FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

GARDNYR MICHAEL CAPITAL, INC.
(CRD No. 30520),

and

PFILIP GARDNYR HUNT, JR.
(CRD No. 1613985),

Respondents.

Disciplinary Proceeding
No. 2011026664301

Hearing Officer - MC

AMENDED HEARING PANEL DECISION[1]

January 28, 2014

Respondent Gardnyr Michael Capital, Inc. ("GMCI") willfully violated MSRB Rule G-17 when, in connection with bond rating trips, it improperly sought and received reimbursements from municipal bond proceeds for unnecessary expenses and for expenses it was contractually obligated to pay. GMCI is censured, fined $10,000 and ordered to pay restitution of $5,322.44, plus interest.

GMCI and Respondent Pfilip Gardnyr Hunt, Jr. willfully violated MSRB Rules G-27 and G-17 by failing to adopt, maintain, or enforce any written supervisory procedures for bond rating trips, and by failing to supervise bond rating trips. For these violations, GMCI is censured and fined $10,000. Hunt is fined $10,000 and is suspended in all principal capacities for three business days. GMCI is assessed costs. Respondents' willful rule violations subject them to statutory disqualification.

The Hearing Panel dismisses two causes of action charging GMCI with violating MSRB Rule G-17 for seeking and obtaining reimbursements from municipal bond proceeds for entertainment expenses incurred in municipal bond rating trips.

[1] The amended decision is being issued to make clear that the Hearing Panel found Respondents' violations to be willful.

Appearances

Carolyn J. Craig, Esq., and Rebecca S. Giltner, Esq., for the Department of Enforcement.

Philip J. Snyderburn, Esq., Snyderburn, Rishoi & Swann, LLP, for Respondents.

I. Background

Respondent Gardnyr Michael Capital, Inc. ("GMCI") is a municipal securities firm offering services as an underwriter for municipalities issuing bonds to finance public works. The services GMCI offers an issuer typically include structuring bond offerings and providing a sales team to market them. In some instances, to help municipalities obtain favorable insurance and bond ratings, GMCI organizes trips to New York City for municipal officials to meet with representatives of bond rating and bond insurance agencies.

When a municipality chooses GMCI to underwrite a bond issue, GMCI negotiates a purchase agreement with the issuing municipal entity. The issuer's counsel usually drafts the contract, which may include provisions for either the municipality or the underwriter to pay certain costs incurred in the process of issuance. Some contracts provide that the underwriter is not responsible for any costs of issuance, and that the costs will be paid from the bond or warrant proceeds. Other contracts make the underwriter responsible to pay specified expenses.[2]

This case presents for the first time the question of whether it is a violation of MSRB Rule G-17[3] for a municipal securities firm to obtain reimbursement for certain costs incurred by municipal officials and firm representatives on bond rating trips.

[2] Hearing Transcript (Hunt) 47-53, 186. References to witness testimony in the hearing transcript are cited as "Tr." followed by the name of the witness whose testimony is cited, and the page number or numbers on which the relevant testimony appears.

[3] MSRB Rule G-17 generally requires brokers and dealers to treat all persons fairly in the conduct of its municipal securities business, and prohibits deceptive, dishonest, and unfair practices. See discussion *infra* Section IV.

The facts are largely undisputed. GMCI is a FINRA member firm with its headquarters in Mobile, Alabama, and offices in Birmingham, Alabama, and Winter Park, Florida.[4] Respondent Pfilip Gardnyr Hunt, Jr., is GMCI's sole owner and its president, secretary, treasurer, director, and, until recently, its chief compliance officer. GMCI employs approximately 22 people.[5]

Since Hunt founded the firm in 1992, GMCI has been involved as underwriter in issuing "[j]ust over 500" bonds, and Hunt has organized six bond rating trips.[6]

The Complaint in this case focuses on three such trips. They took place in December 2007, March 2008, and December 2009. For the December 2007 trip, GMCI was a co-underwriter for the municipal bond issue; it was the sole underwriter for the other two offerings.[7] GMCI organized the trips, paid for transportation, meals, lodging, and in some instances entertainment, then sought and received reimbursements from the municipalities.[8] Hunt was responsible for the first trip; former GMCI investment banker Walter E. Lewis organized the other two.[9]

The gravamen of the Complaint, contained in its first four causes of action, is that by seeking and obtaining reimbursement from municipal bond proceeds for certain bond rating trip expenses, GMCI willfully violated its obligations under MSRB Rule G-17 to "deal fairly with all persons" and "not engage in any deceptive, dishonest, or unfair practice." A fifth cause of action alleges that GMCI and Hunt violated MSRB Rule G-27 by failing to maintain and implement

[4] Joint Stipulations ("Stip.") ¶ 1; Tr. (Hunt) 172.

[5] Stip. ¶ 2; Tr. (Hunt) 172-73.

[6] Tr. (Hunt) 199-200.

[7] Stip. ¶¶ 6, 19, 29.

[8] Stip. ¶¶ 14-15, 22, 25, 33, 37.

[9] Tr. (Hunt) 177, 189, Tr. (Lewis) 42.

written supervisory procedures and to properly supervise the process of seeking reimbursement of expenses arising from the firm's bond rating trips.

The reimbursements at issue total $7,971.41. Enforcement concedes that the dollar value of the allegedly improper reimbursements is small, but argues that "the principle in this case is huge."[10]

Enforcement's position is that, regardless of industry practice, it was "categorically inappropriate"[11] for GMCI to seek reimbursement for any entertainment expenses, any "unnecessary" food or lodging expenses, and any expenses incurred by GMCI that the firm was obligated to pay by the terms of its contract with the municipality. Enforcement argues that it was "inherently wrong" for GMCI "to pass along these expenses to municipal taxpayers" because the expenses "were not reasonably related to, or necessary costs of, the municipal securities offerings," and were therefore unrelated to the business purposes of the trips.[12] Enforcement's expressed rationale for bringing this case is to promote a central purpose of MSRB Rule G-17, which Enforcement argues is to protect not only investors and issuers, but the public at large, specifically taxpayers, who were harmed when GMCI was improperly reimbursed with public funds.[13]

[10] Department of Enforcement's Pre-Hearing Br. 1.

[11] Enforcement does not concede that it was GMCI's practice to seek reimbursement for all of the expenses as it did in these three bond rating trips, noting that the firm varied its practice somewhat on other occasions. Furthermore, Enforcement discounts Respondents' defense that they conformed their acts to industry custom, arguing that "it doesn't really matter" if a practice is customary in the industry. Tr. 258, 269.

[12] Department of Enforcement's Post-Hearing Br. 1-2, 10, 13.

[13] *Id.* at 2.

Respondents answer that in the municipal securities industry it is standard practice for municipalities to reimburse firms for expenses such as the ones at issue in this case, and that the expenses for which GMCI was reimbursed were reasonable.[14]

Respondents contend that Enforcement is applying a "novel" interpretation of MSRB Rule G-17.[15] Respondents deny that any of the reimbursements were dishonest, deceptive, or unfair. Respondents stress the fact that the municipalities knowingly approved the reimbursements, consistent with accepted practice under the prevailing customs and standards of the municipal securities industry. Respondents argue that because prior published disciplinary actions and Notices to Members relating to bond rating trips nowhere state specifically that reimbursements for expenses like those at issue in this case are improper, bringing this unprecedented disciplinary proceeding violates their right to fair notice. Additionally, Respondents argue that because MSRB Rule G-17 is designed to protect customers and issuers, Enforcement's action to extend the rule's protections to taxpayers is also unprecedented, and unsupported by existing interpretive guidelines.[16]

II. The MSRB Rule G-17 Charges: The First Four Causes of Action

The first cause of action focuses on reimbursements for food and lodging expenses incurred when some members of a county delegation traveled to New York a day earlier than was necessary. The second and third causes of action are directed solely at reimbursements for entertainment expenses incurred on two rating trips. The fourth cause of action concerns

[14] Answer ¶ 1; Tr. (Hunt) 182 (Hunt testified that the reimbursements were reasonable and consistent with "the industry standard. The industry's been going to Broadway plays and comedy shows … since the beginning of time.").

[15] Respondents' Post-Hearing Br. 4-5.

[16] *Id.* at 4-8.

reimbursements for transportation, food, and lodging expenses for GMCI representatives on a rating trip which the firm had contractually bound itself to pay.

