UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 98-60134

HATTIER, SANFORD, & REYNOIR;
GUS A. REYNOIR; VANCE G. REYNOIR,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition for Review of an Order of the
Securities and Exchange Commission

BRIEF OF RESPONDENT SECURITIES AND EXCHANGE COMMISSION

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COUNTERSTATEMENT REGARDING ORAL ARGUMENT

The Securities and Exchange Commission respectfully submits that oral argument is not necessary. This appeal involves no serious or novel legal issues. This Court can resolve all legal or factual issues on the basis of the briefs and the record.

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On Petition for Review of an Order of the
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BRIEF OF RESPONDENT SECURITIES AND EXCHANGE COMMISSION

JURISDICTIONAL STATEMENT

The Securities and Exchange Commission had jurisdiction to review a disciplinary action of the National Association of Securities Dealers, Inc. ("NASD") under Section 19(d)(2) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. 78s(d)(2). Under Section 25(a)(1) of the Exchange Act, 15 U.S.C. 78y(a)(1), this Court has jurisdiction of the petition for review of the Commission's order affirming disciplinary sanctions imposed on petitioners. The Commission issued its order on January 13, 1998, and petitioners timely filed a petition seeking review of that order on March 12, 1998.

REGULATION INVOLVED

Rule 10b-10, adopted by the Commission in 1977, is commonly known as the confirmation rule. It provides, in pertinent part:

> It shall be unlawful for any broker or dealer to effect for or with an account of a customer any transaction in * * * any security * * * unless such broker or dealer, at or before completion of such transaction, gives or sends to such customer written notification disclosing * * * [w]hether the broker or dealer is acting as agent for such customer * * * or as principal for its own account.

17 C.F.R. 240.10b-10(a).

In a release issued twenty years ago, the Commission explained the Rule's purposes as follows:

> By requiring brokers and dealers to disclose facts to a customer at or before the completion of a transaction, as defined in the rule, the confirmation rule is intended to deter and prevent deceptive and fraudulent acts and practices. At the same time, confirmations can have important informational value to customers beyond whatever value they may have as an investor protection measure. Among other things, confirmations should assist customers in evaluating the costs and quality of services provided by brokers and dealers in connection with the execution of securities transactions.

Exch. Act Rel. No. 15219, 1978 WL 14791, *2 (Oct. 6, 1978).

PRELIMINARY STATEMENT

The three petitioners in this case, Hattier, Sanford & Reynoir ("HS&R" or "Firm"), a member of the NASD; Gus A. Reynoir, the Firm's president, general partner, and general securities principal; and Vance G. Reynoir, a Firm general partner and municipal securities principal, seek review of a Commission order sustaining disciplinary action taken against them by the NASD.

The Commission found that the Firm violated Rule 10b-10 by issuing confirmations to its customer, the Louisiana Insurance

Commissioner ("Commissioner"), that stated that HS&R was acting as the agent of the Commissioner in trades with a third party when in fact HS&R was acting as principal for its own account. The Commission further found that the Reynoirs were responsible for the violations because of their roles at the Firm, their involvement in the issuance of the false confirmations, and their failure to correct the false confirmations. The Commission sustained the sanctions imposed on petitioners by the NASD. 1/ The fine and suspensions are the only sanctions at issue here.

HS&R provided investment advice to the Commissioner, in his capacity as the court-appointed receiver for certain insurance companies known as "estates." HS&R also traded securities with the estates. In purchasing or selling securities, a broker-dealer like HS&R can act either as principal or as agent. In a principal transaction, the broker-dealer buys or sells for its own account, holds title to the security, and relies for its compensation on the sale of the security at a price above its cost (the difference between its retail price and the prevailing wholesale price of the security is its "markup"). In an agency transaction, it acts on the customer's behalf to effect the trade with a third party at a designated market price or at the best

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1/ The sanctions were: censures; a $60,000 fine, payable jointly and severally by petitioners; the requirement that the Firm engage an independent auditor and implement the auditor's recommendations to the satisfaction of the NASD; suspensions of the Reynoirs in any capacity for 30 days each, not to be concurrent; and the requirement that the Reynoirs requalify by examination as securities principals. The NASD also assessed costs of $1,910.

price obtainable, charges the customer a fee for its services (a "commission"), and has no other beneficial interest in the transaction. The capacity in which a broker-dealer acts can affect its obligations and advice to the customer.

HS&R traded as principal with the estates, and in that capacity charged the Commissioner $500,000 in markups. Yet, during a 15-month period, the Firm issued more than 450 written confirmations of trades to the Commissioner that falsely stated that HS&R was acting as the Commissioner's agent.

The issue in this professional disciplinary proceeding is petitioners' failure to provide the disclosure and documentation required by Rule 10b-10. Unlike in a private action for damages, there is no issue whether the customer was deceived or injured. It is thus not an issue whether the supposed knowledge of an employee of the Louisiana Insurance Department, who was in the process of defrauding the Department in another matter, can be imputed to the Commissioner. At issue is petitioners' disregard of an important responsibility of securities professionals, which was established in this case.

COUNTERSTATEMENT OF THE ISSUES

1. Whether substantial evidence supports the Commission's findings that a brokerage firm and its two co-owners violated Rule 10b-10 by falsely confirming to its customer, the Louisiana Insurance Commissioner, in 453 trades over more than 15 months, that HS&R was acting as his agent in trades with a third party when in fact HS&R was acting as principal for its own account.

2. Whether the Commission abused its discretion in affirming sanctions imposed by the NASD on petitioners that were commensurate with the seriousness and extent of their violations.

THE REGULATORY SYSTEM INVOLVED

The NASD is registered with the Commission as a securities association pursuant to Section 15A of the Exchange Act, 15 U.S.C. 78o-3. The NASD has primary responsibility, subject to comprehensive Commission oversight, for self-regulation of its members. Section 15A requires a registered securities association to adopt rules regulating the conduct of its members and persons associated with members, see Section 15A(b)(6), 15 U.S.C. 78o-3(b)(6), and to enforce those rules through disciplinary proceedings, see Sections 15A(b)(7) & (8), (g)(2), (h)(1), and 19(g) of the Exchange Act; 15 U.S.C. 78o-3(b)(7) & (8), (g)(2), (h)(1), and 78s(g).

During the period at issue in this case, the NASD District Business Conduct Committees were authorized to bring disciplinary proceedings. See former Article II, Section 1 of the NASD Code of Procedure. Disciplinary action taken by a District Committee ("DBCC") was subject to review by the NASD National Business Conduct Committee ("NBCC"), which might affirm, reverse, or modify the action taken by the DBCC. See former Article III, Sections 1 & 4 of the NASD Code of Procedure. 2/

2/ Since that time, the NASD has substantially revised its rules and the structure of its disciplinary proceedings. See NASD Rules 9211, 9310, and 9313.

Final disciplinary action taken by the NASD may be appealed to the Commission, which conducts a de novo review of the record. See Exchange Act Sections 19(d) & (e), 15 U.S.C. 78s(d) & (e); Whiteside & Co. v. SEC, 883 F.2d 7, 9 (5th Cir. 1989). If the Commission finds that a violation has occurred, it must then determine whether to affirm or modify the sanctions imposed by the NASD. Section 19(e)(1)(A), 15 U.S.C. 78s(e)(1)(A). The Commission may "cancel, reduce, or require the remission" of a sanction only if it determines that the sanction is "excessive or oppressive." Section 19(e)(2), 15 U.S.C. 78s(e)(2); Whiteside, 883 F.2d at 10. 3/

Under the statutory scheme, it is the Commission's order, not the order of the NASD, that is subject to this Court's review. See Section 25(a), 15 U.S.C. 78y(a); Whiteside & Co. v. SEC, 557 F.2d 1118, 1120 (5th Cir. 1977).

COUNTERSTATEMENT OF THE CASE

A. Course Of Proceedings And Disposition Below

1. Proceedings before the NASD

Based on a four-month NASD investigation, the DBCC for District Five filed a complaint against petitioners and Richard

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3/ The Commission's Opinion is contained in Petitioners' Record Excerpt, and is cited herein as "Op. __." The initial NASD decision is cited as "DBCC Op. __"; and the decision of the NASD on appeal as "NBCC Op. __." "R. __" refers to the record before the Commission. The transcript of the NASD proceeding, exhibits offered by the NASD, and exhibits offered by petitioners are cited, respectively, as "Tr. __," "NASD Ex. __," and "Ex __." Petitioners' opening brief in this Court is cited as "Br. __"; their appeal brief to the NASD is cited as "NBCC Br. __."

