BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD

In the Matter of Department of Market Regulation, Complainant, vs. Amr "Tony" Elgindy Colleyville, TX and Key West Securities, Inc. Cardiff by the Sea, California, Respondents.	DECISION Complaint No. CMS000015 Dated: May 7, 2003

Hearing Panel dismissal of market manipulation allegations reversed. Held, market maker engaged in market manipulation when it took actions that were designed to manipulate the price of a stock.

For the Complainant: James J. Nixon, Esq., Jeffrey K. Stith, Esq., of NASD's Department of Market Regulation.

For the Respondents Amr "Tony" Elgindy and Key West Securities, Inc.: pro se.

Opinion

NASD's Department of Market Regulation ("Market Regulation") appeals the December 28, 2001 decision of an NASD Hearing Panel. Respondents Amr "Tony" Elgindy ("Elgindy") and Key West Securities, Inc. ("Key West Securities" or the "Firm") cross-appeal the decision. After a review of the entire record in this matter, we reverse the Hearing Panel's dismissal of the allegation that Elgindy and Key West Securities engaged in market manipulation. We affirm the Hearing Panel's finding that Elgindy and Key West Securities violated NASD's rule regarding communications with the public. We order that Elgindy be barred from associating with any member in any capacity and that Key West Securities be expelled from membership for engaging in market manipulation. We affirm the Hearing Panel's sanctions for violating NASD's rule regarding communications with the public. We impose a fine of $51,000, jointly and severally.

This appeal presents the question of whether a market maker that trades a small volume of a stock can violate the antifraud provisions of SEC and NASD rules when the evidence demonstrates that the firm took actions that were designed to artificially increase the price of a stock. We find that such conduct is manipulative and violates Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), SEC Rule 10b-5, and Conduct Rules 2110 and 2120.

In summary, we find that Elgindy attempted to exploit his status as a market maker in a stock to profit from what he believed would be a brief spike in the price of that stock. After noticing that the price of Saf T Lok, Inc. ("Saf T Lok") stock had risen sharply, Elgindy determined that Saf T Lok had benefited incorrectly from a news story. Elgindy believed that the price of Saf T Lok would soon be declining, so he entered market maker bids in increasing amounts in an effort to artificially increase the price of the stock. Although Elgindy was advertising that he would pay increasingly higher prices for Saf T Lok, when other market participants sought to sell him stock at this bid, he repeatedly refused. Once Elgindy had increased the best bid for the stock, instead of buying he would attempt to sell stock to other market makers at the inflated prices that he had helped create. Elgindy methodically increased his short position[1] in anticipation of major decreases in the price of Saf T Lok shares.

I. Background and Procedural History

Elgindy entered the securities industry in 1989. Elgindy was the owner, general securities principal, director of research, and head of trading at Key West Securities, a former NASD member, from March 1995 through July 1998. Elgindy voluntarily terminated his registration with Key West Securities in July 1998, and NASD cancelled the Firm's registration for failure to pay its NASD fees in November 1998.[2] Elgindy has not been associated with an NASD member since July 1998.

On March 2, 2000, Market Regulation filed a two-cause complaint against Elgindy and Key West Securities.[3] The first cause alleged that Elgindy and Key West Securities engaged in

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[1] A speculative short seller sells securities that he or she does not own at higher prices and later covers his or her short positions by purchasing the stock. Short sellers realize a profit by buying these securities on the open market at lower prices. See Randolph K. Pace, 51 S.E.C. 361, 365 (1993); United States v. Russo, 74 F.3d 1383, 1388 (2d Cir.), cert. denied, 519 U.S. 927 (1996).

[2] Elgindy's registration was revoked by NASD in September 1998 for his failure to pay fines and costs stemming from a previous NASD action.

[3] NASD investigated Key West Securities' activities after receiving a complaint from Saf T Lok regarding press releases issued by the Firm.

manipulation by short selling Saf T Lok stock at artificially high prices and later attempting to cover their short positions at lower prices by causing the price of Saf T Lok stock to drop through the issuance of deceptive sell recommendations, in violation of Conduct Rules 2110 and 2120, Section 10(b) of the Exchange Act, and SEC Rule 10b-5. The first cause alleged that, as part of this manipulative scheme, Elgindy and Key West Securities continuously increased the Firm's bid in Saf T Lok stock and established new inside bids, without intending to honor these bids. The second cause alleged that Elgindy and Key West Securities violated Conduct Rules 2110 and 2210 by failing to disclose Key West Securities' market maker status in the Firm's sell recommendations, which were communications with the public.

II. Facts

The conduct at issue occurred from October 9 to November 11, 1997 (the "review period"). During the review period, Key West Securities was a market maker in Saf T Lok stock. Saf T Lok, a manufacturer of locking devices for handguns, was listed on the NASDAQ ("Nasdaq") SmallCap Market.

Key West Securities' trading activities in Saf T Lok stock coincided with an October 9, 1997 Associated Press report, which stated that the Clinton administration and gun manufacturers had reached an agreement that would require child safety locks on most handguns sold in the United States. Although this report did not mention Saf T Lok, Saf T Lok's trading volume and share price increased significantly in the hours and days following this report. The day before the report, the trading volume in Saf T Lok stock had been 147,473 shares. The volume on October 9 and 10 was 12,036,089 shares and 17,642,215 shares, respectively. On October 13 and 14, the next trading days, the volume decreased to 5,024,985 shares and 1,860,133 shares, respectively.

