FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. HEDGE FUND CAPITAL PARTNERS LLC (CRD No. 113326), and HOWARD G. JAHRE (CRD No. 2238671), Respondents.	Disciplinary Proceeding No. 2006004122402 Hearing Officer – RSH **EXTENDED HEARING PANEL DECISION** January 26, 2011

Respondents violated Rules 8210 and 2110 by providing false and misleading information to FINRA in connection with an investigation of the Respondent Firm; Rule 2110 and IM-1000-1 by willfully filing misleading Forms U4; and Article III, Section 3(b) of FINRA Bylaws and Rule 2110 by employing a statutorily disqualified person. In addition, the Respondents committed numerous other violations as follows: (1) both Respondents violated Rule 2110 by allowing a hedge fund to improperly pay rent with soft dollars; (2) both Respondents violated Rules 2211(d)(1) and 2110 by distributing misleading and exaggerated sales materials; (3) Respondent Firm violated Rules 2211(d)(1) and 2110 by distributing unbalanced sales materials; (4) Respondent Firm violated Rules 2211(b)(2)(A) and 2110 by failing to retain institutional sales materials; (5) both Respondents violated Rules 1031 and 2110 by allowing unregistered employees to act in registered capacities; (6) both Respondents violated Rules 1031 and 2110 by allowing a registered person to park her license at the Respondent Firm; (7) Respondent Firm violated Exchange Act Section 17(a)(1) and Rule 17a-4 thereunder, and Rules 3110 and 2110 by failing to retain e-mail and instant messages; and (8) both Respondents violated Rules 3010(a), 3010(b), and 2110 by failing to supervise e-mail and instant message retention, annual compliance meetings, and the registration of associated persons. For these violations, Respondent HedgeCap was expelled and Respondent Jahre was barred from associating with any FINRA member firm in any capacity. The Respondents were also ordered to pay costs.

Appearances

For Enforcement: Gregory R. Firehock, Senior Litigation Counsel; Leo J. Kane, Senior Counsel; and Jeffrey Pariser, Senior Litigation Counsel, for the FINRA DEPARTMENT OF ENFORCEMENT, Washington, D.C.

For Respondents: Jason A. Lief and David E. Danovitch, GERSTEN SAVAGE LLP, New York, NY

DECISION

I. INTRODUCTION

The Department of Enforcement ("Enforcement") brought this disciplinary proceeding against Respondents Hedge Fund Capital Partners, LLC ("HedgeCap" or the "Firm") and Howard G. Jahre ("Jahre"), its president and majority owner (collectively "Respondents"). HedgeCap operated a "hedge fund hotel" by providing office space and other services, soliciting potential investors, and executing trades for hedge funds. Enforcement alleges that from May 2005 to September 2006, the Respondents violated numerous NASD Rules[1] and certain provisions of the Securities Exchange Act of 1934 ("Exchange Act") in connection with HedgeCap's hedge fund hotel business. Enforcement also alleges that the Respondents gave false responses to multiple requests for information, thereby impeding FINRA's investigation of the Respondents' conduct. Enforcement recommends that HedgeCap be expelled from FINRA, and that Jahre be barred. The Respondents, while admitting that they violated some FINRA rules, contend that the violations were inadvertent, and the result of "sloppiness" and "misplaced

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[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. Initially, FINRA adopted NASD's rules and certain NYSE rules, but it is in the process of establishing a consolidated FINRA rulebook. To that end, on December 15, 2008, certain consolidated FINRA rules became effective, replacing parallel NASD rules, and in some cases the prior rules were re-numbered and/or revised. *See* Regulatory Notice No. 08-57, FINRA Notices to Members, 2008 FINRA LEXIS 50 (Oct. 2008). This Decision refers to and relies on the NASD rules that were in effect at the time of the Respondents' alleged misconduct and cited in the Complaint as the basis for the charges against them.

trust," rather than intentional wrongdoing. They argue that an expulsion and bar are therefore out of proportion to the violations that occurred.

II. PROCEDURAL HISTORY

Enforcement filed an eleven-cause Complaint with the Office of Hearing Officers on March 27, 2009. The Respondents filed their Answer to the Complaint on May 12, 2009. The hearing was held on May 4, 2010, through May 14, 2010, in New York, NY, before an Extended Hearing Panel composed of the Hearing Officer, a former member of FINRA's District 10 Committee, and a former member of FINRA's District 3 Committee. Enforcement called six witnesses: Jahre; Frank Napolitani ("Napolitani") (formerly a managing director and part owner of HedgeCap); Perry C. Hubbard ("Hubbard") (a FINRA senior investigator); Kimberly Flanders ("Flanders") (investigator in FINRA's advertising regulation department); G. William Johnston ("Johnston") (an Enforcement investigator); and Steven Solano ("Solano") (HedgeCap's former chief compliance officer). The Respondents called two witnesses: Jahre and JP (an information technology ("IT") consultant who worked on HedgeCap's IT system). The Hearing Panel accepted into evidence 224 exhibits submitted by Enforcement, 68 exhibits submitted by the Respondents, and one jointly-submitted exhibit containing the parties' stipulations.[2] Both parties submitted post-hearing briefs, as well as post-hearing stipulations regarding admitted exhibits. Final submissions were filed on July 30, 2010.

Based upon a review of the entire record, the Extended Hearing Panel makes the following findings of fact and conclusions of law.

[2] In this decision, "Tr." refers to the transcript of the hearing; "CX" to Enforcement's exhibits; "RX" to Respondents' exhibits; and "Stips" to the parties' stipulations.

III. BACKGROUND

A. Investigation of HedgeCap's Business Activities

FINRA began the investigation that led to the filing of the Complaint in January 2006, when it requested information from HedgeCap as part of its "mini-sweep" of hedge fund hotels.[3]

B. Respondents

1. Howard Jahre

Howard G. Jahre, 62, is the owner, President, Chief Executive Officer ("CEO"), and Chief Compliance Officer ("CCO") of HedgeCap. Jahre is an attorney and holds a license to practice law in New York; however, he has never practiced. After graduating from law school in 1973, Jahre went into his family's business, which imported and distributed musical instruments. He sold the family business sometime around 1986, and first became registered with FINRA in 1995. He currently holds Series 7, Series 24, and Series 63 licenses. Jahre became associated with HedgeCap in July 2003. In February 2004, Jahre became HedgeCap's President and Managing Member, and in April 2005 acquired a majority ownership interest in the firm.[4] He has been the only supervisor at HedgeCap since its inception.[5]

2. HedgeCap

HedgeCap has been registered with FINRA since 2001. Between May 2005 and September 2006 (the "Review Period"), HedgeCap focused mainly on providing three types of services to hedge funds. First, the firm solicited hedge fund managers to rent a portion of the firm's office space at 546 Fifth Avenue in Manhattan. Second, it introduced its tenants and other hedge fund managers to potential investors. Third, HedgeCap operated an agency trading desk

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[3] Tr. 561-563.
[4] Stips ¶ 3; Tr. 735-737, 1784-1785, 1810-1811; CX-215 at 2.
[5] Tr. 740-742, 752-753, 1484; Stips ¶ 71.

through which hedge funds and other clients could trade, thereby generating trading commissions for the firm.[6]

In May 2005, HedgeCap employed approximately 11–12 people, of whom approximately four worked in the main office. Napolitani, who was a co-owner of HedgeCap, worked closely with Jahre, and handled many administrative tasks. But he was never registered as a principal, and had no supervisory authority at HedgeCap. Several other individuals were registered through HedgeCap, and worked to raise capital for HedgeCap's hedge fund tenants; however, they were employed by outside marketers, including Cyprian Consulting, LLC ("Cyprian") and Broadreach Group Capital Partners ("Broadreach"). These third-party marketers were compensated with a portion of the fees generated by the assets they raised for the hedge funds.[7] Currently, HedgeCap has one employee and seven or eight FINRA-registered persons besides Jahre.[8]

From early summer 2005 to November 2005, in order to save money, Jahre was HedgeCap's CCO.[9] Solano became HedgeCap's CCO beginning in November 2005 and remained in that position through mid-January 2007.[10] Solano was an "outsourced compliance officer" who worked part-time for HedgeCap and for "six or seven" other firms while at HedgeCap.[11] Jahre has been HedgeCap's CCO since January 2007.[12]

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[6] Stips ¶¶ 1, 2; Tr. 70.
[7] Tr. 81-82, 84.
[8] Tr. 731-732, 1975.
[9] Tr. 745-746, 804.
[10] CX-222 at 2; Tr. 1459-1460. Although Solano was registered with HedgeCap all during that period, a different person served as HedgeCap's CCO during the summer of 2006. Tr. 365; CX-223 at 2.
[11] Tr. 1487-1488, 746, 79-80.
[12] Tr. 1459-1460.

IV. FINDINGS OF FACT AND CONCLUSIONS OF LAW

A. HedgeCap and Jahre Violated Rule 2110 by Allowing Bigger Capital to Pay Rent with Soft Dollars (Count I)

1. Findings of Fact

Common law and the Investment Advisers Act of 1940 impose fiduciary obligations on money managers[13] and require them to exercise the utmost care to avoid enriching themselves at the expense of their clients.[14] Generally, money managers breach their fiduciary obligations if they do not seek out the lowest commission rates available for their clients. At the same time, money managers control brokerage commissions — "soft dollars" — and can use them to pay for a variety of services and benefits, thus creating an incentive for the managers to avoid getting the lowest commission rates if in return they can use the soft dollars generated for services and benefits. To address the inherent potential for conflicts of interest stemming from soft dollar arrangements, Section 28(e) of the Exchange Act provides a safe harbor for money managers, shielding them from liability for paying soft dollars in the form of commission rates for research-related or brokerage-related expenses.[15] If managers choose to use their clients' soft dollars to cover expenses outside the safe harbor, they must fully disclose to their clients the specific expense for which they intend to use soft dollars. If they do not make such a disclosure, they can be found to have fraudulently misappropriated the assets of their clients.[16]

During the Review Period, HedgeCap rented office space to hedge fund clients at its Fifth Avenue offices. Although most of the hedge funds' advisors paid cash (hard dollars) for rent,

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[13] "Money manager" and "investment manager" are synonymous with "investment adviser" as defined in the Investment Advisers Act of 1940.

[14] *See SEC Report of Investigation in the Matter of Investment Information, Inc. Relating to the Activities of Certain Investment Advisers, Banks, and Broker-Dealers*, Exchange Act Rel. No. 16679, 1980 SEC LEXIS 1842, at *14 (Mar. 19, 1980).

[15] *See* OCIE Inspection Report on Soft Dollar Practices of Broker-Dealers, Investment Advisers and Mutual Funds at 3, (SEC Sept. 22, 1998) *available at* http://www.sec.gov/news/studies/softdolr.htm ("OCIE Report").

[16] *See Republic New York Sec. Corp.*, Exchange Act Release No. 41036, 1999 SEC LEXIS 278, at *2–4 (Feb. 10, 1999).

HedgeCap allowed some of its hedge fund advisor tenants to pay rent in soft dollars, through trading commissions.[17]

Jahre was aware that under Securities and Exchange Commission ("SEC") safe harbor regulations, hedge fund advisors could use soft dollars to pay for certain expenses, such as research, but that other expenses, such as rent and general operating expenses, could be paid with soft dollars only if the expenses were disclosed to the hedge fund's investors in the fund's offering documents.[18] In documents submitted to FINRA staff during its investigation, HedgeCap stated that Jahre was responsible for supervising the firm's soft dollar activities, and that he did not delegate this responsibility.[19] Under HedgeCap's written supervisory procedures ("WSPs"), Jahre was responsible for ensuring that HedgeCap conducted reviews of the relevant documents so that HedgeCap would be compliant with soft dollar rules.[20] For these reasons, Jahre reviewed offering documents of prospective tenants to determine whether they disclosed that certain expenses could be paid with soft dollars. Napolitani also reviewed hedge funds' offering documents; however, only Jahre had the authority to approve soft dollar arrangements.[21]

In July 2005, HedgeCap agreed to allow Bigger Capital ("Bigger"), a hedge fund tenant, to direct at least $2,200 per month in trading commissions to HedgeCap to cover rent.[22] Jahre was responsible for the firm's relationship with Bigger, participated in the months-long negotiations with Bigger, and was aware that Bigger entered a soft-dollar arrangement with HedgeCap.[23] Although Jahre did not execute a formal agreement with Bigger reflecting the soft dollar arrangement until January 4, 2006, Bigger paid its rent from October 1, 2005, to

[17] Stips ¶¶ 4, 5; Tr. 88-89.
[18] Tr. 128, 163.
[19] CX-208 at 12:5f, 14:8f, 14:8g; Tr. 97-98.
[20] CX-1 at 46-47, 50.
[21] Tr. 90, 92-94, 1234-1235.
[22] Stips ¶ 5.
[23] Tr. 102-103, 109-111, 113-114; CX-6, CX-7, CX-9, CX-11, CX-12.

September 30, 2006, by directing at least $2,200 per month in trading commissions to HedgeCap.[24]

Bigger's Offering Memorandum dated February 2004 stated that its hedge fund advisor was responsible for bearing his "own expenses incurred in connection with [his] duties in managing the Fund, including payment for . . . office space for officers and employees of the General Partner and its affiliates." HedgeCap had a copy of Bigger's Offering Memorandum at the outset of the soft dollar arrangement.[25]

Solano was HedgeCap's CCO during most of the time the Bigger agreement was in effect. Solano testified that he had no role in overseeing the firm's soft dollar arrangements and was not consulted or informed about the arrangements. Jahre admitted that he did not delegate oversight of the Firm's soft dollar arrangements with hedge funds to Solano.[26]

At the hearing, Jahre claimed that he had delegated responsibility for soft-dollar compliance oversight to Napolitani, even though Napolitani did not have a Series 24 license and had never held any supervisory positions in the securities industry. Napolitani denied that Jahre ever delegated this compliance function to him, and Jahre admitted that there was no written evidence of his purported delegation. The Hearing Panel did not find Jahre to be credible and concluded that Jahre was responsible for overseeing HedgeCap's soft dollar arrangement with Bigger, and knew, or should have known, that Bigger's soft dollar payments to HedgeCap violated Bigger's Offering Memorandum.