A. The Mobile County Rating Trip – December 2007 – Day Early Food and Lodging Expenses

In 2007, Mobile County, Alabama competed with other jurisdictions to be the site for a major steel production plant. Jay M. Ross, the Mobile County Attorney, described the project as a "huge economic development for Mobile [County] at the time" and a "big, big deal for Alabama." Ross estimated that the project represented a three to four billion dollar investment, which was expected to bring between 3,000 and 4,000 jobs to Mobile County. It required a commitment of $70 million by the County, making it "the single biggest bond deal that Mobile County had ever done."[17] The County planned to issue municipal bonds to raise funds to acquire and improve land for the plant and to levy a tax to pay principal and interest on the bonds.[18] GMCI was a co-underwriter for the offering.[19]

Mobile County sought favorable ratings from credit rating agencies and bond insurance.[20] At the County's request, GMCI organized a trip to New York City for County officials to meet with credit rating agency analysts and a bond insurer. The meetings were scheduled for Monday, December 10, 2007, at 9:30 a.m. and 3:30 p.m.[21]

Four of the seven Mobile County officials making up the County delegation chose to travel a day before the others. They flew to New York on Saturday, December 8, 2007, where

[17] Tr. (Ross) 159-60.

[18] Stip. ¶¶ 3-5.

[19] *Id.* ¶ 6.

[20] *Id.* ¶ 7.

[21] *Id.* ¶ 8; JX-1.

they were joined by Respondent Hunt, his wife, and an officer from GMCI's co-underwriter. The other three County officials traveled to New York on Sunday, December 9.[22]

The reasons some members of the delegation went a day early had nothing to do with the bond issue. According to County Attorney Ross, when the trip was being planned, one of the Mobile County Commissioners announced that he wanted to go on Saturday because he had "some business connections on something he was working on with the county," unrelated to the bond issue, that involved contacting a banker.[23] Three other Mobile County officials, including Ross, not involved with the "business connections" or the banker, also decided to go early and informed Hunt, who said he would meet them in New York on Saturday.[24] Ross testified that he was unaware of any prohibition against traveling a day earlier than necessary to be at the Monday morning meeting.[25]

The early-traveling group left Mobile on Saturday at 7:45 a.m. and arrived in New York at approximately 2:00 p.m.[26] The County Commissioner with other "business connections" left his colleagues and "disappeared for a few hours."[27] Hunt and his wife spent Saturday and Sunday shopping.[28] The other Mobile County officials who went on Saturday were also on their own both Saturday and Sunday.[29]

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[22] Stip. ¶¶ 9-10. Hunt's wife accompanied him.

[23] This commissioner, Stephen Nodine, did not testify at the hearing. Tr. (Ross) 157.

[24] *Id*.

[25] *Id.* at 158.

[26] *Id*. at 155; JX-1.

[27] Tr. (Ross) 167.

[28] Tr. (Hunt) 190.

[29] *Id*. at 192.

On Saturday, two Mobile County officials incurred costs for lunch, and all four incurred costs for dinner as well as lodging at a Renaissance Hotel for Saturday night.[30]

On Sunday, the three other Mobile County officials arrived in New York City. The entire delegation met for dinner for what the group's itinerary described as a "preparation session," and then attended a theatrical production that GMCI paid for.[31]

On Monday, the delegation met with two ratings agencies and a bond insurance agency. They returned to Alabama on Tuesday morning. The total costs of the trip included a van for transportation, airfare, and meals; GMCI sought and received a total of $16,707.38 for these expenses, including the Saturday meal and lodging costs.[32]

Hunt paid these expenses with GMCI's corporate credit card.[33] He then submitted a bill for reimbursement. Initially, Hunt sought reimbursements for meals, including liquor, for himself, his wife, and the representative of the co-underwriter who also went to New York on Saturday, but this contravened the agreement between the underwriters and Mobile County, and Ross directed Hunt to remove those costs from the reimbursement request.[34]

Ross then requested County approval for the remaining expenses, including those incurred on Saturday.[35] The County subsequently reimbursed GMCI from bond offering

[30] Stip. ¶¶ 11-12; Tr. (Ross) 156. At his on-the-record interview, Hunt was unable to remember whether the group engaged in any business discussions during the Saturday dinner. At the hearing, however, he claimed that the County Attorney later informed him that they had discussed the presentations they planned to make on the following Monday. Tr. (Hunt) 213-14. In his testimony, however, Ross did not mention any such business discussions occurring at the Saturday dinner.

[31] The delegation attended a performance of The Blue Man Group, a comedy show. Tr. (Ross) 163. GMCI paid for the show as a gift entertainment expense under MSRB Rule G-20. Tr. (Hunt) 183. Enforcement found no fault with this.

[32] Stip. ¶ 15.

[33] *Id*. ¶ 14.

[34] Tr. (Ross) 165-66; JX-4. Hunt testified that the agreement between GMCI and Mobile County was "verbal" and that his initial request for reimbursement for his, his wife's, and the other underwriter representative's expenses was "just a mistake." Tr. (Hunt) 181.

[35] Tr. (Ross) 166.

proceeds. The costs incurred and reimbursed for the Saturday meals and lodging totaled $2,707.[36] The Complaint's first cause of action charges that by seeking and obtaining reimbursement for the Saturday "unnecessary meals and lodging expenses," GMCI violated MSRB Rule G-17's requirement to "deal fairly with all persons and not engage in any deceptive, dishonest, or unfair practice."[37]

B. The Russell County Rating Trip – March 2008 – Entertainment Expenses

In 2008, the Russell County, Alabama Public Building Authority decided to issue municipal warrants to raise funds for improvements to County government buildings.[38] The principal and interest were to be paid by a property tax and from general County revenues.[39]

GMCI was the sole underwriter for the warrant offering. Former GMCI investment banker Walter E. Lewis organized the rating trip to New York City for Russell County officials and GMCI representatives to meet with analysts for two bond insurers on March 18, 2008, and two credit rating agencies on March 19.[40] Lewis recommended the trip. Russell County had never obtained a bond rating before, and Lewis felt it was important for County economic development officials and leaders to "tell the story" of "what was going on" with the County's economy and its growth.[41] Lewis paid the costs of the trip, including transportation and entertainment, and then submitted an invoice to the issuer and the issuer's paying agent to recoup the expenditures as a "cost … of issuance."[42]

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[36] Stip. ¶¶ 11-14.

[37] Compl. ¶¶ 27-28.

[38] Stip. ¶¶ 16-17.

[39] *Id.* ¶ 18.

[40] *Id.* ¶¶ 19-21.

[41] Tr. (Lewis) 68-69.

[42] *Id.* at 64-67.

Four Russell County officials, two outside attorneys, and two GMCI representatives in addition to Lewis made the trip.[43] Lewis submitted an invoice for reimbursement to GMCI for $20,428.46. The expenses included $1,106.97 for nine tickets for a Broadway show; three County officials, Lewis, and one other GMCI representative attended the performance.[44] By seeking and obtaining reimbursement for the show, an expense that allegedly "should not have been paid for by the taxpayers," the Complaint's second cause of action charges that GMCI willfully violated MSRB Rule G-17.

C. The Lawrence County Rating Trip – December 2009 – Entertainment And Other Expenses

In 2009, Lawrence County, Alabama decided to issue two series of warrants to raise funds for renovation and construction of an annex to the County courthouse.[45] GMCI was sole underwriter. Lewis organized a rating trip to New York City for three County officials, the County's outside counsel, another GMCI representative and himself to meet with a credit rating agency analyst on December 3, 2009, and with analysts from another credit rating agency and a bond insurer on December 4.[46]

1. The Entertainment Expenses

Using his GMCI credit card, Lewis purchased tickets for the Lawrence County group to attend a Broadway show on the evening of December 3 for $1,008.[47] Lewis also purchased tickets for the group to tour the Empire State Building the following day, at a cost of $534.[48] The

[43] Stip. ¶ 22.

[44] *Id.* ¶¶ 23-25. Four of the tickets, which Lewis purchased a week in advance of the trip, went unused. Tr. (Lewis) 75-76.

[45] Stip. ¶¶ 26-28.

[46] *Id.* ¶¶ 29-32.

[47] *Id.* ¶¶ 33-34.

[48] *Id.* ¶¶ 35-36.

total reimbursement for the trip's costs, paid from the proceeds of the warrant offerings, came to $13,328.55.[49] For obtaining reimbursement for $1,542 for the show and the tour, "items that should not have been paid for by the taxpayers," the Complaint's third cause of action charges GMCI with willfully violating MSRB Rule G-17.

