

NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

MORTON BRUCE ERENSTEIN

(CRD No. 201845)

Respondent.

Disciplinary Proceeding
No. C9B040080

Hearing Officer – SNB

Corrected Hearing Panel Decision¹

December 15, 2005

Respondent is barred for violations of NASD Procedural Rule 8210 and Conduct Rule 2110 by refusing to answer a question during an on-the-record interview (“OTR”) and failing to respond to a written request for information until notified that disciplinary charges were going to be filed.

Appearances

Michael J. Newman, Esq., Regional Counsel, Woodbridge, NJ, Rory C. Flynn, Esq., Washington, DC, of Counsel, for the Department of Enforcement.

John J. Phelan, III, Esq., Boca Raton, FL, for Respondent Morton Bruce Erenstein.

I. Procedural History

On August 6, 2004, the Department of Enforcement filed a two-count Complaint charging that Morton Bruce Erenstein (“Respondent”) failed to answer a question during an on-the-record interview (“OTR”), and failed to timely respond to a written request for information, in violation of NASD Procedural Rule 8210 and NASD Conduct Rule 2110. Respondent filed

¹ This decision is issued to correctly reflect that Enforcement requested a one-year suspension and a fine of \$25,000, rather than a bar. After Respondent’s counsel brought this error to the Hearing Officer’s attention, she consulted with the other Panelists in the proceeding. The Panel confirmed that a bar was the appropriate sanction in this proceeding, regardless of Enforcement’s recommendation.

an Answer denying the charges and requesting a hearing. Respondent also raised affirmative defenses that the tax returns sought by Enforcement were not discoverable or relevant, that Enforcement failed to negotiate or discuss production of the tax returns, that the procedures applied were unfair and in violation of the 14th Amendment to the Constitution, and that Enforcement effectively deprived Respondent of his right to counsel because he is charged with a violation based on his counsel's objections. The Hearing was held in Boca Raton, Florida on December 14, 2004, before a Hearing Panel that included a Hearing Officer and two Panelists.² The Department of Enforcement called one NASD staff member, Jack Litsky. Respondent testified on his own behalf.

On May 4, 2005, Respondent filed a notice indicating that he had filed bankruptcy, resulting in a stay of these proceedings. After the conclusion of the bankruptcy proceedings, on November 8, 2005, Enforcement moved for the issuance of the decision. Due to the discharge order in the bankruptcy proceeding, Enforcement no longer seeks monetary sanctions.

II. Facts

The facts are generally uncontested. Respondent became registered with the NASD as a General Securities Representative in 1969. Respondent was registered with Cullum & Burks

² One Panelist was a former member of the District 9 and 10 Committees, and the other Panelist was a current member of the District 7 Committee. Enforcement offered Complainant's Exhibits ("CX") 1-20, which were admitted without objection. Respondent offered Exhibit ("RX") A, which was admitted without objection. References to the Hearing transcript are cited as "Tr. at p."

Following the hearing, the record was left open for ten days to permit Respondent to file supplemental materials concerning the filing of his amended 1998 tax return. Respondent filed these materials on December 22, 2004. Enforcement's objection to the inclusion of these materials in the record is hereby denied.

Securities, Inc., a member firm, in May 2002, and he continues to be so registered. He is therefore subject to NASD's jurisdiction.³

On October 3, 2003, Enforcement conducted an OTR with Respondent to question him about a customer complaint alleging, in part, that Respondent converted \$10,000 of the customer's funds.⁴ The customer alleged that she wrote a check to Respondent for \$10,000 for "investment purposes," but there was no record of the money being credited to her account.⁵ During the OTR, Respondent testified that the customer paid him this money as compensation for services he provided in assisting her to redeem savings bonds.⁶ Respondent said that he had no written records that would corroborate this.⁷ Respondent refused to answer questions about whether he reflected the \$10,000 payment in his tax returns on the grounds that it was irrelevant, and on the advice of his counsel.⁸

On October 3, 2003, following the OTR, Enforcement sent Respondent a request, pursuant to Rule 8210, for copies of his State and Federal tax returns for 1998 – 2000 or any other tax return that reflected the \$10,000 payment received by the customer.⁹ The letter was

³ CX-1, p. 1-2.

