BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of

Department of Market Regulation,

Complainant,

vs.

Steven Richard Jaloza
Muttontown, NY

Neal Anthony Impellizeri
Plandome, NY

and

Michael Raymond Gimeli
Babylon, NY,

Respondents.

DECISION

Complaint No. 2005000127502

Dated: July 28, 2009

**Hearing Panel found that two respondents engaged in fraudulent sales practices involving OTC Bulletin Board securities and all respondents violated the Recommendation Rule by recommending purchases of OTC Bulletin Board securities without reviewing or ensuring that their firm reviewed materials necessary to provide a reasonable basis for making the recommendations. Held, findings of violations of the Recommendation Rule reversed and dismissed; findings of fraud affirmed in part and reversed in part; sanctions vacated in part and modified in part.**

**Appearances**

For the Complainant: Matthew Campbell, Esq., Financial Industry Regulatory Authority Department of Market Regulation.

For the Respondents: Richard Roth, Esq., for Michael Gimeli; Steven Jaloza and Neal Impellizeri pro se.

## Decision

Pursuant to NASD Rule 9311, Steven Richard Jaloza ("Jaloza"), Neal Anthony Impellizeri ("Impellizeri"), and Michael Raymond Gimeli ("Gimeli") appeal a FINRA Hearing Panel's April 24, 2007 decision, which found that the respondents violated the "Recommendation Rule" by recommending to customers two OTC Bulletin Board™ ("OTCBB") stocks without their firm's affirmative determination that the issuers' current financial statements and material business information provided a reasonable basis for the recommendations.[1] The Hearing Panel further found that Impellizeri and Jaloza fraudulently misrepresented and omitted material information regarding the same OTCBB securities and that Impellizeri made unreasonable price predictions about the same securities and executed two unauthorized trades. The Hearing Panel barred respondents in all capacities. FINRA's Department of Market Regulation ("Market Regulation") cross-appealed and objected to the Hearing Panel's failure to order Impellizeri and Jaloza to pay restitution to the four defrauded customers identified in the record.

After a thorough review of the record, we modify the Hearing Panel's findings and sanctions.

### I. Background

Jaloza entered the securities industry in 1988 and joined Benchmark Securities Group, Inc. ("Benchmark") as a general securities representative in 2002. He left Benchmark in September 2003 and is not currently working in the securities industry. Impellizeri entered the securities industry in 1985. He was associated with Benchmark as a general securities representative and general securities principal (although he did not function at the firm as a principal) from September 2002 through September 2003 and is not currently working in the securities industry. Gimeli entered the securities industry in 1991. He was associated with Benchmark as a general securities representative from August 2002 through September 2003 and is currently associated with The Concord Equity Group, LLC as a general securities representative.

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[1] Following the consolidation of NASD and the member regulation, enforcement and arbitration functions of NYSE Regulation into FINRA, FINRA began developing a new "Consolidated Rulebook" of FINRA Rules. The first phase of the new consolidated rules became effective on December 15, 2008. *See FINRA Regulatory Notice 08-57* (Oct. 2008). Because the complaint in this case was filed before December 15, 2008, the procedural rules that apply are the NASD Rule 9000 Series, as it existed on December 14, 2008. The conduct rules that apply are those that existed at the time of the conduct at issue.

II. Procedural History

Market Regulation's Fraud Surveillance section initiated the complaint in this matter, which Market Regulation filed in April 2006. Causes one and two of the complaint alleged, and the Hearing Panel found, that between January and May 2003, while associated with Benchmark, Jaloza and Impellizeri engaged in fraudulent practices in their sales of two OTCBB securities to retail customers, in violation of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), Rule 10b-5 thereunder, and NASD Rules 2110 and 2120.[2] The complaint also alleged that Impellizeri executed two unauthorized trades, but the Hearing Panel decision did not make a specific finding as to this allegation. Causes four and five of the complaint alleged, and the Hearing Panel found, that Jaloza, Impellizeri, and Gimeli recommended purchases of the same two OTCBB securities without reviewing materials necessary to provide a reasonable basis for making the recommendation, in violation of NASD Rule 2315 (the "Recommendation Rule") and Rule 2110. The Hearing Panel barred Jaloza, Impellizeri, and Gimeli in all capacities and imposed costs.

This appeal followed.

III. Facts

A. Fiore, Benchmark and JIG Group

In March 2002, Louis Joseph Galeotafiore, Jr. (a/k/a Lou Fiore) ("Fiore") joined Benchmark as a general securities principal, and he assumed the position of president of the firm. Fiore had relocated the firm's main office from Oklahoma City to the former Long Island offices of a defunct day trading firm with which Fiore had been associated. Fiore planned to expand Benchmark's business by bringing in additional representatives who would also bring business to the firm. In the summer of 2002, Fiore met Jaloza who, at the time, was seeking to associate with a firm. After Jaloza reached an agreement with Fiore for his association with Benchmark, Jaloza introduced Fiore to Impellizeri and Gimeli, both of whom also became associated with Benchmark.

Jaloza, Impellizeri, and Gimeli formed JIG Group, Ltd. ("JIG") as a holding company to receive commission and override payments from Benchmark and to pay for overhead. Jaloza, Impellizeri, and Gimeli each owned an equal share of JIG, and they operated it as a partnership. Impellizeri served as president and Gimeli served as secretary of JIG. According to JIG's agreement with Fiore, JIG members would recruit new brokers to join Benchmark and bring investment banking deals to Fiore for consideration. In return, Benchmark agreed to pay JIG an override equal to 85 percent of the commissions that the brokers whom JIG introduced to Benchmark produced at the firm and 85 percent of the revenues generated on investment banking

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[2] Market Regulation initially alleged in cause three of the complaint that Gimeli also engaged in fraudulent sales practices, but Market Regulation withdrew these allegations before the Hearing Panel convened for a hearing.

deals that JIG introduced to the firm. JIG introduced numerous registered representatives to Benchmark, but the firm nonetheless encountered economic difficulties. In response, Fiore approached JIG and suggested that, rather than accepting payment from Benchmark of overrides that were due, they contribute the money to the firm in exchange for an ownership interest in Benchmark. Although the respondents agreed, the plan never came to fruition.

B. The Securities

The complaint alleged violations related to respondents' sales of two OTCBB securities, SRM Networks, Inc. ("SRM") and Telecommunications Products, Inc. ("TCPD").

*1. SRM*

SRM was an Internet solutions company that specialized in website hosting and development services for small to medium-size businesses. As of the December 13, 2002 filing of SRM's Form 10-QSB for the quarter ended September 30, 2002, SRM reported that it had not been successful in fully implementing its business plan due to lack of funding. The company reported that it had been researching potential acquisition candidates or other suitable business partners to assist the company with realizing its business plan.

For the nine months ended September 30, 2002, SRM reported total assets of $703,769, total liabilities of $723,578, and revenues of $40. SRM reported that, in June 2002, it entered into a Letter of Intent to acquire all of the outstanding common stock of WeComm, Ltd. ("WeComm"), a U.K. corporation, in a tax-free reverse merger. The reverse merger with WeComm, however, was not completed. On January 31, 2003, SRM completed a reverse merger with Hy-Tech Computer Systems, Inc. ("Hy-Tech") and changed its name to Hy-Tech Technology Group, Inc. ("HYTT"). Hy-Tech was headquartered in Florida, operated out of five additional states, and manufactured and distributed computer systems and components. In a Form 10-KSB for the year ended December 31, 2002 (filed April 24, 2003), HYTT reported no assets and total liabilities of $943,655.

Jaloza, Impellizeri, and Gimeli first learned of SRM from Fiore, before SRM's merger with Hy-Tech, shortly after they joined Benchmark. Anthony Feruzzi ("Feruzzi"), Benchmark's trader, had taken a position of 100,000 shares in SRM, and Benchmark was making a market in the stock. Fiore testified that he was concerned about the level of risk that resulted from Feruzzi's position in SRM and that he hoped to interest Jaloza, Impellizeri, and Gimeli in selling the stock to their customers. Fiore asked respondents to meet with SRM's consultants, and they did in January 2003. The consultants presented an overview of the company, stated that SRM's reverse merger with WeComm was imminent, and boasted about an anticipated European road show. Respondents viewed the presentation as very positive and concluded that their more speculative clients should perhaps take a small position in the stock.

