

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD

In the Matter of the  
Membership Continuance Application of  
  
Homeland Securities Financial Services  
Group, Inc.  
Louisville, Kentucky

**DECISION**

Application No. A8A050063

Dated: August 10, 2006

**Department of Member Regulation denied Firm's application seeking approval of a change in ownership and control. Held, the matter is remanded with specific instructions for Member Regulation to reconsider the application in a manner consistent with the NAC's directives.**

**Appearances**

For Homeland Securities Financial Services Group, Inc.: Alan M. Wolper, Esq.

For NASD's Department of Member Regulation: Kevin Kulling, Esq., Mark Koerner, Esq.

**Decision**

Pursuant to Membership and Registration Rule 1015(a), Homeland Securities Financial Services Group, Inc. ("Homeland Securities" or "the Firm") appeals from a January 19, 2006 decision of NASD's Department of Member Regulation ("Member Regulation") denying the Firm's application to transfer a 100% ownership interest ("the Application").<sup>1</sup> After conducting a hearing and reviewing the record, we vacate Member Regulation's decision and remand the matter for reconsideration of the Application in light of our specific findings and directives as stated in this decision.

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<sup>1</sup> NASD Membership and Registration Rule 1017(a)(4) requires a member to apply for approval of "a change in the equity ownership or partnership capital of the member that results in one person or entity directly or indirectly controlling 25 percent or more of the equity or partnership capital."

## **I. BACKGROUND**

### **A. The Firm and Its Principals**

#### **1. The Firm**

On December 17, 2004, Homeland Holding Company, LLC (“HHC”), a Kentucky limited liability company, entered into a “Stock Purchase Agreement” to purchase 100% of the outstanding capital stock of The MerchantHouse Securities, Inc. (“MerchantHouse”), an NASD member firm and Delaware corporation. The purchase price of \$54,000 was payable with \$20,000 deposited into an escrow account as a good faith deposit and the balance of \$34,000 due by the closing date. The sale was effected on the closing date, February 10, 2005.

HHC’s principals are Mandy Ward (“Ward”) (90% ownership interest), Thomas Nelson (“T. Nelson”) (5% ownership interest), and Dawn Nelson (“D. Nelson”) (5% ownership interest), T. Nelson’s wife. The new owners changed MerchantHouse’s name to Homeland Securities in February 2005. The main office of the Firm is located at 9960 Corporate Campus Drive, Suite 1400, Louisville, Kentucky.

The Firm’s Business Plan states that the Firm will engage primarily in the sale of private placements of oil and natural gas drilling programs to “accredited business owners, individuals or entities or individual investors, business owners or entities who meet the net worth suitability requirements.”

#### **2. Mandy Ward**

Ward is not registered in the securities industry in any capacity and the Business Plan does not propose that she will be actively involved in the Firm’s management. Ward also has no history of investing in, owning an interest in, or having any other involvement with a broker-dealer. She is reported on the Firm’s Uniform Application for Broker-Dealer Registration (“Form BD”) as a control person of HHC.

#### **3. Thomas Nelson**

T. Nelson is the Firm’s proposed president, chief compliance officer, and executive representative, and he is the designated principal responsible for the supervision of private placements. He has been registered as a direct participation programs limited representative (Series 22) and a uniform securities agent state law (Series 63) since April 1997, selling only direct participation drilling programs. He was approved as a direct participation programs limited principal (Series 39) in February 1998. T. Nelson failed the introducing broker-dealer financial and operations principal examination (Series 28) in June 2005. He was previously associated with an NASD member firm, Tidal Petroleum, Inc. (“Tidal Petroleum”), from 1998 until September 2004.

#### 4. Dawn Nelson

D. Nelson is the Firm's proposed vice president and secretary. She also has been registered as a direct participation programs limited representative and a uniform securities agent state law since April 1997, selling only direct participation drilling programs. She was also previously associated with Tidal Petroleum from 1998 until September 2004. She passed the direct participation programs limited principal examination on April 25, 2005.

#### B. Homeland Securities' Initial Membership Continuance Application

The Firm initially submitted its Application on January 4, 2005, with NASD's Kansas City District No. 4 office. NASD reassigned the Application to the Chicago District No. 8 office on January 7, 2005, after determining that the Firm intended to relocate its main office from Kansas to Kentucky.<sup>2</sup>

The Application was accompanied by various documents, including the Firm's Business Plan; pro-forma financial statements; written supervisory procedures; business continuity plan; anti-money laundering compliance program; annual needs analysis for 2005; continuing education needs program; pro-forma Form BD; the Stock Purchase Agreement; a letter from Ward stating that she did not plan to be involved with the management of the Firm; and Central Registration Depository ("CRD<sup>®</sup>") information for T. Nelson and D. Nelson.

Homeland Securities stated in its Business Plan that:

[HHC] stands as a source of strength for the Firm and is the source of all future anticipated and unanticipated needs for capital. No additional external sources of capital that may affect the control of the Firm are anticipated. [HHC] will allocate an available equity financing amount of \$100,000 should the need arise over the first two years of operations.

#### C. Member Regulation's Requests for Additional Information

On February 3, 2005, Member Regulation requested that the Firm provide additional information in support of its Application. Among other things, Member Regulation asked that the Firm supply bank statements and checks to demonstrate that HHC has the "financial capability and resources" for the \$100,000 funding commitment stated in the Business Plan.

