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NASD REGULATION, INC.
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,	
Complainant,	Non-Summary Suspension Proceeding No. ARB010013
v.	Hearing Officer - AWH
	DECISION
	January 25, 2002
Respondent.	

Respondent failed to demonstrate a bona fide inability to pay the amount due under a settlement agreement to resolve an arbitration proceeding. Respondent's registration suspended in accordance with Article VI, section 3 of the NASD By-Laws and Procedural Rules 9510, *et seq*.

David Minnick, Esq., for the Department of Enforcement.

____________________, Esq., for ___________.

DECISION

In December 1999, ________________ ("________") commenced an NASD Arbitration Proceeding against _______________ ("_____" or "Respondent"). On October 20, 2000, ____ entered into a settlement agreement to resolve the arbitration proceeding, agreeing to pay ______ $22,750. However, Respondent never made any payments under the settlement agreement. On May 1, 2001, pursuant to Article VI, Section 3 of the NASD By-Laws and Rule 9510 *et seq*., the NASD informed Respondent that it intended to suspend Respondent's registration on May 21, 2001, unless it received documentary evidence that he had complied with the settlement agreement, or certain other enumerated events had occurred.[1] On May 10, 2001, ____'s attorney filed a letter with NASD Regulation ("NASDR"), requesting a hearing and asserting a defense of a bona fide inability to pay the settlement.[2] On August 30, 2001, a hearing was held to allow ____ to present his defense.

Findings of Fact

Background

In October 1998, ____ became associated as a registered representative with member firm, ______. CX 7, at 1.[3] In December 1999, ____ became registered with the NASD as a General Securities Representative through member firm _____________ & __., ____. ("______________"), his current employer. CX 1, at 3. While he was working at ______, that firm paid ____'s previous employer, _____________ ("________"), $47,000 for the payout of ____'s contract with ______. CX 7, at 1. According to the terms of his employment agreement with ______, ____ agreed to repay this amount to the firm. *Id.* ______ also advanced ____ $5,000 per month, for a period of five months, as a draw against his commissions. *Id.*

[1] These events included the Claimant agreeing to installment payments of the amount due, the Claimant agreeing to an alternative form of settlement, the Respondent filing a bankruptcy petition in U.S. Bankruptcy Court pursuant to Title 11 of the United States Code, or the U.S. Bankruptcy Court discharging the arbitration award.

[2] *See* "Self-Regulatory Organizations; Order Granting Accelerated Approval to Proposed Rule Change" etc., Exchange Act Release No. 40026, 1998 SEC LEXIS 1154, at *7 (May 26, 1998) (citing *Bruce M. Zipper*, Exchange Act Release No. 33376, 1993 SEC LEXIS 3525 (Dec. 23, 1993)) ("The Commission has recognized that a bona fide inability to pay an arbitration award is an important consideration in determining whether any sanction for failure to pay an arbitration award is excessive or oppressive").

[3] References to Enforcement's exhibits are designated CX_; Respondent's exhibits, as RX_; the parties' joint stipulations, as Stip._; the Transcript of the Pre-Hearing Conference, as Pre-Hearing Tr._; and the Transcript of the Hearing, as Tr._.

On September 24, 1999, ____ terminated his employment with ______, and ______ requested that ____ return the $72,000 paid to ____ and advanced to ______ on ____'s behalf. *Id.* ____ failed to satisfy this demand, and on or about December 17, 1999, ______ filed a Statement of Claim against ____ with NASD Dispute Resolution. *Id.* On October 20, 2000, ______ and ____ entered into a settlement agreement under which ____ agreed to pay ______ $22,750.[4] Tr. 32-33; CX 2. Following this agreement, ______ dismissed its claims against ____ and terminated the arbitration. CX 7, at 2.

On November 19, 2000, ____ failed to make his initial payment due under the agreement with ______. *Id.* After this failure, ______'s attorney sent ____ a letter dated November 22, 2000, notifying ____ of his default under the settlement agreement. *Id*. In this letter, the attorney also told ____ that if he did not cure his default within 10 days, ______ would notify the NASDR. *Id.* Nevertheless, ____ failed to make any payments to ______ under the settlement agreement. Tr. 33.

In a letter dated April 27, 2001, ______'s counsel informed NASDR of ____'s default. CX 5. On May 1, 2001, NASDR informed ____ by letter that, if he did not provide documentary evidence that he had complied with the agreement, or that certain events had occurred before May 21, 2001, the NASD would suspend his registration on that day. CX 6. The letter also informed ____ of his right to a hearing. *Id*.

