BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of Department of Market Regulation, Complainant, vs. John Cherry, III Orlando, FL, Respondent.	DECISION Complaint No. 20110269351 Dated: March 3, 2015

The respondent misused and converted customer funds, committed securities fraud, and engaged in outside business activities without disclosure to his firm. Held, findings and sanctions modified.

Appearances

For the Complainant: Gary Jackson, Esq., Department of Market Regulation, Financial Industry Regulatory Authority

For the Respondent: Jeremy L. Bartell, Esq.

Decision

Pursuant to FINRA Rule 9311, John Cherry, III ("Cherry") appeals a December 17, 2013 Hearing Panel decision. The Hearing Panel found that Cherry misused and converted customer funds for his own benefit in violation of NASD Rule 2330(a) and FINRA Rules 2150(a) and 2010 and barred him from associating with a FINRA member firm in any capacity.[1] The Hearing Panel also ordered him to pay restitution in the amount of $174,000 plus interest, and ordered him to pay FINRA $300,000 in disgorgement. The Hearing Panel further found that Cherry willfully violated § 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), Exchange Act Rule 10b-5, and FINRA Rule 2020, and that these violations constituted an

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

alternative basis for the sanctions imposed. Finally, the Hearing Panel found that Cherry engaged in outside business activities without the required written disclosure to his firm in violation of NASD Rule 3030 and FINRA Rules 3270 and 2010, and imposed a separate bar for these violations.

After an independent review of the record, we modify the findings and sanctions. We find that Cherry converted customer funds, and that this misconduct constituted an independent violation of FINRA Rule 2010, as well as a violation of NASD Rule 2330(a) and FINRA Rule 2150(a).[2] We also find that Cherry engaged in deceptive conduct that violated Exchange Act § 10(b), Exchange Act Rule 10b-5, and FINRA Rules 2020 and 2010, and that these violations constitute an alternative basis for the sanctions imposed. In connection with this deceptive conduct and conversion of customer funds, Cherry engaged in outside business activities that he failed to disclose to his firm in violation of NASD Rule 3030 and FINRA Rules 3270 and 2010. We find that a bar is the appropriate sanction for conversion, and a separate bar is appropriate for Cherry's outside business activities. We modify the award of restitution to account for payments made by Cherry to his customers, and modify the disgorgement order to include prejudgment interest.

I. Background

Cherry entered the securities industry in February 2002. Cherry was registered as a general securities representative with World Group Securities, Inc. ("WGS"), an affiliate of World Financial Group, Inc. ("World Financial"), from April 2002 to April 2011. On April 18, 2011, WGS filed a Uniform Termination Notice for Securities Industry Registration ("Form U5") terminating Cherry's registration because Cherry "was not believed to have been fully forthcoming with WGS" regarding its investigation of the conduct at issue in this proceeding. Cherry is not currently associated with any FINRA member firm.

II. Procedural History

On July 25, 2012, FINRA's Department of Market Regulation ("Market Regulation") filed a two-cause complaint against Cherry. The first cause alleged that Cherry misused and converted customer funds and committed fraud in violation of NASD Rule 2330(a), FINRA Rules 2150(a), 2020 and 2010, and Exchange Act § 10(b) and Exchange Act Rule 10b-5. The crux of Market Regulation's allegations was that Cherry misused and converted customer funds to purchase a home titled in his wife's name. Cause two alleged that Cherry failed to disclose outside business activities to his firm in violation of NASD Rule 3030 and FINRA Rules 3270 and 2010. Cherry answered the complaint, denying the allegations and asserting several affirmative defenses.

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[2] The Hearing Panel found a violation of FINRA Rule 2010 solely predicated on Cherry's violation of NASD Rule 2330(a) and FINRA Rule 2150(a). As discussed below, however, it is well-settled that conversion constitutes an independent violation of FINRA Rule 2010. Accordingly, we modify the findings to include this additional violation.

On December 17, 2013, after a two-day hearing, the Hearing Panel issued a decision finding that Cherry had converted customer funds in violation of NASD Rule 2330(a) and FINRA Rules 2150(a) and 2010. The Hearing Panel imposed a bar for his conversion, and ordered Cherry to pay his customers $174,000 in restitution, plus prejudgment interest, and to pay FINRA $300,000 in disgorgement. The Hearing Panel also found that Cherry violated Exchange Act § 10(b), Exchange Act Rule 10b-5, and FINRA Rule 2020, and that these violations provided an alternative basis for the sanctions imposed. Finally, the Hearing Panel found that Cherry engaged in outside business activities that were not disclosed to his firm when he used family-owned businesses to obtain customer funds, and that this misconduct violated NASD Rule 3030 and FINRA Rules 3270 and 2010. The Hearing Panel imposed a second bar for Cherry's outside business activities. Cherry's appeal followed.

III. Facts

A. Cherry Meets BD and DD and Solicits Them to Invest in a Portfolio of Securities

In early 2009, Cherry was introduced to DD by a childhood friend of DD's who had recently joined WGS and was working under Cherry. At the time, DD and her mother, BD, owned and operated a real estate brokerage business, Home Sales. The real estate business had been founded by BD's deceased husband, but BD and DD had continued to operate it after his death. By 2009, the real estate market was not doing well, and BD and DD were looking for ways to supplement their income and diversify their investments. BD and DD wanted investments that would generate monthly income for BD, who was planning to retire. BD and DD testified that they pooled their assets and held a bank account together in the name of their business, Home Sales.

In April 2009, DD met with Cherry in person for the first time at his home in Orlando, Florida (the "Florida House").[3] Later that month, BD met with Cherry at the Florida House. Both DD and BD also met with Cherry at WGS's Brooklyn, New York office. Like Cherry, both DD and BD lived part of the time in Florida and part of the time in New York City.