The Firm responded on March 2, 2005, submitting a copy of an authorization dated February 10, 2005, for HHC to borrow up to \$100,000 from Ward to capitalize and fund the

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<sup>2</sup> The Firm filed a Form BD amendment on March 2, 2005, changing its main office address to Louisville, Kentucky.

Firm's operations, as necessary. The Firm also submitted a copy of a bank statement from Fifth Third Bank, Louisville, Kentucky ("HHC's Bank Account"), showing a balance of \$109,517.75 on February 23, 2005, with deposits made from January 18, 2005, through February 23, 2005. The Firm stated in its cover letter that this statement was from HHC's Bank Account, although the only name that appears on it is Ward's. Finally, the Firm provided a copy of a bank statement for Homeland Securities from Fifth Third Bank ("Homeland Securities' Bank Account"), showing a deposit of \$10,000 on January 21, 2005.

On May 2, 2005, Member Regulation made a second request for additional information, asking the Firm to provide copies of HHC's Bank Account statements from January 31 through April 30, 2005, and to provide the source documents (i.e., copies of checks) for any deposits made to HHC's Bank Account since January 18, 2005.

The Firm responded on May 13, 2005, providing a copy of an account summary for Homeland Securities' Bank Account, showing a balance of \$16,997.10 as of April 29, 2005. The Firm provided a deposit reconstruction statement from Fifth Third Bank for HHC's Bank Account, showing a deposit of \$3,718.04 on February 7, 2005, and a copy of a cancelled personal check written by Ward in that amount on February 7, 2005. The Firm also provided a second deposit reconstruction statement from Fifth Third Bank for HHC's Bank Account, showing a deposit of \$90,000 on January 18, 2005, with mostly illegible copies of 11 checks that the Firm stated was "evidence supporting the requested deposits." The Firm acknowledged that "[t]he printouts from the bank are a little difficult to read, but the source of all of the funds was Ms. Mandy Ward. Upon examining the checks, you will see that most checks originated from Ms. Ward's account ending in [ ]."

Unsatisfied with the financial information provided, Member Regulation sent the Firm a third request for additional information on June 13, 2005, stating that the copies of the checks sent by the Firm on May 13, 2005, were "almost unreadable." Member Regulation stated that it needed further information "[t]o try and understand what is printed on these checks." Since the Firm had represented that the illegible checks had originated from Ward's account, Member Regulation therefore requested copies of Ward's checking account ("Ward's Personal Account") statements from January 2005 to June 2005. Member Regulation also asked the Firm to prepare a list of Ward's Personal Account checks that included "who the check is made payable to and who signed the check and their relationship to the Firm or to Ward." Member Regulation also asked for copies of Ward's 2003 and 2004 federal income tax returns.

On June 17, 2005, the Firm provided Member Regulation with copies of Ward's 2003 and 2004 federal income tax returns and "more legible copies of the checks" relating to the capital infusions made to HHC by Ward from January 18 through February 23, 2005. At this time, the Firm clarified that the checks were not drawn from Ward's Personal Account as previously indicated, but rather were cashier's checks signed by employees of National City Bank.

On June 28, 2005, Member Regulation sent a fourth request for additional information to the Firm, stating that it had repeatedly requested information and documents regarding the "ultimate source of funds that will support the Broker/Dealer." Member Regulation noted that

the most recent information provided by the Firm related to the cashier's checks, and Member Regulation therefore asked the Firm to provide the names of the persons or entities that had funded the cashier's checks or had contributed, or planned to contribute, to financing the Firm's business.

On July 1, 2005, the Firm responded and again provided Member Regulation with copies of the 11 cashier's checks. The Firm stated that Ward had funded these cashier's checks from her home equity line of credit ("Home Equity Account"), and that therefore there was "no corresponding bank statement." The Firm provided a prepared list of seven Home Equity Account checks and copies of the front side only of seven Home Equity Account checks, made payable to and signed by Ward, for varying amounts: 1) Home Equity Account check #1013 for \$20,000 on October 26, 2004; 2) Home Equity Account check #1018 for \$35,000 on December 31, 2004; 3) Home Equity Account check #1014 for \$20,000 on November 2, 2004; 4) Home Equity Account check #1017 for \$16,300 on December 14, 2004; 5) Home Equity Account check #1015 for \$20,000 on November 16, 2004; 6) Home Equity Account check #1016 for \$25,000 on November 29, 2004; and 7) Home Equity Account check #1019 for \$35,000 on February 23, 2005. There was no indication on any of the copies that the checks had been processed and cashed. The Firm also provided a copy of a cancelled check from Ward's Personal Account for \$3,718.04 on February 7, 2005. The Firm stated that these checks had either been deposited directly into HHC's Bank Account, or had been used to purchase the cashier's checks previously provided to Member Regulation. The Firm represented that the 11 cashier's checks and the one personal check from Ward had "ultimately funded [HHC]."

In a letter dated July 5, 2005, Member Regulation notified the Firm that its Application was "considered to be lapsed" pursuant to NASD Rule 1012(b)(1)(A) or (B) because the Firm had failed to provide adequate information and documentation regarding the nature and source of the Firm's capital. Member Regulation further advised the Firm to submit a new Application if it wished to continue to seek approval for the change in ownership.

