BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD REGULATION, INC.

In the Matter of	
District Business Conduct Committee for District No. 10,	DECISION
Complainant,	Complaint No. C10960208
vs.	District No. 10 (NY)
A.S. Goldmen & Co., Inc. Iselin, NJ,	Dated: May 14, 1999
Anthony J. Marchiano Naples, FL,	
Stuart E. Winkler Brooklyn, NY, and	
Stacy Meyers Staten Island, NY,	
Respondents.	

Held, that a firm, through its vice president of investment banking, sales, trading and compliance and its head trader, charged retail customers fraudulently excessive mark-ups in 500 warrant sales during a four-day period in July 1994, that the firm dominated and controlled the market for the warrants, and that the firm manipulated the market for the warrants by bidding for and purchasing the warrants while engaged in a distribution of the warrants. The case also involves a finding that the firm, its vice president, and its sole owner and president failed adequately to develop written supervisory procedures and failed adequately to enforce a supervisory system. The firm is censured, fined $150,000 (jointly and severally with its president), ordered to pay restitution of $549,903, plus interest, and required to retain an independent consultant. The president of the firm is censured, fined $150,000 (jointly and severally with the firm), and required to requalify as a principal. The vice president is censured, fined $36,000, and suspended for two years. The head trader is censured, fined $5,000, and required to requalify as a general securities representative.

I. Summary

A.S. Goldmen & Co., Inc. ("Goldmen" or "the Firm"), Anthony J. Marchiano ("Marchiano"), Stuart E. Winkler ("Winkler"), and Stacy Meyers ("Meyers") appealed this matter pursuant to NASD Procedural Rule 9311. Following an independent review of the entire record in this matter, we affirm in part and reverse in part the findings of the District Business Conduct Committee for District No. 10 ("DBCC"). The gravamen of our findings is that, during a four-day period in July 1994, Goldmen, through Winkler and (to a lesser extent) Meyers, charged retail customers fraudulently excessive mark-ups in 500 sales of Innovative Tech Systems, Inc. ("ITSY") warrants (cause three), that the Firm dominated and controlled the ITSY warrant market (cause three), and that Goldmen manipulated the market by bidding for and purchasing ITSY warrants while engaged in a distribution of the warrants (in contravention of Securities and Exchange Act Rule 10b-6, an anti-manipulation rule) (cause one).

We affirm the DBCC's findings as follows:

- that Goldmen and Winkler engaged in manipulative trading practices in violation of NASD Conduct Rules 2110 and 2120, Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), and Exchange Act Rule 10b-6;

- that Goldmen and Winkler charged fraudulently excessive mark-ups in violation of NASD Conduct Rules 2110, 2120 and 2440;

- that Meyers also is responsible for Goldmen's excessive mark-ups, although not found to have acted fraudulently, in violation of NASD Conduct Rules 2110 and 2440; and

- that Goldmen, Winkler and Marchiano failed adequately to establish, maintain and enforce a supervisory system.[1]

We reverse and dismiss the DBCC's findings that Goldmen failed to comply with undertakings in connection with an underwriting and received excessive underwriting compensation (cause two).[2]

We impose the following sanctions:

- Censure the Firm, fine it $150,000 (jointly and severally with Marchiano), order payment of restitution of $549,903, plus interest, and require the Firm to retain an independent consultant;

- Censure Winkler, fine him $36,000, and suspend him for two years;

- Censure Marchiano, fine him $150,000 (jointly and severally with Goldmen), and require him to requalify as a principal;

- Censure Meyers, fine her $5,000, and require her to requalify as a general securities representative; and

---

[1] We also affirm the DBCC's dismissal as to Meyers of the allegations of manipulative trading practices (in contravention of NASD Conduct Rules 2110 and 2120, Section 10(b) of the Exchange Act, and Exchange Act Rule 10b-6) and of fraud with respect to Goldmen's excessive mark-ups (in contravention of NASD Conduct Rule 2120).

[2] We note that, on appeal, Market Regulation staff filed a motion to reverse and dismiss the DBCC's findings under cause two. Staff asserted that it had determined that its calculation of excessive underwriting compensation under cause two, upon which the DBCC relied, was erroneous. In light of staff's assertion that the underwriting compensation calculations contained in the DBCC decision are erroneous, we hereby reverse the DBCC's findings and dismiss cause two.

- Assess DBCC hearing costs of $13,520 (jointly and severally as to Goldmen, Winkler and Marchiano).

II. Background

Goldmen has been a registered broker/dealer with its principal place of business in New York City since 1989. The records of the Central Registration Depository ("CRD") indicate that the Firm is still registered. Respondents asserted on appeal that, as a result of the DBCC's decision, all of the Firm's brokers had resigned, and the Firm had ceased retail operations. Since the Firm's inception, Marchiano has been the sole owner and President. He has been employed in the securities industry since 1982 and is registered as a general securities representative and principal.

At all times relevant, Winkler was Goldmen's Vice President in charge of investment banking, sales, trading and compliance. Winkler has been employed in the securities industry since 1979 and is registered as a general securities representative and principal. As discussed below, Winkler, rather than Marchiano, supervised the day-to-day operations of the Firm.

At all times relevant, Meyers was Goldmen's head trader. Meyers has been employed by Goldmen since 1990 and is registered as a general securities representative.

III. Discussion

A. The ITSY Manipulation and Mark-ups

ITSY was incorporated on May 2, 1986 under the name Windy City Capital Corporation. ("Windy City"). In a January 1990 reverse merger, Windy City acquired substantially all of the assets of and changed its name to ITSY. ITSY designs, develops and markets proprietary software used by businesses and the facilities management industry to oversee and manage costs associated with the design, construction and management phases of projects. During the relevant period, ITSY was an operating company and was listed on The Nasdaq SmallCap Market. In July 1998, ITSY was acquired by another company.

On April 15, 1994, Goldmen, acting through Winkler, agreed to act as a managing underwriter of a firm-commitment $6,950,000 ITSY offering consisting of 1.3 million shares of common stock at $5 per share and 1.8 million redeemable warrants at $.25 per warrant. The warrants were immediately tradeable and entitled the registered holder to purchase one share of common stock at an exercise price of $7 for a period of 60 months beginning one year after the effective date of the offering. Although the record indicated that Goldmen allocated shares of ITSY common stock to other broker/dealers in the offering, it did not allocate ITSY warrants. It therefore placed most, if not all, of the warrants with its own customers. In connection with the public offering, on May 13, 1994, ITSY filed a registration statement with the Securities and Exchange Commission ("SEC") whereby ITSY registered the 1.3 million shares of common stock and the 1.8 million redeemable warrants, and (as explained below) also shelf-registered 1.3 million bridge debt warrants.[3] On July 26, 1994, the SEC declared the registration statement effective.

---

[3] Securities Act Rule 415 provides that securities may be registered for offering on a delayed basis. Securities that are registered for offering at a later time may be referred to as "shelf registered."

Independently of Goldmen, ITSY also raised $1.3 million through bridge financing.[4] Under the terms of the bridge loans, ITSY agreed to provide the lenders with seven percent promissory notes and one redeemable warrant for every dollar that ITSY borrowed. In May 1994, ITSY completed the bridge financing and issued 1.3 million bridge debt warrants to 21 investors in return for $1.3 million in financing. The registration statement for the ITSY offering shelf-registered the securities held by the 21 investors (hereafter referred to as "the Selling Security Holders"), but noted that Goldmen was not underwriting the securities and that those securities were not being offered as part of the public offering. The bridge debt warrants were redeemable on the same terms as the public offering warrants.

