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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 57655 / April 11, 2008

Admin. Proc. File No. 3-12573

In the Matter of the Application of

DENNIS TODD LLOYD GORDON
AND
STERLING SCOTT LEE
c/o Joel A. Gordon
Joel A. Gordon & Associates
6666 Harwin Drive, Suite 220
Houston, Texas 77036

For Review of Disciplinary Action Taken by

NASD

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION -- REVIEW OF DISCIPLINARY PROCEEDINGS

Violations of Rules of Fair Practice

Permitting Unregistered Individual to Function as Principal

Failing to Maintain Accuracy of Membership Application

Charging Excessive Markups

Failing to Disclose Markups on Customer Confirmations

Individuals who served, respectively, as (a) chairman, chief executive officer, and principal and (b) president, chief compliance officer, and principal of former NASD member firm (1) permitted an unregistered individual to function as a principal of the firm, (2) failed to maintain the accuracy of the firm's membership application, and (3) charged retail customers excessive markups. President was responsible for firm's failure to disclose those markups on customer confirmations. Held, association's findings of violations and sanctions imposed are sustained in part and set aside in part.

APPEARANCES:

Joel A. Gordon, Esq., of Joel A. Gordon & Associates, for Sterling Scott Lee and Dennis Todd Lloyd Gordon.

Marc Menchel, Alan Lawhead, James Wrona, and Carla J. Carloni, for NASD.

Appeal filed: February 23, 2007
Last brief received: May 30, 2007

I.

Dennis Todd Lloyd Gordon, the chairman, chief executive officer, and a principal of former NASD member firm Lloyd Scott and Valenti, Ltd. ("LSVL" or the "Firm") and Sterling Scott Lee, LSVL's president, chief compliance officer, and also a principal of the Firm (together, "Applicants"), appeal from NASD disciplinary action. 1/ NASD found that, between February 2000 and May 2003, Applicants permitted an unregistered individual to function as a principal of the Firm, in violation of NASD Membership and Registration Rule 1021, 2/ NASD Conduct Rule 2110, 3/ and Article V, Section 1 of NASD's By-Laws, 4/ and that Applicants failed to

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1/ On July 26, 2007, the Commission approved a proposed rule change filed by NASD to amend NASD's Certificate of Incorporation to reflect its name change to Financial Industry Regulatory Authority, Inc., or FINRA, in connection with the consolidation of the member firm regulatory functions of NASD and NYSE Regulation, Inc. See Securities Exchange Act Rel. No. 56146 (July 26, 2007), 72 Fed. Reg. 42,190 (Aug. 1, 2007) (SR-NASD-2007-053). Because the disciplinary action here was taken before that date, we continue to use the designation NASD.

2/ NASD Membership and Registration Rule 1021 requires, among other things, that "[a]ll persons engaged . . . in the . . . securities business of a member who are to function as principals shall be registered as such" with NASD. NASD Manual at 3171 (2000).

3/ NASD Conduct Rule 2110 requires NASD members to observe high standards of commercial honor and just and equitable principles of trade. Id. at 4111. NASD Rule 115 provides that persons associated with members shall have the same duties and obligations as members under the rules. Id. at 2111. A violation of NASD's Membership and Registration rules also constitutes a violation of Conduct Rule 2110. E.g., Michael F. Flannigan, 56 S.E.C. 8, 18 (2003).

4/ As relevant here, Article V, Section 1 of NASD's By-Laws prohibits a member from permitting any person associated with the member to engage in the investment banking or

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maintain the accuracy of the Firm's membership application, in violation of Article IV, Section 1 of NASD's By-Laws. 5/ NASD found further that Applicants, acting with scienter, caused LSVL to charge fraudulently excessive markups in thirty-one retail sales during a three-month period in 2002, in violation of NASD Rules 2110, 2120, 6/ 2440, 7/ IM-2440, 8/ and Section 10(b) of the Securities Exchange Act of 1934 and Exchange Act Rule 10b-5, 9/ and that Applicants failed to disclose those markups on customer confirmations, in violation of NASD Rule 2230, 10/

4/ (...continued)
securities business without first determining that such person meets eligibility requirements and is not subject to disqualification. NASD Manual at 1310.

5/ Article IV, Section 1 of NASD's By-Laws requires members to ensure that membership applications are kept current by supplemental amendments. Id. at 1308; see also IM-1000-1, id. at 1311 (stating that filing with NASD incomplete or inaccurate information that is misleading or could tend to mislead may be conduct inconsistent with just and equitable principles of trade).

6/ NASD Conduct Rule 2120 prohibits the use of manipulative, deceptive, or other fraudulent devices in connection with any transaction in, or purchase or sale of, any security. Id. at 4141.

7/ NASD Conduct Rule 2440 requires that securities transactions entered into between members and their customers occur at fair prices, taking into account all relevant circumstances. Id. at 4351.

8/ IM-2440 deems it a violation of NASD Conduct Rules 2110 and 2440 "for a member to enter into any transaction with a customer in any security at any price not reasonably related to the current market price of the security." Id. IM-2440 was renumbered IM-2440-1 as of April 16, 2007. Order Granting Approval to Proposed Rule Change Relating to Additional Mark-Up Policy for Transactions in Debt Securities, Except Municipal Securities, Exchange Act Rel. No. 55638 (Apr. 16, 2007), 90 SEC Docket 1367, 1368 n.14.

9/ 15 U.S.C. § 78j(b) and 17 C.F.R. § 240.10b-5. Exchange Act Section 10(b) and Rule 10b-5 thereunder generally make it unlawful for any person to use any manipulative or fraudulent device in connection with the purchase or sale of any security.

10/ NASD Conduct Rule 2230 sets forth disclosure and other requirements governing customer confirmations, including the requirement, when an NASD member is "acting as a broker" for a customer, to disclose "the source and amount of any commission or other remuneration received" in connection with the transaction reported in the confirmation. NASD Manual at 4213.

Exchange Act Section 10(b), and Exchange Act Rule 10b-10. 11/ NASD barred Gordon and Lee in all capacities and ordered them, jointly and severally, to pay restitution of $20,832.40 plus interest. 12/ We base our findings on an independent review of the record.

II.

This case involves two distinct types of misconduct. First, NASD found that Applicants allowed a person who had not registered with NASD in any capacity to exercise significant management authority over the Firm, and that Applicants did not report that person's association with LSVL to NASD, as required. Second, NASD found that Applicants, acting with scienter, caused LSVL to charge fraudulently excessive markups that were not disclosed on confirmations sent to customers. We turn first to the misconduct related to the Firm's association with an unregistered person.

A. Misconduct Related to Association with Unregistered Principal

1. Facts

In late 1998 or early 1999, Gordon met Michael Guss, a Russian-trained lawyer who had immigrated to the United States in 1991. 13/ In 1996, Guss pleaded guilty to a felony involving

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11/ 17 C.F.R. § 240.10b-10. Exchange Act Rule 10b-10 requires, in relevant part, that a non-market maker broker-dealer who, acting as a principal for its own account, "after having received an order to buy [an equity security] from a customer, . . . purchased the equity security from another person to offset a contemporaneous sale to such customer or, after having received an order to sell from a customer, . . . sold the security to another customer to offset a contemporaneous purchase from such customer" must disclose in writing to the customer "the difference between the price to the customer and the dealer's contemporaneous purchase (for customer purchases) or sale price (for customer sales)." Rule 10b-10(a)(2)(ii)(A), 17 C.F.R. § 240.10b-10(a)(2)(ii)(A).

12/ NASD also assessed costs. Gordon's request for a stay pending appeal was denied on March 5, 2007.

13/ Guss was known by several names, including Mikhail Soroejine and Mike Kale. We refer to him throughout this opinion as Michael Guss, the name he gave when he testified on the record during the NASD staff's investigation. Guss did not testify before the NASD Hearing Panel.

In a separate NASD disciplinary proceeding, which was settled, LSVL and Guss were censured, fined, and required to pay restitution to injured customers; LSVL was further

(continued...)

money laundering. As a result of that conviction, Guss was, at all times relevant to this matter, disqualified from registration in the securities industry. 14/ Applicants admit that they knew that Guss was not registered with NASD, but deny any knowledge of his disqualification. 15/ They do not dispute, however, that they failed to determine whether Guss was disqualified.

Gordon and Lee became registered with LSVL in approximately February 2000 and May 2000 respectively. LSVL was wholly owned successively by two holding companies. As of February 2000, LSVL was held by Devonshire Forte, Ltd. ("Devonshire"). Gordon and Lee each owned twenty percent of the shares of Devonshire and served on its board of directors. The majority owner of Devonshire, holding sixty percent of its shares, was Elena Sordia, a Russian attorney. Guss testified during the NASD staff's investigation that he held a general power of attorney for Sordia. 16/

In May 2002, Envision Ventures, Inc. ("Envision") acquired LSVL from Devonshire. As with Devonshire, Gordon and Lee each owned twenty percent of the shares of Envision and served on its board of directors. Kathia Santiago, a former fashion model and Guss's wife, was the majority owner of Envision, holding sixty percent of its stock.