2. GMCI's Transportation, Lodging, And Meal Reimbursements

For the Lawrence County rating trip, GMCI and the County entered into two Warrant Purchase Agreements, one for each series of warrants the County planned to issue. Each agreement provided that GMCI would be responsible for paying all travel and lodging expenses for GMCI representatives accompanying the County officials. Lewis charged the costs of his and another GMCI representative's airfare, lodging and meal expenses, totaling $2,615.44, on GMCI's credit card. Then GMCI sought and received reimbursements for these expenses although despite the express terms of the Warrant Purchase Agreements.[50] The Complaint's fourth cause of action charges that this constituted a willful violation of MSRB Rule G-17.

III. MSRB Rule G-17

MSRB Rule G-17 states "In the conduct of its municipal securities or municipal advisory activities, each broker, dealer, municipal securities dealer and municipal advisor shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice."

An Interpretive Notice, *Guidance on Disclosure and Other Sales Practice Obligations to Individuals and Other Retail Investors in Municipal Securities* (July 14, 2009) ("July 2009 Notice") states: "Rule G-17 is the core of the MSRB's investor protection rules." As Enforcement argues, Rule G-17 is designed to "promote fair practices in the municipal securities

[49] *Id.* ¶ 37.
[50] *Id.* ¶¶ 38-42.

market."[51] Enforcement relies on the July 2009 Notice and a number of other Interpretive Notices issued by the MSRB to support its contention that GMCI violated Rule G-17 by obtaining reimbursements for the particular expenses alleged in the first four causes of action. As Enforcement points out, these Interpretive Notices, in conjunction with the plain language of Rule G-17, establish the importance of Rule G-17 in establishing a high ethical standard.

A. Interpretive Notices

Well before the three trips at issue in this case occurred, an early Interpretive Notice, *Regarding Rule G-17, On Disclosure of Material Facts* (March 18, 2002) ("March 2002 Notice") established that Rule G-17:

> imposes a duty on dealers not to engage in deceptive, dishonest, or unfair practices. This first prong of rule G-17 is essentially an antifraud prohibition. Second, the rule imposes a duty to deal fairly. Statements in the MSRB's filing for approval of rule G-17 and the SEC's order approving the rule note that rule G-17 was implemented to establish a minimum standard of fair conduct by dealers in municipal securities. In addition to the basic antifraud prohibitions in the rule, the duty to "deal fairly" is intended to "refer to the customs and practices of the municipal securities markets, which may, in many instances differ from the corporate securities markets."

A later Interpretive Notice, *Dealer Payments in Connection with the Municipal Securities Issuance Process* (January 29, 2007) ("January 2007 Notice") states that dealers:

> should be aware that characterizing *excessive or lavish expenses* for the personal benefit of issuer personnel as an expense of the issue *may*, depending on all the facts and circumstances, constitute a deceptive, dishonest or unfair practice. A dealer may violate Rule G-17 by knowingly facilitating such a practice by, for example, making arrangements and advancing funds for the *excessive or lavish* expenses to be incurred and thereafter claiming such expenses as an expense of the issue. (emphasis supplied).

The January 2007 Notice goes on to state that:

> the MSRB does not mean to suggest that issuers or dealers curtail legitimate expenses in connection with the bond issuance process and recognizes that it sometimes is advantageous for issuer officials to visit bond rating agencies to provide information that will facilitate the rating of the new issue. It is the character, nature and extent of expenses

[51] Department of Enforcement's Pre-Hearing Br. 11-12.

> paid by dealers or reimbursed as an expense of issue, even if thought to be a common industry practice, which may raise a question under applicable MSRB rules.

A more recent Interpretive Notice, *Notice Concerning the Application of MSRB Rule G-17 To Underwriters of Municipal Securities* (August 2, 2012) ("August 2012 Notice"), issued after the trips that are the subject of this case, stated:

> Under Rule G-17 … brokers, dealers, and municipal securities dealers ("dealers") must, in the conduct of their municipal securities activities, deal fairly with all persons and must not engage in any deceptive, dishonest, or unfair practice. This rule is most often cited in connection with duties owed by dealers to investors; however, it also applies to their interactions with other market participants, including municipal entities such as states and their political subdivisions that are issuers of municipal securities ("issuers") … The examples discussed in this notice are illustrative only and are not meant to encompass all obligations of dealers to municipal entities under Rule G-17. The notice also does not address a dealer's duties when the dealer is serving as an advisor to a municipal entity … The MSRB notes that an underwriter has a duty of fair dealing to investors in addition to its duty of fair dealing to issuers.

The only mention of expenses associated with bond issuance in the August 2012 Notice is the following, which makes specific reference to MSRB Rule G-20, not G-17:

> Dealers should consider carefully whether payments they make in regard to expenses of issuer personnel in the course of the bond issuance process, including in particular, but not limited to, payments for which dealers seek reimbursement from bond proceeds or issuers, comport with the requirements of Rule G-20. For example, a dealer acting as a financial advisor or underwriter *may violate* Rule G-20 by paying for *excessive or lavish travel, meal, lodging and entertainment expenses in connection with an offering* (such as may be incurred *for rating agency trips*, bond closing dinners, and other functions) *that inure to the personal benefit of issuer personnel and that exceed the limits or otherwise violate the requirements of the rule.* (emphasis supplied).

MSRB Rule G-20's focus is "Gifts, Gratuities, and Non-Cash Compensation." Rule G-20(a) places a limit of $100 annually on the value of gifts municipal securities dealers may give to others. It contains exceptions, however, such as:

> (b) *Normal Business Dealings.* Notwithstanding the foregoing, the provisions of section (a) of this rule shall not be deemed to prohibit occasional gifts of meals or tickets to *theatrical, sporting, and other entertainments* hosted by the broker, dealer or municipal securities dealer … provided, that such gifts shall not be so frequent or so extensive as to raise any question of propriety. (emphasis supplied).

MSRB Rule G-20(d), entitled "Non-Cash Compensation in Connection with Primary Offerings" also makes mention of entertainment. After prohibiting municipal securities dealers from making or accepting non-cash compensation "[i]n connection with the sale and distribution of a primary offering of municipal securities," it explains:

> Notwithstanding the provisions of section (a) of this rule, the following non-cash compensation arrangements are permitted … (ii) occasional gifts of meals or tickets to *theatrical, sporting, and other entertainments*; provided that such gifts are not so frequent or so extensive as to raise any question of propriety and are not preconditioned on achievement of a sales target. (emphasis supplied).

Recognizing that MSRB Rule G-17 and the Interpretive Notices do not provide guidance specifically applicable to the facts of this case, Enforcement emphasizes that MSRB rules are "principles-based" and flexible by design.[52]

Enforcement's position is that GMCI and the municipal officials involved with the three rating trips were wrong "essentially to collude to take taxpayers' money for their own personal benefit" and that by doing so they engaged in "a deceptive, dishonest, and unfair practice" and "plainly violated Rule G-17's ethical standard."[53] Enforcement contends that the MSRB had put GMCI and other municipal securities firms on notice of Rule G-17's requirements when "the MSRB warned underwriters that they cannot pass costs that are unnecessary and unrelated to the offering to the taxpayers, and that doing so will violate Rule G-17."[54]

Enforcement cites to an Interpretive Notice that the MSRB issued in July 1985 directed at syndicate managers concerning costs they assessed syndicate members.[55] In it, the MSRB warned syndicate managers that they "should take care in determining the actual expenses

[52] Department of Enforcement's Post-Hearing Br. 7-8.

[53] *Id.* at 13.

[54] *Id.* at 14.

[55] *Id.* at n.89.

involved in handling designated sales and may be acting in violation of rule G-17 if the expenses charged to syndicate members bear no relation to or otherwise overstate the actual expenses incurred."[56]

Enforcement argues that the Notices, particularly the January 2007 Notice discussed above, alerted the municipal securities industry that reimbursements like those at issue here could be found to be improper. The January 2007 Notice states that covering expenses for the "personal benefit of the issuer" may be deceptive, dishonest, and unfair, and that "for example, making arrangements and advancing funds for the *excessive or lavish* expenses to be incurred and thereafter claiming such expenses as an expense of the issue" may be an unfair practice. (emphasis supplied).[57]

In addition, Enforcement quotes *Reminder Notice on Fair Practice Duties to Issuers of Municipal Securities* (September 29, 2009) ("September 2009 Notice"), which states that the MSRB "previously noted that Rule G-17 may apply in connection with certain payments made and expenses reimbursed during the municipal bond issuance process for *excessive or lavish* entertainment or travel expenses." (emphasis supplied).[58]

Finally, Enforcement quotes, in part, a sentence from the August 2012 Notice.[59] The full sentence states "Dealers are reminded of the application of MSRB Rule G-20, on gifts, gratuities, and non-cash compensation, and Rule G-17, in connection with certain payments made to, and expenses reimbursed for, issuer personnel during the municipal bond issuance process."

