PLEASE NOTE THE LATER CASE HISTORY OF THIS DECISION FOLLOWING THE TEXT OF THE DECISION.

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD

In the Matter of the Continued Association of X[1] as a General Securities Representative[2] with The Sponsoring Firm	**Redacted Decision** Notice Pursuant to Section 19(d) Securities Exchange Act of 1934 Decision No. SD03005 Date: 2003

On August 21, 2000, the Sponsoring Firm ("the Firm") completed an MC-400 application ("Application")[3] seeking to permit X, a person subject to a statutory disqualification, to continue

[1] The names of the Statutorily Disqualified individual, the Sponsoring Firm, the Proposed Supervisor, and other information deemed reasonably necessary to maintain confidentiality have been redacted.

[2] In addition to registration as a general securities representative, the Sponsoring Firm is also seeking for X to be registered in the following capacities: registered options principal (Series 4); interest rate options (Series 5); foreign currency options (Series 15); general securities principal (Series 24); municipal securities principal (Series 53); limited representative - equity trader (Series 55); and uniform securities agent state law examination, for which he is grandfathered in the state of State 1.

[3] This matter was previously processed by the Chair and Vice-Chair of the Statutory Disqualification Committee on behalf of the National Adjudicatory Council pursuant to Procedural Rule 9523. X originally applied to be employed both by the Sponsoring Firm and another affiliated entity. The NAC filed a 19h-1 Notice approving that application in 2001. Subsequently, the situation at the two firms involved in that filing changed dramatically. The NAC therefore determined that the Application had to be examined in light of the new circumstances, and it withdrew that Notice in a 2002 letter to the Commission.

to associate with the Sponsoring Firm in the numerous capacities listed below. In January 2003, a subcommittee ("Hearing Panel") of the Statutory Disqualification Committee of NASD held a hearing on the matter. X appeared, accompanied by counsel and by his Proposed Supervisor and the Sponsoring Firm's Compliance Officer. LL appeared on behalf of the Department of Member Regulation.

A. X's Statutorily Disqualifying Event

In 1999, the Commission filed a civil complaint in U.S. District Court against X and eight other parties seeking injunctive relief, disgorgement of ill-gotten gains plus pre-judgment interest, and civil money penalties. The complaint was based upon numerous alleged violations of the Securities Act of 1933 ("Securities Act") and the Securities Exchange Act of 1934 ("Exchange Act"), and the rules promulgated thereunder. The Commission's action alleged that the named parties had manipulated the after-market trading for a stock ("Firm 1") traded on the NASDAQ Small Cap Market, and that such manipulation included artificially inflating the share price of that stock. X was the managing general partner of the Sponsoring Firm, which was the initial and primary market maker for Firm 1.

X submitted a Consent and Undertakings in 2000, wherein he consented to the entry of a Final Judgment of Permanent Injunction. In 2000**,** a United States District Court entered the Permanent Injunction, which:

1) permanently enjoined X from:

   a) obtaining money or property by means of any untrue statement of a material fact, or omitting to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, false or misleading; or

   b) engaging in any transaction, practice, or course of business that operates or would operate as a fraud or deceit upon the purchaser, in violation of Section 17(a)(2) and (3) of the Securities Act;

2) required X to pay disgorgement of all profits and monies received as a result of gains from his sales of the common stock of Firm 1 ($205,000 plus prejudgment interest of $135,138.65, totaling $340,138.65); and,

3)

Also in 2000, X submitted an Offer of Settlement in a parallel administrative proceeding brought by the Commission based on the same misconduct. The Commission accepted the offer

("Order").[4] The Commission's Order suspended X from association with any broker or dealer for a period of two months, and imposed no additional fine. The two-month suspension ended in 2000, and X paid his civil penalty and disgorged all profits with interest. Since the completion of the two-month suspension, X has been employed as a proprietary trader by the Sponsoring Firm's Office of Supervisory Jurisdiction ("OSJ") in State 2, awaiting the outcome of his NASD MC-400 Application.[5]

B. Background Information

1. X

X has been registered with the Sponsoring Firm since 1985 in the following capacities: general securities representative (Series 7); municipal securities principal (Series 53); foreign currency options (Series 15); interest rate options (Series 5); registered options principal (Series 4); and equity trader (Series 55). X was also registered as a general securities principal (Series 24) and financial and operations principal (Series 27) from 1985 until 2000, when he was ordered to re-qualify in those capacities pursuant to an NASD Order, as discussed below. He retook and passed the general securities principal qualification examination in 2000. X is not seeking to maintain his financial and operations principal (Series 27) registration.

