

This Order has been published by FINRA's Office of Hearing Officers and should be cited as OHO Order 08-05 (C02050006).

**FINANCIAL INDUSTRY REGULATORY AUTHORITY  
OFFICE OF HEARING OFFICERS**

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

Respondent.

Disciplinary Proceeding  
No. C02050006

Hearing Officer – LBB

March 27, 2008

**ORDER APPROVING AND FORWARDING  
CONTESTED OFFER OF SETTLEMENT**

**I. Introduction**

Respondent was charged in a January 12, 2005, Complaint with refusing to answer certain questions at an on-the-record interview (“OTR”), in violation of NASD Procedural Rule 8210 and Conduct Rule 2110. On August 8, 2005, the Hearing Panel granted Enforcement’s motion for summary disposition on both liability and sanctions.

On February 12, 2007, the National Adjudicatory Council (“NAC”) affirmed the Hearing Panel’s ruling on liability but remanded the matter to the Office of Hearing Officers for a hearing on sanctions. The NAC concluded that “[Respondent] produced sufficient evidence to raise a question as to the outcome of sanctions in this case and that the record developed to date does not otherwise suggest that the decision to summarily bar [Respondent] was correct as a matter of law.” NAC Decision and Remand Order at 14. The NAC remanded the case “to determine the sanctions, if any, to be imposed for [Respondent]’s misconduct.” *Id.*

Shortly before the hearing on remand was to take place, Respondent submitted a contested offer of settlement pursuant to NASD Procedural Rule 9270(f), proposing a two-year suspension and a \$10,000 fine. The Hearing Panel approves the settlement pursuant to Rule 9270(f) and forwards the proposed settlement to the NAC for its consideration.

## **II. Facts<sup>1</sup>**

NASD commenced an investigation in December 2002 concerning statements issued by Morgan Stanley for certain hedge fund customer accounts serviced by Respondent. On July 24, 2003, NASD staff issued a written request that Respondent provide on-the-record testimony pursuant to NASD Procedural Rule 8210.<sup>2</sup>

Pursuant to this request, Respondent provided on-the-record testimony to NASD staff on September 25, 2003, concerning his dealings with "SB" and "CS," two individuals responsible for investing the assets of certain hedge funds. Staff's questioning focused primarily upon an account held at Morgan Stanley in the name of the "Fund," and Respondent's handling of complaints received from SB and CS concerning errors allegedly committed by Morgan Stanley in executing and reporting certain option transactions on behalf of the Fund. Respondent answered fully each question posed to him by NASD staff during this first interview session.<sup>3</sup>

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<sup>1</sup> This section, including footnotes, is taken verbatim from the NAC's February 12, 2007 decision. It is reproduced here for the convenience of the reader. The text of footnote 1 of the NAC's decision read: "The facts stated herein represent the undisputed facts and evidence set forth by the parties in support of and in opposition to Enforcement's motion for summary disposition."

<sup>2</sup> The addendum accompanying the staff's request for Respondent's testimony advised that Respondent was obligated to answer all questions asked by NASD staff and that his failure to do so could subject him to disciplinary action and the imposition of sanctions. The addendum further advised Respondent that he could inspect and purchase a copy of the official transcript of his on-the-record interview. Finally, the addendum stated that "NASD staff does not release copies of exhibits to testimony but you may review these exhibits at NASD's offices."

<sup>3</sup> On November 5, 2001, Respondent was served with a Securities and Exchange Commission subpoena, in an investigative matter concerning SB and CS, requesting that Respondent produce documents and provide testimony. In response to the subpoena, Respondent asserted his Fifth Amendment privilege against self-incrimination "as to all matters." Although Respondent initially requested the postponement of his NASD testimony until a date after the completion of the Commission's investigation concerning SB and CS, Respondent complied with the request that he appear and subject himself to questioning by NASD staff on September 25, 2003.

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After testifying for approximately two hours, the parties mutually agreed to adjourn Respondent's investigative interview and continue at a later date.

