

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 50031/July 16, 2004

Admin. Proc. File No. 3-11369

In the Matter of the Application of

CHRIS DINH HARTLEY
1331 Cotterell Drive
San Jose, California 95121

For Review of Disciplinary Action Taken by
NASD

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION -- REVIEW OF DISCIPLINARY
PROCEEDING

Violations of Conduct Rules

Failure to Inform Employer of Private Securities
Transactions

Conduct Inconsistent with Just and Equitable
Principles of Trade

Associated person of member firm of registered securities
association engaged in private securities transactions for
compensation without prior written notification to firm and
firm's written approval. Held, association's findings of
violation and the sanctions it imposed are sustained.

APPEARANCES:

Eric M. Chial, of Lewitas & Associates, P.C., for Chris Dinh
Hartley.

Jennifer C. Brooks, for NASD.

Appeal filed: January 2, 2004
Last brief received: April 6, 2004

Chris Dinh Hartley, who was an investment company products and variable contracts representative with Pruco Securities Corporation, an NASD member firm, appeals from NASD disciplinary action. NASD found that, during the period September 1996 through January 1997, Hartley violated NASD Conduct Rules 3040 and 2110 by selling promissory notes for compensation without giving Pruco prior written notification and receiving Pruco's prior written approval. 1/ NASD suspended Hartley for 90 days and fined him \$7,500. 2/ We base our findings on an independent review of the record.

II.

Hartley, a "non-captive" insurance agent, 3/ was primarily engaged in selling life insurance and variable annuities for Pruco and other insurance companies. In August 1996, he attended a presentation given by Randy Scianna, an insurance agent and owner of his own insurance agency, that was aimed at recruiting salespersons for the promissory notes of First Lenders Indemnity Corporation ("FLIC"). FLIC was engaged in the purchase and resale in the commercial market of automobile installment loan contracts, and was offering promissory notes that matured in nine months and paid 10% interest. According to FLIC, the proceeds from the sale of its notes would be used to purchase additional automobile loan contracts.

Scianna provided Hartley with various materials concerning FLIC, including a Dun and Bradstreet report and FLIC's "Disclosure Document" that was used to solicit sales of the company's notes. According to Hartley, Scianna assured him that

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- 1/ Rule 3040 provides, among other things, that, prior to participating in any securities transaction outside the regular course or scope of employment, a person associated with a member firm must give the firm prior written notification and, if compensation may be received, obtain the firm's prior written approval. Rule 2110 requires adherence to high standards of commercial honor and just and equitable principles of trade.
- 2/ NASD also assessed costs.
- 3/ A "captive agent" is required to sell only the products of his or her employer.

FLIC's notes were not securities. 4/ However, the second page of the Disclosure Document that Hartley received recited in block capital letters as follows: "THE COMPANY BELIEVES THAT THE NOTES ARE EXEMPT SECURITIES... THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION."

Hartley decided to sell FLIC notes to his customers. On September 9, 1996, he signed a FLIC agent agreement and a FLIC "Representative's Compliance Declaration." As required, he initialed each of the statements in the Declaration, including the following: " I have notified my Broker/Dealer of my participation in providing this exempt security to my clients." "In the eyes of my Broker/Dealer I am in complete compliance." These statements were false. Hartley had not given Pruco any notification of his decision to sell FLIC notes. Scianna also questioned Hartley as to whether he had checked with Pruco, and Hartley replied that he had asked for permission to sell FLIC notes and had been told that "it was fine."

From September 21, 1996 through January 10, 1997, Hartley sold six FLIC notes in the total amount of \$255,000 to five customers, two of whom were Pruco clients. Hartley earned a total of \$10,160 in commissions on his sales.

According to Hartley, in late September or October 1996, he had a brief conversation about the FLIC notes with his Pruco supervisor, Marlene Kasparian. 5/ Kasparian had remarked to Hartley that she had money in the bank that "wasn't doing anything." Hartley suggested that she might be interested in purchasing a FLIC note that he was selling. Kasparian replied that she wasn't interested, and did not question Hartley about the notes or his sales.

