

NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

ROBERT E. STRONG  
(CRD No. 3079588),

Respondent.

Disciplinary Proceeding  
No. C04050005

Hearing Officer—Andrew H. Perkins

**HEARING PANEL DECISION**

March 1, 2006

**Respondent, the former Chief Compliance Officer at Jesup & Lamont Securities Corporation, is suspended for nine months in all supervisory capacities and fined \$15,000 for failing to adequately supervise a research analyst, in violation of Conduct Rules 3010(a) and 2110; failing to ensure that research reports the firm published contained required disclosures, in violation of Conduct Rules 2711(h) and 2110; failing to enforce restrictions on the content of draft reports sent to covered companies before the report is issued, in violation of Conduct Rules 2711(c) and 2110; failing to file timely an annual attestation of supervisory procedures, in violation of Conduct Rules 2711(i) and 2110; and failing to preserve records relating to draft research reports, in violation of Exchange Act Rule 17a-4(b)(4) and NASD Conduct Rule 2110.**

Appearances

James M. Stephens, Kansas City, MO, and Mark A. Koerner, Chicago, IL (Rory C. Flynn, NASD Chief Litigation Counsel, Washington, DC, Of Counsel) for the Department of Enforcement.

Robert E. Strong, *pro se*.<sup>1</sup>

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<sup>1</sup> The Respondent was represented by counsel until November 18, 2005.

## DECISION

### I. INTRODUCTION

The Department of Enforcement (“Enforcement”) brought this proceeding against Jesup & Lamont Securities Corp. (“Jesup & Lamont”), an NASD member firm, and its Chief Compliance Officer, Robert E. Strong (“Strong” or the “Respondent”), alleging that between October 2002 and September 2003 they failed to comply with various requirements of NASD Conduct Rule 2711, which governs research analysts’ conflicts of interest.<sup>2</sup> In addition, Enforcement charged Strong with failing to supervise Gary Davis (“Davis”), one of Jesup & Lamont’s two research analysts.

The Complaint contains 12 causes of action. The first five causes of action pertain to Strong, and the remaining seven to Jesup & Lamont. On April 7, 2005, NASD accepted Jesup & Lamont’s Offer of Settlement.<sup>3</sup> Accordingly, this decision applies only to Strong and the first five causes of the Complaint.

The first cause of action alleges that Strong violated Conduct Rules 3010(a) and 2110 by failing to reasonably supervise Davis’ research activities and prevent him from violating Conduct Rule 2711. The Complaint alleges that Davis sold securities from his personal accounts when his most recent recommendation for those securities was “buy” or “strong buy,” and that he purchased securities for his personal accounts within the blackout period surrounding the publication of his research reports on the purchased securities.

The second cause of action alleges that Jesup & Lamont, acting through Strong, failed to make certain disclosures in Davis’ research reports, in violation of Conduct Rule 2711(h). The Complaint alleges that some reports omitted one or more of the following required disclosures:

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<sup>2</sup> See NASD Notice to Members 02-39, “Research Analysts and Research Reports,” 2002 NASD LEXIS 47 (July 2002).

<sup>3</sup> The Complaint also charged Jesup & Lamont with other violations not relevant to the present proceeding.

(1) Davis had a financial interest in the company; (2) a definition of the term “strong buy”; (3) an adequate price chart; (4) the valuation methods used to set the price target; and (5) Jesup & Lamont made a market in the stock.

The third cause of action alleges that Strong submitted a draft research report to a company that included a research summary and price target, in violation of Conduct Rule 2711(c).

The fourth cause of action alleges that Jesup & Lamont, acting through Strong, untimely filed its attestation regarding supervisory procedures for research analysts for calendar year 2002, in violation of Conduct Rule 2711(i).

Finally, the fifth cause of action alleges that Strong failed to maintain copies of draft research reports Jesup & Lamont sent to companies before their publication, in violation of Conduct Rule 2711(c).

The hearing on the charges against Strong was held at NASD’s offices in New York City on December 6, 2005. The Hearing Panel included the Hearing Officer and two current members of NASD’s District 10 Committee. Enforcement presented four witnesses, including Strong, and offered 42 exhibits in evidence. Strong testified in his defense and offered 19 exhibits in evidence.<sup>4</sup> The Hearing Officer admitted all of the offered exhibits.

On January 31, 2006, Strong filed a motion for leave to supplement Davis’ testimony. Enforcement advised the Office of Hearing Officers that it did not oppose the motion. Accordingly, the Hearing Officer grants Strong’s motion. Davis’ affidavit is admitted in evidence as Respondent’s Exhibit 20.