⁴ CX-2; Tr. at p. 38-41, 70.

⁵ CX-17; Tr. at p. 33.

⁶ CX-2, p. 64-72; Tr. at p. 37-38.

⁷ *Id.* at p. 85.

⁸ *Id.* at p. 85-86; Tr. at p. 115-116.

⁹ CX-3; Tr. at p. 126.

sent to Respondent's residential address as then reported on the Central Registration Depository (his "CRD address").¹⁰ Enforcement requested a response by October 17, 2003.¹¹

On October 14, 2003, Respondent's attorney, John J. Phelan, III ("Attorney Phelan"), requested an extension of time to respond to the request until October 31, 2003, because Respondent needed more time to locate the tax records.¹² Respondent's attorney also informed Enforcement of Respondent's new residential address, and noted that Respondent had amended his Form U-4 to reflect this new address.¹³ Enforcement granted the request for an extension, and warned Respondent that a failure to timely respond could result in disciplinary action against him.¹⁴ On October 31, 2003, Attorney Phelan responded on Respondent's behalf, refusing to provide the tax returns and related information, claiming that Enforcement had not shown that the information had any relevance to the ongoing investigation and that the tax returns are properly regarded as "confidential communications," not open to "general inquiry."¹⁵ In asserting his relevance objection, Mr. Phelan stated, "if you were to issue a subpoena to Mr. Respondent and then ask a Court to enforce it, the Court would require you to show some relevance...[w]e do not believe such a showing can be made."¹⁶ Additionally, in describing the confidential nature of tax returns, Phelan noted that "[g]enerally, production of tax returns may

¹⁰ CX-3.

¹¹ *Id.*

¹² CX-4.

¹³ CX-5; Tr. at p. 121.

¹⁴ CX-6; Tr. at p. 127-128.

¹⁵ CX-7, p. 3-4.

¹⁶ *Id.* at 3.

not be required without a showing of some special need and that the information sought is not more readily available elsewhere as it [is] here.”¹⁷

After receiving the letter, on November 3, 2003, Enforcement staff member Jack Litsky telephoned Attorney Phelan to emphasize that a failure to respond to Enforcement’s request was a violation of Rule 8210 and Respondent would be facing possible sanctions.¹⁸ Enforcement followed up with a letter on the same day.¹⁹

Respondent did not provide the requested tax information. As a result, on June 3, 2004, Enforcement issued a Wells Notice to Respondent advising him that Enforcement would recommend disciplinary action based on his failure to answer the OTR question regarding his tax returns, and his failure to produce requested tax returns.²⁰

On June 21, 2004, Respondent, through his counsel, provided his amended tax return for 1998, which was dated October 2003.²¹ The amended return reported an additional \$10,000 in gross income for 1998.²²

¹⁷ *Id.* at 4.

¹⁸ Tr. at p. 53-55, 158, 161-62.

¹⁹ CX-8; Tr. at p. 55-56.

²⁰ CX-9; Tr. 58-59, 128.

²¹ CX-10; Tr. at p. 59, 128.

²² CX-10, p. 4; Tr. at p. 144. From the record it does not appear that Erenstein ever produced his original 1998 tax return, nor did he produce requested returns for 1999 and 2000.

III. Discussion

Procedural Rule 8210 authorizes NASD to require any person subject to its jurisdiction to provide information and testimony related to any matter under investigation. The Rule serves as a key element in NASD's oversight function and allows NASD to carry out its regulatory functions without subpoena power.²³ When an individual fails to provide requested information, including information requested during an OTR, NASD's ability to perform its regulatory responsibilities is subverted.²⁴ Moreover, it is well settled that a respondent cannot dictate the terms and conditions under which information will be furnished, nor can NASD members "take it upon themselves to determine whether information requested is material to an NASD investigation of their conduct."²⁵

Here, Respondent seems to suggest that he could, based upon his own determination of the requested information's relevance, shield his tax returns from the repeated and unambiguous requests of NASD staff. He is incorrect. Respondent claims that Enforcement had an obligation to negotiate with his counsel on the relevance of the requested information, pursuant to