Leading up to October 9, Elgindy suspected that Saf T Lok would be delisted and strongly believed that Saf T Lok would become bankrupt. Very early on October 9, after learning about the Clinton administration's agreement with gun manufacturers, but before deciding to engage in a short-selling strategy, Elgindy called Saf T Lok to find out whether it was going to benefit from the agreement. After Saf T Lok informed Elgindy that it would not benefit from the gun manufacturers' agreement, Elgindy surmised that the stock price would drop once the public discovered this information. At 10:15:10 a.m., he began short selling Saf T Lok stock.

After the Associated Press report, Saf T Lok stock, which had opened at $.43 per share, closed at $3 per share on October 9. On October 10, it closed at $4.56 per share. In the month that followed, the stock price declined gradually. Through November 11, 1997, Saf T Lok's daily closing prices were between $2.03 and $3.65, with an average of $2.95 per share.

A. Key West Securities' Trading Activity and Press Releases

On October 9, 1997, starting at 10:25 a.m., Key West Securities repeatedly established inside bid quotes for Saf T Lok stock at increasingly higher prices. The trading records show that although Elgindy was raising Key West Securities' bid in Saf T Lok stock, he was not honoring those bids when other market makers sought to sell the Firm stock at its bid.

During October 9 and October 10, 1997, Elgindy engaged in a series of short sales that gradually increased Key West Securities' short position from zero to 58,000 shares. While Key West Securities made only one purchase of Saf T Lok stock on October 9 and October 10, 1997, it was issuing numerous SelectNet broadcast and preferenced orders to sell the stock.[4] Key West Securities became a market maker in Saf T Lok stock approximately six months before October 9, 1997. With the exception of a purchase on October 6, 1997 to cover a short position, however, Elgindy did not buy any shares of Saf T Lok stock from June 1997 through October 9, 1997.

During the review period (October 9 through November 11), Key West Securities issued five press releases, each recommending Saf T Lok stock as a "sell." None of these press releases disclosed that Key West Securities was making a market in Saf T Lok stock or that it was willing to conduct transactions on a principal basis. The Firm issued one press release on October 9, two on October 10, and one each on October 24 and November 11, 1997.

B. <u>Elgindy's Testimony</u>

During Market Regulation's investigation of this matter and during the Hearing Panel hearing, Elgindy testified regarding his role at the Firm and his activities relating to Saf T Lok stock. Elgindy testified that he entered all the Firm's quotes for Saf T Lok stock, he decided that the Firm would make recommendations regarding Saf T Lok stock, and he wrote the five press releases that Key West Securities issued.

Regarding the Firm's press releases, Elgindy testified that the press release that the Firm issued at 12:48 p.m. on October 9, 1997 was the first press release that the Firm had issued

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4 At the times relevant to the complaint, SelectNet was an order delivery system operated by Nasdaq that permitted market participants to enter buy or sell orders in Nasdaq securities into the system. A firm entering a SelectNet order to buy or sell a Nasdaq security could direct its order to a single market maker (referred to as a "preferenced" order). Preferenced SelectNet orders triggered the market maker's obligation to honor its quotes, assuming the order was received by the market maker and was priced at the market maker's quote, and the market maker was not adjusting its quote. A SelectNet order also could be broadcast to all market makers in an issue (referred to as a "broadcast" order). <u>See</u> <u>Order Approving Proposed Rule Change To Provide Non-member Viewing Access To SelectNet and that the Transmission of Broadcast Orders Through SelectNet Be Solely on an Anonymous Basis</u>, Exchange Act Rel. No. 35732, 1995 SEC LEXIS 1201 (May 18, 1995).

covering Saf T Lok stock. Elgindy testified that his purpose in writing each of the five press releases was to inform the public that the stock was overvalued.

Regarding the Firm's accumulation of a short position in Saf T Lok, Elgindy testified that—before selling short any shares of Saf T Lok stock on October 9—he investigated the Associated Press report and determined that it had nothing to do with Saf T Lok. Elgindy testified that he would not buy Saf T Lok's product and therefore he could not buy its stock. Elgindy further testified that he believed that the surge in Saf T Lok's stock price on October 9 was a case of mistaken identity and that the price of Saf T Lok stock would fall once everyone realized this fact. Based on the price of Saf T Lok before October 9, Elgindy testified that he could not justify buying the stock on October 9 when it was priced above $2.[5] Elgindy testified that he was confident enough in his assessment that Saf T Lok was overvalued that he would have shorted one million shares if he had had the money.

At the Hearing Panel hearing, Elgindy was asked why his Firm's bid in Saf T Lok was repeatedly the highest bid, given that he did not purchase any shares of the stock. Elgindy testified that on October 9 and 10 he was primarily raising his Firm's offer quotation so that his Firm was not at the inside offer. Elgindy claimed that—because the Excess Spread Rule required him to move his bid in tandem with his offer—the Firm was required to raise its bid, which included instances of the Firm quoting the highest bid in Saf T Lok stock. We analyze the Excess Spread Rule and Elgindy's testimony on this point later in this decision.

C. Hearing Panel Decision and Appeal

The Hearing Panel dismissed the allegation that Elgindy and Key West Securities engaged in market manipulation. The Hearing Panel found that Market Regulation had failed to prove that Elgindy "had sufficient power" to interfere with market forces so as to manipulate Saf T Lok's stock price upward. The Hearing Panel made no finding regarding whether Elgindy took actions that were designed to manipulate the market for Saf T Lok stock. The Hearing Panel found, however, that Elgindy and Key West Securities entered high bids without intending to honor them, in violation of NASD's requirement that members shall observe just and equitable principles of trade.

