NASD REGULATION, INC.
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. COLEMAN & COMPANY SECURITIES, INC. (BD #1486) New York, NY, and AARON J. YORKE, IV (CRD #701412) New York, NY, Respondents.	Disciplinary Proceeding No. CAF980022 Hearing Officer—Andrew H. Perkins **Hearing Panel Decision** June 25, 1999

Digest

The Hearing Panel found that Coleman & Company Securities, Inc. unjustifiably terminated a firm commitment underwriting in violation of NASD Conduct Rule 2110. The Hearing Panel fined the firm $200,000 and suspended the firm for a period of three months from participating in any underwritings and thereafter for an additional nine months from acting as a lead managing underwriter. During the initial three-month suspension, and as a condition to its resuming any underwriting activity, the Hearing Panel ordered the firm to retain a consultant and revise its compliance manual in accordance with the consultant's recommendations. Finally, the Hearing Panel ordered the firm to pay the costs of this proceeding in the amount of $1,834.50.

Appearances

Brian L. Rubin, Counsel, Robert L. Furst, Senior Attorney, Thomas B. Lawson, Chief Counsel, and Rory C. Flynn, Chief Litigation Counsel, Washington, DC, counsel for the Department of Enforcement.

Ira Lee Sorkin, Lance Croffoot-Suede, and Christina A. Sessa, Squadron, Ellenhoff, Plesent & Sheinfeld, LLP, counsel for Coleman & Company Securities, Inc.

DECISION

I. Procedural Background

On May 12, 1998, the Department of Enforcement (Enforcement) filed its Complaint in this disciplinary proceeding against Coleman & Company Securities, Inc. (Coleman or the "Firm") and its President and Chief Executive Officer, Aaron Jones Yorke, IV (Yorke).[1] The Complaint charged that on November 27, 1995, Coleman and Yorke terminated—without justification—the firm commitment initial public offering of 1 million shares of common stock in Hungarian Broadcasting Company (the "HBC Underwriting") in violation of NASD Conduct Rule 2110. In its Answer, Coleman admitted that it terminated the HBC Underwriting and asserted that the cause for the termination was the failure and refusal of Coleman's clearing firm, Schroeder Wertheim & Co., to deliver the necessary funds to close the offering, in contravention of their

[1] On July 27, 1998, Yorke settled the charges against him. (Order Accepting Offer of Settlement of Aaron Jones Yorke, IV (July 27, 1998)). Accordingly, this Decision relates only to Coleman.

clearing agreement.[2] Coleman also raised affirmative defenses challenging the constitutionality of NASD Conduct Rule 2110 and the legal sufficiency of the Complaint.[3]

Enforcement moved to strike all of Coleman's affirmative defenses, and Coleman cross-moved to dismiss the Complaint. On October 2, 1998, the Extended Hearing Panel (the "Hearing Panel")[4] denied Coleman's motion to dismiss and denied in part Enforcement's motion to strike Coleman's affirmative defenses. The Hearing Panel concluded that NASD Conduct Rule 2110 is not unconstitutionally vague, and the Complaint therefore should not be dismissed. The Hearing Panel denied Enforcement's motion to strike Coleman's first, second, and third affirmative defenses and granted the motion to strike the fourth affirmative defense. The fourth affirmative defense asserted factors in mitigation of sanctions if a violation were found, but they did not constitute defenses to the charged violation.

On October 9, 1998, Enforcement filed 23 stipulations,[5] which it represented had been agreed to by Coleman's counsel (the "Stipulations").[6] Included among them was a stipulation to the authenticity and admissibility of all of the exhibits filed with the Parties' pre-hearing submissions, except those to which specific objections were noted. (Stip. ¶ 23.)

On February 17, 1999, Coleman and Enforcement reached an agreement on liability whereby Coleman would accept Enforcement's proffer of the facts and not contest liability.

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[2] Coleman Answer ¶ 1.

[3] Coleman Answer ¶¶ 18, 19.

