FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. RON WILLIAM HOWELL (CRD No. 2895047), Respondent.	Disciplinary Proceeding No. 20080138685 Hearing Officer – LBB **HEARING PANEL DECISION** November 22, 2011

For unregistered sales of securities, in violation of NASD Conduct Rule 2110, Respondent Ron William Howell is suspended in all capacities for three months and fined $7,500. For failure to supervise a registered representative, failure to maintain adequate written supervisory procedures with respect to one of his firm's types of business, and failure to implement adequate supervisory controls over his own account activities as a producing manager, in violation of NASD Conduct Rules 3010, 3012, and 2110, Howell is fined an additional $5,000 and suspended in all principal capacities for three months, to run consecutively with the suspension in all capacities. Howell is also ordered to pay costs.

Appearances

Scott M. Andersen, Esq., Director, Enforcement Center, Joseph Darcy, Esq., Principal Counsel, and Robert Moreiro, Esq., Senior Counsel, New York, New York, for the Department of Enforcement.

Ron William Howell, *pro se*.

DECISION

The Department of Enforcement ("Enforcement") filed the Complaint in this disciplinary proceeding on February 25, 2011, asserting three causes of action against Respondent Ron William Howell ("Howell") and one cause of action against Respondent Dan Evan Landau ("Landau"). The First Cause of Action charges both Respondents with the sale of unregistered

securities, in violation of Section 5 of the Securities Act of 1933 ("Securities Act") and NASD Conduct Rule 2110. The Second Cause of Action charges Howell with failure to supervise Landau with respect to Landau's sale of unregistered securities, and failure to implement adequate written supervisory procedures concerning the sale of stock distributed pursuant to a Securities and Exchange Commission ("SEC") Form S-8 registration, in violation of NASD Conduct Rules 3010 and 2110. The Third Cause of Action charges Howell with violating NASD Conduct Rules 3012 and 2110 by failing to establish procedures to supervise his own activities as a producing branch manager.[1] Respondents answered the Complaint, denying that their conduct violated the Securities Act and FINRA's Rules.

A hearing was held in Los Angeles, California, from September 21-22, 2011, before a Hearing Panel composed of two current members of the District 2 Committee and a Hearing Officer. Landau failed to appear at three pre-hearing conferences and at the hearing, and the Hearing Officer held that Landau was in default.[2]

Introduction and Summary

This proceeding involves the resale of securities that were distributed to employees and consultants of three companies – Nexia Holdings, Inc. ("Nexia"), U.S. Microbics, Inc. ("Microbics"), and its majority-owned subsidiary, Subsurface Waste Management of Delaware, Inc. ("Subsurface"). During the period from March 1, 2007, until February 4, 2008, the employees and consultants received options to purchase the securities and quickly exercised their

[1] As of July 30, 2007, NASD consolidated with the member regulation and enforcement functions of NYSE Regulation and began operating under a new corporate name, the Financial Industry Regulatory Authority (FINRA). References in this decision to FINRA include, where appropriate, NASD. Following consolidation, FINRA began developing a new FINRA Consolidated Rulebook. The first phase of the new consolidated rules became effective on December 15, 2008, including certain conduct rules and procedural rules. *See* Regulatory Notice 08-57 (Oct. 2008). This decision refers to and relies on the NASD Conduct Rules that were in effect at the time of Respondent's alleged violations. The applicable rules are available at www.finra.org/rules.

[2] Pursuant to FINRA Procedural Rule 9269, the Hearing Officer is simultaneously issuing a separate default decision with respect to the charge against Landau.

options. Howell and Landau, as the registered representatives for the recipients' accounts, immediately sold the securities in the public market. Howell quickly journaled the substantial majority of the proceeds of each sale to the issuers' accounts at Private Equity Securities ("PES" or "Firm"), the Respondents' firm.

Each of the three issuers filed a Form S-8 with the SEC in connection with the distribution of the shares to the employees and consultants. Form S-8 may be used to register securities distributions "in a compensatory or incentive context," in connection with employee benefit plans.[3] "A Form S-8 provides a streamlined method of registering stock issued to compensate employees and consultants, as opposed to the more detailed and prolonged process required to register shares used to raise capital."[4] A Form S-8 registration is not available as a means of raising capital, where the employees and consultants act as conduits to distribute their shares to the public market, and funnel all or part of the proceeds of the sales back to the issuer.[5]

The sales of the S-8 securities that are at issue in this proceeding were transparently capital-raising transactions, causing the S-8 registrations to be ineffective. By acting as the registered representative for the sale of the Nexia stock by 21 customers, Howell violated Section 5 of the Securities Act and NASD Conduct Rule 2110.

Howell failed to supervise Landau in his sales of the shares of Microbics and Subsurface, in violation of NASD Conduct Rules 3010 and 2110. Howell failed to establish and maintain adequate written supervisory procedures ("WSPs") with respect to S-8 transactions, in violation of Rules 3010 and 2110. Howell did not designate anyone to supervise his own account activity

[3] *See* "Registration of Securities on Form S-8," Exchange Act Rel. No. 41109, 64 Fed. Reg. 11103 (Mar. 8, 1999); General Instructions to Form S-8, available on SEC website; 17 C.F.R. § 239.16b; *see also*, e.g., *Proposed Rule: Use of Form S-8 and Form 8-K by Shell Companies*, Exchange Act Rel. No. 49566, 2004 SEC LEXIS 827, at *8 (Apr. 15, 2004).

