BEFORE THE NATIONAL BUSINESS CONDUCT COMMITTEE

NASD REGULATION, INC.

In the Matter of District Business Conduct Committee for District No. 2, Complainant, vs. Stephen J. Gluckman Respondent.	Decision Complaint No. C02960042 District No. 2 Dated: January 23, 1998

This matter was appealed by respondent Stephen J. Gluckman ("Gluckman") pursuant to NASD Procedural Rule 9310 (superceded).[1] For the reasons discussed below, we affirm the April 11, 1997 decision of the District Business Conduct Committee for District No. 2 ("DBCC") in which Gluckman was censured, fined $55,000, and barred from associating with any member of the Association in any capacity for violating NASD's Conduct Rules 2110 and 3040.

Factual Background

Gluckman entered the securities industry in 1983. From January 1991 to September 1994, Gluckman was registered as a general securities representative with United International Securities, Inc. ("UIS"), a former NASD member. From September 1994 until May 12, 1995, he was registered as a general securities representative with Metropol, Inc. Gluckman has not been associated with a member firm since May 1995.

The one-cause complaint, issued on November 14, 1996, alleged that from about May 5 through August 11, 1992, Gluckman participated in two private securities transactions, in that he

[1] We cite here the Procedural Rules that were in effect at the time Gluckman appealed. We will apply NASD's new procedural rules governing disciplinary proceedings to cases served on a respondent on or after August 7, 1997 and appealed or called for review. See Special Notice to Members 97-55 (August 1997).

recommended and prepared agreements for two customers to invest in a motion picture project called "A Time Machine: The Journey Back" ("Time Machine"), without providing prior written notice to UIS, in violation of Conduct Rules 2110 and 3040.

Gluckman alleged in his answer that the Time Machine agreements were "private and exclusive" to the parties and were not securities. He alleged that, in any event, he did not "participate" in the two transactions, but merely referred the parties to one another. Gluckman denied recommending the investments or preparing the agreements.

The Time Machine Agreements. KP, RB and PB were Gluckman's customers at UIS. KP, RB and PB had previously invested in a UIS product involving a limited partnership to produce a motion picture called Blue Bears, Ltd. ("Blue Bears") with Clyde Lucas ("Lucas") and Birgitta Johansson ("Johansson").

Between January and March of 1992, Gluckman telephoned KP regarding investing in the Time Machine documentary that was being produced by Lucas. On May 5, 1992, KP met Gluckman and Lucas in a restaurant near her home. Lucas, on behalf of Soledad Productions ("Soledad"), and KP signed an agreement whereby Soledad was responsible for creating and distributing the Time Machine documentary. KP agreed to provide Soledad with $50,000 and to "participate in the gross revenues derived from Soledad's efforts." Soledad agreed to pay KP $75,000 by no later than November 26, 1992, and "[i]f for any reason whatsoever" Soledad failed to pay KP the $75,000 by that date, then Soledad agreed to transfer automatically five percent ownership in the documentary and its revenues to KP. Furthermore, in such event, Soledad agreed to owe KP $75,000 plus 10 percent interest on the unpaid balance until she was paid in full "as originally intended."

On August 10, 1992, Gluckman telephoned RB and PB regarding investing in the Time Machine project. On August 11, 1992, RB and PB entered into an agreement with Lucas and Johansson on behalf of Soledad Productions/7th Voyage Productions (hereinafter collectively referred to as "Soledad"). Under the terms of the agreement, Soledad was responsible for creating and distributing the Time Machine documentary. RB and PB agreed to pay Soledad $50,000 and elected to "participate in the gross revenues." Soledad agreed to pay RB and PB $75,000 by November 30, 1992, and if for any reason Soledad failed to do so, then Soledad would owe RB and PB $75,000 plus eight percent interest on the unpaid balance until RB and PB were paid in full as originally intended. Additionally, RB and PB were then entitled to receive a two percent ownership interest in the documentary and its revenue.

