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SECURITIES AND EXCHANGE COMMISSION

This file is maintained pursuant to the Freedom of Information Act (5 U.S.C. 552). It contains a copy of each decision, order, rule or similar action of the Commission, for November 2006, with respect to which the final votes of individual Members of the Commission are required to be made available for public inspection pursuant to the provisions of that Act.

Unless otherwise noted, each of the following individual Members of the Commission voted affirmatively upon each action of the Commission shown in the file:

WILLIAM H. DONALDSON, CHAIRMAN

CYNTHIA A. GLASSMAN, COMMISSIONER

HARVEY J. GOLDSCHMID, COMMISSIONER

PAUL S. ATKINS, COMMISSIONER

ROEL C. CAMPOS, COMMISSIONER

1 Document

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 54774 / November 17, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12480

In the Matter of **CHARLES B. SPADONI,** **Respondent.**	**ORDER OF FORTHWITH SUSPENSION PURSUANT TO RULE 102(e)(2) OF THE COMMISSION'S RULES OF PRACTICE**

I.

The Securities and Exchange Commission deems it appropriate to issue an order of forthwith suspension of Charles B. Spadoni pursuant to Rule 102(e)(2) of the Commission's Rules of Practice [17 C.F.R. 200.102(e)(2)].[1]

II.

The Commission finds that:

1. Spadoni is an attorney admitted to practice in Connecticut.

2. On October 27, 2006, a judgment of conviction was entered against Spadoni, in U.S. v. Triumph Capital Group, Inc., et al., Criminal No. 3:00CR-217 (EBB), in the United States District Court for the District of Connecticut, finding him guilty of: (a) one count of racketeering in violation of 18 U.S.C. § 1962(c) concerning acts of bribery and obstruction of justice; (b) one count of racketeering conspiracy in violation of 18 U.S.C. § 1962(d) concerning acts of bribery and obstruction of justice; (c) one count of theft/bribery concerning programs receiving federal funds in violation of 18 U.S.C. §§ 666(a)(2) and 2; (d) four counts of wire fraud/theft of honest services in violation of 18 U.S.C. §§ 1343, 1436, and 2; and (e) one count of obstruction of justice in violation of 18 U.S.C. §1503.

[1] Rule 102(e)(2) provides in pertinent part: "Any ... person who has been convicted of a felony or a misdemeanor involving moral turpitude shall be forthwith suspended from appearing or practicing before the Commission."

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3. As a result of this conviction, Spadoni was sentenced to 36 months imprisonment in a federal penitentiary and ordered to pay a fine in the amount of $50,000.

III.

In view of the foregoing, the Commission finds that Spadoni has been convicted of a felony within the meaning of Rule 102(e)(2) of the Commission's Rules of Practice.

Accordingly, IT IS ORDERED that Charles B. Spadoni is forthwith suspended from appearing or practicing before the Commission pursuant to Rule 102(e)(2) of the Commission's Rules of Practice.

By the Commission.

Nancy M. Morris
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

This file is maintained pursuant to the Freedom of Information Act (5 U.S.C. 552). It contains a copy of each decision, order, rule or similar action of the Commission, for November 2006, with respect to which the final votes of individual Members of the Commission are required to be made available for public inspection pursuant to the provisions of that Act.

Unless otherwise noted, each of the following individual Members of the Commission voted affirmatively upon each action of the Commission shown in the file:

CHRISTOPHER COX, CHAIRMAN

CYNTHIA A. GLASSMAN, COMMISSIONER

PAUL S. ATKINS, COMMISSIONER

ROEL C. CAMPOS, COMMISSIONER

ANNETTE NAZARETH, COMMISSIONER

4 Documents

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
November 8, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12474

In the Matter of **Calneva Capital Corp.,** **Casino Casino Corp.,** **FDN, Inc.,** **Royal Belle Capital Corp.,** **Studio Capital Corp., and** **Unique Video Products, Inc.,** **Respondents.**	**ORDER INSTITUTING PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Calneva Capital Corp. ("Calneva") (CIK No. 1056882) is a dissolved Colorado corporation located in Greenwood Village, Colorado with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Calneva is delinquent in its periodic filings with the Commission, having not filed a periodic report since it filed a Form 10-QSB for the period ended September 30, 2000, which reported that the company had generated no revenues and a net loss from operations of $7,481 for the previous quarter.

2. Casino Casino Corp. (CIK No. 1015353) is a dissolved Colorado corporation located in Denver, Colorado with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Casino Casino is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-SB registration statement on May 30, 1996.

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3. FDN, Inc. (CIK No. 835767) is a Colorado corporation located in Greenwood Village, Colorado with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). FDN is delinquent in its periodic filings with the Commission, having not filed a periodic report since it filed a Form 10-QSB for the period ended September 30, 2000, which reported that the company had a net loss from operations of $10.4 million for the prior three quarters. As of November 1, 2006, the company's common stock (symbol "FDNN") was traded on the over-the-counter markets.

4. Royal Belle Capital Corp. ("Royal Belle") (CIK No. 1068146) is a dissolved Colorado corporation located in Greenwood Village, Colorado with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Royal Belle is delinquent in its periodic filings with the Commission, having not filed a periodic report since it filed a Form 10-QSB for the period ended September 30, 2001, which reported that the company had generated no revenues and a net loss from operations of $2,307 for the previous quarter.

6. Studio Capital Corp. (CIK No. 1056883) is a dissolved Colorado corporation located in Greenwood Village, Colorado with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Studio Capital is delinquent in its periodic filings with the Commission, having not filed a periodic report since it filed a Form 10-QSB for the period ended September 30, 2000, which reported that the company had a net loss from operations of $7,534 for the previous three quarters.

7. Unique Video Products, Inc. ("Unique") (CIK No. 1063528) is a dissolved Colorado corporation located in Denver, Colorado with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Unique is delinquent in its periodic filings with the Commission, having not filed a periodic report since it filed a Form 10-Q for the period ended July 31, 1998, which reported total assets of $501, no revenue, and net losses of $1,169.

B. DELINQUENT PERIODIC FILINGS

8. As discussed in more detail above, all of the respondents are delinquent in their periodic filings with the Commission (*see* Chart of Delinquent Filings, attached hereto as Appendix 1), have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

9. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual

reports (Forms 10-K or 10-KSB), and Rule 13a-13 requires issuers to file quarterly reports (Forms 10-Q or 10-QSB).

10. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities of the Respondents identified in Section II registered pursuant to Section 12 of the Exchange Act.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means of verifiable delivery.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Nancy M. Morris
Secretary

Attachment

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Appendix 1

Chart of Delinquent Filings

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Calneva Capital Corp.					
	10-KSB	12/31/01	04/01/02	Not filed	55
	10-QSB	03/31/02	05/15/02	Not filed	54
	10-QSB	06/30/02	08/14/02	Not filed	51
	10-QSB	09/30/02	11/14/02	Not filed	48
	10-KSB	12/31/02	03/31/03	Not filed	44
	10-QSB	03/31/03	05/15/03	Not filed	42
	10-QSB	06/30/03	08/14/03	Not filed	39
	10-QSB	09/30/03	11/14/03	Not filed	36
	10-KSB	12/31/03	03/30/04	Not filed	32
	10-QSB	03/31/04	05/17/04	Not filed	30
	10-QSB	06/30/04	08/16/04	Not filed	27
	10-QSB	09/30/04	11/15/04	Not filed	24
	10-KSB	12/31/04	03/31/05	Not filed	20
	10-QSB	03/31/05	05/16/05	Not filed	18
	10-QSB	06/30/05	08/15/05	Not filed	15
	10-QSB	09/30/05	11/14/05	Not filed	12
	10-KSB	12/31/05	03/31/06	Not filed	8
	10-QSB	03/31/06	05/15/06	Not filed	6
	10-QSB	06/30/06	08/14/06	Not filed	3
Total Filings Delinquent	19				
Casino Casino Corp.					
	10-QSB	06/30/96	08/14/96	Not filed	123
	10-QSB	09/30/96	11/14/96	Not filed	120
	10-KSB	12/31/96	03/31/97	Not filed	116
	10-QSB	03/31/97	05/15/97	Not filed	114
	10-QSB	06/30/97	08/14/97	Not filed	111
	10-QSB	09/30/97	11/14/97	Not filed	108
	10-KSB	12/31/97	03/31/98	Not filed	104
	10-QSB	03/31/98	05/15/98	Not filed	102
	10-QSB	06/30/98	08/14/98	Not filed	99
	10-QSB	09/30/98	11/16/98	Not filed	96

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Casino Casino Corp.					
	10-KSB	12/31/98	03/31/99	Not filed	92
	10-QSB	03/31/99	05/17/99	Not filed	90
	10-QSB	06/30/99	08/16/99	Not filed	87
	10-QSB	09/30/99	11/15/99	Not filed	84
	10-KSB	12/31/99	03/30/00	Not filed	80
	10-QSB	03/31/00	05/15/00	Not filed	78
	10-QSB	06/30/00	08/14/00	Not filed	75
	10-QSB	09/30/00	11/14/00	Not filed	72
	10-KSB	12/31/00	04/02/01	Not filed	67
	10-QSB	03/31/01	05/15/01	Not filed	66
	10-QSB	06/30/01	08/14/01	Not filed	63
	10-QSB	09/30/01	11/14/01	Not filed	60
	10-KSB	12/31/01	04/01/02	Not filed	55
	10-QSB	03/31/02	05/15/02	Not filed	54
	10-QSB	06/30/02	08/14/02	Not filed	51
	10-QSB	09/30/02	11/14/02	Not filed	48
	10-KSB	12/31/02	03/31/03	Not filed	44
	10-QSB	03/31/03	05/15/03	Not filed	42
	10-QSB	06/30/03	08/14/03	Not filed	39
	10-QSB	09/30/03	11/14/03	Not filed	36
	10-KSB	12/31/03	03/30/04	Not filed	32
	10-QSB	03/31/04	05/17/04	Not filed	30
	10-QSB	06/30/04	08/16/04	Not filed	27
	10-QSB	09/30/04	11/15/04	Not filed	24
	10-KSB	12/31/04	03/31/05	Not filed	20
	10-QSB	03/31/05	05/16/05	Not filed	18
	10-QSB	06/30/05	08/15/05	Not filed	15
	10-QSB	09/30/05	11/14/05	Not filed	12
	10-KSB	12/31/05	03/31/06	Not filed	8
	10-QSB	03/31/06	05/15/06	Not filed	6
	10-QSB	06/30/06	08/14/06	Not filed	3
Total Filings Delinquent	41				
FDN, Inc.					
	10-KSB	12/31/00	04/02/01	Not filed	67
	10-QSB	03/31/01	05/15/01	Not filed	66

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
FDN, Inc.					
	10-QSB	06/30/01	08/14/01	Not filed	63
	10-QSB	09/30/01	11/14/01	Not filed	60
	10-KSB	12/31/01	04/01/02	Not filed	55
	10-QSB	03/31/02	05/15/02	Not filed	54
	10-QSB	06/30/02	08/14/02	Not filed	51
	10-QSB	09/30/02	11/14/02	Not filed	48
	10-KSB	12/31/02	03/31/03	Not filed	44
	10-QSB	03/31/03	05/15/03	Not filed	42
	10-QSB	06/30/03	08/14/03	Not filed	39
	10-QSB	09/30/03	11/14/03	Not filed	36
	10-KSB	12/31/03	03/30/04	Not filed	32
	10-QSB	03/31/04	05/17/04	Not filed	30
	10-QSB	06/30/04	08/16/04	Not filed	27
	10-QSB	09/30/04	11/15/04	Not filed	24
	10-KSB	12/31/04	03/31/05	Not filed	20
	10-QSB	03/31/05	05/16/05	Not filed	18
	10-QSB	06/30/05	08/15/05	Not filed	15
	10-QSB	09/30/05	11/14/05	Not filed	12
	10-KSB	12/31/05	03/31/06	Not filed	8
	10-QSB	03/31/06	05/15/06	Not filed	6
	10-QSB	06/30/06	08/14/06	Not filed	3
Total Filings Delinquent	23				
Royal Belle Capital Corp.					
	10-KSB	12/31/01	04/01/02	Not filed	55
	10-QSB	03/31/02	05/15/02	Not filed	54
	10-QSB	06/30/02	08/14/02	Not filed	51
	10-QSB	09/30/02	11/14/02	Not filed	48
	10-KSB	12/31/02	03/31/03	Not filed	44
	10-QSB	03/31/03	05/15/03	Not filed	42
	10-QSB	06/30/03	08/14/03	Not filed	39
	10-QSB	09/30/03	11/14/03	Not filed	36
	10-KSB	12/31/03	03/30/04	Not filed	32
	10-QSB	03/31/04	05/17/04	Not filed	30
	10-QSB	06/30/04	08/16/04	Not filed	27
	10-QSB	09/30/04	11/15/04	Not filed	24
	10-KSB	12/31/04	03/31/05	Not filed	20

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Royal Belle Capital Corp.					
	10-QSB	03/31/05	05/16/05	Not filed	18
	10-QSB	06/30/05	08/15/05	Not filed	15
	10-QSB	09/30/05	11/14/05	Not filed	12
	10-KSB	12/31/05	03/31/06	Not filed	8
	10-QSB	03/31/06	05/15/06	Not filed	6
	10-QSB	06/30/06	08/14/06	Not filed	3
Total Filings Delinquent	19				
Studio Capital Corp.					
	10-KSB	12/31/00	04/02/01	Not filed	67
	10-QSB	03/31/01	05/15/01	Not filed	66
	10-QSB	06/30/01	08/14/01	Not filed	63
	10-QSB	09/30/01	11/14/01	Not filed	60
	10-KSB	12/31/01	04/01/02	Not filed	55
	10-QSB	03/31/02	05/15/02	Not filed	54
	10-QSB	06/30/02	08/14/02	Not filed	51
	10-QSB	09/30/02	11/14/02	Not filed	48
	10-KSB	12/31/02	03/31/03	Not filed	44
	10-QSB	03/31/03	05/15/03	Not filed	42
	10-QSB	06/30/03	08/14/03	Not filed	39
	10-QSB	09/30/03	11/14/03	Not filed	36
	10-KSB	12/31/03	03/30/04	Not filed	32
	10-QSB	03/31/04	05/17/04	Not filed	30
	10-QSB	06/30/04	08/16/04	Not filed	27
	10-QSB	09/30/04	11/15/04	Not filed	24
	10-KSB	12/31/04	03/31/05	Not filed	20
	10-QSB	03/31/05	05/16/05	Not filed	18
	10-QSB	06/30/05	08/15/05	Not filed	15
	10-QSB	09/30/05	11/14/05	Not filed	12
	10-KSB	12/31/05	03/31/06	Not filed	8
	10-QSB	03/31/06	05/15/06	Not filed	6
	10-QSB	06/30/06	08/14/06	Not filed	3
Total Filings Delinquent	23				

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Unique Video Products, Inc.					
	10-QSB	10/31/98	12/15/98	Not filed	95
	10-QSB	01/31/99	03/19/99	Not filed	92
	10-KSB	04/30/99	07/29/99	Not filed	88
	10-QSB	07/31/99	09/14/99	Not filed	86
	10-QSB	10/31/99	12/17/99	Not filed	83
	10-QSB	01/31/00	03/17/00	Not filed	80
	10-KSB	04/30/00	07/31/00	Not filed	76
	10-QSB	07/31/00	09/15/00	Not filed	74
	10-QSB	10/31/00	12/15/00	Not filed	71
	10-QSB	01/31/01	03/19/01	Not filed	68
	10-KSB	04/30/01	07/30/01	Not filed	64
	10-QSB	07/31/01	09/14/01	Not filed	62
	10-QSB	10/31/01	12/17/01	Not filed	59
	10-QSB	01/31/02	03/19/02	Not filed	56
	10-KSB	04/30/02	07/29/02	Not filed	52
	10-QSB	07/31/02	09/16/02	Not filed	50
	10-QSB	10/31/02	12/17/02	Not filed	47
	10-QSB	01/31/03	03/17/03	Not filed	44
	10-KSB	04/30/03	07/29/03	Not filed	40
	10-QSB	07/31/03	09/15/03	Not filed	38
	10-QSB	10/31/03	12/15/03	Not filed	35
	10-QSB	01/31/04	03/16/04	Not filed	32
	10-KSB	04/30/04	07/29/04	Not filed	28
	10-QSB	07/31/04	09/14/04	Not filed	26
	10-QSB	10/31/04	12/17/04	Not filed	23
	10-QSB	01/31/05	03/18/05	Not filed	20
	10-KSB	04/30/05	07/29/05	Not filed	16
	10-QSB	07/31/05	09/16/05	Not filed	14
	10-QSB	10/31/05	12/16/05	Not filed	11
	10-QSB	01/31/06	03/17/06	Not filed	8
	10-KSB	04/30/06	07/31/06	Not filed	4
	10-QSB	07/31/06	09/14/06	Not filed	2

Total Filings Delinquent 32

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
November 27, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12486

In the Matter of **Amanda Company, Inc.,** **Com21, Inc.,** **Eco Soil Systems, Inc., and** **Healthtrac, Inc.,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Amanda Company, Inc. ("AMNA")[1] (CIK No. 1000266) is an expired Utah corporation located in Irvine, California with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). The company is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended December 31, 2002, which reported a net loss of $271,212 for the prior three months. For fiscal year 2002, AMNA's auditors expressed uncertainty as to whether the company could continue as a going concern in light of its recurring losses and stockholders' deficit. As of August 21, 2006, the company's common stock was quoted on the Pink Sheets, had eight market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3). AMNA's common stock had an average daily trading volume of 79,844 shares during the year ended October 30, 2006.

[1] The short form of each issuer's name is also its stock symbol.

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2. Com21, Inc. ("CMTOQ") (CIK No. 945379) is a Delaware corporation located in San Jose, California with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). The company is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2003, which reported a net loss of $5,817,000 for the prior three months. On July 15, 2003, CMTOQ filed for bankruptcy under Chapter 11 in the United States Bankruptcy Court for the Northern District of California. That proceeding was later converted to a Chapter 7 proceeding which was still pending as of November 20, 2006. In a Form 8-K filed on August 6, 2003, CMTOQ stated that it believed that its outstanding stock was without value. As of August 21, 2006, the company's common stock was quoted on the Pink Sheets, had eight market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3). CMTOQ's common stock had an average daily trading volume of 421,493 shares during the year ended October 30, 2006.

3. Eco Soil Systems, Inc. ("ESSI") (CIK No. 876103) is an inactive Nebraska corporation located in San Diego, California with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). The company is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2001, which reported a net loss of $3,326,000 for the prior three months. On October 15, 2002, ESSI filed for bankruptcy under Chapter 7 in the United States Bankruptcy Court for the Southern District of California. The bankruptcy proceeding was terminated on December 15, 2004 after the trustee determined that ESSI did not have sufficient assets to make a distribution to creditors. As of August 21, 2006, the company's common stock was quoted on the Pink Sheets, had ten market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3). ESSI's common stock had an average daily trading volume of 113,386 shares during the year ended October 30, 2006.

4. Healthtrac, Inc. ("HTAC") (CIK No. 790948) is a cancelled British Columbia corporation located in Redwood City, California with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). The company is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended November 30, 2003, which reported a net loss of $1,333,100 for the prior nine months. For fiscal year 2003, HTAC's auditors expressed doubt about the company's ability to continue as a going concern, in light of its recurring losses and working capital deficit. As of August 21, 2006, the company's common stock was quoted on the Pink Sheets, had eleven market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3). HTAC's common stock had an average daily trading volume of 244,937 shares during the year ended October 30, 2006.

B. <u>DELINQUENT PERIODIC FILINGS</u>

5. All of the Respondents are delinquent in their periodic filings with the Commission (*see* Chart of Delinquent Filings, attached hereto as Appendix 1), were quoted on the Pink Sheets as of August 21, 2006, had average daily trading volumes in

excess of 79,000 shares during the year ended October 30, 2006, have repeatedly failed to meet their obligations to file timely periodic reports, and are headquartered in the Western United States.

6. Each of the respondents either failed to cure their delinquencies after being sent delinquency letters by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a current address on file with the Commission as required by Commission rules, did not receive such letters.

7. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports (Forms 10-K or 10-KSB), and Rule 13a-13 requires issuers to file quarterly reports (Forms 10-Q or 10-QSB).

8. As a result of their failure to make required periodic filings, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II of this Order are true, and to afford the Respondents an opportunity to establish any defenses to such allegations; and

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months or to revoke the registrations of securities of the Respondents identified in Section II pursuant to Section 12(j) of the Exchange Act.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that each Respondent shall file an Answer to the allegations contained in this Order within ten (10) days after service of this

Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If a Respondent fails to file the directed Answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon each Respondent personally, by certified or express mail, or by any other means permitted by the Commission's Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Nancy M. Morris
Secretary

Attachment

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

Appendix 1

Chart of Delinquent Filings
In the Matter of Amanda Company, Inc., et al.

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Amanda Company, Inc.					
	10-QSB	03/31/03	5/15/03	Not filed	42
	10-QSB	06/30/03	8/14/03	Not filed	39
	10-KSB	09/30/03	12/29/03	Not filed	35
	10-QSB	12/31/03	2/17/04	Not filed	33
	10-QSB	03/31/04	5/17/04	Not filed	30
	10-QSB	06/30/04	8/16/04	Not filed	27
	10-KSB	09/30/04	12/29/04	Not filed	23
	10-QSB	12/31/04	2/14/05	Not filed	21
	10-QSB	03/31/05	5/16/05	Not filed	18
	10-QSB	06/30/05	8/15/05	Not filed	15
	10-KSB	09/30/05	12/29/05	Not filed	11
	10-QSB	12/31/05	2/14/06	Not filed	9
	10-QSB	03/31/06	5/15/06	Not filed	6
	10-QSB	06/30/06	08/14/06	Not filed	3
Total Filings Delinquent	14				
Com21, Inc.					
	10-Q	06/30/03	8/14/03	Not filed	39
	10-Q	09/30/03	11/14/03	Not filed	36
	10-K	12/31/03	3/30/04	Not filed	32
	10-Q	03/31/04	5/17/04	Not filed	30
	10-Q	06/30/04	8/16/04	Not filed	27
	10-Q	09/30/04	11/15/04	Not filed	24
	10-K	12/31/04	3/31/05	Not filed	20
	10-Q	03/31/05	5/16/05	Not filed	18
	10-Q	06/30/05	8/15/05	Not filed	15
	10-Q	09/30/05	11/14/05	Not filed	12
	10-K	12/31/05	3/31/06	Not filed	8
	10-Q	03/31/06	5/15/06	Not filed	6
	10-Q	06/30/06	08/14/06	Not filed	3
	10-Q	09/30/06	11/14/06	Not filed	0
Total Filings Delinquent	14				

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Eco Soil Systems, Inc.					
	10-Q	06/30/01	8/14/01	Not filed	63
	10-Q	09/30/01	11/14/01	Not filed	60
	10-K	12/31/01	4/1/02	Not filed	55
	10-Q	03/31/02	5/15/02	Not filed	54
	10-Q	06/30/02	8/14/02	Not filed	51
	10-Q	09/30/02	11/14/02	Not filed	48
	10-K	12/31/02	3/31/03	Not filed	44
	10-Q	03/31/03	5/15/03	Not filed	42
	10-Q	06/30/03	8/14/03	Not filed	39
	10-Q	09/30/03	11/14/03	Not filed	36
	10-K	12/31/03	3/30/04	Not filed	32
	10-Q	03/31/04	5/17/04	Not filed	30
	10-Q	06/30/04	8/16/04	Not filed	27
	10-Q	09/30/04	11/15/04	Not filed	24
	10-K	12/31/04	3/31/05	Not filed	20
	10-Q	03/31/05	5/16/05	Not filed	18
	10-Q	06/30/05	8/15/05	Not filed	15
	10-Q	09/30/05	11/14/05	Not filed	12
	10-K	12/31/05	3/31/06	Not filed	8
	10-Q	03/31/06	5/15/06	Not filed	6
	10-Q	06/30/06	08/14/06	Not filed	3
	10-Q	09/30/06	11/14/06	Not filed	0
Total Filings Delinquent	22				
Healthtrac, Inc.					
	10-K	02/29/04	5/31/04	Not filed	30
	10-Q	05/31/04	7/15/04	Not filed	28
	10-Q	08/31/04	10/15/04	Not filed	25
	10-Q	11/30/04	1/14/05	Not filed	22
	10-K	02/28/05	5/30/05	Not filed	18
	10-Q	05/31/05	7/15/05	Not filed	16
	10-Q	08/31/05	10/17/05	Not filed	13
	10-Q	11/30/05	1/17/06	Not filed	10
	10-K	02/28/06	5/30/06	Not filed	6
	10-Q	05/31/06	7/17/06	Not filed	4
	10-Q	08/31/06	10/15/06	Not filed	1
Total Filings Delinquent	11				

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 2570 / November 30, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12490

In the Matter of **KELSEY L. GARMAN,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Kelsey L. Garman ("Garman" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that

1. Garman controlled and directed the activities of four funds that pooled the money of unsophisticated individual investors. Garman was the general and managing partner of three funds, Koinonia 100/200, Koinonia Investment Club, II and the Koinonia Kingdom Club and Garman served as the sole nominee trader for another group of investors doing business as the Koinonia Income Account (collectively "The Koinonia Funds or Funds"). Garman represented to investors in the Koinonia Funds that those

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funds were earning substantial profits when in fact the Funds had generally sustained trading losses. Garman permitted investors to withdraw funds as though they had in fact made trading profits as previously represented to them by Garman. From 1994 to early 2004 Garman received at least $457,000 of fees from managing and trading the Koinonia Funds for investors and was an investment adviser to the Funds. Garman, age 71, is a resident of Springfield, Missouri.

2. On November 8, 2006, a final judgment was entered by consent against Garman, permanently enjoining him from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933 ("Securities Act"), Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, and Sections 206(1) and 206(2) of the Advisers Act, in the civil action entitled Securities and Exchange Commission v. Kelsey L. Garman et al., Civil Action Number 04-WM-0354 (BNB), in the United States District Court for the District of Colorado.

3. The Commission's complaint alleged that, in connection with the sale of interests in the Funds that Garman falsely claimed that the funds had been profitable, when in fact they had sustained trading losses in violation of the anti-fraud provisions of the federal securities laws. The complaint also alleged that Garman offered and sold unregistered securities.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Garman's Offer.

Accordingly, it is hereby ORDERED:

Pursuant to Section 203(f) of the Advisers Act, that Respondent Garman be, and hereby is barred from association with any investment adviser.

By the Commission.

Nancy M. Morris
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
November 30, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12491

In the Matter of **American International Petroleum Corp.,** **Metal Recovery Technologies, Inc.,** **Seven Seas Petroleum, Inc.,** **Touch America Holdings, Inc., and** **U. S. Plastic Lumber Corp.,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. American International Petroleum Corp. ("AIPN") [1] (CIK No. 799119) is a revoked Nevada corporation located in Houston, Texas with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). The company is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2002, which reported a net loss of $7,794,009 for the prior nine months. On October 7, 2004, AIPN filed for bankruptcy under Chapter 11 in the United States Bankruptcy Court for the Western District of Louisiana. On February 4, 2005, the trustee filed a reorganization plan with the bankruptcy court which proposed the termination of all of AIPN's equity securities, but the plan has not yet been confirmed. The bankruptcy proceeding was still

[1] The short form of each issuer's name is also its stock symbol.

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pending as of November 17, 2006. As of August 21, 2006, the company's common stock was quoted on the Pink Sheets, had twenty-one market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3). AIPN's common stock had an average daily trading volume of 339,788 shares during the six months ended November 16, 2006.

2. Metal Recovery Technologies, Inc. ("MXAL") (CIK No. 796117) is a void Delaware corporation located in East Chicago, Indiana with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). The company is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 1998, which reported a net loss of $592,614 for the prior nine months. On July 1, 1999, MXAL was the subject of an involuntary bankruptcy petition filed under Chapter 7, that was later converted to a Chapter 11 proceeding, in the United States Bankruptcy Court for the Northern District of Indiana. The bankruptcy proceeding was still pending as of November 17, 2006. As of August 21, 2006, the company's common stock was quoted on the Pink Sheets, had eight market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3). MXAL's common stock had an average daily trading volume of 30,138 shares during the six months ended November 16, 2006.

3. Seven Seas Petroleum, Inc. ("SVSSF") (CIK No. 947156) is a Cayman Islands corporation located in Houston, Texas with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). The company is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2002, which reported a net loss of $113,900,000 for the prior nine months. On December 20, 2002, an involuntary Chapter 7 bankruptcy proceeding was commenced against SVSSF, which was later converted to a Chapter 11 proceeding, in the United States Bankruptcy Court for the Southern District of Texas. The bankruptcy proceeding was still pending as of November 17, 2006. As of August 21, 2006, the company's common stock was quoted on the Pink Sheets, had nine market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3). SVSSF's common stock had an average daily trading volume of 17,284 shares during the six months ended November 16, 2006.

4. Touch America Holdings, Inc. ("TCAHQ") (CIK No. 1144835) is a dissolved Delaware corporation located in Butte, Montana with both common and preferred stock registered with the Commission pursuant to Exchange Act Section 12(g). The company is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2002, which reported a net loss of $62,336,000 for the prior nine months. On June 19, 2003, TCAHQ filed for bankruptcy under Chapter 11 in the United States Bankruptcy Court for the District of Delaware. On October 6, 2004, the bankruptcy court ordered the termination of the common stock of TCAHQ. The bankruptcy proceeding was pending as of November 17, 2006. As of August 21, 2006, the company's common stock was quoted on the Pink Sheets, had thirteen market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3). TCAHQ's common stock had an average daily trading volume of 88,442 shares during the six months ended

November 16, 2006. TCAHQ's preferred stock is traded on the over-the-counter markets (symbol "TAAPP").

5. U.S. Plastic Lumber Corp. ("USPL") (CIK No. 1014851) is a revoked Nevada corporation located in Chicago, Illinois with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). The company is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2003, which reported a net loss of $4,443,000 for the prior nine months. On July 23, 2004, USPL filed for bankruptcy under Chapter 11 in the United States Bankruptcy Court for the Southern District of Florida. On January 13, 2006, the bankruptcy court authorized the sale of substantially all of the assets of the company. The bankruptcy proceeding was still pending as of November 17, 2006. As of August 21, 2006, the company's common stock was quoted on the Pink Sheets, had seventeen market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3). USPL's common stock had an average daily trading volume of 33,967 shares during the six months ended November 16, 2006.

B. <u>DELINQUENT PERIODIC FILINGS</u>

6. All of the Respondents are delinquent in their periodic filings with the Commission (*see* Chart of Delinquent Filings, attached hereto as Appendix 1), were quoted on the Pink Sheets as of August 21, 2006, had average daily trading volumes in excess of 17,000 shares during the six months ended November 16, 2006, have repeatedly failed to meet their obligations to file timely periodic reports, and are headquartered in the Central United States.

7. Each of the respondents either failed to cure their delinquencies after being sent delinquency letters by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a current address on file with the Commission as required by Commission rules, did not receive such letters.

8. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports (Forms 10-K or 10-KSB), and Rule 13a-13 requires issuers to file quarterly reports (Forms 10-Q or 10-QSB).

9. As a result of their failure to make required periodic filings, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II of this Order are true, and to afford the Respondents an opportunity to establish any defenses to such allegations; and

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months or to revoke the registrations of securities of the Respondents identified in Section II pursuant to Section 12(j) of the Exchange Act.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that each Respondent shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If a Respondent fails to file the directed Answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon each Respondent personally, by certified or express mail, or by any other means permitted by the Commission's Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Nancy M. Morris
Secretary

Attachment

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

<u>**Appendix 1**</u>

Chart of Delinquent Filings
In the Matter of American International Petroleum Corp., et al

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
American International Petroleum Corp.					
	10-K	12/31/02	3/31/03	Not filed	44
	10-Q	03/31/03	5/15/03	Not filed	42
	10-Q	06/30/03	8/14/03	Not filed	39
	10-Q	09/30/03	11/14/03	Not filed	36
	10-K	12/31/03	3/30/04	Not filed	32
	10-Q	03/31/04	5/17/04	Not filed	30
	10-Q	06/30/04	8/16/04	Not filed	27
	10-Q	09/30/04	11/15/04	Not filed	24
	10-K	12/31/04	3/31/05	Not filed	20
	10-Q	03/31/05	5/16/05	Not filed	18
	10-Q	06/30/05	8/15/05	Not filed	15
	10-Q	09/30/05	11/14/05	Not filed	12
	10-K	12/31/05	3/31/06	Not filed	8
	10-Q	03/31/06	5/15/06	Not filed	6
	10-Q	06/30/06	08/14/06	Not filed	3
	10-Q	09/30/06	11/14/06	Not filed	0
Total Filings Delinquent	16				
Metal Recovery Technologies, Inc.					
	10-K	12/31/98	3/31/99	Not filed	92
	10-Q	03/31/99	5/17/99	Not filed	90
	10-Q	06/30/99	8/16/99	Not filed	87
	10-Q	09/30/99	11/15/99	Not filed	84
	10-K	12/31/99	3/30/00	Not filed	80
	10-Q	03/31/00	5/15/00	Not filed	78
	10-Q	06/30/00	8/14/00	Not filed	75
	10-Q	09/30/00	11/14/00	Not filed	72
	10-K	12/31/00	4/2/01	Not filed	67
	10-Q	03/31/01	5/15/01	Not filed	66
	10-Q	06/30/01	8/14/01	Not filed	63
	10-Q	09/30/01	11/14/01	Not filed	60
	10-K	12/31/01	4/1/02	Not filed	55
	10-Q	03/31/02	5/15/02	Not filed	54
	10-Q	06/30/02	8/14/02	Not filed	51
	10-Q	09/30/02	11/14/02	Not filed	48
	10-K	12/31/02	3/31/03	Not filed	44
	10-Q	03/31/03	5/15/03	Not filed	42
	10-Q	06/30/03	8/14/03	Not filed	39
	10-Q	09/30/03	11/14/03	Not filed	36
	10-K	12/31/03	3/30/04	Not filed	32

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Metal Recovery Technologies, Inc. (continued)	*10-Q*	03/31/04	5/17/04	Not filed	30
	10-Q	06/30/04	8/16/04	Not filed	27
	10-Q	09/30/04	11/15/04	Not filed	24
	10-K	12/31/04	3/31/05	Not filed	20
	10-Q	03/31/05	5/16/05	Not filed	18
	10-Q	06/30/05	8/15/05	Not filed	15
	10-Q	09/30/05	11/14/05	Not filed	12
	10-K	12/31/05	3/31/06	Not filed	8
	10-Q	03/31/06	5/15/06	Not filed	6
	10-Q	06/30/06	08/14/06	Not filed	3
	10-Q	09/30/06	11/14/06	Not filed	0
Total Filings Delinquent	32				
Seven Seas Petroleum, Inc.					
	10-K	12/31/02	3/31/03	Not filed	44
	10-Q	03/31/03	5/15/03	Not filed	42
	10-Q	06/30/03	8/14/03	Not filed	39
	10-Q	09/30/03	11/14/03	Not filed	36
	10-K	12/31/03	3/30/04	Not filed	32
	10-Q	03/31/04	5/17/04	Not filed	30
	10-Q	06/30/04	8/16/04	Not filed	27
	10-Q	09/30/04	11/15/04	Not filed	24
	10-K	12/31/04	3/31/05	Not filed	20
	10-Q	03/31/05	5/16/05	Not filed	18
	10-Q	06/30/05	8/15/05	Not filed	15
	10-Q	09/30/05	11/14/05	Not filed	12
	10-K	12/31/05	3/31/06	Not filed	8
	10-Q	03/31/06	5/15/06	Not filed	6
	10-Q	06/30/06	08/14/06	Not filed	3
	10-Q	09/30/06	11/14/06	Not filed	0
Total Filings Delinquent	16				
Touch America Holdings, Inc.					
	10-Q	12/31/02	2/14/03	Not filed	45
	10-Q	03/31/03	5/15/03	Not filed	42
	10-K	06/30/03	9/29/03	Not filed	38
	10-Q	09/30/03	11/14/03	Not filed	36
	10-K	12/31/03	3/30/04	Not filed	32
	10-Q	03/31/04	5/17/04	Not filed	30
	10-Q	06/30/04	8/16/04	Not filed	27
	10-Q	09/30/04	11/15/04	Not filed	24
	10-K	12/31/04	3/31/05	Not filed	20

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Touch America Holdings, Inc. (continued)					
	10-Q	03/31/05	5/16/05	Not filed	18
	10-Q	06/30/05	8/15/05	Not filed	15
	10-Q	09/30/05	11/14/05	Not filed	12
	10-K	12/31/05	3/31/06	Not filed	8
	10-Q	03/31/06	5/15/06	Not filed	6
	10-Q	06/30/06	08/14/06	Not filed	3
	10-Q	09/30/06	11/14/06	Not filed	0
Total Filings Delinquent	16				
U.S. Plastic Lumber, Inc.					
	10-K	12/31/03	3/30/04	Not filed	32
	10-Q	03/31/04	5/17/04	Not filed	30
	10-Q	06/30/04	8/16/04	Not filed	27
	10-Q	09/30/04	11/15/04	Not filed	24
	10-K	12/31/04	3/31/05	Not filed	20
	10-Q	03/31/05	5/16/05	Not filed	18
	10-Q	06/30/05	8/15/05	Not filed	15
	10-Q	09/30/05	11/14/05	Not filed	12
	10-K	12/31/05	3/31/06	Not filed	8
	10-Q	03/31/06	5/15/06	Not filed	6
	10-Q	06/30/06	08/14/06	Not filed	3
	10-Q	09/30/06	11/14/06	Not filed	0
Total Filings Delinquent	12				

SECURITIES AND EXCHANGE COMMISSION

This file is maintained pursuant to the Freedom of Information Act (5 U.S.C. 552). It contains a copy of each decision, order, rule or similar action of the Commission, for November 2006, with respect to which the final votes of individual Members of the Commission are required to be made available for public inspection pursuant to the provisions of that Act.

Unless otherwise noted, each of the following individual Members of the Commission voted affirmatively upon each action of the Commission shown in the file:

CHRISTOPHER COX, CHAIRMAN

PAUL S. ATKINS, COMMISSIONER

ROEL C. CAMPOS, COMMISSIONER

ANNETTE NAZARETH, COMMISSIONER

KATHLEEN L. CASEY, COMMISSIONER

33 Documents

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

October 24, 2006

IN THE MATTER OF CONVERSION SOLUTIONS HOLDINGS CORP. File No. 500-1	: : : : : :	ORDER OF SUSPENSION OF TRADING

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Conversion Solutions Holding Corp. ("Conversion"), a Delaware Corporation located in Kennesaw, Georgia, which trades in the over-the-counter market under the symbol "CSHD".

Questions have arisen regarding the accuracy and completeness of information contained in Conversion's press releases and public filings with the Commission concerning, among other things, (1) the company's purported ownership and control of two bond issuances, in the face amount of €5 billion and $500 million, issued by the Republic of Venezuela, and (2) the company's purported contractual relationship with Deutsche Bank.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed company.

Therefore, IT IS ORDERED, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the above-listed company is suspended for the period from 9:30 a.m. EDT, October 24, 2006, through 11:59 p.m. EST, on November 6, 2006.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Document 1 of 33

SECURITIES AND EXCHANGE COMMISSION

17 CFR PARTS 200 and 240

[RELEASE NOS. 34-54684; IC-27542; File No. S7-11-05]

RIN 3235-AJ50

AMENDMENTS TO THE TENDER OFFER BEST-PRICE RULES

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: We are adopting amendments to the language of the third-party and issuer tender offer best-price rules to clarify that the provisions apply only with respect to the consideration offered and paid for securities tendered in a tender offer. We also are amending the third-party and issuer tender offer best-price rules to provide that any consideration that is offered and paid according to employment compensation, severance or other employee benefit arrangements entered into with security holders of the subject company that meet certain requirements will not be prohibited by the rules. Finally, we are amending the third-party and issuer tender offer best-price rules to provide a safe harbor provision so that arrangements that are approved by certain independent directors of either the subject company's or the bidder's board of directors, as applicable, will not be prohibited by the rules. These amendments are intended to make it clear that the best-price rule was not intended to capture employment compensation, severance or other employee benefit arrangements. We are also making a technical amendment to correct a cross-reference in the rules that govern the ability to delegate authority for purposes of granting exemptions under the best-price rule.

Document 2 of 33

EFFECTIVE DATE: [Insert date 30 days after Federal Register Publication].

FOR FURTHER INFORMATION CONTACT: Brian V. Breheny, Chief, or Mara L. Ransom, Special Counsel, Office of Mergers and Acquisitions, Division of Corporation Finance, at (202) 551-3440.

SUPPLEMENTARY INFORMATION: We are adopting amendments to Rule 13e-4[1] and Rule 14d-10[2] under the Securities Exchange Act of 1934[3] and making certain technical changes to a delegated authority rule that is affected by the amendments to the best-price rule.[4]

I. BACKGROUND

A. Introduction and summary

On December 16, 2005, we proposed changes to the issuer and third-party tender offer best-price rules[5] to make it clear that the best-price rule generally was not intended to apply to compensatory arrangements.[6] We believed that these amendments were necessary to alleviate the uncertainty that the various interpretations of the best-price rule by courts have produced. We also intended that the amendments would reduce a

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1 17 CFR 240.13e-4.

2 17 CFR 240.14d-10.

3 15 U.S.C. 78a et seq.

4 17 CFR 200.30-1.

5 For purposes of this release, unless otherwise indicated, our references to the "tender offer best-price rule" or the "best-price rule" are intended to refer to both Exchange Act Rule 13e-4(f)(8)(ii) (17 CFR 240.13e-4(f)(8)(ii)) and Exchange Act Rule 14d-10(a)(2) (17 CFR 240.14d-10(a)(2)).

6 Amendments to the Tender Offer Best-Price Rule, Release No. 34-52968 (Dec. 22, 2005) [70 FR 76116] (the "Proposing Release").

regulatory disincentive to structuring an acquisition of securities as a tender offer, as compared to a statutory merger, to which the best-price rule does not apply.[7] We received 11 comment letters on the proposed amendments.[8] In general, commenters supported our proposed changes to the tender offer best-price rule and believed that the proposed changes, if adopted, would meet our objectives. We did, however, receive a number of comments with regard to specific aspects of the proposed changes. The changes we adopt today are, in most respects, consistent with those proposed on December 16, 2005, but include certain revisions made in response to concerns raised by commenters.

The amendments to the best-price rule will change the language of the rule to clarify that the provisions of the rule apply only with respect to the consideration offered and paid for securities tendered in a tender offer. The amendments are premised on our view that the best-price rule was never intended to apply to consideration paid pursuant to arrangements, including employment compensation, severance or other employee benefit arrangements, entered into with security holders of the subject company, so long as the consideration paid pursuant to such arrangements was not to acquire their securities.[9] Accordingly, the amendments provide that consideration offered and paid according to employment compensation, severance or other employee benefit arrangements entered into with security holders of the subject company of a tender offer, where the

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7 Statutory mergers are also known as "long-form" or unitary mergers, the requirements of which are governed generally by applicable state law.

8 The public comments we received are available for inspection in our Public Reference Room at 100 F Street, NE, Washington DC, 20549 in File No. S7-11-05, or may be viewed at http://www.sec.gov/rules/proposed/s71105.shtml.

9 See the definition of "subject company" at Exchange Act Rule 14d-1(g)(7) (17 CFR 240.14d-1(g)(7)).

arrangements meet certain requirements, are not prohibited by the best-price rule.

The amendments also provide for a non-exclusive safe harbor, which states that arrangements, and any consideration offered and paid according to such arrangements, that are approved by either a compensation committee of the subject company's board of directors or a committee performing similar functions, regardless of whether the subject company is a party to the arrangement, are not prohibited by the best-price rules. Alternatively, if the bidder is a party to the arrangement, the arrangement may be approved by either a compensation committee or a committee performing similar functions of the bidder's board of directors.[10] In order to satisfy the safe harbor, we have provided certain alternatives for bidders or subject companies, as applicable, that do not have a compensation committee or that are foreign private issuers.[11]

The principal changes from the proposals, as discussed in detail below, are:

- For purposes of the exemption and the safe harbor, the persons who may enter into an employment compensation, severance or other employee benefit arrangement have been expanded to include all security holders of the subject company, as opposed to only employees and directors of the subject company;
- The requirements of the exemption have been modified;
- The approval of the directors of the subject company will satisfy the safe harbor requirements, regardless of whether the subject company is a party

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10 See the definition of "bidder" at Exchange Act Rule 14d-1(g)(2) (17 CFR 240.14d-1(g)(2)).

11 See the definition of "foreign private issuer" at Rule 405 of the Securities Act of 1933 (17 CFR 230.405).

to the arrangement;

- A special committee of the board of directors of the subject company or the bidder, as applicable, comprised solely of independent members and formed to consider and approve the arrangement may approve the arrangement and satisfy the safe harbor requirements if the subject company's or bidder's board of directors, as applicable, does not have a compensation committee or a committee of the board of directors that performs functions similar to a compensation committee or if none of the members of those committees is independent;
- The approving directors do not need to determine that the arrangements meet the additional requirements of the compensation arrangement exemption to qualify for the safe harbor;
- The safe harbor provides certain accommodations for foreign private issuers;
- A new instruction provides that a determination by the board of directors that the board members approving an arrangement are independent in accordance with the provisions of the safe harbor will satisfy the independence requirements of the safe harbor; and
- The exemption and safe harbor are included as part of the issuer, as well as third-party, best-price rule.

B. History of the best-price rule and the reasons for today's amendments

Section 14(d)(7) of the Exchange Act[12] requires equal treatment of security holders.[13] Based on the objectives of the Williams Act[14] and the protections afforded by Section 14(d)(7), the Commission adopted Rules 13e-4(f)(8) and 14d-10 in 1986.[15] These rules codified the positions that both an issuer tender offer and a third-party tender offer must be open to all holders of the class of securities subject to the tender offer (commonly referred to as the "all-holders rule") and that all security holders must be paid the highest consideration paid to any security holder (commonly referred to as the "best-price rule").[16] The rules provided that no one may "make a tender offer unless: (1) [t]he tender offer is open to all security holders of the class of securities subject to the tender offer; and (2) [t]he consideration paid to any security holder pursuant to the tender offer is the highest consideration paid to any other security holder during such tender offer."[17]

Since the adoption of these rules, the best-price rule has been the basis for

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12 15 U.S.C. 78n(d)(7).

13 The statute and rules governing third-party tender offers apply to tender offers for more than 5 per cent of any class of any equity security registered pursuant to Section 12 of the Exchange Act, or any equity security of an insurance company that would have been required to be registered but for the exemption contained in Section 12(g)(2)(G) of the Exchange Act, or any equity security issued by a closed-end investment company registered under the Investment Company Act of 1940. See Section 14(d)(1) of the Exchange Act.

14 Pub. L. No. 90-439, 82 Stat. 454 (1968).

15 See Amendments to Tender Offer Rules: All-Holders and Best-Price, Release No. 34-23421 (July 17, 1986) [51 FR 25873].

16 Id.

17 Exchange Act Rules 13e-4(f)(8) (17 CFR 240.13e-4(f)(8)) and 14d-10(a) (17 CFR 240.14d-10(a)).

litigation brought in connection with tender offers in which it is claimed that the rule was violated as a result of the bidder entering into new agreements or arrangements, or adopting the subject company's pre-existing agreements or arrangements, with security holders of the subject company.[18] When ruling on these best-price rule claims, courts generally have employed either an "integral-part test" or a "bright-line test" to determine whether the arrangement violates the best-price rule.

The integral-part test states that the best-price rule applies to all integral elements of a tender offer, including employment compensation, severance and other employee benefit arrangements or commercial arrangements that are deemed to be part of the tender offer, regardless of whether the arrangements are executed and performed outside of the time that the tender offer formally commences and expires.[19] Courts following the integral-part test have ruled that agreements or arrangements made with security holders that constituted an "integral part" of the tender offer violate the best-price rule.[20]

The bright-line test, on the other hand, states that the best-price rule applies only

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18 See, e.g., Epstein v. MCA, Inc., 50 F.3d 644 (9th Cir. 1995), rev'd on other grounds sub nom.; Matsushita Elec. Indus. Co. v. Epstein, 516 U.S. 367 (1996); Lerro v. Quaker Oats Co., 84 F.3d 239 (7th Cir. 1996); Walker v. Shield Acquisition Corp., 145 F. Supp.2d 1360 (N.D. Ga. 2001).

19 See Epstein, 50 F.3d 644; Perera v. Chiron Corp., 1996 U.S. Dist. LEXIS 22503 (N.D. Cal. 1996); Padilla v. MedPartners, Inc., 1998 U.S. Dist. LEXIS 22839 (C.D. Cal. 1998); Millionerrors Inv. Club v. General Elec. Co., 2000 U.S. Dist. LEXIS 4778 (W.D. Pa. 2000); Maxick v. Cadence Design Sys., Inc., 2000 U.S. Dist. LEXIS 14099 (N.D. Cal. 2000); McMichael v. United States Filter Corp., 2001 U.S. Dist. LEXIS 3918 (C.D. Cal. 2001); Karlin v. Alcatel, S.A., 2001 U.S. Dist. LEXIS 12349 (C.D. Cal. 2001); Harris v. Intel Corp., 2002 U.S. Dist. LEXIS 13796 (N.D. Cal. 2002); Cummings v. Koninklijke Philips Elec., N.V., 2002 U.S. Dist. LEXIS 23383 (N.D. Cal. 2002); In re: Luxottica Group S.p.A., 293 F. Supp.2d 224 (E.D. N.Y. 2003).

20 Id.

to arrangements executed and performed between the time a tender offer formally commences[21] and expires.[22] Jurisdictions following the bright-line test have held that agreements or arrangements with security holders of the subject company do not violate the best-price rule if they are not executed and performed "during the tender offer."[23]

These differing interpretations of the best-price rule have made using a tender offer acquisition structure unattractive because of the potential liability of bidders for claims alleging that compensation payments violate the best-price rule.[24] This potential liability is heightened by the possibility that claimants can choose to bring a claim in a jurisdiction that recognizes an interpretation of the best-price rule that suits the claimant's case. These differing interpretations do not best serve the interests of security holders and have resulted in a regulatory disincentive to structuring an acquisition of securities as

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21 See Exchange Act Rule 13e-4(a)(4) (17 CFR 240.13e-4(a)(4)) and Exchange Act Rule 14d-2 (17 CFR 240.14d-2) (relating to procedures for formal commencement of tender offers).

22 See Lerro, 84 F.3d 239; Gerber v. Computer Assoc. Int'l, Inc., 303 F.3d 126 (2d Cir. 2002); In re: Digital Island Securities Litig., 357 F.3d 322 (3d Cir. 2004); Walker v. Shield Acquisition Corp., 145 F. Supp.2d 1360 (N.D. Ga. 2001); Susquehanna Capital Group v. Rite Aid Corp., 2002 U.S. Dist. LEXIS 18290 (E.D. Pa. 2002); Katt v. Titan Acquisitions, Inc., 244 F. Supp.2d 841 (M.D. Tenn. 2003).

23 Id.

24 Commenters cited the judicial interpretations as one reason for the decline in the use of tender offers and some indicated that they do not recommend the use of tender offers if other acquisition structures are available. See, e.g., the letters from the American Bar Association, Business Law Section, Committee on Federal Regulation of Securities ("ABA"); Cravath, Swaine & Moore LLP, Davis Polk & Wardwell, Latham & Watkins LLP, Simpson Thacher & Bartlett LLP, Skadden, Arps, Slate, Meagher & Flom LLP, Sullivan & Cromwell LLP, and Wachtell, Lipton, Rosen & Katz ("Law Firm Group"); and Association of the Bar of the City of New York, Special Committee on Mergers, Acquisitions and Corporate Control Contests ("NYCBA").

a tender offer, as compared to a statutory merger, to which the best-price rule does not apply. We believe that the interests of security holders are better served when all acquisition structures are viable options.[25] We intend for the amendments we are adopting today to alleviate this regulatory disincentive.

C. Overview of the proposed amendments

As we discussed in the Proposing Release, we do not believe that the best-price rule should be subject to a strict temporal test because such a test lends itself to abuse. However, we also do not believe that all payments that are conditioned on or otherwise somehow related to a tender offer, including payments under compensatory or commercial arrangements that are made to persons who happen to be security holders, whether made before, during or after the tender offer period, should be subject to the best-price rule. Accordingly, we proposed amendments to the best-price rule that did not follow the approach of either the integral-part or the bright-line test. Instead, we proposed to change the language of the best-price rule so that only consideration paid to security holders for securities tendered into a tender offer will be evaluated when determining the highest consideration paid to any other security holder for securities tendered into the tender offer.

Our proposed amendments to the third-party tender offer best-price rule also acknowledged that critical personnel decisions often are required to be made concurrently with decisions regarding whether to pursue a transaction with the subject company in a

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25 As we indicated in the Proposing Release, at the time we adopted Regulation M-A (17 CFR 229.1000-229.1016) we stated that "[o]ur goals in proposing and adopting these changes are to…harmonize inconsistent disclosure requirements and alleviate unnecessary burdens associated with the compliance process…").

tender offer. We believed, and continue to believe, that these decisions generally are made independently from the consideration paid for securities tendered in the tender offer. We therefore proposed a specific exemption from the third-party tender offer best-price rule for consideration offered and paid according to employment compensation, severance or other employee benefit arrangements entered into with employees and directors of the subject company of a tender offer where the amounts payable under the arrangements meet certain requirements. We also proposed a safe harbor to the exemption from the third-party tender offer best-price rule for consideration offered and paid according to certain employment compensation, severance or other employee benefit arrangements that were approved by either the compensation committee or a committee performing similar functions as the compensation committee of the board of directors of either the subject company or bidder, depending on which entity was a party to the arrangement.

II. AMENDMENTS TO THE BEST-PRICE RULE

A. Amendments to the basic standard in Exchange Act Rules 13e-4(f)(8)(ii) and 14d-10(a)(2)

1. Discussion

We proposed amendments to the issuer and third-party best-price rule to address the uncertainty that the various court interpretations have produced while ensuring that the intent of the best-price rule – equal treatment of security holders – is satisfied. The amendments revise the best-price rule to state that no one may make a tender offer unless "[t]he consideration paid to any security holder for securities tendered in the tender offer is the highest consideration paid to any other security holder for securities tendered in the tender offer." The clause "for securities tendered in the tender offer" would replace the clauses "pursuant to the tender offer" and "during such tender offer," as the rule previously read, to clarify the intent of the best-price rule. Today, we adopt these changes as proposed.

2. Comments regarding the proposed amendments to the basic standard in Exchange Act Rules 13e-4(f)(8)(ii) and 14d-10(a)(2)

Although commenters generally favored the proposals, certain commenters expressed some concerns regarding the proposed amendments.[26] These commenters were of the view that the proposed changes likely would alter the bright-line precedent that has been established by courts. Specifically, one commenter indicated that the removal of the phrase "during the tender offer" would be used to argue that payments made at any time are for "securities tendered in" the tender offer, which would expand the application and, therefore, the potential claims that could be made under the best-price rule.[27] We believe that the amendments we are adopting today, as discussed in more detail below, will provide sufficient certainty in assuring that payments made with respect to compensatory arrangements will not be captured by the best-price rule such that any temporal certainty that may previously have been present under the "bright-line test" will no longer be necessary. As stated above, we also do not believe that the best-price rule should be subject to a strict temporal test, which could provide opportunities for evasion of the rule.

As we articulated in the Proposing Release, the flexible concept of a tender offer is consistent with the purpose of the best-price rule, in that it prevents bidders from impermissibly circumventing the rule by limiting the application of the rule to stated

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26 See, e.g., letters from ABA; Dechert LLP ("Dechert"); and Law Firm Group.

27 Letter from Law Firm Group.

dates.[28] The best-price rule was not intended to apply to all payments made to persons who happen to be security holders of a subject company, whether made before, during or after the formal tender offer period. Further, the amendments that we are adopting today will remove the potentially expansive concept of consideration paid "pursuant to" the tender offer in order to focus the analysis as to whether the consideration to which the best-price rule would apply was paid "for securities tendered in" the tender offer.

In response to questions that we posed about whether employees and directors who enter into arrangements with the bidder or subject company and do not tender their securities into a tender offer will avoid the strictures of the best-price rule as proposed, commenters generally agreed that no violation of the best-price rule should occur under these circumstances.[29] Commenters believed that this outcome was appropriate. We agree, because the best-price rule would not be applicable in these instances.

B. Exemption for consideration offered and paid pursuant to compensatory arrangements

1. Discussion

We are adopting an amendment to the issuer and third-party best-price rules so that consideration offered and paid pursuant to employment compensation, severance or other employee benefit arrangements that are entered into with security holders of the subject company and that meet certain substantive requirements are not prohibited by the

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28 See note 21 above.

29 See, e.g., letters from ABA; Jason A. Gonzalez ("Gonzalez"); and Law Firm Group.

best-price rules.[30] We believe that amounts paid pursuant to arrangements meeting the requirements of this provision should not be considered when calculating the price paid for tendered securities.

We have revised the proposed exemption for compensatory arrangements that meet specified substantive requirements to address a number of the comments received. We have expanded the persons who may enter into an employment compensation, severance or other employee benefit arrangement to include all security holders of the subject company, as opposed to only employees and directors of the subject company. We are also extending this exemption to issuer tender offers.[31] Finally, we have modified the requirements of the exemption so that the amounts to be paid pursuant to an arrangement will have to be "paid or granted as compensation for past services performed, future services to be performed, or future services to be refrained from performing, by the security holder (and matters incidental thereto)" and may "not [be] calculated based on the number of securities tendered or to be tendered in the tender offer

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30 The exemption and safe harbor were proposed as amendments to Rule 14d-10(c) of the third-party tender offer rules. The exemption and the safe harbor are adopted as new Rules 14d-10(d)(1) and 14d-10(d)(2), respectively, and Rules 13e-4(f)(12)(i) and 13e-4(f)(12)(ii), respectively. Because we are inserting the exemption and safe harbor into an existing subparagraph (and redesignating old subparagraph (d) as (e), etc.), we are also making a technical change to reflect this redesignation in the rules that govern the ability to delegate authority for purposes of granting exemptions under the best-price rule.

31 The term "issuer tender offer," as defined in Rule 13e-4(a)(2) (17 CFR 240.13e-4(a)(2)), refers to a tender offer for, or a request or invitation for tenders of, any class of equity security, made by the issuer or an affiliate of such issuer of the class of such equity security. For purposes of this release, all references to "subject company," as defined for purposes of the third-party tender offer rules are intended to refer to "issuer," for purposes of the issuer tender offer rules. Similarly, all references to "bidder," as defined for purposes of the third-party tender offer rules are intended to refer to an "issuer" and "affiliate," for purposes of the issuer tender offer rules.

by the security holder."

2. Comments regarding the compensatory arrangement exemption

a. Parties to the arrangement

As proposed, the exemption would have applied to employment compensation, severance or other employee benefit arrangements entered into with employees or directors of the subject company. We solicited comment regarding whether the exemption should be restricted to such persons. Commenters believed that the exemption should be expanded and suggested expansion of the exemption to encompass consultants,[32] independent contractors,[33] employees or directors of the bidder,[34] and/or any security holder of the subject company.[35] Commenters were of the view that it would be appropriate to expand the class of persons because arrangements entered into with the expanded class of persons are, like those entered into with employees and directors, intended to cover compensation for past services or incentives for future services and not tied to the number of shares to be tendered.[36] We agree and have expanded the exemption to apply to any security holder of the subject company. While, as a practical matter, the challenges to the best-price rule to date have focused primarily on

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32 See, e.g., letters from Law Firm Group and Shearman & Sterling LLP ("Shearman").

33 Letter from New York State Bar Association, Business Law Section, Committee on Securities Regulation ("NYSBA").

34 See, e.g., letters from Gonzalez and Society of Corporate Secretaries & Governance Professionals, Securities Law Committee ("SCSGP").

35 See, e.g., letters from ABA and Dechert.

36 See, e.g., letter from SCSGP.

employment compensation, severance and other employee benefit arrangements with employees or directors of the subject company, we believe that the role of the person who is a party to the arrangement is irrelevant.

b. Types of arrangements covered by the exemption

In the Proposing Release, we asked whether we should expand the exemption to include commercial arrangements, in addition to employment compensation, severance or other employee benefit arrangements. Several commenters favored extending the exemption to commercial arrangements.[37] In doing so, commenters generally argued that it is not uncommon for security holders of the subject company of a tender offer to enter into commercial arrangements with the bidder and, absent a specific exemption, such arrangements could be (and have been) challenged under the best-price rule.[38] Other commenters suggested that providing an express exemption for employment compensation, severance or other employee benefit arrangements but not providing a similar exemption for commercial arrangements may undermine our objectives in adopting these amendments.[39]

We do not believe that it is appropriate to provide a separate exemption for commercial arrangements. As is reflected in an instruction to the exemption, which is adopted as proposed,[40] the fact that the exemption extends to employment compensation,

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37 See, e.g., letters from ABA; Dechert; Intel Corporation ("Intel"); NYCBA; NYSBA; SCSGP; and Securities Industry Association, Capital Markets Committee ("SIA").

38 See, e.g., letters from Dechert, Intel and NYCBA.

39 See, e.g., letter from NYSBA.

40 As noted in Section II.C.2.d., the instruction now applies to both the exemption and the safe harbor.

severance or other employee benefit arrangements does not mean that an arrangement of any other nature, including a commercial arrangement, with a security holder should be treated as consideration paid for securities tendered in a tender offer. This instruction should alleviate the concerns raised by commenters about whether the perceived exclusivity of the exemption will create an unintended inference.[41] Also, because of the wide variety of potential commercial arrangements that could be negotiated at the time of a tender offer we are presently unable to craft a specific exemption for commercial arrangements – unlike the language of the compensation arrangement exemption – that could be tailored to be functional while assuring security holders of the intended benefits of the best-price rule.

In the Proposing Release, we also asked whether we should consider adopting a de minimis exception to the best-price rule whereby holders of a certain percentage of securities of the subject company would be exempt from the application of the best-price rule. Some commenters were in favor of a de minimis exception, although the commenters had differing views as to the percentage to be applied to the exception, to whom the exception would apply and what types of arrangements should be available under the exception.[42] We determined that it would not be appropriate to implement a de minimis exception because it could undermine the protections of the best-price rule.

In the Proposing Release, we also asked whether the proposed exemption should provide a definition or provide examples of what we mean when we refer to

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41 Further, the best-price rule does not apply if a security holder refrains from tendering into a tender offer. See Section II.A.2. above.

42 Letters from ABA; Law Firm Group; NYCBA; NYSBA; SCSGP; and SIA.

"employment compensation, severance or other employee benefit arrangements." Commenters were mixed in their preference as to whether or not defining the phrase or offering examples would be helpful, although most did not believe it would be necessary.[43] Some commenters expressed the view that if the phrase was defined and an employment compensation, severance or other employee benefit arrangement did not fall squarely within the definition or list of examples, potential bidders might opt to use a transaction structure other than a tender offer.[44] Others stated that the phrase "employment compensation, severance or other employee benefit arrangement" uses terms that are generally understood and an attempt to define the phrase or provide examples would raise questions of interpretation.[45] We agree and generally believe that providing a definition or a list of examples is not necessary and would invite confusion.

c. Additional requirements of the exemption

We proposed that, for purposes of satisfying the exemption, the amounts to be paid pursuant to an arrangement would have to relate "solely to past services performed or future services to be performed or refrained from performing, by the employee or director (and matters incidental thereto)" and could "not [be] based on the number of securities the employee or director owns or tenders." As we explained in the Proposing Release, we included these requirements so that the amounts paid pursuant to employment compensation, severance or other employee benefit arrangements were

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43 See, e.g., letters from ABA; Intel; Law Firm Group; and SCSGP.

44 See, e.g., letter from Intel.

45 See, e.g., letters from ABA and SCSGP.

based on legitimate compensatory reasons.[46] We also believed that it was not appropriate to permit the exemption of any payments to be made that were proportional to or otherwise based on the number of securities held by the security holder because such a relationship between the payment and the securities tendered presented the type of situation the best-price rule was adopted to guard against.

Most of the commenters believed that excluding employment compensation, severance or other employee benefit arrangements from the application of the best-price rule would provide certainty and address the issues raised by the current legal precedent.[47] A number of commenters suggested, however, that we remove the requirements of the exemption.[48] These commenters generally were concerned that the courts would scrutinize whether the requirements were satisfied, resulting in the substitution of one set of disputed facts for another.[49] Commenters also were concerned that it might be difficult to determine whether or not the requirements have been met, given that it would require the ability to discern the intent of the parties at the time the arrangement was made.[50] At least one commenter also expressed the concern that the requirements might unnecessarily circumscribe the availability of the exemption.[51]

We have considered these comments and determined to retain the requirements

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46 Proposing Release at Section II.B.1.

47 See, e.g., letters from Dechert; Law Firm Group; and NYCBA.

48 See, e.g., letters from ABA; Dechert; Law Firm Group; NYCBA; and SIA.

49 See, e.g., letters from ABA; Dechert; Law Firm Group; and SIA.

50 See, e.g., letter from Dechert.

51 See, e.g., letter from Shearman.

with certain modifications. While we recognize that it may be difficult to determine in all instances whether or not the requirements have been satisfied, we believe making the exemption available without the requirements might subject the exemption to abuse. These requirements are designed to prevent the compensation being paid or granted under an arrangement from being for securities tendered in the tender offer.[52]

i. Requirement that the amount payable under the compensatory arrangement is being paid or granted as compensation

With respect to the first requirement, some commenters asked that we remove the reference to "solely" in order to avoid language that might unnecessarily circumscribe the availability of the exemption.[53] We agree and have substituted the first clause that read "relate solely to" with "is being paid or granted as compensation for" to clarify that it was our intent to provide an exemption only for employment compensation, severance or other employee benefit arrangements for which there is a legitimate compensatory purpose.

One commenter also asked that we consider using a term other than "services" to avoid the possibility that certain forms of consideration, which may be paid or granted

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52 Some commenters asked us to confirm whether any compensatory arrangement that is conditioned upon the security holder, who is a party to the arrangement, tendering securities into the tender offer would render the arrangement less likely to be one that should fall within the exemption or whether it is objectionable for the compensatory arrangement to be conditioned upon consummation of the tender offer. We believe that conditioning an arrangement on a security holder tendering securities into the tender offer would most likely violate one or both of the requirements of the exemption. We do not believe that conditioning an arrangement on the completion or consummation of the tender offer, without any requirements as to the security holder who is a party to the arrangement tendering shares in the tender offer, is relevant to a determination as to whether the exemption is available.

53 See, e.g., letters from SCSGP and Shearman.

pursuant to the arrangements, would not meet the requirements of the exemption.[54] The commenter was concerned that the use of the term "services" might exclude those arrangements that called for compensation to be paid that was unconventional, such as the purchase of assets owned or used by an employee or director. We considered this concern and note that this requirement is intended only to require that the consideration paid is for services performed or to be performed or to be refrained from being performed – not to restrict the forms of consideration to be paid under an arrangement. We believe that the inclusion of the phrase "and matters incidental thereto" also should provide flexibility to cover other service-related compensation.

ii. Requirement that the amount payable under the compensatory arrangement is not calculated based on the number of securities tendered

With respect to the second requirement, several commenters expressed concern as to whether we intended for employment compensation, severance or other employee benefit arrangements that are in the form of equity-based awards to be captured by this requirement.[55] Because equity-based awards are almost always based on the number of securities "owned or tendered," commenters argued that the grant of equity-based awards or the modification of previously granted equity-based awards generally would fall outside of the compensation arrangement exemption to the best-price rule by virtue of failing to meet this second requirement. They suggested that we clarify the intent of the requirement. For similar reasons, commenters also suggested that we remove the reference to securities "owned" and refocus the provisions of this requirement on

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[54] Letter from NYCBA.

[55] See, e.g., letters from ABA; NYCBA; and SIA.

securities "tendered."[56] We believe that we have addressed these concerns by adding the word "calculated" before "based" and replacing "owns or tenders" with "tendered or to be tendered" so that the exemption now requires that the arrangement "not [be] calculated based on the number of securities tendered or to be tendered..." We believe these changes address the concerns raised by commenters and clarify that we did not intend for equity-based employment compensation, severance or other employee benefit arrangements that are premised on legitimate compensatory reasons to fall outside this exemption from the best-price rule.

C. Arrangements approved by independent directors

1. Discussion

We proposed a safe harbor from the third-party tender offer best-price rule for consideration offered and paid according to employment compensation, severance or other employee benefit arrangements entered into with employees and directors of the subject company that are approved by certain committees of the subject company's or bidder's board of directors. As we stated in the Proposing Release, we believe that the fiduciary duty requirements of board members, coupled with significant advances in the independence requirements for compensation committee members and recent advances in corporate governance, provide safeguards to allow employment compensation, severance or other employee benefit arrangements that are approved by independent compensation committee members and groups of independent board members to be exempt from the

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56 See, e.g., letter from ABA.

best-price rule.[57] As proposed, this provision would have operated as a safe harbor within the broader proposed exemption that included the two requirements discussed above. As we noted in the Proposing Release, we believed that providing such a safe harbor would provide increased certainty to bidders and subject companies in connection with the application of the best-price rule. We also believed that the proposed safe harbor struck the proper balance between the need for certainty in planning and structuring proposed acquisitions and the statutory purposes of the best-price rule. Most of the commenters agreed that providing the safe harbor was a good idea, although some commenters suggested certain changes to the provisions of the safe harbor to address issues on which we requested comment or that commenters identified.[58]

We are adopting the safe harbor provision with certain modifications. First, we added the safe harbor to both the issuer and third-party tender offer best-price rules. Next, we amended the language of the safe harbor so that arrangements can be approved by either a compensation committee or a committee performing similar functions of the subject company's board of directors, regardless of whether the subject company is a party to the arrangement. Alternatively, if the bidder is a party to the arrangement, the arrangement may be approved by either a compensation committee or a committee performing similar functions of the board of directors of the bidder. In the case of issuer tender offers, arrangements must be approved by either a compensation committee of the

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57 See, e.g., New York Stock Exchange, Inc. and National Association of Securities Dealers, Inc. Order Approving Proposed Rule Changes, Release No. 34-48745 (Nov. 4, 2003) [68 FR 64154] and Section 303A.05 of the New York Stock Exchange's Listed Company Manual (requiring the compensation committee to be comprised solely of independent directors).

58 See the discussion at Section II.C.2. below.

issuer's board of directors or a committee performing similar functions, regardless of whether the issuer is a party to the arrangement. Alternatively, if an affiliate is a party to the arrangement, the arrangement may be approved by either a compensation committee or a committee performing similar functions of the board of directors of the affiliate. We are also amending the safe harbor to allow a special committee of the approving entity formed to consider and approve the arrangement to approve the arrangement and meet the requirements of the safe harbor if the approving entity does not have a compensation committee or a committee of the board of directors that performs functions similar to a compensation committee or if all the members of either of those committees are not independent. All of the members of the committee used to approve an arrangement must be independent, as defined.[59] We have made certain accommodations to these requirements for foreign private issuers, as discussed below.

Most of the commenters believed that providing the safe harbor would create certainty in an otherwise uncertain environment caused by the legal precedent that has evolved in this area.[60] In this regard, commenters were of the view that the safe harbor should provide as much certainty as possible, while still retaining a certain amount of flexibility so as to allow parties to be able to take advantage of it.[61] Commenters provided significant specific guidance regarding the operation of the proposed safe

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[59] Therefore, it is not necessary for the entire compensation committee of the bidder or subject company to approve the arrangement and, in fact, a subcommittee of this committee may approve the arrangement, so long as the subcommittee is comprised entirely of members that are independent in accordance with the requirements of the listing standards. See the related discussion at Section II.C.2.b. and note 72 below.

[60] See, e.g., letters from ABA, Dechert and NYCBA.

[61] See, e.g. letters from Law Firm Group and NYCBA.

harbor and offered suggestions regarding the most effective means of accomplishing its purpose. The safe harbor we are adopting today has been revised from the proposal to address the following concerns, as discussed in further detail below:

- The approval of the directors of the subject company will satisfy the safe harbor requirements, regardless of whether the subject company is a party to the arrangement;[62]
- A special committee of the board of directors of the subject company or the bidder, as applicable, comprised solely of independent members and formed to consider and approve the arrangement may approve the arrangement and satisfy the safe harbor requirements if the subject company's or bidder's board of directors, as applicable, does not have a compensation committee or a committee of the board of directors that performs functions similar to a compensation committee or if none of the members of such committees is independent;
- Foreign private issuers may have the arrangement approved by any members of the board of directors or any committee of the board of directors authorized to approve the arrangement under the laws or regulations of their home country, and the members of the board or committee need not be independent in accordance with the U.S. listing standards but must be independent in accordance with the laws, regulations, codes or standards of their home country;

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62 Alternatively, as adopted, the safe harbor is available where the arrangement is approved by the bidder's board of directors, but only if the bidder is a party to the arrangement.

- The approving directors do not need to determine that the arrangements meet the additional requirements of the compensation arrangement exemption;
- A new instruction provides that a determination by the board of directors that the board members approving an arrangement are independent in accordance with the provisions of the safe harbor will satisfy the independence requirements of the safe harbor; and
- We have expanded the safe harbor to apply to issuer, in addition to third-party, tender offers.