Fiore determined that Benchmark would become an investment banker for SRM/HYTT.[3] In December 2002, at Fiore's request, Jaloza prepared a draft consulting agreement that detailed the investment banking services that Benchmark would provide to SRM/HYTT, in exchange for which Benchmark would receive 150,000 warrants to purchase SRM/HYTT stock at $1 per share. The record is unclear as to whether the agreement was ever executed. Fiore also determined that Benchmark would make a market in SRM/HYTT stock. On January 24, 2003, respondents began selling SRM/HYTT stock to some of their customers.

*2. TCPD*

TCPD was a development-stage company in the technology industry. According to TCPD's Form 10-KSB for the year ended March 31, 2002, TCPD's business plan was to develop software to provide video-on-demand and teleconferencing services to small and medium-size hotels in the United States and abroad. TCPD reported in its 10-KSB that it had no revenues and no operating capital. The company reported that it would require a minimum of $1 million of additional capital to continue to fund its operations. In a Form 10-QSB for the quarter ended September 30, 2002, TCPD reported a net loss of $101,666, an accumulated deficit of $2,167,262, and a net stockholders' deficiency of $72,018. TCPD's auditor expressed doubt about TCPD's ability to continue as a going concern.

In late 2002, Jaloza had several meetings with TCPD's representatives. Jaloza had known one of TCPD's public relations consultants for some time through other business ventures, and he trusted him. Impellizeri, Gimeli, Fiore, and other members of Benchmark's staff joined Jaloza for some of the meetings. Fiore agreed to enter into a consulting agreement with TCPD to provide the company with investment banking services. In January 2003, Fiore instructed Jaloza to prepare a draft consulting agreement similar to the agreement he had prepared for Benchmark and SMR/HYTT. On March 26, 2003, TCPD issued a press release in which it announced that it had engaged Benchmark as an investment banker. The record does not contain a copy of an agreement executed by both parties, but a copy of the agreement signed by TCPD's chief executive officer states that Benchmark would receive 120,000 shares of TCPD stock, options to acquire 800,000 shares of TCPD stock at an exercise price of $.35 per share, and options to acquire an additional two million shares at an exercise price of $.50 per share. In May 2003, SB, an individual affiliated with TCPD,[4] forwarded a stock certificate for 400,000

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[3] In an on-the-record interview, Fiore testified that Jaloza, Impellizeri, and Gimeli were his "investment banking team." Respondents, however, denied having any knowledge of Fiore's relying on them for investment banking decisions and testified that they had no authority to bind Benchmark in any investment banking agreements.

[4] It is unclear from the record exactly what position SB held with respect to TCPD. He may have been a consultant to the company or may have been employed by the company.

shares of TCPD stock to Impellizeri.[5] Impellizeri provided the stock certificate immediately to Benchmark, and Benchmark deposited it into its trading account.

C. Benchmark's Due Diligence Files

Respondents contended that SRM/HYTT and TCPD were firm-recommended stocks, and Fiore did not dispute this. Fiore testified that Benchmark maintained a due diligence file for each security that the firm recommended. He testified that the due diligence files were supposed to include Forms 10-K and 10-Q for the stocks that Benchmark was recommending. He stated that he confirmed that the files were complete for some, but not all, securities that the firm recommended. As explained in more detail below, Market Regulation proffered little reliable evidence concerning the actual contents of the firm's due diligence files for SRM and TCPD.

The testimony was contradictory on the issue of who was responsible for the due diligence files. Fiore suggested that respondents were, in part, responsible, but respondents denied this assertion. Benchmark's written supervisory procedures stated that the "designated principal" conducted due diligence reviews of all microcap issuers' current financial and business information before firm representatives recommended the securities to customers. Although Benchmark's procedures manual did not identify the designated principal for this particular task, it more generally listed individuals not involved in this case as designated principals for sales practice issues. Benchmark's procedures manual also listed Fiore as a principal and the firm's president and chief compliance officer. Jaloza, Impellizeri, and Gimeli were not listed as principals.

IV. Discussion

After a thorough review of the record, we modify the Hearing Panel's findings of violation as follows: reverse in part and affirm in part findings that Impellizeri misrepresented and omitted material information regarding the two OTCBB securities (cause two); reverse and dismiss findings that Impellizeri made baseless price predictions (cause two); dismiss allegation (cause two) (not addressed by the Hearing Panel) that Impellizeri executed two unauthorized trades; reverse and dismiss findings that Jaloza fraudulently misrepresented and omitted material information regarding the two OTCBB securities (cause one); and reverse and dismiss findings

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[5] The record contains conflicting explanations of the transfer. Fiore testified that respondents received the TCPD stock as compensation for services that JIG provided to SB and transferred the stock to Benchmark partially to fund JIG's buyout of one of Benchmark's original investors. Respondents denied that JIG performed services for SB. Impellizeri testified that, although the stock certificate was sent to him, the certificate itself was made out to Benchmark. He stated that he accepted the certificate on behalf of Benchmark.

that Jaloza, Impellizeri, and Gimeli recommended to customers two OTCBB stocks without complying with NASD Rule 2315 (causes four and five).[6]

A. Fraudulent Misrepresentations and Omissions

The Hearing Panel found that Jaloza and Impellizeri engaged in fraudulent sales practices in violation of Section 10(b) of the Exchange Act, Rule 10b-5 thereunder, and NASD Rules 2120 and 2110. In order to establish a violation of Rule 10b-5, the NAC must find that respondents: (1) made material misrepresentations or omissions (2) in connection with the purchase or sale of a security, and (3) acted with scienter. *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1467 (2d Cir. 1996). NASD Rule 2120, FINRA's anti-fraud rule, parallels Rule 10b-5, and provides that no member shall effect any transactions, or induce the purchase or sale of any security, by means of any manipulative, deceptive or fraudulent device.

Market Regulation's complaint alleged myriad fraudulent misrepresentations and omissions as to Jaloza and Impellizeri. The Hearing Panel made specific findings on some, but not all, of the allegations. As discussed in more detail below, we affirm some of the Hearing Panel's findings of violation as to Impellizeri, dismiss other Hearing Panel findings of fraud as to Impellizeri, and dismiss all findings of fraud as to Jaloza.[7]

*1. Impellizeri*

*a. Impellizeri's Fraudulent Omissions*

We affirm the Hearing Panel's findings that Impellizeri failed to advise customers JW and J & CH of Benchmark's business dealings with SRM/HYTT and of Benchmark's interest in promoting sales of SRM/HYTT stock. We find that Impellizeri's omissions were material and

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[6] The Hearing Panel states in its decision that Gimeli did not testify in his own defense at the hearing and that all references in the decision to Gimeli's testimony are to the testimony that he gave pre-hearing during an on-the-record interview. Gimeli did in fact testify rather extensively at the Hearing Panel hearing, and the Hearing Panel erred in not considering his hearing testimony. In reaching our findings on appeal, we have reviewed and considered Gimeli's Hearing Panel testimony as well as his on-the-record testimony, and we have not relied on the Hearing Panel's credibility determinations with respect to Gimeli.

[7] Market Regulation withdrew all allegations of fraud as to Gimeli. The Hearing Panel nonetheless observed in its decision that the evidence would have supported a finding that Gimeli violated the anti-fraud rules by failing to disclose his own self-interest in selling SRM/HYTT and TCPD stocks. In that Market Regulation withdrew all allegations of fraud as to Gimeli, we specifically reject the Hearing Panel's observation.

that his conduct was fraudulent.[8] NASD Rule 2120 and Exchange Act Rule 10b-5 are designed to ensure that sales representatives fulfill their obligation to their customers to be accurate when making statements about securities. *Michael R. Euripides*, Complaint No. C9B950014, 1997 NASD Discip. LEXIS 45, at *16-18 (NASD NAC July 28, 1997). "The antifraud provisions 'give rise to a duty to disclose any information necessary to make an individual's voluntary statements not misleading.'" *Donner Corp. Int'l*, Exchange Act Rel. No. 55313, 2007 SEC LEXIS 334, at *32 n.42 (Feb. 20, 2007) (citing *SEC v. Druffner*, 353 F. Supp. 2d 141, 148 (D. Mass. 2005)), *remanded on other grounds*, 2008 FINRA Discip. LEXIS 11 (FINRA NAC Jan. 8, 2008), *aff'd*, Exchange Act Rel. No. 58917, 2008 SEC LEXIS 3140 (Nov. 7, 2008); *see also SEC v. Fehn*, 97 F.3d 1276, 1290 n.12 (9th Cir. 1996) (stating that the federal securities laws impose a duty to disclose material facts that are necessary to make disclosed statements, whether mandatory or volunteered, not misleading). Here, we find that Impellizeri omitted from his disclosures to customers JW and J & CH any mention of the potentially lucrative benefits that could accrue to Benchmark from Impellizeri's sales of the securities because of Benchmark's consulting arrangements with SRM/HYTT and positions in SRM/HYTT stock.

