NASD REGULATION, INC.
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,	:	
Complainant,	:	Disciplinary Proceeding
	:	No. C8A000024
v.	:	
	:	Hearing Officer—Andrew H. Perkins
PAUL E. CARNEY	:	
(CRD #1943974)	:	**Hearing Panel Decision**
Vernon Hills, IL,	:	February 2, 2001
Respondent.	:	

Digest

The Complaint charged the Respondent, a formerly registered representative, with the following violations of the Conduct Rules of the National Association of Securities Dealers, Inc. ("NASD"): (1) issuing false profit and loss documents to a customer, in violation of Rule 2110; (2) effecting unauthorized transactions in a customer's securities account, in violation of Rule 2110; and (3) failing to respond to requests for information issued by NASD Regulation, Inc. ("NASD Regulation"), in violation of Rule 2110 and NASD Procedural Rule 8210.

Without admitting liability, the Respondent stipulated to the underlying facts. A hearing was held before a Hearing Panel of NASD Regulation, Inc., following which the Hearing Panel found that the Respondent committed the violations charged. As sanctions, the Hearing Panel barred the Respondent

from associating with any member firm in any capacity, ordered him to pay restitution in the amount of $1,700,000, plus pre-judgment interest thereon, and ordered him to pay costs in the amount of $1,794.80.

Appearances

Dale A. Glanzman, Esq., Chicago, Illinois (Rory C. Flynn, Chief Litigation Counsel, Washington, DC, Of Counsel) for the Department of Enforcement.

Steven J. Rotunno, Esq., Kubasiak, Cremieux, Fylstra, Reizen & Rotunno, Chicago, Illinois, for Paul E. Carney.

DECISION

I. Introduction

The Department of Enforcement ("Enforcement") filed the Complaint in this proceeding on March 31, 2000, alleging that, between approximately July 28, 1997, and the end of March 1998, Paul E. Carney ("Carney") effected more than 1400 trades in two accounts owned by L.O, incurring losses of approximately $2,364,325. To conceal these losses, the Complaint alleges that Carney prepared and delivered false profit and loss statements to L.O., showing that the transactions had been profitable. The Complaint further alleges that Carney continued to effect trades in L.O.'s accounts after being directed in writing to stop. Finally, the Complaint alleges that, on June 3, 1999, Carney refused 39 times to answer questions at his on-the-record interview. Carney, through his counsel, filed an Answer on July 6, 2000, in which he admitted that he engaged in "conduct he now understands was inappropriate." (Ans. 3.) The Answer further stated that he suffered a mental illness at the time, which impaired his judgment.

Carney also acknowledged that his conduct called for a fine and a suspension from the securities industry. (Id. at 4.)

On November 15, 2000, the Parties filed Stipulations regarding the relevant, material facts underlying the charges in the Complaint.[1] Significantly, Carney stipulated to the alleged trades, losses, false profit and loss statements, and to the fact that he declined to answer 39 questions posed to him by NASD Regulation staff at his on-the-record interview on June 3, 1999, on the ground that to do so would violate his Fifth Amendment right against self-incrimination.

On November 29, 2000, the Hearing Panel, composed of the Hearing Officer and two current members of the District Committee for District 8, conducted a hearing in Chicago, Illinois.[2] Enforcement offered the testimony of three persons, including Carney, and 22 exhibits, of which 21 were admitted into evidence.[3] The Respondent testified on his own behalf and offered the testimony of Cheryl Pecaut, a clinical psychologist who treated Carney at the time of the alleged violations. At the hearing, Carney did not contest Enforcement's evidence; rather, Carney centered his presentation on the issue of sanctions. (Tr. 11, 21, 166-67.) Carney urged the Hearing Panel to impose a ten-year suspension rather than a bar so that he could keep his current job, which he argued provides him with the best chance of paying restitution to his customers.

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[1] References to the Stipulations are cited as "Stip. ¶ ___."

[2] Reference to the hearing transcript are cited as "Tr. ___."

[3] Reference to Enforcement's exhibits are cited as "C-___." The Hearing Officer refused to admit Exhibit C-23, which, pursuant to Code of Procedure Rule 9267(b), is attached to the Record as a supplemental document.

II. Findings of Fact and Conclusions of Law

The underlying facts are undisputed and largely stipulated.

A. Background

Carney has worked in the securities industry and been registered as a General Securities Representative since 1989. (CX-1.) In February 1997, he joined R.D. Kushnir & Co. ("Kushnir"), an NASD member firm, where he worked as a broker until he was discharged on March 27, 1998. (CX-1; Stip. ¶ 1.) The NASD terminated his registration effective April 7, 1998.[4] (Id.) Carney is not currently employed in the securities industry or registered with the NASD. (CX-1; Tr. 125.) He is employed by Addis Bank Corp., a mortgage broker. (Tr. 125.)

