

FINANCIAL INDUSTRY REGULATORY AUTHORITY¹
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

JOHN H. ARNETTE
(CRD No. 7458),

Respondent.

Disciplinary Proceeding
No. 2005002734201

DEFAULT DECISION

Hearing Officer – SW

Date: January 4, 2008

Respondent: (1) failed to appear for two on-the-record interviews, in violation of NASD Procedural Rule 8210 and NASD Conduct Rule 2110; and (2) engaged in private securities transactions, in violation of NASD Conduct Rules 3040 and 2110. Respondent is barred for violating NASD Procedural Rule 8210 and NASD Conduct Rule 2110. In light of the bar, the Hearing Officer did not impose a separate sanction for the private securities violations.

Appearances

Laura Leigh Blackston, Esq., Regional Counsel, New Orleans, LA, for the
Department of Enforcement.

No appearance by or for John H. Arnette.

DECISION

I. Procedural Background

On August 9, 2007, the FINRA Department of Enforcement (“Enforcement”) filed the attached two-count Complaint against Respondent John H. Arnette (“Respondent”),

¹ As of July 30, 2007, NASD consolidated with the member firm regulation functions of NYSE and began operating under a new corporate name, the Financial Industry Regulatory Authority (FINRA). References in this decision to FINRA include, where appropriate, NASD.

alleging that Respondent: (i) participated in the sale of securities (i.e., the sale of purchase/lease agreements with attached management contracts) without providing prior written notice to his employer, Intersecurities, Inc. ("Intersecurities"), in violation of NASD Conduct Rules 3040 and 2110; and (ii) failed to appear for two on-the-record interviews requested pursuant to NASD Procedural Rule 8210, in violation of Rules 8210 and 2110.

On November 1, 2007, Enforcement filed a Motion for Entry of Default Decision ("Motion"), supported by the declaration of Laura Leigh Blackston, Esq., Regional Counsel in FINRA's New Orleans, LA office, and by six exhibits.² For the reasons set forth below, Enforcement's Motion is granted.

II. Respondent's Default

On August 9, 2007, Enforcement served the Complaint and Notice of Complaint on Respondent, via certified mail, at his address of record in FINRA's Central Registration Depository ("CRD address").³ (DECL at ¶ 24; DX-4, p. 12). Respondent did not file an answer to the Complaint. (DECL at ¶ 24).

Thereafter, on September 10, 2007, Enforcement sent a Second Notice of Complaint and Complaint, via certified mail, to Respondent at his CRD address. (DECL at ¶ 25; DX-6, p. 2). To date, Respondent has not filed an answer to the Complaint. (DECL at ¶ 26).

² Hereinafter, the statements in the Motion for Entry of Default Decision will be designated as "Motion, p.;" the statements in the Blackston Declaration will be designated as "DECL at ¶;" and Enforcement's exhibits will be designated as "DX-" with the appropriate page or paragraph number.

³ Respondent's CRD address is [REDACTED] (DX-1, p. 2).

The Hearing Officer finds that Enforcement complied with NASD Procedural Rule 9134(b)(1) by sending the mailings to Respondent's CRD address.⁴ Accordingly, the Hearing Officer finds that Respondent received effective constructive notice of this proceeding and further finds that Respondent defaulted by failing to answer the Complaint.⁵

III. Findings of Fact and Conclusions of Law

A. Jurisdiction

Respondent initially became registered as a general securities representative in September 1970. (DX-1, pp. 3-4). From December 23, 1992 to October 5, 2005, Respondent was registered with Intersecurities as a general securities representative. (DX-1, p. 6). In the Form U-5 that it filed on behalf of Respondent, Intersecurities disclosed that it had discharged Respondent for failing to disclose and obtain approval for his outside business activities. (*Id.*). From October 19, 2005 to February 14, 2007, Respondent was registered with FINRA member Cullum & Burks Securities, Inc. as a general securities representative. (DX-1, p. 5; DECL at ¶ 5). Respondent is not currently associated with any FINRA member firm. (DX-1, p. 5; DECL at ¶ 7).

