

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD

In the Matter of

Department of Enforcement,

Complainant,

vs.

Respondent.

AMENDED DECISION
ORDERING REMAND

Complaint No. CAF030042

Dated: December, 29 2005

The Hearing Panel granted respondent's motion for summary disposition, finding that Enforcement failed to establish that respondent violated NASD Conduct Rules 2460 and 2110 by a preponderance of the evidence. Held, findings reversed and case remanded to determine appropriate sanctions.

DECISION

Pursuant to NASD Procedural Rule 9311, NASD's Department of Enforcement ("Enforcement") appeals an August 27, 2004 Hearing Panel decision granting respondent's motion for summary disposition. After a thorough review of the record, we conclude that the Hearing Panel erred in dismissing Enforcement's allegations against respondent. We reverse the Hearing Panel's finding that respondent did not violate NASD Conduct Rules 2460 and 2110 and remand this matter to the Hearing Panel to determine the appropriate sanctions.

I. Background

From approximately May 1999 to November 2000, respondent was registered with the Firm as a general securities representative and a general securities principal. In December 2000, respondent became associated with another NASD member firm, and she is currently registered with this firm as a general securities principal.

II. Procedural History

In 2003, Enforcement filed a three-cause complaint against the Firm, the chief financial officer and Respondent.¹ The Firm and the chief financial officer failed to file answers to the complaint and were deemed in default. Only cause one of the complaint relates to respondent.

Cause one alleged that respondent violated NASD Conduct Rules 2460 and 2110 by soliciting payments from issuers to: (1) prepare and file Form 211 applications on the issuers' behalf, and (2) publish quotations in the issuers' stock. Respondent filed an answer in 2003, denying the allegations and requesting a hearing. A hearing was held in 2004. Upon completion of Enforcement's case-in-chief, both respondent and Enforcement made oral motions for summary disposition under NASD Procedural Rule 9264.² The Hearing Panel granted respondent's motion, denied Enforcement's motion, and dismissed the complaint. Enforcement filed a written motion for reconsideration of this denial. In a 2004 decision, the Hearing Panel denied this motion and set forth the basis for its decision to grant respondent's motion for summary disposition. Enforcement's appeal of this matter followed.

III. Facts

From May 1999 to December 2000, respondent worked as a registered principal in the branch office of the Firm. Respondent supervised the retail activities of the office and received 75% of the commissions generated through her clients' purchases and sales.

The Firm's primary business was market making for stocks listed on the Over-The-Counter Bulletin Board®³ and the Pink Sheets®.⁴ The Firm made money by entering into

¹ Cause one of the complaint alleged that the Firm and respondent violated Conduct Rule 2640. Causes two and three of the complaint alleged respectively that the Firm and chief financial officer failed to: (1) establish adequate written supervisory procedures, and (2) reasonably supervise respondent.

² NASD Procedural Rule 9264 provides that in a disciplinary action, either the complainant or a respondent may move for summary disposition of any or all of the causes of action against the respondent. A hearing panel may grant a summary disposition motion if there is no genuine issue with regard to any material fact that the moving party relies on in filing its motion and the opposing party does not come forward with specific facts showing a genuine issue in dispute. See *Celotex Corp. v. Catrett*, 477 U.S. 317, 322-23 (1986); *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 585-86 (1986).

³ The Over-The-Counter Bulletin Board® ("OTCBB") is an inter-dealer quotation system owned by NASD that displays real-time quotes, last-sale prices, and volume information in certain over-the-counter ("OTC") equity securities. The term "OTC equity security" is defined in NASD Rule 6610.

⁴ Pink Sheets LLC® is a privately owned inter-dealer quotation system that displays quotes in OTC equity securities.

investment banking agreements (“IBAs”) to provide “investment banking” services to certain issuers in return for a flat fee.⁵ As a registered principal of the Firm, respondent executed IBAs with three issuers: (1) Company 1; (2) Company 2; and (3) Company 3.⁶ These issuers were all clients of respondent, and she referred each of the issuers to the chief financial officer. After respondent’s referral, the chief financial officer approved the issuers’ IBAs. There is no evidence that the Firm provided respondent’s clients with any of the investment banking services described in the IBAs. Instead, the Firm simply filed a Form 211 application and became a market maker for the issuers who entered into the IBAs. Under NASD Market Place Rule 6740, an NASD member must submit a Form 211 application to NASD prior to becoming a market maker in any non-Nasdaq stock.⁷

The Firm’s chief financial officer was responsible for determining whether the Firm would file a Form 211 application for an issuer that entered into an IBA. The chief financial officer worked in the Firm’s corporate office and also determined whether the Firm would become a market maker in the issuer’s stock. In connection with the execution of the IBAs, each issuer paid the Firm a \$5,000 fee.⁸ Respondent had requested these fees and had instructed the issuers to send a check either to: (1) the Firm’s corporate office, or (2) respondent’s branch office where it would be forwarded to the corporate office. Respondent signed and submitted the Form 211 applications to NASD on behalf of the Firm. In some cases, respondent responded to deficiency letters written by NASD staff regarding the Form 211 filings. Shortly after these filings, the Firm became a market maker for each of the issuers’ stock.

