PLEASE NOTE THE LATER CASE HISTORY OF THIS DECISION, FOLLOWING THE TEXT OF THE DECISION.

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD

In the Matter of the Continued Membership of Sponsoring Firm 1
In the Matter of the Continued Association of X as a General Securities Representative, General Securities Principal, and Financial and Operations Principal with Sponsoring Firm 2
In the Matter of the Continued Association of X as a General Securities Representative, Equity Trader, General Securities Principal, Municipal Securities Principal, and Financial and Operations Principal with Sponsoring Firm 1

REDACTED DECISION

Notice Pursuant to
Section 19(d)
Securities Exchange Act
of 1934

Decision No. SD03006

On August 6, 2003, Sponsoring Firm 1[1] submitted a Membership Continuance Application ("MC-400A" or "Application") to permit it to remain a member of NASD in spite of its statutory disqualification. On August 6, 2003, Sponsoring Firm 1 submitted a Membership Continuance Application ("MC-400" or "Application") to permit X, a person subject to a statutory disqualification, to continue to associate with Sponsoring Firm 1 in the numerous capacities listed above. Also on August 6, 2003, Sponsoring Firm 2 submitted an MC-400 to permit X to associate with Sponsoring Firm 2 in the capacities listed above.

In September 2003, a Hearing Panel of the Statutory Disqualification Committee of NASD held a hearing on these matters. X appeared and was accompanied by the Director of Compliance for Sponsoring Firm 1 and Sponsoring Firm 2, . PL appeared on behalf of the Department of Member Regulation ("Member Regulation").

A. Statutorily Disqualifying Event for Sponsoring Firm 1 and X

Sponsoring Firm 1 and X are both subject to a statutory disqualification as a result of a judgment rendered against them by a U.S. District Court for State 1("District Court") in 2003. Following a bench trial, the District Court permanently enjoined Sponsoring Firm 1 and X from: (1) committing fraud in the offer or sale of securities in violation of Section 17(a) of the Securities Act of 1933 ("Securities Act"); (2) committing fraud in connection with the purchase or sale of any security in violation of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"); (3) committing fraud as a control person in violation of Section 10(b) and 15(c)(1) of the Exchange Act; (4) committing fraud in connection with a distribution of securities in violation of Section 10(b) of the Exchange Act and Rule 10b-6 thereunder, and; (5) selling unregistered securities in violation of Section 5 of the Securities Act.[2]

The District Court ordered Sponsoring Firm 1 and X to disgorge $134,224, plus prejudgment interest, which represented the joint profits gained as a result of Sponsoring Firm 1 and X's illegal activities. The District Court ordered that X was jointly and severally liable for the disgorgement because "[X] did play an intimate role in the fraudulent transactions."

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[1] The names of the Statutorily Disqualified individual, the Sponsoring Firm, the Proposed Supervisor and other information deemed reasonably necessary to maintain confidentiality have been redacted.

[2] Sponsoring Firm 1 and X argue that their appeal of the District Court's judgment eliminates the permanent injunction as a statutory disqualification. We do not agree. An appeal of a District Court's permanent injunction does not change the classification of the injunction as a disqualifying event because the entry of the injunction is the disqualifying event. See Robert J. Sayegh, 52 S.E.C. 1110, 1112 (1996).

In summary, the District Court found that Sponsoring Firm 1 and X, along with other individuals ("Group A"), conducted a fraudulent blind pool offering, subsequent market manipulation, and fraudulent sale of the securities of Company A. We set forth the details of two aspects of the District Court's findings because we consider them important to our evaluation of these Applications.

As to the registration statement filed in connection with the public offering of Company B, the District Court found that Firm 1 and X made misrepresentations and failed to disclose material facts in several respects. Among other violations of the antifraud provisions of the Securities Act and the Exchange Act, X acted as a promoter, and Sponsoring Firm 1 acted as an underwriter for the offering, when the registration statement represented that the offering was a self-underwriting. Group A had selected another company with which Company B would merge and had decided on the terms of the merger; however, the registration statement did not disclose this information. The Company B offering was controlled by Group A, which had a prearranged, undisclosed call option to purchase the entire portion of the offering that others, including nominees of Sponsoring Firm 1 and X, had purchased. The registration statement failed to disclose any of this information.