Participation in the Transactions. At the DBCC hearing, KP testified that Gluckman informed her that Lucas, who had produced Blue Bears, "was also the producer of Time Machine" and was "looking for investor money." According to KP, Gluckman recommended that she invest in the Time Machine project and encouraged her to obtain the funds while refinancing her house. On May 5, 1992, Gluckman met KP and Lucas at a coffee shop. He brought the Time Machine agreement with him for

KP's and Lucas' signature. On that day, KP provided a $15,000 check to Lucas, and she provided him with a second check for $35,000 at a later date.

RB and PB testified that Gluckman telephoned and recommended that they invest in the Time Machine project as a short-term investment providing a quick profit. PB testified that Gluckman informed her that Lucas' partner, Johansson, was responsible for Blue Bears, which Gluckman said "was doing quite well." According to PB, Gluckman thought that the Time Machine investment would be "a good deal" because "within three months it was to be completed and on the air" and "for the $50,000 [investors] would receive $75,000 back." RB and PB viewed the Time Machine documentary at the home of Lucas and Johansson, and discussed the investment with them. On August 11, 1992, Gluckman brought the Time Machine agreement to RB's and PB's home for RB's and PB's signature and they gave him a $50,000 check made payable to Equity Partners, Inc. On August 13, 1992, the Time Machine agreement was signed by Lucas and Johansson, and a copy of the agreement was sent to RB and PB.

At the DBCC hearing, Gluckman argued that he did not participate in the transactions.[2] He testified that he did not recommend that KP or RB and PB invest in the Time Machine project; rather, he relayed the terms of the agreement to them as presented to him by Lucas. He stressed that KP telephoned Lucas directly to discuss the Time Machine investment, and that RB and PB viewed the documentary at Lucas' home and discussed the investment directly with Lucas. Gluckman also testified that he did not "prepare" the Time Machine agreements, but only typed them. Gluckman admitted that in order to protect KP, RB and PB in the event that they were not paid the $75,000 as planned, he requested that Lucas add a clause to the agreements entitling KP, RB and PB to a percentage of the documentary's ownership and revenues. He also admitted receiving a five percent referral fee from Lucas for the two transactions.

At the DBCC hearing, Gluckman also admitted that he did not give written notice of the two Time Machine transactions to UIS. He argued, however, that he orally provided notice of the transactions to Nick Fleming ("Fleming"), the president of UIS. Gluckman testified that he informed Fleming that he intended "to put two people together" for an investment, and that he had spoken with the NASD regarding whether he could receive a referral fee for the two transactions. According to Gluckman, Fleming did not have a problem with his involvement in the transactions as long they did not involve the sale of a security. Gluckman produced a copy of a January 15, 1992 letter signed by Fleming that authorized Gluckman to engage in certain outside real estate matters, life insurance, and living trust matters. In that letter, Gluckman stated that securities transactions would be handled through

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[2] Gluckman stated in his answer that with respect to the Time Machine transaction involving KP, the "extent of his participation" was to refer Lucas to KP. He stated that the agreement between KP and Lucas "was on terms that [he] was not aware." With respect to the Time Machine transaction involving RB and PB, Gluckman stated that the "particular transaction must have been between [RB and PB] and Lucas and, therefore, it was foreign to me."

UIS in the usual manner. Gluckman argued that the letter showed his "intent" to abide by NASD rules. At the DBCC hearing, Fleming testified that he did not recall having any discussion with Gluckman about the Time Machine transactions, and that he first learned of the transactions in a March 27, 1993 letter from KP.

The DBCC found that the Time Machine agreements were securities. It determined that the agreements represented investment contracts, defined as: (1) investments of money; (2) in a common enterprise; (3) with the expectation of profits; and (4) based upon the efforts of others. The DBCC reasoned that under the terms of the agreements, KP, RB and PB invested their money in a common enterprise--the Time Machine documentary--with the expectation of making a profit solely from the efforts of Soledad, which had sole responsibility for the creation and distribution of the documentary.[3]

The DBCC also found that Gluckman's actions constituted "participation" under Rule 3040. It reasoned that by Gluckman's own admissions, he contacted the customers at Lucas' request, described to them in detail the proposed transactions, typed the agreements, had certain default clauses added to the agreements to protect the customers,[4] and received a five percent fee from Lucas for referring the customers. Gluckman also admitted that he failed to provide written notice of the transactions to UIS. Hence, the DBCC concluded that Gluckman violated Rule 3040.