During their initial meetings, DD and BD discussed their financial situation and goals with Cherry. In addition, Cherry provided to both a "Dream Map," which was a WGS marketing tool on which a customer would provide information about her assets, liabilities and financial goals for the purpose of receiving appropriate investment recommendations. BD and DD each completed a Dream Map. Cherry presented them with the results that referred to various investment products offered by WGS, including securities, but nowhere mentioned investments in real estate.

DD and BD testified that they discussed with Cherry investing in a portfolio of securities that Cherry would choose. Accordingly, at Cherry's direction, they made a number of deposits

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[3] Cherry and his wife were living in the Florida House at the time, but did not own the house.

with an entity called the Cherry Group Unlimited, LLC (the "Cherry Group"). The Cherry Group was a Cherry family-owned, New York limited liability company first formed by Cherry in 2002 under the name Amplusall, LLC. In 2007, Cherry changed its name to the Cherry Group. During the relevant time period, Cherry was a member and the registered agent for the Cherry Group, and his wife was listed as a manager.

The first payment BD and DD made to the Cherry Group was a cashier's check dated April 23, 2009, for $100,000 drawn on the Home Sales account. A second payment of $250,000 was made to the Cherry Group with a check dated June 12, 2009, also drawn on the Home Sales account. A third payment of $74,000 was made to the Cherry Group by wire transfer from the Home Sales account on June 30, 2009. In December 2009, Cherry assisted BD in obtaining a reverse mortgage on her home, and a fourth deposit of $50,000 was made to the Cherry Group from the loan proceeds. Accordingly, DD and BD invested a total of $474,000 through Cherry. BD and DD understood from Cherry that their funds had been invested in a portfolio of securities with a third-party money manager. DD and BD testified that Cherry indicated that their investments would generate $4,700 per month in income.

On June 3, 2009, DD signed a Client Account Form to open an account with WGS. The form was signed by Cherry as the registered representative and by a WGS supervisor. On the form, DD indicated that her investment objectives were growth and income, with a moderate risk tolerance and long-term horizon. DD also represented that she had no prior investment experience. In fact, both DD and BD testified that they had never had a brokerage account prior to working with Cherry. DD also applied for life insurance with Cherry listed as the registered representative on the order ticket. DD, however, was denied coverage for medical reasons.

B. Cherry Creates the False Appearance that BD's and DD's Funds Are Invested in Securities and Makes a Few Interest Payments

Soon after BD's and DD's initial investment, DD asked Cherry for documentation of the investment. In response to this request, BD received an email from an AOL account with a document attached purporting to be from an entity called Equitable Investment Strategies ("Equitable") and signed by an individual named GV. The document was dated July 31, 2009, welcomed BD as a "preferred client," and stated that her "investment on April 27th, 2009 of $100,000 is a five-year quarterly yielding plan." BD received a similar document from Equitable on September 30, 2009, also signed by GV. This letter acknowledged her second $250,000 investment, welcomed her as a client, referred to her investment as a "quarterly yielding plan," and stated that her request for monthly distributions would be honored. Both documents described her investments as "[a]sset alloc [sic] – 60 month distribution, aggressive growth, auto re-newable account, non-distribution." Both documents also referred to the plan type as "[e]quity [b]uilder" and indicated that "applied interest" would be paid. Neither document mentioned any investment in real estate.

Cherry made sporadic interest payments to BD for approximately one year. The first payment, which was made the month after BD received the second confirmation of her supposed investment with Equitable, was on October 19, 2009, for $1,700 and was followed a few days later by a check for $3,000. The payments, which varied in amount and timing, continued until

November 23, 2010, when Cherry made a final interest payment of $2,930.84. Cherry paid BD total interest payments of $35,764.17. All but one of the payments were made by the Cherry Group or another Cherry family-owned entity called CAJ Marketing.[4] One payment for $4,700 was made on April 29, 2010 from Cherry's personal bank account.

When the interest payments stopped, BD and DD repeatedly attempted to contact Cherry by telephone, email and text. Cherry provided a number of excuses for why the payments had stopped. First, he told BD and DD that the person at Equitable responsible for making the payments had suffered a heart attack, causing confusion in the office. Later, he claimed that the IRS had frozen Equitable's accounts, and he also was trying to get back money he had invested with Equitable. When DD asked whether they should contact a lawyer, Cherry discouraged this and blamed their insistence on immediate repayment for making it more difficult for him to obtain payment. Cherry suggested that they did not understand the complexities of the situation. Cherry eventually stopped responding to BD's and DD's calls and emails.

C. Cherry Uses BD's and DD's Funds to Purchase a Home in His Wife's Name

It is undisputed that the funds BD and DD deposited with the Cherry Group were used to purchase the Florida House, the home in which Cherry and his wife had been living. The home was titled in Cherry's wife's name. Cherry, however, claimed he had no involvement in that transaction and has offered various contradictory explanations for how it came about. During FINRA's investigation, he claimed that DD and BD invested their funds with Equitable for the purpose of making real estate investments, and that GV loaned the money to Cherry's wife to purchase the Florida House without Cherry's knowledge. At the hearing, Cherry changed his story and admitted that he knew about the supposed loan to his wife. It appears that he did so because Market Regulation introduced emails between Cherry and a mortgage broker showing that Cherry was involved with the purchase of the Florida House. He continued to deny, however, any involvement in the transaction and claimed that the transaction came about because BD and DD invested in the Cherry Group, an entity controlled by Cherry's wife, for the purpose of making real estate investments. In this version, Equitable and GV had no involvement, and Cherry does not explain the Equitable documents sent to BD.