In mid-January 1997, Scianna began receiving complaints from FLIC noteholders that they were not being paid when notes matured or were receiving late or no interest payments. Hartley also began receiving calls from clients asking why their monthly

4/ Scianna, whom Hartley called as a witness, testified that he did not tell Hartley that the notes were not securities, but that the notes were exempt securities. However, NASD credited Hartley's testimony, and we accept that determination.

5/ Kasparian testified that she did not recall having such a conversation, but NASD credited Hartley's testimony that it occurred.

interest checks were late. In early March, Scianna advised Hartley to stop doing business with FLIC and, on March 10, returned a FLIC subscription agreement and check to Hartley that Hartley had forwarded from one of his customers. Thereafter, Hartley discontinued the sale of FLIC notes.

Pruco agents customarily updated the firm as to their outside activities once a year following Pruco's annual compliance meeting. After Pruco's compliance meeting in November 1997, some eight months after his last abortive sale of a FLIC note, Hartley amended his Form U-4 by including the name FLIC in a list of 40 outside entities with which he had conducted business during the year. 6/

Susan Korp, the business manager of Hartley's office who was then serving as compliance officer, questioned Hartley about FLIC, and Hartley told her that he had sold FLIC promissory notes. Korp passed this information on to the office's interim managing director. The director approved Hartley's amended Form U-4 without taking further action.

Nearly two years later, in August 1999, Hartley received a letter from an attorney representing the receiver appointed for FLIC by a bankruptcy court. The letter stated that the receiver's investigation had revealed that FLIC had been engaged in a Ponzi scheme, and that the commissions paid to Hartley for selling FLIC notes constituted fraudulent transfers recoverable by the receiver. The letter further stated that the court had authorized the receiver to sue Hartley to recover his commissions. It offered to settle the matter for 85% of the amount that FLIC had paid Hartley, and threatened suit unless Hartley accepted the settlement offer within 14 days. Hartley promptly remitted payment, accepting the receiver's settlement offer.

III.

NASD Conduct Rule 3040 provides that an associated person who intends to participate in a securities transaction outside the regular course or scope of employment must give prior written notice to his or her employer describing the proposed transaction in detail and stating whether he or she may receive selling compensation. If selling compensation is to be received, the associated person may not engage in the transaction unless the employer gives its prior approval in writing.

6/ The firm's 1996 meeting had been held in August, prior to Hartley's sale of FLIC notes.

Without informing Pruco and obtaining its approval, Hartley sold six FLIC notes in the total amount of \$255,000 to five customers. He earned commissions of \$10,160 on the sales. Hartley states that he "no longer disputes that the FLIC notes were 'securities.'" We believe that they are included within the definition of "security" in Section 2(a)(1) of the Securities Act of 1933 7/ and Section 3(a)(10) of the Securities Exchange Act of 1934 8/ as "any note," and that they are not excluded from that definition under the Supreme Court's "family resemblance" test. 9/ FLIC's notes do not resemble any of the instruments that the Court recognized as not constituting securities, and there is no basis for adding the notes to the list of non-securities. Investors were attracted by the notes' high rate of interest, and FLIC purportedly sought to raise money from their sale to carry on its regular business. The notes were distributed throughout the United States. Purchasers of the notes reasonably considered that they were making an investment, and no other scheme of regulation was available. We accordingly conclude that Hartley violated NASD Conduct Rule 3040 by selling securities for compensation without giving Pruco prior written notification and receiving Pruco's prior written approval. 10/

NASD determined that Hartley's violation of Rule 3040 also constituted a violation of Conduct Rule 2110, which requires adherence to high standards of commercial honor and just and equitable principles of trade. Hartley argues that he did not violate Rule 2110. He asserts that NASD did not consider or gave insufficient weight to various mitigating circumstances, and that his conduct was "neither intentional, reckless, nor grossly negligent."

7/ 15 U.S.C. § 77b(a)(1).

8/ 15 U.S.C. § 78c(a)(10).

9/ See Reves v. Ernest & Young, 494 U.S. 56, 63-65 (1990).

