

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS**

DEPARTMENT OF MARKET REGULATION,

Complainant,

v.

STEPHEN IRA GOLDEN
(CRD No. 224150),

RICHARD F. KRESGE
(CRD No. 729077),

Respondents.

Disciplinary Proceeding
No. 2005000323905

Hearing Officer – DMF

**AMENDED EXTENDED
HEARING PANEL DECISION¹**

May 29, 2008

Summary

Respondent Golden aided and abetted the fraudulent manipulation and parking of municipal securities, in violation of MSRB Rules G-14 and G-17, for which he is barred in all principal capacities, suspended for six months in all other capacities, and fined \$10,000. Respondent Kresge participated in, and aided and abetted, the fraudulent manipulation and parking of municipal securities, in violation of Section 10(b) of the Securities Exchange Act, Exchange Act Rule 10b-5, and MSRB Rules G-14 and G-17, for which he is barred in all principal capacities, suspended for two years in all other capacities, fined \$50,000, and ordered to re-qualify. In addition, Respondents are ordered to pay costs.

DECISION

I. Introduction

The Department of Market Regulation's Complaint, filed on March 22, 2007, charged Respondents Stephen Ira Golden and Richard F. Kresge with participating in a fraudulent manipulation and parking scheme involving municipal securities, in violation of Section 10(b) of the Securities Exchange Act, Exchange Act Rule 10b-5, and MSRB

¹ This Amended Decision is issued to correct a typographical error on p. 11 of the original Decision.

Rules G-17 and G-14, or, alternatively, with aiding and abetting the scheme, in violation of Rules G-17 and G-14. Respondents contested the charges and requested a hearing, which was held in New York, New York, on December 3-6, 2007, before an Extended Hearing Panel.

II. Facts

A. Respondents

Golden has worked in the securities industry since 1969. At all relevant times, he was qualified as a municipal securities representative and principal, pursuant to MSRB Rule G-3, and was registered with FINRA in those capacities, among others. During the initial portion of the relevant period, he was co-owner and president of FINRA member Golden Harris Capital Group, Inc., and supervised the firm's municipal securities trading desk. In 2002, J.B. Hanauer & Co. acquired Golden Harris, after which Golden became registered in various capacities through Hanauer, including as a municipal securities representative and principal. He remains associated with that firm.²

Kresge entered the securities industry in 1986. At all relevant times he was qualified as a municipal securities representative and principal, pursuant to MSRB Rule G-3. He was registered with FINRA in those capacities, among others, through FINRA member Yankee Financial Group, Inc., which he owned and for which he served as president. Yankee is no longer in business and Kresge is not currently registered, but he remains subject to FINRA jurisdiction for purposes of this proceeding, pursuant to Article V, Section 4 of FINRA's By-Laws.³

² CX 40, 60, 61; Tr. 262, 409. In this decision, "Tr." refers to the hearing transcript; "CX" refers to Complainant's exhibits; "RX-CG" refers to Respondent Golden's exhibits; and "RX-RK" refers to Respondent Kresge's exhibits.

³ CX 62, 44; Tr. 65, 254.

B. The Connectors

The charges in the Complaint concern trading in municipal securities issued by the Connector 2000 Association, Inc. (Association) in 1998 to finance, construct and operate a toll road called the Southern Connector, which was designed to be part of a southern loop around the city of Greenville, South Carolina. The Association issued bonds totaling approximately \$200 million in three series, all of which were payable solely from the revenues that would be generated by the toll road.⁴

The Series A Senior Current Interest Bonds and Series B Senior Capital Appreciation Bonds were investment grade and insured. The Series C Subordinate Capital Appreciation Bonds were unrated, uninsured, zero-coupon bonds issued in a series of tranches with maturity dates beginning in 2008 and ending in 2028. This case focuses on the 2012 maturity tranche of the Series C bonds, identified as CUSIP 20786LBP5, which had a total value, at maturity, of \$3.9 million, and more particularly on a \$2 million portion of this tranche that is referred to in this Decision as “the Connectors.”⁵

C. Schlesinger’s Trading of the Connectors

In December 1998, Steven Schlesinger, a municipal securities trader who was then employed by American Third Market Co. LLC, purchased the Connectors in a proprietary account of the firm. In 1999, Schlesinger began orchestrating a complex series of trades through which the Connectors were traded in circular patterns at ever-increasing prices. While the specific routes varied, in general Schlesinger arranged for a trader at another firm, or one of his own customers, to purchase the Connectors from him

⁴ CX 2-4.

⁵ CX 2; Tr. 780, 794-95, 818.

at a specified price, hold them for a brief period, and then sell them to another trader or customer identified by Schlesinger, or to Schlesinger himself, at a price specified by Schlesinger that gave the selling trader or customer a small profit. The purchaser, if not Schlesinger himself, would then hold the bonds for a brief period and sell them as directed by Schlesinger. Sooner or later the Connectors would come back to Schlesinger, but within a month or so Schlesinger would arrange another round trip of trades. In January 2000, Schlesinger left American Third and became employed as a bond trader with Zeus Securities, Inc., where he continued to employ the same circular trading patterns, now routing the Connectors through his trading account at Zeus.⁶

Schlesinger's circular trading of the Connectors continued until July 2004. During the period June 1999 through July 2004, Schlesinger orchestrated more than 200 Connectors trades, and during this time the reported market price of the Connectors increased from approximately \$45 in June 1999 to more than \$70 by July 2004. During this period, virtually every trade of the Connectors was at a higher price than any prior trade.⁷

The frequent trading of the Connectors and the price at which they traded were in stark contrast with the \$1.9 million remainder of the tranche. After a few sales in June 1999, there were only a handful of trades in those bonds: in September 1999, a \$115,000 block of the bonds traded at prices that were already somewhat below the price at which the Connectors were trading; in September 2000, a \$100,000 block of the bonds traded at

⁶ CX 51-52 (on-the-record (OTR) testimony of Schlesinger), CX 1 (summary schedule of Connectors trades). The Connectors trades set forth in CX 1 include both trades reported to MSRB and trades that the Department identified from documents it obtained during the investigation, including account statements, order tickets, trade confirmations, and transaction summaries. Tr. 834-36. CX 72, provided by MSRB, lists trade details for all trades reported to MSRB, and subsequently disseminated to the market through services such as Bloomberg. Tr. 281, 390, 465, 539, 675-76, 782-83.

⁷ CX 1; Tr. 839.

a price more than \$20 below the contemporaneous price at which the Connectors were being traded among Schlesinger and his allies; and in October 2002, a \$100,000 block of the bonds was traded, again at a price more than \$20 below the contemporaneous Connectors trades orchestrated by Schlesinger. The Connectors also traded far more frequently, and at a significantly higher price, than the other tranches of the Series C bonds, or even the rated, insured Series A and Series B bonds.⁸

D. Kresge's Role

Kresge played a key role in Schlesinger's scheme. From the very beginning of the scheme in June 1999 until it collapsed in July 2004, Kresge, on behalf of Yankee, purchased and re-sold the Connectors in numerous transactions. Kresge acknowledged that, in each case, both the purchase and the sale were directed by Schlesinger. That is, Schlesinger called him to initiate the transaction, told him the price he would pay to purchase the Connectors, and told him to whom and at what price he would sell them. In total, Yankee, acting through Kresge, participated as buyer or seller in more than 80 Connectors trades, or more than 40 paired transactions—i.e., a purchase combined with a subsequent sale. Yankee earned approximately \$1,000 on each paired transaction.⁹

Most of the transactions in which Kresge participated followed the same circular pattern, which involved Olla Industries, a hedge fund customer of Schlesinger. To facilitate the trading, Schlesinger arranged with Kresge for Olla to open a delivery versus

⁸ CX 1, 6A, 71 at 2; Tr. 828-30, 853.

⁹ Tr. 70, 76, 89, 103; CX 1, 51-52 (Schlesinger OTR).

payment (DVP) account at Yankee, linked to Olla's prime brokerage account at Spear Leeds.¹⁰

Schlesinger had authority to direct trades in Olla's DVP account at Yankee.¹¹ To accomplish a round trip, Schlesinger sold the Connectors from Zeus to Yankee, at a price he specified; Yankee, in turn, sold the Connectors to Olla's DVP account, again at a price specified by Schlesinger; the Connectors were then transferred to Olla's prime brokerage account at Spear Leeds. Within a short time, the Connectors were transferred from Olla's prime brokerage account to a DVP account that Olla maintained at Zeus, and sold from that account to Zeus' trading account, whereupon the cycle began again with a sale from Zeus to Yankee.¹²

This pattern began in February 2000, and recurred in May, June, September, November, and December 2000. It continued every month in 2001, except October and December; every month in 2002, except March and June; and every month in 2003 from January through August. Most of the sales from Yankee to Olla had substantially delayed settlement dates, dictated by Schlesinger.¹³

Kresge was involved in other types of Connectors transactions as well. On some occasions, Schlesinger simply sold the Connectors to Yankee and later repurchased them. On other occasions, Kresge purchased the Connectors from, or sold them to, traders at

¹⁰ Tr. 67-68, 77, 233; CX 43-44 (Kresge OTR). A prime brokerage account allows an institutional investor, such as a hedge fund, to use a centralized master account to hold all the customer's funds and securities, while allowing the investor to execute transactions through DVP accounts at other firms. No funds or securities are maintained in the DVP accounts; instead, the executing firms complete trades on behalf of the customer by delivering the securities through the DVP accounts to the customer's prime brokerage account, in exchange for payment from that account—i.e., delivery versus payment.