Nevertheless, Respondent remains subject to FINRA jurisdiction for purposes of this proceeding, pursuant to Article V, Section 4 of the NASD By-Laws, because (1) the Complaint was filed within two years after Respondent's registration with Cullum & Burks was terminated, and (2) the Complaint charges him with misconduct while he was

⁴ See Dep't of Enforcement v. Verdiner, No. CAF020004, 2003 NASD Discip. LEXIS 42, at * 5 n.1 (NAC Dec. 9, 2003) (finding that respondent received constructive notice when the complaint was mailed to respondent's CRD address).

⁵ The following Findings of Fact and Conclusions of Law incorporate the allegations in the attached Complaint, pursuant to NASD Rules 9215(f) and 9269, and NASD Notice to Members 99-77.

associated with a FINRA member, and with failures to appear for two on-the-record interviews requested pursuant to Rule 8210 during the period of retained jurisdiction.

B. Respondent Participated in the Offer and Sale of Securities to Four Customers without Providing Prior Written Notice to Intersecurities

Count one of the Complaint alleges that during the period from March 18, 2003 through February 4, 2004, while associated with Intersecurities, Respondent solicited customers JV, BV, TC, and DC to invest a total of \$409,158 in Resort Holdings Universal Leases ("RH Leases"), which were purchase/lease agreements with attached management contracts, without requesting or obtaining prior written approval from his employer. (Complaint at ¶¶ 2-3). The RH Leases purported to pay 9% of the purchase price annually and had a term of 25 years. (Complaint at ¶ 3).

Enforcement submitted additional information with its Motion showing that the investors expected to receive their 9% rate of return through the efforts of the management company to manage and rent the condominium units at favorable rates. (Motion, p. 3). The investors were not assigned a specific condominium unit. (*Id.*). The customers believed that their investment was risk-free and carried a guaranteed interest rate. (DECL at ¶ 13A). The four customers are no longer receiving payments on the agreements, *i.e.*, the 9% return on their investments, and they have been unable to recoup their principal. (DECL at ¶¶ 9, 13B).

During his employment at Intersecurities and prior to his participation in the RH Leases, Respondent had sought and received approval for various outside business activities, including his DBA, Arnette Financial Services. (DECL at ¶ 10). However, Respondent did not seek prior approval for the sale of the RH Leases, nor did he disclose

his association with Resort Holdings to Intersecurities.⁶ (Id.). Respondent admitted to Intersecurities that he received \$20,454 from Resort Holdings for his activity. (Id.).

Intersecurities had issued compliance bulletins to its representatives, dated December 3, 2001 and November 20, 2000, warning against selling away and specifically mentioning time shares in condominiums/vacation properties as transactions that might be deemed to involve a security. (DECL at ¶ 12).

Enforcement also disclosed that, on April 19, 2007, the Texas State Securities Board entered a default judgment against Respondent regarding his sale of RH Leases to the four customers because the leases were deemed to be securities.⁷ (Motion, p. 3). Previously in 2006, the Maryland and Oklahoma securities commissions held that the RH Leases were securities.⁸ (Id.).

NASD Conduct Rule 3040 requires that an associated person who intends to participate in a private securities transaction, prior to the transaction, must “provide written notice to the member with which he is associated describing in detail the proposed transaction and the person’s proposed role therein and stating whether he has received or may receive selling compensation in connection with the transaction” In addition, Rule 3040 provides that, if the transaction is for compensation, the member firm must approve or disapprove of the proposed transaction in writing.

⁶ Following receipt of a customer complaint by JV and BV relating to the RH Leases, Respondent requested his firm’s approval of the activity. (DECL at ¶ 10). Intersecurities denied approval. (Id.).

⁷ In re John Hutchison Arnette, SOAH Docket No. 312-06-3016 (Texas State Office of Administrative Hearings, April 19, 2007).