At the end of his testimony on September 25, 2003, NASD staff requested that Respondent provide copies of documents that NASD staff believed might augment documents provided to NASD by Commission staff.<sup>4</sup> Respondent agreed to provide the documents requested.<sup>5</sup> In turn, Respondent requested that he be permitted to inspect, before testifying again, all documents within NASD's investigative files relating to Respondent. NASD staff at first consented to Respondent's request and established a date for his inspection. Prior to that date, however, NASD staff reversed their position. They informed Respondent that he could inspect only those documents that Respondent provided to the Commission and that NASD staff would not permit Respondent, prior to the completion of his on-the-record testimony, to inspect any documents obtained from anyone other than Respondent.

On November 20, 2003, Respondent appeared before NASD staff to provide additional on-the-record testimony. Respondent testified fully for approximately one hour about various issues, at which point NASD staff marked certain documentary evidence for identification as an exhibit. NASD staff marked for identification as "Exhibit 1" to Respondent's testimony a compilation consisting of 70 pages of e-mails and other documents. A copy of this exhibit was presented to Respondent and his counsel for reference during Respondent's interview.

Respondent's counsel asked NASD staff whether he could obtain a copy of the exhibit for his files. Staff responded that he could not. Counsel then inquired whether a copy of the exhibit would be attached to the official transcript of Respondent's interview. NASD staff stated

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<sup>4</sup> Despite earlier informing the Commission of his intention to assert his Fifth Amendment privilege "as to all matters," Respondent ultimately provided Commission staff with certain documents concerning his handling of the Fund account. Commission staff later provided copies of these documents to NASD.

<sup>5</sup> Subsequent to his first day of testimony, NASD staff also requested, by electronic mail sent to his counsel, that Respondent provide certain additional information. Respondent complied and provided the information requested.

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that it would not. NASD staff explained that NASD does not, as a matter of policy, provide interview witnesses with copies of exhibits compiled from documents provided by other persons. Staff stated that such documents are maintained in NASD's files and generally would be available for inspection after the completion of testimony.

In response, Respondent's counsel noted that NASD staff had previously informed Respondent that he could inspect certain documents maintained within NASD's files, only to then have the staff unilaterally withdraw that invitation before the second day of Respondent's testimony. Thus, notwithstanding the staff's on-the-record assurances, Respondent's counsel objected to the use of any documents that were not either provided to Respondent and his counsel for their files or attached to the transcript of Respondent's testimony.

After acknowledging counsel's objection on the record, NASD staff proceeded to question Respondent concerning page one of Exhibit 1. Respondent answered the questions posed to him concerning this excerpt of Exhibit 1 for which he possessed personal knowledge. NASD staff continued their interview of Respondent with questions concerning the second page of Exhibit 1. Respondent answered staff's questions.

When staff began questioning Respondent, however, concerning a fax cover sheet from SB to Respondent dated June 24, 1999 (page seven of Exhibit 1), counsel for Respondent again interposed his objection to staff's use of documentary evidence during Respondent's interview. Counsel stated that, by not either providing a copy of the document for Respondent's keeping or attaching the exhibit to the interview transcript, NASD could not assure Respondent that the interview exhibits would not be lost, mishandled, or otherwise altered at a later date. Counsel stated that, absent the implementation of his suggested "precautions," he would advise

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Respondent not to answer any additional questions concerning exhibits presented to him by NASD staff during his testimony.<sup>6</sup>

NASD staff reiterated that the exhibits to investigative interviews become part of NASD's record of the matter at issue and are maintained in NASD's files by staff for inspection at a later date.<sup>7</sup> This response, however, proved insufficient to allay counsel's objections.

Respondent's counsel stated that "we are not going to testify on a document to which we're not going to be given a copy or attached to the record ... I'm going to instruct [Respondent] not to answer any questions if that's the line you're going to take." Indeed, when NASD staff returned to questioning Respondent about the exhibit before him, Respondent complied with his counsel's instruction to him not to answer NASD staff's questions.

When NASD staff asked Respondent whether he would answer any further questions concerning any documents to be identified as exhibits during his testimony, Respondent's counsel stated "I will instruct my client not to answer any of those questions" and Respondent compliantly stated that, "under the advice of counsel, that's my position."

