

**NASD OFFICE OF HEARING OFFICERS**

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DEPARTMENT OF ENFORCEMENT,	:	Disciplinary Proceeding
	:	No. CAF030042
	:	
Complainant,	:	<b>Hearing Panel Decision,</b>
	:	<b>Order Granting</b>
v.	:	<b>Respondent's</b>
	:	<b>Motion for Summary</b>
Respondent	:	<b>Disposition and</b>
	:	<b>Denying Enforcement's</b>
	:	<b>Motion for Reconsideration</b>
	:	
	:	Hearing Officer - SW
	:	
Respondent.	:	Date: August 27, 2004
	:	

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**Respondent was charged with violating NASD Conduct Rules 2460 and 2110, which prohibit the receipt of consideration for filing Form 211 applications. At the conclusion of Complainant's case-in-chief, the Hearing Panel found that Enforcement failed to establish the charges by a preponderance of the evidence. Therefore, the Hearing Panel granted Respondent's oral motion for summary disposition and dismissed the Complaint as to Respondent. After considering Complainant's written motion for reconsideration, the Hearing Panel affirmed its dismissal of the Complaint as to Respondent.**

**Appearances**

Rodney W. Turner, Esq., Senior Attorney, Washington, DC, and Roger D.

Hogoboom, Esq., Assistant Chief Litigation Counsel, Denver, CO, for the Department of Enforcement.

MM, Esq., Carlsbad, CA, for Respondent.

## DECISION

### I. Procedural Background

#### A. Complaint and Answer

On August 15, 2003, the Department of Enforcement (“Enforcement”) filed a three-count Complaint against Respondents ESC, KSC, and Respondent. ESC and KSC failed to file answers to the Complaint and were deemed in default. Only count one of the Complaint contains allegations relating to Respondent who participated in the disciplinary proceeding.

Count one of the Complaint alleges that Respondent solicited or received payments from four issuers to prepare and file Form 211 applications and publish quotations in their stock, in violation of NASD Conduct Rules 2460 and 2110.<sup>1</sup> Specifically, the Complaint alleges that Respondent was entitled to receive 25% of the fees paid by the issuers.

Respondent denied the allegations and requested a Hearing.

#### B. The Hearing

The Hearing was held in Los Angeles, California, before a Hearing Panel composed of the Hearing Officer, and one current member and one former member of the District 2 Committee.<sup>2</sup>

Upon completion of Enforcement’s case-in-chief, Respondent and Enforcement made oral motions for directed verdicts. Because NASD rules do not provide for motions for directed verdicts, the Hearing Panel considered the motions as motions for summary

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<sup>1</sup> Count one of the Complaint also alleges that ESC violated NASD Conduct Rules 2460 and 2110 by soliciting or receiving payments from the above four issuers and seven additional issuers.

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disposition under NASD Procedural Rule 9264(b).<sup>3</sup> After hearing arguments from both Parties, the Hearing Panel granted Respondent's motion, dismissing the Complaint as to her.

At the Hearing, Enforcement made an oral motion for reconsideration, which the Hearing Panel denied. Subsequently, on May 12, 2004, Enforcement filed a written motion for reconsideration. On May 26, 2004, Respondent filed an objection to Enforcement's motion. After reviewing the motion for reconsideration and the objection, and determining that Enforcement neither raised any new arguments nor proffered any new evidence, the Hearing Panel hereby denies Enforcement's motion for reconsideration.

Reaffirming their decision, the Hearing Panel sets forth below the basis for their determination that Enforcement failed to prove by a preponderance of the evidence that Respondent violated NASD Conduct Rules 2460 and 2110 as alleged in the Complaint.

## **II. Findings of Fact and Conclusions of Law**

### **A. Jurisdiction**

Respondent first became associated with an NASD member firm in July 1989.<sup>4</sup> (JX-1, p. 10). From July 1, 1999 to December 19, 2000, Respondent was associated with ESC as a general securities representative and a general securities principal. (JX-1, p. 5).

