

NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT

Complainant,

v.

DAVID A. JOHNSON
(CRD No. 2407687),
[REDACTED]
[REDACTED]

Respondent.

Disciplinary Proceeding
No. C9A040061

Hearing Officer – SNB

DEFAULT DECISION

May 9, 2005

For violating Rules 8210 and 2110, Respondent is barred from associating with any NASD member in any capacity. For violating Rules 3040 and 2110, Respondent is ordered to pay restitution to CN and MB in the amount of \$22,702.83 and \$20,000, respectively, plus interest calculated pursuant to 26 U.S.C. §6621(a)(2) from the date of the investment giving rise to each customer's loss. However, in light of the bar for violations of Rules 8210 and 2110, no other sanctions are imposed for Respondent's violation of Rules 3040 and 2110.

Appearances

Thomas H. Huber, Esq., Regional Counsel, NASD, Philadelphia, PA, and Rory C.

Flynn, Esq., Washington, DC, of Counsel, for the Department of Enforcement.

No appearance by or for Respondent.

DECISION

I. Background

On December 27, 2004, the Department of Enforcement ("Enforcement") filed a two-cause Complaint in this proceeding, attached to this Decision as Exhibit A. The Complaint alleges that Respondent David A. Johnson ("Respondent") violated NASD

Rules 3040 and 2110 by selling securities outside the scope of his employment without notifying or receiving authorization from the firm with which he was registered. The Complaint also alleges that Respondent violated NASD Rules 8210 and 2110 by failing to respond to NASD Staff requests for information. Respondent did not file an Answer to the Complaint. On March 9, 2005, Enforcement filed a Motion for Entry of Default Decision and Request for Sanctions, supported by the declaration of Thomas M. Huber and three exhibits. Respondent did not reply to the Motion. For the reasons set forth below, the Motion is granted.¹

II. Respondent's Default

Enforcement sent the Complaint and Notice of Complaint to Respondent on December 23, 2004, by first class and certified mail to his last known residential address listed in the Central Registration Depository (the "CRD address"). Enforcement also sent the Complaint and Notice of Complaint to Respondent on December 23, 2004, by first class and certified mail to a second address listed in a vendor report that showed that Respondent possibly resided there at that point in time (the "vendor address"). In the same manner, Enforcement sent the Complaint and Second Notice of Complaint to these same addresses on January 25, 2005. Respondent did not file an Answer to the Complaint.

Enforcement complied with Procedural Rule 9134(b)(1) by mailing the Complaint and Notices of Complaint to Respondent's CRD address, thereby giving Respondent constructive notice of this proceeding. By failing to file an Answer, Respondent defaulted. Pursuant to Rules 9215(f) and 9269(a)(2), the allegations in the Complaint are deemed admitted.

¹ The factual determinations in this decision are based on the allegations of the attached Complaint, which are deemed admitted, and the declaration and exhibits filed by Enforcement with its motion.

III. Jurisdiction

Respondent first became registered with the NASD in October 1993. Between September 1995 and December 31, 2003, Respondent was registered with Investors Capital Corp. ("ICC"), an NASD member firm. Respondent has not been registered with NASD since that registration was terminated on December 31, 2003.

Although Respondent is not currently associated with a member firm, NASD has jurisdiction to bring this proceeding, pursuant to Art. V, § 4 of NASD's By-Laws, because (1) the Complaint charges Respondent with misconduct while he was registered and with failing to comply with requests for information made during the two-year period following termination of his last association, and (2) the Complaint was filed within that two-year period.

IV. Violations

A. Private Securities Transactions of an Associated Person

The Complaint alleges that, from about June 19, 2002 to about July 25, 2002, Respondent offered and sold to customer CN two promissory notes issued by Big Man Small Planet, Inc. ("BMSP"), a Pennsylvania corporation for which Respondent was the founder, President and Chairman. These notes were for \$12,702.83 and \$10,000 with 15 and 18-month terms, respectively, and they have not been repaid. Additionally, on August 27, 2002, Respondent offered and sold to customer MB a \$20,000 18-month promissory note issued by BMSP, which also has not been repaid.

Based upon this conduct, Enforcement alleges that Respondent violated Rule 3040, which prohibits any person associated with an NASD member from participating in any manner in a private securities transaction without providing prior written notice to the member "describing in detail the proposed transaction and the person's proposed role

therein..." If the person has received or may receive compensation for participating, the member must advise the person, in writing, whether the member approves or disapproves the person's participation. If the member approves, "the transaction shall be recorded on the books and records of the member and the member shall supervise the person's participation in the transaction as if the transaction were executed on behalf of the member."