BD and DD testified that they intended for their funds to be invested in securities and knew nothing about the Florida House purchase or any other real estate investment. They also testified that they never had any business dealings with Cherry's wife, and had never even

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[4] CAJ Marketing is a Florida corporation that was incorporated by Cherry on April 30, 2009. At the time of incorporation, CAJ Marketing had two directors—Cherry and one of the individuals from whom Cherry purchased the Florida House. The Florida House was listed as the principal address for CAJ Marketing, and Cherry was listed as its registered agent. The record includes a document dated May 14, 2009, in which Cherry unilaterally purports to elect his wife as sole director and 100% owner of CAJ Marketing, and specifically gives Cherry's wife authority to open bank accounts for the company. The document was signed by Cherry as director and secretary, but does not include the signature of the other director.

spoken to her with the exception of a greeting. It is undisputed that there are no documents evidencing any loan by BD or DD, or any evidence of a security or other interest for BD and DD in the Florida House.

D. BD and DD Complain, and Cherry Is Terminated by WGS

Unable to obtain the return of their investment from Cherry, DD contacted WGS to complain. DD spoke with WGS's Chief Compliance Officer ("CCO"), who began an investigation. WGS's CCO testified that she located DD's customer records in WGS's computer database, and spoke with Cherry several times about the complaint. She asked Cherry for various documents and asked to speak with Cherry's wife and GV.

Cherry was generally uncooperative during the investigation. He failed to provide many of the requested documents or provided documents with important information redacted. He claimed his wife did not want to speak with the CCO, and that GV wanted the CCO to speak with his attorney. Despite a number of requests, however, Cherry never provided contact information for Equitable, GV, or his attorney, and the CCO testified that she was unable to identify GV on her own. On April 19, 2011, the CCO sent Cherry an email terminating him. In the Form U5 filed by WGS for Cherry, WGS stated that he had been terminated because he had not been "forthcoming" in connection with the investigation.

BD and DD eventually filed an arbitration claim against World Financial and Cherry. World Financial settled with BD and DD for $300,000, but the arbitration claim against Cherry is still pending.

E. Cherry Fails to Disclose His Outside Business Activities to WGS

During the course of its investigation of BD's and DD's complaint, WGS learned that Cherry had failed to disclose certain outside business activities. In 2007, Cherry disclosed to WGS in writing that he was a "member" or "partner" of the Cherry Group, and that he was an "independent contractor." In this disclosure, Cherry also stated that he had not discussed his affiliation with the Cherry Group with any WGS customer, and that he had not marketed, solicited, or sold any product or service of the Cherry Group to any WGS customer. He also stated that he had taken steps to ensure that "everyone" understood that the Cherry Group was not affiliated with WGS. During WGS's investigation, Cherry claimed that, despite his earlier disclosures, he only took control of the Cherry Group in 2010, and was not responsible for it prior to that time.

Cherry never disclosed the existence of CAJ Marketing to WGS at all. Cherry argued that he was not required to disclose it because his wife owned the company.

In 2006, Cherry disclosed Equitable to WGS as an outside business activity. In that disclosure, Cherry represented that he was hired by Equitable as a speaker at real estate seminars, and that he had not discussed this affiliation with any WGS customer. He also represented that he had not marketed, solicited, or sold any Equitable product or service to any WGS customer.

IV. Discussion

On appeal, Cherry alternately relies on various barriers and obfuscations he created to distance himself from the purchase of the Florida House and argues that BD and DD intended to invest in real estate. We reject these arguments. As discussed below, we find that BD and DD deposited money with the Cherry Group at Cherry's direction to invest in a portfolio of securities. Instead of investing the funds as agreed, Cherry engaged in a deceptive scheme intended to mislead BD and DD into believing that their funds had been invested in securities as directed when, in fact, Cherry had used their funds to purchase a home titled in his wife's name.

A. BD and DD Intended to Invest in Securities

The crux of Cherry's defense is that BD and DD intended to invest their funds in real estate. With respect to how their funds came to be used to purchase the Florida House specifically, he has made several contradictory claims. He first claimed that, unbeknownst to him, Equitable and GV loaned the money to Cherry's wife. Later, he admitted that he did know about the loan but claimed that BD and DD deposited their funds in the Cherry Group to invest in real estate transactions, and that the Cherry Group "allowed" the funds to be used by his wife to purchase the Florida House. He also has claimed that his wife, BD and DD arranged for the loan directly. Cherry admitted that there are no documents evidencing any loan by BD and DD, or any interest for them in the Florida House.

BD and DD, on the other hand, consistently testified that they intended for their money to be invested in a portfolio of securities, and that they knew nothing about the use of their funds to purchase the Florida House. BD and DD testified that after the downturn in the real estate market, they were seeking to diversify their investments and needed an investment that would provide income for BD, who was planning to retire. They testified that they deposited their funds with the Cherry Group at Cherry's direction for the purpose of investing in securities. They claimed never to have spoken to Cherry's wife, aside from a possible greeting. They also maintained that they were real estate experts and would not have needed Cherry to make a real estate investment. They testified, rather, that they relied on Cherry for his securities expertise.