¹¹ Kresge testified that Yankee had written authorization from Olla for Schlesinger to trade the account, but he could not produce it. Tr. 69. In his testimony during an arbitration proceeding after his trading scheme collapsed, however, Schlesinger denied having written authorization to trade the account. CX 53. Whether or not Schlesinger's authorization was in writing is immaterial—his actual authority to place the trades is not in dispute.

¹² Tr. 840-41, 844-48; CX 1, 71 at 1 (staff diagram of the Zeus-Yankee-Olla trade pattern).

¹³ CX 1; Tr. 840-41, 847-48.

other firms at Schlesinger's direction. All of the transactions, however, fit within the larger pattern of circular trading of the Connectors, and the terms of all the transactions were dictated by Schlesinger.¹⁴

E. Golden's Role

In contrast to Kresge, Golden disputed the Department's allegations regarding the number of Connectors trades in which he took part and his role in those trades. The Department cited 20 Connectors purchases or sales (10 paired transactions) at Golden Harris, and eight purchases or sales (four paired transactions) at Hanauer. Golden, however, denied having any involvement in, or even knowing of, the first nine trade pairs at Golden Harris. Although Golden acknowledged taking part in the last pair of trades at Golden Harris and all four pairs at Hanauer, his description of his interactions with Schlesinger on those trades differed substantially from Kresge's testimony. He also disputed Schlesinger's OTR testimony that his trades with Golden were pre-arranged, and that when he sold the Connectors to Golden, it was with the understanding that he would take them back within a short period of time and would guarantee Golden against any loss.¹⁵

1. Connectors Trades at Golden Harris

The 10 pairs of transactions at Golden Harris occurred in August and September 1999, January, February, June and August 2000, February and December 2001, and March and June 2002. All of these trades fit within the general pattern of Schlesinger's circular trading.¹⁶

¹⁴ Tr. 76, 244, 840-41; CX 1, 43-44.

¹⁵ CX 51 at 33-34. Schlesinger, who has been barred from the securities industry for his involvement in the Connectors trading, did not testify at the hearing.

¹⁶ CX 1.

In the first six pairs, Golden Harris purchased the Connectors from the account of one of its customers, Bedford Capital, and sold them to Schlesinger, initially when he was at American Third, and later when he was at Zeus. Like Olla, Bedford Capital was a hedge fund that maintained a DVP account at Golden Harris, linked to a prime brokerage account at Spear Leeds. Although its name and contact person were different, Bedford Capital had the same taxpayer identification number as Olla, and, according to Golden, came to Golden Harris through Schlesinger. In pairs seven through 10, Golden Harris purchased the Connectors directly from Zeus, held them for a short period, and then sold them back to Zeus.¹⁷

Golden testified that the first nine trades must have been effected, without his knowledge, by William Fleno, who was a trader at Golden Harris at the relevant time. In contrast, Fleno testified, on behalf of the Department, that the trades were all executed, or at least approved, by Golden.¹⁸

The Panel found it more probable that Fleno, rather than Golden, executed the first nine trade pairs. Fleno, not Golden, completed the trade tickets for trade pairs two through nine (the trade tickets for the first trade pair could not be found). Moreover, in a taped telephone call in July 2004, as Schlesinger's scheme was collapsing, Fleno told one trader, "I know [Schlesinger] does these back and forth a lot. I have done these quite a bit for him over the years, these Connectors, you know." In another taped call, he told a

¹⁷ CX 1, 9, 10; Tr. 355-56, 503, 843, 880-81. Fleno claimed he learned about Bedford Capital from another source, and that Golden was responsible for opening the account. Tr. 592-93. Like nearly all of Fleno's testimony, however, the Panel found this not credible. Bedford Capital had the same taxpayer identification number as Olla, and its account was used to route the Connectors through Golden Harris to Schlesinger as part of the circular trading pattern. Fleno also admitted that he placed orders for new issue bonds through Bedford Capital, and in doing so he "might have gone through Schlesinger." Tr. 636. The Panel finds, therefore, that the Bedford Capital account came to Golden Harris through Schlesinger, as Golden testified.

¹⁸ Compare Tr. 354, 357 (Golden) with Tr. 598-605 (Fleno).

different trader, “I used to do this with [Schlesinger] beforehand. Like, I’ve done this [Connectors] trade, not in the last two years, but, like, all the time. . . . The guy that buys it goes in and out, in and out, over, like, a five or six year period.”¹⁹

Fleno offered no credible explanation for either of these circumstances. With regard to his handwriting on the trade tickets, he testified that he completed them for Golden, at Golden’s direction. But witnesses who worked on the Golden Harris trading desk testified that, except in unusual circumstances, traders, including Golden, completed their own trade tickets.²⁰ Therefore, the Panel did not find it credible that Fleno would have completed every one of the Connectors trade tickets if Golden had executed the trades.

With regard to his recorded statements to the other traders, Fleno claimed that when he used phrases such as “I have done these” and “I’ve done this [Connectors] trade,” he was using “I” to refer not to himself, but to Golden Harris as a firm.²¹ But the Panel listened to the recordings of these conversations, and it was clear from the context and manner in which Fleno made these statements that he was referring to his personal

¹⁹ CX 57 at 24, 32; CX 67. CX 67 contains the actual audio recordings of the calls, while CX 57 is a transcript of the recordings prepared by a court reporter. The quotations in the text are based upon a careful review of the corresponding portions of the audio files themselves, which are the best evidence of the words actually spoken, rather than the transcript, which contains a few minor errors. Fleno testified that when he referred to “the guy” he meant Schlesinger. Tr. 625.

²⁰ Tr. 728 (Cicarelli), 761-62 (DiMauro), 908-09 (Silver).

²¹ Tr. 621.

trading history with Schlesinger; therefore, the Panel did not find his explanation credible.²²

On the other hand, the Panel also found Golden's testimony that he was unaware of Fleno's Connectors trades at Golden Harris not credible. All of the former Golden Harris employees who testified at the hearing, including those called by Golden, emphasized that he exercised very careful oversight of the trading desk, including being aware of all of the traders' positions, and, based on observing his demeanor at the hearing, the Panel agrees with this assessment of Golden's personality.²³ While Fleno had more authority and independence than the other traders, it is not credible that he would have purchased such a substantial amount of unrated, zero coupon Connectors without Golden's approval. In that regard, the Panel noted that Fleno did not otherwise trade South Carolina bonds or zero coupon bonds at Golden Harris, and that his Connectors purchases represented a large position for the firm and a substantial

²² The Department argued that Fleno's testimony that the Connectors trades were Golden's was supported by Schlesinger's OTR testimony and the fact that Bedford Capital was Golden's customer. Schlesinger did not testify at the hearing, and his OTR testimony is ambiguous on this point. He testified that he had engaged in pre-arranged parking transactions with Golden, but believed there were "more than one, not more than five" trade pairs. He later testified that he could only remember one Connectors trade with Golden at Golden Harris. After the Department suggested that Golden Harris' records indicated ten Connectors trade pairs at that firm, Schlesinger said, "I absolutely don't remember it being that many." As the Department notes, when asked, he said that he had only dealt with Golden at Golden Harris, but he again emphasized that he "had no idea" there had been so many Connectors trades at Golden Harris. CX 51 at 33, 38-40. The Panel found this ambiguous OTR testimony less persuasive than the trade tickets and Fleno's recorded statements. With regard to the Bedford Capital account, both the documentary evidence (CX 10, RX-SG 12) and the testimony (Tr. 503-11 (Golden), 593-96 (Fleno)) were in substantial conflict regarding Golden's and Fleno's involvement with the account, and again the Panel finds the trade tickets and Fleno's statements more persuasive evidence.

