

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

DEPARTMENT OF ENFORCEMENT,	:	
	:	
	:	
Complainant,	:	
	:	Disciplinary Proceeding
v.	:	No. C05000002
	:	
RICHARD A. FRONDORF	:	Hearing Panel Decision
(CRD #2054157)	:	
Abita Springs, LA	:	Hearing Officer - EBC
	:	
	:	September 5, 2000
and	:	
	:	
Slidell, LA,	:	
	:	
	:	
Respondent.	:	

Digest

The Department of Enforcement’s Complaint alleges that the Respondent, Richard A. Frondorf (“Frondorf” or the “Respondent”), in an attempt to qualify for a prize offered by his employer firm, caused checks to be issued and sent to three customers and thereby created margin loan balances in their accounts, without the customers’ knowledge and consent. The Complaint further alleges that Frondorf induced these customers to provide false written statements concerning his activity, which he, in turn, provided to his employer. Based on the foregoing, Respondent is charged with violating NASD Conduct Rule 2110. In his Answer, Frondorf admitted that he violated Rule 2110, as alleged in the Complaint, but requested a hearing on the issue of sanctions. The Hearing Panel suspended

Respondent from associating with any NASD member in all capacities for two months, fined him \$7,500, and ordered him to pay hearing costs in the amount of \$1,543.

Appearances

Mark P. Dauer, Esq., Senior Regional Attorney, New Orleans, Louisiana and Rory C. Flynn, Esq., Chief Litigation Counsel, Washington, DC (Of Counsel), for the Department of Enforcement.

George C. Freeman, III, Esq., New Orleans, Louisiana, for Respondent Richard A. Frondorf.

DECISION

I. Introduction

On February 14, 2000, the Department of Enforcement (Enforcement) filed a one-cause Complaint against Frondorf, a registered general securities principal and representative. The Complaint alleges that Frondorf, in an attempt to qualify for a prize being offered by his employer firm, Edward D. Jones & Company, L.P., (“Edward Jones” or the “Firm”), caused three checks totaling \$6,500 to be issued and sent to three customers¹ and thereby created margin loan balances in their accounts, without the customers’ knowledge or consent. The Complaint further alleges that Frondorf induced these customers to provide false written statements concerning his activity, which he, in turn, provided to Edward Jones. Based on the foregoing, Respondent is charged with violating NASD Conduct Rule 2110. Frondorf, through his counsel, filed an Answer on March 13, 2000, in which he admitted that he engaged in the misconduct alleged in the Complaint, but requested a hearing on the issue of sanctions.

On June 29, 2000, the Hearing Panel, composed of two current members of the District Committee for District 5 and the Hearing Officer, conducted a hearing for the purpose of receiving

¹ The record establishes that Frondorf caused unauthorized withdrawals totaling \$8,000. (See *infra*, p. 4.)

evidence and hearing argument on the issue of sanctions.² Enforcement offered three exhibits, all of which were admitted in evidence without objection,³ and otherwise relied on the Parties' pre-hearing stipulations.⁴ Respondent, in addition to testifying on his own behalf, offered the testimony of five witnesses: the three customers who received the unauthorized checks (LD, BN, and GH); Matthew Cotton, a registered representative at Edward Jones (Tr. 95); James E. Walther, III, a financial advisor and branch office manager at Legg Mason Wood Walker, Inc. ("Legg Mason") (Tr. 100), where Frondorf is currently is employed (Tr. 27-28); and Barbara L. Weaver, the southeastern regional compliance officer for Legg Mason. (Tr. 114-15.)

II. Facts and Legal Conclusion

There is no dispute as to any of the core facts giving rise to this disciplinary proceeding.

A. Frondorf's Background in the Securities Industry

Frondorf first entered the securities industry in or about May 1990 when he became associated with F.N. Wolf & Company. After leaving F.N. Wolf & Company, Frondorf joined Edward Jones, where he was employed as an investment representative from March 1993 to April 22, 1999. (Tr. 29-30.) Since May 4, 1999, Frondorf has been employed as a financial advisor at Legg Mason (Tr. 27-28) and currently holds Series 7 and Series 24 licenses. (Tr. 28.) Frondorf has no prior disciplinary record. (Tr. 29-31, 99, 123.)

² References to the transcript of the hearing are cited as "Tr. ____."

³ Tr. 27.

⁴ References to the Parties' Stipulations, which were filed on June 27, 2000, are cited as "Stip., p. ____."

