

NASD REGULATION, INC.
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,	:	
	:	
Complainant,	:	Disciplinary Proceeding
	:	No. C07980021
v.	:	
	:	
	:	
	:	
	:	Hearing Panel Decision
	:	
	:	Hearing Officer - GAC
	:	
	:	
	:	
	:	May 6, 1999
Respondents.	:	

Digest

The Department of Enforcement (“Enforcement”) filed a six cause Complaint alleging that Respondents _____ (“_____”) and _____ (“_____”) (collectively as the “Respondents”) violated NASD Conduct Rule 2110 and SEC Rule 15c2-4 by failing to establish a proper escrow account in connection with a securities offering; violated Conduct Rule 2110 by conducting a securities business while the firm maintained insufficient minimum net capital; violated Conduct Rule 2110 by failing to comply with the Customer Protection Rule under SEC Rule 15c3-3; violated Conduct Rule 2110 by filing inaccurate FOCUS Reports; violated Conduct Rules 2110 and 3110(a) by failing to accurately prepare

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the firm's net capital computation; and violated Conduct Rule 2110 by failing to give telegraphic notice of the firm's net capital deficiency.

Based on the hearing record, the Hearing Panel found that Respondents committed the acts and violations as alleged in the Complaint. The Hearing Panel censured each Respondent, fined each Respondent \$2,000 and required that Respondent _____ requalify through examination as a Financial and Operations Principal within six months from the date of the issuance of this decision, or cease functioning in that capacity until he does requalify.

Appearances

Alan M. Wolper, Esq., Regional Counsel, Atlanta, Georgia, (Rory C. Flynn, Esq., Washington, DC, Of Counsel), on behalf of the Department of Enforcement.

_____, Esq., on behalf of Respondents _____.

DECISION

I. PROCEDURAL BACKGROUND

A. Complaint

Enforcement filed a six cause Complaint on July 6, 1998. The first cause alleges that the Respondents violated NASD Conduct Rule 2110 and SEC Rule 15c2-4 by failing to establish an escrow account for the sale of _____, ____ (“_____”) securities. The securities were being sold as part of a Private Placement Memorandum (“PPM”), pursuant to Regulation D of the Securities Act of 1933.¹ According to the Complaint, _____ was

¹ Complaint, & 5.

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appointed as the “exclusive agent for

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soliciting investment” in _____, and undertook to represent _____ on a best efforts basis.²

The Regulation D offering was for a minimum of 30 and a maximum of 52 shares of _____ at \$25,000 per share (“Offering”). It is alleged that _____ was obligated to deposit funds received from investors in the Offering either in a “separate bank account” over which _____ would serve as agent, or in an escrow account at a bank. Instead, funds were deposited in a brokerage account at _____, _____ clearing firm, and thereafter prematurely released.

The second cause alleges that the Respondents violated NASD Conduct Rule 2110 by failing to comply with SEC Rule 15c3-1 in that _____ conducted a securities business while the firm maintained less than its minimum required net capital. It is based on the allegation that _____ minimum net capital requirement increased from \$50,000 to \$250,000 because it controlled customer funds in connection with the Offering.

The third, fourth, fifth and sixth causes of action are all related to the second cause of action, in that they represent further potential liabilities if _____ net capital requirement was in fact raised to \$250,000 as a result of its participation in the Offering. The third cause alleges that the Respondents violated the Customer Protection Rule, thereby violating NASD Conduct Rule 2110. By accepting and holding customer funds for the Offering, the cause alleges that _____ disqualified itself for the SEC Rule 15c3-3(k)(2)(ii) exemption, and was therefore obligated to comply with SEC Rule 15c3-3 from May 2 through October 14, 1996. It is alleged that _____ failed to comply with the rule by failing to establish a Special Reserve Bank Account for the Exclusive Benefit of Customers (“Reserve Account”), or make the necessary deposits into the Reserve Account.

² Complaint, §§ 5, 6.

