

BEFORE THE NATIONAL BUSINESS CONDUCT COMMITTEE

NASD REGULATION, INC.

In the Matter of

District Business Conduct Committee
For District No. 10

Complainant,

vs.

Ilana Abby Knapp
Basking Ridge, New Jersey,

Respondent.

DECISION

Complaint No. C10960116

District No. 10

Dated: November 20, 1997

Ilana Abby Knapp ("Knapp") has appealed the April 1, 1997 decision of the District Business Conduct Committee for District No. 10 ("DBCC") pursuant to Procedural Rule 9310. After a review of the entire record in this matter, we find that, as alleged in cause two of the complaint, Knapp failed to respond to an NASD request for information, in violation of Procedural Rule 8210 and Conduct Rule 2110 (formerly Article IV, Section 5 and Article III, Section 1, respectively, of the NASD Rules of Fair Practice). We reverse the DBCC's findings as to cause one, and remand cause one to the DBCC for hearing. In light of our order of remand, we impose sanctions only as to cause two as follows: we affirm Knapp's censure and bar from associating with any NASD member firm in any capacity; we reduce Knapp's fine to \$20,000, and we eliminate the order of restitution.

Background. Knapp entered the securities industry in 1975 and was employed by E.A. Moos & Co., L.P. ("EA Moos" or "the Firm") from May 1978 through November 1994. During the relevant time, Knapp was a general securities principal and financial and operations principal ("FINOP") with Moos, as well as a limited partner of the Firm. Knapp is not presently associated with a member firm.

Facts. Based on the statements of Edward A. Moos ("Moos"), Managing Partner of EA Moos, and the Firm's accountants, the DBCC determined that Knapp issued checks from the Firm's account in an amount in excess of \$35,000 without the Firm's knowledge or approval, which were used by Knapp to pay for personal goods and services and not for EA Moos' benefit.

In an affidavit, Moos stated that an internal audit of the Firm for October 31, 1992 through November 1, 1994, revealed that Knapp had issued company checks in excess of \$350,000 without Moos' knowledge or permission and that were not for the benefit of the Firm. Moos stated that the recipients of the funds were persons or entities known to Knapp, and that the payments were for her benefit and/or the benefit of persons chosen by her. Moos further stated that after discovering Knapp's "embezzlement," he and his accountants came upon many invoices and canceled checks that showed that Knapp had used EA Moos' funds to pay for goods and services that were provided to persons and/or firms of which he had no knowledge, and which had no connection to the Firm. He alleged that the Firm had not authorized any of these checks. Moos stated that Knapp admitted that she had converted between \$50,000 and \$70,000 of EA Moos' funds. Moos submitted with the affidavit canceled checks and invoices totaling approximately \$28,000 as examples of Knapp's conduct.

In a memorandum to Moos dated July 13, 1995, the Firm's accountants stated that Knapp had attended a meeting with Moos and the accountants on November 30, 1994, in which Moos and the accountants confronted Knapp with evidence of her having engaged in numerous transactions totaling between \$50,000 and \$70,000 that appeared to be for her personal benefit, and which Moos stated had been unauthorized. The memorandum stated that the accountants advised Knapp that possible criminal charges could be brought against her, and that Knapp admitted "her guilt and culpability" and promised to pay the money back to the Firm. The memorandum stated that Moos and Knapp met alone and agreed upon the terms of her dismissal from the Firm.

Knapp left Moos effective November 30, 1994. The Uniform Termination Notice ("Form U-5") filed by the Firm on December 23, 1994, indicated that Knapp had been "permitted to resign" because Knapp had embezzled approximately \$250,000 of funds, goods, and services from EA Moos.¹

In an agreement entered into by Knapp and EA Moos on December 1, 1994 ("the Agreement"),² Knapp and EA Moos severed their business relationship. Knapp gave up all ownership and financial interest in EA Moos and agreed to a severance package. The parties granted mutual releases to each other "from any and all actions, causes of action, suits, debts, dues, sums of money . . . and demands whatsoever in law" The Agreement states that: "Any legal action

¹ The Form U-5 was not part of the record before the DBCC. We have, however, taken administrative notice of this document.

² On appeal to the NBCC, Knapp submitted the Agreement for entrance into the record. We have determined to accept the Agreement into the record on appeal notwithstanding the parties' failure to address the requirements under the Code of Procedure for adducing new evidence. Knapp's counsel indicates that NASD District No. 10 staff had possession of this document but chose not to make it part of the record before the DBCC. Because Knapp neither responded to NASD requests for information nor participated in the DBCC proceeding, she waived her right to submit documentary or testimonial evidence to the DBCC. Nevertheless, we find that the information contained in this Agreement is material to our consideration of this matter, and we therefore make the Agreement part of the record.

