NASD REGULATION, INC.
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. MICHAEL J. ALBINO (CRD #864412), et al., Respondents.	:	Disciplinary Proceeding No. CAF970002 **Hearing Panel Decision** Hearing Officer - EBC February 17, 1999
DEPARTMENT OF ENFORCEMENT, Complainant, v. ROBERT J. ROSATO (CRD #1723366) Melville, New York Respondent.	:	

Digest

The Department of Enforcement's Complaint charges Respondent Robert J. Rosato ("Rosato" or "Respondent"), a registered general securities representative and principal, with engaging in various fraudulent and improper sales practices in dealing with seven former customers and the accounts they maintained at Stratton Oakmont, Inc. ("Stratton" or the "Firm"). More specifically, the Complaint alleges that Rosato violated Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rule 10b-5 thereunder, and NASD Conduct Rules 2110 and 2120, by effecting unauthorized transactions in six customers' accounts; making a baseless and improper price prediction and an improper promise to recover losses to one of these customers; and refusing to execute an order to sell. Rosato also is charged with violating

Section 10(b) of the Exchange Act and SEC Rule 10b-5, and NASD Conduct Rules 2110, 2120, 2310, and 3110 by falsifying new account documentation, and recommending and effecting transactions that were unsuitable for another customer. Rosato filed an Answer denying the charges, and requested a hearing.

The Hearing Panel found that Rosato, in violation of Section 10(b) of the Securities Exchange Act and SEC Rule 10b-5, and NASD Conduct Rules 2120 and 2110, made a baseless and improper price prediction and an improper promise to recover losses, as alleged in the Complaint. The Panel also found that Rosato, in violation of NASD Conduct Rule 2110, effected or otherwise was responsible for unauthorized trades in three customers' accounts. However, the Panel concluded that Rosato's unauthorized trading activity did not constitute fraud and that the Department of Enforcement (Enforcement) failed to prove Rosato engaged in the other misconduct alleged in the Complaint. Accordingly, these allegations were dismissed. With respect to sanctions, the Hearing Panel censured Respondent, suspended him for eight months (60 days for the unauthorized trading and six months for the false and misleading statements), ordered him to pay restitution in the amount of $17,957.69 (plus pre-judgment interest), and fined him $ 30,000 ($20,000 for the false and misleading statements and $10,000 for the unauthorized trades). The Hearing Panel also ordered Rosato to pay costs in the amount of $2,237.50.

Appearances

Jonathan I. Golomb, Senior Attorney, Washington, DC, George C. McGuigan, Jr., Senior Regional Attorney, Dallas, Texas, and Rory C. Flynn, Chief Litigation Counsel, Washington, DC, for the Department of Enforcement.

Martin P. Unger, Esq. and Andrew S. Zeitlin, Esq., Tenzer Greenblatt LLP, New York, New York for Robert J. Rosato.[1]

DECISION

Procedural Background

On October 15, 1997, Enforcement filed a multiple cause Complaint against Rosato and 32 other former Stratton registered representatives, principals, or associated persons alleging generally that they engaged in various fraudulent and improper sales practices, prepared false and materially misleading sales scripts, or failed to exercise proper supervision while at Stratton. After the proceeding was initiated, 25 Respondents settled and orders accepting their respective offers of settlement were issued. Three Respondents defaulted by failing to answer the Complaint,[2] and one was deemed in default, pursuant to Rule 9241(f), for failing to appear at numerous pre-hearing conferences.[3] One Respondent died, the proceeding was stayed as to another due to his pending bankruptcy proceeding, and Enforcement voluntarily dismissed the Complaint as to another. A hearing was held for the sole purpose of adjudicating the charges against Rosato and, accordingly, this Decision relates only to him.

I. The Charges

The Complaint charges Rosato with engaging in fraudulent and improper sales practices in dealing with seven former Stratton customers, RD, NO, MB, EW, RK, WG, and GS, and their accounts. More particularly, the Complaint alleges that Rosato persuaded RD to purchase shares of Dollar Time Group, Inc. ("Dollar Time"), a speculative stock trading at slightly more than $.50 per share, by predicting a ¼ to ½ of a point increase in the price of the stock over three to

[1] Messrs. Unger and Zeitlin represented Rosato throughout this proceeding and at the hearing. After the hearing, on December 9, 1998, counsel filed a Notice of Withdrawal indicating that, as of that date, they were no longer representing Rosato.

[2] See Order, dated June 17, 1998.

[3] See Order, dated October 8, 1998.

four weeks (Complaint, ¶ 88), and by telling RD that Stratton had the ability to recover losses faster than any other firm. (Complaint, ¶ 300.) The Complaint further alleges that Rosato purchased more shares of Dollar Time than RD had authorized; effected other transactions without the consent or authorization of NO, MB, RK, GS, and WG (Complaint, ¶¶ 265-70); and failed to execute an order to sell placed by WG. (Complaint, ¶ 342.) Finally, the Complaint alleges that Rosato falsified information pertaining to EW's financial condition on the new account documentation for his Stratton account, and recommended and effected transactions in speculative securities that were unsuitable for EW in light of his investment objectives and financial needs. (Complaint, ¶¶ 362, 380.) As a result of the foregoing, Rosato is charged with violating Section 10(b) of the Exchange Act and SEC Rule 10b-5, and NASD Conduct Rules 2110, 2120, 2310, and 3110.

II. The Hearing

A hearing on these charges was held on November 5 and 6, 1998, before a Hearing Panel composed of an NASD Hearing Officer, a former member of the District Committee for District 10, and a former member of the District Committee for District 5.[4] At the hearing, Enforcement offered the testimony of five witnesses – four of the customers identified in the Complaint, RD, NO, MB, and EW, and Debra Armour, an employee of NASD Regulation, Inc. who supervised its investigation of Stratton. (Tr. 94-95.)[5] Enforcement also offered 40 exhibits, 37 of which were admitted in evidence.[6] Respondent testified on his own behalf, and offered ten exhibits, all

[4] References to the transcript of the hearing are cited as "Tr. __."

[5] RD and EW testified in person, NO and MB testified via video-conferencing, and Ms. Armour testified by telephone.

[6] References to Enforcement's exhibits are cited as "CX ___." CX 3S-6S, 9S-10S, 13S, 15, 17-18, 22-23, 25, 130-151, and 208-209 were admitted in evidence. Prior to the hearing, the Hearing Officer overruled Respondent's objections to CX 15, 17-18, 22-23, 25, 132, 135, 138-139, 142, 144-145, 147, and 149, and sustained his objections to CX 26-28. See Transcript of September 11, 1998 Pre-Hearing Conference, pp. 45-55. At the hearing, Enforcement nonetheless sought to admit CX 26-27. Respondent also attempted to renew his objections to CX 135, 138-139, 142, 144-145, 147, and 149, and objected to the admission of CX 141 and CX 207. The Hearing Officer

of which were admitted in evidence.[7] In addition, prior to the hearing, the Parties filed stipulations concerning many of the relevant underlying facts.[8]

After Enforcement completed the presentation of its direct case, Rosato orally moved, through his counsel, to dismiss the charges pertaining to RD, GS, RK, WG, and EW on the ground that Enforcement failed to introduce sufficient evidence to establish a prima facie case that Rosato engaged in the misconduct alleged. (Tr. 200-10, 219.) Enforcement opposed the motion. (Tr. 210-19.) The Hearing Panel determined that Enforcement introduced sufficient evidence to establish a prima facie case that Rosato committed the violations alleged in the Complaint pertaining to RD and, although it ultimately decided to dismiss the allegations pertaining to EW, the Panel concluded it was appropriate to require Rosato to defend those charges because material credibility issues were involved. In all other respects, the Hearing Panel granted the motion and dismissed the charges pertaining to GS, RK, and WG.

The Complaint alleges that Rosato effected trades without the consent and authorization of GS, RK, and WG, and failed to execute an order to sell placed by WG. In his Answer and throughout this proceeding, Rosato consistently denied these charges.[9] In support of these allegations, Enforcement did not offer testimony from GS, RK, or WG's daughters[10] but, instead,

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reaffirmed her prior rulings; overruled Respondent's objection to CX 141; and sustained his objection to CX 207. (Tr. 24-25, 112-13.) All other exhibits offered by Enforcement were admitted without objection. See Transcript of September 11, 1998 Pre-Hearing Conference, pp. 45-55; Joint Stipulation Between Complainant and Respondent Rosato as to Documents, filed August 17, 1998.

