BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of Department of Enforcement, Complainant, vs. Hedge Fund Capital Partners, LLC New York, NY, and Howard G. Jahre New York, NY, Respondents.	DECISION Complaint No. 2006004122402 Dated: May 1, 2012

Respondents distributed exaggerated, misleading, and unbalanced institutional sales materials and failed to retain institutional sales materials; allowed unregistered persons to act in registered capacities, employed a statutorily disqualified individual, and permitted a registered representative to "park" her license at the firm; willfully filed misleading Forms U4; failed to retain emails and instant messages; failed to establish and maintain adequate supervisory systems and procedures; made false statements to FINRA; and improperly allowed a hedge fund tenant to pay its rent with soft dollars. Held, findings and sanctions affirmed.

Appearances

For the Complainant: Gregory R. Firehock, Esq., Leo F. Orenstein, Esq., Department of Enforcement, Financial Industry Regulatory Authority

For the Respondents: Pro Se

Decision

Hedge Fund Capital Partners, LLC ("HedgeCap" or "the Firm") and Howard G. Jahre ("Jahre") appeal a January 26, 2011 Extended Hearing Panel decision. The Hearing Panel found that HedgeCap and Jahre, the Firm's president and majority owner, violated numerous FINRA

rules and provisions of the Securities Exchange Act of 1934 ("Exchange Act").[1] The Hearing Panel found that respondents disseminated exaggerated, misleading, and unbalanced institutional sales materials and failed to retain copies of institutional sales materials. The Hearing Panel further found that HedgeCap and Jahre permitted five associated persons (including one statutorily disqualified individual) to market hedge funds without being properly registered, and allowed another associated person to "park" her registration at the Firm. Further, the Hearing Panel found that respondents failed to adequately supervise certain activities at HedgeCap, failed to retain emails and instant messages, and made willfully misleading disclosures on three Uniform Applications for Securities Industry Registration or Transfer ("Forms U4"). Finally, the Hearing Panel found that Jahre and HedgeCap responded falsely to numerous requests for information, testified falsely, and improperly permitted a hedge fund adviser to use soft dollars to pay rent to HedgeCap in violation of the hedge fund's offering memorandum. In connection with these violations, the Hearing Panel expelled HedgeCap and barred Jahre in all capacities.

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

I. Background

Jahre entered the securities industry in 1995 and became associated with HedgeCap in July 2003. During all relevant time periods, Jahre was, and continues to be, registered with HedgeCap as a general securities representative and general securities principal. Jahre is also an attorney licensed in New York State, although he has never practiced law.

HedgeCap has been a FINRA member since 2001. Jahre became HedgeCap's president in February 2004, and he acquired a majority ownership interest in the Firm in April 2005. During all relevant time periods, Frank Napolitani ("Napolitani") was the Firm's co-owner and registered with the Firm as a general securities representative. Napolitani was never registered with the Firm as a general securities principal, had no authority to hire or fire individuals without Jahre's approval, and did not supervise anyone at the Firm.

Jahre served as HedgeCap's chief compliance officer from mid-2005 until November 2005, when he hired Steven Solano ("Solano"). Solano worked part-time at HedgeCap while serving as a compliance officer for six or seven other member firms. Solano remained the Firm's chief compliance officer until January 2007.[2] During all relevant time periods, Jahre was the only supervisor at the Firm.

From May 2005 until September 2006, approximately 11 or 12 registered individuals worked for HedgeCap. The Firm focused generally on providing services to hedge funds. The

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[1] The conduct rules that apply in this case are those that existed at the time of the conduct at issue.

[2] Another individual, Peter Marquardt, served as the Firm's chief compliance officer for several months in mid-2006.

Firm solicited hedge fund managers to rent a portion of the Firm's office space in New York City, introduced its tenants and other hedge fund managers to potential investors, and operated an agency trading desk. A number of the individuals registered with HedgeCap were employed by third-party marketers and worked to raise capital for HedgeCap's hedge fund customers. The Firm compensated the third-party marketers with a portion of the fees the marketers generated.

II. Procedural History

The investigation of respondents began in January 2006 when FINRA requested information from HedgeCap as part of a "mini-sweep" of hedge fund "hotels." FINRA's Department of Enforcement ("Enforcement") filed an 11-cause complaint against respondents on March 27, 2009. Enforcement alleged that: (1) respondents violated NASD Rule 2110 by improperly allowing a hedge fund tenant to pay its rent to HedgeCap with soft dollars; (2) respondents violated NASD Rules 2211(d)(1) and 2110 by distributing exaggerated, misleading, and unbalanced institutional sales materials in the form of emails from Jahre; (3) HedgeCap violated NASD Rules 2211(d)(1) and 2110 by distributing additional unbalanced institutional sales materials; (4) HedgeCap violated NASD Rules 2211(b)(2)(A) and 2110 by failing to retain institutional sales materials; (5) respondents violated NASD Rules 1031 and 2110 by allowing unregistered persons to act in registered capacities; (6) respondents violated Article III, Section 3(b) of NASD's By-Laws and NASD Rule 2110 by employing a statutorily disqualified individual; (7) respondents violated Article V, Section 2 of NASD's By-Laws, NASD Rule 2110, and Interpretive Material ("IM") 1000-1 by willfully filing misleading Forms U4; (8) respondents violated NASD Rules 1031 and 2110 by allowing a registered representative to "park" her license at the Firm; (9) HedgeCap violated NASD Rules 3110 and 2110, and Exchange Act Section 17(a)(1) and Exchange Act Rule 17a-4, by failing to retain emails and instant messages; (10) respondents violated NASD Rules 3010 and 2110 by failing to establish and maintain an adequate supervisory system, failing to establish, maintain, and enforce written supervisory procedures, and failing to hold an annual compliance meeting; and (11) respondents violated NASD Rules 8210 and 2110 by providing false responses to FINRA requests for information and providing false testimony.

HedgeCap and Jahre denied most of the complaint's allegations, but admitted certain deficiencies with respect to HedgeCap's email retention policies and procedures. They also stipulated to many of the facts underlying the allegations set forth in the complaint and asserted that any rule violations resulted from sloppy practices rather than an intentional disregard for rules and regulations.

The Hearing Panel conducted an eight-day hearing in May 2010. Enforcement called six witnesses. Respondents called Jahre and an information technology consultant who worked on HedgeCap's email and instant messaging retention systems. On January 26, 2011, the Hearing Panel issued its decision, which found that respondents engaged in the misconduct specified in the complaint. The Hearing Panel expelled HedgeCap and barred Jahre in all capacities. Respondents appealed.

III. Discussion

A. Respondents Violated FINRA's Advertising Rules

The Hearing Panel found that HedgeCap and Jahre violated FINRA's advertising rules in three distinct ways. First, the Hearing Panel found that respondents distributed exaggerated, misleading, and unbalanced institutional sales materials in the form of emails from Jahre, in violation of NASD Rules 2211(d)(1) and 2110. Second, the Hearing Panel found that HedgeCap distributed additional unbalanced institutional sales materials, in violation of NASD Rules 2211(d)(1) and 2110. Third, the Hearing Panel found that HedgeCap failed to retain institutional sales materials, in violation of NASD Rules 2211(b)(2)(A) and 2110. For the reasons set forth below, we affirm the Hearing Panel's findings.

1. Jahre's Misleading and Unbalanced Emails to Institutional Investors

NASD Rule 2210(d)(1) provides that all communications with the public must be fair and balanced and provide a sound basis for evaluating a security. NASD Rule 2210(d)(1)(A). Communications with the public cannot contain false, exaggerated, or misleading statements or claims and may not predict or project performance or make exaggerated claims or forecasts. NASD Rules 2210(d)(1)(B) & (D). "Communications with the public" include "institutional sales material," which is defined as "any communication that is distributed or made available only to institutional investors." *See* NASD Rules 2210(a)(4) & 2211(a)(2). NASD Rule 2211(d)(1) expressly provides that all institutional sales material is subject to, among other things, the content standards set forth in NASD Rule 2210(d)(1).

Between June and August 2006, Jahre wrote and sent approximately 13 emails to potential institutional investors concerning a collateralized mortgage obligation ("CMO") arbitrage strategy to be pursued through a start-up fund.[3] Although the emails from Jahre contained minor variations, they generally stated the CMO arbitrage strategy had "zero risk to principal because of [the fund creator's] hedging techniques and a very robust double digit return profile." The emails further stated that "the strategy can comfortably earn 25-40% per annum, with the possibility of higher returns." Jahre claimed "[t]here is no risk to capital and in the event we cannot execute the strategy, because of some remote contingencies, the investor will still get all capital back plus a nominal (4-6%) return." Jahre stated that the arbitrage strategy was proprietary and secretive and would not be disclosed to investors unless they signed a non-disclosure agreement.

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[3] Although Jahre testified that he sent between 20 and 25 such emails in 2006, the record contains only 13 emails. Jahre personally sent 12 of the 13 emails, and directed a third-party marketer to forward one email to a potential investor. Further, between July and October 2007, Jahre sent approximately 11 additional emails to potential investors touting this same investment. These later emails generally did not contain such detailed projections as did the earlier emails. The emails did, however, claim that the investment presented "de minimis" risk with no discussion concerning the specifics of the investment or risks involved.

As a result of Jahre's efforts, one hedge fund invested $100 million in the start-up fund. Jahre testified that after the credit markets experienced extreme difficulties beginning in 2007, the strategy underlying the fund became untenable. The record demonstrates that the hedge fund investor lost at least $20 million in connection with this investment, and Jahre testified that the investing fund no longer has any assets under management.[4]

We find that respondents violated NASD Rules 2211(d)(1) and 2110 in connection with Jahre's emails concerning the CMO arbitrage strategy and start-up fund.[5] First, Jahre's emails to institutional investors were institutional sales materials subject to the content standards of NASD Rule 2210(d). *See* NASD Rules 2211(a)(2) & (d)(1) (providing, respectively, that institutional sales materials consist of any communication that is distributed or made available only to institutional investors and that institutional sales materials are subject to the content standards of NASD Rule 2210).

Second, Jahre's emails violated the content standards set forth in NASD Rule 2210(d) and, in turn, NASD Rule 2211(d), in myriad ways. Jahre's emails contained exaggerated and unsubstantiated predictions of performance, lacked any description of the risks involved with the investments, and were not fair and balanced. In fact, Jahre's emails made carte blanche minimizations of the risks involved and promised investors that, at a minimum, they would get all of their capital back plus a small return. *Cf. Dep't of Enforcement v. Murphy*, Complaint No. 2005003610701, 2011 FINRA Discip. LEXIS 42, at *83 (FINRA NAC Oct. 20, 2011) (finding communication that omitted any discussion of risks involved with a "safe option strategy" was not fair and balanced), *appeal docketed*, SEC Admin. Proceeding No. 3-14609 (Oct. 14, 2011). Indeed, notwithstanding the email's lack of discussion concerning the investment's risk, Jahre admitted at the hearing that the investment had multiple risks (such as fluctuations in interest rates, mortgage holders not wanting to refinance, risk that others would utilize the same strategy, and credit market risks).

Jahre's emails also failed to provide a sound basis for evaluating the facts concerning the investment and did not provide any explanation or support for Jahre's recommendation of the investment. *See Dep't of Enforcement v. Beloyan*, Complaint No. 2005001988201, 2011 FINRA

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[4] During an on-the-record interview and at the hearing, Jahre stated that the hedge fund broke even on its investment and "got all [its] money back." A FINRA investigator, however, testified at the hearing that a director at the hedge fund (EB) informed him he never told Jahre that the fund had gotten its money back and the hedge fund lost $23 million in connection with this investment. After Jahre learned that Enforcement planned to call EB during a break in the proceedings, Jahre admitted that he phoned EB during that same break and then testified that the hedge fund could have lost $20 million.

[5] Generally, a violation of another FINRA rule is also a violation of NASD Rule 2110's requirement that all FINRA members, in conducting their business, "observe high standards of commercial honor and just and equitable principles of trade." *See Joseph Abbondante*, Exchange Act Rel. No. 53066, 2006 SEC LEXIS 23, at *2 (Jan. 6, 2006) (holding that a violation of a FINRA rule also violates NASD Rule 2110).

Discip. LEXIS 44, at *21-22 (FINRA NAC Dec. 20, 2011) (finding that emails did not provide a sound basis for evaluating an investment where they did not provide any support or explanation for the investment and made no risk disclosures); *NASD Notice to Members 03-07*, 2003 NASD LEXIS 3, at *9 n.4 (Feb. 2003) (stating that "a transaction will be considered recommended when the member or its associated person brings a specific security to the attention of a customer through any means").[6] Moreover, although Jahre's communications stated that the strategy underlying the investment was "not viable until now," the emails made numerous exaggerated claims and projections regarding future performance of the investment. We find that HedgeCap and Jahre violated FINRA's advertising rules.[7] *See Dep't of Mkt. Regulation v. Ryan & Co., LP*, Complaint No. FPI040002, 2005 NASD Discip. LEXIS 8, at *30 (NASD NAC Oct. 3, 2005) (holding that misconduct of firm's president is imputed to firm).

