

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

DEPARTMENT OF ENFORCEMENT,	:	
	:	
Complainant,	:	Disciplinary Proceeding
	:	No. C01980001
v.	:	
	:	DECISION
DONALD CLEWELL MAIER	:	
(CRD #317433),	:	Hearing Panel
	:	
Monte Sereno, CA,	:	
	:	June 30, 1998
	:	
Respondent.	:	

Digest

The Department of Enforcement filed a complaint alleging that a registered representative violated NASD Conduct Rules 2110 and 3040 by engaging in private securities transactions without giving his employer prior written notification and NASD Conduct Rule 2110 by filing a false report with his employer. The Hearing Panel held that the Respondent violated NASD Conduct Rules 2110 and 3040, censured him, suspended him for 30 business days, and fined him \$39,750. The Hearing Panel also ordered that the Respondent requalify by examination before reassociating with an NASD member.

Appearances

David A. Watson, Esq., Regional Counsel, San Francisco, California, for the Department of Enforcement. Rory C. Flynn, Chief Litigation Counsel, Washington, DC, of counsel.

Donald C. Maier, *pro se*.

Procedural Background

The Department of Enforcement (Enforcement) filed the Complaint in this proceeding against Donald C. Maier (Maier) on January 20, 1998. In Cause One of the Complaint, Enforcement alleged that Maier violated NASD Conduct Rules 2110 and 3040 by engaging in private securities transactions without giving his employer prior written notification. In Cause Two of the Complaint, Enforcement alleged that Maier violated NASD Conduct Rule 2110 by filing an annual questionnaire with his employer falsely stating that: (1) he had complied with all of his employer's procedures concerning private placements; (2) he had not offered or sold securities other than those that were products offered by his employer; and (3) he had not offered or sold any unregistered securities.

Maier filed his Answer on March 13, 1998, and requested a hearing. In his Answer, Maier admitted receiving fees for referring investors to Prism Financial Limited Liability Company (Prism), but he denied violating any of the NASD's rules. Maier explained that he "was simply introducing likely prospects" to the issuer.¹ Because Maier was paid a finder's fee rather than a sales commission and did not make the actual sales

¹ Answer ¶ 3.

presentations, he thought he had not violated NASD Conduct Rule 3040. In his Answer, Maier further stated that he had relied upon Prism's representations that its legal counsel had assured Prism's President that Maier legally could receive a fee for referring prospects. Regarding Cause Two of the Complaint, Maier stated that he had filed the annual questionnaire in good faith, without any intent to deceive.

On April 24, 1998, Enforcement filed a Motion for Summary Disposition. The motion was supported by a Statement of Undisputed Facts. Maier filed a response to the motion on May 7, 1998, in which he admitted each of the facts in the Statement of Undisputed Facts and requested a hearing on the issue of sanctions. The Hearing Panel considered the Motion for Summary Disposition but deferred ruling on it until the Hearing.²

The Hearing was held on May 14, 1998, by a Hearing Panel composed of two current members of the District Committee for District 1 and the Hearing Officer. Enforcement called Maier to testify and introduced 9 exhibits into evidence.³ Maier elected not to testify further on his own behalf, present documentary evidence, or call any other witnesses.

At the Hearing, Maier confirmed that he conceded the factual allegations in the Complaint, but not the characterization of his activities as "selling."⁴ Enforcement then renewed its Motion for Summary Disposition and the Hearing Panel granted it, finding

² In the Hearing Panel's opinion, because Maier was the only witness scheduled to testify at the hearing, no economy would have been achieved by granting the motion before the hearing and no prejudice would accrue to Enforcement by deferring the ruling.

³ References to the hearing transcript are indicated by "TR."

⁴ TR. at 18.

that the admitted facts established by a preponderance of the evidence that Maier had violated NASD Rules 2110 and 3040. The Hearing Panel then heard further evidence and argument on the issue of sanctions.