As to the complaint's second cause, the Hearing Panel found that Elgindy and Key West Securities' sell recommendations violated Conduct Rule 2210 because they failed to disclose Key

[5] Although Elgindy testified that he could not justify purchasing the stock on October 9, 1997 because it was priced above $2, he increased Key West Securities' inside bid to more than $2 on several occasions, giving the appearance that he was willing to purchase the stock at prices above $2. In fact, Elgindy's only purchase during the period in question was of 1,000 shares at $4.656 a few minutes before the market closed on October 10, 1997.

West Securities' market-making status or its willingness to conduct transactions on a principal basis. The complaint also alleged that Elgindy and Key West Securities' failure to disclose the Firm's short positions in the Firm's sell recommendations violated Conduct Rules 2110 and 2210 as well as the SEC's and NASD's antifraud rules. In its post-hearing brief, Market Regulation withdrew this allegation because Conduct Rule 2210 does not require a member firm to disclose its ownership interest in a recommended equity security. We agree that Conduct Rule 2210 has no such disclosure requirement.

For sanctions, the Hearing Panel suspended Elgindy and Key West Securities for one year, fined each $2,000 for failing to honor bids, and fined each $1,000 for violating NASD's rule regarding communications with the public. All the parties appealed.

On appeal, Market Regulation asserts that the Hearing Panel's conclusion that Elgindy and Key West Securities did not engage in market manipulation was erroneous for several reasons. First, Market Regulation argues that the evidence shows that Elgindy and Key West Securities did in fact manipulate the price of Saf T Lok stock. Second, Market Regulation states that the Hearing Panel applied the wrong legal standard. Market Regulation asserts that it was not required to prove that Elgindy and Key West Securities' activities moved the price of Saf T Lok stock to prove manipulation. Instead, Market Regulation argues that, to prove manipulation, it need only prove that Elgindy and Key West Securities attempted to manipulate the price of Saf T Lok through their fictitious bidding activity. Market Regulation also contends that the Hearing Panel correctly concluded that Elgindy and Key West Securities violated Conduct Rule 2110 by entering a series of high bids without intending to honor them.

Elgindy and Key West Securities argue on appeal that the Hearing Panel correctly found that Elgindy and the Firm did not engage in market manipulation. Elgindy and Key West Securities contend that the price movements in Saf T Lok stock were caused by events and forces other than Elgindy and the Firm and that their dissemination of accurate information in sell recommendations cannot, as a matter of law, constitute manipulation. Elgindy and the Firm further argue that Market Regulation failed to prove that they intended to affect the price of Saf T Lok stock. Elgindy and Key West Securities also argue that the Hearing Panel erroneously concluded that they violated Conduct Rule 2110 by posting a series of high bids for Saf T Lok stock without intending to honor them. Elgindy and the Firm request that the Hearing Panel's sanctions for this violation be eliminated.[6]

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[6] In June 2002, Elgindy's attorney made a motion to withdraw immediately from the case and adjourn oral argument indefinitely pending Elgindy's retention of a new attorney. Market Regulation opposed the motion and argued that the progress of the appeal should not be delayed indefinitely. The NAC Subcommittee, however, allowed Elgindy's attorney to withdraw and, with the agreement of the parties that the appeal would move forward, cancelled oral argument and considered this matter based on the appellate briefs and the written record. We affirm the Subcommittee's rulings on these motions and adopt them as our own.

III. Discussion

The Hearing Panel dismissed the allegation that Elgindy[7] and Key West Securities engaged in a manipulation of the market for Saf T Lok stock. We disagree and reverse the Hearing Panel's finding. We affirm the other relevant findings of the Hearing Panel.

A. Market Manipulation

We find that Elgindy engaged in a manipulative scheme when he posted artificially high bids that were designed to inflate the price of Saf T Lok stock. We overturn the Hearing Panel's finding of no manipulation because the Hearing Panel erred in formulating the legal standard for this case. Consistent with established case law, we conclude that Market Regulation had to establish that, in connection with the trading of Saf T Lok stock, Elgindy took actions the purpose of which was to artificially affect the price of Saf T Lok stock. Market Regulation was not required to prove that Elgindy's conduct had an actual effect on the price of Saf T Lok stock.

1. Legal Basis for Liability

Section 10(b) of the Exchange Act makes it "unlawful for any person . . . to use or employ, in connection with the purchase or sale of any security . . ., any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe."[8] SEC Rule 10b-5 prohibits the use, "in connection with the purchase or sale of any security," of "any device, scheme, or artifice to defraud" or any other "act, practice, or course of business" that "operates . . . as a fraud or deceit."[9]

The United States Supreme Court has explained that the Exchange Act "was designed to protect investors against manipulation of stock prices." Basic Inc. v. Levinson, 485 U.S. 224, 230 (1988). The Supreme Court has defined manipulation as affecting the price of securities by artificial means, that is, means unrelated to the natural forces of supply and demand. See Ernst & Ernst v. Hochfelder, 425 U.S. 185, 199 (1976).

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[7] For purposes of the discussion section, when we refer to Elgindy we are referring to Elgindy and Key West Securities.

[8] 15 U.S.C. § 78j (2001).

[9] 17 C.F.R. § 240.10b-5 (2002). The analysis that follows regarding the application of Section 10(b) and Rule 10b-5 applies equally to NASD's antifraud provision, Rule 2120. See Market Regulation Comm. v. Shaughnessy, Compl. No. CMS950087, 1997 NASD Discip. LEXIS 46 (NBCC June 5, 1997), aff'd, Kevin Eric Shaughnessy, 53 S.E.C. 692 (1998).