2. Additional Institutional Sales Materials Distributed by HedgeCap

In addition to respondents' violations related to Jahre's emails, we affirm the Hearing Panel's finding that HedgeCap distributed unbalanced institutional sales materials, in violation of NASD Rules 2211(d)(1) and 2110.

From May 2005 through September 2006, certain HedgeCap employees and third-party marketers employed by HedgeCap (and ostensibly supervised by Jahre) distributed hedge fund marketing materials to potential institutional investors. They distributed 20 different marketing documents to potential investors in 1,465 solicitations, often by email. The marketing materials included power point presentations, newsletters, brochures, and fund summaries.

Similar to Jahre's emails, these materials violated NASD Rule 2211(d) and 2110. First, respondents stipulated that they distributed the marketing materials to potential institutional investors. We thus find that the materials were institutional sales materials and thus were subject to the content standards of NASD Rule 2210(d). *See* NASD Rule 2211(a)(2).

Second, the marketing materials violated the content standards of NASD Rule 2210(d). While some of the materials contained general disclaimers and statements regarding risk, and referred to other documents for more specific disclosures, the materials did not present a fair and balanced assessment of the investments they were touting. *See, e.g., Sheen Fin. Res., Inc.*, 52 S.E.C. 185, 190 (1995) (stating that failure to discuss risks specifically associated with investment rendered advertisement misleading); *Jay Michael Fertman*, 51 S.E.C. 943, 950 (1994) (finding sales literature failed to disclose in a balanced way the risks and rewards of

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6 *See also* NASD IM-2210-8 (providing guidelines for communications with the public concerning CMOs).

7 "An associated person can be held personally liable for a violation of NASD Rule 2210." *Dep't of Enforcement v. Jordan*, Complaint No. 2005001919501, 2009 FINRA Discip. LEXIS 15, at *38 n.16 (FINRA NAC Aug. 21, 2009); *see also* NASD Rule 0115 (providing that associated persons have the same duties and obligations as FINRA members under FINRA's rules).

touted investments and that general disclaimers of risk failed to alert investors to specific risks of touted investments); *Dep't of Enforcement v. Donner Corp. Int'l*, Complaint No. CAF020048, 2006 NASD Discip. LEXIS 4, at *36-37 (NASD NAC Mar. 6, 2006) (finding that inclusion of hyperlinks to issuers' financial filings were insufficient to cure deficiencies in research reports), *aff'd in relevant part*, Exchange Act Rel. No. 55313, 2007 SEC LEXIS 334 (Feb. 20, 2007). Further, many of the materials contained exaggerated performance projections. For example, one power point described the particular fund's objectives of "compounded average annual return of 16%-18% net of fees." Another sought to "achieve 15% compounded returns net of fees." Several others stated that they sought to achieve long-term returns of 30 percent. These projections violated NASD Rule 2210(d)(1)(D), which prohibits exaggerated claims or forecasts.

In connection with Jahre's emails and the violative institutional sales materials, respondents argue that, because they sent these materials solely to institutional and sophisticated investors, they did not violate NASD Rules 2210(d) or 2211(d). The content standards for communications with the public, however, expressly include institutional sales materials. The fact that the recipient of respondents' communications were institutional and sophisticated does not excuse respondents' flagrant disregard for the content standards of NASD Rules 2210(d) and 2211(d), including their failures to provide a fair and balanced assessment of the risks of the particular investments at issue.

We also reject respondents' argument that IM-2210-1 relieves them of their obligations to comply with FINRA's advertising rules. IM-2210-1 states, in pertinent part, that "[m]embers must ensure that statements are not misleading within the context in which they are made . . . . [and] [m]embers must consider the nature of the audience to which the communication will be directed. Different levels of explanation or detail may be necessary depending on the audience to which a communication is directed." Respondents' sales materials, especially Jahre's emails, failed in numerous ways to comply with the content standards of NASD Rules 2210(d) and 2211(d), and nothing in IM-2210-1 excuses or permits the exaggerated statements, unsubstantiated predictions of performance, lack of risk disclosures, and unbalanced statements contained in the materials. Respondents' argument that they complied with suitability requirements contained in other FINRA rules, even if true, has no bearing on our finding that they violated FINRA's advertising rules. Enforcement did not charge respondents with recommending unsuitable investments.

Respondents further argue that the Hearing Panel impermissibly relied upon the testimony of a FINRA special examiner on matters of law in determining that they violated FINRA's advertising rules and erroneously applied the standards set forth in NASD Notice to Members 03-07, which they argue apply only to retail investors.[8] We disagree. The Hearing Officer noted that the examiner was testifying as a fact witness, not offering her opinion as an

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[8] Notice to Members 03-07 reminded FINRA members of their obligation to comply with FINRA's advertising rules and suitability standards when selling hedge funds, and provided examples of risk disclosures that should be included in any communications with the public concerning hedge funds.

expert. Moreover, NASD Rule 2211(d) expressly provides that institutional sales materials are in fact subject to the content standards set forth in NASD Rule 2210(d). Thus, the examiner's testimony to this effect and disputed by respondents is entirely consistent with the express terms of the rule, and nothing in the notice suggests that institutional sales materials are exempt from the rule. Moreover, even if the Hearing Panel relied upon the examiner's testimony or applied the wrong legal standard, our de novo review of the matter (and reliance upon the clear and unambiguous language of NASD Rule 2211(d)) cures any alleged improprieties. *See Dist. Bus. Conduct Comm. v. Guevara*, Complaint No. C9A970018, 1999 NASD Discip. LEXIS 1, at *39 n.16 (NASD NAC Jan. 28, 1999) (holding that de novo review is intended to insulate proceedings from procedural unfairness), *aff'd*, 54 S.E.C. 655 (2000).[9]

For all of these reasons, we find that respondents violated NASD Rules 2211(d) and 2110.

3. HedgeCap Failed to Retain Institutional Sales Materials

We also affirm the Hearing Panel's finding that HedgeCap failed to retain institutional sales materials. NASD Rule 2211(b)(2)(A) provides that members must maintain a file of all institutional sales material for three years from the date of last use. Prior to the hearing, respondents stipulated that:

> To raise capital for HedgeCap's hedge fund clients, HedgeCap's employees and marketers distributed institutional marketing materials to potential institutional investors. . . . HedgeCap did not maintain a copy of every piece of the above materials in a file for three years.

Based upon this stipulation, the Hearing Panel found that the Firm violated NASD Rules 2211(b)(2)(A) and 2110.

On appeal, respondents argue that the Hearing Panel misconstrued this stipulation. Respondents aver that the stipulation "merely means that HedgeCap could not say with 100% certainty that every single document requested by FINRA was maintained and produced and that not one single document was perhaps inadvertently lost due to oversight." We reject respondents' retroactive interpretation of their previous stipulation, which was clear and unambiguous. *See Abbondante*, 2006 SEC LEXIS 23, at *10 n.12 ("Stipulated facts serve important policy interests in the adjudicatory process, including playing a key role in promoting timely and efficient litigation; we will honor stipulations in the absence of compelling circumstances.").

Respondents also argue that the Firm maintained copies of such materials in an electronic file and that their stipulation to the contrary was based upon Jahre's narrow and inaccurate belief

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[9] We also reject respondents' assertion that FINRA's advertising rules (as well as many of the rules underlying the complaint) are not applicable to HedgeCap because its business consisted mostly of providing services to hedge funds.

that the Firm, because it did not maintain hard copies of such documents, did not comply with NASD Rule 2211(b)(2)(A). We reject respondents' argument. First, respondents' stipulation that they did not maintain such materials in a file was unambiguous and broad enough to include both hard copies and electronic copies. Jahre's claimed misunderstanding of how the Firm maintained its files until just prior to the hearing does not constitute compelling circumstances necessary to disregard the plain meaning of the stipulation at issue. Jahre professed his lack of technological knowledge well before he entered into the clear and unambiguous stipulations at issue, yet he still stipulated that the Firm did not maintain such materials in a file without any reservations or limitations concerning electronic storage.

Second, respondents attempt to use excluded evidence to support their claim that they did maintain such files and to disregard their stipulation. The excluded evidence at issue is a CD that contains a number of electronic files (allegedly including institutional sales materials required to be maintained by the Firm that Jahre asserts were saved, without his prior knowledge, by Napolitani). Prior to the hearing, Enforcement objected to the CD and argued that it was "nothing more than a document dump" and had no apparent relevance to any issues in the case. At the hearing, the Hearing Officer excluded the CD from evidence. Respondents have not demonstrated that the Hearing Officer improperly excluded this evidence. Moreover, although Napolitani testified extensively (and was cross-examined at the hearing), he did not testify about these files, whether they consisted of all institutional sales materials utilized by the Firm during the relevant three-year period, and whether he saved all institutional sales materials electronically for a period of three years. In fact, Napolitani testified that he was not familiar with FINRA's advertising rules during the relevant time period. For all of these reasons, we decline to disregard respondents' unambiguous stipulation concerning the Firm's failure to retain institutional sales materials, and we find that HedgeCap violated NASD Rules 2211(b)(2)(A) and 2110.

B. Respondents Violated FINRA's Registration Requirements and Employed a Statutorily Disqualified Individual

The Hearing Panel found that HedgeCap and Jahre: (1) allowed unregistered persons to act in registered capacities, in violation of NASD Rules 1031 and 2110; (2) allowed a registered representative to "park" her license at the Firm, in violation of NASD Rules 1031 and 2110; and (3) improperly employed a statutorily disqualified individual, in violation of Article III, Section 3(b) of NASD's By-Laws and NASD Rule 2110. For the reasons set forth below, we affirm the Hearing Panel's findings.

1. Respondents Permitted Unregistered Persons to Act in Registered Capacities

During the relevant time period, HedgeCap employed 11 or 12 independent contractors to market hedge funds through the Firm. These individuals were registered through HedgeCap and supervised by Jahre. They contacted potential investors and marketed hedge funds to them, emailed potential investors, described the specific fund they were marketing, attached marketing materials for the funds, and often followed up with phone calls. At least four of these individuals began these activities with the Firm before they were licensed and registered.[10]

We find that respondents violated NASD Rules 1031 and 2110 by permitting unregistered individuals to market hedge funds to investors and potential investors. NASD's By-Laws prohibited member firms from permitting a person to associate with a member to engage in its investment banking or securities business unless such person satisfied FINRA's qualification requirements. *See* NASD By-Laws, Art. V, Sec. 1.[11] NASD Rule 1031 provides that "[a]ll persons engaged or to be engaged in the investment banking or securities business of a member who are to function as representatives shall be registered as such." NASD Rule 1031(b) defines a representative as a person "associated with a member . . . who [is] engaged in the investment banking or securities business for the member including the functions of supervision, solicitation or conduct of business in securities." "'[I]nvestment banking or securities business' means the business, carried on by a broker . . . of purchasing and selling securities upon the order and for the account of others[.]" *See* NASD By-Laws, Art. I(u).

HedgeCap and Jahre argue that these individuals did not solicit customer orders or accounts, but merely attempted to make introductions of investments to potential investors. We reject respondents' narrow view of the unregistered individuals' activities. *See Michael F. Flannigan*, 56 S.E.C. 8, 17-18 (2003) (affirming finding that firm and its president violated FINRA's registration rules by permitting unregistered individuals to solicit customers and confirm indications of interest for an initial public offering); *First Capital Funding, Inc.*, 50

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[10] Anton Szpitalak began raising capital for hedge funds through HedgeCap in June 2005, but did not take and pass his Series 7 examination until May 2006. Pamela Valeri began raising capital for hedge funds through the Firm in June 2005, but did not obtain a waiver of the requirement that she take and pass the Series 7 exam until October 2005. Catheryn Robinson began raising capital for hedge funds through the Firm in May 2005, but did not pass the Series 7 exam until September 2005. Finally, Michael Leverone began raising capital for hedge funds through the Firm in May 2005, but did not pass his Series 7 exam until mid-June 2005. HedgeCap filed Forms U4 for three of these individuals (Pamela Valeri, Catheryn Robinson, and Michael Leverone) before they began their marketing activities. HedgeCap filed a Form U4 for Szpitalak in March 2006, although he began his marketing activities for HedgeCap in June 2005. The activities of another individual employed by the Firm, Robert Mudry ("Mudry"), are discussed separately in Part III.B.3 *infra*.

[11] We apply NASD's By-Laws as they existed when the misconduct occurred, although the provisions at issue are materially the same as FINRA's By-Laws.

