regional Counsel, NASD Regulation, Inc., Department of Enforcement District No. 8, Chicago, Illinois. Rory C. Flynn, Chief Litigation Counsel, NASD Regulation, Inc., Department of Enforcement, Washington, D.C.

_____, Esq. and _____, Esq., _____ New York, New York 10006.

DECISION

I. Introduction

On March 3, 1998, Enforcement served a Complaint on Respondent² asserting violations of NASD Conduct Rules 2110 and 3050(c). Cause One alleges that Respondent violated the Free-Riding and Withholding Interpretation (IM-2110-1) by opening two brokerage accounts, one at _____ and the other at _____, with his sister, DD, in joint tenancy with right of survivorship and permitting IPOs to be purchased in the Joint Accounts which traded at an immediate profit in the after-market. Cause Two alleges that Respondent violated NASD Conduct Rules 2110 and 3050(c) by failing to give written notice to his employer of the Joint Accounts and also by failing to give written notice to _____ and _____ that he was registered with _____.

Respondent filed an Answer on March 30, 1998 denying the allegations of the Complaint and asserting as an affirmative defense that Respondent had no beneficial interest in the Joint accounts. Respondent represented that he agreed to allow his sister to place his name on the Joint Accounts with right of survivorship so that Respondent “could ensure that the contents of the accounts would be safeguarded for [D’s] children in the event something happened to her.”³ Further, Respondent asserted that the Joint Accounts were opened and maintained by DD for her exclusive use and sole benefit and that, pursuant to a duly notarized agreement (“the Agreement”) executed before the Accounts were opened, Respondent renounced all interest in the Joint Accounts.

² Respondent is a financial consultant with _____ and also an accountant. Tr. at 22-23, 157-58.

³ Answer at ¶13.

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On June 22, 1998, pursuant to Code of Procedure Rule 9264, Respondent filed a Motion for Summary Disposition (“Motion”).⁴ Respondent argued that he was entitled to summary disposition on both Causes because Enforcement’s theories of wrongdoing turned on the incorrect factual premise that Respondent had a financial or beneficial interest in the Joint Accounts.⁵ Respondent argued that the affidavits and exhibits submitted with the Motion demonstrated that the Joint Accounts “were maintained exclusively by, and for the sole benefit of, [D] in order to establish her own financial independence from her husband with whom she was having disagreements over financial matters.”⁶ Further, Respondent asserted that the Joint Accounts were established with his sister as a joint tenant with rights of survivorship “so that in the event of her disability or death, he could oversee the distribution of the Joint Account assets to her two young children.”⁷ Respondent argued that he did not commit notification violations because he expressly renounced all beneficial interest in the Joint Accounts.⁸

Enforcement filed a Response to the Motion (“Opposition”) arguing that there were genuine issues of material fact that could be decided only at the Hearing and that Respondent was not entitled to judgment as a matter of law. In support of its Opposition, Enforcement cited a number of facts to demonstrate that Respondent had a beneficial interest in the Joint Accounts.⁹ In addition, Complainant raised a number of issues which questioned both the purported purpose of the Agreement and whether

⁴ The Motion was supported by the Affidavits of Respondent, DD, and certain exhibits, including the Agreement between Respondent and DD.

⁵ Respondent _____ Memorandum of Law in Support of his Motion for Summary Disposition of the Complaint (“Supporting Mem.”) at 2.

⁶ Id.

⁷ Id.

⁸ Id. at 12.

⁹ Opposition at 3-5.

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the Agreement between Respondent and his sister either had been revoked or modified by the opening of the Joint Accounts.¹⁰ Further, Enforcement argued that Respondent was not entitled to judgment as a matter of law since as a joint tenant he owned an undivided interest in the Joint Accounts by operation of law.¹¹

After reviewing the filings of the Parties, the Hearing Panel found there were disputed issues of material fact and that Respondent was not entitled to judgment as a matter of law. Thus, it denied Respondent's Motion.¹²

The Parties presented evidence to the Hearing Panel in a one day Hearing held in New York on July 28, 1998. Enforcement called three witnesses in its direct case: _____, a district administrative manager for _____; _____, a former broker with _____ from whom DD purchased the securities in the Joint Accounts; and _____, a field supervisor with NASD Regulation who investigated the facts underlying the allegations of the Complaint.

Respondent testified on his own behalf. In addition, Respondent's sister also testified on behalf of Respondent.

II. Findings of Fact and Conclusions of Law

A. Evidence Presented at the Hearing

The majority of material facts presented at the Hearing are not disputed. The alleged violations which gave rise to the Complaint were discovered during the examination of _____ when an IPO was reviewed.¹³ During the course of that investigation two accounts were discovered in the name of

¹⁰ Opposition at 7-8.

¹¹ Opposition at 4.