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The fourth cause of action alleges that the Respondents violated NASD Conduct Rule 2110 by filing inaccurate FOCUS Reports with the Association for the months of June and September 1996. The alleged inaccuracies relate to the firm's stated net capital. The fifth cause of action alleges that the Respondents violated NASD Conduct Rules 2110 and 3110(a) by filing inaccurate books and records with the NASD. The nature of these inaccuracies relates to its net capital computations for the months of May, June, July, August, and September 1996. The sixth cause of action alleges that the Respondents violated NASD Conduct Rule 2110 by failing to give telegraphic notice on May 31, June 28, July 31, August 30 and September 30, 1996, of its net capital deficiency as required by SEC Rule 17a-11.

B. Answer

The Respondents filed an Answer on August 5, 1998. Respondents admit that, at all relevant times, _____ was employed by _____ as its President and Chief Executive Officer, and was registered by the firm with the Association as a Municipal Securities Representative, Municipal Securities Principal, General Securities Representative, General Securities Principal and Financial and Operations Principal.

The Respondents admit in their Answer that because the Offering was not handled on a firm-commitment basis, Respondents were required to comply with SEC Rule 15c2-4. Respondents also admit that _____ violated Rule 15c2-4 by failing to establish a proper escrow or trust account. The Respondents however, assert that _____ had no involvement in either _____ failure to comply with SEC Rule 15c2-4 or with _____ alleged control of the funds that were deposited in the _____ account. Rather, they argue that _____ reasonably delegated responsibility for establishing an escrow account over the funds in question.

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According to the Answer, the person with the delegated responsibility was experienced in financial matters and also consulted legal counsel.

For the second cause, Respondents deny that _____ minimum net capital requirement increased from \$50,000 to \$250,000 as a result of its involvement with the Offering.

Respondents admit that from May 2, 1996, through approximately October 14, 1996, funds received from individuals who invested in _____ were deposited in the _____ account.

However, Respondents assert that the _____ account was opened by _____, not _____,

and that with respect to the _____ account, _____ acted only upon direction from _____

President, _____ (“_____”). Respondents further assert that _____ had no

involvement with any accepting, holding, depositing or withdrawing of customer funds from the _____ account.

In response to causes three through six, the Respondents refer back to their responses given for the second cause of action in denying the allegations.

Respondents assert that they voluntarily brought to the SEC’s and NASD’s attention certain alleged improper actions of _____ and _____ in connection with the use of the funds collected, thereby preventing further harm to other investors. Those actions, according to the Respondents, would make it inequitable to proceed against the Respondents on the violations asserted in the Complaint. Respondents assert that the alleged violations were unintentional, and isolated in nature.

C. The Hearing

The Hearing was held in Atlanta, Georgia on October 19, 1998, before a Hearing Panel composed of the Hearing Officer, and two current members of the District 7 Committee.

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Enforcement presented three witnesses and Respondent _____ was the only witness for the Respondents.

Enforcement called David Paulukaitis, Jane A. Villeneuve and Deonne Stephens-Duffy as witnesses. All three Enforcement witnesses are NASD Regulation, Inc. employees from the Atlanta, Georgia office. Paulukaitis is an Associate Director, Villeneuve is a Special Investigator, and Stephens-Duffy is a Senior Compliance Examiner. Paulukaitis was called on Enforcement's direct case, and Villeneuve and Stephens-Duffy were called as rebuttal witnesses. Respondents' counsel cross-examined each of Enforcement's witnesses and called _____ as a witness.

The Hearing Officer admitted into evidence 23 exhibits offered by Enforcement without objection from the Respondents. (CX 1 - 24).³ The Hearing Officer also admitted one exhibit offered by the Respondents. (RX 2).⁴ The Parties jointly submitted "Stipulated Facts," filed on October 6, 1998. The Stipulated Facts are referenced in detail in the Findings of Fact portion of this Decision.

II. FINDINGS OF FACT AND CONCLUSIONS OF LAW

³ References to Enforcement's Exhibits admitted at the Hearing are designated "CX." CX-19 was marked but not offered at the Hearing.

⁴ Respondents marked another document as RX 1 but that document was not offered at Hearing.