Several courts have held that manipulation can be established by proving that a manipulator's purpose in engaging in certain conduct was to artificially affect the price of a stock. It is not necessary to prove that the manipulator's conduct actually affected the stock's price. See Markowski v. SEC, 274 F.3d 525, 529 (D.C. Cir. 2001), cert. denied, 2002 U.S. LEXIS 5578 (2002); GFL Advantage Fund, Ltd. v. Colkitt, 272 F.3d 189, 205-206 (3d Cir. 2001), cert. denied, 122 S. Ct. 2588 (2002) (stating that market manipulation in violation of Section 10(b) and Rule 10b-5 does not require proof that the manipulative conduct impacted a security's price); Chemetron Corp. v. Business Funds, Inc., 718 F.2d 725, 728 (5th Cir. 1983) (same).

The Markowski case was originally an NASD disciplinary action, in which the National Adjudicatory Council ("NAC") found that Markowski's firm manipulated the market by maintaining high bid prices for an issuer's securities, and absorbed all unwanted securities into inventory, thereby preventing sales from depressing market prices. Market Surveillance Comm. v. Markowski, Compl. No. CMS920091, 1998 NASD Discip. LEXIS 35 (NAC July 13, 1998). The SEC affirmed the NAC decision. On appeal, the Court of Appeals held that fictitious transactions are not required to find a manipulation; rather, registered persons can engage in manipulation by trading securities when their purpose is manipulative. Markowski, 274 F.3d at 529. There, the court rejected the manipulators' argument that their conduct was lawful because it involved bids and trades that were "real," meaning that real transactions took place with real customers. Id. at 528-529. The court stated that real transactions can be executed with a manipulative purpose and therefore violate Section 10(b) of the Exchange Act, Rule 10b-5, and NASD rules. Id. The Markowski court also rejected the manipulators' argument that their net loss in the transactions precluded a finding of scienter or manipulation. Id. at 529 ("Just because a manipulator loses money doesn't mean he wasn't trying.").

Here, the Hearing Panel below dismissed Market Regulation's allegation that Elgindy had engaged in market manipulation on the grounds that Market Regulation "fell far short" of proving that the Firm's actions had transformed the market into a "stage-managed performance." We conclude that the Hearing Panel applied an incorrect legal standard. A market manipulator need not succeed in moving a stock's price at will to violate the SEC's and NASD's antifraud rules. See Markowski, 274 F.3d at 529, GFL Advantage, 272 F.3d at 205-206, Chemetron, 718 F.2d at 728.[10]

The Hearing Panel also reasoned that manipulation cases generally have certain "hallmarks," including "a rapid price surge dictated by a firm that controlled the market, little investor interest, an abundant supply of shares, and the absence of any known prospects for the

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10 Further, it is irrelevant to a finding of manipulation that the manipulator lost money or did not profit. See R.B. Webster Invs., Inc., 51 S.E.C. 1269, 1274 (1994) (stating that a "manipulator simply may not be clever or lucky enough to profit from his or her misdeed.").

issuer or favorable developments affecting it." The Hearing Panel implied that because Market Regulation failed to prove that this case involved these "hallmarks," the Hearing Panel's conclusion that the evidence did not prove manipulation was bolstered. We disagree with this reasoning. The "hallmarks" that the Hearing Panel recited appear to us to describe a classic "pump and dump" manipulation, which is not the exclusive blueprint for market manipulations. Section 10(b) is a catchall provision that allows regulators to deal with new manipulative schemes, and thus it must be applied flexibly. See Chiarella v. United States, 445 U.S. 222, 226 (1980); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 202 (1976); Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 12 (1971). Further, the United States Court of Appeals stated that Section 10(b) and Rule 10b-5 "are not intended as a specification of particular acts or practices that constitute 'manipulative or deceptive devices or contrivances,' but are instead designed to encompass the infinite variety of devices that are alien to the climate of fair dealing." Herpich v. Wallace, 430 F.2d 792, 802 (5th Cir. 1970) (citation omitted).

We hold that the Hearing Panel erred in applying the law and that Market Regulation can establish manipulation in this case by showing that Elgindy engaged in market activities with the purpose of artificially affecting the price of Saf T Lok stock, regardless of whether his efforts were the cause of the market's movement.

2. *Evidence of Elgindy's Manipulative Scheme*

We conclude that Elgindy's activities establish by a preponderance of the evidence that his purpose was to manipulate the price of Saf T Lok stock. We find that several interrelated aspects demonstrate the manipulative scheme: (1) Elgindy repeatedly bid up Saf T Lok's stock price and immediately sold the stock short; (2) Elgindy did not honor Key West Securities' bid when other firms sought to sell stock to the Firm; (3) Elgindy repeatedly sold short at his Firm's bid; and (4) Key West Securities made five sell recommendations in press releases. We find that the interrelations between these actions are more important than all four actions considered in isolation because our conclusion that Elgindy engaged in a manipulative scheme is based on the dynamics of the market and Elgindy's actions in that context.

a. Bidding Up and Selling Short

On October 9 and 10, 1997, Key West Securities was a market maker in Saf T Lok stock. By entering quotes, a market maker is announcing its willingness and commitment to buy stock at its bid price and sell stock at its ask price.[11] See NASD Rule 4613(a); Conduct Rule 3320; Exchange Act Section 3(a)(38).