S.E.C. 1026, 1029-30 (1992) (finding that member firm and its president violated FINRA's registration rules by permitting an unregistered individual to send pre-qualification forms with information regarding an investment to potential investors and that firm was "engaged at least in an 'attempt to induce' the purchase or sale of securities"); *see also NASD Notice to Members 88-50*, 1988 NASD LEXIS 169, at *3 (July 1988) ("unregistered persons may not discuss general or specific investment products or services offered by the firm . . . or solicit new accounts or orders").[12]

Respondents also suggest that because two of the unregistered individuals were previously registered representatives and had simply let their licenses lapse, any violations of FINRA's registration requirements with respect to these individuals were technical in nature. We disagree. *See Flannigan*, 56 S.E.C. at 17 (stating that "the NASD's registration requirement provides an important safeguard in protecting public investors and strict adherence to that requirement is essential"). They further assert that the registration violations were not willful or intentional, but resulted from their failure to have an appropriate email archiving system in place (such that Jahre could have discovered that these individuals had been sending emails to potential investors).[13] Enforcement, however, did not need to demonstrate that respondents intended to violate FINRA's registration requirements. *Cf. Dep't of Enforcement v. Usher*, Complaint No. C3A980069, 2000 NASD Discip. LEXIS 5, at *6 (NASD NAC Apr. 18, 2000) (holding that proof of intent is not required to show that respondent acted as a registered representative while suspended). Consequently, we find that HedgeCap and Jahre violated NASD Rules 1031 and 2110.

2. Respondents Permitted a Registered Representative to Park her License at the Firm

The Hearing Panel found that respondents violated NASD Rules 1031 and 2110 by permitting Jamie Lombardy ("Lombardy"), an individual registered with HedgeCap as a representative, to park her license at the Firm. We affirm these findings.

NASD Rule 1031(a) provides that a member firm shall not maintain a registered representative's registration solely to avoid FINRA's examination requirements. The rule further provides that a member firm shall not make application for the registration of any person as a

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[12] Respondents argue that to the extent that the Hearing Panel relied upon Notice to Members 88-50, it applies "strictly to cold calling activities to retail customers." We reject respondents' narrow reading of the applicability of this notice and find that they violated NASD Rules 1031 and 2110 by permitting unregistered individuals to engage in activities that required registration. We also reject respondents' characterization of Anton Szpitalak's activities as ministerial. The record shows that he sent marketing materials and called potential investors in connection with hedge funds for which the Firm was seeking to raise capital. *See Flannigan*, 56 S.E.C. at 17 (rejecting argument that unregistered individual's activities were merely administrative or clerical).

[13] Respondents' failure to retain emails is discussed separately in Part III.D *infra*.

representative if the firm does not intend to employ the representative in the firm's investment banking or securities business.

In May 2004, Lombardy ended her association with another member firm. Lombardy was licensed as a registered representative, and her license was set to expire in May 2006. *See* NASD Rule 1031(c) (providing that any registered representative whose most recent registration has been terminated for two or more years shall pass an examination). Lombardy's husband was a partner with a compliance consulting firm that leased space from HedgeCap and provided legal and compliance advice to the Firm. In April 2006, Jahre permitted Lombardy to register with the Firm to avoid her license expiring as a favor to her husband so that the Firm might obtain services from him at a discount. Lombardy did not have an office, desk, or email account at the Firm. Lombardy did not perform any services for, or receive any compensation from, the Firm.

We find that respondents violated NASD Rules 1031 and 2110 by permitting Lombardy to park her license at HedgeCap to avoid her license from expiring. *See Mkt. Regulation Comm. v. Faherty*, Complaint No. CMS920005, 1998 NASD Discip. LEXIS 44, at *28-30 (NASD NAC Oct. 14, 1998) (finding that, where individual registered with firm simply to avoid the expiration of her securities license, she "parked" her registration with the broker-dealer in violation of NASD Rules 1031 and 2110), *rev'd on other grounds*, 56 S.E.C. 172 (2003). We also find that Jahre never intended to employ Lombardy in the Firm's investment banking or securities business. The Hearing Panel rejected as not credible Jahre's explanation that "in the back of his mind" Lombardy might at some point provide services to the Firm requiring registration. Respondents have not presented any evidence on appeal to overturn the Hearing Panel's credibility finding, and we do not disturb that finding on appeal. *See Geoffrey Ortiz*, Exchange Act Rel. No. 58416, 2008 SEC LEXIS 2401, at *18 (Aug. 22, 2008) ("We give great weight and deference to credibility determinations by a Hearing Panel, which can only be overcome by substantial record evidence.").

3. Respondents Employed a Statutorily Disqualified Individual

We affirm the Hearing Panel's findings that HedgeCap and Jahre violated Article III, Section 3(b) of NASD's By-Laws and NASD Rule 2110 by employing Mudry, a statutorily disqualified individual.

NASD's By-Laws prohibited a statutorily disqualified person from associating with a broker-dealer while disqualified. *See* NASD By-Laws, Art. III, Sec. 3(b). Article III, Section 4 of NASD's By-Laws provided that, "[a] person is subject to a 'disqualification' with respect to membership, or association with a member, if such person . . . has been . . . barred or suspended from being associated with a member of, any self-regulatory organization." FINRA has stated that "a person who is subject to disqualification may not associate with a FINRA member in **any capacity** unless and until approved in an Eligibility Proceeding." *See* Statutory Disqualification Process, *available at* www.finra.org/Industry/Enforcement/Adjudication/NAC /StatutoryDisqualificationProcess. NASD's By-Laws defined a "person associated with a member" or "associated person of a member" as "a natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by a member, whether or not any such person is registered or exempt from registration." *See* NASD By-Laws, Article I(dd). FINRA has construed the definition of an associated person broadly.

See Dist. Bus. Conduct Comm. v. Paramount Invs. Int'l, Inc., Complaint No. C3A940048, 1995 NASD Discip. LEXIS 248, at *12 (NASD NBCC Oct. 20, 1995).

Jahre hired Mudry in October 2005, and he began his employment with the Firm on November 1, 2005, to perform the following services: "(1) introduce and open up trading accounts . . . (2) provide Capital Introduction Services to the HedgeCap hedge fund managers . . . who are tenants . . . (3) introduce and open up Soft Dollar Brokerage Accounts; [and] (4) raise capital for hedge fund managers that are not current . . . HedgeCap clients." The Firm required that Mudry pass the Series 7 and Series 63 examinations at his "earliest convenience." HedgeCap initially paid Mudry $6,000 per month, but increased his monthly draw to $8,000 per month beginning in January 2006. HedgeCap also reimbursed Mudry for his business-related travel expenses.[14]

During the time Mudry was employed at HedgeCap, he actively sought execution business for HedgeCap's equity desk and attempted to locate hedge fund tenants to fill the Firm's office space and raise capital for hedge funds. Mudry often identified himself as a "managing partner" or "managing director" of the Firm. Mudry, however, was not registered with the Firm and delayed taking his Series 7 examination. In April 2006, after pressure from Napolitani to take the Series 7 exam, Mudry for the first time informed the Firm that he had a disciplinary history.[15] Mudry disclosed to Napolitani and Jahre that, in December 2001, he had been barred in all capacities by the New York Stock Exchange for failing to respond to written requests for information. Mudry also disclosed that: (1) pursuant to a consent judgment entered in May 2004, the New Jersey Bureau of Securities ordered that he pay $680,000 in restitution to three customers, fined him $60,000, and revoked his registration in connection with, among other things, the sale of unregistered securities and acting as an unregistered broker-dealer and employing an unregistered agent; and (2) in August 2000, the State of Maine barred him from association with any broker-dealer, investment adviser, or issuer in connection with fraudulent representations to customers. Upon learning this information, Solano promptly informed Jahre that Mudry was statutorily disqualified and that "he should not even introduce himself to a financial institution without providing a legal course of action to explain his ability to associate with one."

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[14] By the end of March 2006, HedgeCap had paid Mudry $39,000 in draws against future commissions and reimbursed him approximately $3,000 for travel expenses.

[15] Although Mudry had not been associated with a member firm since September 2000, no one at HedgeCap performed a background check on Mudry, asked him about any regulatory issues or history, or obtained his authorization to check his Central Records Depository ("CRD"®) records. Jahre argues on appeal that he "had good reason to believe that it was not necessary to perform a background check prior to hiring Mudry" based upon his "rolodex of valuable connections within the securities industry," a "great recommendation" from a prior employer, and Mudry's prior employment as "Managing Director for a very large and prestigious hedge fund." This argument is without any basis in fact or law.

Napolitani recommended that Jahre fire Mudry, and he informed Jahre that Mudry had been marketing hedge funds without a license for more than six months, had put the Firm at risk, and should have disclosed his regulatory history. Although Jahre told Napolitani he would fire Mudry, that was not Jahre's intent. Instead, Jahre stopped paying Mudry his $8,000 monthly draw and instructed Mudry to stop using his HedgeCap email address. Mudry, however, continued to work for HedgeCap in the same capacity through the end of 2006, used his personal email account to conduct Firm business, and the Firm paid Mudry $8,640 for "T&E Reimbursement" and "COBRA Reimbursement," all with Jahre's knowledge.[16]

HedgeCap filed a Form U4 for Mudry in May 2006.[17] Mudry passed his Series 7 exam in September 2006,[18] and the Firm filed a Membership Continuance Application ("MC-400") seeking approval for Mudry to associate with HedgeCap notwithstanding his statutory disqualification. The Firm withdrew the MC-400 in January 2007, and Mudry stopped working for the Firm at that time. The bar imposed by the New York Stock Exchange in December 2001 rendered Mudry statutorily disqualified. *See* NASD By-Laws, Art. III, Sec. 4(a). Notwithstanding that Mudry was statutorily disqualified and had not been approved to associate with HedgeCap despite his disqualification, Mudry associated with the Firm and actively engaged in the Firm's securities business for more than 14 months. Moreover, even after HedgeCap and Jahre discovered that Mudry was statutorily disqualified, they permitted him to continue to associate with the Firm in the same capacity until he ceased providing services to the Firm in January 2007. We conclude that respondents violated Article III, Section 3(b) of NASD's By-Laws and NASD Rule 2110.

HedgeCap and Jahre attempt to blame Solano for Mudry's employment with the Firm while statutorily disqualified and the failure to do a pre-hire background check of Mudry. Solano, however, testified that he relied upon Jahre to inform him who was working at the Firm and who might require registration. Jahre, as the Firm's president and Mudry's direct supervisor, was responsible for ensuring that the Firm did proper background checks on its proposed employees and did not employ statutorily disqualified individuals in violation of FINRA's rules (and the Firm's own written supervisory procedures). Jahre failed to do so, and he failed to ensure that the Firm took appropriate measures upon learning of Mudry's disqualification.

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16 Jahre also gave Mudry approximately $5,000.

17 As we discuss in Part III.C *infra*, we find that respondents made willfully misleading disclosures on Mudry's Form U4.

18 On appeal, respondents argue that Mudry "was constantly being pushed to take the Series 7." The record, however, shows that Mudry worked at the Firm for approximately 10 months before taking and passing the Series 7 examination, and he worked at the Firm while statutorily disqualified.

C. Misleading Forms U4

The Hearing Panel found that respondents willfully filed misleading Forms U4 in connection with Mudry's employment with the Firm, in violation of Article V, Section 2 of NASD's By-Laws, NASD Rule 2110, and NASD IM-1000-1. We affirm the Hearing Panel's findings.

Article V, Section 2 of NASD's By-Laws required that an associated person provide "reasonable information with respect to the applicant as NASD may require" and to keep his Form U4 current at all times.[19] NASD IM-1000-1 requires member firms and their associated persons to file, in connection with membership or registration as a registered representative, complete and accurate information. "The duty to provide accurate information and to amend the Form U4 to provide current information assures regulatory organizations, employers, and members of the public that they have all material, current information about the securities professional with whom they are dealing." *Richard A. Neaton*, Exchange Act Rel. No. 65598, 2011 SEC LEXIS 3719, at *17-18 (Oct. 20, 2011). Filing a misleading Form U4 violates NASD IM-1000-1 and the high standards of commercial honor and just and equitable principles of trade to which FINRA holds its members and their associated persons under NASD Rule 2110. *See Jason A. Craig*, Exchange Act Rel. No. 59137, 2008 SEC LEXIS 2844, at *8 (Dec. 22, 2008).

Mudry began working for HedgeCap in November 2005. However, Forms U4 filed for Mudry on May 18, 2006, May 25, 2006, and May 30, 2006, all stated that Mudry had been unemployed from November 1, 2005, until May 2006. The Forms U4 also represented that Mudry's start date and employment date at the Firm was May 18, 2006. This information was false, as Mudry had worked at the Firm for almost seven months while statutorily disqualified at the time the false Forms U4 were filed.

