BEFORE THE NATIONAL BUSINESS CONDUCT COMMITTEE

NASD REGULATION, INC.

In the Matter of District Business Conduct Committee For District No. 9 Complainant, v. Shamrock Partners, Ltd. Media, Pennsylvania and James T. Kelly Newtown Square, Pennsylvania, Respondents.	DECISION Complaint No. C9A960002 District No. 9 Dated: August 5, 1997

This matter was appealed by respondents Shamrock Partners, Ltd. ("Shamrock" or the "Firm") and James T. Kelly ("Kelly") pursuant to NASD Procedural Rule 9310. For the reasons discussed below, we hold that Shamrock and Kelly violated Article III, Sections 1 and 4 of the NASD's Rules of Fair Practice (now and hereinafter referred to as "Conduct Rules 2110 and 2440") when from October 26 to November 11, 1992, Shamrock acting through Kelly, effected in a principal capacity five purchases of Stylex Homes, Inc. (old) ("Stylex") common stock from customers at prices which were not fair and reasonable in that the mark-downs on the purchases exceeded 5%. We order that Shamrock and Kelly be censured; fined $15,000; assessed hearing costs of $1,155 and appeal costs of $750; pay customers Robert C. Hackney ("Hackney") and Ronald Hayes, Sr. ("Hayes") restitution in the amount of $10,674.22. The fine, restitution and costs are to be paid jointly and severally. We also order that Shamrock and Kelly demonstrate corrective action with regard to their mark-up and mark-down policy and submit to a staff interview.

Background. Shamrock is a registered broker/dealer and has been a member of the Association since February 1989. Kelly first became registered with the Association as a general securities principal in 1983. At the times relevant herein, Kelly was the president of Shamrock

and was registered with the Association as a general securities principal. Kelly is presently registered as a general securities principal and is associated with Shamrock.

Facts

In October 1992, customers Hackney and Hayes called Kelly and said they wanted to sell 40,000 shares of Stylex stock. Hackney told Kelly he had been shown a bid of $.75 per share less $.07 per share commission by Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch"). Hackney wanted to know if Ron Hayes, Jr. ("Hayes, Jr.") who was Hayes's son and a Shamrock broker, could sell the stock for him at a lower commission than Merrill Lynch was offering. Kelly contacted the market makers and verified that the best bid at that time was $.75 per share. Kelly was informed by market makers that the market for the stock was extremely thin and volume was very light, but that lately there were more buyers than sellers. Kelly was also informed that the spreads on the stock were large in comparison to price.

Kelly told Hackney that if he were patient, Shamrock could sell the stock at about $1 per share over the next few weeks. Kelly also told Hackney that he would place a stop-order at $.75 per share. Kelly was willing to stop the order at $.75 because Hayes was a promoter and Kelly wanted to get further business from him.

Following the conversation with Kelly, Hackney sent Hayes Jr. a letter dated October 19, 1992, which read as follows:

> This letter is to confirm that I will be sending you my certificate for 40,000 shares of Stylex Homes, Inc. common stock, and have asked you to arrange the sale of the shares at $1.00 per share. I also agree to pay to Shamrock Partners, Ltd. a commission of $.05 per share sold. Thank you for assisting me in this transaction. I look forward to working with you on this and future transactions.

Kelly's understanding of the telephone conversation and the subsequent letter was that "[Kelly] stopped [the order] at 75 cents and [Kelly] was working the order at a dollar or better."

Between October 26 and November 11, 1992, Shamrock made five purchases of Stylex stock, one from customer Hayes and four from customer Hackney. Shamrock then executed five sales of Stylex during this same period. Set forth in Exhibit A to the complaint are the alleged violative trades and the calculations of the mark-downs. This exhibit was prepared by NASD staff from the Firm's order tickets, confirmations, and trade blotter.

The five purchases at issue, which took place in October and November 1992, are identified in the chart set forth below.