2. Comments regarding the safe harbor

a. The committee approval required

i. Approving party

As proposed, for purposes of satisfying the safe harbor, an arrangement would have needed to be approved by the applicable committee of the board of directors of either the subject company or the bidder, depending on whether the subject company or bidder is a party to the arrangement. We requested comment on whether the safe harbor could be modified to work better with state law protections. Several commenters advocated that the safe harbor provide that the arrangement may be approved by the applicable committee of the subject company, regardless of whether the subject company is a party to the arrangement.[63] We agree with these comments and have followed this approach in the amendments we are adopting. We believe the duties owed by the subject company's board members to the security holders subject to a tender offer provide certain

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63 See, e.g., letters from ABA; Dechert; Law Firm Group; NYCBA; and SIA.

protections of security holder interests regardless of whether the subject company is a party to the arrangement because the subject company's directors have a duty to act in the best interests of the security holders of the subject company. Also, this provides additional flexibility to parties wanting to take advantage of the safe harbor; bidders that, for whatever reason, do not have a compensation committee with independent directors will be able to rely upon the safe harbor by allowing the subject company to approve the compensation arrangement whether or not the bidder is a party to the arrangement. The safe harbor adopted today also allows approval by the applicable committee of the bidder's board of directors only if the bidder is a party to the arrangement. The amendments to the issuer tender offer rules follow a similar approach with respect to the approval required by the directors of the issuer or an affiliate of the issuer.

ii. Approving body

The proposed safe harbor would have allowed a compensation committee or a committee performing similar functions comprised solely of independent members of the board of directors to approve the arrangement. The safe harbor adopted today includes this provision. In the Proposing Release, we sought comment as to whether certain entities (e.g., small business issuers, foreign private issuers) may not have established compensation committees or committees performing similar functions such that the safe harbor may not be available to them. Commenters suggested we expand the approving body to include, among others, the entire board of directors or another duly authorized committee of the board.[64]

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64 See, e.g., letters from ABA; Dechert; Law Firm Group; NYCBA; NYSBA; and SIA.

In response to these comments, the safe harbor adopted today has been expanded in two respects. First, the safe harbor allows a special committee of the board of directors of the subject company or the bidder, as applicable, comprised solely of independent members and formed to consider and approve the arrangement, to approve the arrangement and satisfy the safe harbor if the subject company's or bidder's board of directors, as applicable, does not have a compensation committee or a committee that performs functions similar to a compensation committee or does have one of these committees but none of its members is independent. The safe harbor adopted today also has been expanded to allow foreign private issuers to obtain the approval by any or all members of the board of directors or any committee of the board of directors authorized to approve the arrangement under the laws or regulations of the home country of the approving party.

We believe that expanding the safe harbor to include approvals by a special committee comprised of independent directors and the accommodation for foreign private issuers is appropriate for purposes of the best-price rule. Allowing a special committee, in lieu of a compensation or similar committee, to approve the compensatory arrangement provides additional flexibility to parties who want to rely on the safe harbor. Further, because the members of the special committee would have to be independent, we believe the approval by a special committee should not compromise investor protection.[65]

The accommodation for foreign private issuers is appropriate because those issuers may not have compensation or similar committees. Deferring to the laws and

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65 State law also creates an incentive for board members to be disinterested from the transaction. See, e.g., 8 Del. C. §144 and Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983).

regulations of the home country of foreign private issuers makes it more likely that they will avail themselves of the safe harbor and, consequently, conduct tender offers that will include U.S. security holders.

b. Determining independence

In the Proposing Release, we solicited comment regarding the appropriateness of relying on the independence standards for compensation committee members as defined in the listing standards. One commenter suggested that we rely upon state law duties of directors because the approving body is already relying upon state law standards of fiduciary duties in approving the arrangement.[66] Other commenters suggested that codifying an independence definition similar to other definitions provided in some Exchange Act rules – as opposed to relying upon a definition that is determined by reference to the listing standards, as we have in other Exchange Act rules – would be a better approach because this would provide a consistent definition.[67] We disagree and are adopting the provisions related to the independence standards as proposed, with an accommodation for foreign private issuers. We believe this approach is appropriate because the definitions under the listing standards have previously been approved by us and are consistent with the approach we have followed in the past.[68] In addition, the

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66 See letter from Dechert.

67 See, e.g., letter from Shearman, which refers to Rule 16b-3(d), but we presume that the commenter is referring to the definition of "Non-Employee Director" provided in Exchange Act Rule 16b-3(b)(3) (17 CFR 240.16b-3(b)(3)).

68 See, e.g., Item 407 of Regulations S-B and S-K (17 CFR 228.407 and 17 CFR 229.407) as adopted in Executive Compensation and Related Person Disclosure, Release No. 33-8732A (Aug. 29, 2006) [71 FR 53158] and Self-Regulatory Organizations; New York Stock Exchange, Inc. and National Association of Securities Dealers, Inc. Order Approving Proposed Rule Changes, Release No. 34-48745 (Nov. 4, 2003) [68 FR 64154].

amendments, as adopted, clarify that a director of a registered closed-end investment company is considered to be independent if the director is not an "interested person" of the investment company, as defined in Section 2(a)(19) of the Investment Company Act of 1940.[69] This clarification is necessary because compensation committee listing standards typically do not apply to registered investment companies.[70]

The amendments do not require that the approving body of a foreign private issuer be comprised of members that are independent as defined in the listing standards. While foreign private issuers may rely on the listing standards when determining independence for purposes of the new rule, those issuers will have the alternative of determining the independence of the members of the board or committee approving a compensatory arrangement for purposes of the safe harbor in accordance with home country laws, regulations, codes and standards. We believe this accommodation is appropriate because foreign private issuers may not be subject to the listing standard's independence provisions as they relate to compensation committees and should be provided with the flexibility to rely on home country laws, regulations, codes and standards in adhering to independence standards. We recognize that foreign private issuers may be subject to regulatory schemes and structures that differ from those that apply to U.S. issuers and that some of these schemes and structures may have a definition that is not consistent with the definition of independence contained in U.S. listing standards. Nevertheless, we are comfortable with this approach and believe that it

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69 15 U.S.C. 80a-2(a)(19).

70 See, e.g., Section 801 of the American Stock Exchange Company Guide; NASDAQ Rule 4350(a)(2); and, Section 303A.00 of the New York Stock Exchange's Listed Company Manual.

balances the premise of the safe harbor – approval of arrangements by independent board members – against the potential that local independence standards differ drastically from the listing standard's definitions.

We also received comments regarding the possibility that a member of an existing compensation committee or a committee that performs functions similar to a compensation committee may not be independent for purposes of a particular tender offer.[71] Recusal by a member of the approving body from considering and approving the arrangement under those circumstances in accordance with state or local law or the listing standards would not eliminate the availability of the safe harbor.[72]

In the Proposing Release, we requested comment regarding whether the language of the proposed amendments provided sufficient certainty and clarity. Some commenters stated that the safe harbor should be clarified to state that a conclusion by the board of directors that each member of the approving committee is independent should be sufficient to determine conclusively that such committee members meet the applicable independence requirements.[73] We have added an instruction to the safe harbor that a determination by the bidder's or the subject company's board of directors, as applicable, that the members of the committee approving an arrangement are independent in accordance with the provisions of the safe harbor will satisfy the requirements of the safe

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71 See, e.g., letter from SCSGP.

72 A bidder or subject company's standing compensation committee may include multiple board members, each of whom has qualified as independent in accordance with the requirements of the applicable listing standards. The safe harbor does not require that each of the members of a company's standing compensation committee participate in the consideration and approval of an arrangement.

73 See, e.g., letters from Law Firm Group and NYCBA.

harbor. We believe that clarifying this point is consistent with the provisions of the safe harbor and the intent of the best-price rule.

c. Procedural aspects of the approval of arrangements

We proposed that, for purposes of satisfying the safe harbor, an arrangement needed to be approved by the applicable committee as meeting the additional requirements of the proposed compensation arrangement exemption – specifically, that the amount to be paid pursuant to a compensatory arrangement must "relate[] solely to past services performed or future services to be performed or refrained from performing, by the employee or director (and matters incidental thereto) and [may not be] based on the number of securities the employee or director owns or tenders." We solicited comment on the appropriateness of these requirements. Commenters believed that requiring the committee to consider these additional factors was unnecessary and could potentially lead to confusion regarding the application of the safe harbor.[74] We agree with these comments, and the safe harbor adopted today does not require that the approving committee consider these requirements. The language of the safe harbor adopted today does require that the independent directors approve the arrangement as an employment compensation, severance or other employee benefit arrangement. We believe this procedural requirement is necessary so directors understand that by approving an arrangement and thereby satisfying the requirements of the safe harbor, they are determining that the arrangement is compensatory.[75]

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74 See the discussion at Section II.B.2.c. above.

75 This procedural requirement is not intended to affect the state law or listing standard approval or documentation requirements for matters considered by the board of directors or committees of the board of directors.

In response to our request for comment, many commenters expressed the view that committee approval of specific arrangements, as compared to approval of plans or programs, with security holders of a subject company should not be required by the proposed safe harbor.[76] We have not made changes in response to these comments, as we believe they are inconsistent with a basic premise of the safe harbor, which is that individuals vested with the fiduciary responsibility for approving compensation arrangements will consider and approve arrangements with security holders of the subject company of a tender offer and, therefore, the best-price rule need not apply. Based on this premise, directors would need to have knowledge of the specific arrangements with security holders and the related tender offer when the approval is given. Of course, the corporate procedures for obtaining and documenting such approval remain matters of state law and the requirements of the safe harbor do not limit the ability of the independent directors to approve multiple specific arrangements or stock grants generally.

Many commenters requested that the timing of the required approval of arrangements by the committee and the ability of committees to reapprove or ratify arrangements originally approved before the consideration of a specific transaction or the effectiveness of these rule changes be clarified. We have not proposed changes to the safe harbor to address these comments, as we do not believe it is necessary to address such procedural issues in the rule itself. We do note, however, that the revised best-price rule states that "[t]he consideration paid to any security holder for securities tendered in the tender offer [shall be] the highest consideration paid to any other security holder for

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[76] See, e.g., letters from ABA; Intel; Law Firm Group; NYCBA; SCSGP; and Shearman.

securities tendered in the tender offer" and, as such, approval pursuant to the provisions of the safe harbor would need to be received before the consideration is paid in the tender offer. We also note that the requirements of the safe harbor do not prohibit ratification of arrangements provided that the tender offer consideration has not been paid yet.

d. Challenges to the applicability of the safe harbor

Commenters requested clarification of the proposed safe harbor to provide that any finding of a violation of fiduciary duties by the board would not nullify the application of the safe harbor.[77] We have not adopted changes to the safe harbor to address these comments. A violation of state law fiduciary duties would not have any impact on the availability of the safe harbor, as remedies are generally available for such allegations under state law.

We have also expanded the application of the proposed instruction that no inference should be drawn that consideration paid pursuant to arrangements other than compensation arrangements, such as commercial arrangements, constitutes consideration paid for securities tendered in the tender offer. The adopted instruction now relates to both the exemption and the safe harbor. The fact that directors approve an arrangement as an employment compensation, severance or other employee benefit arrangement in order to meet the requirements of the safe harbor should not raise an inference that consideration paid or to be paid pursuant to other arrangements that may be entered into with security holders of the subject company constitutes consideration paid for securities tendered in a tender offer.

We also received comments about whether the language of the safe harbor was

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77 See, e.g., letters from Intel and SIA.

potentially ambiguous and whether the safe harbor was self-operating.[78] In order to address these comments, we adopted the exemption and the safe harbor as new sections of the third-party and issuer best-price rules.[79] We also amended the language of the safe harbor so that it is clear that the negotiation, execution and amendment of, and any payments made or to be made or benefits granted or to be granted according to, arrangements approved pursuant to the safe harbor are not prohibited by the best-price rule.

e. Application of the safe harbor to the issuer best-price rule

In the Proposing Release, we proposed to add the safe harbor to the third-party best-price rule but did not propose an analogous safe harbor to the issuer best-price rule. To date it does not appear that claims of a violation of the best-price rule have been made under the issuer tender offer rules. Commenters, however, were unanimous in their request that we extend the safe harbor to the issuer best-price rule.[80] They reasoned that the need to enter into employment compensation, severance or other employee benefit arrangements also arises during issuer tender offers because similar issues of severance and retention often are present, especially in restructuring and recapitalization transactions.[81] Commenters also believed that there appeared to be no compelling reason to distinguish between the issuer and third-party best-price rules, especially because

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78 See, e.g., letter from Dechert.

79 See note 30 above.

80 See, e.g., letters from ABA; Dechert; Gonzalez; Intel; Law Firm Group; NYCBA; NYSBA; Perkins Coie LLP ("Perkins"); SCSGP; Shearman; and SIA.

81 See, e.g., letters from ABA; Intel; and SCSGP.

doing so might have unintended consequences.[82] We agree and the amendments we are adopting today add the safe harbor to the issuer best-price rule at Rule 13e-4(f)(12).

III. PAPERWORK REDUCTION ACT

We have not prepared a submission to the Office of Management and Budget under the Paperwork Reduction Act of 1995 because the proposals do not impose any new recordkeeping or information collection requirements, or other collections of information requiring the approval of the Office of Management and Budget.

IV. COST-BENEFIT ANALYSIS

A. Background

On December 16, 2005, we proposed amendments to the best-price rule to clarify that the best-price rule applies only with respect to the consideration offered and paid for securities tendered in a tender offer. We also proposed that the rule exclude employment compensation, severance and other employee benefit arrangements between subject company employees or directors and the subject company or bidder from the application of the best-price rule, as long as the compensatory arrangements meet certain requirements. Finally, we proposed an accompanying safe harbor to the exemption for those compensatory arrangements that were approved by a compensation committee (or a committee performing similar functions) of either the bidder or the subject company, depending upon who was a party to the arrangement.

We are adopting the amendments substantially as proposed. First, we are adopting the amendment to the language of the best-price rule that clarifies that the provisions of the rule apply only with respect to the consideration offered and paid for

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82 See, e.g., Law Firm Group; SCSGP; and SIA.

securities tendered in a tender offer. We also are amending the third-party and issuer tender offer best-price rules to provide that any consideration that is offered and paid according to employment compensation, severance or other employee benefit arrangements entered into with security holders of the subject company that meet certain requirements will not be prohibited by the rules. Finally, we are amending the third-party and issuer tender offer best-price rules to provide a safe harbor provision so that arrangements that are approved by the independent directors of either the subject company's or the bidder's board of directors, as applicable, will not be prohibited by the rules.

We expect that these amendments will make it clear that the best-price rule was not intended to capture compensatory arrangements. The amendments also are intended to alleviate the reluctance bidders and subject companies have expressed in planning and structuring transactions as tender offers due to differing judicial interpretations of the best-price rule that have been rendered by courts to date. We also want to diminish a regulatory disincentive against structuring transactions as tender offers, as compared to statutory mergers, to which the best-price rule does not apply. We recognize that the amendments may create costs and benefits to parties engaging in tender offers and to the economy as a whole. We have identified those costs and benefits below.

B. Benefits

The amendments to the rule will benefit investors most directly through their intended effect of lowering the costs of tender offer transactions that arise from the risk of litigation under the current case law. Bidders and subject companies are expected to respond with increased tender offer activity as a result of choosing to structure an acquisition as a tender offer, rather than a statutory merger. Some benefits from lower litigation-related costs are expected to arise in each instance, depending on the cost of the litigation risk that would be borne otherwise. This cost would likely continue to persist as a regulatory obstacle in the absence of the amendment; such cost would deter the use of tender offers relative to statutory mergers and the conduct of acquisitions as tender offers that would not occur otherwise. The magnitude of the benefit from the amendment will thus partly depend on the magnitude of the substitution into tender offers and any tender offer-related increase in acquisition activity generally. In the Proposing Release, we requested comment on the magnitude of these and other potential benefits of the proposed amendments. We received no direct response to this request. Commenters also did not indicate that the judicial interpretations of the best-price rule were preventing potential acquisitions from proceeding in any form. Commenters did indicate that the judicial interpretations of the best-price rule were causing transactions to proceed as statutory mergers, as opposed to tender offers. Accordingly, we do not expect the amended best-price rule to materially impact the number of transactions that occur overall, but rather the form in which the transaction takes place.[83]

The comments that we received on the proposed amendments are consistent with the view that benefits would occur through a reduction in the litigation-related cost of

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[83] Under the assumption that the amendments do not have a material impact on the number of overall acquisitions conducted annually, an estimate of the potential increase in tender offers can be obtained from an estimate of the potential decline in statutory mergers, expressed as a fraction of the total. For example, if 5% of the transactions that would otherwise be conducted as statutory mergers will now be conducted as tender offers, an estimated 35.7% increase in the number of tender offers might result annually (based upon the number of statutory mergers and tender offers that have taken place over the last 10 years).

conducting tender offers, leading to an increased incentive to undertake tender offers. As to the regulatory incentives to conduct statutory mergers as compared to tender offers, one commenter indicated that the economic efficiencies of using tender offers, as compared to mergers, have been lost because of the potential liability associated with conducting a tender offer that may be subject to a lawsuit where a compensatory arrangement is involved.[84] This commenter endorsed the objectives of the amendments to the best-price rule. Several commenters also indicated generally that the amendments would meet the objectives of the best-price rule.[85] Others expressed their support by indicating that the amendments would provide clarity and certainty to participants in tender offers, particularly regarding the perceived litigation risk that has been present in the best-price rule.[86] Almost all of the commenters suggested additional changes to the amendments, particularly with respect to the exemption and safe harbor from the best-price rule.

The litigation-related costs that the amendment would eliminate stem from diverging court interpretations of the best-price rule that have emerged in the past decade.

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84 See, e.g., letter from Law Firm Group (citing the benefit of the relatively shorter amount of time that it takes to conduct a tender offer (30 days) as compared to mergers (90-120 days)). Similar support for the fact that tender offers, as compared to mergers, provide the benefit of time can be found in the letters from ABA, Dechert and SIA. Other benefits of tender offers include the fact that management support is not necessary for the bidder to acquire the target company (i.e., individuals make their own investment decision) and control by a bidder may be obtained without necessarily purchasing all of the outstanding securities of the target company. See Eleanor M. Fox and Byron E. Fox, Corporate Acquisitions and Mergers (2006 ed.) at 5E-6.

85 See, e.g., letters from ABA and NYCBA.

86 See, e.g., letters from Dechert; SCSGP; and Shearman.

The best-price rule has been interpreted as requiring, in some courts, that the amounts paid pursuant to compensation arrangements be included as part of the consideration paid to security holders in the tender offer either because the compensation was offered or paid during a tender offer and, in other courts, because the compensatory arrangement constituted an "integral part" of the tender offer. These interpretations have made parties reluctant to structure acquisitions as tender offers for fear of exposure to potential liability. We believe it is appropriate to amend the best-price rule to clarify this point now, rather than to wait and see how the courts might interpret the rule in the future. These amendments are thus intended to eliminate a regulatory obstacle to the use of tender offers as a viable alternative to statutory mergers for parties who wish to conduct an acquisition. We believe that the interests of security holders are better served when all acquisition structures are viable options.[87]

We recognize that the application of our exemption and safe harbor is limited to compensatory arrangements. Parties who wish to enter into arrangements that are not compensatory in nature may continue to be reluctant to engage in tender offers. In these situations, parties may choose to engage in a statutory merger, as opposed to a tender offer, to accomplish an acquisition because the litigation risk continues to be too great. While we do not intend for arrangements entered into with security holders that are not compensatory to be presumed to be in violation of the best-price rule,[88] we also believe that it is appropriate to limit our exemption and safe harbor to arrangements that are

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87 A disincentive against structuring transactions as tender offers has potential negative consequences to acquirors and security holders. <u>See</u> prior note 84 for a discussion of some of the benefits of tender offers.

88 The rule, as adopted, includes the proposed instruction to this effect.

compensatory in nature.

Depending upon the jurisdiction in which a best-price rule claim has been brought, the potential costs to bidders as a result of certain of the judicial interpretations of the best-price rule have been substantial. An intended benefit of our amendments will be to assist parties in reducing their exposure to potential costs arising from allegations of best-price rule violations. These potential costs include, among others, the cost of litigation to defend against alleged violations of the best-price rule.[89] We believe bidders will be less likely to be subject to a claim because our amendments provide an exception to the best-price rule for compensatory arrangements without the loss of the basic protections that the rule is designed to provide to security holders.

C. Costs

The best-price rule prohibits certain conduct in connection with a tender offer. In this regard, the amendments to the best-price rule do not add any new requirements. Rather, the amendments clarify that certain conduct is not prohibited by the rule and add means by which parties can comply, via an exemption or a safe harbor provision, with the rule. Continued compliance with the best-price rule can be achieved in the same manner and by the same persons responsible for compliance under the rule in effect before our

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89 In sixteen published judicial opinions over the last ten years, approximately half were decided in favor of the plaintiff with the other half being decided in favor of the defendant. Extrapolating from these opinions, we assume an average of three claims per year are brought, that one claim is settled per year, that the costs of defending all three actions would total no more than $10 million per year (based on the staff's estimate of attorney's fees), and that the costs associated with settling one such action would be $15 million (based on historical data). See, e.g., Technology Briefing Software: Computer Associates Ordered to Pay $11 Million, The N.Y. Times, Sept. 6, 2002 at C6 and $18.25 Million Settlement Approved in Litigation Resulting From Take-Over, Securities Class Action Reporter, March 15, 2006 at 17. Based on these assumptions, the annual cost savings would be approximately $25 million.

amendments today. Reliance upon the exemption or the safe harbor, however, may entail additional costs. We discuss these additional costs below. We do not believe these costs are substantial.

The amendments seek to modify the language of the existing best-price rule to remove the reference to "during." Some commenters have indicated that the effect of this change would be to expand the potential timeframe in which litigants could argue that a best-price rule violation has occurred.[90] If the commenter's concerns were realized, it is possible claims that the best-price rule has been violated might continue to be brought, only under a different, potentially more expansive, theory. We do not believe that a temporal limitation in the best-price rule is appropriate because such a strict timeframe might lend itself to abuse. Further, we believe that the amendments providing for the exemption and the safe harbor to the best-price rule provide sufficient certainty to parties desiring to engage in a tender offer such that any concern regarding continued litigation under the best-price rule as a result of the removal of "during" is reduced.

The exemption and the safe harbor adopted today provide that, presuming certain requirements are met, consideration paid pursuant to certain arrangements will not be prohibited by the best-price rules. Parties may be able to challenge whether the provisions of the exemption or the safe harbor have been met. Complying with the conditions of the exemption and safe harbor, therefore, may be a cost of complying with the best-price rule.

To the extent parties choose to rely upon the safe harbor, bidders and/or subject companies, in the case of third-party tender offers, or issuers and/or affiliates, in the case

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90 See, e.g., letters from ABA; Dechert; and Law Firm Group.

of issuer tender offers, may need to take extra steps – such as obtaining approval of the compensatory arrangement by directors – to comply with the safe harbor. However, most bidders, issuers, affiliates and subject companies are already required to have a compensation committee or a committee performing similar functions, so the cost of forming, organizing and convening a committee should be a cost that already is being incurred by most bidders, issuers, affiliates or subject companies. Companies without such a committee will incur a cost, most likely in the form of legal fees.

Further, bidders, issuers, affiliates or subject companies may already have their compensation committee or a committee performing similar functions approve specific employment compensation, severance or other employee benefit arrangements in the ordinary course of performing its duties. These bidders, issuers, affiliates or subject companies would not incur additional costs to comply with the amended best-price rule and, even if they are not already engaging their committees to perform this function, the costs should be limited to the time and expense associated with reviewing the specific arrangement and holding a meeting of the committee. With respect to subject company approval, it is possible that subject company directors may already be reviewing arrangements executed in connection with negotiated acquisitions[91] in order to meet their state law fiduciary duties when considering and determining whether to recommend the transaction to the security holders of the subject company.[92]

To the extent parties choose to rely upon the exemption, we recognize there may

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91 See, e.g., Item 1012(a) of Regulation M-A (17 CFR 229.1012(a)), which requires a statement as to whether the subject company is advising security holders in a third-party tender offer to accept or reject the tender offer or to take other action.

92 See, e.g., letters from ABA and SIA.

be similar costs associated with adhering to the exemption. While we have not dictated the manner or method by which we expect the parties to meet the requirements of the exemption, we expect that, at the very least, it will take the parties time to make a determination as to whether the compensatory arrangement meets the requirements of the exemption. The time it takes for the parties to make this determination is a cost but we believe that the cost should be minimal.

Under the amendments, some compensatory arrangements may qualify for the safe harbor provision with approval by a committee of the bidder's board. Since the bidder's board does not typically owe a fiduciary duty to security holders of the subject company, the amendments could impose costs on security holders of the subject company by making it possible for transactions to occur without safeguards associated with directors' fiduciary duties. However, such costs are likely to be limited because they would be dependent upon the ability of security holders of the subject company to anticipate such transactions and contract in advance of the transaction with management, employees, or other security holders of the subject company. In addition, such costs may be limited to the extent that other rights of action, such as litigation in state courts, exist for security holders in the subject company.

Finally, the rule may introduce costs associated with new litigation risks. It is possible that the amended best-price rule will simply shift the litigation to state law; security holders may claim that directors have breached their fiduciary duties in approving the compensatory arrangement.[93] In addition, or alternatively, they may claim

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93 We requested comment about whether this potential outcome should impact the structure of the amendments to the best-price rule. Certain commenters noted that the fiduciary duties owed by the bidder's directors to the bidder's security

that the provisions of the exemption or safe harbor were not satisfied. Whether a successful claim can be made against members of the board of directors for breach of their fiduciary duties or for failure to satisfy the provisions of the exemption or safe harbor is uncertain. As a result, the potential costs associated with identifying the alleged illegal behavior and bringing a claim of liability could be imposed on potential plaintiffs. We note that commenters, when asked about shifting litigation to state law issues, did not object, so long as no remedy would be available under the best-price rule.[94]

D. Small business issuers

Although the amended rules apply to small business issuers, we do not anticipate any disproportionate impact on small business issuers. Like other issuers, small business issuers should incur relatively minor compliance costs, and should find it unnecessary to hire extra personnel. It is possible that the safe harbor, for the reasons mentioned above, will cause small business issuers in particular to incur some cost due to the establishment of an appropriate approving body and the time and expense of reviewing the compensatory arrangement and convening a meeting. This is because small business issuers are less likely to have the pre-existing infrastructure in place. But we do not believe that these costs are unreasonable in order to ensure that the purpose of the best-price rule is met. Further, the exemption and safe harbor available under the amended rules are non-exclusive methods of complying with the best-price rule so any additional costs incurred are voluntary.

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holders would guide their actions and, therefore, provide some level of protection. See, e.g., the ABA letter.

94 See, e.g., letters from Law Firm Group and NYCBA.

The issues of equal treatment among security holders in the context of tender offers affect small business issuers as much as they affect larger issuers. Thus, we do not believe that applying the amendments to small business issuers would be inconsistent with the policies underlying the small business issuer disclosure system.

V. CONSIDERATION OF BURDEN ON COMPETITION AND PROMOTION OF EFFICIENCY, COMPETITION AND CAPITAL FORMATION

Section 3(f) of the Exchange Act[95] and Section 2(c) of the Investment Company Act[96] require the Commission, whenever it engages in rulemaking, to consider or determine if an action is necessary or appropriate in the public interest and to consider whether the action would promote efficiency, competition, and capital formation. In addition, Section 23(a)(2) of the Exchange Act requires the Commission, when making rules under the Exchange Act, to consider the impact such rules would have on competition.[97] Exchange Act Section 23(a)(2) prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

The amendments to the best-price rule are intended to improve market efficiency by providing greater clarity to bidders, subject companies and security holders as to the situations in which compliance with the best-price rule has been met. Courts rendering decisions arising from allegations of a violation of the best-price rule have differed in their approach to resolving these claims and the resulting uncertainty has left parties who

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95 15 U.S.C. 78c(f).

96 15 U.S.C. 80a-2(c).

97 15 U.S.C. 78w(a)(2).

want to engage in a tender offer unsure about how to proceed. The amendments are intended to clarify the application of the best-price rule where employment compensation, severance or other employee benefit arrangements have been or are expected to be entered into in contemplation of an acquisition of securities that is structured as a tender offer. Specifically, the amendments provide for an exemption and a safe harbor provision from the best-price rule for certain arrangements that either meet certain requirements or that are approved by independent directors. The resulting clarity should make the determination as to whether to engage in a tender offer a more viable one for bidders, issuers, affiliates and subject companies, resulting in a positive effect upon market efficiency.

As to the impact on competition, the amendments to the best-price rule are intended to have a positive impact on competition among the alternative mechanisms for completing acquisitions. Bidders desiring to acquire another entity by conducting a tender offer would have the benefit of the amendments to the best-price rule that delineate the instances in which the negotiation or execution of employment compensation, severance or other employee benefit arrangements would not run afoul of the requirements of the best-price rule. Previously, the existence of compensatory arrangements might have caused parties to hesitate before engaging in a tender offer in order to weigh the potential benefits of the acquisition carefully against the potential for liability for a best-price rule violation. Ultimately, the parties may have declined to pursue a tender offer as an alternative to a statutory merger in completing the transaction. The amendments, however, are designed to alleviate the need to hesitate and, therefore, increase competition between these alternative acquisition mechanisms. Having more acquisition structures available to parties contemplating an acquisition is a positive effect of the rule upon competition.

We acknowledge the possibility that, because bidders, issuers, affiliates and subject companies may desire to take advantage of the safe harbor to the best-price rule where arrangements approved by an appropriate approving body of directors meet the requirements of the safe harbor and therefore consideration paid pursuant to such arrangement are not prohibited by the rule, those bidders, issuers, affiliates and subject companies may need to reevaluate whether they have an approving body and adequate policies and procedures in place to take advantage of the safe harbor. Such an evaluation could place a limitation on the ability of the parties to move quickly and efficiently in pursuing an acquisition, which could diminish the beneficial effect on market efficiency and competition. We believe, however, that the approval of directors is an important step in the availability of the safe harbor and, therefore, any increased efforts or costs that need to be expended to comply with the safe harbor are appropriate to provide equal treatment of security holders. Further, we believe that we have provided sufficient flexibility in the operation of the safe harbor to ease this potential impact. We also have provided an exemption that does not require director approval.

The amendments should promote capital formation, as they are intended to significantly reduce the uncertainty caused by the varying judicial interpretations of the best-price rule. The clarifications to the best-price rule are expected to have the effect of alleviating regulatory disincentives to structuring an acquisition of securities as a tender offer, as compared to a statutory merger, where the best-price rule is inapplicable. It is difficult to estimate the magnitude of these effects, if or when they would occur, and the extent to which they will be offset by the costs of the amendments, nor have we received comments on their likely magnitude.

We requested comment on these matters in the Proposing Release. We received no comments in response to these specific requests, but some comments touched on these issues. Commenters generally expressed support for the proposal to amend the best-price rule, given the structural impediments to the use of tender offers as a result of the case law that has developed.[98] They generally believed that the amendments would provide clarity and greater certainty to the tender offer process.[99]

VI. FINAL REGULATORY FLEXIBILITY ACT ANALYSIS

This Final Regulatory Flexibility Act Analysis has been prepared in accordance with the Regulatory Flexibility Act. This analysis relates to proposed revisions to the tender offer best-price rule under the Exchange Act to clarify that the rule applies only with respect to the consideration offered and paid for securities tendered in an issuer or third-party tender offer and should not apply to consideration offered and paid according to employment compensation, severance or other employee benefit arrangements entered into with security holders of the subject company. The amendments provide an exemption and safe harbor from the strictures of the best-price rule for arrangements that meet certain criteria or that are approved by independent directors, respectively.

A. Reasons for the proposed amendments

The best-price rule was adopted originally to provide fair and equal treatment of all security holders of the class of securities that are the subject of a tender offer by

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98 See, e.g., letter from Law Firm Group.

99 See, e.g., letters from ABA and NYCBA.

requiring that the consideration paid to any security holder is the highest paid to any other security holder in the tender offer. We proposed amendments to the best-price rule on December 16, 2005. The amendments we adopt today are, in most respects, consistent with the proposed amendments but include certain revisions made in response to concerns raised by commenters. The objectives of the changes are as follows:

First, we want to make it clear that compensatory arrangements between security holders and the subject company or bidder are not captured by the application of the best-price rule. We believe that amounts paid pursuant to employment compensation, severance or other employee benefit arrangements should not be included in the consideration paid for tendered securities. These payments are made for a different purpose, to provide compensation in exchange for services rendered or in connection with severance or similar events.

Second, since the adoption of the best-price rule, it has been the basis for litigation brought in connection with tender offers in which it is claimed that the best-price rule was violated as a result of the bidder in a tender offer entering into new, or adopting the subject company's pre-existing, employment compensation, severance or other employee benefit arrangements with security holders of the subject company. In the process of resolving these claims, courts have interpreted the best-price rule in different ways. We are adopting changes to the rule to alleviate the uncertainty that the various interpretations of the best-price rule by courts have produced.

Finally, we want to reduce the regulatory disincentive to structure acquisitions of securities in the form of tender offers, as compared to statutory mergers, to which the best-price rule does not apply. We understand that the prospect of the uncertain application of the best-price rule that has arisen as a result of the case law has made parties averse to the use of tender offers as a means to accomplish extraordinary transactions, and we believe the amendments to the rule will reduce this aversion to the use of tender offers.

B. Significant issues raised by public comment

An Initial Regulatory Flexibility Analysis was prepared in accordance with the Regulatory Flexibility Act in connection with the Proposing Release, and we solicited comments on any impact the proposed changes might have on any aspect of our IRFA. We did not receive any public comments that responded directly to the IRFA or that dealt directly with the proposal's impact on small business issuers.

C. Small entities subject to the proposed rules

The changes to the best-price rule will affect issuers that are small businesses. Exchange Act Rule 0-10(a)[100] defines an issuer, other than an investment company, to be a "small business" or "small organization" for purposes of the Regulatory Flexibility Act if it had total assets of $5 million or less on the last day of its most recent fiscal year. An investment company is considered to be a "small business" or "small organization" if it, together with other investment companies in the same group of related investment companies, has net assets of $50 million or less as of the end of its most recent fiscal year.[101] These are the types of entities that we refer to as small entities in this discussion. We estimate that there are approximately 2,500 public issuers, other than investment companies, that may be considered small businesses. We estimate that there are

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100 17 CFR 240.0-10(a).

101 17 CFR 270.0-10.

approximately 230 investment companies that may be considered small businesses. Of these 230 investment companies that may be considered small businesses, we estimate that 94 are closed-end investment companies, including closed-end investment companies electing to be treated as business development companies, as defined in Section 2(a)(48) of the Investment Company Act,[102] that may be affected by the proposed amendments.

The Commission received a total of 412 issuer and 141 third-party tender offer schedules in its 2006 fiscal year. We estimate that half of the 14 issuer tender offer schedules were filed by subject companies that were small business issuers and the other half were filed by investment companies that are small businesses as that term is defined for purposes of the Regulatory Flexibility Act.[103] We further estimate that 18 of the third-party tender offer schedules received by the Commission in its 2006 fiscal year were tender offers where the target companies were small business issuers.[104] We note that our use of small business issuers is a broader category of issuers than small entities. Therefore, we believe that the amendments are likely to affect a limited number of small business issuers and, for the same reason, an even smaller number of small entities that are reporting companies.

We requested comment on the number of small entities that would be impacted by our proposals, including any available empirical data. We received no responses to our

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102 15 U.S.C. 80a-2(a)(48).

103 A small business issuer is defined as a company that, among other things, has revenues of less than $25,000,000. See Securities Act Rule 405 (17 CFR 230.405).

104 No investment company that is a small business, as that term is defined for purposes of the Regulatory Flexibility Act, conducted a third-party tender offer in the 2006 fiscal year of the Commission.

request.

D. Reporting, recordkeeping and other compliance requirements

The amendments to the best-price rule are expected to result in relatively small costs to all bidders and subject companies, large or small. Even before our proposed amendments, the best-price rule required bidders to pay any security holder pursuant to the tender offer the highest consideration paid to any other security holder for securities tendered in the tender offer. Therefore, the changes to the best-price rule should not impose significant additional costs, if any, and should not require any specialized professional skills. The task of complying with the changes could be performed by the same person or group of persons responsible for compliance under the rules that were in effect before today's amendments at a minimal incremental cost.

We understand that the exemption and safe harbor from the best-price rule may impose extra steps on the bidder and/or subject company to comply with the exemption and safe harbor, and such compliance could entail new costs. For example, with respect to the safe harbor for compensatory arrangements that are approved by the directors of the bidder or subject company, most bidders and subject companies already are required to have a compensation committee or a committee performing similar functions, so the cost of forming and organizing a committee should be a cost that already is being incurred by the bidder or subject company. This is particularly the case where the bidder or subject company either has a class of securities listed on a registered national securities exchange or on an automated inter-dealer quotation system of a national securities association because the listing standards of each generally impose certain requirements regarding the formation and composition of the members of the board of directors and its committees.

Small entities or organizations may be less likely to have a class of securities listed on a registered national securities exchange or on an automated inter-dealer quotation system of a national securities association. As a result, it is possible that small entities or organizations will be less likely to have the pre-existing infrastructure in place for a compensation committee or a committee performing similar functions to approve employment compensation, severance or other employee benefit arrangements. Such small entities or organizations likely will incur additional costs to take advantage of this safe harbor. The cost, however, should be limited to the expense of organizing a committee, reviewing the specific arrangement and holding a meeting of the committee. We believe these costs are appropriate to promote equal treatment of security holders in the application of the best-price rule.

With respect to the exemption for compensatory arrangements that meet certain requirements, all bidders or subject companies that choose to avail themselves of this exemption will need to make a determination as to whether the arrangement at issue meets the requirements. This determination likely will entail additional costs, even if only in the form of the additional time it will take to make this determination. However, the amendments do not mandate any particular method or procedure that a bidder or subject company must follow in making this determination.

Both the exemption and the safe harbor, however, are optional provisions and serve as non-exclusive methods to ensure compliance with the best-price rule. This means that bidders and subject companies that are small entities or organizations will not be required to take advantage of the provision, so any additional expenses that may be incurred, if any, would be optional on the part of the small entity or organization. We acknowledge, however, that the cost of foregoing the application of the exemption or safe harbor might be significant if there is a risk of potential liability where a compensatory arrangement is found to violate the best-price rule and the cost of that violation is expected to be greater than the cost of complying with the exemption or safe harbor. In that circumstance, entities would be likely to structure transactions as statutory mergers.

E. Agency action to minimize effect on small entities

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish the stated objectives while minimizing any significant adverse impact on small entities or organizations. In connection with the proposals, we considered the following alternatives:

1. Establishing different compliance or reporting requirements or timetables that take into account the resources of small entities;

2. The clarification, consolidation, or simplification of the compliance or reporting requirements for small entities;

3. The use of performance rather than design standards; and

4. An exemption for small entities from coverage of the best-price rule, or any part thereof, for small entities.

We have considered a variety of reforms to achieve our regulatory objectives. However, we believe that the original intent of the best-price rule, to require equal treatment of security holders, would not be served by a best-price rule that applied only to bidders and subject companies of a certain size. Further, we believe that uniform rules applicable to all bidders and subject companies, regardless of size, are necessary to alleviate the uncertainty that the parties to tender offers face. Therefore, the establishment of different requirements for small entities would not be practicable, nor would it be in the public interest. For similar reasons, the clarification, consolidation or simplification of the compliance and reporting requirements for small entities also would not be practicable.

Although the best-price rule generally employs performance standards rather than design standards, the amendments to the rule would implement certain design standards in order to clarify that the rule should not apply where employment compensation, severance or other employee benefit arrangements are made or will be made or have been granted or will be granted, as long as they have been approved by the directors of an appropriate approving body of either the bidder or the subject company. We intend for the implementation of design standards, in this case, to be more useful to bidders and subject companies because the circumstances in which the best-price rule would likely be inapplicable will be delineated clearly. This should provide greater certainty in the application of the rule and the enforcement of the application of the rule. Therefore, implementing design rather than performance standards in the application of the rule appears to be more effective in promoting compliance with the rule, as amended.

As discussed above, most bidders and subject companies that engage in tender offers and are subject to the best-price rule are not small entities or organizations, as defined for purposes of the Regulatory Flexibility Act. Further, where small entities are bidders and/or subject companies in the tender offer, the proposed changes to the best-price rule, in general, and the invocation of the exemption or safe harbor, in particular, impose minimal additional costs or burdens. Therefore, exempting small entities from the best-price rule altogether would not be justified in this context.

VII. STATUTORY BASIS

The amendments to the best-price rule are adopted pursuant to Sections 3(b), 13, 14, 23(a) and 36 of the Exchange Act, as amended, and Section 23(c) of the Investment Company Act, as amended. The amendments to the Rules of Practice are adopted pursuant to Section 19 of the Securities Act, as amended and Sections 4A, 19 and 23 of the Exchange Act, as amended.

VIII. TEXT OF THE RULES AND AMENDMENTS

List of Subjects

17 CFR Part 200

Administrative Practice and Procedure; Authority delegations (Government Agencies).

17 CFR Part 240

Reporting and recordkeeping requirements, Securities.

In accordance with the foregoing, the Securities and Exchange Commission amends Title 17, chapter II of the Code of Federal Regulations as follows:

PART 200 – ORGANIZATION; CONDUCT AND ETHICS; AND INFORMATION AND REQUESTS

1. The general authority citation for part 200, subpart A is revised to read as follows:

Authority: 15 U.S.C. 77o, 77s, 77sss, 78d, 78d-1, 78d-2, 78w, 78ll(d), 78mm, 80a-37, 80b-11, and 7202, unless otherwise noted.

* * * * *

2. Amend §200.30-1 by revising paragraph (e)(11) the phrase "pursuant to Rule 14d-10(e) (§240.14d-10(e) of this chapter)." to read "pursuant to Rule 14d-10(f) (§ 240.14d-10(f) of this chapter).".

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PART 240 – GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

3. The general authority citation for part 240 is revised to read as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

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4. Amend §240.13e-4 by revising paragraph (f)(8)(ii), redesignating paragraph (f)(12) as paragraph (f)(13) and adding new paragraph (f)(12) to read as follows:

§240.13e-4 Tender offers by issuers.

* * * * *

(f) * * *

(8) * * *

(ii) The consideration paid to any security holder for securities tendered in the tender offer is the highest consideration paid to any other security holder for securities tendered in the tender offer.

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(12)(i) Paragraph (f)(8)(ii) of this section shall not prohibit the negotiation, execution or amendment of an employment compensation, severance or other employee benefit arrangement, or payments made or to be made or benefits granted or to be granted according to such an arrangement, with respect to any security holder of the issuer, where the amount payable under the arrangement:

(A) Is being paid or granted as compensation for past services performed, future services to be performed, or future services to be refrained from performing, by the security holder (and matters incidental thereto); and

(B) Is not calculated based on the number of securities tendered or to be tendered in the tender offer by the security holder.

(ii) The provisions of paragraph (f)(12)(i) of this section shall be satisfied and, therefore, pursuant to this non-exclusive safe harbor, the negotiation, execution or amendment of an arrangement and any payments made or to be made or benefits granted or to be granted according to that arrangement shall not be prohibited by paragraph (f)(8)(ii) of this section, if the arrangement is approved as an employment compensation, severance or other employee benefit arrangement solely by independent directors as follows:

(A) The compensation committee or a committee of the board of directors that performs functions similar to a compensation committee of the issuer approves the arrangement, regardless of whether the issuer is a party to the arrangement, or, if an affiliate is a party to the arrangement, the compensation committee or a committee of the board of directors that performs functions similar to a compensation committee of the affiliate approves the arrangement; or

(B) If the issuer's or affiliate's board of directors, as applicable, does not have a compensation committee or a committee of the board of directors that performs functions similar to a compensation committee or if none of the members of the issuer's or affiliate's compensation committee or committee that performs functions similar to a compensation committee is independent, a special committee of the board of directors formed to consider and approve the arrangement approves the arrangement; or

(C) If the issuer or affiliate, as applicable, is a foreign private issuer, any or all members of the board of directors or any committee of the board of directors authorized to approve employment compensation, severance or other employee benefit arrangements under the laws or regulations of the home country approves the arrangement.

Instructions to paragraph (f)(12)(ii): For purposes of determining whether the members of the committee approving an arrangement in accordance with the provisions of paragraph (f)(12)(ii) of this section are independent, the following provisions shall apply:

1. If the issuer or affiliate, as applicable, is a listed issuer (as defined in §240.10A-3 of this chapter) whose securities are listed either on a national securities exchange registered pursuant to section 6(a) of the Exchange Act (15 U.S.C. 78f(a)) or in an inter-dealer quotation system of a national securities association registered pursuant to section 15A(a) of the Exchange Act (15 U.S.C. 78o-3(a)) that has independence requirements for compensation committee members that have been approved by the Commission (as those requirements may be modified or supplemented), apply the issuer's or affiliate's definition of independence that it uses for determining that the members of the compensation committee are independent in compliance with the listing

standards applicable to compensation committee members of the listed issuer.

2. If the issuer or affiliate, as applicable, is not a listed issuer (as defined in §240.10A-3 of this chapter), apply the independence requirements for compensation committee members of a national securities exchange registered pursuant to section 6(a) of the Exchange Act (15 U.S.C. 78f(a)) or an inter-dealer quotation system of a national securities association registered pursuant to section 15A(a) of the Exchange Act (15 U.S.C. 78o-3(a)) that have been approved by the Commission (as those requirements may be modified or supplemented). Whatever definition the issuer or affiliate, as applicable, chooses, it must apply that definition consistently to all members of the committee approving the arrangement.

3. Notwithstanding Instructions 1 and 2 to paragraph (f)(12)(ii), if the issuer or affiliate, as applicable, is a closed-end investment company registered under the Investment Company Act of 1940, a director is considered to be independent if the director is not, other than in his or her capacity as a member of the board of directors or any board committee, an "interested person" of the investment company, as defined in section 2(a)(19) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(19)).

4. If the issuer or affiliate, as applicable, is a foreign private issuer, apply either the independence standards set forth in Instructions 1 and 2 to paragraph (f)(12)(ii) or the independence requirements of the laws, regulations, codes or standards of the home country of the issuer or affiliate, as applicable, for members of the board of directors or the committee of the board of directors approving the arrangement.

5. A determination by the issuer's or affiliate's board of directors, as applicable, that the members of the board of directors or the committee of the board of directors, as

applicable, approving an arrangement in accordance with the provisions of paragraph (f)(12)(ii) are independent in accordance with the provisions of this instruction to paragraph (f)(12)(ii) shall satisfy the independence requirements of paragraph (f)(12)(ii).

Instruction to paragraph (f)(12): The fact that the provisions of paragraph (f)(12) of this section extend only to employment compensation, severance and other employee benefit arrangements and not to other arrangements, such as commercial arrangements, does not raise any inference that a payment under any such other arrangement constitutes consideration paid for securities in a tender offer.

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5. Amend §240.14d-10 by revising paragraph (a)(2), redesignating paragraphs (d) and (e) as paragraphs (e) and (f) and adding new paragraph (d) to read as follows:

§ 240.14d-10 Equal treatment of security holders.

(a) * * *

(2) The consideration paid to any security holder for securities tendered in the tender offer is the highest consideration paid to any other security holder for securities tendered in the tender offer.

* * * * *

(d)(1) Paragraph (a)(2) of this section shall not prohibit the negotiation, execution or amendment of an employment compensation, severance or other employee benefit arrangement, or payments made or to be made or benefits granted or to be granted according to such an arrangement, with respect to any security holder of the subject company, where the amount payable under the arrangement:

(i) Is being paid or granted as compensation for past services performed, future services to be performed, or future services to be refrained from performing, by the security holder (and matters incidental thereto); and

(ii) Is not calculated based on the number of securities tendered or to be tendered in the tender offer by the security holder.

(2) The provisions of paragraph (d)(1) of this section shall be satisfied and, therefore, pursuant to this non-exclusive safe harbor, the negotiation, execution or amendment of an arrangement and any payments made or to be made or benefits granted or to be granted according to that arrangement shall not be prohibited by paragraph (a)(2) of this section, if the arrangement is approved as an employment compensation, severance or other employee benefit arrangement solely by independent directors as follows:

(i) The compensation committee or a committee of the board of directors that performs functions similar to a compensation committee of the subject company approves the arrangement, regardless of whether the subject company is a party to the arrangement, or, if the bidder is a party to the arrangement, the compensation committee or a committee of the board of directors that performs functions similar to a compensation committee of the bidder approves the arrangement; or

(ii) If the subject company's or bidder's board of directors, as applicable, does not have a compensation committee or a committee of the board of directors that performs functions similar to a compensation committee or if none of the members of the subject company's or bidder's compensation committee or committee that performs functions similar to a compensation committee is independent, a special committee of the board of directors formed to consider and approve the arrangement approves the arrangement; or

(iii) If the subject company or bidder, as applicable, is a foreign private issuer, any or all members of the board of directors or any committee of the board of directors authorized to approve employment compensation, severance or other employee benefit arrangements under the laws or regulations of the home country approves the arrangement.

Instructions to paragraph (d)(2): For purposes of determining whether the members of the committee approving an arrangement in accordance with the provisions of paragraph (d)(2) of this section are independent, the following provisions shall apply:

1. If the bidder or subject company, as applicable, is a listed issuer (as defined in §240.10A-3 of this chapter) whose securities are listed either on a national securities exchange registered pursuant to section 6(a) of the Exchange Act (15 U.S.C. 78f(a)) or in an inter-dealer quotation system of a national securities association registered pursuant to section 15A(a) of the Exchange Act (15 U.S.C. 78o-3(a)) that has independence requirements for compensation committee members that have been approved by the Commission (as those requirements may be modified or supplemented), apply the bidder's or subject company's definition of independence that it uses for determining that the members of the compensation committee are independent in compliance with the listing standards applicable to compensation committee members of the listed issuer.

2. If the bidder or subject company, as applicable, is not a listed issuer (as defined in §240.10A-3 of this chapter), apply the independence requirements for compensation committee members of a national securities exchange registered pursuant to section 6(a) of the Exchange Act (15 U.S.C. 78f(a)) or an inter-dealer quotation system

of a national securities association registered pursuant to section 15A(a) of the Exchange Act (15 U.S.C. 78o-3(a)) that have been approved by the Commission (as those requirements may be modified or supplemented). Whatever definition the bidder or subject company, as applicable, chooses, it must apply that definition consistently to all members of the committee approving the arrangement.

3. Notwithstanding Instructions 1 and 2 to paragraph (d)(2), if the bidder or subject company, as applicable, is a closed-end investment company registered under the Investment Company Act of 1940, a director is considered to be independent if the director is not, other than in his or her capacity as a member of the board of directors or any board committee, an "interested person" of the investment company, as defined in section 2(a)(19) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(19)).

4. If the bidder or the subject company, as applicable, is a foreign private issuer, apply either the independence standards set forth in Instructions 1 and 2 to paragraph (d)(2) or the independence requirements of the laws, regulations, codes or standards of the home country of the bidder or subject company, as applicable, for members of the board of directors or the committee of the board of directors approving the arrangement.

5. A determination by the bidder's or the subject company's board of directors, as applicable, that the members of the board of directors or the committee of the board of directors, as applicable, approving an arrangement in accordance with the provisions of paragraph (d)(2) are independent in accordance with the provisions of this instruction to paragraph (d)(2) shall satisfy the independence requirements of paragraph (d)(2).

<u>Instruction to paragraph (d)</u>: The fact that the provisions of paragraph (d) of this section extend only to employment compensation, severance and other employee benefit

arrangements and not to other arrangements, such as commercial arrangements, does not raise any inference that a payment under any such other arrangement constitutes consideration paid for securities in a tender offer.

* * * * *

By the Commission.

Nancy M. Morris
Secretary

Date: November 1, 2006

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 54683 / November 1, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12469

In the Matter of **SALVATORE FAVATA (aka Sam Favata),** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Salvatore Favata (aka Sam Favata) ("Favata").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

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III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Favata, age 46, is a resident of Yorba Linda, California. From December 2002 until April 2006 Favata was the president of National Consumer Mortgage LLC's ("NCM") investment division. During the relevant period, Favata engaged in the unregistered offer and sale of so-called "private money investment notes." Favata was not registered in any capacity with the Commission or the NASD.

2. On October 19, 2006, a final judgment was entered by consent against Favata, permanently enjoining him from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933, Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. Salvatore Favata, Civil Action Number SACV06-943 JVS (ANx), in the United States District Court for the Central District of California.

3. The Commission's complaint alleged that, in connection with the sale of "private money investment notes," Favata falsely told investors that their money would be used to fund high interest rate residential mortgage loans, that they would receive annual interest payments between 30-60 percent of their original investment, and that the loans underlying the notes would be secured by real property. In reality, Favata used investor funds to pay returns to existing investors in a Ponzi-scheme fashion, to pay operating expenses of NCM's more conventional mortgage brokerage business and to pay Favata's gambling debts which amounted to more than $10 million. The complaint also alleged that Favata sold unregistered securities and acted as an unregistered broker-dealer.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Favata's Offer.

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act, that Respondent Favata be, and hereby is barred from association with any broker or dealer. Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

Commissioner Campos Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 54689 / November 2, 2006

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2507 / November 2, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12470

In the Matter of **HORST HANSEN,** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against Horst Hansen ("Hansen" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has agreed to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934 ("Order") as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Respondent, 71 years old, is a German citizen and resides in Ahrenberg, Germany. In 1966 Respondent joined the German company OTTO (Gmbh & Co.) KG (hereinafter "OTTO"). In 1974 he was appointed to OTTO's Board of Directors and was promoted to the Chief Financial Officer of OTTO. OTTO acquired Spiegel, Inc. ("Spiegel") in 1982 and Respondent was then appointed to Spiegel's Board of Directors. Respondent became a member of Spiegel's Audit

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Committee in 1987 and from 2000 to 2003 Respondent was the Chair of Spiegel's three-member Audit Committee.

2. Section 13(a) of the Exchange Act requires publicly held companies to file certain information and documents with the Commission, in accordance with rules and regulations the Commission prescribes as necessary or appropriate to protect investors and insure fair dealing in securities. Pursuant to Section 13(a)(2) of the Exchange Act, and Rules 13a-1 and 13a-13 promulgated thereunder, documents that must be filed include annual and quarterly reports.

3. As a publicly held company whose securities traded on the Nasdaq, Spiegel was required to comply with Section 13(a) of the Exchange Act. In compliance with that section, Spiegel timely filed its required quarterly and annual reports with the SEC through the filing of its third quarter 2001 Form 10-Q quarterly report on November 13, 2001. Spiegel's 2001 Form 10-K annual report was due to be filed with the Commission on March 31, 2002.

4. In February 2002 Spiegel's independent auditor advised that it would have to consider including a "going concern" modification on its audit report of Spiegel's 2001 financial statements unless Spiegel obtained either new credit or waivers from its lending banks for all breaches of loan covenants through December 31, 2002.

5. Spiegel had not obtained either new credit facilities or waivers of all breaches of loan covenants through 2002 on the day its 2001 Form 10-K was to be filed with the Commission. Spiegel's management did not want to file its 2001 Form 10-K with a "going concern" modification. Thus, on March 31, 2002 Spiegel filed a Form 12b-25 which advised that its 2001 Form 10-K would be filed within 15 days. The Form 12b-25 stated that Spiegel was "not in a position to issue financial statements for its 2001 fiscal year pending resolution of" its lack of compliance with its loan covenants and its sale of FCNB. The Form did not mention the "going concern" modification of Spiegel's independent auditor.

6. Spiegel still had not obtained either new credit facilities or waivers of its breaches of loan covenants on April 15, 2002, when the 15 day period provided under the Form 12b-25 expired. Spiegel's American management recommended on that day that Spiegel not file at all rather than file with a "going concern" modification.

7. Spiegel's first quarter 2002 Form 10-Q was due to be filed with the Commission on May 15, 2002. Spiegel again did not file its required report but instead filed a Form 12b-25, which stated only that it was not in a position to file its Form 10-Q pending resolution of its debt covenant violations and acquisition of new credit facilities.

8. Spiegel's decision not to file its 2002 first quarter Form 10-Q kept material information from the public markets. Had Spiegel timely filed, it would have been required to disclose that on February 18, 2002 Spiegel reached its $700 million borrowing capacity under its revolving credit facility and it had no other available letter of credit facilities.

9. On May 29, 2002 Spiegel's general counsel advised Respondent that Section 20(c) of the Exchange Act [15 U.S.C. § 78t(c)] prohibited directors and officers from hindering, delaying or obstructing the filing of a required report without just cause. On May 29, 2002 Spiegel's Chief Executive Officer ("CEO") wrote to Respondent, acknowledging that although not filing the 2001 Form 10-K violated federal securities laws, he preferred a delisting of Spiegel's stock rather than filing with a "going concern" modification. The CEO changed his mind the next day and recommended that Spiegel file the 2001 Form 10-K under any circumstances. The CEO, however, did not inform Respondent that he had changed his mind.

10. On May 31, 2002 Respondent, who had his own vote and the proxy of the second member of Spiegel's Audit Committee, met with the third member of the Audit Committee. Respondent and the other Audit Committee member telephoned Spiegel's American corporate counsel to ask what the consequences were if Spiegel still did not file its 2001 Form 10-K. Spiegel's outside counsel advised filing and told them Spiegel and its individual employees were running risks by the continued refusal to file. Despite this legal advice, Respondent and the other member of the Audit Committee voted shortly thereafter to recommend postponing Spiegel's 2001 Form 10-K and 2002 first quarter Form 10-Q until Spiegel's auditor provided an unqualified audit opinion.

11. Thereafter Spiegel's three-member Board Committee, which made all decisions for Spiegel between the semi-annual Board of Directors meetings, adopted the Audit Committee's recommendation not to file until an unqualified audit opinion was obtained. Respondent was not a member of Spiegel's Board Committee.

12. Spiegel filed its 2001 Form 10-K on February 4, 2003, only after SEC staff advised that they intended to recommend the Commission take enforcement action against Spiegel. The Form 10-K, filed over fifteen months after Spiegel's prior public filing, disclosed that shareholders' equity had decreased from $792 million to $215 million, total assets had shrunk from $2.7 billion to $1.9 billion and total debt increased from $795 million to $1 billion.

13. On February 26, 2003 Spiegel filed its first, second and third quarter 2002 Forms 10-Q with the Commission.

14. On March 7, 2003 the Commission filed a complaint against Spiegel, Inc. in the U.S. District Court for the Northern District of Illinois which in part alleged that Spiegel's failure to timely file its required reports violated Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 promulgated thereunder. On March 27, 2003, the Court entered an Amended Partial Final Judgment in which Spiegel, without admitting or denying the substantive allegations of the Commission's complaint, agreed to the Judgment including an Order that in part permanently enjoined it from violations of Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 promulgated thereunder. Spiegel filed for bankruptcy on March 17, 2003 and on July 23, 2004 registration of its shares was revoked pursuant to Section 12(j) of the Exchange Act.

15. Respondent caused Spiegel to violate Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 promulgated thereunder by recommending, as a Director of Spiegel and the

Chair of Spiegel's Audit Committee, that Spiegel withhold filing its required reports with the Commission until Spiegel obtained the opinion it desired from its outside auditor.

Undertakings

16. In connection with any related judicial or administrative proceeding or investigation commenced by the Commission or to which the Commission is a party, Respondent has undertaken to be interviewed by Commission staff, either in Germany or by telephone, and to testify, either in Germany or by telephone, as requested by the staff upon reasonable notice.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent Hansen's Offer.

Accordingly, it is hereby ORDERED that Respondent cease and desist from causing any violations and any future violations of Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Nazareth
Not Participating

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 54708 / November 3, 2006

Admin. Proc. File No. 3-11813

In the Matter of

IRFAN MOHAMMED AMANAT

OPINION OF THE COMMISSION

BROKER-DEALER PROCEEDING

CEASE-AND-DESIST PROCEEDING

Grounds for Remedial Action

Antifraud Violations

Respondent, who was associated as chief technology officer with former registered broker-dealer firm, engaged in fraudulent scheme to obtain market data rebates from Nasdaq by executing thousands of wash trades and matched orders through automated trading program that he designed. His wash and matched trades enabled firm to receive nearly $50,000 in rebates. Respondent willfully violated antifraud provisions of federal securities laws. Held, it is in the public interest to bar Respondent from association with any broker or dealer subject to a right to reapply after five years, impose a cease-and-desist order, and assess civil money penalties.

APPEARANCES:

Martin S. Siegel, David J. Molton, and John J. W. Inkeles, of Brown Rudnick Berlack & Israels LLP, for Irfan Mohammed Amanat.

Valerie A. Szczepanik, Nancy A. Brown, and Kathleen L. Furey, for the Division of Enforcement.

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Appeal filed: January 26, 2006
Last brief filed: May 10, 2006

I.

The Division of Enforcement ("Division") appeals from an administrative law judge's decision dismissing all charges against Irfan Mohammed Amanat, who was associated as chief technology officer 1/ with MarketXT, Inc. ("MarketXT"), an electronic communications network ("ECN"), 2/ registered broker-dealer, and NASD member. In the order instituting proceedings ("OIP"), the Division alleged that, during a three-day period in March 2002, MarketXT reported thousands of wash trades and matched orders 3/ on the Nasdaq Stock Market, Inc. ("Nasdaq"). It alleged that Amanat executed those trades through two accounts at a broker-dealer affiliated with MarketXT, using a computerized program that he designed. As a result of the trading, MarketXT improperly qualified for Nasdaq's market data revenue rebate program for the first quarter of 2002 (ending March 31, 2002), and received from Nasdaq approximately $50,000 in rebates. The OIP charged Amanat with willfully violating Section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934, 4/ and willfully aiding and abetting, and causing, MarketXT's violations

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1/ As an officer and employee of MarketXT, Inc., Amanat was "associated" with the firm. See 15 U.S.C. § 78c(a)(18) ("person associated with a broker or dealer" or "associated person" includes any officer, employee, or person "directly or indirectly controlling, controlled by, or under common control with such broker or dealer").

2/ An ECN is an electronic trading system that automatically matches buy and sell orders at specified prices. See 17 C.F.R. § 240.11Ac1-1(a)(8) (defining an "ECN"). In January 2000, MarketXT obtained from the Commission's Division of Market Regulation a no-action letter that effectively permitted it to operate as an ECN. In August 2002, Market Regulation revoked the firm's ECN no-action letter, after NASD ordered the firm to cease doing business as a broker-dealer for failure to maintain required net capital.

3/ Wash trades are "transactions involving no change in beneficial ownership." SEC v. U.S. Envtl., Inc., 155 F.3d 107, 109 (2d Cir. 1998) (quoting Ernst & Ernst v. Hochfelder, 425 U.S. 185, 205 n.25 (1976)), cert. denied, 526 U.S. 1111 (1999). Matched orders are "orders for the purchase [or] sale of a security that are entered with the knowledge that orders of substantially the same size, at substantially the same time and price, have been or will be entered by the same or different persons for the sale [or] purchase of such security." Id.

4/ 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5.

of Exchange Act Section 15(c)(1)(A). 5/ We base our findings on an independent review of the record, except with respect to those findings not challenged on appeal. Based on that review, we have determined that a preponderance of the evidence supports the allegations in the OIP. 6/ For the reasons set forth below, we conclude that Amanat willfully violated Exchange Act Section 10(b) and Exchange Act Rule 10b-5.

II.

Amanat is a self-taught computer programmer who received a bachelor's degree in biomedical engineering from Johns Hopkins University in 1993. The following year, while pursuing graduate studies, he began working part-time as a programmer for an order entry firm owned by his brother. 7/ In late 1997 or early 1998, Amanat joined his brother's business full-time. By 2002, that business had grown into Tradescape Corporation, 8/ the parent company of several subsidiaries, including MarketXT and Momentum Securities, LLC ("Momentum"), 9/ a registered broker-dealer (collectively, "Tradescape").

At all relevant times, Amanat acted as chief technology officer for MarketXT and its affiliates. His responsibilities included developing new trading strategies and programming trading systems. As part of Amanat's role as chief technology officer, he supervised a staff of

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5/ 15 U.S.C. § 78o(c)(1)(A) (prohibiting brokers or dealers from using "any manipulative, deceptive, or other fraudulent device or contrivance" in connection with securities transactions). MarketXT was named as a respondent in this proceeding, but settled charges that it violated antifraud, net capital, and recordkeeping provisions. Without admitting or denying the findings, MarketXT consented to the revocation of its broker-dealer registration and an order to disgorge the revenue rebated by Nasdaq. Payment of disgorgement was waived, however, based on sworn financial statements demonstrating the firm's inability to pay. MarketXT, Inc., Securities Exchange Act Rel. No. 51864 (June 17, 2005), 85 SEC Docket 2665.

6/ See Steadman v. SEC, 450 U.S. 91, 101 (1981)

7/ Order entry firms are broker-dealers that route customer orders to market makers for execution.

8/ Amanat's family owned fifty-three percent of Tradescape Corporation through a combination of direct ownership and family trusts. Amanat was a beneficiary of the family trust that held the largest ownership interest and a member of Tradescape Corporation's board of directors. His brother was Tradescape Corporation's chief executive officer ("CEO").

9/ Momentum was not a respondent in this proceeding.

software developers, technicians, and engineers on MarketXT's order execution and routing programs. He thus was familiar with and understood MarketXT's technical systems.

Amanat was considered to be a skilled programmer who was knowledgeable about the securities industry and new developments in the field. A Momentum manager, Brian Ignatowitz, testified that "[Amanat] knew everything. He would always stay on top of everything in the industry, [and] he always knew what the new hot thing was in the market, what all the traders were doing." Other Tradescape employees called Amanat "a very effective programmer" and "extremely competent" at programming.

A. Nasdaq's Rebate Program

Nasdaq, like other Consolidated Tape Association ("CTA") participants, received market data revenue for trades that it reported to the CTA 10/ in securities listed on the New York Stock Exchange, Inc. ("Tape A" securities) and on the American Stock Exchange, LLC ("Amex") or regional exchanges ("Tape B" or "Amex-listed" securities). During the period at issue, Nasdaq had a market data rebate program under which it shared a portion of its market data revenue with NASD member firms that exceeded certain levels of reported trading activity in exchange-listed securities. 11/ Nasdaq gave qualifying firms, i.e., those averaging at least five hundred trades per day in Tape A or Tape B securities in a calendar quarter, forty percent of the market data revenue it received from the CTA that was attributable to the firms' trades.

Amanat first learned of Nasdaq's rebate program in December 2001. He acknowledged that he was aware that MarketXT had "cash flow" problems in March 2002. 12/ He decided to

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10/ The CTA administers the consolidated tape system, which disseminates transaction information for exchange-listed securities. In the first quarter of 2002, the CTA was comprised of representatives from nine market centers, including the American Stock Exchange, LLC, New York Stock Exchange, Inc., and NASD. Nasdaq participated in the CTA pursuant to NASD's participation. The CTA operates by virtue of the CTA Plan, a national market system plan approved by the Commission in accordance with Exchange Act Section 11A, 15 U.S.C. § 78k-1.

11/ See Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the National Association of Securities Dealers, Inc., Exchange Act Rel. No. 41174 (Mar. 16, 1999), 69 SEC Docket 1039 (establishing NASD's rebate program). The rebate program subsequently was extended in January 2002.

12/ The record reflects that the auditors had considered issuing a "going concern" opinion on MarketXT's financial statements. Furthermore, not only MarketXT but also its affiliates had financial problems during the relevant period. Tradescape employees testified that (continued...)

attempt to qualify MarketXT for Nasdaq's rebate program in Tape B securities for the quarter ending March 31, 2002. 13/ On March 6, 2002, a Nasdaq official sent Amanat "background information" on the rebate program. In response, he asked whether trades that crossed within a firm would count towards earning rebates, and was told that they would. He also asked whether MarketXT could qualify for rebates for the March 2002 quarter. On March 11, 2002, Amanat heard from Nasdaq that, with three weeks left in the quarter, the firm was averaging only forty-nine qualifying trades per day, far less than the required daily average of five hundred trades.

B. Amanat Develops a Trading Strategy to Earn Rebates

During the first quarter of 2002, Amanat was working on computer programs for various trading strategies, including arbitrage programs, pairs trading, and what he described as mirror trading. In early to mid-March 2002, he began modifying an arbitrage program he had designed for another trader in order to increase MarketXT's number of trades and qualify for rebates. He called this new program "RLevi2." Amanat stated that RLevi2's sole purpose was to earn rebates for MarketXT. He believed that rebate trading would be a profitable, long-term strategy. He calculated that MarketXT could obtain $50,000 in rebates from Nasdaq if RLevi2 generated the requisite number of qualifying trades in the time remaining in the March 2002 quarter.

Amanat had been monitoring the volume of MarketXT's trades in Tape B securities, and was aware of who at the firm was engaging in automated trading. He selected exchange-traded funds, or "ETFs," 14/ for his automated trading. He understood that ETFs were considered Tape B securities, and that ETFs, as Tape B securities, generated larger rebates than Tape A

12/ (...continued)
telephones and data centers had been disconnected, and that salaries and benefits were cut.

13/ Prior to March 2002, MarketXT was reporting insignificant trading in Tape B securities. For example, in January 2002, the firm executed a total of thirty-seven trades in Amex-listed securities, averaging about two Tape B trades per day. In February 2002, the firm executed a total of 2,064 trades in Amex-listed securities, averaging about 109 Tape B trades per day.

14/ An "ETF" is an investment vehicle that allows investors to participate in the performance of an established market index without having to purchase the basket of individual stocks that comprise the index. ETFs track indices such as the Nasdaq-100 ("QQQs"), S&P 500 ("SPYs"), and Dow Jones Industrial Average ("DIAs").

securities. 15/ He also understood that ETFs could be bought and sold easily because they were highly liquid securities.

Amanat admitted that he alone conceived, wrote, and operated RLevi2. He testified that Tradescape compliance and other personnel knew "in general" that he wanted to trade ETFs for the rebates, but that they left the "coding details" to him. Amanat seemed to have been secretive about RLevi2. He did not show the program to anyone, despite urging his superiors to encourage ETF trading. Amanat claimed that he did not think that other traders would be interested in using RLevi2, although he believed that it would be a profitable, long-term strategy. None of the Tradescape employees who testified at the hearing understood RLevi2 or knew how it operated.

C. RLevi2's Characteristics

Amanat wrote RLevi2 so that it automatically sent pairs of buy and sell market orders to MarketXT at regular, timed intervals (originally a pair every five to six seconds). 16/ RLevi2 covered every purchase order with a sell order to ensure that his position remained flat. Amanat testified that MarketXT's computer processed orders in milliseconds. He could adjust RLevi2's parameters for the time interval between a buy and sell order. He also could shorten the time interval between buy and sell pairs of orders, thereby increasing the number of trades executed.

Amanat acknowledged that he knew that MarketXT "swept" its order book and matched any new order against outstanding orders on MarketXT's system before sending that order to be filled in the marketplace. His expert opined that RLevi2 was designed to match orders within MarketXT's system. The expert further concluded, based on "conversations" and the trading generated by RLevi2, that Amanat coded RLevi2 to hold a MarketXT buy order on the firm's book while it waited to execute against a MarketXT sell order.

Amanat was familiar with the term "wash trade." He knew that it referred to the purchase and sale of securities "within some short frame of time for the same account." He also knew that wash trading was illegal because he previously had assisted Tradescape compliance personnel in monitoring for wash trades. Nonetheless, Amanat admitted that he did not program RLevi2 to

15/ Historically, trades in Tape B securities have resulted in larger revenues than trades in Tape A securities, and that was true in the first quarter of 2002. The "print value," or revenue allocation to a CTA participant per trade, was \$0.37 for Tape A securities and \$4.02 for Tape B securities.

16/ A market order is an order to buy or sell a security at the best available price. Robert J. Prager, Exchange Act Rel. No. 51974 (July 6, 2005), 85 SEC Docket 3413, 3418 n.12.

prevent wash trading, although he could have done so. 17/ He stated that no one asked or told him to do this.

D. Amanat Begins Trading to Earn Rebates

Sometime after March 14, 2002, Amanat began running RLevi2, which he described as a "work-in-progress," in his personal, or "Irfan," account at Momentum. He then sought and obtained permission to open a proprietary account for his rebate trading. 18/ The new account was opened in the name of Momentum's vice president of technology affairs, Scott Ignall, and designated "Signr" for "Scott Ignall rebate." 19/ Amanat ran RLevi2 in the Signr account as well.

On Friday, March 22, 2002, Momentum manager Ignatowitz asked Amanat by e-mail for the number of trades required to qualify for rebates for the March 2002 quarter. In one e-mail to Ignatowitz, Amanat responded, "Sheesh – It's close. If we don't ramp up [the ETF trading] next week, we won't make it!" In another e-mail to Ignatowitz, he wrote, "We needed about 30,000 transactions this quarter. We've had about 15-20,000, so maybe we need 10,000 more. I'll get the exact #."

Amanat asked Nasdaq for the information several minutes later. After receiving from Nasdaq a printout of MarketXT's trading through March 19, Amanat inquired, "[C]an you tell me how many more trades are needed to qualify for Tape A and B? Is it about 18,000 trades needed?" A Nasdaq official replied, "[R]ight -- 18,000 trades gets you qualified for Tape B. Tape A, well, we'll get their [sic] next quarter." Amanat relayed this information to his brother, who was Tradescape's CEO. In an e-mail, he wrote that he was "18,000 trades short for the tape revenue."

17/ In his brief, Amanat notes that Nigito testified that it was impossible to program to prevent wash trades. However, Amanat's own hearing testimony contradicts that proposition. Amanat testified that he subsequently modified the "code" to include "wash trade preventions."

18/ Amanat did not hold any securities licenses and knew that, pursuant to Momentum's internal policies, a proprietary account could not be set up for him without assigning a registered representative to supervise the account. At the hearing, Momentum manager Ignatowitz stated that a proprietary account had "a lot more buying power" than a retail account. He stated further that gains or losses in a proprietary account "go to the firm."