²³ Tr. 393-94 (Small) (Golden kept on top of the positions of traders every day, reviewed all trade tickets and position reports, and "was always very much aware of what [the traders] were doing"); 422-24 (Harris) (as co-owner it was his "assumption that ... [Golden and Fleno] both knew what our firm's position was so that they could both respond if someone wanted to buy something or sell something"); 716-20 (Cicarelli) (Golden oversaw the firm's traders and was aware of what they were trading, no one made trades in excess of a million bonds without his approval, and he reviewed the firm's inventory reports); 745-48 (DiMauro) (Golden was in charge of the trading desk, kept himself informed of the positions the traders were taking, reviewed daily reports concerning the firm's trading activity, was in control of the firm's finances, and wanted to know what the positions were every day); 913 (Silver) (Golden "was in charge" and was interested in what positions the traders were taking).

commitment of the firm's capital. In addition, although Golden testified that he would not have paid attention to a particular trade if the bonds were purchased by Golden Harris and sold the same day—which occurred with the first five trade pairs—in Fleno's last four trade pairs, which Golden claimed he was unaware of, Golden Harris held the \$2 million Connectors position for as long as two weeks. Given his careful oversight of the trading desk, Golden must have been aware of those positions.

Finally, there was no reason for Fleno to hide the trades from Golden. Like Fleno, Golden had a close, long-term professional relationship with Schlesinger, so there was no reason for Fleno to be concerned that Golden would refuse Schlesinger's requests regarding the Connectors. In fact, Golden admits that he did one Connectors trade pair with Schlesinger after Fleno left Golden Harris, and that he did four Connectors trade pairs at Hanauer, all at Schlesinger's behest. Accordingly, the Panel found that, while Fleno was directly responsible for the first nine Connectors trade pairs at Golden Harris, Golden must have known of and approved the trades.

Golden admits that he was responsible for the tenth Connectors trade pair at Golden Harris, in June 2002. In that instance, as in the prior three Connectors trade pairs, Golden Harris bought the Connectors directly from Schlesinger at Zeus, held them for a period (in this case, 11 days), and sold them back to Zeus at a slightly higher price. Golden offered no explanation for this trade pair; rather, he testified that he was distracted by the upcoming sale of Golden Harris to Hanauer and had no recollection of the trades.²⁴

This, too, the Hearing Panel rejected as not credible. As shown by his claimed recollection of every detail of his subsequent Connectors trades at Hanauer, Golden

²⁴ Tr. 273, 365-66.

would have paid close attention to and remembered a trade of this magnitude, involving a type of issue that Golden admitted he would not normally trade. Instead, the Panel concluded that Golden was simply unable to offer a colorable justification for this trade pair.

2. Connectors Trades at Hanauer

Golden also acknowledges having participated in four pairs of Connectors trades at Hanauer. The first pair was unusual because it involved only a \$300,000 portion of the Connectors, rather than the full \$2 million.²⁵ Golden purchased these bonds from MuniCenter, a brokers' broker,²⁶ on December 30, 2003; MuniCenter, in turn, had obtained the Connectors from Zeus. Golden held the Connectors until January 29, 2004, when he sold them for a slightly higher price to Yankee, with a delayed settlement date of February 17, 2004. The same day, Yankee bundled these bonds with another \$1.4 million portion of the Connectors and sold them to Olla, with the same delayed settlement date. Before the delayed settlement date, Olla sold the bonds to Zeus' trading account, completing the circle.²⁷

Although they fit within the same circular trading pattern, Golden sought to distinguish this trade pair from all of the other Connectors trades because it involved only a \$300,000 portion of the \$2 million Connectors. According to Golden, Schlesinger contacted him about the purchase, explaining that he had an unidentified customer who wanted to sell the bonds before year end in order to take a tax loss. Schlesinger told him

²⁵ It appears that in December 2003, Schlesinger, who was under great pressure from Zeus' clearing firm and Zeus' management regarding his Connectors trading, broke the Connectors into several blocks, and sold them to several buyers, including Golden. By the end of February 2004, the blocks had been re-formed into the complete \$2 million. CX 1, 31.

²⁶ A brokers' broker acts as an intermediary in transactions between broker-dealers to provide anonymity, communication, and order matching. Brokers' brokers deal only with broker-dealers. Tr. 929.

²⁷ CX 1.

there was a good chance that Golden could make a profit on the bonds, and if Golden could not sell them after 30 days, maybe Schlesinger could persuade the customer who needed the tax loss to re-purchase them. On that basis, Golden decided to purchase the bonds.²⁸

Golden said he tried to find a buyer for the bonds without success, and at the end of 30 days went back to Schlesinger, saying he was about to put the bonds out for bid, but Schlesinger told him the customer might want to re-purchase. He gave Schlesinger a price on the bonds, and Schlesinger later came back and said he could use the bonds. But instead of purchasing the bonds himself, he directed Golden to sell them to Yankee.²⁹

In March 2004, Golden took part in a second pair of Connectors trades at Hanauer. Golden testified that Schlesinger called and said that he (Schlesinger) had a trade to execute, but could not do the trade himself because of credit line issues, so he asked Golden to execute the trade. According to Golden, he told Schlesinger that he did not know the market for the Connectors, and normally did not trade bonds like the Connectors, but agreed to purchase them to help out Schlesinger. He said he told Schlesinger that he would work hard to sell the bonds, but did not know who would want to buy them. Schlesinger replied that he knew the market for the bonds and, if necessary, would help Golden find a buyer. But Golden insisted that when he purchased the bonds Schlesinger did not tell him who the buyer would be, or guarantee him a profit.³⁰

²⁸ Tr. 274-75. The “tax loss” rationale that Golden says Schlesinger offered for the trade made no sense; there could be no tax loss on the trade because the price of the Connectors had increased with every prior trade, and the price that Golden paid was the highest yet.

²⁹ Tr. 277-79. The price (\$68.207), which Golden said he arrived at independently, was exactly the same, to the tenth of a cent, as the price that Yankee paid on the same day for another \$1.4 million of the Connectors that Yankee purchased from another member firm. CX1.

³⁰ Tr. 268-69, 273, 284, 286.

Golden testified that he set several conditions on the transaction “that I [knew] would make the trade valid and legitimate.” One condition was that “it’s going to have to be a reputable account that’s going to buy the bonds.” He imposed this condition to prevent Schlesinger from telling him to buy the Connectors from Yankee and resell them to Yankee, or to buy them from Zeus and resell them to Zeus, “which obviously I knew was an improper trade.” Golden acknowledged that he did not typically express such conditions when he made trades, but explained, “Here, he was asking me to help him on a bond that I really had not done any research on, had not followed in the market place and I was really leaving myself open.”³¹

Golden then purchased the Connectors—this time the entire \$2 million—from Yankee (which had purchased them that day from Olla), on terms that Schlesinger provided. Then, within two hours, he resold the Connectors to Wolfe & Hurst, a brokers’ broker. Although Golden testified during his OTR that he was certain that Wolfe & Hurst called him to purchase the bonds, that was untrue. Wolfe & Hurst recorded calls on its trading line, and those recordings establish that Golden called Wolfe & Hurst, having already received the terms of the sale from Schlesinger, including an extended settlement. Wolfe & Hurst promptly closed the circle by selling the bonds back to Yankee, as Schlesinger instructed, for a small markup and the same extended settlement, and the pattern continued.³²

³¹ Tr. 270-72, 298. Golden also acknowledged that during his OTR he testified that he set an additional condition—that there could not be anything illegal about the transaction—but insisted that this condition was implicit, not explicit.

³² CX 1, 39-40 (Golden OTR), 58, 68; Tr. 287-92. In fact, after Golden called Wolfe & Hurst with the trade terms Schlesinger had given him, Schlesinger called Wolfe & Hurst directly, telling the trader, “I had the wrong price. You’re buying them from Golden at 60 flat. ... And then selling them to the other guy for 69.05.” CX 58 at 7-8, 68. Golden put his end of the trade through at the new price without speaking to Wolfe & Hurst. Tr. 294-95.

