

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

DEPARTMENT OF ENFORCEMENT,	:	
	:	
Complainant,	:	Non-Summary Suspension
	:	Proceeding
v.	:	No. ARB000005
	:	
	:	DECISION
	:	
	:	Hearing Officer - DMF
	:	
Respondent.	:	August 2, 2000
	:	

Digest

In accordance with Rule 9513(a), the Office of Dispute Resolution notified the respondent _____ that his registration would be suspended pursuant to Article VI, Section 3 of the NASD's By-Laws and Rule 9510, et seq. for failing to pay an arbitration award. _____ requested a hearing pursuant to Rule 9514(a). At the hearing, he acknowledged he was subject to the award and had not paid it, but argued he should not be suspended because he is financially unable to pay the award. The Hearing Officer, sitting as the Hearing Panel pursuant to Rule 9514(b), held that _____ adequately established a bona fide present inability to pay the award, and dismissed the proceeding.

Appearances

Shelly A. Goering, Regional Counsel, Cleveland, OH, (Rory C. Flynn, Chief Litigation Counsel, Washington, DC, of counsel), for the Department of Enforcement.

_____, Esq., Cleveland, OH, for respondent.

DECISION

Introduction

Pursuant to Rule 9513(a), the Office of Dispute Resolution notified _____ by letter dated May 2, 2000 that he was subject to suspension or cancellation of his registration in accordance with Article VI, Section 3 of the NASD By-Laws and Rule 9510, et seq. for failing to pay the arbitration award rendered in NASD Arbitration No. 98-04122. On May 11, 2000, _____ filed with the Office of Hearing Officers a request for a hearing pursuant to Rule 9514(a). The undersigned Hearing Officer was appointed as the Hearing Panel for this matter pursuant to Rule 9514(b)(1).

A hearing was held on June 16, 2000. At the hearing _____ offered his own testimony and 3 Exhibits (RX 1-3). As agreed during the hearing, _____ also submitted certain documents after the hearing relating to his communications with the Internal Revenue Service. (Tr. II. pp. 32-33.)¹ Enforcement offered no testimony or exhibits. _____ did not dispute that the arbitration award was properly issued or that he had not paid any part of it. The parties agreed that the only issue for consideration was _____'s ability to pay. (Tr. I, p. 5.) After a review of the entire record, the Hearing Officer finds that _____ has satisfactorily shown a bona fide inability to pay the award at the present time. Therefore, this proceeding will be dismissed.

Background

_____ was associated with EVEREN Securities, Inc. from 1996 until 1998. After his association with EVEREN terminated, EVEREN initiated an arbitration claim against _____ for failing to pay two promissory notes that became due from _____ to EVEREN upon termination

of his association with the firm. (Request for Hearing, pp. 1-2; Arbitration Award, p. 1.) Thus, the arbitration did not involve any customer claim, or any claim of wrongful or unethical actions by ____.

An NASD arbitration panel issued an award against ____ effective December 23, 1999, requiring him to pay a total of \$108,258.16 on the two notes. (Arbitration Award, p. 2.) The Office of Dispute Resolution served the award on ____'s attorney on January 4, 2000. On April 17, 2000, the Office of Dispute Resolution received a letter from EVEREN's attorney representing that ____ had not sought to vacate, modify or correct the award, but had not paid it. The Office of Dispute Resolution thereupon issued its May 2 letter notifying ____ that he would be suspended and ____ requested a hearing, as described above.²

Discussion

Article VI, Section 3 of the NASD's By-Laws provides: "The NASD after 15 days notice in writing may suspend or cancel ... the registration of any person ... for failure to comply with an award of arbitrators properly rendered pursuant to the Rules of the Association, where a timely motion to vacate or modify such award has not been made pursuant to applicable law or where such a motion has been denied" There is no dispute that the award in question was properly rendered and that ____ has not paid it. The only issue in this proceeding is ____'s claim that he is financially unable to pay the award. (Tr. I, p. 5.)