[7] References to Rosato's exhibits are cited as "RX ___." RX 1-8, 10 were admitted without objection and, prior to the hearing, the Hearing Officer overruled Enforcement's objection to RX 9. See Transcript of Final Pre-Hearing Conference, pp. 39-45; Joint Stipulation Between Complainant and Respondent Rosato as to Documents, filed August 17, 1998.

[8] References to the "Amended Joint Stipulations of Uncontested Facts Between Complainant and Respondent Rosato," filed on September 18, 1998, are cited as "Stip. ¶ ___."

[9] See Answer, ¶¶ 32-34, 38-41; Robert J. Rosato's Amended Statement of Uncontested and Contested Facts, ¶¶ 2, 6-7, 9.

[10] WG died sometime before the hearing. Although WG controlled the subject account, the account was maintained in the names of his three daughters. (Stip. ¶ 6.a-b.) WG's daughters purportedly wrote and signed a letter to Stratton complaining about various wrongdoings by Rosato, including the conduct alleged in the Complaint. (See CX 142.)

relied solely on written hearsay statements that were neither sworn nor executed under penalty of perjury.[11] The Hearing Panel recognizes that the federal rules of evidence do not apply in NASD disciplinary hearings and that hearsay statements are admissible and, in some cases, may be the basis for findings. However, "before reliance can be placed on such evidence, its reliability and probative value must be carefully assessed." In re Gary L. Greenberg, 50 S.E.C. 242, 245 (1990) (footnote omitted). In this case, given the nature of the hearsay statements and in the absence of any corroborating testimony or documentary evidence, the Hearing Panel determined that the hearsay statements of GS, RK, and WG (and his daughters) were not entitled to any material weight.[12] See, e.g., District Business Conduct Committee No. 3 v. Gibbs, Complaint No. DEN-1001, 1991 NASD Discip. LEXIS 93, at * 36-37 (NBCC Aug. 26, 1991) (dismissing unauthorized trading charges that were supported exclusively by hearsay evidence) , aff'd, 51 S.E.C. 482 (1993), aff'd, 25 F.3d 1056 (10th Cir. 1994) (table).

On December 23, 1998, pursuant to the schedule established at the conclusion of the hearing, Enforcement submitted proposed findings of fact and conclusions of law. Respondent did not file any proposed findings and conclusions but, on December 23, 1998, moved for an extension of time to submit his papers. Given that the Parties had been afforded ample opportunity to prepare and file post-hearing materials and, in the absence of any discernible prejudice to Respondent as a result of his failure to submit such materials, the Hearing Officer denied his motion.

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[11] Enforcement's evidence in support of the alleged unauthorized trading activities in GS's and RK's accounts consisted of two complaint letters to Stratton, one purportedly written and signed by GS and the other by RK. (See CX 135, 147.) In support of the allegations of misconduct pertaining to the account controlled by WG, Enforcement submitted the above-noted letter from his daughters and a purported declaration of WG that appears to bear a witness acknowledgment pre-dating WG's execution of the declaration. (See CX 141.)

[12] The Hearing Panel notes that respondents in NASD disciplinary hearings are entitled to a "fair" procedure, as provided in Section 15A(b)(8) of the Exchange Act, notwithstanding the relaxed admissibility standards that apply. Enforcement should use the "fair" procedure requirement as guidance in determining the nature and quality of the evidence it presents at disciplinary hearings.

Findings of Fact

I. Rosato's Background in the Securities Industry

Rosato first entered the securities industry in March 1987, when he joined The Dreyfus Service Corp. Thereafter, from August 1990 to May 1995, Rosato was associated with Stratton; while associated with Stratton, in November 1990, he became registered as a general securities representative (Stip. ¶ 1.c-d; CX 130) and, in March 1995, became registered as a general securities principal. (CX 130.) After his termination from Stratton,[13] from June 1995 until April 1996, and from April 1996 until August 1996, Rosato was associated and registered with Duke & Co., Inc. ("Duke") and Bishop, Allen, Inc., respectively. Since November 1996, Rosato has been associated and registered with Tasin & Company, Inc. (Stip. ¶ 1.c; CX 130.)

Rosato, Duke, and other agents of Duke were named in an Order to Show Cause issued, on September 15, 1995, by the Alabama Securities Commission. The Order to Show Cause stemmed from the parties' alleged violations of a prior suspension order issued by that Commission against Duke. (Stip. ¶ 1.e; CX 130.) The matter was resolved pursuant to a Consent Order that required Duke to pay an administrative assessment of $3,500 and the costs of the investigation. (Stip. ¶ 1.e.) Rosato has not been the subject of any other prior disciplinary proceeding. (Stip. ¶ 1.f.)

II. Rosato's False and Misleading Statements to RD and the Unauthorized Purchase of Dollar Time Shares

In or about 1994, RD opened an account, Account No. 82-421580, at Stratton. According to Rosato, although he was not the broker of record for RD's account (Stip. ¶ 3.a; Tr. 49, 61-62, 241, CX 132), on or about January 17, 1995 he called RD, because RD was concerned about the

[13] Stratton's Form U-5 for Rosato disclosed that he had been discharged for engaging in excessive trading. (Tr. 298.) However, Rosato testified that he never received any customer complaints for engaging in excessive trading, while at Stratton, and that he has never been named in any arbitration or other proceeding charging him with excessive trading. According to Rosato, he was terminated from Stratton as a result of a personal disagreement with the Firm's President. (Tr. 305-06.)

performance in his Stratton account and the assigned broker had refused to return his telephone calls. (Tr. 243-44, 246.) Rosato testified that, during this initial conversation, he updated RD on his position in IDM Environmental Corp. ("IDM Environmental") warrants, and briefly mentioned Dollar Time stock as "something that [he] was moving on with [his] clients." (Tr. 244.) Two days later, on January 19, 1995, Rosato again called RD; the content of that conversation is undisputed.[14] At the outset of the conversation, RD expressed frustration over extensive losses in his Stratton account and told Rosato that he was "upset beyond belief" because the assigned broker had failed to follow RD's instructions to sell his IDM Environmental warrants. (CX 133, pp. 2-3; see also Tr. 300.) As Rosato was well aware, RD, at that time, was considering pursuing these matters with the SEC. (CX 133, pp. 2-3.)

Rosato, after suggesting that IDM Environmental warrants might further decline in value, stated:

> [o]ne last point and I will let you get off the phone. Out of any brokerage firm in the country, I think Stratton Oakmont has the ability to make up losses quicker and faster than anyone else, and I think you might realize that based on the type of units that we do.
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> You get 1,000, 2,000, 3,000 units with $7.00 stock and hypothetically it goes to 14 the first day of trading, like almost every offering that we've done has done, you back in the ballgame immediately. But, if you sit on your hands and wait and you want to see what happens and you flounder around a little bit, we are not going to get this account back in the black or the break-even point. I just want you to be aware of that.

(CX 133, p. 4; see also Tr. 257-58.) By way of explanation, Rosato testified that these statements referred to the short-term historical performance of Stratton's initial public offerings, all of which were so-called "hot issues." (Tr. 258-59.)

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[14] Stratton taped the January 19, 1995 conversation. At the hearing, Enforcement introduced a transcript of the tape recording (CX 133), which Rosato stipulated accurately reflected his January 19 conversation with RD. (Stip. ¶ 3.c.) That RD could not recall the details of the January 19 conversation or that he had two separate conversations with Rosato is therefore immaterial.

During the January 19 conversation, immediately after discussing Stratton's ability to recoup losses, Rosato recommended that RD invest in Dollar Time, which was not an initial public offering. In this connection, Rosato stated:

> . . . I think it is the right move for you to do, and I think you see the stock move in the next three to four weeks; I think it happens in that timeframe [sic]. I am not saying it is doubling and tripling but I think a quarter of point . . . a half point . . . is a real nice percentage gain.

