NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant v. JOHN M. MEYERS (CRD No. 2580153), BRIAN C. KLEIN (CRD No. 2723977), ISRAEL E. LOZADA (CRD No. 2984203), Respondents.	Disciplinary Proceeding No. C3A040023 (Consolidating C3A040023, C3A040024 and C3A40025) Hearing Officer – DMF **HEARING PANEL DECISION** August 5, 2005

Summary

Respondents failed to disclose to customers that they would be receiving additional compensation for selling the particular stock they recommended and they made unreasonable price predictions for the stock, all in violation of Section 10(b) of the Securities Exchange Act of 1934, SEC Exchange Act Rule 10b-5, and NASD Rules 2120 and 2110. For these violations, Respondent Meyers is suspended in all capacities for eighteen months and fined $45,000; Respondent Klein is suspended in all capacities for one year and fined $40,000; and Respondent Lozada is suspended in all capacities for one year and fined $65,000. In addition all Respondents are required to re-qualify and are ordered to pay costs.

Appearances

Jacqueline D. Whelan, Esq., Denver, CO, and Sylvia M. Scott, Esq., Los Angeles, CA (Rory C. Flynn, Esq., Of Counsel) for Complainant.

Richard Slavin, Esq. and Amy S. Gare, Esq., Bridgeport, CT, for Respondents Meyers and Klein.

Robin Nackman, Esq. and Jeffrey Feinberg, Esq., Smithtown, NY, for Respondent Lozada.

DECISION

I. Procedural History

In May 2004, the Department of Enforcement filed separate Complaints against Respondents John M. Meyers, Brian C. Klein and Israel E. Lozada. Each Complaint charged that during the period from approximately October 1, 1998 until approximately November 30, 1999, the Respondent, while associated with former NASD member First Providence Financial Group, LLC, violated Section 10(b) of the Securities Exchange Act of 1934, SEC Exchange Act Rule 10b-5, and NASD Rules 2120 and 2110 in connection with the sale of Natural Health Trends Corporation (NHTC) stock by (1) failing to disclose to purchasers that he would receive additional compensation, over and above his normal commission, for the sale of NHTC stock and (2) making unreasonable price predictions for NHTC to purchasers. Except for allegations identifying specific affected customers, the Complaints were identical. Therefore, in July 2004, the Chief Hearing Officer, on her own initiative and after obtaining and considering the views of the parties, consolidated all three Complaints in a single proceeding, pursuant to Rule 9214.

All three Respondents filed Answers to the Complaints and requested a hearing. The consolidated hearing was held in New York, NY, March 8-11 and 15-18, 2005, before an Extended Hearing Panel that included the Hearing Officer, a former member of the District 10 Committee and a former member of the District 3 Committee.

II. Facts

A. Respondents

Meyers entered the securities industry in 1995. From 1996 to 1998 he was registered with former NASD member Walsh Manning Securities, LLC, initially as a general securities representative but beginning in 1997 also as a general securities principal. In 1998 he became associated with First Providence as a general securities representative and principal. Since 2001 he has been registered in both capacities through Brookstreet Securities Corporation, and he currently manages a Brookstreet office of supervisory jurisdiction. He has no prior disciplinary record. (JX 16; Tr. 1435-40, 1578-79.)

Klein entered the securities industry in 1996. From 1996 to 1998 he was registered through Walsh Manning as a general securities representative; he was registered through First Providence in the same capacity from 1998 to 2001. Since 2001 he has been registered through Brookstreet in the office of supervisory jurisdiction supervised by Meyers. He has no prior disciplinary history. (JX 15; Tr. 1080-81, 1337-38.)

Lozada entered the securities industry in 1997. Like Meyers and Klein, he was registered as a general securities representative through Walsh Manning from 1997 to 1998, and through First Providence from 1998 to 2001. He was registered through other NASD members from 2001 to 2003, but he is currently employed by an insurance company and is not registered or associated with any NASD member. He also has no prior disciplinary history. (CX 143; Tr. 1819-24.)

B. NHTC

NHTC was incorporated in 1988 under another name and became NHTC in 1993. As of October 1998, the beginning of the relevant period, NHTC's public SEC filings described the company as "a corporation which develops and operates businesses to promote human wellness," including marketing a line of over-the-counter (OTC) homeopathic pharmaceutical products.[1] Those filings disclosed that NHTC's operations had not been successful. For 1997, the company had a net loss of more than $7.7 million on total revenues of approximately $7 million, compared to a net loss of approximately $900,000 the year before on sales of nearly $5 million, and as of December 31, 1997, NHTC had an accumulated deficit of more than $11 million. To obtain working capital, during 1997 NHTC had sold convertible debentures and convertible preferred stock through private placements, but by year end 1997 it had a working capital deficit of more than $4.6 million. In certifying the company's 1997 year end financial statements, NHTC's auditors expressed "substantial doubt about [NHTC's] ability to continue as a going concern," if it were unable to obtain additional funding during 1998. (CX 5; JX 1.) NHTC's SEC filings disclosed that its operating problems continued in 1998. To obtain cash to fund its operations, during the first six months of the year NHTC sold more than $3.7 million in convertible preferred stock through private placements. In spite of this, as of June 30, 1998, NHTC had a working capital deficit of over $3 million, and management was seeking at least $3 million in additional capital to continue the firm's business plan. NHTC's SEC filings were available to Respondents. (CX 5; JX 2-3; Tr. 1111, 1252-53, 1352-54, 1603.)

In November 1998, NHTC's management gave an up-beat "road show" presentation to NHTC's retail brokers, including Respondents. During the road show, NHTC's management provided an overview of the company, described the "Natural

---

[1] As of the end of 1997, NHTC also operated three vocational schools that offered training for persons to become licensed in therapeutic massage and/or skin care, and operated natural health care centers that "provided multidisciplinary complementary health care in the areas of alternative and nutritional medicine," as well as a business that "offered on-site massages to businesses," but NHTC closed or sold all those businesses prior to October 1998. Thus, as of October 1998, NHTC's sole remaining line of business was the marketing of homeopathic OTC products. (JX 1-3.)