¹² The Parties were informed of the decision of the Hearing Panel during the Final Pre-Hearing Conference on July 22, 1998.

¹³ Tr. at 19, 124.

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Respondent and DD as joint owners with the right of survivorship.¹⁴ The investigation also revealed that five IPOs were purchased in the Joint Accounts which traded at an immediate premium in the after-market for a transaction profit of \$130,000.¹⁵

The record establishes that on June 6, 1989, prior to the opening of the Joint Accounts, an agreement (“the Agreement”)¹⁶ was executed between Respondent and his sister, D, which provided in pertinent part, as follows:

WHEREAS an investment or investment accounts will be established in the name of [DDJ] or [DD] either in care of or jointly with _____;

IT IS AGREED

1. _____ is permitting [D] to use his name on the account or accounts for convenience only and will have no financial interest in any account.
2. All funds in said accounts shall belong to [D] (Social Security Number ***) and all taxes that become payable in connection with said accounts shall be the responsibility of [D].

The Agreement was prepared by Respondent’s father, an estate and trust lawyer, and properly notarized.¹⁷

Both Respondent and his sister testified that the Agreement was entered into because DD was having marital and financial problems and wanted to segregate from her husband certain large commission checks which were due her from her last employer.¹⁸ Respondent further testified, and his sister confirmed, that the purpose of the Agreement was to make clear that DD understood that Respondent was acting “in an accommodation capacity, that all funds in her account were really hers *

¹⁴ Id. at 19, 129.

¹⁵ Id. at 129; CX- 17. Complainant’s Exhibits admitted at the Hearing are designated “CX.”

¹⁶ CX-28 at 9.

¹⁷ Tr. at 160, 162, 163, 242-43.

¹⁸ Id. at 161, 240, 241-42. To this end, DD wanted Respondent’s name on the account statements so it appeared that he had control of the accounts.

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* * [that] she was responsible for all gains and losses in the account, for all interest and dividends and taxes on the funds were completely hers.”¹⁹

The first account opened after the Agreement was executed was at _____ in the name “[DDJ], care of _____ L. _____.”²⁰ Respondent testified that the account was not opened as a joint account because he then would need an employee account number and, because “the purpose of the account was to keep it separate from her husband, we felt it [would be] more advantageous to open it in care of.”²¹ DD’s first deposit of \$75,000 was made into the account on June 7, 1989 and, based on Respondent’s recommendation, invested in municipal bonds.²² Over time, Respondent made other conservative investments for DD in the account.²³

Both Respondent and DD testified that either in 1991 or 1992 DD decided that she wanted to take greater risks in investing and be more speculative.²⁴ DD wanted to continue to have Respondent’s name on any new accounts so he could look after the investments.²⁵ Respondent agreed as long as the Agreement remained in effect.²⁶

¹⁹ Id. at 163 -64; see also id. at 243. Respondent testified, and DD confirmed, that he is the executor under DD’s will and also the trustee under the trust for her children created by her will. Id. at 160-61, 239. Respondent and DD further testified that if anything happened to DD, funds from the accounts opened pursuant to the Agreement would be handled through her estate. Id. at 164, 243-44.

²⁰ RX-E; Tr. at 164-66, 244-45. Respondent’s Exhibits admitted at the Hearing are designated “RX.”

²¹ Tr. at 165-66. Respondent further testified that since the account and fund belonged to DD, there was no reason to make it an employee account. Id. at 197. Respondent, however, was aware that _____ “frowned upon in care of accounts” and thought at some point they might need to convert it to a joint account. Id. at 166.

²² The funds for the account were from a commission paid to DD from her last employer. Tr. at 244. Respondent’s recommendation to invest in municipals was in keeping with his investment philosophy. Id. at 167. Respondent has been employed at _____ since November 1985 and manages assets of approximately \$160 million. He invests primarily in blue chips, high quality stocks, convertible corporate bonds, corporate bonds, convertible preferreds, municipal bonds, treasuries, and selected mutual funds. Id. at 157-58.

²³ Id. at 167.

²⁴ Id. at 167-68, 246-47.

²⁵ Id. at 168-69. DD testified that she wanted Respondent’s name on the accounts when she went outside _____ as a protective measure so that he could channel the money properly if anything happened to her. She further testified that he reviewed the account statements. Id. at 278. Similarly, Respondent testified that all the

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Thereafter, DD opened an account at _____ in 1992 in her name with Respondent as joint tenants. The New Account Application²⁷ reflects Respondent's then business address at _____, his employer or firm affiliation as "self-employed," and his occupation as "accountant." It also reflects marital status as "married" and spouse's name as [D] and employment as "housewife."