(CX 133, pp. 5-6; Stip. ¶ 3.b.) At that time, Dollar Time stock was trading at approximately 9/16 per share (CX 133, p. 5; Tr. 281; Stip. ¶ 3.a); a ¼ to ½ of a point increase would represent a 44% to 88% gain in the value of the stock. However, according to a prospectus for Dollar Time, dated July 29, 1994, the Company's financial condition was, at best, precarious. The Company had a net loss of more than $21 million for its fiscal year ending March 26, 1994 and, as of March 31, 1994, its cost of sales exceeded sales by 150%. The prospectus also disclosed that unless the Company obtained additional financing, eliminated or reduced its outstanding leasehold obligations, or materially increased its revenues, it would be required to "significantly reduce its current operations and substantial questions [would] be raised as to the Company's ability to continue as a going concern." As stated in the prospectus, were that to occur, the Company would consider filing for protection under the federal bankruptcy laws. (CX 3S, pp. 4-5.) Finally, Dollar Time's prospectus stated in large bold print, under the heading "Risk Factors," that the securities "involve a high degree of risk." (CX 3S, p. 4.)[15]

Rosato admitted that, prior to recommending Dollar Time, he performed no research about the Company; did not obtain any informational literature; did not review the prospectus; and never even saw the private placement memorandum. (Tr. 255-56, 285.) Rather, his recommendation to RD was based solely on Stratton's recent "involvement" with the security

[15] Rosato admitted that he did not advise RD that Dollar Time was unprofitable or mention any of the risk factors discussed in Dollar Time's prospectus. (Tr. 286-89.) However, because Enforcement did not charge Rosato with inadequate risk disclosure, the Hearing Panel declines to find any violations based on Rosato's omissions.

(the Firm had become a market maker in Dollar Time)[16] and a sudden increase in the stock's trading volume over the previous two or three days. (Tr. 256-57, 299, 312.)

Based on Rosato's recommendation, however, RD authorized Rosato to sell his IDM Environmental warrants and to use the proceeds from this sale to purchase Dollar Time stock. (Tr. 65, 247; CX 132, 133.) According to RD, he had lost approximately $20,000 on his IDM Environmental stock holdings; he understood, based on Rosato's statements, that an investment in Dollar Time would enable him to recover at least some of these losses and was persuaded by Rosato's positive price prediction to purchase Dollar Time stock. (Tr. 53-54, 56-57.)

On January 19, 1995, RD's IDM Environmental warrants were sold yielding net proceeds of $20,302.50, and 44,000 shares of Dollar Time stock were purchased, at a price of .57812 per share, for a total cost of $25,447.28. (CX. 134.)[17] This exceeded RD's authorized purchase by $5,144.78 (representing approximately 8,899 shares of Dollar Time). (Tr. 50, 66.) The monthly statement for RD's account shows that, at the time of the purchase of Dollar Time stock, the account had a cash balance of approximately $4,750. The cash in the account and proceeds from a contemporaneous, January 19 sale of RD's Select Media Communication, Inc. ("Select Media") warrants[18] were used to fund the purchase of the additional Dollar Time shares.[19] (CX 134.) When RD learned about the "overbuy" of Dollar Time stock, he immediately complained to Stratton. (Tr. 50-51; CX 132.) Two months later, in March 1995, the transaction was

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[16] According to Rosato, one or two days before he recommended the stock to RD, a Stratton board meeting was held, during which the Firm's President and a member of the corporate finance department discussed Dollar Time and indicated "it was going to be a focused stock of Stratton's and that the firm was committed to the company as its investment banker." (Tr. 255-57.)

[17] The account statements in the record show the settlement dates of transactions and, at that time, trades settled five business days after the trade date. (Tr. 282-83.)

[18] RD testified that he did not authorize the sale of the Select Media warrants (Tr. 68), and Rosato confirmed that he never received an order from RD to sell the Select Media warrants to fund the purchase of Dollar Time stock. (Tr. 250.)

corrected and RD's position in Dollar Time was reduced to 35,100 shares, reflecting an investment of $20,302.19 – the approximate amount of the proceeds from the sale of IDM Environmental warrants. (RX 2, p. 3; see also Tr. 51-52.) RD did not incur any loss as a result of the "overbuy" of the stock (Stip. ¶ 3.f) but, as of April 28, 1995, the value of his Dollar Time holdings declined to $4,387.50, representing a loss of $15,914.69. (RX 2, p. 4.) According to RD, he ultimately lost approximately $20,000 on the investment. (Tr. 61.)

Rosato testified that, after receiving RD's order to purchase Dollar Time stock, he immediately orally related the order, consistent with RD's instructions, to the broker of record, and had no further involvement in, and received no compensation from, either the purchase of Dollar Time shares or the sale of RD's IDM Environmental warrants (or the sale of his Select Media warrants). (Tr. 247-48, 252, 254.) He further testified that he did not prepare the order ticket for the purchase of Dollar Time stock (see RX 1) and never even saw the order ticket prior to the hearing. (Tr. 248-49, 301.)[20] He admitted, however, that he did not take any steps to ensure that the order was executed in accordance with RD's instructions. (Tr. 302-03.)[21]

III. Unauthorized Trading in NO's and MB's Stratton Accounts

A. Customer NO

During all times relevant, NO maintained an account, Account No. 59420037, at Stratton that was serviced by Rosato. (Stip. ¶ 5.a; CX 138, 140.) On April 25, 1995 (trade date), Rosato effected the sale of 5,000 shares of The Care Group, Inc. ("Care Group") and the purchase of 2,500 shares of DualStar Technologies Corp. ("DualStar") in NO's Stratton account. (Stip. ¶ 5.c;

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[19] RD's Select Media warrants were sold yielding net proceeds of $858. After the Dollar Time stock purchase, RD had a cash balance of approximately $470 in his account. (CX 134.)

[20] Rosato also testified that he did not prepare or see an order ticket to sell RD's Select Media warrants, and never received any compensation from this sale. (Tr. 250-51, 254.)

[21] Enforcement introduced no countervailing evidence to establish that Rosato had any greater involvement in the "overbuy" of Dollar Time shares than that to which he testified. Nor did it offer any evidence that Rosato received any compensation from the transactions at issue.

CX 140.) NO first learned about these transactions, in the middle of May 1995, when he returned from vacation and reviewed the confirmation slips that had been sent to him in his absence. (Tr. 33, 35, 38; CX 139.) Shortly thereafter, on or about May 22, 1995, he complained to Rosato about the unauthorized sale of Care Group stock and purchase of DualStar stock in his account. (Tr. 35; CX 138-139.) According to NO, Rosato seemed surprised about the trades and told him that they were a mistake and would be corrected. (Tr. 35-36, 38.) During a subsequent telephone call NO placed to Stratton, he was advised that Rosato no longer was employed there, and thereafter pursued the matter of the unauthorized transactions with a member of the Firm's Compliance Department. (Tr. 35-37, 39; CX 138-139.) Ultimately, well after Rosato left the Firm[22] and after the Securities Investor Protection Corporation (SIPC) began its liquidation of Stratton, NO was compensated by SIPC for the loss he incurred as a result of the subject unauthorized trades. (Tr. 41.)

Rosato admitted that he did not recall having any conversations with NO about the sale of Care Group stock or the purchase of DualStar stock before these trades were effected, and that NO had not authorized these transactions. (Tr. 227-28, 231.) Rosato claimed, however, that the trades were simply a "mistake" or an "error" (Tr. 228-29), and immediately after NO complained about the trades, he attempted to correct the "error" by instructing his assistant to submit the appropriate correction form to the Firm's Operations Department. (Tr. 230-31.) After leaving Stratton, Rosato received no further communication from either NO or the Firm about the unauthorized transactions in NO's account and made no efforts to confirm that they had been corrected. (Tr. 231.)[23]

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[22] Rosato testified that he left Stratton on or about May 22, 1995. (Tr. 230.)

[23] Enforcement also adduced testimony from NO and introduced documentary evidence suggesting that Rosato effected other unauthorized transactions in NO's Stratton account, including the initial purchase of Care Group shares. (Tr. 31-32; CX. 138.) However, because the Complaint does not allege that these other trades were unauthorized, the Hearing Panel has declined to make any findings regarding them.

