

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD REGULATION, INC.

In the Matter of
the Continued Association of

X

as a

General Securities Representative¹

with

The Sponsoring Firm 1

and the Association of

X

as a

General Securities Representative

with

The Sponsoring Firm 2

REDACTED DECISION

Notice Pursuant to
Rule 19h-1
Securities Exchange Act
of 1934

Decision No. SD01017

On August 21, 2000, the Sponsoring Firm 1 completed an MC-400 application ("Application No. 1") seeking to permit X, a person subject to a statutory disqualification, to continue to associate with the Sponsoring Firm 1 in the numerous capacities listed below. On February 20, 2001, the Sponsoring Firm 1 also completed an MC-400 application ("Application No. 2") seeking to permit X to associate with the Sponsoring Firm 2 in the numerous capacities listed below. A hearing was not held in this matter. Rather, pursuant to NASD Procedural Rule 9523, NASD Regulation Inc.'s ("NASD

¹ In addition to registration as a general securities representative, the Sponsoring Firm 1 and the Sponsoring Firm 2 are also seeking for X to be registered in the following capacities: registered options principal (Series 4); interest rate options (Series 5); foreign currency options (Series 15); general securities principal (Series 24); municipal securities principal (Series 53); equity trader (Series 55); financial and operations principal (Series 27); and uniform securities agent state law examination, for which he is grandfathered in State 1.

Regulation") Department of Member Regulation ("Member Regulation") recommended to the Statutory Disqualification Committee that X's proposed continued association with the Sponsoring Firm 1 and the Sponsoring Firm 2 be approved pursuant to the terms and conditions set forth below. The Sponsoring Firm 1 and the Sponsoring Firm 2 have consented to the imposition of these terms and conditions in letters dated April 2001, and July 2001, respectively.

X's Statutorily Disqualifying Event. In 1999, the United States Securities and Exchange Commission ("SEC" or "Commission") filed a complaint against X and others seeking injunctive relief, disgorgement of ill-gotten gains plus pre-judgment interest, and civil money penalties. The complaint was based upon numerous alleged violations of the Securities Act of 1933 ("Securities Act") and the Securities Exchange Act of 1934 ("Exchange Act"), and the rules promulgated thereunder. The Commission's action alleged a manipulation of the after-market trading for a stock traded on the Nasdaq Small Cap Market, which included the artificial inflation of the price per share from \$1 to \$13. X was the managing general partner of the initial and primary market maker for the stock at issue.

X submitted a Consent and Undertakings in 2000, wherein he consented to the entry of a Final Judgment of Permanent Injunction ("PI"). In 2000, a United States District Court for State 1 entered the PI, which:

- 1) permanently enjoined X from:
 - a) obtaining money or property by means of any untrue statement of a material fact, or omitting to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, false or misleading; or
 - b) engaging in any transaction, practice, or course of business that operates or would operate as a fraud or deceit upon the purchaser,in violation of Section 17(a)(2) and (3) of the Securities Act;
- 2) required X to pay disgorgement of all profits and monies received as a result of gains from his sales of the common stock of Company A (\$205,000 plus pre-judgment interest of \$135,138.65, totaling \$340,138.65); and,
- 3) ordered him to pay a civil penalty in the amount of \$25,000.

Also in 2000, X submitted an Offer of Settlement in a parallel administrative proceeding brought by the Commission based on the same misconduct. The Commission accepted the offer in 2000 ("Order"). The Commission's Order suspended X from association with any broker or dealer for a period of two months, effective July 2000.

The two-month suspension ended in September 2000, and X paid his fine and disgorged all profits with interest.

X's Background. X is seeking dual registration with the Sponsoring Firm 1 and the Sponsoring Firm 2. He has been registered with the Sponsoring Firm 1 since 1985 in the following capacities: general securities representative (Series 7), municipal securities principal (Series 53), foreign currency options (Series 15), interest rate options (Series 5) and registered options principal (Series 4). X was also registered as a general securities principal (Series 24) and financial and operations principal (Series 27) from May 1985 until May 2000, when he was ordered to re-qualify in those capacities. He passed the general securities principal qualification examination in 2000 and the equity trader (Series 55) qualification examination in 1999.

