FINANCIAL INDUSTRY REGULATORY AUTHORITY[1]
OFFICE OF HEARING OFFICERS

DEPARTMENT OF MARKET REGULATION, Complainant, v. Respondent.	Disciplinary Proceeding No. 2005000191701 **HEARING PANEL DECISION** Hearing Officer – SW Date: April 30, 2008

Respondent Giarmoleo is suspended from associating with any FINRA member in any capacity for one year and fined $27,500 for violating Section 10(b) of the Exchange Act, SEC Rule 10b-5 thereunder, and NASD Conduct Rules 2120, 2310, 2315, and 2110, as alleged in count one of the Complaint.

Appearances

Ralph D. Martin, Esq., and Michael J. Dixon, Esq., Rockville, MD, for the Department of Market Regulation.

Rodney L. Drake, Esq., Bohemia, NY, for Respondent Paul M. Giarmoleo.

DECISION

I. PROCEDURAL HISTORY

A. Complaint and Answer

On December 26, 2006, the Department of Market Regulation ("Market Regulation") filed a six-count Complaint, which was amended effective February 28, 2007 ("Complaint"), against four Respondents: (i) S.G. Martin Securities, LLC ("SG Martin" or the "Firm"); (ii) Emanuel Pantelakis; (iii) Paul M. Giarmoleo; and

[1] As of July 30, 2007, NASD consolidated with the member firm regulation functions of NYSE and began operating under a new corporate name, the Financial Industry Regulatory Authority (FINRA). References in this decision to FINRA include, where appropriate, NASD.

(iv) ["Respondent 4"]. Prior to the Hearing, Market Regulation filed a motion to withdraw the allegations of the Complaint against Respondent 4, which motion was granted on September 5, 2007. In addition, Respondents SG Martin and Pantelakis submitted a settlement agreement that was subsequently accepted by FINRA.

Accordingly, the Hearing only addressed count one of the Complaint, which contained allegations against Respondent Giarmoleo regarding his recommendation that customers purchase shares of Surface Tech, Inc. ("Surface Tech" or the "Company"). Count one of the Complaint alleges that Respondent Giarmoleo violated Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), SEC Rule 10b-5 thereunder, and NASD Conduct Rules 2110, 2120, 2310, and 2315 when he recommended the purchase of Surface Tech to 14 customers.

Respondent Giarmoleo denied that his actions violated Section 10(b) of the Exchange Act, SEC Rule 10b-5 thereunder, and NASD Conduct Rules 2110, 2120, 2310, and 2315.

B. Hearing

The Hearing Panel, consisting of a former member of the District 10 Committee, a former member of the District 5 Committee, and a Hearing Officer, conducted a Hearing in New York, NY, on November 13-15, 2007.[2]

The Hearing Panel finds that Enforcement met its burden of showing by a preponderance of the evidence that Respondent Giarmoleo violated Section 10(b) of the Exchange Act, SEC Rule 10b-5 thereunder, and NASD Conduct Rules 2110, 2120, 2310, and 2315 when he recommended the purchase of Surface Tech to his customers.

[2] "Tr." refers to the transcript of the Hearing held on November 13-15, 2007; "CX" refers to the exhibits submitted by Enforcement; "RX" refers to the exhibits submitted by Respondent Giarmoleo; and "JX" refers to the exhibit submitted jointly by Enforcement and Respondent Giarmoleo.

II. FINDINGS OF FACT AND CONCLUSIONS OF LAW

A. Jurisdiction

Respondent Giarmoleo entered the securities industry in 1990. (CX-4, pp. 2, 12). On November 23, 2001, he was registered as a general securities representative and principal with SG Martin. (CX-4, p. 3). His registrations were terminated on January 3, 2005, and he is not currently associated with any FINRA member firm. (CX-4, pp. 2-3, 13).

Respondent Giarmoleo remains subject to FINRA jurisdiction for purposes of this proceeding, pursuant to Article V, Section 4 of the NASD By-Laws, because (1) the Complaint was filed within two years after his association with SG Martin was terminated, and (2) the Complaint charges him with misconduct while he was associated with a FINRA member.

B. Background

From March 26 to May 5, 2003, while associated with SG Martin, Respondent Giarmoleo solicited 14 customers to purchase Surface Tech, a speculative stock. (CX-98). Surface Tech, based in California, had patented a method to resurface alloy wheels without removing the wheels from the automobile. (CX-10, p. 1).

The prior December, Mr. Labrozzi, president and secretary of Tequesta Capital Corp. ("Tequesta Capital"), a stock promoter, had contacted Respondent Giarmoleo to discuss the possibility of SG Martin providing investment-banking services to Surface Tech. (Tr. pp. 142-143, 406-407). Respondent Giarmoleo understood that he would receive a bonus or referral fee if Surface Tech became SG Martin's investment banking client. (Tr. pp. 117-118, 409).

In early January 2003, the president of Surface Tech, Mr. Pittman, and the vice president, Tom Laurence, made a presentation to the SG Martin brokers over several days that (i) described the Company's business, (ii) explained the Company's potential for growth, and (iii) offered a before-and-after demonstration of the wheel refurbishing process. (CX-22, p. 3 at ¶ 15; Tr. pp. 154, 416). Surface Tech was quoted on the Pink Sheets under the stock symbol "SFCI" beginning on January 10, 2003.[3] (CX-112; Tr. p. 668).