Aftermarket trading in ITSY warrants commenced at approximately 12:00 p.m. on July 26. Within the first hour of trading, Goldmen purchased approximately 950,000 warrants from 14 of the 21 Selling Security Holders at prices ranging from $.75 to $1 per warrant.[5] By the close of trading on July 26, Goldmen had purchased a total of 1,250,000 ITSY warrants from 19 of the 21 Selling Security Holders at prices ranging from $.75 to $1.25. Goldmen entered the first quotations for the warrants on July 26 with a bid of $.375 and an offer of $1. The inside bid during the periods on July 26 when Goldmen was purchasing from the Selling Security Holders ranged from $1.375 to $1.75. Thus, Goldmen's purchases were below the prevailing quotations. On the morning of July 27, Goldmen purchased an additional 50,000 warrants from the remaining two Selling Security Holders at a price of $1.25 per warrant. The inside bids at the time of the two purchases were $1.75 and $1.625, thereby making these purchases below the prevailing quotations as well.

Each of the 21 Selling Security Holders held accounts at Goldmen. Six of the accounts were opened four days prior to the effective date of the offering. Winkler was the registered representative for eight of the accounts; Marchiano was the registered representative for three accounts.[6] Winkler negotiated Goldmen's purchases from the Selling Security Holders. He testified that he was the only Goldmen representative involved in the purchases. Winkler was aware of the bridge financing before he agreed to act as an underwriter in the ITSY offering. He testified that he understood that bridge financiers generally "flipped" their securities with the expectation of generating a quick profit. He therefore expected that the bridge financiers would provide a ready supply of ITSY warrants once the registration statement was declared effective.

---

[4] Bridge financing generally involves a short-term loan made in anticipation of intermediate or long-term financing. William Thompson ("Thompson"), Chairman and Chief Executive Officer of ITSY, testified that the company had insufficient cash flow to cover the expenses associated with the underwriting process, thereby necessitating the bridge financing. Although the bridge financing occurred independently of Goldmen's underwriting of the ITSY offering, Winkler helped ITSY locate bridge lenders.

[5] There were other sales by Selling Security Holders to Goldmen on July 26 for which Goldmen was unable to produce an order ticket with a legible time stamp. If these sales also occurred during the first hour, the total number of warrants purchased during the first hour would have exceeded one million.

[6] The three accounts were opened, respectively, by Marchiano's ex-wife's step-father, Marchiano's barber, and a client of two years.

1) Domination and Control and Fraudulently Excessive Mark-ups -- ITSY Warrant Market

a) Goldmen's Domination and Control of the ITSY Warrant Market. The third cause of the complaint alleged that Goldmen dominated and controlled the ITSY warrant market and charged retail customers fraudulently excessive mark-ups in sales of ITSY warrants. The DBCC made findings in accordance with the complaint. On appeal, respondents did not dispute that, in terms of volume, Goldmen dominated the market for ITSY warrants. Respondents argued, however, that Goldmen's domination of the market did not result in its control of the market. Therefore, the issue before us is whether the evidence demonstrated that Goldmen controlled the market. We find that it did. For the reasons discussed below, we find that Goldmen dominated the market for ITSY warrants from July 26 through July 29 to such an extent that there was no independent competitive market for the ITSY warrants, and Goldmen controlled the wholesale prices. See In re Steven B. Theys, 51 S.E.C. 473 (1993); In re Meyer Blinder, 50 S.E.C. 1215 (1992).

Respondents argued that Goldmen could not have controlled the market for ITSY warrants because there were so many other market makers. Goldmen was one of several market makers for ITSY warrants during the mark-up review period (July 26 through July 29, 1994) and the manipulation review period (July 26 and 27, 1994).[7] Unlike other market makers, however, Goldmen held tight control over the supply of ITSY warrants by virtue of its purchases from the Selling Security Holders and its placement of ITSY warrants with its own customers. Additionally, other market makers were unaware of the extent of Goldmen's control of the supply of ITSY warrants because Goldmen did not report its purchases of 1.3 million warrants from the Selling Security Holders.[8] Because the trades were not reported, other market makers also did not know that Goldmen had purchased these warrants at prices below the inside bid. In any event, the existence of other market makers does not preclude a finding of domination and control, particularly where, as discussed below, we find control of the supply and fragmentation of the remainder with other broker/dealers. See In re James C. Padgett, Exchange Act Rel. No. 38423 (Mar. 20, 1997); In re Frank L. Palumbo, Exchange Act Rel. No. 36427 (Oct. 26, 1995).

During the mark-up review period, 2,971,688 ITSY warrants were purchased by all broker/dealers. Of this amount, Goldmen purchased 2,785,688 (93.8%). The next closest market participant purchased 34,200 warrants (1.15%). During the review period, all broker/dealers sold 2,686,535 ITSY warrants. Of this amount, Goldmen sold 2,528,935 (94.1%). The most that any other broker/dealer sold was 32,800 (1.22%). The remainder of ITSY warrants bought and sold was fragmented among several broker/dealers. In terms of number of warrants traded, Goldmen accounted

[7] On July 26, 28 and 29, there were 13 market makers in ITSY warrants including Goldmen. On July 27, there were 12 market makers in ITSY warrants including Goldmen.

[8] Winkler testified that he did not report the purchase transactions because they were negotiated trades that occurred at below-market prices, and his securities counsel had advised him in prior similar situations that he did not have to report the trades. Winkler did not consult with counsel on these particular trades. Although the complaint did not allege that Goldmen's failure to report these trades violated NASD rules, the DBCC found in its decision that Goldmen erred in not reporting the trades and that Marketplace Rule 4642(a)(1) required that the trades be reported. In that this was not alleged in the complaint, we will not reach the issue of whether Goldmen complied with Marketplace Rule 4642 in this decision. We note, however, that the fact that other market makers were unaware of Goldmen's purchases of a significant amount of ITSYwarrants on July 26 and 27 is worthy of consideration in connection with the manipulation and domination and control allegations.

for 96.91% of all warrants traded (and 99% of Goldmen's trades were between itself and its customers).[9]

In terms of number of trades, Goldmen accounted for 62.74% of all purchase transactions, 89.73% of all sales transactions, and 91.32% of all market transactions during the mark-up review period. Goldmen's retail customer activity accounted for 89.45% of the total market transactions in ITSY warrants. As of July 29, Goldmen and its customers controlled the public float of ITSY warrants by holding 99.64% of the float.[10] In sum, given Goldmen's control of the supply of ITSY warrants and the fragmentation of the remainder of the market, "it is clear that the other market makers did not provide [an independent market.]" Palumbo, supra at 13.

We also find that the evidence shows that Goldmen controlled the wholesale prices of the warrants through a series of upticks and inter-dealer purchases. Winkler set the first offer in the ITSY warrant aftermarket at $1 ($.75 above the offering price of $.25). During the first two hours and 11 minutes of trading, Goldmen increased its offer six times, even though it was accumulating a substantial inventory.[11] Goldmen's upticks and the one inter-dealer purchase that it executed on July 26 resulted in

---

[9] The broker/dealer with the next highest volume accounted for only 3.09% of all warrants traded. Other broker/dealers that traded ITSY warrants were responsible for less than one percent of warrants traded. "Meager activity by market makers other than [Goldmen] supports our conclusion that, on the [days] in question, a viable independent market did not exist away from [the Firm]." In re Michael Alan Leeds, 51 S.E.C. 500 (1993), appeal dismissed, No. 93-1486 (D.C. Cir. Aug. 2, 1995) at 7.

[10] On July 26, Goldmen sold only 21,500 warrants to other broker/dealers, but it traded nearly 4 million ITSY warrants with its own customers and did not sell a single share of ITSY common stock. In contrast, the total number of warrants traded by other market makers equaled only 75,000. On July 27, Goldmen traded nearly 700,000 ITSY warrants with its customers in 202 transactions. On that day, Goldmen did not sell a single ITSY warrant to other broker/dealers and sold only 5,200 shares of ITSY common to its customers. On July 27, other market makers engaged in only six ITSY warrant transactions involving 13,500 warrants. On July 28, Goldmen traded nearly 400,000 ITSY warrants with its customers in 96 transactions, but did not sell a single warrant to another broker/dealer. Away from Goldmen, other market makers traded just over 80,000 ITSY warrants in 22 transactions. On July 29, Goldmen traded more than 170,000 ITSY warrants with its customers in 53 transactions, but did not sell a single warrant to another broker/dealer. On that day, only two ITSY warrant transactions (involving 800 warrants) occurred away from Goldmen.

