BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of Department of Enforcement, Complainant, vs. Gerald J. Kesner Lakewood, CO, Respondent.	DECISION Complaint No. 2005001729501 Dated: February 26, 2010

Respondent failed to disclose material information when recommending an investment to customers. Respondent also made an unsuitable recommendation. Held, findings and sanctions affirmed.

Appearances

For the Complainant: Leo F. Orenstein, Esq. and Helen G. Barnhill, Esq., Department of Enforcement, Financial Industry Regulatory Authority

For the Respondent: Josiah O. Hatch, Esq.

Decision

Pursuant to NASD Rule 9311,[1] Gerald J. Kesner ("Kesner") appeals the Hearing Panel's decision in this matter. In that decision, the Hearing Panel found that Kesner violated Section

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[1] Following the consolidation of NASD and the member regulation, enforcement, and arbitration functions of NYSE Regulation into FINRA, FINRA began developing a new "Consolidated Rulebook" of FINRA Rules. The first phase of the new consolidated rules became effective on December 15, 2008. *See FINRA Regulatory Notice 08-57* (Oct. 2008). Because the complaint in this case was filed before December 15, 2008, the procedural rules that apply are those that existed on December 14, 2008. The conduct rules that apply are those that existed at the time of the conduct at issue.

10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), Exchange Act Rule 10b-5, and NASD Rules 2120 and 2110 for failing to disclose certain material facts to customers related to the customers' purchase of shares of a telemarketing company. The Hearing Panel also found that Kesner recommended to two customers an unsuitable investment, in violation of NASD Rules 2310 and 2110. The Hearing Panel barred Kesner for the fraud violation and imposed a separate bar for the suitability violation.

I. Background

Kesner entered the securities industry in 1993 when he registered as a general securities representative. Since 1999, Kesner has also been a chartered financial analyst. Kesner has been associated with several FINRA member firms since he entered the securities industry. Kesner's conduct relevant to this decision occurred during the time when he was associated with Raymond James Financial Services, Inc. ("Raymond James" or "the Firm"). Kesner first registered with Raymond James in June 1998 as a general securities representative, and he remains registered in that capacity with the Firm. From January 1998 to September 2008, Kesner was also employed by Capital Financial Group, Inc. ("CFG") as an investment adviser.[2]

II. Facts

A. The Acquisition

1. Background of the Investment

JH and SH (together, "the Sellers") owned ComTec Teleservices, Inc. and ComTec Services, LLC[3] (together, "ComTec"), a telemarketing company. In July 2001, the Sellers, who were Kesner's clients, approached Kesner and suggested that he form an investor group to purchase all of ComTec's shares and membership interests. Kesner and the Sellers came to the basic terms of the transaction before Kesner approached any potential investors. JH told Kesner that he would be willing to sell ComTec at a lower price to someone he knew and trusted. Kesner and the Sellers agreed that an acceptable price for ComTec was $5 million.[4] The Sellers

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[2] Since 1998, Raymond James was CFG's broker-dealer.

[3] The Sellers formed ComTec Services, LLC on March 31, 2001. As of that date, new business was done through the limited liability company and existing business remained with the corporate entity, ComTec Teleservices, Inc.

[4] The Sellers arrived at the $5 million purchase price based upon Kesner's valuation of ComTec that he performed in 2000. Using CFG's valuation software, Kesner determined ComTec's worth based on the prior four years of earnings and revenue, cash flow, discounted cash flow, book value, and estimated future growth. The Sellers and Kesner had a second valuation performed later in 2000 by a call center consultant based in Scotland who valued the company between $6 and $10 million. Two of Kesner's customers, ML and CL (together, the "Ls"), testified at the hearing below that Kesner represented to them that ComTec was actually

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required as a condition of the sale an upfront payment of $2 to $3 million with the remainder paid to them over time. The Sellers also required that Kesner be the majority shareholder in ComTec after the acquisition.

Around the time the Sellers were discussing the potential sale of ComTec with Kesner, the Sellers were negotiating with ComTec's former chief financial officer, Peter Christiansen ("Christiansen"), to extinguish an outstanding obligation they owed to him. When the Sellers acquired ComTec in the 1990s, Christiansen became entitled to 25 percent of the proceeds should ComTec be sold. In July 2001, Christiansen agreed to relinquish his interest in ComTec for $100,000.[5] Kesner admitted that he knew, prior to the closing of the ComTec acquisition by the investor group, that Christiansen received $100,000 from the Sellers, but he did not disclose this fact to any of the investors.[6] Kesner testified that he viewed the payment as "a non-issue" and felt that the transaction had "no bearing on the partners."

2. *Raymond James Approves Kesner's Participation in the ComTec Acquisition*

On July 18, 2001, Kesner sought approval of his participation in the ComTec investor group from Raymond James. In an email to his branch manager at the Firm, Kesner outlined the particulars of the transaction. Kesner noted that he "would maintain at least a 51% ownership" in the company with his partners "having no more than a 49% stake." Kesner represented that the transaction would be financed by $500,000 cash from him and debt financing collateralized by the partners. Raymond James approved the transaction as an outside business activity on August 1, 2001.[7]

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worth more than $5 million, but that the Sellers were willing to sell the company to Kesner for less than its true worth because the Sellers were friends and clients.

[5] The Sellers initially offered Christiansen $50,000 in November 2000 to eliminate the payment clause in the event of the future sale of ComTec.

[6] Kesner stated throughout these proceedings that he believed this amount represented a profit interest rather than a right to claim 25 percent of the proceeds from the sale of the company.

[7] In 2007, Raymond James entered into an Acceptance, Waiver, and Consent agreement with FINRA related to the ComTec transaction. FINRA censured and fined Raymond James $12,000 for failing to treat Kesner's involvement in the ComTec acquisition as a private securities transaction and failing to supervise Kesner's participation in that transaction.

3. Kesner Seeks Financing

Kesner was responsible for obtaining financing for the transaction. After contacting several potential lenders, Kesner arranged to finance the acquisition with a bank loan through the Colorado Business Bank (the "Bank"). The Bank's vice president, Douglas Derks, told Kesner that the Bank would be interested in providing the financing if Kesner "could provide the appropriate level of collateral." Although the terms would change, the initial loan presentation considered by the Bank in September 2001 reflected that the investors would buy ComTec for $5 million, of which they would borrow $3 million from the Bank. The balance would be paid in the form of a $1.5 million subordinated note back to the Sellers and $500,000 cash from Kesner, which the loan presentation stated he was receiving from an early inheritance. The investors would secure the loan by a blanket lien on ComTec's assets, marketable securities owned by the investors that were held in their Raymond James accounts, second deeds of trust on all of the investors' homes, and the Sellers would secure the loan with securities that the Sellers would purchase with the proceeds of the ComTec sale.

4. Kesner Forms the Investor Group

Kesner approached several of his clients and Dennis Leonida ("Leonida"), his boss at CFG, to join the investor group.[8] While the composition of the potential investor group changed over time, the final investor group which participated in the purchase of ComTec was composed of Kesner and his wife and four other couples: the Ls,[9] the Fs, the Gs, and the Ns.[10] At the time of the ComTec transaction, ML was 43 years old, employed as an anesthesiologist, and earned approximately $390,000 annually. CL was 42 years old and previously had worked as a nurse. The Ls' August 2001 financial statement listed their net worth as $2.1 million, with approximately $1.3 million invested in securities with Raymond James.

