

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of

Department of Enforcement,

Complainant,

vs.

Midas Securities, LLC,

World Trade Financial Corporation,

Jason Troy Adams,

Frank Edward Brickell,

Jay S. Lee,

and

Rodney Preston Michel
Los Angeles, CA,

Respondents.

DECISION

Complaint No. 2005000075703

Dated: March 3, 2011

Respondents Midas Securities, LLC, World Trade Financial Corporation and Frank Edward Brickell sold unregistered securities in violation of Section 5 of the Securities Act of 1933 and NASD Rule 2110. For these violations, the Hearing Panel fined Midas Securities, LLC, \$30,000; fined World Trade Financial Corporation \$15,000; and fined Frank Edward Brickell \$15,000, and suspended him in all capacities for 30 business days. For related supervisory violations of NASD Rules 3010 and 2110, the Hearing Panel fined Midas Securities \$25,000; fined WTF Corporation \$15,000; fined Rodney Preston Michel \$15,000, and suspended him in all principal capacities for 45 days; fined Jay S. Lee \$20,000 and suspended him in all principal capacities for two years; and fined Jason Troy Adams \$10,000 and suspended him in all principal capacities for 30 business days. Held, findings affirmed and sanctions modified.

Appearances

For the Complainant: Jonathan Golomb, Esq., and Leo F. Orenstein, Esq., Department of Enforcement, Financial Industry Regulatory Authority

For the Respondents: Irving M. Einhorn, Esq.

Decision

Pursuant to NASD Rule 9311, Midas Securities, LLC (“Midas Securities”), World Trade Financial Corporation (“WTF Corporation”), Jason Troy Adams (“Adams”), Frank Edward Brickell (“Brickell”), Jay S. Lee (“Lee”) and Rodney Preston Michel (“Michel”) (together, “the respondents”) appeal a May 12, 2009 Hearing Panel decision. In that decision, the Hearing Panel found that Midas Securities, WTF Corporation, and Brickell sold unregistered securities, in violation of Section 5 of the Securities Act of 1933 (“Securities Act”) and NASD Rule 2110.¹ For these violations, the Hearing Panel fined Midas Securities \$30,000; fined WTF Corporation \$15,000; and fined Brickell \$15,000 and suspended him in all capacities for 30 days.

The Hearing Panel also found that Midas Securities, WTF Corporation, Michel, Adams, and Lee failed to supervise the registered representatives who participated in the sale of the unregistered securities, in violation of NASD Rules 3010 and 2110.² Finally, the Hearing Panel found that Midas Securities, WTF Corporation, and Michel failed to maintain adequate written supervisory procedures in violation of NASD Rules 3010 and 2110. For these supervisory violations, the Hearing Panel fined Midas Securities \$25,000; fined WTF Corporation \$15,000; fined Michel \$15,000 and suspended him in all principal capacities for 45 days; fined Lee \$20,000 and suspended him in all principal capacities for two years; and fined Adams \$10,000 and suspended him in all principal capacities for 30 business days. After reviewing the record, we affirm the Hearing Panel’s findings, but modify the sanctions that the Hearing Panel imposed.

¹ A violation of Securities Act Section 5 Act constitutes a violation of NASD Rule 2110. *See Alvin W. Gebhart*, Exchange Act Rel. No. 53136, 2006 SEC LEXIS 93, at *54 n.75 (Jan. 18, 2006), *aff’d in relevant part*, *Gebhart v. SEC*, 2007 U.S. App. LEXIS 27183 (9th Cir. Nov. 21, 2007) (finding that respondent’s sale of unregistered notes was a violation of NASD Rule 2110); *Stephen J. Gluckman*, Exchange Act Rel. No. 41628, 1999 SEC LEXIS 1395 (July 20, 1999).

² A violation of NASD Rule 3010 is also a violation of NASD Rule 2110. *Dep’t of Enforcement v. Ronald Pellegrino*, Complaint No. C3B050012, 2008 FINRA Discip. LEXIS 10, at *47 (FINRA NAC Jan. 4, 2008).

I. Background

A. Midas Securities and Its Associated Persons

1. Midas Securities

Midas Securities has been a FINRA member since 2000. Midas Securities' brokerage business is almost exclusively limited to the receipt and liquidation of over-the-counter securities in unsolicited transactions. Midas Securities' primary business is to provide a vehicle in the United States' market for the execution of securities orders originating from Korea. In 2002, Midas Securities acquired a registered brokerage firm that engaged in a retail securities business.

2. Jay S. Lee

Lee joined Midas Securities in 2002. Lee is the President, Chief Executive Officer, Chief Compliance Officer, and Financial and Operations Principal ("FINOP") of Midas Securities. Lee is registered with Midas Securities as a general securities representative, general securities principal, equity trader, and an options principal.

B. World Trade Financial Corporation and Its Associated Persons

WTF Corporation has been a FINRA member since 1998. Approximately 75 percent of WTF Corporation's business involves the receipt and liquidation of over-the-counter securities in unsolicited transactions. None of the stock WTF Corporation receives in connection with this business is registered.

1. Rodney P. Michel

Michel joined WTF Corporation in 1998. Michel is the President, FINOP, and majority owner of WTF Corporation. He is registered with WTF Corporation as a general securities representative, general securities principal, municipal securities representative, municipal securities principal, FINOP, and an equity trader.

During the relevant period, Michel was WTF Corporation's Chief Compliance Officer. According to WTF Corporation's supervisory procedures manual, Michel had overall responsibility for compliance and supervision at the firm, and for establishing the firm's supervisory systems. In addition, Michel had joint responsibility with Adams for supervising the sale of restricted stock.

2. Jason T. Adams

Adams joined WTF Corporation in 1999. Adams is registered with WTF Corporation as a general securities representative, general securities principal, and an equity trader. During the relevant period, Adams was the Vice President and Trade Desk Supervisor. In addition to the joint responsibilities he shared with Michel mentioned above, he received copies of all stock certificates received for deposit into accounts at WTF Corporation.

3. *Frank E. Brickell*

Brickell joined WTF Corporation in 2007. He is registered with WTF Corporation as a general securities representative, general securities principal, and an equity trader.

