NASD REGULATION, INC.
OFFICE OF HEARING OFFICERS

DEPARTMENT OF MARKET REGULATION, Complainant, v. AMR "TONY" ELGINDY (CRD #1824634) Colleyville, TX, and KEY WEST SECURITIES, INC. (BD #38305) Cardiff by the Sea, CA, Respondents.	Disciplinary Proceeding No. CMS000015 Hearing Officer - JN **HEARING PANEL DECISION** December 28, 2001

Department of Market Regulation failed to prove that member firm and its owner-principal manipulated the market for a stock. Respondents found liable under Rule 2110 for making a series of high bids without intending to honor them. Respondents also found liable for violating Rule 2210 by disseminating recommendations without disclosing firm's market maker status. For the bids, Respondents were each fined $2,000 and suspended for one year. For the recommendations, they were each fined $1,000.

Appearances

For the Complainant: James J. Nixon and David H. Katz

For the Respondents: Martin P. Russo and Jason M. Ewasko

DECISION

I. Introduction

The Department of Market Regulation's Complaint, filed on March 3, 2000, contained two Causes. The First Cause alleged that Respondents engaged in manipulation (in violation of

NASD Rules 2110 and 2120, Section 10(b) of the Securities Exchange Act of 1934, and SEC Rule 10b-5) by "repeatedly upticking and establishing new published inside bids, without any intent to purchase the security" and issuing deceptive sell recommendations. The Second Cause alleged that Respondents violated Rules 2110 and 2210 by issuing recommendations which failed to disclose that they held a short position in the involved stock and that the firm was a market maker in it.[1] Respondents denied the charges.

A Hearing Panel composed of a member of the Market Regulation Committee, a member of the Association's District 10 Committee, and an NASD Regulation Hearing Officer conducted hearings on April 10, April 11, and May 17 of 2001 in New York City. The Department of Market Regulation introduced twenty-one exhibits (cited with the prefix "CX") and presented the testimony of one witness, the manager of its fraud section. Respondents introduced thirty exhibits (cited with the prefix "RX"); they presented testimony from Mr. Elgindy and from an employee of another market maker in the security involved. Market Regulation filed a post-hearing brief on July 13, 2001. Respondents filed their post-hearing brief on August 17, 2001, and Market Regulation replied on August 31, 2001.

A. Background

Respondent Elgindy was the founder, owner, general securities principal, director of research, and head of trading of Respondent Key West Securities, Inc. (Complaint, ¶ 3; Answer, ¶ 2; Tr. 566).[2] The firm, along with several others, made a market in the stock of Saf-T-Lock

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[1] Market Regulation later withdrew its claim that the reports were defective for failure to disclose Respondents' short position (Market Regulation Brief, p. 1, fn. 1).

[2] For purposes of this case, there is no distinction between Mr. Elgindy's activities and those of his firm. In this Decision, references to him should be read as applying to the firm as well. References to "Respondent" should be read as referring to Mr. Elgindy.

Inc., a company which manufactured locking devices for handguns; its stock traded as a Nasdaq SmallCap security, under the trading symbol "LOCKC" (Complaint, ¶ 3; Answer, ¶ 3).[3]

The Department of Market Regulation alleges that Elgindy manipulated the LOCKC market between October 9 and November 11, 1997. Most of the key events happened on October 9, 1997, which began with an Associated Press report that "[t]he Clinton administration has struck an agreement with most of the nation's gun manufacturers that will provide child-safety locks for most handguns sold in the United States…" (RX-13).

After the announcement, the volume and price of LOCKC stock rose significantly. LOCKC's trading volume, which averaged 266,628 shares during the six trading days before October 9, 1997, rose to over 12 million shares on that day (RX-7). The stock's price similarly reflected significant gains. It opened at 7/16 ($00.44) on October 9, began to rise shortly after trading began, and closed at $3.00 (RX-11). On October 10, the stock closed at 4 and 9/16 ($4.56), a high for the period in question. Thereafter, a general downward trend began. Through November 11, LOCKC's daily closing prices ranged from $2.03 (October 21) to $3.65 (October 14), with an average price of $2.95 (RX-11).

