

NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

JOSEPH L. KARCAGI
(CRD No. 264316),

Respondent.

Disciplinary Proceeding
No. C07050028

DEFAULT DECISION

Hearing Officer - SW

Dated: August 26, 2005

Respondent (1) failed to respond completely to requests for information and failed to appear for an on-the-record interview, in violation of NASD Procedural Rule 8210 and NASD Conduct Rule 2110, and (2) engaged in private securities transactions, in violation of NASD Conduct Rules 3040 and 2110. Respondent was barred for violating NASD Procedural Rule 8210 and NASD Conduct Rule 2110 by failing to appear for an on-the-record interview. In light of the bar, the Hearing Officer did not impose sanctions on Respondent for his private securities violations or for his failure to respond completely to the NASD staff's requests for information.

Appearances

Joel R. Beck, Esq., Regional Counsel, Atlanta, GA, and Rory C. Flynn, Esq., Of Counsel, Washington, DC, for the Department of Enforcement.

No appearance for Joseph L. Karcagi.

DECISION

I. Procedural Background

On April 13, 2005, the NASD Department of Enforcement ("Enforcement") filed its Complaint in this disciplinary proceeding alleging that Respondent Joseph L. Karcagi ("Respondent"): (i) participated in the sale of securities (i.e., the sale of preferred stock and a promissory note) without providing prior written notice to his employer, Summit Brokerage Services, Inc. ("Summit Brokerage"), in violation of NASD Conduct Rules

3040 and 2110; and (ii) failed to respond completely to two requests for information and failed to appear in response to a request for an on-the-record interview, pursuant to NASD Procedural Rule 8210, in violation of Rules 8210 and 2110.

Respondent failed to answer the Complaint. On June 24, 2005, Enforcement filed a Motion for Entry of Default Decision ("Motion"), supported by the declaration of Joel R. Beck, Regional Counsel in NASD's Atlanta office, and by three exhibits.¹ For the reasons set forth below, Enforcement's Motion is granted.

II. Respondent's Default

On April 13, 2005, Enforcement served the Complaint and Notice of Complaint on Respondent, via first class mail and certified mail, at his address of record in NASD's Central Registration Depository ("CRD address").² (DECL at ¶ 6; CX-1, p. 1; CX-2). Respondent did not file an answer to the Complaint. (DECL at ¶ 8).

Thereafter, on May 12, 2005, Enforcement sent a Second Notice of Complaint and the Complaint, via first class mail and certified mail, to Respondent at his CRD address. (DECL at ¶ 8). To date, Respondent has not filed an answer to the Complaint. (DECL at ¶ 10).

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

¹ Hereinafter, the statements in the Beck Declaration will be designated as "DECL at ¶" and Enforcement's exhibits will be designated as "CX-" with the appropriate page number.

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

III. Findings of Fact and Conclusions of Law

A. Jurisdiction

Respondent first became associated with an NASD member on December 27, 1973. (CX-1, p. 13; DECL at ¶ 4). From June 4, 2001 to December 11, 2003, Respondent was registered as a general securities principal and a general securities representative with Summit Brokerage. (CX-1, p. 2; DECL at ¶ 4). Respondent is not employed currently in the securities industry. (*Id.*)

Article V, Section 4 of the NASD's By-Laws creates a two-year period of retained jurisdiction over former registered persons, covering misconduct occurring before the registration terminated and failures to provide information requested during the period of retained jurisdiction.

Enforcement filed the Complaint on April 13, 2005, within two years of the date that Respondent's registration terminated. The Complaint alleges misconduct that occurred while Respondent was registered through Summit Brokerage, as well as failures to respond completely to requests for information and a request to appear for an on-the-record interview issued during the period of retained jurisdiction. NASD thus has jurisdiction over this proceeding.

B. Respondent Participated in the Offer and Sale of Securities to Two Customers Without Providing Prior Written Notice to Summit Brokerage

Count one of the Complaint, attached to this Default Decision as Exhibit A, alleges that during the period November 2002 to October 2003, while associated with Summit Brokerage, Respondent participated in the sale of three securities to his broker-dealer customer RS. Specifically, the securities included a promissory note issued by

Screenbridge, LLC and shares of Series B redeemable preferred stock issued by Contrarian Films and Great American Radio Network. (Complaint at ¶ 3). The Screenbridge, LLC promissory note matured on November 2003, and as of March 2005, customer RS had not received payment on the note. (Complaint at ¶ 6).