Respondent testified that he did not recall what information was on the form when it was sent to him for signature and that he never would sign a form which describes his occupation as an "accountant" and as "self-employed."²⁸ Both Respondent and his sister testified that the Agreement applied to this new account and that all the money deposited into the account would come from DD's account at _____,²⁹ DD would own the money and stock in the account, she would receive the proceeds of any sales and be responsible for all losses and reporting all gains and losses on her tax returns. In addition, both Respondent and DD testified that she would make all investment decisions with respect to the account.³⁰ Respondent admitted that he never gave the required written notice to _____ or _____ because "I didn't think it was my account."³¹

confirmations and statements for the _____ accounts were mailed to his attention at _____ and that he kept his eye on the accounts. Id. at 225.

²⁶ Id. at 169, 248-49.

²⁷ CX-2. The New Account Application bears the legend _____ because that firm was the clearing agent for _____ and _____ had no forms of its owns. Tr. at 86 and 169.

²⁸ Tr. at 170-71. Similarly DD testified that she did not recall what other information was on the form when she signed it and that she never would describe herself as a "housewife." Id. at 249-51.

²⁹ Id. at 182. Similarly, Respondent testified that all money that came out of the account would go into DD's account at _____. Id.

³⁰ Id. at 172, 251-52.

³¹ Id. at 173. Respondent also testified that he did not attempt to conceal this account from _____. Id. at 174. Mr. _____ confirmed that he found no evidence that Respondent ever attempted to conceal from any person that his name was on the Joint Accounts. Id. at 147.

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No trades were made in the _____ account until 1995 when DD opened a new account at _____.³² The _____ account was opened by _____, a registered representative, in the name of Respondent and his sister as joint tenants with right of survivorship.³³ The Report of New Account reflects Respondent's business address, but not his occupation or employer. DD's employer is reflected as _____, her position as VP/Marketing and "approx net worth 2 mill."³⁴ The question on the Report of New Account "is customer employed by a member firm" is checked "no."³⁵

Mr. _____ testified that the account was established in joint tenancy because that is the way DD wanted it and he understood that he would be dealing with her.³⁶ Mr. _____ confirmed that he dealt solely with DD with respect to trading in the account.³⁷ He also testified, however, that he understood that as a joint tenant, Respondent could place orders and that "if one dies the other one has assets in the account * * *."³⁸ Mr. _____ testified that he never was told about the Agreement between Respondent and DD and if he had known that Respondent was a registered representative with _____, he never would have permitted the IPOs in the joint account to be traded.³⁹ Mr.

³² DD testified that she never made any trades with any broker at _____. Tr. at 252-53. After she opened her account at _____, Mr. _____ arranged for a purchase of an IPO at _____ and then had the security transferred to _____. *Id.* Mr. _____ formerly was employed by _____, but had no contact with DD until she became his client at _____. *Id.* at 80-81, 97.

³³ CX-7 at 5. The Report of New Account bears the _____ legend since that firm was the clearing agent for _____ and _____ had no new account forms of its own. Tr. at 85.

³⁴ CX-7 at 5. DD testified that the handwriting on the account form is not her handwriting and that her signature does not appear anywhere on the form. Tr. at 256. DD testified that she gave information to Mr. _____ to complete the form, but that certain information reflected thereon is not correct. For example, she did not have a net worth of \$2 million and was not V.P. of Marketing. *Id.*

³⁵ CX-7 at 5. Mr. _____ testified that although he did not remember checking the box "no," he probably did. He also testified that his name appears on the New Account Form. Tr. 87-88.

³⁶ *Id.* at 86-87.

³⁷ *Id.* at 91-92.

³⁸ *Id.* at 88-89.

³⁹ *Id.* at 106-07.

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_____ further testified that in 1995, at the request of DD, he met Respondent who was introduced as an accountant.⁴⁰

Respondent testified that the Agreement continued to apply to the _____ account, that all funds for investment came from his sister, that DD made all the investment decisions, and that all gains and losses belonged to DD. Further, if anything happened to DD, the funds in the _____ account would go to her estate.⁴¹ Respondent testified that he never gave DD, directly or indirectly, any money to purchase securities in the _____ account nor did he receive from DD, directly or indirectly, any distributions from the account.⁴² Respondent again admitted that he did not give the required written notices to _____ or _____ because he did not consider it his account.⁴³

On cross-examination, Respondent stated that he was aware that _____ prohibited representatives from carrying accounts at other firms, but that he had no interest in the Joint Accounts -

⁴⁰ Id. at 92-93, 121. Mr. _____ testified that he first met Respondent during a dinner with Respondent and his sister in 1995 and that Respondent told him he was an accountant and self-employed. Id. Respondent also testified that he met Mr. _____, but said the first time was at a social function with other brokers in January 1995. Thereafter, Respondent confirmed that he met Mr. _____ in April 1995 when he came to his offices at _____ to discuss his taxes and the two of them then had dinner with DD. Id. at 179.