Meanwhile, beginning on the morning of October 9, 1997, Elgindy engaged in a series of short sales, culminating in a total short position of 58,000 LOCKC shares (CX-6, pp. 36; Tr. 147-148; Market Regulation Brief, p. 8; Respondents' Brief, p. 4). The alleged manipulation involves this short position. According to the Department, Respondent first inflated the short sale "buy" prices by a series of high bids – which he did not intend to honor – and then lowered prices by releasing deceptive sell recommendations about LOCKC. These acts, says Market

[3] The transcripts sometimes refer to the company as "Saf T Lok."

Regulation, enabled Elgindy to make the short sales at artificially high prices, while intending later to cover them with purchases made at lower prices.[4]

II. Liability

A. Manipulation

The applicable legal principles are well settled. As the SEC has explained, "[i]n essence, a manipulation is intentional interference with the free forces of supply and demand…. Investors and prospective investors…are…entitled to assume that the prices they pay and receive are determined by the unimpeded interaction of real supply and real demand so that those prices are the collective marketplace judgments that they purport to be. Manipulations frustrate these expectations. They substitute fiction for fact…. The vice is that the market has been distorted and made into a 'stage-managed performance.'"[5] In proving manipulation, prosecutors may rely on "inferences drawn from a mass of factual detail. Findings must be gleaned from patterns of behavior, from apparent irregularities, and from trading data" (Pagel, supra).

Where, as here, the Complaint alleges fraudulent manipulation, the Department must show that Respondents acted with scienter – "a mental state embracing intent to deceive, manipulate, or defraud…sometimes established through a showing of recklessness amounting to an extreme departure from the standards of ordinary care…." Morgan Stanley & Co., supra, 2000

[4] The Department acknowledged during the hearing that it lacked proof of profit and was "not claiming any profit" (Tr. 257-258, 450).

[5] In re Pagel, Inc., 48 S.E.C. 223, 226 (1985), aff'd sub nom. Pagel, Inc. v. SEC, 803 F.2d 942 (5th Cir. 1986). This language has been frequently cited by the SEC and the National Adjudicatory Council. See, e.g., In re Patten Securities Corp., Exchange Act Rel. No. 32619, 1993 SEC LEXIS 1762 at *10-11 (July 12, 1993); Market Regulation Committee v. Morgan Stanley & Co., 2000 NASD Discip. LEXIS 1 at *57 (NAC, January 28, 2000).

NASD Discip. Lexis 1 at *60 – *61 (citations omitted). That element can be established through circumstantial evidence.[6]

Applying those concepts to the instant record, the Hearing Panel, including one member who is a trader and another with trading experience, concludes that Market Regulation has failed to prove manipulation by a preponderance of the evidence.[7]

1.) Alleged manipulation by high bids

Market Regulation argues that Elgindy's high bids manipulated the market by causing price increases in LOCKC stock.[8] As discussed later, in the context of Rule 2110 liability, there is evidence that Respondent made a series of high bids without intending to honor them. But, in the Panel's view, such action fell far short of "stage-managing" market performance.

First, Mr. Elgindy's role in the October 9, 1997 LOCKC market was miniscule. Of the twelve million shares which changed hands on October 9, 1997, only 46,000 were handled by his firm (RX-7). Respondent's LOCKC trading on that day thus accounted for only .0038 percent of the total volume. In contrast, fourteen market makers each traded over 100,000 shares on that day – with three of them accounting for over 6.4 million shares. During the period between October 1 and October 13 of 1997, Key West was responsible for only .08 percent of the total volume of LOCKC trades (Tr. 322).

Respondents were so insignificant that a trader for Knight Securities, one of the three biggest market makers (handling over 2.4 million LOCKC shares on the day in question), had no recollection of Key West – other than its status as another market maker (Tr. 590). She did not

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[6] See, e.g., In re Meyer Blinder, Exchange Act Rel. No. 31095, 1992 SEC LEXIS 1215 at *33 (August 26, 1992).