Rule 3040 is intended to protect both the investing public and NASD members.

The purpose of NASD Rule 3040 is to ensure that a member firm adequately supervises the suitability and due diligence responsibilities of its associated persons. ... The rule also serves to protect employers against investor claims arising from an associated person's private transactions and to prevent customers from being misled as to the employing firms' sponsorship of their associated person's transactions.

Department of Enforcement v. Carcaterra, No. C10000165, 2001 NASD Discip. LEXIS 39, at *8-9 (NAC Dec. 13, 2001) (citations omitted).

Based upon the allegations in the Complaint, the promissory notes that Respondent sold to his customers were securities under the Federal securities laws. The term "security" is defined very broadly in Section 3 of the Securities Exchange Act of 1934, and includes "any note ... but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited." In Reves v. Ernst & Young, 494 U.S. 56 (1990), the Supreme Court explained that in interpreting the definition of "security," "we are not bound by legal formalisms, but instead take account of the economics of the transaction under investigation. ... Congress' purpose in enacting the securities laws was to regulate investments, in whatever form they are made and by whatever name they are called."

494 U.S. at 60-61 (citations omitted). In general, notes issued in an investment context, as here, are securities.²

The other elements of Rule 3040 are also satisfied in this case. Respondent sold securities directly to his customers and Respondent received "selling compensation" for the sales. "Rule 3040 defines 'selling compensation' broadly to include any compensation paid directly or indirectly from whatever source in connection with or as a result of the purchase or sale of a security." Jim Newcomb, 2001 SEC LEXIS 2172 at *16 (Oct. 18, 2001). Here, Respondent was founder, President and Chairman of BMSP, the issuer of the securities, and so compensation from the sale of securities can fairly be attributed to him.

Therefore, pursuant to Rule 3040, Respondent was required to give written notice to his employer firm and to receive its written permission before participating in the sale of the promissory notes. He did not do so, and accordingly, the Hearing Panel finds that Respondent violated Rule 3040, as charged.

B. Failure to Respond

The Complaint also alleges that on June 2 and 26, 2004, NASD Staff sent Respondent requests for information concerning his alleged involvement in sales of BMSP promissory notes to CN and MB.³ The Staff sent the requests to Respondent at his CRD address by first class and certified mail, pursuant to NASD Procedural Rule 8210. In the same manner, on July 12, 2004, and July 26, 2004, Enforcement also sent requests for information to Respondent at a possible alternate address. The Staff served

² Id. at 59.

³ These letters requested responses by June 18, 2004 and July 12, 2004.

the requests in accordance with Rule 8210(d), and therefore Respondent is deemed to have received them. Respondent did not respond.

Rule 8210 authorizes NASD to require any person subject to its jurisdiction to provide information related to any matter under investigation. The Rule serves as a key element in NASD's oversight function and allows NASD to carry out its regulatory functions without subpoena power.⁴ Here, although Respondent received valid constructive notice of the Staff's requests,⁵ he failed to respond to them. Respondent thereby violated Rules 8210 and 2110.

V. Sanctions

For failing to respond to Staff requests for information made pursuant to Rule 8210, the NASD Sanction Guidelines ("Guidelines") recommend a bar as the standard sanction.⁶ There is no evidence of any mitigating circumstances that would justify a lesser sanction for the violation. Therefore, Respondent will be barred for failing to respond to Staff requests for information.

For engaging in private securities transactions in violation of Rules 3040 and 2110, Respondent is ordered to pay restitution to CN and MB in the amount of \$22,702.83 and \$20,000, respectively, plus interest calculated pursuant to 26 U.S.C.

⁴ See, e.g., Dep't of Enforcement v. Valentino, No. FP1010004, 2003 NASD Discip. LEXIS 15, at *12 (NAC May 21, 2003), *aff'd*, 2004 SEC LEXIS 330 (Feb. 13, 2004) ("It is well established that because NASD lacks subpoena power over its members, a failure to provide information fully and promptly undermines NASD's ability to carry out its regulatory mandate.") (citation omitted); Joseph G. Chiulli, Exchange Act Release No. 42,359, 2000 SEC LEXIS 112, at *16 (Jan. 28, 2000) (noting that Rule 8210 provides a means for the NASD effectively to conduct its investigations, and emphasizing that NASD members and associated persons must fully cooperate with requests for information).

