NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. PHILIPPE N. KEYES (CRD No. 1172528), 23034 Birch Glen Circle Valencia, CA 91354, Respondent.	Disciplinary Proceeding No. C02040016 Hearing Officer—Andrew H. Perkins **HEARING PANEL DECISION** November 29, 2004

Respondent is barred for participating in private securities transactions without giving prior written notice to the NASD member firm with which he was associated, in violation of NASD Conduct Rules 3040 and 2110. In light of the bar, no additional sanction is imposed for using misleading sales literature, in violation of NASD Conduct Rules 2210 and 2110.

Appearances

For the Department of Enforcement: Jacqueline D. Whelan, Regional Counsel, and Joel T. Kornfeld, Senior Regional Attorney, Los Angeles, CA (Rory C. Flynn, NASD Chief Litigation Counsel, Washington, DC, Of Counsel).

For the Respondent: Richard A. Ruben, Esq., Woodland Hills, CA.

DECISION

I. INTRODUCTION

The Department of Enforcement (the "Department") filed a two-count Complaint on April 5, 2004, charging that Philippe N. Keyes ("Keyes" or the "Respondent") violated NASD Conduct Rules 3040 and 2110 by engaging in selling away (private securities transactions) without providing his employer with prior written notice, and NASD Conduct Rules 2210 and

2110 by using unbalanced and misleading sales literature in connection with the recommendation and sale of securities.[1] Keyes filed a detailed Answer[2] on May 12, 2004, in which he denied the charges and requested a hearing in Los Angeles, CA.

On August 16, 2004, a one-day hearing was held in Los Angeles before a hearing panel composed of the Hearing Officer and two current members of District 2 Committee.[3] The Department presented the testimony of the NASD investigator assigned to this case and offered 24 exhibits, which were admitted in evidence; the Respondent testified on his own behalf.[4]

II. FINDINGS OF FACT AND CONCLUSIONS OF LAW

A. Background

Keyes worked in the securities industry for 15 years.[5] Between April 2000 and November 28, 2001, he was associated with Investors Capital Corporation ("ICC"), an NASD member firm, and registered with NASD as an Investment Company and Variable Contracts Products Representative.[6] Keyes worked out of his own office in Valencia, California, and his supervisor, Ronald Wightman ("Wightman"), was located in an ICC office of supervisory jurisdiction in Salt Lake City. ICC's home office was in Massachusetts.

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[1] The Complaint also named Ronald D. Wightman as a respondent. Wightman, however, submitted an offer of settlement that NASD accepted by order dated August 24, 2004.

[2] In addition to a denial of the charges and two affirmative defenses, the Respondent set out 29 mitigating circumstances. At the hearing, the Respondent used his Answer as a pre-hearing brief.

[3] The Hearing Panel heard testimony from two witnesses, including the Respondent, and received 24 exhibits the Parties offered jointly. In addition, on July 29, 2004, the Parties filed Stipulations, covering many of the salient facts.

[4] References to the hearing transcript are cited as Tr., and the exhibits are cited as Ex. The Respondent did not offer any exhibits.

[5] Stip. ¶¶ 1–11.

[6] Stip. ¶ 10; Ex. 22, at 5.

Most recently, Keyes was associated with Spelman & Co., Inc. His registration as an Investment Company and Variable Contracts Products Representative terminated effective April 9, 2002.[7] He is not currently associated with an NASD member firm or registered with NASD.

B. Jurisdiction

NASD has jurisdiction under NASD By-Laws, Article V, Section 4. The Complaint is based upon conduct that commenced while Keyes was registered with NASD, and the Department filed the Complaint within two years after his registration terminated.