13/ (...continued)
required to undertake an ownership change, and Guss was barred in all capacities. In June 2004, LSVL filed a Form BDW to withdraw its broker-dealer registration.

14/ See Article III, Section 4(g)(2) of NASD's By-Laws, NASD Manual at 1307 (stating that person convicted of felony is subject to disqualification from association with NASD member for ten years after date of conviction); Article V, Section 2(b) of NASD's By-Laws, id. at 1311 (stating that NASD shall not approve an application for registration of a person not eligible to be an associated person of a member).

15/ Guss testified, during the NASD staff's investigation, that he informed Gordon and Lee generally about the guilty plea in 2000 or 2001, but Gordon and Lee testified that they did not learn of the plea until approximately October 2003, after the NASD staff's investigation started. Although NASD's hearing panel, which heard Applicants' testimony, found that Applicants either "knew, or should have known," that Guss was statutorily disqualified, NASD's National Adjudicatory Council expressly declined to make that finding, noting that the evidence was inconclusive. Like the NAC, we do not find that Applicants knew of Guss's disqualification.

16/ Although the terms of the power of attorney and the evidence regarding whether Guss held a proxy for Sordia are unclear, our findings are based on what the record shows about the authority Applicants actually allowed Guss to exercise.

LSVL was not a profitable venture for either holding company. The Firm required repeated funding from the holding companies in order to survive. Gordon and Lee anticipated, however, that if LSVL made money, they would receive a share of the profits. 17/

Gordon and Lee described Guss's official role at the Firm as its "webmaster," i.e., limited to maintaining its Internet website and related Internet activities. 18/ Despite his ostensibly limited role, however, Guss directed the Firm's activities. The record establishes that, working nearly full time for the Firm, Guss exercised authority over a broad range of Firm operations, including the recruiting, hiring, and firing of Firm personnel; setting employee sales quotas; and issuing policies regarding employee use of Firm supplies and equipment. Guss was also involved in establishing policies regarding employee accountability and other administrative matters, in addressing a customer complaint about an apparent discrepancy in an account, and in handling the Firm's relations with its clearing firm.

The Firm's business plan involved expansion by opening branch offices and hiring "independent brokers, getting them set up under the [LSVL] umbrella." Guss actively sought to establish LSVL branch offices and recruit individual brokers. 19/ Guss interviewed potential candidates and negotiated relevant agreements. 20/

17/ There was a one-time special distribution from LSVL to one of the holding companies, as a result of which Lee and Gordon each received several thousand dollars.

18/ Applicants testified that Guss was responsible for "setting up all the websites, designing the website, developing the website, hosting the website," and for developing the software and website for NexStox, an Internet trading division of LSVL, seeing that it worked, and conducting an email campaign to advertise NexStox.

19/ All individuals associated with LSVL, whether registered or unregistered, were employed and compensated by the holding company and "assigned" by the holding company to work at LSVL. The record shows that Lee had some responsibilities for hiring and firing these employees. Gordon testified, however, that "[i]f necessary, I'm sure [Guss] would call a board meeting if he wanted to overrule [Lee]," although he also stated that "it didn't happen very often, if at all."

20/ For example, in a February 5, 2003 email to Lee, an LSVL registered representative complained that "when michael hierd [sic] me," he told the registered representative one thing regarding compensation, but now Lee was telling him something different.

For example, Guss arranged for Jeffrey Chicola to establish a New York branch office in June 2000. 21/ Gordon admitted that Guss "was involved in recruiting" for another branch office in New York, "[a]nd if there was a deviation from the [standard employment] agreement, Mr. Guss, may have discussed it with the brokers. He may have asked or even directed Sterling [Lee] or I to accept it."

On July 22, 2002, Guss sent an email to Gordon, with a copy to Lee, saying that he "urgently" needed a template of an agreement "for the crew in Long Island," who had called Guss and said that "they wanted to go ahead with a switch to LSVL. I will need to discuss with you their wish list and some of the adjustments we might need to make to get those kids on board." Lee apparently acquiesced in Guss's handling the matter on behalf of LSVL, replying, "Great news!" and saying that he would have someone email Guss a current copy of the requested agreement. 22/ LSVL eventually opened an additional New York branch office at Guss's recommendation.

In a January 2002 email, Guss instructed Lee to

> get [a new registered representative] registered (with pre-hire dated of 1/15/2002 [sic]). He will come on board in a couple of weeks and will start an [office] here in FL. . . . [W]e will support him in several ways for a test period of time . . . . [W]e will pick up some of his expenses (still in negotiation). Test period is 3 months as he has to show at least $15k worth of production.

In a September 18, 2002 email to Lee, with a copy to Gordon, Guss reported that he was "working on" arrangements for a Florida branch office; on September 22, 2002, he reported that "[t]he negotiations here in FL are in the final stage" and attached a copy of a branch office agreement.

In a February 6, 2003 email to Gordon and Lee, Guss proclaimed, "We might be in serious luck. I might be landing a producer here in FL today. . . . He is also bringing in additional brokers (if it works out)." In December 2002, Guss alerted Gordon and Lee by email that an individual from Chile would be submitting a pre-hire form and asked them to "[p]lease process his hire."

21/ Initially, Guss recruited Chicola to be LSVL's president. However, Chicola was unable to start work at LSVL as soon as Guss wanted him to, and by the time he did start, Lee had already become president of LSVL.

22/ Both Lee and Gordon testified that Guss had no authority to bind the Firm to contracts. However, Lee and Gordon accepted Guss's involvement in contract negotiation because, as Gordon testified, "[h]e represented the largest shareholders . . . of both [Devonshire Forte] and Envision Ventures."

The record also shows that Guss asserted and exercised authority to terminate Firm employees, including registered personnel. In a December 11, 2001 email, Guss instructed Lee and Gordon to "[p]lease fire all the worthless brokers who have not paid renewals by the 21st. Please fire all the rest of the worthless brokers who paid their renewals but still owe the firm money as soon as possible." 23/ In early January 2003, Guss directed Lee to ask an LSVL employee who held several securities licenses "to resign effective immediately" and asked Lee to find a new employee and then to "get rid of" another employee as soon as the new hire was found. 24/ In a January 27, 2003 email, Guss informed Lee that yet another employee "is fired as of today." In February 2003, Guss asked Lee to terminate a licensed employee whom Guss described as "a quitter, whiner and complainer"; several days later, Lee sent the succinct reply, "[D]one."

Lee and Gordon acceded to Guss's authority. In a January 2002 email to an LSVL employee, Lee identified Guss as one of the "powers" who "have the power to tell me to fire people." A former LSVL employee testified that, when Lee terminated her employment with the Firm, he said that "if Michael [Guss] wanted to let me go, there was nothing he could do to help me." Gordon himself admitted in testimony that it was within Guss's power to fire Gordon and Lee, the president and CEO of the Firm: "If he wanted to have a board meeting and have us fired, so be it."

Guss also directed numerous aspects of LSVL's business operations, including working conditions, policies, and employee assignments. In a November 24, 2001 email captioned "Policy Issus" [sic], Guss provided a ten-point list of "new corporate policies and action directives" with which the holding company "expects LSVL to comply." Guss directed that new brokers recruited to work for LSVL submit to a credit check, document at least $24,000 of annual brokerage production for the last fiscal year, and agree that their outstanding debts to the Firm be paid in full by the end of each month starting with the second month of their registration with the Firm. Guss added that "LSVL management should have no right to waive any of the above without prior approval by [Devonshire Forte]." Guss further stated that "all licensed employees" must "be able to operate Q-Charts quote system" and be able to explain "equities' and options' quotes and charts in Q-Charts system" (and that training of any employees who lacked familiarity with that system "must commence immediately") and that employees must "refresh their skills pertaining to opening NexStox.com accounts."

23/ It is not clear what "renewals" Guss is referring to. In another email, Guss discusses the need to make sure registered representatives pay Devonshire their "outstanding dues."

24/ The employee in question testified that she was not a salesperson for LSVL and that her responsibilities were more administrative than sales-oriented. However, a January 3, 2003 email from Guss to Gordon and Lee directing Lee to "ask [the employee] to resign immediately" stated that a new employee to be hired "has to take up all the licensed functions" she performed.

In a later email, dated December 11, 2001, Guss told Lee and Gordon that "[t]he new recruitment policies must be adopted and strictly adhered to" and that "[a]ll the policies submitted in the letter [sic] of 11/24 must be implemented." In the same email, Guss directed Lee and Gordon to assign an employee to "a permanent mission of harassing the brokers who owe the firm money with collection letters"; emphasized the "need to establish rigid accountability of the employees"; and proposed "installing software in the girls' computers allowing management to remotely oversee what they are doing."