Knapp may hereinafter take in violation of this Agreement will result in the forfeiture by Knapp of the severance payments [agreed to by EA Moos]." The Agreement did not specify repayment of any sums alleged to have been embezzled by Knapp.

NASD District No. 10 staff subsequently began an investigation into Knapp's termination, and on March 3, 1995, a staff examiner ("Examiner") sent Knapp a request for information pursuant to Procedural Rule 8210. The Examiner asked Knapp to address Moos' allegations, provide details of all conversations with the Firm concerning the embezzlement, and provide copies of all correspondence and/or memoranda of conversations with EA Moos. The letter was addressed to Knapp at her Central Registration Depository ("CRD") address, _____, Basking Ridge, New Jersey (the "Basking Ridge address"). The record did not contain evidence of receipt. The Examiner did not receive a reply. The Examiner sent a second request to Knapp on April 6, 1995, at the same address. This request was copied to Knapp's counsel. The receipt was returned to District No. 10 signed by "Crystal A. Nixon." The Examiner did not receive a reply to the request for information.

On appeal, Knapp submitted a letter marked "Copy" dated March 7, 1995, from Knapp's counsel to the Examiner.³ In this letter, counsel contended that the NASD did not have jurisdiction over Knapp based on Knapp's "voluntary surrender" of her license. The letter did not, however, respond to the questions asked in the March 3 request for information.

The complaint was issued on September 10, 1996. The First Notice of Complaint was mailed to Knapp on September 10, 1996, via Certified Mail - Return Receipt Requested at the Basking Ridge address. The complaint was returned marked "Forwarding Order Expired." The Second Notice of Complaint was sent via Certified and First-Class Mail to Knapp at the Basking Ridge address. On October 18, 1996, District No. 10 staff served the Second Notice and the complaint on Knapp at _____, Springfield, New Jersey.⁴ The return receipt, dated October 21, 1996, was returned to District No. 10 signed by "C. Nixon."

In correspondence to Knapp dated October 23, 1996, the regional attorney stated that staff had received a telephone call from Knapp's counsel on October 22, 1996, and that staff was sending him a copy of the Notice and complaint via facsimile at his request. The regional attorney advised Knapp that her answer to the complaint must be received by November 11, 1996. Having failed to receive an answer, the DBCC issued a default decision on April 1, 1997.

On appeal, Knapp submitted a letter dated November 6, 1996, marked "Copy," in which Knapp's counsel stated: "Please find the Answer of the Respondent in the above matter. Please set the matter down for a hearing at the earliest possible date." Knapp also submitted a document entitled "Answer and Affirmative Defenses" signed by Knapp's counsel and an attached "Certificate of

³ This letter was not part of the record before the DBCC. We accept it into the record on appeal.

⁴ The DBCC's decision indicated that District No. 10 staff had received this address from "a reliable source."

Mailing" signed by Knapp's counsel, which indicated that the answer had been mailed to District No. 10 on November 6, 1996.⁵

Discussion. After careful consideration of the record, including the documents made part of the record on appeal, we find that Knapp failed to respond to an NASD request for information as alleged in cause two. As to cause one, we dismiss the DBCC's findings and remand cause one to the DBCC. On remand, the DBCC may take whatever action concerning the conduct addressed in cause one that it deems appropriate, i.e., after appropriate inquiry and consideration, the DBCC may issue an amended complaint against Knapp, pursue settlement, or dismiss.

At the outset, we have determined that the DBCC properly entered a default judgment in this matter. Knapp was properly served at her last known address as reflected in the NASD's records (Knapp's CRD address). Knapp was served a second time at another address that staff had obtained on October 18, 1996. As evidence of Knapp's actual receipt of the complaint, Knapp's counsel contacted District No. 10 staff on October 22, 1996, and asked to be served with the Notice and complaint via facsimile. District No. 10 staff served Knapp's counsel, but did not receive an answer. District No. 10 staff received no further communication from either Knapp or her attorney between October 22, 1996 and April 1, 1997, at which time the default decision was issued.

In determining the validity of the default decision, we have considered a copy of an answer that counsel purportedly filed with District No. 10 on November 6, 1996, which Knapp's counsel has submitted on appeal. Regional counsel has stated that District No. 10 did not receive this communication, and Knapp's counsel has not provided any proof of service. Regional counsel contends on appeal that District 10 not only did not receive the answer, but did not receive counsel's letters to staff dated March 7, 1995 and October 22, 1995, which Knapp's counsel has submitted on appeal. Knapp's counsel has not, however, provided any explanation in response. Since it is not possible to determine: (1) whether counsel actually mailed the two letters and the answer; and (2) if they were mailed, whether they were actually received by District No. 10, we find that the DBCC acted in good faith when it issued the default judgment in this matter. Knapp, through counsel, has not provided any evidence that District No. 10 actually received her November 6, 1995 answer.

