BEFORE THE NATIONAL BUSINESS CONDUCT COMMITTEE

NASD REGULATION, INC.

In the Matter of District Business Conduct Committee For District No. 1, Complainant, vs. L.H. Alton & Company San Francisco, California and Lewis Hunt Alton c/o L.H. Alton & Company San Francisco, California, Respondents.	DECISION Complaints Nos. C01960003 and C01960024 District No. 1 Dated: December 17, 1997

L.H. Alton & Company ("LHAC" or "the Firm") and Lewis Hunt Alton ("Alton") have appealed the June 20, 1997 decision of the District Business Conduct Committee for District No. 1 ("DBCC") pursuant to Procedural Rule 9310 of the NASD's Code of Procedure (now superceded)[1]. We hold that LHAC and Alton violated Membership and Regulation Rules 1020, 1030, and 1120 (formerly Schedule C of the Association's By-Laws) and Conduct Rules 2110 and 3010 (formerly Article III, Sections 1 and 27 of the Rules of Fair Practice) by: 1) conducting a securities business while maintaining insufficient net capital; 2) filing inaccurate FOCUS I and FOCUS II reports; 3) permitting an unregistered person to act as a representative and principal of LHAC; 4) participating in the underwriting of several "hot issues"

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

without obtaining required information from the purchasers of the hot issues; 5) failing to complete a training needs analysis and to develop written training plans concerning the Firm Element of the Continuing Education Requirements; and 6) failing to maintain written supervisory procedures relating to compliance with Conduct Rule 3070 (formerly Article III, Section 50 of the Rules of Far Practice). In light of our findings, we fine LHAC and Alton $40,000 (joint and several) and impose costs of the DBCC hearing (joint and several). For LHAC, we impose sanctions of censure, suspension from participating in underwritings for 30 business days, compliance with the independent consultant requirement, and costs of our hearing. For Alton, we impose sanctions of censure, suspension in all principal capacities for 30 days and, thereafter, suspension from acting in any principal capacity until an independent consultant acceptable to the District staff is designated to prepare a report on LHAC's supervisory and compliance procedures, and requalification by examination.

Background

LHAC has been a member of the NASD since February 14, 1985. LHAC is a limited partnership and Alton is its general partner. Alton first entered the securities industry in September 1971. Alton has been registered with the Association as, among other things, a general securities principal and a financial and operations principal ("FINOP"). Alton's registrations remain effective and LHAC is currently an Association member.

Facts

Complaint number C01960003 arose from an NASD review and subsequent investigation of LHAC's participation in the selling of three public offerings. On February 23, 1995, LHAC participated in a public offering by selling 4,000 shares of Toy Biz, Inc. ("Toy Biz") stock. LHAC sold Toy Biz to the following entities: Maxim Financial Corporation, CFAM, Horizon Properties, Arista Asset, Omega Partners, Trust Company of America, and Empire Asset. In response to a questionnaire from NASD Regulation, LHAC identified all of these entities as investment partnerships or corporations. On April 11, 1995, LHAC participated in a public offering by selling 4,500 shares of Expert Software, Inc. ("Expert Software") stock to Empire Asset, Horizon Properties, Omega Partners, Maxim Financial Corporation, Bonnell, and AIM Advisors, Inc. LHAC also identified all of these entities as investment partnerships or corporations. On August 3, 1995, LHAC participated in a public offering by selling 5,000 shares of Moovies, Inc. ("Moovies") stock to Empire Asset. LHAC identified Empire Asset as an investment partnership or a corporation.

District No. 1 filed complaint number C01960003 on January 29, 1996 (the "January Complaint"). Thereafter, District No. 1 filed complaint number C01960024 against LHAC and Alton on October 14, 1996 (the "October Complaint"). The October Complaint arose from an investigation following a periodic examination of LHAC, conducted in February of 1996. Both respondents agreed to have the two complaints consolidated into one proceeding.