Kesner was the "consolidator" of the financial information that the investors provided to the Bank. He stated that he "personally saw the financial statements for each of the partners and

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[8] Kesner testified that he had not contacted any of the potential investors, with the exception of Leonida, until after he sought approval from Raymond James to engage in the ComTec transaction.

[9] The Ls engaged CFG in 1997 to provide them with a broad range of financial services, including investment advice and financial planning. In connection with engaging CFG, the Ls opened an account at Raymond James. The Ls testified that they became Kesner's client soon after they engaged CFG as their financial adviser. Kesner "was assigned to manage [the Ls'] financial affairs." Kesner provided advice related to their stock portfolio, and the Ls relied upon Kesner in making their investment decisions.

[10] The initial investor group included the Kesners, Dennis Leonida and his wife, the Fs, and the Ls. The Leonidas initially agreed to guarantee $800,000 of the Bank loan, as did the Fs, and the Ls agreed to guarantee $400,000.

confirmed their potential ability to pay their proportionate share of the transaction." Kesner knew the form of collateral that was contributed by the other investors and the value of that collateral. Kesner represented to the investors that the other members of the investor group, including himself, had the financial ability to meet their potential liabilities with regard to the loan.

5. *Terms of the Transaction*

The Bank approved the loan in October 2001. The Sellers, however, became unwilling to collateralize or guarantee the loan and required that the Bank revise the terms before going forward. Under the revised terms, the total purchase price for ComTec was reduced to $4.5 million.[11] The November 30, 2001 loan presentation reflects that the investors would borrow $2.5 million from the Bank with the remainder of the purchase to be paid through a $1.5 million note back to the Sellers and $500,000 cash from Kesner. In December 2001, the Bank approved the $2.5 million loan. The loan was secured by ComTec's assets, a second deed of trust on the investors' personal residences, and pledges of the investment portfolios owned by the Ls and Leonidas.[12] All of the investors would be unlimited guarantors.

In approximately January 2002, Dennis Leonida decided that he was "uncomfortable about committing all of [his] liquid assets and the equity in [his] home" toward guaranteeing the ComTec loan transaction and reduced his $800,000 commitment to $400,000. To cover the shortfall, SG and his wife, who were Leonida's friends, agreed to participate and guarantee $400,000 of the loan. By early March of 2002, the Leonidas had withdrawn completely from the transaction. Soon thereafter Kesner solicited MN to participate in the transaction. The Ns agreed to guarantee $200,000 of the loan. To cover the remaining $200,000 needed to guarantee the loan, the Fs offered to raise their commitment to $1 million. The Bank, however, determined that the Fs' assets were insufficient for them to pledge this amount and required additional collateral from another source.[13] Kesner resolved the collateral deficit by consolidating securities that the Ls owned into an investment account that they had already pledged toward the ComTec loan guarantee.[14] The Ls testified that they understood that they needed to pledge their

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11 The Sellers reduced the price in order to delay the sale until after April 1, 2002, for capital gains purposes.

12 ML testified that he understood that the other investors were pledging their home equity, but he did not know whether others were pledging securities accounts.

13 The March 18, 2002 loan presentation showed that the Fs' net worth was $851,000. The Bank determined the Fs' net worth based on their financial statements from August 2001 that Kesner provided to the Bank. The Fs' net worth was concentrated in their real estate. The Bank determined that the net value of their real estate was $659,000.

14 The Ls' Raymond James statements from the end of February 2002 reflect that the value of this account was approximately $595,000. Because Kesner transferred other assets owned by

[Footnote continued on next page]

securities account in order to make up for the shortfall in their own collateral.[15] On March 28, 2002, the market value of their Raymond James pledged account was $837,238.

As a condition of the loan, the Bank required $500,000 in cash toward the purchase price paid at the closing. The Bank understood that Kesner would provide these funds from the receipt of an inheritance, but ultimately Kesner did not receive this inheritance. In order to satisfy the Bank's request that Kesner evidence his ability to make the $500,000 cash payment at the closing, he borrowed the money from the Sellers in January 2002 and deposited the funds in his personal bank account. Kesner supplied to the Bank a personal checking account statement for the period from January 19, 2002, through February 20, 2002, showing an opening balance of $500,330.52 and an ending balance of $500,100.55. The Bank was unaware that Kesner received the $500,000 from the Sellers rather than from an inheritance. Kesner also did not disclose the loan to the other investors. Kesner testified in an on-the-record interview prior to the FINRA hearing that he viewed the loan as a "private transaction with" the Sellers that was "immaterial" and "had no financial bearing on ComTec or the partners." Kesner repaid the Sellers at the closing of the ComTec transaction.

6. ComTec Transaction Closes

On April 3, 2002, the ComTec transaction closed. The Sellers and the investors consummated the transaction through two separate purchase and sale agreements. Under the first purchase and sale agreement ("First Agreement"), the Sellers sold 100 percent of their LLC membership interests to ComTec for $2.5 million, consisting of $1 million cash and a $1.5 million promissory note subordinated to the Bank loan. Under the second purchase and sale agreement ("Second Agreement"), the Sellers sold all of the shares of ComTec's common stock

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the Ls and held at Raymond James into the pledged account on March 19, 2002, the market value of the pledged account increased to $837,238.

On March 26, 2002, CL entered into a Securities Account Control Agreement giving the Bank a first priority security interest in the Ls' pledged account held at Raymond James. The Agreement prohibited the release of the account and withdrawal of cash or securities from the account without the written approval of the Bank.

[15] The Bank discounted the value of the Ls' securities and the real estate of all of the investors. The Bank determined that the Ls' real estate had a net value of $320,000; the Gs' real estate had a net value of $458,000; the Ns' real estate had a net value of $232,000; and the Kesners' real estate had no value after accounting for liens and the Bank's discount. The Bank's March 18, 2002 loan presentation reflected that the Ls' pledged Raymond James account had a discounted value of $664,000.

for $2 million.[16] ComTec itself purchased the bulk of the shares and the investor group purchased the remaining shares. The investors received their shares in the following proportions: 57 percent to the Kesners, 20 percent to the Fs, 9 percent to the Ls, 9 percent to the Gs, and 5 percent to the Ns. The Second Agreement also expressly provided in the "PURCHASE AND SALE OF THE SHARES" section that "[i]n addition to all other amounts payable under this Agreement, at the Closing Gerald [Kesner] shall pay to [the Sellers] the sum of Five Hundred Thousand Dollars ($500,000) in cash by cashier's check."

The investors also executed a "Hold Harmless Agreement" contemporaneous with the closing. The purpose of the Hold Harmless Agreement was to apportion the investors' joint and several liability if they defaulted on the $2.5 million Bank loan in a manner that was "allocated among the parties according to agreed-upon percentages." The Bank was not a party to the Hold Harmless Agreement. The Hold Harmless Agreement provided that the Fs were responsible for $1 million of the first $2 million of aggregate liabilities, the Ls and the Gs were responsible for $400,000 each, the Ns for $200,000, and the Kesners were responsible for any liabilities in excess of $2 million. Kesner represented to the Ls that all of the investors had sufficient assets to meet their obligations under the Hold Harmless Agreement.

