FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. RANDY CARLSON (CRD No. 726574), Respondent.	Disciplinary Proceeding No. 2007008724701 Hearing Officer – SNB **AMENDED HEARING PANEL DECISION**[1] June 8, 2012

For selling unregistered securities in violation of Section 5 of the Securities Act and NASD Rule 2110, Respondent is fined $10,000, ordered to disgorge $35,269 in commissions, and shall only be employed by a member firm that agrees to subject Respondent to heightened supervision regarding compliance with Section 5 of the Securities Act for a one-year period. In addition, Respondent is ordered to pay the costs of this proceeding.

Appearances

Jonathan I. Golumb, Esq., and Michael Rogal, Esq., for the Department of Enforcement.

Richard F. Ensor, Esq., and James R. Kruse, Esq., for the Respondent.

DECISION

I. Procedural History[2]

Enforcement filed an Amended Complaint with the Office of Hearing Officers on October 4, 2011, and Respondent Randy Carlson ("Respondent") filed his Answer to the

[1] This amended decision is being issued to correctly reflect the hearing dates in this matter.

[2] As of July 30, 2007, NASD began operating under a new corporate name, the Financial Industry Regulatory Authority ("FINRA"). References in this decision to FINRA include, where appropriate, NASD. On December 15, 2008, certain consolidated FINRA rules became effective, replacing parallel NASD rules, and in some cases the prior rules were re-numbered and/or revised. *See* Regulatory Notice No. 08-57, FINRA Notices to Members, 2008 FINRA LEXIS 50 (Oct. 2008). This Decision refers to and relies on the NASD rules that were in effect at the time of the Respondent's alleged misconduct and cited in the Complaint as the basis for the charges against him.

Amended Complaint on October 21, 2011. The Amended Complaint charges that Respondent sold unregistered shares of Ever-Glory International ("EGLY") in violation of Section 5 of the Securities Act of 1933 ("Securities Act") and NASD Conduct Rule 2110.

The Hearing was held in Salt Lake City, Utah, on December 13 and 14, 2011.[3] The hearing panel was composed of a hearing officer, a current member of FINRA's District 9 Committee, and a current member of FINRA's District 11 Committee. Enforcement presented testimony from two witnesses: a FINRA Investigator and Respondent. Respondent presented testimony from his supervisor and testified on his own behalf. The parties filed post-hearing briefs on January 26 and January 27, 2012.

II. Findings of Fact

A. Origin of the Proceeding

This proceeding followed FINRA's investigation of a dramatic increase in the price and volume of EGLY securities, as well as spam emails touting the stock in June 2006.[4]

B. Respondent

Respondent registered with Wilson-Davis & Co. (the "Firm") as a general securities representative in 1993, and continues to be registered there.[5]

[3] "Tr." refers to the transcript of the hearing; "CX" to Enforcement's exhibits; "RX" to Respondent's exhibits, "JX" to joint exhibits, and "Stip." to stipulations. Enforcement's exhibits CX-1-2, CX-3 pp. 5-19, CX-4-10, and CX-12, Respondent's exhibits RX-1- 56, RX 65-80, and RX-82, and joint exhibits JX-1-9 were admitted into evidence. Tr. 287-294.

[4] JX-1, JX-3; pp. 4, 7-9.

[5] Stip. 1.

C. EGLY

EGLY was formed in July 2005 as a result of a reverse merger between Andean Development Corporation ("Andean")[6] and Perfect Dream Limited ("PDL"), a British Virgin Islands company that had acquired all the assets of a Chinese clothing manufacturer in December 2004.[7]

The shares at issue in this case were derived from convertible notes that had been issued by Andean prior to the reverse merger. On or about January 31, 2005, Andean issued five convertible promissory notes ("Convertible Notes"), in the aggregate amount of $57,000 in consideration of payment of an obligation that Andean incurred on or before July 31, 2003.

