

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
No. 2013037818301**

TO: Department of Enforcement
Financial Industry Regulatory Authority ("FINRA")

FROM: Needham & Company, LLC
CRD No. 16360

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Respondent Needham & Company, LLC ("Needham" or the "Firm") submits this Letter of Acceptance, Waiver and Consent ("AWC") for the purpose of proposing a settlement of the alleged rule violations described below. This AWC is submitted on the condition that, if accepted, FINRA will not bring any future actions against Respondent alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. Needham hereby accepts and consents, without admitting or denying the findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of FINRA, or to which FINRA is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by FINRA:

BACKGROUND

Needham has been a FINRA member since 1985 and is headquartered in New York, New York. Needham is a small, full-service investment banking firm that focuses primarily on institutional investors. The Firm has more than 130 registered personnel in five offices.

OVERVIEW

In April 2010, Toys R Us ("TRU") and its private equity owners ("Sponsors") invited Needham and other broker-dealers to compete for a role in TRU's planned initial public offering (the "TRU IPO"). To win this investment banking business from TRU, Needham's equity research analyst participated in the Firm's solicitation efforts and the Firm offered favorable research coverage to TRU. Moreover, Needham failed to adopt and implement adequate written supervisory procedures governing analyst involvement in investment banking solicitations and offers of favorable research coverage. Therefore, in the context of the TRU IPO, Needham violated three separate provisions of NASD Rule 2711, the research analyst conflict of interest rule: 2711(c)(4), which prohibits research analysts from participating in efforts to solicit investment banking business; 2711(e), which prohibits firms from directly or indirectly offering favorable research to obtain investment banking business; and 2711(i), which requires firms to

adopt and implement written supervisory procedures reasonably designed to ensure that the member and its employees comply with the provisions of NASD Rule 2711.

Needham allowed its research analyst to participate in the Firm's solicitation efforts by allowing the analyst to present his views on TRU to TRU's management and Sponsors during the "solicitation period" – *i.e.*, the period after a company has indicated it is considering a prospective transaction, such as an IPO, and before the company has made a bona fide award of a mandate for the transaction. Before TRU awarded the TRU IPO business, it asked the equity research analysts from the firms competing for the business to make presentations to TRU's management and Sponsors. TRU provided specific topics for the analysts to address and put the firms on notice that, as part of the underwriter-selection process, it would consider each analyst's views of the company. Needham's research analyst presented to TRU and its Sponsors on May 5, 2010, thereby participating in the Firm's efforts to solicit investment banking business from TRU.

Needham also offered favorable research to induce TRU to award its investment banking business. The Firm's analyst's presentation to TRU and the Sponsors supported the Firm's investment banking pitch and offered a positive evaluation of TRU, and the Firm's investment banker's pitch to TRU and the Sponsors strongly implied the Firm would offer favorable research coverage to TRU.

Supervisory personnel at Needham were aware that TRU had asked the Firm's research analyst to make a presentation to TRU that was not part of the analyst's due diligence, that TRU would take the presentation into account when awarding the underwriting mandate in the TRU IPO, and that the presentation would include the analyst's favorable views of the company. Nevertheless, the Firm's supervisory personnel allowed the analyst to make the presentation. Accordingly, Needham failed to adopt and implement written supervisory procedures reasonably designed to ensure compliance with NASD Rule 2711.

TRU and the Sponsors selected Needham as co-manager for the TRU IPO. TRU, however, eventually decided not to proceed with the offering.

FACTS AND VIOLATIVE CONDUCT

I. Needham Violated NASD Rule 2711(c)(4) by Allowing Its Research Analyst to Participate In the Solicitation of Investment Banking Business.

NASD Rule 2711, the research analyst conflict of interest rule, is designed to insulate research analysts from a myriad of conflicts that could impair their impartiality. Taken together, the various provisions of the rule play a critical role in protecting analysts from improper influences and promoting their independent role advising investors. NASD Rule 2711(c)(4) is a key component of the rule that is designed to preclude analysts from participating in efforts to obtain investment banking business from issuers given that analysts typically initiate coverage of issuers when their firms play a role in bringing the issuer public.

NASD Rule 2711(c)(4) states, at the outset, that "[n]o research analyst may participate in efforts to solicit investment banking business." The rule clarifies this broad prohibition by stating

further that "no research analyst may, among other things, participate in any 'pitches' for investment banking business to prospective investment banking clients or have other communications with companies for the purpose of soliciting investment banking business." Thus, the rule prohibits a research analyst from being part of the deal team seeking to win investment banking business.

