NASD REGULATION, INC.
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,	:	
Complainant,	:	Disciplinary Proceeding No. C02990052
v.	:	
	:	**Hearing Panel Decision**
SHAILESH B. PATEL (CRD #2610523) Huntington Beach, CA,	:	Hearing Officer - Ellen B. Cohn
	:	June 27, 2000
Respondent.	:	

Digest

Shailesh B. Patel ("Patel" or "Respondent"), a registered general securities representative and principal, was charged with misusing customer funds in the amount of $40,000 in violation of NASD Conduct Rules 2330(a) and 2110.[1] Patel filed an Answer denying the substantive allegations in the Complaint and requested a hearing. The Hearing Panel found that Patel committed the violations alleged and, by way of sanctions, barred him from associating with any NASD member firm in all capacities.

[1] The Complaint refers to Conduct Rule 2330(e), which apparently was a typographical error. At the commencement of the hearing, Enforcement requested that the Complaint be deemed amended to refer to Rule 2330(a) in place of Rule 2330(e). There being no objection to Enforcement's request and no confusion as to the nature and substance of the violations charged, the Hearing Officer granted Enforcement's request and deemed the Complaint amended nunc pro tunc.

Appearances

Sylvia M. Scott, Esq., Regional Counsel, Los Angeles, California, Rory C. Flynn, Chief Litigation Counsel, Washington, DC, Of Counsel, for the Department of Enforcement.

Matthew R. Rutherford, Esq., Law Offices of Matthew R. Rutherford, San Diego, California, for Respondent Shailesh B. Patel.

DECISION

I. Introduction

On September 10, 1999, the Department of Enforcement (Enforcement) filed a one-cause Complaint alleging that Patel, while associated with Corporate Securities Group, Inc. ("CSG" or the "Firm"), violated NASD Conduct Rules 2110 and 2330(a) by misusing $40,000 that he received from customers DB and JJB (husband and wife). According to the Complaint, on or about March 18, 1997, DB and JJB wire transferred $40,000 to Patel in order to purchase certain bonds, but Patel failed to purchase the bonds or make any other investment on their behalf. Respondent filed an Answer in which he denied that the customers' funds were intended for the purchase of bonds or any other investment purpose and claimed that DB and JJB had agreed to lend him $40,000 to purchase office equipment.

A hearing in this proceeding was held on March 14 and 16, 2000, before a Hearing Panel composed of an NASD Hearing Officer, and a current and former member of the District Committee for District 2.[2] Enforcement called four witnesses, namely DB and JJB,[3] the Respondent, and John

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

[3] DB and JJB testified by telephone over Respondent's objection. As a general matter, telephone testimony is permissible in NASD disciplinary proceedings and satisfies the fairness requirements of Section 15A(b)(8) of the Securities Exchange Act of 1934 where there is an adequate opportunity to cross-examine the witness. The Hearing Officer granted Enforcement's motion for leave to offer the testimony of JJB and DB by telephone, given

Busacca, who currently is Director of Compliance at Joseph Charles & Associates, Inc. and was, during all times relevant, a Compliance Examiner or the Supervisor of Compliance Examiners at CSG. (Tr. 212-13.) Enforcement also offered 22 exhibits, all of which were admitted in evidence.[4] Patel offered four exhibits, all of which also were admitted in evidence.[5] In addition, prior to the hearing, the Parties stipulated to many of the core underlying facts.[6]

II. Findings of Fact

A. Respondent's Background

Patel first registered with the NASD as a general securities representative in or about June 1995, while he was associated with Chatfield Dean & Co. Thereafter, from December 1995 through March 1996, he was associated with two other NASD member firms. From in or about August 1996 to June 1997, and during all times relevant, Patel was registered as a general securities representative through CSG and, in or about March 1997, became registered as a general securities principal through CSG. (Stip. ¶ 1.) The Firm terminated Patel for cause as a result of his dealings with DB and JJB. (Stip. ¶ 2.) Patel currently is associated with another NASD member firm. (Stip. ¶ 1.)

(footnote cont'd)

that neither is subject to the Association's jurisdiction and that, due to financial, professional, and personal reasons, they were unable to travel from New York City, where they reside, to appear at the hearing in Los Angeles. See Order Granting Enforcement's Motion for Leave to Offer Telephone Testimony, dated January 18, 2000.

[4] References to Enforcement's exhibits are cited as "CX ___." Two of Enforcement's exhibits (i.e., CX 13 and 21) were admitted over Respondent's objection (see Transcript of Final Pre-Hearing Conference, pp. 6-17; Tr. 345-49), and, at hearing, Enforcement decided to withdraw one of its proposed exhibits (i.e., CX 12). (Tr. 345.)

