

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 59375A / February 10, 2009

INVESTMENT ADVISERS ACT OF 1940
Release No. 2842A / February 10, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13367

In the Matter of

PATRICK J. VAUGHAN

Respondent.

**ORDER INSTITUTING ADMINISTRATIVE
PROCEEDINGS PURSUANT TO SECTION
15(b) OF THE SECURITIES EXCHANGE
ACT OF 1934 AND SECTION 203(f) OF THE
INVESTMENT ADVISERS ACT OF 1940,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 (“Exchange Act”) and Section 203(f) of the Investment Advisers Act of 1940 (“Advisers Act”) against Patrick J. Vaughan (“Respondent” or “Vaughan”).

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) the Exchange Act and Section 203(f) of the Advisers Act, Making Findings, and Imposing Remedial Sanctions (“Order”), as set forth below.

III.

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

Respondent

1. Vaughan, age 54, resides in Cockeysville, Maryland. He was a registered representative associated with various broker-dealers from 1983 through the present. During the period January 2003 through November 2005, Vaughan was associated with Ferris Baker Watts, Inc. ("Ferris") as the firm's Director of Retail Sales.

Other Relevant Individuals and Entities

2. Ferris is a Delaware corporation headquartered in Washington, D.C. Ferris is both a registered broker-dealer and a registered investment adviser. Ferris has over 600 employees, including over 250 registered representatives working in over forty branch offices in eight states and the District of Columbia.

3. Stephen Glantz ("Glantz"), age 55, was formerly a resident of Chagrin Falls, Ohio. He was a registered representative associated with various broker-dealers from 1997 through 2005. During the period January 2003 through November 2005, Glantz was associated with Ferris. On September 4, 2007, Glantz pled guilty to one count of securities fraud and one count of making false statements to law enforcement officials. On December 14, 2007, Glantz was sentenced to 33 months in prison and ordered to pay \$110,000 in restitution.

4. IPOF Fund ("IPOF") is an Ohio limited partnership, not registered with the Commission in any capacity. IPOF was formed by David A. Dadante ("Dadante") in 1999. Dadante operated IPOF as an investment company and solicited funds from investors purportedly to purchase stock in initial public offerings. Dadante caused IPOF to raise \$50 million from at least 100 investors in unregistered securities offerings and used some of the proceeds to fund his lavish lifestyle and to make Ponzi scheme-type payments. Dadante deposited the remaining investor funds into brokerage accounts that he controlled in the names of IPOF and other entities at several broker-dealers, including Ferris. Glantz served as the registered representative for the Ferris accounts controlled by Dadante. On April 20, 2007 IPOF was permanently enjoined from violating Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933 ("Securities Act"), Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Section 7(a) of the Investment Company Act of 1940 in SEC v. David A. Dadante et. al., Case No. 1:06-cv-0938 (N.D. Ohio).

5. Dadante, age 54, was formerly a resident of Gates Mills, Ohio. Dadante was the founder and general partner of IPOF. He was not registered with the Commission in any capacity. On August 6, 2007, Dadante pled guilty to two counts of securities fraud. On November 1, 2007, Dadante was permanently enjoined from violating Sections 5(a), 5(c), and 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1) and 206(2)

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.

of the Advisers Act in SEC v. David A. Dadante et. al., Case No. 1:06-cv-0938 (N.D. Ohio). On November 29, 2007, the Commission barred Dadante from association with any investment adviser. On December 14, 2007, Dadante was sentenced to 156 months in prison and ordered to pay over \$28 million in restitution.

6. Innotrac Corp. (“Innotrac”) is a Georgia corporation with its principal place of business in Duluth, Georgia. Its common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act and is traded under the symbol “INOC” on NASDAQ. Innotrac provides order processing, order fulfillment, and call center services to large corporations that outsource these functions.

Background

7. From at least August 2002 through November 2005, Glantz, Dadante, and a registered representative at another brokerage firm, all participated in a scheme to manipulate the market for the stock of Innotrac. All three pled guilty to violations of Section 10(b) of the Exchange Act and in their plea agreements, they all admitted that they artificially inflated and maintained the price for Innotrac stock. Glantz also admitted in his plea agreement that he engaged in unauthorized and unsuitable trading in his customers’ accounts. During the period from August 2002 through November 2005, Dadante used IPOF to acquire more than 30% of the outstanding common stock of Innotrac, and through IPOF and other accounts controlled by him, controlled on average approximately 35% of the public float for Innotrac and typically accounted for between 35% and 50% of the approximate 11,000 share average daily trading volume in Innotrac. Dadante acquired a substantial portion of his Innotrac holdings during the period January 2003 through February 2004 in the IPOF account at Ferris for which Glantz was the registered representative. During the scheme, Glantz purchased Innotrac stock for certain of his other customers at Ferris, and, through their accounts, controlled approximately an additional 25% of Innotrac’s public float. Acting in concert, Glantz, Dadante, and the other registered representative employed a variety of manipulative trading practices, including marking the closing price for Innotrac stock, engaging in matched and wash trades, and attempting to artificially create downbids to suppress short selling of Innotrac. To perpetrate the manipulative scheme, and to generate income for himself, Glantz also engaged in unauthorized and unsuitable trading in Innotrac and certain other securities in the accounts of customers other than IPOF.