Trade No.	Date	Purchase from customers		CIDP[1]	EGP[2]	% Mark-down
		No. Shares	Price			
1	Oct. 26	7,500	$1.125	$1.21875	$621.09	11.8%[3]
2	Nov. 4	2,500	$1.250	$1.875	$1,328.13	33.3%
3	Nov. 5	2,500	$1.250	$1.875	$1,328.13	33.3%
4	Nov. 9	1,000	$1.250	$2.000	$650.00	37.5%
5	Nov. 11	12,700	$1.250	$1.875	$6,746.88	33.3%
Total		26,200			$10,674.22	

The chart set forth below identifies the contemporaneous inter-dealer sales of Stylex stock made by Shamrock from October 26, 1992 through November 11, 1992, and the best bid quoted on the Nasdaq Bulletin Board ("Bulletin Board") for each transaction date.

Date	No. Shares Sold	Price Sold	Name of Market Maker Sold To	Best Bid Quote
Oct. 26	7,500	$1.21875	Paragon	1.125
Oct. 30	2,000	$1.8125	Paragon	1.25
Nov. 4	550	$1.875	Paragon	1.25
Nov. 5	2,000	$2.00	Paragon	1.25
Nov. 9	1,600	$2.00	Paragon	1.25
Nov. 11	10,000	$1.875	Paragon	1.25

The transactions upon which NASD staff calculated the mark-downs were Shamrock's contemporaneous sales to another broker/dealer (Paragon). Staff then calculated the difference between what Shamrock paid the customers for the stock and the prices Shamrock received in the inter-dealer sales to market maker Paragon (less an imputed 5% mark-down). This method which

[1] Contemporaneous inter-dealer price.

[2] Excess gross profit above the prices Shamrock received in inter-dealer sales to market maker Paragon less an imputed 5% mark-down.

[3] This 11.8% mark-down also includes a $375 commission charged to the customer on this transaction.

the staff used to compute the mark-downs charged by Shamrock in the transactions at issue is the same method which was approved by the Securities and Exchange Commission ("SEC" or "Commission") to compute the mark-downs in In re Hamilton Bohner, Inc., 50 S.E.C. 125 (1989). As in Hamilton, Shamrock's mark-downs were computed based on the prices Shamrock received in actual contemporaneous sales of Stylex to a market maker.

On November 12, 1992, Shamrock sold 2,000 shares of Stylex to Paragon at $1.875. On November 19, 1992, Shamrock sold 300 shares of Stylex to Paragon at $2. On December 4, 1992, Shamrock bought 21,300 shares from Hackney and Hayes at $1.35 per share.[4] Shamrock sold 14,800 of these shares to Paragon between December 2 and 4, 1992 at prices ranging from $1.35 per share to $2 per share.[5] Shamrock sold an additional 3,000 shares on March 24, 1993 for $1 per share. Thereafter, there was a trading halt in Stylex and Shamrock was left with 3,350 shares that it was unable to sell. Shamrock contended that it had incurred a loss of $3,759.82 in trades that occurred after the time period alleged in the complaint.[6]

Shamrock admitted that prior to October 18, 1992 and after December 4, 1992, it was not a market maker in Stylex. Shamrock claimed, however, that it was a market maker in Stylex during the brief period in which the transactions in question occurred. Shamrock was not listed in the National Quotation Bureau Pink Sheets ("Pink Sheets") as a market maker for Stylex and did not enter quotations on the Bulletin Board for Stylex. Shamrock also was not both a buyer and seller of Stylex in the inter-dealer market. Kelly stated that during the relevant time period, he would quote a bid and offer price for Stylex to market makers and non-market makers who contacted him to ascertain the market; however, he admitted that if he was asked to buy stock from a market maker he would say he did not have any interest in buying. The only inter-dealer transactions that Shamrock effected in Stylex were sales of the shares it had purchased from Hackney and Hayes.

Although Kelly did not execute all of the trades with Hackney and Hayes, he was the principal at Shamrock responsible for trading, and in particular, for trading this stock. Kelly admitted that he was the principal in charge of the trading desk. At all relevant times, Kelly was also the president of Shamrock.

