BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD REGULATION, INC.

In the Matter of Department of Enforcement Complainant, v. Howard R. Perles Staten Island, New York, and Laurence M. Geller Demarest, New Jersey, Respondents.	DECISION Complaint No. CAF980005 Dated: August 16, 2000

Two traders at separate firms aided and abetted prearranged, matched trading with a third firm and failed to reflect accurately the prearranged trades on the books and records of their respective firms. Held, Hearing Panel's dismissal of aiding and abetting prearranged, matched trades reversed and finding of liability made; Hearing Panel's finding of negligent prearranged trading mooted by other findings; Hearing Panel's finding of books and records violation affirmed; Hearing Panel's dismissal of aiding and abetting an unregistered distribution of securities affirmed, and sanctions affirmed in part and modified in part.

The Department of Enforcement ("Enforcement") has appealed an August 18, 1999 decision of a Hearing Panel, and Howard R. Perles ("Perles") and Laurence M. Geller ("Geller") have cross-appealed from the same decision. The Hearing Panel dismissed allegations that Perles and Geller had aided and abetted an unregistered distribution of common stock, concluding that Enforcement had not proven the allegation. The Hearing Panel also dismissed allegations that Perles and Geller had aided and abetted a manipulation of the market through prearranged trading, holding that Enforcement lacked the legal authority to allege aiding and abetting a violation of Section 10(b) of the Securities Exchange

Act of 1934 ("Exchange Act"), Exchange Act Rule 10b-5, or NASD Conduct Rule 2120, and holding that Enforcement had not proven the allegations. The Hearing Panel found, however, that Perles and Geller had violated just and equitable principles of trade by engaging in prearranged trading with another firm, VTR Capital, Inc. ("VTR"), and violated Section 17(a) of the Exchange Act, Exchange Act Rule 17a-3, and Conduct Rules 2110[1] and 3110 by failing to reflect accurately those prearranged trades on the books and records of their respective firms. The Hearing Panel fined Perles $25,000, suspended him for one year, ordered that he requalify as a general securities representative, and assessed costs. The Hearing Panel fined Geller $25,000, suspended him for 30 business days, and assessed costs.

This case presents a sharp conflict between, on one hand, Perles' and Geller's direct testimony that they did not engage in prearranged trading with VTR and, on the other hand, compelling circumstantial evidence that tends to prove Perles and Geller engaged in prearranged trading. We resolve this conflict by interpreting the circumstantial evidence and evaluating the credibility of Perles' and Geller's testimony in light of our experience. Our analysis leads us to the conclusion that Perles and Geller engaged in prearranged trading with VTR on April 19 through 21, 1995.

We affirm the Hearing Panel's dismissal of the allegation that Perles and Geller aided and abetted an unregistered distribution. We reverse the dismissal of the allegation that they aided and abetted a manipulation, and we find that Perles and Geller aided and abetted prearranged trading. We affirm the Hearing Panel's finding of a books and records violation. We affirm the Hearing Panel's order that Perles be fined $25,000, suspended for one year, required to requalify as a general securities representative, and assessed costs. We modify Geller's sanctions and order that he be fined $25,000, suspended for 30 business days, required to requalify as a general securities representative, and assessed costs.

I. Background and Facts

Perles entered the securities industry in 1983 as a general securities representative. In 1991, he joined I.A. Rabinowitz & Co. ("I.A. Rabinowitz"), which changed its name to IAR Securities in 1997. In 1998, IAR Securities merged with VTR, and is now known as Fairchild Financial Group, Inc. ("Fairchild"). Perles is currently associated with Fairchild as a general securities principal. During the period relevant to this proceeding, April 19 through 21, 1995, Perles was registered only as a general securities representative.

Geller entered the securities industry in 1987 as a general securities representative. In 1990, he joined Wien Securities Corp. ("Wien Securities") as a trader. He has been registered as a general securities representative at Wein Securities from 1990 until the present.

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[1] NASD Rule 115 indicates that persons associated with a member shall have the same duties and obligations under the NASD's Rules as members.

A. VTR's Scheme to Manipulate the Price of Interiors Stock

The complaint named two other respondents in addition to Perles and Geller: VTR and Edward McCune ("McCune"), VTR's President. The complaint alleged that VTR and McCune violated a series of NASD and Securities and Exchange Commission ("SEC") rules by: (1) participating in the unregistered distribution of 300,000 shares of Class A common stock issued by Interiors, Inc. ("Interiors"); (2) purchasing the Interiors stock during the distribution; (3) failing to comply with corporate financing requirements; (4) artificially increasing the price of Interiors stock; (5) engaging in "wash" and "matched" trades of Interiors stock;[2] and (6) violating VTR's restriction agreement, which prohibited it from retail trading as a principal.

In summary, Enforcement alleged that VTR had engaged in a "pump and dump" scheme using Interiors stock. VTR first obtained control over a large block of Interiors stock at a price that was slightly below market. VTR then created trading activity in Interiors stock by engaging in prearranged, matched trades with two other broker-dealers over three days. While VTR was creating the appearance of active trading, it methodically raised the price of Interiors stock to more than double VTR's acquisition cost. Once VTR had increased the price of Interiors stock, it gradually sold the stock it controlled to its customers, reaping excessive profits for VTR of approximately $400,000.

Perles was a trader at I.A. Rabinowitz and Geller was a trader at Wien Securities. Enforcement alleged that Perles engaged in prearranged, matched trades with VTR on the first day of VTR's manipulation of Interiors stock and Geller engaged in prearranged, matched trades with VTR on the second and third day of VTR's manipulation. Prior to the hearing involving Perles and Geller, VTR and McCune settled.[3]

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[2] The Hearing Panel referred to Perles' and Geller's misconduct as prearranged, circular trades and wash and matched trades. "A wash trade is a securities transaction which involves no change in the beneficial ownership of the security." In re Edward Christian Farni, Exchange Act Rel. No. 39133 n.2 (Sept. 25, 1997). "A matched order is the entering of a sell (or buy) order knowing that a corresponding buy (or sell) order of substantially the same size, at substantially the same time and substantially the same price either has been or will be entered." Id. Here, we refer to the violative trades as prearranged or matched trades in order to describe the misconduct precisely.

[3] Order of Acceptance of Settlement by Respondents VTR and Edward McCune (Dec. 11, 1998). VTR was censured, required to pay restitution of $300,000, and fined $100,000 (jointly and severally with McCune). McCune was censured, fined $100,000 (jointly and severally) and suspended for eight months in all capacities. Prior to Enforcement filing the complaint, NASD Regulation accepted a Letter of Acceptance, Waiver and Consent from VTR's trader, David Noble ("Noble"), in which Noble was censured, suspended for 15 business days, and fined $10,000.

B. Unregistered Distribution of 300,000 Shares of Interiors Stock

In 1995, Interiors was a Delaware corporation engaged in manufacturing and marketing antique reproduction and contemporary picture frames and a variety of decorative accessories for the home. For its fiscal year ending June 30, 1994, Interiors had sales revenues of approximately $65 million.

On June 30, 1994, Interiors conducted an initial public offering of its stock that was underwritten by J. Gregory & Company, Inc. The registration statement for the initial offering covered 450,000 Class A shares of common stock, 400,000 Class WA warrants, and 225,000 Class WB warrants. On January 30, 1995, pursuant to the "Alternate A" prospectus, Interiors filed a shelf registration for a proposed additional offering of up to 500,000 Class A shares of common stock.

