FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. NICHOLAS D. SKALTSOUNIS (CRD No. 825000), RESPONDENT 2, and JOHN B. GUYETTE (CRD No. 1711681), Respondents.	Disciplinary Proceeding No. 2009018819001 Hearing Officer – MC **EXTENDED HEARING PANEL DECISION** December 6, 2011

Respondent John B. Guyette (i) misrepresented and omitted material facts when he sold securities to customers, violating Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, and NASD Conduct Rules 2110, 2120, and IM-2310-2; and (ii) made unsuitable investment recommendations to two customers, violating NASD Conduct Rules 2110, 2310, and IM-2310-2. For these violations, he is suspended from association in any capacity with any FINRA member firm for one year, and fined $86,140, which includes disgorgement of commissions. In addition, he is ordered to pay hearing costs.

Respondent Nicholas D. Skaltsounis allowed sales of securities to customers by registered representatives without disclosure of material facts, and permitted registered representatives to use a document containing a material misstatement of fact in the sales of securities, violating NASD Conduct Rule 2110. For this misconduct, he is suspended from associating in any principal capacity with any FINRA member firm for three months, suspended in all capacities for 30 days, and fined $10,000. In addition, he is ordered to pay hearing costs.

Respondent 2 is not liable for the violations of NASD Conduct Rules 2110 and 3010 alleged against him. Those charges are therefore dismissed.

Appearances

David F. Newman, Senior Regional Counsel, and Stuart P. Feldman, Senior Regional Counsel, Philadelphia, Pennsylvania, for the Department of Enforcement.

Jeffrey J. Scott, Esq., Denver, Colorado, for Respondent John B. Guyette.

Steven S. Biss, Esq., Charlottesville, Virginia, for Respondents Nicholas D. Skaltsounis and Respondent 2.

I. Introduction

The Department of Enforcement filed the four-cause Complaint in this disciplinary proceeding on August 20, 2010. It arose from sales of securities of a private placement issued by a special purpose corporation known as Medical Provider Funding Corporation VI ("MP VI") from August through November 2008 ("the Relevant Period") by registered representatives of former FINRA member firm Community Bankers Securities, LLC ("CBS" or the "Firm"). The allegations are directed against three individuals: (i) John B. Guyette, who was a senior vice president, member of the board of directors, and registered representative of the Firm; (ii) Nicholas D. Skaltsounis, who was the Firm's president and chief executive officer; and (iii) Respondent 2, who was an operations principal.

A. Respondents and Jurisdiction

Guyette began employment in the securities industry in 1987.[1] During the Relevant Period, Guyette was registered with FINRA through the Firm as a General Securities Representative, General Securities Principal, and Financial and Operations Principal. He remained registered through CBS until December 23, 2009,[2] based in the Firm's office in

[1] Complainant's Exhibit 1, p. 5. References to the testimony at the March 15, 2011, hearing are to "Tr. 1," with page references; references to the testimony on the March 22 and 23, 2011, hearing dates are to "Tr. 2" and "Tr. 3," with page references. References to the exhibits introduced by the Department of Enforcement are designated "CX-__"; and exhibits introduced by Skaltsounis and Respondent 2 are designated "SXLX-__."

[2] CX-1, p. 3.

Greeley, Colorado.[3] He has not been associated with a FINRA member firm since March 26, 2010.[4] However, because the Complaint was filed within two years after the date he was last registered with a FINRA member firm, and because the Complaint charges him with misconduct occurring while he was so registered, pursuant to Article V, Section 4 of its By-Laws, FINRA retains jurisdiction over Guyette for the purposes of this disciplinary proceeding.

Skaltsounis was registered through CBS as a General Securities Representative, General Securities Principal, Financial and Operations Principal, Registered Options Principal, and General Securities Sales Supervisor, from February 21, 2003, to December 23, 2009.[5]

Respondent 2 was registered through CBS from April 30, 2003, to December 23, 2009, as an Investment Company and Variable Contracts Products Representative, General Securities Representative, General Securities Principal, Investment Company and Variable Contracts Principal, and Registered Options Principal.[6] The CBS written supervisory procedures identified Respondent 2 as one of four vice presidents and "producing managers,"[7] and as the trade desk supervisor responsible for approval of "account names or designation changes for orders."[8]

When Enforcement filed the Complaint, both Skaltsounis and Respondent 2 were registered with FINRA through other member firms,[9] and are therefore subject to FINRA's jurisdiction.

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[3] Tr. 1, p. 246.

[4] CX-1, p. 1.

[5] CX-5, pp. 2-3.

[6] CX-6, p. 3.

[7] SXLX-3, p. 27.

[8] *Id.* at 32.

[9] CX-5, p. 1; CX-6, p. 1.

B. The MedCap Offerings and MP VI

According to the private placement memorandum ("PPM"), MP VI was a "special purpose subsidiary" of Medical Capital Holdings, Inc. ("MedCap").[10] It was the sixth in a series of such entities offering notes with maturity dates ranging from two to six years, promising minimum annual interest payments of 9.0% to 9.5% to maturity. After purchasing a note, an investor was to receive interest payment checks until the note matured. On the maturity date, the investor was to receive the return of the original amount invested. Minimum investments ranged from $25,000 to $50,000.[11] For MP VI, the minimum investment was $50,000 in notes maturing in two, three, or six years.[12] A purchaser of a $100,000 note therefore expected to receive monthly interest payments of $750 until the maturity date, when MP VI would return the total original $100,000 investment.

The private placement memoranda of all of the MedCap offerings were essentially identical. MP VI's PPM stated that MP VI was formed to finance "healthcare receivables," such as monies owed to physicians for medical services, and that MedCap acquired the receivables for less than the fully collectible amount billed.[13] The PPM stated that investment in the notes "involves significant risks"[14] and that the notes were suitable only for persons with "substantial financial resources" and "no need for liquidity."[15]

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[10] CX-21, p. 1.

[11] For example, the minimum investment allowable for MP III was $25,000. CX-18, p. 1. For MP VI, it was $50,000. CX-21, p. 1.

[12] CX-21, p. 1.

[13] *Id.* at 6. For example, MedCap estimated that for $1,000 billed, the "expected net revenue" would be $220. MedCap would purchase the receivable for 90% of the expected net revenue, or $198, from the hospital or physician to whom the $1,000 was owed, and would then attempt to collect as much of the $1,000 as possible. Tr. 2, pp. 207-208.

[14] CX-21, pp. 3, 5.

[15] *Id.* at 3.

From CBS's involvement with the first MedCap offerings through MP VI, its due diligence reports consistently echoed this assessment. The due diligence report on MP I and II described them as involving "a high degree of risk" and "suitable only for persons having substantial financial resources who understand the long-term nature of the purchase of the notes as well as the risk factors." It identified as risk factors "limitations on transferability, risks related to the business operations …, risks related to the Healthcare Industry, and the general risks associated with an investment in notes."[16] A later report CBS prepared on MP V stated that there was "No change from previous offerings" in risk and suitability factors.[17]

The CBS due diligence report on MP VI, dated July 31, 2008, described investment in the notes as a "somewhat 'high risk' investment," and stated that CBS would "rely on experienced representatives to offer [them] only to investors that meet the 'accredited investor' status and have the wherewithal to handle the risk." It also described MP VI's "structure" as being "consistent with past successful Medical Capital offerings" stating that MedCap "loans funds to 'healthcare providers' against the provider's accounts receivables," and acquires the receivables "at a discount to the face amount and attempt[s] to collect them fully." The report cited the importance of MP VI's use of a trustee "to oversee the use of investor's funds" and emphasized that MedCap had been "very successful in raising funds over the years."[18] CBS and MP VI executed the Broker-Dealer Agreement for CBS to sell MP VI on July 31, 2008.[19]

[16] CX-12, p. 1.

[17] *Id.* at 8.

[18] *Id.* at 9.

[19] CX-20.

C. The Charges

The First Cause of Action alleges that Skaltsounis and Respondent 2 violated NASD Conduct Rule 2110[20] by permitting Guyette and other registered representatives to recommend and sell MP VI securities to customers without disclosing material facts, and to use MP VI's PPM in selling the securities, which Skaltsounis and Respondent 2 knew or should have known contained a material misstatement of fact.

The Second and Third Causes of Action concern only Guyette and charge him with misconduct in his sales of MP VI notes. The Second Cause of Action alleges that he violated Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rule 10b-5 thereunder, as well as NASD Conduct Rules 2110 and 2120, and IM-2310-2, by knowingly failing to disclose a material fact, and by knowingly or recklessly making material misrepresentations, in the course of selling MP VI securities to a number of customers between August and November 2008. The Third Cause of Action alleges that Guyette violated NASD Conduct Rules 2110 and 2310, and IM-2310-2, by making unsuitable recommendations to three customers to invest in MP VI.