Solano sent Jahre and Mudry copies of each of the inaccurate Forms U4 to review before he filed them electronically, and Jahre signed each of the inaccurate Forms U4 manually before Solano filed them electronically. As the Firm's signatory of the Forms U4, Jahre attested that he had "taken appropriate steps to verify the accuracy and completeness of the information contained" in the forms and that he had communicated with Mudry's previous employers for the past three years and retained documentation in the Firm's files concerning these employers. Jahre took none of these steps. We conclude that respondents violated Article V, Section 2 of

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[19] "Form U4, as well as an amendment thereto, is filed electronically with CRD by a member firm on behalf of an individual. The member firm must provide a paper copy of the Form U4 to the individual for manual signature. As part of the member firm's recordkeeping requirements, the signed copy is kept on file by the member firm and must be made available upon regulatory request." *Douglas J. Toth*, Exchange Act Rel. No. 58074, 2008 SEC LEXIS 1520, at *9 n.8 (July 1, 2008), *aff'd*, 319 Fed. Appx. 184 (3d Cir. Apr. 6, 2009).

NASD's By-Laws, NASD Rule 2110, and NASD IM-1000-1 in connection with the materially misleading Forms U4 filed for Mudry.[20]

We also find that HedgeCap and Jahre willfully filed materially misleading Forms U4. In order to find a willful violation of federal securities laws we must find "that the person charged with the duty knows what he is doing." *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000). Thus, as is the case here, "[a] willfulness finding is predicated on [the] intent to commit the act that constitutes the violation–completing the Form U4 inaccurately." *Dep't of Enforcement v. Zdzieblowski*, Complaint No. C8A030062, 2005 NASD Discip. LEXIS 3, at *14 (NASD NAC May 3, 2005). We need not find that respondents intentionally violated FINRA rules. *See Wonsover*, 205 F.3d at 414 (finding that the law does not require that the willful actor "also be aware that he is violating one of the Rules or Acts").

Solano sent Jahre copies of each of the materially misleading Forms U4 for Jahre's approval before he filed them electronically under Jahre's name. Jahre returned to Solano each of the false Forms U4, which he signed manually, so that Solano could file them electronically. Jahre knew that Mudry had been employed at the Firm since November 2005 (indeed, Jahre personally hired Mudry), notwithstanding the false representations to the contrary on the Forms U4. The Hearing Panel found that Jahre's claim that he never read any of the Forms U4 was not credible, and on appeal respondents have not presented substantial evidence to disturb these credibility findings. *See Ortiz*, 2008 SEC LEXIS 2401, at *18. Moreover, even if Jahre did not review the Forms U4 before returning the signed signature pages and permitting the forms to be filed electronically using his signature, he was reckless in not doing so and discovering that the information contained in each of the Forms U4 regarding Mudry's employment history with the Firm was false. Jahre and HedgeCap (through Jahre's actions) willfully filed misleading Forms U4.[21]

HedgeCap and Jahre argue that Solano was responsible for the misleading Forms U4 and he was the individual responsible for filing the misleading forms. We reject respondents' attempt to shift blame. *See Thomas E. Warren, III*, 51 S.E.C. 1015, 1019 (1994) (rejecting applicant's attempts to shift blame to others for misconduct); *Dep't of Enforcement v. Harvest*

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[20] The false information concerning Mudry's employment was material. *See Dep't of Enforcement v. Knight*, Complaint No. C10020060, 2004 NASD Discip. LEXIS 5, at *13 (NASD NAC Apr. 27, 2004) (stating that "[b]ecause of the importance that the industry places on full and accurate disclosure of information required by the Form U4, we presume that essentially all the information that is reportable on the Form U4 is material"); *see also Dep't of Enforcement v. Toth*, Complaint No. E9A2004001901, 2007 NASD Discip. LEXIS 25, at *34-35 (NASD NAC July 27, 2007) (finding that omitted information was material because a reasonable person would have viewed the information as extremely relevant), *aff'd*, 2008 SEC LEXIS 1520, *aff'd*, 319 Fed. Appx. 184.

[21] As a result of our finding that respondents acted willfully, they are subject to statutory disqualification under Article III, Section 4 of FINRA's By-Laws and Exchange Act Section 3(a)(39)(F).

Capital Invs., LLC, Complaint No. 2005001305701, 2008 FINRA Discip. LEXIS 45, at *43 (FINRA NAC Oct. 6, 2008) (finding president of firm liable for inaccurate Forms U4 and rejecting president's attempt to shift blame to others who used his password for electronic filing).[22] Moreover, Jahre approved each of the inaccurate Forms U4 before Solano filed them electronically on his behalf.

We also reject respondents' purported reliance upon an original, handwritten Form U4 for Mudry that did not contain inaccurate information to demonstrate that they did not violate FINRA's rules. The contents of this handwritten, and unfiled, Form U4 are irrelevant. Consequently, respondents violated Article V, Section 2 of NASD's By-Laws, NASD Rule 2110, and NASD IM-1000-1.

D. HedgeCap Failed to Retain Emails and Instant Messages

The Hearing Panel found that HedgeCap failed to retain emails and instant messages, in violation of NASD Rules 3110 and 2110, Exchange Act Section 17(a)(1), and Exchange Act Rule 17a-4. For the reasons set forth below, we affirm the Hearing Panel's findings.

NASD Rule 3110(a) generally requires that member firms make and preserve records in conformance with all applicable securities laws and regulations. Exchange Act Section 17(a) requires that broker-dealers maintain certain records, and Exchange Act Rule 17a-4(b)(4) requires member firms to preserve, for at least three years, all communications sent and received by the member relating to its business, including email communications and instant messages relating to a member firm's business. *See* Exchange Act Rule 17a-4(b)(4); *Reporting Requirements for Broker or Dealers under the Securities Exchange Act of 1934*, Exchange Act Rel. No. 38245, 62 Fed. Reg. 6469, 6472 (Feb. 12, 1997); *NASD Notice to Members 03-33*, 2003 NASD LEXIS 40, at *6 (July 2003) ("Members must also ensure that their use of instant messaging complies with applicable SEC and NASD recordkeeping requirements.").

HedgeCap did not have a system to ensure that emails and instant messages were retained and backed up from May 2005 through September 2006. HedgeCap's written supervisory procedures ("WSPs") required that all emails related to the Firm's business be sent through the Firm's email system and be retained. HedgeCap employees, however, used non-HedgeCap email to conduct Firm business and thus the Firm did not retain their emails. Further, the Firm did not assign Firm email accounts to the marketers employed by, and registered with, HedgeCap, and they did not use HedgeCap's email system. Thus, the Firm could not directly

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[22] Respondents also argue that the person who provides information for a regulatory filing (i.e., Mudry) is responsible for ensuring the accuracy of that filing, and they point to numerous cases rejecting registered representatives' attempts to shift blame for inaccurate Forms U4 to others at their firms. These cases, however, are inapposite. Jahre's actions, not Mudry's, are at issue in this case. The record shows that false and misleading Forms U4 were filed under Jahre's electronic signature, Jahre reviewed all such filings before they were filed, and Jahre had personal knowledge that Mudry had been employed at the Firm since November 2005 and thus knew the information contained in the Forms U4 was false.

access the marketers' emails, and the Firm did not preserve these emails in its records. HedgeCap also failed to maintain an archive server. Only those emails kept or saved by individuals at the Firm were preserved, and emails that were deleted were not saved.

Likewise, although the Firm's WSPs stated that the Firm adopted an instant messaging system and had filters in place blocking connections to instant messaging services, it did not do so. Some of the Firm's associated persons used outside instant messaging services for business purposes, and those messages were not systematically retained. Consequently, we find that HedgeCap violated NASD Rules 3110 and 2110, Exchange Act Section 17(a), and Exchange Act Rule 17a-4.

E. Supervisory Violations

The Hearing Panel found that respondents failed to establish and maintain an adequate supervisory system, in violation of NASD Rules 3010(a) and 2110, and failed to establish, maintain, and enforce written supervisory procedures, in violation of NASD Rules 3010(b) and 2110. Specifically, the Hearing Panel found that respondents failed to maintain an adequate supervisory system with regard to email and instant messaging retention and registering representatives and did not enforce the Firm's WSPs. The Hearing Panel also found that HedgeCap violated NASD Rule 3010(a)(7) by failing to hold an annual compliance meeting. We affirm these findings.

NASD Rule 3010(a) requires member firms to "establish and maintain a supervisory system . . . that is reasonably designed to achieve compliance with the applicable securities laws, rules and regulations, and with applicable NASD rules." NASD Rule 3010(b) requires that member firms "establish, maintain, and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of registered representatives and associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable rules of NASD."

NASD Rule 3010(a)(7) requires that a member firm's supervisory system provide for an annual meeting or interview with each registered representative to discuss compliance matters. "This means, at a minimum, that the representatives that attend the compliance conference must be able to . . . in an interactive environment, ask questions and engage in dialogue with the presenters." *NASD Notice to Members 98-18*, 1998 NASD LEXIS 20, at *2-3 (Feb. 1998); *NASD Notice to Members 99-45*, 1999 NASD LEXIS 20 (June 1999) (although member firms have substantial flexibility in implementing annual compliance meetings, each representative must be given an opportunity to discuss compliance matters and ask questions).

We find that respondents violated NASD Rules 3010(a), 3010(b), and 2110. First, although the Firm's WSPs contained provisions governing the retention of emails and instant messages (and even specified a specific system that the Firm purportedly used to retain such information), the Firm did not have any such retention system from May 2005 until at least September 2006, and no one performed a semi-annual review of the Firm's archiving process as required by its WSPs. Indeed, Jahre had prior knowledge that securities rules and regulations required the Firm to have a retention system for emails and instant messages. Second, respondents permitted hedge fund marketers (including Mudry) to engage in activities requiring

registration when they were not properly registered, in violation of FINRA rules and the Firm's WSPs. The Firm's supervisory system was inadequate to prevent and detect such violations. Third, HedgeCap failed to conduct an annual compliance meeting in 2005. To save money, Solano instead distributed a power point presentation for Firm employees to review.

As HedgeCap's president, Jahre had responsibility for the Firm's operations unless and until he reasonably delegated his duties to someone else and had no reason to know that the assigned person was not properly performing the delegated functions. *See Robert J. Prager*, Exchange Act Rel. No. 51974, 2005 SEC LEXIS 1558, at *43 n.45 (July 6, 2005) (holding that firm's president had final responsibility for the firm's operations unless and until he reasonably delegated the duties to someone else). With several minor exceptions, there is no evidence in the record that Jahre ever delegated any supervisory authority to Solano or Napolitani.[23] Jahre testified that he generally did not delegate any responsibilities in writing because: "I don't write things down in a little notebook like I'm in kindergarten. I mean I'm running a business. . . . If I had to write everything down on the WSPs, I could never make any money."

Moreover, even assuming that we credit Jahre's argument that he delegated supervisory authority and responsibility to someone else (which we do not), Jahre could not rely upon such delegated supervisors without any additional follow-up. *See Ronald Pellegrino*, Exchange Act Rel. No. 59125, 2008 SEC LEXIS 2843, at *47 (Dec. 19, 2008) ("[I]t is not sufficient for the person with overarching supervisory responsibilities to delegate supervisory responsibility to a subordinate, even a capable one, and then simply wash his hands of the matter until a problem is brought to his attention. . . . Implicit is the additional duty to follow-up and review that delegated authority to ensure that it is being properly exercised." (internal quotation and citation omitted)). First, Napolitani was not licensed as a principal and had little, if any, supervisory experience prior to joining HedgeCap. Under these circumstances any purported delegation of supervisory authority to Napolitani would have been unreasonable. *See Dep't of Enforcement v. VMR Capital Mkts. US*, Complaint No. C02020055, 2004 NASD Discip. LEXIS 18, at *25 (NASD NAC Dec. 2, 2004) (holding that general securities representative's lack of registration as a principal made any delegation of supervisory authority to him unreasonable).

Second, with respect to any purported delegation to Solano, who as the Firm's part-time chief compliance officer visited the Firm infrequently, Jahre's subsequent review and assessment of the supervisory regime at the Firm was particularly important.[24] Routine and rigorous follow-up was warranted given Jahre's knowledge that the Firm "was in a stage of great transition." *See Richard F. Kresge*, Exchange Act Rel. No. 55988, 2007 SEC LEXIS 1407, at *30 (June 29, 2007) ("We have often stressed the obvious need to keep [a] new office with . . . untried personnel under close surveillance."). Jahre, however, failed to adequately ensure that any purported delegated supervisory authority was being properly executed. HedgeCap and Jahre

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[23] HedgeCap's WSPs delegated responsibility for the annual compliance meeting to the Firm's chief compliance officer.