Findings of Fact

Maier admitted the violations alleged in the Complaint.⁵ He also did not dispute the underlying material facts.

Maier registered with the NASD as a General Securities Representative in 1961.⁶ From August 1981 to October 1996, he was associated with Securities America, Inc. (SAI), a member of the NASD.⁷ Maier voluntarily terminated his association with SAI in October 1996 after the NASD started the investigation that led to Enforcement filing the Complaint in this proceeding.⁸ He is not currently associated with an NASD member. This is his first disciplinary action.⁹

In late 1993 or early 1994, Maier was approached by Joel E. de Angelis (de Angelis), a wholesaler whom Maier knew, about whether he would be interested in referring investors to Prism for a fee.¹⁰ Prism was conducting a private placement and searching for investors who would be willing to purchase one or more units in Prism. Each unit sold for \$25,000 and entitled the owner to a share in Prism's profits and gains.¹¹ According to the Confidential Private Placement Memorandum, the proceeds of the

⁵ TR. at 17, 19.

⁶ TR. at 7.

⁷ TR. at 7-8.

⁸ TR. at 64.

⁹ TR. at 8.

¹⁰ TR. at 38-39.

private placement were to be used to establish and demonstrate the performance of a hedge fund (Prism Fund).¹²

Maier expressed an interest in Prism because his income had declined while he had been out of work due to an illness. Maier testified that his “income was strapped at that time,” and Prism appeared to him to be a good way to make some needed money.¹³ To learn more about Prism and his ability to be paid for soliciting investors, Maier met with Brian Prendergast, Prism’s President and developer of the Prism Fund.

Maier knew that there were prohibitions on private securities transactions, so he specifically asked Prendergast if he needed to notify SAI before entering into an agreement with Prism.¹⁴ According to Maier, Prendergast assured him that he could receive referral fees without violating NASD’s rules and that there was no need to notify SAI about the arrangement. Maier said that Prendergast told him that Prism’s attorney had researched the issue and concluded that a referral fee could be paid because Maier would not make the actual sales presentations.¹⁵ According to Maier, Prendergast characterized the payments as advances against management fees.

Maier however admitted that he knew that he would not have any management responsibilities: He was to be paid just for referring investors.¹⁶ Nevertheless, Maier

¹¹ Ex. 9.

¹² Id.

¹³ TR. at 29.

¹⁴ TR. at 40.

¹⁵ TR. at 31, 40, 42.

¹⁶ TR. at 41-42.

made no effort to verify what Prendergast told him. Maier did not speak to Prism's attorney or ask for a written legal opinion.¹⁷ Instead—without notifying SAI—Maier entered into a Solicitation Agreement with Prism dated February 24, 1994.

The Solicitation Agreement provided that Maier would receive 0.7% of the total management fee due Prendergast and de Angelis for each Prism Unit Maier “sold.”¹⁸ This fee was payable in installments: \$2,000 in advance and the balance in monthly installments over the life of the Prism Fund.¹⁹

The Solicitation Agreement also provided that Maier would receive an equity interest in Prism. Upon termination or dissolution of the Prism Fund, Maier was entitled to receive an amount equal to 0.5% of the ending equity of the Prism Fund multiplied by the number of units Maier “sold.”²⁰

Maier also had an oral agreement with Prism under which he was to be paid an additional \$350 for every investor referred to Prism by Kevin Keyes, an acquaintance of Maier's whom he introduced to Prendergast.²¹

In January or February 1994, Maier set up two sales presentations and invited some of his clients—most of whom also were SAI's clients—to listen to a presentation about Prism given by Prendergast and de Angelis.²² One meeting was held at Maier's

¹⁷ TR. at 42.

¹⁸ Ex. 6, at 1.

¹⁹ Id.

²⁰ Id.

²¹ TR. at 33.

