

**NASD
OFFICE OF HEARING OFFICERS**

DEPARTMENT OF ENFORCEMENT,

COMPLAINANT,

v.

**GERALD J. KESNER,
(CRD No. 2337113),**

RESPONDENT.

**DISCIPLINARY PROCEEDING
NO. 2005001729501**

COMPLAINT

The Department of Enforcement alleges:

SUMMARY

1. Gerald Kesner, a registered representative with Raymond James Financial Services, Inc., presented an investment opportunity to several of his clients involving the purchase of the outstanding shares of a telemarketing company, CT, through the use of a commercial loan in a leveraged buy-out. Kesner structured the transaction so that the investors did not contribute any cash. Rather, they pledged collateral to secure a bank loan, the proceeds of which represented fifty percent of the purchase price. In return they received CT shares. One set of investors, the Ls, unknowingly pledged far more collateral to secure the loan than the other investors, yet they did not receive a proportionately larger number of CT shares. Moreover, the collateral, which comprised their home equity and their securities portfolio, represented over 60 percent of the L's assets. This transaction, which was structured and recommended by Kesner, was unsuitable as it put at risk the majority of the L's assets, including their home, without proportionate benefit. It was

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also unsuitable because the Ls were, unknowingly, treated disparately from other investors, to their detriment. Such conduct violated NASD Conduct Rules 2310 and 2110.

2. Kesner also failed to provide investors with the following material information relating to the CT acquisition: 1) CT's sellers paid an individual \$100,000 to relinquish his right to 25 percent of the proceeds upon the sale of CT just months before they sold the company for \$5,000,000 to Kesner; 2) Kesner borrowed \$500,000 from the CT sellers in or about January 2002 and placed the funds in his personal bank account to satisfy a condition of closing imposed by the lending Bank without disclosing the source of the funds to the Bank; 3) the nature and amount of the collateral pledged by each investor; and 4) information as to the financial strength and net worth of the other investors. Such conduct violated Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5 thereunder and NASD Conduct Rules 2120 and 2110.

RESPONDENT

3. The Department realleges and incorporates by reference paragraphs 1-2 above.
4. Gerald J. Kesner entered the securities industry in April 1993 as a General Securities Representative of two NASD member firms. Kesner later became registered as a General Securities Representative with member firm Raymond James Financial Services, Inc. in June 1998. While registered with Raymond James, Kesner was also employed by a Registered Investment Advisory Company, Capital Financial Group, Inc. (CFG). During all periods mentioned herein, Kesner was associated with Raymond James and was registered with NASD under Article V of the By-Laws as a General Securities Representative. Kesner continues to be associated with Raymond James.

BACKGROUND

5. The Department realleges and incorporates by reference paragraphs 1-4 above.
6. On or about July 18, 2001, Kesner sought approval from Raymond James to participate with other investors in a transaction involving the purchase of a telecommunications service company, CT,. CT was owned by the Hs, who were CFG advisory clients.
7. As a result of a previous purchase of CT by the Hs, the former Chief Financial Officer of CT, PC, was entitled to 25 percent of the proceeds should CT be sold. In anticipation of the sale of their company, the Hs paid \$100,000 to PC in or about July 2001. In return for the \$100,000, PC relinquished his right to the sale proceeds.
8. From approximately July, 2001 through March, 2002, Kesner negotiated the terms and conditions of the acquisition of CT from the Hs. Kesner formed an investor group to purchase all of the shares of CT. The investor group included Kesner, his wife and four other couples, the Ls, the Fs, the Gs and the Ns.
9. The CT acquisition was leveraged and was financed largely through a \$2,500,000 loan from CBank to the investor group. Kesner provided information about the investors' assets and finances to CBank in connection with the loan application. Each of the investors offered the equity in their homes as collateral and the Ls also pledged a large portion of their securities account portfolio to secure the loan. CBank required that each investor be jointly and severally liable for the debt. CT also pledged its assets to secure the CBank loan.
10. Kesner structured the terms of the acquisition and certain aspects of the CBank loan. He determined the collateral that would be pledged by each investor to secure the bank loan

and the investors' resulting interest in CT, as reflected (approximately) in the table below.