[4] *SEC v. Phan*, 500 F.3d 895, 899 (9th Cir. 2007) (cited herein as "*Phan.*").

[5] *See*, e.g., *Newbridge Sec. Corp.*, Init. Dec. Rel. No. 380, 2009 SEC LEXIS 2058, at *8 (June 9, 2009); "Registration of Securities on Form S-8," Exchange Act Rel. No. 41109, 64 Fed. Reg. at 11104.

on behalf of his firm's clients, and thereby failed to establish proper supervisory procedures with respect to his trading, in violation of NASD Conduct Rules 3012 and 2110.

Findings of Fact

I. Respondent

Howell was first registered with a FINRA member firm in 1997. He changed firms a number of times, and remained registered with FINRA member firms until July 2010. He was registered with FINRA member firm Finance 500, Inc., from October 2002 through July 2004. He purchased PES, a non-operating FINRA member firm, in August 2006, filed a continuing membership application, and began the Firm's operations soon thereafter. He was registered with PES, in Irvine, California, where he was the president, chief executive officer, and chief compliance officer, from August 2006 until July 2010.[6] He is not currently registered with a FINRA member firm. CX-4, 15, 16; Tr. 29-31.

Although Howell was not registered with a FINRA member firm at the time the Complaint was filed, he is subject to FINRA's jurisdiction for purposes of this proceeding, pursuant to Article V, Section 4(a)(i) of FINRA's By-Laws, because the Complaint was filed within two years after termination of his last registration, and charges him with violations that occurred while he was registered with a member firm.

II. Howell's Sales of Nexia S-8 Securities

Nexia issued options for the purchase of Nexia stock to 21 employees and consultants pursuant to an S-8 Registration Statement. All 21 recipients established accounts with PES, exercised their options almost immediately upon receipt, quickly sold their shares, and transferred about 75% of the proceeds back to Nexia, the issuer.

[6] Howell filed a Form BDW for PES in July 2010. Tr. 29.

At the time of the transactions that are the subject of the Complaint, Nexia was a holding company located in Utah. The company engaged in a variety of businesses, including real estate, office management, and beauty salons. Tr. 40, 119, 149; CX-66.[7] Nexia was a thinly-traded microcap company that was traded on OTC Bulletin Board. The company had low revenues, was short of cash, and was losing money before, during, and after the "relevant period," March 2007 until February 2008. Nexia shares declined steadily in price before, during, and after the relevant period. As of March 31, 2007, Nexia had an accumulated deficit of $16 million. It incurred an operating loss of $1.4 million for the quarter ending March 31, 2007. Its SEC filings included a qualification that expressed "substantial doubt about the Company's ability to continue as a going concern." CX-65 at 46, CX-66 at 51, CX-67 at 30, CX-68 at 23, CX-74; Tr. 149, 151-152, 167. Immediately prior to the S-8 distributions that are the subject of the First Cause of Action, there were about 1.8 billion shares of Nexia outstanding. CX-67 at 2.

Nexia filed a Form S-8 Registration Statement on or about March 5, 2007, for its 2007 employee benefit plan. CX-71. Twenty-one Nexia employees and consultants received options to purchase Nexia stock pursuant to the S-8 registration. The Nexia options expired a year from the date of issue, and vested upon exercise. The exercise price was set at 75% of the market price at time of exercise, to be paid to Nexia within 10 days of the date of exercise. CX-71, CX-2A-2U, CX-5.[8]

Before opening accounts for S-8 transactions, Howell routinely checked EDGAR for filings by the issuers, including Nexia, Subsurface and Microbics. He would look at the S-8

[7] There is no record information on Nexia's current operations.

[8] The only Nexia registration other than the Form S-8 filing was a single Form SB-2 for an offering unrelated to this proceeding. Tr. 149-150.

filings, the number of shares, and the conditions on which the shares were to be offered to employees. Tr. 59.

In January 2007, Howell opened accounts for the 21 Nexia employees and consultants who received the options. The accounts were all opened during one week, which was as fast as Howell could open them. Howell signed all the account opening statements both as the registered representative and the principal on the accounts. CX-2A-2U, 5; Tr. 78-79. Most of the customers were located in Utah. Howell sent account opening documents to customers by mail and fax, and communicated with some by telephone. Tr. 65, 83, 90, 114; CX-5. Howell also opened an account for Nexia at PES. Tr. 105. The Firm never received any revenue from Nexia. Tr. 124.[9]

The account opening documents for the employees and consultants provided that Nexia automatically received copies of statements and confirmations for the accounts of the Nexia employees and consultants. Howell testified that statements and confirmations were sent to Nexia so it could administer the employee benefit plan. CX-5. Howell had very little information about the services the consultants performed for Nexia. JF's application stated that the customer was retired. Howell testified that JF had been a Nexia consultant, but that he otherwise knew nothing about JF other than the information on the application. JF was a customer solely for the Nexia transactions. CX-5; Tr. 86-89. Howell testified that customer RS was a professor at a junior college and did consulting work for Nexia "in something related to education." Tr. 37-38. Howell did not recall what customer RL did for Nexia, but testified that either Nexia or RL had told him that RL performed services for the company. Tr. 92-93.

[9] Respondent testified that the Nexia account "held" the shares of Nexia stock, presumably indicating that PES maintained an account for Nexia, as an introducing broker, for the stock that was held by PES's clearing firm. Tr. 107. Nexia stock was held at Legent Clearing, PES's clearing firm, located in Nebraska. Tr. 131, 238; CX-5.