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_____ became a member of the NASD in June 1994. The firm conducts a general and municipal securities business on a fully-disclosed basis.⁵ _____ is presently employed as President and Chief Executive Officer of _____.⁶ _____ entered the securities industry in 1984 as a Municipal Securities Representative. In 1988, _____ became registered as a Municipal Securities Principal and in 1991 registered as a General Securities Representative and Principal. _____ joined _____ in March 1994, becoming registered as a General Securities Representative and Principal, Municipal Securities Representative and Principal, and Introducing Broker/Dealer Financial and Operations Principal that same month.⁷

In February 1996, _____, then a registered representative of _____, formed _____, a Georgia Limited Liability Corporation. _____ was to serve, among other things, as the investment advisor to mutual funds that _____ anticipated creating.⁸ Although _____ had been registered with _____ since October 1995, and had worked as a retail broker there, he ceased to function in that capacity in early 1996.⁹ _____, though an independent entity from _____,¹⁰ was located in a room at _____ offices and used many of _____ facilities.¹¹

⁵ Stipulated Facts, & 1.

⁶ Stipulated Facts, & 3.

⁷ Stipulated Facts, & 3; CX 2, pp. 2-3.

⁸ Stipulated Facts, & 6.

⁹ Stipulated Facts, & 5.

¹⁰ Stipulated Facts, & 6.

¹¹ Hearing Tr. pp. 100-101.

In late 1995 and early 1996, _____ and his partners met with _____ to discuss _____ concept of forming _____.¹² Thereafter, _____, through _____ and his partners “agreed to take on the role of assisting [_____] ... set up the PPM and help set up the marketing for raising capital.”¹³

On March 20, 1996, _____ released a PPM, pursuant to Regulation D. The Offering was for a minimum of 30 and a maximum of 52 shares of _____ at \$25,000 per share.¹⁴ The Offering was to be done on a “best efforts, all-or-none” basis with respect to the minimum number of shares offered, and on a “best efforts” basis with respect to the remaining 22 shares.¹⁵ The PPM named _____ as manager of _____ and _____ as one of two shareholders of _____.¹⁶ It further designated _____ as the only entity (other than executive officers of _____) responsible for selling the Offering.¹⁷ _____ also appointed _____ as “its exclusive agent for soliciting investment in _____” through the Offering. In the agreement, _____ undertook “the representation of _____ on a best efforts basis.”¹⁸

¹² Hearing Tr. pp. 53-54.

¹³ Hearing Tr. pp. 53-54.

¹⁴ Stipulated Facts, & 7.

¹⁵ Stipulated Facts, & 8.

¹⁶ The second shareholder was _____. CX 5, p. 10. _____ claims that _____ never received the shares of _____ to make it an owner.

¹⁷ Stipulated Facts, & 8.

¹⁸ Stipulated Facts, & 9; CX 3, p. 2.

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Given the nature of the Offering, and _____ role as agent for soliciting investment in _____, _____ was required to operate in compliance with SEC Rule 15c2-4.¹⁹ Under SEC Rule 15c2-4, _____ had the option of depositing funds received from investors in the Offering in either a “separate bank account” over which _____ would serve as agent, or in an escrow account at a bank.²⁰ It is clear from the plain language of SEC Rule 15c2-4 that such account was required to be with a bank – not a securities brokerage firm.²¹

Pursuant to the agreements between _____ and _____, in a letter dated April 25, 1996, _____, on behalf of _____, gave _____ “full and irrevocable authority to open for _____ an escrow account in which _____ would serve as trustee.”²² However, instead of _____ establishing an escrow account at a bank, as contemplated in SEC Rule 15c2-4, _____ opened a securities brokerage account with _____ & Co. (“_____”), _____ clearing firm, for the purpose of holding the funds raised in the Offering. Thus, the account was not properly set up as a bank account pursuant to SEC Rule 15c2-4.²³

¹⁹ Stipulated Facts, & 11.

²⁰ Stipulated Facts, & 12. SEC Rule 15c2-4 makes it improper “for any broker, dealer or municipal securities dealer participating in any distribution of securities, other than a firm-commitment underwriting, to accept any part of the sale price of any security being distributed unless: (b) If the distribution is being made on an “all-or-none” basis, or on any other basis which contemplates that payment is not made to the person on whose behalf the distribution is being made until some further event or contingency occurs: (1) the money or other consideration received is promptly deposited in a separate bank account, as agent or trustee for the persons who have the beneficial interests therein, until the appropriate event or contingency has occurred, and then the funds are promptly transmitted or returned to the persons entitled thereto, or (2) all such funds are promptly transmitted to a bank which has agreed in writing to hold all such funds in escrow for the persons who have the beneficial interests therein and to transmit or return such funds directly to the persons entitled thereto when the appropriate event or contingency has occurred.”