Impellizeri sold 88,000 shares of SRM/HYTT stock to nine customers between January 24 and March 4, 2003, including 7,500 shares to JW and 3,500 shares to J & CH.[9] At that time, Benchmark had already developed a relationship with SRM/HYTT. Impellizeri knew that Benchmark had agreed to make a market in SRM stock, and Fiore had advised him that the firm had taken a significant position in the stock, which Fiore sought to sell into the market. Impellizeri also knew that Jaloza had drafted a consulting agreement for Benchmark to act as SRM/HYTT's market liaison and investment banker. Impellizeri was familiar with the terms of the standard agreement upon which Jaloza relied, and he knew that, if the parties executed the agreement as anticipated, as SRM/HYTT's investment banker, Benchmark would earn 150,000 options for SRM/HYTT stock. Impellizeri testified during the Hearing Panel hearing that, notwithstanding this knowledge, he did not disclose to customers J & CH and JW that Benchmark could potentially receive options, that Benchmark was negotiating with SRM/HYTT to act as its market liaison, or that the firm held a significant position in SRM/HYTT stock.

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[8] Impellizeri communicated with customers through the use of telephone lines and the U.S. mail service, thereby satisfying the interstate commerce requirement for Section 10(b) and Rule 10b-5. *See SEC v. Hasho*, 784 F. Supp. 1059, 1106 (S.D.N.Y. 1992).

[9] The Hearing Panel found, as alleged in Market Regulation's complaint, that Impellizeri omitted material information regarding Benchmark's beneficial interest in selling SRM/HYTT stock with respect to nine customers, including JW and J & CH (the customers who testified). The seven customers not identified in the complaint and the Hearing Panel decision are identified in a summary chart included in the record. These customers did not testify; the Hearing Panel made findings of violation with respect to Impellizeri's sales to these customers based solely on Impellizeri's own testimony. Because we are not persuaded that Impellizeri's testimony alone is sufficient to overcome Market Regulation's burden of proof and in light of the Hearing Panel's failure in the decision to even identify these customers, we confine our findings of violation to Impellizeri's sales to customers JW and J & CH.

Customers JW and J & CH each testified that Impellizeri did not disclose Benchmark's relationship with SRM/HYTT to them.[10]

We find that Impellizeri's omissions were material. Utilizing the "reasonable investor" test, we find that a reasonable investor would consider this type of information – relating to the member firm's interest in promoting the stock and ownership of the stock – material. *See Richmark Capital Corp.*, Exchange Act Rel. No. 48757, 2003 SEC LEXIS 2680, at *13 (Nov. 7, 2003) (finding that broker-dealer's economic motivation for recommending the purchase of a particular security is material); *Kevin D. Kunz*, 55 S.E.C. 551, 565 (2002) ("When a broker-dealer has a self-interest (other than the regular expectation of a commission) in serving the issuer that could influence its recommendation, it is material and should be disclosed."), *aff'd*, 64 Fed. Appx. 659 (10th Cir. 2003); *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153 (1972) (finding material that sellers had right to know that defendants, who were acting as market makers, would benefit financially from sales); *Chasins v. Smith Barney & Co.*, 438 F.2d 1167, 1172 (2d Cir. 1970) (finding material the failure to disclose that the firm was making a market in the recommended stock). In *Hasho*, 784 F. Supp. at 1108, a seminal case on the issue of materiality, the court concluded that the failure to disclose to customers the amount of commissions earned on the sales of house stocks was a material omission. The court stated that, "[m]isrepresenting or omitting to disclose a broker's financial or economic incentive in connection with a stock recommendation constitutes a violation of the anti-fraud provisions" of the federal securities laws. *Id* at 1110. Here, Impellizeri failed to advise two customers of Benchmark's potential consulting relationship with the issuer, that the firm stood to receive 150,000 SRM/HYTT options, that Benchmark had taken a position in the stock, and that it intended to make a market in SRM/HYTT. The potential effect of Benchmark's beneficial interest on Impellizeri's objectivity is a factor that, in our view, a reasonable investor would find material. *Cf. SEC v. Blavin*, 760 F.2d 706, 711 (6th Cir. 1985) (finding registered person's investment in a security that he promoted to clients material).

We also find that Impellizeri's omissions were made in connection with the purchase or sale of a security. *See Superintendent of Ins. of New York v. Bankers Life & Cas. Co.*, 404 U.S.

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[10] The Hearing Panel also found that Impellizeri omitted material information regarding Benchmark's business relationship with TCPD when selling securities to customers JW and TA. We reverse and dismiss the Hearing Panel's findings. Impellizeri knew that Benchmark had commenced discussions with TCPD to develop an investment banking relationship, and he acknowledged that he may have seen a draft of the January 16, 2003 consulting agreement between TCPD and Benchmark. Impellizeri, however, testified that he did in fact advise his clients of Benchmark's investment banking relationship with TCPD. Neither JW nor TA contradicted Impellizeri's version of those events. JW did not recall any conversations at all with Impellizeri regarding TCPD, and TA stated in his affidavit that he could not recall whether or not Impellizeri disclosed the investment banking relationship. We therefore conclude that the evidence is insufficient to support a finding that Impellizeri fraudulently omitted information regarding Benchmark's business relationship with TCPD.

6, 12 (1971). The record unequivocally demonstrates that Impellizeri sold 7,500 shares of SRM/HYTT stock to JW and 3,500 shares to J & CH in January 2003.

We further find that Impellizeri acted with scienter by recklessly omitting material information in his sales of SRM/HYTT stock to JW and J & CH.[11] Recklessness is an extreme departure from the standards of ordinary care that presents a danger of misleading buyers and sellers that is either known to the respondent or is so obvious that the respondent must have been aware of it. *Faber*, 2004 SEC LEXIS 277, at *19. We find that Impellizeri was reckless in his omissions.

Impellizeri was no novice. He first entered the securities industry in 1985, and at the time of the misconduct, he was qualified as a general securities principal. Impellizeri was experienced in the market for speculative securities; he suggested that speculative securities were his specialty. Impellizeri was introduced to SRM/HYTT by Fiore and Feruzzi, and he knew that Benchmark held a position in SRM/HYTT stock. Indeed, Fiore had expressed concern to Impellizeri over the size of the position that Feruzzi had taken on behalf of Benchmark in SRM/HYTT stock. Impellizeri was aware that Fiore was anxious to sell some of Benchmark's SRM/HYTT holdings. Impellizeri admitted that he knew Benchmark also stood to receive 150,000 SRM/HYTT options as part of a consulting deal and that Fiore had asked Jaloza to prepare the standard consulting agreement for Benchmark and SRM/HYTT to sign. Impellizeri also understood that Benchmark was making a market in SRM/HYTT. Notwithstanding the depth of Impellizeri's understanding of Benchmark's beneficial interest in SRM/HYTT sales, he nonetheless admittedly omitted this information from discussions with JW and J & CH.

As a securities professional recommending securities to prospective investors, Impellizeri had a duty, of which he should have been aware, to disclose material adverse facts, including his firm's interest in promoting stock sales. *Richard R. Morrow*, 53 S.E.C. 772, 781 (1998) (finding that, as a securities professional, applicant had a duty "to disclose facts that he knew or were 'reasonably ascertainable'" when recommending securities purchases); *Michael A. Niebuhr*, 52 S.E.C. 546, 552 (1995) (finding that securities salesperson had a duty to disclose all material facts, including adverse interests, that could influence a stock recommendation). In recommending SRM/HYTT stock to JW and J & CH, Impellizeri disregarded his duty, and we find his actions reckless.

We find that Impellizeri fraudulently omitted from his recommendations of SRM/HYTT stock to JW and J & CH disclosure of Benchmark's beneficial interest in promoting SRM/HYTT stock.

*b. Other Allegations Against Impellizeri*

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[11] Scienter is the "intent to deceive, manipulate or defraud," *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976), and may be established by a showing that a respondent acted recklessly. *Dane S. Faber*, Exchange Act Rel. No. 49216, 2004 SEC LEXIS 277, at *19 (Feb. 10, 2004).

The complaint alleged, and the Hearing Panel found, other fraudulent misrepresentations and omissions as to Impellizeri. As discussed in detail below, we reverse and dismiss the Hearing Panel's findings.