Respondent Giarmoleo requested that Mr. Pittman provide him with audited financial statements for Surface Tech.[4] (Tr. pp. 156, 191; CX-22, p. 4 at ¶ 21). He testified that he anticipated that SG Martin would receive financial statements and other material business information from Surface Tech in order for SG Martin to meet the requirements of SEC Rule 15c2-11 and thereafter quote Surface Tech as a market maker on the OTC Bulletin Board.[5] (*Id.*). SG Martin never received financial statements or any

[3] The Pink Sheets are daily printed listings containing quotations for thousands of over-the-counter stocks that are not listed on any of the major stock markets. These quotations are entered by dealers acting as market makers in the individual securities. The pink sheets are printed by the National Quotation Bureau. *FINRA Glossary of Terms* available at *http://www.finra.org/Resources/Glossary/P011182*.

[4] Respondent Giarmoleo testified that he repeatedly asked for Surface Tech's financial statements, and that Mr. Pittman initially said a new audit was being done. (Tr. pp. 161, 180-181). Subsequently, Mr. Pittman said he did not have the $30,000 needed to pay for an audit, stating, "I have to keep the doors open." (Tr. p. 205).

[5] SEC Rule 15c2-11, promulgated under Section 15(c)(2) of the Exchange Act, makes it unlawful for a broker or dealer to publish any quotations for a security in any quotation medium, unless such broker or dealer: (1) has in its possession certain specified information; (2) believes that the specified information is accurate in all material respects; and (3) believes that the sources of the specified information are reliable.

written material business information from Surface Tech and never quoted Surface Tech on the OTC Bulletin Board.[6] (JX-1, pp. 220-221; Tr. p. 663).

After Surface Tech's January 2003 presentation, the SG Martin group, consisting of SG Martin, Mr. Pantelakis, and Respondent Giarmoleo, received a total of 407,000 shares of Surface Tech stock as follows: (i) 167,500 shares to Mr. Pantelakis; (ii) 167,500 shares to Respondent Giarmoleo; and (iii) 72,000 shares to SG Martin. (CX-14, p. 2; CX-17, pp. 5, 7). Surface Tech had countersigned a letter on SG Martin letterhead, dated March 14, 2003, but not countersigned by SG Martin, which provided that in exchange for 75,000 shares of Surface Tech stock, SG Martin would supply investment banking services to Surface Tech.[7] (CX-17). There was no evidence presented during the Hearing that SG Martin provided any investment banking services to Surface Tech or had executed any other agreement with Surface Tech.[8] (Tr. p. 167).

After receiving 167,500 shares of Surface Tech on March 25, 2003, Respondent Giarmoleo began selling shares of Surface Tech on March 26, 2003.[9] (CX-98). He recommended and sold a total of 35,190 shares to 14 customers at prices ranging from

[6] The OTC Bulletin Board is a quotation service that displays real-time quotes, last-sale prices, and volume information in domestic and certain foreign securities. *See NASD Notice to Members* 99-43 (June 1999). Although the OTC Bulletin Board was formerly operated by the NASDAQ, and is currently operated by FINRA, it is unlike other listed markets where individual companies apply for listing and must meet and maintain strict listing standards; individual brokerage firms, or market makers initiate quotations for specific securities on the OTC Bulletin Board. *(Id.).*

[7] There was no explanation provided at the Hearing for the discrepancy between the 75,000 shares of Surface Tech listed in the March 2003 letter and the 72,000 shares that SG Martin actually received. (Tr. pp. 22, 890).

[8] Respondent Giarmoleo stated that Surface Tech never provided the necessary information to SG Martin for SG Martin to provide investment banking services to Surface Tech. (JX-1, pp. 220-221).

[9] Surface Tech listed Respondent Giarmoleo as owner of 167,500 shares of Surface Tech, via his sole proprietorship, Global International Enterprises, on March 25, 2003. (CX-14, p. 2). However, the Surface Tech shares were not deposited into his Ameritrade account until May 28, 2003. (CX-18, p. 9; Tr. p. 257).

$0.75 to $1.00 per share for a total of $32,326.[10] (*Id.*). Of the 14 customers, one customer, RS, was a long-term client of Respondent Giarmoleo.[11] (Tr. p. 306). Ira Bader, SG Martin's operations manager, provided Respondent Giarmoleo with the names of the other 13 customers, representing to him that each was interested in speculative investments. (Tr. pp. 76, 265, 295-296; JX-1, p. 168). When soliciting these 13 customers, Respondent Giarmoleo only had information regarding the customers' names, locations, telephone numbers, and stock positions, if any. (Tr. pp. 288-289).