[11] Trading in ITSY warrants commenced at 12:00 p.m. on July 26. During approximately the first two hours of trading in ITSY warrants, the following occurred:

- At 12:04:46, Goldmen was alone at the inside offer of $1.125. It upticked 1/8 and created a new inside offer of $1.25, which it held alone.

- At 12:05:59, Goldmen was alone at the inside offer of $1.25. It upticked 1/4 and created a new inside offer of $1.50, which it shared with two other firms.

- At 12:21:57, Goldmen was alone at the inside offer of $1.50. It upticked to $1.75, leaving another market maker alone at the new inside offer of $1.625. That market maker upticked 14 seconds later to $1.75, the new inside offer, which it shared with Goldmen and two other market makers. At 12:21:57, Goldmen held an inventory of approximately 850,000 warrants.

- At 13:38:56, Goldmen shared the inside offer of $1.75 with another market maker. Goldmen upticked to $1.875, leaving the other market maker alone at the inside offer. Less than two minutes an increase during approximately the first two hours of trading (12:00 p.m. to 2:11 p.m.) in the inside offer for ITSY warrants from $1 to $1.9375, and the inside bid increased from $.375 to $1.5625. Once Goldmen increased the inside ask, it began selling the ITSY warrants that it had accumulated in inventory to its retail customers. Between 2:00 p.m. and the close of the market on July 26, Goldmen sold more than 1.4 million ITSY warrants. Despite the increase in the inside offer, Goldmen sold only 21,500 warrants to other broker/dealers before 2:00 p.m. (Goldmen sold only an additional 3,000 warrants to other broker/dealers between 2:00 p.m. and the close of the market.)[12]

At 14:11:04, Goldmen again raised the inside offer, to $1.9375. At 14:07, while holding an inventory of approximately 1.6 million warrants, Goldmen commenced a massive retail sales effort that resulted in Goldmen's retail sales of more than 1.4 million ITSY warrants in 275 transactions at prices ranging from $1.625 to $2.05.[13] Goldmen's retail sale prices contrast sharply with the prices of $1 or less that it paid to acquire nearly 900,000 warrants during the first 15 minutes of trading.

In addition to increasing the inside offer on July 26 with its own upticks, Goldmen increased the inside offer during a seven-minute period on July 28 through a series of three inter-dealer purchases

---

later, the other market maker upticked, leaving Goldmen at the new inside offer of $1.875 with another market maker. At 13:38:56, Goldmen held an inventory in excess of 1.6 million warrants.

- At 13:56, Goldmen was alone at the inside offer of $1.875. Another market maker down-ticked to create a new inside offer of $1.75. At 14:04, Goldmen bought 2,000 warrants from that market maker at $1.75. This was Goldmen's only inter-dealer purchase on July 26. At the time, Goldmen held an inventory of approximable 1.7 million warrants. After Goldmen hit the market maker's offer, the other market maker upticked and left Goldmen alone at the inside offer of $1.875.

- At 14:11:04, Goldmen was alone at the inside offer of $1.875. It upticked 1/16 and was alone at a new inside offer of $1.96875. At the time of this uptick, Goldmen held an inventory of approximately 1.5 million warrants.

12 Respondents argued that other market makers also increased their quoted offers during the review period and that Goldmen established the inside offer less than 30% of the time on July 26. During the first two hours of trading, however, when Goldmen moved the inside ask from its initial offer of $1 to $1.875, Goldmen held the inside offer for all but approximately 10 minutes (and held it alone for approximately 45 minutes of the two hours). While it is true that other market makers increased their offers during the first two hours, none of those upticks served to increase the inside ask. Goldmen's upticks directly or indirectly increased the inside ask. Furthermore, the SEC has rejected the argument that a firm cannot control pricing if other firms set the inside bid or ask. <u>Palumbo</u>, <u>supra</u>; <u>In re George Salloum</u>, Exchange Act Rel. No. 35563 (Apr. 5, 1995).

Respondents also argued that Goldmen did not control the ITSY warrant market because the Firm did not set the inside bid and did not endeavor to increase the inside bid. We reject this argument. Since Goldmen controlled the supply of ITSY warrants, the Firm did not need to set the inside bid in order to exercise control. Other firms would have had to have sold short in order to sell to Goldmen. Because Goldmen controlled the supply, it did not need to purchase additional warrants (and did so only to increase the ask), thereby making the bid somewhat unimportant to it. Goldmen's interest was in selling the ITSY warrants that it already had accumulated to its retail customers. The offer, therefore, was what it sought to increase.

13 Goldmen set its retail prices by marking up five percent from the inside ask.

of 6,000 warrants at prices that exceeded Goldmen's bid.[14] At the time of these purchases, Goldmen held an inventory of well in excess of 300,000 ITSY warrants. Prior to these three purchases, Goldmen had not purchased any ITSY warrants from another broker/dealer since 1:56 p.m. on July 26, when it bought 2,000 warrants from a market maker that was alone at the inside ask, causing that market maker to uptick, thereby increasing the inside ask. On July 28, subsequent to the three inter-dealer purchases, starting at 10:29 a.m., Goldmen sold ITSY warrants to numerous customers in 80 different transactions at or near $2 per warrant. Before these three purchases on July 28, Goldmen had sold ITSY warrants to only two of its customers in only two transactions.

Respondents argued that Goldmen did not control the market because the spreads for ITSY warrants were not unusually wide from July 26 through July 29. We reject this argument. Because the ITSY warrant market was dominated and controlled by Goldmen, the spread was nothing more than the difference between bid and ask quotations, "which were not subject to market discipline." Blinder, supra, at 14. In a market that is dominated to such an extent that one broker/dealer -- in this case, Goldmen -- controls the supply and therefore the market, the quotations, no matter how "fair and reasonable" the spread, are not a reliable basis for assessing the prevailing market, and a narrow spread does not negate a finding of control. Id.

In conclusion, we find the evidence of domination and control to be overwhelming. Goldmen controlled the supply of ITSY warrants to such an extent that it controlled wholesale pricing and precluded the development of an independent and competitive market. As a result, Goldmen was "empowered to set prices arbitrarily." Padgett, supra at 8, (quoting Salloum, supra). We affirm the DBCC's findings that there was no independent competitive market for ITSY warrants from July 26 through 29, 1994 and that Goldmen dominated and controlled the market for ITSY warrants at that time.[15]

b) Fraudulently Excessive Mark-ups in ITSY Warrant Transactions. Under cause three, the DBCC found that from July 26 through 29 (the mark-up review period), Goldmen and Winkler violated Conduct Rules 2110, 2120 and 2440 and Meyers violated Conduct Rules 2110 and

[14] At 10:15, Goldmen purchased at the inside ask ($1.8125) 2,000 warrants from the market maker that was alone at the inside ask. That market maker immediately upticked, leaving two other market makers alone at the new inside ask of $1.875. One minute later, Goldmen purchased 2,000 warrants from one of the two market makers at the inside ask, and that market maker immediately upticked, leaving the one other market maker alone at the inside ask. Five minutes later, Goldmen bought 2,000 warrants from the market maker at the inside ask, and that market maker immediately upticked, thereby increasing the inside offer from $1.8125 to $1.90625.

[15] During the appeal hearing, respondents produced a document that listed the other market makers in ITSY warrants and each firm's net capital. Respondents argued that, since Goldmen's size and net capital were smaller than most of these other firms, Goldmen could not have controlled the market. We note at the outset that this document contained new evidence that was not previously introduced into the record of this proceeding. Although this evidence was introduced in a manner inconsistent with the requirements of NASD Procedural Rule 9346 (which requires that a party seeking to adduce new evidence request permission to do so 30 days after service of the notice of appeal), we have determined to accept it into the record of this proceeding. Market Regulation Staff did not object to the entrance of this evidence into the record. We find, however, given the evidence of domination and control outlined above, that the net capital of the other market makers, no matter how high, did not preclude market control by Goldmen.