⁴¹ Id. at 177-78, 204. In support of this testimony, Respondent submitted DD's tax returns for 1995-96, Respondent's monthly checking account statements and deposit slips for 1995 and 1996, copies of DD's checks and wire transfer payments to _____ and _____ for the purchase of stock, and DD's checking account statements for the relevant time periods. RX-C through RX-P. In addition, the staff examiner, Mr. _____ testified that he found no evidence that any money from Respondent went into the Joint Accounts or that any distributions from the Joint Accounts went to Respondent. He also admitted that all of the funds from the Joint Account were deposited into a single name account in the name of DD at _____, that all of the gains and losses from the Joint Accounts were reported on DD's tax returns, that none were reported on Respondent's tax returns, that there was no evidence that Respondent ever exercised any investment discretion over the Joint Accounts or ever placed a buy or sell order in the Joint Accounts. Tr. at 137-140. DD also testified that she made the investment decisions with respect to the _____ account and never discussed them with Respondent. She testified that she provided all the funds that went into the account, received all the funds from proceeds of sales, reported all losses and gains on her tax returns, and that if something happened to her, the funds from the account would go into her estate. Id. at 257-59.

⁴² Id. at 183.

⁴³ Id. at 178. As with the _____ account, Respondent acknowledged that he knew DD intended to purchase IPO stock in the account, but testified that he did not believe this created a problem with the Free-Riding Interpretation because "it was not my account." Id. See also id. at 173-74. Respondent also testified that all distributions from the account were mailed to his attention at _____ offices for deposit into DD's single name account. Id. at 182-83. The distribution checks were opened by _____ employees and Respondent directed how the distributions and accounts should be handled. Id. at 209-10.

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- “my name was there for accommodation purposes only.”⁴⁴ Respondent also admitted receiving the _____ compliance outline⁴⁵ which prohibits employees from opening accounts without giving notice.⁴⁶ With respect to the new account documents for _____, Respondent admitted that the documents reflect that he had the authority to purchase and sell securities without notice to his sister and that in the event of her death all the funds in the account would belong to him.⁴⁷ Nevertheless, Respondent testified that because of the Agreement with DD, any funds that came out of the account would go to her or her estate.⁴⁸

Further, Respondent admitted that four days after signing the _____ new account forms, on February 14, 1995, he completed a 1996 Compliance Disclosure Form and did not disclose the account.⁴⁹ Respondent testified, however, that because of the definition of employee related accounts, he did not believe he needed to disclose anything on the Compliance Disclosure Form.⁵⁰ In April 1995, three months later, he completed an Outside Interest Questionnaire and checked “no” to the

⁴⁴ Tr. at 197.

⁴⁵ CX-20 at 6-14.

⁴⁶ Tr. at 203. Respondent testified that he never discussed the Agreement with anyone at _____ or whether it was proper to establish the Joint Accounts with his sister. Id. at 196, 198. Respondent reviewed the forms _____ required him to sign and, because he did not believe that he had a financial or beneficial interest, he did not speak with anyone about the accounts. Id. Mr. _____, a district administrative manager for _____ and the supervisor for the office in which Respondent is employed (Tr. at 31), gave similar testimony and testified as to the opportunities that Respondent had to disclose the Joint Accounts or to discuss the Agreement with _____. See, e.g., id. at 35-42, 52-53. He also testified as to _____ policy regarding the purchase of hot issues and brokers maintaining accounts at other firms. Id. at 34. Such activities are prohibited.

⁴⁷ Id. at 203-04. By signing the _____ account documents, Respondent and DD agreed that “the authority hereby conferred shall remain in force until written notice of its revocation, signed by both parties thereto” and delivered to the brokerage firm. CX-7 at 7. The _____ account documents signed by Respondent also contain a representation that neither he nor any member of his immediate family is an employee of any exchange or member thereof. CX-7 at 9.

⁴⁸ Id. at 204-05.

⁴⁹ Id. at 207-08 and CX-20 at 21.

⁵⁰ Id. at 228. The question to which Respondent answered “none reported” required him to “review the employee/related securities or commodities accounts outside of _____” and report any changes. For purposes of completing that document, the _____ Branch Officer Policy Manual defined employee-related accounts as including any account in which the employee has a financial interest or exercises control. CX-20 at 15.

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question whether he owned or had a beneficial interest in any securities position of 5,000 shares or more which is not carried in his account at _____.⁵¹ Although there were large positions in securities in the _____ account after that date, Respondent never made any changes to his disclosure form.⁵²

B. Findings

Based on the evidence presented at the Hearing, the Hearing Panel finds no dispute as to the opening of the Joint Accounts by Respondent and his sister as joint tenants with right of survivorship,⁵³ no dispute that Respondent was aware that IPOs were purchased in the Joint Accounts, no dispute that the securities in the account were traded at an immediate profit in the secondary market,⁵⁴ and no dispute that Respondent failed to notify _____ of the opening of the Joint Accounts and also failed to inform _____ and _____ that he was registered with _____.⁵⁵ Thus, the only issue for the Hearing Panel's determination is whether the Agreement between Respondent and his sister obviates Respondent's obligations to comply with the requirements of the Free-Riding Rule and the notification requirements of NASD Conduct Rule 3050(c). The Hearing Panel finds it does not.