Under NASD Rule 2711(c)(4), an analyst may communicate with an issuer during the solicitation period as part of the analyst's due diligence efforts to gather information about the company, but may not communicate with the issuer in furtherance of soliciting a role for his investment bank in the underwriting. In the context of a meeting requested by an issuer during the solicitation period for the purpose of obtaining an analyst's views as part of the underwriter selection process, an analyst from a soliciting investment bank may not communicate to the issuer his views about the issuer or the issuer's industry, such as his views about valuation or comparable companies.

In April 2010, TRU notified Needham of its interest in bringing the company public through an initial public offering. TRU also notified Needham and several other firms competing for the TRU IPO business that, as part of the process of selecting underwriters, it wanted to hear the views of each firm's analyst who would cover the company following the TRU IPO. Each firm understood that TRU would consider the Firm's analyst's views in determining whether the firm would receive an underwriting role in the TRU IPO. TRU gave the firms a list of topics it wished the analysts to cover, including the retail industry outlook, valuation, and comparables. TRU scheduled meetings with the analysts for May 4 and May 5, 2010, in New York.

On May 4, 2010, TRU and the Sponsors met with the equity research analysts from the firms competing for the TRU IPO business and provided background and financial information on the company.

On May 5, 2010, each firm's analyst made a separate presentation to TRU and the Sponsors. After presenting to TRU and the Sponsors in New York, the Needham analyst made the same presentation by telephone to executives from one of the Sponsors, who were meeting separately in Boston with a Needham senior executive and a member of the Firm's investment banking department.

Under the circumstances, the analysts' presentations on May 5 constituted part of each firm's pitch for the TRU IPO and therefore violated NASD Rule 2711(c)(4). The presentations occurred during the solicitation period for the TRU IPO. TRU made clear to each firm that its analyst's presentation would be a factor in TRU's determination of whether the firm would be awarded a role in the IPO. Each analyst presentation was structured so that the analyst spoke and TRU management and Sponsors asked questions. These meetings were not designed to provide information to the analyst that the analyst could use to "vet" the proposed transaction.

Needham understood that one of the principal reasons it was invited to compete for the TRU IPO was because of its research analyst and that its analyst's views would influence what underwriting role, if any, the Firm received in the TRU IPO. In an email to several Needham investment bankers about the anticipated TRU IPO, one executive wrote, in part, "In the Needham Qualifications section, our argument is twofold: We are a credible full

service investment banking firm serving growth companies and we have the best toy analyst in the industry Most importantly, feature [the Needham analyst] as the supreme toy guru of the universe.”

The Needham analyst understood that his May 5 presentations to TRU and the Sponsors could help determine whether the Firm would win a role in the TRU IPO. In an email about his role in the TRU IPO, he wrote: “This is me batting in the big leagues.”

The Needham analyst conveyed his enthusiasm about the TRU IPO to his colleagues, as well. When a rival firm announced in early May 2010 that it was initiating research coverage of toy manufacturers and the toy industry, the Needham analyst sent an email to a colleague stating the firm’s initiation of coverage was “[s]hameless positioning to get a certain upcoming toy IPO.” and that he “would do it too. I would crawl on broken glass dragging my exposed junk to get this deal.”

In another email about the other firm’s initiation of coverage on the toy industry, the Needham analyst wrote that “[s]omebody is posturing for the Toys R Us IPO,” but that “may just be MY interpretation because right now, my whole life is about posturing for the Toys R Us IPO.” (emphasis in original)

The Needham analyst understood that, to improve the Firm’s chances of winning a role in the TRU IPO, he needed to impress TRU and the Sponsors. While preparing his presentation, the Needham analyst sent an email to several colleagues stating that he was “looking to prepare a list of clients about whom this statement would be true: ‘I wouldn’t even THINK of buying stock in a toy retailer without talking to [the Needham analyst].’” When one of his colleagues responded to his email, the Needham analyst wrote that he was “trying to impress a certain group of private investors, wink, wink.”

