

PLEASE NOTE THE LATER CASE HISTORY OF THIS DECISION FOLLOWING THE TEXT OF THE DECISION.

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD REGULATION, INC.

REDACTED DECISION

In the Matter of
the Association of

X

as a

General Securities Representative

with

The Sponsoring Firm

Notice Pursuant to

Section 19(d)

Securities Exchange Act
of 1934

Decision No. SD01005

On September 13, 2000, the Sponsoring Firm¹ (or "the Firm") completed its Membership Continuance Application ("MC-400" or "the Application") to permit X, a person subject to a statutory disqualification, to associate with the Firm as a general securities representative. In December 2000, a subcommittee ("Hearing Panel") of the Statutory Disqualification Committee of NASD Regulation, Inc. ("NASD Regulation") held a hearing on the matter. X appeared and was accompanied by the Proposed Supervisor, a general securities principalRB, President of BFI; AP, a registered representative from BFI; his psychiatrist; and his counsel. BA appeared on behalf of NASD Regulation's Department of Member Regulation ("Member Regulation").

X's Statutorily Disqualifying Event and Background. X is subject to a statutory disqualification, under Section 3(a)(39)(F) of the Securities Exchange Act of 1934 ("Act") and Article III, Section 4(g) of the NASD By-Laws, as a result of his 1998 guilty plea to two felonies in a United States District Court for State 1. The first felony count of the indictment alleged that, between February and March 1996, X used a facility or means of interstate commerce (the Internet) knowingly to persuade, induce, entice, and coerce (and knowingly to attempt to persuade, induce, entice, and coerce) a person under the age of 18 years to engage in a sexual act, in violation of Title 18, United States Code, Section 2422(b). The second felony count of the indictment alleged that, in March 1996, X knowingly traveled in interstate commerce, for the purpose of engaging in a sexual act with a person under the age of 18, in

¹ The names of the Statutorily Disqualified individual, the Sponsoring Firm, the Proposed Supervisor, and other information deemed reasonably necessary to maintain confidentiality have been redacted.

violation of Title 18, United States Code, Section 2423(b).² X was sentenced to 18 months' incarceration and three years of supervised release (probation). As conditions of probation, X was ordered to undergo mental health and substance abuse treatment programs, as well as to pay \$25,000 in restitution to a trust fund for the victim and to have no contact with the victim. X served more than 15 months in prison, and he completed the mental health and substance abuse requirements. His three-year probationary term is scheduled to end in 2002.

X has been in the securities business since 1983. He was registered with the following broker-dealers in the following capacities over the last 12 years.

<u>Broker-Dealer</u>	<u>Registration Period</u>	<u>Registration Capacity/Capacities</u>
[Firm A]	02/18/88 - 08/22/90	general securities representative ("GSR"), direct participation program representative ("DPR"), and direct participation program principal ("DPP")
[Firm B]	09/04/90 - 11/24/92	GSR and DPP
[Firm C]	04/16/93 - 12/31/94	GSR and DPR
[Firm D]	01/23/95 - 09/15/98	GSR

According to CRD, X was terminated by [Firm D] because he became subject to the instant statutory disqualification. Since the date of his guilty plea, X has been employed as an inmate college tutor at a correctional institute (since July 1998) and as a manager at Company A (since October 1999).

X also has some regulatory history. In 1991, the NASD's District Business Conduct Committee ("DBCC") filed a complaint against Firm 1, HH and X, alleging violations of the NASD's Rules of Fair Practice in connection with private offerings. The respondents submitted an offer of settlement, which the NASD accepted in 1992. Without admitting or denying, the respondents consented to the entry of the following findings: Firm 1, acting through X and HH, failed to terminate a

² In sum, X was alleged to have engaged in sexual discussions, via an "Internet chatroom" with a 14-year old girl. X, who was 41 years old at the time, allegedly represented himself as a younger person, closer to her age, in these discussions. X and the girl arranged, via Internet, to meet for sexual relations in a hotel room in another state, where she would be traveling with her mother. Upon meeting X at the hotel, the girl realized the deception about his age, left the room and alerted her mother, who reported the incident to the police. This led to the charges, the guilty plea, and the sentence described above.

private offering on the expiration date when the required minimum units had not been sold; prepared and disseminated to prospective investors sales literature which contained false and misleading statements; and solicited investors through the use of sales literature and sold units to investors who had neither an existing nor a prior business relationship with Firm 1. X was censured and fined in the amount of \$45,000, which he paid fully as of February 1995.