Since at least 1992, L.O. had been one of Carney's customers. (Tr. 27.) When Carney moved from firm to firm, L.O. moved his accounts with him. In July 1997, L.O. moved two accounts to Kushnir: a personal account and a charitable remainder trust account for which L.O. was the trustee (the "CRT Account"). (Stip. ¶ 2; Tr. 29; CX-2; CX-3.) Although L.O. claims that he instructed Carney to limit the CRT Account to low risk investments (CX-13, at 2), the evidence shows that he signed option agreements for both accounts at the time he opened them. (CX-4; CX-5.) Over the ensuing eight months Carney effected more than 1400 trades in the two accounts, the vast majority of which were options in the S&P 100 index. (Stip. ¶ 3; CX-6; CX-7.)

[4] The NASD has jurisdiction over this proceeding pursuant to Article V, Section 4 of the NASD's By-Laws. (Stip. ¶ 1.) The Complaint charges misconduct while Carney was registered with Kushnir, and the Complaint was filed within two years after the effective date of termination of Carney's registration.

B. Issuing False Profit and Loss Reports

Early on, Carney's strategy seems to have been profitable—particularly in October 1997. Carney then bet the market was headed lower due to the Gulf War, and he invested his clients' funds accordingly. Instead, the market rose, and in a matter of just a few days, in Carney's words, he "destroyed" his clients' accounts. (CX-16, at 3.) Unwilling to inform his clients of his error in judgment, he embarked on months of unauthorized trading and deceit in an effort to recoup his customers' losses.[5] Finally, however, faced with ever mounting losses, Carney confessed his misconduct to his employer, Richard Kushnir. In a memorandum dated March 19, 1998, Carney stated:

> Here are the facts. After a fantastic month in October 1997, I informed my clients that we should stop trading for a short period of time, or take our profits and buy some good quality stocks. I even went to Las Vegas with two clients to celebrate. When I returned we had battleships steaming to the Gulf and a military conflict seemed eminent [sic]. I became convinced that with the technical damage that was already done, that not only could the market retest the lows made earlier, but could even violate those lows, creating perhaps a 10% to 20% correction. I did not just want to sit on the sidelines and miss the move I have been waiting for, for years. As you know the market exploded straight up. As a result, I was brutilized in just a few short days.
>
> I panicked. We weren't even done celebrating our big success, and in a manner [sic] of days I destroyed my clients accounts. In an instant of extremely poor judgement [sic] I began misleading my clients concerning how the trading was going and where their accounts stood. I felt responsible for the large declines in their account values.
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> * * *
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> It seems that in the last four months I didn't have a profitable day. I felt that I needed to continue to trade to make up for that falling account values. . . . The phone calls began to come in with clients questioning on how their accounts were sizable in one month and decreased by half the next. I violated my clients trust and confidence . . . .

[5] Although not charged, there is evidence in the record that Carney engaged in similar misconduct in several customer accounts in addition to L.O.'s.

* * *

> The bottom line is I have lied to my clients concerning their account values. Most importantly, to [M.C.] and [L.O.]. They have no knowledge of the substantial losses their accounts have incurred. [L.O.] is tired of me dancing around his account status, especially since January 1998.

(CX-16, at 3-4.) Upon receipt of this memorandum, Mr. Kushnir discharged Carney.

To hide the losses and unauthorized trading in L.O.'s two accounts, Carney prepared and sent to L.O. numerous false profit and loss statements entitled "Realized Gain/Loss," which showed that the trading in L.O.'s accounts was profitable. (Stip. ¶¶ 6, 7.) In reality, Carney's trading had generated losses of approximately $2,059,715 in L.O.'s personal account and another $304,610 in the CRT Account. (Stip. ¶ 4.) Carney also prepared and delivered to L.O. a letter dated February 18, 1998, that falsely represented that neither of L.O.'s accounts had lost money. (Stip. ¶ 8.) Carney further compounded his deceit by misstating the account balances in a document dated March 3, 1998, that falsely represented the net value of the CRT Account.[6] (Stip. ¶ 9.)

Without question, Carney violated NASD Conduct Rule 2110 by providing L.O. the foregoing false documentation. Rule 2110 "sets forth a standard intended to encompass a wide variety of conduct that may operate as an injustice to investors or other participants in the marketplace." In re Daniel J. Alderman, Exchange Act Release No. 35997, 1995 SEC LEXIS 1823, at * 7 (July 20, 1995), aff'd, 104 F.3d 285 (9th Cir. 1997). Conduct Rule 2110 "is not limited to rules of legal conduct but rather . . .

[6] L.O. further testified that Carney repeatedly told him that his confirmations and monthly account statements were wrong and that they did not reflect accurately the trading in his two accounts. (Tr. 32.)

it states a broad ethical principle." In re Timothy L. Burkes, 51 S.E.C. 356 (1993), aff'd mem., Burkes v. SEC, 29 F.3d 630 (9th Cir. July 24, 1994). Brokers owe a special duty of fair dealing to their clients. Charles Hughes & Co. v. SEC, 139 F.2d 434, 437 (2d Cir. 1943), cert. denied, 321 U.S. 786 (1944). A registered representative's denial of any wrongdoing, indicates a serious lack of trustworthiness and an egregious violation of his duty of fair dealing owed to his customers. District Bus. Conduct Comm. for Dist. No. 2, v. Aaron Eugene Granath, No. C02970007, 1998 NASD Discip. LEXIS 19, at *20 (Mar. 6, 1998).