When recommending Surface Tech,[12] Respondent Giarmoleo gave each of the clients basically the same information, *i.e.*, (i) what the Company's president told him, (ii) what he reviewed on the Company's web site, and (iii) what he read in the Company's press releases.[13] (Tr. pp. 249-250; JX-1, p. 185). He believed that Surface Tech had the potential to be the next "Jiffy Lube" or "Meineke" and planned to acquire a Surface Tech franchise. (CX-22, pp. 3, 6 at ¶¶ 14, 29). However, his belief in the

[10] 1,700 of the 35,190 shares of Surface Tech were purchased via direct matches with Tequesta Capital. (CX-93). Surface Tech had provided Tequesta Capital with 410,000 shares on January 31, 2003, which Tequesta Capital deposited into its account at SG Martin on February 28, 2003. (CX-9, pp. 19-20; CX-16, p. 8; Tr. p. 143). The remaining 33,490 shares of Surface Tech sold to customers were sold from SG Martin's proprietary account, which included 72,000 shares received from Surface Tech, 24,690 shares purchased from Tequesta Capital, and 5,500 shares purchased from the street. (CX-93).

[11] Customer RS purchased 10,000 shares of Surface Tech at $0.82 per share for $8,235, which was approximately 28% of the 35,190 shares purchased and 25% of the funds expended. (CX-98).

[12] A transaction is considered to be recommended when the member or its associated person brings a specific security to the attention of the customer through any means, including, but not limited to, direct telephone communication. *See NASD Notice to Members* 96-60 (Sept. 1996).

[13] On April 15, 2003, Tequesta Capital issued a press release on behalf of Surface Tech claiming that the Company had licensed its technology and the "new total billed under licensing agreements should surpass $7 million in 2003." (CX-10, p. 1). In a March 11, 2003 email, Tequesta Capital reported that Surface Tech's "licensed field technicians billed over $1,000,000 in 2001 and over $2,000,000 in 2002." (CX-9, pp. 12-13; Tr. pp. 678, 680). The Company anticipated adding 100 technicians in 2003 and that "the total billing is anticipated to surpass $10,000,000." (CX-9, p. 13). Respondent Giarmoleo spoke with an independent licensed field technician based in Atlanta, GA, who said he was doing financially well using the Surface Tech process. (Tr. pp. 134, 198; JX-1, p. 187).

Company's potential was based primarily on information that he received from the Company's president.[14] (CX-22, pp. 3-4 at ¶ 16).

When recommending Surface Tech, Respondent Giarmoleo was aware that there were no publicly available financial statements for the Company, and that he and SG Martin had not obtained any statements either from the Company or any other source. (Tr. pp. 129, 199). Surface Tech never followed through on providing the necessary information to create a private placement memorandum. (JX-1, p. 222). Respondent Giarmoleo failed to discover, until years later, that Surface Tech had a balance sheet and earnings statement as of September 30, 2002, which had been prepared in connection with its reverse merger in December 2002.[15] (CX-6, p. 10; CX-7; Tr. pp. 241-242). The financial statements indicated that, as of September 30, 2002, the Company had assets of $15,178, and negative net operating income of $80,512. (CX-7; Tr. pp. 669-670).

Although Respondent Giarmoleo's only financial information on the Company was that it was "burning $4,000 a month," he admitted that he advised his customers that if the Company was "managed right" it could be worth "two dollars down the road." (Tr. pp. 167, 250-251; JX-1, p. 154).

In addition, with the exception of customer RS who had been his client for eight or nine years, Respondent Giarmoleo had no information concerning the net worth,

[14] Respondent Giarmoleo affirmed that his father, an automotive expert who was involved in the auto body business for 45 years, favorably evaluated Surface Tech's patented process. (Tr. pp. 201-202; CX-22, p. 3 at ¶¶ 13, 14). He and his father were so impressed with the process that they were attempting to purchase a Surface Tech franchise for Long Island in New York (Tr. p. 168; CX-22, p. 3 at ¶ 14).

[15] Surface Technologies Group, Inc., a private Nevada corporation, completed a reverse merger with Shirazi Corporation, a public company, in December 2002 and changed the name of the combined entity to Surface Tech, Inc. (CX-6, pp. 6-23). Shirazi's common stock was listed and traded on the Pink Sheets under the stock symbol "SHRZ." (CX-6, p. 20). The reverse merger was accomplished through the auspices of Tequesta Capital, which paid the legal fees associated with the reverse merger. (CX-22, p. 2 at ¶ 7).

income, age, or employment status of any of the customers that he solicited. (Tr. pp. 296, 306). Respondent Giarmoleo did not review the customers' new account applications prior to contacting them; nor did he ask them about their financial condition. (Tr. p. 296).

After May 2003, the price of Surface Tech declined rapidly.[16] Enforcement presented evidence that, as of June 25, 2004, Surface Tech stock was selling for only a few cents per share, and the customers had suffered unrealized and realized losses in excess of $20,000. (CX-98). The four customers who testified at the Hearing, NY, MH, JW and FP, had not sold their Surface Tech stock. (CX-98; Tr. pp. 556, 612). Any customer who held Surface Tech now holds the stock under the name BrandQuest Development Group.[17] (Tr. p. 778; CX-110).

C. Respondent Giarmoleo Violated the Fraud, Suitability, and Recommendation Rules

The Complaint alleges that, in selling Surface Tech to his customers, Respondent Giarmoleo: (i) made fraudulent misrepresentations and omissions, in violation of Section 10(b) of the Exchange Act, SEC Rule 10b-5 thereunder, and NASD Conduct Rule 2120; (ii) recommended that the customers buy Surface Tech without having a reasonable basis for believing the stock was suitable for them, as required by NASD Conduct Rule 2310; and (iii) failed to base his recommendation on a review of the Company's current financial statements, as required by NASD Conduct Rule 2315.

