

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD REGULATION, INC.

In the Matter of

Market Regulation Committee,

Complainant,

vs.

La Jolla Capital Corp.

and

Harold Bailey Gallison, Jr.
Respondents.

DECISION

Complaint No. CMS950110

Market Regulation Committee

Dated: February 27, 1998

La Jolla Capital Corporation ("La Jolla") and Harold B. Gallison, Jr. ("Gallison") have appealed, pursuant to NASD Procedural Rule 9310, a May 23, 1997 decision of the Market Regulation Committee ("MRC"). We find that La Jolla and Gallison violated NASD Conduct Rules 2110 and 3010 (formerly Article III, Sections 1 and 27 of the NASD Rules of Fair Practice) by failing properly to supervise the conduct of registered representatives employed in La Jolla's New York office. Accordingly, we order that La Jolla and Gallison be censured and fined \$100,000 each; that Gallison be barred from associating with any member in a principal or supervisory capacity and that he requalify by examination within 90 days in any other capacity in which he wishes to become associated; and that La Jolla be required to retain an independent consultant to audit and monitor La Jolla's compliance program for two years.

Factual Background

Gallison entered the securities industry in March 1982 when he became associated with First Affiliated Securities, Inc., as a general securities representative and, later, as an options principal. Gallison became a general securities principal in 1989 while associated with Burnett, Grey & Co., Inc. In August of 1992 Gallison joined La Jolla, where he served as President, Chief Executive Officer ("CEO"), Supervisor of Trading, and Chief Compliance Officer during the relevant period. Gallison is presently La Jolla's President, CEO, and Supervisor of Trading.

La Jolla has been an NASD member since May 1990 and has its home office in San Diego, California. In June 1993 La Jolla had between six and eight offices of supervisory jurisdiction ("OSJ"). A Series 24 principal was responsible for overseeing the day-to-day operations of each OSJ, including the conduct of the registered sales personnel in that OSJ. According to La Jolla's supervisory manual then in effect, each OSJ manager reported directly to Gallison. In supervising the OSJ managers, Gallison reviewed each OSJ's trade blotter, all customer account statements, and all trade tickets. Gallison, however, considered each OSJ manager to be the "owner" of his or her OSJ and to be the "front line" of the firm's supervisory hierarchy.

Late in October of 1993, La Jolla opened a New York OSJ with an OSJ manager named Mark Furman ("Furman"). Furman had entered the securities industry in July 1988 as an investment company and variable contracts products representative, and had qualified as a general securities representative in September 1992.¹ La Jolla hired Furman on September 7, 1993, while Furman was preparing to take the Series 24 examination. During September and October of 1993, Furman studied for the exam and worked in La Jolla's San Diego headquarters learning the operations of the office. During that period, Gallison and Furman frequently discussed how to open up the New York office, and the pitfalls and problems he might encounter with the office. Furman spent time in each of La Jolla's departments, including trading, operations and compliance. On October 27, 1993, Furman passed the Series 24 examination, and he immediately was registered as a general securities principal and given control of the New York office.

As manager of La Jolla's New York office, Furman was responsible for supervising four registered representatives: Alex Gincherman ("Gincherman"); Michael Garber ("Garber"), Alex Folgen ("Folgen"), and Dimitry Mishiev ("Mishiev"). Gincherman entered the securities industry in October 1991 and qualified as a general securities representative in February 1992.² Garber entered the

¹Furman's complete employment history is as follows: Pruco Securities Corp. (July 1988 to March 1989); The Prudential Insurance Co. Of America (July 1988 to March 1989); La Jolla Capital Corp. (September 1993 to July 1995); Argent Securities, Inc. (July 1995); Investech Capital Corp. (July 1995); Euro-Atlantic Securities, Inc. (September to October 1995). Since his departure from Euro-Atlantic Securities, Furman has not been registered with any member firm. Furman had no disciplinary history with the Association when La Jolla hired him.