D. Homeland Securities' Renewed Membership Continuance Application

On August 4, 2005, the Firm renewed its Application with Member Regulation.<sup>3</sup> The Firm indicated its surprise that copies of the checks drawn on the Home Equity Account bearing the name of Ward as the account holder were insufficient evidence of the nature and source of the Firm's capital. The Firm also stated that Member Regulation's requests "at times, appear to be over-burdensome in nature." Nonetheless, "to retort [Member Regulation's] expressed allegation that an undisclosed individual funded the purchase of [the Firm]," Homeland Securities provided evidence to demonstrate that Ward was the owner of the Home Equity Account. The Firm submitted a copy of a Quitclaim Deed, dated September 15, 1999, for a house that Ward had received in a divorce property settlement with her former husband. The

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<sup>3</sup> Pursuant to Membership and Registration Rule 1012(b)(2), "[i]f an Applicant wishes to continue to seek . . . approval of a change in ownership, . . . then the Applicant shall be required to submit a new application and fee."

Firm provided further documentation to show that the house had been used as collateral to fund the Home Equity Account opened on October 13, 2003, for \$175,000, with Ward as the sole borrower and signatory. The Firm also stated that HHC's Bank Account shows that it was funded with an initial deposit of \$90,000, which had come from the cashier's checks purchased by Ward with the funds from her Home Equity Account. The Firm explained that Ward had used cashier's checks as a matter of convenience to expedite her purchase of a broker-dealer by avoiding any delay that might be caused while waiting for a check to clear. The Firm provided another statement for HHC's Bank Account for February 2005 that showed additional deposits totaling \$93,718.04, which the Firm stated had been comprised of three checks drawn from the Home Equity Account and one check from Ward's Personal Checking Account.

A Membership Interview was held on November 21, 2005, pursuant to Membership and Registration Rule 1017(f). At the Membership Interview, it was learned, for the first time, that the Home Equity Account had been substantially paid down from its original \$175,000 amount. At the conclusion of the Membership Interview, Member Regulation staff gave the Firm a "Membership Interview Exit Checklist," which T. Nelson later signed and dated December 6, 2005, that requested further information regarding the Home Equity Account, namely a "list of all payments made to the Home Equity Loan, beginning with the original \$90,000 loan amount, the date and amount of each payment and the source of funds for each payment." The Membership Interview Exit Checklist also requested the Firm to "provide independent documentation supporting each and every payment and reflecting its source."

On December 16, 2005, the Firm sent a letter to Member Regulation in response to the Membership Interview Exit Checklist. The Firm confirmed that Ward's Home Equity Account had been paid down a total of \$169,250 since January 3, 2005. The Firm indicated that on that date, Ward entered into an "Installment Purchase Agreement" to sell two antique automobiles to Drill Quest, L.P. ("Drill Quest"), an Oklahoma limited partnership, for \$169,250. Ward requested that Drill Quest make installment payments during the ensuing nine months directly to the Home Equity Account because she was "constantly traveling," and this arrangement would "relieve her of having to receive the check herself and subsequently submit it to the bank." The Firm stated that it was unable to submit copies of the cancelled Drill Quest checks because it could not get copies of third party checks from the bank. The Firm also submitted copies of the titles to the two antique automobiles, showing Ward as the owner as of October 23, 2002, and a letter from National City Bank stating that the balance on the Home Equity Account as of December 14, 2005, was \$35,126.47.

In its December 16, 2005 cover letter to Member Regulation, the Firm also discussed the ownership structure of Drill Quest. The Firm explained that Drill Quest had been formed to act as a holding company that would purchase and hold assets of its owners, Joyce Rose (90%), Brian Rose (5%), and Jason Rose (5%). Joyce Rose was stated to be the ex-wife of David Rose, and the mother of Brian and Jason Rose. According to documents in Member Regulation's files at that time, David Rose (who is the father of Brian and Jason Rose) is an individual with an extensive disciplinary history of cease and desist and consent orders from various states regarding violative sales of oil and gas interests, for several different companies, including

enTerra Energy (“enTerra”).<sup>4</sup> The Firm stated that “David Rose is not affiliated in any form or fashion with [Drill Quest] and has no ownership in the limited partnership,” and that “neither David Rose, [or] enTerra Energy . . . is affiliated in any form or fashion with [Homeland Securities] or [HHC], nor do they have ownership in either entity.” The Firm stated that although Brian Rose does not have ownership in Homeland Securities or HHC, he is the managing director of Jupiter Energy, LLC (“Jupiter Energy”), “an issuer for who[m] [Homeland Securities] intends to raise capital.” The Firm also stated that David Rose “is not affiliated in any form or fashion with Jupiter Energy, LLC and has no ownership in the company.”

On December 21, 2005, the Firm forwarded to Member Regulation net capital computations and copies of financial records for the Firm from January 1, 2005, through October

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<sup>4</sup> The record contains a copy of a complaint for permanent injunction filed by Kentucky securities authorities against David Rose and enTerra in July 2004, alleging failure to register securities, offers and sales of securities by unregistered agents, and inadequate disclosure in the offering of such securities. One of the addresses listed for David Rose on the face of this complaint is 9960 Corporate Campus Drive, Suite 1400, Louisville, Kentucky, which is the same address listed for Homeland Securities in its Application materials.