[56] The July 1985 MSRB Notice is reprinted in the MSRB Rule Book at 141-42 (2013).

[57] Department of Enforcement's Post-Hearing Br. 11.

[58] Department of Enforcement's Pre-Hearing Br. 14.

[59] *Id.*

Applying these various references to expense reimbursements to this case, Enforcement concludes that here the "costs incurred for Broadway shows and sightseeing tours were not reasonably related to the underwriting of the offerings and were not necessary to underwrite the offerings. They were personal entertainment expenses that ultimately burdened the taxpayers" and GMCI acted intentionally or recklessly by seeking and receiving the reimbursements at issue.[60]

B. Reported Disciplinary Actions In Rating Trip Cases

1. The RBC Case

There are only a few reported cases dealing with bond rating trips. One is *RBC Capital Markets Corp.*, in which the Securities and Exchange Commission made findings of fact and imposed sanctions pursuant to a settlement with RBC Capital Markets Corporation ("RBC").[61] The case arose from bond rating trips occurring in 2004 and 2005 in which RBC was found to have violated MSRB Rules G-17 and G-20. The trips were similar in purpose to the trips at issue here. But the expenses were far more extravagant than in this case. RBC arranged for hotel, transportation, dining and entertainment, paid the costs, and obtained reimbursements from the municipality.[62] On the RBC trips, municipal officials "were accompanied by family members, dined at upscale restaurants, attended Broadway shows and sporting events, and had access to a private car service."[63]

Unlike this case, there were specific municipal regulations which prohibited the municipality from reimbursing officials for entertainment, bar bills, expenses incurred by

[60] Department of Enforcement's Pre-Hearing Br. 14-15.

[61] Exchange Act Rel. No. 59439, 2009 SEC LEXIS 435 (Feb. 24, 2009).

[62] *Id*. at *5.

[63] *Id*. at *2.

relatives, and travel more than a half-day in advance of, or following, business meetings.[64] RBC and the municipal delegation flagrantly violated these regulations.

On the March 2004 trip, the bond rating meetings took place on a single day. There were five officials in the delegation. Three officials brought a total of six additional family members and traveled to New York five days before the meetings. The other two officials arrived three days before the meetings. The delegation and the family members attended four Broadway shows and a professional basketball game, for a total cost of $7,250, and used a private car service costing $8,883, only $1,000 of which was attributable to transportation to the meetings.[65]

RBC's payments of expenses totaled $33,452, for which the firm sought and obtained reimbursement from proceeds of the bond offerings as costs of issuance. Following the trip, in August and September 2004, the SEC conducted an examination of RBC's municipal bond underwriting practices. At the conclusion of the examination, the examiners warned RBC of their concerns over the propriety of "(a) the types of expenses being advanced to clients, (b) the fact that RBC was paying expenses for family members of clients, and (c) the possible excessiveness of Rating Trip expenses."[66]

Despite the warning, the following year RBC organized another bond rating trip for the same municipality. This time, five municipal officials brought along a total of nine family members. Meetings were scheduled for only two days; however, the officials and their family members spent six days in New York. They attended five Broadway shows and a performance at the Metropolitan Opera for a total cost of $8,450. RBC paid the expenses, then sought and obtained reimbursement from the municipality totaling $42,213.48. RBC did so even though it

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

[65] *Id.* at *9-10.

[66] *Id.* at *10-11.

had written two letters to the municipality advising it that officials should personally pay or reimburse the municipality for the expenses incurred by family members.[67]

The SEC concluded that by this conduct RBC violated MSRB Rule G-17, "which requires municipal securities dealers to deal fairly with all persons and not to engage in any deceptive, dishonest, or unfair practice."[68]

2. The Merchant Capital Case

A second reported decision, which like *RBC Capital Markets Corp.* is a settled case, is *Merchant Capital, LLC*.[69] The firm, Merchant Capital, L.L.C. ("Merchant Capital"), arranged bond rating trips to which municipal officials invited family members, friends, and business associates. As in *RBC Capital Markets Corp.*, the SEC found that Merchant Capital violated "the gifts and gratuities, fair dealing and supervisory rules of the … [MSRB] by paying for travel and entertainment expenses of family members, friends or associates of senior officials at two public finance clients (the 'Issuers') and later receiving reimbursement for such expenses from the Issuers, and, in certain instances, directly from the proceeds of bond offerings made by the Issuers." The SEC pointed out that these family members, friends and associates, "although they did not attend business meetings, incurred expenses for airfare, car service, meals at upscale restaurants, and tickets to Broadway shows and various sporting events" in violation of MSRB Rules G-17 and G-20.[70]

[67] *Id*. at *13-18.

[68] *Id*. at *19.

[69] Exchange Act Rel. No. 60043, 2009 SEC LEXIS 1827 (June 4, 2009).

[70] *Id*. at *2-3.

3. The Frazer Lanier Case

A third case is a 2011 FINRA disciplinary action publicly reported in August 2011. In it, an Alabama municipal securities firm, The Frazer Lanier Company, Inc., accepted findings of fact, without admitting or denying them, that in 2008 and 2009, in connection with two bond rating trips to New York City, it violated MSRB Rules G-20 and G-17 when it advanced payment for expenses for travel and entertainment expenses incurred by wives and a sister-in-law who accompanied municipal officials on the trips. The Letter of Acceptance, Waiver and Consent does not address the issue of entertainment expenses, but explicitly points out that:

> The interpretations to MSRB Rule G-20 explain that payment of travel expenses 'can be especially problematic where such payments cover expenses incurred by family or other guests of issuer personnel' [and states that] Advancing payment … of the expenses of the … wife and subsequent reimbursement of those expenses … from the proceeds of the municipal issues … exceeded the limits of MSRB Rule G-20 and was not covered by the Rule's exception for normal business dealings.[71]

IV. GMCI Willfully Violated MSRB Rule G-17 By Seeking And Obtaining Reimbursement For Excessive Expenses Incurred Unrelated To Purposes Of A Bond Rating Trip As Alleged In the First Cause of Action

As set forth above, four Mobile County officials, Hunt, his wife, and a representative of GMCI's co-underwriter, traveled to New York City on Saturday, December 8, 2007, two days before the first scheduled official business meeting. No official business took place on that Saturday. Nonetheless, GMCI paid for meal expenses and lodging for the early delegation. Under the circumstances, the Hearing Panel agrees with Enforcement that GMCI violated MSRB Rule G-17 by seeking and obtaining reimbursement for costs associated with what can only be described as a day spent in personal pursuits.

Rule G-17 explicitly commands that municipal securities dealers "shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice." The duty of fair

[71] *Frazer Lanier Co., Inc.*, No. 2010021263901 (June 17, 2011).

dealing imposed by Rule G-17 governs the obligations of municipal securities dealers to issuers. The MSRB has made it clear that Rule G-17 "may apply in connection with certain payments made and expenses reimbursed during the municipal bond issuance process for excessive or lavish entertainment or travel expenses."[72]

The Hearing Panel recognizes that the expenditures here were not as lavish and excessive as those incurred by RBC and Merchant Capital. But we also note that excessive is defined as "exceeding a normal, usual, reasonable, or proper limit," and "being more than is usual, required, or permitted."[73] To charge an issuer for food and lodging for a stay in New York for a day on which there is no activity related the business purpose of the trip is excessive.

Respondents argue that Rule G-17 does not impose upon municipal securities dealers an obligation of fair dealing to taxpayers, but only to municipalities and to bond customers.[74] The Hearing Panel does not find it necessary to resolve the question of whether Rule G-17 does or does not do so. It is enough, and well-established, that municipal securities dealers are obligated to deal fairly with issuers. It is also clear that approval by municipal officials of excessive, unnecessary expenditures, drawn from the issuer's bond proceeds, does not render the expenses reasonable or proper.[75] The Hearing Panel notes that the officials in the RBC and Merchant Capital cases approved the lavish and excessive expenditures, not surprisingly, since they enjoyed them personally. Their approval did not make the reimbursements proper.[76]

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[72] September 2009 Notice.

[73] *The American Heritage Dictionary of the English Language* (4th ed. 2000).

[74] Respondents' Post-Hearing Br. 5-6.