Discussion

Shamrock Was Not a Market Maker. We agree with the District Business Conduct Committee for District No. 9 ("DBCC") that Shamrock was not a market maker in Stylex stock.

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[4] This trade was not charged in the complaint.

[5] There was a reverse 1-for-10 split in the stock on November 22. For ease of reference, all stock prices are quoted as if the split had not occurred.

[6] Respondents argue that the mark-downs must be calculated on transactions involving the entire 40,000 shares. The Hamilton case, however, specifically states that "both mark-downs and mark-ups must be reasonably related to the prevailing market price at the time a transaction is executed. Transactions occurring over a period of time cannot be lumped together for the purpose of determining whether mark-downs or mark-ups are fair." (emphasis added).

Section 3(a)(38) of the Securities Exchange Act of 1934 ("Exchange Act") defines a market maker as "any dealer who, with respect to a security, holds himself out (by entering quotations in an inter-dealer communications system or otherwise) as being willing to buy and sell for his own account on a regular or continuous basis." Factors to be considered are: (1) whether the firm entered quotations; (2) whether the firm sold the security to other dealers; (3) whether the firm provided quotations on the security to other dealers; and (4) whether the firm simply acquired the stock for resale to retail customers. The SEC has held that "in order to be treated as a market maker for mark-up purposes, a dealer must be engaged in actual wholesale trading activity in the security in question, i.e., regularly or continuously buying the security from other dealers at or around its bid quotation and selling it to other dealers at or around its ask quotation." In re Century Capital Corp. of South Carolina, 50 S.E.C. 1280, 1281 n. 5 (1992).

Shamrock was not a market maker in Stylex stock because it did not enter quotations in the Bulletin Board for Stylex and was not listed in the Pink Sheets as a market maker. In addition, Shamrock was not active in the inter-dealer market on a regular and continuous basis. Kelly admitted that although he provided quotes to any market maker who contacted him, he did not buy any stock. Further, if a market maker offered stock to Kelly, he would say that he did not have any interest in purchasing Stylex.[7] Kelly's lack of interest in buying is not consistent with the obligations of a market maker to provide liquidity to the market on a continual basis as both a buyer and seller. The evidence indicates that Shamrock was only ready and willing to make sales to other dealers to the extent necessary to dispose of the shares it could purchase from the two customers.

We agree with the DBCC that Kelly's testimony that he told market makers that he was a market maker in Stylex or that he had an interest in the stock does not suffice to make Shamrock a market maker. Occasionally providing quotations to other dealers who request them is not sufficient to demonstrate market maker status. In re Network 1 Financial Securities, Inc., Exchange Act Rel. No. 34930 (Nov. 3, 1994).

The only inter-dealer transactions that Shamrock effected in Stylex were sales of shares it purchased from the two customers, Hackney and Hayes. Shamrock merely acted as a conduit for the shares between these two customers and market makers. The SEC has held that:

> to be treated as a market maker, a dealer must, among other things, advertise its willingness to buy and sell securities for its own account and stand ready to buy and sell to other dealers at its quoted prices. Merely buying shares from other dealers for resale to customers does not qualify a broker/dealer as a market maker.

In re Sacks Investment Company, Inc., et al., 51 S.E.C. 492 (1993).

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[7] We do not find credible Kelly's attempt at the appeal hearing to retract this admission.

We agree with the DBCC that the evidence and the applicable case law do not support Shamrock's claim that it was a market maker in Stylex from October 26, 1992 through December 4, 1992.[8]

Shamrock's Mark-Downs were Excessive. The NASD's Mark-up Policy states that it is inconsistent with just and equitable principles of trade for any member to enter into a securities transaction with a customer at a price not reasonably related to the security's current market price. Mark-ups and mark-downs exceeding 5% of the prevailing market price are generally viewed as excessive and a violation of Conduct Rules 2110 and 2440. NASD Notice to Members 92-16 (April 1, 1992). The Commission has consistently held that where a dealer is not a market maker, the best evidence of current or prevailing market price, absent countervailing evidence, is the dealer's contemporaneous cost. In re Alstead, Dempsey & Company, Inc., 47 S.E.C. 1034, 1035 (1984). Both mark-ups and mark-downs must be reasonably related to the prevailing market price at the time a transaction is executed. Transactions occurring over a period of time cannot be lumped together for the purpose of determining whether mark-downs or mark-ups are fair. In re Hamilton Bohner, Inc., 50 S.E.C. 125 (1989).

