BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD

In the Matter of Department of Enforcement, Complainant, vs. Alvin W. Gebhart, Jr. Fallbrook, CA, and Donna T. Gebhart Fallbrook, CA, Respondents.	DECISION Complaint No. C02020057 Dated: May 24, 2005

Hearing Panel found that respondents engaged in private sales of unregistered securities and made negligent omissions of material fact. Held, findings affirmed in part, modified in part, and sanctions modified.

APPEARANCES

For Complainant: Sylvia M. Scott, Esq., Leo F. Orenstein, Esq., NASD Department of Enforcement.

For Respondents: John H. L'Estrange, Jr., Esq., Charles F. Goria, Esq.

DECISION

Pursuant to Procedural Rule 9312(a), the National Adjudicatory Council ("NAC") Review Subcommittee ("Review Subcommittee") called this matter to review the findings in, and the sanctions imposed by, a February 9, 2004 NASD Hearing Panel decision. The Hearing Panel found that, from January 1997 to February 2000, Alvin W. Gebhart, Jr. ("Alvin Gebhart") and Donna T. Gebhart ("Donna Gebhart") (together, "the Gebharts" or "respondents") offered and sold unregistered securities, through negligent material omissions, without providing written notice to, or obtaining prior approval from, their employer. The Hearing Panel dismissed, however, the Department of Enforcement's ("Enforcement") allegations that respondents fraudulently omitted material information in connection with the offer and sale of securities. Finding that Alvin Gebhart was primarily responsible for the violations, the Hearing Panel: (1) suspended Alvin Gebhart for one year in all capacities and fined him $100,000; and

00005151 2011

(2) suspended Donna Gebhart for seven months in her capacity as a general securities representative and fined her $7,500. The Hearing Panel also ordered respondents to pay costs of $5,141.21, jointly and severally.

We affirm the Hearing Panel's findings that respondents offered and sold unregistered securities that were not exempt from registration without providing written notice to, or obtaining prior approval from, their firm. We modify, however, the Hearing Panel's findings that respondents made negligent omissions and instead find that they recklessly omitted material facts. We also increase the sanctions imposed by the Hearing Panel. We bar Alvin Gebhart from associating with any member firm in all capacities. In light of the bar, we vacate the $100,000 fine that the Hearing Panel imposed on him. As for Donna Gebhart, we increase the fine to $15,000, increase her suspension to one year, and order her to requalify by examination as a condition of continued employment in the securities industry.

I. Background

Alvin Gebhart first became registered as an investment company products/variable contracts representative in May 1983. From on or about January 30, 1996, through August 11, 2000, Alvin Gebhart was associated with Mutual Service Corporation ("MSC") as an investment company products/variable contracts representative. On December 10, 1997, he also became associated with MSC as a general securities representative. Prior to joining MSC, Alvin Gebhart was associated with MONY Securities Corporation ("MONY") as an investment company products/variable contracts representative. Alvin Gebhart is currently registered with another member firm.

Donna Gebhart was associated with MSC as an investment company products/variable contracts representative from on or about February 14, 1996, through August 11, 2000. On April 27, 1998, she became registered with MSC as a general securities representative. Donna Gebhart is currently registered with another member firm. Alvin and Donna Gebhart, husband and wife, worked in the same office for some of the relevant time period. From April 15, 1997, the Gebharts conducted business under the name Gebhart & Associates, Inc., which has been a registered investment adviser since June 3, 1998.

II. Factual Findings

A. The MHP Promissory Notes

This matter involves the sale by respondents of promissory notes issued by MHP Conversions, LLC ("MHP"), a California limited liability company. MHP was formed in 1997 to facilitate "resident acquisitions" services offered by Community Service Group ("CSG"), which managed sales of mobile home parks from their owners to their residents. CSG's acquisition services involved setting up a separate, non-profit entity that would acquire a mobile home park and selling shares in the non-profit entity to the park's residents. The residents' purchase of shares was financed by a number of sources, including private financings, the State of California, local municipalities, and the U.S. Department of Housing and Urban Development ("HUD").

MHP was formed to simplify the financing operations for CSG's resident acquisitions services.[1] MHP obtained financing to purchase each mobile home park through the issuance of promissory notes. Holders of promissory notes would be paid in full when the notes matured or when CSG sold the mobile home park to its residents, whichever occurred earlier. During the relevant period, MHP (and CSG, prior to MHP's formation) issued promissory notes (the "MHP notes") that were one year in duration and paid interest rates between 14 and 19 percent. Each promissory note stated it would "ultimately" be secured by recorded deeds of trust on a property, the description of which usually contained nothing more than a city and state of location. The MHP notes further provided that, until such deeds of trust were recorded, "the sole asset" of MHP was a $100,000 deed of trust on a property known as Eastern Trailer Park, in El Cajon, California. No registration statement for the MHP notes was filed or in effect with the SEC at any time.

B. Archer Introduces Alvin Gebhart to the MHP Notes Program

From February 1994 to January 1996, Alvin Gebhart was associated with MONY, where his business consisted primarily of selling insurance, mutual funds, and variable annuities. While at MONY, Alvin Gebhart met John T. Archer ("Archer"), a MONY registered representative. Over the course of a couple of conversations in 1995 and early 1996, Archer introduced Alvin Gebhart to CSG's resident acquisitions program and inquired whether Alvin Gebhart had clients who might be interested in investing in that program. Subsequently, Alvin Gebhart referred three of his clients to Archer and was "most likely" present at Archer's presentations to them. Alvin Gebhart testified that, at that point, he did not "feel any danger" with the MHP notes because Archer had been marketing the program for years, he had no reason to doubt that MONY had approved Archer's sales, and his clients would be dealing only with Archer and could make their own decisions.

C. Alvin and Donna Gebhart Join MSC

Dissatisfied with his compensation and the nature of his assigned work, Alvin Gebhart left MONY in late January 1996, became registered with MSC as an investment company products/variable contracts representative, and opened an MSC non-Office of Supervisory Jurisdiction branch office located in Rancho Bernardo, California.[2] When he first opened this branch office, Alvin Gebhart sold only variable annuities, insurance products, and mutual funds. At around the same time, Donna Gebhart decided to join her husband in his business. On

---

1 MHP's owners, and their respective interests, were as follows: (i) Eivocs, Inc., 50 percent, which was owned by James Scovie ("Scovie") and his wife; and (ii) David W. Mounier, Inc., 50 percent, which was owned by David Mounier ("Mounier") and his wife. CSG was owned by Scovie.

2 MSC's home office principals in Florida supervised Alvin Gebhart's branch office, one of approximately 300 MSC branch offices in 1996. Alvin Gebhart testified that MSC sent him a compliance manual and a "marketing book," but did not otherwise offer assistance to help set up his branch office.

February 14, 1996, Donna Gebhart became registered with MSC as an investment company products/variable contracts representative.

As part of their application to join MSC, the Gebharts each completed an outside business activities questionnaire. Respondents represented that Alvin Gebhart was engaged in insurance sales, medical benefit planning services, and financial planning, but that they were not otherwise engaged in any outside business activities.

On February 16, 1996, Alvin Gebhart acknowledged receiving and reading the compliance section of MSC's policies and procedures manual. Alvin Gebhart testified that he "scanned" the compliance manual and followed it "[a]s best I could." The manual contained the following instruction concerning private securities transactions: "All Representatives must notify MSC in advance, in writing, of their intent to 'engage in private securities transactions outside the regular course or scope of their association or employment.' No Representative is allowed to participate in such transactions without MSC's consent and written approval." The manual also explained that MSC conducted a due diligence investigation before approving private securities transactions, and that, if a product were approved, all commissions would flow through MSC. In addition, the manual provided this cautionary advice:

> The failure of Representatives to notify their member firms about proposed private security transactions raises a number of serious problems. The securities or investments which Representatives believe to be exempt from registration may, in fact, not be exempt, and private transactions in such instruments may cause violations of . . . securities laws and . . . NASD[ ] Rules . . . . Notification to the employer serves to protect Representatives in matters in which they may not be as well informed.