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<sup>4</sup> The hearing transcript is cited as “Tr.,” followed by the page number. Enforcement’s exhibits are referred to as “CX”, and Strong’s are referred to as “RX.”

## II. FINDINGS OF FACT

### A. Respondent Strong

Strong started his securities career at NASD where he was an examiner in the New York office for approximately nine years. In June 1998, Strong joined PricewaterhouseCoopers Securities LLC (“PwC”) as its Director of Compliance.<sup>5</sup> PwC primarily was involved in investment banking and municipal bond underwritings.<sup>6</sup> PwC did not conduct any research activity during Strong’s tenure with the firm.<sup>7</sup>

In 2001, PwC outsourced its compliance function and terminated Strong’s employment.<sup>8</sup> Thereafter, he was out of work for approximately one year before he joined Jesup & Lamont in July 2002 as its Chief Compliance Officer.<sup>9</sup> Before Strong assumed this role, Jesup & Lamont did not have an in-house compliance officer. Instead, the firm had relied on two outside consultants.<sup>10</sup>

Strong served as Jesup & Lamont’s Chief Compliance Officer until he left the firm in or about November 2005.<sup>11</sup> In addition, Strong was registered as a General Securities Representative, a General Securities Principal, and a Municipals Principal from October 2002 until he left the firm. Currently, Strong is not employed in the securities industry.<sup>12</sup>

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<sup>5</sup> Tr. 286; CX 1, at 2.

<sup>6</sup> Tr. 286.

<sup>7</sup> Tr. 287.

<sup>8</sup> Tr. 287.

<sup>9</sup> Tr. 288.

<sup>10</sup> Tr. 234.

<sup>11</sup> Tr. 288. Strong was registered with NASD and associated with Jesup & Lamont on January 28, 2005, when Enforcement filed the Complaint. *See* CX 1. Accordingly, NASD has jurisdiction of this proceeding.

<sup>12</sup> CX 1, at 3. At the time of the Hearing, he remained registered with NASD as a General Securities Principal, a General Securities Representative, and a Municipals Principal.

## **B. Jesup & Lamont**

The present Jesup & Lamont was established in April 2002 when Broadmark Capital acquired most of the assets and employees of the former Jesup & Lamont.<sup>13</sup> The newly constituted firm had approximately 25 brokers engaged in a broad range of activities, including retail and institutional sales, market making, investment banking, and research.<sup>14</sup> William F. Moreno (“Moreno”), a principal at Broadmark Capital, became Jesup & Lamont’s Co-President and Chief Financial Officer. He also assumed the compliance responsibilities for the new firm.<sup>15</sup>

Once the acquisition was completed, Moreno turned most of his attention to expansion efforts.<sup>16</sup> These activities left Moreno with little time for his compliance responsibilities, so he hired Strong to assume that role.<sup>17</sup> Moreno testified that he fully delegated all compliance responsibilities to Strong as soon as he joined the firm. Moreno expected Strong to “come in and take over that position, review, modify, improve the written supervisory procedures, implement them and, you know, oversee that activity for the firm.”<sup>18</sup> Moreno further testified that he delegated supervision of the research department to Strong. He expected Strong to keep Jesup & Lamont compliant with all regulations relating to research activities.<sup>19</sup> Strong, on the other hand, denied that he had any supervisory responsibilities or authority.

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<sup>13</sup> Broadmark Capital, an NASD member firm, had lost its offices due to the attack on the World Trade Center on September 11, 2001. Broadmark Capital used the acquisition of the assets of the former Jesup & Lamont as a quick way to get back in business. Tr. 233.

<sup>14</sup> Tr. 237.

<sup>15</sup> Tr. 234.

<sup>16</sup> Tr. 241-42.

<sup>17</sup> *See* Tr. 106.

<sup>18</sup> Tr. 241.

<sup>19</sup> Tr. 243.

### **C. NASD Investigation**

In 2003, NASD began a routine cycle examination of Jesup & Lamont. In connection with that examination, in October 2003, Martin P. Nye (“Nye”), a Special Investigator with NASD’s New York office, reviewed Jesup & Lamont’s compliance with NASD’s rules governing research.<sup>20</sup> Nye discovered a number of violations of NASD Conduct Rule 2711 with regard to Davis’ research activities.