J. Bickerstaff, an HS&R salesman, on August 10, 1995 (NASD Ex. 1). The complaint charged them with violating Commission Rule 10b-10, 17 C.F.R. 240.10b-10; Rule 17a-3, 17 C.F.R. 240.17a-3; Rule 17a-4, 17 C.F.R. 240.17a-4; and Section 4 of the NASD's Government Securities Rules by falsely confirming to the Commissioner that HS&R acted in an agency capacity for him in 453 trades from July 1993 to October 31, 1994 when in fact HS&R acted as principal for its own account. The complaint also charged them with violating Commission Rule 10b-5, 17 C.F.R. 240.10b-5, and engaging in conduct inconsistent with just and equitable principles of trade in violation of Article III, Section 1 of the NASD Rules of Fair Practice. It further alleged that petitioners had failed properly to supervise Bickerstaff in violation of Article III, Sections 1 and 27 of the Rules of Fair Practice.

Following a December 1995 hearing at which G. Reynoir, V. Reynoir, Bickerstaff (who had by that time agreed to settle the charges against him), and others testified, the DBCC found that petitioners had committed the violations as charged. The DBCC censured and fined petitioners $250,000 jointly and severally; suspended the Reynoirs for thirty days each (the suspensions not to run concurrently); required the Reynoirs to requalify as General Securities Representatives and Principals; required HS&R to engage the services of an independent auditor to review its books and records and supervisory procedures and to implement the recommendations of the auditor in a satisfactory manner; and assessed costs of the proceeding in the amount of $1,910 against

petitioners, jointly and severally. The DBCC assessed no sanctions for the failure to supervise it had found.

On appeal, the NBCC affirmed the DBCC's findings that petitioners violated Rules 10b-10, 17a-3, and 17a-4 and Section 4 of the NASD Rules. The NBCC set aside the DBCC's findings of violations of: (1) Rule 10b-5, concluding that petitioners did not fraudulently conceal the fact that the Firm was executing trades, or receiving compensation, in some capacity; (2) Article III, Section 1 of the NASD Rules of Fair Practice, which did not apply at that time to transactions in Government securities; and (3) failure to supervise, because petitioners committed primary violations. The NBCC reduced the fine from $250,000 to $60,000 and modified the requalification requirement to apply only to the Reynoirs' registration as principals. The NBCC otherwise affirmed the sanctions. See NBCC Op. 9-13.

2. Proceedings before the Commission

Petitioners appealed the NASD's decision to the Commission. Based on an independent review of the record, the Commission found that HS&R violated Rule 10b-10 by issuing the 453 false confirmations and that the Reynoirs were responsible for the violations (Op. 5-7). The Commission did not find, however, that petitioners violated Rules 17a-3 and 17a-4 or Section 4 of the NASD Government Securities Rules, because "the principal allegations here are that the underlying confirmations were inaccurate, not that the copies made and preserved of these confirmations were inaccurate" (Op. 5-6 n.11).

The Commission sustained the sanctions imposed by the NASD, stating that "[g]iven the scope and magnitude of the violations we have found here, we do not conclude that the sanctions imposed are either excessive or oppressive" (Op. 8-9; footnote omitted).

B. Facts

1. HS&R Trades as Principal for the State Insurance Commissioner.

In January 1993, as part of a first-time investment program, Louisiana Insurance Commissioner James H. Brown ("Commissioner") entered into a money management contract ("Contract") with the brokerage firm of HS&R (Tr. 174-75, 255, 299; NASD Ex. 1). G. Reynoir, the Firm president, and V. Reynoir, a Firm principal and general partner, co-owned the Firm. The Reynoirs were designated in the Firm's compliance manual as the "principals to recommend appropriate actions to achieve [Firm] compliance with applicable rules and regulations" (Ex. 11; see Tr. 98-99, 326).

The Commissioner was the court-appointed receiver for a number of failed or distressed insurance companies ("estates") (Tr. 114-15). Pursuant to the Contract, HS&R managed a portfolio of assets worth approximately $25 million held by about 40 of these estates (Tr. 59-60, 231, NASD Ex. 1, p. 14). Over the approximately two-year life of the Contract, the Firm received fees totalling $70,000 for advising the Commissioner on investing in U.S. Government securities (Tr. 280-81; NASD Ex. 1, p. 14). The Commissioner also entered into money management contracts with three other firms, each of which was to manage a portfolio of assets about the same size as HS&R's in return for fees

slightly higher or lower than HS&R's (see Tr. 25, 101, 231; NASD Exs. 7, p. 9, & 10; Exs. 37, p. 8, & 38, p. 8).

Unlike the other firms, however, HS&R not only provided investment advice but also traded Government securities with its designated estates (Tr. 87-89). HS&R purchased securities for sale to the estates from, and sold securities acquired from them to, the First National Bank of Commerce ("FNBC") (Tr. 144, 214-15, 236). HS&R traded with the estates until March 1995 when the Commissioner terminated the money management contracts (Tr. 65).

As the Reynoirs knew, HS&R acted at all times as a principal for its own account in executing trades with the estates, not as an agent of the Commissioner or of the estates in trades with a third party. See Tr. 335 ("We operated as principal on every damn thing for the Insurance Department, Receivership Division."). (G. Reynoir); NASD Ex. 1, pp. 16-42; see also Tr. 181, 321, 334, 358. That is, HS&R bought securities from FNBC for HS&R's own account and then sold them to the estates, charging markups; or HS&R bought securities from the estates, charging markdowns, and then sold them to FNBC (NASD Ex. 1, pp. 16-42).

The Commissioner's account "was the largest account that [HS&R] had" (Tr. 217). G. Reynoir described it as "'the most important account we have in the office'" (id.). The "big money * * * was in the executions" (Tr. 219), according to Richard Bickerstaff, the HS&R salesman who handled the account and with whom HS&R split the compensation (Tr. 155). Between January 1993 and March 1995, HS&R charged the Commissioner $501,675 in markups

(or markdowns) on transactions with the Contract estates (Tr. 68-70).

For each trade with an estate, HS&R prepared a written confirmation to the Commissioner. HS&R generated the statements from order tickets written by Bickerstaff and others at the Firm (see, e.g., Tr. 81, 130, 373-74; NASD Exs. 20, 22).

Referring to the order tickets and confirmations, G. Reynoir testified that "[e]very copy of the trade ticket comes across my desk. I look it over and okay it, put my initials in the lower left-hand corner" (Tr. 316; see Tr. 81, 323, 394). The confirmations purported to disclose, among other information, the capacity in which the Firm was acting (see, e.g., Tr. 340; NASD Exs. 19, 20, 22). 4/ The Firm sent the confirmations to the attention of Charles E. Reichman, Director of Accounting and Investments for the Commissioner, with copies to a custodian bank (see, e.g., NASD Exs. 20-23). 5/

4/ The other three money managers did not execute transactions, either as principal or agent, and thus did not issue confirmations, but acted only as investment advisers to their estates. Specifically, these managers would contact broker-dealers and arrange or negotiate the transaction for the Commissioner; then the broker-dealers would deal directly with the Louisiana Insurance Department, delivering the securities, charging for their services, and sending confirmations (Tr. 87-88; see Tr. 25-28, 31-32, 108-09, 132). The money managers received no compensation from the transactions, only fees for investment advice under their contracts (see Tr. 28, 88, 285).

5/ The custodian, Hancock Bank, which was one of the money managers, provided "central custody/safekeeping services for the entire portfolio managed by all professional money managers" and rendered, through Reichman, "monthly statements of accounts of assets held and invested to the (continued...)

Reichman was the state employee who negotiated the money management contracts and was responsible for administering them (Tr. 140-41, 253, 266). In late 1995, Reichman was convicted in federal court of a scheme to defraud the state in connection with a different contract, of which, NASD counsel stipulated (Tr. 91), HS&R and the Reynoirs had been unaware. Reichman had engaged a company owned by Bickerstaff to furnish investment services to the state beyond those provided by HS&R (see NASD Ex. 6), and then from April 1993 to February 1994 had extorted money from Bickerstaff (see Tr. 33, 37, 48-49; NASD Ex. 11).

Reichman reported to Randal M. Beach, the newly appointed Deputy Commissioner for the Office of Receivership (Tr. 253, 266). Beach assumed the position "as a layman" without "any expertise in investment matters" (Tr. 257, 274, 292). He testified that "[o]ne of the first things that I did when I went to Receivership, New Year's of '93, was to sit down with Mr. Reichman and ask him to walk me through the program" (Tr. 257). According to Beach, "I believed that I had a man that I could trust that was under my supervision taking care of [the investment program] on a day-to-day basis" (Tr. 308). Beach testified that "[i]f Charles [Reichman] told me, 'It's operating like it's supposed to be' and I got a monthly report that showed we were doing well, then I was satisfied" (Tr. 274; see Tr. 300-

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5/(...continued)
Commissioner" (see Ex. 38, p. 8). The Bank's account statements listed the total cost of purchases or sales of estate securities, but did not discuss HS&R's role or capacity in executing estate trades (see, e.g., Ex. 36).