²Gincherman's employment history is as follows: First Hanover Securities (October 1991 to April 1992); American Bond Group, Inc. (April to September 1992); Meridian Associates, Inc. (July to October 1992); Robert M. Cohen & Co., Inc. (August to September 1993); La Jolla Capital Corp. (October 1993 to March 1994); Cartwright & Walker Securities, Inc. (February to November 1994). Gincherman had no disciplinary history when La Jolla hired him. He has not been registered since November 1994.

securities industry as a general securities representative in May 1992.³ Mishiev qualified as a general securities representative in October 1992, after having failed the Series 7 examination twice earlier that year.⁴ Folgen also qualified as a general securities representative in October 1992, also after having failed the Series 7 examination twice before.⁵ Thus, of the four registered representatives Furman was assigned to supervise, two had two years of experience and two had one year of experience.

It is undisputed that during the brief operation of La Jolla's New York office, from October 1993 through February 1994, Furman, Gincherman, and Garber engaged in serious misconduct in the sale of Jutland Enterprises, Inc. ("Jutland") stock. Jutland was little more than a shell. It was incorporated in 1988 to complete a public offering and to acquire an operating company. Although Jutland developed a bakery concept, "Cafe 2,000," in 1991, no stores were ever opened. In November 1991, Jutland acquired the rights to, but not the property of, "Yellow Submarine," a sandwich shop that had two operational stores. No additional Yellow Submarine stores were acquired or opened. Jutland last filed quarterly and annual reports for the quarter ending September 30, 1993 and for the year ending December 31, 1992, respectively. Jutland's operating losses consistently increased from 1991 through 1993. For the nine months ended September 30, 1993, Jutland's

³Garber's employment record is as follows: South Richmond Securities, Inc. (May to June 1992); Berkeley Securities Corp. (June to October 1992); Corporate Securities Group, Inc. (October 1992 to April 1993); J. Gregory & Co., Inc. (April to October 1993); La Jolla Capital Corp. (October 1993 to February 1994); Cartwright and Walker Securities, Inc. (February to May 1994); W.B. McKee Securities, Inc. (May to June 1994); Cartwright and Walker Securities, Inc. (July 1994 to February 1995); La Jolla Capital Corp. (February to April 1995). Since leaving La Jolla in April 1995, Garber has not been registered with a member firm. Garber had no disciplinary history prior to this incident.

⁴Mishiev's employment history is as follows: J. Gregory & Co., Inc. (April to August 1992); Barrett Day Securities, Inc. (September 1992 to January 1993); Corporate Securities Group, Inc. (January to May 1993); J. Gregory & Co., Inc. (May to October 1993); La Jolla Capital Corp. (October to December 1993); Securities Planners, Inc. (December 1993); La Jolla Capital Corp. (December 1993 to January 1994); Cartwright and Walker Securities, Inc. (February 1994 to February 1995); La Jolla Capital Corp. (February to April 1995). Mishiev has not been registered since April 1995. Mishiev had no disciplinary history when LaJolla hired him.

⁵Folgen's employment history is as follows: J. Gregory & Co., Inc. (April to June 1992); Barrett Day Securities, Inc. (June 1992 to February 1993); Securities Planners, Inc. (February to April 1993); Corporate Securities Group, Inc. (April to June 1993); J. Gregory & Company, Inc. (June to October 1993); La Jolla Capital Corp. (October 1993 to February 1994); Cartwright and Walker Securities, Inc. (February to April 1994); W.B. McKee Securities, Inc. (May 1994); Securities Planners, Inc. (June to December 1994). Folgen has not been registered since December 1994. Folgen had no disciplinary history when LaJolla hired him.

operating losses were \$153,636. There is no evidence that Jutland ever reported an operating profit.

Gallison was well-acquainted with Jutland Enterprises and its stock before La Jolla opened the New York office. La Jolla was a market maker in Jutland shares from December 1992 until after the New York office opened in October 1993, and Gallison was the firm's head trader throughout this period. Gallison admittedly knew that Jutland was "a low assets . . . start-up situation and very, very speculative." Gallison also knew that Jutland had reported net losses throughout its history, including significant losses during 1992 and 1993. Gallison knew that Jutland's total market valuation, which reached a high of \$68 million in January 1994, was not warranted by Jutland's financial situation. During this time, Gallison was aware of Jutland's "troubled financial history and even cloudier future."