C. Unauthorized Transactions in L.O.'s Accounts

Unable to make sense of the conflicting data supplied by Carney, on January 4, 1998, L.O. instructed Carney in writing to stop all trading in his accounts. (CX-11.) L.O. repeated that instruction in a second memorandum dated February 10, 1998, which Carney signed at L.O.'s request to document the fact that Carney received it. (CX-12.) Despite receiving these two unequivocal directives to cease trading, Carney continued with his efforts to trade his way out of the losses he had caused.[7] The Parties stipulated that Carney effected approximately 176 unauthorized transactions in L.O.'s personal account and approximately 76 unauthorized transactions in the CRT Account.[8] (Stip. ¶ 11.) Carney thereby violated NASD Conduct Rule 2110, as alleged in the Complaint. A registered representative who effects unauthorized transactions in a customer's account, irrespective of deception or intent, violates the

[7] L.O. testified that he also met with Carney on January 7, 1998, to go over his accounts and to reiterate that he did not want Carney effecting any further trades until the accounts could be reconciled. (Tr. 34-36.) According to L.O., Carney told him that he would continue to see some activity that would result from Carney correcting the mistakes in the account. (Tr. 36.)

obligation to observe just and equitable principles of trade required by Conduct Rule 2110. See, e.g., In re Keith L. DeSanto, Exchange Act Release No. 35860, 1995 SEC LEXIS 1500 (June 19, 1995), aff'd, 101 F.3d 108 (2d Cir. 1996) (table).

D. Failure to Answer Questions at On-The-Record Interview

On or about May 21, 1999, NASD Regulation staff requested, pursuant to and in accordance with NASD Procedural Rule 8210, that Carney appear on June 3, 1999, at its offices in Chicago, Illinois, for an on-the-record investigative interview concerning, among other issues, the activities described in the First and Second Causes of the Complaint in this proceeding. (Stip. ¶ 14.) In compliance with the request, Carney appeared with counsel on June 3. (Stip. ¶ 15.) During the interview, the staff reminded Carney that he was obligated to answer all of the questions asked of him and that his refusal to do so could result in disciplinary action against him.[9] (Id.) Specifically, NASD Regulation staff advised Carney that refusing to answer questions in reliance on the Fifth Amendment to the Constitution of the United States would constitute a violation of Rule 8210. (Id.; CX-19, at 7.) Despite this warning, Carney invoked the Fifth Amendment privilege against self-incrimination 39 times and refused to answer certain questions asked by NASD Regulation staff.[10] (Stip. ¶ 16.) Carney did answer other questions that he and his counsel considered not to carry a risk of self-incrimination.

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[8] Exhibits A and B to the Complaint indicate that Carney effected 172 unauthorized transactions in L.O.'s personal account and 69 unauthorized transactions in the CRT Account between January 5 and March 30, 1998.

[9] The transcript of his on-the-record interview is included in the record as Exhibit CX-19.

[10] Carney asserted the privilege on the grounds that there was a possibility he could be subject to a criminal action.

NASD Procedural Rule 8210(a)(1) authorizes the NASD to require an associated person "to provide information orally, in writing, or electronically . . . with respect to any matter involved in [an] investigation . . . ." The Rule provides a means for the NASD, in the absence of subpoena power, to obtain information from its members and associated persons in connection with its investigations.[11] As such, the Rule is a "key element in the NASD's effort to police its members."[12] A failure to respond "undermines the NASD's ability . . . to carry out its self-regulatory functions,"[13] and frustrates its ability "to conduct investigations and thereby protect the public interest."[14]

Carney's status as a defendant or a potential defendant in a criminal proceeding does not allow him to invoke the Fifth Amendment in response to the NASD Regulation's requests: the privilege against self-incrimination simply does not apply in NASD investigations and proceedings. As stated by the Court of Appeals for the Second Circuit with respect to New York Stock Exchange proceedings:

> interrogation by the New York Stock Exchange in carrying out its own legitimate investigatory purposes does not trigger the privilege against self-incrimination. . . . Most of the provisions of the Fifth Amendment, in which the self-incrimination clause is embedded, are incapable of violation by anyone except the government in the narrowest sense. . . . [T]his is but one of many instances where government relies on self-policing by private organizations to effectuate the purposes underlying federal regulating statutes.

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[11] In re Daniel C. Adams , 47 S.E.C. 919 (1983).

[12] In re Richard J. Rouse, 51 S.E.C. 581, 1993 SEC LEXIS 1831, at *7 (1993). See also, e.g., In re Joseph P. Hannan, Exchange Act Release No. 40438 (Sept. 14, 1998) ("Since the NASD lacks subpoena power, it must rely upon Rule 8210 in connection with its obligation to police the activities of its members and associated persons.").