The Fourth Cause of Action involves only Respondent 2. It alleges that he failed to establish, maintain, and enforce a supervisory system and written supervisory procedures reasonably designed to achieve compliance with applicable regulatory requirements with regard to the MP VI note offerings, in violation of NASD Conduct Rules 2110 and 3010.

[20] As of July 30, 2007, NASD consolidated with the member regulation and enforcement functions of NYSE Regulation and began operating under a new corporate name, the Financial Industry Regulatory Authority (FINRA). The first phase of the new consolidated rules became effective on December 15, 2008, including certain conduct rules and procedural rules. *See* Regulatory Notice 08-57 (Oct. 2008). Because the misconduct alleged in the Complaint occurred from August through November 2008, prior to the effective date of the new consolidated rules, this Decision refers to and relies on the NASD Conduct Rules that were in effect at the time the misconduct occurred. The applicable rules are available at www.finra.org/rules.

D. The Hearings

Guyette and his customers reside in Colorado; Skaltsounis and Respondent 2 reside in Virginia. For economy of time and expense, the parties consented to the bifurcation of the hearing. As a result, the Panel convened in Denver, Colorado, on March 15, 2011, for a hearing focused on the two causes of action involving Guyette. On March 22 and 23, 2011, the Panel reconvened in Washington, DC, to hear the causes of action pertaining to Skaltsounis and Respondent 2. The parties stipulated that the Extended Hearing Panel would consider only the evidence presented in the Denver hearing to decide the allegations against Guyette. Skaltsounis and Respondent 2 chose not to appear at the Denver hearing, although their counsel appeared and participated. Neither Guyette nor his counsel appeared at the Washington hearing.

Because of the bifurcation of the hearing, and the structure of the Complaint, this Decision addresses: first, the charges against Guyette; second, the charges brought against Skaltsounis and Respondent 2 jointly; and third, the charge brought solely against Respondent 2.

II. Findings of Fact and Conclusions of Law

A. The Case against Guyette: Second and Third Causes of Action

Guyette first visited MedCap's offices in Anaheim, California, in 2003, after which he began selling customers notes issued by MP II.[21] In the following years, Guyette personally invested in MP II, IV, and V,[22] and sold customers notes issued by MP II, III, IV, V, and VI.[23]

As noted above, the Complaint's Second Cause of Action charges that, beginning in August 2008, Guyette (i) fraudulently made misrepresentations in the course of recommending

[21] Tr. 1, pp. 156, 247.

[22] Tr. 1, p. 226. Guyette testified that the reason he did not invest in MP VI was that he did not have the funds available to do so when it was offered. Tr. 1, pp. 227-228.

[23] Tr. 1, pp. 143-146.

and selling investments in MP VI to his customers, and (ii) omitted to inform customers of a material fact.

The misrepresentations alleged in the Second Cause of Action relate to Guyette's reckless characterizations of MP VI notes as safe and secure investments. Guyette made these misrepresentations because he misunderstood the risks of investing in MP VI.

The omitted material fact was that in August 2008, MedCap special purpose corporations that had issued notes prior to the MP VI offering failed to make scheduled repayments of principal to investors on the notes. Knowing this, Guyette should have warned customers to whom he sold investments in MP VI that the missed repayments might be indicative of risk that MP VI, too, might be unable to fulfill its repayment obligations.

1. Guyette Knowingly Omitted and Recklessly Misrepresented Material Facts

a. Guyette Embraced the Early MedCap Offerings

From his initial visit to MedCap headquarters in October 2003, Guyette enthusiastically embraced the MedCap offerings. Guyette failed to familiarize himself sufficiently with the offering materials and the risks they described, and instead simply relied upon what MedCap employees and personnel told him. As a consequence, he made representations to customers that were inconsistent with information provided in the offering materials on significant, material issues. When he became aware of circumstances that he should have recognized as red flag indicators of risks, he accepted the explanations offered by MedCap personnel and attempted to assuage the concerns of his customers, instead of alerting them to growing indications that MP VI might not be as safe an investment as he had consistently represented.

Guyette's enthusiasm for the MedCap offerings revealed itself in his testimony that he had "loved the safety" of the MedCap notes.[24] A principal reason for his confidence in their safety was his acceptance of MedCap's representations about the oversight role played by the designated bank trustee for each offering. Guyette believed MedCap's representations about how the money was "always handled by the trust department of the bank" and that the trustee bank required MedCap "to keep 105 percent of assets over liabilities" on deposit for each of the offerings. In addition, Guyette testified that he saw with his "own eyes a stack of papers" consisting of accounts receivable, from which he believed MedCap selected "only those that were from A-rated insurance companies" or "secured … by the government" for purchase.[25] At the hearing, he stood by a quotation attributed to him in a MedCap newsletter called "The Capital Report" saying "I love the safety of the program … the third-party trustee is very important to me."[26] Guyette testified that everyone associated with MedCap with whom he spoke reassured him of the safety and security of the notes based on the requirements the trustee bank imposed on the management of investor funds.[27]

Guyette was unaware that the private placement memoranda described a far more limited role for the trustee bank. For example, even though he claimed that he had read the PPM for MP II before recommending it, Guyette did not know that the trustee: (i) was under no obligation to monitor, supervise, or verify MP II's acts or omissions; (ii) had no responsibility to make calculations of principal or interest; (iii) was not responsible for determining any collateral

[24] Tr. 1, p. 176.

[25] Tr. 1, pp. 223-225.

[26] Tr. 1, pp. 175-176. The report also quoted him as saying that MedCap notes were "an easy, easy sell." Guyette denied saying this, insisting he would not make such a statement because "nothing is easy in this business."

[27] Tr. 1, pp. 137-138.

coverage ratios; and (iv) was not required to monitor whether MP II defaulted or otherwise breached its obligations.[28]

Guyette did not participate in any of the CBS due diligence committee meetings concerning the MedCap offerings.[29] Guyette testified that he never read the CBS due diligence reports describing the MedCap notes as high-risk and lacking liquidity.[30] He testified that if he had read and believed the risk warnings, he "absolutely" would not have sold MP VI to his customers.[31]

Guyette's due diligence reviews consisted primarily of conversations with MedCap employees and his trips to MedCap's offices in California. He made four visits between 2003 and 2008.[32] The last occurred in May 2008, when he was accompanied by Lawrence M. "Pete" Barnes, Jr., a member of CBS's due diligence committee.[33] The purpose of the meeting was to inquire about reports that customers had experienced some delays in receiving interest payments. Guyette testified that he spoke to MedCap personnel about this.[34] Following the meeting, Barnes submitted a report to CBS, after Guyette reviewed and approved it.[35] Their report summarized reassuring representations by MedCap officers and employees about the MedCap business model and its success. Guyette and Barnes accepted MedCap's claim that the company had not missed any timely interest or principal payments.[36]

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[28] Tr. 1, pp. 136-138.

[29] Tr. 1, pp. 134-135, 232-233.

[30] Tr. 1, pp. 173-174.

[31] Tr. 1, pp. 174-175.

[32] Tr. 1, pp. 229-230. The occasion for one visit was when he won a MedCap contest and received an expense-paid three-day trip to Hawaii with MedCap personnel.

[33] Tr. 1, pp. 239-240.

[34] Tr. 1, pp. 153-154.

[35] Tr. 1, p. 236.

[36] CX-15, p. 6. MedCap paid the expenses of the trip. CX-15, p. 3.

b. Guyette Misrepresented the Risks of MP VI

Guyette maintained his enthusiasm when MP VI became available, recommending and selling notes to 19 customers. Guyette sold them to 11 customers in August 2008,[37] five in September, two in October, and one in November.[38] He characterized MP VI, inaccurately, as a safe investment. For example, he told one customer, JR, that MP VI was "a very safe investment."[39] As a result, on August 15, 2008, JR invested $100,000 in MP VI because he believed Guyette and thought that it was "a good investment with no risk and assured interest."[40] Guyette told another customer, JY, that the MP VI notes were secured.[41] Because JY thought this meant it was a safe investment, he invested a total of $200,000 on September 5, 2008.[42] Guyette made these recommendations recklessly, heedless of the inherent risks. He did so despite learning, as early as August 5, 2008, that MedCap had failed to make timely principal payments on previously issued notes, and without informing customers of this fact. [43]

c. Guyette Failed to Disclose Material Red Flags

Guyette testified that he learned early in August 2008, while actively recommending MP VI to his customers, that MP II had missed repayments of principal.[44] He received a letter from MedCap to broker-dealers, dated August 5, 2008, in which MedCap's Chief Executive Officer stated that MedCap recently had been unable to repay principal to some investors when their notes matured because of "a temporary liquidity issue," related to the "recent credit market

[37] Tr. 1, pp. 167-171.