NASD staff then explained to Respondent that they planned to terminate his testimony. Staff further stated that they intended to recommend that NASD commence disciplinary proceedings against Respondent and bar him for violating NASD Procedural Rule 8210.

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<sup>6</sup> Counsel for Respondent also offered as an alternative safeguard reading the contents of the exhibits into the record.

<sup>7</sup> Staff's response to counsel's objection was, in its entirety:

Okay. At this point, I'm just telling you that this is the way it is going to be done. I can't possibly, unless I put this under some sort of armed guard, give you assurances that nothing will happen. I will give you our statement, our position, that this document becomes part of the NASD record, this will be kept in our files. And unless you're insinuating that I or someone on the staff would alter this document, there is no way for the document to be altered. I want to leave it at that point. I'm not going to go through further discussions. Either [Respondent] is going to answer the questions or not. You tell me.

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Respondent and his counsel acknowledged the portent of staff's position.<sup>8</sup> NASD staff thereafter adjourned the interview without any additional questioning of Respondent.

### **Discussion**

The Remand Order identified certain specific issues that were to be addressed at an evidentiary hearing on sanctions:

1. Whether Respondent's conduct was an intentional attempt to delay an NASD investigation or was based on a good-faith reliance on counsel.
2. How material was the information withheld.
3. Whether Respondent proposed possible mitigative efforts to comply with staff's request for information.

The Hearing Panel has considered each of those issues based on the available evidence. In addition, the Hearing Panel considered the sanctions imposed in recent decisions in disciplinary proceedings involving partial responses to Rule 8210 requests. The Hearing Panel determined that the offer of settlement is supported by the evidence and consistent with the sanctions imposed in other cases.

#### **I. Consideration of the Issues Identified in the Remand Order Supports Approval of the Contested Offer of Settlement.**

As discussed below, the evidence supports a finding that Respondent acted in good-faith reliance on counsel and not with the intention of delaying the investigation; the information was material, but Respondent's responses to substantial examination before the refusal to answer suggest that much of the information withheld could have been obtained even in the absence of an agreement on the document issue; and Respondent did make limited proposals to try to work out a solution to the impasse, but the staff's responses suggested that they were not interested in a compromise solution.

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<sup>8</sup> In response to NASD staff's statements that they would seek to bar him, Respondent's counsel stated "[w]e understand that" and Respondent stated "if you need to bar me, . . . do what you gotta do."

**A. The evidence does not establish that Respondent's conduct was an intentional attempt to delay a FINRA investigation and supports an inference that he acted in good-faith reliance on counsel.**

As noted above, Respondent's counsel instructed him not to answer certain questions at the OTR. Respondent has stated in an affidavit that he did not testify because of his concerns about the integrity of the record. Respondent Dec. of Oct. 11, 2007 ¶¶ 18 – 26 (submitted with hearing exhibits for remand hearing). His view of the situation was that he was being asked to testify without following "proper procedural safeguards to ensure ... that my testimony would not be impeached later on by the introduction of documents that clearly were not the documents I was testifying to during the NASD investigation." His concerns were heightened because, in his view, the staff had breached an agreement to make documents available for review prior to the OTR. Respondent Dec. ¶25.

Enforcement urges the Hearing Panel to find that Respondent engaged in a deliberate strategy of delay, and that the objections were merely a subterfuge so that Respondent could avoid incriminating himself. *See* Department of Enforcement's Opposition to Offer of Settlement, dated Jan. 25, 2008, at page 4. This argument is pure speculation and is not supported by the evidence in the record. Enforcement attempts to contrast Respondent's responses to general questions about the accounts in question and his practices with respect to those accounts with his responses about Morgan Stanley's computer problems with respect to those records, arguing that Respondent's testimony was intentionally vague except when he testified about alleged computer problems, which supported his defense to potential charges. A review of the two transcripts does not support Enforcement's position. In fact, as reflected in the text reproduced above, the NAC's February 12, 2007, decision found that Respondent testified fully at both OTR sessions until the issues related to testimony concerning documents arose.