B. Customer MB

During all times relevant, MB maintained an account, Account No. 15976645, at Stratton that was serviced by Rosato. (Stip. ¶ 7.a; Tr. 117; CX 144, 146.) On April 25, 1995 (trade date) Rosato effected the purchase of 2,000 shares of DualStar stock in MB's Stratton account. (Stip. ¶ 7.b; CX 146.) MB testified that he never authorized Rosato to purchase DualStar (Tr. 118-19) and indicated, in a written statement he submitted to NASDR, that he first learned about the purchase, on or about May 1, 1995, when he received and reviewed a confirmation slip or monthly account statement reflecting the trade. (CX 144; see also Tr. 119.) Shortly thereafter, MB complained to Rosato about the unauthorized purchase of DualStar stock in his account, and Rosato told him that the trade was an error and would be canceled. (Stip. ¶ 7.c; Tr. 119, 125-26; CX 144.) MB had two subsequent conversations with Rosato about canceling the trade and each time Rosato informed him that he would be receiving a confirmation reflecting the cancellation of the trade (Tr. 235-37); however, the purchase of DualStar was not canceled by the time Rosato left Stratton in the third week of May. (Tr. 122; see also CX 146, p. 2.) By letter, dated May 31, 1995, MB advised Stratton's Compliance Department about the unauthorized purchase of DualStar. (Tr. 122; CX 145.) Ultimately, in June 1995, MB sold the 2,000 shares of DualStar for a loss of $4,086 (Stip. ¶ 7.e.; CX 146), and Stratton compensated him for 50% of his loss. (Tr. 124, 128-29; see also Stip. ¶ 2.b.)

Rosato admitted that MB had not authorized the April 25 purchase of DualStar, but claimed, as he had during his initial conversation with MB, that the trade was an "error" or a "mistake." (Tr. 232-34.) According to Rosato, after his initial conversation with MB about the unauthorized DualStar purchase, he immediately instructed his assistant to submit the necessary form to correct the transaction. (Tr. 234-35.) He also testified that, after each of the two subsequent conversations he had with MB, during which MB complained about the failure to

cancel the trade, he instructed his assistant to resubmit the transaction correction form. (Tr. 235-37.) However, Rosato admitted that he did not personally take any steps to ensure that the unauthorized purchase of DualStar in MB's account was corrected (Tr. 236), and was not even certain that his assistant actually prepared and submitted any of the three correction forms. (Tr. 235-37.)

C. Credibility Findings

The Hearing Panel discredits Rosato's testimony that the trades at issue were somehow erroneously posted to NO's and MB's accounts. First, his testimony is implausible given that he has not denied completing the order tickets; to the contrary, he has admitted that he was responsible for effecting these trades. (Stip. ¶¶ 5.c, 7.b.) Further, he proffered no explanation as to how or why purchases of DualStar – on the same day – were mistakenly executed in these two customers' accounts. Rosato's testimony that he attempted to correct the so-called errors also is suspect and seemingly at odds with his prior investigative testimony. When then questioned about customer complaints of unauthorized trading, in addition to denying that he effected any unauthorized trades while at Stratton, Rosato testified that all such complaints were resolved through discussions with the customers "in an attempt to have them recall the specific circumstances" pertaining to the challenged transactions. (CX 131, pp. 14-15.) Noticeably absent from Rosato's investigative testimony is any suggestion that he ever attempted to reverse, cancel, or otherwise correct a trade challenged by a customer. Finally, the Hearing Panel observes that Rosato did not seek to offer the testimony of his former assistant or anyone who had been employed in Stratton's Operations Department to corroborate that he had, in fact, attempted to cancel the unauthorized trades in NO's and MB's accounts.

IV. Falsification of Account Documentation for EW's IRA and Suitability Violations

EW was, during all times relevant, and presently is, self-employed as the President of Kingston Window Cleaning, a commercial janitorial service located in Kingston, New York. (Tr. 141-42; CX 150; RX 7.) In October 1993, approximately six months before EW opened an individual retirement account at Stratton, EW and his mother opened a joint account at the Firm, Account No. 864-39282 (the "Joint Account"). (Tr. 166, 169; RX 10, p. 23.) In November 1993, Rosato became the registered representative for the Joint Account. (RX 10, p. 25.) Although EW initially testified that this account was relatively inactive, including only one $7,000 purchase of Toys R Us stock (Tr. 138), the relevant account statements (RX 10, pp. 23-51) show that speculative securities involving a high degree of risk (including one or more initial public offerings underwritten by Stratton) routinely were purchased in the Joint Account.[24] (Stip. ¶ 10; CX 1S, 4S-6S, 9S-10S.) And, despite claiming that he never read any of the prospectuses for these issues, including the block print risk disclosures (Tr. 179-80, 195), EW did acknowledge that, at least some of the issues he purchased in the Joint Account, involved a high degree of risk. (Tr. 172, 178.)

In March 1994, EW, who was then 47 years old, opened an individual retirement account at Stratton, Account No. 953030 (the "IRA"). During all times relevant, Rosato serviced EW's IRA. (Tr. 139; CX 150.) The IRA was funded by a transfer of securities and cash from an individual retirement account that EW previously maintained at Shearson. (Tr. 139.)

The new account form for the Stratton IRA shows that EW had annual income of $100,000, a net worth of $1 million, and indicates EW's investment objectives as including

[24] EW initially testified that he held only one account, the Joint Account, at Stratton before he opened the IRA. However, on cross-examination, he claimed that he held two accounts, the Joint Account and an account in his own name. (Cf. Tr. 138-39 with Tr. 165-67.) When confronted with the account statements for the Joint Account, EW seemed to suggest that his prior testimony about the lack of his prior stock trading activities related to the individual

growth companies, speculative activity, and safety of principle. (CX 150.) EW testified, however, that the information on the new account form relating to his financial condition and investment objectives was inaccurate and inconsistent with the information he believed he related to Rosato. (Tr. 145-46.) According to EW, when he opened the IRA, he spoke to Rosato (as opposed to his assistant) and advised him that he had annual income of $50,000, a net worth of approximately $300,000, and that he was interested in "some growth and some safety of principle." (Tr. 139-41, 183.) EW also testified that, at that time, he advised Rosato that he was self-employed and owned his own company. (Tr. 141.)

There is no dispute that Rosato initiated the investment ideas for EW's Stratton IRA. (Tr. 157.) During the first month the IRA was open, Rosato sold six of the eight securities that had been transferred from Shearson and purchased shares of Octagon, Inc. ("Octagon") and IDM Environmental (CX 151, p. 2), both admittedly speculative issues (Stip. ¶ 10) that had been underwritten by Stratton. (See CX 5S, 9S.)[25] The subsequent purchases in EW's IRA, namely DualStar, Select Media, United Leisure Corp., and Care Group, three of which were underwritten by Stratton (see CX 4S, 10S, 13S), also were speculative issues. (Stip. ¶ 10.) Throughout the existence of the account, there was limited, if any, diversification and, at any given time, the equity in the account was highly concentrated in one speculative security. For example, in April 1994, the investment in Octagon represented approximately 80% of the total portfolio value (cash plus priced securities) of the account, and the investment in IDM Environmental

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account, not the Joint Account. (Tr. 165-67.) At best, EW was confused; at worst, he intentionally was attempting to mislead the Hearing Panel about his prior stock trading activities at Stratton.

[25] EW also testified that, with the exception of the initial purchase of Octagon stock in the IRA, he typically learned of trades in the IRA after they were executed. (Tr. 148-51.) Rosato did not claim that EW initiated any specific investment ideas for the IRA, but contradicted EW's testimony concerning the extent to which he and EW discussed trades in the IRA before they were effected. Among other things Rosato testified that he and EW discussed the sale of the stock that had been transferred from Shearson, as well as the initial purchases of both Octagon and IDM Environmental. (Tr. 272-73, 275-78.). Insofar as EW suggests that trades in the IRA were unauthorized, because the Complaint does not set forth such allegations, the Hearing Panel need not resolve the conflict in testimony and has not made not made any findings in this regard.

represented approximately 86% of the account's total portfolio value. (CX 151, p. 2.) As of the months ending April 1994 through March 1995 (exclusive of February 1995),[26] the total portfolio value of the IRA ranged from $46,968.58 to $34,843.44, with 80% to 99% of the portfolio concentrated in one of the speculative securities that Rosato had purchased for the account. (CX 151.)