B. ComTec's Failure

In or around November 2002, ComTec's largest client terminated its business relationship with the company. In September 2003, 17 months after the sale, ComTec defaulted on the loan from the Bank. Thereafter, Kesner negotiated with the Bank for a stay of principal payments through December 2003. Beginning in January 2004, the investors started making principal payments on the loan in the proportions to which they had agreed pursuant to the Hold Harmless Agreement.[17] The Fs made two principal payment contributions, but were unable to afford further payments. The Fs' portion of the principal contribution was subsequently divided among the Ls, the Gs, and the Ns. Two years after the closing, in April 2004, ComTec ceased operations and owed approximately $1.97 million on the loan. Because the balance of the loan was below $2 million, Kesner was no longer obligated to the other investors under the Hold Harmless Agreement. Kesner filed for bankruptcy in November 2004.[18]

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[16] The outstanding stock of ComTec acquired by the investors secured the $1.5 million note in the First Agreement. Kesner also personally guaranteed the note in the form of a promissory note guarantee.

[17] The Fs were responsible for 50 percent, the Ls and the Gs were responsible for 20 percent each, and the Ns were responsible for 10 percent.

[18] The Ls were listed as creditors in the bankruptcy filing and lodged an objection to the bankruptcy, but later withdrew the objection. In exchange for their withdrawal, Kesner provided the Ls an affidavit to be used in connection with litigation against the Sellers. Kesner received a bankruptcy discharge on March 29, 2005.

C. The Aftermath

The Fs, who were responsible under the Hold Harmless Agreement for $1 million of the $2 million balance, subsequently abandoned their pledged property to foreclosure and disappeared. The Ls, the Gs, and the Ns refinanced their houses, obtained a loan from another bank, and used these proceeds to pay off the Bank.[19] The Ls, the Gs, and the Ns brought a civil suit against the Sellers, which resulted in a confidential settlement. The Ls also brought an arbitration action against Leonida, CFG, and Raymond James that resulted in an award against CFG and Raymond James (joint and several) in the amount of $469,917.[20]

III. Procedural History

The Department of Enforcement ("Enforcement") filed a two-cause complaint against Kesner on March 30, 2007. The complaint alleged that Kesner violated Section 10(b) of the Exchange Act, Exchange Act Rule 10b-5, and NASD Rules 2120 and 2110 for failing to disclose to eight customers material facts that would have been important to the customers' decision to invest in the acquisition of ComTec. The complaint also alleged that Kesner violated NASD Rules 2310 and 2110 by recommending to the Ls an unsuitable investment related to the acquisition of the outstanding shares of ComTec.

The Hearing Panel found Kesner liable for violating the antifraud provisions of the federal securities laws and FINRA's rules and making an unsuitable recommendation. The Hearing Panel barred Kesner for each violation. This appeal followed.[21]

IV. Discussion

After a thorough review of the record, we affirm the Hearing Panel's findings of violation. We conclude that Kesner engaged in fraudulent misconduct by failing to disclose material facts to the investors in violation of Section 10(b) of the Exchange Act, Exchange Act

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[19] In the spring of 2006, the Ls, the Gs, and the Ns sold the Fs' abandoned property and received approximately $650,000 after real estate fees. The investors used the proceeds from the sale to pay off the new loan.

[20] The arbitration panel awarded compensatory damages to the Ls "based on claims of negligence, suitability, and negligent supervision."

[21] Pursuant to NASD Rule 9346, Kesner made a motion to adduce additional evidence before the FINRA National Adjudicatory Council ("NAC") subcommittee ("Subcommittee") empanelled to consider this appeal. Kesner sought to introduce an email and attachment dated October 10, 2001, from Douglas Derks of the Bank to Kesner, attaching a draft loan commitment letter. The Subcommittee granted Kesner's motion. We adopt the Subcommittee's ruling as our own.

Rule 10b-5, and NASD Rules 2120 and 2110.[22] We further find that he made an unsuitable recommendation to the Ls in violation of NASD Rules 2310 and 2110. We discuss the violations in detail below.

A. Fraudulent Failures to Disclose

Exchange Act Section 10(b), Exchange Act Rule 10b-5, and NASD Rule 2120 prohibit fraudulent and deceptive acts and practices in connection with the offer, purchase, or sale of a security.[23] Liability for failing to disclose material information is "premised upon a duty to disclose arising from a relationship of trust and confidence between parties to a transaction." *Chiarella v. United States*, 445 U.S. 222, 230 (1980). A registered representative owes such a duty to his clients to disclose material information fully and completely when recommending an investment. *See De Kwiatkowski v. Bear, Stearns & Co.*, 306 F.3d 1293, 1302 (2d Cir. 2002) ("[T]he broker owes duties of diligence and competence in executing the client's trade orders, and is obliged to give honest and complete information when recommending a purchase or sale."); *Magnum Corp. v. Lehman Bros. Kuhn Loeb, Inc.*, 794 F.2d 198, 200 (5th Cir. 1986) ("The law imposes upon the broker the duty to disclose to the customer information that is material and relevant to the order."); *Hanly v. SEC*, 415 F.2d 589, 596-97 (2d Cir. 1969); *SEC v. Hasho*, 784 F. Supp. 1059, 1106 (S.D.N.Y. 1992); *Dep't of Mkt. Regulation v. Field*, Complaint No. CMS040202, 2008 FINRA Discip. LEXIS 63, at *32-33 (FINRA NAC Sept. 23, 2008).

In order to establish that Kesner failed to disclose material information in violation of Section 10(b) and NASD Rule 2120, it is necessary that Enforcement prove by a preponderance of the evidence that the omissions involved material information and were made in connection

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22 NASD Rule 2110 requires that FINRA members shall, in conducting their business, "observe high standards of commercial honor and just and equitable principles of trade." NASD Rule 0115 makes all FINRA rules, including NASD Rule 2110, applicable to both FINRA members and all persons associated with FINRA members. Conduct that violates other SEC or FINRA rules is inconsistent with the high standards of commercial honor and just and equitable principles of trade and therefore also violates NASD Rule 2110. *Joseph Abbondante*, Exchange Act Rel. No. 53066, 2006 SEC LEXIS 23, at *36 (Jan. 6, 2006), *aff'd*, 209 F. App'x 6 (2d Cir. 2006).

23 Section 10(b) of the Exchange Act makes it "unlawful for any person . . . [t]o use or employ, in connection with the purchase or sale of any security . . . , any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe." 15 U.S.C. § 78j(b). Exchange Act Rule 10b-5 makes it unlawful, in connection with the purchase or sale of any security, "to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading." 17 C.F.R. § 240.10b-5. NASD Rule 2120 is FINRA's antifraud rule and is similar to Section 10(b) and Exchange Act Rule 10b-5. *Mkt. Regulation Comm. v. Shaughnessy*, Complaint No. CMS950087, 1997 NASD Discip. LEXIS 46, at *24 (NASD NBCC June 5, 1997), *aff'd*, 53 S.E.C. 692 (1998).

with the purchase and sale of a security.[24] *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1467 (2d Cir. 1996); *Dep't of Enforcement v. Gonchar*, Complaint No. CAF040058, 2008 FINRA Discip. LEXIS 31, at *27 (FINRA NAC Aug. 26, 2008), *aff'd*, Exchange Act Rel. No. 60506, 2009 SEC LEXIS 2797 (Aug. 14, 2009), *appeal docketed*, No. 09-4215 (2d Cir. Oct. 8, 2009). A violation of the antifraud provisions also requires a showing that the material omissions were made with scienter.[25] *First Jersey Sec.*, 101 F.3d at 1467; *Dep't of Enforcement v. Apgar*, Complaint No. C9B020046, 2004 NASD Discip. LEXIS 9, at *11 (NASD NAC May 18, 2004).