### **D. Research Violations**

#### **1. Trading Violations**

NASD Conduct Rule 2711 contains two prohibitions regarding trading by research analysts that are relevant to this case. First, Rule 2711(g)(3) prohibits a research analyst from purchasing or selling a security in a manner inconsistent with his most recent published recommendation. Here, Nye compared Davis’ research reports with his trading records and found many instances where his trades appeared to be inconsistent with his research recommendations. Nye found 41 sales that Davis made between October 2002 and September 2003 when his most recent recommendation for the subject securities was either a “buy” or a “strong buy.” The transactions are identified on the attached Exhibit A. Davis violated Conduct Rule 2711(g)(3) by making these sales. Each sale was inconsistent with Davis’ most recent published recommendation.

Second, Conduct Rule 2711(g)(2) generally prohibits a “research analyst account”<sup>21</sup> from purchasing or selling any security issued by a company that the research analyst follows for a period beginning 30 calendar days before and ending 5 calendar days after the publication of a research report concerning the company or a change in a rating or price target of the company’s

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<sup>20</sup> Tr. 21.

<sup>21</sup> A “research analyst account” means any account in which a research analyst or member of the research analyst’s household has a financial interest, or over which the research analyst has discretion or control, other than an investment company registered under the Investment Company Act of 1940. Davis maintained three personal securities accounts at Jesup & Lamont, including an IRA account. Tr. 24-25.

securities. Nye discovered that Davis purchased shares of Collagenex Pharmaceutical, Inc., Nastech Pharmaceutical Co., and AVI BioPharma, Inc. stock within the prohibited period, in violation of Rule 2711(g)(2).

## **2. Disclosure Violations**

NASD Conduct Rule 2711(h) requires research reports to contain a number of specific disclosures that Davis omitted on some of the reports Jesup & Lamont published between December 2002 and July 2003. The reports issued on Collagenex, AVI, and Med-Design Corp. failed to disclose that Davis had a financial interest in the subject companies, in violation of Rule 2711(h)(1)(A). The reports issued on Discovery Laboratories, Inc., Nastech, and Med-Design failed to define the term “strong buy,” in violation of Rule 2711(h)(4). The reports issued on Discovery, Nastech, Med-Design, AVI, and Curative Health Services, Inc. failed to include a price chart that met the requirements of Rule 2711(h)(6). The reports issued on Collagenex, Discovery, Nastech, Med-Design, AVI, InKline Pharmaceuticals, Inc., and Providian Financial Corp. failed to disclose the risks that might impede the companies from reaching the price targets in the reports, in violation of Rule 2711(h)(7). And the reports issued on InKline and Curative failed to disclose that Jesup & Lamont made a market in those companies, in violation of Rule 2711(h)(8).

## **3. Communication of Draft Report**

Conduct Rule 2711(c) provides that a member may submit a research report to the subject company before its publication only as necessary to verify the factual accuracy of information in the report and provided that the sections submitted for review do not contain the research summary, the research rating, or the price target. On December 9, 2003, Davis sent a draft research report to Discovery that contained both a research summary and a price target, in violation of Conduct Rule 2711(c). In addition, Jesup & Lamont violated Exchange Act Rule 17a-4(b)(4) by failing to maintain a copy of the draft report.

#### **4. Late Attestation of Supervisory Procedures for Research Analysts**

Conduct Rule 2711(i) requires each member to attest annually to NASD that it has adopted and implemented written supervisory procedures reasonably designed to ensure that the member and its employees comply with the provisions of Rule 2711. At the time, the Rule required members to file such attestations no later than December 31 of each year.<sup>22</sup> Strong did not file Jesup & Lamont's annual attestation for calendar year 2002 until February 27, 2003.

#### **E. Strong's Supervision and Compliance Activities**

Strong arrived at Jesup & Lamont in July 2002, the same month that Conduct Rule 2711 took effect.<sup>23</sup> When he arrived, he found that Jesup & Lamont had not developed written supervisory procedures for research, as required by Rule 2711. Thus, one of his first priorities was to revise the firm's written supervisory procedures. Strong completed the initial revision in October 2002 and a later revision in August 2003. Exhibit RX 7 is a copy of the October 2002 Written Supervisory Procedures, and Exhibit CX 32 contains relevant excerpts from the August 2003 edition.<sup>24</sup>

When Strong first revised Jesup & Lamont's Written Supervisory Procedures, he included himself in Section 1.0, "OFFICERS, DESIGNATED PRINCIPALS, AND THEIR RESPONSIBILITIES," and noted his position as Chief Compliance Officer effective July 2002.<sup>25</sup> This first version of the Written Supervisory Procedures did not designate anyone with responsibility for research activities. In the August 2003 version, Strong added "research activity" to his responsibilities.<sup>26</sup> Otherwise, the two versions of the Written Supervisory

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<sup>22</sup> On July 29, 2003, the annual filing date was modified to April 1. *See* NASD Notice to Members 03-44, 2003 NASD LEXIS 52 (August 2003).