Guss also gave orders directly to LSVL personnel. For example, in a May 2002 email, Guss gave an LSVL employee an "urgent mission" to deal with several requests related to reporting trade information and editing reports regarding order routing required by Commission rule. In a July 15, 2002 email, he passed along a customer inquiry regarding an alleged $232 discrepancy in the customer's account, asking an administrative employee at LSVL to "look into it and reply to the customer directly . . . [and] copy me . . . ." 25/ On another occasion, Guss interceded to make sure that a customer's account was set up to allow margin trading before the account was funded.

Guss held himself out to persons outside the Firm as having authority to communicate for and make commitments on behalf of LSVL. In an email regarding a proposed branch office agreement, Guss referred to "[m]y firm, Lloyd, Scott & Valenti, Ltd." On LSVL's behalf, Guss represented: "We will ask you to provide a subordinated loan . . . . We will sign a [branch office] agreement . . . . We will lease . . . all your current hardware. . . . We will weed out all the bad traders and brokers . . . . We can complete all that in 4-6 weeks." Applicants were copied on the email. Guss also identified himself with LSVL in email correspondence with a clearing firm, reminding the firm that "we submitted a proposal of a new clearing agreement to you. . . ." 26/ In an email seeking to attract potential registered representatives to join LSVL, Guss referred to "our own brokers"; Guss signed the email "Michael, repsupport@lsvl.net."

Persons outside LSVL dealt with Guss as someone they expected to be able to act on behalf of LSVL. For example, in a February 2003 email to Gordon, copy to Lee, Guss wrote:

> PCCM [an issuer] have officially requested me to consider putting LSVL on the cover of their SB-2 offering as the lead best-efforts underwriter. . . . We need to fast-track this deal and by the end of next week . . . we must have all the ducks in a row to have the selling agreement fully prepared. Can we pull this off?

25/ The customer apparently had complained that his account balance decreased by $232 from one day to the next despite no intervening account activity.

26/ The email also states, "you wrote to me promising to get back . . . ." Applicants were copied.

Jeffery Chicola, who worked in the original LSVL New York branch office during 2000 and 2001, testified that "all big decisions," "all major decisions," and "all money decisions" were made by Guss while Chicola was at LSVL. Chicola further testified that Guss told him that Gordon and Lee would do whatever Guss told them to do. When there were disagreements, Chicola testified, Chicola would bring in Guss and the matter in question would be handled as Guss directed.

Although at the hearing Applicants asserted that Guss's role at the Firm was limited primarily to technical support, other portions of their testimony and certain internal emails show that they recognized that his role was far more expansive. In a December 11, 2001 email to Lee, Gordon wrote, "As [Sordia's] proxy, we report to Michael [Guss]. He is our boss . . . ." In an October 17, 2002 email addressed to "the staff at the Austin office" of LSVL, Gordon characterized Guss as "one of your superiors." In the same email, Gordon instructed the staff that they should "follow Michael's instructions without fail." 27/

Moreover, Applicants were apparently aware that Guss's active managerial role was in violation of NASD requirements. Two former LSVL staff members testified that Applicants instructed them, before a routine NASD examination in 2001, to avoid referring to Guss other than as the Firm's webmaster and to put documents that had Guss's name on them out of sight. 28/ In a February 11, 2002 letter to Guss and Lee, Gordon expressed concern about

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27/ The email stated that Guss would "not provide you with instructions related to specific securities, securities related issues, or brokerage related instructions." However, this assertion is contradicted by other emails discussed above.

28/ Although Lee denied having given such instructions, the NASD hearing panel, which heard the witnesses testify, credited the staff members' testimony, finding that Applicants "instructed the firm's staff to remove documents bearing MG's name from view" and "directed LSVL staff to refrain from discussing [Guss] with NASD examiners, telling them to say that [Guss] was the firm's webmaster, if asked." Applicants argue that, contrary to the assertion in NASD's brief, the record is devoid of any evidence suggesting that Applicants told "brokers" not to mention Guss to the NASD examiners. Although the witnesses who testified were not part of LSVL's sales force, Applicants' instructions nonetheless suggest that they were attempting to conceal the true nature of Guss's involvement with the Firm from the examiners.

Applicants argue that the record shows they did not attempt to conceal Guss from regulators because "Lee took calls from Guss, which were openly announced to Lee by the receptionists in the presence of NASD examiners," Gordon mentioned Guss in a Pre-Membership Interview, and "over 8000 emails which disclosed the existence of Guss were voluntarily delivered to examiners."

(continued...)

> Michael's increased direct involvement with registered representatives of the b/d . . . . It should be noted that if Michael engages in conversations with parties where it is implied by Michael that he can cause LSVL to do or not do specific business, he might be engaging in investment banking/securities activities of the firm as an unregistered associated person, which is obviously against the rules.

Gordon stated in the letter that Guss's direct involvement with the sales staff was a problem "for both Sterling and myself." In a late February 2002 series of emails between Lee and Guss, on which Gordon was copied, Guss asked why certain stocks were on LSVL's approved product list and who was "pushing" those stocks. Lee responded:

> It is not a need for [Devonshire] to know who is pushing certain stocks. That is an LSVL function. It is a [moot] point anyway. I can only surmise (and probably correctly) that you are talking to the brokers . . . . [Devonshire's] engagement with brokers about investment activity is a violation of our policies. I am not sure how many more times this must be re-iterated before it becomes common practice of [Devonshire]. I think we should just register you as an associated person so we will not have this discussion anymore. Following the rules is of the UTMOST importance.

Lee admitted that Guss had "obviously" been told before the February 2003 emails were sent that he should not discuss investment activity with LSVL registered representatives, and that Guss "didn't get the message the first time, and it took three times or something." 29/ Lee conceded that it was "possible" that Guss had been engaging in activity that would have required a securities license. Lee testified that he had little leverage to "keep [Guss] corralled," but stated that he could not have cut off contact with Guss: "His family had a large investment in the entire parent company and the subsidiary." Gordon similarly admitted, "Honestly, Michael [Guss] has the – the representative of the largest shareholder has a lot of input."

28/ (...continued)
We find that this evidence does not establish that Applicants did not attempt to conceal the nature of Guss's involvement with the Firm. Applicants have not shown that the receptionists' announcements or any mention of Guss in the Pre-Membership Interview disclosed the degree of Guss's involvement with LSVL. As far as the email messages were concerned, NASD's 2003 examination was unannounced, and Applicants cooperated with NASD examiners pursuant to NASD Procedural Rule 8210.

29/ Lee paraphrased his advice to Guss, "Why don't you just get registered? You keep coming up to the line and maybe stepping a foot over. If you want to leap in, you need to get registered."

2. Analysis

a. NASD defines principals as persons associated with a member "who are actively engaged in the management of the member's investment banking or securities business, including supervision, solicitation, conduct of business or the training of persons associated with a member for any of these functions." 30/ NASD has informed its members that "[a] registration determination does not depend on the individual's title, but rather on the functions that he or she performs." 31/

It is clear from the record that Guss, although not holding an official managerial title at the Firm, nonetheless filled a management role at LSVL. Guss devoted a substantial amount of time and attention to LSVL, giving directions and orders to Gordon and Lee about a wide variety of matters related to the conduct of LSVL's business. 32/ Applicants acceded to Guss's authority. They repeatedly referred to Guss as a "boss" or "superior," someone who was "running" the Firm and "making the decisions." Employees were told to "follow [Guss's] instructions without fail." We have previously held that a person who devotes significant time to firm affairs and participates in management decisions is a principal, whether or not the person holds an official firm title. 33/

30/ NASD Membership and Registration Rule 1021(b).

31/ NASD Notice to Members 99-49 (June 1999), 1999 NASD LEXIS 24, at *4; cf. Gordon Kerr, 54 S.E.C. 930, 935 (2000) (basing determination as to whether individual is supervisor on both responsibilities assigned and activities performed). While Rule 1021(b) lists five categories of persons who are required to register as principals, we have previously sustained NASD determinations that persons who do not fall into one of those categories are principals where, as here, the requirement of active engagement in the management of the member's investment banking or securities business is satisfied. See, e.g., Richard F. Kresge, Exchange Act Rel. No. 55988 (June 29, 2007), 90 SEC Docket 3072, 3092-93; Samuel A. Sardinia, 46 S.E.C. 337, 343 (1976).

32/ The record contains more than 200 pages of copies of emails. Numerous other emails not explicitly mentioned in this opinion further support the conclusions reached here.

33/ Sardinia, 46 S.E.C. at 343; see also Kresge, 90 SEC Docket at 3092-93 (finding that individual who held no official firm title, but provided financial support to branch office, played a substantial role in office finances, was actively involved in hiring, participated in meetings, and acted as leader of personnel initially opening office was "actively engaged in the management" of firm's securities business and therefore should have been registered as a principal); Kirk A. Knapp, 51 S.E.C. 115, 129 (1992) (finding that individual continued to function as principal despite relinquishing titles of president and director).