[24] Solano testified that he was aware of problems at the Firm only if Jahre brought an issue to his attention.

failed to establish and maintain an adequate supervisory system and procedures, in violation of NASD Rules 3010 and 2110. *See Quest Capital Strategies, Inc.*, Initial Decisions Rel. No. 141, 1999 SEC LEXIS 727, at *54 (Apr. 12, 1999) (holding that failures of firm's owner and president to reasonably supervise are imputed to his firm).[25]

F. Respondents Permitted a Hedge Fund Customer to Pay Rent to the Firm with Soft Dollars

The Hearing Panel found that respondents improperly allowed a hedge fund tenant to pay its rent to HedgeCap with soft dollars, in violation of NASD Rule 2110's requirement that firms and registered representatives observe high standards of commercial honor and just and equitable principles of trade in conducting their business. For the reasons set forth below, we affirm the Hearing Panel's findings.

Investment advisers have fiduciary obligations to their customers that prohibit them from using customer assets to benefit themselves without first obtaining a customer's consent. *See SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1963); *SEC OCIE Inspection Report on Soft Dollar Practices of Broker-Dealers, Inv. Advisers and Mutual Funds*, at 3, 7 (SEC Sept. 22, 1998), *available at* http://www.sec.gov/news/studies/softdolr.htm (hereinafter, "SEC Sweep Report"). Investment advisers control "soft dollars," which are products and services (other than the execution of securities transactions) that an investment adviser receives from or through a broker-dealer in exchange for the adviser's direction of customer brokerage transactions to the broker-dealer. *See* SEC Sweep Report, at 6. Soft dollars are customer assets, and investment advisers generally may not use soft dollars unless they disclose fully to their customers the specific expense for which they intend to use them. *See Republic New York Sec. Corp.*, 53 S.E.C. 1283, 1284 (1999). An investment adviser's failure to disclose the specific expense for which it intends to use soft dollars, and subsequent use of such soft dollars, constitutes misappropriation of customer assets.[26] *See Republic New York*, 53 S.E.C. at 1285.

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[25] Respondents suggest that their supervisory and other problems resulted from the fact that FINRA commenced "an extremely long and business-impeding investigation." We reject respondents' attempt to blame FINRA for their supervisory failures and other misconduct. *Dep't of Enforcement v. Am. First Assoc. Corp.*, Complaint No. E1020040926-01, 2008 FINRA Discip. LEXIS 27, at *17 (FINRA NAC Aug. 15, 2008) (holding that respondent could not shift responsibility for complying with regulatory rules and requirements to FINRA).

[26] Exchange Act Section 28(e) provides that a person who exercises investment discretion with respect to an account shall not be deemed to have acted unlawfully or to have breached a fiduciary duty solely by reason of causing the account to pay more than the lowest available commission if he determines that the amount of the commission is reasonable compared to the brokerage and research services provided. Office rent, however, does not constitute brokerage or research services. *See SEC Interpretative Release Concerning the Scope of Section 28(e)*, Exchange Act Rel. No. 23170, 1986 SEC LEXIS 1689, at *12 n.10 (Apr. 23, 1986).

Because broker-dealers execute the trades that generate soft dollar commissions, the Commission has put them on notice that they may be liable for an adviser's misconduct relating to soft dollars. *Id.* at 1293; SEC Sweep Report, at 12-13. Moreover, NASD Rule 2110 provides that "[a] member, in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade." "FINRA's disciplinary authority under NASD Rule 2110 is also broad enough to encompass business-related conduct that is inconsistent with just and equitable principles of trade, even if that activity does not involve a security." *John M.E. Saad*, Exchange Act Rel. No. 62178, 2010 SEC LEXIS 1761, at *13 (May 26, 2010) (internal quotations omitted), *appeal pending*, No. 10-1195 (D.C. Cir. July 22, 2010). In the absence of the violation of another securities law or rule, conduct may violate NASD Rule 2110 if it is unethical or committed in bad faith. *See Kirlin Securities, Inc.*, Exchange Act Rel. No. 61135, 2009 SEC LEXIS 4168, at *65 (Dec. 10, 2009).

Jahre was responsible for supervising the Firm's soft dollar activities, never delegated such responsibility, and was responsible for reviewing the relevant documents of the Firm's hedge fund clients to ensure that the Firm complied with soft dollar rules. Jahre and Napolitani reviewed offering documents of prospective hedge fund tenants to determine whether they disclosed that the hedge fund tenants could pay expenses such as office rent with soft dollars. Jahre, however, was the only individual at the Firm with authority to approve soft dollar arrangements.[27]

In 2005, Jahre negotiated with a prospective hedge fund tenant (the "Hedge Fund Tenant"). Jahre ultimately agreed with the Hedge Fund Tenant that beginning in October 2005, it would direct at least $2,200 per month in trading commissions to HedgeCap to cover rent.[28] From October 1, 2005 until September 30, 2006, the Hedge Fund Tenant paid its rent to HedgeCap by directing to the Firm at least $2,200 per month in trading commissions. However, the Hedge Fund Tenant's offering memorandum dated February 2004 did not disclose that its investment adviser would pay expenses such as office rent with soft dollars. Indeed, a section of the offering memorandum entitled, "Management and Partnership Expenses," stated that the Hedge Fund Tenant's adviser "will bear [its] own expenses incurred in connection with its duties in managing the Fund, including payment for . . . office space for officers and employees of the General Partner and its affiliates." Thus, the Hedge Fund Tenant's offering memorandum expressly provided that the fund's investment adviser, and not the Hedge Fund Tenant, would pay for office rent. Respondents had a copy of the Hedge Fund Tenant's offering memorandum at the outset of the Hedge Fund Tenant's payment of rent to HedgeCap with soft dollars.

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[27] Jahre claimed, without any documentary evidence, that he delegated responsibility for soft dollar compliance to Napolitani. Napolitani denied Jahre's claim. The Hearing Panel found that Jahre's allegation that he delegated responsibility to Napolitani was not credible. Respondents have not presented substantial evidence to overturn the Hearing Panel's credibility determination, and we decline to disturb this credibility finding. *See Ortiz*, 2008 SEC LEXIS 2401, at *18. Further, Jahre admittedly did not delegate oversight of HedgeCap's soft dollar practices to Solano, the Firm's chief compliance officer.

[28] The Hedge Fund Tenant also agreed to pay the Firm a monthly "license fee" of $375.

Jahre knew that the Firm could not accept from the Hedge Fund Tenant soft dollars for rent unless this practice was disclosed in the Hedge Fund Tenant's offering documents. Despite this knowledge and the language of the Hedge Fund Tenant's offering memorandum, Jahre personally negotiated and agreed to the Hedge Fund Tenant's payment of rent to HedgeCap in soft dollars. By knowingly arranging for the Hedge Fund Tenant to pay its rent to HedgeCap with soft dollars and accepting such soft dollars, in violation of the Hedge Fund Tenant's offering memorandum and the fiduciary obligations of its investment adviser, HedgeCap and Jahre acted unethically. Such unethical misconduct violates NASD Rule 2110's requirement that member firms and associated persons observe high standards of commercial honor and just and equitable principles of trade. *See Dep't of Enforcement v. Shvarts*, Complaint No. CAF980029, 2000 NASD Discip. LEXIS 6, at *11 (NASD NAC June 2, 2000) ("Disciplinary hearings under Conduct Rule 2110 are ethical proceedings, and one may find a violation of the ethical requirements where no legally cognizable wrong occurred.").

Respondents argue that the Hedge Fund Tenant's offering memorandum did not forbid the use of soft dollars for rent. Respondents point to language in its offering memorandum in a section entitled, "Trading and Clearing Arrangements," which provided that "[t]he General Partner may in its sole discretion make other arrangements for trade execution, clearance and settlement and custody of assets." This general provision, however, does not support respondents' argument and makes no reference to paying rent with soft dollars, whereas the offering memorandum specifically provides that the Hedge Fund Tenant's investment adviser would pay for office rent. *Cf. Paneccasio v. Unisource Worldwide, Inc.*, 532 F.3d 101, 111 (2d Cir. 2008) (stating that "specific language in a contract will prevail over general language where there is an inconsistency between two provisions").

Respondents also argue that Enforcement failed to demonstrate that they aided and abetted the violation of any rule in connection with HedgeCap's receipt of rent in soft dollars. The complaint, however, did not allege that HedgeCap and Jahre aided and abetted any violation of securities laws but instead alleged that respondents failed to observe "high standards of commercial honor and just and equitable principles of trade," in violation of NASD Rule 2110. Enforcement was not required to demonstrate that respondents aided and abetted any violation of FINRA or Commission rules and regulations. *See Eliezer Gurfel*, 54 S.E.C. 56, 63 (1999) ("Proof of scienter is not required to establish a violation of NASD Conduct Rule 2110."), *aff'd*, 205 F.3d 400 (D.C. Cir. 2000); *see also Dep't of Enforcement v. Conway*, Complaint No. E102003025201, 2010 FINRA Discip. LEXIS 27, at *29 (FINRA NAC Oct. 26, 2010) ("NASD Rule 2110 reaches beyond legal requirements and, among other things, depends upon general rules of fair dealing, the reasonable expectations of parties, and marketplace practices."), *appeal docketed*, SEC Admin. Proceeding No. 3-14146 (Nov. 24, 2010); *Dep't of Enforcement v. Puma*, Complaint No. C10000122, 2003 NASD Discip. LEXIS 22, at *12 (NASD NAC Aug. 11, 2003) ("We reject Puma's argument on appeal that he is not liable for the unauthorized transaction because Enforcement failed to prove that he acted fraudulently. The complaint did not charge Puma with fraud. Nor is proof of fraud an element of an unauthorized transaction allegation under NASD Conduct Rule 2110."). Rather, Enforcement was required to show that respondents acted unethically or in bad faith, in violation of NASD Rule 2110. *See Kirlin Securities*, 2009 SEC LEXIS 4168, at *65. As set forth above, we find that respondents acted unethically in connection with its soft dollar arrangements with the Hedge Fund Tenant.

Further, respondents argue that the fact that the rental payments were outside of the safe harbor provisions of Exchange Act Section 28(e) is insufficient to demonstrate they violated FINRA's rules. We agree that the inapplicability of the safe harbor provisions does not by itself demonstrate a violation of another rule or regulation. Respondents, however, violated NASD Rule 2110 by negotiating and agreeing to an arrangement whereby the Hedge Fund Tenant's investment adviser paid rent to HedgeCap in soft dollars instead of paying for rent with its own funds, in direct conflict with the Hedge Fund Tenant's offering memorandum and its investment adviser's fiduciary obligations. Such conduct did not comport with NASD Rule 2110's high standards of commercial honor and just and equitable principles of trade.

Finally, respondents argue that the Hedge Fund Tenant's investment adviser did not pay to HedgeCap trading commissions that were excessive, but instead HedgeCap matched the trading commissions the Hedge Fund Tenant was paying to other broker-dealers (and, in some instances, charged less to the Hedge Fund Tenant for its trades). Respondents thus assert that the Hedge Fund Tenant's investment adviser did not breach its fiduciary duties to the Hedge Fund Tenant and respondents therefore did not violate NASD Rule 2110. We reject respondents' arguments. The record does not demonstrate the level of commissions paid by the Hedge Fund Tenant to HedgeCap.[29] Regardless, the Commission has stated that "the adviser may not use its client's assets for its own benefit without prior consent, even if it costs the client nothing extra." SEC Sweep Report, at 7; *Kingsley, Jennison, McNulty & Morse Inc.*, 51 S.E.C. 904, 907-08 (1993) (holding that adviser breached its fiduciary duties even though its client paid the same rate of commission because adviser would have used its own money instead of its client's assets in the form of soft dollars). For all of these reasons, we find that respondents violated NASD Rule 2110 in connection with HedgeCap's receipt of soft dollars.

G. NASD Rule 8210 Violations

The Hearing Panel found that HedgeCap and Jahre made false statements to FINRA in response to numerous requests for information and during an investigative interview, in violation of NASD Rules 8210 and 2110. We affirm these findings.

NASD Rule 8210 requires persons subject to FINRA's jurisdiction to provide information requested by FINRA orally or in writing in response to requests for information. Because FINRA lacks subpoena power, it must rely upon NASD Rule 8210 "to police the activities of its members and associated persons." *Joseph Patrick Hannan*, 53 S.E.C. 854, 858-59 (1998). "[C]ompliance with Rule 8210 [is] essential to enable NASD to execute its self-regulatory functions." *PAZ Sec., Inc.*, Exchange Act Rel. No. 57656, 2008 SEC LEXIS 820, at *12 (Apr. 11, 2008), *aff'd*, 566 F.3d 1172 (D.C. Cir. 2009). An associated person is prohibited from providing false or misleading information to FINRA in response to an NASD Rule 8210 request for information or testimony. *See Ortiz*, 2007 FINRA Discip. LEXIS 3, at *32. "Providing false and misleading information [to] FINRA subverts FINRA's ability to carry out

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[29] *See also infra* Part IV.A (discussing respondents' motion to adduce additional evidence, including affidavit allegedly describing commissions paid by the Hedge Fund Tenant).

its regulatory functions" and is also conduct inconsistent with just and equitable principles of trade under NASD Rule 2110. *Id.* at 33.