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[11] Moreover, market makers play a crucial role in the securities markets. The price of a security "quoted by the broker dealers involved, becomes, in itself, perhaps the most significant piece of information about the security, representing, as it does, what is supposedly the collective judgment of those interested in the security, based on what information they may individually

[Footnote continued on next page]

We find that—during three episodes on October 9—Elgindy increased the Firm's bid and "bid up"[12] the price of Saf T Lok stock with the intention of selling short the stock to other market participants that were willing to buy at or near the artificially high prices that Elgindy was quoting. First, Elgindy bid up the price of Saf T Lok beginning at 10:26:20 a.m. Over the next one minute and 13 seconds, Elgindy established a new inside bid 10 times as the inside bid rose from $1.31 to $1.719. Elgindy's increasingly higher bids accounted for 31 cents of the 40-cent increase. Thirteen seconds after increasing the inside bid to $1.719, Elgindy began entering SelectNet broadcast and preferenced sell orders in efforts to sell shares of Saf T Lok short. Elgindy attempted to sell short a total of 22,000 shares of Saf T Lok. He succeeded in receiving executions for six of his sell orders, and he sold short a total of 12,000 shares during this episode.

Second, beginning at 10:50:12 a.m., Elgindy again bid up the price of Saf T Lok stock and immediately attempted to sell the stock short. From 10:50:12 to 10:51:17 a.m., Elgindy established increasingly higher bids for Saf T Lok seven times in a row. During this time, he alone raised the bid from $2.06 to $2.28. Approximately one minute later, he attempted to sell more Saf T Lok stock short. From 10:52:14 to 10:53:03 a.m., Elgindy entered six broadcast sell orders to sell a total of 12,000 shares of Saf T Lok. Another firm partially executed one of Elgindy's broadcast orders and Elgindy sold short 1,000 shares.

Third, at 11:41:06 a.m., and over the next one and one-half minutes, Elgindy increased the inside bid five times as the bid rose from $2.50 to $2.688. Only one other market maker increased the inside bid at this time, accounting for three cents of the increase in the bid. Less than one minute later another market maker increased the inside bid and, at 11:43:14 a.m., Key West Securities joined the inside bid at $2.719. Elgindy maintained the highest bid for approximately one and one-half minutes, after which (at 11:44:50 a.m.) he lowered his bid to $2.468, and he was no longer at the inside bid. Immediately after lowering his bid, from 11:44:54 to 11:45:45 a.m., Elgindy entered three SelectNet broadcast sell orders and two SelectNet preferenced sell orders in an attempt to sell a total of 25,000 shares of Saf T Lok. Elgindy attempted to sell at prices ranging from $2.718 to $2.593. Elgindy succeeded in short selling 5,000 shares, and increased the Firm's short position to 29,000 shares as of 11:45:41 a.m.

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have." See Robert B. Martin, Jr., Broker-Dealer Manipulation of the Over-the-Counter Market – Toward A Reasonable Basis for Quotations, 25 Bus. Law. 1463, 1469 (1970).

[12] "Bidding up," as we use the term here, is the process of a firm posting increasingly higher bids for a stock. See F.N. Wolf & Co., 1996 SEC LEXIS 8, at *52-54 (Initial Decision) (Jan. 3, 1996).

If any of Elgindy's four other sell orders had been executed, those sales would have been short sales as well.

We find that these three episodes of Elgindy's bidding up and immediate attempts to sell Saf T Lok shares were the core of Elgindy's manipulative scheme. Elgindy sought to raise the price of Saf T Lok stock to an artificially high level by entering bids that falsely represented that the Firm was willing to buy Saf T Lok stock when in fact the Firm was not willing to buy. At the same time, Elgindy was attempting to induce others to raise their bid quotes so that Elgindy could sell Saf T Lok shares to them.

b. Not Honoring Bids

We find that Elgindy's repeated refusal to honor Key West Securities' bid is persuasive evidence that the Firm's bids were fictitious in that Elgindy posted them as part of a manipulative scheme in order to inflate the price of Saf T Lok stock. The record contains several examples of Elgindy's refusal to honor the Firm's bids, the most salient of which took place during the three episodes when Elgindy bid up the price of Saf T Lok stock and then attempted to execute numerous short sales.

During the first episode discussed above, at 10:28:35 a.m. on October 9, Key West Securities changed its bid to $1.687, which matched the inside bid. Key West Securities remained at this bid for approximately one minute and 45 seconds until 10:30:16 a.m. From 10:30:09 to 10:30:15 a.m., DATK[13] presented three 500-share preferenced sell orders to Key West Securities at its bid. Although Elgindy had ample time to execute the orders, he executed none of them and let each order "time out."[14]

Likewise, during the second and third episodes discussed above, Key West Securities repeatedly failed to honor its bid. During the second episode, from 10:52:02 to 10:53:03 a.m.—shortly after establishing the inside bid—other firms preferenced Key West Securities with 11 sell orders at the Firm's bid. Elgindy did not execute any of these preferenced sell orders. Finally, at 11:43:14 a.m., Key West Securities joined the inside bid at $2.718 and remained at the inside bid for approximately one and one-half minutes until 11:44:45 a.m. Between 11:43:53 and 11:44:43 a.m., DATK and CLYN[15] preferenced Key West Securities with five sell orders to

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13 DATK was the Nasdaq designation for Datek Securities Corporation.

14 A SelectNet order remained on the Nasdaq workstation for a certain period, after which time the order automatically expired. This expiration was referred to as "timed out."

