

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD REGULATION, INC.

In the Matter of

Market Regulation Committee,

Complainant,

vs.

James T. Patten
Bernardsville, New Jersey

and

Greater Metropolitan Investment
Services, Inc.
Mendham, New Jersey,

Respondents.

DECISION

Complaint No. CMS960085

Market Regulation Committee

Dated: February 3, 1998

James T. Patten ("Patten") has appealed,¹ pursuant to NASD Procedural Rule 9310, a March 12, 1997 decision of the Market Regulation Committee ("MRC"). We find that Patten: intentionally and/or recklessly reported 147 fictitious and substantive transactions to The Nasdaq Stock Market ("Nasdaq"), at or near the close of the market, in order to affect the closing price of the securities, in violation of Article III, Sections 1 and 18 of the Rules of Fair Practice (now known and hereinafter referred to as "Conduct Rules 2110 and 2120");² intentionally and/or recklessly effected 13 transactions between accounts that he owned and controlled which involved no change in beneficial ownership, in violation of Conduct Rules 2110 and 2120;³ and published

¹ Greater Metropolitan Investment Services, Inc. ("GMIS" or "the Firm") did not appeal the MRC's decision.

² This practice is known as "marking the close."

³ This practice is known as "wash sale transactions."

and circulated 95 reports of purchase and sale transactions which he knew or should have known were non-bona fide, in violation of Conduct Rules 2110 and 2120 and Schedule D, Part X, Section 2 and Part XI, Section 2 to the Association's By-Laws (now known and hereinafter referred to as "Marketplace Rules 4632 and 4642"). We also find that Patten and GMIS: violated GMIS' restriction agreement with the Association by effecting more than an occasional transaction per month in GMIS' investment account without obtaining prior approval to modify the agreement, in violation of Conduct Rule 2110 and Schedule C, Part 1, Section (1)(e) to the Association's By-Laws (now known and hereinafter referred to as "Membership and Registration Rule 1014(c)"); failed to enforce supervisory procedures to detect and deter marking the close activity, in violation of Conduct Rule 2110 and Article III, Section 27 of the Rules of Fair Practice (now known and hereinafter referred to as Conduct Rule 3010").

In light of our findings, we order that Patten be censured, fined \$175,000 individually and \$55,000 (jointly and severally with the Firm); and that Patten be suspended for one year as a registered representative and for two years in a principal capacity. We further order that Patten not be associated with any NASD member in any capacity until he requalifies by examination.

Factual Background

During the relevant period, Patten was registered as a general securities representative and a general securities principal and was employed as a trader at GMIS. Throughout the period under review, Patten was acting as GMIS' president, compliance officer, municipal securities principal, financial and operations principal, general securities principal, and options principal. GMIS has been a registered broker/dealer since 1986.

Discussion

Marking the Close (Cause One). The complaint alleged that from approximately May through October 31, 1995, Patten intentionally and/or recklessly caused GMIS to enter, at or near the close of the market, 147 trade reports in the relevant securities (71 of which were fictitious and 76 of which substantive (based on actual trades)).⁴

The NASD examiner ("Examiner") who conducted the examination of GMIS determined after the complaint had been filed that Patten actually had effected 77 fictitious trade reports and 70 substantive trade reports in the relevant securities, rather than 71 fictitious, and 76 substantive, trade reports, as had been alleged in the complaint. The Examiner testified that he initially had determined into which category to place the transactions by examining the Firm's purchase and sale blotter and by relying on Patten's admissions. While preparing for the hearing before the MRC, the Examiner determined that there were no order tickets for six of the transactions he had originally listed as substantive transactions, which made it necessary to increase the number of trades alleged to be fictitious from 71 to 77, and to decrease the number alleged as substantive to

⁴ The securities at issue are those of Tristar Corporation ("Tristar"), Initio, Inc. ("Initio"), and Bailey Corporation ("Bailey").

70. During the MRC hearing, Patten disputed the exact number of substantive transactions that marked the close, claiming that 23 of the substantive transactions did not mark the close because subsequent trades closed the market. Patten, however, did not offer any evidence in support of his claim.

