

NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,	:	
	:	
	:	
Complainant,	:	Disciplinary Proceeding
	:	No. C9B040074
v.	:	
	:	
RESPONDENT FIRM	:	HEARING PANEL DECISION
	:	
	:	Hearing Officer – SW
and	:	
	:	Dated: March 14, 2005
JAMES C. ACKERMAN	:	
	:	
	:	
Respondents.	:	

The Respondents were jointly and severally fined \$3,000, the Firm was censured, and Respondent Ackerman was suspended from functioning as the Firm’s Director of Compliance for one year, for violating NASD Membership and Registration Rule 1021 and NASD Conduct Rule 2110 by maintaining the principal license of GE from January 2003 to January 2004 when GE was not acting in a principal capacity at the Firm. The Department of Enforcement failed to prove by a preponderance of the evidence that the Respondents violated NASD Membership and Registration Rule 1031 when they maintained the general securities license of GE at the Firm from January 2003 to January 2004.

Appearances

David F. Newman, Esq., Regional Counsel, Philadelphia, PA, and Michael J. Newman, Esq., Regional Counsel, Woodbridge, NJ, for the Department of Enforcement.

Brian S. Hamburger, Esq., Teaneck, NJ, for Respondents.

DECISION

I. Procedural Background

On July 21, 2004, the Department of Enforcement (“Enforcement”) filed a one-count Complaint against Respondent [Firm] (the “Firm” or the “Respondent Firm”) and its president Respondent James C. Ackerman (“Respondent Ackerman”), (collectively, the “Respondents”).

The Complaint alleges that the Firm, acting through Respondent Ackerman, permitted GE to maintain his securities licenses at the Firm from January 2003 until January 2004, although GE was not active in the Firm’s investment banking or securities business, in violation of NASD Membership and Registration Rules 1021 and 1031, and NASD Conduct Rule 2110. The Respondents deny the allegation stating that GE was active at the Firm.

The Hearing Panel, consisting of a current member of the District 4 Committee, a former member of the District 9 Committee, and a Hearing Officer, conducted a Hearing in Woodbridge, New Jersey, on November 11 and 12, 2004.¹

II. Findings of Fact

A. The Respondents

The Firm has been an NASD member firm since 1987. (II Tr. p. 6). As of January 2002, the beginning of the relevant period, the Firm consisted of five individuals, including Respondent Ackerman, the Firm’s founder, president, and chief executive officer, and GE, a registered representative and principal at the Firm.² (II Tr. pp. 6, 11-12).

¹ “Tr.” refers to the transcript of the Hearing held on November 11, 2004; “II Tr.” refers to the transcript of the Hearing held on November 12, 2004; “JX” refers to the exhibits, which initially were submitted by Enforcement, but were adopted by the Respondents and designated as joint exhibits; and “RX” refers to the Respondents’ exhibits.

² By November 2004, the Firm had 60 registered representatives and seven branch offices. (II Tr. p. 16).

Respondent Ackerman has been registered with NASD since 1987 when he founded the Firm. (II Tr. p. 6). Respondent is currently registered as general securities representative and general securities principal. (Id.).

B. Registered Representative GE and the Firm

GE first became associated with NASD on September 20, 1991 through NASD member firm A.S. Goldmen & Co., Inc. (JX-1, pp. 1, 7). From December 2000 to January 2001, GE was employed by EarlyBirdCapital, Inc. as a general securities representative and general securities principal. (JX-1, p. 2).

When he left the securities industry in 2001, GE was president of a jewelry manufacturing business in which his father-in-law initially had an interest. (Tr. pp. 202, 206). Although GE was engaged in the jewelry manufacturing business full time, he maintained an interest in finance and intended to return to the securities industry.³ (Tr. p. 208).

In late 2002, Respondent Ackerman began negotiations to add to the Respondent Firm⁴ the investment banking expertise of DM, a registered representative with Atlas Capital Services, LLC (“Atlas Capital”). (II Tr. pp. 11-13). Previously, in mid-2002, DM had discussed the possibility of GE joining DM’s investment banking team at Atlas Capital. (Tr. pp. 192-193, 287). In late 2002, GE applied for employment with Atlas Capital. (Tr. pp. 143, 194).