[4] Under NASD Procedural Rule 9231(c), the Chief Hearing Officer designated this matter an Extended Hearing. Accordingly, an Extended Hearing Panel was appointed.

[5] The Stipulations are cited as "Stip. ¶[number]."

[6] Although the Stipulations were signed only by Enforcement's counsel, they stated that Coleman had agreed to their filing.

Pursuant to that agreement, Enforcement filed a proffer of the facts it would prove at the hearing if it presented its evidence (the "Proffer"). The Proffer incorporated the Stipulations of October 9, 1998. Enforcement also filed a notice on February 19, 1999, stating that the hearing would be limited to the issue of sanctions.

The day before the hearing, Coleman filed Respondent's Proffer and Pre-Hearing Submission. Coleman objected to Enforcement's Proffer because Coleman considered that it included argument. Coleman did not, however, challenge the facts in the Proffer or the Stipulations. Instead, Coleman sought leniency because it had been sold since the HBC Underwriting, and Coleman's new owners had not been involved in the termination of the HBC Underwriting.[7] Accordingly, Coleman argued that a censure alone would be a sufficient sanction.[8]

Upon the opening of the hearing on February 23, 1999, Coleman confirmed that it did not contest liability because its current owners were not associated with Coleman when the alleged wrongdoing took place.[9] (Tr. 7, 10.) In other words, Coleman did not contest liability because it lacked sufficient knowledge to rebut Enforcement's evidence. Thus the Hearing Panel took liability as admitted and heard the Parties evidence and arguments on the issue of sanctions.

At the hearing, Enforcement introduced 47 exhibits into evidence. Enforcement did not call any witnesses to testify.

Coleman offered the testimony of Philip Puccio, its President and CEO, and Ehud D. Laska, its Chairman. Coleman also offered two exhibits that were admitted into evidence.

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[7] Respondent's Proffer and Pre-Hearing Submission at 2.

[8] Id. at 5.

On March 3, 1999, pursuant to a schedule established at the conclusion of the hearing, Coleman submitted a post-hearing memorandum on the issue of whether sanctions against a firm are appropriate where the violations were committed when the firm was under prior ownership. Enforcement filed a reply memorandum on March 8, 1999.

II. Findings of Fact

Coleman has been a member of the National Association of Securities Dealers, Inc. ("NASD") since 1951. It also was a member of the New York Stock Exchange from 1951 to February 23, 1998, when it withdrew from membership. Coleman is based in New York and has one branch office in California. (Proffer ¶¶ 1, 2.) Currently, Coleman is owned by a holding company that, in turn, is owned 67% by Interbank, about 30% by several outside investors, and about 3% by Coleman employees. (Tr. 148-49.) Interbank, a merchant bank located in New York City, invested in Coleman in April 1996 and shortly thereafter Ehud David Laska (Laska), Interbank's President, became Chairman of Coleman's Board of Directors. (Tr. 145, 147.) Under Laska's direction, Coleman replaced many of its senior officers, including James Jedrlinic, who was the principal financial officer and head of marketing.[10] (Tr. 144-46.) The only senior member of Coleman's previous management team Interbank ultimately retained is Stanley Bartels, Vice President and head of investment banking (Bartels). (Tr. 163.) Bartels, now an Executive Vice President at Coleman, is responsible for Coleman's underwriting business and sits on its

[9] References to the hearing transcript are cited as "Tr. [page number]." All transcript cites are to the transcript page numbers, not the exhibit page numbers. Enforcement's exhibit references are "Ex. C[number]," and Coleman's exhibit references are "Ex. R[number]."

[10] Mr. Jedrlinic was also a former owner of Coleman. Interbank bought out his interest in August 1997. (Tr. 147.)

investment banking committee. (Tr. 191-92; Ex. C76.) Bartels also was in charge of underwriting at the time of the HBC Underwriting.