01). 6/ Beach further testified that others in the Department "had put the contract together and the program together before I went to Receivership" and that he "assumed that they agreed" that the program was operating properly (Tr. 297). Beach reported to Commissioner Brown (see Tr. 266).

HS&R sent statements to FNBC confirming the Firm's trades with FNBC (e.g., NASD Ex. 22, p. 2). Throughout the relevant period, HS&R also received confirmations from FNBC consistently stating that FNBC sold the Government securities to (or bought them from) HS&R (Tr. 64-65, 71-72, 122-24). Although HS&R required that "[a]ll incoming mail shall be given to and reviewed by a General Principal" (Ex. 11 at 2), no one at the Firm was assigned to compare these incoming FNBC confirmations with HS&R's confirmations to the Commissioner (see Tr. 364-65, 393-95).

Charlotte Alexander, who, at one point during the relevant period, "worked in the entry desk" at HS&R "in a clerical role" and "didn't understand at that point the difference between a principal and an agent" filed FNBC's and HS&R's confirmations (Tr. 383-84, 419). FNBC did not send confirmations to the Commissioner showing that it had sold securities to HS&R because FNBC did not trade with the Commissioner (Tr. 75, 79, 153).

6/ Reichman sent monthly reports to Beach. The reports summarized the account balances and monthly yield of estate investments, but did not discuss trades with the estates (see, e.g., Tr. 202-03; Ex. 30). HS&R and the Reynoirs offered no evidence of the long-term return on the investments (see, e.g., Tr. 227, 448).

2. G. Reynoir Refuses To Resolve the Dispute Between Agency or Principal, and the Firm Issues False Confirmations to the Commissioner.

During the first six months of the Contract, HS&R executed several transactions with the estates, and accurately confirmed as principal to the Commissioner, as well as to FNBC (Tr. 121-22, 124). From July 1993 to October 1994, however, the Firm falsely confirmed 453 trades with the estates as agent (Tr. 59-81; NASD Ex. 1, pp. 16-42). The first 280 of these confirmations showed the Firm's markups as commissions; the remaining 173 did not show the compensation the Firm received (e.g., NASD Exs. 20, 22).

In July 1993, Richard Doskey, the Firm's financial and operations limited principal ("FINOP"), learned that HS&R was trading as principal with the estates, and advised Bickerstaff that doing so could adversely affect HS&R's capital position (Tr. 143-44, 385-87, 390). By Alexander's account, Doskey said, "'You can't do these tickets as principal. You have to do them as agent'" (Tr. 385). Bickerstaff responded, "'No, we've been doing them as principal. We did it as principal. We need to do the tickets as principal'" (id.). Then Doskey "said, absolutely not, he [Bickerstaff] couldn't do them as principal" (Tr. 386).

The two men took their disagreement to G. Reynoir (see Tr. 363). Bickerstaff objected "very much" to confirming the trades as agency trades, he explained to Doskey and G. Reynoir, because "if we started sending out tickets with commissions on them it was going to throw up a red flag and that we could not charge commissions [under the Contract]" (Tr. 220-21) (Bickerstaff).

G. Reynoir testified that, despite the Firm's procedures designating him as a Firm principal responsible for regulatory compliance, he did not resolve the dispute when he was asked to:

> [Bickerstaff] and my cashier at the time, Richard Doskey, came in, and they were having an argument of whether the tickets out [sic] to go out one way or the other way. They came into my office, and one guy says, 'I want it out this way,' and the other guy says, 'I want them out that way.' You know what I told them? 'Do what's right. Don't bother me with this. I've got my own problems. You all have been in this business a long time. You know what's right and what's wrong. Do what's right, and do the tickets the right way. Now, get out of my office because I have other things to do that are pressing on me.' That's what I told them.

(Tr. 325). Bickerstaff testified that G. Reynoir instructed him "to change the nature of the tickets to reflect a commission showing to the Department as opposed to sending out a principal transaction where the * * * mark-up was not disclosed" (Tr. 143; see Tr. 145, 220).

After that discussion, between July 20 and September 20, 1993, the Firm confirmed 280 transactions to the Commissioner as agent, when in fact HS&R had acted as principal (NASD Ex. 1, pp. 16-32; e.g., NASD Ex. 20). HS&R inserted its markups as commissions on the confirmations and stated the dollar prices of the securities differently than they would have been stated on a principal trade (see NASD Exs. 1, pp. 25-32, & 20). On principal trades, the price of the security displayed on the confirmation already included an undisclosed markup (see, e.g., NASD Ex. 23); on the 280 trades shown as agency, which stated commissions, the

Firm decreased (sale to estate) or increased (purchase from estate) the stated price of the security by the amount of the commission (see, e.g., NASD Ex. 1, pp. 31-32). This produced, in turn, a decreased or increased "extension" amount (unit price multiplied by quantity), to which the Firm added or from which it subtracted the stated commission to arrive at the original bottom-line "net amount" of the principal trade (see Tr. 64-68, 77-78, 126-29, 147, 392-93; e.g., NASD Ex. 21).

Thus, although the characterization as agency did not change the total price of the trade, each HS&R confirmation represented to the Commissioner that an estate had bought from or sold to a third party at the third-party's price for the security when in fact the estate had bought from or sold to HS&R at HS&R's price -- one higher than the price presented on the ticket for a sale to the estate or lower than the price presented on the ticket for a purchase from it (see, e.g., NASD Exs. 1, pp. 31-32, & 12). G. Reynoir reviewed and approved each of the false confirmations for the 280 transactions (Tr. 316, 394; e.g., NASD Ex. 20). 7/

3. The Reynoirs Learn That Reichman Does Not Want the Firm's Confirmations To Show the Firm's Compensation, and the Firm Issues More False Confirmations.

In September 1993, as Bickerstaff had predicted, Reichman complained "that he was beginning to receive confirmations showing commissions, which was not allowed under the contract,

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7/ The record indicates that between July and December 1993 HS&R acted and confirmed as principal in one trade, not at issue, in which it liquidated an estate's non-Government securities investment (see Tr. 188-90, 275-76; Exs. 10, 42).

[and asked HS&R] to go back to sending principal confirmations." Tr. 146; see Tr. 221 ("It took him three months, but it did, indeed, finally pop up."). 8/

Bickerstaff discussed Reichman's call with G. Reynoir (Tr. 146-47). V. Reynoir, although professedly "not day to day that involved with" the Firm's estate trades (Tr. 356), knew that the Firm was managing money for the estates (see Tr. 58, 137-38; NASD Ex. 5, p. 6), "on one or two occasions * * * may have helped [Bickerstaff and Alexander] write the [trade] tickets" (Tr. 374), and learned that trades had been mischaracterized (Tr. 355).

The Firm responded to Reichman with an offer to cancel and rebook the 280 false confirmations issued between July 20 and September 20, 1993, to indicate that the trades were conducted in a principal capacity (Tr. 149-50, 355). The Firm recognized that the Insurance Department was entitled to corrected documents that documented the status of HS&R as a principal (see Br. 28 (quoting G. Reynoir); see also NASD Ex. 2, p. 19). Reichman, however, stated that he would prefer to "let sleeping dogs lie" (Tr. 150). Beach knew nothing about the false confirmations (Tr. 303). HS&R and the Reynoirs acquiesced in Reichman's request, and made no effort to correct the confirmations (see Tr. 223-24, 354-55).

Bickerstaff testified that at this time he advised G. Reynoir, "'Gus, we have to go back to confirming these tickets to the Department as a principal, thereby showing no commission on

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8/ The Commission stated in its Opinion that the issue of whether the Contract authorized HS&R to charge commissions was not before it (Op. 4 n.7).

the confirmations'" (Tr. 147). Bickerstaff stated that G. Reynoir told him "to put the commission on the contra party side. That would be the FNBC side" (id.).

In 173 transactions with the Contract estates between September 29, 1993 and October 31, 1994, HS&R continued to confirm principal trades to the Commissioner as agency trades (NASD Ex. 1). In response to Reichman's concerns, however, HS&R ceased reporting its compensation on the confirmations (Tr. 106, 394-95). However, the Firm's computer system required entry of a commission on an agency transaction (Tr. 421-25). Accordingly, HS&R showed the markups (represented as commissions) that had been appearing on the confirmations to the Commissioner, on the Firm's confirmations of its trades with FNBC instead (see Tr. 61-64, 71, 79, 81, 395; compare NASD Ex. 20 with NASD Ex. 22). G. Reynoir reviewed and approved HS&R's confirmations for the 173 transactions (Tr. 81, 316, 394; e.g., NASD Ex. 22). 9/

Beginning in January 1995, after having falsely confirmed to the Commissioner as agent for more than 15 months and after a two-month lull in trading, HS&R correctly confirmed its last few months of trades with the Contract estates as principal (see Tr. 65, 83-84, 148; NASD Exs. 1, pp. 41-42, & 23). By that time, Doskey had retired from HS&R, and Alexander had replaced him as FINOP and begun directing preparation of the confirmations (Tr.