1. VTR's Unregistered Distribution of Interiors Stock

On April 18, 1995, Interiors entered into a financial consulting agreement ("Financial Consulting Agreement") with VTR and McCune, under which VTR would sell 300,000 shares of Interiors' common stock at $0.93 per share within 24 hours of the date of the agreement. The execution of the Financial Consulting Agreement triggered two events that resulted in an unregistered distribution of Interiors stock. First, VTR arranged for Interiors to sell 300,000 shares of its stock to five investors. Second, VTR sold more than 300,000 shares of Interiors to its customers, creating a short position in its inventory, which it subsequently covered by acquiring the 300,000 shares that Interiors sold to the five investors. The Hearing Panel found that these activities by VTR were an attempt to circumvent its restrictive agreement with the NASD, which prohibited VTR from retail trading as a principal.

Immediately after signing the Financial Consulting Agreement, Interiors sold 300,000 shares of its common stock at $0.93 per share to the following five investors: Hartley Bernstein ("Bernstein"), VTR's outside attorney; International Reserve Corp.; Ulster Investments; Lidco, Ltd.; and KAM Group, Inc. (collectively, the 'Short-Term Investors"). Several of the Short-Term Investors had ties to VTR and McCune.

The Short-Term Investors held the stock they purchased from Interiors for less than eight days. Except for Bernstein, they delivered their shares to VTR on April 24, 1995. Bernstein delivered his 20,000 shares to VTR two days later. Although the Short-Term Investors delivered their Interiors stock to VTR on April 24 and 26, VTR did not pay them until May 4, May 22, or May 31. Moreover, although the share price of Interiors had increased to $2 1/8 on April 21, VTR paid all but one of the Short-Term Investors $0.95 per share, and paid the fifth Short-Term Investor $0.98 per share.

Immediately after VTR and Interiors entered into the Financial Consulting Agreement, VTR manipulated the market by engaging in prearranged trades with two other firms and then aggressively sold Interiors stock. From April 19 to April 21, VTR sold its customers 366,700 shares, resulting in a short position of 337,749 shares at the close of trading on April 21, 1995. VTR covered this short

position on April 24 and 26, in large part by acquiring the shares held by the Short-Term Investors. The last trades in Interiors stock on April 19, 20, and 21 were $2.00, $2 1/8, and $2 1/8 per share, respectively.

2. Hearing Panel's Findings Regarding VTR

The Hearing Panel found that the distribution of 300,000 shares of Interiors stock in April 1995 was unregistered. The shelf registration statement that Interiors had filed in January 1995 did not cover the sale to the Short-Term Investors or the subsequent distribution of the 300,000 shares to the public. Moreover, the "Alternate A" prospectus, for the shelf registration of an additional 500,000 shares, stated in the "Plan of Distribution" that an updated prospectus would be prepared and distributed when Interiors offered any of the subject shares to the public. The "Alternate A" Prospectus was not, however, updated or amended for the April 1995 distribution.

The parties have not challenged these findings made by the Hearing Panel. We find that the record supports these conclusions and we adopt them.

C. Trading of Interiors Stock Between VTR and Perles and Between VTR and Geller

The record contains no evidence that in April 1995 Perles and Geller knew each other, or that either of them knew McCune, the President of VTR. There was no evidence that Perles or Geller knew about VTR's restriction agreement or the Financial Consulting Agreement between VTR and Interiors.

After VTR entered into the Financial Consulting Agreement with Interiors and before VTR substantially covered its short position with the 300,000 shares of Interiors stock from the Short-Term Investors, VTR engaged in three days of high-volume trading with Perles at I.A. Rabinowitz and Geller at Wien Securities.

1. Trades by Perles

Enforcement introduced the following evidence regarding Perles' trading: On April 19, 1995, Perles purchased and sold for I.A. Rabinowitz shares of Interiors stock with VTR, back and forth, more than 28 times -- usually at prices differing by a penny. I.A. Rabinowitz started the day and ended the day holding no shares of Interiors stock, long or short. Perles' trades with VTR on April 19 resulted in a profit of $1,240 for his firm, without accounting for ticket, correspondent, or other charges. Perles purchased and sold Interiors stock as follows:

April 19, 1995

	Time	Seller	Buyer	Price	Shares	Rabinowitz' Inventory
1	10:59	VTR	Rabinowitz	$1.50	10,000	10,000
2	10:59	Rabinowitz	Customer	$1.75	10,000	-0-
3	11:10	Rabinowitz	VTR	$1.75	19,200	(19,200)
4	11:24	Rabinowitz	VTR	$1.75	5,000	(24,200)
5	11:24	Rabinowitz	VTR	$1.75	10,000	(34,200)
6	11:26	Rabinowitz	VTR	$1.75	3,500	(37,700)
7	11:40	VTR	Rabinowitz	$1.74	10,000	(27,700)
8	11:42	VTR	Rabinowitz	$1.74	10,000	(17,700)
9	11:48	Rabinowitz	VTR	$1.75	8,000	(25,700)
10	11:50	VTR	Rabinowitz	$1.625	10,000	(15,700)
11	11:50	Rabinowitz	Customer	$1.875	10,000	(25,700)
12	11:55	VTR	Rabinowitz	$1.74	25,700	-0-
13	12:03	VTR	Rabinowitz	$1.75	20,000	20,000
14	12:03	Rabinowitz	Customer	$1.80	10,000	10,000
15	12:04	Rabinowitz	Customer	$2.00	10,000	-0-
16	12:27	Rabinowitz	VTR	$2.00	14,600	(14,600)
17	12:29	Rabinowitz	VTR	$2.00	9,750	(24,350)
18	12:32	Rabinowitz	VTR	$2.00	9,000	(33,350)
19	12:40	Rabinowitz	VTR	$2.00	15,000	(48,350)
20	12:46	VTR	Rabinowitz	$1.99	10,000	(38,350)
21	13:03	Rabinowitz	VTR	$2.00	15,100	(53,450)
22	13:08	VTR	Rabinowitz	$1.99	15,000	(38,450)
23	13:29	VTR	Rabinowitz	$1.99	15,000	(23,450)
24	13:34	Rabinowitz	VTR	$2.00	8,300	(31,750)
25	13:43	Rabinowitz	VTR	$2.00	6,500	(38,250)
26	13:46	VTR	Rabinowitz	$1.99	15,000	(23,250)
27	13:55	VTR	Rabinowitz	$1.99	13,250	(10,000)
28	14:01	VTR	Rabinowitz	$1.99	10,000	-0-

Enforcement introduced into evidence the trade tickets that Perles filled out on April 19, 1995. On both a "buy" and a "sell" ticket for trades taking place in the morning of April 19, Perles wrote down several successive trades, drew a line through each one and wrote the sum of all the trades at the top of the ticket.

Perles testified regarding his job and his employer as follows: In April 1995, I.A. Rabinowitz' trading room was not automated. Perles and his assistant took all orders by telephone and recorded them on paper order tickets. The only computer terminal they had was a Nasdaq Workstation with Level 3 Service, which they used to update quotes and access the ACT system.[4]

Perles declined to describe himself as a trader because his authority in the trading room was limited to "maintain[ing] an orderly market." Perles described his job responsibilities as two pronged: executing and reporting all orders from I.A. Rabinowitz' branches, and making markets in up to 50 securities. He testified: "I was there to buy the stock if we had buyers. I was there to sell the stock if we had sellers." Perles reported to and was supervised by Isaac Rabinowitz ("Rabinowitz"), who reviewed the firm's trading on a daily basis. Perles testified that "traders" usually possessed greater authority and responsibility to take positions in stocks, but that at his firm, Rabinowitz retained these powers.