The record evidence shows that Patten executed and reported 147 fictitious and substantive transactions, at or near the close of the market. In pre-hearing testimony and at the MRC hearing, Patten gave a variety of reasons for executing and reporting those transactions at or near the close of the market. Patten testified that he had recommended the relevant securities to numerous customers who, based on his recommendations, had committed large sums of money to purchase them, and that he had executed and reported transactions in these securities at or near the close of the market because he had lost patience with how the securities were performing. Patten admitted that he had marked the close of Initio and Tristar securities to give the appearance of a more orderly market because the market for those securities was often thinly traded and had wide spreads. Patten also stated that there were days on which no trades had been entered in Initio, which resulted in the security not being listed in the newspaper the next day. Patten testified that when the security was not listed in the newspaper, he would receive about 400 telephone calls from customers asking why it had not been not listed. Patten also admitted in his pre-hearing testimony that when a stock closed at the offer at the end of the day, he would not enter a transaction to mark the close, but if the stock closed at the bid on a prior day and the next day's transactions were only slightly higher, he would mark the close for the purpose of getting an up-tick in the stock.

Patten testified that he would receive telephone calls from his customers asking: why spreads in the securities were excessive; why the securities did not trade on a particular day; and why the securities were not listed in the newspaper on certain days. Patten explained that entering transactions at the close was a way to avoid these telephone calls and "appease the problem." Patten testified that he realized he could not change the spread, but admitted at the MRC hearing that by marking the close, he was attempting to give the illusion to his customers that the spread did not exist. Patten stated that he "fell into a trap of trying to . . . give the appearance of a . . . more orderly market."

We concur with the MRC's conclusion that Patten's marking the close activity resulted in the dissemination of false and misleading information to the investing public regarding the price and the extent of the trading activity in the securities at issue, in violation of Conduct Rules 2110 and 2120. Patten knew that many of his customers monitored the prices of the securities in the newspaper and that prices were relied upon by investors in making investment decisions. Patten not only intentionally deceived his own customers, but misled other investors into believing that the securities were closing at higher prices and that certain securities were active, when on some days, Patten reported the only trade of the day.

Wash Sale Transactions (Cause Two). The complaint alleged that from approximately May through October 31, 1995, Patten intentionally and/or recklessly effected 15 transactions between accounts that he owned and controlled, that involved no change in beneficial ownership, for the purpose of creating a false and misleading appearance of active trading in the securities at

issue.⁵ Patten testified in his pre-hearing testimony that he "owned" the accounts at issue, but subsequently disputed that claim at the MRC hearing with respect to his wife's IRA account by stating that it was her asset, not his. Patten admitted that the purpose of his entering the wash sale transactions was no different from his purpose for entering the fictitious transactions,⁶ which was to affect the closing price of the securities and to show activity in the securities so they would be listed in the newspaper the next day.

We agree with the MRC that there is insufficient evidence to conclude that Patten "owned" his wife's IRA account.⁷ As a result, we find that only 13 of the 15 transactions alleged in the complaint were wash sale transactions. We also concur with the MRC's finding that these transactions were reported for the purpose of creating the false or misleading appearance of active trading in the securities and to affect the closing price of the securities, in violation of Conduct Rules 2110 and 2120.⁸

Fictitious Trade Reports (Cause Three). The complaint alleged that Patten intentionally and/or recklessly published and circulated 89 reports of purchase and sale transactions,⁹ which he knew or should have known were non-bona fide.¹⁰ The Examiner requested order tickets and confirmations for the 89 transactions from GMIS, but was never provided with the underlying documentation for the trades. After the complaint had been filed, the Examiner determined that certain trades from the substantive transactions list had to be transferred to the fictitious transactions list because he was unable to find order tickets for those transactions. Accordingly, instead of 89 non-bona fide reports as cited by the complaint, the Examiner found evidence of 95 non-bona fide transaction reports. These transactions included transactions which marked the

⁵ The securities at issue are the same as those in the first cause.

⁶ Patten stated that the wash sale transactions were no different than the fictitious trades, except that he wrote order tickets for the wash sale transactions.

⁷ The complaint alleged that Patten "owned and controlled" the IRA account of his wife. Based on the requirement in the complaint that Patten own and control his wife's IRA account, we cannot find that Patten engaged in wash sale transactions with respect to that account, since he did not "own" it.

⁸ The MRC also found that Patten failed in his responsibility to verify with NASD Regulation, Inc. whether the trades were reportable transactions or journal entries. Since the complaint included no allegations to that effect, we do not incorporate those findings into our decision.

⁹ The Market Regulation staff submitted the following documentary evidence in support of this allegation: a schedule of the fictitious trade reports and the equity audit trail indicating that the fictitious trades were reported to Nasdaq.

