

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD REGULATION, INC.

In the Matter of	:	
	:	
	:	
Market Regulation Committee,	:	DECISION
	:	
Complainant,	:	Complaint No. CMS960174
	:	
vs.	:	
	:	
Vincent M. Carrella,	:	Dated: April 14, 2000
	:	
Respondent.	:	

In the decision issued below, respondent was found to have engaged in fraudulent sales practices and effected an unauthorized transaction. Held, remanded for further proceedings.

Vincent M. Carrella ("Carrella") appealed a March 22, 1999 decision of the Market Regulation Committee ("MRC")¹ of NASD Regulation, Inc. ("NASD Regulation"). After a review of the entire record, we remand this case to the Office of Hearing Officers to conduct a new hearing.

Background

Carrella first became associated with a member of the NASD in October 1992. During all periods relevant to the complaint in this matter, Carrella was registered with Sterling Foster & Company, Inc. ("Sterling Foster") as a general securities representative and a general securities principal.

¹ The MRC was formerly known as the Market Surveillance Committee.

Factual and Procedural History

The MRC filed the complaint against Carrella and 15 other respondents on September 18, 1996.² The complaint alleged in relevant part that, in dealing with three customers, Carrella engaged in fraudulent sales practices and effected an unauthorized transaction in violation of NASD Conduct Rules 2110 and 2120 and Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Securities and Exchange Commission ("SEC") Rule 10b-5.³ Carrella filed an answer in which he denied the substantive allegations of the complaint.

On December 24, 1996, the parties were informed that the MRC had appointed an extended hearing panel to preside over the case.⁴ The hearing panel consisted of three members, including a current member of the MRC. This latter member was designated the chairperson ("Chair") of the extended hearing panel. The parties were also informed that the MRC had appointed an attorney advisor to assist the hearing panel. On February 28, 1997, the respondents filed a joint motion for an appointment of a professional hearing officer. On March 3, 1997, the motion was denied because the new NASD Code of Procedure ("New Code"), authorizing the use of professional hearing officers, had not been approved at that time.⁵

On March 3, 1997, the NASD Regulation Department of Enforcement ("Enforcement") moved the hearing panel to sever the proceeding on grounds that severance would expedite and

² The current appeal relates only to Carrella, however.

³ Of the 19 causes of action listed in the complaint, only the tenth cause related to Carrella. The tenth cause alleged that, from January through February 1995, Carrella participated in a "boiler room" at Sterling Foster and personally made fraudulent misrepresentations and omissions to three customers while recommending that they purchase securities issued by Advanced Voice Technologies, Inc. ("Advanced Voice"), in violation of NASD Conduct Rules 2110 and 2120 and Section 10(b) of the Exchange Act and SEC Rule 10b-5. The tenth cause of action also alleged that Carrella made an unauthorized sale in one of the customer's accounts.

⁴ NASD Code of Procedure Rule 9223(b), as it existed at the time of the filing of the complaint in this matter, provided that hearing panels appointed by the MRC were to be comprised of "two or more persons." Rule 9223(c) provided that "extended hearing panels" were to be comprised of "three or more persons." The main reason that the NASD adopted the "extended hearing" rule was to enable the NASD to compensate those individuals willing to dedicate a substantial amount of time and effort to participate as panelists in large and complicated disciplinary cases. See Proposed Rule Change Relating to Extended Hearings, Exchange Act Rel. No. 24184 (Mar. 5, 1987).

⁵ The SEC approved the New Code on August 7, 1997. See NASD Notice to Members 97-55 (Aug. 1997). The New Code became effective upon approval. Id.

simplify the proceedings. Carrella and the other respondents joined in the motion.⁶ The motion was denied on March 13, 1997.

On March 20, 1997, the United States District Court for the Southern District of New York enjoined NASD Regulation from proceeding against certain parties in this case. On March 21, 1997, the remaining respondents moved the MRC hearing panel for a stay because grand jury testimony was being sought from some of them. On March 26, 1997, the motion was denied.