²³ See, e.g., *Dep't of Enforcement v. Valentino*, No. FPI010004, 2003 NASD Discip. LEXIS 15, at *12 (NAC May 21, 2003), *aff'd*, 2004 SEC LEXIS 330 (Feb. 13, 2004) ("It is well established that because NASD lacks subpoena power over its members, a failure to provide information fully and promptly undermines NASD's ability to carry out its regulatory mandate.") (citation omitted); *Joseph G. Chiulli*, Exchange Act Release No. 42,359, 2000 SEC LEXIS 112, at *16 (Jan. 28, 2000) (noting that Rule 8210 provides a means for the NASD effectively to conduct its investigations, and emphasizing that NASD members and associated persons must fully cooperate with requests for information).

²⁴ *Joseph P. Hannan*, Exch. Act Rel. No. 40,438, 1998 SEC LEXIS 1955, at *9 (Sept. 14, 1998).

²⁵ *General Bond & Share Co. v. SEC*, 39 F.3d 1451, 1461 (10th Cir. 1994); See also, *Paul Joseph Benz*, Exchange Act Release No. 51046, 2005 SEC LEXIS 116 (Jan. 14, 2005); *Robert Fitzpatrick*, Exchange Act Release No. 44956, 2001 SEC LEXIS 2185 (Oct. 19, 2001); *Joseph Patrick Hannan*, Exchange Act Release No. 40438, 1998 SEC LEXIS 1955 at *11 (Sept. 14, 1998) ("an NASD member may not second guess or impose conditions on the NASD's request for information") (internal quotes omitted).

“procedural rules of both the S.E.C. and NASD Regulation [.]”²⁶ Certainly, concerns pertaining to the relevance of NASD requests for information should “be raised, discussed and resolved with the NASD in the cooperative spirit and prompt manner contemplated by [Rule 8210].”²⁷ However, a failure to do so in no way relieves an associated person of his or her obligation to provide any requested information to NASD.²⁸

Moreover, the relevance of the requested information should have been clear – in investigating the potential conversion of the customer’s funds, Respondent’s treatment of the funds is clearly relevant. If he had reported the funds as income, it would tend to support his claim that the checks were intended as compensation for his services; conversely, if the money were not declared, it would lend credence to the customer’s version of events.

Respondent’s arguments centering on the purported confidential nature of tax returns are also without merit in a NASD proceeding. Tax returns are routinely sought pursuant to Rule 8210 requests, and are not afforded any greater level of protection than other documents and records.²⁹

Similarly, Respondent’s purported reliance on the advice of counsel does not excuse his conduct. The SEC has consistently held that reliance on counsel is “immaterial to an associated

²⁶ Answer, p. 6. Respondent asserts that Enforcement refused to respond to requests for clarification by Respondent’s counsel. While there was insufficient record evidence to establish this, if true, it is unfortunate. Enforcement should be forthright and cooperative in its interactions with Respondents and their counsel. As noted above, however, this is not an excuse for a failure to respond to a request for information pursuant to Rule 8210.

²⁷ *Richard J. Rouse*, Exchange Act Release No. 32658, 1993 SEC LEXIS 1831 at *8 n. 9 (July 19, 1993)

²⁸ *Hannan*, 1998 SEC LEXIS at *12; *See also Dep’t of Enforcement v. Cromwell Investments*, 2003 NASD Discip. LEXIS 53 at *42 (Nov. 19, 2003) (“[A]n NASD member firm or associated person who is requested to provide testimony, documents or other information pursuant to Rule 8210 has an unqualified obligation to respond fully and promptly to the request.”).

person's obligation to supply requested information to the NASD."³⁰ As an associated person, Respondent had an obligation to obey Procedural Rule 8210, "which is unequivocal with respect to the obligation to cooperate with NASD."³¹

Respondent also asserts that Enforcement's failure to consider his attorney's arguments regarding relevance violated his right to counsel under NASD Rules. As noted above, however, although dialogue may be desirable and expected, Enforcement is not compelled to bargain with opposing counsel during the course of an investigation simply to obtain the cooperation expected of all associated persons. Certainly, a failure to yield to an opposing attorney's objections, and pursuit of requested information through an Enforcement action, if necessary, does not constitute a deprivation of the right to counsel.