In December 2002, DM advised GE that he was planning to leave Atlas Capital and join the Respondent Firm. (Tr. p. 149). DM told GE that it would make more sense for GE to join

³ As of November 11, 2004, GE was no longer involved in the jewelry manufacturing business and was seeking employment in the securities industry. (Tr. p. 140).

⁴ From 1987 to 1997, the Firm concentrated in private mortgage-backed securities and mergers and acquisitions transactions. (II Tr. pp. 7-8). In 1998, NASD approved changes in the Firm’s membership application to permit the Firm to offer on-line transactions. (II Tr. p. 8).

the Respondent Firm, rather than join Atlas Capital and have to switch to the Respondent Firm later when DM moved to the Respondent Firm. (Tr. pp. 195, 287).

In late 2002, DM discussed with Respondent Ackerman the three-member investment banking team that DM wanted to bring to the Firm. (II Tr. pp. 19-20). Respondent Ackerman understood that DM and the third team member had actual investment banking experience, but that GE would need to be trained. (Tr. pp. 337-338; II Tr. pp. 16, 25).

Respondent Ackerman spoke with GE in late December 2002 and again on January 7, 2003 about GE's possible employment. (II Tr. pp. 21, 56; JX-4). On January 8, 2003, two days before GE's licenses would have expired, NASD, at the request of the Firm, approved GE as a registered representative and registered principal of the Firm. (JX-1, p. 1). Respondent Ackerman directed the Firm's FINOP to submit the applications to NASD for GE's registrations. (II Tr. p. 109).

GE had had an interest in investment banking for quite some time.⁵ (Tr. pp. 197, 280). Respondent Ackerman, DM, and GE believed that GE would be a valuable addition to the Firm because GE, having been a successful retail broker for almost a decade, had numerous contacts with high net worth individuals, as well as other financial advisors and money managers, who could benefit from the on-line capabilities of the Firm.⁶ (Tr. pp. 255, 326; JX-4).

In addition, through his manufacturing business, GE had a number of contacts in the small business community, a possible source of investment banking deals. (Tr. pp. 325-326).

⁵ GE had known DM for approximately 30 years and wanted to emulate DM's success in corporate finance. (Tr. pp. 197, 280, 252-253).

⁶ During his career, GE was a retail broker, a compliance officer, and a branch manager. (Tr. pp. 205-206).

Finally, GE was detail-oriented, smart, and a diligent worker, the qualities required in the document intensive investment banking sector. (Tr. pp. 263, 291, 335, 339). GE anticipated that he would slowly wind down his involvement in the jewelry manufacturing business by either selling the business or bringing in another person. (Tr. p. 200).

Respondent Ackerman, GE, and DM anticipated that DM would join the Firm in the first quarter of 2003, i.e., January, February, or March, and would immediately begin training GE. (Tr. pp. 143, 321). DM did not actually join the Respondent Firm until six months later on June 26, 2003 because of unexpected delays in completing his pending transactions at Atlas Capital. (JX-27, p. 1).

GE was generally unsuccessful in bringing in business to the Firm. Between January 2002 and June 2003, prior to DM joining the Firm, GE attempted to solicit both retail and institutional customers for the on-line trading business of the Firm with little success, despite the concerns raised by the NASD staff in May 2003.⁷ (Tr. pp. 43-44). GE testified that he contacted approximately a dozen individuals who expressed a preliminary interest in using the services of the Firm. (Tr. p. 211). GE also solicited some money managers and financial planners that he knew. (Tr. p. 217). RS of Wachovia and PG of Prudential expressed an initial interest in the possibility of conducting institutional trading via the Firm's on-line system. (Tr. pp. 217-218).

⁷ On May 15, 2003, the NASD staff began a routine examination of the Respondent Firm and raised a question concerning GE's participation in the securities business of the Firm. (Tr. p. 36). The period covered by the examination was February 10, 1999 to April 30, 2003. (Id.). Subsequently, in a November 24, 2003 letter of caution, the NASD staff noted the Respondents' violation of NASD Membership and Registration Rule 1031 and referred the violation to Enforcement, but the NASD staff failed to specifically cite a violation of NASD Membership and Registration Rule 1021 for the maintenance of GE's general principal license. (JX-12, p. 2; Tr. p. 138).