The outcome of this matter rests largely on the resolution of this testimonial conflict. The Hearing Panel found BD's and DD's testimony to be credible and found Cherry not credible. While we conduct a de novo review of the Hearing Panel's decision, we give substantial weight and deference to the Hearing Panel's credibility findings. *See Eliezer Gurfel*, 54 S.E.C. 56, 62 n.11 (1999), *aff'd*, 205 F.3d 400 (2000). It is well settled that the "credibility determinations of an initial fact-finder, which are based on the hearing of witnesses' testimony and observing their demeanor, are entitled to considerable weight and deference, and can be overcome only where the record contains substantial evidence for doing so." *John Montelbano*, 56 S.E.C. 76, 89 (2003), *appeal denied*, 2011 U.S. App, LEXIS 18428 (2d Cir. 2011). We find no substantial evidence in the record to warrant overturning the Hearing Panel's credibility determinations. To the contrary, the record amply supports those findings, and we affirm them.

Cherry's various explanations for how his customers' money was used to purchase the home in which he and his wife lived are replete with contradictions and inconsistencies and

make no sense in light of the record evidence. For example, Cherry's stories at the hearing—that BD and DD invested their funds with the Cherry Group, that the Cherry Group was authorized to use the funds to purchase the Florida House, and that his wife alone arranged a loan with BD and DD—contradicted his earlier on-the-record testimony during FINRA's investigation in which he claimed that, unbeknownst to him, Equitable and GV loaned BD's and DD's funds to his wife.

Cherry's story at the hearing also makes no sense in light of the documents BD received from Equitable. The documents, which indicate an investment in securities, were sent after DD asked Cherry for evidence of their investment, and, accordingly, must have been arranged by or sent on behalf of Cherry. These documents, which were sent from a nondescript AOL account, were fraudulent because there never was any investment with Equitable.[5] Indeed, Cherry never called anyone from Equitable to testify and failed to provide his firm with any contact information for Equitable or its supposed representative, GV. Moreover, the excuses Cherry gave BD and DD when the interest payments stopped—i.e., that the person responsible for making the payments at Equitable had suffered a heart attack and that Equitable's accounts had been frozen—were patently false in light of his testimony at the hearing that BD's and DD's investment stayed with the Cherry Group, and underscores Cherry's lack of credibility.

Cherry's testimony is also suspect because of the many barriers he purposely erected to avoid responsibility for his misconduct. For example, to distance himself from the interest payments made to BD, he unilaterally transferred control of CAJ Marketing to his wife, claimed his wife controlled the Cherry Group, and even blamed his wife for making an interest payment from his personal bank account. He emphasized the fact that the Florida House is titled in his wife's name alone, and stated that this is the reason he could not return BD's and DD's money. He also relied on the fact that he never provided any documents to BD and DD evidencing a securities investment and that the Equitable documents did not appear to come from him or bear his name.

Finally, Cherry offers no explanation for why BD and DD did not complain after receiving the Equitable documents if they actually intended to invest in real estate. Nor does he explain why two experienced real estate professionals would make such an investment without any documentation or retaining some interest in the property. In short, Cherry's self-serving and uncorroborated testimony is not credible in light of the record evidence.

For these reasons, we affirm the Hearing Panel's determination that Cherry is not credible, and we credit the testimony of BD and DD. Accordingly, we find that BD and DD intended for their money to be invested in a portfolio of income-producing securities, and that Cherry took their funds and used them to purchase the Florida House without their knowledge or authorization.

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[5] The Hearing Panel raised questions about the authenticity of a number of documents introduced by Cherry, including a document purporting to be signed by his wife but in which her first name is misspelled.

B. Cherry Converted BD's and DD's Funds for His Personal Use

1. Cherry Converted BD's and DD's Funds for His Own Benefit in Violation of FINRA Rule 2010

FINRA Rule 2010 requires associated persons to conduct their business in accordance with "high standards of commercial honor and just and equitable principles of trade." FINRA Rule 2010 encompasses all unethical, business-related conduct, even if that conduct is not in connection with a securities transaction. *See Denise M. Olson*, Complaint No. 2010023349601, 2014 FINRA Discip. LEXIS 7, at *7 (FINRA Bd. of Governors May 9, 2014), *appeal docketed*, Admin. Proc. File No. 3-15916 (SEC June 9, 2014); *see also Vail v. SEC*, 101 F.3d 37, 39 (5th Cir. 1996) (affirming the SEC's finding that an associated person violated just and equitable principles of trade by misappropriating funds from a political organization for which he served as the treasurer).

Conversion is defined as "an intentional and unauthorized taking of and/or exercise of ownership over property by one who neither owns the property nor is entitled to possess it." *John Edward Mullins*, Exchange Act Release No. 66373, 2012 SEC LEXIS 464, at *33 (Feb. 10, 2012). It is well-settled that conversion violates FINRA Rule 2010. *See Olson*, 2014 FINRA Discip. LEXIS 7, at *8 (finding that a registered representative's conversion of firm funds violated Rule 2010); *Mullins*, 2012 SEC LEXIS 464, at *74 (finding that a registered representative's conversion of the funds of a foundation for which he served as an officer violated NASD Rule 2110, the predecessor to FINRA Rule 2010).

We find that Cherry converted BD's and DD's funds to purchase a home in his wife's name. BD and DD transferred their funds to the Cherry Group at Cherry's direction for the purpose of investing in securities. Cherry, however, intentionally took those funds and used them to purchase the house in which he and his wife were living. He did so without authorization from BD and DD. Cherry's misconduct was unethical and violated just and equitable principles of trade and high standards of commercial honor. Accordingly, we find that Cherry converted funds in violation of FINRA Rule 2010.