[7] "[T]he NASD is an expert body whose 'businessman's judgment' may be brought to bear in reaching its decision." (Id., at *16).

know Mr. Elgindy, had no memory of his price quotes, and no information that the LOCKC market was being manipulated on October 9 or October 10, 1997 (Tr. 592, 595).

On this record, the Panel is not persuaded that Elgindy had sufficient power to influence anyone. The Panel believes that his activities did not rise to the level of manipulation.

In any event, the LOCKC increases were more likely caused by other events in which Respondents had no role. Before trading opened on October 9, 1997, the Associated Press transmitted a report that "[t]he Clinton Administration has struck an agreement with most of the nation's gun manufacturers that will provide child-safety locks for most handguns sold in the United States..." (RX-13). After the opening, LOCKC volumes and prices increased significantly (RX-7, RX-10 – RX-12). As stated in a Bloomberg report: "Saf-T-Lock Inc. shares surged by as much as eight-fold as investors bet that a joint declaration by President Clinton and eight leading gun manufacturers to install child-proof safety locks on guns would prove to be a windfall for the company" (RX-12).

When asked what precipitated the heavy LOCKC activity in October of 1997, the Knight trader referred to action by "the Clinton Administration" concerning a "safety lock" (Tr. 590). The staff's witness explained that "President Clinton made an announcement that morning from the Rose Garden about safety locks used in guns, and referring to all guns, not referring to this company, but when he used the words safety lock, people heard Saf T Lok…" (Tr. 397). A LOCKC employee reportedly attributed the October 9 purchases to that very assumption (RX-42, p. 9). Moreover, there was evidence showing that LOCKC sustained similar sharp price and volume increases in March of 2000, after announcement of a subsequent Presidential gun lock agreement (RX-26, RX-28 – RX-30).

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[8] Complaint, ¶¶ 11, 12, 15, 16, 21, 22; Market Regulation Brief, pp. 4, 5, 14, 15.

The Panel believes that the increases were more likely attributable to the above events than to anything which Mr. Elgindy did. Market Regulation has the burden of proving its case by a preponderance of the evidence – i.e., that it is more likely than not that Mr. Elgindy manipulated the market for LOCKC. As the National Adjudicatory Council explained in Department of Enforcement v. Ryan Mark Reynolds, 2001 NASD Discip. LEXIS 17 at *55-56 (June 25, 2001) (citations omitted), even equally compelling inferences would not prove a cause by a preponderance of the evidence. Applying that principle here, the Panel finds that the Department failed to prove that Elgindy's high bids interfered with market forces so as to manipulate LOCKC's prices upward.[9]

2.) Alleged manipulation by negative recommendations

Between October 9 and November 11, 1997, Elgindy issued five negative reports about LOCKC, recommending that investors sell the stock (CX-15, CX-16, CX-19, CX-20, CX-21).[10] None of these reports disclosed that Key West made a market in the stock. Focusing on these recommendations, the Complaint charges Respondents with "attempting to cover [their LOCKC] short position at a lower price by causing the price of the security to drop through the dissemination of deceptive sell recommendations about the security" (¶ 7). The Panel finds a failure of proof with regard to this theory of manipulation.

First, the Panel finds no persuasive evidence that the reports had any impact on the stock's prices. Elgindy issued the allegedly manipulative negative reports during the mornings of

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[9] The Department cites Gob Shops of America, Inc., 1959 SEC LEXIS 22 (May 6, 1959) as stating that increasingly higher bids are a manipulative technique (Market Regulation Brief, p. 14). That case, involving activity by an underwriting firm which owned nearly 20% of the stock in issue, is readily distinguishable. Mr. Elgindy was not the underwriter of LOCKC stock, and his holdings were comparatively miniscule.

[10] These occurred on October 9, October 10, October 24, and November 11, 1997.