IV. Discussion

This case involves the very narrow issue of whether a registered principal who causes her firm to violate NASD Conduct Rule 2460 by requesting and accepting prohibited payments from an issuer can be held liable under the rule when she has not personally benefited from those

⁵ The services listed in the IBAs, among others, included market intelligence, assistance with blue-sky exemptions, and services regarding investor relations.

⁶ A fourth IBA for Company 4 was executed using respondent’s name, but without her consent.

⁷ Market Place Rule 6740 requires a member firm to submit a Form 211 application to NASD’s Department of Market Regulation for its review and determination of whether the member firm has demonstrated compliance with SEC Rule 15c2-11 before the member firm initiates or resumes quotation of a non-Nasdaq security in any quotation medium. SEC Rule 15c2-11 makes it unlawful for a broker to publish any quotations for a security unless the broker: (1) has in its possession specific information regarding the issuer; (2) believes that this information is accurate in all material aspects; and (3) believes that the sources of the information are reliable.

⁸ Respondent signed the IBAs and discussed the terms of the IBAs with the issuers.

payments. After reviewing the record in this matter, we reverse the Hearing Panel's finding that respondent did not violate Conduct Rules 2460 and 2110. We also grant Enforcement's motion for summary disposition under NASD Procedural Rule 9264.⁹

A. The Firm Accepted Payments in Violation of Conduct Rule 2460

NASD Conduct Rule 2460 provides that "[n]o member or person associated with a member shall accept any payment or other consideration, directly or indirectly, from an issuer of a security . . . for publishing a quotation, acting as a market maker in a security, or submitting an application in connection therewith." The purpose of Conduct Rule 2460 is "to assure that members act in an independent capacity when publishing a quotation or making a market in an issuer's securities."¹⁰ Here, respondent's actions allowed the Firm to circumvent this purpose.

Under the IBAs executed by respondent, the Firm profited from an agreement where each issuer paid the Firm \$5,000 to: (1) file a Form 211 application on behalf of the issuers, and (2) make a market in the issuers' securities. These IBAs purportedly required the Firm to provide "investment banking" services to the issuers in exchange for the \$5,000 fee. Respondent testified that the only service the Firm actually provided pursuant the IBAs was the performance of "due diligence" that is typically required in order for a firm to file a Form 211 application. Respondent also testified that under the IBAs, the issuers would have access to the Firm's "market knowledge" which allegedly included information regarding Standard and Poor's listing requirements, and the requirements for "blue sky" exemptions from state registrations.

There is, however, no evidence that the issuers ever availed themselves of the Firm's "market knowledge" in exchange for the \$5,000 fee. In fact, the Hearing Panel concluded that based on the timing of the payments, the timing of the submissions of the Form 211 applications, and the lack of evidence that any other services were provided to the issuers, it could have found that the Firm received these payments from the issuers in violation of NASD Conduct Rules 2460 and 2110.¹¹ We therefore find that the fees generated by the IBAs were in exchange for the

⁹ NASD Procedural Rule 9264 provides that in a disciplinary action, either the complainant or a respondent may move for summary disposition of any or all of the causes of action against the respondent if there are no genuine issues of material fact in dispute. Here, the material facts we rely on in granting Enforcement's summary disposition motion have been established either by the parties stipulation or respondent's testimony. Consequently, we find that there are no material facts in dispute that would preclude granting Enforcement's motion.

¹⁰ See *Notice of Filing and Immediate Effectiveness of Proposed Rule Change by NASD, Relating to NASD Rule 2460 Concerning Payments for Market Making*, Exchange Act Rel. No. 39478, 1997 SEC LEXIS 2644, at *3 (Dec. 22, 1997).

¹¹ The Hearing Panel did not find respondent liable for her role in securing these payments because it erroneously concluded that respondent's signing of the Form 211 applications was a

filing of the Form 211 applications and making a market in the issuers' securities. This is the exact activity that Conduct Rule 2460 prohibits.¹² Consequently, we find that the Firm violated Conduct Rule 2460.

B. Respondent Was Responsible for the Firm's Conduct Rule 2460 Violation

The Hearing Panel concluded that respondent's role in the Firm's alleged Conduct Rule 2460 violation was minor and placed responsibility on chief financial officer, who had the ultimate authority to commit the Firm to make a market on behalf on the issuers.¹³ The Hearing Panel further concluded that because respondent had no authority to bind the Firm to make a market on an issuer's behalf, she could not be held liable under Conduct Rule 2460. The Hearing Panel's interpretation of the rule is too narrow and ignores respondent's significant level of involvement in the Firm's Conduct Rule 2460 violation.¹⁴

The record reflects that no one had a greater role in the Firm's Conduct Rule 2460 violation than respondent. Respondent played a significant, if not indispensable, role in procuring the \$5,000 payments that the Firm received from the issuers. As a registered principal of the Firm, respondent had the authority to submit Form 211 applications to NASD on behalf of the issuers. Respondent executed these applications in exchange for a \$5,000 fee that she requested and directed the issuers to send to the Firm. Moreover, respondent served as the initial contact person, referring the issuers to the chief financial officer. Respondent signed the IBAs and discussed the terms of the IBAs with the issuers. Respondent also signed the Form 211 applications and reviewed these applications before they were sent to NASD. Finally, respondent served as the contact person for any follow-up work with NASD regarding the Form 211 applications.

