

Appearances

Thomas K. Kilkenny, Regional Counsel, NASD Regulation, Inc., Philadelphia, Pennsylvania,
for the Department of Enforcement.

_____, *pro se*.

Introduction

The National Association of Securities Dealers, Inc. (NASD) notified _____
(_____), by letter dated August 10, 1998, that his registration was subject to suspension or
cancellation for failure to pay the arbitration award rendered on June 6, 1996, in NASD Arbitration No.
95-02994. By letter dated August 12, 1998, _____ requested a hearing under Rule 9514(a) on his
ability to pay the award.

At the hearing on September 18, 1998, the Department of Enforcement (Enforcement) offered
4 exhibits (CX-1, 2, 4 & 5), and _____ offered his own testimony and 4 exhibits (R-1-4).¹

After reviewing the evidence and arguments presented during the hearing, the Hearing Officer
concludes that _____ has shown that he is unable to pay the award. Accordingly, this proceeding will
be dismissed.

Facts

_____ has been registered with the NASD as a general securities representative since 1973.²
Currently, he is associated with _____, Inc. where he works in the operations

¹ Enforcement elected not to offer into evidence the two documents that had been pre-marked as
CX-3 and 6. (Tr. 36.)

² CX-5.

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department in a salaried position.³ He earns approximately \$30,000 per year.⁴ _____'s total earned income for the last year is approximately \$43,000.⁵

On June 6, 1996, an NASD arbitration panel issued an award against _____ in the amount of \$24,402.50 plus forum fees.⁶ _____ has not made any payment against the amount of the award although he did pay the claimants a total of \$2,000 or \$3,000 as part of an earlier agreement that they withhold asking the NASD to initiate suspension proceedings against him.⁷ Under this agreement, the payment to the claimants was not to be credited against the balance due them under the arbitration award.⁸

The NASD sent _____ a letter on August 10, 1998, initiating this proceeding, and _____ filed a timely request for a hearing.

At the hearing, _____ admitted that the arbitration award had been validly issued and that he had not paid it. In his defense, _____ argued that he has not intentionally disregarded the award, but he has been unable to pay it.⁹ To support his defense, _____ offered both testimony and several exhibits, including a "Disclosure of Assets and Financial Disclosure Form" used by the NASD, which is based on a similar form used by the SEC.¹⁰

³ Tr. 30-31

⁴ R-3.

⁵ R-2, at 2.

⁶ CX-1.

⁷ Tr. 22-23.

⁸ Tr. 23.

⁹ Tr. 8.

¹⁰ R-2.

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In summary, _____ testified that he is just now getting back on his feet after a few bad years. In 1996 his total income was just \$12,700.¹¹ In 1997, he made \$39,300.¹² Currently _____ earns \$2,500 per month, and his household expenses exceed that amount.¹³ _____'s income is supplemented by his wife's income of \$1,300 per month.¹⁴ Together, they are not able to pay all of their current expenses in full as they fall due.

_____ and his wife have no liquid assets that could be used to pay all or a portion of the arbitration award. Although they own a home worth \$255,000, they have three mortgages on it totaling approximately \$241,000.¹⁵ The second and third mortgages secure debts due the builder of their home, including deferred rent that they were unable to pay in 1995.¹⁶ _____ has not been able to make payments on either of these mortgages since January 1997.¹⁷ Consequently, if they sold their home at its full appraised value, they could not expect to net any money after the costs of sale. Further, _____ does not own an automobile or other tangible assets that could be sold to raise money to pay the award. Their only car is in his wife's name, and the outstanding loan balance on it exceeds its current value.¹⁸

Enforcement did not show that any of the information _____ submitted was materially incorrect or that there was any reason to believe that he has undisclosed assets or income that could be

¹¹ Tr. 21.

¹² Id.

¹³ R-3.

¹⁴ Id.

¹⁵ R-2.

¹⁶ Tr. 18, 21.

¹⁷ Tr. 19.

¹⁸ R-2.

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used to pay the award. There also was no evidence that _____ would receive any extraordinary income in the future.

Discussion

To establish an inability-to-pay defense to suspension proceedings for failure to pay an arbitration award, a respondent must demonstrate that he is unable to make some meaningful payment toward the award from available assets or income, even if he cannot satisfy the full award.¹⁹ An inability-to-pay defense may be rejected if it appears that the respondent either has the ability to divert funds from other expenditures to pay the award or has the ability to borrow the funds.²⁰ If a registered representative unreasonably fails to pay the award or negotiate a settlement at the time the award is final, he may be disciplined even if he later shows he cannot pay the award.²¹

In this case, however, the evidence established that _____ has no assets, liquid or otherwise, that could be used to pay the award. Moreover, consistent with _____'s testimony, there is nothing to suggest he could borrow money to satisfy the award. Mr. and Mrs. _____ already have three loans on their house, two of which are in arrears, and they have outstanding credit card bills exceeding \$12,700, which were incurred, in part, because their income in 1996 was insufficient to meet their

¹⁹ District Business Conduct Committee for District No. 7 v. Escalator Securities, Inc., Complaint No. C07930034, 1998 NASD Discip. LEXIS 21 (NBCC Feb. 19, 1998); District Business Conduct Committee for District No. 8 v. Miguel Angel Cruz, Complaint No. C8A930048, 1997 NASD Discip. LEXIS 62 (NBCC Oct. 31, 1997); Herbert Garrett Frey, Exchange Act Release No. 34-39007 (Sept. 3, 1997); Michael H. Novick, Exchange Act Release No. 37503, 62 S.E.C. Docket 1129 (July 31, 1996); District Business Conduct Committee for District No. 7 v. Bruce M. Zipper, Complaint No. C07910138, 1994 NASD Discip. LEXIS 194 (NBCC Oct. 31, 1994), aff'd, 51 S.E.C. 928 (1993).

²⁰ Id.

²¹ 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).

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necessary household expenses.²² Moreover, the evidence does not suggest that _____ had any greater financial ability to pay the award when it was issued than he has at present.

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.²³ 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, based on financial information submitted by a respondent, that the respondent is unable to pay a sanction, 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.²⁴ The Hearing Officer concludes that a similar provision is appropriate here.

Order

Accordingly, this proceeding is dismissed. 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.

²² Tr. 22; R-2.

²³ Compare 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 which the National Business Conduct Committee held that the respondents had adequately established inability to pay monetary sanctions.

²⁴ See, e.g., Brent Duane Green, Exchange Act Release No. 39210 (Oct. 7, 1997).

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Furthermore, nothing in this decision shall preclude the NASD from suspending or canceling _____'s registration in the future if his financial condition changes and he fails to satisfy the award.²⁵

Andrew H. Perkins
Hearing Officer

²⁵ The Hearing Officer considered all of the arguments of the parties. They are rejected or sustained to the extent that they are inconsistent or in accord with the views expressed herein.