BEFORE THE NATIONAL BUSINESS CONDUCT COMMITTEE

NASD REGULATION, INC.

In the Matter of	:	
Market Regulation Committee	:	DECISION
Complainant,	:	
vs.	:	Complaint No. CMS920002
Warren R. Schreiber East Hills, New York	:	Market Regulation Committee
	:	Dated: August 22, 1997
and	:	
Marian S. Gargano Atlantic City, New Jersey,	:	
Respondents.	:	

This matter was appealed by respondents Warren R. Schreiber ("Schreiber") and Marian S. Gargano ("Gargano"), pursuant to Article III, Section 1 of the Association's Code of Procedure (now Procedural Rule 9310). On September 7, 1995, the Market Surveillance Committee (now and hereinafter referred to as the Market Regulation Committee) ("MRC") issued a decision in which Schreiber was censured, fined $100,000, barred from association with any NASD member in any capacity, and assessed costs of $22,104.45, jointly and severally with Castleton-Rhodes, Inc. ("Castleton" or "the Firm"); and Gargano was censured and fined $2,500. For the reasons stated below, we affirm the MRC's findings with the exception of those allegations under cause VII that Schreiber violated Section 15(c)(1) of the Securities Exchange Act and Rule 15c 1-5 thereunder, and affirm the sanctions imposed as to both respondents.

We find, among other things, that Schreiber:

(1) Knowingly participated at various times in the unregistered distribution of 486,000 shares of common stock, 2.7 million warrants, and 2,688,000 shares of common stock of Merlin Baines & Co., Inc. ("Merlin") in violation of Article III, Section 1 of the NASD's Rules of Fair Practice ("Rules") (now and hereinafter referred to as Conduct Rule 2110);

(2) Knowingly employed manipulative and deceptive practices in connection with the acquisition of the stock and warrants to obtain control of Merlin and manipulate the price of the shares, in violation of Conduct Rule 2110, Article III, Section 18 of the Rules (now and hereinafter referred to as Conduct Rule 2120), Section 10(b) of the Securities Exchange Act ("Exchange Act"), and Rule 10b-5 thereunder;

(3) Recommended and effected the purchase of stock of Merlin while in possession of material, nonpublic information, in violation of Conduct Rules 2110 and 2120, and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder;

(4) Engaged in securities transactions with or on behalf of customers without disclosing that the Firm and Merlin were under common control, in violation of Conduct Rule 2110 and Article III, Section 13 of the Rules (now and hereinafter referred to as Conduct Rule 2240); and

(5) Engaged in an improper distribution of equity securities issued by an affiliate of the Firm (i.e. the shares of Merlin), in violation of Conduct Rule 2110 and Schedule E of the NASD's By-Laws (now and hereinafter referred to as Conduct Rule 2720).[1]

We also find that Gargano, while an associated person with a member, sold Merlin shares through another member firm, and failed to notify the executing firm of her association with a member firm, in violation of Article III, Sections 1 and 28 of the Rules (now and hereinafter referred to as Conduct Rule 3050).

I. Background

Schreiber entered the securities business in December 1981 as a general securities representative and general securities principal of Brodis Securities Incorporated. He remained at Brodis Securities until September 1985. He was thereafter associated with the following members: G.K. Scott & Co. Inc., where he was registered as a general securities representative and general securities principal (November 1985-November 1986); Hibbard Brown & Co., Inc., where he was registered as a general securities representative and general securities principal (November 1986-June 1988); Robyns Capital Corp., where he was registered as a general securities representative and general securities principal (July 1988-August 1989); Integrated Assets Group, Inc., where he was registered as a general securities representative and general securities principal (June 1989-February 1991); Castleton, where he was registered as a general securities representative and general securities

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[1] The MRC dismissed the allegations against Schreiber set forth in cause IX (violation of SEC Rule 10b-6) for pleading defects in the complaint and lack of evidence of his direct personal involvement. The MRC also dismissed the allegations against Schreiber set forth in cause X (violations of confirmation disclosure requirements of Rule 10b-10 and Article III, Section 12 of the Rules (now and hereinafter referred to as Conduct Rule 2230) due to lack of evidence to indicate that Schreiber was responsible for the preparation of confirmations. We find no reason to revisit these determinations.

principal (August 23, 1989-September 14, 1989 and September 20, 1989-March 21, 1990); Vanderbilt Securities, Inc., where he was registered as a general securities representative (May 1990-October 1990); I.A. Rabinowitz & Co., where he was not registered (September 1990-December 1990); J. Gregory & Company, Inc., where he was registered as a general securities representative (April 1991-August 1994); and VTR Capital, Inc. (November 1994-present), where he currently is registered as a general securities representative.

Gargano entered the securities business in June 1978 with Merrill Lynch, Pierce, Fenner & Smith and became registered as a general securities representative in November 1978. She joined Shearson Lehman Brothers, Inc. in June 1988 as a general securities representative, and she remained there until August 1990. In July 1992, she joined Comprehensive Capital Corporation as a general securities representative, where she remained until October 1993. Gargano currently is not associated with an NASD member.

II. Summary of the MRC Action

The 26-cause complaint was filed on January 15, 1992. Only those causes relevant to the appeals of Schreiber (Causes I, II, III, IV, V, VI, VII, VIII, and XXIV) and Gargano (Cause XX) will be discussed in this decision.

In summary, the complaint alleged that in October 1989, Castleton, Jules B. Lipow ("Lipow"),[2] Gerald H. Cahill ("Cahill"),[3] and Schreiber[4] obtained control of Merlin,[5] a blind pool, development stage company,

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[2] Lipow was the President and owner of Castleton from August 28, 1989, through February 22, 1990, and was registered as a general securities representative of the Firm from October 25, 1989, through February 14, 1990, and as a general securities principal from November 22, 1989, through February 14, 1990.

[3] Cahill, an attorney who was not named as a respondent in this matter, was barred from association with any broker or dealer by the Securities and Exchange Commission ("SEC") in 1976.

[4] From August 1989 until February 1990, Castleton was owned by Elements Financial Corporation, which was solely owned by Lipow. Lipow purchased Castleton for $150,000, $100,000 of which was obtained by means of a bank loan that was guaranteed by Lipow, Cahill, and Schreiber. Schreiber had been the owner of Robyns Capital Corporation, an NASD member that voluntarily ceased conducting a securities business in 1989. Schreiber met Lipow through a business acquaintance who had leased office space from Schreiber at Robyns Capital. Lipow made a $50,000 subordinated loan to Robyns Capital in 1988 and, in return, was permitted to use its offices. In addition, Schreiber introduced Lipow to Cahill, who also leased office space from Schreiber. When Schreiber joined Castleton, many former Robyns Capital employees followed him.