On September 9 and 10, 1996, respondents acknowledged receiving and reading an updated MSC manual, which provided more detailed procedures concerning outside business activities and private securities transactions. Citing NASD Conduct Rule 3040, the amended manual explained that, for private securities transactions, "a Representative must obtain prior approval in writing" and that "[m]ere disclosure . . . is <u>not</u> sufficient." The amended manual also explained that "[o]ffering any security not listed in MSC's Product Notebook, specifically including so-called 'exempt' or alleged non-securities 'deals,'" required advance written approval by MSC.[3]

---

[3] Citing only the introductory paragraph of the section addressing "outside business activities and private securities transactions," the Hearing Panel found that the amended manual did not clearly identify which types of outside business activities required affirmative written approval from MSC. In our view, however, when the cited passage is read in the context of the entire section it introduces, MSC's instructions clearly explain that private securities transactions require written approval.

D. The Gebharts' Decision to Sell MHP Notes and Their Communications with MSC Compliance Director Michael Poston

Between January 10 and October 3, 1996, the three clients whom Alvin Gebhart referred to Archer ultimately invested a total of $65,000 in MHP notes. For these investments, Archer paid Alvin Gebhart finder's fees, using personal checks. On October 3, 1996, the Gebharts themselves invested $7,000 in an MHP note.

On or about October 23, 1996, Archer met with the Gebharts and asked if they had more clients who would be interested in investing in MHP notes. During this meeting, the Gebharts learned a little more about the mobile home park conversion process and obtained literature describing the program. According to the Gebharts, Archer told them the notes were secured by second deeds of trust, and that "there was always at least 45% equity in the park above the 1st and the 2nd deeds of trust." Archer also said that CSG's officers worked with HUD, FHA, and Banc One to obtain financing for the individual purchasers of the mobile home parks. In addition, Archer represented that the MHP notes were not securities but, instead, a "fixed-income product" and "real estate second deeds of trust," and that, to "avoid any possibility of securities issues," there would always be fewer than 10 investors in each park. Finally, Archer said that MONY's Compliance Department had approved his sales of MHP notes. Unbeknownst to the Gebharts, however, Archer had never sought nor received written approval from MONY to participate in these types of transactions.

Donna Gebhart explained that she and her husband liked that the MHP notes had a fixed rate of interest, were short-term, that Archer had sold them for years, and that the financing for park residents came from "large entities." But apart from the information that Archer gave them, the Gebharts neither knew nor sought further details. Alvin Gebhart testified that, at that time, he had no reason to distrust Archer. Alvin Gebhart's manager at MONY, Bill Freiss, had recruited Archer and spoke highly of him. In addition, Alvin Gebhart assumed the MHP investments had been successful because none of his three clients who had already invested had complained.

Archer advised the Gebharts to contact MSC's Compliance Department to see if they could sell the product. On October 23, 1996, Alvin Gebhart called MSC's Compliance Department to discuss the CSG program and spoke with Michael Poston ("Poston"), MSC's Compliance Director, who had approximately 800 representatives under his supervision. The Gebharts and Poston recalled this conversation somewhat differently. Alvin Gebhart testified that he described the CSG program, explained that he would be splitting commissions with Archer, and answered "a lot" of questions from Poston. He further testified that Poston said the CSG program "sounded like a good idea" and asked the Gebharts to send him more information. Alvin Gebhart admitted, however, that he did not inform Poston about his three clients who had already invested. Donna Gebhart, who heard her husband talking on the phone, testified that Alvin Gebhart informed Poston that he wanted to offer MHP notes to his clients. Poston, in contrast, did not understand that Alvin Gebhart was requesting permission to sell anything. Instead, he thought Alvin Gebhart was calling to see if MSC "had a position" on trailer park programs and to ask about MSC's procedures should he want to offer the notes to his clients. Poston testified that he told Alvin Gebhart he would need to submit a detailed letter describing

the program and his proposed role. Nevertheless, Poston testified that Alvin Gebhart said he had not sold the products to anyone, which Poston took "as an indication that [Alvin Gebhart] . . . had no interest in it." Poston stated that the call lasted five minutes.[4]

Subsequently, Alvin Gebhart sent to Poston a letter enclosing written materials concerning the CSG program and asking Poston to "review [the] information and please let me know what you think of it." The materials included a description of the park conversion strategy, "pro forma" financial documents, an investment summary for one specific park conversion project, examples of past and pending park conversions, and newspaper clippings describing CSG's involvement in past park conversions.[5] Poston testified that he "didn't know what to make of [the letter]" and did not interpret it as a written request for approval to sell MHP notes. Poston did not contact Gebhart again, and it is undisputed that MSC did not provide the Gebharts with written approval to sell the MHP notes. Alvin Gebhart allegedly assumed that Poston's silence was tantamount to MSC's approval. Alvin Gebhart testified that the MHP notes were "not a security that I knew about," and respondents both claimed they assumed that MSC would have contacted them if there was a problem.

E. <u>The Gebharts' Sales of MHP Notes</u>

Without providing to, or receiving from, MSC any additional communications about the program, the Gebharts began selling MHP notes in early 1997. Alvin and Donna Gebhart jointly served their clients, including determining whether the MHP notes were suitable for them. In general, both Gebharts were present for client meetings, but Alvin Gebhart did most of the talking.

Alvin Gebhart testified that, when meeting with clients, he presented "a variety of investment strategies" and discussed the MHP notes as one alternative that would "fit in [clients'] portfolio[s], based on their objectives." The Gebharts provided customers with CSG/MHP promotional materials, such as descriptions of projects, newspaper clippings, testimonials, and descriptions of CSG's resident acquisitions program. Alvin Gebhart informed potential investors that the MHP notes were "secured by [a] recorded deed of trust" and that "if the worst case scenario came down they would be part owners of that [trailer] park." Likewise, Donna Gebhart sometimes explained to potential investors that the investments were secured by a trust, that noteholders would be owning a piece of a trailer park, and that HUD was involved. The Gebharts also informed their customers that MSC "had reviewed the information on this investment." Alvin Gebhart testified that he told customers that an MHP note "had risks to it," and he denied ever characterizing the MHP notes as safe. Alvin Gebhart did not, however,

---

4 While the Hearing Panel did not indicate whose version of the conversation was credible, it concluded that Alvin Gebhart provided Poston with verbal notice of the mobile home park program.

5 The Hearing Panel did not find credible Poston's testimony that he received from Alvin Gebhart only a few newspaper clippings and a few abstracts of examples of trailer park conversions. We do not disturb the Hearing Panel's credibility determination.

inform his clients about the financial condition of CSG or MHP, nor did he inform them that he would receive a commission on any transactions in MHP notes.

From January 1997 to February 2000, the Gebharts sold more than $2.36 million of MHP notes to 45 clients, including more than $62,000 in notes sold to themselves. Donna Gebhart testified that Archer "always assured" them that the parks "were in good shape" and "had a lot of equity in them." Until April 2000, MHP made monthly interest payments due under the existing notes. The Gebharts delivered "Gebharts & Associates" account statements and financial analyses to customers that listed their MHP investments under various categories, such as "fixed annuities," "mutual funds," and "unit investment trusts." CSG provided deeds of trust to clients who specifically requested them and to entities that administered clients' retirement accounts, such as First Regional Bank, when funds in such accounts were used to invest in MHP notes. The trust deeds, however, never contained recording information.

For the Gebharts' sales, Archer received 10 percent commissions, out of which he paid the Gebharts commissions of six percent for new investments and three/four percent for reinvestments. From 1997 through 1999, the Gebharts received $104,634 in commissions.

F. The Gebharts' Relevant Communications with MSC

The Gebharts made numerous representations to MSC concerning the extent of their outside business activities. In August 1997, the Gebharts completed MSC's 1997 Compliance Survey, in which they acknowledged they: (1) had read, and understood their responsibility to follow, the MSC compliance procedures set forth in the policies and procedures manual; (2) had notified MSC, in writing, of all outside business relationships for which they received compensation; and (3) had not engaged in private securities transactions as defined in MSC's manual without written approval. From January through August 1997, however, the Gebharts sold 11 MHP notes raising $135,495.19.