In 2000, NASD Regulation accepted X's and the Sponsoring Firm 1's Letter of Acceptance, Waiver and Consent ("AWC") for violations of NASD Rules 1120, 2110, 3010, and SEC Rule 15c3-1. The AWC stated that the Sponsoring Firm 1, acting through X: effected securities transactions when it failed to maintain the minimum required net capital; operated offices of supervisory jurisdiction while failing to designate an appropriately registered principal in each of the locations; allowed an individual to act in the capacity of a general securities principal despite the fact that the individual was not qualified or registered in that capacity; and, failed to prepare, maintain and/or enforce adequate written supervisory procedures regarding both the regulatory element of the continuing education requirement and the review of activities for, and the conducting of an annual inspection of, each office of supervisory jurisdiction. For these transgressions, X and the Sponsoring Firm 1 were fined \$55,000, jointly and severally, and X was suspended as a general securities principal and financial and operations principal for 30 days, and required to re-qualify before acting in those capacities.

X and the Sponsoring Firm 1 are the subject of a pending civil complaint alleging common law fraud. This claim arose from the misconduct that led to X's injunction and suspension.

The Firms. The Sponsoring Firm 1 became a member of the Association in 1984. The Sponsoring Firm 1 has four offices of supervisory jurisdiction and no branch offices. The Sponsoring Firm 1 currently has four general partners and one limited partner (all five will become limited partners when the applications are approved) and it employs 15 registered principals and 48 registered representatives. It is engaged in proprietary trading.

The Sponsoring Firm 1's 2001 off-cycle municipal examination has been scheduled, but has not commenced. The Sponsoring Firm 1's 2000 routine examination resulted in a Letter of Caution ("LOC") for violations of SEC Rule 17a-3(a)11 (books and records: inadequate net capital computation) and SEC Rule 17a-5(a) (financial report: monthly FOCUS).

Besides the disciplinary events described above, the Sponsoring Firm 1 has no other disciplinary history.

The Sponsoring Firm 2 became a member of the Association in 2000. The Firm has one main office, but no offices of supervisory jurisdiction or branch offices. The Sponsoring Firm 2 employs six registered principals and five registered representatives. To date, it has not engaged in any business activity, but it is expected to become and act as the general partner of the Sponsoring Firm 2.

The Sponsoring Firm 2 currently has two principal/members, RP² and SH. If the Sponsoring Firm 2's MC-400 Application is approved the proposed structure will be as follows: X, along with CR, and CTV, will also become principal/members of the Sponsoring Firm 2 and they will all become limited partners of the Sponsoring Firm 1. The limited partners will continue to act as proprietary traders with the Sponsoring Firm 1 and the Sponsoring Firm 2 will then become the sole general partner of the Sponsoring Firm 1. The Sponsoring Firm 1 and the Sponsoring Firm 2 have represented that they do not contemplate that the Sponsoring Firm 2 will engage in any form of securities trading because the Sponsoring Firm 1 limited partners will be able to engage in securities trading through the Sponsoring Firm 1.³

The Sponsoring Firm 2's 2000 routine examination was filed without action. The 2001 routine examination has not yet been scheduled. The Sponsoring Firm 2 has no other disciplinary history.

X's Business Activities and Supervision. X will work out of one of the Sponsoring Firm 1's offices of supervisory jurisdiction located in State 2. He will become a limited partner (but not managing partner) of the Sponsoring Firm 1, and will continue to trade the Sponsoring Firm 1's account. X will continue to be compensated with the gains or losses of the Sponsoring Firm 1, as well as with the gains or losses that result from his proprietary trading. He will not be involved in supervising the day-to-day activities of individuals at the Sponsoring Firm 1.

X also will be compensated from the gains or losses of the Sponsoring Firm 2, as well as from the gains or losses that result from his proprietary trading, if any. He will act as an equity member of the Sponsoring Firm 2, and may be involved in trading the Sponsoring Firm 2's account. He will not be involved in supervising the day-to-day activities of individuals at the Sponsoring Firm 2. He will have voting rights and will be allowed to participate in decisions concerning policy and general business as set forth in

² RP is X's brother.

³ In a letter dated 2001, the Sponsoring Firm 1 represented that it needs to change its business structure because State 1 law provides too much power to general partners, which restricts the decision-making capabilities of the Sponsoring Firm 1 and hampers its ability to attract professional managers.