[5] Merlin was incorporated in June 1987 in Delaware. From that time through about November 1989, John G. Abruscato ("Abruscato") served as President, CEO, and a Director of Merlin, and his son, Christopher Abruscato, served as Vice President, Secretary, and the only other Director of Merlin. Merlin's

from Abruscato, Merlin's President and principal shareholder. Abruscato agreed to turn over management control of Merlin to the co-conspirators, as well as control of a majority of the outstanding unregistered securities of Merlin, in exchange for assistance in marketing these securities and effecting distribution of proceeds totaling approximately $250,000 to Abruscato, members of his family, and 16 other early-stage investors.

On October 6, 1989, Cahill purchased 4,000,000 Merlin unregistered warrants owned by Abruscato and his wife, Constance Abruscato, and two other unaffiliated warrant holders, for a total of $67,000. Thereafter, on November 10, 1989, Schreiber, through Herschel Krasnow ("Krasnow"),[6] a representative under his supervision, arranged for a client of the Firm, First National Funding Corp. ("FNFC"), to purchase 486,000 unregistered shares of Merlin common from Abruscato, his family, and 16 other early-stage investors at a price of $.375 per share, for a total of $182,250.[7] Following these sales of unregistered securities, Abruscato turned over control of Merlin to Cahill through Cahill's associate, Victor J. Lombardi ("Lombardi"), who was named President of Merlin.

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offices were in Abruscato's residence in Massapequa Park, New York. Abruscato, a former trader, was barred by the NASD for a stock parking scheme and falsification of a trade ticket, see In re John G. Abruscato, 43 S.E.C. 209 (1966), and in 1972 settled SEC charges of aiding and abetting violations of Section 15(b) of the Exchange Act and Rule 15b3-1 thereunder. See In re Steven C. Burns, John G. Abruscato, Norman Kreit, Howard Lazell, William A. Certilman, Exchange Act Rel. No. 9621 (June 1, 1972). In 1992, Abruscato pled guilty to a federal criminal information in connection with his role in the Merlin manipulation.

In June 1987, Merlin sold 12,000,000 unregistered shares of its common stock through private transactions. At a price of $.0001 per share, 7,000,000 of these shares were acquired by Abruscato; 600,000 were acquired by his son, Christopher; and 400,000 shares were acquired by four other members of the Abruscato family. The balance of 4,000,000 shares was purchased by 16 other early-stage individual investors, one of whom was Gargano, at a price of $.025 per share. All 12,000,000 shares were restricted and legended, and could not be resold without registration or without reliance on a valid exemption from registration.

In September 1987, Merlin participated in an initial public offering underwritten by Sherman, Fitzpatrick & Co., Inc., which closed in November 1987. In this offering, 2,402,600 units were sold at a price of $.25 per unit. Each unit consisted of one share of common stock and two warrants, each warrant redeemable at $.50 per share.

[6] Krasnow was registered as a general securities representative and principal of Castleton from August 1989 through March 1990 in the Firm's Bal Harbour, Florida branch office.

[7] Gargano effected the sale of her restricted securities through an executing broker/dealer without informing the broker/dealer in writing of the fact that she was a registered person.

Cahill and Lipow subsequently made efforts to merge Merlin with an operating company. On December 21, 1989, while in possession of material nonpublic information concerning a proposed merger between Merlin and Apollo Energy Corporation ("Apollo"),[8] and just minutes before the issuance of a press release concerning the proposed merger, the Group purchased, on the basis of nonpublic information about the proposed merger, a total of 2,688,000 shares of restricted stock at $.0213 per share from 19 Merlin shareholders, and placed them in five accounts at Castleton that were owned, controlled, or favored by the Group. Following the announcement of the proposed merger, Castleton's sales force sold approximately 700,000 of these shares, mostly in short sales, to approximately 138 retail customers of Castleton at prices ranging from $.375 to $.625 per share from December 22, 1989, through mid-January 1990, without disclosure of the fact that Merlin was under Castleton's control, resulting in profit or reduced indebtedness to the Group of about $540,000.[9]

The MRC found, among other things, that in furtherance of the scheme, Lipow, Cahill, and Schreiber, among others, manipulated the price of Merlin stock and sold it to the public through Castleton's sales force at artificially high prices; engaged in the distribution of unregistered Merlin common stock and warrants; created nominee accounts at Castleton to purchase restricted stock but conceal the true ownership of the securities in order to avoid a breach of the firm's restrictive agreement; distributed securities to the public without disclosing the fact that they controlled Merlin, in contravention of Conduct Rule 2720; created and distributed fraudulent financial reports relating to Merlin; issued false opinions of counsel in connection with the sale of Merlin restricted stock; and engaged in prearranged trading in Merlin stock and warrants.

Schreiber maintained before the MRC and on appeal that while a conspiracy to manipulate Merlin securities and attendant violations took place, he was not aware of or involved in any of the violations found by the MRC. He also maintained that the testimony of Lipow, an admitted conspirator, which was offered by the staff to link Schreiber with the alleged violations, was false and incredible, and that no other evidence showed that he was aware of or was involved in the alleged violations.

Gargano failed to file an answer and to participate in the MRC proceedings, but maintained on appeal that although she had been given her Merlin stock and agreed to sell it when requested to do so by Abruscato, she had not opened a securities account with a member firm to effect the sale.

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[8] Apollo, an investment banking client of Castleton, was a privately held Delaware corporation based in Carrollton, Texas, which was engaged in oil and gas exploration and development. Sankar Ramani ("Ramani") was Chairman and President of Apollo. The proposed merger between Merlin and Apollo was abandoned in February 1990.

[9] According to MRC hearing testimony from Lipow, the final part of the plan was for Lipow, Schreiber, Cahill, Krasnow and Lombardi to purchase the remaining 7,000,000 restricted shares still owned by Abruscato at low prices for public resale at higher prices. The final part of the plan was thwarted because of the failure of the purchase of the 2,688,000 restricted shares to settle.

III. Findings and Discussion

On appeal before an Extended Hearing Committee of the National Business Conduct Committee ("NBCC"), Schreiber and Gargano objected to all findings of violation found by the MRC. Following our consideration of the entire record, we make the following findings.[10] Due to the nature of the manipulative scheme and the manner in which the complaint is pled, our findings and conclusions are cumulative, and are not necessarily reiterated in connection with each precedent or subsequent cause discussed.

Credibility Determinations. In affirming in overwhelming part the MRC's findings, we agree with the MRC's determination to credit the hearing testimony of Lipow, and not credit that of Schreiber. On appeal, Schreiber concedes that the fraudulent scheme described in the complaint took place substantially as alleged; he merely denies his role in it. The testimony of Lipow, an eyewitness and a central participant in all aspects of the scheme, was consistent with documentary and testimonial evidence which established the existence of the scheme, and was convincing as to the role played by Schreiber, another central participant. We also give considerable weight and deference to the MRC's decision to credit Lipow and not Schreiber because the MRC heard the witnesses testify and observed their demeanor. See Brewer v. Chater, 103 F.3d 1384, 1392-93 (7th Cir. 1997) (credibility ruling of administrative law judge will be disturbed only if it is "patently wrong"); see also Vanasco v. SEC, 395 F.2d 349, 351-52 (2d Cir. 1968) (same).