Finally, the DBCC rejected Gluckman's argument that various federal and state statutes of limitations barred this action, citing the SEC's recent decision in In re Larry Ira Klein, Exchange Act Rel. No. 37835 (Oct. 17, 1996), in which the Commission rejected the argument that a statute of limitations applies to NASD Regulation disciplinary proceedings.

In determining sanctions, the DBCC noted that the NASD previously had imposed sanctions against Gluckman for violating Rule 3040, which the DBCC thought should have resulted in Gluckman's "heightened awareness" of the Rule's requirements. The DBCC therefore concluded that Gluckman's conduct involved a willful disregard of Rule 3040. The DBCC also considered that KP, RB and PB were familiar with Lucas and Johansson because of their prior investments in Blue Bears, and that at least KP believed UIS was involved with the Time Machine transactions. It noted that supervision of the product by a broker/dealer could have assured the customer of at least potential legal rights against the broker/dealer for the significant customer losses suffered. With respect to Gluckman's contention

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[3] The DBCC also found that the terms of the agreements were similar to "notes," another security, in that they provided for repayment of the money invested by a specific date.

[4] In a June 13, 1993 letter to Fleming, Gluckman stated that he had "drawn up" the agreement involving KP and had "put in a protection clause for her, in case [Lucas] did not meet his admitted time frame for paying her back in full." At the DBCC hearing, Gluckman also admitted having requested that Lucas add the clauses entitling the investors to a percentage of the documentary's ownership and revenues.

that he orally informed Fleming of the transactions, the DBCC determined that even if Fleming had been notified orally, Gluckman's disclosure would have been misleading based on his representation that no security was involved.[5]

Discussion

We agree that the Time Machine agreements are securities. We find that the terms of the agreements are similar to both notes and investment contracts. The agreements are similar to notes in that the investors agreed to advance Soledad $50,000, and Soledad agreed to repay them $75,000 by a specified date. Under Reves v. Ernst & Young, 494 U.S. 56, 62-70 (1990), a note is presumed to be a security unless: (1) it bears a strong resemblance to certain notes recognized as being outside the securities laws;[6] or (2) based on certain factors described by the Court in Reves, it should be added to the list of non-securities.[7]

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[5] Prior to the DBCC hearing, Gluckman requested a copy of his "file." After providing Gluckman with copies of the exhibit and witness lists, NASD Regulation staff advised him that his file contained no exculpatory information, and that all other information, excluding privileged intra-staff communications, would be made available to him on request. For a second time, at the DBCC hearing, Gluckman was offered the opportunity to review his file, but he chose not to review it. On appeal, Gluckman again referenced this file and requested that he be permitted to adduce a copy of his full CRD record and information regarding the qualifications of the DBCC hearing panelists. Gluckman also sought to have the DBCC panelists testify at the NBCC appeal hearing. By letter dated October 1, 1997, the Subcommittee of the National Business Conduct Committee ("NBCC") that presided over the appeal hearing ("NBCC Subcommittee") denied this request because Gluckman had not met the standard for the introduction of additional evidence under Rule 9312 of NASD's Code of Procedure. We adopt the NBCC Subcommittee's ruling.

[6] The types of notes intended to be excluded from the definition of a security are those notes issued in a purely commercial or consumer context, such as notes secured by a home mortgage or short-term notes secured by assignment of accounts receivable. Id., at 65-66. The presumption in favor of a security is not overcome by the exemption contained in Section 3(a)(3) of the Securities Exchange Act of 1934, however, merely because the term of the note is less than nine months. That exemption has been held to apply to short-term, high quality instruments issued to fund current operations and sold to highly sophisticated investors. See In re Phyllis J. Elliott, 51 S.E.C. 991, 993 n.10 (1994).

[7] These factors are: (1) the borrower's and lender's purpose; (2) the plan of distributing the notes; (3) the expectations of the investing public regarding whether the instruments were securities; and (4) the presence of any alternative scheme of regulation or other factor that significantly reduces the risk of the instrument so as to make securities regulation unnecessary. Id. at 66-69.