Guss also represented himself outside LSVL as one acting on behalf of the Firm, referring to LSVL as "my" firm and speaking of LSVL's actions in terms of what "we" had done or would do. Third parties with whom he dealt on the Firm's behalf understood Guss to be in a position to act for the Firm, which is additional evidence of his principal status. 34/ Under the circumstances, we believe that Guss was associated with the Firm in a principal capacity without the requisite registration, in violation of NASD rules, and that Applicants actively facilitated that association.

NASD Membership and Registration Rule 1021 requires, among other things, that "[a]ll persons engaged . . . in the . . . securities business of a member who are to function as principals shall be registered as such with NASD . . . ." Applicants contend that Rule 1021 does not require that individuals who "only provide functions to support" a firm's securities and investment banking business register as principals and that "functions not involved in the chain of the securities transaction do not require registration as a principal." They contend that Guss's involvement was limited to LSVL's "general, back-office and other non-securities related business activities" and that registration as a principal was therefore not necessary. Applicants cite no authority in support of the narrow "chain-of-securities transactions" rule they articulate, and we are aware of none.

Moreover, Guss's involvement at LSVL went far beyond the limited functions described by Applicants. As set forth above, Guss was extensively involved in personnel matters at LSVL: from establishing branch offices; hiring and negotiating the terms of registered representatives' employment; and ordering the termination of LSVL employees. He negotiated with clearing firms and gave extensive instructions about LSVL operations and policies. We have previously held that conduct of this nature supports the determination that registration as a principal is required. 35/

Applicants assert that "any person in any member firm can submit a request to make policy," but argue that, if Guss had the ability to make policy, he would have phrased his instructions as orders rather than mere requests. Applicants further contend that Guss was not

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34/ Hans N. Beerbaum, Exchange Act Rel. No. 55731 (May 9, 2007), 90 SEC Docket 1863, 1866-68 (unregistered person held self out as principal and officer of firm); L.H. Alton & Co., 53 S.E.C. 1118, 1125 n.21 (1999) (unregistered person held self out as partner); William J. Blalock, 52 S.E.C. 77, 84 & n.25 (1994) (unregistered person held self out as president of firm), aff'd, 96 F.3d 1457 (11th Cir. 1996) (Table).

35/ See, e.g., Knapp, 51 S.E.C. at 129 (negotiating employment contract, salary, and benefits and firing employee contributed to determination that individual was principal); Kirk A. Knapp, 50 S.E.C. 858, 861 (1992) (hiring of salesperson was factor contributing to conclusion that individual exercised managerial role and was acting as a principal); see also Douglas Conrad Black, 51 S.E.C. 791, 794 (1993) (employee who supervises another employee is a principal).

managing LSVL because the directives he gave were not necessarily followed. We have previously held, however, that the fact that one is consulted about firm affairs may "illustrate[] . . . influence in the management of the firm" whether or not the views articulated prevail. 36/ Moreover, we observe that many of Guss's directives to Applicants, in fact, take the form of orders and have noted above a number of instances where Applicants followed Guss's directives. Both Lee and Gordon acknowledge that they were under a lot of pressure to do what Guss wanted because he was the representative of the majority shareholder of the holding companies that successively owned LSVL and could have them fired if he so chose.

Applicants assert that Guss's powers at LSVL were limited because, they say, the power of attorney that Guss held for Sordia specifically prohibited him from exercising signatory authority. They also assert that Guss never exercised a proxy. We have previously held that an individual who is actively engaged in the management of a firm may be a principal without finding that the individual had signatory authority, or held a proxy, or otherwise exercised voting control over a firm or the holding company for a firm. 37/ The record establishes that Guss had extensive authority over the Firm's activities; that Guss exercised it; and that Applicants viewed Guss as acting on Sordia's, then Santiago's, behalf, with or without signatory authority or proxy.

Applicants argue that no individual act by Guss required registration and that "if each act by Guss independently does not constitute a violation, the mere cumulation of the same acts will not change the outcome." They also refer to "common practice" and assert that various things Guss did for LSVL are commonly handled by outsiders who are not required to register; for example, they claim that recruiting is sometimes handled by recruiting firms.

In determining whether an individual is required to register as a principal we consider all of the relevant facts and circumstances, including the cumulation of individual acts that might not, on their own, show management. As discussed above, Guss undertook responsibility for a wide range of issues related to the conduct of LSVL's business and the tenure and conduct of its employees. 38/ Moreover, even if no individual function required Guss to be registered, the

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36/ Sardinia, 46 S.E.C. at 343; see also Knapp, 51 S.E.C. at 129 (finding that individual who demanded to be included in discussions about issues including hiring and budget decisions, personnel and salary rates, and leasing acted as principal).

37/ E.g., Kresge, 90 SEC Docket at 3092-93; Sardinia, 46 S.E.C. at 343.

38/ See, e.g., Juan Carlos Schidlowski, 48 S.E.C. 507, 510 (1986) (reviewing "very broad responsibility" given to individual across several departments in concluding that principal registration was required).

combination of functions he exercised clearly brought him within NASD's definition of a principal. 39/

Applicants argue that they took affirmative steps to ensure that Guss did not engage in LSVL's securities business. However, the weight of the evidence shows that any such steps were ineffective. Applicants knew that Guss wielded controlling power, and they allowed that to happen.

For the reasons discussed above, we find that Guss functioned as a principal and was not registered. In permitting Guss to associate with the Firm as a principal without determining his eligibility or the existence of any disqualification, Applicants violated Rules 1021 and 2110 and were responsible for the Firm's violation of Article V, Section 1 of NASD's By-Laws.

b. We also find that Applicants were responsible for LSVL's violation of Article IV, Section 1(c) of NASD's By-Laws based on their failure, during the entire period at issue here, to list Guss on the Firm's Form BD. Between February 2000 and May 2003, Applicants made more than twenty Form BD filings on behalf of LSVL. Applicants stipulated at the hearing that Guss's name did not appear on any Form BD submission made by LSVL at any time.

Article IV, Section 1(c) requires that each NASD member "ensure that its membership application with [NASD] is kept current at all times by supplementary amendments." 40/ Firms must file amendments with NASD "not later than 30 days after learning of the facts or circumstances giving rise to the amendment." 41/ Because Guss was actively involved in the management of LSVL, LSVL's Form BD should have reflected that involvement. 42/ Applicants'

39/ Applicants argue that "separate functions are the basic premise for different registrations, [and] . . . [w]ithout compartmentalization there would be no need for different registration qualifications." In some instances different functions may require different registrations, but the question in this proceeding is merely whether Guss was required to register as a principal. Guss was not registered in any capacity; issues about registration in other capacities are not before us.

40/ NASD Manual at 1308.

41/ Id.

42/ Question 9 on Form BD asks, among other things, whether any person not named in other specified sections of the form "control[led] the management or policies of the applicant through agreement or otherwise." "Control" is defined as "[t]he power, directly or indirectly, to direct the management or policies of a company, whether through ownership of securities, by contract, or otherwise." Based on our findings set forth above, we conclude that Guss controlled the management of LSVL within this definition.

failure to disclose Guss's involvement with LSVL caused LSVL's application to be incomplete, inaccurate, and misleading.

c. i. Guss's investigative testimony and the accompanying exhibits (most of which were emails) were introduced into evidence at the hearing. When asked by the hearing officer whether there was an objection to the introduction of that evidence, counsel for Applicants answered that there was not. Applicants now assert that neither they nor their counsel were present when NASD's Department of Enforcement ("NASD Enforcement") took Guss's investigative testimony and that they therefore had no opportunity to cross-examine Guss. They therefore argue that fundamental fairness and due process mandate that all testimony and emails involving Guss that were introduced into the record should be stricken.

Hearsay evidence may be admitted in NASD proceedings, depending on its probative value and reliability, and the fairness of its use. 43/ Among the factors we may consider in determining whether to rely on hearsay are possible bias of the declarant; the type of hearsay at issue; whether the statements are signed and sworn to rather than anonymous, oral, or unsworn; whether the statements are contradicted by direct testimony; whether the declarant was available to testify; and whether the hearsay is corroborated. 44/

There is little reason to suspect bias in Guss's testimony or the emails he wrote; to the extent the evidence shows that Guss was required to register as a principal, Guss is implicated in the violation just as Applicants are. 45/ The reliability of the contested evidence is high. Guss's investigative testimony, which was given under oath, is consistent with much of the other testimony in the proceeding, including in many instances that of Applicants. Emails written by Guss are generally consistent with emails written by Gordon and Lee. Thus, direct testimony and other evidence tends to corroborate the contested evidence, not contradict it. Moreover, as the discussion above shows, our conclusions depend not on the resolution of evidentiary conflicts as to what Guss did -- Guss's actions during the relevant period are largely undisputed -- but rather on the conclusions we draw as to whether what he did caused him to be deemed a principal as that term is used in NASD rules. We therefore reject Applicants' argument that the contested evidence should be stricken.

ii. Applicants also argue that the hearing panel should not have "credit[ed] Chicola's testimony and reject[ed Applicants']." Applicants assert that they have a combined total of thirty-six years of licensure without having been sanctioned or reprimanded by NASD,

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43/ See Kevin Lee Otto, 54 S.E.C. 847, 854 & n.12 (2000), aff'd, 253 F.3d 960 (7th Cir. 2001).