Overall, Howell relied on Nexia's representations that the consultants performed services for Nexia. Tr. 86-88.

All but one of the customers received their options in March and April 2007.[10] Almost all exercised their options and received their shares in March and April 2007. A few of the options were exercised in May and June 2007. All the recipients of Nexia S-8 stock sold their shares almost immediately upon receipt, except for some who sold before receipt. The longest holding period was about two months. CX-1, 1A, 1B, 2A-2U; Tr. 125-126. All the notices of exercise included a handwritten instruction to sweep the funds to Nexia's account at PES. CX-5. All the shares were sold on the OTC Bulletin Board. Tr. 132; CX-2A-2U. Howell executed all sales of Nexia's S-8 stock. Tr. 80, 115, 162. The S-8 share recipients all paid for their Nexia shares with the proceeds from the sale of Nexia stock. Howell journaled the funds from the recipients' accounts to the Nexia account. Tr. 85, 97-105, 108; CX-2A-2U, CX-3, CX-4, CX-31. PES charged a 5% commission on the S-8 sales. Tr. 111; CX-1A, CX-89 at 187.

All told, Howell sold about 552 million S-8 shares of Nexia for the 21 recipients for $271,981. All sales were cleared by Legent Clearing LLC, located in Nebraska. The average share price was about $.0005. Nexia received $218,238 from the sales proceeds. PES received commissions of $15,818. CX-1A, 1B, CX-5.

III. Landau's Sales of Microbics and Subsurface S-8 Stock

Howell is charged with failing to supervise Landau's sales of Microbics and Subsurface S-8 stock by four Microbics employees. Microbics was a microcap company that was traded on the OTC Bulletin Board. The company was engaged in environmental remediation. It was thinly traded, losing money, and short of funds before, during, and after the relevant period. The

[10] One received his options in September 2006, prior to the S-8 registration, but did not exercise his options until March 7, 2007, about two days after Nexia filed its Form S-8 registration. CX-2A.

price of its shares steadily declined before, during, and after the relevant period. All of its securities registrations were for S-8 transactions. As of March 31, 2007, Microbics had an accumulated deficit of $33 million. For the six months ending March 31, 2007, the company had a net loss of $1.7 million. The company's March 31, 2007, Form 10-Q noted that as of September 30, 2006, Microbics was "having difficulties generating cash flows to meet its obligations and that the Company is dependent upon management's ability to develop profitable operations. These factors among others may raise substantial doubt about the Company's ability to continue as a going concern." CX-81, 83; Tr. 149-150, 156, 167.

Microbics and its subsidiaries owned approximately 79% of Subsurface, a company also in precarious financial condition. Subsurface was also traded on the OTC Bulletin Board, thinly traded, losing money, and short of funds. As of March 31, 2007, it had an accumulated deficit of $15.4 million. It incurred a net loss of $1.2 million for the previous six months, with a substantial negative cash flow. Subsurface's March 31, 2007, Form 10-QSB noted that the company's auditor had expressed doubt about the company's ability to continue as a going concern, as of September 30, 2006. CX-76, 79; Tr. 149-150, 155-156, 167.

Microbics filed a Form S-8 with the SEC, dated April 27, 2007. The Form S-8 set the exercise price for options granted pursuant to the filing at 85% of fair market value on the date of the grant. The Form S-8 provided that payment would be due after exercise, and could be made from the proceeds of the sale of the shares received.[11] There was no vesting period. CX-82; Tr. 165. Subsurface filed a Form S-8 with the SEC dated February 27, 2007, and another dated

[11] The benefit plan provided that payment could be made "through a 'same day sale' commitment from the Participant and a broker-dealer that is a member of the National Association of Securities Dealers (an 'NASD DEALER') whereby the participant irrevocably elects to exercise the Option and to sell a portion of the Shares so purchased to pay for the Exercise Price, and whereby the NASD Dealer irrevocably commits upon receipt of such shares to forward the Exercise Price directly to the Company…." CX-82 at 9.

March 7, 2006. The terms were essentially the same as the terms of the Microbics Form S-8 registration.[12] CX-75, 78; Tr. 164.[13]

The same four Microbics employees were granted options for both Microbics and Subsurface pursuant to their Form S-8 registrations. Landau opened accounts for the recipients of Microbics and Subsurface S-8 options in August 2006. The applications identified Landau as the registered representative, and Howell as the principal. CX-1A, 1B, 12; Tr. 94-95, 191-192.[14]

Landau's customers exercised their Microbics options from May to December 2007.[15] The notices of exercise all had handwritten notes directing that the proceeds of the sales be swept to an account that belonged to Microbics. CX-8A-8D. All Microbics stock was sold prior to receipt, and the funds were journaled to Microbics within a few days after the sale. The proceeds of the sale were $128,787, with about 90% going to Microbics. The commission on the sale was $6,899. All told, 30,000,000 shares were sold. CX-1A, 1B, 8A-8D. Landau was the broker for all Microbics sales. CX-1A, 12, 45; Tr. 112, 192. The shares were sold in the over-the-counter market. All were cleared through Legent. CX-14.

The four recipients of Subsurface options exercised their options from March 2007 to February 2008. All four exercise notices had handwritten notes, directing that the funds be swept to a Subsurface account at PES. CX-1A, 7-7D, 31. The shares were received during that same period, and almost all were sold before receipt. CX-1A, 1B. The proceeds of the sales were $718,819, of which $644,902, or about 90%, was journaled to a Subsurface account at PES.