II. Procedural History

On March 31, 2008, FINRA's Department of Enforcement ("Enforcement") filed a five-cause complaint against the respondents. The causes that are relevant to this proceeding are causes one, three and four.³ Cause one alleged that WTF Corporation, Midas Securities, and Brickell (together, the "selling respondents") sold unregistered securities in violation of Section 5 of the Securities Act. Cause three alleged that, WTF Corporation, Michel, and Adams (together, the "WTF supervisors") failed to supervise the WTF Corporation representatives who sold these unregistered securities, and that WTF Corporation and Michel failed to maintain adequate written supervisory procedures. Cause four alleged that Midas Securities and Lee failed to maintain adequate written supervisory procedures and failed to supervise the Midas Securities representatives who sold the unregistered securities. On October 6, 2008, WTF Corporation, Adams, Brickell, and Michel each filed an answer to the complaint. On October, 16, 2008, Midas Securities and Lee also filed answers. The Hearing Panel conducted a hearing from November 10 through 12, 2008.

In a decision issued on May 12, 2009, the Hearing Panel found the respondents liable for the violations alleged in the complaint. The Hearing Panel imposed the sanctions listed above for the respondents' misconduct. On June 4, 2009, the respondents appealed the Hearing Panel's decision. On June 10, 2009, Enforcement filed a cross appeal.

III. Facts

FINRA's investigation into the sales of iStorage Networks, Inc. ("iStorage") stock was triggered by FINRA's receipt of spam e-mails touting the stock in December 2004 and January 2005. FINRA also discovered a press release announcing that iStorage had begun trading as a public company on the over-the-counter market on December 9, 2004, as well as several other press releases dated December 2004 and January 2005 that announced positive news concerning iStorage's business and operations. FINRA staff suspected that the spam e-mails and press releases might be part of a scheme to manipulate the price of iStorage stock.

Upon investigation, FINRA staff determined that iStorage was incorporated in 1997 as Camryn Information Services, Inc. ("Camryn"). Between 1999 and early May 2004, Camryn was a privately held shell company with no registered or publicly traded shares. Camryn had

³ Cause two alleged supervisory failures by Barron Moore, Inc., and Patrick Francis Harte, Jr. These respondents settled with Enforcement prior to the hearing. Cause five alleged that Midas Securities and Lee failed to timely update a Form U4. On September 17, 2008, Enforcement filed an amended complaint that did not include cause five.

only four shareholders: (1) Doyle Mark White (“White”), President of Camryn; (2) Paul Johnson (“Johnson”); (3) Joel Holt (“Holt”); and (4) Gary Zinn (“Zinn”). White owned 5 million shares of Camryn. The remaining balance of 3 million shares was held equally by Johnson, Holt, and Zinn (together, “the Initial Shareholders”). The shares the Initial Shareholders held were restricted securities.⁴

In early November 2004, Camryn entered into a merger with iStorage, which at the time was a development-stage corporation. Following the merger, Camryn changed its name to iStorage and issued a 3.334 to 1 stock split under which the Initial Shareholders each received 3.334 million shares of iStorage on November 8, 2004.

FINRA staff further determined that immediately following the merger, the Initial Shareholders deposited 4,511,000 shares of iStorage into their accounts at WTF Corporation and Midas Securities, and then proceeded to sell 3,070,800 of those shares to other individuals and entities.⁵ None of the shares were registered. Because the trading pattern looked like it could be an unlawful public distribution of unregistered securities, FINRA staff examined the respondents’ involvement in the transactions.

Neither Midas Securities or WTF Corporation had any written supervisory procedures covering what steps their representatives needed to take to investigate the source of unregistered stock that their customers acquired and sought to liquidate. As President of Midas Securities, Lee testified that he did not want his representatives to make any decision as to whether a stock was restricted because it was “not their duty.” Lee further admitted that it was his opinion that if one of his representatives tried to contact an attorney for assistance in determining whether a stock was restricted, Lee would “stop them” because he believed it was not the representative’s responsibility.

⁴ “Restricted” stock is not freely tradable and is defined as “securities acquired . . . from the issuer, or from an affiliate of the issuer, in a transaction or chain of transactions not involving any public offering.” 17 C.F.R. § 230.144(a)(3)(i).

⁵ Between November 2004 and March 2005, a series of transactions resulted in the unlawful distribution of more than 3 million shares of iStorage stock that generated proceeds of \$396,300. WTF Corporation, through Brickell, sold approximately 2.3 million shares of this stock. Midas Securities, through two of its representatives, Benjamin Centeno (“Centano”) and Jeffrey Santohigashi (“Santohigashi”), sold the remaining 760,000 shares. The stock was sold to the public, in transactions involving three customers who had received the iStorage shares from the Initial Shareholders. Immediately after the unregistered sales of the iStorage shares, these customers directed Centano and Santohigashi to wire the proceeds from the sales. Centano and Santohigashi never made any inquiry about how the customers obtained the shares, nor did they perform any due diligence on the sellers of the iStorage shares.

IV. Discussion

Securities Act Section 5 prohibits any person from selling a security in interstate commerce unless a registration statement is in effect as to the offer and sale of that security or there is an applicable exemption from the registration requirements.⁶

To establish a *prima facie* case of a violation of Securities Act Section 5, Enforcement must show that: (1) no registration statement was in effect as to the securities; (2) selling respondents sold or offered to sell the securities; and (3) interstate transportation or communication was used in connection with the sale or offer of sale.⁷ There is no dispute that the selling respondents sold the unregistered shares of iStorage stock using interstate means. There is also no dispute that no registration statement was on file or in effect for the sale of these iStorage shares. Consequently, Enforcement has established a *prima facie* case of a violation of Securities Act Section 5.

A. The Selling Respondents Failed to Prove that the iStorage Transactions Were Exempt from Registration

Once Enforcement establishes a *prima facie* case, the burden shifts to the selling respondents to show that the transactions were exempt from the Securities Act's registration requirements.⁸ "Exemptions from the registration requirements of the Securities Act are

⁶ 15 U.S.C. § 77e(a) and (c); *see also Jacob Wonsover*, 54 S.E.C. 1, 8 (1999), *aff'd*, 205 F.3d 408 (D.C. Cir. 2000).