Neither Complainant nor Respondent provided any decisional authority for the exact issue presented in this proceeding.⁵⁶ As a matter of law, however, as a joint owner or tenant with a Right of

⁵¹ *Id.* at 211 and CX-26 at 3.

⁵² *Id.* at 211.

⁵³ *Id.* at 169, 176-77 and 205; Joint Stipulation at ¶¶ 7,8, 10, 11; CX-2 at 1, CX-7 at 5.

⁵⁴ Five IPOs were purchased in the Joint Accounts over a ten month period and each traded at a premium in the immediate secondary market for a transaction profit of \$130,970 and a realized profit of \$107,411. Joint Stipulation at ¶¶ 9, 12, 15, 16, and 18; CX-2 at 2-4, CX-7 at 10-39, CX-17; Tr. at 130-134.

⁵⁵ In fact, as the evidence clearly demonstrates, Respondent admitted all these facts. Joint Stipulation at ¶¶ 20 and 21; Tr. at 173, 178.

⁵⁶ Complainant relies on the decision in District Business Conduct Committee for District No. 1 v. Dickerson,

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survivorship, Respondent had a beneficial ownership interest in the Joint Accounts.⁵⁷ It is black letter law that joint tenants “have one and the same interest” in the property in which “each owns an undivided interest in the whole and attached to which is the right of survivorship.”⁵⁸ In fact, decisional law establishes that even though one party retains dividend income, pays taxes thereon, or retains control over the property, the rights of ownership attendant to joint tenancy with the right of survivorship are unaffected.⁵⁹

Here, Respondent, as a joint tenant, had an undivided interest in the Joint Accounts by operation of law. As a matter of law, he was a full owner of the Joint Accounts and, pursuant to the Agreement he signed with _____, he could have taken any action he wished with respect to the account.⁶⁰ Moreover, by operation of law, had anything happened to his sister, all of the assets in the account would belong to Respondent.

The Hearing Panel finds Respondent’s position that he did not intend to violate the Rules and was only acting as an accommodation party to assist his sister unavailing.⁶¹ Decisional law establishes that a Free-Riding violation does not require proof of *scienter*.⁶²

Complaint No. C01940017, 1995 NASD Discip. LEXIS 43, (NBCC November 15, 1995). Complainant’s Post-Hearing Brief at 5. The facts of that proceeding, however, are distinguishable from those presented here. See Respondent’s Post-Hearing Submission at 2-3.

⁵⁷ It is recognized that securities accounts that are opened as “joint tenants with right of survivorship” are owned by the persons in joint tenancy. 48A C.J.S. Joint Tenancy, Section 15 at 341-42.

⁵⁸ Black’s Law Dictionary, 5th ed. at 1313 (1979).

⁵⁹ 48A C.J.S. Joint Tenancy, Section 15, at 342-43.

⁶⁰ Moreover, it is incorrect to conclude that Respondent only permitted his name to be listed on the Joint Accounts and otherwise had nothing to do with them. He signed the documents opening the Joint Accounts, received the trade confirmations and statements for the Joint Accounts, and admitted that he had full knowledge of the trading activity in the Joint Accounts. Moreover, since there was no evidence that _____ and _____ ever were informed of the Agreement between Respondent and DD, Respondent could have made investment decisions with respect to the Joint Accounts.

⁶¹ Although this defense does not avoid a violation of the Rules at issue, it may be relevant for purposes of sanctions.

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Further, the Hearing Panel finds that whatever contractual obligations Respondent has to DD pursuant to the Agreement do not obviate his responsibility to comply with the Free-Riding Rule. To find otherwise, would create an untenable situation. Brokers could make side agreements with family members, friends, and business associates which would permit such individuals to participate in the purchase of “hot issues” with other brokers. Similarly, a decision that a broker can avoid a Free-Riding violation by showing that profits were transferred to non-registered persons, or requires Enforcement to demonstrate that an actual benefit was received by the broker from the transactions, effectively would eliminate this Rule and prevent its enforcement.⁶³

In addition, the Hearing Panel finds that the Agreement does not excuse Respondent’s failure to give the proper notices to _____, _____, and _____ pursuant to Conduct Rule 3050. To find otherwise would prevent member firms from knowing the trading activity in accounts in which brokers hold a beneficial interest. Brokers would argue that such side agreements obviated their responsibility to report such accounts to member firms.