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[12] The same language concerning the method of payment was used in the S-8 forms for Subsurface. CX-75 at 15, CX-78 at 20.

[13] There were no registrations other than Form S-8 registrations for Nexia and Subsurface. Tr. 149.

[14] The capacity in which the Microbics employees received their options for Subsurface stock is unclear. There is no evidence concerning whether the four recipients were also employed by Subsurface, or performed consulting work for Subsurface.

[15] There is no evidence in the record of the grant dates for the Subsurface and Microbics options.

The commissions on the sales were $39,333. More than 100 million shares of Subsurface were sold. CX-1A, 1B, 7A-7D, 31. Landau was the broker for all Subsurface sales. CX-1A, 12, 45; Tr. 45-46, 112, 192. The shares were sold in the over-the-counter market. All were cleared through Legent. CX-7A-7D, CX-13.

IV. Howell's Supervision of Landau's S-8 Business

Howell supervised Landau at PES. Landau was under heightened supervision. Howell reviewed all of Landau's customer accounts, correspondence, and e-mails. Tr. 39, 45. Howell supervised Landau's sale of the Microbics, Subsurface, and other S-8 shares. For S-8 transactions, Howell testified that he reviewed orders, monitored Landau's e-mails and written communications, reviewed and approved option exercise forms, and sent the forms to Legent. He also reviewed the flow of funds. He communicated with the S-8 recipients by telephone or e-mail to confirm that they wanted to sell their S-8 shares. Tr. 45-46, 69, 237-240. Howell testified that because the office was so small, he was aware of everything Landau did. Tr. 241-242.

By July 2007, Howell knew that the SEC had concerns about Landau's S-8 transactions at Finance 500, when Landau received a Wells notice from the SEC concerning Landau's sales of S-8 shares. Tr. 42, 48-50; CX-92. Rather than regarding the Wells notice as a red flag, Howell testified that he believed that it might go away without action by the SEC. Tr. 47-49. Landau sold some shares of Microbics after receiving the Wells notice. Tr. 53.

V. The Firm's Written Supervisory Procedures for S-8 Transactions

As the Firm's chief compliance officer, Howell was responsible for its WSPs. Tr. 74, 75; CX-84 at 19, 29. The Firm's WSPs did not include any specific procedures for sales of S-8 stock. Tr. 60-61, 176; CX-84. Howell testified that there was no need to address the sale of S-8 stock in the WSPs because "it would be like writing a note to myself." He believed that he knew

the appropriate steps for supervision of the sale of S-8 stock, primarily to examine relevant documents to determine if the issue was registered. Tr. 61. Howell also noted that the sale of S-8 stock was not a large part of PES's business, comprising about 2.5% of the total number of accounts at PES. Tr. 241.

VI. Howell's Customer Account Activity Was Not Supervised

As noted above, Howell was the registered representative for the Nexia accounts. Howell had no supervisor at PES. Tr. 215; CX-27, 28. During the relevant period, there were two other representatives with principal licenses – Landau, and Jeffrey York ("York"). Tr. 30, 32. The Firm's Membership Agreement required the Firm to have two principals. Tr. 77. Nonetheless, Howell believed that it was proper to supervise himself because he believed there was nobody at the Firm who was qualified to supervise him. He regarded York as unqualified because York was Landau's nephew and lacked broad industry experience. Landau was on heightened supervision and could not be a supervisor. CX-28, CX-88 at 56; Tr. 73.

PES filed a Firm Notification to Rely on the Limited Size and Resources Exception in NASD Rule 3012 in March 2007. CX-90. The Firm's WSPs provided for the supervision of a producing manager's customer account activity. The WSPs noted that the Firm was of limited size and resources and did not have procedures for independent review of producing managers. CX-84. Paraphrasing Rule 3012, the procedures stated, "A qualified person conducts reviews and is knowledgeable about PES's policies and control procedures." Howell testified that he intended "qualified person" to refer to the fact that he supervised himself. CX-84 at 30; CX-88 at 30; Tr. 76.

CONCLUSIONS OF LAW

I. First Cause of Action: Howell Violated Section 5 of the Securities Act, and Therefore NASD Conduct Rule 2110, by Unregistered Securities Sales

The Hearing Panel finds that Howell made unregistered securities sales, in violation of Section 5 of the Securities Act, thereby violating NASD Conduct Rule 2110.

A. Elements of a Violation of Section 5 of the Securities Act

Section 5 of the Securities Act provides that, unless a registration statement is in effect or an exemption applies, it is unlawful to sell a security through the use of any means or instrumentality of transportation or communication in interstate commerce or of the mails.[16] The purpose of the registration requirements is to "protect investors by promoting full disclosure of information thought necessary to informed investment decisions."[17] A violation of Section 5 of the Securities Act constitutes a violation of NASD Conduct Rule 2110.[18]

To establish a prima facie case of a violation of Section 5, Enforcement must show that: (1) no registration statement was in effect as to the securities; (2) respondent sold the securities; and (3) interstate transportation or communications were used in connection with the sale.[19] The prohibitions of Section 5 extend to those who engage in significant steps in the distribution

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[16] 15 U.S.C. § 77e(a) and (c); *see also Rodney R. Schoemann*, Exchange Act Rel. No. 9076, 2009 SEC LEXIS 3939, at * 20-21 (Oct. 23, 2009); *Jacob Wonsover*, Exchange Act Rel. No. 41123, 1999 SEC LEXIS 430, at *15-16 (Mar. 1, 1999), *aff'd*, 205 F.3d 408 (D.C. Cir. 2000).