19/ In his investigative testimony, Amanat stated that he understood that the account was in Ignall's name only, but that he did not keep Ignall informed about Amanat's trading in the Signr account. Amanat affirmed that testimony at the hearing.

E. Monday, March 25, 2002

On March 25, 2002, beginning at 10:42 a.m., Amanat ran RLevi2 in the Irfan account, sending simultaneous buy and sell one hundred share market orders in DIAs to MarketXT every six seconds. At 11:44 a.m., in an e-mail to two traders with the heading, "ETF Trades!," Amanat exclaimed, "1008 [ETF] trades and counting! . . . I gotta get to 3600 a day for the next 5 days to make it." He continued to run RLevi2 in the Irfan account until 1:30 p.m. The orders entered by Amanat executed against each other, resulting in 1,696 wash trades in DIAs by day's end. The 1,696 wash trades in DIAs accounted for over ninety-nine percent of the DIA trading volume at MarketXT that day and ninety-nine percent of the DIA trades sent from the Irfan account and effected on MarketXT. Almost no one else at MarketXT was trading DIAs. Indeed, for the entire quarter up until March 25, 2002, MarketXT had executed only thirty trades in DIAs.

Amanat admitted that the 1,696 trades in DIAs were "wash trades" as he understood that term, but denied that he designed RLevi2 intending to produce wash trades. Amanat's expert testified that the orders for the 1,696 DIA trades were submitted simultaneously and paired up against each other, and that the element of risk involved in those trades was "close to de minimis."

Amanat's trading on March 25, 2002, caught the attention of Brian Nigito, a MarketXT programmer who reported to Amanat. Nigito had accepted a job at another firm, and March 25 was his last day at MarketXT. That morning, Nigito observed what he described as an "unusual" pattern of buy and sell orders for one hundred share DIAs being executed on MarketXT at regular intervals, several seconds apart. Nigito found the transactions to be unusual because they involved "[v]ery regular trades, a fixed number [of seconds] apart, [and] not as much quote activity as [he] would expect for [the] . . . number of trades." Nigito concluded that most likely Amanat was responsible because the regularity of the trading indicated to him that it was automated, and Amanat was the only Tradescape employee engaged in automated ETF trading on MarketXT. Amanat testified that he was not speaking to Nigito because Nigito was changing jobs. As Nigito left the office that day, he announced in a loud voice that Amanat was "painting the tape." Nigito testified that he used this phrase to mean that Amanat was buying from and selling to himself or engaging in wash trading.

Nigito also called another programmer, Michael Bundy, and alerted him to Amanat's trading. Bundy viewed the trading and agreed with Nigito's assessment that it was "unusual." He noted that the trades were occurring at a "fixed and regular interval . . . like a clock, ticking on a wall, regardless of market activity." He contacted Momentum's executive vice-president, J. William Lauderback, and compliance officer Elizabeth Cummins. 20/

20/ The record is not clear as to when Cummins learned of the nature of Amanat's trading. While Bundy testified that he and Lauderback brought the trading to her attention on

(continued...)

Several people informed Amanat on March 25 that Nigito had accused him of "painting the tape." Amanat acknowledged at the hearing that he "understood [that] 'painting the tape' was the term used when people think you are trying to manipulate the market." However, he took no steps to determine if his trading violated any legal or regulatory requirements. Amanat explained that the trades "were meant . . . to gain market data rebates and that was legitimate in [his] eyes." When asked on cross-examination why he did not contact Tradescape compliance personnel and request that they examine his trading in light of Nigito's accusations, Amanat replied, "They [compliance personnel] knew the type of trading I was doing. I didn't have to notify them, they were viewing it." On further questioning, however, Amanat admitted that, even if compliance personnel were viewing his trading on Momentum's computer screens, they would be unable to ascertain, without further investigation, the contra parties to the trades.

F. Tuesday, March 26, 2002

On March 26, 2002, Amanat adjusted RLevi2, decreasing the number of seconds between each pair of trades. In the morning, he ran RLevi2 in both the Irfan and Signr accounts, sending pairs of buy and sell market orders in SPYs to MarketXT every two to three seconds. The SPY orders in the Irfan and Signr accounts executed against each other, resulting in 1,516 wash trades and matched orders. The 1,516 wash trades and matched orders in SPYs accounted for nearly eighty-one percent of the SPY trading volume on MarketXT that day, making Amanat's trades a significant part of MarketXT's volume in that security. In the afternoon, Amanat ran RLevi2 in the Irfan account. He sent buy and sell market orders in DIAs to MarketXT every two to three seconds, resulting in an additional forty-nine wash trades.

G. Wednesday, March 27, 2002

After two days of running RLevi2 in the Irfan and Signr accounts, Amanat was still thousands of trades short of the 18,000 trades needed to qualify for rebates. He decided to decrease again the number of seconds between his paired market orders. He also adjusted the program so that each buy order preceded a sell order by seven hundred milliseconds.

On March 27, 2002, Amanat ran RLevi2 in the Irfan and Signr accounts, sending pairs of buy and sell one hundred share market orders in SPYs to MarketXT every one to three seconds. This activity resulted in over 11,000 wash trades and matched orders in SPYs. It accounted for over ninety-three percent of the trading volume in SPYs on MarketXT that day and ninety-three percent of the total SPY trades sent from the Irfan and Signr accounts and effected on MarketXT.

Several people noticed Amanat's trading in SPYs. Nasdaq Market Operations staff called MarketXT early in the afternoon of March 27 and asked if there was a "system problem." The

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20/ (...continued)
March 25, 2002, Cummins did not recall whether she first spoke to Bundy on that day or on March 27, 2002.

staff remarked on the large volume of one hundred share trades, which was out of the ordinary for the firm. A MarketXT employee replied that there was no problem of which he was aware, but that he would inquire further. Meanwhile, Bundy also had observed the SPY trading that day. He noted that the trading pattern was similar to that on March 25, but instead of one trade occurring in each time interval, there seemed to be three trades occurring. Bundy reported the trading to Lauderback and Cummins.

Cummins testified that, when she investigated the SPY trading on March 27, 2002, she discovered that Amanat was on both sides of the trades. Cummins told Momentum's chief operating officer, R. Daniel Connell, to stop the trading. Ignall located the RLevi2 program running on Amanat's computer and shut it down. Cummins sent an e-mail to Amanat, who she understood was responsible for the trading, and instructed him to call her.

Amanat had been out of the office for several hours, letting RLevi2 operate automatically in his absence. Upon his return, he discovered that RLevi2 had stopped running. Without determining why the program had stopped running, he restarted it. Amanat testified that, when he did so, "all hell broke loose." Telephones started ringing, and he received an e-mail from Connell ordering him to stop the RLevi2 program immediately. 21/ Amanat shut down the program. Connell thereafter informed Amanat that the thousands of March 27 SPY trades in the Signr account were wash trades and that such trading was "wrong." 22/

Amanat testified that, during the three trading days in question, he made numerous adjustments to the RLevi2 program, monitored his open position, profits and losses, and net number of open buy and sell orders, and reviewed his limit orders. 23/ However, Amanat claimed that he did not monitor the trading that RLevi2 produced while it was operating because the computer would have been slowed down and a trade would have been missed. He claimed that he also did not review RLevi2's results after it stopped running each day.

H. Amanat Pursues Rebates for his Trading

On March 28, 2002, the day after he was told by Tradescape compliance and supervisory personnel that his trading was wrong, Amanat sent an e-mail to Nasdaq inquiring about rebates

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21/ Around this same time, Connell sent an e-mail to Ignall stating that Nasdaq had called "again," apparently about the trading.

22/ Another contemporaneous e-mail from Connell indicates that, while Connell (along with Ignall) had been out of town the prior week, Connell had instructed that RLevi2 be "shut down" because it was "experiencing problems." At the hearing, Amanat claimed that he did not know that Connell previously had ordered his program to be shut down.

23/ A limit order is an order to buy or sell a security at a specific price or better. Robert J. Prager, 85 SEC Docket at 3418 n.12.

for his trades. He asked, "[C]ould you send me the list of trades we've done on [T]ape A and B, and tell me if we [MarketXT] qualified (crossing my fingers here!) Thanks!" Amanat did not reveal to Nasdaq that he had been on both sides of his trades, or that the firm had told him that his trading must stop. 24/ At the hearing, Amanat was asked why he pursued rebates after being told that the March 27 SPY trades were wash trades. Amanat answered, "I didn't know what percent or what was the problem. All I know is that Dan Connell said there was a problem, [and] I had to stop trading in that [Signr] account." He added, "I didn't know there was any reason why I couldn't ask about those rebates."

The trading data reveals that a total of 20,483 trades in Tape B securities were effected on MarketXT between March 25 and 27, 2002. 25/ Of those trades, seventy percent or over 14,000 of them were Amanat's wash and matched trades in and between the Irfan and Signr accounts. The thirty percent that were not wash or matched trades included trading by other Tradescape employees and Amanat's trading using programs other than RLevi2. 26/ Amanat, his expert, and

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24/ The Tape B administrator testified that CTA participants consider wash trades and matched orders to be illegitimate and non-qualifying for purposes of allocating market data revenues. She stated that, if a CTA participant receives market data revenue based on wash trades and matched orders, it "should return that revenue to the administrator of the tape and the revenue should be reallocated based on the correct trade allocation."

25/ Contrary to the law judge, we find, based on our review of the resulting trading, that the substantial majority of orders generated by RLevi2 were executed on MarketXT, and not routed to SuperSOES, a Nasdaq trading system, or otherwise exposed to the rest of the market. According to the Division's analysis, on March 25, 2002, the Irfan account generated 1,696 trades in DIAs (in which the Irfan account was on both sides of the trade) on MarketXT. The total number of DIA trades on all markets from the Irfan and Signr accounts was 1,710. On March 26, 2002, the Irfan and Signr accounts generated 1,608 SPY trades (in which Irfan and/or Signr appeared on both sides of the trade) on MarketXT, and 2,290 SPY trades on all markets. On March 27, 2002, the Irfan and Signr accounts generated 11,405 SPY trades (in which Irfan and/or Signr appeared on both sides of the trade) on MarketXT, and a total of 12,218 SPY trades on all markets.

26/ The law judge faulted the Division's expert for, among other things, failing to "compute the thousands of trades that were excluded from the Division's exhibits." However, the Division's expert, using Momentum's audit trail data, identified patterns suggestive of wash and matched trades. Based on those patterns, he requested from MarketXT trading data for March 25 through 28, 2002, in order to identify the parties to those trades. From the data, the Division's expert identified trades in which the Irfan and/or Signr accounts were involved, and trades which appeared sufficiently close in time to be wash or matched trades. The Division's expert testified that he excluded Amanat's limit orders and certain market orders in and between the Irfan and Signr accounts from his analysis

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the Division's expert all agreed that the greater than 14,000 trades in question executed with Amanat on both sides of the trades. The trading data reveals that, on March 25, 2002, the DIA orders that Amanat, using RLevi2, sent and executed on MarketXT matched one hundred percent of the time. On March 26, 2002, ninety-four percent of the SPY orders and seventy-five percent of the DIA orders matched. On March 27, 2002, the SPY orders sent using RLevi2 matched ninety-nine percent of the time. 27/ As a result, MarketXT averaged six hundred thirty-one trades per day in Tape B securities for the first quarter of 2002, thereby qualifying for rebates. 28/ In June 2002, MarketXT received from Nasdaq nearly $50,000, which represented the revenue earned, in part, because of Amanat's trading. 29/

26/ (...continued)
because, although some of the trades were suggestive of wash or matched trades, the patterns were not as clear.

From the record, we understand that the trading data used by the Division was provided to Amanat. While at the hearing, Amanat objected to the data, asserting that trades were missing, he identified only "OTC" and "World Com" trades and trades that assertedly had routed out of MarketXT. Amanat stated that he had not sought to obtain any additional data from any Tradescape entity. Moreover, he did not offer an alternative analysis of the data produced by the Division.

27/ These percentages contradict the law judge's findings that there were only a "few pairings among the thousands of trades," and that the wash and matched trades were a "small percentage of the market orders in ETFs . . . placed by the RLevi2 program."

28/ Apart from the rebates, Amanat did not make any profits on his trading between March 25 and 27, 2002, using the RLevi2 program. In his brief, Amanat asserts that the RLevi2 program generated profits of $20,000 and that this fact, among others, demonstrates that his trading was not riskless, and therefore was not wash or matched trading. However, Amanat's own testimony contradicts the assertion that he made a profit using RLevi2. At the hearing, he acknowledged that the $20,000 figure reflected "arbitrage profits" from his "mirroring trading and the rest."

29/ In January 2005, Nasdaq reimbursed the CTA for Tape B revenue received based on MarketXT's March 2002 trading. In February 2005, the Commission issued a report of investigation arising out of that trading. See Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 Regarding the Nasdaq Stock Market, Inc., as Overseen by its Parent, the National Association of Securities Dealers, Inc., Exchange Act Rel. No. 51163 (Feb. 9, 2005), 84 SEC Docket 3129.

III.

A. Amanat Willfully Violated Section 10(b) and Rule 10b-5

Exchange Act Section 10(b) makes it unlawful for any person "[t]o use or employ in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." 30/ Rule 10b-5, which implements this section, prohibits fraud, misleading statements or omissions, and any act, practice, or course of business that operates as a fraud "in connection with the purchase or sale of any security." 31/

1. Amanat Engaged in a Fraudulent Scheme

Amanat engaged in a fraudulent scheme to earn rebates for MarketXT. By generating thousands of wash trades and matched orders that MarketXT falsely reported to Nasdaq, Amanat misrepresented the number of legitimate trades in Tape B securities executed by MarketXT for the March 2002 quarter. Amanat's misrepresentations were material because they caused Nasdaq to believe that MarketXT had reached the trading threshold required to qualify for rebates. His misrepresentations triggered Nasdaq's payment to MarketXT of rebates for all of its reported trades, both legitimate and illegitimate. Moreover, Amanat's trades through MarketXT caused Nasdaq to receive more than its proper share of market data revenue, thereby defrauding other CTA participants. 32/

30/ 15 U.S.C. § 78j(b).

31/ 17 C.F.R. § 240.10b-5; see SEC v. Zandford, 535 U.S. 813, 825 (2002) (a scheme to defraud is "in connection with" with a securities transaction if it "coincides" with that transaction).

32/ Amanat claims that Section 10(b)'s materiality requirement was not met because the $50,000 in Tape B revenue that MarketXT gained was so small in comparison to the total amount of Tape B revenue in fiscal year 2002 as to be immaterial. Amanat's conduct in misrepresenting his wash trades was material. Nasdaq and CTA participants reasonably would have wanted to know that trades were illegitimate because those trades enabled MarketXT improperly to qualify for market data revenue. See, e.g., TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 445 (1976) (question of materiality involves significance of omitted or misrepresented fact to reasonable investor). Moreover, the firm earned only $50,000 because Amanat's trading, which he viewed as a long-term strategy, was stopped in its early stages.

Amanat contends that his wash trading could not have violated Section 10(b) and Rule 10b-5 because it did not affect the market price of the ETFs. 33/ However, those provisions have been broadly construed. 34/ Wash and matched trades have long been recognized as fraudulent devices proscribed by Section 10(b) and Rule 10b-5. 35/ In SEC v. Graham, 36/ for example, the court held that wash trades and matched orders arranged by a customer "for the purpose of obtaining a float in a scheme similar to check-kiting" constituted fraud under Section 10(b) and Rule 10b-5. The court found that the customer defrauded the broker-dealers through which he traded by causing those broker-dealers to remit sale proceeds to him that they would not have paid had they known the true nature of the transactions. 37/ Quoting the Supreme Court's decision in United States v. Naftalin, 38/ the court stated that the antifraud provisions were broad

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33/ The OIP did not allege that Amanat's wash trading affected the price of the ETFs. Nor did the Division "stipulate[] that Amanat's trades did not have a deceptive impact on the marketplace," as represented in Amanat's brief. The Division has maintained throughout this proceeding that Amanat used wash and matched trades to defraud Nasdaq and other CTA participants.

34/ See, e.g., Chiarella v. United States, 445 U.S. 222, 226 (1980) ("Section 10(b) was designed as a catch-all clause to prevent fraudulent practices"); Affiliated Ute Citizens v. United States, 406 U.S. 128, 151 (1972) (Section 10(b) and Rule 10b-5 "are broad and, by repeated use of the word 'any,' are obviously meant to be inclusive"); Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 11 n.7 (1971) (Section 10(b) and Rule 10b-5 prohibit all fraudulent schemes in connection with the purchase and sale of securities, whether they involve "a garden type variety of fraud, or present a unique form of deception. Novel or atypical methods should not provide immunity from the securities laws.") (internal quotation marks and citations omitted); SEC v. Nat'l Sec., Inc., 393 U.S. 453, 467 (1969) (courts must look to see whether the "alleged conduct is the type of fraudulent behavior that was meant to be forbidden by the statute and the rule," and ask whether "[t]he broad antifraud purposes of the statute and the rule would clearly be furthered by their application to this type of situation").

35/ See Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 476-77 (1977).

36/ 222 F.3d 994 (D.C. Cir. 2000).

37/ Id. at 1000; see also Orlando Joseph Jett, Securities Act Rel. No. 8395 (Mar. 5, 2004), 82 SEC Docket 1211 (trader's trading strategy of generating illusory profits constituted fraud on firm that employed him because it caused firm to pay trader bonuses and other benefits in reliance on those illusory profits). The Graham court therefore found it unnecessary to address the argument that the customer's trades constituted a fraud on the market.

38/ 441 U.S. 768 (1979).

prohibitions designed to "achieve a high standard of business ethics . . . *in every facet of the securities industry*." 39/

As in Graham, we find that the wash trades and matched orders entered by Amanat for the purpose of obtaining rebates for MarketXT constituted fraud under Section 10(b) and Rule 10b-5. 40/ Amanat committed fraud by generating Tape B rebates in a manner that deceived Nasdaq and CTA participants as to Nasdaq's proper share of market data revenue. 41/

Amanat also contends that his wash trades could not violate Section 10(b) and Rule 10b-5 because they did not meet the "definition" of wash trades on the Commission's website. The website contains a general statement that wash trades violate Rule 10b-5 "if they are done to create the false or misleading appearance of active trading in a security." 42/ However, the website expressly states that this information is provided as a "service" to investors and is

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39/ Graham, 222 F.3d at 1002 (internal quotation marks omitted and emphasis in original).

40/ Amanat's expert testified that Amanat's trading was not fraudulent because it was "common" for traders to engage in trading with "themselves" to generate market data revenue. However, on cross-examination, Amanat's expert could identify only one other instance of such trading, involving Swift Trade Securities USA, Inc. Swift Trade was the subject of an NASD enforcement action for engaging in a deceptive trading scheme from April 2002 to May 2002 to earn rebates, using a computer software program to generate wash trades in QQQs. That action settled in 2002, with NASD imposing censures, fines, and disgorgement against Swift Trade and its president. See NASD Notices to Members (Disciplinary Actions Nov. 2002), 2002 WL 31548129.

41/ We reject Amanat's assertion that his wash and matched trading should have been addressed through rulemaking rather than adjudication. The fact that Amanat used wash and matched trades in connection with a novel scheme to obtain market data rebates does not obviate our broad discretion in determining which method to pursue. See SEC v. Chenery Corp., 332 U.S. 194, 202-03 (1947) ("[A]n administrative agency must be equipped to act either by general rule or by individual order."). "[B]ecause we cannot foresee every possible application of rules, we may determine specific applications on a case-by-case basis in adjudication." KPMG Peat Marwick LLP, 54 S.E.C. 1135, 1173 n.94 (2001), reh'g denied, 55 S.E.C. 1 (2001), pet. denied, 289 F.2d 109 (D.C. Cir. 2002).

We also reject Amanat's assertion that the Division "transform[ed] what, at most, is a claim that [his] activities caused Nasdaq to breach the CTA Plan into a claim for securities fraud." Amanat's conduct was designed to deceive Nasdaq into paying rebates to which MarketXT was not lawfully entitled.

42/ See http://www.sec.gov/answers/wash.htm.

"neither a legal interpretation nor a statement of [Commission] policy." 43/ Furthermore, the fact that Amanat's purpose was to generate rebates for the firm based on trading activity is consistent with the statement on the website.

2. Amanat Acted With Scienter

Violations of Section 10(b) and Rule 10b-5 require scienter, "a mental state embracing intent to deceive, manipulate, or defraud." 44/ It includes recklessness, which is defined as "an extreme departure from the standards of ordinary care" presenting a danger of defrauding others that is "either known to the [respondent] or so obvious that the [respondent] must have been aware of it." 45/ Amanat acted with scienter. 46/ He knew or was, at a minimum, reckless in not knowing that the thousands of ETF trades he was executing on MarketXT in the Irfan and Signr accounts through RLevi2 matched against each other at least seventy-five percent of the time on each of the trading days in question.

43/ Id.; see SEC v. Calvo, 378 F.3d 1211, 1218 (11th Cir. 2004) (summary of telephone interpretation on SEC's website could not afford any relief to defendant where website unambiguously stated that interpretation was not binding).

44/ Ernst & Ernst v. Hochfelder, 425 U.S. at 193 n.12.

45/ Steadman v. SEC, 967 F.2d 636, 641-42 (D.C. Cir. 1992) (quoting Sundstrand Corp. v. Sun Chem. Corp., 553 F.2d 1033, 1045 (7th Cir.), cert. denied, 434 U.S. 875 (1977)). In this case, the law judge, citing The Rockies Fund, Inc. v. SEC, 428 F.3d 1088 (D.C. Cir. 2005), erroneously concluded that the specific intent standard under Section 9(a) of the Exchange Act (prohibiting wash sales and matched orders conducted "[f]or the purpose of creating a false or misleading appearance of active trading" of a registered security on a national exchange) should be applied to wash sales and matched orders under Section 10(b) and Rule 10b-5. The Rockies Fund declined to reach the issue of what standard of intent should be applied to wash trades and matched orders under the statute and rule. In fact, the court observed that "Rule 10b-5 generally requires only extreme recklessness." Id. at 1093 (internal quotation marks and citation omitted). Amanat was not charged with violating Section 9(a).

46/ Amanat argues that we must defer to the law judge's credibility findings. However, the law judge made no explicit credibility findings here. Even if she had, we do not accept those findings "blindly." Kenneth R. Ward, Securities Act Rel. No. 8210 (Mar. 19, 2003), 79 SEC Docket 3035, 3055, aff'd, 75 Fed. Appx. 320 (5th Cir. 2003). Rather, we have stated previously that "there are circumstances where, in the exercise of our review function, we must disregard explicit determinations of credibility." Id. Based on our close review of the record, we find that Amanat's testimony that he did not design his RLevi2 program to generate wash or matched trades was internally inconsistent and belied by substantial, contrary evidence.

The record shows that Amanat knew that MarketXT had "cash flow" problems. He also believed that trading for rebates would be a profitable, long-term strategy. E-mails in the record reflect that Tradescape personnel, including Amanat, viewed rebates as a source of cash. Amanat inquired about the specifics of Nasdaq's rebate program and what it took to earn rebates. He knew that trades that crossed internally within a firm would qualify toward rebates. He knew that a firm, such as MarketXT, that averaged at least five hundred or more daily trades in Tape A or Tape B securities in a calendar quarter would qualify for rebates; that the rebates for trades in Tape B securities were larger than those for Tape A securities; and that trades in ETFs qualified for the larger Tape B rebates. 47/

Amanat conferred with Nasdaq officials and knew that, with one trading week left in the first quarter of 2002, MarketXT needed 18,000 trades to qualify for Nasdaq's rebates. Amanat resolved to "ramp up" his rebate trading in the short time left in the quarter by using RLevi2, a computerized program that he alone designed and operated, and that no one else at Tradescape had seen or understood. Amanat coded RLevi2 to send simultaneous or near simultaneous pairs of buy and sell orders. 48/ We find that the program held the buy order on MarketXT while it waited for a sell order to arrive and execute on MarketXT's system, a system that he knew swept its order book and matched any new buy order against outstanding orders before sending that order to be filled in the marketplace. As a result, the RLevi2 program minimized the risk that Amanat's buy order would execute with a sell order from any market participant other than himself.

Amanat has not disputed that his wash and matched trades involved no change in beneficial ownership. He nonetheless claims that he did not design RLevi2 to generate wash or matched trades. In his brief, Amanat hypothesizes that former MarketXT programmer, Brian Nigito, "reconfigured" MarketXT's system so that his purchase and sell orders would not "route out consecutively as intended, and that the MarketXT program would first sweep the MarketXT

47/ Amanat contends that he also chose to trade in ETFs because the Commission "has acknowledged [in no-action letters] that ETFs are not subject to manipulation by exempting ETFs from [Exchange Act] Rule 10a-1," which requires that short sales must occur at a price above the price at which the immediately preceding sale was affected. Those no-action letters make clear that ETFs are not exempt from the Exchange Act's antifraud provisions. We also have stated that "[n]o-action letters are staff determinations not to recommend enforcement action. They do not necessarily reflect the views of the Commission nor do they have the force of law." Enron Corp., Public Utility Holding Act Rel. No. 27782 (Dec. 29, 2003), 81 SEC Docket 3802, 3821 n.50.

48/ Amanat disputes the characterization of his March 26 and 27, 2002, orders as "simultaneous" or "near simultaneous," arguing that the "cycle time of MarketXT is in milliseconds, not in seconds." We find those trades to be nearly simultaneous and nearly riskless, particularly since the buy orders were held on the firm's system waiting for the corresponding sell orders.

book for matches." He further hypothesizes that "[i]t was this unexpected and unintended circumstance that resulted in the heretofore unheard of washes of market orders in ETFs, creating a 'perfect storm' of 'unintended, inadvertent and unforeseeable' results."

Even assuming that Amanat did not design RLevi2 to generate wash or matched trades, his development and operation of an automated system with a high probability of producing wash and matched trades was reckless. 49/ Operating a computer program that he described as a "work in progress," Amanat continually adjusted RLevi2's parameters between March 25 and 27, 2002, without, according to his testimony, reviewing any of the trades RLevi2 was producing on each of those days. Amanat did not examine his trading even when he learned that he had been accused of "painting the tape" with his trades. 50/ Amanat knew from prior experience assisting Tradescape compliance personnel what wash trades were and that they were illegal. He knew how to safeguard a program against wash trades, but RLevi2 contained nothing to prevent wash trades.

Moreover, Amanat's hypothesis appears to be inconsistent with the evidence. We find particularly significant Amanat's admission at the hearing that he knew that MarketXT's system swept its order book for matches. His own expert confirmed that RLevi2 was configured to hold and match orders on MarketXT before an order would be sent to the marketplace. Furthermore, Amanat acknowledged on cross-examination that he was speculating about whether Nigito had, in fact, changed MarketXT's system. Amanat stated, "These are things I'm assuming from afterwards. . . . I'm not trying to say that is what necessarily happened." While Nigito appeared and testified at the hearing, Amanat never asked Nigito whether, during the time that they were not speaking, Nigito had somehow reconfigured MarketXT's system.

People who saw the trading produced by RLevi2, including Nigito, Bundy, Lauderback, Cummins, Connell, and Nasdaq Market Operations staff, recognized that Amanat's trading was

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49/ At the hearing, Amanat testified that some thirty percent of the RLevi2 trades routed out of MarketXT. However, as indicated previously, he failed to substantiate that claim. While, in his brief, he cites Division Exhibit 27, that exhibit, which discusses trading solely on MarketXT, states that seventy percent of all the trades effected on MarketXT between March 25 and 27, 2002, were wash and matched trades. It says nothing about the percentage of trades routed out of MarketXT. Thus, contrary to the law judge's findings, the substantial majority of orders generated by RLevi2 were held on MarketXT, and not sent out to SuperSOES or otherwise exposed to the rest of the market.

50/ Amanat asserted that, after being accusing by Nigito of "painting the tape," he thought the problem in the trading was caused by limit orders, so he stopped his limit order trading in response. However, on March 25, 2002, Amanat was using market orders, and not limit orders, in DIAs, the security in which his trades were matching on that day. Moreover, Amanat did not stop his limit order trading; rather, he continued to use limit orders on March 26 and 27, 2002.

problematic. Although Amanat claimed that he was ignorant of that fact before March 27, 2002, he was on notice by that afternoon, at the latest, that his program was producing wash and matched trades. Amanat admitted that Connell and Cummins informed him that he had engaged in wash sales in the Signr account and that his trading was "wrong." Nevertheless, he proceeded to ensure that Nasdaq paid MarketXT the rebates that his trading had earned, without revealing to Nasdaq that he had been ordered to stop the trading. 51/

Amanat suggests that, when he contacted Nasdaq on March 28, 2002, he did not know how many trades were "wrong," and therefore non-qualifying, for rebate purposes. However, he knew that, without the thousands of March 27 SPY trades, MarketXT could not possibly meet Nasdaq's trading threshold for rebates. If Amanat was still unsure of the number of MarketXT's qualifying trades, he could have waited to pursue rebates until that number was ascertained. 52/ He had to know by June 2002, when Nasdaq paid $50,000 53/ in rebates to MarketXT, that his

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51/ Amanat claims that "his trading was intended to do exactly what Nasdaq encouraged him to do, i.e., to execute many trades that, with the promised rebates, would be profitable." Clearly, Nasdaq was encouraging legitimate trading, not wash trading. Nasdaq staff considered the March 27, 2002, trading to be unusual for MarketXT, and called the firm to inquire about a "system problem." Amanat also claims that he relied on Nasdaq to insure that RLevi2 complied with applicable regulatory requirements. However, Nasdaq staff never saw the RLevi2 program, nor did they know the nature of Amanat's trading. In any event, Amanat cannot shift his responsibility for compliance to Nasdaq. See, e.g., Castle Sec. Corp., Exchange Act Rel. No. 52580 (Oct. 11. 2005), 86 SEC Docket 1466, 1469 n.8.

Amanat also blames his colleagues for failing to ensure that RLevi2 did not produce wash trades, or for failing to break his trades and stop him from trading once they knew what it had produced. As stated earlier, no one at Tradescape saw the RLevi2 program or knew how RLevi2 operated. Once the nature of Amanat's trading was discovered, Tradescape personnel disabled the program, and subsequently told Amanat to stop the trading after he restarted it. Even if they had failed to stop him sooner, Amanat was responsible for his own actions. See, e.g., Jett, 82 SEC Docket at 1249 ("Even if, contrary to the record, Jett's supervisors and co-workers knew about his fraud on the firm – indeed even if they ordered him to commit it – that would not relieve Jett of responsibility for what he knew or was reckless in not knowing and for what he did.").

52/ Amanat did not argue or point to any evidence that he was under a time deadline in pursuing rebates from Nasdaq.

53/ Amanat asserts that only a portion of the trades that qualified MarketXT for a $50,000 rebate were attributable to his wash trading and that some of the trading was legitimately

(continued...)

trading improperly had qualified the firm for that revenue. 54/ Amanat willfully violated Section 10(b) and Rule 10b-5. 55/

IV.

A. Bar from Association

Exchange Act Section 15(b)(6) 56/ authorizes the Commission to bar a person associated with a broker-dealer if he has willfully violated the federal securities laws and such sanction is in the public interest. In determining whether a bar is in the public interest, we consider the factors identified in Steadman v. SEC. 57/ Those factors include the degree of scienter involved, the isolated or recurrent nature of the infraction, the sincerity of any assurances against future violations, and the likelihood that a respondent's occupation will present opportunities for future violations. 58/

Amanat committed serious violations of the antifraud provisions. He defrauded Nasdaq and, through Nasdaq, other CTA participants of valuable market data revenue when he executed over 14,000 wash and matched trades that MarketXT reported to Nasdaq. Amanat's conduct

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53/ (...continued)
done by others. However, Amanat would not have met the trading threshold necessary to obtain rebates without his wash and matched trades on March 25, 26, and 27, 2002.

54/ Amanat raises a vague claim that he was the victim of "selective prosecution." To prevail on such a claim, he must establish that he was singled out for enforcement action while others similarly situated were not, and that his prosecution was motivated by arbitrary or unjust considerations, such as race, religion, or the desire to prevent his exercise of a constitutionally-protected right. See, e.g., Amato v. SEC, 18 F.3d 1281, 1285 (5th Cir.), cert. denied, 513 U.S. 928 (1994). Amanat has not substantiated any of those elements.

55/ A willful violation of the securities laws means the intentional commission of an act that constitutes the violation; there is no requirement that the actor must "also be aware that he is violating one of the Rules or Acts." Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000) (internal quotation marks and citation omitted). In light of our conclusion that Amanat willfully violated Section 10(b) and Rule 10b-5, we do not address whether he willfully aided and abetted, and was a cause of, MarketXT's violations.

56/ 15 U.S.C. § 78o(b)(6).

57/ 603 F.2d 1126, 1140 (5th Cir. 1979), aff'd on other grounds, 450 U.S. 91 (1981).

58/ Id. at 1140.

demonstrates at least recklessness. He continued trading despite accusations that he was "painting the tape" with his trades. After being warned that his trading was "wrong" and had to stop, he continued to pursue rebates for the trades, concealing from Nasdaq what he had been told about the improper nature of his trading. Amanat's trading was not an isolated incident, but a recurrent pattern that stopped only after it was detected.

Amanat has offered no assurances against future violations. His involvement in the financial industry presents opportunities for future violations. While Amanat asserts in his brief that he has been "effectively unemployed" as of January 2003, the record reflects that he has held at least two positions since then. In 2003, he was a consultant for Computer Clearing Services, Inc. ("CCS"), a clearing firm and broker-dealer, where he was paid $100,000 a year. From 2004 or 2005 until recently, he was associated with FX Trading, LLC ("FXT"), a futures commission merchant, where he served as "chief technical officer" and was responsible for the firm's financial records. 59/ Given his age (30's) and prior experience, Amanat will have ample opportunities to commit future violations if a bar is not imposed.

In addition, we note that, in February 2005, NASD found that Amanat omitted to describe his role at CCS or tell NASD that our enforcement staff had requested a "Wells submission" 60/ in this matter during NASD's consideration of CCS's application to transfer a controlling interest in CCS to an Amanat family-owned and controlled entity. In denying CCS's application, NASD concluded that CCS failed to demonstrate that it and its associated persons, including Amanat, were capable of complying with the federal securities laws and NASD rules. 61/ In a June 2006 proceeding against FXT, the National Futures Association ("NFA") found that Amanat was acting as a principal of FXT, without being registered as one, in violation of NFA registration

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59/ The Division has moved, pursuant to Rule of Practice 452, for leave to adduce this new evidence concerning Amanat's activities. See 17 C.F.R. § 201.452 (motion for leave to adduce additional evidence "shall show with particularity that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence previously"). We have determined to grant the motion. The documents are material because they contradict representations made by Amanat in his submissions on appeal. There were reasonable grounds for the Division's failure to adduce the documents previously because they did not exist until after the hearing before the law judge.

60/ A "Wells submission" is an opportunity for a person involved in an investigation to provide a written statement to the Commission setting forth the person's interests and position with regard to the subject matter of the investigation. 17 C.F.R. § 202.5(c).

61/ See Membership Continuance Application of Computer Clearing Services, Inc., Application No. A02036058 (NASD National Adjudicatory Council Feb. 10, 2005) (finding that CCS's application contained inaccurate statements concerning Amanat's role at CCS and his failure to disclose the investigation that led to this proceeding).

rules. 62/ The record as a whole, especially the evidence regarding the seriousness of Amanat's violations, the degree of scienter involved, the lack of assurances against future violations, and the opportunity to commit future violations, leads us to conclude that imposition of a bar with a right to reapply in five years is a measured response to Amanat's wrongdoing when evaluated against the Steadman factors and is appropriate in the public interest.

B. Cease-and-Desist Order

Exchange Act Section 21C authorizes the Commission to enter a cease-and-desist order against any person who "is violating, has violated, or is about to violate" any provision of the Exchange Act or rule or regulation thereunder. 63/ In considering whether a cease-and-desist order is appropriate, we look to whether there is some risk of future violations. 64/ We also consider whether other factors demonstrate a need for a cease-and-desist order, including the seriousness of the violation, its isolated or recurrent nature, whether the violation is recent, the degree of harm to investors or the marketplace resulting from the violation, the respondent's state of mind, the sincerity of assurances against future violations, the opportunity to commit future violations, and the remedial function to be served by a cease-and-desist order in the context of any other sanctions sought in the proceeding. 65/

Amanat engaged in multiple acts producing thousands of wash and matched trades in three days. His trading fraudulently induced Nasdaq to pay MarketXT rebates and improperly inflated Nasdaq's volume to the detriment of other CTA participants, a harm that likely would have increased if the trading had not been detected and stopped. As we have found, Amanat's conduct was at least reckless. He has remained involved in the financial industry, and thus has opportunities to commit future violations. The recent findings made by NASD and the NFA underscore his failure or refusal to comply with applicable regulatory requirements. Moreover, his wash or matched trading to generate market data revenue detracted from the accuracy and usefulness of the market data streams. We conclude that Amanat poses a substantial, continuing risk of harm to investors and the marketplace. A cease-and-desist order is in the public interest.

62/ See FX Trading, LLC & Shaheryar Khan, NFA Case No. 06-BCC-001 (NFA Business Conduct Committee June 7, 2006) (finding numerous violations of NFA rules and imposing permanent bar against FXT and Khan).

63/ 15 U.S.C. § 78u-3.

64/ KPMG, 54 S.E.C. at 1185. The risk of future violations required to support a cease-and-desist order is significantly less than that required for an injunction. Id. at 1191. A single violation can be sufficient to indicate some risk of future violation. See Geiger v. SEC, 363 F.3d 481, 489 (D.C. Cir. 2004).

65/ KPMG, 54 S.E.C. at 1192.

C. Civil Money Penalties

Exchange Act Section 21B(a) authorizes the Commission to assess a civil money penalty where a respondent has willfully violated the Exchange Act or rules and regulations thereunder, and such a penalty is in the public interest. 66/ It specifies a three-tier system identifying the maximum amount of a penalty. For each "act or omission" by a person, the maximum amount of a penalty is $6,500 in the first tier, $60,000 in the second tier, and $120,000 in the third tier. 67/ A second-tier penalty is permissible if the act or omission involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement. 68/

The Division seeks a second-tier penalty against Amanat. Because his conduct involved fraud, a second-tier penalty is permissible. Although the Division has requested $60,000 for each violative act or trading day, for a total of $180,000, we have determined to consider the three-day trading period as one act. A $60,000 civil money penalty is within statutory limits.

We further find that Amanat's violations harmed Nasdaq and other CTA participants. 69/ While MarketXT, and not Amanat, was directly enriched by his conduct, Amanat and his family held an ownership interest in Tradescape, which included MarketXT as a subsidiary. Amanat does not appear to have been the subject of prior regulatory action. However, findings in recent proceedings by other regulatory bodies indicate a strong likelihood of future violations. The need

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66/ 15 U.S.C. § 78u-2(a). In deciding whether a penalty is in the public interest, the Commission may consider the following six statutory factors: (1) fraud; (2) harm to others; (3) unjust enrichment; (4) prior violations; (5) need for deterrence; and (6) such other matters as justice requires. 15 U.S.C. § 78u-2(b).

67/ Pursuant to the Debt Collection Improvement Act of 1996, the Commission has increased the maximum penalty amounts for violations. See 17 C.F.R. § 201.1002, Subpt. E, Table II.

68/ 15 U.S.C. § 78u-2(b)(2). A third-tier penalty not only must have involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement, but also must have "directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons or resulted in substantial pecuniary gain to the person who committed the act or omission." 15 U.S.C. § 78u-2(b)(3).

69/ See supra text at pp.15 &17.

to deter misconduct by others is present. 70/ A second-tier civil money penalty of $60,000 is in the public interest.

An appropriate order will issue. 71/

By the Commission (Chairman COX and Commissioners ATKINS, CAMPOS and CASEY); Commissioner NAZARETH not participating.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

70/ Amanat's assertion that he cannot pay a civil money penalty is unsubstantiated. He has not filed any required documentation, such as a sworn financial statement demonstrating an inability to pay. The Division's newly-produced evidence indicates that, at a February 2006 district court hearing on a preliminary injunction motion brought by the Commodity Futures Trading Commission against FXT, Amanat appeared and did not dispute evidence that he had a personal bank account at the Bank of Dubai containing at least $350,000, as of November 2005.

71/ We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 54708 / November 3, 2006

Admin. Proc. File No. 3-11813

In the Matter of

IRFAN MOHAMMED AMANAT

ORDER IMPOSING REMEDIAL SANCTIONS

On the basis of the Commission's opinion issued this day, it is

ORDERED that Irfan Mohammed Amanat be, and he hereby is, barred from association with any broker or dealer subject to a right to reapply for association after five years to the appropriate self-regulatory organization or, if there is none, to the Commission; and it is further

ORDERED that Amanat cease and desist from committing or causing any violations or future violations of Section 10(b) or Rule 10b-5 of the Securities Exchange Act of 1934; and it is further

ORDERED that Amanat pay a civil money penalty of $60,000.

Payment of the civil money penalty shall be: (i) made by United States postal money order, certified check, bank cashier's check, or bank money order; (ii) made payable to the Securities and Exchange Commission; (iii) mailed or delivered by hand to the Office of Financial

Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Alexandria, VA 22312; and (iv) submitted under cover letter that identifies the respondent and the file number of this proceeding.

A copy of the cover letter and check shall be sent to Valerie A. Szczepanik, Division of Enforcement, Securities and Exchange Commission, Northeast Regional Office, 3 World Financial Center, Room 4300, New York, NY 10281-1022.

By the Commission.

Nancy M. Morris
Secretary

Jill M Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 54710 / November 3, 2006

Admin. Proc. File No. 3-11812

In the Matter of

JAMES T. PATTEN

OPINION OF THE COMMISSION

BROKER-DEALER PROCEEDING

CEASE-AND-DESIST PROCEEDING

Grounds for Remedial Action

Manipulation

Associated person of registered broker-dealer charged with manipulating, and aiding and abetting another's manipulation of, the price of securities sold to public investors. Held, proceeding is dismissed.

APPEARANCES:

Ira Lee Sorkin, of Dickstein Shapiro Morin & Oshinsky, LLP, for James T. Patten.

William Kuehnle, Donald Dowie, and Keshia West, for the Division of Enforcement.

Appeal filed: December 29, 2005
Last brief received: May 3, 2006
Oral argument: October 11, 2006

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I.

James T. Patten, president and owner of Greater Metropolitan Investment Services, Inc. ("GMIS"), a broker-dealer formerly registered with the Commission, appeals from the decision of an administrative law judge finding that Patten violated antifraud provisions of the securities laws 1/ as a result of what the law judge found to be Patten's manipulative trading activity in the stock of Initio, Inc., which was then listed on the Nasdaq Small Cap Market. The law judge barred Patten from association with any broker or dealer, ordered him to pay a $60,000 civil penalty, and ordered him to cease and desist from committing, causing, or aiding and abetting violations of the provisions he was found to have violated. We base our decision upon an independent review of the record.

II.

This case concerns trading in Initio stock during the latter half of 2002 and early 2003. During this time, Initio's president, Martin Fox, was negotiating a possible merger of Initio with a third party. It is undisputed that the potential merger was dependent on Initio remaining listed on Nasdaq, and that such listing was threatened when, in May 2002, Initio's bid price began consistently to close below $1 per share, the minimum price required for continued listing on Nasdaq. 2/

On July 25, 2002, Initio's bid price had closed below $1 for thirty consecutive trading days, and, as a result, Nasdaq notified Fox that Initio's stock would be delisted unless, within the next 180 days, its bid price closed at or above $1 for at least ten consecutive trading days. Thereafter, during the summer and early fall of 2002, Fox placed a series of orders to buy Initio shares at prices above $1, both with GMIS and with another firm with which he had accounts. Patten apparently was unaware of the orders Fox placed with this other firm. Other market participants who were unaffiliated with Initio or Patten and not alleged by the Division to have

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1/ Specifically, Patten was charged with violating and causing violations of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5, and aiding and abetting and causing another's violation of those same provisions, which prohibit the use of manipulative and deceptive devices in connection with the purchase or sale of a security.

2/ NASD Rule 4310(c)(4) requires that securities maintain a minimum closing inside bid price of at least $1 for continued inclusion on Nasdaq's Small Cap Market. The closing inside bid of a stock is set by the inside, or highest, bid reflected by a market maker at the close of the market. When a security's closing bid price falls below $1 for thirty consecutive trading days, "the issuer shall be notified promptly and shall have a period of 180 calendar days from such notification to achieve compliance. Compliance can be achieved . . . by meeting the applicable standard for a minimum of 10 consecutive business days." NASD Rule 4310(c)(8)(D).

been involved with the manipulation, including various firms making a market in Initio, also entered orders or raised their bids above $1, with the result that, between July 26 and September 10 (a total of thirty-two consecutive trading days), Initio's bid price closed at or above $1. Orders that Patten entered on behalf of Fox caused Initio's closing bid price to equal or exceed $1 on five of those days. In late August, Nasdaq notified Initio that, because its stock price had returned to the requisite level for the required period, it would not be delisted.

Thereafter, during the fall of 2002, Initio's stock price again fell below $1. Consequently, in late October, Nasdaq again notified Initio that it would be delisted unless its closing bid price reached or exceeded $1 for ten consecutive days during the next 180-day period. Approximately one month later, and following further negotiations regarding Initio's possible merger, Fox and Patten, who had not traded in the stock during most of the fall, independently began placing orders to buy Initio shares at prices ranging from $.89 to $1.03. Although Patten's orders had the effect of causing Initio's closing bid price to exceed $1 on several days during late November through early January, the company failed to achieve that price for the requisite ten-day period set by Nasdaq. Initio was delisted by Nasdaq later that spring, and failed to effect the merger that was being negotiated.

III.

Certain of the circumstantial evidence in this case could be consistent with Patten's involvement with the manipulation of Initio's stock price. The record, however, does not include sufficient circumstantial and direct evidence to impose liability on Patten. There is an apparent temporal link between Initio's merger negotiations and threatened delisting on the one hand and, on the other, Patten's entry of orders at Fox's direction and for himself to buy Initio shares at or above the $1 level. But there is no evidence in the record that Patten was at any time aware of either the merger negotiations or of the threat to Initio's listing status. Nor is the evidence regarding the nature of Patten's relationship with Fox sufficient to support a finding that Patten was assisting Fox's efforts to manipulate the price of Initio.

Other circumstantial evidence is ambiguous, or supports the opposite inference. Patten's trading during the summer of 2002 affected the closing bid on only a small number of days; the closing bid price was set on the majority of trading days during that period by market participants unaffiliated with Initio or Patten. During the following winter, Patten's trading activity never produced the result he was allegedly seeking – causing the closing bid price to equal or exceed $1 for at least ten consecutive days – although there did not appear to be any market impediment to doing so. In fact, on several days during the period at issue, Patten entered orders to sell Initio stock, placing downward pressure on its price and, presumably, acting counter to the alleged manipulation.

Under all the circumstances, and based on our de novo review of the record, we have concluded that the record before us does not establish by a preponderance of the evidence that Patten committed the offenses charged. 3/ We will accordingly dismiss this proceeding.

An appropriate order will issue. 4/

By the Commission (Chairman COX and Commissioners ATKINS, CAMPOS, NAZARETH, and CASEY).

Nancy M. Morris
Secretary

3/ On August 8, 2006, the Division submitted an unopposed motion to adduce additional evidence regarding Patten's recent disciplinary history. Under Commission Rule of Practice 452, 17 C.F.R. § 201.452, the evidence must be material, and there must be reasonable grounds for failure to adduce such evidence previously. We have determined to grant the Division's motion and have considered the additional evidence in our review of this matter.

4/ We have considered all of the contentions advanced by the parties. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 54710 / November 3, 2006

Admin. Proc. File No. 3-11812

In the Matter of

JAMES T. PATTEN

ORDER DISMISSING PROCEEDINGS

On the basis of the Commission's opinion issued this day it is

ORDERED that the proceedings instituted on February 8, 2005 against James T. Patten be, and they hereby are, dismissed.

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 54699 / November 3, 2006

Admin. Proc. File No. 3-12143

In the Matter of the Application of

JUSTIN F. FICKEN
c/o Gary G. Pelletier, Esq.
Denner O'Malley LLP
Four Longfellow Place, 35th Floor
Boston, Massachusetts 02114

For Review of Disciplinary Action Taken by

NASD

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION -- REVIEW OF DISCIPLINARY PROCEEDING

Failure to Provide Requested Testimony

Former associated person of member firms of registered securities association asserted the privilege against self-incrimination in response to association's request for certain testimony during an initial on-the-record interview and failed to appear for a subsequent on-the-record interview. Held, the proceeding is remanded for further consideration.

APPEARANCES:

Gary G. Pelletier and Brad Bailey, of Denner O'Malley LLP, for Justin F. Ficken.

Marc Menchel, Alan Lawhead, and Leavy Mathews III, for NASD.

Appeal filed: January 9, 2006
Last brief received: April 24, 2006

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I.

Justin Farley Ficken, a former general securities representative of Prudential Securities, Inc. ("Prudential") and of its successor, Wachovia Securities, LLC ("Wachovia"), both NASD member firms, appeals from NASD disciplinary action. NASD found that Ficken refused to provide requested testimony at an on-the-record interview ("OTR") and failed to appear for a subsequent OTR, in violation of NASD Procedural Rule 8210 and NASD Conduct Rule 2110. 1/ NASD barred Ficken from associating with any NASD member in any capacity. 2/ To the extent we make findings, we base them on an independent review of the record.

II.

Ficken was a general securities representative with Prudential from January 2000 until July 2003, when his registration was transferred to Wachovia. On September 29, 2003, Ficken resigned from Wachovia. 3/ On October 2, 2003, NASD opened an investigation into Ficken's

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1/ NASD Procedural Rule 8210 requires members and associated persons to provide testimony in connection with any NASD investigation, complaint, examination, or proceeding. NASD Conduct Rule 2110 requires members and associated persons to observe high standards of commercial honor and just and equitable principles of trade. Violations of NASD rules such as NASD Procedural Rule 8210 constitute conduct inconsistent with the just and equitable principles of trade provisions of NASD Conduct Rule 2110. See, e.g., Elliot M. Hershberg, Securities Exchange Act Rel. No. 53145 (Jan. 19, 2006), 87 SEC Docket 494, 497 (holding that the failure to provide information requested by NASD constitutes a failure to observe high standards of commercial honor and just and equitable principles of trade), appeal filed, No. 06-1086 (2d Cir.); E. Magnus Oppenheim & Co., Exchange Act Rel. No. 51479 (Apr. 6, 2005), 85 SEC Docket 475, 478 (holding that a violation of another NASD rule is also a violation of NASD Conduct Rule 2110); Chris Dinh Hartley, Exchange Act Rel. No. 50031 (July 16, 2004), 83 SEC Docket 1239, 1244 (same); Stephen J. Gluckman, 54 S.E.C. 175, 185 (1999) (same).

2/ NASD also assessed costs.

3/ Ficken's departure coincided with increasing regulatory scrutiny of certain Prudential associated persons' alleged improper market timing and late trading activities in mutual funds. On November 4, 2003, the Commission filed a complaint against Ficken and some of his former Prudential associates in the United States District Court for the District of Massachusetts alleging, among other things, fraud in connection with their market timing trades in numerous mutual funds. See SEC v. Martin J. Druffner, et al., Civil Action No. 03-12154-RCL (D. Mass. Nov. 4, 2003). That same day, the Commission issued a press release announcing the civil fraud action and acknowledging "the assistance of the Secretary of the Commonwealth of Massachusetts, NASD, and the

(continued...)

activities to determine whether he had engaged in, among other things, improper market timing and late trading in mutual fund shares while he was at Prudential. According to a declaration filed by the NASD special investigator responsible for that investigation, NASD decided to investigate Ficken after it learned that Ficken had been terminated by Wachovia "in connection with an already existing NASD investigation into market timing and late trading activity in mutual fund shares" at Prudential. 4/

The OTRs and Ficken's Assertion of the Fifth Amendment Privilege

On November 20, 2003, NASD sent a letter to Ficken requesting his appearance, pursuant to NASD Procedural Rule 8210, at an OTR scheduled for December 17, 2003. Ficken appeared at the scheduled OTR and answered questions, primarily about market timing, for over three hours. When NASD staff questioned Ficken about his involvement in late trading activity at Prudential, Ficken's attorney requested that the OTR be adjourned to consider Ficken's assertion of the Fifth Amendment privilege against self-incrimination. 5/ Ficken's counsel stated that "we are aware there's a grand jury in Boston and that they're receiving information from the [Commission]; and we're aware also that -- we are aware also that members of the NASD have been consulting with the [Commission]." Thereafter, Ficken, on the advice of counsel, asserted his Fifth Amendment privilege against self-incrimination in response to certain questions propounded by NASD staff. The OTR subsequently was adjourned.

3/ (...continued)
New York Stock Exchange in [the Commission's] investigation." See Lit. Rel. No. 18444 (Nov. 4, 2003).

Also on November 4, 2003, the Enforcement Section of the Massachusetts Securities Division of the Office of the Secretary of the Commonwealth of Massachusetts (the "Massachusetts Securities Division") filed an administrative complaint against Ficken and certain of his former Prudential associates regarding the same allegations charged in the Commission's complaint. See Docket No. E-2003-259 (Nov. 4, 2003). Ficken subsequently informed NASD in the proceeding below that he had received notice that the New York Stock Exchange was conducting a similar investigation regarding such allegations. The record does not indicate when Ficken received such notice.

4/ On October 20, 2003, Wachovia filed a Uniform Termination Notice for Securities Industry Registration for Ficken, stating that he was permitted to resign due to "business practices inconsistent with management philosophy." Ficken has not been associated with any NASD member since leaving Wachovia.

5/ The Fifth Amendment to the United States Constitution provides that no person shall be compelled in any criminal case to be a witness against himself. U.S. CONST. amen. V.

In early January 2004, NASD scheduled a subsequent OTR with Ficken for later that month. At the request of Ficken's counsel, the OTR was twice postponed and rescheduled ultimately for February 9, 2004. On February 6, 2004, three days before the rescheduled OTR, Ficken's counsel informed NASD in writing that Ficken would "not present himself to the NASD for further testimony on February 9, 2004" because Ficken had been informed by the United States Department of Justice (the "DOJ") that he was a "target of a federal criminal investigation" and was likely to be indicted on "matters similar, or relating, to the same circumstances about which the NASD is seeking his testimony." 6/ Ficken did not appear at the February 9, 2004 OTR and has not provided any further testimony to NASD.

The Prehearing Conference

On February 11, 2004, NASD's Department of Enforcement ("NASD Enforcement") filed a complaint against Ficken, alleging that he failed to appear for an OTR and respond to questions relating to allegations of late trading. On March 5, 2004, NASD Enforcement moved for summary disposition.

At a prehearing conference on April 6, 2004, Ficken's counsel stated that he was prepared to show that an NASD employee had worked with the Commission on this case, in support of the theory that NASD was a "state actor." Ficken's counsel also asserted that he believed Ficken could produce evidence of sufficient cooperation among the Commission, NASD, the DOJ, and the New York Stock Exchange (the "NYSE") to show that the nature of the actions being brought by them against him were all the same. NASD counsel countered that NASD had conducted "a separate independent investigation and the NASD has handled it in that way from day one."

Noting that the Hearing Panel lacked authority to subpoena witnesses, the Hearing Officer stated that "[w]e have always had employees come in, never had a case where they have refused." The Hearing Officer suggested that, if Ficken sought to call the NASD employee referred to by Ficken's counsel as a witness at a hearing and NASD declined to make him available, the Hearing Officer might draw an adverse inference against NASD based on its refusal. The Hearing Officer deferred a ruling on NASD Enforcement's motion for summary disposition "pending the completion of discovery" of any evidence supporting the allegation that NASD functioned as a state actor in its prosecution of this case.

On April 30, 2004, Ficken's counsel sent a letter to the Hearing Officer to update him on counsel's attempts to obtain testimony from an NASD employee and a Commission employee,

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6/ Ficken's counsel had received on January 13, 2004 a formal notification from the DOJ that Ficken was "the target of a federal grand jury investigation in the District of Massachusetts regarding alleged violations of federal securities laws . . . in connection with his activities at [Prudential]" and likely would be indicted. In his most recent brief to the Commission, filed on April 24, 2006, Ficken states that he has yet to be indicted.

both of whom were identified by name. 7/ The letter explained that neither the Commission nor NASD would make their respective employees available for testimony.

Replacement of Hearing Officer

On May 18, 2004, the Hearing Officer in the proceeding was reassigned and a different Hearing Officer designated in his place. 8/ On May 25, 2004, the new Hearing Officer held a prehearing conference. Ficken's counsel asserted that "the information that is being developed during an interrogation of Mr. Ficken . . . is being turned over to the [Commission] or the [Commission] has access [to] it and the [Commission] is also cooperating with the [DOJ]." 9/

Ficken's counsel also claimed that the NASD employee in question "had done some calculations with or had given them to the [Commission] and had been in communication with" a Commission employee, and "that the information being developed by the NASD and the calculations and some of the documents that the NASD produced at the earlier testimony of Mr. Ficken is finding its way ultimately into the [DOJ]'s investigation and also to the [Commission]." Ficken's attorney stated further that the DOJ was "looking at emails that were the subject of inquiry made by the NASD to [Ficken] when I was present at the first proceedings. To my knowledge the likely sources that would have produced those e-mails to the [DOJ] have been narrowed down to either the [Commission] or the NASD." NASD counsel countered that Commission access to NASD files does not make NASD a state actor. He argued that even though NASD Enforcement had made available to Ficken's counsel all investigative files that were subject to Ficken's discovery, Ficken provided no detail or support for his claims about shared "calculations." NASD counsel also argued that Ficken previously had provided testimony to Commission staff in the Commission's pending proceeding. He stated that during the OTR, while Ficken answered questions related to market timing, Ficken would not respond to

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7/ The NASD employee identified by Ficken was one of the NASD staff members who questioned Ficken at the December 17, 2003 OTR.

8/ The record does not disclose the reason for the reassignment of this proceeding to a new Hearing Officer.

9/ According to Ficken, on May 24, 2004, at a separate prehearing conference in connection with the Massachusetts Securities Division's administrative complaint against him, the Assistant United States Attorney (the "AUSA") involved with the DOJ's criminal investigation moved for a limited stay of discovery in the Massachusetts Securities Division case. Ficken maintains that the AUSA stated that the Massachusetts Securities Division case was "parallel" to the DOJ's criminal investigation of him. According to Ficken, the Massachusetts Securities Division granted a limited stay until September 30, 2004. Ficken also asserts that the DOJ attempted, unsuccessfully, to obtain a stay of the Commission's civil action against him on the purported basis that the Commission's action ran parallel to the DOJ's criminal investigation.

questions about late trading. NASD counsel noted that the Commission's civil action did not allege late trading.

Summary Disposition

On June 14, 2004, a Hearing Panel granted NASD Enforcement's motion for summary disposition and barred Ficken from associating with any NASD member in any capacity. On July 8, 2004, Ficken appealed the Hearing Panel's decision to NASD's National Adjudicatory Council (the "NAC"). Ficken moved to introduce into evidence documents in addition to the correspondence from his counsel that has been discussed above, including a Commission press release. 10/ On December 7, 2005, the NAC affirmed the Hearing Panel's findings and sanction. The NAC found that Ficken's "unsubstantiated, generalized assertion" that NASD staff forwarded some of its documents regarding the Ficken investigation to the Commission and the DOJ "demonstrates no government coercion or significant encouragement and does not support a finding that NASD's investigation of him was state action." 11/ The NAC also found that Ficken's claims were insufficient to raise an inference that NASD Enforcement's investigation should be attributed to the government. The NAC concluded that Ficken was not excused from his obligation to provide the requested testimony and affirmed the Hearing Panel's decision to grant summary disposition in this matter. Finding no mitigating factors, the NAC affirmed the Hearing Panel's imposition of a bar against Ficken. This appeal followed.

III.

We must determine whether Ficken engaged in the conduct found by NASD, whether the conduct violated the NASD rules he was found to have violated, and whether those rules were applied in a manner consistent with the purposes of the Securities Exchange Act of 1934. 12/ Applying this standard, we note that Ficken did not fully respond to the questions propounded by NASD staff at the OTR on December 17, 2003. While Ficken answered questions related to market timing, he invoked his Fifth Amendment privilege against self-incrimination in refusing to answer questions concerning his involvement in late trading activity at Prudential. Moreover, he declined to appear at the subsequent OTR. The failure to respond to NASD's requests for

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10/ See supra note 3. The other documentary evidence consisted of two news articles regarding NASD sanctions against top executives of other financial firms. Ficken also moved to stay the NAC proceeding for one year in light of his "imminent federal criminal indictment" in the DOJ investigation. Ten months later, on May 13, 2005, the NAC denied Ficken's stay motion and admitted the other evidence, but denied introduction of the Commission press release. On May 19, 2005, the NAC heard oral argument.

11/ Dep't of Enforcement v. Justin F. Ficken, Complaint No. C11040006, 2005 NASD Discip. LEXIS 7, at *9 (NAC Dec. 7, 2005).

12/ See Exchange Act Section 19(e)(1), 15 U.S.C. §78s(e)(1).

testimony demonstrates a prima facie violation of NASD Procedural Rule 8210. In asserting his Fifth Amendment privilege against self-incrimination as a defense against NASD Procedural Rule 8210 and NASD Conduct Rule 2110 violations, Ficken must show that NASD's actions constituted state action.

Ficken contends that he was unable to meet his burden to show that NASD's actions constituted state action, because NASD did not afford him adequate discovery prior to granting summary disposition. Therefore, we next consider whether NASD followed its summary disposition rules in a manner consistent with the Exchange Act. Under NASD's rules, summary disposition is appropriate where there "is no genuine issue with regard to any material fact " and the moving party "is entitled to summary disposition as a matter of law." 13/ NASD's summary disposition rules generally are based on the Federal Rules of Civil Procedure governing summary judgment. 14/ Summary disposition is appropriate against a party that, after adequate time for discovery, "fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which the party will bear the burden of proof" at a hearing. 15/

In its decision on summary disposition in this proceeding, NASD observed that courts have held that it may be treated as a state actor if the government has exercised "coercive power" over NASD or "has provided such significant encouragement, either overt or covert" that its actions "must in law be deemed to be that of the State." 16/ NASD concluded that Ficken "offered no evidence that the government compelled NASD's investigation of him." 17/ NASD also concluded that the "government's use of information generated from NASD's independent

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13/ NASD Procedural Rule 9264(e).

14/ See, e.g., Dep't of Enforcement v. U.S. Rica Fin., Inc., Complaint No. C01000003, 2003 NASD Discip. LEXIS 24, at *12 (NAC Sept. 9, 2003) (stating that federal law provides significant guidance in cases involving motions for summary disposition); Order Approving a Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to Amendments to the Code of Procedure and Other Provisions, Exchange Act Rel. No. 43102 (Aug. 1, 2000), 72 SEC Docket 2976, 2978 (approving proposal "to modify NASD Rule 9264(a) to track the language in the [Federal Rules of Civil Procedure] . . . .").

15/ Celotex Corp. v. Catrett, 477 U.S. 317, 322 (1986). All reasonable inferences must be drawn in favor of the party opposing summary judgment. See, e.g., Harris v. Coweta County, Ga., 433 F.3d 807, 810 (11th Cir. 2005); U.S. Rica Fin., Inc., 2003 NASD Discip. LEXIS 24, at *12.

16/ 2005 NASD Discip. LEXIS at *8, quoting D.L. Cromwell Invs., Inc. v. NASD Regulation, Inc., 279 F.3d 155, 161 (2d Cir. 2002).

17/ Id. at *11.

regulatory and enforcement duties does not establish NASD as a state actor." 18/ Based on these considerations, NASD determined that its denial of a hearing in this matter was consistent with its precedent.

In Frank P. Quattrone, a disciplinary proceeding also considering assertion of the Fifth Amendment privilege, we noted that the Fifth Amendment restricts only governmental conduct, and will constrain a private entity only insofar as its actions are found to be "fairly attributable" to the government. 19/ A violation of the Fifth Amendment, therefore, requires "state action" on the part of the private entity whose actions are being challenged. 20/

As we noted in Quattrone, the Supreme Court has held that private parties' actions may constitute state action if there is such a "close nexus between the State and the challenged action" that the seemingly private behavior "may be fairly treated as that of the State itself." 21/ According to the Court, "no one fact can function as a necessary condition across the board for finding state action; nor is any one set of circumstances absolutely sufficient, for there may be some countervailing reason against attributing activity to the government." 22/ The Court has identified certain facts "that can bear on the fairness of such an attribution," such as whether a challenged activity "results from the State's exercise of its 'coercive power'"; whether "the State provides 'significant encouragement, either overt or covert'"; or whether "a private actor operates as a 'willful participant in the joint activity with the State or its agents.'" 23/ Some courts have described this last fact pattern as the "joint action" test, and have focused on inquiries such as whether "the state has so far insinuated itself into a position of interdependence with the private entity that it must be recognized as a joint participant in the challenged activity" or whether "the particular actions challenged are inextricably intertwined with those of the government." 24/

18/ Id.

19/ Exchange Act Rel. No. 53547 (Mar. 24, 2006), __ SEC Docket ___, citing D.L. Cromwell, 279 F.3d at 161 (citing Lugar v. Edmondson Oil Co., 457 U.S. 922, 937 (1982)).

20/ Id.

21/ Brentwood Acad. v. Tennessee Secondary Sch. Ath. Ass'n, 531 U.S. 288, 295 (2001).

22/ Id. at 295-296.

23/ Id. at 296.

24/ See, e.g., Kirtley v. Rainey, 326 F.3d 1088, 1092, 1094 (9th Cir. 2003) (stating that "joint action" test and "government compulsion" test are separate tests for establishing state action and under the former considering whether "the state has so far insinuated itself into a position of interdependence with the private entity that it must be recognized as a joint (continued...)

We noted in Quattrone that the court in D.L. Cromwell found no state action where NASD and government regulators "pursued similar evidentiary trails" in their parallel investigations because "their independent investigations were proceeding in the same direction . . . ." 25/ The court there found that NASD Enforcement issued its requests for information "as a product of its private investigation" and accepted NASD testimony that "none of the demands [for information] was generated by governmental persuasion or collusion . . . ." 26/ However, the court also observed that, although NASD Enforcement had not acted in concert with government regulators when NASD Enforcement issued its information requests in D.L. Cromwell, NASD could in certain circumstances be deemed a state actor. The court noted that NASD's Criminal Prosecution Assistance Unit, which, at the time, was a self-contained group within NASD Enforcement, "was in fact working with the government, and when it does it may well be a state actor." 27/

In Quattrone, we concluded that NASD's grant of summary disposition on the issue of liability against Quattrone was inappropriate and not in accordance with its rules. 28/ We stated that "Quattrone did not need to show that NASD" requested his testimony "solely at the Commission's behest, but only that NASD engaged in willful participation in joint action with the Commission." 29/ It appears to us that in its decision in the current proceeding, NASD similarly did not address the question of joint action in considering whether it was a state actor.

24/ (...continued)
participant in the challenged activity" and under the latter considering whether "the coercive influence or 'significant encouragement' of the state effectively converts the private action into a government action"); Bass v. Parkwood Hospital, 180 F.3d 234, 241-242 (5th Cir. 1999) (similar); Mathis v. PG&E, 75 F.3d 498, 503, 504 (9th Cir. 1996) (in discussing "inextricably intertwined" inquiry, stating, in dicta, that had a private entity's internal investigation produced a coerced confession and been conducted in close cooperation with a county task force, that would likely support a finding of state action on a joint action theory); cf. People v. Sporleder, 666 P.2d 135, 138-39 & n.3 (Col. 1983) (stating, in dicta, that the installation of a pen register on defendant's telephone line by a telephone company in the context of a joint investigation by the telephone company and the district attorney's office of harassing telephone calls strongly suggested state action).

25/ D.L. Cromwell, 279 F.3d at 162-63.

26/ Id. at 163.

27/ Id.

28/ Exchange Act Rel. No. 53547 (Mar. 24, 2006), __ SEC Docket ___.

29/ Id. at ___.

Because we released our Quattrone opinion after NASD issued its decision in this proceeding, NASD did not have the opportunity to evaluate that opinion before ruling on Ficken's claims.

Before us, Ficken contends that any weakness in his opposition to NASD's motion for summary disposition is due to lack of discovery. Ficken argues that, if he had been given sufficient opportunity to conduct discovery, he could have demonstrated that a hearing on the issue of whether NASD was a state actor in this instance was appropriate. In support of this argument, Ficken adverts to the contemporaneous investigations of him by the Commission, the DOJ, NASD, and state authorities. Ficken observes that NASD sought to question him about "identical information" relating to late trading or market timing activities implicated in the Commission's civil action against him, the Massachusetts Securities Division's administrative complaint, and the DOJ's investigation. He notes, moreover, that NASD sought the testimony of two of his co-defendants in the Commission's civil action. 30/ Ficken considers the "most telling evidence" of the cooperation between the Commission and NASD to be the Commission's press release acknowledging the assistance of NASD, the Massachusetts Securities Division, and the NYSE in its investigation. 31/

Ficken asserts further that the NASD employee who participated in the December 17, 2003 OTR either shared certain unspecified calculations with a Commission employee, or relied upon calculations made by a Commission employee, in pursuing NASD's investigation of Ficken. Ficken claims that this NASD employee also shared other documents related to Ficken's activities with the Commission employee and with the DOJ. Ficken maintains that NASD collaborated with the DOJ to "garner testimony that would buttress" the Commission's civil complaint against him and the DOJ's criminal investigation of him.

Ficken complains about the absence of testimony or affidavits from NASD and the Commission refuting his assertions. He asserts that he has been denied the opportunity to discover information that is essential to his opposition. NASD observed in its decision in this proceeding that "the mere absence of an express denial of collusion does not prove that NASD's

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30/ According to the declaration filed by the NASD special investigator responsible for NASD's investigation of Ficken, NASD's investigation of Ficken was part of an ongoing investigation into market timing and late trading at Prudential.

31/ See supra note 3. NASD asserts that the reason the NAC denied introduction of the press release is that Ficken offered no reason for his failure to introduce it before the Hearing Panel, other than that he discovered it after summary disposition had been granted. Ficken has not moved to adduce the press release as additional evidence in his appeal before us. Pursuant to Rule 452 of our Rules of Practice, 17 C.F.R. § 201.452, we may adduce additional evidence on our own motion and we do so here to admit the press release into evidence.

actions should be imputed to the government." 32/ We note, however, that in the past, NASD has made its employees who possess material, non-privileged information available for testimony at a respondent's request or produced affidavits responding to an issue. 33/

We have observed previously that cooperation between the Commission and NASD will rarely render NASD a state actor, and the mere fact of such cooperation is generally insufficient, standing alone, to demonstrate state action. 34/ We reiterate that we consider the burden of demonstrating joint activities sufficient to render NASD a state actor to be high, and that burden falls on the party asserting state action. To survive summary disposition, Ficken must produce testimony or affidavits to support his assertions of joint action.

While a party must be afforded "a full opportunity to conduct discovery" to obtain the "affirmative evidence" that is "essential to his opposition" to summary disposition, 35/ he "may not use the discovery process to go on a fishing expedition in the hopes that some evidence will turn up to support an otherwise unsubstantiated theory." 36/ He is required to state "the precise manner in which [the facts he does possess] support[] his claims," to explain "why he needs

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32/ 2005 NASD Discip. LEXIS at *10.

33/ See, e.g., D.L. Cromwell, 279 F.3d at 163 (noting that Criminal Prosecution Assistance Unit and NASD Enforcement staff "testified consistently" that the latter's demands for testimony were not generated by "governmental persuasion or collusion . . . ."); Robert Fitzpatrick, 55 S.E.C. 419, 428-29 (2001) (noting that NASD had directed staff involved in alleged ex parte contacts to submit affidavits), petition for review denied, 63 Fed. Appx. 20 (2d Cir. 2003); Ashvin R. Shah, 52 S.E.C. 1100, 1104 n.17 (1996) (noting that NASD asked whether respondent wished NASD examiner to testify). See Anderson v. Liberty Lobby, 477 U.S. 242, 250 n.5 (1986) (stating that summary disposition may be denied where the nonmoving party "has not had the opportunity to discover information that is essential to his opposition"). See also NASD Procedural Rule 9252(a) (permitting a respondent to request that NASD invoke its Rule 8210 to compel production of documents or testimony from a person subject to NASD jurisdiction).

34/ Quattrone, __ SEC Docket at ___. See also Scher v. NASD, 386 F. Supp. 2d 402, 408 (S.D.N.Y. 2005) (finding, where an NASD investigator shared information with the district attorney's office with which he once worked approximately one year after plaintiff's OTR, that "such collaboration," which ultimately led to plaintiff's criminal prosecution, "does not in itself demonstrate that a 'close nexus' existed between the challenged conduct of the NASD and a state actor").

35/ See Anderson, 477 U.S. at 250 n.5 & 256-257.

36/ G.K. Scott & Co., Inc., 51 S.E.C. 961, 973 (1994); accord John Montelbano, Exchange Act Rel. No. 47227 (Jan. 22, 2003), 79 SEC Docket 1474, 1493.

additional discovery," to "state with some precision the materials he hope[s] to obtain with further discovery," and to explain "exactly how" the further information would support his claims. 37/ To obtain discovery in opposition to a properly supported motion for summary disposition, Ficken must be able to satisfy these standards. To the extent that Ficken satisfies this burden, NASD will be expected to give due consideration to Ficken's request for additional discovery.

Given the circumstances here, including the fact that our Quattrone opinion had not yet been issued at the time NASD issued its decision in this proceeding and the questions concerning whether Ficken had sufficient access to relevant information, we think it appropriate to remand this proceeding to NASD for further consideration. 38/ We do not intend to suggest any view on the outcome of this remand.