In addition, the record contains copies of numerous cease and desist and consent orders from various state securities authorities against David Rose and his previous firm, Robo Exploration (f/k/a Robo Enterprises), including: 1) Ohio (September 1999) (cease and desist order for failing to register securities or claim exemption from registration); 2) Maryland (July 1999) (cease and desist order for sales of unregistered securities by unregistered sales agents and for making material misrepresentations or omissions in connection with such offers or sales); 3) Pennsylvania (August 1998) (cease and desist order for failure to disclose recent disciplinary history and administrative proceedings in other states); 4) Wisconsin (July 1998) (order of prohibition for fraud in the offer of securities and offers by an unlicensed agent); 5) Illinois (March 1997) (consent order for violation of Illinois securities laws in connection with placement of advertising seeking capital for development of natural gas wells); 6) Kansas (January 1997) (cease and desist order for unregistered offers by unregistered sales agents to sell securities); 7) South Dakota (cease and desist order February 1994, cease and desist order December 1996, and consent order April 1998) (for sales of unregistered securities to South Dakota residents); and 8) Kentucky (September 1989) (cease and desist order for sales of unregistered securities by unregistered sales agents).

The record also indicates that T. and D. Nelson had consulting agreements with enTerra from September 2004 through June 2005.

At the March 23, 2006 membership appeal hearing before the subcommittee of the NAC (“Subcommittee”) assigned to this matter, counsel for the Firm confirmed that all of these documents had previously been presented to the Firm during the proceeding before Member Regulation, in accordance with Rule 1017(f).

31, 2005; financial records for HHC from January 1, 2005, through October 31, 2005; and FOCUS reports for the Firm.

E. Member Regulation's Denial of Homeland Securities' Renewed Application

On January 19, 2006, Member Regulation denied the Firm's Application for a change in ownership and control because it "did not fully meet each of the standards contained in Rule 1014."<sup>5</sup> Member Regulation concluded that the Firm's Application was not "complete and accurate," as required by Membership and Regulation Rule 1014(1)(1), because "the source of funding documents submitted by the [Firm] . . . did not provide adequate information as to the nature and source of the [Firm's] capital."

Member Regulation stated in its decision that, during the Membership Interview, staff discovered that the Home Equity Account that had been drawn on indirectly to fund the Firm had been substantially paid down. Upon questioning by Member Regulation staff, Ward stated that she had made payments to the Home Equity Account with cash she kept at home. Member Regulation noted, however, that in correspondence subsequent to the Membership Interview the Firm indicated that Ward had not made the payments with cash but, rather, Drill Quest had made payments to the Home Equity Account for the purchase of two antique automobiles from Ward. Member Regulation noted further that the Firm had not provided any evidence to support the payments by Drill Quest, and had not supplied statements for the Home Equity Account. Member Regulation thus concluded that the Firm failed to provide "adequate information regarding the source of funding [of the Firm]," and had "provided misleading information to [Member Regulation] related to the source of funding."

F. Request for NAC Review

Pursuant to Membership and Registration Rule 1015(a), on February 13, 2006, the Firm filed a written request for review of Member Regulation's decision and a hearing. The Firm requests that we reverse Member Regulation's denial of its Application, or remand the matter to Member Regulation with instructions.

First, the Firm states that Member Regulation placed unnecessary emphasis on the fact that it had to make supplemental requests for information following the Firm's initial submissions.

Second, the Firm claims that Member Regulation was wrong to conclude that the paydown of the Home Equity Account was suspicious, or that Ward had contradicted herself by stating at the Membership Interview that she had used her cash to make the payments and then later supplied documents to indicate that Drill Quest had paid down the Home Equity Account.

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<sup>5</sup> Membership and Registration Rule 1017(g) requires that, in rendering a decision on an application, Member Regulation shall consider whether the applicant and its associated persons meet each of the 14 standards for NASD membership set forth in Rule 1014(a).



Third, the Firm states that Member Regulation incorrectly denied its Application because Ward could not produce copies of the Home Equity Account statements or copies of the cancelled Drill Quest checks used to pay down a portion of the Home Equity Account.

G. NAC Hearing

On March 23, 2006, pursuant to Membership and Registration Rule 1015(f), the Subcommittee held a hearing in connection with the Firm's Application. The NAC Subcommittee admitted into evidence 18 exhibits on behalf of the Firm (Exhibits #1-15, and 17-19), and 17 exhibits on behalf of Member Regulation (Exhibits #1-6, and 8-18).<sup>6</sup> We summarize below the evidence presented by the parties.

1. Homeland Securities Witness Mandy Ward

Ward testified that she worked for National City Bank in an executive position in operations for 27 years and accepted a severance package in January 2006. Beginning in early 2004, she began to examine different investments that she might make as she approached retirement age – preferably businesses in which she would not have to be involved on a daily basis. After discussions with a friend, she decided to invest in a broker-dealer, to look for a suitable firm to buy, and to search for people to operate it. She interviewed different people in late 2004 and concluded that T. and D. Nelson were properly experienced people to run a securities firm. At the same time, she was working with a lawyer to find a broker-dealer to purchase. She formed HHC on December 15, 2004, for the purpose of purchasing a broker-dealer, and signed the Stock Purchase Agreement with MerchantHouse on December 17, 2004.