C. Sale of Wynn Notes

In early 2000, Wightman recruited Keyes to join ICC, which he did in April 2000.[8] Larry Lee ("Lee") of Income Builders[9], Wightman's general broker for Allianz Life Insurance Company, had referred Wightman to Keyes. Keyes had worked with Lee for about eight years in connection with his annuity business through Life USA.[10] Shortly after joining ICC, Lee and Wightman invited Keyes to meet certain representatives of The Wynn Company, Inc. ("Wynn") in Salt Lake City.[11] The purpose of the meeting was to introduce Keyes to the Wynn secured commercial note program (the "Wynn Program"). Keyes also planned to meet with Wightman to establish a business plan for his association with ICC.[12]

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[7] Ex. 22, at 4.

[8] Tr. at 73.

[9] Income Builders was a general life insurance broker in Salt Lake City. (Tr. at 159.)

[10] Tr. at 80.

[11] *Id.* at 78–79, 150–51; Stip. ¶ 107.

[12] Tr. at 80.

In or about July 2000, Keyes met at Wynn's headquarters with Dennis Wynn,[13] Lee, and others. Wightman attended a portion of the meeting. Dennis Wynn gave a sales presentation regarding Wynn's business and the Wynn Program.[14] In addition, Keyes was given some sales pamphlets that described the Wynn Program.

Essentially, Wynn's business was the sale of automobiles through high-interest loans to individuals with impaired credit ratings. The average purchase price of the cars was $5,400, and the average term of the car loans was 24 months. The purchase loans carried annual interest rates of 28–30%.[15] To finance its operations, Wynn sold promissory notes to individual investors (the "Wynn Notes"). The Wynn Notes were secured by an Assignment of Payments Agreement, and the notes and assignment agreements were held in escrow by an escrow agent.[16]

Following the sales presentation, Keyes toured Wynn's facility. He concluded that the company appeared to be an operating company. Keyes testified that employees were answering the phones and there were cars for sale on the premises. He also saw a few checks from people who had purchased automobiles. Based on his observations and conversations with Wynn employees, Keyes concluded that Wynn was a viable operation.[17] Keyes did not ask to review any of Wynn's books and records, including any of the documentation for the Wynn Program.

Keyes then went from the Wynn meeting to Wightman's office to talk about their business relationship. Wightman discussed his desire to build a sales team and to implement a

[13] Dennis Wynn is Wynn's founder and president.

[14] Tr. at 83–84.

[15] Ex. 2, at 2.

[16] Keyes testified, however, that he understood that the Wynn Notes were secured directly by the automobiles and that Wynn held title to the automobiles. (Tr. at 86.)

[17] Tr. at 88–89.

new business strategy. Wightman wanted to transfer his team's existing annuity business to Integrity Life and then convert the policies from fixed to variable annuities. Wightman also discussed rolling the interest their customers earned on the Wynn notes into variable annuity contracts.[18]

After his meetings with Wightman and Dennis Wynn, Keyes prepared some sales literature on the Wynn Program and began selling Wynn Notes to his clients. Between January 2, 2001, and November 20, 2001, Keyes sold Wynn Notes with a face value of $1,900,634.70.[19] Keyes received $63,412 as commissions from Wynn on these transactions.[20] Keyes conceded that he participated[21] in the foregoing sales without providing ICC with written notice of his intent to participate in the transactions or receiving ICC's written permission to participate in the transactions.[22]

NASD Conduct Rule 3040 prohibits an associated person from participating in private securities transactions ("selling away") without prior detailed written notice to his or her firm. Rule 3040 defines a "private securities transaction" as "any securities transaction outside the regular course or scope of an associated person's employment with a member. Where a broker may receive selling compensation, the member firm must respond to the notice in writing indicating whether it approves or disapproves of the person's participation in the proposed transaction. If the member approves the transaction, the member must record the transaction in

[18] Tr. at 90–91.

[19] Stip. ¶¶ 13–46.

[20] *Id.* at ¶¶ 104–05.

[21] *Id.* at ¶¶ 49–103.

[22] *Id.* at ¶¶ 111–12.

its books and records and supervise the associated person's participation in the transaction as if the transaction were executed by the member firm.