Nonetheless, we have considered Knapp's affirmative defenses as stated in her purported "Answer" to be material to this proceeding, since they indicate that Moos gave Knapp explicit or implicit approval to write certain checks and to pay certain invoices. The parties do not dispute that Knapp wrote checks and paid invoices out of the Firm's account. At issue is whether Knapp paid these funds with or without Moos' authorization. Thus, despite the validity of the default decision issued by the DBCC, we have concluded that the written evidence in the record is inconclusive as to the central issue of cause one, and the record contains no testimony to clarify inconsistencies. Cf. In re Troy A. Wetter, 51 S.E.C. 763 (1993) (record sufficient to make findings notwithstanding lack of

⁵ These documents were not made part of the record before the DBCC. Although Knapp has not specifically requested that these documents be made part of the record, or stated why these documents are material, we are treating Knapp's submission as a request to adduce evidence, and we accept them into the record on appeal.

testimony to clarify inconsistencies or upon which to base credibility findings); In re James M. Russen, Jr., 51 S.E.C. 675 (1993) (NASD findings affirmed on basis that record showed that the written evidence in the record provided sufficient basis upon which to base findings). Since the material issue of whether Moos sanctioned Knapp's payments appears to require the receipt of additional evidence including hearing testimony, we have concluded that cause one should be remanded to the DBCC for the purpose of taking such testimony and assessing the parties' credibility.

We also order that the complaint be amended to reflect the total amount of the alleged embezzlement. As to cause one, should the DBCC find that Knapp embezzled funds from EA Moos, it is inappropriate for NASD Regulation to require Knapp to repay such funds to the Firm. Knapp and the Firm have entered into the Agreement that settles between them all aspects of this matter, including any debts or sums of money that the parties may owe to each other.

We affirm the DBCC's findings as to cause two. Knapp does not contest receipt of the NASD's requests for information, and the record fully supports the conclusion that she and her attorney were served with the requests. It is also undisputed that Knapp failed to respond to these requests. Although counsel's letter of March 7, 1995 was purportedly sent to District No. 10 staff in response to the March 3, 1995 request, it did not respond to NASD staff's inquiries. Staff's follow-up request for information, dated April 6, 1995, served also on Knapp's counsel, gave a new deadline of April 17, 1996. Knapp failed to respond. Likewise, counsel's letter of October 22, 1996, purportedly sent to District No. 10 staff following the issuance of the complaint, did not respond to NASD staff's inquiries. The record is uncontroverted that Knapp failed to respond to staff's requests for information.

Sanctions. Based on our findings as to cause two, we impose a censure, bar in all capacities, and \$20,000 fine. We have considered and do not credit Knapp's arguments that she was in any way excused from providing prompt and complete responses to the NASD's requests for information. We do not credit Knapp's contention that the terms of the Agreement precluded her responding to the NASD's requests for information. First, the terms of the Agreement do not expressly address the issue of providing requested information to the NASD. Second, even if the Agreement expressly addressed this issue, Knapp would not be excused from this obligation. The Securities and Exchange Commission ("SEC") often has observed that members cannot be permitted to impose conditions under which they will provide information to the NASD. In re Charles R. Stedman, 51 S.E.C. 1228 (1994). Even the threat of possible litigation does not excuse an associated person from full cooperation. In re Darrell Jay Williams, 50 S.E.C. 1070 (1992).

Contrary to Knapp's contention, the fact that NASD staff requested information from Knapp when she was no longer associated with a member firm also does not excuse her failure to respond. As the SEC stated in In re Reed A. Hatkoff, 51 S.E.C. 769, 773 (1993), such a device would allow an associated person to "immunize himself from being probed regarding his wrongdoing by the simple device of leaving the industry."

Based on the foregoing, we impose a censure, bar in all capacities, and \$20,000 fine. The bar shall be effective as of the date of this decision.⁶

On Behalf of the National Business Conduct Committee,

Joan C. Conley, Corporate Secretary

⁶ We have considered all of the arguments of the parties. They are rejected or sustained to the extent that they are inconsistent or in accord with the views expressed herein.

Pursuant to NASD Procedural Rule 8320, any member who fails to pay any fine, costs, or other monetary sanction imposed in this decision, after seven days' notice in writing, will be summarily suspended or expelled from membership for non-payment. Similarly, 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 be summarily revoked for non-payment.