44/ Rooney A. Sahai, Exchange Act Rel. No. 51549 (Apr. 15, 2005), 85 SEC Docket 862, 872 & n.21 (citing Charles D. Tom, 50 S.E.C. 1142, 1145 (1992)); Otto, 54 S.E.C. at 854.

45/ As indicated, Guss settled NASD allegations against him. See supra note 13.

whereas Chicola was dismissed from LSVL for cause. We find that Applicants have not provided a sufficient basis for rejecting the hearing panel's determination to credit Chicola.

Credibility determinations by the fact finder deserve special weight, and can be overcome only when there is substantial evidence for doing so. 46/ Substantial evidence corroborates Chicola's testimony as to Guss's role at LSVL. The emails in the record, the testimony of other LSVL employees, the investigative testimony of Guss, and the testimony of Applicants corroborate Chicola's testimony.

B. Misconduct Related to the Pricing of Securities

1. Facts

Between June 6 and August 30, 2002, LSVL effected thirty-one transactions in Pacific CMA, Inc. ("PCCM"), a thinly traded equity security that traded on the Over-the-Counter Bulletin Board. Although executed by the Firm as a dealer, i.e., in a principal capacity from its own proprietary account, each of these trades was "riskless" in that the stock was acquired by the Firm only after the purchasers had agreed to buy the stock. 47/ Although LSVL's riskless principal trades represented at least 65% of the total trading volume of PCCM shares in each of the three months in question, it is undisputed that the Firm was not a market maker in the stock. 48/

46/ Daniel D. Manoff, 55 S.E.C. 1155, 1161-62 & n.6 (2002) (citing cases).

47/ We have defined a riskless principal transaction as one in which "after receiving an order to buy or sell from a customer, the broker-dealer purchases the security from another person to offset a contemporaneous purchase by the customer or sells the security to another person to offset a contemporaneous sale by the customer." Confirmation of Transactions, Exchange Act Rel. No. 33743 (Mar. 9, 1994), 56 SEC Docket 656, 657 n.11. See also Rule 10b-10(a)(2)(ii)(A), 17 C.F.R. § 240.10b-10(a)(2)(ii)(A) (requiring certain disclosures when riskless principal transactions are effected).

As noted above, see supra note 10, Rule 2230 requires disclosure of the amount of any remuneration received in connection with a trade when an NASD member is "acting as a broker" for a customer. Although, as discussed below, see infra text accompanying note 59, a riskless principal trade is the economic equivalent of an agency trade, the Firm technically was acting as a dealer here (rather than a broker), and therefore, by its terms, Rule 2230 does not cover the trades.

48/ Section 3(a)(38) of the Exchange Act, 15 U.S.C. § 78c(a)(38), in relevant part, defines "market maker" as "any dealer who, with respect to a security, holds himself out (by

(continued...)

The PCCM trades at issue were executed using an account that Applicants had established at LSVL for the purpose of conducting riskless principal trades. 49/ These trades were effected as follows: An LSVL registered representative initially identified a shareholder of PCCM who owned and wanted to sell a large block of stock. The registered representative then sought out potential purchasers of the stock. As he found purchasers for varying quantities of the selling shareholder's shares, he matched purchases and sales and called the trades in to Lee. Lee executed all thirty-one of the trades at issue. 50/ Gordon reviewed the supporting documentation for the trades at the end of the month.

LSVL purchased PCCM from the seller at the inside bid, charged the selling customer approximately an additional five percent of the purchase price, and then sold the stock to the previously identified purchasers at the inside offer. 51/ LSVL kept as remuneration the difference between the price it paid to purchase the shares, i.e., the inside bid price less five percent, and the price for which it sold the shares, with the registered representative retaining seventy-five percent of the money and the Firm retaining twenty-five percent. 52/ Applicants do

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48/ (...continued)
entering quotations in an inter-dealer communications system or otherwise) as being willing to buy and sell such security for his own account on a regular or continuous basis." Under Exchange Act Rule 15c3-1, 17 C.F.R. § 240.15c3-1, LSVL, which maintained a minimum net capital of only $5,000, was not permitted to act as a market maker.

49/ Although Lee asserted that the Firm "didn't keep an inventory" and "didn't have an account [where] we would have shares deposited," the record shows that the PCCM shares in question were briefly in the LSVL cross principal trading account between the time they were bought and the time they were sold.

50/ Only Lee and Gordon were authorized to execute trades in the riskless principal trading account.

51/ The inside offer and bid prices, respectively, are the lowest price a dealer is willing to sell at and the highest price a dealer is willing to pay for the security.

52/ On August 8, 2003, Gordon wrote a letter to Commission staff asking for "clarification and/or a no-action letter regarding the specific use of a riskless principal cross-trading account." The letter confirms the testimony given at the hearing, including the fact that LSVL took as its remuneration the difference between the best bid (paid to the seller) and the best offer (received from the buyer). The letter described the trading activity as ongoing rather than proposed and stated that NASD had "questioned the firm's ability to retain the spread due to the fact that it exceeds the 5% mark-up/commission guideline."
(continued...)

not dispute that this resulted in markups ranging from 12.9% to 54.55% on the trades, based on the purchase price of the shares. 53/ The Firm had total profits from these trades of $32,301. 54/

2. Analysis

a. NASD Conduct Rule 2440 states that any securities transaction entered into between a member and its customer must be "at a price which is fair, taking into consideration all relevant circumstances." 55/ NASD's Mark-Up Policy, IM-2440, states that a member firm that enters into any transaction with a customer "in any security at any price not reasonably related to the current market price" violates both Rule 2440 and Conduct Rule 2110, which requires NASD members to observe high standards of commercial honor and just and equitable principles of trade.

Where a firm is not a market maker, the best evidence of the current market price, absent countervailing evidence, is the dealer's contemporaneous cost. 56/ Moreover, when, as here, the trade is a riskless principal transaction, contemporaneous cost must be used as the basis for

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52/ (...continued)
Commission staff declined to provide the interpretive guidance or no-action relief that Gordon requested on the basis that, as a matter of policy, such relief is given only prospectively, not retroactively.

53/ The markups on two trades were 12.9% and 25%; and 29.03% on six other trades. On the remaining twenty-three trades, the markups were 33.3% or higher. These percentages are based on a purchase price that included the approximately five percent charged to the selling customer. If that charge were deducted, the markups would have been even larger because they would be measured from a lower purchase price.

In dollar amounts, the markup profits on the trades ranged from $200 to $3,000.

54/ The extent to which these profits were excessive is discussed below. See infra text accompanying notes 100-01.

55/ See also A.S. Goldmen & Co., 55 S.E.C. 147, 153 (2001) ("The prices that a broker dealer charges its retail customers for securities must be reasonably related to the prevailing market price of the security.").

56/ First Independence Group, 51 S.E.C. 662, 664-65 (1993), aff'd, 37 F.3d 30 (2d Cir. 1994); Adams Sec., Inc., 51 S.E.C. 311, 312 (1993). As discussed above, see supra note 48, LSVL was not a market maker.

calculating markups. 57/ We have previously found that "in the case of riskless principal transactions, where the trades occur virtually simultaneously with the sale to customers, the contemporaneous cost is a particularly reliable indicator of the actual market price." 58/ Moreover, as we have previously explained:

> [A] riskless principal transaction is the economic equivalent of an agency trade. Like an agent, a firm engaging in such trades has no market making function, buys only to fill orders already in hand, and immediately 'books' the shares it buys to its customers. Essentially, the firm serves as an intermediary for others who have assumed the market risk. The firm in these circumstances provides no liquidity to the interdealer market. For this limited role, a firm is adequately compensated by a markup over its cost. 59/

NASD has taken the position that markups for equity securities should generally not exceed five percent. NASD has stated that markups exceeding five percent are generally viewed as excessive and a violation of rules requiring adherence to just and equitable principles of trade and fair pricing unless the member can show the markup charged to be fair under the unique circumstances of the trade. 60/ NASD has also stated that "if a member seeks to charge its

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57/ R.B. Webster Invs., Inc., 52 S.E.C. 288, 291 n.18 (1995); Kevin B. Waide, 50 S.E.C. 932, 934, 936-37 (1992).

58/ First Independence Group, 51 S.E.C. at 665.

59/ Waide, 50 S.E.C. at 935-36 (citations omitted). In Waide, we explained that in riskless principal transactions, contemporaneous cost can play two roles: as factual evidence of the market price and as a fair base upon which to base markups. Id. at 934. We concluded that, even if countervailing evidence tended to show that the dealer's contemporaneous cost did not accurately reflect the market price, fairness nonetheless dictated that contemporaneous cost be used as a base price for calculating markups. Id.