None of GE's discussions resulted in actual business being transferred to the Firm. (Tr. pp. 241-242). During his tenure with the Firm, GE obtained only nine new retail accounts for the Firm, including his own account and accounts of relatives. (JX-18).

In June 2003 after DM joined the Firm, he began to train GE. (Tr. pp. 297, 299, 301). GE reviewed two investment banking deals to learn the mechanics of structuring such deals. (JX-19; JX-20; JX-21; Tr. pp. 297, 299, 301). However, in addition to being unsuccessful in soliciting on-line securities business for the Firm, GE was also unsuccessful in persuading his contacts to give the Firm investment banking deals. (Tr. p. 188). Accordingly, in January 2004, Respondent Ackerman and GE mutually agreed that GE would terminate his association with the Firm. (Tr. p. 187).

C. NASD Membership and Registration Rule Violation

1. The Respondents Did Not Violate NASD Membership and Registration Rule 1031 by Maintaining GE's Registration as a Securities Representative

NASD Membership and Registration Rule 1031 has two parts. The first part requires registration if individuals are engaged in certain activities; the second part requires that an application for registration not be filed or that a registration be terminated if individuals are not engaged in certain activities.

NASD Rule 1031 provides that all persons engaged in or to be engaged in the investment banking or securities business of a member who are to function as representatives shall be registered with NASD in the category of registration appropriate to the function to be performed.

Representatives are described as persons associated with a member, including assistant officers other than principals, who are engaged in the investment banking or securities business for the member. Article I (p) of the NASD By-Laws provides that "investment banking or

securities business” means the business of “underwriting or distributing issues of securities, or of purchasing securities and offering the same for sale as a dealer, or of purchasing and selling securities upon the order and for the account of others.”

NASD has explicitly stated that the determination of whether registration is required turns not on individuals’ official titles, but on whether they perform the functions of representatives.⁸ Functions performed by representatives include, but are not limited to, communicating with members of the public to determine their interest in making investments, discussing the nature or details of particular securities or investment vehicles, recommending the purchase or sale of securities, and accepting or executing orders for the purchase or sale of securities.⁹

NASD Rule 1031 also provides that a member shall not maintain a representative registration with NASD for any person (1) who is no longer active in the member’s investment banking or securities business, (2) who is no longer functioning as a representative, or (3) where the sole purpose is to avoid the examination or re-examination requirement. Specifically, a member shall not make application for the registration of any person as a representative where there is no intent to employ such person in the member’s investment banking or securities business.

A member may, however, maintain or make application for the registration as a representative of: (i) a person who performs legal, compliance, internal audit, back-office operations, or similar responsibilities for the member; (ii) a person who performs administrative

⁸ NASD Notice to Members, 99-49 (June 1999).

⁹ Id.

support functions for registered personnel; or (iii) a person engaged in the investment banking or securities business of a foreign securities affiliate or subsidiary of the member.

Enforcement did not persuasively argue that the sole purpose GE was hired by the Firm was to avoid the examination process, and it is clear that was not the case. Respondent Ackerman, GE, and DM all testified credibly that GE was hired with the expectation that he would become an integral part of the Firm's investment banking team and Enforcement offered nothing to contradict that testimony.

Instead, Enforcement argued that, although GE may have been hired with the expectation that he would participate in the Firm's investment banking or securities business, GE was not actually active in the Firm's investment banking or securities business between January 2003, when he was registered, and January 2004, when his registration was terminated. In support, Enforcement pointed out that during this period (i) GE worked 40 hours a week in his jewelry manufacturing business, (ii) he failed to send out any correspondence or business cards, and (iii) he did not receive any compensation for his activities.

These facts do not, however, establish that GE was not performing the functions of a registered representative during this period. Working full time at another job does not preclude a person from also engaging in the activities of a registered representative, and NASD rules do not distinguish between full time and part time work. Put another way, Rule 1031 requires that a person who engages in registered representative activities be registered even if that person does so on only a part time or occasional basis.