We agree with the DBCC that in this case contemporaneous inter-dealer transactions existed for all retail purchases at issue. Specifically, Shamrock's contemporaneous sales to Paragon constituted the best evidence of the prevailing market price for Stylex at the time of Shamrock's purchases from the customers. Thus, those sales constitute the proper basis for assessing the fairness of the retail prices paid to customers Hackney and Hayes in the five purchases at issue. As is evident from the chart set forth above, based upon the prices of the contemporaneous inter-dealer sales, the mark-downs on the purchases from customers Hackney and Hayes ranged from 11.8% to 37.5% in excess of the prevailing market price.

Respondents argue that Shamrock was a market maker and thus was entitled to base the prices it paid to customers on the bid quotations. Respondents maintain that the prices Shamrock paid to Hackney and Hayes were fair because those prices constituted the best bid at the time. As explained above, we find that Shamrock was not a market maker; moreover, we agree with the DBCC that even if Shamrock had been a market maker, it would not have been entitled to base the price it paid to customers on the best quotation. The Commission has repeatedly "rejected the use of quotations as a reliable indication of prevailing market prices." In re Dale Dwight Schwartzenhauer, 50 S.E.C. 1155, 1161 (1992). The Commission has held that even a market

[8] We agree with the DBCC that the Century Capital, Network 1, and Sacks Investment cases are applicable and relevant to the instant matter although it is a mark-down rather than a mark-up case. Respondents' attempt to distinguish these cases because they are mark-up cases is without merit. We further note that in their Reply Brief submitted on appeal, respondents have taken out of context the findings on page 5 of the DBCC decision that Kelly was the principal responsible for trading, for trading this stock, and for making a market in this stock. These findings related to Kelly's position and responsibilities at Shamrock. No one denies that Kelly was the principal at the firm responsible for the trading department and that he provided quotes in Stylex for market makers who called to obtain quotations. These responsibilities, however, are not evidence that Shamrock was a market maker in Stylex. Therefore, we find without merit respondents' argument made at the appeal hearing and in their Reply brief that the DBCC found that Shamrock was a market maker as a factual matter, but not as a legal matter.

maker cannot base retail prices on quotations unless there is an active, independent market in the security and the reliability of those quotations is validated by actual inter-dealer transactions during the period at issue. In re Century Capital Corp., 50 S.E.C. 1280 (1992). As the dealer seeking to justify having based retail prices on bid quotations, it is Shamrock's burden to establish the validity of those bids. In re First Independence Group, Inc., 51 S.E.C. 662, 665 (1993), aff'd 37 F.3d 30 (2d Cir. 1994). The record contains no evidence that the quotations in Stylex were validated by actual transactions occurring in an active market.[9] Thus, we agree with the DBCC that even if Shamrock were to be accorded market maker status, the mark-downs were properly computed based upon the contemporaneous inter-dealer sales.

We further agree with the DBCC that there is no evidence demonstrating that the transactions involved any extraordinary effort, expense or complexity. Therefore, we disagree with respondents' argument that the mark-downs were justified based upon unusual or extraordinary work or effort expended by Shamrock.

Shamrock's "At Risk" Defense Does Not Justify Excessive Mark-Downs. Based upon the fact that the purchases from the two customers were contemporaneous to Shamrock's sales to Paragon, we do not believe that Shamrock actually was in a position of any significant risk. Even if Shamrock did incur some risk, we agree with the DBCC that the risk Shamrock took in acting as principal rather than agent in the transactions at issue did not justify its having charged excessive mark-downs. The Commission has repeatedly held that a broker/dealer is not entitled to charge excessive mark-ups simply because it is in a risk position. In re Network 1 Financial Securities, Inc., Exchange Act Rel. No. 34930, n. 4 (Nov. 3, 1994); In re Sacks Investment Company, Inc., 51 S.E.C. 492, 495, n. 17 (1993); In re Dale Dwight Schwartzenhauer, 50 S.E.C. 1155, n. 21 (1992).