2. Conclusions of Law

Because broker dealers are responsible for executing the trades that generate soft dollar commissions, they play a critical role in ensuring that soft dollar payments either fall within the

[24] Stips ¶ 5; CX-208 at 12-15; Tr. 1237.
[25] Stips ¶ 6.
[26] Tr. 1496, 1223.

SEC's 28(e) safe harbor or are fully disclosed. For this reason, the SEC has imposed on broker dealers a duty to inquire whether a fund advisor has permission to use soft dollar payments outside the safe harbor categories:

> A broker which causes or assists an institution to violate a duty to the investor may be aiding and abetting a fraudulent or deceptive act or practice. Furthermore, a broker would have a duty to inquire with respect to his participation in a course of conduct which, to a reasonable person, would raise a question of fraudulent or deceptive acts or practices.[27]

After providing that guidance to the industry, the SEC brought a number of actions against broker-dealers and investment advisers for soft dollar violations, including cases in which it found broker-dealers liable for aiding and abetting an adviser's fraudulent soft dollar violations.[28] HedgeCap's WSPs contained a section on soft dollars explaining the SEC's guidance and directing Jahre to follow procedures to ensure that HedgeCap's soft dollar arrangements were proper.[29]

NASD Rule 2110 imposes on member firms and registered persons a duty to observe "high standards of commercial honor" and "just and equitable principles of trade." The SEC has consistently stated that rent payments do not qualify for the safe harbor under Section 28(e) of the Exchange Act because office space expenses are not associated with research or execution.[30] As such, it is inappropriate to use soft dollars to pay for rent unless there is full and fair

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[27] OCIE Report at 12-13 (citing *Report of Investigation in the Matter of Investment Information, Inc. Relating to the Activities of Certain Investment Advisers, Banks, and Broker-Dealers*, Exchange Act Rel. No. 16679, 1980 SEC LEXIS 1842, at *24-25 (Mar. 19, 1980)).

[28] *See Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934*, Exchange Act Rel. No. 54165, 2006 SEC LEXIS 1625, at *117 n.183 (July 18, 2006) (citing more than a dozen cases from 1994 to 2002). The SEC noted: "In all Section 28(e) arrangements, … the broker-dealer may be subject to liability for aiding and abetting violations by money managers where the broker-dealer pays for services that are not within Section 28(e)."

[29] CX-1 at 50-55.

[30] *See* OCIE Report at 25; *SEC Interpretive Release Concerning the Scope of Section 28(e)*, Exchange Act Rel. No. 23170, 1986 SEC LEXIS 1689, at *12 n.10 ("obvious overhead expenses such as office space, typewriters, furniture and clerical assistance would not constitute research").

disclosure to investors that their soft dollars are being used for that purpose.[31] Bigger's Offering Memorandum did not contain any such disclosure. To the contrary, the Offering Memorandum explicitly stated that "office space" was an expense that would be paid by the investment manager.[32]

HedgeCap and Jahre acknowledged that they had received Bigger's Offering Memorandum and that they had reviewed it to determine whether the payments were appropriate. They knew or should have known that it was not appropriate for Bigger's investment manager to pay rent with soft dollars. Nevertheless, HedgeCap entered into arrangements that allowed Bigger's investment manager to use his investors' money to cover expenses he should have paid on his own. As a result, HedgeCap failed to observe high standards of commercial honor and just and equitable principles of trade, and thereby violated Rule 2110.

Jahre was responsible for the Firm's relationship with Bigger and personally approved and signed the office space rental agreement, knowing that it required Bigger to generate $2,200 per month in commissions for HedgeCap. By playing this substantial role, Jahre also violated Rule 2110.

B. HedgeCap and Jahre Violated Rules 2211(d)(1) and 2110 by Distributing Exaggerated, Misleading, and Unbalanced E-mails (Count II)

1. Findings of Fact

Between December of 2005 and June of 2006, Jahre personally sent over 20 e-mails to potential investors regarding an "arbitrage strategy" in the collateralized mortgage obligation ("CMO") market to be pursued by a startup fund, Lismore Advisors LLC.[33] The strategy,

[31] *See* OCIE Report at 10.
[32] CX-5 at 28.
[33] CX-14--CX-21; CX-23--CX-26; Tr. 1025, 1082.

labeled "Project Entropy," was devised by Judah Frankel, who Jahre claimed was a "foremost authority" on CMOs.[34]

These e-mails had minor differences, but were essentially identical.[35] The e-mails typically read as follows:

> Dear ______,
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> I am the managing member of Hedge fund Capital Partners, LLC as well as a member of the New York Bar. My business is raising capital for alternative asset strategies including hedge funds, fund of funds, and non-correlated market strategies….I currently represent exclusively one of the foremost authorities on collateralized mortgage obligations. He has obtained patents on his bond strategies and has run money for Renaissance Capital as well as built the CMO desk at Morgan Stanley.
>
> He has come up with a strategy in the CMO market which has zero risk to principal because of his hedging techniques and a very robust double digit return profile. It has taken us six months to put this together and because of the low interest rate environment as well as the lack of certain data bases, the strategy was not viable until now.
>
> There is up to a three year window to execute this strategy before the street finds out the methodology. We anticipate that the strategy can comfortably earn 25-40% per annum, with the possibility of higher returns depending on the leverage as well as our ability to execute the plan in full.
>
> There is no risk to capital and in the event we cannot execute the strategy, because of some remote contingencies, the investor will still get all capital back plus a nominal (4-6%) return.
>
> I am looking to raise 500 million dollars from no more than six entities, all of which will be in managed accounts in the name of the entity. I will not go to the investment banks because of leakage risk, nor to funds of funds which have too many layers of due diligence and therefore leakage risk as well.
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> Because of its proprietary and secretive nature, any potential investor must sign [a non-disclosure agreement] before we disclose the strategy….I would very much appreciate meeting with you at your earliest convenience as I believe you will find this to be a compelling risk/reward scenario.
>
> Best Regards,
> Howard Jahre, Esq.[36]

Flanders, a special investigator with over 10 years' experience in FINRA's Advertising Regulation department, reviewed all of the e-mails and testified that they each violated FINRA

[34] CX-14; Tr. 1845.
[35] Tr. 1024-1025.
[36] CX-15.

rules in three important ways.[37] First, each e-mail contained predictions or projections of performance, including claims of returns of up to 100 percent annually and "comfortable" returns of 25–50 percent.[38] Aside from violating the FINRA rules, these claims also lacked any historical support, because, as Jahre explained, the "strategy" was not "viable until now." Nonetheless, at the hearing Jahre insisted that the claims were true.[39] Second, each e-mail lacked risk disclosures, and minimized the risks in the investment.[40] Third, none of the e-mails provided a sound basis for evaluating the facts about the proposed investment.[41] Instead, the investors targeted in the e-mails would have to sign a non-disclosure agreement ("NDA") before the strategy would be disclosed.[42]

In response to questioning from the Panel, Jahre admitted that the strategy had multiple risks: risk that mortgage holders would not want to refinance; execution risk; risk that the credit markets would crash; risk that interest rates would change; and risk that the strategy would be disclosed. The strategy also entailed bid/ask spread, liquidity, regulatory, legal, and market risks. However, none of these risks was disclosed until after the potential investor signed the NDA.[43]

Between July and October of 2007, Jahre sent out at least 11 additional, similar e-mails touting the CMO arbitrage strategy.[44] Like Jahre's earlier e-mails, these lacked risk disclosures and minimized investment risks. They also failed to provide a sound basis for evaluating the investment, instead requiring an NDA prior to describing the "details of the strategy."[45]

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[37] Tr. 1356.
[38] Tr. 1357-1358,1353.
[39] Tr. 1028, 1083-1084.
[40] Tr. 1359-1360, 1352-1353.
[41] Tr. 1353.
[42] Tr. 1361-1362.
[43] Tr. 1871-1874, 1881-1887.
[44] CX-27- CX-37.
[45] CX-27- CX-37 ("deminimis [sic] principal risk"); Tr. 1364-1365.

Jahre found only one investor to invest in the CMO arbitrage strategy -- a hedge fund called DKR that invested $100 million.[46] During his investigative testimony, Jahre told Enforcement that the investment was performing as projected, meaning 25–50 percent returns.[47] At the hearing, Jahre testified that he had learned from EB, Jahre's contact at DKR, that while DKR had not earned any returns, it had broken even on its investment and "got all their money back."[48] However, Johnston, a FINRA investigator, testified that EB told Enforcement that he did ***not*** tell Jahre that DKR had gotten their money back.[49] In fact, according to EB, DKR lost $23 million in the year it held the investment.[50]

During Jahre's testimony at the hearing, Jahre learned from Enforcement that it intended to contact EB during a break in Jahre's testimony. When Jahre returned to testify, he admitted that he had spoken to EB during a break in the hearing (approximately May 11, 2010), and that EB told him that DKR could have lost "around $20 million."[51]

2. Conclusions of Law

Rule 2210(d)(1) sets forth the content standards "Applicable to All Communications with the Public."[52] The Rule provides in relevant part that all such communications

> (A) [S]hall be based on principles of fair dealing and good faith, must be fair and balanced, and must provide a sound basis for evaluating the facts in regard to any particular security or type of security. . . . No member may omit any material fact or qualification if the omission, in the light of the context of the material presented, would cause the communication to be misleading.

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[46] Tr. 1066-1067.
[47] Tr. 1086-1087; CX-230 at 134-135.
[48] Tr. 384-395, 1068-1069, 1074-1075, 1147-1148.
[49] Tr. 1443, 1432.
[50] Tr. 1433-1434.
[51] Tr. 1155-1156.
[52] There can be no serious question that Jahre's e-mails were "communications with the public." Although Jahre claims that all of the e-mails were sent to institutional investors, Rule 2210(a) expressly defines "communications with the public" as including "Institutional Sales Material," as defined in Rule 2211(a)(2). That rule defines "Institutional Sales Material" as "any communication that is distributed or made available only to institutional investors." Rule 2211(d) further expressly confirms that "[a]ll institutional sales material and correspondence are subject to the content standards of Rule 2210(d)(1)."

> (B) No member may make any false, exaggerated, unwarranted or misleading statement or claim in any communication with the public. No member may publish, circulate or distribute any public communication that the member knows or has reason to know contains any untrue statement of a material fact or is otherwise false or misleading.
>
> . . .
>
> (D) Communications with the public may not predict or project performance, . . . or make any exaggerated or unwarranted claim, opinion or forecast. . . .[53]

Jahre's e-mails all violated the content standards of 2210(d). First, they contained statements projecting performance. Second, his claims were exaggerated, unwarranted, and misleading. Jahre refused to explain the basis for these claims at his on-the-record testimony, claiming that he could not disclose the "strategy" on trade secret and confidentiality grounds.[54] Given that the "strategy" was not "viable until now," as Jahre stated in the e-mails, he lacked any reasonable basis for making the wild performance claims. Third, Jahre's e-mails were not fair and balanced. According to the e-mails, the strategy had "zero risk" to principal (*e.g.* CX-14), "next to zero risk to principal" (*e.g.* CX-17), or "literally zero or deminimus [sic] principal risk" (*e.g.* CX-19). And many of the e-mails suggested that in a worst case scenario, applicable only if "some remote contingencies" occurred, "the investor will still get all capital back plus a nominal (4-6%) return" (*e.g.* CX-14). Others promised that "[i]n the unlikely event" the strategy did not work, "the money will be returned to the investor, with the only loss an opportunity loss for a few months" (*e.g.* CX-19). Finally, none of the e-mails provided a sound basis for evaluating the facts regarding the investment. Instead, the e-mails declined to provide any actual information regarding the strategy "[b]ecause of its proprietary and secretive nature" (*e.g.* CX-14).

[53] NASD Rule 2210(d)(1).
[54] CX-230 at 266-67.

Jahre explained the Frankel strategy for the first time at the hearing. In answering questions asked by the Hearing Panel, Jahre admitted that the strategy entailed numerous risks; however, Jahre did not disclose any of them in his e-mails.

Jahre argued that the FINRA content standard rules should not apply to the e-mails he sent out because the prospective investors he targeted were all sophisticated and experienced institutions that would not make investments based simply on his initial e-mails; the e-mails were simply an introduction, and a way in the door so that he could obtain an NDA and explain Frankel's strategy. Flanders testified that FINRA's longstanding practice has been to apply the content standards set forth in Rule 2210(d) to communications with institutional investors. She also testified that Notice to Members ("NTM") 03-07, which explains Rule 2210(d), is consistent with this longstanding practice, and does not exempt institutional sales materials from the FINRA content rules.[55]

The Hearing Panel was not persuaded by Jahre's argument, and found that Jahre and HedgeCap violated 2210(d)(1) and 2110 by distributing his exaggerated, misleading, and unbalanced e-mails.

C. HedgeCap Violated Rules 2211(d)(1) and 2110 by Distributing Unbalanced Institutional Sales Materials (Count III)

1. Findings of Fact

During the Review Period, HedgeCap employed several individuals (including Jahre and Napolitani), and engaged over 12 independent contractors, to market hedge funds to potential institutional investors. The independent contractors were registered with HedgeCap, but were employed by third-party marketing firms.[56] None of the independent marketers worked out of

[55] Tr. 1352, 1368-1369.
[56] Stips ¶¶ 7, 8.

the HedgeCap offices, and none of the third-party firms had a separate supervisor.[57] Jahre was the only supervisor of the third-party marketers.[58] Hedge fund managers paid commissions to HedgeCap for any successful marketing efforts by the marketers, and HedgeCap in turn paid out 90 percent of those commissions to the marketers and retained 10 percent as its fee.[59] HedgeCap had marketing agreements with all of the hedge funds that the third-party marketers represented.[60]

To raise capital for HedgeCap's hedge fund clients, HedgeCap's employees and marketers distributed institutional marketing materials, some of which were prepared by the marketers, to potential institutional investors and high net worth individuals.[61] HedgeCap's marketers distributed 20 different marketing documents in more than 1450 solicitations.[62] If anyone invested in the hedge funds as a result of these solicitations, both the representatives and HedgeCap would be compensated.[63] The 20 distinct communications included power-point presentations, monthly newsletters, brochures, and fund summaries.[64] Many of the communications contained performance projections.[65] Many others contained language touting the benefits of the various funds, but lacked any risk disclosures.[66]

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[57] Tr. 1107-1108.
[58] Tr. 1113.
[59] Stips ¶ 8.
[60] Tr. 1106-1107.
[61] Stips ¶ 9; Tr. 378-379.
[62] Stips ¶ 10; CX-61-CX-80; Complaint Exh. B.
[63] Tr. 375-376.
[64] CX-61, CX-63, CX-64, CX-68, CX-75, CX-77 (power points); CX-67, CX-70, CX-74 (newsletters); CX-66 (brochure); CX-62, CX-65, CX-69, CX-71, CX-72, CX-73, CX-76, CX-78, CX-79, CX-80 (summaries).
[65] CX-63 at 8 (describing objectives of "compounded average annual return of 16%–18% net of fees, or roughly 11%–13% above the risk-free rate of interest"); CX-64 at 5 ("achieve 15% compounded returns net of fees"); CX-65 at 2 (same); CX-66 at 4 (fund "aims to achieve average long-term returns in excess of 30% per annum"); CX-68 at 5 ("achieve 30% compounded returns net of fees"); CX-74 at 2 ("[t]arget returns are 18–22% net of fees"); CX-75 at 7 ("target returns after management fees: 18%"); CX-76 at 3 ("[t]arget returns are 18–22% net of fees"); CX-79 at 2 ("targeting returns in the 9–13% range"); Tr. 1372-1376.
[66] CX-61 – CX-80; Tr. 1388–1389.