In addition, Gallison had outside business dealings involving Jutland stock. On January 6, 1993, Gallison signed an Investment Banking Agreement with a consulting company ("Company 1") a La Jolla customer, whereby La Jolla agreed to provide Company 1 with investment banking and merger counseling in exchange for free Jutland stock. La Jolla received three transfers of free stock from the account of DO, Company 1's President and a La Jolla client: 2,000 shares on January 6, 1993; 3,000 shares on April 19, 1993; and 2,000 shares on January 22, 1994.

Despite Jutland's meager financial prospects, the evidence shows that between October 1993 and February 1994, Furman, Gincherman, and Garber engaged in serious misconduct in connection with transactions in Jutland stock. They made the following misrepresentations, predictions, and unrealistic comparisons about Jutland to at least eight La Jolla customers:

- Jutland was the subject of a pending merger or acquisition;
- Jutland's stock price would rise 100-fold;
- The price of Jutland stock had fallen because Jutland's officers had exercised a significant number of stock options;
- Jutland was in the hamburger business; was similar to "Checkers"; and was going to be the next "McDonalds";
- Jutland was planning to expand its operations to include coffee stores that would compete with "Starbucks";
- Jutland was positioned for rapid expansion; was a much better investment than "U.S. Banknote"; was heavily capitalized and very liquid; and was going to buy fast food franchises or chains in the future; and
- Jutland would be listed on the Nasdaq Stock Market in the Spring of 1994.

It is undisputed that these representations were knowingly false and violated NASD Conduct Rule 2120. The violations committed by Furman and the other registered representatives in La Jolla's New York office resulted in customer losses exceeding \$50,000 (excluding settlements by La Jolla).

Although Gallison reviewed the trade blotters and trade tickets from each La Jolla office, there is no evidence that Gallison took any additional steps to supervise Furman or the registered representatives at La Jolla's New York office. Gallison did not visit the New York office, hold compliance meetings with Furman or the other New York personnel, or inquire whether Furman was properly performing his supervisory functions. Although La Jolla ordinarily required its new OSJ managers to complete an operations checklist, Gallison did not ensure that Furman completed the checklist, and there is no evidence that Furman ever did so.

Gallison did hire a national compliance officer, Greg Mehlmann ("Mehlmann"), on October 26, 1993, just one day before Furman passed the Series 24 examination and days before Furman opened the New York office. In February 1994, La Jolla amended its compliance manual to delegate to Mehlmann the responsibility of supervising the OSJs, and to make Mehlmann "the primary liaison between compliance and the branch offices including the New York branch office." According to the compliance manual, Mehlmann was required to visit each branch office twice a year (once more than the Association's requirement) and to report his findings in writing. Yet, neither Mehlmann nor any other La Jolla supervisory employee ever visited the New York office before it closed. In fact, there is no evidence of any efforts undertaken by Mehlmann to supervise the New York office.

Following a wide-ranging investigation of trading in Jutland stock, including examinations of M. Rimson & Co., Inc., Securities Planners, Inc. ("SECP"), and La Jolla, the MRC (then known as the Market Surveillance Committee) issued a complaint on October 13, 1995, against La Jolla, Gallison, Furman, Garber, Gincherman and others.⁶ The complaint alleged, and the MRC found, that Furman⁷,

⁶The complaint also named SECP and six other registered representatives: Edward McKay ("McKay"), Eugene Flaksman, Valery Shtraykher, Alex Shindman, Igor Shekhtman and Boris Poleschuk. The complaint alleged that McKay and SECP failed properly to supervise registered representatives of SECP and that the individual respondents made material misrepresentations about and executed unauthorized trades of Jutland stock. The MRC found that each respondent violated the Association's Conduct Rules as alleged in the complaint. Only Gallison and La Jolla appealed.

⁷The MRC imposed the following sanctions on Furman: censure; \$55,000 fine; 30-day suspension from associating with any member of the Association in any capacity; requalification as a general securities representative no later than 90 days after completing his suspension; bar from associating with any member of the Association in any supervisory and/or principal capacity; and \$5,500 in restitution plus interest.

Garber⁸, and Gincherman⁹ violated Conduct Rules 2110 and 2120 by making material misrepresentations in the purchase and sale of Jutland stock, and that La Jolla and Gallison violated Conduct Rules 2110 and 3010 by failing to establish, maintain and enforce an adequate supervisory system with respect to the registered personnel in La Jolla's New York office.