Lipow testified, with the aid of contemporaneous notes, against his personal interest in admitting his participation in the scheme.[11] He testified that Schreiber participated in meetings with him or Cahill "whenever an event occurred" which forwarded the scheme. We conclude, as did the MRC, that given Lipow's limited industry experience and ignorance of broker/dealer operations, Schreiber's participation as Castleton's de facto head of operations, leader of its sales force, and trader with extensive experience in underwriting and trading penny stock issues was essential to the planning and execution of the scheme. We further find that Schreiber's

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[10] Counsel for Schreiber sought the introduction of additional evidence on appeal, including the testimony of Cahill. Counsel failed to establish good cause for his failure to adduce this evidence before the MRC, and the Extended Hearing Committee denied the request. We ratify the action of the Extended Hearing Committee in this regard, noting in particular that in addition to the failure to establish good cause, counsel's request to adduce Cahill's testimony was not timely. Counsel for Schreiber also raised a number of issues concerning the fairness of the MRC proceeding, which we determine are without merit.

[11] We acknowledge Schreiber's argument that Lipow had reason to dislike him, but we do not accept that Lipow went so far as to "falsely inject Mr. Schreiber's name into historical events at which he was not actually present." Similarly, we do not accept Schreiber's argument that testimony of other respondents was "purchased" by the staff as a result of their settlements with the NASD, which waived collection of Lipow's agreed-upon fine until he might seek to return to the securities industry. We observe that the waiver of the right to the immediate collection of fines in connection with NASD settlements is not unusual, and find that the waiver was not an improper inducement.

contention that the massive scheme unfolded around him without his knowledge or participation is incredible and is contradicted by ample evidence in the record.

Cause I. The first cause alleged that Schreiber, with others, participated in an unregistered distribution of 486,000 shares of Merlin common stock, in violation of Conduct Rule 2110. In September 1989, as the first part of a fraudulent scheme to obtain control and manipulate the shares of Merlin, Schreiber and Lipow determined to find a customer to purchase 486,000 shares of Merlin common stock owned by John and Constance Abruscato, affiliates of Merlin. Subsequently, Krasnow, a member of Schreiber's sales force, was introduced by Schreiber to Lipow, and thereafter solicited FNFC to purchase on November 10, 1989, 486,000 shares of Merlin common stock at $.375 per share from the Abruscatos= account at York Securities, Inc. ("York") for a total of $182,250. The shares were purchased by Castleton on an agency basis for the account of FNFC. The sale was executed in two parts -- a 386,000-share block from the account of Constance Abruscato, and a 100,000-share block from the account of John Abruscsato. Both York order tickets indicated that "Warren" was the Castleton contact for the trades.

Schreiber nevertheless denies any knowledge of or involvement in the transaction and the existence of any evidence of such knowledge or involvement. Schreiber also claims that the 486,000 shares in question had previously been registered in an earlier underwriting, and were thus freely tradeable.

We affirm the MRC's findings of violation. Since the Abruscatos, as controlling shareholders of Merlin, were affiliates of Merlin, and the block represented 20 percent of the publicly traded "float" of Merlin at the time, the transaction was not exempt from the registration requirements of Section 5 of the Securities Act, notwithstanding the claim that the shares had previously been registered.[12] The stock could only have been sold

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[12] Section 5(a)(1) of the Securities Act prohibits sales of unregistered securities:

> Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly . . . [t]o make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise.

Section 5(c) of the Securities Act prohibits offers to sell securities for which no registration statement has been filed:

> It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security, or while the registration statement is the subject of a refusal order or stop order or (prior to the effective date of the registration statement) any public proceeding or examination under Section 8.

in one of three ways: (1) pursuant to the exemption provided by SEC Rule 144; (2) pursuant to an effective registration statement; or (3) pursuant to another exemption from registration. The transaction was not the subject of an effective registration statement, and there was no evidence presented that the transactions were otherwise exempt from registration.

We find that Schreiber was directly involved in the transaction. As head of Castleton's sales force, an experienced trader, and a co-conspirator involved in all significant aspects of the fraudulent scheme, Schreiber knew that the transaction needed to be registered, but participated nonetheless. Schreiber admits that he put Lipow in touch with Krasnow because Lipow wanted to locate a buyer for a large block of stock on speculation. He further admits involvement in assisting Krasnow in later seeking to cancel the trade because the customer had agreed to purchase only half of the securities, but that the full amount of the trade was later posted to the customer's account (an action purportedly taken without Schreiber's knowledge).

Lipow testified that Schreiber was aware of the plan to obtain control of Merlin "within minutes of [his] being first approached by Gerry Cahill." Lipow stated that "I had no experience and I had no ability to have this 486,000 share trade executed and didn't even know if it was a good deal or a bad deal, but Warren [Schreiber] seemed to feel that it was an opportunity and he started working on it over the next two-week period." Lipow stated that Schreiber participated in negotiations with Abruscato as to price. Lipow further testified that Schreiber reported to him on his efforts to place the entire block.

The record establishes that Schreiber, who was experienced in penny stock underwriting and trading, was well aware of the registration requirements for securities transactions. He failed, in connection with causes I-III, to conduct a "searching inquiry" of transferability in connection with his marketing of substantial amounts of little-known securities. See Michael A. Niebuhr, Exchange Act Rel. No. 36620 (December 21, 1995). We conclude, like the MRC, that at the time of the transaction, Schreiber knew or should have known that no registration statement had been filed with the SEC for the distribution of such securities and that no exemption from registration was available, in violation of Conduct Rule 2110.

Cause II. The second cause alleges that Schreiber, with others, participated in an unregistered distribution of 2,700,000 Merlin warrants, in violation of Conduct Rule 2110. On or about October 6, 1989, in furtherance of the fraudulent scheme, Constance Abruscato, an affiliate of Merlin, sold 2,7000,000 Merlin warrants at $.02 per warrant on an agency basis through York to Lipow, Schreiber, and Castleton, who purchased the warrants on an agency basis for VJL Development Corp. ("VJL"), an account in which Cahill had a beneficial interest. The transaction was part of Castleton's total purchase of 4,000,000 warrants through York on that date, since Castleton also purchased 1,300,000 warrants from two unaffiliated customers of York at $.01 per warrant.

All the warrant trades were executed simultaneously. The York order ticket for one of the unaffiliated customers contained the phone number for Castleton and the name "Warren." Schreiber acknowledged that he

might have been on the Castleton trading desk at the time the trades were executed. Lipow testified that Schreiber was aware of the warrant purchases at the time and that Schreiber either wrote up the Castleton ticket for the warrant purchases or had a clerk write it up; and that Schreiber participated in conversations with Lipow and Cahill in which he stated that the planned exercise of the warrants would not constitute an underwriting of a blind pool, an activity prohibited by the firm's restriction agreement.