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<sup>6</sup> Member Regulation objected to the Firm's submission of Exhibits #14, #15, #16, and #18. The Firm later withdrew its submission of Exhibit #16.

The Firm objected to the submission of Member Regulation's Exhibit #17.

The Subcommittee determined to admit all of the Firm's exhibits (except Exhibit #16, which had been withdrawn) for the purposes of the hearing and to accord them whatever weight it later determined to be necessary. The Subcommittee also determined to admit all of Member Regulation's exhibits (except Exhibit #7, which had been withdrawn) for the same reason, and to admit Member Regulation Exhibit #17 for the purpose for which it was offered – to demonstrate that the address of the Firm listed in the Business Plan was the same as the address for David Rose listed on the cover page of the Kentucky complaint for permanent injunction. We affirm these rulings by the Subcommittee. In light of our decision to remand this matter for further evidence to be gathered on the issue of the source of funding of the Firm, however, we need not rule further on the substance of this evidence. Rather, we encourage Member Regulation to consider these documents in connection with any other information collected during the remand proceeding for this case.

Ward stated that she was aware during late 2004 that she would need funds to purchase the broker-dealer. She knew she had had the \$175,000 Home Equity Account since 2003, and she therefore decided to write several checks to herself from that account for the later purchase of cashier's checks to fund the purchase of the broker-dealer. Ward stated that she realized from her years in the banking industry that a bank might put a holding period on a personal check, and she wanted to be able to have the funds immediately available to her when she found the appropriate broker-dealer. Ward admitted on cross-examination by Member Regulation staff, however, that she probably could have obtained a cashier's check within one day of finding an appropriate broker-dealer. Ward also was unable to explain why she wrote the Home Equity Account checks as early as October and November 2004, but did not obtain a cashier's check until December 31, 2004 or January 25, 2005. Ward stated that she wrote the Home Equity Account checks to herself, converted them to cashier's checks, and kept the cashier's checks at home in her safe until she needed them. Ward admitted that she had produced only the front sides of the Home Equity Account checks, and that she had obtained those copies not from the bank, but from the carbon copy produced in her checkbook when she wrote the checks. She admitted that the front sides of these checks did not show that they had been cashed. She also admitted that she had not produced any statements from the Home Equity Account to show that funds had been withdrawn from the account when she wrote the checks.

Ward then described the funding of HHC, and ultimately Homeland Securities, as follows. On January 18, 2005, she made a \$90,000 deposit into HHC's Bank Account. Ward stated that the \$90,000 deposit was comprised of funds derived from: 1) a \$20,000 Home Equity Account check dated October 26, 2004, which she deposited into Ward's Personal Account and then wrote a personal check for \$20,000 to HHC's Bank Account on January 18, 2005; 2) a \$35,000 Home Equity Account check dated December 31, 2004, which she used to purchase four cashier's checks in the amounts of \$5,000, \$5,000, \$5,000, and \$20,000 that were deposited into HHC's Bank Account; and 3) two Home Equity Account checks dated November 2, 2004 and December 14, 2004, respectively, totaling \$36,000, of which she used \$35,000 to purchase six cashier's checks in the amounts of \$5,000, \$5,000, \$5,000, \$5,000, \$5,000, and \$10,000 to deposit into HHC's Bank Account.<sup>7</sup> Ward testified that the monies deposited into HHC's Bank Account were later deposited into Homeland Securities' Bank Account. She explained that this had been accomplished through a series of "actions by written consent" by HHC to deposit funds into the Firm's account and withdrawals of various amounts from HHC's Bank Account. She then identified a series of statements from Homeland Securities' Bank Account showing deposits made.

Ward further testified that she has collected antique automobiles for several years and is particularly passionate about 1950's vintage convertibles. She stated that she owned six cars and decided in January 2005 to sell two of them to pay back her Home Equity Account. Ward

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<sup>7</sup> In response to questions from the Subcommittee, Ward stated that she had obtained numerous cashier's checks in varying amounts, rather than one large cashier's check, because she was not certain at the time how much money she would need at any given time. She also stated that she wanted the flexibility to use the money for other reasons, such as home repairs.

admitted to Member Regulation staff on cross-examination, however, that she had not mentioned the sales of the automobiles in connection with the funding of the broker-dealer at any time in the Application process until the December 16, 2005 letter from the Firm to Member Regulation.<sup>8</sup> Ward previously discussed with Brian Rose his interest in those cars. She stated in response to a question from the Subcommittee that she did not make any attempt to find or contact other potential purchasers of the automobiles. On January 3, 2005, she signed the Installment Purchase Agreement to sell the cars for \$169,250. The Installment Purchase Agreement was between Ward as seller and Drill Quest as buyer, and Jason Rose, not Brian Rose, signed the document on behalf of Drill Quest. Ward stated that she knew, however, that Brian Rose had an ownership interest in Drill Quest. Ward testified that she arranged to transfer title to the two automobiles after the payment of the final installment within nine months of the January 3, 2005 Installment Purchase Agreement. The title transfers showed August 1, 2005, as the date of transfer of title from Ward to Drill Quest.