²¹ Id.

²² Stipulated Facts, & 13; CX 6.

²³ Stipulated Facts, & 14.

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From May 9 until May 31, 1996, _____ deposited \$90,000 from six (6) investors into the _____ account. One such customer, D.B. sent in a check for \$15,000 to invest in .6 of a share of _____ as part of the Offering. In a letter dated May 30, 1996 (“May 30 letter”), _____ purportedly received instructions from D.B. to withdraw the funds he had sent in, and to have the original subscription documents returned to him. The letter, addressed to _____, instructed the firm to “hold the funds in a separate account entitled _____ Advisor until I instruct you otherwise in writing, except that you may release \$2,500 from the account representing a non-interest bearing loan from me to the _____ Advisor due in 30 days.”²⁴ When _____ received the May 30 letter, _____ (“_____”), a principal at _____, brought the letter to _____ attention.²⁵ _____ instructed _____ to contact their attorney, _____, for advice on how to proceed.²⁶ In an attempt to get the funds released pursuant to instructions in the May 30 letter, _____ had _____ sign an “Indemnification Agreement” (“Agreement”). That Agreement stated that “_____ in [his] personal capacity, agree[s] to hold harmless [_____], _____ as trustee, ... from any liability or claim of liability resulting from the withdrawal, pursuant to an agreement with an investor in [_____], of moneys from the _____ Advisor escrow account ... on or about May 29, 1996”²⁷

²⁴ Stipulated Facts, & 17; CX 10.

²⁵ Hearing Tr. p. 57.

²⁶ Id. There is no evidence in the record that _____ was contacted or that he gave any legal advise with regard to the May 30 letter.

²⁷ CX 11.

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Pursuant to the instruction in the May 30 Letter, on or about June 18, 1996, _____ caused \$15,000 to be transferred from the _____ account to a second _____ account that had been opened by _____ in May 1996. The Parties now acknowledge that the May 30 letter was a forgery - that customer D.B. did not sign the letter, had no knowledge of the letter, and did not authorize the withdrawal of his funds from the _____ account.²⁸

On three subsequent occasions, on or about June 20, 1996, June 25, 1996, and August 13, 1996, _____ followed instructions from the May 30 letter and two letters from _____, and mailed three checks for \$2,500 each to _____. Those funds were paid out of the second _____ account.²⁹

Delegation of Authority

Given that the Respondents admit that _____ violated SEC Rule 15c2-4 by not establishing an appropriate bank account for the funds from the Offering, the Parties agreed that there are two issues to be decided. The first, relating principally to the first cause of action, is whether _____, as President and Financial and Operations Principal of _____ reasonably delegated his responsibilities regarding the Offering. _____ claims that there had been a reasonable delegation of authority - a claim disputed by Enforcement.

Regarding delegation of authority, the SEC has held,

The president of a brokerage firm is responsible for the firm's compliance with all applicable requirements unless and until he reasonably delegates a particular function to another person in the firm, and neither knows nor has reason to know that such person is not properly performing his duties.³⁰

²⁸ Stipulated Facts, & 21.

²⁹ Stipulated Facts, && 22, 23, 24.

³⁰ Steven P. Sanders, Exchange Act Rel. No. 40600 (October 26, 1998), *quoting* Kirk A. Knapp, 50 S.E.C. 858, 862 (1992).

In describing _____ role as an “investment banker,” _____ testified that he delegated to three people the work relating to _____ since _____ had no prior experience with private placements and _____ personally had no experience in private placements.³¹

The first person to whom _____ delegated responsibility was _____. (“_____”), _____ in-house counsel. _____ was “to take on the key role in preparing _____ and preparing the financial and marketing plan for _____.”³² _____ designated _____ as “one of the people that would ensure compliance” of the PPM to the pertinent laws and regulations.³³

_____, however, was not and had never been registered in any capacity with the NASD.³⁴ There was also conflicting evidence regarding _____ association with

³¹ Hearing Tr. pp. 54 -55, 89.

³² Id. See Hearing Tr. p. 54.

³³ Hearing Tr. p. 81.

³⁴ Hearing Tr. 143-144; CX 20, 24.