[5] References to Respondent's exhibits are cited as "RX ___." Prior to the hearing, the Hearing Officer overruled Enforcement's objection to two of Respondent's proposed exhibits, which had been pre-marked RX D and RX E and were admitted in evidence as RX C and RX D, respectively. (See Transcript of Final Pre-Hearing Conference, pp. 29-40.)

[6] References to the Parties' Joint Stipulations, which were filed on January 10, 2000, are cited as "Stip. ¶ ___."

B. Misuse of Customer Funds

1. Background: Respondent's Initial Contacts with DB and JJB

In or about January or February 1997, DB and JJB were introduced to Patel by one of DB's co-workers who had invested in securities through Patel. (Stip. ¶ 3; Tr. 28-29, 127, 162.) The introduction was made primarily so that Patel could establish a broker-customer relationship with DB and JJB. Neither DB nor JJB has ever met Patel or had a social relationship with him. (Stip. ¶ 3; see also Tr. 28-29, 127-29.)

During subsequent conversations with Patel, DB and JJB informed him that they had $40,000 to invest (Stip. ¶ 3; Tr. 294) and, as for investment goals, explained that they were interested in supplementing their income in order to pay off a car loan and enable DB to stop working so she could stay home to raise her daughter. (Tr. 30-33, 129.) According to DB, Patel estimated that she and her husband would need approximately $1,600 per month in supplemental income in order to accomplish this goal (Tr. 31, 101, 122-23), and Patel initially recommended investments in stocks and discussed general investment strategies with her. (Tr. 31.)[7]

On or about March 13, 1997, Patel completed and signed a CSG new account form for DB and JJB in anticipation of their opening an account at CSG (Stip. ¶ 4; Tr. 280-86; CX 1) and, on or about March 18, 1997, he completed and signed an "Options Information Form and Agreement," which DB and JJB signed the following day. (Stip. ¶ 6; CX 3.) CSG sent the new account form and options agreement to DB and JJB with letters addressed "Dear Valued Client" and "Dear Customer," thanking them for "entrusting [CSG] to take care of [their] investment needs" (Tr. 46, 283; see CX 1)

[7] During the initial stages of the customer-broker relationship, DB, as opposed to her husband, dealt primarily with Patel. (Tr. 29-30.)

and for their business and confidence in CSG. (CX 3.) Prior to opening their account at CSG, DB and JJB had never invested in securities, with the exception of investments DB made through her employer's 401(k) plan, and had never utilized the services of a securities broker. (Tr. 27-28, 43, 49-50, 127, 133, 164.)[8] Further, according to DB, Patel was aware that neither she nor her husband had any prior investment experience. (Tr. 51.)

2. The Transfer and Use of the Customers' Funds and Subsequent Events

There is no dispute that, on March 18, 1997, DB and JJB wired $40,000 to Patel's personal bank account at Bank of America (Stip. ¶ 5; CX 2) and that, within three weeks, Patel used these funds for his own benefit, i.e., to pay overdue rent on his office space and overdue phone bills, to purchase computer equipment and office furniture, and to entertain brokers whom he was attempting to recruit in connection with establishing his own financial services business. (Tr. 274-80.) There also is no dispute that, as of September 1997, Patel had returned only $4,500 to DB and JJB and did not return the entire balance of their funds until approximately 1½ years later – after DB and JJB filed an arbitration claim against him and CSG. (Stip. ¶16.) There are many other undisputed core facts relating to the events that transpired after DB and JJB transferred the funds to Patel. However, as to the intended use of the

---

[8] Patel acknowledged that he erroneously indicated on the new account form that DB and JJB had a pre-existing account at Fidelity, which would be transferred to CSG (Tr. 286-87), and that the new account form and options agreement contained discrepancies regarding the customers' liquid net worth and investment objectives. (Tr. 286-89.) DB and JJB also claimed that both the new account form and the options agreement overstated their net worth and noted that the options agreement incorrectly represented that they had prior investment experience in trading stocks, bonds, and options. (Tr. 42-43, 47-48, 49-52, 133, 136-37.) According to DB and JJB, when they discussed the discrepancies and some of the errors in the forms with Patel, he indicated they "were just standard forms" and it was not a "big deal" if they contained errors. (Tr. 42-44, 134, 138.) The Complaint does not allege any violations stemming from the misstatements on the forms and, accordingly, the Hearing Panel has not made any findings or conclusions in this regard.

funds and circumstances attendant to the transfer, the customers' and Respondent's testimony varied dramatically.