On July 31, 2005, as part of PDL's acquisition of Andean, PDL exchanged the Convertible Notes for 2.5 million restricted common shares.[8] These shares were issued to seven entities. The shares at issue in this case were received by three of these entities, which received a total of 1,243,860 shares, or approximately 12% of the shares of EGLY.[9] Specifically, Worldwide Capital Asia Corp. ("Worldwide") received 517,544 shares; Oriental Blossom, Inc. ("Oriental") received 226,316 shares; and National Group of Companies MFG ("National Group") received 517,544 shares. Andean's Form 8K filed on August 25, 2005, disclosed that these newly issued shares were restricted.[10]

In November 2005, Andean changed its name to EGLY and effected a 7.6 to 1 forward stock split of its common shares, increasing the total shares outstanding to more than 79,000,000

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[6] Andean was created in 1994 as an operating business, but by 2003, it had no operations, revenues or other evidence of business activities. Accordingly, its value was as a public shell company that could be used as a vehicle for a reverse merger with an operating business. Stip. 2; JX-2; JX-3, pp. 4, 7-9; Tr. 39-40, 48.

[7] Stip. 2.

[8] JX-5 p. 5.

[9] Stip. 5.

[10] JX-5 p. 4.

shares. As a result, Worldwide owned 3,933,334 shares; Oriental owned 1,700,000 shares; and National Group owned 3,800,000 shares.[11]

D. Respondent Opens the Customer Accounts

In February 2005, a client introduced Respondent to an individual named MS.[12] From his conversations with MS, Respondent learned that MS lived in Canada and owned a number of companies in different locations.[13] MS told Respondent that he financed struggling companies and received convertible debt in connection with these activities so that he could have the flexibility to liquidate his positions.[14] Following these discussions, Respondent opened three corporate accounts for which MS was the authorized representative: Shayla Investments LLC ("Shayla"); National Healthcare Manufacturing ("National Healthcare"); and Portfolio Management ("Portfolio").[15]

Over the next several months, MS referred other customers to Respondent, including two entities, Oriental and Worldwide, both of which had received EGLY shares in exchange for the Convertible Notes, as discussed above. MS had a business relationship with Worldwide and was designated as an authorized officer on Worldwide's Large Block Disposition form filed with the Firm.[16]

MS referred six other customers who opened accounts with Respondent: Ideal World Management; Blue Chip IR; Birch Capital; Douglas Furth; Charles Van Musscher; and Robert

[11] Stip. 6.

[12] Tr. 186.

[13] Tr. 188-189.

[14] Tr. 189.

[15] RX-2, RX-3; Tr. 186-187.

[16] JX-6; CX-9 p. 10; Tr. 56.

Bragg.[17] As discussed below, these customers participated in transfers among accounts and sales of EGLY into the market.

E. Deposit and Distribution of EGLY Shares among the Customer Accounts

In 2005 through 2006, MS and the customers he introduced deposited 19 million unregistered EGLY shares into accounts with Respondent, over 2 million of which were sold into the public market during the time period at issue in the Complaint.

Specifically, on or about December 1, 2005, National Group, which had received 3.8 million EGLY shares in exchange for its Convertible Note, transferred 1.5 million EGLY shares to MS's Shayla account.[18] On or about February 2, 2006, National Group transferred an additional 1 million EGLY shares to the Shayla account.[19] In April and November 2006, National Group transferred the remaining 1.3 million EGLY shares to MS's National Healthcare account.[20]

On or about December 2, 2005, Worldwide, which received 3,933,334 EGLY shares in exchange for its Convertible Note, deposited exactly that number of shares into its account with Respondent.[21] Respondent indicated in his documentation of this deposit that the shares were acquired from EGLY "a few months ago" for cash.[22] Between February and September 2006, Worldwide transferred 1.5 million EGLY shares to MS's Shayla account. In the letter of

[17] Tr. 247-248. Respondent testified that one or two referrals might have been received indirectly from MS. *Id.* at 248.

[18] Stip. 7. Respondent was unable to locate a Securities Deposit Declaration or a Large Block Disposition with regard to this deposit. Tr. 205.