Nor does the fact that the Firm did not provide letterhead or business cards to GE or pay him any compensation prove that GE did not engage in registered representative activities on

behalf of the Firm. GE testified that he communicated with members of the public via telephone to determine their interest in making investments through the Firm.

Although Enforcement obtained GE's telephone records and had GE identify which telephone calls were made to Respondent Ackerman and DM, Enforcement failed to have GE identify which telephone calls were made to solicit individuals to use the Firm's on-line services. The uncontradicted testimony of GE shows, and the Hearing Panel finds, that during the period in question, GE was attempting to solicit business for the Firm from persons with whom he had a prior relationship and who already had a certain level of trust and confidence in GE. The telephone records, as presented by Enforcement, are consistent with testimony of Respondent Ackerman and GE that GE periodically called Respondent Ackerman to update him on GE's success or failure in soliciting business.

In addition, Enforcement argued that the fact that GE did not have an employment agreement with the Firm shows he was not involved in the securities business of the Firm. However, the only other registered representative at the Firm during the period successfully solicited variable annuity business for the Firm without an employment agreement with the Firm. (II Tr. pp. 32). In addition, when DM joined the Firm in June 2003, DM did not execute an employment agreement, and it is clear that DM was involved in the securities business of the Firm.¹⁰ (II Tr. p. 118). There was no evidence presented that the Firm had ever executed employment agreements with its registered representatives; the Firm's registered representatives are primarily independent contractors who are recompensed solely on what they produce for the Firm. (II Tr. p. 37).

¹⁰ DM's investment banking team generated in excess of \$400,000 in gross revenues for the Firm in 2003. (II Tr. p. 35).

Finally, Enforcement argued that the nine accounts GE referred to the Firm, for which he was not paid, constituted minimum activity and should not be considered sufficient to establish that GE participated in the securities business of the Firm. Soliciting securities business from relatives, however, does constitute solicitation. If GE had solicited his relatives to open securities accounts at the Firm without being registered, he would have violated Rule 1031.¹¹

There is no question that GE was not successful in soliciting business for the Firm. However, the NASD compliance examiner who testified agreed that solicitation rather than success and earning commissions is the key factor in determining whether an individual's actions require registration.¹² (Tr. pp. 131). Respondent Ackerman testified and GE confirmed that GE attempted to solicit business for the Firm's on-line securities business.

GE was a credible witness and Enforcement provided no evidence to discredit his testimony that he solicited business for the Firm between January 2003 and January 2004. Even if the Hearing Panel had determined that GE had lied to the Respondents about his activities, Enforcement also failed to provide any evidence that Respondent Ackerman knew or should have known that GE was deceiving him about his solicitation activities. Accordingly, the Hearing Panel finds that Enforcement failed to demonstrate by a preponderance of the evidence that the Firm or Respondent Ackerman violated NASD Membership Rule 1031.

¹¹ See NASD Notice to Members, 00-50 (Aug. 2000) (the definition of representative has been consistently interpreted by the NASD to require registration of persons who engage in activities that constitute a portion of registered representatives' traditional dealings with public customers, including persons who solicit accounts on behalf of members).

¹² See In re Voss & Co., 47 S.E.C. 626, 630 n. 9 (1981) (recognizing that for registration violations, "payment of compensation is not necessary to a finding of violation").

2. The Respondents Did Violate NASD Membership and Registration Rule 1021 by Maintaining GE's Registration as a Securities Principal

Similar to NASD Membership and Registration Rule 1031, NASD Membership and Registration Rule 1021 has two parts, the first part requires registration if individuals are engaged in certain principal activities, and the second part requires that an application for registration not be filed or be terminated, if individuals are not engaged in certain principal activities.

Specifically, NASD Rule 1021 provides that a member shall not maintain a principal registration with NASD for any person (1) who is no longer active in the member's investment banking or securities business, (2) who is no longer functioning as a principal, or (3) where the sole purpose is to avoid the examination requirement.