2440 by charging the Firm's customers undisclosed, fraudulently excessive mark-ups[16] of $549,903 (dollar amount in excess of five percent) in 500 retail sales of ITSY warrants, as indicated on Exhibit A attached hereto.[17] We affirm the DBCC's findings.

Respondents asserted that, as a market maker in ITSY warrants, Goldmen properly calculated its retail prices from the inside ask. We disagree. In cases in which a firm dominates and controls a market, the appropriate basis for calculating the prevailing market price for the security is the price that the firm paid in the inter-dealer market (or retail market in the absence of inter-dealer trades) to acquire the stock. Palumbo, supra. We find that Market Regulation staff properly computed Goldmen's mark-ups based on Goldmen's costs in wholesale purchases or, in the absence of wholesale purchases, in retail purchases with an imputed five percent mark-down. See, e.g., Palumbo, supra (finding that it is appropriate for NASD to use contemporaneous retail purchases as evidence of prevailing market price in a dominated and controlled market).

The unreliability of the quotations for ITSY warrants is further demonstrated by the fact that fewer than half of the 76 inter-dealer trades that occurred during the four-day mark-up review period occurred at the inside ask.[18] Furthermore, none of Goldmen's inter-dealer sales of approximately 25,000 ITSY warrants occurred at the inside ask. Of its four inter-dealer purchases, two occurred at the inside ask, but two did not. Interestingly, all of Goldmen's four purchases occurred at prices in excess of Goldmen's bid, notwithstanding that Goldmen held substantial amounts of ITSY warrants in its inventory at the time of the four 2,000-warrant purchases. Cf. Salloum, supra (finding that even though certain transactions occurred at quoted prices, given firm's control of the supply of the securities at issue, firm's contemporaneous cost was the best evidence of prevailing market).

Additionally, the limited number of inter-dealer trades away from Goldmen and of Goldmen's sales to and purchases from other market makers demonstrates that, in addition to controlling the supply of ITSY warrants, Goldmen failed to conduct a wholesale market in any realistic sense. Goldmen was, for all intents and purposes, acquiring stock for sale to retail customers, a fact which further undermines Goldmen's argument that it should have been entitled to rely on inter-dealer quotes because of its status as a market maker. See, e.g., Blinder, supra (finding that where a dealer sells primarily to retail customers, its own ask quotation can be a self-serving figure).[19]

---

[16] Although the DBCC held Meyers responsible for excessive mark-ups, it dismissed allegations that she was responsible for Goldmen's violation of Conduct Rule 2120 (fraud). We affirm this finding.

[17] Of the 500 retail sales, 191 occurred at mark-ups of between five and 10 percent. The remaining 309 sales occurred at mark-ups in excess of 10 percent over the prevailing market price. The dollar amount of the mark-ups in excess of 10 percent over the prevailing market price is $429,639.

[18] Of the 76 inter-dealer trades in ITSY warrants, 63 were away from Goldmen.

[19] Respondents also argued that other market makers executed retail sales at prices similar to those charged by Goldmen, thereby indicating that Goldmen's retail prices were fair and reasonable. We reject this argument. Prices that other dealers may be charging their customers are irrelevant in evaluating Goldmen's mark-ups, since one dealer's pricing practices, which may or may not be improper, cannot legitimize another dealer's practices. In re Bison Securities, Inc., Exchange Act Rel. No. 32034 (Mar. 23, 1993). In accordance with precedent in this area, we have determined the appropriateness of Goldmen's prices based on the prevailing market price which, given Goldmen's domination and control of the market, is Goldmen's contemporaneous cost.

Thus, we affirm the DBCC's finding that Goldmen's mark-ups in its sales of ITSY warrants, the majority of which exceeded 10%, were fraudulently excessive.

2) Manipulative Trading Practices -- Rule 10b-6 Violation. Under cause one, the DBCC found that on July 26 and 27 (the manipulation review period), Goldmen and Winkler violated Section 10(b) of the Exchange Act, Exchange Act Rule 10b-6,[20] and Conduct Rules 2110 and 2120 by purchasing and/or bidding for ITSY warrants while engaged in a distribution of those warrants.[21] We affirm the DBCC's finding.

Rule 10b-6 was intended to assure prospective investors in a securities offering that the price of the offering had not been influenced improperly by persons with a significant interest in the success of the offering. It is an antimanipulation rule intended to prevent persons participating in a distribution of securities from artifically conditioning the market and to protect the integrity of the market as an independent pricing mechanism. Review of Antimanipulation Regulation of Securities Offerings, Exchange Act Rel. No. 33924 (Apr. 19, 1994). In order to find a violation of Rule 10b-6, we must find that Goldmen participated in a distribution of securities and, at the same time, purchased and/or bid for the securities.

It is undisputed that Goldmen, a market maker in ITSY warrants during the manipulation review period, displayed bid and ask quotations in The Nasdaq SmallCap Market and purchased ITSY warrants from customers and other broker/dealers on July 26 and 27. Goldmen therefore purchased and/or bid for ITSY warrants during the relevant period.

The DBCC also concluded that Goldmen's purchases of 1.3 million ITSY warrants from the Selling Security Holders and subsequent sales to its retail customers constituted a distribution. Under Rule 10b-6, a distribution was not limited to a public offering under the Securities Act of 1933. Prohibitions Against Trading by Persons Interested in a Distribution, Exchange Act Rel. No. 18528 (Mar. 3, 1982). Rule 10b-6 defined the term "distribution" for purposes of the rule as an offering of securities, whether or not subject to registration, that is distinguished from ordinary trading transactions by the magnitude of the offering and the presence of special selling efforts and selling methods. See Exchange Act Rule 10b-6(c)(5). The SEC has indicated that the definition of distribution must remain flexible to permit the protections afforded by Rule 10b-6 "to evolve with changes in the practices and methods of offering securities." Exchange Act Rel. No. 33924 at 6 (Apr. 19, 1994). The term "distribution" is to be interpreted "in light of [Rule 10b-6's] purposes as covering offerings of such a nature or magnitude as to require restrictions upon open market purchases by participants in order to prevent manipulative practices." In re Billings Associates, Inc., 43 S.E.C. 641, 648 (1967).

Factors relevent to the magnitude element are: the number of shares for sale, the trading volume that those shares represent, the percentage of outstanding shares, and the public float.

[20] The conduct at issue occurred in July 1994. In 1994, Exchange Act Rule 10b-6 prohibited any person engaged in a distribution of securities from purchasing or bidding for the security until that person had completed his participation in the distribution. In December 1996, the SEC adopted Regulation M to replace Rules 10b-6, 10b-6A, 10b-7, 10b-8, and 10b-21. See Exchange Act Rel. No. 38,067 (Dec. 20, 1996).

[21] The DBCC dismissed all allegations of manipulation with respect to Meyers. As noted above, for the reasons discussed in the DBCC's decision, we affirm that dismissal.

Exchange Act Rel. No. 33924. The SEC has also stated that volume alone is not the only deciding factor and that the percentage of the public float that is represented by the securities being distributed must be considered. Exchange Act Rel. No. 18528.