An appropriate order will issue. 39/

By the Commission (Chairman COX and Commissioners ATKINS, CAMPOS, NAZARETH and CASEY).

Nancy M. Morris

Nancy M. Morris
Secretary

37/ Krim v. BancTexas Group, Inc., 989 F.2d 1435, 1442-1443 (5th Cir. 1993).

38/ Ficken raises additional arguments, among them the contentions that NASD improperly replaced the original Hearing Officer in this matter with a new Hearing Officer who was "favorably disposed" toward NASD and that the statements of the original Hearing Officer should bind the subsequent Hearing Officer. In light of our decision to remand this proceeding to NASD, we do not address these arguments.

Ficken also objects to the sanction imposed as unduly harsh under the circumstances. According to the NASD Sanction Guidelines, a bar is the standard sanction for an NASD Procedural Rule 8210 violation where an individual fails to respond in "any" manner; where mitigation exists, the recommended sanction is a two-year suspension. NASD Sanction Guidelines at 39. We note that Ficken appeared at the initial OTR and answered questions for over three hours before invoking his Fifth Amendment privilege.

39/ We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 54699 / November 3, 2006

Admin. Proc. File No. 3-12143

In the Matter of the Application of

JUSTIN F. FICKEN
c/o Gary G. Pelletier, Esq.
Denner O'Malley LLP
Four Longfellow Place, 35th Floor
Boston, Massachusetts 02114

For Review of Disciplinary Action Taken by

NASD

ORDER REMANDING DISCIPLINARY PROCEEDING TO REGISTERED SECURITIES ASSOCIATION

On the basis of the Commission's opinion issued this day, it is

ORDERED that this disciplinary proceeding with respect to Justin F. Ficken be, and it hereby is, remanded to NASD for further consideration.

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

Commissioner Campos
Not Participating

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 54711 / November 6, 2006

Admin. Proc. File No. 3-12094

In the Matter of the Application of

MAY CAPITAL GROUP, LLC

and

MELVIN ROKEACH

c/o Michael Beckman, Esq.
Beckman, Lieberman & Barandes, LLP
116 John Street, Suite 1313
New York, New York 10038

For Review of Action Taken by

NASD

ORDER DENYING MOTION FOR RECONSIDERATION

I.

On May 12, 2006, we issued an opinion (the "May 12, 2006 Opinion") remanding to NASD an application by May Capital Group, LLC ("May Capital"), an NASD member firm, seeking permission for Melvin Rokeach, an individual subject to a statutory disqualification, to continue to associate with May Capital despite his statutory disqualification. 1/ Rokeach's disqualification stemmed from his failure to disclose a felony conviction on a Form U-4 application for securities industry registration and his misrepresentation of that conviction as a misdemeanor on an amendment to that form. After accepting Rokeach's submission of a Letter of Acceptance, Waiver, and Consent ("AWC"), NASD imposed a six-month suspension on Rokeach for this misconduct. Rokeach sought to associate with May Capital after serving his suspension. NASD denied the application, and Rokeach appealed that denial to the Commission.

1/ May Capital Group, LLC and Melvin Rokeach, Securities Exchange Act Rel. No. 53796 (May 12, 2006), __ SEC Docket __.

Document 8 of 33

We remanded the matter to NASD on the ground that we were unable to determine whether, as required by Section 19(f) of the Securities Exchange Act of 1934, 2/ NASD's denial of the membership continuance application was consistent with the purposes of the Exchange Act. In its denial, NASD stated explicitly that it did not conduct its evaluation of the membership continuance application in accordance with the principles articulated in our decision in Paul Edward Van Dusen. 3/ We had held previously that those principles applied where the Commission imposed a suspension or bar with a right to reapply for the misconduct underlying a statutory disqualification and the disqualified individual subsequently applied to reenter the industry. 4/ The May 12, 2006 Opinion found that those principles also applied where, as here, NASD itself imposed the suspension or bar with a right to reapply for the misconduct underlying a statutory disqualification and the statutorily-disqualified individual subsequently applied to reenter the industry. 5/ The May 12, 2006 Opinion also noted that we could not determine whether, as required by the principles articulated in Van Dusen and its progeny, "enough new information was brought to NASD's attention to allow it to consider the conduct underlying the [statutory disqualification] as forming a significant pattern with Rokeach's other misconduct." 6/ Our opinion found that it was "thus appropriate to remand the matter to NASD for its reconsideration." 7/ NASD now seeks reconsideration of that opinion.

II.

We review NASD's motion to reconsider under Rule 470 of our Rules of Practice. 8/ Rule 470 permits us to reconsider our decisions in exceptional cases. 9/ The remedy is intended to correct manifest errors of law or fact or to permit the presentation of newly discovered

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2/ 15 U.S.C. § 78s(f).

3/ 47 S.E.C. 668 (1981).

4/ See May Capital, __ SEC Docket at __ (citing Van Dusen, 47 S.E.C. at 671 and Reuben D. Peters, Exchange Act Rel. No. 49819 (June 7, 2004), 82 SEC Docket 3959, 3968).

5/ Id. at __.

6/ Id. at __. We noted further that NASD did not address whether considering Rokeach's termination by Park Avenue Securities, LLC, the NASD member firm with whom Rokeach associated before May Capital, was consistent with Van Dusen. For example, NASD did not address specifically enough whether Park Avenue's supervisory experience with Rokeach had any relevance to the supervisory procedures proposed by May Capital.

7/ Id. at __.

8/ 17 C.F.R. § 201.470.

9/ Reuben D. Peters, Order Denying Motion for Reconsideration, Exchange Act Rel. No. 51237 (Feb. 22, 2005), 84 SEC Docket 3497, 3498 (citing the comment to Rule 470).

evidence. 10/ NASD argues that our opinion "commit[ted] two critical errors" of law that should be corrected on reconsideration. As discussed below, NASD's motion provides no basis for reconsidering the May 12, 2006 Opinion.

A. NASD argues that we committed our first manifest error of law by "retroactively" applying the Van Dusen analysis to Rokeach's application. 11/ We disagree, however, that the May 12, 2006 Opinion implicates retroactivity concerns. Such concerns do not arise where an agency has not overruled or disavowed any controlling precedent upon which a party relied to its detriment. 12/ The question of retroactivity also does not arise where an agency has not "alter[ed] petitioners' existing rights or obligations" but rather has "merely clarified what those existing rights or obligations had always been." 13/ We had not previously considered whether the Van Dusen principles applied to the membership continuance applications of individuals whose statutory disqualifications resulted from NASD enforcement action. The May 12, 2006 Opinion, therefore, did not overrule or disavow any controlling precedent and did not alter NASD's existing rights or obligations; it merely clarified that those existing rights and obligations included applying the Van Dusen principles to Rokeach's membership continuance application. Therefore, the question of retroactivity does not arise here.

10/ Id. (citing KPMG Peat Marwick LLP, 55 S.E.C. 1, 3 n.7 (2001)).

11/ Although NASD "challenges the way in which the Commission has imposed these constraints (i.e., retroactive application through the adjudicatory process without the benefits and procedural safeguards provided by alternative methods such as notice-and-comment rulemaking)," it is "well-settled" that "'the choice between rulemaking and adjudication lies in the first instance within the [agency's] discretion.'" Cassell v. FCC, 154 F.3d 478, 486 (D.C. Cir. 1998) (quoting NLRB v. Bell Aerospace Co., 416 U.S. 267, 294 (1974)); cf. SEC v. Chenery Corp., 332 U.S. 194, 202-03 (1947) (stating that "the choice made between proceeding by general rule or by individual, ad-hoc litigation is one that lies primarily in the informed discretion of the administrative agency"); see also E.F. Hutton & Co., 49 S.E.C. 829, 835 (1988) (stating that even a new interpretation of an existing rule that differs from prior interpretations may be announced through adjudication if the burden it imposes is outweighed by the danger of permitting a result inconsistent with a statutory design or legal and equitable principles).

12/ See Borden, Inc. v. NLRB, 19 F.3d 502, 510 (10th Cir. 1994); Farmers Tel. Co. v. FCC, 184 F.3d 1241, 1250 (10th Cir. 1999) (citing Borden).

13/ Farmers Tel. Co., 184 F.3d at 1250; cf. Orr v. Hawk, 156 F.3d 651, 654 (6th Cir. 1998) (stating that a rule simply "clarifying an unsettled or confusing area of the law . . . restates what the law according to the agency is and has always been" and is "no more retroactive in its operation than is a judicial determination construing and applying a statute").

Even if retroactivity concerns were implicated in this case, we find that we may apply the principles announced in our May 12, 2006 Opinion retroactively. In SEC v. Chenery Corp., 14/ the Supreme Court stated that "retroactivity must be balanced against the mischief of producing a result which is contrary to a statutory design or to legal and equitable principles. If that mischief is greater than the ill effect of the retroactive application of a new standard, it is not the type of retroactivity which is condemned by law." 15/ NASD contends that retroactive application of the May 12, 2006 Opinion "imposes substantial new burdens on NASD" by requiring that it "be bound by the Van Dusen framework in assessing [Rokeach's] application." However, the May 12, 2006 Opinion held that we could not find, as required by Section 19(f) of the Exchange Act, that NASD acted in a manner consistent with the purposes of the Exchange Act in denying the membership continuance application unless NASD applied the principles articulated in Van Dusen. 16/ Those principles prevent the unfairness that ordinarily would result from NASD denying a membership continuance application on the sole basis of misconduct as to which NASD had already determined the public interest requirements in imposing a suspension or bar with a right to reapply on which the time had run. 17/ Additionally, a practice by which "SROs, through denial of reentry applications, may, in effect, routinely extend those persons' bar from the securities industry beyond the period after which the settlement would allow them to reapply, based solely on the misconduct leading to the settlement," would cause "the incentive to settle [to] diminish markedly," undermining the "ability to settle cases in pursuance" of "anti-fraud and investor protection goals" that are also purposes of the Exchange Act. 18/ Our May 12, 2006 ruling requiring application of the Van Dusen framework is therefore consistent with the Chenery rationale disfavoring a result "contrary to a statutory design or to legal and equitable principles."

The case law since Chenery further supports the May 12, 2006 Opinion. Those cases hold that, "[a]s a general principle, new rules announced in agency adjudications may be applied retroactively absent any 'manifest injustice.'" 19/ In determining if manifest injustice exists, a

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14/ 332 U.S. 194 (1947).

15/ Id. at 203.

16/ May Capital, __ SEC Docket at __.

17/ Id. at __.

18/ Id. at __; Harry M. Richardson, Exchange Act Rel. No. 51236 (Feb. 22, 2005), 2005 SEC LEXIS 414, at *18.

19/ See, e.g., Consol. Freightways v. NLRB, 892 F.2d 1052, 1058 (D.C. Cir. 1989) (quoting Clark-Cowlitz Joint Operating Agency v. FERC, 826 F.2d 1074, 1081 (D.C. Cir. 1987)).

basic distinction has emerged "between (1) new applications of law, clarifications, and additions" and (2) "substitution of new law for old law that was reasonably clear." 20/

> "[R]etroactivity in the former case is natural, normal, and necessary, a corollary of an agency's authority to develop policy through case-by-case adjudication . . . ." In contrast, the latter situation "may give rise to questions of fairness, [rendering it] necessary to deny retroactive effect to a rule announced in an agency adjudication in order to protect the settled expectations of those who had relied on the preexisting rule." Consequently, "retroactivity is appropriate when the agency's ruling represents a new policy for a new situation, rather than being a departure from a clear prior policy." 21/

As noted above, prior to our May 12, 2006 Opinion, we had not announced a specific policy for the membership continuance applications of statutorily-disqualified individuals whose statutory disqualifications resulted from NASD enforcement action. The May 12, 2006 Opinion, therefore, constituted a new application of law and policy for a situation new to Commission consideration. No one's settled expectations based on reliance on any other rule were disrupted. As such, the May 12, 2006 Opinion may be applied retroactively. 22/

NASD's attempts to establish a clear prior Commission policy or controlling precedent from which the May 12, 2006 Opinion departed are unavailing. Although NASD asserts that "the Commission stated that Van Dusen did not apply to such cases," it provides no citation for this assertion, and we have never made such a holding. NASD also contends that we had previously indicated that the principles articulated in Van Dusen would not apply to Rokeach's application because we stated in Harry M. Richardson 23/ that, "[w]here an initial public interest determination was made by an entity other than the Commission, different considerations may

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20/ Farmers Tel. Co., 184 F.3d at 1251 (quoting Williams Natural Gas Co. v. FERC, 3 F.3d 1544, 1554 (D.C. Cir. 1993)).

21/ Id. (alterations in original) (quoting Williams Natural Gas, 3 F.3d. at 1554).

22/ Cf. Williams Natural Gas, 3 F.3d at 1554 (finding that the "present case falls squarely within our precedents authorizing retroactivity for agency rules that do not represent a shift from a 'clear prior policy'" because "FERC simply did not have a policy" prior to its decision establishing the rule at issue and consequently that rule "may be fairly characterized as a 'new rule for a new situation'" that "may be retroactively applied"); Marshall E. Melton, Investment Advisers Act Rel. No. 2151 (July 25, 2003), 80 SEC Docket 2812, 2814, 2822 (stating that the case "presented us with the opportunity to review and reconsider [our] traditional approach" to the disciplinary consequences of consent antifraud injunctions and announcing a "refined and expanded policy" "for future cases").

23/ Exchange Act Rel. No. 51236 (Feb. 22, 2005), 2005 SEC LEXIS 414.

apply." 24/ We do not believe our statement constituted a preexisting rule, on which NASD could rely, that Van Dusen would not apply to NASD's consideration of a membership continuance application where the statutory disqualification resulted from NASD, rather than Commission, enforcement action. As noted in the May 12, 2006 Opinion, this statement referred not to whether NASD was bound by its own prior public interest determination but to "our belief that NASD might not be bound by the initial public interest determination of another self-regulatory organization." 25/ We therefore reject NASD's contention that "the rule announced in [the May 12, 2006 Opinion] departs abruptly from previous Commission decisions."

We also reject any suggestion that NASD was entitled to rely on a policy of its own of not applying Van Dusen where the statutory disqualification resulted from NASD enforcement action. Any NASD policy cannot be imputed to the Commission. 26/ We had never held that Van Dusen would not apply to the membership continuance applications of statutorily-disqualified individuals whose disqualifications resulted from NASD enforcement action. NASD's "understanding" to the contrary derives, apparently, from its own interpretation of our prior cases applying the Van Dusen standards to disqualifications resulting from Commission enforcement action. NASD's situation is therefore "no different from that of other parties who act in reliance on their own . . . interpretation of a statute or regulation but later find out (via a court or agency decision) that their interpretation was wrong." 27/

B. NASD also argues that Rule 470 requires our reconsideration because we committed a second manifest error of law by applying Van Dusen to Rokeach's membership continuance application without a legal basis. Congress has made clear that NASD's regulatory authority is

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24/ Id. at *8 n.14.

25/ May Capital, __ SEC Docket at __; see also Richardson, 2005 SEC LEXIS 414, at *8 n.14 (citing Arthur H. Ross, 50 S.E.C. 1082, 1085 n.13 (1992) (stating that "the NYSE's settlement of its disciplinary action should not bind the NASD in discharging its function of determining whether Ross is fit to re-enter the supervisory sphere")).

26/ See Farmers Tel. Co., 184 F.3d at 1245-46, 1251-52 (rejecting suggestion that the interpretation of NECA, "an independent organization established by the FCC" which "consist[s] entirely of industry participants," "acts exclusively as an agent for its members," and lacks the "authority to perform any adjudicatory or governmental functions," "should somehow be imputed to the FCC as 'well-established' policy that was overruled by the FCC order" and thus finding "that the FCC's ruling did not represent a departure from clear prior policy").

27/ Id. at 1252.

subject to Commission oversight. 28/ We made the Van Dusen ruling in reviewing, under Exchange Act Section 19(f), NASD's denial of a membership continuance application. The Van Dusen framework proceeded from an interpretation of, and was crafted to ensure compliance with, the requirement under Exchange Act Section 19(f) that NASD's action be consistent with the purposes of the Exchange Act. 29/ This was the same legal basis upon which we acted here; our analysis did not depend, as NASD contends, on the terms or enforcement of the AWC or on Rokeach's testimony about what expectations he may have had from the settlement.

III.

NASD urges that reconsideration "will protect the investing public by allowing NASD to exclude as an associated person an individual who has made numerous misrepresentations to regulators and therefore has demonstrated that he is incapable of upholding the high standards of business ethics that NASD demands of associated persons." The May 12, 2006 Opinion in no way prevents NASD from denying a membership continuance application under appropriate circumstances. We required simply that NASD evaluate such an application in accordance with standards that ensure NASD, as it must, acts consistently with the purposes of the Exchange Act when denying an application. Although NASD argues that we should replace the May 12, 2006 Opinion "with an opinion that evaluates whether the NAC correctly concluded that Rokeach posed a risk of harm to the investing public," Section 19(f) of the Exchange Act does not permit us to uphold this conclusion unless we find that NASD acted consistently with the purposes of the Exchange Act. We remanded because we could not make this determination. We find that NASD's motion does not present the exceptional circumstances required for us to reconsider our earlier opinion.

Accordingly, IT IS ORDERED that the motion for reconsideration filed by NASD be, and it hereby is, DENIED.

By the Commission.

Nancy M. Morris
Secretary

28/ Richardson, 2005 SEC LEXIS 414, at *15 n.26 (citing S. Rep. No. 94-75, at 23).

29/ See id. at *15 ("NASD correctly states that the policy quoted by the Commission in Van Dusen . . . originally appeared in a release that dealt with applications for association that were directed to the Commission itself, not an SRO. By relying on that policy in Van Dusen, however, we clearly indicated our view that it also was relevant in SRO considerations of applications to associate.").

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 2566 / November 7, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12473

In the Matter of Stephen J. Treadway, Respondent.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Stephen J. Treadway ("Treadway" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.2. below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

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1. Treadway, age 59, a resident of New York, New York, was, during the relevant period, the Chief Executive Officer and a Managing Director of PA Fund Management LLC f/k/a PIMCO Advisors Fund Management LLC ("PAFM"), the Chief Executive Officer and a Managing Director of PA Distributors LLC f/k/a PIMCO Advisors Distributors LLC ("PAD"), and the Chairman of the Board of Trustees for the PIMCO Funds: Multi-Manager Series (the "PIMCO Funds"). The PIMCO Funds is a registered investment company. PAFM is a registered investment adviser that advises the PIMCO Funds. PAD is a registered broker-dealer that distributes the PIMCO Funds. Treadway joined PIMCO in 1996. Treadway resigned from all positions at the PIMCO entities on July 30, 2004. Treadway received a J.D. from Columbia Law School in 1972. During the relevant period, Treadway had NASD Series 7, 24, and 63 licenses. He has no disciplinary history.

2. On October 30, 2006, a final judgment was entered by consent against Treadway, permanently enjoining him from future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rules 10b-5(b) and 10b-5(c) thereunder, Section 34(b) of the Investment Company Act of 1940 ("Investment Company Act"), and Section 206(2) of the Advisers Act, and from breaching his fiduciary duty within the meaning of Section 36(a) of the Investment Company Act, in the civil action entitled Securities and Exchange Commission v. Stephen J. Treadway, Case Number 04 Civ. 3464 (VM), in the United States District Court for the Southern District of New York. Treadway also was enjoined for one year from the date of the final judgment, pursuant to Section 36(a) of the Investment Company Act, from serving or acting with respect to any registered investment company as an officer, director, member of any advisory board, investment adviser, depositor, or principal underwriter; ordered to pay disgorgement of $261,215 plus prejudgment interest thereon in the amount of $49,304.32; and ordered to pay a civil penalty in the amount of $261,215.

3. The Commission's complaint alleged that Treadway violated the federal securities laws by permitting an undisclosed market timing arrangement with Canary Capital Partners LLC ("Canary"), whereby Canary was permitted to market time certain of the PIMCO Funds. The complaint alleged that Treadway approved this trading arrangement in approximately January 2002, before any trading started, and despite knowing that the disclosures in the PIMCO Funds' prospectus represented to investors that the PIMCO Funds discouraged and restricted market timing. The complaint further alleged that Treadway, the former CEO of PAFM and PAD, as well as former Chairman of the Board of Trustees for the PIMCO Funds, did not disclose his knowledge of the Canary market timing arrangement to the Board of Trustees until approximately September 2003.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Treadway's Offer.

Accordingly, it is hereby ORDERED:

Pursuant to Section 203(f) of the Advisers Act, Respondent Treadway be, and hereby is, barred from association with any investment adviser, with the right to reapply for association after one year to the appropriate self-regulatory organization, or if there is none, to the Commission.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

CORRECTED

SECURITIES EXCHANGE ACT OF 1934
Release No. 54712 / November 6, 2006

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2510 / November 6, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12472

In the Matter of **DAVID KREINBERG, CPA,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against David Kreinberg, CPA ("Respondent" or "Kreinberg") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the

[1] Rule 102(e)(3)(i) provides, in relevant part, that:

The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any . . . accountant . . . who has been by name . . . permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

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purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.4 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Kreinberg, 41, a resident of Teaneck, New Jersey, is a certified public accountant with a lapsed New York license. Kreinberg held various positions, including senior manager, at Deloitte & Touche LLP ("D&T") until April 1994, when he became Vice President of Financial Planning at Comverse Technology, Inc. ("CTI"). He served as Vice President of Finance and Treasurer at CTI from 1996 until May 1999. Kreinberg performed many of the day-to-day functions of the CFO prior to being appointed as CFO. In May 1999, Kreinberg was appointed CFO of CTI. He resigned this position on April 28, 2006. Kreinberg also served as the CFO of Ulticom, Inc. ("Ulticom") from December 1999 to September 2001, and was a Director of Ulticom between April 2000 and April 28, 2006. Kreinberg reviewed and signed each of CTI's annual reports on Form 10-K since April 2000, and quarterly reports on Form 10-Q since June 1999. He assisted in the preparation of CTI's annual and quarterly reports beginning in 1994. He also reviewed, approved and helped to prepare each proxy statement CTI filed since at least 1999.

2. CTI was, at all relevant times, a New York corporation, the subsidiaries of which provided software, systems and related services for multimedia communication and information processing applications. CTI was headquartered in Woodbury, New York, throughout most of the relevant period and currently maintains office space and/or operations facilities in Manhattan and Long Island, New York; its subsidiaries had operating facilities in Wakefield, Massachusetts; Tel Aviv, Israel and various other locations within the United States, Europe, Asia, South America, Africa and Canada. Prior to July 31, 2006, CTI's common stock was registered with the Commission pursuant to Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act") and traded on the NASDAQ National Market System under the symbol "CMVT." It is now registered under Section 12(b) and continues to trade on the NASDAQ National Market System. CTI's fiscal year ends on January 31. Prior to 1998, CTI's fiscal year ended on December 31.

3. Ulticom is a New Jersey corporation based in Mount Laurel, New Jersey, that provides service enabling signaling software for fixed, mobile and Internet communications. Prior to July 31, 2006, Ulticom's common stock was registered with the Commission pursuant to Section 12(g) of the Exchange Act and traded on the NASDAQ National Market System under the symbol "ULCM." It is now registered under Section 12(b) and continues to trade on the NASDAQ National Market System. Prior to going public in 2000, Ulticom was a wholly-owned subsidiary of CTI. Ulticom is currently a majority-owned subsidiary of CTI. Ulticom's fiscal year ends on January 31.

4. On November 2, 2006, a final judgment was entered against Kreinberg, permanently enjoining him from violating Section 17(a) of the Securities Act of 1933 ("Securities Act"), Sections 10(b), 13(b)(5), 14(a), and 16(a) of the Exchange Act, and Exchange Act Rules 10b-5, 13a-14, 13b2-1, 13b2-2, 14a-9, and 16a-3, and for aiding and abetting violations of Section 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Exchange Act Rules 12b-20, 13a-1, and 13a-13, in the civil action entitled Securities and Exchange Commission v. Jacob "Kobi" Alexander et. al, Civil Action Number 1:06-CV-03844-NGG-RER, in the United States District Court for the Eastern District of New York. Kreinberg was also prohibited from acting as an officer or director of any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act or that is required to file reports pursuant to Section 15(d) of the Exchange Act, and was ordered to pay $2,394,917.68 in disgorgement, which includes prejudgment interest.

5. The Commission's Complaint alleges, among other things, that no later than 1998, Kreinberg engaged in a fraudulent scheme with CTI's former Chairman and Chief Executive Officer and CTI's former General Counsel and later, Senior General Counsel, to grant undisclosed, in-the-money options to themselves and others, by backdating stock option grants to coincide with historically low closing prices for CTI's stock. From 1999 through at least April 2002, the Complaint also alleges that Kreinberg and CTI's former Chairman and Chief Executive Officer created a slush fund of backdated options which the former Chairman and Chief Executive Officer, with Kreinberg's knowledge, were used to recruit and retain key personnel. According to the Complaint, Kreinberg's fraudulent misconduct caused CTI, between fiscal year 1998 and fiscal year 2005, (i) to file materially false and misleading financial statements that materially understated its compensation expenses and materially overstated its quarterly and annual net income and earnings per share, and (ii) to make disclosures in its periodic filings and proxy statements that falsely portrayed CTI's options as having been granted at exercise prices equal to the fair market value of CTI's common stock on the date of the grant. According to the Complaint, Kreinberg also misled CTI's outside auditors in an attempt to hide the scheme. The Complaint alleges that Kreinberg, and others, failed to file all required Commission Forms 3 and 4 to disclose his option-related activity and also filed Forms 3 and 4 that contained false or misleading statements with regard to the options' expirations dates (based on backdated grant dates) and the exercise prices. Beginning in 2000, the Complaint alleges that Kreinberg initiated a similar backdating scheme at Ulticom, a publicly-traded company whose stock was majority-owned by CTI, which resulted in Ulticom making materially false and misleading financial statements, and materially false and misleading disclosures regarding option grants, in its filings with the Commission.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanction agreed to in Respondent Kreinberg's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

Kreinberg is suspended from appearing or practicing before the Commission as an accountant.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 8750 / November 8, 2006

SECURITIES EXCHANGE ACT OF 1934
Release No. 54720 / November 8, 2006

INVESTMENT ADVISERS ACT OF 1940
Release No. 2567 / November 8, 2006

INVESTMENT COMPANY ACT OF 1940
Release No. 27549 / November 8, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12476

In the Matter of **HARTFORD INVESTMENT FINANCIAL SERVICES, LLC, HL INVESTMENT ADVISORS, LLC, AND HARTFORD SECURITIES DISTRIBUTION COMPANY, INC.,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, SECTIONS 203(e) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTIONS 9(b) AND 9(f) OF THE INVESTMENT COMPANY ACT of 1940**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted against: (1) Hartford Investment Financial Services, LLC ("Hartford Investment") pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") and Sections 9(b) and 9(f) of the Investment Company Act

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of 1940 ("Investment Company Act"); (2) HL Investment Advisors, LLC ("HL Advisors") pursuant to Section 8A of the Securities Act, Sections 203(e) and 203(k) of the Advisers Act and Sections 9(b) and 9(f) of the Investment Company Act; and (3) Hartford Securities Distribution Company, Inc. ("Hartford Distribution") pursuant to Section 8A of the Securities Act, Section 15(b) of the Exchange Act, Section 203(k) of the Advisers Act and Sections 9(b) and 9(f) of the Investment Company Act.

II.

In anticipation of the institution of these proceedings, the Respondents have submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933, Section 15(b) of the Securities Exchange Act of 1934, Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, and Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Order"), as set forth below.

III.

On the basis of this Order and Respondents' Offer, the Commission finds[1] that:

Respondents

1. **Hartford Investment Financial Services, LLC** is a Delaware limited liability company located in Simsbury, Connecticut. It has been registered as both an investment adviser and broker-dealer with the Commission since 1997. Hartford Investment is the investment adviser, distributor and underwriter for the 51 Hartford retail mutual funds; 44 of which are series of the Hartford Mutual Funds, Inc. and 7 of which are series of The Hartford Mutual Funds II, Inc. (collectively the "Retail Funds"). Hartford Investment is responsible for managing the investment activities of the Retail Funds either directly or through subadvisers it selects. As of June 30, 2005, Hartford Investment managed approximately $26.7 billion in assets.

2. **HL Investment Advisors, LLC** is a Connecticut limited liability company located in Simsbury, Connecticut. It has been registered as an investment adviser with the Commission since 1986. HL Advisors is the investment adviser for the 36 funds supporting Hartford's variable and fixed annuity products; 26 of which are series of the Hartford HLS Series Funds, Inc. and 10 of which are series of the Hartford HLS Series Funds II, Inc. (collectively the "HLS Funds"). These two series funds constitute the only investment options underlying the variable annuities

[1] The findings herein are made pursuant to Respondents' Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

and variable insurance products. HL Advisors is responsible for managing the investment activities of the Hartford HLS Funds either directly or through subadvisers it selects. As of June 30, 2005, HL Advisors managed approximately $58.8 billion in assets.

3. **Hartford Securities Distribution Company, Inc.** is a Connecticut corporation located in Simsbury, Connecticut. Hartford Distribution has been registered as a broker-dealer with the Commission since 1995. Hartford Distribution is the distributor and underwriter for the HLS Funds and group and registered annuity products. Prior to November 1, 1998, Hartford Distribution also served as the distributor and underwriter for the Retail Funds, after which Hartford Investment replaced Hartford Distribution in that role.

Other Relevant Entity

4. **Hartford Life, Inc. ("Hartford Life")** is a Delaware corporation located in Simsbury, Connecticut and is the parent company to Hartford Investment, HL Advisors, and Hartford Distribution, among others. The Respondents are operated by many of the same officers and employees. They also share finance, legal and administrative functions. As a result, each Respondent knew of the role the others played with respect to shelf space and directed brokerage. Hartford Financial Services Group, Inc. ("Hartford") is the parent company to Hartford Life. Hartford is one of the nation's largest financial services and insurance companies, with 2004 revenues of $22.7 billion. As of September 30, 2005, Hartford had total assets of $280.5 billion. The financial information of Hartford Investment, HL Advisors, and Hartford Distribution is incorporated in the consolidated financial statements of Hartford Life, which, in turn, is incorporated in the consolidated financial statements of Hartford.

Overview

5. Between 2000 and 2003, Hartford offered and sold more than 20 million shares of the Retail Funds and 44 million shares of the HLS Funds.

6. From at least January 2000 through December 2003, Hartford Investment and HL Advisors, with Hartford Distribution's knowledge, made material misrepresentations and omitted to state material facts to the Retail and HLS Funds' (collectively the "Funds") shareholders and Boards of Directors relating to their use of $51 million of Fund assets in the form of directed brokerage commissions to satisfy financial obligations to certain broker-dealers for the marketing and distribution of the Retail and HLS Funds.

Hartford Investment and Hartford Distribution Entered into Financial Arrangements with Broker-Dealers for Shelf Space

7. From at least January 2000 through December 2003, Hartford Investment and Hartford Distribution, with the knowledge and approval of HL Advisors, negotiated and entered into revenue sharing agreements with 73 broker-dealers as a *quid pro quo* for special marketing and distribution benefits for the Retail Funds and the HLS Funds, respectively.

8. Specifically, Hartford Investment and Hartford Distribution typically agreed to remunerate broker-dealers for the special marketing and distribution benefits based on either a specific percentage of gross sales of the Retail and HLS Funds or the value of Hartford Fund shares held by the broker-dealers' customers for more than one year ("aged assets"), or, in some cases, both.

9. The special marketing and distribution benefits that Hartford Investment, HL Advisors and Hartford Distribution received were referred to as "shelf space" and included: inclusion of the Funds on the broker-dealers' "preferred list" of mutual funds; participation in the broker-dealers' national and regional conferences which were held to educate and train registered representatives regarding the Retail and HLS Funds; access to the broker-dealers' sales force; links to Hartford's website from the broker-dealers' websites; and articles in the broker-dealers' publications highlighting new products and services.

10. The purpose behind these special marketing and distribution benefits was to incentivize broker-dealers to increase sales of the Retail and HLS Funds. Fund families that did not enter into shelf space arrangements typically did not receive these benefits. As the Funds' advisers, Hartford Investment and HL Advisors benefited from these special benefits because an increase in sales of Funds resulted in an increase in the investment management fee Hartford Investment and HL Advisors received. Likewise, as the Funds' distributors and underwriters, Hartford Investment and Hartford Distribution benefited because as sales of the Retail and HLS Funds increased, so did the amount of sales charges they received.

Hartford Investment and HL Advisors Represented in the Retail and HLS Funds' Public Filings That the Shelf Space Arrangements Were Not Paid For By Shareholders

11. The Retail and HLS Funds provided prospectuses and statements of additional information ("SAI") to Fund shareholders. Hartford Investment and HL Advisors prepared and distributed the Retail and HLS Funds' prospectuses and SAIs, and thus were responsible for ensuring that they were accurate.

12. Hartford Investment and HL Advisors made some disclosure of shelf space payments, but misrepresented that the shelf space was not paid for by shareholders. Specifically, Hartford Investment disclosed in its Retail Funds prospectuses that:

> ADDITIONAL COMPENSATION TO BROKERS: In addition to the commissions described above, the distributor pays additional compensation to dealers based on a number of factors described in the fund's statement of additional information. **This additional compensation is not paid by you.** [emphasis added]

13. Similarly, both the Retail and HLS Funds' SAI misrepresented that shareholders do not pay for shelf space. Specifically, the SAIs represented that Hartford Investment, Hartford Distribution and their affiliates pay, "out of their own assets," compensation to brokers-dealers for shelf space.

14. Contrary to those representations, Hartford Investment and Hartford Distribution often used the brokerage commissions generated by the Retail and HLS Funds portfolio transactions, which are assets of the Funds and their shareholders, to meet their financial obligations under the shelf space arrangements.

Hartford Investment and HL Advisors Used Directed Brokerage Commissions to Satisfy Hartford Investment and Hartford Distribution's Obligations Under the Shelf Space Arrangements

15. As part of their normal operations, the Retail and HLS Funds bought and sold securities through broker-dealers. Hartford Investment and HL Advisors retained an unaffiliated subadviser to, among other things, select broker-dealers to execute these transactions. Hartford Investment and HL Advisors, as the investment advisers for the Retail Funds and HLS Funds, respectively, paid commissions out of the Funds' assets to those broker-dealers for the portfolio transactions that they executed. As such, the assets used to pay these directed brokerage commissions were assets of the Funds.

16. Hartford Investment and HL Advisors used directed brokerage to meet Hartford Investment and Hartford Distribution's obligations under the shelf space arrangements. Had these obligations been satisfied with cash payments, those cash payments would have come from Hartford Life and its affiliates' assets. In order to reduce Hartford Life and its affiliates' expenses, officers of Hartford Investment and Hartford Distribution instructed their staff that it was their preference to satisfy the financial obligations under the shelf space arrangements by directing brokerage commissions to broker-dealers rather than paying in cash. In fact, between January 2000 and December 2003, Hartford Investment and Hartford Distribution successfully negotiated with at least 61 of the 73 broker-dealers with which they had shelf space arrangements the right to satisfy at least a portion of their financial obligations by directing a certain amount of portfolio transactions to those broker-dealers.

17. Hartford Investment and Hartford Distribution frequently calculated the amount of brokerage commissions to direct to a broker-dealer by projecting the sales of that particular broker-dealer for the next year and then multiplying an agreed upon percentage. The resulting dollar amount represented the amount of brokerage that Hartford Investment or HL Advisors would be required to direct to that broker-dealer to satisfy Hartford Investment and Hartford Distribution's financial obligations under the shelf space arrangements.

18. When Hartford Investment and HL Advisors used directed brokerage instead of cash to meet Hartford Investment and Hartford Distribution's obligations under the shelf space arrangements, they were often required to "gross up," or direct additional brokerage commissions to the broker-dealer above the agreed-upon cash amount, to cover the transaction costs associated with executing the fund portfolio transactions. Thus, Hartford Investment and HL Advisors had to direct an average of 1.3 times the amount of brokerage commissions that it would have paid in cash to satisfy an equivalent amount of their obligation under their shelf space arrangements.

19. Hartford Investment and Hartford Distribution treated the shelf space arrangements as payment obligations. They continually tracked the amount of brokerage commissions directed to broker-dealers so that they knew whether they were satisfying the terms of the shelf space arrangements. Hartford Investment and Hartford Distribution also received requests for payment from some of the broker-dealers that reflected the amount of directed brokerage that was due under the shelf space arrangements.

20. In addition, on several occasions Hartford Investment and HL Advisors adjusted the total amount of brokerage commissions that they directed to broker-dealers when sales of the Retail and HLS Funds by the broker-dealers were higher than projected and the amount previously directed would not satisfy Hartford Investment and Hartford Distribution's financial obligations under their shelf space arrangements.

21. Between January 2000 and December 2003, Hartford Investment and HL Advisors instructed the Retail and HLS Funds' subadviser to direct brokerage commissions totaling $51 million to broker-dealers to satisfy Hartford Investment and Hartford Distribution's *quid pro quo* shelf space obligations.

Hartford Investment and HL Advisors Omitted to State Material Facts to the Retail and HLS Funds' Shareholders Regarding the Use of Directed Brokerage

22. Hartford Investment and HL Advisors also omitted to state additional material facts to shareholders regarding the use of directed brokerage. Specifically, the Retail Funds' SAI and the HLS Funds' prospectus stated that they may direct brokerage commissions to broker-dealers who also sold shares of the Retail and HLS Funds. These representations were misleading.

23. Hartford Investment and HL Advisors did not merely direct fund portfolio transactions to broker-dealers in recognition of Fund shares sold by them. In fact, each year Hartford Investment and Hartford Distribution calculated their financial obligations to certain broker-dealers under the negotiated shelf space arrangements that Hartford Investment and Hartford Distribution had with these broker-dealers and directed the Funds' brokerage commissions to meet their obligations under those arrangements.

Hartford Investment and HL Advisors Did Not Follow Their Own Guidelines for Use of Directed Brokerage

24. During the relevant period, Hartford Investment, HL Advisors and Hartford Distribution had written guidelines relating to the direction of brokerage commissions to broker-dealers. They violated these guidelines by directing the Retail and HLS Funds' brokerage commissions to meet their financial obligations under the shelf space arrangements.

25. Under these guidelines, Hartford Investment, HL Advisors and Hartford Distribution were prohibited, among other things, from directing brokerage to broker-dealers in recognition of marketing or referral arrangements that would benefit them; directing a specific

percentage of brokerage commissions based on the broker-dealer's future sale or promised future sale of shares of the Funds; and directing brokerage to a broker-dealer in exchange for placement of the Funds on a preferred list. However, with respect to the shelf space arrangements discussed above, Hartford Investment, HL Advisors and Hartford Distribution in fact benefited from the increased sales in the form of increased management fees and/or sales charges; they routinely agreed to direct brokerage to a broker-dealer based on anticipated future sales of the Funds; and Hartford Investment and Hartford Distribution specifically negotiated shelf space arrangements in order for the Funds to be placed on broker-dealers' preferred lists and, in many cases, were included on a preferred list.

Hartford Investment, HL Advisors and Hartford Distribution Failed to Disclose the Use <u>of Fund Assets to the Retail and HLS Funds' Boards</u>

26. Despite their duty to do so, Hartford Investment and HL Advisors failed to disclose to the Retail and HLS Funds' Boards of Directors ("Boards") that Hartford Investment and Hartford Distribution had entered into shelf space arrangements and that they were meeting their financial obligations under those arrangements by directing brokerage commissions to broker-dealers which, in turn, gave rise to a conflict of interest.

27. Hartford Investment and HL Advisors, as fiduciaries, owed a duty to the Boards to tell them about the existence and details of the shelf space arrangements. However, Hartford Investment and HL Advisors failed to communicate to the Boards that Hartford Investment and Hartford Distribution negotiated with at least 61 broker-dealers from 2000 to 2003 to pay a specific percentage of gross sales and/or aged assets for special marketing and distribution services.

28. Likewise, Hartford Investment and HL Advisors failed to inform the Boards that Hartford Investment and Hartford Distribution negotiated the right to satisfy their financial obligations under the shelf space arrangements with directed brokerage paid with Fund assets rather than cash out of Hartford Life and its affiliates' assets.

29. During the relevant period, Hartford Distribution was required, pursuant to the Principal Underwriting Agreement that it executed with the Funds, to inform the Boards that it negotiated shelf space arrangements with broker-dealers and that under those arrangements it could satisfy its financial obligation with directed brokerage commissions paid from Fund assets instead of cash from Hartford's assets, yet failed to do so. Moreover, Hartford Distribution knew that neither Hartford Investment nor HL Advisors informed the Boards of that practice.

30. As a result, the Boards were not aware of and did not authorize Hartford Investment and Hartford Distribution's use of directed brokerage to satisfy their financial obligations under their shelf space arrangements. Furthermore, Hartford Investment and HL Advisors deprived the Boards of the opportunity to exercise their independent judgment to decide how to use fund assets in accordance with the best interests of the Retail and HLS Funds' shareholders.

Violations

31. Sections 17(a)(2) and 17(a)(3) of the Securities Act generally prohibit any person, in the offer or sale of securities, from making any untrue statement of a material fact, or omitting to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or engaging in any transaction, practice or course of business which operates or would operate as a fraud or deceit upon the purchaser.

32. Section 206(2) of the Advisers Act prohibits an investment adviser from engaging in any transaction, practice or course of business which operates as a fraud or deceit upon any client or prospective client.

33. Section 34(b) of the Investment Company Act prohibits any person from making any untrue statement of a material fact, or omitting to state any fact necessary in order to prevent the statements made therein, in the light of the circumstances under which they were made, from being materially misleading, in any registration statement, application, report, account, record, or other document filed or transmitted pursuant to the Investment Company Act.

34. As a result of the conduct described above,

a. Hartford Investment and HL Advisors willfully[2] violated Sections 17(a)(2) and 17(a)(3) of the Securities Act, Section 206(2) of the Advisers Act and Section 34(b) of the Investment Company Act.

b. Hartford Distribution caused and willfully aided and abetted Hartford Investment and HL Advisors' violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act and Section 206(2) the Advisers Act.

Undertakings

35. The Respondents have voluntarily undertaken the following:

a. The Respondents formed a Disclosure Review Committee designed to ensure that prospectus and SAI disclosures for investment products are accurate, appropriate, timely and, where appropriate, consistent. The Committee includes senior business leaders, compliance officers and attorneys.

b. The Respondents have appointed a senior level employee to implement the following written policies and procedures:

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[2] "Willfully" as used in this Order means intentionally committing the act which constitutes the violation, Cf. Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000); Tager v. SEC, 344 F.2d 5, 8 (2d Cir. 1965).

i. all revenue sharing arrangements relating to the sale of fund shares must be in writing and in a form approved by the chief legal officer of Hartford Life or his delegate.

ii. all revenue sharing arrangements relating to the sale of variable annuities offering investment in Hartford Separate Accounts that invest in the Hartford HLS Funds must be in writing and in a form approved by Hartford Life's chief legal officer or his delegate.

36. The Respondents agree to undertake the following:

a. Within 90 days of the entry of the Order, the Respondents shall appoint a senior level employee who shall be responsible for the following:

i. oversight over compliance matters related to: preventing and detecting conflicts of interests related to the Investment Products Division's lines of businesses; breaches of fiduciary duty by the Respondents; violations of the federal securities laws by the Respondents; and the creation and maintenance of policies, procedures and/or guidelines relating to the compliance matters listed in this paragraph.

ii. procedures designed to ensure that when the Respondents, or any subadviser retained by the Respondents, place trades with a broker-dealer that also sells Retail and HLS Funds shares, the person responsible for selecting such broker-dealer is not informed by Respondents of, and does not take into account, the broker-dealer's promotion or sale of Retail and HLS Funds shares.

b. The Respondents will annually submit, for review and approval by the Retail and HLS Funds' Boards, any changes in the disclosures that the Funds will include in the Funds' prospectuses and SAIs about payments made by Respondents, or any of their affiliates, to broker-dealers or other intermediaries relating to the sale of the Retail and HLS Funds shares in addition to dealer concessions, shareholder servicing payments, and payments for services that the Respondents, or any of their affiliates, otherwise would provide, such as sub-accounting. The disclosures shall state whether such payments are intended to compensate broker-dealers for various services, including, without limitation, placement on the broker-dealers' preferred or recommended fund list, education of personnel, marketing support and other specified services.

c. The Respondents will make annual presentations to the Compliance Committee for the Retail and HLS Funds' Boards which shall include an overview of its revenue sharing arrangements and policies, any material changes to such policies, the number and types of such arrangements, the types of services received, the identity of participating broker-dealers and the total dollar amounts paid.

d. Within 90 days of the entry of the Order, the Respondents shall establish an Internal Compliance Controls Committee to be chaired by the Vice President, Securities Compliance of Hartford Life, which Committee shall have as its members senior business leaders from the Investment Products Division, at least one member of Hartford Life's legal department and at least one member of the Disclosure Review Committee.

e. Notice of all meetings of the Internal Compliance Controls Committee shall be given to the outside independent counsel of the Retail and HLS Funds' Boards, to the extent that such meetings relate to the Retail and HLS Funds.

f. The Internal Compliance Controls Committee shall review compliance issues relating to the Investment Products Division's lines of businesses, endeavor to develop solutions to those issues as they may arise from time to time, and oversee implementation of those solutions. The Internal Compliance Controls Committee shall provide reports on internal compliance matters relevant to the Retail and HLS Funds to the Retail and HLS Funds' Boards with such frequency as they may reasonably instruct, and in any event at least quarterly. The Internal Compliance Controls Committee shall also provide reports on internal compliance matters relevant to all other products within the Investment Products Division to Hartford Life's Board with such frequency as it may reasonably instruct, and in any event at least quarterly.

g. The Internal Compliance Controls Committee shall review at least annually the Investment Products Division's policies and procedures established to address compliance issues under the Investment Advisers Act, Investment Company Act and any other applicable federal securities laws and that any violations are reported to the Internal Compliance Controls Committee and shall document that review.

h. The Internal Compliance Controls Committee shall promptly report to Hartford Life's Board or the Retail or HLS Funds' Boards, whichever is appropriate, any breach of fiduciary duty owed to Hartford Life's Board and/or violations of the federal securities laws of which the Internal Compliance Controls Committee becomes aware in the course of carrying out its duties.

i. All employees of the Investment Products Division of Hartford Life shall be required to receive annual compliance training relating to business ethics and disclosure obligations jointly planned by the Internal Compliance Controls Committee and Hartford Life's legal department.

j. One year from the entry of this Order, the Respondents shall submit an affidavit to the Commission staff attesting to their compliance with the undertakings described in the Order.

37. For good cause shown, the Commission's staff may extend any of the procedural dates set forth above.

IV.

In view of the foregoing, the Commission deems it appropriate, in the public interest, and for the protection of investors to impose the sanctions specified in the Offer submitted by Hartford Investment, HL Advisors and Hartford Distribution.

Accordingly, pursuant to Section 8A of the Securities Act, Section 15(b) of the Exchange Act, Sections 203(e) and 203(k) of the Advisers Act, and Sections 9(b) and 9(f) of the Investment Company Act, it is hereby ORDERED that:

A. Hartford Investment, HL Advisors and Hartford Distribution are censured.

B. Respondent Hartford Investment cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act, Section 206(2) of the Advisers Act and Section 34(b) of the Investment Company Act.

C. Respondent HL Advisors cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act, Section 206(2) of the Advisers Act and Section 34(b) of the Investment Company Act.

D. Respondent Hartford Distribution cease and desist from committing or causing any violations and any future violations of Section 17(a)(2) and 17(a)(3) of the Securities Act and cease and desist from causing any violations and any future violations of Section 206(2) of the Advisers Act.

E. The Respondents shall, within 30 days of the entry of this Order, pay disgorgement in the amount of $40 million and civil money penalties in the amount of $15 million, for which they shall be jointly and severally liable. The Respondents shall pay the entire $55 million to the affected Hartford Funds in the amounts described in Section IV.G.

F. There shall be, pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, a Fair Fund established for the funds described in Paragraph IV.E. Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondents agree that they shall not, after offset or reduction in any Related Investor Action based on Respondents' payment of disgorgement in this action, argue that they are entitled to, nor shall they further benefit by offset or reduction of any part of Respondents' payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondents agree that they shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the United States Treasury or to a Fair Fund, as the Commission directs. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondents by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

G. The Respondents shall distribute the following amounts to the affected Hartford Funds listed below:

FUND:	**DISTRIBUTABLE AMOUNT:**
Hartford Advisers Fund	$1,265,000
Hartford Capital Appreciation Fund	$5,181,000
Hartford Disciplined Equity Fund	$291,500
Hartford Dividend and Growth Fund	$1,017,500
Hartford Focus Fund	$192,500
Hartford Global Financial Services Fund	$5,500
Hartford Global Communications Fund	$5,500
Hartford Global Health Fund	$104,500
Hartford Global Leaders Fund	$1,914,000
Hartford Global Technology Fund	$22,000
Hartford Growth Fund	$154,000
Hartford Growth Opportunities Fund	$412,500
Hartford International Capital Appreciation Fund	$5,500
Hartford International Opportunities Fund	$27,500
Hartford MidCap Value Fund	$55,000
Hartford MidCap Fund	$2,458,500
Hartford Small Company Fund	$671,000
Hartford SmallCap Growth Fund	$38,500
Hartford Stock Fund	$1,567,500
Hartford Value Opportunities Fund	$16,500
Hartford Value Fund	$11,000
Hartford Advisers HLS Fund	$6,803,500
Hartford Capital Appreciation HLS Fund	$11,566,500
Hartford Disciplined Equity HLS Fund	$500,500
Hartford Dividend and Growth HLS Fund	$3,855,500

Hartford Focus HLS Fund	$110,000
Hartford Global Communications HLS Fund	$11,000
Hartford Global Financial Services HLS Fund	$5,500
Hartford Global Health HLS Fund	$115,500
Hartford Global Leaders HLS Fund	$3,344,000
Hartford Global Technology HLS Fund	$88,000
Hartford Global Advisers HLS Fund	$572,000
Hartford Growth HLS Fund	$33,000
Hartford Growth Opportunities HLS Fund	$841,500
Hartford International Capital Appreciation HLS Fund	$11,000
Hartford International Opportunities HLS Fund	$313,500
Hartford International Small Company HLS Fund	$11,000
Hartford MidCap Value HLS Fund	$159,500
Hartford MidCap HLS Fund	$3,817,000
Hartford Small Company HLS Fund	$1,650,000
Hartford SmallCap Growth HLS Fund	$121,000
Hartford Stock HLS Fund	$5,560,500
Hartford Value Opportunities HLS Fund	$60,500
Hartford Value HLS Fund	$33,000
TOTAL:	**$55,000,000**

H. Respondents shall maintain the undertakings enumerated in paragraphs 35(a)-(b).

I. Respondents shall comply with the undertakings enumerated in paragraphs 36(a)-(j).

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

Commissioner Atkins
Not Participating

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 54723 / November 8, 2006

Admin. Proc. File No. 3-12169

In the Matter of the Application of

PHILIPPE N. KEYES
c/o Richard A. Ruben
5850 Canoga Avenue, Suite 400
Woodland Hills, California 91367

For Review of Action Taken by

NASD

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION -- REVIEW OF DISCIPLINARY PROCEEDING

Failure to Provide Written Notice to, and to Obtain Prior Written Approval from, Member Firm Employer Regarding Private Securities Transactions

Use of Misleading Sales Literature

Associated person of member firm of registered securities association engaged in private securities transactions without giving prior written notification to, or obtaining prior written approval from member. Associated person used misleading sales literature in connection with the private securities transactions. Held, association's findings of violation sustained, but proceeding remanded for reconsideration of sanctions imposed.

APPEARANCES:

Richard A. Ruben, for Philippe N. Keyes.

Marc Menchel, Carla J. Carloni, and Jennifer C. Brooks, for NASD.

Appeal filed: February 2, 2006
Last brief received: April 26, 2006

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I.

Philippe N. Keyes, formerly associated with Investors Capital Corporation ("ICC"), an NASD member firm, appeals from NASD disciplinary action. NASD found that, from January 2001 through November 2001, Keyes engaged in private securities transactions without prior written notice to, and prior written approval from, his employer in violation of NASD Conduct Rules 3040 and 2110. 1/ NASD also found that Keyes used misleading sales literature in connection with these transactions in violation of NASD Conduct Rules 2210 and 2110. 2/ NASD barred Keyes from associating with any member firm in any capacity for violating the prohibition on private securities transactions. NASD also assessed costs, but declined to impose additional sanctions for the sales literature violations. We base our findings upon an independent review of the record.

II.

Keyes's Conduct

The facts in this matter are largely undisputed. Keyes began working for ICC in April 2000 as an investment company products and variable contracts limited representative. ICC terminated Keyes in November 2001 for failure to comply with the firm's policies and procedures. Keyes was last associated with a member firm in April 2002.

Ronald Wightman recruited Keyes to join ICC. Wightman was a registered principal for ICC and worked out of ICC's office of supervisory jurisdiction in Salt Lake City, Utah. Keyes worked out of an office in Valencia, California, and Wightman was his direct supervisor.

In June or July 2000, Keyes attended a sales presentation in Salt Lake City given by Dennis Wynn, the founder of the Wynn Company ("Wynn"), a Utah corporation. During this presentation, Keyes was introduced to Wynn's secured commercial note program (the "Wynn note program"). Essentially, Wynn's business was the sale of used automobiles through high-interest loans to customers with impaired credit ratings. The loans carried an interest rate of

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1/ NASD Conduct Rule 3040 prohibits any person associated with a member from participating in any manner in a private securities transaction outside the regular course or scope of his or her employment without providing prior written notice to the member. If an associated person is compensated for the transactions, he must receive the firm's written permission before he engages in the transactions.

NASD Conduct Rule 2110 requires that members and associated persons "observe high standards of commercial honor and just and equitable principles of trade."

2/ NASD Conduct Rule 2210 sets forth general advertising standards for sales literature applicable for all member communications with customers or the public.

twenty-eight to thirty percent and an average term of twenty-four months. To finance its operations Wynn sold promissory notes to individual investors (the "Wynn notes"). The Wynn notes bore a twelve-month maturity date and provided an interest rate of ten to twelve percent. According to Wynn, the loan contracts between the automobile purchasers and Wynn and the titles to the automobiles were held in escrow by an escrow agent. Marketing materials for the Wynn notes stated that the notes were secured by a "portfolio of automobile contracts with titles held by an escrow agent" and that the escrow agent "monitor[ed]" the notes to ensure that the collateral was maintained at 150 percent of the notes' value. At maturity, investors could liquidate the note, repurchase it, or invest an additional amount.

During that same trip to Salt Lake City, Keyes toured Wynn's headquarters. Keyes testified that he saw Wynn's physical structure and its staff conducting business. He stated that he saw automobiles for sale, a repair shop with mechanics working on vehicles, and "one or two" checks received from automobile purchasers. Based upon these observations, Keyes concluded that Wynn was a viable operation. Keyes did not review Wynn's financial statements or the purported escrow agreement, or independently verify the existence of an escrow relationship or how the escrow agent evaluated the collateral as 150 percent of the face amount of the Wynn note.

After Keyes toured Wynn's headquarters, he met with Wightman in Wightman's Salt Lake City office. According to Keyes, he and Wightman discussed Wightman's desire to expand his sales team's annuity business and to convert existing fixed annuity contracts into variable annuity products. Keyes testified that Wightman told Keyes that part of this plan included rolling the interest earned by ICC customers from the Wynn notes into variable annuities. Keyes testified further that, when he sold Wynn notes to customers, he recommended that they roll the interest earned from the notes into variable annuities sold by ICC. According to Keyes, Wightman instructed Keyes that he should communicate only with Wightman and not with other ICC personnel.

Keyes began selling the Wynn notes in January 2001. From January 2001 through November 2001, Keyes introduced thirty-five customers to Wynn. These customers purchased Wynn notes having a total value of $1,900,634.70. Wynn paid Keyes $63,412 in finder's fees for referring these customers.

Keyes also introduced another person associated with ICC to the Wynn note program in 2001. At first, Keyes paid this associated person for referring customers who later purchased Wynn notes. Later, the associated person sold Wynn notes directly to customers.

Keyes admitted that he provided customers with three pieces of sales literature describing various aspects of the Wynn note program in connection with the sale of Wynn notes. Keyes received two of the pieces of sales literature from Wynn, a tri-fold brochure and an informational flyer. The third piece of sales literature was an "investment triangle" which Keyes prepared and used as a sales brochure.

The tri-fold brochure described the Wynn notes as secured by a "portfolio of automobile contracts with titles held by an escrow agent." It assured potential investors of the notes' low risk, stating that "the collateral backing [each] note is carefully managed for safety and security. . . . Note holders have enjoyed solid growth, reliable income, and peace of mind." The brochure also highlighted the Wynn notes as "suitable for IRA's, SEP's and other retirement plans."

The informational flyer contained information about Wynn and its business. It described the Wynn note program and contained a "frequently asked questions" section. The flyer described features of the Wynn notes, including an interest rate of "10% APR" with a twelve-month maturity, and the fact that interest would be paid to the note holders monthly, unless they requested that the "interest compound within the note." The flyer stated that Wynn "secures all promissory notes with real assets, equal to at least 150% value of the amount of money you are lending." The flyer explained that the collateral securing the notes consisted of two parts: the loan contracts between the consumer and Wynn and the actual titles to the automobiles. The flyer also stated that an "independent, third-party escrow agent" monitors the Wynn notes to ensure that collateral is maintained at 150 percent of the Wynn notes' value.

The investment triangle prepared by Keyes compared the rate of return and risk of the Wynn notes with other types of investments. At its apex, the triangle listed investments in stocks. The second tier listed investments in mutual funds. The Wynn notes were listed in the third tier with a rate of return of 10.5 percent. The fourth tier listed annuities with a rate of return of 5.5 percent. At its base, the triangle listed bank investments (with a 1.5 percent rate of return), money market funds (with a 1.85 percent rate of return), and certificates of deposit (with a 3.75 percent rate of return).

ICC prohibited the sale of all promissory notes, and the Wynn notes were not approved ICC products. ICC required its associated persons to submit a form entitled "Registered Representative Outside Business Activities of Associated Person" on which the associated person was to disclose outside business activity and income earned from that activity. Keyes disclosed on that form his employment as an accident and disability insurance salesperson and continuing education instructor, but did not update the form to disclose his involvement with Wynn. In addition, Keyes did not update his Uniform Application for Securities Industry Registration or Transfer Form ("Form U-4"), which requires associated persons to disclose in detail involvement in another business, to reflect his involvement with Wynn.

Wynn filed for bankruptcy in July 2002. 3/ Two of Keyes's customers were among the list of creditors holding the twenty largest unsecured claims that was compiled in the Wynn bankruptcy proceeding. The claims of these two customers totaled $429,632.08.

3/ The Wynn bankruptcy originally was filed under Chapter 11 and was converted to a Chapter 7 petition.

Procedural History of NASD Disciplinary Action Against Keyes

On August 16, 2004, an NASD Hearing Panel (the "Hearing Panel") commenced a disciplinary hearing to consider allegations that Keyes participated in private securities transactions without giving prior written notice to and receiving prior written approval from ICC, that he used misleading sales literature in connection with those transactions, and that this conduct constituted a failure to observe high standards of commercial honor and just and equitable principles of trade. 4/ Keyes admitted, through written stipulations and in his testimony before the Hearing Panel, the material facts necessary to establish that he committed the alleged violations, but contended that the Wynn notes were not securities. On November 29, 2004, the Hearing Panel unanimously found that the Wynn notes were securities and that Keyes had committed the alleged violations. The Hearing Panel barred Keyes in all capacities for the private securities violations and ordered him to pay the hearing costs. The Hearing Panel declined to impose additional sanctions for the sales literature violation in light of the bar that it imposed for the private securities transactions.

On December 21, 2004, Keyes appealed the decision of the Hearing Panel to NASD's National Adjudicatory Council ("NAC"). On appeal, Keyes did not challenge the Hearing Panel's findings that the Wynn notes were securities or that Keyes had committed the alleged violations. Keyes argued only that mitigating factors warranted a reduction in the sanctions. The NAC rejected Keyes's argument, finding that the extent of his private securities transactions and numerous aggravating factors outweighed his claimed mitigating factors and warranted a bar under the relevant Sanction Guidelines.

III.

It is undisputed that Keyes failed to inform ICC in writing of his sales of more than $1.9 million in Wynn notes to thirty-five customers over an eleven-month period. It also is undisputed that Keyes received $63,412 in selling compensation from Wynn but failed to obtain ICC's written permission to engage in the transactions. 5/ Keyes has admitted that he violated Conduct Rule 3040 and has stipulated in writing to facts establishing this violation.

4/ NASD also named Wightman as a respondent, but prior to the hearing he settled with NASD. NASD fined him $10,000 and suspended him for thirty days.

5/ The Hearing Panel determined that the Wynn notes were securities under the test developed by the United States Supreme Court in Reves v. Ernst & Young, 494 U.S. 56, 63-65 (1990), and Keyes does not dispute this finding. We concur that the Wynn notes at issue are securities within the meaning of Securities Act Section 2(a)(1), 15 U.S.C. § 77b(a)(1), and Exchange Act Section 3(a)(10), 15 U.S.C. § 78c(a)(10). The Wynn notes do not resemble the list of financial instruments that the Supreme Court specifically excluded as securities in Reves. Nor do the four factors considered in Reves suggest that the Wynn notes should be added to the list of excluded financial instruments.

Conduct Rule 2210 governs members' communications with the public, and Rule 2210(d) prohibits a member from making any false, exaggerated, unwarranted, or misleading statements in its communications with the public. Public communications must be based upon principles of fair dealing and good faith, provide a sound basis for evaluating the facts discussed, and not omit material facts or qualifications that would cause a communication to be misleading in light of this context. 6/

It is undisputed that the three pieces of sales literature distributed by Keyes were misleading. The tri-fold brochure promoted the Wynn notes' "solid growth" and "reliable income." However, these statements were misleading because the brochure did not disclose that the notes were illiquid and carried a high risk of default. The tri-fold brochure and the information flyer falsely claimed that the Wynn notes were collateralized to 150 percent of their value. The investment triangle was misleading because it compared the Wynn notes to stocks, mutual funds, and money market funds without disclosing that the Wynn notes were illiquid and carried a high risk of default. Keyes has admitted that he violated Conduct Rule 2210; his testimony before the Hearing Panel and his written stipulations establish the facts necessary to find these violations.

IV.

Although Keyes admits that he committed the violations alleged by NASD, he contends that the bar imposed for the private securities transaction is excessive in light of certain facts that he asserts mitigate his actions. Exchange Act Section 19(e) provides that we may cancel, reduce, or require the remission of a sanction if we find that it imposes an unnecessary or inappropriate burden on competition, or if it is excessive or oppressive. 7/ NASD Sanction Guidelines recommend imposition of a fine of between \$5,000 and \$50,000 for private securities transactions and a one-year suspension or bar where, as here, the sales exceeded \$1,000,000. 8/ Using these Guidelines, NASD found that Keyes's private securities transactions warranted a bar.

6/ NASD Conduct Rule 2210(d)(1)(A). See also Jay Michael Fertman, 51 S.E.C. 943, 950 (1994) (holding that NASD rules require that sales literature must "disclose in a balanced way the risks and rewards of the touted investment").

7/ 15 U.S.C. § 78s(e)(2). Keyes does not claim, and the record does not show, that NASD's action has imposed an undue burden on competition.

8/ NASD Special Notice to Members 03-65 (Oct. 2003). The guideline provides that the first step is to assess the extent of the selling away, including the dollar amount of sales, the number of customers, and the length of time over which the selling away occurred. The second step is to consider the other factors described in the principal considerations for the guideline and the general principles applicable to all guidelines. The presence of one or more aggravating or mitigating factors may increase or decrease sanctions.

We have held repeatedly that engaging in private securities transactions is a serious violation. 9/ Rule 3040 protects investors from unsupervised sales and protects the member firm from liability and loss resulting from those sales. 10/ Violation of this rule deprives investors of a member firm's oversight and due diligence, protections they have a right to expect. 11/ Here, Keyes sold more than $1.9 million in Wynn notes to thirty-five customers over an eleven-month period. These large amounts of unapproved private securities transactions to numerous customers over an extended period warrant substantial sanctions.

NASD also identified several aggravating factors present in this case. Keyes created the impression that ICC sanctioned his conduct when he marketed the Wynn notes to customers as part of an investment plan in which they would roll the interest earned from the Wynn notes into variable annuities sold by ICC. He did so despite the fact that ICC prohibited the sale of all promissory notes and the Wynn notes were not approved ICC products.

Keyes's sale of the Wynn notes resulted in injury to the investing public. When Wynn filed for bankruptcy, customers still holding Wynn notes became unsecured creditors in Wynn's Chapter 7 bankruptcy proceeding. Two of Keyes's customers were among the twenty largest unsecured claims in the Wynn bankruptcy filing; their claims totaled $429,632.08. 12/ The sale of Wynn notes also resulted in Keyes's monetary gain. Keyes earned $63,412 in finder's fees from the sale of Wynn notes. A further aggravating factor is that Keyes recruited another person associated with ICC to sell Wynn notes. NASD also found that Keyes failed to report his involvement with the Wynn note program on his Form U-4 or in any ICC compliance materials, undercutting his contention that he did not make efforts to conceal this activity.

NASD further found that Keyes continued to refer customers to the Wynn note program even though he was on notice that Wynn was experiencing financial difficulties. NASD bases this finding on the fact that one of Keyes's customers notified Keyes in or about August 2001 that the customer's interest check from Wynn had bounced. Although Wynn subsequently issued the customer a new check that was backed by sufficient funds, NASD concluded that Keyes should have viewed the episode as a red flag and conducted further inquiry into Wynn's financial

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9/ See, e.g., Alvin W. Gebhart, Jr., Exchange Act Rel. No. 53136 (Jan. 18, 2006), 87 SEC Docket 437, appeal filed, No. 06-71201 (9th Cir.); Chris Dinh Hartley, Securities Act Rel. No. 50031 (July 16, 2004), 83 SEC Docket 1239, 1247; Stephen J. Gluckman, 54 S.E.C. 175, 192 (1999); Gerald James Stoiber, 53 S.E.C. 171, 180 (1997); Ronald W. Gibbs, 52 S.E.C. 358, 365 (1995).

10/ Gebhart, 87 SEC Docket at 468; Gluckman, 54 S.E.C. at 192.

11/ Gebhart, 87 SEC Docket at 468; Stoiber, 53 S.E.C. at 180.

12/ The record is silent as to whether other investors in the Wynn note program suffered any losses.

condition. We cannot conclude from this record that one bounced check, which was subsequently reissued backed by sufficient funds, should have put Keyes on notice to conduct further inquiry into Wynn's financial condition. However, independent of any red flag raised by the bounced check, Keyes's lack of inquiry, including his failure to examine Wynn's financial statements or the purported escrow agreement or to attempt to verify the existence of an escrow agreement, further supports imposition of serious sanctions. 13/

Keyes contends that the sanctions imposed upon him are too severe when compared with sanctions imposed in other NASD disciplinary proceedings. The appropriate sanction, however, depends on the facts and circumstances of each particular case. 14/ Moreover, all but one of the cases cited by Keyes involved sanctions imposed under a prior version of the Sanction Guidelines that, unlike the current version of the Guidelines, did not expressly provide for a bar in cases in which the sales of securities in question exceed $1 million. Rather, the prior version of the Guidelines provided that the Hearing Panel consider a bar (or a suspension for longer than one year) in egregious cases, leaving it to the Hearing Panel's discretion to determine the dollar value of the sales or other factors that would meet this standard. The cases that Keyes relies on where less than a bar was imposed involved lower sales amounts (and lower selling compensation), fewer investors, or shorter time frames, and imposed a fine in addition to the suspension. 15/ In the Gebhart case, the one case cited by Keyes that was decided by NASD

13/ For this reason, we also disagree that NASD should have considered as mitigating Keyes's contention that he performed due diligence with respect to the Wynn notes when he visited Wynn's headquarters.

14/ See Butz v. Glover Livestock Comm'n Co., 411 U.S. 182, 187 (1973); Jonathan Feins, 54 S.E.C. 366, 380 & n.36 (1999); Christopher J. Benz, 52 S.E.C. 1280, 1285 (1997), petition denied, 168 F.3d 478 (3d Cir. 1998) (Table).

15/ See Mark H. Love, Exchange Act Rel. No. 49248 (Feb. 13, 2004), 82 SEC Docket 686, 699 (noting that a thirty-day suspension fell on the low end of the Guideline range and a $25,000 fine fell at the mid-range where respondent referred three sets of customers to an outside program and received no compensation for the referrals); Hartley, 83 SEC Docket at 1245-48 (imposing a ninety-day suspension and $7,500 fine where respondent sold $255,000 worth of securities to five customers over a period of four months); Jim Newcomb, 55 S.E.C. 406 (2001) (sustaining NASD disciplinary action imposing a fine of $32,000 and a two-year suspension where respondent sold close to $1 million worth of promissory notes to forty-eight customers over an eighteen-month period and received $12,000 in selling compensation); Dep't of Enforcement v. Horn, Complaint No. C06010025 (Hearing Panel decision, Sept. 13, 2002) (imposing a fine of $10,000 and a six-month suspension on each of two respondents who sold away $345,000 of securities to seven customers over the course of four months); Dep't of Enforcement v. Roger Hanson, 2002 NASD Discip. LEXIS 5 (NAC Mar. 28, 2002) (imposing a six-month

(continued...)

under the currently applicable version of the Guidelines, a comparable amount of improper sales activity was at issue, $2 million, and the respondent primarily responsible for the improper sales was barred, as was Keyes. NASD specifically found that the second respondent "played a less substantial role" in the activity. 16/ Keyes's conduct in selling over $1.9 million in Wynn notes to thirty-five customers over the course of eleven months, while receiving $63,412 in selling compensation, is among the more egregious cases of those cited by Keyes. Therefore, we reject his claim that the sanctions imposed on him are disproportionate to those imposed in other cases.

Keyes argues that there are a number of mitigating factors that justify a reduction in the sanction imposed by NASD. 17/ With one exception, we find his claims of mitigation to be without merit. Keyes argues that he was unaware of the prohibitions on selling away contained in Conduct Rule 3040 and that he was never warned by ICC or Wightman that he should not participate in the Wynn note program. The Hearing Panel found that Keyes's testimony that he was unaware of the prohibitions on private securities transactions was not plausible given his securities industry experience. If anything, Keyes's claimed ignorance of his obligations is only aggravated in light of his fifteen years experience in the securities industry and the fact that he previously taught a preparatory class for the Series 6 qualification examination. 18/

15/ (...continued)
suspension, $5,000 fine, and disgorgement of commissions where respondent sold $220,500 in limited partnerships to fifteen customers over the course of three months); Dep't of Enforcement v. Carcaterra, 2001 NASD Discip. LEXIS 39 (NAC Dec. 13, 2001) (imposing a thirty-day suspension with respect to respondent's engaging in private securities transactions of $10,000 to one customer during a two-month period); Dep't of Enforcement v. Fergus, 2001 NASD Discip. LEXIS 3 (NAC May 17, 2001) (imposing suspensions of 60, 90, and 180 days (and fines of $8,000, $34,825.42, $35,000, respectively) on respondents whose respective violations involved selling away to three customers who invested 132,950.15, five customers who invested $898,749.50, and twenty customers who invested $1.7 million from February through March 1997).

16/ Gebhart, 87 SEC Docket at 468 n.104 (In sustaining the sanctions imposed, we noted that the record supported a finding that the respondents' "responsibility for these violations was equivalent.").

17/ Keyes also argues that we should review various findings made by the Hearing Panel. However, it is the decision of the NAC, not the decision of the Hearing Panel, that is the final action of NASD which is subject to Commission review. See 15 U.S.C. § 78s(e).

18/ We repeatedly have stated that the prohibition on private securities transactions are fundamental to an associated person's duty to his customers and his firm. See, e.g., Gluckman, 54 S.E.C. at 192; Stoiber, 53 S.E.C. at 180.

Keyes also contends that ICC's compliance and supervisory procedures were inadequate and that had ICC inquired about the Wynn note program he would have disclosed it. As a participant in the securities industry, however, Keyes is responsible for compliance with regulatory requirements and cannot shift his responsibility for compliance to his supervisors. 19/

Keyes argues that his lack of disciplinary record and the fact that he repaid some customers justifies reducing the sanction imposed by NASD. However, lack of disciplinary history is not mitigating for purposes of sanctions because an associated person should not be rewarded for acting in accordance with his duties as a securities professional. 20/ Keyes's claimed repayment of some customers does not support a reduced sanction because he testified that he did so contemporaneously with the initiation of NASD's investigation. 21/ Keyes also argues that a lesser sanction is justified because he cooperated with NASD in its investigation of his conduct and he testified truthfully. However, when Keyes registered with NASD he agreed to abide by its rules, which are unequivocal with respect to the obligation to cooperate with NASD, and compliance with this obligation is not a mitigating factor. 22/ Although Keyes contends that he testified truthfully, the Hearing Panel found that his testimony that he was unaware of the prohibitions on private securities transactions was not plausible. Keyes's additional assertion that he did not attempt to deceive his customers is undermined by his admitted use of misleading sales literature in connection with his violation of NASD Conduct Rule 2210.

Keyes argues that the sanctions imposed by NASD should be reduced because he did not believe the Wynn notes were securities subject to Conduct Rule 3040. In support of this claim, Keyes points to a legal opinion provided to Wynn by its counsel that the Wynn notes were not

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19/ See Thomas C. Kocherhans, 52 S.E.C. 528, 531 (1995) (rejecting respondent's argument that he was not warned by his manager and therefore he could not know that his conduct was inappropriate); see also Patricia H. Smith, 52 S.E.C. 346, 348 n.8 (1995) (rejecting respondent's attempt to blame her misconduct on training received from member firm).