Vaughan’s Failure to Supervise

8. Vaughan failed reasonably to supervise Glantz with a view toward preventing and detecting his violations of the federal securities laws by failing to respond reasonably to red flags regarding Glantz’s misconduct and lack of supervision, as discussed below.

9. During Glantz’s tenure at Ferris, Vaughan was the firm’s Director of Retail Sales and reported to Ferris Senior Executive B. Vaughan was one of the highest level supervisors for Ferris’ retail brokers. Vaughan and Senior Executive B recruited and hired Glantz. They both had the requisite degree of responsibility, ability or authority at Ferris to affect the conduct of Glantz.

10. When Glantz was hired, Vaughan and Senior Executives A and B all knew that Glantz had ten customer complaints on his Form U-4. Several employees of the firm's Beachwood, Ohio office had also warned them that Glantz had a questionable reputation in the industry.

11. Despite Glantz's history, Vaughan and Senior Executives A and B permitted Glantz to work under a special arrangement which allowed him greater freedom of action than other registered representatives at Ferris. Glantz, a retail broker, was permitted to manage both retail and institutional accounts. Vaughan and Senior Executive B also permitted Glantz, a retail broker assigned to Ferris' Beachwood, Ohio branch office, to work at Ferris' Institutional Trading Desk in Baltimore several days a week. The special arrangement under which Glantz was permitted to work was extremely unusual at Ferris. Glantz took advantage of that special arrangement to evade Ferris' supervisory procedures.

12. Glantz began working for Ferris on January 2, 2003, and problems with his conduct arose very shortly after he started. On May 23, 2003, Vaughan received by email a copy of a compliance department memorandum addressed to members of the firm's Credit Committee (the "May 23 Memo") which warned that there might be manipulative and unsuitable trading in Innotrac and that Glantz was not being properly supervised. The May 23 Memo reported, among other things, that a number of Glantz customer accounts held large positions in Innotrac, that Ferris customers owned approximately 40% of the total float and 19% of the outstanding shares of Innotrac, and that IPOF owned approximately 31% of the total float and 15% of the outstanding shares. This memorandum stated that "[w]hile the price of [Innotrac] has been in an up-trend, I believe this is largely due to the IPOF's accumulation of the shares in small lots on almost a daily basis driving the price higher." The May 23 Memo also noted that Glantz was accumulating Innotrac shares in a similar manner in some of his other customer accounts, that IPOF was a "control person" of Innotrac but had not made the necessary filings with the Commission, and that the IPOF account had a margin debit of \$9.381 million. The memorandum further reported that the trading in the IPOF account was not consistent with its investment objective of "growth and income." The May 23 Memo also contained a chart showing a high concentration of Innotrac stock and significant margin debts in other Glantz customer accounts, the majority of which were individual accounts or profit sharing plans whose investment objectives were reported as "growth and income." The May 23 Memo further stated that "without question, there is and has been a breakdown of supervisory responsibilities and who shares or owns supervisory responsibilities over the activity in the account and Mr. Glantz."

13. Ferris' Credit Committee responded to the size of IPOF's margin debt by raising the margin requirements for the account. A few weeks later, the author of the May 23 Memo, Ferris' Compliance Director, and Senior Executive A had a conference call with Vaughan and Senior Executive B to discuss the May 23 Memo. Neither Vaughan nor Senior Executive B reasonably responded to the red flags raised in the May 23 Memo as a result of this call.

14. In late July and August 2003, the compliance department informed Senior Executive A that: (1) the Beachwood branch manager was continuing to have problems supervising Glantz because he was working out of Ferris' Baltimore office; (2) the IPOF account was continuing to acquire a significant number of Innotrac shares; (3) Dadante was manipulating

the bid for Innotrac; and (4) Dadante had opened another account and engaged in free-riding, as a result of which the compliance department had restricted the account.

15. On September 4, 2003, Vaughan, Senior Executive B, and Glantz met with Senior Executive A to discuss IPOF and the significant and unusual accumulation of Innotrac shares in IPOF and another Glantz customer account. Vaughan and Senior Executives A and B failed to reasonably responded to the red flags discussed at this meeting.

16. By February 4, 2004, the margin balance in the IPOF account had grown to \$18.1 million and the account posed a significant credit risk for Ferris. That same day, Senior Executive A wrote a memo to the Credit Committee, which he emailed to Vaughan, admitting that there continued to be “a lack of clear definition as to who has day to day supervisory responsibilities for Steve Glantz.” The Credit Committee restricted the IPOF account by prohibiting the use of margin for any future purchases of Innotrac. However, Vaughan and Senior Executives A and B all failed to reasonably respond to the red flags discussed in this memorandum regarding Glantz’s conduct and lack of supervision at that time.