In March 2006, Solano provided Jahre with an analysis prepared by a law firm that explained the disclosure requirements applicable to hedge fund marketing.[67] Although Jahre understood that hedge fund "sales materials" were required to disclose risks and be fair and balanced, he did not consider the hedge fund materials communicated by HedgeCap employees and marketers to be sales materials subject to NASD advertising rules.[68] Jahre thus did nothing to ensure that applicable risks were included in hedge fund marketing materials used during the Review Period.[69]

2. Conclusions of Law

Rule 2211(d)(1) requires all institutional sales material and correspondence to comply with the content standards of Rule 2210, described in Section B.2 above.[70] The sales materials sent out by HedgeCap's employees and third-party marketers failed to do so. For example, many of the communications contained performance projections, in violation of Rule 2210(d)(1)(D).[71] The communications also failed to make fair and balanced presentations. While several contained claims minimizing risk,[72] most of the 20 separate communications contained *no risk disclosure at all*. As NASD warned in NTM 03-07, this is particularly egregious in the case of hedge funds solicitations, because those investments are "often risky and lacking in

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[67] CX-58 ("Capital Introduction for Hedge Funds, What Lies Beneath," White and Case LLP (Nov. 23, 2004) (with handwritten notation "*Gave copy to Howard on 3/3/06")).
[68] Tr. 1113.
[69] CX-230 at 86-87, 95-98.
[70] The materials constituted either "Sales Literature" or, to the extent any individual item was distributed only to institutional investors, "Institutional Sales Material." *See* Rule 2210(a)(2). In either case, HedgeCap's disseminations were "communications with the public" and subject to the content standards in Rule 2210(d)(1).
[71] *E.g.*, CX-61 at 30-36 (showing leveraged rates of return ranging from 16% to 52%, and unleveraged rates of return from 5% to 23%); CX-63 at 8 (describing objectives of "compounded average annual return of 16%–18% net of fees, or roughly 11%–13% above the risk-free rate of interest"); CX-64 at 5 ("achieve 15% compounded returns net of fees"); CX-68 at 5 ("achieve 30% compounded returns net of fees").
[72] *E.g.*, CX-63 at 21 (maximum loss of any "single notional position . . .would drawdown [sic] no more than 6% of fund NAV"); CX-78 at 3 ("The strategy is designed to achieve positive returns regardless of market direction and places an emphasis on capital preservation"); CX-66 at 6 (fund's "framework diffuses risk through diversification . . . . ").

transparency."[73] NTM 03-07 provided several examples of risk disclosures that could "balance sales material or oral presentations that promote the advantages of hedge fund investing with full disclosure of the risks hedge funds present." Among these were disclosures that hedge funds "[o]ften engage in leveraging and other speculative investment practices that may increase the risk of investment loss;" that hedge funds "can be highly illiquid;" and that they "often charge high fees."[74] None of these types of disclosures was made in any of the 20 communications sent out by HedgeCap marketers.

The Hearing Panel found that HedgeCap violated Rules 2211(d)(1) and 2110 by distributing unbalanced institutional sales materials.

D. HedgeCap Violated Rules 2211(b)(2)(A) and 2110 By Failing to Retain Institutional Sales Materials (Count IV)

1. Findings of Fact

HedgeCap stipulated that it did not maintain, in a file for three years as required by Rule 2211(b)(2)(A), a copy of every piece of sales material it sent out during the Review Period.[75] Consequently, when Enforcement requested "sales, marketing and advertising materials" from hedge funds maintaining accounts at HedgeCap, the Firm did not produce all of the responsive sales materials.[76]

Hubbard, a FINRA investigator, testified that HedgeCap's failure to maintain these records in a file as required seriously hampered and delayed Enforcement's investigation, in particular its attempt to review institutional sales materials to determine if they complied with

[73] NASD Notice to Members 03-07 at 49 (Feb. 2003).
[74] *Id.*
[75] Stips ¶ 11 (sales materials listed in Exhibit B to complaint). Tr. 610-613.
[76] CX-199 at 4e; Tr. 612-613.

Rules 2210 and 2211. Specifically, FINRA had to undertake a lengthy review of HedgeCap's e-mails to supplement the Firm's incomplete production of sales materials.[77]

2. Conclusions of Law

Rule 2211(b)(2)(A) requires FINRA-regulated firms such as HedgeCap to maintain copies of all institutional sales materials for three years:

> Members must maintain all institutional sales material in a file for a period of three years from the date of last use. The file must include the name of person who prepared each item of institutional sales material.[78]

Nobody at HedgeCap maintained a file of all institutional sales materials,[79] and there is no dispute that HedgeCap's record keeping failure violated Rules 2211(b)(2)(A) and 2110.

The Hearing Panel thus found that HedgeCap violated Rules 2211(b)(2)(A) and 2110.

E. HedgeCap and Jahre Violated Rules 1031 and 2110 by Allowing Unregistered Persons to Act in Registered Capacities (Count V)

1. Findings of Fact

a. Four HedgeCap Third-Party Marketers Began Marketing for HedgeCap Prior to Obtaining Their Registration

During the Review Period, HedgeCap allowed more than 12 independent contractors to market hedge funds through HedgeCap to institutional investors.[80] Jahre was responsible for ensuring that the Firm did not allow unregistered persons to engage in activities requiring registration.[81] Four of these independent contractors were employed by Broadreach, and as discussed below, began marketing for HedgeCap before they were registered.

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[77] Tr. 642-643.
[78] NASD Rule 2211(b)(2)(A).
[79] *See* Stips ¶ 11 (sales materials attached to 1465 e-mails referenced in Exhibit B to Complaint were not maintained in a file).
[80] Stips ¶ 28.
[81] Tr. 1515.

On March 30, 2006, HedgeCap filed a Uniform Application for Securities Industry Registration or Transfer ("Form U4") for Anton Szpitalak which represented his "Start Date" as October 1, 2005. In fact, Szpitalak began raising capital for hedge funds through HedgeCap in June 2005, but he did not take and pass his Series 7 exam until almost a year later, on May 17, 2006. He was voluntarily terminated from HedgeCap on December 4, 2006.[82]

When HedgeCap filed a Form U4 for Pamela K. Valeri on May 24, 2005, her NASD licenses had lapsed. Valeri began raising capital for hedge funds through HedgeCap in June 2005. After registering with NASD through HedgeCap, Valeri never took her Series 7 examination, but obtained a conditional waiver of the testing requirement on October 24, 2005. She was voluntarily terminated by HedgeCap on February 7, 2007.[83]

HedgeCap filed a Form U4 for Catheryn L. Robinson on May 19, 2005, at which time her NASD licenses had lapsed. Robinson began raising capital for hedge funds through HedgeCap in May, 2005. After registering with NASD through HedgeCap, she did not take and pass her Series 7 exam until September 15, 2005. She was voluntarily terminated by HedgeCap on April 12, 2007.[84]

On May 6, 2005, when HedgeCap filed a Form U4 for Michael E. Leverone, his NASD licenses had lapsed. Leverone began raising capital for hedge funds through HedgeCap in May, 2005. After registering with NASD through HedgeCap, he did not take and pass his Series 7 exam until June 17, 2005. Leverone has not been terminated from HedgeCap.[85]

Before they were registered, Szpitalak, Valeri, Robinson, and Leverone all sent out e-mails to prospective investors saying that they were raising funds for specific hedge funds.

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[82] Stips ¶ 29; CX-208 at 19; CX-54, CX-56, CX-57.
[83] Stips ¶ 30; CX-208; Tr. 621-624.
[84] Stips ¶ 31; CX-208 at 19, CX-46, CX-47, CX-52, CX-48;Tr. 629–633.
[85] Stips ¶ 32; CX-208 at 19, CX-49.

Their e-mails often described the funds and their management, and always enclosed the funds' marketing materials or prospectuses. Although HedgeCap filed Forms U4 for Valeri, Robinson, and Leverone around the time they began marketing, as HedgeCap's WSPs recognized, its representatives were required to also pass the Series 7 test to become registered with NASD.[86]

Jahre admitted that some of HedgeCap's third-party marketers marketed hedge funds before being registered.[87] He maintained, however, that they did not need to be registered, because their e-mails enclosing the hedge funds' marketing materials were simply "ministerial," or mere solicitations of interest.[88] The third-party marketers, however, understood that they needed to be registered to provide marketing materials.[89]

b. HedgeCap Hired Robert Mudry, a Disqualified Individual, and Failed to File a Form U4 for 6 Months

In or around October 2005, HedgeCap, through Jahre, agreed to hire Robert Mudry.[90] Prior to his employment with HedgeCap, Mudry had not been associated with any FINRA member firm since September 2000.[91] Mudry began working for HedgeCap on November 1, 2005, and was initially paid a draw of $6,000 per month. In January 2006, HedgeCap increased Mudry's draw to $8,000 per month.[92] HedgeCap also agreed to reimburse Mudry for his business-related travel expenses.[93]

Mudry's responsibilities were memorialized in an October 17, 2005 e-mail, which was drafted by Napolitani and set forth the terms of Mudry's employment at HedgeCap. Napolitani

[86] CX-1 (HedgeCap WSPs) at 17-19.
[87] Tr. 1190.
[88] Tr. 1195-1198.
[89] CX-42a, CX-46, CX-239 at 21-23.
[90] Stips ¶ 12.
[91] Stips ¶ 15.
[92] Stips ¶ 13.
[93] CX-84; Tr. 164-165.

sent the e-mail to Mudry, with a copy to Jahre.[94] Consistent with the terms of the e-mail, beginning on November 1, 2005, Mudry was employed at HedgeCap to provide the following services: (1) "introduce and open up trading accounts (e.g., hedge funds, family offices, traditional money managers, etc…) that will execute equities business with our trading desk on a DVP basis";[95] (2) "provide Capital Introduction Services to the HedgeCap hedge fund managers with whom are [sic] tenants at 546 Fifth Avenue, or any other future office space for which HedgeCap manages";[96] (3) "introduce and open up Soft Dollar Brokerage accounts";[97] and (4) "raise capital for hedge fund managers that are not currentl [sic] HedgeCap clients."[98]

Napolitani testified that he and Jahre recognized that Mudry needed to be registered to engage in each of these activities.[99] Nevertheless, the October 17, 2005 e-mail only required Mudry to pass NASD's Series 7 and Series 63 examinations "at your earliest convenience."[100] Mudry's compensation package included 25 percent of the gross revenues from his accounts after his draw and "any other benefits if provided" were deducted, but the e-mail noted that Mudry could only share in commissions after passing the NASD examinations.[101] Because the e-mail did not make passing the Series 7 and Series 63 exams a precondition to engaging in any activities, Mudry was paid in full (and got a performance-based raise) for five months even though he never obtained his licenses.[102] Jahre admitted that HedgeCap did not condition any of Mudry's activities on his actually passing the exams.[103]

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[94] CX-84; Tr. 767-768, 773, 155-156.
[95] Tr. 158-159.
[96] CX-84; Tr. 159.
[97] CX-84; Tr. 159-160.
[98] CX-84; Tr. 163-164.
[99] Tr. 158, 160-161.
[100] CX-84.
[101] CX-83.
[102] Stips ¶¶ 13-14.
[103] Tr. 776.

After he was hired, Mudry went right to work, actively attempting to raise capital for hedge funds associated with the Firm, as well as seeking execution business for HedgeCap's equity desk and hedge fund tenants for the Firm's offices.[104] As Jahre testified, Mudry was his "right hand man,"[105] a "superstar" performer during his first three months.[106]

Jahre claimed that none of Mudry's efforts could be considered capital-raising because Mudry's role was limited to setting up meetings between Jahre and Mudry's investor and fund manager contacts.[107] This claim was belied not only by the terms of Mudry's employment discussed above, but also by the substantial, contemporaneous e-mail record of Mudry's activities showing his direct, independent efforts to raise capital for hedge funds before the Firm ever filed its first Form U4 for Mudry.[108] Furthermore, Jahre acknowledged that Mudry was allowed to inform potential investors that he was calling about an investment with a particular hedge fund and to describe its manager, the manager's history, the fund's past performance, and the fund's strategy.[109] At least 50 percent of the time, Mudry met with potential investors without Jahre.[110]

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[104] Stips ¶ 17; Tr. 769, 166.
[105] Tr. 971.
[106] Tr. 794-796.
[107] CX-208 at 2.
[108] CX-85 (Mudry e-mail to Napolitani noting meetings, without Jahre, "with EGS in Saddle River . . . for commission flow" and with "an investor for Bigger Capital," one of HedgeCap's tenants), CX-89 (Napolitani e-mail to Mudry scheduling meeting to discuss "progress you've made on raising assets for our tenants" and " trading accounts that you've prospected"), CX-93 (Napolitani e-mail to Mudry: "I would highly recommend to reach out to any of your contacts at hedge funds and see if you can get any trading accounts opened up"), CX-94 (Mudry e-mail to Nikodem seeking "trading flow" from hedge fund); CX-95 (Napolitani e-mail to Mudry acknowledging "I know you're working hard to raise… capital"), CX-97 (Mudry e-mail to Napolitani: "Despite my best and persistent efforts on behalf of Bigger Capital with some of my choice investor contacts, I have found virtually no interest in their strategy over the last several months"), CX-101 (e-mails between Jahre, Napolitani, and Mudry regarding having Mudry try to open trading accounts for funds); Tr. 186-190, 197.
[109] Tr. 819-820.
[110] Tr. 174.