Net Capital and FOCUS Reports. The Securities Exchange Act of 1934 ("Exchange Act") Rule 15c3-1(a) required LHAC to maintain minimum net capital of $100,000 during December 1995 and January 1996. From December 29, 1995 through January 3, 1996, LHAC claimed as part of its net

capital a $100,100 asset, which was a check that Alexander Lushtak ("Lushtak") deposited on December 29, 1995 at TransPacific National Bank. On November 7, 1995, Lushtak opened bank account number 02-214296 at TransPacific National Bank (the "TransPacific Account") in the name of LHAC. Lushtak was not a principal and was not an employee of LHAC. He had earlier in 1995 negotiated with Alton to purchase an interest in LHAC, but the negotiations failed to result in an agreement. Although this account was in LHAC's name, Lushtak signed the initial account agreement and had authority to withdraw funds from the account. The address listed on the November 7 TransPacific account agreement was Lushtak's office in San Francisco, not LHAC's address.

Alton signed a second account agreement for the TransPacific Account on November 8, 1995. Alton also listed the account name as LHAC but provided LHAC's office address. After Alton signed this second agreement, either Alton or Lushtak could withdraw funds from the account. On December 29, 1995, a check for $100,100 drawn from the account of A & A Financial Management, Lushtak's company, was deposited into the TransPacific Account. On January 2, 1996, Lushtak withdrew $100,000 from the TransPacific Account.

After December 31, 1995, Alton filed -- on behalf of LHAC -- a FOCUS I report for the month of December 1995 stating that LHAC had net capital of $172,000. On January 21, 1996, Alton filed a FOCUS II report for the quarter ending December 31, 1995 making the same statement.

Registration Status of James Fuller. During 1995, LHAC employed James Fuller ("Fuller"). Fuller began visiting LHAC's office in the Spring of 1995, in anticipation of Fuller joining the Firm as part of a restructuring. Alton's intention was to register Fuller as a principal of LHAC. Fuller previously had been registered with another member firm as a general securities principal. In response to requests from LHAC, NASD Regulation mailed Alton two Central Registration Depository ("CRD") reports, dated July 11 and August 5, 1995, that showed that Fuller's applications for registration were deficient. Although Fuller had taken the required examinations for NASD general securities principal and general securities representative, he had not complied with the fingerprint card requirement and was missing an employment date on his Uniform Application for Securities Industry Registration or Transfer ("Form U-4"). Fuller's state registrations were also deficient because he had not taken the series 63 exam. Fuller did not become registered with NASD as a representative and principal of LHAC until August 22, 1995. Before becoming registered, Fuller initialed more than 100 trade tickets at LHAC and worked on the underwriting of a company named AJAY Sports, Inc. ("AJAY Sports").

Free-Riding and Withholding Interpretation. The October Complaint alleges additional violations by LHAC of IM-2110-1 (the "Free-Riding and Withholding Interpretation") arising out of LHAC's participation in selling three additional public offerings in the last four months of 1995. On August 24, 1995, LHAC sold 2,400 shares of Computron Software Inc. ("Computron Software") stock as part of a public offering to Fiduciary Trust International. On October 6, 1995, LHAC sold 9,000 shares of ESS Technology, Inc. ("ESS Technology") as part of a public offering. Among other accounts, LHAC sold shares to West Highland, Concord Asset Management, Morgan Stanley Asset Management, Inc., Weiss, Peck & Greer, Spear Leeds & Kellogg, T. Rowe Price Associates, Inc., Massachusetts Financial Services, Overlook Management Group, Inc. and Merchandising Network, Inc. On December 12, 1995, LHAC sold 2,500 shares of Metatools, Inc. ("Metatools") to Tudor Investment Corporation, Strong

Capital Management, Inc. and Concidine Capital. In response to NASD Regulation's questionnaires regarding these three public offerings, LHAC identified all of these entities as investment partnerships or corporations.

Continuing Education and Written Supervisory Procedures. During the NASD Regulation examination of LHAC in February 1996, examiner Paul Frohan ("Frohan") received a supervisory procedures manual from LHAC in response to his written request, sent before the examination began, that the Firm gather certain documents. This manual contained no written needs analysis or training plans relating to the continuing education requirements of LHAC. The manual also contained no mention of LHAC implementing such training plans.

The manual also contained no evidence of an annual compliance meeting for registered representatives and had an incomplete provision requiring the reporting of all significant regulatory events to the NASD as required by Conduct Rule 3070.