9/ The record indicates that in 16 transactions between September 21, 1993 to October 31, 1994, not at issue here, HS&R transferred securities from one estate to another and confirmed as principal (Tr. 81-83).

391, 397-98). Bickerstaff explained HS&R's decision to change the characterization of the trades as follows (Tr. 148-49):

> that would be in compliance with Mr. Reichman's instructions to show the confirmations going through * * * without showing any commission or mark-up, and also the size of these trades were not as large as what were previously done * * * [and] this reduced size of transactions would allow me to operate and confirm as principal.

During this same period, the Louisiana legislature, as well as state and federal prosecutors, were investigating whether the Commissioner or members of his office, including Reichman, had improperly procured or administered the money management contracts (see, e.g., Tr. 54, 224). In the course of these well-publicized inquiries, questions were raised about whether HS&R "could earn a profit as principal on the securities" and whether the money managers "charged any commissions on their work on behalf of the Department" (see Tr. 99-100, 287). In February 1995, Commissioner Brown testified in a state legislative hearing that none of the money managers received commissions and that he knew of no provision in the Contract "allowing [HS&R] to act as principal" (Tr. 287-88). He stated that it was his understanding that "'The money managers, if they traded every day, they'd make the same thing as if they traded once a year'" (Tr. 287).

4. The Firm Corrects Three Months of False Confirmations, but Does Not Deliver Them to the Commissioner, and Leaves the Remaining Thirteen Months of False Confirmations Untouched.

In early 1995, in the midst of these investigations, G. Reynoir, Bickerstaff, and Reichman discussed the 280 false

confirmations that HS&R had issued between July 20 and September 20, 1993 (Tr. 223-24, 354). Reichman told them to prepare corrected confirmations for the Firm's own records but not to send them to the Commissioner. 10/ By this time, Beach had been told by Reichman "that there had been some problems with the characterization of some trades but that it had been corrected," but Beach "never got involved in the details of that" (Tr. 303).

Under V. Reynoir's direction, the Firm canceled and rebooked the confirmations for the July to September 20, 1993 transactions (Tr. 67, 339). At Reichman's request, however, the Firm did not issue the restated confirmations to the Commissioner, but, rather, retained them at the Firm (Tr. 67, 317, 345-46). At some later date, the Firm provided copies to the state attorney general's office (Tr. 345), which subsequently contacted the NASD (see Tr. 133-34).

The Firm made no effort to correct the confirmations that it had issued to the Commissioner from September 29, 1993 to October 31, 1994, which falsely stated that the Firm was acting in an agency capacity but which did not show any commissions (see Tr. 85-86, 330-31, 334). G. Reynoir testified that HS&R corrected only the July to September 20, 1993 confirmations because "Mr. Reichman wanted those -- he earmarked those three months' tickets

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10/ Bickerstaff testified that he and G. Reynoir asked Reichman, "'Look, those tickets that are showing commissions that you got, you know, we never did correct those things. What do you want us to do about them,' and he told us that he thought it might be a pretty good idea to correct them but don't send them out" (Tr. 224; see Tr. 150, 316-17, 354).

he wanted changed, period" (Tr. 358). The Reynoirs professed to have believed that the Firm otherwise had confirmed its trades to the Commissioner as principal (see, e.g., Tr. 334, 358).

Neither the Firm nor the Reynoirs made any effort to investigate the source or extent of HS&R's issuance of false confirmations to the Commissioner (see, e.g., Tr. 334, 355-58). 11/ In an attempt to explain how he could have been unaware that any of the 453 false confirmations he reviewed and approved were false when issued, G. Reynoir testified that he did not spend "a lot of time" checking each ticket (Tr. 316). He explained that (Tr. 323-24):

> When I'm checking twenty, thirty, forty, fifty, and in some cases maybe ninety to a hundred tickets a day, it's possible for me just to miss that one little block [showing capacity in which the Firm is acting], okay. * * * If you've got a hundred tickets to check like this and it's six o'clock at night and you get the phones ringing off the hook and your wife says, "We're having company for dinner, you'd better get here," I'm checking these damn tickets pretty quick.

G. Reynoir further claimed that the Firm's hundreds of false agency confirmations had not been apparent to him because "[i]t is possible that we might have had some agency transactions with

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11/ In fact, in their September 1995 answer to the complaint, petitioners stated that the Firm's trades with the estates from September 1993 through October 1994 "were correctly documented to the Department as sales by HS&R acting as principal" and claimed that during that period only HS&R's confirmations to FNBC "documented the status of HS&R as an agency status" (NASD Ex. 2, p. 15). G. Reynoir seemed to want to maintain that stance at the hearing (see Tr. 330, 334), but his counsel, who prepared the answer, declared the statement in the answer to be a "typo" and conceded that the confirmations to the Commissioner were false (Tr. 331-32).

some other insurance companies that we were doing business with that * * * are out of jurisdiction of the Insurance Commissioner because they are not in financial trouble" (Tr. 333; see 323-24, 407-08, 410-11). 12/ When asked by a member of the NASD hearing panel why he had failed to notice the absence of 453 HS&R principal transactions with estates during the 15-month period from July 1993 to October 1994, G. Reynoir answered, "I guess I just wasn't sharp enough or take the time enough to go out and check these things out to the nth degree" (Tr. 410-11).

STANDARD OF REVIEW

The Court reviews issues of law de novo, but has stated, with regard to the Commission's review of broker-dealer disciplinary proceedings, that "[c]onsiderable weight should be accorded to an executive department's construction of a statutory scheme it is entrusted to administer." Vail v. SEC, 101 F.3d 37, 39 (5th Cir. 1996); accord Whiteside & Co. v. SEC, 557 F.2d 1118, 1120 (5th Cir. 1977).

The Commission's "factual findings are conclusive in this court if supported by substantial evidence." Whiteside & Co. v. SEC, 883 F.2d 7, 9 (5th Cir. 1989); accord Whiteside, 557 F.2d at 1120; Exchange Act Section 25(a)(4), 15 U.S.C. 78y(4). Agency decisions based on credibility are reviewable only if contradicted by "'uncontrovertible documentary evidence or physical facts.'" Edward J. Mawod & Co. v. SEC, 591 F.2d 588,

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12/ He acknowledged that any such transactions, unlike the trades with the Contract estates, would not have been limited to U.S. Government securities (Tr. 408).

593 (10th Cir. 1979), quoting NLRB v. Dixie Gas, Inc., 323 F.2d 433, 435 (5th Cir. 1963). The Court will not overturn the Commission's decision to impose a particular sanction unless it finds that the decision is arbitrary or "a gross abuse of discretion." Amato v. SEC, 18 F.3d 1281, 1284 (5th Cir. 1994); Whiteside, 883 F.2d at 10.

SUMMARY OF ARGUMENT

Commission Rule 10b-10 requires a broker-dealer to provide its customer with contemporaneous written notice of the capacity in which the broker-dealer is acting. Over a period of more than 15 months, HS&R charged the Louisiana Insurance Commissioner approximately $500,000 in markups without properly disclosing that the Firm was acting as principal for its own account. Instead, HS&R issued 453 confirmations of trades that represented to the Commissioner that the Firm was acting as his agent. Petitioners admit that the confirmations are false. It is irrelevant to a violation of Rule 10b-10 in this regulatory professional disciplinary proceeding whether HS&R benefitted from the violation or whether the Commissioner was harmed by it or knew or should have known the capacity in which HS&R acted.

Substantial evidence supports the Commission's findings that the Reynoirs were responsible for the Firm's violations. The Reynoirs were the Firm principals in charge of regulatory compliance. G. Reynoir was the Firm president, and reviewed and approved all of the false confirmations. The Reynoirs have admitted that they knew in September 1993 that the Firm had

issued false confirmations, but they allowed the Firm to continue issuing false confirmations until 1995. G. Reynoir's excuses -- that he took little time to review the confirmations; that they were regular on their face; that there were many to review; and that he may have confused them with confirmations the Firm issued to the Commissioner for other work -- are unavailing. V. Reynoir's only defense is a meritless attempt to deny on appeal his unequivocal admission at the hearing that he knew in 1993 that the Firm had mischaracterized transactions.

The Commission did not abuse its discretion when it declined to conclude that the sanctions imposed on petitioners rose to the high level of "excessive or oppressive." The sanctions are commensurate with the seriousness and extent of petitioners' violations. According to their own brief, "for a significant period of time" the Firm "systematically generated" hundreds of false confirmations and did nothing during that period to correct them. HS&R issued the false confirmations in order to serve the interests of the Firm, and repeatedly modified the confirmations to suit its own purposes. The Firm's partial and belated efforts to provide the customer with proper disclosure and documentation came only at the request of the customer and amid federal and state investigations of the money management contracts.