Perles testified that although I.A. Rabinowitz was a market maker, market making was not the firm's primary focus. Perles characterized the main thrust of the firm's activities as retail sales. I.A. Rabinowitz' market making was mainly limited to stocks that it had helped underwrite and for which it had created retail interest. The other stocks in which I.A. Rabinowitz made a market were those selected personally by Rabinowitz.

Perles was a salaried employee. He did not receive commissions or performance-based bonuses, and his compensation was not related to the profitability of I.A. Rabinowitz' market-making activities.

At the hearing, Perles denied that he had any arrangement with VTR regarding Interiors stock. He explained that all the trades were the result of normal order flow. In response to questions about the large short position that he accumulated -- as great as 53,450 shares at 1:03 p.m. on the 19th -- he stated that he had not been concerned about how he could cover the position. He explained that I.A. Rabinowitz' customers had sufficient shares in their accounts to cover his short positions.

Under questioning from the Hearing Panel, Perles admitted that he did not know and did not inquire if any of his firm's customers were interested in selling. He also admitted that he had not followed closely the reported volume in Interiors stock, and he did not know how much capital I.A. Rabinowitz had. Perles testified that the largest position that he remembered ever carrying overnight was approximately half a million dollars worth of a single stock.

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[4] The Automated Confirmation Transaction Service or "ACT" system is an automated Nasdaq service for price and volume reporting, comparison, and clearing of pre-negotiated trades completed in Nasdaq and the OTC Bulletin Board Service.

The OTC Bulletin Board is a regulated quotation service that displays real-time quotes, last-sale prices, and volume information in certain over-the-counter equity securities.

The Hearing Panel did not find Perles' testimony credible. The Hearing Panel concluded that Perles had engaged in wash and matched trades and that his trading had distorted the true volume of transactions in Interiors stock. In the alternative, the Hearing Panel found that Perles had been "negligent in failing to investigate further when he encountered this pattern and volume of trading, at a negotiated price, in a stock that usually had significantly less activity."

2. Trades by Geller

Enforcement introduced the following evidence regarding Geller's trading: On April 20 and 21, 1995, Geller traded 234,300 shares of Interiors with VTR and 2,500 shares of Interiors in a single transaction with a firm other than VTR. Geller started and ended each day without a substantial position, long or short, in the stock. Except for one trade on April 20, Geller executed each and every one of the trades with VTR at a spread of one-sixty-fourth of a dollar, or 1.5625 cents. Combining both days' trades with VTR, Geller generated a profit of approximately $3,400 for Wien Securities. Geller purchased and sold Interiors stock with VTR on April 20 and 21, 1995 as follows:[5]

	Time	Seller	Buyer	Price	Shares	Wien's Inventory
			April 20, 1995			
1	10:25	Wien	VTR	$2.00	8,500	(8,500)
2	10:25	Wien	VTR	$2.00	10,800	(19,300)
3	10:32	Wien	VTR	$2.00	11,000	(30,300)
4	10:36	Wien	VTR	$2.00	20,000	(50,300)
5	10:43	Wien	VTR	$2.00	13,850	(64,150)
6	10:49	VTR	Wien	$1.984375	22,000	(42,150)
7	10:53	Wien	VTR	$2.00	9,800	(51,950)
8	10:58	VTR	Wien	$1.984375	18,000	(33,950)
9	11:04	Wien	VTR	$2.00	11,900	(45,850)
10	11:10	VTR	Wien	$1.984375	15,900	(29,950)
11	11:20	VTR	Wien	$1.984375	12,500	(17,450)
12	11:26	Wien	VTR	$2.00	14,400	(31,850)
13	11:32	Wien	VTR	$2.00	7,400	(39,250)
14	11:37	VTR	Wien	$1.984375	15,000	(24,250)
15	11:40	VTR	Wien	$1.984375	13,500	(10,750)
16	11:46	VTR	Wien	$1.984375	10,750	-0-

[5] Multiple trades executed at the same time have been combined.

			Afternoon			
17	12:01	Wien	VTR	$2.00	8,650	(8,650)
18	12:03	Wien	VTR	$2.00	10,800	(19,450)
19	12:07	VTR	Wien	$1.984375	23,000	3,550
20	14:56	Wien	VTR	$2.125	10,000	(6,450)
21	15:08	Wien	VTR	$2.125	11,200	(17,650)
22	15:20	Wien	VTR	$2.125	8,200	(25,850)
23	15:30	VTR	Wien	$2.00	1,000	(24,850)
24	15:34	VTR	Wien	$2.109375	10,500	(14,350)
25	15:43	VTR	Wien	$2.109375	12,000	(2,350)
26	15:56	Wien	VTR	$2.125	1,500	(3,850)
27	15:57	Wien	VTR	$2.125	5,500	(9,350)
28	16:01	VTR	Wien	$2.109375	9,000	(350)
	Time	**Seller**	**Buyer**	**Price**	**Shares**	**Wien's Inventory**
			April 21, 1995			
29	10:17	Wien	VTR	$2.125	14,000	(14,350)
30	10:25	Wien	VTR	$2.125	10,500	(24,850)
31	10:29	Wien	VTR	$2.125	8,700	(33,550)
32	10:31	Wien	VTR	$2.125	6,450	(40,000)
33	10:35	VTR	Wien	$2.109375	17,000	(23,000)
34	10:55	VTR	Wien	$2.109375	14,500	(8,500)
35	11:04	Wien	VTR	$2.125	7,300	(15,800)
36	11:09	Wien	VTR	$2.125	1,000	(16,800)
37	11:12	VTR	Wien	$2.109375	16,450	(350)
			Afternoon			
38	13:31	Wien	VTR	$2.1875	14,700	(12,550)
39	13:32	Wien	VTR	$2.1875	2,600	(15,150)
40	13:41	VTR	Wien	$2.17185	15,200	50
41	15:03	Wien	VTR	$2.1875	6,300	(6,250)
42	15:04	Wien	VTR	$2.1875	1,800	(8,050)
43	15:54	VTR	Wien	$2.171875	8,000	(50)

Geller testified about his responsibilities and his firm as follows: In 1995, Geller was one of 20 to 25 traders at Wien Securities. He was responsible for trading Nasdaq, OTC Bulletin Board, and "Pink Sheet"[6] stocks. He worked a list of approximately 200 to 300 stocks, of which 20 to 80 were active on any given day. At that time, most of the trading at Wien Securities was conducted by telephone. Although Geller had access to SelectNet,[7] he did not use it in 1995 for the stocks he traded.

Wien Securities monitored Geller's trading by setting volume parameters, but no price parameters, on his activities. Essentially, if Geller stayed under the volume limit and his trading was within the market, he was left alone. Stephen Wien testified that to the best of his recollection the volume limit in 1995 was 25,000 to 50,000 shares. If Geller exceeded the limit, the transaction would pop up on his managers' terminals, and one of them would question Geller about the trade. In 1995, Geller traded approximately 156,000,000 shares of stock.

Geller's compensation at Wien Securities was based on the profit he made for the firm. He received one-third of the profit less ticket, correspondence, and SelectNet charges.