In addition, during July 2003, Respondent participated in the sale of Series B redeemable preferred stock issued by Contrarian Films to another broker-dealer customer, LS. (Complaint at ¶ 4).

Respondent failed to provide written notice to Summit Brokerage of his involvement in each of these private securities transactions, and each of these transactions was outside the scope of Respondent's employment with Summit Brokerage. (Complaint at ¶ 5).

Enforcement submitted additional information with its Motion showing that RS invested \$50,000 and LS invested \$10,000 in these private securities transactions. (DECL at ¶ 13). For his involvement in these private securities transactions, Respondent received an undetermined amount of compensation from another individual. (*Id.*). Both customers LS and RS executed declarations stating that Respondent recommended the investments. (*Id.*). Summit Brokerage affirmed that Respondent did not provide the firm with notice of his involvement in these transactions. (*Id.*).

Under Rule 9215(f) and Notice to Members 99-77, the allegations of count one of the Complaint are deemed admitted, and they are hereby incorporated in this Default Decision as findings of fact.

NASD Conduct Rule 3040 requires that an associated person who intends to participate in a private securities transaction, prior to the transaction, must "provide

written notice to the member with which he is associated describing in detail the proposed transaction and the person's proposed role therein and stating whether he has received or may receive selling compensation in connection with the transaction"³

The shares of Series B preferred stock of Contrarian Films and Great American Radio Network are explicitly "securities" within the meaning of Section 3(a)(10) of the Securities Exchange Act of 1934, 15 U.S.C. §78c(a)(1). Additionally, the Court in Reves v. Ernst & Young, 494 U.S. 56 (1990) recognized that every promissory note is presumed to be a security, as defined in Section 3(a)(10) of the Securities Exchange Act of 1934.⁴ There has been no evidence presented to refute this presumption. Accordingly, based on the allegations deemed admitted, the Hearing Officer finds that the promissory note issued by Screenbridge, LLC is also a security.

Respondent's solicitation of broker-dealer customers LS and RS to invest in the securities was sufficient to trigger the requirement that he notify Summit Brokerage in writing. A failure to provide prior written notice of an intent to participate in the solicitation of securities constitutes a violation of Conduct Rule 3040.⁵ A violation of

³ In addition, Rule 3040 provides that, if the transaction is for compensation, the member firm must approve or disapprove of the proposed transaction in writing. If the member approves a person's participation in the proposed transaction, the transaction must be recorded on the books and records of the member and the member must supervise the person's participation in the transaction.

⁴ Although the language of Section 3(a)(10) excludes any note that has a maturity not exceeding nine months, the exclusion only applies to prime quality negotiable paper of a type not ordinarily purchased by the general public; that is, paper used to facilitate well recognized types of current operational business requirements and of a type eligible for discounting by Federal Reserve banks. See Zeller v. Bogue Elec. Mfg. Corp., 476 F. 2d. 795 (2nd Cir. 1973). See also SEC v. R.G. Reynolds Enter., Inc., 952 F. 2d 1125, 1132 (9th Cir. 1991) (it is the character of the note not its maturity date, which determines coverage under the federal securities laws). There is no evidence presented that the promissory note issued by Screenbridge, LLC fits the notion of prime quality commercial paper.

⁵ See Stephen J. Gluckman, 1999 SEC LEXIS 1395, at **14-15 (July 20, 1999).

Conduct Rule 3040 is also a violation of Conduct Rule 2110's requirement to "observe high standards of commercial honor and just and equitable principles of trade."⁶

Based on the allegations deemed admitted, the Hearing Officer finds that Respondent participated in the sale of preferred stock and a promissory note to customers LS and RS without providing prior written notice of these transactions to Summit Brokerage and thereby violated NASD Conduct Rules 3040 and 2110.

C. Respondent Failed to Respond Completely to Requests for Information and Failed to Appear for an On-the-Record Interview

Count two of the Complaint alleges that the NASD staff sent Respondent two requests for information, pursuant to NASD Procedural Rule 8210, on August 9 and November 10, 2004, concerning the allegations of count one of the Complaint.

