



dismissed Cause Two of the Complaint, holding that the registered representative had not made a specific price projection without a reasonable basis therefor.

Accordingly, the Hearing Panel censured the registered representative, suspended him in all capacities for 60 days, and fined him \$5,000. The Hearing Panel also ordered that the registered representative retake the Regulatory Element of the Continuing Education Requirements under Rule 1120 before reassociating with an NASD member.

### **Appearances**

Jacqueline D. Whelan, Esq., Regional Counsel, Denver, Colorado, for the Department of Enforcement. Rory C. Flynn, Chief Litigation Counsel, Washington, DC, of counsel.

Christopher E. Jann, *pro se*.

### **Procedural Background**

The Department of Enforcement (Enforcement) filed a two-cause Complaint against Christopher E. Jann (Jann) on October 17, 1997. In Cause One, Enforcement alleged that Jann violated NASD Conduct Rules 2110 and 2120 by making false and misleading statements in connection with the offer and sale of securities. In Cause Two, Enforcement alleged that Jann violated NASD Conduct Rule 2110 by projecting the future price of a security without a reasonable basis for the projection.

Jann filed his Answer on December 1, 1997, and requested a hearing. On December 22, 1997, the Hearing Officer held the Initial Pre-Hearing Conference at which

Jann was represented by counsel.<sup>1</sup> With the agreement of Jann's counsel, the Hearing Officer scheduled the Hearing for April 7 and 8, 1998, in New York City.

On December 26, 1997, the Hearing Officer issued an order directing the Parties to file pre-hearing submissions, including witness and exhibit lists, by March 17, 1998. The Hearing Officer also set a final pre-hearing conference for March 19, 1998.

Jann did not file a pre-hearing submission or appear at the scheduled final pre-hearing conference. Therefore, the Hearing Officer issued an order directing Jann to show cause why he should not be held in default under NASD Rule 9241(f).

During the telephone conference on the Order to Show Cause, Jann affirmed his desire to have a hearing. In addition, in response to questioning about his failure to file witness and exhibit lists, Jann stated that he did not "really have any witnesses" and ". . . as far as any documents, . . . there isn't anything that I have to provide."<sup>2</sup> Jann stated that he just wanted to be able to "tell [his] side of the story and see what happens."<sup>3</sup> Enforcement did not object to Jann proceeding in this manner, so the Hearing Officer continued the proceeding without holding Jann in default.

The Hearing was held on April 7, 1998, by a hearing panel composed of two current members of the District Committee for District 10 and the Hearing Officer. Enforcement called three witnesses to testify and introduced 11 exhibits (Ex's. C1-11) into evidence. Lonnie Morgan, Supervisor of Examiners with NASD in Denver, Colorado,

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<sup>1</sup> Chad N. Cagan, Esq., of Sonnenblick, Parker & Selvers, P.C., represented Jann until February 2, 1998, at which time the Hearing Officer granted Mr. Cagan's motion to withdraw as Jann's counsel.

<sup>2</sup> Conference Transcript at 7 (March 30, 1998). References to the hearing transcript are indicated by "TR."

<sup>3</sup> Id. at 12.

and DR and FB, two of Jann's former customers, testified for Enforcement. Jann elected not to testify, present documentary evidence, or call any other witnesses.<sup>4</sup>

### **Findings of Fact**

Jann, a high school graduate, is 28 years old. Before entering the securities industry in September 1995, he was self-employed, delivering furniture.<sup>5</sup> Jann got his start in the securities industry with Sterling Foster & Company, Inc. (Sterling Foster), a former member of the NASD.

Jann worked as a registered representative at Sterling Foster from September 1995 to March 1997.<sup>6</sup> Essentially, his job entailed cold calling leads that were identified from purchased lists.<sup>7</sup> Relying on information supplied by Sterling Foster's analysts, he would interest prospective customers in opening an account.<sup>8</sup> Sterling Foster provided absolutely no training.<sup>9</sup> Jann learned the business by walking around Sterling Foster's office and listening to the other salesmen.<sup>10</sup> He interpreted his training as learning to use a better vocabulary to help him sound more professional.<sup>11</sup>

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<sup>4</sup> However, Enforcement introduced the entire transcript of Jann's testimony taken on April 14, 1997, during the course of the investigation of the charges against him. By offering the transcript, Enforcement has sponsored Jann's testimony. Thus, Enforcement is bound by his uncontradicted testimony.

<sup>5</sup> Ex. C11 at 9-10.

<sup>6</sup> Ex. C11 at 11; Ex. C1 at 1.