According to EW, after he noticed a substantial decline in his account between May and June 1994, and periodically thereafter, he complained to Rosato generally about the performance in the account, but still trusted Rosato to manage the account. (Tr. 151-52, 194.) In April 1995, EW closed his Stratton IRA. (Tr. 156.)[27] In or about 1996, after learning that Stratton was involved in "questionable" business practices, EW decided to closely review the performance in the IRA and contacted the NASD. (Tr. 156-58.) Although EW testified that he was troubled about the lack of "diversification of risk" in the account, he acknowledged that he never raised that issue with Rosato while the IRA was open. (Tr. 191-92, 199.)

Rosato's testimony about the circumstances pertaining to the opening of EW's IRA, including his discussion with EW concerning his investment objectives, differed from EW's. According to Rosato, when he and EW first discussed opening an IRA at Stratton, they "talked about trading that account in the same exact fashion as his joint account" (Tr. 268) and, in Rosato's view, there was no question that EW was interested in short-term trading and growth in the Joint Account. (Tr. 262.) Rosato further testified that, consistent with his practice in opening new accounts for existing clients, after EW advised him that he wanted to open an IRA at Stratton, Rosato transferred the call to his assistant, who completed a "New Account Information" worksheet. (Tr. 264-66.) The "New Account Information" worksheet for EW's

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[26] There is no account statement in the record for the month ending February 1995.

IRA shows, in addition to personal background information, that EW had annual income of approximately $100,000, a net worth of approximately $1,000,000 (exclusive of residence), and includes as investment objectives growth and speculation. (RX 7.) Pursuant to Stratton's standard procedures, after a "New Account Information" worksheet was completed, the information was typed on a new account form that was sent to the customer for his signature. (Tr. 266-67.) The customer would return a signed new account form to Stratton's Operations Department, and the broker of record would not receive a copy of the form. (Stip. ¶ 2.a.ii.) Rosato testified that he did receive a holding page for EW's account, which reflected the financial information included on the new account form as well as EW's investment objectives. He could not recall, however, whether safety of principle was included as an investment objective on the holding page. (Tr. 269-70.)

Apart from the fact that Rosato did not actually prepare the new account form, the Hearing Panel concludes that EW – not Rosato – was responsible for the erroneous information, if any, on the form.[28] When EW received the new account form from Stratton, he made several handwritten changes, including adding safety of principle (but deleting income) as an investment objective, checking the appropriate box to grant Rosato "limited discretion," and providing the name of his wife and her employer. (Tr. 145-46; CX 150.)[29] While EW thus carefully reviewed the form, making additions and deletions, he nonetheless did not change the information regarding his annual income and net worth, or delete speculative activity as an investment

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[27] EW testified that, during the thirteen months the account was open, its value declined approximately $13,000. (Tr. 155-56.)

[28] Nor does the Hearing Panel credit EW's testimony that, when he opened the IRA, he told Rosato about his financial condition (i.e., that he had an annual income of $50,000 and a net worth of $300,000), his investment objectives (i.e., that he was interested in some growth and safety of principle), and provided personal background information. When cross-examined, EW's recollection of this conversation was uncertain. Further, his testimony about the conversation, as a whole, is less than plausible. It is unlikely that EW would have discussed his personal background with Rosato when EW had a pre-existing (five month) account relationship with him.

[29] EW testified that he made all the handwritten additions and deletions on the new account form. (Tr. 145; see CX 150.)

objective. (Tr. 185-86; See CX 150.) Further, EW was unable to offer any credible explanation for choosing to make some changes, but not others. In this regard, EW testified that, at that time, he simply did not think information pertaining to his annual income or net worth was "consequential." (Tr. 147.)

Moreover, the circumstances attendant to the opening of the IRA cast doubt on EW's subsequent representations concerning his investment objectives. EW decided to transfer his IRA from Shearson to Stratton because the Joint Account at Stratton had outperformed his Shearson account and he was impressed with the returns that Rosato had obtained. (Tr. 181.) Moreover, EW acknowledged that he expected Rosato to manage the IRA in the same manner as he handled the Joint Account, and that he was interested in receiving the same level of returns in his IRA as he had received in the Joint Account. As to the latter, EW testified that the "greed factor . . . set in." (Tr. 181.) And, although EW complained, at the hearing, about the lack of diversification and concentrations in speculative securities in his Stratton IRA (Tr. 190-91), in fact, EW was concerned only with the profitability or lack of profitability of a given transaction. For example, when asked about his failure to complain to Rosato about a November 1994 purchase of the securities of United Leisure Corp. (a speculative issue underwritten by Stratton) – which represented approximately 94% of the total portfolio value of the account at month end – EW stated: "[t]here's no problems in profits. There's problems in losses." (Tr. 195.) Finally, despite EW's testimony that he viewed any investment in the stock market as speculative (Tr. 164, 186), the Hearing Panel finds that he understood the risks involved in trading speculative issues and was willing to assume those risks in his Stratton IRA. (Tr. 197-98.)

Legal Discussion and Conclusions

I. The Baseless and Improper Price Prediction and Promise to Recover Losses

A. Violations of Section 10(b), SEC Rule 10b-5, and NASD Conduct Rule 2120

Section 10(b) makes it "unlawful for any person . . . to use or employ, in connection with the purchase or sale of any security . . . any manipulative deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe as necessary or appropriate in the public interest or for the protection of investors."[30] Pursuant to its rule-making authority under this section, the SEC promulgated Rule 10b-5, which makes it unlawful for "any person, directly or indirectly, by use of any means or instruments of transportation or communication in interstate commerce, or of the mails, or any facility of any national securities exchange

> (a) to employ any device, scheme, or artifice to defraud;
>
> (b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or
>
> (c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security."[31]

To establish a violation of Section 10(b) and SEC Rule 10b-5, in addition to the jurisdictional interstate commerce prerequisite, Enforcement must prove, by a preponderance of the evidence, that: (1) the respondent made an untrue statement of fact or omitted to state a material fact (where there is a duty to speak); (2) the statement or omission was made in

[30] 15 U.S.C. § 78j(b).

[31] 17 C.F.R. § 240.10b-5.

connection with the purchase or sale of a security; (3) the statement or omission was material;[32] and (4) the respondent acted with the requisite degree of scienter.[33] NASD Conduct Rule 2120[34] is the equivalent of SEC Rule 10b-5,[35] absent the jurisdictional element.

In this case, because Rosato communicated with RD through telephone calls and confirmations and monthly account statements that were sent through the mails, the jurisdictional predicate of SEC Rule 10b-5 is satisfied.

Generally, predictions of specific and substantial increases in the price of a speculative security within a relatively short period of time are fraudulent within the meaning of Section 10(b) and Rule 10b-5. See, e.g., In re Donald A. Roche, Exchange Act Release No. 38742, 64 S.E.C. Docket 2042, 1997 SEC LEXIS 1283, at * 6 (June 17, 1997).[36] Such statements are considered per se fraudulent because, in a free market, it is impossible to predict with any measure of confidence the timing and amount by which a speculative security will increase in price. Thus, when a respondent makes such a price prediction in connection with the purchase or sale of a speculative security, no further proof of scienter is required. Predictions of specific and substantial increases in the price of non-speculative securities that are made without a reasonable

[32] A fact is considered material within the meaning of Section 10(b) and Rule 10b-5 if there is a substantial likelihood that the information in question "'would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available.'" Basic, Inc. v. Levinson, 485 U.S. 224, 231-32 (1988) (quoting TSC Industries, Inc. v. Northway, 426 U.S. 438, 449 (1976)).

[33] The Supreme Court has defined scienter as "a mental state embracing intent to deceive, manipulate or defraud." Ernst & Ernst v. Hochfelder, 425 U.S. 185, 194 n.12 (1976).