15 CLYN was the Nasdaq designation for Carlin Equities Corp.

sell a total of 4,500 Saf T Lok shares at Key West Securities' bid price. Key West Securities did not buy any of these shares. Three of the orders were cancelled[16] and two timed out.

During the entire trading day on October 9, Elgindy received 21 preferenced sell orders at the Firm's bid. Elgindy, however, executed none of these preferenced orders. We conclude that Key West Securities' bid prices on October 9 were not a market maker's bids—a commitment that it will buy stock at that price—but rather were a series of fictitious bids that Elgindy published in an effort to encourage other market makers to bid up the price of Saf T Lok stock.

c. Selling Short at the Firm's Bid

An additional aspect of Elgindy's conduct that reinforces our conclusion that Elgindy was engaged in a manipulative scheme was his repeated willingness to sell short at his Firm's bid. The trading records regarding Saf T Lok demonstrate that Elgindy was so determined to sell Saf T Lok stock short that he repeatedly entered sell orders at the Firm's bid price. Such activity is unusual because market makers typically generate revenue by buying at their bid and selling at their ask. Elgindy, however, sought to capitalize immediately on his Firm's artificially high bids.

At 10:51:17 a.m. on October 9, Key West Securities established the inside bid of $2.281 in Saf T Lok stock and maintained the inside bid for almost two minutes without buying any stock. During this two-minute period, Elgindy entered five broadcast sell orders at his bid price. One of these orders was partially executed. Elgindy repeated this pattern; he attempted to sell at the Firm's bid price six times on October 9. We find that Elgindy's entering sell orders at the Firm's bid bolsters our conclusion that Elgindy intended to artificially inflate the price of Saf T Lok stock so that he could sell it short at inflated prices.[17]

d. Key West Securities' Sell Recommendations

We also find that the five sell recommendations issued by Key West Securities in press releases—although accurate—were intended to further Elgindy's manipulative scheme by decreasing the price of Saf T Lok stock. We find that Elgindy was attempting to cause the price of Saf T Lok stock to drop so that he could quickly cover his short position at a profit. Our

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16 A firm that entered a broadcast or preferenced order into SelectNet could cancel the order after a minimum period had elapsed.

17 We recognize that market makers occasionally seek to sell stock at their bid due to existing market conditions. Based on our review of Elgindy's quotes and the activities of other market makers in Saf T Lok stock at the time, however, we find that Elgindy established a pattern of selling at the Firm's bid that had no relation to market conditions or market making obligations.

finding is not based, however, on the premise that any of the statements in the press releases were false.

Key West Securities issued its first sell recommendation regarding Saf T Lok at 12:48 p.m. on October 9.[18] The press release stated that an employee of Saf T Lok had told Key West Securities that the announcement regarding the agreement between the Clinton administration and gun manufacturers had nothing to do with Saf T Lok and that the price of the stock probably had increased because people assumed that the announcement related to Saf T Lok. At the hearing below, Elgindy admitted that he had determined early in the morning of October 9—before accumulating a short position in Saf T Lok stock—that the trading interest in Saf T Lok stock was a case of mistaken identity. Elgindy further admitted that he believed that the price of Saf T Lok shares would fall once everyone realized this mistake. After Elgindy concluded that Saf T Lok would not benefit from the gun manufacturers' agreement, he built the Firm's short position in Saf T Lok stock from zero to 36,500 shares before issuing the first press release.

The following day, Key West Securities started the trading day with a short position of 46,000 shares of Saf T Lok and increased its short position to 58,000 shares by 10:18:34 a.m. At 11:13 a.m. on October 10, Key West Securities issued a second press release over Business Wire, reiterating its "sell" recommendation. This press release stated that Saf T Lok's president had indicated that Saf T Lok would be delisted. At 2:27 p.m., Key West Securities issued a third press release over Business Wire, reiterating its "sell" recommendation.

On October 24, and November 11, 1997, Key West Securities issued its fourth and fifth press releases over Business Wire, each reiterating its "sell" recommendation. None of the five press releases disclosed Key West Securities' status as a market maker or its willingness to conduct transactions on a principal basis.

We conclude that the press releases are circumstantial evidence that Elgindy had no intention of honoring his artificially high bids, but rather that he had planned to sell short at inflated prices and cover his short position once the price had fallen. In this respect, the press releases were a final aspect of Elgindy's manipulative scheme.

e. Elgindy's Ability To Move the Market

The Hearing Panel found that Market Regulation had failed to prove that Elgindy's actions overcame market forces and manipulated Saf T Lok's stock price upward. The Hearing Panel noted that Elgindy's role in trading Saf T Lok stock was miniscule in relation to the total

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[18] Elgindy testified that Key West Securities, which had been in business for approximately two and one-half years, had issued only two or three press releases before issuing the five press releases regarding Saf T Lok.

volume of Saf T Lok shares that were traded. On appeal, Elgindy defends the Hearing Panel's finding and highlights the testimony below of a Saf T Lok market maker who testified that she had no recollection of Key West Securities other than the Firm's status as a market maker.