10/ As noted above, the FLIC notes had a maturity of nine months. Although the securities acts exempt such notes from coverage, the exemption has been limited by court decisions to prime quality commercial paper as opposed to investment securities. See, e.g., R.G. Reynolds Enterprises, Inc., 952 F. 2d 1125, 1132 (9th Cir. 1991); Holloway v. Peat, Marwick, Mitchell & Co., 900 F. 2d 1485, 1489 (10th Cir. 1990); Baurer v. Planning Group, Inc., 669 F. 2d 770, 776 (D.C. Cir. 1981).

NASD's determination that Hartley violated Rule 2110 is in accord with our policy that a violation of another NASD rule, including Rule 3040, also constitutes a violation of Rule 2110. 11/ Conduct that violates other NASD rules (with which associated persons like Hartley are presumed to be familiar) 12/ is by its very nature inconsistent with high standards of commercial honor and just and equitable principles of trade. 13/ We accordingly sustain NASD's finding of violation.

IV.

Under Section 19(e) (2) of the Exchange Act, we must sustain NASD sanctions unless we find them excessive or oppressive or an undue burden on competition. 14/ Hartley argues that no sanctions should be imposed on him, let alone what he characterizes as the overly severe sanctions that NASD assessed. He complains particularly about his suspension, which NASD's National Adjudicatory Council ("NAC"), after calling this matter up for review, increased to 90 days from the 30 days assessed by the NASD Hearing Panel, 15/ Hartley's major contentions are that

11/ Stephen J. Gluckman, Securities Exchange Act Rel. No. 41628 (July 20, 1999), 70 SEC Docket 418, 428. See also Gerald James Stoiber, 53 S.E.C. 171, 180 n.22 (1997), aff'd. on other grounds, 161 F.3d 745 (D.C. Cir. 1998); Steven B. Theys, 51 S.E.C. 473, 480 (1993).

12/ Carter v. SEC, 726 F.2d 472, 473-474 (9th Cir. 1983); Jay Frederick Keeton, 50 S.E.C. 1128, 1130 (1992).

13/ If no other rule has been violated, a violation of Rule 2110 requires evidence that the respondent acted in bad faith or unethically. See, e.g., Calvin David Fox, Exchange Act Rel. No. 48731 (October 31, 2003), 81 SEC Docket 2017, 2020-2021. In light, among other things, of Hartley's false statements to FLIC and Scianna that he had notified Pruco of his decision to sell FLIC notes and obtained Pruco's approval, it would appear, although NASD did not seek to establish a violation on this basis (and thus we do not), that Hartley violated Rule 2110 independently of his violation of Rule 3040.

14/ 15 U.S.C. § 78s(e) (2).

15/ The NASD Sanction Guidelines for "selling away" provide for suspensions of 10 business days to one year or, in egregious
(continued...)

he was guilty of only an innocent mistake, that he reasonably believed that the FLIC notes were not securities, and that he did not try to deceive anyone.

The evidence in the record undercuts Hartley's protestations. Both FLIC's Disclosure Document and its Compliance Declaration put Hartley on notice that the FLIC notes might well be securities. Yet Hartley made no further inquiry, and never gave Pruco notice prior to his sales even though the Declaration required him to represent that he had done so. Instead, he falsely affirmed in the Declaration that he had given Pruco notice and obtained its approval for his sales, and he repeated the same falsehoods to Scianna. While he mentioned the notes briefly to Kasparian after he had begun selling them, it was not in the context of making inquiry or seeking approval. Nor did he provide Kasparian with the necessary details about the notes and his sales activities. Even on his amended 1997 Form U-4, submitted long after his sales of FLIC notes had ended, Hartley merely included FLIC's name in a list of 40 entities with which he had conducted business during the year. He furnished additional information only when questioned by Korp.

Hartley further complains that NASD did not properly evaluate the seven factors listed in the NASD Sanction Guidelines as guides in determining the appropriate sanctions for "selling away." 16/ However, we consider that, if anything, NASD was lenient in evaluating those factors. Five of the seven guideline factors serve to aggravate Hartley's offense. Thus Hartley falsely represented to FLIC and Scianna that his employer had approved his sales. He sold away to two customers of Pruco. 17/

15/ (...continued)
cases, suspensions of up to two years or a bar, and fines of \$5,000 to \$50,000.