Rule 1021 does provide that a member may maintain or make application for the registration as principal of persons who perform legal, compliance, internal audit, back-office operations,¹³ or similar responsibilities for the member. Principals are defined as persons associated with a member, in the manner enumerated in subparagraphs (1) through (5) of the rule, who are actively engaged in the management of the member's investment banking or securities business, including supervision, solicitation, conduct of business, or the training of persons associated with a member for any of those functions. The enumerated subparagraphs of the rule list: (1) sole proprietors; (2) officers; (3) partners; (4) managers of offices of supervisory jurisdiction; and (5) directors of corporations.¹⁴

¹³ NASD Notice to Members, 03-20 (Apr. 2003) reported technical amendments to the NASD Registration Rules, including amendments to Rules 1021(a) and 1031(a) to permit a member to maintain or make application for the registration of a principal or representative who performs back-office operations.

¹⁴ NASD Notice to Members, 99-49 (June 1999).

GE was not an officer, partner, manager, or director of the Firm. GE did not perform legal, compliance, internal audit, or back-office operations for the Firm. GE unequivocally testified that he never had any supervisory responsibilities at the Firm.

Respondent Ackerman argued that he intentionally had GE's principal license maintained in order to have a back-up or contingent principal to meet NASD's requirements that each NASD member maintain two principals. The Hearing Panel does not find such explanation persuasive.

Although Respondent Ackerman may have had such a fleeting thought upon learning of GE's management and compliance experience, Respondent Ackerman did not record such a plan in the contemporaneous notes he made on January 7, 2003, regarding GE's hiring, and Respondent Ackerman did not convey such a plan to GE. In addition, Respondent Ackerman did not list back-up or contingent principal as one of GE's duties when he explained GE's activities at the Firm to the NASD staff during NASD's audit of the Firm in 2003. (JX-6; JX-7; JX-8; JX-13).

The Hearing Panel finds it more plausible that Respondent Ackerman did not consider all of the implications of GE's principal license when he directed his FINOP to file the necessary forms with NASD for GE's registration in January 2003.

In any event, the NASD Rules do not provide for a “contingent principal.” Rule 1021 clearly and unambiguously provides that a person shall not be registered as a principal unless he is actually functioning in a role that permits such a registration.¹⁵

Because the undisputed evidence establishes that GE never had, and never exercised, any principal responsibilities at the Firm, the Hearing Panel finds that the Respondents violated NASD Membership and Registration Rule 1021 and Conduct Rule 2110 by maintaining GE’s principal license.¹⁶

III. Sanctions

The NASD Sanction Guidelines for registration violations by a firm and/or an individual recommend a fine of \$2,500 to \$50,000.¹⁷ The Guidelines also recommend, in egregious cases, a suspension up to 30 business days for a firm, and a suspension in any or all capacities for up to six months for an individual.¹⁸

Enforcement did not request a separate sanction for the Rule 1021 violation. Instead, Enforcement argued that for both violations, the Respondents should be jointly and severally fined \$12,000, the Firm should be censured, and Respondent Ackerman should be suspended in his principal capacity for 30 days.

¹⁵ NASD rules address the emergency situation raised by Respondent Ackerman. NASD Membership and Registration Rule 1021(d)(1) provides “[a]ny person associated with a member as a Registered Representative whose duties are changed by the member so as to require registration in any principal classification shall be allowed a period of 90 calendar days following the change in his duties during which to pass the appropriate Qualification Examination for Principals. Upon elevation, the member shall submit to NASD an amended ‘Uniform Application for Securities Industry Registration or Transfer’ and the applicable fees. In no event may a person function as a Principal beyond the initial 90 calendar day period following the change in his duties without having successfully passed the appropriate Qualification Examination.”

¹⁶ A violation of a Registration Rule 1031 is also a violation of Conduct Rule 2110. Michael F. Flannigan, Exch. Act Rel. No 47,142 (Jan. 8, 2003) at <http://www.sec.gov/litigation/opinions/34-47142.htm>.

¹⁷ NASD Sanction Guidelines, p. 50 (2004).

¹⁸ Id.