According to DB and JJB, shortly before they wired the funds, Patel changed his investment recommendation and advised them to invest in bonds instead of stocks, citing as a reason the volatility of the stock market, and suggested that DB and JJB make a short-term investment in California bonds, which according to Patel were yielding good returns. (Tr. 33-34, 36, 129-30.) DB and JJB further testified that, based on Patel's recommendation, they decided to invest the full amount of funds available from a home equity line of credit, i.e., $40,000, in California bonds. (Tr. 36, 130.) From the outset, DB and JJB understood that their investment funds would be returned in full after three months (Tr. 34, 131) and, sometime thereafter, understood that their investment would yield monthly interest payments of approximately $2,200 to $2,300. (Tr. 131.) DB and JJB also understood, based on the fact that they were dealing with Patel in his capacity as a registered representative of CSG, that the bonds would be purchased through CSG, and JJB believed, based on conversations with Patel, that the funds had been wired to a corporate account Patel maintained with CSG. (Tr. 37-38, 132.)[9]

Patel acknowledged that he established a CSG account for DB and JJB so that they could invest in securities (Tr. 294) and that he discussed investments in the stock market with them. (Tr. 307.) However, according to Patel, almost immediately after the customers' CSG account was established, DB and JJB agreed to lend him $40,000, which he knew they had obtained from a home equity line of credit. (Tr. 295-97.) At that time, Patel was in arrears on rental payments for his office, had other outstanding, overdue bills, and needed money to establish his business. (Tr. 295.) Patel

[9] JJB, as opposed to DB, discussed the mechanics of the transfer with Patel and signed the wire transfer instructions. (Tr. 38, 131-32.)

further testified that he directed DB and JJB to wire funds to an account, which he identified as a personal account, and explained that he, not CSG, would be responsible for making interest payments to them. (Tr. 295-96.) In this connection, Patel introduced evidence to demonstrate that, in April 1997, he attempted to obtain his own home equity loan purportedly to finance the interest payments due DB and JJB and to repay the loan he had obtained from them. (Tr. 255-56, 312; RX D.)

(a) Events Subsequent to the Transfer

The events that occurred after DB and JJB wired the funds to Patel are, as noted above, for the most part undisputed. On or about May 9, 1997, DB and JJB received from Patel a check, dated May 12, 1997, in the amount of $2,250 (the "May 12 Check"). (Stip. ¶ 7; Tr. 59-61; see CX 4.) Patel included in the lower left-hand corner of the check the notation "INT. DIV. April 1997" (Tr. 60, 274-75; CX 4), and DB and JJB testified that they understood the check represented a dividend payment on the bonds. (Tr. 60, 146.) Shortly thereafter, in response to JJB's request,[10] Patel sent DB and JJB a "Confirmation Statement" on "SP Capital and Asset Management" letterhead, purporting to show that DB and JJB held an investment with a current market value of $39,800 in a product identified as "Income & Bond," which DB and JJB understood referred to the investment in California bonds that they made through Patel. (Tr. 52-56, 142-45, 297-98; CX 21.) Patel claimed the "Confirmation Statement" was a "sample" he provided DB and JJB to show them what a confirmation statement would look like after he established his own business, but that he failed to print the word "sample" on the document. (Tr. 298-99.)

---

[10] According to DB and JJB, they received the "Confirmation Statement" in response to their request for a written statement showing their investment in California bonds. (Tr. 54-55, 142-43.)

On or about May 16, 1997, the bank returned the May 12 Check for insufficient funds. (Stip. ¶ 7; Tr. 41-42, 147-48; CX 5.) Immediately thereafter, JJB contacted Patel; according to JJB, Patel claimed that the bank had made a mistake and that there were sufficient but uncleared funds available to cover the May 12 Check. (Tr. 148-49.) In any event, at JJB's request, Patel agreed to wire transfer replacement funds to DB and JJB no later than May 22 or May 23. (Tr. 150; CX 6.) When Patel failed to do so, JJB orally complained to CSG, specifically to John Busacca, about his dealings with Patel and the fact that the dividend check he received from Patel had "bounced." (Stip. ¶ 8; Tr. 150-52, 215-17; CX 15.) After Busacca determined that the Firm had no record of any activity in the customers' CSG brokerage account and no record of having received any funds from DB and JJB, the Firm commenced an investigation. (Stip. ¶ 8.) As part of the Firm's investigation, Busacca spoke with Patel and, at CSG's request, on May 27, 1997 Patel provided the Firm with a written statement in response to DB's and JJB's complaint (the "May 27 Memorandum"). (Stip. ¶ 9.)