Golden's next Connectors trades were in April 2004. According to Golden, once again Schlesinger called him, saying he could not purchase the bonds himself, and "I need to sell them. Can you help me out?" Golden purchased the bonds as a favor to Schlesinger, and also agreed to a same-day settlement on the purchase. At the same time, Schlesinger advised him to call Olla's principal about opening a DVP account at Hanauer. Golden thought that Olla, as a hedge fund with access to underwriters, would be a potential source of valuable new bond issues, just as Bedford Capital had been at Golden Harris. He contacted Olla's principal and opened an account for Olla that day.³³

Golden testified that when he bought the bonds, he had no idea who was going to buy them, but hoped and expected that Schlesinger would find him a buyer. Two days later he received a call from a trader at another firm, who told him that Schlesinger had asked her to call him about the Connectors. Golden sold the bonds to her, and she resold them to Zeus the same day.³⁴

Golden's final Connectors trades were in June 2004. This time when Schlesinger called Golden he said that he owned the bonds and needed to sell them. Golden testified that initially he refused, telling Schlesinger (falsely) that he lacked authority to make the purchase, but Schlesinger asked him to check with the supervisor of Hanauer's bond trading desk, Kenneth Meiselman. Schlesinger also told him that Olla had traded the Connectors before and there was a good chance it would be willing to purchase them again. Golden said that, after satisfying himself that the risk factors on the bonds were under control and the pricing was reasonable, he spoke to Meiselman, telling him that

³³ Tr. 301, 305-07. Golden testified that Bedford Capital, by providing access to new bond issues, "happened to be an extremely profitable account for Golden Harris. We literally traded millions and tens of millions of dollars we purchased from Bedford Capital." Tr. 505.

³⁴ CX 1; Tr. 307-09.

Schlesinger was asking him to do the trade as a favor, but failing to disclose that he had purchased the Connectors on prior occasions at Schlesinger's request. Meiselman approved the purchase; the next day, Golden sold the Connectors to Olla, with a delayed settlement date.³⁵

Once again, the Panel did not find Golden's testimony regarding the Connectors trades at Hanauer credible. In contrast to the trades at Golden Harris, as to which Golden professed to recall nothing, he claimed to remember many self-serving details about each of the trades he did at Hanauer. But the only one of those details that could be tested—his testimony during his OTR that he was certain that Wolfe & Hurst contacted him with the terms of his sale of the Connectors in March 2004—was proven false by the recorded conversation showing that he called Wolfe & Hurst with trade details provided by Schlesinger.³⁶ In addition, having had an opportunity to observe Golden's demeanor, the Panel found that much of his testimony about the supposed details of the trades appeared strained and rehearsed, and therefore not credible.

F. The Collapse of Schlesinger's Scheme

Schlesinger's trading scheme unraveled in mid-2004. In September and October 2003, Zeus' clearing firm, Sterne Agee Clearing, began raising questions with Zeus management about the Connectors trades, initially expressing concern about delayed

³⁵ CX 1; Tr. 310-37.

³⁶ CX 39, 40, 58, 68. Golden addressed this issue at length in his December 2004 OTR. When asked whether Schlesinger had told him "who to sell [the Connectors] to," Golden responded, "He didn't tell me who to sell to. Wolfe and Hurst came to me." When twice asked if Wolfe & Hurst came to him, Golden said, "Yes." Later in his OTR he testified, "Wolfe and Hurst called me up and said, I understand you have these bonds. I have somebody who can pay you 69 and I need a 4/23 2004 settlement date. I didn't have a problem with the settlement date because I knew Wolfe and Hurst and they were reliable. So I said, fine." When questioned further about the transaction, Golden again stated that he "did not know what the settlement date was prior to [Wolfe & Hurst] stating it." CX 39 at 37, 41, 45. In fact, all of this was untrue. The recordings show that Golden called Wolfe & Hurst, and that he gave Wolfe & Hurst the terms of the trade, including the extended settlement date, which he had obtained from Schlesinger.

settlement dates for certain Connectors trades, and later raising questions about the price of the Connectors. Sterne Agee continued to express concern about the Connectors trades in 2004. In response, Zeus management told Schlesinger that he was not to engage in any Connectors trades without express permission.³⁷

Furthermore, by 2004 there was reason for concern about the Association's ability to pay its obligations on the Connectors when they came due. Although the Southern Connector was completed and opened in 2001, ahead of schedule, the actual revenues generated by its operations were substantially less than had been projected when the bonds were issued. In 2003, because of the revenue shortfall, the trustee invaded the senior bonds debt service reserve to pay a portion of the interest due on the Series A bonds, and Standard & Poor's downgraded the Series A and Series B bonds. In early July 2004, the Association publicly reported that the trustee had used interest earned on the subordinated bonds debt service reserve, as well as the senior bonds debt service reserve, to pay interest due on the Series A bonds.³⁸

At that time, the Connectors were in an account belonging to Olla, which could not, or would not, continue to hold the bonds. Because Zeus and its clearing firm had prohibited him from purchasing the Connectors, Schlesinger arranged, through Kresge, for Yankee to take them from Olla. Knowing that Yankee, too, was unable to hold the bonds, Schlesinger then arranged for Wolfe & Hurst to buy the bonds from Yankee, on the representation that he would purchase them from Wolfe & Hurst. Although Schlesinger tried to complete that purchase, Zeus' clearing firm refused to accept the trade. When Schlesinger was unable to complete his purchase of the bonds, Wolfe &

³⁷ CX 31, 35, 36, 51-52.

³⁸ CX 3-4; RX-SG 4.

Hurst became suspicious and concerned about the value of the bonds, and demanded that Yankee break the trade and take the Connectors back.³⁹

Schlesinger then called Fleno at his new firm, Commerce Capital Markets, telling Fleno that he had “a huge problem ... on these Connectors zeros.” He asked Fleno “to pick them up today, and I will give you an account to sell them to tomorrow.” Initially he told Fleno he would be buying the Connectors from Wolfe & Hurst, and gave him the price to pay, but later told Fleno he would be buying the Connectors from Yankee. Kresge later called Fleno, and they completed the trade on the terms Schlesinger had provided.⁴⁰

Schlesinger was unable to purchase the Connectors from Fleno, because Sterne Agee still refused to accept any Connectors trades, and he could not arrange for anyone else to buy them. Commerce Capital became concerned about Schlesinger’s inability to take the Connectors and the value of the bonds in light of the Association’s report. In early August, at Schlesinger’s behest, a trader at another firm agreed to purchase the Connectors from Commerce Capital, but that firm, too, became concerned about the value of the bonds, and canceled the purchase. By that time the price of the Connectors had dropped from more than \$70 to between \$17 and \$25.50.⁴¹

III. Discussion

The Department charged that Golden and Kresge participated in a fraudulent manipulation and parking scheme orchestrated by Schlesinger, in violation of Section

³⁹ Tr. 104-30, 930-32, CX 1, 51-52, 58, 67.

⁴⁰ Tr. 614-25; CX 57, 67.

⁴¹ CX 1, 57, 67. An arbitration proceeding ensued to determine who would bear the losses incurred on the Connectors. In 2006, FINRA accepted a Letter of Acceptance, Waiver and Consent (AWC) from Schlesinger in which he consented to a bar from association with any FINRA member. In 2007, FINRA accepted an AWC from Fleno in which he consented to a four-month suspension and a \$5,000 fine, and an AWC from Commerce Capital Markets, Fleno’s former employer, in which the firm consented to a censure and a \$75,000 fine. CX 64-66.

10(b) of the Exchange Act, Rule 10b-5, and MSRB Rules G-17 and G-14. Alternatively, the Department charged that Respondents aided and abetted Schlesinger's fraudulent scheme, in violation of Rules G-17 and G-14. Under either theory of violation, the first issue is whether the Department proved that Schlesinger's circular trading scheme amounted to fraudulent manipulation and parking of the Connectors.

A. Manipulation

"A manipulation, in essence, is 'the creation of deceptive value or market activity for a security, accomplished by an intentional interference with the free forces of supply and demand.'"⁴² The SEC has explained that "proof of a manipulation almost always depends on inferences drawn from a mass of factual detail. Findings must be gleaned from patterns of behavior, from apparent irregularities, and from trading data. When all of these are considered together, they can emerge as ingredients in a manipulative scheme designed to tamper with free market forces."⁴³

"Wash ... trades have long been recognized as fraudulent devices proscribed by Section 10(b) and Rule 10b-5."⁴⁴ "Wash sales are 'transactions involving no change in beneficial ownership'"⁴⁵ Similarly, the SEC has found manipulation based on "directed trading [that] caused [a] stock to trade in a circular fashion, at continually

⁴² Robert J. Prager, Exchange Act. Rel. No. 51974, 2005 SEC LEXIS 1558, at *21 (July 6, 2005) (quoting Swartwood, Hesse, Inc., 50 S.E.C. 1301, 1307 (1992)).

⁴³ Pagel, Inc., 48 S.E.C. 223, 226 (1985), aff'd, 803 F.2d 942 (8th Cir. 1986).

⁴⁴ Irfan Mohammed Amanat, Exchange Act Rel. No. 54708, 2007 SEC LEXIS 2558, at *30 (Nov. 3, 2007).