Discussion

Net Capital. Cause one of the October Complaint alleges that LHAC and Alton utilized the instrumentalities of interstate commerce to engage in the securities business while failing to maintain net capital of $100,000 in contravention of SEC Rule 15c3-1. Securities Exchange Act Rule 15c3-1, 17 C.F.R. §240.15c3-1 (hereinafter "Rule 15c3-1"). LHAC and Alton do not dispute that on December 29, 1995 and January 3, 1996, LHAC's minimum net capital requirement was $100,000. LHAC's compliance with the net capital requirement on December 29 hinges on whether the $100,100 in the TransPacific Account qualifies as net capital for LHAC. There is, however, no real dispute that LHAC violated the net capital rule on January 3, because when Lushtak withdrew $100,000 from the TransPacific Account on January 2, LHAC fell below the $100,000 requirement. The discussion that follows analyzes only whether a net capital violation also occurred on December 29, 1995.

Under the net capital rule, a broker/dealer must deduct from its capital assets that are not liquid or readily convertible into cash. In re FundCLEAR, Inc., 51 S.E.C. 1316, 1319 (1994); see Rule 15c3-1(c)(2)(iv). A broker/dealer must have exclusive control over collateral used to secure an otherwise non-allowable asset. FundCLEAR at 1320; see Memorandum to NASD Stating SEC Policy on Joint Deposit Accounts as Liquid Assets, (cited in In re Kirk L. Ferguson, 51 S.E.C. 1247, 1249 n.13 (1994) ("cash held jointly by a sole proprietor of a broker/dealer and his wife in bank accounts would not be considered assets readily convertible to cash by the firm")). Accordingly, we find that a broker/dealer must have exclusive control over a bank account for the funds in that account to qualify as net capital under Rule 15c3-1. Because a firm's ability to obtain such funds from a non-exclusively controlled account is questionable, the firm does not have control over the funds. See Ferguson, 51 S.E.C. at 1249 (personal checks drawn against various lines of credit held jointly by FINOP and his wife were not an allowable asset for net capital purposes because, among other reasons, the lines of credit could be drawn against at any time by FINOP or his wife and, therefore, were not readily convertible into cash).

This case illustrates the purpose behind deducting from a firm's capital funds over which the firm does not have exclusive control. Here, Lushtak withdrew $100,000 from the TransPacific Account on

January 2 without consulting with LHAC. Alton testified that he did not learn of the withdrawal for several weeks. Lushtak, however, withdrew the funds without impediment on January 2. Therefore, we find that LHAC did not have exclusive control over the account and the $100,100 deposit did not qualify as capital. Accordingly, LHAC did not have sufficient net capital on December 29, 1995 and January 3, 1996.[2]

LHAC and Alton argue that the net capital allegation should be dismissed because Alton believed that Lushtak would not withdraw the funds so quickly. Alton testified that he understood that Lushtak would be contributing a total of $250,000 to LHAC and would be making one million dollars available for borrowing. The District No. 1 regional attorney introduced documents authored by Alton that contradicted Alton's explanation. Because we base our finding of a violation on LHAC's lack of control over the funds, we need not resolve the conflicting versions of how long Alton thought the funds would remain in the account. Although Alton claims he acted in good faith in computing the Firm's net capital, intent does not enter into the determination of whether a net capital violation occurred. In re Kirk L. Ferguson, 51 S.E.C. 1247, 1250 n.14 (1994). We agree with the DBCC and find that LHAC and Alton violated the net capital rule on December 29, 1995 and January 3, 1996.

Inaccurate FOCUS Reports. Cause two of the October Complaint alleges that LHAC and Alton filed with NASD Regulation false and inaccurate FOCUS I and FOCUS II reports in that the reports falsely reflected that LHAC had cash of $100,100 and net capital of $172,000 on December 31, 1995, in contravention of SEC Rule 17a-5. Based on our finding of a net capital violation, a finding of liability as to cause two necessarily follows. The FOCUS I and FOCUS II reports filed by Alton for LHAC were materially inaccurate because the reports misstated LHAC's assets by $100,100. In fact, LHAC had only $71,900 in net capital. Consequently, we find that LHAC and Alton violated Conduct Rule 2110 by filing materially inaccurate FOCUS I and FOCUS II reports.

Fuller's Lack of Registration. Cause three of the October Complaint alleges that LHAC and Alton permitted Fuller to act as a representative and a principal of LHAC without being registered with the Association as a representative or a principal. During the time LHAC employed Fuller, but before he became registered, Fuller performed several activities for which he should have been registered.