State 1 Limited Liability Company law and the Sponsoring Firm 2's operating agreement. MB, the proposed supervisor for X's association with the Sponsoring Firm 1, will continue to supervise any trading activities in which X may engage.

The Proposed Supervisor, who has been a corporate securities representative since 1999 and a general securities principal since 2000, is a supervisor assigned to the Sponsoring Firm 1 office of supervisory jurisdiction where X will continue to be employed. The Proposed Supervisor has no disciplinary history. The Proposed Supervisor will be assisted in supervising X by CTV, currently a general partner of the Sponsoring Firm 1. The Proposed Supervisor 2 has been a general securities representative since 1994 and a general securities principal since 1997. He works out of the Sponsoring Firm 1's home office and has no disciplinary history.

Member Regulation, the Sponsoring Firm 1, and the Sponsoring Firm 2 have agreed that the following terms and conditions will govern X's association with the Sponsoring Firm 1 and the Sponsoring Firm 2:

1. X will conduct all of his securities business in the same room as the Proposed Supervisor.
2. X will never become the managing partner of the Sponsoring Firm 1.
3. The Proposed Supervisor will have access to all of X trading materials and he will review X's trading and associated activities on a daily basis. Any problems will be directed by the Proposed Supervisor to the Proposed Supervisor 2 before discussion with X.
4. The Proposed Supervisor will review and initial all of X's incoming correspondence before X reviews it, and the Proposed Supervisor will review, approve, and initial all of X's outgoing correspondence before X sends it. Any problems will be directed by the Proposed Supervisor to the Proposed Supervisor 2 before discussion with X. The Proposed Supervisor will retain copies of all of X's incoming and outgoing correspondence in a file.
5. The Proposed Supervisor 2 will receive (via electronic systems) and review all documentation regarding X's trading activity on a daily basis. The Sponsoring Firm 1's and the Sponsoring Firm 2's compliance departments will review all of X's trading activity on a weekly basis. The Proposed Supervisor 2 will discuss with X any problems directed to him by the Proposed Supervisor, and notify compliance in writing of the discussion and any resolution. Compliance will retain this writing in a file.
6. The Proposed Supervisor, the Proposed Supervisor 2, and The Sponsoring Firm 1's and the Sponsoring Firm 2's compliance departments will separately

document their respective reviews of X's trading activity, and keep separate logs evidencing their review.

7. The Proposed Supervisor, the Proposed Supervisor 2, and the Sponsoring Firm 1's compliance departments will address all problems or potential problems on behalf of X with the Sponsoring Firm 1's limited partners, whether or not resolved under items 3, 4 or 5 above. The limited partners will take appropriate action to ensure that X is complying with all relevant securities laws, rules and regulations. The limited partners will set forth in writing how they handled and/or resolved potential problems and problems concerning X's securities-related activity, and the compliance department will retain copies of these writings in a file.
8. The Proposed Supervisor and the Proposed Supervisor 2 will have weekly meetings with X to review all aspects of X's work at the Sponsoring Firm 1 and the Sponsoring Firm 2, including compliance with the Sponsoring Firm 1's and the Sponsoring Firm 2's policies and procedures. (the Proposed Supervisor 2 will participate in these meetings by conference call.) The Proposed Supervisor and the Proposed Supervisor 2 will maintain a record of the various matters discussed and reviewed with X during these weekly meetings and forward a copy to the Sponsoring Firm 1's and the Sponsoring Firm 2's compliance departments.
9. All complaints from sources other than the Proposed Supervisor pertaining to X, whether written or verbal, will be reviewed by the Proposed Supervisor and the Proposed Supervisor 2. The Proposed Supervisor and the Proposed Supervisor 2 will immediately forward all complaints to the Sponsoring Firm 1's and the Sponsoring Firm 2's compliance departments and the Sponsoring Firm 1's limited partners. The limited partners will set forth in writing how they handled and/or resolved issues concerning X's securities-related activity, and the compliance departments will retain copies of these writings in a file.
10. The supervisory procedures of the Sponsoring Firm 1 and the Sponsoring Firm 2 will be amended to specify the responsible supervisors for X, and will include the special supervisory program set forth above.
11. For the duration of X's statutory disqualification, the Sponsoring Firm 1 and the Sponsoring Firm 2 must obtain prior approval from Member Regulation if they wish to change X's primary, responsible supervisor from the Proposed Supervisor to another person, and if they wish to change the person to whom the Proposed Supervisor directs matters as discussed above (which person must be a limited partner of the Sponsoring Firm 1) from the Proposed Supervisor 2 to another person.