[38] Tr. 1, pp. 171-172.

[39] Tr. 1, pp. 93-94.

[40] Tr. 1, pp. 98, 103.

[41] Tr. 1, pp. 40-41, 44.

[42] Tr. 1, p. 45.

[43] Tr. 1, pp. 107-108, 173.

[44] Tr. 1, p. 156.

contraction." The letter stated that although MedCap temporarily lacked the cash to redeem some of the previous notes now becoming due, it would continue to make monthly interest payments on those notes until it could repay investors their principal, and expected to correct the problem within 30 days.[45]

Through August and September 2008, Guyette continued to hear from customers to whom he had sold previously issued MedCap notes who were not repaid principal when their notes matured.[46] As a result, Guyette started calling MedCap on a daily basis.[47] MedCap representatives repeatedly assured him that the company was "just having cash flow problems" affecting its ability to repay principal," which would be resolved shortly, but in the meantime it would continue to pay interest on the notes.[48] Curiously, Guyette found it reassuring that the missed payments were "just the principal" and that MedCap was continuing to make interest payments to customers.[49]

Guyette acknowledged that these developments concerned him. Nonetheless he continued to recommend and sell MP VI notes to his customers, who were "lined up to buy" them. Guyette did not ask MedCap for documentation to verify the claims that the cash flow problems were temporary, and he did not discuss with anyone at CBS whether he should suspend selling the notes, or whether he should disclose the repayment issues to purchasers of MP VI.[50] Instead, Guyette continued to accept what MedCap told him.[51] He testified that he believed in his "heart of hearts" that the missed principal repayments were "just a temporary thing that

[45] CX-25.

[46] Tr. 1, p. 157.

[47] Tr. 1, pp. 184, 254-255.

[48] Tr. 1, p. 158.

[49] Tr. 1, pp. 185-186.

[50] Tr. 1, p. 159.

[51] Tr. 1, p. 185.

would be settled by the next day or two"[52] and that "at any minute this thing would be resolved."[53]

Guyette testified that he could not recall if he ever considered disclosing the missed repayments to customers, and did not take into consideration the possibility that the information might have discouraged them from purchasing MP VI notes.[54] Guyette's customer JY, for example, testified that Guyette gave him no indication that principal payments were not being made to purchasers of similar, previously issued notes, and that had he known, it would have affected his decision to proceed with the purchases of the two MP VI notes Guyette sold to him, which were not finalized until mid-December 2008.[55]

On November 10, 2008, the trustee bank issued a notice of default for MP III.[56] On November 19, 2008, CBS instructed its brokers to cease sales of MP VI.[57]

d. By Recklessly Misrepresenting and Omitting Material Facts in Recommending MP VI, Guyette Violated Section 10(b) of the Exchange Act , Rule 10b-5 thereunder, and NASD Conduct Rules 2110, 2120, and IM-2310-2

Section 10(b) of the Exchange Act, and Rule 10b-5, make it unlawful for a person to make, in connection with the purchase or sale of a security, "any untrue statement of a material fact or to omit to state a material fact necessary … to make the statements made … not misleading." Materiality exists when the information that is misrepresented or omitted would be considered important by an investor in deciding whether to make an investment.[58]

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[52] Tr. 1, p. 254.

[53] Tr. 176-177.

[54] Tr. 1, pp. 253-256.

[55] Tr. 1, pp. 54-56.

[56] CX-31.

[57] CX-30; Tr. 1, p. 177.

[58] *Basic, Inc. v. Levinson*, 485 U.S. 224, 240 (1988).

To establish liability for violating these requirements, it is necessary to demonstrate that the person making the statements or omitting to make necessary disclosures acted with scienter. This requires proof that the person "either knew the statement was false or was reckless in disregarding a substantial risk that it was false.… A popular definition of recklessness in this context is 'an extreme departure from the standards of ordinary care.'"[59]

NASD Conduct Rule 2120, which has been described as "NASD's anti-fraud rule … the equivalent of SEC Rule 10b-5," similarly proscribes inducing the purchase or sale of any security by fraud or deception.[60] IM-2310-2 requires registered representatives to provide fair treatment to customers, and provides that fraudulent acts, such as "non-disclosure or misstatement of material facts," may violate NASD rules. It is also well established that a broker has a duty to investigate and verify the representations made by a company that he or she recommends to customers, and that the duty to investigate means that a broker cannot "recklessly state facts about matters of which he is ignorant."[61] The duty to investigate requires a broker to "give honest and complete information when recommending a purchase or a sale."[62]

The Panel finds that Guyette acted recklessly by recommending MedCap VI as a "very safe" and "secure" investment without appreciation of the risks identified in the PPM and in CBS's due diligence reports characterizing the series of MedCap offerings as inherently risky,

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[59] *Makor Issues & Rights, Ltd. v. Tellabs Inc.*, 513 F.3d 702, 2008 U.S. App. LEXIS 975, at *3 (7th Cir. 2008); *Dep't of Enforcement v. Cipriano*, 2007 NASD Discip. LEXIS 23, at *23 (N.A.C. July 26, 2007).

[60] *Market Regulation Comm. v. Shaughnessy*, No. C950087, 1997 NASD Discip. LEXIS 46, at *24 (N.B.C.C. June 5, 1997), *aff'd*, 53 S.E.C. 692 (1998). A violation of NASD Conduct Rule 2120 is also a violation of NASD Conduct Rule 2110. *Cipriano*, at *30, n.20.

[61] *Hanly v. SEC*, 415 F.2d 589, 596, 1969 U.S. App. LEXIS 11358 (2d Cir. 1969) (A broker "cannot deliberately ignore that which he has a duty to know and recklessly state facts about matters of which he is ignorant."). *See Dept. of Enforcement v. Abbondante*, No. C07050029, 2007 NASD Discip. LEXIS 23, at *28-29 (N.A.C. July 26, 2007), quoting *Nassar & Co.*, 47 S.E.C. 20, at 22 (1978). In *Abbondante*, the respondent was held to have been "extremely reckless" when, in part, he failed to read a prospectus and relied on "unsubstantiated testimonials" of the employees of the company he recommended, while failing to disclose his knowledge of customer losses.

[62] *De Kwiatkowsky v. Bear, Stearns & Co.*, 306 F.3d 1293, 1302 (2d Cir. 2002).

and by failing to inform prospective purchasers of those risks. Although he testified that he did not wish to expose his customers to risk of loss, Guyette apparently did not understand, or he ignored, the risks to which he exposed the customers to whom he recommended and sold MP VI notes.

Guyette's recklessness resulted from his failure to read, or to understand, the MedCap VI PPM and its virtually identical predecessors. Although the memoranda described the limited role of the trustee in overseeing the uses to which MP VI could put investors' funds, Guyette did not comprehend those limitations. Therefore his representations about the extent of protection provided by the trustee were mistaken, and gave customers a false sense of security. Guyette's uninformed acceptance of the representations of MedCap personnel rendered his unsupported claims about the security of the notes reckless.

As Guyette testified, he understood that even though his customers signed forms stating that they had read the PPM and had not relied on representations by any person, his affirmative recommendations of MP VI undermined the significance of these acknowledgments.[63]

Finally, Guyette's knowing failure to inform investors of MedCap's missed principal repayments was a material omission and a failure to provide information he knew or should have known reasonable investors would consider important to know prior to deciding whether or not

[63] Furthermore, Guyette testified that he did not expect customers to read private placement memoranda because "it's just not human nature to read all this stuff." Tr. 1, pp. 202-204.

to invest in MP VI. For these reasons, the Panel finds that Guyette violated Section 10(b) of the Exchange Act, Rule 10b-5 thereunder, NASD Conduct Rules 2110 and 2120, and IM-2310-2.[64]

2. Guyette Made Unsuitable Recommendations of MP VI to Two Customers

At the March 15, 2011, hearing, customers JR and JY testified that they invested in MP VI in reliance upon Guyette's recommendations.

a. Customer JR

Customer JR, a 78-year-old retired professor of geology, is a resident of Fort Collins, Colorado.[65] In 2005, JR's annual income, consisting of his pension, Social Security checks, and stock dividends, was in the range of $29,000; his net worth was approximately $500,000.[66] By 2008, his annual income had risen to approximately $90,000, and his net worth had increased to approximately $900,000.[67] In 2005, his financial advisor thought he might be interested in MP III and suggested he meet with Guyette to inquire about the note.[68] Guyette presented MP III as a reliable investment. JR concluded that the interest rate was attractive and asked whether the note was guaranteed. Guyette answered that it was secure. Consequently, JR decided to invest

[64] In addition, Enforcement must prove that a respondent used "any means or instrumentality of interstate commerce." 17 C.F.R. § 240.10b-5; *see SEC v. Softpoint, Inc.*, 958 F. Supp. 846, 865 (S.D.N.Y. 1997) (finding that the jurisdictional requirements of the federal antifraud provisions are interpreted broadly and are satisfied by intrastate telephone calls and the use of the U.S. mail), *aff'd*, 159 F.3d 1348 (2d Cir. 1998). In this case, these facts establish the jurisdictional requirements: (i) account documentation associated with the investments of JY and JR in MP VI reflect that Guyette and his customers filled out account forms in Colorado which were then mailed to CBS's Richmond offices; and (ii) paperwork problems delaying JY's investment in MP VI required Guyette to communicate with MedCap and JY's bank by phone and mail in order to consummate JY's purchase of MP VI. *See* CX-37, CX-39; Tr. 1, pp. 57, 176.