Discussion

Gallison's and La Jolla's appeals raise the sole issue of whether the record supports a finding that they failed to establish, maintain, and enforce written supervisory procedures with respect to Furman and the registered representatives in La Jolla's New York office in violation of Conduct Rules 2110 and 3010. After a careful review of the record and oral arguments and briefs on appeal, we conclude that Gallison's and La Jolla's supervision fell below the standards set by Conduct Rule 3010 and that their conduct failed to meet the high standards set by Conduct Rule 2110. For the reasons stated below, we affirm the MRC's findings of violation and modify the sanctions imposed.

As a threshold matter, counsel for La Jolla and Gallison argued on appeal that this matter should be remanded because the MRC applied an incorrect standard when assessing the respondents' written supervisory procedures and actual supervisory practices. Counsel mistakenly argued that the scope of our review does not permit us to correct that perceived error. In fact, we are obligated to review the record de novo and to make an independent determination based on the entire record in this matter, including the parties' briefs and oral arguments on appeal. See, e.g., In re Ronald Earl Smits, 50 S.E.C. 1020 (1992); In re Thomas P. Reynolds Securities, Ltd., 49 S.E.C. Doc. 1407, 1409. (Sept. 16, 1991); In re Bradley Kanode, 50 S.E.C. 409 (1990).

Conduct Rule 3010 requires that members establish, maintain, and enforce a supervisory system with written procedures and that these procedures be "reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable rules of [the] Association." The standard of "reasonableness" is determined based on the particular circumstances of each case. In re

⁸The MRC imposed the following sanctions on Garber: censure; \$20,000 fine; \$11,925 in restitution plus interest; eight-month suspension from associating with any member firm in any capacity; requalification by examination as a general securities representative no later than 90 days after completing his suspension; and two years' special supervision, in the event Garber does seek to requalify and become associated with a member firm.

⁹The MRC imposed the following sanctions on Gincherman: censure; \$15,000 fine; \$6,093.75 in restitution plus interest; 45-day suspension from associating with any member firm in any capacity; requalification by examination as a general securities representative no later than 90 days after completing his suspension.

Christopher Benz, Exchange Act Rel. No. 38440 (March 26, 1997); In re Consolidated Investment Services, Inc., Exchange Act Rel. No. 36687 (Jan. 5, 1996); In re Rita H. Malm, Exchange Act Rel. No. 35000 (Nov. 23, 1994).

The duty of supervisory care owed by a firm and its President is heightened where, as here, the firm opens an office that is distant from the firm's headquarters and compliance personnel. The Securities and Exchange Commission ("SEC") has cautioned that "as firms expand their size through the opening of new branch offices . . . it is essential that supervisory oversight remain diligent and not be fragmented or dissipated The need for central control increases, not decreases, as branch offices become more numerous, dispersed and distant." In re Smith Barney, Harris Upham & Co., Inc., Exchange Act Rel. No. 21813 (March 5, 1985). There is an "obvious need to keep [a] new office with . . . semi-independent status and untried personnel under close surveillance." In re SECO Securities, Inc., 49 S.E.C. 873, 876 (1988). See also In re Conrad C. Lysiak, 51 S.E.C. 841 (1993); In re Reynolds & Co., 39 S.E.C. 902 (1960) ("The existence of numerous and scattered branch offices complicates the problem of supervision and makes essential the installation of an adequate system of control. The growth of securities firms also tends to increase the number of inexperienced personnel who require especially careful supervision . . ."). La Jolla's New York office was located 3,000 miles from La Jolla's headquarters and should have received increased supervisory attention.

The standard of supervisory care is further heightened where, as here, the remote office is staffed with unseasoned personnel. In In re Gary W. Chambers, Exchange Act Rel. No. 27963 (April 30, 1990), where a compliance officer allegedly failed to supervise the activities of registered representatives located in a remote branch office, the SEC noted that "because most of the California branch office brokers were newly licensed, Chambers should have been particularly concerned about supervising their activities." Similarly, Gallison and La Jolla should have been concerned about the inexperience of the registered personnel employed in New York. Furman, who was to bear the heavy responsibility of supervising four registered representatives, had himself passed the Series 7 examination just 13 months earlier and passed the Series 24 examination just days earlier. None of the representatives Furman was to have supervised had even two years of experience in the industry; Gincherman and Garber passed their Series 7 examinations in February and May of 1992, and Folgen and Mishiev each passed the Series 7 examination in October of 1992.