⁵ See David I. Cassuto, Exchange Act Release No. 48,087, 2003 SEC LEXIS 1496, at *9 (June 25, 2003).

⁶ NASD Sanction Guidelines at p. 35 (2005 ed.).

§6621(a)(2) from the date of the investment giving rise to each customer's loss.⁷

However, in light of the bar for violations of Rule 8210 and 2110, no other sanctions will be imposed for Respondent's violation of Rule 3040 and Rule 2110.⁸

VI. Conclusion

For violating Rules 8210 and 2110, Respondent David A. Johnson is barred from associating with any NASD member in any capacity. For violating Rules 3040 and 2110, Respondent is ordered to pay restitution to CN and MB in the amount of \$22,702.83 and \$20,000, respectively, plus interest calculated pursuant to 26 U.S.C. §6621(a)(2) from the date of the investment giving rise to each customer's loss. However, in light of the bar for violations of Rules 8210 and 2110, no other sanctions are imposed for Respondent's violation of Rules 3040 and 2110. The bar shall become effective immediately if this Decision becomes the final disciplinary action of NASD.

SO ORDERED.


Sara Nelson Bloom
Hearing Officer

Dated: May 9, 2005

Copies to: David A. Johnson (via overnight and first class mail)
Thomas M. Huber, Esq. (via electronic and first class mail)
Rory C. Flynn, Esq. (via electronic and first class mail)

⁷ Pursuant to the Sanction Guidelines' General Principles, "[w]here appropriate to remediate misconduct, Adjudicators should order restitution..." Adjudicators may order restitution where an identifiable person has suffered a quantifiable loss as a result of respondent's misconduct. *Id.* at 5.

⁸ See Dep't of Enforcement v. Hodde, No. C10010005, 2002 NASD Discip. LEXIS 4, at *17 (NAC Mar. 27, 2002).

NASD OFFICE OF HEARING OFFICERS

Department of Enforcement,

Complainant,

v.

David A. Johnson,
CRD No. 2407687

Respondent.

Disciplinary Proceeding
No. C9A040061

Hearing Officer -

COMPLAINT

Date: December 23, 2004

Upon information and belief, Complainant alleges as follows:

1. Respondent David A. Johnson ("Johnson") first became registered with NASD in October 1993 as an Investment Company and Variable Contracts Products Representative. He was registered with Investors Capital Corp. ("ICC") in that capacity from September 1995 to December 31, 2003. He has not been registered with any member since December 31, 2003. NASD retains jurisdiction over Johnson for purposes of this Complaint pursuant to Article V, Section 4 of NASD's By-Laws in that: the misconduct alleged in Cause One occurred while Johnson was associated with ICC; and, this Complaint was filed within, and the violations of Procedural Rule 8210 alleged in Cause Two occurred within, two years after ICC filed a Form U-5 with NASD for Johnson.

CAUSE ONE OF COMPLAINT
(Conduct Rules 3040 and 2110)

2. The allegations in Paragraph 1 above are re-alleged and incorporated herein by reference.
3. Johnson was a founder of a Pennsylvania corporation named Big Man Small Planet, Inc. ("BMSP") and he was the President and Chairman of the Board of BMSP. According to a Private Placement Memorandum dated October 4, 1999 for a private offering of securities by BMSP, it was a start-up company engaged in marketing specialty health and fitness products it had developed.
4. From about June 19, 2002 to about July 25, 2002, Johnson offered and sold to CN, or otherwise participated in selling to CN, two promissory notes issued by BMSP. The respective amount of the promissory notes was \$12,702.83 and \$10,000 and the respective duration of the notes was fifteen (15) months and eighteen (18) months.
5. On about August 27, 2002, Johnson offered and sold to MB, or otherwise participated in selling to MB, a promissory note issued by BMSP. The amount of the promissory note was \$20,000 and it had a duration of eighteen (18) months.
6. As of the date of this Complaint, CN and MB have not been paid the funds due to them under the terms of the respective notes.
7. The BMSP promissory notes CN and MB purchased constituted securities under the Federal securities laws.
8. Johnson's participation in the transactions set forth in paragraphs 3 and 4 above occurred outside the scope of his employment with ICC. Before he participated in the transactions, Johnson did not provide ICC written notice describing the proposed transactions and his proposed role in them and, accordingly, did not receive written acknowledgement from ICC concerning the transactions.