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_____ during the relevant period. Enforcement introduced an affidavit of _____ that stated that _____ severed his relationship with _____ in late December 1995 or very early January 1996.³⁵ _____ further described his involvement with the PPM as “very limited,” in that he “reviewed _____ proposed business plan, and helped ... _____ in his effort to identify people to serve as advisors to the board of directors of _____.”³⁶ According to the affidavit, _____ does not recall _____ delegating any responsibility to _____ for establishing an escrow account to be used for _____. Further, _____ stated that while associated with _____, he never established an escrow account in connection with any private placement.³⁷

_____ admits that he did not delegate to _____, or any other person individually the specific responsibility of establishing an escrow account for the Offering.³⁸ Contrary to the affidavit from _____, _____ maintained that he had delegated responsibility for the Offering to _____, but acknowledged that during the relevant period, _____ “was going through a very difficult time at that point and I don’t know if he had started medication or not, but ... he had had a lot of trouble at home, and he was in and out of the office pretty much for the next six months of that year really. He’d come in every now and then and try to help us out”³⁹

The second person named by _____ to work on the _____ matter was one of _____ partners, _____. According to _____, _____, “was going to handle anything that

³⁵ CX 20.

³⁶ Id.

³⁷ Id.

³⁸ Hearing Tr. p. 81.

³⁹ Hearing Tr. p. 79.

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had to do with _____.⁴⁰ In 1996, _____ was a General Securities Representative and Principal. _____ was the only registered individual to whom _____ had delegated his responsibilities for the Offering.⁴¹ However, according to _____, _____ “had very little background” with respect to private placements, and had no experience in preparing them.⁴² “[A]bout the only thing operationally that had to be done” according to _____, “was set up that account and it was set up wrong.”⁴³ Despite _____ obvious lack of experience, _____ relied on him for the critical matter of setting up the proper bank account, and it was _____ who advised _____ that the account had been set up properly.⁴⁴

The third person was _____, an attorney from a law firm who, according to _____, “was very involved in private placements, very experienced in them, to handle the ... legal part of it and making sure compliance with all NASD and SEC requirements.”⁴⁵ However, it appears that _____ role was limited with respect to establishing the proper bank account. Regarding the escrow account, _____ said that _____ advised him that there was no conflict with him (_____) serving as an officer of _____.⁴⁶ As to the proper establishment of the account, as noted above, _____ relied on _____ for that advice.

⁴⁰ Hearing Tr. p. 55.

⁴¹ Hearing Tr. p. 93.

⁴² Hearing Tr. pp. 92-93.

⁴³ Hearing Tr. p. 94.

⁴⁴ Hearing Tr. pp. 107-108.

⁴⁵ Id.

⁴⁶ Id.

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Although _____ identified _____ as someone with delegated responsibility, compliance with SEC and NASD rules cannot be delegated to someone not associated with the member firm. Ultimately, responsibility for compliance must rest with a member firm's officers and designated principals. However, the issue of _____ involvement does raise the issue of reliance on counsel. Even had _____ relied on _____ advice for the proper establishment of the escrow account, which the record does not clearly establish, such reliance on advice of counsel would not relieve _____ of liability in this case. Reliance on advice of counsel has been recognized as a defense, under limited circumstances, only where proof of the respondent's state of mind ("scienter") is required, such as in cases alleging fraud. Proof of scienter is not required, however, to establish a violation of SEC Rule 15c2-4. Reliance on counsel may, however, be a mitigating factor in setting sanctions.⁴⁷

Based on a review of the evidence, the Hearing Panel concludes that the responsibility for ensuring compliance with SEC Rule 15c2-4 was not reasonably delegated. As described above, _____ delegated the responsibility to three people, only one of whom was registered with the Association. It appears that _____ had no more background or expertise in Regulation D offerings than _____. _____, the other associated person designated by _____, disputes that he was given such responsibility. Even if he had been delegated the responsibility, that delegation was irresponsible, given what _____ believed to be _____ personal problems and unpredictable work schedule.

⁴⁷ District Business Conduct Committee for District No. 1 v. John Thomas Higley, Complaint No. C01950034, 1997 NASD Discip. Lexis 5, at *9, 11 (NBCC Mar. 5, 1997).