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<sup>2</sup> Hereinafter, references to the transcripts of the Hearing on April 26 and 27, 2004 will be designated as "Tr. p."; Enforcement's exhibits presented at the Hearing will be designated as "CX-"; and the Parties joint exhibits will be designated as "JX-."

<sup>3</sup> On April 20, 2004, the Hearing Panel denied Enforcement's earlier written motion for summary disposition, which was filed on March 8, 2004.

<sup>4</sup> Respondent initially became registered as a general securities representative on July 8, 1992. (JX-1, p. 9).

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From January 12, 2001 to January 27, 2004, Respondent was registered as a general securities principal with World Trade Financial Corporation. (JX-1, p. 4). Respondent is currently registered as a general securities representative with World Trade Financial Corporation. (Id.). Thus, NASD has jurisdiction over this proceeding.

**B. Background**

***1. Respondent's Relationship with ESC, and her Execution of Form 211 Applications on ESC's Behalf***

The material facts are undisputed. In 1999, Respondent and Mr. TF formed ATC, Ltd., and each initially owned 50% of ATC.<sup>5</sup> (CX-6, pp. 14-15). On May 1, 1999, ATC entered into an agreement with ESC whereby ATC would operate as an office of supervisory jurisdiction ("OSJ") for ESC in San Diego, CA. (CX-8). ESC was not responsible for any costs relating to or arising from the branch office in San Diego.<sup>6</sup> (CX-8, p. 3).

Approximately 60 to 90 days after establishing ATC as the OSJ for ESC, Mr. TF succeeded to Respondent's 50% interest in ATC.<sup>7</sup> (Tr. pp. 386, 390-391, 406). Thereafter, Mr. TF became entitled to 100% of the income and responsible for 100% of the debts of ESC's San Diego branch office. (Id.).

In July 1999, Respondent became registered as a general securities principal with ESC. (JX-1, p. 5). At the time of the conduct alleged in the Complaint, Respondent was

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<sup>5</sup> Mr. TF was the president of ATC. (Tr. p. 187; CX-6, p. 15). Subsequently, Mr. TF was convicted of securities fraud in California. (Tr. p. 228).

<sup>6</sup> ATC was responsible for all expenses incurred in establishing and operating the branch office, including "security deposits, licensing fees, rents, equipment and furniture, employees and sales costs, office supplies and related operation costs." (CX-8, p. 1). All of the fixtures, furniture, records and computers of the San Diego branch office were the sole and exclusive properties of ATC. (CX-8, p. 2). Mr. TF executed the agreement on behalf of ATC. (CX-8, p. 12).

<sup>7</sup> There was no evidence presented concerning the details of the agreement whereby Mr. TF became 100% responsible for the expenses of the San Diego office. (Tr. pp. 405-406).

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neither an officer nor an owner of ATC, nor an officer or an owner of ESC.<sup>8</sup> (Tr. pp. 261, 391). Respondent worked out of the San Diego office of ESC as an independent contractor and received 75% of the commissions generated through purchases or sales of her customers. (Tr. p. 388). ESC did not provide any other funds, services, or compensation to Respondent. (Id.)

ESC and its San Diego office derived a significant portion of their revenues from market making activities for stock listed on the OTC Bulletin Board and the Pink Sheets.<sup>9</sup> (Tr. p. 386). ESC also entered into investment banking agreements (“IBA”) to provide specific services to certain issuers in return for a flat fee.<sup>10</sup> (JX-2; JX-4; JX-6; JX-8). There is no evidence that ESC provided the services listed in the IBAs in exchange for the fees it received from issuers; instead, ESC simply filed a Form 211 application and became a market maker for the issuer. (Tr. pp. 363, 373-374).