Hungarian Broadcasting Company ("HBC") was formed in September 1994 to acquire companies that had commercial broadcasting licenses and to own, develop, expand, and operate television stations in Hungary. (Proffer ¶¶ 3, 4.) To raise capital, HBC sought to issue an initial public offering of common stock. To that end, on or about June 9, 1995, Coleman and HBC executed an underwriting "letter of intent," under which Coleman agreed to undertake the organization and management of an underwriting group to effect a firm commitment initial public offering for HBC.

On September 8, 1995, HBC filed a Registration Statement with the Securities and Exchange Commission ("SEC") for an initial public offering of 1,000,000 shares of common stock at $7 per share. The SEC declared the Registration Statement effective on November 17, 1995. (Proffer ¶¶ 5-8.)

On Monday, November 20, 1995, Coleman and HBC executed a firm commitment Underwriting Agreement on behalf of itself and another underwriter (the "HBC Underwriting Agreement" or the "Agreement"). Under the Agreement, Coleman agreed to purchase 800,000 shares of HBC common stock at $7 per share. The other underwriter agreed to purchase the balance of shares at the same price. The underwriters further agreed to pay HBC $6.3 million, the net proceeds from the initial public offering.

More than 230 customers purchased HBC common stock from the initial public offering. (Proffer ¶ 17; Ex. C28.) Trading in HBC common stock commenced on Monday, November 20, 1995, and the opening quote was $7 ¼ – $7 ¾. From Tuesday, November 21 through Friday, November 24, shares of HBC's common stock sold at approximately $5 ½ to $6 ¼, and the trading volume totaled more than 610,000 shares. (Proffer ¶ 18.)

The closing date for the underwriting initially was set for Friday, November 24, 1995, but that day Coleman and HBC agreed to extend the closing date to Monday, November 27. (Proffer ¶¶ 10–16, 19.) By November 27, approximately 54,000 shares had traded in the aftermarket. (Proffer ¶ 20.)

Following issuance of the HBC initial public offering, approximately 12 institutional (DVP) accounts and 32 retail customers failed to affirm their commitments to purchase shares worth a total of $2,133,000. (Proffer ¶¶ 22-24; Ex. C18; Ex. C30; Ex. C31.) As a result, Coleman terminated the Underwriting because it had insufficient funds to close. (Proffer ¶ 21; Ex. C 45, at 5; Ex. C75.) Consequently, HBC did not receive any funds from the Underwriting. (Proffer ¶¶ 25, 26; Ex. C6; Ex. C8; Ex. C12.) In addition, the termination required that transactions involving approximately 660,000 shares of HBC common stock had to be unwound and canceled. At least 50 NASD member firms and their clearing agents were affected. (Proffer ¶ 27; Ex. C28; Ex. C29; Ex. C73.)

At the time Coleman terminated the HBC Underwriting, Bartels sent notice to HBC and the members of the underwriting syndicate that the underwriting was terminated due to "market conditions." (Proffer ¶ 28 (a); Ex. C8, at 2.) Later, Coleman advanced several other reasons for the termination, none of which admitted the real reason for the termination—Coleman's insufficient capital. (Proffer ¶ 28.)

The Hearing Panel also finds that Coleman's termination of the HBC Underwriting on November 27, 1995, was unjustified. The HBC Underwriting Agreement provided that the underwriters would purchase—on a firm commitment basis—1,000,000 shares of HBC common stock at $7 per share.[11] Although the Agreement contained what is known in the securities industry as a "market out" clause (Ex. C5, at 25-26), there is no evidence that there was a material adverse change either in the market or in HBC's business, operations, condition, earnings, or prospects.[12] To the contrary, the evidence overwhelmingly supports the inference that Coleman terminated the HBC Underwriting because the price of HBC stock fell in the aftermarket, purchasers failed to affirm their orders, and Coleman had insufficient capital to purchase the offered shares. Coleman terminated the underwriting because it could not meet its firm commitment under the Agreement.

In or about July 1996, HBC sued Coleman to recover the funds due it under the Underwriting Agreement. Coleman eventually paid HBC $300,000 to settle that case. (Tr. 92.)