The reasonableness of a supervisory system, such as La Jolla's, also depends on how well it accounts for the past and future training of the personnel being supervised. See Conduct Rule 3010(a)(6) (supervisory system must include "[r]easonable efforts to determine that all supervisory personnel are qualified by virtue of experience or training to carry out their assigned responsibilities"). La Jolla's supervisory system did not account for this variable. La Jolla did not attempt to evaluate the past training of Gincherman, Garber, Folgen, and Mishiev. Gallison simply assumed that all registered representatives have a uniform, acceptable level of knowledge and training. This is particularly problematic because, as Gallison conceded, La Jolla does not train its registered sales personnel in any way.

Gallison contends that he was not responsible for the supervisory breakdown that led to the violations at La Jolla's New York office because: (1) Furman was the manager responsible for supervising the New York office, and Gallison reasonably believed that Furman was equipped to handle that responsibility;¹⁰ (2) it was impossible to predict that Furman, a Series 24 principal, would participate in the violative conduct; and (3) Gallison reasonably delegated his supervisory responsibility by hiring Mehlmann as La Jolla's national compliance officer.

We reject Gallison's first two arguments because, regardless of whether Gallison's assessment of Furman's qualifications and character was reasonable (it was not), La Jolla was required to establish a continuing supervisory system to monitor its employees' behavior. Rule 3010(a)(5) requires firms to assign "each registered person to an appropriately registered representative(s) and/or principal(s) who shall be responsible for supervising that person's activities." Thus, it is well-established that "a system of supervisory procedures which rely (sic) solely on the branch manager is insufficient." In re Dickinson, Exchange Act Rel. No. 36338 (Oct. 5, 1995); In re Shearson Lehman Brothers, Inc., Exchange Act Rel. No. 23640 (Sept. 24, 1986). It was not sufficient, as Gallison seemed to claim, that La Jolla designated each branch as an OSJ and assigned it a Series 24 principal. See In re Prudential-Bache Securities, Inc., 48 S.E.C. 372, 400 (1986). La Jolla was also required to "provide effective staffing, sufficient resources and a system of follow up and review to determine that any responsibility to supervise delegated to compliance officers, branch managers and other personnel is being diligently exercised." In re Mabon, Nugent & Co., 47 S.E.C. 862, 867 (1983). The system must provide sufficient checks "to insure that the first line of compliance, the branch manager, [is] functioning adequately." Shearson Lehman Brothers, Inc., *supra*, at 4. LaJolla, which had a heightened duty of supervision because the New York office was distant and was staffed with inexperienced personnel, failed to meet even this basic requirement imposed on all firms.

In addition, La Jolla and Gallison failed to recognize and investigate the "red flag" of unusual trading of Jutland stock in the New York office. See In re Michael H. Hume, Exchange Act Rel. No. 35608 (April 17, 1995) ("[a] failure to supervise can arise where a supervisor was aware only of "red flags" or "suggestions of irregularity"); In re Randolph K. Pace, 51 S.E.C. 361 (1993). The record shows that eight customers executed 13 transactions in Jutland stock and suffered losses exceeding \$50,000 (excluding settlements) during the brief period of operations in the New York office. Gallison conceded that no other La Jolla OSJ was selling Jutland stock. In reviewing the trade tickets and trade blotters from each OSJ, as Gallison says was his practice, Gallison should have noted and inquired further about the high concentration of Jutland transactions in the New York office when compared to the absence of Jutland transactions in La Jolla's other OSJs.

¹⁰Gallison argued that Furman was intelligent, articulate, and motivated; had no prior disciplinary problems; and had spent two months in the headquarters office, including time in each of La Jolla's departments, learning about the operation of the business.