17. After February 4, 2004, neither Dadante nor IPOF purchased any more Innotrac stock through Ferris. Glantz, however, continued to engage in manipulative, unsuitable and unauthorized trading in other customer accounts. Among other things, Glantz utilized excessive margin to make unauthorized purchases of speculative stocks for customer accounts. Glantz’s use of margin and the nature and concentration of the stocks he purchased were unsuitable for his customers. Glantz did not disclose these facts, or the risks involved, to his customers. Glantz effected such trades deliberately for the purpose of increasing his own income.

18. In March 2004, many months after Glantz began splitting his time between Ferris’ Baltimore office and the Beachwood office, Vaughan and Senior Executive B officially transferred Glantz to Ferris’ Baltimore branch office. Neither of them informed the Baltimore branch manager of any issues involving Glantz or his handling of his customers’ accounts.

19. In September 2004, two new Ferris compliance officers conducted the annual compliance audit for the Baltimore branch. When they reviewed Glantz’s accounts, they became concerned that Glantz was engaging in unsuitable trading and was orchestrating transactions in his customers’ accounts that were designed to artificially support the price of Innotrac. During the audit, the Baltimore branch manager told the compliance officers, among other things, that he was unable to supervise Glantz and that Glantz needed to be terminated. The compliance officers subsequently wrote a memorandum to Senior Executive A detailing their findings regarding Glantz. The memorandum, which was not provided to Vaughan, discussed several Glantz accounts other than IPOF, the majority of which had been previously discussed in the May 23 Memo. The memorandum reported that all of these accounts had stated investment objectives of “growth and income” and had appeared on Ferris’ “active account” report for the month of September 2004, and that most of the accounts had engaged in frequent, short-term trading during this period. The memorandum further stated that these accounts had a “preponderance for large share quantity, low-priced, speculative investments.” The memorandum also reported that on September 30, 2004, Glantz cross traded 50,000 shares of Innotrac worth over \$400,000 by selling

these shares from one of his customer's accounts to four other customers' accounts, and that these trades were a "cause for concern." This memorandum concluded that "the appropriate supervisory oversight is currently not in place for Mr. Glantz."

20. On December 8, 2004, one of the compliance officers who participated in the compliance audit for the Baltimore branch discovered that Glantz had purchased 105,700 additional Innotrac shares worth approximately \$927,000 for certain of his customers in December and told Senior Executive A about these trades. This compliance officer called three of the customers whose accounts were involved in the trades.

21. On December 15, 2004, Senior Executive A wrote a memorandum to Vaughan and Senior Executive B recommending that Glantz be terminated (the "Termination Memo"). He emailed the Termination Memo to Vaughan and Senior Executive B in the early morning hours of December 16, 2004. In the Termination Memo, Senior Executive A stated, among other things, that Glantz's investments and use of margin for the accounts of one of his individual customers was "clearly unsuitable" and that the trading in these accounts exposed Glantz and Ferris to "claims of churning." The Termination Memo also reported that compliance had contacted the customers for whose accounts Innotrac had been purchased in December 2004, that none of the customers had initiated the trades, that they did not know that the purchases had been made, and that there was no written discretionary authority for these accounts. The Termination Memo also stated that Glantz had structured the December trades to avoid disrupting the market for Innotrac. The Termination Memo further stated that Glantz had been "essentially unsupervised" during his tenure at Ferris and concluded by recommending that Glantz be terminated.

22. Senior Executive A and Ferris' Compliance Director at that time met with Vaughan and Senior Executive B to discuss the issues raised in the Termination Memo. Senior Executive B challenged the recommendation that Glantz be terminated and suggested that Glantz instead be placed on special supervision. At the end of the meeting, Senior Executive A retracted his recommendation that Glantz be fired and agreed with Senior Executive B to allow Glantz to be placed on special supervision. Vaughan acquiesced in that decision.

23. In January 2005, in accordance with the special supervision memorandum, Senior Executive B became Glantz's supervisor. Glantz continued to engage in fraudulent trading practices during the period of his special supervision. During this period, Senior Executives A and B continued to receive red flags regarding Glantz's violative conduct but failed to respond reasonably to those warnings. Glantz remained an employee of Ferris until November 2005, at which time several IPOF investors filed a lawsuit and named Ferris as a defendant.

Violations

24. As a result of the conduct described above, Vaughan failed reasonably to supervise Glantz with a view to detecting and preventing Glantz's violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

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.

Accordingly, pursuant to Section 15(b) of the Exchange Act and Section 203(f) of the Advisers Act, it is hereby ORDERED that:

A. Respondent be, and hereby is, suspended from association in a supervisory capacity with any broker, dealer, or investment adviser for a period of six (6) months, effective immediately upon the entry of this Order.

B. IT IS FURTHER ORDERED that Respondent shall, within 30 days of the entry of this Order, pay disgorgement of \$12,721 and prejudgment interest of \$3,906, for a total of \$16,627, to the United States Treasury. It is further ordered that Respondent shall, within 30 days of the entry of this Order, pay a civil money penalty in the amount of \$50,000 to the United States Treasury. If timely payments are not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Payments 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 Patrick J. Vaughan 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 Timothy L. Warren, Division of Enforcement, Securities and Exchange Commission, 175 W. Jackson Blvd., Chicago, IL 60604.

By the Commission.

Elizabeth M. Murphy
Secretary