III. Conclusions of Law

A. Jurisdiction

The NASD has jurisdiction over Coleman and this proceeding. Coleman is currently a member of the NASD, as it was when the alleged violation occurred and when Enforcement filed the Complaint.[13]

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[11] In a "firm commitment" underwriting agreement, the underwriters agree that they will purchase the shares being offered for the purpose of resale to the public. The underwriters must pay for and hold the shares for their own account if they are not successful in finding public purchasers. The risk of loss on any unsold shares is assumed by the underwriter. See, e.g., Walk-In Medical Centers, Inc. v. Breuer Capital Corp., 818 F.2d 260, 266 (2d Cir. 1987).

[12] In fact, Coleman abandoned this defense before the hearing.

[13] See Article XIII, Section 1(b) of the NASD's By-Laws.

B. Coleman's Responsibility for Terminating the HBC Underwriting and Sanctions

Coleman neither contests what happened nor the egregiousness of its misconduct. (Tr. 58.) Rather, Coleman argues that it should not be severely sanctioned because none of its present owners had any involvement in the HBC Underwriting. (Respondent's Post-Hearing Mem. at 2.) In other words, Coleman contends that the Hearing Panel should take the change of ownership into account as a mitigating factor in assessing sanctions. (Id. at 3.) In support, Coleman cites three SEC decisions that it argues demonstrate that Coleman's change of ownership should significantly reduce the sanctions. However, each of the cases is distinguishable from the present one and is found not to be controlling on the issue of sanctions in this case.

The first case, In re Laidlaw & Co., Inc.,[14] involved multiple charges against several firms for a variety of manipulative activities and fraud in connection with the distribution and aftermarket trading of a security. In settlement of the charges against three of the firms and one individual respondent, the SEC imposed only a censure. And as to one of the settling firms, without discussion or analysis, the Findings and Order Imposing Remedial Sanctions noted that the firm represented in its settlement offer that "it is under new ownership and management which did not participate in or have any knowledge of the violations."[15] It is not clear, however, from the SEC's order if this factor was given much weight in light of the fact that the other respondents also received only a censure. In any event, "it goes without saying that settled cases are

[14] Exchange Act Release No. 11564, 1975 SEC LEXIS 1109 (July 31, 1975).

[15] Id. 1975 SEC LEXIS, at *7.

questionable precedent, particularly on the issue of sanctions, since parties to a settlement may be motivated by pragmatic considerations."[16]

The second case cited by Coleman is In re Steadman Sec. Corp.,[17] which did not involve a change of corporate ownership. In Steadman, the SEC had brought charges against Charles Steadman (Steadman), Steadman Security Corp. ("SSC"), and its five wholly-owned subsidiaries.[18] Steadman served as the investment manager for SSC and its funds. The gravamen of the charges in the Complaint was that Steadman had concealed from investors the nature of his and the funds' banking relationships, which facts the SEC concluded would be material to investors. In addition, the Complaint charged various irregularities in the fund's filing requirements. The SEC found that the respondents committed most of the violations charged and specifically found that Steadman's conduct was egregious. However, in setting remedial sanctions, the SEC declined to put the funds out of business. Instead, the SEC focused on Steadman, the "real parent" and person in control of SSC and its subsidiaries.[19] The SEC justified this result by emphasizing the following three factors. First, the SSC organization managed a fairly substantial investment company complex, and it would be within the public interest to let the organization continue if it was rid of Steadman's corrupting influence. Second, if the SEC put SSC out of business, the non-voting shareholders would be stripped of the going concern value of their interests. And, third, putting SSC out of business would be inconsistent with its decision to

[16] In re Orlando Joseph Jett, Initial Decisions Release No. 127, 1998 SEC LEXIS 1501, at *111, n.54 (July 21, 1998) (citations omitted).