On November 17, 1997, Joshua Helmle ("Helmle"), a compliance auditor, conducted MSC's first audit of the Gebharts' branch office. Among the materials that respondents provided to Helmle for his review were computer-generated business logs that included entries for the MHP transactions, described as "Fixed 1 Yr (Trailer Park)" and "trailer park investment."[6] Helmle's review of the Gebharts' office was favorable. As part of the audit, the Gebharts completed MSC's Representative Questionnaire, which asked, among other things, whether the representative: (1) had "received compensation from a source other than MSC for initiating or processing a transaction in any type of investment"; and (2) participated in any offering of general partnership interests, commercial paper, promissory notes, or joint venture participations other than through MSC. Respondents answered "no" to both questions, despite the fact that, in 1997, they earned $7,401 in commissions by selling MHP notes. Respondents generally testified that they answered "no" because they believed they had already disclosed all of their outside

---

[6] The Hearing Panel did not credit Helmle's testimony that the logs he reviewed did not include the MHP transactions. We do not disturb this determination.

business activities and did not need to disclose them again. Alvin Gebhart further testified that he believed the questions related to securities transactions and did not concern the MHP notes.

In July and August 1998, the respondents again represented on MSC's 1998 Compliance Survey that they had not engaged in any unapproved private securities transactions and that they had provided MSC with written notice of all outside business relationships for which they received compensation. However, from September 1, 1997 through July 1998, the Gebharts sold $414,428.88 in MHP notes. In 1998, the Gebharts earned $21,510 in commissions from their sales of MHP notes.

On September 14, 1998, Alvin Gebhart and Linda Prijic ("Prijic"), office manager for Gebhart & Associates, inquired with MSC's operations department about how a client could purchase for a 403(b) account a "note on the 2nd deed of trust on the trailer park investment" and attached a copy of an MHP note. After receiving additional information, on September 24, 1998, MSC's operations department forwarded to respondents a wire from MSC's clearing firm approving the MHP notes for the 403(b) account. Poston testified that MSC's operations department has no responsibilities for reviewing or approving outside business activities.

In February 1999, Helmle conducted a second audit of the Gebharts' office for MSC. Helmle's audit report reflects that the Gebharts' main sources of revenue were securities sales, insurance sales, and investment advisory services, but did not identify any other sources. The audit report also inaccurately indicated that the Gebharts' office did not prepare its own monthly statements. In connection with the audit, the Gebharts represented on a questionnaire that they understood Rule 3040's prohibition on selling away and had not engaged in any private securities transactions. The questionnaire also asked whether the Gebharts had issued or participated in any offering of promissory notes other than through MSC. To this question, Alvin Gebhart answered "yes" and wrote "2nd Deeds of Trusts." Donna Gebhart provided a similar response but also added, "Investment by Rep & Clients." Alvin Gebhart testified that he answered "yes" because he had a better understanding of the form than he did in 1997.[7]

On October 6, 1999, the Gebharts, for the third year in a row, acknowledged on MSC's annual compliance survey that they had provided MSC with written notification of all outside business relationships for which they received compensation and had not engaged in private securities transactions without prior written approval. In 1999, however, the Gebharts earned $75,723 in commissions from sales of the MHP notes.

---

[7] The extent to which Helmle discussed these "yes" responses with the Gebharts is unclear. Alvin Gebhart did not remember any discussions with Helmle about the MHP notes. While Donna Gebhart remembered that she and Alvin Gebhart discussed their responses with Helmle, she did not remember the whole conversation, adding that "we would have answered [Helmle] truthfully." Helmle testified that the Gebharts told him that they and a few of their clients had invested in this particular investment "via a mutual friend." The Hearing Panel, however, found that Helmle's testimony concerning his audit and his conversations with the Gebharts was not reliable. We find no reason to disturb the Hearing Panel's credibility determination.

G. The Collapse of CSG and MHP

In a letter dated April 4, 2000, Scovie, president of CSG, informed MHP noteholders that he had been diagnosed with brain cancer in January 2000, had been unable to participate in the operations of CSG, and that interest payments then due under the notes would not be made. One month later, Scovie again wrote to noteholders, explained that it was not possible to make interest or principal payments, and described the steps he was taking to resume payments. Scovie also disclosed that CSG had not recorded all of the investors' deeds of trust and that, of the approximately $3,670,000 in existing notes, only $605,000 was secured by recorded deeds of trust. The Gebharts immediately began taking steps to try to protect their clients' interests, including informing MSC about the collapse and filing for an involuntary bankruptcy proceeding against MHP. On August 11, 2000, MSC terminated the Gebharts' registrations. The Gebharts' customers ultimately filed a class action lawsuit against the Gebharts and MSC. *Tickel et al. v. Alvin Gebhart Jr. and Mutual Service Corp.*, No. GIC 759642 (Cal. Super. Ct.) (action filed Dec. 18, 2000).

III. Procedural History

On December 13, 2002, Enforcement filed a four-cause complaint against Alvin Gebhart, Donna Gebhart, and Archer concerning their sales of the MHP notes from December 1994 to February 2000. The only pertinent allegations are those raised in the first three causes against the Gebharts.[8] Cause one of the complaint alleged that the Gebharts offered and sold promissory notes issued by MHP that were not registered as securities, in violation of Section 5 of the Securities Act of 1933 ("Securities Act") and NASD Conduct Rule 2110. Cause two alleged that the Gebharts made misrepresentations and omissions of material facts in the sale of MHP notes, in violation of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), Rule 10b-5 thereunder, and NASD Conduct Rules 2110 and 2120. Cause three alleged that the Gebharts sold the MHP notes without providing prior written notification to, or receiving prior approval from, MSC, in violation of Conduct Rules 2110 and 3040. The Gebharts jointly filed an answer, in which they generally denied the allegations, raised several affirmative defenses, and asserted that mitigating circumstances existed. On February 9, 2004, the Hearing Panel issued its decision, finding that Alvin Gebhart, assisted by Donna Gebhart, offered and sold unregistered securities through negligent material omissions without providing prior written notice to, or obtaining prior approval from, MSC and imposing sanctions. The Hearing Panel declined, however, to find that the Gebharts fraudulently sold the MHP notes.

On March 8, 2004, the Review Subcommittee called this matter for review. During the appellate proceedings, respondents filed a Motion for Leave to Introduce Additional Evidence to Supplement the Record, whereby they sought to introduce 16 additional exhibits. A subcommittee of the NAC ("Subcommittee") granted respondents' motion in part, admitting into

---

[8] On June 25, 2004, a default decision found that Archer acted as an unregistered broker, fraudulently offered and sold unregistered securities, and engaged in private securities transactions without approval of his firm. Archer was barred from associating with any member firm.

evidence six paragraphs of a declaration of Alvin Gebhart, in which he declared he may have an inability to pay the sanctions.[9] Respondents were informed that, should they wish to introduce evidence of Alvin Gebhart's inability to pay, they were required to document his financial status. On September 25, 2004, respondents submitted a Statement of Financial Condition of Alvin and Donna Gebhart.

IV. Discussion

As explained below, we affirm the Hearing Panel's findings that the Gebharts sold unregistered securities that were not exempt from registration and that they engaged in private securities transactions for compensation without providing written notice to, or receiving written approval from, their firm. We disagree, however, with the Hearing Panel's findings that the Gebharts' sales of the MHP notes involved only negligent omissions of material information. We find that the Gebharts' conduct was much more serious than that and hold that their omissions of material fact were reckless.[10]

A. Sales of Unregistered Securities

Section 5 of the Securities Act makes it unlawful for any person to make a sale, or any offer for sale, of a security for which no registration statement is in effect, unless there is an exemption from registration. *Michael A. Niebuhr*, 52 S.E.C. 546, 549 (1995). Scienter is not an element of a Section 5 violation. *Butcher & Singer, Inc.*, 48 S.E.C. 640, 643 (1987). The Gebharts sold the MHP notes, stipulated that no securities registration statement was in effect for the MHP notes, and have made no claim that the MHP notes were exempt from registration. Whether the Gebharts are liable for violating Section 5, therefore, turns on whether the MHP notes were securities.