In the analysis below, we follow Waide in using LSVL's contemporaneous cost as the base price for calculating markups. We further note, however, that applicants did not introduce sufficient countervailing evidence to show that LSVL's contemporaneous cost did not accurately reflect the current market price of PCCM.

60/ NASD Notice to Members 92-16 (Apr. 1992), 1992 NASD LEXIS 47, at *7; see also IM-2440 (stating that NASD Board of Governors has reaffirmed "5% policy" on numerous occasions since its adoption in 1947 and has each time "reaffirmed the philosophy" of the policy). The fact that a markup of more than five percent is generally considered excessive does not mean that markups of five percent or less are automatically deemed fair. IM-2440(a)(4); Notice to Members 92-16, 1992 NASD LEXIS 47, at *7-8.

customers more than a 5 percent markup or markdown, it must be fully prepared to justify its reasons for the higher markup or markdown with adequate documentation." 61/

In these riskless principal trades, LSVL was not selling shares from a general supply that it maintained in inventory, but was instead matching orders from a particular buyer and a particular seller, with the trades executed as close as possible to simultaneously. There is no dispute as to the price LSVL paid for the shares – its contemporaneous cost. As noted above, the markups on the trades in question ranged from 12.9% to 54.55% above LSVL's contemporaneous cost. They were therefore presumptively excessive.

The burden of justifying markups in excess of five percent is on the member firm and not, as Applicants suggest, NASD. 62/ Moreover, as noted above, the member firm must establish the reasons for the higher markup with "adequate documentation." 63/ Applicants do not dispute that the markups at issue here all exceeded ten percent above the Firm's contemporaneous cost. Nor do they deny that they were responsible for these markups. Although Applicants claim to have based the Firm's markups on quotations, we have held repeatedly that quotations that are not validated by comparison with actual inter-dealer transactions should not be relied on to establish the prevailing market price, in determining an appropriate retail markup. 64/ As we stated in Adams Securities, Inc., "[Q]uotations only propose a transaction and do not reflect the actual result of a completed arm's-length sale. Moreover, quotations may have little value as evidence of the current market. They often show wide spreads between the bid and ask prices and are likely to be subject to negotiation." 65/

Applicants also claim that the prices they charged, while well above the levels generally deemed fair by NASD, were justified by special circumstances. The special circumstances the Applicants cite are the extra effort and expense that they allege were involved in arranging the trades. Applicants asserted that arranging LSVL's riskless principal transactions in general involved extra efforts and expenditures such as phone contacts, travel, and personal meetings with potential buyers and sellers; investigation to determine whether the stocks in question

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61/ Notice to Members 92-16, 1992 NASD LEXIS 47, at *7.

62/ See, e.g., Steven P. Sanders, 53 S.E.C. 889, 896 (1998) ("It is entirely appropriate that applicants bear the burden of coming forward with evidence justifying markups above 5% because they were in the best position to know about . . . special circumstances surrounding [the] trades.").

63/ Notice to Members 92-16, 1992 NASD LEXIS 47, at *7.

64/ E.g., R.B. Webster Invs., 52 S.E.C. at 291; Adams Sec., Inc., 51 S.E.C. 1092, 1095 (1994).

65/ 51 S.E.C. at 1095 (citation omitted).

should be added to LSVL's approved product list; additional paperwork (especially if a stock was restricted); and complying with requirements to obtain specific disclosures and attestations.

Applicants failed, however, to show how the asserted extra effort and expense with respect to riskless principal trades in general applied to the particular PCCM trades at issue here. Moreover, they provided no documentation of any extra effort or expense associated with those trades. 66/ Gordon's February 11, 2005 letter to NASD stated that he was unfamiliar with the PCCM transactions and therefore could not provide any specific information about them. Lee testified that he did not know how the registered representative who arranged the PCCM trades found the seller, although he believed that Guss may have been the source of the contact. 67/ Lee was unable to provide specifics about any due diligence he did before adding PCCM to LSVL's approved product list, and he had "no idea" whether the stock at issue was restricted.

As stated above, the spread was taken as the markup in every PCCM transaction. Thus, the remuneration retained by LSVL varied based on market quotations, not on effort involved in the transactions. We have previously found the use of such a pricing pattern to "preclude[] any attempt to justify the mark-ups on the basis of the particular circumstances of each sale." 68/

66/ At the hearing, Gordon identified four paragraphs of his letter to Commission staff requesting interpretive guidance or no-action relief as relevant to the circumstances that, in Gordon's view, justified markups of up to fifty-four percent on the trades. These paragraphs, however, merely outline the steps involved (soliciting buyers and sellers and crossing the trades at the best bid and offer), providing no detail as to any extra time or efforts involved in those steps.

Applicants assert that NASD Enforcement stated that unique facts and circumstances justify the higher markups charged. However, viewed in context, Enforcement was by no means agreeing that there were unique facts and circumstances or that the markups were justified; instead, Enforcement counsel was restating Applicants' position in questioning Lee about the alleged unique circumstances.

67/ See supra text following note 26.

68/ J.A. Winston & Co., 42 S.E.C. 62, 69-70 (1964); accord Inv. Planning, Inc., 51 S.E.C. 592, 597-98 (1993) (finding that applicants charged excessive markups where "blanket policy" of charging customers a set percentage markup did not take account of transaction's size, or degree to which customer received "unique" services; "[e]ven assuming that in certain cases enhanced services could have justified higher compensation, applicants did not charge the particular customers who benefited from those services").

(continued...)

Undisclosed markups on sales of securities to retail customers can violate the antifraud provisions of the securities laws if they are not reasonably related to the baseline against which they are measured and if the responsible parties acted with scienter. 69/ We do not, however, find fraud on this record.

b. Exchange Act Rule 10b-10 requires disclosure of markups to customers on riskless principal transactions. 70/ Individuals found to be responsible for a firm's violation of Rule 10b-10 can be found to have violated that rule. 71/ LSVL did not disclose the markups charged on the PCCM trades on customer confirmations. LSVL's supervisory procedures manual made Lee, as chief compliance officer, responsible for maintaining copies of transaction confirmations, and Lee admitted that he received copies of confirmations. He testified that, "as a compliance officer, I take responsibility for [the markups] not being posted on the tickets." Although Lee testified that either he or Gordon had instructed the clearing firm to disclose to customers the compensation that the Firm received in connection with the transactions, Lee failed to follow through to make sure that these instructions were implemented. We therefore find that Lee violated Exchange Act Section 10(b) and was responsible for the Firm's violations of Exchange Act Rule 10b-10.

Although NASD also found Gordon liable for failing to ensure that the confirmations contained appropriate disclosure of the Firm's remuneration, we find that the record does not establish Gordon's liability. Lee was responsible for the contents of the confirmations. The record does not demonstrate that Gordon knew or should have known that Lee was not fulfilling

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68/ (...continued)
The assertion that LSVL "had no intention of taking the spread as compensation" on every riskless principal trade, even if true, is irrelevant. We are concerned here only with the thirty-one trades in PCCM stock with respect to which LSVL did take a markup equivalent to the spread, resulting in excessive markups.

69/ D.E. Wine Invs., Inc., 53 S.E.C. 391, 394 (1998); after remand, 54 S.E.C. 1213 (2001).

70/ See supra note 11. As we have previously observed, the purpose of requiring firms "in what are characterized as 'riskless' principal transactions to disclose their markup or markdown is to 'enable customers to make their own assessments of the reasonableness of transaction costs in relation to the services offered by broker-dealers.'" Marc N. Geman, 54 S.E.C. 1226, 1246 (2001) (quoting Securities Confirmations, Exchange Act Rel. No. 15219 (Oct. 6, 1978), 15 SEC Docket 1245, 1250), aff'd, 334 F.3d 1183 (10th Cir. 2003).

71/ E.g., Hattier, Sanford & Reynoir, 53 S.E.C. 426, 431-32 (1998) (finding that president of firm who reviewed and approved inaccurate confirmations and principal of firm who was informed that confirmations were inaccurate but took no steps to correct them violated Rule 10b-10), aff'd, 163 F.3d 1356 (5th Cir. 1998) (Table).

his responsibility. 72/ We therefore reverse NASD's finding that Gordon was responsible for LSVL's violations of Rule 10b-10. 73/

* * *

For the reasons set forth above, we sustain NASD's findings that Applicants were responsible for the excessive, undisclosed markups charged by LSVL, and that Applicants thereby violated Rules 2110 and 2440 and IM-2440. We also find that Lee violated Section 10(b) of the Exchange Act and was responsible for LSVL's violations of Exchange Act Rule 10b-10.

III.