Between 12:00 p.m. on July 26 and 12:00 p.m. on July 27, Goldmen purchased 1.3 million ITSY warrants from the 21 Selling Security Holders (the majority of the purchases actually occurred within the first hour on July 26). Over the course of these two days, Goldmen sold to its retail customers more than 2.4 million warrants in 522 transactions (which included some of the 1.8 million warrants from the offering and the 1.3 million warrants that it had purchased from the Selling Security Holders). The 1.3 million warrants represented 38.6% of the public float and more than 36% of the total ITSY warrants issued and outstanding at the time of the sales. We find that Goldmen's sales effort satisfied the magnitude element. See In re Collins Securities Corporation, 46 S.E.C. 20 (1975) (the fact that an offering amounted to more than 30% of the outstanding stock satisfied the magnitude prong), rev'd on other grounds, Collins Securities Corp. v. SEC, 502 F.2d 320 (D.C. Cir. 1977); Billings Associates, supra (placement of 900,000 shares of a security constitutes a distribution); In re J. H. Goddard & Co., Inc., 42 S.E.C. 638 (1965) (sales of two blocks of stock totaling 32,480 shares while other firms traded 244,000 shares was a distribution); In re Bruns, Nordeman & Company, 40 S.E.C. 652 (1961) (sales of two blocks of 42,550 and 61,515 shares of common stock constituted a distribution).

In contrast, other market makers traded only approximately 69,200 ITSY warrants in 39 trades on July 26 and 13,500 ITSY warrants in six trades on July 27. Clearly, the activity in ITSY warrants by other market makers on July 26 and 27 was insubstantial in comparison to Goldmen's sales. Cf. In re Theodore A. Landau, 40 S.E.C. 1119 (1962) (finding that a broker/dealer may be engaged in a distribution notwithstanding the fact that the number of shares involved represents a small part of the total shares outstanding when there is no evidence of substantial activity in the stock by other broker/dealers during the period in question).[22]

Goldmen also engaged in special selling efforts with respect to the ITSY warrants. ITSY warrants were virtually the only securities that Goldmen sold to its retail customers on July 26 and 27. Goldmen effected 597 sales on those two days, 522 of which (92.9%) involved sales of ITSY warrants. In sharp contrast, Goldmen sold only 5,200 shares of ITSY common stock to its customers in seven transactions, and not one of those seven occurred on the first day of aftermarket trading (July 26).

Additionally, although retail activity away from Goldmen was scant on July 26 and 27,[23] Goldmen sold 2.4 million ITSY warrants (but only 5,200 shares of ITSY common stock) during these two days. Goldmen's retail sales of ITSY warrants far exceeded any other firm's sales and far exceeded its own sales of other stocks on July 26 and 27. We agree with the DBCC that this evidence supports the conclusion that Goldmen engaged in special selling efforts.

---

[22] Respondents argued that, in order to determine that the evidence in this case met the magnitude test, the DBCC improperly aggregated the sales by the 21 Selling Security Holders without proof that they acted in concert. It is not necessary for us to determine that the 21 Selling Security Holders acted in concert in order to conclude that Goldmen's purchases from them and sales to its retail customers constituted participation in a distribution. Cf. Goddard, supra (finding a distribution without demonstrating that sellers acted in concert); Bruns, Nordeman, supra (same).

[23] Retail activity away from Goldmen on July 26 and 27 involved only 24 sales of 81,700 warrants.

Furthermore, in terms of dollar amounts, Goldmen paid its registered representatives higher commissions for sales of ITSY warrants than it paid for sales of other common stocks or warrants. Although all Goldmen representatives received a commission payout of 50% of the Firm's gross commissions for all sales of all securities, including ITSY warrants, the average dollar amount that the registered representatives received as commissions for sales of ITSY warrants was nearly triple the average commission dollar amounts for sales of other securities. Indeed, Winkler testified that he routinely changed the "cost basis" from which he calculated the firm's commissions throughout the course of the day. He indicated that he sometimes allowed the commission payout to include the spread (i.e., Winkler would calculate the Firm's gross commission from the inside bid and pay the representatives 50% of that number), or sometimes he used a higher number and reduced the commission calculation. He testified:

> I could, 20 minutes later, instruct the trading department [they are] no longer getting the stock from $1.50, they're getting it from $1.55, and now the gross spread is $.20, the nickel would go into the firm's trading account as profit. Five minutes after that, I can say, "You know what? I want the firm to make more money, the hell with the brokers. I don't like them anyhow. There [sic] getting less commission." And I tell the trading personnel, "Anybody calls you, the stock is now coming from a higher cost," and I give them the number. And then the firm, instead of the firm making 50% of the gross, I'm not, shall we say, taking profit off of the top, and then taking 50% of what I'm giving [the sales staff.]

DBCC Hearing Transcript ("Hearing Tr.") at 1763.

Thus, while claiming to pay the sales staff a straight 50%, Winkler in fact increased and decreased the sales staff's commissions at will. On average, the commissions that Goldmen earned on ITSY warrant transactions on July 26 and 27 equalled 24.31% of the total proceeds of the sales (of which the registered representatives received a straight 50%). In contrast, on July 26 and 27, Goldmen earned average commissions of 5.93% of total proceeds on sales of ITSY common and average commissions of 8.65% of total proceeds for sales of other securities. Thus, although the sales force always received 50% of Goldmen's gross commission, Winkler's varying methods of determining how to calculate that gross commission enabled the Firm to pay the sales force increased commission dollar amounts without having to change the percentage payout. The SEC has indicated that "the presence of special selling efforts and selling methods may be indicated in a number of ways, including the payment of compensation greater than that normally paid in connection with ordinary trading transactions." Prohibitions Against Trading by Persons Interested in a Distribution, Exchange Act Rel. No. 19565 (Mar. 4, 1993) at n. 13.

Thus, having determined that Goldmen participated in a distribution while entering bids and purchasing securities, we conclude that the Firm and Winkler manipulated the ITSY warrant market and violated Rule 10b-6.

3) Winkler's Involvement - Scienter. We affirm the DBCC's findings that Winkler was responsible for the Firm's manipulation of the ITSY warrant market and for charging Goldmen's customers fraudulently excessive mark-ups in sales of ITSY warrants. Like the DBCC, we also find that Winkler acted with scienter.

At all times relevant, Winkler was a principal and Vice President of Goldmen, responsible for investment banking, sales, trading, and all areas of supervision and compliance. Winkler readily acknowledged that he ran the Firm and that, although Marchiano owned the Firm, he (Marchiano) deferred to Winkler "on everything." Hearing Tr. at 1744.

Winkler also admitted his responsibility for: locating and accepting ITSY as a corporate financing candidate (without Marchiano's input or approval); negotiating with ITSY; determining ITSY's offering price; acquiring Goldmen's large inventory position in ITSY warrants (in many instances, at prices below the prevailing inside bid); deciding not to report Goldmen's purchases of ITSY warrants from the Selling Security Holders; setting Goldmen's opening bid in ITSY warrants; deciding when and if Goldmen would uptick its offer for ITSY warrants; establishing Goldmen's retail pricing practices (for all securities, including ITSY warrants); supervising all department heads, including Meyers (Goldmen's head trader); ensuring Goldmen's compliance with Exchange Act Rule 10b-6; deciding when and if to sell ITSY warrants to the Firm's retail customers; and determining whether Goldmen dominated and controlled markets. Winkler reviewed trading runs and other trading records on a daily basis and monitored the Firm's inventory daily. Although Meyers was the head trader, Winkler made all trading decisions.[24]

Winkler testified that he controlled virtually every aspect of Goldmen's involvement in the ITSY warrant market. Winkler also testified that all departments reported to him, that he was not supervised by anyone, and that even Marchiano, the Firm's owner and president, reported to him for regulatory purposes. Like the DBCC, we find that during the mark-up and manipulation review periods, Winkler was responsible for virtually all of Goldmen's actions and specifically for dominating, controlling and manipulating the ITSY warrant market; charging fraudulently excessive mark-ups in retail sales of ITSY warrants; and violating Exchange Act Rule 10b-6. We further find that Winkler acted with scienter.