B. Frondorf's Misconduct

In March 1999, Edward Jones conducted a sales contest, known as a "Diversification Contest." In order to qualify for the "prize," which was a trip, the broker was required to satisfy specific production quotas in several areas, one of which involved customers with margin balances. (Stip., p. 1; Tr. 31.) Frondorf fell short of meeting the quota in this area by three customers. He determined to satisfy the quota by directing and causing checks to be issued and sent to three of his customers, LD, BN, GH, who had margin agreements on file with the Firm. (Tr. 31-32.) More specifically, Frondorf caused a check in the amount of \$3,000 to be issued and sent to LD, and caused two checks, each in the amount of \$2,500, to be issued and sent to BN and GH. As a result, each of the customers had a debit balance, equal to amount of the check received, in his or her Edward Jones account. (Stip., pp. 1-2; see also Tr. 70-71, 81, 88; CX 1-3). Frondorf was motivated to engage in this conduct not so much by the prospect of qualifying for the trip but in order to satisfy the Firm's expectations of him and to retain his reputation and status at the Firm. (Tr. 61-62.)⁵

Frondorf never expected the customers to negotiate the checks; rather, he had intended to inform them, before they received the funds, that the checks were mistakenly issued and that they should simply return them. He failed to do so, however, because he was out of town. (Tr. 42-43.) When LD

⁵ In this regard, Frondorf testified:

A. The Edward Jones region that I was in was a very competitive region and I was – I was highly thought of and one of the things – other than the production of income is you [are] just expected to win the trips. And so . . . that's why I sent down the checks . . . because I . . . felt I needed to keep pace.

Q. So it wasn't a trip, it was the status of winning the trip [?]

A. Yes. It wasn't so much going on another trip.

(Tr. 61-62.)

and GH received their checks, they questioned Frondorf's secretary,⁶ who told them that an error had been made and that they should return the checks to the Firm. (Stip., p. 2; Tr. 32-33, 71, 89.) BN apparently concluded on her own that the check was issued in error. (Tr. 81.) In any event, each of the customers returned the checks to Frondorf's office, and their accounts were promptly credited and the loans canceled. None of the three customers suffered any financial harm (Stip., p. 2) and apparently were not at risk. (Tr. 97.)

Edward Jones learned about the unauthorized funds withdrawals from Frondorf's former sales assistant. (Stip., p. 2.) According to Frondorf, after he informed his sales assistant, who had voluntarily left Edward Jones, that he could not re-hire her because he had already hired a replacement, she became upset and then reported the matter to the Firm. (Tr. 33.) Thereafter, the Firm "invited" Frondorf to its home office in St. Louis to explain the withdrawals. (Tr. 33-34, 62.) Before going to Edward Jones' home office, Frondorf met with all three customers to inform them that he had been directed to report to the Firm's home office to explain the circumstances surrounding the withdrawals from their accounts, and each either offered or agreed to write letters on his behalf. (Stip., p. 2; Tr. 34, 71-74, 76-77, 82-83, 89-90.) At least two of the customers, LD and BN, understood, based on their contemporaneous conversations with Frondorf, that the unauthorized withdrawals were not the result of a clerical error but that Frondorf caused the checks to be issued in order to qualify for a prize in a sales contest that was sponsored by Edward Jones. (Tr. 71-72, 81-82.)⁷

⁶ Frondorf was out of the office when the customers called to inquire about the checks. (Tr. 42.)

⁷ GH testified that he did not learn about the sales contest until some time thereafter, but that he was aware at the time he wrote his letter that Frondorf had caused the check to be issued and that he "probably" would have written the letter even if he had known about Frondorf's motive for issuing the check. (Tr. 93-94.)

Each of the letters suggested that the checks were issued as a result of a misunderstanding between the customer and Frondorf, and each “incorrectly implied or stated” that Frondorf had received the customer’s approval before the checks were issued. (Stip., p. 2; Tr. 54.) For example, LD states in his April 21, 1999 letter:

It has been brought to my attention by Rick Frondorf that a transaction in my account is currently under review. In our conversation of today, Rick reminded me of a previous telephone conversation between us that took place in early March of this year. I recall inquiring about the possibility of borrowing \$3,000 against my margin to do some fixing up expenses on a building I was in the process of acquiring.

Apparently, Rick interpreted this inquiry as a request for the funds. In fact, I had decided to use other personal funds to do the fixing up needed on the building.

(CX 1.) Similarly, BN states in her April 20, 1999 letter:

Regarding the check for \$2500 which I recently received, I have been checking my telephone notes and found a conversation I had with Rick Frondorf on March 10. I had asked him about the Jones Visa card and he explained the margin account also.