As to the trading of Company A's stock, the District Court found that Sponsoring Firm 1 and X—as a control person of Sponsoring Firm 1—participated in and furthered a market manipulation. Firm 1 was a market maker in Company A securities. Through Firm 1's market-maker transactions, Group A raised artificially the price of Company A securities from five cents per share to more than five dollars per share by employing the following manipulative devices: (1) Group A agreed to protect Sponsoring Firm 1 from market risk by buying out any long position and covering any short position that Sponsoring Firm 1 established, both at a profit to Sponsoring Firm 1; (2) Firm 1 arranged for the investors that previously owned Company B stock and warrants to sell these securities back to Sponsoring Firm 1 at the direction of Group A and for the purpose of obtaining control over the outstanding shares of Company A; (3) Sponsoring Firm 1 effected "wash sales" and "matched orders" between accounts that were controlled by Group A; and (4) Sponsoring Firm 1 effected trades involving undisclosed nominees.

B. Sponsoring Firm 1's and Sponsoring Firm 2's Background

Sponsoring Firm 1 is a State 1 corporation with its principal place of business in State 1. Sponsoring Firm 1 was formed in 1984, and became a member of NASD in 1985. In 2003, Sponsoring Firm 1 informed NASD that it was ceasing operations as a broker-dealer because its net capital was below the minimum amount required pursuant to Exchange Act Rule 15c3-1.

According to Sponsoring Firm 1's MC-400 Application and related documents, as a result of the fact that Sponsoring Firm 1 is not currently conducting a securities business, it presently has no Offices of Supervisory jurisdiction, and no branch offices. The firm's only office is located in State 1. Sponsoring Firm 1 maintains that it employs one salaried employee (who is also a registered principal), 11 registered principals, and seven registered representatives. According to CRD, prior to Sponsoring Firm 1 ceasing operations as a result of its net capital deficiency, the firm engaged in several lines of business, including: retailing mutual funds and over-the-counter corporate equities, selling corporate debt

securities, underwriting corporate securities or participating in underwritings as a selling group member, and selling private placements, tax shelters and limited partnerships.

Sponsoring Firm 2 is a State 1 corporation with its principal place of business in State 1. Sponsoring Firm 2 was formed in 1991, and has been a member of NASD since 1995. Sponsoring Firm 2 presently has no Offices of Supervisory jurisdiction, and no branch offices. The firm is located in State 1. Sponsoring Firm 2 maintains that it employs four registered principals and one registered representative. Sponsoring Firm 2 represents that it is engaged in over-the-counter market making in corporate securities, proprietary trading, and acting as a municipal securities dealer.

C. Qualifications and Employment History of X

X has worked in the securities business since 1980. He is qualified as a general securities representative, financial and operations principal ("FINOP"), general securities principal, municipal securities principal, limited representative – equity trader, general securities principal, and uniform securities agent state law.

X is the President, Treasurer and FINOP of Sponsoring Firm 1. He is also the President, Treasurer and FINOP of Sponsoring Firm 2. Sponsoring Firm 1 and Sponsoring Firm 2 are "sister" corporations and they share the same address. Company C, which is not a broker-dealer, owns 100 percent of both Sponsoring Firm 1 and Sponsoring Firm 2. X is President and a Director of Company C. X controls or owns between 20 and 33 percent of Company C. X, therefore, has both a substantial indirect ownership interest in Sponsoring Firm 1 and Sponsoring Firm 2, and he is the most senior executive at both firms.

D. Disciplinary Histories

We begin by summarizing the disciplinary history of Sponsoring Firm 1 and X. We summarize Sponsoring Firm 2's disciplinary history at the end of this section.