[13] In re John J. Fiero, Exchange Act Release No. 39544, 1998 SEC LEXIS 49, at *5 (Jan. 13, 1998), rev'd on other grounds, Summary Order No. 98-4103 (2d Cir. Jan. 20, 1999).

[14] In re Barry C. Wilson, Exchange Act Release No. 37867, 1996 SEC LEXIS 3012, at *14 (Oct. 25, 1996) (quoting Rouse, 51 S.E.C. at 588, 1993 SEC LEXIS 1831, at *16).

United States v. Solomon, 509 F.2d 863, 867, 869 (1975).

The courts have repeatedly held that NASD Regulation, in performing its statutory mandate, is not a government actor.[15] Accordingly, the invocation of the Fifth Amendment privilege against self-incrimination cannot be a valid defense to a violation of Rule 8210. E.g., In re Vladislav S. Zubkis, Exchange Act Release No. 40409, n.2 (Sept. 8, 1998) ("It is well established . . . that the self-incrimination privilege does not apply to questioning in proceedings by self-regulatory organizations, since such entities are not part of the government."); In re Edward C. Farni II, 51 S.E.C. 1118, 1994 SEC LEXIS 1630, at *3 (1994) ("a refusal to provide information is a violation [of Rule 8210], without regard to invocation of the right against self-incrimination"); In re Daniel C. Adams, 47 S.E.C. 919, 921 (1983) (an invocation of the Fifth Amendment privilege would not affect the right of the NASD to sanction the respondent for his refusal to provide information, since the NASD is not a part of the government); In re Richard Neuberger, 47 S.E.C. 698, 699 (1982); In re Lawrence H. Abercrombie, 47 S.E.C. 176, 177 (1979). See also District Bus. Conduct Comm. No. 10 v. Gerald Cash McNeil, 1999 NASD Discip. LEXIS 3, at * 13-15 (rejecting respondent's argument that he was deprived of his Fifth Amendment right against compelled self-incrimination because the District Business Conduct

[15] See, e.g., Jones v. SEC, 115 F.3d 1173, 1182-83 (4th Cir. 1997) (rejecting claim based on the Fifth Amendment's Double Jeopardy Clause because the NASD is not a government agency); Datek Securities, Inc. v. NASD, 875 F. Supp. 230, 234 (S.D.N.Y. 1995) (dismissing Fifth and Fourteenth Amendment claims challenging the fairness of a disciplinary proceeding because the NASD is not a state actor.) See also, e.g., District Bus. Conduct Comm. No. 10 v. Gerald Cash McNeil, No. C3B960026, 1999 NASD Discip. LEXIS 3, at *13-15 (NAC Jan. 21, 1999).

Committee denied his request to postpone the hearing until after his pending criminal action had been resolved).[16]

Moreover, even if Carney were subject to a pending criminal proceeding involving the same issues that were the subject of the NASD Regulation's investigation,[17] he would not be entitled to refuse to answer questions touching on the issues underlying the criminal proceeding. Dual or parallel proceedings and investigations are not uncommon in the securities industry. The "Association's disciplinary and regulatory function coexists with other forums of redress, whether they be governmental or judicial, and the NASD's process does not stop when another entity's process begins." Market Surveillance Comm. v. Wakefield Financial Corp., No. MS-936, 1992 NASD Discip. LEXIS 124, at *36 (NBCC May 7, 1992) (finding no unfair prejudice to the respondents as a result of the hearing panel's refusal to stay the disciplinary proceeding pending the outcome of criminal proceedings). See also In re Dan Adlai Druz, Exchange Act Release No. 36306, 60 S.E.C. Docket 911, 1995 SEC LEXIS 2572, at *34 (Sept. 29, 1995) (rejecting respondent's argument that the New York Stock Exchange should have stayed its disciplinary action pending the completion of a criminal case), aff'd, 103 F.3d 112 (2d Cir. 1996).[18]

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[16] Even in civil proceedings where parties may assert a Fifth Amendment privilege, the trier of fact may draw an adverse inference based on a defendant's invocation of such privilege. See, e.g., Baxter v. Palmigiano, 425 U.S. 308, 318 (1976); United States v. One Parcel of Property Located at 15 Black Ledge Drive, 897 F.2d 97, 103 (2d Cir. 1990); SEC v. Bremont, 954 F. Supp. 726, 732-33 (S.D.N.Y. 1997).

[17] There is no evidence that there is an open criminal proceeding or investigation.

[18] Likewise, federal courts routinely have acknowledged that the SEC and the Justice Department may each seek to enforce the federal securities laws, by pursuing "simultaneously or successively" separate civil and criminal actions arising out of the same set of operative facts. See, e.g., SEC v First Financial Group of Texas, Inc., 659 F.2d 660, 666-69 (5th Cir. 1981); SEC v. Grossman, 121 F.R.D. 207, 209-10 (S.D.N.Y. 1987); SEC v. Musella, Fed. Sec. L Rep. (CCH) ¶ 99,156 (S.D.N.Y. 1983).