October 9, October 10 (two releases), October 24, and November 11. Yet for some of those days, LOCKC's closing price was actually higher – in some instances significantly higher – than on the prior day (RX-11). For example, on October 8, 1997, the day preceding the first Elgindy negative release, the stock closed at .44 cents. On October 9, the day of his first report, the stock closed at $3.00 (Id.). On October 10, following his next two releases, the stock closed at $4.56 (Id.). There was no evidence that investors or market makers paid any attention to the releases, and the closing prices suggest that few, if any, did so – an understandable result, considering Elgindy's relatively small and unimportant role in the marketplace.

Moreover, though LOCKC's prices eventually dropped, there is no reason to infer that such declines were any more attributable to Mr. Elgindy's opinions than to various negative reports from other sources. A Bloomberg report of October 9, 1997, reported that although the stock's prices "soared," major gun manufacturers were skeptical about the product; the issuer recognized that the White House agreement would not produce imminent higher sales because the product was more expensive than the competition's; and the stock would soon be de-listed from the Small Cap market (RX-15). Another Bloomberg report, dated October 13, 1997, stated that: six of the eight major gun manufacturers would not buy the product; sales "have already been disappointing for the company"; a Smith & Wesson vice president regarded the product as overrated; and the issuer was due for de-listing from the Small Cap market (RX-17). Yet another Bloomberg report, issued after the close on October 13, stated that "[s]hares of Saf-T-Lok fell 27 percent today, as seven major gunmakers said they don't plan to buy the company's gun locks" (RX-18).

On this record, the Panel finds that the declines were more likely caused by other negative news than by Elgindy's recommendations. In such circumstances, as noted above in the context

of the allegedly manipulated price increases, Market Regulation failed to carry its burden of proving manipulation by a preponderance of the evidence (see, Reynolds, supra).

Nor were the recommendations deceptive. Elgindy testified that every sentence was true; Market Regulation's witness testified that she knew of nothing in the releases which was untrue; and the Department's counsel acknowledged that the prosecution was not trying to prove the falsity of any statement in them (Tr. 247-248, 394, 439, 522). If the Department's attorneys had evidence of such falsity, they would have introduced it, especially where they were striving to prove fraud. In these circumstances, it is a fair inference that the releases accurately reflected Mr. Elgindy's opinions and the factual bases for them.

The dissemination of accurate information cannot be regarded as artificially changing a stock's price for purposes of manipulation. In re Olympia Brewing Company Securities Litigation, 613 F. Supp. 1286, 1292 (N.D. Ill. 1985). As the court there said, "[I]f anything, the information concerning the overpricing was a service to the market, as it injected information into the market tending to indicate that the…shares were overpriced when this was in fact the case" (Id.). See also GFL Advantage Fund v. Colkitt, 2001 U.S. App. LEXIS 24572 (3rd Cir. 2001), citing Olympia and recognizing that an essential element of manipulation "is the injection of 'inaccurate information' into the market" (Id., at *29-30; emphasis added). On this record, the Panel is unwilling to adopt a theory whereby truthful statements about the issuer and its product somehow constitute fraudulent manipulation.[11]

[11] The Department cites In re Edward J. Mawod & Co., Exchange Act Rel. No. 13512, 1977 SEC LEXIS 1811, at *10 (May 6, 1977), which mentions the "dissemination of reports about a merger" as part of a manipulation, without finding that such reports were fraudulent (Market Regulation Brief, p. 18). The Mawod reports were inextricably linked to preceding wash sales and matched orders, executed to create the false impression of trading activity and thus "[e]nhance Epoch's merger prospects" (at *10). Elgindy's reports involved quotes from the issuer, statements about its prospective delisting, and opinions about its product. There is no contention that those subjects were fraudulently created.