Geller testified that he had a general recollection that VTR's trader initiated all of the trades on April 20 and 21, 1995. In addition, all of the trades with VTR were executed at negotiated prices. Geller testified that he lacked any further recollection about these trades, but that there was nothing unusual about them. Geller denied that there was an unrecorded repurchase agreement or prearrangement with VTR regarding Interiors stock. At the hearing, Geller introduced a portion of the on-the-record investigative testimony of VTR's trader, Noble, who stated that he had no repurchase agreement or prearrangement for trading with Geller. Geller also testified that it was not unusual for other broker-dealers both to buy and sell stock from VTR in the same day.

Stephen Wien testified for Geller and corroborated a portion of Geller's testimony. Stephen Wien and one other general securities principal acted as co-managers of the trading room in which Geller worked. Stephen Wien testified that it was not unusual to receive buy and sell orders from the same broker in the course of a day. He also testified that his firm's principals had properly supervised Geller at the time these trades were executed, and that none of the trading room supervisory personnel had noticed anything unusual about the trades. Stephen Wien also testified that there was nothing unusual about "shorting a stock into a rising market."

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[6] The Pink Sheets are a subscription service for broker-dealers that lists market makers and quoted prices. In 1995, the Pink Sheets were a daily publication. Currently, the Pink Sheets are operated by Pink Sheets LLC.

[7] SelectNet is an automated Nasdaq service that enables securities firms to route orders, negotiate terms, and execute trades in Nasdaq securities over an electronic network.

The Hearing Panel did not find Geller's denial that he had engaged in prearranged trading credible. The Hearing Panel concluded that there was no explanation for Geller's trading in Interiors Stock in April 20 and 21, 1995, other than VTR and Geller prearranged the trades.

II. Discussion

We begin by addressing a procedural point of first impression under the 1997 Code of Procedure. We then discuss why allegations of aiding and abetting a violation of the NASD's antifraud rule are actionable, and we conclude by evaluating the circumstantial and testimonial evidence in this case.

Prior to the Hearing Panel hearing, Perles and Geller timely filed a joint motion for summary disposition, pursuant to Procedural Rule 9264. The motion argued for dismissal of the aiding and abetting violations and also challenged the books and records allegation on the ground that it "failed to state a claim upon which relief can be granted." The Hearing Panel treated the motion as a motion to dismiss, deferred ruling on the legal validity of the aiding and abetting allegations, and denied the motion as to the books and records allegation.

We agree that the Hearing Panel had the authority to entertain a motion to dismiss filed pursuant to Procedural Rule 9264. Procedural Rule 9147 provides that a Hearing Officer may rule on procedural motions and administrative matters arising during a case. We conclude that the Hearing Panel's decision to treat a motion to dismiss as allowable under the summary disposition rule was an appropriate procedural ruling.[8]

A. Aiding and Abetting a Violation of the NASD's Antifraud Rule

The Hearing Panel dismissed the complaint's allegation that Perles and Geller aided and abetted a violation of the NASD's antifraud rule, Conduct Rule 2120, concluding that aiding and abetting "a manipulative or deceptive act is not a violation of Rule 2120." We reverse. We find that the Supreme

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[8] While the procedure followed by the Hearing Panel may well have been reasonable, we believe that as a general matter, a Hearing Panel should attempt to rule promptly on a motion for summary disposition or a motion to dismiss. In most circumstances, if upon motion, timely made, a respondent persuades the Hearing Panel that Enforcement's complaint is not legally valid, neither the respondent nor Enforcement should be required to present evidence at a hearing when the outcome of the proceeding rests on a question of law. In this case, however, the Hearing Panel reasonably deferred ruling on the legal validity of the aiding and abetting claim because Enforcement had an alternate legal theory -- violation of just and equitable principles of trade -- that drew upon the same facts as the aiding and abetting claim and was not the subject of a motion to dismiss.

Court's strict textual approach to interpreting an antifraud provision of the Exchange Act does not apply to our interpretation of the NASD's Conduct Rules.

As an initial matter, we hold that aiding and abetting a fraud is precisely the kind of misconduct that the NASD's just and equitable principles of trade rule seeks to prohibit. In this case, to establish that Perles and Geller aided and abetted a violation of the NASD's antifraud rule, Enforcement had to prove that (1) VTR committed fraud; (2) Perles and Geller knowingly and substantially assisted the fraud; and (3) Perles and Geller had a general awareness that their role was part of an overall activity that was improper. As discussed below, we find that Perles and Geller knowingly and substantially assisted VTR's fraud and they were aware of their roles. This kind of conduct by two registered persons is directly in conflict with NASD Conduct Rule 2110, which requires that registered persons shall "observe high standards of commercial honor and just and equitable principles of trade." Perles and Geller rejected commercial honor and engaged in an unjust and inequitable scheme. We conclude that their aiding and abetting a violation of the NASD's antifraud rule was a violation of Conduct Rule 2110.

The Hearing Panel reasoned that the Supreme Court's decision in Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164 (1994), compelled the conclusion that Enforcement could not allege aiding and abetting liability for a violation of Conduct Rule 2120. We disagree. In Central Bank, the Supreme Court held that a private plaintiff may not maintain an aiding and abetting lawsuit under Section 10(b) of the Exchange Act[9] or Rule 10b-5 thereunder because the text of Section 10(b) does not reach those who aid and abet a person who commits a manipulative or deceptive act. Id. at 177. Reasoning that "Congress knew how to impose aiding and abetting liability when it chose to do so," the Supreme Court concluded that Congress' failure to use the words "aid" and "abet" in Section 10(b) was dispositive. Id. at 176.

We recognize two critical distinctions between the Supreme Court's holding in Central Bank and our interpretation of Conduct Rule 2120.[10] First, the Supreme Court explained that the question of

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[9] Section 10(b) states:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . .
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe . . . .

[10] Conduct Rule 2120 provides:

aiding and abetting liability was addressed under a line of cases that "determined the scope of conduct prohibited" by Section 10(b).[11] Following this line of cases, the Supreme Court focused strictly on the "text of the statute." Id. at 173. The Supreme Court noted that although Section 10(b) has no aiding and abetting provision, "various provisions of the securities laws prohibit aiding and abetting, although violations are remediable only in actions brought by the SEC." Id. at 183 (citing Exchange Act Section 15(b)(4)(E) (SEC may proceed against brokers and dealers who aid and abet a violation of the securities laws); and 15 U.S.C. ' 78u-2, Exchange Act Section 21B (civil penalty provision added in 1990, applicable to brokers and dealers who aid and abet various violations of the Exchange Act.))

The Supreme Court's approach to interpreting the scope of liability under Section 10(b) stands in contrast to our approach to interpreting the NASD's antifraud rule. We find that Conduct Rule 2120 should be interpreted flexibly, with a view towards eliminating fraud and manipulation. The NASD adopted its antifraud rule against the backdrop of the Exchange Act, which requires the SEC to determine that a self-regulatory organization has rules that are "designed to prevent fraudulent and manipulative acts and practices." Exchange Act '15A(b)(6). The NASD's By-Laws identify preventing "fraudulent and manipulative acts and practices" as one of the reasons that the NASD Board of Governors is authorized to adopt Conduct Rules. NASD By-Laws, Art. XI, Sec. 1. Because preventing fraud and manipulation is central to the NASD's purpose, we pay particular attention to the general NASD rule regarding rule interpretation. It states: "The Rules shall be interpreted in such a manner as will aid in effectuating the purposes and business of the Association . . . ." Rule 113. Following this interpretative framework, we conclude that prohibiting the aiding and abetting of a manipulation effectuates the NASD's purpose of preventing manipulation. See In re Lile & Co., 42 S.E.C. 664, 670 n.12 (1965) ("In some respects the NASD's powers are broader than the Commission's authority, since it is thus authorized to act with respect to some unethical practices which may not be within the reach of the provisions of the securities acts which deal with fraud upon investors."); cf. In re Daniel Joseph Alderman, 52 S.E.C. 366, 369 (1995), aff'd, 104 F.3d 285 (9th Cir. 1997) (finding that an NASD Conduct Rule set "forth a standard intended to encompass a wide variety of conduct that may operate as an injustice to investors or other participants in the marketplace.")