[19] CX-5 p. 7.

[20] JX-7 pp. 1-4, CX-5 p. 6.

[21] Stip. 8.

[22] JX-6.

authorization for the transfer of 1 million of these shares, Worldwide indicated that Shayla was a "business associate" and the transfer was a "private business transaction."[23]

On or about November 16, 2006, Oriental, which had received 1,720,002 EGLY shares in exchange for its Convertible Notes, deposited 1.7 million EGLY shares into its account with Respondent.[24] In December 2006, Oriental transferred these 1.7 million shares to MS's Shayla account.[25]

F. Sales and Transfers of EGLY Stock by MS Accounts

Between January 11, 2006 and November 3, 2006, Respondent sold 1,091,400 EGLY shares into the market on behalf of MS's Shayla account, for proceeds to Shayla of $1,561,745. MS also transferred EGLY shares to other customer accounts which later sold EGLY shares into the market.

Specifically, Between December 2005 and October 2006, Shayla transferred more than 1.6 million EGLY shares to five other customers of Respondent: 100,000 shares to Birch Capital; 750,000 shares to Blue Chip IR; 600,000 shares to Ideal World Management; 150,000 shares to Charles Van Musscher; and 60,000 shares to Piranha.[26] Blue Chip IR then transferred 175,000 of these shares to Douglas Furth and 10,000 shares to Robert Bragg.[27] Between June and August 2006, National Healthcare Manufacturing transferred 350,000 EGLY shares to Birch Capital and 100,000 shares to Blue Chip IR.[28]

[23] JX-6 p. 4. Respondent appears to have signed this letter of authorization, along with his supervisor. *Id.* at p.5.

[24] Stip. 9; CX-6 p. 14.

[25] CX-6 p. 14.

[26] CX-5 pp. 7-8.

[27] CX-5 p. 2.

[28] CX-5 p. 6.

G. Sales by the Transferee Accounts

The accounts that received shares from accounts controlled by MS also sold a large volume of EGLY shares through Respondent. As detailed below, during 2006, Respondent sold more than 1 million shares on behalf of the transferee accounts for proceeds of almost $1.3 million. Combined with Shayla's sales discussed above, in 2006, Respondent sold over 2 million EGLY shares for proceeds of approximately $2.8 million.

Specifically, Respondent sold 600,000 EGLY shares for Ideal World Management for proceeds of $846,999; 10,000 EGLY shares for Robert Bragg for proceeds of $20,951; 1,000 EGLY shares for Douglas Furth for proceeds of $2,028; 4,750 EGLY shares for Blue Chip IR for proceeds of $8,401; 365,000 EGLY shares for Birch Capital for proceeds of $338,315; and 25,000 EGLY shares for Charles Van Musscher for proceeds of $9,780. Respondent also sold 3,000 EGLY shares for Worldwide for proceeds of $6,242.

Respondent was aware that MS was transferring large blocks of EGLY shares to customers that he referred to Respondent. He was also aware that MS and the other customers were coordinating their sales of EGLY shares to avoid dominating the market. In fact, Respondent apprised these customers of the sales activity of other customers with their permission and at their request.[29]

Respondent's sales of over 2 million EGLY shares for proceeds of approximately $2,800,000 from January through November 2006 generated commissions of $70,538. Respondent was credited with 50% of the commissions earned, or $35,269.[30]

[29] Tr. 257-258.

[30] Stip. 10-12.

H. Respondent's Investigation to Determine whether EGLY was Freely Tradable

Respondent acknowledged at the hearing that there were red flags associated with sales of EGLY shares that he needed to investigate to assure himself that the EGLY shares in his customer accounts were freely tradable.[31]

Respondent admitted that he knew that Blue Chip, Van Musscher, and possibly Furth provided investor relations services to EGLY.[32] However, Respondent offered no evidence indicating that he made an inquiry to determine whether they received their EGLY shares in return for services provided to the issuer.