For the foregoing reasons, the Hearing Panel finds that, as a joint tenant of the Joint Accounts in which “hot issues” were traded, Respondent violated the Free-Riding Interpretation (NASD Conduct Rule IM-2110-1). The Hearing Panel further finds that Respondent violated NASD Conduct

⁶² In re Equity Securities Trading Co., Inc., Ex. Act Release No. 34-39520, 66 SEC Docket 525, 526, 1998 SEC LEXIS 18, at *8-9, (January 7, 1998); District Business Conduct Committee for District No. 8 v. Oak Ridge Investments, Inc., Complaint No. C8A940046 at 8-9, 1996 NASD Discip. LEXIS 59, at *19, (NBCC, September 5, 1996)[“it is not necessary for the staff to demonstrate bad faith, willfulness, intent, or any other mental state as an element of the violation.”]; District Business Conduct Committee for District No. 7 v. Swanson, Complaint No. C07950011, 1997 NASD Discip. LEXIS 14, at *14 (NBCC, January 21, 1997)[a violation of Conduct Rule 2110 does not require a finding of “fraud, *scienter*, or injury.”].

⁶³ For these reasons, Respondent’s defense that the profits and losses were reported on DD’s tax returns and that the proceeds of the transactions were transferred to an account in her name is not sufficient to avoid Respondent’s obligations under the Rules. In this instance, as would be true in similar situations, there is no way for the Association to demonstrate that Respondent ultimately would not receive a financial benefit from the trades. There is nothing to prevent DD from transferring the proceeds back to Respondent after the disciplinary proceeding is concluded.

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Rules 2110 and 3050(c) by failing to notify _____ of the Joint Accounts and by failing to notify _____ and _____ that he was registered with _____.

III. Sanctions

The NASD Sanction Guideline applicable to Free-Riding and Withholding violations⁶⁴ recommends a fine of \$1,000 to \$15,000 if Respondent is the restricted buyer.⁶⁵ The Guideline also recommends that the Hearing Panel consider suspending respondent representative in any and all capacities for up to 30 business days. In imposing sanctions, the relevant factors to be considered are whether respondent had any interest in the restricted account and whether respondent engaged in misconduct for the purpose of improperly conferring financial benefit on another person or entity.⁶⁶

The Guideline applicable to violations of NASD Conduct Rules 3050 and 2110 for transactions for or by associated persons⁶⁷ recommends a fine of \$1,000 to \$25,000 for an associated person.⁶⁸ In imposing sanctions, the relevant factors to be considered are whether the violative transactions presented real or perceived conflicts of interest for employer firm and/or customers, whether the violative transactions involved “hot” issues and/or violations of the Free-Riding Rule, and whether respondent provided verbal notice of the violative transactions to employer member and/or executing member.⁶⁹

⁶⁴ 1998 NASD Sanction Guidelines (“Guidelines”) at 22.

⁶⁵ The Free-Riding and Withholding Interpretation prohibits, among others, employees of NASD Members and their “immediate family” from selling or buying hot issues. Because he was a joint tenant with full rights of ownership in the Joint Accounts and an employee of a member firm, Respondent is a restricted buyer for purposes of the Free-Riding Rule.

⁶⁶ Guidelines at 22.

⁶⁷ *Id.* at 16.

⁶⁸ The applicable Guideline only recommends a suspension or bar in egregious cases.

⁶⁹ Guidelines at 16.

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With respect to the violation of the Free-Riding Interpretation, the Hearing Panel finds that as a joint tenant with right of survivorship Respondent had a full ownership interest in the Joint Accounts by operation of law. There is no evidence, however, that Respondent engaged in any misconduct for purposes of conferring a financial benefit on his sister. The evidence is undisputed that Respondent had nothing to do with the investment decisions in the Joint Accounts and, in fact, the purchases of the IPOs were contrary to his investment philosophy.⁷⁰

With respect to the violation of Rules 3050 and 2110, there is no evidence that the violative transactions presented any real or perceived conflicts of interest for _____ or for its customers. The violative transactions, however, did involve “hot” issues and violations of the Free-Riding Interpretation. Further, Respondent admitted that he never provided any notice of the violative transactions to _____, _____, or _____.

As recommended by the applicable Guidelines for violations of the Free-Riding Interpretation and Rule 3050, the Hearing Panel also considered the relevant factors listed on pages 89 of the Guidelines.

There is no disciplinary history for Respondent. Rather, the record establishes that during the fourteen years he has been a registered member of the securities industry, with the exception of this proceeding, Respondent never has been the subject of a disciplinary investigation or proceeding; he also never has been the subject of a single customer complaint.⁷¹

Further, in determining appropriate sanctions, the Guidelines direct the Hearing Panel to consider “[w]hether respondent attempted to conceal his or her misconduct.”⁷² Here, there is no

⁷⁰ Tr. at 158-59, 168.