(Complaint at ¶ 9). The Complaint alleges that Respondent responded incompletely to the information requested by not answering each of the questions posed to him and by not providing the requested documents. (Complaint at ¶ 10). Accordingly, in a letter dated February 24, 2005, the NASD staff requested that Respondent appear and testify at an on-the-record interview on March 15, 2005. (Complaint at ¶ 11). Respondent did not appear and testify as requested on March 15, 2005. (Complaint at ¶ 12). The requests for information and documents and the request to appear for an on-the-record interview were sent to Respondent at his CRD address. (Complaint at ¶¶ 9, 11).

Under Rule 9215(f) and Notice to Members 99-77, the allegations of count two of the Complaint are deemed admitted, and they are hereby incorporated in this Default Decision as findings of fact.

⁶ District Bus. Conduct Comm. v. Norman M. Merz, No. C8A960094, 1998 NASD Discip. LEXIS 40 (NAC Nov. 11, 1998).

Procedural Rule 8210(a)(1) gives NASD the authority to require persons associated with a member to report "orally, or in writing, . . . with respect to any matter involved in the investigation." The obligation to answer such requests continues for two years from the termination of a representative's registration. This Rule provides a means for NASD to carry out its regulatory functions in the absence of subpoena power. It is a "key element in NASD's efforts to police its members"; failure to respond subverts the NASD's ability to perform its regulatory responsibilities.⁷

The Hearing Officer finds that Respondent had constructive notice of the Rule 8210 requests because they were mailed to his CRD address. By providing answers to some of the Rule 8210 questions but not all of the questions, and by not providing the documents requested, Respondent failed to respond completely to the two requests for information. By failing to appear in response to a request for an on-the-record interview, Respondent failed to respond to a Rule 8210 request. Accordingly, the Hearing Officer finds that Respondent violated NASD Procedural Rule 8210 and NASD Conduct Rule 2110.

IV. Sanctions

A. Respondent Failed to Respond Completely to NASD Requests for Information and Failed to Appear for an On-the-Record Interview

For failing to respond completely to the NASD staff's requests for information and for failing to appear for an on-the-record interview, Enforcement recommended that Respondent be barred.

The NASD Sanction Guidelines provide that a bar should be standard when an individual respondent does not respond in any manner to a request issued pursuant to

⁷ Richard J. Rouse, 51 SEC 581 (1993); John J. Malach, 51 SEC 618 (1993).

Rule 8210, including a request to appear for an on-the-record interview.⁸ The record does not indicate the existence of any mitigating factors that would warrant a lesser sanction.

Accordingly, the Hearing Officer accepts Enforcement's recommendation, in part, and bars Respondent from associating with any member firm in any capacity for violating NASD Procedural Rule 8210 and NASD Conduct Rule 2110 by failing to appear in response to a request for an on-the-record interview issued pursuant to NASD Procedural Rule 8210. No separate sanction is imposed for Respondent's separate and distinct violation of NASD Procedural Rule 8210 and NASD Conduct Rule 2110 when he failed to respond completely to the NASD staff's requests for information.

B. No Sanction for the Private Securities Transactions Violation

Because the Hearing Officer barred Respondent for violating NASD Procedural Rule 8210 and NASD Conduct Rule 2110, no separate sanction will be imposed on him for violating NASD Conduct Rules 3040 and 2110 by engaging in private securities transactions.⁹

V. Order

Respondent Joseph L. Karcagi is barred from associating with any NASD member firm in any capacity for violating NASD Procedural Rule 8210 and NASD Conduct Rule 2110 by failing to appear in response to a request for an on-the-record interview issued pursuant to NASD Procedural Rule 8210. The bar shall become effective on the date this

⁸ NASD Sanction Guidelines, p. 35 (2005).

⁹ See Dep't of Enforcement v. Jeffrey B. Hodde, No. C10010005, 2002 NASD Discip. LEXIS 4, at *17 (NAC Mar. 27, 2002) (explaining that a bar is the standard sanction for a respondent's failure to respond to information requests, and holding that it is therefore redundant to impose an additional sanction, such as a suspension, for a violation of another NASD rule).

Decision becomes the final disciplinary action of NASD.