<sup>23</sup> Conduct Rule 2711 took effect on July 9, 2002. *See* Order Approving Rule Change Relating to Analyst Conflicts of Interest, Exchange Act Release No. 45908, 2002 SEC LEXIS 1262 (May 10, 2002).

<sup>24</sup> Enforcement concedes that the Jesup & Lamont's revised written supervisory procedures were adequate. Tr. 16.

<sup>25</sup> RX 7, at 13.

<sup>26</sup> CX 32, at 13.

Procedures did not differ materially. Both versions provided that Strong, as the firm's Chief Compliance Officer, was required to review all research reports and to approve and monitor any personal trading by the research analysts to ensure compliance with Conduct Rule 2711.<sup>27</sup> Nonetheless, Strong did little to supervise the firm's research activities.<sup>28</sup>

### **1. Strong's Supervision of Davis' Personal Trading**

Conduct Rule 2711 imposes a number of restrictions on the personal trading of securities in accounts in which a research analyst has a financial interest or over which the analyst has discretion or control. One such restriction is the prohibition that a research analyst account may not purchase or sell securities issued by a company that the research analyst follows for a period beginning 30 calendar days before and ending 5 calendar days after the publication of a research report concerning the company.<sup>29</sup> Strong wholly failed to implement any controls to ensure Davis' compliance with this restriction.

Although Jesup & Lamont's Written Supervisory Procedures required typical Chinese Wall procedures to guard against possible misuse of material, non-public information, there were none in existence when Strong arrived.<sup>30</sup> Strong took some initial steps to correct that situation. Strong established a restricted list<sup>31</sup> and he began to have the employees disclose the accounts they maintained at other firms so that Jesup & Lamont could arrange to receive duplicate statements.<sup>32</sup> However, Strong did not establish a watch list<sup>33</sup> or implement a method that would

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<sup>27</sup> RX 7, at 174-75.

<sup>28</sup> Strong did draft and disseminate several memoranda concerning Conduct Rule 2711. *See* CX 33, CX 35 through CX 41. In addition, he met with the research analysts to review the requirements of Conduct Rule 2711.

<sup>29</sup> *See* Conduct Rule 2711(g)(2).

<sup>30</sup> Tr. 315, 329-30.

<sup>31</sup> A restricted list is a current list of securities in which proprietary, employee and certain solicited customer transactions are restricted or prohibited.

<sup>32</sup> Tr. 315.

<sup>33</sup> A watch list is a current list of securities that generally do not carry trading restrictions, but whose trading is subject to scrutiny by the firm's compliance department.

allow him timely to review employee trades at Jesup & Lamont. Strong's review of employee trading in their Jesup & Lamont accounts was limited to comparing trades appearing on the employees' monthly statements with the securities on the firm's restricted list.<sup>34</sup>

Strong's failure to require Davis to maintain a watch list of companies that he anticipated would be the subject of upcoming research reports allowed Davis to trade those securities during the blackout period surrounding the publication of his research reports, in violation of Conduct Rule 2711(g)(2). Strong neither required Davis to supply any information about his upcoming reports nor enforced the requirement in Jesup & Lamont's Written Supervisory Procedures that Davis get his personal trades pre-approved. In fact, all of the registered representatives at Jesup & Lamont were able to place their personal trades directly with the trading desk.<sup>35</sup> Thus, Davis was free to trade ahead of his upcoming reports without any supervisory oversight.

Strong also failed to take effective action when he discovered in the second quarter of 2003 that Davis was making personal trades without first obtaining Strong's approval.<sup>36</sup> Strong testified that he first learned of Davis' personal trading activity by reviewing Davis' monthly account statements, which he did not start receiving until early 2003—approximately six or seven months after he assumed responsibility for ensuring compliance with Conduct Rule 2711.<sup>37</sup> Strong then delayed speaking to Davis about his trading activity for approximately another two months. When Strong finally did tell Davis in August 2003 that he would have to get his personal trades pre-approved, Davis agreed.<sup>38</sup> Davis nonetheless continued his personal trading activity without getting Strong's approval, and Strong did nothing more to secure Davis'

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<sup>34</sup> Tr. 131-32, 331-32.

<sup>35</sup> Tr. 333-34. In addition, Jesup & Lamont employees were not required to have a registered representative assigned to their personal accounts. Tr. 334.