The National Adjudicatory Council (NAC), in Department of Enforcement v. Levitov, No. CAF980025, 1999 NASD Discip. LEXIS 30 (NAC Nov. 1, 1999), recently re-affirmed these general principles. In Levitov, after respondents were arrested on New York state criminal charges, one respondent requested a four-week adjournment of his testimony so that the direction of the criminal matter could be clarified before he testified, and the other respondent requested an adjournment until the criminal matter was resolved. The staff refused to grant the requested adjournments, and the respondents failed to appear for testimony. The NAC, in affirming the Hearing Panel's decision on liability, stated:

> [t]he respondents were not entitled as a matter of right to adjourn the dates set for their Rule 8210 testimony, regardless of New York State's filing of criminal charges . . . . Furthermore, respondents' desire to resolve the proceedings or, as Levitov requested, to clarify the direction of the criminal matter, provides no excuse for their failure to appear to testify. (1999 NASD Discip. LEXIS at *12.)

The Hearing Panel concludes, based on the controlling precedent, that Carney has failed to raise a legally valid defense for his failure to answer all of the questions asked of him at his on-the-record interview in connection with a *bona fide* NASD Regulation investigation. Accordingly, the Hearing Panel finds that Carney violated NASD Procedural Rule 8210 and NASD Conduct Rule 2110.[19]

III. Sanctions

For the reasons discussed below, the Hearing Panel concludes that Carney should be barred for each of the charged violations. This is an egregious case, involving sustained, repeated violations of the

[19] The SEC has consistently recognized that a violation of another NASD Rule constitutes a violation of the requirement to adhere to "just and equitable principles of trade" set forth in Rule 2110. In re William H. Gerhauser, Exchange Act Release No. 40639, 68 S.E.C. Docket 1238, 1243, 1998 SEC LEXIS 2402, at *20-21 (Nov. 4, 1998).

fundamental duty of fair dealing and honesty that Carney owed his customers. Carney's argument that he should not be barred because of his impaired emotional state is unpersuasive and unavailing. In the Hearing Panel's judgment, the evidence plainly demonstrates that Carney understood fully the nature and consequences of his misconduct, yet he continued in order to benefit himself. Fearful of losing his job, and with concern for his own financial wellbeing, he launched an elaborate scheme of deception involving several customer accounts that ultimately caused those customers considerable financial loss. Carney's effort to excuse his conduct in part does not contradict these factors or show that he should be permitted to remain in the securities industry.

A. Carney's Evidence in Mitigation

Recognizing the seriousness of his misconduct, Carney asked the Hearing Panel to consider two factors in mitigation. First, Carney argued that a 10-year suspension would better meet the NASD's goal of protecting L.O. and the other investors Carney harmed because, if he is barred, he would not be able to keep his current job at Addis Bank Corp., which he claimed gave him the only realistic opportunity of making enough money to repay his customers' losses.[20] Second, Carney asked the Hearing Panel to take into consideration his impaired mental condition at the time he committed the violations. The Hearing Panel, however, found these factors insufficient to warrant allowing Carney to re-enter the securities industry.

With respect to his first argument, Carney explained that Addis was formed after a former client and family friend, Andy Wright, gave him the opportunity to develop and run a new business. (Tr. 125-

26.) Carney currently directs the overall strategy of the company, which operates in four states and employs 102 persons. (Tr. 125-29.) Carney further testified that, although he currently makes just $19,000 per year, if Addis is successful he has an unwritten understanding with Mr. Wright that he will be given an equity interest in the company. (Tr. 127, 129.) Carney stated that his goal in creating Addis "was to put [himself] in a position to make restitution, and you can't do that working at Sears selling comforters." (Tr. 127.) Carney hopes that if Addis is successful and he is given an equity stake in the company, he will be able to make enough on the sale of his interest to pay restitution to his customers.[21] (Tr. 128.) On the other hand, Carney testified that this prospect would be defeated if he is barred from the securities industry or given a longer suspension because Mr. Wright has said he could not retain Carney in his present position under such circumstances. (Tr. 138-39.) Carney did not offer any evidence to corroborate his speculative testimony on these points.

In support of his second argument, Carney introduced the testimony of Cheryl Pecaut, the clinical psychologist who treated Carney for anxiety and depression around the time he committed the alleged violations. Ms. Pecaut testified that she first saw Carney in May or June of 1997. (Tr. 67.) Carney came to her complaining of a high degree of agitation, a lot of mood swings, and occasional panic attacks. (Id.) The immediate cause for his concerns was his personal relationship with the woman with whom he lived at the time. (Tr. 70.) She was pregnant with his child, and he was overwhelmed by

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[20] Carney testified that in addition to L.O. he intends to make restitution to three other customers in the total amount of $235,000. (Tr. 135-36.)

[21] Carney has not yet paid any restitution to any of the harmed customers. (Tr. 135.)

the problems in their relationship and by this development particularly. (Tr. 86, 119.) Ms. Pecaut diagnosed his condition as major depressive disorder with an underlying panic disorder.[22] (Tr. 68-69.)