It is true that Mr. Elgindy's reports failed to disclose his status as a market maker, a violation of Rule 2210(d)(2)(B)'s requirements for communications with the public (see discussion, infra). But, the Panel concludes that those omissions had no significance for purposes of manipulation. As shown, the releases had no apparent impact upon LOCKC prices; the stock's declines were more likely caused by other negative news and opinions, than by anything Mr. Elgindy wrote; and each of the releases truthfully reflected his opinions and the facts underlying them. Those conclusions remain valid whether or not Mr. Elgindy's recommendations identified Key West as a market maker.

Moreover, the record shows that Mr. Elgindy did disclose his market maker status during the time in question. He testified, without contradiction, that on October 9 or 10, 1997, he wrote a LOCKC research report, which he distributed to investors on request, and which disclosed that his firm made a market in the stock (Tr. 521). He similarly disclosed that fact to the Bloomberg service, which circulated two reports (at 10:29 a.m. and 11:13 a.m. on October 10, 1997), which quoted Elgindy's negative comments about LOCKC and his disclosure that Key West was a market maker in the security (RX-16; CX-13, p. 22; CX-17; Tr. 521-522). If Mr. Elgindy was engaging in a "scheme" to deceive people about Key West's role as one of the LOCKC market makers, he would not have disclosed that fact in a research report and certainly would not have announced it to Bloomberg contemporaneously with the asserted manipulation.

With the record in this posture, the Panel is unable to conclude, by a preponderance of the evidence, that Respondent's negative sell recommendations played any role in the marketplace – let alone that he used them to create or stage-manage that market.

3.) Conclusion

Market Regulation failed to prove that Mr. Elgindy's high bids or sell recommendations manipulated the marketplace in LOCKC stock. Though each manipulation case must be judged on its own facts, the misconduct generally has certain "hallmarks" or "earmarks": a rapid price surge dictated by a firm that controlled the market, little investor interest, an abundant supply of shares, and the absence of any known prospects for the issuer or favorable developments affecting it. In re Castle Securities Corporation, Exchange Act Rel. No. 39523, 1998 SEC LEXIS 24 at *8 (January 7, 1998); Department of Enforcement v. Galasso, 2001 NASD Discip. LEXIS 2 at *12 (NAC, February 12, 2001). The instant case lacks any of these characteristics.

B. Rule 2110

In addition to fraudulent manipulation under Rule 2120 and SEC Rule 10b-5, the Complaint alleged that Respondents' conduct also violated NASD Conduct Rule 2110, which provides that members and associated persons "shall observe high standards of commercial honor and just and equitable principles of trade."

1.) High bids without intent to honor

On twenty-seven separate occasions during the morning of October 9, 1997, Respondent made new and higher inside bids (Tr. 162, 234; CX-6, pp. 2, 3, 5, 6, 8, 9, 11). On twenty occasions during that same morning, Elgindy failed to purchase LOCKC stock at his posted price, despite preference orders directed to his firm (CX-6, pp. 4-5).[12] In eight of these instances, Key West either declined the purchase directly or allowed the offer to expire by lapse of time. Eleven of the attempted sales led to cancellations, after the passage of sufficient time for Elgindy

[12] In addition, on twenty other occasions during that same morning, Elgindy failed to sell the stock at his posted price, notwithstanding preference orders directed to Key West (Id. at pp. 3, 6, 9). This factor casts further doubt on the sincerity of his bids.

to have reacted (Tr. 376-377). When asked, during his investigative testimony, whether "[w]ith all the incoming sell orders on which Key West was preferenced, there were plenty of opportunities to buy the stock that day?" Mr. Elgindy answered "[y]es" (CX-13, p. 33).

As evidence of the insincerity of the bids, the Department showed several instances when, as Mr. Elgindy acknowledged, he sold LOCKC stock at the very price for which he was simultaneously purporting to buy it (CX-6, p. 6; Tr. 111, 624-626). Moreover, Respondent's investigative testimony, taken only a few weeks after the transactions in issue, casts further doubt on the good faith of his bids. He said, "I'm such an avid believer that this company is not only overvalued, overbought, oversubscribed to and overrated…but just doesn't have a chance in hell of getting anywhere" and "I wouldn't even buy their lock. How could I buy their stock?" (CX-13, pp. 22-23, 32). Given those strong negative views, his series of high bids was especially questionable.