The Hearing Panel found, without identifying specific customers, that Impellizeri fraudulently misrepresented that the value of SRM/HYTT's stock would appreciate 50 to 100 percent in six months to one year and that Impellizeri failed to inform his customers of the risks associated with investing in SRM/HYTT. The Hearing Panel also found that Impellizeri fraudulently misrepresented to customers JW and J & CH that the price per share of SRM/HYTT stock would increase quickly from $2.36 to $4 and that he failed to inform them of SRM/HYTT's poor financial condition and the risks associated with purchasing SRM/HYTT stock. As to Impellizeri's sales of TCPD, the Hearing Panel found that Impellizeri fraudulently misled customers by failing to advise all of his customers, including customers JW and TA, of TCPD's precarious financial condition, lack of operating history, and need for additional funds to continue operations. The Hearing Panel further found that Impellizeri fraudulently misrepresented to TA that the price per share of TCPD stock would increase because TCPD's stock would soon be recommended by an Internet stock website, "Stock Genie," a pending financial deal was expected to double or triple sales of TCPD stock, and TCPD's share price originally had dropped because of illegal short sales. Additionally, Market Regulation's complaint alleged that Impellizeri's sale in JW's account of the Federated High Income Bond Mutual Fund and purchase of TCPD stock were unauthorized transactions. The Hearing Panel made no findings on the allegation of unauthorized trading in JW's account.

We turn first to the Hearing Panel's findings of baseless price predictions as to SRM/HYTT and TCPD stocks. We note that the Hearing Panel did not find credible Impellizeri's denial that he predicted substantial increases in the prices of SRM/HYTT and TCPD stock. We acknowledge that the credibility findings of the initial fact finder are entitled to considerable weight and can be overturned only by substantial evidence. *See Daniel D. Manoff*, 55 S.E.C. 1155, 1161-62 (2002). Even deferring to the Hearing Panel's credibility finding, however, we are unable to affirm the Hearing Panel's findings based on the testimony of JW and J & CH and TA's affidavit. JW's testimony was inconsistent. JW testified that Impellizeri told him that others were predicting that the price of SRM stock would increase to $4 per share, but he also stated that Impellizeri may not have stated it specifically and that he may have only implied it. He also stated that he could not recall exactly what Impellizeri stated to him about SRM stock. JW had no recollection of any conversations with Impellizeri regarding TCPD stock. We find J & CH's testimony equally unavailing. CH testified that Impellizeri recommended that she purchase SRM stock because he expected the price of the stock to increase quickly to $4 per share. On cross examination, however, CH equivocated. She conceded that Impellizeri never guaranteed a price increase to $4 per share, but stated that she felt that he made the stock sound like a "big deal." CH sent a letter to FINRA regarding her dealings with Impellizeri, but never mentioned in the letter that Impellizeri had told her that SRM's stock price would increase to $4 per share.[12] TA did not testify.[13] Impellizeri entered

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[12] CH testified that she recalled that Impellizeri had indicated that SRM's stock price would

[Footnote continued on next page]

into the record TA's affidavit, which stated that Impellizeri told TA that TCPD could have potentially yielded a high return, but that Impellizeri never stated that the price of the stock would rise or predict a specific price increase.

We do not find that the evidence in this case is sufficient to prove that Impellizeri made fraudulent price predictions in sales of SRM/HYTT or TCPD stock. *Cf. Dep't of Enforcement v. Roy M. Strong*, Complaint No. E8A2003091501, 2008 FINRA Discip. LEXIS 19, at *14-16 (FINRA NAC Aug. 13, 2008) (holding that the failure to prove a violation by a preponderance of the evidence should result in dismissal).

We also are not persuaded that the evidence is sufficient to support the Hearing Panel's findings that Impellizeri failed to inform all customers, including JW and J & CH, of the risks associated with investing in SRM/HYTT and the details of SRM/HYTT's poor financial condition. We also find the evidence insufficient to support the Hearing Panel's findings that Impellizeri failed to disclose to all customers, including JW and TA, TCPD's precarious financial condition, its need for additional funds, and its lack of operating history. Again, we find JW's testimony to be confused and internally inconsistent. JW testified that Impellizeri did not discuss SRM/HYTT's financials with him, but he also emphatically stated that he could not recall with specificity exactly what Impellizeri said to him about the stock. JW did not testify about TCPD because, he contended, Impellizeri's purchase of TCPD stock was unauthorized and the two had not discussed TCPD stock. JW, however, never complained to Impellizeri or Benchmark about an alleged unauthorized TCPD purchase, even after receiving a trade confirmation for the trade. He wrote to Impellizeri in August 2003, but did not mention an unauthorized trade, and he spoke to a representative of FINRA in the summer of 2003 without mentioning the alleged unauthorized TCPD trade until a later conversation in October 2003.[14] CH's testimony also was inconsistent. She testified that Impellizeri did not advise her of the potential risks associated with an SRM/HYTT investment or discuss SRM's financial situation. On cross examination, CH backed away from some of her earlier statements. CH testified that she could not recall the specifics of her conversations with Impellizeri, and she admitted that,

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[cont'd]
increase to $4 per share only after talking with her spouse, JH. JH, however, testified at the Hearing Panel hearing that he did not recall Impellizeri's mentioning a specific future price for SRM stock.

[13] The Hearing Panel states that TA, in fact, testified that Impellizeri predicted that TCPD's share price would increase by 50 to 100 percent in six to 12 months. As noted, TA did not testify, and his affidavit stated that Impellizeri did not predict a particular increase in TCPD's price per share.

[14] The Hearing Panel made no finding with respect to the unauthorized trading allegation and did not discuss the evidence related to the allegation. We have considered the evidence and find it insufficient to support the allegation. We therefore dismiss the allegation of unauthorized trading in JW's account.

prior to the Hearing Panel hearing, she had told Impellizeri's attorney that she could not recall most of her conversations with Impellizeri. TA's signed affidavit suggested that Market Regulation had inaccurately characterized his dealings with Impellizeri. TA stated that Impellizeri advised him that TCPD was a start-up company and therefore a risky investment.

We also considered Impellizeri's own testimony, which suggests that he could have been more diligent about discussing financial details with his customers. Impellizeri's testimony does not, however, overcome the weak customer testimony and lack of other evidence that Impellizeri fraudulently misrepresented and omitted key financial information, baselessly predicted price increases, and executed an unauthorized purchase and sale. We therefore reverse and dismiss the Hearing Panel's remaining findings of fraud as to Impellizeri.

*2. Jaloza*

The Hearing Panel found that Jaloza failed to disclose going-concern opinions and other negative financial information about SRM/HYTT stock to all of his customers, predicted an unrealistic increase in SRM/HYTT's stock price, failed to advise customers that he lacked sufficient information to evaluate accurately SRM/HYTT's prospects, and failed to disclose the financial incentives that drove his recommendations. Market Regulation did not present testimony or written statements from customers to whom Jaloza sold SRM/HYTT. The Hearing Panel based its findings on Jaloza's testimony alone.

We have reviewed Jaloza's testimony and, taken as a whole, his testimony, during both the Hearing Panel hearing and investigative interviews, is not sufficient to carry Market Regulation's burden of proving that Jaloza defrauded the customers to whom he sold SRM/HYTT stock. Jaloza's testimony, during which he candidly admits that he cannot recall with certainty exactly what he told his clients when they bought SRM/HYTT stock, coupled with the lack of customer testimony to support the finding that he misled customers or omitted material information from his discussions with them, leads us to conclude that the evidence is insufficient to prove fraud. Furthermore, Jaloza testified that he explained to his clients that SRM/HYTT was a shell company with little or no funding that needed to proceed with a reverse merger to be successful.