[16] Respondent Giarmoleo testified that "the Company blew themselves up" by putting millions and millions of shares of the stock on the street via an investor group based in Utah, which quickly sold Surface Tech stock after purchasing it in a private offering for a promissory note rather than cash. (Tr. pp. 168, 184, 189). Between July 17, 2003 and April 16, 2004, Respondent Giarmoleo sold 60,000 shares of his Surface Tech stock for about $20,000, leaving 71,500 shares remaining. (Tr. p. 416; CX-18, pp. 15-36).

[17] On October 30, 2006, Surface Tech's symbol changed to "BQDG" for BrandQuest Development Group. (Tr. pp. 665, 778; CX-110).

1. Section 10(b) of the Exchange Act, SEC Rule 10b-5 thereunder, and NASD Conduct Rule 2120: Material Omissions and Misrepresentations

Section 10(b) of the Exchange Act,[18] SEC Rule 10b-5 thereunder, and NASD Conduct Rule 2120[19] are anti-fraud provisions that prohibit any fraudulent scheme or device, or the making of material misrepresentations and omissions, in connection with the offering, purchasing, or selling of securities.[20]

In general, to find a violation of these anti-fraud provisions there must be a showing that (1) misrepresentations and/or omissions were made in connection with the purchase or sale of securities,[21] (2) the misrepresentations and/or omissions were material, and (3) the misrepresentations and/or omissions were made with the requisite intent, *i.e.*, scienter. On the other hand, evidence of scienter is not required to establish that a misrepresentation and/or omission violated NASD Conduct Rule 2110.[22]

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[18] Section 10(b) of the Exchange Act provides:
"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange:

> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest for the protection of investors."

[19] Conduct Rule 2120 parallels SEC Rule 10b–5 and provides that no member shall effect any transaction in, or induce the purchase or sale of, any security by means of any manipulative, deceptive, or fraudulent device. *Prime Investors, Inc.*, Exch. Act Rel. No. 38,487, 1997 SEC LEXIS 761, at *24 (Apr. 8, 1997) (making material misstatements of fact in connection with a sale of a security is a violation of Conduct Rule 2120).

[20] Unlike a private litigant, FINRA need not show reliance upon the alleged misrepresentation, omission or fraudulent device, or damages resulting from such reliance. *See DBCC v. Coastline Financial, Inc.*, Complaint No. C02950059, 1997 NASD Discip. LEXIS 9 (NBCC Mar. 5, 1997).

[21] For the federal securities laws, the transactions must also involve interstate commerce or the mails, or a national securities exchange. Respondent Giarmoleo used a means and instrumentality of interstate commerce when he communicated with his customers via telephone. *See SEC v. Hasho*, 784 F. Supp. 1059, 1106 (S.D.N.Y. 1992), 1992 U.S. Dist. LEXIS 1322, at **148-149 (1992).

[22] *Michael Alan Leeds*, Exch. Act Rel. No. 32,437, 1993 SEC LEXIS 1423 (June 9, 1993).

The "in connection with" requirement of Section 10(b) of the Exchange Act has been construed broadly to include any statement that is reasonably calculated to influence the average investor to purchase or sell a security.[23] There is no dispute that Respondent Giarmoleo's alleged omissions and misrepresentation were made in connection with his selling of the Surface Tech stock.

The Supreme Court has defined scienter as a "mental state embracing intent to deceive, manipulate or defraud."[24] Reckless or willful disregard of the truth satisfies the scienter requirement.[25] Recklessness has been defined as highly unreasonable conduct involving not merely simple or excusable negligence, but an extreme departure from the standards of ordinary care, that presents a danger of misleading buyers or sellers, which is either known to respondent or is so obvious that respondent must have been aware of it.[26]

Enforcement alleges that Respondent Giarmoleo violated the antifraud provisions by intentionally or recklessly: (1) omitting to disclose material facts concerning (i) Surface Tech's financial condition, (ii) the risks in investing in the Company, *e.g.*, its need to obtain financing to successfully grow, (iii) his possible self-interest in recommending the Company, and (iv) the relationship between the stock promoter and SG Martin; and (2) predicting a substantial short-term increase in the value of the Company's stock.

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[23] *Hasho* at 1110 ("any statement that is reasonably calculated to influence the average investor satisfies the 'in connection with' requirement of Rule 10b-5").

[24] *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976).

[25] *IIT v. Cornfeld*, 916 F.2d 909, 923 (2d Cir. 1980).

[26] *Tuchman v. DSC Communications Corp.*, 14 F.3d 1061, 1067 (5th Cir. 1994), 1994 U.S. App. LEXIS 3326 at **14 (1994).

(i) Material Omissions

Facts are material if there is a substantial likelihood that a reasonable investor would consider them important in making an investment decision and would view disclosure of them as significantly altering the total mix of information made available.[27]

The four customers who testified stated that Respondent Giarmoleo did not tell them anything about Surface Tech's financial condition or any risk factors concerning the investment, *e.g.*, the Company's current losses and the Company's need for financing to grow.[28] (Tr. pp. 435, 520, 546, 581-582).