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The argument that Respondent sought to avoid incriminating answers is also inconsistent with the fact that Respondent answered questions concerning his involvement with the principal subjects of the SEC investigation for more than three hours. It seems inconceivable that Respondent would have answered numerous questions about the account statements and trades that were the subject of the SEC's investigation if he were concerned about self-incrimination. Furthermore, Respondent was willing to go forward and respond to questions if the staff had accommodated Respondent's request to attach documents, which is, as Respondent's counsel noted, a common practice in civil litigation. It is unlikely that Respondent would have expressed his willingness to go forward by following this common practice if his intention was to create an excuse to refuse to answer questions about the documents.

Finally, Enforcement does not explain why Respondent needed a subterfuge. If Respondent had been concerned about self-incrimination, he could have refused to answer based on the Fifth Amendment rather than manufacturing a pretext for his refusal. The investigator made it very clear that the staff would recommend a bar if Respondent did not answer the pending question on the document, and that a bar was a common sanction. The penalty for a refusal based on the Fifth Amendment could be no greater.

In arguing that Respondent did not rely on counsel in good faith, Enforcement relies on *Dep't of Enforcement v. Steinhart*, 2003 NASD Discip. LEXIS 23 (N.A.C. August 11, 2003), in which the respondent was barred for refusing to testify. In *Steinhart*, the NAC stated that the respondent's reliance on counsel could not be considered in good faith, "especially when the legal counsel or his client has knowledge that the advice violates the applicable rule." *Id.* at \*9. It is true that Respondent and his counsel received and acknowledged warnings from FINRA staff that they would recommend the institution of disciplinary proceedings if he refused to



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answer, and that there was a range of "likely" sanctions, including a bar. Tr. 162 – 163.

Respondent indicated his understanding of the staff's position in somewhat colorful language:

I understand that you guys are strong-arming me into answering questions without following proper procedures and you have your own procedures. So if you need to bar me, ... do what you gotta do and stop wasting my time.

Tr. 163.

Despite Respondent's acknowledgment that FINRA staff would seek sanctions, and possibly a bar, *Steinhart* is significantly different from this case because Mr. Steinhart completely refused to answer, asserting his Fifth Amendment privilege with respect to all questions, while Respondent testified for about three hours and indicated his willingness to continue to testify about all subjects if his procedural concerns about the documents could be worked out.

Enforcement seeks to distinguish *Dep't of Enforcement v. Erenstein*, No. C9B040080, 2006 NASD Discip. LEXIS 31 at \*19 (N.A.C. Dec. 18, 2006), *aff'd sub nom. Morton Bruce Erenstein*, Exchange Act Rel. No. 56768, 2007 SEC LEXIS 2596 (Nov. 8, 2007). Respondent in *Erenstein* was under investigation for conversion and claimed that the payment in question had been compensation for his services. He refused to answer a question about whether he had reported the funds as income on his tax return and refused to produce the tax return. In reducing the sanctions imposed by the Hearing Panel from a bar to a one-year suspension, the NAC considered the fact that the respondent's refusal to answer was based on his counsel's "apparently good faith objection."

*Erenstein* is different from this case, but nevertheless instructive. While *Erenstein* involved a refusal to answer only a single question and provide a single document, the information sought was important to testing the respondent's defense to the allegations in the

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case. Respondent might have provided the information necessary to complete the investigation if the staff had continued the OTR, and he was willing to answer all questions if his concerns about documents could be addressed. If Mr. Erenstein relied on his counsel in good faith, he, like Respondent, did so after being warned by the FINRA staff that he was subjecting himself to disciplinary action, and was being advised to take an action that clearly violated Rules 8210 and 2110. Furthermore, Mr. Erenstein's objection would have been meritless even in discovery in a court proceeding, while Respondent was proposing to follow the procedures that are prevalent in discovery in civil litigation. Respondent's conduct was not substantially more egregious, if at all, than Mr. Erenstein's conduct.

There is no evidence that Respondent refused to answer the question posed for any reason other than his reliance on counsel. Counsel's direction to Respondent was clear and unequivocal, and Respondent made it plain in that his refusal to answer was based on the advice of counsel. He never refused to answer any questions, or even protested, in the absence of direction from counsel. Respondent appears to have relied on counsel in good faith.