The Sponsoring Firm. According to the MC-400 and related documents, the Sponsoring Firm is headquartered in State 2 and it currently has one Office of Supervisory Jurisdiction ("OSJ") and no branch offices. It employs three registered principals and seven registered representatives. The Sponsoring Firm became a member of the Association in 1985, and it clears its trades through Firm 2. The Sponsoring Firm is a general securities firm, and its principal products are the retail sales of direct participation programs (i.e. oil and gas limited partnerships).

The record shows two disciplinary events against the Sponsoring Firm over the last 10 years, and both of them stemmed from the Firm's 1997 routine examination. In 1998, NASD Regulation's District Office filed a complaint against the Sponsoring Firm and its President alleging violations of NASD Rules 1120(b) and 2110. The District claimed that the Sponsoring Firm, acting through RB, had failed to comply with certain aspects of the firm element of the NASD's continuing education program. The Sponsoring Firm and RB submitted an offer of settlement in 1999, which the NAC determined to accept in 1999. Without admitting or denying, the respondents consented to the entry of the following findings: the Sponsoring Firm, acting through RB, failed to comply with NASD Rules 1120(b) and 2110 in that, during 1996 and 1997, it did not: a) annually evaluate and prioritize its training needs, b) develop a written training plan, and c) maintain records documenting the content of its programs and the completion of the programs by covered registered persons. The Sponsoring Firm and RB were censured and fined \$1,000, jointly and severally.

In 1998, NASD Regulation issued the Sponsoring Firm a Letter of Caution ("LOC") for violations of Conduct Rule 3010 (involving the Sponsoring Firm's supervision of transactions), SEC Rule 17a-3 (involving the Firm's checks received and forwarded blotter and its purchase and sales blotter), Regulation D, Paragraph 503 (involving the Sponsoring Firm's filing of Form D), and Conduct Rule 3110 (involving the Firm's treatment of customer account information). In response to the LOC, the Sponsoring Firm sent a letter to NASD Regulation outlining the corrective measures that it took to ensure that there would be no repeat violations of these rules.

Applicant's next routine examination is scheduled for 2002. The Firm does not employ any statutorily disqualified individuals, and it is not a member of any other self-regulatory organization.

X's Proposed Duties and the Proposed Supervisor. The Sponsoring Firm proposes to employ X in the capacity of a general securities representative, mainly selling direct participation programs and a select number of mutual funds. The Firm represents that he would be limited to sales of products approved by the compliance officer of the Firm. X would work out of an OSJ that the Sponsoring Firm has proposed to establish for him to be located in State 3. He would be compensated with commissions earned for selling approved products.

As represented in the MC-400 Application and related documentation, the Sponsoring Firm proposes that the Proposed Supervisor, a general securities principal, would be responsible for supervising X. The Proposed Supervisor has been registered with the Sponsoring Firm as a general securities representative and general securities principal since November 2000. The Proposed Supervisor has also been registered at Firm 2 as a general securities representative, direct participation program representative, and direct participation program principal since of 1997, and as a general securities principal since June of 1998, and he was President of Firm 2 from 1997 through 2000.³ Prior to his employment with Firm 2, the Proposed Supervisor was registered as a general securities representative with the Sponsoring Firm from 1994 through 1997. There have been no disciplinary or regulatory proceedings, complaints, or arbitrations against the Proposed Supervisor.

The Sponsoring Firm has also provided a back-up supervisory structure involving AP and RB, which would be incorporated when the Proposed Supervisor is not present in the State 3 OSJ to supervise X. This back-up proposal is set forth in greater detail in the Discussion section below.

Member Regulation's Recommendation. Member Regulation recommends denial of the Sponsoring Firm's Application to employ X as a registered representative. In making this recommendation, Member Regulation states that it is chiefly concerned with the egregiousness of X's misconduct, which involved "both stealth and taking advantage of a victim in a vulnerable class -- a minor." Member Regulation also mentions that X's conviction was recent and that he remains on probation with the criminal authorities until 2002. Member Regulation concluded that X's misconduct casts substantial doubt on his ability to act in a trustworthy manner with the investing public and that his felony conviction, examined in light of the circumstances relating to the conviction, creates an unreasonable risk of harm to the market and investors.