[17] Exchange Act Release No. 13695, 1977 SEC LEXIS 1388 (June 29, 1977), rev'd in part and remanded sub nom. Steadman v. SEC, 603 F.2d 1126 (5th Cir. 1979), aff'd, 450 U.S. 91 (1981).

[18] Steadman, 1977 SEC LEXIS, at *14.

[19] Steadman, 1977 SEC LEXIS, at *64.

give Steadman time to dispose of his SSC stock. As a whole, it is clear that the SEC considered Steadman to be responsible ultimately for all of the charged violations. Therefore, it drew a distinction between sanctioning Steadman and the funds he controlled.[20]

In considering the sanctions against Steadman, the SEC concluded that strong sanctions were required to protect the public interest for two reasons. First, where misconduct is egregious, the SEC held that it must take effective measures to protect investors and the public interest from future harm. Second, the SEC held that the quantum of remedial action also must be measured by reference to the impact the decision is likely to have on the welfare of investors as a class and on the ethical climate of the industries it regulates.[21] The SEC concluded by reaffirming that the purpose of sanctions must be to demonstrate not only to the respondents but to others that the SEC will deal harshly with egregious cases.[22]

The Hearing Panel agrees with the SEC's assessment of the purpose of sanctions and the reasoning expressed in Steadman but finds the case, as suggested by Enforcement, to be an aberration from the general rule. The SEC did not purport to set out a general rule that corporations should not be sanctioned for conduct predating a change in ownership or management; rather, it stressed the particular facts presented. Accordingly, the Hearing Panel concludes that Steadman provides only minimal support for Coleman's argument that severe sanctions should not be assessed in this case.

[20] Steadman, 1977 SEC LEXIS, at *64-65.

[21] Steadman, 1977 SEC LEXIS, at *60.

[22] Id.

Steadman is also distinguishable on the grounds that—unlike the passive investors in SSC—Coleman's new owners' investments are not unfairly jeopardized by the imposition of the sanctions Enforcement requests. Here, the new owners are sophisticated investors, who had completed a due diligence review of Coleman's books and records before purchasing the firm. (Tr. 155-57.) In addition, they had actual knowledge of the potential liabilities flowing from the termination of the HBC Underwriting. (Tr. 156-57.) Laska admitted that he knew of the existence of the pending HBC lawsuit by August 1996 when Interbank invested additional funds in Coleman. (Tr. 157-58.) Although Mr. Laska repeatedly tried to suggest that he had little knowledge of the HBC Underwriting and its termination, the Hearing Panel discredits this testimony. Mr. Laska has for years been in the investment banking business. After obtaining an MBA at Stanford in 1980, he joined The First Boston as an investment banker. (Tr. 143.) From there he went to Citicorp where he served as its Deputy Chief Financial Officer and spent some time in its investment banking group. He was then at Drexel Burnham where he specialized in restructuring financial institutions. From Drexel he joined PaineWebber in 1989 to head up its restructuring group following which he went on his own concentrating on merchant banking and restructuring. (Tr. 144.) In light of this vast experience in assessing the financial prospects of companies and his more recent experience at Interbank buying and investing in companies, it is not credible that Mr. Laska was unadvised of the risks involved in purchasing Coleman. Accordingly, the Hearing Panel finds no unfairness in assessing serious sanctions against Coleman despite the change in ownership.

The third case Coleman relies upon is In re Arthur Lipper Corp.[23] In Lipper, the SEC had charged IOS, Ltd. ("IOS") and its related companies with fraud. More specifically, the SEC had alleged that IOS had executing brokers surrender "excess brokerage" fees to IOS and Investors Planning Corporation of America ("IPC"), a mutual fund retailer controlled by IOS.[24] In assessing sanctions, the SEC declined to sanction IPC because it was a "mere instrumentality" of IOS, not an independent actor.[25] In doing so, the SEC did not absolve IPC because of a change in management but because IPC was not the responsible party. Therefore, sanctioning IPC was not viewed to be in the public interest.[26] Consequently, the Hearing Panel does not find Lipper applicable to this proceeding. Coleman was the primary actor in the HBC Underwriting, not just an instrumentality used by another regulated entity.