Second, the Supreme Court recognized that civil liability for aiding and abetting a violation of Section 10(b) differs from criminal liability for aiding and abetting because Congress has enacted a general aiding and abetting statute applicable to all federal criminal offenses. Id. at 181 (citing 18 U.S.C. ' 2.) Therefore, the holding in Central Bank that aiding and abetting liability was not available

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> No member shall effect any transaction in, or induce the purchase or sale of, any security by means of any manipulative, deceptive or other fraudulent device or contrivance.

[11] Id. at 172 (citing Dirks v. SEC, 463 U.S. 646 (1983); Aaron v. SEC, 446 U.S. 680 (1980); Chiarella v. United States, 445 U.S. 222 (1980); Santa Fe Industries, Inc. v. Green, 430 U.S. 462 (1977); and Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976)).

under Section 10(b) and Rule 10b-5 was limited to the implied civil cause of action for private plaintiffs. See United States v. O'Hagan, 521 U.S. 642, 664 (1997) ("Central Bank's discussion concerned only private civil litigation under '10(b) and Rule 10b-5, not criminal liability.") Criminal liability for aiding and abetting a violation of Section 10(b) still exists.

Furthermore, the Supreme Court has rejected the expansion of Central Bank's approach to situations beyond private civil actions. See O'Hagan, 521 U.S. 642, 664-65 (1997). In O'Hagan, the Supreme Court overruled two federal circuit courts that had held, based on an expansive reading of Central Bank, that in a criminal prosecution, Section 10(b) and Rule 10b-5 do not prohibit a person from trading in securities for personal profit, using confidential information misappropriated in breach of a fiduciary duty to the source of the information. Id. at 649-50; overruling United States v. O'Hagan, 92 F.3d 612 (8th Cir. 1996) and United States v. Bryan, 58 F.3d 933, 943-959 (4th Cir. 1995). The Supreme Court upheld the "misappropriation theory" of insider trading and rejected the Eighth Circuit's analysis that Central Bank required a narrower definition of insider trading. Id. at 650, 663-64. The Supreme Court explained that Central Bank applied only to private Section 10(b) lawsuits. Id. at 664. Consistent with the Supreme Court's reasoning in O'Hagan, we will not import Central Bank's approach to interpreting Section 10(b) to our interpretation of Rule 2120.[12]

We affirm that the NASD's just and equitable principles of trade rule encompasses liability for aiding and abetting a violation of the NASD's antifraud rule. The SEC has ruled, after the Central Bank decision, that a respondent violated the New York Stock Exchange's just and equitable principles of trade rule by aiding and abetting violations of Regulation X.[13] See In re John Thomas Gabriel, 51 S.E.C. 1285, 1291 (1994). We conclude that here the NASD's just and equitable principles of trade rule likewise authorized Enforcement to allege that Perles and Geller aided and abetted a manipulation.

Turning to our own precedents, we note that we recently upheld an aiding and abetting allegation in Market Surveillance Comm. v. John Roger Faherty, 1998 NASD Discip. LEXIS 44, at *1 (NAC Oct. 14, 1998), appeal filed. There, we held that Faherty had aided and abetted his firm's manipulation of a stock in violation of Section 15(c) of the Exchange Act and Rule 15c1-2 thereunder. The Hearing Panel below failed to recognize that in Faherty we concluded that Central Bank did not eliminate aiding and abetting liability for a federal antifraud provision other than Section 10(b). Given that Enforcement can allege that a respondent aided and abetted a violation of Section 15(c) and

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[12] We do not suggest that any NASD rules at issue in this case are criminal statutes or that they should be interpreted as criminal statutes. We discuss the criminal aiding and abetting statute because it provides authority, from outside the antifraud provisions of the Exchange Act, for federal prosecutors to charge aiding and abetting a fraud. The NASD's Conduct Rule 2110 provides authority, from outside the NASD's antifraud rule, for Enforcement to allege aiding and abetting a fraud as a violation of "high standards of commercial honor and just and equitable principles of trade."

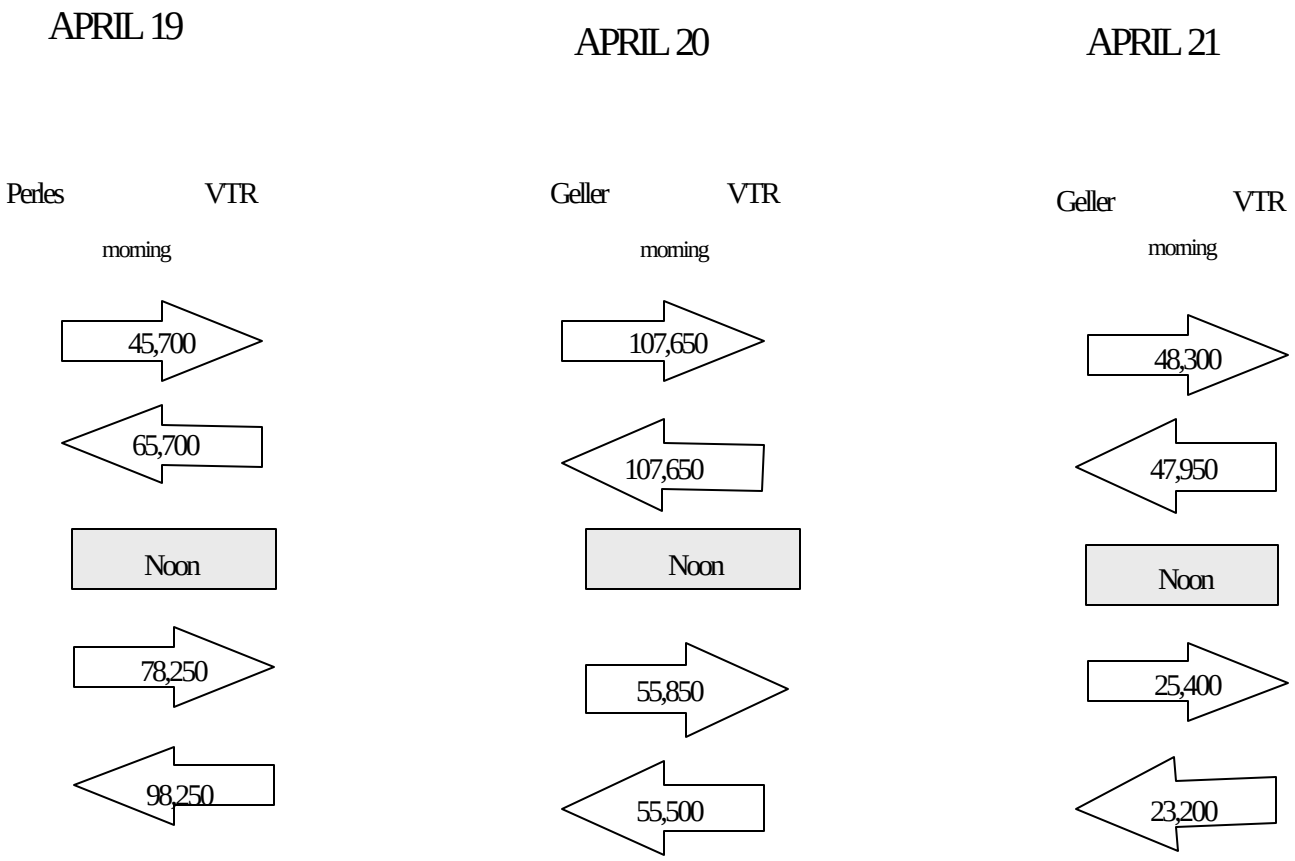
[13] The Board of Governors of the Federal Reserve System issued Regulation X pursuant to Section 7 of the Exchange Act. See 12 C.F.R. ' 224.1.