NASD Conduct Rule 3040 protects both the investing public and NASD member firms. On the one hand, the Rule ensures that member firms adequately supervise the suitability and due diligence responsibilities of their associated persons and protects investors from being misled as to employing firms' sponsorship of transactions that are conducted away from the firms. On the other hand, the Rule serves to protect employers against investor claims arising from associated persons' private securities transactions.[23] To achieve these purposes, the reach of Rule 3040 is construed broadly, encompassing the activities of associated persons who participate in any manner in a transaction.[24]

Keyes contends, however, that he did not violate Conduct Rule 3040 because the Wynn Notes were not "securities." The Hearing Panel rejects this defense. The Hearing Panel concludes that the Wynn Notes fall within the definition of "security" in Section 2(a)(1) of the Securities Act of 1933[25] and Section 3(a)(10) of the Securities Exchange Act of 1934[26] as "any note," and that they are not excluded from that definition under the Supreme Court's "family resemblance" test set forth in *Reves v. Ernst & Young*, 494 U.S. 56, 63–65 (1990).

The Supreme Court devised the family resemblance test in *Reves* to "distinguish, on the basis of all of the circumstances surrounding the transactions, notes issued in an investment

[23] *Department of Enforcement v. Carcaterra*, No. C10000165, NASD Discip. LEXIS 39, at *8–9 (N.A.C. Dec. 13, 2001).

[24] *See Stephen J. Gluckman*, Exchange Act Release No. 41,628, 1999 SEC LEXIS 1395, at *17 (July 20, 1999).

[25] 15 U.S.C. § 77b(a)(1).

[26] 15 U.S.C. § 78c(a)(10).

context (which are 'securities') from notes issued in a commercial or consumer context (which are not)."[27] The four factors identified by the Court were (1) the motivations of the seller and buyer of the note—"[i]f the seller's purpose is to raise money for the general use of a business enterprise or to finance substantial investments and the buyer is interested primarily in the profit the note is expected to generate, the instrument is likely to be a 'security'"; (2) the plan of distribution—notes that are "offered and sold to a broad segment of the public" are likely to be "securities"; (3) the reasonable expectations of the investing public—if notes are characterized as "investments" they are likely to be "securities"; and (4) "whether some factor such as the existence of another regulatory scheme significantly reduces the risk of the instrument, thereby rendering application of the Securities Acts unnecessary."[28]

The Wynn notes do not resemble any of the instruments that the Court recognized as being exempt from the definition of a security, and there is no basis for adding the notes to the list of non-securities. The purpose of the notes was to raise operational capital for Wynn's business; investors were attracted by the notes' high rate of interest; the notes were distributed broadly;[29] purchasers of the notes reasonably considered that they were making an investment; and no other scheme of regulation was available.[30] Contrary to the Respondent's argument, the fact that a bank might have acted as an escrow agent under the Wynn Program does not mean that the notes were regulated under the banking laws. Indeed, Keyes points to no applicable banking regulation. The Hearing Panel further finds that the Wynn Notes were not

[27] *Reves*, 494 U.S. at 62-63.

[28] *Id.* at 66-69.

[29] Keyes himself sold the Notes to approximately 35 investors. (Tr. at 99.)

[30] *See Chris Dinh Hartley*, Exchange Act Release No. 50,031, 2004 SEC LEXIS 1507, at *8 (July 16, 2004).

collateralized,[31] and the note holders ended up as unsecured creditors when Wynn filed a petition under Chapter 11 of the Bankruptcy Code.[32] Thus, the Wynn Notes were not subject to an alternative regulatory scheme and did not have any risk-reducing attributes that would render the application of the Securities Act unnecessary.[33]

Accordingly, the Hearing Panel concludes that the Wynn Notes were securities and that Keyes violated NASD Conduct Rule 3040 by selling securities for compensation without giving ICC prior written notification or receiving ICC's prior written approval. Keyes also thereby violated NASD Conduct Rule 2110, which requires the observance of high standards of commercial honor and just and equitable principles of trade.[34]

D. Misleading Sales Literature

In connection with the foregoing transactions, Keyes provided potential investors with three pieces of sales literature pertaining to the Notes.[35] He received two of the pieces from Wynn—a tri-fold brochure (the "Brochure")[36] and an informational flyer.[37] The third piece was an "investment triangle,"[38] which he prepared and used as a sales brochure.[39]

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[31] Tr. at 154.