---

[9] In their motion, respondents sought to introduce four categories of documents: (1) NASD BrokerCheck records showing certain disciplinary information for other persons allegedly involved in the relevant events (including MONY, MSC, and some of their associated persons); (2) unsworn declarations of 10 customers, generally recounting their favorable impressions of the Gebharts; (3) a declaration of an attorney who represented the plaintiff classes in *Tickel* and in a separate class action against Archer and MONY, comparing the settlements obtained by the classes; and (4) a declaration of Alvin Gebhart, in which he sought to authenticate the proposed exhibits and asserted his inability to pay. Except as explained in the text, the Subcommittee denied respondents' motion because respondents failed to demonstrate, as to some proposed evidence, good cause for failing to introduce the evidence below or, as to other proposed evidence, why the evidence was material. *See* Procedural Rule 9346(b). We adopt the Subcommittee's rulings.

[10] The complaint alleged that Donna Gebhart was liable as a primary violator. It is unclear whether the Hearing Panel evaluated Donna Gebhart's liability as a primary violator or, instead, as an aider and abettor. To the extent that the Hearing Panel found Donna Gebhart liable as an aider and abettor, we dismiss those findings.

We agree with the Hearing Panel that the MHP notes were securities. Section 3(a)(10) of the Exchange Act defines security to include any "note . . . but shall not include any note . . . which has a maturity at the time of issuance not exceeding nine months." As the Supreme Court held in *Reves v. Ernst & Young*, 494 U.S. 56, 62-63 (1990), however, the definition of "security" should not be interpreted to encompass literally all notes. "Congress' purpose in enacting the securities laws was to regulate *investments*," and notes are used "in a variety of settings, not all of which involve investments." *Id.* at 61-63. To distinguish notes that are securities, the Court adopted the so-called family resemblance test. Under that test, a note is presumed to be a security, and that presumption may be rebutted only by a showing that the note bears a strong resemblance to one of several enumerated categories of non-securities notes, based on four factors (the "*Reves* factors").[11] If a note is not sufficiently similar to one of the enumerated categories, the family resemblance test requires an examination, using the same four factors, to determine whether another category should be added. *Id.* at 67. We conclude, after applying the family resemblance test, that the MHP notes neither bear a strong resemblance to any of the enumerated categories of non-securities notes nor belong to a category that should be added.

The first *Reves* factor is the motivation that would prompt a reasonable seller and buyer to enter into the transaction. "If the seller's purpose is to raise money for the general use of a business enterprise or to finance substantial investments and the buyer is interested primarily in the profit the note is expected to generate, the instrument is likely to be a 'security.'" *Id.* at 66. This factor strongly suggests that the MHP notes were securities. MHP's motivation in selling the promissory notes was to raise money to purchase numerous parks for its resident acquisitions program. As such, we find that MHP's motivation was to "raise money for the general use of a business enterprise." *Id.* at 66.[12] Furthermore, the record demonstrates that the buyers' interest in the MHP notes was primarily—if not exclusively—to receive a very generous interest rate of 14 to 19 percent. *Id.* at 67-68 & n.4; *Stoiber v. SEC*, 161 F.3d 745, 750 (D.C. Cir. 1998).

The second *Reves* factor is the plan of distribution of the instrument to determine whether there is common trading for speculation or investment. *Reves*, 494 U.S. at 66. To establish "common trading," all that is required is a showing that the instruments are "offered and sold to a broad segment of the public." *Id.* at 68. CSG's method of distribution of its notes was limited, in that it apparently relied only on Archer and the Gebharts. There is no evidence that the notes were advertised, that any member firm put the notes on its approved product list, or that there were any secondary market sales. However, the Gebharts sold the MHP notes to approximately

---

[11] The enumerated non-securities notes are "the note delivered in consumer financing, the note secured by a mortgage on a home, the short-term note secured by a lien on a small business or some of its assets, the note evidencing a 'character' loan to a bank customer, short-term notes secured by an assignment of accounts receivable, or a note which simply formalizes an open-account debt incurred in the ordinary course of business (particularly if, as in the case of the customer of a broker, it is collateralized)." *Reves*, 494 U.S. at 65 (citing *Exchange Nat'l Bank of Chicago v. Touche Ross & Co.*, 544 F.2d 1126, 1138 (2d Cir. 1976)).

[12] That the MHP notes raised money for the general use of a business strongly indicates that the MHP notes were unlike any of the enumerated non-securities notes.

45 individuals, and Archer sold MHP notes to a similar number of customers. While there is no apparent bright line test for how many investors satisfy the second *Reves* factor, we find that the number of customers who invested in MHP notes is high enough to demonstrate common trading. *SEC v. Current Fin. Servs.*, 100 F. Supp. 2d 1, 5 (D.D.C. 2000) (holding that sales to 570 investors, with the use of newspaper advertisements, demonstrated sales to the public), *aff'd sub nom. SEC v. Rayburn*, 22 Fed. Appx. 1 (D.C. Cir. 2001) (unpublished); *Dist. Bus. Conduct Comm. v. Kunz*, Complaint No. C3A960029, 1999 NASD Discip. LEXIS 20, at *18 (NAC July 7, 1999) (holding that the solicitation of more than 100 unrelated persons indicates that the products were securities), *aff'd, Kevin D. Kunz*, Exchange Act Rel. No. 45290, 2002 SEC LEXIS 104 (Jan. 16, 2002), *aff'd*, 64 Fed. Appx. 659 (10th Cir. 2003) (unpublished); *cf. SEC v. Ralston Purina Co.*, 346 U.S. 119, 125 (1953) (holding that the Securities Act registration requirements apply to "a 'public offering' whether to few or to many").

The third *Reves* factor—the reasonable expectations of the investing public concerning whether the instrument is a security—strongly suggests that the MHP notes were securities. The Court explained that the "fundamental essence of a 'security' [is] its character as an 'investment.'" *Reves*, 494 U.S. at 68-69. Alvin Gebhart discussed the MHP notes with clients as an "investment vehicle," and Donna Gebhart testified that she and Alvin Gebhart recommended the MHP notes because they had short-term maturities and paid a favorable, fixed rate of interest. Moreover, the Gebharts mailed account statements that listed customers' investments in the MHP notes under categories such as "mutual funds" and "annuities." Given these circumstances, a reasonable person would perceive the MHP notes to be investments.

The fourth *Reves* factor is the existence of a factor that significantly reduces the risk of the instrument, such as another regulatory scheme, thereby rendering the application of the Securities Acts unnecessary. *Reves*, 494 U.S. at 67. Securing each MHP note with a deed of trust on a given property with sufficient equity certainly might have helped reduce the risk of the MHP notes. In this case, however, any collateralization was "fiction," because CSG failed to record deeds of trust on the properties purportedly securing each note. *SEC v. J.T. Wallenbrock & Assocs.*, 313 F.3d 532, 539-40 (9th Cir. 2002). Moreover, respondents have not demonstrated that any comprehensive, alternative scheme of regulation protected investors in the MHP notes, nor are we aware of any. *Cf. Pollack v. Laidlaw Holdings*, 27 F.3d 808, 815 (2d Cir. 1994) (holding that there was no alternative regulatory scheme governing uncollateralized, oversubscribed mortgage participations, defined as short-term loans for construction and cooperative conversions).

Viewed against the *Reves* factors, therefore, we affirm the Hearing Panel's findings that the MHP notes were "notes" within the meaning of the Exchange Act and, therefore, securities. Accordingly, the Gebharts violated Conduct Rule 2110 by offering and selling unregistered securities that were not exempt from registration.[13]

---

[13] Rules that apply to an NASD "member", like Conduct Rules 2110 and 2120, apply to all members and to persons associated with a member. NASD Rule 115(a).