Because our conclusion that Elgindy engaged in market manipulation is based on our finding that Elgindy's actions were designed to move the price of Saf T Lok, and not that his actions were successful, we need not resolve the issues of whether and to what extent Elgindy's actions moved the price of Saf T Lok stock.[19]

3. *Elgindy Acted with Scienter*

To conclude that Elgindy violated Section 10(b), Rule 10b-5, and Conduct Rule 2120, we must find that he acted with scienter. See Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976). In the context of the SEC's antifraud rules, scienter means intent to deceive, manipulate, or defraud. Id. Scienter generally connotes knowing or intentional conduct, but it also may be established through a showing of reckless conduct. See SEC v. McNulty, 137 F.3d 732, 741 (2d Cir.), cert. denied, 525 U.S. 931 (1998).

As discussed above, we have found that Elgindy's purpose in engaging in certain conduct was to carry out a manipulative scheme. We find that Elgindy's actions demonstrate that his intent as well as his purpose was to manipulate. We therefore find that Elgindy acted with scienter.

4. *Elgindy's Explanation for Increasing the Inside Bid Was Not Credible*

Elgindy's main defense at the hearing below was that Key West Securities' bidding activity was a by-product of his strategy to stay away from the inside offer and the application of the Excess Spread Rule, NASD Rule 4613(d). The Hearing Panel concluded that Elgindy's explanation was not credible and his interpretation of the rule was incorrect. We agree.[20]

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19 Notwithstanding our conclusion that this appeal should not be decided based on proof of Elgindy's movement of the market, we note that—for brief periods of time on October 9—after Elgindy had bid up the price of Saf T Lok shares and after he had lowered his Firm's bid, the inside bid for Saf T Lok declined back toward the price level that other market makers had been quoting before Elgindy started increasing the inside bid.

20 We agree with the Hearing Panel's finding that Elgindy's explanation of his trading activity was not credible. See Jonathan Garrett Ornstein, 51 S.E.C. 135, 137 (1992) (credibility determinations by the fact-finder are entitled to considerable weight). Because the Hearing Panel applied an incorrect legal standard to this case, however, we give the Hearing Panel's finding that the evidence did not prove manipulation no weight or deference. Our finding that Elgindy engaged in market manipulation is based on trade and quotation evidence, the accuracy of which

[Footnote continued on next page]

Elgindy claimed that his objective was to post an offer price that was higher than the inside offer so that he could avoid an onslaught of orders from other market participants. Elgindy testified that the Nasdaq system warned him when he tried to widen his spread too far and therefore he was forced to increase Key West Securities' bid each time he increased its offer because of the Excess Spread Rule. Contrary to Elgindy's testimony, however, the Excess Spread Rule did not apply to Nasdaq SmallCap companies such as Saf T Lok, and thus Key West Securities was not subject to it.[21] Moreover, the Nasdaq system did not warn market makers in SmallCap securities regarding the sizes of their spreads.[22] We conclude, as did the Hearing Panel, that Elgindy's explanation for why he increased his bid was not credible.

* * *

In summary, we conclude that Elgindy's repeated entry of higher bids, which he had no intention of honoring, coupled with his short selling—including repeatedly selling at his Firm's bid—immediately after he had helped raise the inside bid and his issuing of press releases were part of a manipulative scheme the aim of which was to artificially inflate the price of Saf T Lok stock and profit when the share price later declined. Therefore, we find that Elgindy and Key West Securities' employed a manipulative device in violation of Conduct Rules 2110 and 2120, Section 10(b) of the Exchange Act, and SEC Rule 10b-5.

B. Liability for Entering High Bids Without Intending To Honor Them

Because we find that Elgindy and Key West Securities engaged in a manipulative scheme in violation of the SEC's and NASD's antifraud provisions, we need not address the Hearing Panel's finding that Elgindy and the Firm's conduct in entering high bids without intending to

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the parties do not dispute. Under these circumstances, we independently evaluate the evidence and the inferences to be drawn from the evidence. See Hale v. DOT, 772 F.2d 882, 886 (Fed. Cir. 1985) (in agency proceedings, where the reviewing body's final decision is based on a question of law, it can analyze the documentary evidence and reach its own conclusion without giving substantial deference to the initial decision maker's conclusion); Hart v. Gallis, 275 F.2d 297 (7th Cir. 1960) (where the findings are based on documentary evidence, a lower court's findings are given slight weight on appeal).

[21] See Order Approving Proposed Rule Change by NASD Relating to the Elimination of the NASD's Excess Spread Rule Applicable to Market Maker Quotations in Nasdaq SmallCap Securities, Exchange Act Rel. No. 38354, 1997 SEC LEXIS 511 (Feb. 28, 1997).

[22] See id.

honor them violated just and equitable principles of trade. Accordingly, we do not address Elgindy and Key West Securities' argument that they were not given fair notice of this violation.

C. Communications with the Public

Neither party contests the Hearing Panel's finding with respect to Elgindy and Key West Securities' violations of NASD's rule regarding communications with the public. We affirm the violations because, in making recommendations regarding Saf T Lok stock, Elgindy and Key West Securities failed to disclose that the Firm was making a market in the security or that it would sell to or buy from customers on a principal basis. This omission was a violation of Conduct Rules 2110 and 2210(d)(2)(B).

IV. Sanctions

The Hearing Panel suspended Elgindy and Key West Securities for one year and fined each $2,000 for failing to honor Key West Securities' bids. The Hearing Panel fined Elgindy and the Firm each $1,000 for violating NASD's rule regarding communications with the public. Because our findings of violations are substantially different from the Hearing Panel's, we modify the sanctions that the Hearing Panel imposed.