On the other hand, as Enforcement points out in its Pre-Hearing Submission, there are both SEC and NASD decisions in which sanctions have been imposed on a member despite an intervening change in ownership, rejecting arguments similar to Coleman's. In the case of In re Franklin-Lord, Inc., the firm argued that no sanctions should be imposed against it because they would fall on the new owner who had had no role in the violations.[27] The SEC, however, rejected this argument "given the seriousness of the violations": violation of a restrictive agreement, filing inaccurate applications for broker-dealer registration, and effecting municipal securities transactions without paying the required fee and without having a qualified municipal securities

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[23] Exchange Act Release No. 11773, 8 SEC Docket 273, 1975 SEC LEXIS 527 (Oct. 24, 1975), rev'd in part sub nom., Arthur Lipper Corp. v. SEC, 547 F.2d 171 (2d Cir. 1976), cert. denied, 434 U.S. 1009 (1978).

[24] Lipper, 1975 SEC LEXIS, at *10.

[25] Lipper, 1975 SEC LEXIS, at *53.

[26] Id.

[27] Exchange Act Release No. 36741, 61 SEC Docket 340, 1996 SEC LEXIS 72, at *15 (Jan. 19, 1996).

principal.[28] The SEC also noted that the new owner had been the firm's FINOP during much of the period at issue although he had not been charged with any misconduct.

The second decision Enforcement relies upon is the NASD's decision in District Bus. Conduct Comm. for Dist. Number 7 v. Guardian Int'l Sec. Corp.,[29] in which the NASD upheld sanctions against the firm despite a change in ownership. The respondents acknowledged that the current principals of the firm could be held liable for the firm's prior violations but argued that their lack of involvement in the violations "should at least be regarded as a mitigating factor."[30] But, without analysis, the NASD declined to consider a change of ownership of the respondent firm as a mitigating factor.

Based upon its review of the foregoing authority, the Hearing Panel concludes that—under the proper circumstances—a change of ownership and management may be considered when determining remedial sanctions, but in this case the facts do not warrant less severe sanctions than those Enforcement requests.

C. Sanctions

The Hearing Panel first notes that disciplinary sanctions are remedial. Their purpose is to remediate misconduct and to protect the investing public. Accordingly, the NASD Sanction Guidelines direct adjudicators to design sanctions to prevent and discourage future misconduct by the respondent, to deter others from engaging in similar misconduct, and to improve the overall business standards in the securities industry.[31] Ultimately, the process of determining an

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[28] Id.

[29] Complaint No. ATL-1203, 1991 NASD Discip. LEXIS 95 (June 28, 1991).

[30] Guardian, NASD Discip. LEXIS, at *6.

[31] NASD Sanction Guidelines 3 (2d ed. 1998).

appropriate sanction involves a balancing of the concepts of remediation and deterrence, taking into consideration the particular facts and circumstances of the instant case.[32] Hard-and-fast formulas do not apply.[33]

Turning to this case, there are a number of factors that demand severe sanctions to deter others and to assure high standards in the securities industry. First, as Coleman admits, the unjustified termination of a firm commitment underwriting is egregious misconduct that cannot be condoned. The impact on the issuer, the co-underwriters and sellers, the trading brokers, and the market overall is significant. In this case, not only was HBC deprived of the funds due it under the Underwriting Agreement, but numerous investors and brokers were harmed. Hundreds of trades had to be canceled and unwound with attendant disruption to the market. This harm resulted from Coleman's undertaking an underwriting without sufficient capital. Not surprisingly, under these circumstances, Coleman does not try to minimize the seriousness of its misconduct.