2. Cherry's Conversion of Customer Funds Also Violated NASD Rule 2330(a) and FINRA Rules 2150(a) and 2010

FINRA Rule 2150(a) (and its predecessor NASD Rule 2330(a)) provides that "[n]o member or person associated with a member shall make improper use of a customer's securities or funds."[6] The Hearing Panel found that Cherry violated NASD Rule 2330(a) and FINRA Rule 2150(a) when he used BD's and DD's funds to purchase the Florida House, and that his violation

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[6] NASD Rule 2330(a) applies to Cherry's misconduct prior to December 14, 2009. FINRA Rule 2150(a) applies to his misconduct occurring on or after December 14, 2009. *See FIRNA Regulatory Notice 09-60*, 2009 FINRA LEXIS 171 (Oct. 2009).

of FINRA Rule 2150(a) also constituted a violation of FINRA Rule 2010.[7] Cherry argues that NASD Rule 2330(a) and FINRA Rule 2150(a) do not apply because the funds invested belonged to BD, and BD was not his customer. We disagree, and find that both BD and DD were Cherry's customers.

FINRA Rule 0160(b)(4) defines "customer" broadly, only excluding brokers and dealers from the definition of a customer. In the context of the applicability of the suitability rule, a customer relationship can arise "when a broker recommends a security to a *potential* investor, even if that potential customer does not have an account at the firm." *See FINRA Regulatory Notice 12-25*, 2012 FINRA LEXIS 32, at *21 (May 2012).

The case law also supports a broad definition of "customer" to include people with even informal business relationships with registered representatives and does not require the actual opening of an account. *See, e.g., WMA Sec., Inc. v. Ruppert*, 80 F. Supp. 2d 786, 788-89 (S.D. Ohio 1999) (finding a customer relationship existed where the customer never opened an account and the registered representative sold the customer products not approved by the firm). It is sufficient that the customer is solicited to become a customer and that the customer turns over funds to the registered representative. *See Oppenheimer & Co. v. Neidhardt*, 56 F.3d 352, 357 (2d Cir. 1995) (finding a customer relationship where customers were solicited and turned over funds for investment); *Dep't of Enforcement v. Zayed*, Complaint No. 2006003834901, 2010 FINRA Discip. LEXIS 13, at *18-20 (FINRA NAC Aug. 19, 2010) (rejecting a registered representative's claim that no customer relationship was established where no account was opened and no securities were sold to them); *Dep't of Enforcement v. Am. First Assocs. Corp.*, Complaint No. E1020040926, 2008 FINRA Discip. LEXIS 27, at *21-22 (FINRA NAC Aug. 15, 2008) (finding a customer relationship where no account was ever opened), *aff'd sub nom. Joseph Ricupero*, Exchange Act Release No. 62891, 2010 SEC LEXIS 2988 (Sept. 10, 2010). It is not necessary that there be an actual purchase or sale of securities for a customer relationship to exist. *See, e.g., Lehman Bros., Inc. v. Certified Reporting Co.*, 939 F. Supp. 1333, 1340 (N.D. Ill. 1996) (noting that "customer" is defined broadly and finding a customer relationship where a registered representative recommended a security, but plaintiffs did not purchase it through him).[8]

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[7] It is well settled that a violation of another FINRA rule, including FINRA Rule 2150(a), is a violation of FINRA Rule 2010. *See William J. Murphy*, Exchange Act Release No. 69923, 2013 SEC LEXIS 1933, at *26 n.29 (July 2, 2013) (stating that "a violation of another Commission or NASD rule or regulation . . . constitutes a violation of [FINRA Rule 2010]"), *aff'd sub nom. Birkelbach v. SEC*, 751 F.3d 472 (11th Cir. 2014).

[8] Cherry's reliance on *Department of Enforcement v. Gulley*, Complaint No. C05990034, 2000 NASD Discip. LEXIS 25 (NASD Hearing Panel June 5, 2000), is misplaced because that case does not address the scope of NASD Rule 2330(a). Moreover, the NAC is not bound by a hearing panel's decision.

Cherry had sufficient contacts with BD and DD to establish a customer relationship with both of them. Cherry presented DD with the Dream Map (a WGS document), and she opened an account with Cherry at WGS. DD's new client documents were signed by Cherry and a supervisor. Cherry signed and submitted an order ticket to purchase a life insurance product for DD. BD also met with Cherry and he presented her with a Dream Map. Most importantly, she and her daughter turned over their funds to Cherry for investment in securities, including funds that Cherry helped BD obtain through a reverse mortgage. Under these circumstances, we find that a customer relationship was established with both BD and DD. Accordingly, when Cherry used his customers' funds to purchase Florida House rather than investing them in securities as BD and DD had directed, he made improper use of customer funds in violation of NASD Rule 2330(a) and FINRA Rules 2150(a) and 2010.

3. Cherry's Misconduct Also Constituted Securities Fraud

We also find that Cherry willfully committed securities fraud in violation of Exchange Act § 10(b), Exchange Act Rule 10b-5, and FINRA Rules 2020 and 2010, and that these violations constitute an alternative basis for the sanctions imposed.[9] Section 10(b) is violated when a person, acting with scienter, misrepresents or omits material facts in connection with a securities transaction. *See Alvin W. Gebhart, Jr.*, Exchange Act Release No. 58951, 2008 SEC LEXIS 3142, at 23 (Nov. 14, 2008), *aff'd*, 595 F.3d 1034 (9th Cir. 2010). In addition to misrepresentations or omissions, Exchange Act Rule 10b-5 prohibits any "device, scheme or artifice to defraud" or any conduct that would "operate as a fraud or deceit upon any person." 17 C.F.R. 240.10b-5; *see also SEC v. Monarch Funding Corp.*, 192 F.3d 295, 308 (2d Cir. 1999) (stating that to have violated Exchange Act § 10(b) and Rule 10b-5 a respondent must have made a material misrepresentation or omission, or used a fraudulent device). Scienter is defined as "a mental state embracing intent to deceive, manipulate, or defraud." *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193, n.12 (1976). The materiality requirement is met where the deception involves information withheld or misrepresented that a reasonable investor would consider important. *See Basic Inc. v. Levinson*, 485 U.S. 224, 240 (1988).