Products Industry," and discussed NHTC's products, marketing strategy ("guerilla marketing"), and acquisition strategy (including a proposed acquisition of Kaire International, which "distribute[d] natural products through its network of 425,000 marketing associates"). (CX 8A; Tr. 1173-77, 1451-53, 1858-63.)

For the entire year 1998, however, NHTC had operating losses of more than $2.7 million, and it ended the year with a working capital deficit of over $2 million. NHTC's primary remaining business division owed approximately $1.6 million to creditors at year end 1998; NHTC reported that it was attempting to work out a settlement with the creditors, but warned that if that effort failed it might cease the operations of that portion of its business. NHTC's accountants continued to express doubts about its ability to continue as a going concern without substantial additional capital. (CX 5; JX 5.)

In February 1999, NHTC purchased the assets and some of the liabilities of Kaire, as forecast at the road show. The value of the assets that NHTC purchased, however, was less than the amount of liabilities it acquired. NHTC incurred more than $1 million in operating losses for the first half of 1999, and it continued to report that it needed capital and that it had a working capital deficit of approximately $1.8 million. (JX 6, 13.)

NHTC participated in another road show at First Providence during 1999 at which it provided its "Financial Summary and Operating Plan as of June 30, 1999." The Plan listed a number of accomplishments to date and initiatives for the balance of 1999, and included a press release stating that NHTC had record sales for the first six months of 1999, due primarily to its acquisition of Kaire, and that NHTC's net loss had decreased to just under $1 million for the second quarter of 1999. According to NHTC's SEC filings, however, by the end of the third quarter of 1999 NHTC had a net loss from operations for the year of approximately $2 million, a working capital deficit of nearly $6 million, still needed substantial additional financing, and was attempting to reach settlements with certain of its creditors. NHTC warned that any failure to obtain additional financing or to reach satisfactory settlements with its creditors "would have a material adverse effect on its business, prospects, financial conditions and results of operations." (CX 8B; JX 8.)

C. Respondents' Sales of NHTC Stock

NHTC was listed on the Nasdaq small cap market. As of October 1, 1998, the price of NHTC was less than $2 per share. The price generally increased, with some temporary set-backs, through the rest of 1998 and into 1999. In January 1999, NHTC exceeded $4 on several dates, and after falling back below $4 in February, it exceeded $5 per share on several days in March 1999, reaching an intra-day high of $6.625 on March 9. From that point, NHTC began a slow but steady decline. By early May 1999, the stock was at $3.50; by late summer it was generally in the low $3 range; in September it fell below $3 and never reached that price again; by the end of 1999 it was again below $2. (JX 10.)

From October 2, 1998 through April 30, 1999, First Providence accounted for more than 84% of the retail interest in NHTC. As of April 30, 1999, approximately 4.7 million shares of NHTC, or approximately 75% of the total outstanding NHTC shares, were held in the accounts of First Providence customers. (CX 3, 4; CPX 1; Tr. 109-10.)[2]

As of May 1999, First Providence changed clearing firms, and there is less detailed information in the record concerning its sales from that point to the end of the

[2] CPX 1 is Complainant's Post-Hearing Exhibit 1, filed on May 19, 2005, pursuant to the agreement of the parties and the Hearing Officer's ruling that the first page of CX 4 was inaccurate in certain respects, and should be revised. (Tr. 1046-47.)

period in question, November 30, 1999. Nevertheless, it is undisputed that First Providence kept NHTC on the list of stocks that its registered representatives were allowed to recommend to their customers throughout the period.[3] (CX 10; Tr. 1094-95.)

All three Respondents began recommending and selling NHTC to their customers in early October 1998 and continued to recommend it thereafter, notwithstanding the company's operational history or the movements of its stock. Klein, for example, sold more than 50,000 shares of NHTC in 26 transactions to 19 customers in October 1998; in January 1999, as the price of NHTC rose, he sold more than 130,000 shares; in July 1999, after the stock had been falling for several months and the company's operations had shown continuing losses, he still sold more than 60,000 shares; and in October, when the stock had slipped below $3, he sold more than 50,000 shares. As of the end of 1999, Klein's customers held nearly 800,000 shares of NHTC. (CX 12-14, 62; Tr. 1413.)

Meyers and Lozada also sold large volumes of NHTC to their clients, and like Klein, their sales never flagged even as the stock price faded. For example, Meyers sold more than 190,000 shares of NHTC to his customers in October 1998; approximately 75,000 shares in January 1999; more than 50,000 shares in July 1999; and more than 80,000 shares in October 1999. Lozada sold more than 300,000 shares in October 1998; more than 55,000 shares in January 1999; more than 40,000 shares in July 1999 and nearly 70,000 shares in October 1999. At the end of 1999, both Meyers' customers and Lozada's customers held more than 1.1 million shares in their accounts. (CX 64-66; 111, 112-13, 156.)

[3] In December 2003, First Providence and its two owners, Kenneth M. Klein (Respondent Klein's brother) and Paul G. Wasserman submitted a Letter of Acceptance, Waiver and Consent to NASD pursuant to which First Providence was expelled from NASD membership and the individuals were barred from association with any NASD member in any capacity. (CX 1.)

Respondents also aggressively discouraged their customers from selling NHTC throughout the period. Although the customers who testified conceded that Respondents did not refuse to accept sell orders, they testified that when they sought to sell NHTC, all of the Respondents predicted that the stock would continue to gain or would recover from its losses, and in a number of cases persuaded them to purchase additional NHTC shares. (Tr. 50, 127, 161-62, 243-44, 267, 395-96, 431-32, 531-32, 551, 596-97, 662-63, 706, 733, 931-32, 938.)

