

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 8474 / August 25, 2004

SECURITIES EXCHANGE ACT OF 1934
Release No. 50251 / August 25, 2004

ADMINISTRATIVE PROCEEDING
File No. 3-11603

In the Matter of

**NEEDHAM & COMPANY,
INC.,**

Respondent.

**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
SECTIONS 15(b)(4) 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 Section 8A of the Securities Act of 1933 (“Securities Act”) and Sections 15(b)(4) and 21C of the Securities Exchange Act of 1934 (“Exchange Act”) against Needham & Company, Inc. (“Needham” 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 Respondent and the subject matter of these proceedings, 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 Sections 15(b)(4) and 21C of the Securities Exchange Act of 1934, as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

A. RESPONDENT

Needham & Company, Inc. is a broker-dealer registered with the Commission pursuant to Section 15(b) of the Exchange Act and is a member of NASD, Inc. Needham's principal place of business is in New York, New York.

B. SUMMARY

During 1999, 2000 and 2001, Needham received four payments in consideration for publishing research on four public companies. Needham did not disclose those payments in its research reports. The firm's failure to disclose these payments was in violation of Section 17(b) of the Securities Act.

In addition, from July 1999 through June 2001, Needham failed to preserve business-related internal electronic mail communications that it was required to maintain pursuant to Section 17(a) of the Exchange Act and Rule 17a-4 thereunder.

C. FACTS

1. Background

During the period 1999 through at least 2003, broker-dealers that were underwriting public offerings sometimes paid other broker-dealers to issue research on or "cover" their issuer clients. These arrangements were made with regard to both initial public offerings ("IPOs") and secondary offerings. In some situations, the issuers directed the underwriters to make the payments, and in others, the lead underwriters selected the firms that received the payments. Some firms issuing the research actively solicited the payment.

In certain instances, the payments were made to firms that were not participating in the underwriting, and therefore not earning investment banking fees from the issuer on the particular offering. In other instances, firms that were underwriting small portions of the offering received additional payments in consideration for publishing research. These payments often were significantly larger than the underwriting fee the firm received.

Section 17(b) of the Securities Act requires that any person who receives consideration, directly or indirectly, from an issuer, underwriter, or dealer for issuing research

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

must fully disclose the receipt of the payment (whether past or prospective) and the amount. However, the broker-dealers that received these payments failed to disclose in their research reports that they received payment for publishing research.

2. **Needham Failed to Disclose Its Receipt of Payments to Publish Research**

On four occasions during 1999 through 2001, Needham received payments from other investment banking firms for research coverage of those firms' investment banking clients (the "issuers"). These payments ranged in amounts from \$75,000 to \$100,000. Needham published research regarding these issuers without disclosing in the reports the receipt of the consideration and the amount received.

For example, on January 21, 2000, Needham was paid \$75,000 by the lead underwriter for issuing research on Crossroads Systems, Inc. in connection with the company's October 19, 1999 initial public offering. The letter accompanying the check to Needham referred to the payment as an "adjustment for research." Moreover, e-mails between Needham and the lead underwriter indicate that in September and October 1999, the Needham syndicate desk negotiated with the lead underwriter regarding both the payment and the date by which Needham would issue research in connection with the offering. Handwritten notations on Needham's internal syndicate documents recounted these conversations, stating: "10/13 [lead underwriter's employee] offered \$75,000 for research within 90 day[s]...we accepte[d]." Although Needham underwrote 37,950 shares of the 4,312,500 shares offered in the transaction, and was paid \$9,487.50 as its underwriting fee, the \$75,000 research payment was in addition to the payment for Needham's underwriting services. Needham initiated coverage and published a research report on Crossroads Systems, Inc. on January 19, 2000 without disclosing the \$75,000 payment.

In another instance, on January 12, 2001, Needham received a \$100,000 payment for issuing research from an investment bank in connection with the October 16, 2000 initial public offering for Endwave Corporation. The settlement letter that accompanied the check made out to Needham identified the \$100,000 as a "research payment." Needham's internal chronology of the negotiations regarding this payment included such notes as: "10/16...what do you need to do research ... \$100,000 ...we have a deal! [A]lso asked that we move up in bracket and get part of \$100,000 in stock instead of check." and "No further contact until I called (courtesy) Friday, 1/12/01 to say research would be ready on 1/18/01..." Although Needham participated as an underwriter for the offering, and underwrote 69,000 shares of the 6,900,000 shares offered in the transaction, the \$100,000 research payment was far larger than the \$14,490 underwriting fee Needham received for its underwriting services during the transaction. Needham initiated coverage and published a research report on Endwave Corporation on January 17, 2001. Although Needham was aware at the time it issued the report that it would be paid or had already been paid for issuing the research, Needham did not disclose the \$100,000 payment.

Also, on December 14, 1999, Needham received a \$100,000 payment for issuing research from an investment bank in connection with a common stock follow-on offering for Ancor Communications, Inc. on August 18, 1999. Needham did not participate as an

underwriter for the offering. Needham internal documents indicate that Needham solicited payment for its research on Ancor Communications: “Research for pay / competed for cover ask \$150,000...”; “7/8...req[uest] paid for research. Q[uarter] 3 or Q[uarter] 4...”; and “9/21...expect \$100,000 check for [covering analyst’s] research.” Needham published research reports on Ancor Communications on November 16, 1999 and January 31, 2000. Although Needham was aware at the time it issued the reports that it would be paid or had already been paid for issuing the research, Needham did not disclose the \$100,000 payment.