On May 10, 2001, ____ filed a hearing request with NASDR, asserting an inability to pay the amounts due under the settlement agreement. According to the letter, as of May 7, 2001, ____ had a substantial federal tax lien against him and no liquid assets. Additionally, the letter stated that his total gross pay for the two-week period

[4] According to the terms of this agreement, ____ was to pay $4,500 within 30 days of October 22, 2000, and make twelve monthly installments of $1,500, commencing 30 days after the $4,500 payment.

ending April 30, 2001, was $1,007. The letter stated that ____ was "prepared to comply with the terms of the settlement when his financial situation improve[d]."

On May 25, 2001, ____ filed a Statement of Financial Condition with NASDR, showing a negative net worth of $46,380. CX 8. He showed a gross income of $82,000 for the year 1999, and $142,417 for the year 2000. *Id*. During a June 4, 2001, pre-hearing conference, ____'s attorney agreed to send Enforcement information supporting the Statement of Financial Condition, including ____'s tax returns for the years 1999 and 2000. Pre-Hearing Tr. 8-11.[5]

During the August 31, 2001 hearing, the parties stipulated that ____ had failed to make any payments pursuant to the settlement agreement. Thus, the issue in contention during the hearing was ____'s ability to pay the amount he owed ______. Following the hearing, both parties submitted Proposed Findings of Fact and Conclusions of Law. ____ reiterated his bona fide inability to pay defense in his submission. Enforcement disputed ____'s defense in its Proposed Findings, alleging that ____ violated NASD Conduct Rule 2110 when he failed to pay the arbitration settlement.

<u>____'s Contentions</u>

During the hearing, ____ contended that, although he intends to pay the amount he owes ______ under the settlement agreement, he is currently unable to do so. Tr. 28. According to ____, when he entered into the settlement agreement, he was expecting an increase in income from anticipated commissions he hoped to earn on a large account. Tr. 16. However, due to uncertain economic conditions, the account holder pulled out of

[5] He also agreed to submit all documents reflecting ____'s income for the year 2001, his bank account records, his credit card statements, a copy of his income tax lien, a copy of his note payable to _____, and his apartment lease.

the stock market. Tr. 18. Consequently, ____ failed to realize any commissions on the account, and his expected income from the account never materialized. *Id*.

After his client pulled out of the market, ____ sought to borrow money from a bank to pay the amount due under the settlement agreement. Tr. 19. However, the bank would not lend him the money, due to an outstanding federal tax lien. Tr. 19. Following the hearing, ____ submitted documentation, which he received after the hearing, showing that, as of August 27, 2001, he owed $82,769.39 to the IRS.

____ testified that he has no extra income to pay any amount under the settlement agreement. Tr. 26. He contends that during the year 2001, he paid $4,100 per month for personal expenses (including $1,564.50 for rent, $300 for clothes and “incidentals,” and $800 for business expense, lunches, and entertainment). RX 1; RX 4; Tr. 25. He also submitted a chart showing a net income, for the period January 2001 to August 2001, of $31,071.00, and expenses for that period totaling $32,880.00. RX 2.

When ____ began working at ________________, that firm made a personal loan to him of $10,000. CX 9. In a letter dated June 14, 2001, _______, the Chief Financial Officer of _____, stated that $1,000 “is to be automatically deducted” from ____’s pay each month to repay the loan. *Id*.

<u>Enforcement’s Case</u>

Enforcement disputes ____’s asserted defense of a bona fide inability to pay, and alleges that ____ violated NASD Conduct Rule 2110 when he failed to pay the amount owed to ______ under the settlement agreement.[6] Enforcement contends that since

[6] Enforcement seeks a fine of $5,000 and a suspension for 90 days for the asserted violation of Conduct Rule 2110. However, this is not a disciplinary proceeding initiated under Procedural Rules 9200, *et seq*. Accordingly, that relief is not available in this proceeding.

signing the settlement agreement, ____ has had several opportunities to satisfy all, or a portion, of his debt to ______. Enforcement cites the following sources of funds that ____ could have used to pay or reduce his debt to ______: (1) the $10,000 loan he received from _________ shortly after he joined the firm in September 1999; (2) the $4,120.85 he earned during the months of November and December 2000, and (3) the $63,973.27 he made in gross earnings from January 2001 through July 2001. RX 5; RX 6; Tr. 38, 73, 101; CX 8, at 2, CX 12; CX 29, at 3.