Kesner has admitted that, before the investors purchased ComTec, he knew and failed to disclose to them that the Sellers paid Christiansen $100,000 and that this payment was related to ComTec. Kesner also admitted that he did not disclose to the investors or the Bank that he received the $500,000 loan from the Sellers. Finally, Kesner also admitted that he did not disclose to the Ls the nature and amount of collateral pledged by each investor as well as the financial strength, net worth, and income of the other investors in the investor group.[26] Kesner denied that any of this was material information that he was obligated to disclose. Kesner also argued that he acted without scienter.

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24 There is no dispute that Kesner's conduct occurred in connection with the purchase or sale of securities.

25 In addition, there must also be proof that Kesner used "any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange." 17 C.F.R. § 240.10b-5. Kesner does not dispute that he communicated with his customers through telephone calls and the U.S. mail service thereby satisfying the interstate commerce requirement. *See SEC v. Softpoint, Inc.*, 958 F. Supp. 846, 865 (S.D.N.Y. 1997) (determining that the jurisdictional requirements of the federal antifraud provisions are interpreted broadly and are satisfied by intrastate telephone calls and the use of the U.S. mail), *aff'd*, 159 F.3d 1348 (2d Cir. 1998).

26 Kesner contends, however, that he circulated the Bank's loan commitment letters to the investors that showed the collateral pledged by the investors and that the investors should have read these letters. For example, the "Collateral" section of the March 26, 2002 loan commitment letter lists a first security interest in ComTec's accounts receivable, furniture, fixtures and equipment, contract rights, and general intangibles. The section further lists first or second deeds of trust of the investors' real property and "[a] collateral assignment of the [Ls'] Investment Portfolios." The investors' receipt of the loan commitment letters, which did not disclose the value of the collateral or the financial strength, net worth, and income of the other investors, does not lessen Kesner's liability for failing to disclose material facts. *Cf. Larry Ira Klein*, 52 S.E.C. 1030, 1036 (1996) ("Klein's delivery of a prospectus to Towster does not excuse his failure to inform her fully of the risks of the investment package he proposed."); *Field*, 2008 FINRA Discip. LEXIS 63, at *35-36 (rejecting argument that misrepresentations were excused when investment's risk factors were disclosed in written materials and that customers should have read these materials).

1. The Omitted Statements Were Material

When a registered representative recommends a security to a customer, he must disclose "material adverse facts." *Richard H. Morrow*, 53 S.E.C. 772, 781 (1998). Whether information is material "depends on the significance the reasonable investor would place on the . . . information." *Basic Inc. v. Levinson*, 485 U.S. 224, 240 (1988). Information is material "if there is a substantial likelihood that a reasonable [investor] would consider it important in deciding how to [invest] . . . [and] the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Id.* at 231-32 (*quoting TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)).

We find that reasonable investors would have considered the information that Kesner withheld from the investors material to their investment decisions. The omitted facts would alter how investors valued and assessed the risks of the transaction. Had the investors known about the $100,000 that Christiansen, who was ComTec's former chief financial officer, accepted to extinguish his right to 25 percent interest in ComTec's sale proceeds, they could have raised questions regarding whether the $4.5 million purchase price was reasonable. The investors were deprived of the opportunity to address this question before the closing as a result of Kesner's silence. Kesner stated that he knew about the $100,000 payment and its relationship to ComTec, but not the particulars of the transaction because he was not involved in it. Kesner claimed that he believed that the $100,000 represented a profit interest rather than a right to claim 25 percent of the sale proceeds. In Kesner's view, the payment was "a non-issue" that had "no bearing on the partners." Even if Kesner did not know enough about the payment to Christiansen to weigh its import, he had a duty to learn more about it. A registered representative is required to disclose material facts that are "reasonably ascertainable" and "cannot deliberately ignore that which he has a duty to know." *Hanly*, 415 F.2d at 595-97. The purpose of the payment to Christiansen was reasonably ascertainable to Kesner. Kesner had direct dealings with the Sellers and came to the terms of the transaction with them and obtained the financing.

A reasonable investor would also consider it important when determining to invest that Kesner obtained the Bank loan under false pretenses by securing the $500,000 from the Sellers.[27]

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[27] Kesner argues that he was not required to disclose the $500,000 loan from the Sellers because the investors were already informed of it by Peter Stapp ("Stapp"), an attorney involved in the ComTec closing. Kesner's argument is without merit both legally and factually. It was Kesner's duty, not a third party's, to disclose material information fully and completely to the investors with respect to the ComTec transaction that he was recommending. *See Field*, 2008 FINRA Discip. LEXIS 63, at *32-33; *Dep't of Enforcement v. Cipriano*, Complaint No. C07050029, 2007 NASD Discip. LEXIS 23, at *27 (NASD NAC July 26, 2007). Kesner has admitted that he did not disclose the loan to the investors. A registered representative who is making a recommendation to a customer cannot shift his responsibility for compliance with the federal securities laws and FINRA's rules related to that recommendation to others. *See Justine Susan Fischer*, 53 S.E.C. 734, 741 & n.4 (1998) (holding that "[a] broker has responsibility for his own actions and cannot blame others for his own failings"). Moreover, Kesner's argument is without evidentiary support. Stapp did not testify that *he* informed the investors of the loan, but

[Footnote continued on next page]

A preponderance of the evidence shows that when making the lending determination, the Bank understood that Kesner was making an equity contribution to the purchase. As a result of Kesner's subterfuge, the Bank could have declared the loan to be in default under a "False Statements" provision in the promissory note.[28] In addition, Kesner represented to the investors that everyone investing in the ComTec acquisition had sufficient assets to meet their respective obligations when he himself did not.

Kesner's version of events related to the $500,000 has shifted throughout these proceedings. Prior to the hearing, Kesner admitted that the Bank required a $500,000 cash contribution to the ComTec transaction from the investors.[29] He also told Raymond James, when seeking prior approval of the transaction, that he would be contributing $500,000 cash into the transaction. In his investigative testimony before the hearing, Kesner described the loan as a "private transaction with" the Sellers that was "immaterial" and "had no financial bearing on ComTec or the partners." At the hearing, Kesner denied that the $500,000 was a condition of the loan and that he circumvented that condition by obtaining the $500,000 from the Sellers. Kesner asserted that his recollection of events at the hearing was more accurate than his prior statements because he based his prior statements, in part, on a review of the Bank's loan presentation documents that, in his view, were inaccurate.[30]

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rather, that the investors were aware of the loan before he was. Stapp's testimony was undercut by the investors who testified that they were unaware prior to the closing of the Sellers' $500,000 loan to Kesner. *See, e.g.*, *Field*, 2008 FINRA Discip. LEXIS 63, at *24 (finding that similarities among investors' testimony strengthens the reliability of that testimony).

[28] The relevant provision of the promissory note states: "Any warranty, representation or statement made or furnished to Lender by Borrower or on Borrower's behalf under this Note or the related documents is false or misleading in any material respect, either now or at the time made or furnished or becomes false or misleading at any time thereafter."