On the morning of May 5, 2010, the Needham analyst presented to TRU and the Sponsors in New York. During his presentation, the analyst discussed his experience covering the toy industry, explained how he would sell TRU to investors, and touted Needham’s research capabilities. For example:

- The Needham analyst’s presentation stated that his “essential message” to investors would be that TRU “is a great growth story ... because it *engineers* sales growth, margin expansion and market share gains through significant improvements in stores, service, systems, selection and sourcing. This will continue.” (emphasis in original) It further stated that the “emphasis here is on how TRU has *created* value rather than just riding the wave of a hot product category.” (emphasis in original)
- A slide titled “The Investment Case for Toys R Us,” identified some of the points he would stress with investors, including TRU’s “[r]ecord levels of Gross Margins and EBITDA,” “[b]etter-than-expected sales in Core/Learning toys,” “[p]roven ability to manage debt,” and its “[p]roven resilience in economic turmoil.” The analyst stated that “TRU has a unique ability to flow the goods at crunch time, when sales escalate by a factor of 10. TGT and WMT can’t do that

smoothly, and chaos ensues.” And he explained that “what needs to be stressed is that TRU is creating its own success, not riding external factors.”

- His presentation stated that the analyst “strongly believe[d] that TRU will demonstrate it deserves a strong valuation because, by virtue of its store setup, sourcing and better systems, it is creating wealth out of nothing. The toy industry and the baby industries are not inherently great businesses. TRU is making them good businesses.”
- He stated that TRU had achieved strong results despite a weak economy, and that he would “stress with investors that these results have been achieved against a pretty awful background for retail, especially for a debt-heavy company, but TRU has excelled.”
- His presentation summarized his views on TRU’s positioning as follows: “TRU has demonstrated it has a powerful brand with global consumer appeal, the ability to grow sales while expanding profit margins, and strong positive cash flow. We believe the investment community will highly value TRU when it returns to the public markets.”
- The Needham analyst included a slide in his presentation that highlighted the Firm’s research capabilities, providing a list of institutional investors who purportedly “wouldn’t even think of investing in TRU without speaking to [the Needham analyst].” He stated that he “expect[ed] to talk to maybe twice as many investors as what’s on this list. These are just the ones I know for a fact will want to talk, based on what we talk about now, or on the fact that 5 years ago we spoke about TRU.”
- His presentation concluded with answers to a list of “Questions Potential Investors May Ask.”

Later in the afternoon of May 5, 2010, the Needham analyst gave the same presentation by telephone to executives from one of the Sponsors who were in Boston. Beforehand, he provided a copy of his presentation, including his slide deck and talking points, to the Sponsor. On the same day, a member of the Firm’s investment banking department and a senior executive from the Firm met separately with the Sponsor. During that meeting, the Needham investment banker made a presentation to the Sponsor in which he touted the Firm’s research capabilities generally, the Needham analyst’s reputation, specifically, and the Needham analyst’s ability to influence trading:

- The investment banker’s presentation included a slide stating that “Needham’s equity research analysts and sales force regularly speak to a number of investors with strong consumer sector interest who may not receive large allocations on IPOs book-run by bulge bracket banks.” and listed numerous examples of such investors. The presentation further stated that the Needham analyst “maintains active dialogues with a number of institutional investors focused on retail stocks” and listed those investors.

- The presentation included a slide with the Needham analyst's "Biography," which stated that the Needham analyst had "earned #1 Earnings Estimator and #1 Stock Picker in the Forbes.com/Starmine survey for Leisure Equipment & Products and in the same year was the #3 Stock Picker in the Wall Street Journal Survey."
- The investment banker's presentation stated that the Needham analyst's "frequent research commentary on major companies generates trading activity and influences the direction of stock price movements." He presented two charts, entitled "LTM Capital Market Reaction to Needham Equity Research," showing a generally positive correlation between the Needham research analyst's ratings for certain toy manufacturers' stocks and the movement in the price of those stocks.

After the May 5, 2010 presentations, Needham executives continued to tout the Firm's research analyst to TRU and the Sponsors.

A Needham executive called an executive at one of the Sponsors and left a voice mail message seeking to secure a role for Needham in the TRU IPO because, among other things, the Firm's research analyst "was the axe in the space and we had spent a great deal of time working with the management on this and other issues."

Another Needham executive sent an email to an executive at one of the Sponsors stating that he "truly believe[s] our analyst ... (who I think you have met and, I am told, has spent time with management trying to prepare for the deal) adds value in the space. Of all the analysts I speak to re [other retailers], I learn more from him than others."

In an email discussing the Firm's efforts to win the TRU IPO business, the same executive wrote that the Needham analyst "deserves it in general and has earned it in particular."