Moreover, some of the Securities Deposit Declarations signed by customers indicated that they purchased their shares for cash from EGLY and held them for only a few months.[33] As Respondent acknowledged at the hearing, if the shares came directly from EGLY, it would be necessary to determine whether they were registered or exempt from registration.[34]

However, Respondent does not recall the inquiry he made with respect to EGLY shares and there are no documents that reflect his inquiry.[35] Respondent's supervisor testified that he approved the EGLY sales based upon information provided by Respondent. However, he does not recall the facts upon which he based his approval.[36] At the hearing, Respondent offered no explanation of how he could have concluded that customer sales of EGLY unregistered stock would have been permissible under Section 5 of the Securities Act.

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[31] Tr. 199-200.

[32] Tr. 248-50.

[33] JX-6 p. 1 (Worldwide); JX-7 p. 3 (National Healthcare); JX-8 pp. 1.3, 5, (Shayla).

[34] Tr. 200-202.

[35] Tr. 203-204.

[36] Tr. 120-124.

III. Violation of Section 5 of the Securities Act

A. Enforcement Established a Prima Facie Case for 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.[37] The purpose of the registration requirements is to "protect investors by promoting full disclosure of information thought necessary to informed investment decisions."[38] A violation of Section 5 of the Securities Act constitutes a violation of NASD Conduct Rule 2110.[39]

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.[40] A showing of scienter is not required because "[t]he Securities Act of 1933 imposes strict liability on sellers of unregistered securities."[41]

The prohibitions in Section 5 of the Securities Act extend not only to those who engage in the actual sale of securities, but also to those who engage in significant steps in the distribution

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[37] 15 U.S.C. § 77e(a) and (c); *see also Rodney R. Schoemann*, Securities Act. Rel. No. 9076, 2009 SEC LEXIS 3939, at *20-21 (October 23, 2009) *aff'd* 398 F. App'x 603 (D.C. Cir. 2010)(unpublished); *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).

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

[39] *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).

[40] *Midas Securities, LLC, et al.*, Exchange Act Rel. No. 66200, 2012 SEC LEXIS 199 (Jan. 20, 2012); *Schoemann*, 2009 SEC LEXIS 3939, at *20-21; *Gebhart*, 2006 SEC LEXIS 93, at *53.

[41] *Id.* (citing *Swenson v. Engelstad*, 626 F.2d 421, 424 (5th Cir. 1980)); *SEC v. Calvo*, 378 F.3d 1211, 1215 (11th Cir. 2004).

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.[42]

Here, the evidence establishes a prima facie case. There is no dispute that the EGLY sales were unregistered. No registration statement was in effect with respect to the EGLY securities. Respondent sold unregistered shares of EGLY on behalf of his customers. The sales involved interstate activity because the shares were sold into the over-the-counter market, thereby entering interstate commerce. The shares were quoted on the Pink Sheets, a national communications medium. Thus, Enforcement established a prima facie case that Respondent engaged in unregistered sales of EGLY shares, in violation of Section 5 of the Securities Act.

B. Respondent Failed to Establish that the Transactions Qualified for the Brokers' Exemption

Exemptions from registration are affirmative defenses that must be established by the person claiming the exemption. Furthermore, "Exemptions from registration provisions are construed narrowly 'in order to further the purpose of the Act: To provide full and fair disclosure of the character of the securities, and to prevent frauds in the sale thereof.'"[43] Evidence in support of an exemption must be explicit, exact, and not built on mere conclusory statements.[44]

1. The Brokers' Exemption, Section 4(4) of the Securities Act

Respondent asserted that the sales at issue were exempt under Section 4(4) of the Securities Act, which exempts "brokers' transactions executed upon customers' orders on any exchange or in the over-the-counter market but not the solicitation of such orders." The brokers'

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[42] *See SEC v. Calvo*, 378 F.3d 1211, 1215; *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. 34-23827, 1986 SEC LEXIS 326, at *11 (Nov. 20, 1986).

[43] *SEC v. Platforms Wireless Int'l Corp.*, 617 F.3d 1072, 2010 U.S. App. LEXIS 15328, at *16 (9th Cir. July 27, 2010) (citing *SEC v. Ralston Purina Co.*, 346 U.S. 119, 126 (1953)).