⁴⁵ SEC v. U.S. Environmental, Inc., 155 F.3d 107, 109 (2d Cir. 1998) (quoting Ernst & Ernst v. Hochfelder, 425 U.S. 185, 205 n.25 (1976)).

increasing prices The directed trading was manipulative because it artificially increased the volume of trading in, and the price of, [the] stock.”⁴⁶

Schlesinger’s scheme displayed all of the characteristics of manipulation. The trading of the Connectors and the inexorable increase in their price had nothing to do with market forces. There was no significant market demand for the Connectors, and indeed very little market demand for any of the other Association bonds. Instead, all of the Connectors trading was directed by Schlesinger, and the price increases reflected Schlesinger’s need to provide guaranteed returns to the traders and customers who cooperated in his scheme, not market forces.⁴⁷ And he accomplished his scheme by directing wash trades through which the Connectors made repeated round trips with no change in the beneficial ownership of the bonds.

Schlesinger’s motives are unclear. The circular trading continued for years without Schlesinger or any other participant selling any of the Connectors into the market at a manipulated price. During his OTR, he indicated it was merely a device to allow him to retain control over the bonds, hoping their true market value would increase, but he also acknowledged that the unrealized profits suggested by the inflated value of the Connectors could provide additional trading capital.⁴⁸ As discussed below, Kresge testified that Schlesinger told him the trading was intended to benefit Olla, by setting a “market price” that would allow Olla to book supposed unrealized profits on the bonds.

⁴⁶ Robert J. Prager, 2005 SEC LEXIS 1558, at *23. “A ‘directed order’ has been defined as a pre-arranged order where a third party arranges for the buyer of securities to contact the seller, or where a third party pre-arranges a transaction between brokerage firms.” United States v. Corr, 543 F.2d 1042, 1046 n.7 (2d Cir. 1976).

⁴⁷ In his OTR, Schlesinger admitted that he was probably the only market for the Connectors, and explained that the increasing price of the Connectors on each transaction “just reflects ... giving of a small profit to somebody who helped me out.” CX 51 at 15-16, 44.

⁴⁸ CX 52 at 71, 83.

Schlesinger's motives, however, are irrelevant. His actions had the effect of distorting the market for the Connectors. And it is not significant that the Connectors were never sold into the general market at a manipulated price. Schlesinger's manipulation undermined the integrity of the marketplace—precisely the type of misconduct that Section 10(b) and Rule 10b-5 are intended to address.⁴⁹

Finally, there is no doubt that Schlesinger had the scienter required to establish securities fraud. He admitted in his OTR that he deliberately directed circular trades, including wash trades, at ever-increasing prices that he knew bore no relation to the true market for the Connectors.

B. Parking

Parking is a device that may be used to facilitate manipulation or other improper activities. The elements of parking are: “(1) a pre-arrangement to sell and then buy back securities (to conceal true ownership); (2) on the same, or substantially the same, terms (thus keeping the market risk entirely on the seller); (3) for a bad faith purpose, accomplished through a sham transaction in which nominal title is transferred to the purported buyer while the economic incidents of ownership are left with the purported seller.”⁵⁰ During his OTR, Schlesinger admitted these elements.⁵¹

Therefore, the Panel found the evidence sufficient to establish that Schlesinger's scheme was a fraudulent manipulation of the market for the Connectors, accomplished, at

⁴⁹ The fact that the Connectors were not sold into the market at inflated prices does not mean that the manipulation was essentially benign. As the ultimate collapse of the scheme, resulting losses, and subsequent arbitration proceeding demonstrated, Schlesinger and the traders who cooperated in his scheme put their employer firms, and those firms' clearing firms, at substantial risk of loss.

⁵⁰ Yoshikawa v. SEC, 192 F.3d 1209, 1214 (9th Cir. 1999). Circular trading, in which a security makes several stops on the way back to the beneficial owner, as in this case, may constitute parking. David E. Lynch, Exchange Act. Rel. No. 46439, 2002 SEC LEXIS 2248 (Aug. 30, 2002).

⁵¹ CX 51 at 20, 22, 24, 27, 32-33, 36, 42-44.

least in part, through parking transactions, in violation of Section 10(b) of the Exchange Act and Rule 10b-5.⁵²

C. Participation

The next issue is whether Kresge and Golden “participated” in Schlesinger’s manipulation and parking scheme, and therefore are liable as “primary violators” of Section 10(b) and Rule 10b-5. The demarcation between participation and aiding and abetting is not clearly defined in the case law, but in SEC v. U.S. Environmental, Inc.,⁵³ the court addressed that issue in an analogous case concerning a trader who, it was alleged, had been involved in a stock manipulation scheme.

The SEC alleged that the trader “agreed to execute trades as directed by [a stock promoter], and ... also agreed to move, or adjust, the price [his firm] quoted for [the stock] at [the promoter’s] direction. In return, [the promoter] assured [the trader] that [his firm] would receive a profit on the transactions [the promoter] directed.”⁵⁴ The court held that these allegations were sufficient to support imposing primary liability, rather than aiding and abetting liability, on the trader. The court reasoned that a person who “effect[ed] the very buy and sell orders that artificially manipulated [the] stock price upward” participated in the manipulation, “despite the fact that someone else directed the market manipulation scheme.”⁵⁵

The court also explained that “whether [the defendant] was a primary violator rather than an aider and abetter turns on the nature of his acts, not on his state of mind.”

⁵² Violations of Section 10(b) and Rule 10b-5 must involve conduct in connection with the purchase or sale of a security and the use of a means or instrumentality of interstate commerce or the mails. Schlesinger’s scheme involved the purchase and sale of the Connectors and was accomplished, in part, through numerous telephone calls between Schlesinger and his allies.

⁵³ 155 F.3d 107 (2d Cir. 1998).

⁵⁴ Id. at 109.

⁵⁵ Id. at 112.

Nevertheless, the court emphasized that scienter is an essential element of a violation of Section 10(b) or Rule 10b-5, and held that proof that the defendant “executed trades that he knew were for a manipulative purpose,” or “recklessly participated in the manipulation,” would be sufficient to establish scienter. And the court stated that “as long as [the defendant], with scienter, effected the manipulative buy and sell orders, [the defendant’s] personal motivation for manipulating the market is irrelevant Even if [the defendant] were motivated by a desire to obtain compensation rather than by a desire to change [the security’s] market price ... [the defendant] is liable under § 10(b) if, with scienter, he effected the manipulative trades.”⁵⁶

1. Kresge

Applying this analysis to the facts of this case, it is clear that Kresge participated in Schlesinger’s manipulation and parking scheme. Kresge executed a large portion of the total number of manipulative Connectors trades identified by the Department, as Schlesinger directed. He admitted that the trades were pre-arranged by Schlesinger, who gave him both the price he would pay to purchase the Connectors and the price he would charge in selling them, guaranteeing him a profit of approximately \$1,000 per trade pair. Under U.S. Environmental, this is sufficient to find that he participated in the manipulation.

Furthermore, Kresge acted with scienter because his actions were, at a minimum, reckless. For purposes of imposing liability under Section 10(b) and Rule 10b-5, recklessness is defined as “an extreme departure from the standards of ordinary care ...

⁵⁶ Id. at 111-12. Because the lower court had dismissed the case on the ground that the complaint’s allegations were insufficient on their face to support primary liability, the court addressed the adequacy of the allegations, rather than the evidence required to support those allegations.

which presents a danger of misleading buyers or sellers that is either known to the [respondent] or is so obvious that the [respondent] must have been aware of it.”⁵⁷

Over a period of several years, Kresge, as directed by Schlesinger, executed transactions that were replete with red flags. The same bonds were traded over and over again, nearly every month, among the same parties, at ever-increasing prices, and with all terms dictated by Schlesinger. Yet Kresge executed these trades as Schlesinger directed—without asking any probing questions, or receiving any reasonable responses to the few superficial questions he did ask—and he caused the trades to be reported to the market, through his clearing firm, as though they were bona fide transactions.⁵⁸

Kresge testified that he viewed his role in the Connectors trades as “to basically process paper.” He pointed out that Olla’s account at Yankee was a DVP account linked to Olla’s prime brokerage account at Spear Leeds, and said that in other cases where Yankee had DVP accounts linked to prime brokerage accounts, “I received step-ins and step-outs all day long, and that’s exactly what I thought [the Connectors trades were].”⁵⁹

In step-in/step-out transactions, a large trade is negotiated for an institutional customer by the prime broker. For a variety of reasons, the prime broker, or the customer’s investment manager, may then arrange to “step out” a portion of the trade to firms at which the customer maintains DVP accounts. Because the terms of the trade have already been negotiated, the DVP firm that “steps into” a portion of the trade is, as Kresge said, basically processing paper on the trade, not negotiating terms.⁶⁰

⁵⁷ Sundstrand Corp. v. Sun Chem. Corp., 553 F.2d 1033, 1044-45 (7th Cir. 1977).