B. Private Securities Transactions

We also affirm the Hearing Panel's finding that the Gebharts, by selling MHP notes, engaged in private securities transactions without providing prior written notice to, or receiving prior written approval from, MSC. Conduct Rule 3040(b) provides that "[p]rior to participating in any private securities transaction, an associated person shall provide written notice to the member with which he is associated describing in detail the proposed transaction and the person's proposed role therein and stating whether he has received or may receive selling compensation in connection with the transaction." In cases where an associated person may receive selling compensation, a member firm must inform the associated person in writing whether it approves or disapproves of the private securities transaction. Conduct Rule 3040(c). Scienter is not required for a Rule 3040 violation. *Dep't of Enforcement v. Fergus*, Complaint No. C8A990025, 2001 NASD Discip. LEXIS 3, at *44 n.30 (NAC May 17, 2001), *aff'd sub nom. Frank Thomas Devine*, Exchange Act Rel. No. 46746, 2002 SEC LEXIS 2780 (Oct. 30, 2002). A violation of Rule 3040 is also a violation of Rule 2110. *Chris Dinh Hartley*, Exchange Act Rel. No. 50031, 2004 SEC LEXIS 1507, at *9-10 (July 16, 2004).

The Gebharts' sales of MHP notes constituted "private" securities transactions. A private securities transaction is defined as "any securities transaction outside the regular course or scope of an associated person's employment with a member." Conduct Rule 3040(e)(1). From January 1997 to February 2000, the Gebharts sold approximately $2.4 million in MHP notes to about 45 different customers in 117 transactions and earned more than $104,634 in commissions. The MHP notes, however, were not on an MSC approved product list, and the Gebharts' sales were not recorded on MSC's books and records. *See Dep't of Enforcement v. Vastano*, Complaint No. C3A020013, 2003 NASD Discip. LEXIS 41, at *14-15 (NAC Dec. 5, 2003) (holding that sales of investments, which were not on an approved product list or recorded on member firm's books, were private securities transactions), *aff'd, Joseph Vastano, Jr.*, Exchange Act Rel. No. 50219, 2004 SEC LEXIS 1806 (Aug. 19, 2004).

In addition, the Gebharts failed to provide MSC with advance written notice of, or receive prior written approval for, their sales of the MHP notes. Alvin Gebhart supplied Poston with written materials concerning the CSG program and, in a letter, asked Poston to review that information. This letter, however, fell far short of the detailed written notice required by Rule 3040. The materials included an "investment summary"—evidently for notes sold in connection with one particular mobile home park—that summarized the total amount CSG sought to raise, the interest rate paid to investors, the length of the notes, the purported collateral, and the expected use for the proceeds. The written materials did not, however, include a sample promissory note, explain Archer's role, or explain the breadth of the CSG/MHP program. Most significantly, the letter did not explain the Gebharts' proposed role or that they would receive selling compensation or indicate that the Gebharts planned to sell the MHP notes. *Cf. Dep't of Enforcement v. Van Dyk*, 2004 NASD Discip. LEXIS 12, at *19 & n.19 (NAC Aug. 9, 2004) (finding that written notice was not detailed enough to comply with Rule 3040); *see also Dep't of Enforcement v. Hartley*, Complaint No. C01010009, 2003 NASD Discip. LEXIS 49, at *24 (NAC Dec. 3, 2003) (holding that detailed written notice is required to satisfy Rule 3040), *aff'd, Chris Dinh Hartley*, 2004 SEC LEXIS 1507. Accordingly, the Gebharts engaged in private

securities transactions without proving written notice to, or receiving written approval from, their employer, in violation of Conduct Rules 3040 and 2110.

C. Fraudulent Sales of MHP Notes

Enforcement also alleged that the Gebharts fraudulently sold the MHP notes by: (1) imparting positive information concerning the risk and quality of the MHP investments while failing to disclose material negative information about MHP's business and financial condition and the risks associated with the investment; (2) failing to disclose the substantial commissions received by Archer and the Gebharts for selling the MHP notes; and (3) not having an adequate basis for recommending the MHP notes. The Hearing Panel, which appears to have made findings only with respect to the last of these three allegations, found that the Gebharts negligently omitted their failure to conduct an adequate investigation. As explained below, we modify this finding and hold that the Gebharts' conduct was not merely negligent, but reckless.

A violation of Section 10(b) of the Exchange Act, Rule 10b-5 thereunder, and Conduct Rule 2120 "requires a showing that: (1) the misrepresentations or omissions were made in connection with the purchase or sale of a security; (2) the misrepresentations or omissions were material; and (3) the misrepresentations or omissions were made with scienter." *Dane S. Faber*, Exchange Act Rel. No. 49216, 2004 SEC LEXIS 277, at *13-14 & n.11 (Feb. 10, 2004) (citing *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1467 (2d Cir. 1996)). Misrepresentations and material omissions are inconsistent with just and equitable principles of trade. *Id.* A fact is material if there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information available." *Id.*; *Dep't of Enforcement v. Reynolds*, Complaint No. CAF990018, 2001 NASD Discip. LEXIS 17, at *28 (NAC June 25, 2001). We turn first to whether the Gebharts made material omissions.

1. Material Omissions

We affirm the finding that the Gebharts recommended MHP notes without an adequate basis. A broker has the obligation to investigate whether an investment is suitable prior to recommending such an investment to prospective investors. Recklessly recommending securities without an adequate basis falls within the scope of Section 10(b). "A securities dealer occupies a special relationship to a buyer of securities in that by his position he implicitly represents he has an adequate basis for the opinions he renders." *Hanly v. SEC*, 415 F.2d 589, 596 (2d Cir. 1969); *see also Willard G. Berge*, 46 S.E.C. 690, 693 (1976) ("A professional who recommends the unknown securities of obscure issuers is under a duty to investigate and to see to it that his recommendations have a reasonable basis."). In particular, the Commission has explained that a salesman cannot recommend the securities of obscure issuers—particularly debt securities—without reliable financial data. *Willard G. Berge*, 46 S.E.C. at 693. Nor can a salesman simply rely on an issuer's "self-serving statements." *Dan King Brainard*, 47 S.E.C. 991, 996 (1983); *see also Hanly*, 415 F.2d at 597 ("Where the salesman lacks essential information about a security, he should disclose this as well as the risks which arise from his lack of information.").

Respondents argue that Alvin Gebhart "did everything he could to make sure the trailer park deal was legitimate." We could not disagree more. For the most part, the Gebharts recommended MHP notes to customers simply on the basis of information that Archer provided to them and the fact that the first three of their customers who invested had not complained. The Gebharts testified that they did not see, nor ask to see, any financial statements for CSG/MHP. Alvin Gebhart also admitted that he: (1) did not know into which bank accounts customers' investments would be deposited; (2) did not know or ask about the identities of CSG's shareholders, MHP's officers, or their compensation; (3) did not know the amount of Archer's compensation; (4) did not know the total amount of money that MHP was raising for each trailer park; (5) did not see evidence that non-profit organizations were being formed; and (6) did not know the net worths of CSG or MHP. As for the purported collateral, Donna Gebhart testified that she never saw a recorded trust deed and Alvin Gebhart could not recall whether he had ever seen a recorded trust deed. The Gebharts' only independent research was to visit two mobile home parks, and it is not clear what insight the Gebharts gained other than the fact that the parks existed. In short, the Gebharts wholly failed to ensure that they had an adequate basis to recommend the MHP notes.[14]

As a result of their failure to investigate diligently the MHP notes, the Gebharts failed to learn or disclose to customers material negative information about MHP's financial condition and the risks associated with the MHP notes. The Gebharts represented to their clients—through in-person solicitations, promotional materials, and the text of the promissory notes themselves—that the MHP notes would be secured by deeds of trust on mobile home parks. The Gebharts failed to learn or disclose, however, that the owners of CSG and MHP failed to record the deeds of trust, leaving the Gebharts' customers with unsecured investments. In addition, the Gebharts failed to learn or disclose that each park was substantially overencumbered, subjecting the investors to the risks that MHP's assets and income would be insufficient to continue paying investors interest and principal. Misrepresentations and omissions concerning the financial condition of the issuer and the risks associated with an investment, such as these, are material.[15] *See Dep't of Enforcement v. Reynolds*, 2001 NASD Discip. LEXIS 17, at *29 (holding that a reasonable investor would consider significant information pertaining to an issuer's financial

---

[14] Respondents blame "the realtor in the transaction" for not making full disclosure to the lenders about the notes and the collateral and assert that they encouraged their customers to visit the mobile home parks. Registered representatives, however, cannot shift to others their independent duty to ensure that they have an adequate basis to recommend a security. *Dane S. Faber*, 2004 SEC LEXIS 277, at *21.