3. **Needham Failed to Maintain Electronic Mail Communications**

From July 1999 through June 2001, Needham’s employees used e-mail to conduct Needham’s business as a broker, dealer and member of an exchange. During that period, Needham failed to preserve copies of business-related e-mail as required under Section 17(a)(1) of the Exchange Act and Rule 17a-4 thereunder. Although Needham retained “external” e-mail (e-mail that was sent to someone outside the firm), it did not preserve all of its “internal” e-mail (e-mail that was sent only between employees of the firm) that related to its business. As a result, the Commission did not have access to that e-mail in connection with the investigation that resulted in this proceeding.

D. **LEGAL DISCUSSION**

1. **Needham Violated Section 17(b) of the Securities Act**

Section 17(b) of the Securities Act provides:

It shall be unlawful for any person, by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, to publish, give publicity to, or circulate any notice, circular, advertisement, newspaper, article, letter, investment service, or communication which, though not purporting to offer a security for sale, describes such security for a consideration received or to be received, directly or indirectly, from an issuer, underwriter, or dealer, without fully disclosing the receipt, whether past or prospective, of such consideration and the amount thereof.

15 U.S.C. § 77q(b).

In order to violate Section 17(b), a person must “(1) publish or otherwise circulate (using a means of interstate commerce), (2) a notice or type of communication (which describes a security), (3) for consideration received (past, currently, or prospectively, directly or indirectly), (4) without full disclosure of the consideration received and the amount.” *SEC v. Gorsek*, 222 F. Supp. 2d 1099, 1105 (C.D. Ill. 2001). Courts have held that Section 17(b) does not require a showing of scienter. *SEC v. Liberty Capital Group, Inc.*, 75 F. Supp. 2d 1160, 1163 (W.D. Wash. 1999); *SEC v. Huttoe*, 1998 WL 34078092 (D.D.C. Sept. 14, 1998).

Needham published and circulated communications in the form of research reports that described certain securities for consideration received, but did not disclose the receipt or amount of these payments. As a result, investors did not receive information relating to the objectivity of the research.

2. **Needham Violated Section 17(a)(1) of the Exchange Act and Rule 17a-4 Thereunder**

Section 17(a)(1) of the Exchange Act provides that each member of a national securities exchange, broker, or dealer “shall make and keep for prescribed periods such records, furnish copies thereof, and make and disseminate such reports as the Commission, by rule, prescribes as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this title.”

The Commission has emphasized the importance of the records required by the rules as “the basic source documents” of a broker-dealer. *Statement Regarding the Maintenance of Current Books and Records by Brokers and Dealers*, 4 SEC Docket 195 (April 6, 1974). The record keeping rules are “a keystone of the surveillance of broker and dealers by [Commission] staff and by the securities industry’s self-regulatory bodies.” *Edward J. Mawod & Co.*, 46 S.E.C. 865, 873 n.39 (1977) (citation omitted), *aff’d sub nom. Mawod & Co. v. SEC*, 591 F.2d 588 (10th Cir. 1979).

Pursuant to its authority under Section 17(a)(1) of the Exchange Act, the Commission promulgated Rule 17a-4. Rule 17a-4(b)(4) in turn requires each broker-dealer to “preserve for a period of not less than 3 years, the first two years in an accessible place.... [o]riginals of all communications received and copies of all communications sent by such member, broker or dealer (including inter-office memoranda and communications) relating to his business as such.” Rule 17a-4 is not limited to physical documents. The Commission has stated that internal electronic mail communications relating to a broker-dealer’s “business as such” fall within the purview of Rule 17a-4 and that, for the purposes of Rule 17a-4, “the content of the electronic communication is determinative” as to whether that communication is required to be retained and accessible. *Reporting Requirements for Brokers or Dealers under the Securities Exchange Act of 1934*, Rel. No. 34-38245 (Feb. 5, 1997).

From July 1999 through June 2001, Needham failed to preserve business-related internal e-mail for three years in violation of Section 17(a)(1) of the Exchange Act and Rule 17a-4 thereunder.

E. CONCLUSIONS

Based on the foregoing and Needham's Offer of Settlement, the Commission finds that with respect to payments received for the issuance of research, Needham willfully violated Section 17(b) of the Securities Act by publishing communications that described securities for consideration received, directly from an underwriter, without disclosing the receipt of such consideration and the amount thereof.

Based on the foregoing and Needham's Offer of Settlement, the Commission finds that with respect to electronic mail communications during the relevant period, Needham willfully violated Section 17(a) of the Exchange Act and Rule 17a-4 promulgated thereunder by failing to preserve business-related internal electronic mail communications for three years.

F. UNDERTAKINGS

Needham has undertaken to review its procedures regarding the preservation of electronic mail communications for compliance with the federal securities laws and regulations, and the rules of NASD, Inc. Within ninety days of the issuance of this Order, unless otherwise extended by the staff of the Commission for good cause shown, Needham undertakes and agrees to inform the Commission in writing that it has completed its review and that it has established systems and procedures reasonably designed to achieve compliance with those laws, regulations, and rules concerning the preservation of electronic mail communications. In determining whether to accept the Offer, the Commission has considered these undertakings.

IV.

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 of Settlement.

Accordingly, it is hereby ORDERED:

A. Pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, that Respondent cease and desist from committing or causing any violations and any future violations of Section 17(b) of the Securities Act and Section 17(a) of the Exchange Act and Rule 17a-4 promulgated thereunder.

B. Respondent is censured pursuant to Section 15(b)(4) of the Exchange Act.

C. It is further ordered that Respondent shall, within ten days of the entry of this Order, pay a civil money penalty in the amount of \$700,000 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 Needham & Company, Inc. 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 Antonia Chion, Division of Enforcement, Securities and Exchange Commission, 450 5th Street N.W., Washington, D.C. 20549-0801.

D. Respondent shall comply with the undertakings contained in Section III.F above.

By the Commission.

Jonathan G. Katz
Secretary