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[9] In fact, respondents admitted that trading in the stock was extremely thin, the volume was very light, and the spreads on the stock were large. Respondents also admitted that before Shamrock executed the first transaction for Hackney it made market makers aware that it had an interest in the stock in order to find out where the "real market" was for the stock. Furthermore, on the very same days Shamrock purchased Stylex from the two customers, Shamrock consistently sold Stylex on its own behalf to Paragon at prices above the best bid quote on the Bulletin Board for that day.

Furthermore, we reject respondents' argument on appeal that because of the age of the case they cannot meet their burden to establish the validity of the bids. Respondents claim that the complaint was not issued until three years and four months after the alleged violations and that this period is beyond the recordkeeping requirements for firms. Respondents argue that because of the delay in bringing the complaint they could not obtain records from other firms which might show that these firms had contemporaneous transactions at the bid prices published in the Pink Sheets. There is no evidence that respondents even attempted to obtain such records from other firms. Consequently, we cannot find any prejudice to the respondents. In addition, the recordkeeping requirements set forth in Securities Exchange Act Rule 17a-4(a) require firms to keep records regarding the purchases and sales of securities for six years.

Disclosure of the Mark-Downs to the Customers is not a Defense. There was testimony that the mark-downs were fully disclosed to the customers. In addition, respondents introduced a statement from Hayes which stated that "it was disclosed to me that I would be charged a commission of $375 and that there was a 3/32 mark-down." Hayes also said that "the commission and mark-down was [sic] disclosed to me at the time of the transaction and I did then and do now consent to said commission plus mark-down."[10]

We agree with the DBCC that this disclosure did not make the excessive mark-downs permissible. Disclosure is a factor to be considered in determining the fairness of a mark-down. "Disclosure itself, however, does not justify a commission or mark-up which is unfair or excessive in light of all other relevant circumstances." See NASD Conduct Rule IM-2440 Mark-Up Policy; Hamilton Bohner, supra.

Absence of Blue Sheets Does Not Affect Decision. On appeal, respondents argue that Association staff violated their constitutional and due process rights by failing to provide respondents with "blue sheet"[11] information regarding Stylex. According to the record, staff did not possess blue sheet information from other broker/dealers regarding Stylex. The lack of blue sheet information does not affect the case against the respondents. The Commission has held that the NASD should provide a respondent with any blue sheet information actually in the NASD's possession. In re Sacks Investment Co., Inc., 51 S.E.C. 492, 496 n. 19 (1993). The Commission, however, has also held that if the NASD did not solicit blue sheets, then other evidence can be used to show that the respondent is not a market maker and to show that mark-downs were excessive. The Commission has clarified that In re Sacks Investment Co. merely requires the NASD to provide respondents with any blue sheet information actually in the NASD's possession. In re U.S. Securities Clearing Corp., Exchange Act Rel. No. 35066 (Dec. 8, 1994).

Consequently, we find that respondents' rights were not violated because the NASD did not gather blue sheet information from other broker/dealers for Stylex.

Other Due Process Violation Claims. Respondents argue that their due process rights were violated because the Association staff failed to provide them with an opportunity to address

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[10] We note that this statement from the customer related to the first trade, in which the percentage of mark-down was "only" 11.8%, whereas the percentage of mark-down on the other four trades was in excess of 30%. We also note that the evidence of the disclosure was indirect. Shamrock's executive vice-president and financial officer, Huard, testified that "[he] would assume the immediate disclosure [of the commission and mark-down] would have been by [Hayes's] son." Kelly testified that the prices at which the stock was sold "to the street" were disclosed to Hackney by the broker and the branch manager.