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By delegating his regulatory responsibility to three people who were either unregistered and/or unqualified, _____ failed to make a reasonable delegation. The Hearing Panel therefore finds _____, along with _____ violated NASD Conduct Rule 2110 and SEC Rule 15c2-4 as alleged in the first cause of the Complaint.

Net Capital Requirement

The second issue, which focused on the second cause of action, was whether the Respondents were deemed to have held customer funds by virtue of their relationship and possible control of the _____ account, thus raising the firm's net capital requirement to \$250,000. Control of customer funds is an important benchmark in setting a member firm's net capital requirement. The Parties agree that the allegations in causes three through seven all relate to the issue in Cause 2, as stated above.⁴⁸

Enforcement argued that there were two distinct bases for finding that _____ net capital requirement was raised to \$250,000 as a result of its activities with _____. First, _____ failed to establish a proper escrow account for the _____ PPM. By failing to adequately insulate itself from the funds by establishing an escrow account with an unaffiliated bank, it became subject to the increased net capital requirement. That interpretation is supported by NASD Notice to Members 84-7, issued in 1984 ("NTM 84-7") and reissued in

⁴⁸ _____ net capital requirement increased from \$50,000 to \$100,000 during the relevant period for reasons unrelated to the _____ PPM. Respondents' counsel argues that one wrongful act, failing to establish an escrow account, resulted in all seven causes of action.

1998.⁴⁹ NTM 84-7 provided SEC staff interpretations of Rule 15c2-4 in a question and answer format. Included was the following:

(7) Question: How is compliance with the Rule affected where the issuer ... and a broker-dealer participating in the distribution are affiliated?

Answer: Since the Rule imposes an obligation on a broker-dealer to ensure that funds received by it are not dissipated in any fashion and not disbursed to the issuer unless the contingency has been fully satisfied, where an issuer and broker-dealer are affiliated, the broker-dealer should not act as agent or trustee for the funds. See Securities Exchange Act Release No. 11532 (July 11, 1975). Instead, an escrow agent should be used that is a bank unaffiliated with both the issuer ... and the broker-dealer.

(10) Question: May some person other than a bank (e.g., and attorney for the broker-dealer) act as an escrow agent within the meaning of the Rule?

Answer: No, the escrow agent must be a bank that is unaffiliated with either the issuer or the broker-dealer.

Thus, having failed to satisfy the requirement under SEC Rule 15c2-4 for the establishment of a proper bank account, _____ was subject to the higher net capital requirement once it began handling customer funds.

The second basis outlined by Enforcement was that it did in fact exercise control over the funds in the _____ account. This is evidenced by the Certificate and Corporate Resolution, as well as the documentary and testimonial evidence that _____ used his authority to withdraw investors' money from the _____ account. The Respondents argue that they did not control the _____ account because no steps were taken by the Respondents regarding the

⁴⁹ NTM 84-7 was reissued as an attachment to NTM 98-4, which was simply termed a "Reminder of

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_____ account except at the direction of _____. Respondents point to the efforts made to obtain the indemnification agreement prior to releasing the funds. Although _____ acted upon the direction of others, that does not mean that it did not exercise control of the funds. In fact it did. It was _____, on behalf of _____, who had authority to act on behalf of the account, and, as noted above, _____ exercised that authority by improperly releasing funds to _____.

The Hearing Panel therefore finds that the Respondents exercised control over customer funds, thereby elevating the firms' net capital requirement to \$250,000. Since there is no dispute that during the relevant period _____ did not maintain net capital of at least \$250,000, the Hearing Panel finds that Respondents violated NASD Conduct Rule 2110 and SEC Rule 15c3-1 as alleged in the second cause of the Complaint.

Having found that the Respondents violated the second cause of action by failing to maintain the required net capital, the Hearing Panel finds that the Respondents likewise violated Causes 3, 4, 5, and 6 of the Complaint. As discussed above, each of these causes is premised on the firm functioning in compliance with the net capital requirements. Given that the firm was under its minimum net capital, _____ was obligated, but failed, to file a telegraphic notice in accordance with SEC Rule 17a-11. _____ was also obligated to establish a reserve fund under SEC Rule 15c3-3, the Customer Protection Rule, for the period of May through September 1996, but failed to establish such a fund.⁵⁰ _____'s Focus reports that were filed for June and September 1996 did not show a net capital requirement of \$250,000. Consequently, the Focus reports were inaccurate when filed. As FINOP for the firm, _____

Members' Obligations to Comply with Rules 15c2-4."