D. Sales Compensation

From October 1998 through October 1999, First Providence paid its representatives, including Respondents, sales credits above and beyond their normal sales compensation for their sales of NHTC stock. The gross sales credits on Respondents' NHTC sales during this period ranged from $.125 to $.625 per share, and Respondents generally received a payout of 50% of the gross credits. These sales credits accounted for the bulk of Respondents' compensation during the 13 month period October 1998 through October 1999. For Meyers, NHTC sales accounted for 82% of his total gross commissions of approximately $635,000 for the entire period; for Klein, they accounted for approximately 80% of his total gross commissions of more than $575,000 for the entire period; and for Lozada, they accounted for nearly 70% of his total gross commissions of more than $800,000 for the entire period, including more than 90% of his gross commissions in seven of the 13 months.[4] (CX 14, 66, 113.)

[4] For the period October 1, 1998 through April 30, 1999, NHTC sales accounted for approximately 88% of Klein's and Meyers' and 93% of Lozada's gross commissions. Respondents' earnings from NHTC sales were disproportionate to the number of transactions involved. Meyers, for example, calculated that his NHTC sales, which accounted for 80% of his gross commissions, represented only 14% of his total trades during the 13-month period in question. Although Respondents received both a share of the firm's mark-up and a sales credit for selling NHTC, they generally received only a small portion of the firm's modest

In November 1999, however, the picture changed drastically. Although First Providence still allowed its representatives to recommend NHTC, the firm stopped paying them sales credits on NHTC sales, and NHTC sales accounted for only 5.2% of Meyers' gross commissions, compared to 72.4% the prior month, just 1% of Lozada's gross commissions, compared to 73% the prior month, and none of Klein's gross commissions, compared to 60.1% the prior month.[5] (CX 14, 66, 113.)

The sales credits paid by First Providence were not disclosed on the trade confirmations or account statements that were sent to its customers, and all three Respondents testified that they did not ordinarily tell their customers that they would, or might, receive undisclosed sales credits for selling NHTC. Meyers testified that the question of his compensation came up frequently in his conversations with customers. He said that "in a lot of cases" he told his customers that he would "discount my commissions for them, or my markup for them," but he did not disclose that he would or might receive a sales credit; moreover, he sometimes told customers that he would discount his commissions on the purchase of NHTC and plan to take a higher commission when the customer sold the stock at a profit, even though he knew that First Providence did not pay its representatives anything on a sale of NHTC. Klein testified that he "always discuss[ed] commissions" with his customers, but did not disclose that he might receive a sales credit unless a customer asked, and he recalled only one customer who he thought had asked about sales credits. Lozada also testified that he "would

commissions on sales of stocks for which the firm did not make a market, and they received nothing at all for executing a sale of NHTC on behalf of a customer. (CX 12, 64, 112; Tr. 1500, 1529-30.)

[5] During November 1999, First Providence began offering sales credits on another stock, Bitwise, and for each Respondent sales of that stock accounted for the bulk of their compensation that month. (CX 12, 64, 112.)

always tell [his customers] the commission I was charging," but acknowledged that he did not normally tell them that he might receive a sales credit on his NHTC sales, except for a few who he said "asked if I was getting anything else." He said he told those customers "there was a potential for me to … earn something additionally," and they did not express any concern.[6] (Tr. 1106, 1304-05, 1339-40, 1473-74, 1500, 1510-11, 1518, 1706-07, 1750, 1754-56, 1836-38, 1930-31.)

Respondents testified that they did not disclose the sales credits to their customers, in part, because they did not know whether they would receive the credits. According to Respondents, the credits were offered and paid at the whim of Paul Wasserman, who was one of First Providence's owners and its sales manager, and were generally contingent on the First Providence sales force, as a whole, achieving a sales target, referred to as a "break point." In fact, however, all three Respondents received sales credits for virtually every consummated sale of NHTC from October 1998 through October 1999. Meyers failed to receive a credit on only one completed sale during that period and Klein on only four completed sales; Lozada received a credit on every completed sale.[7] (Tr. 1089-93, 1284-85, 1294, 1344-45, 1462-63, 1679-83, 1845-46; CX 14, 66, 113.)

---

[6] According to Lozada, the customers were not concerned because he told them that the sales credits were not charged to them. While it was true that the customers did not pay the sales credits directly, if First Providence had not paid its representatives sales credits to sell NHTC, it could have passed along the savings to its customers in the form of a reduced price or mark-up.

[7] Respondents did not receive a credit if the trade was not completed by the customer – i.e., a "sell out." Although Enforcement did not obtain the trade tickets for a few of the trades from First Providence, which would have shown the credit on those trades, the testimony established that if a Respondent's gross commission for any trade exceeded 5% it reflected a sales credit, because First Providence never charged a markup above 5%. Therefore, it was possible to determine that Respondents received sales credits on trades for which there was no trade ticket in evidence. (Tr. 1278, 1280-81, 1345.)

Respondents also testified that they did not believe they were required to disclose the sales credits to their customers. Meyers testified that when he was employed at both Walsh Manning and at First Providence, he asked his superiors whether he was required to advise customers that he might receive a sales credit, and was told that he did not have to make such a disclosure. Lozada testified that a First Providence compliance officer overheard him discuss his sales credit with a customer and told him not to discuss sales credits with customers unless he was certain he would be receiving a credit. According to Lozada, the compliance officer warned him that "if somebody doesn't buy the stock because they expect you to get a credit and you don't. And then the stock does well and they didn't buy it. I could potentially have an issue, as ridiculous as that sounds." He discussed the compliance officer's warning with Wasserman, who "said no, you don't have to [disclose the sales credit], but if [a] client asks you, you can tell him." (Tr. 1496-97, 1751-52, 1838-39, 1848-49.)

