

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

DEPARTMENT OF ENFORCEMENT,	:	
	:	
	:	
Complainant,	:	Disciplinary Proceeding
	:	No. C04980035
	:	
v.	:	
	:	
	:	DECISION
ROBERT LEE DAVIS, JR.	:	
(CRD #720134)	:	Hearing Panel
Sacramento, CA	:	
	:	
	:	January 27, 1999
Respondent.	:	

Digest

The Department of Enforcement filed a two-count Complaint alleging that Respondent Robert Lee Davis, Jr. violated NASD Rule 2110 by improperly using the funds of a private individual, and violated NASD Rule 2110 and Procedural Rule 8210 by failing to respond to two requests for information from the NASD. Respondent submitted an Answer to the Complaint admitting the Complaint's allegations and waiving his right to a hearing. Based on the Complaint, the Answer, and the written submissions of the Department of Enforcement, the Hearing Panel held that, as alleged in the Complaint, Respondent violated NASD Rule 2110 by improperly using the funds of a private individual and violated NASD Rule 2110 and Procedural Rule 8210 by failing to respond to two requests for information. The Hearing Panel censured Respondent, fined him \$50,000 for the misuse of funds and \$25,000 for the failure to respond, and ordered him to pay restitution in the amount of \$8,500 plus interest. In addition, Respondent was permanently barred from associating with any member firm in any capacity for each of the violations.

Appearances

Lisa J. Henoch, Senior Regional Counsel, Kansas City, Missouri, for the Department of Enforcement.

Rory C. Flynn, Counsel, Washington, DC, for the Department of Enforcement.

Robert Lee Davis, Jr. pro se.

DECISION

I. Procedural Background

The NASD Regulation, Inc. (“NASDR”) Department of Enforcement (“Enforcement”) filed the Complaint in this proceeding against Respondent Robert Lee Davis, Jr. on July 22, 1998. The Complaint was served on Respondent on July 20, 1998 at his last known address and at a second address. A Second Notice of Complaint was served on Respondent on August 24, 1998 at his last known address and at a second address. The Second Notice of Complaint required Respondent to submit an answer to the Complaint no later than September 8, 1998. On September 8, 1998, Respondent filed an Answer, admitting the Complaint’s allegations and waiving a hearing.

On October 16, 1998, the Hearing Officer issued an order directing Enforcement to file and serve its case against Respondent by November 9, 1998, including “all evidence ... that Enforcement considers necessary to support the sanctions sought, including mitigating or aggravating factors.”¹ In the same order, the Hearing Officer set December 7, 1998 as the deadline for Respondent to file and serve “any opposition or other response to Enforcement’s submissions, which should include any argument or evidence that Respondent wishes the Hearing Panel to consider.”

¹ The order provided that because Respondent admitted liability, additional evidence supporting allegations of misuse of funds and failure to respond would not be required.

Enforcement served its submissions on Respondent on November 6, 1998, and filed them on November 9, 1998. The submissions included a Memorandum in Support of Sanctions filed by Enforcement and three exhibits. Respondent filed nothing in response to Enforcement's submissions. Accordingly, the Hearing Panel, composed of two current members of the District Committee for District 4 and the Hearing Officer, considered this matter on the basis of the Complaint, Respondent's Answer, and Enforcement's submissions.²

II. Findings of Fact and Conclusions of Law

A. Jurisdiction

Respondent first became registered as an investment company and variable contracts product representative in December 1980. (CX-1, 3). Respondent, subsequently, became registered as a general securities representative in 1988 and was employed as a general securities representative with NASD member firms, MTL Equity Products, Inc. ("MTL Equity") from January 1992 to August 1995, The Advisors Group, Inc. from August 1995 to June 1996, and FFP Securities, Inc. ("FFP Securities") from July 1996 to April 1998. (CX-1, 1-3). Respondent currently is not employed in the industry.³

Under Article V, Section 4(a) of the Association's By-Laws, the NASD retains jurisdiction over Respondent for two years following the termination of his registration with FFP Securities on April 9, 1998. During this period of retained jurisdiction, NASD may institute a disciplinary proceeding against Respondent based upon conduct that occurred prior to his termination and based on his failure to provide information pursuant to Rule 8210, while subject

² Hereinafter references to Enforcement's exhibits will be designated as "CX-" with the appropriate page number; references to the Answer will be designated as "Ans."; and, references to the Complaint will be designated as "Cmpl."

³ FFP Securities filed a termination notice for Respondent on April 9, 1998. (CX-1, 2).

to the NASD's jurisdiction. Enforcement filed the Complaint in this proceeding on July 22, 1998, within two years of Respondent's termination, and the alleged violative conduct related to Respondent's conduct while associated with a member firm and to his failure to provide information while subject to NASD's jurisdiction. Accordingly, the Hearing Panel finds that the NASD has jurisdiction over Respondent.