In the Panel's view, a market maker who posts a bid thereby announces his or her willingness to buy the stock at that price. See Rule 3320 ("No member shall make an offer to buy…any security at a stated price unless such member is prepared to purchase…at such price and under such conditions as are stated at the time of such offer to buy…"). Investors and other market makers are entitled to rely on the representation inherent in the announcement of bids. A bad faith posting undermines that reliance and thus the integrity of marketplace signals.

Rule 2110 takes account of "marketplace practices" and is designed to prevent conduct which "may operate as an injustice to…participants in the marketplace" Department of Enforcement v. Aleksandr Shvarts, 2000 NASD Discip. LEXIS 6 at *11 (NAC, June 2, 2000). Making a series of high bids for LOCKC without intending to honor them and doing so without any legitimate excuse meets that test. Respondent Elgindy thus violated Rule 2110.

2.) Elgindy's excuse

Respondent said that his high bids were forced by the "excess spread" rule, which required a corresponding increase in a bid whenever he raised the offer price – a step which he repeatedly took to "stay out of the way" of incoming business which might freeze his computers (Tr. 474-475, 488, 494, 499, 505-506).[13] As he put it, the rule played a "huge role" in his actions (Tr. 488).

The Panel rejects this purported justification for several reasons. First, the defense shows on its face that Elgindy's bids were motivated by other considerations and were not good faith offers to buy the stock. Raising bids to accommodate the assumed excess spread rule does not justify dishonoring them. Second, posting high bids would scarcely promote "staying out of the way" of computer-paralyzing traffic; on the contrary, such prices would encourage responses from other firms, not deter them.

In any event, in October of 1997 (when the bids occurred) the excess spread rule, by its terms, did not apply to Nasdaq SmallCap securities. See Rule 4613(d), reprinted in NASD Manual (July 1997), p. 5692. See also Exchange Act Rel. No. 38354, 1997 SEC LEXIS 511 (February 28, 1997); Exchange Act Rel. No. 38804, 1997 SEC LEXIS 1401 (July 1, 1997); and Exchange Act Rel. No. 39120, 1997 SEC LEXIS 1986 (September 23, 1997), all approving NASD's exclusion of such securities from the excess spread rule at least through October 13, 1997. "[S]ecurities professionals…are part of a highly regulated industry and, as such, [are] required to know the law that is applicable to their conduct within the industry."[14] Respondent, who had substantial experience as a securities professional, including several years of trading and

[13] See former Rule 4613(d), which detailed the required spread and its calculation.

[14] In re Marc N. Geman, Exchange Act Rel. No. 43963, 2001 SEC LEXIS 282 at *69 (February 14, 2001).

market making (Tr. 458, 632, 633), should have known that the rule did not apply to trading in LOCKC.

Finally Respondent's testimony belies his "excess spread rule" defense. When a panelist asked "[h]ow did you know what the maximum spread was?" Mr. Elgindy answered: "Because it tells you. If you try to go over your spread, it says excess spread violations" (Tr. 513). The panelist then asked "[I]n order to be able to get it to give you the excess spread you would have to try, you did not try to do so?" Respondent answered: "…we did try to widen our spread and it was widened to a dollar. It would say excess spread override, excess spread violations." When read as asserting that Respondent's computer system would produce an "excess spread violation" warning, the testimony is incorrect. In fact, the NASD exempted SmallCap securities from the excess spread rule precisely because there was no such technology. As stated in the above-cited February 28, 1997 S.E.C. release:

> The NASD and Nasdaq are proposing to exclude market maker quotations in Nasdaq SmallCap securities from coverage under [the excess spread rule]. This is because, unlike with Nasdaq National Market securities, Nasdaq does not presently calculate and display through the Nasdaq system the average spread of all market makers in Nasdaq SmallCap securities or a comparison of the size of an individual market maker's quoted spread in a SmallCap security relative to the average spread of all market makers in Nasdaq SmallCap securities (footnote omitted). Thus, Nasdaq does not presently provide market makers in SmallCap securities with any indication as to whether they are satisfying the requirements of the 150% Excess Spread Rule (emphasis added).