<sup>7</sup> Ex. C11 at 11, 14.

<sup>8</sup> Ex. C11 at 14, 17.

<sup>9</sup> Ex. C11 at 11-15.

<sup>10</sup> Ex. C11 at 14-15.

<sup>11</sup> Ex. C11 at 15.

In or about January 1996, Jann called FB to solicit him to invest in the initial public offering of The Company Doctor stock.<sup>12</sup> FB opened an account with Jann and bought some shares of The Company Doctor. FB made money on this investment, so he was receptive to Jann’s next solicitation involving Embryo Development Corporation (Embryo), a development stage corporation organized in March 1995 to acquire, produce, and sell bio-medical devices.<sup>13</sup>

Jann recommended that FB invest in Embryo.<sup>14</sup> Jann told FB that Embryo had developed a new hypodermic needle that would prevent the accidental transmission of blood-borne diseases such as AIDS and hepatitis.<sup>15</sup> According to Jann, the Food and Drug Administration (FDA) had approved the needle, and a press release to that effect was expected to be released soon, which Jann said would cause the price of the stock to rise.<sup>16</sup> In Jann’s words, the new needle was going to put Embryo “over the top.”<sup>17</sup> In addition, Jann told FB that Embryo was a good company, and it was making money.<sup>18</sup> Relying on these representations—particularly that the FDA had approved the Embryo needle—FB bought 1000 shares of Embryo stock in February 1996 for \$8 per share.<sup>19</sup>

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<sup>12</sup> Ex. C6 at 5.

<sup>13</sup> Ex. C10.

<sup>14</sup> TR. at 63.

<sup>15</sup> Id.

<sup>16</sup> Id.

<sup>17</sup> TR. at 64.

<sup>18</sup> Id.

<sup>19</sup> TR. at 65.

FB also referred Jann to DR. Jann recommended that DR also purchase Embryo stock.<sup>20</sup> Jann assured DR that investing in Embryo was a sure thing, a “fantastic investment.”<sup>21</sup> Jann further characterized the investment as a “chance of a lifetime” opportunity.<sup>22</sup> As he had with FB, Jann told DR that Embryo had developed a new hypodermic needle that had FDA approval, and a public announcement about the needle was expected “any day.”<sup>23</sup> Relying on Jann’s representations, DR purchased 3000 shares of Embryo stock on February 14, 1996, for \$8 per share.<sup>24</sup>

FB’s and DR’s common investment objective was to wait for publication of the news about Embryo’s needle, see price appreciation, and then sell.<sup>25</sup> Both of them expected this to occur rapidly, so FB and DR compared notes daily over the two weeks after they purchased the Embryo stock, as they awaited publication of the announcement about Embryo’s new needle.<sup>26</sup> When no announcement appeared, DR called Embryo.<sup>27</sup> Embryo’s Chief Financial Officer told DR that the needle had not been approved by the FDA, and, in fact, Embryo had not yet produced a prototype for the FDA’s review.<sup>28</sup>

Armed with this information, FB and DR demanded that their purchases be canceled and their money returned.<sup>29</sup> Jann was unresponsive to their initial calls, so they

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<sup>20</sup> TR. at 22, 29-30.

<sup>21</sup> TR. at 22-23.

<sup>22</sup> Ex. C3 at 1.

<sup>23</sup> TR. at 22; Ex. C3.

<sup>24</sup> Ex. C4.

<sup>25</sup> TR. at 48-49.

<sup>26</sup> TR. at 52.

<sup>27</sup> TR. at 25.

<sup>28</sup> Id.

<sup>29</sup> TR. at 26.

contacted Sterling Foster's compliance department.<sup>30</sup> After considerable effort, Sterling Foster finally canceled the purchases in or about April 1996.<sup>31</sup>

In addition to misrepresenting that the FDA had approved Embryo's manufacture and sale of the needle, Jann failed to tell FB and DR that Embryo's stock was a high-risk, speculative security.<sup>32</sup> Furthermore, Jann failed to disclose any of the risk factors in Embryo's prospectus, including that Embryo lacked manufacturing experience; Embryo had lost \$895,000 on revenues of \$35,000 during its development stage; Embryo had insufficient capital to continue without the proceeds of its initial public offering; Embryo's auditors had issued an opinion questioning Embryo's ability to continue as a going concern; and Embryo faced stiff competition from major companies such as Johnson & Johnson, which were substantially better capitalized than Embryo.<sup>33</sup>

## **Legal Discussion and Conclusions**

### **I. Jurisdiction**

The NASD has jurisdiction over this disciplinary proceeding under Article V, Section 4 of the NASD's Bylaws. Jann was registered with the NASD both at the time of the alleged violations and at the time Enforcement filed the Complaint.