X has one other disciplinary event. In 2000, NASD accepted X's and the Sponsoring Firm's Letter of Acceptance, Waiver and Consent ("AWC") for violations of NASD Rules 1120, 2110, 3010, and SEC Rule 15c3-1. The AWC stated that at various times from 1996 through 1999, the Sponsoring Firm, acting through X: effected securities transactions when it failed to maintain the minimum required net capital; operated offices of supervisory jurisdiction while failing to designate an appropriately registered principal in each of the locations; allowed an individual to act in the capacity of a general securities principal despite the fact that the individual was not qualified or registered in that capacity; and failed to prepare, maintain and/or enforce adequate written supervisory procedures regarding both the regulatory element of the continuing education requirement and the requirement that each OSJ have an annual inspection and a review of its activities. X and the Sponsoring Firm agreed to be fined $55,000, jointly and severally, X was suspended as a general securities principal and financial and operations principal for 30 days, and he was required to re-qualify before acting in those capacities.

2. The Firm

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[4] In 2000, the Commission dismissed with prejudice its U.S. District Court complaint against the Sponsoring Firm.

[5] This is consistent with prior NASD practice. A person who becomes statutorily disqualified while he or she is employed in the securities industry is permitted to remain in the industry until the MC-400 application process has been completed.

The Sponsoring Firm became a member of NASD in 1984. The Sponsoring Firm has five OSJs and no branch offices. The Sponsoring Firm currently has three general partners and one limited partner. The partnership interests are as follows: X, general partner, 52%; the Proposed Supervisor, general partner, 18%; Employee 1, general partner, 18%; and Employee 2 (brother of X), limited partner, 12%.[6] In total, the Sponsoring Firm employs 16 registered representatives, nine of whom are registered principals. The Sponsoring Firm currently is engaged in proprietary trading only; it does not offer third market execution services or service retail or institutional customer accounts. The Firm proposes that X will continue to be located at the Sponsoring Firm's OSJ in State 2. The Sponsoring Firm is not a member of any other self-regulatory organization.

The Firm has two formal disciplinary actions in its regulatory history. The first was the 2000 AWC discussed above in the recitation of X's disciplinary history. The second formal disciplinary action is an AWC accepted by NASD in 2002, in which the Sponsoring Firm was censured and fined $172,000. The deficiencies involved trading activity relating to third market order flow from 1998 to 2000, including limit order display violations, short sale violations, and market making function violations.

NASD issued Letters of Caution ("LOC") to the Sponsoring Firm for its 2002 and 2000 routine examinations. The 2002 LOC noted the Firm's failure to maintain adequate fidelity bond coverage from January 2002 through October 2002. The Firm responded in a letter dated January 2003, reporting that it had addressed the deficiency. The 2000 LOC noted violations of recordkeeping rules, inadequate net capital computations, and FOCUS reporting violations. The Firm responded in a letter dated January 2001, reporting that it had resolved the deficiencies.

C. X's Proposed Business Activities and Supervision

The Sponsoring Firm proposes that X will continue to work out of the Firm's OSJ located in State 2. He will continue to serve as a general partner of the Sponsoring Firm, trading the Sponsoring Firm's proprietary account. The Firm will also continue to compensate X with the gains or losses of the Sponsoring Firm, as well as with the gains or losses that result from his proprietary trading. X will not be involved in supervising the day-to-day activities of individuals at the Sponsoring Firm.

The Sponsoring Firm proposes that the Proposed Supervisor, another general partner of the Sponsoring Firm, will be primarily responsible for supervising X. Employee 1, also a general partner with the Sponsoring Firm, has been identified by the Firm as the contingent supervisor, who will only serve in that capacity if the Proposed Supervisor is unavailable. The Proposed Supervisor and Employee 1 currently work out of the Firm's main office in State 1.