1. *NASD Actions Against Sponsoring Firm 1 and X*

In 2003 NASD's Department of Market Regulation ("Market Regulation") filed a complaint against Sponsoring Firm 1 that alleged the following: from September 1999, through June 2000 Sponsoring Firm 1 failed to submit required information to the Order Audit Trail System ("OATS") on 191 consecutive business days; and from October 2000 through December 2000, Firm 1 failed to submit required information to OATS on 35 consecutive business days, in violation of NASD Marketplace Rule 6955(a) and Conduct Rule 2110. Market Regulation also alleged that Sponsoring Firm 1 failed to establish and maintain a supervisory system reasonably designed to achieve compliance with the applicable securities laws and regulations concerning OATS data submission in violation of NASD Conduct Rules 2110 and 3010. Finally, Market Regulation alleged that Sponsoring Firm 1 failed to accept or decline in the Automated Confirmation Transaction Service ("ACT") 1,399 transactions in eligible securities within 20 minutes after execution from October 2001 through December 2001 in violation of NASD Marketplace Rule 6130(b) and Conduct Rule 2110. The Hearing Panel for this matter held a hearing that concluded in 2003, but the Hearing Panel has not yet issued a final decision.

In 2003, an NASD Hearing Panel found that Sponsoring Firm 1 violated Section 10(b) of the Exchange Act, Exchange Act Rule 10b-5, and NASD Rules 2510, 2120, and 2110 by churning the account of a customer, as well as, violated Rules 3010 and 2110 by failing to reasonably supervise trading in this customer's account. The Hearing Panel also found that X failed to supervise the trading in the customer's account, in violation of NASD rules. This matter is currently on appeal to the NAC.

In2003, NASD issued Sponsoring Firm 1 a Letter of Caution ("LOC") for failure to provide NASD with a hard copy response to the information requested in a breakpoint survey letter.

In 1997, NASD issued Sponsoring Firm 1 an LOC for violations of NASD Conduct Rule 3380. NASD staff had reviewed preferenced SelectNet orders submitted by Sponsoring Firm 1 to a market maker or an ECN and subsequent cancellation of the orders prior to the minimum ten second time period. Sponsoring Firm 1 was not required to submit a letter in response to the LOC because the Nasdaq system was modified to inhibit the cancellation of SelectNet orders within ten seconds of entry.

In 1996, Sponsoring Firm 1 and X were censured, fined $25,000, jointly and severally, and required to make restitution to customers in the amount of $13,686.05, plus interest and costs of $1,750, jointly and severally. NASD found that Sponsoring Firm 1 manipulated the market in the common stock of an over-the-counter "Pink Sheets" company, in violation of NASD rules and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. NASD further found that Sponsoring Firm 1 charged excessive and fraudulent markups in violation of NASD rules, and Exchange Act Section 10(b) and Exchange Act Rule 10b-5. NASD also found that X and Sponsoring Firm 1 failed to establish, implement and enforce reasonable supervisory procedures designed to prevent the manipulation and markup violations, in violation of NASD rules. X was suspended in all capacities for 30 days and required to requalify by examination as a general securities principal within 90 days of the decision or be

suspended in all principal capacities until requalified. The matter was appealed to the SEC. In 1998, the SEC affirmed NASD's decision.

In 1995, NASD issued Sponsoring Firm 1 an LOC as a result of the firm entering approximately 137 orders in SelectNet to sell Company D shares at a price above the inside bid, the majority of which were equal to or above the inside ask price. This practice was alleged to have been a possible abuse of the SelectNet System, causing legitimate orders to scroll off the SelectNet screen sooner than normal.

In 1994, Sponsoring Firm 1 submitted a Letter of Acceptance Waiver and Consent ("AWC") to NASD. NASD alleged that Sponsoring Firm 1, acting through its principals and representatives, failed to comply with Exchange Act Rule 15c2-6 in that Sponsoring Firm 1 sold shares of Company E to non-established and non-accredited public customers in contravention of the rule's compliance requirements. In addition, the sales literature that was distributed to public customers was misleading and Sponsoring Firm 1, acting through its principals, failed to supervise a registered representative so as to ensure compliance with Exchange Act Rule 15c2-6.