When Mudry first joined HedgeCap, he was advised that "if your performance warrants it (e.g. trading revenues), [your compensation] will increase up to $8,000 (gross) draw . . . ."[111] In January 2006, two months after Mudry started, HedgeCap increased his draw to $8,000 per month.[112] By March 29, 2006, HedgeCap had paid Mudry a total of $39,000 in draws against future commissions. By April 12, 2006, HedgeCap had provided Mudry with three checks totaling $3,034 for "T&E Reimbursements."[113]

Jahre was Mudry's supervisor, and Mudry kept Jahre apprised of his efforts on behalf of HedgeCap.[114] Mudry regularly identified himself in e-mails to business contacts as a "Managing Partner" or "Managing Director" of HedgeCap, and copied Jahre on the e-mails.[115] Jahre claimed that Mudry never fulfilled these roles at HedgeCap, but Mudry's use of these titles was "fine with" Jahre because they helped Mudry and HedgeCap get business.[116]

Solano testified that the activities Mudry was hired to do "absolutely" required registration.[117] Napolitani testified that Jahre contemporaneously recognized the "importance of [Mudry] having a Series 7 while [Mudry] was out doing what he was doing."[118] Although everyone apparently agreed that Mudry needed a Series 7 license to engage in the activities he was doing, at the end of March, 2006 — five months after Mudry began employment — HedgeCap had not even filed a Form U4 for him.[119]

Solano testified that he had no role in ensuring that Mudry and others did not engage in activities requiring registration prior to actually registering because he was not made aware of

[111] CX-84.
[112] Stips ¶ 13.
[113] Stips ¶ 14.
[114] Stips ¶ 18.
[115] Stips ¶ 19.
[116] Tr. 968-969, 939.
[117] Tr. 1545-1546.
[118] Tr. 228.
[119] Tr. 302.

the arrangements between those individuals and HedgeCap; instead, Jahre would simply tell Solano to get certain individuals registered.[120] Nobody at HedgeCap asked Mudry about regulatory issues, asked for a copy of any previous Uniform Termination Notice for Securities Industry Registration ("Form U5"), secured his "Pre-Hire Authorization" to check his Central Records Depository ("CRD") record, contacted his prior employers, or otherwise conducted a background check.[121]

On April 4, 2006, Mudry told HedgeCap about his disciplinary history. At that time, HedgeCap became aware that Mudry had been barred in all capacities by the New York Stock Exchange ("NYSE"), the State of Maine, and the State of New Jersey. The bar rendered Mudry subject to statutory disqualification from registration with NASD.[122] Nevertheless, Mudry continued working for HedgeCap until January 2007, when HedgeCap filed a Form U5 disclosing that Mudry's association with HedgeCap had been voluntarily terminated effective January 12, 2007.[123] Mudry was not registered with NASD at the time HedgeCap hired him or at any time during the November 1, 2005 to January 12, 2007 period that he was working for HedgeCap.[124]

2. Conclusions of Law

NASD Membership and Registration Rule 1031 states that all persons engaged in the securities business of a member firm who are to function as representatives must be registered with NASD as a person functioning in the appropriate category of registration. The rule defines a "representative" to include all persons associated with a member firm who engage in the

[120] Tr. 1517-1518.
[121] Tr. 787-788.
[122] Stips ¶ 20.
[123] Stips ¶ 27.
[124] Stips ¶ 16.

"functions of supervision, solicitation or conduct of business of securities."[125] Members are required to register any person who contacts potential customers of the firm for the purpose of opening accounts or soliciting orders for the firm.[126]

In NTM 88-50, NASD made clear that "[p]ursuant to [FINRA] By-Laws, unregistered persons may not discuss general or specific investment products or services offered by the firm . . . or solicit new accounts or orders." Firms are responsible for advising associated, unregistered persons not to engage in registered activities:

> The member should provide unregistered persons with orientation and training that specifically addresses the limitations of such persons' activities, the regulatory consequences of exceeding these limitations, and the fact that such persons are associated persons of the member, subject to the rules of the NASD and its disciplinary authority.

NTM 88-50 also advised member firms to monitor their associated, unregistered personnel to ensure they do not step over the line: "Members are advised to review the activities of unregistered employees to ascertain that such persons are not functioning in a manner requiring registration."

As described above, Mudry and HedgeCap's third-party marketers solicited securities business for the Firm when they contacted potential investors as part of their effort to market specific hedge funds. Their e-mails reveal that they regularly discussed "general or specific investment products or services offered by the firm." Furthermore, with respect to Mudry, Respondents stipulated: "Beginning in November 2005, Mudry actively sought execution business for the firm's equity desk and attempted to locate hedge fund tenants for the firm's offices."[127] Their supervisor, Jahre, thought it was permissible for an unregistered person to

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[125] NASD Membership and Registration Rule 1031(b).
[126] *See* NASD NTM 88-24 (Mar. 30, 1988). *See Dep't of Enforcement v. Flannigan*, No. C8A980097, 2001 NASD Discip. LEXIS 36, at *8, n.10 (N.A.C. June 4, 2001); NASD NTM 88-50.
[127] Stips ¶ 17.

inform potential investors that he was calling about an investment with a particular hedge fund and to describe the fund's manager, the manager's history, the fund's past performance, and the fund's strategy.[128] Jahre's "monitoring and supervision" did not deter violations, but rather facilitated them.

HedgeCap violated Rules 1031 and 2110 by improperly permitting Mudry and four third-party marketers to engage in the securities business of the Firm.[129] As HedgeCap's president, and as the direct supervisor of Mudry and the third-party marketers, Jahre also violated Rules 1031 and 2110.[130]

F. HedgeCap and Jahre Violated Art. III, § 3(b) of NASD By-Laws and Rule 2110 by Employing a Statutorily Disqualified Person (Count VI)

1. Findings of Fact

On April 4, 2006, after HedgeCap had repeatedly warned Mudry that he was required to take NASD's Series 7 examination, Mudry finally admitted to the firm that he had an extensive disciplinary history--he had been barred in all capacities by the NYSE, the State of Maine, and the State of New Jersey.[131] Mudry also had agreed to pay fines, a settlement with his previous employer, and restitution to investors totaling over $800,000.[132] The bar rendered Mudry subject to statutory disqualification from registration with NASD.[133] HedgeCap's WSPs prohibited the Firm from employing "individuals who have been statutorily disqualified."[134]

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[128] CX-231.

[129] *See Dep't of Enforcement v. Flannigan*, 2001 NASD Discip. LEXIS 36, at *18 (N.A.C. June 4, 2001) (firm violated 1031 by allowing unregistered persons to solicit customers on behalf of the firm). *See also Cambridge Group, Inc.,* 50 SEC 752 (Oct. 8, 1991) (firm allowed unregistered employee to attempt to find investors for some of the hedge funds that operated out of the firm's office space).

[130] *See Dep't of Enforcement v. Harvest Capital Inv.*, 2008 FINRA Discip. LEXIS 45, at *30 n.17 (N.A.C. Oct. 6, 2008) (citing *Dep't of Market Regulation v. Ryan & Co., LP*, No. FPI040002, 2005 NASD Discip. LEXIS 8, at *30 (N.A.C. Oct. 3, 2005) (holding that because the respondent was the firm's president and owner, he and the firm were "for all intents and purposes . . . one and the same")).

[131] Stips ¶ 20.

[132] CX-154; Tr. 852-853.

[133] Stips ¶ 20.

[134] CX-1 at 19.

HedgeCap could have learned of Mudry's statutory disqualification through a simple internet search, as well as from FINRA's CRD.[135] Merely following the Firm's "pre-hire certification and CRD authorization" process — which was supposed to occur prior to the individual working at HedgeCap — would have uncovered Mudry's statutory disqualification.[136] However, HedgeCap did not obtain Mudry's "pre-hire authorization" to check his CRD records until April 4, 2006,[137] and did not have him complete "the Pre-Hire paperwork as required by the firm and NASD" until April 24, 2006.[138] Jahre described HedgeCap's failure to follow these processes as a "total oversight"; however, the oversight was Jahre's alone, because Solano relied on Jahre to inform him of who was working at the Firm and might need registration.[139]

After learning of Mudry's disciplinary history, Napolitani immediately recommended that Jahre fire Mudry.[140] The next morning, Napolitani followed up with an e-mail observing that Mudry had been "marketing funds without a license (putting [HedgeCap] at risk)" since November 2005 and reiterating that HedgeCap should fire Mudry for his dishonesty and other character issues. Napolitani argued that Mudry "should have disclosed [his regulatory issues] prior to us hiring him" and that "[a]ny major firm would've thrown him out on his ear yesterday." Jahre responded to Napolitani's e-mail by writing "agree, want me to get rid of him today or maybe tell him after his vacation."[141]

[135] Tr. 1527-1528.
[136] Tr. 1530, 1543-1545.
[137] CX-108, Tr. 243.
[138] CX-118.
[139] Tr. 919, 1511-1513.
[140] Tr. 218, 222.
[141] CX-110.

Although Jahre told Napolitani that he would fire Mudry, Jahre testified at the hearing that he never intended to fire Mudry, and that he had misrepresented his intentions in order to "mollify" Napolitani.[142] Ultimately, however, Jahre merely took away Mudry's HedgeCap e-mail address and stopped paying his $8,000 monthly draw while the Firm pursued a waiver from NASD through the MC-400 process.[143] Solano advised HedgeCap to eliminate Mudry's HedgeCap e-mail account because, until he was licensed, Mudry "should not be performing any kind of firm business."[144] Instead, because Mudry was willing to "work for free" during the waiver process, Jahre continued to employ Mudry in essentially the same capacity as before — albeit with a non-HedgeCap e-mail account. Although HedgeCap took away Mudry's HedgeCap e-mail address, Mudry continued to get e-mails, which were re-routed to his AOL account. [145] Jahre acknowledged at the hearing that Mudry continued "working on my behalf" after HedgeCap purportedly "terminated his HedgeCap affiliation."[146] Accordingly, even after Mudry revealed in April 2006 that he was statutorily disqualified, Jahre continued to allow Mudry to raise capital for hedge funds (and seek trading flow) through the end of 2006.[147]

Jahre claimed that he relied upon Solano's advice in allowing Mudry to continue working for HedgeCap.[148] However, the contemporaneous record shows that Solano advised Jahre that Mudry was "statutorily disqualified" and that Mudry "should not even introduce himself to a financial institution."[149] Solano testified that he told Jahre that Mudry could not associate with HedgeCap in any manner whatsoever, other than to the extent necessary to "complete the MC-

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[142] Tr. 868-869.
[143] Stips ¶ 21.
[144] Tr. 211.
[145] Tr. 1122, 212-213; CX-208, CX-116 (Mudry e-mail telling potential source of capital to contact Mudry at his AOL e-mail address).
[146] Tr. 791.
[147] Tr. 997, 257-258, 267; CX-114, CX-115, CX-117, CX-125, CX-129, CX-137.
[148] Tr. 907-909.
[149] CX-113.

400 application…."[150] Jahre claimed at the hearing that he did not think the bar would prevent Mudry from being registered by NASD. Solano testified, however, that when Jahre raised this issue, Solano told him that the bar disqualified Mudry from registering with NASD.[151]

Between April and October 2006, HedgeCap provided Mudry with three checks totaling $8,639.89 for "T&E Reimbursement" and/or "COBRA Reimbursement." Jahre also gave Mudry a "gift" of approximately $5,000.[152]

On September 19, 2006, after Mudry passed his Series 7 examination, NASD formally acted upon the submitted Form U4 and advised HedgeCap that Mudry was statutorily disqualified.[153] NASD's letter noted that HedgeCap could only continue its NASD membership if it obtained relief from the prohibition on associating with an ineligible person.[154] On October 5, 2006, the Firm filed an MC-400 application.[155] Mudry continued to provide services to HedgeCap while the MC-400 was in process.[156]

In January 2007, after NASD began seeking information regarding Mudry's association with the Firm, Mudry left the Firm and the MC-400 application was abandoned. At the hearing, Jahre testified that HedgeCap withdrew the MC-400 application and Mudry left the Firm because Napolitani delivered an "ultimatum:" either Mudry left, or Napolitani would.[157] Jahre faulted Napolitani for forcing out Mudry, whom Jahre effusively praised throughout his testimony.[158]

Mudry continued working for HedgeCap until January 2007, when HedgeCap filed a Form U5 disclosing that Mudry's association with HedgeCap had been voluntarily terminated

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[150] Tr. 1542-1543.
[151] Tr. 1532.
[152] Stips ¶ 21.
[153] Stips ¶ 26.
[154] CX-163 at 1.
[155] CX-168; Stips ¶ 26.
[156] Stips ¶ 27.
[157] Tr. 1020-1021.
[158] Tr. 854-855 (Mudry "is a decent guy, a good guy. I believe he's an honest guy"), 1020-1022 (Mudry deserved to be reinstated through MC-400 process), 1128 ("I like Bob a lot, and I trusted him").

effective January 12, 2007.[159] Mudry never registered with NASD, and remained statutorily disqualified, during the entire 14 months he worked for HedgeCap.[160]

2. Conclusions of Law

Pursuant to FINRA's By-Laws Article III, Section 3(b), member firms are not permitted to employ a person in *any* capacity if that person has been statutorily disqualified:

> No person shall become associated with a member . . . if such person is or becomes subject to a disqualification under Section 4 . . . and no member shall be continued in membership, if any person associated with it is ineligible to be an associated person under this subsection.

Pursuant to FINRA's By-Laws Article III, Section 4, a person is statutorily disqualified if another SRO has barred him:

> A person is subject to a 'disqualification' with respect to membership, or association with a member, if such person: (a) has been and is expelled or suspended from membership or participation in, or barred or suspended from being associated with a member of, any self-regulatory organization . . . .