TRU and the Sponsors eventually selected Needham as co-manager for the TRU IPO.

Several weeks later, a media report was published about the TRU IPO underwriter-selection process. A colleague sent an email to the Needham analyst recounting the media report and highlighting that some research analysts had "felt 'grilled and cajoled' about [TRU's] valuation, making the analysts suspect they were competing for investment banking business." The Needham analyst replied: "The analysts 'suspect that they are competing for investment-banking business? Wow. Can't slip anything by a crackerjack analyst, can you?'"

When the Needham analyst learned in June 2010 that TRU was reconsidering the timing of the TRU IPO, he sent an email stating that TRU "might put [the TRU IPO] off until next year. Which, of course, would be bad for yours truly."

As a result of the foregoing, Needham violated NASD Rule 2711(c)(4) and FINRA Rule 2010.

II. Needham Violated NASD Rule 2711(e) by Offering Favorable Research Coverage to Induce Receipt of TRU's Investment Banking Business.

NASD Rule 2711 recognizes that a firm can create a conflict for an analyst and compromise the analyst's independence if it promises favorable research coverage in an effort to win investment banking business. Therefore, NASD Rule 2711 contains a broad prohibition against directly or indirectly offering favorable research: "No member may directly or indirectly offer favorable research, a specific rating, or a specific price target . . . to a company as consideration or inducement for the receipt of business or compensation." Accordingly, in the context of a solicitation period where the issuer has stated that it will consider an analyst's views as part of the underwriter selection process, a firm cannot indicate to a prospective investment banking client its analyst's positive views of the company or the company's prospects, even if honestly held, or the positive prospective valuation the analyst may give the company.

Under the circumstances of the TRU IPO, Needham offered favorable research coverage to induce receipt of investment banking business.

As described in more detail in Section I, above, the Needham research analyst expressed favorable views about TRU during his presentations on May 5, 2010. For example, he told TRU and the Sponsors that his "essential message" to investors would be that TRU "is a great growth story . . . because it engineers sales growth, margin expansion and market share gains through significant improvements in stores, service, systems, selection and sourcing." His presentation stated that he "strongly believe[d] that TRU will demonstrate that it deserves a strong valuation because, by virtue of its store setup, sourcing and better systems, it is creating wealth out of nothing. The toy industry and the baby industries are not inherently great businesses. TRU is making them good businesses." And his presentation summarized his views on TRU's positioning as follows: "TRU has demonstrated it has a powerful brand with global consumer appeal, the ability to grow sales while expanding profit margins, and strong positive cash flow. We believe the investment community will highly value TRU when it returns to the public markets."

Also, as noted above, the Needham investment banker's presentation included slides that showed the generally positive correlation between the analyst's research coverage and the stock prices of certain toy manufacturers.

By including favorable views of TRU in the analyst's presentations, and by implying favorable research coverage of TRU in the investment banker's presentation, Needham indicated to TRU that post-IPO research coverage would be positive.

As a result of the foregoing, Needham violated NASD Rule 2711(e) and FINRA Rule 2010.

III. Needham Violated NASD Rule 2711(h) by Omitting from Research Reports Required Disclosures Concerning Conflicts of Interest.

NASD Rule 2711(h) requires members and research analysts to disclose in research reports certain financial and compensation relationships with subject companies so as to inform readers of potential conflicts of interest. From January 1, 2010, through September 30, 2013, and from May 5, 2014, to June 10, 2014, Needham omitted numerous required disclosures from its research reports. In particular, in May and June 2014, Needham omitted from approximately 312 research reports approximately 1,090 required disclosures when its vendor disabled the system's functionality for incorporating the disclosures.

For example, in certain cases the Firm failed to disclose that its research analysts received compensation based upon (among other factors) Needham's investment banking revenues and that the Firm made a market in the subject company's securities. In other research reports, Needham failed to disclose that the research analyst, or a member of the analyst's household, had a financial interest in the subject company. Needham also failed to disclose in some research reports that it acted as a manager or co-manager of a public offering for the subject company or that it received compensation for investment banking services from the subject company within the 12 months prior to publication of the research report. In certain other research reports, Needham failed to disclose that the subject company was, or had been in the past 12 months, a client of the Firm and the types of services provided.

Needham also failed to direct readers in a clear manner to required disclosures in 41 compendium monthly research reports (covering six or more subject companies) and a significant number of industry reports.