In 1990, aN NASD District Business Conduct Committee issued a decision and Order of Acceptance of Respondents' Offer of Settlement. NASD had alleged that Sponsoring Firm 1, acting through X, failed to comply with Schedule C of NASD's By-Laws in that Sponsoring Firm 1, in violation of its restriction agreement with NASD, failed to obtain NASD's written approval prior to changing its method or system of clearance. Sponsoring Firm 1 had self-cleared at least 10 securities transactions for customers, and did not clear these transactions through its clearing agent as required. In addition, NASD alleged that for the periods ending October 1988 and November 1988, Sponsoring Firm 1, acting through X, failed to comply with Exchange Act Rule 15c3-3 in that Sponsoring Firm 1 failed to establish a Special Reserve Account for the Exclusive Benefit of Customers ("Special Reserve Account") as required, failed to calculate the amount required to be deposited in the Special Reserve Account and failed to make the required deposit to the Special Reserve Account. Sponsoring Firm 1 and X were censured and fined $2,000, jointly and severally.

In 1990, NASD's National Business Conduct Committee ("NBCC") accepted an AWC from Sponsoring Firm 1. The AWC alleged violations of Part IV, Section 4(a) of Schedule D of NASD's By-Laws, because the firm failed to report its Nasdaq volume. Sponsoring Firm 1 was fined $250.

2. *State Regulatory Actions Against Sponsoring Firm 1 and X*

The State 2 Commissioner of Securities issued an Order against Sponsoring Firm 1 and X in 1991. The Commissioner found that Sponsoring Firm 1 and X were selling unregistered securities to residents in State 2. Sponsoring Firm 1 was ordered (1) to cease and desist all violations of the State 2 Securities Act of 1973, (2) to file with the Commissioner within 30 days of its receipt of the Final Order acceptable supervision guidelines setting forth a written plan of supervision of its employees, agents, and salespersons, and (3) to pay a civil penalty in the amount of $25,000. X, in the Final Order, was ordered to cease and desist all violations of the State 2 Securities Act, and to pay a civil penalty in the amount of $10,000.

In 1991, the State 3 Securities Division issued a Cease and Desist Order against Sponsoring Firm 1 for offering unregistered securities to State 3 residents. The Cease and Desist Order was vacated in 1992.

3. *NASD Actions Against Sponsoring Firm 2*

In 2003, Sponsoring Firm 2 submitted an AWC to NASD and consented to a monetary fine of $2,000. NASD had alleged that Sponsoring Firm 2 reported transactions in OTC Equity Securities to ACT and failed to append the "S" modifier identifying the transaction as a short sale.

E. Member Regulation's Recommendation

In two letters dated September 2003, Member Regulation made the following recommendations. First, that NASD deny Sponsoring Firm 1's Application to continue its membership in NASD. Second, assuming that NASD allowed Sponsoring Firm 1 to remain a member, that NASD deny X's Application to remain associated with Sponsoring Firm 1. Third, that NASD deny X's Application to remain associated with Sponsoring Firm 2.

F. Discussion

After carefully reviewing the entire record in this matter, we deny each of the three Applications.

1. *Sponsoring Firm 1's Application*

In evaluating Sponsoring Firm 1's Application, we consider the key factors to be: (1) the nature, gravity, and recency of the permanent injunction; (2) Sponsoring Firm 1's substantial disciplinary history; and (3) Sponsoring Firm 1's failure to present a plan which demonstrated that the firm could maintain the high standards of compliance that we require of NASD members.