[cont'd]

ministerial task and that respondent had to receive a direct benefit from the payments in order to establish that she violated Conduct Rule 2460.

¹² See *id.* at *4 (stating that "such payments may be viewed as a conflict of interest since they may influence the member's decision as to whether to quote or make a market in a security and, thereafter, the prices that the member would quote").

¹³ The chief financial officer also determined whether the Firm would enter into an IBA with a particular issuer and whether the Firm would file a Form 211 application for that issuer.

¹⁴ We note that in analogous contexts, we have imposed liability on associated persons who are directly involved in the conduct that leads to a firm's violation of NASD rules. See *Michael A. Rooms*, Exchange Act Rel. No. 51467, 2005 SEC LEXIS 728, at *5 (Apr. 1, 2005) (affirming NASD finding that principal was liable for causing firm to violate penny stock rules); *Davrey Fin. Servs., Inc.*, Exchange Act Rel. No. 51780, 2005 SEC LEXIS 1288, at *12 (June 2, 2005) (holding principal liable for member firm's books and records violation); *Wilshire Discount Sec., Inc.*, 51 S.E.C. 547, 551 (1993) (finding FINOP liable for firm's net capital violations).

The Hearing Panel, however, concluded that respondent's execution of these Form 211 applications was a "ministerial" task because the chief financial officer had the final say as to whether to file the application. We disagree. NASD is responsible for protecting investors from fraud, preventing manipulative acts and practices, and promoting just and equitable principles of trade in the securities industry. Pursuant to this responsibility, NASD requires that a firm filing a Form 211 application must have one of its principals attest to the accuracy of the information provided in the application. NASD's decision to require a registered principal to attest to such information in the Form 211 is an important attempt to bolster the reliability of the information contained in these forms and to prevent potential fraud in the quotation and trading of unlisted securities. We therefore reject the Hearing Panel's conclusion that respondent's signing of the Form 211 applications in this case was a trivial task.

The Hearing Panel also found that since respondent purportedly did not benefit from the issuers' payment to the Firm, she could not be held liable under Conduct Rule 2460. Nothing in Conduct Rule 2460, however, suggests that an associated person must benefit personally in order to violate the rule. We find that respondent's participation in the Firm's receipt of funds from issuers in exchange for market making activities was significant and that she should be held responsible for her role. As a principal in the Firm's branch office, respondent requested and accepted payment from the issuers on behalf of the Firm via the IBAs that she executed. Conduct Rule 2460 prohibits the acceptance of payment by an NASD member in exchange for filing a Form 211 application or making a market on behalf of an issuer, and applies equally to both members and persons associated with members who act to secure such payments. Consequently, we find respondent liable under Conduct Rule 2460.

V. Sanctions

NASD Procedural Rule 9348 provides that "[i]n any appeal or review proceeding pursuant to the Rule 9300 Series, the [NAC] may affirm, dismiss, modify, or reverse with respect to each finding, or remand the disciplinary proceeding with instructions." Here, the Hearing Panel granted respondent's summary disposition motion after Enforcement presented its case-in-chief. In presenting its case, Enforcement argued that respondent should be suspended for six months and fined \$20,000 for her misconduct, and identified several aggravating factors in support of these requested sanctions. Respondent, however, neither had the opportunity to present evidence to rebut these aggravating factors, nor to identify any mitigating factors to be considered by the Hearing Panel in its sanctions determinations. Consequently, we remand this matter to the Hearing Panel with instructions to conduct a hearing to determine what sanctions should be imposed for respondent's violation of Conduct Rules 2460 and 2110.

VI. Conclusion

We find that respondent is liable for violating NASD Conduct Rules 2460 and 2110. We reject the argument that she cannot be held liable because she did not have authority to commit the Firm to make markets and did not obtain a specific benefit for her misconduct.¹⁵ We therefore reverse the Hearing Panel's dismissal of Enforcement's allegations against respondent and grant Enforcement's motion for summary disposition. Due to the procedural posture of this case, we also remand this matter to the Hearing Panel with instructions to conduct a hearing to determine the appropriate sanctions for respondent's violations. In ordering this remand, we express no view on what sanctions would be appropriate in this case.

On Behalf of the National Adjudicatory Council,

Barbara Z. Sweeney, Senior Vice President and
Corporate Secretary

¹⁵ We have also considered and reject without discussion all other arguments advanced by the parties.