### **II. Fraud in the Offer and Sale of Securities**

Conduct Rule 2120, which is the NASD's equivalent to SEC Rule 10b-5, is designed to ensure that members and associated persons fulfill their obligations to

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<sup>30</sup> TR. at 26.

<sup>31</sup> TR. at 27, 66.

<sup>32</sup> TR. at 27-29, 69-70, 73.

<sup>33</sup> Id. See also Ex. C10.

customers by prohibiting material misrepresentations in the purchase and sale of securities.<sup>34</sup> To prove that a registered representative violated Conduct Rule 2120, Enforcement must show by a preponderance of the evidence that: (1) the registered representative made an untrue statement of fact or omitted to state a material fact where he had a duty to speak; (2) the statement or omission was material; (3) the statement or omission was made in connection with the purchase or sale of a security; and (4) the registered representative acted with the requisite scienter.<sup>35</sup>

#### *Jann's Misrepresentations and Omissions*

As found above, Jann misrepresented: (1) Embryo's financial condition, (2) the status of Embryo's development of its new hypodermic needle, and (3) his possession of non-public information that Embryo was about to publicly announce that the FDA had approved Embryo's new hypodermic needle. In addition, Jann failed to tell FB and DR about any of the significant risks associated with investing in Embryo, including the negative financial information that was available in Embryo's prospectus.

#### *Materiality*

Jann's misrepresentations and omissions were material. "Materiality depends on the significance the reasonable investor would place on the withheld or misrepresented information."<sup>36</sup> Information is material to a reasonable investor if it "would have been viewed . . . to have changed the 'total mix' of information made available."<sup>37</sup> In other

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<sup>34</sup> See, e.g., DBCC No. 2 v. Coastline Financial, Inc., No. C02950059, 1997 NASD Discip. LEXIS 9, at \*15 (NBCC March 5, 1997).

<sup>35</sup> Id.

<sup>36</sup> Basic Inc. v. Levinson, 485 U.S. 224, 240 (1988) (adopting the TSC standard for actions under Section 10(b) and Rule 10b-5).

<sup>37</sup> Id. at 231; SEC v. Mayhew, 121 F.3d 44, 52 (2d Cir. 1997).

words, a fact is material if there is a substantial likelihood that a reasonable investor would consider the information to be important.<sup>38</sup> Aside from information disclosing the earnings and distributions of a company, material facts include those which “affect the probable future of the company and those which may affect the desire of investors to buy, sell, or hold the company's securities.”<sup>39</sup>

Jann’s misrepresentations concerning Embryo and its new hypodermic needle were material because a reasonable investor would consider the information important. Jann portrayed the needle as Embryo’s most important product. In his words, the needle was going to put Embryo “over the top.” And the significance of FDA approval could not have been greater, for Embryo could not sell the needle without FDA approval. Furthermore, this was a critical factor underlying FB’s and DR’s decisions to purchase Embryo stock. FB testified that Jann’s representation that Embryo had secured FDA approval was the “primary factor” underlying FB’s decision to purchase Embryo stock because he knew how long and difficult a process it is to get medical devices approved by the FDA.<sup>40</sup> FDA approval would have given Embryo a significant jump start ahead of potential competitors.

Jann’s misrepresentation that he had non-public information that Embryo was about to announce that it had secured FDA approval to sell the needle was also material. This misrepresentation created the unfounded impression that Jann was offering FB and

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<sup>38</sup> Basic, 485 U.S. at 231.

<sup>39</sup> Mayhew, 121 F.3d at 52 (quoting SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 848 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969)).

<sup>40</sup> TR. at 65.

DR a terrific investment. It also bolstered Jann's recommendations to purchase Embryo stock by falsely lending an air of certainty and authority to his recommendations.<sup>41</sup>

The risk factors that Jann withheld also were material. These factors addressed the speculative nature of Embryo's stock, including such core issues as Embryo's history of losses, its lack of operations, and its questioned ability to continue as a going concern. Because these facts affected Embryo's future and the desire of investors to buy its stock, they were material.<sup>42</sup>

*In Connection With*

The Hearing Panel also finds that Jann made the foregoing misrepresentations and omissions to induce FB and DR to buy Embryo stock. Because FB and DR purchased Embryo stock, the misrepresentations and omissions were made in connection with the purchase or sale of a security.<sup>43</sup>

*Scienter*

Scienter is "a mental state embracing intent to deceive, manipulate, or defraud."<sup>44</sup> Reckless or willful disregard of the truth satisfies the scienter requirement.<sup>45</sup> Scienter is a question of fact that can be proved through circumstantial evidence and inferences drawn from the surrounding circumstances.<sup>46</sup>

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<sup>41</sup> See SEC v. Hasho, 784 F. Supp. 1059, 1109 (S.D.N.Y. 1992).

