STATE OF NEW JERSEY
DEPARTMENT OF LAW & PUBLIC SAFETY
DIVISION OF CONSUMER AFFAIRS
NEW JERSEY BUREAU OF SECURITIES
OAL DKT. NO. BOS 1796-02

IN THE MATTER OF: **CLEARING SERVICES OF AMERICA, INC.** **JEFFREY P. CAHN,** **ESTATE OF LOUIS R. MERCALDO,** **RACHEL E. NEUFELD,** **WILLIAM SCHANTZ, and** **GERARD SHERLOCK**	:	Administrative Action **FINAL DECISION AND ORDER ADOPTING THE OAL PARTIAL SUMMARY DECISION WITH AMENDMENTS**

BEFORE FRANKLIN L. WIDMANN, CHIEF
NEW JERSEY BUREAU OF SECURITIES

This matter is before Franklin L. Widmann, Chief of the New Jersey Bureau of Securities (hereinafter "Bureau Chief"), Division of Consumer Affairs, to review the March 15, 2004 Partial Summary Decision (the "Order") of Administrative Law Judge (hereinafter "ALJ") Stephen G. Weiss in this matter, and to render a Final Decision pursuant to N.J.A.C. 1:1-12.5(e). On April 28, 2004, the Bureau Chief signed an order, which was amended as to form at the request of the Office of Administrative Law by an order dated May 4, 2004, and which was subsequently approved by the Acting Director of the Office of Administrative Law pursuant to N.J.A.C. 1:1-18.8(e), extending for 30 days the time for filing this Final Decision to no later than June 2, 2004. A second extension order was signed by the Bureau Chief on May 27, 2004, due to a delay in transmission of the case file for review, and the second order of extension was approved by the Director on June 15, 2004, extending the time to file this decision to no later than July 2, 2004.

Based upon a thorough review of the Initial Decision and of the entire record:

IT IS on this 16th day of June, 2004, ORDERED that:

The Partial Summary Decision of Administrative Law Judge Stephen G. Weiss in this matter, dated March 15, 2004, is affirmed for the reasons set forth therein with the following amendments:

The findings of fact not materially in dispute made by the ALJ in the Order are adopted, except to note from the clear progression of the findings that finding #25 contains a clerical error with regard to the "remaining five items" drawn from finding of fact #23. The remaining five items are (a), (c), (d), (e) and **(g)**; not "(f)," as it currently reads. Item (f) from finding #23 was addressed by the ALJ in finding #24, and was therefore not a "remaining" item for the purposes of finding #25. The fact that this was merely a clerical error is confirmed by its repetition in finding #27, wherein "the fact that the notes were guaranteed" is labeled as item "(f)," when this precise description was designated "(g)" in finding #23, in which all of the letter designations were originally assigned.

All of the ALJ's findings of fact, and in particular those numbered #28 through #55, clearly illustrate the failure of Respondent Cahn and Respondent Clearing Services of America, Inc. to "reasonably supervise" the Respondent-Agents, as required by N.J.S.A. 49:3-58(a)xi. The statute provides that the Bureau Chief may suspend or revoke any registration if he finds that the registrant: "(xi) has failed reasonably to supervise: his agents if he is a broker-dealer or issuer; the agents of a broker-dealer or issuer for whom he has supervisory responsibility; or his employees who give investment advice if he is an investment adviser." Id.

In New Jersey, reasonable supervision requires at least that those with supervisory responsibilities: 1) adhere strictly to the compliance procedures that they or their employers themselves have set up to prevent improper activities; 2) respond in a reasonable manner to so-called "red flags" which suggest improper activities by those being supervised; and 3) exercise particular vigilance when indications of irregularity do come to their attention. These fundamental components of reasonable supervision in the securities industry are illuminated by the determinations of the S.E.C. in the matters

cited by staff. In the Matter of Nicholas A. Boccella, 42 S.E.C. Docket 1388, File No. 3-7149, February 27, 1989; In the Matter of J.B. Hanauer & Co., et al., 70 S.E.C. Docket 1131, File No. 3-999, September 2, 1999; In the Matter of the Application of Shearson Lehman Hutton Inc., et al., 49 S.E.C. 1119, Release No. 34-26766, April 28, 1989. Although the ALJ did not expressly apply these fundamental components of reasonable supervision to his findings of fact in his discussion, it is patently evident from his findings of fact that the ALJ viewed Respondent Cahn and Respondent Clearing Services of America, Inc. to have failed in their supervisory responsibilities. The Bureau therefore amends the Order to expressly provide that the facts found by the ALJ in this case demonstrate that Respondent Cahn and Respondent Clearing Services of America, Inc. failed to reasonably supervise the Respondent-Agents by failing to meet the three basic components of reasonable supervision set out above, contrary to N.J.S.A. 49:3-58(a)xi.

The Bureau of Securities specifically adopts the legal conclusions of the ALJ in the Order, and in particular his conclusions that the notes in question are securities, regardless of whether the analysis employed to reach that conclusion is patterned upon the tests elucidated in S.E.C. v. W.J. Howe Co., 328 U.S. 293 (1946), or in Reves v. Ernst & Young, 494 U.S. 56 (1990), and that the notes were not exempted from registration requirements pursuant to N.J.S.A. 49:3-50(a)10. These are the only conclusions that can be reached consistent with the legislative scheme embodied in the entire Uniform Securities Law, 1997, N.J.S.A. 49:3-47 to -76, of this state. The fact that the meaning of the term "commercial paper" as used in N.J.S.A. 49:3-50(a)10, is informed by the substantial body of federal case law and by S.E.C. Release No. 33-4412, 26 Fed. Reg. 9158 (1961) as cited by the ALJ, does not render that meaning contrary to state legislative intent in New Jersey. It is, to the contrary, in complete accord with the expressed policy of our statute that it be construed to effectuate its general purpose to make uniform the law of those states which enact similar laws, and to co-ordinate its interpretation and administration with related federal regulations. N.J.S.A. 49:3-75.

In New Jersey, as in a number of other states, the commercial paper exemption requires that the commercial paper be of prime quality, and of a type sold only to highly sophisticated investors. See People v. Dempster, 242 N.W.2d 381 (Mich 1976); Tanner v. State Corp., Comm'n, 574 S.E. 2d 525 (Va 2003); Joseph C. Long, 12 Blue Sky Law § 6:46 (2001). The ALJ was completely correct when he concluded that: "[a] literal interpretation [of the exemption] clearly would frustrate the salutary purposes of the New Jersey Act to prevent fraud by regulating the marketing and sale of securities to the public. The exemption, ... must be read to further, not obstruct, those purposes." [Order at 25].

Moreover, any presumption that they are commercial paper, emanating solely from the nine-month term of the notes in this case, is rebutted by the ALJ's findings of fact with regard to the failure of the notes to meet the other essential requirements of genuine commercial paper. Specifically, findings 1, 4, 5, and 14 negate the notion that the notes were of prime quality and of a type sold only to sophisticated investors. The burden of proving these essential requirements is, and has always been, on the persons claiming the exemption. N.J.S.A. 49:3-50(d).

For all of the foregoing reasons, the Bureau of Securities adopts the Order of March 15, 2004 as amended herein and for the reasons set out in the Order itself.

NEW JERSEY BUREAU OF SECURITIES

BY: Franklin L. Widmann

Franklin L. Widmann, Chief