The Form 211 application is an application that an NASD member must submit to NASD prior to becoming a market maker in any non-Nasdaq stock, pursuant to NASD Market Place Rule 6740.<sup>11</sup> (Tr. pp. 24-25). KSC, ESC’s chief financial officer,

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<sup>8</sup> There was no evidence presented that Respondent was a director of ESC.

<sup>9</sup> A market maker is a firm that maintains a firm bid and offer price in a given security by standing ready to buy or sell at publicly quoted prices. Pink Sheets are printed by the National Quotation Bureau and are daily listings that contain quotations for thousands of over-the-counter stocks that are not listed on any of the major stock markets. These quotations are entered by dealers acting as market makers in the individual securities. See Glossary of Terms at <http://www.nasd.com/resources/glossary.asp>.

<sup>10</sup> The services listed in the IBAs included “services . . . regarding . . . the public securities market, investor relations and other areas of investment banking as requested.” (JX-6, p. 2, at ¶3; JX-8, p. 2 at ¶3). Other services included: market intelligence; assistance with “blue sky” exemptions; assistance with S&P listing; and presenting the company to a registered SEC Edgar filing agent. (JX-2, p. 2, at ¶3a; JX-4, p. 2 at ¶3a). ESC charged a separate fee for presenting potential merger candidates to its customers. (JX-6, p. 2, at ¶4; JX-8, p. 2 at ¶4).

<sup>11</sup> NASD Market Place Rule 6740 requires a member firm to submit a Form 211 application to the NASD Market Regulation Department for its review and its determination that the member firm has demonstrated compliance with SEC Rule 15c2-11 before the member firm initiates or resumes quotation of a non-NASDAQ security in any quotation medium.

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compliance officer, and part owner, determined whether ESC would file a Form 211 application to become a market maker in an issuer's stock. (Tr. pp. 291, 399).

Respondent was in charge of the retail side of ESC's San Diego branch office.<sup>12</sup> (Tr. p. 284). In ESC's Written Supervisory Procedures, Respondent was listed as a co-manager of the branch office and responsible for:

supervising all areas of retail sales, including but not limited to account maintenance, review and supervision. Suitability, churning, commissions, markups and markdowns. Order ticket review, client communication and customer services. Customer complaints, dispute resolution. She will further be responsible for keeping and maintaining all necessary blotters, records and reports, including customers position logs, correspondence logs, and trade blotters as well as compliance with all State, Federal and SRO laws, rules and regulations. (CX-9, p. 2).

Respondent had no authority to, and did not, make a market or submit quotations for any security on behalf of ESC. (Tr. pp. 287-288). However, in 1999 and 2000, Respondent as a registered principal of ESC executed IBAs, with the approval of KSC, for at least three issuers: (i) Never Miss A Call, Inc. ("Never Miss A Call"); (ii) Bidder Communications, Inc. ("Bidder Communications"); and (iii) Northern Ostrich Corp. ("Northern Ostrich"). (JX-4; JX-6; JX-8; Tr. pp. 313-314). An earlier fourth IBA was executed using Respondent's name, but without her consent or approval, for Great Bear Resources, Inc. ("Great Bear"). (Collectively the "Issuers").<sup>13</sup> (Tr. p. 293; JX-2).

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SEC Rule 15c2-11, promulgated under Section 15(c)(2) of the Securities Exchange Act of 1934, makes it unlawful for a broker or dealer to publish any quotations for a security in any quotation medium, unless such broker or dealer: (1) has in its possession certain specified information; (2) believes that the specified information is accurate in all material respects; and (3) believes that the sources of the specified information are reliable.

<sup>12</sup> Mr. PR, a vice president of ESC, was responsible for supervising all areas of trading. (CX-9, p. 2). Mr. PR reported to and was supervised by KSC and the president of ESC, Mr. SR. (Id.).

<sup>13</sup> Respondent discovered that her name had been signed to the Great Bear IBA during NASD's investigation in 2002. (Tr. pp. 293-295).