Ward stated that she arranged for Drill Quest to make the installment payments for the automobiles directly to the Home Equity Account because she would be traveling a lot for work and did not want to be inconvenienced by having to accept the checks and then make her own deposits. Ward admitted, however, that she had not made arrangements such as this for any of her other financial obligations at the time, and she mentioned that her mother paid bills for her when she was out of town. Ward stated that on December 16, 2005, the Firm submitted to Member Regulation a schedule of the payments made by Drill Quest to the Home Equity Account. Ward testified that she did not have copies of the cancelled checks from Drill Quest, and that she had thus far been unable to obtain 2005 statements from the bank for the Home Equity Account. Ward stated that she had received statements for the Home Equity Account periodically throughout 2005 and had been able to verify that the installment payments had been made, but that she had not kept copies of those statements.

In response to a question from the Subcommittee, Ward stated that she had never requested that Drill Quest provide copies of the cancelled checks paid to the Home Equity Account. Ward admitted on cross-examination that she had not attempted to obtain statements for the Home Equity Account until January 2006. She also admitted that she had been able to obtain statements for Homeland Securities' Bank Account and HHC's Bank Account and had produced them at Member Regulation's request. She testified, however, as to the various efforts she had made to obtain 2005 Home Equity Account statements since early January 2006, and the mistakes made by the bank in obtaining them. She stated that thus far, she had only been able to get a March 21, 2006 letter from the bank (Firm Exhibit #18) apologizing for the delay and listing some information about payments made to the account in 2005: \$12,500 on April 20, 2005, and \$16,750 on July 21, 2005. Ward maintains that these amounts correlate to Drill

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<sup>8</sup> Ward maintained, however, that Member Regulation staff had not asked any questions until that time that would have prompted her to give this information. She asserted that she would have produced all of this information earlier if she had understood that Member Regulation staff wanted it.

Quest's installment payments for the cars as listed on the schedule the Firm provided to Member Regulation on December 16, 2005.

Ward testified that she never tried to conceal information from Member Regulation, that she answered all questions to the best of her ability, and that she provided all documentation that she understood Member Regulation to be requesting. Ward recalled that she attended the Membership Interview with T. and D. Nelson on November 21, 2005. She denied, however, that she had seen a letter to Member Regulation dated November 8, 2005, signed by T. Nelson, that stated that they would bring to the meeting "the Firm's financials . . . that reflect the full funding of the Firm." She stated that during the Membership Interview staff had pressed her to answer questions about the amounts paid down on the Home Equity Account even though she had said she was reluctant to answer without having access to her documents. She did not specifically recall stating that she had used her cash to pay down the Home Equity Account, but she stated that she had been unable to recall the balance of the Home Equity Account at the time, and what percentage may have been paid down in cash or check. She testified that, if she had understood during the Membership Interview that staff wanted her to explain where she had gotten the money to pay down the Home Equity Account, she would have informed them of the automobile sales and the Installment Purchase Agreement. In response to questioning from the Subcommittee, Ward admitted that she had previously used the Home Equity Account for home remodeling costs and had never used more than \$20,000 from the account at one time.

Ward also testified that after the Firm supplied Member Regulation with documentation on December 16 and 21, 2005, in response to the Membership Interview Checklist, Member Regulation did not contact her again to request further documentation. Ward stated that she would have agreed to an extension of time with Member Regulation staff in order to secure any other documents that Member Regulation needed.<sup>9</sup> Instead, Ward stated that the next time she heard from Member Regulation was the written denial of the Application on January 19, 2006.

## 2. Homeland Securities Witness Brian Rose

Brian Rose testified that he has been in the oil and gas exploration business for his entire adult life. He stated that he has an ownership interest in Drill Quest, along with his mother and his brother, Jason Rose, but that his father, David Rose, does not have any interest in Drill Quest.

Brian Rose stated that he agreed to purchase Ward's two antique automobiles in January 2005. He stated that he believed that he paid less than fair market value for the cars, and that he did not know if Ward had made a profit on the sale. He asserted that his father was not involved in the purchase of the automobiles. Brian Rose testified that Drill Quest made regular

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<sup>9</sup> Membership and Registration Rule 1017(g)(3) provides that if Member Regulation fails to serve a decision within 180 days after the filing of an application "or such later date as [Member Regulation] and the Applicant have agreed in writing, the Applicant may file a written request with the NASD Board requesting that the NASD Board direct [Member Regulation] to issue a decision."

installment payments to National City Bank to pay down the Home Equity Account because Ward had requested that this be done as a convenience to her. He stated that Drill Quest's account was a business account, that his mother was authorized to and had signed the checks, and that he delivered the checks to National City Bank in person. He did not get any receipts from the bank for the payments. Brian Rose stated that Drill Quest had never purchased any other automobiles, and that he did not have with him, and had not looked for, copies of Drill Quest's 2005 bank statements or copies of the cancelled checks. Brian Rose also acknowledged that the Installment Purchase Agreement mentioned 5% interest, but he stated that the checks had not included interest payments and that he had no discussions with Ward about paying any interest due under the Agreement. Brian Rose admitted that the January 3, 2005 Installment Purchase Agreement did not specify exact dates for the payments to be made, but that he had tentatively set a schedule and tried to adhere to it. He stated that the schedule of payments made by Drill Quest to the Home Equity Account that the Firm had previously provided to Member Regulation on December 16, 2005, was correct.