⁷ *Gebhart*, 2006 SEC LEXIS at *53; *SEC v. Cont'l Tobacco Co. of S. Carolina, Inc.*, 463 F.2d 137, 155 (5th Cir. 1972).

⁸ The respondents erroneously assert that it is Enforcement's burden to prove that an unlawful distribution occurred in order to establish a Section 5 violation. Accordingly, the respondents vigorously argue that Enforcement's case fails because there is not sufficient evidence regarding whether the Initial Shareholders engaged in an unlawful distribution of unregistered iStorage shares. Under well-established case law, however, it is the respondents' responsibility to investigate whether the unregistered iStorage shares were part of an unlawful distribution, since the respondents claim an exemption for the shares. *See SEC v. Blazon Corp.*, 609 F.2d , 960, 968 (9th Cir. 1979) (stating that "[t]he burden of proof is on the person who would claim [a Section 5] exemption"); *Robert G. Leigh*, 50 S.E.C. 189, 192 (1990) (stating that "[i]t is well settled that the burden of establishing the availability of a [Section 5] exemption rests on the person claiming it"); *see also SEC v. Cavanagh*, 1 F. Supp. 2d 337, 361-363 (S.D.N.Y.), *aff'd*, 155 F.3d 129 (2d Cir. 1998); *John A. Carley*, Initial Decision Rel. No. 292, 2005 SEC LEXIS 1745, at *87 (July 18, 2005), *aff'd*, 2008 SEC LEXIS 222 (Jan. 31, 2008) (citing *Swenson v. Engelstad*, 626 F.2d 421, 425 (5th Cir. 1980)). Moreover, there is evidence in the record that strongly indicates that an unlawful distribution occurred. *See infra* note 13.

construed narrowly.” *Blazon Corp.*, 609 F.2d at 968. Thus, evidence in support of an exemption must be “explicit, exact, and not built on mere conclusory statements.”⁹

The selling respondents contend that the sale of the iStorage shares qualified for an exemption under Section 4(4) of the Securities Act. Section 4(4) is known as the “broker’s exemption” and exempts from Section 5’s registration requirements any “brokers’ transactions executed upon customers’ orders on [an] exchange or in the over-the-counter market.” *Newbridge Secs. Corp.*, Initial Decisions Release No. 380, 2009 SEC LEXIS 2058, at *134 (June 9, 2009).

Section 4(4) is “intended to exempt trading transactions with respect to securities already issued to the public.” *Quinn & Co.*, 44 S.E.C. 461, 466-67 (1971), *aff’d*, 452 F.2d 943 (10th Cir. 1971). Therefore, Section 4(4) “cannot be used to exempt distributions by issuers or underwriters.” *Id.*¹⁰ “The legislative history of the brokers’ exemption indicates that it was meant to preserve the distinction between [the] *distribution* [of securities], with which the Securities Act is mainly concerned, and [the] *trading* [of securities].” *Id.* (emphasis added).

WTF Corporation, Midas Securities, and Brickell, however, did not meet their burden of proving that the iStorage shares were eligible for the broker’s exemption. This is because in order to be eligible for the broker’s exemption, the selling respondents must show that they conducted a sufficient inquiry to satisfy themselves that the three million iStorage shares at issue were not part of an unlawful distribution.¹¹ Accordingly, the Commission has held that “[a] broker relying on the broker’s exemption cannot merely act as an order taker, but must make whatever inquiries are necessary under the circumstances to determine that the transaction . . . is not part of an unlawful distribution.” *Leigh*, 50 S.E.C., at 193; *Carley*, 2005 SEC LEXIS 1745, at *10; *see also Newbridge Secs. Corp.*, 2009 SEC LEXIS 2058, at *135-36 (stating that “[w]hen a dealer is offered a substantial block of a little-known security . . . then [a] searching inquiry is called for”).

⁹ *Robert G. Weeks*, Exchange Act Rel. No. 48684, 2003 SEC LEXIS 2572, at *42 n.34 (Oct. 23, 2003).

¹⁰ Securities Act Section 2(a)(11) defines “underwriter” to include “any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security.” 15 U.S.C. § 77b(a)(11). Section 2(a)(11) further defines “issuer” to include “any person directly or indirectly controlling or controlled by the issuer.” *Id.*

¹¹ *See Laser Arms Corp.*, 50 S.E.C. 489, 503 (1991) (stating that a “dealer who offers to sell, or is asked to sell a substantial amount of securities must take whatever steps are necessary to be sure that this is a transaction not involving an issuer, person in a control relationship with an issuer or an underwriter” and thus, an unlawful distribution). Here, it is undisputed that the selling respondents made no inquiry into whether the Initial Shareholders were acting as an underwriter, issuer or control person, and thus whether the iStorage transactions were part of an unlawful distribution.

Here, contrary to established case law, the selling respondents admit that they did not make *any* inquiry as to whether the iStorage shares were part of an unlawful distribution. *See Benjamin Werner*, 44 S.E.C. 745, 747 n.5 (1971) (stating that a “broker is at least obligated to question his customer to obtain facts reasonably sufficient under the circumstances to indicate whether the customer is engaged in a distribution”) (citation omitted)). Instead, they contend that they relied on the transfer agent and clearing firm to make this determination. The selling respondents’ contentions have no merit. The Commission has made it clear that registered representatives may not rely on transfer agents or clearing firms to investigate whether a transaction involving unregistered securities is exempt from Section 5’s registration requirements. *See Wonsover*, 1999 SEC LEXIS 430, at *29 (rejecting the view that a representative can rely on a transfer agent to conduct the appropriate inquiry into whether the sale of an unregistered security complies with Section 5); *Carley*, 2005 SEC LEXIS 1745, at *112 (broker handling “large blocks of little-known security . . . was not entitled to rely on . . . the acquiescence of the transfer agent and clearing broker”).¹²

Because there was no registration statement in effect for the sale of the iStorage shares and the selling respondents did not make an inquiry into the source of these shares, they could not reasonably assume that the shares were exempt from Section 5’s registration requirements. *See Owen V. Kane*, 48 S.E.C. 617, 622 (1986) (concluding that because petitioner did not make the necessary investigation, “he had no reasonable basis for believing that the . . . stock [he] sold was exempt from registration”).¹³ Consequently, the selling respondents cannot claim the

¹² We also reject the selling respondents’ argument that they did not have to make an inquiry into whether the iStorage shares were exempt because the shares did not contain restrictive legends indicating that the unregistered shares were not freely tradable. *See Quinn & Co., Inc.*, 452 F.2d 943, 947 (10th Cir. 1971) (stating that petitioners “were not entitled to rely on the lack of cautionary legends on the stock certificates” as a means of determining compliance with the Securities Act’s registration provisions); *see also Leigh*, 50 S.E.C. at 194 (stating that, “the transfer agent’s willingness to reissue the [stock] certificates without restrictive legends did not relieve [the registered representative] of his obligation to investigate”).