**B. The information sought was material, but it is not clear that Respondent was unwilling to provide substantial additional information that would have mitigated the effect of his refusal to answer.**

The documents about which Respondent refused to testify were clearly material to the investigation. They generally relate to the accounts of the hedge funds that were the subject of the investigation, and most were written by or directed to Respondent. But because the OTR was stopped as soon as Respondent refused to answer, it is not clear that he was unwilling to provide most of the information sought by the staff, even if the issues concerning the handling of the document could not be resolved. Thus, it is not clear that his refusal materially interfered with the ability of the staff to obtain the information necessary to complete their investigation.

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Some of the documents expressly point out the existence of errors in the account statements, which are relevant to the possibility that the hedge funds sent statements to their customers based upon information that they knew was unreliable. The documents also contain statements relevant to Respondent's apparent intent to assert in defense of any possible charges that the problems were caused by Morgan Stanley computer "glitches," and his contention that he pointed the problems out both to the customer and to others at Morgan Stanley. The compilation of documents includes the first pages from a number of account statements for hedge funds that had been the subject of questions at the OTR. These statements appear to relate to the issues of whether Morgan Stanley provided inaccurate account statements to the hedge funds, and whether the hedge funds provided fraudulent account statements to their investors.

Because the OTR was terminated with Respondent's first refusal to answer a question, the effect of the refusal on FINRA's ability to gather material information is unclear. There is no record of the questions that the investigator would have asked concerning the documents or of whether Respondent would have systematically refused to answer.<sup>9</sup> Respondent did initially respond to questions about the documents, and the record suggests that he might have continued to respond except to the extent that the questions were tied to his knowledge of specific documents. He was also willing to testify if the documents were read into the record, a

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<sup>9</sup> At the OTR, Respondent's counsel appeared to state that he would not allow the Respondent to answer any questions related to documents. "If you're going to tell me you're not going to provide me a copy or attach it to the court reporter's deposition transcript or alternatively take some precautions that this particular document can't be altered, outside of the assurance that you have already provided me, I will instruct my client not to answer any of those questions." OTR Tr. 161 at lines 19 – 25. Respondent had already answered a number of questions concerning a document, and had refused to answer only when asked if he had received a specific document. Thus, it appears that the objection would not have extended to all questions relating to documents, based on documents, or even about statements in documents, but only to questions that would relate to respondent's receipt, creation, or familiarity with specific documents. While the conditioning of further responses was clearly improper, *Toni Valentino*, Exchange Act Rel. No. 49255, 2004 SEC LEXIS 330 at \*11 (Feb. 13, 2004), in the absence of further questioning, the scope of the refusal to answer is unclear.

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cumbersome procedure at best, but nonetheless indicating a willingness to answer as long as his concern for the integrity of the record was satisfied.

Furthermore, the objectives of the OTR might well have been satisfied without testimony about whether Respondent had received the specific documents. He might well have testified to the subjects covered by the documents; general questions about the creation of documents, sending documents, or receiving documents; or the contents of types of documents, for example. It is also quite possible that Respondent might have answered specific questions related to the documents if the documents had been used to refresh his recollection, which would not have required him to specifically acknowledge receipt of a document or to rely on its contents. In the absence of further efforts to elicit such testimony, the materiality of the information that Respondent refused to provide is unclear.

While the subject matter of the documents was material, it is not clear that Respondent's refusal to answer prevented the staff from obtaining substantial material information. It appears quite possible, if not likely, that sufficient information could have been developed at the OTR, by questioning that did not require the witness to commit to receipt or knowledge of a specific document, to determine whether it was appropriate to initiate a disciplinary proceeding against Respondent for whatever role he might have had in the activities that were the subject of the SEC investigation that apparently prompted FINRA to investigate Respondent's conduct.