[34] NASD Conduct Rule 2120 provides that "[n]o member shall effect any transaction in, or induce the purchase or sale of, any security by means of any manipulative, deceptive or other fraudulent device or contrivance."

[35] See, e.g., DBCC No. 2 v. Coastline Financial, Inc., Complaint No. C02950059, 1997 NASD Discip. LEXIS 9, at * 15 (NBCC March 5, 1997).

[36] See also, e.g., In re Alfred Miller, 43 S.E.C. 233, 235 (1966) ("predictions of substantial price increases within relatively short periods of time with respect to a promotional and speculative security of an unseasoned company are a 'hallmark' of fraud and cannot be justified").

basis are likewise fraudulent. Donald A. Roche, 1997 SEC LEXIS 1283, at * 6.[37] Irrespective of whether the prediction is made with respect to a speculative or non-speculative security, materiality is presumed: it is obvious that any prediction of a substantial increase in the price of a security would affect a reasonable investor's decision to buy, hold, or sell a security.

Dollar Time was a risky and speculative investment. Nonetheless, in recommending Dollar Time to RD, Rosato predicted that the stock would increase by 44% to 88% over a three to four week period. Even if Dollar Time was less speculative, the record indicates that Rosato did not have a reasonable basis to support this prediction: it was based solely on the fact that Stratton had become a market maker in the stock and an increase in trading volume over the previous two to three days. Rosato did not, however, explain why these factors alone would necessarily portend an increase in price – either in the short-term or long-term. Further, it is evident that he performed no research or analysis of the fundamentals of the Company. Had he done so, he would have learned that Dollar Time's financial condition was, at best, unstable and that the Company questioned its ability to continue as a going concern. Rosato acted recklessly, at a minimum, when he made an unsubstantiated and unreasonable price prediction of a rapid and substantial increase in Dollar Time's stock.[38] Indeed, Dollar Time shares declined substantially after RD purchased the stock: within three months, the value of RD's Dollar Time investment dropped approximately 78%.

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[37] See also, e.g., SEC v. R.A. Holman & Co., 366 F.2d 456, 458 (2d Cir. 1966); SEC v. Wellshire Securities, Inc., 737 F. Supp. 251, 256 (S.D.N.Y. 1990); SEC v. Rega, [1975-76 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,222, at p. 98,148 (S.D.N.Y. 1975) (citing Berko v. SEC, 316 F.2d 137, 143 (2d Cir. 1963)); In re Lester Kuznetz, 48 S.E.C. 551, 553 (1986). Enforcement alleged both that the price prediction at issue was per se fraudulent and that Respondent had no reasonable basis for making it. It did not, however, allege that Respondent had no reasonable basis for recommending Dollar Time to RD and, consequently, the Hearing Panel will not address this related concept.

[38] Recklessness is sufficient to satisfy the scienter requirement. See, e.g., Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1568-69 (9th Cir. 1990), cert. denied, 499 U.S. 976 (1991). Recklessness has been defined as conduct "involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it." Id., at 1569 (quoting Sundstrand Corp. v. Sun Chem. Corp., 553 F.2d 1033, 1045 (7th Cir.), cert. denied, 434 U.S. 875 (1977)).

Despite Respondent's arguments to the contrary,[39] it is immaterial that he expressed his Dollar Time price prediction as a matter of opinion: "[t]he fraud is not ameliorated where the positive prediction about the future performance of securities is cast as opinion or possibility rather than as a guarantee." SEC v. Hasho, 784 F. Supp. 1059, 1109 (S.D.N.Y. 1992). See also, e.g., In re Richard J. Puccio, Admin. Proc. File No. 3-8438, 1995 SEC LEXIS 1724, at * 20 (July 10, 1995), aff'd, Exchange Act Release No. 37849, 1996 SEC LEXIS 2897 (Oct. 22, 1996). Nor is it relevant to a finding of fraud that Rosato expressed the price prediction as a range rather than a precise amount. Alfred Miller, 43 S.E.C. at 235 (finding predictions of stock increases ranging from 50 cents to 80 cents and $1.00 or $1.50 by year-end were fraudulent). See also SEC v. Hasho, 784 F. Supp. at 1107-09.

Rosato, immediately prior to predicting a 44% to 88% increase in the price of Dollar Time, represented that Stratton "had the ability to recover losses faster than any other firm." A "representation that an investment will recoup losses from previous investments is a price or profit prediction," SEC v. Hasho, 784 F. Supp. at 1109, and therefore fraudulent. Rosato argues, however, that his statement about Stratton's ability to recover losses was mere puffery and not actionable.[40] The Hearing Panel, viewing this statement in context, disagrees and considers it an egregious misrepresentation. Rosato made the statement at a time when RD was agitated about

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[39] See Pre-Hearing Submission of Respondent Robert J. Rosato, pp. 4-6. Respondent's reliance on Marchese v. Nelson, 809 F. Supp. 880, 888 (D. Utah 1993), Shamsi v. Dean Witter Reynolds, Inc., 743 F. Supp. 87, 91 (D. Mass. 1989), and Rotstein v. Reynolds, 359 F. Supp. 109, 113 (N.D. Ill. 1973) is misplaced. In contrast to the statement at issue here, these cases involved general optimistic "sales talk" about the future profitability of the stock market or a particular stock. In fact, in Shamsi, while the court found certain statements to be non-actionable (e.g., a broker's assurances that the customer could trust him and the firm to select low risk stocks that would increase in value), it also held that the inclusion of a percentage increase "takes the prediction out of the realm of mere puffery, and into that of an actionable misrepresentation." 743 F. Supp. at 92.

[40] See Pre-Hearing Submission of Respondent Robert J. Rosato, pp. 4-5. Respondent cites Metzner v. D.H. Blair & Co., 689 F. Supp. 262, 264 (S.D.N.Y. 1988) in support of his argument that this statement is not an actionable misrepresentation. This case is simply inapplicable. The broker's statement (i.e., that losses sustained as a result of another broker's incompetence and dishonesty would be recouped) was not made in the context of a recommendation that the customer engage in new trading.

the substantial losses in his Stratton account, some of which apparently were attributable to another broker's failure to honor RD's instructions to sell his IDM Environmental warrants. Rosato made the statement as a predicate for and in connection with his recommendation that RD purchase Dollar Time, but conceded it was irrelevant to Dollar Time, which was not an initial public offering. Moreover, Rosato's assurance that Stratton would be able to recover RD's losses was not isolated, but coupled with his price prediction concerning the performance of Dollar Time stock. Far from innocent hyperbole, Rosato's representation about Stratton's purported track record in recovering losses was designed to – and did – enhance the perceived reliability of Rosato's price prediction concerning Dollar Time stock and fraudulently induced RD to purchase Dollar Time shares as a means to recover losses from his IDM Environmental securities holdings.[41]

Based on the foregoing, the Hearing Panel concludes that Rosato violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and NASD Conduct Rule 2120 by making a baseless and improper price prediction and an improper promise to recover losses to RD, as alleged in the Complaint.

B. Rosato's Violations of NASD Conduct Rule 2110

NASD Conduct Rule 2110 requires that "[a] member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade."[42] The Rule "articulates a broad 'elastic' standard [and] . . . appropriately encompasses the myriad types of misconduct that may injure public investors and the marketplace." In re Protective Group

[41] Misrepresentations regarding a firm's research capabilities or a broker's skill and expertise also have been held to violate the antifraud provisions of the federal securities laws. See, e.g., Marbury Management, Inc. v. Kohn, 629 F.2d 705, 707 (2d Cir. 1980); Richard J. Puccio, 1995 SEC LEXIS 1724, at * 18-19. The statement made by Rosato about Stratton's ability to recover losses also implicates misrepresentations of this nature.

[42] Rule 2110 is applicable to associated persons pursuant to Rule 0115(a), which states that "[t]hese Rules shall apply to all members and persons associated with a member. Persons associated with a member shall have the same duties and obligations as a member under these Rules."