On or about May 28, 1997, Patel and the customers entered into a letter agreement in an attempt to resolve the customers' complaint and to agree on a payment schedule (the "May 28 Letter Agreement"). (Stip. ¶ 10; Tr. 66-67.) Pursuant to the May 28 Letter Agreement, Patel was required to return DB's and JJB's "initial capital" of $40,000 on June 10, 1997 and, by that date, also was required to pay them a total of $5,625 (in periodic payments), representing the interest earned on their "investment." (CX 7.)[11] Patel originally proposed to return the funds to DB and JJB on July 7, 1997 and to pay them a total of $6,750 as interest (CX 7); however, because DB and her husband were no longer comfortable with Patel, they decided to forgo interest of $1,125 in favor of a more expeditious

[11] Patel maintained that there was a prior version of this document. See infra, pp. 12-13.

return of their funds and a prompt termination of their relationship with Patel. (Tr. 67-68.) In or about late May 1997, Patel sent DB and JJB $2,250 to cover the May 12 Check and, on or about June 4, 1997, he wired an additional $2,250 to them. (Stip. ¶¶ 11-12; CX 9.) After DB and JJB received these funds from Patel, JJB prepared and signed a handwritten note addressed to CSG retracting his complaint against Patel (CX 10)[12] and, on or about June 5, 1997, Patel sent CSG's Compliance Officer a copy of JJB's note along with a copy of the May 28 Letter Agreement. (Stip. ¶ 15; CX 11.)

When Patel failed to make the other payments required by the letter agreement, on or about September 10, 1997, DB and JJB filed an arbitration claim against Patel and CSG with the NASD. (Stip. ¶ 16; CX 17.) Approximately eight months later Patel paid the customers' attorney $9,500 (i.e., $5,000 in March and $4,500 in May). (Stip. ¶ 17; RX A.) Thereafter, on or about September 14, 1998, the customers, Patel, and CSG entered into an agreement to settle the arbitration proceeding, pursuant to which, Patel was required to pay DB and JJB $42,500 (in addition to the previous payments he made to their attorney). (Stip. ¶ 17; CX 16.) Ultimately, DB and JJB received $43,500 and their attorney received $13,000. (Stip. ¶ 18.) To satisfy the terms of the settlement, Patel paid $24,500 and CSG paid $18,000. Pursuant to a separate agreement between CSG and Patel and a promissory note Patel executed, Patel agreed to pay CSG $18,000 as reimbursement for the amount it contributed to the settlement. (Stip. ¶ 17; Tr. 318; CX 18.) As of the hearing, Patel had paid CSG $10,250. (Tr. 340-41.)

[12] According to DB and JJB, Patel urged them to withdraw their complaint telling them that he would be fined thousands of dollars and possibly fired if they did not do so. DB and JJB further testified that although they were reluctant to withdraw their complaint, they had agreed to do so because they felt sorry for Patel and, by that time, they had received the replacement funds to cover the May 12 Check. (Tr. 69-70, 154-56; 192-93.)

(b) The Hearing Panel's Assessment of the Evidence and Credibility Findings

There is substantial evidence supporting the customers' contention that they gave Patel $40,000 with the intention and expectation he would use their funds to purchase California bonds. By contrast, the Hearing Panel finds that Patel's version of the events is inherently incredible and inconsistent with the documentary and other evidence offered at the hearing, and that he otherwise lacked credibility.

DB and JJB, throughout their testimony and in declarations prepared in connection with the arbitration proceeding (Tr. 196), steadfastly maintained that they had wired their $40,000 to Patel for the sole purpose of making an investment in California bonds and consistently denied making a loan to Patel or having any discussions with him about the possibility of making a personal loan to him. (Tr. 73, 159-60; CX 19, p. 2; CX 20, p. 2.) They also confirmed that Patel never provided them any financial information about himself from which they could assess the risk involved in making a personal loan to him; never sent them any correspondence referencing a loan; and never orally indicated that their $40,000 was a personal loan. (Tr. 73-74, 159-60.)

Indeed, the Hearing Panel finds it implausible that even unsophisticated customers would make a personal, unsecured loan to an individual whom they had never met. The nature of DB's and JJB's dealings with Patel before they wired their funds to him also belies the conclusion that they intended to lend money to him: up until that time, all of DB's and JJB's dealings with Patel were in the context of establishing a customer-broker relationship and establishing an account and investment relationship with

CSG.[13] The Panel also notes that DB and JJB had no motive to prevaricate: they do not stand to gain any financial benefit based on the outcome of this proceeding, and they understood this to be the case. (Tr. 75-76, 161.)[14]

Busacca's testimony and contemporaneous notes of his initial conversation with JJB corroborate the essence of the customers' statements. According to Busacca, JJB repeatedly indicated that he had invested $40,000 in a California revenue bond through Patel (Tr. 215-16, 220, 225; CX 15) and never mentioned that he and his wife had loaned money to Patel. (Tr. 220.) Busacca also confirmed that JJB did not understand that there was anything untoward about wiring funds directly to Patel for the purpose of making an investment through CSG. (Tr. 218-19.)

