

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD

In the Matter of  
the Continued Membership  
of  
Firm 1  
with  
NASD

**Redacted Decision**

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

Decision No. SD04016

Date: 2004

On November 20, 2003, at the direction of NASD's Department of Member Regulation ("Member Regulation"), Firm 1<sup>1</sup> ("the Firm") submitted a Membership Continuance Application ("the Application") seeking to retain its membership with NASD. Member Regulation directed the Firm to file the Application based on Member Regulation's view that the Firm was subject to a statutory disqualification. According to Member Regulation, the Firm was disqualified because of an NASD decision issued in December 2002, in which NASD barred Employee 1, the Firm's president, chief executive officer ("CEO"), and sole owner, from acting as a supervisor and suspended him for two years from associating with any member firm in any principal capacity. Member Regulation concluded that Firm 1 allowed Employee 1 to act in a capacity requiring registration as a principal while he was suspended as a principal and barred as a supervisor.

In June 2004, an NASD Statutory Disqualification Committee Hearing Panel ("Hearing Panel") held a hearing on the matter. Employee 1 appeared at the hearing on behalf of himself. Employee 2, Firm 1's current president, and Employee 3, Firm 1's chief financial officer, appeared on behalf of the Firm. Employee A of Firm 2 in City 1, State 1, represented the Firm. LL and KA appeared on behalf of Member Regulation.

For the reasons explained below, we conclude based on the unique facts and circumstances of this case that Firm 1 is not subject to a statutory disqualification.

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<sup>1</sup> 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.

## I. Background

Firm 1 has been an NASD member since 1984. Firm 1 is a corporation, and Employee 1 owns 100 percent of its stock. (Firm 1 seeks Market Regulation approval of Employee 1's sale of the Firm.) Employee 1 had been Firm 1's president and CEO until March 2003, when Employee 2 replaced him in those positions. At the commencement of this proceeding in November 2003, Firm 1's only office was located in City 2, State 1. In April 2004, Firm 1 relocated its office to City 3, State 1. As of the date of the Application, three registered principals and 20 registered representatives were associated with the Firm. The Firm is engaged primarily in the following types of business: general securities, bonds, mutual funds, variable annuities, and limited partnerships (oil and gas, real estate, and equipment leasing).

## II. Firm 1's Statutory Disqualification Application

Member Regulation directed the Firm to file the Application based on Member Regulation's conclusion that Firm 1 was statutorily disqualified because the Firm allowed Employee 1 to act in a capacity requiring registration as a principal while he was suspended as a principal and barred as a supervisor as a result of a December 2002, decision of NASD's Office of Hearing Officers. The December 2002 decision held that the Firm and Employee 1, its then president, CEO, and 100 percent shareholder, violated Conduct Rules 2110 and 3010<sup>2</sup> by failing to exercise reasonable supervision. NASD censured and jointly and severally fined the Firm and Employee 1 \$20,000. NASD also barred Employee 1 as a supervisor, suspended him from acting as a principal for two years, and required him to requalify as a principal. Employee 1 was not barred or suspended as a registered representative. Neither the Firm nor Employee 1 appealed the Hearing Panel decision. The decision became final in February 2003, and Employee 1's supervisory bar and principal suspension became effective in March 2003.

As of February 2003, Firm 1's Board of Directors had approved the appointment of Employee 2 as president and CEO and the appointment of Employee 3 as treasurer and financial and operations principal ("FINOP") of the Firm. The Firm filed an amendment to the Form BD in September 2003, in which it indicated that Employee 2 had replaced Employee 1 as president and CEO in March 2003.

In October 2003, NASD's Department of Enforcement ("Enforcement") filed a complaint in [CASE REDACTED] against Firm 1 and Employee 1 alleging that, commencing in March 2003, Firm 1 allowed Employee 1 to associate with it as the Firm's sole owner and president in violation of a previously imposed principal suspension and supervisory bar and in contravention

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<sup>2</sup> Rule 2110 requires that a member, in the conduct of its business, observe high standards of commercial honor and just and equitable principles of trade. Rule 3010 requires that NASD members establish and maintain a system designed to supervise the activities of all associated persons and to achieve compliance with applicable securities laws and regulations.

of Article III, Section 3 of NASD's By-Laws and NASD Conduct Rule 2110.<sup>3</sup> Firm 1 and Enforcement filed with the Hearing Officer in [CASE REDACTED] a joint report on the status of their settlement negotiations stating that the parties had reached an oral understanding as to the terms of a settlement of the matter. According to the terms of the proposed settlement, Employee 1 would be barred from the securities industry and Firm 1 would be censured and fined \$17,500. The parties represented in the joint status report that "consummation of the settlement [was] awaiting the sale of Firm 1."