[29] In a written statement, Kesner explained that "[i]n December 2001 in a discussion with Doug Derks of Colorado Business Bank he noted the fact that the Bank would be more comfortable if there was additional money being put into the deal on the front end instead of being paid over time. Doug told me verbally that he wanted $500,000 in cash contributed to the purchase price of Comtec at closing instead of structuring a consulting contract with the [Sellers] that paid them $500,000 over four years. Subsequently, the [Sellers'] attorney drafted a promissory note whereby the [Sellers] would loan me $500,000 to meet this requirement, which would be paid back to them at the closing."

[30] The Bank's September 24, 2001, November 30, 2001, and March 18, 2002 loan presentation documents included the statement that "[t]he $500M cash down will come from Gerald [Kesner] who is receiving the cash from an early inheritance."

The Hearing Panel found that Kesner was not credible and rejected his denials. The Hearing Panel found that Kesner's hearing testimony was inconsistent with his prior admissions and was contradicted by the plain language of the Second Agreement and the Bank officials' testimony given in other proceedings related to the ComTec acquisition.[31] The initial fact-finder's credibility determinations are entitled to considerable deference, which may only be overcome by substantial evidence. *Dane S. Faber*, Exchange Act Rel. No. 49216, 2004 SEC LEXIS 277, at *17-18 (Feb. 10, 2004) (stressing that deference is given to initial decision maker's credibility determination "based on hearing the witnesses' testimony and observing their demeanor"). The substantial evidence necessary to reverse the Hearing Panel's findings of credibility is absent; we thus agree with the Hearing Panel's determination.

We also find that a reasonable investor in the position of the Ls would want to know all of the facts regarding the collateralization of the Bank loan. The Ls pledged a highly disproportionate share of the collateral and pledged the only liquid assets. Further, the Fs, who received a higher proportion of the ComTec stock and assumed the greatest obligation under the Hold Harmless Agreement, lacked sufficient assets to meet this obligation. As a result, the Ls faced a greater risk of loss in the event of default than the other investors irrespective of the purported protection of the Hold Harmless Agreement.

2. *Kesner Acted with Scienter*

We also find, by a preponderance of the evidence, that Kesner acted with scienter. Scienter is defined as "a mental state embracing intent to deceive, manipulate, or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976). Scienter is established if a respondent acted intentionally or recklessly. *See Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 127 S. Ct. 2499, 2507 n.3 (2007); *Irfan Mohammed Amanat*, Exchange Act Rel. No. 54708, 2007 SEC LEXIS 2558, at *35 (Nov. 3, 2007), *aff'd*, 269 F. App'x 217 (3d Cir. 2008). Reckless conduct includes "a highly unreasonable omission, involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a

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[31] Kesner argues that the bankers' testimony was "inadmissible hearsay" and that the bankers' testimony was contradicted by the Bank's loan commitment letters, which do not reflect the $500,000 obligation. Hearsay is allowable evidence in FINRA proceedings. *See Kevin Lee Otto*, 54 S.E.C. 847, 854 (2000) ("The Commission has held repeatedly that hearsay is admissible in administrative proceedings and, in appropriate circumstances, may even constitute the sole basis for findings of fact."), *aff'd*, 253 F.3d 960 (7th Cir. 2001); *Dep't of Enforcement v. Puma*, Complaint No. C10000122, 2002 NASD Discip. LEXIS 13, at *7-8 (NASD NAC Oct. 21, 2002); *see also Charles D. Tom*, 50 S.E.C. 1142, 1145 (1992) (setting forth test for admission of hearsay evidence). Moreover, as the record reflects, the bankers gave their testimony under oath and the testimony was corroborated by other evidence in the record, including Kesner's own prior statements. The admission of the testimony was not improper. *See Field*, 2008 FINRA Discip. LEXIS 63, at *25 n.18; *see also Harry Gliksman*, 54 S.E.C. 471, 480-81 (1999) (finding that prior given affidavit that was corroborated by other record evidence was admissible because it was probative and reliable), *aff'd*, 24 F. App'x 702 (9th Cir. 2001).

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." *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977) (internal quotation omitted); *see Meadows v. SEC*, 119 F.3d 1219, 1226 (5th Cir. 1997). Proof of scienter may be "a matter of inference from circumstantial evidence." *Herman & MacLean v. Huddleston*, 459 U.S. 375, 390 n.30 (1983).

Kesner had information that he failed to disclose about the Sellers' $100,000 payment to Christiansen, the $500,000 loan from the Sellers, and the value of the Fs' collateral as well as the Fs' financial strength, net worth, and income. In the case of a material omission, "scienter is satisfied where, [as here,] the [respondent] had actual knowledge of the material information." *GSC Partners CDO Fund v. Washington*, 368 F.3d 228, 239 (3d Cir. 2004); *Fenstermacher v. Philadelphia Nat'l Bank*, 493 F.2d 333, 340 (3d Cir. 1974); *see also Kenneth R. Ward*, Exchange Act Rel. No. 47535, 2003 SEC LEXIS 687, at *39 (Mar. 19, 2003) (finding scienter established when representative was aware of material information and failed to make appropriate disclosures to customers), *aff'd*, 75 F. App'x 320 (5th Cir. 2003); *Field*, 2008 FINRA Discip. LEXIS 63, at *33-34 (same). Kesner's omissions presented a danger of misleading the Ls and the other investors.[32] For example, ML and SG testified that they would have wanted to know

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[32] Kesner's argument that he acted without scienter because none of the investors believed that he "had done anything more than attempt to make a success of their collective investment," and, to that end, the Ns and the Gs continue to view him "as their advisor or trusted colleague" is without merit. Certain investors' belief that Kesner did not intend them harm is irrelevant to a finding of fraud. *See, e.g., Wilshire Disc. Sec., Inc.*, 51 S.E.C. 547, 551 n.15 (1993) ("[E]ven assuming that certain investors ratified or endorsed [respondent's] action, that would not alter the objective fact that [respondent] fraudulently departed from the . . . stated use of proceeds.").

We also reject Kesner's claim that the investors' sophistication and representation by counsel excused his omissions. Irrespective of whether the investors were sophisticated and had an attorney draft certain ComTec transaction documents, Kesner was not relieved of his obligation to disclose material facts about the ComTec transaction to the investors. *See, e.g., Lester Kuznetz*, 48 S.E.C. 551, 554 (1986) (stating that a customer's investment experience does not give a representative "license to make fraudulent representations"), *aff'd*, 828 F.2d 844 (D.C. Cir. 1987); *Field*, 2008 FINRA Discip. LEXIS 63, at *37 n.25. Further, to the extent that Kesner is arguing that he was advised by counsel, the record does not show that Kesner made full disclosure to counsel and relied on counsel in determining not to disclose material facts to the investors. *See Markowski v. SEC*, 34 F.3d 99, 105 (2d Cir. 1994) (invoking advice of counsel requires a respondent to show that he made complete disclosure to his counsel of the intended action; requested counsel's advice as to the legality of the intended action; received counsel's advice that the conduct was legal; and relied in good faith on that advice). Kesner's other arguments are similarly without merit. He contends that he did not intentionally or recklessly attempt to deceive the investors because Raymond James determined that the ComTec transaction was an outside business activity, the investors executed letters stating that they understood that Kesner was participating in the ComTec purchase, but not in his capacity as a registered representative, and there was no finding of fraud in the Ls' arbitration action against

[Footnote continued on next page]

about the $500,000 loan that Kesner obtained from the Sellers before the ComTec purchase. ML further testified that he would have wanted to know before he purchased ComTec about the $100,000 payment to Christiansen and that the Fs had insufficient collateral, according to the Bank's valuation, to meet the Fs' $1 million obligation under the Hold Harmless Agreement.