We find that Cherry's conduct violated these provisions when he intentionally engaged in a fraudulent scheme to convert $474,000 from his customers. Cherry directed BD and DD to deposit their funds with the Cherry Group for the purpose of investing in securities, and instead used their funds to purchase the Florida House in his wife's name. Cherry led his customers to believe that their funds had been invested as directed by making supposed interest payments, causing false documentation of their purported investment to be sent to them, and lying to them about the reasons why their funds could not be returned. Cherry's deceptive conduct was intentional and the information he withheld and misrepresented to his customers—i.e., that he intended to use their funds to purchase the home in which he was living—was material.

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[9] As a result of this finding of a willful violation, Cherry is also subject to statutory disqualification under Article III, Section 4 of the FINRA By-Laws.

Cherry argues that Market Regulation failed to demonstrate the requirement of § 10(b) and Rule 10b-5 that his conduct be "in connection with" a securities transaction because the funds transferred to the Cherry Group by BD and DD were not for the purpose of purchasing securities and no actual securities were purchased. As discussed above, we find that BD and DD intended for their funds to be invested in securities. Moreover, it is well-settled that the "in connection with" requirement is met where, as here, a broker accepts payment for securities that he never intends to deliver. *See, e.g.*, *Grippo v. Perazzo*, 357 F.3d 1218, 1223-24 (11th Cir. 2004) (holding that the "in connection with" requirement had been met even though no security had been purchased because the defendant had accepted and deposited plaintiff's money for the payment of securities); *SEC v. Lauer*, 52 F.3d 667, 670 (7th Cir. 1995) (finding that the "in connection with" requirement was met where no security was sold and noting that "[i]t would be a considerable paradox if the worse the securities fraud, the less applicable the securities laws"); *Kenneth Leo Bauer*, 26 S.E.C. 770, 773 (1947) (finding a willful violation of § 10(b) and Rule 10b-5 where respondent did not purchase securities with customers' funds, and instead converted the funds); *see also SEC v. Zanford*, 535 U.S. 813 (2002) (stating that there need not be an actual purchase or sale of securities to fulfill the requirement that the fraud be "in connection with the purchase or sale of securities"). Accordingly, we find that the "in connection with a purchase or sale of securities" requirement is met because BD and DD deposited their funds with Cherry for the purpose of purchasing securities.

Cherry's fraudulent conduct also violated FINRA Rule 2020, which provides that "[n]o member shall effect any transaction in, or induce the purchase or sale of, any security by means of any manipulative, deceptive or other fraudulent device or contrivance." Under FINRA Rule 0140, FINRA Rule 2020 applies to associated persons as well as members. Any violation of Exchange Act § 10(b) and Rule 10b-5 also violates FINRA Rule 2020, which covers an even broader range of fraudulent conduct. *See Dep't of Enforcement v. Fillet*, 2008011762801, 2013 FINRA Discip. LEXIS 26, at *38-9 (FINRA NAC Oct. 2, 2013), *appeal docketed*, Admin. Proc. File No. 3-15601 (SEC Nov. 1, 2013). A violation of any regulation or FINRA rule, including FINRA Rule 2020, is also a violation of FINRA Rule 2010. *See Murphy*, 2013 SEC LEXIS 1933, at *26 n.29. Accordingly, Cherry's misconduct violated FINRA Rules 2020 and 2010.

C. Cherry Engaged in Outside Business Activities Without Disclosing Them to His Firm in Violation of NASD Rule 3030 and FINRA Rules 3270 and 2010

FINRA Rule 3270 (and its predecessor NASD Rule 3030) provides that associated persons cannot engage in outside business activities without providing "prior written notice" to their firm in the form required by the firm.[10] Cherry violated these rules when he conducted business through the Cherry Group and CAJ Marketing without making the required written disclosures to WGS. Cherry used the Cherry Group to raise money from BD and DD, and used

[10] FINRA Rule 3270 is applicable to Cherry's violations which occurred on or after December 15, 2010. NASD Rule 3030 applies to his misconduct prior to December 15, 2010, and requires "prompt written notice" of outside business activities. *See FINRA Regulatory Notice 10-49*, 2010 FINRA LEXIS 96 (Oct. 2010).

both entities to make interest payments to BD and DD. These activities were outside the scope of his relationship with WGS, and contributed to his fraudulent scheme and conversion of BD's and DD's funds.

Cherry did not disclose any of his involvement with CAJ Marketing to WGS. With respect to the Cherry Group, Cherry's disclosures to WGS were false and misleading. In his 2007 disclosure of the Cherry Group, Cherry represented that he was not marketing the Cherry Group's products and services to WGS customers, and that customers understood the distinction between WGS and the Cherry Group. Cherry, however, used WGS materials to solicit funds from BD and DD, who believed the funds would be invested in a portfolio of securities, and directed them to deposit these funds with the Cherry Group. He also used the Cherry Group and CAJ Marketing to conceal his misconduct and lull his customers into thinking their funds had been invested in securities by using them to make purported interest payments to BD. Accordingly, we find that Cherry violated NASD Rule 3030 and FINRA Rules 3270 and 2010.

V. Sanctions

We have considered FINRA's Sanction Guidelines ("Guidelines")[11] in determining the appropriate sanctions for Cherry's violations. For the reasons set forth below, we affirm the bars and modify the restitution and disgorgement orders.