[75] We also find it significant that three Mobile County officials did not follow the example of their four colleagues, and, reasonably and properly, did not travel or incur expenses, until the eve of the scheduled Monday meetings.

[76] Respondents also argue that GMCI had to obtain reimbursement for expenses incurred by the municipal officials or risk violating MSRB Rule G-20's prohibition against gifts to officials exceeding $100 annually. Tr. 31-32, 206-07. The Hearing Panel finds no merit in this argument. As Enforcement noted, the officials could have paid their own expenses for the time they spent in New York unrelated to the business purposes of the rating trip. Tr. 271.

For these reasons, we find that Enforcement sustained its burden of proof as to the first cause of action, and established that GMCI willfully violated MSRB Rule G-17.[77]

V. GMCI Did Not Violate MSRB Rule G-17 By Seeking And Obtaining Reimbursement For Entertainment Expenses That Were Not Lavish Or Excessive As Alleged In The Third And Fourth Causes Of Action

1. MSRB Rule G-17 And The Published Interpretive Notices and Precedents Do Not Prohibit Entertainment Expense Reimbursements As Per Se Violations Of MSRB Rule G-17

Enforcement contends "that it is categorically excessive or lavish to pay for entertainment out of the cost of issue … It's just an inappropriate category of expenses."[78] However, there is no language in MSRB Rule G-17, in the Interpretive Notices, or in the published disciplinary actions supporting that contention. Rather, there is a recognition, at least by implication, that some non-lavish, non-excessive expenditures for entertainment are acceptable. As noted above, the August 2012 Notice makes specific reference to entertainment. It also makes specific reference, albeit in the context of discussing MSRB Rule G-20, to "theatrical, sporting and other entertainments." Other Interpretive Notices addressing questions related to reimbursement of expenses incurred on bond rating trips by municipal officials and municipal securities firm representatives, and the few related published disciplinary actions, do not prohibit reimbursement of entertainment expenses.

Enforcement is correct that "a violation can be found even though the rule or concept at issue has never been litigated."[79] But, as demonstrated above, the relevant Interpretive Notices

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[77] Enforcement charged all of Respondents' violations as willful, in that Respondents acted intentionally, "they knew the actions they were taking," without necessarily intending to violate any MSRB rules. Tr. 274. The Hearing Panel agrees. *See, e.g., Jacob Wonsover*, 54 S.E.C. 1, 18 n.36 (1999), *petition for review denied*, 205 F.3d 408 (D.C. Cir. Mar. 14, 2000); *see also Tager v. SEC*, 344 F.2d 5, 8 (2d Cir. 1965) (stating that there is "no requirement that the actor … be aware that he is violating one of the Rules or Acts" to uphold a finding of willfulness).

[78] Tr. 251.

[79] *Wanda P. Sears*, Exchange Act Rel. No. 58075, 2008 SEC LEXIS 1521, at *16 n.25 (July 1, 2008).

and disciplinary actions recognize that in the municipal securities industry, municipal securities firms organize rating trips for municipal officials in connection with bond issues, pay expenses incurred by officials and firm representatives, and then subsequently seek approval to obtain reimbursement from municipal entities and from bond issuance proceeds. As noted above, the January 2007 Notice states that "it sometimes is advantageous for issuer officials to visit bond rating agencies to provide information that will facilitate the rating of the new issue. It is the character, nature and extent of expenses paid by dealers or reimbursed as an expense of issue, even if thought to be a common industry practice, which may raise a question under applicable MSRB rules."

The MSRB has also recognized, in the context of MSRB Rule G-20's requirements, that entertainment may be among the permissible expenses. Indeed, the August 2012 Notice expressly states that an underwriter risks violation of MSRB Rule G-20 by:

> paying for *excessive or lavish* travel, meal, lodging *and entertainment expenses in connection with an offering* (such as may be incurred *for rating agency trips*, bond closing dinners, and other functions) that inure to the personal benefit of issuer personnel and that exceed the limits or otherwise violate the requirements of the rule. (emphasis supplied).

Enforcement is correct that MSRB Interpretive Notices have put firms on notice that by paying and seeking reimbursement for expenses on rating trips, they may run afoul of Rule G-17: "A dealer may violate Rule G-17 by knowingly facilitating such a practice by, for example, making arrangements and advancing funds for the *excessive or lavish* expenses to be incurred and thereafter claiming such expenses as an expense of the issue;"[80] and "Rule G-17 may apply in connection with certain payments made and expenses reimbursed during the municipal bond

[80] January 2007 Notice.

issuance process for *excessive or lavish* entertainment or travel expenses."[81] By their terms, however, these pronouncements affirm that what is wrong is reimbursement for entertainment or travel expenses that are *excessive or lavish*. The clear implication is that it is permissible to seek and obtain reimbursement for entertainment or travel expenses that are *neither* excessive nor lavish.

In sum, the regulatory notices imply that entertainment, including theatrical performances, may be permissible, within limits. The published disciplinary actions discussed above support this conclusion. They endorse the principle that *excessive and lavish* expenditures for entertainment, travel, and lodging, unnecessary and unrelated to the conduct of the rating trips, are improper and violate MSRB Rule G-17.

2. Prior Disciplinary Cases Gave GMCI Insufficient Notice For Enforcement's New Interpretation

It is true that, even if GMCI was following accepted industry practice when it sought the reimbursements at issue, as it argues, it could nonetheless violate MSRB rules. What may be currently acceptable conduct by the prevailing standards of the municipal securities industry is "a relevant factor, but the controlling standard remains one of reasonable prudence."[82] And it is also true that, as Enforcement argues, the disciplinary process may properly be employed even in the absence of precisely applicable precedent.[83] The Hearing Panel acknowledges that regulators may enforce a new application of a rule, particularly an ethical rule, without running the risk of wrongly imposing an invalid rule change, when the new application "does not establish a new

[81] September 2009 Notice.

[82] *SEC v. GLT Dain Rauscher, Inc.*, 254 F.3d 852, 857 (9th Cir. 2001).

[83] Department of Enforcement's Post-Hearing Br. 8 (*citing Wanda P. Sears*, Exchange Act Rel. No. 58075, 2008 SEC LEXIS 1521, at *16 n.25 (July 1, 2008)).

standard of conduct and where the application can be 'reasonably and fairly implied'" from the rule and applicable law.[84]

Enforcement argues that by bringing this disciplinary proceeding, it has not deprived GMCI of fair notice. The absence of a previous disciplinary proceeding for the precise conduct charged here is not a concern, in Enforcement's view, because "notice of every possible situation that may result in a Rule G-17 violation is not required."[85] Enforcement cites cases supporting the principle that the requirements of MSRB Rule G-17, and the language of MSRB's interpretive notices, are sufficiently specific to provide "the person of ordinary intelligence a reasonable opportunity to know what is prohibited."[86] Accordingly, in Enforcement's view, GMCI should have reasonably foreseen that Rule G-17 could be applied to prohibit the conduct at issue, because it was intrinsically wrong to pass entertainment expenses incurred on the trips to taxpayers, and conduct "that is intrinsically wrong does not need to be spelled out in the rule."[87]

However, the Hearing Panel finds that the cases on which Enforcement relies apply the principle to circumstances significantly distinguishable from the circumstances here. For example, in one case, the respondent was disciplined for engaging in an outside business activity by preparing tax returns for her clients for compensation. She complained that there were no precedents specifying that preparing tax returns would be deemed a violative outside business activity. The SEC pointed out, however, that the outside business rule generically proscribes all types of outside business activity. In addition, the SEC noted that the respondent cited no

[84] *Dep't of Enforcement v. Shvarts*, No. CAF980029, 2000 NASD Discip. LEXIS 6, at *29 (N.A.C. June 2, 2000).

[85] Department of Enforcement's Post-Hearing Br. 7.

[86] *Id*. (*quoting Dep't of Enforcement v. Sisung*, No. C05030036, 2006 NASD Discip. LEXIS 16, at *74 (N.A.C. Aug. 28, 2006)).

[87] *Id.* at 9.

precedent suggesting that preparing tax returns would *not* qualify as an outside business. Furthermore, numerous regulatory publications emphasize the requirement that "any kind of business activity" away from a firm had to be reported to the firm.[88]

Enforcement also relies on a markup case which found for the first time that markups of 4% violated MSRB Rule G-27. The Rule does not mention markups, and there was no precedent specifically holding that markups of less than 5% violated the Rule.[89] The respondent protested on grounds of lack of fair notice. However, the SEC declared that:

> It is well-established that the NASD's rule and policy on unfair prices are sufficiently definite … we find that the MSRB's price standards give adequate guidance to those who, like applicants, deal in municipal bonds … As summarized above, the industry has been repeatedly warned that markups below 5% are by no means protected. It is clear that the markups in question unjustly benefited the firm while doing the opposite for its customers. A reasonable professional attuned to the needs of clients would have foreseen and avoided that result.[90]

Enforcement argues, in the same vein, that GMCI should have foreseen that the reimbursements it sought and obtained violated MSRB Rule G-17.