[65] Tr. 1, p. 89; CX-39, p. 1.

[66] Tr. 1, pp. 99-100.

[67] Tr. 1, p. 102.

[68] Tr. 1, p. 89-90.

in MP III.[69] Pleased with the rate of return and the regularity of the payments, he continued to invest in MedCap offerings.[70]

When JR spoke to Guyette about investing in MP VI, he was aware of volatility in the market, and asked Guyette if he thought MedCap was in "any serious trouble." JR wanted a safe investment with a good return.[71] Guyette told him that there was "no problem," and reiterated that MedCap was "a very safe investment."[72] Guyette said nothing of risks. Although JR received the PPM for MP VI, he does not recall Guyette reviewing it with him.[73] JR testified that he glanced at it. He saw a paragraph on risk and suitability but inferred that the language was "pro forma" and did not consider it significant.[74] Guyette made no mention of any missed principal payments in any of the previous notes issued by MedCap.[75] Consequently, on August 15, 2008, several days after Guyette learned of a missed MP II principal repayment, and at about the time he learned of a missed MP III principal repayment,[76] JR invested $100,000 in MP VI believing it was "a good investment, with no risk and assured interest."[77]

b. Customer JY

Customer JY, a 68-year-old software engineer, has been retired since his employer downsized the department in which he worked in 2003.[78] A resident of Loveland, Colorado, he

[69] Tr. 1, pp. 90-91.

[70] Tr. 1, p. 92.

[71] Tr. 1, pp. 93, 95.

[72] Tr. 1, pp. 93-94.

[73] Tr. 1, pp. 96-97.

[74] *Id*.

[75] Tr. 1, p. 107.

[76] Tr. 1, pp. 156-157.

[77] Tr. 1, p. 98; CX-39.

[78] Tr. 1, p. 38; CX-37, p. 1.

has a part-time job at Walmart.[79] After retiring, JY invested in two retirement accounts, two annuities and a long-term care account, all of which he manages with the assistance of his financial advisor, with whom he meets twice yearly.[80] JY first learned of MedCap offerings at a seminar given by the financial advisor,[81] who later introduced him to Guyette. JY testified that Guyette was his primary source of information concerning MedCap.[82] Before meeting Guyette, JY had never invested in any private offerings.[83] He estimated that his net worth in 2008 was more than $500,000 but less than $1 million.[84]

At the meeting with JY, Guyette said that the notes MedCap issued were secured, and that banks, before releasing any funds to be used to purchase the accounts receivable, required MedCap to deposit at least 105% of the value of the notes.[85] Guyette told JY that he had sold many MedCap notes and had never encountered any problems.[86] JY testified that Guyette gave him the PPM and pointed out that it described the note as a "Secured Note," which JY understood to mean that it was safer than stocks.[87]

JY testified that Guyette did not discuss the PPM's characterization of MP VI as a risky investment with him. JY did not read the PPM carefully, but merely flipped through it.[88] JY provided his personal information to Guyette, who filled out the account documentation required

[79] Tr. 1, p. 34.

[80] Tr. 1, pp. 37-38. JY works with the same financial advisor as JR.

[81] Tr. 1, p. 34-35.

[82] Tr. 1, p. 79.

[83] Tr. 1, pp. 36-37.

[84] Tr. 1, p. 47.

[85] Tr. 1, pp. 39-40.

[86] Tr. 1, p. 40.

[87] Tr. 1, p. 41; CX-21, p. 1.

[88] Tr. 1, p. 43.

for the purchase.[89] The documentation correctly reflected that his investment objective was "income" and his risk tolerance was "average."[90] He did not read the subscription agreement, but signed and initialed where Guyette indicated he should do so.[91] He noted that it showed his net worth as exceeding $1 million, but testified this was inaccurately high.[92] On September 5, 2008, about one month after Guyette learned of missed principal repayments, JY decided to invest a total of $200,000 in two MP VI notes.[93]

JY acknowledged that his new account application stated that the investment "may involve investment risks, including the potential loss of principal." JY testified that he did not read this at the time, however.[94] What was important to him, he said, was that Guyette assured him that the notes were secured.[95]

MP VI ceased paying JY interest in July or August of 2009. JY then received notification that the Securities and Exchange Commission was taking action against MedCap and that a receiver for MedCap had been appointed.[96] JY called Guyette, who stated that he had spoken with the head of MedCap, and assured him that MedCap would resolve its difficulties within a month, and then "there would be no problems."[97] JY learned nothing further from Guyette about MP VI.[98]

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[89] Tr. 1, p. 46.

[90] Tr. 1, pp. 48-49.

[91] Tr. 1, pp. 50-51.

[92] Tr. 1, p. 47.

[93] Tr. 1, p. 45.

[94] Tr. 1, pp. 68-69.

[95] Tr. 1, p. 74. The PPM describes the MP VI notes as "redeemable secured notes." CX-21, p. 1.

[96] CX-37, p. 20; Tr. 1, pp. 57-58.

[97] Tr. 1, p. 60.

[98] Tr. 1, pp. 62-63.

Subsequently, JY received notifications from the designated trustee, the Bank of New York, and the receiver, informing him that the bank claimed that it had only a limited role in MP VI, denied having any responsibility to investigate disbursements from the trust account, and denied having had any involvement in overseeing the purchases of medical receivables by MedCap.[99]

c. Guyette's Recommendations of MP VI to JY and JR Were Unsuitable and Violated NASD Conduct Rules 2310 and 2110, and IM-2310-2

Conduct Rule 2310 states in relevant part:

> In recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his … financial situation and needs.

IM-2310-2, titled "Fair Dealing with Customers," underscores that implicit in all relationships between registered representatives and their customers there is a "fundamental responsibility for fair dealing," and that sales to customers must be tailored to their specific needs and financial situations.

Rule 2310 thus requires a broker to have reasonable grounds for believing that recommendations are suitable for a customer based upon that customer's particular financial situation and needs.[100] In order to establish the prerequisite reasonable grounds, a broker must ensure that he or she has an adequate and reasonable understanding of the investment before recommending it to customers. To recommend an investment without understanding its essential features is by itself sufficient to render the recommendation unsuitable.[101] Merely providing a

[99] Tr. 1, pp. 60-61.

[100] *Larry Ira Klein*, Exch. Act Rel. No. 37835, 1996 SEC LEXIS 2922, at *16-18 (Oct. 17, 1996).

[101] *See Richard G. Cody*, Exch. Act Rel. No. 64565, 2011 SEC LEXIS 1862, at *26 (May 27, 2011).

prospectus is not a substitute for informing a customer of the risks, particularly when a broker knows that the customer is concerned about the safety of an investment.[102]

Furthermore, a broker's recommendation of a particular investment implies that the broker is making it responsibly, informed by "actual knowledge and careful consideration."[103] To make a proper recommendation, a broker must adequately understand an investment, and appreciate its potential risks, rewards, and consequences. A broker's personal belief in what he represents about an investment does not excuse failure to develop an adequate basis for the recommendation before making it.[104]

The Panel finds that Guyette lacked an adequate and reasonable understanding of the risks inherent in the MP VI notes he recommended to JY and JR. By Guyette's own description, most of his customers were conservative investors.[105] Typical of them, JY and JR had average risk tolerance[106] and had come to him concerned about the volatility of the stock market in 2008, seeking a secure investment alternative to stocks.[107] They were older and sought income-producing investments. Nonetheless, Guyette recommended that they invest in MP VI. Because Guyette did not understand the risks, he was incapable of properly advising JY and JR. For these reasons, Guyette's recommendations of MP VI to customers JY and JR were unsuitable, and in violation of NASD Conduct Rules 2110 and 2310, and IM-2310-2.