Gallison's review of the Jutland trades in the New York office may have been affected by his prior and ongoing involvement with Jutland stock. As noted earlier, La Jolla made a market in Jutland, and Gallison was Supervisor of Trading. Both La Jolla and Gallison benefitted financially from that activity. Gallison had signed an Investment Banking Agreement with Company 1 whereby Company 1 paid Gallison by giving him shares of Jutland stock (Company 1's president, DO, transferred the shares to La Jolla's proprietary account). During the period in question, Company 1 had a large position in, and was an active trader of, Jutland stock. For example, Company 1's closing positions in Jutland stock were: 215,270 shares worth \$1,506,890 on October 29, 1993; 202,228 shares worth \$1,415,596 on November 26, 1993; 99,413 shares worth \$596,478 on January 31, 1994; and 96,513 shares worth \$120,641 on February 28, 1994. During those months, Company 1's account at La Jolla engaged in nine, six, five, and six trades in Jutland stock, respectively. During those same months, La Jolla executed numerous trades for the accounts of DO and Company 2, another entity controlled by DO that shared a common address with Company 1 and DO. Gallison's involvement with Jutland stock, the remoteness of La Jolla's New York OSJ, and the inexperienced personnel staffing that office should have heightened Gallison's scrutiny.

We also reject Gallison's argument that he was not responsible for the supervisory breakdown because he had hired Mehlmann as La Jolla's national compliance manager. Gallison, as President of La Jolla, was responsible for compliance with all of the requirements imposed on La Jolla "unless and until he reasonably delegate[d] particular functions to another person in that firm, and neither [knew] nor ha[d] reason to know that such person's performance [was] deficient." Patrick v. SEC, 19 F.3d 66, 69 (2d Cir. 1994); In re Universal Heritage Investments Corp., 47 S.E.C. 839, 845 (1982). First, although La Jolla hired Mehlmann in October 1993, La Jolla's compliance manual shows that Gallison did not officially and specifically delegate supervisory duties to Mehlmann until February 1994, just before La Jolla closed the New York office. Second, even assuming that Gallison delegated supervisory responsibilities to Mehlmann immediately upon Mehlmann's hiring, the record shows that such a delegation could not have been reasonable because no attention was given to the heightened supervisory needs, described earlier, of La Jolla's New York office, which had opened just days later. Finally, after Gallison delegated supervisory duties to Mehlmann, the "red flag" of unusual trading in Jutland stock made Gallison's continued reliance upon his delegation, without further investigation, unreasonable.

The record establishes that La Jolla's New York office operated in a supervisory vacuum and that neither La Jolla's supervisory manual nor Gallison's practices were reasonably designed to address that void. We find that Gallison, as the President, Chief Compliance Officer and Supervisor of Trading of La Jolla during the relevant period, was ultimately responsible for ensuring that La Jolla established, maintained and enforced a supervisory system that was reasonably designed to achieve compliance with federal securities laws and regulations and the rules of the Association. Accordingly, we find that LaJolla and Gallison failed properly to supervise in violation of Conduct Rule 3010. We further find that they failed to do so in violation of Conduct Rules 2110 and 3010.

Sanctions

The selection of an appropriate remedial sanction depends on the facts and circumstances of each case and cannot be determined precisely by comparison with actions taken in other proceedings. See Butz v. Glover Livestock Comm'n Co., 411 U.S. 182, 187 (1973); Hiller v. SEC, 429 F.2d 856, 858-59 (2d Cir. 1970). In setting the sanctions to be imposed upon Gallison and La Jolla, we weighed the "Principal Considerations in Determining Sanctions" that are listed in the Sanction Guideline for supervision violations: (1) prior or other similar misconduct; (2) extent of inadequacy in written supervisory procedures and controls; (3) absence of any reasonable explanation for the inadequacy in written procedures; (4) extent of supervisor's periodic review and follow-up; (5) "red flags" that should have alerted firm and/or principal to intensify supervision; (6) extent of any inadequacy in the actual supervision of the employee(s); (7) absence of any reasonable explanation for the supervisory failure; (8) extent of employee misconduct; (9) disciplinary history; (10) demonstrated new corrective measures or controls to prevent recurrence; (11) prompt and voluntary restitution; and (12) other mitigating or aggravating factors.¹¹

Among these, we find most significant the serious inadequacy of La Jolla's written supervisory procedures and Gallison's failure to note and investigate the trading in Jutland stock by personnel in La Jolla's New York office. Although La Jolla and Gallison presented evidence that La Jolla's written supervisory procedures and periodic review procedures have since been improved, we reject the respondents' proffered explanation for the breakdown at the New York office. La Jolla's and Gallison's failure properly to supervise led to serious harm to La Jolla's public customers and created the possibility of more serious harm. Accordingly, we order that Gallison and La Jolla be censured and fined \$100,000 each.