Securities Corp., Exchange Act Release No. 34547, 57 S.E.C. Docket 1080, 1994 SEC LEXIS 2516, at * 21 (Aug. 18, 1994) (footnote omitted). It is axiomatic that conduct violative of Rule 10b-5 and Conduct Rule 2120 supports a violation of Conduct Rule 2110.[43] Having found that Rosato made a baseless and improper price prediction and an improper promise to recover losses, in violation of Section 10(b) of the Exchange Act and Rule 10b-5, and NASD Conduct Rule 2120, the Hearing Panel also finds that Rosato violated NASD Conduct Rule 2110.

II. Unauthorized Trading

Unauthorized trading, absent "deception, misrepresentation or nondisclosure" does not violate SEC Rule 10b-5, Pross v. Baird Patrick & Co., 585 F. Supp. 1456, 1459 (S.D.N.Y. 1984), or its counterpart, NASD Conduct Rule 2120. District Business Conduct Committee No. 2 v. Granath, Complaint No. C02970007, 1998 NASD Discip. LEXIS 19, at * 10-11 (NAC March 6, 1998). However, irrespective of deception or intent, a registered representative who effects unauthorized transactions in a customer's account violates the obligation to observe just and equitable principles of trade required by Conduct Rule 2110. See, e.g., In re Keith L. DeSanto, Exchange Act Release No. 35860, 1995 SEC LEXIS 1500 (June 19, 1995), aff'd, 101 F.3d 108 (2d Cir. 1996) (table).

In this case, Respondent admitted that he effected unauthorized transactions in the accounts of NO and MB. For the reasons discussed above, the Hearing Panel does not find Respondent's explanation that these trades were errors or mistakes sufficiently credible to defeat a finding that he violated Conduct Rule 2110. On the other hand, there is no evidence establishing that Rosato acted with the requisite degree of scienter to sustain a finding that he violated the antifraud provisions of the federal securities laws or NASD Conduct Rule 2120, by effecting unauthorized purchases of DualStar in NO's and MB's accounts. The record does not

[43] See generally District Business Conduct Committee No. 9 v. Euripides, Complaint No. C9B950014, 1997 NASD Discip. LEXIS 45, at *16-23 (July 28, 1997); Market Regulation Committee v. Kevin Eric Shaughnessy, Complaint

suggest that his conduct was part of a broader fraudulent or deceptive scheme;[44] that Rosato effected the trades notwithstanding these customers' previous refusals to purchase DualStar; or that he attempted to persuade them to ratify the transactions through deception, misrepresentation, or nondisclosure.[45] To the contrary, when NO and MB confronted Rosato about the unauthorized trades, he promptly acknowledged that the trades should be reversed or canceled. Under these circumstances, the Hearing Panel cannot conclude that Rosato's unauthorized trading activity in NO's and MB's accounts constitutes a violation of Section 10(b) of the Exchange Act, SEC Rule 10b-5, and Conduct Rule 2120.

With respect to the "overbuy" of Dollar Time shares in RD's account, there is no dispute that RD only authorized Rosato to purchase shares of Dollar Time in an amount that could be covered by the proceeds from the sale of his IDM Environmental warrants. The evidence in the record also demonstrates that Rosato properly communicated RD's instructions to the broker of record for RD's account and did not prepare the order ticket for RD's Dollar Time stock purchase (or the tickets for the contemporaneous sale of IDM Environmental and Select Media warrants from his account). Nonetheless, the Hearing Panel concludes that Rosato, as the registered representative who received RD's order, had an obligation and responsibility to the

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No. CMS950087, 1997 NASD Discip. LEXIS 46, at *24-27 (NBCC June 5, 1997).

[44] See, e.g., District Business Conduct Committee No. 2 v. Granath, 1998 NASD Discip. LEXIS 19, at * 11-12 (finding that respondent engaged in unauthorized trading, in violation of Rule 2120, by liquidating stock positions in nine inactive or abandoned accounts and purchasing equal amounts of other stocks, without attempting to locate the account holders); District Business Conduct Committee No. 3 v. Marcum, Complaint No. DEN-1000, 1991 NASD Discip. LEXIS 52 (May 13, 1991) (finding that respondent violated Article III, Section 18 of the Rules of Fair Practice (current Rule 2120), by engaging in a fraudulent scheme whereby he effected a series of unauthorized transactions in a customer's account and then attempted to conceal his conduct, by sending false account information to the customer and providing the firm with an inaccurate address for the customer to ensure that the customer did not receive account statements generated by the firm).

[45] See SEC v. Hasho, 784 F. Supp. at 1110 (finding that defendants violated Rule 10b-5 by engaging in a pattern of unauthorized trading in customers' accounts that was preceded by the customers' refusals to purchase and followed by attempts to induce customer ratification through misrepresentations regarding, among other things, the future price of the securities).

customer to ensure that the trades were effected in accordance with his instructions. By failing to do so, Rosato violated the broad ethical principles set forth in Conduct Rule 2110.

III. The Account Documentation Falsification Charges and Alleged Suitability Violations

The Hearing Panel concludes, based on a review of the testimony and documentary evidence in the record, that Enforcement has failed to prove, by a preponderance of the evidence, that Rosato was responsible for inaccurate information, if any, on the new account form for EW's Stratton IRA. There is no evidence in the record that Rosato prepared the form or ever saw the actual form. Moreover, the evidence demonstrates that EW – not Rosato – was responsible for any misstatements on the form pertaining to his financial condition and investment objectives. Although he made certain changes to the form, he choose not – for whatever reason – to correct the purportedly inaccurate information pertaining to his financial condition and investment objectives. The law does not impose an obligation upon a registered representative to obtain underlying information (e.g., tax returns) from a customer in order to verify and, if necessary, correct the written representations a customer chooses to make when opening a new securities account. Accordingly, the charges that Rosato violated Rules 2110 and 3110 by falsifying information on EW's new account form must be dismissed.[46]

Conduct Rule 2310 provides that "[i]n recommending to a customer, the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs." The Rule obligates a registered representative to make a "customer-specific determination of suitability and to tailor his recommendations to the customer's financial profile and investment objectives." In re F.J. Kaufman & Co. of Virginia, 50 S.E.C. 164, 168 (1989) (footnote omitted).

Thus, even when a customer may affirmatively seek to engage in an aggressive trading strategy, a representative is under a duty to refrain from making recommendations that are incompatible with the customer's financial profile. E.g., In re John M. Reynolds, 50 S.E.C. 805, 808-09 (1992); In re Clyde J. Bruff, 50 S.E.C. 1266, 1269 (1992).

In this case, the weight of the evidence demonstrates that EW was interested in pursuing a relatively aggressive trading strategy in his IRA: he wanted Rosato to manage the account as Rosato had managed the Joint Account and was interested in achieving the same high level of returns in his IRA as had been obtained in the Joint Account. When he opened his Stratton IRA, EW was well aware of the types of securities that had been purchased in the Joint Account; understood the risks involved in trading these types of securities; and was willing to assume those risks in exchange for the opportunity to realize short-term profits. Further, the Hearing Panel believes that EW's failure to question the activity in his account in a timely manner undermines his subsequent claim that the investments in the IRA were unsuitable. See, e.g., DBCC No. 3 v. Gibbs, 1991 NASD Discip. LEXIS 93.

The Hearing Panel, in determining whether the trading strategy was consistent with EW's financial profile, must rely on the written representations on the new account form, because Enforcement failed to prove that Rosato knew, but disregarded, other financial information about EW, in making securities recommendations to him and effecting transactions in his Stratton IRA. The new account form showed that EW had a net worth of $1,000,000; this apparently was intended to reflect his liquid net worth.[47] The Hearing Panel cannot find that any particular concentration in the IRA, which represented a limited portion of EW's liquid net worth – at most approximately four percent – was per se unsuitable. Accordingly, the Hearing Panel dismisses

[46] In addition, as Enforcement noted in its pre-hearing submission, it incorrectly charged falsification of information pertaining to a customer's financial condition as a violation of Rule 3110.

[47] Although the new account form did not distinguish between liquid and illiquid net worth, the "New Account Information" worksheet indicated that EW had a net worth of $1,000,000 (exclusive of residence).

the allegations that Rosato made unsuitable investment recommendations to EW and effected unsuitable transactions in his IRA.