[32] Ex. 11.

[33] *Cf. Department of Enforcement v. Luther A. Hanson*, 2001 NASD Discip. LEXIS 41, at *14–15 (N.A.C. Dec. 13, 2001) (holding that the fact that the respondent left a number of customers unpaid after defaulting on its promissory notes and filing for bankruptcy is inconsistent with the notion that regulation under the federal securities laws was unnecessary). *See also Hartley*, 2004 SEC LEXIS 1507 (finding that notes issued by a lender and promoted with a brochure nearly identical to the one used by Keyes were securities).

[34] *See Stephen J. Gluckman*, Exchange Act Release No. 41,628, 1999 SEC LEXIS 1395, *22 (July 20, 1999)(citations omitted).

[35] Stip. ¶¶ 115–18.

[36] Ex. 1.

[37] Ex. 2.

[38] Ex. 3.

[39] Tr. at 106.

In general, NASD Conduct Rule 2210(d) requires that sales literature " 'disclose in a balanced way the risks and rewards for the touted investment.' "[40] When sales literature sets forth points attractive to investors, it also must explain any contingent or speculative factors and provide a sound basis for evaluating a potential investment.[41] Rule 2210(d)(1)(B) prohibits exaggerated, unwarranted, or misleading statements or claims.[42] Moreover, communications may not omit any material that could cause communications to be misleading.

Keyes admits that the Wynn sales literature did not conform to the requirements of NASD Conduct Rule 2210.[43] Moreover, the evidence shows that each of the communications failed to address adequately the investment risks associated with the Notes while using language intended to create the impression of safe and certain returns. The brochure also made the false claim that the Notes were collateralized to 150% of their face value. In addition, the triangle compared the relative risks and returns of various classes of investments without disclosing the relevant differences among them. In summary, none of the communications provided potential investors with a sound basis for evaluating the facts regarding the Notes.[44]

The Hearing Panel concludes that the Wynn sales literature was not based on principles of fair dealing and good faith, and failed to provide a sound basis for evaluating the facts associated with an investment in the Notes. The sales literature was seriously deficient and

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[40] *Robert L. Wallace*, Exchange Act Release No. 40,654, 1998 SEC LEXIS 2437, at *10 n. 8 (Nov. 10, 1998) (citing *Jay Michael Fertman*, Exchange Act Release No. 33,479, 1994 SEC LEXIS 149, at *17 (Jan. 14, 1994)).

[41] *See Excel Financial, Inc.*, Exchange Act Release No. 39,296, 1997 SEC LEXIS 2292, at *16, *19 (Nov. 4, 1997); *see also* Rule 2210(d)(1)(A).

[42] *See Department of Enforcement v. U.S. Rica Financial, Inc*., No. C01000003, 2003 NASD Discip. LEXIS 24, at *13 (N.A.C. Sept. 9, 2003).

[43] Ans. ¶¶ 13–14.

[44] *See* Ex. 14.

misleading. Accordingly, the Hearing Panel finds that Keyes violated NASD Conduct Rules 2110 and 2210, as alleged in the second cause of the Complaint.