<sup>36</sup> Tr. 296.

<sup>37</sup> Tr. 296. Strong testified that he did not have the ability to review daily trading online. Tr. 318-19.

<sup>38</sup> Tr. 293-94.

compliance with the firm's Written Supervisory Procedures. At no point did Strong implement any controls to halt Davis' trading in the securities of companies he covered. For example, Strong did not instruct the trading desk to hold Davis' orders until Strong approved them.<sup>39</sup> Nor did Strong report Davis' unapproved trading activity to Moreno or anyone else at Jesup & Lamont.<sup>40</sup>

In addition, Strong failed to reasonably supervise Davis' compliance with the restrictions in Conduct Rule 2711(g)(3) that a research analyst's purchases and sales of a covered company's security must not be done in a manner inconsistent with the analyst's most recent published recommendation. At first Strong did not review Davis' trades at all. Then, when Strong finally noticed the inconsistent sales on Davis' account statements, Strong took no action.

Strong justified his inaction by pointing to the size of Davis' holdings and the overall pattern of his trades. Strong testified that he concluded from reviewing Davis' account statements that after the sales Davis still held substantial positions in the subject companies. Strong viewed these substantial holdings as overriding evidence that Davis had not altered his "Buy" and "Strong Buy" recommendations.<sup>41</sup> Thus, Strong did not consider Davis' sales of a portion of his holdings as activity that was inconsistent with his recommendations. In addition, Strong observed that after a sale in some cases Davis turned around and purchased the same stock. In such cases, Strong disregarded the sales because he viewed the subsequent purchases to be consistent with Davis' recommendations.<sup>42</sup> Accordingly, Strong concluded that the restriction in Conduct Rule 2711(g)(3) did not apply to Davis' sales. However, Conduct Rule 2711(g)(3) expressly applies to purchases and sales, not an analyst's overall account position. Accordingly, the Hearing Panel rejected Strong's contention that Davis' activity did not violate the Rule.

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<sup>39</sup> Tr. 295.

<sup>40</sup> Tr. 295.

<sup>41</sup> Tr. 343-46.

<sup>42</sup> Tr. 343-46.

Strong further justified his lax supervision by arguing that Conduct Rule 2711 was not designed to apply to research analysts like Davis who sent their reports to very few people. According to Strong's reasoning, such a limited distribution did not pose the same degree of risk as that posed by a broad distribution typically associated with traditional research activity.<sup>43</sup> Indeed, Strong questioned whether the Rule even applied to Davis' research activity.<sup>44</sup> Accordingly, Strong did not emphasize his supervision of Davis' compliance with Conduct Rule 2711. Here again, however, the Hearing Panel found that Strong's argument had no merit. Davis' activity and reports were governed by Conduct Rule 2711, and Strong therefore was obligated to supervise Davis in a reasonable and appropriate manner.

## **2. Strong's Supervision of Davis' Research Reports**

Strong reviewed the form of Davis' research reports, but not their content. Thus, for example, Strong verified that the reports contained a disclosure, but he did not verify that the disclosures were accurate.<sup>45</sup> Strong also did not check that other required information was included and accurate despite the fact that he had assigned himself those responsibilities in Jesup & Lamont's Written Supervisory Procedures. In fact, Strong testified that he did not read the text of the reports.<sup>46</sup> It was not until mid-2003 or later that Strong began to verify the accuracy of the reports after he realized that he could not rely on Davis.<sup>47</sup> Strong claimed he thereafter independently verified the disclosures and information required by Conduct Rule 2711.

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<sup>43</sup> Tr. 343.

<sup>44</sup> Tr. 342, 346.

<sup>45</sup> Tr. 303, 309.

<sup>46</sup> Tr. 311.

<sup>47</sup> Tr. 311-12.

### **III. CONCLUSIONS OF LAW**

#### **A. Strong Failed to Supervise Davis Properly**

Strong concedes that Davis repeatedly violated Conduct Rule 2711 between October 2002 and September 2003, as alleged in the Complaint. Nonetheless, Strong argues that he cannot be held responsible for failing to supervise Davis because he was not Davis' supervisor. Despite the fact that Strong listed himself as having responsibility for "research activity" in the August 2003 version of the firm's Written Supervisory Procedures, Strong contended that his responsibilities actually were limited to compliance activities. Strong testified that he did not view himself as a line supervisor because he did not have the ability or authority to affect Davis' conduct. In particular, Strong noted that he lacked the power to hire and fire research analysts, which Moreno confirmed.<sup>48</sup>