Rather than paying ______, ____ deferred current income in order to contribute to his 401(k) account, repaid part of his loan from _____, and paid other "discretionary" expenses. From October 22, 2000, through August 15, 2001, ____ contributed $4,890.63 of income to his 401(k) account. RX 5; RX 6; CX 29, at 2; Tr. at 39-43, 71-73. During 2001, ____ repaid $6,000 of the ____________ loan. CX 29, at 2-3; CX 12; Tr. 62. Between December 20, 2000, and June 26, 2001, ____ incurred $1,102.85 of "discretionary expenses" at such establishments as the New York Sports Club, Starbucks, Nobody Beats the Wiz, and two tanning salons. CX 13-15, 17, 19, 24, 25.[7] ____ has not sought additional employment to supplement his income, and he continues to live in the same apartment, rather than seeking to reduce his housing costs. Tr. 38, 47-51; CX 23.

On May 5, 2001, ____ signed a subscription agreement evidencing an interest in an investment vehicle known as SB Venture Capital Management II LLC ("SB Agreement"). CX 21, Tr. 88. According to ____ he was "granted" an interest in this

[7] These discretionary expenses include at least $395.00 at the New York Sports Club, $65.34 at Starbucks, and more than $331.48 at other places, such as Sparrow Wine, Makeovers 00, and Ebay during the year 2001. CX 13-17. Additionally, Enforcement shows that he spent $185.46 on nonessential items, such as excessive credit card interest, cash advance fees, credit card membership fees, insufficient funds fees, and ATM fees. CX. 24, 25, 13-18. During 2001, ____, who does not own a car, paid automobile-related expenses of others in the amount of $125.57. CX 13, 17.

subscription. However, he has not inquired about assigning to ______ his interest in this private placement investment. Tr. 89-90. ____ also listed "non-liquid securities, including limited partnership investments" with a value of $630 on his Financial Statement. CX 8, at 3. Enforcement contends that ____ could have used these funds to reduce indebtedness to ______.

Enforcement contends that ____'s documentary portrayal of his financial situation is internally inconsistent. In February 2000, ____ represented to _____ on his new account form that he had an annual income of $100,000 and a liquid net worth of "1M+."[8] CX 26, at 9. In the SB Agreement, ____ was required to certify that he was "an accredited investor." To so certify he should have initialed a space to indicate that he had either an annual income in excess of $200,000, a net worth in excess of $1,000,000, or a net worth that was three to five times the investment in the units to be purchased. CX 21, at 8. In fact, however, no space was initialed on the form. Because, as discussed below, ____ has not provided reliable evidence of his net worth, the Hearing Officer cannot determine his net worth on the basis of the record.

Although ____ asserted that he would not receive gross earnings from ____ ________ in his upcoming September 15, 2001, paycheck, he failed to provide any written documentation or proof to support that assertion, but admitted that $500 of his income for the period would be contributed to his 401(k) account. Tr. 116. ____ also failed to produce requested bank records explaining transfers between accounts at Chase or the use of those transferred funds. CX 13, at 3; CX 14, at 3; CX 15; CX 16, at 2, CX 17, at 3; and CX 18, at 2. ____ submitted the statements for his primary checking

[8] Enforcement contends that "1M+" means in excess of one million dollars. ____ contends that it means in excess of one thousand dollars. Under the circumstances, the Hearing Officer finds the notation to be ambiguous.

account, but did not explain the following transactions in the account: a deposit of $10,016.28 into his checking account on January 12, 2001; a check for $7,430 (to an unidentified payee) that cleared his account on January 17, 2001; a check for $5,500 (to an unidentified payee) that cleared on March 20, 2001; and the entry "Deduction-Notice Mailed," for $2,800 on April 16, 2001. CX 18, at 1, 2; CX 15, at 1, 3.

Discussion

Pursuant to Article VI, section 3 of the NASD By-Laws and the Rule 9510 series, the NASD may suspend the registration of any person who fails to comply with a settlement agreement related to an NASD arbitration proceeding. *See* NASD Procedural Rule 9511(a)(2)(A). The Rule 9510 series further provides that in order to initiate non-summary proceedings, the NASD must provide written notice to the person and allow the person to file a request for a hearing. *See* NASD Procedural Rules 9513(a) and 9514(a). One of the issues that may be raised as a defense in these proceedings is whether the respondent has a bona fide inability to pay the award or the amount due under the settlement agreement.[9]

Respondents in non-summary suspension proceedings bear the burden of establishing their *bona fide* inability to pay a settlement of an arbitration where such inability is raised as a defense to suspension of their registration for failure to pay the settlement.[10] Respondents appropriately bear this burden because their ability to pay is a

[9] "Self-Regulatory Organizations; Order Granting Accelerated Approval to Proposed Rule Change" etc., Exchange Act Release No. 40026, 1998 SEC LEXIS 1154, at *7 (May 26, 1998) (stating the Commission's view that the issues to be resolved in these proceedings are "somewhat narrow").