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[102] *Larry Ira Klein*, at *16.

[103] *Richard G. Cody*, at *27, *citing F.J. Kaufman & Co.*, Exch. Act Rel. No. 27535, 1989 SEC LEXIS 2376, at *10, n.18 (Dec. 13, 1989), 50 S.E.C. 164, 168-169 (1989), *quoting Alexander Reid & Co., Inc.*, Exch. Act Rel. No. 6727, 1962 SEC LEXIS 514, at *11 (Feb. 8, 1962), 40 S.E.C. 986, 990 (1962).

[104] *Richard G. Cody*, at *27-28, n.11.

[105] Tr. 1, p. 179.

[106] Tr. 1, p. 197.

[107] Tr. 1, p. 180.

3. Sanctions against Guyette

For making reckless misrepresentations or material omissions, in violation of Section 10(b) of the Exchange Act, Rule 10b-5 thereunder, NASD Conduct Rules 2110 and 2120, and IM-2310-2, Enforcement recommends that Guyette should be suspended from associating with any FINRA member firm in any capacity for six months, and fined $5,000. This recommendation falls within the range suggested by the FINRA Sanction Guidelines, which call for a fine between $10,000 and $100,000, and a suspension for a period between 10 business days and two years, or a bar in egregious cases.[108] In addition, Enforcement recommends requiring Guyette to disgorge the net commissions he earned for his sales of MP VI to his customers by incorporating this amount in the fine.[109]

For making unsuitable recommendations to customers JY and JR to invest in MP VI, in violation of NASD Conduct Rules 2110 and 2310, and IM-2310-2, Enforcement recommends that Guyette be suspended from association with any FINRA member firm in any capacity for an additional six months, and fined an additional $5,000. This recommendation, too, falls within the range of sanctions suggested by the Sanction Guidelines, which suggest a fine of $2,500 to $75,000 and suspension in all capacities for 10 business days to one year.[110]

Guyette's misconduct was serious. He repeatedly recommended MP VI to customers without investigating and understanding the risks in the notes, and recklessly represented that MP VI was a safe, secure investment.[111] For the reasons set forth above, and because of the

[108] *FINRA Sanction Guidelines*, p. 88 (2011).

[109] The Panel finds that Enforcement sufficiently established that Guyette received commissions totaling $76,140 from his sales of MP VI notes. CX-35.

[110] *Sanction Guidelines* at 94. For egregious cases, the Guidelines recommend a longer suspension of up to two years, or a bar.

[111] As noted above, Guyette made the same reckless representations when recommending earlier MedCap offerings to customers, but the Complaint does not charge him with doing so.

seriousness of Guyette's misconduct and the necessity to deter him and others from similar future misconduct, the Panel concludes that it is appropriate to impose the sanctions Enforcement recommends.

The Panel therefore suspends Guyette from associating with any FINRA member firm in any capacity for six months, and fines him $5,000, for violating Section 10(b) of the Exchange Act, Rule 10b-5 thereunder, and NASD Conduct Rules 2110 and 2120, and IM-2310-2, as charged in the Complaint's Second Cause of Action. In addition, the Panel orders Guyette to disgorge the commissions he earned from his sales of MP VI notes, by paying a fine in the amount of $76,140.[112]

Further, the Panel suspends Guyette from associating with any FINRA member firm for an additional six months, and fines him $5,000, for violating NASD Conduct Rules 2110 and 2310, and IM-2310-2, as alleged in the Complaint's Third Cause of Action. The suspensions are to be served consecutively.

Finally, the Panel orders Guyette to pay hearing costs in the amount of $2,870.50, consisting of an administrative fee of $750 and the cost of the transcript.

B. The Case against Skaltsounis and Respondent 2: First Cause of Action

1. The Importance of MedCap, and MP VI, to CBS

From 2003 to 2008, CBS sold $57 million in MedCap notes. Although on average, from 2005-2008, sales of MedCap notes constituted only 2.67% of CBS's total annual product sales, in 2006, MedCap sales generated 18.23% of CBS's gross commissions; in 2007, 25.12% of

[112] Enforcement did not request an order of restitution. As Guyette noted, in 2009 a federal court appointed a receiver to collect MedCap's assets for the benefit of investors and, as of February 10, 2011, the receiver reported collecting more than $120,646,980, and it was continuing to pursue collection efforts. Respondent John B. Guyette's Pre-Hearing Brief, p. 4. For these reasons, the Panel declines to order restitution.

CBS's gross commissions, and in 2008, 20.68% of CBS's gross commissions.[113] From August to November of 2008 – after the Firm learned that MedCap had missed principal repayments – CBS made 62 sales of MP VI notes for $6.8 million.[114] Skaltsounis was aware of the volume of sales.[115]

As noted above, the First Cause of Action of the Complaint charges that Skaltsounis and Respondent 2 (i) allowed Guyette and other CBS registered representatives to recommend and sell MP VI notes to customers without disclosing the fact that MP III had failed to make scheduled principal repayments; and (ii) allowed CBS's registered representatives to continue to use MP VI's PPM in selling the notes, when they knew or should have known that the PPM inaccurately represented that affiliated MedCap offerings had never defaulted in the payment of their obligations. By this conduct, the Complaint alleges that Skaltsounis and Respondent 2 violated NASD Conduct Rule 2110.

2. Skaltsounis' Role

Skaltsounis, as president and chief executive officer of CBS, was responsible for overall supervision with "complete authority over the management and operations of the Company."[116] He served on the CBS board of directors with Guyette and CBS's executive vice president, Paula Collier.[117] He was responsible, along with the vice president and chief compliance officer, James M. Mitchell, for ensuring that CBS established and maintained written supervisory

[113] Tr. 2, pp. 75-76, 81; SXLX-18.

[114] Tr. 2, p. 149; CX-35; CX-36.

[115] Tr. 2, p. 302.

[116] Tr. 2, p. 262; SXLX-1, p. 11.

[117] Paula Collier was CBS's executive vice president and a "producing manager" according to the Firm's written supervisory procedures. SXLX-3, p. 27; Tr. 3, p. 14. Collier was also the board's treasurer and secretary. SXLX-1, pp. 7, 11-12; Tr. 3, pp. 4-5, 9-10. She reported directly to Skaltsounis. SXLX-2, p. 1.

procedures.[118] Because Guyette brought MedCap to CBS, and was responsible for most of the Firm's MedCap business,[119] Skaltsounis relied on Guyette as the primary resource person for CBS on the MedCap offerings, and spoke frequently with him about them.[120]

Skaltsounis testified that although he understood that MP VI was not a "safe" investment, he was unaware that Guyette told his customers it was safe.[121] Skaltsounis testified that he reviewed only one MedCap offering PPM, and he did not read it thoroughly because of its length and because CBS had so many private placements.[122] He misunderstood the limited oversight provided by the trustee bank in the offerings. He believed, as Guyette did, that the trustee provided significant safeguards. Skaltsounis believed, wrongly, that the trustee was the conduit for revenues, funds, and collateral for MP VI.[123] He did not know that the trustee had no responsibility for reviewing the actions or omissions of the special purpose corporation through which the notes were offered.[124]

In addition to the one PPM he cursorily read, Skaltsounis reviewed a Note Issuance and Security Agreement between the trustee bank and MP IV. Despite doing so, he was unaware of that document's description of the limited role of the trustee. He did not realize that it explicitly stated that the trustee had no obligation to review or determine the accuracy of MedCap's documentation concerning collateral for the offerings, or to monitor the percentages of receivable and non-receivable assets.[125]

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[118] Tr. 3, pp. 7, 14-15.

[119] Tr. 2. p. 78.

[120] Tr. 3, pp. 31-32.

[121] Tr. 3, p. 33.

[122] Tr. 2, p. 267-268.

[123] Tr. 2, pp. 277-278.

[124] Tr. 2, p. 270.

[125] Tr. 2, pp. 273-274; SXLX-13, p. 25.

When Respondent 2 informed him of the first missed principal repayments, Skaltsounis participated in a conference call with CBS's registered representatives to inform them of the problem. However, Skaltsounis did not direct them to disclose it to their customers.[126] Skaltsounis remained confident in MP VI, based on MedCap's representations about the strength of its collateral.[127]

Nevertheless, Skaltsounis was sufficiently concerned about the missed payments to monitor the situation. When Respondent 2 and CBS representatives reported they were receiving inconsistent explanations from MedCap, Skaltsounis decided to speak personally with the president of MedCap.[128]

The explanations that MedCap's president gave to Skaltsounis were problematic, but Skaltsounis was unable to explain why he accepted them at face value. The president told Skaltsounis that MedCap had been able to reduce liabilities from $250 million to $58 million. However, he also said medical service providers owing money to MedCap needed refinancing but were unable to obtain it because of the illiquid credit market. Skaltsounis was unclear about why the providers needed refinancing, and said he was "not sure" if MedCap had made an "outright purchase" of the medical receivables.[129] The president also told Skaltsounis that MedCap did not possess a line of credit.[130] He said that MedCap could have retired currently outstanding notes earlier, but had gotten "greedy" and instead reinvested money in more receivables.[131] Furthermore, delays in issuing MP VI had prevented MedCap from using the

[126] Tr. 2, p. 279-281.