III. SANCTIONS

A. Selling Away

Selling away is a serious violation. Conduct Rule 3040 is designed not only to protect investors from unsupervised sales, but also to protect securities firms from liability and loss resulting from such sales. Such misconduct deprives investors of a firm's oversight, due diligence, and supervision—protection investors have a right to expect.[45]

The NASD Sanction Guidelines ("Guidelines") recommend a fine ranging from $5,000 to $50,000, with suspensions that vary in length according to the dollar amount of sales. Here, where the amount is above $1 million, the Guidelines recommend a suspension of one year to a bar, a period that can be increased or decreased based on aggravating or mitigating factors.[46]

In addition to the dollar amount of sales, adjudicators are to consider twelve other factors when determining sanctions in selling away cases: (1) number of customers; (2) length of time over which the selling away activity occurred; (3) whether the product has been found violative of federal or state securities laws or federal, state or SRO rules; (4) whether respondent had a proprietary or beneficial interest in, or was otherwise affiliated with, the selling enterprise or issuer, and, if so, whether respondent disclosed this information to his customers; (5) whether the respondent attempted to create the impression that his employer sanctioned the activity; (6) whether respondent's selling away activity resulted, either directly or indirectly, in injury to the investing public and, if so, the nature and extent of the injury; (7) whether respondent sold away

[45] *Hartley*, 2004 SEC LEXIS 1507, at *15.

to customers of his or her employer; (8) whether respondent provided the member firm with verbal notice of the details of the proposed transaction and, if so, the firm's verbal or written response, if any; (9) whether respondent sold the securities after the member firm instructed him or her not to sell the product at issue; (10) whether respondent participated in the sale by referring customers or selling the product directly to customers; (11) whether respondent recruited other registered individuals to sell the product; and (12) whether respondent misled his employer about the existence of the selling away activity or otherwise concealed the selling away activity from the firm.[47]

Taking the foregoing into consideration, the Hearing Panel concludes that this is an egregious case. Keyes sold nearly $2 million of Wynn Notes to 35 customers over approximately 11 months before ICC detected the activity and terminated Keyes' employment. In addition, Keyes made no effort to separate these transactions from his other activities through ICC. Indeed, Keyes testified that he marketed the Wynn Notes as part of the scheme devised by Wightman to switch customers from fixed to variable annuities. These were ICC customers. Furthermore, the Hearing Panel notes that a number of customers had not cashed out before Wynn filed for bankruptcy protection. They therefore likely lost substantially all of their investments because they were unsecured creditors in the bankruptcy proceeding.[48] Keyes also recruited at least one other person to find investors willing to invest in the Wynn Program.[49]

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[46] NASD Sanction Guidelines 17 (2004 ed.).

[47] *Id.* at 17–18.

[48] In addition, Keyes' attorney represented that the Wynn bankruptcy was converted to a Chapter 7 case, indicating that there were insufficient assets to support a reorganization plan. Keyes testified in his on-the-record interview on October 25, 2002, that he could not recall the extent of the losses his customers suffered. (Ex. 20, at transcript pp. 142–43.)

[49] Ex. 19.

Conversely, Keyes portrays his violation as minor and caused in substantial part by his reliance on Wightman, his supervisor. But most of the factors Keyes cites are not mitigating. Rather, they are more properly viewed as the absence of aggravating circumstances. For example, Keyes emphasizes that he did not act with scienter and that he has no disciplinary history. Scienter is not an element of either offense, however, and NASD has repeatedly rejected the argument that lack of a disciplinary history is a mitigating factor.[50]

Keyes also stresses that he admitted his wrongdoing and cooperated with NASD's investigation. While these generally may be considered mitigating factors, in this case any credit to be given Keyes is overshadowed by his refusal to acknowledge responsibility for his violations. Keyes places all of the blame with Wightman, while totally ignoring his duties as a securities professional. But, as a registered person, Keyes cannot shift responsibility to his firm or his supervisor.[51] Moreover, Keyes exhibited absolutely no understanding of NASD's rules relating to selling away and communications with the public. Keyes testified that, although he had been registered with NASD for approximately 15 years and had taught the review course for the Series 6 exam for approximately 8 years, he had never heard of the rules governing outside business activities. The Hearing Panel finds this testimony lacks credibility. The prohibition against selling away is fundamental to a registered representative's duty to his customers and his firm. Moreover, as a registered person in the securities industry, Keyes is assumed as a matter of

[50] See, e.g., *Department of Enforcement v. Roethlisberger*, No. C8A020014, 2003 NASD Discip. LEXIS 48, at *18 (N.A.C. Dec. 15, 2003).