9. Based on the foregoing, Johnson violated NASD Conduct Rules 3040 and 2110.

CAUSE TWO OF COMPLAINT
(Procedural Rule 8210 and Conduct Rule 2110)

10. The allegations in Paragraph 1 above are re-alleged and incorporated herein by reference.
11. By a letter dated June 2, 2004, NASD requested, pursuant to Procedural Rule 8210, that Johnson provide NASD information and documents concerning his alleged involvement in sales of BMSP promissory notes to CN and MB. The letter requested the information by June 18, 2004 and it warned Johnson that if he failed to comply, NASD could take disciplinary action against him pursuant to which he could be barred. The letter was sent in accordance with Rule 8210. Specifically, the letter was sent by first class and certified mail to the residential address shown for Johnson in the Central Registration Depository ("CRD"). The envelope sent by first class mail was not returned. A return receipt card bearing Johnson's apparent signature, above which was printed "Dave Johnson," was received for the envelope sent by certified mail. Johnson failed to provide NASD any information or documents by June 18, 2004 or thereafter.
12. By a letter dated June 26, 2004, NASD again requested that Johnson provide, pursuant to Rule 8210, information and documents concerning his alleged involvement in sales of BMSP promissory notes to CN and MB. The letter requested the information by July 12, 2004 and it warned Johnson that if he failed to comply, NASD could take disciplinary action against him pursuant to which he could be barred. The letter was sent in accordance with Rule 8210. Specifically, the letter was sent to Johnson's residential address shown in the CRD by first class and certified mail. The envelope sent by first class mail was not returned. A return receipt card bearing Johnson's apparent signature,

above which was printed "David Johnson," was received for the envelope sent by certified mail. Johnson failed to provide NASD any information or documents by July 12, 2004 or thereafter.

13. By a letter dated July 12, 2004, NASD again requested that Johnson provide, pursuant to Rule 8210, information and documents concerning his alleged involvement in sales of BMSP promissory notes to CN and MB. The letter requested the information by July 26, 2004 and it warned Johnson that if he failed to comply, NASD could take disciplinary action against him pursuant to which he could be barred. The letter was sent in accordance with Rule 8210. Specifically, the letter was sent by first class and certified mail to the residential address shown for Johnson in the CRD. In addition, the letter was sent by first class and certified mail to a second address that NASD's staff believed, based on information received from an information vendor, might be a more current address for Johnson. Neither envelope sent by first class mail was returned. Both envelopes sent by certified mail were returned marked "Unclaimed." Johnson failed to provide NASD any information or documents by July 26, 2004 or thereafter.
14. By a letter dated July 26, 2004, NASD again requested that Johnson provide, pursuant to Rule 8210, information and documents concerning his alleged participation in sales of BMSP promissory notes to CN and MB. The letter requested that Johnson provide the information by August 9, 2004 and it warned Johnson that if he failed to comply, NASD could take disciplinary action against him pursuant to which he could be barred. The letter was sent in accordance with Rule 8210. Specifically, the letter was sent by first class and certified mail to the residential address shown for Johnson in the CRD and to the same second address to which the prior letter had been sent. Neither envelope sent by

first class mail was returned. The envelope sent to Johnson's CRD address by certified mail was returned marked "Unclaimed." NASD's staff received a signed return receipt card for the envelope sent to the second address by certified mail (the card appears to have been signed by someone other than Johnson). Johnson failed to provide NASD any information or documents by August 9, 2004 or thereafter.

15. To the date of this Complaint, Johnson has failed to provide NASD any of the requested information or documents.
16. Based on the foregoing, Johnson violated NASD Procedural Rule 8210 and Conduct Rule 2110.

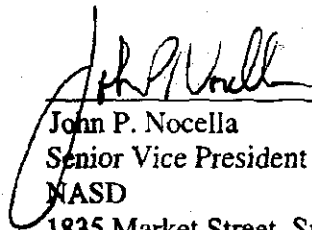
PRAYER FOR RELIEF

WHEREFORE, Complainant respectfully requests:

- A. Findings of fact and conclusions of law that Johnson committed the violations charged and alleged herein;
- B. An order imposing sanctions upon Johnson in accordance with NASD Rule 8310;
- C. An order requiring Johnson 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 relating to this proceeding as are deemed fair and appropriate under the circumstances in accordance with NASD Rule 8330; and

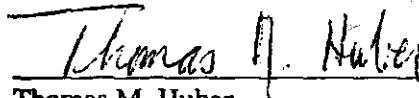
E. An order granting all further relief that is warranted under the circumstances.

Date: December 23, 2004



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