⁸ In re Diane J. Burda, 2006 Md. Sec. No-Act. LEXIS 50 (Maryland Office of the Attorney General, Securities Division, Sept. 27, 2006); In re Brian Jason Ross, 2006 Okla. Sec. LEXIS 2 (Oklahoma Securities Commission, Jan. 24, 2006).

Rule 3040 applies only if the RH Leases are securities. The Hearing Officer finds that the RH Leases are investment contracts, which are included within the definition of "security" in Section 3 of the Securities Exchange Act of 1934. An investment contract involves (1) an investment of money, (2) in a common enterprise, (3) with an expectation of profits produced by the efforts of others.⁹

The RH Leases satisfied all three elements. First, the purchasers invested substantial sums of money. Second, there was a common enterprise because there was vertical and horizontal commonality. There was "vertical commonality" because the investors' fortunes were tied to the management company's success at renting out the condominiums at favorable rates. (Motion, p. 3). There was "horizontal commonality," meaning "a pooling of interests amongst the investors," because the investors were not assigned a specific condominium unit. (*Id.*). Finally, the investors expected to receive their 9% rate of return because of the efforts of the management company to do all the work of renting and managing the units with no effort required on the part of the investors. Accordingly, the Hearing Officer finds that, for purposes of this Default Decision, the evidence is sufficient to establish that the RH Leases were investment contracts, and thus securities.

Respondent's solicitation of customers JV, BV, TC, and DC to invest in the RH Leases and his receipt of compensation triggered the requirement that he notify Intersecurities of his participation in writing and that Intersecurities approve the transactions in writing. A failure to provide prior written notice of an intent to participate

⁹ See *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298-99 (1946).

in the solicitation of securities constitutes a violation of Conduct Rule 3040.¹⁰ A violation of Conduct Rule 3040 is also a violation of Conduct Rule 2110's requirement to "observe high standards of commercial honor and just and equitable principles of trade."¹¹

Based on the allegations deemed admitted, the Hearing Officer finds that Respondent participated in the sale of securities to customers JV, BV, TC, and DC, without providing prior written notice of the transactions to Intersecurities and thereby violated NASD Conduct Rules 3040 and 2110.

C. Respondent Failed to Appear for Two On-the-Record Interviews

On December 7, 2005, FINRA began an investigation of Respondent following the receipt of a Form U-5 disclosing Respondent's termination by Intersecurities for failing to disclose and obtain firm approval of outside business activities. (DECL at ¶ 8).

Count two of the Complaint alleges that, in connection with the investigation, the FINRA staff sent Respondent two requests that he appear for on-the-record interviews, pursuant to NASD Procedural Rule 8210, by letters dated March 1, 2007 and March 23, 2007. (Complaint at ¶ 5). The requests to appear were sent to Respondent at his CRD address. (Exhibit A to the Complaint). On each occasion, Respondent sent a letter to the FINRA staff stating his unwillingness to appear for the interviews, and he failed to appear for the interviews on March 21, 2007, and April 13, 2007, as requested. (Complaint at ¶ 6; Exhibit A to the Complaint).

The Hearing Officer finds that Respondent received the two requests to appear for

¹⁰ Stephen J. Gluckman, 1999 SEC LEXIS 1395, at **14-15 (July 20, 1999).

¹¹ District Bus. Conduct Comm. v. Norman M. Merz, No. C8A960094, 1998 NASD Discip. LEXIS 40 (NAC Nov. 11, 1998).

on-the-record interviews based on his written responses to the FINRA staff. (*Id.*). In any event, Respondent is deemed to have received the two requests that were sent to his CRD address pursuant to NASD Procedural Rule 8210(d). Failure to comply with Rule 8210 requests for on-the-record interviews is a serious violation because it subverts FINRA's ability to perform its regulatory responsibilities.¹²

The allegations of count two of the Complaint and the evidence submitted by Enforcement are sufficient to establish that Respondent violated NASD Procedural Rule 8210 and thereby violated NASD Conduct Rule 2110 by failing to appear for two requested on-the-record interviews.