20/ See Daniel D. Manoff, 55 S.E.C. 1155, 1165-66 & n.15 (2002) (rejecting lack of disciplinary history as mitigating sanction of a bar); Henry E. Vail, 52 S.E.C. 339, 342, aff'd, 101 F.3d 37 (5th Cir. 1996) (per curiam) (same); Ernest A. Cipriani, 51 S.E.C. 1004, 1007 & n.15 (1994) (same).

21/ See Arthur Lipper Corp., 46 S.E.C. 78, 98 (1975) (holding that repayment made after commencement of investigation into violative conduct has minimal mitigative weight), aff'd, 547 F.2d 171 (2d Cir. 1976).

22/ Michael Markowski, 51 S.E.C. 553, 557 (1993), aff'd, 34 F.3d 99 (2d Cir. 1994). NASD Guidelines provide that an associated person's "substantial assistance" to the NASD during an investigation is generally mitigating. Keyes's cooperation in the investigation was consistent with the responsibilities he agreed to when he became an associated person and does not constitute substantial assistance.

securities. However, because Keyes stipulated in writing that he did not review this opinion until March 2002, after the last of his Wynn note transactions, he cannot claim that he relied on that opinion to conclude that the Wynn notes were not securities. In any event, Keyes was not entitled to rely on the representations of the issuer or its legal counsel and had a duty to make an adequate independent investigation. 23/ Given these facts, Keyes's subjective belief as to whether or not the Wynn notes were securities is not a mitigating factor.

Keyes contends that future violations by him are unlikely and that he is remorseful for his conduct. We are unpersuaded by these claims, given Keyes's repeated attempts to shift some of the blame for his violations to others and his failure to appreciate the fundamental duties of a securities professional with respect to the prohibitions on private securities transactions.

As noted above, we have found most of Keyes's claims of mitigation to be without merit. However, there is one area where we find, contrary to NASD, that Keyes has demonstrated some mitigation. Keyes maintains that he provided oral notice of his involvement with the Wynn note program to Wightman, that Wightman approved of Keyes's conduct and, therefore, Keyes believed that he had permission from ICC to participate in the Wynn note program. He also asserts that Wightman instructed him to communicate only with Wightman and not with ICC about the program.

NASD found that any notice that Keyes may have given to Wightman was not mitigating in light of the significant aggravating factors present in this case. However, the record in this proceeding is sufficiently unclear as to the extent of Wightman's involvement in, or approval of, Keyes's actions with respect to the Wynn notes that we are unable to agree with NASD that Keyes has not demonstrated some mitigation with respect to this point. The only testimony concerning Wightman's role in the transactions comes from Keyes, as Wightman did not testify before the Hearing Panel and his investigative testimony is unclear. Thus, under the circumstances of the record before us in this matter, we believe that Keyes's claim that Wightman knew of and approved of the Wynn note transactions provides some mitigation.

Nevertheless, a number of factors lessen the degree to which Wightman's actions serve to mitigate Keyes's misconduct. Regardless of what Wightman told Keyes, Keyes has not shown, and the record does not indicate, that he provided Wightman with the specific information required by Conduct Rule 3040, including identification of the investors, the amount of money to be invested, Keyes's proposed role in the transactions, and that he would received selling compensation in connection with the transactions. Moreover, because Keyes received selling

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23/ See Gilbert M. Hair, 51 S.E.C. 374, 377 (1993) (holding that reliance by a registered representative on an issuer's representations is not sufficient for purposes of mitigating NASD's rule against private securities transactions); Frank W. Leonesio, 48 S.E.C. 544, 548 (1986) (stating that respondents may not rely on the self-serving statement of an issuer that an investment is not a security and have a duty to make an adequate independent investigation).

compensation from the Wynn note program transactions, he was required to receive written permission from ICC before offering the Wynn notes for sale. 24/ It is undisputed that ICC did not provide Keyes with written permission to participate in the Wynn note transactions. Furthermore, ICC's prohibition on the sale of all promissory notes is inconsistent with the claim that Keyes believed that Wightman, if he did approve Keyes's sale of the notes, had authority from ICC in doing so. Therefore, although we find Keyes's claim that Wightman knew of and approved his conduct to be a mitigating factor, its impact is lessened by the facts discussed above. As discussed above, Keyes's conduct was inconsistent with the fundamental duties an associated person owes his customers and his firm. Accordingly, we remand this case to NASD to determine appropriate sanctions that factor in (1) the mitigation we find above for the private securities transactions violations, and (2) the sales literature violations. 25/

An appropriate order will issue. 26/

By the Commission (Chairman COX and Commissioners CAMPOS, NAZARETH and CASEY); Commissioner ATKINS not participating.

Nancy M. Morris
Secretary

24/ See NASD Conduct Rule 3040(c).

25/ Keyes makes a number of unsupported arguments of procedural unfairness in NASD's disciplinary proceeding, none of which we find persuasive. For example, he argues that his termination from ICC and NASD's subsequent bar constitutes "double punishment," but Keyes's termination is not relevant to what sanction is appropriate for his misconduct. He claims that NASD breached a "good faith settlement deal" but offers no explanation as to how this mitigates his misconduct. He contends that NASD conducted a "protracted and inefficient investigation" that prevented him from "earning a living," but the record indicates that NASD conducted its investigation in a timely manner. Moreover, the record indicates that NASD followed its procedural rules, including bringing specific charges, notifying Keyes of those charges, and providing Keyes with an opportunity to defend those charges. Accordingly, we reject Keyes's assertion that the proceeding was procedurally unfair.

26/ We have considered all of the contentions advanced by the parties. We have rejected or sustained these contentions to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 54723 / November 8, 2006

Admin. Proc. File No. 3-12169

In the Matter of the Application of

PHILIPPE N. KEYES
c/o Richard A. Ruben
5850 Canoga Avenue, Suite 400
Woodland Hills, California 91367

For Review of Action Taken by

NASD

ORDER REMANDING DISCIPLINARY PROCEEDING TO REGISTERED SECURITIES ASSOCIATION

On the basis of the Commission's opinion issued this day, it is

ORDERED that the findings of violation made by NASD against Philippe N. Keyes, and NASD's assessment of costs be, and they hereby are, sustained; and it is further

ORDERED that the sanctions imposed by NASD on Philippe N. Keyes be, and they hereby are, remanded for reconsideration.

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 54722 / November 8, 2006

Admin. Proc. File No. 3-12245

In the Matter of the Application of

RAGHAVAN SATHIANATHAN
c/o S.T. Allen & Co.
336 Bloomfield Avenue
Montclair, NJ 07042

For Review of Action Taken by

NASD

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION -- REVIEW OF DISCIPLINARY PROCEEDING

Unsuitable Recommendations

Discretionary Trading Without Written Authorization

Associated person of member firms of registered securities association made unsuitable recommendations to customers and exercised discretion in the account of a customer without written authorization. Held, association's findings of violation and the sanctions it imposed are sustained.

APPEARANCES:

Raghavan Sathianathan, pro se.

Marc Menchel, Alan B. Lawhead, Carla J. Carloni, and Brant K. Brown, for NASD.

Appeal filed: March 22, 2006
Last brief received: July 10, 2006

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I.

Raghavan Sathianathan, formerly associated with Salomon Smith Barney Inc. ("Smith Barney") and Morgan Stanley DW Inc. ("Morgan Stanley"), NASD member firms, appeals from NASD disciplinary action. NASD found that Sathianathan made unsuitable recommendations to two customers in violation of NASD Conduct Rules 2310 and 2110, and exercised discretion in the account of one of those customers without the customer's written authorization in violation of NASD Conduct Rules 2510(b) and 2110. NASD barred Sathianathan from associating with any member firm in any capacity for his violations of NASD's suitability rule. NASD also assessed costs, but declined to impose additional sanctions for Sathianathan's unauthorized discretionary trading. We base our findings upon an independent review of the record.

II.

The facts in this matter are largely undisputed. Smith Barney hired Sathianathan in its Little Falls, New Jersey, branch office on August 24, 1998. In November 1998, Sathianathan passed the general securities representative examination and became registered with Smith Barney. He voluntarily left Smith Barney on February 16, 2001, and joined Morgan Stanley at its office in New York City. Sathianathan resigned from Morgan Stanley in February 2002.

Sathianathan's sales practices came into question almost immediately after he started with Smith Barney. During Sathianathan's first year with Smith Barney, his supervisor became concerned that Sathianathan's dealings with his customers had not "shown a consistent pattern of . . . acceptable behavior." On September 27, 1999, the supervisor issued Sathianathan a "warning/probation letter" placing him on probation for four months and instructing him to adhere to a list of seven guidelines. One of the guidelines was entitled "proper portfolio management" and defined this term to include limited or no use of margin, proper asset allocation and diversification, and elimination of any excessive trading or commissions.

The violative conduct at issue in this proceeding occurred from September 2000 through June 2001. Sathianathan made recommendations alleged by NASD to be unsuitable to two of his customers, Anjan Venkatramani and Srikar Srinath, who were twenty-eight-year-old engineers with Juniper Networks, Inc. ("Juniper"), a California company specializing in telecommunications equipment. In mid 1999, Juniper engaged in an initial public offering and, between that time and the time of the recommendations at issue in this proceeding, the stock experienced significant price volatility. Venkatramani's and Srinath's compensation packages included Juniper stock options.

Class A and Class B Shares of Mutual Funds

The suitability issues in this proceeding include Sathianathan's recommendations to Venkatramani and Srinath that they purchase Class B shares of various mutual funds. Typically, Class A shares differ from Class B shares with respect to their cost structure. Class A shares usually include an initial sales charge, or front-end load, a fee that is levied upon the purchase of mutual fund shares, while Class B shares do not. Class A shares include breakpoint discounts, which reduce the front-end load incrementally in the event that the investor invests specified amounts in the fund. At each breakpoint, the representative's commission rate is reduced. Most mutual funds waive front-end loads for investments in Class A shares of more than $1 million. Many mutual fund families also permit investors to aggregate their investments in multiple funds within the same family when calculating whether the investor has reached a breakpoint.

Unlike Class A shares, Class B shares usually include a contingent deferred sales charge ("CDSC"), or back-end load, which is a fee that is levied upon the sale of mutual fund shares. Typically, the CDSC is reduced with each year that the investor holds the fund shares, phasing out entirely after a certain number of years, and at some point afterward the Class B shares convert into Class A shares. Since there are no breakpoints for Class B shares, there is no reduction in the commission rate for larger investments in Class B shares. This means that, for investments at or above the breakpoint levels, the representative receives a larger percentage commission for Class B shares than for Class A shares.

A mutual fund's expense ratio measures the fund's total annual expenses expressed as a percentage of the fund's net assets. The expense ratio includes asset-based sales charges, such as charges permitted under Investment Company Act Rule 12b-1, 1/ that are taken from the mutual fund's assets to pay to market the fund and distribute its shares. The expense ratios for Class B shares often are up to 75 basis points higher than the expense ratios for Class A shares.

Sathianathan's Recommendations to Venkatramani

In or around April 2000, Venkatramani opened an account with Smith Barney at its Menlo Park, California, branch office. He deposited into the account 13,500 shares of Juniper stock that he had acquired through the exercise of stock options. The account application contained a section entitled "Risk Tolerance" that indicated Venkatramani had a moderate risk tolerance (out of a choice of aggressive, moderate, or conservative). The application also indicated that Venkatramani's investment objectives did not allow for speculation and that he had no investment experience.

In May 2000, after meeting Sathianathan through Sathianathan's younger brother, Venkatramani moved his account from the Menlo Park branch to Smith Barney's Little Falls branch office so that Sathianathan could serve as his financial consultant. In contrast to the account application completed in connection with Venkatramani's Menlo Park branch account, the account application that Sathianathan filled out and that Venkatramani signed in May 2000 when he opened the account with Sathianathan listed Venkatramani's risk tolerance as "aggressive," indicated that his investment objectives allowed for speculation, and stated that he had been investing in stock since 1995. However, Sathianathan testified that Venkatramani had informed him that Venkatramani's investment objective was the preservation of capital.

1/ 17 C.F.R. § 270.12b-1.

Sathianathan also knew that Venkatramani had no prior investment experience and that "his level of sophistication was almost zero." Although Venkatramani was not interested in aggressive or speculative investing, Sathianathan marked the account form to indicate that Venkatramani's risk tolerance was aggressive and that he was interested in speculative investing because, according to Sathianathan, without doing so, Smith Barney would not allow the customer to engage in certain hedging strategies.

Primarily as a result of the increase in value of Juniper shares and Venkatramani's exercise of additional Juniper stock options, the value of Venkatramani's account increased from approximately $2 million as of June 30, 2000, to over $10 million in September 2000. In August and September 2000, Sathianathan contacted the Smith Barney Global Equity Derivatives department, which specialized in hedging strategies, to price potential ways to diversify Venkatramani's concentrated equity position in Juniper. The Global Equity Derivatives Department proposed several alternatives and recommended a program entitled "Enhanced Equity Monetization Securities," which consisted of private contracts between eligible investors and Smith Barney. According to Smith Barney, these contracts allowed investors to monetize a portion of their equity position without realizing a taxable event. Sathianathan rejected the Global Equity Derivatives Department's proposal. Instead, he recommended that Venkatramani hold his Juniper shares until early 2001, at which time they would be eligible for long-term capital gains treatment, and diversify his holdings by purchasing mutual fund shares on margin using the Juniper shares as collateral.

On September 26, 2000, consistent with the strategy proposed by Sathianathan, Venkatramani purchased $200,000 of Class B shares in each of fourteen different mutual funds, none of which was in the same fund family. Sathianathan also recommended that Venkatramani invest $500,000 in the Smith Barney Spectrum Fund, a new Smith Barney fund, because Sathianathan claims he felt pressure to put some of Venkatramani's assets into a Smith Barney product. Sathianathan stated that he "didn't want to buy Smith Barney funds, but [he] felt obliged to buy one, so [he] bought a new one [for Venkatramani's account], a brand new one with no bad record or whatever." Venkatramani's Smith Barney account was non-discretionary, and each of the mutual fund purchases was made based on Sathianathan's recommendation. Venkatramani invested a total of $3.3 million, and all of the purchases were effected on margin using Juniper stock, which closed at $230.50 per share on September 26, 2000, as the margin collateral. At the time that Sathianathan made his recommendations to Venkatramani, the account was erroneously credited with additional shares of stock he did not own, and this resulted in the account being overvalued by approximately $3 million for a total account value of approximately $13 million. Sathianathan received $66,600 in commissions as a result of Venkatramani's purchases.

Sathianathan testified that he had little experience with mutual fund investments at the time that he made his recommendations to Venkatramani. In preparing his recommendations, Sathianathan reviewed the funds' information from Morningstar and the funds' three-year performance records, but did not compare the funds' securities holdings to determine whether Venkatramani could have achieved appropriate diversification by using fewer funds or funds within the same fund family. Sathianathan also recommended that Venkatramani purchase Class B shares of the recommended mutual funds to avoid the front-end sales charges levied on the purchase on Class A shares. Sathianathan specifically recommended that Venkatramani purchase $200,000 in each fund because he knew that many investment companies prohibit purchases of Class B shares, rather than Class A shares, in larger amounts. Sathianathan also stated that he was focused not on breakpoints but on obtaining commissions and increasing the amount of assets under his management.

Also on September 26, 2000, Venkatramani invested, on Sathianathan's recommendation, $1 million in index warrants issued by Smith Barney. The prospectus for the index warrants stated that the warrants involved "a high degree of risk" and that purchasers "should be prepared to sustain a total loss of the purchase price of their warrants." Venkatramani purchased the warrants on margin, and he used Juniper stock as the collateral for the margin loan. Sathianathan received a six percent commission for the purchase of the warrants.

During the three months that followed the purchases described above, the price of Juniper shares fell from a closing price of $230.50 per share on September 26, 2000, to a closing price of $123.12 per share on December 22, 2000. On December 26, 2000, pursuant to Sathianathan's recommendation, Venkatramani invested $200,000 in each of three different mutual funds which were in different fund families, none of which Venkatramani previously had purchased. Venkatramani purchased these funds on margin using Juniper stock as the margin collateral.

Juniper's stock price continued to decline into early 2001. In February 2001, when Juniper's stock price had fallen below $100 per share, Venkatramani's account began to become subject to margin calls. On February 8, 2001, based on Sathianathan's recommendation, Venkatramani sold the Smith Barney warrants for approximately $925,000 to cover a margin call resulting in a loss of approximately $75,000. On February 14, 2001, Venkatramani sold approximately $470,000 in shares of the Smith Barney Spectrum Fund resulting in a loss of almost $30,000. Two days later, on February 16, 2001, Venkatramani redeemed $75,000 in each of 17 different mutual funds for a total redemption of $1,275,000. The price declines in the Juniper collateral, and the resulting margin calls and liquidations of the mutual funds, caused Venkatramani to incur a loss of approximately $680,000, as well as approximately $44,000 in CDSCs.

On February 16, 2001, Sathianathan voluntarily left Smith Barney and joined Morgan Stanley. Nevertheless, Venkatramani's assets continued to be sold to cover the margin balance at Smith Barney. By mid April 2001, Venkatramani was forced to redeem all of the mutual funds and sell a portion of his Juniper stock. Ultimately, Venkatramani paid over $100,000 in CDSCs and a little over $193,000 in margin interest.

Sathianathan Purchases Juniper Stock for Venkatramani's Account

On April 12, 2001, the approximately $2.6 million in Juniper stock that remained in Venkatramani's Smith Barney account was transferred to Morgan Stanley. That same month, Sathianathan recommended that Venkatramani sell 25,000 Juniper shares at a time when the stock price had rebounded from a low of $30 per share to over $50 per share. Two days later Venkatramani sold an additional 8,000 shares of Juniper stock at Sathianathan's urging. Venkatramani was unhappy with the price at which the shares were sold, and he and Sathianathan subsequently discussed a trading strategy to recoup some of the losses Venkatramani had incurred. According to Sathianathan, the basic plan was "to sell [Juniper stock] when the price of the stock was high and then to buy it back when it was lower and to do this over the next few years (if need be) by trying to time the market rallies in summer and January."

In May 2001, Venkatramani sent Sathianathan an e-mail in which he relayed a rumor that Juniper would be added to the S&P 500. Sathianathan believed that, if the rumor proved to be correct, Juniper's stock price would increase. Based on the strategy they had discussed earlier and on this rumor, Sathianathan decided to buy back a portion of the 33,000 shares of Juniper stock that Venkatramani had sold in April. On May, 29, 2001, while Venkatramani was out of the country and Sathianathan could not reach him, Sathianathan purchased 13,000 Juniper shares for Venkatramani's account for approximately $47 per share. On June 8, 2001, Sathianathan purchased an additional 10,000 shares of Juniper stock for Venkatramani's account for approximately $38 per share.

On August 2, 2001, Venkatramani sent an e-mail to Sathianathan, in which he indicated that he had not authorized the purchase of 23,000 Juniper shares and that the unauthorized trades had resulted in $400,000 in losses. In response, Sathianathan represented that his decision to purchase the 23,000 Juniper shares was "purely based on what I thought was a strong family relationship that you and I have through the fact that one of your best friends is my brother."

Sathianathan's Recommendations to Srinath

In late May or early June 2000, Srinath met with Sathianathan. After that meeting, Srinath transferred his existing Smith Barney account to the Little Falls branch office so that Sathianathan could serve as his financial consultant. When Srinath first discussed his account with Sathianathan, he informed Sathianathan that his objectives were to diversify his holdings and to protect his net worth. Sathianathan also was aware that Srinath had little previous investment experience and "minimal" experience with mutual finds. Srinath's account opening application, however, indicated that his risk tolerance was aggressive and that his investment objectives included speculative investments. By December 2000, Srinath had transferred, at Sathianathan's urging, all of the assets in his other Smith Barney accounts to his account at the Little Falls branch office.

In December 2000, Sathianathan recommended that Srinath purchase $1,750,000 in Class B shares of different mutual funds. Although Sathianathan recommended that Srinath purchase these shares using a margin loan with Juniper stock as collateral, Srinath decided against using margin loans to fund the purchases. Instead, Srinath instructed Sathianathan to sell a portion of his Juniper stock to pay for the mutual fund purchases, and Srinath purchased $150,000 of Class B shares in each of nine stock mutual funds. Srinath also instructed Sathianathan to invest a portion of his assets in two bond funds. Sathianathan purchased for Srinath $200,000 in each of two bond mutual funds; none of the funds was in the same fund family. Sathianathan admitted that he performed no independent analysis of the funds he recommended to Srinath. Rather, he selected a subset of the mutual funds that he had recommended to Venkatramani three months earlier.

Procedural History of NASD Disciplinary Action Against Sathianathan

In late 2001, NASD began an investigation of Sathianathan following Smith Barney's filing of an amended Uniform Termination Notice for Securities Industry Registration ("Form U-5") that disclosed a customer complaint by Venkatramani involving Sathianathan. An NASD Hearing Panel (the "Hearing Panel") conducted a two-day disciplinary hearing in July 2004. On November 30, 2004, the Hearing Panel issued a decision that found that Sathianathan had violated NASD Rules 2310, 2510, and 2110. The Hearing Panel dismissed an allegation that Sathianathan committed fraud. The Hearing Panel barred Sathianathan from associating with any NASD member firm in any capacity for the suitability rule violations and did not impose a separate sanction for the unauthorized discretionary trading.

Sathianathan appealed the decision of the Hearing Panel to NASD's National Adjudicatory Council ("NAC"). On March 7, 2005, and on March 10, 2005, he filed motions to adduce additional evidence on appeal. In addition, Sathianathan submitted a letter dated May 11, 2005, to NASD's Office of the General Counsel containing two exhibits. The NAC treated portions of this letter as a further motion to adduce additional evidence. The subcommittee of the NAC assigned to hear the case considered all three motions and, in a letter dated July 8, 2005, issued its ruling admitting one of the exhibits and denying the motions to adduce with respect to the other exhibits, but including the exhibits in the record before us on appeal. On June 23, 2005, and on June 29, 2005, Sathianathan again sought leave to adduce further additional evidence, and the subcommittee denied the motions as untimely in a letter dated July 20, 2005. All of the subcommittee's rulings regarding Sathianathan's motion to adduce additional evidence were affirmed by the NAC.

With respect to the allegations against Sathianathan, the NAC, in a decision dated February 21, 2006, found that his recommendations were unsuitable in numerous ways and that he was motivated by his own interest and financial gain. The NAC determined that Sathianathan's violations of the suitability rule and numerous aggravating factors warranted a bar under the relevant Sanction Guidelines.

Sathianathan appealed NASD's decision to the Commission on March 26, 2006. After submitting an amended initial brief on May 25, 2006, and a reply brief on July 10, 2006, he submitted a motion to adduce additional evidence on August 25, 2006. Sathianathan attached to the motion the twenty-two additional exhibits he sought to adduce. One of the exhibits already has been admitted by the NAC upon Sathianathan's motion. Another exhibit is a BNA article from 2005 containing a quantitative analysis of a portion of NASD disciplinary decisions over a four-year span.

Seventeen of the documents had been included in Sathianathan's motions to adduce evidence before the NAC. Sathianathan has not shown with particularity that the additional evidence he seeks to introduce is material and that there are reasonable grounds for his failure to adduce the evidence previously as he is required to do by Rule 452 of the Commission's Rules of Practice. 2/ Nevertheless, as a discretionary matter, we will admit these seventeen documents into evidence in this proceeding.

The remaining three documents Sathianathan seeks to adduce are descriptions, handwritten by Sathianathan, of documents that he asked NASD to compel from Smith Barney and Morgan Stanley. These documents are Srinath's account application from his account at Smith Barney's Menlo Park office, Srinath's January 2001 Smith Barney account statement, and an e-mail that Sathianathan alleges Venkatramani sent to an associated person of Morgan Stanley in May 2001.

NASD denied his request to compel the account application and the account statement as untimely. With respect to the e-mail, the subcommittee of the NAC noted "recent press reports" that indicated that Morgan Stanley might have access to e-mails to which it earlier had denied having access. The subcommittee determined not to remand the case to the Hearing Panel given the amount of time that had elapsed since the conduct at issue. Rather, the subcommittee determined to "credit [ ] Sathianathan's contention regarding a May 2001 e-mail" and provided him "an opportunity, in writing, to state his recollection as to the contents of the e-mail." There is no evidence in the record that Sathianathan made such a submission.

Sathianathan cannot move to adduce these three documents because he does not have them in his possession. Therefore, we are construing his motion to adduce these documents as an argument that NASD erred in refusing to compel them. NASD Procedural Rule 9252 enables respondents to request that NASD invoke Rule 8210 to compel production of documents in disciplinary hearings. Rule 9252, however, requires respondents to make such a request no later than 21 days before the scheduled hearing date in the underlying proceeding. Sathianathan did not file his request until after the Hearing Panel issued its decision. Moreover, NASD Procedural Rule 9346 requires a respondent who seeks to adduce additional evidence on appeal to demonstrate good cause for failing to introduce the evidence before the Hearing Panel and to show that the evidence is material.

2/ 17 C.F.R. § 201.452

Sathianathan has not established good cause for his failure to introduce the account application and account statement before the Hearing Panel. Sathianathan also has failed to establish that the documents are material. He states that the account statement "will refute the NASD's attempt to draw a parallel between my recommendations to [Venkatramani] and my recommendations to [Srinath]." However, the contents of Srinath's account statement are not material given that Sathianathan admitted that he performed no independent analysis of the funds he recommended to Srinath and instead selected them from a subset that he had recommended to Venkatramani. He states that the account application "refutes NASD's unsubstantiated allegation that [he] made misrepresentations on Srinath's account application form." NASD, however, did not charge Sathianathan with making misrepresentations on the account statement. In addition, Sathianathan makes no argument concerning NASD's ruling providing him with the opportunity to state his recollection of the alleged May 2001 e-mail or his failure to make a submission stating his recollection of the contents of that e-mail as provided by NASD. Given these facts, we cannot conclude, as Sathianathan would have us do, that NASD committed error in refusing to compel the three documents at issue.

III.

Unsuitability

NASD Conduct Rule 2310 requires that, in recommending a transaction to a customer, a registered representative "shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs." 3/ As we have frequently stated, a broker's recommendations must be consistent with his customers' best interests. 4/

Sathianathan's Recommendations to Venkatramani

The recommendations that Sathianathan made to Venkatramani were unsuitable in numerous ways. Sathianathan knew that Venkatramani's investment objectives were to preserve his newly acquired wealth and to obtain moderate growth, and that he had no prior investment experience. Sathianathan even sought pricing models from Smith Barney's Global Equity Derivative Department on various hedging strategies intended to protect Venkatramani's wealth which was concentrated in one highly volatile stock. The Global Equity Derivative Department responded with several alternatives and a recommended strategy. Sathianathan rejected the

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3/ See Maximo Justo Guevara, 54 S.E.C. 655, 662 (2000), petition denied, 47 Fed. Appx. 198 (3d Cir. 2002) (Table); Rafael Pinchas, 54 S.E.C. 331, 341 (1999).

4/ Wendell D. Belden, Exchange Act Rel. No. 47859 (May 14, 2003), 80 SEC Docket 699, 704; Jack H. Stein, Exchange Act Rel. No. 47335 (Feb. 10, 2003), 79 SEC Docket 2276, 2280; Daniel Richard Howard, 55 S.E.C. 1096, 1100 (2002), aff'd, 77 Fed. Appx. 2 (1st Cir. 2003).

Department's recommendation and instead recommended that Venkatramani increase the leverage in his account by purchasing approximately $4 million in seventeen different mutual funds and the Smith Barney fund, in eighteen different fund families, and $1 million in speculative warrants on margin using the highly speculative Juniper stock as the sole collateral.

Sathianathan's recommendations that Venkatramani invest in Class B shares in seventeen different mutual funds (in addition to shares in the Smith Barney fund), all in different fund families, were unsuitable because they were designed to maximize his own commissions rather than to establish a suitable portfolio. When breakpoints are available, Class B shares, while maximizing the commissions paid to the account representative, often entail greater fees and expenses than Class A shares. Yet Sathianathan recommended that Venkatramani purchase $200,000 in each fund because Sathianathan was aware that many fund companies prohibit purchases of Class B shares in larger amounts. He admitted he structured the purchases to avoid these limitations and to prevent the fund companies from requiring that the purchases be made in Class A shares. He admitted that his recommendations were based, at least in part, on his desire to maximize his commissions.

Moreover, by recommending that Venkatramani purchase Class B shares in seventeen different fund families and shares in the Smith Barney fund, Sathianathan ensured that Venkatramani's purchases would not be aggregated to qualify for Class A share breakpoint discounts and the resulting lower commissions. Although Sathianathan claims the purpose of his recommendation of so many different funds was to diversify Venkatramani's account, he admitted that he gave no serious consideration to whether he could have achieved appropriate diversification in Venkatramani's account while allowing him to take advantage of breakpoint discounts offered on Class A shares. Rather, Sathianathan recommended that Venkatramani structure his mutual fund purchases in plain disregard of the mutual funds' policies, expressed through the dollar limits on the purchase of Class B shares, that it would be more advantageous for an investor making a large investment to purchase Class A shares, and in disregard of NASD's directions to its members to consider all of the expenses charged, and discounts offered, by a mutual fund in determining whether the purchase of that fund's shares is suitable. 5/

Sathianathan's recommendation that Venkatramani use margin for his purchases also was unsuitable given that his investment objectives were moderate growth and the preservation of capital, and that he had no prior investment experience. Using a margin loan with the highly

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5/ Wendell D. Belden, 80 SEC Docket at 704-06; see also Suitability Issues for Multi-Class Mutual Funds, NASD Regulatory and Compliance Alert (Summer 2000) ("[M]embers generally should not recommend Class B or C shares to investors who seek to purchase in large amounts and who would incur significantly lower sales charges for Class A share purchases due to the availability of breakpoints, rights of accumulation, or letters of intent."); NASD Notice to Members 95-80 (Sept. 1995) (reminding members that, in determining whether a fund is suitable for an investor, a member should consider the fund's expense ratio and sales charges as well as its investment objectives).

speculative Juniper stock as collateral failed to manage the risk posed to Venkatramani by his concentrated holdings in that stock. Moreover, the margin purchase added an additional source of volatility to the portfolio, and required Venkatramani to pay interest charges on the margin loan, adding to the cost of maintaining the account and increasing the amount by which his investment had to appreciate before realizing a net gain. 6/ The recommendation to use margin to purchase Class B mutual fund shares also failed to take into account the possibility that Venkatramani would have to pay CDSCs if, as ultimately happened, he had to sell Class B shares in order to cover margin calls prior to the expiration of the CDSC period. Sathianathan admitted that he failed to consider the consequences if a margin call were to occur, likening the event to the chances of "a meteorite hitting New York City tomorrow."

Sathianathan's recommendation that Venkatramani invest $1 million in speculative Smith Barney warrants also was unsuitable given Venkatramani's stated investment objective to preserve his newly acquired wealth by diversifying his holdings. The warrants could potentially expire worthless, and the prospectus stated that the warrants involved "a high degree of risk." Sathianathan has not articulated a reason as to why he believed the purchase of the warrants would further Venkatramani's investment goals or was consistent with an investment strategy of moderate growth and preservation of capital.

Sathianathan's Recommendations to Srinath

The recommendations that Sathianathan made to Srinath also were unsuitable. Sathianathan's recommendations that Srinath invest in Class B shares in nine different mutual funds in nine different fund families resulted in unnecessary costs. Sathianathan's mutual fund recommendations to Srinath, like those he made to Venkatramani, were designed to maximize his own commissions, and they failed to account for the fact that by aggregating Srinath's purchases into fewer funds and fewer fund families and by purchasing Class A shares rather than Class B shares, Srinath could have qualified for breakpoint discounts available with Class A shares and could have paid less in fees and expenses.

6/ See Stephen Thorlief Rangen, 52 S.E.C. 1304, 1307-08 (1997) (finding the use of margin to be unsuitable for unsophisticated investors who were seeking income producing investments and did not wish to speculate). To avoid the use of margin to purchase the mutual funds, Venkatramani would have had to liquidate part of his position in Juniper stock and incur capital gains taxes, which may have been more costly than paying margin interest. However, Sathianathan does not claim, and nothing in the record indicates, that he weighed the suitability of paying margin interest instead of incurring capital gains taxes or that he analyzed the impact of the choice of whether to liquidate Juniper stock or to use it as collateral on the total risk to Venkatramani's position.

Sathianathan's Arguments

Sathianathan provides several reasons why he believes the recommendations that he made were suitable. Sathianathan maintains that it is wrong to assume that Class B shares were unsuitable given the amounts invested by Venkatramani and Srinath. He contends that the fact that many mutual fund companies restrict Class B share purchases to amounts at or below $250,000 is a "strong signal that Class A shares are more profitable than Class B shares for the mutual fund companies." He argues that, accordingly, recommending Class A shares to his customers would have violated "basic expectations of the workings of free markets . . . that what is more profitable for the mutual fund family is more costly for customers."

Sathianathan offers nothing in support of this proposition. To the contrary, he admits in his brief on appeal that a customer investing over $1 million in mutual funds can benefit from the breakpoint discounts offered on Class A shares. Moreover, he admitted that, prior to making his recommendations, he failed to perform any calculations or to consider hypothetical scenarios to determine which class of shares would be more beneficial to the customers in the long run. Sathianathan cites to "academic studies conducted by Nobel prize winning economists" that he asserts show that investors generally prefer not to pay initial sales charges even if they have to pay more in deferred charges. He also refers to "basic financial theory that more diversification is better."

There is no evidence, however, that Venkatramani and Srinath ever manifested a preference to avoid up-front charges. More fundamentally, a general preference "not to pay initial sales charges" does not address whether Class B shares, with their lack of up-front sales charges but higher costs and commissions, were suitable for these customers. While Class B shares may be suitable for some investors, particularly those who cannot take advantage of breakpoint discounts, Venkatramani and Srinath were investing millions of dollars and would have qualified for breakpoint discounts had they invested in Class A shares in fewer fund families. In addition, a general preference to avoid initial sales charges does not address the risk that Venkatramani would have to pay CDSCs if he had to sell Class B shares in order to cover margin calls prior to the expiration of the CDSC period. Moreover, the assertion that more diversification is better is beside the point; Sathianathan could have achieved appropriate diversification while obtaining the lower costs available when purchasing Class A shares had he recommended that Venkatramani and Srinath select mutual funds from fewer mutual fund families.

Sathianathan argues that NASD made an incomplete analysis of the cost of concentrating mutual fund purchases into a small number of mutual fund families in order to purchase lower-cost Class A shares. Specifically, he claims that, as an associated person of Smith Barney, he would have been forced to purchase Smith Barney funds, which he contends were poor-performing and expensive and, therefore, unsuitable. Without accepting Sathianathan's conclusions with respect to the performance of Smith Barney funds, this argument is based on the faulty assumption that the only alternative to Sathianathan's unsuitable recommendation was to invest all of his customers' assets in Smith Barney funds.

Sathianathan argues that various applications for accounts opened by Venkatramani at Smith Barney and at other firms establish that Venkatramani's investment objective was growth and that he was interested in aggressive and speculative investing. He further argues that it is incorrect to infer, as he claims NASD did, that Sathianathan made material misrepresentations on the account application that he filled out for Venkatramani. However, the application that Sathianathan completed was inconsistent not only with Venkatramani's earlier Smith Barney application that indicated his risk tolerance was moderate rather than aggressive and that his investment objectives did not allow for speculation, but also with Sathianathan's testimony that Venkatramani had informed him that Venkatramani's investment objective was the preservation of capital and that, as Sathianathan stated, "his level of sophistication was almost zero." Sathianathan's testimony and Venkatramani's first Smith Barney application establish that Venkatramani's investment objective was to obtain moderate growth and preserve his wealth, and Sathianathan's recommendations were unsuitable given these objectives.

Sathianathan argues that NASD did not consider his entire recommendation to Venkatramani. Sathianathan claims that he originally recommended that Venkatramani hedge his concentrated position in Juniper stock and that this recommendation was suitable. However, even if he did so, the fact that Sathianathan originally may have made a suitable recommendation does not change the fact that his subsequent recommendations, the ones on which Venkatramani acted, were unsuitable. Sathianathan also claims that NASD failed to consider that he made a calculation of the "return versus risk tradeoff that turned out to be incorrect due to a historic stock market collapse" and Smith Barney's error in crediting Venkatramani's account with additional shares at the time of his September recommendations. However, neither the overall performance of the stock market nor Smith Barney's error change the fact that Sathianathan's recommendations were unsuitable because they involved unnecessary costs and were too risky given the investment objectives and investment experience of his customers. In addition, while Sathianathan appears to argue that the amount of margin that Venkatramani assumed was suitable given Smith Barney's overvaluation of his account, the issue is not the amount of margin but whether the use of margin collateralized by a highly speculative security was suitable for an unsophisticated investor seeking moderate growth. As we conclude above, under the circumstances presented here, Sathianathan's recommendation that Venkatramani use margin was unsuitable.

Accordingly, we find that Sathianathan's recommendations to Venkatramani and Srinath were unsuitable in violation of NASD Conduct Rules 2310 and 2110. 7/

Unauthorized Trades

NASD Conduct Rule 2510(b) prohibits a registered representative from exercising any discretionary power in a customer's account without prior written authorization from the customer and written acceptance from the member firm. Conduct Rule 2510(d)(1) provides that these requirements do not apply to "discretion as to the price at which or time when an order given by a customer" to purchase or sell a "definite amount" of a "specified security" will be executed. 8/

Sathianathan exercised discretion in Venkatramani's account when he purchased 23,000 shares of Juniper stock while Venkatramani was out of the country. It is undisputed that Venkatramani did not know of these trades at the time they were made, and he did not provide Sathianathan with written authorization to make the transactions. Sathianathan argues that he had price and time discretion to make the trades in accordance with Conduct Rule 2510(d). However, Sathianathan's testimony and his e-mail communications with Venkatramani show that the two men discussed a general strategy whose "basic plan was to sell [Juniper shares] when the price of the stock was high and then to buy it back when it was lower and to do this over the next few years (if need be) by trying to time the market rallies in summer and January." Sathianathan and Venkatramani did not agree on specific amounts for each of these purchases. When Sathianathan purchased the 23,000 Juniper shares, he did so pursuant to this general strategy and a rumor that Juniper might be added to the S&P 500. These general strategy discussions, however, did not include specific orders for the purchase of a definite amount of Juniper stock. Moreover, Sathianathan admitted that his decision to purchase the 23,000 Juniper shares was not based on an order to purchase a definite amount of Juniper stock, but instead was "purely based on what I thought was a strong family relationship that you and I have through the fact that one of your best friends is my brother." We find that Sathianathan violated NASD Conduct Rules 2510(b) and 2110 by exercising discretionary authority over Venkatramani's account without prior written authorization.

7/ NASD charged Sathianathan with violating Conduct Rule 2110, which directs registered representatives of NASD member firms to conduct their business in accordance with just and equitable principles of trade. It is well established that a violation of a Commission or NASD rule or regulation constitutes a violation of Conduct Rule 2110. See Stephen J. Gluckman, 54 S.E.C. 175, 185 (1999).

8/ Conduct Rule 2510(d)(1) was amended effective January 31, 2005. See NASD Notice to Members 04-71 (Oct. 2004). We have analyzed Sathianathan's conduct under the rule in effect at the time of his alleged misconduct.

IV.

Sathianathan makes a number of arguments that, taken together, generally contend that NASD's disciplinary proceeding was deficient on procedural and due process grounds. These various claims can be grouped into three general categories: (1) that Sathianathan is a whistleblower and therefore cannot be subject to this disciplinary proceeding by NASD; (2) that he is the victim of selective prosecution by NASD; and (3) that the NASD proceedings were unfair and tainted by bias.

Sathianathan argues that NASD instituted this proceeding in retaliation for what he claims is his whistleblowing to federal and state enforcement authorities about "criminal activities by leading NASD member firms Smith Barney and Morgan Stanley" with respect to an arbitration proceeding that Venkatramani filed regarding Sathianathan's conduct. He states that, because this disciplinary action was brought in retaliation for his alleged whistleblowing, federal whistleblower statutes protect him from being sanctioned. Sathianathan cites to Section 1107 of the Sarbanes Oxley Act, which added paragraph (e) to Section 1513 of Title 18 of the United States Code, the federal criminal statute that protects a witness, victim, or informant from retaliation. It establishes criminal penalties for a person who knowingly, with the intent to retaliate, takes an action harmful to a person for providing to law enforcement truthful information about the commission or possible commission of a federal offense. Sathianathan also relies on Sections 241 and 242 of Title 18 which establish criminal penalties for conspiring to injure, oppress, threaten, or intimidate any person in the free exercise of a right or privilege provided by the Constitution or the laws of the United States.

As an initial matter, we note that although Sathianathan raises the argument that he is a whistleblower numerous times throughout the record, he never clearly identifies the allegedly criminal activities about which he allegedly informed enforcement authorities beyond the general classifications of "material perjury" and "fraudulent activities." Even assuming, however, that Sathianathan had knowledge of unlawful activity about which he informed federal or state authorities, the statutes that Sathianathan cites do not provide him with immunity in this disciplinary proceeding. Sections 241, 242, and 1513 of Title 18 are federal criminal statutes directed at punishing prohibited retaliatory action by a party against a person who has provided to law enforcement truthful information about the commission or possible commission of a crime. They do not purport to provide a defense in a disciplinary action or to estop NASD from taking disciplinary action consistent with its rules. As such, these provisions are not relevant with respect to this disciplinary proceeding and do not provide Sathianathan with an affirmative defense or immunity from sanction for his misconduct.

Sathianathan also argues that he has been selectively targeted by NASD as a result of his whistleblowing and his refusal to assist Smith Barney in the Venkatramani arbitration proceeding. To establish a claim of selective prosecution, a petitioner must demonstrate that he was unfairly singled out and that his prosecution was motivated by improper considerations such as race, religion, or the desire to prevent the exercise of a constitutionally protected right. 9/ No such showing was made here. The record is clear that this proceeding resulted from an investigation by NASD in response to Smith Barney and Morgan Stanley amending Sathianathan's Forms U-5 and U-4, as they were required to do by NASD rules, to reflect Venkatramani's customer complaint and, later, his arbitration claim. Moreover, NASD conducted its own investigation and prosecuted the case based on the facts in the record and there is no evidence that NASD gave any consideration to any alleged whistleblowing by Sathianathan with respect to Venkatramani's arbitration.

Sathianathan argues that the amendment to his Form U-5 that Smith Barney filed to reflect Venkatramani's customer complaint establishes that this action was motivated by improper considerations. Sathianathan claims that Smith Barney's amendment of his Form U-5 was retaliatory and defamatory. Even were it true that Smith Barney acted with improper motives, this does not establish that NASD's investigation and prosecution were motivated by improper concerns. Moreover, Sathianathan has failed to establish that Smith Barney acted with retaliatory motive, given that Smith Barney was required to report the customer complaint pursuant to NASD By-Laws. 10/

Sathianathan further asserts that prosecution based on improper considerations can be inferred from the fact that the NAC claimed that the investigation was triggered when Smith Barney amended his Form U-5 on November 16, 2001, to reflect the filing of an arbitration claim by Venkatramani, but that Venkatramani did not file for arbitration until February 7, 2002. This contention is baseless. The NAC erred in stating that the November 16, 2001, Form U-5 that triggered the investigation was based on the filing of an arbitration claim rather than a customer complaint, but this error does not establish retaliatory motive.

Sathianathan also asserts that NASD's proceedings were unfair and biased. Among other things, he contends that he was prevented from communicating with officers of NASD and from referring to or reviewing his exhibits while testifying. Our review of the transcript of the hearing indicates that the Hearing Panel attempted to confine the record to relevant evidence and to ensure that NASD's procedures were being followed. We see no evidence of bias or that Sathianathan was treated unfairly in any way. The record indicates that Sathianathan was given wide latitude to present evidence and make arguments. The Hearing Officer allowed Sathianathan to file a forty-two page single-spaced pleading that the Hearing Officer admitted as a post-hearing brief, even though the Hearing Panel had not requested post-hearing briefs. We

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9/ United States v. Huff, 959 F.2d 731, 735 (8th Cir. 1992); see also Maximo Justo Guevara, 54 S.E.C. 655, 665 (2000); Richard J. Puccio, 52 S.E.C. 1041, 1046 (1996).

10/ NASD By-Laws, Art. V, Sec. 3(b).

conclude that Sathianathan had a full and fair opportunity to present his case and defend himself against the charges alleged by NASD. 11/

V.

Exchange Act Section 19(e) provides that we may cancel, reduce, or require the remission of a sanction if we find that it imposes an unnecessary or inappropriate burden on competition, or if it is excessive or oppressive. 12/ NASD Sanction Guidelines recommend imposition of a monetary sanction of between $2,500 and $75,000 for unsuitable recommendations and a suspension for a period of ten business days to one year, and, in egregious cases, consideration of a longer suspension (of up to two years) or a bar. 13/ Using these Guidelines, NASD found that Sathianathan's unsuitable recommendations warranted a bar.

We conclude, as did NASD, that Sathianathan engaged in repeated violations of the suitability rule. He recommended multiple purchases of Class B shares of mutual funds to Venkatramani and Srinath that were unsuitable because they were designed to maximize his commissions rather than to establish an appropriate portfolio in that his customers could have invested in lower-cost Class A shares given the large amounts that they intended to invest. His recommendations that Venkatramani purchase the mutual funds and warrants on margin using his concentrated position in Juniper stock as collateral were unsuitable because they entailed too much risk given Venkatramani's investment objectives and experience. He recommended that Venkatramani purchase speculative index warrants that were unsuitable given his investment objectives of moderate growth and preservation of wealth and given his lack of investment experience. Sathianathan's numerous violations of NASD's suitability rule warrant serious sanctions.

NASD also identified numerous aggravating factors. Sathianathan's misconduct resulted in substantial losses to his unsophisticated customers and resulted in his own monetary gain. His misconduct occurred after he had been placed on probation by his supervisor and after he had been instructed specifically to limit his use of margin, to ensure proper asset allocation and diversification, and to eliminate excessive trading or commissions. He has sought to shift the blame for his violations to others, repeatedly blaming his supervisors, the firms with which he was associated, and general market conditions for his violative conduct. His statement that "instead of blaming customers [Venkatramani] and [Srinath], I have been pro-investor by

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11/ Rita H. Malm, 52 S.E.C. 64, 74 (1994) (respondents in self-regulatory organization disciplinary proceedings are entitled to a full and fair opportunity to present their case and defend themselves against charges).

12/ 15 U.S.C. § 78s(e)(2). Sathianathan does not claim, and the record does not show, that NASD's action has imposed an undue burden on competition.

13/ NASD Sanction Guidelines 99 (2006).

blaming my former employer [NASD member] firms" reveals a troubling inability to accept accountability for his own conduct. Sathianathan's arguments to us have demonstrated a fundamental lack of understanding of his duties as a securities professional in general and his responsibility to provide his customers with suitable recommendations in particular. Under the circumstances, a bar from association with any broker or dealer serves to protect the investing public from further harm.

Sathianathan contends that the sanctions imposed upon him are too severe when compared with sanctions imposed in other NASD disciplinary proceedings. The appropriate sanction, however, depends on the facts and circumstances of each particular case. 14/ Moreover, one of the two cases cited by Sathianathan is a settled case. 15/ We have repeatedly stated that pragmatic considerations may justify lesser sanctions in negotiated settlements. 16/ In the other case, an NASD hearing panel imposed a one-year suspension and a fine of $25,000 for what it concluded was a "serious" violation of its suitability rule, but the dollar amounts invested were significantly smaller than those invested here. 17/ Sathianathan also points to the fact that NASD imposed two bars, one for the unsuitable recommendations made to Venkatramani and the other for the unsuitable recommendations made to Srinath, as evidence that NASD treated him differently than other associated persons, and asserts that NASD has never before imposed multiple bars on one applicant. His assertion is factually incorrect: NASD has imposed more than one bar on a single applicant when a complaint includes multiple causes of action that the adjudicator determines warrant separate sanctions. 18/ Therefore, we reject his

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14/ See Butz v. Glover Livestock Comm'n Co., 411 U.S. 182, 187 (1973); Jonathan Feins, 54 S.E.C. 366, 380 & n.36 (1999); Christopher J. Benz, 52 S.E.C. 1280, 1285 (1997), petition denied, 168 F.3d 478 (3d Cir. 1998) (Table).

15/ See NASD Regulation Censures and Fines Stifel, Nicolaus & Company, and Two Individuals for the Unsuitable Sale of Class B Mutual Fund Shares, NASD Notice to Members - Disciplinary Actions 318 (May 2001).

16/ See, e.g., Anthony A. Adonnino & Thomas Cannizzario, Exchange Act Rel. No. 48618 (Oct. 9, 2003), 81 SEC Docket 981, 999, aff'd, 111 Fed. Appx. 46 (2d Cir. 2004); Richard J. Puccio, 52 S.E.C. 1041, 1045 (1996).

17/ See Dep't of Enforcement v. Fantetti, (Hearing Panel decision, July 18, 2005).

18/ See, e.g., Guang Lu, Exchange Act Rel. No. 51047 (Jan. 14, 2005), 64 SEC Docket 2639 (sustaining two separate bars, one for failure to obtain written authorization before transacting trades in discretionary accounts and the other for providing a false answer on Form U-4), aff'd, No. 05-1153 (D.C. Cir. May 9, 2006) claim that the sanctions imposed on him are disproportionate to those imposed in other cases. For all the reasons stated above, we do not find the sanctions imposed by NASD to be excessive or oppressive.

Accordingly, we sustain NASD's findings of violation and the sanctions it imposed against Sathianathan. An appropriate order will issue. 19/

By the Commission (Chairman COX and Commissioners ATKINS, CAMPOS, NAZARETH and CASEY).

Nancy M. Morris

Nancy M. Morris
Secretary

19/ We have considered all of the contentions advanced by the parties. We have rejected or sustained these contentions to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 54722 / November 8, 2006

Admin. Proc. File No. 3-12245

In the Matter of the Application of

RAGHAVAN SATHIANATHAN
c/o S.T. Allen & Co.
336 Bloomfield Avenue
Montclair, NJ 07042

For Review of Action Taken by

NASD

ORDER SUSTAINING DISCIPLINARY ACTION TAKEN
BY REGISTERED SECURITIES ASSOCIATION

On the basis of the Commission's opinion issued this day, it is

ORDERED that the disciplinary action taken by NASD against Raghavan Sathianathan, and NASD's assessment of costs be, and they hereby are, sustained.

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
November 8, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12475

In the Matter of **FuelNation, Inc.,** **SDT Holding Corp.,** **Samessa Holding Corp.,** **Silver Quest, Inc., and** **Sytron, Inc.,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. FuelNation, Inc. ("FuelNation") (CIK No. 910111) is a Florida corporation located in Davie, Florida with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). FuelNation is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 2004, which reported a net loss of $1,329, 018 for the prior three months. As of October 27, 2006, the company's stock (symbol "FLNA") was quoted on the Pink Sheets, had nineteen market makers and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3).

2. SDT Holding Corp. ("SDT Holding") (CIK No. 927652) is a dissolved Colorado corporation located in Guildford, Surrey, England with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). SDT

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Holding is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended June 30, 1997.

3. Samessa Holding Corp. ("Samessa Holding") (CIK No. 1086760) is a Nevada corporation located in Englewood, Colorado with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Samessa Holding is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended June 30, 2003, which reported no revenues and an accumulated deficit of $995 during the company's development stage.

4. Silver Quest, Inc. ("Silver Quest") (CIK No. 1051843) is a dissolved Idaho corporation located in Aurora, Colorado with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Silver Quest is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 1998, which reported a net loss of $13,843 accumulated during the company's development stage.

5. Sytron, Inc. ("Sytron") (CIK No. 1021525) is a Pennsylvania corporation located in Broomfield, Colorado with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Sytron is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-SB on February 1, 2000, which reported a net loss of $594,376 for the year ended September 30, 1999. On September 18, 2000, a company creditor filed an involuntary Chapter 7 petition in the U.S. Bankruptcy Court for the District of Colorado, which is still pending. As of October 27, 2006, the company's stock (symbol "SITRQ") was quoted on the Pink Sheets, had one market maker and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

6. All of the Respondents are or were affiliated with the CEO of Samessa Holding, are delinquent in their periodic filings with the Commission (*see* Chart of Delinquent Filings, attached hereto as Appendix 1), have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance at their most recent address shown in their most recent filing with the Commission, or did not receive the letters because of their failure to keep an updated address on file with the Commission as required by Commission rules.

7. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports (Forms 10-K or 10-KSB), and Rule 13a-13 requires issuers to file quarterly reports (Forms 10-Q or 10-QSB).

8. As a result of their failure to file required periodic filings, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II of this Order are true, and to afford the Respondents an opportunity to establish any defenses to such allegations; and

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months or to revoke the registrations of each class of securities registered pursuant to Exchange Act Section 12 of the Respondents identified in Section II.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that each Respondent shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If a Respondent fails to file the directed Answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon each Respondent personally, by certified or registered mail, or by any other means permitted by the Commission's Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Nancy M. Morris
Secretary

Attachment

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Appendix 1

Chart of Delinquent Filings

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
FuelNation, Inc.					
	10-QSB	06/30/04	08/16/04	Not filed	26
	10-QSB	09/30/04	11/15/04	Not filed	23
	10-KSB	12/31/04	03/31/05	Not filed	19
	10-QSB	03/31/05	05/16/05	Not filed	17
	10-QSB	06/30/05	08/15/05	Not filed	14
	10-QSB	09/30/05	11/14/05	Not filed	11
	10-KSB	12/31/05	03/31/06	Not filed	7
	10-QSB	03/31/06	05/15/06	Not filed	5
	10-QSB	06/30/06	08/14/06	Not filed	2
Total Filings Delinquent	9				
SDT Holding Corp.					
	10-K	08/31/97	12/01/97	Not filed	106
	10-Q	11/30/97	01/14/98	Not filed	105
	10-Q	02/28/98	04/14/98	Not filed	102
	10-Q	05/31/98	07/15/98	Not filed	99
	10-K	08/31/98	11/30/98	Not filed	95
	10-Q	11/30/98	01/14/99	Not filed	93
	10-Q	02/28/99	04/14/99	Not filed	90
	10-Q	05/31/99	07/15/99	Not filed	87
	10-K	08/31/99	11/29/99	Not filed	83
	10-Q	11/30/99	01/14/00	Not filed	81
	10-Q	02/29/00	04/14/00	Not filed	78
	10-Q	05/31/00	07/17/00	Not filed	75
	10-K	08/31/00	11/29/00	Not filed	71
	10-Q	11/30/00	01/16/01	Not filed	69
	10-Q	02/28/01	04/16/01	Not filed	66
	10-Q	05/31/01	07/16/01	Not filed	63
	10-K	08/31/01	11/29/01	Not filed	59
	10-Q	11/30/01	01/14/02	Not filed	57
	10-Q	02/28/02	04/15/02	Not filed	54
	10-Q	05/31/02	07/15/02	Not filed	51
	10-K	08/31/02	11/29/02	Not filed	47
	10-Q	11/30/02	01/14/03	Not filed	45
	10-Q	02/28/03	04/14/03	Not filed	42
	10-Q	05/31/03	07/15/03	Not filed	39
	10-K	08/31/03	12/01/03	Not filed	34

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
SDT Holding Corp.					
	10-Q	11/30/03	01/14/04	Not filed	33
	10-Q	02/28/04	04/13/04	Not filed	30
	10-Q	05/31/04	07/15/04	Not filed	27
	10-K	08/31/04	11/29/04	Not filed	23
	10-Q	11/30/04	01/14/05	Not filed	21
	10-Q	02/28/05	04/14/05	Not filed	18
	10-Q	05/31/05	07/15/05	Not filed	15
	10-K	08/31/05	11/29/05	Not filed	11
	10-Q	11/30/05	01/16/06	Not filed	9
	10-Q	02/28/06	04/14/06	Not filed	6
	10-Q	05/31/06	07/17/06	Not filed	3
Total Filings Delinquent	36				
Samessa Holding Corp.					
	10-QSB	09/30/03	11/14/03	Not filed	35
	10-QSB	12/31/03	02/17/04	Not filed	32
	10-KSB	03/31/04	06/29/04	Not filed	28
	10-QSB	06/30/04	08/16/04	Not filed	26
	10-QSB	09/30/04	11/15/04	Not filed	23
	10-QSB	12/31/04	02/14/05	Not filed	20
	10-KSB	03/31/05	06/29/05	Not filed	16
	10-QSB	06/30/05	08/15/05	Not filed	14
	10-QSB	09/30/05	11/14/05	Not filed	11
	10-QSB	12/31/05	02/14/06	Not filed	8
	10-QSB	03/31/06	05/15/06	Not filed	5
	10-QSB	06/30/06	08/14/06	Not filed	2
Total Filings Delinquent	12				
Silver Quest, Inc.					
	10-QSB	06/30/98	08/14/98	Not filed	98
	10-QSB	09/30/98	11/16/98	Not filed	95
	10-KSB	12/31/98	03/31/99	Not filed	91
	10-QSB	03/31/99	05/17/99	Not filed	89
	10-QSB	06/30/99	08/16/99	Not filed	86
	10-QSB	09/30/99	11/15/99	Not filed	83
	10-KSB	12/31/99	03/30/00	Not filed	79
	10-QSB	03/31/00	05/15/00	Not filed	77
	10-QSB	06/30/00	08/14/00	Not filed	74
	10-QSB	09/30/00	11/14/00	Not filed	71

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Silver Quest, Inc.					
	10-KSB	12/31/00	04/02/01	Not filed	66
	10-QSB	03/31/01	05/15/01	Not filed	65
	10-QSB	06/30/01	08/14/01	Not filed	62
	10-QSB	09/30/01	11/14/01	Not filed	59
	10-KSB	12/31/01	04/01/02	Not filed	54
	10-QSB	03/31/02	05/15/02	Not filed	53
	10-QSB	06/30/02	08/14/02	Not filed	50
	10-QSB	09/30/02	11/14/02	Not filed	47
	10-KSB	12/31/02	03/31/03	Not filed	43
	10-QSB	03/31/03	05/15/03	Not filed	41
	10-QSB	06/30/03	08/14/03	Not filed	38
	10-QSB	09/30/03	11/14/03	Not filed	35
	10-KSB	12/31/03	03/30/04	Not filed	31
	10-QSB	03/31/04	05/17/04	Not filed	29
	10-QSB	06/30/04	08/16/04	Not filed	26
	10-QSB	09/30/04	11/15/04	Not filed	23
	10-KSB	12/31/04	03/31/05	Not filed	19
	10-QSB	03/31/05	05/16/05	Not filed	17
	10-QSB	06/30/05	08/15/05	Not filed	14
	10-QSB	09/30/05	11/14/05	Not filed	11
	10-KSB	12/31/05	03/31/06	Not filed	7
	10-QSB	03/31/06	05/15/06	Not filed	5
	10-QSB	06/30/06	08/14/06	Not filed	2
Total Filings Delinquent	33				
Sytron, Inc.					
	10-QSB	12/31/99	02/14/00	Not filed	80
	10-QSB	03/31/00	05/15/00	Not filed	77
	10-QSB	06/30/00	08/14/00	Not filed	74
	10-KSB	09/30/00	12/29/00	Not filed	70
	10-QSB	12/31/00	02/14/01	Not filed	68
	10-QSB	03/31/01	05/15/01	Not filed	65
	10-QSB	06/30/01	08/14/01	Not filed	62
	10-KSB	09/30/01	12/31/01	Not filed	58
	10-QSB	12/31/01	02/14/02	Not filed	56
	10-QSB	03/31/02	05/15/02	Not filed	53
	10-QSB	06/30/02	08/14/02	Not filed	50
	10-KSB	09/30/02	12/30/02	Not filed	46
	10-QSB	12/31/02	02/14/03	Not filed	44
	10-QSB	03/31/03	05/15/03	Not filed	41
	10-QSB	06/30/03	08/14/03	Not filed	38

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Sytron, Inc.					
	10-KSB	09/30/03	12/29/03	Not filed	34
	10-QSB	12/31/03	02/16/04	Not filed	32
	10-QSB	03/31/04	05/17/04	Not filed	29
	10-QSB	06/30/04	08/16/04	Not filed	26
	10-KSB	09/30/04	12/29/04	Not filed	22
	10-QSB	12/31/04	02/14/05	Not filed	20
	10-QSB	03/31/05	05/16/05	Not filed	17
	10-QSB	06/30/05	08/15/05	Not filed	14
	10-KSB	09/30/05	12/29/05	Not filed	10
	10-QSB	12/31/05	02/14/06	Not filed	8
	10-QSB	03/31/06	05/15/06	Not filed	5
	10-QSB	06/30/06	08/14/06	Not filed	2

Total Filings Delinquent 27

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
NOV 0 8 2006

In the Matter of **FuelNation, Inc. and Sytron, Inc.** **File No. 500-1**	**ORDER OF SUSPENSION OF TRADING**

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of FuelNation, Inc. because it has not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 2004.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Sytron, Inc. because it has not filed any periodic reports since it filed a Form 10-SB on February 1, 2000.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed companies.

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the above-listed companies is suspended for the period from 9:30 a.m. EST on November 8, 2006, through 11:59 p.m. EST on November 21, 2006.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

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UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

CORRECTED

SECURITIES EXCHANGE ACT OF 1934
Release No. 54736 / November 9, 2006

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2513 / November 9, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12477

In the Matter of **THOMAS P. CLARK,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against Thomas Clark ("Respondent" or "Clark") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings

[1] Rule 102(e)(3)(i) provides, in relevant part, that:

> The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any . . . accountant . . . who has been by name . . . permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

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herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III., ¶ 3 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Thomas Clark, age 58, was, but no longer is, a certified public accountant licensed to practice in the State of Minnesota. In addition to other positions, he served as Chief Financial Officer of Health Risk Management, Inc. ("HRMI") from 1987 until October 2000 and served as the president of HRMI's wholly owned HMO subsidiary from December 2000 until his resignation in March 2001.

2. HRMI was, at all relevant times, a Minnesota corporation with its principal place of business in Minneapolis, Minnesota. HRMI was a healthcare management company that, among other activities, administered HRM PA, Inc., a small Medicaid HMO in Pennsylvania (the "HMO"). At all relevant times, HRMI's common stock was registered with the Commission pursuant to Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act"), and traded on the NASDAQ National Market.

3. On January 27, 2006, the Commission filed a complaint against Clark in <u>SEC v. Thomas P. Clark</u>, (Civil Action No. 06-cv-00380). On October 19, 2006, the court entered an order permanently enjoining Clark, by consent, from future violations of Sections 10(b) and 13(b)(5) of the Exchange Act and Rules 10b-5, 13b2-1 and 13b2-2 thereunder, and aiding and abetting violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20 and 13a-13 thereunder. Clark was also ordered to pay a $20,000 civil money penalty and was barred from acting as an officer or director of a public company for five years.

4. The Commission's complaint alleged, among other things, that: (a) Clark deliberately mischaracterized a $1.35 million payment by HRMI which resulted in HRMI filing materially false and misleading financial statements in the company's quarterly reports on Form 10-Q for the second and third quarters of fiscal year 2000; (b) on August 1, 2000, Clark and one of the HMO's healthcare providers, agreed that HRMI would pay the provider $1.85 million to settle an arbitration initiated by the provider; (c) because the HMO's net worth had declined to the point that state regulators were threatening to put the HMO in receivership, Clark did not want the entire $1.85 million payment to be categorized as an expense; (d) accordingly, Clark negotiated a "Consulting Agreement" with the provider that disguised $1.35 million of the $1.85 million settlement as a pre-paid retainer for consulting services that HRMI never used or needed; (e) Clark disclosed $500,000 of the settlement, and HRMI's legal expenses, in HRMI's second quarter 2000 Form 10-Q, which was filed three weeks after the settlement was reached; (f) Clark failed, however, to disclose the $1.35 million prepaid "retainer" in that Form 10-Q; (g) Clark finally disclosed the payment in HRMI's third quarter 2000 Form 10-Q, but improperly booked the settlement as a prepaid asset rather than as an expense; (h) in doing so, Clark materially

understated HRMI's expenses for the second quarter of 2000 and materially overstated HRMI's assets for the third quarter of 2000; and (i) Clark hid the Consulting Agreement, and the true dollar amount of the settlement, from HRMI's auditor and falsely represented to HRMI's auditor that HRMI had informed the auditor of all material contracts for the second and third quarters of 2000.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanction agreed to in Respondent Clark's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

Clark is suspended from appearing or practicing before the Commission as an accountant.

By the Commission.

Nancy M. Morris
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 8751 / November 14, 2006

SECURITIES EXCHANGE ACT OF 1934
Release No. 54745 / November 14, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12478

In the Matter of **City of San Diego, California,** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against the City of San Diego, California (the "City" or "Respondent").

II.

In anticipation of the institution of these proceedings, the City has submitted an Offer of Settlement ("Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, the City consents to the entry of this Order Instituting Cease-and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934 ("Order"), as set forth below.

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III.

On the basis of this Order and the City's Offer, the Commission finds that:[1]

A. SUMMARY

This matter involves the City of San Diego's violations of the antifraud provisions of the federal securities laws in connection with the offer and sale of over $260 million in municipal bonds in 2002 and 2003. At the time of these offerings, City officials knew that the City faced severe difficulty funding its future pension and health care obligations unless new revenues were obtained, pension and health care benefits were reduced, or City services were cut. The City's looming financial crisis resulted from (1) the City's intentional under-funding of its pension plan since fiscal year 1997; (2) the City's granting of additional retroactive pension benefits since fiscal year 1980; (3) the City's use of the pension fund's assets to pay for the additional pension and retiree health care benefits since fiscal year 1980; and (4) the pension plan's less than anticipated earnings on its investments in fiscal years 2001 through 2003.

Despite the magnitude of the problems the City faced in funding its future pension and retiree health care obligations, the City conducted five separate municipal bond offerings, raising more than $260 million, without disclosing these problems to the investing public. In each of these offerings, the City prepared disclosure documents that are used with municipal securities offerings—that is, preliminary official statements and official statements—and made presentations to rating agencies.[2] In addition, in 2003 it prepared and filed information pursuant to continuing disclosure agreements under Exchange Act Rule 15c2-12 with respect to $2.29 billion in outstanding City bonds and notes.[3] Although the City provided some disclosure about its pension and retiree health care obligations, it did not reveal the gravity of the City's financial problems, including that:

- The City's unfunded liability to its pension plan was expected to dramatically increase, growing from $284 million at the beginning of fiscal year 2002 and $720

[1] The findings herein are made pursuant to the City's offer of settlement and are not binding on any other person or entity in this or any other proceeding.

[2] An official statement is a document prepared by an issuer of municipal bonds that discloses material information regarding the issuer and the particular offering. A preliminary official statement is a preliminary version of the official statement that is used to describe the proposed new issue of municipal securities prior to the determination of the interest rate(s) and offering price(s). The preliminary official statement may be used to gauge interest in an issue and is often relied upon by potential purchasers in making their investment decisions.

[3] Continuing disclosures are disclosures of material information relating to prior years' municipal bond offerings that are periodically provided to the marketplace by the bonds' issuer pursuant to contractual agreements and Exchange Act Rule 15c2-12.

million at the beginning of fiscal year 2003 to an estimated $2 billion at the beginning of fiscal year 2009;

- The City's total under-funding of the pension plan was also expected to increase dramatically, growing tenfold from $39.2 million in fiscal year 2002 to an estimated $320 to $446 million in fiscal year 2009;
- The City's projected annual pension contribution would continue to grow, from $51 million in 2002 to $248 million in 2009; and
- The estimated present value of the City's liability for retiree health benefits was $1.1 billion.

The City's enormous pension and retiree health liabilities and failure to disclose those liabilities placed the City in serious financial straits. When the City eventually disclosed its pension and retiree health care issues in fiscal year 2004, the credit rating agencies lowered the City's credit rating. The City also has not obtained audited financial statements for fiscal years 2003, 2004, and 2005.

Consequently, the City violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit the making of any untrue statement of material fact or omitting to state a material fact in the offer or sale of securities.[4]

B. THE RESPONDENT

City of San Diego, California is a California municipal corporation with all municipal powers, functions, rights, privileges, and immunities authorized by the California Constitution and laws, including the power to issue debt. The City is the seventh most populous city in the country, with approximately 1.3 million residents.

C. RELATED PARTY

San Diego City Employees' Retirement System ("CERS") is a defined benefit plan[5] established by the City to provide retirement, disability, death, and retiree benefits to its members,

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[4] The Commission acknowledges that in the City's offering documents for sewer revenue bonds issued in 1995, 1997, and 1999 and sewer revenue bonds that were offered but not issued in 2003, in its continuing disclosures, and in its communications with rating agencies, the City failed to disclose that the City's wastewater fee rate structure did not comply with certain federal and state clean water laws, that the City was not in compliance with the terms of certain government grants and loans, and that the City could have been required to repay those grants and loans due to such non-compliance. The offerings in the 1990s, however, predate the offerings that are the subject of this Order, and the City did not consummate the 2003 offering because issues arose regarding the adequacy of its pension disclosure. In addition, in 2004, the City came into compliance with the federal and state clean water laws and the grant and loan covenants by adopting a new fee rate structure. The City thereby avoided having immediately to repay the government grants and loans.

[5] A defined benefit plan is a traditional pension plan under which pre-determined retirement benefits are based on a formula established by factors such as age, years of service, and

i.e., City employees and their beneficiaries. CERS is administered by the CERS Board, which during the relevant period included eight City employees, including the City Treasurer and the Assistant City Auditor and Comptroller, one retiree, and three non-employee City citizens appointed by the City Council as CERS Board members.

D. FACTS

1. Background

a. Structure of the City's Government

Until January 2006, the City's form of government was a city manager system.[6] Legislative powers of the City were vested in the City Council ("Council"), which made policies and appointed a professional city manager to carry out those policies. The Council was composed of nine full-time Council members who served for staggered four-year terms. Eight of the Council members represented the City's eight districts. The Mayor, who was elected at large, presided at the meetings of the Council and served as the official head of the City for ceremonial purposes. The Mayor and each Council member had one vote; the Mayor had no veto power.

Prior to 2006, the City Manager ("Manager") was the City's chief administrative officer and had substantial control over local government decisions. The Manager, appointed by the Mayor and Council, advised the Council of the City's present and projected financial condition, appointed and removed all city department heads (except the City Auditor and Comptroller ("City Auditor"), City Attorney, and City Clerk), prepared the City's budget, and carried out the Council's budget plan. During the relevant time period, the City's general fund budget was less than $900 million. The City Manager had several Deputy City Managers, one of whom was in charge of the Financing Services Department, which had responsibility for overseeing the City's issuance of municipal securities.

Prior to 2006, the City Auditor was also appointed by the Council, and was required to file at least monthly with the City Manager and Council a summary statement of revenues and expenses for the preceding accounting period.[7] The Auditor was the City's chief financial officer and was responsible for the preparation and issuance of the City's Comprehensive Annual Financial Reports, also referred to as CAFRs. The City's Comprehensive Annual Financial Reports included audited financial statements prepared pursuant to standards established by the

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compensation, and in which the employer bears risk if the employer and employee contributions and the investment return on those contributions are not sufficient to fund the pension benefits.

[6] In January 2006, the City transitioned from a City Manager / Council form of government to a strong Mayor form of government. Under the new system, the Mayor became the City's chief executive officer and the City Manager's position was eliminated. The Council continues to act as the legislative body. City of San Diego City Charter, Article XV.

[7] City of San Diego City Charter, Article V, Section 39.

Government Accounting Standards Board ("GASB")[8] and various statistical, financial, and other information about the City. Portions of the Comprehensive Annual Financial Reports for the years ended June 30, 2001, and June 30, 2002 were attached as appendix B to the preliminary official statements and the official statements. The Comprehensive Annual Financial Reports for 2001 and 2002 were also filed as continuing disclosures.

The elected City Attorney served as the chief legal officer for the City. The City Attorney's office advised the Council, City Manager, and all City departments on legal matters, including disclosure in the City's securities offerings. The City Attorney was responsible for preparing all ordinances, resolutions, contracts, and other legal documents.

b. The City's Pension Plan

The City provided a defined benefit pension plan and retiree health care benefits to its employees through CERS. CERS functioned as a trust for the benefit of its members (i.e., approximately 18,500 current and former City employees and officials). The City was the creator of the trust and determined its terms, including the members' required contributions and the levels of benefits. CERS was administered by a Board of Administration, which controlled the investment of CERS's funds and which owed fiduciary duties to CERS members. CERS's assets consisted of past contributions by the City and CERS members and investment earnings on those funds. CERS's liabilities consisted of operating expenses and the future pension benefits that were owed to members.

Each year, CERS hired an actuary to determine the value of the plan's assets and liabilities based on certain actuarial assumptions and the amount that needed to be contributed to the plan so that the plan accumulated sufficient assets to pay pension (but not health care) benefits when due.[9] Pursuant to the City Charter, the City was to contribute half of that amount, which was expressed in terms of a percentage of payroll expenses, with the other half to be contributed by the employees, which amount was determined as a percentage of compensation based on the employee's age upon entry into CERS.

At least three concepts were particularly important in the disclosure to the public of the City's pension obligations and funding of those obligations: (1) CERS's funded ratio; (2) the

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[8] GASB is the organization that establishes standards of state and local governmental accounting and financial reporting.