We affirm the Hearing Panel's finding that Kesner engaged in fraud, in violation of Section 10(b) of the Exchange Act, Exchange Act Rule 10b-5, and NASD Rules 2120 and 2110, when he failed to disclose material information to the investors.

B. Unsuitable Recommendation

We also affirm the Hearing Panel's findings that Kesner violated NASD Rules 2310 and 2110 when he recommended that the Ls invest in ComTec.

NASD Rule 2310 provides that a representative in recommending a transaction to a customer "shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs." Compliance with the suitability rule requires a registered representative to "make a customer-specific determination of suitability and . . . tailor his recommendations to the customer's financial profile and investment objectives." *F.J. Kaufman & Co.*, 50 S.E.C. 164, 168 (1989). A broker's suitability obligation also includes ensuring that a customer understands the risks involved in the investment. *Patrick G. Keel*, 51 S.E.C. 282, 284-85 (1993); *Dep't of Enforcement v. Chase*, Complaint No. C8A990081, 2001 NASD Discip. LEXIS 30, at *17 (NASD NAC Aug. 15, 2001), *aff'd*, Exchange Act Rel. No. 47476, 2003 SEC LEXIS 566 (Mar. 10, 2003).

Kesner did not have reasonable grounds to recommend the ComTec transaction to the Ls. In order for a registered representative "to have reasonable grounds for believing that an investment is suitable for a particular customer, he must disclose material information related to risk that he possesses about an investment when the failure to make such disclosures would otherwise violate the antifraud provisions of the securities laws." *Dep't of Enforcement v. Frankfort*, Complaint No. C02040032, 2007 NASD Discip. LEXIS 16, at *32 (NASD NAC May 24, 2007). As discussed above, Kesner failed to disclose critical information to the Ls related to the ComTec transaction, specifically the $100,000 payment to Christiansen, the $500,000 loan that Kesner obtained from the Sellers before the ComTec purchase, and the Fs' insufficient collateral to meet their obligation under the Hold Harmless Agreement. As a result of these omissions, the Ls could not know the full extent of their exposure, and Kesner was precluded from understanding the Ls' risk tolerance and determining whether his recommendation to invest in ComTec was suited for the Ls' needs.

[cont'd]

Raymond James, CFG, and Leonida. None of these assertions obviated the need for Kesner to disclose materials facts that he knew.

Further, regardless of Kesner's omissions, it was not reasonable for Kesner to recommend an investment that risked the bulk of the Ls' net worth and restricted their access to a majority of their liquid assets. The Ls' primary investment objective was growth with a medium to high level of risk tolerance. The Ls were also concerned about preserving capital to coincide with ML's possible retirement at age 55. The Ls' investment in the ComTec transaction was not consistent with these factors. At the time of the closing, the Ls provided collateral valued at $984,000, which included the Bank's discounted value of their home ($320,000) and Raymond James account ($664,000), to meet their $400,000 obligation under the Hold Harmless Agreement. Even with the Bank's discounted numbers, the Ls' collateral represented approximately 47 percent of their entire net worth and nearly 40 percent of the value of the $2.5 million Bank loan. And despite pledging the greatest amount of collateral, and in turn obligating themselves to the greatest amount of risk, the Ls received merely a 9 percent ownership share in ComTec. The ComTec transaction exposed the Ls' assets to a risk of loss that was inconsistent with their financial circumstances and needs.

Kesner disputes that the ComTec transaction as structured for the Ls was unsuitable because the Ls' risk was limited to $400,000 as set forth by the Hold Harmless Agreement, the Ls knew that the Bank loan imposed joint and several liability, and the Ls knew that they were risking their collateral that included the assets in their Raymond James account. Kesner's arguments are without merit. First, the fact that the Ls agreed to pledge such a substantial amount does not establish that the transaction was suitable. *See Dep't of Enforcement v. Stein*, Complaint No. C07000003, 2001 NASD Discip. LEXIS 38, at *10 (NASD NAC Dec. 3, 2001), *aff'd*, Exchange Act Rel. No. 47335, 2003 SEC LEXIS 338 (Feb. 10, 2003); *see also Klein*, 52 S.E.C. at 1037-38 ("[S]uitablity relates to whether a specific securities transaction is appropriate for a particular investor, not whether that individual can afford to lose the money invested."). Second, the Ls' risk was not limited to $400,000 because the Bank was not bound by the Hold Harmless Agreement and could execute against all collateral that the Ls pledged or pursue them for the entire balance of the $2.5 million loan, leaving the Ls to sue the other investors for contribution. And, the investors' obligations under the Hold Harmless Agreement were not secured; thus, if the other investors lacked assets to satisfy a judgment to contribute, such as the Fs, the Ls had no recourse. Moreover, the Ls pledged their Raymond James account without sufficient information to make an informed decision. We do not credit Kesner's testimony that CL orally agreed to pledge the Ls' Raymond James account in order to meet the Fs' collateral shortfall. Both of the Ls testified that they pledged their securities account to meet a shortfall in their own collateral based on the Bank's discounted valuation of their home and understood that their risk was limited to $400,000 because Kesner told them so and told them that all of the investors had sufficient assets to meet their respective obligations. The Hearing Panel determined that the Ls' testimony was more credible than Kesner's. The Hearing Panel, moreover, found it not credible that the Ls would have pledged additional collateral to satisfy the Fs' shortfall without requesting an adjustment in their ownership interests. We will not disturb these findings. *See Faber*, 2004 SEC LEXIS 277, at *17-18.

Kesner further argues that the investment was not unsuitable because the Ls "knew or had the opportunity to know" the other collateral pledges of the other investors through a review of the Bank's loan commitment letters or communication directly with the Bank. As we previously

found, however, the loan commitment letters did not disclose the value of the collateral or the financial strength, net worth, and income of the other investors. More importantly, it was Kesner's obligation to ensure that the Ls fully understood the risks involved in the ComTec transaction and were able and willing to undertake such risks. *See Chase*, 2001 NASD Discip. LEXIS 30, at *17-18; *see, e.g.*, *Paul F. Wickswat*, 50 S.E.C. 785, 787 (1991) (finding that high-risk trading recommendations were at odds with the customer's stated objectives and representative was required to "obtain either a meaningful consent to the adoption of new investment objectives or an assent to a limited departure from [the customer's] general objectives"). Kesner failed to make any such assessment and, to that end, to fulfill his suitability obligation.[33]

We affirm the finding that Kesner violated NASD Rules 2310 and 2110.[34]

V. Sanctions

The Hearing Panel barred Kesner for each violation. We affirm both the bar for Kesner's fraud and the imposition of a separate bar for making an unsuitable recommendation.

A. Fraudulent Omissions

The FINRA Sanction Guidelines ("Guidelines") for intentional or reckless omissions of material facts recommend a fine of $10,000 to $100,000, and a suspension of 10 business days to two years.[35] In an egregious case, the Guidelines recommend a bar.[36] For the reasons discussed below, we determine that Kesner's misconduct was egregious.