¹⁰ The securities at issue were Tristar and Initio, two of the companies referenced in the first cause.

close and those which did not. The record contains admissions by Patten that he reported fictitious transactions to Nasdaq.¹¹

The MRC found that Patten reported 95¹² fictitious transactions to Nasdaq in violation of Conduct Rule 3310 and that his activities were manipulative and deceptive, in violation of Conduct Rules 2110 and 2120. The MRC also found that Patten's reporting of fictitious transactions resulted in the dissemination of false and misleading information to the investing public regarding the price of the securities and the trading activity in the securities. We adopt the MRC's findings.

Restriction Agreement (Cause Four). The complaint alleged that Patten and GMIS violated GMIS' restriction agreement with the Association. Membership and Registration Rule 1014(c) requires that where restrictions are placed on its business activities, an applicant for membership must, prior to approval of membership, execute a written agreement with the Association agreeing to abide by the restrictions specified in the determination and agreeing not to modify its business activities in any way inconsistent with such agreement without first notifying the Association and receiving its written approval. The evidence shows that Patten attempted to modify his restriction agreement by submitting a letter dated March 11, 1991, to the NASD's District 10 office, and that the request had not been approved by the NASD at the time of the alleged misconduct. Patten renewed his efforts to have the restriction agreement modified after the Market Regulation staff requested a copy of the amended restriction agreement during its investigation. The record demonstrates that District No. 10 granted Patten's modification request on August 26, 1996.

Before the modification, the restriction agreement stated that GMIS would only effect an occasional transaction in GMIS' investment account. Although the Securities and Exchange Act of 1934 does not define the term "occasional transaction," Rule 15c3-1(a)(2)(iii)(B) states that if a broker or dealer effects more than 10 transactions in any one calendar year for its own investment account, that broker is a "dealer" and must maintain a net capital of not less than \$100,000. Under GMIS' restriction agreement, as in effect during the relevant period, GMIS was required to maintain a net capital of \$50,000. From about May 1 through October 31, 1995, Patten effected

¹¹ Patten made these admissions in a February 26, 1996 letter to Market Regulation staff; in his pre-hearing testimony on February 27, 1996; and during the MRC hearing.

¹² Although the complaint alleged that Patten had executed 89 fictitious trade reports, the Examiner determined after the complaint had been filed that Patten had executed 77, rather than 71 fictitious trade reports that marked the close, increasing the total number of fictitious trade reports from 89 to 95. Commission precedent indicates that, even if a pleading is defective, the defect can be remedied if the record demonstrates that the respondent understood the issue and was afforded an opportunity to defend. In re Orion Securities, Inc., Exchange Act Rel. No. 35001 (Nov. 23, 1994). We believe that the complaint provided a sufficient basis for the respondent to understand the issue, notwithstanding the modification at the hearing in the number of fictitious and substantive transactions. Accordingly, we conclude that Patten was afforded an opportunity to defend against the allegations of misconduct.

between 31 and 58 transactions per month in GMIS' investment account, in violation of the restriction agreement and without obtaining written approval to modify the agreement from District No. 10.

The evidence establishes that Patten failed to follow through with the NASD's District No. 10 office to confirm that the amended agreement he had submitted to them had been approved. Notwithstanding Patten's argument that GMIS maintained sufficient net capital to transact more than an occasional transaction in the Firm's investment account, Patten had no authority to engage in such transactions until he had received written approval from the Association. Accordingly, we find that Patten violated Conduct Rule 2110 and Membership and Registration Rule 1014(c).

Failure to Establish, Maintain and Enforce Supervisory Procedures (Cause Five). The complaint alleged, and the MRC found, that from about May 1 through October 31, 1995, GMIS and Patten (in his capacity as GMIS' president and compliance officer), failed to establish, maintain and enforce supervisory procedures which would have enabled GMIS to detect and deter marking the close activity.¹³

We affirm the MRC determination that Patten and the Firm failed to establish, maintain, and enforce written supervisory procedures in violation of Conduct Rules 2110 and 3010. While we do not suggest that a firm's supervisory procedures need address each federal, state, and self-regulatory rule and regulation, each firm's written procedures must be reasonably designed to supervise the business activities in which it is engaged. See Conduct Rule 3010(b)(1). GMIS had a workstation that enabled Patten to enter trades at or near the close of the market. In light of this capability, it was necessary for GMIS to have written supervisory procedures reasonably to ensure compliance in the area of trade reporting.¹⁴

Procedural Issue

On appeal, the Market Regulation attorney requested leave to adduce additional evidence regarding a breakdown of the sanctions by cause. This request was made based on the respondent's claim in his brief on appeal that he was disadvantaged because the MRC did not indicate which portion of the total fine was attributable to which violation. Upon denial of that request, Patten requested that he be provided with all information, materials and evidence provided to NASD staff by the MRC or by the NASD staff to the MRC in connection with the MRC's decision. We have considered the respondent's argument and find it to be without merit.