[9] An actuarial valuation is a determination by an actuary, as of a specified date, of the normal cost, actuarial accrued liability, actuarial value of the assets, and other relevant values for a pension plan based on certain actuarial assumptions. The actuarial value of assets refers to the value of cash, investments, and other property belonging to a pension plan as used by the actuary for the purpose of preparing the actuarial valuation for the pension plan. The actuarial accrued liabilities are what is owed in connection with past services, as determined by one of the actuarial cost methods. Actuarial assumptions are estimates of future events with respect to certain factors affecting pension costs, including rates of mortality, disability, employee turnover, retirement, rates of investment income, and salary increases. Actuarial assumptions are generally based on past experience, often modified for projected changes in conditions.

City's unfunded liability to CERS; and (3) the City's net pension obligation, also called the NPO. CERS's funded ratio was the ratio of its assets to liabilities. The City's unfunded liability to CERS was the dollar shortfall between CERS's assets and liabilities. The City's net pension obligation was the cumulative difference between what the City actually contributed to CERS and the amount that the City would have contributed had it conformed to a funding method recognized by GASB.

2. The City's Pension and Retiree Health Care Benefits and Funding of CERS

The City failed to disclose material information regarding substantial and growing liabilities for its pension plan and retiree health care and its ability to pay those obligations in the future in the disclosure documents for its 2002 and 2003 offerings, in its continuing disclosures filed in 2003, and in its presentations to the rating agencies. As more fully described below, the City's substantial and growing pension and retiree health care liabilities resulted from several factors, including: (1) the City's intentional under-funding of its annual pension contribution; (2) the City's granting of new retroactive pension benefits; (3) the City's use of certain CERS earnings to pay for various additional pension and retiree health care benefits and to pay a portion of employees' pension contributions; and (4) CERS's earning less than anticipated returns on its investments.

a. The City's Historical Practice of Using "Surplus Earnings" to Fund Pension and Retiree Health Care Benefits

In fiscal year 1980, the City began instructing CERS to use "surplus earnings"—i.e., earnings above the actuarially projected 8% return rate[10]—to fund an ever-increasing amount of additional benefits for CERS members. Pension plans typically retain surplus earnings to support the plan's financial soundness and to make up for years in which earnings fall short of the assumed return rate. Rather than retaining its surplus earnings, the City began using surplus earnings in fiscal year 1980 to fund an annual extra or "13th check" to retirees. The City continued using surplus earnings to pay for retiree health care benefits in fiscal year 1982 and to pay an ever-increasing amount of the employees' CERS contributions in fiscal year 1998.[11]

In total, the City used surplus earnings to pay pension benefits and employees' contributions totaling $150 million as of the end of fiscal year 2001 and an additional $25 million as of the end of fiscal year 2002. According to a 2005 CERS audit, the City's use of surplus

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[10] Without regard to its actual historical rate of return on investments, the CERS Board assumed an annual rate of investment return of 8%, which the actuary incorporated into his calculations. CERS defined surplus earnings as the amount of realized investment earnings in excess of the actuarially projected 8% return rate.

[11] In fiscal years 2003 and 2004, the City used CERS's surplus earnings from prior years to pay up to 27% of the employees' contributions.

earnings accounted for 17% of the increase in the City's unfunded liability to CERS from fiscal year 1997 through fiscal year 2003.

b. Manager's Proposal 1: The City Proposes Additional Benefits in Exchange for Contribution Relief

In fiscal year 1996, the City agreed to increase significantly and retroactively all employees' pension benefits. The City, however, could not afford to fund the cost of the benefit increases. The City therefore made the pension benefit increases contingent on CERS's agreement to the City's under-funding of its annual contribution to CERS.

In fiscal year 1997, the City and CERS entered into an agreement, which was referred to as Manager's Proposal 1, that set the City's annual contribution at gradually increasing rates through fiscal year 2008. This funding method, which the City termed "Corridor" funding, was not recognized by GASB and set annual funding rates that were not actuarially determined and were projected to be below GASB-recognized funding rates through fiscal year 2006. In other words, under Corridor funding, the City would be intentionally under-funding its annual liability to CERS in fiscal years 1997 through 2006.[12] After fiscal year 2006, it was estimated that the funding rate of Manager's Proposal 1 would equal a GASB-accepted rate. Manager's Proposal 1 also contained a provision intended to protect CERS's financial soundness. Specifically, if CERS's funded ratio fell below 82.3%, the City would have to increase its CERS contribution rate.

In fiscal years 1996 and 1997, the City estimated that under Manager's Proposal 1, by the end of fiscal year 2008, the City's net pension obligation would be $110.35 million. Because the City's Corridor funding method was not GASB-recognized, GASB required that the City disclose its net pension obligation in its annual financial statements.

c. The *Corbett* Litigation Requires the City to Fund Additional Retroactive Benefits

In March 2000, the City again retroactively increased pension benefits. Specifically, the City and CERS settled a class action lawsuit brought by CERS members, with *Corbett* as the named class plaintiff.[13] Under the *Corbett* settlement, the City retroactively gave increased pension benefits to both current and retired City employees, increasing CERS's liabilities. Under

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[12] Manager's Proposal 1 was viewed skeptically by some members of the CERS Board who were not City employees. The majority of the CERS Board, however, consisted of City officials who received benefit increases that were contingent on the Board's approval of Manager's Proposal 1. Moreover, CERS's actuary informed the CERS Board that Manager's Proposal 1 was a sound proposal and CERS's fiduciary counsel opined that the Board would be acting within the ambit of its fiduciary discretion in approving Manager's Proposal 1.

[13] The *Corbett* plaintiffs raised various claims based on a 1997 California Supreme Court decision which held that an employee's salary for purposes of calculating basic pension benefits included the value of overtime and accrued leave.

Manager's Proposal 1, however, the City's contributions to CERS did not increase. As a result, the City's unfunded liability to CERS increased by $185 million.

In negotiating the *Corbett* settlement, however, the City purposefully structured certain of the increased *Corbett* benefits to avoid having those benefits adversely affect CERS's reported funded ratio and the City's reported unfunded liability to CERS. Specifically, the City structured the *Corbett* settlement so that the increased benefits for retired CERS members were to be paid in a given year only if there were sufficient surplus earnings from that year to pay the benefit. If there were insufficient surplus earnings in a given year to pay the increased benefit, then the cost of the increased benefit would become CERS's liability and would eventually be paid from future years' surplus earnings. The City and CERS treated the increased benefits to retired CERS members as contingent liabilities that were not taken into account in determining CERS's funded ratio or the City's unfunded liability to CERS. As of June 30, 2001, according to CERS's actuary, if the contingent portion of the *Corbett* settlement had been included in CERS's valuation, the City's unfunded liability to CERS would have increased by $70 to $76 million and CERS's funded ratio would have decreased by 2% to 2 ½ % from what was actually reported by the City. Thus, the City's pension situation was even more dire than the numbers, as they were reported by the City, indicated.

d. CERS's Actuary Report for Fiscal Year 2001 Shows a Dramatic Increase in the City's Pension Liabilities

In fiscal year 2001, CERS's investment return began to fall short of its anticipated 8% annual return. The City was informed of CERS's declining performance in February 2002, when it received CERS's annual actuarial valuation for fiscal year 2001. This report stated that as of the end of fiscal year 2001, CERS's funded ratio was 89.9% and the City's unfunded liability to CERS was $284 million, as compared to a funded ratio of 97.3% and an unfunded liability of $69 million only one year earlier. Moreover, the report noted that if the *Corbett* contingent benefit to CERS retired members were included, the City's unfunded liability to CERS would have increased to at least $354 million and CERS's funded ratio would have fallen to at least 87.9%.

CERS's actuary attributed these changes to a number of factors, including CERS's actuarial investment losses[14] of $95.6 million (and warned that there would be further actuarial investment losses in fiscal year 2002 unless the markets improved during the remaining five months of the fiscal year). In his report, CERS's actuary also warned that "all parties" should be "acutely aware that the current practice of paying less than the [actuarial] computed rate of contribution … will help foster an environment of additional declines in the funded ratio in absence of healthy investment returns."

In May 2002, the City learned that CERS would likely not have any surplus earnings from fiscal year 2002 to pay for the contingent benefits—specifically, retiree health care benefits, the 13th check, and the *Corbett* increase to retirees.

[14] Actuarial investment losses are the difference between the assumed investment rate, which in the City's case was 8% annually, and the actual investment results.

e. The Blue Ribbon Committee Report Puts the City on Notice about its Growing Pension and Retiree Health Care Liabilities

In April 2002, the City received a warning that the City's pension and retiree health care liabilities would continue to grow and that the City was not adequately planning to meet those liabilities. This came in the form of a report from the City's Blue Ribbon Committee to the City Council.[15] The report stated that the Blue Ribbon Committee had three principal concerns regarding CERS. First, the City was granting retroactive retirement benefit increases but pushing the cost of those benefit increases into the future, long after the individuals involved in the decisions were gone. Second, the City's budgetary process did not adequately comprehend the steadily growing annual expense of the pension contribution, "particularly given the uncontrollable and non-discretionary nature of this liability." The Committee stated that the City's pension contribution would substantially increase and warned that any future benefit increases, particularly retroactive increases, would "significantly exacerbate this problem." Third, the City's budgetary process did not recognize that retiree health care costs were a non-discretionary expense that would grow at an increasing rate and that the City was not paying out of its current year's budget the full cost for their future retiree health benefits. This report thus squarely put the City on notice that it had substantial future pension and healthcare liabilities it would probably be unable to pay under the current system.

f. Manager's Proposal 2: The City Again Proposes Additional Pension Benefits in Exchange for Relief from an Impending Lump Sum Payment

In fiscal year 2003, the City again increased its pension liability by granting additional retroactive benefits, used additional CERS assets to pay for additional pension and retiree health care benefits and an increased portion of the employees' contribution, and obtained additional time to under-fund its annual CERS contribution.

In the second half of fiscal year 2002, the City agreed to increase pension benefits for fiscal year 2003. From as early as October 2001, however, the City was concerned that CERS's funded ratio would fall below the 82.3% floor established by Manager's Proposal 1, which would require the City, at the very least, to increase its contributions to CERS by at least $25 million to be at a higher GASB-accepted rate.

Concerned about having to pay the additional $25 million, the City sought to condition the pension benefit increases on the City's obtaining from CERS relief from the floor of Manager's Proposal 1. In November 2002, the City and CERS agreed to Manager's Proposal 2 and the City

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[15] In April 2001, the Mayor had appointed a nine-member committee of San Diego citizens, known as the Mayor's Blue Ribbon Committee on City Finances, to independently evaluate the City's fiscal health and make any appropriate recommendations. In February 2002, the Blue Ribbon Committee presented its report to the Council's Rules Committee, identifying nine areas of concern, two of which related to the City's pension fund. The same report was made to the full Council in April 2002.

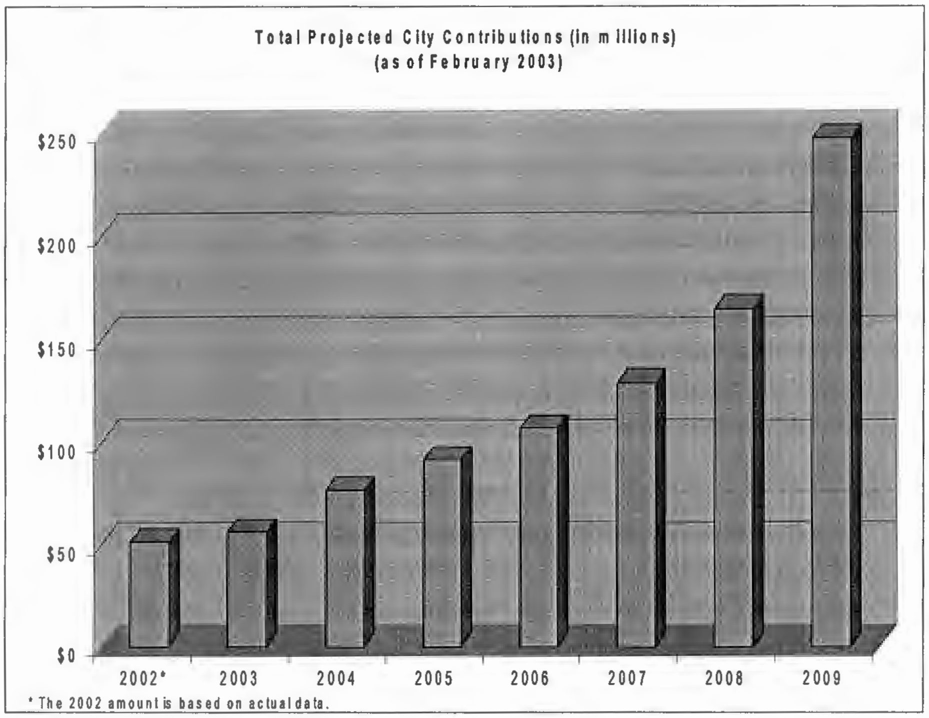
adopted the increased pension benefits as of July 2002. Under Manager's Proposal 2, once CERS's funded ratio fell below 82.3%, the City would have five years to increase its contributions to CERS to reach a GASB-recognized funding rate.

As a result of CERS's actuarial losses in fiscal year 2002, CERS did not have surplus earnings to pay the 13th check, the cost of retiree health care, and the *Corbett* benefit increase to retired CERS members. In conjunction with Manager's Proposal 2, however, the City directed CERS to use certain of its reserve accounts to pay the 13th check and the retiree health care benefits, and to pay an increased portion of certain City employees' CERS contributions. The reserve funds could have been used to increase CERS's funded ratio and decrease the City's unfunded liability to CERS; instead, the City directed that CERS use the reserve funds to pay additional benefits.

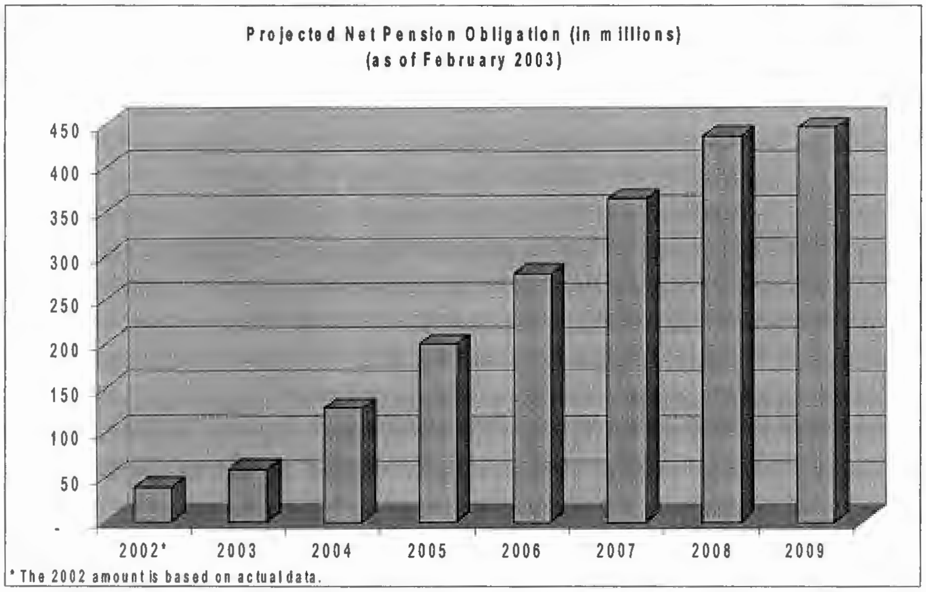
g. CERS's Actuary Report for Fiscal Year 2002 and Projections for the Future Show that the City Faces Substantial Problems Funding its Pension and Retiree Health Care Liabilities

In early 2003, the City received two reports from CERS's actuary. These reports provided the City with negative information regarding the present and projected status of CERS's funded ratio and the City's unfunded liability to CERS. First, in January 2003, the City received CERS's actuary report for fiscal year 2002. This report stated that during fiscal year 2002, CERS suffered an actuarial loss of $364.8 million and that as of the end of fiscal year 2002, CERS's funded ratio was 77.3% and the City's unfunded liability to CERS was $720 million, as compared to a funded ratio of 89.9% and unfunded liability of $284 million only one year earlier. The actuary's report further stated that if the *Corbett* contingent benefit to CERS retired members had been included, the City's unfunded liability to CERS would have been at least $790 million, and CERS's funded ratio would have been approximately 75.3%. In the concluding comment, the actuary stated that CERS was "in adequate condition," which was the first time that the actuary had not described CERS as "actuarially sound."

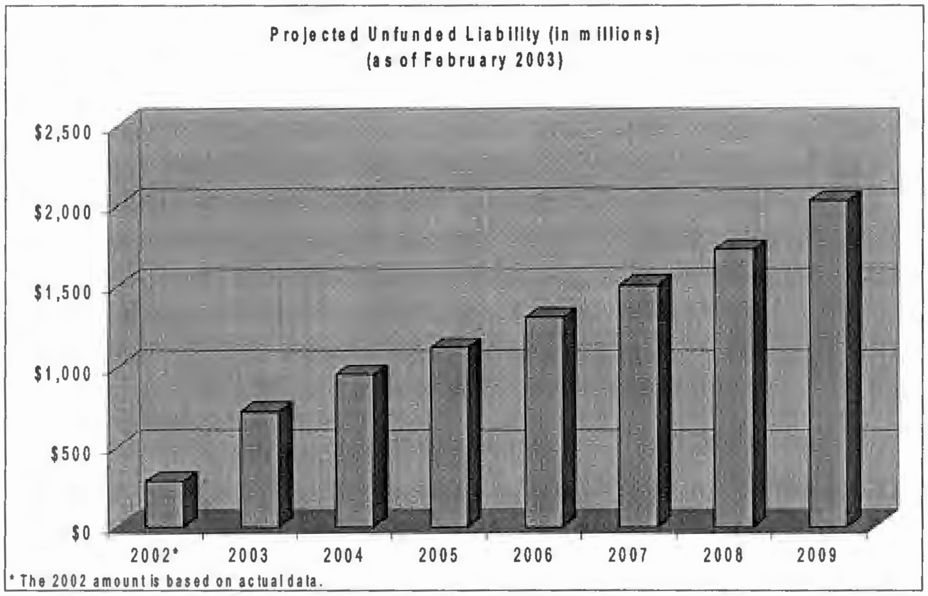
Second, in February 2003, CERS's actuary provided to the City projections of the City's contributions under Manager's Proposal 2, the City's net pension obligation, the City's unfunded liability to CERS, and CERS's unfunded ratio. Specifically, the City's contribution rate was projected to more than quadruple—from 9.83% of payroll in fiscal year 2002 ($51 million) to 35.27% of payroll in fiscal year 2009 ($248 million). The following chart illustrates the growth in the City's projected annual contribution to CERS:



The City's net pension obligation was projected to grow by tenfold—from $39.23 million in fiscal year 2002 to as much as $446 million in fiscal year 2009. The following chart illustrates the growth in the City's projected net pension obligation:



The City's unfunded liability was projected to increase more than seven fold—from $284 million at the beginning of fiscal year 2002 to $2 billion at the beginning of fiscal year 2009. CERS's funded ratio was projected to continue to fall—from 77.3% at the beginning of fiscal year 2003 to 65.6% at the beginning of fiscal year 2009. The following chart illustrates this dramatic increase in the City's projected unfunded liability to CERS:



The City had knowledge of these projections prior to all of its 2003 municipal securities offerings.

h. The *Gleason* Litigation: CERS Members Challenge Manager's Proposal 1 and Manager's Proposal 2

Further evidence that the City's under-funding of CERS was potentially threatening the City's future fiscal health came in January 2003, when CERS members filed a class action, with *Gleason* as the named class plaintiff, against the City and CERS alleging breaches in connection with the City's under-funding of CERS under Manager's Proposal 1 and Manager's Proposal 2. Among other things, the *Gleason* complaint alleged that by 2009, the City would owe approximately $2.8 billion to CERS, with an annual City budget expense of more than $250 million. In March 2003, the CERS attorney in the *Gleason* litigation advised CERS that (1) certain CERS Board members had breached their fiduciary duty by adopting Manager's Proposal 2; and (2) CERS should exercise its right to nullify Manager's Proposal 2. The CERS Board, which included the City Treasurer and the Assistant City Auditor and Comptroller, rejected this advice. If Manager's Proposal 2 had been nullified, the City would have been required to make an immediate potential payment to CERS of up to $159 million.

i. CERS's Response to the Blue Ribbon Committee Report Advises the City's Officials of the Growing Pension and Retiree Health Care Crisis.

In February 2003, additional detailed information about the City's pension funding crisis was presented to City officials when CERS responded to the Blue Ribbon Committee's report.[16] In its response, CERS advised the City that as of June 30, 2002, CERS's funded ratio had fallen to 77.3% and the City's unfunded liability to CERS had increased to $720 million. The response also stated that the falling funded ratio and the increasing unfunded liability resulted from three factors: a dramatic decline in CERS's investment performance in fiscal years 2001 and 2002; the City's granting of increased benefits; and the City's contributions to CERS at less than a GASB-recognized rate.

With respect to the City's under-funding, the response stated that the annual amount of the City's under-funding of CERS continued to increase in fiscal years 2002 and 2003, which was contrary to the initial projections from Manager's Proposal 1 that the annual amount of under-funding would decline beginning in fiscal year 2001. The response further stated that the City's net pension obligation would reach $102 million by the end of fiscal year 2003 and $423 million by the end of fiscal year 2009.

The response also discussed the City's future liability for retiree health care. CERS's actuary had estimated that the present value of the City's liability for future retiree health care was in excess of $1.1 billion. The response further stated that the City was not making any contributions to CERS to pay for this liability, that CERS had been paying for this liability with money in a reserve funded with CERS's surplus earnings from prior years, that the reserve would be depleted in fiscal year 2006, and that in fiscal year 2006, the City would have to pay an estimated $15 million for retiree health care. The response warned that absent a change in the benefit and a dramatic decrease in future health care costs, the City could be facing significant future funding obligations. The response recommended that the City consider funding this future health care liability as part of its annual contribution to CERS.

j. The City's Study of Its Pension Obligations Concludes that the City's Pension Liabilities Could Negatively Impact the City's Credit Rating

In April 2003, the City received additional information regarding the projected growth of its future pension liabilities and the possible negative effect those liabilities would have on the City's credit rating and ability to issue municipal securities. In February 2003, the City hired a financial adviser to analyze CERS's funding and to develop potential solutions. On April 16,

[16] From February 9 through 13, 2003, the local newspaper wrote three front page, above-the-fold articles about the City's under-funded pension system and the CERS response. The newspaper articles explained that (1) by the end of FY 2009 the City's unfunded liability to CERS was projected to increase to almost $2 billion; and (2) the City's unfunded liability for retiree health care was estimated to be $1.1 billion.

2003, the financial adviser provided to the City a preliminary pension analysis. In its analysis, the financial adviser stated that because of the City's under-funding, the City's unfunded liability would continue to grow and CERS's funded ratio would continue to fall through fiscal year 2021 regardless of actuarial gains or losses. The financial adviser estimated that under Manager's Proposal 2, the City's unfunded liability to CERS would grow to $1.9 billion at the end of fiscal year 2009 and to $2.9 billion at the end of fiscal year 2021, and CERS's funded ratio would fall to 66.5% at the end of fiscal year 2009 and would be 67% at the end of fiscal year 2021.

The preliminary pension analysis also stated that the City's large unfunded liability to CERS would cause the City's contribution to CERS to increase dramatically. The analysis estimated that the City's contribution rate to CERS would more than double—from 18.87% of payroll (or $107.5 million) in fiscal year 2004 to 40.9% of payroll ($286.9 million) in fiscal year 2009.

The preliminary pension analysis also discussed the effect that the City's unfunded liability would have on the City's credit rating. The financial adviser stated that the City's current unfunded liability would not only trigger an adverse credit event but that the rating agencies would expect the City to develop a plan to reduce its unfunded liability by increasing its annual contributions and/or funding the unfunded liability by issuing bonds. The financial adviser further stated that if the City did not develop and implement such a plan, the City's unfunded liability could cause the City "significant credit and legal challenges." The City's disclosures in 2003 failed to inform investors of the financial adviser's analysis.

3. The Offerings, Continuing Disclosures, and Rating Agency Presentations

a. The Bond Offerings and the City's Preparation of the Offerings' Disclosure Documents

During 2002 and 2003, the City conducted the following five municipal securities offerings totaling $261,850,000 in par value:

- $25,070,000 Public Facilities Financing Authority of the City of San Diego Lease Revenue Bonds, Series 2002B (Fire and Safety Project) (June 2002)
- $93,200,000 City of San Diego, 2002-03 Tax Anticipation Notes Series A (July 2002)
- $15,255,000 City of San Diego/Metropolitan Transit Development Board Authority 2003 Lease Revenue Refunding Bonds (San Diego Old Town Light Rail Transit Extension Refunding (April 2003)
- $17,425,000 City of San Diego 2003 Certificates of Participation (1993 Balboa Park/Mission Bay Park Refunding) (May 2003)
- $110,900,000 City of San Diego 2003-04 Tax Anticipation Notes Series A (July 2003)

A transactional financing team prepared the offering documents, that is, the preliminary official statement and the official statement, for each of the five municipal bond offerings. The financing team consisted of outside consultants and officials from the City Manager's office (financing services division), Auditor and Comptroller's office, and the City Attorney's office. The outside consultants included, among others, bond counsel, disclosure counsel, and underwriters. The preliminary official statement and the official statement for each of the five offerings consisted of a description of the offering, a general description of the City, including financial, economic, statistical, and other information in appendix A, and audited annual financial statements from the City's Comprehensive Annual Financial Reports in appendix B. Information regarding its pension and retiree health care obligations was provided in both appendices A and B.

The outside consultants took the lead in drafting the description of the bond offerings. City officials in the financing services division were responsible for drafting appendix A. The financing services division updated Appendix A on an ongoing basis and at the time of a bond offering, forwarded the latest version of Appendix A to the entire financing team. The team met several times to review, comment on, and ultimately finalize the preliminary official statements and official statements at "page-turner meetings." Appendix B was prepared by the Auditor's office and the City's outside auditor. The Council approved all of the 2002 and 2003 offerings at open session meetings.

b. The Continuing Disclosures

During the relevant period, the City also filed annual continuing disclosures relating to its \$2.29 billion in outstanding bonds for the purpose of updating investors on the state of the City's finances.[17] City officials in the financing services division coordinated, reviewed, and filed the 2002 and 2003 continuing disclosures. Almost all of these continuing disclosures included appendix A and portions of the City's Comprehensive Annual Financial Reports. The financing services division was responsible for ensuring that the most updated and accurate version of appendix A was attached to the continuing disclosures before they were filed.

c. The 2003 Rating Agency Presentations

The City made presentations to the rating agencies on a yearly basis, both in connection with specific bond offerings and to update the rating agencies on the City's general credit. The presentations were made orally with PowerPoints in meetings with representatives from Fitch Ratings, Moody's Investors Service, and Standard and Poor's. In 2003, the rating agencies specifically asked the City to address the pension plan as part of its annual presentations. These presentations were important because they directly affected the City's bond ratings. The 2003

[17] An underwriter of municipal securities covered by Exchange Act Rule 15c2-12 may not purchase or sell municipal securities in connection with an offering unless the issuer has undertaken in a written agreement or contract for the benefit of the bondholders to provide its audited annual financial statements and certain other annual financial and operating information, to nationally recognized municipal securities information repositories and state information depositories designated by the Commission and to provide notices of certain material events and notices of any failures to file on the nationally recognized municipal securities information repositories or the Municipal Securities Rulemaking Board and state information depositories.

PowerPoint presentations were prepared and presented by officials from the City Manager's office, including the financing services division, and the City Auditor and Comptroller's office. The financing services division drafted the pension portion of the 2003 PowerPoint presentation. Officials from the City Auditor's office made the oral presentation on the pension plan and fielded numerous questions on that topic from the rating agencies.

4. The False and Misleading Disclosures

In the preliminary official statement and the official statements for the 2002 and 2003 offerings, the 2003 presentations to the rating agencies, and the 2003 continuing disclosures, the City made substantial disclosures regarding (1) the City's policies for funding CERS; and (2) the status of CERS's funding and the City's liability to CERS. Additionally, in the preliminary official statements, the official statements, and continuing disclosures, the City made certain representations regarding its retiree health care obligations. The disclosures (collectively "Disclosures"), however, were misleading because the City failed to include material information regarding the City's current funding of its pension and retiree health care obligations, the City's future pension and retiree health care obligations, and the City's ability to pay those future obligations.

First, with respect to the pension issues, the City failed in the Disclosures to reveal several material facts, including that (1) the City was intentionally under-funding its pension obligations so that it could increase pension benefits but push off the costs associated with those increases into the future; (2) because of the City's under-funding of its pension plan, its net pension obligation was expected to continue to grow at an increasing rate, reaching from $320 million to $446 million by the end of fiscal year 2009; (3) the City's unfunded liability was expected to continue to grow at a substantial rate, reaching approximately $2 billion by fiscal year 2009; (4) this growth in the City's unfunded liability resulted from the City's intentional under-funding of its pension plan, the City's granting of new retroactive pension benefits, the City's use of pension plan earnings to pay additional benefits, and the pension plan's less than anticipated investment return; (5) the City's annual pension contribution was expected to more than quadruple by fiscal year 2009; and (6) the City would have difficulty funding its future annual pension contributions unless it obtained new revenues, reduced pension benefits, or reduced City services. Moreover, the City falsely disclosed in Appendix B to its preliminary official statements and its official statements that its net pension obligation was funded in a reserve.

Additionally, with respect to retiree health care benefits, the City failed to disclose in its preliminary official statements, official statements, and continuing disclosures that[18] (1) the estimated present value of its liability for retiree health care was $1.1 billion; (2) the City had been covering the annual cost for retiree health care with pension plan earnings from prior years that were expected to be depleted in fiscal year 2006; (3) after fiscal year 2006, the City would have to pay for the retiree health care benefits from its own budget at an estimated annual cost of $15 million; and (4) the City had not planned for paying such additional costs.

[18] The issue of retiree health care was not addressed in the rating agency presentations.

5. The City's Knowledge of the Misleading Disclosures

The City, through certain of its officials, knew that its Disclosures were misleading. The Mayor and Council were responsible for approving the issuance of the bonds and notes, including issuance of the preliminary official statements and official statements. The Mayor and Council delegated final approval of the official statements to the City Manager. The City Manager's office was responsible for the preparation of the preliminary official statements and the official statements, including appendix A. The City Auditor's office was responsible for the preparation of appendix B to the preliminary official statements and official statements. Through their designees on the CERS Board, among other things, both the City Manager's and the City Auditor's offices had knowledge about the City's use of CERS's surplus earnings, Manager's Proposals 1 and 2, CERS's actuary reports for fiscal years 2001 and 2002, and CERS's response to the Blue Ribbon Committee Report. Also, several representatives of the City Manager's office, City Attorney's office, and Auditor and Comptroller's office attended relevant closed session meetings of the Council where Manager's Proposals 1 and 2 and the *Corbett* and *Gleason* litigations were discussed. Moreover, the Blue Ribbon Committee Report and CERS's response to the Blue Ribbon Committee Report were both presented to a committee of the Council at which officials from the City Manager's and Auditor and Comptroller's office were present. Finally, the offices of the City Manager and the City Auditor were responsible for the City's study of its pension obligations that occurred in early 2003. Through their participation and involvement in the above-referenced matters, certain city officials knew or were reckless in not knowing that the Disclosures were false and misleading.

Specifically, by early 2002, the City, through its officials, knew, among other things, that (1) CERS's funded ratio would likely fall below the 82.3% floor set by Manager's Proposal 1; (2) the City was proposing Manager's Proposal 2 to avoid the effects of CERS's falling below the floor; (3) Manager's Proposal 2 allowed the City more time to under-fund CERS; and (4) the Blue Ribbon Committee had raised concerns about the City's under-funding of CERS and the future retiree health care liability. By early 2003, the City, through its officials, knew, among other things, that (1) the City's projected total contributions to CERS would grow from $77 million in fiscal year 2004 to $248 million in fiscal year 2009; (2) CERS had fallen below the 82.3% floor of Manager's Proposal 1; (3) the City and CERS had adopted Manager's Proposal 2 to allow the City more time to under-fund CERS; and (4) CERS was using reserved surplus earnings to pay certain benefits and to pay an increased portion of the employees' CERS contribution.

6. Materiality and the City's Voluntary Disclosure

The misleading Disclosures were material in view of the City's overall financial health. The Disclosures were also material given the magnitude of the City's projected annual CERS payments in the future and the potential consequences of those liabilities to the City, including inability to make the payments without reduction in other services.

The nature and level of under-funding brought into question the City's ability to fund the pension and health care benefits in the future as well as its ability to repay the bonds and notes. Under such a scenario, the City could be forced to choose between paying pension contributions, paying what the City owes on its bonds and notes, reducing services, and/or raising fees and taxes.

The materiality of the misleading Disclosures was demonstrated by the impact on the City's bond ratings when it finally disclosed key facts about the pension plan on January 27, 2004 in a voluntary report of information, after a non-employee CERS Board member raised concerns about the City's disclosure. The voluntary report provided information regarding (1) CERS's current and estimated future funded status; (2) the City's current and estimated future liabilities to CERS; (3) the reasons for the substantial decrease in CERS's funded ratio and increase in the City's liability to CERS; (4) the City's previous use of CERS funds to pay for retiree health care and the City's estimated future liabilities for retiree health care; and (5) the City's anticipated difficulty funding its increasing CERS contribution without new City revenues, a reduction in pension benefits, a reduction in City services, or other actions. Shortly after the disclosures in the voluntary report, the rating agencies lowered their ratings on the City's bonds and notes.

E. Legal Discussion

1. The Securities Act and Exchange Act Antifraud Provisions

State and local governments are exempt from the registration and reporting provisions of the Securities Act and the Exchange Act. Similarly, the Commission's authority to establish rules for accounting and financial reporting under Section 19 of the Securities Act and Section 13(b) of the Exchange Act does not extend to municipal securities issuers. The City and other municipal securities issuers, however, are subject to the antifraud provisions of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. In addition, the Commission has promulgated a broker-dealer rule, Exchange Act Rule 15c2-12, which in general limits market access for certain municipal securities issues to those offerings in which the issuer agrees to file annual financial disclosures of specified financial and operating information as well as notices of certain events, if material, and notices of any failures to file with repositories designated by the Commission. The antifraud rules apply to such disclosure and to any other statements made to the market.

Section 17(a) of the Securities Act prohibits misrepresentations or omissions of material facts in the offer or sale of securities. Section 10(b) of the Exchange Act and Rule 10b-5 thereunder prohibit misrepresentations or omissions of material fact in connection with the purchase or sale of any security. These provisions prohibit the making of any untrue statement of material fact or omitting to state a material fact in the offer, purchase, or sale of securities. A fact is material if there is a substantial likelihood that its disclosure would be considered significant by a reasonable investor. Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1987); TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976).

Section 17(a)(1) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 require a showing that defendants acted with scienter. Aaron v. SEC, 446 U.S. 680, 701-02 (1980). Scienter is "a mental state embracing intent to deceive, manipulate or defraud." Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976). In the Ninth Circuit, recklessness satisfies the scienter requirement. Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1569 (9th Cir. 1990) (en banc). Recklessness is "an extreme departure from the standards of ordinary care, and which presents a danger of misleading [investors] that is either known to the defendant or is so obvious that the actor must have been aware of it." Id., 914 F.2d at 1569. Scienter, however, need not be shown to establish a violation of Section 17(a)(2) or (3). Aaron v. SEC, 446 U.S. 680, 697 (1980). Violations of these sections may be established by showing negligence. SEC v. Hughes Capital Corp., 124 F.3d 449, 453-54 (3d Cir. 1997); SEC v. Steadman, 967 F.2d 636, 643 n. 5 (D.C. Cir. 1992).

2. The City's Violations of the Antifraud Provisions of the Securities Act and the Exchange Act

The City's public disclosures in the preliminary official statements and official statements for its 2002 and 2003 offerings, its 2003 continuing disclosures, and presentations to the rating agencies failed to disclose material information regarding the City's current funding of its pension and retiree health care obligations, the City's future pension and retiree health care obligations, and the City's ability to pay those future obligations. The omission of this information caused the information that was disclosed to be misleading.

This information was material to investors. The magnitude of the City's unfunded liabilities was enormous. For example, the City knew that by 2009 the unfunded liability would reach $1.9 billion and its actuarially required contribution would be approximately $240 million compared to $51 million in FY 2002. The City's under-funding of CERS and unfunded liabilities to CERS and for retiree health care were projected to continue to grow at an increasing rate. The increase in the City's under-funding and unfunded liabilities resulted, in part, from the City's decisions to increase pension and retiree health care benefits but push the costs of those increases into the future, to use CERS's prior earnings to cover additional benefits, and to pay a portion of the employees' contribution to CERS. All of this information raised a question whether the City could pay for these pension and retiree health care obligations and repay the bonds and notes issued by and on behalf of the City.

The City, through its officials, acted with scienter.[19] City officials who participated in drafting the misleading disclosure were well aware of the City's pension and retiree health care issues and the magnitude of the City's future liabilities. Moreover, even though the City officials knew that the City's pension issues were of concern to the rating agencies, they failed to disclose material information regarding the City's pension and retiree health care issues. In light of the City's officials' detailed knowledge of the magnitude of the City's pension and retiree health care liabilities and of the rating agencies' interest in those liabilities, the City officials acted recklessly in failing to disclose material information regarding those liabilities.

F. REMEDIAL EFFORTS AND UNDERTAKINGS

1. Since 2005, Respondent has implemented several remedial measures with a view to detect and prevent securities violations. Specifically, the City has terminated certain officials in the City Manager's and Auditor and Comptroller's offices or has allowed them to resign. The City has filled these positions with new employees generally having significant relevant experience with

[19] The City's scienter is based on the mental state of its officials. SEC v. Manor Nursing Centers, Inc., 458 F.2d 1082, 1089 n.3 (2d Cir. 1972).

other municipal governments or the private sector. The City has hired a full time municipal securities attorney who is responsible for coordinating the City's public disclosure and who has conducted continuing education for the City's deputy attorneys on the City's disclosure requirements.

2. The Mayor resigned and has been replaced by a former City police chief. In January 2006, pursuant to a public referendum, the City changed from a strong city manager form of government to a strong mayor form of government.

3. The City has hired new outside professionals including new auditors for its fiscal year audits. The City also hired individuals not affiliated with the City to act as the City's Audit Committee and charged the Committee with investigating the City's prior disclosure deficiencies and making recommendations to prevent future disclosure failures. The City has also hired new disclosure counsel for all of its future offerings, who will have better and more continuous knowledge on the City's financial affairs. This disclosure counsel has conducted seminars for City employees on their responsibilities under the federal securities laws.

4. The City has also enacted ordinances designed to change the City's disclosure environment. First, the City created a Disclosure Practices Working Group, comprised of senior City officials from across city government. The Working Group is charged with reviewing the form and content of all the City's documents and materials prepared, issued, or distributed in connection with the City's disclosure obligations relating to securities issued by the City or its related entities; and conducting a full review of the City's disclosure practices and to recommend future controls and procedures. Second, the Mayor and City Attorney must now personally certify to the City Council the accuracy of the City's official statements. Third, the City Auditor must annually evaluate the City's internal financial controls and report the results to the City Council.

5. Respondent shall comply with the following undertakings to:

a. Retain, not later than 60 days after the date of this Order, at its expense, an independent consultant not unacceptable to the Commission's staff (the "Independent Consultant"). The City shall require the Independent Consultant to (a) conduct annual reviews for a three-year period of the City's policies, procedures, and internal controls regarding its disclosures for offerings, including disclosures made in its financial statements, pursuant to continuing disclosure agreements, and to rating agencies, the hiring of internal personnel and external experts for disclosure functions, and the implementation of active and ongoing training programs to educate appropriate City employees, including officials from the City Auditor and Comptroller's office, the City Attorney's office, the Mayor, and the City Council members regarding compliance with disclosure obligations; (b) make recommendations concerning these policies, procedures, and internal controls with a view to assuring compliance with the City's disclosure obligations under the federal securities laws; and (c) assess, in years two and three, whether the City is complying with its policies, procedures, and internal controls, whether the City has adopted any of the Independent Consultant's recommendations from prior year(s) concerning such policies, procedures, and internal controls for disclosures for offerings, and whether the new policies, procedures, and internal controls were effective in achieving their stated purposes;

b. No later than 10 days following the date of the Independent Consultant's engagement, provide to the Commission staff a copy of an engagement letter detailing the Independent Consultant's responsibilities pursuant to paragraph 5(a) above;

c. Arrange for the Independent Consultant to issue its first report within 120 days after the date of the engagement and the following two reports within 60 days following each subsequent one-year period from the date of engagement. Within 10 days after the issuance of the reports, the City shall require the Independent Consultant to submit to Kelly Bowers of the Commission's Pacific Regional Office a copy of the Independent Consultant's reports. The Independent Consultant's reports shall describe the review performed and the conclusions reached and shall include any recommendations deemed necessary to make the policies, procedures, and internal controls adequate and address the deficiencies set forth in Section III.D of the Order. The City may suggest an alternative method designed to achieve the same objective or purpose as that of the recommendation of the Independent Consultant provided that the City's Mayor and City Attorney certify in writing to the Commission staff that they have a reasonable belief that the alternative method is expected to have the same objective or purpose as that of the Independent Consultant's recommendation;

d. Take all necessary and appropriate steps to adopt, implement, and employ the Independent Consultant's recommendations or the City's alternative method designed to achieve the same objective or purpose as that of the Independent Consultant's recommendation; and

e. Require the Independent Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with the City, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity; provided however, that the Independent Consultant may enter into an agreement with the City to serve as an independent monitor to oversee the City's remedial efforts with respect to enhanced accountability, greater transparency, increased fiscal responsibility, and independent oversight. Except as permitted above, the agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Pacific Regional Office, enter into any employment, consultant, attorney-client, auditing or other professional relationship with the City, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement.

6. In determining whether to accept the City's Offer, the Commission considered these undertakings and remediation measures.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in the City's Offer.

Accordingly, it is hereby ORDERED that:

A. The City cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder; and

B. The City comply with the undertakings enumerated in paragraph 5 of Section III.F. above.

By the Commission.

Nancy M. Morris
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 54754 / November 15, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12479

In the Matter of **1st Global Capital Corp.,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against 1st Global Capital Corp. ("1st Global" or "the Firm").

II.

In anticipation of the institution of these proceedings, 1st Global has submitted an Offer of Settlement (the "Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, 1st Global consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

On the basis of this Order and the Offer, the Commission finds that:

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RESPONDENT

1st Global is a broker-dealer registered with the Commission pursuant to Section 15(b) of the Exchange Act, with its principal offices in Dallas, Texas. 1st Global has a network of over 1,200 registered representatives ("RRs") located throughout the country. The vast majority of 1st Global's RRs are certified public accountants or tax accountants.

The Firm derives the majority of its revenue from the sale of mutual fund products, including tax-advantaged qualified tuition savings plans, commonly known as Section 529 College Savings Plans ("529 Plans").[1] During January 2002 through September 2003, 1st Global sold 529 Plan units totaling over $45 million. In fiscal 2003, 529 Plan unit sales represented approximately 1% of the Firm's total revenues.

SUMMARY

1. This matter involves violations of Municipal Securities Rulemaking Board ("MSRB") rules by 1st Global in connection with its offer and sale of investments in 529 Plans units. Between January 2001 and 2004, 1st Global recommended and sold investments in particular classes of 529 Plan units without necessarily having reasonable grounds to believe that its recommendations were suitable, based upon 529 Plan fee structures and customer needs and objectives, and by failing to deal fairly with its customers in connection with sales of 529 Plan unit investments. As a result, 1st Global willfully violated MSRB Rules G-17 and G-19, and Exchange Act Section 15B(c)(1), by making unsuitable recommendations in connection with the offer and sale of 529 Plan investments.

FACTS

529 Plan Investments

2. States generally organize their 529 Plans as trusts, either directly through legislation or by delegating authority to a state agency to form the trusts that issue 529 Plan units. Individual investors (usually called account owners) invest for their beneficiaries' qualifying higher education costs by purchasing units issued by these trusts. In turn, these trusts generally invest their assets in pooled investment vehicles (most commonly mutual funds). Because these trusts are sponsored by state governments or agencies, the units they issue are municipal securities.

3. Under Section 529 of the Internal Revenue Code, earnings on 529 Plan contributions grow federal tax-free, and withdrawals are free of federal tax if used for qualified expenses, such as tuition, fees, room, board, textbooks and other education expenses at qualified higher-education institutions. If an account holder uses a withdrawal for non-qualified expenses, however, the account holder must pay ordinary income taxes and a 10% penalty on the earnings.

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[1] Section 529 of the Internal Revenue Code provides for two types of tax-advantaged qualified tuition savings programs: prepaid tuition programs and state-sponsored tuition savings plans. Prepaid tuition programs, which involve the prepayment of tuition expenses for students at colleges and universities, have no investment options and are not addressed by this Order.

Investors therefore have significant disincentives against use of withdrawals for anything other than qualified, *i.e.* education-related, expenses.

4. 529 Plan contributions are treated as gifts to the named beneficiary for gift tax purposes, but they qualify for the annual gift tax exclusion (currently $12,000 or less per year). As a result, investors' annual contributions to 529 Plans often are $12,000 or less.[2]

5. Investors may acquire interests in 529 Plans either directly from the state trust or a state agency acting on its behalf (in which case the plan is a "direct-sold 529 Plan"), or from a financial intermediary, such as a broker, dealer, or bank municipal securities dealer, or other bank (in which case the plan is a "broker-sold 529 Plan"). 529 Plans generally invest in professionally-managed portfolios that hold shares in several mutual funds or other pooled investment vehicles. The underlying investment options in 529 Plans vary from plan to plan, with some plans offering a wide range of funds and others offering more limited choices.

529 Plan Expenses and Unit Classes

6. All 529 Plans include fees and expenses, which vary not only from plan to plan, but also within a single 529 Plan. The offering document for a 529 Plan, which is often called a program description or plan description, describes the fees and expenses associated with the 529 Plan. 529 Plan fees may include one-time enrollment or application fees, annual (fixed-dollar) account maintenance fees, sales loads, deferred sales charges, program management and administrative fees (usually asset-based),[3] and asset-based distribution fees, in addition to the fees and expenses of the underlying mutual funds. In some instances, it also is necessary to review the prospectuses for the underlying mutual funds in 529 Plans to ascertain all applicable fees and expenses.

7. Broker-sold 529 Plans often use load-waived shares of mutual funds as their underlying investments, and impose sales charges and asset-based distribution fees (virtually identical to Rule 12b-1 fees paid by many mutual funds) at the 529 Plan level. These 529 Plans usually offer classes of units that emulate the share classes at a load mutual fund (*e.g.*, Class A units that charge a front-end load, Class B units that charge a deferred sales charge, Class C units that charge no load but feature relatively higher asset-based distribution fees, etc.). As a result of these sales loads and additional fees, broker-sold 529 Plans often cost more than direct-sold plans.

8. Many broker-sold 529 Plans also emulate the "breakpoints" offered by mutual fund complexes (usually following the breakpoint schedule of the fund complex that manages the

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2 Account holders may contribute up to $60,000 per beneficiary and treat the contribution as made over a five calendar-year period.

3 Generally, "program management" fees are additional asset-based fees charged by a 529 Plan's program manager, which is usually a mutual fund complex that manages a state's 529 Plan pursuant to a contract with the state. "Administrative" fees are also asset-based fees, but are generally paid to the state agency charged with administering the 529 Plan in order to defray its costs. Both of these fees are generally deducted at the 529 Plan level, rather than coming from the underlying mutual funds.

underlying funds available through the particular 529 Plan).[4] In reaching a breakpoint, an investor is often permitted to aggregate transactions made by certain family members and transactions in certain other related accounts, e.g., 529 Plan accounts held by the same account owner, but with different beneficiaries.[5] 529 Plans generally disclose the schedule of available breakpoints and how an investor may qualify for breakpoints in their offering documents. The prospectuses for the mutual funds underlying a 529 Plan, which are incorporated by reference in the 529 Plan offering documents, may also contain relevant breakpoint information.

9. The class of 529 Plan units that an investor purchases determines the selling RR's compensation structure and may materially affect the up-front costs and/or long-term investment returns of the investor. Sales loads, deferred sales charges, and other fees and expenses vary widely not only from plan to plan, but also among the classes of units offered by a single plan.

10. Additional fees and expenses associated with 529 Plans, such as program or administrative fees, also may vary based on unit class. For example, under one 529 Plan sold by 1st Global, annual program fees for Class B and Class C units were 85 basis points higher than the program fees for Class A units.

11. Typically, units denominated as Class A charge a front-end load, while other classes, such as Class B and Class C, have different sales charge and expense characteristics. A "front-end load" is a sales charge that certain principal underwriters or distributors charge to the investor at the time an investor buys units. When the purchase is through a broker-dealer, the fund's principal underwriter or distributor pays a part of the front-end load amount to the broker-dealer.

12. Unlike Class A units, Class B units do not carry a front-end load. Rather, Class B units generally carry "contingent deferred sales charges" ("CDSCs"), which means that a gradually declining "load" is charged to investors if units are redeemed within a certain number of years, generally five to nine, after purchase. 529 Plan underwriters pay brokers a concession at the point of sale for Class B units, just as they do for sales of Class A units. So that the underwriter can recover the cost of the concession, Class B units impose a higher asset-based distribution fee. Many Class B units convert to Class A units, but typically not until after seven to nine years.

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4 "Breakpoints" is a term that usually refers to the discounts to the front-end loads or deferred sales charges (depending on the share class) many mutual funds offer at certain pre-determined levels of investment. Generally, an investor can procure a breakpoint discount through either a single purchase large enough to reach a breakpoint or multiple purchases in a single mutual fund or any of the funds in a fund complex the aggregate value of which is large enough to reach a breakpoint. An investor may aggregate purchases over time to meet applicable breakpoint thresholds through a "right of accumulation" ("ROA") or "letter of intent" ("LOI"). An investor may be eligible for a discount through an ROA by aggregating the amount of his or her current purchase with the amount of certain prior purchases. An LOI is a written statement of intent by the investor to purchase a certain amount of mutual fund shares over what is usually a thirteen-month period. Loads and breakpoints can vary among funds within a fund complex or between fund complexes, as do the specific terms and conditions under which breakpoint discounts may become available.

5 In addition, certain mutual funds also allow investors to aggregate shares purchased through various other accounts (such as retirement accounts and shares purchased as the underlying investment in a 529 Plan) in reaching breakpoints.

13. Class C units typically do not charge a front-end load, and generally impose a significantly lower CDSC than Class B units (or none at all). Like Class B units, Class C units generally charge relatively high asset-based distribution fees. Class C units, however, typically do not convert to Class A units and therefore continue to impose higher distribution fees for as long as the investor holds the units.

14. Because of the unique cost structures associated with 529 Plan units, which may not correspond to sales of mutual fund shares, careful analysis of the costs of differing classes of 529 Plan units is necessary. For example, Class C mutual fund shares typically are expensive to own over a long period because of the relatively high distribution fees, but in one popular 529 Plan sold by 1st Global in mid-2002, Class C 529 Plan units were the least expensive alternative for certain plan investments for over 17 years. Under another 529 plan, Class C units were the least expensive investment in some funds for the first four years, and Class B units were the least expensive unit class thereafter; Class A units were never the least expensive class of unit class for this plan investment, even with a very lengthy holding period. Broker-dealers recommending a 529 Plan investment to a customer must analyze the plan carefully to compare the relative costs of the different classes of units before recommending that a customer purchase a particular unit class.

Withdrawal Dates and Unit Class Selection

15. The anticipated number of years until withdrawal is a critical factor in determining the appropriate class of units class for a 529 Plan investment. *See* MSRB Fair Practice Notice, *Application of Fair Practice and Advertising Rules to Municipal Fund Securities* (May 14, 2002) (noting, in discussing the application of MSRB rules to sales of 529 Plans, the importance of the number of years until withdrawal in determining which unit class would be suitable for a particular customer) ("MSRB 529 Plan Notice").

16. 529 Plan investors typically have a relatively precise time horizon for their investment, because the age of the beneficiary and their likely college entry date are known. As a result, a broker-dealer making recommendations to customers concerning 529 Plan units can determine with relative precision the class of units offered of the particular fund [or funds] that is more economically beneficial to a particular customer.

17. In recommending 529 Plan investments, broker-dealers implicitly represent to their customers that the recommended class of units class is suitable, given, among other things, the age of the child. Where the beneficiary of a 529 Plan is a young child, the effect of higher annual, ongoing expenses on the performance of the investment may be significant, even where the initial investment is relatively small.

1st Global's Sales of 529 Plan Investments

18. 1st Global recommended and sold to its customers classes of 529 Plan units where it lacked reasonable grounds for believing that the investment in the particular unit class was suitable, based upon 529 Plan fee structures and customer needs, particularly the beneficiary's age. The Commission staff analyzed 101 accounts (from over 4,000 529 Plan accounts), and in 69 of the accounts analyzed, 1st Global RRs failed to recommend the lowest-cost class of units

that 1st Global offered of the particular fund [or funds] in the customer's 529 Plan. The difference between the value of the class of units purchased and the value of the lowest-cost unit class available, at the end of the expected holding period, ranged from less than 1% to over 10%. In 33 of the 69 accounts analyzed, the additional cost to investors (including foregone earnings) equaled or exceeded 5% of the amount of the initial investment (assuming 10% growth).[6]

19. In some instances, 1st Global sold classes of units other than the lowest-cost unit class that 1st Global offered of the particular fund [or funds] in the customer's 529 Plan at least in part because 1st Global failed to evaluate adequately the substantial effect of an anticipated lengthy holding period on comparative unit class costs, particularly for small investments. For example, one 1st Global customer invested $11,000 each for five-month old twins in Class C units of a popular 529 Plan investment. If he had purchased Class A units in the same investment, his investment for each child would be worth an estimated $4,100, or 9%, more than the value of Class C units when the children reach college age, or over 37% of the initial investment amount (based on 10% earnings growth assumptions). Similarly, another customer invested $6,000 each for two and a half year old triplets in Class B units of a different Alliance College Bound Fund mutual fund. Had this customer purchased Class A units in the same investment, each child's account would have been worth almost $400, or 1.75%, more than the value of Class B units when the children reach college age, or over 6.3% of the initial investment amount. A third customer invested $4,000 for a nineteen-month old in Class C units of a different 529 Plan. If this customer had purchased Class A units in the same investment instead, it would be worth an estimated $1,200, or almost 9%, more than the value of Class C units when the child reaches college age, or over 29% of the initial investment amount. Such differences in performance may be significant, particularly to parents with limited resources.

20. In addition, the difference in investment returns was exacerbated for some 1st Global 529 Plan customers where the amount they invested, either in an individual purchase or in aggregated purchases, was sufficient to qualify for breakpoints, but the RR recommended that they invest in either Class B or Class C shares, thus forfeiting the breakpoints. For example, a 1st Global customer invested $100,000 for a one-month old child in Class C units of a 529 Plan. Had this customer purchased the Class A units under the same plan instead, his investment would have qualified for a breakpoint and would be worth an estimated $48,000, or over 10%, more than the value of Class C units when the child reaches college age, or 48% of the initial investment amount. Another 1st Global customer invested $100,000 for five of her grandchildren, whose ages ranged from three to 11, in Class C 529 Plan units. If the customer had purchased Class A units instead, her investment would be worth an estimated $14,200, or 5.6%, more than the value of Class C units when the children reach college age, or over 14% of the initial contribution, in part because of the breakpoints associated with $100,000 in purchases in the plan in which she invested.[7]

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6 As a result of the 529 Plan commission structures, 1st Global did not necessarily receive greater commissions from these transactions than it would have earned had it sold the most economical unit class to its customers.

7 The grandmother's $5,000 investment for her oldest grandchild was appropriately invested in Class C units, which were the most economical share class given the grandchild's age.

1st Global's Policies and Procedures

21. Prior to July 2002, 1st Global's written supervisory procedures simply advised RRs that in the recommendation of mutual funds, they "should match the customer's objectives with the stated objective and investment strategy of the recommended fund."

22. Beginning in July 2002, 1st Global's written supervisory procedures advised RRs that, in recommending mutual funds in general, they are charged with assisting the client in determining what investment vehicle best meets their needs and objectives. The written supervisory procedures specified that the RRs should keep in mind, among other things, the customer's investment time horizon and the charges associated with the fund. In a section on mutual fund share class distinctions, the written supervisory procedures advised RRs that they were obligated to know the specifics regarding any mutual fund they sold, and that they should ensure that they discussed the different mutual fund share classes in detail with the client. The 1st Global written supervisory procedures section on 529 Plans stated that, in recommending such investments, the RR was obligated to determine suitability, and that they should consider and discuss with the customer, among other things, the associated fees and expenses.

23. Beginning in approximately September 2002, 1st Global issued specific 529 Plan Suitability Guidelines that advised RRs to "[m]ake sure the client is fully informed of the various fees and expenses and how they can affect performance of the investment."

24. 1st Global's policies and procedures generally advised RRs of their responsibility to recommend suitable investments, including 529 Plan investments. At least until early 2004, however, the Firm's policies and procedures failed to explain adequately the economic impact of ongoing expenses and breakpoint discounts associated with purchases of different classes of 529 Plan units. Further, at least until early 2004 1st Global did not provide adequate guidelines on comparing the costs of the respective classes of 529 Plan units and evaluating the effect of those differing costs on the performance of the investment.

25. 1st Global's supervisory procedures were inadequate to determine whether its RRs were evaluating the suitability of their recommendations of particular classes of 529 Plan units in light of the 529 Plan structure and fees and the customers' objectives and needs, particularly the beneficiary's age. Further, to the extent the Firm had procedures, they were ineffectively implemented for this purpose.

26. 1st Global relied primarily on two procedures to detect and prevent unsuitable recommendations of unsuitable classes of 529 Plan units. First, the Firm relied on supervisory reviews of each 529 Plan unit purchase for suitability. 1st Global's written supervisory procedures, however, failed to provide adequate guidance on when suitability reviewers should perform steps such as calculating comparative expenses or contacting RRs or customers in analyzing 529 Plan unit class and other issues. The 1st Global reviewers, moreover, had limited training and experience for this function, and the reviews were perfunctory. In fact, the primary reviewer failed to understand that 529 Plans have offering documents separate from, and generally in addition to, the prospectuses for the underlying mutual funds. As a result, on some

occasions he did not utilize the appropriate information concerning fees and costs in reviewing 529 Plan transactions for suitability. As a result, 1st Global suitability reviews were ineffective in preventing and detecting unsuitable unit class transactions.

27. The second procedure that 1st Global relied upon to prevent and detect unsuitable recommendations of classes of 529 Plan units was a Mutual Fund Disclosure Form ("MFDF"). After August 31, 2002, 1st Global procedures required that a MFDF be provided to each customer opening a new account and to customers whose aggregate purchases of Class B or C units equaled or exceeded $100,000.[8] These requirements applied to 529 Plan investments. The MFDF included a "cost to purchase" section that generally described the features of Class A, B and C shares and had blanks for the RR to fill in with the specific fees and expenses of the share class.

28. 1st Global, however, did not require its RRs to complete blanks on the MFDF regarding the fees and expenses of 529 Plan unit classes that the client did not purchase. As a result, the MFDF, even if completed as required by 1st Global, did not establish that 1st Global RRs were identifying, evaluating and disclosing to the customer the comparative costs of the 529 Plan unit classes or the impact of ongoing fees and expenses on the performance of the recommended investments. Further, 1st Global RRs sometimes failed to obtain an MFDF as required, failed to fill in *any* of the blanks in the cost-to-purchase section of the form, or incorrectly disclosed the amounts of fees and expenses in that section. The MFDF thus was ineffective to detect and prevent the sale of unsuitable classes of 529 Plan units.[9]

LEGAL ANALYSIS

29. MSRB Rule G-17 requires municipal securities dealers to deal fairly with all persons and not to engage in any deceptive, dishonest or unfair practice.

30. MSRB Rule G-19 provides that, in recommending a municipal securities transaction, a dealer shall have reasonable grounds for believing that the recommendation is suitable, based upon information about the security that is available from the issuer of the security or otherwise, and based upon the facts disclosed by or otherwise known about the customer.

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[8] Prior to August 31, 2002, 1st Global only required an MFDF to be completed where a customer was switching from one mutual fund investment to another. 1st Global continued to require that an MFDF be completed under these circumstances.

[9] Beginning in August 2003, 1st Global adopted monthly compliance reports to review certain mutual fund transactions. None of the monthly compliance reports, however, was specifically designed to review 529 Plan unit purchases, and most such purchases were not included in the compliance reports because they were smaller than the threshold monetary amounts. Further, the compliance reports were inadequately designed and implemented to identify and evaluate B and C mutual fund share or 529 Plan unit transactions for breakpoint implications. Thus, the monthly reports begun in August 2003 were inadequate to detect and prevent the sale of unsuitable 529 Plan unit classes.

31. Section 15B(c)(1) of the Exchange Act provides that no broker, dealer or municipal securities dealer, using the instrumentalities of interstate commerce, shall effect transactions in, or induce or attempt to induce the purchase or sale of, any municipal security in contravention of any MSRB rule.

32. Because 1st Global and its RRs did not adequately understand and evaluate the comparative costs of the various classes of 529 Plan units they sold, they lacked reasonable grounds to believe that their recommendations were suitable, based upon 529 Plan fee structures and customer needs and objectives. 1st Global willfully violated MSRB Rules G-17 and G-19 and Exchange Act Section 15B(c)(1) by recommending 529 Plan units to the Firm's customers when it did not necessarily have reasonable grounds to believe that the recommendations were suitable and by failing to deal fairly with its customers in connection with sales of 529 Plan units. *See* MSRB 529 Plan Notice; *In the Matter of Wheat, First Securities, Inc.,* Admin. Proc. File Nos. 3-9688 and 3-9794, Exchange Act Release No. 48378 (August 20, 2003); *In the Matter of Joseph H. Stafford*, Admin. Proc. File No. 3-6626, Exchange Act Release No. 23366 (June 22, 1986); *see generally In the Matter of the Application of Wendell D. Belden*, Admin. Proc. File No. 3-10888, Exchange Act Release No. 47859 (May 14, 2003).

UNDERTAKINGS

1st Global has undertaken the following:

33. Notice to Customers. Within 45 days after entry of the Order, 1st Global shall prepare letters not unacceptable to the Commission's staff to be sent to each of its 529 Plan customers (those who still hold their entire initial 529 Plan units and those who sold some or all of the units prior to the entry of the Order) notifying them of the findings in this Order and providing them with a copy of the Order.

34. Independent Consultant. Within 45 days after entry of the Order, 1st Global shall retain the services of an Independent Consultant not unacceptable to the Commission's staff, and thereafter exclusively bear all costs, including compensation and expenses, associated with the retention of the Independent Consultant. 1st Global shall retain the Independent Consultant to conduct a comprehensive review of, and recommend corrective measures concerning, the Firm's policies and procedures relating to recommendations to customers of 529 Plan units.

35. Cooperation. 1st Global shall cooperate fully with the Independent Consultant and shall provide the Independent Consultant with access to 1st Global's files, books, records and personnel as reasonably requested.

36. Report of Independent Consultant. 1st Global shall further retain and require the Independent Consultant to submit to 1st Global and to the Commission's staff an initial written report within 120 days after entry of the Order and a final written Report within 160 days after entry of the Order. Both the initial report and the final report shall describe, at a minimum:

a. the review performed by the Independent Consultant;

b. the conclusions reached by the Independent Consultant;

c. the adequacy of the Firm's policies and procedures respecting RRs' recommendations of 529 Plan units;

d. the Independent Consultant's recommendations for policies and procedures to address any deficiencies identified;

e. an effective system for implementing the recommended policies and procedures;

f. an effective system for verifying and recording compliance with the recommended policies and procedures.

37. <u>Firm's Response to Recommendations.</u>

a. Within 135 days after entry of the Order, 1st Global shall in writing advise the Independent Consultant and the Commission's staff which recommendations from the Independent Consultant's initial report the Firm has determined to accept, and which recommendations it considers to be unnecessary or inappropriate.

b. With respect to any recommendation that 1st Global considers unnecessary or inappropriate, 1st Global shall either explain why the objective or purpose of the recommendation is unnecessary or inappropriate, or provide in writing an alternative policy, procedure or system designed to achieve the same objective or purpose.

c. 1st Global shall attempt in good faith to reach an agreement with the Independent Consultant within 150 days of entry of the Order as to any recommendation that 1st Global considers unnecessary or inappropriate.

d. In the event the Independent Consultant and 1st Global are unable to agree on an alternative proposal not unacceptable to the Commission's staff within that time, 1st Global shall abide by the recommendation of the Independent Consultant.

e. Within 175 days of entry of the Order, 1st Global shall in writing advise the Independent Consultant and the Commission's staff of the recommendations and proposals that it is adopting.

38. For good cause shown, and upon receipt of a timely application from the Independent Consultant or 1st Global, the Commission's staff may extend any of the procedural dates set forth above.

39. To ensure the independence of the Independent Consultant, 1st Global: (i) shall not have authority to terminate the Independent Consultant, without the prior written approval of the Commission's staff; (ii) shall compensate the Independent Consultant, and persons engaged to assist the Independent Consultant, for services rendered pursuant to the Order at their reasonable and customary rates; (iii) shall not be in and shall not have an attorney-client relationship with the Independent Consultant, and shall not seek to invoke the attorney-client or any other doctrine or privilege to prevent the Independent Consultant from transmitting any information, reports, or documents to the Commission or the Commission's staff.

40. To further ensure the independence of the Independent Consultant, 1st Global shall require the Independent Consultant to agree that, for the period of the engagement and for a period of two years after completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with 1st Global, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the Independent Consultant will require that any firm with which the Independent Consultant is affiliated, or of which the Independent Consultant is a member, and any person engaged to assist the Independent Consultant in performance of his or her duties under the Order, shall not, without prior written consent of the Commission's staff, enter into any employment, consultant, attorney-client, auditing or other professional relationship with 1st Global, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement.

IV.

In view of the foregoing, the Commission deems it appropriate, and in the public interest, to impose the sanctions agreed to in the Offer of 1st Global.

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 15(b) of the Exchange Act, 1st Global is censured;

B. Pursuant to Section 21C of the Exchange Act, 1st Global shall cease and desist from committing or causing any violations and any future violations of Section 15B(c)(1) of the Exchange Act, including (1) failing to deal fairly with all persons and not engage in any deceptive, dishonest or unfair practice under MSRB Rule G-17, and (2) recommending a municipal securities transaction without reasonable grounds for believing that the recommendation is suitable, based upon information about the security that is available from the issuer of the security or otherwise, and based on the facts disclosed by or otherwise known about the customer, in violation of MSRB Rule G-19;

C. Within 10 days of the entry of this Order, 1st Global shall pay a civil money penalty in the amount of $100,000 to the United States Treasury. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies 1st Global Capital Corp. as a respondent in these proceedings and the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Rose L. Romero, District Administrator, Fort Worth District Office, Securities and Exchange Commission, Burnett Plaza, Suite 1900, 801 Cherry Street, Unit #18, Fort Worth, Texas, 76102-6882;

D. 1st Global shall comply with the terms of the undertakings set forth in paragraphs 33 through 40, and not later than 200 days after the date of the Order, unless otherwise extended by the staff of the Commission for good cause shown, 1st Global's chief executive officer shall certify in writing to the staff of the Commission that 1st Global has: (1) implemented procedures, and a system for applying such procedures, that can reasonably be expected to prevent and detect recommendations of unsuitable 529 Plan units; and (2) taken all necessary and appropriate steps to adopt and implement all recommendations and proposals of the Independent Consultant.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 54757/November 15, 2006

In the Matter of **Research Affiliates, LLC**	:	**ORDER AFFIRMING THE DENIAL OF REQUESTS FOR CONFIDENTIAL TREATMENT**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and consistent with the public interest and protection of investors, pursuant to Sections 13(f)(3) and (4) of the Securities Exchange Act of 1934 ("Exchange Act"), to affirm the denial by the Division of Investment Management (the "Division") of the requests for confidential treatment of information for the calendar quarters ended September 30, 2005 and December 31, 2005 (collectively, the "Requests"), filed by Research Affiliates, LLC ("Research") pursuant to Section 13(f) of the Exchange Act.

II.

1. Research is an investment manager that represents that it provides investment advisory services based on indices that are used to build passive portfolios.

2. Under Section 13(f)(5)(A) of the Exchange Act, Research is an institutional investment manager ("Manager") that exercises investment discretion over $100 million or more in reportable securities, as defined in Rule 13f-1(c) under the Exchange Act.

3. Research is subject to the reporting requirements of Rule 13f-1(a) under the Exchange Act, which requires Research to file Form 13F reports with the Commission on a quarterly basis.

4. On September 7, 2005, Research filed a request, pursuant to Rule 24b-2 under the Exchange Act, for confidential treatment of information required to be filed with the Commission pursuant to Section 13(f) of the Exchange Act ("Form 13F information") for the calendar quarter ended June 30, 2005.*

* On July 7, 2006, Research amended this filing to disclose all of the holdings for which confidential treatment had been sought. The request for this quarter therefore is moot.

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5. On November 10, 2005, Research filed a request, pursuant to Rule 24b-2 under the Exchange Act, for confidential treatment of Form 13F information for the calendar quarter ended September 30, 2005.

6. On February 2, 2006, Research filed a request, pursuant to Rule 24b-2 under the Exchange Act, for confidential treatment of Form 13F information for the calendar quarter ended December 31, 2005.

7. On March 23, 2006, the Division, acting under delegated authority, denied Research's Requests ("Denial Letter").

8. On March 29, 2006, Research filed a Notice of Intention to Petition for Review indicating that it would appeal to the Commission the Division's Denial Letter.

9. On April 4, 2006, Research filed a Petition for Review of the Division's Denial Letter ("Petition").

10. Rule 24b-2(b)(2)(ii) under the Exchange Act requires that a request for confidential treatment of Form 13F information contain, among other things, "a statement of the grounds of objection referring to, and containing an analysis of, the applicable exemption(s) from disclosure under the Commission's rules and regulations adopted under the Freedom of Information Act [("FOIA")]."

11. Rule 200.80(b)(4) under the Commission's FOIA rules provides that the Commission generally will not publish or make available to any person matters that "[d]isclose trade secrets and commercial or financial information obtained from a person and privileged or confidential."

12. The Form 13F confidential treatment instructions (the "Instructions") state that a Manager "requesting confidential treatment must provide enough factual support for its request to enable the Commission to make an informed judgment as to the merits of the request" and to "address all pertinent factors."

13. The Instructions require that a request that is based upon a claim that the subject information is confidential, commercial or financial information must provide supporting information in five specific areas: (1) a description of the investment strategy, including the extent of any program of acquisition or disposition; (2) an explanation of why disclosure of the securities would be likely to reveal the strategy; (3) a demonstration that the revelation of the investment strategy would be premature; (4) a demonstration that failure to grant the request for confidential treatment would be likely to cause substantial harm to the Manager's competitive position; and (5) a statement of the period of time for which confidential treatment is requested.

14. Rule 24b-2(b)(2)(ii) under the Exchange Act also requires that a request for confidential treatment of Form 13F information contain "a justification of the period of time for which confidential treatment is sought."

III.

We have carefully reviewed Research's Petition and the Division's Denial Letter. For the reasons generally discussed below, we find that Research has failed to provide sufficient information, either in its Requests or in its Petition, to substantiate its requests for confidential treatment.

Research generally describes itself as providing investment advisory services based on proprietary indices that are used to build passive portfolios. Research states that its indices ("Fundamental Indexes") are based on a variety of alternative economic measures of the worth of an underlying company, such as revenue, sales, book value, cash flow and dividends, among others. Research states that it has a patent pending on the method of creating and weighting the indices and related analytical processes. Research also has made publicly available a methodology paper that precisely describes how the Fundamental Indexes are calculated. Specifically, the methodology paper, among other things, specifies 11 steps to define the universe of stocks and generate portfolio weights for the Fundamental Indexes, defines the RAFI factors used to create the Fundamental Indexes (sales, cash flow, book value, and dividend distributions), and includes instructions for additions, removals, splits, and mergers.

Research has not justified its requests for confidential treatment. Among other things, in light of the public disclosure of Research's strategy, Research has not, as required by Instructions 2.c. and 2.d., demonstrated that disclosure of Research's securities positions on Form 13F would be premature or be likely to cause Research substantial harm. Research itself already has disclosed how the Fundamental Index is composed and has provided information that would enable others to engage in an investment strategy based on Research's purportedly proprietary index. Research cannot argue that the strategy would be revealed prematurely by disclosure on Form 13F or that such disclosure would be likely to cause Research harm because Research already has disclosed its strategy.

Even assuming that Research had demonstrated that it would be likely to suffer harm despite its public disclosure of its strategy, Research has failed to demonstrate the likelihood that such harm would be substantial. For example, Research did not provide any quantitative data regarding the cost of developing or maintaining any of the indices even though such data should have been readily available to Research.

In addition, Research has not justified the time period for which confidential treatment is requested. Although the Fundamental Index is rebalanced annually, Research does not limit its requests to the time period remaining until the next rebalancing but instead requests one year for each position.

Accordingly, the Commission affirms the Division's denial of Research's Requests. Research's requests do not demonstrate that the failure to grant its requests for confidential treatment would be likely to cause substantial harm to its competitive position, as required by the Instructions to Form 13F. Furthermore, Research does not attempt to quantify the extent to which it could be harmed by disclosure, and thus does not demonstrate that it would be likely to suffer "substantial" harm to its competitive position. Revelation of Research's investment strategy would not be premature because Research already has publicly disclosed the methodology behind its investment strategy. In addition, Research's requests also fail to justify the requested one-year period of confidential treatment.

IV.