[10] *See Bruce M. Zipper*, Exchange Act Release No. 33376, 51 S.E.C. 928, 1993 SEC LEXIS 3525 at *8 (Dec. 23, 1993) ("Because the scope of his assets is peculiarly with Zipper's knowledge, we think Zipper should properly bear the burden of adducing evidence with respect to those assets.").

matter peculiarly within their knowledge.[11] When they raise the defense, the NASD is entitled to make a searching inquiry into their assertions.[12]

To meet this burden, a respondent must show more than a current lack of funds on hand to pay the settlement in full. An inability to pay defense may be rejected if it appears that the respondent is capable of reducing his living expenses, has the ability to divert funds from other expenditures to pay the settlement, could borrow the funds, or could make some meaningful payment toward the settlement from available assets or income, even if he could not pay the full amount of the settlement.[13]

Here, ____ has failed to satisfy his burden of proof. The record demonstrates that ____ has both the assets and the income to make some meaningful payment toward the settlement.

From the time he was obligated to make payments under the settlement agreement to the date of the hearing, ____ contributed $4,890.63 to his 401(k) account. The evidence indicates that he was about to add $500 to that account as a result of his next paycheck from ______. Those funds could have been diverted to meet his obligation to ______. ____ also has an interest in the SB Agreement and other non-liquid securities with a value of at least $630, which could be used to reduce his debt to ______.

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[11] *Id.*

[12] *Daniel Joseph Avant*, Exchange Act Release No. 36423, 52 S.E.C. 442, 1995 SEC LEXIS 2816, at *11 (Oct. 26, 1995); *Zipper*, 1993 SEC LEXIS 3525, at *8.

[13] *DBCC No. 7 v. Escalator Securities, Inc.* No. C07930034, 1998 NASD Discip. LEXIS 21, at *12, 13 (NBCC Feb. 19, 1998) ("[T]he Firm must be required to demonstrate that the fine or award is so large in relation to its actual capital that it is unable to obtain the additional capital to pay the fine or award by, among other things, reducing expenses and salaries, raising capital, and/or borrowing money."). *DBCC No. 8 v. Miguel Angel Cruz,* No. C8A930048, 1997 NASD Discip. LEXIS 62, at *106 (NBCC Oct. 31, 1997)(Holding that Cruz could not rely on the inability-to-pay defense because he could have diverted funds from other unnecessary expenses, such as charitable contributions and a car lease, to pay the fine.).

____ failed to provide Enforcement with the complete documentation necessary to portray his true financial situation. He submitted bank statements to Enforcement, but failed to explain certain deposits or transfers and payments out of the accounts. The full extent of his assets cannot be determined on the record in this proceeding because ____ has declined to supply the necessary evidence. Nevertheless, the evidence demonstrates that he has now, and has had since the date of the settlement agreement, sufficient assets to make a meaningful payment toward the settlement.

Since the date of the settlement agreement, ____ has also had sufficient income from which he could have made a meaningful payment toward the settlement. In addition to the contributions of his income to his 401(k) plan, ____ repaid $6,000 of his loan from ______ in 2001. From those two sources, up to $10,000 in income would have been available to make payments under the settlement agreement. He has not explained a deposit of more than $10,000 to his checking account in January 2001, nor the two checks totaling almost $13,000 that were deducted from the account in January and March 2001. Moreover, ____ has made no effort to alter his lifestyle and reduce his discretionary expenses. For example, while paying nothing to ______, he incurred monthly sports club fees of $79, and a variety of charges at several tanning and other salons. His own estimate is that he spends $800 per month for “business expenses, lunches, and entertainment.” He failed to explain why some or all of that income could not have been paid, instead, toward the amount due under the settlement.

Conclusion

Upon consideration of the evidence, the Hearing Officer finds that ____ has failed to establish a bona fide inability to pay, or to make any meaningful payment towards, the settlement agreement that he entered into with ______.

Accordingly, pursuant to Article VI, section 3 of the NASD By-Laws and Rule 9514(g), _____________'s registration shall be suspended effective as of the date of issuance of this Decision, and that such suspension shall continue until he provides documentary evidence to NASD Regulation showing: (1) that he has paid the full amount due under the Settlement Agreement to pay the Award; (2) Claimant has agreed to a modification of the Settlement Agreement or, (3) he has filed a bankruptcy petition in a United States Bankruptcy Court or that the debt has been discharged by a United States Bankruptcy Court.

SO ORDERED.

____
Alan W. Heifetz
Hearing Officer