⁵⁰ Hearing Tr. pp. 40 - 41.

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was responsible for the filing of accurate Focus reports, and filed reports in June and September 1996 that were inaccurate, inasmuch as they contained the wrong net capital figures.⁵¹ _____ net capital computations as of May 31, June 30, July 31, August 31, and September 30, 1996, were also not accurately prepared, in violation of NASD Conduct Rules 2110 and 3110(a). As with the requirement for telegraphic notice, the responsibility for satisfying SEC Rule 15c3-3 is the function of a firm's FINOP, who in this case is _____.⁵²

III. SANCTIONS

The Respondents have argued that all the causes in the Complaint are based on the same single wrongful act of failing to establish a proper bank account to handle customer funds for the _____ PPM. The Hearing Panel agrees as to _____. As for _____, his failure to properly delegate his authority to competent individuals is what led in large part to the failure to establish the proper account. _____ testified that he had no experience in private placements.⁵³ In an interview with NASD staff, _____ also admitted that he was unaware of the requirements of SEC Rule 15c2-4.⁵⁴

In determining appropriate sanctions, the Hearing Panel reviewed the principal considerations outlined in the NASD Sanction Guidelines ("Guidelines"). Given that the root of the violations was a failure to comply with the escrow requirements under SEC Rule 15c2-4,

⁵¹ NASD Membership and Registration Rule 1022(b)(2).

⁵² Id.; Whiteside & Company, Inc., Exchange Act. Rel. No. 26187 (October 14, 1988); Hearing Tr. p. 41.

⁵³ Hearing Tr. p. 89.

⁵⁴ Hearing Tr. p. 146.

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the Hearing Panel used those Guidelines to establish the sanctions in this case.⁵⁵ Respondents' disciplinary history also is one of the considerations. This action is _____ only formal disciplinary action.⁵⁶ _____ has only one minor disciplinary matter in its history.⁵⁷

The Hearing Panel also considered the fact that the Respondents were the first to bring the problem of the escrow account to the attention of the securities regulators - first to the SEC and then to the NASD. At that time, the Respondents were concerned that they and the investors had been subject to a fraud by _____. The sanctions for a violation of SEC Rule 15c2-4 under the Guidelines are fines ranging from \$1,000 to \$10,000. The Guidelines do not call for any type of suspension except in egregious cases, which this is not. There are no allegations that any of the violations was intentional. Quite the contrary, in his closing argument, counsel for Enforcement noted, "I don't think _____ was trying to do anything wrong here."⁵⁸ Consequently, the Hearing Panel finds that a fine at the bottom of the Guidelines range is appropriate.

By reason of the foregoing, the Hearing Panel hereby censures each Respondent, and fines each Respondent \$2,000. The Hearing Panel further orders that _____ requalify through examination as a Financial and Operations Principal within six months from the date of the issuance of this decision, or cease functioning in that capacity until he does requalify.

⁵⁵ NASD Sanction Guidelines, p. 21. (May 1998).

⁵⁶ Stipulated Facts, & 4. NASD Sanction Guidelines, Principal Consideration No. 1, p. 8. (May 1998).

⁵⁷ Stipulated Facts, & 2.

⁵⁸ Hearing Tr. p. 164.

IV. CONCLUSION

The Hearing Panel found that Respondents _____ and _____ violated each of the seven causes of action as alleged in the Complaint. The Hearing Panel censured each Respondent, fined each Respondent \$2,000 and ordered that _____ requalify through examination as a Financial and Operations Principal within six months from the date of the issuance of this decision, or cease functioning in that capacity until he does requalify.

The Hearing Panel assessed joint and several costs against Respondents _____ and _____ in the amount of \$864.00, consisting of a \$300.00 administrative fee and \$ 564.00 for the cost of the Hearing transcript.⁵⁹

Hearing Panel

By: Gary A. Carleton
Hearing Officer

⁵⁹ The Hearing Panel considered all of the arguments of the Parties. They are rejected or sustained to the extent they are inconsistent or in accord with the views expressed herein.