In contending that the sanctions are excessive, petitioners underestimate the seriousness of their violations and misread the NASD Sanction Guidelines. The $60,000 fine, payable jointly and severally, and 30-day suspensions of the Reynoirs, not to run

concurrently, fall well within the range of sanctions provided by the Guidelines. Petitioners' unproven assertions that the Commissioner knew the capacity in which HS&R was acting and that no harm resulted from the Firm's false confirmations, even if true, do not excuse their conduct. The Commission's order should be affirmed in all respects.

ARGUMENT

I. THE COMMISSION'S FINDINGS THAT PETITIONERS VIOLATED RULE 10B-10 ARE SUPPORTED BY SUBSTANTIAL EVIDENCE.

Commission Rule 10b-10 is a "central tenet[ ]" of securities regulation. Protective Group Securities Corp., 51 S.E.C. 1233, 1242 (1994). The requirement that broker-dealers provide their customers with contemporaneous written notice of the capacity in which they execute the customers' trades is a longstanding requirement of the federal securities laws. See Exchange Act Section 11(d)(2), 15 U.S.C. 78k(d)(2) (applicable to non-Government securities); 17 C.F.R. 240.10b-10(a) (applicable to all securities other than U.S. Savings Bonds and municipals). Petitioners admit (Br. 9, 15) that HS&R issued confirmations for 453 trades over more than 15 months that falsely stated that the Firm was acting in an agency capacity for the Commissioner when in fact the Firm was acting as principal for its own account.

Congress and the Commission have recognized that the capacity in which a broker-dealer acts can influence its advice to the customer, and have determined that without written confirmation of capacity, transactions with broker-dealers pose an unacceptable risk of harm to customers. See 15 U.S.C.

78k(d)(2); 17 C.F.R. 240.10b-10(a). 13/ Courts have also recognized the importance of proper disclosure and documentation of capacity. 14/ Petitioners concede its importance (Br. 20).

Rule 10b-10's clear and specific mandate serves to ensure both disclosure and documentation of capacity. The Rule thus serves to "assist customers in evaluating the costs and quality

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13/ In enacting Exchange Act Section 11(d)(2) in 1934, Congress heard evidence that "tended to prove[ ] that a broker-dealer who deals in securities for his own account finds it difficult to give disinterested advice to a customer with regard to the securities the customer seeks to buy." S. Rep. No. 792, 73rd Cong., 2d Sess. 11 (1934). Congress believed that a broker-dealer should confirm its capacity "in order that the customer may be aware of any factors tending to influence the broker's advice." H.R. Rep. No. 1383, 2d Sess. 22 (1934). See 2 SEC, Report of Special Study of Securities Markets, H.R. Doc. No. 95, 88th Cong., 1st Sess. 615, 666 (1963) (noting that "[p]rincipal markups ordinarily run higher than agency commissions" and that "this factor may dominate [the] choice of capacity"); SEC, Report on the Feasibility and Advisability of the Complete Segregation of the Functions of Dealer and Broker (1936) at xv ("A broker who trades for his own account or is financially interested in the distribution or accumulation of securities, may furnish his customers with investment advice inspired less by any consideration of their needs than by the exigencies of his own position.").

14/ See Lowell H. Listrom & Co. v. SEC, 803 F.2d 938, 940-41 (8th Cir. 1986) (inadequate confirmation of capacity); Boruski v. SEC, 289 F.2d 738, 740 (2d Cir. 1961) (same) (former Commission Rule 15c1-4); Norris & Hirshberg, Inc. v. SEC, 177 F.2d 228, 231 (D.C. Cir. 1949) (same); Cant v. A.G. Becker & Co., 374 F. Supp. 36 (N.D. Ill. 1974) (same); see also Chasins v. Smith, Barney & Co., 306 F. Supp. 177, 178 (S.D.N.Y. 1969) (noting that in principal trade, price paid by customer "was fixed by the judgment of the broker and not the interplay of the market"), aff'd 438 F.2d 1167, 1172 (2d Cir. 1970) ("The investor * * * must be permitted to evaluate overlapping motivations through appropriate disclosures, especially where one motivation is economic self-interest."); Armstrong, Jones & Co. v. SEC, 421 F.2d 359, 362-63 (6th Cir. 1970) (lack of written disclosure of broker-dealer's common control relationship with issuer).

of services provided by brokers and dealers in connection with the execution of securities transactions" and to "deter and prevent deceptive and fraudulent acts and practices." Exch. Act Rel. No. 15219, 1978 WL 14791, *2 (Oct. 6, 1978). See Op. 8 n.16 (it "works to protect investors and combat broker-dealer fraud") (citing Bison Securities, Inc., 51 S.E.C. 327, 333 (1993)).

It is irrelevant to a violation of Rule 10b-10 whether the broker-dealer benefits from the violation or whether the customer is harmed by it or knew or should have known the capacity in which the broker-dealer acted. 17 C.F.R. 240.10b-10; see Blaise D'Antoni & Assocs. v. SEC, 289 F.2d 276, 277 (5th Cir. 1961) (Rule X15c3-1); Armstrong, Jones & Co. v. SEC, 421 F.2d 359 (6th Cir. 1970) (Rule 15c1-5). In D'Antoni, 289 F.2d at 277, this Court held with regard to another Commission rule that "operates to assure confidence and safety to the investing public" that "[t]he question is not whether actual injuries or losses were suffered by anyone." Rather, liability was established because the firm "subjected its customers to" undue risks "by conducting its business in violation of [the] rule." Id.

Armstrong involved another Commission rule designed "to insure that customers know" certain facts "which might affect the broker-dealer's objectivity about the stock" it was trading. 421 F.2d at 363. The court held that it "must" affirm the Commission's finding of violations because "[t]he Rule requires the broker-dealer to give written notice to the customer" and "[t]here was no evidence that petitioners gave their customers

written notice." Id.; see Remmele & Co., 45 S.E.C. 432, 433 (1974) (noting "[t]he important prophylactic purpose" of a Commission rule and stating, "[t]he investing public is entitled to expect that those subject to the rule meet its requirements").

Substantial evidence supports the Commission's findings that the Reynoirs were responsible for the Firm's violations of Rule 10b-10. As the Commission found (Op. 6), the Reynoirs were responsible because of their "respective roles at the Firm, varied involvement in the issuance of the confirmations, and failure to correct the erroneous confirmations." G. Reynoir was president of the Firm, the Reynoirs were its co-owners, and, during the relevant period, they were the Firm principals in charge of regulatory compliance. See p. 9, supra. Thus, the Reynoirs "bear a heavy responsibility in ensuring that the firm complies with applicable rules and regulations." Hutchison Financial Corp., 51 S.E.C. 398, 403-4 (1993); accord Gross v. SEC, 418 F.2d 103, 107 (2d Cir. 1969) (holding individual liable for aiding and abetting firm's securities fraud violation "[o]n the basis of [his] participation in the management of the firm and his knowledge of the course of conduct in which his firm was engaging with respect to [the] securities"); Cost Containment Services, 59 S.E.C. Dkt. 1060, 1064-65 (1995); Mark James Hankoff, 48 S.E.C. 705, 707-8 (1987). Yet they failed in numerous ways to carry out that responsibility.

G. Reynoir, knowing full well that the Firm "operated as principal on every damn thing for the Insurance Department,

Receivership Division" (Tr. 335), personally reviewed and approved all of the false agency confirmations that the Firm sent to the Commissioner, as well as the underlying order tickets. This alone is more than sufficient to establish his liability for violating Rule 10b-10. See Hamilton Bohner, Inc., 50 S.E.C. 125, 129 (1989) (firm president who "authorized the transmission to [client] of the firm's inaccurate and incomplete confirmations" violated Rule 10b-10). Furthermore, Bickerstaff testified that G. Reynoir instructed him to begin confirming as agent in July 1993 and, when Reichman complained in September 1993, to continue confirming as agent but shift the commission amounts shown on the tickets over to the confirmations to FNBC. Tr. 143, 147. 15/

But G. Reynoir is liable even under his own account of events. He testified that his financial operations manager and the salesman handling the Commissioner's account brought a disagreement to him specifically about "whether the tickets ou[gh]t to go out one way or the other way." Tr. 325. Reynoir says he told them, "Don't bother me with this * * * get out of my

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15/ G. Reynoir denied giving these instructions, but the NASD hearing panel, which viewed the witnesses under extensive direct- and cross-examination, credited Bickerstaff's testimony over Reynoir's. DBCC Op. 9. This credibility determination is entitled to great weight. See Edward J. Mawod & Co. v. SEC, 591 F.2d 588, 593 (10th Cir. 1979). Prior to the NASD hearing in December 1995, Bickerstaff had cooperated with federal and state prosecutors, pled guilty to failing to report Reichman's misconduct to the authorities, pled nolo contendere to charges of splitting fees with Reichman, and agreed to settle the NASD's charges against him (Tr. 96-97, 158, 184; NASD Ex. 11). It is worth noting that, at the hearing, attorney Charles Hamilton, representing HS&R and the Reynoirs, vouched for Bickerstaff's credibility (Tr. 50; see Tr. 438).

office because I have other things to do that are pressing on me." Tr. 325. The only guidance he claims to have given was "Do what's right," but the men had come to Reynoir -- the Firm president and, with V. Reynoir, the chief compliance officer -- in the first place because they did not know what to do. Under any version of events, then, G. Reynoir is responsible for the Firm's issuance of the false confirmations.