⁵⁸ CX 72 (MSRB reported trades); Tr. 86 (Kresge knew that municipal bond trades are reported to MSRB and become part of the bond’s trade history), 846 (Yankee’s trades were reported to MSRB).

⁵⁹ Tr. 70, 72.

⁶⁰ Tr. 174-75, 212-13, 233-240.

The Connectors trades, however, bore no resemblance to step-in/step-out trades. Kresge was not executing a small portion of a large transaction that had been negotiated by Olla's prime broker (Spear Leeds). Instead, he was executing the entire \$2 million Connectors trade, and was receiving his trade instructions, not from Olla's prime broker or an independent investment manager, but from Schlesinger, who in most instances was the contra party on either the purchase or the sale.⁶¹

But even if Kresge's professed belief that the trades were step-in/step-out trades had been reasonable, that would not have excused his failure to recognize and respond to red flags that clearly signaled the trades were manipulative and entailed parking. Kresge did the same trade involving the same block of Connectors over and over, a clear red flag suggesting that these were manipulative wash trades.⁶² At a minimum, this should have led him to check the publicly available information regarding the trading history of the Connectors, as well as the other tranches of the Series C bonds. He would have quickly discovered that the prices and trading patterns of the Connectors made no sense, except as an indication of manipulation and parking.⁶³

⁶¹ Kresge testified as to the Olla Connectors trades, "Yes, they're going through me and I'm delivering it or picking it up, but the ultimate decision is either ending up at or coming from Spear-Leeds." Tr. 236. But while this may be an accurate description of a legitimate step-in/step-out transaction, it is not what happened here. The Olla Connectors trades came, not from Olla's prime broker, Spear Leeds, but from Schlesinger, an interested party. During his OTR, Kresge professed to be stunned when, after he testified that he did not buy the Connectors from Schlesinger, the staff pointed out that the majority of his purchases came directly from Zeus, saying, "I don't remember Zeus." CX 43 at 55. But Kresge had to identify the firm he was buying from when he completed his trade ticket; apparently he simply paid no attention to the identity of the contra party on transactions he completed at Schlesinger's direction.

⁶² Kresge testified that it was not unusual to receive frequent step-out trades from a customer that involved the same security, citing trades in Chrysler stock, but the Connectors trades involved a single large block of a thinly traded bond issue, and in that regard also bore no resemblance to the sort of step-out trades described by Kresge.

⁶³ When Schlesinger approached another trader, Michael Molloy, in July 2004 and asked him to do his first Connectors trade, Molloy refused, in part because when he looked at the trading history of the Connectors, he noted that they had "traded once a month, every month, for the past six months, and all in that price range," and concluded that Schlesinger "was parking the bonds." Tr. 782-85. Kresge had far more reason to reach the same, accurate conclusion.

Kresge, however, did virtually nothing. He did not check the trading history, and claimed he did not realize his trades (all at higher prices than had ever before been reported for the Connectors) were setting a market price. In 2003, he learned that the Connectors were revenue bonds for a toll road, but nothing more, and he never looked at the trade history of the other tranches of the Series C bonds. Eventually, he did become curious enough to ask Schlesinger the reason for his repeated circular trading. Schlesinger responded that “he was trying to capture the increased value of the bonds as interest rates came down. So, he was pegging the value of the bond, meaning that ... as the interest rate came down, the bonds went up.” Although Kresge testified that this appeared quite reasonable to him, in fact it raised an additional red flag, because it suggested a motive for Schlesinger to manipulate the market.⁶⁴ Therefore, the Panel concluded that Kresge participated in a fraudulent manipulation and parking scheme, in violation of Section 10(b) and Rule 10b-5.

The Panel also found that Kresge’s participation in the scheme violated MSRB Rules G-17 and G-14. Under Rule G-17, Kresge was required to “deal fairly with all persons and ... not engage in any deceptive, dishonest, or unfair practice.” Participating in a fraudulent scheme, in violation of Section 10(b) and Rule 10b-5, is plainly a violation of this provision. Rule G-14 provides, in relevant part, that no person associated with a municipal securities dealer may “distribute or publish, or cause to be distributed or published, any report of a purchase or sale of municipal securities, unless

⁶⁴ Tr. 71, 84-85, 87, 89, 95, 98. Kresge also argued that his obligations were limited because Olla and all of the traders he dealt with were Sophisticated Municipal Market Professionals (SMMPs), as defined by the MSRB. But in issuing an interpretation of Rule G-17 addressing a municipal securities dealer’s obligations to SMMPs, the MSRB emphasized, “This interpretation does nothing to alter a dealer’s duty not to engage in deceptive, dishonest, or unfair practices under rule G-17 or under the federal securities laws.” Interpretive Notice Regarding the Application of MSRB Rules to Transactions with Sophisticated Municipal Market Professionals (Apr. 30, 2002), available at <http://www.msrb.org/msrb1/rules/notg17.htm>.

such ... person ... has no reason to believe that the reported transaction is fictitious or in furtherance of any fraudulent, deceptive or manipulative purpose.” Kresge knew that his clearing firm would report his trades in the Connectors to MSRB, and they would become part of the trade history of the Connectors, and he allowed this to occur even though he had good reason to know that the trades were in furtherance of a fraudulent, manipulative scheme.⁶⁵

2. Golden

Golden was not as deeply or directly involved in Schlesinger’s manipulation as Kresge. With respect to the first nine trade pairs at Golden Harris, the Panel found that, while he must have been aware of, and permitted, the trades, they were executed by Fleno. Golden himself executed only one trade pair at Golden Harris and four trade pairs at Hanauer, including one that involved only a \$300,000 portion of the Connectors.

Because the legal standards for determining whether this level of involvement is sufficient to establish participation are unclear, the Panel concluded that Golden’s actions should be analyzed under aiding and abetting standards, rather than under the standards for primary liability.

D. Aiding and Abetting

The Complaint charged, as an alternative to participation, that Kresge and Golden aided and abetted Schlesinger in carrying out his manipulative scheme. Respondents point out that in Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.,⁶⁶

⁶⁵ Kresge argued that FINRA examined Yankee, and looked specifically at its Connectors trades, but did not advise Yankee that the Connectors trades were illegal or violated any rule. Tr. 180-92. But Kresge had an independent obligation to recognize and respond to the red flags on the Connectors trades, and cannot transfer that obligation to the examiners. The SEC has held that Respondents “cannot shift their burden of compliance to [FINRA]. We have previously held that industry professionals are not released from their obligations based on erroneous advice from [FINRA].” B.R. Stickle & Co., 51 S.E.C. 1022, 1025 (1994).

⁶⁶ 511 U.S. 164 (1994)

the Supreme Court held that aiding and abetting was not a viable theory of violation under Section 10(b) and Rule 10b-5. They acknowledge that Congress subsequently overrode this insofar as it authorized the SEC to pursue aiding and abetting liability, but argue that this exception was limited to the SEC, and is not available to FINRA.⁶⁷

There is no occasion for the Panel to address this argument, however, because the Department has not charged Respondents with aiding and abetting liability under Section 10(b) or Rule 10b-5. Instead, the Complaint charges that by aiding and abetting Schlesinger's scheme, Respondents violated MSRB Rules G-17 and G-14.

In Robert J. Prager, where the SEC found that the Respondent violated NASD Rule 2110 by aiding and abetting a fraudulent manipulation scheme, the SEC stated that "[t]he three elements necessary to find aiding and abetting liability ... are the following: (1) securities law violations by [another]; (2) [the Respondent's] substantial assistance in furtherance of those violations; and (3) [the Respondent's] providing that assistance with the requisite scienter."⁶⁸ The Panel concludes that proof of these elements is also sufficient to establish an aiding and abetting violation of Rules G-17 and G-14.⁶⁹ As explained above, Schlesinger's violation is clear. The remaining questions are whether each Respondent provided substantial assistance to Schlesinger, and did so with scienter.

⁶⁷ 15 U.S.C. § 78t(e) ("any person that knowingly provides substantial assistance to another person in violation of a provision of this title, or of any rule or regulation issued under this title, shall be deemed to be in violation of such provision to the same extent as the person to whom such assistance is provided."). See Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 128 S.Ct. 761 (2008).

⁶⁸ 2005 SEC LEXIS 1558, at *20.

⁶⁹ Rule G-17 is the MSRB counterpart to NASD Rule 2110, and the case law under Rule 2110 provides guidance in applying Rule G-17. DBCC v. Northridge Capital Corp., No. C07940045, 1995 NASD Discip. LEXIS 231, at *19 (N.B.C.C. May 24, 1995). Because the Complaint expressly charged that Respondents violated Rules G-17 and G-14 by aiding and abetting Schlesinger's fraudulent scheme, specifically alleging that Respondents provided substantial assistance and acted with scienter, and the parties litigated on that basis, the Panel has applied the aiding and abetting analysis employed by the SEC in Robert J. Prager. The Panel does not mean to suggest that those elements must be satisfied in order to establish a violation of Rule G-17 or Rule G-14 in other circumstances.