In fashioning a remedial sanction, we also note that La Jolla's and Gallison's disciplinary histories include prior supervision violations.¹² In November 1993, the State of Colorado revoked Gallison's registration with the right to reapply after five years for failing to supervise a Denver, Colorado branch office. In January 1994, La Jolla responded to allegations by the State of Illinois, that La Jolla failed reasonably to supervise at least one salesperson by consenting to pay a \$1,000 fine and agreeing to offer rescission of the trades in question. Also, in August 1995, La Jolla and Gallison entered into a

¹¹NASD Sanction Guidelines ("Guidelines"). See Guidelines (1993 ed.) at 44 (Supervision).

¹²La Jolla has also entered into consent orders with the States of New Hampshire, Colorado, and South Carolina for conduct unrelated to supervision. In separate actions, Gallison has also been censured and ordered to disgorge commissions by the NASD and ordered to cease and desist by the SEC for conduct unrelated to supervision.

consent order with the Nevada Securities Division pursuant to which they paid a \$25,000 civil penalty, \$15,000 in investigation costs, and rescinded investments made by 10 Nevada residents based upon allegations that La Jolla sold unregistered securities and failed properly to supervise a branch office and a registered representative.¹³ Gallison has proven himself incapable of properly supervising his firm or his employees. Accordingly, we order that Gallison be barred from associating with any member firm in a principal or supervisory capacity and that he requalify by examination in any other capacity in which he wishes to become associated within 90 days, or else be suspended in those capacities until such requalification.

The serious inadequacy of La Jolla's written supervisory procedures, the repeated breakdowns at La Jolla's OSJs, Gallison's repeated supervisory lapses, and our decision to bar Gallison from serving in a principal or supervisory capacity, necessitate continuing, external support in the area of supervision. Therefore, we order, as did the MRC, that La Jolla retain an independent consulting firm ("Independent Consultant") that is mutually agreeable to La Jolla and NASD Regulation for two years following the date of this decision. The Independent Consultant shall begin reviewing La Jolla's compliance and written supervisory procedures within 60 days after the date of this decision and shall issue written recommendations to La Jolla and to NASD Regulation's District No. 2 staff within 120 days after the date of this decision. Within 30 days of receiving these recommendations, La Jolla shall report in writing to the District staff any modifications made to its written supervisory procedures based upon the Independent Consultant's recommendations, and the reasons for failing to implement any of the Independent Consultant's recommendations. The Independent Consultant shall conduct follow-up reviews and prepare follow-up reports addressing La Jolla's written supervisory procedures every 120 days thereafter until the conclusion of the two-year period. Each such report shall be issued to La Jolla and to the District staff, and La Jolla shall respond to each report within 30 days as described above.

¹³We note that in September 1997, the District Business Conduct Committee for District No. 2 found that La Jolla and Gallison, among others, violated Conduct Rules 2110 and 3010 by falsely portraying penny stock transactions as being exempt from the penny stock rules, by altering letters from customers falsely to reflect trades as being unsolicited, and by failing to establish, maintain and enforce adequate written supervisory procedures. This matter is currently under appeal, and therefore we will not consider it when imposing sanctions.

Accordingly, we order that La Jolla and Gallison be censured and fined \$100,000 each; that Gallison be barred from associating with any member in a principal or supervisory capacity and that he requalify by examination in any other capacity in which he wishes to become associated or be suspended in those capacities until the time of such requalification; that La Jolla be required to retain an independent consultant to audit, alter, and monitor La Jolla's compliance program for two years as described above; and that Gallison and La Jolla be required to pay, jointly and severally, the hearing costs of the MRC. The suspension imposed herein will commence on a date to be set by the President of NASD Regulation, Inc.¹⁴

On Behalf of the National Adjudicatory Council,

Joan C. Conley, Corporate Secretary

¹⁴The recommended sanctions are consistent with the applicable NASD Sanction Guidelines ("Guidelines"). See Guidelines (1993 ed.) at 44 (Supervision).

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 be summarily 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 be summarily revoked for non-payment.