Over the course of several months of treatment, Carney became increasingly concerned about his performance at work. (Tr. 99, 101.) By October 1997, Carney was so concerned about his declining performance that he wanted Ms. Pecaut to observe him at work to "see what he was up against, to see if [she] could help him kind of reverse what he saw to be a decline in his performance." (Tr. 70-71.) Ms. Pecaut agreed, and she eventually made a total of three visits to his office. The second visit, in December 1997, was set up at Carney's request for Ms. Pecaut to speak to Mr. Kushnir because Carney was worried about losing his job. (Tr. 72-73.) The main thrust of her conversation with Mr. Kushnir appears to have been how he could help monitor Carney to assure that he kept taking his medication.[23] (Tr. 74-75.) Mr. Kushnir agreed to help. Nevertheless, by the final visit in early 1998, things had gotten much worse. (Tr. 77.)

It was Ms. Pecaut's professional judgment that Carney's depressive and anxiety disorders made it difficult for him to process information correctly and quickly, which could lead him to make bad decisions, and that the disorders caused him to fear the disappointment of others. (Tr. 72, 77.) From this opinion, the Hearing Panel was asked to infer that his conditions contributed to the difficulty he was having at work and helped explain his deceit. Significantly, however, Ms. Pecaut also testified that

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[22] Ms. Pecaut also testified that Carney had a history of depression going back to his college years. (Tr. 82.) In her opinion, Carney suffers from a genetic chemical imbalance that manifests itself as a depressive condition when triggered by trauma. (Tr. 83.)

[23] Mr. Carney had been prescribed to take the antidepressants Prozac and Zoloft, and the anti-anxiety drug Xanax. (Tr. 85.)

Carney was not delusional. (Tr. 95.) For example, in her opinion Carey fully understood that his clients were losing money. (Tr. 113.) And from the evidence as a whole, it is equally clear that Carney knew that his massive deception was wrong. He knew that he improperly effected unauthorized trades in L.O.'s accounts after January 4, 1998, and he knew that it was wrong to fabricate false profit and loss reports to hide the losses and his improper trading.

Considering Carney's evidence in the most favorable light possible, it does not justify permitting Carney to remain in the securities industry. This was not a situation where Carney made a single bad decision. Here Carney carried out a lengthy and complicated scheme to deceive L.O. and his other customers. For months, Carney operated without authority in an effort to save his job. But more importantly, the evidence clearly shows the high degree of effort and attention to detail that he expended in his deceptive scheme. Contrary to Ms. Pecaut's assertion that he might lack the capacity to concentrate due to his depression, the record shows that he was able to produce detailed profit and loss reports to conceal his wrongdoing. There is nothing in the record that suggests that Carney did not understand the gravity of his conduct or that he lacked the ability to obey L.O.'s instructions to stop trading. Certainly, over the course of many months he could have ceased his wrongful conduct. But it was not until he finally realized that he would not be able to save his job that he confessed to Mr. Kushnir. In summary, the Hearing Panel concludes that Carney acted out of self-interest and in total disregard of his customers' welfare.

B. Issuing False Profit and Loss Reports

The NASD Sanction Guideline for "Forgery And/Or Falsification of Records"—which is the Guideline that comes the closest to covering the misconduct at issue in this case[24]—recommends the imposition of a bar in egregious cases.[25] The sanctions recommended in the Guideline indicate that the NASD views the falsification of records as an inherently egregious offense. In addition to the principal considerations that adjudicators always should consider in imposing sanctions,[26] the Guideline recommends that adjudicators consider the nature of the falsified documents.[27]

Enforcement recommends that Carey be barred. As the Hearing Panel already indicated, it agrees with Enforcement's recommendation.

Carney's misconduct was not the result of a temporary lapse in judgment. He knowingly, deliberately, and repeatedly lied to his customers regarding the value of their accounts. To bolster these falsehoods, Carey prepared false profit and loss reports, which he gave to his customers over several months. While Carney eventually admitted his wrongdoing to his firm, it is clear from the evidence that

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[24] Enforcement did not address which Guidelines should be applied.

[25] NASD Sanction Guidelines 35 (1998 ed.).

[26] Id., at 8-9. The following principal considerations are relevant in assessing the appropriate remedial sanctions for Carney's misconduct: (1) relevant disciplinary history, if any; (2) whether he accepted responsibility for and acknowledged the misconduct to his employer prior to detection and intervention by the firm or a regulator; (3) whether he voluntarily and reasonably attempted, prior to detection and intervention to pay restitution or otherwise remedy the misconduct; (4) whether he engaged in numerous acts and or a pattern of misconduct; (5) whether he engaged in the misconduct over an extended period of time; (6) whether he attempted to conceal his misconduct; (7) whether the respondent's conduct injured the investing public; (8) whether he provided substantial assistance to NASDR in its investigation of the underlying misconduct, or whether he attempted to conceal information from NASDR; and (9) whether respondent's misconduct was the result of an intentional act, recklessness, or negligence; (10) whether the member firm with which the respondent is and was associated disciplined respondent for the misconduct at issue prior to regulatory detection; and (11) whether the respondent's misconduct resulted in the potential for his monetary or other gain.

had he been more successful with the unauthorized trading, he would not have. Put differently, the evidence suggests that if Carney had been presented with additional opportunities to continue in this misconduct, he would have. It is equally clear that Carney was motivated by his desire to benefit himself and save his job. Thus, although Carney eventually accepted responsibility for his misconduct, the Hearing Panel finds that the mitigative effect of his admissions is dwarfed by the egregiousness of his misconduct. The Hearing Panel also observes that Carney has made no restitution payments despite his repeated statements that this is his goal.