As a result of the foregoing, Needham violated NASD Rule 2711(h)(1), (2), (8) and (11) and FINRA Rule 2010.

IV. Needham Violated NASD Rule 2711(i) Because It Failed to Adopt and Implement Policies and Procedures Reasonably Designed to Prevent Violations of Rule 2711(c)(4), (e), and (h).

NASD Rule 2711(i) provides supervision requirements that specify a firm's obligations to develop effective policies and procedures to oversee research analyst conflicts of interest. Specifically, the rule states, "Each member subject to this rule must adopt and implement written supervisory procedures reasonably designed to ensure that the member and its employees comply with the provisions of this rule"

Communications between an analyst and an issuer during the solicitation period present a risk that the analyst will become part of the firm's effort to solicit investment banking business from the issuer and/or offer favorable research to induce receipt of the issuer's investment banking business. Needham failed to adopt and implement written supervisory procedures reasonably designed to ensure compliance with Rule 2711 so as to avoid conduct that, under the circumstances constituted (a) participation by its research analyst in the solicitation of a role in the TRU IPO, and (b) an offer of favorable research.

Needham published approximately 10,000 research reports between January 1, 2010, and September 30, 2013. During that time, on a monthly basis, Needham reviewed all disclosures for every company in the Firm's research universe to ensure that the appropriate disclosures were included in its disclosure database. Additionally, the Firm sampled three research reports per month to determine whether the reports contained all of the disclosures required by NASD Rule 2711(h). However, review of such a small sample size was not reasonably designed to ensure compliance with NASD Rule 2711(h) disclosure requirements.

As a result of the foregoing, Needham violated NASD Rule 2711(i) and FINRA Rule 2010.

- B. The Firm also consents to the imposition of the following sanctions:
- a censure; and
 - a fine in the amount of \$2.5 million.

Needham agrees to pay \$1.5 million of the monetary sanction upon notice that this AWC has been accepted and that such payment is due and payable and agrees to pay the remaining \$1 million of the monetary sanction, pursuant to the terms of an installment payment plan, within twelve months of receiving notice that this AWC has been accepted. Needham has submitted an Election of Payment form showing the method by which it proposes to pay the fine imposed.

Needham specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time hereafter, the monetary sanction imposed in this matter.

The sanctions imposed herein shall be effective on a date set by FINRA staff.

II.

WAIVER OF PROCEDURAL RIGHTS

Needham specifically and voluntarily waives the following rights granted under FINRA's Code of Procedure:

- A. To have a Complaint issued specifying the allegations against it;
- B. To be notified of the Complaint and have the opportunity to answer the allegations in writing;
- C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made and to have a written decision issued; and
- D. To appeal any such decision to the National Adjudicatory Council ("NAC") and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, Needham specifically and voluntarily waives any right to claim bias or prejudice of the Chief Legal Officer, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

Needham further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of FINRA Rule 9143 or the separation of functions prohibitions of FINRA Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

III.

OTHER MATTERS

Needham understands that:

- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs ("ODA"), pursuant to FINRA Rule 9216;
- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against it; and
- C. If accepted:
 1. this AWC will become part of Needham's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against the Firm,
 2. this AWC will be made available through FINRA's public disclosure program in response to public inquiries about the Firm's disciplinary record;
 3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and
 4. Needham may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. Needham may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects the Firm's: (i) testimonial obligations; or (ii) right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.

- D. Needham may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. The Firm understands that it may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA or its staff.

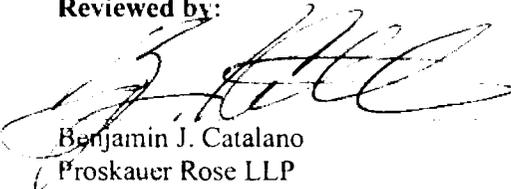
The undersigned, on behalf of the Firm, certifies that a person duly authorized to act on its behalf has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; has agreed to its provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce the Firm to submit it.

Date: 12/8/14

Needham & Company, LLC

By: 
James M. Abbruzese
Chief Administrative Officer

Reviewed by:

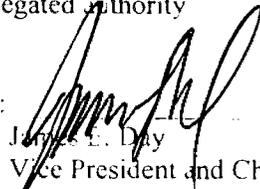


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Counsel for Respondent

Accepted by FINRA:

Date 12/10/14

Signed on behalf of the Director of ODA, by
delegated authority

By: 
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