In Bruce M. Zipper, Exchange Act Release No. 33376, 55 S.E.C. Docket 2002 (Dec. 23, 1993), the SEC found that a bona fide inability to pay was an important consideration in determining whether to impose a sanction against a registered person for failing to pay an

¹ "Tr. I" refers to the transcript of the pre-hearing conference held on May 31, 2000; "Tr. II" refers to the transcript of the hearing on June 16, 2000.

arbitration award. The SEC also explained: “Because the scope of his assets is particularly within Zipper’s knowledge, we think Zipper should properly bear the burden of adducing evidence with respect to those assets.”

Subsequent decisions by the SEC and the NASD shed additional light on the standards that a respondent must meet to establish an inability to pay. For example, because the obligation to pay an arbitration award arises when the award is received, a respondent who is able to pay the award at that time and unreasonably fails to do so may be disciplined even if the respondent’s assets later decrease to a level that is inadequate to pay the award.³ Furthermore, an inability to pay defense may be rejected if it appears that the respondent has the ability to divert funds from other expenditures to pay the award, or could borrow the funds, or could make some meaningful payment toward the award from available assets or income, even if the respondent could not pay the full award.⁴

The Hearing Officer has reviewed the financial information _____ has provided with these standards in mind. The information is extensive and detailed. It includes _____’s lengthy written statement concerning the relevant facts and circumstances, including his past gross commission production and net income for the period 1992-1999 (RX 1); a completed NASD financial disclosure form and supporting documents, including copies of _____’s 1999 tax returns and his most recent earnings statement from Raymond James and Associates, where he is

² See attachments to Notice of Filing Documents Considered in Issuing Rule 9513 Notice, filed by Enforcement on May 24, 2000.

³ District Business Conduct Committee for District No. 7 v. Richard J. Lanigan, Complaint No. C07940042 (NBCC Dec. 8, 1994), aff’d, Exchange Act Release No. 36028, 59 S.E.C. Docket 2212 (July 27, 1995).

⁴ District Business Conduct Committee for District No. 7 v. Escalator Securities, Inc. Complaint No. C07930034 (NBCC Feb. 19, 1998); District Business Conduct Committee for District No. 8 v. Miguel Angel Cruz, Complaint No. C8A930048 (NBCC Oct. 31, 1997); Herbert Garrett Frey, Exchange Act Release No. 39007 (Sept. 3, 1997); Michael H. Novick, Exchange Act Release No. 37503, 62 S.E.C. Docket 1129 (July 31, 1996); District Business

currently associated (RX 2); and a number of receipts showing recent payments of overdue mortgage payments and utility and other bills. (RX 3). Enforcement cross-examined _____ regarding these materials, but did not offer any independent evidence to contradict _____'s testimony or the documents he offered.

_____ 's financial disclosure form claimed total assets of \$321,887.98, of which \$271,000 represented the purchase value of his jointly-owned home. (RX 2, p. 2.) During the hearing, _____ testified that he and his wife purchased the home in 1997, and that its current market value might be about \$300,000. (Tr. II, p. 14.) The only liquid asset reported by _____ was a Raymond James account with a cash balance of \$24.47 as of June 12, 2000.⁵ (RX 2, p. 28.)

In contrast, _____ 's financial disclosure form claimed liabilities totaling \$806,307.34. (RX 2, p. 3.) That amount was clearly excessive, because _____ claimed a first mortgage obligation on his home of \$538,118.64, based on the total of all principal and interest payments that would become due over the remaining life of the mortgage. (Tr. II, p. 14.) The proper amount for determining _____ 's present net worth would be the current principal balance. _____ testified he did not know that amount, but that the original principal was about \$225,000 - \$230,000. (Tr. II, p. 22.) In addition, _____ 's claimed liabilities included an estimated \$200,000 for payment of the arbitration award in question and attorneys fees he incurred in defending the claim. (Tr. II, p. 20.) It appeared from the testimony that this amount might be somewhat excessive because _____ thought he had an obligation to pay EVEREN's attorneys fees over and above the arbitration award. (Tr. II, p. 21.) Even if the first mortgage liability were reduced to \$225,000 and the amount due as a result of the arbitration were reduced to the principal amount

Conduct Committee for District No. 7 v. Bruce M. Zipper, Complaint No. C07910138 (NBCC Oct. 31, 1994), aff'd, Exchange Act Release No. 35606, 58 S.E.C. Docket 235 (April 17, 1995).

of the award (\$108,000), however, _____ would have a substantial negative net worth, and no significant liquid assets from which the award could be paid.