[15] Enforcement further alleged that respondents did not disclose that MHP's ability to pay investors was, in turn, "dependent upon one man's ability to run the trailer park business," noting that MHP failed in June 2000 after Scovie became critically ill. The preponderance of the evidence, however, does not support Enforcement's allegation. When the Gebharts were selling the MHP notes, both Scovie and Mounier were involved in the operations of CSG and MHP. Mounier left CSG/MHP on February 18, 2000, one week after the Gebharts sold their last MHP note. There is nothing that indicates whether, while Mounier was working for CSG/MHP, operations could have continued without Scovie.

condition and profitability); *SEC v. Hasho*, 784 F. Supp. 1059, 1109 (S.D.N.Y. 1992) (failure to disclose risk factors is a material omission).[16]

The Gebharts also failed to disclose the commissions that they and Archer earned, which totaled 10 percent. A broker's failure to disclose the commissions he makes is a material omission. *Hasho*, 784 F. Supp. at 1110 ("Misrepresenting or omitting to disclose a broker's financial or economic incentive in connection with a stock recommendation constitutes a violation of the anti-fraud provisions."); *see also Michael Niebuhr*, 52 S.E.C. 546, 552 (1995) (salesperson must disclose all material facts, including self-interest that could influence a recommendation). In this case, the amount of the commissions was important to reasonable investors because of what it meant concerning the Gebharts' incentives as well as the risks of investing in the promissory notes. Given that the notes carried interest rates between 14 and 19 percent, the healthy commissions paid meant that MHP had to earn a significant rate of return to pay the commissions and meet the interest payments.

Accordingly, we find that respondents made material omissions and recommended securities without an adequate basis. We now turn to whether respondents possessed the requisite scienter.

2. Scienter

Scienter requires proof that a respondent intended to deceive, manipulate, or defraud, or that he acted recklessly. *Dep't of Enforcement v. Apgar*, Complaint No. C9B020046, 2004 NASD Discip. LEXIS 9, at *16 (NAC May 18, 2004) (citing, *inter alia*, *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976), and *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1569 (9th Cir. 1990)); *see also Hanly*, 415 F.2d at 596 ("[A] salesman cannot deliberately ignore that which he has a duty to know and recklessly state facts about matters of which he is ignorant."); *Dane S. Faber*, 2004 SEC LEXIS 277, at *19 n.18 (holding that Rule 2120 requires showing of intentional or reckless conduct). The courts have defined recklessness as not merely simple, or even inexcusable negligence, but as "an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it." *Dane S. Faber*, 2004 SEC LEXIS 277, at *19 n.18 (quoting cases; internal quotation marks omitted); *Reynolds*, 2001 NASD Discip. LEXIS 17, at *44.

In finding that the Gebharts' failure to investigate was merely negligent—and therefore a violation only of NASD Rule 2110—the Hearing Panel found that the Gebharts "truly believed that they had fulfilled their responsibilities to assure that MHP and CSG were appropriate investments." Enforcement argues that the Hearing Panel incorrectly considered the Gebharts'

---

[16] Our findings with respect to the Gebharts' misrepresentations and material omissions do not rely on the testimony provided by the Gebharts' customers at the hearing. The Hearing Panel did not make determinations as to the customers' credibility, and we decline to make such determinations. For similar reasons, we do not rely on the testimony provided by the Gebharts' customers in depositions taken in the class actions against Archer and Alvin Gebhart.

personal beliefs when deciding whether their conduct was reckless. The question of recklessness is primarily, but not exclusively, an objective test. In an excellent explanation of where the line is drawn in the context of material omissions, the Seventh Circuit has explained that recklessness is shown where "the danger of misleading buyers must be actually known or so obvious that any reasonable man would be legally bound as knowing and the omission must derive from something more egregious than even 'white heart/empty head' good faith." *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977) (footnotes omitted). The *Sundstrand* court pointedly explained that its recklessness test contains a subjective component and that recklessness would not be shown if, for example, "a trial judge found . . . that a defendant genuinely forgot to disclose information or that it never came to his mind." *Id.* at 1045 n.20; *cf. Kunz*, 1999 NASD Discip. LEXIS 20, at *45 n.21 (basing negligence finding on respondents' mistaken belief that they could rely on audited financial statements and an issuer's counsel to determine what information needed to be in a private placement memorandum); *Reynolds*, 2001 NASD Discip. LEXIS 17, at *46 (basing negligence finding on respondent's good faith, albeit unreasonable, beliefs about an issuer formed through a basic investigation). Nevertheless, "good faith, without more, does not necessarily preclude a finding of recklessness." *SEC v. The Infinity Group Co.*, 212 F.3d 180, 192 (3d Cir. 2000). When evaluating a respondent's alleged good faith beliefs, we must "examine the foundation such a belief would have rested upon" because a good faith belief will not insulate respondents from liability "if it is the result of reckless conduct." *Id.* at 193.

With these principles in mind, we respectfully disagree with the Hearing Panel's finding that the Gebharts' failure to investigate resulted only from negligence. Instead, we find that their failure was reckless. The Hearing Panel based its finding about the Gebharts' true beliefs on four factors that, in our view, provided scant reasons for the Gebharts to believe they had fulfilled their duty to investigate. First, the Hearing Panel noted the Gebharts and three of their clients had a "one-year personal payment history" when they began directly selling MHP notes to customers. This payment history, however, was not substantial: only one of their customers had a year's history with the MHP notes, and their own personal investment was only three months old. But more importantly, as Enforcement correctly argues, this payment history was not inconsistent with a Ponzi scheme.

Second, the Hearing Panel found that the "general information [the Gebharts] gathered about mobile home park conversions from HUD and other municipal and state agencies" supported their beliefs that they had investigated the notes. The record contains little evidence of what information the Gebharts actually gathered: Alvin Gebhart testified that he knew that HUD had processed "at least 1,100 loans" to assist persons "purchase their homes" and that a local municipality was "working on these mobile home park conversions." That possible sources of funding existed to finance the residents' acquisition of parks, however, offered the Gebharts no insight into the financial condition and business practices of CSG and MHP.

Third, the Hearing Panel noted MSC's "lack of response" to the information the Gebharts provided to it. This factor, however, is more relevant to whether the Gebharts thought they were authorized to sell the MHP notes than to whether they believed they had performed an adequate investigation. In any event, when faced with the uncertainty created by MSC's lack of response, the Gebharts did not press MSC to learn what its actual position was concerning the MHP notes.

Moreover, a broker has a personal responsibility to conduct an investigation into securities he recommends and cannot rely on either his employer or the issuer. *See Dep't of Enforcement v. Golub*, Complaint No. C10990024, 2000 NASD Discip. LEXIS 14, at *23 & n.17 (NAC Nov. 17, 2000).