On balance, the Hearing Panel concludes that there are insufficient mitigating factors present to warrant limiting the sanction to a suspension, as Carney requests. Accordingly, the Hearing Panel has determined to bar Carney from association with any NASD member.[28] In imposing these sanctions, the Hearing Panel has considered that sanctions in disciplinary proceedings such as this are intended not only to deter the respondent from future misconduct but also to deter others from engaging in similar misconduct. See In re Daniel Joseph Alderman, 52 S.E.C. 366, 370 (1995) ("for self-regulatory exchanges to maintain their credibility as effective participants in the regulatory process, . . . [they] must also impose sanctions severe enough to deter others from engaging in similar misconduct") (quoting In re Kenneth Sonken, 48 S.E.C. 832, 836 (1987)), aff'd 104 F.3d 285 (9th Cir. 1997).

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[27] Id., at 35.

[28] In accordance with NASD Notice to Members 99-86 (Oct. 1999), the Hearing Panel has not also imposed a fine because it is ordering Carney to pay restitution for the unauthorized trading.

C. Unauthorized Trading

For the reasons already discussed, the Hearing Panel has determined that it is appropriate to bar Carney for executing unauthorized transactions in L.O.'s accounts. The applicable NASD Sanction Guideline[29] recommends a bar in egregious cases, which this is.

In District Bus. Conduct Comm. No. 10 v. Hellen, No. C3A970031, 1999 NASD Discip. LEXIS 22 (NAC June 15, 1999), the National Adjudicatory Council ("NAC"), citing prior decisions, delineated three categories of egregious unauthorized trading. First, there is "quantitatively egregious" unauthorized trading which is characterized by a large number of unauthorized transactions.[30] The existence of numerous unauthorized transactions "often constitutes compelling circumstantial evidence that the [trades] were not the result of miscommunications or mistakes."[31]

Second, there is unauthorized trading that is "egregious because it is accompanied by certain aggravating misconduct." This type of egregious unauthorized trading includes those cases where a respondent attempts to conceal the conduct or to evade NASD investigative efforts, or where there is a history of prior unauthorized trading.[32]

Third, there is "qualitatively egregious" unauthorized trading. Typically, unauthorized trading is deemed to be "qualitatively egregious" where the respondent was motivated to make money at the

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[29] NASD Sanction Guidelines 86 (1998 ed.).

[30] See also, District Bus. Conduct Comm. for District No. 2 v. Granath, No. C02970007, 1998 NASD Discip. LEXIS 19, at *19-20 (NAC Mar. 6, 1998) (imposing a bar when the Respondent executed 24 unauthorized transactions); District Bus. Conduct Comm. for District No. 7 v. Levy, No. C07960085, 1998 NASD Discip. LEXIS 22, at *12 (NAC Mar. 6, 1998) (imposing a bar when the Respondent executed 16 unauthorized transactions).

[31] Hellen, 1999 NASD Discip. LEXIS at *16 ("In addition, the volume of the violations significantly increases the gravity of the respondent's transgression.").

customer's expense, or executed unauthorized trades after using high-pressure sales tactics designed to intimidate and induce the customers to authorize the trades.[33] In Hellen, the NAC identified two factors as relevant to a determination of whether the unauthorized trading was or was not qualitatively egregious: (1) "the strength of the evidence that the trades at issue were unauthorized";[34] and (2) "the evidence relating to the respondent's motives."[35]

In this case, the Hearing Panel finds that the evidence overwhelmingly supports a finding that Carney's unauthorized trading meets each of the foregoing criterion. As discussed above, Carney effected hundreds of trades against L.O.'s repeated written instructions. This is not a case of possible mistake. Carney acted in bad faith. His overriding concern was his own welfare, not his clients.' Carney wanted to save his job after having made some bad investment decisions on his clients' behalf. Worried that he would be fired if they found out that he had "destroyed" their accounts, Carney embarked on a trading binge trying to recover those losses and protect himself. His actions caused even more damage, increasing their losses. The Hearing Panel also cannot overlook Carney's deceptive behavior. Under these circumstances, Carney's belated pleas for leniency because he wants to repay his customers' losses at some time in the future cannot be granted. In the Hearing Panel's opinion, Carney would represent a real and substantial threat to his clients' welfare if he were allowed to rejoin the securities

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[32] Id.

[33] Id. at *17-18.

[34] Id. at *18.

[35] Id.

industry in the future. In addition, here also, the Hearing Panel believes that a bar is warranted to serve as a deterrent to others. Accordingly, the Hearing Panel has determined to bar Carney for his unauthorized trading in L.O.'s accounts.