1. Kresge

Having found that Kresge participated in Schlesinger's manipulation, the Panel also finds, in the alternative, that he aided and abetted the manipulation, in violation of Rules G-17 and G-14. As explained above, Kresge provided substantial assistance to Schlesinger in carrying out his scheme by allowing him to direct every aspect of the Connectors trades he placed through Yankee.⁷⁰

Kresge also had the required scienter. In Robert J. Prager, the SEC explained, "‘Extreme recklessness’ satisfies the scienter requirement for aiding and abetting liability. Extreme recklessness ‘may be found if the alleged aider and abettor encountered red flags, or suspicious events creating reasons for doubt that should have alerted him to the improper conduct of the primary violator.’"⁷¹ As explained above, Kresge encountered and ignored numerous red flags and suspicious events, all of which indicated that Schlesinger was engaged in manipulation and parking. Insofar as Kresge failed to recognize or appreciate these circumstances, he could only have done so by deliberately ignoring what was before his eyes, which was itself extremely reckless.⁷²

Therefore, the Panel found that Kresge aided and abetted Schlesinger's scheme. The Panel also found that, by aiding and abetting Schlesinger's manipulation and parking scheme, Kresge violated Rule G-17's prohibition against any person associated with a

⁷⁰ See Robert J. Prager, 2005 SEC LEXIS 1558, at *24 (finding substantial assistance where the Respondent effected dozens of trades at the direction of the stock promoter who masterminded the manipulation).

⁷¹ Id., (footnotes omitted) (quoting Howard v. SEC, 376 F.3d 1136, 1143 (D.C. Cir. 2004)).

⁷² "Registered representatives may not deliberately ignore that which they have a duty to know" Dep't of Enforcement v. Nicolas, No. CAF040052, 2008 FINRA Discip. LEXIS 9, at *54 (N.A.C. Mar. 12, 2008) (citing Hanly v. SEC, 415 F.2d 589, 596 (2d Cir. 1969)). Kresge also argued that there was no evidence that he had entered into a conspiracy with Schlesinger, but "[i]t is not necessary ... to find that [Respondent] conspired with others to play a role in the directed trading scheme to find him liable for aiding and abetting. It is enough to find that [Respondent] knew or was severely reckless in not knowing that he was aiding and abetting directed trading." Dep't of Enforcement v. J. Alexander Securities, Inc., No. CAF010021, 2004 NASD Discip. LEXIS 16, at *40 (N.A.C. Aug. 16, 2004), aff'd sub nom. Robert J. Prager, Exchange Act. Rel. No. 51974, 2005 SEC LEXIS 1558 (July 6, 2005).

municipal securities dealer engaging in “any unfair, dishonest, or unfair practice.” Finally, the Panel found that by causing trades that he executed in aiding or abetting Schlesinger’s scheme to be reported, Kresge violated the prohibition in Rule G-14 on causing trades to be reported unless there is “no reason to believe that the reported transaction is ... in furtherance of any fraudulent, deceptive or manipulative purpose.”

2. Golden

Although the Panel did not find that Golden participated in Schlesinger’s manipulative scheme, the Panel did find that he aided and abetted the scheme, and in doing so violated Rules G-17 and G-14. He provided substantial assistance to Schlesinger at Golden Harris by allowing Fleno to effect trades in the Connectors. And after Fleno left Golden Harris, he executed one pair of Connectors trades for Schlesinger there, and four more at Hanauer. The trades at Hanauer provided particularly significant assistance to Schlesinger, because they took place when he was under great pressure from Zeus’ clearing firm, and may have allowed him to continue his scheme for several additional months before its collapse.

The Panel also found that Golden provided this assistance with the required scienter. It was readily apparent to the Panel from observing Golden testify that he is a highly experienced and very knowledgeable municipal bond trader. Even so, if he had just failed to note and address the suspicious circumstances surrounding the first few Connectors trades that Fleno executed at Golden Harris, the Panel might not have found that his conduct rose to the level of extreme recklessness. Those trades occurred at somewhat irregular intervals, were executed by Fleno, and involved Golden Harris purchasing the Connectors from its customer Bedford Capital and selling them on the same day to Schlesinger at American Third or, later, Zeus.

The later Golden Harris trade pairs executed by Fleno and the June 2002 trade pair executed by Golden himself, however, all involved Golden Harris purchasing the Connectors from Schlesinger at Zeus, holding them for a brief period, and then selling them back to Schlesinger at Zeus. These trades were suspicious on their face, because they suggested that Schlesinger might be parking the bonds, and they were precisely the sort of trades that Golden testified he would not do for that very reason. While there can be innocent explanations for purchasing and re-selling a security, there were many red flags accompanying these transactions, including the pattern of trades; the fact that they involved a substantial position in an issue that Golden would not normally trade; and the prices at which the trades were executed. The Panel found that Golden must have been aware of the trades that Fleno did, and Golden admitted he executed the last one, but was unable to offer any justification for it.

The Connectors trades that Golden engaged in at Hanauer are even more troubling. In his OTR, Schlesinger testified that he pre-arranged the Connectors trades with Golden, telling Golden that if he took the Connectors, Schlesinger would take them back in a short period of time, and also testified that Golden understood that Schlesinger would guarantee him against loss on the trades.⁷³ This is consistent with the evidence regarding Schlesinger's interactions with other traders who agreed to do the Connector trades. While Golden steadfastly denied that his Connectors trades at Hanauer were pre-arranged, as explained above, the Panel did not find his self-serving testimony regarding the details of the trades credible. But even accepting Golden's testimony at face value,

⁷³ CX 51 at 33-34. In contrast, when Schlesinger was asked during his OTR about Molloy, Schlesinger testified, truthfully, that he approached Molloy about parking the Connectors, but Molloy refused and became angry. CX 51 at 37-38.

there were many red flags on the Connectors trades he did at Hanauer, particularly with regard to the last three trades.

According to Golden, in March and again in April, Schlesinger asked him as a friend to purchase the Connectors, explaining, “I need to get it done,” and “I need to sell [the Connectors], can you help me out?”⁷⁴ And in June, Schlesinger was back, prevailing on Golden to buy the Connectors again. Two highly experience bond traders—Meiselman, who managed the bond trading desk at Hanauer, and Michael Molloy, who refused to purchase the Connectors from Schlesinger—testified that repeated requests from a friend to do him a favor by executing the same trade would raise a clear red flag.⁷⁵ The Panel wholeheartedly agrees.

There were more red flags. Golden testified that he would not normally have purchased the Connectors, and did so only to accommodate Schlesinger, who had been a friend for 20 years.⁷⁶ But in March and April, Schlesinger did not own the Connectors; rather, on both occasions the Connectors were owned by Yankee. Thus, if Golden is to be believed, he actually did the trade at Schlesinger’s behest to help out Kresge, a trader whom Golden did not know, and to whom he had never spoken, even in connection with his March and April purchases of the Connectors.⁷⁷ Moreover, Golden’s testimony that he imposed conditions on the trades that he did not normally express strongly suggests that he recognized the suspicious circumstances surrounding these trades, yet nevertheless agreed to them.

⁷⁴ Tr. 286, 301.

⁷⁵ Tr. 450 (Meiselman), 808-09 (Molloy).

⁷⁶ Tr. 268, 285.

⁷⁷ CX 39 (Golden OTR) at 55 (first time he ever spoke to Kresge was in late 2004), 57 (not his normal practice to enter a trade order without speaking to the contra party).

When Schlesinger called Golden in April, the Connectors were back at Yankee, another red flag. Golden knew the circumstances were suspicious, because, according to Golden, he “expressed to [Schlesinger] I was unhappy with him calling on our friendship.” Golden testified, “I considered him a friend. That was the reason I was talking to him. But on the other hand, I had my value system and what I thought was over the line a little bit. On the second trade, I told him I thought he was, you know, getting to the line”⁷⁸

Nevertheless, Golden agreed to purchase the Connectors from Yankee once again, with the expectation and hope, he says, that Schlesinger, who appeared to have no financial interest in the trade, would again find him a buyer. But although he again cites “friendship” as the reason he agreed to the trade, Golden had a more substantial motive for agreeing to the April trade. When he agreed to it, Schlesinger helped him establish a relationship with Olla that Golden thought would give him valuable access to new bond issues. Schlesinger’s willingness to “give up” Olla in order to persuade Golden to do a trade with Yankee was yet another red flag suggesting that Schlesinger was the true, undisclosed owner of the bonds.⁷⁹

When Schlesinger called again in June, he owned the bonds and wanted Golden to buy them. Golden clearly recognized the red flags, because, he testified, he told Schlesinger that he did not have authority to make the purchase, even though that was not true. He testified that when, at Schlesinger’s request, he asked Meiselman if he could do

⁷⁸ Tr. 309-10.