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In connection with the execution of the IBAs, the Issuers each paid ESC \$5,000. (JX-2; JX-3; JX-4; JX-5; JX-6; JX-7; JX-8; JX-9). Shortly thereafter, Respondent, as a registered principal of ESC, signed and submitted Form 211 applications to NASD on behalf of ESC to make markets in the stock of the four Issuers. (CX-20; CX-28; CX-29; CX-39; CX-43; CX-44). BC, a non-registered employee of ATC, prepared each of the Form 211 applications that Respondent signed. (Tr. pp. 188, 342). In addition to signing the Form 211 applications, in several instances, Respondent responded to deficiency letters written by the NASD staff regarding ESC's Form 211 filings. (CX-13; CX-15; CX-17; CX-23; CX-31; CX-44; CX-46). More specifically:

- On January 6, 2000, Great Bear paid ESC \$5,000 and executed an IBA. (JX-2; JX-3). Respondent signed and submitted a Form 211 application for Great Bear on February 2, 2000.<sup>14</sup> (CX-20; CX-21). ESC became a market maker for Great Bear on May 4, 2000. (CX-26; CX-27).
- On April 10, 2000, Never Miss A Call paid ESC \$5,000, and executed an IBA on April 12, 2000. (JX-4; JX-5). Respondent signed and submitted a Form 211 application for Never Miss A Call and its amendment on April 12, 2000.<sup>15</sup> (CX-28; CX-29). ESC became a market maker for Never Miss A Call on June 1, 2000. (CX-36; CX-37).
- On September 15, 2000, Bidder Communications paid ESC \$5,000, and executed an IBA on September 18, 2000. (JX-6; JX-7; CX-38).

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<sup>14</sup> On March 14, 2000, Respondent responded to a letter from the NASD staff listing certain deficiencies in Great Bear's Form 211 filing. (CX-22; CX-23). In a letter dated May 3, 2000, the NASD staff cleared ESC to enter quotations on the OTC Bulletin Board for Great Bear. (CX-24).

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Respondent signed and submitted a Form 211 application for Bidder Communications on September 29, 2000. (CX-39). ESC became a market maker for Bidder Communications on November 3, 2000. (CX-41; CX-42).

- On September 15, 2000, Northern Ostrich paid ESC \$5,000, and executed an IBA on September 18, 2000. (JX-8; JX-9). Respondent signed and submitted a Form 211 application for Northern Ostrich on October 2, 2000.<sup>16</sup> (CX-43; CX-44). ESC became a market maker for Northern Ostrich on May 3, 2001.<sup>17</sup> (CX-48; CX-49).

**C. No Violation of NASD Conduct Rule 2460 by Respondent Proven**

***1. NASD Conduct Rule 2460***

In August 1997, NASD Conduct Rule 2460, entitled “Payments for Market Making,” became effective.<sup>18</sup> Conduct Rule 2460 provides that:

(a) No member or person associated with a member shall accept any payment or other consideration, directly or indirectly, from an issuer of a security, or any affiliate or promoter thereof, for publishing a quotation, acting as market maker in a security, or submitting an application in connection therewith.

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<sup>15</sup> On April 26, 2000, Respondent responded to a deficiency letter from the NASD staff regarding Never Miss A Call’s Form 211 filing. (CX-30; CX-31). In a letter dated May 31, 2000, the NASD staff cleared ESC to enter quotations on the OTC Bulletin Board for Never Miss a Call. (CX-34).

<sup>16</sup> On November 6, 2000, Respondent on behalf of ESC responded to a deficiency letter from the NASD staff regarding Northern Ostrich’s Form 211 filing. (CX-46; CX-45). In a letter dated May 2, 2000, the NASD staff cleared ESC to enter quotations on the Pink Sheets for Northern Ostrich. (CX-47).

<sup>17</sup> On December 19, 2000, Respondent terminated her association with ESC, five months before ESC became the market maker for Northern Ostrich. (JX-1, p. 4).

<sup>18</sup> NASD Notice to Members 97-46 (August 1997).