On November 8, 1989, Castleton sold 3,500,000 of the aforementioned warrants at $.0177 per warrant from the VJL account on an agency basis to First Interregional Equity Corp. ("FIEC"). The FIEC order ticket bore the name "Warren Schriber [sic]" and Castleton's phone number in the box designated "special instructions."[13] The Lombardi purchase was paid for by a check for $63,000 drawn on the account of "Stonehill Publishing," a company owned by Cahill. FIEC's xerox copy of the check had handwritten notes outside the text of the check which included the name "Warren Schreiber" and the Castleton phone number. Schreiber testified that he had a "vague recollection" that he executed this trade with FIEC at Lipow's request.

Schreiber nevertheless denies any knowledge of or involvement in the alleged transaction and the existence of any evidence of such knowledge or involvement.

We affirm the MRC's findings of violation. Like the transaction discussed in connection with cause I, this transaction, which involved a public sale by an affiliate of the issuer, was not the subject of an effective registration statement, and there was no evidence presented that the transaction was otherwise exempt from registration.

Schreiber was directly involved in the transaction, and as head of Castleton's sales force, an experienced trader, and as a co-conspirator involved in all significant aspects of the fraudulent scheme, knew that the transaction needed to be registered, but participated nonetheless. The testimony of Lipow and Lawrence J. Doherty ("Doherty"), a representative of FIEC, together with corroborating documentary evidence, links Schreiber to the transaction. Further, the size of the transactions, together with the fact that Castleton was not a market maker, make it implausible that Schreiber would not have been previously involved in a scheme to move the unregistered warrants into the hands of his co-conspirators, or would not have thereby been alerted to the scheme. In this regard, we observe that low-priced warrants are a typical means for providing undisclosed compensation to those involved in a distribution, who stand to profit once a trading market for the underlying security develops and the price of the underlying security advances.

The transfer of the 2,700,000 warrants owned by Constance Abruscato constituted an unregistered distribution, and Schreiber, for reasons relating to his participation in the overall scheme and his role in the transactions, knowingly participated therein. As stated in connection with cause I, the record establishes that Schreiber, who was experienced in penny stock underwriting and trading, was well aware of the registration requirements for securities transactions. We conclude, like the MRC, that at the time of the transaction,

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[13] The FIEC trader confirmed that he had written Schreiber's name on the ticket, but stated that Schreiber "may have been the person that we bought the securities from, but I'm not sure at this time."

Schreiber knew or should have known that no registration statement had been filed with the SEC for the distribution of such securities and that no exemption from registration was available, in violation of Conduct Rule 2110.

Cause III. The third cause alleged that Schreiber, with others, participated in an unregistered distribution of 2,688,000 shares of Merlin common stock, in violation of Conduct Rule 2110. As part of the fraudulent scheme, Abruscato sold, and by request, persuasion, and threat of lawsuit, induced other shareholders to sell in concert, a total of 2,688,000 unregistered, restricted shares of Merlin in purported compliance with SEC Rule 144 which was intended for distribution to the public through Castleton. From December 10 through December 18, 1989, as a part of the fraudulent scheme, Cahill and Lombardi sought the assistance of FIEC to serve as a conduit for the shares. On December 21, 1989, FIEC trader Doherty informed Abruscato that FIEC would not be able to sell this Merlin common stock directly to Castleton on an agency basis because Castleton was not at that time a market maker for Merlin common stock. Doherty informed Abruscato that M. Rimson & Co., Inc. ("Rimson") was a market maker for Merlin common stock, whereupon Abruscato informed Doherty that he knew someone at Rimson who could make the necessary arrangements to purchase the shares from FIEC for Rimson and then sell those same securities to Castleton.

On December 21, 1989, Schreiber and his co-conspirators effected the distribution of a total of 2,688,000 restricted shares of Merlin common stock by arranging for the sale of such securities from the customer accounts established at FIEC, through Rimson, to five accounts at Castleton which they controlled or favored.[14] After acquiring the 2,688,000 shares from the five accounts, Schreiber, his co-conspirators, and the Castleton sales force distributed approximately 800,000 unregistered shares of Merlin common stock to the public between December 21, 1989, and February 8, 1990, at prices of up to $.625 per share, in violation of Conduct Rule 2110.

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[14] On December 21, 1989, FIEC sold to Rimson on an agency basis 588,000 shares of Merlin common stock at $.00105 per share and 2,100,000 shares at $.02625 per share. Within five minutes of the sale of the 2,688,000 shares to Rimson, Castleton purchased the 2,688,000 shares from Rimson on an agency basis at $.0213 per share. The 2,688,000 shares of Merlin common stock were then distributed to five controlled or favored accounts at Castleton as follows: 700,000 shares to the REO Management Corp. Pension Plan (AREO account@), established by Lipow; 338,000 shares to the Philip Oberlander account (AOberlander account@), established by Lipow for the benefit of Oberlander, a close associate; and 700,000 shares to the OVSK, Ltd. account ("OVSK account"), established by Cahill. In addition, Krasnow solicited FNFC's purchase of 250,000 shares of Merlin common stock, and Schreiber solicited E.E. Corp. (AEEC@) to purchase 700,000 shares of Merlin. The latter transaction is discussed in additional detail in connection with cause VI, below. These shares represented 18.66 percent of the outstanding Merlin shares as of December 21, 1989. Schreiber was listed as the registered representative on four of the five accounts. The MRC concluded that the accounts, with the exception of the FNFC account, were used as de facto inventory accounts to park the stock until it could be distributed to the public and to disguise the fact that Castleton was violating its restriction agreement by exceeding its permissible inventory position in Merlin stock. We affirm that determination.

Schreiber nevertheless denies any knowledge of or involvement in the purported Rule 144 transactions or the creation of nominee accounts. Schreiber asserts that he did not participate in the solicitation of purchases of these shares, and received no compensation in connection with the manipulative scheme.

We reject these contentions. As noted above, and as discussed in further detail in connection with cause VI, below, Schreiber was involved in the alleged transaction. Schreiber attended a meeting in early December with Lipow,[15] Lester Morse ("Morse")(Merlin's counsel) and Cahill, in which they discussed the possible sale of the 2,688,000 restricted shares under Rule 144. According to Morse, Lipow, Cahill, and Schreiber told him that "they were either buying or had bought the inside position [of Merlin] and they asked what the status of the stock would be as (sic) with regard to 144." It was concluded that the shares could not be sold without registration, and Schreiber admitted that he did not feel that the transaction could be done under Rule 144. In addition, Lipow testified that Schreiber was aware of the proposed Rule 144 sales as a result of discussions with Cahill and Lipow. Despite his knowledge that the transaction had to be registered, Schreiber participated in the transaction.[16]

On December 21, 1989, at about 4:02 p.m., FIEC sold 588,000 shares at $.00105 and 2,100,000 shares at $.02625 to Rimson as agent for the restricted shareholders.[17] Rimson had already received Castleton's buy order for the shares earlier in the day, and immediately resold the shares to Castleton.[18]

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15 Lipow confirmed the existence of the meeting, but did not recall attending it.