IV. Sanctions

A. Baseless and Improper Price Prediction and Promise to Recover Losses

The applicable NASD Sanction Guideline[48] recommends that, for intentional or reckless misconduct, the adjudicator should consider imposing a suspension of ten days to two years and that, in egregious cases, a bar should be considered. It also suggests the imposition of fines ranging from $10,000 to $100,000. Enforcement has requested that Rosato be suspended for 120 days and fined $10,000 for this misconduct. It also seeks an order requiring Rosato to pay restitution to RD in the amount of $15,914.69, representing his loss on the Dollar Time investment as of April 28, 1995, plus pre-judgment interest.

Although the misrepresentations Rosato made to RD were an isolated incident, and not part of a pattern of misconduct, he had absolutely no reasonable basis for making them and intentionally or recklessly disregarded RD's interests, causing him to sustain additional, substantial losses in his Stratton account. Moreover, Rosato apparently was motivated to deceive RD as part of an effort to dissuade him, at least temporarily, from contacting the SEC about another Stratton broker's misconduct. While Rosato's conduct in this regard did not rise to the level of intimidation, it cannot be countenanced. Further, to date, Rosato has not accepted responsibility for and acknowledged his misconduct, or expressed any remorse for the harm he caused RD. Therefore, the Hearing Panel believes that the suspension and fine sought by Enforcement is not sufficiently remedial. Upon consideration of the attendant facts and

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[48] There is no Sanction Guideline that specifically applies to baseless price predictions or improper promises to recover losses. Because these statements are forms of misrepresentations, the Hearing Panel has applied the guideline applicable to misrepresentations or material omissions of fact. NASD Sanction Guidelines 80 (2d ed. 1998).

circumstances, the Hearing Panel concludes it is appropriate to suspend Rosato for six months and fine him $20,000 for the baseless price prediction and improper promise to recover losses that he made to RD.[49]

With respect to Enforcement's request for restitution, the Hearing Panel notes that restitution is a traditional equitable remedy designed to "restore the status quo where otherwise a . . . victim would unjustly suffer loss." In re David Joseph Dambro, 51 S.E.C. 513, 518 (1993). The NASD Sanction Guidelines generally recognize that, in cases where an identified individual has suffered a quantifiable loss as a result of a respondent's misconduct, it is fitting to order the respondent to pay restitution.[50] The Guidelines also suggest that, when ordering restitution, adjudicators may consider requiring the respondent to pay pre-judgment interest on the base amount, calculated pursuant to 26 U.S.C. § 6621(a)(2), i.e., the interest rate used by the Internal Revenue Service to determine interest due on the underpaid taxes.[51] The Guidelines recommend that pre-judgment interest should be measured from the date of the occurrence of the violative activity that gave rise to the loss.

In this case, it is appropriate to order Rosato to pay restitution and pre-judgment interest to remediate his misconduct. As of April 28, 1995, the value of Dollar Time stock dropped to approximately .125 per share and RD sustained a loss of $15,914.69. RD also testified that he ultimately lost approximately $20,000 – essentially his entire investment – on the Dollar Time

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[49] In imposing sanctions for this as well as Rosato's unauthorized trading activities, the Hearing Panel has not considered his prior disciplinary record. The three-page extract from Respondent's CRD record that Enforcement introduced is, at best, vague in describing Rosato's complicity in violating the Alabama Securities Commission's suspension order, and Enforcement did not introduce a copy of the Order to Show Cause or any related underlying documents, which would have been necessary to develop the record. Nor has the Hearing Panel considered the disclosures on Stratton's Form U-5. Putting aside Rosato's testimony denying that he had been discharged for excessive trading, the disclosures on the Form U-5 are no more than unproved allegations and, therefore, may not be considered in assessing sanctions.

[50] NASD Sanction Guidelines 6 (1998 ed.).

[51] Id., at 12. The Internal Revenue Service rate, which is adjusted each quarter, reflects market conditions, and thus approximates the time value of money for each quarter in which the customer lost the use of his funds.

transaction. Although it is unclear from the record whether RD's losses were realized or unrealized, Respondent did not suggest that Dollar Time shares have any present residual value or that there is any market for the stock. As a practical matter, whether RD's losses technically were realized or unrealized is therefore irrelevant. In addition, the Hearing Panel notes that Respondent did not claim or present any evidence to demonstrate that the price of Dollar Time shares rebounded after the end of April 1995; nor did he challenge RD's testimony concerning the approximate amount of the loss he sustained from his investment in Dollar Time.

Enforcement has requested restitution in the amount of $15,914.69, apparently because the amount of RD's total losses are not precisely quantifiable. The Hearing Panel agrees that, in order to avoid a potential windfall to the customer, it is appropriate to calculate restitution in an amount that can easily be verified. Accordingly, in addition to the suspension and fines set forth above, Rosato is ordered to pay restitution to RD in the amount of $15,914.69 plus pre-judgment interest, calculated pursuant to 26 U.S.C. § 6621(a)(2), which shall run from the date of RD's purchase of Dollar Time stock, i.e., January 19, 1995, to the date of this decision.

B. Unauthorized Trading

The Sanction Guideline for unauthorized trading recommends that, in cases involving customer losses, the adjudicators should consider suspending an individual respondent for ten to 30 days, and that, in egregious cases, a longer suspension of up to two years or a bar should be considered.[52] It also suggests the imposition of a fine ranging from $5,000 to $75,000. Enforcement has requested that Rosato be barred and fined $25,000 for the unauthorized trades he effected or otherwise caused in the accounts of NO, MB, and RD. It also seeks an order requiring Rosato to pay restitution to MB in the amount of $2,043, representing the amount of the uncompensated loss he sustained as a result of Rosato's unauthorized purchase of DualStar, plus pre-judgment interest.

The Hearing Panel declines to impose sanctions of the magnitude Enforcement has requested and believes that, under the facts and circumstances attendant to the unauthorized trades, such sanctions would be oppressive. As discussed above, there is no evidence that Rosato's unauthorized trading activity was intentional, part of a fraudulent scheme, or otherwise accompanied by deceptive misconduct. While the Hearing Panel believes that Rosato should have taken more responsibility for ensuring that the trades in NO's and MB's accounts were corrected, the evidence does not demonstrate that his conduct was egregious. Accordingly, the Hearing Panel concludes that sanctions toward the low end of the range are sufficiently remedial to redress Rosato's unauthorized trading activities and, for this misconduct, imposes a 60-day suspension and a fine of $10,000.

For the reasons set forth above, the Hearing Panel does, however, agree that it is appropriate to order Rosato to pay restitution to MB for the loss he incurred as a result of Rosato's unauthorized purchase of DualStar in MB's Stratton account. MB's uncontroverted testimony establishes that Stratton paid him partial compensation and thereby reduced his loss to $2,043. Accordingly, in addition to the suspension and fines set forth above, Rosato is ordered to pay restitution to MB in the amount of $2,043 plus pre-judgment interest, calculated pursuant to 26 U.S.C. § 6621(a)(2), which shall run from the date of the purchase, i.e., April 25, 1995, to the date of this decision.

V. Conclusion and Order

Having considered all the evidence submitted by Enforcement, the Hearing Panel finds that Rosato violated Section 10(b) of the Exchange Act, SEC Rule 10b-5, and NASD Conduct Rules 2120 and 2110 by making a baseless and improper price prediction and an improper promise to recover losses to RD, and violated Rule 2110 by effecting or otherwise causing unauthorized trades in the accounts of NO, MB, and RD. In all other respects, the Hearing Panel

[52] NASD Sanction Guidelines 86 (1998 ed.).

dismisses the allegations against him. Rosato is censured, fined $30,000, ordered to pay restitution in the amount of $17,957.69, plus pre-judgment interest, as specified above, and suspended from association with any NASD member in any capacity for eight months. Rosato also is ordered to pay costs in the amount of $2,237.50, which includes an administrative fee of $750 and hearing transcript costs of $1,487.50.

These sanctions shall become effective on a date set by the Association but not before the expiration of 45 days after the date of this decision.[53]

Hearing Panel

By: _____
Ellen B. Cohn
Hearing Officer

Copies to:

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Mr. Ira A. Boshnack (via first class mail)
Mr. Stephen G. Buxton (via first class mail)
Mr. Robert Koch II (via first class mail)

[53] 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.