There is no Sanction Guideline for market manipulation. We start with the principle that market manipulation is one of the most serious violations that a respondent can commit. Manipulation is a direct assault on NASD's mission to bring integrity to the markets. Moreover, market makers play a crucial role in the securities market. Elgindy and Key West Securities abused the privilege of being a liquidity provider and instead pursued their goal of amassing a large short position. They also usurped Nasdaq's quotation dissemination function for small cap securities and employed it in an attempt to further their manipulative scheme.

We conclude that Elgindy and Key West Securities' misconduct violated the public trust and jeopardized market integrity. In light of the egregiousness of their misconduct, we bar Elgindy from associating with any NASD member in any capacity and expel Key West Securities from NASD membership.[23] We do so to deter potential manipulators and to protect the public adequately from recurrence of similar misconduct.[24]

As to Key West Securities, we expel it from NASD membership because all aspects of its business were controlled and directed by Elgindy. Elgindy was the Firm's founder, sole owner, head trader, and director of research. The Firm had no customer accounts. As Elgindy described it, the Firm was a "two man operation." Given these circumstances, we find that the Firm's activities were so inextricably linked with Elgindy that the Firm should be expelled.

Our approach is similar to the standard used by the SEC in ordering a remedy in fraud cases. In the context of ordering joint and several disgorgement in securities fraud cases, the SEC has used an alter ego test or a similar test. See Daniel R. Lehl, 2002 SEC LEXIS 1796, *52 (SEC May 17, 2002). In Lehl, the SEC ordered joint and several disgorgement when it concluded that an individual and his financial consulting corporation had inextricable links between them and that the individual dominated and controlled the corporation.[25]

Although we do not adopt the SEC's analysis as set forth in Lehl as a necessary requirement for adjudicators when assessing—in a similar case—whether to expel a firm in an NASD disciplinary case, we do find the SEC's analysis helpful in this case. We view the question of joint and several liability for disgorgement as similar to the question of whether the sanction against a firm should be different from the sanction against the person in control of the firm, when that person is barred.

We also note that Key West Securities and Elgindy did not argue that their respective

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23 In reaching our conclusion regarding these sanctions, we have considered the factors that the SEC considers when it bars a person from the securities industry. See Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979), aff'd, 450 U.S. 91 (1981). Specifically, we have considered the egregiousness of Elgindy's manipulative activity, his prior disciplinary history (involving the entry of non bona fide orders into SelectNet), the intentional nature of his misconduct, the insincerity of Elgindy's explanations, and his denials of any wrongful conduct. We have also considered the same factors with respect to Key West Securities.

24 The guideline most closely related to Elgindy and Key West Securities' market manipulation is the marking the close or open guideline, which recommends a range of monetary sanctions (from $25,000 to $100,000) and states that, in egregious cases, a bar or expulsion may be appropriate. See NASD Sanction Guidelines (2001 ed.) at 63 (Marking The Close Or Open).

25 Id. ("If a party dominates and controls a corporation and uses the domination and control to commit fraud, the party is an alter ego of a corporation.") (citing SEC v. Great Lakes Equities Co., 775 F. Supp. 211, 213 (E.D. Mich. 1991)).

responsibilities should be viewed differently. The Hearing Panel ordered below that Elgindy and Key West Securities each be suspended for one year, among other sanctions. On appeal, Elgindy and the Firm argued that they did not commit the violation that the Hearing Panel had found; however, neither Elgindy nor the Firm argued that Key West Securities should be treated differently than Elgindy.

We turn next to the principal considerations for determining sanctions listed in the Sanction Guidelines and we conclude that none of these factors militates against imposing a bar on Elgindy and expelling Key West Securities. Elgindy has a relevant disciplinary history, involving the violation of the SOES rules for entering non bona fide orders into SelectNet. Further, Elgindy offered false exculpatory reasons for his actions, and his actions were intentional.

According to the NASD's policy on the Imposition and Collection of Monetary Sanctions, adjudicators may refrain from imposing monetary sanctions in certain cases in which a bar or expulsion is imposed. See NASD Sanction Guidelines (2001 ed.) at 14. The NASD policy, however, contains no recommendation regarding market manipulation violations. We therefore take our guidance from the overriding purpose of all disciplinary sanctions, which is to remedy misconduct, deter future misconduct, and protect the investing public. Id. at 13. Considering these goals and given the egregiousness of the misconduct, we impose a \$50,000[26] fine on both Elgindy and the Firm, jointly and severally, in addition to barring Elgindy and expelling Key West Securities.

For violating NASD's rule regarding communications with the public, we modify the Hearing Panel's sanction and fine Elgindy and Key West Securities \$1,000, jointly and severally, a fine in the range suggested by the Sanction Guideline.[27] The sanction for violating NASD's rule regarding communications with the public is at the lower range of the guideline because we have considered that Elgindy disclosed the Firm's market maker status to a reporter from Bloomberg News on one occasion on October 10, 1997.

Accordingly, we fine Elgindy and Key West Securities \$51,000, jointly and severally; bar Elgindy from associating with any NASD member in any capacity; and expel Key West

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26 For market manipulation, we impose a joint and several fine of \$50,000, a fine at the midpoint of the range suggested by the marking the close or open guideline.

27 See NASD Sanction Guidelines (2001 ed.) at 88 (Communications With The Public—Failing To Comply With Rule Standards Or Use Of Misleading Communications).

Securities from NASD membership. The bar and expulsion are effective upon service of this decision.[28]

On Behalf of the National Adjudicatory Council,

Barbara Z. Sweeney
Senior Vice President and Corporate Secretary

[28] We also have considered and reject without discussion all other arguments advanced by Elgindy, Key West Securities, and Market Regulation.