Mudry became statutorily disqualified in December 2001 when he was barred by the NYSE for failing to appear for testimony and failing to produce documents and information. Mudry's bar by the NYSE statutorily disqualified him from membership in NASD, and HedgeCap was prohibited from associating with a statutorily disqualified person. Therefore, Mudry was prohibited from associating with the Firm *in any manner*.

Despite Mudry's status as a statutorily disqualified person, and despite a provision in the Firm's WSPs that prohibited the employment of statutorily disqualified individuals, Mudry associated with HedgeCap from November 2005 to January 2007. As HedgeCap's President and Mudry's direct supervisor, Jahre had a duty to determine whether Mudry was disqualified and to

[159] Stips ¶ 27.
[160] Stips ¶ 16.

prevent him from associating with the firm while statutorily disqualified.[161] Even after learning that Mudry was statutorily disqualified, Jahre allowed Mudry to continue working for HedgeCap to raise capital for its hedge fund clients. By allowing Mudry's association in spite of his disqualified status, HedgeCap and Jahre violated Article III, Section 3(b) of FINRA's By-Laws and Rule 2110.

G. HedgeCap and Jahre Violated Art. V, § 2 of NASD By-Laws, Rule 2110, and IM-1000-1 by Willfully Filing False and Misleading Forms U4 (Count VII)

1. Findings of Fact

On May 18, 2006, six weeks after learning that Mudry was statutorily disqualified from membership, and while Mudry continued with his capital raising and other activities requiring registration, HedgeCap filed a Form U4 for Mudry in an attempt to have him reinstated notwithstanding that he was subject to statutory disqualification. An Amended Form U4 was filed on May 25, 2006, and another Amended Form U4 was filed on May 30, 2006 (collectively, the "Forms U4").[162] The two amendments were filed to supply missing information requested by NASD relating to various aspects of Mudry's extensive disciplinary history.[163]

The Forms U4 each listed Mudry's "Start Date" and "Employment Date" as May 18, 2006.[164] The Forms U4 also indicated in the "Employment History" section that Mudry had

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[161] To prevent a firm from associating with a statutorily disqualified individual, NTM 88-50 advised members to "conduct a reasonable investigation of [unregistered] persons' backgrounds to determine that they are not statutorily disqualified from becoming associated with the member." HedgeCap conducted no such investigation when it hired Mudry. Moreover, it did not even require Mudry to complete an employment application or any of the other standard "pre-hire" paperwork that it required of its other new employees.
[162] Stips ¶ 22.
[163] Stips ¶ 22; CX-130, CX-131, CX-132.
[164] Stips ¶ 23.

been "unemployed" from "11/2005 to present."[165] Each of these statements was false; Mudry had been employed by HedgeCap since November 1, 2005.[166]

By signing the May 18, 2006 Form U4, Jahre attested that he had "taken appropriate steps to verify the accuracy and completeness of the information contained in and with this application."[167] Jahre admitted that he made no effort to verify the accuracy or completeness of any of the items in Mudry's Forms U4.[168] By signing the Forms U4, Jahre also attested that he had communicated with all of Mudry's previous employers for the past three years and retained documentation in the Firm's files confirming the names of the employers contacted and the dates of those contacts.[169] Jahre admitted that he had not done this either.[170] During Jahre's investigative testimony, he confirmed that the Forms U4 were inaccurate. Nevertheless, he never sought to amend them to correct the misstatements.[171] At the hearing, Jahre admitted that the employment dates on the Forms U4 were "absolutely not true" and "totally false."[172] Jahre claimed that he never even read any of the Forms U4.[173]

Jahre electronically signed each Form U4 and was thus responsible for ensuring their accuracy.[174] Each Form U4 states that an electronic signature has the same legally binding effect as a manual signature.[175] Solano testified that he took steps to ensure that both Jahre and Mudry reviewed and approved the three false Forms U4 before filing. Solano presented Jahre with each of the false Forms U4 at the time they were submitted and had Jahre return a manually-signed

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[165] Stips ¶ 24.
[166] Stips ¶ 13; CX-84.
[167] CX-127 at 13.
[168] Tr. 929.
[169] CX-127 at 13.
[170] CX-231 at 43-44.
[171] CX-231 at 142-143.
[172] Tr. 925-927.
[173] Tr. 930, 949
[174] *See* CX-127 at 13; CX-136 at 9; CX-141 at 9.
[175] *See* CX-127 at 11; CX-136 at 8; CX-141 at 8.

copy.[176] Before filing the first false U4 on May 18, 2006, Solano sent it to Mudry, with a copy to Jahre, and instructed:

> Please review for completeness and accuracy the following attachment representing your Form U4 application with Hedge Fund Capital Partners.
>
> If correct, please have Howard and yourself sign the signature page and fax back to me. Upon receipt I will submit electronically to CRD.[177]

Mudry responded later that day "Steve, Reviewed [sic] doc and sent signed page by Howard and myself to your office."[178] As was his practice for all regulatory filings, Solano made sure to retain Jahre's manually-signed signature page in the Firm's records.[179] Solano testified that the purpose of sending the document to Jahre and Mudry, and obtaining their signatures, was to demonstrate that "they had reviewed the application for completeness and accuracy with — by the evidence of their signature. So I would not submit absent those signatures."[180]

When Solano submitted Mudry's amended Forms U4 on May 25, 2006, and May 30, 2006 (which repeated the false employment representations in the original filing),[181] he again obtained in advance a signed copy from Jahre reflecting Jahre's authorization to file the Forms U4.[182] Thus, Jahre received actual notice of the contents of the Forms U4 and specifically authorized each of the filings with a manual signature.

The false statements regarding Mudry's prior employment were clearly material, and were a deliberate attempt to hide a serious violation of NASD membership rules prohibiting

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[176] Tr. 1549-1550.
[177] CX-124 (May 18, 2006 Solano e-mail to Mudry and Jahre attaching draft Form U4).
[178] CX-128 (May 18, 2006, Mudry e-mail to Solano and Jahre); CX-134 at 13 (May 25, 2006 Mudry Form U4 with manually signed signature page); CX-140 at 13 (May 30, 2006 Mudry Form U4 with manually signed signature page); Tr. 944 (confirming Jahre's signature on CX-126); Tr. 945 (confirming Jahre's signature on CX-134); Tr. 946-947 (confirming Jahre's signature on CX-140).
[179] Tr. 1551-1552.
[180] Tr. 1550-1551.
[181] Stips ¶ 24; CX-136 at 5; CX-141 at 5.
[182] *See* CX-134 at 13 (May 25, 2006 Mudry Form U4 with manually signed signature page); CX-140 at 13 (May 30, 2006 Mudry Form U4 with manually signed signature page); CX-133 (May 25, 2006 faxed manually signed signature page for Mudry Form U4).

employment of a statutorily disqualified person. Had Jahre told the truth, NASD would have been alerted that the Firm had been employing a statutorily disqualified person for six months and that Jahre had failed in his responsibility to adequately investigate the background of a new hire. NASD would have been further alerted to the possibility — which turned out to be true — that Jahre allowed Mudry to engage in activities requiring registration.

Having observed and questioned Jahre during the hearing, the Hearing Panel did not find credible Jahre's denials that he had reviewed the Forms U4 before they were filed, and found that Jahre, and therefore, HedgeCap, willfully filed false and misleading Forms U4.

2. Conclusions of Law

It is well-established that submitting a false Form U4 is a serious violation of NASD rules. Article V, Section 2 of NASD's By-Laws requires persons who apply for registration with FINRA to provide "such . . . reasonable information with respect to the applicant as [FINRA] may require." FINRA then uses the Form U4 "to monitor and determine the fitness of securities professionals."[183] Applicants must complete a Form U4 disclosing, among other things, their employment history.

As the SEC recently reiterated, it is critical that such filings be true and accurate:

> We have repeatedly stated, "the candor and forthrightness of individuals making these filings is critical to the effectiveness of this screening process." Every person submitting Form U4 has the obligation to ensure that the information provided on the form is true and accurate. [184]

Accordingly, as FINRA made clear in IM-1000-1, filing a false Form U4 violates FINRA rules:

> The filing with FINRA of information with respect to membership or registration as a Registered Representative which is incomplete or inaccurate so as to be misleading, or which could in any way tend to mislead, or the failure to correct such filing after notice thereof, may be deemed to be conduct inconsistent with

[183] *See Dep't of Enforcement v. Kaweske,* No. C07040042, 2007 NASD Discip. LEXIS 5, at *33 (N.A.C. Feb. 12, 2007) (quoting *Rosario R. Ruggiero*, 52 S.E.C. 725, 728 (1996)).
[184] *Dep't of Enforcement v. Scott Mathis*, 2009 SEC LEXIS 4376, at *16 (Dec. 7, 2009).

> just and equitable principles of trade and when discovered may be sufficient cause for appropriate disciplinary action.[185]

There is no dispute that the three Forms U4 HedgeCap submitted on behalf of Mudry were materially false and misleading as alleged in the Complaint. Each of the forms twice misrepresented Mudry's prior six-month employment by the Firm and the May 18, 2006 Form U4 twice misrepresented Jahre's supposed investigation into his background.

As HedgeCap's president and Mudry's supervisor, Jahre was well aware that HedgeCap had been paying Mudry to work for the Firm during the six months preceding the filing of the Forms U4. Jahre's level of knowledge is well within the "willfulness" standard recently reaffirmed by the SEC:

> "[W]illfully" under the federal securities laws means that the respondent "intentionally committ[ed] the act which constitutes the violation." It does not require that the person "also be aware that he is violating one of the Rules or Acts." Thus, to find that Mathis' actions were willful, we need to find that Mathis voluntarily committed the acts that constituted the violation; it is not necessary for us to determine whether Mathis was aware of the rule he violated or whether he acted with a culpable state of mind.[186]

Put more simply by the National Adjudicatory Council ("NAC"), willfulness just requires the "intent to commit the act that constitutes the violation — completing the Form U4 inaccurately."[187] Here Jahre both knew the facts and knew that they were stated inaccurately on Mudry's Forms U4.

The Hearing Panel found that HedgeCap and Jahre violated Art. V, § 2 of NASD's By-Laws, Rule 2110, and IM-1000-1 by willfully filing false and misleading Forms U4.

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[185] IM-1001-1. *See Scott Mathis*, 2009 SEC LEXIS 4376, at *16; *Thomas R. Alton*, 52 S.E.C. at 382.
[186] *Scott Mathis*, 2009 SEC LEXIS 4376, at *19 (citing cases; footnotes omitted).
[187] *Dep't of Enforcement v. Paul Zdzieblowski*, 2005 NASD Discip. LEXIS 3, at *6 (N.A.C. May 3, 2005).

H. HedgeCap and Jahre Violated Rules 1031 and 2110 by Allowing a Registered Person to Park Her License at HedgeCap (Count VIII)

1. Findings of Fact

Jamie Lombardy ("Lombardy") left the employ of an NASD member firm in May 2004, and her license was scheduled to lapse in May 2006.[188] In April 2006, she registered with HedgeCap.[189] Lombardy's husband, Christopher Lombardy ("Mr. Lombardy"), was a partner with a compliance consulting firm that leased office space from HedgeCap and later provided legal and compliance advice to the Firm.[190] HedgeCap agreed to allow Lombardy to maintain her license at HedgeCap to prevent it from lapsing.[191] Although HedgeCap did not need Lombardy to provide any services requiring registration, it allowed her to "hang" or park her license with HedgeCap solely as an "accommodation to her husband."[192]

HedgeCap filed a Form U4 on behalf of Lombardy in April 2006, the month before her license was set to lapse.[193] It was understood at the outset that Lombardy would provide no services unless HedgeCap "ever needed some admin help" such as "data entry" that would be paid on an hourly basis.[194] She did not have an office, desk, or e-mail account at HedgeCap; she had no responsibilities; she never entered into an employment agreement with HedgeCap; she did no work; and she received no compensation or payments from HedgeCap.[195] Jahre was aware that purely ministerial services such as data entry do not require a Series 7 license or registration with NASD.[196] Instead of rejecting this proposal, Jahre viewed it as an opportunity to "make a deal" with Mr. Lombardy's firm to obtain compliance services at a lower price than

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[188] Stips ¶ 33; CX-176.
[189] Stips ¶ 36; CX-176, CX-221 at 1.
[190] Stips ¶ 34.
[191] Stips ¶ 35.
[192] CX-212 at 2, CX-174; Tr. 1216.
[193] Stips ¶ 36.
[194] CX-174, CX-175; Tr. 369-370.
[195] Tr. 1211, 427, 479-481.
[196] Tr. 1217.

HedgeCap was paying its current compliance officer, Solano.[197] Lombardy remained registered with HedgeCap until December 5, 2006, when Jahre executed a Form U5 indicating that she had been voluntarily terminated.[198]

Jahre was Lombardy's putative supervisor while she was registered with HedgeCap.[199] During his investigative testimony, Jahre acknowledged that it is "[d]efinitely not appropriate" to allow someone to hang her license with a firm when she is not providing any services, and claimed that he would never allow it.[200] At the hearing, Jahre claimed that registering Lombardy was permissible because "in the back of my mind, and it was a long shot," he considered "teach[ing] her eventually how to market and raise capital."[201]

The Hearing Panel, having listened to and observed Jahre, did not credit this belated, self-serving rationalization, which was not documented anywhere, and was belied by the written record.

2. Conclusions of Law

NASD Rule 1031(a) specifically prohibits a firm from allowing a registered person to park his or her license at the firm:

> A member shall not maintain a representative registration with [FINRA] 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 requirements prescribed in paragraph (c).

When HedgeCap filed a Form U4 for Lombardy in April 2006, one month before her license was scheduled to lapse, it did so solely as an accommodation to her husband, who was a

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[197] CX-174.
[198] Stips ¶ 36.
[199] Stips ¶ 37; Tr. 1217.
[200] CX-231 at 183-184.
[201] Tr. 1214.

tenant at HedgeCap. Contemporaneous e-mails, which Jahre sent or received, confirm that HedgeCap contemplated she would perform no services except possibly assisting with data entry for $12 an hour. Such administrative activities do not warrant registration, so it was clear at the outset that her registration with HedgeCap was designed to prevent Lombardy's registration from lapsing. As discussed above, during the eight-month period when she parked her license with HedgeCap, Lombardy did nothing for HedgeCap (not even administrative work). She was not provided with any of the usual indicia of employment, such as an e-mail address, and HedgeCap never assigned her any responsibilities or paid her any money. By allowing her to park her license, HedgeCap violated Rules 1031 and 2110.