The MRC hearing panel began hearing testimony on April 2, 1997. On July 15, 1997, following 10 (of the 21) days of hearings,⁷ the attorney advisor for the hearing panel informed the parties by letter that "due to the potential that a conflict of interest may arise as a result of recent events in his personal life, [the Chair] has determined to recuse himself from further participation in this matter." The attorney advisor to the hearing panel also informed the parties that although he had information pertaining to the Chair's potential conflict of interest, he "was not at liberty to disclose any details regarding this situation." In addition, the attorney advisor stated that the chairman of the MRC had unilaterally "elected to 'undo' the Extended Hearing designation, thereby rendering the panel an ordinary two person panel." The attorney advisor further asserted that although "it is necessary that at least one of the members [pursuant to the NASD's rules] also be a member of the [MRC], and neither of the two remaining members of the hearing panel is a current member" of the MRC, the chairman of the MRC and the attorney advisor were "not troubled by that fact."

On August 12, 1997, respondents jointly filed (1) a request for discovery on the issue of the Chair's recusal; (2) a motion to dismiss based on the lack of jurisdiction; and (3) a motion to remove the current hearing panel. (The latter motion was made on the grounds that, without the discovery of relevant facts as to the Chair's potential conflict of interest, the remaining hearing panel members should be presumed to be tainted by the potential conflict of interest which caused the Chair's recusal.) The hearing panel summarily denied the motions on August 26, 1997, and the hearings resumed the next day. At that time, respondents made an oral motion for reconsideration. The hearing panel denied the motion for reconsideration as well.

In late September 1997, unknown to the parties, the Chair began working for NASD Regulation as an associate director of District No. 10 in New York. On October 6, 1997,

⁶ Enforcement moved to sever the case as to six of the respondents, including Carrella, who were charged with sales practice violations only, on the grounds that severance would allow for a more expeditious hearing. These six respondents joined in Enforcement's motion, albeit for slightly different reasons. The respondents argued that they would be unduly prejudiced by the evidence presented against Sterling Foster and the firm's senior managers.

⁷ The hearing sessions began on April 2, 1997, and ended on June 5, 1998. During that period, 21 days of hearings were held.

during a hearing session in New York, Carrella and other respondents asked the hearing panel and the attorney advisor whether the Chair had become associated in any capacity with NASD Regulation. The attorney advisor acknowledged to the parties that the Chair was employed by NASD Regulation as an associate director of District No. 10.

On October 17, 1997, respondents filed a motion seeking discovery on the circumstances surrounding the recusal of the Chair based on reports that he had become employed by the NASD. By letter dated November 11, 1997, the attorney advisor informed the parties of the following: (1) the last hearing session in which the Chair participated was June 20, 1997; (2) the Chair did not begin discussions with NASD Regulation about employment until June 27, 1997; (3) the Chair recused himself on July 15, 1997; and (4) the Chair started working for NASD Regulation on September 29, 1997. The attorney advisor also informed the parties that, based on this information, the remaining members of the hearing panel had determined to deny respondents' motion. The November 11 letter had a signature line for the Chair with a declaration that the information was true and correct, but it was not signed.

The hearings below concluded on June 5, 1998. On March 22, 1999, the MRC issued its decision, finding, among other things, that Carrella had engaged in fraud. The MRC imposed a bar, a \$100,000 fine and \$161,623 in disgorgement on Carrella. The MRC also imposed hearing costs of \$2,000 on him. This appeal followed.

Discussion

Carrella argues on appeal that the proceedings before the MRC were fundamentally flawed. We find that the procedural errors committed below, taken together, militate in favor of granting Carrella a new hearing in this matter. First, the hearing panel should have informed the parties of the reasons for the Chair's recusal at the time when it occurred (or shortly thereafter). Second, regardless of whether an actual conflict of interest existed, the hearing panel should have granted Carrella's request for a new hearing before a different panel once it became clear that the Chair had engaged in employment discussions with NASD Regulation while he was still technically acting as Chair. *Cf. Antoniu v. SEC*, 877 F.2d 721, 725-26 (8th Cir. 1989) (respondents are entitled to a fair hearing, which includes the participation of adjudicators who are free not only from actual bias but from the appearance of bias), *cert. denied*, 494 U.S. 1004 (1990). Third, the MRC erred by unilaterally rescinding the "extended hearing panel" designation and converting the panel to a "regular" panel composed of the two remaining members, neither of whom was then a current member of the MRC, as required by the NASD rules at the time.⁸