Respondent Giarmoleo testified that he told the customers that Surface Tech was a speculative stock and that the customers did not buy such securities based on current financial condition, but on the Company's potential for growth. (Tr. pp. 393-394). Accordingly, he argued that his failure to disclose the Company's financial condition and the risk factors was not a violation because the Company's particular financial condition and inherent risks were not material to the customers' decision to purchase.[29]

Information concerning the financial condition of a company is presumptively material.[30] Risk factors are material information, and failure to provide them is a material omission.[31] Even accepting Respondent Giarmoleo's argument that the

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[27] *Basic Inc. v. Levinson*, 485 U.S. 224, at 231-232 (1988); *TSC Indus., Inc. v. Northway, Inc*., 426 U.S. 438, 449 (1976).

[28] Respondent Giarmoleo admitted that he never reviewed financial statements for Surface Tech. (Tr. pp. 129, 186, 199).

[29] Respondent Giarmoleo knew Surface Tech was a "startup" and that it was "burning money." (Tr. p. 181).

[30] *SEC v. Murphy*, 626 F.2d 633, 653 (9th Cir. 1980); *SEC v. Blavin*, 557 F. Supp. 1304, 1313 (E.D. Mich. 1983), *aff'd*, 760 F.2d 706 (6th Cir. 1985) (materiality of information relating to financial condition, solvency and profitability not subject to serious challenge).

[31] *Hasho*, *supra*.

customers were principally interested in the Company's growth potential, he failed to provide information necessary for the customers to fairly evaluate the Company's growth potential, *i.e.*, its current losses and its need to obtain financing to realize its potential.

The Hearing Panel finds that Respondent Giarmoleo's failure to disclose this financial information presented a danger of misleading the customers that was obvious and that he must have been aware of it. Therefore, his failure to disclose the Company's financial condition to the customers, as well as his lack of financial information about the Company, was at least reckless. (Tr. p. 174).

As to Respondent Giarmoleo's alleged self-interest in recommending Surface Tech, it is well established that undisclosed payments to brokers are material facts that should be disclosed to investors, because a reasonable investor could find that there was an actual or potential conflict of interest.[32] There is no dispute that at the time he made the sales, he owned 167,500 shares of Surface Tech stock.

Respondent Giarmoleo testified that he received Surface Tech stock as a bonus or finder's fee from SG Martin, and that SG Martin obtained the Surface Tech stock as a fee for investment bank services. However, the evidence showed that he received his stock directly from Surface Tech, and there was no corroboration that his stock related to SG Martin's provision of investment banking services, or, indeed, that SG Martin ever provided any services to Surface Tech other than recommending the stock to its customers.[33] By failing to disclose the fact that Surface Tech had given him a large

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[32] *Timothy J. Brannon*, Exch. Act Rel. No. 39,949, 1998 SEC LEXIS 840 at *7 (May 4, 1998) (failing to disclose such payments violates the antifraud provisions of the federal securities laws).

[33] The unsigned March 14, 2003 investment banking letter stated that Surface Tech would pay SG Martin 75,000 shares of Surface Tech; there was no mention of the 167,500 shares provided to Respondent Giarmoleo or the 167,500 shares provided to Mr. Pantelakis. (CX-17).

number of shares, Respondent Giarmoleo violated the principle that a broker must disclose any economic self-interest that could influence his recommendation.[34]

Respondent Giarmoleo argued that he disclosed his interest in Surface Tech by telling the customers that he had a position in the stock. (Tr. pp. 270, 412). But, he did not tell them that Surface Tech had given him the stock, at no charge. Respondent Giarmoleo must have known that omitting this information presented the obvious danger that his customers would mistakenly believe that he had purchased the stock based on his evaluation of the stock, rather than having been given the stock by the Company. The Hearing Panel, therefore, finds that his failure to disclose his receipt of 167,500 shares of Surface Tech prior to soliciting his customers was a reckless material omission.

The Hearing Panel finds that Respondent Giarmoleo recklessly omitted material information when he failed to disclose to his customers information about (i) the financial condition of the Company, (ii) the risk factors concerning the Company, and (iii) the undisclosed payments from the Company, in violation of Section 10(b)(5) of the Exchange Act, SEC Rule 10b-5 thereunder, and NASD Conduct Rules 2120 and 2110.

(ii) Price Prediction a Material Misrepresentation

With respect to a speculative security, price predictions are considered per se fraudulent because, in a free market, it is impossible to predict with any measure of confidence the timing and amount by which a speculative security will increase in price.[35] The fraud, moreover, is not remedied where the positive predictions about the future

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[34] *Chains v. Smith Barney & Co., Inc*., 438 F.2d 1167, 1172 (2d Cir. 1970) ("The investor . . . must be permitted to evaluate overlapping motivations through appropriate disclosures, especially where one motivation is economic self-interest").