B. Allegations of the Complaint

1. Respondent's Failure to Repay a Customer Loan Violated Conduct Rule 2110

While associated with MTL Equity, Respondent received \$8,500 as a loan from customer JD on March 5, 1994. (Cmpl. ¶4). The loan was to be used as a good faith deposit for the purchase of real property. (Cmpl. ¶4). Respondent was to apply for an additional loan from the Small Business Administration ("SBA") to complete the acquisition. (CX-2, 3). Respondent, according to the terms of a promissory note between customer JD and Respondent, promised to deposit the borrowed funds in an escrow account pending approval of the SBA financing and his acquisition of the real property. (CX-2, 3). Respondent was to withdraw the funds from the escrow account and return them to customer JD with 10% interest, if Respondent either did not receive SBA financing or did not purchase the real property. (CX-2, 3). The promissory note required Respondent to make variable installment payments, regardless of whether he received SBA financing or purchased the property, beginning no later than July 18, 1994 and continuing until the note was paid in full, but no later than January 18, 1995. (CX-2, 3).

Respondent never deposited the funds in an escrow account, used the funds to purchase the real property, nor returned the funds to customer JD on January 18, 1995 or at any time thereafter. (Ans. ¶1; Cmpl. ¶6). Instead of using the borrowed funds to invest in real estate,

Respondent used the funds to pay business and personal living expenses.⁴ (Ans. ¶1; Comp. ¶7). When JD's attorney complained to the NASD regarding Respondent's conduct on October 24, 1997, Respondent had at that time ignored JD's demands for payment on the promissory note for more than three years. (CX-2, 1).

NASD Conduct Rule 2110 requires that registered persons observe high standards of commercial honor and adhere to just and equitable principles of trade. Respondent's failure to use the borrowed funds as authorized by customer JD and his failure to repay the borrowed funds as required by the promissory note clearly establish an improper use of funds; accordingly, Respondent's conduct constitutes a violation of NASD Conduct Rule 2110.

Although Respondent did not use the borrowed funds as authorized, he represented in his Answer that he had made arrangements with JD's attorney to repay the borrowed funds. (Ans.-Considerations). In explaining his failure to return the borrowed funds, Respondent stated that he was incapacitated and unable to attend to his daily responsibilities during 1995 and 1996 because he was suffering from chronic depression.⁵ (Ans.-Considerations). The NASD has held that improper use of funds occurs when an associated person uses funds for a purpose that was not directed by the customer, but without the intent permanently to deprive the customer of the funds.⁶ The Hearing Panel concludes that, based on the documentary evidence and Respondent's admission, Respondent improperly used the funds of a customer and thereby violated Rule 2110.

⁴ Respondent, in his Answer, confirmed that the statements made in paragraphs 1 through 10 of the Complaint were true. (Ans. ¶1).

⁵ He attributed his inability to cope in part to the stress associated with the breakup of his 19-year marriage, health problems of his son, and unsuccessful law school attendance. (Ans.-Considerations).

⁶ See In re Robert L. Johnson, 51 S.E.C. 828 (1993), SEC LEXIS 3161 (November 18, 1993) (finding misuse of funds when registered principal of firm that had ceased doing business failed promptly to re-register unit trust in customer's name and to transmit distributions to customer, and failed to repay customer for almost two years.).

2. Respondent Failed to Respond to Two Requests for Information

NASDR staff requested, pursuant to Rule 8210, that Respondent provide information and documentation relating to a complaint from customer KS, noted in the termination notice filed by FFP Securities on April 9, 1998.⁷ (Cmpl. ¶10). The staff sent this request to Respondent at his last known residential address as listed in NASD's Central Registration Depository ("CRD address") via regular mail and certified mail, return receipt requested, on April 24, 1998. (Cmpl. ¶11). The U.S. Postal Service returned the certified mail, marked "unclaimed." (Cmpl. ¶11). The U.S. Postal Service did not return the request sent by regular mail. (Cmpl. ¶11). Respondent failed to respond to the request. (Cmpl. ¶12).

The staff again requested that Respondent provide information relating to KS's customer complaint in a May 20, 1998 letter issued pursuant to Rule 8210. (Cmpl. ¶13). The staff sent the request to Respondent's CRD address, via regular mail and certified mail, return receipt requested. (Cmpl. ¶13). The U. S. Postal Service returned the certified mail, marked "unclaimed." (Cmpl. ¶13). The U.S. Postal Service did not return the request sent by regular mail. (Cmpl. ¶13). Respondent failed to respond to the request. (Cmpl. ¶13).