On the other hand, Strong could not identify anyone else with line supervision responsibility for the research analysts. In his opinion, Moreno was the closest person.<sup>49</sup> Moreno, however, testified that he was not responsible for research. He considered Strong the individual who was responsible for research; accordingly, he directed the research analysts to submit their reports to Strong for review.<sup>50</sup>

The Hearing Panel recognizes that Strong was not responsible for supervising the sales representatives and that he did not have the authority to hire and fire registered representatives. Thus, for example, Strong was not responsible for supervising Davis' sales activities. However, Strong was responsible for supervising the firm's research activities. Indeed, Strong listed this as one of his responsibilities in the August 2003 version of the firm's Written Supervisory Procedures. In addition, as the Chief Compliance Officer, Strong was responsible for ensuring

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<sup>48</sup> Tr. 265.

<sup>49</sup> Tr. 313.

<sup>50</sup> Tr. 261-62.

that Davis complied with the requirements of Conduct Rule 2711. Accordingly, once Strong had discovered that Davis had failed to comply with the Written Supervisory Procedures pertaining to Conduct Rule 2711, Strong had a heightened responsibility to supervise Davis' activities.<sup>51</sup>

Strong was an important supervisor at Jesup & Lamont. The firm hired him in July 2002 to upgrade its compliance program and specifically to address compliance with NASD's then new rule governing research activities. Strong assumed responsibility for the firm's supervisory procedures. He revised the firm's Written Supervisory Procedures at least twice during the relevant period, and he met with the research analysts to explain the new rule governing research analysts and research reports. In addition, once Strong took over this supervisory function, all research reports were sent to him for his review.

Strong had sufficient red flags regarding Davis' compliance with Conduct Rule 2711 and the firm's related Written Supervisory Procedures that Strong was required to investigate and follow up, particularly because he knew that the research analysts had no other effective line supervisor. Nonetheless, the evidence is clear that Strong did little. Although he testified that he admonished Davis regarding his failure to get his trades pre-approved, Strong did nothing more. Such inaction did not meet Strong's supervisory responsibilities. A supervisor has an obligation to respond decisively to indications of irregularity.<sup>52</sup> At a minimum, once Strong learned that Davis continued to make unapproved trades, Strong should have made recommendations to limit

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<sup>51</sup> See *Department of Enforcement v. Levitov*, No. CAF970011, 2000 NASD Discip. LEXIS 12, at \*\*25-26 (June 28, 2000) (compliance officer failed to supervise properly for compliance with rules governing markups even though he had no official supervisory responsibility over the representatives who committed the violations). See also *First Albany Corp.*, 51 S.E.C. 145 (1992) (firm officials can be responsible for failure to supervise even if they lacked the ability to hire and fire).

<sup>52</sup> Cf. *Robert Grady*, Exchange Act Release No. 41309, 1999 SEC LEXIS 768, at \*8 (Apr. 19, 1999) (holding that a supervisor must follow up and review when alerted by a "red flag" to the possibility of improper conduct) (citations omitted).

Davis' activities.<sup>53</sup> Strong could not simply rely on Davis' representations that he would comply with the firm's Written Supervisory Procedures.<sup>54</sup>

In addition, Strong failed to review Davis' research reports adequately. As discussed above, Strong did not undertake an independent review of the reports' content. In fact, Strong admitted that he did not read the text of the reports Davis submitted.<sup>55</sup> He simply relied on Davis to comply with Conduct Rule 2711. Such a cursory review of the reports was inadequate. By failing to gather the necessary information to evaluate the reports, Strong failed to exercise reasonable supervision over Davis in accordance with Conduct Rule 2711 and the firm's Written Supervisory Procedures.<sup>56</sup>

Strong's improper supervision also allowed Davis to forward a draft report to Discovery that included a research summary and a price target, in violation of Conduct Rule 2711(c). Here also, Strong failed to institute an adequate review procedure to ensure that Davis met the requirements of Conduct Rule 2711. There is no evidence to show that Strong made any effort to implement procedures that would limit Davis' ability to send draft reports to the companies he covered.

In conclusion, the Hearing Panel finds that Strong utterly failed to exercise reasonable supervision of Davis for compliance with Conduct Rule 2711, in violation of NASD Conduct Rules 3010 and 2110.

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<sup>53</sup> See *John H. Gutfreund*, 51 S.E.C. 93 (1992).

<sup>54</sup> *Grady*, 1999 SEC LEXIS 768, at \*\*8-9.

<sup>55</sup> Tr. 311.