Exchange Act Rule 15c1-2, the logical corollary is that Enforcement can allege that a respondent aided and abetted a violation of the NASD's antifraud rule. Indeed, our predecessor, the National Business Conduct Committee ("NBCC"), repeatedly found that member firms or associated persons violated the NASD's rules by aiding and abetting violations of NASD rules. See, e.g., In re Richard A. Holman, 41 S.E.C. 252 (1962) (finding aiding and abetting liability under Article III, Secs. 1 and 18 of the former NASD Rules of Fair Practice); In re H.C. Keister & Co., 43 S.E.C. 164 (1966) (same); In re Kirk A. Knapp, 50 S.E.C. 858, 860 (1992) (same). In several of these cases, the complaint alleged that a respondent had violated both the NASD's antifraud rule and just and equitable principles of trade. See Holman, 41 S.E.C. at 255. Based on these NASD and SEC precedents, we hold that the NASD has the authority to find that a respondent's aiding and abetting a violation of Conduct Rule 2120 is a violation of the NASD's rules.[14]

B. Perles and Geller Aided and Abetted Prearranged Trading

Enforcement argued that the trading records could be summarized to show the matched trading between Perles and VTR and between Geller and VTR as follows:

[14] We do not reach the issue of whether Enforcement has the authority to bring a disciplinary action against a respondent for aiding and abetting a violation of SEC Rule 10b-5 after Central Bank. Enforcement did not appeal the Hearing Panel's dismissal of this theory of the case and the parties' briefing of this issue below was not particularly helpful to us. We consider our previous decision in Faherty to be the logical starting point for any discussion of whether Enforcement can allege aiding and abetting liability. The parties neither discussed Faherty nor the relationship between Enforcement's alleging aiding and abetting under Rule 15c1-2 and Rule 10b-5. Significantly, neither of these SEC rules explicitly authorizes aiding and abetting liability. The parties also did not discuss In re John Thomas Gabriel, 51 S.E.C. 1285 (1994) (upholding aiding and abetting liability under the NYSE's rules), and other arguably relevant cases. See In re Kevin Upton, 52 S.E.C. 145, 150 n. 23 (1995) ("Because Section 15(b)(4)(E) of the Exchange Act under which these proceedings were brought specifically authorizes the Commission to impose sanctions for aiding and abetting a violation of the federal securities laws and rules, the rationale of the Supreme Court in [Central Bank] . . . is not implicated"), overruled on other grounds, 75 F.3d 92, 98 (2d Cir. 1996); see also Exchange Act ' 19(g)(1).



To establish liability for aiding and abetting a violation of the NASD's antifraud rule, Enforcement must prove that: (1) another party has committed a violation; (2) the alleged aider and abettor knowingly and substantially assisted the principal violation; and (3) the alleged aider and abetter had a general awareness that his role was part of an overall activity that was improper. See In re Kirk L. Knapp, 50 S.E.C. 858, 860 (1992); In re RFG Options Co., 49 S.E.C. 878, 883 (1988); Market Surveillance Comm. v. John Roger Faherty, 1998 NASD Discip. LEXIS 44, at *20 (NAC Oct. 14, 1998) appeal filed; accord Levine v. Diamanthuset, Inc., 950 F.2d 1478, 1483 (9th Cir. 1991).

The first prong of the test for aider and abettor liability is satisfied here. In preparation for the unregistered distribution of Interiors stock, VTR sought to generate artificial trading interest in Interiors stock by engaging in prearranged, matched trades on April 19 through 21, 1995. As to the second prong, we find that both Perles and Geller knowingly and substantially assisted VTR in increasing the volume of trading in Interiors stock to create the false impression of active trading interest. The evidence regarding Perles' and Geller's trading convinces us that they both knowingly and substantially assisted VTR by trading Interiors stock back and forth with VTR pursuant to a prearrangement to do so. Wash and matched trades are considered manipulative per se, and no further showing of manipulative intent is required to establish a violation. Edward J. Mawod & Co. v. SEC, 591 F.2d 588, 595 (10th Cir. 1979). We also find that Perles and Geller knew that engaging in prearranged, matched trades was improper. Wash and matched trades are a manipulative practice which is

prohibited under the Exchange Act. Exchange Act ' 9(a)(1); see Ernst & Ernst v. Hochfelder, 425 U.S. at 206.[15] Therefore, Enforcement satisfied the third prong of the aiding and abetting liability test.[16]

1. Perles Aided and Abetted Prearranged Trading

We find that Perles engaged in prearranged trading with VTR on April 19, 1995. The weight of the circumstantial evidence, considered as a whole, persuades us that Perles was aiding and abetting a violation of the NASD's antifraud rule. We consider circumstantial evidence to be potentially as persuasive as direct evidence. "Proof of a manipulation almost always depends on inferences drawn from a mass of factual detail." In re Pagel, Inc., 48 S.E.C. 223, 226 (1985).

First, Perles traded a large volume of Interiors stock when its recent trading volume had been small. Cf. In re Edward J. Mawod & Co., 46 S.E.C. 865, 872-73 (1977), aff'd, 591 F.2d 588 (10th Cir. 1979) (finding that a broker-dealer aided and abetted a manipulation when it executed trades that equaled 37 percent of the issuer's float over two months). On April 19, Perles traded 123,950 shares with VTR, which equaled approximately 12.2 percent of the publicly available shares.[17] Between April 3 and April 18, the average daily trading volume was 18,191 shares. On April 7, 10, 13, and 17, the daily trading volumes were 200, 200, 1,000, and 800 shares, respectively. We find that Perles' trading volume in Interiors stock is an important factor in assessing his role in the manipulative scheme.

Second, Perles accumulated two large short positions, one in the morning and again in the afternoon, that were notably "aggressive" as compared to normal trading activity. When combined with the extremely small profits that Perles was earning for his firm (approximately $1,240), we find that the risk-to-reward ratio for Perles' behavior was economically irrational and we view this behavior as another factor in assessing his role in the manipulative scheme. See Market Regulation Comm. v. Morgan Stanley & Co., 2000 NASD Discip. LEXIS 1, at *68 (NAC Jan. 18, 2000) (manipulator's attempt to explain price-quoting activities as benign rejected because such activity was economically irrational). The evidence showed that Perles was shorting into a rising market, a strategy that normally increases the risk, potentially in unlimited measure, unless there is appropriate hedging or a prearrangement to cover the short position. The large short positions created by Perles, reaching a peak of 37,700 shares in the morning and 53,450 in the afternoon, combined with the one-cent profit margin he was making on the trades, signifies that he had prearranged these trades and was not engaged in normal trading.