⁷⁹ Similarly, Molloy, the trader who refused to do a Connectors trade, testified that when Schlesinger asked him to purchase the Connectors, he promised Molloy that if he did, “he would divulge a DVP account.” Molloy understood this to mean that Schlesinger “was going to give up one of his accounts that he had to me, and then it would be an account I could call and eventually do business with.” Molloy, however, refused to do the trade because he “didn’t think the bonds were worth anywhere near where he wanted me to trade them.” Tr. 777-79.

the trade, he wanted Meiselman to say no. But he also admits that he failed to tell Meiselman that he had done the same trade for Schlesinger in March and April. Meiselman testified, credibly, that “if there were prior trades on the same bonds and you’re going back and forth on the same bonds, and now a guy is asking you to do a favor on the bonds again, that would raise a lot of flags to me. I wouldn’t have allowed the trade.”⁸⁰

In short, even taking Golden’s testimony at face value, it is clear that he “encountered red flags, or suspicious circumstances creating reasons for doubt that should have alerted him to the improper conduct of” Schlesinger, but closed his eyes to these obvious signs that Schlesinger was engaged in manipulation and parking. Accordingly, the Panel found that Golden’s conduct satisfied the requirements for aiding and abetting. As with Kresge, the Panel also found that by aiding and abetting Schlesinger’s scheme, and by causing trades executed in connection with the scheme to be reported, Golden violated Rules G-17 and G-14.⁸¹

IV. Sanctions

It is well established that “conduct that violates the antifraud provisions of the federal securities laws is especially serious and subject to the severest of sanctions under the securities laws.”⁸² There are no specific Sanction Guidelines for participating in, or aiding and abetting, manipulation and parking, but the Panel considered the Guidelines for misrepresentations or material omissions of fact relevant in determining the appropriate sanctions here. Those Guidelines recommend, for intentional or reckless

⁸⁰ Tr. 315, 327, 450.

⁸¹ Apart from the April 2004 trades, Golden’s Connectors trades were reported to MSRB and the market. CX 72.

⁸² Marshall E. Melton, Exchange Act Rel. No. 48228, 2003 SEC LEXIS 1767, at *29-30 (July 25, 2003).

misconduct, a \$10,000 to \$100,000 fine and a suspension of up to two years, or in egregious cases a bar. The Panel also consulted the principal considerations in determining sanctions set forth in the Guidelines, which are applicable to all violations.⁸³

A. Kresge

By any measure, Kresge had a substantial involvement in Schlesinger's scheme. In terms of the principal considerations in the Guidelines, there are a number of aggravating circumstances. Kresge engaged in numerous violative trades over a period of several years, his actions were reckless, and he gained financially from the trading. In addition, Kresge has a disciplinary history.⁸⁴

Some potential aggravating factors, however, are not present here. Kresge was reckless in failing to recognize that he was involved in a manipulative scheme, but he never denied or attempted to conceal his actions. And he did not originate the scheme or conspire with Schlesinger to carry it out; rather, he turned a blind eye to red flags that should have alerted him that Schlesinger was engaged in manipulation and parking.

Both the seriousness of Kresge's misconduct and his reckless failure to recognize the suspicious circumstances surrounding Schlesinger's directed trading lead the Panel to conclude that Kresge must be barred as a principal in order to protect investors and the integrity of the market. The Panel found, however, that a lengthy suspension in other capacities, coupled with a substantial fine and a re-qualification requirement, will

⁸³ FINRA Sanction Guidelines at 6-7, 93 (2007), available at <http://www.finra.org>. In determining the appropriate sanctions in this case, as in considering liability, the Panel carefully evaluated the relevant considerations as they applied to each Respondent individually. Although both Respondents' misconduct involved Schlesinger's manipulation and parking scheme, Respondents' actions and their roles in the scheme differed significantly, and the Panel therefore conducted a distinct sanctions analysis for each Respondent.

⁸⁴ CX 62. Kresge's prior final disciplinary matters are from the early 1990's and do not involve manipulation or parking, or misconduct of a similar nature or degree. Kresge also has a disciplinary matter pending before the National Adjudicatory Council, but, as the Department stipulated, the Panel did not consider that pending matter in determining the appropriate sanctions in this case.

accomplish FINRA's remedial goals. Accordingly, Kresge will be barred in all principal capacities, suspended for two years in all other capacities, fined \$50,000 (due when and if he seeks to return to the securities industry), and ordered to re-qualify.

B. Golden

Golden was not involved in nearly as many Connectors trades as Kresge. He did not take part directly in the first nine trade pairs at Golden Harris, although he must have known of and approved them. He did one trade pair at Golden Harris in June 2002, but his first Connectors trade at Hanauer was not until January 2004, and that trade involved only a portion of the Connectors. His last three Connector trade pairs took place within a relatively short period and involved a close business friend of many years. Finally, while Golden aided and abetted Schlesinger's manipulation and parking scheme, he did not originate it or conspire with Schlesinger to carry it out.

Nevertheless, the Panel found that a number of aggravating factors supported the imposition of substantial sanctions. Golden was a knowledgeable and experienced municipal securities professional who must have recognized the many suspicious circumstances and red flags surrounding the Connectors trades. While he did not reap substantial financial gains from the Connectors trades themselves, the Panel notes that the early trades at Golden Harris involved the account of Bedford Capital, which, Golden testified, brought millions of dollars in new bond issues to Golden Harris. And when Schlesinger persuaded him to purchase the Connectors in April 2004, he also put Golden in touch with Olla, which Golden believed might be another highly valuable source of new bond issues.

Most troubling, however, was Golden's persistent refusal to acknowledge his misconduct, as well as his lack of candor in defending his actions. It was apparent that

Golden's testimony was carefully contrived to try to excuse his actions, and, as set forth above, in many respects it was not credible. Of particular concern to the Panel was Golden's obdurate refusal to accept responsibility, as the supervisor of the Golden Harris trading desk, for Fleno's Connectors trading, of which Golden must have been aware. Also of great concern is Golden's failure to take responsibility for misleading his own supervisor, Meiselman, with regard to the final Connectors trade pair at Hanauer.

Under these circumstances, the Panel concluded that to protect the investing public and the integrity of the markets, a bar in all principal capacities is an appropriate remedial sanction. In addition, the Panel concluded that a six-month suspension in all other capacities and a \$10,000 fine are required to prevent and deter such misconduct in the future by Golden, and to deter others from engaging in similar misconduct.⁸⁵

V. Conclusion

Respondent Stephen Ira Golden aided and abetted the fraudulent manipulation of municipal securities, in violation of MSRB Rules G-17 and G-14. For this violation, he is barred from associating with any member firm in any supervisory capacity, suspended from associating with any member firm in any capacity for six months, and fined \$10,000. If this Decision becomes FINRA's final action in this matter, the bar will be effective immediately, the suspension will commence on July 21, 2008, and end on January 20, 2009, and the fine will be due and payable at a date determined by FINRA.

Respondent Richard F. Kresge participated in, and aided and abetted, the fraudulent manipulation of municipal securities, in violation of Section 10(b) of the Securities Exchange Act, Exchange Act Rule 10b-5, and MSRB Rules G-17 and G-14.

⁸⁵ In arriving at these sanctions, the Panel gave full consideration to the evidence that Golden is not currently serving in a principal capacity, or as a bond trader, at Hanauer and that Hanauer has subjected him to special supervision while this proceeding is pending. Tr. 1034; RX-SG 13.

For this violation, he is barred from associating with any member firm in any supervisory capacity, suspended from associating with any member firm in any capacity for two years, fined \$50,000 and ordered to re-qualify. If this Decision becomes FINRA's final action in this matter, the bar will be effective immediately, the suspension will commence on July 21, 2008, and end on July 20, 2010, the fine will be due and payable at such time as he seeks to return to the securities industry, and he must re-qualify before acting in any capacity requiring qualification.

In addition, Respondents, jointly and severally, shall pay costs in the amount of \$9,207.91, which represents the cost of the hearing transcripts together with a \$750 fee.⁸⁶

**EXTENDED HEARING
PANEL**

By: David M. FitzGerald
Hearing Officer

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⁸⁶ The Extended Hearing Panel has considered and rejects without discussion all other arguments of the parties.