Beginning in January 2006, FINRA sent HedgeCap numerous written requests for information. Jahre directly made, was involved in the preparation of, or approved all of the Firm's responses to FINRA's requests. Indeed, Jahre testified that he reviewed all of the Firm's responses before they were sent to FINRA and that a response could not be sent without his prior approval. As set forth below, respondents repeatedly provided false information to FINRA in connection with five issues.

1. False Responses Regarding Soft Dollar Arrangements

In January 2006, FINRA requested information regarding, among other things, "a detailed description of all services, including but not limited to office space . . . provided to any hedge funds that maintain an account at your firm." The Firm responded that "[t]he sole services HedgeCap provides to the hedge funds maintained at the firm is the use of office space in return for hard dollars." In August 2006, the Firm responded to another request for information and stated that it did not receive from hedge funds or hedge fund managers any compensation for office rent, and later informed FINRA that rent "was waived" for several hedge funds (including the Hedge Fund Tenant). The Firm further stated that:

> As an aside, the funds chose to trade with Hedgecap because of, but not limited to: their expectations of HedgeCap's trader(s), it's [sic] front-end trading technology, and its execution capabilities and/or pricing. Moreover, all costs, expenses, charges, etc. for the office space provided was [sic] assumed by Hedgecap's clearing firm . . .

FINRA staff, after reviewing the Firm's initial document production, determined that the Firm may have had existing soft dollar arrangements with hedge funds related to office rent. Consequently, in November 2006, FINRA asked the Firm to "[i]dentify the name of each hedge fund manager that HedgeCap provided office space to between January 1, 2006 and September 20, 2006" and to provide a description of the terms of the arrangement. Respondents failed to acknowledge the soft dollar arrangement with the Hedge Fund Tenant and instead informed FINRA that "[t]he only soft-dollar hedge fund entity that [the Firm] had during the Review Period was [Fund X]." The Firm further stated that the Hedge Fund Tenant had paid monthly rent of $375 for office space.

In March 2007, FINRA conducted an on-the-record interview of Jahre. Jahre testified that the Firm rented office space at market rates payable in hard dollars. FINRA staff asked Jahre about the Firm's written responses that it did not accept soft dollars for rent, and Jahre reiterated that HedgeCap's tenants paid rent only in hard dollars and that there was "no expectation of a soft dollar trade" and no expectation that its tenants would trade through the Firm as part of their agreement for office space. Jahre further stated that there were no trading minimums with any tenant and, when asked whether there was "any expectation of a soft dollar trade that would be generated through" the Firm, he responded "[n]ot at all." These responses, at least with respect to the Hedge Fund Tenant, were false.

Based on the Firm's written responses, Jahre's testimony, and the contrary information in FINRA's possession, FINRA sent respondents another request for information and asked that they certify the documents and information provided to FINRA were complete and accurate. In July 2007, respondents finally acknowledged that HedgeCap had soft dollar arrangements with the Hedge Fund Tenant and two other funds. At another on-the-record interview conducted in October 2007, Jahre conceded that several hedge funds did in fact pay for a portion or all of their rent with commissions, that the prior response was just "a mistake," and that Jahre "was under the impression that everybody was only paying hard dollars and then I was reminded after the testimony that that wasn't true." We find that respondents' responses to FINRA's requests for information and Jahre's March 2007 on-the-record testimony were false and misleading in violation of NASD Rules 8210 and 2110.

Respondents continue to argue that they did not believe they had negotiated any soft dollar arrangements because HedgeCap did not charge any hedge funds excessive commissions. For the reasons stated above, we reject respondents' contention. *See supra*, Part III.F. Moreover, respondents' assertion is undercut by their own emails to the Hedge Fund Tenant, in which they expressly refer to soft dollars while negotiating the agreement with the Hedge Fund Tenant. Respondents also admitted that their initial responses regarding soft dollars were not accurate in their July 2007 response to FINRA's request for information and Jahre's October 2007 on-the-record testimony.

Respondents also argue that FINRA's initial question asked "whether hedge funds occupying HedgeCap's office space paid a higher per share commission rate to account for . . . the office space and associated services provided by HedgeCap" and that the question asked only about hedge funds that maintained accounts at the Firm. Regardless of the information sought in this specific request, numerous subsequent requests from FINRA were not limited to hedge funds maintaining accounts at the Firm, and did not refer to the rate of commissions paid by any hedge fund. For example, the August 2006 request asked the Firm to "list all hard dollar payments received by HedgeCap from hedge funds or hedge fund managers during the Review Period, including but not limited to office space and capital introduction." And during Jahre's investigative interview, in response to FINRA's questions Jahre falsely testified that there was no expectation that the Firm's tenants would trade through the Firm as part of their agreements for office rent. Respondents repeatedly evaded answering FINRA's questions and consistently failed to inform FINRA of the Firm's soft dollar arrangement with the Hedge Fund Tenant, in violation of NASD Rules 8210 and 2110.

2. <u>False Responses Regarding Emails</u>

In August 2006, FINRA requested all emails and instant messages sent or received by Steven Fletcher ("Fletcher") (an employee of one of the outside marketers hired by HedgeCap) and others between January 2004 and December 2005. On August 31, 2006, HedgeCap sent FINRA a disk containing, among other things, Fletcher's emails. The Firm stated that "all electronic communications sent or received [by Fletcher and others] have been compiled" and were included on the disk. This response was false. Indeed, just three days before respondents provided this information to FINRA, Napolitani wrote Jahre an email stating that "obtaining [Fletcher's] emails from 2005 is going to be a problem." Napolitani also forwarded Jahre emails

stating that Fletcher's emails were not archived, "once an email is deleted it is gone," and that Fletcher "had a worm in his computer" that caused him to lose "a lot of data."

In June 2007, FINRA sent the Firm another request for information asking "whether all emails for the HedgeCap registered representatives associated with [the third-party marketers] were retained during the relevant period." The request further asked the Firm to describe each email retention failure. The Firm responded that "HedgeCap believes all emails for [the third-party marketers] have been retained." Jahre executed a declaration certifying that this response was complete and accurate. Respondents never informed FINRA that their production of Fletcher's emails was incomplete, and their responses to FINRA regarding Fletcher's emails were misleading and violated NASD Rules 8210 and 2110.

Respondents suggest that their inaccurate responses should be excused because they produced "at least hundreds of emails from Fletcher" in response to FINRA's requests. Respondents' production of certain emails, however, does not excuse their misstatements to FINRA that *all* of Fletcher's emails had been produced. Respondents also argue that they eventually produced all of Fletcher's emails with the help of the third-party marketers, and that Fletcher testified that his emails were retained.[30] The record, however, demonstrates that when respondents represented to FINRA that all of Fletcher's emails had been produced they knew that this was untrue. In addition, respondents' assertion that they eventually produced all of Fletcher's emails, even if true, does not excuse their false response to FINRA. Respondents violated NASD Rules 8210 and 2110.

3. False Responses Regarding Email Retention

In November 2006, FINRA asked HedgeCap to "describe all policies and procedures relating to the retention and archiving of e-mails." In December 2006, HedgeCap responded that:

> [The Firm] has utilized the service of an outside vendor, Information Technology Builders, for all IT solutions, including the implementation of a full document retention and storage system. IT Builders is utilizing the services of my [sic] BackUpMyInfo, Inc. . . . to effectuate the system.

This response was false. At the time of the Firm's response, the Firm did not have a system in place to retain emails and instant messages. Indeed, Jahre knew that the Firm lacked such a system, and in July 2007 the Firm admitted that its prior response regarding email and instant message retention was inaccurate, stating that it:

> [N]ever engaged BackUpMyInfo, Inc. to back-up HedgeCap's email. At the time of [the Firm's] December 15, 2006 letter response to the NASD, HedgeCap's IT Service Provider had recommended that HedgeCap use BackUpMyInfo, Inc. as an

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30 On appeal, respondents seek to adduce Fletcher's entire on-the-record interview transcript. We discuss this in Part IV.B *infra*.

> outsourced backup solution and at the time of HedgeCap's December 15th response that was HedgeCap's intention. Shortly thereafter, HedgeCap received a second opinion on that outsourced solution and ultimately determined that the cost associated with BackUpMyInfo, Inc. was much more costly than purchasing a tape backup system . . . . The tape backup system was implemented by HedgeCap in early January 2007. . . . [O]n July 17, 2007, HedgeCap engaged Smarsh, Inc. to retain the firm's emails and instant messages.

Notwithstanding respondents' prior statements and admissions, they now argue that Napolitani and John Paolantonio ("Paolantonio") (an information technology consultant who worked on HedgeCap's email and instant messaging retention systems) testified that in December 2006, the Firm's response regarding its retention and archiving of emails was accurate. We find that their testimony does not support respondents' argument. Paolantonio testified that the Firm did not have an archiving system in place until mid-2007, and that emails were backed up and overwritten every 10 days and that until the archiving system was in place deleted emails could only be retrieved by an administrator for 30 days, after which point they could not be recovered.[31] Napolitani testified that IT Builders provided some of the information for the Firm's December 2006 responses, and testified that sometime in 2007 the Firm engaged Smarsh, Inc. to set up an email and instant message retention system. Even if a third party provided certain information to respondents, respondents were ultimately responsible for the content and accuracy of the responses to FINRA's requests. Indeed, Jahre reviewed each response personally. Finally, we reject Jahre's argument that his limited knowledge of technology caused the false responses. Jahre's alleged lack of technological knowledge is irrelevant and does not excuse the false responses to FINRA regarding the Firm's email and instant messaging retention systems.[32]

4. <u>False Responses Regarding Hedge Fund Marketing</u>

In January 2006, FINRA issued HedgeCap a request for information that asked the Firm to "indicate if the firm sells or offers interests in" each hedge fund that maintained an account at the Firm in 2004 and 2005, the "total dollar amount placed or sold for each fund," and copies of all "[s]ales, marketing, and advertising materials" for each hedge fund. HedgeCap and Jahre

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[31] Paolontonio explained the difference between backing up electronic communications and archiving them. "The backing up basically just means that you're taking a snapshot of the data every single night and putting it on a tape, and then it's there. In case something goes wrong you can bring it back. That tape is good obviously for 10 days or until it gets overwritten again. Archiving is when you set up your system to actually journal and send every inbound and outbound email to an off-site third-party source that they store these e-mails and they cannot be touched."

[32] We also reject Jahre's attempt to blame Napolitani for the misrepresentations regarding the Firm's email and instant messaging retention. *See Warren*, 51 S.E.C. at 1019 (rejecting applicant's attempts to shift blame to others for misconduct). Jahre testified that he reviewed the Firm's responses to FINRA's Rule 8210 requests before they were sent.

stipulated that they subsequently identified five hedge funds (including the Hedge Fund Tenant) that maintained accounts at the Firm during the relevant time period, and they further stipulated that the Firm stated to FINRA in writing that it did not perform any capital introduction services on behalf of these funds. This information was false.

Respondents now argue that they provided truthful answers because, at the time of FINRA's request, the Firm did not have accounts with the funds at issue. Respondents' argument is without factual support in the record, and it is contrary to the stipulations they entered into concerning these responses. We do not find that compelling circumstances exist to disregard the parties' stipulations in this case. *See Abbondante*, 2006 SEC LEXIS 23, at *10 n.12 (holding that stipulated facts will be honored unless compelling circumstances exist). Respondents violated NASD Rules 8210 and 2110.

5. False Responses Regarding Approval of Sales Materials

In August 2006, FINRA sent HedgeCap a request for information seeking details regarding the Firm's "process for reviewing and/or approving hedge fund sales materials used by its employees in providing capital introduction services" and asked respondents to identify the individuals responsible for review and approval and how they evidenced such review and approval. Respondents stated in writing that the Firm reviewed and approved materials used by its employees, and that Michael Leverone ("Leverone") and Fletcher (both independent contractors registered with the Firm) performed such reviews and "evidenced their approval with their signatures." This information was false, and respondents stipulated that neither Leverone nor Fletcher approved or evidenced their approval of HedgeCap's sales materials. Indeed, the Firm's WSPs did not authorize either Leverone or Fletcher to approve hedge fund sales materials on behalf of the Firm.

Respondents now argue that although the Firm's WSPs did not authorize Leverone or Fletcher to review and approve hedge fund marketing materials, FINRA asked about the Firm's process for reviewing such materials (and thus its answer was correct). Regardless of whether the Firm's actual process was consistent with its WSPs, respondents stipulated that neither Leverone nor Fletcher approved sales materials. *See id.* Respondents' response to the contrary was false and inaccurate.