We find that the Time Machine agreements do not resemble notes which are considered non-securities under Reves since they were marketed to the members of the general public as investments, and do not represent commercial or consumer loans. See In re Gerald James Stoiber, Exchange Act Rel. No. 39112, at 8-9 (Sept. 22, 1997) (upholding promissory notes as securities under Reves and stating that "the focus of inquiry should be on the need of the offerees' for the protections afforded by the federal securities laws"). The Time Machine agreements were issued for the purpose of raising money to support the Time Machine documentary, and KP, RB and PB, who were public customers of Gluckman at UIS, invested in order to earn a return on their investment. No alternate scheme or other factor reduces the risk of the investments such that securities regulation is unnecessary. The record shows that the agreements were sold to respondent's securities customers as an alternative to other investments.

The Time Machine agreements can also be analyzed as investment contracts. Under the test for an investment contract established in SEC v. Howey, 328 U.S. 293, 299-300 (1946), the agreements represent an investment in a common enterprise with a reasonable expectation of profits to be derived solely from the efforts of others. Under the terms of the agreements, the investors were provided with a contingency of interest and a share in profits if they were not repaid the $75,000 by the specified date. The agreements specifically provided that only Soledad would be responsible for the documentary's creation and distribution. According to the agreements' contingency clauses, the parties invested in a "common enterprise," such that KP, RB and PB would earn a profit only when Soledad earned a profit. Hence, under both the investment contract test, and the note test, the Time Machine agreements qualify as securities.[8]

We also find that Gluckman "participated" in the private securities transactions within the meaning of Rule 3040. Rule 3040 prohibits any person associated with a member from participating "in any manner" in a private securities transaction. It is undisputed that Gluckman referred the customers to Lucas, typed the agreements, and received a five percent fee for the transactions. The referral of investors to an issuer alone has been held to constitute participation under Rule 3040. See In re Gilbert M. Hair, 51 S.E.C. 374, 379 (1993) (holding that salesman who referred customer to issuer of promissory note and received compensation participated in the private securities transaction); see also In re Ronald J. Gogul, Exchange Act Rel. No. 35824, at 5-6 (June 8, 1995) (same).

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[8] Gluckman argues that he contacted the NASD to inquire as to whether he could receive a referral fee and was advised that he could as long as the transactions did not involve the sale of a security. He provides only few details of this conversation, however, and does not describe the question he posed to the NASD. Gluckman also claims to have relied on Lucas' assertions that the transactions did not involve the sale of a security. As the DBCC properly admonished, whenever there is a question as to whether a transaction is a security, it is the associated person's obligation to inquire in writing with the employer, so that the employer, not the promoter, makes the determination of whether a product is a security. See In re Gilbert M. Hair, 51 S.E.C. at 377.

Under Rule 3040, prior to participating in any private securities transaction, an associated person must provide written notice to the member firm describing in detail the proposed transaction and the person's proposed role therein. If an associated person is to receive selling compensation, the associated person must obtain prior written notice of the member's approval under Rule 3040(c). By Gluckman's own admission, he failed to give UIS written notice of the transactions. Gluckman violated Rule 3040 by failing to give UIS written notice and by failing to obtain UIS' approval before engaging in the transactions.[9] Such conduct violates the high standards of commercial honor and just and equitable principles of trade required by Rule 2110. See In re William Louis Morgan, 51 S.E.C. 622, 625 & n. 12 (1993).

Finally, much of Gluckman's argument focused on his contention that federal and state statutes of limitation bar this action.[10] No statute of limitations bars this proceeding. See In re Larry Klein, at 13-14; In re Frederick C. Heller, 51 S.E.C. 275, 280 (1993) ("[T]here is no requirement in the federal securities laws or the NASD's rules that there be such a statute of limitations."). Cf. In re Timoleon Nicholaou, 51 S.E.C. 1215, 1221 (1994), aff'd, 81 F.3d 161 (6th Cir. 1996) (refusing to apply five-year statute of limitations to New York Stock Exchange broker/dealer disciplinary proceeding).