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[6] In his role as a limited partner, Employee 2 has no direct supervisory role with the Sponsoring Firm, and he is not proposed to be involved in the supervision of X.

The Proposed Supervisor has been with the Sponsoring Firm since 1991. He has been a general securities representative (Series 7) since 1991, a limited representative-equity trader (Series 55) April 2000, and a general securities principal (Series 24) since 1999. The Proposed Supervisor has no disciplinary history.

Employee 1 has been employed by the Sponsoring Firm since 1994. He has been registered as a general securities representative (Series 7) since 1994, a general securities principal (Series 24) since 1999, and a limited representative-equity trader (Series 55) since 2000. Employee 1 also has no disciplinary history.

D. Member Regulation Recommendation

In a letter dated 2003, Member Regulation recommended that the NAC approve the Sponsoring Firm's Application to continue to employ X, subject to an agreed-upon set of heightened supervisory procedures.

E. Discussion

After carefully reviewing the entire record in this matter, we deny the Sponsoring Firm's Application to continue to employ X in the capacities requested.

1. *Permanent Injunction Against Engaging in Securities Fraud*

In reaching this determination, we first look to the recent and serious misconduct in which X engaged. X was subject to two separate disqualifying events – the 2000 Permanent Injunction and the Commission's 2000 suspension order. The period of suspension imposed by the Commission expired in 2000, and thus X is no longer subject to a disqualification based on the Commission's suspension order. X continues to be statutorily disqualified, however, for the remainder of his securities industry career due to the statutory disqualification that resulted from the Permanent Injunction. See NASD By-Laws, Art. 3, Sec. 4(h).

The Commission's complaint alleged that X participated in a comprehensive "shell-game and manipulation of the after-market" for the stock of Firm 1 as follows. The manipulators drove the price of Firm 1 stock from $1 per share to $13 per share, despite the fact that Firm 1 was a development stage company with purported total sales of only $5,049 for the year end just one month prior to the start of public trading in its stock. The manipulation included giving or receiving bribes for participation in the manipulation, controlling the floating supply of Firm 1 stock, pegging the opening price at $5 per share, dominating and controlling the secondary market in Firm 1 stock, and issuing a forged endorsement letter of Firm 1's product and a false press release stating that Firm 1 had $5 million in contracts.

The Commission's complaint further alleged that X was the managing general partner of the Sponsoring Firm, which was the initial and primary market maker for Firm 1 stock. In 1993, X received 250,000 shares of stock in another company, Firm 2, at $1 per share from the

individual, Employee 3, who was orchestrating the manipulation of Firm 1. In exchange for this cheap stock, X agreed to participate with Employee 3 in the manipulation by operating as Firm 1's initial market maker, trading Firm 1 stock in the Pink Sheets and the Bulletin Board without a registration statement, and colluding with Employee 3 in initiating and creating a trading market in Firm 1 stock, including pegging Firm 1's opening price at $5 per share. The stock opened in 1994 at $5 per share, and X continued to sell Firm 1 stock from his account, his brother's account, and the accounts of his other associates at the Sponsoring Firm at prices ranging from $5 to $8.50 per share. X's market-maker quotes for Firm 1 were fraudulent because they were determined in collusion with Employee 3 and induced by the guarantee of quick profits from cheap stock, rather than based on any independent assessment of the market or the company, or based on legitimate customer demand for the stock.

The Permanent Injunction that resulted from X's misconduct enjoined him from any future misrepresentations or omissions, or from engaging in any further practice that would operate as a fraud or deceit upon a securities purchaser. X's serious securities-related misconduct that led to the issuance of the Permanent Injunction supports our determination to deny the Sponsoring Firm's Application to permit X to continue to associate with the Firm.

Member Regulation argued that we should not consider the circumstances of the Permanent Injunction against X, but rather we should look only to whether X engaged in any intervening misconduct, as well as to the disciplinary history of the Firm, the proposed supervisor, and the proposed supervisory structure. We reject Member Regulation's position.