Membership and Registration Rule 1021(a) requires that all persons engaged in the securities business of a member who are to function as principals shall be registered as such with the Association in the category of registration appropriate to the function to be performed. Similarly, Membership and Registration Rule 1031(a) requires that all persons engaged in the securities business of a member who are to function as representatives shall be registered as such with the Association. The Membership and Registration Rules define the function of a principal as being engaged in the management of the member's investment banking or securities business, including the functions of supervision, solicitation or conduct of business, or the training of persons associated with a member for any of these functions.

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[2] The record showed that LHAC conducted a securities business on these dates.

The record establishes that Alton received the CRD reports that showed Fuller was deficient due to lack of fingerprints and lack of an employment date. The record also establishes that Fuller signed more than 100 order tickets while employed by LHAC, a task that qualifies as supervision of LHAC's securities business. Fuller also signed correspondence as a principal of LHAC while working on the AJAY Sports underwriting, an activity that qualifies as engaging in the securities business of LHAC. Alton argued that he did not authorize Fuller to sign documents as a principal of LHAC and, therefore, this cause should be dismissed. We reject this argument. Once LHAC employed Fuller, Alton became responsible for limiting Fuller's activities so as to prevent him from acting as a principal of the Firm. LHAC and Alton failed to fulfill this responsibility. We agree with the DBCC and find that LHAC and Alton permitted Fuller to act as a principal of LHAC without being registered with the Association as a principal or representative.

Free-Riding and Withholding Interpretation. The January and October Complaints allege that LHAC participated in underwriting public issues that traded at a premium in the secondary market when such secondary trading began ("hot issues"), specifically: Toy Biz, Expert Software, Moovies, Computron Software, ESS Technology and Metatools. Both the January and October Complaints allege that LHAC sold these hot issues to several entities without obtaining information required by the Free-Riding and Withholding Interpretation.

Subsection (f) of the Free-Riding and Withholding Interpretation requires a member firm to obtain, prior to the execution of a sale of a hot issue to an investment partnership or corporation, documentation showing whether any restricted persons have an interest in the investment partnership or corporation that is purchasing the hot issue. Prior to the execution of such a transaction, the member firm must obtain either: 1) a current list of the names and business connections of all persons having any beneficial interest in the account, or 2) a written representation from a practicing attorney or a CPA stating that such attorney or accountant reasonably believes that no person with a beneficial interest in the account is a restricted person under the Free-Riding and Withholding Interpretation. See IM 2110-1(f).

Subsection (f) also requires member firms to maintain copies of documents satisfying the above requirements for at least three years following the member's last sale of a new issue to the account. The evidence introduced at the DBCC hearing demonstrates that LHAC did not have on file the required documentation for any of the investment partnerships or corporations to which they sold the hot issues listed in the complaints. The record shows that LHAC attempted to obtain documentation satisfying the requirements of the Free-Riding and Withholding Interpretation after NASD Regulation's examiners began investigating LHAC's handling of these hot issues. In all cases, LHAC was attempting to obtain the required information well after it had executed the transactions. Even after these efforts, LHAC was unsuccessful in obtaining any information identifying whether restricted persons had beneficial interests in several of the accounts in question. LHAC's successes and failures in later contacting these accounts is, however, irrelevant to the alleged violation. LHAC did not maintain the required documents for three years after the sales of the hot issues.

LHAC and Alton argue that the definition of a hot issue is vague and should not apply to the public offering of ESS Technology. We find no merit in this contention. The Free-Riding and Withholding Interpretation defines a hot issue as a public offering that trades at a premium in the

secondary market whenever such secondary market begins. IM-2110-1(a). The evidence submitted at the DBCC hearing establishes that each of the six public offerings traded at a premium in the immediate secondary market.

LHAC and Alton also argue that the Firm's employees misunderstood the free-riding questionnaires that NASD Regulation required LHAC to complete and, therefore, the several entities that LHAC incorrectly listed as investment partnerships or corporations should not serve as the basis of a violation. While the DBCC decision does not specifically identify which of the numerous entities it based its finding on, we base our finding of a violation on the following accounts, for which LHAC did not maintain the required documentation: Maxim Financial Corporation, CFAM, Arista Asset, Omega Partners, Empire Asset, Bonnell, West Highland, Concord Asset Management, Overlook Management Group, Inc., Merchandising Network, Inc., Tudor Investment Corporation and Concidine Capital.