[51] *Department of Enforcement, v. Guang Lu*, No. C9A020052, 2004 NASD Discip. LEXIS 8, at *35 (May 13, 2004) (quoting *Rafael Pinchas*, Exchange Act Release No. 41,816, 1999 SEC LEXIS 1754, at *14 (Sept. 1, 1999).

law to have read and had knowledge of NASD's Rules and the standards in the securities industry.[52]

In conclusion, the evidence and Keyes' demeanor support the Hearing Panel's conclusion that Keyes should be barred. Keyes represents a substantial risk to the investing public, and he demonstrated an unwillingness to conform his conduct to the rules governing all securities professionals. The Hearing Panel will not impose a fine in light of the bar. A monetary fine would serve no additional remedial purpose.[53]

B. Misleading Sales Literature

The Guidelines governing communications with the public recommend that widely distributing a misleading advertisement warrants a fine ranging from $1,000 to $20,000 and a suspension of up to 60 days.[54] The Hearing Panel finds that the Respondent's conduct was serious and involved a number of aggravating factors. For instance, Keyes demonstrated total ignorance of his responsibility to use only approved sales literature. In addition, he took no steps to ensure that the materials he used were accurate. And, with respect to the investment triangle he

[52] *See, e.g., Department of Enforcement v. U.S. Rica Financial, Inc.*, No. C01000003, 2003 NASD Discip. LEXIS 24, at *39 n.11 (Sept. 9, 2003).

[53] *See e.g.*, *Department of Enforcement v. Castle Securities Corp*., No. C3A010036, 2004 NASD Discip. LEXIS 1, at *36–37 (N.A.C. Feb. 19, 2004).

[54] Guidelines 85–86.

prepared and distributed, Keyes made no effort to ensure that he would not mislead investors regarding the substantial risks involved with the Wynn Program.

Accordingly, the Hearing Panel concludes that a sanction at the upper end of the recommended range would be appropriate under the facts and circumstances of this case.[55] However, in light of the bar imposed on the first violation, the Hearing Panel will not impose an additional sanction for this violation. A suspension would be redundant,[56] and a monetary fine would serve no additional remedial purpose.[57]

IV. ORDER

Philippe N. Keyes is barred from associating with any member firm in any capacity for engaging in selling away (private securities transactions) without providing his employer with prior written notice, in violation of NASD Conduct Rules 3040 and 2110.

In addition, the Respondent is ordered to pay costs in the amount of $2,221.69, which includes an administrative fee of $750 and transcript costs of $1,471.69.

These sanctions shall become effective on a date set by the NASD, but not earlier than 30 days after this Decision becomes the final disciplinary action of the NASD, except that, if this

[55] The Hearing Panel would have imposed a six-month suspension in all capacities and a $15,000 fine.

[56] *Department of Enforcement v. Hodde*, No. C10010005, 2002 NASD Discip. LEXIS 4, at *17 (N.A.C. Mar. 27, 2002).

[57] *See e.g.*, *Castle Securities Corp.*, 2004 NASD Discip. LEXIS 1, at *36–37.

Decision becomes the final disciplinary action of NASD, the bar shall become effective immediately.[58]

Andrew H. Perkins
Hearing Officer
For the Hearing Panel

Copies to:

Richard A. Ruben, Esq. (facsimile and first-class mail)
Philippe N. Keyes (overnight delivery and first-class mail)
Jacqueline D. Whelan, Esq. (first-class and electronic mail)
Rory C. Flynn, Esq. (first-class and electronic mail)

[58] 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.