Accordingly, by failing to answer a question during an on-the-record interview, and failing to timely produce requested documents, the Respondent violated NASD Procedural Rule 8210 and Conduct Rule 2110.³²

²⁹ See *Dep't of Enforcement v. Dennis Sturm*, 2002 NASD Discip. LEXIS 2 (Mar. 21, 2002); *DBCC v. Chlowitz*, 1999 NASD Discip. LEXIS 31 (Nov. 4, 1999) (barring respondent for failing to produce tax returns, despite claims of invasion of privacy).

³⁰ *Michael Markowski*, Exchange Act Release No. 32562, 1993 SEC LEXIS 1695 at *11 (Jun. 30, 1993) *aff'd*, 34 F.3d 99 (2d Cir. 1994); See also *Dep't of Enforcement v. Steinhart*, 2003 NASD Discip. LEXIS 23 (Aug. 11, 2003) (reliance on counsel not a defense to failure to provide requested information).

³¹ *Id.*

³² A violation of Procedural Rule 8210 is also a violation of Conduct Rule 2110, contravening "high standards of commercial honor." *Dep't of Enforcement v. Baxter*, No. C07990016, 2000 NASD Discip. LEXIS 3, at *25 (NAC, Apr. 19, 2000).

IV. Sanctions

Enforcement argues that a suspension and a \$25,000 fine is the appropriate sanction in this case; Respondent urges the Panel to impose no sanction.³³ Under the NASD Sanction Guidelines, “[i]f the individual did not respond in any manner, a bar should be standard. Where mitigation exists, or the person did not respond in a timely manner, consider suspending the individual in any or all capacities for up to two years.”³⁴

Here, Respondent ignored repeated requests for his tax returns, producing his amended 1998 tax return only after receiving a Wells Notice indicating that the NASD staff intended to file charges against him. His refusal was knowing and unequivocal. Clearly, the NASD should not have to initiate disciplinary proceedings to obtain a response to a request for information under Rule 8210.³⁵ Although Respondent submitted his amended 1998 tax return after receiving the Wells Notice, this belated cooperation does not mitigate Respondent’s refusal to respond to NASD requests. Forcing NASD Staff to bring charges and conduct a hearing to obtain requested information would subvert the organization’s ability to regulate the industry.

At the Hearing, Respondent asserted that he was following the advice of counsel when he refused to answer questions and refused to produce his tax returns. Although reliance on counsel is inappropriate as a defense in this case, it may be considered as a mitigating factor. However, for reliance upon counsel to validly act in mitigation, it must be reasonable. It is not reasonable to rely on counsel when such reliance is clearly in contravention of NASD rules;

³³ As noted above, given the the discharge order entered in Respondent’s bankruptcy petition, Enforcement does not seek, nor is it appropriate for the Panel to award, monetary sanctions.

³⁴ NASD SANCTION GUIDELINES, at p. 35 (2005 ed.).

³⁵ See *Dep’t. of Enforcement v. Quattrone*, 2004 NASD Discip. LEXIS 17 at **52-53, 55-56 (NAC Nov. 22, 2004).

rather, reliance on counsel is considered mitigating when such reliance is to ensure compliance with applicable securities laws and rules.³⁶ Here, NASD informed the Respondent on numerous occasions that failing to produce the requested tax returns would constitute a violation of NASD Procedural Rule 8210.

Accordingly, because there are no mitigating circumstances that would warrant a lesser sanction, the Respondent is barred from association with any NASD member in any capacity for failing to provide information requested pursuant to Rule 8210.³⁷

V. Conclusion

Morton Bruce Erenstein is barred from association with any member firm in any capacity for failing to answer a question during an on-the-record interview, and failing to timely produce requested documents, in violation of NASD Procedural Rule 8210 and Conduct Rule 2110. The bar shall become effective immediately if this Decision becomes the final disciplinary action of NASD.

HEARING PANEL

By: Sara Nelson Bloom
Hearing Officer

Copies to: John J. Phelan, III, Esq. (*via facsimile and first class mail*)
Michael J. Newman, Esq. (*via facsimile and first class mail*)
Rory C. Flynn, Esq. (*via facsimile and first class mail*)

³⁶ *Id.* at 52-54.

³⁷ 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.