In determining the sanction to be imposed, the Hearing Panel considered the following principal considerations: (1) the Respondents' relevant disciplinary history; (2) whether the individual or member firm accepted responsibility for and acknowledged the misconduct; (3) whether reasonable supervisory procedures were properly implemented; (4) whether the Respondents engaged in the misconduct over an extended period of time; (5) whether the Respondents engaged in numerous acts/and or a pattern of misconduct; and (6) whether the misconduct resulted in injury to the investing public.¹⁹

The Hearing Panel particularly noted that the Respondents engaged in similar misconduct previously. In 1999, Respondent Ackerman executed a Letter of Acceptance of Waiver and Consent ("AWC") regarding NASD Membership and Registration Rules. (JX-28). In the AWC, Respondent Ackerman accepted a finding that the Firm, acting through Respondent Ackerman, permitted an individual to maintain his FINOP registration with the Firm from September 1998 through June 1999, although that individual was not functioning in that capacity, and that during the same period Respondent Ackerman acted as the Firm's FINOP without being registered in such capacity.²⁰ (JX-28, p. 5). In addition, rather than acknowledging the current Rule 1031 violation, Respondent Ackerman offered his "contingent principal" justification, which exhibits little, if any, understanding of the NASD's membership and registration rules.²¹ The supervisory procedures as implemented by Respondent Ackerman as the Director of Compliance were not

¹⁹ Id. at p. 8.

²⁰ Respondent Ackerman and the Firm were each fined \$3,000, a total of \$6,000, for permitting an individual to maintain his FINOP license at the Firm. For acting as an unregistered FINOP, Respondent Ackerman was censured and fined an additional \$6,500. (JX-28, p. 5).

²¹ Respondent Ackerman testified that he believed, and currently believes, if something had happened to him to prevent him from functioning as the Firm's principal, in the absence of having designated GE as a contingent principal, the Firm would have been closed down because at that time Respondent Ackerman was the only other registered principal.

sufficient to prevent the original violation or its continuance for a year. All of these are aggravating factors for purposes of arriving at the appropriate sanctions.

On the other hand, the violation of Registration and Membership Rule 1031 in connection with GE's registration was not one of numerous violative acts, nor did it constitute a pattern of misconduct. Furthermore, the misconduct did not result in injury to the investing public.

Considering all these circumstances and crafting a sanction that will respond directly to the misconduct, the Hearing Panel: (1) jointly and severally fines the Respondents \$3,000; (2) censures the Firm; and (3) suspends Respondent Ackerman from functioning in his capacity as the Firm's Director of Compliance for one year. The suspension as the Firm's Director of Compliance does not impact Respondent Ackerman's ability to undertake other principal responsibilities at the Firm.

IV. Conclusion

The Respondents are jointly and severally fined \$3,000, the Firm is censured, and Respondent Ackerman is suspended from functioning as the Firm's Director of Compliance for one year for violating NASD Membership and Registration Rule 1021 and Conduct Rule 2110 by maintaining the principal license of GE from January 2003 to January 2004 when GE was not acting in a principal capacity at the Firm.

The Hearing Panel also orders the Respondents to jointly and severally pay the \$4,178.26 costs of the Hearing, which include an administrative fee of \$750 and Hearing transcript costs of \$ 3,428.26. The sanctions, including the fines and the fees, shall become effective on a date determined by NASD, but not sooner than thirty days from the date this Decision become the final disciplinary action of NASD, except that, if this Decision becomes the final disciplinary

action of NASD, Respondent Ackerman's suspension shall commence on May 2, 2005 and the suspension shall conclude on May 1, 2006.²²

SO ORDERED.

HEARING PANEL

By: _____
Sharon Witherspoon
Hearing Officer

Dated: Washington, DC
March 14, 2005

Copies to:
[Respondent Firm] (via Federal Express and first class mail)
James C. Ackerman (via Federal Express and first class mail)
Brian S. Hamburger, Esq. (via facsimile and first class mail)
David F. Newman, Esq. (via electronic and first class mail)
Michael J. Newman, Esq. (via electronic and first class mail)
Rory C. Flynn, Esq. (via electronic and first class mail)

²² The Hearing Panel has considered all of the arguments of the Parties. They are rejected or sustained to the extent that they are inconsistent or in accord with the views expressed herein.