E. Price Predictions

All three Respondents acknowledged that they offered their customers predictions as to the future price appreciation of NHTC. Meyers testified that his target price for NHTC "was more in a range between 6 and $8 per share," and that he probably communicated that price range to his customers "if they wanted to know where the stock was going." Although he testified he did not specifically recall giving that price range to anyone, he also said that he provided it "[i]f they asked, and it came up more often than not, yes." He testified that he gave his $6 to $8 price range when the stock was selling in the $3 to $3 ½ range, and the prediction contemplated holding the stock six months to a year. He testified that his target was not based on statements by either Wasserman or

Hartke, First Providence's analyst, but on his own assessment of NHTC's potential profits and earnings per share. He denied ever offering any prediction higher than $6 to $8 per share. (Tr. 1669-70, 1724-33, 1746-48.)

Klein testified that he advised customers that the price of NHTC might double. He also testified that he heard a price prediction of $7-$10 discussed among First Providence brokers, and admitted that he might have conveyed that target price to his customers. Klein did not recall Wasserman or Hartke offering a specific price prediction on NHTC, but testified that, even if they did, the predictions he made to his customers were based on his own independent analysis. (Tr. 1180-81, 1184-86, 1306-07, 1320, 1340, 1351, 1425.)

In contrast, Lozada testified that Wasserman provided a $10 price target for NHTC, and that Hartke supported Wasserman's target, although Lozada never saw any written analysis to support the target price. Lozada testified that he conveyed that price target to his customers, giving them a time-frame of six months to a year. Lozada testified that he offered customers the $10 target throughout the entire period in question, but also testified, inconsistently, that he gave customers a $6-$7 "near term" prediction, and a $10 "long term" prediction. Lozada testified that he never reviewed NHTC's SEC filings himself, and he never tried to undertake any independent analysis of Wasserman's price prediction because he was not competent to conduct such an analysis. (Tr. 1869-70, 1873, 1883-84, 1935-43.)[8]

---

[8] The customer evidence in the record, including both testimony at the hearing from some customers and written questionnaires completed by those and other customers in early 2001, suggests that Respondents' made more varied and sweeping price predictions than Respondents admit having employed. Meyers' customers report a wide variety of predictions over the 13 month period in question, including $10-$12 within a year, $6-$10 in the near future, a three to six month target price of $20, a $14-$18 target price, $12-$15, and $10 in the next few months. (CX 68, 70, 71, 79, 84, 86.) Klein's customers also reported such predictions as $12-$15, $15 in six months, $8 within nine months, $7-$10 quickly, $10-$12.50, and

III. Discussion

The Complaint charged that Respondents violated Section 10(b) of the Securities Exchange Act, SEC Rule 10b-5, and NASD Rules 2120 and 2110 by failing to disclose that they would receive sales credits for the sale of NHTC and by making unreasonable price predictions for NHTC. Section 10(b) of the Exchange Act makes it unlawful "to use or employ, in connection with the purchase or sale of any security … any … deceptive device or contrivance." Rule 10b-5 implements this provision by prohibiting "any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person," and, in particular, it makes it unlawful 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." NASD Rule 2120 similarly prohibits any NASD member or associated person from "effect[ing] any transaction in … any security by means of any … deceptive or other fraudulent device or contrivance." Rule 2110 requires, more generally, that members and associated persons "observe high standards of commercial honor and just and equitable principles of trade."

> Conduct Rule 2120, the NASD's anti–fraud rule, parallels SEC Rule 10b–5, and provides that no member shall effect any transactions, or induce the purchase or sale of any security, by means of any manipulative, deceptive, or fraudulent device. To find a violation of Conduct Rule 2120 and Rule 10b–5, there must be a showing that: (1) misrepresentations and/or omissions were made in connection with the purchase or sale of securities;

$20 within 12 months. (CX 16, 18, 21, 24, 25, 29.) And Lozada's customers reported predictions such as $6, $12-$14, $10-$20, $7-$10, and $10 in 30 days. (CX 115, 116, 119, 120, 124.) The Hearing Panel rejects Respondents' arguments that the customers' evidence is unreliable because the questions on the questionnaires were unclear, leading or otherwise improper. Indeed, even taking into account the passage of time between the sales in 1998 and 1999 and the customers' responses to the questionnaires in 2001 and their testimony in 2005, the customer evidence provides consistent and credible evidence that Respondents made price predictions for NHTC. Given Respondents' own testimony regarding their price predictions, however, the Panel finds it unnecessary to rely on the various dollar amounts or time periods cited by the customers in the questionnaires or testimony insofar as they conflict with Respondents' admissions.

> (2) the misrepresentations and/or omissions were material; and (3) they were made with the requisite intent, i.e., scienter.
>
> Scienter has been defined as an "intent to deceive, manipulate or defraud." Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976). Scienter may also be established by a showing that the respondent acted recklessly. See, e.g., In re DWS Securities Corp., 51 S.E.C. 814 (1993). "Recklessness" has been defined by a majority of the federal circuit courts of appeals as being "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." Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1569 (9th Cir. 1990).
>
> A misrepresentation may violate Conduct Rule 2110 even where there is no finding of intent to mislead. Kauffman v. SEC, No. 94–3011 (3d Cir. Oct. 20, 1994). "[C]oncepts such as fraud and scienter are irrelevant," and there is no need for a finding of materiality or harm to investors, Id. (citing Eichler v. SEC, 757 F.2d 1066, 1070 (9th Cir. 1985)). "Proceedings instituted by the NASD . . . are instituted to protect the public interest, not to redress private wrongs. Thus it [is] unnecessary for the NASD to show that customers [are] in fact misled." In re Wall Street West, Inc., 47 S.E.C. 677, 679 (1981), aff'd, Wall Street West, Inc. v. SEC, 718 F.2d 973 (10th Cir. 1983).