However, unlike the markup context, here there is no well-established MSRB policy that would lead a prudent member firm to reasonably foresee that seeking reimbursement for *any* entertainment expense incurred on a bond rating trip would violate MSRB Rule G-17.

Enforcement argues that the January 2007 Notice sufficiently placed GMCI and its fellow members of the municipal securities industry on notice that the expenses at issue here would be improper. As Enforcement points out, the Notice's stated purpose was "to remind … dealers … of the application of Rule G-17, on fair dealing, in connection with certain payments made and expenses reimbursed during the municipal bond issuance process." But as Enforcement notes,

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[88] *Sears*, 2008 SEC LEXIS 1521, at *16 n.26 (*quoting NASD Notice to Members* 01-79).

[89] Department of Enforcement's Post-Hearing Br. 8 (*citing Investment Planning, Inc. v. Hafeman*, 51 S.E.C. 592, 1993 SEC LEXIS 1897 (1993)).

[90] *Inv. Planning, Inc.*, 51 S.E.C. at 595-98.

the Notice also states that whether the payments and reimbursements violate Rules G-20, G-17, and G-27 depends on "all the facts and circumstances." [91] In the January 2007 Notice, the MSRB did not proscribe any particular species of expense reimbursement, but alerted members that reimbursement of "excessive or lavish" expenses *may* violate MSRB rules.

Enforcement argues that the phrase "excessive or lavish" refers only to "one example of misconduct," and that "In any event … it is excessive and lavish to make taxpayers pay for anything that is unrelated to the offering." [92] The Hearing Panel agrees that the phrase "excessive and lavish" identifies a class of improper expenditures, and is not to be read restrictively. We also agree with Enforcement that "Conduct that is intrinsically wrong does not need to be spelled out in the rule"[93] and that a general rule such as MSRB Rule G-17 should be "read broadly." [94] Nonetheless, "the parameters of the rule must be sufficiently clear so that associated persons have fair notice of what conduct is proscribed." [95]

It has been pointed out previously that when FINRA proposes to enforce "a new theory of liability" of which it believes members of the industry "should have been aware," it runs the risk of applying "a novel interpretation" with "no prior notice … of the applicability of this new theory of liability … [possibly raising] concerns sufficient to warrant dismissal of the charges."[96] Indeed, if FINRA "knew about the … practice well before the underlying events in this action took place and yet did not publicly condemn it" until after the conduct occurred, it might

[91] Department of Enforcement's Post-Hearing Br. 11.

[92] *Id*. at 11 n.54.

[93] *Id*. at 9.

[94] *See, e.g., James W. Browne*, Exchange Act Rel. No. 58916, 2008 SEC LEXIS 3139, at *24 n.24 (Nov. 7, 2008).

[95] *Id.* at *25.

[96] *Id.* at *29-31.

"penalize an individual who has not received fair notice."[97] In such circumstances, not having taken "steps to advise the public that it believed the practice was questionable" until after the conduct occurred, the regulator "may not sanction … pursuant to a substantial change in its enforcement policy that was not reasonably communicated."[98]

The Hearing Panel finds merit in GMCI's defense that the firm did not have the notice required by fairness that it could be subject to disciplinary action for violating MSRB Rule G-17 by incurring, and seeking reimbursement for, *any* entertainment costs incurred by its representatives and municipal officials on a bond rating trip. The relevant Interpretive Notices and disciplinary actions, with which Hunt testified he was familiar, made GMCI aware of its responsibility not to incur and seek reimbursement for excessive and lavish costs. The evidence indicates that GMCI consciously made what it considered reasonable, not lavish, arrangements.[99]

For these reasons, the Hearing Panel dismisses the Complaint's second and third causes of action, alleging that GMCI violated MSRB Rule G-17 by seeking and obtaining reimbursements for entertainment expenses on bond rating trips. We find that it was not unreasonable for GMCI to interpret MSRB Rule G-17, the relevant Interpretive Notices and disciplinary actions as permitting reimbursement for entertainment on bond rating trips as a cost of issuance, so long as those costs were not excessive and lavish. We find that FINRA and the MSRB "knew about the … practice" of firms seeking and obtaining reimbursement for entertainment expenses incurred on bond rating trips "well before the underlying events in this

[97] *Kevin Upton v. SEC*, 75 F.3d 92, 98 (2d Cir. 1996).

[98] *Upton*, 75 F.3d at 98.

[99] Hunt testified that it was his understanding that Rule G-17 and the interpretive notices do not prohibit entertainment expenses, but refer to the *RBC Capital Markets* and *Merchant Capital* cases, which are concerned with "excessive and lavish travel and … unofficial personnel," not entertainment. Hence, GMCI chose "vans, not limousines" and selected "mid grade meals, mid grade hotels" when making travel arrangements. Tr. (Hunt) 182-83, 226-28.

action took place and yet did not publicly condemn it."[100] To penalize GMCI's seeking and obtaining reimbursement for these entertainment expenses by applying Enforcement's *de novo* application of Rule G-17, making any expense for entertainment on a bond rating by definition excessive and lavish, and therefore a "deceptive, dishonest, or unfair practice," imposes a "substantial change in … enforcement policy that was not reasonably communicated" in advance.[101] Because GMCI was not fairly put on notice that *any* entertainment expense incurred and reimbursed on a bond rating trip would be deemed to violate MSRB Rule G-17, we decline to do so. In reaching this conclusion, the Hearing Panel does not endorse the practice of municipal securities firms seeking and obtaining reimbursement for entertainment expenses incurred in bond rating trips. We find only that Enforcement's allegation that by doing so GMCI committed a per se violation of Rule G-17 appears to be a *de novo* application of the Rule, and that GMCI did not have fair notice that the Rule would be applied in this fashion prior to the March 2008 and December 2009 bond rating trips.

VI. GMCI Willfully Violated MSRB Rule G-17 By Seeking And Obtaining Reimbursement For Expenses It Was Obligated By Contract To Pay As Alleged In The Fourth Cause Of Action

The fourth cause of action is significantly different from the first three. When Lawrence County selected GMCI to be its underwriter, it executed two Warrant Purchase Agreements, one for each series of warrant offerings. Both expressly obligated GMCI to "pay … the cost of transportation and lodging for representatives … to attend meetings … and … all other expenses incurred by [GMCI] in connection with its public offering and the distribution of the [warrants]."[102]

[100] *Upton*, 75 F.3d at 98.

[101] *Id*.

[102] JX-19, at 8, JX-20, at 8.

In this regard, the contracts between GMCI and Lawrence County differ from the other purchase agreements. The Mobile County agreement was silent on which party was obligated to pay for bond rating trip expenses.[103] In contrast, the Russell County purchase agreement provided that GMCI's rating trip travel expenses would be paid as a cost of issuance.[104]

Using GMCI's credit card, Lewis paid for airfare, lodging, and meals for himself and the other GMCI representative on the Lawrence County December 2009 rating trip. These expenses totaled $2,615.44. Then, despite the clear terms of the contracts, GMCI submitted these costs for reimbursement, and Lawrence County reimbursed the firm.[105]

Both Hunt and Lewis conceded that the plain language of the agreements between GMCI and Lawrence County required GMCI to pay its travel costs.[106] Hunt insisted, however, that the language of the purchase agreements "wasn't the agreement with the county. The agreement with the county was it was going on their nickel, the cost of issuance, and that's the way it was billed." Hunt attempted to explain away the language allocating responsibility for bond rating trip costs by describing it as inoperative, comparing it to "old, holdover language, boilerplate … passed around from bond attorney to bond attorney for a decade." [107] Hunt insisted that the contradiction between the purchase agreement language and what occurred "doesn't matter.[108]

[103] JX-2, at 5 ¶ 7.

[104] JX-9, at 7. Purchase agreements GMCI signed with two other municipal entities also provided for GMCI's travel expenses to be deemed costs of issuance. JX-24, at 7, JX-26, at 9.

[105] Stip. ¶¶ 40-42.

[106] Tr. (Hunt) 187, Tr. (Lewis) 58-59, 105.