[44] *Schoemann*, 2009 SEC LEXIS 3939, at *23; *John A. Carley*, Exchange Act Rel. No. 57246, 2008 SEC LEXIS 222, at *24 (Jan. 31, 2008), *aff'd in relevant part, Zacharias, et.al. v. SEC*, 569 F.3d 458 (D.C. Cir. 2009).

exemption, as it is commonly known, is designed to exempt "ordinary brokerage transactions" and is not available if the broker "knows or has reasonable grounds to believe that the selling customers' part of the transaction is not exempt from Section 5 of the Securities Act."[45]

Thus, the exemption is available only if the broker conducts an inquiry adequate to determine if the securities may be sold lawfully. The amount of inquiry varies based upon the circumstances of the particular case:

A dealer who is offered a modest amount of a widely traded security by a responsible customer, whose lack of relationship to the issuer is well known to him, may ordinarily proceed with considerable confidence. On the other hand, when a dealer is offered a substantial block of a little-known security, either by persons who appear reluctant to disclose exactly where the securities came from, or where the surrounding circumstances raise a question as to whether or not the ostensible sellers may be merely intermediaries for controlling persons or statutory underwriters, then searching inquiry is called for.

The problem becomes particularly acute where substantial amounts of a previously little known security appear in the trading markets within a fairly short period of time and without the benefit of registration under the Securities Act of 1933. In such situations, it must be assumed that these securities emanate from the issuer or from persons controlling the issuer, unless some other source is known and the fact that the certificates may be registered in the names of various individuals could merely indicate that those responsible for the distribution are attempting to cover their tracks.[46]

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[45] *Midas Securities,*2012 SEC LEXIS 199, at *26; citing *Carley,*2008 SEC LEXIS 222, at *24.

[46] Distribution by Broker-Dealers of Unregistered Securities, Exchange Act Rel. No. 6721, 1962 SEC LEXIS 74, at *4-5 (Feb. 2, 1962). The standards set forth in this 1962 release have been cited in numerous cases involving sales of unregistered securities by registered representatives. *See, e.g., Geiger v. SEC*, 363 F.3d 481, 485 (D.C. Cir. 2004); *Jacob Wonsover*, 1999 SEC LEXIS 430, at *28; *see also* FINRA Reg. Notice 09-05, at 4.

"A broker relying on Section 4(4) cannot merely act as an order taker, but must make whatever inquiries are necessary under the circumstances to determine that the transaction is only a normal 'brokers' transaction' and not part of an unlawful distribution."[47] Although brokers are not required to be experts on the details of the Securities Act, "familiarity with the rudiments is essential."[48]

A registered representative may not delegate his responsibility to others and thereby relieve himself of responsibility for compliance with the registration requirements of Section 5 of the Securities Act.[49] The SEC and the courts have repeatedly rejected the defense by representatives that they relied on transfer agents, counsel for the issuer, clearing firms, or assurances from issuers that a stock was "free trading." It is also inadequate for representatives to rely solely on their firms to conduct the necessary investigation.[50]

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[47] *Robert G. Leigh*, Exchange Act Rel. No. 27667, 1990 SEC LEXIS 153, at *10 (Feb. 1, 1990); *see also* Sales of Unregistered Securities by Broker-Dealers, Exchange Act Rel. No. 9239, 1971 SEC LEXIS 19, at *7-8 (July 7, 1971).

[48] *Paul L. Rice*, Exchange Act Rel. No. 11667, 1975 SEC LEXIS 775, at *5 (Sept. 22, 1975); see also *Leigh*, 1990 SEC LEXIS 153, at *11; *Robert Stead*, 1971 SEC LEXIS 3977, at *98 (Dec. 21, 1971) ("Indeed, such a professional has a duty to be familiar with the registration requirements of the Securities Act as well as the circumstances under which an exemption from such requirements is available.").