¹³ The respondents’ reliance on the broker’s exemption without making a proper inquiry into the source of the iStorage shares is particularly unreasonable because several factors suggest that these shares *were* part of an unlawful distribution. First, the shares were unregistered and a substantial volume of more than three million shares were made available in roughly six days. *See Distribution by Broker-Dealers of Unregistered Secs.*, Exchange Act Rel. No. 6721, 1962 SEC LEXIS 74, at *4-5 (Feb. 2, 1962) (discussing how it must be assumed that the issuer is the source of unregistered securities appearing in substantial amounts in the market over a short time period). Second, the issuer of the shares was an unknown, development-stage company with no operating or earnings history. *See Charles F. Kirby*, Exchange Act Rel. No. 47149, 2003 SEC LEXIS 46, at *21-22 (Jan. 9, 2003), (discussing how petitioner failed to make an appropriate inquiry where company at issue had limited assets, limited trading history, and there was little or no information available regarding the company’s business). Finally, after the sales of the unregistered iStorage shares, the selling respondents’ customers directed them to quickly wire

broker's exemption.¹⁴ Further, in light of the circumstances surrounding the sale of the iStorage shares, the selling respondents' failure to have made an inquiry as to whether such sales would comply with the Securities Act's registration requirements was particularly problematic. Instead of doing so, the selling respondents did nothing but attempt to shift responsibility for compliance to third parties.¹⁵ Accordingly, the selling respondents did not meet their burden of proving that the three million unregistered iStorage shares sold to the public were eligible for the broker's exemption. We therefore find that Midas Securities, WTF Financial and Brickell violated Securities Act Section 5 and NASD Rule 2110.

B. WTF Corporation, Michel, Midas and Lee Failed to Develop and Maintain Adequate Supervisory Procedures to Investigate the Sale of Unregistered Securities

NASD Rule 3010 "requires member firms to establish and maintain a supervisory system that is reasonably designed to achieve compliance with the applicable securities laws, rules, and regulations."¹⁶ NASD Rule 3010 also requires that a member firm "establish, maintain, and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of registered representatives and associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable rules of NASD." Consequently, a firm's procedures must be tailored to the specific nature of the firm's business.¹⁷

[cont'd]

the proceeds from the sales. *See Laser Arms Corp.*, 50 S.E.C. 489, 505 (1991) (discussing how petitioner should have investigated further to determine whether it was violating the Securities Act by selling its customer's unregistered securities rather than delivering the proceeds of the securities' sales to the customer).

¹⁴ *See Newbridge Secs. Corp.*, 2009 SEC LEXIS 2058, at *134 (stating that a Section 4(4) exemption "is not available to a broker who knows or has reasonable grounds to believe that . . . the transaction is not exempt from Section 5"); *Carley*, 2008 SEC LEXIS 222, at *34 (same).

¹⁵ The respondents contend that reliance on the transfer agent was the "standard practice" in the industry. We note that the Commission has held that a securities professional's purported reliance on a transfer agent to determine whether a stock is restricted is not a defense to a Securities Act registration violation. *See Kirby*, 2003 SEC LEXIS 46, at *39 n.58; *see also SEC v. Dain Rauscher, Inc.*, 254 F.3d 852, 857 (9th Cir. 2001) (rejecting claim that compliance with an industry standard absolves a securities professional from liability under federal securities laws").

¹⁶ *Dep't of Enforcement v. Strong*, Complaint No. C04050005, 2007 NASD Discip. LEXIS 10, at *11 (NASD NAC Feb. 23, 2007), *aff'd*, Exchange Act Rel. No. 57426, 2008 SEC LEXIS 467 (Mar. 4, 2008).

¹⁷ NASD Membership and Registration Rule Interpretive Material 3010-1, *available at* http://finra.complinet.com/en/display/display_main.html?rbid+2403&element_id=3718.

More than 75 percent of both Midas Securities' and WTF Corporation's business involved the receipt and liquidation of unregistered securities. Nevertheless, it is undisputed that neither firm maintained written supervisory procedures: (1) requiring their representatives to make any inquiry when they received large volumes of thinly traded, unregistered shares for liquidation, or (2) offering guidance as to what due diligence was required when dealing with the unregistered stock that was deposited and sold in each firm's customer accounts.

It is also undisputed that neither firm's procedures instructed its representatives to determine whether the unregistered shares they sold were freely tradable by asking how their customers acquired the shares. Instead, WTF Corporation, Michel, Midas and Lee relied completely on third parties to determine whether the shares were freely tradable. By doing so, they completely ignored their obligation to determine whether the iStorage shares were part of an unlawful distribution and provided no meaningful mechanism to detect whether any of the unregistered securities they sold were exempt from the Securities Act's registration requirements. We therefore find that Midas Securities, WTF Corporation, and their respective presidents, Lee and Michel, violated NASD Rules 3010 and 2110 by failing to establish and maintain a system and written procedures to ensure compliance with Section 5's registration requirements.¹⁸

C. Lee and the WTF Supervisors Failed to Reasonably Supervise Persons Selling Unregistered iStorage Shares

Under NASD Rule 3010, a supervisor is responsible for "reasonable supervision," a standard that "is determined based on the particular circumstances of each case."¹⁹ This standard, among other things, creates a duty for supervisors "to investigate 'red flags' that suggest that misconduct may be occurring and to act upon the results of such investigation."²⁰ Therefore, a

¹⁸ The Commission has established that absent a clear delegation of supervisory authority, final responsibility for proper supervision of trading activities at a member firm may rest with the firm's president. *See William H. Gerhauser, Sr.*, 53 S.E.C. 933, 940-41 (1998) (stating that "the president of a corporate broker-dealer is responsible for compliance with all of the requirements imposed on his firm unless and until he reasonably delegates particular functions to another person in that firm, and neither knows nor has reason to know that such person's performance is deficient"). Here, there is no such delegation of authority, and as president of their respective firms, we find that both Lee and Michel are liable under NASD Rule 3010 and 2010.