IT IS ORDERED that, after considering Research's requests for confidential treatment of Form 13F information, the Commission, pursuant to Sections 13(f)(3) and (4) of the Exchange Act, affirms the denial by the Division of Research's Form 13F confidential treatment requests for the calendar quarters ended September 30, 2005 and December 31, 2005.

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

SECURITIES AND EXCHANGE COMMISSION

[RELEASE NO. 34-54766; File No. S7-06-05]

November 16, 2006

Order Granting the New York Stock Exchange Inc.'s (n/k/a the New York Stock Exchange LLC) Application for an Exemption Pursuant to Section 36 of the Securities Exchange Act of 1934

I. Introduction

On May 26, 2005, the Securities and Exchange Commission (the "Commission") received an application from the New York Stock Exchange, Inc. (n/k/a the New York Stock Exchange LLC) ("NYSE" or "Exchange")[1] for an exemption pursuant to Section 36[2] of the Securities Exchange Act of 1934 (the "Exchange Act"),[3] in accordance with the procedures set forth in Exchange Act Rule 0-12.[4] The NYSE has requested exemptive relief from Section 12(a) of the Exchange Act[5] to permit its members and brokers or dealers to trade certain unregistered debt securities on its facilities.[6] On July 8, 2005, the Commission approved publication of a notice of the application submitted by the NYSE, a proposed exemption order,[7]

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[1] On October 17, 2006, the NYSE submitted an updated application to the Commission.

[2] 15 U.S.C. 78mm. Section 36 of the Exchange Act gives the Commission the authority to exempt any person, security or transaction from any Exchange Act provision by rule, regulation or order, to the extent that the exemption is necessary or appropriate in the public interest and consistent with the protection of investors.

[3] 15 U.S.C. 78a et seq.

[4] 17 CFR 240.0-12. Exchange Act Rule 0-12 sets forth procedures for filing applications for orders for exemptive relief pursuant to Section 36.

[5] 15 U.S.C. 78l(a).

[6] The NYSE made its exemption request with regard to the Automated Bond System ("ABS"), an existing bond trading facility. Subsequently, the NYSE filed a proposed rule change, SR-NYSE-2006-37 (the "NYSE Bonds Proposal"), to establish a new trading facility, NYSE Bonds, which would replace ABS. Accordingly, the Commission is granting the exemption described herein for use in conjunction with ABS and any successor bond trading facility, which would include NYSE Bonds, in the event that the NYSE Bonds Proposal is approved.

[7] See Release No. 34-51998 (July 8, 2005), 70 FR 40748 (July 15, 2005).

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and a proposed rule change by the NYSE that would incorporate the terms of the proposed exemption into the NYSE's rules.[8] We received 19 comment letters on the proposed exemption order.[9] The responses are discussed more fully below. This order grants the NYSE's application for an exemption, subject to the conditions set forth below.

In connection with NYSE's request for an exemption, it has also proposed a rule change, SR-NYSE-2004-69, to establish rules for the trading of unlisted debt securities on the Exchange. The Commission, via authority delegated to the Division of Market Regulation, today is also approving that rule change,[10] as well as a rule change relating to trade reporting for transactions in unregistered debt securities proposed by the National Association of Securities Dealers, Inc. ("NASD").[11]

II. Order Granting the New York Stock Exchange's Application for an Exemption Pursuant to Section 36 of the Securities Exchange Act of 1934

Section 12(a) of the Exchange Act provides in relevant part that "[i]t shall be unlawful for any "member, broker or dealer to effect any transaction in any security (other than an exempted security) on a national securities exchange unless a registration is effective as to such security for such exchange." Section 12(b) of the Exchange Act[12] dictates how the registration referred to in Section 12(a) must be accomplished. Accordingly, all equity and debt securities that are not "exempted securities" or are not otherwise exempt from Exchange Act registration

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[8] See Release No. 34-51999 (July 8, 2005), 70 FR 41067 (July 15, 2005) (SR-NYSE-2004-69).

[9] The commenters are as follows: Bond Market Association; Representative Michael Castle; Mr. William Dolan; Mr. Donald Dueweke; Mr. Howard Friedman; Ms. Robyn Greene: Mr. Denis Kelleher; Mr. Ron Klein; Mr. Dennis J. Lehr; Multiple Markets, Inc.; the National Association of Securities Dealers, Inc.; NASDAQ Stock Market LLC; New York Stock Exchange LLC; Mr. Joseph Riveiro; Mr. David Russell Jr.; and Mr. Fred Siesel.

[10] See Release No. 34-54767 (November 16, 2006) (SR-NYSE-2004-69).

[11] See Release No. 34-54768 (November 16, 2006) (SR-NASD-2006-110).

[12] 15 U.S.C. 78l(b).

must be registered by the issuer under the Exchange Act before a member, broker or dealer may trade that class of securities on a national securities exchange.

Contrarily, brokers or dealers who trade debt securities otherwise than on a national securities exchange may trade debt securities regardless of whether the issuer registered that class of debt under the Exchange Act. This is so because Exchange Act registration for securities traded other than on a national securities exchange is required only for certain equity securities. In particular, Section 12(g) of the Exchange Act,[13] the only Exchange Act provision other than Section 12(a) to impose an affirmative Exchange Act registration requirement, requires the registration of equity securities exclusively.

As the Commission has stated in the past, we believe that this disparate regulatory treatment may have negatively and unnecessarily affected the structure and development of the debt markets.[14] In 1994, to reduce existing regulatory distinctions between exchange-traded debt securities and unlisted debt securities that trade in the "over-the-counter" ("OTC") market, we adopted Exchange Act Rule 3a12-11.[15] Rule 3a12-11 provides for the automatic effectiveness of Form 8-A registration statements for exchange-traded debt securities, exempts exchange-traded debt from the borrowing restrictions under Section 8(a) of the Exchange Act,[16] and exempts exchange-traded debt from certain proxy and information statement requirements under Sections

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[13] 15 U.S.C. 78l(g). Section 12(g)(1) of the Exchange Act and Rule 12g-1 [17 CFR 240.12g-1] promulgated thereunder require an issuer to register a class of equity securities if the issuer of the securities, at the end of its fiscal year, has more than $10,000,000 in total assets and a class of equity securities held by 500 or more recordholders.

[14] See Release Nos. 34-34922 (November 1, 1994), 59 FR 55342 (November 7, 2004), and 34-34139 (June 1, 1994), 59 FR 29398 (June 7, 1994).

[15] 17 CFR 240.3a12-11.

[16] 15 U.S.C. 78h(a).

14(a), (b) and (c) of the Exchange Act.[17] Despite these efforts, the vast majority of secondary trading of debt securities continues to occur in the OTC market, which suggests that there still may be regulatory impediments that need to be addressed.[18]

In addition, we have sought to increase the level of transparency in the public debt markets. We have long believed that price transparency in the U.S. capital markets is fundamental to promoting the fairness and efficiency of our markets.[19] In 1998, the Commission's staff conducted a review of the public debt markets and found that in the area of corporate debt securities, price transparency was deficient.[20] Following the staff's 1998 review, the NASD was encouraged to develop systems to receive and redistribute prices of transactions in corporate debt securities on an immediate basis.[21]

We view the exemptive relief requested by the NYSE as another step to improve the public debt markets. The Commission believes that granting the NYSE's application will serve the public interest by minimizing unnecessary regulatory disparity and promoting competition. Currently, unlike on a national securities exchange, broker-dealers may trade debt securities in the OTC market regardless of whether the issuer registered that class of debt under the Exchange Act. The exemption is designed to minimize that disparate regulatory treatment and promote

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[17] 15 U.S.C. 78n(a), (b) and (c).

[18] The NYSE estimates that there are over 22,000 publicly offered corporate bond issues having a par value in excess of $3 trillion but only 8% of the $3 trillion par value is registered under the Exchange Act and so may be traded on the NYSE. See NYSE's request for exemptive relief. Letter to Jonathan G. Katz, Secretary, Commission, from Mary Yeager, NYSE, dated May 26, 2005. See Release No. 34-51998.

[19] See Testimony of Chairman Arthur Levitt Before the House Subcommittee on Finance and Hazardous Materials, Committee on Commerce, Concerning Transparency in the United States Debt Market and Mutual Fund Fees and Expenses (September 29, 1998).

[20] Id.

[21] Id.

competition between the corporate debt security markets. Moreover, the exemption may improve the existing level of transparency on the current OTC market.

At the same time, the conditions of the exemption serve to protect investors by minimizing any reduction in information available as a result of the exemption. Further, the conditions are designed to ensure that investors continue to have access to comprehensive public information about an issuer, including the issuer's detailed disclosure in a registration statement filed under the Securities Act of 1933 and accompanying trust indenture qualified under the Trust Indenture Act of 1939, and substantially all of the public information that would be available if the debt securities were registered under Section 12 of the Exchange Act.

We received 19 comment letters on the proposed exemption order. The commenters generally supported the proposed exemption. We have, however, added an additional condition to the exemption based on a response from the Bond Market Association ("BMA"). The BMA expressed concern that debt securities of an issuer that does not have equity securities listed on a national securities exchange, such as a wholly-owned subsidiary of an issuer of equity securities, would lose the exemption from state law regulation provided by Section 18 of the Securities Act[22] for "covered securities" if the NYSE unilaterally delisted debt securities eligible for trading under this exemption order. To address this concern, we have added a new condition to the order stating that the NYSE will delist a class of debt securities only if the issuer of the class of debt security does not object to the delisting. As the potential loss of covered security status under

[22] 15 U.S.C. 77r. Section 18 of the Securities Act preempts state regulation that would require the registration or qualification of covered securities, or registration or qualification of securities transactions that involve covered securities. Under Section 18, a security is a "covered security" if it is: (1) listed, or authorized for listing, on the NYSE or the American Stock Exchange, or listed, or authorized for listing, on the National Market System of the Nasdaq Stock Market (or any successor to such entities); (2) listed, or authorized for listing, on a national securities exchange (or tier or segment thereof) that has listing standards that the Commission determines by rule (on its own initiative or on the basis of a petition) are substantially similar to the listing standards applicable to securities described above; or (3) is a security of the same issuer that is equal in seniority or that is a senior security to a security described in the two preceding paragraphs.

Section 18 of the Securities Act would be an unintended consequence of this exemption, this additional condition would allow an issuer with listed debt securities to maintain covered security status with respect to its securities at its option.

Another commenter, the NASDAQ Stock Market LLC, argued that limiting the bonds eligible to trade pursuant to this exemption exclusively to companies with equity listed on the NYSE, or their wholly-owned subsidiaries, would potentially be anti-competitive to other national securities exchanges. We do not believe this exemption will provide the NYSE with an unfair competitive advantage over other exchanges. Although the unlisted bonds that will trade on the ABS, and any successor bond trading facility pursuant to this exemption will not be eligible to trade on other exchanges pursuant to the unlisted trading privileges of Section 12(f) of the Exchange Act,[23] another exchange may petition the Commission for similar relief that would permit that exchange's members to trade unregistered debt securities on its facilities subject to the conditions imposed by the Commission in this order.

In granting this relief, we expect that the NYSE will design and implement all rules related to the relief in a manner that protects investors and the public interest and does not unfairly discriminate between customers, issuers, brokers or dealers. We view the exemptive relief requested by the NYSE as another step to improve the public markets and believe that granting the NYSE's application will minimize unnecessary regulatory disparity, promote competition and transparency in the public debt markets and is necessary and appropriate in the public interest and consistent with the protection of investors.

Accordingly, IT IS ORDERED pursuant to Section 36 of the Exchange Act that, under the terms and conditions set forth below, an NYSE member, broker or dealer may effect a

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[23] 15 U.S.C. 78l(f). Section 12(f) of the Exchange Act permits a national securities exchange to extend unlisted trading privileges to any security that is listed and registered on a national securities exchange.

transaction on the ABS, and any successor bond trading facility, in a debt security that has not been registered under Section 12(b) of the Exchange Act without violating Section 12(a) of the Exchange Act.[24] This exemption does not extend to any other section or provision of the Exchange Act.

For purposes of this order, a "debt security" is:

> Any security that, if the class of securities were listed on the NYSE, would be listed under Sections 102.03 or 103.05 of the NYSE's Listed Company Manual. A debt security does not include any security that, if the class of securities were listed on the NYSE, would be listed under Sections 703.19 or 703.21 of the NYSE's Listed Company Manual. Provided, however, under no circumstances does a debt security include any security that is defined as an "equity security" under Section 3(a)(11) of the Exchange Act.

References to Sections 102.03, 103.05, 703.19, and 703.21 of the NYSE's Listed Company Manual are to those sections as in effect on January 31, 2005.

For purposes of this order, the following conditions must be satisfied:

(1) The issuer of the debt security has registered the offer and sale of such security under the Securities Act of 1933;[25]

(2) The issuer of the debt security, or the issuer's parent company if the issuer is a wholly-owned subsidiary,[26] has at least one class of common or preferred equity securities registered under Section 12(b) of the Exchange Act and listed on the NYSE;

(3) The transfer agent of the debt security is registered under Section 17A of the Exchange Act;[27]

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[24] As noted previously, NYSE members will be able to effect transactions on the NYSE in accordance with the terms of this exemption without violating NYSE rules only after SR-NYSE-2004-69 becomes effective.

[25] 15 U.S.C. 77a et seq.

[26] The terms "parent" and "wholly-owned" have the same meanings as defined in Rule 1-02 of Regulation S-X [17 CFR 210.1-02].

[27] 15 U.S.C. 78q-1.

(4) The trust indenture for the debt security is qualified under the Trust Indenture Act of 1939;[28]

(5) The NYSE has complied with the undertakings set forth in its exemptive application to distinguish between debt securities registered under Section 12(b) of the Exchange Act and listed on the NYSE and debt securities trading pursuant to this order; and

(6) The NYSE will delist a class of debt securities that are listed on the NYSE as of the date of this order only if the issuer of that class of debt security does not object to the delisting of those securities.

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

[28] 15 U.S.C. 77aaa - 77bbbb.

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 8752 / November 16, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12476

In the Matter of **HARTFORD INVESTMENT FINANCIAL SERVICES, LLC, HL INVESTMENT ADVISORS, LLC, AND HARTFORD SECURITIES DISTRIBUTION COMPANY, INC.,** **Respondents.**	**ORDER UNDER RULE 602(e) OF THE SECURITIES ACT OF 1933, GRANTING A WAIVER OF THE DISQUALIFICATION PROVISIONS OF RULE 602(c)(3)**

Hartford Investment Financial Services, LLC ("Hartford Investment"), HL Investment Advisors, LLC ("HL Advisors") and Hartford Securities Distribution Company, Inc. ("Hartford Distribution") (together, "the Respondents") submitted a letter on behalf of the Respondents and their affiliates, dated March 16, 2006, requesting a waiver of the disqualification from the exemption under Regulation E under the Securities Act of 1933 ("Securities Act") arising from the settlement of a cease-and-desist and administrative proceeding commenced by the Commission. On November 8, 2006, pursuant to the Respondents' Offer of Settlement, the Commission instituted an Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act, Section 15(b) of the Securities Exchange Act of 1934, Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 and Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Order") against the Respondents.

The Order censures the Respondents and finds that (1) Hartford Investment willfully violated Sections 17(a)(2) and 17(a)(3) of the Securities Act, Section 206(2) of the Advisers Act of 1940 ("Advisers Act") and Section 34(b) of the Investment Company Act of 1940 ("Investment Company Act"); (2) HL Advisors willfully violated Sections 17(a)(2) and 17(a)(3) of the Securities Act, Section 206(2) of the Advisers Act and Section 34(b) of the Investment Company Act; and (3) Hartford Distribution caused and willfully aided and abetted violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act and Section

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206(2) of the Advisers Act. The Order also requires (1) Hartford Investment and HL Advisors to cease and desist from committing or causing any violations or any future violations of 17(a)(2) and 17(a)(3) of the Securities Act, Section 206(2) of the Advisers Act and Section 34(b) of the Investment Company Act; (2) Hartford Distribution to cease and desist from committing or causing any violations or any future violation of Sections 17(a)(2) and 17(a)(3) of the Securities Act and cease and desist from causing any violations or any future violations of Section 206 (2) of the Advisers Act; (3) the Respondents to pay, jointly and severally, $40 million in disgorgement and $15 million in civil penalties, all of which shall be distributed to the affected Hartford Funds; and (4) the Respondents to comply with certain undertakings.

Regulation E provides an exemption from registration under the Securities Act, subject to certain conditions, for securities issued by certain small business investment companies and business development companies. The Regulation E exemption is not available for the securities of an issuer if, among other things, any investment adviser or underwriter for the securities to be offered is subject to an order of the Commission entered pursuant to Section 15(b) of the Exchange Act or Section 203(e) of the Advisers Act. The Commission may waive the disqualification upon a showing of good cause. *See* Rule 602(e) under the Securities Act.

Based on the representations set forth in the Respondents' March 16, 2006 request letter, the Commission has determined that, pursuant to Rule 602(e), a showing of good cause had been made and that the request for a waiver of the disqualification should be granted.

Accordingly, **IT IS ORDERED**, pursuant to Rule 602(e) under the Securities Act, that a waiver of the disqualification provision of Rule 602(c)(3) under the Securities Act resulting from the entry of the Order is hereby granted.

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 54763 / November 16, 2006

Admin. Proc. File No. 3-12384

In the Matter of the Application of

NASDAQ STOCK MARKET, LLC

For Review of Action Taken by the

CONSOLIDATED TAPE ASSOCIATION

ORDER GRANTING PROTECTIVE ORDER

The Consolidated Tape Association ("CTA") has moved for a protective order pursuant to Rule of Practice 322. 1/ The CTA seeks to limit from disclosure to the public: (1) portions of the minutes of eight meetings of the CTA and Consolidated Quotation ("CQ") Operating Committee between January 2005 and May 2006 that do not relate to the calculation of the CTA entry fee, and (2) a memorandum from the Securities Industry Automation Corporation ("SIAC") dated January 9, 2006. The Nasdaq Stock Market, Inc. ("Nasdaq") has informed the Commission that the parties' positions are "in accord" regarding the documents to be protected.

We have reviewed the Committee minutes and the January 9, 2006, memorandum and recognize that certain information contained in those documents is sensitive. At this stage in the proceeding, we believe that the harm to CTA and CQ Plan participants resulting from complete disclosure outweighs the benefits. However, we have determined that disclosure of information in the portions of the Committee minutes that do not relate to the calculation of the CTA entry fee and January 9, 2006, memorandum may be necessary to the resolution of the issues before us.

1/ 17 C.F.R. § 201.322(b).

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Accordingly, IT IS HEREBY ORDERED that:

1. All persons who receive access to the aforementioned portions of the Committee minutes and the January 9, 2006, SIAC memorandum or the information contained in these documents shall keep them confidential and, except as provided in this Order, shall not divulge the documents or information to any person.

2. No person to whom these documents or information covered by this Order is disclosed shall make any copies or otherwise use such documents or information, except in connection with this proceeding or any appeal thereof.

3. Except as otherwise provided in this Order, the portions of the Committee minutes that do not relate to the calculation of the CTA entry fee and the January 9, 2006, SIA memorandum shall be disclosed only to the parties to this action, their counsel, the Commission, any staff advising the Commission in its deliberative processes with respect to this proceeding, and in the event of an appeal of the Commission's determination, any staff acting for the Commission in connection with that appeal.

4. The Office of the Secretary shall place the documents in sealed envelopes or other sealed containers marked with the title of this action, identifying each document and marked "CONFIDENTIAL."

5. The requirements of sealing and confidentiality shall not apply to any reference to the existence of the documents or to citation of particular information contained therein in testimony, oral argument, briefs, opinions, or in any other similar use directly connected with this action or any appeal thereof.

6. The Commission expressly reserves the authority to reach a different conclusion regarding the confidentiality of the documents or information covered by this Order at any time before it determines the issues raised in the proceeding.

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 230

[Release No. 33-8754; File No. S7-18-06]

RIN 3235-AJ73

COVERED SECURITIES PURSUANT TO SECTION 18 OF THE SECURITIES ACT OF 1933

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission ("SEC" or "Commission") proposes for comment an amendment to a Rule under Section 18 of the Securities Act of 1933 ("Securities Act"), as amended, to designate certain securities listed on The NASDAQ Stock Market LLC ("Nasdaq") as covered securities for purposes of Section 18 of the Securities Act. Covered securities under Section 18 of the Securities Act are exempt from state law registration requirements.

DATES: Comments should be received on or before [insert date 30 days after publication in the Federal Register].

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/proposed.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-18-06 on the subject line; or
- Use the Federal eRulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

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Paper Comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-18-06. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/proposed.shtml). Comments are also available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: Heather Seidel, Senior Special Counsel, (202) 551-5608, Hong-anh Tran, Special Counsel, (202) 551-5637 or Michou Nguyen, Special Counsel, (202) 551-5634, Division of Market Regulation ("Division"), Commission, 100 F Street, NE, Washington, DC 20549-6628.

SUPPLEMENTARY INFORMATION:

I. Introduction

In 1996, Congress amended Section 18 of the Securities Act to exempt from state registration requirements securities listed, or authorized for listing, on the New York Stock Exchange LLC ("NYSE"), the American Stock Exchange LLC ("Amex"), or the

National Market System of The NASDAQ Stock Market LLC ("Nasdaq/NGM")[1] (collectively, the "Named Markets"), or any national securities exchange designated by the Commission to have substantially similar listing standards to those markets.[2] More specifically, Section 18(a) of the Securities Act provides that "no law, rule, regulation, or order, or other administrative action of any State . . . requiring, or with respect to, registration or qualification of securities . . . shall directly or indirectly apply to a security that – (A) is a covered security."[3] Covered securities are defined in Section 18(b)(1) of the Securities Act to include those securities listed, or authorized for listing, on the Named Markets, or securities listed, or authorized for listing, on a national securities exchange (or tier or segment thereof) that has listing standards that the Commission determines by rule are "substantially similar" to the Named Markets.[4]

Pursuant to Section 18(b)(1)(B) of the Securities Act, the Commission adopted Rule 146.[5] Rule 146(b) lists those national securities exchanges, or segments or tiers thereof, that the Commission has determined to have listing standards substantially similar to those of the Named Markets and thus securities listed on such exchanges are

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1 As of July 1, 2006, the National Market System of The NASDAQ Stock Market LLC is known as the National Global Market. See Securities Exchange Act Release Nos. 53799 (May 12, 2006), 71 FR 29195 (May 19, 2006) and 54071 (June 29, 2006), 71 FR 38922 (July 10, 2006).

2 See National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416 (October 11, 1996).

3 15 U.S.C. 77r(a).

4 15 U.S.C. 77r(b)(1)(A) and (B). In addition, securities of the same issuer that are equal in seniority or senior to a security listed on a Named Market or national securities exchange designated by the Commission as having substantially similar listing standards to a Named Market are covered securities for purposes of Section 18 of the Securities Act. 15 U.S.C. 77r(b)(1)(C).

5 Securities Exchange Act Release No. 39542 (January 13, 1998), 63 FR 3032 (January 21, 1998).

deemed covered securities.[6] Nasdaq has petitioned the Commission to amend Rule 146(b) to determine that its listing standards for securities listed on the Nasdaq Capital Market ("NCM")[7] are substantially similar to those of the Named Markets and, accordingly, that securities listed pursuant to such listing standards are covered securities for purposes of Section 18(b) of the Securities Act.[8] If the Commission makes this determination, then securities listed on the NCM would be exempt from state law registration requirements.[9]

II. Background

In 1998, the Chicago Board Options Exchange, Incorporated ("CBOE"), Pacific Exchange, Inc. ("PCX") (now known as NYSE Arca, Inc.), the Philadelphia Stock Exchange, Inc. ("Phlx"), and the Chicago Stock Exchange ("CHX") petitioned the Commission to adopt a rule determining that specified portions of the exchanges' listing standards were substantially similar to the listing standards of the Named Markets.[10] In response to the petitions, and after extensive review of the petitioners' listing standards, the Commission adopted Rule 146(b), determining that the listing standards of the

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6 17 CFR 230.146(b).

7 The Nasdaq Capital Market was previously named the Nasdaq SmallCap Market.

8 See letter from Edward S. Knight, Executive Vice President and General Counsel, Nasdaq, to Nancy M. Morris, Secretary, Commission, dated March 1, 2006 (File No. 4 - 513).

9 15 U.S.C. 77r.

10 See letter from David P. Semak, Vice President, Regulation, PCX, to Arthur Levitt, Jr., Chairman, Commission, dated November 15, 1996; letter from Alger B. Chapman, Chairman, CBOE, to Jonathan G. Katz, Secretary, Commission, dated November 18, 1996; letter from J. Craig Long, Esq., Foley & Lardner, Counsel to CHX, to Jonathan G. Katz, Secretary, Commission, dated February 4, 1997 ("CHX Petition"); and letter from Michele R. Weisbaum, Vice President and Associate General Counsel, Phlx, to Jonathan G. Katz, Secretary, Commission, dated March 31, 1997.

CBOE, Tier 1 of the PCX, and Tier 1 of the Phlx were substantially similar to those of the Named Markets and that securities listed pursuant to those standards would be deemed covered securities for purposes of Section 18 of the Securities Act.[11] Further, in 2004, the International Stock Exchange, Inc. ("ISE") petitioned the Commission to amend Rule 146(b) to determine that its listing standards for securities listed on ISE are substantially similar to those of the Named Markets and, accordingly, that securities listed pursuant to such listing standards are covered securities for purposes of Section 18(b) of the Securities Act.[12] The Commission subsequently amended Rule 146(b) to designate options listed on ISE as covered securities.[13]

Nasdaq has petitioned the Commission to amend Rule 146(b) with a determination that its listing standards for securities listed on the NCM are substantially similar to those of the Named Markets, and that NCM securities are "covered securities" under Section 18(b) of the Securities Act.

III. Discussion

Under Section 18(b)(1)(A) of the Securities Act,[14] the Commission has the authority to compare the listing standards of a petitioner with those of either the NYSE, Amex, or Nasdaq/NGM. The Commission initially has compared Nasdaq's listing standards for all NCM securities with only one of the Named Markets. If the listing standards in a particular category did not meet the standards of that market, the

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11 Securities Exchange Act Release No. 39542, supra note 5.

12 See letter from Michael Simon, Senior Vice President and General Counsel, ISE, to Jonathan G. Katz, Secretary, Commission, dated October 9, 2003.

13 Securities Act Release No. 8442 (July 14, 2004), 69 FR 43295 (July 20, 2004).

14 15 U.S.C. 77r(b)(1)(A).

Commission compared the standards to the other two markets.[15] In addition, the Commission has interpreted the "substantially similar" standard to require listing standards at least as comprehensive as those of the Named Markets.[16] If a petitioner's listing standards are higher than the Named Markets, then the Commission may still determine that the petitioner's listing standards are substantially similar to the Named Markets. Finally, the Commission notes that differences in language or approach would not necessarily lead to a determination that the listing standards of the petitioner are not substantially similar to those of a Named Market.

The Commission has reviewed listing standards for securities traded on NCM[17] and, for the reasons discussed below, preliminarily believes that the standards overall are not substantially similar to those of a Named Market. However, Nasdaq has filed a proposed rule change to amend its quantitative listing standards for NCM securities.[18] In view of Nasdaq's proposed rule change, the Commission preliminarily believes that it could make a finding that the NCM's listing standards are substantially similar to those of a Named Market, and thus amend Rule 146(b) to include securities listed on the NCM. The Commission also notes that Nasdaq's qualitative listing standards for NCM

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15 This approach is consistent with the approach that the Commission has previously taken. See Securities Act Release Nos. 7422 (June 9, 1997), 62 FR 32705 (June 17, 1997) and 7494 (January 13, 1998), 63 FR 3032 (January 21, 1998).

16 Securities Act Release No. 7422, supra note 15.

17 See generally Nasdaq Rules 4310, 4320, and 4350.

18 See Securities Exchange Act Release No. 54378 (August 28, 2006), 71 FR 52351 (September 5, 2006) ("Nasdaq Proposed Rule Change"); see also letter from Edward S. Knight, Executive Vice President and General Counsel, Nasdaq, to Heather Seidel, Senior Special Counsel, Division of Market Regulation ("Division"), Commission, dated August 11, 2006 ("Nasdaq Letter").

securities are identical to the qualitative listing standards for Nasdaq/NGM securities.[19]

A. Common Stock

As discussed below, the Commission preliminarily believes that some, but not all, of the requirements in Nasdaq's quantitative initial listing standards for common stock listing on the NCM are substantially similar to those of Amex's common stock listing standards. The Commission therefore preliminarily believes that the NCM common stock initial listing standards are not currently substantially similar to those of Amex's common stock listing standards.

Specifically the Commission preliminarily believes that the NCM listing requirements are substantially similar to Amex Standard 1 through 3 requirements relating to operating history, bid price, round lot holders,[20] and shares held by the public.[21] However, under the NCM standards, an issuer may qualify for listing by satisfying either a shareholder equity requirement (at least $5 million),[22] a market value of listed securities test (at least $50 million),[23] or an income test (at least $750,000 in

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19 Such qualitative listing standards relate to, among other things, the number of independent directors required, conflicts of interest, composition of the audit committee, executive compensation, shareholder meeting requirements, voting rights, quorum, code of conduct, proxies, shareholder approval of certain corporate actions, and the annual and interim reports requirements. See Nasdaq Rule 4350.

20 The Commission notes that the NCM listing standards require at least 300 round lot holders, while Amex's listing standards require 400 or 800 (depending upon the number of shares held by the public), or 300 or 600 for its alternate listing standards. The Commission preliminarily does not believe this difference precludes a determination of substantial similarity between the standards.

21 See generally Section 101 of the Amex Company Guide and Nasdaq Rule 4310.

22 Nasdaq Rule 4310(c)(2)(A)(i).

23 Nasdaq Rule 4310(c)(2)(A)(ii). The market value of listed securities refers to the closing bid price multiplied by the number of securities listed on Nasdaq or listed on another self-regulatory organization ("SRO"). See Nasdaq Rule 4200.

after tax net income from continuing operations in the last fiscal year or two out of the last three fiscal years).[24] Amex's common stock listing Standards 1 and 3 not only require the satisfaction of an equity test, but Standard 1 also requires the satisfaction of an income test (at least $750,000 in pre-tax income from continuing operations in the last fiscal year or two of the last three fiscal years),[25] and Standard 3 also requires the satisfaction of a market value test (at least $50 million).[26] Amex Standard 2 does not require an income test or a market value test but does require an operating history of two years[27] as compared to the NCM, which requires only one year.[28] An additional difference is that Amex Standards 2 and 3 require the aggregate market value of publicly held shares to be $15 million, whereas Nasdaq's requirement is $5 million.[29] The Commission preliminarily believes that these differences preclude the Commission from making a determination that the NCM common stock initial listing standards are substantially similar to those of the Amex.

Nasdaq has filed a proposed rule change under Section 19 of the Exchange Act[30]

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24 Nasdaq Rule 4310(c)(2)(A)(iii).

25 See Amex Rule 101(a)(1) - (2).

26 See Amex Rule 101(c)(1) - (2).

27 See Amex Rule 101(b)(1).

28 See Nasdaq Rule 4310(c)(3).

29 Specifically, Amex Standard 3, which allows an issuer to meet a requirement for the market value of listed securities of $50 million (rather than an income test), requires an aggregate market value of publicly held shares of $15 million (Amex Standard 2, which requires a two-year operating history, also requires an aggregate market value of publicly held shares of $15 million). The NCM standard, which permits an issuer to meet either a market value of listed securities test or an income test, in either instance only requires an aggregate market value of publicly held shares of $5 million. See Sections 101(b)(4) and (c)(3) of the Amex Company Guide and Nasdaq Rule 4310(c)(7)(A).

30 15 U.S.C. 78s.

to modify its NCM initial listing standards for common stock. Specifically, Nasdaq's proposal would require an issuer to have: (i) shareholder's equity of $4 million and net income from continuing operations of $750,000 in the most recently completed fiscal year or in two of the last three most recently completed fiscal years; (ii) shareholder's equity of $4 million and a market value of listed securities of $50 million; or (iii) shareholder's equity of $5 million and a two-year operating history.[31] Moreover, Nasdaq's proposal also would increase the aggregate market value of publicly held shares from $5 million to $15 million in scenario (ii) and (iii) above.[32] If these rule changes were approved prior to Commission action on this rule proposal, the Commission preliminarily believes it could find the NCM listing standards for common stock to be substantially similar to those of Amex.

The Commission preliminarily believes that the continued listing requirements for common stock listed on the NCM, while not identical, are substantially similar to those of Amex. Amex's delisting criteria are triggered by poor financial conditions or operating results of the issuer.[33] Specifically, Amex will consider delisting an equity issue if: (i) stockholders' equity is less than $2 million and such issuer has sustained losses from continuing operations and/or net losses in two of its three most recent fiscal years; (ii) stockholders' equity is less than $4 million and such issuer has sustained losses from continuing operations and/or net losses in three of its four most recent fiscal years; (iii) stockholders' equity is less than $6 million if such issuer has sustained losses from continuing operations and/or net losses in its five most recent fiscal years; or (iv) the

31 See Nasdaq Proposed Rule Change, supra note 18.

32 Id.

33 See generally Sections 1001 through 1006 of the Amex Company Guide.

issuer has sustained losses which are so substantial in relation to its overall operations or its existing financial resources, or its financial condition has become so impaired that it appears questionable, in the opinion of the Exchange, as to whether such company will be able to continue operations and/or meet its obligations as they mature.[34]

Although the NCM does not have the same continued listing provisions, Nasdaq also looks at the financial condition and operating results of the issuer. Specifically, for continued inclusion, Nasdaq requires shareholder's equity of at least \$2.5 million, market value of listed securities of at least \$35 million, or net income of \$500,000 from continuing operations in the past fiscal year or two out of three past fiscal years.[35] Further, Nasdaq requires a minimum bid price for continued listing of \$1 per share.[36] In addition, for continued listing, Nasdaq requires an issuer to have a minimum number of publicly held shares of at least 500,000 shares with a market value of at least \$1 million.[37]

The Commission preliminarily believes that the differences in the maintenance criteria for common stock listed on Amex and on the NCM are not material and that,

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34 See Section 1003(a) of the Amex Company Guide. Amex also will consider delisting if: (i) an issuer has sold or otherwise disposed of its principal operating assets or has ceased to be an operating company or has discontinued a substantial portion of its operations or business; (ii) if substantial liquidation of the issuer has been made; or (iii) if advice has been received, deemed by the Exchange to be authoritative, that the security is without value, or in the case of a common stock, such stock has been selling for a substantial period of time at a low price. See Section 1003(c) and (f)(v) of the Amex Company Guide.

35 Nasdaq Rule 4310(c)(2)(B)(i) - (iii)..

36 Nasdaq Rule 4310(c)(4). Amex will consider delisting if the price per share is "low." See Amex Rule 1003(f)(v).

37 Nasdaq Rule 4310(c)(7)(A). Amex will consider delisting the common stock of an issuer if the aggregate market value of such publicly held shares is less than \$1 million for more than 90 consecutive days, the number of publicly held shares is less than 200,000 shares, or the number of its public stockholders is less than 300. See Section 1003(b) of the Amex Company Guide.

taken as a whole, the criteria are substantially similar.[38]

The Commission requests comment on whether the NCM's common stock listing rules are "substantially similar" to Amex's rules.

B. Secondary Classes of Common Stock and Preferred Stocks

The Commission notes that only Nasdaq has listing standards for the trading of a secondary class of common stock. A secondary class of common stock is a class of common stock of an issuer that has another class of common stock listed on an exchange. The Commission compared the secondary classes of common stock listing standards of the NCM with the listing standards of the Nasdaq/NGM. The Commission also compared the NCM listing standards for preferred stocks with those of Nasdaq's NGM.

With respect to the number of round lot holders,[39] bid price,[40] and number of publicly held shares[41] requirements,[42] the Commission preliminarily believes that

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38 As noted above, the Commission has interpreted the substantially similar standard to require listing standards at least as comprehensive as those of the Named Markets, and differences in language or approach of the listing standards are not dispositive.

39 Both Nasdaq NCM and NGM require 100 round lot holders. See NASD Rules 4310(c)(6)(B) and 4420(k)(4). Nasdaq/NGM also requires 100 round lot holders for continued listing. Although the NCM requirements do not explicitly require a continuing number of round lot holders, Nasdaq has filed a proposed rule change to clarify that the 100 round lot holders requirement also will apply as a continued listing requirement for the NCM preferred and secondary classes of common stock standards. See Nasdaq Proposed Rule Change, supra note 18.

40 While the NCM bid price requirement for initial listing is $4 and the Nasdaq/NGM requirement is $5, the Commission preliminary does not believe this difference is material. Both NGM and NCM require a $1 bid price for continued listing. See Nasdaq Rules 4310(c)(4), 4420(k)(3), and 4450(h)(3).

41 Both Nasdaq NCM and NGM require 200,000 publicly held shares for initial listing, and 100,000 publicly held shares for continued listing. See Nasdaq Rules 4310(c)(7)(B), 4420(k)(1), and 4450(h)(1).

42 The Commission notes that these requirements apply to instances when the common stock or common stock equivalent security of the issuer is listed on

Nasdaq's initial and continued listing requirements for secondary classes of common stock and preferred stocks listing on the NCM are substantially similar to the listing standards for the Nasdaq/NGM. The Commission preliminarily believes, however, that the initial and continued listing requirements for market value of publicly held shares for NCM are not substantially similar to Nasdaq/NGM standards. In particular, the NCM listing standards require that there be at least 200,000 publicly held shares having a market value of at least $2 million for initial listing and 100,000 publicly held shares having a market value of $500,000 for continued listing.[43] The Nasdaq/NGM standards require that there shall be at least 200,000 publicly held shares having a market value of at least $4 million for initial listing and 100,000 publicly held shares having a market value of $1 million for continued listing.[44]

Nasdaq has filed a proposed rule change to increase the requirements for its NCM listing standards for both preferred and secondary classes of common stock for the market value of publicly held shares to $3.5 million for initial listing and $1 million for continued listing.[45] Nasdaq also has proposed to amend its initial and continued NCM listing rules for secondary classes of common stock and preferred stock to require that the common stock or common stock equivalent of the issuer either be listed on Nasdaq or be

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Nasdaq/NGM, NCM, Global Select Market ("GSM") (the GSM is a segment of the NGM, see Securities Exchange Act Release Nos. 53799 and 54071, supra note 1), or another national securities exchange. If the common stock or common stock equivalent is not listed on one of these markets then the security must meet the common stock listing requirements for the relevant market (either Nasdaq/NGM or NCM). See generally NASD Rules 4310(c)(6)(B) and 4420(k).

43 See Nasdaq Rules 4310(c)(7)(B).

44 See NASD Rules 4420(k)(1) - (2) and 4450(h)(1) - (2).

45 See Nasdaq Proposed Rule Change, supra note 18.

a covered security as defined in Rule 146(b).[46] Given these proposed revisions to the NCM's initial and continued listing standards for secondary classes of common stock and preferred stocks, the Commission preliminarily believes it could find that such standards are substantially similar to those of Nasdaq's NGM.

The Commission requests comment on whether the NCM secondary classes of common stock and preferred stock rules are "substantially similar" to Nasdaq/NGM's rules.

C. Convertible Debt

The Commission has compared the NCM listing standards for convertible debt to Amex's listing standards for debt.[47] The Commission preliminarily does not believe that Nasdaq's standards are substantially similar to Amex's standards. Although the NCM's initial listing standards require a higher level of principal amount outstanding (the NCM standards require $10 million versus $5 million for Amex), Amex also requires that either (i) the issuer of the debt security (or an issuer that controls or is under common control with such issuer or that has guaranteed such issuer's debt) have equity securities listed on Amex, the NYSE, or Nasdaq/NGM, or (ii) that the debt security have a certain level of rating.[48]

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46 Id.

47 See generally Nasdaq Rule 4310(c)(5) and Sections 104 and 1003 of the Amex Company Guide.

48 See Section 104 of the Amex Company Guide and Nasdaq Rule 4310(c)(5). Amex also will generally not list a convertible bond or debenture unless current last sale information is available in the United States, with respect to the underlying security into which the bond or debenture is convertible. Further, Amex will not list a convertible debt issue containing a provision permitting an issuer discretion to reduce the conversion price unless the issuer establishes a minimum 10-day period within which such price reduction will be in effect. See Section 104 of the Amex Company Guide. The Commission preliminarily

Specifically, Amex will not list a debt security unless one of the following conditions is met: (i) the issuer of the debt security also has equity securities listed on Amex, the NYSE, or Nasdaq/NGM; (ii) an issuer of equity securities listed on Amex, the NYSE, or Nasdaq/NGM directly or indirectly owns a majority interest in, or is under common control with, the issuer of the debt security; (iii) an issuer of equity securities listed on Amex, the NYSE, or Nasdaq/NGM has guaranteed the debt security; (iv) a nationally recognized securities rating organization (an "NRSRO") has assigned a current rating to the debt security that is no lower than an S&P Corporation "B" rating or equivalent rating by another NRSRO; or (v) if no NRSRO has assigned a rating to the issue, an NRSRO has currently assigned an investment grade rating to an immediately senior issue or a rating that is no lower than an S&P Corporation "B" rating, or an equivalent rating by another NRSRO, to a pari passu or junior issue.[49] This requirement is designed to ensure that the issuer (or guarantor) of a debt security listed on Amex is in reasonably sound financial condition, while also providing Amex with considerable flexibility in determining which debt issues qualify for listing on the Exchange.[50] The Commission preliminarily believes that the absence of these provisions would make the NCM's initial listing standards for debt securities not substantially similar to those of Amex.

Nasdaq has filed a proposed rule change to adopt a debt rating provision similar to

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believes that these provisions are not material to its determination. See Securities Act Releases No. 7494, supra note 15 (the Commission found PCX listing standards to be substantially similar to Amex even with the absence of these provisions).

49 See Section 104 of the Amex Company Guide.

50 See Securities Exchange Act Release No. 7422, supra note15.

Amex's provision to make its NCM initial listing standards more comparable to Amex's initial listing standards.[51] In light of this proposal, the Commission preliminarily believes it could find that the NCM's listing standards for convertible debt are substantially similar to those of Amex.

The Commission preliminarily believes that the continued listing requirements for convertible debt securities listed on the NCM are substantially similar to the Amex requirements. The NCM requires that the principal amount outstanding be maintained at $5 million.[52] Amex generally will delist a bond if the aggregate market value or the principal amount of the bond publicly held is less than $400,000, or if the issuer is not able to meet its obligations on the listed debt.[53] Although not identical, the Commission preliminarily believes that both standards are designed to ensure the continued liquidity of the debt security, and are substantially similar.

The Commission requests comment on whether the NCM convertible debt listing rules are "substantially similar" to Amex's listing standards for debt securities.

D. Warrants

The Commission has compared the NCM's standards for warrants to Nasdaq's NGM standards, and preliminarily believes that the NCM standards are not substantially similar to the Nasdaq/NGM standards. The NCM initial listing standards require that

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51 See Nasdaq Proposed Rule Change, supra note18.

52 See Nasdaq Rule 4310(c)(5).

53 See Section 1003(b)(iv) of the Amex Company Guide. Section 1003(e) of the Amex Company Guide states that convertible bonds will be reviewed when the underlying security is delisted and will be delisted when the underlying security is no longer the subject of real-time reporting in the United States. The Commission does not believe that this is material because although Nasdaq does not have an identical rule, it does have the discretion to delist beyond its standards.

100,000 warrants be outstanding for initial listing, whereas Nasdaq/NGM requires that there be 450,000 warrants outstanding.[54] Further, the NCM standards require the issuer's underlying security to be traded on Nasdaq/NGM, NCM, GSM or any national securities exchange.[55] Nasdaq therefore allows the underlying security to be traded on markets that the Commission has not determined to be substantially similar to Amex, the NYSE, or Nasdaq/NGM under Rule 146(b).[56] In addition, the NCM does not have any continuing maintenance standards for warrants whereas Nasdaq/NGM requires that the underlying security of the issuer must continue to be listed on Nasdaq/NGM.[57]

Nasdaq has filed a proposed rule change with the Commission to increase the required number of warrants outstanding for initial listing on the NCM from 100,000 to 400,000.[58] Nasdaq's proposal also would require for initial listing that the security underlying the warrant that is to be listed on the NCM be a covered security as defined in Rule 146(b) (if it is listed on a market other than Nasdaq).[59] Further, Nasdaq would require that the security of the issuer underlying the warrant continue to be listed on Nasdaq or be a covered security as defined in Rule 146(b).[60] Given these proposed revisions to the NCM's warrant listing standards, the Commission preliminarily believes it could find the NCM's listing standards for warrants to be substantially similar to those

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54 See Nasdaq Rules 4310(c)(9)(A) - (B) and 4420(d).

55 See Nasdaq Rule 4310(c)(9)(A) - (B).

56 In contrast, Nasdaq's NGM standards require the issuer of the warrant to meet its common stock "price and earnings" listing requirements. See Nasdaq Rule 4420(d).

57 See Nasdaq Rule 4450(d).

58 See Nasdaq Proposed Rule Change, supra note 18.

59 Id.

60 Id.

of Nasdaq/NGM.

The Commission requests comment on whether the NCM's listing rules for warrants are "substantially similar" to Nasdaq/NGM's listing rules

E. Index Warrants

For index warrants traded on the NCM, Nasdaq has adopted the same standards (both initial and continuing) that it applies to index warrants traded on the Nasdaq/NGM market.[61] Therefore, the Commission preliminarily believes that the listing standards for index warrants traded on the NCM are substantially similar to the standards applicable to index warrants traded on the Nasdaq/NGM market.

F. Units

The NCM, Amex, and Nasdaq/NGM all evaluate the initial and continued listing of a unit by looking to its components.[62] If all of the components of a unit individually meet the standards for listing, then the unit would meet the standards for listing.[63] The Commission preliminarily believes that it would be able to make a finding that the NCM listing standards for units are substantially similar to a Named Market in light of Nasdaq's proposed revisions to its NCM's listing standards for the different categories of securities that could make up the components of a unit, as discussed above.[64]

G. Other Changes

Sections (b)(1) and (b)(2) of Rule 146 use the term "Nasdaq/NMS" to refer to the

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61 See generally Nasdaq Rule 4310(c)(9)(C).

62 A unit is a type of security consisting of two or more different types of securities (e.g., a combination of common stocks and warrants). See Securities Exchange Act Release No. 48464 (September 9, 2003), 68 FR 54250 (September 16, 2003).

63 See generally Section 101(g) of the Amex Company Guide and Nasdaq Rules 4310(c)(10) and 4420(h)(1)(a) – (c).

64 See Nasdaq Proposed Rule Change, supra note 18.

National Market System of The NASDAQ Stock Market LLC. In addition, Rule 146(b)(1)(i) refers to the Pacific Exchange Incorporated, Rule 146(b)(1)(ii) refers to the Philadelphia Stock Exchange, Incorporated, and Rule 146(b)(1)(iv) refers to the International Securities Exchange, Incorporated. As noted above, on July 1, 2006, what was the National Market System of The NASDAQ Stock Market LLC became known as the Nasdaq Global Market.[65] Further, in April 2006, the Pacific Exchange, Incorporated was renamed NYSE Arca, Inc.,[66] and in September 2006, the International Securities Exchange, Incorporated was renamed the International Securities Exchange, LLC. The proposed rule change includes changes to Rule 146(b) to account for these name changes. Finally, the proposal includes a change to reflect the legal name of the Philadelphia Stock Exchange, Inc.

H. Comments

The Commission has received three comment letters on Nasdaq's petition.[67] The State Regulation of Securities Committee of the American Bar Association Section of Business Law ("ABA Committee") expressed support of the petition, assuming that Nasdaq's representation of the data and analysis contained in the petition is accurate.[68] The North American Securities Administrator's Association ("NASAA"), stated that it does not oppose the Nasdaq petition but is concerned generally about what it perceives to

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65 The NGM includes a new segment known as the Nasdaq Global Select Market. See Securities Exchange Act Release Nos. 53799 and 54071, supra note 1.

66 See Securities Exchange Act Release No. 53615 (April 7, 2006), 71 FR 19226 (April 13, 2006).

67 See File No. 4 - 513, supra note 8.

68 See letter to Nancy M. Morris, Secretary, Commission, from Alan M. Parness, Vice Chair, ABA Committee, dated April 3, 2006.

be deficiencies in listing standards at several of the Named Markets and encourages the Commission to undertake an SRO oversight initiative to set uniform principles for these Named Markets.[69]

IV. Solicitation of Comments

The Commission seeks comment generally on the desirability of amending Rule 146(b) to include securities of the NCM. As discussed above, based on its review of Nasdaq's listing rules for its NCM, the Commission preliminarily believes that the current original and continued listing standards for the NCM are not substantially similar to those of the Amex, the NYSE, or Nasdaq/NGM. The Commission seeks comments on its preliminary analysis. The Commission also seeks comments on whether the proposed changes to its NCM standards that Nasdaq has filed would make the NCM's initial listing and continued listing standards substantially similar to those of a Named Market.

In addition, if the NCM securities are designated as covered securities under Rule 146(b)(1), then the NCM's listing standards would be subject to Rule 146(b)(2) under the Securities Act. Rule 146(b)(2) conditions the designation of securities as "covered securities" under Rule 146(b)(1) on the identified exchange's listing standards continuing to be substantially similar to those of the Named Markets. Thus, under Rule 146(b)(2), the designation of certain securities as covered securities would be conditioned on

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69 See letter to Nancy M. Morris, Secretary, Commission, from Patricia D. Struck, NASAA President and Wisconsin Securities Administrator, dated March 29, 2006; and electronic mail to Robert L.D. Colby, Acting Director, Division, Commission, from Randall Schumann, Legal Counsel, Wisconsin DFI-Division of Securities, NASAA Corporation Finance Section Member, dated June 1, 2006. In addition, the Commission's Advisory Committee on Smaller Public Companies recommended on April 23, 2006 that the Commission make NCM stocks "covered securities." SEC Advisory Committee on Smaller Public Companies, Final Report, at 97-100 (2006).

Nasdaq maintaining listing standards for NCM securities that were found to be substantially similar to those of the Named Markets. Commenters may wish to address the application and effect of Rule 146(b)(2) on the proposal.

The Commission also invites commenters to provide views and data as to the costs, benefits, and effects associated with the proposed amendments. In addition to the questions posed above, commenters are welcome to offer their views on any other matter raised by the proposed amendment to Rule 146(b). Finally, the Commission requests comment on whether it could use a different methodology to determine whether the NCM's listing standards are "substantially similar" to the Named Markets.

V. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 does not apply because the proposed amendment to Rule 146(b) does not impose recordkeeping or information collection requirements or other collection of information, which require the approval of the Office of Management and Budget under 44 U.S.C. 3501 et seq.

VI. Cost and Benefits of Proposed Rulemaking

Congress amended Section 18 of the Securities Act to exempt covered securities from state registration requirements. These securities are listed on the Named Markets or any other national securities exchange determined by the Commission to have substantially similar listing standards to the Named Markets.[70] Consistent with statutory authority, the Commission proposes to determine (if the Commission were to approve the rule changes that Nasdaq has filed) that the listing standards for securities listed on the NCM are substantially similar to those of either Amex, the NYSE, or Nasdaq/NGM.

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[70] 15 U.S.C. 77r(b)(1)(B).

Securities listed on the NCM therefore would be covered securities subject only to federal regulation.

By exempting securities listed on the NCM from state law registration requirements, the Commission expects that the listing process for those securities would become easier as one layer of regulation is eliminated. Moreover, the Commission also expects adoption of the rule would reduce the administrative burden the issuers of covered securities face inasmuch as compliance with state blue sky law requirements would be preempted.[71]

The Commission also preliminarily believes that the proposed amendment to Rule 146(b) should permit Nasdaq to compete with other markets whose listed securities are exempt from state law registration requirements for new securities products and listings. This result would likely enhance competition and, potentially, liquidity, thus benefiting market participants and the public. The proposed amendment would eliminate state registration of securities listed on the NCM. There may be a cost to investors through the loss of benefits of state registration and oversight, although the cost is difficult to quantify. The Commission believes that Congress contemplated these costs in relation to the economic benefits of exempting covered securities from state regulation. The Commission, however, is considering the costs and benefits of the proposed amendment to Rule 146(b) and requests commenters to provide views and supporting information as to the costs and benefits associated with this proposal.

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71 A 1996 Report relating to Securities Market Reform: State Registration of Securities – Costs and Benefits stated that up to 1 percent of an issue's cost, which is generally covered by the offering's underwriter, could be apportioned to the legal/administrative costs of state level regulation. One benefit of this proposal would be to eliminate this type of legal/administrative cost with respect to NCM securities.

VII. Consideration of Promotion of Efficiency, Competition, and Capital Formation

As required under the Securities Act,[72] the Commission has preliminarily considered the proposed rule's impact on efficiency, competition, and capital formation. National securities exchanges compete for the listing of securities. Thus, the Commission preliminarily believes that amending Rule 146(b) to designate securities traded on the NCM as covered securities (if the Commission were to approve the rule changes that Nasdaq has filed) would offer potential benefits for investors because it would facilitate the ability of Nasdaq to compete for listings, which should increase competition and enhance the overall liquidity, and thus the efficiency of the U.S. securities markets. The Commission also preliminarily believes that the proposed rule would serve to reduce the cost of raising capital because it would streamline the registration process for issuers listing on the NCM. In addition, the Commission believes that the proposed rule amendment, consistent with Congressional action, is designed to promote efficiency by removing a layer of duplicative regulation. The Commission also preliminarily believes that the proposed amendment to Rule 146(b) should permit Nasdaq to compete with other markets whose securities are exempt from state law registration requirements for new securities products and listings. Finally, the proposed amendment to Rule 146(b) should not impair efficiency, competition, and capital formation because it would impose no recordkeeping or compliance burdens, but would provide a limited purpose exemption under the federal securities laws.

Thus, the Commission preliminarily believes that the proposed amendment to Rule 146(b) would promote efficiency, competition, and capital formation. Commenters

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72 15 U.S.C. 77b(b).

should consider the proposed amendment's effect on efficiency, competition, and capital formation.

VIII. Regulatory Flexibility Act Certification

Section 603(a) of the Regulatory Flexibility Act[73] requires the Commission to undertake an initial regulatory flexibility analysis of the proposed amendment to Rule 146 on small entities, unless the Commission certifies that the proposed amendment, if adopted, would not have a significant economic impact on a substantial number of small entities.[74] For purposes of Commission rulemaking in connection the Regulatory Flexibility Act, an issuer is a small business if its "total assets on the last day of its most recent fiscal year were $5 million or less."[75] An exchange is a small business if it has been exempt from the reporting requirements of Rule 601[76] and it is not affiliated with any person other than a natural person that is not a small business.[77]

The Commission believes that the proposal to amend Rule 146(b) would not affect a substantial number of small entities because to list its securities on the NCM, an issuer's aggregate market value of publicly held shares must be at least $5 million.[78] If an entity's market value of publicly held shares is at least $5 million, it is reasonable to believe that its assets are worth at least $5 million. Therefore, an entity seeking to list securities on the NCM generally will have assets with a market value of at least equal to

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73 5 U.S.C. 603(a).

74 5 U.S.C. 605(b).

75 17 CFR 230.157. See also 17 CFR 240.0-10(a).

76 17 CFR 242.601 (formerly Rule 11Aa3-1 under the Act).

77 17 CFR 240.0-10(e).

78 As of June 30, 2006, the Division estimates that there were 557 listed issuers of securities on the NCM.

$5 million and thus would not be considered a small entity. Further, Nasdaq itself is not a small entity for purposes of the RFA.[79]

Accordingly, the Commission hereby certifies, pursuant to Section 605(b) of the Regulatory Flexibility Act,[80] that amending Rule 146(b) as proposed would not have a significant economic impact on a substantial number of small entities. The Commission encourages written comments regarding this certification. The Commission solicits comment as to whether the proposed amendment to Rule 146(b) could have an effect that has not been considered. The Commission requests that commenters describe the nature of any impact on small entities and provide empirical data to support the extent of such impact.

IX. Small Business Regulatory Enforcement Fairness Act of 1996

For purposes of the Small Business Enforcement Fairness Act of 1996, a rule is "major" if it results or is likely to result in:

(i) an annual effect on the economy of $100 million or more;

(ii) a major increase in costs or prices for consumers or individual industries; or

(iii) significant adverse effects on competition, investment, or innovation.[81]

The Commission requests comment regarding the potential impact of the proposed amendment on the economy on an annual basis. Commenters should provide empirical data to support their views to the extent possible.

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79 17 CFR 240.0-10(e).

80 5 U.S.C. 605(b).

81 Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C., and as a note to 5 U.S.C. 601).

X. Statutory Authority

The Commission is proposing an amendment to Rule 146 pursuant to the Securities Act of 1933,[82] particularly Sections 18(b)(1)(B) and 19(a).[83]

Text of the Proposed Rule

List of Subjects in 17 CFR Part 230

Securities.

For the reasons set forth in the preamble, Title 17, Chapter II of the Code of Federal Regulations is proposed to be amended as follows:

PART 230 – GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933

1. The general authority citation for Part 230 is revised to read as follows:

Authority: 15 U.S.C. 77b, 77c, 77d, 77f, 77g, 77h, 77j, 77r, 77s, 77z-3, 77sss, 78c, 78d, 78j, 78l, 78m, 78n, 78o, 78t, 78w, 78ll(d), 78mm, 80a-8, 80a-24, 80a-28, 80a-29, 80a-30, and 80a-37, unless otherwise noted.

* * * * *

2. Section 230.146 is amended by revising paragraphs (b)(1) and (b)(2) to read as follows:

§ 230.146 Rules under Section 18 of the Act.

* * * * *

(b) * * *

(1) For purposes of Section 18(b) of the Act (15 U.S.C. 77r), the Commission finds that the following national securities exchanges, or segments or tiers thereof, have

[82] 15 U.S.C. 77a et seq.

[83] 15 U.S.C. 77r(b)(1)(B) and 77s(a).

listing standards that are substantially similar to those of the New York Stock Exchange ("NYSE"), the American Stock Exchange ("Amex"), or the National Market System of the Nasdaq Stock Market ("Nasdaq/NGM"), and that securities listed on such exchanges shall be deemed covered securities:

(i) Tier I of the NYSE Arca, Inc.;

(ii) Tier I of the Philadelphia Stock Exchange, Inc.;

(iii) The Chicago Board Options Exchange, Incorporated;

(iv) Options listed on the International Securities Exchange, LLC; and

(v) The Nasdaq National Capital Market.

(2) The designation of securities in paragraphs (b)(1)(i) through (v) of this section as covered securities is conditioned on such exchanges' listing standards (or segments or tiers thereof) continuing to be substantially similar to those of the NYSE, Amex, or Nasdaq/NGM.

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

November 16, 2006

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 8753 / November 16, 2006

SECURITIES EXCHANGE ACT OF 1934
Release No. 54764 / November 16, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12476

In the Matter of HARTFORD INVESTMENT FINANCIAL SERVICES, LLC, HL INVESTMENT ADVISORS, LLC, AND HARTFORD SECURITIES DISTRIBUTION COMPANY, INC., Respondents.	ORDER UNDER SECTION 27A(b) OF THE SECURITIES ACT OF 1933, AND SECTION 21E(b) OF THE SECURITIES EXCHANGE ACT OF 1934, GRANTING WAIVERS OF THE DISQUALIFICATION PROVISIONS OF SECTION 27A(b)(1)(A)(ii) OF THE SECURITIES ACT OF 1933 AND SECTION 21E(B)(1)(A)(ii) OF THE SECURITIES EXCHANGE ACT OF 1934

Hartford Investment Financial Services, LLC ("Hartford Investment"), HL Investment Advisors LLC ("HL Advisors") and Hartford Securities Distribution Company, Inc. ("Hartford Distribution") (together, "the Respondents") submitted a letter on behalf of the Respondents and their affiliates, dated March 16, 2006 requesting a waiver of the disqualification provisions of Section 27A(b)(1)(A)(ii) of the Securities Act of 1933 ("Securities Act") and Section 21E(B)(1)(A)(ii) of the Securities Exchange Act of 1934 ("Exchange Act") arising from the settlement of a cease-and-desist and administrative proceeding commenced by the Commission. On November 8, 2006, 2006, pursuant to the Respondents' Offer of Settlement, the Commission instituted an Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933, Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940 and Section 9(b) and 9(f) of the Investment Company Act of 1940 ("Order") against the Respondents.

The Order censures the Respondents and finds that (1) Hartford Investment willfully violated Sections 17(a)(2) and 17(a)(3) of the Securities Act, Section 206(2) of the Investment Advisers Act of 1940 ("Advisers Act") and Section 34(b) of the Investment

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Company Act of 1940 ("Investment Company Act"); (2) HL Advisers willfully violated Sections 17(a)(2) and 17(a)(3) of the Securities Act, Section 206(2) of the Advisers Act and Section 34(b) of the Investment Company Act; and (3) Hartford Distribution caused and willfully aided and abetted violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act and Section 206(2) of the Advisers Act. The Order also requires (1) Hartford Investment and HL Advisers to cease and desist from committing or causing any violations or any future violations of 17(a)(2) and 17(a)(3) of the Securities Act, Section 206(2) of the Advisers Act and Section 34(b) of the Investment Company Act; (2) Hartford Distribution to cease and desist from committing or causing any violations or any future violation of Sections 17(a)(2) and 17(a)(3) of the Securities Act and cease and desist from causing any violations or any future violations of Section 206 (2) of the Advisers Act; (3) the Respondents to pay, jointly and severally, $40 million in disgorgement and $15 million in civil penalties, all of which shall be distributed to the affected Hartford Funds; and (4) the Respondents to comply with certain undertakings.

The safe harbor provisions of Section 27A(c) of the Securities Act and Section 21E(c) of the Exchange Act are not available for any forward looking statement that is "made with respect to the business or operations of the issuer, if the issuer...during the 3-year period preceding the date on which the statement was first made...has been made the subject of a judicial or administrative decree or order arising out of a government action that (I) prohibits future violations of the antifraud provisions of the securities laws; (II) requires that the issuer cease and desist from violating the antifraud provisions of the securities laws; or (III) determined that the issuer violated the antifraud provisions of the securities laws[.]" Section 27A(b)(1)(A)(ii) of the Securities Act; Section 21E(B)(1)(A)(ii) of the Exchange Act. The disqualifications may be waived "to the extent otherwise provided by rule, regulation or order of the Commission." 27A(b) of the Securities Act; Section 21E(B) of the Exchange Act.

Based on the representations set forth in the Respondents' March 16, 2006 request letter, the Commission has determined that, under the circumstances, the request for a waiver of the disqualifications resulting from the entry of the Order is appropriate and should be granted.

Accordingly, **IT IS ORDERED**, pursuant to Section 27A(b) of the Securities Act and 21E(B) of the Exchange Act, that a waiver from the disqualification provisions of Section 27A(b)(1)(A)(ii) of the Securities Act and Section 21E(B)(1)(A)(ii) of the Exchange Act as to the Respondents and their affiliates resulting from the entry of the Order is hereby granted.

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

Commissioner Nazareth
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 8755 / November 17, 2006

SECURITIES EXCHANGE ACT OF 1934
Release No. 54776 / November 17, 2006

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2516 / November 17, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12481

In the Matter of **BRUCE M. PERRY** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against Bruce M. Perry ("Perry").

II.

In anticipation of the institution of these proceedings, Perry has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Perry consents to the entry of this Order Instituting Cease-and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934 ("Order"), as set forth below.

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III.

On the basis of this Order and Perry's Offer, the Commission finds[1] that:

Perry

1. Bruce M. Perry, age 60, served as chief executive officer of Mount Sinai Medical Center, Inc., from January 1999 through October 2001. Mount Sinai terminated Perry on October 8, 2001.

Mount Sinai's 2001 Bond Offering

2. Mount Sinai is a not-for-profit corporation located in Miami Beach, Florida, which operates a multi-campus hospital, including a 701-bed, teaching and research hospital and various satellite outpatient facilities and physician offices.

3. On May 24, 2001, Mount Sinai, through the City of Miami Beach Health Facilities Authority (the "Authority"), issued three series of municipal bonds (Series 2001A, Series 2001B and Series 2001C) totaling approximately $184 million (the "2001 Bonds"). The purpose of the issuance was primarily to re-finance Mount Sinai's acquisition of the Miami Heart Institute and Medical Center, purchased by Mount Sinai in June 2000. The 2001 Bonds were limited obligations of the Authority payable solely from payments made by Mount Sinai pursuant to a loan agreement between Mount Sinai and the Authority. The bonds were rated "BBB," "Baa3," and "BBB+" by Standard & Poor's, Moody's Investors Service, Inc. and Fitch, Inc., respectively.

4. The Official Statements to the bond offerings contained Mount Sinai's audited financial statements for the years 1999 and 2000. The Official Statements also included Mount Sinai's forecasted financial statements, as of March 30, 2001, for the years 2001 through 2003. The forecasted financial statements projected operating losses totaling $7.5 million for fiscal year 2001, losses totaling $2.6 million for fiscal year 2002, and operating income of $2.5 million for fiscal year 2003.

5. The Official Statements contained an anti-fraud certificate, signed by Perry as CEO, that certified on behalf of Mount Sinai: (i) the statements and information contained in the Official Statement were true, correct and complete in all material respects; (ii) the Official Statement did not contain any untrue or incorrect statements or omissions of material fact; and (iii) Mount Sinai's financial condition had not materially or adversely changed since December 31, 2000.

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[1] The findings herein are made pursuant to Respondent's Offer and are not binding on any other person or entity in this or any other proceeding.

6. In addition, the Official Statements contained another certificate, executed by Mount Sinai's chief financial officer ("CFO"), in which he certified to Mount Sinai's bond counsel that the Official Statements did not contain any untrue statements or omissions of a material fact.

7. The terms of the bond covenants required Mount Sinai to file quarterly reports with various repositories, which would then be available for review by existing and prospective investors. Accordingly, on August 24, 2001, Mount Sinai filed its second-quarter report for the quarter ended June 30, 2001. The second-quarter report was signed by Mt. Sinai's CFO.

Misrepresentations and Omissions in the Official Statement

8. Mount Sinai, through Perry and other former senior management, failed to disclose the hospital's deteriorating financial condition at the time of the offering. Specifically, Mount Sinai failed to disclose in the Official Statements that the hospital was experiencing a significant deterioration in its cash position and was in the midst of a severe liquidity problem. Indeed, Mount Sinai's financial condition began to materially decline after it underwent a computer conversion in December 2000 to update its patient accounting system within its business office. The computer conversion gave rise to major problems that substantially impacted Mount Sinai's billing and collection process. For example, Mount Sinai experienced substantial delays in billings and a significant rise in failed billings to third-party payors. In addition, the hospital's patient accounts receivable grew substantially -- increasing from approximately $70 million at the end of December 2000 to more than $90 million by June 30, 2001. As a direct result of its billing and collections problems, Mount Sinai's cash position began to materially worsen after December 2000, and continued to worsen through at least the time of the issuance of the 2001 Bonds in May.

9. In addition, Mount Sinai, at the direction of Perry and other former senior management, represented in the Official Statements that eight of the hospital's high-volume managed care contracts had been renegotiated, and that the renegotiated contracts were expected to contribute approximately $10 million of additional revenue to the hospital on an annual basis beginning in 2001. In fact, at the time of the issuance of the 2001 bonds, only three of the eight major contracts had actually been renegotiated.

10. Moreover, the financial statements forecasting the hospital's anticipated revenue through the end of 2003, which were included in the Official Statements, were misleading. The forecasted financial statements projected operating losses for 2001 and 2002 totaling $7.5 million and $2.6 million, respectively, and a relatively small surplus in 2003. The forecasted financials included net patient service revenue and accounts receivable projections that were calculated using Mount Sinai's 2001 contractual deduction rate.[2] That contractual

[2] Contractual deductions are an estimate of the deductions that the hospital expects will not be paid based on contracts or other arrangements with its third-party payors. Mount Sinai recorded net patient service revenue based

deduction rate, however, was based on the false notion that Mount Sinai had renegotiated all of its eight largest managed care contracts.

11. Given the facts known by Perry and other Mount Sinai former senior managers, the representations made by Perry and the CFO in the anti-fraud certificates accompanying the Official Statements were false and misleading. The representations in the anti-fraud certificates that the Official Statements did not contain any untrue statements or omissions of a material fact, and that Mount Sinai's financial condition had not materially or adversely changed since fiscal year 2000, were contradicted by Mount Sinai's deteriorating financial situation, the actual situations with the renegotiation of the managed care contracts, and the inaccurate projections included in the forecasted financial statements.

False and Misleading Statements to
<u>Institutional Investors and Bond Rating Agencies</u>

12. During a presentation given to prospective institutional bond investors on April 30, 2001, Mount Sinai represented that it had been successful in renegotiating all eight of its largest managed care contracts and that the renegotiated rates would result in a $10 million improvement to revenue beginning in 2001. In fact, as mentioned above, only three of the contracts had been renegotiated. Mount Sinai also provided institutional investors with baseless projections concerning the hospital's net patient service revenue and accounts receivable. Mount Sinai, through Perry and other former senior management, was aware that Mount Sinai's cash position had materially declined prior to the bond offering, and that the cash situation at the hospital continued to be a major concern up until the date of the bond offering. Perry and others nevertheless failed to disclose this cash crisis or update the hospital's financial information. To the contrary, Perry certified that Mount Sinai's financial condition had not materially or adversely changed since December 31, 2000. Mount Sinai's CFO also falsely certified to bond counsel that the Official Statement did not contain any untrue statements or omissions of a material fact. In light of the severe cash crisis and growing accounts receivable problem that Perry and others knew the hospital was experiencing before the bond offering, these certifications were plainly false.

13. In March and April 2001, Mount Sinai, through Perry and other former senior management, gave similar presentations to certain bond rating agencies during which Mount Sinai again represented that it had renegotiated all eight of its largest managed care contracts, resulting in an annual improvement in revenues of $10 million.

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on a percentage that reflected the average of all of the hospital's contractual deductions with its third-party payors. This percentage is called the "contractual deduction rate."

Misrepresentations and Omissions in Mount Sinai's Second-
<u>Quarter Report for the Period Ended June 30, 2001</u>

14. Mount Sinai's second-quarter report for the period ending June 30, 2001 reflected a $5 million write-off in accounts receivable Mount Sinai recorded in June 2001. Although the second-quarter report discussed the $5 million write-off, Mount Sinai failed to adequately disclose in the report the circumstances requiring the write-off. By the time of the filing of the second-quarter report, Perry and other senior management at Mount Sinai knew that the managed care contracts had not been renegotiated and that Mount Sinai may have been using a contractual deduction rate for recording net patient service revenue that was too low. Mount Sinai nevertheless failed to disclose this information to investors in its second-quarter report.

15. Mount Sinai also failed to disclose in the second-quarter report that by the time of the filing of that report, Perry and other senior management knew additional write-offs of accounts receivable would be necessary, and that those write-offs could be as high as $20 million. Mount Sinai ultimately recorded a $21 million reduction in net patient service revenue and accounts receivable in September 2001, which was mostly the result of the improper contractual deduction rate used by Mount Sinai for the first nine months of 2001.

16. Additionally, Mount Sinai failed to disclose in the second quarterly report that, at the time of its filing, Mount Sinai continued to struggle with its cash flow situation. Finally, the report failed to disclose the fact that an accounting firm began running Mount Sinai's business office because of the problems with its billing and collection process.

<u>Violations</u>

17. As a result of the conduct described above, Perry violated, and caused Mount Sinai's violations of, Section 17(a) of the Securities Act, which prohibits fraudulent conduct in the offer or sale of securities.

18. As a result of the conduct described above, Perry violated, and caused Mount Sinai's violations of, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in connection with the purchase or sale of securities.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Perry's Offer.

Accordingly, it is hereby ORDERED that:

A. Perry cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940
Release No. 27558 / November 20, 2006

In the Matter of

INVESTMENT TECHNOLOGY GROUP, INC.
380 Madison Avenue, 4th Floor
New York, NY 10017

(812-13191)

ORDER PURSUANT TO SECTION 9(c) OF THE INVESTMENT COMPANY ACT OF 1940 GRANTING A PERMANENT EXEMPTION FROM SECTION 9(a) OF THE ACT

Investment Technology Group, Inc. ("ITG") filed an application on May 24, 2005 and an amendment to the application on June 23, 2006, requesting a permanent order under section 9(c) of the Investment Company Act of 1940 ("Act") exempting ITG and any other company of which ITG is or hereafter becomes an affiliated person (together with ITG, "Covered Persons") from section 9(a) of the Act with respect to an injunction entered by the U.S. District Court for the Southern District of New York on March 19, 1987 ("Injunction"). The requested order would not extend to Jefferies Group, Inc. or any person of which Jefferies Group, Inc. is or becomes an affiliated person.

On October 23, 2006, the Commission issued a notice of the application (Investment Company Act Release No. 27521). The notice gave interested persons an opportunity to request a hearing and stated that an order disposing of the application would be issued unless a hearing was ordered. No request for a hearing has been filed, and the Commission has not ordered a hearing.

The matter has been considered and it is found that the conduct of ITG has been such as not to make it against the public interest or protection of investors to grant the permanent exemption from the provisions of section 9(a) of the Act and that the prohibition of section 9(a) as applied to ITG would be unduly and disproportionately severe.

Accordingly,

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IT IS ORDERED, pursuant to section 9(c) of the Act, on the basis of the representations contained in the application, as amended, that Covered Persons be and hereby are permanently exempted from the provisions of section 9(a) of the Act, operative solely as a result of the Injunction described in the application (File No. 812-13191).

By the Commission.