**C. Possible mitigative efforts by Respondent to comply with staff's request for information.**

Enforcement states that "[t]here were alternatives available, short of an outright refusal to testify, that would address Respondent's concerns about the integrity of the exhibits, if such concerns were genuine." Department of Enforcement's Opposition to Offer of Settlement at Page 6. Enforcement even suggests a few possible alternatives. *Id.* at fn. 3. At the OTR,

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however, neither the FINRA staff nor Respondent suggested any of these alternatives. Only two compromise solutions to the impasse were mentioned: Respondent's counsel suggested that the document be attached, subject to a court-ordered protective order (Tr. 160, lines 3 – 6); or, as noted above, the entire contents of the document could be read into the record.

In fact, the staff appeared to be distinctly averse to a discussion of any alternatives other than pursuing the OTR in exactly the manner that was planned. In response to a lengthy explanation by Respondent's counsel of his concerns about the integrity of the documents, the investigator responded, "Okay. At this point, I'm just telling you that this is the way it's going to be done." Tr. 159, lines 5 – 6.

As Enforcement suggests, it is possible that the issue could have been resolved entirely by some accommodation on both sides. Additionally, even if the issue could not have been fully resolved, it might have been partially resolved, as Respondent had already answered some questions concerning the document and would likely have answered more. While Respondent did not make substantial mitigative efforts, his efforts appeared to be a reasonable opening for discussions on mitigative efforts, but FINRA staff appeared to close the door on such discussions.

## **II. The Proposed Sanction Is Consistent With Several Recent Decisions Involving Partial Responses to Rule 8210 Requests.**

While the Hearing Panel recognizes that the appropriate sanctions depend on the facts and circumstances of each case,<sup>10</sup> the Hearing Panel found it instructive to consider recent cases involving refusals to answer only certain questions and incomplete responses to Rule 8210 requests. In each of these cases, the sanction imposed was less than a bar.

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<sup>10</sup> See, e.g., *Morton Bruce Erenstein*, Exchange Act Rel. No. 56768, 2007 SEC LEXIS 2596 at \*30 (November 8, 2007).

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In *Perpetual Securities, Inc.*, Exchange Act Rel. No. 56613, 2007 SEC LEXIS 2353 (October 4, 2007), *motion for reconsideration denied*, 2007 SEC LEXIS 2922 (December 13, 2007), the respondent had answered some of the questions posed by FINRA staff, failed to answer others, and failed to provide requested documents. The SEC reduced the sanction imposed by FINRA from a bar to a suspension of two years. In a recent case, the SEC modified the sanction imposed by FINRA, imposing a two-year suspension and a \$5,000 fine rather than a bar. *Rooney A. Sahai*, Exchange Act Rel. No. 55046, 2007 SEC LEXIS 13 (January 5, 2007). The SEC cited the respondent's "minimum and dilatory cooperation" in finding that a suspension on the high end of the range in the Sanction Guidelines was appropriate, but noted that the respondent had responded partially to several of the staff's requests.

The Hearing Panel also considered *Morton Bruce Erenstein*, Exchange Act Rel. No. 56768, 2007 SEC LEXIS 2596 (November 8, 2007), discussed above. Finally, the NAC reduced the sanctions imposed on an associated person who provided partial responses to FINRA information requests in *Dep't of Enforcement v. Baldwin*, No. E8A20050252 (Feb. 20, 2008). In *Baldwin*, the respondent submitted a number of untimely and partial responses to questions concerning how his firm had been capitalized after a finding of a net capital deficiency. The NAC affirmed the Hearing Panel's determination that the respondent had violated NASD Rule 8210, but reduced the sanction from a bar to a two-year suspension and a fine of \$25,000.

The sanction proposed by the Contested Offer of Settlement is consistent with the sanctions imposed in each of these litigated cases, and his conduct was not more egregious than the conduct of the respondents in any of these cases.

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### **Conclusion**

The Hearing Panel approves and forwards Respondent's Contested Offer of Settlement. The Hearing Panel has considered the factors identified in the NAC's remand order as well as several recent cases involving partial responses to Rule 8210 requests, and finds that the sanction that Respondent proposes in his Contested Offer of Settlement is supported by the facts and consistent with the sanctions imposed in other matters.

**SO ORDERED.**

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**HEARING PANEL**

By: Lawrence B. Bernard  
Hearing Officer