[127] Tr. 2, pp. 282-284.

[128] Tr. 2, p. 286.

[129] Tr. 2, pp. 288-289.

[130] Tr. 2, p. 290.

[131] Tr. 2, p. 293.

funds generated by sales of MP VI notes to repay principal to purchasers of earlier issued notes and cover the shortfall. When asked if this was a red flag, Skaltsounis answered that "[i]t would be now."[132] Instead of recognizing that this might be an indication that the MedCap offerings could be employing Ponzi scheme practices, he viewed marketing MP VI as an opportunity to raise money that would enable it to lend to other MedCap affiliates.[133]

Like Guyette, Skaltsounis accepted without question MedCap's representations that the notes were fully collateralized,[134] and believed that the missed payments in earlier MedCap offerings were unrelated to MP VI because it was a "stand alone" special purpose corporation.[135] He accepted MedCap's assurance that its cash flow problem would be resolved quickly, and that each matured note would be honored.[136] In Skaltsounis' words, he "bought their explanation … [that] it was a temporary situation."[137] Consequently, he did not suspend sales of MP VI while ascertaining the dimensions of the repayment problem.

In November 2008, CBS's executive vice president Paula Collier called Skaltsounis to recommend that CBS suspend sales of MP VI. Skaltsounis was unable to recall what precipitated Collier's decision, but he agreed with her and he decided "to shut it down."[138] Collier suggested that Respondent 2 write and send a memorandum directing CBS's representatives to stop recommending and selling MP VI.[139] On November 19, 2008, Collier

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[132] Tr. 2, pp. 290-291.

[133] Tr. 2, p. 297.

[134] *Id.*

[135] Tr. 2, p. 308.

[136] Tr. 2, pp. 293-294.

[137] Tr. 2, p. 300.

[138] Tr. 2, p. 303-304. According to Respondent 2, the issuance of a notice by the bank trustee for MP III, informing note holders that a default had occurred, precipitated Collier's action. Tr. 2, pp. 146-147. The default notice is dated November 10, 2008. CX-31.

[139] Tr. 3, p. 80.

sent an e-mail, with Respondent 2's November 18 memorandum attached, informing representatives that CBS was suspending sales of MP VI.[140]

3. Skaltsounis Violated NASD Conduct Rule 2110

It is axiomatic that "the president of a brokerage firm is responsible for the firm's compliance with all applicable requirements" imposed by securities regulations, unless he or she reasonably delegates the responsibility to another person in the firm.[141] In this case, the evidence clearly established that Skaltsounis was responsible for directing the activities of the Firm, in its Richmond, Virginia, and Greeley, Colorado, offices.[142] Skaltsounis acknowledged that he possessed ultimate supervisory responsibility for the entire Firm.[143] Skaltsounis made no claim that he delegated his overall responsibility to any other person in the Firm. As he admitted, and as his counsel conceded in argument, as chairman, chief executive officer, and control person, "the buck stops there."[144]

NASD Conduct Rule 2110 requires a registered person "in the conduct of his business" to "observe high standards of commercial honor and just and equitable principles of trade." The rule establishes a broad ethical principle,[145] whose purpose is to protect the overall integrity of the securities industry.[146] It applies to a broad spectrum of conduct impacting investors and includes violations of securities laws and NASD conduct rules.[147] A failure to fulfill obligations

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[140] SXLX-11, pp. 48-49.

[141] *Richard F. Kresge*, Exch. Act Rel. No. 55988, 2007 SEC LEXIS 1407, at *28-29 (June 29, 2007).

[142] Tr. 2, p. 235.

[143] Tr. 2, p. 262.

[144] Tr. 3, p. 236.

[145] *Dep't of Enforcement v. Conway*, No. E102003025201, 2010 SEC LEXIS 3589, at *28 (Oct. 26, 2010).

[146] *Timothy L. Burkes*, 51 S.E.C. 356, 359, 1993 SEC LEXIS 949, at *8-10 (Apr. 14, 1993).

[147] *Dep't of Enforcement v. Shvartz*, No. CAF980029, 2000 NASD Discip. LEXIS 6, at *12-13 (N.A.C. June 2, 2000).

owed to customers is a failure to uphold "just and equitable principles of trade" and violates Rule 2110.[148]

Based upon the evidence, the Panel finds that Skaltsounis, relying on Guyette's representations as well as the reports of the due diligence committee, misunderstood, as did Guyette, the role of the trustee as a safeguard in the operations of the MedCap offerings. Ill-informed, but confident in the product, on July 31, 2008, Skaltsounis allowed Guyette and other CBS registered representatives to recommend and sell customers investments in MP VI. Virtually immediately upon doing so, he learned of MedCap's failure to repay principal owed to CBS investors in earlier offerings. Skaltsounis was actually unaware that the PPM for MP VI, which he knew or should have known Guyette and other CBS registered representatives would use in their sales efforts, contained the material misstatement that the prior MedCap offerings had a track record of no failed payments of their obligations when due. More important, while monitoring the growing cascade of missed payments by MedCap offerings following the launch of MP VI, Skaltsounis accepted without question the reassurances of MedCap's president. As the CBS's president and chief executive officer, Skaltsounis was ultimately responsible for the failures of Guyette and other CBS registered representatives to alert current and prospective MP VI investors of MedCap's alarming increase in failed principal repayments from August to November 2008, while CBS representatives continued to sell the notes.

It is true that, shortly after the bank trustee issued its notice that MP III had defaulted, and Collier advised him to do so, Skaltsounis decided to suspend the Firm's sales of MP VI notes to investors. By that time, however, considerable damage had been done as a result of investors

[148] *Id.* at *12, citing *In re NASD, Inc*., 19 S.E.C. 424, 1945 SEC LEXIS 2782 (June 11, 1945).

purchasing MP VI notes without knowing of MedCap's growing inability to fulfill its obligations to note holders.

By these failures, Skaltsounis failed to adhere to the broad ethical principles required of him, and therefore violated NASD Conduct Rule 2110, as charged in First Cause of the Complaint.

4. Sanctions against Skaltsounis

Enforcement argues that Skaltsounis' violations of Rule 2110, by permitting CBS representatives to recommend MP VI notes using the PPM with a material misstatement, and by allowing them to continue to sell the notes without informing customers of the failed principal repayments to noteholders of earlier offerings, resulted from negligence, as opposed to intentional or reckless misconduct.[149] Because of the serious consequences of Skaltsounis' misconduct, Enforcement recommends imposition of a suspension from associating with any FINRA member firm in any principal capacity for six months, suspension from associating with any FINRA member firm in any capacity for 30 days, and a fine of $10,000.[150]

FINRA's Sanction Guidelines recommend a fine between $2,500 and $50,000 for negligent misrepresentations or omissions of material fact, and a suspension in any or all capacities for up to 30 business days. For intentional or reckless misrepresentations and omissions, constituting a more serious degree of misconduct, the Guidelines recommend a fine of $10,000 to $100,000, suspension in any or all capacities for 10 business days to two years, or, in egregious cases, a bar.[151] Enforcement's suspension recommendations are therefore more severe than the Guidelines' recommended maximum sanctions for negligent misrepresentations

[149] Department of Enforcement's Pre-Hearing Brief, pp. 15-16; Tr. 3, pp. 173, 184-185, 238.

[150] Department of Enforcement's Pre-Hearing Brief, p. 24.

[151] *Sanction Guidelines* at 88.

or omissions, and are within the range of sanctions the Guidelines recommend for intentional or reckless misrepresentations or omissions.

The Panel agrees with Enforcement's characterization of Skaltsounis' violations as negligent, rather than intentional, in nature. The Panel finds fault not so much with Skaltsounis' failure to focus on the claim in MP VI's PPM that holders of affiliated MedCap offerings had always received timely payments, but with Skaltsounis' failure to respond appropriately to the increasingly alarming red flags, particularly the explanations MedCap offered in its efforts to assuage concern. Certainly Skaltsounis' inaction impacted CBS customers, who invested approximately $6.8 million in MP VI and suffered significant losses.[152] It is noteworthy, as Enforcement argues, that the MedCap offerings constituted a substantial share of CBS's business, and MP VI generated sizable commissions to CBS.[153] The problems the MedCap offerings encountered after August 2008 should have generated more concern on Skaltsounis' part than they did. The failures of affiliated notes to repay principal and the inconsistent, unsatisfactory explanations MedCap officials offered Skaltsounis should have prompted him to act, at the very least to direct CBS representatives to make disclosures to customers.