IV. Sanctions

A. Respondent Failed to Appear for Two On-the-Record Interviews

For failing to appear for two on-the-record interviews as alleged in count two of the Complaint, Enforcement recommended that Respondent be barred. The FINRA Sanction Guidelines provide that a bar should be standard when an individual respondent does not respond in any manner to a request issued pursuant to Rule 8210.¹³ The record does not indicate the existence of any mitigating factors that would warrant a lesser sanction.

Accordingly, the Hearing Officer accepts Enforcement's recommendation and bars Respondent from associating with any member firm in any capacity for failing to

¹² See, e.g., Richard J. Rouse, Exchange Act Rel. No. 32,685, 1993 SEC LEXIS 1831, at *7 (1993); Joseph G. Chiulli, Exchange Act Rel. No. 42,359, 2000 SEC LEXIS 112, at *16 (Jan. 28, 2000) (noting that Rule 8210 provides a means for FINRA to conduct its investigations effectively, and emphasizing that FINRA members and associated persons must fully cooperate with requests for information).

¹³ FINRA Sanction Guidelines, p. 35 (2007).

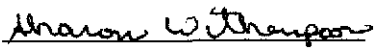
appear for two on-the-record interviews scheduled pursuant to NASD Procedural Rule 8210.

B. The Hearing Officer Imposes No Separate Sanction for Respondent's Private Securities Transaction Violations

Because the Hearing Officer barred Respondent for his Rule 8210 violation, the Hearing Officer will impose no separate sanction for Respondent's violation of NASD Conduct Rules 3040 and 2110, by failing to request and receive firm approval prior to participating in private securities transactions.¹⁴

V. Order

Respondent John H. Arnette is barred from associating with any FINRA member firm in any capacity for failing to appear for two on-the-record interviews, scheduled pursuant to Rule 8210, in violation of NASD Procedural Rule 8210 and NASD Conduct Rule 2110. The bar shall become effective on the date this Decision becomes the final disciplinary action of FINRA.


Sharon Witherspoon
Hearing Officer

Date: Washington, DC
January 4, 2008

Copies to:

John H. Arnette (via FedEx and first class mail)
Laura Leigh Blackston, Esq. (via electronic and first class mail)
Mark P. Dauer, Esq. (via electronic and first class mail)
David R. Sonnenberg, Esq. (via electronic and first class mail)

¹⁴ See Dep't of Enforcement v. Jeffrey B. Hodde, No. C10010005, 2002 NASD Discip. LEXIS 4, at *17 (NAC Mar. 27, 2002) (explaining that a bar is the standard sanction for a respondent's failure to respond to information requests and holding that it is therefore redundant to impose an additional sanction, such as a suspension, for a violation of another NASD rule).

**FINANCIAL INDUSTRY REGULATORY AUTHORITY (FINRA)
OFFICE OF HEARING OFFICERS**

DEPARTMENT OF ENFORCEMENT,

COMPLAINANT,

v.

JOHN H. ARNETTE,
General Securities Representative
(CRD No. 7458),

Respondent.

**DISCIPLINARY PROCEEDING
No. 2005002734201**

HEARING OFFICER: _____

COMPLAINT

The Department of Enforcement alleges:

1. John H. Arnette entered the securities industry on September 1, 1970 as a General Securities Representative. Arnette during all periods herein, was associated with member firm Intersecurities, Inc., and was registered with FINRA (f/k/a/ National Association of Securities Dealers or NASD) under Article V of the By-Laws as a General Securities Representative. Arnette was terminated on February 14, 2007, is not currently associated with any member firm, and has not previously been the subject of a formal disciplinary action by any regulatory body. Although Arnette is not currently registered, he remains subject to the jurisdiction of FINRA at least until February 14, 2009, pursuant to Article V, Section 4 of FINRA's By-Laws, which provide for a two-year period of retained jurisdiction over formerly registered persons after the termination date.