Both Reynoirs knew about the false confirmations but failed to correct the problem. They have admitted that they knew in September 1993 that the past three months' confirmations, covering 280 trades with the estates, were false. See Br. 28 (quoting G. Reynoir); Tr. 355 (V. Reynoir). They recognized that, if the Firm sent incorrect confirmations, the Commissioner was entitled to corrected documents. See Br. 20, 28; NASD Ex. 2, p. 15. But simply because Reichman said that he would prefer to "let sleeping dogs lie" (Tr. 150) -- a response that the Reynoirs now admit (Br. 12 n.19) "does not make a lot of sense" -- the Reynoirs made no effort to correct the confirmations (e.g., Tr. 224). Moreover, they made no effort to investigate why HS&R had issued them, and the Firm continued to issue false confirmations for 13 more months. It was not until 1995, amid federal and state investigations of the money management contracts, that HS&R finally prepared accurate confirmations for the July to September 1993 trades. Even then, HS&R did not send those confirmations to the Commissioner, but retained them at the Firm. HS&R never corrected the 173 false confirmations for the September 1993 to

October 1994 trades. 16/ The Commission correctly found the Reynoirs responsible for the Firm's violations of Rule 10b-10.

The Reynoirs nonetheless contend (Br. 16) that they "did not know, or have reason to know, at the time, that incorrect confirmations were being systematically generated incorrectly by the firm." Notwithstanding the Reynoirs' attempts (e.g., Br. 7-9) to distance themselves from the violations, they had ample reason to know that the Firm was violating Rule 10b-10.

G. Reynoir's contention that he had multiple confirmation tickets to review and was "checking these damn tickets pretty quick" (Tr. 324) is no excuse for issuing false confirmations. The fact that the Firm used confirmation tickets that designated the capacity in which it was acting with a number code in "one little block" (Tr. 323) on the ticket does not diminish the importance of that information or of its being accurate. G. Reynoir's claim that "[t]he confirmations at issue were regular on their face[,] * * * complete[,] [and] internally consistent" (Br. 8) is demonstrably false. For over a year, from September 29, 1993 to October 31, 1994, the confirmations listed the Firm as agent but showed no commission, which, petitioners recognize (Br. 16 n.21), is contrary to Rule 10b-10. See 17 C.F.R. 240.10b-10(a)(2)(B) (requiring agents to disclose commissions).

16/ Contrary to petitioners' assertion (Br. 12, citing Tr. 337) G. Reynoir did not testify that Reichman "told the firm to stop working on" correcting confirmations. He testified that in 1995 Reichman told him, "'Don't send [the corrected July to September 1993 confirmations] now.'" Tr. 337.

G. Reynoir also claims (see Br. 4, 8) unconvincingly that he failed to notice the absence of 453 principal confirmations during the 15-month period from July 1993 through October 1994 because the Firm issued confirmations to the Commissioner for other work. But Reynoir admitted (e.g., Tr. 217, 335) that he knew that the Firm was trading as principal with the Contract estates and that this was the Firm's largest and most important account. The record indicates that the Firm confirmed few other trades to the Commissioner during the relevant period. 17/

Nonetheless, G. Reynoir asserts (Br. 8) that in addition to the Contract-estate trades and the other, occasional trades specified in the record, HS&R handled "[a]n unspecified number of additional insurers' investments * * * at the same time" that "involved a lot of executions" (emphases omitted). For this vague assertion, Reynoir cites testimony that the Firm "had a lot of executions before the money management contract." Tr. 245 (emphasis added). Even if the Firm traded as principal with insurance companies before the Contract (see Tr. 244-45), and even if these companies were not later designated as Contract estates, G. Reynoir nowhere specifies the volume of this trading, if any, that continued into the relevant period.

17/ See nn. 7, 9, supra (describing a total of 17 transactions). Those of petitioners' exhibits that purport to describe trades are not to the contrary. See Exs. 2, 41, 44, Tr. 211 (trades outside of relevant period); Exs. 3, 40 (not trades with Commissioner); Exs. 6, 21, 31, 32, 43, Tr. 174, 196-7, 203, 277-8 (apparently Contract-estate trades).

G. Reynoir further asserts (Br. 9), without any support, that it is "safe to say" that HS&R executed "a considerable number of transactions * * * for the Department acting as 'agent' and as 'principal.'" The assertion is based entirely on Reynoir's own testimony, in which he states (Tr. 327): "I don't know if we charged a spread or a markup or we operated as agent on some transactions and principal on others. I have no idea."

In any event, G. Reynoir acknowledged that any trades with non-Contract insurers would not have been limited to U.S. Government securities (Tr. 408), as were trades with the Contract insurers, so he could have differentiated the trades. Even if, however, "a lot" of other trades of U.S. Government securities took place during the relevant period, G. Reynoir has still not explained his failure to notice the absence of 453 more principal trades. G. Reynoir also fails to explain why, if a serious possibility of confusion existed, he made no attempt to keep track of the various accounts, by a list or any other means. See Br. 8. With good reason, the Commission concluded (Op. 7 n.13) that G. Reynoir's claims "are neither persuasive on their face nor supported by the record."

V. Reynoir's arguments against the Commission's finding of liability are limited to conclusory denials (e.g., Br. 7, 13-14) and a lengthy footnote in which he struggles to extricate himself from his admission that he knew in September 1993 about the prior three months' false confirmations (see Br. 20 n.24). He

completely ignores the evidence in the record consistent with that admission. See p. 17, supra.

With regard to his admission, V. Reynoir claims (Br. 20 n.24) that "some of [his] testimony" before the NASD was "terribly garbled." In fact, his testimony is clear (Tr. 355):

> Q It was your understanding in September of 1993 that those three months' worth of transactions had been mischaracterized as agency transactions; is that correct?
>
> A That is correct.

Contrary to V. Reynoir's elaborate rationalizations on appeal, the "time about which [he] was speaking" (Br. 21 n.24) is clear, not only from the above question but from the next ones. "And some eighteen months later or sixteen months later, again on the * * * instructions from Mr. Reichman, did you go ahead and recharacterize them at that time as principal transactions?" NASD counsel asked. Tr. 355. In responding, V. Reynoir again referred back to September 1993. Id. Next, NASD counsel pressed him to explain "why did the firm continue to characterize all of its transactions with the State as agency transactions without disclosing the commission for another thirteen months?" Tr. 355-56. At that point, Reynoir did not deny that he was involved as early as 1993; rather, he stated, "Look, I was not day to day that involved with this." Tr. 356 (emphasis added). Then he sought refuge in generalities and heated denials that the Firm had done anything wrong. Id. His continuing to testify in that manner in "the ensuing discussion," see Br. 20 n.24, does not

detract from his unequivocal admission that he knew in 1993 that three months of transactions were mischaracterized.

V. Reynoir's suggestion (id.) that he may have been confused when testifying does not withstand scrutiny. On the question by NASD counsel immediately preceding the one about his knowledge as of September 1993, V. Reynoir showed that he was fully capable of asking for clarification of a question ("I'm sorry; repeat that. I didn't quite understand," Tr. 353) and rejecting what he perceived to be any mischaracterization of the facts ("That's not correct. That's not correct at all," Tr. 354). Contrary to his assertion (Br. 20 n.24), at no point before or during his direct- or cross-examination by counsel did the hearing panel ask him about anyone else's testimony. See Tr. 344-59. 18/ If his testimony about his knowledge as of 1993 had been "terribly garbled," his counsel had every opportunity on re-direct to

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18/ V. Reynoir's counsel makes the unsupported assertion (Br. 20 n.24) that "[a]bout midway through the proceedings, the structure of the hearing broke down completely and the hearing panel asked undersigned counsel and everyone of Respondents' witnesses to comment on what every other witness had said." This appears to refer to a panel member's question asked toward the end of the hearing, after all of the witnesses, including V. Reynoir, had been examined by counsel. See Tr. 399. It is hardly an accurate description of the resumption of questioning by petitioners' counsel and follow-up questions by the panel that ensued. See Tr. 399-432. Indeed, when petitioners' counsel was asked after his closing statement, addressed to the merits of the case, for "any comments" his clients "may desire to make regarding the fairness of the hearing process" and whether they "had a reasonable opportunity to present [their] arguments and evidence," he replied, "No statement. No further statements." Tr. 456-57. Not until their appeal to this Court have petitioners asserted that there was a "br[eak] down" in "the structure of the hearing."

correct it, but made no effort to do so. See Tr. 365-66. V. Reynoir's arguments, like G. Reynoir's, are completely meritless.