For all of these reasons, the Panel cannot accept Mr. Elgindy's purported reliance on the excess spread rule as a defense to his bids.

3.) Fair notice of the charge under Rule 2110

Respondent's counsel argued that the Complaint's First Cause charged only manipulation, leaving no room for a finding of other misconduct (Tr. 435-436). The Panel disagrees.

The test is whether the Complaint provided "fair notice" to the Respondents of the alleged violative conduct.[15] See, In re Daniel Joseph Avant, Exchange Act Rel. No. 36423, 1995 SEC LEXIS 2816 (October 26, 1995), sustaining NASD findings of liability for untimely payment of an arbitration award, where the Complaint alleged that Respondent "failed to honor the award." As the S.E.C. there explained: "…the language of the NASD's complaint is broad enough to encompass both a failure to pay this award and the untimeliness of [Respondent's] payment…. We conclude that the record demonstrates that [Respondent] both understood the issues before the NASD and was afforded a sufficient opportunity to defend against those allegations" (at *5).

The present case passes that test. As noted, the Complaint specifically named Rule 2110 as a basis of liability, along with the anti-fraud provisions (¶ 42). Cf. District Business Conduct Committee v. A.S. Goldmen & Company, 1995 NASD Discip. LEXIS 202 (NBCC, March 6, 1995), (dismissing finding of violation of a provision not alleged in the Complaint). Second, the Complaint repeatedly alleged that Mr. Elgindy made various "new published inside bids, without any intent to purchase the security" (¶¶ 11, 15, 21), the very conduct which the Panel here finds violative of Rule 2110. Moreover, Mr. Elgindy not only knew that such conduct was in issue, he went on to defend it extensively, contending that he made the high bids as a by-product of the excess spread rule.

[15] See, e.g., District Business Conduct Committee v. Franklin-Lord, Inc., 1994 NASD Discip. LEXIS 20 at *22

Finally, the fact that the Department failed to prove manipulation under the anti-fraud rules does not necessarily exonerate Respondents from liability under Rule 2110. See, e.g., Department of Enforcement v. Block, 2001 NASD Discip. LEXIS 35 at *24 (August 16, 2001) (dissemination of false memorandum violated Rule 2110, but not Rule 10b-5); Department of Enforcement v. Kevin D. Kunz, 1999 NASD Discip. LEXIS 20 at *35 (July 7, 1999) (material misstatements constituted "negligent misconduct under Conduct Rule 2110" even though evidence of alleged fraud was insufficient); District Business Conduct Committee v. Aaron Eugene Granath, 1998 NASD Discip. LEXIS 19 at *19 (March 6, 1998) (unauthorized trade violated Rule 2110 even though evidence of alleged fraud was lacking). See also District Business Conduct Committee v. Michael R. Euripides, 1997 NASD Discip. 45 at *18 (July 28, 1997) ("A misrepresentation may violate Conduct Rule 2110 even where there is no finding of intent to mislead").

In short, Rule 2210 itself and the conduct were alleged and known to Respondent. The Complaint gave Mr. Elgindy fair notice that his conduct in allegedly bidding without intent to honor was in issue, and the Panel sees nothing unfair in finding him liable for that activity under Rule 2110.

C. Rule 2210

During the time in question, Rule 2210(d)(2)(B) provided that "in making a recommendation… [a member] must disclose…that the member usually makes a market in the securities being recommended…and/or that the member…will sell to or buy from customers on a principal basis" (NASD Manual, July 1997, p. 4174). Elgindy's recommendations (CX-15, CX-

(NBCC, July 28, 1994).

16, CX-19, CX-21) said nothing about his firm being a market maker or its willingness to conduct transactions on a principal basis. Those issuances thus flatly violated this rule.