Jahre also violated Rules 1031 and 2110 because he was aware from e-mails that she was going to perform, at most, administrative tasks that did not require registration. Jahre approved the parking arrangement beforehand, he was Lombardy's designated supervisor during her eight-month tenure with HedgeCap, and he signed her Form U4.

I. HedgeCap Violated Rules 3110 and 2110 by Failing to Retain E-Mails and Instant Messages (Count IX)

1. Findings of Fact

HedgeCap stipulated that HedgeCap did not have a system during the Review Period that allowed it to ensure that the Firm's e-mails and instant messages (IMs) were retained, backed up, or otherwise kept available for regulatory review.[202] HedgeCap's failure contravened its own WSPs, which recognized the requirement to preserve e-mails and IMs and contained detailed procedures for doing so.[203]

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[202] Stips ¶ 38.
[203] CX-1 at 30–32.

a. E-mails

With respect to e-mails, HedgeCap's WSPs required that all e-mails related to HedgeCap's business use the Firm's e-mail system, and represented that all of those e-mails would be automatically retained.[204]

Contrary to what its WSPs stated, HedgeCap did not require all of its registered representatives and other employees to use the Firm's e-mail system.[205] Among others, Napolitani and Mudry used non-HedgeCap e-mail addresses to conduct HedgeCap business.[206] HedgeCap did not assign a HedgeCap e-mail address to any of the independent contractors who raised capital for hedge funds on HedgeCap's behalf, even though they were HedgeCap registered representatives. Those contractors used non-HedgeCap e-mail accounts that were not directly accessible by HedgeCap personnel for supervisory review, and contractor e-mails were not regularly preserved in HedgeCap's records.[207]

Similarly, and again contrary to the Firm's WSPs, HedgeCap did not preserve all e-mails of personnel who used a HedgeCap e-mail account. The Firm did not maintain an "archive server" or any other "database of current and historical messages" described in the WSPs.[208] Rather, if users decided to delete their e-mail, that e-mail was "gone."[209] The only way an e-mail would be preserved at HedgeCap was if an individual user chose to keep the e-mail in an electronic folder or in hard copy.[210]

The WSPs also stated that Jahre, or a designated supervisor, on a "semi-annual basis," would review the Firm's e-mail archiving process to ensure that "messages are properly retained

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[204] CX-1 at 30-31.
[205] Stips ¶ 42.
[206] Tr. 145-147; CX-83.
[207] Stips ¶ 43.
[208] Stips ¶¶ 39, 44.
[209] Tr. 1119.
[210] Stips ¶ 39.

on the e-mail server and then transferred to the archive server." The results of this review were required to be "documented in the E-mail Review File."[211] In fact, nobody at HedgeCap performed the required review, and consequently none of the reviews were documented in any of HedgeCap's files.[212] HedgeCap did not review any of its employees' e-mails until April 2006, when Napolitani began monitoring Mudry's e-mails.[213] Notwithstanding his supervisory responsibility to review e-mails of the Firm's registered representatives, Jahre never reviewed anyone's e-mails at HedgeCap, and did not ensure that somebody else conducted such a review.[214]

b. Instant Messages

With respect to IMs, the Firm's WSPs claimed that HedgeCap adopted an "Omnipod IM System," but the Firm never actually did so.[215] Although HedgeCap's WSPs stated that HedgeCap had in place filters blocking connections to IM services,[216] HedgeCap did not block all of the Firm's users from access to outside IM services, and some of its associated persons used outside IM services for business purposes.[217] IMs were not retained unless an individual HedgeCap employee installed IM retention software on his or her work computer.[218]

The WSPs also required Jahre, or a designated supervisor, on a "semi-annual basis" to review, and document the review of, the Firm's IM procedures, to determine if "instant messages are properly recorded and maintained."[219] Nobody performed the required review, and

[211] Stips ¶ 45; CX-1 at 31.
[212] Stips ¶ 45.
[213] Tr. 1132, 1127.
[214] CX-231 at 56-60.
[215] Stips ¶ 40.
[216] CX-1 at 31.
[217] Stips ¶ 41.
[218] Stips ¶ 41.
[219] Stips ¶ 46.

consequently none of the reviews were documented in any of HedgeCap's files.[220] Jahre knew that HedgeCap employees used instant messaging for business purposes and that instant messages were not being retained,[221] but did not consider obtaining IM retention systems because of the associated costs.[222]

Jahre, who was responsible for ensuring that the Firm had an e-mail retention and archiving system,[223] was specifically and repeatedly advised as early as November 2005 that HedgeCap did not have, and needed to adopt, electronic record retention systems.[224] Solano further advised Jahre by April 2006 that HedgeCap needed e-mail and IM retention systems, but Jahre refused to act on that advice, citing the time and expense involved.[225]

HedgeCap's failure to have e-mail and IM retention systems impeded the investigation that led to this proceeding.[226] When FINRA's Enforcement staff requested the production of e-mails and IMs during the course of its investigation, HedgeCap represented that it was unable to produce many of the requested communications as a result of the Firm's failure to properly retain its electronic communications.[227] HedgeCap did not implement e-mail or IM retention systems until July 2007.[228]

2. Conclusions of Law

Member firms' responsibility to retain electronic records such as e-mails and IMs relating to their business is well-established.[229] Section 17(a)(1) of the Exchange Act requires broker-

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[220] CX-231 at 165-66; Tr. 342-343.
[221] Tr. 344-345, 347.
[222] Tr. 339.
[223] CX-1 at 30-31; Tr. 1572-1573.
[224] CX-179; Tr. 1159.
[225] Tr. 1575-1576.
[226] Tr. 643.
[227] CX-208 at 21-25.
[228] CX-208 at 22.
[229] *See* NASD NTM 03-33 at 344–45 (July 2003); *Dep't of Enforcement v. Legacy Trading Co.*, No. 2005000879302, 2009 FINRA Discip. LEXIS 12, at *54-*55 (N.A.C. Mar. 12, 2009).

dealers to "make and keep for prescribed periods" such records as the SEC prescribes by rule as necessary or in the public interest. Under Exchange Act Rule 17a-4(b)(4), broker-dealers are required to "preserve for a period of not less than 3 years, the first two years in an accessible place . . . [o]riginals of all communications received and copies of all communications sent . . . by the member, broker or dealer (including inter-office memoranda and communications) relating to its business as such."

FINRA Rule 3110, in turn, requires its members to preserve records in accordance with the SEC's rule. Electronic communications fall within the purview of Rule 3110, and failing to preserve e-mails and IMs relating to a broker-dealer's business violates the rule.[230]

As discussed above, HedgeCap did not retain numerous e-mails and IMs during the relevant period. HedgeCap's failure to preserve a substantial portion of its e-mails and IMs violated Section 17(a)(1) of the Exchange Act, Rule 17a-4(b)(4) thereunder, and NASD Rules 3110 and 2110.

J. HedgeCap and Jahre Violated Rules 3010(a), 3010(b), and 2110 by Failing to Supervise Registered Representatives and Associated Persons (Count X)

1. Findings of Fact

At the hearing, Jahre repeatedly tried to blame Solano or Napolitani for HedgeCap's violations, but Solano was never a supervisor, and Napolitani did not have a supervisory license or any supervisory authority. Solano was a part-time CCO, and visited HedgeCap's offices just five to ten times during the 14 months he acted as the Firm's CCO.[231] Although Solano held a Series 24, he never supervised anyone at HedgeCap.[232] Solano testified that he addressed any

[230] *See Legacy Trading*, at *54-*55 (failure to preserve e-mails); NTM 03-33 at 345 (IMs).
[231] Tr. 81, 403-404.
[232] Tr. 1462, 1479; CX-1 at 6-7.

issues relating to supervision with Jahre, and reported any compliance problems to Jahre.[233] In any event, Jahre had "first and final say on every matter," including compliance issues. Solano testified that "it was made clear to me very early on that this was his operation, his business, and he would run it his way."[234] Solano typically did not know anything about compliance issues HedgeCap faced unless someone at HedgeCap let him know about them, and Jahre limited Solano's access to information regarding HedgeCap's business and decision-making processes.[235]

Napolitani worked at HedgeCap between June 2005 and April 2008.[236] Napolitani had Series 62 and 63 licenses, but not a Series 24 or other license qualifying him to act in a supervisory capacity while at HedgeCap.[237]

Jahre was HedgeCap's only supervisor during the Review Period, but he admitted that supervision "bores me."[238] Jahre's lack of interest in supervision resulted in an utter failure to know or enforce supervisory procedures. Among other things, Jahre testified that he does "not know all the rules, and I admit to it."[239] Jahre did not read HedgeCap's WSPs in any detail,[240] and did not even attempt to follow the WSPs because, as Jahre put it, "if I would run the firm according to these WSPs, I would be out of business."[241]

Jahre testified that he did not document his many purported delegations of authority, and repeatedly demonstrated contempt for basic notions of responsible supervision. He testified, "I don't write things down in a little notebook like I'm in kindergarten. I mean I'm running a

[233] Tr. 1494, 1515.
[234] Tr. 1479-1480.
[235] Tr. 544, 1491-1498.
[236] CX-216 at 5; Tr. 69-70.
[237] CX-216 at 9; Tr. 67.
[238] CX-231 at 140.
[239] Tr. 922.
[240] Tr. 1980, 1990.
[241] Tr. 1230.

business."[242] Jahre claimed that Napolitani was responsible for "everything to do with e-mails, instant messages, and computers;" but Jahre never made a written delegation to that effect. Jahre said, "[i]f I had to write everything down on the WSPs, I could never make any money."[243]

When confronted at the hearing with damaging e-mails, Jahre asserted that he hadn't read e-mails sent directly to him by the people he was supposed to supervise. He then admitted that this was not appropriate supervision, and that "I did not do a good job supervising my employees" with regard to reviewing e-mails.[244]

Jahre's, and therefore, HedgeCap's failure to supervise activities at the Firm resulted in numerous violations, as discussed in Sections A through I, above. In addition, although HedgeCap was required to hold a live annual compliance meeting that permitted interactive communication (NASD Rule 3010(a)(7)), in 2005, to save money, Solano merely distributed a PowerPoint presentation on compliance issues by e-mail for employees to read on their own.[245]

2. Conclusions of Law

Many of the violations in this case could have been avoided by diligent and responsible supervision.

Rule 3010(a) requires firms to establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with the applicable securities laws and regulations. Rule 3010(b) requires that each firm establish, maintain and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of registered persons and other associated persons that are reasonably designed to achieve compliance with the applicable laws, rules and regulations. Here,

[242] Tr. 1169-1170.
[243] Tr. 1166-1167.
[244] Tr. 1162-1163.
[245] CX-198, CX-193, CX-194; Tr. 1682-1684.

HedgeCap's WSPs addressed e-mail and IM retention, registration of representatives, soft dollar arrangements, and the like, but they were not enforced.

Although supervisory deficiencies permeate most of the violations, the Complaint charges that HedgeCap and/or Jahre failed to maintain or enforce an adequate supervisory system in three distinct ways.

First, HedgeCap had policies and procedures in its WSPs requiring it to retain e-mails and IMs. The WSPs even specified the retention system and software the Firm would use to retain its IMs. However, the Firm (and Jahre) made no effort to implement a retention system, notwithstanding its own procedures and warnings by its CCO, Solano, and others that a retention system was necessary. HedgeCap and Jahre failed to implement a critical supervisory tool that would have allowed it to adequately monitor its employees' communications and, when NASD sought e-mails as part of its investigation, to comply with regulatory requests. By failing to maintain a supervisory system to preserve electronic communications, HedgeCap and Jahre violated Rules 3010(a) and 2110, and by failing to enforce written procedures designed to preserve these communications, HedgeCap and Jahre violated Rules 3010(b) and 2110.

Second, HedgeCap's procedures and NASD Rule 3010(a)(7) required the firm to hold an annual compliance meeting. NASD Notice to Members 98-18 specified that meetings require live attendance: "This means, at a minimum, that the representatives that attend the compliance conference must be able to hear presenters live and, in an interactive environment, ask questions and engage in dialogue with the presenters."[246] In 2005, HedgeCap did not hold a live meeting that allowed for interactive questioning. Instead, to save money, HedgeCap simply sent around a

[246] NASD NTM 98-18 (Feb. 1998).

PowerPoint presentation for employees to read on their own. By failing to hold the required meeting, HedgeCap violated NASD Rules 3010(a)(7) and 2110.[247]

Third, NASD registration rules and HedgeCap's own WSPs required its representatives to be properly registered. Nevertheless, the Firm allowed hedge fund marketers (including, most egregiously, Mudry) to market to potential investors before they were licensed with NASD. Jahre was the direct supervisor of all of these individuals and he was aware of their marketing activities. If HedgeCap and Jahre had been adequately supervising Mudry and the other hedge fund marketers, the Firm could have ensured that they were properly registered.[248] By failing to maintain a supervisory system to ensure that none of its unregistered employees and marketers engaged in activities requiring registration, HedgeCap and Jahre violated Rules 3010(a) and 2110. Moreover, by failing to enforce HedgeCap's own written procedures requiring such registration, HedgeCap and Jahre violated Rules 3010(b) and 2110.