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[15] As securities professionals, Perles and Geller were charged with knowledge of industry rules. See In re B.R. Stickle & Co., 51 S.E.C. 1022, 1025 (1994).

[16] Based on our review of the facts, we also believe that Perles and Geller acted as primary violators of the NASD's antifraud rule, an allegation that was not made in the complaint.

[17] At this time, Interiors had distributed 1,017,500 shares of common stock to the public.

Third, the symmetrical pattern of Perles' trading with VTR tends to show that Perles agreed in advance to engage in this trading. Cf. Mawod, 46 S.E.C. at 872-73 (finding that back-and-forth trading of large blocks of stock by customers constituted wash and matched trading). Although Perles swapped 123,950 shares of Interiors stock with VTR in 28 trades, Perles' inventory of Interiors stock at the end of the day was exactly the same as when he began the day.[18]

Fourth, we find that Perles' trade tickets revealed that he knew he would be engaging in prearranged trades with VTR. The evidence showed that Perles combined many of the trades with VTR on a single ticket by crossing out the amount of the trade and adding a new trade. For example, on the sell ticket for the morning trading on April 19, 1995, there are five separate entries (19,200, 5,000, 10,000, 3,500, 8,000), each crossed through, and all appearing under the last number on the ticket, 45,700. These crossed-out entries correspond to the trades numbered 3, 4, 5, 6, and 9 on the chart of Perles' trading. Importantly, Perles did not total the trades as he entered them on the ticket, meaning that he left the ticket open because he knew that he would be adding to the ticket as the day went on.

Perles denied that he left the ticket open because he knew there would be additional trades, claiming instead that he combined the trades because Rabinowitz wanted him to save on ticket charges. Perles testified that if the ticket was still in the box next to his desk and had not been billed, he would pull the ticket back and add to it when he got another order. We agree with the Hearing Panel that Perles' testimony was not credible.[19]

We find Perles' explanation unconvincing and inconsistent with the manner in which he recorded the trades on the ticket. Under Perles' version of events, if the ticket had gone to billing before the final entry, the ticket would not have shown the total number of shares traded, and it would not have been possible to know from the face of the ticket that the crossed-out trades needed to be added together to

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[18] We do not view the fact that Perles ended the day with a flat position in Interiors stock as definitive circumstantial evidence of prearrangement. Rather, it is his pattern of back-and-forth trading, resulting in his return at the end of the day to the same position that he held at the beginning of the day, that we find persuasive.

[19] We give the Hearing Panel's credibility determination considerable weight because they observed Perles' testimony and cross-examination. See In re Jonathan Garrett Ornstein, 51 S.E.C. 135, 137 (1992); In re Frank J. Custable, 51 S.E.C. 643, 648 (1993); accord In re Warren R. Schreiber, Exchange Act. Rel. No. 40629, pp. 4-5 (Nov. 3, 1998) (SEC unable to accept credibility determinations when initial decision-maker did not state that it had taken into account all of the record evidence). The rule from Schreiber does not apply to this case, because the Hearing Panel discussed and considered all of the evidence in the record, including Perles' and Geller's demeanor, Stephen Wien's testimony, the on-the-record testimony of Noble, and the substantial circumstantial evidence surrounding the trades.

determine the total volume. We conclude that Perles left his order ticket open because he knew that he would be executing additional trades under the prearrangement with VTR.

Turning to Perles' testimony that he did not engage in prearranged trades, we agree with the Hearing Panel that this testimony was not credible. Perles' claim that his trades on April 19 were executed in response to normal order flow is not believable.[20] We simply do not accept the notion that in the normal course of trading Perles found a counterparty to buy and sell more than 100,000 shares of Interiors at razor-thin margins. In addition, we find Perles' explanation of his limited authority as a trader inconsistent with his testimony that his trading in Interiors resulted from normal order flow.[21] In trading Interiors stock, Perles was not merely responding to orders from the firm's customers.

In sum, the circumstantial evidence strongly supports one conclusion: Perles and VTR prearranged the trading activity that took place between them on April 19, 1995.

2. Geller Aided and Abetted VTR's Prearranged Trading

We find that Geller engaged in prearranged trading with VTR on April 20 and 21, 1995. The circumstantial evidence of prearranged trading convinces us, by a preponderance of the evidence, that Geller was aiding and abetting a violation of the NASD's antifraud rule.

First, Geller traded a large volume of Interiors stock when its recent trading volume had been small. Cf. Mawod, 46 S.E.C. at 872-73. On April 20 and 21, Geller traded 234,300 shares with VTR, which was 24.1 percent of the reported total volume from April 19 through April 21, 1995. Again, the average daily trading volume between April 3 and 18 had been 18,191 shares. We recognize that on April 19, the trading volume was 441,000 and that Geller testified that he was interested in taking part in this active trading. Geller's testimony, however, does not square with the modest profits that he made when the spread between the inside bid and offer was much wider for the stock. We find that Geller's stated reason for the trading was inconsistent with the actual transactions.

Second, Geller accumulated four large short positions that were relatively aggressive as compared to normal trading strategies. When combined with the extremely modest profits that Geller was earning (approximately $3,400 for his firm) and the fact that he was shorting into a rising market, we find that the risk-to-reward ratio for Geller's behavior was economically irrational. See Market

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[20] We reach our assessment based on our experience in the securities industry. See In re Monroe Parker Secs., Inc., Exchange Act Rel. No. 39057, p.6 (Sept. 11, 1997).

[21] We have considered Perles' argument on appeal that he lacked a motive to engage in prearranged trades because he was compensated as a salaried employee. Evidence of a respondent's profit-making from a manipulation "is not talismanic." In re Brooklyn Capital & Secs. Trading, Inc., 52 S.E.C. 1286, 1293 (1997) (quoting In re R.B. Webster Invs., Inc., 51 S.E.C. 1269, 1274 (1994)).

Regulation Comm. v. Morgan Stanley & Co., 2000 NASD Discip. LEXIS 1, at *68. The large short positions created by Geller, reaching a peak of 64,150 and 40,000 shares, combined with the one-sixty-fourth of a dollar profit margin he was making on the trades, signify that Geller had prearranged these trades and was not engaged in normal trading activities.

Third, the symmetrical pattern of Geller's trading with VTR tends to show that Geller agreed in advance to engage in the trading.[22] Cf. Mawod, 46 S.E.C. at 872-73. Although Geller traded back and forth with VTR 163,150 shares on April 20 and 71,150 shares on April 21, Geller's position at the end of each morning and at the end of each day was very close to exactly the same as when he started.

Fourth, the Hearing Panel found that Geller's explanation for his trading behavior was not credible. Geller attributed his trading with VTR to his desire to get "involved" due to the market volume at the time. According to Geller, increased market volume alone was sufficient reason for him to establish a short position of 60,000 shares when the total daily volume in the stock had been as little as 200 shares just seven trading days earlier. We agree with the Hearing Panel that Geller's testimony that he somehow naturally found a counterparty that bought and sold 234,300 shares of Interiors was not credible.