The Commission's findings of violations by the petitioners are supported by substantial evidence.

II. THE COMMISSION DID NOT ABUSE ITS DISCRETION IN DECLINING TO CONCLUDE THAT THE SANCTIONS WERE "EXCESSIVE OR OPPRESSIVE."

The Commission's affirmance of the sanctions imposed by the NASD is neither arbitrary nor "a gross abuse of discretion." See Amato v. SEC, 18 F.3d 1281, 1284 (5th Cir. 1994). Petitioners admit (Br. 9, 15) that "for a significant period of time" the Firm "systematically generated" hundreds of false confirmations and made no effort during that period to correct them. The Reynoirs were responsible for these violations. "Given the scope and magnitude of the violations," the Commission did not hold that the sanctions were "excessive or oppressive." Op. 8-9.

The scope of judicial review of sanctions under the "excessive or oppressive" standard, Exchange Act Section 19(e)(2), 15 U.S.C. § 78s(e)(2), is limited. Under Section 19(e)(2), self-regulatory organizations like the NASD have wide discretion in disciplining their members. 19/ Moreover, as

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19/ See Donald William Collins, 46 S.E.C. 642, 647 (1976) ("'Self-regulation' or 'cooperative regulation' cannot function adequately unless the securities industry's self-regulatory bodies are vested with an authority commensurate with their responsibilities.") (citation omitted); Remmele, 45 S.E.C. at 435 ("The issue before us is not whether we would have imposed the identical sanctions of censure, suspension and fine imposed by the NASD, but whether such sanctions are excessive or oppressive, having due regard to the public interest.").

this Court recognized in Whiteside & Co. v. SEC, 557 F.2d 1118, 1120 (5th Cir. 1977):

> The SEC is the agency mandated by statute to review the imposition of disciplinary sanctions by self-regulatory organizations such as NASD, 15 U.S.C.A. § 78s(d), and we should not undermine its role by a grudging interpretation of the legislation. This is particularly important in an area of expertise as intricate as the securities field where public interest and public image are very important.

Petitioners have limited the sanctions that are subject to review here, contesting only the fine and suspensions (see Br. 2-3 n.1).

The $60,000 fine and the other sanctions are fully justified by the seriousness and extent of the violations. The Firm charged the Commissioner approximately $500,000 in markups without properly disclosing the capacity in which it acted. Instead, the Firm created and distributed false confirmations for many months in connection with numerous transactions. The Firm took liberties with the confirmations that extended to misstating the capacity in which it acted, misstating the dollar prices of securities, and shifting the commission amounts shown on the tickets over to the confirmations to FNBC.

In engaging in these activities, petitioners, who are experienced securities professionals (Tr. 13-14), showed concern for HS&R's capital position, but disregarded the best interests of the customer and their regulatory responsibilities. 20/

20/ Petitioners, in hindsight, dismiss concern for the Firm's capital position as "imagined" (Br. 30), but they believed that by trading with the estates as principal HS&R put (continued...)

Indeed, petitioners limited their efforts to confirm the capacity in which the Firm acted to requests from Reichman. 21/

As the Commission has explained, sanctions, including fines, suspensions, and requalifications, "serve[ ] to impress upon [broker-dealers] the importance" of regulatory compliance and reeducate them about their responsibilities to the investing public. See Cost Containment, 59 S.E.C. Dkt. at 1066; Protective Group, 51 S.E.C. at 1242; Remmele, 45 S.E.C. at 433-35. "The public interest requires that appropriate sanctions be imposed to secure compliance with the rules, regulations and policies of both NASD and SEC." Boruski v. SEC, 289 F.2d 738, 740 (2d Cir. 1961); see Lowell H. Listrom & Co. v. SEC, 803 F.2d 938, 941 (8th Cir. 1986) (noting in Rule 10b-10 case the need "to promote disclosure of information, protect the investing public, and facilitate compliance"). The Commission did not abuse its

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20/(...continued)
itself at risk of loss and occasionally did sustain losses. E.g., Tr. 378-79. According to G. Reynoir, "You can buy in the Government market, you can take a position in Governments and an hour later lose your shirt because something happens and the market falls out of bed." Tr. 322. There is no evidence that petitioners made any effort to locate Doskey, the former FINOP who had raised the concern about impairment of the Firm's capital position, or to request his appearance at the hearing (in person or, as with another witness, by telephone, see Tr. 22-23, 54-56).

21/ In September 1993, petitioners failed to correct hundreds of false confirmations simply because Reichman said, "let sleeping dogs lie." Even after preparing corrected copies for some trades at Reichman's request in 1995, petitioners chose not to submit those confirmations because Reichman told them not to. According to G. Reynoir, HS&R never provided the state with proper documentation of the remaining 173 trades because no one asked for it (Tr. 358).

discretion in determining that the sanctions served those purposes here.

This is no mere "recordkeeping matter" or "failure to keep correct records," as petitioners claim (Br. 31, 34). In the only written statements they issued to the Commissioner for the 453 trades between July 1993 and October 1994, they misrepresented the capacity in which the Firm acted. Beach, and presumably his superiors at the Insurance Department, believed the confirmations to be correct (see Tr. 303). Therefore, contrary to petitioners' assertion that "the Department was never, ever deceived" (Br. 31), petitioners either deceived the Department about the capacity in which the Firm was acting or about the correctness of HS&R's confirmations of the trades. The Commission properly distinguished (Op. 5-6 n.11) violations of Rule 10b-10 from violations of recordkeeping provisions like Rules 17a-3 and 17a-4, involving the failure to make or maintain copies of records.

In contesting the sanctions, petitioners attempt to divert attention from the way in which they handled the confirmations to the supposed lack of consequences of their conduct. Petitioners argue that the sanctions "should be significantly reduced" because, in their view, "the substance and form of the transactions at issue were clearly communicated to, and understood by, the customer" and "the conduct at issue caused no injury or loss to anyone" (Br. 1, 17, 31).

These assertions, even if true, do not change the central fact that petitioners disregarded their duties as securities

professionals. HS&R was responsible for complying with Rule 10b-10 regardless of whether the Department knew enough or cared enough about the capacity in which the Firm executed the trades (see Br. 17-18, NBCC Br. 19); received the investment return to which it was entitled under the Contract (see Br. 18, 19, 32-33); or could have learned from someone else the capacity in which HS&R was executing trades (see Br. 10 & n.18, NBCC Br. 5-6). See Armstrong, 421 F.2d at 363; Remmele, 45 S.E.C. at 433; Bison, 51 S.E.C. at 333 n.20 (broker-dealers "cannot shift their responsibility for compliance with our requirements" to other firms); Lowell Niebuhr & Co., 18 S.E.C. 471, 478 (1945) ("we can give no weight to the [firm's] argument that no one was injured by the falsification of its ledgers and financial statement").

In any event, it is not true, as petitioners assert (Br. 18, 19, 32-33), that "the substantive purposes of Rule 10b-10 were, at all times, fulfilled" (Br. 1). Harm was done. The state did not receive accurate, regular, contemporaneous documentation of its transactions. The Firm issued false documents in connection with numerous transactions. Because petitioners failed to investigate and correct the false confirmations, the true facts regarding the trades were not established until long after they occurred, as a result of outside investigations and disciplinary proceedings. See p. 21, supra. Notwithstanding petitioners' assertion that the state benefited from these trades (e.g., Br. 18), they have not shown that the state paid less for principal trades than it would have paid for agency trades or that the

long-term return on HS&R's investments made HS&R's choice of capacity worthwhile for the state. See nn. 6, 13, supra.

Petitioners' assumption that information was "clearly communicated to, and understood by, the customer" (Br. 1, 17) is not established by the record. In promulgating Rule 10b-10, the Commission determined the manner in which information should be communicated in order to "ensur[e] full and fair disclosure to investors of the substance of the transactions effected by their brokers." Op. 8 n.16. There is no evidence that petitioners or anyone else conveyed the required information to the Commissioner in writing contemporaneously with any trade.

Indeed, to the extent petitioners disclosed the information at all, they disclosed it "in a manner that results in the facts being * * * obtusely or cryptically communicated," not "clearly and intelligibly communicated." Cant v. A.G. Becker & Co., 374 F. Supp. 36, 46 (N.D. Ill. 1974). Apparently, petitioners contend that they told Reichman one thing orally and represented something else to the Commissioner in writing through agency confirmations with and then without commissions showing. This is a formula for confusion, not clarity. See C.A. Benson & Co., 42 S.E.C. 107, 109 (1964) (a principal confirmation showing a commission "is contradictory and tends to confuse customers as to the broker-dealer's capacity, as well as the nature and extent of his compensation in the transaction").