<sup>56</sup> See *Department of Enforcement v. Doherty*, No. C9B040036, (O.H.O. Mar. 15, 2005), at [http://www.nasd.com/web/idcplg?IdcService=SS\\_GET\\_PAGE&ssDocName=NASDW\\_014146](http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_014146).

## **B. Strong's Failure to File Annual Attestation for Calendar Year 2002**

Conduct Rule 2711(i) requires each member to attest annually to NASD that it has adopted and implemented written supervisory procedures reasonably designed to ensure that the member and its employees comply with the provisions of Rule 2711. Strong admits that he was responsible for this filing and that he failed to file it on time. The filing was due on or before December 31, 2002, but Strong did not file it until February 27, 2003. Accordingly, the Hearing Panel finds that Strong violated Conduct Rule 2711(i).

## **IV. SANCTIONS**

The NASD Sanction Guidelines (“Guidelines”) for “Failure to Supervise” recommend a fine of \$5,000 to \$50,000, plus the amount of any financial gain, and a suspension in all supervisory capacities for up to 30 business days.<sup>57</sup> In egregious cases, the Guidelines recommend consideration of a suspension of up to two years or a bar. Aggregating all of the offenses, Enforcement requested a six-month suspension in all supervisory capacities and a \$25,000 fine.<sup>58</sup> In addition, Enforcement requested that Strong be ordered to requalify by examination in all principal capacities.

The Hearing Panel began its consideration of sanctions with reference to the principal considerations listed in the “Failure to Supervise” Guidelines. The Guidelines direct adjudicators to consider: (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.<sup>59</sup>

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<sup>57</sup> NASD Sanction Guidelines 108 (2005 ed.).

<sup>58</sup> Aggregation of similar violations is permitted where: (1) the violative conduct was unintentional or negligent; (2) the conduct did not result in injury to public investors; or (3) the violations resulted from a single systemic problem. Guidelines 4.

<sup>59</sup> Guidelines 108.

The evidence establishes that Strong failed to implement adequate procedures and controls to ensure compliance with Conduct Rule 2711. Strong made no meaningful effort to enforce the Written Supervisory Procedures. Strong did nothing to halt Davis' ongoing disregard of the Written Supervisory Procedures governing his personal trading. In addition, Strong ignored his responsibility to review Davis' research reports to assure that they complied with Conduct Rule 2711.

The Hearing Panel also considered the following Principal Considerations generally applicable to sanctions.<sup>60</sup> First, Strong did not accept responsibility or acknowledge that he failed to supervise Davis properly. Despite the fact that he included research activity as one of his responsibilities in the Written Supervisory Procedures, he nevertheless maintained that others had supervisory responsibility for research. Second, Strong's failure to supervise persisted over a period of 15 months. Strong did not offer a reasonable explanation for his failure to implement adequate supervisory procedures and controls sooner. Therefore, the Hearing Panel finds that the violation was egregious, requiring a suspension for more than 30 business days.

On the other hand, the Hearing Panel found that Strong's violations resulted from negligence, not intentional misconduct. On balance, the Hearing Panel concluded that Strong was not up to the task of assuming complete responsibility for compliance at Jesup & Lamont. When Strong arrived, the firm was in the process of a substantial change in its operational structure and it had lost the outside personnel who had provided compliance guidance in the past. The evidence shows that there were a number of serious gaps in Jesup & Lamont's Written Supervisory Procedures that needed to be addressed immediately, including adding required procedures to cover Conduct Rule 2711 which was taking effect the same month Strong started at Jesup & Lamont. While Strong did address the problems with the firm's Written Supervisory Procedures, he did not appreciate the need to follow through with implementing the changes.

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<sup>60</sup> *Id.* 6-7.

Instead of vigilance, Strong approached his position as an advisor. Rather than verify compliance and follow up on known irregularities, Strong assumed that the research analysts would come to him if they needed assistance. In this manner, Strong abdicated his supervisory responsibilities for the research department.

Balancing the foregoing factors, the Hearing Panel concluded that a suspension of nine months in all supervisory capacities and a fine of \$15,000 are appropriately remedial under the facts and circumstances of this case. The Hearing Panel agrees with Enforcement's assessment that the various violations should be treated as a whole for the purposes of sanctions. The only violation that did not flow directly from Strong's failure to supervise Davis is the failure to file the annual attestation of supervisory procedures for research analysts on time for calendar year 2002, as required by Conduct Rule 2711(i). As to this violation, the Hearing Panel concludes that an additional sanction would not serve a remedial purpose.<sup>61</sup> Significantly, Jesup & Lamont's Written Supervisory Procedures were adequate, as Enforcement admits. Thus, there is no evidence that Strong filed the attestation late in order to cover up any default regarding the Written Supervisory Procedures. Rather, the Hearing Panel accepts Strong's contention that he overlooked the filing deadline.