Discussion. After careful review of the entire record in this matter, we have determined to deny the Sponsoring Firm's Application to employ X as a general securities representative. We find that it would not be in the public interest to permit X to engage in the securities business at this time and that his employment in the industry may create an unreasonable risk of harm to the market and/or investors.

At the outset, we note that X was recently convicted of a very serious crime -- knowingly enticing a person under 18 to engage in a sexual act and traveling in interstate commerce for the purpose of engaging in a sexual act with that minor person. Although not securities-related, X's misconduct was of a fraudulent and deceptive nature and it was knowingly directed against a vulnerable child. X's activities cast doubt on his character and lead us to question his ability to act in a trustworthy and responsible manner in interactions with the investing public.

With regard to the question of X's judgment and trustworthiness, we further note that his record in this industry is not blemish-free and that he has previously engaged in misleading conduct involving

³ The Proposed Supervisor remains registered with Firm 2 as a representative for wholesale activities, but he no longer has any supervisory role with Firm 2.

solicitations for the sale of securities. In 1992, he paid a \$45,000 fine in settlement of a very serious matter, which involved his dissemination of false and misleading sales literature to prospective investors. X admitted that he reviewed the documents and saw phrases such as "guaranteed minimum return of 16.5% per year," but he nonetheless distributed them to the public.

We also conclude that the recency of X's conviction and the pendency of the probationary period through October 2002 militate against allowing X's re-entry into the securities industry at this time.⁴

Additionally, we are concerned with the plan proposed by the Firm to supervise X's return to the industry. The Sponsoring Firm's main office is in State 2, which is where RB is located. The Sponsoring Firm is proposing to open a new OSJ, located in State 3. X would be assigned to this location, as would AP. The Proposed Supervisor, however, would not be permanently located in State 3, because his business responsibilities require him to travel extensively and his residence is in State 4. The Proposed Supervisor maintains that he would typically be in the State 3 office once or twice a month, for one week at a time. The Proposed Supervisor and RB explained that, for tax reasons, the Firm's primary business, the sale of oil and gas partnerships, usually occurs during the final two months of each year. For this reason, the Sponsoring Firm proposed that the Proposed Supervisor could be physically located in State 3 during November and December of each year, when almost 100% of X's sales would be made. For the remainder of the year, the Sponsoring Firm proposed that when the Proposed Supervisor was not available on-site, AP could review correspondence and that RB and AP could review customer orders prior to execution. X stated that during those 10 months of each year, he would be trying to market mutual funds to the large clientele of physicians that he has developed over the years.

We are not satisfied with any of the supervisory proposals made by the Sponsoring Firm. X is a statutorily disqualified person, and although his felony conviction was not securities-related, he has shown a tendency toward deceptive conduct. The Proposed Supervisor will not be physically present in close proximity to X during all working days under any proposal advanced by the Firm. RB is on the other side of the country, and AP is only a registered representative with no experience as a principal, and is still in the process of qualifying as a Series 8 general securities sales supervisor. For these reasons, we conclude that under the proffered supervisory plan, the Sponsoring Firm is unable to provide the required heightened level of supervision necessary to assure us that it will effectively prevent and detect possible misconduct on the part of this statutorily disqualified person.

⁴ X's psychiatrist testified that X had completed the required psychiatric and substance abuse programs and that he had substantially rehabilitated himself. Although the psychiatrist stated that X presents a minimal risk of similar future offenses, he (the psychiatrist) was unable to represent that X poses no potential future risk to the investing public. In our view, X has not demonstrated that he has rehabilitated himself during the short period that has elapsed since his felony conviction, and with regard to remediation and rehabilitation supervised by the social agency closest to the problem, we defer to the remedial probationary program imposed by the court, which does not end until 2002.

The nature, seriousness and recency of X's conviction and the inadequate supervisory structure proposed by the Firm lead us to conclude that, in light of the circumstances, X's re-entry into the securities industry at this time would create an unreasonable risk of harm to the market and investors. Accordingly, we deny the Sponsoring Firm's Application to employ X.

On Behalf of the National Adjudicatory Council,

Joan C. Conley
Senior Vice President and Corporate Secretary

LATER CASE HISTORY:

X subsequently appealed this decision to the SEC. The SEC affirmed NASD's decision in this matter.