Furthermore, although the Firm did disclose a 3/32 mark-down, such disclosure would not be adequate because the Firm did not disclose the prevailing market price used to reach that mark-down and did not disclose the fact that the Firm was not a market maker in Stylex.

[11] Blue sheets consist of information from broker/dealers, generally market makers, setting forth a firm's inter-dealer and agency trades by date, size, and contra-party in a subject security or securities.

the DBCC before a complaint was filed. In this case, respondents were provided with the opportunity to defend themselves after the complaint was issued and that is all that is required under the NASD rules. Therefore, we find respondents' argument without merit.

Respondents also argue on appeal that they had a due process right to know the DBCC hearing panel's recommendation to the full DBCC. Respondents claim (without citing any authority) that they are entitled to know the actual decision of the hearing panel members. We find respondents' argument has no merit. Article II, Section 6 of the NASD Code of Procedure (now Code of Procedure Rule 9223) specifically permits the DBCC to appoint a hearing panel and provides that the hearing panel shall "present its recommended findings and sanctions to the full [DBCC], which shall make the final determination by a majority vote of those present and voting at a duly constituted meeting thereof." The decision in this case was rendered in accordance with NASD rules. The Commission has upheld this procedure. See In re Conrad C. Lysiak, 51 S.E.C. 841 (1993) (the NASD's decision at the district level was properly rendered by the full District Committee, rather than by the panel that sat at the hearing).

This Case is Not Barred by the Statute of Limitations. We agree with the DBCC that this case is not barred by the statute of limitations. At the hearing and in their brief, respondents argue that this action is precluded by the statute of limitations. Respondents argue that the complaint was not issued until three years after all of the information utilized in the complaint was known and compiled by the NASD. We do not find this argument to have merit. The SEC has repeatedly held that:

> there is no requirement in the federal securities laws or the NASD's rules that there be such a statute of limitations. Indeed, the imposition of a limitations period urged by respondents would impair the NASD's statutory obligation and duty to protect the public and discipline its members.

In re Frederick C. Heller, 51 S.E.C. 275, 280 (1993).

We are aware that one federal court of appeals has held that an SEC administrative proceeding is subject to the general five-year statute of limitations contained in 28 U.S.C. § 2462.[12] That statute, however, does not apply to NASD Regulation disciplinary actions. Even if a five-year statute of limitations were applicable, this action was commenced within the five-year period established by that statute.

Respondents' Claim that the Customers Got the Best Price Possible is not Supported by the Record. We agree with the DBCC that respondents' assertion that the customers would not have received greater proceeds through any other dealer lacks evidentiary support and is not persuasive. As the SEC has frequently pointed out, quotations constitute the starting point for negotiation. If Shamrock had negotiated on behalf of the customers the prices it negotiated on its own behalf in contemporaneous inter-dealer trades, and had executed the transactions as agent and charged a reasonable commission, the customers would have derived substantially greater

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[12] Johnson v. SEC, 87 F.3d 484 (D.C. Cir. 1996).

proceeds from the sales, and Shamrock's compensation almost certainly would have been considered fair and reasonable.

Sanctions

We affirm the DBCC's findings and the sanctions imposed by the DBCC. The sanctions are within the range recommended by the NASD Sanction Guidelines.[13] We find that the sanctions are appropriate and remedial. We affirm the DBCC's decision not to impose pre-judgment interest on the restitution amount due to the delay by the staff in preparing and prosecuting this case.

Accordingly, Shamrock and Kelly are censured; fined $15,000 jointly and severally; assessed $1,155 in DBCC hearing costs and $750 in appeal costs jointly and severally; ordered to pay customers Hackney and Hayes $10,674.22 in restitution jointly and severally; and required to demonstrate, to the staff of District No. 9, corrective action with regard to their mark-up and mark-down policy and to submit to a staff interview.[14]

On Behalf of the National Business Conduct Committee,

Joan C. Conley, Corporate Secretary

[13] See Guidelines (1993 ed.) at 28 (Markup/Markdown Violations).

[14] 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 be summarily 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.