¹³ The MRC also concluded that Patten's and GMIS' "failure to supervise" was egregious in that it was the cause of most of the underlying violations alleged in the complaint. This reference to "failure to supervise" is misplaced, however, since it was not charged in the complaint.

¹⁴ We note that in this case, Patten claimed that he could not be held liable for failing to supervise himself. This argument mischaracterizes the alleged violation. The complaint alleged that the Firm's supervisory procedures were devoid of any discussion of how the Firm would monitor trading activity. It did not allege that Patten failed to supervise himself.

The NASD prosecutorial staff has the "ministerial function" of incorporating the MRC's findings into a draft decision, subject to the MRC's review. See In re David Arm, 50 S.E.C. 338, 346 (1990). Moreover, the SEC has held that NASD prosecutorial staff may confer with the MRC for the purpose of ascertaining the rationale for its decision. In re David A. Gingras, 50 S.E.C. 1286 (1992). There is no requirement that discussions of this nature be reported to the respondent and we find that it would be improper for these communications, which were not incorporated in the final MRC decision, to be considered as evidence on appeal.

Sanctions

At the outset, we note that the MRC decision did not apportion the sanctions by cause or articulate its basis for imposing a \$445,000 fine. See In re Robert A. Grunburg, Exchange Act Rel. No. 36182 (September 1, 1995); In re Michael H. Novick, 51 S.E.C. 1258 (September 2, 1994); In re Jonathan Feins, Exchange Act Rel. No. 37091 (April 10, 1996). We agree with respondent's argument on appeal that the \$445,000 fine imposed by the MRC¹⁵ was excessive. Nevertheless, we find that Patten's marking the close activity constitutes serious misconduct that necessitates our affirmation of the suspensions imposed by the MRC.

We have reduced the fine and apportioned the sanctions on a cause-by-cause basis as follows. We reduce the \$445,000 fine imposed by the MRC on Patten to: a \$125,000 individual fine for marking the close (cause one)¹⁶ and a \$50,000 individual fine for reporting of fictitious trades (cause three),¹⁷ for a total individual fine of \$175,000. We affirm the \$55,000 joint and several fine as to Patten and the Firm, and attribute \$30,000 to the restriction agreement violation (cause four)¹⁸ and \$25,000 to the failure to enforce supervisory procedures (cause five).¹⁹ As to Patten, we affirm the censure and the one-year suspension in all capacities. We also affirm the two-year suspension in a principal capacity as to Patten and the requirement that Patten not be

¹⁵ In Patten's appeal brief, he stated that he challenged only the sanctions imposed with respect to the first three causes in the complaint.

¹⁶ The sanctions are consistent with the applicable Guidelines. See Guidelines (1996 ed.) at 32 ("Marking the Close").

¹⁷ The sanctions are consistent with the applicable Guidelines See Guidelines (1996 ed.) at 55 (Trade-Reporting). Although respondents had no prior history of trade reporting violations, we considered the number of transactions (95) and the fact that there was evidence of manipulative intent, to be aggravating factors that required application of the subsequent violations category under the Guideline, with a fine range of \$10,000 to \$100,000.

¹⁸ The sanctions are consistent with the applicable NASD Sanction Guidelines ("Guidelines"). See Guidelines (1996 ed.) at 43 (Restrictive Agreement).

¹⁹ The recommended sanctions are consistent with the applicable Guidelines. See Guidelines (1996 ed.) at 53 (Supervision).

associated with any NASD member in any capacity until he requalifies. Patten's suspensions are attributable to his marking the close activity.²⁰

We note that the respondent has cited a number of factors in mitigation of the violations.²¹ While we have fully considered these factors in arriving at our sanctions in this matter, we do not consider them to be of sufficient force to warrant sanctions reduced below the levels set forth herein.