District Business Conduct Committee for District No. 9 v. Michael R. Euripides, Complaint No. C9B950014, NASD Discip. LEXIS 45 (N.B.C.C. July 28, 1997).[9]

A. Failure to Disclose Additional Selling Compensation

To establish that Respondents violated Section 10(b), SEC Rule 10b-5 and NASD Rule 2120 as to the first charge Enforcement was required to show, by a preponderance of the evidence, that (1) the Respondents received additional selling compensation; (2) they failed to disclose that fact in connection with the purchase or sale of securities; (3) the fact was material; (4) disclosure of that fact was necessary in order to make the statements Respondents made to the purchasers, in light of the circumstances under

[9] To establish a violation of Section 10(b) and Rule 10b-5, there must also be proof that the respondent used "any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange." In this case, this requirement is satisfied, inter alia, because the Respondents sold NHTC through interstate telephone calls.

which they were made, not misleading; and (5) Respondents had the required state of mind, i.e., scienter.

There is no dispute that Respondents received additional selling compensation in the form of sales credits for virtually every completed sale of NHTC during the period October 1, 1998 through October 31, 1999, or that they failed to disclose they would, or might, receive such credits to their customers who purchased NHTC. And it is also undisputed that the sales credits were not otherwise disclosed to the customers, for example on trade confirmations or monthly statements. The remaining questions are whether the information was material; whether the failure to disclose it was, under all the circumstances, misleading; and whether the Respondents acted with scienter.

"The test for materiality is whether the reasonable investor would consider a fact important in making his or her investment decision." Martin R. Kaiden, Exch. Act Rel. No. 41629, 1999 SEC LEXIS 1396, at *18 n.25 (SEC July 20, 1999). Most of Respondents' customers who testified at the hearing said that disclosure of the additional compensation would have been important to them, because it would have suggested that Respondents' recommendations to purchase NHTC were influenced by Respondents' economic self-interest, and therefore might not be objective. (Tr. 48-49, 65, 128-29, 161, 206-07, 244, 314, 401-02, 453-54, 497.) Respondents themselves all testified that they understood that First Providence offered the sales credits to "motivate" them to sell NHTC. (Tr. 1087, 1344, 1803, 1933.) Meyers and Klein denied that, in fact, the sales credits affected their decisions to recommend NHTC to their customers, but that was not credible, given that during the period in question they were generally compensated more for selling NHTC than other securities, earned the vast bulk of their compensation from

NHTC sales, and substantially reduced their NHTC sales as soon as the credits were withdrawn. Given these factors, Lozada's admission that the credits did motivate him to sell NHTC to his customers (Tr. 1933) was far more candid than Meyers' and Klein's denials.

In any event, the issue is not whether the credits actually motivated Respondents, but rather whether the fact that Respondents would, or might, receive sales credits for selling NHTC over and above their normal, disclosed compensation was material information for prospective purchasers. The Hearing Panel finds that it was material for the reasons cited by the customers: it would raise legitimate concerns in the minds of reasonable customers that Respondents' recommendations might be motivated by their own self-interest in selling NHTC over other possible investments, a factor that might reasonably have influenced their investing decisions.[10]

In addition to being material, an omitted fact must be disclosed only if, under all the circumstances, it would be misleading not to disclose it. In this case, Respondents received sales credits specifically for selling NHTC. They testified that they generally discussed their compensation with their customers without revealing that they would receive sales credits for NHTC sales, and Respondents' mark-up compensation was

[10] Respondents rely on United States v. Alvarado, 2001 U.S. Dist. LEXIS 21100 (S.D.N.Y. Dec. 17, 2001), where the court stated: "In ordinary circumstances, the compensation of a registered representative is not a material fact to the transaction being entrusted to him." In support of this conclusion, the court stated that "relevant information relates to the security being sold and the terms of the transaction entrusted to him, including the amount of the commission being charged by the brokerage house for the transaction. Since the registered representative's commission paid by the brokerage house is not charged to the transaction, it is not material to the customer's transaction and it need not be disclosed." Under the facts presented in this case, however, the Panel rejects this analysis. As the testifying customers reasonably explained, even if the sales credits being paid to Respondents were not charged to the customers, knowledge that the registered representative recommending a purchase of NHTC was being paid a substantial undisclosed additional amount to recommend that particular security would have been quite relevant and material to their decision as to whether to follow the recommendation.

disclosed to customers in trade confirmations, but not the sales credits.[11] Further, the sales credits represented a substantial portion of the price of the stock, and a very substantial portion of Respondents' overall compensation. Under these circumstances, the Panel concludes that it was misleading for Respondents not to disclose to the customers that they would, or might, receive additional sales credits for NHTC.

The Panel rejects Respondents' argument that their failure to disclose the sales credits was not misleading because they were not certain they would receive them. First, the facts do not support the claimed uncertainty; in fact, Respondents received sales credits for virtually every sale. Second, to the extent that there was any uncertainty, that could have been included in the disclosure.

Scienter encompasses both an intent to deceive and recklessness – "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 [Respondent] or is so obvious that the actor must have been aware of it." Even if a Respondent lacked scienter, a misleading failure to disclose a material fact may violate Rule 2110.

Respondents argue that they lacked scienter because, although the payment of sales credits or other incentives is fairly common in the securities industry, there is no established rule, standard or practice requiring disclosure. In that regard, Respondents cite Platsis v. E.F. Hutton & Co., 946 F.2d 38, 41 (6th Cir. 1991), where the court stated, with respect to a failure to disclose certain mark-ups and credits:

---

[11] This case is thus distinguishable from Castillo v. Dean Witter Discover & Co., 1998 U.S. Dist. LEXIS 9489 (S.D.N.Y. June 25, 1998), holding that the firm had no duty to disclose its internal incentive structure, under which registered representatives were paid higher commissions for selling proprietary mutual funds, where "the total fees were disclosed, as was the fact that those fees would be used to pay commissions and incentive compensation to brokers." The court observed: "While it does violate the duty of a broker to fail completely to disclose his or her economic interest in a transaction, the plaintiffs cite to no cases that hold that a duty exists in this factual context where plaintiffs were aware that they were dealing with Dean Witter employees who received commissions and were aware of the total commissions received."