¹⁹ *Christopher J. Benz*, 52 S.E.C. 1280, 1284 (1997), *petition for review denied*, 168 F.3d 478 (3d Cir. 1998) (table).

²⁰ *Michael T. Studer*, Exchange Act Rel. No. 50543A, 2004 SEC LEXIS 2828, at *23 (Nov. 30, 2004) (citation omitted); *accord George J. Kolar*, 55 S.E.C. 1009, 1009 (2002) (stating that "[d]ecisive action is necessary whenever supervisors are made aware of suspicious circumstances, particularly those that have an obvious potential for violations"); *Quest Capital Strategies, Inc.*, 55 S.E.C. 363, 371 (2001) (stating that "supervisors must act decisively to detect

supervisor's failure to respond to such red flags constitutes a failure to supervise reasonably under NASD Rules 3010 and 2110.²¹

1. The WTF Supervisors' Failure to Supervise

Here, Michel and Adams shared responsibility for supervising the activities of the WTF Corporation representatives who sold the unregistered iStorage securities.²² Together, they ignored key "red flags" that should have prompted them to investigate whether the representatives under their supervision were participating in an unlawful distribution. For example, Michel and Adams knew that iStorage was a new, development-stage company, and that Brickell sold approximately 2.3 million unregistered shares of iStorage shares.

Nevertheless, Michel and Adams did nothing to investigate whether these sales complied with the Securities Act's registration requirements.²³ In addition, they also knew that WTF Corporation's customers sold the iStorage shares and immediately asked to be wired the proceeds from those sales.²⁴ Despite knowing this information, neither Michel nor Adams responded to these red flags, and they failed to conduct *any* inquiry regarding unregistered sales of iStorage stock. Moreover, the WTF supervisors failed to conduct, or direct Brickell to conduct, *any* inquiry into whether the iStorage sales complied with Section 5's registration

[cont'd]

and prevent violations of the securities laws when an indication of irregularity is brought to their attention"); *Consolidated Inv. Servs., Inc.*, 52 S.E.C. 582, 588 (1996) (stating that "any indication of irregularity brought to a supervisor's attention must be treated with the utmost vigilance").

²¹ See *Studer*, 2004 SEC LEXIS 2828, at *26.

²² As WTF Corporation's President and Trade Desk Supervisor, respectively, Michel and Adams were each responsible for supervising the representatives selling the unregistered iStorage shares. See *James L. Owsley*, 51 S.E.C. 524, 533 (1993) (stating that "[u]nder a proper and reasonable interpretation of [NASD] rules, supervisory obligations are imposed on associated persons to the degree consonant with the positions they occupy").

²³ See *Owsley*, 51 S.E.C. at 535 (finding firm's Chief Executive Officer and President both violated NASD Rule 3010 where they "were aware that vast amounts of the securities of two small and unseasoned companies were being sold" by a branch office "[but] made no independent investigation to determine the registration status of those securities").

²⁴ Cf. *Laser Arms Corp.*, 50 S.E.C. at 505 (discussing how representative should have known a further investigation was necessary where representative sold customer's unregistered securities and the customer immediately demanded that representative deliver the proceeds from the sales).

requirements. Consequently, we find that WTF Corporation, Michel and Adams violated NASD Rules 3110 and 2110, by failing to supervise reasonably Brickell's sale of unregistered iStorage shares.

2. *Lee's Failure to Supervise*

Similarly, Lee admits that he did not investigate the legality of the iStorage sales despite the fact that representatives at Midas Securities sold approximately 760,000 unregistered shares of the unknown, thinly traded stock. Lee contends that he was not required to respond to this red flag because he did not have supervisory responsibility over Centano and Santohigashi. Instead, Lee seeks to shift responsibility to William Cantrell ("Cantrell"), a principal that Lee asserts he hired in June 2004 as a replacement for Centano and Santohigashi's former supervisor, Randy Wong ("Wong").²⁵ As discussed below, the record does not support Lee's contention.

The weight of evidence in the record indicates that Lee abandoned his supervisory responsibilities and did not effectively delegate this responsibility to another qualified supervisor. First, Cantrell credibly testified that he did not have supervisory responsibility over Centano and Santohigashi. Indeed, the Hearing Panel specifically found Cantrell to be "far more credible than Lee on the subject of Cantrell's duties and responsibilities at Midas Securities." We find nothing in the record that would prompt us to reverse the Hearing Panel's credibility determination. *See Dane S. Faber*, Exchange Act Rel. No. 49216, 2004 SEC LEXIS 277, at *17-18 (Feb. 10, 2004).

Second, both Centano and Santohigashi testified that it was Lee, rather than Cantrell, who was their supervisor. Although these representatives named Lee as their supervisor, they also testified, and it is not in dispute, that Lee did very little to supervise directly their sales activities involving the unregistered iStorage shares. The Hearing Panel also found this testimony to be credible and we do not disturb this credibility determination. *Faber*, 2004 SEC LEXIS 277, at *17-18. Lee argues that because a different section of Midas Securities' written procedures identify Lee, Cantrell, and two others as "responsible supervisors" for "registered personnel," the Hearing Panel erred in finding that Lee had supervisory responsibilities. Lee's argument is unpersuasive. The Hearing Panel has broad discretion to make credibility determinations and the weight of the testimonial evidence supports the Hearing Panel's determination in this case. *Cf. Kirk A. Knapp*, Exchange Act Rel. No. 30391, 1992 SEC LEXIS 430, at *10 (Feb. 21, 1992) (rejecting firm president's claim that another principal with title of "sales manager" had supervisory responsibility for a certain representative where testimony from sales manager and another representative did not corroborate the President's claim").