Finally, HedgeCap and Jahre argue generally with respect to all of the requests for information that the "vast majority" of their responses to FINRA's Rule 8210 requests were not misleading, and that FINRA's requests were "a fishing expedition which, unsurprisingly, resulted in HedgeCap providing a mere five responses which the Hearing Panel found to be inaccurate." We firmly reject respondents' suggestion that their accurate responses to most of FINRA's requests somehow excuse inaccurate responses to the remainder of FINRA's requests. Respondents' repeated misleading and inaccurate responses required that FINRA staff issue numerous requests for information and conduct several investigative interviews over a lengthy period of time. For all of these reasons, we find that HedgeCap and Jahre violated NASD Rules 8210 and 2110 by responding falsely to numerous requests for information and questions during Jahre's on-the-record interview.

IV. Respondents' Motion to Adduce Evidence

On appeal, HedgeCap and Jahre filed a motion to adduce additional evidence, which requests that we admit into the record numerous additional documents. For the reasons set forth below, we deny respondents' motion.

Pursuant to FINRA Rule 9346(b), a party seeking to introduce additional evidence on appeal must demonstrate that: (1) the evidence is material; and (2) there was good cause for failing to introduce the evidence below. Admitting evidence pursuant to Rule 9346 is reserved for extraordinary circumstances. *See* Rule 9346(a); *Dep't of Mkt. Regulation v. Jerry William Burch*, Complaint No. 2005000324301, 2011 FINRA Discip. LEXIS 16, at *21-22 (FINRA NAC July 28, 2011) (rejecting respondent's motion to adduce additional evidence and finding that he failed to demonstrate that extraordinary circumstances existed).

A. Affidavit from the Hedge Fund Tenant and Schedule of Commission Rates

HedgeCap and Jahre seek to introduce an affidavit from the Hedge Fund Tenant's principal, along with a schedule of commission rates that the Hedge Fund Tenant paid to its former broker, to demonstrate that it paid lower commissions to HedgeCap than to its former firm. They argue that this proposed evidence is material because it shows that respondents reduced the trading commissions that the Hedge Fund Tenant paid and, according to respondents, that the Hedge Fund Tenant's payment of rent in soft dollars did not disadvantage the investment adviser's customer. We reject respondents' argument. First, the amount of commission paid by the Hedge Fund Tenant is irrelevant. *See supra*, Part III.F. Second, HedgeCap and Jahre have not demonstrated that good cause exists for their failure to introduce such evidence below. Indeed, respondents (who were represented by counsel before the Hearing Panel) raised the issue of the trading commission rates in their pre-hearing brief before the Hearing Panel but did not seek to introduce any supporting evidence at the hearing. *See FCS Sec.*, Exchange Act Rel. No. 64852, 2011 SEC LEXIS 2366, at *32 (July 11, 2011) ("Applicants should have foreseen that these transactions would be a subject of scrutiny at the hearing, and they should have introduced evidence that would have supported their assertions about the transactions, including whatever background information was necessary to understand the transactions."). Accordingly, we decline to admit these documents into evidence.

B. Fletcher's Investigative Testimony

Respondents seek to introduce the transcript of Fletcher's investigative testimony, in which he allegedly testified that he had an email system that retained all emails on a tape backup system. Respondents argue that this testimony contradicts the Hearing Panel's finding that they falsely informed FINRA that they had produced all of Fletcher's emails. Respondents also argue that although Fletcher was listed as one of their witnesses, "the Hearing Panel decided at the very last minute of the hearing that Mr. Fletcher's testimony was not necessary in light of the Stipulations dated March 22, 2010" and that Fletcher was not permitted to testify.

We decline to admit the transcript of Fletcher's investigative testimony. This proposed evidence, even if respondents' characterization of it is accurate, does not absolve respondents' false statement to FINRA that they produced all of Fletcher's emails. Whether Fletcher retained

his emails has no bearing on respondents' false statement, and the proposed evidence is therefore not material to the issues before us. In addition, respondents' characterization of the Hearing Panel's refusal to let Fletcher testify is inaccurate, and they have not demonstrated good cause for failing to introduce the evidence below. *See id.* We thus deny respondents' request to admit Fletcher's testimony into evidence.

C. Leverone's Investigative Testimony

Respondents seek to introduce into evidence Leverone's investigative testimony transcript. Respondents argue generally that Leverone "gave testimony relating to nearly every cause of action alleged" in the complaint, and they list myriad issues that he purportedly testified about during his investigative interview. Respondents argue that while they listed him as an anticipated witness, and he reassured them he would testify, he ultimately decided not to testify at the hearing.

We reject respondents' request to admit Leverone's testimony into evidence. Respondents' broad and unsubstantiated assertions concerning the importance of Leverone's testimony do not satisfy the materiality requirement contained in Rule 9346. Further, although Enforcement had portions of Leverone's transcript as a proposed exhibit (it was not admitted at the hearing), respondents did not seek to introduce the investigative transcript before the Hearing Panel (even after learning that he would not appear as a witness) and have not demonstrated good cause for failing to do so. Respondents also did not seek to compel Leverone to appear at the hearing pursuant to Rule 9252.[33] We thus find that extraordinary circumstances do not exist to admit this proposed evidence into the record.

D. Affidavit of EB

Respondents seek to introduce an affidavit of EB, a former director of one of HedgeCap's customers that invested in the CMO arbitrage strategy promoted by respondents through exaggerated, misleading, and unbalanced institutional sales materials. Respondents assert that the affidavit will show that EB and a team of officers at the hedge fund performed extensive due diligence on the investment and they concluded that risk to principal was de minimis and that the investment should have theoretically performed as respondents claimed in the sales materials. Respondents thus assert that they had a reasonable basis for making the performance claims that they did in the sales materials. They also argue that the affidavit will clarify that the loss suffered by the hedge fund, referenced in the Hearing Panel decision, was not directly correlated to the investment strategy itself. Respondents argue that good cause exists because they could not have anticipated that the Hearing Panel would have rejected as not credible Jahre's testimony concerning the investment strategy.

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[33] Rule 9252 provides that a respondent may request that FINRA invoke Rule 8210 to compel the testimony of a person subject to FINRA's jurisdiction. *See* Rules 9252(a) & (b).

We decline to admit this proposed evidence. EB's opinions regarding the investment strategy are not material to whether respondents' communications violated FINRA's advertising rules in that the communications made performance projections, made exaggerated, unwarranted, and misleading claims, were not fair and balanced, and failed to provide a sound basis for evaluating the investment. Likewise, respondents could have sought to either introduce this affidavit or have EB testify at the hearing, but chose not do so. Indeed, during the hearing while Jahre was testifying, he learned that Enforcement would be contacting EB during a break, which caused Jahre to later testify that the fund may have lost $20 million on this investment. Respondents have not demonstrated that this affidavit should be admitted pursuant to Rule 9346, and we decline to admit this evidence into the record.

E. Full Investigative Testimony Transcripts of 13 Individuals

Finally, respondents seek to admit in their entirety 13 investigative transcripts for numerous individuals. They argue that Enforcement introduced, and the Hearing Panel admitted, portions from four of the 13 transcripts that "were precisely tailored by Enforcement to reflect an extremely one-sided view of the [sic] each witness' testimony." Respondents argue that this is prejudicial and presents a false picture regarding the issues on appeal. We do not agree.

First, for nine of the 13 transcripts that respondents seek to introduce (i.e., those transcripts for which no portions were admitted into evidence), they have not explained why these transcripts should be admitted at this juncture, what they allegedly demonstrate, or how they relate to this case. We find that HedgeCap and Jahre have not demonstrated that we should admit these transcripts into the record on appeal pursuant to Rule 9346. Second, with respect to the four transcripts for which the Hearing Panel admitted certain portions of into the record, respondents have not specifically explained why full transcripts are material other than to state that they are allegedly necessary to balance the one-sided view of the parties' testimony created by the portions submitted by Enforcement. Third, respondents were instructed, pursuant to the scheduling order entered in this case, to designate portions of any investigative interview in advance (other than those used for impeachment or rebuttal). Respondents did not designate any portions of the 13 transcripts and never sought to introduce these transcripts for impeachment or rebuttal purposes. Consequently, we find that respondents have failed to show that the transcripts are material and that good cause existed for their failure to introduce them before the Hearing Panel.

V. Sanctions

The Hearing Panel: (1) expelled HedgeCap, and barred Jahre in all capacities, in connection with their violations of NASD Rule 8210; (2) expelled HedgeCap, and barred Jahre in all capacities, for willfully filing false Forms U4; (3) expelled HedgeCap, and barred Jahre in all capacities, for permitting Mudry to associate with the Firm while statutorily disqualified; and (4) expelled HedgeCap, and barred Jahre in all capacities, for their misconduct related to FINRA's advertising rules, FINRA's registration rules, recordkeeping requirements, supervisory rules, and soft dollars.

For the reasons set forth below, we affirm the Hearing Panel's sanctions.

A. Respondents' NASD Rule 8210 Violations

Absent mitigating circumstances, a bar should be the standard sanction for failing to respond truthfully to FINRA. *See Ortiz*, 2007 FINRA Discip. LEXIS 3, *43.[34] If there are mitigating factors present, adjudicators should consider suspending the individual in any or all capacities for up to two years.[35] In the case of a firm, the Guidelines state that, in egregious cases, adjudicators should consider expulsion. If there are mitigating factors present, adjudicators should consider suspending the firm with respect to any or all activities or functions for up to two years.[36] The Guidelines instruct adjudicators to consider, in addition to the principal considerations and general principles applicable to all violations, the importance of the information requested as viewed from FINRA's perspective.[37]

We affirm the Hearing Panel's expulsion of HedgeCap and bar of Jahre for their numerous misrepresentations to FINRA. Respondents repeatedly made misrepresentations to FINRA concerning five different subject matters. Jahre directly made, was involved in the preparation of, or approved the Firm's responses to FINRA's requests. Jahre also falsely testified during his on-the-record interview that the Firm had no soft dollar arrangements with hedge fund tenants. Respondents' misrepresentations were intentional, and they demonstrated a pattern of obstruction and prolonged delay. Indeed, FINRA staff testified that FINRA's investigation took more than two years to complete primarily because of respondents' misleading responses to numerous requests for information.[38] The information sought by FINRA related to its investigation of the Firm's practices with its hedge fund customers and compliance with important FINRA rules. Respondents frustrated FINRA's investigation into their alleged misconduct with repeated false statements to FINRA's numerous requests.[39] We reject Jahre's attempt to blame others for certain of the misrepresentations, including FINRA because it

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34 *See also FINRA Sanction Guidelines*, 33 (2011), http://www.finra.org/web/groups/industry/@ip/@enf/@sg/documents/industry/p011038.pdf [hereinafter *Guidelines*]. We apply the applicable FINRA Sanction Guidelines (the "Guidelines") in place at the time of this decision. *See id.* at 8 (providing that the Guidelines apply to all disciplinary matters, including pending matters).

35 *Guidelines*, at 33.

36 *Id.*

37 *Id.*

38 *See id.* at 6-7 (Principal Considerations in Determining Sanctions, Nos. 8, 9, 10, 12, and 13).

39 *See id.* at 7 (Principal Considerations in Determining Sanctions, No. 12).

allegedly "bombarded [the Firm] with a barrage of 8210 requests within three months of opening it's [sic] doors."[40]

There are no mitigating factors present.[41] We find that respondents' numerous false statements to FINRA were egregious. Anything short of an expulsion of HedgeCap and a bar of Jahre would be insufficient to remedy respondents' misconduct and to deter respondents from engaging in future misconduct. *See Ortiz*, 2008 SEC LEXIS 2401, at *32 ("Because of the risk of harm to investors and the markets posed by such misconduct, we conclude that the failure to provide truthful responses to requests for information renders the violator presumptively unfit for employment in the securities industry."). We therefore expel the Firm from FINRA membership and bar Jahre in all capacities for their false statements to FINRA.

B. False Forms U4

The Guidelines for filing a false, misleading, or inaccurate Form U4 recommend a fine of between $5,000 and $100,000 and a suspension of the responsible principal in all supervisory capacities of 10 to 30 business days.[42] In egregious cases, such as those involving repeated false, inaccurate, or misleading filings, those failing to disclose a statutory disqualification, or where the failure to disclose delayed regulatory investigations or terminations for cause, the Guidelines recommend considering a longer suspension in any or all capacities of up to two years or a bar in all supervisory capacities.[43] The Guidelines also recommend suspending the firm with respect to any or all activities or functions until it corrects the deficiency.[44] In evaluating the appropriate sanctions to impose, the Guidelines provide three principal considerations specific to Form U4 violations: the nature and significance of the information at issue, whether the failure resulted in a statutorily disqualified individual becoming or remaining associated with a member firm, and whether the misconduct resulted in any harm to any other person or entity.[45]

We affirm the Hearing Panel's expulsion of HedgeCap and bar of Jahre in all capacities in connection with the false Forms U4 filed for Mudry. On three separate occasions, Forms U4 were filed for Mudry that stated he had been unemployed until May 2006 and had not started

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40 *See id.* at 6-7 (Principal Considerations in Determining Sanctions, No. 2).