> Since very few brokers disclosed these credits at the time these events took place and there was no established regulatory duty to disclose these items, an intent to deceive or an 'extreme departure from the standards of ordinary care' could not be established merely by the omission of this information in the absence of special circumstances.

Similarly, in Shivangi v. Dean Witter Reynolds, Inc., 825 F.2d 885 (5th Cir. 1987), the court held that the plaintiffs had failed to establish that the defendants acted with scienter in failing to disclose certain mark-ups, finding that the defendants had "no actual intent to deceive," and that they "did not know nor should have known the danger of misleading the customers by the omission."

This case, however, involves special circumstances. Respondents were paid undisclosed sales credits specifically for selling NHTC, a stock that Respondents acknowledged was highly speculative. The credits were paid over an extended period, amounted to a substantial portion of the overall price of the stock and also represented the bulk of Respondents' gross commissions – more than 90% in some months – and the Panel finds that the credits were a substantial motivating factor in Respondents recommending the stock to their customers, as evidenced by the fact that when the credits ended in November 1999, Respondents drastically reduced their NHTC sales. Under these circumstances, the Panel finds the holding in SEC v. Hasho, 784 F. Supp. 1059, 1110 (S.D.N.Y. 1992) applicable here as well:

> The failure to disclose ... commissions deprives the customer of the knowledge that his registered representative might be recommending a security based upon the registered representative's own financial interest rather than the investment value of the recommended security. Misrepresenting or omitting to disclose a broker's financial or economic incentive in connection with a stock recommendation constitutes a violation of the anti-fraud provisions.

Registered representatives, as securities professionals, have an independent obligation to determine whether disclosure of particular information is required to avoid misleading their customers. Respondents should have recognized that the failure to disclose the sales credits was likely to mislead their customers regarding Respondents' motives in recommending NHTC, and therefore that they were required to disclose that information. Indeed, Meyers admitted that he asked his supervisors at both First Providence and his prior firm, Walsh Manning, whether he had to disclose sales credits, suggesting that he understood that information regarding sales credits would be material to customers (Tr. 1752), and Lozada acknowledged that disclosure of the credit "could be important to the customer, yes." (Tr. 1933.) And although Meyers and Lozada both testified that they were told they did not have to disclose the credits, neither one claimed that he was given any rational explanation for that conclusion. As the SEC has explained:

> Nor are statements made by a salesman's superiors an adequate basis for representations made to investors. When a securities salesman undertakes to recommend a security, he must adhere to stringent standards. He is under a duty to make an adequate independent investigation in order to ensure that his representations have a reasonable basis. This the respondents failed to do. Instead, their conduct amounted to a total abdication of the basic responsibilities imposed on professionals in the securities business.

Dan King Brainard, 47 S.E.C. 991, 996 (1983) (footnotes omitted).

Therefore, the Panel concludes that, under the particular circumstances of this case, Respondents' failure to disclose that they would, or might, receive sales credits for selling NHTC was reckless. Accordingly, the Panel concludes that Respondents violated

Section 10(b), Rule 10b-5 and NASD Rules 2120 and 2110 by failing to make the disclosure.[12]

B. Price Predictions

The second charge is that the Respondents made unreasonable price predictions for NHTC. To establish this violation, Enforcement was required to prove that Respondents made price predictions, and that the price predictions were misleading and material. In addition, to establish that the price predictions violated Section 10(b) of the Exchange Act, SEC Rule 10b-5 and NASD Rule 2120, Enforcement had to prove that Respondents acted with scienter, which is not an element of a Rule 2110 violation.

Respondents all admitted that they made price predictions for NHTC to their customers. They argued that these were simply opinions or forecasts, not misrepresentations, but it is firmly established that when a registered representative makes a price prediction, even if offered as an opinion, the representative implicitly represents that he or she has a reasonable basis for the prediction. If the representative does not have a reasonable basis for the prediction, the implied representation is false and misleading.[13]

---

[12] Even assuming that Respondents did not act with scienter, Respondents failure to disclose the credits was materially misleading and at least negligent, and therefore violated Rule 2110.

[13] See Hanley v. SEC, 415 F.2d 589 (2d Cir. 1969) ("A securities dealer occupies a special relationship to a buyer of securities in that by his position he implicitly represents that he has an adequate basis for the opinions he renders"); SEC v. Hasho, 784 F. Supp. at 1109 ("Guarantees and predictions of substantial price rises with respect to securities are actionable absent a reasonable basis for the prediction. … The fraud is not ameliorated where the positive prediction about the future performance of securities is cast as an opinion or possibility rather than as a guarantee").

In the case of a speculative stock, it is unlikely that there can be a reasonable basis for such a prediction.[14] Respondents acknowledged that NHTC was a speculative stock. The company had a history of operating losses, it had accumulated a large working capital deficit and had repeatedly advised that it needed capital infusions to survive, and its auditors had expressed concerns about its ability to continue as a going concern. NHTC had sold off much of its pre-existing business in order to focus on the sale of homeopathic remedies, but had continued to incur operating losses. NHTC also sought to, and ultimately did, acquire Kaire, but that firm also had a history of operating losses, and the assets that NHTC acquired were worth less than the liabilities. In order to raise operating capital, NHTC had issued convertible debentures and preferred stock, some of which had been converted to common stock, while the balance remained outstanding and convertible. These conversions substantially diluted NHTC's pre-existing common stock, and had the potential to dilute it even further. While it was by no means clear that NHTC would fail – indeed, as of the date of the hearing in 2005 NHTC was still in business and its stock was Nasdaq-listed – these uncertainties unquestionably made NHTC a highly speculative investment, and as a result Respondents could not reasonably have predicted that the price of the stock would appreciate.