A. A Bar Is the Appropriate Sanction for Cherry's Conversion of Customer Funds

The Guidelines direct that the standard sanction for conversion is a bar, regardless of the amount converted.[12] The conversion of customer assets is one of the most serious violations that can be committed by an associated person. Conversion is antithetical to the ethical principles that underpin the self-regulation of securities markets, and it is misconduct that "poses so substantial a risk to investors and/or the market as to render the violator unfit for employment in the securities industry, and a bar in therefore an appropriate remedy." *Mullins*, 2012 SEC LEXIS 464, at *74.[13] The sanction of a bar for Cherry's conversion is supported by the presence of numerous applicable aggravating factors.[14]

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[11] *See FINRA Sanction Guidelines* (2013), http://www.finra.org/web/groups/industry/@ip/@enf/@sg/documents/industry/p011038.pdf [hereinafter *Guidelines*].

[12] *Id.* at 36.

[13] For improper use of funds in violation of NASD Rule 2330(a) and FINRA Rule 2150(a), the Guidelines recommend a bar unless the improper use resulted from a misunderstanding of the intended use of the funds, or other mitigation exists. *See Guidelines*, at 36. We find that there was no such misunderstanding or other mitigating factors. Accordingly, the sanction of a bar is also appropriate based on Cherry's violation of these rules.

[14] We have reviewed the record, and find no applicable mitigating factors.

We find it aggravating that Cherry's violations involved the conversion of almost half a million dollars from unsophisticated customers and resulted in a significant financial benefit to him.[15] Neither BD nor DD had experience investing in securities, and BD was elderly and trusted Cherry. It is further aggravating that Cherry's conversion of funds occurred over the course of two years, involved four separate acts of conversion, and was intentional and willful.[16] It is also aggravating that Cherry concealed his misconduct from his customers by making purported interest payments, by his connection to the false statements purportedly from Equitable suggesting that a securities investment had been made, and through his lies to DD and BD about Equitable's role and why Equitable had purportedly stopped making payments.[17] Finally, we find it aggravating that Cherry has not acknowledged any wrong-doing, was dishonest and not forthcoming during FINRA's investigation, and has blocked any attempt to make restitution to his customers by titling the home he purchased with their money in his wife's name.[18]

Cherry's violations are so antithetical to the conduct required of securities professionals that we find him unfit for continued employment in the securities industry. Accordingly, we affirm the sanction of a bar in all capacities for Cherry's conversion of customer funds.[19]

B. The Pending Arbitration Does Not Preclude Restitution

The Hearing Panel ordered Cherry to pay BD and DD $174,000 as restitution—the amount converted by Cherry less the amount they received from their settlement with WGS. Restitution is "used to restore the status quo ante where a victim otherwise would unjustly suffer loss."[20] The Guidelines provide that restitution may be ordered when an identifiable person has suffered a quantifiable loss caused by respondent's misconduct.[21]

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15 *Guidelines*, at 6-7 (Principal Considerations in Determining Sanctions, Nos. 11, 17, 19).

16 *Id.* (Principal Considerations in Determining Sanctions, Nos. 8, 9, 13).

17 *Id.* at 6 (Principal Considerations in Determining Sanctions, No. 10).

18 *Id.* at 6-7 (Principal Considerations in Determining Sanctions, Nos. 2, 4, 12).

19 Cherry's violations of Exchange Act § 10(b), Exchange Act Rule 10b-5 and FINRA Rule 2020 serve as an alternative basis for the sanctions imposed. We consider the Guidelines for misrepresentations or material omissions of fact in determining the sanctions for these violations. *Guidelines*, at 88. The Guidelines recommend that an adjudicator consider a bar in egregious cases involving intentional or reckless misconduct. *Id.* We find that Cherry's intentional misconduct was egregious and a bar is appropriate on these alternative grounds.

20 *Guidelines*, at 4 (General Principles Applicable to All Sanction Determinations, No. 5).

21 *Id.*

Restitution is appropriate to remediate Cherry's misconduct. BD and DD suffered a significant loss as a direct result of Cherry's conversion of their funds. The record clearly identifies that amount of this loss. While Cherry's firm's settlement with BD and DD compensated them for part of that loss, they have not been made whole for a significant portion of it. Accordingly, an order of restitution is appropriate to compensate them. However, we modify the restitution order to credit the interest payments made by Cherry to BD, and order Cherry to pay restitution to BD and DD in the amount of $138,235.83, plus prejudgment interest.[22]

Cherry argues that an order of restitution is not appropriate because BD and DD have a pending arbitration against him. We disagree. We have the authority to order restitution in a disciplinary matter, and we know of no authority that supports the proposition that we should refrain from doing so when there is a pending arbitration. *See Dep't of Enforcement v. Siegel*, Complaint No. C05020055, 2007 NASD Discip. LEXIS 20, at *62 n.53 (NASD NAC May 11, 2007) (noting the absence of authority supporting refraining from awarding restitution when an arbitration is pending), *aff'd*, Exchange Act Release No. 58737, 2008 SEC LEXIS 2459 (Oct. 6, 2008), *rev'd*, 592 F.3d 147 (D.C. Cir. 2010).[23]

C. Disgorgement

The Hearing Panel ordered Cherry to pay $300,000 to FINRA as disgorgement of his ill-gotten gains. The Guidelines recommend that adjudicators consider a respondent's ill-gotten gain when determining an appropriate remedy, and provide that disgorgement may be appropriate where "the record demonstrates that the respondent obtained a financial benefit from his or her misconduct."[24] The purpose of disgorgement is to prevent unjust enrichment, and it is an appropriate remedy where a respondent has converted customer funds. *See Dep't of Enforcement v. Mission Sec. Corp.*, Complaint No. 2006003738501, 2010 FINRA Discip. LEXIS 1, at *48 (FINRA NAC Feb. 24, 2010), *aff'd*, Exchange Ac Release No. 63453, 2010 SEC LEXIS 4053 (Dec. 7, 2010).