On June 9, 1998, Respondent contacted the NASD staff, acknowledged receipt of the April 24 and May 20, 1998 requests, and stated his intent to respond. (Cmpl. ¶15). However, Respondent failed to follow through and provide a response to the requests for information. (Cmpl. ¶15). Respondent admitted that the allegations in paragraphs 9 to 16 of the Complaint, regarding his failure to respond, were true. (Ans. ¶2; Cmpl. ¶s 9-16)).

⁷ Customer KS alleged she gave Respondent a check for \$16,000 to purchase securities, and Respondent neither purchased the securities nor returned the \$16,000. (CX-3, 2-3).

NASD Procedural Rule 8210(a)(1) authorizes the NASD to require persons associated with a member of the NASD to report “orally, [or] in writing . . . with respect to any matter” under investigation by it. The purpose of this rule is to provide a means for the NASD to carry out its regulatory functions in the absence of subpoena power; it is a “key element in the NASD’s effort to police its members.”⁸ Failure to respond subverts the NASD’s ability to carry out its regulatory responsibilities.⁹

In this case, NASDR sent the two requests to Respondent’s CRD Address, as required by NASD Procedural Rule 8210. Respondent’s Answer admitted receipt of the requests and his failure to respond. The Hearing Panel concludes that Respondent actually received the requests and refused to respond in violation of NASD Procedural Rule 8210. The Hearing Panel also concludes that, by violating Rule 8210, Respondent failed to “observe high standards of commercial honor and just and equitable principles of trade,” in violation of Rule 2110.

III. Sanctions

Enforcement suggested a censure for each violation, fines of \$50,000 for Respondent’s misuse of customer funds¹⁰ and \$25,000 for his failure to respond, a permanent bar from associating with any member in any capacity for both violations, and an order to pay restitution to JD of \$8,500 plus 10% interest.

The Hearing Panel determined that the most applicable Sanction Guideline is the guideline relating to the improper use of funds or securities.¹¹ The Sanction Guideline for improper use of

⁸ Richard J. Rouse, 51 S.E.C. 581, 1993 WL 276149, at *2 (1993).

⁹ John L. Malach, 51 S.E.C. 618, 1993 WL 307544, at *2 (1993).

¹⁰ The \$50,000 fine is the top of the range for the improper use of funds. NASD Sanction Guidelines, 34 (1998).

¹¹ There is no specific guideline that addresses a failure to repay a loan from a customer.

funds recommends a fine in the range of \$2,500 to \$50,000, and, unless the improper use resulted from a misunderstanding of the customer's intended use of the funds or securities or other mitigation exists, a bar. The Sanction Guidelines also recommend that adjudicators order restitution where an identifiable person has suffered a quantifiable loss as a result of a respondent's misconduct.¹²

The Hearing Panel concluded that, even though Respondent had no prior disciplinary history, several factors warranted imposing a bar and a significant fine. In particular, Respondent's misconduct continued for a significant period of time, and he ignored JD's demands for payment for more than three years. In addition, Respondent's misconduct directly harmed a member of the investing public while directly benefiting Respondent in the amount of \$8,500. The Hearing Panel, therefore, censures Respondent, bars him from associating with any member firm, fines him \$50,000 for violating Conduct Rule 2110, and orders him to pay restitution to JD in the amount of \$8,500 plus interest.

For a failure to respond, the NASD Sanction Guidelines recommend a fine in the range of \$25,000 to \$50,000 and provide that, if an individual does not respond in any manner, a bar should be standard.¹³ Under the NASD Sanction Guidelines,¹⁴ the following factors are considered: (1) Respondent's lack of a response, (2) Respondent's representation that he would respond and his subsequent failure to respond, and (3) whether the request for information related to an investigation involving a significant customer complaint. There are no mitigating factors

¹² NASD Sanction Guidelines, 6 (1998).

¹³ NASD Sanction Guidelines, 31 (1998).

¹⁴ NASD Sanction Guidelines, 8 and 31 (1998).

that warrant a reduction in the sanctions recommended in the NASD Sanction Guidelines.¹⁵

Accordingly, the Hearing Panel censures Respondent, bars him from associating with any member firm, and fines him \$25,000 for violating Conduct Rule 2110 and Procedural Rule 8210.

IV. Conclusion

Therefore, Respondent is censured, fined \$50,000 for the misuse of customer funds and \$25,000 for the failure to respond, and ordered to pay restitution to JD in the amount of \$8,500 plus 10% interest per annum, from March 5, 1994 until paid. In addition, Respondent is permanently barred from associating with any member in any capacity for each of the violations. 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.¹⁶

HEARING PANEL

By: Sharon Witherspoon
Hearing Officer

Dated: Washington, DC
January 27, 1999

Copies to:
Robert Lee Davis, Jr. (via certified and first class mail)
Lisa J. Henoeh, Esq. (via first class mail)
Rory C. Flynn, Esq. (via first class mail)

¹⁵ NASD Sanction Guidelines, 31 (1998).

¹⁶The Hearing Panel has 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.