In spite of all this, Respondents argue that they had a reasonable basis for the price predictions they made. Meyers and Klein contend that they did not simply offer their customers arbitrary price targets, but rather arrived at those price targets based on statements made by NHTC's management in a road show given to First Providence brokers, coupled with a review of publicly available information. In contrast, Lozada

[14] See Department of Enforcement v. Reynolds, No. CAF990018, 2001 NASD Discip. LEXIS 17, at *26-27 (NAC June 22, 2001), and cases cited therein.

contends that he reasonably relied on price predictions offered by First Providence's sales manager, Wasserman, that were endorsed by the firm's stock analyst, Hartke.

Meyers testified that he based his $6-$8 price projection for NHTC on the Kaire acquisition and the sales growth projections that NHTC management offered at the road show presentation. According to Meyers, NHTC management "thought they could achieve somewhere between 25 and 40 million in sales, or 30 million. I remember it was close to doubling what they were currently billing." He said he made some effort to verify this projection, but "it is tough to verify a sales projection, they are guessing and they know the business better than anyone." Nevertheless, he thought they were "well within the range that was achievable, based on the business plan they had set forth." On the other hand, he knew that NHTC "had failed miserably to that point. They had changed management, they restructured the stock, there was a reverse split prior to their recommendation being brought to me. They were remodeling their business plan, going in another direction, cutting roots, selling off some of their nonperforming assets …." Meyers was impressed that NHTC was acquiring Kaire, which had a new product involving "antioxidants that supposedly had a million benefits, it was 40 times more powerful than Vitamin E as an antioxidant and a hundred times more powerful than Vitamin C," though he also acknowledged that Kaire's "numbers had fallen off so dramatically they were in desperate need." Based on all this, Meyers projected that NHTC would achieve "somewhere around 3 or $4 million in profitability" and "[j]udging by how many shares were outstanding, I think that would have led them to maybe a 50 to 75 [cents] per share profit." He calculated his target price based on this assessment. (Tr. 1453-54, 1476-77, 1731-33, 1742, 1745.)

The Panel rejects Meyers' contention that the process he described gave him a reasonable basis for predicting that the price of NHTC would reach $6-$8, or any other figure. Meyers admitted that he had no training or experience in forecasting the performance of stocks (Tr. 1745-46, 1758-59), and his prediction for NHTC rested on an uncritical, and unreasonable, acceptance of profitability forecasts during a road show by management of a company that "had failed miserably to that point" and was warning in its SEC filings that it desperately needed financing just to continue in operation.[15] Under these circumstances, the Panel finds Meyers lacked a reasonable basis for his price predictions for NHTC. On the contrary, Meyers' price predictions were plainly driven by salesmanship concerns; as Meyers testified: "If a client asked me where is the stock going to go, I am not going to tell him I can't tell him. … They want to know where are we buying and where do we think we are going to sell it." (Tr. 1745.) In this case, Meyers told the customers that NHTC would reach $6-$8, without having any reasonable basis for predicting such a price.

Like Meyers, Klein admitted that he had no experience or training in forecasting stock prices. He testified that for his analysis he "went on the computer and … looked at the high-low, the book value, the industry, trading versus S&P, trading versus other companies … and any recent news releases," as well as NHTC's business plan. He also had access to NHTC's SEC filings, but he was not certain whether he had looked at them. And of course, he attended the road show given by NHTC's management. He failed to

---

[15] See Nassar & Co., Inc., 47 S.E.C. 20, 22 (1978) (the respondent's "reliance on [the issuer's] self-serving statements was patently unwarranted. It fell far short of the stringent standards to which a professional in the securities business must adhere when he under-takes to recommend securities, particularly the unknown securities of an obscure issuer. In that situation, he is under a duty to make an adequate independent investigation to ensure that his representations have a reasonable basis"); Hanley v. SEC, 415 F.2d at 597 ("A salesman may not rely blindly upon the issuer for information concerning a company, although the degree of independent investigation which must be made by a securities dealer will vary in each case. Securities issued by smaller companies of recent origin obviously require more thorough investigation").

explain, however, how the information he gathered from these sources reasonably supported his prediction that the price of NHTC would double, particularly given that he knew that it had never been profitable, that it had working capital difficulties and that it needed financing to continue in business.[16] Klein conceded that his prediction that the price of NHTC would double "was mostly based on what the company itself told me, or told the boardroom, [during the road shows,] where they were with earnings, where they were projected to be." As explained above, however, it is well established that the self-serving forecast of the issuer's management that it expects to turn around a failing company is insufficient to establish a reasonable basis for predicting that the price of the company's stock will double. (Tr. 1109-12, 1180-86, 1263, 1269, 1352-55, 1358-61.)

Lozada claimed to have relied on, and conveyed to his customers, a price forecast made by Wasserman, which he says First Providence's analyst endorsed, although he admitted he was unaware of any written analysis supporting Wasserman's forecast. Even if Lozada's claim is true,[17] as explained above, the SEC has held that statements made by a superior are not adequate to support representations to customers; rather, a registered representative must independently determine whether the statements are reasonable. Lozada admits that he made no effort to determine whether Wasserman's price targets were reasonable – indeed, he says he lacked the ability to do so – but he nevertheless passed them along to his customers in order to sell NHTC.

---

[16] Klein testified that he believed NHTC had solved its financing problem when he learned that another broker-dealer planned to underwrite a secondary NHTC offering. He obtained a "red herring" prospectus for the offering, and "without a doubt" told his customers about the planned offering, but the offering fell through, and, in any event, Klein failed to note from the prospectus that 81% of the proceeds of the offering was to be used to redeem preferred stock, leaving less than $800,000 for additional working capital, which Klein conceded would not have been enough to solve NHTC's financing problems. (Tr. 1358-60.)