[49] *Wonsover*, 1999 SEC LEXIS 430, at *15 (finding that reliance on transfer agent and respondent's firm did not relieve the individual broker of his obligation to explore whether shares are freely tradable).

[50] *Id.* at *12-14; *Wonsover*, 1999 SEC LEXIS 430, at *29 (stating that the SEC has rejected the "truncated view" that a representative could function as a "mere order taker" and rely on his firm and the transfer agent to conduct the appropriate inquiry); *Rice*, 1975 SEC LEXIS 775, at *5; Distribution by Broker-Dealers of Unregistered Securities, Exchange Act Rel. No. 6721, 1962 SEC LEXIS 74, at *3 (Feb. 2, 1962) ("[A] dealer who offers to sell, or is asked to sell a substantial amount of securities must take whatever steps are necessary to be sure that this is a transaction not involving an issuer, person in a control relationship with an issuer or an underwriter. For this purpose, it is not sufficient for him merely to accept 'self-serving statements of his sellers and their counsel without reasonably exploring the possibility of contrary facts.'"); Sales of Unregistered Securities by Broker-Dealers, Exchange Act Rel. No. 9239, 1971 SEC LEXIS 19, at *8 (July 7, 1971) ("Any determination that such an exemption exists should only be made after the broker-dealer has reviewed the facts surrounding the acquisition of the shares and competent outside counsel having no proprietary interest in the offering has furnished a supporting opinion describing the relevant facts in sufficient detail to provide an explicit basis for the legal conclusions stated.").

2. Respondent Did Not Meet his Burden of Establishing an Affirmative Defense Under the Brokers' Exemption

Here, Respondent failed to demonstrate that he made the searching inquiry required to establish an exemption from the registration requirements. There were numerous red flags that a distribution was taking place. EGLY was a thinly-traded Pink Sheet Stock. MS told Respondent that he was in the business of providing financing to struggling companies and received convertible debt in connection with these activities so that he could have liquidity. Thus, he was in a position to be a substantial factor in the distribution of EGLY shares[51] In that regard, MS deposited large blocks of EGLY shares in several accounts. MS referred eight other customers who also deposited large blocks of EGLY shares. These customers transferred large blocks of EGLY stock among each other without evidence of the economic purpose of these transfers. Respondent knew that some of the customers selling EGLY shares were in the investor relations business.[52] He also knew that the customers were coordinating their sales. Moreover, Respondent facilitated the sale of over 2 million EGLY shares for proceeds of approximately $2.8 million within a one-year period.

Despite these red flags, Respondent was unable to recall the substance of his inquiry. He admitted that he failed to review EGLY's SEC filings and he did not ascertain whether any particular exemption from registration was available before the sales took place.

The burden was on Respondent to establish that he performed a searching inquiry prior to selling the EGLY shares in order to qualify for the Section 4(4) exemption. However, he failed

[51] *See SEC v. Sierra Brokerage Services Inc.*, 608 F. Supp. 2d 923, 951, n.28 (S.D. Ohio 2009).

[52]While transfers of unregistered securities to consultants as compensation for services may be lawful under certain circumstances, there have been many cases in which transactions involving distributions by or to consultants have been found to be unlawful. *Schoemann*, 2009 SEC LEXIS 3939; *Newbridge Sec. Corp.*, 2009 SEC LEXIS 2058 (A.L.J. June 9, 2009); *SEC v. Sierra Brokerage Services Inc.*, 608 F. Supp. 2d 923.

to do so. Therefore, the Panel finds that Respondent violated Section 5 of the Securities Act and NASD Conduct Rule 2110.

IV. Sanctions

For the sale of unregistered securities in violation of NASD Conduct Rule 2110 and Section 5 of the Securities Act, the FINRA Sanction Guidelines ("Guidelines") recommend a fine of $2,500 to $50,000. The recommended fine may be increased by adding the amount of a respondent's financial benefit. In egregious cases, the Guidelines recommend consideration of a suspension in any or all capacities for up to two years or a bar.