Skaltsounis argues that he and CBS were entitled to rely on MedCap's explanations for the missed repayments of principal and to wait, as they did, until after a formal notice of default was issued by the bank trustee before taking action.[154] The Panel agrees with the argument that Skaltsounis' conduct should not be judged solely with the benefit of hindsight, but rejects his

[152] As noted above on page 22, at footnote 113, Enforcement did not request an order for restitution in the sanctions it recommended for Guyette. As Guyette pointed out, a federal receiver was appointed to collect MedCap assets for the benefit of investors who lost their investments, and had reported collecting more than $120 million for that purpose. Guyette's Pre-Hearing Brief, p. 4. Although there was no direct testimony on customer losses, MedCap's inability to repay principal and make interest payments clearly resulted in substantial investor losses.

[153] Department of Enforcement's Pre-Hearing Brief, p. 25.

[154] Tr. 3, pp. 231-233.

argument that MedCap's explanations were "plausible," and that on the basis of the information Skaltsounis possessed, he was justified in doing nothing from August to November 2008.[155]

For all of these reasons, the Panel finds that, to deter Skaltsounis and others from future similar misconduct, it is necessary to impose suspensions more severe than the maximum period recommended by the Guidelines for negligent misconduct, but less severe than the sanctions recommended by Enforcement.

Therefore, the Panel orders that Skaltsounis be suspended in any principal capacity for three months, suspended in all capacities for 30 business days, and pay a fine of $10,000, plus the costs of the hearing held on March 22 and 23, 2011.

5. Respondent 2's Role in Reviewing MP VI

Respondent 2 testified that the CBS due diligence committee reviewed the MedCap offering private placement memoranda and spoke with the registered representatives who visited MedCap's offices.[156] He testified that he wrote due diligence reports to be filed and to serve "as evidence" that the Firm had conducted proper reviews.[157] Respondent 2 and another member of the due diligence committee reviewed the PPM for MP VI on July 31, 2008.[158] Respondent 2, like Guyette and Skaltsounis, did not notice that the PPM contained the claim, accurate at the time but quickly to be rendered incorrect, that there were no missed payments of interest or principal in any of the earlier offerings,[159] and did not realize that the role of the bank trustee was

[155] Tr. 3, pp. 224-226.

[156] Tr. 3, p. 87.

[157] Tr. 2, p. 254.

[158] Tr. 3, p. 93. Guyette, although a member of the committee, did not participate in the due diligence review.

[159] Tr. 2, pp. 144-146. This statement was true when the PPM was written; as noted above, it was not until early August 2008, shortly after MP VI was launched, that MP II and III failed to make some principal repayments as they became due, that this statement became inaccurate.

significantly more limited than he believed it to be.[160] In the due diligence report for MP VI, Respondent 2 relied in part upon his reviews of the previous MedCap offerings, and what had been, up to that point, a successful six-year track record of payments of interest and principal to investors in earlier MedCap offerings.[161] As he had done before in his due diligence reports, he remarked on the importance of the trustee in providing oversight of the use of investors' funds.[162]

Shortly after Respondent 2 prepared the MP VI report, he learned that a customer had not received a MedCap check when due. Respondent 2 did not find this alarming at the time, thinking that the check may have merely been misdirected.[163] A few days later, James Mitchell, CBS's chief compliance officer, called to ask if Respondent 2 knew of any reason why a MedCap principal repayment was late, and if any others had been missed. Respondent 2 was still not alarmed, because the payment was only a few days late.[164] After a second, similar phone call from Mitchell, Respondent 2 printed out a schedule of the earlier MedCap offering notes with their maturity dates to monitor principal repayments.[165] The schedule showed that by August 5, 2008, MP II had missed the deadline for repaying principal to two CBS customers and MP III had missed the deadline for repaying principal to one customer.[166] This prompted Respondent 2 to call MedCap.

The person who spoke to Respondent 2 gave him inconsistent explanations that raised more questions than they answered. The MedCap representative explained that a "perfect storm"

[160] Respondent 2 testified that "It was our understanding that the trustee managed the flow of funds between investors and Medical Capital" and that the trustee verified collateral held by the special purpose corporations. Tr. 2, pp. 63-65.

[161] Tr. 2, p. 84; Tr. 3, p. 97.

[162] Tr. 2, p. 85.

[163] Tr. 2, p. 92-93.

[164] Tr. 2, pp. 93-94.

[165] Tr. 2, pp. 116-118; CX-24.

[166] Tr. 2, pp. 118-120.

of factors had caused MedCap to miss some principal repayments.[167] The factors he identified were: (i) some of the older special purpose corporations had insufficient cash because many of their notes had matured and had been redeemed, leaving insufficient funds to repay principal to the remaining note holders as their notes became due;[168] (ii) in July and August 2008, an unexpectedly large number of notes matured, requiring repayments of principal totaling $65 million, instead of the usual average monthly total of $5 to $20 million in repayments;[169] (iii) several medical providers, which were doctors' offices, were unable to obtain refinancing of loans taken from MedCap that had become due, because of the national credit crisis;[170] and (iv) unexpected delays in issuing and selling MP VI made the expected revenue stream from MP VI investors unavailable to alleviate the shortfall.[171] Respondent 2 immediately reported what he had been told to Skaltsounis[172] and provided him and Collier with at least weekly updates thereafter.[173] Later, at Collier's direction, Respondent 2 wrote the memorandum notifying CBS's registered representatives that the Firm was suspending sales of MP VI.[174]

6. Respondent 2 Did Not Violate NASD Conduct Rule 2110

Enforcement's arguments for Respondent 2's alleged negligent liability are founded on its contentions that Respondent 2 was: (i) the principal in charge of supervising private offerings at CBS; (ii) primarily responsible for CBS's offering of MP VI as chairman of the due diligence

[167] Tr. 2, p. 123.

[168] Tr. 2, pp. 127-129.

[169] Tr. 2, p. 129.

[170] Tr. 2, pp. 130-131.

[171] Tr. 2, pp. 135-136.

[172] Tr. 2, pp. 123-124.

[173] Tr. 3, p. 125.

[174] Tr. 3, p. 80.

committee; and (iii) the person who ultimately took control of CBS's offering of MP VI after learning of the missed principal repayments.[175]

The evidence does not support Enforcement's contentions.

Respondent 2's full-time responsibility was as an operations manager for CBS in the Richmond office, in charge of day-to-day operations, fielding calls from brokers and clients, opening accounts and processing paperwork.[176] A CBS organization chart placed him on the third tier of management below Skaltsounis and identified him as one of two people responsible for "Operations" and reporting directly to Collier.[177] The CBS supervisory manual approved in August 2008 described Respondent 2 as one of four "producing managers," and as "Trade Desk Supervisor" responsible for "Approval of Account Name or Designation Changes for Orders."[178] Nowhere did it identify Respondent 2 as the principal responsible for supervising private offerings such as MP VI.

Respondent 2 denied that he was the principal responsible for direct participation programs. He testified that the Firm's written supervisory procedures accurately reflected the assignment of this responsibility to Guyette.[179] Skaltsounis testified that Respondent 2 was not responsible for communicating missed MedCap payments to the Firm's registered

[175] Department of Enforcement's Reply Brief, pp. 3-7.

[176] Tr. 2, p. 246.

[177] SXLX-2, p. 2.

[178] SXLX-3, pp. 27, 32.

[179] Tr. 2, pp. 52-53; SXLX-3, p. 38. In his hearing testimony, Skaltsounis corroborated Respondent 2's testimony that Guyette was responsible for private placements. Tr. 3, p. 54. Skaltsounis admitted that he testified in an investigative on-the-record interview that the written procedures were inaccurate, and that Respondent 2 was the direct participation program principal. CX-47, pp. 34-35. When questioned about his prior inconsistent testimony at the hearing, Skaltsounis testified that he had been mistaken at the investigative interview. Tr. 2, pp. 265-266.

representatives.[180] Respondent 2 and Skaltsounis testified that Respondent 2 reported what he learned about the problem to Skaltsounis and Collier.[181]

Respondent 2 and Skaltsounis testified that Respondent 2's responsibility as chairman of the due diligence committee was to gather information about products under review, to determine whether to recommend that Skaltsounis approve the sale of the products.[182] The chairmanship of the due diligence committee was not a supervisory role; rather, Respondent 2 was to coordinate the gathering of information.[183] Respondent 2 testified that he had no authority to suspend the sales of MP VI.[184]

The Panel finds that the evidence is insufficient to sustain the allegations against Respondent 2 in the Complaint's First Cause of Action. The evidence does not establish by a preponderance that (i) Respondent 2 was the CBS principal responsible for supervising private offerings; (ii) as chairman of the due diligence committee, he was primarily responsible for MP VI; (iii) he held the authority to approve the MP VI offering for sale by the Firm's brokers; or (iv) he controlled the MP VI offering.