During the course of our conversation Rick thought I wanted the \$2500 loan. This was a simple misunderstanding.

(CX 2.) And, GH states in his April 21, 1999 letter:

Rick informed me about my account being under review concerning the \$2,500 margin check. It concerns me because the whole thing seems to be my error. We had spoken about it in March and I had told him that I wanted the \$2,500 from margin, because I was expecting a large bill for my boat insurance. I later decided against the insurance and completely forgot that I had requested the check.

(CX 3.) In their letters, the customers also expressed their satisfaction with Frondorf as an investment broker and their intention to continue to do business with him. (CX 1-3.) In fact, each of the customers has done so: BN and GH transferred their Edward Jones accounts to Frondorf at Legg Mason (Tr. 83, 87), and LD, a certified public accountant (Tr. 67), opened a new account with Frondorf at Legg Mason and has continued his practice of referring other customers to Frondorf. (Tr. 69-70.)

Although Frondorf did not dictate the letters to the customers or present pre-prepared letters to them for their signature, he admitted that he influenced the substance of their letters by reminding the customers of their prior conversations during which they expressed an interest in borrowing funds against their margin accounts. (Tr. 44-46, 55-61.) As for his motivation in soliciting the customers' assistance in concealing the unauthorized withdrawals from Edward Jones, Frondorf testified:

I got nervous. I was scared to death. I thought I was going up there to be fired. So what I thought I needed to do was get in touch with the customers and go to the home office with something that I felt was going to save my position.

(Tr. 34; see also Stip., p. 2.)

In April 1999, Frondorf – armed with the customers' letters – met with Edward Jones management in St. Louis. Apparently, the Firm was not satisfied with Frondorf's explanation of the circumstances surrounding the funds withdrawals and terminated him. (Stip., p. 2.) Immediately after he learned that he had been terminated, Frondorf – in an attempt to persuade Edward Jones to reverse its termination decision – disclosed the full extent of his misconduct to the Firm. (Tr. 35, 63-64.) In this regard, Frondorf testified: “. . . I thought they would have mercy on me and see that I – that I made a mistake, I'm a good guy and, you know, give me a second chance. . . . I was hoping for a second chance.” (Tr. 63.)

When Frondorf interviewed with Mr. Walther and Ms. Weaver for his current position at Legg Mason, he was candid and forthright and fully disclosed all of the events that led to his termination from Edward Jones, including his solicitation of the customer letters. He also was forthright and fully cooperated with NASD Regulation, Inc. staff in its investigation of this matter. (Stip., pp. 2-3; Tr. 36-37, 103, 106-07, 117-119.)

Frondorf admitted, and there is no doubt that as a legal matter, his conduct violated the “high standards of commercial honor and just and equitable principles of trade” that NASD Conduct Rule 2110 seeks to promote. (Answer ¶ 3.) Indeed, as Frondorf acknowledged throughout this proceeding, he made two mistakes or errors in judgment: the first was causing an unauthorized withdrawal of funds from his customers accounts; the second was his attempt to conceal his misconduct from his employer firm. 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). In this case, either of Respondent’s “errors” constitutes a violation of the Rule. Cf. In re Robert Lester Gardner, Exchange Act Rel. No. 35899 (June 27, 1995), aff’d, 89 F.3d 845 (9th Cir. 1996) (table) (unauthorized trading in a customer’s account is a violation of the requirement to observe just and equitable principles of trade); Timothy L. Burkes, 51 S.E.C. 356 (1993), aff’d, 29 F.3d 630 (9th Cir. 1994) (table) (where an associated person caused unearned commissions to be improperly credited to his commission account in order to satisfy his employer firm’s production requirements).

III. Sanctions

There is no NASD Sanction Guideline that specifically addresses a broker’s “unauthorized withdrawal” of customer funds. In such circumstances, the Sanction Guidelines encourage adjudicators “to look to the guidelines for analogous violations.”⁸ The Parties have suggested that the Hearing Panel should look for guidance to the Sanction Guideline for “Unauthorized Transactions” in imposing

⁸ NASD Sanction Guidelines 2 (1998 ed.).

sanctions. The Hearing Panel agrees that this Guideline provides a reasonable starting point for its assessment of appropriate and fitting sanctions in this case.⁹