[17] *SEC v. Ralston Purina Co*., 346 U.S. 119, 124 (1953).

[18] *Alvin W. Gebhart*, Exchange Act Rel. No. 53136, 2006 SEC LEXIS 93, at *54 (Jan. 18, 2006), *rev'd and remanded in part on other grounds*, 2007 U.S. App. LEXIS 27183 (9th Cir. Nov. 21, 2007) ("Further, because we have consistently held that a violation of a Commission or NASD rule or regulation is inconsistent with just and equitable principles of trade, we find that the Gebharts' sale of the unregistered MHP notes also constitutes a violation of NASD Conduct Rule 2110."); *Stephen J. Gluckman*, Exchange Act Rel. No. 41628, 1999 SEC LEXIS 1395 (July 20, 1999); *see William H. Gerhauser*, Exchange Act Rel. No. 40639, 1998 SEC LEXIS 2402 (Nov. 4, 1998).

[19] *Rodney R. Schoemann*, 2009 SEC LEXIS 3939, at *20-21; *Alvin W. Gebhart*, 2006 SEC LEXIS 93, at *53.

process. Anyone who is a "necessary participant" or a "substantial factor" in the unlawful transaction, including a registered representative, violates Section 5 of the Securities Act.[20]

B. Resales of Securities Distributed Pursuant to Form S-8 Registration

In 1953, the SEC adopted Form S-8 as a simplified form for the registration of securities offered to employees pursuant to employee stock purchase plans. The abbreviated Form S-8 registration was subsequently made available for distributions to consultants.[21] The abbreviated disclosure format was permitted because the offerings are made to a registrant's employees primarily for compensatory and incentive purposes, rather than to the public to raise capital to finance a registrant's business.[22]

Issuers cannot use employees and consultants who receive S-8 stock as conduits to the public market.[23] Even if the initial grant of securities was genuinely intended as compensation, a Form S-8 registration becomes ineffective when the funds from the resale are transferred to the issuer.[24] The SEC has placed two limitations on the use of the Form S-8. Form S-8 registration cannot be used to register offers or sales of securities to employees or consultants where, (1) "[b]y prearrangement or otherwise, the issuer or promoter controls or directs the resale of the securities in the public markets;" or (2) "[t]he issuer or its affiliates directly or indirectly receive a percentage of the proceeds from such resales."[25]

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[20] *See SEC v. Calvo*, 378 F.3d 1211, at 1215 (11th Cir. 2004); *SEC v. Murphy*, 626 F.2d 633, 649-52 (9th Cir. 1980); *SEC v. Universal Express, Inc.*, 475 F. Supp. 2d 412, 422 (S.D.N.Y. 2007), *aff'd sub nom. SEC v. Altomare*, 300 Fed. Appx. 70 (2d Cir. 2008) (*per curiam*) (unpublished), *cert. denied*, 129 S. Ct. 2745 (2009); *Owen V. Kane*, Exchange Act Rel. No. 23827, 1986 SEC LEXIS 326, at *11 (Nov. 20, 1986).

[21] *Newbridge Sec. Corp.*, 2009 SEC LEXIS 2058, at *8-9.

[22] *Newbridge Sec. Corp.*, 2009 SEC LEXIS 2058, at *8.

[23] *Phan,* 500 F.3d at 903.

[24] *Phan*, 500 F.3d at 902-06; *Newbridge Sec. Corp.*, 2009 SEC LEXIS 2058, at *8.

[25] Registration of Securities on Form S-8, 64 Fed. Reg. 11103, 11106 (March 8, 1999); *Phan*, 500 F.3d at 904 ("[W]e hold that an S-8 form cannot be used to register a securities transaction in which the issuer or promoter controls or directs a resale or directly or indirectly receives a percentage of the proceeds.").

C. Howell Violated Section 5 of the Securities Act and NASD Conduct Rule 2110 by Acting as the Broker for Unregistered Sales of Nexia Stock

Howell's sales of Nexia securities violated Section 5 of the Securities Act, and NASD Conduct Rule 2110. The recipients of the Nexia options were conduits to the public market, raising capital for a company that needed funds to continue as a going concern. As a result, the Form S-8 registration was ineffective, and the resales into the public market were unregistered.

The Nexia transactions violate both of the SEC's specific limitations on the use of Form S-8. First, the resale was prearranged. Every one of the 21 recipients handled the options in the same way, immediately exercising their options, selling the stock, and journaling most of the proceeds to Nexia. The accounts were set up so that Nexia could monitor the recipients' activity by receiving copies of account statements and trade confirmations for the recipients. The evidence supports a strong inference that the resales were prearranged, and there is no contrary evidence. Second, the transactions also failed the second test because most of the sales proceeds were journaled to Nexia.

Comment [LBB1]: There used to be a Section 2. In the absence of one, I don't need a Section 1.