It is true that Respondent 2 recommended approval of MP VI to Skaltsounis, but it was Skaltsounis who was responsible for approving or disapproving the sale of MP VI notes by CBS. The Panel finds that Enforcement did not prove by a preponderance of the evidence, therefore, that Respondent 2 permitted the Firm's brokers to recommend and sell MP VI securities to customers without disclosing material facts, and to utilize MP VI's materially misleading PPM, as alleged in the First Cause of Action.

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[180] Tr. 2, p. 307.

[181] Tr. 2, pp. 123-124, 279-280.

[182] Tr. 2, p. 255; Tr. 3, pp. 62-63.

[183] Tr. 2, p. 255; Tr. 3, pp. 61-63.

[184] Tr. 2, p. 147.

C. The Supervision Case against Respondent 2: Fourth Cause of Action

As noted above, the Complaint's Fourth Cause of Action, directed solely against Respondent 2, alleges that he violated NASD Conduct Rules 2110 and 3010 by failing to establish and maintain a supervisory system, and to establish and enforce written supervisory procedures, reasonably designed to achieve compliance with applicable securities laws and regulations specifically applicable to private securities offerings and related suitability, disclosure, and other sales practice issues. The Complaint specifically alleges further that Respondent 2: (i) having determined that the MedCap offerings contained a high risk of loss, as due diligence committee chairman, failed to ensure that CBS established a supervisory system to educate its representatives on the risks and instruct them on what they could and could not represent to customers when recommending MedCap notes; (ii) failed to disseminate the committee's due diligence reports on the MedCap offerings to brokers selling MP VI, and failed to establish and implement procedures for doing so, thereby allowing registered representatives, such as Guyette, to tell customers the notes were a safe and secure investment; (iii) failed to enforce CBS's due diligence committee guidelines requiring the Firm to investigate and understand the products it sold, particularly the limited role of the trustee bank in the operations of the MedCap special purpose corporations; and (iv) disregarded red flags of MedCap's failures to make scheduled repayments of principal to customers when due, which indicated that MP VI might fail to meet its future payment obligations, and failed to require the Firm's registered representatives to disclose the missed payments to investors and prospective investors in MP VI.

Enforcement argues that Respondent 2 is liable because he was "the principal in charge of supervising private offerings" at CBS and that he demonstrated his authority as such by "taking control of the MP VI offering" after CBS learned of the failed principal repayments by

affiliated MedCap offerings.[185] Enforcement also relies on the fact that at an on-the-record interview during the investigation of this case, Skaltsounis testified that Respondent 2 was the supervisor in charge of direct participation products.[186]

At the hearing, however, Skaltsounis testified that his investigative interview testimony was incorrect. Rather, he said, Guyette was responsible for oversight of direct participation products. Skaltsounis testified that CBS delegated that responsibility to Guyette because he was most knowledgeable about those products. Skaltsounis' corrected recollection is consistent with the Firm's written supervisory procedures, which identified Guyette, not Respondent 2, as the supervisor in charge of direct participation products.[187]

In unrebutted testimony, Respondent 2 testified that he was not responsible for establishing a system for the review and supervision of private placements, or for training the sales staff. Respondent 2 specifically denied that he was responsible for establishing, maintaining, or enforcing the Firm's supervisory system for review of sales of private securities offerings, and asserted that these were the responsibilities of the compliance department.[188] Skaltsounis corroborated Respondent 2, and testified specifically that Respondent 2 had no responsibility for drafting supervisory procedures, or for supervising private placement sales, and was only responsible for supervising the registered representatives under his charge.[189]

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[185] Department of Enforcement's Reply Brief, p. 2.

[186] *Id.* at 3.

[187] Skaltsounis testified at the hearing that at the on-the-record interview he had forgotten that Collier had specifically selected Guyette to be in charge of direct participation products. Tr. 3, pp. 50-53. The only direct evidence supporting Enforcement's contention that Respondent 2 held that position is Skaltsounis' on-the-record interview testimony, which he now recants. For his part, Guyette denied that he was the supervisor for direct participation programs and claimed that the written supervisory manual giving him that designation was inaccurate. Tr. 1, pp. 132-133. The Panel finds that Enforcement failed to establish by the preponderance of the evidence that Respondent 2 was the principal in charge of direct participation products and that he was responsible for supervising the private offerings at CBS.

[188] Tr. 2, pp. 244-245.

[189] Tr. 3, pp. 37, 54, 59-60.

Skaltsounis testified that Respondent 2 had no role in drafting the written supervisory procedures manual; was never involved in meetings with him and James M. Mitchell, the chief compliance officer, concerning reviews of the compliance system and implementation of the written supervisory procedures;[190] and did not serve on the Firm's board of directors, comprising Skaltsounis, Guyette, and Collier.[191] Furthermore, the Firm's written supervisory procedures manual designated Mitchell, the chief compliance officer, as the person responsible for establishing CBS's supervisory systems[192] and did not delegate to Respondent 2 any of the responsibilities described in the section devoted to supervision of direct participation programs.[193] Skaltsounis testified that he, Guyette, and Collier shared the responsibility of supervising private placement sales,[194] and that Mitchell, Collier, and he were responsible for establishing the system of supervisory procedures.[195]

On the basis of this record, the Panel concludes that Enforcement has failed to establish by a preponderance of the evidence that Respondent 2 is liable as charged in the Fourth Cause of the Complaint. That charge is, therefore, dismissed.

III. Conclusion

For the reasons set forth above, the Extended Hearing Panel dismisses the charges against Respondent 2.

For misrepresenting and omitting material facts in selling securities to customers, in violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder,

[190] Tr. 3, pp. 14-15.

[191] Tr. 3, p. 6.

[192] SXLX-3, p. 15.

[193] Tr. 2, pp. 243-245; Tr. 3, pp. 66-67; SXLX-3, p. 38.

[194] Tr. 3, p. 54.

[195] Tr. 3, p. 73.

and NASD Conduct Rules 2110 and 2120, and IM-2310-2, Respondent John B. Guyette is suspended from associating in any capacity with any FINRA member firm for six months and is fined $5,000. For making unsuitable investment recommendations to customers, in violation of NASD Conduct Rules 2110 and 2310, and IM-2310-2, he is suspended from associating in any capacity with any FINRA member firm for six months, to be served consecutively to the above suspension, and is fined an additional $5,000. Furthermore, he is ordered to disgorge and pay as a fine $76,140 in commissions he earned during the course of his misconduct. Finally, he is ordered to pay costs in the amount of $2,870.50, consisting of an administrative fee of $750 and the cost of the transcript of the Denver portion of the hearing.

If this Decision becomes FINRA's final disciplinary action, Guyette's suspensions shall become effective on the opening of business on February 6, 2012, and shall end at the close of business on February 5, 2013. The fines and costs shall be due and payable on Guyette's return to the securities industry.

For violating NASD Conduct Rule 2110 by permitting registered representatives to sell securities to customers without disclosing material facts, and permitting registered representatives to use a document containing a material misstatement of fact in the sale of securities, Respondent Nicholas D. Skaltsounis is suspended from associating with any FINRA member firm in any principal capacity for three months, suspended in all capacities for 30 business days, and is fined $10,000. In addition, he is ordered to pay the costs of the hearing in the amount of $4,758.00, consisting of an administrative fee of $750 and the cost of the transcript.

If this Decision becomes FINRA's final disciplinary action, Skaltsounis' suspensions shall become effective on the opening of business on February 6, 2012. The suspension in all

capacities shall end at the close of business on March 19, 2012. The suspension in any principal capacity shall end on May 5, 2012. The fine and costs shall be due and payable on Skaltsounis' return to the securities industry.[196]

HEARING PANEL.

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By: Matthew Campbell
Hearing Officer

Copies to:

Nicholas D. Skaltsounis (via overnight courier and first-class mail)
Respondent 2 (via overnight courier and first-class mail)
John B. Guyette (via overnight courier and first-class mail)
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David F. Newman, Esq. (via electronic and first-class mail)
Mark P. Dauer, Esq. (via electronic mail)
David R. Sonnenberg, Esq. (via electronic mail)

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