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33 Kesner seems to argue that he was relieved of his suitability obligation because "the purchaser group, including Mr. Kesner, had engaged counsel to protect their interests." The record does not support that Kesner relied on counsel to determine that ComTec was suitable for the Ls. Further, we reject Kesner's attempt to shift his own responsibility for determining suitability to another. "[A] registered representative who is making a recommendation to a customer cannot shift his responsibility for compliance with NASD rules related to that recommendation to others." *Frankfort*, 2007 NASD Discip. LEXIS 16, at *36.

34 A violation of FINRA's suitability rule is also a violation of NASD Rule 2110. *See Wendell D. Belden*, Exchange Act Rel. No. 47859, 2003 SEC LEXIS 1154, at *14 (May 14, 2003).

35 *FINRA Sanction Guidelines* 93 (2007), http://www.finra.org/web/groups/industry/@ip/@enf/@sg/documents/industry/p011038.pdf [hereinafter *Guidelines*].

36 *Id.*

The Guidelines for omissions of material facts advise that adjudicators consider the "Principal Considerations in Determining Sanctions."[37] We find that several of these considerations apply to Kesner's misconduct and serve to aggravate sanctions. Kesner's failure to disclose to the investors that he obtained the $500,000 loan from the Sellers and that the Sellers paid Christiansen $100,000 to extinguish an interest in ComTec was deliberate. Likewise, Kesner's intentional failure to disclose to the Ls the value of the Fs' collateral and financial condition was a disregard of his duty of fair dealing to his customers.[38] The investors could not make informed investment decisions and accurately assess whether an investment in ComTec was in their best interests as a direct result of Kesner's omissions. Kesner's misconduct caused the investors to suffer financially when ComTec failed and placed their homes and financial security at risk.[39] We also consider relevant in assessing the appropriate remedial sanctions that Kesner's misconduct resulted in the potential for his monetary gain.[40] Kesner received 57 percent of ComTec's outstanding shares once the transaction closed and had the most to gain from the acquisition. Kesner also risked the least. Kesner's net worth during the relevant time was approximately $134,000, and the Bank determined that Kesner's pledged real estate had no value after accounting for his mortgage and the Bank's discount on pledged assets.

Kesner argues in favor of mitigation that he relied on "competent legal advice concerning the transaction." "To constitute mitigation, however, the claim must have sufficient content and sufficient supporting evidence." *Howard Brett Berger*, Exchange Act Rel. No. 58950, 2008 SEC LEXIS 3141, at *38 (Nov. 14, 2008), *aff'd*, No. 09-0062-ag (2d Cir. Oct. 1, 2009). In determining whether to credit an advice of counsel claim, courts and the Commission consider the following: that the person made complete disclosure to counsel, sought advice on the legality of the intended conduct, received advice that the intended conduct was legal, and relied in good faith on counsel's advice. *Markowski*, 34 F.3d 99 at 105; *Berger*, 2008 SEC LEXIS 3141, at *38. The Commission recently stated that it "'isn't possible to make out' an advice-of-counsel claim 'without producing the actual advice from an actual lawyer.'" *Berger*, 2008 SEC LEXIS 3141, at *40 (*quoting SEC v. McNamee*, 481 F.3d 451, 456 (7th Cir. 2007)). In *McNamee*, the Seventh Circuit rejected a defendant's argument that "reliance on advice of counsel exculpates his conduct" because the defendant "offered nothing other than his say-so." 481 F.3d at 455-56. In addition, a client's full and complete disclosure is central to a finding of good faith reliance on counsel. *See Dolphin & Bradbury, Inc. v. SEC*, 512 F.3d 634, 642 (D.C. Cir. 2008); *SEC v. Merchant Capital*, 483 F.3d 747, 772 (11th Cir. 2007). Kesner has provided no evidence of whether he provided counsel with all the relevant facts and made full disclosure to counsel, received legal advice, and then reasonably relied on that advice. *See Berger*, 2008 SEC LEXIS 3141, at *40. Kesner's advice of counsel claim is entirely deficient and does not provide him with any mitigation.

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37 *Id.* at 6-7 (Principal Considerations in Determining Sanctions).

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

39 *Id.* at 6 (Principal Considerations in Determining Sanctions, No. 11).

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

Kesner also contends that it should be mitigating that he paid Leonida's (his supervisor at CFG) legal fees that resulted from the Ls' arbitration action. We disagree. The Guidelines suggest that adjudicators consider for purposes of sanctions whether the respondent voluntarily and reasonably attempted, prior to detection and intervention, to pay restitution or otherwise remedy the misconduct.[41] First, there is no evidence to substantiate Kesner's statement that he paid these legal fees. Second, even if the record supported Kesner's statement, he did not act to remedy his misconduct prior to detection and intervention.[42] *See Eliezer Gurfel*, 54 S.E.C. 56, 63 (1999) (rejecting argument that respondent's repayment of funds was mitigating), *aff'd*, 205 F.3d 400 (D.C. Cir. 2000); *Henry E. Vail*, 52 S.E.C. 339, 342 (1995) ("Noting in mitigation that he has repaid the Club and that he has no other disciplinary history, Vail argues that the sanctions are excessive. We disagree."), *aff'd*, 101 F.3d 37 (5th Cir. 1996).

The Hearing Panel found aggravating for purposes of sanctions that Kesner did not accept responsibility for his misconduct and blamed the Ls for his predicament because they relied on him for information regarding the ComTec transaction.[43] Kesner argues that he was merely defending himself and that his "good faith" defense should not be grounds for "punishment."[44] We disagree that Kesner was defending himself in good faith and find this

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41 *Guidelines*, at 6 (Principal Considerations in Determining Sanctions, No. 4).

42 Kesner makes additional arguments in support of mitigation against a bar. Kesner contends that he "was not a recidivist from previous FINRA warnings" and that his lack of disciplinary history is relevant. While the existence of a disciplinary history is an aggravating factor when determining the appropriate sanction, its absence is not mitigating. *See Rooms v. SEC*, 444 F.3d 1208, 1214-15 (10th Cir. 2006) (determining that the lack of disciplinary history is not mitigating and representative "was required to comply with the NASD's high standards of conduct at all times"). Moreover, the responsibility for compliance with applicable requirements was Kesner's alone. *See John Montelbano*, Exchange Act Rel. No. 47227, 2003 SEC LEXIS 153, at *26-27 (Jan. 22, 2003) (highlighting that the responsibility for compliance with applicable requirements cannot be shifted to regulatory authorities). Kesner argues that it is relevant that he also participated in the transaction, exposed himself to substantial risk, and ultimately filed for bankruptcy. Kesner's own belief in ComTec and the fact that he filed for bankruptcy are not dispositive to our sanctions determination. Kesner's personal belief in an investment and his willingness to speculate with his own funds do not excuse his failure to disclose material information to his customers. *See Faber*, 2004 SEC LEXIS 277, at *22.

43 *Guidelines*, at 6 (Principal Considerations in Determining Sanctions, No. 2).