By contrast, when Busacca orally confronted Patel about his dealings with DB and JJB, although Patel denied that DB and JJB had made an investment in California revenue bonds, he never mentioned to Busacca that the customers had made a loan to him. (Tr. 227-29.) Similarly, Patel never mentioned in the May 27 Memorandum he submitted to CSG that he had borrowed funds from DB and JJB or that they had agreed to lend him funds. (Tr. 307-08; CX 6.) To the contrary, Patel repeatedly characterized the customers' funds as an investment. He stated:

> Around March 3 & 4, 1997 . . . [DB and JJB] decided that they had about $40,000 to invest, however the stock market was very volatile during this period, so [DB and JJB] were very nervous. During this process I suggested that they wait for the volatility to calm down or make an ***investment*** in a project that I was involved in. They agreed to the project I was involved in and hence $40,000 was wired to my account.

---

[13] That DB and JJB may have had unrealistic expectations as to the amount of returns they would receive from a $40,000 investment in bonds, as Respondent argued, does not mean that they agreed to lend him the funds. In addition, they apparently believed that the individual, who initially introduced them to Patel, had realized a 100% return on the investments he had made through Patel. (Tr. 165.)

[14] The Hearing Panel rejects Respondent's attempts to discredit DB and JJB. (See Tr. 383.) That the customers testified about matters not included in their declarations does not undermine their credibility. In addition, contrary to Respondent's contention, that JJB may not have recalled certain facts included in his declaration does not mean that his testimony and declaration were inconsistent.

> The terms of my project were That they ***invest*** $40,000 until July 7, 1997., for which [they] would receive $2250 per month in interest (April, May and June). After which the $40,000 would be returned to them and invested in the stock market or whatever they wanted to invest in. The reason they decided to ***invest*** and get $2200.00 per month was that they could payoff [their] car loan by or around July 31, 1997., and not face the volatility of the stock market.

(CX 6) (emphasis supplied). In fact, Busacca, who "handled most of the . . . followups [sic] and investigation" of JJB's complaint for CSG (Tr. 215), concluded that Patel was "selling away," or "investing away." (Tr. 231-32, 239.)

At the hearing, when Patel was asked why he did not advise CSG that the $40,000 was a loan or that he had borrowed funds from DB and JJB, he testified: "[b]ecause when I was preparing [the] document, I did not know the right words to put in there and I was under a lot of pressure because I was in debt and I had to get that money to take care of my business." (Tr. 308.) Patel's response is troubling in two respects: first, it suggests that he allowed his professional integrity to be comprised as a result of his precarious financial condition; second, the Hearing Panel finds his testimony patently incredible given that, by the time he had prepared the May 27 Memorandum, he had applied to Oceanside Mortgage for a loan, and he admittedly was familiar with the term "loan" and knew what it meant. (Tr. 308, 327.)

Moreover, Patel acknowledged that he never executed a promissory note in connection with the purported loan he received from DB and JJB (Tr. 329); nor did he provide to CSG or introduce at the hearing any documentation that reasonably could be construed as memorializing the purported loan. As to the latter, Patel claimed that, on March 19, 1997, after he received the customers' funds, the loan was memorialized in a letter agreement between the parties, which was essentially identical to the May

28 Letter Agreement. (Tr. 299-302.) According to Patel, however, as a result of either his or his counsel's inadvertent error, the document was not included in Respondent's exhibits (Tr. 264-65) and, in fact, he never produced it at the hearing. Although Patel considered the so-called "prior" version of the May 28 Letter Agreement an important document in support of his defense (Tr. 305), he apparently also never furnished a copy of the document to CSG and never referred to the purported "prior" letter agreement in any of the written statements he gave to CSG. (See Tr. 303-04; CX 6, 8, 11.) To the contrary, the written statements Patel prepared referred only to the May 28 Letter Agreement and the parties' "verbal" agreements. (Id.)

Patel's testimony about the existence of a prior letter agreement not only is incredible, but also, even if believed, is of little consequence. Assuming, as Patel testified, that the prior agreement is identical to the May 28 Letter Agreement (with the exception of the first paragraph) (Tr. 302), it would not corroborate Patel's contention that DB and JJB had agreed to lend him funds. Nowhere in the May 28 Letter Agreement is there any mention of a "loan" or a "borrowing"; instead, the May 28 Letter Agreement refers only to the customers' "initial capital . . . of $40,000" and their "[i]nvestment of $40,000." (CX 7.) Indeed, Patel acknowledged that he never used the term "loan" in any of the documentation he prepared pertaining to his transaction with DB and JJB, and he was unable to explain the reason for this glaring omission.[15]

[15] He testified as follows:

> Q. Do you know the difference between [an] investment and [a] loan?
>
> A. Yes.
>
> Q. When a bank refinances and gives you money, does it make any investment or does it make a loan?