With respect to Jaloza's sales of TCPD stock, the Hearing Panel found that Jaloza did not adequately review TCPD's financial filings and business operations and misrepresented to all of his customers that the issuer showed considerable potential.[15] With respect to customer CB, the Hearing Panel found that Jaloza misrepresented that TCPD had a good business plan and "was

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[15] Market Regulation's complaint also alleged that Jaloza did not disclose to all of his customers TCPD's poor financial condition, the risks associated with investing in TCPD, its lack of operating history, its lack of revenues, its need for additional financing, and TCPD's consulting agreement with Benchmark. The Hearing Panel decision did not specifically address these allegations. As discussed in more detail below, we have considered the evidence, find it insufficient to support these allegations, and therefore dismiss them.

doing well." The Hearing Panel found that he failed to inform CB that TCPD: had a financial relationship with Benchmark, was not an operating company, needed to raise $1 million to stay in business, faced significant competition from better-financed companies, and had other significant financial shortcomings.[16]

The Hearing Panel based its findings on Jaloza's own testimony and CB's testimony. Jaloza testified that he told CB that TCPD was a start-up company with little money and that it needed to raise additional capital to get its video on demand business running. He also contended that he told CB that TCPD had little operating history and was a speculative investment, and that Benchmark might have entered into a consulting agreement with TCPD. CB, a retired college professor, bought 177,500 shares of TCPD stock in eight separate purchases between March 3 and May 19, 2003. He denied that Jaloza provided him with financial details or any negative information about TCPD before recommending the stock. CB also testified, however, that he understood Jaloza's recommendation of TCPD to be speculative and that Jaloza explained that TCPD was a start-up company. CB stated that he understood that TCPD had no revenues or profits and that it would need to spend money to become fully operational. Although CB claimed that Jaloza did not disclose Benchmark's potential relationship with TCPD, he conceded on cross examination that Jaloza may have advised him of this relationship. CB also stated that he could not recall the conversations that he had with Jaloza before purchasing TCPD. He stated that Jaloza never predicted how high the price of TCPD stock would rise and that he believes that Jaloza provided him with enough information for CB to have decided to purchase TCPD stock. CB also conceded that his memory of his dealings with Jaloza was not very good.[17]

CB's testimony suggests that Jaloza's statements to him regarding TCPD perhaps could have encompassed more material information. We do not, however, find that CB's and Jaloza's testimonies are sufficient for us to conclude that Market Regulation has proven that Jaloza defrauded CB. CB's concession that Jaloza may indeed have provided him with more information than he can recall and his inability to recall other important facts about their communications make his testimony less reliable. Furthermore, we find CB's testimony to be internally inconsistent in that he stated, on the one hand, that Jaloza did not provide him with

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[16] The complaint also alleged that Jaloza fraudulently advised customer CB that the price of TCPD stock would increase and that "the price was cheap." The Hearing Panel decision did not specifically address these allegations. The complaint also contained similar allegations with respect to Jaloza's customer TB. TB, however, refused to testify and signed an affidavit that refuted Market Regulation's allegations. Prior to the commencement of the Hearing Panel hearing, Market Regulation voluntarily moved to withdraw the allegations of the complaint related to customer TB.

[17] CB testified that he spent some time in the spring of 2003 at the chemical engineering department of the University of Chile. He alleged that Jaloza did not communicate with him during that time. Jaloza stated that they had talked and communicated via email. An email address and telephone number for the chemical sciences department at the University of Chile appeared in Jaloza's email records and business telephone records for that period.

financial information regarding TCPD, but also testified that he understood TCPD to be a speculative investment in a start-up company that had not generated revenues or profits and required additional funds to become functional. We also have considered Jaloza's testimony which, taken as a whole, is also insufficient to carry Market Regulation's burden of proving that Jaloza defrauded CB or any customers to whom he sold TCPD. Furthermore, Jaloza's testimony regarding his statements to CB and other customers to whom he sold TCPD is corroborated by the affidavits of two customers who purchased TCPD from Jaloza.[18]

We reverse and dismiss the Hearing Panel's findings of fraud as to Jaloza and dismiss all allegations of fraud as to Jaloza not specifically addressed in the Hearing Panel decision.

* * * *

We acknowledge the seriousness of Market Regulation's allegations of fraud. By dismissing the Hearing Panel's findings against Jaloza in full and Impellizeri in part, we do not mean to suggest that Jaloza's and Impellizeri's disclosures to their customers were as inclusive and as detailed as they could have been or that the factual allegations, if proven, would not have supported findings of violation. We find, however, that the record evidence is not sufficient to prove that Jaloza acted fraudulently or that Impellizeri's fraudulent omissions extend beyond his failure to disclose Benchmark's beneficial interest in selling SRM/HYTT stock. We therefore reverse and dismiss the Hearing Panel's findings of violation with respect to Jaloza and, in the manner outlined above, we partially dismiss the Hearing Panel's findings of fraud with respect to Impellizeri.

B. Rule 2315 – FINRA's Recommendation Rule

NASD Rule 2315, which became effective October 30, 2002, is known as "the Recommendation Rule." It generally requires member firms to review current financial statements and material business information before a registered representative may recommend transactions in low-priced over-the-counter equity securities. FINRA stated in its notice to the membership of the approval of Rule 2315 that "Rule 2315 is intended to address abuses in transactions involving thinly capitalized (microcap) securities." *NASD Notice to Members 02-66* (Oct. 2002). Rule 2315 does not supersede existing suitability obligations attendant to recommending securities transactions, and compliance with the rule does not provide a safe harbor for recommending microcap securities. *Id.*

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[18] Jaloza customers TB (who purchased 50,000 shares of TCPD in March and April 2003) and HS (who purchased 50,000 shares of TCPD in January and March 2003) signed affidavits in which they contended that: Jaloza informed them that TCPD was a start-up company with no historical revenues and an inherently risky investment. Although neither TB nor HS could recall whether or not Jaloza mentioned Benchmark's investment banking relationship with TCPD to them, HS recalled that Jaloza had disclosed such a relationship to him when discussing other potential investments, and stated that he just could not recall as to TCPD specifically.

Rule 2315(a) states:

> **No member or person associated with a member** shall recommend that a customer purchase or sell short any equity security that is published or quoted in a quotation medium ... **unless the member has reviewed** the current financial statements of the issuer, current material business information about the issuer, and made a determination that such information, and any other information available, provides a reasonable basis under the circumstances for making the recommendation.

Rule 2315(c) states:

> (1) **A member shall designate a registered person** to conduct the review required by this Rule. In making such designation, the member must ensure that:
>
> (A) Either the person is registered as a Series 24 principal, or ... is appropriately supervised by a Series 24 principal; and
>
> (B) Such designated person has the requisite skills, background and knowledge to conduct the review required under this Rule.
>
> (2) **The member shall document** the information reviewed, the date of the review, and the name of the person performing the review of the required information.

Respondents argue that the complaint inadequately alleged a violation of Rule 2315 because it alleged that respondents *individually* failed to conduct their own due diligence reviews, not that they failed to ensure that Benchmark had conducted the requisite reviews. Respondents argue that the plain language of Rule 2315, combined with the history of FINRA's adoption of Rule 2315, places the onus of conducting a due diligence investigation before recommending a microcap security on the member firm, not the associated person. Respondents argue that registered individuals are entitled to rely on their member firms' due diligence investigations to comply with Rule 2315. Respondents further argue that, even if the NAC concludes that the complaint properly pled a violation of Rule 2315, the evidence does not prove that respondents violated the rule. We address these arguments below.

*1. Associated Persons' Obligations Under NASD Rule 2315*

Respondents argue that NASD Rule 2315 obligates firms, not associated persons, to conduct a due diligence review of OTC equity securities, and that associated persons need not verify in any manner that their firms conducted a due diligence review. While we agree that the rule imposes the due diligence review obligation specifically on the firm, we further find that Rule 2315 also imposes certain obligations on associated persons.

In January 1998, NASD published for comment an early draft of proposed Rule 2315. The original proposed rule language stated:

> (a) **No member or person associated with a member** shall recommend to a customer the purchase, sale, or exchange of any equity security ... **unless the member or person**

> **associated with a member has reviewed** reasonably current financial statements of the issuer, and such financial statements and other information available provides a reasonable basis under the circumstances for making the recommendation.[19]

*See NASD Notice to Member 98-15* (Request for Comment) (Jan. 1998). NASD Notice to Members 98-15 describes the rule proposal as requiring **the member or associated person** to review reasonably current financial statements of the issuer and to determine that there is a reasonable basis before making a recommendation. That notice also solicited comments concerning this aspect of the proposed rule:

> Because the proposed rule will place an increased burden on retail firms, NASD Regulation is specifically soliciting comment on whether both the member firm and its registered representative must perform the review required by the proposed rule, or whether it would be sufficient if either the firm or the representative making the recommendation conducted the review.

NASD received many comments responsive to the rule proposal. The comments included the suggestion that having both the firm and the associated person making the recommendation conduct a review of the required information was overly burdensome and unworkable. The comments further noted that an individual salesperson's conducting a review of the information in addition to the firm's review would not necessarily add any benefit to the process because, in most instances, the associated person would not possess any special skills or training in reviewing financial information.