16 Lipow testified that some time before December 21, 1989, he had given Schreiber a sheet of figures showing the number of shares available and prices at which the affiliates and the remaining owners of restricted shares would sell. Lipow stated that "at that point Warren took it from there and I infer that he [Schreiber] made a blended price of the whole transaction."

17 Five affiliates of Merlin sold 588,000 shares at $.00105 per share less commissions, of which 288,000 were sold by John and Constance Abruscato. The remaining 14 non-affiliated selling shareholders sold 2,100,000 shares at $.02625 per share less commissions. The sales prices were approximately the same as the selling shareholders' original cost.

18 The FIEC order tickets for the sale of the shares to Rimson were time-stamped 4:02 p.m. and the Rimson order ticket for the purchase from FIEC was time-stamped by hand as "1555" (3:55 p.m.). Doherty, of FIEC, testified that someone from Castleton who identified himself as "Warren" called him at least twice on December 21 regarding the transactions. Doherty identified "Warren" as Warren Schreiber, and testified that from these conversations he had the impression that Schreiber was a trader, and he therefore, after brief conversations with him, directed Schreiber to FIEC's traders. During the hearing, Doherty positively identified Schreiber's voice as the voice on the phone on December 21, 1989. Doherty testified that Abruscato, Cahill, and Lombardi also called him throughout the day regarding the status of the transactions. The Rimson order ticket for the sale of the shares to Castleton was time-stamped by hand as "1600" (4:00 p.m.) and bore the notation "Warren" in the contra-broker box. Howard Perles ("Perles"), an assistant trader at Rimson,

With respect to the 2,688,000 restricted Merlin shares purchased in the five Castleton accounts, as noted in footnote 14, above:

(1) 250,000 shares were placed in the account of Krasnow's client, FNFC, which as discussed in cause I, above, had purchased 486,000 common shares from John and Constance Abruscato in November 1989. The shares were not sold and remained in the account during the relevant period.

(2) 338,000 shares were purchased by the Oberlander account, a nominee account established by Lipow with Schreiber listed as the registered representative of record. 300,000 of these shares were later transferred free to the account of Sarah Schreiber, Schreiber's sister-in-law, at Friedman, Billings and Ramsey in Washington D.C., and then sold back to Castleton on January 11, 1990 at $.50 per share to cover Castleton's short sales to retail customers. Proceeds of $148,000 (after commissions) from the sale back to Castleton were wired to a bank account of a company owned by Meir Schreiber, who is Schreiber's brother and Sarah Schreiber's husband.[19]

(3) 700,000 shares were sold to the OVSK account, an account controlled by Cahill with Schreiber listed as the registered representative of record. The check OVSK tendered in payment for the shares bounced, the trade was canceled by Castleton's clearing firm, and shares were placed in the clearing firm's proprietary account.

(4) 700,000 shares were sold to the REO account, an account for a company owned by Lipow, with Schreiber listed as the registered representative of record. 127,371 shares were later transferred free from this account into a Castleton inventory account to cover short sales to retail customers.

(5) 700,000 shares were sold at $.0213 per share by Schreiber to EEC, which was owned by AE, a client of Schreiber to whom Schreiber owed $50,000. The customer sold 135,000 shares

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executed the sale of the shares to Castleton. Perles testified that he placed the notation "Warren" on the ticket and that it represented "the person who completed the trade on the other side" who called and "identified himself" as "Warren" and who gave him the order for 2,688,000 shares. The Castleton tickets for the purchases by the five accounts were all time-stamped by Rimson, obviously well before execution, at 1:09-1:10 p.m. Lipow testified that Schreiber was responsible for effecting the transaction for Castleton and "either wrote these tickets or had these tickets written per his direction."

[19] Castleton and/or Lipow owed $100,000 to Schreiber's brother, and this transaction represented the repayment of that debt. Schreiber testified that he made sure that his brother was repaid and that he gave Lipow the account number for Sarah Schreiber's account.

back to Castleton on or about January 18, 1990 at $.50 per share (for 75,000 shares) and $.35 per share (for 60,000 shares), and Castleton used these shares to cover short sales to retail customers.

Lipow testified that on December 21, 1989, the day of the trades, Schreiber apprised him that Castleton was buying the 2,688,000 shares, that 250,000 shares were going into the FNFC account, and that 700,000 shares were going to EEC. According to Lipow, Schreiber then asked Cahill, who also was present, if he had an account that could be used to place some shares, to which Cahill responded, "You can use OVSK." Lipow then volunteered the REO account and Cahill suggested the Oberlander account for the placement of the remaining shares. Lipow testified that a maximum of 700,000 shares were allocated to the EEC, REO, and OVSK accounts at Schreiber's suggestion in order to keep control of the stock while maintaining the ownership percentage of any one account at less than five percent of outstanding shares.

We affirm the MRC's findings of violation as to Schreiber. As the evidence shows, Schreiber was fully aware of and was personally involved in assuring the success of the transaction. The distribution of the 2,688,000 shares was not the subject of an effective registration statement, and there was no evidence presented that the transaction was otherwise exempt from registration. Among other things, Schreiber knew or was reckless in not knowing that the sale of these restricted securities was not in conformity with Rule 144 in that the limitations on the amount of the securities that could be sold by affiliates and non-affiliates acting in concert had been exceeded since the aggregate amount of the securities sold was substantially greater than ten percent of the shares outstanding. Schreiber also knew that the manner of the sale was inconsistent with the requirements of SEC Rule 144, in that Schreiber and his co-conspirators solicited and arranged for the solicitation of customers= orders to buy the securities.

Cause V. The fifth cause alleged that Schreiber, with others, employed manipulative and deceptive practices in connection with the acquisition of restricted Merlin shares, to obtain control of Merlin and manipulate the price of Merlin shares and to distribute these shares to obtain financial gain, incorporating by reference the actions alleged in causes I-IV of the complaint, in violation of Conduct Rules 2110 and 2120, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

In connection with the matters discussed in causes I and II, above, the co-conspirators, led by Cahill, and with Schreiber's knowledge and participation, in fulfillment of their part of an agreement with Abruscato, obtained control of 4,000,000 Merlin warrants (2,700,000 from Constance Abruscato, an affiliate of Merlin) and engaged the assistance of Krasnow, who solicited FNFC to purchase 486,000 shares of Merlin common stock. In November 1989, the co-conspirators, with Cahill in the lead, gained control of Merlin's management through the replacement of its president and legal counsel with their nominees. The co-conspirators advanced the scheme by, among other things, procuring opinions of counsel for the purported SEC Rule 144 sale of 2,688,000 shares of Merlin that were known to be false (Cahill); engaging in prearranged trading in securities of Merlin common stock and warrants as part of the scheme to obtain control of the securities of Merlin (Schreiber, Lipow, Lombardi, and Cahill); establishing nominee accounts and soliciting favored accounts for the purpose of parking unregistered Merlin common stock to avoid inventory limitations as discussed in cause III,

above (Schreiber, Lipow, and Cahill), and creating and distributing fraudulent financial reports of Merlin that purported to have been filed with the SEC but were never filed (Cahill). On December 21, 1989, while in possession of material nonpublic information concerning a proposed merger between Merlin and Apollo, and just minutes before the issuance of a press release concerning the proposed merger, Schreiber and his co-conspirators: completed the purchase of 2,688,000 shares of restricted stock at $.0213 per share from 19 Merlin shareholders; placed the stock in five accounts at Castleton; and thereafter sold and used Castleton's sales force to sell Merlin common stock to customers at prices they set which ranged from $.35 to $.625 per share, 16 to 30 times higher than the price of $.0213 per share for which the stock was acquired, while no additional changes in the fundamental business of Merlin were taking place, and without revealing the fact that Merlin was under the control of Castleton. As discussed in detail below in connection with cause VI, Schreiber reduced his indebtedness through the execution of this fraudulent scheme. But for a breakdown in the execution of the scheme, Schreiber would have profited further.[20] Schreiber thus violated Conduct Rules 2110 and 2120 and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