²² TR. at 35-36; Ex. 4.

home, the same location where he met with clients to conduct business as an SAI registered representative.²³

As a result of Maier's referrals, 13 individuals invested \$350,000 in Prism, and Maier was paid \$28,000 for these referrals.²⁴ In addition, Maier received \$1,750 for investors referred to Prism by Kevin Keyes.²⁵

Maier's efforts on behalf of Prism and his acquisition of a beneficial interest in Prism violated SAI's procedures. SAI's compliance manual prohibited SAI's representatives from steering or leading clients to issuers or from finding clients for issuers except in an official capacity as an SAI registered representative.²⁶ Further, SAI's manual prohibited SAI's registered representatives from accepting "compensation of any kind from any source for securities transactions other than sources authorized by SAI."²⁷ SAI had not authorized Maier either to refer investors to Prism or to collect fees from Prism for referrals.

In addition to failing to get approval from SAI to solicit investors for Prism, in July 1994 Maier falsely reported to SAI that: (1) he had not sold any unregistered investment products; (2) he had not been paid any finder's fees; and (3) he had not sold, or offered for sale, any unapproved securities products.²⁸ The false report was submitted by Maier in connection with his annual compliance review conducted by SAI.²⁹

²³ TR. at 36.

²⁴ Ex. 7, at 2.

²⁵ Id.

²⁶ Ex. 2, at 5.

²⁷ Id.

²⁸ Ex. 2, at 11; TR. at 27-28.

²⁹ TR. at 22.

At the hearing, Maier testified that he answered these questions in the negative because he did not consider his activities to be selling or marketing.³⁰ Instead, he viewed his role as limited. In his view he was only informing his and SAI's clients about the existence of Prism, without making a recommendation that they invest.³¹ He also said that he did not consider the fees he received from Prism to be finder's fees; rather, he considered them to be "advance management fees."³²

Maier's explanation of his answers, however, is not supported by the terms of the Solicitation Agreement. The Solicitation Agreement provided that Maier was to receive a fee for each unit he "sold." Contrary to Maier's construction, the Solicitation Agreement did not characterize Maier's fees as management fees. Further, Maier readily admitted that he had no management functions and provided no services to Prism apart from finding prospective investors. Moreover, he called them finder's fees in an October 20, 1997, letter to the NASD.³³ Accordingly, the Hearing Panel concludes that the fees received by Maier under the Solicitation Agreement were finder's fees or sales commissions.

Legal Discussion and Conclusions

I Jurisdiction

The NASD has jurisdiction over this disciplinary proceeding under Article V,

³⁰ TR. at 23-24, 28-29, 41, 44-45.

³¹ TR. at 42, 44; Ex. 8, at 1.

³² TR. at 11.

³³ Ex. 8, at 1.

Section 4 of the NASD's Bylaws. Article V, Section 4 of the NASD's By-laws provides:

A person whose association with any member has been terminated and is no longer associated with any member of the [NASD] ... shall continue to be subject to the filing of a complaint under the Code of Procedure based upon conduct which commenced prior to the termination ... but any such complaint shall be filed within ... two (2) years after the effective date of the termination

The Complaint is based on Maier's conduct while he was associated with SAI, and it was filed within two years after Maier's last association with a member firm.

II. Private Securities Transactions

NASD Conduct Rule 3040 provides that "no person associated with an NASD member firm shall participate in any manner in a private securities transaction except in accordance with the requirements of this rule."

The Rule defines a "private securities transaction" as:

any securities transaction outside the regular course or scope of an associated person's employment with a member, including, though not limited to, new offerings of securities which are not registered with the Commission, provided however that transactions subject to the notification requirements of Rule 3050, transactions among immediate family members (as defined by IM-2110-1, "Free-riding and Withholding"), for which no associated person receives any selling compensation, and personal transactions in investment company and variable annuity securities, shall be excluded.

The transactions at issue in this proceeding were clearly outside the regular course and scope of Maier's employment with SAI, and they did not fit within any of the exclusions described in Conduct Rule 3040. They were, therefore, covered by Rule 3040.