In November 2003, Member Regulation advised Firm 1 that the Firm was statutorily disqualified from NASD membership as a result of the Firm's continued association with Employee 1 in a principal or supervisory capacity. In November 2003, Firm 1 filed the Application. In March 2004, Member Regulation advised Firm 1 that the Firm had filed the Application incorrectly and requested that it resubmit the Application.<sup>4</sup> In March 2004, Firm 1 resubmitted the Application. In Firm 1's filing, the Firm indicated that Employee 1 was in the process of selling the Firm, that Employee 1's only role at the Firm was that of registered representative (a role in which he was not barred or suspended), that he served only his existing clients, and that Employee 1's association with the Firm would cease entirely once he sold the Firm.<sup>5</sup> Thus, Firm 1 sought to continue in membership with Employee 1 being the Firm's sole stockholder (pending his sale of the stock) and acting as a registered representative of the Firm.

In March 2004, the Firm also filed with Member Regulation a request for approval of a change in ownership under Membership and Registration Rule 1017 to request NASD's approval of Employee 1's sale of Firm 1 to Employee 2 (five percent), Employee 3 (35 percent), and Employee 4 (60 percent), all of whom were and still are affiliated with Firm 1.<sup>6</sup> The application indicated that Employee 2 would continue as president and Employee 3 as chief financial officer.

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<sup>3</sup> In Case No. [CASE REDACTED], NASD also alleged that the Firm: did not employ a qualified FINOP; allowed a person to act as a FINOP while not properly qualified; allowed a general securities principal to continue working while inactive due to continuing education lapses; failed timely to file Rule 3070 reports; and failed timely to amend its Form BD. Firm 1 and Employee 1 generally denied the allegations of the complaint. The action is pending.

<sup>4</sup> Initially, Firm 1 filed a Form MC 400, which applies when a member firm seeks to continue in membership while allowing a statutorily disqualified person to associate with the firm in a capacity in which the person is disqualified. Member Regulation thereafter directed Firm 1 to file a Form MC 400A, which applies when a member firm is itself statutorily disqualified.

<sup>5</sup> In April 2004, Employee 1, as sole shareholder of Firm 1, adopted a resolution appointing Firm 1's proposed purchasers, Employee 4, Employee 3, and Employee 2 as directors of Firm 1 and abdicating all authority as a director of the Firm.

<sup>6</sup> Membership and Registration Rule 1017 requires NASD members to file applications for approval of certain changes to their ownership, control or business operations.

NASD initially rejected the application because it was not substantially complete. In April 2004, Firm 1 filed a revised Rule 1017 application, which Member Regulation denied. Firm 1 filed a new Rule 1017 application, which Member Regulation denied in November 2004. As of the issuance of this decision, Firm 1 has not appealed the denial.

In April 2004, Firm 1 filed a Form U5 Uniform Termination Notice for Securities Industry Registration to terminate Employee 1. In June 2004, Firm 1 amended the Application to request that Firm 1 be allowed to continue its NASD membership, pending Member Regulation's approval of Employee 1's sale of his Firm 1 stock, with Employee 1 associated only as a passive sole stockholder of the Firm. The amended application noted that Employee 1 is no longer associated with the Firm in any other capacity.

At the June 2004 hearing, Firm 1 represented, through the testimony of Employee 2, Employee 1 and Employee 3 and the representations of its attorney, that Employee 1 abdicated all supervisory responsibilities to Employee 2 and resigned as president and CEO immediately upon commencement of the principal suspension and supervisory bar. Firm 1's attorney represented that Employee 1 had retained other counsel in early 2003 to attempt to comply with the bar and suspension and to determine how best to divest his ownership interest in Firm 1. Employee 1 acknowledged that he may have failed initially to comply fully with the bar and suspension based, in part, on advice from his former counsel and stated that he therefore has chosen to settle Case No. [CASE REDACTED] (which alleges that Employee 1 acted in capacities in which he was barred or suspended) and has agreed to be permanently barred from the securities industry. Employee 3, Employee 2, and Employee 1 testified that Employee 1 and Firm 1's prospective purchasers (Employee 3, Employee 2 and Employee 4) have already agreed to the terms of the sale of Firm 1. They contend that, because Firm 1's revenues will not affect the purchase price, Employee 1 is disinterested in Firm 1's financial affairs and otherwise uninvolved in the Firm's business. They represent that in April 2004, Employee 3, Employee 4, and Employee 2 relocated the Firm to City 3, State 1, that Employee 1 has never been to the new office, and that he does not possess a key to the new office. Employee 2 and Employee 3 also indicate that Employee 1 has no access to the Firm's bank accounts and that they do not provide Employee 1 with any financial reports relating to the Firm.<sup>7</sup>