[107] Tr. (Hunt) 187.

[108] *Id.* In response to Enforcement's questions on this point, Hunt added, "We can get [the language] amended, if that's what you want."

Lewis also testified that, notwithstanding the language of the agreements, he understood that Lawrence County would reimburse GMCI for its travel expenses.[109] Lewis stated that after FINRA brought to his attention that the reimbursement violated the terms of the purchase agreements, he contacted Peggy King, the Lawrence County Administrator. She then wrote a letter (the "King Letter").[110]

The King letter is dated February 6, 2012, more than two years after the trip. King wrote that the provisions of the purchase agreement allocating expenses are "somewhat confusing. Lawrence County anticipated, and did pay for your portion of the travel and meals related to the rating trip to New York. That understanding was further evidenced by Lawrence County authorizing the reimbursement from the bond Costs of Issuance account for your portion of the rating trip."[111]

The Hearing Panel finds, contrary to the County Administrator's post hoc letter, that the language of the purchase agreements is clear and unambiguous, and not at all "confusing." In negotiating with GMCI, Lawrence County followed the usual practice, which is for the issuer, not the underwriter, to draft the contract.[112] This is typically done by counsel hired to represent

[109] Tr. (Lewis) 112.

[110] The King Letter is RX-2. Tr. (Lewis) 103-05.

[111] RX-2. Respondents also offered RX-3, also written by Ms. King, stating: "This letter is to inform Finra [sic] that the rating trip expenses incurred by county personnel and GMC personnel were incurred with the concurrence of and at the direction of Lawrence County, and GMC was authorized by the County to be reimbursed from the County's Costs of Issuance account." (emphasis in original). The Hearing Panel notes that the language in this statement is virtually identical to the language of RX-4, a letter "To Whom It May Concern" signed by the Russell County Administrator, dated July 9, 2012, which states in whole: "This letter is to inform Finra [sic] that the rating trip expenses incurred by county personnel and GMC personnel were incurred with the concurrence of and at the direction of Russell County, and GMC was authorized by the County to be reimbursed from the County's Costs of Issuance account." We note that among other things, FINRA is misspelled identically, the sentence structure of the two documents is identical, and that they use identical phrases (e.g., "incurred with the concurrence of and at the direction of…."). We find that these identical features suggest a single author, and that the letters appear likely to have been presented by GMCI to the two county officials in preparation for use at the hearing, and as such, their reliability is questionable.

[112] Tr. (Lewis) 51-53.

the issuer's interests.[113] As a result, purchase agreements often differ in their provisions, depending upon an issuer's perceptions of its interests in particular cases.[114] The language of the Lawrence County contracts clearly benefitted the issuer by reducing its costs of issuance. The evidence reflects that GMCI submitted its reimbursement claim contrary to the contracts. By doing so, GMCI gained a financial advantage not provided by the agreement, to the disadvantage of Lawrence County.[115] The Parties could easily have amended the contracts if GMCI had bargained for reimbursement from Lawrence County, and if the County had actually agreed to reimburse GMCI's trip costs.

The Hearing Panel finds that the evidence does not support Hunt's claim that the wording of the Lawrence County purchase agreements governing reimbursement is meaningless, outdated "boilerplate" that does not reflect the intent of the parties. Rather, it appears that the terms determining who would pay trip costs were bargained for and that they mean what they say.

The purpose of MSRB Rule G-17 is to establish a "minimum standard of fair conduct"[116] and to "codify basic standards of fair and ethical conduct."[117] Such standards required GMCI, "in the absence of justifying or extenuating circumstances," to respect the terms of its contractual

[113] *Id*. at 53-54.

[114] *Id.* at 53.

[115] The Hearing Panel notes that this is not inconsistent with evidence that GMCI, in billing for the costs of the Mobile County trip, had similarly sought reimbursement for expenses for Hunt and his wife's meals, liquor, and lodging, until the Mobile County Attorney noticed and rejected the request, requiring GMCI to amend and resubmit it.

[116] March 2002 Notice.

[117] *In the Matter of Municipal Securities Rulemaking Board*, Order Approving Proposed Rule Changes, Exchange Act Rel. No. 15247, 1978 SEC LEXIS 515 (Oct. 19, 1978).

obligations. It follows that disregarding clear contractual obligations is "dishonorable and inequitable conduct."[118]

The Hearing Panel rejects GMCI's defense and finds, as charged in the Complaint's fourth cause of action, that GMCI wilfully violated its ethical obligations under MSRB Rule G-17 when it sought and received reimbursement for costs contrary to its contractual obligations to Lawrence County.

VII. GMCI And Hunt Willfully Failed To Supervise Bond Rating Trips In Violation Of MSRB Rule G-27

MSRB Rule G-27 requires municipal securities dealers to supervise their business activities "to ensure compliance with Board rules," and to "establish and maintain a system to supervise the municipal securities activities of each registered representative, registered principal, and other associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable Board rules."[119] Furthermore, the January 2007 Notice pointed out that municipal securities dealers need to have supervisory policies and procedures "adequate to detect and prevent violation of MSRB rules" specifically "in regard to expenses of issuer personnel in the course of the bond issuance process, including in particular but not limited to payments for which dealers seek reimbursement from bond proceeds."[120]

GMCI had no written policies or procedures concerning bond rating trips and providing guidance for determining how to seek reimbursements for the firm and for municipal officials

[118] *See Samuel B. Franklin & Co.*, 38 S.E.C. 113, 116 (1957), *aff'd*, 290 F.2d 719 (9th Cir. 1961) (interpreting ethical obligations imposed by Section 1 of Article III of the NASD Rules of Fair Practice, predecessor to FINRA Rule 2010).

[119] MSRB Rule G-27(a) and (b).

[120] January 2007 Notice.

from offering proceeds.[121] Hunt was the person at GMCI with responsibility for the firm's written supervisory procedures.[122]

Lewis was unable to recall any written policies or procedures applicable to any aspect of bond rating trips and the reimbursement process.[123] Lewis claimed that he and Hunt "talked a lot [in terms of] what we were going to do in terms of the rating trips" and had "tons of discussions about what we were going to do there … why we were going there, things of that nature."[124] But Lewis could not recall Hunt ever reviewing details of rating trips, such as specific expenditures.[125] There were no policies and procedures identifying what costs could properly be reimbursed by offering proceeds, placing limitations on expenses, requiring documentation of expenditures, or providing guidelines on who could attend the trips.[126]

Hunt also conceded that there were no written supervisory procedures pertaining to rating trips,[127] but claimed that he supervised Lewis, and that there were "verbal" policies regarding bond rating trips.[128] Lewis, however, was unable to say there were any unwritten policies to guide GMCI representatives in organizing bond rating trips and deciding what reimbursements

[121] Stip. ¶ 46.

[122] *Id.* ¶ 44.

[123] Tr. (Lewis) 89-90.

[124] *Id.* at 87.

[125] *Id.* at 87, 89.

[126] *Id.* at 90-91.

[127] Tr. (Hunt) 195.

[128] *Id.* at 181-82, 196.

would be permissible to seek from municipalities.[129] And no one provided oversight of Hunt's bond rating trips, the expenses he paid and for which he sought reimbursement.[130]

Respondents contend that because bond rating trips were infrequent, and because Hunt and Lewis were the only ones who organized them, specific written supervisory procedures were unnecessary.[131] The Hearing Panel disagrees. Even though Hunt, according to his testimony, has organized only six trips in his 27-year career in the municipal securities industry,[132] GMCI organized five in the two-year period during which the three bond rating trips at issue occurred. And despite the small number of rating trips, Lewis testified persuasively that they were an important service GMCI offered to its municipal clients. For example, Lewis recommended the bond rating trip to Russell County, which had not previously obtained a bond rating, because he believed that Russell County officials needed to appear personally to "tell the story" of the County and its development plans.[133]

Consequently, the Hearing Panel finds that, by having no written supervisory procedures pertaining to rating trips and reimbursement for the costs incurred, and no procedures in place by which they actually supervised the trips, GMCI and Hunt failed to meet their obligation to

[129] *Id.* at 148.

[130] Hunt also conceded that nobody supervised him in any regard. He then asked rhetorically "Some underling's going to tell me as the owner of the firm what to do? Come on." Hunt testified that the principle that one may not supervise himself "[s]ounds good in theory," but insisted that "in reality it doesn't work that way." Tr. (Hunt) 194-95.

[131] Tr. 31-32.

[132] Tr. (Hunt) 198-99.