²⁵ It is undisputed that Cantrell took over some of the "back office" functions that were performed by Wong. The parties, however, dispute whether Cantrell took over Wong's supervisory functions.

Third, Midas Securities' written supervisory procedures designated Lee as the firm's Chief Supervisory Officer and as such, Lee was responsible for approving every transaction involving restricted securities. Fourth, these procedures also identified Lee alone as the principal at Midas Securities with responsibility for both sales and the supervision of associated persons.²⁶

In the face of direct evidence establishing Lee's supervisory responsibility, Lee attempts to establish that Cantrell had supervisory responsibility for the Midas Securities' representatives, by pointing to several of what he refers to as "circumstantial indicators," of Cantrell's supervisory responsibility, including that: (1) Cantrell supervised representatives for 13 years prior to joining Midas Securities; (2) Lee paid Cantrell a higher salary than Wong, even though Wong performed both supervisory and back office functions; (3) Cantrell sporadically performed *some* supervisory functions, including approving new account forms and reviewing trade tickets; and (4) that it would be illogical for Lee, who was absent from his office at least 50 percent of the time, not to delegate his supervisory responsibilities to Cantrell.²⁷

Even considering these circumstantial indicators, we still find that the weight of the evidence, including corroborated direct testimony of Midas Securities' employees and

²⁶ Lee seeks to introduce an email, dated June 11, 2004, from Cantrell to Midas Securities that purportedly confirms Cantrell's salary and supervisory responsibilities. The Hearing Panel excluded this email because Midas Securities and Lee failed to file pre-hearing submissions, including an exhibit list. The Hearing Panel noted that Midas Securities and Lee did not show good cause for this failure and precluded them from introducing documents or calling witnesses that were not identified in the other parties' pre-hearing submissions.

We affirm the Hearing Panel's ruling, but also note that the weight of evidence in the record does not demonstrate that Lee made an effective delegation of his supervisory responsibilities. *See infra* note 27. Consequently, the excluded email, at best, only proves that *both* Cantrell and Lee had supervisory responsibilities. Thus, even if Lee shared supervisory responsibility with Cantrell, Lee's failure to investigate the iStorage sales still did not meet the standards of NASD Rule 3010. *Cf. Owsley*, 51 S.E.C. at 536 (concluding that the firm's Chief Executive Officer shared responsibility and liability under NASD Rule 3010 with the firm's president for taking no action to investigate whether sales of large volume of thinly traded, unregistered securities complied with the Securities Act's registration requirements).

²⁷ We note that even if Lee intended to delegate to Cantrell all supervisory authority over the representatives, Lee did not do so effectively. Cantrell, the purported supervisor was unaware of this delegation, as well as the representatives he was supposedly supervising. *Cf. Knapp*, 1992 SEC LEXIS 430, at *10 (finding that petitioner "never made a reasonable or effective delegation of authority" to an employee where, among other things, the employee denied that he acted as a supervisor and the record showed that "the sales force did not consider the employee to be its supervisor, and was not even aware that the employee was supposedly functioning in that capacity").

documentary evidence in the form of Midas Securities' own written supervisory procedures, demonstrates that Lee had supervisory responsibility over Centano and Santohigashi. Accordingly, we find that Midas Securities and Lee failed to supervise reasonably Centano and Santohigashi's sale of the iStorage shares, in violation of NASD Rules 3010 and 2110.

V. Sanctions

For selling unregistered securities in violation of Securities Act Section 5, the Hearing Panel fined Midas Securities \$30,000; fined WTF Corporation \$15,000; and fined Brickell \$15,000 and suspended him in all capacities for 30 days. For failing to maintain adequate written supervisory procedures and failing to supervise the registered representatives who sold the unregistered securities, the Hearing Panel fined Midas Securities \$25,000; fined WTF Corporation \$15,000; fined Michel \$15,000 and suspended him in all principal capacities for 45 days; and fined Lee \$20,000 and suspended him in all principal capacities for two years. For failing to supervise the registered representatives who sold the unregistered securities, the Hearing Panel fined Adams \$10,000 and suspended him in all principal capacities for 30 business days. We have considered the FINRA Sanction Guidelines ("Guidelines")²⁸ in determining the appropriate sanction for the respondents' violations, the potentially mitigating factors raised by the respondents on appeal, as well as Enforcement's arguments for higher sanctions. We find that the sanctions the Hearing Panel imposed on the respondents for their violations should be modified.

A. Selling Unregistered Securities

The Guidelines for the sale of unregistered securities in violation of Section 5 provide for a fine of \$2,500 to \$50,000 and consideration of a suspension or bar in egregious cases.²⁹ The Guidelines further set forth three specific considerations for such violations: (1) whether the respondent attempted to comply with an exemption from registration; (2) whether respondent sold before effective date of registration statement; and (3) share volume and dollar amount of transactions involved.³⁰ In addition, we consider the Principal Considerations in Determining Sanctions.³¹

²⁸ *FINRA Sanction Guidelines* (2007), <http://www.finra.org/web/groups/industry/@ip/@enf/@sg/documents/industry/p011038.pdf> [hereinafter "*Guidelines*"].

²⁹ *Id.* at 26. We note that there was no registration statement in effect for the iStorage shares. Consequently, the second consideration regarding whether the respondents sold before the registration statement's effective date is not applicable here and we do not address it.

³⁰ *Id.*

³¹ *Id.* at 6-7.

First, we find that the selling respondents intentionally violated Section 5's registration requirements rather than complying with the broker's exemption. As noted above, the selling respondents failed to make a "searching inquiry" into whether the iStorage shares were part of an unlawful distribution. Significantly, not only did the selling respondents fail to make the required inquiry, they did not make *any* inquiry to determine whether the iStorage shares were part of an unlawful distribution and therefore eligible for the broker's exemption. Instead, the respondents ignored established case law and relied on third parties to make the inquiry that they were required to make in order to rely on the broker's exemption. In addition, the selling respondents' misconduct involved the sale of a significant volume of unregistered shares. WTF Corporation, for example, sold 2.3 million iStorage shares and Midas Securities sold 760,000 shares. The proceeds from these sales were significant as well, generating \$396,300.