Coleman did, however, attempt to mislead HBC, other market participants, and the NASD regarding the reason it terminated the underwriting. Only after considerable regulatory pressure and a lawsuit by HBC did Coleman reluctantly concede that the termination was wrongful. In fact, even at the hearing, Coleman remained unwilling to provide a full account of the circumstances surrounding the HBC Underwriting. Mr. Laska repeatedly disclaimed detailed knowledge despite the fact that Mr. Bartels, Coleman's Executive Vice President in charge of underwriting, is still at the firm. Contrary to Coleman's assertion, Mr. Bartels did not just have the HBC Underwriting

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[32] See, e.g., Berko v. SEC, 316 F.2d 137, 141 (2d Cir. 1963).

[33] Cf. In re Consolidated Inv. Services, Inc., Exchange Act Release No. 36687 61 S.E.C. Docket 19, 25 (Jan. 5, 1996) (sanctions are determined on a case-by-case basis and cannot be determined by comparison with action taken in other cases).

"dropped in his lap" once the deal was in progress. (Tr. 190.) Mr. Bartels was principally involved with the underwriting. He signed the Letter of Intent (Ex. C3), the Underwriting Agreement (Ex. C5), and the termination statement (Ex. C8). Nevertheless, Coleman, through its new owners, took the position that it did not have sufficient knowledge of the facts surrounding the termination of the HBC Underwriting to address the issues on the merits.

In the Hearing Panel's judgment, Coleman's position is disingenuous. At a minimum, Coleman had access to information about the termination from Mr. Bartels, but Coleman failed to provide it. The Hearing Panel does not believe that current management would have failed to learn more about the underlying facts when confronted by both a lawsuit and regulatory proceedings. This course of conduct is antithetical to the high standards required of broker-dealers under NASD Conduct Rule 2110 and should be deterred. In the Hearing Panel's opinion, imposition of a censure without more would be insufficient.

The Hearing Panel also finds Coleman's disciplinary history to be relevant. Coleman has been disciplined by the New York Stock Exchange for numerous net capital and reporting violations. (Ex. C38; Ex. C40; Ex. C41; Ex. C42.) Most recently, Coleman settled such charges and agreed to a censure and a $200,000 fine. (Ex. C42, at 21.) Coleman also entered into a Letter of Acceptance, Waiver and Consent ("AWC") dated June 7, 1995, in settlement of charges brought by the NASD. (Ex. C39.) Under the AWC, Coleman consented to a censure and a $40,000 fine for rule violations concerning the manner in which it handled customer funds in a Regulation D offering. (Ex. C39, at 4.)

Coleman, on the other hand, argues that its disciplinary history should be ignored because all of the violations occurred before its current management took over. In effect, Coleman attempts to divorce itself from its past by pointing to the fact that it is entirely under new ownership and control. The Hearing Panel, however, finds Coleman's arguments unpersuasive. First, in the Hearing Panel's judgment, Coleman's prior disciplinary problems are related to the issues presented in this case. The underlying reason for the termination of the HBC Underwriting was Coleman's lack of adequate capital. Thus, although the prior regulatory issues disclosed in Coleman's CRD record are not "underwriting violations," they are connected closely enough to be considered.[34] Second, the Hearing Panel is troubled by Coleman's premise that it should be given credit for having conducted itself properly since new management took over. Coleman points to the fact that it closed six public offerings without incident. (Tr. 96.) However, the uncontested evidence also shows that for several of these offerings Coleman was not in compliance with its own policies and procedures, which prohibit Coleman from acting as a lead underwriter. (Tr. 132.)

At the hearing, Coleman vehemently objected to Enforcement's argument that the Hearing Panel should consider Coleman's failure to abide by its policies and procedures, and the Hearing Panel ruled that uncharged and unproved misconduct is not relevant in determining sanctions. (Tr. 125-38.) But Coleman cannot have it both ways. It cannot claim credit that it is operating in complete compliance with all rules and regulations and demand the Hearing Panel not evaluate the claim. Although, under the NASD Sanction Guidelines, uncharged conduct

[34] The Hearing Panel refused to consider evidence on more recent net capital violations because Coleman had not been charged with the violations.

ordinarily is not relevant to the determination of sanctions, Coleman put its recent operations in issue as a mitigating factor. Under the circumstances, it is appropriate for the Hearing Panel to evaluate Coleman's claims of perfect regulatory compliance.