Discussion. After careful review of the entire record in this matter, we conclude that the Sponsoring Firm 1's and the Sponsoring Firm 2's applications to employ X in the capacities requested should be approved subject to the terms and conditions set forth above.

These applications involve an individual who is subject to a PI and was subject to a Commission suspension order (two separate disqualifying events). The period of suspension has expired, thus X is no longer subject to a disqualification based on the Commission's suspension order. We therefore review this matter to determine X's eligibility in light of the statutory disqualification that resulted from the PI.

In reaching our determination to approve X's continued association with the Sponsoring Firm 1 and the Sponsoring Firm 2, we have considered that when the SEC suspended X in July 2000 for two months, the Commission was charged with weighing the requirements of the public interest in light of X's misconduct. The Commission concluded that it was appropriate to suspend X from association with any broker or dealer for two months. Accordingly, in reviewing the Sponsoring Firm 1's and the Sponsoring Firm 2's applications sponsoring X's association notwithstanding his permanent injunction, NASD Regulation must follow the guidance set forth by the Commission in Paul Van Dusen, 47 S.E.C. 668 (1981) and Arthur H. Ross, 50 S.E.C. 1082 (1992). Van Dusen and Ross require that these applications must be granted absent other acts of misconduct or circumstances of record bearing adversely on the firms' or X's fitness to continue in the securities industry.⁴ Accordingly, NASD Regulation had to focus its inquiry on any "other [intervening] misconduct in which the applicant may have engaged, the nature and disciplinary history of a prospective employer, and the supervision to be accorded the applicant." Van Dusen, at 671.

The record does not reveal any misconduct by X after the entry of the SEC's Order. The Sponsoring Firm 1 and the Sponsoring Firm 2 have agreed to extensive, well-structured supervisory controls that will govern X's activities. This supervisory arrangement will be carried out by an on-site supervisor as well as the firms' compliance departments and an off-site supervisor, who will be a limited partner of the Sponsoring Firm 1. Both supervisors have no regulatory disciplinary history and appear to be fully capable of supervising X's activities. The Sponsoring Firm 2 also has no disciplinary history. Given these factors, NASD Regulation believes that the Sponsoring Firm 1's disciplinary history will not affect the Sponsoring Firm 1's ability to supervise X, who the SEC determined should only be sanctioned by a suspension for two months.

Given the terms of X's 2000 settlement with the Commission and the teachings of Van Dusen and Ross, we conclude that the Sponsoring Firm 1's and the Sponsoring Firm 2's applications satisfy the conditions necessary for X to continue in the securities

⁴ Although Van Dusen and Ross specifically deal with a bar with a right to reapply, we believe that their holdings are instructive in this situation involving an injunction followed by a suspension. (See also SEC Rule 19h-1(a)(iv).)

industry in the agreed-upon capacities with the Sponsoring Firm 1 and the Sponsoring Firm 2.

NASD Regulation certifies that: 1) X meets all applicable requirements for the proposed employment; 2) the Sponsoring Firm 1 and the Sponsoring Firm 2 are not members of any other self-regulatory organization; 3) the Sponsoring Firm 1 and the Sponsoring Firm 2 have represented that neither the Proposed Supervisor nor the Proposed Supervisor 2 are related by blood or marriage to X; and 4) the Sponsoring Firm 1 and the Sponsoring Firm 2 do not employ any other statutorily disqualified individuals.

Accordingly, in conformity with the provisions of SEC Rule 19h-1, the registrations (enumerated above) of X with the Sponsoring Firm 1 will continue to be effective and the registrations of X with the Sponsoring Firm 2 will become effective, unless otherwise notified by the Commission within 30 days of receipt of this notice.

On Behalf of the National Adjudicatory Council,

Barbara Z. Sweeney
Senior Vice President and Corporate Secretary