On January 13, 1999, NASD submitted a rule filing for proposed Rule 2315. *See* SR-NASD-1999-004 (Microcap Initiative Proposed Recommendation Rule), www.FINRA.org/Industry/Regulation/RuleFilings/1999/P001280. In the rule filing, NASD advised the Commission that, in light of comments received in response to NASD Notice to Members 98-15, NASD had amended the proposed rule language to require a member to review certain current financial information and other business information about the issuer, and to require members to designate qualified registered individuals to review the information required by the rule and to maintain a record of the review. NASD also represented to the Commission that the associated person making the recommendation to the customer would be obligated under the proposed rule to ensure that the member has conducted the review of the specified information before making the recommendation to a customer. The language proposed in the rule filing is essentially the same as the current rule language (with respect to the sections at issue in this case). The language of NASD's rule filing shows that NASD chose to place the burden of conducting a due diligence review on the member firm and the burden of ensuring that the firm had, in fact, complied with such review requirements of Rule 2315 on the associated person before he or she recommends a security.

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[19] The language currently contained in subsection (c) of Rule 2315 was not included in the original rule proposal.

In February 1999, the Commission published notice of the proposed rule and requested comments. *See* Exchange Act Rel. No. 41075, 1999 SEC LEXIS 377 (Feb. 19, 1999). The Commission stated that proposed Rule 2315 requires members to obtain and review the issuer's financial statements and other business information and to designate a responsible registered person to conduct the review. The notice stated that "[t]he associated person making the recommendation to the customer is obligated, prior to the recommendation, to assure that the member has conducted such a review of the specified information in accord with the proposed rule."[20] *Id.* at *14. Subsequently, the Commission approved the amended proposed Rule 2315. *See* Exchange Act Rel. No. 46376, 2002 SEC LEXIS 2156 (Aug. 19, 2002); *NASD Notice to Members 02-66* (SEC Approves NASD Rule 2315; Recommendations to Customers in OTC Equity Securities) (Oct. 2002).

Based on the history of FINRA's development of Rule 2315 and the language of Rule 2315 itself, we hold that Rule 2315 places the burden on member firms to conduct a review of the current financial statements of the issuer and current material business information about the issuer, and to make a determination that the information provides a reasonable basis for recommending the security. We further hold that Rule 2315 requires the associated person, before recommending the purchase or sale of a microcap security, to reasonably ensure that the member has conducted the required due diligence investigation and concluded that there is a reasonable basis for recommending the security. For an associated person to "reasonably" rely on the member firm's due diligence investigation, at a minimum, the associated person must be reasonably assured that there are no flaws or insufficiencies in the member firm's due diligence. Furthermore, the associated person must be alert and ensure that there are no red flags that would suggest that the firm has not satisfied its obligations. Thus, in this case, each respondent was not necessarily required to conduct his own independent due diligence, if he reasonably ensured that Benchmark had adequately conducted an investigation before recommending the securities at issue.[21]

Market Regulation argues, however, that the language of Rule 2315 "unless the member has reviewed the current financial statements" should be interpreted broadly to mean that the member and its associated persons both must conduct the review. Member Regulation relies on NASD Rule 0115(a), which states that FINRA rules apply to all members and associated persons and that associated persons shall have the same duties and obligations as a member under the rules. We do not agree with Market Regulation's interpretation in this instance. The Commission has held that FINRA rules generally apply to associated persons irrespective of whether the rule specifically mentions associated person because of Rule 0115(a). *See Michael Ben Lavigne*, 51 S.E.C. 1068, 1072 & n.25 (1994), *aff'd*, 78 F.3d 593 (9th Cir. 1996). Unlike most NASD rules, however, the Rule 2315 rule filings show that FINRA, in response to

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[20] In response to comments, NASD filed two amendments to the rule filing, neither of which affect the application of the rule in this case.

[21] Additionally, the respondents' duties under Rule 2315 were separate and independent of their duties under the Suitability Rule, Rule 2310.

comments, specifically chose to include "member or person associated with a member" in the section of the rule that indicates what is required before making a recommendation and intentionally deleted "or person associated with a member" from the part of the rule that requires the due diligence review of financial and business documents. Indeed, when the Commission published the rule filing for comment, it stated that the associated person making the recommendation is obligated, prior to making the recommendation, only to "assure that the *member* has conducted such a review of the specified information." 1999 SEC LEXIS 377, at *14 (emphasis added).

Because a violation of the Suitability Rule, Rule 2310, is not alleged in this case, our discussion here of an associated person's duty to perform due diligence does not limit the due diligence requirements of Rule 2310 (the Suitability Rule) and applies only in the context of NASD Rule 2315. It should be noted that Rules 2310 and 2315 impose separate obligations on associated persons, and an associated person's duty to meet the requirements of Rule 2315 is a condition antecedent to meeting the requirements of the Suitability Rule.

In sum, we find that Rule 2315 required respondents, before recommending the securities at issue, to reasonably ensure that Benchmark, through its designated individuals, had complied with Rule 2315. Accordingly, we reject respondents' argument that the rule did not impose any obligations on them and Market Regulation's argument that the rule imposed the obligations of full review on both the member firm and its associated persons.

*2. The Adequacy of Market Regulation's Complaint*

Respondents next argue that the complaint did not adequately allege a violation of NASD Rule 2315. Considering the proceedings below in their entirety, however, we find that the respondents had fair notice of the alleged violations of that rule.

Market Regulation's complaint alleged that respondents violated Rules 2315 and 2110 by recommending purchases of SRM/HYTT and TCPD stock to customers without first reviewing current available financial statements or material business information, without determining that such information provided a reasonable basis for their recommendations, and by relying instead on issuer representatives and promoters and the upward movement of the price and volume of the stock to determine that there was a reasonable basis for their recommendations. Before commencement of the Hearing Panel hearing, Market Regulation filed a motion for summary disposition (as to Rule 2315 violations) based on respondents' pre-hearing testimony that respondents had not reviewed complete SEC filings for SRM/HYTT and TCPD before recommending the securities to customers. Market Regulation argued that respondents' admissions that they recommended TCPD and SRM/HYTT stock to customers without first independently reviewing current financial statements were evidence of their violations of Rule 2315. Respondents denied that their on-the-record testimony in fact supported such a finding and countered that, even if they had not independently reviewed financial filings, Market Regulation had misapplied Rule 2315. They further contended that, under the plain language of Rule 2315, Benchmark, not the individual respondents, was responsible for performing due diligence, and that the rule allowed for associated persons to rely on the due diligence performed by the member firm. The Hearing Officer denied Market Regulation's motion for summary disposition on the basis that, under Rule 2315, it was Benchmark's duty to conduct a due diligence review of TCPD

and SRM/HYTT and that the issue to be resolved at the hearing was whether respondents reasonably relied upon information that the firm had conducted the required review.[22]

NASD Rule 9212 requires that the complaint specify in reasonable detail the conduct alleged to constitute the violative activity and the rule that respondents are alleged to have violated. The Commission has held that a complaint "need not specify all details regarding a case against a respondent." *Wanda Sears*, Exchange Act Rel. No. 58075, 2008 SEC LEXIS 1521 at *11 (July 1, 2008). Rather, the Commission has focused on whether the respondents understood the issues and were afforded a full opportunity to litigate and defend themselves. *Fox & Co. Inv., Inc.*, Exchange Act Rel. No. 52697, 2005 SEC LEXIS 2822, at *32 n.34 (Oct. 28, 2005); *Jonathan Feins*, 54 S.E.C. 366, 378 (1999) ("[T]he question on review is not the adequacy of the ... pleading but ... the fairness of the entire proceeding.").

We find that the complaint, considered in conjunction with the Hearing Officer's summary disposition ruling, which specifically advised the parties that the issue to be resolved was whether respondents reasonably relied upon information that Benchmark had conducted the required review, afforded respondents adequate notice of the alleged violation and a reasonable opportunity to defend themselves.

*3. Evidence that Respondents Violated Rule 2315*

As we held above, under Rule 2315, an associated person making a recommendation to purchase or sell a microcap security is obligated, prior to making the recommendation, to reasonably ensure that the member has conducted a review of the current financial statements and other material business information of the issuer and has determined that a reasonable basis exists for recommending the security. In this case, therefore, Market Regulation carries the burden of demonstrating whether Benchmark conducted the required due diligence. Market Regulation must also show that the respondents had not reasonably ensured that Benchmark had conducted the required due diligence review under Rule 2315.