K. HedgeCap and Jahre Violated Rules 8210 and 2110 by Providing False Responses to Requests for Information, Documents, and Testimony (Count XI)

1. Findings of Fact

a. FINRA's Investigation

FINRA's lead investigator on this matter, Hubbard, testified that FINRA's investigation began in January 2006 and required over two years to complete.[249]

FINRA encountered several difficulties in obtaining relevant information. Enforcement sent numerous letters to HedgeCap pursuant to Rule 8210 that required the Firm to respond, in writing, to specific questions that were relevant to Enforcement's investigation. HedgeCap

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[247] Because HedgeCap's WSPs assigned this responsibility to HedgeCap's CCO, Solano, Jahre was not charged with this particular aspect of the alleged violation.
[248] As NTM 88-50 advises, Mudry's unregistered status was a red flag that his association with the firm might pose an even more serious problem: He might be statutorily disqualified (he was).
[249] Tr. 562-563.

repeatedly provided misleading and inaccurate responses to Enforcement's questions regarding at least five separate aspects of its operations. Jahre directly made, was involved in the preparation of, or approved the misleading responses. Jahre acknowledged that he read all of HedgeCap's 8210 responses before they went out, and that the responses could not be sent without his approval.[250] As detailed below, the Hearing Panel concluded that Jahre also testified falsely in his investigation testimony requested pursuant to Rule 8210.

b. HedgeCap's False Responses Regarding Soft-Dollar Payments (8210 Responses and Jahre's OTR Testimony)

Enforcement's first 8210 request, in January 2006, sought information regarding, among other things, "all services including but not limited to office space . . . provided to any hedge funds that maintain an account at your firm" in order to explore whether HedgeCap accepted soft dollars for rent.[251] HedgeCap's response did not disclose any soft dollar arrangements. Instead, Jahre responded on behalf of the Firm that "[t]he sole services HedgeCap provides to the hedge funds maintained at the Firm is the use of office space in return for hard dollars."[252]

Consequently, Enforcement's next information request regarding rental arrangements with hedge fund tenants asked only about hard dollar payments for rent.[253] HedgeCap responded that it did not receive any hard dollar rent.[254] Enforcement followed up again, this time asking for more information on office space provided to hedge funds.[255] HedgeCap's response once again did not disclose any information about soft dollar rental payments, stating instead that rent

[250] Tr. 1208-1209, 1252-1253.
[251] Stips ¶ 49.
[252] Stips ¶ 50.
[253] CX-201 at 2 (questions 3a–3c); Tr. 575-577.
[254] CX-202 at 2; Tr. 577-578.
[255] CX-203; Tr. 579.

"was waived," and volunteered several reasons why those firms separately chose to trade with HedgeCap — none of which were related to any soft dollar arrangements.[256]

By November 1, 2006, Enforcement had reviewed HedgeCap's initial document production.[257] Contrary to HedgeCap's 8210 responses, e-mails in that production "were showing that there were potential existing soft dollar arrangements related to office space."[258] For that reason, Enforcement's next 8210 request asked HedgeCap to "[i]dentify the name of each hedge fund manager that HedgeCap provided office space to between January 1, 2006 and September 20, 2006" and to provide a "description of the terms of the arrangement" and other details. Once again, however, HedgeCap's response failed to acknowledge the existence of soft dollar rental arrangements (including the arrangement with Bigger Capital discussed above). Although the response identified Bigger Capital and four other hedge funds as tenants, it claimed that all tenants paid "Monthly Rent;" specifically, Bigger Capital had paid "Monthly Rent" of $375 for the office space since October 2005.[259] HedgeCap's responses were false. Bigger Capital paid all of its rent for HedgeCap's office space with soft dollars, and one of the other hedge funds paid some of its rent with soft dollars.[260]

Jahre amplified HedgeCap's false and misleading statements when, at his OTR on March 27, 2007, he volunteered that HedgeCap rented out space at market rates payable in hard dollars. During the testimony, staff asked Jahre about HedgeCap's written 8210 responses that the Firm did not accept soft dollars for rent. Jahre responded that HedgeCap's tenants only paid rent in "[h]ard dollars," that there was "no expectation of a soft dollar trade," that there was "no expectation that those tenants would trade through [HedgeCap] as part of an agreement for their

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[256] CX-204 at 2.
[257] Tr. 581.
[258] Tr. 583.
[259] Stips ¶ 52.
[260] Stips ¶ 53.

space," and that there were no trading "minimums" that were part of any rental arrangements.[261] Enforcement followed up by asking whether there was "any expectation of a soft dollar trade that would be generated through your firm?" Jahre responded, "[n]ot at all."[262]

On June 22, 2007, Enforcement sent yet another 8210 request seeking information regarding HedgeCap's soft-dollar rental arrangements.[263] The 8210 request asked HedgeCap to affirm the completeness and accuracy of its prior responses, and asked Jahre to sign a declaration "certifying that the documents and information provided" in the response "are complete and accurate."[264] Hubbard testified that such requests are made "very infrequent[ly]" and that they were included "to kind of reinforce our interest in getting complete and accurate information."[265]

HedgeCap's response finally acknowledged that it had negotiated soft dollar rental arrangements with Bigger Capital and two other hedge funds.[266] But even then, HedgeCap claimed that each of those funds' offering documents allowed soft dollar rental arrangements.[267] As discussed above, with respect to Bigger Capital, this was false.

The Hearing Panel, having observed and questioned Jahre, found that Jahre knew his OTR testimony was false when he gave it, and that the 8210 responses were carefully orchestrated to impede NASD's investigation. As detailed above, Jahre was directly involved with the Bigger Capital and other soft dollar arrangements into which HedgeCap entered.

HedgeCap's refusal to provide complete and accurate responses to Enforcement's requests necessitated multiple requests on the same topic. This delayed FINRA's investigation in two ways: first, FINRA had to make repeated requests for the same information; and second,

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[261] Stips ¶ 54.
[262] Stips ¶ 54; CX-229 at 32-33.
[263] CX-207.
[264] CX-207 at 4-5, 7.
[265] Tr. 596-597.
[266] CX-208 at 9-10; Tr. 599-601.
[267] CX-208 at 9-10; Tr. 600-602.

new or different information provided in later responses required FINRA to revisit and redo its analyses based on the prior, incomplete information initially provided.[268]

c. HedgeCap's False Responses Regarding Fletcher's E-mails

On August 17, 2006, FINRA sent HedgeCap a letter pursuant to NASD Rule 8210 requesting that HedgeCap produce all e-mails sent or received by Steven Fletcher and others between January 1, 2004, and December 31, 2005.[269] In its response letter dated August 31, 2006, HedgeCap enclosed a CD containing some of Fletcher's e-mails and represented that "all electronic communications sent or received by [Fletcher and others] have been compiled and reproduced on compact disc and enclosed as Exhibit A."[270] At the time HedgeCap sent the August 31, 2006 letter, HedgeCap had been unable to compile and produce all of Fletcher's e-mails created during the request period. Many of Fletcher's e-mails were no longer available.[271]

On August 28, 2006, three days before HedgeCap responded to NASD's Rule 8210 request, Napolitani wrote an internal e-mail stating that "obtaining [Fletcher's] e-mails from 2005 is going to be a problem." Napolitani also internally forwarded to Jahre an e-mail stating that (1) "Fletcher's e-mails were not archived"; (2) "once an e-mail is deleted it is gone"; and (3) Fletcher "had a worm in his computer earlier this year" that caused him to lose a "lot of data."[272]

On June 22, 2007, NASD sent HedgeCap a letter pursuant to Rule 8210 that asked whether Fletcher's firm, Cyprian Consulting, failed to retain e-mails.[273] HedgeCap's July 20, 2007 response letter stated "HedgeCap believes all e-mails for Broadreach and Cyprian have

[268] Tr. 641-642.
[269] Stips ¶ 60.
[270] Stips ¶ 61.
[271] Stips ¶ 62.
[272] Stips ¶ 63.
[273] Stips ¶ 64.

been retained."[274] But HedgeCap was not able to produce all of Fletcher's e-mails.[275] HedgeCap's response letter was signed by HedgeCap's counsel. At FINRA's request, Jahre executed a Declaration "under penalties of perjury" that "certif[ied] that to the best of my knowledge the Response and all documents produced thereunder, are complete and accurate."[276] HedgeCap never admitted in its response to any of the 8210 requests that its production of Fletcher's e-mails was incomplete.[277]

d. HedgeCap's False Response Regarding E-mail Retention

On November 1, 2006, NASD sent a letter pursuant to Rule 8210 asking HedgeCap to "describe all policies and procedures relating to the retention and archiving of e-mails" sent or received by HedgeCap's electronic communication systems.[278] Enforcement made this request because, based upon its review of the e-mails HedgeCap had thus far produced, Enforcement was concerned that HedgeCap was not retaining e-mails.[279]

On December 15, 2006, HedgeCap responded through its counsel by letter as follows:

> [HedgeCap] has utilized the services of an outside vendor, IT Builders, for all IT solutions, including the implementation of a full document retention and storage system. IT Builders is utilizing the services of my [sic] BackUpMyInfo, Inc. . . . to effectuate the system.[280]

As discussed above, this response and related responses were false, and Jahre knew it, because the Firm's lack of e-mail and IM retention had been repeatedly brought to Jahre's attention.[281] Jahre reviewed and approved HedgeCap's December 15, 2006 response to FINRA

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[274] Stips ¶ 65.
[275] Stips ¶ 63; Tr. 1585.
[276] Stips ¶ 66.
[277] Tr. 605.
[278] Stips ¶ 47.
[279] Tr. 606-607.
[280] Stips at ¶ 48.
[281] Stips ¶¶ 38-39, 42-43.

before it was sent.[282] Many months later, after Enforcement staff further questioned HedgeCap regarding its inability to produce certain e-mails that had supposedly been backed up, HedgeCap sent a Rule 8210 response dated July 20, 2007, that conceded that its earlier response regarding e-mail and IM retention was inaccurate.[283]

e. HedgeCap's False Responses Regarding Hedge Fund Marketing

On January 25, 2006, Enforcement sent HedgeCap a letter pursuant to NASD Rule 8210 requesting HedgeCap to "indicate if the firm sells or offers interest in" each hedge fund that maintained an account at HedgeCap in 2004 or 2005.[284] FINRA also requested the "total dollar amount placed or sold for each fund" and copies of all "[s]ales, marketing, and advertising materials" for each fund.[285]

In its response letter dated February 14, 2006, HedgeCap identified five hedge funds that maintained accounts at HedgeCap during the 2004–2005 period, including Bigger Capital, but claimed that HedgeCap did not perform any capital introduction services on their behalf.[286] In fact, in 2005, registered representatives of HedgeCap performed capital introduction services for Bigger Capital and two other hedge funds. HedgeCap's registered representatives sometimes sent materials as part of their marketing efforts.[287] Jahre was the direct supervisor of the hedge fund marketers.[288]

[282] Tr. 141, 1260-1261.
[283] CX-208 at 23.
[284] Stips ¶ 67.
[285] Stips ¶ 67.
[286] Stips ¶ 68.
[287] Stips ¶ 69.
[288] Stips ¶ 71.

Because of an oversight, the 8210 response letter of February 14, 2006, was not signed in the space for Jahre's signature. However, the Parties stipulated that Jahre and Napolitani were the primary authors.[289]

f. HedgeCap's False Response Regarding Approval of Sales Materials

On August 17, 2006, FINRA sent HedgeCap a letter pursuant to NASD Rule 8210 seeking details regarding "HedgeCap's process for reviewing and/or approving hedge fund sales materials used by its employees in providing capital introduction services" between January 1, 2004, and December 31, 2005, including the individuals responsible for review and approval and how they evidenced such review and approval.[290]

HedgeCap's response letter dated August 31, 2006 stated in part that the Firm "review[ed] . . . [and] approved the hedge fund sales materials used by its employees in providing capital introductions . . . ."[291] That letter also stated, in part, that such reviews and approvals were performed by Michael Leverone and Steven Fletcher, who "evidenced their approval with their signatures."[292]

Leverone and Fletcher were independent contractors who were registered with HedgeCap for the purpose of making capital introductions to hedge fund managers through HedgeCap.[293] Jahre was their supervisor.[294] Leverone and Fletcher did not approve, or evidence their approval of, HedgeCap's sales materials.[295] They were not authorized by HedgeCap's WSP manual to approve hedge fund sales materials on HedgeCap's behalf.[296]

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[289] Stips ¶ 70.
[290] Stips ¶ 55.
[291] Stips ¶ 56.
[292] Stips ¶ 56.
[293] Stips ¶ 57.
[294] *Id.*
[295] *Id.* ¶ 58.
[296] *Id.*

Jahre signed and helped draft HedgeCap's 8210 response letter of August 31, 2006.[297] As the direct supervisor of Leverone and Fletcher, and the President of HedgeCap, Jahre knew that Leverone and Fletcher lacked authorization to approve hedge fund sales materials and that neither Leverone nor Fletcher reviewed or approved any such materials on HedgeCap's behalf.

2. Conclusions of Law

Rule 8210 requires member firms and persons subject to FINRA's jurisdiction to provide information requested by FINRA. Because FINRA lacks subpoena power, it must rely upon Rule 8210 "to police the activities of its members and associated persons."[298] The failure to respond truthfully to FINRA requests for information, whether in writing or in oral testimony, constitutes a violation of Rule 8210.[299] The SEC recently reiterated that "supplying false information to NASD during an investigation . . . 'mislead[s] NASD and can conceal wrongdoing' and thereby 'subvert[s]' NASD's ability to perform its regulatory function and protect the public interest."[300] Indeed, untruthful responses are "as harmful as a complete failure to respond and, as such, . . . a bar is the appropriate sanction."[301] Providing false information to NASD is an independent violation of NASD Rule 2110.[302]

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[297] Stips ¶ 59.
[298] *Joseph Patrick Hannan*, Exchange Act. Rel. No. 40438, 53 SEC 854, 858-59 (Sept. 14, 1998).
[299] *Dist. Bus. Conduct Comm. v. Doshi,* No. C10960047, 1999 NASD Discip. LEXIS 6 (N.A.C. Jan. 20, 1999) (imposing a bar for lying during investigative testimony).
[300] *See Geoffrey Ortiz*, Exchange Act. Rel. No. 58416, 2008 SEC LEXIS 2401, at *32 (Aug. 22, 2008) (quoting *Michael A. Rooms*, Exchange Act Rel. No. 51467, 2005 SEC LEXIS 728 (Apr. 1, 2005), *aff'd*, 444 F.3d 1208 (10th Cir. 2006)).
[301] *Dep't of Enforcement v. Duma*, No. C8A030099, 2005 NASD Discip. LEXIS 46, at *29 n.16 (N.A.C. Oct. 27, 2005). *See Dep't of Enforcement v. Legacy Trading Co., LLC and Mark Uselton*, No. 2005000879302, 2009 FINRA Discip. LEXIS 12, at *64 (Mar. 12, 2009) (expelling firm and barring president); *Dep't of Enforcement v. Masceri*, No. C8A040079, 2006 NASD Discip. LEXIS 29, at *35–*39 (N.A.C. Dec. 18, 2006).
[302] *See Geoffrey Ortiz*, 2008 SEC LEXIS 2401, at *23–24 (citing *Rooms v. SEC*, 444 F.3d 1208, 1214 (10th Cir. 2006) (determining that respondent engaged in conduct contrary to just and equitable principles of trade by providing false information to NASD).