NASD Conduct Rule 3040 requires that an associated person who intends to participate in a private securities transaction, prior to the transaction, must “provide written notice to the member with which he is associated describing in detail the proposed transaction and the person’s role therein and stating whether he has received or may receive selling compensation in connection with the transaction” Maier admits that he did not give SAI any such notice of either his agreement to solicit investors for Prism or of his receipt of finder’s fees or sales commissions from Prism.

Accordingly, the Hearing Panel concludes that Maier violated NASD Conduct Rule 3040 by referring investors to Prism for a fee. The Hearing Panel also concludes that, by violating NASD Conduct Rule 3040, Maier failed to “observe high standards of commercial honor and just and equitable principles of trade,” and so violated NASD Conduct Rule 2110.

II. False Report to SAI

Maier also violated NASD Conduct Rule 2110 by falsely reporting to SAI that: (1) he had not sold any unregistered investment products; (2) he had not been paid any finder’s fees; and (3) he had not sold, or offered for sale, any unapproved securities products.

Although Maier attempted to justify his answers by arguing that he was not selling the units in Prism, the Hearing Panel finds that he was. Maier made the initial contact with each of his clients, introduced them to Prism, and hosted a sales presentation at his home. These activities made him an essential part of Prism’s sales activities to those investors.

Even Maier himself acknowledged that his construction of the questions on the annual review was on “thin ice.”³⁴

Accordingly, the Hearing Panel concludes that Maier violated NASD Conduct Rule 2110 by filing a false report with SAI as alleged in Cause Two of the Complaint.

Sanctions

The requirement under NASD Conduct Rule 3040 that a registered representative notify his broker-dealer of all private securities transactions is founded upon the rationale that the broker-dealer must protect investors and itself through supervisory measures that impose conditions on the registered representative’s activities. To implement and enforce those measures, the broker-dealer must be apprised of any associated person’s outside involvement in securities transactions.³⁵ This requirement is a key component to effective investor protection. A registered representative’s failure to notify his or her firm of private securities transactions undermines this system and exposes the firm to potential liability from investors who understood that they were dealing with the firm’s authorized agent.

The NASD Sanction Guidelines recommend a monetary sanction for violations of NASD Conduct Rule 3040 that includes “any commissions, concessions, and other benefits” the respondent received as a result of his violations, plus an additional \$5,000 to \$50,000.³⁶ The Guidelines also provide that a suspension of up to two years should be considered. The Principal Considerations listed in the Guidelines for setting sanctions in a specific case include: (1) whether the respondent had a beneficial interest in the issuer; (2)

³⁴ TR. at 28.

³⁵ Jay Frederick Keeton, 50 S.E.C. 1128 (1992).

³⁶ NASD Sanction Guidelines 15 (1998).

whether the respondent attempted to create the impression that his broker-dealer sanctioned the activity; (3) whether the investors were customers of the respondent's broker-dealer; and (4) whether the respondent provided verbal notice of the transactions to his broker-dealer.

In the present proceeding, Maier obtained a beneficial interest in Prism, failed to give even verbal notice to SAI of his activities on behalf of Prism, and marketed Prism to his clients who were also SAI's clients. And while the Hearing Panel finds that Maier did not intentionally attempt to create the impression that SAI sanctioned the sale of Prism units, Maier did sponsor a sales presentation at his home where he regularly met with SAI's clients. By doing so, he acted in a manner that easily could have misled those clients into believing that SAI sanctioned his activities on behalf of Prism.