The transactions were clearly for the purpose of raising capital. At the time of the S-8 transactions, Nexia's ability to continue as a going concern was in doubt, and it needed an infusion of capital. The transactions were structured in a way that made it almost certain that the recipients would quickly exercise their options, sell the stock immediately, and transfer most of the funds back to Nexia. By setting the exercise price based on the market price at the time of exercise, Nexia reduced the incentive to hold the options because the recipients would receive less than 25% of any increase in the price of the stock. The employees could realize an immediate profit by selling the stock upon exercise of their options because the exercise price

was set at 75% of the current market price, and there was no holding period.[26] Furthermore, all 21 consultants and employees acted as conduits to the issuer, immediately transferring the bulk of the sales proceeds to Nexia.

Finally, Nexia's stock was sold using instrumentalities of transportation or communication in interstate commerce or of the mails. Howell was located in Irvine, California, and Nexia was located in Utah. The customers were located in Utah and other states. The new account applications were sent by fax, mail, and e-mail. The transactions were cleared through Legent in Omaha, and the stock was sold on the OTC Bulletin Board.

II. Second Cause of Action: Howell Failed to Supervise Landau's S-8 Sales; Howell Failed to Implement Adequate Written Supervisory Procedures for the Supervision of the Firm's S-8 Business

A. Howell's Inadequate Supervision of Landau

Conduct Rule 3010(a) requires that FINRA members "establish and maintain a system to supervise the activities of each registered representative, registered principal, and other associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with the Rules of [FINRA]."[27] "Assuring proper supervision is a critical component of broker-dealer operations."[28] Under NASD Rule 3010, a supervisor is responsible for "reasonable supervision," a standard that "is determined based on the particular circumstances of each case."[29] In addition, "[t]he duty of supervision includes the responsibility

[26] Most stock options are issued at the money, and not in the money. In-the-money options are rare. J.M. Fried, "Options Backdating and its Implications," 65 Wash. & Lee L. Rev. 853, 859 (2008).

[27] NASD Conduct Rule 3010(a).

[28] *Richard F. Kresge*, Exchange Act Rel. No. 55988, 2007 SEC LEXIS 1407, at *27 (June 29, 2007).

[29] *Dep't of Enforcement v. Midas Securities, LLC*, No. 2005000075703, 2011 FINRA LEXIS 71, at *22 (N.A.C. Mar. 3, 2011), citing *Christopher J. Benz, 52 S.E.C. 1280, 1284 (1997), petition for review denied, 168 F.3d 478* (3d Cir. 1998) (table).

to investigate 'red flags' that suggest that misconduct may be occurring and to act upon the results of such investigation."[30]

The Microbics and Subsurface transactions were very similar to the Nexia transactions, and violated Section 5 of the Securities Act for the same reasons. Both restrictions on the use of Form S-8 were violated: the resales were clearly prearranged, and the proceeds were journaled to the issuers. The transactions were also clearly for the purpose of raising capital. The companies were in weak financial condition and needed cash. The options were exercised immediately after they were granted, and most of the funds were immediately journaled back to the issuers. In fact, the Form S-8 provided that payment would be due after exercise, and that amount due to the issuer for the exercise of the options could be paid from the proceeds of the resale of the shares received into the public market. All of these facts were known to Howell, and should have been red flags, alerting him to the likely illegality of Landau's sales of the two stocks.

In addition, Howell became aware that the SEC was investigating Landau with respect to very similar transactions at Finance 500. The SEC's Wells notice should have caused Howell to engage in a searching investigation of the Subsurface and Microbics transactions, yet Howell failed to do so. Instead, he permitted Landau to continue to sell Microbics stock after he had received the Wells notice. Howell took no additional action when he learned that Landau had received the Wells notice, essentially disregarding it because, he explained, the investigation might go away.

By failing to supervise Landau with respect to S-8 transactions, Howell violated NASD Conduct Rules 3110 and 2110.

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[30] *Ronald Pellegrino*, Exchange Act Rel. No. 59125, 2008 SEC LEXIS 2843, at *33 (Dec. 19, 2008) (citation omitted); *Dep't of Enforcement v. Midas Securities, LLC*, 2011 FINRA LEXIS 71, at *22-23.

B. The Firm's Written Supervisory Procedures Were Inadequate Because Howell Included No Procedures for S-8 Transactions

Conduct Rule 3010(b) requires that a member "establish, maintain, and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of registered representatives, registered principals, and other associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable Rules of [FINRA]."[31] A firm's written supervisory procedures "document the supervisory system that the firm has established."[32]

A firm's procedures must be tailored to the specific nature of the firm's business.[33] "[G]eneral reference materials are not sufficient written supervisory procedures …."[34] There is no detailed guidance on how specific a firm's procedures must be with respect to each category of business in which it engages. The applicable standard in Rule 3010 is one of "reasonableness," which is determined based on the particular circumstances of each case.[35] Certain types of business have been specifically identified in FINRA's Rules, notices, and case law as requiring specific procedures. The NAC recently held that respondents had violated Rule 3010 by failing to have written supervisory procedures with respect to transactions in unregistered securities.[36] NASD and FINRA Rules have required specific written supervisory

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[31] NASD Conduct Rule 3010(b).

[32] NTM 99-45, 1999 NASD LEXIS 20, at *4 (June 1999).

[33] *Dep't of Enforcement v. Midas Securities, LLC*, 2011 FINRA LEXIS 71, at *20; *Dep't of Enforcement v. Respondent Firm*, No. C01040001, 2005 NASD Discip. LEXIS 47, at *24 (N.A.C. Sept. 6, 2005).

[34] *Dep't of Enforcement v. Respondent Firm*, No. C01040001, 2005 NASD Discip. LEXIS 47, at *24 (N.A.C. Sept. 6, 2005).