[133] Tr. (Lewis) 69.

supervise rating trips, and willfully violated MSRB Rules G-27 and G-17 as charged in the Complaint's fifth cause of action.[134]

VIII. Sanctions

A. The Violations Of MSRB Rule G-17

There are no Sanction Guidelines that specifically address MSRB Rule G-17 violations involving improper reimbursements from municipal securities offering proceeds.

Enforcement characterizes GMCI's Rule G-17 violations as serious, involving "the ethical standards of the industry," but does not argue that they are egregious.[135] In each cause of action, Enforcement alleges the conduct was willful.[136] Enforcement considers it to be an aggravating circumstance that GMCI intentionally obtained improper reimbursements from the costs of issuance, causing economic loss to the issuers, and ultimately taxpayers, resulting in economic gain to GMCI.[137]

For GMCI's Rule G-17 violations, Enforcement recommends a censure, a fine of $20,000, and repayment of the improper reimbursements as restitution to the issuers.

Hunt contends that reimbursements for the expenses for the extra day in New York on the Mobile County trip and GMCI's travel costs on the Russell County trip were acceptable in part because County officials approved them, and the costs were not excessive and lavish. In Hunt's view, traveling a day early is consistent with municipal securities industry practice.

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[134] Although Rule G-17 has been found not to be a "true analogue" to FINRA Rule 2010 in the sense that a violation of any MSRB rule constitutes a violation of G-17, and violation of G-17 requires "a showing of at least negligence," the Hearing Panel finds that Respondents' violations of Rule G-27 here involved negligence, and therefore constituted a violation of Rule G-17 as well. *See Sisung*, 2006 NASD Discip. LEXIS 16, at *53 n.40.

[135] Referring to the Rule G-17 violations, Enforcement argued "This isn't … a felony, but this is - - this is serious." Tr. 275.

[136] *Id.* at 274.

[137] Department of Enforcement's Pre-Hearing Br. 20-21.

The Hearing Panel disagrees. Even if other municipal securities firms routinely schedule and pay for extra days on rating trips, their practice does not excuse GMCI. It is well-settled that a member's improper conduct is not excused because others in the industry do likewise.[138] The January 2009 Notice expressly provides that the nature of reimbursements is what matters, not the fact that a member might believe it is acting in accordance with industry practice.[139] The problem with the Saturday cost reimbursements was not their amount, but their unnecessary nature. And Mobile County's approval does not make the reimbursements proper. As noted above, the Mobile County Attorney who recommended approval of the reimbursements was one of the early travelers who enjoyed the extra, non-business day in New York.

As for the Russell County reimbursement, the Hearing Panel has rejected Hunt's contention that the County orally agreed to permit GMCI to be reimbursed for its travel costs. GMCI violated its clear contractual obligations.

The Hearing Panel agrees with Enforcement's recommendation that GMCI should pay a fine and restitution to return to the municipalities the reimbursements it improperly obtained.

B. The Violations Of MSRB Rule G-27

There are Sanction Guidelines for violations of MSRB Rule G-27. For deficient written supervisory procedures, the Guidelines recommend a fine of $1,000 to $25,000. For failures to supervise, the Guidelines recommend a fine of $5,000 to $50,000.[140]

Enforcement considers Respondents' Rule G-27 supervision violations serious and either intentional or reckless, but not egregious.[141] For GMCI, Enforcement recommends a censure, a

[138] *Patricia H. Smith*, 52 S.E.C. 346, 348 (1995).

[139] January 2007 Notice.

[140] *FINRA Sanction Guidelines* 103-04 (2011).

[141] Department of Enforcement's Pre-Hearing Br. 21.

fine of $20,000, and an undertaking to retain a qualified independent consultant to plan and implement a supervisory system, including written supervisory procedures, reasonably designed to ensure compliance with regulatory requirements concerning rating trips (including Rules G-17 and G-27), and an order that GMCI refrain from participating in any rating trips until the procedures are implemented.[142] For Hunt, Enforcement recommends a censure, a fine of $10,000, and suspension in all principal capacities for 10 business days.[143]

For GMCI's MSRB Rule G-27 violations, the Hearing Panel concludes that a censure and fine of $10,000 are appropriately remedial. The Hearing Panel does not believe it is necessary to order GMCI to retain an independent consultant to design and implement a supervisory system to correct the absence of procedures relating to rating trips and reimbursements. These are not esoteric or complex matters. GMCI should understand clearly that it needs to make appropriate changes to its written supervisory procedures and to implement measures reasonably designed to achieve compliance with MSRB Rule G-17. The Hearing Panel concludes that GMCI and Hunt are fully capable of drafting and implementing the appropriate policies and procedures.

As for Hunt, the Hearing Panel finds that he failed to properly supervise Lewis's conduct of rating trips. He failed to put into place any procedure for review of his own rating trips, and rejected the notion that anybody could provide oversight of his conduct because of his preeminent position in the firm. In this he is incorrect. It is well established that a person cannot supervise himself.[144] For these reasons, a majority of the Hearing Panel agrees that a fine of

[142] *Id.* at 19.

[143] *Id*.

[144] *Stuart K. Patrick*, 51 S.E.C. 419, 422 (1993), *aff'd*, 19 F.3d 66 (2d Cir. 1994).

$10,000 and suspension in all principal capacities for three business days are appropriately remedial sanctions for Hunt's violations of MSRB Rules G-27 and G-17.[145]

IX. Order

For the reasons set forth above, the Complaint's third and fourth causes of action are dismissed.

For violating MSRB Rule G-17 by seeking and obtaining reimbursement from bond proceeds for unnecessary food and lodging expenses unrelated to the business purposes of a bond rating trip, as charged in the Complaint's first cause of action, and seeking and obtaining reimbursement from bond proceeds for costs incurred by its representatives, in violation of the terms of its contract with a municipality, as charged in the Complaint's fourth cause of action, Respondent Gardnyr Michael Capital, Inc., is censured and fined $10,000. GMCI is ordered to pay restitution to Mobile County, Alabama, in the amount of $2,707, plus interest calculated from November 10, 2008, until paid.[146] GMCI is ordered to pay restitution to Lawrence County, Alabama, in the amount of $2,615.44, plus interest calculated from December 30, 2009, until paid.[147] Interest shall be calculated at the rate set forth in the Internal Revenue Code at 26 U.S.C. 6621(a).[148]

For violating MSRB Rules G-27 and G-17 by failing to adopt, maintain, or enforce any written supervisory procedures for rating trips, and by failing to supervise such trips, GMCI is

[145] One member of the Hearing Panel dissents. In his view, it is a mitigating factor that GMCI's bond rating trips were unusual events, and it is understandable that the firm's written supervisory procedures did not address them. Furthermore, the dissenting member of the Hearing Panel finds that in a small firm such as GMCI, Hunt could reasonably supervise his own handling of bond rating trips. The dissenting member of the Hearing Panel concludes that it is unnecessary to impose a fine and suspension on Hunt, and that it would be sufficiently remedial simply to direct Hunt to amend GMCI's written supervisory procedures to add procedures for organizing bond rating trips and seeking reimbursement for costs.

[146] Mobile County reimbursed GMCI by check deposited on November 10, 2008. JX-5.

[147] Lawrence County reimbursed GMCI by check deposited on December 30, 2009. JX-22-23.

[148] The interest rate, which is used by the Internal Revenue Service to determine interest due on underpaid taxes, is adjusted each quarter and reflects market conditions.

censured and fined $10,000, and Respondent Pfilip Gardnyr Hunt, Jr. is fined $10,000, and suspended in all principal capacities for three business days.

GMCI is also ordered to pay costs of the hearing in the amount of $3,151.42, including an administrative fee of $750 and the cost of the transcript.

If this decision becomes FINRA's final disciplinary action, Hunt's suspension shall become effective on the opening of business on March 3, 2014, and shall end at the close of business on March 5, 2014. The fine and costs shall be due on a date set by FINRA, but not sooner than 30 days after this decision becomes FINRA's final disciplinary action in this proceeding.[149] Restitution shall be payable on a date set by FINRA, but not less than 30 days after this decision becomes FINRA's final disciplinary action.

HEARING PANEL.

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By: Matthew Campbell
Hearing Officer

Copies to:

Pfilip Gardnyr Hunt, Jr. *(via overnight courier and first-class mail)*
Philip J. Snyderburn, Esq. *(via electronic and first-class mail)*
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Carolyn J. Craig, Esq. *(via electronic mail)*
Jeffrey D. Pariser, Esq. *(via electronic mail*)

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