The Hearing Panel finds that Maier acted recklessly by failing to notify SAI of his intended sales activities for Prism and by conducting the sales presentation in a manner likely to confuse his customers into believing that SAI sanctioned the sale of Prism units. In addition, the Hearing Panel finds that Maier acted with a reckless disregard for the truth when he falsely reported to SAI that he had not engaged in private securities transactions and had complied with all of SAI's procedures. As Maier admitted, even a minimal inquiry would have countered Prendergast's opinion that Maier could participate as a soliciting agent for Prism without violating NASD's Conduct Rules or SAI's procedures.³⁷

Maier's arguments in mitigation were not persuasive. Essentially, Maier argued that he mistakenly relied on Prendergast's advice and that he acted in reliance on his good-faith belief that he was not engaged in selling the Prism units. Maier tried to paint himself

³⁷ TR. at 29.

as a victim. According to Maier, he was not thinking clearly due to his earlier illness, and he trusted Prendergast because he, like Maier, was a graduate of the Air Force Academy. In other words, although Maier readily admitted that he erred in not notifying SAI of his intent to solicit investors for Prism before he signed the Solicitation Agreement, he tried to mitigate the seriousness of his actions by arguing that he had been misled. Maier does not see that his error goes beyond that simple misjudgment. Maier did not demonstrate that he understood that he had an absolute duty to notify SAI of his intended activities. That is, Maier's mistake was not that he trusted Prendergast, but that he violated an absolute condition of his association with SAI and the absolute requirement of NASD Conduct Rule 3040. Maier's misplaced faith in Prendergast does not mitigate the seriousness of Maier's violation.

The Hearing Panel also finds it significant that early in the investigation Maier himself referred to the payments he received under the Solicitation Agreement as finder's fees. In fact, he admits that he told some of his customers that he would be getting a "referral fee."³⁸ But later, after having it pointed out to him that SAI's Compliance Manual proscribed finder's fees, Maier recharacterized the fees as management fees. Maier knew better. He knew that he would not be providing management services to Prism. Consequently, calling the payments management fees was an artifice to justify his activities on Prism's behalf. Furthermore, Maier admitted that he was well aware of the rule against private securities transactions, which is precisely why he spoke to Prendergast in the first place. It is also significant that Maier did not speak to the attorney Prendergast claimed had drafted and approved the Solicitation Agreement.

³⁸ TR. at 18.

On the other hand, there are several mitigating factors that the Hearing Panel did consider. Maier has had a long, disciplinary-free career in the securities industry. Also, he admitted fault and resigned from SAI when the investigation leading to this disciplinary proceeding commenced. As a result, Maier has been out of the securities industry for more than 18 months. Further, Maier cooperated with NASD's investigation without trying to conceal his involvement with Prism.

On balance, the Hearing Panel concludes that the relevant factors under the Sanction Guidelines suggest that a censure, a fine of \$34,750 (\$5,000 plus \$29,750 in fees Maier received from Prism), and a brief suspension are the appropriate sanctions in this proceeding for Maier's violations of Conduct Rule 3040 as alleged in the Cause One of the Complaint.

In addition, the Hearing Panel concludes that a \$5,000 fine is appropriate under Cause Two of the Complaint for filing the false report with SAI. In setting this fine, the Hearing Panel notes that there is no specific guideline for this offense. Hence, for guidance, the Hearing Panel looked to other guidelines involving sanctions for dishonest behavior and false reporting. For example, the guidelines for filing a false or inaccurate report and for falsification of records recommend fines of \$5,000 to \$100,000. Considering the relative severity of those analogous violations, the facts in this proceeding, and the sanctions assessed under Cause One of the Complaint, a \$5,000 fine is appropriately remedial.

Therefore, Maier is censured, fined a total of \$39,750, and suspended for 30 business days. Maier is also ordered to requalify by examination before reassociating with an NASD member firm. Finally, Maier is assessed hearing costs in the amount of \$624.90,

consisting of transcript costs in the amount of \$324.90 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.³⁹

HEARING PANEL

By: Andrew H. Perkins
Hearing Officer

Copies to:

David A. Watson, Esq. (by first class mail)
Rory C. Flynn, Esq. (by first class mail)
Donald C. Maier (by certified and first class mail)

³⁹ 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.