Fourth, the Hearing Panel found that the Gebharts obtained information about the MHP notes from Archer, "whom they believed to be reliable." Even if we accept this finding, the Gebharts were confronted with numerous red flags that must have heightened their level of concern about the MHP notes. MHP and CSG were relatively unknown entities. The promissory notes usually described the purported collateral with little to no details, vaguely indicated that deeds of trust concerning that collateral would "ultimately" be recorded, and always indicated that, until then, the sole asset of MHP was a deed of trust worth only $100,000. *Cf. Dan King Brainard*, 47 S.E.C. at 998 (respondents ignored warning signals concerning the alleged collateral for securities). The Gebharts knew that their commissions were paid not from CSG or MHP corporate accounts, but from Archer's personal checking account. And the significant amounts of commissions and interest paid meant that MHP and CSG needed to earn impressive rates of return to meet those commitments. Despite these warning signs, the Gebharts proceeded to recommend and sell millions of dollars worth of notes issued by MHP, the financial condition of which the Gebharts knew nothing about. And although the Gebharts—who touted that the MHP notes were secured by deeds of trust on mobile home parks—recognized the importance of the collateral, they took no steps to confirm that trust deeds were being recorded.[17]

In addition to the factors listed by the Hearing Panel, Alvin Gebhart testified that he believed the MHP program was acceptable because he thought that First Regional Bank was reviewing and analyzing the MHP notes before allowing them to be held in retirement accounts. Alvin Gebhart offers no reason, however, why his purported reliance on First Regional Bank was reasonable. There is no evidence that Alvin Gebhart attempted to verify that First Regional Bank was reviewing the MHP notes or obtaining recorded deeds of trust, or to inquire about what the bank's review entailed.

Alvin Gebhart's claim that he believed he fulfilled his duty to investigate is even more suspect in light of his experience in the industry. Contrary to the Gebharts' argument, Alvin Gebhart was not "relatively new to the securities industry when he joined MSC in 1996." As Alvin Gebhart explained to MSC, the year 2000 marked his "21st year in this field." In addition, the Gebharts sold the MHP notes for more than three years; "[a]ny inexperience on respondents' part at the outset of that period should have disappeared long before its conclusion." *Dan King Brainard*, 47 S.E.C. at 1001. In fact, both Alvin and Donna Gebhart increased their knowledge of the industry during the relevant period, becoming registered general securities representatives within one and one-half years after commencing their direct sales of the MHP notes. *See Dane*

---

[17] Respondents argue that Alvin Gebhart "had no access to information that would have contradicted any information Archer provided to them." Even if true, such lack of access itself would have been an additional red flag. *See Willard G. Berge*, 46 S.E.C. at 694 n.21 ("An unsuccessful effort to obtain financial data from an issuer that is selling massive quantities of securities is a red flag warning that something is probably awry.").

S. Faber, 2004 S.E.C. LEXIS 277, at *20-21 (finding respondent acted recklessly in light of respondent's experience); *Michael J. Fee*, 50 S.E.C. 1124, 1126 (1992) (same).

Considering the totality of the evidence, we find that the Gebharts' omissions concerning the financial condition of MHP and the risks of the MHP notes, and their failure to investigate the MHP notes, derived from more than just empty-headedness. The Gebharts—who read MSC's procedures requiring private securities transactions to pass a due diligence investigation and who informed their customers that MSC had reviewed the notes—clearly recognized that customers would find it important that the MHP notes had been investigated. Their failure to investigate the MHP notes therefore represented an extreme departure from the standards of ordinary care and was reckless. *See Dan King Brainard*, 47 S.E.C. at 998-99 (finding that respondents who ignored obvious warning signals were at least "recklessly indifferent to the consequences of their actions"); *Willard G. Berge*, 46 S.E.C. at 694 (salesmen's failure to gather financial data about issuer was violation of antifraud provision); *cf. Everest Sec., Inc.*, 52 S.E.C. 958, 963 (1996) (holding that respondents' claimed reliance on an investigator's due diligence investigation was reckless and a violation of NASD antifraud rule), *aff'd*, 116 F.3d 1235 (8th Cir. 1997).[18] We also find that the Gebharts' failure to disclose commissions was reckless. The danger of misleading customers was so obvious that the Gebharts must have been aware of it, and the Gebharts have not argued otherwise. Accordingly, we hold that respondents fraudulently omitted material facts and failed to have an adequate basis for recommending MHP notes, in violation of Section 10(b) of the Exchange Act, Rule 10b-5 thereunder, and NASD Conduct Rules 2120 and 2110.

V. Sanctions

The Hearing Panel fined Alvin Gebhart $100,000 and suspended him for 12 months in all capacities. The Hearing Panel fined Donna Gebhart $7,500 and suspended her for seven months in her capacity as a general securities representative. As explained below, we think that the Gebharts' violations call for stronger sanctions.[19]

---

[18] Respondents correctly argue that the Hearing Panel's negligence finding was grounded in a determination that the Gebharts credibly testified about their beliefs. Credibility determinations of the initial fact-finder, which are based on hearing the witnesses' testimony and observing their demeanor, are entitled to considerable weight and deference and can be overcome only where there is substantial evidence for doing so. *Dane S. Faber*, 2004 SEC LEXIS 277, at *17-18. As our discussion in the text demonstrates, however, this is the unusual case where there is substantial evidence for overcoming a credibility determination.

[19] We disagree with the Hearing Panel's aggregation of all violative conduct for sanctions purposes. Accordingly, we first assess sanctions for the Gebharts' private securities transactions and their sales of unregistered securities, and then turn to sanctions for their fraudulent conduct.

A. Private Securities Transactions and Sales of Unregistered Securities

For sales of unregistered securities in violation of Section 5 of the Securities Act and Rule 2110, the NASD Sanction Guidelines recommend imposing a fine between $2,500 and $50,000 and, in egregious cases, suspending a respondent for up to two years or imposing a bar. In assessing sanctions for this violation, we consider the principal considerations applicable to all guidelines and the considerations specific to selling unregistered securities. NASD Sanction Guidelines ("Guidelines") (2001 ed.) at 9-10 (principal considerations in determining sanctions), 30 (Unregistered Securities—Sales of).

For determining sanctions for private securities transaction violations, the Guidelines provide that the first step is to assess the extent of the transactions, including the dollar amount of sales, the number of customers, and the length of time over which the activity occurred. *NASD Special Notice to Members 03-65* (Oct. 2003), at 686. The Gebharts sold more than $2.36 million in MHP notes to 45 customers over a period that lasted more than three years. For private securities transactions like these exceeding $1 million, the Guidelines recommend, as a starting point, a fine between $5,000 and $50,000 and a 12-month suspension or a bar.

In addition to these primary considerations, the Guidelines direct that we consider 10 additional principal considerations and the general considerations applicable to all guidelines. *Id.* at 686-87; Guidelines at 9-10. Among these, there are numerous aggravating factors. The MHP notes were unregistered securities sold in violation of Section 5 of the Securities Act. Respondents attempted to create the impression that their firm sanctioned their sales of MHP notes, by corresponding with customers using letterhead that included the words "Securities offered by Mutual Service Corporation" and by informing customers that MSC had reviewed the MHP notes. The Gebharts' misconduct also clearly resulted in the potential for their monetary gain. Furthermore, the Gebharts sold MHP notes directly to customers of MSC, and the Gebharts' sales resulted in injury to the investing public.

Other considerations include whether respondents provided verbal notice of the details of the proposed transaction (and, if so, the Firm's verbal or written response) and the related consideration whether respondents intentionally misled their employer or otherwise concealed their selling away. These considerations present close questions. Although the Hearing Panel found the Gebharts' verbal notice to be substantially mitigating, we do not. While Alvin Gebhart provided some degree of verbal notice to MSC about the CSG program, it is unclear how detailed that notice was, given that he failed to disclose he had already received finder's fees and his lack of detailed knowledge about the CSG program. Moreover, the Firm did not provide the Gebharts with verbal approval or a written response. As for whether respondents concealed their activities, they did not submit to MSC any investor-related documents or correspondence and repeatedly failed on questionnaires and surveys to disclose their private sales of MHP notes, despite questions that called for them to acknowledge such activities.[20] And in connection with

---

[20] The Hearing Panel credited the Gebharts' explanation that they believed they only had to disclose on representative questionnaires information about new programs with which they became involved. Nevertheless, none of the questions on the representative questionnaires

[Footnote continued on next page]

the 1997 audit, the Gebharts evidently failed to disclose that they prepared their own monthly statements, which listed MHP transactions. Notwithstanding these troubling facts, the Gebharts did provide some degree of verbal notice, did not hide evidence of the MHP notes from Helmle, vaguely disclosed their sales on a 1999 representative questionnaire as "2d deeds of trust," and sought approval from MSC to include the notes in a 403(b) account. Given these facts, the preponderance of the evidence does not demonstrate that respondents concealed their activities.