The Hearing Panel found that respondents recommended purchases of SRM/HYTT and TCPD stock without a reasonable basis for believing that the firm had completed due diligence reviews of the issuers' current financial statements and business information and that respondents knew that no one at Benchmark had reviewed SRM/HYTT's and TCPD's current financial statements. We do not agree that the evidence supports this finding.

First, the testimony of Market Regulation analyst Jeff Grant ("Grant") left unanswered the question of what, if anything, Market Regulation had received from Benchmark in the way of due diligence files. Grant, the only Market Regulation analyst to appear at the hearing, testified that he did not conduct Market Regulation's initial investigation in this matter and that, when he began working on the investigation, Market Regulation had already compiled numerous boxes of

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[22] The Hearing Officer did not rule on the issue of whether the complaint sufficiently alleged a violation of Rule 2315.

documents, some of which were produced by Benchmark. Although the boxes included an index that indicated the source for some of the documents, Market Regulation did not enter the index into the record and the index purportedly did not identify the source for all of the documents.[23] Furthermore, Grant testified that he did not know the source of most of the documents contained in Market Regulation's files. Grant testified that he found in Market Regulation's files a Benchmark due diligence file for TCPD, which did not appear to contain SEC filings for TCPD, and he did not find Benchmark due diligence files for HYTT or SRM. He also testified, however, that he found public filings for all three issuers among Market Regulation's investigative files. Grant testified that he assumed that the public filings were retrieved by a Market Regulation analyst who previously had worked on the case, but he could not say for sure that the public filings were not produced by Benchmark during the investigation. Grant could not state with certainty what documents Fiore and Benchmark had produced in response to Market Regulation's investigative requests and which documents had been obtained from other sources. Grant admittedly was not involved with the case during the document production portion of Market Regulation's investigation, and Market Regulation did not produce any evidence that satisfactorily established the source and the chain of custody of the documents contained in Market Regulation's files. In the end, Grant's testimony did not indicate with any amount of certainty exactly what documents, if any, were contained in Benchmark's files regarding TCPD, SRM, or HYTT.

Likewise, Fiore provided on-the-record testimony concerning Benchmark's due diligence files that was too unreliable to shed any light on the topic. Fiore stated that Benchmark did, in fact, maintain due diligence files on the securities at issue and that he and two other individuals (neither of which are respondents in this matter) were the designated principals responsible for Rule 2315 compliance. Fiore testified that Benchmark's associated persons did not have firm approval to sell any security priced below $15 per share unless the firm specifically endorsed the security. Fiore never denied that Benchmark approved of and encouraged respondents' selling the securities at issue. He stated that the due diligence files that the firm maintained should have contained current Forms 10-K and 10-Q for the issuers. He claimed to have reviewed the due diligence files as best as he could, but admitted that he did not check to verify the adequacy of all due diligence files. Fiore's testimony became increasingly incoherent as he continued to testify on the record. He eventually retracted his earlier testimony and stated that Jaloza, Gimeli, and Impellizeri were his investment banking team and that they were responsible for Benchmark's due diligence files. Fiore's on-the-record testimony is internally inconsistent and does not support the Hearing Panel's findings that respondents violated Rule 2315.

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[23] On day three of the Hearing Panel hearing, at the end of Market Regulation's presentation of its case, Market Regulation sought leave to introduce the index into the record, notwithstanding that it had not listed the index as a proposed exhibit in its original exhibit list. Respondents' counsel objected, and the Hearing Panel denied the request, noting that Grant had testified that the index identified the source of some, but not all, of the documents contained in Market Regulation's investigatory file. We do not disturb the Hearing Panel's ruling.

Furthermore, Fiore's on-the-record testimony is hearsay and its reliability must be assessed. The Commission has long held that hearsay evidence is admissible in administrative proceedings. *Rooney A. Sahai*, Exchange Act Rel. No. 51549, 2005 SEC LEXIS 864, at *24 (Apr. 15, 2005). Hearsay evidence, however, "must be evaluated for its probative value, reliability, and the fairness of its use in order to be admissible in administrative proceedings." *Carlton Wade Fleming*, 52 S.E.C 409, 411 n.7 (1995); *see also Mark James Hankoff*, 50 S.E.C. 1009, 1012 (1992). The factors to consider to evaluate the probative value and reliability of hearsay evidence are: (1) the possible bias of the declarant; (2) the type of hearsay at issue; (3) whether the hearsay statements are signed and sworn to rather than anonymous, oral or unsworn; (4) whether the statements are contradicted by direct testimony; (5) whether the declarant was available to testify; and (6) whether the hearsay is corroborated. *Charles D. Tom*, 50 S.E.C. 1142, 1145 (1992).

Based on our evaluation, we do not find that Fiore's on-the-record testimony was reliable. Fiore may have been biased against respondents. He stated that he was "at war" with JIG and admitted that he had held back money that Benchmark owed to JIG when the respondents left Benchmark. Jaloza and Impellizeri testified that, as Benchmark's business wound down, Fiore and JIG were not on good terms, and Fiore fired Impellizeri and Jaloza with no notice and no explanation and filed false Uniform Termination Notices for Securities Industry Registration (Forms U5) about them. Benchmark's Board of Directors subsequently reversed Fiore's determination and rehired them. Fiore then resigned from Benchmark. Although Fiore's testimony was provided in response to a Rule 8210 request and under oath, the latter portion of his testimony appears incoherent and rambling. Furthermore, Fiore's on-the-record testimony that JIG was his "investment banking" arm and that he relied on JIG for maintaining due diligence files is not corroborated and is contradicted by the testimony of Jaloza, Impellizeri, and Gimeli. Each denied that they were Benchmark's "investment banking" arm and that they were responsible for due diligence files, and the firm's supervisory manual does not designate any one of them as the designated person for Rule 2315 compliance. Finally, we note that Market Regulation never explained why Fiore was not called to testify at the Hearing Panel hearing in November 2006. According to CRD, Fiore was associated with a member firm through January 2008, and FINRA presumably maintained jurisdiction over Fiore.

Market Regulation was required to prove that respondents failed to reasonably ensure that Benchmark had performed the review required under Rule 2315.[24] Market Regulation failed. First, the evidence is unclear as to what type of review Fiore or another of his designated principals conducted, if any, and what was contained in due diligence files that they may have maintained at the firm. In our view, the evidence therefore fails to establish that Benchmark failed to conduct the due diligence review required by Rule 2315. Furthermore, the evidence

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[24] The Hearing Panel also found that "none of the [r]espondents ever claimed that he based his recommendations on the [f]irm's determination that SRM's current financial statements and business information provided a reasonable basis for recommending the stock." We do not agree. The three respondents generally claimed with respect to the securities at issue that they relied on Benchmark's due diligence investigations and Fiore's endorsement of the stocks.

indicates that respondents in fact relied, at least in part, on Benchmark's and Fiore's review and endorsement of these issuers. We find that the evidence is insufficient, particularly without knowing the extent of the review conducted by Benchmark, to determine that respondents failed reasonably to ensure that Benchmark had conducted the review required by Rule 2315. Because Market Regulation failed to meet its burden of proof, we dismiss the Hearing Panel's findings of violations of Rules 2315 and 2110. *Cf. Roy M. Strong*, 2008 FINRA Discip. LEXIS 19, at *12-14 (dismissing violation for insufficient proof).

## V. Sanctions

The Hearing Panel barred each respondent and assessed $8,770 in costs, jointly and severally. In light of our dismissal of findings of violation as to Jaloza and Gimeli, we eliminate all sanctions imposed on them. In light of our dismissal of some of the findings as to Impellizeri, we reduce the bar imposed by the Hearing Panel to a six-month suspension, $25,000 fine, and order to pay restitution of $7,929 to customers J & CH. We also affirm the imposition of one-third of the Hearing Panel's costs ($2,923) on Impellizeri and impose no appeal costs.[25]

### A. Obstruction of the Disciplinary Process

The Hearing Panel considered as an aggravating factor that Impellizeri contacted customers CH, JW and TA before the Hearing Panel hearing and purportedly discouraged them from appearing as witnesses. The Hearing Panel considered Impellizeri's actions to be an obstruction of the disciplinary process. The Hearing Panel reasoned that, because the respondents had raised as proof of their innocence their customers' unwillingness to complain and to testify and had questioned other witnesses' motives in appearing at the hearing, the Hearing Panel properly considered Impellizeri's pre-hearing conversations with CH, JW, and TA because the conversations undercut his defense. The Hearing Panel also found that Impellizeri's actions demonstrated his unwillingness to take responsibility for his own misconduct.