---

[24] Winkler testified that Meyers made no trading decisions on her own. She had no discretion to act on behalf of the Firm and always bought and sold within the limits set by Winkler. If an occasion arose where she had to consider acting outside those limits, she first would contact Winkler and obtain his approval. During the relevant period, Winkler worked primarily out of the Firm's New Jersey office. Meyers and the trading room were located in the New York City office. Winkler stated that, with ITSY and all other offerings, he stayed in constant contact with Meyers and directed her trading activities, particularly during the first day of trading. (He also monitored the market on his own Level Three Nasdaq machine.) He stated that "[s]omebody ha[d] to be at least in [his] mind understanding the direction of trading," and that he was that person. Exhibit 13 at 184. On July 27, Winkler left with his family for a trip to London. He stated, however, that he maintained constant telephone contact with Meyers while abroad and that, while away, he handled "[t]he big responsibility of the money at the [F]irm." Id at 193. While Winkler was away, Meyers still had no discretion to commit Firm funds or to buy or sell securities on behalf of the Firm. She could act only within the parameters that Winkler had set.

We find that, although Winkler may have been absent from the office during certain periods, he was aware of and responsible for Goldmen's pricing policy, which was to mark-up from the inside ask, and he knew or should have known that Goldmen dominated and controlled the ITSY warrant market. He maintained regular telephone contact with the office and continued to perform his duties. Regardless of his absence from the trading room, we find it appropriate to hold Winkler responsible for the Firm's violations. See Palumbo, supra.

"Scienter is the 'mental state embracing intent to deceive, manipulate, or defraud.'" Pagel v. SEC, 803 F.2d 942, 946 (8th Cir. 1986). Winkler was, at the time of the misconduct, a 15-year veteran in the securities industry and had worked for much of that time as a securities regulator. He controlled all aspects of Goldmen's involvement in the ITSY warrant market. He assisted ITSY in locating bridge lenders, fully anticipating that the bridge lenders (who would become bridge warrant holders) would "flip" their warrants in the immediate aftermarket. He negotiated Goldmen's purchases of the bridge warrants from the Selling Security Holders at prices that he knew were below the inside bid. He admittedly knew the number of bridge warrants that Goldmen purchased from the Selling Security Holders and that most of the aftermarket volume in ITSY warrants was with Goldmen.[25] He also knew that Goldmen sold more than 1.5 million warrants to its customers in a two-hour period on July 26. By virture of his close contact with Meyers and the daily trade reports that he reviewed, Winkler followed the ITSY warrant aftermarket closely and was aware of (and singularly responsible for maintaining) Goldmen's inventory positions. He knew the Firm's costs and established its practice of setting retail prices based on the inside ask. Winkler possessed the "most critical information necessary [i.e., the Firm's cost] to price [ITSY warrants] fairly." Leeds, supra at 8.

Winkler also knew that, as an underwriter, Goldmen was in a position to dominate and control the ITSY warrant market. In a 1989 communication with NASD staff regarding another underwriting, he indicated:

> We understand that as managing underwriter we are in a position to control and dominate this security. . . . We understand the guidelines concerning mark-ups, mark-downs, cost basis, and the spread. . . . The [F]irm will use its cost basis for mark-ups and mark-downs until such time [sic] the market for this security in our opinion is not dominated by [Goldmen.]

Exhibit 45.[26]

In light of the market information that Winkler possessed and his awareness of the potential for Goldmen to dominate and control the ITSY warrant market, we find that he acted with the requisite scienter with respect to the Firm's fraudulently excessive mark-ups. See Salloum, supra; Leeds, supra; Theys, supra.

We also find that he acted with scienter with respect to the Firm's manipulation of the ITSY warrant market and violation of Rule 10b-6. The SEC has stated that:

> A person contemplating or making a distribution has an obvious incentive to artificially influence the market price of the securities in order to facilitate the distribution or to increase its profitability. [The

---

[25] Winkler testified that Goldmen had the "book" in ITSY warrants during the first day of aftermarket trading. He testified that "having the book" meant that "[other firms come] to [you] because [you] know where all size is, they can do size with you, [you] have the ability to place size." Hearing Tr. at 1717.

[26] Through counsel, in 1993, Goldmen also petitioned the NASD Board of Governors to review and revise the NASD Mark-up Policy.

> Commission has] accordingly held that where a person who has a substantial interest in the success of a distribution takes active steps to increase the price of the security, a prima facie case of manipulative purpose exists.

Exchange Act Rel. No. 33924, at 5.

Winkler purchased the bridge warrants from the Selling Security Holders. He admittedly was responsible for Goldmen's bids for and purchases of 950,000 ITSY warrants (exclusive of the warrants purchased from the Selling Security Holders) during the manipulation review period. Through purchases and upticks, for which Winkler accepted responsibility, Goldmen actively increased the price of ITSY warrants during a period when, through Winkler's efforts, Goldmen held most of the supply of ITSY warrants. During the first two hours of trading on July 26, after developing a long position of more than 1.7 million ITSY warrants and raising its offer six times, under Winkler's direction, Goldmen began a massive sales campaign whereby it distributed to its retail customers more than 1.4 million warrants by the end of the day. Rule 10b-6 is designed to prevent the exact type of manipulation in which Winkler engaged -- purchasing and bidding for ITSY warrants for manipulative purposes while also distributing the warrants to the public. See Collins, supra. Given Winkler's intimate involvement in Goldmen's activities and his experience in the industry, we find that he acted with manipulative intent with respect to the Firm's violation of Rule 10b-6.

4) Meyers' Responsibility for Mark-ups. Like the DBCC, we find that Meyers must be held responsible for the Firm's excessive mark-ups, although given the limits on her control over Goldmen's trading activities, we do not find that she acted with scienter.

Meyers argued that she was not responsible for the Firm's mark-ups because Winkler exercised tight control over the Firm's trading room. Meyers cannot, however, avoid the fact that she was the Firm's head trader. She accepted the position and the title and, no matter how much influence and control Winkler exercised over the trading room, she must accept some responsibility for the Firm's sales practices. Although Winkler set pricing policies, Meyers admitted that it was her responsibility to review the Firm's retail sales to ensure compliance with the NASD's mark-up policy. She reviewed order tickets, supervised other traders and executed most of the Firm's trades. Indeed, in a March 15, 1996 response to an NASD request for information, Goldmen indicated that Meyers was primarily responsible for trading ITSY warrants in July 1994.

Meyers denied that she knew the extent of the Firm's purchases from the Selling Security Holders, but she knew of at least some of the purchases and therefore knew Goldmen's cost in acquiring the ITSY warrants. Furthermore, Meyers testified that she reviewed the ITSY "red herring"[27] before the effective date of the offering. In a 1996 deposition, Meyers testified that she generally tracked the Firm's inventory positions and costs during the trading day and that the Firm's inventory positions and costs were relevant to the determination of the Firm's retail prices.[28] Meyers was responsible for trade reporting and maintaining the Firm's quotes. She also provided Winkler with daily trade reports and was familiar with Goldmen's inventory positions.

---

[27] "Red herring" is a term used to refer to the preliminary prospectus.

[28] Additionally, since Goldmen's inter-dealer sales were away from the inside ask, Meyers should have questioned the reliability of marking up from the inside ask.

Meyers was in a position to observe "red flags" regarding Goldmen's trading activity in ITSY warrants. She knew the Firm's cost and inventory positions in ITSY warrants, she could observe the heavy in-house retail activity at Goldmen and negligible activity away from Goldmen, she could observe the dearth of activity in ITSY common stock, and she reviewed tickets for and/or executed the retail trades in which Goldmen charged excessive mark-ups. "A trader has the responsibility to charge fair markups and is not relieved of that obligation because the firm or its compliance officers approved or even directed his method of calculating mark-ups." In re Jeffrey D. Field, Exchange Act Rel. No. 33952 (Apr. 21, 1994). We find that the evidence amply demonstrates Meyers' responsibility for the Firm's mark-ups.

B. Supervisory Failures

Under cause four, the DBCC concluded that Goldmen, Winkler and Marchiano failed to establish and maintain adequate written supervisory procedures and failed adequately to enforce the Firm's supervisory system. We affirm these findings.