While Schreiber does not dispute the fact that a manipulation took place, he nevertheless denies any knowledge of or involvement in the manipulative scheme and the existence of any evidence of such knowledge or involvement. As demonstrated in the discussions of causes I-III, above, and cause VI, below, these contentions are without merit.

We affirm the MRC's findings of violation as to Schreiber. As the evidence shows, Schreiber was fully aware of and was personally involved in assuring the success of the fraudulent scheme. We agree with the MRC that in view of the evidence,". . . it is inconceivable that all of this could have gone on at [Castleton] during this relatively short time frame without Schreiber's knowledge and active participation. There are simply too many indicia of Schreiber's involvement to ignore."[21]

<u>Cause VI.</u> The sixth cause alleged that Schreiber recommended and effected the purchase of Merlin securities while in possession of material, nonpublic information, in violation of Conduct Rules 2110 and 2120, Section 10(b) of the Exchange Act, and Rule 10b-5 promulgated thereunder. On December 21, 1989, while in possession of information concerning an imminent merger announcement concerning Merlin and Apollo which he had learned as a result of his firm's investment banking activities, Schreiber recommended the purchase of Merlin common stock to AE, a retail customer and owner of the EEC account, to whom Schreiber owed $50,000. AE and Schreiber reached an understanding that EEC profits from the purchase and sale of Merlin securities would reduce the amount of debt then personally owed to AE by Schreiber. As a result, EEC purchased 700,000 shares of Merlin common stock prior to the public release of information regarding the merger on December 21, 1989. EEC's subsequent sale of 75,000 Merlin shares on January 7, 1990, resulted in a reduction of at least $37,500 in Schreiber=s indebtedness to AE. Schreiber thus breached a fiduciary

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[20] <u>See</u> footnote 9, above.

[21] MRC Decision at 32.

obligation owed to Merlin and Apollo.

Schreiber denies that he had any knowledge of the proposed merger until December 22, 1989, after the press release was issued on December 21, 1989; that he recommended the purchase of Merlin to AE; and that he and AE had an agreement to reduce Schreiber's debt by the amount of any profit or that the debt in fact was reduced by the $37,500 profit realized. Like the MRC, we do not credit Schreiber's testimony in this regard, and affirm the findings of violation of the MRC under cause VI.

As a blind pool, blank check company, Merlin's announced business strategy was to merge with an operating company. This was also an objective of the co-conspirators.[22] Once control of Merlin had shifted to the co-conspirators, but before their purchase of the 2,688,000 restricted shares on December 21, merger discussions were commenced in early December between Merlin and Apollo, a privately held oil and gas company controlled by Ramani. According to Lipow, Cahill conducted the discussions on behalf of Merlin, whose president was now Cahill's nominee, Lombardi, with some input from Lipow and Schreiber. Lipow, who had some expertise in oil and gas matters, assisted Cahill in evaluating Apollo's assets, and traveled to Ohio on December 19 and 20, 1989, to meet with Ramani and review Apollo documents.[23] Schreiber's role, according to Lipow, was to determine how to exercise the 4,000,000 warrants obtained by Cahill in October 1989, as well as 800,000 additional warrants held by Merlin's original investors and promoters, in order to raise $2,100,000 for the merged entity, and to organize the Castleton sales force to raise that money. Lipow stated that Schreiber had been kept abreast "at all points" as to the progress of the merger discussions.

As set forth in the discussion of cause III, above, Schreiber effected Castleton's purchase of 2,688,000 unregistered shares of Merlin by about 4:02 p.m. on December 21, 1989. At 5:25 p.m., less than 90 minutes later, Merlin and Apollo issued a press release announcing the signing of a letter of intent to merge.[24] That evening, Castleton held a sales meeting during which Ramani made a presentation to the sales force to encourage Castleton's brokers to sell Merlin stock to their customers.[25]

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[22] For example, Krasnow testified during the staff's investigation and affirmed that testimony during the MRC hearing that Lipow and Schreiber advised him during Krasnow's November 1989 trip to New York that "they were going to merge another company into [Merlin]."

[23] Lipow testified that Schreiber was aware of the trip and that he communicated the favorable results of his meeting with Ramani to both Schreiber and Cahill prior to December 21.

[24] We draw the inference, also relevant to cause V, that the timing of Castleton's prearranged receipt of potential inventory in this unregistered distribution, the virtually simultaneous sale of Merlin shares to the EEC account, which is discussed in additional detail below, and the issuance of the press release indicates that these events were orchestrated, in significant part by Schreiber, expressly for the purpose of advancing the manipulative scheme.

[25] We do not credit Schreiber's claims of non-participation in activities involving Ramani on that date. Lipow testified that Schreiber was a party to a conversation with Ramani on December 21, 1989, during

As discussed in connection with cause V, above, on December 21, 1989, Schreiber's client, AE, purchased 700,000 shares of Merlin at $.0213 per share for his EEC account just before the announcement of the proposed merger. The EEC account subsequently resold 75,000 shares to Castleton for a profit of $37,500, which shares Castleton used to cover retail short sales. Schreiber acknowledged that he owed AE money at the time. According to both AE and Schreiber, EEC had loaned $50,000 to Quartet Capital, a company owned by Schreiber. AE's investigative testimony also identified the amount as $50,000.

We find that Schreiber recommended and effected this sale as alleged. Both Schreiber and AE gave detailed investigative testimony to the staff prior to the hearing during which both indicated that Schreiber had initiated and solicited the Merlin purchase.[26] AE also stated that Schreiber proposed that profits from the transaction be used to offset his indebtedness.