At the outset, we note that FINRA's procedural rules do not preclude respondents, or FINRA representatives, in FINRA disciplinary proceedings from talking to current and former customers who are listed as witnesses for the complainant. Rules 9242 and 9261 require parties to FINRA disciplinary proceedings to exchange witness lists at least 10 days prior to a hearing and to provide the opposing side with the witnesses' names, occupations, addresses and summaries of their expected testimony. The rules do not limit or otherwise address whether parties or their attorneys can contact witnesses listed by opposing parties. We do not find anything inherently inappropriate in Impellizeri's contacting CH, JW, or TA.

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[25] The FINRA Sanction Guidelines for material omissions of fact recommend a fine of $10,000 to $100,000 and a suspension of 10 business days to two years. *FINRA Sanction Guidelines* at 93 (2007), http://www.finra.org/web/groups/industry/@ip/@enf/@sg/document/industry/p011038.pdf. The sanctions that we have imposed therefore are within the range contemplated in the Guidelines.

We next turn to the customers' and Impellizeri's testimony regarding their pre-hearing conversations. TA did not testify, and his affidavit does not address his pre-hearing conversations with Impellizeri. JW testified that Impellizeri contacted him and suggested that, rather than pay extensive legal fees, he would "just as soon" reimburse JW for his losses. JW believed that Impellizeri's statement implied that, if JW did not testify at the hearing, Impellizeri may be willing to reimburse JW's losses. CH testified that Impellizeri left a telephone message encouraging her to talk to him. She could not recall if Impellizeri encouraged them not to attend the hearing. CH and Impellizeri never spoke before the hearing because she did not return his call. Impellizeri admitted that he attempted to contact JW, CH, TA and other clients to whom Market Regulation had talked. He denied that he tried to persuade any of them not to attend the Hearing Panel hearing. He stated that several customers had told him that Market Regulation staff had harassed them, and he wanted his clients to understand that FINRA was not a government agency and could not force them to testify against him.

We do not find that these conversations rise to the level of obstructing a disciplinary proceeding, and we have not considered Impellizeri's actions as an aggravating factor. *Cf. Michael A. Rooms*, Exchange Act Rel. No. 51467, 2005 SEC LEXIS 728 (Apr. 1, 2005) (finding that falsification of documents that firm produced to NASD in response to a Rule 8210 request directed to the firm constituted interference with the disciplinary process), *aff'd*, 444 F.3d 1208 (10th Cir. 2006); *Stratton Oakmont, Inc.*, 52 S.E.C. 1170 (1997) (finding that member firm impeded a disciplinary investigation when it refused to release a customer from a settlement agreement that prevented the customer from discussing his complaint with NASD). We also reject the Hearing Panel's finding that Impellizeri's pre-hearing conversations with JW, CH, and TA demonstrate Impellizeri's unwillingness to take responsibility for his own actions.

B Other Aggravating and Mitigating Factors

Impellizeri seeks to reduce the sanctions imposed. He argues that he has been in the securities business for 25 years and has no disciplinary history and few customer complaints. While Impellizeri's lack of disciplinary history is not mitigating, the totality of the other facts and circumstances warrants a reduction in the sanctions.

As directed by the Guidelines,[26] we have considered the number of trades involved (two) and the number of retail clients (two) who were affected by Impellizeri's omissions. That Impellizeri's violations were relatively isolated also is a factor for consideration.

On the other hand, aggravating factors also exist. The record indicates that the value of HYTT stock has continued to decrease, so Impellizeri's reckless misconduct may have contributed to customer loss, and Impellizeri earned commissions on the sales.

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[26] *See FINRA Sanction Guidelines*, at 6 (Principal Considerations in Determining Sanctions).

We also have considered the nature of Impellizeri's misconduct. "A salesperson must disclose all material facts, including 'adverse interests,' such as a self-interest that could influence a recommendation." *Niebuhr*, 52 S.E.C. 546, 552. Impellizeri failed to disclose JIG's and Benchmark's beneficial interest in his selling SRM/HYTT stock to customers JW and J & CH. The customers were entitled to this disclosure before making their investment decisions. *Id.* By failing to disclose Benchmark's and JIG's beneficial interest, Impellizeri violated the anti-fraud provisions of the federal securities laws. Violations of this nature are "especially serious and subject to the severest of sanctions." *Donner Corp. Int'l*, 2007 SEC LEXIS 334, at *71 (citations omitted). We find that the six-month suspension, $25,000 fine, and restitution order that we have imposed are commensurate with Impellizeri's misconduct and within FINRA's Guidelines.

C. Market Regulation's Cross-Appeal on the Issue of Restitution

The Hearing Panel stated in its decision that it did not order restitution because Market Regulation did not present evidence of the customers' losses. Market Regulation cross-appealed seeking orders of restitution as to Jaloza and Impellizeri. Because we have dismissed the Hearing Panel's findings as to Jaloza, we will address Market Regulation's cross-appeal only as to Impellizeri.

Restitution seeks to require the wrongdoer to restore the victim to the status quo ante. *David Joseph Dambro*, 51 S.E.C. 513, 518 (1993). The amount of restitution may exceed the amount by which the wrongdoer was unjustly enriched and is appropriate when an identifiable person has suffered a quantifiable loss as a result of a respondent's misconduct. *Dambro at 518-519*; *see also FINRA Sanction Guidelines*, at 4 (General Principles No. 5). The loss need only be *a* result rather than *the* result of a respondent's misconduct. *Michael Frederick Siegel*, Exchange Act Rel. No. 58737, 2008 SEC LEXIS 2459, at *51 n.55 (Oct. 6, 2008), *pet. for review filed*, Case No. 08-1379 (D.C. Cir. Dec. 2, 2008). Market Regulation seeks restitution orders of $23,000 to JW and $7,930 to J & CH.

We find that Market Regulation's loss estimation as to customer JW is not fully supported by the record. JW's account statements show purchases of 7,500 shares of SRM/HYTT for $17,825 and 25,000 shares of TCPD for $7,400. We have dismissed the Hearing Panel's findings as to JW's TCPD purchase. As to JW's SRM/HYTT purchases, the record shows that, as of October 2006, HYTT (now Innova Holdings) was worth two cents per share. The record is silent, however, as to whether JW still owns the stock and whether there is a current market for the securities (the date of last valuation in the record is October 2006). It is important that, in making a claim for restitution, Market Regulation present credible evidence of both the fact and the amount of the loss. There was insufficient evidence of loss in this case. We therefore deny Market Regulation's request for an order of restitution as to customer JW.

We find that Market Regulation's loss estimation as to J & CH is supported by the record. J & CH's account statements show that they purchased 3,500 shares of SRM/HYTT for $8,370 in February 2003. They sold 700 shares for $404.13 in March 2003. CH testified that sometime in early 2004, she instructed the firm to sell the remaining SRM/HYTT stock and close their account. After the account closed, she received approximately $36 for the remainder of the stock. Based on this evidence, we find that J & CH lost approximately $7,929 on their

SRM/HYTT investment. We therefore grant Market Regulation's request for an order of restitution as to customers J & CH in the amount of $7,929.

VI. Conclusion

We affirm the Hearing Panel's findings that Impellizeri violated NASD Rules 2110 and 2120, Section 10(b) of the Exchange Act, and Exchange Act Rule 10b-5 by failing to advise customers JW and J & CH of Benchmark's beneficial interest in promoting sales of SRM/HYTT stock. We reverse and dismiss all other Hearing Panel findings of violation as to Impellizeri and all Hearing Panel findings of violation as to Jaloza and Gimeli. We also dismiss all allegations in the complaint not specifically addressed in the Hearing Panel's decision.

We find that Impellizeri's violations were reckless and significant, and we suspend Impellizeri from associating with any member firm in any capacity for six months, fine him $25,000, and order that he pay restitution of $7,929 to customers J & CH.[27] We affirm the Hearing Panel's assessment of costs, but reduce the amount for which Impellizeri is responsible to $2,923. The suspension imposed in this decision will become effective on a date set by FINRA.[28]

On Behalf of the National Adjudicatory Council,

Marcia E. Asquith, Senior Vice President
and Corporate Secretary

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[27] In the event that Impellizeri cannot locate customers J & CH, unpaid restitution should be paid to the appropriate escheat, unclaimed property, or abandoned property fund for the state of the customers' last known address.

We also have considered and reject without discussion all other arguments advanced by the parties.

[28] Pursuant to FINRA Rule 8320, the registration of any person associated with a member who fails to pay any fine, costs, or other monetary sanction, after seven days' notice in writing, will summarily be revoked for non-payment.