Equally troubling was Respondent's explanation of the "Confirmation Statement." It is preposterous to view the document as a "sample" confirmation of the purported loan Patel received from DB and JJB, as he insinuated. (Tr. 298-99.) If, on the other hand, Patel intended it as a "sample" confirmation of a hypothetical transaction, the Hearing Panel questions why he chose to show, on the confirmation, that DB and JJB had a "hypothetical" investment with a current market value of $39,800 in a product he identified as "Income & Bond."[16]

---

* * *

A. . . . actually, they are loaning you the money.

Q. They are loaning you the money?

A. Yes.

(footnote cont'd)

* * *

Q. Why in all of your written documentation – you are a smart man. You know the English language very well --- did you never once use the work L-O-A-N in any correspondence?

A. I guess I'm not a smart man . . . .

Q. Mr. Patel, why did you not use the word "loan"?

A. I don't know.

Q. Yes, you do. Why did you not use the word "loan"?

A. I don't know.

(Tr. 326-27.)

[16] Busacca testified and the notes of his initial conversation with JJB indicate that JJB, in response to Busacca's questions, denied receiving a confirmation for the purchase of the bonds. (Tr. 226; CX 15.) Respondent argued that this supports his contention that the document was merely a "sample" of a confirmation statement. (Tr. 381-82.) The Hearing Panel cannot agree. Given the totality of the conversation between Busacca and JJB, and the fact that Busacca repeatedly mentioned Bear Stearns Securities Corp. ("Bear Stearns"), which was CSG's clearing firm (see CX 1, CX 3), it may well be that JJB believed that Busacca was referring to a confirmation issued by Bear Stearns. There also may be a host of other explanations for JJB's failure to mention the confirmation to Busacca, but Respondent did not seek to cross-examine JJB on this point.

Patel also repeatedly demonstrated his lack of credibility on other matters salient to his defense. For example, when asked why he failed to include the purported loan from DB and JJB as a liability on the loan application he submitted to Oceanside Mortgage, Patel initially testified that he did not disclose any of his liabilities because he was not asked or required to do so. (Tr. 257.) When confronted with a complete copy of the loan application, which clearly included a list of his liabilities (Tr. 258-59; CX 23),[17] Patel changed his testimony and claimed that he was required to disclose only "recorded" loans that would not be paid off within ten months. (Tr. 260-61.)

Furthermore, Patel was unable to offer any explanation as to why he purportedly chose to borrow $40,000 from DB and JJB – at an annualized interest rate of 67.5 percent – and did not attempt to borrow the funds from either CSG or a financial institution, which undoubtedly would have charged him a substantially lower rate of interest. (Tr. 335.)[18]

---

[17] Patel introduced an incomplete copy of the Oceanside Mortgage loan application, which did not include a schedule of his liabilities. (See RX D.)

[18] Patel testified as follows:

> Q: Mr. Patel, prior to recommending to [DB and JJB] that they loan you the $40,000, did you try to get a loan from Corporate Securities Group?
>
> A. No.
>
> Q. Why not?
>
> A. I never asked them.
>
> Q. Why not?
>
> A. I don't know.
>
> Q. Did you try to get any loan that would give you, as the borrower, more favorable terms than the loan that you purportedly obtained from [DB and JJB]?
>
> A. No.

(Tr. 335.)

The only evidence in the record that corroborates Patel's contention that the funds were intended as a loan and not as an investment is the Form U-5 that CSG filed on his behalf. On the Disclosure Reporting Page (DRP), the Firm stated in its summary of the events giving rise to Patel's discharge that "the broker was borrowing from the customer [i.e., DB and JJB] and paying the customer back 2250.00 each month as interest with the principal due in July 1997." (RX C.)[19]

As an initial matter, the Hearing Panel declines to substitute the Firm's disclosures on the DRP for its own independent findings: in making its factual findings the Panel, unlike CSG, has had the benefit of an adversarial evidentiary hearing, which included the sworn testimony of the Respondent and other witnesses. Further, in light of other evidence in the record, the Panel declines to treat the disclosures on the DRP as corroborative of Patel's version of the events. Busacca testified that he had concluded that Patel was "selling away" (Tr. 231-32, 239); never told CSG's Compliance Officer, who had signed the Form U-5 and DRP, that the customers had loaned money to Patel (Tr. 231); and disagreed with the Firm's characterization of Patel's activities on the DRP it filed with the NASD. (Tr. 242.) Busacca further testified that he had originally completed a Form U-5 that, in his view, more accurately described Patel's misconduct, but that CSG's legal department altered the wording because the Firm was concerned about possible subsequent inquiry regarding the adequacy of its supervision of Patel. (Tr. 240-42, 245-46.)[20]

[19] During all times relevant, the Firm prohibited its registered representatives from borrowing money from clients with the exception of financial institutions. (CX 14, p. 4.)