[17] Neither Meyers nor Klein could recall either Wasserman or Hartke offering a specific price target for NHTC, and in his investigative testimony, Hartke denied that he recommended NHTC or offered any target price for it. (CX 150.)

Therefore, the Panel concludes that Respondents violated Section 10(b), Rule 10b-5 and NASD Rules 2120 and 2110 by making unreasonable price predictions for NHTC.

IV. Sanctions

For misrepresentations or material omissions of fact, the Sanction Guidelines recommend a fine of $2,500 to $50,000 and a suspension of up to 30 business days for negligent misconduct. For intentional or reckless misconduct, they recommend a fine of $10,000 to $100,000 and a suspension of 10 business days to two years, or in egregious cases a bar. The fine amount may be increased to take into consideration the respondent's financial benefit from the misconduct. NASD Sanction Guidelines at 93 (2005 ed.). Enforcement requested that the Panel bar all of the Respondents and also impose fines that would require Respondents to disgorge their financial gains from the sale of NHTC.

The Panel determined that the appropriate sanctions in this case are those for intentional or reckless misconduct, and found the following considerations set forth in the Guidelines relevant in determining the specific sanctions to impose in this case. Respondents' misconduct extended over a period of more than a year and involved a large number of transactions and customers – indeed, by the end of the period in question, Respondents' customers, in the aggregate, held approximately 3 million shares of NHTC.[18] As a result of their actions, Respondents enjoyed very substantial personal gains, in the form of mark-ups and undisclosed sales credits, while their customers incurred losses on the stock they purchased, yet none of the Respondents acknowledged any remorse for his actions. All of these are aggravating factors.

[18] As of September 30, 1999, NHTC had approximately 7.2 million shares outstanding. (JX 8.)

The Sanction Guidelines explain that disciplinary sanctions are remedial, and should be designed to prevent the recurrence of misconduct, improve overall standards in the industry, and modify and improve business practices. In determining the level of sanctions needed to accomplish these goals, the Panel considered several factors in addition to those set forth above. The violations in this case took place in 1998 and 1999, when all of the Respondents were relatively new to the securities industry. There was (and remains) no rule or clear standard requiring the disclosure of sales credits, and Meyers and Lozada state that, when they inquired, they were advised by their superiors that no disclosure was required. Although the Panel finds that Respondents did not have, and could not have had, a reasonable basis for the price predictions they made, NHTC was and remains a legitimate, operating company. Finally, there is nothing in the record to suggest that any of the Respondents has engaged in any misconduct during the years since they left First Providence.

While none of these factors mitigates the seriousness of Respondents' misconduct, the Panel finds that under all the circumstances, barring these Respondents from the securities industry is not appropriate. Instead, the Panel concludes that lengthy suspensions, together with substantial fines that will require Respondents to disgorge a significant portion of their earnings from their sales of NHTC, will accomplish NASD's remedial goals.

The Panel finds that Meyers, who had been in the securities industry longer than the other Respondents and who functioned as a principal as well as a representative, should be suspended in all capacities for 18 months, and that Klein and Lozada, who had less experience and functioned only as representatives, should be suspended in all capacities for one year. With respect to disgorgement, Respondents received only a portion of their gross earnings from the sale of NHTC. The Hearing Panel, therefore, reviewed the detailed evidence in the record regarding each Respondent's gross and net earnings, and concluded that to ensure disgorgement of substantial portions of their individual net earnings from the sale of NHTC, Meyers should be fined $45,000, Klein $40,000 and Lozada $65,000. In addition, all three Respondents will be ordered to re-qualify in all capacities.[19]

V. Conclusion

Respondents John M. Meyers, Brian C. Klein and Israel E. Lozada failed to disclose to customers that they would receive additional sales compensation for selling the particular stock they recommended and they made unreasonable price predictions for the stock, all in violation of Section 10(b) of the Securities Exchange Act of 1934, SEC Exchange Act Rule 10b-5 and NASD Rules 2120 and 2110. For these violations, Meyers is suspended in all capacities for eighteen months, fined $45,000 and ordered to re-qualify in all capacities; Klein is suspended in all capacities for one year, fined $40,000 and ordered to re-qualify in all capacities; and Lozada is suspended in all capacities for one year, fined $65,000 and ordered to re-qualify in all capacities. In addition, Meyers, Klein and Lozada are each ordered to pay one-third of the total costs of $10,872.54, which includes an administrative fee of $750 and the costs of the hearing transcript.

These sanctions shall become effective on a date set by NASD, except that if this decision becomes NASD's final disciplinary action in this matter, Meyers' suspension shall begin at the opening of business on October 3, 2005, and end at the close of

[19] Enforcement did not request restitution for customers and the evidence is insufficient to establish that identifiable customers suffered quantifiable injury as a result of Respondents' misconduct.

business on April 2, 2007; Klein's suspension shall begin at the opening of business on October 3, 2005, and end at the close of business on October 2, 2006; and Lozada's suspension shall begin at the opening of business on October 3, 2005, and end at the close of business on October 2, 2006.[20]

HEARING PANEL

____

By: David M. FitzGerald
Hearing Officer

Copies to:

John M. Meyers (via overnight and first class mail)
Brian C. Klein (via overnight and first class mail)
Israel E. Lozada (via overnight and first class mail)
Richard Slavin, Esq. (by facsimile and first class mail)
Robin Nackman, Esq. (by facsimile and first class mail)
Jacqueline D. Whelan, Esq. (electronically and via first class mail)
Sylvia M. Scott, Esq. (electronically and via first class mail)
Rory C. Flynn, Esq. (electronically and via first class mail)

[20] The Hearing Panel has considered and rejects without discussion all other arguments of the parties.