We affirm the findings of the DBCC and conclude that LHAC and Alton violated the Free-Riding and Withholding Interpretation as alleged in cause one of the January Complaint and cause four of the October Complaint.

Continuing Education Requirements. Cause five of the October Complaint alleges that LHAC and Alton failed to complete a training needs analysis, failed to develop written training plans, and failed to implement training plans called for by the Firm Element of the Continuing- Education Requirements, in violation of Membership and Registration Rule 1120.

Membership and Regulation Rule 1120(b)(2) provides that each member must maintain a continuing and current education program for its covered registered persons to enhance their securities knowledge, skill, and professionalism. This rule provides that, at a minimum, each member annually shall evaluate and prioritize its training needs and develop a written training plan.[3]

The record supports the finding that LHAC failed to complete a training needs analysis, failed to develop written training plans, and failed to implement written training plans. Examiner Frohan testified that he did not find anywhere at LHAC a training needs analysis or written training plans. Frohan's search included reviewing LHAC's supervisory procedures manual. Alton attempted to explain the lack of these materials by testifying that when Frohan came to his Firm the procedures manual was missing. Alton suspected that a former employee had stolen the manual. Alton also testified that LHAC employee Allan Yeap ("Yeap") typed all required updates to the procedures manual. Yeap's testimony showed, however, that he did not know what a training needs analysis or a written training plan was. In sum, the evidence established that LHAC did not have the required needs analysis, did not have written training plans, and had not implemented training plans. Therefore, we find that LHAC and Alton violated Membership and Registration Rule 1120.

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[3] In Special NASD Notice to Members 95-13 (March 8, 1995), the NASD announced the addition to the NASD By-Laws of continuing education requirements. Included as part of the Notice to Members was an article that discussed guidelines for firm element training. See also Notice to Members 95-86 (October 1995).

Although the DBCC made a finding that LHAC and Alton violated Membership and Registration Rule 1120 as alleged in cause five, the DBCC did not sustain that cause because, in its view, a first-time violation of the rule should not result in formal disciplinary action. We disagree. We do not consider first-time violations of this rule to be trivial. Consistent with our finding of a violation, we will impose appropriate sanctions pursuant to the NASD Sanction Guidelines.

Failure To Maintain Written Supervisory Procedures and Hold Compliance Meetings. Cause six in the October Complaint alleges that LHAC failed to establish written supervisory procedures for reporting significant regulatory events to the NASD as required by Conduct Rule 3070, failed to establish written supervisory procedures for the reporting of currency and foreign transactions as required by SEC Rule 17a-8, and failed to hold an annual compliance meeting for each of its registered representatives.

The manual obtained by the examiner did not contain provisions that adequately comply with Conduct Rule 3070. LHAC's procedures manual failed to include instructions to report to the NASD when either LHAC or a person associated with LHAC: is the subject of any written customer complaint involving allegations of forgery, or theft or misappropriation of funds or securities; is indicted, convicted of, pleads guilty to, or pleads no contest to any criminal offense (other than traffic violations); is connected with, as described in the rule, a broker, dealer, investment company, investment advisor, underwriter or insurance company that was suspended, expelled or had its registration denied or revoked; and several other provisions. See Conduct Rule 3070(a)(2), (5), (6), (7), (8) & (9). Accordingly, we affirm the DBCC's finding of failure to maintain these written supervisory procedures regarding reportable events.

LHAC and Alton argue that their updated manual, which was missing, would have contained the proper written procedures. Conduct Rule 3010(b)(1) requires that a member establish, maintain, and enforce written procedures to supervise the types of business in which it engages. Because LHAC admitted and the evidence established that the Firm did not have possession of an updated procedures manual, LHAC failed to maintain the required written procedures. LHAC cannot excuse compliance with this requirement by claiming theft of their manual.

Upon our review of the procedures manual, we have located a provision that discusses the reporting of currency and foreign transactions as required by SEC Rule 17a-8. Therefore, we disagree with the DBCC and find no violation based on lack of written procedures for currency and foreign transactions.

The remaining allegation regarding supervision is that LHAC failed to hold an annual compliance meeting for each of its registered representatives. Based on our review of the evidence, we conclude that the preponderance of the evidence shows that such compliance meetings did take place. The evidence adduced in support of this allegation was that LHAC's procedures manual did not contain written acknowledgment of an annual compliance meeting. The direct evidence on this issue, however, established that the meetings did occur. Alton testified that he had a compliance meeting with all of his registered representatives. Two of LHAC's former employees, William Kaynor and Mark Silverman,

submitted letters that stated they had an annual compliance meeting with Alton. No registered representative from LHAC testified that they did not participate in an annual compliance meeting.