Disgorgement of ill-gotten gains may be appropriate where a respondent obtained a financial benefit from his or her misconduct. The purpose of disgorgement is to deprive a person of 'ill-gotten gains' and prevent unjust enrichment.[53]

The Guidelines set forth three specific considerations for the sale of unregistered securities, two of which are relevant here: whether respondent attempted to comply with an exemption from registration, and the share volume and dollar amount of transactions involved.[54]

The Hearing Panel finds that Respondent failed to make an effort to comply with an exemption from registration. While selling millions of shares for a number of customers who were admittedly coordinating sales, Respondent failed to pay much attention to what was required to establish the lawfulness of the transactions when a cursory review of EGLY's SEC filings would have revealed that the shares he sold were not registered.

[53] General Principles Applicable to All Sanction Determinations, No. 6; *see also Zacharias v. SEC*, 569 F.3d at 471-72; *Dep't of Mkt. Regulation v. Ko Sec., Inc.*, No. CMS000I42, 2004 NASD Discip. LEXIS 21, at *11 (N.A.C. Dec. 20, 2004); *Dep't of Enforcement v. Levitov*, No. CAF970011, 2000 NASD Discip. LEXIS 12, at *29-30 (N.A.C. June 28, 2000).

[54] *Guidelines* at 24.

The Hearing Panel found that there were ample red flags indicating that MS obtained his EGLY shares directly from the issuer, and that he, and the customers that he referred to Respondent, were engaged in a statutory underwriting.

The Hearing Panel also considered the volume of transactions and the magnitude of the proceeds. Respondent sold over 2 million shares of EGLY, for proceeds in excess of $2.8 million, an amount paid by public customers without the protections that are the purpose of registration.[55] Respondent also profited from his misconduct.[56]

On the other hand, the majority of the Hearing Panel found as mitigating the enhanced procedures Respondent has now instituted to better comply with Section 5 of the Securities Act.[57] The majority of the Panel also found as mitigating that Respondent's supervisor approved the sales at issue. A majority of the Panel found that Respondent's misconduct was serious, but not egregious. The Panel concluded that a $10,000 fine as well as disgorgement of the $35,269 on commissions received on the sales of EGLY shares is appropriate in this case.[58]

Adjudicators may also design sanctions other than those specified in the Guidelines. For example, adjudicators may require a respondent firm to implement heightened supervision of certain individuals.[59] The Panel believed that a heightened supervision requirement would emphasize to Respondent the importance of complying with the securities laws and prevent the recurrence of Respondent's violative conduct. However, here, the Firm is not a party to the action. Accordingly, the Panel has determined to require that Respondent shall only be

[55] *Guidelines,* Principal Consideration No. 11.

[56] *Id.;* Principal Consideration No. 17.

[57] Tr. 136-137.

[58] The Hearing Officer agrees with the fine, disgorgement, and heightened supervision, but dissents from the majority's decision not to impose a suspension. The Hearing Officer finds no mitigating factors. She concludes that Respondent's misconduct was egregious and warranted a suspension in the range of four months.

[59] *Guidelines* at 3.

employed by a member firm that agrees in writing to provide Respondent with heightened supervision regarding compliance with Section 5 of the Securities Act for a one-year period.

V. Conclusion

For selling unregistered securities in violation of Section 5 of the Securities Act and NASD Rule 2110, Respondent is fined $10,000, ordered to disgorge $35,269 in commissions, and shall only be employed by a member firm that agrees to subject Respondent to heightened supervision regarding compliance with Section 5 of the Securities Act for a one-year period. Respondent is also ordered to pay costs in the amount of $3,349.25, which includes a $750 administrative fee and the cost of the hearing transcripts. 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.[60]

HEARING PANEL

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Sara Nelson Bloom
Hearing Officer
For the Hearing Panel

Copies:
Randy Carlson *(via overnight and first-class mail)*
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David R. Sonnenberg, Esq. *(via electronic mail)*

[60] The Hearing Panel has considered and rejects without discussion all other arguments of the parties.