First, we consider Sponsoring Firm 1's permanent injunction to be extremely serious because it included findings that—among other things—Sponsoring Firm 1 manipulated the price of a stock and violated the antifraud provisions of the Securities Act and the Exchange Act. As the NAC recently

stated: "[M]arket manipulation is one of the most serious violations that a respondent can commit." Dep't of Market Regulation v. Elgindy, Complaint No. CMS000015, 2003 Discip. LEXIS 14, appeal pending, Amr "Tony" Elgindy, Admin. Proceeding File No. 3-11145 (SEC filed June 2, 2003). We find that Sponsoring Firm 1's permanent injunction is directly relevant to whether Sponsoring Firm 1 is committed to complying with the rules that govern NASD members. We conclude that Sponsoring Firm 1 lacks this commitment. Although the misconduct underlying the injunction took place in 1989 and 1990, Sponsoring Firm 1 became statutorily disqualified when the District Court enjoined it from future violations of the securities laws. Under NASD's By-Laws, the disqualifying event occurred in 2003 when the permanent injunction was entered; it is recent and serious in nature.

Sponsoring Firm 1's disciplinary history is recurring, diverse in terms of the nature of the violations and serious. Previously committed serious misconduct includes the 1996 finding by the NBCC that Sponsoring Firm 1 manipulated the market in the common stock of an over-the-counter "Pink Sheets" stock by using Sponsoring Firm 1's dominant and controlling position in the stock to establish, maintain, and then increase artificially the stock's price. The NBCC also found that Sponsoring Firm 1 charged fraudulent markups when selling the stock to Sponsoring Firm 1's retail customers.[3] The NBCC ordered Sponsoring Firm 1 to pay restitution of $13,686.05 plus interest to customers, fined the firm $25,000, and imposed a censure.

In addition, Sponsoring Firm 1 was ordered by the State 2 Commissioner of Securities to cease and desist all violations of the State 2 Securities Act in December 1991. The State 2 Commissioner of Securities found that Sponsoring Firm 1 had sold unregistered securities to residents in State 2.[4]

Another important factor in our analysis was Sponsoring Firm 1's failure to submit a proposed plan under which the firm would change its management to ensure compliance with securities laws and regulations. Such a plan is essential for us to consider thoroughly how the public interest would be served by granting an application. On the other hand, the complete absence of such a plan is a sufficient reason for us to reject this Application. At the hearing in this matter, X observed that Sponsoring Firm 1 would soon be going out of business and would be filing a withdrawal of its registration as a broker-dealer on Form BDW. We must, however, consider this matter as the facts and submissions of the parties stand today. It is possible, despite X's comments at the hearing, that Sponsoring Firm 1 could again conduct a securities business if it obtained sufficient net capital to do so. This possibility, and our intent to promote market integrity and investor protection, prompts us to deny Sponsoring Firm 1's Application.

2. *X's Association with Sponsoring Firm 1*

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[3] The SEC affirmed NASD's findings of violations and sanctions in 1998. See [CASE REDACTED].

[4] For purposes of our analysis, we have given no weight to NASD disciplinary actions that are pending before a Hearing Panel.

Because we deny Sponsoring Firm 1's Application to remain an NASD member, we also deny X's Application to remain associated with Sponsoring Firm 1. Sponsoring Firm 1 may not sponsor X or any other statutorily disqualified individual to associate with it.

3. *X's Association with Sponsoring Firm 2*

Sponsoring Firm 2 proposes to continue X's association with the firm as a FINOP. In evaluating Sponsoring Firm 2's Application to continue to employ X, we consider the key factors to be: (1) the nature, gravity, and recency of the permanent injunction against X; (2) X's serious disciplinary history; and (3) Sponsoring Firm 2's failure to demonstrate that X would be effectively supervised.

First, we find the permanent injunction against X to be serious, for the same reasons that we discussed in connection with Sponsoring Firm 1. The District Court's permanent injunction and findings of manipulation and fraud applied to X as a primary violator or as a supervisor. The District Court found that X was essential to the manipulation: "Group A could not have conducted this manipulative scheme alone; the success of this scheme was dependent upon the trading services of Sponsoring Firm 1, under the supervision of [X]." [CASE REDACTED].