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[22] To prevent any windfall benefits, we order that the restitution award be offset by any restitution that, as of the date of this decision, has already been ordered in BD's and DD's pending arbitration case against Cherry.

[23] We have considered and reject Cherry's argument that a restitution order is also inappropriate because the Hearing Panel excluded 24 of his proffered exhibits. FINRA Rule 9263(a) provides that a Hearing Officer "may exclude all evidence that is irrelevant, immaterial, unduly repetitious, or unduly prejudicial." The excluded exhibits concerned transactions unrelated to the facts of this case and were properly excluded on relevance grounds.

[24] *Guidelines*, at 5. The Guidelines also specifically recommend disgorgement for Cherry's outside business activities violations. *Id.* at 13 n.1.

Cherry argues that he did not benefit from the conversion of BD's and DD's funds because the Florida House is titled in his wife's name, and, therefore, disgorgement is not appropriate. We disagree. Cherry admitted that he lives in the home and the record shows that he and his wife took a first-time homebuyer's tax credit on their joint federal income taxes based on the purchase of the Florida House. Cherry should not be permitted to retain his ill-gotten gains because he purposely titled the house in his wife's name to avoid responsibility for his misconduct. Accordingly, we find that disgorgement in the amount of $300,000 is an appropriate remedy for Cherry's violations. We also order Cherry to pay prejudgment interest on the disgorgement amount.

D. Cherry's Outside Business Activities Violations Were Egregious and a Bar Is Appropriate

The Hearing Panel found that Cherry's outside business activities violations were egregious and imposed a bar. We agree and affirm.

For outside business activities violations, the Guidelines recommend imposing a fine between $2,500 and $50,000 and indicate that adjudicators may also order disgorgement.[25] The Guidelines further recommend that adjudicators consider a suspension of up to 30 days if the violations do not involve aggravating conduct, a suspension of up to one year when there is aggravating conduct, and a longer suspension or bar in egregious cases, including cases involving a substantial volume of activity or a significant injury to customers.[26]

A number of aggravating factors apply to Cherry's misconduct. Cherry's outside business activities involved customers and caused significant injury to them.[27] His violations occurred over a period of two years, and allowed him to benefit from the conversion of a large amount of customer money.[28] Cherry's use of WGS marketing tools created the impression that he was selling a product approved by his firm.[29] Cherry concealed his outside business activities from his firm by failing to disclose his involvement with CAJ Marketing, and making a false and misleading disclosure concerning the Cherry Group.[30] Finally, Cherry's outside business

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25 *Guidelines*, at 13.

26 *Id.*

27 *Id.* at 7 (Principal Considerations in Determining Sanctions, No. 11), 13 (Principal Considerations in Determining Sanctions, Nos. 1, 2).

28 *Id.* at 7 (Principal Considerations in Determining Sanctions, Nos. 8, 9, 17), 13 (Principal Considerations in Determining Sanctions, No. 3).

29 *Id.* at 13 (Principal Considerations in Determining Sanctions, No. 4).

30 *Id.* (Principal Considerations in Determining Sanctions, No. 5). The fact that Cherry's disclosure may have been accurate at the time it was made is not relevant. When he used the

[Footnote continued on next page]

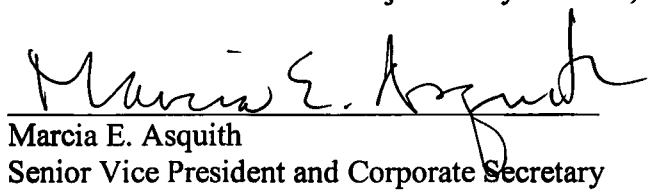
activities violations are egregious because they enabled him to perpetuate his fraudulent scheme resulting in the conversion of customer funds.

Considering these aggravating factors, we find that Cherry's violations are egregious and a bar is the appropriate sanction.

VI. Conclusion

We find that Cherry misused and converted customer funds in violation of FINRA Rules 2010 and 2150(a), and NASD Rule 2330(a). His conversion of customer funds also violated Exchange Act § 10(b), Exchange Act Rule 10b-5, and FINRA Rules 2020 and 2010. For these violations we bar Cherry in all capacities and order him to pay restitution to BD and DD in the amount of $138,235.83 (along with prejudgment interest on any unpaid balance starting on December 1, 2010, until restitution is paid in full), and to pay FINRA $300,000 in disgorgement (along with prejudgment on any unpaid balance starting on December 1, 2009, until paid in full).[31] We further find that Cherry engaged in outside business activities without providing written notice to his firm in violation of NASD Rule 3030 and FINRA Rules 3270 and 2010, and impose a separate bar in all capacities for these violations. Finally, we affirm the Hearing Panel's order that Cherry pay hearing costs of $3,860.71.[32]

On Behalf of the National Adjudicatory Counsel,



Marcia E. Asquith
Senior Vice President and Corporate Secretary

[Cont'd]

Cherry Group to obtain funds from customers, his disclosure became false and misleading and he was obligated to correct it.

[31] Prejudgment interest shall be paid at the rate established for the underpayment of income taxes in Section 6621(a) of the Internal Revenue Code, 26 U.S.C. § 6621(a).

[32] The bars are effective as of the date of this decision.