⁸ Our holding in this regard, however, is narrow in scope. A respondent is not entitled to a three-member extended hearing panel. *See, e.g., In re Keith L. DeSanto*, 52 S.E.C. 316, 322-23 (1995), *aff'd*, 101 F.3d 108 (2d Cir. 1996); *In re Curtis I. Wilson*, 49 S.E.C. 1020, 1024 (1989), *aff'd*, 902 F.2d 1580 (9th Cir. 1990); *In re Harold B. Gallison*, Complaint No. C0296001 (NAC Feb. 5, 1999). A respondent also is not entitled to a new hearing in a case

Were we faced only with the task of deciding whether any single procedural irregularity described above, viewed in isolation, required us to order a new hearing, we might very well have found that such isolated action constituted harmless error.⁹ We are not faced with that situation, however. The cumulative effect of the errors below at the very least gives rise to the appearance of impropriety. In the interest of fairness, therefore, we find that Carrella should be granted a new hearing. Cf. Amos Treat & Co. v. SEC, 306 F.2d 260, 267 (D.C. Cir. 1962) (Administrative proceedings must be attended "not only with every element of fairness but with the very appearance of complete fairness."); In re Scattered Corp., Exchange Act Rel. No. 40646 (Nov. 9, 1998) ("Where, as here, one of the adverse interests being represented is that of an adjudicator in a disciplinary proceeding, the harm inherent both in the possible sharing of confidential information and in divided loyalty is that the fairness of the proceeding may be impaired.").

Generally, cases in which the complaint was authorized and the first attempted service occurred prior to the August 7, 1997 effective date of the New Code should proceed under the old Code of Procedure provisions before the adjudicative entity that acted as the initial fact-finder. See NASD Notice to Members 97-55 (Aug. 1997). In this specific situation, however,

initiated by the MRC simply because a hearing panel member's term on the MRC lapses after being appointed to the hearing panel. This is true, moreover, regardless of whether the other panel member is a current MRC member. NASD Procedural Rule 9223(b), as it existed during the relevant period, provided that the MRC "may appoint a hearing panel consisting of two or more persons, . . . at least one of whom shall be a member of the [MRC]." The rule did not specify that at least one hearing panel member must be an MRC member from the time that the appointment is made until the time when the MRC issues its decision. The rule only required that at least one hearing panel member be a current member of the MRC at the time when the appointment is made.

Here, the attorney advisor informed the parties that the MRC chairman had "elected to 'undo' the Extended Hearing designation, thereby rendering the panel an ordinary two person panel." The remaining panelists were essentially newly appointed to a two-member, regular panel at that point. As a result, the rule required that at least one of the members of the new, two-member hearing panel had to be a current member of the MRC. As discussed above, neither panelist was an MRC member at the time of the new appointment, in violation of the rule.

⁹ See, e.g., In re Datek Secs. Corp., 51 S.E.C. 542, 545 (1993) (noting that minor procedural irregularities at an initial hearing can be cured by the de novo review that the NAC and the SEC apply to disciplinary proceedings); In re Thomas P. Reynolds Secs., Ltd., 50 S.E.C. 721, 726-27 (1991) (explaining that a minor, technical irregularity can be classified as harmless where there is no showing of prejudice to the complaining party).

we are exercising our discretion in consideration of the various procedural and factual complexities that are unique to this case¹⁰ and are granting Carrella a new hearing before a panel appointed by the Office of Hearing Officers.

Accordingly, it is hereby ordered that this case be remanded to the Office of Hearing Officers to conduct a new hearing, ab initio,¹¹ pursuant to the NASD Code of Procedure as in effect today.¹²

On Behalf of the National Adjudicatory Council,

Alden S. Adkins
Senior Vice President and General Counsel

¹⁰ The procedural and factual complexities include the following: (1) the age of this case (the complaint was issued on September 18, 1996); (2) the extensiveness of the record (which began with a complaint naming 16 respondents and produced a certified record on appeal to the NAC of 8,600 pages); and (3) the nature of the procedural irregularities.

¹¹ The new hearing panel may, of course, hold any pre-hearing conferences that are appropriate and in accordance with the New Code.

¹² We have considered all of the arguments of the parties. They are rejected or sustained to the extent that they are inconsistent or in accord with the views expressed herein.