[35] *See, e.g., Christopher Benz*, Exchange Act Rel. No. 38440, 1997 SEC LEXIS 672, at *12 (Mar. 26, 1997) (citing *In re Consol. Inv. Servs., Inc.*, Exchange Act Rel. No. 36687, 1996 SEC LEXIS 83 (Jan. 5, 1996)).

[36] *Dep't of Enforcement v. Midas Securities, LLC*, 2011 FINRA LEXIS 71, at *20-21; *see also*, *Dist. Bus. Conduct Comm. v. Gallison*, C02960001, 1999 NASD Discip. LEXIS 8, at *35-37 (N.A.C. Feb. 5, 1999) (finding a violation of FINRA's rules for failure to have WSPs for the firm's penny stock business); *Richard F. Kresge*, Exchange Act Rel. No. 55988, 2007 SEC LEXIS 1407, at *39 (June 29, 2007) (violation of Rule 3010 for failure to amend WSPs when added a branch office that substantially increased firm's penny stock activity).

procedures for options.[37] FINRA has reminded members of the importance of supervisory procedures for Regulation D offerings and hedge funds sales.[38]

Resales of stock issued pursuant to Form S-8 have characteristics that support the need for specific supervisory procedures. The use of S-8 registration is subject to specific rules set forth in the instructions to the Form S-8, SEC notices, and case law. The SEC has recognized that resales of S-8 securities have been an area of abuse.[39] The red flags for PES's S-8 transactions also should have highlighted the need for specific procedures to ensure compliance. In addition, at least by July 2007, Howell knew that the SEC staff had made a preliminary determination that Landau had violated Section 5 of the Securities Act by making unlawful sales of S-8 stock, in transactions that were similar to the Nexia, Microbics, and Subsurface transactions, which should have caused Howell to ensure that the Firm's procedures were adequate.

By failing to establish, maintain, and enforce written supervisory procedures with respect to PES's S-8 business, Howell violated NASD Conduct Rules 3010 and 2110.

III. Third Cause of Action: Howell Failed to Establish Adequate Supervisory Control Procedures by Failing to Designate Another Principal to Supervise Howell's Activities as a Producing Manager

NASD Conduct Rule 3012(a)(1) requires each member to designate and specifically identify to FINRA one or more principals who shall establish, maintain, and enforce a system of supervisory control policies and procedures. Rule 3012(a)(2) requires a firm's written

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[37] Retired NASD Rule 2869(b)(20), and FINRA Rule 2360(b)(20).

[38] Reg. Notice 10-22, at 7; NTM 03-07 at 50.

[39] "*Registration of Securities on Form S-8,*" Exchange Act Rel. No. 41109, 64 Fed. Reg. 11103 (Mar. 8, 1999) ("Since the 1990 revisions, some issuers and promoters have misused Form S-8 as a means to distribute securities to the public without the protections of registration under Section 5 of the Securities Act."), *Proposed Rule: Use of Form S-8 and Form 8-K by Shell Companies*, Exchange Act Rel. No. 49566, 2004 SEC LEXIS 827, at *12 n.23 (Apr. 15, 2004).

supervisory control policies and procedures to include “procedures that are reasonably designed to review and supervise the customer account activity conducted by the member’s branch office managers, sales managers, regional or district sales managers, or any person performing a similar supervisory function.” In section 3012(a)(2)(A)(i), the Rule requires that a person who is “either senior to, or otherwise independent of, the producing manager must perform such supervisory reviews.”

Rule 3012(a)(2)(A)(ii) carves out a limited exception for the requirement of review of a producing manager’s account activities by a more senior or otherwise independent person. The “Limited Size and Resources” exception provides that if a member is so limited in size and resources that there is no qualified person senior to, or otherwise independent of, the producing manager to conduct the reviews, the reviews may be conducted by a principal who is sufficiently knowledgeable of the member's supervisory control procedures, provided that the reviewer meets the independence standards of the Rule to the extent practicable.

Howell did not designate another principal to supervise his own activities as a producing manager because he did not believe there was anyone at PES who was qualified to supervise him. Rule 3012 does not contain an exception for firms that lack qualified principals to supervise the producing manager. Furthermore, it is well established that self-supervision is inadequate.[40]

The Firm’s membership agreement required the firm to have two principals. NASD Membership Rule 1021(e)(1) requires each firm, except a sole proprietorship, to have “at least two officers or partners who are registered as principals with respect to each aspect of the member’s investment banking and securities business….” If York was not capable of

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[40] *Hans N. Beerbaum*, Exchange Act Rel. No. 55731, 2007 SEC LEXIS 971, at *7 n.8 (May 9, 2007); *Harry Gliksman*, Exchange Act Rel. No. 42255, 1999 SEC LEXIS 2685, at *19 (Dec. 20, 1999).

supervising the aspects of PES's business in which Howell was engaged, Howell should have found a remedy. By engaging in self-supervision, and not establishing supervisory procedures to supervise his own activities as a producing manager, Howell violated NASD Conduct Rules 3012 and 2110.[41]

IV. Sanctions

A. Sanction for the Unregistered Sale of Securities

For the unregistered securities sales in violation of NASD Conduct Rule 2110, the FINRA Sanction Guidelines ("Guidelines") recommend a fine of $2,500 to $50,000. In egregious cases, the Guidelines recommend consideration of a larger fine and a suspension in any or all capacities for up to two years, or a bar. The relevant principal considerations set forth in the Guidelines are: (1) whether the respondent attempted to comply with an exemption from registration; (2) the share volume and dollar amount of transactions involved; and (3) whether the respondent disregarded "red flags" suggesting the presence of unregistered distribution.[42]

The relevant principal considerations support the imposition of a fine and a suspension. Howell did not attempt to comply with an exemption from registration. Although the Nexia transactions were clearly unlawful distributions, designed and implemented to funnel funds back to the issuer, Howell executed the transactions and journaled the funds to Nexia. The dollar amount of the Nexia sales was $271,981. The share volume was substantial, both in terms of the absolute number of Nexia shares sold and as a percentage of the number of shares outstanding.