Petitioners claim (Br. 17 n.22) that "dozens of pieces of evidence" support their assumption that the Insurance Department

knew the capacity in which the Firm acted, but fail to specify how or when the Department supposedly learned the relevant facts of any particular transaction. 22/ Their assumption that it knew that HS&R was executing trades as principal is undermined by their own contention (Br. 9-10, 18, 29) that, other than Reichman in September 1993, "[n]o one from the Department ever complained" about the Firm's agency confirmations. Their only "evidence" (see Br. 17-18) appears to be Bickerstaff's testimony about conversations with Reichman concerning investment opportunities and Beach's testimony about what others supposedly knew.

With regard to Beach, the NASD hearing panel determined (DBCC Op. 9) that "based on his own testimony, we are not persuaded that Beach understands the distinction between a firm acting in a principal capacity and an agency capacity." If Beach did not understand the distinction himself, he certainly could not testify with authority about anyone else's understanding. 23/ In fact, Commissioner Brown's statements contradict Beach's belief that the other money managers acted as agents.

22/ Certainly, it was not from the monthly reports by Hancock Bank or Reichman, which do not discuss HS&R's role in executing trades. See, e.g., nn. 5, 6, supra. FNBC had no contact with the Insurance Department regarding HS&R's trades. See Tr. 75, 79, 153. Exhibit 43, cited by petitioners below (NBCC Br. 11), is merely a record of one specially authorized trade that names HS&R as "broker."

23/ Beach, for example, mistakenly asserted (see Tr. 284-85) that the other three money managers acted in an agency capacity, when in fact they did not execute trades at all. See n. 4, supra. Beach himself was uncomfortable (see Tr. 282-85) with his inability to explain the fact that these managers received no markups or commissions. Petitioners accept (Br. 6) Beach's mistaken testimony as fact.

See p. 19, supra. With regard to Bickerstaff, in none of the Bickerstaff testimony cited by petitioners (Br. 17 n.22) does Bickerstaff ever state that he discussed with Reichman on a trade-by-trade basis the capacity in which HS&R was acting. In any event, petitioners' reliance on Reichman (Br. 10, 17) is dubious given evidence that in another matter Reichman withheld information from the state, solicited bribes, and did not act in the state's best interests. 24/

Petitioners also attempt to support their assumption about the Insurance Department's knowledge by asserting (Br. 32) that the Department is "a very-sophisticated customer." But earlier in this litigation they referred (NBCC Br. 4) to the Department as in need of "professional advice for the investment of [the] estates' funds" and having, on its own, "ma[de] inexpert investment decisions." In their earlier brief (id. at 19), they also asserted that "the Commissioner's office was concerned only about 'the bottom line'" and that "[t]he investment program was analyzed for the rate of return earned by the money managers." None of this changes the fact that HS&R and the Reynoirs were the securities professionals responsible for compliance with Rule 10b-10 and that they disregarded those responsibilities.

24/ As noted, p. 12, supra, during the same period on another contract, Reichman engaged in a "scheme to defraud and to obtain money and to deprive the [Department] of the right to [his] honest services * * * by means of false and fraudulent pretenses and representations." See NASD Ex. 11, p. 3; Tr. 37. The Reynoirs' counsel acknowledged at the hearing that "Mr. Reichman is compromised. We know that." Tr. 448.

Contrary to petitioners' further contention (Br. 32-34), the sanctions are fully consonant with the NASD Sanction Guidelines. Petitioners err by mischaracterizing (Br. 31, 34) this misrepresentation case as a "recordkeeping matter," see p. 39, supra; failing to recognize (see Br. 32-33) that the Guidelines do not specify required sanctions but merely provide a "starting point" in their determination, Op. 9 n.17 (citing cases); 25/ and misreading (see Br. 31-32) specific guidelines.

Under the NASD Sanction Guidelines (1996) at 34, in a misrepresentation case, a fine of up to $50,000 could be imposed not only on the Firm but also on each of the two responsible individuals. This refutes petitioners' claim that a joint-and-several $60,000 fine on HS&R and the Reynoirs is excessive.

Moreover, on appeal, the NASD reduced the original fine of $250,000, intended to approximate the Firm's profits on the relevant transactions. See NBCC Op. 2 n.1, 12. In reducing the fine, the NASD considered factors urged by petitioners, such as lack of a disciplinary history. See id. at 9, 12. Petitioners may contend that the Firm is unable to pay the fine (see Br. 35), but they do not claim that the Reynoirs are unable to pay it or that petitioners are unable to execute promissory notes and pay over time. See Op. 7-6 n.14. 26/ Given these facts,

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25/ Sanctions depend on the facts and circumstances of each case. See Butz v. Glover Livestock Comm'n, 411 U.S. 182, 187 (1973).

26/ The letter transmitting the initial NASD decision to petitioners provided that the fine could be paid in installments over a three-year period. R. 1071.

petitioners' assertion that "[t]he sanctions are tantamount to a death penalty for the firm" (Br. 35) seems exaggerated. 27/

Similarly, the Reynoirs' 30-day suspensions comport with the Guidelines. The Guidelines provide (at 34) that "[w]here aggravating factors exist, [the NASD may] consider suspending individuals and/or firm for a longer duration" than 60 business days. Thus, the Reynoirs' 30-day suspensions fall well within the range of possible suspensions for misrepresentation.

The Reynoirs incorrectly suggest (Br. 32) that the general guideline for suspensions "[w]here aggravating factors are present" is somehow limited by a more specific guideline, set forth in a separate paragraph, for suspensions "[w]here materially inaccurate statements (or omissions) were negligently made and substantial loss resulted." Unlike the more specific guideline, however, the general "aggravating factors" guideline is not restricted to any particular factor and encompasses any of those factors listed under "Principal Considerations In Determining Sanctions." Such considerations include the "[n]umber of misrepresentations or material [omissions]" and "[o]ther aggravating * * * factors." Guidelines at 34. In addition, the Reynoirs fail to note that the NASD did not suspend

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27/ Petitioners first made this assertion almost three years ago in their September 1995 Answer to the NASD Complaint, where they referred to declining business and asserted "[i]f this condition persists for long, HS&R will have to close its doors." NASD Ex. 2, p. 13. At the hearing, G. Reynoir attributed the decline to "adverse publicity" and the state of the bond market. Tr. 319. Petitioners' brief indicates (Br. 3 n.1) that to date, HS&R has been able to withstand these adversities and remain in business.

HS&R and that, by specifying that the Reynoirs' suspensions not run concurrently, minimized disruption to the Firm.

For all of these reasons, the sanctions imposed should be upheld. 28/

CONCLUSION

For the foregoing reasons, the order of the Commission should be affirmed.

Respectfully submitted,

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28/ The cases cited by petitioners in opposition to the sanctions bear no resemblance to this case. See Hateley v. SEC, 8 F.3d 653, 656 (9th Cir. 1993) (reducing disgorgement amount to the extent it "duplicat[ed] the amount that [person splitting fees with petitioners] was required to surrender"); Arthur Lipper Corp. v. SEC, 547 F.2d 171, 184-85 (2d Cir. 1977) (citing "special circumstances," including subsequent abolition of practice at issue, "considerable uncertainty as to the regulatory climate concerning" it before abolition, "the supervision of experienced * * * counsel," and "the inordinately long time in which this proceeding has been pending"); Beck v. SEC, 430 F.2d 673, 674 (6th Cir. 1970) (noting that violation occurred "when [petitioner] was inexperienced in the securities business and was working under the supervision of men who were later adjudged guilty of criminal fraud").

CERTIFICATE OF SERVICE

I hereby certify that on this 24th day of August, 1998, I caused two copies of the attached Brief of Respondent Securities and Exchange Commission to be served by Federal Express overnight delivery service on counsel for the petitioners, Charles E. Hamilton III, Lamothe & Hamilton, Pan American Life Center, Suite 2750, 601 Poydras Street, New Orleans, LA 70130, 504/566-1805, and the original and seven copies of the Brief to be served by Federal Express on the Clerk of Court.

Luis de la Torre
Attorney

CERTIFICATE OF COMPLIANCE

Pursuant to 5th Cir. R. 32.2.7(c), the undersigned certifies that this Brief of Respondent Securities and Exchange Commission complies with the type-volume limitations of 5th Cir. R. 32.2.7(b).

1. EXCLUSIVE OF THE EXEMPTED PORTIONS IN 5TH CIR. R. 32.2.7(b)(3), THE BRIEF CONTAINS: 11,722 words of text.

2. THE BRIEF HAS BEEN PREPARED: in monospaced (nonproportionally spaced) typeface using WordPerfect 5.1, Courier 12pt font, with 10 characters per inch.

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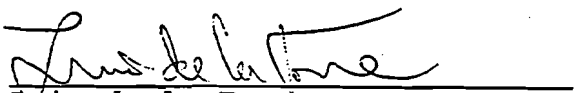

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