Sharon Witherspoon
Sharon Witherspoon
Hearing Officer

Dated: Washington, DC
August 26, 2005

Copies to:

Joseph L. Karcagi (via Federal Express and first class mail)
Joel R. Beck, Esq. (via electronic and first class mail)
Andrew A. Favret, Esq. (via electronic and first class mail)
Rery C. Flynn, Esq. (via electronic and first class mail)

EXHIBIT A

NASD OFFICE OF HEARING OFFICERS

Department of Enforcement,

Complainant,

v.

Joseph L. Karcagi
General Securities Principal
CRD No. 264316

Respondent.

Disciplinary Proceeding
No. C07050028

Hearing Officer -

COMPLAINT

Upon information and belief, Complainant alleges as follows:

1. Respondent Joseph L. Karcagi first entered the securities industry in about January 1970, and was first registered as a general securities principal in approximately August 1978. He was most recently registered with Summit Brokerage Services, Inc. from April 2001 to December 2003. Karcagi is not currently registered with an NASD member, though he remains subject to NASD's jurisdiction pursuant to Article V, Section 4 of the NASD By-Laws.

**FOR A FIRST CAUSE OF COMPLAINT
Participation in Private Securities Transactions
NASD Conduct Rules 3040 and 2110**

2. Paragraph one is realleged and incorporated herein by reference.
3. During the period of November 2002 to October 2003, Respondent Karcagi participated in the sale of three securities to customer RS, one of his broker-dealer clients, specifically, a promissory note issued by Screenbridge, LLC, and Series B redeemable preferred stock issued by Contrarian Films and Great American Radio Network.

4. During July 2003, Respondent Karcagi participated in the sale of Series B redeemable preferred stock issued by Contrarian Films to customer LS, who was also a client of his broker-dealer.
5. Each of these private securities transactions was outside the scope of his employment with Summit Brokerage Services. Respondent Karcagi did not provide written notice to Summit of his involvement in these transactions.
6. As of March 2005, RS had not received payment on the promissory note in which he invested, which matured in November 2003.
7. Such acts, practices and conduct violate NASD Conduct Rules 3040 and 2110.

**FOR A SECOND CAUSE OF COMPLAINT
Failure to Respond Completely to Staff Information Requests and
Failure to Testify
NASD Procedural Rule 8210 and Conduct Rule 2110**

8. The allegations in paragraphs one through seven are realleged and incorporated herein by reference.
9. In connection with an examination into his possible involvement in private securities transactions, NASD staff sought to obtain information from Karcagi. By letters dated August 9 and November 10, 2004, sent to Karcagi at his residential address as reflected in CRD of [REDACTED] NASD staff members requested that Karcagi provide a written statement responding to specific questions, pursuant to NASD Procedural Rule 8210. The November 10th letter also requested that he provide specified documents. According to the letters, Respondent Karcagi's responses were due by August 23 and December 1, 2004, respectively.
10. Respondent Karcagi responded incompletely to the information request letters. He did not answer each of the questions posed to him, and did not provide the requested documents.

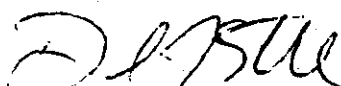
11. By letter dated February 24, 2005, an NASD staff member requested that Karcagi appear and testify at the Atlanta District Office on March 15, 2005, pursuant to Rule 8210. This letter was sent by both first class and certified mail to Respondent Karcagi at his CRD address identified above.
12. Respondent Karcagi did not appear and testify as requested on March 15, 2005.
13. Such acts, practices and conduct violate NASD Procedural Rule 8210 and Conduct Rule 2110.

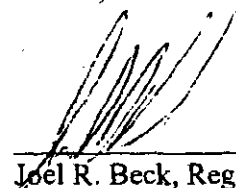
PRAYER FOR RELIEF

WHEREFORE, Complainant respectfully requests:

- A. Findings of fact and conclusions of law that the Respondent committed the violations charged and alleged herein;
- B. An order imposing sanctions upon the Respondent in accordance with NASD Rule 8310.
- C. An order requiring Respondent to disgorge fully any and all ill-gotten gains and/or make full and complete restitution, together with interest;
- D. An order imposing such costs of any proceeding as are deemed fair and appropriate under the circumstances in accordance with NASD Rule 8330; and
- E. An order imposing any other fitting sanction.

April 13, 2005.


Daniel J. Stefek, District Director
NASD, Atlanta District Office


Joel R. Beck, Regional Counsel

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