[35] *Dane S. Faber*, Exchange Act Rel. No. 49,216, 2004 SEC LEXIS 277 at *16 (Feb. 10, 2004); *Charles P. Lawrence*, 43 S.E.C. 607, 610 (1967) ("We have repeatedly held that a specific prediction of the future value of a speculative or unseasoned security is inherently fraudulent"), *aff'd*, 398 F.2d 276 (1st Cir. 1968).

performance of securities are cast as conditional opinion or possibilities rather than as guarantees.[36]

Each of the four customers testified that Respondent Giarmoleo provided a price prediction when he solicited the customer's purchase of Surface Tech. He admitted that he told the customers the stock could increase to $2 per share. (Tr. pp. 250-251). In fact, customer JW kept contemporaneous notes of a conversation in which Respondent Giarmoleo predicted a price increase to $3-$4 per share. (CX-28, p. 23). Respondent Giarmoleo argued that he had a reasonable basis for this price prediction based on his conversations with the officers of Surface Tech, his review of the technology, and his discussions with the technicians who utilized the refurbishing process.[37] There is no dispute that Surface Tech was a speculative security, and, therefore, no prediction of a substantial price increase could be viewed as having a reasonable basis.[38]

The Hearing Panel finds Respondent Giarmoleo's affirmative predictions of a substantial increase in the price of Surface Tech stock were reckless material misrepresentations, in violation of Section 10(b)(5) of the Exchange Act, SEC Rule 10b-5 thereunder, and NASD Conduct Rules 2120 and 2110.[39]

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[36] *Id*.

[37] Prior to recommending the stock, Respondent Giarmoleo did not discover, or discuss, with Mr. Pittman that certain of the Company's independent contractors were not paying their required licensing fees to the Company. (Tr. pp. 168-169).

[38] *See Clinton Hugh Holland, Jr.*, Exchange Act Release No. 36,621, 1995 SEC LEXIS 3452 (Dec. 21, 1995) (holding that securities of companies "with a limited history of operations and no profitability" are speculative), *aff'd*, 105 F.3d 665 (9th Cir. 1997).

[39] *See Hasho*, 784 F. Supp. at 1109; *Lawrence*, 43 S.E.C. at 610.

2. NASD Conduct Rule 2310: Suitability

NASD Conduct Rule 2310(a) provides that, in recommending to a customer the purchase of a security, a representative must have "reasonable grounds for believing that the recommendation is suitable for such customer based on the customer's other security holdings and financial situation and needs."[40] "The test for whether [the broker's] recommended investments were suitable is not whether [the customer] acquiesced in them, but whether [the broker's] recommendations … were consistent with [the customer's] financial situation and needs."[41]

To ensure that the representative can make this determination, Rule 2310(b) requires that the representative make reasonable efforts to obtain information concerning, among other things, the customer's financial status, tax status, and investment objectives.[42] As explained above, Respondent Giarmoleo neither reviewed available information from the customers' account applications nor sought suitability information from the customers when he recommended and sold them Surface Tech. (Tr. p. 296).

Respondent Giarmoleo argued that he complied with Rule 2310 because he knew the customers were interested in speculative securities and the amounts were so insignificant that it was obvious that the purchases would not negatively impact the

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[40] *District Bus. Conduct Comm. v. McNabb*, Complaint No. C01970021, 1999 WL 515761, at *13 (NAC Mar. 31, 1999).

[41] *Wendell D. Belden*, Exch. Act Rel. No. 47859, 2003 SEC LEXIS 1154 (May 14, 2003).

[42] *Hanley v. SEC*, 415 F.2d 589, 597 (2d Cir. 1969) (a broker-dealer cannot recommend a security unless there is an adequate and reasonable basis for such recommendation).

customers' financial condition. For example, customer NY purchased 7,500 shares of Surface Tech for $7,070.[43] (CX-26, p. 1; CX-98).

While the amounts that the customers invested were small, without some inquiry into each customer's financial situation, Respondent Giarmoleo could not simply assume that the investments were not significant to the customer's financial situation and needs.

In addition, Enforcement argued that Respondent Giarmoleo had no basis to make a recommendation to any customer to purchase Surface Tech, because he did not have sufficient information about the Company. Respondent Giarmoleo argued that he undertook a thorough due diligence investigation of the Company.[44] While Respondent Giarmoleo inquired about the financial condition of Surface Tech, he received no financial statements from Surface Tech and had no understanding of the Company's current financial condition when he began soliciting his customers to purchase the stock. Rather, he primarily relied on, and accepted at face value, the information provided by Company insiders.

Accordingly, the Hearing Panel finds that Respondent Giarmoleo lacked reasonable grounds for believing that his recommendations to purchase Surface Tech stock were suitable for the customers. Therefore, the recommendations violated NASD Conduct Rule 2310. A violation of NASD Conduct Rule 2310 is also a violation of NASD Conduct Rule 2110.

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[43] Customer FP purchased 500 shares for $580. (CX-29, p. 1; CX-98; Tr. p. 517). Customer MH purchased 1,500 shares for $1,585. (CX-27, p. 1; CX-98; Tr. p. 543). Customer JW purchased 1,800 shares for $1,795. (CX-28, p. 1; CX-98; Tr. p. 576).