### III. Member Regulation's Recommendation

Member Regulation recommends denial of the Application.<sup>8</sup> Member Regulation contends that Employee 1 continues to act in a supervisory or principal capacity at Firm 1.

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<sup>7</sup> In addition, Employee 3 and Employee 1 testified that Employee 3 had purchased Employee 1's "book" of business from Employee 1 pursuant to an agreement that the two reached in April 2004.

<sup>8</sup> Member Regulation filed its recommendation in April 2004, before Firm 1 amended its Application to indicate that in April 2004, it had filed a Form U5 to terminate Employee 1. Member Regulation did not thereafter amend its recommendation.

Member Regulation notes that, from March 2003, until the present, Employee 1 has continued to hold a 100 percent ownership interest in the Firm which, Member Regulation contends, the principal suspension and supervisory bar prohibit. Member Regulation, moreover, notes that the Firm filed its first Rule 1017 application in March 2004 – one full year after NASD's imposition of a principal suspension. Member Regulation also cited NASD's filing of Complaint No. [CASE REDACTED], which alleges that Employee 1 has continued to remain associated with Firm 1 as president and sole owner and, on one occasion in March 2003, he initialed an order ticket suggesting that he might have been functioning in a supervisory capacity after NASD had imposed the supervisory bar. In addition, Member Regulation questions Firm 1's ability adequately to supervise Employee 1. Member Regulation contends that these events suggest deterioration in the Firm's supervisory and management controls that pose ongoing investor protection concerns.<sup>9</sup>

At the June 2004 hearing, the Hearing Panel noted that the matter before us is whether Firm 1 should be allowed to continue its NASD membership with Employee 1's being solely a passive stockholder who is not otherwise involved in the securities activities or the day-to-day functions of the Firm. Member Regulation indicated in response that its earlier recommendation was based on Firm 1's contention that Employee 1 would be a registered representative of the Firm and that it was not prepared to state a position as to whether Firm 1 should be allowed to continue in membership with Employee 1 as a "passive owner."

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<sup>9</sup> In the written recommendation, Member Regulation also requested that the Statutory Disqualification Committee order Employee 1 to divest his ownership interest in the Firm within 30 days and grant expedited treatment of this matter. At the June 2004 hearing, Member Regulation withdrew the request for an order for Employee 1 to divest his ownership interest. We nonetheless briefly address both requests here.

The NASD By-Laws do not grant authority to the Statutory Disqualification Committee or us, in this context, to order an individual to divest his interest in an NASD firm, particularly given that NASD rules require applications for approval of transfers in ownership of NASD members under Rule 1017. Indeed, Firm 1 has requested Member Regulation's approval of Employee 1's sale of Firm 1. Our finding in this regard, however, should not be read to undercut the ability of Member Regulation to request, or the Statutory Disqualification Committee to require, divestiture as a condition of approval of the association of a statutorily disqualified person.

With respect to Member Regulation's request for expedited treatment, NASD Rule 9526(a) provides that the NASD Board Executive Committee, upon request of the Statutory Disqualification Committee, may direct an expedited review of a statutory disqualification matter if the Executive Committee determines that an expedited review is necessary for the protection of investors. The Hearing Panel did not find that Member Regulation had demonstrated that expedited review of this matter was necessary for the protection of investors and therefore did not recommend that the Statutory Disqualification Committee grant expedited treatment. We concur with the Hearing Panel's denial of Member Regulation's request for expedited treatment.

#### IV. Discussion

At the outset, it is instructive for us to discuss the three pending NASD actions related to Employee 1's suspension and bar and his position at Firm 1.