We find that the selling respondents' violations were egregious and merit significant sanctions. In addition, there are several aggravating factors identified in the Guidelines' Principal Considerations that call for sanctions toward at least the middle range of the recommended sanctions. As noted above, we find that the selling respondents' violations of Section 5's registration requirements were intentional and also find that the three million unregistered shares that were unlawfully distributed to the public was a significant amount.³² In addition, we find it aggravating that the selling respondents have not accepted responsibility for their misconduct by trying to shift their responsibility for compliance with the Securities Act's registration requirements to third parties.³³

After considering the above factors, we find that the Hearing Panel imposed sanctions that were appropriately remedial and we affirm these sanctions. Accordingly, we impose the following sanctions for the selling respondents' violations of Section 5 of the Securities Act and NASD Rule 2110: (1) WTF Corporation will be fined \$15,000; (2) Brickell will be fined \$15,000 and suspended in all capacities for 30 business days; and (3) Midas Securities will be fined \$30,000.

³² *Id.* at 7 (Principal Considerations in Determining Sanctions, Nos. 13 and 18).

³³ *Id.* at 6 (Principal Considerations in Determining Sanctions, No. 2).

B. Deficient Supervisory Procedures and Supervision

As an initial matter, we find that it is appropriate to aggregate the NASD Rule 3110 violations of WTF Corporation, Michel, Midas and Lee because they stemmed from a common cause—the supervisors’ unreasonable reliance on a clearing firm and transfer agent to determine whether the shares were freely tradable. *See Dep’t of Enforcement v. Respondent Firm 1*, Complaint No. C8A990071, 2001 NASD Discip. LEXIS 6, at *30-31 (NASD NAC Apr. 19, 2001) (holding that when a number of violations are the result of a single underlying cause, it is proper to impose a single sanction for these violations). As discussed below, we also find that these violations were serious and merit significant sanctions.

Accordingly, we impose the following sanctions upon the Midas, Lee and the WTF supervisors for their NASD Rule 3110 violations: (1) WTF Corporation will be fined \$30,000; (2) Michel will be fined \$30,000 and suspended for 45 days in all principal capacities; (3) Adams will be fined \$20,000 and suspended in all principal capacities for 30 business days; (4) Midas Securities will be fined \$50,000; and (5) Lee will be fined \$50,000 and suspended for two years in all principal capacities.

1. *Factors Relevant to Failure to Supervise Violations*

The Guidelines for failing to supervise recommend, in egregious cases, suspending the responsible individual in any or all capacities for up to two years or imposing a bar.³⁴ The Guidelines further recommend a fine of \$5,000 to \$50,000, which amount may be increased by the amount of the respondent’s financial benefit.³⁵ In a case against a member firm involving systemic supervision failures, the Guidelines recommend suspending the firm with respect to any or all activities or functions for up to two years or expulsion of the firm.³⁶ The Guidelines for a failure to supervise violation provide three considerations in determining the appropriate sanctions: (1) whether the respondent ignored “red flag” warnings that should have resulted in additional supervisory scrutiny; (2) the nature, extent, size, and character of the underlying misconduct; and (3) the quality and degree of the supervisor’s implementation of the firm’s supervisory procedures and controls.³⁷

³⁴ *Id.* at 108.

³⁵ *Id.*

³⁶ *Id.*

³⁷ *Id.* We note that there were no procedures at Midas Securities or WTF Corporation that addressed how to comply with Section 5’s registration requirements when selling unregistered securities. Consequently, we do not evaluate the supervisors’ implementation of supervisory procedures and controls in our sanctions determinations.

First, we find it aggravating that Midas, Lee and the WTF supervisors ignored several red flags that should have prompted an inquiry into whether the iStorage shares were part of an unlawful distribution.³⁸ These red flags include the fact that: (1) iStorage was a development stage company with little operating history; (2) the iStorage transactions involved a significant volume of unregistered shares; and (3) the customers who deposited and sold the iStorage shares requested that the firms immediately wire the proceeds from the sales. As discussed above, we also find it to be aggravating that the firms sold more than 3 million shares of unregistered iStorage stock to the public with the sale proceeds reaching \$396,300.

2. *Factors Relevant to Deficient Written Supervisory Procedures Violations*

The Guidelines for deficient written supervisory procedures provide for fines ranging from \$1,000 to \$25,000.³⁹ In egregious cases, the Guidelines recommend suspending the firm with respect to any or all relevant activities for up to 30 business days and thereafter until the supervisory procedures are amended to conform to rule requirements.⁴⁰ The Guidelines for deficient supervisory procedures provide two considerations in determining the appropriate sanctions: (1) whether the deficiencies allowed violative conduct to occur or to escape detection; and (2) whether the deficiencies made it difficult to determine the individual or individuals responsible for specific areas of supervision or compliance.⁴¹

Turning to the first consideration, it is undisputed that there were no procedures designed to keep either firm compliant with Section 5's registration requirements or to direct the firms' representatives as to the proper way to avoid unlawful distributions of unregistered securities. Not surprisingly, the respondents violated Section 5 by illegally selling 3 million shares of unregistered securities during the period that the deficient procedures were in effect. As for the second consideration, we find that it does not apply here because: (1) there was no dispute that Michel and Adams had supervisory responsibility over the WTF Corporation representatives who sold the iStorage stock; and (2) Midas Securities' written supervisory procedures clearly identified Lee as the principal at the firm with supervisory responsibility over its representatives that sold unregistered securities, including Centano and Santohigashi.

³⁸ We find it particularly aggravating that Lee went so far as to state that it was his opinion that Midas Securities representatives did not have a duty to determine whether unregistered securities were freely tradable and that he would *prohibit* them from contacting an attorney to assist them in making this determination.

³⁹ *Guidelines*, at 109.