<sup>42</sup> Id.

<sup>43</sup> See Superintendent of Ins. v. Bankers Life & Casualty, Co., 404 U.S. 6, 12 (1971); SEC v. Materia, 745 F.2d 197, 203 (2d Cir. 1984), cert denied, 471 U.S. 1053 (1985).

<sup>44</sup> Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193-94 n.12 (1976).

<sup>45</sup> See, e.g., Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1567 (9<sup>th</sup> Cir. 1990).

<sup>46</sup> Herman & McLean v. Huddleston, 459 U.S. 375, 390 n.30 (1983).

The Hearing Panel finds that Jann acted with scienter because he intentionally deceived FB and DR about Embryo's financial condition, FDA's approval of Embryo's needle, and Embryo's expected announcement concerning FDA approval of the needle. Jann knew or should have known that his representations were false. Jann presented no evidence to support these statements. Instead, Jann defended the charges by denying that he had made the statements at all. The Hearing Panel finds Jann's denial not to be credible. Both FB and DR testified that they made their investments in Embryo based upon Jann's assurances that the Embryo needle was approved by the FDA and that Embryo was about to go public with an announcement to that effect. Jann presented no evidence to undermine FB's and DR's testimony.

In summary, the Hearing Panel finds that Jann violated NASD Conduct Rule 2120 by misrepresenting the facts concerning Embryo's financial condition, FDA's approval of Embryo's needle, and Embryo's expected announcement concerning FDA approval of the needle; and by omitting to disclose the negative financial information and other risk factors in the Embryo prospectus, as charged in the First Cause of the Complaint. The Hearing Panel also finds that by making these misstatements and omissions, Jann violated NASD Conduct Rule 2110, which provides that a registered representative must "observe high standards of commercial honor and just and equitable principles of trade."

### **III. Price Prediction**

Generally, price predictions run afoul of NASD Conduct Rules 2110 and 2120 in two circumstances. First, price predictions of substantial and specific increases in the price

of speculative securities within a relatively short period of time are fraudulent.<sup>47</sup> Second, price predictions of specific and substantial increases in the price of any other securities that are made without a reasonable basis are fraudulent.<sup>48</sup>

In Cause Two of the Complaint, the Department of Enforcement charged that Jann violated NASD Conduct Rule 2110 by making baseless price predictions to FB regarding Embryo stock. Specifically, Enforcement charged that Jann had predicted that the “per share price of Embryo stock would rise from approximately \$4.00 to approximately \$12.00 to \$16.00 upon release of news by [Embryo] that was expected to occur within several days.”<sup>49</sup> Although Jann admitted that he had compared Embryo to a competing company that was trading at about \$30 per share, Jann denied making any price predictions regarding the future price of Embryo stock. The Hearing Panel finds for Jann on Cause Two of the Complaint. The Department of Enforcement failed to prove by a preponderance of the evidence that Jann made a specific, baseless price prediction to FB regarding Embryo stock.

Enforcement’s evidence of Jann’s alleged price prediction was equivocal. On the one hand, FB testified that when Jann first contacted him Embryo was trading at \$4 per share and that Jann expected the price to double on the news that Embryo’s needle was approved by the FDA.<sup>50</sup> On the other hand, FB testified that Jann told him the price would go to \$12 once the news was released—a threefold increase. At no point did FB explain this discrepancy in his testimony.

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<sup>47</sup> See, e.g., Donald A. Roche, 1997 SEC LEXIS 1283, at \*6 (June 17, 1997).

<sup>48</sup> Id.

<sup>49</sup> Complaint at 4.

<sup>50</sup> TR. at 64.

FB's testimony that Jann had made a specific price prediction also was called into question by the other evidence submitted by Enforcement. Both FB and DR conceded that Jann compared Embryo and its new hypodermic needle with another company that had already introduced a safety hypodermic needle. FB testified that Jann limited his comparison to the relative quality of the two needles, but DR admitted that Jann mentioned that the other company was trading at \$30 per share.<sup>51</sup> And FB actually asked Jann about Embryo's competition and the company's safety syringe.<sup>52</sup> Moreover, neither FB nor DR mentioned false or fraudulent price predictions in their complaint letters.