[44] Due diligence is generally defined as a thorough investigation of a company that is preparing to go public, undertaken by the company's underwriter and accounting firm. *See FINRA Glossary of Terms* available at *http://www.finra.org/Resources/Glossary/P011001.*

3. NASD Conduct Rule 2315: The OTC Equity Securities Recommendation Rule

NASD Conduct Rule 2315, the OTC equity securities recommendation rule, which became effective on October 22, 2002, provides, in part, that no person associated with a member shall recommend that a customer purchase any equity security that is published or quoted in a quotation medium, but not listed on NASDAQ or on a national securities exchange, (an "OTC equity security"), unless the member has reviewed the current financial statements of the issuer and the current material business information about the issuer, and made a determination that such information, and any other information available, provides a reasonable basis under the circumstances for making the recommendation. Surface Tech was an OTC equity security.

Rule 2315 defines current financial statements for issuers to include:

(i) a balance sheet as of a date less than 15 months before the date of the recommendation;

(ii) a statement of profit and loss for the 12 months preceding the date of the balance sheet;

(iii) an additional statement of profit and loss for the period from the date of the balance sheet to a date less than six months before the date of the recommendation, if the date of the balance sheet is more than six months before the date of the recommendation;

(iv) publicly available financial statements filed in the 12 months preceding the date of the recommendation; and

(v) all publicity available financial statements filed with the SEC during the 12 months preceding the date of the recommendation contained in registration statements or Regulation A filings.

Subsection (c) of NASD Conduct Rule 2315 states that the member firm shall designate a registered person to conduct the review required by the recommendation rule and then document the information reviewed.

Accordingly, NASD Conduct Rule 2315 prohibited Respondent Giarmoleo from recommending Surface Tech unless SG Martin had completed and documented the review required by the rule. Respondent Giarmoleo admitted that he did not review any financial statements for Surface Tech, and that SG Martin had no such financial statements. Therefore, he must have known that SG Martin had not conducted and documented the required review prior to his recommendations, because without financial statements it could not have done so.

Respondent Giarmoleo argued that because Pink Sheet companies, such as Surface Tech, are not required to file their financial statements with the SEC, there were no publicly available financial statements to be reviewed. Based on this, he argued that the OTC equity security recommendation rule was not applicable to the recommendations of Surface Tech. In the alternative, he argued that the rule was unclear.

The Hearing Panel rejects Respondent Giarmoleo's arguments. His contention that the rule did not apply because there were not publicly available financial statements is inconsistent with the plain language of NASD Conduct Rule 2315, which requires review of a balance sheet as of a date less than 15 months before the date of the recommendation. There is no requirement that this balance sheet be publicly available; on the contrary, the phrase "publicly available" only applies to the categories of information set forth in subsections (iv) and (v) of Rule 2315(b)(1)(A), *e.g.*, financial statements filed with the SEC.

Accordingly, the Hearing Panel finds that Respondent Giarmoleo violated NASD Conduct Rule 2315 by recommending the purchase of Surface Tech stock without having verified that SG Martin conducted the review required by the rule.

III. SANCTIONS

Enforcement recommended that Respondent Giarmoleo be barred for his fraudulent misrepresentations and omissions, arguing that his conduct was egregious because: (i) his conduct was reckless or intentional; (ii) the conduct resulted in substantial financial benefit to him; and (iii) he failed to acknowledge his wrong-doing.

Enforcement also recommended that the Hearing Panel make Respondent Giarmoleo jointly and severally liable for $9,352 in restitution, which SG Martin and Mr. Pantelakis agreed to pay to customers NY, MH, JW, and FP in their settlement agreement with FINRA.

The FINRA Sanction Guidelines ("Guidelines") for intentional or reckless misrepresentations or material omissions of fact recommend fines ranging from $10,000 to $100,000, suspensions of 10 business days to two years, and, in egregious cases, a bar.[45]

There is no explicit sanction guideline for violating the OTC equity securities recommendation rule. However, the rule was intended to supplement existing requirements under the federal securities laws and FINRA's suitability rules that brokers have a reasonable basis for their recommendations.[46] Accordingly, when determining the appropriate sanctions for Respondent Giarmoleo's violations of both the suitability rule and the OTC equity securities recommendation rule, the Hearing Panel considered the Guidelines for unsuitable recommendations, which suggest a fine of $2,500 to $75,000, and suspensions of 10 business days to two years, or, in egregious cases, a bar.[47]

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[45] *FINRA Sanction Guidelines*, p. 93 (2007), available at *http://www.finra.org/web/groups/enforcement/documents/enforcement/p011038.pdf.*

[46] *See SEC Order Approving Proposed Rule Change*, 2002 SEC LEXIS 2156, at *3-4 & n.8 (Aug. 19, 2002).

[47] *Guidelines* at 99.

Neither of the applicable Guidelines includes specific principal considerations for those violations; rather, they direct attention to the general principal considerations for determining sanctions.[48]

The relevant general principal considerations in this case include the following:

(1) whether the respondent engaged in the misconduct over an extended period of time;

(2) whether the respondent attempted to conceal his or her misconduct or to lull into inactivity, mislead, deceive or intimidate a customer, regulatory authorities or, in the case of an individual respondent, the member firm with which he or she is/was associated;

(3) with respect to other parties, including the investing public, the member firm with which an individual respondent is associated, and/or other market participants, (a) whether the respondent's misconduct resulted directly or indirectly in injury to such other parties, and (b) the nature and extent of the injury;

(4) whether the respondent provided substantial assistance to FINRA in its examination and/or investigation of the underlying misconduct, or whether the respondent attempted to delay FINRA's investigation, to conceal information from FINRA, or to provide inaccurate or misleading testimony or documentary information to FINRA;

(5) whether the respondent's misconduct was the result of an intentional act, recklessness or negligence;

(6) whether the respondent's misconduct resulted in the potential for respondent's monetary or other gain.