[20] The Hearing Panel also notes that Respondent did not seek to elicit testimony from CSG's Compliance Officer, who signed the Form U-5 and DRP, to explain the basis for the statements made on the DRP.

III. Discussion and Conclusions of Law

A. Jurisdiction

The NASD has jurisdiction over Patel and this proceeding. Patel was registered with the NASD as a general securities representative and principal at the time of the misconduct alleged in the Complaint and at the time Enforcement filed the Complaint in this proceeding.

B. Misuse of Customer Funds

Conduct Rule 2330(a) prohibits associated persons from making "improper use of a customer's securities or funds." Improper use of funds occurs when an associated person fails to apply a customer's funds as directed or uses the funds for a purpose other than that directed by the customer. See, e.g., Alderman v. SEC, 104 F.3d 285, 289 (9th Cir. 1997) (affirming violation of Rule 2110 for misuse of customer funds where respondent mistakenly transferred customer funds to firm account but then deliberately withheld repayment to the customers for two months); In re Bernard D. Gorniak, Exchange Act Release No. 35996, 59 S.E.C. Docket 2073, 1995 SEC LEXIS 1820 (July 20, 1995) (finding misuse when associated person retained for an indeterminate period customer funds given to him for the purchase of mutual fund shares); In re Robert L. Johnson, 51 S.E.C. 828, 831 (1993) (finding misuse when registered principal of broker-dealer failed promptly to register unit trust in customer's name and failed to return funds to customer for almost two years); In re John C. Gebura, 46 S.E.C. 1121 (1977) (finding misuse when registered principal delayed returning funds to customer after intended investment did not materialize). The misuse of customer funds "is extremely serious and patently antithetical to the 'high standards of commercial honor and just and equitable principles of trade' that the NASD seeks to promote." In re Joel Eugene Shaw, 51 S.E.C. 1224 (1994) (quoting In re Wheaton D. Blanchard, 46 S.E.C. 365, 366 (1976)).

Patel's only defense to the charge that he misused DB's and JJB's funds – his contention that the customers had agreed to lend him $40,000 – is unsupported by the record. Throughout CSG's investigation, the arbitration proceeding they filed, and the hearing in this proceeding, DB and JJB denied lending or intending to lend any money to Patel. The Respondent. on the other hand, presented no written loan documents to support his claim and called no witnesses to support his account of the events; moreover, his testimony was rife with inconsistencies and, as discussed above, to a great extent implausible.[21] Accordingly, the Hearing Panel concludes that Patel improperly used DB's and JJB's investment funds in violation of Conduct Rules 2110 and 2330(a).

IV. Sanctions

The applicable NASD Sanction Guideline recommends that in a case of improper use adjudicators should "[c]onsider a bar."[22] The Guideline suggests that adjudicators may consider the imposition of a less severe sanction (i.e., a suspension in all capacities for six months to two years and thereafter until the respondent pays restitution) "[w]here the improper use resulted from respondent's

[21] Patel's misconduct may well rise to the level of conversion. "'Improper use' rises to the level of conversion where a registered representative deposits a customer's check into his own account instead of into his customer's account without authorization, and fails to repay the customer." Department of Enforcement v. Kendzierski, Complaint No. C9A980021, slip op. (Nov. 12, 1999) (registered representative converted customer funds where he altered the customer's check to substitute his name for his firm's name on the payee line, deposited the check into his personal bank account, and used the money to pay personal expenses). See also, e.g., In re Joel Eugene Shaw, 51 S.E.C. 1224 (1994) (registered representative converted customer funds where he deposited customer checks into his personal bank account and failed to return them until after the conversion had been discovered); In re Joseph H. O'Brien II, 51 S.E.C. 1112 (1994) (president of broker-dealer converted customer funds by withdrawing them from a customer's account without authorization and failing to repay them); In re Ernest A. Cipriani, 51 S.E.C. 1004 (1994) (registered representative collected cash payments from his customer and converted them to his own use); In re Stanley D. Gardenswartz, Exchange Act Release No. 27194, 44 S.E.C. Docket 725 (Aug. 29, 1989) (registered representative forged customers' signatures on a check, deposited the proceeds in his personal account, and used the funds for approximately one year). Enforcement, however, did not allege that the Respondent converted customer funds, and the Hearing Panel finds it unnecessary to reach this issue because it has determined that, in any event, he should be barred for his misconduct.