## II. DISCUSSION

After thoroughly reviewing all of the issues, including the parties' arguments, testimony, and documents submitted at the hearing in this matter, we have determined to vacate the denial of the Application and remand this matter to Member Regulation. In so doing, we instruct Member Regulation to focus on the following information in conducting its review on remand. Specifically, we direct Member Regulation to review the documents that the Firm submitted on the issue of the source of funding of the Firm subsequent to Member Regulation's January 19, 2006 denial of the Application. We also direct Member Regulation to determine which documents and other information it may still need on the issue of the source of funding of the Firm, and to continue to negotiate with the Firm and request further documents and information that it believes it needs in order to satisfy any concern it has with the sources and legitimacy of funding for the Firm.

### A. Legal Standards

NASD Membership and Registration Rule 1017(a) requires a member to file with NASD an application for approval of certain changes in its ownership, control, and business operations. Pursuant to Rule 1017(a)(4), Homeland Securities applied to request Member Regulation's approval of a 100% change in the Firm's ownership and control. In examining the Firm's Application, Member Regulation was required to determine if Homeland Securities and its associated persons met, and would continue to meet upon approval of the Application, the standards for admission to NASD membership set forth in Membership and Registration Rule 1014(a). See NASD Membership and Registration Rule 1017(g)(1). An applicant for a change in ownership bears the burden of establishing the merits of its application and, in particular, that it meets, and will continue to meet, each of the 14 standards for membership approval contained in Rule 1014(a). See *Sierra Nev. Sec., Inc.*, Complaint No. M01970005, 1998 NASD Discip. LEXIS 24, at \*14-15 (NAC May 11, 1998) (rejecting argument that an applicant need not satisfy each of the standards in Rule 1014), *aff'd*, 54 S.E.C. 112 (1999). Member Regulation is authorized to grant or deny an application, in whole or in part. Rule 1017(g)(2).

In general, the standards set forth in Membership and Registration Rule 1014(a) are intended to ensure that members under new ownership will continue to be capable of satisfying all relevant regulatory requirements for the protection of the investing public, the securities markets, the firm, and other member firms.

B. NAC Analysis

Member Regulation denied the Firm's Application on the ground that the Application and its supporting documents were not complete and accurate, as required by Membership and Registration Rule 1014(a)(1). Whether an application is "complete" depends upon whether it contains all of the information and documents that are required to be submitted. In a membership continuance application such as is at issue in this case, Membership and Registration Rule 1017(b)(2) requires an applicant to "describe in detail the change in ownership, control, or business operations and include a business plan, pro forma financials, an organizational chart, and written supervisory procedures reflecting the change." In addition, Rule 1017(b)(2)(A) requires an application to "include the names of the new owners, their percentage of ownership, and the sources of their funding for the purchase and recapitalization of the member." Other application requirements may be contained in any requests for additional information propounded by Member Regulation. *See* Membership and Registration Rule 1017(e).

In this case, Member Regulation made four requests for additional information regarding the source of the Firm's funding between the Firm's filing of the initial Application in January 2005, and Member Regulation's decision to lapse the initial Application due to incomplete information on July 5, 2005. When the Firm renewed its Application in August 2005, it supplied further information to Member Regulation on the funding question. Each time Member Regulation made a request for additional information from the Firm, a new wrinkle seemed to develop in a complicated financial trail involving Home Equity Account checks, cashier's checks, and Ward's Personal Account checks. During the Membership Interview on November 21, 2005, another wrinkle developed when Member Regulation inquired as to whether the Home Equity Account had been paid down. This question led to more documentation being requested by Member Regulation staff and to the Firm's production of the Installment Purchase Agreement for Drill Quest to purchase two antique automobiles from Ward and Drill Quest's alleged direct payments to the Home Equity Account.

The Firm alleges that it supplied the requested documentation to Member Regulation in a full and timely manner on each occasion, and that Member Regulation carried its investigation of the source of the Firm's funding to unnecessary levels. Member Regulation alleges that the Firm did not supply adequate information and had, indeed, provided misleading information in response to its requests. Member Regulation contends that it was justified in denying the Application because the Firm had not supplied sufficient information within the time period provided.

We conclude that, based on the record that was amassed before Member Regulation from August through December 2005, Member Regulation had a legitimate concern regarding the source of the Firm's funding and the circumstances surrounding the purchase of the Firm, and

therefore properly pursued further investigation into that issue. The Firm submitted its Business Plan in January 2005, which stated that HHC was the Firm's "source of all future anticipated and unanticipated needs for capital," and that "[n]o additional external sources of capital that may affect the control of the Firm are anticipated." Ward has maintained that David Rose has no connection with Homeland Securities, HHC, or Jupiter Energy. Yet there were suggestions in the record of connections between Ward and David Rose, a person with a substantial securities disciplinary record in the very area that Homeland Securities wished to enter – sales of oil and gas programs. For example, after testifying at the hearing that she got the idea for investing in a broker-dealer from "friends," on cross-examination, Ward admitted that the only "friend" with whom she spoke about investing in a broker-dealer was David Rose.