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(b) The provisions of paragraph (a) shall not preclude a member from accepting:

(1) payment for bona fide services, including, but not limited to, investment banking services (including underwriting compensation and fees); and

(2) reimbursement of any payment for registration imposed by the Securities and Exchange Commission or state regulatory authorities and for listing of an issue of securities imposed by a self-regulatory organization.

A plain reading of NASD Conduct Rule 2460 shows that the rule has two elements: (1) the acceptance of payment or consideration, directly or indirectly, in exchange for (2) the publication of a quotation, activity as a market maker in a security, or submitting an application in connection therewith.

***2. Respondent's Motion for Summary Disposition Granted and Enforcement's Motion for Reconsideration Denied***

Respondent testified that the fees paid to ESC were for buying access to ESC's market knowledge concerning not only the requirements for filing Form 211 applications but also listing requirements for Standards and Poor's, and requirements for "blue sky" exemptions from state registrations. (Tr. p. 299). However, based on the timing of the payments, the timing of the submissions of the Form 211 applications, and the lack of any other services actually provided, the Hearing Panel could have found that ESC received payments from the Issuers to make a market and/or submit applications to make a market, in violation of NASD Conduct Rules 2460 and 2110.

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The Hearing Panel finds, however, that Respondent did not benefit, directly or indirectly, from the Issuers' payments to ESC, and therefore did not violate Conduct Rule 2460.

The Panel concludes that as a general matter it would be sufficient for purposes of NASD Conduct Rule 2460 if Enforcement had proved that Respondent had received a financial benefit from either the Issuers, or from ESC, for submitting the Form 211 applications. Such a benefit from ESC might include, for example, a bonus, fixed salary, or even access to an office, desk, computer, or telephone service paid for by ESC.<sup>19</sup>

In this unusual case, however, Enforcement failed to show that Respondent received any benefit from anyone for submitting the Form 211 applications. Respondent testified, without contradiction, that she received nothing from the Issuers, and, from ESC, she received only the 75% of the commissions generated on the trades that she executed for her customers to which she was entitled. The Complaint alleges that Respondent was to receive 25% of the fees paid by the Issuers. However, Mr. Thomas E. Lokken, an NASD Assistant Director who supervised the investigation in this proceeding, confirmed that the NASD staff found no evidence of payments to Respondent from any of the four Issuers. (Tr. pp. 102-103, 202-203).

Relying on Rule 0115, Enforcement argued that NASD Conduct Rule 2460 applies equally to members and persons associated with members.<sup>20</sup> There is no dispute, however, that Rule 2460 applies to Respondent because, unlike certain NASD Conduct

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<sup>19</sup> Pursuant to its agreement with ESC, during the relevant period, ATC received no less than 80% of the commissions earned on securities transactions generated in the San Diego office minus the costs of the clearing firm and any other costs related to the transactions. (CX-8, p. 2).

<sup>20</sup> Rule 0115(a) states, "These [NASD] Rules shall apply to all members and persons associated with a member. Persons associated with a member shall have the same duties and obligations as members under these Rules."

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Rules, the Rule applies explicitly to any “person associated with a member.” However, to violate Rule 2460, the person associated with the member must “accept any payment or other consideration, directly or indirectly, from an issuer of a security,” which Respondent did not do.

Enforcement also argued that the SEC and NASD have consistently held responsible those persons who cause firms to violate SEC and NASD rules, such as the net capital rule, SEC Rule 15c3-1, and the books and records rule, SEC Rule 17a-3. Even assuming that the same analysis can be applied under NASD Conduct Rule 2460, Enforcement failed to prove that Respondent was responsible for ESC’s violations of the Rule.

Although Respondent signed the applications, a ministerial function, KSC decided whether ESC would enter into an IBA agreement with any issuer, whether ESC would file a Form 211 application, and whether ESC would make a market in the stock. Although Respondent was the initial contact person for the Issuers, Enforcement presented no evidence that Respondent even recommended to KSC that ESC make a market or file a Form 211 application for a particular Issuer.