Before the MRC, both Schreiber and AE changed their stories, recasting their testimony in a manner which might do Schreiber the least harm. AE stated that Schreiber had not initiated contact concerning Merlin and had not suggested any offset arrangement. AE said that Schreiber's debt had been paid off for over a year and, while he was unable to state precisely "what portion, if any" of the Merlin profit was applied to the debt, testified that Schreiber paid him "much more" than the $12,500 difference between the $50,000 loan amount

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which the topic of Ramani receiving Merlin stock was discussed. Lipow testified that Ramani was to receive a portion of the 2,688,000 Merlin shares, and, when Schreiber advised Lipow on December 21 that Schreiber was about to effect the purchase of the 2,688,000 shares from FIEC, Schreiber told him that he did not want Ramani to receive any of the shares until the merger was consummated. Alan Boxer ("Boxer"), who was Castleton's retail sales manager, testified during the staff investigation that Schreiber was in the office during Ramani's presentation to the sales force on the evening of December 21, 1989, and might have talked to the sales force after the meeting. During the MRC hearing, Boxer testified that he did not think Schreiber attended the meeting, but acknowledged that Schreiber at least was in the office and was walking around talking to people. Several other Castleton registered representatives gave investigative testimony placing Schreiber at the December 21 meeting.

We also reject Schreiber's claim of non-involvement in planning the marketing of the stock. Boxer also testified that before December 21, he had two meetings with Lipow and Schreiber discussing forthcoming retail sales products. Boxer testified that at the first meeting he was told, without Merlin being mentioned, that "there would be a new recommendation and possibly a block of stock could be picked up reasonably that everyone could get decent investments out of the deal." At the second meeting, Lipow and Schreiber mentioned that "they had the stock," and asked him to arrange a sales meeting to introduce Merlin to the Castleton sales staff.

[26] When asked during the staff's investigation about his conversation with AE regarding the Merlin purchase, Schreiber stated: "I just called him and I said, there became available some stock at a very reduced price, a pink sheet stock. Stock was trading--I believe I said the stock was a high as a quarter or higher than that, and it seemed to have fallen down. And there's 700,000 shares available."

and his $37,500 profit. Schreiber denied having initiated contact and claimed that when AE offered to reduce his debt by the amount of the Merlin profit, he said "I can't do business that way, that's illegal, you can't trade on the profits of customers." Schreiber testified that the Merlin profit was not used to reduce his debt to AE at all, and that he still owed AE money, which statement the MRC noted was inconsistent with AE's testimony.

Like the MRC, we do not find the MRC hearing testimony of either Schreiber or AE to be credible, and find much more plausible their unrehearsed investigative testimony, which was taken much closer in time to the events in question and which was more candid, probably because the risks of candor were not as palpable at that time. In addition, like the MRC, we observe that before the MRC, the witnesses could not avoid contradicting each other.

We observe that even if AE initiated contact, Schreiber retained influence over the amount of stock which he recommended that AE purchase. The large amount of stock which he was able to offer AE gave Schreiber additional leverage in obtaining greater potential forgiveness of his debt, without financial risk to either party given Schreiber's knowledge both of the imminent announcement of the Merlin-Apollo merger and of the fact that a manipulative scheme was afoot which would soon drive up the price of the shares. We agree with the MRC that AE would not have offered to reduce Schreiber's debt if Schreiber had not encouraged the purchase. Schreiber's statement, as originally reported by AE, that "I think, from what I hear, that the stock should go up" is particularly telling as evidence of Schreiber's complicity in the manipulation, since apart from the proposed merger, there was no evidence of any other news or matters regarding Merlin, then a non-operating shell company.

Based on our review of the record evidence, we affirm the MRC's findings of violation. We recognize that, as is typical in insider trading cases, much of the evidence supporting a finding that insider trading occurred is necessarily circumstantial. See, e.g., SEC v. Moran, 922 F. Supp. 867 (S.D.N.Y. 1996) (proof of insider trading can well be made through an inference from circumstantial evidence). We note that parties to insider trading cases rarely acknowledge their conduct, and the existence of insider trading is therefore frequently established by circumstantial evidence. See, e.g., SEC v. Singer, 786 F. Supp. 1158, n. 64 (S.D.N.Y. 1992). Given Schreiber's knowledge of the imminent merger announcement; his central role in the prearranged movement of unregistered stock from Abruscato and the group of investors he controlled; his complicity in placing the stock in nominee, controlled, or favored accounts at Castleton, rather than in a proprietary account, in order to avoid breach of the firm's restriction agreement; his recommendation of Merlin to AE, which was motivated in part by his knowledge that the potential profit would be of sufficient financial significance to merit a request for a reduction in a personal debt; and the extraordinarily close coordination demonstrated by the timing of these events, we find that the extensive circumstantial evidence makes much more plausible the scenario described in AE's investigative testimony. We are thus persuaded that Schreiber did recommend and effect a securities transaction for his personal benefit in the manner alleged based on his knowledge of material, nonpublic information regarding the pending Merlin-Apollo merger announcement.

We are also satisfied that the record supports a finding that Schreiber acted with scienter.[27] The case law makes clear that, either as a fiduciary of Merlin or as a tippee of his co-conspirators, Schreiber knew that in trading on this information to his personal advantage, he breached a duty to Merlin shareholders. It is well settled that a fiduciary or tippee who knows or is reckless in not knowing that he was trading on nonpublic information acts with scienter. See Dirks v. SEC, 463 U.S. 646 (1983); Moran, 922 F. Supp. at 891. Particularly given Schreiber's lengthy securities career and his knowledge of and involvement in the broad plan of the fraudulent scheme, which relied in significant part on the merger of Merlin with an operating company to gain marketing cachet, he was aware that trading on such information was unlawful. See, e.g., SEC v. Cherif, 933 F. 2d 403, 408-409 (7th Cir. 1991) (en banc).

In Basic, Inc. v. Levinson, 485 U.S. 224 (1988), the Supreme Court confirmed that, in assessing the materiality of a fact, there must be substantial likelihood that disclosure of the fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information available. Under Basic, the materiality of information in the context of merger negotiations is determined on the basis of a two-prong test that entails a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company's activity. In Basic, the Court rejected a bright-line test for materiality in favor of fact-specific determinations on a case-by-case basis.

The fact of the imminent public announcement of the signing of a letter of intent to merge was "material" at the time of the trade in question. Courts have held that, in certain circumstances, the mere fact that a company is considering an acquisition can, in itself, constitute critical nonpublic information. The fact that the merger that would result in the disappearance of a corporation as a separate entity is an extremely important event in the life of any corporation, and therefore satisfies the "magnitude" prong of the Basic materiality test. As to the "probability" prong, we note that cases that have construed Basic have rejected the notion that information about a contingent corporate event is not material unless the event is more likely than not to occur. See, e.g., McGhee v. Joutras, 908 F. Supp. 566, 572 (N.D. Ill. 1995) (Basic recognized that a merger is the most important event in a small corporation's life, and that inside information regarding such a merger can become material at an earlier stage than would be the case with lesser transactions); In re Columbia Securities Litigation, 747 F. Supp. 237, 243 (S.D.N.Y. 1990) ("more likely than not" test urged by defendants is merely a reformulation of bright-line test that Basic Court rejected; reasonable investors might view merger negotiations as extremely significant even before consummation of the transaction has become more likely than not).