Nancy M. Morris
Secretary

UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940
Release No. 27561 / November 20, 2006

In the Matter of

INTEGRATED ARROs FUND I, ET AL.
c/o Ms. Barbara Leary
Winthrop Management LLC
7 Bullfinch Place, Suite 500
Boston, MA 02114

(812-13309)

ORDER UNDER SECTION 38(a) OF THE INVESTMENT COMPANY ACT OF 1940
RESCINDING A PRIOR ORDER

Integrated ARROs Fund I, Integrated ARROs Fund II and IR Pass-through Corporation filed an application on June 23, 2006 requesting an order under Section 38(a) of the Act rescinding a prior order issued in Investment Company Act Release No. 15693 (Apr. 21, 1987) ("Prior Order").

On October 23, 2006, a notice of the filing of the application was issued (Investment Company Act Release No. 27522). The notice gave interested persons an opportunity to request a hearing and stated that an order disposing of the application would be issued unless a hearing was ordered. No request for a hearing has been filed, and the Commission has not ordered a hearing.

The matter has been considered and it is found that the granting of an order rescinding the Prior Order is necessary and appropriate to the exercise of the powers conferred upon the Commission in the Act.

Accordingly,

IT IS ORDERED, under Section 38(a) of the Act, that the Prior Order is hereby rescinded.

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

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Commissioner Casey
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 8756 / November 21, 2006

SECURITIES EXCHANGE ACT OF 1934
Release No. 54806 / November 21, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12484

In the Matter of	ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934
BEAR, STEARNS & CO. INC.,	
Respondent.	

I.

The Securities and Exchange Commission (the "Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Bear, Stearns & Co. Inc. ("Bear Stearns," the "Firm," or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933 and Section 15(b) of the Securities Exchange Act of 1934, as set forth below.

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III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

A. Respondent

Respondent Bear Stearns, a subsidiary of The Bear Stearns Companies Inc., is a worldwide investment bank and broker-dealer with its principal place of business in New York. In addition to its institutional sales force, Bear Stearns employs salespersons in its Private Client Services division ("PCS") who service individual and small institutional accounts. Bear Stearns is registered as a broker-dealer with the Commission pursuant to Section 15(b) of the Exchange Act and is a member of the NASD and the New York Stock Exchange ("NYSE").

B. Summary

In 2002 and 2003, Bear Stearns violated Section 5 of the Securities Act when five of its salespersons sent customers unauthorized e-mails and faxes that contained sales materials concerning securities offerings during the period after a registration statement had been filed, but before the Commission had declared the registration statement effective ("quiet period"). At the time of this conduct, the securities laws prohibited issuers and their underwriters from making written offers of securities during quiet periods in a form other than the prospectus.[1] In all, the five Bear Stearns salespersons collectively sent approximately ninety e-mails and faxes in violation of Section 5 of the Securities Act.

Bear Stearns also failed reasonably to supervise its employees with a view to preventing and detecting these violations. While Bear Stearns had policies in place during the relevant period requiring pre-approval and post-transmission review of electronic communications, the Firm failed to effectively implement these policies. None of the violative e-mails discussed below was reviewed by a supervisor before being sent to customers. Further, Bear Stearns' policy of reviewing e-mail after transmission, which called for the review of all outgoing e-mail, could not reasonably have been expected to detect or prevent the violative communications, given the volume of e-mails requiring review. Consequently, Bear Stearns failed to prevent or detect most of the violative e-mails discussed below at the time they were transmitted, including dozens of e-mails that described offerings as attractive investment opportunities, without identifying any risk factors, and e-mails that attached "internal use only" sales memoranda. Through its failure to effectively implement its own policies and procedures, Bear Stearns did not reasonably supervise its employees with a view to preventing and detecting its salespersons' Section 5 violations described herein.

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[1] In 2005, the Commission adopted new rules under the Securities Offering Reform. *See Securities Offering Reform*, Securities Act Release No. 8591 (June 29, 2005).

C. Facts

1. Background: Bear Stearns' Policies and Procedures Regarding Its Review of Employees' Outgoing E-mails

During 2002 and 2003 (the "relevant period"), Bear Stearns' firm-wide policies and procedures required that "ALL outgoing correspondence, including letter[s], memos and handwritten notes, must be approved in advance of sending" by branch management. (Emphasis in original.) The pre-approval policy expressly applied to outgoing e-mail and transmissions via facsimile.

Firm policies, repeated in PCS branch management supervisory guides, stated that "all" outgoing correspondence must be approved by branch management "prior to sending." In particular, the management guides noted that written communications regarding securities subject to pending distributions "are not permitted" unless prepared by the Syndicate Department for external distribution, and that correspondence regarding securities sold by prospectus "may be subject to specific requirements and disclosures prior to sending."

Pursuant to these policies, Bear Stearns salespersons were prohibited from mailing any hard-copy correspondence, regardless of subject matter, without management pre-approval. With respect to electronic communications, however, Bear Stearns did not screen all e-mails prior to transmission in order to prevent unauthorized business-related correspondence. Instead, Bear Stearns provided training on the types of external e-mail that required approval, and relied upon its sales force to seek approvals when necessary.[2] Bear Stearns relied on its policies and training its staff regarding those policies, and did not evaluate the efficacy of those policies and procedures even after a December 2002 incident in Bear Stearns' San Francisco office called into question the reliability of that system.

Bear Stearns policies and procedures governing PCS branch management also provided for the review of salespersons' e-mails after they were disseminated.[3] The policies stated that "[a]ll outgoing electronic mail (e-mail) will be forwarded to the designated reviewer on the day it is transmitted," and that "such e-mail will be monitored . . . ." Pursuant to these policies, any outgoing e-mail sent by PCS salespersons during the relevant period was simultaneously copied and sent to e-mail boxes in the compliance

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2 NASD Rule 3010(d)(2) and NYSE Rule 342, in effect during the period in question, provided guidance for broker-dealers concerning compliance with the law and rules governing supervision and review of public communications. With respect to incoming and outgoing correspondence and e-mail, a broker-dealer, such as Bear Stearns, must either: (1) have a "pre-use" policy whereby public communications, such as e-mails, are reviewed before being sent to clients; or (2) sufficiently educate its employees about the Firm's communications policies and procedures, document the employees' education and training, and ensure that the Firm's policies are implemented and followed. See SEC Release Nos. 39510, 39511 (Dec. 31, 1997).

3 Although such after-the-fact review would not, of course, have prevented an initial violation, properly implemented it could have aided in the prevention of subsequent violations.

department. At times, total PCS e-mails sent on a daily basis numbered in the thousands. Faxes sent using Bear Stearns' computers were also forwarded to compliance office computers for review. Employees in the compliance offices, in turn, were responsible for reviewing all external e-mail and faxes sent by PCS salespersons.[4]

In practice, however, because of the large amounts of e-mail to be reviewed, and because Bear Stearns devoted limited resources to this task, supervisors and compliance officers did not always actually review the entire contents of all e-mails. Instead, they typically reviewed e-mail by using an "auto-preview" feature that enabled the reviewers to limit their review to the first few lines of any e-mail. Despite the large volume of outgoing e-mail, Bear Stearns did not revise its procedures, add staff, or otherwise enhance its systems to adequately review that volume of e-mail.

2. Bear Stearns Discovered Certain Violative E-Mails Shortly After They Were Transmitted

In late December 2002, two salespersons in Bear Stearns' San Francisco office sent e-mails to customers about an upcoming mutual fund offering that included sales information not contained in the prospectus. One person's e-mails attached excerpts from an investor's guide on the offering, while the second individual's e-mails included a list of "reasons" why the salesperson considered the fund an "investment worthy of consideration." Bear Stearns detected these e-mails shortly after they were disseminated and soon thereafter terminated the salespersons' employment, but took no additional action.

Nearly one year later, in late November 2003, during the course of a review of sent e-mail, Bear Stearns compliance personnel discovered that, earlier that month, three PCS salespersons in the New York office had sent a number of e-mails to customers about two upcoming initial public offerings ("IPOs") during their respective quiet periods. The e-mails contained sales information other than the statutory prospectus.

- One salesperson sent e-mails to twenty-one individuals at thirteen hedge-funds concerning the upcoming IPOs of two different issuers, one a software company and the other an information technology company, saying "both deals are going to be good." The e-mails attached six pages from the preliminary prospectus for the information technology company that described the IPO's terms and a general overview of that issuer's business and industry, but failed to describe any risk factors. The e-mails also attached an internal Bear Stearns sales force memorandum for the software company's IPO that included "key selling points," among other things, but only a partial list of risk factors. The memorandum was clearly marked "confidential" and "internal

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[4] Additionally, Bear Stearns policies limited communications during the offering period and provided that the only written material to be used to solicit indications of interest during an offering was the preliminary prospectus. Salespersons forwarding a preliminary prospectus to a client were instructed to make no comment on the securities other than to provide the expected offering date. Salespersons were provided training on these policies at the time they were hired, and periodically thereafter.

use only," and specifically said in highlighted portions on every page that it was for use "only" by Bear Stearns salespersons and that "receipt of or access to these materials by any other person is prohibited."

- A second salesperson in the New York office e-mailed the internal sales force memorandum for the software company to a prospective investor.

- A third salesperson in the same office sent an e-mail that identified the Bear Stearns analyst who would cover the software company following its IPO, and quoted the analyst's purported revenue and earnings estimates for 2003 and 2004.

Upon discovering these communications, Bear Stearns notified both issuers, and informed the individuals who received the e-mails that they would be precluded from participating in the IPOs. Bear Stearns also notified the Commission staff. Both issuers filed amendments to their registration statements that disclosed the e-mails as risk factors.

On December 1, 2003, Bear Stearns' compliance staff discovered that a fourth PCS salesperson, located in the Firm's San Francisco office, had sent e-mails to at least four customers about two upcoming notes issued and underwritten by Bear Stearns. The e-mails included personal messages in which the salesperson described the notes as an attractive investment opportunity. For example, the individual informed one customer in writing that the notes were "designed to meet the conservative but bullish stance of many of our clients," and had been "very well received by those looking to protect their investment fully but understand the need for participation" in the Nasdaq 100. Another e-mail advised a customer that the offering was "very attractive in the current tax environment."

3. Subsequent Investigations Revealed That Bear Stearns Had Failed to Discover <u>Other E-Mails Sent During Quiet Periods</u>

Following Bear Stearns' disclosure to the Commission staff concerning the e-mails, both the staff and Bear Stearns commenced investigations that ultimately revealed that these same four salespersons, and at least one additional representative in Bear Stearns' Boston office, collectively had sent dozens of additional e-mails and faxes in 2002-03 concerning certain offerings during their respective quiet periods. Despite policies and procedures that required Bear Stearns supervisors and compliance personnel to review all external communications both before and after dissemination, Bear Stearns had failed to detect all but one of these earlier violative e-mails. They included the following:

- The salesperson in the San Francisco office had sent approximately thirty-six e-mails to prospective investors in July, September, October, and November 2003 concerning two Bear Stearns-issued notes during their respective quiet periods. The e-mails typically described the offerings in favorable terms, often encouraging the recipients to invest. For example, the e-mails described the offerings as a "conservative vehicle that will render nominal but safe returns"; a "choice worth exploring"; "a gift"; an "attractive" option; and "custom built for clients." Bear Stearns had failed to detect any of these e-mails at the time they were sent, despite the frequency with which they were disseminated. In one week in September 2003, the salesperson sent at least one violative e-mail every single day; on November 28, 2003 alone, the representative sent sixteen violative e-mails.

- In early November 2003, one of the salespersons in the New York office had sent at least seven additional e-mails to customers that touted various upcoming offerings. In one e-mail, the salesperson noted that one offering was in "great shape," while another was in "good shape." The remaining six e-mails attached copies of confidential sales force memoranda concerning the software company's IPO and an unrelated follow-on offering.

- In mid-November 2003, in response to a customer's request for information about the software company's IPO, another of the salespersons in the New York office replied by e-mail that the offering had drawn "a lot of interest from small cap tech buyers." The e-mail also described some of the company's acquisitions and future business prospects.

- The third salesperson in the New York office, one week before sending the November 2003 e-mails that attached sales information concerning the information technology company and the software company's IPOs, faxed identical materials to customers. Because the faxes were sent via Bear Stearns' computer system, copies were also forwarded to Bear Stearns' compliance offices for review by compliance personnel, but were not detected.

- A salesperson in Bear Stearns' Boston office had sent at least five e-mails to various customers in 2002 and 2003 that touted certain upcoming IPOs and follow-on offerings. In one April 2002 e-mail, the representative described the issuer as having a "sterling" balance sheet, adding that the company had grown "both organically and through acquisition, to their credit. . . . Good Company in small cap area." In another 2002 e-mail, the salesperson touted an IPO as follows: "Interest high. Numbers compelling, mix, political, etc. Margins above avg . . . valued right . . . strong mgmt."[5] The same individual,

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[5] The inadequacy of Bear Stearns' e-mail review procedures is further shown by the Firm's failure to detect numerous e-mails sent by two of these salespersons in 2002 and 2003 that violated the Firm's policies and procedures because they included internal-use-only documents and information. The e-mails did not violate Section 5 because they were not related to securities offerings. The documents typically included a warning plainly visible on the first page that read "strictly for internal use" or "internal use only." Although these e-mails did not violate the federal securities laws, their detection would have alerted Bear Stearns supervisors that these salespersons were not following Firm policies regarding outgoing communications, and could have enabled management to more effectively supervise these individuals with a view toward preventing subsequent violations of the securities laws.

in November 2003, had also provided two customers with Bear Stearns' internal financial model for the software company.

Despite Bear Stearns' policies requiring pre-approval of all business-related external communications and post-transmission review of all e-mail, the company did not have effective systems to implement the policies. Even after Bear Stearns detected violative communications, it failed to take reasonable steps to prevent and detect additional violations. In one instance, on November 18, 2003, one of the salespersons in the New York office e-mailed to certain customers a copy of a confidential sales force memorandum concerning a follow-on offering. Upon discovering the e-mail on November 20, 2003 as part of a routine review, a compliance employee admonished the salesperson for disseminating an "internal-use only" document outside the Firm, but took no further steps.

4. Bear Stearns' Remedial Steps in Late 2003

After discovering the violative e-mails in late November and early December 2003, Bear Stearns took a number of steps to prevent recurrence of similar problems in the future, including: installing a software program designed to block dissemination of employee e-mail that contained certain objectionable words or phrases; fully employing a previously-installed software program to enhance its manual review of already-sent e-mail; conducting firm-wide meetings to reiterate its policies concerning external communications; restructuring its compliance department to better enable compliance officers to perform surveillance-related tasks, including review of outgoing e-mail; and disciplining the salespersons who provided the sales information discussed herein. Additionally, Bear Stearns cooperated with the Commission staff in its investigation by, among other things, sharing the results of its own internal investigation.

D. Violations

1. Bear Stearns Violated Section 5(b) of the Securities Act

Section 5(b) of the Securities Act requires that a prospectus used after the filing of a registration statement meet the requirements of Section 10 of the Securities Act.[6] Section 2(a)(10) of the Securities Act broadly defines "prospectus" to include any written communication that offered any security for sale. E-mails are a form of written communication. Section 2(a)(3) of the Securities Act broadly defines "offer" to include attempts to dispose of, or solicitations of offers to buy, a security for value.

Because the e-mails described above were written communications that offered securities prior to the effective date of the registration statement, they were prospectuses which had to meet the requirements of Section 10 of the Securities Act. *See, e.g., In re*

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[6] A Section 10 prospectus must contain virtually all of the information required in a registration statement, other than exhibits and other information, such as pricing and pricing-related information. In the IPO context, a Section 10 prospectus must contain a *bona fide* price range.

Gold Properties Restoration Co., Inc., Release No. 6953 (Aug. 27, 1992); *SEC v. People's Bank of Brevard, Inc.*, Litigation Release No. 12753 (Jan. 14, 1991); *In re Martin Rothman*, Release No. 23654 (Sept. 30, 1986). The e-mails sent by Bear Stearns' sales force did not contain the information required by Section 10 of the Securities Act. When Bear Stearns' representatives disseminated those written communications about the pending offerings during their quiet periods, the individuals and the Firm willfully violated Section 5(b) of the Securities Act.[7] The Commission is not required to prove scienter in an action under Section 5(b). *See, e.g., SEC v. Willis*, 472 F. Supp. 1250, 1268 (D.D.C. 1978).

2. <u>Bear Stearns Failed Reasonably to Supervise Its Salespersons</u>

Section 15(b)(4)(E) of the Exchange Act requires broker-dealers to supervise reasonably, with a view to preventing violations of the federal securities laws, persons subject to their supervision. Through its management structure, Bear Stearns was responsible for supervising the salespersons who sent the e-mails in violation of Section 5(b) of the Securities Act. Bear Stearns failed reasonably to supervise with a view to preventing the salespersons' violations of Section 5(b).

"The Commission has repeatedly emphasized that the duty to supervise is a critical component of the federal regulatory scheme." *In the Matter of Oechsle International Advisors, L.L.C.*, Admin. Proc. File No. 3-10554, 5 (August 10, 2001). Section 15(b)(4)(E) provides that a broker-dealer may discharge this responsibility by having "established procedures, and a system for applying such procedures, which would reasonably be expected to prevent and detect" such violations. "Where there has been an underlying violation of the federal securities laws, the failure to have or follow compliance procedures has frequently been found to evidence a failure reasonably to supervise the primary violator." *In the Matter of William V. Giordano*, Admin. Proc. File No. 3-8933 (January 19, 1996). In addition to adopting effective procedures for supervision, broker-dealers "must provide effective staffing, sufficient resources and a system of follow up and review to determine that any responsibility to supervise delegated to compliance officers, branch managers and other personnel is being diligently exercised." *In the Matter of Mabon, Nugent & Co.*, Admin. Proc. File No. 3-6207 (January 13, 1983).

Although Bear Stearns's pre-review policy required the review of all outgoing e-mail, none of the communications described above was reviewed by a supervisor before being sent to customers. Bear Stearns' procedure for reviewing electronic communications after transmission was not a reasonable method of detecting violative communications, and failed to identify most of the violative e-mails. Given the large volume of e-mail that they were tasked with reviewing, the reviewers in some instances merely scanned subject lines and ignored attachments or "internal use only" headings. Effective implementation of its pre- and post-transmission review policies could have

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7 "Willfully" as used in this Order means intentionally committing the act which constitutes the violation, *Cf. Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000); *Tager v. SEC*, 344 F.2d 5, 8 (2d Cir. 1965). There is no requirement that the actor also be aware that he is violating one of the Rules or Acts.

enabled Bear Stearns to prevent and detect the salespersons' transmission of the approximately ninety violative e-mails, the vast majority of which were sent during four months in 2003.

Because Bear Stearns salespersons violated Section 5(b) of the Securities Act, and the Firm failed to employ an effective system to implement the procedures designed to detect or prevent such violations, Bear Stearns failed reasonably to supervise its employees for purposes of Section 15(b)(4)(E) of the Exchange Act.

IV.

Bear Stearns will review its procedures regarding the monitoring of outgoing electronic communications by its employees. Within ninety days of the issuance of this Order, unless otherwise extended by the staff of the Commission for good cause shown, Bear Stearns undertakes and agrees to certify to the Commission in writing that it has completed its review and that it has established procedures, and a system for applying such procedures, which are reasonably expected to prevent and detect, insofar as practicable, violations of Section 5 of the Securities Act.

V.

In determining to accept the Offer, the Commission considered remedial acts voluntarily taken by Respondent, as well as cooperation that Respondent afforded the Commission staff during its investigation of this matter.

VI.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Section 8A of the Securities Act and Section 15(b) of the Exchange Act, it is hereby ORDERED that:

A. Respondent Bear Stearns be, and hereby is, censured pursuant to Section 15(b)(4) of the Exchange Act.

B. Respondent Bear Stearns shall cease and desist from committing or causing any violations and any future violations of Section 5(b) of the Securities Act.

C. Respondent shall comply with the undertakings enumerated in Section IV., above.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Campos
Not Participating

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 54824 / November 28, 2006

ACCOUNTING AND AUDITING ENFORCEMENT
Rel. No. 2517 / November 28, 2006

Admin. Proc. File No. 3-10764

In the Matter of

Kenneth W. Haver, CPA

ORDER DENYING MOTION TO REOPEN PROCEEDING OR VACATE SUSPENSION

I.

On March 4, 2002, the Commission filed a complaint in federal district court against Kenneth W. Haver, a certified public accountant and formerly the chief financial officer of Telxon Corporation ("Telxon"), seeking an injunction against violating the federal securities laws. The complaint alleged that Haver "knowingly or recklessly violated or aided and abetted violations of" the antifraud, reporting, and recordkeeping provisions of the Securities Exchange Act of 1934 and rules thereunder. The complaint alleged specifically that Haver "caused Telxon to improperly recognize revenue for three purported sales transactions" on financial statements contained in a Form 10-Q for the quarter ended September 30, 1998, which "inflated Telxon's quarterly revenues by 23% and quarterly profits by 270%." On March 13, 2002, Haver, without admitting or denying the allegations in the complaint, consented to the entry of a permanent injunction. The federal district court imposed the injunction, without the presentation of any evidence or the adjudication of any issue of fact or law, on April 9, 2002. 1/

1/ See SEC v. Haver, Docket No. 5:02 CV 414 (N.D. Ohio Apr. 9, 2002). The court enjoined Haver from violating Exchange Act Sections 10(b) and 13(b)(5) and Rules 10b-5 and 13b2-1 thereunder and from aiding and abetting violations of Exchange Act Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) and Rules 12b-20, 13a-1, and 13a-13 thereunder. Haver also consented to, and the court imposed, a civil penalty of $75,000.

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On March 13, 2002, the same day as he consented to the entry of the permanent injunction, Haver submitted an offer of settlement to the Commission which stated that, "in anticipation of the institution of public administrative proceedings against him" pursuant to Commission Rule of Practice 102(e), he consented to a suspension from appearing or practicing before the Commission as an accountant. The Commission imposed the suspension on April 24, 2002 (the "Rule 102(e) Order"). 2/ The Commission based the suspension on the existence of the federal court injunction entered with Haver's consent. Rule 102(e)(3) provides that the Commission may suspend from appearing or practicing before it an accountant who has been permanently enjoined, in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the federal securities laws or the rules and regulations thereunder. 3/ The Rule 102(e) Order made no findings regarding the misconduct alleged in the injunctive complaint. Haver consented to the suspension without admitting or denying any findings, except that he admitted the permanent injunction had been entered against him. The Rule 102(e) Order provided that Haver could apply for reinstatement after five years.

Haver now seeks relief from the Rule 102(e) Order. According to Haver, "compelling new evidence" obtained in a related class action by Telxon shareholders against Haver, Telxon, and its auditor, PricewaterhouseCoopers LLP ("PWC"), justifies such relief. The "new evidence" proffered by Haver consists of PWC workpapers produced in the class action which suggest, according to Haver, that Telxon disclosed the three violative transactions to PWC. Haver contends that "the Commission's finding that [he] acted knowingly or recklessly when accounting for [the three violative transactions] . . . was, to a large degree, supported by the testimony of the senior members of the PWC engagement team that Mr. Haver failed to disclose these transactions to the engagement team voluntarily and in response to specific inquiry." Haver argues, therefore, that the "[e]vidence produced by PWC in the securities litigation . . . establishes that this testimony . . . was false and otherwise not credible" and that Haver "did not act with a knowing or reckless intent to defraud."

Haver claims that he "did not have access to PWC's workpapers . . . in support of his defense to the Commission's charges" at the time of his settlement. Haver asserts further that the Commission did not have access to "some" of these workpapers, noting that the judge in the class action lawsuit found that PWC had not "produced a complete set of workpapers to the SEC in good faith." According to Haver, the "existence of compelling evidence (none of which Haver had access to at the time he consented to the Rule 102(e) Order, and some of which was unlawfully withheld from the SEC by Telxon's auditor) supporting Haver's position that he did not act willfully when misreporting the subject transactions, is a compelling circumstance supporting his request for equitable relief."

2/ Kenneth W. Haver, CPA, Securities Exchange Act Rel. No. 45814 (Apr. 24, 2002), 77 SEC Docket 1427.

3/ 17 C.F.R. § 201.102(e)(3).

Haver seeks two forms of relief. First, he seeks "reconsideration of [the Commission's] findings that Mr. Haver violated Sections 10(b) and 13(b)(5) and Rule 13b2-1 of the Exchange Act." Second, he requests that the Commission "reconsider his acceptance of a suspension from practice before the Commission as a term required in settlement of all charges brought against him." Haver notes that the Ohio Accountancy Board revoked his CPA certificate solely on the basis of his acceptance of a suspension from practice before the Commission. 4/

The Division of Enforcement opposes Haver's request on the grounds that he has not "demonstrated compelling facts or circumstances that would support a grant of relief." According to the Division, "Haver does not present a basis for vacating or modifying the sanctions imposed in the Rule 102(e) proceedings," which were based, not on a hearing with a record, but on the consent injunction entered against Haver. The Division notes that the revocation of his CPA certificate by the Ohio Accountancy Board was a foreseeable consequence of the Commission's suspension order. The Division also notes that, as early as next April, Haver may apply for reinstatement to resume appearing or practicing before the Commission.

For the reasons discussed below, we have determined to deny Haver's requested relief.

II.

We have generally considered petitions to vacate orders imposed with a respondent's consent in the context of petitions to vacate administrative bar orders imposed in settled proceedings. 5/ In these cases, we have stated that our "long-standing approach to petitions to vacate or modify . . . reflects [our] statutory obligation to ensure that a request for relief or modification comports with the public interest and investor protection." 6/ The factors that guide this public interest/investor protection inquiry are:

4/ In his reply brief, Haver states that his petition is "fairly characterize[d]" as a "request to vacate the suspension from appearing or practicing before [the Commission]."

5/ See, e.g., William Masucci, Exchange Act Rel. No. 53121 (Jan. 13, 2006), 87 SEC Docket 347 (considering petition to vacate a bar imposed with respondent's consent after respondent consented to injunction by a federal district court); Jesse M. Townsley, Exchange Act Rel. No. 52161 (July 29, 2005), 85 SEC Docket 4341 (same); see also Mark S. Parnass, Exchange Act Rel. No. 50730 (Nov. 23, 2004), 84 SEC Docket 727; Peter F. Comas, Exchange Act Rel. No. 49894 (June 18, 2004), 83 SEC Docket 251; Stephen S. Wien, Exchange Act Rel. No. 49000 (Dec. 29, 2003), 81 SEC Docket 3758; Ciro Cozzolino, Exchange Act Rel. No. 49001 (Dec. 29, 2003), 81 SEC Docket 3769; Edward I. Frankel, Exchange Act Rel. No. 49002 (Dec. 29, 2003), 81 SEC Docket 3778.

6/ Wien, 81 SEC Docket at 3764; see also Cozzolino, 81 SEC Docket at 3774; Frankel, 81 SEC Docket at 3784.

> the nature of the misconduct at issue in the underlying matter; the time that has passed since issuance of the administrative bar; the compliance record of the petitioner since issuance of the administrative bar; the age and securities industry experience of the petitioner, and the extent to which the Commission has granted prior relief from the administrative bar; whether the petitioner has identified verifiable, unanticipated consequences of the bar; the position and persuasiveness of the Division of Enforcement's response to the petition for relief; and whether there exists any other circumstance that would cause the requested relief from the administrative bar to be inconsistent with the public interest or the protection of investors. 7/

Not all of these factors will be relevant in determining the appropriateness of relief in a particular case, and no one factor is dispositive. 8/ We have held that bars should "remain in place in the usual case and be removed only in compelling circumstances." 9/ We agree with the Division of Enforcement, which, as indicated, opposes Haver's request, that Haver's petition does not present such compelling circumstances.

We have noted previously our "strong interest" in the finality of our settlement orders. 10/ "Public policy considerations favor the expeditious disposition of litigation, and a respondent cannot be permitted to [follow] one course of action and, upon an unfavorable [result], to try another course of action." 11/ "If sanctioned parties easily are able to reopen consent decrees years later, the SEC would have little incentive to enter into such agreements. There would

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7/ Wien, 81 SEC Docket at 3765-66; see also Cozzolino, 81 SEC Docket at 3774-75; Frankel, 81 SEC Docket at 3784-85.

8/ Wein, 81 SEC Docket at 3765 (stating that, in considering the factors that guide this public interest/investor protection inquiry, "no one factor is dispositive"); cf. IFG Network Secs., Exchange Act Rel. No. 54127 (July 11, 2006), __ SEC Docket __, __ (stating that, in considering the factors that determine whether a cease-and-desist order is appropriate, "not all factors need to be considered, and no factor is dispositive").

9/ Wien, 81 SEC Docket at 3766; see also Masucci, 87 SEC Docket at 348; Townsley, 85 SEC Docket at 4343; Parnass, 84 SEC Docket at 729; Comas, 83 SEC Docket at 252-53; Cozzolino, 81 SEC Docket at 3775; Frankel, 81 SEC Docket at 3785.

10/ Putnam Invest. Mgmt., Order Denying Motion to Vacate Administrative Orders, Exchange Act Rel. No. 50039 (July 20, 2004), 83 SEC Docket 1262, 1265.

11/ David T. Fleischman, 43 S.E.C. 518, 522 (1967) (finding that "the failure of a respondent to testify and adduce available evidence to meet the charges against him . . . does not entitle him to have the proceedings reopened after the issuance of an adverse decision") (quoted with approval in Gross v. SEC, 418 F.2d 103, 108 (2d Cir. 1969)).

always remain open the possibility of litigation on the merits at some time in the distant future when memories have faded and records have been destroyed." 12/

Haver acknowledges that "the Commission, as a matter of policy, does not generally 'revisit' matters that are closed," but contends that "the circumstances presented here warrant an exception to any such rule." One such circumstance, according to Haver, is his claim that "the Commission found that he acted intentionally or recklessly . . . chiefly on the basis of the false testimony of members of the PWC engagement team that he did not disclose the[] [violative] transactions to his auditors." Haver claims that his new evidence -- certain PWC workpapers -- establishes that he made the appropriate disclosures and did not act intentionally or recklessly.

Haver misconceives the basis for our suspension. The Rule 102(e) Order contained no finding that Haver acted knowingly or recklessly. We based the order on the district court's injunction and Haver's offer of settlement. Commission Rule of Practice 102(e)(3)(iv) provides that one who, like Haver, "has consented to the entry of a permanent injunction . . . shall be presumed . . . to have been enjoined by reason of the misconduct alleged in the complaint." 13/ The injunctive complaint against Haver alleged, as noted above, that he knowingly or recklessly violated the federal securities laws. Haver, therefore, is deemed enjoined by reason of such knowing or reckless violations. We did not, and were not required to, make any findings regarding Haver's misconduct, 14/ and so do not consider here whether Haver's alleged new evidence refutes such findings. 15/

Haver also fails to appreciate the significance of his offer of settlement. Commission Rule of Practice 240(c)(4) provides explicitly that a settling respondent waives all hearings, the filing of proposed findings of fact and conclusions of law, proceedings before, and an initial

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12/ Miller v. SEC, 998 F.2d 62, 65 (2d Cir. 1993) (affirming Commission order denying a petition to set aside a censure imposed by the Commission with respondent's consent).

13/ 17 C.F.R. § 201.102(e)(3)(iv).

14/ Cf. Milton J. Shuck, 38 S.E.C. 69, 72 (1957) (finding it unnecessary to determine whether respondent violated Exchange Act Section 15(c)(3) where court had enjoined respondent from violating that provision because "the existence of the injunction . . . itself clearly furnishe[d] a statutory basis for revocation of registrant's registration under Section 15(b) of the Exchange Act"), aff'd, 264 F.2d 358 (D.C. Cir. 1958).

15/ We did not make any findings regarding whether Haver acted knowingly or recklessly because such findings could conflict with the basis for the district court's injunction. Haver could request that the court now vacate his injunction. See Fed. R. Civ. Pro. 60(b). We do not intend to suggest in this order any view regarding such a petition.

decision by, a hearing officer, and all post-hearing procedures. 16/ Moreover, Haver's offer of settlement states expressly that "[b]y submitting this Offer, Haver hereby acknowledges his waiver of those rights specified in Rules 240(c)(4) and (5) of the Commission's Rules of Practice." Haver does not suggest that his offer to settle was not voluntary, knowing, or informed. 17/ Haver thus forfeited his opportunity to adduce his evidence, 18/ which would require evaluation at the hearing before an administrative law judge that Haver waived. Haver may not now complain that the record is inaccurate or incomplete. 19/

Haver contends that another circumstance warranting relief is the action of the Ohio Accountancy Board in revoking his CPA certificate "solely on the basis of his acceptance of a suspension from practice before the Commission." According to Haver, "an automatic loss of his Ohio CPA certificate was an unforeseeable consequence of his consent to a suspension." Although, as noted above, one of the factors we consider in evaluating petitions to vacate bar orders is whether the petitioner has identified verifiable, unanticipated consequences of the bar, we do not believe that revocation of Haver's CPA certificate was an "unforeseeable consequence" of the suspension. Ohio law provides that the accountancy board may "revoke, suspend, or refuse to renew any CPA certificate" based on the "suspension or revocation of the right to

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16/ 17 C.F.R. § 201.240(c)(4) (2001).

17/ Cf. Sargent v. Dep't of Health and Human Servs., 229 F.3d 1088, 1091 (Fed. Cir. 2000) ("It is well-established that in order to set aside a settlement, an appellant must show that the agreement is unlawful, was involuntary, or was the result of fraud or mutual mistake.").

18/ See William H. Pike, Investment Company Act Rel. No. 20417 (July 20, 1994), 57 SEC Docket 589, 590-91 (rejecting applicant's request that we either expunge an order entered with his consent or allow him to litigate the issues in a reopened administrative proceeding on the ground that he could produce evidence that his misconduct "was far less significant than would appear" because regardless of the significance of any such evidence, applicant had "forfeited the opportunity to adduce it").

19/ See Edward I. Frankel, 52 S.E.C. 1237, 1239 n.5 (1997) (rejecting petition to vacate bar order where petitioner contended that bar order "relied upon erroneous information" because respondent "elected to settle the matter and did not develop the record further" and thus could not "now complain that the record is inaccurate or incomplete"); Cf. Gleason v. Jandrucko, 860 F.2d 556 (2d Cir. 1988) (refusing to set aside a settlement despite plaintiff's assertion that evidence discovered in a subsequent proceeding revealed that defendants perjured themselves at their depositions and concealed evidence because plaintiff "voluntarily chose to settle the action" and could not "be heard now to complain that he was denied the opportunity to uncover the alleged fraud" where "nothing prevented plaintiff during the pendency of the prior proceeding" from attempting to obtain the evidence that plaintiff believed impeached the defendants' testimony).

practice before any state or federal agency." 20/ Haver therefore was in a position to anticipate and foresee the action of the Ohio board. The Ohio Board's action is not a basis for relief. 21/

The other factors noted above that we generally consider in determining whether it is appropriate to vacate an administrative bar order also suggest that vacating Haver's suspension is inappropriate here. The underlying misconduct alleged in the injunctive complaint involved antifraud violations, and "the fact that a person has been enjoined from violating antifraud provisions 'has especially serious implications for the public interest.'" 22/ The time that has passed since issuance of the suspension further militates against relief because even the five-year period after which Haver may apply for reinstatement has not yet elapsed. Under these circumstances, and based on our consideration of the factors previously identified, it would not comport with the public interest or investor protection to vacate Haver's suspension.

Accordingly, it is ORDERED that the motion of Kenneth W. Haver to reopen the proceeding or vacate the suspension imposed on April 24, 2002, be, and it hereby is, denied.

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

20/ See OH. REV. CODE ANN. § 4701.16.

21/ Cf. Townsley, 85 SEC Docket at 4342, 4344 (denying motion to vacate bar order on the ground that "the bar order has prevented [movant] from becoming registered as a commodity trading advisor with the National Futures Association" because movant's inability to become so registered "was a consequence of the bar that he should have anticipated").

22/ Michael T. Studer and Castle Secs. Corp., Exchange Act Rel. No. 50411 (Sept. 20, 2004), 83 SEC Docket 2853, 2861 (quoting Marshall E. Melton, Investment Advisers Act Rel. No. 2151 (July 25, 2003), 80 SEC Docket 2812, 2825).

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 54835. / November 29, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12116

In the Matter of FRED MICHAEL STONE	CORRECTED ORDER PERMITTING ATTORNEY TO RESUME APPEARING AND PRACTICING UNDER RULE 102(e)(5) OF THE COMMISSION'S RULES OF PRACTICE

I.

On December 1, 2005, the Commission, pursuant to Rule 102(e)(1)(iii) of its Rules of Practice, suspended attorney Fred Michael Stone ("Stone") from appearing or practicing before the Commission, with the right to apply to resume appearing and practicing as an attorney after six months. *See* Opinion and Order, Securities Act of 1933 Release No. 8639 (December 1, 2005). The suspension was based on the Commission's findings that while Stone was General Counsel of Millennium,[1] he helped to devise and implement fraudulent schemes to conceal Millennium's identity from a variety of mutual funds and thereby enable Millennium to engage in market timing trades.

In anticipation of the institution of administrative proceedings, Stone consented to entry of the Order without admitting or denying the findings except as to the Commission's jurisdiction over him, which he admitted. The Opinion and Order provided that Stone could apply to resume appearing and practicing before the Commission after a period of six months.

II.

On or about August 15, 2006, over six months after he had been suspended by the Commission, Stone filed an application for reinstatement of the privilege to appear and practice

[1]"Millennium" refers collectively to Millennium Partners, L.P., Millennium Management, L.L.C. (the managing partner of and investment adviser to Millennium USA, L.P.) and Millennium International Management, L.L.C. (the investment adviser to Millennium International, Ltd.).

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before the Commission. His application includes a personal affidavit in which he swore under penalty of perjury that he has complied with the Commission's Opinion and Order, that he is not subject to any suspension or disbarment as an attorney by a court of the United States or of any state, territory, district, commonwealth, or possession, that he is a member in good standing of the bar of New York, and that he has not been convicted of a felony or misdemeanor involving moral turpitude. In addition, he has paid the $1 in disgorgement and the $25,000 civil penalty required by the Order.

III.

Based on the foregoing, the Commission has determined that it is appropriate to permit Stone, pursuant to Rule 102(e)(5), to resume appearing or practicing before the Commission. However, the Commission notes that Stone continues to be prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter until December 1, 2008.

Accordingly, it is HEREBY ORDERED that Stone may resume practicing as an attorney before the Commission.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Nazareth
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 54830 / November 29, 2006

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2518 / November 29, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12487

In the Matter of **ASHLAND INC. and** **WILLIAM C. OLASIN,** **Respondents.**	**ORDER INSTITUTING PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS AND IMPOSING A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Ashland Inc. ("Ashland") and William C. Olasin ("Olasin") (collectively, "Respondents").

II.

In anticipation of the institution of these proceedings, Ashland and Olasin each have submitted an Offer of Settlement (the "Offers"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over Respondents and the subject matter of these proceedings, which Respondents admit, Respondents consent to the issuance of this Order Instituting Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings and Imposing a Cease-and-Desist Order ("Order"), as set forth below.

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III.

FACTS

On the basis of this Order and Respondents' Offers, the Commission finds that:

A. Summary

Between 1999 and 2001, William Olasin, Ashland Inc.'s Director of Environmental Remediation, reduced the cost estimates for remediating environmental contamination at dozens of chemical and refinery sites for which Ashland had responsibility. Ashland used those estimates to determine its environmental reserve, which Ashland disclosed in the periodic reports that it filed with the Commission. Olasin had no reasonable basis for reducing these cost estimates, which had been developed by a team of Ashland engineers, an outside consultant, and a computer program.

Ashland's process for setting its environmental reserve did not establish adequate guidelines for, or require documentation or review of, adjustments to the cost estimates. Ashland included the estimates that Olasin had reduced in its reported environmental reserve. As a result, Ashland materially understated its environmental reserve and overstated its net income in annual and quarterly reports filed from 1999 to 2001.

Ashland violated the reporting, books and records, and internal controls provisions of the Exchange Act, Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) and Rules 12b-20, 13a-1, and 13a-13 thereunder. Olasin caused Ashland's violations, and also violated Rule 13b2-1 of the Exchange Act.

B. Respondents

1. **Ashland Inc.** is a Fortune 500 chemical company incorporated in Kentucky. Ashland's common stock is registered with the Commission under Section 12(b) of the Exchange Act and is listed on the New York and Chicago Stock Exchanges under the symbol "ASH." During the relevant period, Ashland's primary businesses included chemical production and distribution, such as its Valvoline motor oil division, highway and bridge construction, and petroleum refining and marketing. Ashland is responsible for cleaning up environmental contamination at locations throughout the country. Ashland's fiscal year ends on September 30 and, in 2005, Ashland reported revenue of $9.9 billion and operating income of $746 million. Ashland's environmental reserve was a significant item in its financial statements from 1998 to 2005, ranging from a low of $152 million to a high of $178 million.

2. **William Olasin**, age 55, resides in Dublin, Ohio. Olasin was Ashland's Director of Environmental Remediation from 1996 until April 2006, when Ashland reassigned Olasin as a project manager within the Engineering Department. Olasin has a B.A. from Marietta College, Ohio in biology and geology and a B.S. from the University of Michigan in natural resources.

C. Relevant Accounting Principles

As a public company, Ashland is required to fairly, accurately, and timely report its financial results and condition. To ensure fair and accurate reports, the federal securities laws and the Commission's regulations require public companies, such as Ashland, to prepare and present their reports and financial statements in conformity with Generally Accepted Accounting Principles ("GAAP"). Under GAAP, items listed in financial statements must be reliable, *i.e.*, sufficiently faithful in their representation of the underlying obligations and sufficiently free of error and bias to be useful to others making decisions based on the financial statements.[1] Financial statements filed with the Commission that are not prepared in accordance with GAAP are presumed to be misleading or inaccurate. Ashland represented in its Commission filings that its financial statements complied with GAAP.

Ashland's expenditures for environmental compliance have a significant effect on its businesses. As required by GAAP, Ashland accrues an environmental reserve for future costs that it expects to incur to remediate contamination.[2] Ashland explained in its annual reports and the notes to its financial statements that the reserve reflects the company's "estimates of the most likely costs which will be incurred over an extended period to remediate identified environmental conditions for which the costs are reasonably estimable[.]"

D. Ashland's Process for Estimating the Environmental Reserve

From 1999 through 2001, Ashland's environmental remediation efforts were managed by the Remediation Group within the company's Environmental, Health and Safety Department ("EH&S"). As the director of Ashland's Remediation Group, Olasin was responsible for Ashland's determination of its future environmental liability. Olasin supervised a group of six environmental engineers who managed remediation at various sites and determined the initial liability estimates used to set the reserve.

Although Olasin was responsible for the accuracy of all estimates, Olasin's Remediation Group provided estimates for only some categories, including the chemical and refinery sites. For other categories, Olasin reviewed estimates forwarded to him by other Ashland divisions and consultants.

Olasin's Remediation Group used a "decision tree" method for determining the cleanup cost estimates for remediating the chemical and refinery sites. Each spring, the engineers in the

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1 FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises,* paragraphs 63 and 75.

2 Financial Accounting Standard No. 5, *Accounting for Contingencies* ("FAS 5"), requires Ashland to accrue for future remediation costs if it is probable that the company has incurred a liability and it can reasonably estimate the amount of the loss. The American Institute of Certified Public Accountants' Statement of Position 96-1, *Environmental Remediation Liabilities*, identifies future remediation costs that must be included in the company's environmental reserve, such as pre-cleanup activities and performance of remedial action.

Remediation Group met for two days with an independent, outside consultant to analyze each remediation site. Olasin did not participate in these sessions because of the independent consultant's concern that Olasin could bias the input of the engineers. At the sessions, the engineers presented possible remediation strategies for each site and the estimated costs for each remedy. The group critiqued each strategy and cost estimate. The independent consultant, who had a doctorate in engineering and 25 years of environmental remediation experience, facilitated the discussion by asking for justifications for the engineers' estimates and keeping the group within a set of "ground rules," which described the types of costs that should be accrued and listed assumptions that Ashland used in the process.

After the engineers reached a consensus for each site, the consultant entered the estimates into a computer program called "Crystal Ball," which generated a probability range of the total future cost estimates for each site. The Crystal Ball output was forwarded to Olasin for his review. Ashland considered it appropriate for Olasin to correct mistakes in the estimates or otherwise adjust them, as long as he had a reasonable basis for doing so. After his review, Olasin provided the cost estimates to an accountant who worked for Ashland as a contractor. The accountant compiled all estimates into a single report, which Olasin then forwarded to an assistant controller. The assistant controller used the estimates to determine Ashland's environmental reserve, which Ashland recorded in its books and records and reported in its Commission filings.

Ashland conducted this process once each year, and recorded any resulting change to its environmental reserve during the fourth quarter. In the first three quarters of each following year, Ashland carried forward the prior year's reserve estimate, after making adjustments based on expenditures during the quarter and any unusual developments.

E. Olasin's Reductions

Between 1999 and 2001, Olasin made multiple reductions to the cost estimates determined by the team of engineers and the independent consultant that Ashland used to set its environmental reserve. Olasin had no reasonable basis and no supporting documentation for these reductions, which generally were across-the-board reductions of various sites by the same large percentage.

In 1999, after reviewing the Crystal Ball output, Olasin directed the accountant to reduce by 25% the Crystal Ball calculations for fourteen of the chemical and refinery sites whose costs were estimated through the decision tree process – including seven of the ten largest sites. Olasin then directed the accountant to reduce the reserve for all chemical and refinery locations whose costs were estimated through the decision tree process (more than fifty sites) "across the board" by an additional 25%, including the fourteen sites already reduced. There is neither a documented basis for Olasin's reductions nor any evidence that each site's estimate was overstated by the same percentage.

Olasin's reductions decreased Ashland's reserve by over $12 million, which reduced the reserve for Ashland's chemical and refinery sites whose costs were estimated through the decision tree process by 33% and decreased Ashland's total reserve by 6.9% to $166 million. Ashland's annual report and financial statements for 1999 contained the misstated reserve. Olasin's reductions also increased Ashland's fourth quarter net income by 6.7%, to $114 million.

In 2000, Olasin used a two-step process to adjust the estimates for more than 40 chemical and refinery sites whose costs had been estimated through the decision tree process. First, Olasin reduced the estimates for 20 sites by approximately 25%, and reduced the estimates for an additional five sites by approximately 44%, the equivalent of two 25% reductions. Olasin also reduced the estimates for nine sites, including three of the five largest, by 38% to 73% to round number estimates.[3] Olasin also increased the estimates for five sites. Second, Olasin reduced the estimates for 38 sites by an additional 3%. Revised Crystal Ball data reflecting the first series of adjustments was maintained, but no documentation exists to justify the reductions, or to indicate that multiple sites were overstated by the same percentage.

Olasin's reductions in 2000 decreased Ashland's reserve by over $12 million, which reduced the reserve for chemical sites whose costs were estimated through the decision tree process by 41% and reduced Ashland's total reserve by 7% to $163 million. The adjustment also increased Ashland's annual net income before charges for one-time items for 2000 by 2.65% to $292 million, and increased net income after charges for one-time items by 12.1% to $70 million.[4] The adjustment increased Ashland's fourth quarter net income by 9% to $96 million.[5]

In 2001, Olasin made an across-the-board, 10% reduction to estimates for 40 sites, reducing the reserve by $1,904,000 to $176 million. There is no documentation supporting these reductions. Olasin's 10% reduction had the effect of keeping constant the total reserve for the chemical sites that he managed, and reduced Ashland's total environmental reserve by approximately 1%.

Olasin also considered both a 24% and a 10% reduction in 2002, but abandoned the planned reduction when Ashland's internal auditors commenced an internal audit at approximately the time the reduction would have been finalized. A week before the internal auditors interviewed Olasin, the Crystal Ball program was re-run to remove the planned adjustment.[6]

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3 Olasin reduced three of the five largest estimates from $2,968,000, $2,446,000, and $2,324,000 to $800,000, $1,000,000, and $1,000,000, respectively.

4 Ashland incurred one-time charges in 2000 for a discontinued operation and debt retirement.

5 The 2000 adjustment was carried forward during the first three quarters in 2001. Ashland began disclosing its environmental reserve in quarterly reports in the second quarter of 2001. As a result, the reduction in 2000 decreased the environmental reserve that Ashland reported in its quarterly reports for the second and third quarters of 2001 by 7.5% in the second quarter and 6.3% in the third quarter.

6 Ashland's reserve for the chemical sites that were the subject of Olasin's reductions increased considerably when his reductions stopped after 2001. From 2001 to 2005, Ashland's reserve for the chemical onsite locations grew from $18 million to over $36 million.

F. **Ashland's Internal Controls**

During the relevant period, Ashland's internal controls for setting the company's environmental reserve depended on detailed, documented support for the engineers' estimates, as well as the peer critique session led by the independent consultant. Ashland maintained specific, written procedures describing this process. However, Ashland's internal controls were inadequate because they did not establish guidelines for, or require documentation or review of, adjustments to the engineers' cost estimates. Olasin helped design these controls.

Prior to 2001, Ashland's written procedures did not provide a process for adjusting the cost estimates generated by the Crystal Ball process. In 2001, Ashland changed the written procedures to indicate that the "management team" might adjust the estimates produced by the engineers. However, the revised procedures did not identify the "management team" and did not establish any guidelines setting forth when or how an adjustment could be made. In addition, unlike the documented, factual basis required for the original estimates, the procedures did not require documentation or review of any adjustments.

G. **Ashland Receives Complaints in 2002**

In 2002, three engineers who worked for Olasin raised questions about Olasin's conduct regarding the process of setting the environmental reserve in their confidential responses to an internal Code of Conduct Questionnaire and Certification Statement. One engineer specifically alleged, among other things, that Olasin was improperly reducing the reserve through "management adjustments."[7]

In response to these reports, Ashland's law department informed the internal audit department about the first engineer's complaints and asked it to conduct an audit. Consistent with the audit department's normal practice, the internal audit was designed to evaluate internal controls, not to determine whether Ashland's reserve conformed with GAAP. The internal auditors did nothing to familiarize themselves with the accounting rules for an environmental reserve.

The internal auditors reviewed only fiscal years 2001 and 2002, and discovered Olasin's 10% reduction in 2001. The auditors asked Olasin about the 2001 reduction, and Olasin said that he reduced the estimates because, in his judgment, they were approximately 10% too high and he did not have time for a site-by-site review. The auditors asked Olasin for documentation or other support for the reduction in 2001, but he said there was none. The auditors also reviewed individual adjustments that Olasin made in 2002, and asked Olasin and the remediation engineers responsible for the sites in question about the adjustments. Olasin explained the reasons for the adjustments, and the engineers agreed that the adjustments were proper. The auditors did not find the planned across-the-board reductions for 2002. The auditors concluded that the 10% reduction in 2001 (which amounted to less than $2 million) was not quantitatively material and recommended changes to Ashland's environmental reserve process, including documentation and tracking of all changes to cost estimates, and review and approval by the engineers of any change made to site estimates. Ashland implemented these recommendations.

[7] Olasin himself referred to his reductions as "management adjustments."

A few days after responding to a preview of the internal audit report, Olasin told the first engineer (whose identity he had learned) that his performance was suffering and that he should spend the weekend thinking about whether he wanted to stay with the company. The engineer ultimately left Ashland because he believed that he was being subjected to retaliation.[8] Ashland learned about the engineer's concerns about retaliation, including Olasin's instruction that the engineer should consider whether he wanted to continue working at Ashland. Ashland did not discipline Olasin for this conduct, but his supervisor told him that it was wrong. In April 2006, after the Commission staff's investigation was complete, Ashland reassigned Olasin as a project manager within Ashland's Engineering Department and removed him from the reserve setting process.

H. Legal Analysis

1. Reporting Violations

Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder require issuers with securities registered under Section 12 of the Exchange Act to file annual and quarterly reports with the Commission, and the obligation to file such reports includes the requirement that they be true and correct. Rule 12b-20 further requires that such reports contain any additional information necessary to ensure that the required statements in the reports are not, under the circumstances, materially misleading. Financial statements in Commission filings that do not comply with GAAP are presumed to be misleading. Regulation S-X, 17 C.F.R. 210.4-01(a)(1).

GAAP required Ashland to maintain an environmental reserve, and Ashland identified the reserve in its Commission filings as important to its business. As discussed above, Ashland's annual reports and notes to the company's financial statements filed on Form 10-K for 1999 and 2000 materially understated Ashland's environmental reserve and overstated its net income. Ashland also materially understated the company's environmental reserve in its quarterly reports for the second and third quarters of 2001, filed on Form 10-Q. The misstatements ranged from 7% to 12%. As a result of this conduct, Ashland violated Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder. Olasin caused Ashland's violations by improperly reducing the cost estimates used to determine Ashland's environmental reserve.

2. Record Keeping and Internal Controls Violations

Section 13(b)(2)(A) of the Exchange Act requires Section 12 registrants to make and keep books, records, and accounts that accurately and fairly reflect the transactions and dispositions of their assets. Section 13(b)(2)(B) of the Exchange Act requires such registrants to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that, among other things, transactions are recorded as necessary to permit preparation of financial statements in conformity with GAAP and to maintain the accountability of assets. Exchange Act Rule 13b2-1 prohibits the direct or indirect falsification of any book, record, or account subject to

[8] The engineer filed a complaint with the Department of Labor under the whistleblower protection provisions of Section 806 of the Sarbanes-Oxley Act of 2002, and eventually reached a settlement with Ashland.

Section 13(b)(2)(A).

Ashland violated Section 13(b)(2)(A) because its books and records contained inaccurate cost estimates that were used to determine the company's environmental reserve in fiscal years 1999, 2000, and 2001. Olasin caused Ashland's violations by reducing the cost estimates without a reasonable basis and documentation. Ashland's internal controls were deficient, and the company violated Section 13(b)(2)(B), because the company had no guidelines, documentation, or review requirements for adjustments of the cost estimates developed by the team of Ashland engineers. Olasin caused Ashland's violations because he helped design Ashland's controls for the decision tree process. By reducing the engineers' estimates without any reasonable basis, Olasin also caused Ashland's books and records to be falsified and thereby violated Exchange Act Rule 13b2-1.

IV.

UNDERTAKINGS

A. Ashland undertakes to implement the following revisions that it has made to its policies and procedures for determining its environmental reserve:

1. Document all adjustments to the environmental remediation reserve estimates and the reasons for each adjustment to create a clear audit trail of the estimates.

2. Retain all records relating to environmental remediation reserve estimates for a period of seven years following the period to which the reserve estimates relate.

3. Require the manager of Ashland's Environmental Remediation Group, or his or her equivalent or successor, to consult with the remedial engineer or other individual responsible for the environmental remediation estimate for a given site before deciding whether to adjust the estimate of that site.

4. Include in Ashland's Business Responsibility Questionnaire and Certification (or equivalent or successor document) sent to the Environmental Remediation Group and Accounting Department, or to their equivalents or successors, questions concerning whether the individual is aware of any failure to follow the Environmental Remediation Group's (or its equivalent's or successor's) reserve-setting procedures or of any misstatement in Ashland's books and records concerning any environmental remediation reserve.

5. Conduct an annual best practices review with Ashland's outside auditor for the purpose of discussing and, when appropriate, modifying the company's policies and procedures for determining its environmental reserve, including the policies and procedures identified in this Section IV.A or instituted as a result of the undertaking identified in Section IV.C, below. This review

shall include a comparison of each site's reserve estimate to the site's annual budget and historical expenditures.

6. Require a report to Ashland's board of directors or an appropriate committee of the board on an annual basis regarding compliance with these provisions.

B. Ashland undertakes to preclude Olasin from participating in the determination of Ashland's environmental reserve, the creation and maintenance of Ashland's books and records, and the preparation of Ashland's financial statements.

C. Ashland undertakes to retain PricewaterhouseCoopers LLP to review:

1. Ashland's policies, procedures, and internal controls relating to the company's determination of its environmental reserve.

2. Ashland's policies, procedures, and internal controls relating to solicitation and investigation of internal complaints, and measures to prevent retaliation against complainants.

Ashland will require PricewaterhouseCoopers to submit to the audit committee of Ashland's board of directors and the staff of the Division of Enforcement a written report fully documenting its findings and proposed recommendations. Within 90 days after receipt of such report, Ashland's audit committee, or board of directors, as appropriate, will adopt and implement such recommendations; provided, however, that as to any recommendation that Ashland believes is unduly burdensome or impractical, Ashland may suggest an alternative policy or procedure designed to achieve the same objective, submitted in writing to PricewaterhouseCoopers and the staff of the Division of Enforcement. Ashland will require PricewaterhouseCoopers to reasonably evaluate any alternative policy or procedure proposed by Ashland, and Ashland agrees that it will abide by the decision of PricewaterhouseCoopers regarding such alternative proposals.

V.

Based on the foregoing, the Commission finds that:

A. Respondent Ashland violated Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder.

B. Respondent Olasin violated Exchange Act Rule 13b2-1 and caused Ashland's violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder.

VI.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondents' Offers.

Accordingly, pursuant to Section 21C of the Exchange Act, it is hereby ORDERED, that:

A. Respondent Ashland cease and desist from committing or causing any violations and any future violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder.

B. Respondent Olasin cease and desist from committing or causing any violations and any future violations of Exchange Act Rule 13b2-1 and from causing any violations and any future violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder.

C. Respondent Ashland shall comply with its undertakings set forth in Section IV above.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Casey
Not Participating
and
Commissioner Atkins
Dissented as to
Penalty

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 2569 / November 29, 2006

INVESTMENT COMPANY ACT OF 1940
Release No. 27586 / November 29, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12489

In the Matter of

FCA CORP AND ROBERT W. SCHARAR,

Respondents.

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTIONS 203(e) AND 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940 AND SECTIONS 9(b) AND 9(f) OF THE INVESTMENT COMPANY ACT OF 1940

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e) and 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") and Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Investment Company Act") against FCA Corp and Robert W. Scharar ("Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted an Offer of Settlement ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 203(e) and 203(f) of the Investment Advisers Act of 1940 and Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Order"), as set forth below.

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III.

On the basis of this Order and Respondents' Offer, the Commission finds[1] that:

Summary

1. These proceedings involve registered investment adviser, FCA Corp ("FCA"), and its president, Robert W. Scharar ("Scharar"), for causing violations of borrowing limitations set forth in the registration statement applicable to the Australia-New Zealand Fund ("ANZ Fund") and the Japan Fund (collectively "the Funds"). The Funds are series of Commonwealth International Series Trust ("Commonwealth"), a registered investment company. In 2003 and 2004, Commonwealth's registration statement, as amended, contained a policy that, without shareholder approval, no Commonwealth fund was permitted to borrow money except as a temporary measure for extraordinary or emergency purposes. Under this policy, such borrowing was capped at an amount not to exceed the lesser of one-third of the value of the fund's net assets taken at market value including the amount borrowed, or 10% of its total assets, valued at cost, excluding the amount borrowed.

2. During 2003 and 2004, Scharar, who served as the president and portfolio manager of the Commonwealth funds and as the president of FCA, permitted the ANZ and Japan Funds to borrow cash from the Funds' line of credit in excess of these caps without shareholder approval. As a result, FCA and Scharar aided and abetted violations of Section 13(a) of the Investment Company Act, which prohibits a registered investment company from borrowing money except in accordance with the recitals of policy contained in its registration statement, or if authorized by the vote of a majority of its outstanding voting securities, and violated Section 34(b) of the Investment Company Act, which prohibits, among other things, making materially misleading statements in Commission filings.

Respondents

3. FCA Corp, a privately held Texas corporation based in Houston, Texas, has been registered with the Commission as an investment adviser since January 13, 1984. Throughout the relevant period, it served as the investment adviser to Commonwealth, a Massachusetts business trust that has been a registered with the Commission as an investment company since 1991. Throughout the relevant period, Commonwealth consisted of four series, including the Funds. FCA was the investment adviser to each series of Commonwealth.

4. Robert W. Scharar, age 58, resides in Houston and is the president and majority shareholder of FCA. On behalf of FCA, Scharar served as the portfolio manager of each Commonwealth fund throughout the relevant period. He also served as Commonwealth's president and as a member of its board of trustees.

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[1] The findings herein are made pursuant to Respondents' Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

Facts

5. Between January 1, 2003, and December 31, 2004, investors unrelated to Commonwealth, FCA, or Scharar engaged in market-timing activities involving frequent short-term purchases and redemptions of shares in the ANZ Fund and the Japan Fund. This caused the redemption rates for the ANZ and Japan Funds to increase significantly. To meet the liquidity demands of these high redemption levels, as well as the Funds' operating needs, Scharar proposed, and Commonwealth's Board of Trustees authorized, obtaining a line of credit from a bank.

6. In August 2003, Scharar entered into a revolving-credit agreement on behalf of Commonwealth with the bank that served as custodian for Commonwealth Funds ("the Bank"). Under the credit agreement, one or more of the Commonwealth Funds could borrow from the Bank at any time, as long as the aggregate amount borrowed did not exceed $10 million. In addition to this aggregate maximum, the agreement prohibited Commonwealth from borrowing on behalf of any Fund an amount greater than that permitted by a borrowing cap in Commonwealth's fundamental investment restrictions.

7. These fundamental investment restrictions were set forth in a Statement of Additional Information ("SAI") in post-effective amendments to Commonwealth's registration statement signed by Scharar and filed with the Commission on February 28, 2003, November 21, 2003, and February 13, 2004. The fundamental investment restrictions provided that, without majority approval of its shareholders, no Commonwealth fund could borrow money, "except that as a temporary measure for extraordinary or emergency purposes it may borrow . . . an amount not to exceed the lesser of 1/3 of the value of its net assets taken at market value, at the time of the borrowing, including the amount borrowed, or 10% of its total assets valued at cost, excluding the amount borrowed." The credit agreement, which Scharar signed, incorporated an exhibit entitled "Fund Borrowing Limits," which quoted this provision from Commonwealth's fundamental investment restrictions in its entirety.

8. Under the credit agreement, the Bank was authorized to provide cash advances from the credit line to cover cash shortfalls on behalf of Commonwealth at the instruction of Scharar, two FCA employees under his supervision, or any employee or officer of the Bank. In addition, Commonwealth and FCA provided the Bank an "Authorization Letter" granting authority to the Bank's mutual-fund-services department, which was the custodian of a bank account for each Commonwealth Fund, to request advances from the credit line on behalf of the Funds. In practice, the Bank's mutual-fund-services department processed these advances as needed pursuant to the Authorization Letter and applied cash to repay the loans once cash became available.

9. Under the Authorization Letter, which Scharar signed on behalf of both Commonwealth and FCA, these entities expressly retained responsibility for ensuring that any borrowing from the credit line complied with, among other things, the borrowing cap in Commonwealth's fundamental investment restrictions. Each Fund also agreed to promptly inform the Bank from time to time of "any applicable limitations, restrictions and/or prohibitions on borrowings by the particular Fund." As portfolio manager to the ANZ and Japan Funds, Scharar monitored the Funds' credit-line borrowing.

10. To fulfill frequent short-term redemptions, the ANZ and Japan Funds regularly borrowed funds from the Bank line of credit. The amounts borrowed by Commonwealth for the Funds under this line of credit exceeded the borrowing limits, on a regular basis. For example, on September 18, 2003, the ANZ Fund had already borrowed an amount equal to 36% of its total assets, excluding the amount borrowed, thereby exceeding the borrowing cap. On September 25, 2003, the first time the Japan Fund used the credit line, it borrowed an amount equal to 24% of its total assets, excluding the amount borrowed, likewise exceeding the borrowing cap.

11. Altogether, the ANZ Fund carried a credit-line balance exceeding 10% of its total assets on 63 days from September 2003 through December 2004. On 17 of these days, the credit-line balance exceeded 20% of the Fund's total assets. Likewise, the Japan Fund carried a credit-line balance exceeding 10% of its total assets on 115 days during the same period. On 31 of these days, the credit-line balance met or exceeded 50%, and on one occasion 91%, of the Japan Fund's total assets, excluding the amount borrowed.[2] On multiple occasions, each fund borrowed more money even though its credit-line balance already exceeded the amount permitted under the borrowing cap. The Bank was not informed that the borrowing exceeded the borrowing cap.

12. Moreover, the Funds carried a credit-line balance nearly every other day throughout the relevant period. Thus, borrowing under the credit line became a regular aspect of the Funds' operations. Under the circumstances, the Funds did not borrow solely as a temporary measure for extraordinary or emergency purposes as required under the fundamental investment restrictions. During the relevant period, no shareholder vote was sought with respect to the borrowing in either the ANZ Fund or the Japan Fund.

13. Borrowing in excess of the Funds' borrowing limitations during 2003 and 2004 caused the Japan Fund and ANZ Fund to incur additional interest costs in the amounts of $11,875 and $5,531, respectively, which FCA has since paid to the Funds plus interest.

Violations

14. As a result of the above-described conduct, Respondents FCA and Scharar willfully[3] aided and abetted and caused Commonwealth's violations of Section 13(a)(2) of the Investment Company Act, which prohibits any registered investment company from, among other things, borrowing money except in accordance with the recitals of policy contained in its registration statement, unless authorized by the vote of a majority of its outstanding voting securities.

15. As a result of the above-described conduct, Respondents FCA and Scharar willfully violated Section 34(b) of the Investment Company Act, which, among other things, provides that, in any registration statement, application, report, account, record, or other document filed or

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2 The Japan Fund also borrowed in excess of one-third the value of its net assets 65 times during this period. On 32 of these occasions, the amount borrowed met or exceeded 50%, and on one occasion 92%, of the Fund's net assets. On the other hand, because the ANZ Fund was much larger, its borrowing never exceeded one-third the value of its net assets.

3 "Willfully" as used in this Order means intentionally committing the act which constitutes the violation. *See Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000); *Tager v. SEC*, 344 F.2d 5, 8 (2d Cir. 1965). There is no requirement that the actor also be aware that he or she is violating one of the Rules or Acts.

transmitted pursuant to the Investment Company Act, it shall be unlawful for any person so filing or transmitting any such document to omit to state therein any fact necessary in order to prevent the statements made therein, in the light of the circumstances under which they were made, from being materially misleading.

Respondents' Remedial Efforts

16. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondents and cooperation afforded the Commission staff.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondents' Offer. Accordingly, pursuant to Sections 203(e) and 203(f) of the Advisers Act and Sections 9(b) and 9(f) of the Investment Company Act, it is hereby ORDERED that:

A. Respondents FCA and Scharar are censured;

B. Respondents FCA and Scharar cease and desist from committing or causing any violations and any future violations of Section 34(b) of the Investment Company Act and from causing any violations and any future violations of Section 13(a)(2) of the Investment Company Act;

C. Respondent Scharar shall, within ten days of the entry of the Order pay a civil money penalty in the amount of $25,000 to the United States Treasury. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check, or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, Virginia 22312; and (D) submitted under cover letter that identifies Scharar as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Rose Romero, Fort Worth District Office, Securities and Exchange Commission, Burnett Plaza, Suite 1900, 801 Cherry Street, Unit #18, Fort Worth, Texas 76102-6882;

D. Respondent FCA shall, within ten days of the entry of the Order, pay a civil money penalty in the amount of $25,000 to the United States Treasury. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check, or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, Virginia 22312; and (D) submitted under cover letter that identifies FCA as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Rose Romero, Fort Worth District Office, Securities and Exchange Commission, Burnett Plaza, Suite 1900, 801 Cherry Street, Unit #18, Fort Worth, Texas 76102-6882.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Nazareth
Not Participating

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 54840 / November 30, 2006

Admin. Proc. File No. 3-11062r

In the Matter of the Application of

CALVIN DAVID FOX
P.O. Box 7900
Jupiter, Florida 33468

For Review of Disciplinary Action Taken by the

NEW YORK STOCK EXCHANGE, INC.

ORDER DISMISSING APPEAL

Calvin David Fox appeals from disciplinary action taken against him by the New York Stock Exchange, Inc. ("NYSE" or "Exchange"). An NYSE hearing panel found that Fox violated NYSE Rule 476(a)(6) by engaging in conduct inconsistent with just and equitable principles of trade. 1/ This proceeding has previously been before us; on October 31, 2003, we remanded the decision of the NYSE for clarification and explanation of its findings. 2/ In the remand decision, we asked the NYSE to address whether Fox's alleged conduct was in bad faith or unethical. 3/ Following remand, an NYSE hearing panel found in a March 27, 2006 decision ("Hearing Panel Decision") that Fox's alleged conduct was in bad faith and unethical. Evidence submitted by the Exchange, including copies of a postmarked envelope and certified mail receipts, establishes that the NYSE mailed the Hearing Panel Decision to Fox on March 31, 2006. Fox acknowledges that he received it on April 6. The accompanying transmittal letter informed Fox that, if he were

1/ NYSE Rule 476(a)(6).

2/ Calvin David Fox, Securities Exchange Act Rel. No. 48731 (Oct. 31, 2003), 81 SEC Docket 2017.

3/ Cf. Robert J. Jautz, 48 S.E.C. 702, 703-04 (1987) (holding that if only violation alleged by NASD is failure to observe just and equitable principles of trade, there must be a finding of bad faith).

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aggrieved by the Hearing Panel Decision, he could, "pursuant to Exchange Rule 476, a copy of which is enclosed, request a review of the determination and/or penalty within 25 days of the date of this letter." The NYSE further advised Fox that "[f]ailure to exhaust your administrative rights at the Exchange may affect your right to SEC review." Fox filed his request for review of the Hearing Panel Decision with the NYSE Board of Directors on April 27, 2006. The Board of Directors denied Fox's request for review as untimely on May 12, 2006. Fox requested Commission review of the NYSE proceeding on May 24, 2006.

We must first determine whether Fox's request to the NYSE Board of Directors was timely under the NYSE's rules. NYSE Rule 476(e) provides that a hearing panel decision becomes final twenty-five days after "notice thereof has been served upon the respondent in the manner provided in [Rule 476] paragraph (d) . . . ." 4/ NYSE Rule 476(f) provides that a request for review by the NYSE Board of Directors shall be made by filing a written request within twenty-five days after notice of the hearing panel decision is served on the respondent. 5/ NYSE Rule 476(d) provides that "[s]ervice shall be deemed effective . . . upon mailing . . . to the respondent at [respondent's last known office address] or place of residence." 6/ By application of NYSE Rule 476(d), notice of the Hearing Panel Decision was served on Fox on March 31, 2006, and the twenty-five-day time limit began to run as of that date, as the transmittal letter stated. As a consequence, Fox was required to file his request for review no later than April 25, 2006. Fox, therefore, was two days late when he filed his request on April 27, 2006.

Fox argues that the NYSE's rules for service of documents, properly interpreted, provide that service is complete only upon delivery of the documents. Fox states that he received the letter on April 6, 2006, and that, therefore, his April 27 filing was within the twenty-five-day limit specified in NYSE Rule 476. Fox argues that the NYSE's rules on service of process are based on our Rules of Practice and "federal rules." He specifically claims that it "would be a denial of fundamental due process and equal protection" if the term "service" in NYSE Rule 476(d) is not construed to mean "actual receipt" (emphasis deleted), citing to our Rule of Practice 141(a)(2). 7/ That Rule provides that service to an individual of an Order Instituting Proceedings shall be made "by delivering" a copy of such order.

Fox's argument is inconsistent with the plain language of NYSE Rule 476(d) which states that service is effective upon mailing, not actual delivery. Moreover, Fox was specifically notified in the March 31, 2006 letter that he must file any request for review by the NYSE Board of Directors within twenty-five days "of the date of this letter." Fox offers no support for the

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4/ NYSE Rule 476(e).

5/ NYSE Rule 476(f).

6/ NYSE Rule 476(d).

7/ 17 C.F.R. § 201.141(a)(2).

proposition that NYSE rules "are based" on our Rules of Practice. He offers no explanation for why the unambiguous words "[s]ervice shall be deemed effective . . . upon mailing" in NYSE Rule 476(d) should be construed differently to mean "by delivering" as provided in our Rule 141(a)(2). Indeed, our Rules 141(b) and 150(d) provide that, for written decisions by a hearing officer, documents that are analogous to NYSE Hearing Panel Decisions, service may be "complete upon mailing." 8/

Given the clarity of the governing NYSE rule, the notice given to Fox in the plainest possible terms in the March 31, 2006 letter itself, and the ample time between Fox's April 6 receipt of the March 31 letter and Hearing Panel Decision and the due date of April 25, overlooking his late filing would be inappropriate. Accordingly, we sustain the NYSE's determination that Fox's request for review was untimely.

Fox's failure to exhaust his remedies at the NYSE precludes our consideration of his application for review. 9/ The precedent on this issue is well settled: "It is clearly proper to require that a statutory right to review be exercised in an orderly fashion, and to specify procedural steps which must be observed as a condition to securing review." 10/ Here, Fox did not follow the clear steps provided by NYSE. Fox's appeal must, therefore, be dismissed.

Accordingly, IT IS ORDERED that the above-captioned proceeding be, and it hereby is, dismissed.

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

8/ 17 C.F.R. §§ 201.141(b), 201.150(d).

9/ MFS Secs. Corp., Exchange Act Rel. No. 47626 (Apr. 3, 2003), 79 SEC Docket 3612 (appeal dismissed for failure to exhaust NYSE remedies), aff'd, 380 F.3d 611 (2d Cir. 2004); cf. David I. Cassuto, Exchange Act Rel. No. 48087 (June 25, 2003), 80 SEC Docket 1775 (NASD); Gary A. Fox, 55 S.E.C. 1147 (2002) (NASD); Datek Secs. Corp., Exchange Act Rel. No. 32306 (May 14, 1993), 54 SEC Docket 199 (late filing of request for review by NASD National Business Conduct Committee); Royal Secs. Corp., 36 S.E.C. 275 (1955) (late filing of request for review by NASD Board of Governors).

10/ Royal Secs. Corp., 36 S.E.C. at 277.