The DBCC's decision discusses the fact that LHAC failed to maintain written records of such meetings. The complaint, however, did not allege a failure to maintain written records of compliance meetings. Rather, the complaint alleged that such meetings never took place. Limiting our review to the question of whether the record supports the allegation in the complaint, we disagree with the DBCC's conclusion and find no violation of the supervision rule based on LHAC's failure to conduct annual compliance meetings.

Procedural Issues

Alton made a motion to the National Business Conduct Committee ("NBCC") subcommittee that presided over this hearing ("Subcommittee") to adduce additional evidence in the form of witness testimony from a list of 48 individuals. The Subcommittee denied this motion and we affirm that denial. Procedural Rule 9312 requires that parties seeking to introduce new evidence satisfy the burden of demonstrating that: (1) there was good cause for failing to adduce the evidence before the DBCC; and (2) the evidence is material to the proceeding.

Alton's motion identified two issues that his proposed witnesses would address. First, they would testify as to Alton's character and competency to continue as a registered principal in the securities business. Second, the witnesses would offer additional testimony regarding the Firm's bookkeeping, records, syndicate records, and procedures manual. Alton's stated reason for not calling these witnesses at the DBCC hearing was that he did not know that the DBCC would impose the "totally unexpected sanction" of a bar from acting in any principal, supervisory or ownership capacity.

Alton has not demonstrated good cause for his failure to have these witnesses testify at the DBCC hearing. Consequently, we affirm the Subcommittee's denial. As a registered representative, Alton is charged with knowledge of Procedural Rules 9410 and 8310, which state that the DBCC can impose a broad range of sanctions in disciplinary proceedings, including barring an associated person and expelling a member firm. See Carter v. SEC, 726 F.2d 472, 474 (9th Cir. 1983) (per curiam) (registered representative presumed as a matter of law to have knowledge of NASD rules). Moreover, in response to both of the complaints issued in these actions, Alton signed a one-page Notice of Answer that included the statement that the undersigned (Alton) was aware that a finding of rule violations may result in the imposition of a number of sanctions, including a bar of an associated person in any or all capacities. Alton's claimed misunderstanding of the seriousness of the DBCC proceedings is no reason to allow, in effect, a completely new fact-finding phase on appeal. We agree with the denial of Alton's motion.

Sanctions

LHAC and Alton cite to a number of SEC decisions and argue that because sanctions in those cases were lighter than the sanctions imposed by the DBCC, the DBCC's sanctions should be reduced. It is well recognized that the appropriate sanctions depend upon the facts and circumstances of each particular case and cannot be determined precisely by comparison with actions taken in other proceedings

or against other individuals in the same proceeding. See Butz v. Glover Livestock Comm'n Co., 411 U.S. 182, 187 (1973); Hiller v. SEC, 429 F.2d 856, 858-59 (2d Cir. 1970). LHAC and Alton's argument fails to account for the unique facts in this case and also fails to address the factors listed in the NASD Sanction Guidelines ("Guidelines") that we consider when imposing sanctions in any case.

We impose a $40,000 fine on LHAC and Alton (joint and several). We have attributed $20,000 of this fine to the net capital and FOCUS reports violations. We find that these violations were aggravated by these facts: LHAC continued to do business while having only $71,900 in net capital; and LHAC did not learn of Lushtak's withdrawal of $100,000 from the account until several weeks after the fact. We affirm the censures of LHAC and Alton and the imposition of DBCC hearing costs. We also suspend LHAC from engaging in underwritings for 30 business days and order that LHAC comply with the independent consultant requirement. We eliminate Alton's bar in a principal, supervisory or ownership capacity, impose a 30-day suspension in all principal capacities, require that before Alton again acts in any principal capacity that he designate an independent consultant ("Independent Consultant")[4] acceptable to the District Staff to prepare a report on LHAC's supervisory and compliance procedures, and require that Alton requalify by examination before acting in any principal capacity.[5]