Exchange Act Section 19(e)(2) directs us to sustain NASD's sanctions unless we find, having due regard for the public interest and the protection of investors, that the sanctions are excessive or oppressive or impose an unnecessary or inappropriate burden on competition. 74/ NASD barred Gordon and Lee in all capacities for their registration violations; imposed additional bars in all capacities for their markup violations; ordered them, jointly and severally, to pay restitution of $20,832.40 plus interest for the excessive markups; and assessed costs. We sustain the bar imposed by NASD for the registration violations because, as explained below, we conclude that Applicants' multi-year acquiescence in Guss's management of LSVL despite his lack of registration poses too great a risk to the markets and investors protected by the self-regulatory system to allow them to remain in the securities industry. Although the markup violations were serious, we have not found them to be fraudulent. We find the bar imposed by NASD for the mark-up violations excessive, and reduce the sanction to a six-month suspension and impose an additional concurrent thirty-day suspension on Lee based on violations of Section 10(b) and Rule 10b-10. We sustain the order of restitution, which we find to be appropriate redress for the customers who were charged the excessive markups. We also conclude that the

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72/ The head of a brokerage firm "is responsible for the firm's compliance with all applicable requirements unless and until he or she reasonably delegates a particular function to another person in the firm, and neither knows nor has reason to know that such a person is not properly performing his or her duties." Kresge, 90 SEC Docket at 3090 n.42 (citing Rita H. Malm, 52 S.E.C. 64, 69 & n.15 (1994)) (additional citations omitted).

73/ See Schidlowski, 48 S.E.C. at 509 ("A firm's president is not automatically at fault when other individuals in the firm engage in misconduct of which he has no reason to be aware.").

74/ 15 U.S.C. § 78s(e)(2). Applicants do not allege, and the record does not show, that NASD's action imposed an undue burden on competition.

sanctions imposed on Applicants will have the salutary effect of deterring others from engaging in the same serious misconduct. 75/

We initially observe that NASD's determination to bar Applicants for the registration violations was consistent with its Sanction Guidelines. 76/ The Sanction Guidelines provide that, for egregious cases of violation of Rule 1021, a bar should be considered. 77/ The Guidelines further provide that in determining the sanction for a Rule 1021 violation, consideration should be given to (1) whether a registration application has been filed and (2) the nature and extent of the unregistered person's responsibilities. 78/ Here, no registration application had been filed, despite the length of time that Guss was involved in managing LSVL. Although Guss's purported responsibilities at LSVL were allegedly limited to Internet-related activities, the record shows that his actual spheres of influence were very widespread. Guss exercised great power through his connection to the principal shareholders of the successive holding companies, so much so that Applicants regarded him as their "boss." The fact that Applicants knowingly tolerated the involvement of an unregistered "boss" for as long as they did made their conduct truly egregious. Moreover, Applicants directed LSVL staff to mention only Guss's involvement as LSVL's webmaster in their dealings with NASD examiners and to put away documents that mentioned him, and Applicants additionally concealed Guss's role from NASD by failing to update LSVL's Form BD to reflect Guss's involvement. Several of NASD's generally applicable considerations in determining sanctions also support the

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75/ In making this determination, we are mindful that although "'general deterrence is not, by itself, sufficient justification for expulsion or suspension . . . it may be considered as part of the overall remedial inquiry.'" PAZ Sec., Inc., 494 F.3d 1059, 1066 (D.C. Cir. 2007) (quoting McCarthy v. SEC, 406 F.3d 179, 189 (2d Cir. 2005)); see also Boruski v. SEC, 289 F.2d 738, 740 (2d Cir. 1961) ("The public interest requires that appropriate sanctions be imposed to secure compliance with the rules, regulations, and policies of both NASD and SEC . . . .").

76/ The Sanction Guidelines have been promulgated by NASD in an effort to achieve greater consistency, uniformity, and fairness in the sanctions that are imposed for violations. NASD Sanction Guidelines 1 (2006 ed.) ("Sanction Guidelines"). Since 1993, NASD has published and distributed the Sanction Guidelines so that members, associated persons, and their counsel will have notice of the types of disciplinary sanctions that may be applicable to various violations. Id. The Guidelines are not NASD rules that are approved by the Commission, but NASD-created guidance for NASD Adjudicators, which the Guidelines define as Hearing Panels and the National Adjudicatory Council. Id. Although the Commission is not bound by the Sanction Guidelines, it uses them as a benchmark in conducting its review under Exchange Act Section 19(e)(2).

77/ Sanction Guidelines at 48.

78/ Id.

imposition of a stringent sanction such as a bar for the registration violations found: Applicants did not accept responsibility for or acknowledge the registration violations to NASD prior to NASD's detection and intervention; Applicants do not assert that they reasonably relied on legal advice as to whether Guss was acting as a principal; Applicants allowed Guss to act as a principal for an extended period of time; Applicants attempted to mislead NASD by failing to identify Guss as a principal and Applicants' conduct was at least reckless, demonstrating what NASD called "a willingness to evade NASD rules that we find troubling." 79/

We previously have noted that "NASD's registration requirement 'provides an important safeguard in protecting public investors,' and 'strict adherence' to that requirement is 'essential'" because it "serves a significant purpose in the policing of the securities markets" and "in the protection of the public interest . . . ." 80/ As we have also observed, the "registered principal is the person at a broker-dealer to whom the NASD looks to ensure compliance with regulatory requirements," 81/ and the registration requirements are intended to ensure that principals "maintain the requisite levels of knowledge and competence." 82/ Thus, regulatory compliance depends to a significant extent on qualifications of the principal.

Applicants enabled Guss to guide the affairs of LSVL as an unregistered principal for more than three years and failed to amend LSVL's Form BD to notify NASD of his involvement. Applicants knew that Guss was not registered and expressed concern in emails about the propriety of his involvement with the Firm's operations. Moreover, Lee testified that he did not think Guss had "a substantial amount of knowledge about NASD rules." Although the record is unclear as to Applicants' awareness of Guss's felony conviction, 83/ Applicants had a duty to ascertain his eligibility and whether he was subject to a disqualification. We agree that, in light of the pervasive management role that Guss exercised, and of Applicants' acquiescence in Guss's managerial activity, the misconduct at issue here was egregious. We therefore do not think it is excessive or oppressive for NASD to impose a bar for Applicants' registration violations. The remedial purpose of a bar in egregious cases is to protect the

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79/ Sanction Guidelines at 6-7.

80/ Flannigan, 56 S.E.C. at 17 (finding that individuals engaged in conduct requiring registration as representatives of an NASD member firm without being so registered) (citations omitted).

81/ Black, 51 S.E.C. at 794.

82/ Jon G. Symon, 54 S.E.C. 102, 110 (1999) (ordering the requalification by examination of a former registered securities principal, whose registrations as a general securities principal and a financial and operations principal had lapsed).

83/ See supra note 15.

investing public from a recurrence of the misconduct. We therefore sustain the bar imposed by NASD for the registration violations.

The Sanction Guidelines recommend suspension of up to two years or a bar for egregious cases of violations of Rules 2110, 2440, and IM-2440. 84/ In determining the sanction for such violations, the Sanction Guidelines indicate that whether Applicants had discretion as to the amount of markup on each trade should be considered. 85/ The Guidelines also generally recommend ordering restitution where appropriate to remediate misconduct. 86/

With respect to the pricing violations, LSVL charged excessive markups of more than ten percent (in many cases, far more than ten percent) in thirty-one retail sales over a three-month period. Applicants did not introduce evidence demonstrating that special circumstances made the markups charged fair; indeed, by taking the spread on all thirty-one transactions at issue, they applied a pricing pattern that precludes any attempt to justify the markups on the basis of the particular circumstances of each individual sale. 87/ Lee also failed to ensure that customers were informed of the markups by disclosure on confirmations, thus depriving them of their ability to assess the reasonableness of the transaction costs they paid. 88/ Applicants had complete discretion as to the markups charged; their roles in running the firm and in setting up the riskless principal trading account, with the intent of taking the spread on each transaction, means that responsibility for the markups charged can be laid squarely at their feet. 89/ Applicants' conduct with respect to the pricing violations evinces a profound disregard for the

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84/ Sanction Guidelines at 95.

85/ Id.

86/ Id. at 4.

87/ Applicants knew that LSVL was not a market maker and therefore could not rely on its role as a market maker as justification for taking the spread.

88/ See Geman, 54 S.E.C. at 1246 (discussing purpose of Rule 10b-10 requirement that dealers disclose markup or markdown in riskless principal transactions). We have previously found that Rule 10b-10, the source of the requirement of confirmation disclosures at issue, "works to protect investors and combat broker-dealer fraud by ensuring full and fair disclosure to investors . . . ." Hattier, Sanford & Reynoir, 53 S.E.C. at 433 n.16.