III. Sanctions

A. Rule 2110

Posting bids without intending to honor them is a violation which is not specifically listed in the NASD Sanction Guidelines. In such circumstances, the Guidelines state that "[a]djudicators are encouraged to look to the guidelines for analogous violations" (Id., at p. 2). Because Elgindy made the bids at the outset without intending to honor them, the instant misconduct is arguably more serious than "backing away." The Panel nevertheless begins with the guideline for that offense because it is the closest analogy. For backing away, the Guidelines recommend a fine of $1,000 to $2,000 for a "first action" (which this is)[16] and, in egregious cases, suspension of the firm and/or the responsible individual for up to two years (Id., at p. 55).

The Panel finds that the circumstances here are egregious. First, the conduct was not limited to one or two isolated instances. It involved several separate time periods on the day in question and a total of twenty specific occasions when Mr. Elgindy failed to honor preference orders directed to his firm. As noted, some were ultimately canceled by the seller after passage of time, some "timed out," and some were declined directly by Elgindy. He had no legitimate excuse for his conduct and virtually admitted that he posted the bids for purposes other than making good faith purchases. Finally, Respondent acknowledged a disciplinary history, involving violations of the SOES rules and entry of non bona fide orders into SelectNet (Tr. 561,

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[16] "An 'action' means a Letter of Acceptance, Waiver and Consent (AWC), a settled case, a Minor Rule Violation Plan Letter, or a fully litigated case" (Guidelines, at p. 12). There was no prior "action" against Respondent Elgindy for backing away or for posting bids without intending to honor them.

606). This prior trading misconduct is particularly aggravating in the context of the present case, involving the posting of bids without intending to honor them.[17]

The Panel also recognizes that there were no backing away complaints, and no evidence that any firm or investor sustained any injury as a result of Mr. Elgindy's conduct. As noted, there was also no evidence that he profited from the misconduct in issue.

On balance, the Panel concludes that the appropriate sanctions for each Respondent should be a fine of $2,000 and a suspension of one year.

B. Rule 2210

For inadvertent use of misleading communications, the Guidelines recommend a fine of $1,000 to $20,000. The Panel believes that Elgindy's omissions were inadvertent. He testified that he had little experience in drafting press releases and apparently believed large firms did not disclose market-maker status in their recommendations (Tr. 519). As noted above, he also testified (without contradiction) that his research report disclosed Key West's status. In addition, he made contemporaneous disclosures of that status to the Bloomberg news service. In these circumstances, the Panel cannot conclude that his conduct was intentional. Nor was there evidence that any market maker or investor was in any way influenced by the recommendations in issue. Considering all of the circumstances, the Panel treats the Rule 2210 misconduct as relatively minor and imposes a fine of $1,000 on each Respondent.[18]

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[17] At the same time, the Panel notes that the disciplinary history was not recent. The incident happened at least eight years ago and at least four years before the conduct in issue here.

[18] The Panel has considered all of the arguments of the parties. They are rejected or sustained to the extent that they are inconsistent or in accord with the views expressed herein.

IV. Conclusion

For making a series of bids without intending to honor them, in violation of Rule 2110, Respondents are each fined $2,000, to be paid if and when such Respondent re-enters the securities industry. For this same misconduct, Respondent Key West's membership is suspended for one year, and Respondent Elgindy is suspended for one year in all capacities. For issuing recommendations without disclosing that Key West was a market maker and/or that the firm would sell to or buy from customers on a principal basis, in violation of Rule 2210, each Respondent is fined $1,000, such fines to be paid if and when Respondent Elgindy re-enters the securities industry.

These sanctions shall become effective on a date set by the Association, but not earlier than 30 days after this Decision becomes the final disciplinary action of the Association, except that if this Decision becomes the final disciplinary action of the Association, Respondents' suspensions shall become effective with the opening of business on February 19, 2002 and end at the close of business on February 18, 2003.

HEARING PANEL

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Jerome Nelson
Hearing Officer

Dated: Washington, D.C.
December 28, 2001

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