16/ Those factors are: whether the respondent (1) had an interest in the issuer, (2) attempted to create the impression that his employer sanctioned the activity, (3) sold away to customers of his employer, (4) provided his employer with verbal notice of all relevant factors, (5) sold the securities despite an employer's prohibition or warning, (6) was properly registered to sell the securities, and (7) sold directly to customers or referred them to a properly registered individual.

17/ We do not agree with Hartley's claim that this circumstance
(continued...)

He did not provide Pruco with verbal notice of all relevant factors. He was not properly registered to sell FLIC notes. And he sold FLIC notes directly to customers, and did not simply refer customers to a properly registered individual. 18/

NASD pointed out that one of the Guidelines' overriding considerations in determining sanctions is whether the respondent's misconduct resulted in injury to others and, if so, "the nature and extent of that injury." Hartley complains that the NAC failed to recognize that FLIC noteholders will recoup from 44% to 74% of their funds in the FLIC bankruptcy proceeding. He also asks that we take into account the fact that he "voluntarily" returned the commissions that he earned on his FLIC transactions. We do not consider that Hartley is deserving of a reduction in sanctions because his clients may be able to recover some of their losses. Moreover, we note that Hartley surrendered his FLIC commissions only after he was threatened with a lawsuit by FLIC's receiver in bankruptcy.

NASD has already taken into account other mitigating factors cited by Hartley -- Pruco's inadequate training and supervision, the fact that Hartley told Kasparian that he was selling FLIC notes (although he did not provide all of the details), and that Hartley cooperated in NASD's investigation and expressed genuine remorse. No further reduction in sanctions is warranted based on these considerations.

Selling away is a serious violation. Conduct Rule 3040 is designed not only to protect investors from unsupervised sales,

17/ (...continued)

was ameliorated because the two customers did not use money from their Pruco accounts to purchase FLIC notes. The purpose of Rule 3040 is to protect investors from unsupervised sales and securities firms from exposure to loss and litigation from transactions by associated persons outside the scope of their employment. See, e.g., Jim Newcomb, Exchange Act Rel. No. 44945 (October 18, 1991), 76 SEC Docket 172, 181. We fail to see how investors and firms are better protected if customers use funds for outside transactions with firm personnel that are not taken from the customers' accounts with the firm.

18/ Hartley argues that it is unfair to apply the last two factors to him since he did not know that the FLIC notes were securities. However, as noted above, Hartley was on notice that the FLIC notes might well be securities.

but also to protect securities firms from liability and loss resulting from such sales. Such misconduct deprives investors of a firm's oversight, due diligence, and supervision, protections investors have a right to expect. Hartley's misconduct illustrates the potential for harm to public investors through unsupervised securities transactions.

Hartley points out that the NASD Hearing Panel found that he is unlikely to engage in similar misconduct in the future. However, the NAC did not adopt that conclusion, and it is the NAC's conclusions that are before us for review, not those of the Hearing Panel. Despite clear indications that FLIC notes might well be securities, Hartley made no effort to consult Pruco before beginning his sales, while falsely representing to FLIC and Scianna that he had done so. His conduct exhibits a disturbing disregard for applicable requirements. We conclude that the sanctions imposed on Hartley are neither excessive nor oppressive. Nor do they impose an undue burden on competition.

An appropriate order will issue. 19/

By the Commission (Chairman DONALDSON and Commissioners GLASSMAN and ATKINS); Commissioners GOLDSCHMID and CAMPOS not participating.

Jonathan G. Katz
Secretary

19/ We have considered all of the arguments advanced by the parties. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
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In the Matter of the Application of

CHRIS DINH HARTLEY
1331 Cotterell Drive
San Jose, California 95121

For Review of Disciplinary Action Taken by

NASD

ORDER SUSTAINING DISCIPLINARY ACTION TAKEN BY REGISTERED
SECURITIES ASSOCIATION

On the basis of the Commission's opinion issued this day, it
is

ORDERED that the disciplinary action taken by NASD against
Chris Dinh Hartley, and NASD's assessment of costs, be, and they
hereby are, sustained.

By the Commission.

Jonathan G. Katz
Secretary