Ward also stated that although she was aware that David Rose and enTerra had operated out of the same building as Homeland Securities, she could not confirm that the suite number for the offices was the same as indicated on the cover page of the pending Kentucky action for permanent injunction against David Rose and enTerra. Ward was also unable to answer why enTerra's name appears on a faxed copy of a \$5,000 check written by Ward to deposit in Homeland Securities' Account on March 4, 2005.

Moreover, Brian Rose, David Rose's son, was the only person to whom Ward spoke about purchasing the automobiles that appear to have been the source of financing the Firm. Brian Rose is also the managing director of Jupiter Energy, the entity proposed to be the issuer of the oil and gas interests to be sold by Homeland Securities.

The record contains other examples of questions regarding a connection between the Firm and enTerra, David Rose's company. T. and D. Nelson, the proposed president and vice president of the Firm, had consulting agreements with enTerra from September 2004 until June 2005. An employee of enTerra actually placed the advertisements for Ward seeking properly qualified individuals to operate the broker-dealer she was attempting to purchase. In addition, the record compiled by Member Regulation has other indications of possible connections between Ward and David Rose, including with regard to antique automobiles such as came into play here.

Each time Member Regulation probed, it uncovered another layer that raised new questions with respect to the Firm's funding. In that regard, the Firm's scrimpy responses to Member Regulation's requests for information, capped by Ward's responses during the Membership Interview about the manner in which her Home Equity Account had been paid down (especially when she had never before borrowed against it in amounts even close to the amount at issue here), provided a reasonable basis for Member Regulation's continuing concerns.

And there are still unanswered questions here. At the hearing, Ward testified that since early January 2006, she has made numerous requests to the bank to obtain copies of the 2005 Home Equity Account statements. Her requests remain unsatisfied to date. Ward also admitted at the hearing that she had provided only copies of the carbon duplicate front sides of the checks she wrote on her Home Equity Account to fund the purchase of cashier's checks to fund the Firm, but there is still no documentation in the record to show that those checks were cashed.

The Firm argues that Member Regulation denied the Application solely on the basis that inadequate information had been supplied, and that Member Regulation should not now be allowed to probe more deeply into the question of connections between the Firm and David Rose. The Firm further argues that NASD's Membership and Registration rules provide only that an applicant must supply information or evidence regarding the source of funding, and not documentation, per se. The Firm states that it provided adequate information to Member Regulation through the un rebutted testimony of Ward and Brian Rose regarding the payments to the Home Equity Account, and their testimony that David Rose and his money are not connected to Homeland Securities, HHC, Drill Quest, or the purchase of the two antique automobiles.

Some of the information – and its importance to understanding the source of the Firm's funding – was never presented to Member Regulation for consideration in the first instance. The question of the value and completeness of the information that the Firm seeks now to rely upon should be evaluated in the first instance in light of the record as a whole by Member Regulation. The record suggests that the Firm may have been recalcitrant in not providing complete, clear and accurate information to Member Regulation on the issues requested during the time period required by NASD's rules. On the other hand, the record also suggests that Member Regulation may have closed the period of review without asking for an agreement to extend the time when it believed that the information was incomplete, and then denied the Application solely on the basis of inadequate information.

In any case, we find that we cannot conclude on the basis of the record before us that the information supplied by the Firm on the source of its funding is complete and accurate. Yet, under the circumstances presented here, we choose not to affirm Member Regulation's denial of the Application based solely on inadequate information. We find that Member Regulation is the proper forum for the further exploration of this issue of the source of funding presented by this Application. Accordingly, we vacate Member Regulation's denial of the Application and remand this matter for consideration of the issue of the source of the Firm's funding, pursuant to Membership and Registration Rule 1015(j)(1). We direct Member Regulation to review the evidence that the Firm has submitted to date, including the testimony and documents presented at this hearing, on the issue of the source of funding of the Firm. We also direct Member Regulation to determine which documents and other information it may still need on the issue of the source of funding of the Firm, and to continue to negotiate with the Firm and request further necessary documents and information to satisfy its concern with the sources and legitimacy of funding for the Firm.

In that regard, we are not addressing whether Member Regulation can or should explore the issue of the connections, if any, between David Rose and the Firm *other than* with regard to the issue of the source of funding for the Firm. But it certainly is the case that, based on the record in this matter, Member Regulation can and should explore to its reasonable satisfaction any issues it may feel exist with regard to "the ultimate source of funds that will support the Broker-Dealer." Given David Rose's record with regard to our industry, Member Regulation is simply discharging its responsibilities in digging much deeper than might normally be the case to ensure that he is not a source of funding and that it is satisfied that it knows "the nature and source of [the Firm's] funding."



### **III. CONCLUSION**

After reviewing the record and considering the parties' arguments, we vacate Member Regulation's denial of the Application and remand this matter to Member Regulation.<sup>10</sup>

On Behalf of the National Adjudicatory Council,

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Barbara Z. Sweeney, Senior Vice President  
and Corporate Secretary

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<sup>10</sup> We have considered and reject without discussion all other arguments raised by the parties.