In Case No. [CASE REDACTED], Enforcement alleged, in part, that Employee 1 acted in supervisory and principal capacities at Firm 1 subsequent to the commencement in March 2003 of a principal suspension and supervisory bar previously imposed by NASD. The purpose of NASD's complaint in [CASE REDACTED] is to determine whether Firm 1 and Employee 1 have violated the supervisory bar and principal suspension and, if so, to impose appropriately remedial sanctions for the Firm's and Employee 1's misconduct. Firm 1 and Enforcement have reached an agreement to settle Case No. [CASE REDACTED], although the settlement is not final and the case is pending. Employee 1 admitted during the course of the current proceeding that he may have acted in capacities in which he was barred or suspended, as alleged in Case No. [CASE REDACTED]. Thus, Case No. [CASE REDACTED] addresses the issue of whether Employee 1 previously violated the supervisory suspension and principal bar.

In the second proceeding, Firm 1's application for approval of Employee 1's proposed sale of the Firm, Member Regulation must determine if the proposed sale meets the standards set forth in NASD's Membership Rules, is in the public interest, and provides adequate protection for public investors. Member Regulation denied that application. Firm 1 filed another Rule 1017 application, which Member Regulation denied. To date, Firm 1 has not appealed the denial.

The only issue before us in this matter is whether we concur with Member Regulation's determination that Firm 1 is subject to a statutory disqualification because of Employee 1's association with it and, if so, whether Firm 1 should be allowed to continue in membership. In this proceeding, we do not have before us and therefore do not rule on: whether Employee 1's past conduct at Firm 1 violated the supervisory bar and principal suspension; whether to impose sanctions as appropriate for past misconduct; or whether Employee 1's sale of Firm 1 should be approved.

##### A. Proof Required to Prove that Firm 1 Is Statutorily Disqualified

This statutory disqualification proceeding differs from proceedings in which disqualified individuals seek to associate with member firms. In proceedings involving disqualified individuals who seek to associate with member firms, Member Regulation's "reason to believe"<sup>10</sup> that a disqualification exists is based solely on a predicate finding by an adjudicative body. For

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<sup>10</sup> NASD Rule 9522(a) states that, if Member Regulation staff has "reason to believe" that a disqualification exists, staff shall notify the member or person associated with the member of the disqualification.

example, the disqualification may be based on an NASD bar in all capacities, a state determination of guilt in a criminal matter, or an SEC determination in a civil proceeding.

In statutory disqualification proceedings such as this one, in which a member firm is subject to a disqualification as a result of a disqualified person's current association with the member firm, Member Regulation's "reason to believe" that a disqualification exists must be based on two factors: (1) a predicate finding by an adjudicative body; and (2) a determination by Member Regulation that the disqualified person currently is associating in a disqualified capacity with the member firm at issue. Thus, in proceedings such as this involving a disqualified member firm, Member Regulation must present a theory as to why the firm is disqualified and evidence to support the theory. In contrast, Member Regulation is not required to present evidence of an improper association in statutory disqualification proceedings in which an individual (as opposed to a member firm) is disqualified.

In this case, Member Regulation's theory of disqualification is that Employee 1 currently is associated with Firm 1 in a disqualified capacity, *i.e.*, he is associated as a supervisor or principal. Member Regulation therefore must demonstrate not only that NASD issued a decision in which it barred Employee 1 as a supervisor and suspended him in all principal capacities, but it must also prove that Employee 1 currently is associating with Firm 1 as a supervisor or principal. Our determination as to whether Member Regulation has met the burden of demonstrating that Employee 1 currently is associated with Firm 1 in a disqualified capacity (and, therefore, whether Firm 1 is subject to disqualification) does not preclude Enforcement from investigating or filing a complaint against Employee 1 or Firm 1 for Employee 1's prior improper association with Firm 1, if such association exists. The fact that a firm may not be subject to disqualification because it presently is not associating with a person subject to disqualification does not mean that either the firm or the disqualified person may not be the subject of a disciplinary proceeding for any violative association that may have occurred in the past but is not currently manifested.

#### B. Firm 1 Is Not Subject to a Statutory Disqualification

Rule 9522(a)(1) indicates that, if Member Regulation staff "has reason to believe that a disqualification exists or that a member or person associated with a member otherwise fails to meet [NASD's] eligibility requirements," Member Regulation shall issue a written notice of the disqualification to the member firm. Member Regulation commenced this proceeding when, in November 2003, it issued a notice of disqualification to Firm 1 based on its belief that a disqualification existed as a result of NASD's December 2002 decision against Employee 1.