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[4] Initially, Alton is required to retain an Independent Consultant who shall conduct a review of LHAC's compliance and written supervisory policies, procedures, and practices to determine their adequacy and consistency with applicable laws and regulations, and to make recommendations of ways to improve these policies, procedures, and practices. The Independent Consultant must file a report with his recommendations within six months of being retained. The Independent Consultant shall provide a copy of his report to Alton and to the staff of NASD Regulation's District No. 1 office. Thereafter, LHAC will have six months to implement the Independent Consultant's recommendations or demonstrate, to the District Staff's satisfaction, why such recommendations should not be implemented. Within six months of issuing his report, the Independent Consultant will perform a follow-up examination of LHAC to determine whether LHAC is complying with the Independent Consultant's report. The Independent Consultant will report his follow-up findings to Alton and to the staff of NASD Regulation's District No. 1 office.

All fees, expenses and costs associated with the Independent Consultant, including the review and preparation of reports, shall be paid by LHAC and Alton (joint and several) . LHAC and Alton shall cooperate fully with the Independent Consultant, including obtaining the full cooperation and assistance of LHAC's employees or other persons under LHAC's control.

[5] We apportion the sanctions as follows: insufficient net capital and inaccurate FOCUS reports -- $20,000; permitting an unregistered person to act as a representative and principal of LHAC -- $2,500; both Free-Riding and Withholding Interpretation violations -- $10,000 and 30-day suspension of LHAC from engaging in underwriting activities; continuing education program violations -- $2,500; and failure to maintain written supervisory procedures -- $5,000. We base Alton's 30-day suspension, the Independent Consultant requirement, and the requalification requirement on a combination of the net capital, Free-Riding and Withholding, continuing education, and supervision violations.

We note that these sanctions are consistent with the applicable NASD Sanction Guidelines

In deciding on the level of sanctions we have also considered LHAC and Alton's previous disciplinary history and their statement about that history. On August 23, 1990, LHAC and Alton were censured and fined $6,000 (joint and several) as part of an Offer of Settlement. LHAC and Alton were found to have made payments in connection with securities transactions to a firm when that firm was suspended from membership in the NASD and to have permitted two persons to act as principals of LHAC without being registered as principals with the NASD. We have also considered a June 9, 1992 Letter of Caution to LHAC and Alton, a May 17, 1995 compliance conference with LHAC and Alton, and LHAC and Alton's statements about the Letter of Caution and compliance conference.[6]

("Guidelines"). See Guidelines (1996 ed.) at 12, 25, 27, 35, 41, and 53.

[6] The 1992 Letter of Caution identified the following deficiencies: 1) inadequate written supervisory procedures addressing currency and foreign transactions and failure to hold annual compliance meetings with registered representatives, 2) net capital computation inaccuracy regarding a capitalized lease, 3) failure to maintain copies of customer confirmations prepared by the Firm's clearing broker/dealer, 4) failure to disclose on customer confirmations that LHAC made a market in the security, and 5) failure to comply with the Free-Riding and Withholding Interpretation's requirement to obtain information about investment partnerships and corporations purchasing hot issues.

The 1995 compliance conference involved the following issues: 1) failure to register an LHAC employee as a principal, 2) inadequate written supervisory procedures addressing annual compliance meetings, insider trading, employee accounts at other broker/dealers, reporting of employee outside business activities and failure to provide written records of annual compliance meetings with registered representatives, 3) failure to have evidence that purchasers of hot issues were not restricted persons as defined by the Free-Riding and Withholding Interpretation, 4) failure to maintain customer confirmations, and 5) failure to disclose on customer confirmations that LHAC made a market in the security.

Accordingly, we order that LHAC and Alton are fined $40,000 (joint and several) and assessed $2,350.66 in DBCC costs (joint and several). LHAC is censured, suspended from participation in underwriting activities for 30 business days, ordered to comply with the Independent Consultant requirement, and assessed $750 in appeal costs. Alton is censured, suspended in all principal capacities for 30 days, ordered to designate an Independent Consultant not unacceptable to the District Staff to prepare a report on LHAC's supervisory and compliance procedures before acting in any capacity requiring registration as a principal, ordered to comply with the requirements of footnote four, supra, regarding the Independent Consultant, and ordered to requalify by examination before acting in any capacity requiring registration as a principal.[7] The suspensions will commence on a date to be set by the President of NASD Regulation, Inc.

On Behalf of the National Business Conduct Committee,

Joan C. Conley, Corporate Secretary

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

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