

Legal: Selling Away Your License

David E. Robbins

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Engaging in an outside business activity puts your career at risk. Why? Because your firm will be on the hook if things go wrong.

Let's start with this assumption: You're not a modern day Charles Ponzi, engaging in nonexistent securities transactions or business ventures, promising great returns and achieving them by robbing Peter to pay Paul. But you have encouraged some friends and relatives—who may not have brokerage accounts with you—to invest in either private placements, a real estate agency or in your soon-to-be-published book, "Gullible Investors."

You believe these ventures to be unrelated to your day-to-day responsibilities as a broker. Therefore, you have not advised your firm of them.

Engaging in an outside business activity puts your career at risk. Why? Because your firm will be on the hook if things go wrong.

As bad luck will have it, the private placements that invested in a trendy business venture soon fail. Your real estate agents become franchisees of a competitor. And too few readers are gullible enough to buy your book.

The friends and relatives who invested are upset. Some are mad enough to sue you.

You can't believe what you discover next: The investors in your failed ventures cite court cases that, under the law, make them customers of your firm despite never having an account there.

Once in arbitration, the attorney for the "customers" argues that since the firm clothed the broker with the "apparent authority" to engage in these outside business activities, the firm is liable for the broker's acts. The attorney cites the agency law theory of "respondent superior," which makes employers liable for actions of employees, including independent contractors.

Why Outside Businesses Can Kill Careers

Under agency law, an investor claiming this apparent authority on the part of the broker must prove that he or she exercised reasonable reliance on the broker's representations. Reliance by itself isn't sufficient. A blind confidence or trust won't give rise to apparent authority under the law.

It must be a reliance based on good faith and made in the exercise of reasonable prudence. The question arbitrators ask, after it's clear the person relied on the broker's representations, is this: Under all the circumstances, was the person justified acting as a reasonable man, in believing the broker acted on the authority of the brokerage firm?

The firm will attempt to cut itself loose from the case. It will argue it had a reasonable supervisory system in place designed to prevent selling away and to monitor outside activities. It will attempt to show that the branch manager implemented these internal rules in a reasonable manner. If it can show that a reasonable (not perfect) supervisory system was implemented, the firm has a safe harbor.

If a broker did not get prior written approval from the firm to engage in outside business activities or private securities transactions (NASD Rules 3030 and 3040), this will increase the chances of the broker alone being liable for an arbitration award. If the broker did get such approval, the firm may also be liable.

So be forewarned: Any kind of outside business activity puts your career as a broker at risk. If "customers" of an outside venture complain, the firm will put the blame on you. You may indeed be the one at fault under the law. The firm may have no choice but to fire you and disclose that your termination was the result of unreported outside business activity and selling away.

And having that kind of disclosure on your record could end your career.

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NASDR Pursues Hubby/Wife in Selling Away Case

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A Michigan broker is in trouble with NASDR for allegedly "selling away" from his firm. Although his lawyer won't identify him, the case involves a broker who referred a customer to his wife--who is a broker at another firm, according to the husband's attorney, Walter Baumgardner Jr. of St. Clair Shores, Mich.

The problem, according to the NASDR, was that the wife deposited the commission she got on a \$28,000 trade into a joint checking account she shared with her husband. The husband didn't do the trade because the investment, a tax-credit partnership from City-Equity Group, was not approved by his firm.

The trouble began when Citi-Equity, a Los Angeles firm that has raised more than \$80 million to build low- and moderate-income housing, turned out to be a fraud and its principal, Gary Lefkowitz, was convicted and sentenced to 293 months in jail.

The clients, who lost most of the \$28,000 they invested with Citi-Equity, sued Baumgardner's client in court and complained to the NASD. The NASDR now claims the husband/broker "sold away" from his firm because the commission was deposited into the joint checking account. The regulator wants to ban the broker for life from the securities industry, Baumgardner says.

The man's wife, meanwhile, has given up her license, Baumgardner claims.

A ruling from the NASD's district business conduct committee in Chicago was expected around press time in November, but had not yet been released. The ruling could have wide-ranging implications.

"It must be the position of the NASD that any broker who puts money into a joint checking account with a wife [or husband] is splitting commissions with a non-registered person," Baumgardner cracks.

Seriously, Baumgardner says independent brokers who share office space and expenses, or refer clients to one another, also could be accused of selling away.

"I'm amused by the position of the NASD, but at the same time it's very serious," Baumgardner says.

Arthur Don, a Chicago securities lawyer, said he thinks the NASDR views the case as one in which the broker got around the fact that his firm didn't sell the Citi-Equity partnership, and directed the trade to his wife.

"I think the NASD wouldn't have pushed if [the couple] had an existing relationship with the wife," Don says. "But here they have a relationship with a broker who can't sell it." The wisest thing, Don says, would have been to direct the trade to another broker. The NASDR declined to comment on the case.

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