89/ Sanction Guidelines at 6-7.

essential duty to treat one's customers fairly. 90/ Several of NASD's generally applicable considerations in determining sanctions also support the imposition of serious sanctions for the pricing violations found: Applicants did not accept responsibility for or acknowledge their misconduct prior to detection and intervention by NASD; Applicants did not rely on reasonable legal advice; Applicants engaged in a pattern of misconduct; Applicants' misconduct injured customers who were unknowingly charged excessive markups; and the misconduct resulted in monetary gain to LSVL, and thus indirectly to Applicants through their part-ownership of Envision, the holding company that owned LSVL during the months in question. 91/ We find, however, that, in light of the relatively small number of trades over a three-month period, the sums involved, and the commensurately limited financial benefit to Applicants, the bar imposed by NASD for Applicants' markup violations is excessive, and we therefore impose instead a six-month suspension on both Applicants, and an additional thirty-day suspension (to run concurrently) on Lee based on the violations of Exchange Act Section 10(b) and Exchange Act Rule 10b-10. 92/

Applicants argue that the sanctions imposed by NASD are far too harsh and that the bars imposed are not in the public interest, citing their lack of a previous disciplinary record. 93/ However, lack of disciplinary history is not a mitigating factor. An associated person should not be rewarded for acting in accordance with his duties as a securities professional. 94/ Applicants argue that they should not be barred for isolated negligent violations. As discussed above,

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90/ See Frank L. Palumbo, 52 S.E.C. 467, 480 (1995) (stating that recklessly overcharging customers without justification demonstrates "a marked insensitivity to [the] obligation to deal fairly with customers").

91/ Sanction Guidelines at 6-7.

92/ In reducing the sanction imposed by NASD, we also note that we did not find the markups fraudulent.

93/ Applicants also argue that NASD failed to conduct the analysis required by Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979), aff'd on other grounds, 450 U.S. 91 (1981). NASD is not required to apply Steadman in determining sanctions. NASD did, however, conduct a multi-factor analysis that included many of the Steadman factors, although it did so without tracking the Steadman language.

94/ Philippe N. Keyes, Exchange Act Rel. No. 54723 (Nov. 8, 2006), 89 SEC Docket 792, 801 n.20 (citing 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 (1995) (same), aff'd, 101 F.3d 37 (5th Cir. 1996) (per curiam); Ernest A. Cipriani, 51 S.E.C. 1004, 1007 & n.15 (1994) (same)).

however, their violations were neither isolated nor negligent, and involved turning a blind eye to Guss's extensive participation in the management of the Firm. 95/

Applicants further argue that a bar is inappropriate because they did not engage in criminal conduct. Engaging in criminal conduct could make the imposition of a bar more compelling, but the Guidelines allow the imposition of bars in cases of egregious misconduct whether or not criminal conduct is present. Allowing those who engage in egregious misconduct to remain in the securities industry simply because their conduct does not rise to the level of criminality would be a grave disservice to the market, to investors, and to the public interest.

Applicants argue that Gordon "attempted to cure any possible infractions by requesting from the NASD the nature of any specific violations so that he could take 'corrective action without delay.'" However, Gordon's letter postdated the commencement of NASD's examination of LSVL. Remedial action taken after the initiation of an examination has little mitigative value. 96/

Applicants argue that they should not be barred because the evidence against them is "merely circumstantial." It is unclear which evidence Applicants regard as circumstantial; many of the facts regarding both Guss's involvement at LSVL and the markups charged in the thirty-one transactions at issue are undisputed, and much of the evidence is direct. But to the extent the evidence is circumstantial, there is no impediment to the use of circumstantial evidence in an NASD proceeding. 97/

95/ Applicants argue that if they had intended to engage in wrongdoing, they would have destroyed the emails they turned over during NASD's examination rather than providing them. We do not view the fact that Applicants chose not to engage in this further instance of wrongdoing as a basis for reducing the sanctions imposed on them. Moreover, since NASD's 2003 examination was not announced to LSVL in advance, the fact that evidence was not destroyed proves little. See supra note 28.

96/ Keyes, 89 SEC Docket at 801 & n.21; Arthur Lipper Corp., 46 S.E.C. 78, 98 (1975); see also Sanction Guidelines at 9 (stating that accepting responsibility, acknowledging wrongdoing, employing subsequent corrective measures, and attempting to pay restitution or otherwise remedy misconduct are relevant considerations in sanctioning only if done prior to detection or intervention by a regulator).

97/ See, e.g., Donald M. Bickerstaff, 52 S.E.C. 232, 237-38 (1995) (noting that Supreme Court has stated that "circumstantial evidence can be more than sufficient" in civil actions, and basing finding on such evidence) (quoting Herman & Maclean v. Huddleston, 459 U.S. 375, 390 & n.30 (1983)).

(continued...)

Finally, Applicants argue that NASD Enforcement originally offered to settle this proceeding if Applicants agreed to a suspension and a fine. They contend that this alleged willingness by NASD Enforcement to accept a lesser sanction as appropriate shows that NASD Enforcement did not consider that more stringent sanctions were necessary, but rather acted vindictively when Applicants chose to litigate. The record is devoid of evidence about settlement negotiations between Applicants and NASD Enforcement. 98/ In any event, even if NASD Enforcement proposed to settle the matter if Applicants agreed to a suspension and fine, it is well established that those who offer to settle may properly receive lesser sanctions than they otherwise might have based on "pragmatic considerations such as the avoidance of time-and-manpower-consuming adversary proceedings." 99/

NASD required Applicants to pay restitution in the amount of $20,832.40. 100/ In ordering restitution, NASD considered two measures: (1) LSVL's profit on each transaction in excess of a ten percent markup and (2) LSVL's profit on each transaction in excess of $200. NASD ordered restitution based on the lesser of these two calculations for each transaction, effectively allowing LSVL a $200 "ticket charge" for each transaction. This measure of restitution is quite favorable to Applicants. 101/ NASD provided that Applicants may be given

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97/ (...continued)
We have already dealt with Applicants' objections to the testimony of Chicola and Guss. See supra Section II.A.2.c.

98/ Applicants also contend that "It wasn't until **AFTER** the NASD was stiffed of its money by the member firm, LSVL that the NASD sought the money from [Applicants]. Had LSVL given the NASD the money it so greatly desired, then Enforcement would have sought nothing more from [Applicants than] a short suspension" (emphasis in original). The assertions contained in Applicants' briefs are not evidence. The record does not support an inference that NASD Enforcement's decision to seek a bar and restitution was based on LSVL's failure to pay monies assessed against it. NASD provided that Applicants may be given credit for, and reduce their restitution amount by, restitution amounts that they prove LSVL or Guss paid to injured customers.

99/ See, e.g., David A. Gingras, 50 S.E.C. 1286, 1294 (1992) (NASD review proceeding).

100/ NASD did not assess restitution for one sale in August 2002 for which NASD Enforcement did not identify a purchasing customer.

101/ See also supra note 53 (noting that if NASD had deducted the approximately five percent charge to selling customer from purchase price used in calculating markups, markups would have been even larger). Applicants do not take issue with NASD's restitution
(continued...)

credit for, and reduce their restitution amount by, restitution amounts that they prove LSVL or Guss paid to injured customers. We affirm NASD's order of restitution, a remedial measure that will benefit LSVL's customers who were charged excessive markups.

An appropriate order will issue. 102/

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

Nancy M. Morris
Secretary

101/ (...continued)
calculations. Our opinion should not be construed as suggesting that markups of ten percent or below or ticket charges of $200 or less are presumptively permissible.

102/ We have considered all of the arguments advanced by the parties. We reject or sustain them to the extent that they are inconsistent or in accord with the views expressed herein.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 57655 / April 11, 2008

Admin. Proc. File No. 3-12573

In the Matter of the Application of

DENNIS TODD LLOYD GORDON
AND
STERLING SCOTT LEE
c/o Joel A. Gordon
Joel A. Gordon & Associates
6666 Harwin Drive, Suite 220
Houston, Texas 77036

For Review of Disciplinary Action Taken by

NASD

ORDER SUSTAINING IN PART AND SETTING ASIDE IN PART DISCIPLINARY ACTION TAKEN BY REGISTERED SECURITIES ASSOCIATION

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

ORDERED that NASD's findings that Dennis Todd Lloyd Gordon and Sterling Scott Lee violated NASD Rules 1021 and 2110 and were responsible for violations of Article IV, Section 1(c) and Article V, Section 1 of NASD's By-Laws and the sanctions imposed by NASD for these violations be, and they hereby are, sustained; and it is further

ORDERED that NASD's findings that Gordon and Lee violated NASD Rules 2110 and 2440 and IM-2440 and that Lee violated Exchange Act Section 10(b) and was responsible for violations of Exchange Act Rule 10b-10 be, and they hereby are, sustained; and it is further

ORDERED that NASD's findings that Gordon and Lee violated Exchange Act Rule 10b-5 and NASD Rules 2120 and 2230 and that Gordon violated Exchange Act Section 10(b) and was responsible for violations of Exchange Act Rule 10b-10 be, and they hereby are, set aside; and it is further

ORDERED that the permanent bar imposed by NASD for the violations of Exchange Act Section 10(b), Exchange Act Rules 10b-5 and 10b-10, NASD Rules 2110, 2120, 2230, and 2440, and IM-2440, be, and it hereby is, reduced to a six-month suspension, with a concurrent thirty-day suspension in the case of Lee; and it is further

ORDERED that NASD's order of restitution and its assessment of costs be, and they hereby are, sustained.

By the Commission.

Nancy M. Morris
Secretary