The facts of this case, therefore, differ significantly from those in cases in which registered principals have been held liable for a member’s net capital or books and records violations. In those cases, the principals held liable for the member’s violations had the responsibility for maintaining the member’s net capital or its books and records.<sup>21</sup>

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<sup>21</sup> See DBCC v. McKee, No. C3A940068, 1996 NASD Discip. LEXIS 12 (NBCC Mar. 20, 1996) (CEO had effectively delegated responsibility for net capital matters to Linders, and Linders as FINOP bore general responsibility for maintaining the firm’s books and records); William H. Gerhauser, 53 S.E.C. 933, 1998 SEC LEXIS 2402 (Nov. 4, 1998) (Gerhauser, Sr. as the FINOP was responsible for the Firm’s financial responsibility rules); and Dept. of Enforcement v. Davrey, No. C3B020015, 2003 NASD Discip. LEXIS 35 (OHO Aug. 11, 2003) (Davrey as the Firm’s president, chief executive officer, chief financial

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In contrast, Respondent was not an officer or control person of ESC, and she had no authority to bind or commit ESC to make a market on behalf of any issuer.

### **3. *Summary Disposition Standard***

In this case, Enforcement and Respondent each made an oral motion for a directed verdict at the conclusion of Enforcement's case-in-chief. NASD rules do not provide for such a motion, but Rule 9264(b) provides that, with leave of the Hearing Officer, either party may move for summary disposition after the hearing has commenced. Therefore, the Hearing Panel considered the motions as motions for summary disposition under Rule 9264(b). Pursuant to NASD Code of Procedure Rule 9264(e), the Hearing Panel "may grant the motion for summary disposition if there is no genuine issue with regard to any material fact and the Party that files the motion is entitled to summary disposition as a matter of law."

Based upon the evidence adduced by Enforcement, there is no genuine issue with regard to the material facts that: (i) Respondent did not receive any compensation or benefit, directly or indirectly, from filing the Form 211 applications; and (ii) Respondent did not determine whether ESC would enter into the IBA agreements with the Issuers, whether it would file Form 211 applications, or whether it would make a market in the Issuers' stocks, and had no authority to do so.

Therefore, the Hearing Panel concludes that Respondent is entitled to summary disposition dismissing the Complaint's charge that she violated NASD Conduct Rule 2460. Furthermore, because the Complaint charges Respondent with violating NASD

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officer, compliance officer, and FINOP had both the primary and the ultimate responsibility for assuring the accuracy of the Firm's records).

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Conduct Rule 2110 based on her alleged violation of Rule 2460, the Hearing Panel concludes that she is entitled to summary disposition dismissing that charge as well.<sup>22</sup>

#### **IV. Conclusion**

The Hearing Panel grants Respondent's motion for summary disposition and dismisses the Complaint as to her.<sup>23</sup>

#### **HEARING PANEL**

by: \_\_\_\_\_  
Sharon Witherspoon  
Hearing Officer

Date: Washington DC  
August 27, 2004

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<sup>22</sup> It is well settled that any violation of the federal securities laws and/or the NASD Conduct Rules is viewed as a violation of NASD Conduct Rule 2110 without attention to the surrounding circumstances because members of the securities industry are expected and required to abide by the applicable rules and regulations. See Dep't of Enforcement v. Shvarts, No. CAF980029, 2000 NASD Discip. LEXIS 6, at \*12-\*13 (NAC June 2, 2000). Although under certain circumstances a violation of NASD Conduct Rule 2110 may be found where no other legally cognizable wrong has occurred, the Complaint did not allege that Respondent's conduct violated Rule 2110 on any theory other than as a violation of Rule 2460; therefore, the Hearing Panel has not considered whether Respondent's conduct could have been found to violate Rule 2110 on some other theory not alleged by Enforcement in this case.

<sup>23</sup> 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.