41 We reject respondents' suggestion that in determining sanctions we should consider that the investigation "cost the firm hundreds of thousands of dollars in attorneys fees." *See Ashton Noshir Gowadia*, 53 S.E.C. 786, 793 (1998) (holding that "economic harm alone is not enough to make the sanctions imposed upon [respondent] by the NASD excessive or oppressive").

42 *Guidelines*, at 69-70.

43 *Id.*

44 *Id.*

45 *Id.* at 69.

working for the Firm until that time. This information was false (Mudry had been employed at the Firm since November 2005) and highly significant, as Mudry was statutorily disqualified and not permitted to associate with a FINRA member firm in any capacity unless and until he had obtained relief to do so. Jahre, the individual at the Firm who hired Mudry and under whose name the false Forms U4 were filed, knew that Mudry had been employed at the Firm since November 2005.[46] The false Forms U4 concealed the fact that Mudry had actively worked at the Firm for approximately seven months notwithstanding his disqualification.[47] The Firm and Jahre, as its principal owner, also stood to gain financially by permitting Mudry to associate with the Firm and work his "rolodex of valuable connections within the securities industry" to raise funds for the Firm's hedge fund clients.[48]

We also find respondents' relevant disciplinary histories aggravating.[49] In 2009, FINRA accepted a Letter of Acceptance, Waiver, and Consent from respondents, which found that they filed a misleading and inaccurate Form U5 for a former employee. FINRA censured the Firm, suspended Jahre in all principal capacities for 10 business days, and fined respondents $10,000. Under the circumstances, and in light of numerous aggravating factors, we find respondents' filing of false Forms U4 to be egregious and, notwithstanding the suggested sanctions set forth in the *Guidelines*, warrant an expulsion of HedgeCap and bar of Jahre in all capacities.[50]

C. Permitting Statutorily Disqualified Individual to Associate with the Firm

The Guidelines for permitting a statutorily disqualified individual to associate with a member firm prior to approval recommend a fine of between $5,000 and $50,000 for firms and supervisory principals.[51] In egregious cases, the Guidelines recommend considering a suspension of the firm with respect to any or all activities or functions for up to two years, suspending the supervisory principal in any or all capacities of up to two years, or barring the supervisory principal (particularly where he knowingly allowed a disqualified person to become

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46 *See id.* at 7 (Principal Considerations in Determining Sanctions, No. 13).

47 *See id.* at 6 (Principal Considerations in Determining Sanctions, No. 10).

48 *See id.* at 7 (Principal Considerations in Determining Sanctions, No. 17).

49 *See id.* at 2 (General Principles Applicable to All Sanction Determinations, No. 2) (recommending more severe sanctions for recidivists); *see also id.* at 6 (Principal Considerations in Determining Sanctions, No. 8) (instructing adjudicators to consider "[w]hether the respondent engaged in numerous acts and/or a pattern of misconduct").

50 Under the circumstances, we find it appropriate to sanction both the Firm and Jahre for this misconduct. *See Harvest Capital*, 2008 FINRA Discip. LEXIS 45, at *50 n.30 (finding it appropriate and necessary to sanction both the firm and its president for misconduct).

51 *Guidelines*, at 43.

associated).[52] In evaluating the appropriate sanctions to impose, the Guidelines provide three principal considerations specific to these violations: the nature and extent of the disqualified person's activities and responsibilities, whether an MC-400 was pending, and whether the disqualification resulted from financial or securities misconduct.[53]

We affirm the Hearing Panel's expulsion and bar imposed upon HedgeCap and Jahre, respectively, for this misconduct. First, Mudry actively sought execution business for HedgeCap's equity desk and attempted to locate hedge fund tenants to fill the Firm's office space and raise capital for hedge funds. Mudry often identified himself as a "managing partner" or "managing director" of the Firm. Mudry's activities and responsibilities at the Firm were extensive and substantial. Second, Mudry performed these activities for more than 10 months before the Firm filed an MC-400 seeking to permit Mudry to associate with the Firm notwithstanding his statutory disqualification. Third, we find that although the bar imposed by the NYSE upon Mudry resulted directly from his failure to cooperate with its investigation of him, NYSE's investigation sought information from Mudry concerning the alleged theft of $300,000 as disclosed on a Form U5 filed by his prior firm.

We find that respondents' employment of Mudry, despite his disqualification, was egregious. Neither Jahre nor any other individual at the Firm performed a background check on Mudry, despite that he had not been employed by a member firm since September 2000. We reject respondents' argument that they did not, at a minimum, act recklessly with respect to hiring and employing Mudry, and give no weight to their alleged reliance on his prior association with a "very large and prestigious hedge fund" as justification for their employment of Mudry despite the NYSE bar. Moreover, even after discovering that Mudry was statutorily disqualified, respondents permitted him to continue to perform services on behalf of HedgeCap for many months. For all of these reasons, expelling HedgeCap and barring Jahre are the only appropriate sanctions for this misconduct.[54]

D. Remaining Violations

In connection with respondents' misconduct related to FINRA's advertising rules, allowing unregistered employees to act in registered capacities and allowing an employee to park her license at the Firm, failing to retain emails and instant messages, failing to adequately supervise and implement adequate supervisory controls and procedures, and improper soft dollar payments, the Hearing Panel imposed a single sanction and expelled HedgeCap and barred Jahre in all capacities. We affirm these sanctions.

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52 *Id.*

53 *Id.*

54 Given the numerous aggravating factors, we find that expelling HedgeCap for this misconduct is appropriate, notwithstanding the guidance provided by the *Guidelines* with respect to the Firm.

As an initial matter, we find that it is appropriate to impose a unitary sanction for these remaining violations because the remaining violations of FINRA rules all resulted from the broad and systemic supervisory failures at the Firm.

For failing to supervise, the Guidelines recommend imposing a fine between $5,000 and $50,000 and a suspension in all supervisory capacities for up to 30 business days, and limiting the activities of the appropriate branch office or department for up to 30 business days.[55] In egregious cases, the Guidelines recommend suspending the responsible individual in any or all capacities for up to two years or imposing a bar, and in a case against a firm involving systemic supervisory failures, the Guidelines recommend a suspension of up to two years or expelling the firm.[56] The Guidelines also recommend considering, in addition to the general principles and principal considerations applicable to all violations, the nature, extent, and size of the underlying misconduct; whether the respondent ignored red flags; the quality and degree of the supervisor's implementation of the firm's supervisory procedures and controls; and whether individuals responsible for the underlying misconduct attempted to conceal misconduct from the respondent.[57] "Proper supervision is the touchstone to ensuring that broker-dealer operations comply with the securities laws and NASD rules. It is also a critical component to assuring investor protection." *Dennis S. Kaminski*, Exchange Act Rel. No. 65347, 2011 SEC LEXIS 3225, at *35 (Sept. 16, 2011).

For recordkeeping violations, the Guidelines recommend imposing a fine of $1,000 to $10,000, suspending the firm for up to 30 business days, and suspending the responsible individual for up to 30 business days.[58] In egregious cases, the Guidelines recommend imposing a fine of $10,000 to $100,000, and a lengthier suspension (up to two years) or expelling the firm and barring the responsible individual. The Guidelines instruct adjudicators to consider the nature and materiality of inaccurate or missing information.[59] Recordkeeping rules are the "keystone of the surveillance of brokers and dealers[.]" *Edward J. Mawod & Co.*, Exchange Act Rel. No. 13512, 1977 SEC LEXIS 1811, at *16 (May 6, 1977), *aff'd*, 591 F.2d 588 (10th Cir. 1979).

For registration violations, the Guidelines recommend imposing a fine of $2,500 to $50,000, and suspending the individual in any or all capacities for up to six months. In egregious cases, the Guidelines recommend suspending the firm for up to 30 business days, and a lengthier suspension (up to two years) or a bar for the individual.[60]

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55 *Guidelines*, at 103.

56 *Id.*

57 *Id.*

58 *Guidelines*, at 29.

59 *Id.*

60 *Guidelines*, at 45.

For the failure to comply with FINRA's advertising rules and the use of misleading communications, the Guidelines recommend a fine of $1,000 to $20,000. In egregious cases, the Guidelines recommend suspending the firm for up to one year, and suspending the responsible individual in any or all capacities for up to 60 days.[61]

Jahre testified that supervision "basically bores him" and that if he "would run the Firm according to [its] WSPs, I would be out of business." Jahre also testified that "[i]f he had to write everything down on the WSPs, I could never make any money." The problems at the Firm were systemic and covered various areas of the Firm's activities, operations, and functions. Further, the problems occurred for an extended period of time, and Jahre ignored several warnings concerning issues and later attempted to conceal such problems from FINRA. Certain problems, such as the failure to retain electronic communications, hindered FINRA's investigation into respondents' misconduct. At a minimum, Jahre's misconduct was reckless, and appeared to be motivated largely by potential financial gain by cutting corners at the Firm and disregarding the Firm's WSPs and FINRA's rules. Jahre continues to blame others, including FINRA, for respondents' egregious misconduct.[62] Consequently, we affirm the Hearing Panel's expulsion of HedgeCap and bar of Jahre for their violation of various FINRA rules.[63]

VI. Conclusion

We affirm the Hearing Panel's findings that: (1) respondents violated NASD Rules 2211(d)(1) and 2110 by distributing exaggerated, misleading and unbalanced institutional sales materials; (2) HedgeCap violated NASD Rules 2211(d)(1) and 2110 by distributing additional unbalanced institutional sales materials; (3) HedgeCap violated NASD Rules 2211(b)(2)(A) and 2110 by failing to retain institutional sales materials; (4) respondents violated NASD Rules 1031

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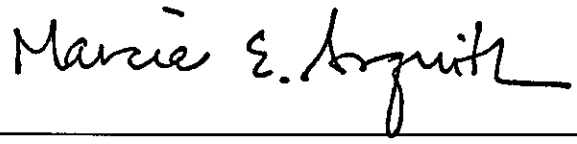
61 *Id.* at 79. There are no specific guidelines addressing violative soft dollar arrangements.

62 *See id.* at 6 (Principal Considerations in Determining Sanctions, No. 2).

63 Respondents suggest that the Hearing Panel's sanctions were greatly disproportionate because, among other things, the most recent "FINRA audit came back with a very mild caution letter, which should indicate to the panel that the firm has taken it's [sic] lumps, learned from its mistakes, and has been operating in a pristine matter for the past five years." The record does not support respondents' assertion, and we do not consider the Firm's alleged receipt of a "mild caution letter" from FINRA as mitigating. *See Dep't of Enforcement v. DaCruz,* Complaint No. C3A040001, 2007 NASD Discip. LEXIS 1, at *52 (NASD NAC Jan. 3, 2007) ("Subsequent compliance with the federal securities laws and NASD's rules is not mitigating, but conduct consistent with a registered representative's obligations as an associated person"). Likewise, we reject respondents' claim that FINRA should be "comforted" by the Firm's recent application to limit its permissible activities and employees. This fact has no bearing on the matters before us.

and 2110 by allowing unregistered persons to act in registered capacities; (5) respondents violated Article III, Section 3(b) of NASD's By-Laws and NASD Rule 2110 by employing a statutorily disqualified individual; (6) respondents violated Article V, Section 2 of NASD's By-Laws, NASD Rule 2110, and IM-1000-1 by willfully filing misleading Forms U4; (7) respondents violated NASD Rules 1031 and 2110 by allowing a registered representative to park her license at the Firm; (8) HedgeCap violated NASD Rules 3110 and 2110, Exchange Act Section 17(a)(1), and Exchange Act Rule 17a-4 by failing to retain emails and instant messages; (9) respondents violated NASD Rules 3010 and 2110 by failing to establish and maintain an adequate supervisory system, failing to establish, maintain, and enforce written supervisory procedures, and failing to hold an annual compliance meeting; (10) respondents violated NASD Rules 8210 and 2110 by providing false responses to FINRA requests for information and providing false testimony; and (11) respondents violated NASD Rule 2110 by improperly allowing a hedge fund tenant to pay its rent to HedgeCap with soft dollars. We further affirm the Hearing Panel's sanctions imposed upon respondents for their misconduct. Accordingly, we: (a) expel HedgeCap from FINRA membership; (b) bar Jahre in all capacities; (c) affirm the Hearing Panel's order that HedgeCap and Jahre pay, jointly and severally, $15,119.90 in costs; and (d) impose appeal costs of $1,705.90.[64]

On behalf of the National Adjudicatory Council,



Marcia E. Asquith
Senior Vice President and Corporate Secretary

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[64] The expulsions and bars are effective as of the date of this decision. Further, pursuant to FINRA Rule 8320, any member that fails to pay any fine, costs, or other monetary sanction imposed in this decision, after seven days' notice in writing, will summarily be 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 summarily be revoked for non-payment.

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