The Hearing Panel found that Geller was vague in his responses to questions about the size of the short positions he established in Interiors stock on April 20 and 21, 1995. When asked how he intended to cover the relatively large short positions, he speculated that he could have been looking at two different scenarios: Either he could have had a sell order on the stock, or he could have been working an "arbitrage situation." Geller explained that a trading strategy he specialized in was to buy a stock's derivatives when he shorted the stock. We find no evidence to support either of these explanations. There is no dispute that Geller did not have sell orders for Interiors stock on April 20 and 21. As to Geller's buying Interiors warrants, on cross-examination Geller was unable to confirm that Interiors' warrants were available in the amount he needed or that they were so inexpensively priced that he could carry out his hedging strategy.[23] We find, as did the Hearing Panel, that Geller's explanations were mere speculation, rationalization, and "nothing more than an attempt at obfuscation."

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[22] Although we find essentially the same factors dispositive as to both Perles and Geller, we find no evidence that Perles and Geller acted together. Our conclusion that Perles engaged in prearranged trading is independent of our conclusion that Geller engaged in prearranged trading. However, we view the evidence of the trading patterns of Perles and Geller, considered together with all the other evidence, as consistent with Enforcement's theory of a manipulation orchestrated by VTR.

[23] Although Geller testified that he employed "arbitrage" strategies, we understand his strategy to involve a form of hedging.

We conclude that the inferences resulting from Geller's trading activity prove that he engaged in prearranged, matched trading with VTR on April 20 and 21, 1995.

C. Negligently Engaging in Matched Trading

Because we find that Perles and Geller aided and abetted a violation of Conduct Rule 2120 by participating in prearranged trading, we need not address the Hearing Panel's finding that Perles and Geller committed the less serious violation of negligently participating in wash and matched trades with VTR. We note that the Hearing Panel based its finding of a violation of just and equitable principles of trade on the failure of Perles and Geller to make reasonable inquiries of VTR. Our finding that Perles and Geller were participants in prearranged trades moots the Hearing Panel's conclusion that Perles and Geller ignored "red flags" which indicated that VTR was manipulating the trading volume of Interiors stock. We conclude that Perles and Geller acted intentionally, not negligently.

D. Dismissal of Unregistered Distribution Allegations

The Hearing Panel granted the Respondents' motion to dismiss the allegations that the Respondents aided and abetted an unregistered distribution of Interiors stock. We affirm.

We find that the circumstantial evidence introduced by Enforcement -- large trading volume, large short positions established in a rising market, a symmetrical pattern of trading, and razor-thin profits, repeated exactly in numerous trades -- do not prove that Perles or Geller knew or had a general awareness that they were part of an unregistered distribution of Interiors stock. Moreover, Enforcement introduced no other evidence of their participation in the unregistered distribution. Accordingly, we uphold the Hearing Panel's dismissal of Enforcement's allegation that Perles and Geller aided and abetted an unregistered distribution of Interiors stock.

E. Books and Records Violation

Section 17(a) of the Exchange Act and Rule 17a-3(a)(6) require registered broker-dealers to "make and keep" memoranda of all brokerage orders, which are to include any instructions given or received for the purchase and sale of securities.[24] NASD Conduct Rule 3110 requires members to make and keep accurate records required by Section 17(a) of the Exchange Act and the rules promulgated by the SEC thereunder.

These rules required Perles and Geller to make and keep accurate records of all of the terms and conditions underlying the prearranged, matched trades they executed with VTR. Not surprisingly, neither Perles nor Geller accurately recorded that their trades with VTR were prearranged or matched

[24] See also Exchange Act Rule 17a-3(a)(7).

trades.[25] We conclude that Perles and Geller violated NASD Conduct Rules 2110 and 3110, Section 17(a) of the Exchange Act, and SEC Rule 17a-3 by failing to reflect accurately the terms and conditions of the trades they executed with VTR in Interiors stock.

III. Sanctions

The NASD Sanction Guidelines ("Guidelines") state that adjudicators should consider a respondent's relevant disciplinary history in determining sanctions. Guidelines, p. 3 (1998 ed.). In addition, the Guidelines embrace the concept of progressive sanctions. "An important objective of the disciplinary process is to deter future misconduct by imposing progressively escalating sanctions on recidivists." Id.

Perles' disciplinary history includes three prior incidents. First, in 1990, he settled charges brought by the Alabama Securities Commission that he had sold securities that were not registered in Alabama. Second, in 1992, Perles settled a complaint brought by the NASD's Market Surveillance Committee, which alleged that Perles had assisted in an unregistered distribution of stock. Under the terms of the settlement, Perles was fined $5,000 and suspended for five business days from associating with any NASD member in any capacity. Third, in 1995, Perles settled an administrative proceeding brought by the SEC, which charged him with violating Sections 5(a) and 5(c) of the Securities Act of 1933 by facilitating sales of unregistered stock. Under the terms of the settlement, the SEC suspended him for three months and ordered him to cease and desist from further violations.

The Sanction Guideline's general principles explain that "[r]elevant disciplinary history may include . . . (b) past misconduct that, while unrelated to the misconduct at issue, evidences prior disregard for regulatory requirements, investor protection, or commercial integrity." Guidelines at 3. We find that Perles' disciplinary history evidences disregard for regulatory requirements. Accordingly, we treat Perles' disciplinary history as an aggravating factor in determining his sanctions.

Geller's disciplinary history shows that in 1991, he was fined $1,500 and suspended for one day for failing to pay timely four arbitration awards totaling $5,007. We conclude that Geller's disciplinary history is not relevant to this action.

The Hearing Panel ordered that Perles be fined $25,000, suspended in all capacities for one year, ordered to requalify as a general securities representative, and assessed costs. The Hearing Panel ordered that Geller be fined $25,000 and suspended for 30 business days.

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[25] See In re Goldman, Sachs & Co., Exchange Act Rel. No. 33576 (Feb. 3, 1994) (approving a settlement in which a broker-dealer committed the violation of failing to reflect on its books trades that were prearranged, subject to an agreement to reestablish the positions traded, and negotiated with the same party to eliminate risks.)

There is no specific guideline for manipulation. We have previously affirmed that aiding and abetting a market manipulation is a matter of the "highest gravity." Market Surveillance Comm. v. John Roger Faherty, 1998 NASD Discip. LEXIS 44, at *33 (NAC Oct. 14, 1998), appeal filed (imposing a bar on respondent for aiding and abetting a manipulation). Here, Perles and Geller assisted VTR in artificially increasing the volume of trading in Interiors stock. Although VTR's entire scheme was wider-ranging than simply creating the appearance of active trading in Interiors stock, Perles' and Geller's misconduct requires us to impose substantial sanctions in order to deter these respondents and others from engaging in prearranged trading.[26]

Accordingly, we order that Perles be fined $25,000, suspended in all capacities for one year, required to requalify as a general securities representative, and assessed costs of the Hearing Panel proceeding. We also order that Geller be fined $25,000, suspended in all capacities for 30 business days, required to requalify as a general securities representative, and assessed costs of the Hearing Panel proceeding.[27]

On Behalf of the National Adjudicatory Council,

Joan C. Conley,
Senior Vice President and Corporate Secretary

[26] Although we have found that Perles and Geller also committed recordkeeping violations, we base our sanctions on the manipulation violation. We consider the recordkeeping violation to be essentially incidental to and subsumed by the prearranged trading. The Guideline for recordkeeping violations recommends a fine of $1,000 to $10,000 and a suspension of the responsible individual for up to 30 business days. In egregious cases, the Guideline suggests that an adjudicator consider a lengthier suspension or a bar. Guidelines (1998 ed.) at 28 (Recordkeeping).

[27] 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 Procedure 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 sanctions, after seven days' notice in writing, will summarily be revoked for non-payment.