FIRST CAUSE OF ACTION
NASD Conduct Rules 2110 and 3040, Private Securities Transactions,
Against Respondent Arnette

2. During the period from on or about March 18, 2003 through on or about February 4, 2004, Arnette participated in private securities transactions with four public customers without requesting or obtaining prior written approval of his employer member firm. Specifically, Arnette solicited customers JV, BV, TC, and DC to make total investments of \$409,158 in Resort Holdings Universal Leases.
3. Resort Holding Universal Leases were purchase/lease agreements with an attached management contract. The contracts purported to pay 9% of the purchase price annually and had a term of 25 years.
4. Such acts, practices, and conduct constitute separate and distinct violations of NASD Conduct Rules 2110 and 3040 by Respondent Arnette.

SECOND CAUSE OF ACTION
NASD Conduct Rule 2110 and Procedural Rule 8210, Failure to
Respond to Requests for Information,
Against Respondent Arnette

5. By letters dated March 1, 2007 and March 23, 2007, the FINRA District Staff requested that Arnette appear for an on-the-record interview to provide certain information to the staff concerning the activities described in the First Cause of Complaint. These requests for information were sent pursuant to, and in accordance with, the provisions of Procedural Rule 8210, all as more fully detailed on Exhibit "A," attached hereto.

6. Respondent Arnette failed to appear for his on-the-record interviews on March 21, 2007 and April 13, 2007 and indicated by letter to the District staff his unwillingness to appear for these interviews.
7. Such acts, practices, and conduct constitute separate and distinct violations of NASD Conduct Rule 2110 and Procedural 8210 by Respondent Arnette.

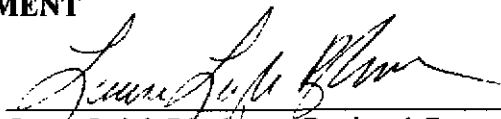
RELIEF REQUESTED

WHEREFORE, the Department respectfully requests that the Panel:

- A. Order that one or more of the sanctions provided under NASD Rule 8310(a), including monetary sanctions be imposed including that the Respondent be required to disgorge fully any and all ill-gotten gains and/or make full and complete restitution, together with interest.
- 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.

FINRA DEPARTMENT OF ENFORCEMENT

Date: August 9, 2007



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SCHEDULE OF REQUESTS FOR JOHN H. ARNETTE'S
 APPEARANCE FOR AN ON THE RECORD INTERVIEW
 UNDER THE PROVISION OF
 NASD RULE 8210

DATE OF ASSOCIATION REQUEST	CRD HOME ADDRESS	METHOD	INFORMATION REQUESTED	DUE DATE OF RESPONSE	APPEARED AT OTR YES/NO	COMMENTS
3/1/2007	[REDACTED]	REGULAR & CERTIFIED MAIL 7005 1160 0000 7001 5784	REQUEST THAT MR. ARNETTE APPEAR IN THE DISTRICT OFFICE ON MARCH 21, 2007 AT 9 A.M.	3/18/2007	NO	REQUEST SENT VIA REGULAR MAIL. NOT RETURNED. REQUEST SENT VIA CERTIFIED MAIL RETURNED ON 4/2/07 - UNCLAIMED ON 3/5/07. REGIONAL ATTORNEY, LAURA LEIGH BLACKSTON RECEIVED A FAX FROM MR. ARNETTE, INDICATING THAT HE WOULD NOT ATTEND THE OTR
3/23/2007	[REDACTED]	REGULAR & CERTIFIED MAIL 7005 1160 0000 7001 3414	REQUEST THAT MR. ARNETTE APPEAR IN THE DISTRICT OFFICE ON APRIL 13, 2007 AT 10 A.M.	4/6/2007	NO	NEITHER THE REQUEST SENT VIA REGULAR MAIL NOR THE REQUEST SENT VIA CERTIFIED MAIL WAS RETURNED. MR. ARNETTE SENT LETTERS TO REGIONAL ATTORNEY, LAURA LEIGH BLACKSTON AND SPECIAL INVESTIGATOR, PAT BOURGEOIS, RECEIVED ON 4/2/07, INDICATING THAT HE WOULD NOT ATTEND THE OTR