⁴⁰ *Id.*

⁴¹ *Id.*

3. *Additional Aggravating Factors*

Although more than 75 percent of both Midas Securities' and WTF Corporation's business involved the sale of unregistered securities, both firms intentionally failed to implement procedures designed to detect or investigate possible violations of Section 5's registration requirements.⁴² We also find it aggravating that the respondents sought to shift the responsibility for compliance with the Securities Act to third parties instead of accepting responsibility for their inattention to the Act's registration requirements.⁴³

4. *Midas Securities' and Lee's Disciplinary Histories*

We also consider that Midas Securities and Lee have a relevant disciplinary history. Specifically, Midas Securities and Lee were sanctioned in a Letter of Acceptance, Waiver and Consent ("AWC") for a separate violation of Securities Act Section 5 involving the sale of unregistered securities.⁴⁴ Moreover, the misconduct that was the subject of the AWC occurred just six weeks before the misconduct that is the subject of this proceeding.⁴⁵ Consequently, we find that it would be appropriately remedial to impose a significantly higher sanction upon Midas Securities and Lee for their violations.⁴⁶

Taking all of the foregoing factors into careful consideration, we find that misconduct of Midas, Lee and the WTF supervisors was egregious.⁴⁷ Accordingly, we further find that the

⁴² *Id.* at 7 (Principal Considerations in Determining Sanctions, No. 13).

⁴³ *Id.* at 7 (Principal Considerations in Determining Sanctions, No. 2).

⁴⁴ *Id.* at 6-7 (Principal Considerations in Determining Sanctions, No. 1).

⁴⁵ Midas Securities and Lee's misconduct occurred despite pledges in the AWC that Midas Securities undertook corrective actions to "prevent any [improper] sale of unregistered securities." The AWC also stated that "the firm has done a thorough review of procedures for the acceptance of restricted . . . securities [and] will obtain an expert opinion such as outside counsel when it is unclear if securities are registered or unregistered."

⁴⁶ *Id.* at 2 (stating that "[d]isciplinary sanction should be more severe for recidivists [and that] [a]djudicators should consider imposing more severe sanctions when a respondent's disciplinary history includes . . . past misconduct similar to that at issue").

⁴⁷ In light of the egregiousness of the respondents' supervisory failures, Enforcement requests that the fines for the supervisory failures be increased to \$30,000 (a \$15,000 increase) for WTF Corporation, \$30,000 for Michel (a \$15,000 increase), \$20,000 for Adams (a \$10,000 increase), and \$50,000 each for Midas Securities and Lee (a \$25,000 and \$30,000 increase, respectively, and the highest recommended under the Guidelines). We agree, and find that the sanctions requested by Enforcement are sufficiently remedial to achieve the deterrence

following sanctions are appropriately remedial: WTF Corporation will be fined \$30,000; Midas Securities will be fined \$50,000; Michel will be fined \$30,000 and suspended in all principal capacities for 45 days; Lee will be fined \$50,000 and suspended in all principal capacities for two years; and Adams will be fined \$20,000 and suspended in all principal capacities for 30 business days.⁴⁸ We further prohibit Midas Securities and WTF Corporation from receiving and selling unregistered securities until they comply with the following independent consultant requirement. Midas Securities and WTF Corporation shall, at their own expense, retain an independent consultant with an expertise in Section 5's registration requirements. The independent consultant must be acceptable to FINRA's district office and shall review the firms' procedures and recommend written supervisory procedures designed to ensure each firm's compliance with Section 5 registration requirements. Midas Securities and WTF Corporation shall adopt, modify, or reject these written supervisory procedures, implement them, and communicate their implementation to FINRA's district office in writing. *See Guidelines*, at 3 (stating that "to achieve deterrence and remediate misconduct, Adjudicators may impose sanctions that: (a) require a respondent firm to retain a qualified independent consultant to design and/or implement procedures for improved future compliance with regulatory requirements; [or] (b) suspend or bar a respondent firm from engaging in a particular line of business . . .").

VI. Conclusion

For violating NASD Rule 2110 by selling unregistered securities, WTF Corporation and Brickell are fined \$15,000 each, Brickell is suspended from associating with any member firm in any capacity for 30 business days, and Midas Securities is fined \$30,000. For violating NASD Rules 3010 and 2110 by failing to establish and maintain a system to supervise the activities of

[cont'd]

contemplated by the Guidelines. *See Id.* (stating that adjudicators should determine sanctions "with a view toward ensuring that the sanctions imposed are . . . sufficiently remedial to achieve deterrence").

⁴⁸ The respondents argue that the sanctions imposed are higher than a settled case involving similar misconduct. We find it inappropriate, however, to compare sanctions imposed in litigated cases with those imposed in negotiated settlements. *Id.* at 1 (stating that it is a "broadly recognized principle that settled cases generally result in lower sanctions than fully litigated cases to provide incentives to settle"). In addition, the respondents also assert that the suspensions imposed should be staggered because overlapping the suspensions of WTF Corporation's compliance personnel would put the firm out of business and leave the firm's customers "without the ability to transact business." The respondents' assertion has no merit. The Commission has previously rejected similar arguments by respondents who cite customer hardship as a reason to find that a sanction was excessive. *See Hans N. Beerbaum*, Exchange Act Rel. No. 55731, 2007 SEC LEXIS 971, at *20 (May 9, 2007) (rejecting respondent's argument that bar imposed was excessive where respondent claimed FINRA did not consider the impact of the bar on his clients).

each registered representative, registered principal, and other associated person that is reasonably designed to achieve compliance with Section 5 of the Securities Act, and for failing to supervise the registered representatives selling unregistered iStorage shares, WTF Corporation is fined \$30,000, Midas Securities is fined \$50,000, Michel is fined \$30,000 and suspended in all principal capacities for 45 days, Adams is fined \$20,000 and suspended from associating with any member firm in any principal capacity for 30 business days, and Lee is fined \$50,000 and suspended from associating with any member firm in any principal capacity for two years.⁴⁹ In addition, we prohibit Midas Securities and WTF Corporation from receiving and selling unregistered securities until they obtain an independent consultant to review their procedures.

We also affirm the Hearing Panel's order directing the respondents to pay hearing costs in the amount of \$4,207.13, and we impose \$3,454.55 in appeal costs, which include an administrative fee of \$ 1,000 and hearing transcript costs of \$ 2,454.55.⁵⁰

On Behalf of the National Adjudicatory Council,

Marcia E. Asquith, Senior Vice President and
Corporate Secretary

⁴⁹ We have also considered and reject without discussion all other arguments advanced by the parties.

⁵⁰ Pursuant to NASD Rule 8320, any member that 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.