44 Kesner contends that this violates his right to due process. Because FINRA is not a governmental actor, constitutional and common law due process requirements do not apply. *See Desiderio v. Nat'l Ass'n of Sec. Dealers, Inc.*, 191 F.3d 198, 206 (2d Cir. 1999) (dismissing due process claim because FINRA is not a government actor). In addition, the record shows that Kesner received a fair process in accordance with FINRA's Code of Procedure and the Exchange Act. See 15 U.S.C. § 78o-3(b)(8), (h)(1) (requiring that self-regulatory organizations provide

[Footnote continued on next page]

factor aggravating. Kesner provided inaccurate information at the hearing in an effort to minimize his own responsibility.[45] *See Frankfort*, 2007 NASD Discip. LEXIS 16, at *41 ("Providing inaccurate information in an effort to minimize one's own responsibility serves to aggravate sanctions."). The Hearing Panel determined that Kesner falsely denied during his testimony that a $500,000 payment from the investors was a condition of the Bank loan and continued to falsely state that the investor group knew about the $500,000 loan from the Sellers—even after he admitted that he did not tell the investors about the loan and several of the investors testified that they did not know about the loan before the ComTec transaction closed. Kesner's untruthfulness reflects strongly on his fitness to serve in the securities industry. Kesner's failure to appreciate the gravity of his misconduct and the potential threat that his actions posed warrants significant sanctions. *See, e.g.*, *Geoffrey Ortiz*, Exchange Act Rel. 58416, 2008 SEC LEXIS 2401, at *28 (Aug. 22, 2008) (finding that the fact that respondent never accepted responsibility for his misconduct and blamed others for what occurred were factors that supported a bar). Moreover, Kesner's actions cast serious doubt upon his commitment to the standards demanded of registered persons in the securities industry, including the obligation to disclose material information related to a recommended investment.

Kesner argues that a bar is inappropriate because "there was one, unique transaction involved." Kesner misses the point and demonstrates a misunderstanding of the seriousness of his violation. Even one transaction resulting from fraud is inexcusable. Further, Kesner's misconduct involved three types of fraudulent omissions and several customers. To protect investors and prevent Kesner from similar misconduct in the future, we bar Kesner from associating with any member firm in any capacity. A bar will also serve to deter others from engaging in similar misconduct by omitting to disclose all material facts to customers. *See Frankfort*, 2007 NASD Discip. LEXIS 16, at *42 (barring respondent for fraudulent omissions and noting that the bar will serve to deter others in the industry who might otherwise engage in similar misconduct).

B. Unsuitable Recommendation

The Guidelines for unsuitable recommendations suggest a fine of $2,500 to $75,000 and a suspension of 10 business days to one year.[46] In egregious cases, adjudicators should consider

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fair procedures); *Sundra Escott-Russell*, 54 S.E.C. 867, 873-74 (2000) (finding requirements of the Exchange Act met when FINRA brought specific charges, the respondent had notice of such charges, the respondent had an opportunity to defend against such charges, and FINRA kept a record of the proceedings). Kesner was afforded a full opportunity to litigate and defend himself. The record is clear that all the procedural safeguards required by Section 15A(b)(8) and (h)(1) were satisfied. Kesner's assertion of a due process violation is without merit.

[45] *See Guidelines*, at 7 (Principal Considerations in Determining Sanctions, No. 12).

[46] *Guidelines*, at 99 (Suitability—Unsuitable Recommendations).

a suspension of up to two years or a bar.[47] Kesner's misconduct was egregious and warrants a bar. By withholding material information from the Ls, Kesner recommended an investment without concern for their understanding of the risk involved or their willingness to accept that risk and prevented him from sufficiently assessing the Ls' risk tolerance. We acknowledge that Kesner's unsuitable recommendation related only to one transaction and set of investors and was not made over an extended period.[48] We find aggravating for purposes of sanctions, however, that Kesner was not truthful when he testified that the Ls agreed to pledge their securities account to cover the Fs' collateral shortfall.[49] We further find that Kesner's misconduct resulted in his potential monetary gain.[50] Kesner solicited the Ls for an additional pledge of collateral when he knew that the Fs' collateral was insufficient and represented to the Ls that all of the investors in the group had sufficient assets to fulfill their respective obligations under the Hold Harmless Agreement. Kesner's inaccurate statements misled the Ls.[51] Without the Ls' pledge of additional collateral that made up for the Fs' shortfall as well as their own, the prospect of the ComTec transaction closing and Kesner receiving his 57 percent share in the company diminished substantially.

In favor of a lesser sanction, Kesner argues that the Ls were sophisticated customers with a high risk tolerance who had participated in other leveraged investments with joint and several liability in the past. We do not find Kesner's argument persuasive. The Ls testified that they relied greatly on Kesner's investment advice and relied strictly upon him in recommending ComTec to them. Kesner represented that investing in ComTec involved minimal risk because ComTec was a successful company and that all of the investors could meet their obligations under the Hold Harmless Agreement. Kesner put his own interests ahead of his customers when he ignored obvious risks of losses to the Ls—losses that materialized when ComTec failed.[52] The fact that the Ls, in the past, may have participated in other investments that involved risk does not mean that they understood the magnitude of the risk involved in the ComTec transaction that Kesner recommended here and provides Kesner with no mitigation. *Cf. Dist. Bus. Conduct Comm. v. Goodman*, Complaint No. C9B960013, 1999 NASD Discip. LEXIS 34, at *46 n.29 (NASD NAC Nov. 9, 1999) (rejecting argument that customers' sophistication mitigated misconduct that involved sales practice abuses and where customers could not accurately assess their risk involved in an investment), *aff'd*, 54 S.E.C. 1203 (2001); *see also*

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47 *Id.*

48 *Id.* at 6-7 (Principal Considerations in Determining Sanctions, Nos. 9, 18).

49 *Id.* at 7 (Principal Considerations in Determining Sanctions, No. 12).

50 *Id.* (Principal Considerations in Determining Sanctions, No. 17).

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

52 *Id.* at 6-7 (Principal Considerations in Determining Sanctions, Nos. 11, 13). To recoup their losses, the Ls filed a civil proceeding and arbitration related to the ComTec transaction. Enforcement did not seek restitution in the present matter.

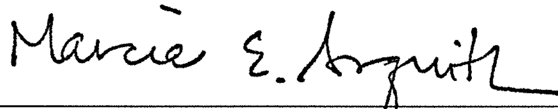
Dist. Bus. Conduct Comm. v. Vaughan, Complaint No. C07960105, 1998 NASD Discip. LEXIS 47, at *13 (NASD NAC Oct. 22, 1998) ("A customer's prior transactions . . . are not relevant in a suitability determination . . . ."); *Dale E. Frey*, Initial Decisions Rel. No. 221, 2003 SEC LEXIS 306, at *41 (Feb. 5, 2003) ("[P]ast transactions should not be used to assume that the current trade is appropriate.").

Kesner's demonstrated indifference to FINRA rules poses a serious risk to the investing public. To ensure that Kesner causes no similar harm to the investing public in the future and to deter others in the industry from recommending unsuitable investments, we bar Kesner from associating with any member firm in any capacity.

VI. Conclusion

We affirm the Hearing Panel's findings that Kesner made material omissions, in violation of Section 10(b) of the Exchange Act, Exchange Act Rule 10b-5, and NASD Rules 2120 and 2110 and made an unsuitable recommendation, in violation of NASD Rules 2310 and 2110. Accordingly, we bar Kesner for the fraud violation and impose a separate bar for the suitability violation. The bars are effective upon service of this decision. We affirm the Hearing Panel's imposition of hearing costs in the amount of $4,075.70 and order that Kesner pay appeal costs of $1,374.60.[53]

On Behalf of the National Adjudicatory Council,



Marcia E. Asquith, Senior Vice President and Corporate Secretary

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