The Gebharts argue that they did not realize the MHP notes were securities because Archer told them that MHP notes were not securities. As a result, Alvin Gebhart allegedly thought that the MHP notes were "fixed income product[s], much like a fixed annuity," that MSC historically did not require be recorded on its books. The Gebharts' purported belief, however, lacked a reasonable basis. "A registered representative . . . may not rely on a colleague's interpretation of whether a particular transaction is covered by NASD Rule 3040." *Hartley*, 2003 NASD Discip. LEXIS 49, at *15 n.13. And other than reliance on Archer, respondents offer no explanation why they believed the MHP notes were akin to fixed annuities, an investment product that is offered by insurance companies. In addition, Donna Gebhart testified that they never approached any lawyers to determine whether the MHP notes were securities. In short, any belief that respondents had that the MHP notes were not securities was a "product of their own inattentiveness." *Kunz*, 1999 NASD Discip. LEXIS 20, at *70.

The Gebharts also argue that they were misled into believing they did not need written authorization to sell the notes because neither Poston nor the MSC auditor raised any questions about their activities. Here too, respondents' purported beliefs were highly unreasonable. Registered representatives are responsible for knowing and abiding by NASD rules and regulations. *Hartley*, 2003 NASD Discip. LEXIS 49, at *31. In addition, the Gebharts annually acknowledged receiving and reading MSC's compliance manual, which explained that representatives were required to provide written notice of, and receive written approval for, private securities transactions. *Cf. Vastano*, 2003 NASD Discip. LEXIS 41, at *19 (noting that respondent ignored provision in compliance manual concerning private securities transactions); *Van Dyk*, 2004 NASD Discip. LEXIS 12, at *27-28 (holding that respondent's indifference toward NASD rules and firm procedures was reckless and an aggravating factor).[21]

[cont'd]
limited responses to "new" programs. We also note that, in their 1997 representative questionnaire, respondents disclosed other "old" activities for which they had obtained approval, such as seminars they conducted.

[21] Respondents contend that the MSC manual was deficient and unclear because it indicated that "real estate" activities did not require prior written approval and did not define "security." It is highly unreasonable, however, for an experienced securities professional to assume that a manual's use of the term "real estate" encompassed investments that had any ties to real property. And while the absence of a definition of "security" may sometimes mitigate selling away activities, here it does not, given respondents' registrations as general securities representatives, Alvin Gebhart's substantial experience, and language in the manual that, in essence, warned about the hazards of assuming a product is not a security without seeking advice from MSC.

The Hearing Panel stated that it was favorably impressed with respondents' remorse. While we have sometimes considered a respondent's contrition when assessing sanctions, *see Hanson*, 2001 NASD Discip. LEXIS 41, at *19, an acceptance of responsibility is of most mitigative value when it is made *prior* to detection of the misconduct by a respondent's firm or a regulator. We also note that respondents dampen the effectiveness of their professed remorse by continuing to blame others—such as the MSC Compliance Department, realtors, and banks—for the fate that befell their customers. Accordingly, we have considered respondents' professed remorse but find that that it has little mitigative value. Likewise, while there is evidence that respondents cooperated with Enforcement's investigation, we find that such cooperation was not substantial enough to be mitigating.

We do find it slightly mitigating that respondents made efforts to assist customers in recovering their losses, including filing a bankruptcy action against MHP and suing their insurance provider to secure coverage for their personal liability. Through distributions from the bankruptcy estate and the settlement of the class action, it is expected that noteholders will receive 84 percent of their investments back. Nevertheless, remedial efforts are most mitigating when they occur prior to detection and intervention. In this case, the Gebharts' remedial efforts occurred only after MHP collapsed, which we view as the functional equivalent of detection, and therefore were not purely voluntary on their part. Moreover, requiring customers to pursue private litigation against their broker is not what we consider to be remedial conduct. And while the Gebharts assert they gave up any claim for their own losses, there is evidence that the Gebharts did not personally contribute to cover the difference between the class action settlement amount and their insurance coverage.[22]

Disciplinary sanctions are remedial in nature and are designed to deter future misconduct and improve overall business standards in the securities industry. In light of the totality of the circumstances, the sanctions imposed by the Hearing Panel are not strong enough to serve these goals. Accordingly, we bar Alvin Gebhart for his violations of Rule 3040 and 2110. In light of the bar, we do not fine Alvin Gebhart, and his claim of inability to pay is, therefore, moot. As for Donna Gebhart, we agree with the Hearing Panel that she played a less substantial role. Nevertheless, Rule 3040 applies to representatives who participate "in any manner" in private securities transactions, language which the Commission interprets broadly. *Mark H. Love*, Exchange Act Rel. No. 49248, 2004 SEC LEXIS 318, at *7 (Feb. 13, 2004). Moreover, as a registered representative, Donna Gebhart bore the same responsibilities as any registered

---

[22] Respondents assert that they incurred legal expenses in assisting customers and ask for credits of the amounts they helped their customers recover. No fine is imposed on Alvin Gebhart, so this request is moot as to him. While we do impose a fine on Donna Gebhart, respondents have provided no documentation of their legal expenses and, therefore, no evidentiary support for a credit. *See Hanson*, 2001 NASD Discip. LEXIS 41, at *24 n.22 (declining to offset against a fine undocumented legal expenses allegedly incurred to assist customers recover losses against bankrupt issuer). Because of this lack of documentation, we do not reach the question of what circumstances would warrant giving a credit.

representative. We therefore suspend Donna Gebhart for one year in all capacities, fine her $5,000, and order her to requalify before re-entering the industry.

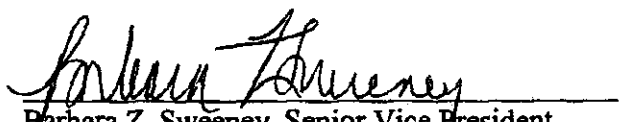
B. Misrepresentations and Omissions of Material Fact

For reckless or intentional misrepresentations or omissions of material fact, the Guidelines recommend a fine between $10,000 and $100,000, and a suspension between 10 business days and two years or, in egregious cases, a bar. Guidelines at 96 (Misrepresentations or Material Omissions of Fact). In imposing sanctions for these violations, we consider the general principles applicable to all sanction determinations, which we discussed in the previous section. In light of these guidelines, we find that Alvin Gebhart's fraudulent solicitations were egregious, and we bar him for such conduct. As for Donna Gebhart, we impose a $10,000 fine, a one-year suspension in all capacities, and order her to requalify before re-entering the securities industry. Donna Gebhart has not demonstrated an inability to pay the fines imposed in this decision.

VI. Conclusion

Accordingly, we hold that Alvin and Donna Gebhart sold unregistered securities that were not exempt from registration; engaged in private securities transactions without providing written notice to, or receiving written approval from, their firm; and recklessly omitted material facts in connection with the sales of securities, in violation of the Securities Act, the Exchange Act, and NASD Rules. For these violations, we bar Alvin Gebhart, which is effective upon service of this decision. For Donna Gebhart, we suspend her in all capacities for one year, impose a $15,000 fine, and order her to requalify before re-entering the securities industry.[23] The separate one-year suspensions imposed on Donna Gebhart shall be served concurrently. We also affirm the $5,141.21 in costs, joint and several, imposed by the Hearing Panel.

On Behalf of the National Adjudicatory Council,



Barbara Z. Sweeney, Senior Vice President
And Corporate Secretary

---

[23] We also have considered and reject without discussion all other arguments advanced by respondents.

Pursuant to NASD Procedural 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.