## **V. ORDER**

For the reasons set forth above, Strong is suspended for nine months in all supervisory capacities and fined \$15,000 for the violations alleged in the first four causes of the Complaint.<sup>62</sup> In addition, Strong is ordered to pay costs in the amount of \$3,723.54.<sup>63</sup>

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<sup>61</sup> Standing alone, this violation would not require any sanctions beyond a letter of caution.

<sup>62</sup> The Hearing Panel has considered all of the parties' arguments. They are rejected or sustained to the extent that they are inconsistent with the views expressed herein.

<sup>63</sup> The costs are composed of an administrative fee of \$750 and transcript costs of \$2,973.54.

These sanctions shall become effective on a date set by the NASD, but not earlier than 30 days after this Decision becomes the final disciplinary action of the NASD; except, if this Decision becomes NASD's final disciplinary action, Strong's suspension shall begin at the opening of business on May 1, 2006, and end at the close of business on January 31, 2007.

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Andrew H. Perkins  
Hearing Officer  
For the Hearing Panel

Copies to:

Robert E. Strong (FedEx, next day delivery, and first-class mail)  
James M. Stephens, Esq. (electronic and first-class mail)  
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Rory C. Flynn, Esq. (electronic and first-class mail)  
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## EXHIBIT A

### Davis Sales Between October 2002 and September 2003

<b>Company</b>	<b>Trade Settlement Date</b>	<b>Shares Sold</b>	<b>Date of Relevant Research Report with Buy or Strong Buy Recommendation</b>
Collagenex	03/19/2003	671	02/27/2003
Collagenex	04/01/2003	5,000	02/27/2003
Collagenex	06/03/2003	2,500	02/27/2003
Collagenex	06/26/2003	1,000	02/27/2003
Collagenex	07/17/2003	6,500	02/27/2003
Collagenex	07/24/2003	1,000	02/27/2003
Collagenex	08/01/2003	5,000	02/27/2003
Collagenex	08/01/2003	5,000	02/27/2003
Discovery	04/23/2003	5,000	01/02/2002
Discovery	09/09/2003	10,000	07/22/2003
Discovery	09/17/2003	8,000	07/22/2003
Nastech	10/08/2002	2,600	03/20/2002
Nastech	01/07/2003	1,755	03/20/2002
Nastech	01/30/2003	1,755	03/20/2002
Nastech	02/03/2003	1,576	03/20/2002
Nastech	02/05/2003	800	03/20/2002
Nastech	04/23/2003	4,000	03/21/2003

<b>Company</b>	<b>Trade Settlement Date</b>	<b>Shares Sold</b>	<b>Date of Relevant Research Report with Buy or Strong Buy Recommendation</b>
Nastech	06/03/2003	4,000	03/21/2003
Nastech	06/26/2003	1,200	03/21/2003
Nastech	07/24/2003	1,800	03/21/2003
Med-Design	10/18/2002	2,500	04/23/2003
Med-Design	01/02/2003	1,200	04/23/2003
Med-Design	04/28/2003	4,000	02/19/2003
Emisphere	03/10/2003	10,000	06/04/2002
Emisphere	03/11/2003	10,000	06/04/2002
Emisphere	03/14/2003	10,000	06/04/2002
Emisphere	03/18/2003	2,000	06/04/2002
Emisphere	03/20/2003	6,400	06/04/2002
AVI	12/30/2002	1,500	12/17/2002
AVI	02/27/2003	3,000	12/17/2002
AVI	03/18/2003	10,000	12/17/2002
AVI	05/01/2003	15,000	12/17/2002
AVI	05/06/2003	10,000	12/17/2002
AVI	05/13/2003	8,000	12/17/2002
AVI	05/19/2003	300	12/17/2002
AVI	06/16/2003	1,700	12/17/2002

<b>Company</b>	<b>Trade Settlement Date</b>	<b>Shares Sold</b>	<b>Date of Relevant Research Report with Buy or Strong Buy Recommendation</b>
AVI	06/24/2003	2,900	12/17/2002
AVI	08/25/2003	20,000	12/17/2002
AVI	08/25/2003	3,000	12/17/2002
AVI	08/26/2003	5,000	12/17/2002
InKine	05/08/2003	20,000	04/16/2003