[22] NASD Sanction Guidelines 34 (1998 ed.).

misunderstanding of his or her customer's intended use of the funds or securities, or other mitigation exists . . . ."[23]

In this case, there are no mitigating factors present to justify the imposition of any sanction less severe than a bar; to the contrary, the Hearing Panel finds there are several aggravating factors present. Patel took advantage of customers who were unsophisticated in investment matters and intentionally misused a substantial amount of their funds ($40,000), which he knew they had obtained through a home equity line of credit, to pay his own expenses. As both DB and JJB testified, as a result of their dealings with Patel, they would not consider dealing with a broker again. (Tr. 75, 160.) In this connection, DB testified:

> [o]ur intent from the beginning was solely to invest with Mr. Patel because [of his] expertise [as a] broker with Corporate Securities. He was recommended . . . by a co-worker that, in my view, seemed to say that Mr. Patel did know what he was doing, and that was the only reason we invested with him. [W]e learned . . . a very, very valuable lesson here, and, you know, . . . if this happens to enough people what has happened to my husband and myself . . . I think it's definitely going to make an impact on the industry . . . .

(Tr. 75.) The Hearing Panel also considers highly aggravating the fact that Patel, at the hearing, not only demonstrated no remorse for his conduct but also blatantly lied to the Panel.

The evidence demonstrates that Patel acted for personal gain, with a complete disregard of his customers' welfare. Patel was not a novice in the securities industry when he engaged in this misconduct: by that time, he was a registered securities principal and had been employed in the securities industry for approximately two years. That he may have hoped to promptly return the

---

[23] Id. The Sanction Guideline for improper use also recommends the imposition of a fine ranging between $2,500 and $50,000. However, in cases where a respondent is barred for improper use or conversion of customer funds, NASDR generally will not impose a fine. NASD Notice to Members 99-86 (Imposition and Collection of Monetary Sanctions) (Oct. 1999). See also Department of Enforcement v. Brinton, 1999 NASD Discip. LEXIS 36, at *9-10 (NAC Dec. 14, 1999).

customers' funds by obtaining a home equity loan, or that he ultimately returned the customers' funds (plus interest) and paid their attorney's fees – after the customers filed an arbitration proceeding against him – does not mitigate the fact that he breached his customers' trust and abused the broker-customer relationship. See, e.g., Cipriani, 51 S.E.C. at 1007-06 (the fact that respondent ultimately paid back the money afforded no justification for the misappropriation); In re Raymond M. Ramos, 49 S.E.C. 868, 972 (1988) ("[T]he fact that Ramos ultimately paid the money back does not warrant permitting his return to the securities business where he poses a threat to other investors.").[24] The Hearing Panel also notes that the absence of a disciplinary history does not mitigate the seriousness of Patel's misconduct.[25]

V. Conclusion and Order

Therefore, having considered all the evidence, Respondent Patel is barred from associating with any NASD member in all capacities. Patel also is ordered to pay costs in the amount of $3,733, which include an administrative fee of $750 and hearing transcript costs of $2,983. These sanctions shall become effective on a date set by the Association, but not sooner than 30 days from the date this

[24] For these reasons, the Hearing Panel also rejects as mitigating the fact that Respondent did not file a bankruptcy petition. The Panel also notes that, pursuant to Section 523(a) of the United States Bankruptcy Code, 11 U.S.C. § 523, certain debts, including those for money obtained by false pretenses, are not dischargeable.

[25] As the National Adjudicatory Council stated several months ago,

> [r]egistered individuals are required as part of the terms of their admission to the securities industry to comply with the NASD's Rules and observe high standards of conduct. We are not compelled to reward a respondent because he has acted in the manner in which he agreed (and was required) to act when entering this industry as a registered person. We therefore do not find that the absence of a disciplinary history should mitigate the seriousness of the misconduct or the severity of the sanctions imposed.

Department of Enforcement v. Balbirer, 1999 NASD Discip. LEXIS 29, at *10-11 (NAC Oct. 18, 1999). The NAC recently reiterated that the absence of a disciplinary history is not a mitigating factor. Department of Enforcement v. Testino, Complaint No. 3A99031, slip op. (NAC April 13, 2000).

Decision becomes the final disciplinary action of the NASD; provided, however, that the bar shall become effective immediately upon the Decision becoming the final disciplinary action of the NASD.[26]

Hearing Panel.

By: _____
Ellen B. Cohn
Hearing Officer

Copies to:

Sylvia M. Scott, Esq. (electronically and via first class mail)
Rory C. Flynn, Esq. (electronically and via first class mail)
John P. Cione, Esq. (via overnight courier)
Matthew R. Rutherford, Esq. (via overnight courier)

[26] 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.