In assessing sanctions, we considered each cause separately. First, we considered the following aggravating factors from the Guideline for marking the close: (1) that the misconduct extended over an extended period, from May through October 1995; (2) that there were 147 marking the close transactions during the relevant period; (3) that out of a total of 147 transactions, 77 were fictitious; (4) that the conduct was intentional; (5) that the transactions resulted in the dissemination of false and misleading information to the investing public regarding the price of the securities and the trading activity in the securities, which damaged market integrity; and (6) that the wash sales were an aggravating factor since they were effected to mark the close.²² Second, we considered the following aggravating factors from the Guideline for trade-reporting violations: (1) that the misconduct continued over the same six-month period involved in the marking the close violations; and (2) that 95 fictitious trades were involved, 77 of which were effected to mark the close. Third, we considered the following aggravating factors from the Guideline for restrictive agreement violations: (1) that, over a six-month period, from May through October 1995, Patten and the Firm effected between 31 and 58 transactions, which was more than an occasional (more than 10) transaction in GMIS' investment account; and (2) that the misconduct was intentional. Fourth, with respect to the respondent's failure to maintain and enforce supervisory procedures, we consulted the aggravating factors for the Guideline on supervision and determined that there was an absence of any reasonable explanation for the failure.

Conclusion

We order that Patten be censured; fined \$175,000, individually (\$125,000 for marking the close and \$50,000 for reporting fictitious trades); that the Firm and Patten be fined \$55,000 (joint and several) (\$30,000 for the restriction agreement violation and \$25,000 for the failure to

²⁰ See Guidelines (1996 ed.) at 32 ("Marking the Close").

²¹ The respondent has argued: (1) that he has no prior similar misconduct on his record; (2) that he did not attempt to conceal his misconduct after it had been discovered; (3) that he has hired a general securities principal to ensure that the misconduct at issue in this matter would not be repeated in the future; and (4) that he has instituted new written procedures to address marking the close activity.

²² Since we considered the wash sale transactions to be an aggravating factor with respect to the marking the close violation, we did not impose separate sanctions for those transactions.

maintain and enforce supervisory procedures); that, in connection with his marking the close activity, Patten be suspended for one year as a registered representative and for two years in a principal capacity. We further order that Patten not be associated with any NASD member in any capacity until he requalifies by examination.²³ The suspensions imposed herein will commence on a date to be set by the President of NASD Regulation, Inc. Based on the fact that the MRC decision did not assess costs for the MRC proceeding, Patten is not responsible for any costs associated with that proceeding.

On Behalf of the National Business Conduct Committee,

Joan C. Conley, Corporate Secretary

²³ We have considered all of the arguments of the parties. They are rejected or sustained to the extent that they are inconsistent or in accord with the views expressed herein.

Pursuant to NASD Procedural Rule 8320, any member who 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.

Direct: (202) 728-8381
Fax: (202) 728-8894

Joan C. Conley
Corporate Secretary

March 23, 1998

VIA FIRST CLASS/CERTIFIED MAIL
RETURN RECEIPT REQUESTED

Michael Q. Carey, Esq.
Attorney At Law
230 Park Avenue - Suite 2240
New York, New York 10169-2240

Re: Complaint No. CMS960085: Market Surveillance Committee v. James T. Patten and Greater Metropolitan Investments Services, Inc.

Dear Counsel:

Enclosed herewith is the Decision of the National Business Conduct Committee in connection with the above-referenced matter. Any fine and costs assessed should be made payable and remitted to the National Association of Securities Dealers, Inc., Department #0651, Washington, D.C. 20073-0651.

You may appeal this decision to the U.S. Securities and Exchange Commission ("SEC"). To do so, you must file an application with the Commission within thirty days of your receipt of this decision. A copy of this application must be sent to the NASD Regulation, Inc. ("NASD Regulation") Office of General Counsel as must copies of all documents filed with the SEC. Any documents provided to the SEC via fax or overnight mail should also be provided to NASD Regulation by similar means.

Your application must identify the NASD Regulation case number, and set forth in summary form a brief statement of alleged errors in the determination and supporting reasons therefor. You must include an address where you may be served and phone number where you may be reached during business hours. If your address or phone number changes, you must advise the SEC and NASD Regulation. If you are represented by an attorney, he or she must file a notice of appearance.

The address of the SEC is:
Office of the Secretary
U.S. Securities and Exchange
Commission
450 Fifth Street, N.W., Stop 6-9
Washington, D.C. 20549

The address of NASD Regulation is:
Office of General Counsel
NASD Regulation, Inc.
1735 K Street, N.W.
Washington, D.C. 20006

Questions regarding the appeal process may be directed to the Office of the Secretary at the SEC. The phone number of that office is 202-942-7070.

Very truly yours,

Joan C. Conley
Corporate Secretary

Enclosure

cc: Tamara Sesok, Esq.