Article III, Section 3(a) of NASD's By-Laws states that no registered broker-dealer shall continue in membership if the broker-dealer becomes subject to a disqualification under Article III, Section 4. Article III, Section 4(e) states that a member firm will become subject to a disqualification from membership in NASD if the firm has associated with it a person who is suspended or barred. Effective March 2003, NASD suspended Employee 1 for two years as a principal and barred him from acting as a supervisor. Thus, Employee 1's continued and current association with Firm 1 as a principal or supervisor would subject Firm 1 to a disqualification.

Employee 1 is not otherwise disqualified from the industry. To proceed with our analysis, we must determine if Employee 1 currently is acting in a supervisory or principal capacity at Firm 1.

We turn first to NASD's definition of principal. NASD Membership and Registration Rule 1021 states that all principals must be registered as such and defines principal as follows:

Persons associated with a member, enumerated in subparagraphs (1) through (5) hereafter, who are actively engaged in the management of the member's investment banking or securities business, including supervision, solicitation, conduct of business or the training of persons associated with a member for any of these functions are designated as principals. Such persons shall include:

- (1) Sole proprietors;
- (2) Officers;
- (3) Partners;
- (4) Managers of Offices of Supervisory Jurisdiction; and
- (5) Directors of Corporations.

The term "actively engaged in the management" of a member firm's business means involvement in the day-to-day conduct of the member's securities business and the implementation of corporate policies related to such business. *See NASD Notice to Members 99-49* (NASD Regulation Provides Interpretive Guidance on Registration Requirements). Additionally, we previously have held that even individuals who are not involved in the day-to-day management of a member firm, but who are otherwise actively involved in the member firm's investment banking or securities business, could meet the definition of principal. *See DBCC for District No. 2 v. American National Equities*, Complaint No. LA-4323, 1991 NASD Discip. LEXIS 86 (NAC Nov. 25, 1991).

We next assess Employee 1's present position at Firm 1 to determine if his current activities are supervisory in nature or require that he register as a principal.<sup>11</sup>

The record before us indicates that Employee 1 currently holds no official positions at Firm 1. Employee 2 has assumed all of Employee 1's supervisory functions and is the Firm's president and CEO. Employee 3 has assumed all financial duties and is the Firm's chief financial

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<sup>11</sup> The record suggests that, during some period subsequent to NASD's imposition in March 2003 of the supervisory bar and principal suspension, Employee 1 may have been acting in principal or supervisory capacities. If such conduct in fact occurred, however, it is not clear that it continued through March 2004 when Firm 1 submitted its revised Application. As noted above, the issue of whether Firm 1 and Employee 1 previously violated NASD's supervisory bar and principal suspension is before NASD in a pending disciplinary matter [CASE REDACTED]. Whatever action Employee 1 previously may have taken, the issue before us is whether Firm 1 currently is subject to a statutory disqualification.



officer. Employee 1 is no longer a member of Firm 1's Board of Directors; Firm 1's proposed purchasers currently fill all Board seats. Employee 3 has purchased Employee 1's "book" of business,<sup>12</sup> and the parties to the sale of Firm 1 have reached an agreement as to the financial terms of the sale of Firm 1. The purchase price to which the parties have agreed is unrelated to Firm's securities revenues. Thus, Employee 1's proceeds from his sale of Firm 1 will not change regardless of any changes in Firm 1's financial situation or business operations. Employee 2 and Employee 3 testified that they relocated the Firm to City 3, State 1 and that Employee 1 has never been to the new office. Employee 1 does not have a key to the new office and is not authorized to enter orders or use equipment in the office. Employee 3 and Employee 2 testified that only they have signatory authority over the Firm's bank accounts and that neither of them provides Employee 1 financial or other types of updates on the Firm's business. Furthermore, since Firm 1 filed a Form U5 to terminate Employee 1's association as a registered representative with Firm 1, Employee 2's and Employee 3's only contact with Employee 1 has been with regard to Firm 1's improperly delivered mail.<sup>13</sup>

Member Regulation offered no evidence to dispute Employee 1's, Employee 2's and Employee 3's description of the current state of affairs at Firm 1. Employee 1 has admitted that he previously may have acted in contravention of the principal suspension and supervisory bar (for example, by initialing one order ticket in March 2003), but that such evidence relates to past misconduct and is not necessarily telling as to current affairs at Firm 1. NASD will address Employee 1's and Firm 1's alleged past misconduct in Case No. [CASE REDACTED].

Member Regulation did not argue before us that Employee 1's passive ownership of 100 percent of the stock of Firm 1 alone is sufficient to require that he register as a principal. We nevertheless have considered this issue and determine that, based on the facts and circumstances of this case, it is not.