Second, X's disciplinary history reveals a pattern of misconduct that causes us to question his ability to remain associated with any NASD member without significant risk that misconduct may continue, particularly in the absence of an effective supervisory plan for him. In 1996, the NBCC found that X failed to establish, implement and enforce reasonable supervisory procedures designed to prevent manipulation and excessive markups. While we understand that the NBCC did not find that X participated directly in the manipulation and excessive markups, he did fail to supervise. We find that X's connection with manipulative schemes—including the Company A securities manipulation and X's failure to implement supervisory procedures to prevent manipulation—establishes a pattern of violative conduct. In addition, we note and accept the District Court's finding on the issue of whether there is a reasonable likelihood that X will continue to engage in violations of the federal securities laws. The District Court found that the manipulation of Company A stock was "not an isolated event," because Sponsoring Firm 1, through X, had been associated with three other securities frauds[CASE REDACTED]. In light of X's lengthy and serious disciplinary history, we disapprove of Sponsoring Firm 2's Application to continue X's association with the firm.

Third, we deny Sponsoring Firm 2's Application to continue to employ X because we are not persuaded that the proposed supervisory plan is likely to be effective. Sponsoring Firm 2 proposed at the hearing that X remain associated with the firm only in the capacity of a FINOP.[5] Sponsoring Firm 2

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[5] In Sponsoring Firm 2's MC-400, it proposed that X continue to serve as Sponsoring Firm 2's President, Treasurer, and FINOP, and remain registered as a general securities principal and general securities representative. Because X could not be properly supervised while remaining President and FINOP of Sponsoring Firm 2, we disapprove of Sponsoring Firm 2's proposal as contained in its MC-

[Footnote continued on next page]

proposed that the Proposed Supervisor, its Director of Compliance, would supervise all of the firm's transactions and would make daily inquiries of X in his proposed role as FINOP. X's proposed role as FINOP of Sponsoring Firm 2 is one of critical importance and places him in a position of power and influence over Sponsoring Firm 2's activities. A firm's FINOP serves the vital function of monitoring a firm's net capital position and complying with the financial responsibility requirements under the federal securities laws and rules of self-regulatory organizations. In light of X's disciplinary history, we do not agree that he should continue to fulfill this important role at Sponsoring Firm 2. Moreover, Sponsoring Firm 2's Proposed Supervisor admitted that he did not have the relevant training or experience to supervise Sponsoring Firm 2's FINOP. X's proposal, made at the hearing, to have X's FINOP activities supervised by Employee 1, an associated person of Sponsoring Firm 2 who has passed the qualification examination for the Series 27 but is not designated as Sponsoring Firm 2's FINOP, is likewise insufficient. We find this proposal insufficient because of Employee 1's history as a subordinate and "student" of X and the fact that X, as a controlling shareholder of Sponsoring Firm 2's parent corporation and FINOP of Sponsoring Firm 2, would exert significant influence over Employee 1's employment at Sponsoring Firm 2. Under these circumstances, Sponsoring Firm 2's proposal does not meet our standards for effective heightened supervision of a statutorily disqualified individual.

Finally, in its post-hearing submission, Sponsoring Firm 2 indicates that it expects to be sold to new owners in the near future. Again, we must consider this matter based on the party's submissions and not on possible future events. Accordingly, we deny Sponsoring Firm 2's Application to permit X to continue to associate with Sponsoring Firm 2.

G. Conclusion

For the foregoing reasons, we find that: (1) it is not in the public interest for Sponsoring Firm 1 to remain a member of NASD; (2) it is not in the public interest for X to remain associated with Sponsoring Firm 1; and (3) it is not in the public interest for X to remain associated with Sponsoring Firm 2. Accordingly, we deny Applications SD-[XXXX], SD-[XXXX], and SD-[XXXX].

On Behalf of NASD,

Barbara Z. Sweeney
Senior Vice President and Corporate Secretary

[cont'd]
400. To the extent that X proposed to remain associated with Sponsoring Firm 2 as a general securities representative only, we deny this proposal based on the serious and recent nature of his permanent injunction and X's lengthy and serious disciplinary history.

LATER CASE HISTORY:

Sponsoring Firm 2 filed an application for review of this decision with the SEC. The SEC dismissed the appeal.