Based on this Guideline and the decision in District Business Conduct Committee No. 10 v. Hellen, Complaint No. C3A970031, 1999 NASD Discip. LEXIS 22 (NAC June 15, 1999), Enforcement requests that Frondorf be suspended from associating with any member firm in all capacities for four months and fined \$7,500.¹⁰ Enforcement suggests that, despite the fact that there was no customer loss, a suspension is appropriate because Frondorf was motivated by self-interest when he effected the unauthorized withdrawals and because he initially took steps to conceal his misconduct from Edward Jones. Respondent argues that no suspension and only a minimal fine should be imposed pointing to the fact that: (1) there was no customer loss; (2) he subsequently admitted the full scope of his misconduct to Edward Jones, Legg Mason, and the NASD; (3) his conduct was aberrational and he is determined to follow all applicable rules in the future; and (4) he has accepted responsibility for and is remorseful about his misconduct.

The Hearing Panel, upon consideration of all of the evidence and the Parties' arguments, has determined that it is appropriate to suspend Frondorf, albeit for less time than that which Enforcement requested, and to impose the fine requested by Enforcement. The Sanction Guideline for "Unauthorized Transactions" recommends that an individual be fined \$5,000 to \$75,000 and suggests that, in cases involving customer losses, adjudicators should consider a suspension of 10 to 30 business days and

⁹ The Guideline, however, provides less than a perfect analogy. It focuses primarily on actual or potential harm to customers whereas, in this case, Respondent's conduct – both his initial wrong in causing the unauthorized withdrawals and his subsequent solicitation of the customers' letters – was focused towards misleading the Firm.

¹⁰ Enforcement also suggest that Frondorf be ordered to pay the costs of the hearing. (See Department of Enforcement's "Hearing Brief," p. 5.)

that, in egregious cases, a longer suspension of up to two years or a bar should be considered.¹¹ There is no doubt that Frondorf's misconduct did not give rise to any customer loss and that the absence of customer harm is an important factor to consider in imposing sanctions – under the Guideline for “Unauthorized Transactions” and under the principal considerations that adjudicators should consider whenever imposing sanctions.¹² However, the Hearing Panel does not believe that the absence of customer loss should be dispositive, and Respondent's wooden and overly formalistic application of the Guideline ignores certain core facts.

The Panel, in imposing sanctions, cannot ignore Frondorf's attempts – which involved the aid of his customers – to conceal from his employer firm the fact that he caused the withdrawal of funds and corresponding debit balances, without the customers' consent or authorization. Indeed, the principal considerations in the Sanction Guidelines expressly direct adjudicators to consider whether an individual respondent “attempted to conceal his or her misconduct” from “the member firm with which he or she is/was associated.”¹³ Nor can the Panel ignore the fact that Frondorf was motivated to engage in misconduct for personal gain – even if solely for his own reputational benefit.¹⁴

An analysis of Frondorf's misconduct under the National Adjudicatory Council's decision in District Business Conduct Committee for District No. 10 v. Hellen,¹⁵ suggests that his misconduct

¹¹ NASD Sanction Guidelines 86 (1998 ed.).

¹² Id. at 9.

¹³ Id.

¹⁴ The NASD Sanction Guidelines suggest that adjudicators consider “[w]hether the respondent's misconduct resulted in the potential for respondent's monetary or other gain.” Id.

¹⁵ District Business Conduct Committee for District No. 10 v. Hellen, Complaint No. C3A970031, 1999 NASD Discip. LEXIS 22 (NAC June 15, 1999).

neither exemplifies good faith nor is it “qualitatively egregious.”¹⁶ Typically, unauthorized trading is deemed to be “qualitatively egregious” where the respondent was motivated to make money at the customer’s expense, or executed unauthorized trades after using high-pressure sales tactics designed to intimidate and induce the customers to authorize the trades.¹⁷ 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”;¹⁸ and (2) “the evidence relating to the respondent’s motives.”¹⁹

As to the first factor, Frondorf has admitted that he caused unauthorized withdrawals from three customers’ accounts. As to the second factor, the NAC stated:

As concerns respondents’ motives in cases involving small numbers of unauthorized trades, in many such cases there is credible evidence indicating that a registered representative acted with a good faith belief that a trade, albeit unauthorized, would benefit his or her customer or that an unclear, ambiguous or misunderstood communication from a customer led a registered representative to believe, honestly but mistakenly, that he or she was authorized to trade. (Footnote omitted.) In such cases, or others involving similar evidence that a registered representative acted in good faith, imposition of a lengthy suspension or bar is not appropriate. Such trading, while unauthorized and thus a violation of Conduct Rule 2110, is not qualitatively egregious.