In support of its analysis, Member Regulation cites to the SEC's reasoning in Paul Van Dusen, 47 S.E.C. 668 (1981) and Arthur H. Ross, 50 S.E.C. 1082 (1992), decisions which enunciated the standard for NASD to follow when it evaluates an application to re-enter the securities industry from an individual who previously had been barred by the Commission with a right to reapply. In Van Dusen, the SEC stated that "[p]rior to accepting Van Dusen's offer of settlement . . . [it] carefully weighed the requirements of the public interest in the light of his alleged misconduct. And [the SEC] concluded that it was appropriate to allow him, after 18 months, to apply for permission to become associated with a broker-dealer in a supervisory capacity." In such situations, the SEC stated that, following the expiration of the time that it has specified as the date after which an application for re-entry may be made, "the Commission upon a proper showing will generally act favorably upon the application." Van Dusen, 47 S.E.C. at 671.

Here, X's situation differs from a Van Dusen case in two important aspects. First, X's sole statutorily disqualifying event – the Permanent Injunction – includes no right to reapply after a specified period of time. In a Van Dusen case, the SEC both creates a second statutory disqualification in addition to a permanent injunction by barring the individual, and determines how long that individual must wait before applying by setting a time period for the right to reapply. Second, X's settlement of the SEC's administrative proceeding did not indicate that the SEC had carefully weighed the requirements of the public interest in light of X's alleged misconduct, as the SEC stated that it had done in Van Dusen. We therefore find that we are not

limited here to a consideration of whether X engaged in any intervening misconduct, but rather, we can examine the seriousness of the underlying misconduct that led to the imposition of the recent Permanent Injunction against X.

2. *Disciplinary History of X and the Firm*

In addition to the recent Permanent Injunction, we are concerned by other recent disciplinary infractions by X and the Firm that indicate lax standards with regard to regulatory compliance. First, X and the Sponsoring Firm consented to the imposition of the 2000 AWC, which included violating net capital rules, operating OSJs without appropriately registered principals, failing to properly register another principal, and failing to have appropriate written procedures for continuing education requirements and OSJ inspections. NASD sanctioned X and the Sponsoring Firm for this misconduct by fining them $55,000, jointly and severally; suspending X as a general securities principal and financial and operations principal for 30 days, and requiring X to requalify before again acting in those capacities.

Moreover, in 2002, NASD accepted an AWC against the Firm for numerous trading activity violations from 1998 to 2000, including limit order display violations, short sale violations, and market making function violations. For this misconduct, NASD censured the Sponsoring Firm and imposed a $172,000 fine. We acknowledge that X asserts that the Firm has been restructured as a result of this AWC, and that it no longer engages in the types of activities that would lead to such violations. We note, however, that this alleged restructuring is very recent, and the Firm has not had sufficient time to demonstrate regulatory compliance within its newly reorganized format.

We are troubled by this disciplinary history for both X and the Firm, although we recognize that the Proposed Supervisor and the contingent supervisor, Employee 1, have not been the subject of any formal or informal disciplinary action.

An additional factor that causes us to reject this Application is that X owns 52% of the Sponsoring Firm, giving him de facto control of the Firm and of the other partners, including the Proposed Supervisor, who owns only 18% of the Firm. In addition, X's brother owns 12% of the Firm, which gives X's family even a greater majority ownership of the Sponsoring Firm. The Firm maintains that it has specific provisions in its Partnership Agreement to limit X's ability to control the management affairs of the Sponsoring Firm. We remain concerned about X's level of control, however, particularly because the Firm had proposed that X be located at the Firm's OSJ in State 2, and supervised off-site by the Proposed Supervisor, who is located at the Firm's main office in State 1. X's disciplinary history demonstrates his tendencies to act autonomously to the detriment of his Firm and his partners. We are therefore not satisfied that the Firm has proposed an adequate supervisory structure to ensure that X will not engage in harmful conduct in the future.

For the foregoing reasons, we find that it is not in the public interest for X to remain associated with the Sponsoring Firm, and we deny the Application.

On Behalf of the National Adjudicatory Council,

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Barbara Z. Sweeney
Senior Vice President and Corporate Secretary

LATER CASE HISTORY:

X subsequently appealed this decision to the SEC. In 2004, the SEC remanded this matter to NASD's NAC. Subsequently, events led to the Firm's withdrawal of the application to associate X.