Sanctions

We affirm the sanctions imposed by the DBCC of a censure, $55,000 fine,[11] and bar from associating with an NASD member firm in any capacity. We agree with the DBCC that no mitigation exists here. We decline to find credible Gluckman's testimony that he informed Fleming of his intention to introduce investors to Lucas. Not only did Gluckman's answer fail to mention that he gave Fleming oral notice, but also Gluckman provided few details of the purported oral notice at the DBCC hearing. Moreover, given the consideration Gluckman took to document his real estate activities and to obtain

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[9] We also reject Gluckman's argument that his referral fee was not "compensation." Under Rule 3040(e)(2), "selling compensation" is broadly defined as "any compensation paid directly or indirectly from whatever source in connection with or as a result of the purchase or sale of a security, including . . . finder's fees." See e.g., In re Gilbert M. Hair, 51 S.E.C. at 378.

[10] Much of the appellate briefing consisted of Gluckman's argument that various one and three year statutes of limitations found in the Securities Act of 1933 and the Securities Exchange Act of 1934, and the California Corporation Code's four-year statute of limitations, barred this proceeding. At the appellate hearing, Gluckman's argument largely focused on the application of these statutes of limitations. Gluckman was given an additional three days to submit a post-hearing brief, regional counsel was given a three-day right to respond, and Gluckman submitted a reply brief. Gluckman's post-hearing submissions again largely focused on his argument that this proceeding was barred by the statutes of limitation.

[11] The fine consists of the $5,000 fee that Gluckman received for the transactions, plus $50,000.

UIS approval to do so, we find it unusual that Gluckman would give only oral notice of the Time Machine transactions to UIS as he alleged.

Having been sanctioned in the past for violating Rule 3040,[12] we believe that Gluckman should have had a "heightened awareness"of the Rule's requirements. We also note that the investors were Gluckman's securities customers at UIS and that these customers previously had invested with the Time Machine promoters through UIS. This led at least one customer to believe that UIS was involved in the transactions. Gluckman's responsibility to notify UIS of the transactions and to obtain its approval was apparent.

Gluckman's involvement in the two private securities transactions resulted in the very consequences that Rule 3040 was designed to prevent. NASD member firms are charged with the responsibility to exercise appropriate supervision over their personnel for the protection of investors. Where employees effect transactions for customers outside the normal channels and without disclosure to the employer, the public is deprived of protection which it is entitled to expect. Rule 3040 not only protects employers from exposure to potential liability, but also protects public investors by ensuring oversight and supervision of a broker's sales efforts.

Based on Gluckman's past disciplinary history involving violations of Rule 3040, his having provided written notice to UIS of certain other outside business activities, and the fact that the transactions at issue involved UIS customers and an issuer previously involved with UIS, we find that Gluckman willfully disregarded Rule 3040's requirements. We find that a bar is appropriate in this case, as Gluckman's lack of remorse indicates that his customers continue to be exposed to extreme risk.

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[12] Gluckman accepted a Letter of Acceptance, Waiver and Consent on August 2, 1985, in which he was censured and fined $1,000 under Conduct Rule 2110 for selling units of a limited partnership to a customer without giving prior written notice to his employer in violation of the Board of Governors Interpretation concerning private securities transactions, the predecessor to Rule 3040.

Conclusion

Accordingly, Gluckman is censured, fined $55,000, and barred from associating with any Association member in any capacity. The bar imposed is effective immediately upon issuance of this decision.[13] In addition, Gluckman is assessed NBCC hearing costs of $750.[14]

On Behalf of the National Business Conduct Committee,

Joan C. Conley, Corporate Secretary

[13] We note that these sanctions are consistent with the applicable NASD Sanction Guidelines ("Guidelines"). See Guidelines (1996 ed.) at 45 (Selling Away (Private Securities Transactions)).

[14] 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.

Pursuant to NASD Procedural Rule 8320, any member who fails to pay any fine, costs, or other monetary sanction imposed in this decision, after seven day's notice in writing, will summarily be suspended or expelled from membership for non-payment. Similarly, the registration of any person associated with a member who fails to pay any fine, costs, or other monetary sanction, after seven days notice in writing, will summarily be revoked for non-payment.