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[41] The Third Cause of Action of the Complaint also charges Howell with violating NASD Conduct Rules 3012 and 2110 by failing to document in the Firm's WSPs the factors used to determine that complete compliance with Rule 3012(a)(2)(A)(i) was not possible. See Complaint ¶ 66. Enforcement did not mention this issue in its pre-hearing brief. The Firm's WSPs do not document the factors used to determine that complete compliance was not possible. CX-84. Accordingly, Howell also violated NASD Conduct Rules 3012 and 2110 by failing to document these factors in the Firm's WSPs. The determination of this aspect of the violation did not affect the Hearing Panel's determination of the appropriate sanctions.

[42] *FINRA Sanction Guidelines* ("Guidelines") at 26.

The Hearing Panel also considered that the matter involved the shares of a single issuer, executed over a short period of time.

Having considered the foregoing, the Hearing Panel imposes a fine of $7,500, and a suspension of three months, for Howell's violation of Rule 2110 by making unregistered securities sales.

B. Sanctions for Supervisory Violations

The Hearing Panel imposes a single sanction for Howell's supervisory violations. For failure to discharge supervisory obligations, the Guidelines recommend a fine of $5,000 to $50,000, and a suspension in any or all capacities for up to one year.[43] For deficient supervisory procedures, the Guidelines recommend a fine of $1,000 to $50,000. In egregious cases, the Guidelines recommend a suspension in any or all capacities for up to a year.[44]

The Hearing Panel considered a number of factors in determining the appropriate fine and suspension. There were numerous red flags that should have alerted Howell to the unlawfulness of Landau's sales. Howell also ignored the SEC's concerns about Landau's similar transactions at Finance 500.

Howell evinced a lack of concern about the need to comply with the specific requirements of FINRA's Rules in a very small firm. For example, he did not recognize that the requirement of a second principal was related to the need to supervise his activities, but regarded compliance as a regulatory nuisance. "[I]n our membership agreement we had to maintain two principals. Okay. Fine. I did that. And I did that to comply – to be in compliance with our membership agreement. It doesn't say I have to draw any conclusions about what that second principal's supposed to do." Tr. 77. Similarly, his attitude toward hiring York as a principal was

[43] Guidelines at 103.

[44] Guidelines at 104.

that he was simply fulfilling a mechanical requirement. Although he knew that York lacked broad experience, Howell hired him "because I needed him as a Series 24." Tr. 73. He also saw nothing deceptive about the statement in the Firm's WSPs concerning supervision of Howell as a producing manager that "a qualified person conducts reviews and is knowledgeable about Private Equity Securities' policies and control procedures," knowing that he considered himself to be the only "qualified person" in the Firm, and he would not be supervised. Tr. 76.

Having considered the foregoing, the Hearing Panel finds that the appropriate sanction for Howell's supervisory failures is a $5,000 fine, and a suspension in all principal capacities for three months, to run consecutively with the suspension in all capacities.

Conclusion

For unregistered sales of securities in violation of NASD Conduct Rule 2110, Respondent Ron William Howell is suspended from associating with any member firm in any capacity for three months and fined $7,500.[45] For failure to supervise, failure to implement adequate written supervisory procedures, and failure to implement adequate supervisory controls of his own activities as a producing manager, in violation of NASD Conduct Rules 3010, 3012, and 2110, Howell is fined an additional $5,000 and suspended in all principal capacities for three months, to run consecutively with the suspension in all capacities. Howell is also ordered to pay costs.

If this decision becomes FINRA's final disciplinary action, the suspension in all capacities shall begin at the opening of business on January 16, 2012, and end on the close of business on April 16, 2012. The suspension in all principal capacities shall begin at the opening of business on April 17, 2012, and end at the close of business on July 17, 2012. Respondent is

[45] Enforcement did not seek disgorgement. Howell did not directly receive commissions because he was on a salary but he owned 96% of PES. Tr. 110-111, 113. The Hearing Panel considered the amount of the commissions paid to the Firm as one factor in determining the appropriate fine and suspension.

ordered to pay costs in the amount of $2,882.20, which includes a $750 administrative fee and the cost of the hearing transcript. The fines and costs shall be payable on a date set by FINRA, but not less than 30 days after this decision becomes FINRA's final disciplinary action in this matter.[46]

HEARING PANEL

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Lawrence B. Bernard
Hearing Officer

Copies to: Ron William Howell (*via overnight courier and first-class mail*)
Scott M. Andersen, Esq. (*via e-mail and first-class mail*)
Joseph Darcy, Esq. (*via e-mail and first-class mail*)
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David R. Sonnenberg, Esq. (*via e-mail*)

[46] The Hearing Panel has considered all the arguments advanced by the parties, and rejects or sustains them to the extent that they are inconsistent or in accord with the views expressed herein.