The definition of principal contained in Rule 1021 includes sole proprietors. We do not find that Employee 1's present status is that of sole proprietor. The term "sole proprietor" generally suggests that one person owns all of the assets of the business, is personally liable for the debts of the business, and is involved in the day-to-day management of the business. The term generally does not apply to corporate entities. *See Herman v. Galvin*, 40 F. Supp. 2d 27, 29 (D. Mass. 1999); *In re San Juan Dupont Plaza Hotel Fire Litig.*, 45 F.3d 569, 573 (1st Cir. 1995) (citing Black's Law Dictionary 1392 (6th ed. 1990), which defines "sole proprietorship" as "[a] form of business in which one person owns all the assets of the business in contrast to a partnership, trust, or corporation"). Employee 1, although still owner of the stock of the corporate entity, is not involved in the operations of the Firm and is disinterested in the Firm's

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<sup>12</sup> All of Employee 1's former customers who have been asked to sign a form to transfer their accounts to Employee 3 have done so.

<sup>13</sup> Employee 2, Employee 3 and Employee 1 also testified that Employee 2's and Employee 3's contact with Employee 1 regarding Employee 1's pending sale of Firm 1 to Employee 2, Employee 3 and Employee 4 occurs only through Firm 1's attorney.

finances. Firm 1 is a corporate entity that is operated by individuals other than Employee 1. In our view, Employee 1 is not a sole proprietor of Firm 1.

Rule 1021 also requires all individuals who are actively engaged in the management of a member firm's investment banking or securities business to be registered as principals. We acknowledge that in many or perhaps most cases, a 100 percent owner of a broker-dealer may be found to be sufficiently engaged in the member firm's investment banking or securities business to require principal registration; but the requirement for registration arises from the active engagement in the management of the firm's investment banking or securities business, not merely from the ownership of stock. The facts of this case suggest that Employee 1 is wholly uninvolved in Firm 1's affairs. Even his interest as an owner is somewhat diluted by the fact that Employee 1 is in the process of selling Firm 1, and his remuneration for the sale of Firm 1 is set. Furthermore, the Firm's proposed new owners are operating the Firm. Indeed, the record suggests that, if Employee 1 wanted to actively participate in the Firm's operations, his lack of authority over the Firm's bank accounts and his inaccessibility to the Firm's facilities would likely hamper his efforts.

In past decisions, we, like the SEC, have relied on factors in addition to ownership to find that a person has acted in the capacity of a principal. *See Gordon Kerr*, Exchange Act Rel. No. 43418, 2000 SEC LEXIS 2132 (Oct. 5, 2000) (considering responsibilities assigned by the firm and activities actually performed by the individual in determining that individual functioned in a principal capacity); *L. H. Alton & Co.*, 53 S.E.C. 1118 (1999) (finding that individual's designation as partner of the firm, his review and initialing of 100 trade tickets, and his review of and signature on important documents for the firm proved that individual functioned in a principal capacity); *Kirk A. Knapp*, 50 S.E.C. 858 (1992) (holding that individual's ownership of substantially all of the stock of the firm, his conducting sales meetings and dissemination of memoranda to sales staff, his hiring of sales personnel, his signature on firm newsletters, and his involvement in firm advertisements evidenced individual's violation of a principal bar). Based on the facts and circumstances of this case, including Employee 1's agreement in principal to sell Firm 1, his resignation from the Firm, his absence from the Firm's Board of Directors, his replacement by the prospective buyers as an officer of the Firm, and his lack of involvement in the day-to-day management of the Firm, we do not find that Employee 1 currently is functioning as a principal or supervisor at Firm 1. We therefore do not find that Employee 1 currently is acting in contravention of NASD's supervisory bar and principal suspension.

Thus, because Firm 1 does not currently have associated with it in a disqualified capacity a person subject to a statutory disqualification, Firm 1 is not itself statutorily disqualified from continuing in membership. *See* Article III, Sections 3 and 4 of NASD's By-Laws.V.

Conclusion

Accordingly, we find that, based on these facts and circumstances, Employee 1 is not statutorily disqualified from exercising a passive ownership of Firm 1 and that Firm 1 therefore is not associated with a statutorily disqualified person and is not itself statutorily disqualified. Firm 1 therefore may continue its NASD membership in the manner in which it currently operates.

On Behalf of the National Adjudicatory Council,

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Barbara Z. Sweeney, Senior Vice President and  
Corporate Secretary