⁷¹ RX-F; Tr. at 159.

⁷² Guidelines at 9, ¶10.

evidence that Respondent attempted to conceal the Joint Accounts from _____.⁷³ There also is no credible evidence that Respondent concealed his employment as a _____ financial consultant from _____.⁷⁴ Although there is conflicting testimony as to how Respondent first was introduced to Mr. _____, whether as an accountant or financial consultant,⁷⁵ there is undisputed evidence that Mr. _____ called Respondent several times at his offices at _____ and also met Respondent there to discuss his taxes.⁷⁶

The Guidelines also direct the Hearing Panel to consider “[w]hether respondent’s misconduct resulted in the potential for respondent’s monetary or other gain.”⁷⁷ Here, the evidence is undisputed that Respondent complied with the terms of the Agreement. Both Respondent and DD testified, and the Hearing Panel found their testimony entirely credible, that Respondent received absolutely no monetary or other gain from the Joint Accounts.⁷⁸ Even Mr. _____ admitted that he found no evidence that Respondent invested funds into, or received funds out of the Joint Accounts.⁷⁹ Although DD could transfer proceeds back to Respondent at the conclusion of this proceeding, based on the

⁷³ In fact, when asked, Mr. _____ admitted that he found no evidence that Respondent attempted to conceal his involvement with the Joint Accounts. Tr. at 147. The evidence introduced at the Hearing demonstrates that Respondent received at the _____ offices all account statements (Tr. at 63, CX-7 at 10-35, CX-22 at 6, 54-61, 67-71, 77-98), trade confirmations (CX-7 at 36-39, CX-22 at 7, 26-53, 62-64, 72-74, 99-126), and all checks issued out of the Joint Accounts. Tr. at 209-10. Further, Mr. _____ testified that _____ employees would have opened the Joint Account documents (see Tr. at 75-76), a fact confirmed by Respondent (Tr. at 210).

⁷⁴ DD purchased only one stock in the _____ account which subsequently was transferred to _____. All other IPO transactions were conducted in the _____ account.

⁷⁵ Cf. Tr. at 92-93 (testimony of Mr. _____) with Tr. at 174-75 (testimony of Respondent) and Tr. 271 (testimony of DD). DD testified that she “never tried to conceal that [_____] was employed by _____” and that she told Mr. _____ about _____ affiliation with _____ “almost from the beginning.” Id.

⁷⁶ Tr. at 105-06, 179-80.

⁷⁷ Guidelines at 9, ¶17.

⁷⁸ Tr. at 172, 182-85, 257-59.

⁷⁹ Tr. at 137-38. Mr. _____ also testified that all checks issued out of the Joint Accounts were deposited into DD’s single name account at _____. Id. at 138.

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evidence and the demeanor of Respondent and DD at the Hearing, the Hearing Panel finds this possibility too remote to consider as a basis for sanctions.

The Guidelines provide that the Hearing Panel also may consider “[w]hether Respondent demonstrated reasonable reliance on competent legal or accounting advice.”⁸⁰ The undisputed evidence shows that before opening the Joint Accounts, Respondent and DD obtained the legal advice of their father, a trusts and estates attorney who drafted the Agreement.⁸¹ Although Respondent’s father admittedly is not a securities lawyer (Tr. at 188), he did advise Respondent that by operation of the Agreement, Respondent could list his name on the Accounts as an accommodation to DD without incurring the consequences of ownership. In reasonable reliance on his father’s legal advice, Respondent entered into the Agreement and allowed DD to use his name on the Joint Accounts.⁸²

A further relevant consideration for purposes of this proceeding is “whether the respondent’s misconduct resulted directly or indirectly in injury to other parties * * *.”⁸³ Here, Enforcement does not allege that Respondent’s conduct affected the market and the record is devoid of any such proof

The final consideration is whether Respondent provided substantial assistance to Enforcement in its investigation.⁸⁴ Based on the evidence and testimony at the Hearing, the Hearing Panel rejects Enforcement’s contentions that Respondent provided anything less than full assistance to Enforcement’s investigation. In Respondent’s very first response to Enforcement’s request for information, approximately two and one half years ago, Respondent described the Agreement and the

⁸⁰ Guidelines at 8, ¶7.

⁸¹ Tr. at 160, 161-63, 242-43.

⁸² See. Tr. at 162.

⁸³ Guidelines at 9, ¶11.

⁸⁴ Guidelines at 9, ¶12.

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essential circumstances concerning the creation and ownership of the Joint Accounts.⁸⁵ No evidence was introduced at the Hearing to refute the representations set forth in Respondent's March 18, 1996 statement to Enforcement. In fact, in all material respects, the testimony of the witnesses fully corroborates Respondent's written statement.