In addition, the Hearing Panel considers it appropriate to enter an order of restitution in this case. Although Enforcement did not request such relief until the hearing, Carney indicated that he considered restitution an appropriate sanction. (Tr. 17.)

Restitution is a traditional equitable remedy designed to "restore the status quo where otherwise a . . . victim would unjustly suffer loss."[36] The NASD Sanction Guidelines generally recognize that, in cases where an identified individual has suffered a quantifiable loss as a result of a respondent's misconduct, it is fitting to order the respondent to pay restitution.[37] The Guidelines also suggest that, when ordering restitution, adjudicators may consider requiring the respondent to pay pre-judgment interest on the base amount, calculated pursuant to 26 U.S.C. § 6621(a)(2), i.e., the interest rate used by the Internal Revenue Service to determine interest due on underpaid taxes.[38] The Guidelines recommend that pre-judgment interest should be measured from the date of the occurrence of the violative activity that gave rise to the loss.

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[36] In re David Joseph Dambro, 51 S.E.C. 513, 518 (1993).

[37] NASD Sanction Guidelines 6.

[38] Id., at 12. The Internal Revenue Service rate, which is adjusted each quarter, reflects market conditions, and thus approximates the time value of money for each quarter in which the customer lost the use of his or her funds.

Here, the Parties stipulated L.O.'s losses to be "approximately" $2,364,325. (Stip. ¶ 4.) At the hearing, however, when questioned about entry of an order of restitution, Carney's counsel stated that he believed the actual amount of L.O.'s loss was $1,700,000. (Tr. 57-59.) Since there is insufficient evidence in the record to determine the amount of L.O.'s losses independent of the agreement of the Parties, the Hearing Panel will accept Carney's estimation and order Carney to pay restitution in the principal sum of $1,700,000, plus pre-judgment interest thereon from March 30, 1998, the date of the last unauthorized trade.

D. Failure to Answer Questions at On-The-Record Interview

The applicable NASD Sanction Guideline, as amended by NASD Notice to Members 99-86, recommends that a bar should be standard where an individual respondent fails to provide testimony, but if mitigation exists, adjudicators should consider suspending the individual in any or all capacities for up to two years.[39] The Guideline thus recognizes that a refusal to provide information is a serious violation given NASD Regulation's inability to subpoena required information.[40] In this case, Enforcement requested that Carney be barred for his failure to provide complete testimony.

Carney argued that he only refused to answer those questions to which he was entitled to assert his Fifth Amendment right against self-incrimination, and, therefore, he argues he cannot be sanctioned. But, as discussed above, a respondent may not refuse to answer questions in an NASD investigation

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[39] NASD Sanction Guidelines 31 (1998 ed.).

[40] Rouse, 1993 SEC LEXIS 1831, at *11. See also, e.g., In re Barry C. Wilson, 1996 SEC LEXIS 3012, at *14 ("[a]bsent subpoena power, members and associated persons must cooperate fully in providing information requested by the NASD in order for the NASD to carry out its regulatory functions. . . . Failing to cooperate with the NASD is a serious violation.").

because of actual or potential exposure to criminal action. The assertion of the privilege against self-incrimination—even if upon advice of counsel—"is not mitigative of a refusal to respond to NASD investigative requests . . . ." District Bus. Conduct Comm. No. 7 v. Joiner, No. C07940022, 1994 NASD Discip. LEXIS 200, at *12 (NBCC Dec. 8, 1994). The Hearing Panel believes that if NASD Regulation, as a matter of course, were to treat the assertion of the Fifth Amendment as mitigative for purposes of sanctions, this would be tantamount to recognizing the existence of a privilege that clearly does not apply in the NASD's investigations or disciplinary proceedings. Accordingly, the Hearing Panel has determined to bar Carney for refusing to answer completely all of the questions asked of him at his on-the-record interview.

IV. Order

Therefore, having considered all the evidence,[41] on each of the causes in the Complaint, the Hearing Panel bars the Respondent Paul E. Carney from associating with any member firm in any capacity. The Hearing Panel further orders Carney to pay restitution to L.O. in the principal sum of $1,700,000, plus pre-judgment interest thereon calculated pursuant to 26 U.S.C. § 6621(a)(2) from March 30, 1998, until the date of this Decision.

Carney is also ordered to pay costs in the total amount of $1,794.80, which include an administrative fee of $750 and hearing transcript costs of $1,044.80.

These sanctions shall become effective on a date set by the NASD, but not sooner than 30 days from the date this Decision becomes the final disciplinary action of the NASD, except that if this

Decision becomes the final disciplinary action of the Association, the bars shall become effective immediately.

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Andrew H. Perkins
Hearing Officer
For the Hearing Panel

Copies to:

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Steven J. Rotunno, Esq. (by facsimile and first-class mail)
Dale A. Glanzman, Esq. (by first-class and electronic mail)
Rory C. Flynn, Esq. (by first-class and electronic mail)

[41] The Hearing Panel has 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.