FINRA sent numerous 8210 letters to HedgeCap during the course of the investigation. The Firm repeatedly provided false answers on five separate topics, and thereby violated Rules 8210 and 2110.

Because Jahre signed, certified, or was closely involved in the preparation of each of the inaccurate responses, he personally violated Rules 8210 and 2110.[303] This case is similar to *Harvest Capital*, in which the NAC held not only the firm, but also the firm's principal, Cotto, responsible for his firm's incomplete and misleading responses to FINRA's 8210 requests.[304] Like Jahre, Cotto owned the firm, actively managed its business, and made decisions regarding the hiring and firing of employees. The NAC ruled that Cotto and Harvest Capital's incomplete and misleading responses to requests for information were egregious and "willfully deficient," warranting a bar for Cotto and an expulsion for his firm.[305] Jahre and HedgeCap's consistent pattern of false and misleading responses similarly frustrated Enforcement's investigation of this matter, and therefore constituted egregious violations of Rules 8210 and 2110.

Jahre also violated Rule 8210 by knowingly providing false testimony in his OTR when he claimed that HedgeCap did not allow any of its hedge fund clients to use soft dollars to pay for rent. HedgeCap was a hedge fund hotel that made soft dollar arrangements with several of its tenants, all with Jahre's participation; thus, Jahre certainly knew that his testimony was false.

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[303] *See Dep't of Enforcement v. Harvest Capital Inv., LLC*, No. 2005001305701, 2008 FINRA Discip. LEXIS 45 (N.A.C. Oct. 6, 2008). In *Dep't of Enforcement v. Harrison A. Hatzis*, OHO 2006005178801 (Mar. 22, 2010), the president and owner of firm who signed documents sent to FINRA (an application for membership) was deemed to be ultimately responsible for accuracy of information even though he had counsel assist in the process. *See id.* ("Moreover, '[i]t is axiomatic that the person who provides information for a regulatory filing and executes that filing is responsible for ensuring that the information contained therein is accurate.' (citing *Dep't of Enforcement v. Howard*, No. C11970032, 2000 NASD Discip. LEXIS 16, at *31 (N.A.C. Nov. 16, 2000)).

[304] *See Harvest Capital*, at *39.

[305] *Id.* at *54-56.

Like false written responses to Rule 8210 requests, false testimony violates Rules 8210 and 2110.[306]

V. Sanctions

After listening to, observing, and asking its own questions of Jahre during his three days of testimony, the Hearing Panel concluded that virtually every violation stemmed from Jahre's disregard for the rules and regulatory structure that govern a brokerage firm. As HedgeCap's principal, Jahre was responsible for ensuring that the Firm and its employees complied with the securities laws and FINRA rules in the conduct of its business. Yet, he displayed contempt and even hostility towards his supervisory responsibilities, and appeared willfully ignorant of FINRA rules. While recognizing that he was ultimately responsible for supervision at HedgeCap, he admitted that he was most concerned with running his business. He did not seem to know or care whether FINRA rules or HedgeCap's WSPs were being followed, and considered regulation to be a nuisance and an impediment to running his business.

In determining sanctions, the Hearing Panel considered the FINRA Sanction Guidelines ("Guidelines")[307] as well as the Guidelines' Principal Considerations in Determining Sanctions ("Principal Considerations").[308]

A. Failure to Respond Truthfully in Response to Rule 8210 Requests for Information and Testimony (Count Eleven — HedgeCap and Jahre)

The Hearing Panel found that the Respondents' failure to provide truthful responses to FINRA's Rule 8210 requests was egregious and most troubling. As discussed above, the Hearing Panel found that the false written responses to requests for information and Jahre's false investigative testimony were deliberate attempts to prevent Enforcement from uncovering the

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[306] *See Dep't of Enforcement v. Taylor*, No. C8A050027, 2005 NASD Discip. LEXIS 53 (N.A.C. Dec. 30, 2005).
[307] FINRA Sanction Guidelines (2007), *available at* www.finra.org/sanctionguidelines.
[308] *Id.* at 6-7.

Respondents' violations. The Guidelines provide that in an egregious case of a firm or individual failing to respond truthfully to requests for information, an adjudicator should consider expelling the firm and barring the individual. If mitigation exists, the Guidelines direct the adjudicator to consider suspending the firm and individual for up to two years. The Principal Considerations to be used in determining sanctions are: (1) the nature of the information requested; and (2) whether the requested information has been provided, and if so, the number of requests made, the time respondent took to respond, and the degree of regulatory pressure required to obtain a response.[309]

This case is egregious, and there are no mitigating facts. The information FINRA sought pertained to an investigation of HedgeCap's practices with its hedge fund clients, and the false information HedgeCap and Jahre gave FINRA investigators misled the investigators, and required them to send multiple requests, needlessly prolonging the investigation.

The Hearing Panel concludes that the egregious nature of the Respondents' violations coupled with the lack of any mitigating factors warrant HedgeCap's expulsion from FINRA membership and Jahre's bar from the securities industry. The risk of harm to investors and the markets posed by providing false information and obstructing FINRA's investigation renders the violators presumptively unfit for employment in the securities business.[310] FINRA's ability to request and obtain information from its members and their associated persons is crucial to FINRA's performance of its regulatory mission.[311] Supplying false information to FINRA during an investigation subverts FINRA's ability to perform its regulatory function and protect the

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[309] Guidelines, at 35.
[310] *Geoffrey Ortiz*, 2008 SEC LEXIS 2401, at *32.
[311] *Dep't of Enforcement v. Ortiz*, No. E0220030425-01, 2007 FINRA Discip. LEXIS 3, at *33 (N.A.C. Oct. 10, 2007) *aff'd,* Exchange Act Release No. 58416, 2008 SEC LEXIS 2401 (Aug. 22, 2008).

public interest.[312] Here, the evidence amply demonstrates Jahre's untruthfulness and his unwillingness to comply with FINRA's Conduct Rules. The Hearing Panel concluded that he poses too great a threat to the investing public to permit him to remain in the securities industry. Accordingly, the Hearing Panel will expel HedgeCap and bar Jahre for providing false information in response to requests for information pursuant to Rule 8210.[313]

B. Willfully Filing a False Form U4 (Count Seven — HedgeCap and Jahre)

The Hearing Panel finds the violations in Count Seven to be egregious. In addition to the Principal Considerations discussed above, the Guidelines for false Form U4 violations[314] advise consideration of the "nature and significance of the information at issue." By lying about Mudry's start date, HedgeCap and Jahre concealed the fact that they had associated with a statutorily disqualified individual for the past six months. Their misrepresentation would also discourage any inquiry into whether Mudry was engaged in activities requiring registration during that period (he was). Jahre was personally involved in bringing Mudry to HedgeCap, failing to investigate his background, overseeing his activities, and filing the three false Forms U4 at issue.

The Hearing Panel finds that Jahre and HedgeCap's egregious violations were intentional and willful, and that they should therefore be expelled and barred from the securities industry.

C. Associating With a Statutorily Disqualified Person (Count Six — HedgeCap and Jahre)

The Hearing Panel finds that HedgeCap and Jahre's association with a statutorily disqualified person was also egregious and warrants HedgeCap's expulsion and Jahre's bar from

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[312] *Id.*
[313] The Hearing Panel did not fine the Respondents in light of the imposed sanctions. *See* NASD NTM 99-86, 1999 NASD LEXIS 63 (Oct. 1999).
[314] Guidelines, at 73–74.

the securities industry. The Guidelines for disqualification-related violations[315] advise consideration of the following:

"Nature and extent of the disqualified person's activities and responsibilities." Mudry not only associated with HedgeCap, he was allowed to hold himself out as a "managing director" of the Firm and actively sought to bring in clients for all three of HedgeCap's business lines: rental of office space, introduction of capital for hedge funds, and providing order flow for the agency trading desk. Jahre oversaw all of these activities.

"Whether Form MC-400 application was pending:" Mudry actively pursued HedgeCap's business during all of the 11 months that preceded HedgeCap's filing of his MC-400 application.

"Whether disqualification resulted from financial and/or securities misconduct:" Although Mudry's automatic disqualification resulted from his failure to cooperate in the NYSE's investigation of him, that investigation arose after Mudry settled serious allegations of fraud and other misconduct with the State of Maine, the State of New Jersey, and his prior employer, and paid over $800,000 in fines and restitution. Jahre was aware of this history by at least early April 2004, but continued to encourage his activities on behalf of the Firm for an additional nine months.

The Hearing Panel finds that Jahre's and HedgeCap's violations were egregious and therefore barred and expelled them, respectively, from the securities industry.

D. Counts One, Two, Three, Four, Five, Eight, Nine and Ten

All of the remaining violations, considered in light of the Principal Considerations in Determining Sanctions, aggravate the already egregious violations discussed above.[316] The violations resulted primarily from Jahre's inadequate supervision of HedgeCap and its associated

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[315] Guidelines, at 46.
[316] *See* Guidelines, at 6–7.

persons.[317] The scope of misconduct was broad, involving "numerous acts" that form a "pattern of misconduct" --violative advertising, record retention failures, disregard of registration requirements, inadequate supervision, and lying to regulators.[318] Much of the misconduct spanned the entire review period and beyond, which was "an extended period of time."[319] Jahre and HedgeCap attempted to "conceal [their] misconduct or lull into inactivity, mislead, [and] deceive . . . regulatory authorities" repeatedly, both in regulatory filings (Forms U4 for Mudry and Lombardy) and in responses to the investigation.[320] Thus, HedgeCap and Jahre "attempted to delay FINRA's investigation, to conceal information from FINRA, and to provide inaccurate or misleading testimony or documentary information to FINRA.[321]

The Hearing Panel found that most of the violations were "the result of intentional acts [or] recklessness."[322] The sheer number and variety of violations, as well as Jahre's explanations for them during the hearing and his investigative testimony, demonstrate "that the misconduct at issue was [not] aberrant . . . .[323] Several of the violations — sales literature violations, employing Mudry, soft dollar arrangements — were motivated by "the potential for respondent's monetary or other gain."[324] Finally, the Hearing Panel found that the Respondents did not "accept responsibility for and acknowledge the misconduct to . . . a regulator prior to detection . . . ."[325] Instead, they either tried to blame others for their violations, or misrepresented what occurred.

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[317] *Id.* (Principal Consideration No. 5). *See also id.* (Principal Consideration No. 6: "adequate training and educational initiatives").
[318] *Id.* (Principal Consideration No. 8). *See id.* at 7 (Principal Consideration No. 18: "The number, size and character of the transactions at issue.").
[319] *Id.* at 6 (Principal Consideration No. 9).
[320] *Id.* (Principal Consideration No. 10).
[321] *Id.* at 7 (Principal Consideration No. 12).
[322] *Id.* (Principal Consideration No. 13).
[323] *Id.* (Principal Consideration No. 16).
[324] *Id.* (Principal Consideration No. 17).
[325] *Id.*, at 6 (Principal Consideration No. 2).

Considered in the aggregate, these additional violations are further evidence of Jahre and HedgeCap's flagrant disregard of FINRA rules, and the Hearing Panel finds that the violations merit HedgeCap's expulsion and Jahre's bar from the securities industry. As the NAC recently held, "[t]he Guidelines permit the 'batching' of violations for purposes of determining sanctions in disciplinary proceedings where the violations result from a single systemic problem or cause."[326]

VI. ORDER

Respondents violated Rules 8210 and 2110 by providing false and misleading information to FINRA in connection with an investigation of the Respondent firm; Rule 2110 and IM-1000-1 by willfully filing a misleading Form U-4; and Article III, Section 3(b) of FINRA By-Laws and Rule 2110 by employing a statutorily disqualified person. For these violations Respondent HedgeCap is expelled and Respondent Jahre is barred from associating with any FINRA member firm in any capacity. In addition, the Respondents committed numerous other violations as follows: (1) both Respondents violated Rule 2110 by allowing a hedge fund to improperly pay rent with soft dollars**;** (2) both Respondents violated Rules 2211(d)(1) and 2110 by distributing misleading and exaggerated sales materials; (3) Respondent Firm violated Rules 2211(d)(1) and 2110 by distributing unbalanced sales materials; (4) Respondent Firm violated Rules 2211(b)(2)(A) and 2110 by failing to retain institutional sales materials; (5) both Respondents violated Rules 1031 and 2110 by allowing unregistered employees to act in registered capacities; (6) both Respondents violated Rules 1031 and 2110 by allowing a registered person to park her license at the Respondent Firm; (7) Respondent Firm violated Exchange Act Section 17(a)(1) and Rule 17a-4 thereunder, and Rules 3110 and 2110 by failing

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[326] *Dep't of Enforcement v. Conway,* 2010 FINRA Discip. LEXIS 27, at *53 (N.A.C. Oct. 26, 2010); *See Dep't of Enforcement v. Zaragoza*, 2008 FINRA Discip. LEXIS 28, at *29 (N.A.C. Aug. 20, 2008).

to retain e-mail and instant messages; and (8) both Respondents violated Rules 3010(a), 3010(b), and 2110 by failing to supervise e-mail and instant message retention, annual compliance meetings, and the registration of associated persons. For these additional violations, Respondent HedgeCap was expelled from FINRA membership. For Respondent Jahre's additional violations, he was barred from associating with any FINRA member firm in any capacity. If this decision becomes FINRA's final disciplinary action, HedgeCap's expulsion and Jahre's bar shall be effective immediately.[327] The Respondents are also ordered to pay costs in the amount of $15,119.90, which includes a $750.00 administrative fee and the cost of the hearing transcript.

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Rochelle S. Hall
Hearing Officer
For the Extended Hearing Panel

Copies to:

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Leo J. Kane, Esq. *(via electronic mail)*
Mark Dauer, Esq. *(via electronic mail)*
David Sonnenberg, Esq. *(via electronic mail)*

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