Similarly, the Hearing Panel rejects Enforcement's contention that Respondent delayed turning over a copy of the Agreement. Respondent provided a copy of the Agreement contemporaneously with his March 18, 1996 statement to the _____ legal department which, as a matter of firm policy, handled all communications with Enforcement in connection with this matter.⁸⁶ Any alleged delay in forwarding the Agreement to Enforcement was not the fault of Respondent.⁸⁷

Enforcement argues that substantial sanctions are appropriate against Respondent and urges the Hearing Panel to impose a fine equal to the transaction profit of \$130,970, plus \$2,000 to \$40,000 as suggested by the applicable Sanction Guidelines, a suspension for 10 to 30 business days, and a requirement that Respondent requalify by examination.⁸⁸ The Hearing Panel rejects Enforcement's suggestion. It finds that the such sanctions are much too onerous under the circumstances.

The Sanction Guidelines make very clear that "[d]isciplinary sanctions are remedial in nature and should be designed to deter future misconduct and to improve the overall business standards in the securities industry."⁸⁹ The Hearing Panel finds that no remedial purpose would be served in punishing Respondent by the imposition of the onerous sanctions suggested by Enforcement.

⁸⁵ CX-20 at 3-4.

⁸⁶ Tr. at 187-88.

⁸⁷ It also should be noted that Respondent has not been charged with a violation of NASD Procedural Rule 8210 for failure to respond in a timely manner.

⁸⁸ Complainant's Post-Hearing Brief at 2.

⁸⁹ Guidelines at 3, ¶1.

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The Hearing Panel finds the testimony of Respondent entirely credible, that he acted in good faith, and that there was no intent to violate the Free-Riding Interpretation and NASD Conduct Rule 3050(c).⁹⁰ Respondent was forthcoming both in response to Enforcement's request for information and in his testimony at the hearing. Moreover, while he clearly (and admittedly) made the wrong decision with respect to lending his name to the Joint Accounts, the Hearing Panel found that he did so solely for the purpose of assisting his sister during a difficult time. Further, he never attempted to conceal the existence of the Joint Accounts from _____. His conduct certainly cannot be characterized as deceptive, manipulative, or intended to violate NASD rules and, accordingly, falls far short of the type of conduct that typically results in the imposition of serious sanctions.⁹¹

Further, no remedial purpose would be served by predicating part of the sanctions on the transaction profit. The Hearing Panel finds that Respondent did not receive any realized profit from the transactions in the Joint Account. Rather, DD alone realized all the profits as evidenced by the tax returns admitted into evidence at the Hearing. Thus, there is no reason to penalize or punish Respondent by requiring him to pay a fine with funds he never actually controlled or received.

The Guidelines clearly give the Hearing Panel discretion to tailor sanctions to the specific facts of individual cases to respond to the misconduct at issue.⁹² Further, the Guidelines make clear that the

⁹⁰ Although good faith or absence of intent is irrelevant to a determination of whether a violation occurred, it is an appropriate consideration on the issue of sanctions. See In the Matter of Albert H. Harris, 45 SEC 971, Exchange Act Release No. 11687, 1975 SEC LEXIS 729 (September 26, 1975); District Business Conduct Committee for District No. 8 v. Podesta & Co., Complaint No. C8A960040, 1998 NASD Discip. LEXIS 27, at 36, n.25 (NBCC, March 24, 1998). See also District Business Conduct Committee for District No. 2 v. Hampton, Complaint No. C02940055, 1995 NASD Discip. LEXIS 25, at *8 (NBCC, May 3, 1995).

⁹¹ See, eg., Respondent's Supporting Mem. at 10 and cases cited therein.

⁹² Guidelines at 4, ¶3.

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recommended sanctions are not absolute and that Adjudicators may consider imposing sanctions that fall outside the recommended range.⁹³

Respondent has been in the securities business for over 14 years and, prior to this proceeding, had an unblemished record. Not one customer complaint ever has been filed against him. Absent his lapse of judgment with respect to the Joint Accounts, his business conduct has been exemplary and is the type that should be encouraged in the industry. Further, the specific circumstances of this case are unusual.

The Hearing Panel finds no other aggravating or mitigating factors. Accordingly, having considered all the evidence submitted by the Parties,⁹⁴ the Hearing Panel finds that the remedial purpose contemplated by the Guidelines will be served best in this case by issuing a letter of caution to Respondent for the violations alleged in both Causes One and Two of the Complaint. The costs of the Hearing (\$914.50) also are assessed against Respondent _____. These sanctions shall become effective on a date set by the Association, but not before the expiration of 45 days from the date of this decision.

Hearing Panel

By _____
Ellen A. Efros
Hearing Officer

Dated: Washington, DC
December 2, 1998

⁹³ Guidelines at 1, "Overview."

⁹⁴ The Hearing Panel considered all the arguments of the Parties. They are rejected or sustained to the extent they are inconsistent or in accord with the views expressed herein.