1) Inadequate Written Procedures. Conduct Rule 3010 states that each member shall establish and maintain a system to supervise the activities of each registered representative and associated person that is reasonably designed to achieve compliance with applicable securities laws. We find that Goldmen's written procedures were inadequate and that Winkler and Marchiano were responsible for the inadequacies.

Goldmen's written supervisory procedures lacked specific procedures designed to ensure compliance with the NASD's mark-up policy and did not discuss the concept of domination and control as it applies to fair pricing. The written procedures also inadequately addressed the prevention and detection of manipulation and compliance with Exchange Act Rule 10b-6. With respect to these two areas, the written procedures failed to explain what reviews would be conducted and by whom. See In re Castle Securities Corporation, Exchange Act Rel. No. 39523 (Jan. 7, 1998) (finding a supervisory violation where procedures manual failed to address the determination of fair prices in a dominated and controlled market and did not provide for prevention and detection of manipulation of the market); Palumbo, supra (compliance procedures that simply ensured that retail prices were not higher than five percent above the inside offer did not provide specific enough methods for ascertaining a fair price); In re Gary E. Bryant, 51 S.E.C. 463 (1993) (finding a violation where firm's written procedures provided a list of things not to do, but did not establish a mechanism for ensuring compliance).

We find Winkler and Marchiano responsible for Goldmen's inadequate written procedures. The Firm's compliance and supervisory manuals themselves list Winkler and Marchiano as responsible for all areas of senior management (and specifically designate Marchiano as the person with supervisory responsibilities). Marchiano was a principal, the President and the sole owner of the Firm. In a deposition in June 1996, Marchiano testified that he oversaw the Firm's management and that he assisted in the preparation of the supervisory manual. He also testified that, although he delegated all compliance responsibilities to Winkler, he was responsible for ensuring that the individuals to whom he delegated responsibility were "doing their job properly." As discussed in Section III(A)(3) of this decision, Winkler acknowledged his responsibility for all areas of compliance and supervision at Goldmen. We thus find it appropriate to hold both Winkler and Marchiano responsible.

2) Ineffective Supervision. We also find that Winkler and Marchiano failed adequately to supervise.

Winkler failed to supervise Meyers. Meyers was inadequately trained for her position as head trader. Meyers testified that she had not received the supervisory procedures manual before 1996 and had not received the compliance manual until one week before her May 1996 deposition. She also had never seen NASD Notice to Members 92-16 (regarding mark-ups) and never had discussed the concept of domination and control with Winkler or Marchiano before July 1994. Indeed, Meyers stated that, prior to July 1994, she was never instructed as to her responsibilities as a trader. Winkler was head of compliance and ultimately responsible for the trading department. He admitted that he supervised Meyers and that she reported to him. We find that Meyers was trained inadequately for her position as head trader and hold Winkler responsible.

We also find that Marchiano failed to supervise Winkler. Marchiano was a principal, the President and sole owner of Goldmen. Although we acknowledge that, as President, it was appropriate for Marchiano to delegate many of his responsibilities to Winkler, we also find that Marchiano, as Winkler's superior, should have established a system of checks and balances whereby he maintained some supervisory control over Winkler. He failed to do so. As a result, Winkler received no supervision whatsoever.[29] Even though Winkler was a senior and powerful person at the Firm, he should not have been allowed to function without any oversight. Marchiano, as Winkler's superior, is responsible for this failure. Cf. In re Rita H. Malm, Exchange Act Rel. No. 35000 (Nov. 23, 1994) (implicit in the delegation of a supervisory function is the responsibility to follow-up to ensure that delegated authority is exercised properly); In re Stuart K. Patrick, 51 S.E.C. 419 (1993) (direct superior of person to whom responsibilities were delegated should have supervised).

Thus, we find that Goldmen, Winkler and Marchiano failed adequately to maintain and enforce supervisory procedures and violated Conduct Rules 2110 and 3010.

C. Procedural Matters

Respondents raise several procedural objections. First, they argue that the DBCC erred in refusing to compel the testimony of traders from other firms who were market makers in ITSY warrants during the relevant period.[30] Respondents sought to introduce this testimony to demonstrate that the other market makers were not "controlled" by Goldmen and that their quotes were bona fide during the relevant period. The DBCC refused to compel the testimony because it determined that the testimony would not have been relevant. The DBCC reasoned that a determination as to the validity of quotations and domination and control of a market must be made based on actual market transactions, not the recollections and perceptions of traders. We concur. The appropriate method for validating quotations is to compare the quotations to actual inter-dealer transactions. In re Alstead, Dempsey & Company, 47 S.E.C. 1034 (1984). The proper method for determining whether a firm dominates and controls a market is to consider whether the firm at issue was an underwriter for an offering of the security and to evaluate the actual aftermarket trading activity in the security. In re Steven P. Sanders, Exchange Act Rel. No. 40600 (Oct. 26, 1998); Palumbo, supra. The record contained ample evidence regarding actual trading in ITSY warrants during the review period. Furthermore, the perceptions of

[29] Winkler testified that in July 1994, no one supervised him.

[30] Counsel for respondents asserted that he contacted traders at the other market makers and requested that they testify at the DBCC hearing regarding their perceptions as to the ITSY warrant market during the relevant period. Counsel asserted that these individuals were unwilling to testify voluntarily. Respondents therefore requested that the DBCC invoke its authority under Procedural Rule 8210 to require the traders to testify.

other market makers may not have been accurate, since they were unaware of Goldmen's purchases of 1.3 million ITSY warrants from the Selling Security Holders. We conclude that respondents were not prejudiced by the DBCC's decision to exclude market maker testimony.

Second, respondents argue that the DBCC erred in refusing to compel the testimony of Thomas Garvey ("Garvey") (a former NASD employee who participated in the NASD's investigation of Goldmen and who was not employed with the NASD at the time of the DBCC hearing) and Raymond Knight ("Knight") (an analyst in the Corporate Finance Department). The DBCC concluded that neither individual could offer non-cumulative evidence and therefore denied respondents' requests. We concur.

Although Garvey was the investigator who prepared many of the mark-up schedules, another NASD employee, Edward Rosenblatt ("Rosenblatt"), reviewed, verified and updated his work and testified at length regarding Garvey's methods of preparation and the NASD's investigation. Moreover, the underlying documentation used to prepare the schedules and tables was provided to respondents. We do not find that respondents were prejudiced by Garvey's failure to testify, and we conclude that the DBCC acted properly. Cf. In re DMR Securities, 47 S.E.C. 180 (1979) (finding that it was not improper for the NASD to base mark-up findings on schedules prepared by a former NASD employee who was not available at the hearing).

As to Knight, we note at the outset that his testimony is moot because we have determined to dismiss cause two (excessive underwriting compensation) which is the cause as to which he would have testified if called. Additionally, Knight's direct supervisor testified at length regarding the allegations of excessive underwriting compensation.[31] Thus, respondents were not prejudiced by Knight's failure to testify.

Finally, respondents argued that the DBCC improperly limited testimony and evidence to the review period.[32] We find that respondents were not prejudiced by the DBCC's action. Evidence as to trading in ITSY warrants during the period subsequent to Goldmen's domination and control of the market need not have been entered into the record of this proceeding in order to provide respondents with a fair hearing. See Leeds, supra. The SEC has noted that evidence of subsequent anti-manipulative conduct by an alleged manipulator or evidence that the price of a manipulated stock remained high after the period of manipulation does not defeat a finding of manipulation during the review period. See Patten, supra (finding that respondent's failure to sell off its inventory and the fact that the price of a manipulated stock remained high did not negate finding of manipulation). Thus, respondents were not prejudiced by the DBCC's actions in this regard.