Ability to pay is not determined only by net worth, however; cash flow is also important. In that regard, the information provided by _____ indicated the following: In 1996, _____ moved from Dean Witter to EVEREN and earned a total of \$65,915.76 for the year. In 1997, he was associated with EVEREN for the entire year, but his earnings dropped to \$44,575.27. In 1998, he left EVEREN and became associated with Roney & Co., and his earnings for the full year were \$47,320.07. In 1999, he was associated with Roney, which merged into Raymond James (where he remains), but earned only \$26,703.91. (RX 1, p. 2.) In 2000, through May 31 he has earned \$26,019.31, as confirmed by a Raymond James earnings statement.⁶ (RX 2, p. 34.) _____ testified that he has tried unsuccessfully to obtain an advance from Raymond James; that he has no ability to borrow funds to pay the award, which is consistent with his financial condition as set forth in the record; and that, with the assistance of Raymond James, he is continuing to try to work out a payment plan with EVEREN. (Tr. II, pp. 27-28.)

_____ also claimed basic monthly living expenses for his family of \$5,448.64. (RX 1, p. 16.) On the whole, these expenses appear reasonable; even if one were to quibble with some of the amounts, however, given _____'s current income with Raymond James, there is no reason to believe he could divert enough funds from his family's basic living expenses to make any significant payment towards the arbitration award. Indeed, the documents provided by _____ indicate that he has had serious difficulty meeting his basic mortgage and utility obligations. (RX 3.)

⁵ _____ also reported IRA and 401(k) assets of \$4,573.89. _____ has already tapped most of his retirement savings in order to meet his family's living expenses and to pay taxes on early distribution of those funds. (Tr. II, p. 23-24.)

In summary, _____'s financial condition is precarious, and has been since the arbitration award became due. There is no evidence that at any relevant time he has had sufficient assets to satisfy the award, or make any substantial payment on it.

The Hearing Officer concludes, therefore, that _____ has adequately established his bona fide inability to pay the award, and that, in light of this showing, his registration should not be suspended.⁷ This does not mean, of course, that _____ is free from his obligation to pay the award, or that the NASD may not suspend or cancel his registration in the future if his financial circumstances improve and he fails to pay the award.

In addition, the Hearing Officer notes that when the SEC determines that the respondent is unable to pay a sanction, based on financial information submitted by a respondent, it typically includes in its order a specific provision authorizing the SEC staff to move to reopen the proceeding upon a showing that the respondent has misrepresented his or her financial condition.⁸ The Hearing Officer concludes that a similar provision is appropriate here, as well.

Accordingly, this proceeding is dismissed. The Department of Enforcement may seek to reopen this proceeding at any time upon a showing that the information provided by _____ to demonstrate his inability to pay the award was materially inaccurate or incomplete, and misrepresented his true financial condition. Nothing in this decision shall preclude the NASD

⁶ _____'s wife is a part time employee of the Cuyahoga Public Library; her 1999 earnings were approximately \$13,500. (RX 2, p. 11.)

⁷ The decision in this case is consistent with District Business Conduct Committee for District No. 5 v. James C. Arnold, Complaint No. C05960034 (NBCC Feb. 25, 1997) and District Business Conduct Committee for District No. 2 v. Louis Fratkin, Complaint No. C02950041 (NBCC Jan. 22, 1997). In both cases, the National Business Conduct Committee held that the respondents had adequately established their inability to pay monetary sanctions.

⁸ See, e.g., Brent Duane Green, Exchange Act Release No. 34-39210 (Oct. 7, 1997).

This Decision has been published by the NASDR Office of Hearing Officers and should be cited as OHO Redacted Decision ARB000005.

from suspending or canceling _____'s registration in the future if his financial condition improves and he fails to satisfy the award.⁹

SO ORDERED

David M. FitzGerald
Hearing Officer

⁹ The Hearing Officer 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.