Coleman further argues that its failures to follow its internal policies and procedures should not be held against it because Coleman brought the problem to the NASD's attention and Coleman has pledged to revise its compliance manual. (Tr. 128-30.)[35] Here again, however, the Hearing Panel does not find Coleman's arguments persuasive. The significance of its continuing problems with internal procedures—particularly those related to its underwriting business—is that more should have been done. Coleman cannot avoid the consequences of its misconduct by pointing to continued flawed regulatory compliance. Under these circumstances, the Hearing Panel concludes that Coleman's closing of six offerings since the HBC Underwriting is not a mitigating factor.

When Coleman's new owners took over, they made a number of changes to improve and expand Coleman's operations[36] with one notable exception: they retained Mr. Bartels as its head of underwriting. In the Hearing Panel's opinion this is significant. While the present owners claim to have no connection to the misconduct in terminating the HBC Underwriting, this is not the case. Coleman's underwriting business is run by Mr. Bartels, as it was at the time of the HBC Underwriting. In August 1998, Coleman stressed his importance in a letter to the NASD in which

[35] The discussions with the NASD, during which Coleman acknowledged the short comings of its compliance manual and pledged to retain a consultant to assist in revising the manual, occurred in connection with settlement talks of the instant charge.

[36] Many of the changes in policies and personnel are detailed in the report prepared by Coleman's outside counsel for the New York Stock Exchange as an undertaking in the settlement of the charges of net capital and reporting violations discussed above. (Ex. C71.)

Coleman indicated its desire to engage in firm commitment underwritings. (Ex. C76.) Coleman's heavy reliance on Mr. Bartels is troubling to the Hearing Panel because he has not successfully cleared up the deficiencies in Coleman's compliance manual over the last several years. Consequently, the Hearing Panel concludes that any sanctions in this matter should address remedying these deficiencies before Coleman participates in further underwritings. Accordingly, in addition to a $200,000 fine, the Hearing Panel determines that Coleman should be suspended for a period of three months from participating in any underwritings and thereafter for an additional nine months from acting as a lead managing underwriter. Furthermore, during the initial three-month suspension, and as a condition to its resuming any underwriting activity, Coleman shall retain a consultant, not unacceptable to the NASD, and revise its compliance manual in accordance with the consultant's recommendations.

In assessing these additional sanctions, the Hearing Panel is not sanctioning Coleman for its failure to follow its compliance manual, nor is the Hearing Panel sanctioning Coleman for any possible misconduct committed by Mr. Bartels. Such issues are outside the scope of this proceeding. Rather, the Hearing Panel has devised these sanctions to protect the investing public from future harm. In the Hearing Panel's opinion, Coleman has not yet effectively addressed the management defaults that contributed to the wrongful termination of the HBC Underwriting; it should address these problems before it participates in future underwritings.

IV. Order

Therefore, having considered all of the evidence Enforcement submitted, Respondent Coleman & Company Securities, Inc. is fined $200,000. In addition, Coleman & Company Securities, Inc. is suspended for a period of three months from participating in any underwritings and thereafter for an additional nine months from acting as a lead managing underwriter. Furthermore, during the initial three-month suspension, and as a condition to its resuming any underwriting activity, Coleman & Company Securities, Inc. is ordered to retain a consultant, not unacceptable to the NASD, and revise its compliance manual in accordance with the consultant's recommendations.[37]

Coleman & Company Securities, Inc. is further ordered to pay the costs of this proceeding in the amount of $1,834.50, which includes an administrative fee of $750 and hearing transcript costs of $1,084.50.

These sanctions shall become effective on a date set by the NASD, but not earlier than 30 days after the date this Decision becomes the final disciplinary decision of the NASD.

Andrew H. Perkins
Hearing Officer
For the Hearing Panel

Copies to:

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[37] 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.