Investors	Percent CT Ownership	Value of CT stock	Approximately Collateral Pledged to Secure Joint and Several \$2,500,000 Bank Loan		Investors' Approximate Net Worth (at or about time of acquisition)	
			Real Estate	Stock	w/ home	w/o home
Kesners	57%	\$2,850,000	\$70,000	-0-	\$ 134,000	\$ 74,000
Fs	20%	\$1,000,000	\$655,000	-0-	\$ 851,000	\$ 196,000
Ls	9%	\$ 450,000	\$500,000	\$837,239	\$2,148,000	\$1,648,000
Gs	9%	\$ 450,000	\$600,000	-0-		\$1,696,515
Ns	5%	\$ 250,000	\$276,000	-0-	\$250,000 - \$500,000	\$34,000-
totals	100 %	\$5,000,000				\$284,000

11. Kesner did not disclose to the investors the value of the collateral pledged by the other investors. Moreover, Kesner did not provide them with information as to the financial situation of other investors, representing only that they had the financial wherewithal to cover their loan commitment.

12. At the closing of the acquisition in April 2002, the investor group purchased all of the outstanding stock of CT from the Hs for \$5,000,000. The purchase price consisted of the \$2,500,000 in cash obtained from CBank; approximately \$1,625,000 in subordinated promissory notes from CT; approximately \$375,000 in cash, paid out of CT's profit at the time of closing; and, unbeknownst to CBank, an employment contract pursuant to which the Hs were guaranteed compensation of approximately \$500,000.

FIRST CAUSE OF ACTION

(NASD Conduct Rules 2110 and 2310; Unsuitable Recommendation to the Ls)

13. The Department realleges and incorporates by reference paragraphs 1-12 above.
14. Kesner provided advisory services to the Ls through CFG and was one of two registered representatives responsible for their securities accounts at Raymond James.
15. At the time of the CT transaction, Mr. L. was 43 years old and employed full-time. His wife CL was 42 years old and not employed outside the home. The Ls, who had two children, planned to retire at the age of 55. Mr. L was earning a salary of approximately \$300,000 per year. The Ls' primary investment objective was growth with a medium to high risk tolerance. Their net worth was approximately \$2,148,000. Of this amount, approximately \$1,358,000 was invested at Raymond James. \$500,000 of their net worth comprised net equity in their home and \$20,000 was held as cash. The remaining assets, totaling approximately \$267,000, comprised a boat, car, notes receivable and the cash value of a life insurance policy. In the spring 2001, the Ls cash flow was sufficient to meet expenses but not significantly greater and their savings reserve was low.
16. Kesner recommended that the Ls join the investor group Kesner assembled and acquire CT stock by pledging the equity in their home and certain securities held at Raymond James as collateral for the loan the group would obtain to finance the acquisition. Kesner advised the Ls that this would enable them to make use of "stagnant capital" tied up in home equity. Kesner told the Ls the investment bore minimal risk and that the investors would profit in a relatively short period of time. As a result of the foregoing, the Ls decided to proceed with an investment in CT.
17. At Kesner's recommendation, the Ls pledged approximately \$1,337,239 in collateral. In return, they received 9 percent of CT shares, worth \$450,000. The CT interest the Ls received was not proportionate to their pledge of collateral. The L's collateral

represented approximately 53 percent of the loan amount and approximately 26 percent of the total purchase price, yet they received only 9 percent of CT's outstanding and issued shares. Thus, they bore a disproportionately large share of the risk, but received a disproportionately small allocation of benefit. In addition, because the two investors receiving the largest percentage of ownership, the Kesners and the Fs, were under-collateralized, the L's significant collateral was unduly exposed.