Hellen, 1999 NASD Discip. LEXIS 22, at *20-21. In this case, the Respondent did not act in good faith: he was not operating under a mistaken impression that he was authorized to issue the checks and

¹⁶ In Hellen the National Adjudicatory Council (NAC), based on its analysis of prior decisions, defined three categories of egregious unauthorized trading: (1) “quantitatively egregious” unauthorized trading, which is characterized by a large number of unauthorized transactions; (2) unauthorized trading that is accompanied by certain aggravating misconduct, including cases where a respondent attempts to evade NASD investigative efforts, or has a history of engaging in unauthorized trading; and (3) “qualitatively egregious” unauthorized trading. 1999 NASD Discip. LEXIS 22, at *16-18. Frondorf’s misconduct does not fall within either of the first two types of egregious unauthorized trading: his activity involved only three unauthorized withdrawals and the types of aggravating factors that the NAC discussed in the context of the second category of unauthorized trading are not present here.

¹⁷ Id. at *17-18.

¹⁸ Id. at *18.

create debit balances in his customers' accounts; nor did he believe that the unauthorized withdrawals would somehow benefit his customers. On the other hand, his actions did not inure to the detriment of his customers; in fact, Frondorf never intended that the customers would negotiate the checks (and thereby incur margin interest) and, after they returned the checks, their accounts were promptly credited and the loans canceled.

In imposing sanctions and in declining to impose the four-month suspension requested by Enforcement (or an even lengthier suspension), the Hearing Panel has considered the fact that both Mr. Walther, who is Frondorf's current branch office manager at Legg Mason, and Ms. Weaver, the southeastern regional compliance officer for Legg Mason, decided to hire Frondorf even after he fully explained the events surrounding his termination from Edward Jones. They both concluded that Frondorf had "learned his lesson" and would not engage in future misconduct. (See generally Tr. 102-05, 116-23.) In this regard, Ms. Weaver testified:

Q. Knowing what you knew, you still went ahead and authorized Mr. Walther to hire him?

A. Yes.

Q. Why did you do that?

A. * * *

It's based on obviously a one-on-one interview with somebody, a feeling for whether they have learned from what they have done, a feeling for whether I think primarily they understand the severity of what they have done.

And, I don't think there was any question that Rick understood that not only from the perspective of it having cost him his career at that particular firm but realizing

¹⁹ Id.

now that he had violated industry regulations which are there for a purpose and that is for the protection of customers.

And so my determination in speaking with Rick directly, in talking with . . . Jim Walther who had also interviewed him at length was that while these had been very bad judgments on Rick's part that the lesson learned and the cost at that point already from having been terminated from a firm that he intended to work for, as he told me, for the rest of his life, had taught him a lesson that frankly would go on, stay with him forever.

(Tr. 120-21.) Similarly, Matthew Cotton, an investment representative at Edward Jones who has known Frondorf for the past seven or eight years, testified that, if it were within his authority, he too would hire Frondorf notwithstanding his misconduct. (Tr. 98-99.) Mr. Cotton further testified that, with the exception of the conduct involved in this proceeding, Frondorf was an exemplary broker who had received many awards each year and "was highly participatory in [the] region as far as helping younger brokers . . . and making sure that they were trained properly" (Tr. 99.)

In imposing sanctions, the Hearing Panel also has considered the fact Frondorf's misconduct was aberrational and isolated in nature, and that he provided substantial assistance to the NASD in the course of its investigation. Moreover, the Hearing Panel notes that none of the three customers involved feels that Frondorf betrayed his or her trust or undermined his or her confidence in Frondorf or in the integrity of the securities industry. To the contrary, each continues to do business with him and one has continued to refer other clients to him. Under all of the circumstances, the Panel believes that the NASD's remedial goals will be served by suspending Frondorf in all capacities for a period of two months and ordering him to pay a fine of \$7,500, as Enforcement suggested.

IV. Conclusion and Order

Therefore, having considered all the evidence, Frondorf is suspended from associating with any member firm in all capacities for two months and ordered to pay a fine of \$7,500. Frondorf also is ordered to pay costs in the amount of \$1,543, which include an administrative fee of \$750 and hearing transcript costs of \$793. 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 suspension shall become effective with the opening of business on Monday, November 6, 2000 and end at the close of business on Thursday, January 4, 2001.²⁰

Hearing Panel.

By: _____
Ellen B. Cohn
Hearing Officer

Copies to:

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²⁰ 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.