FB's testimony and credibility on this issue also must be weighed in light of his investment objective and knowledge at the time he purchased Embryo stock. Considering all of FB's testimony, it is clear that he was speculating on the information that Embryo was about to make an announcement concerning its hypodermic needle. He was counting on that announcement to cause Embryo's stock price to jump quickly. Once it did, FB's goal was to sell, just as he had done after he purchased shares in The Doctor Company. FB was not looking for long-term price appreciation.

FB was comfortable with this gamble because he had independent knowledge about the type of needle that Embryo was developing. FB testified that he knew that the competing needle was very hard to use.<sup>53</sup> Accordingly, FB knew that a better needle would have a huge world-wide market. None of this information came from Jann.

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<sup>51</sup> TR. at 31.

<sup>52</sup> TR. at 73.

<sup>53</sup> Id.

In light of these facts and DR's testimony that Jann had mentioned a competing company that was trading at a higher price than Embryo, the Hearing Panel concludes that Jann compared Embryo to this other company, but the evidence does not establish that Jann made a specific price prediction to FB in violation of NASD Conduct Rule 2110 as charged in Cause Two of the Complaint. Rather, it is the Hearing Panel's conclusion—based on all the evidence and the credibility of the witnesses—that FB himself made the price projection based on his own experience and information about Embryo's competitor and the deficiencies of its safety syringe. Based upon this information, FB concluded that Embryo would reach the same price level as its competitor once the public was informed about Embryo's new safety needle receiving FDA approval. Consequently, the Hearing Panel dismisses Cause Two of the Complaint.

### **Sanctions**

The starting point under the NASD Sanction Guidelines (Guidelines) for intentional or reckless misrepresentations and omissions of material facts is a fine of \$5,000 to \$50,000 and a suspension of at least three months.<sup>54</sup> The Guidelines however are not absolute.<sup>55</sup> Sanctions should be set considering all of the aggravating and mitigating facts present in each case.

Applying these guiding principles to this proceeding, the Hearing Panel concludes that—on balance—the evidence warrants sanctions slightly below the recommended range for intentional or reckless misrepresentations. In reaching this conclusion, the Hearing

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<sup>54</sup> NASD Sanctions Guidelines 34 (1996). The Hearing Panel heard and decided this proceeding before the new NASD Sanction Guidelines became effective on May 15, 1998.

<sup>55</sup> Guidelines at 4.

Panel carefully considered each of the Principal Considerations listed in the Guidelines together with the evidence relating to Jann's experience, training, and supervision.

Jann had very limited experience and no training. Sterling Foster did, however, provide him with its analysts' reports and recommendations for securities such as Embryo, which Sterling Foster was promoting. Jann testified upon questioning by the NASD that he relied on the stock reports Sterling Foster gave him to make recommendations to his customers.<sup>56</sup>

While his reliance on Sterling Foster's stock reports is not a defense to the charge of misrepresentation under NASD Conduct Rule 2120, the Hearing Panel considers Jann's youth, lack of experience, lack of training, and naiveté to be factors that should be considered in setting sanctions. The Hearing Panel is of the opinion that Jann recklessly misled his customers FB and DR.

In addition, FB and DR secured a full refund from Sterling Foster of their investments when their purchases were canceled. As such, neither sustained a loss. Nor did Enforcement present any evidence to show that Jann harmed any other customers or to counter Jann's assertion that none of his customers complained about his sales practices. There was no evidence that Jann acted in concert with others at Sterling Foster as part of a larger fraudulent scheme. Enforcement also did not present evidence of any other aggravating factors bearing on the issue of sanctions.

Therefore, having considered all of the evidence submitted by the Parties, Christopher E. Jann is censured; fined \$5,000; and, consistent with the Department of

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<sup>56</sup> Ex. C11, at 17, 19, 24-25, 53.

Enforcement's recommendation, suspended in all capacities for 60 days. Jann is also ordered to retake the Regulatory Element of the Continuing Education Requirements under Rule 1120 before reassociating with an NASD member. Finally, Jann is assessed hearing costs in the amount of \$906.50, consisting of transcript costs in the amount of \$706.50 and administrative expenses of \$300. 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.<sup>57</sup>

HEARING PANEL

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By: Andrew H. Perkins  
Hearing Officer

Copies to:

Jacqueline Whelan, Esq. (by first class mail)  
Rory C. Flynn, Esq. (by first class mail)  
Christopher E. Jann (by certified and first class mail)

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<sup>57</sup> The Hearing Panel 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.