(7) the number, size and character of the transactions at issue; and

(8) the level of sophistication of the injured or affected customer.[49]

Respondent Giarmoleo's conduct constituted a serious breach of his obligation as a registered representative. The Hearing Panel agrees that Respondent Giarmoleo's

[48] *Id*. at 6-7.

[49] *Id.*

omissions and misrepresentation were reckless and that, until the Hearing, he did not appreciate the seriousness of his actions.

On the other hand, the Hearing Panel found that several of the aggravating factors enumerated in the general principal considerations for determining sanctions were not present in this case. For example, the misconduct did not occur over an extended period of time; it occurred over a period of less than 45 days. There was no evidence that Respondent Giarmoleo attempted to conceal his conduct from his Firm or FINRA, or that he attempted to "lull into inactivity" or intimidate any customer, FINRA, or SG Martin.

With respect to the investing public, the extent of the injury to the customers cannot be determined because, as of the Hearing, the majority of the customers had not sold their shares of Surface Tech stock. Nevertheless, the number and size of the transactions were not substantial; there were 14 customers who invested $32,326 in 35,190 shares of Surface Tech stock. Respondent Giarmoleo testified that he did not solicit new money from his customers to purchase Surface Tech. (Tr. p. 297). Even assuming the customers' investment declined to zero, the potential injury to the customers is not great because Respondent Giarmoleo sold each customer a modest number of shares.[50]

There was no evidence presented that any of the customers lacked the sophistication needed to understand that Surface Tech stock was a speculative investment, which could result in a loss of their entire investment. The four customers who testified understood that Surface Tech was a speculative security.

[50] The four customers' purchases ranged from $580 to $7,070, while their net worth ranged from $400,000 to $1,000,000. (CX-26, p. 1; CX-27, p. 1; CX-28, p. 1; CX-29, p. 1; CX-98; Tr. pp. 517, 443, 576).

There was no evidence presented that Respondent Giarmoleo attempted to delay FINRA's investigation, or to conceal information from FINRA. In fact, he acknowledged that he (i) did not review Surface Tech's financial statements, (ii) did not seek financial information from the inherited customers, and (iii) made price predictions regarding Surface Tech.

The Hearing Panel finds that Respondent Giarmoleo was not intentionally attempting to harm his customers; he believed in the growth potential of Surface Tech, although he was clearly reckless in conveying that view under the circumstances.

While the lack of the above aggravating factors does not mitigate the seriousness of Respondent Giarmoleo's misconduct, *i.e.*, providing price predictions and failing to disclose material information, the Hearing Panel finds that, under these circumstances, barring Respondent Giarmoleo from the securities industry is not appropriate because doing so would be punitive rather than adhering to FINRA's overall directive that sanctions should remediate misconduct. Accordingly, the Hearing Panel concludes that a significant suspension, together with a fine requiring that he disgorge his undisclosed compensation, will accomplish FINRA's remedial goals.

The Hearing Panel finds that Respondent Giarmoleo should be suspended for one year in all capacities from any FINRA member, and fined $27,500 (a $7,500 fine plus $20,000 to deprive him of the $20,000 in additional compensation that he earned when he sold 60,000 shares of his Surface Tech stock)[51] for violating Section 10(b)(5) of the Exchange Act, SEC Rule 10b-5 thereunder, and NASD Conduct Rules 2120, 2310, 2315, and 2110. Because Enforcement failed to show that the four customers for whom it

[51] Subsequent to April 16, 2004, Respondent Giarmoleo sold his remaining 71,500 shares of Surface Tech, but there was no evidence presented that calculated what he earned when he sold those shares.

requested restitution had sold their shares of Surface Tech and experienced a quantifiable loss, the Hearing Panel does not impose restitution on Respondent Giarmoleo.[52]

IV. CONCLUSION

Respondent Giarmoleo is suspended for one year from associating with any FINRA member in any capacity, and fined $27,500 for violating Section 10(b) of the Exchange Act, SEC Rule 10b-5 thereunder, and NASD Conduct Rules 2120, 2315, 2310, and 2110, as alleged in count one of the Complaint.

The Hearing Panel also orders Respondent Giarmoleo to pay $7,536.64, which amount equals the total costs of the Hearing consisting of a $750 administrative fee and $6,786.64 in transcript fees. The costs and fines shall be due and payable when, and if, Respondent Giarmoleo seeks to return to the securities industry.

The sanctions shall become effective on a date determined by FINRA, but not sooner than thirty days from the date this Decision become the final disciplinary action of FINRA, except that, if this Decision becomes the final disciplinary action of FINRA, Respondent Giarmoleo's suspension in all capacities shall commence at the opening of business on July 7, 2008 and conclude at the close of business on July 6, 2009.[53]

HEARING PANEL.

By:_____
Sharon Witherspoon
Hearing Officer

Dated: Washington, DC
April 30, 2008

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[52] *Guidelines* at 4.

[53] 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.

Copies to:

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