---

[31] Respondents also argued that Knight's testimony might have supported a claim of selective prosecution. This argument does not change our view that Knight's testimony was not material. To demonstrate selective prosecution, respondents must establish that they were singled out for enforcement action while others who were similarly situated were not and that their prosecution was motivated by arbitrary or unjust considerations. In re G. K. Scott, 51 S.E.C. 961 (1994). Respondents have not presented a theory of selective prosecution that meets the elements of such a claim Respondents "may not use the discovery process to go on a fishing expedition in the hopes that some evidence will turn up to support an otherwise unsubstantiated theory." Scott at 17.

[32] We note that, at the appeal hearing, respondents' counsel and Market Regulation staff discussed the price of ITSY warrants during periods subsequent to the review period. We did not consider these arguments or any others that referred to evidence (i.e., the price of ITSY warrants outside the review period) that is not a part of the record before us.

D. Sanctions

At the outset, we note that the misconduct in which respondents engaged is egregious and deserving of serious sanctions. Respondents' actions placed the investing public at risk and harmed the industry as a whole by interfering with free market forces. Respondents' conduct demonstrated "a marked insensitivity to their obligation to deal fairly with customers." Palumbo, supra, at 20. Although we have not held Marchiano responsible for the underlying manipulative and sales practices violations, we find that his failure to supervise and/or exercise any type of oversight over Winkler's activities enabled Winkler to orchestrate Goldmen's manipulative activity and excessive prices.

Like the DBCC, we find that Winkler is primarily responsible for Goldmen's misconduct and that his involvement was necessary and instrumental in Goldmen's manipulation of the ITSY warrant market and the excessive prices that Goldmen charged its customers. In light of our dismissal of the DBCC's findings under cause two (excessive underwriting compensation), however, we have determined to reduce the fine imposed by the DBCC as to Winkler. Thus, we affirm the censure, reduce the $50,000 fine imposed by the DBCC to $36,000 ($12,000 each for causes one, three and four), and affirm the two-year suspension in all capacities imposed by the DBCC.

As to the Firm, we similarly find that while its misconduct was egregious, it is appropriate to reduce the sanctions in light of our dismissal of cause two. Thus, we affirm the censure, reduce the $200,000 fine imposed by the DBCC to $150,000, which we impose jointly and severally on the Firm and its owner, Marchiano, and reduce the DBCC's order of restitution from $1,050,069 to $549,903 (mark-ups in excess of five percent as indicated in Exhibit B attached hereto[33] -- to be paid to the customers listed on Exhibit B), plus interest at the rate set forth in Section 6621(a) of the Internal Revenue Code, 26 U.S.C. 6621(a)(2), from the dates of the sales listed on Exhibit B until the date that restitution is paid.[34] We also affirm the requirement that the Firm retain a qualified independent consultant but modify the terms of the requirement:

> 1) The Firm will, at its own expense, retain an independent consultant who is acceptable to NASD Regulation staff, within 60 days of the date when this decision becomes final.
>
> 2) The consultant shall review the Firm's policies, practices and procedures (including supervisory and compliance procedures) with particular attention to mark-up and mark-down procedures and procedures regarding compliance with Rule 10b-6.

---

[33] The DBCC's restitution order included excessive underwriting compensation which it found that the Firm received under cause two. Since we have dismissed cause two, we reduced the order of restitution accordingly.

[34] Satisfactory proof of payment of the restitution, or of reasonable and documented efforts undertaken to effect restitution, shall be provided to the staff of NASD Regulation no later than 120 days after the date when this decision becomes final. If, for any reason, Goldmen is unable to locate a customer after reasonable and documented efforts within such period, or such additional period agreed to by the staff of NASD Regulation, Goldmen shall forward any unpaid restitution and interest to the appropriate escheat, unclaimed property or abandoned property fund for the state in which the customer last resided.

3) The consultant shall provide to the Firm (and the Firm shall provide to NASD Regulation staff) a written explanation as to whether the Firm's procedures are consistent with federal securities laws and the rules and regulations of NASD Regulation. If the consultant determines that the Firm is not in compliance, he shall provide the Firm (and the Firm shall provide NASD Regulation staff) with an explanation of the manner in which the Firm is not in compliance, recommendations regarding changes to the Firm's procedures, and recommendations as to implementation of the recommended changes. The Firm thereafter shall adopt and implement the proposed changes.

4) The Firm and its employees shall cooperate with the consultant and shall place no restrictions on the consultant's communications with NASD Regulation staff. For a period of two years following the date of the Consultant's last report, the Firm shall not employ or otherwise hire the consultant.

As to Meyers, we affirm the censure and $5,000 fine. We eliminate the 90-day suspension imposed by the DBCC. We order that she requalify in all capacities requiring qualification within 120 days of the date when this decision becomes final. As head trader, Meyers must be held accountable for the Firm's excessive mark-ups. We note, however, that the sanctions that we have imposed take into account the nature of her misconduct as compared to that of Winkler, who was more directly involved in the Firm's sales, pricing, and establishing of retail policies.[35]

As to Marchiano, we have determined to affirm the censure and requirement to requalify as a principal. Marchiano's failure to ensure that he maintained some control over and supervision of Winkler demonstrates that he needs to reacquaint himself with the obligations attendant to his position. For this reason, we believe that it is appropriate for him to requalify as a principal within 120 days of the date when this decision becomes final. In lieu of the $50,000 individual fine and six-month suspension imposed by the DBCC, we have determined to convert the Firm's $150,000 fine to a fine that is joint and several as to the Firm and Marchiano.

Thus, we have determined to impose the following sanctions:[36]

- Censure Goldmen, fine the Firm $150,000, jointly and severally with Marchiano, order

[35] We also have determined to eliminate Meyers from responsibility for the DBCC costs of $13,520, which the DBCC assessed jointly and severally as to Goldmen, Marchiano, Winkler and Meyers.

[36] There are no guidelines for Rule 10b-6 violations and manipulations under Conduct Rule 2120. The sanctions with respect to Goldmen are consistent with the applicable NASD Sanction Guidelines ("Guidelines"). See Guidelines (1996 ed.) at 33 (Mark-up Violations and Excessive Commissions) and 53 (Supervision). The sanctions with respect to Winkler and Meyers are consistent with the applicable Guidelines. See Guidelines (1996 ed.) at 33 (Mark-up Violations and Excessive Commissions) and 53 (Supervision). The sanctions imposed as to Marchiano ($150,000 fine, jointly and severally with Goldmen) are outside the range recommended in the Guidelines. See Guidelines (1996 ed.) at 53 (Supervision). The $150,000 joint and several fine as to the Firm and Marchiano is appropriate in that, as owner of the Firm, Marchiano benefitted from Winkler's misconduct. Furthermore, Marchiano's failure to supervise and maintain control over Winkler enabled Winkler to proceed with the misconduct at issue.

restitution of $549,903 to be paid to customers in accordance with Exhibit B attached hereto, plus interest at the rate set forth in Section 6621(a) of the Internal Revenue Code, 26 U.S.C. 6621(a)(2), from the dates of the sales listed on Exhibit B until the date that restitution is paid, and require the Firm to retain an independent consultant in accordance with the terms described earlier in this decision.

- Censure Winkler, fine him $36,000, and impose a two-year suspension in all capacities.

- Censure Meyers, fine her $5,000, and require that she requalify by examination within 120 days in all capacities requiring qualification or cease acting in such capacities until she has requalified.

- Censure Marchiano, fine him $150,000, jointly and severally with the Firm, and require that he requalify by examination within 120 days as a principal or cease acting in all principal capacities until he has requalified.

- Impose DBCC costs of $13,520.64 jointly and severally as to Goldmen, Winkler and Marchiano.

The suspensions imposed herein shall commence 30 days after issuance of this decision. The Firm is required to pay the restitution ordered herein within 120 days of the date when this decision becomes final. The Firm must retain the independent consultant within 60 days of the date when this decision becomes final.[37]

---

[37] 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.

On Behalf of the National Adjudicatory Council,

____

Joan C. Conley
Senior Vice President and Corporate Secretary