18. The Ls could not independently evaluate the equity or merits of the transaction because Kesner did not tell them what collateral other investors had pledged. Nor did he provide them with information as to the other investors' financial status. Thus the Ls did not know that the value of the collateral they pledged represented approximately 53 percent of the obligation to CBank or that their assets substantially exceeded the assets of the other participants.
19. Kesner recommended that the Ls acquire CT stock as described in paragraph 16 above without having reasonable grounds for believing that the recommendation was suitable for the Ls based on their financial situation and needs. The recommended transaction was not suitable for the Ls because:
 - (i) the Ls pledged collateral that exceeded 60 percent of their assets, including their home equity and a large portion of their investment portfolio. This exposed the L's assets, including their home, to a risk of loss that was inconsistent with their financial circumstances and needs; and
 - (ii) the transaction was structured in a manner that (a) unduly exposed the Ls to risk that was materially disproportionate to the benefit they obtained and (b) assigned other investors a more favorable risk-benefit ratio to the Ls detriment.

20. Kesner was aware of the Ls financial circumstances and needs because he was their financial advisor. He understood the risk to which they were exposed and knew that their risk was disproportionate to that of the other investors because he determined the terms and conditions upon which the members of the investment group would acquire CT stock. Kesner knew or should have known that his recommendation to the Ls was not suitable for them.
21. Such acts, practices, and conduct constitute separate and distinct violations of NASD Conduct Rules 2110 and 2310 by Kesner.

SECOND CAUSE OF ACTION

(Violations of Section 10(b) of the Exchange Act, Rule 10b-5 thereunder and NASD Conduct Rule 2120 and 2110; Manipulative and Deceptive Devices)

22. The Department realleges and incorporates by reference paragraphs 1 through 21 above.
23. In connection with the acquisition of the outstanding shares of CT stock, Kesner omitted to disclose to the investors that:
- a. the Hs had purchased PC's 25 percent interest in CT's sale proceeds for \$100,000 in July, 2001, nine months before the Hs offered to sell CT to the investors for \$5,000,000, as described in paragraph 7 above, which prevented the investors from evaluating the fairness of the price paid by the investor group; and
 - b. he had borrowed \$500,000 from the Hs in January 2002, and placed the funds in his personal bank account in order to satisfy a condition of closing required by CBank, which prevented the investors from evaluating whether CBank had provided funds to the investor group in reliance upon misleading information about the group's financial resources.

24. In connection with the Ls acquisition of CT stock, Kesner omitted to disclose to the Ls:
- a. the nature and amount of the collateral pledged by each investor, which prevented the Ls from discovering the inequitable relationships between the security pledged and ownership interests, as more fully described in paragraphs 10 and 17 above; and
 - b. information as to the financial strength, net worth and income of the other investors which prevented the Ls from evaluating the extent to which the collateral they pledged was unduly exposed to risk of loss.
25. The information described in paragraphs 23 and 24 above was material because a reasonable investor would consider it important in determining whether to acquire CT stock under the terms and conditions offered to them. Kesner knew, recklessly disregarded or should have known that the information he failed to disclose was material. He knew, recklessly disregarded or should have known that the omission of this information caused information he did provide the investors (with respect to paragraph 23) and the Ls (with respect to paragraph 24) to be misleading.
26. Kesner employed the means and instrumentalities of interstate commerce to solicit the investors, including the Ls, to acquire CT stock as described above.
27. The omission of material information in connection with securities transactions, as described in paragraphs 23-26 above, constituted separate and distinct violations of Section 10(b) of Securities and Exchange Act of 1934, Rule 10b-5 promulgated thereunder and NASD Conduct Rules 2120 and 2110.

PRAYER

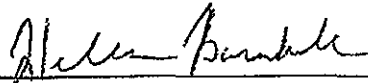
WHEREFORE, the Department respectfully requests that the Panel:

A. order that one or more of the sanctions provided under NASD Rule 8310(a) be imposed; and

B. order that the Respondent bear such costs of proceeding as are deemed fair and appropriate under the circumstances in accordance with NASD Rule 8330.

NASD DEPARTMENT OF ENFORCEMENT

Date: March 27, 2007


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