There is no question that the imminent public announcement of the Merlin-Apollo merger was material. The fact that a blind pool, penny stock corporation like Merlin was about to announce the signing of a letter of intent to merge with an operating company would have constituted information that a reasonable investor would deem important in determining whether to buy, sell, or hold Merlin stock. Like the MRC, we find that Schreiber recognized the value of this information, and sought personally to profit from it within the context of

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[27] This series of events, and the inferences which we draw from them, similarly support our finding of Schreiber's scienter based on his knowledge of and involvement in the overall manipulative scheme alleged in cause V, above.

the larger manipulation.

Cause VII. The seventh cause alleged that Schreiber, with others, engaged in securities transactions with or on behalf of customers without disclosing that Castleton and Merlin were under common control, in violation of Conduct Rules 2110 and 2240.[28] From December 1989 through February 9, 1990, Castleton and Merlin were under common control. A critical aspect of the fraudulent scheme discussed in cause V, above, and incorporated herein, is the fact that while in control of Merlin, Schreiber and his co-conspirators engaged in purchase and sale transactions with or on behalf of customers in the securities of Merlin without disclosing the existence of such control in writing or otherwise, at or before the completion of the transactions.

We note that once Cahill, Schreiber, and Lipow arranged for the purchase of the 486,000 common shares from the Abruscatos and the purchase of the 4,000,000 warrants by Cahill through Lombardi, resulting in the installation of Lombardi as President of Merlin, the replacement of its outside counsel, and control of its checkbook and corporate seal, the co-conspirators gained control of the corporation, an essential aspect of the fraudulent scheme. Since Lombardi was installed as President of Merlin before December 21, 1989, we find that the co-conspirators were required to disclose the existence of such control to all of their customers who bought or sold Merlin stock as described herein at least as early as that date and thereafter.

We affirm the MRC's findings of violation. There is no evidence that appropriate disclosure of the fact of common control was made to any of the many customers who purchased or sold Merlin securities on and after December 21, 1989. While Schreiber disclaims any involvement in the fraudulent scheme and any responsibility for Castleton's operations, we agree with the MRC that by virtue of his role in and operational control over Castleton and its sales force, Schreiber had a duty to make sure that such disclosure was made, but failed to discharge this responsibility.

Cause VIII. The eighth cause alleged that Schreiber, with others, engaged in an improper distribution of equity securities issued by an affiliate (i.e. Merlin) of Castleton, in violation of Conduct Rules 2110 and 2720. From December 21, 1989, through February 9, 1990, Castleton and persons associated with Castleton beneficially owned 10 percent or more of the outstanding voting securities of Merlin, an affiliate of Castleton. Schreiber and his co-conspirators engaged in a distribution of Merlin common stock as described in detail above and failed to comply with Conduct Rule 2720, in violation of Conduct 2110.

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[28] Conduct Rule 2240 requires that a member controlled by, controlling, or under common control with, the issuer of any security, shall, before entering into any contract with or for a customer for the purchase and sale of such security, disclose to such customer the existence of such control, and if such disclosure is not made in writing, it shall be supplemented by the giving or sending of written disclosure at or before the completion of the transaction. We dismiss the allegations of the complaint as to Section 15(c)(1) of the Exchange Act and Rule 15c1-5 thereunder. The provisions of Rule 15c1-5 are virtually identical to those of Conduct Rule 2240, with the exception that the Rule directs its prohibitions at entities only, while Conduct Rule 2240 is directed toward members and their associated persons, a much wider universe.

Conduct Rule 2720 (formerly Schedule E) requires, among other things, that NASD members and persons associated with members not participate in the distribution of the securities of an affiliate unless, among other things, a qualified independent underwriter for purposes of participating in the preparation of registration documents and recommending a price for the security to be distributed is retained; the fact that the offering is being made of securities of an affiliate of the member is disclosed; a date by which the offering is reasonably expected to be completed and the terms for release of the proceeds from escrow is disclosed in a registration statement or other similar document; and required filings are made with the SEC.

Rule 2720 defines an affiliate as a company that controls, is controlled by, or is under common control with a member. A member is presumed to control a company if the member and its associated persons beneficially own 10 percent or more of the outstanding voting securities of the company and the company is a corporation. A member is presumed to be under common control with a company if: (1) the same natural person or company controls both the member and the company by owning 10 percent or more of the outstanding voting securities of a company that is a corporation; or (2) a person having the power to direct or cause the direction of the management or policies of the member or the company also has the power to direct or cause the direction of the management or policies of the other entity in question.

We affirm the MRC's findings of violation. There is no evidence that the requirements of Rule 2720 were satisfied in connection with the distribution. As noted above in connection with the discussion of cause VII, once Cahill, Schreiber, and Lipow arranged for the purchase of the 486,000 common shares from the Abruscatos and the purchase of the 4,000,000 warrants by Cahill through Lombardi, resulting in the installation of Lombardi as President of Merlin, they obtained effective control of Merlin. In addition, following the purchase of the 2,688,000 unregistered Merlin shares from FIEC through Rimson on December 21, 1989, Castleton beneficially owned and controlled more than 10 percent of the company's voting securities. The purchase of these shares and the subsequent distribution of the shares to the five Castleton accounts and thereafter to the public constituted a public distribution for purposes of Rule 2720. As previously discussed, Schreiber played a central role in this distribution, and breached the duties imposed by Rule 2720.

Cause XX. The twentieth cause alleged that Gargano, while an associated person of a member firm, opened an account at FIEC, sold Merlin shares through that account, and failed to notify FIEC of her association with another member firm, in violation of Conduct Rules 2110 and 3050. From July 6, 1988, to August 2, 1990, Gargano was an associated person of Shearson Lehman Brothers, Inc. On December 15, 1989, Gargano tendered a stock certificate for 250,000 shares of Merlin common to a messenger for sale through a broker/dealer, purportedly pursuant to SEC Rule 144. On December 19, 1989, Gargano signed a document entitled "Rule 144 Seller's Representation Letter" in which she made certain representations to FIEC "in connection with my order to you to sell 162,500 shares of Merlin Baines as broker or dealer for my account. . . ." On December 21, 1989, Gargano sold 162,500 shares of Merlin common stock through an account in her name at FIEC. Gargano failed to notify FIEC of her association with a member firm, in violation of Conduct Rules 2110 and 3050.

Conduct Rule 3050(c) provides that a person associated with a member, prior to opening an account or placing an initial order for the purchase or sale of securities with another member, shall notify both the employer member and the executing member, in writing, of his or her association with the other member; provided, however, that if the account was established prior to the association of the person with the employer member, the associated person shall notify both members in writing promptly after becoming so associated.

Gargano did not file an answer to the complaint. The MRC found Gargano to have violated the alleged provisions by virtue both of her default and the evidence in the record.

On appeal, Gargano filed a written statement and was granted leave to participate in the appeal hearing. Gargano insisted that she never opened an account with FIEC or authorized the opening of any account, but acknowledged that she turned her Merlin shares over to a messenger who came to her home. She did not deny any of the remaining allegations of the complaint.

We affirm the MRC's findings of violation. It is undisputed that on December 21, 1989, Gargano sold 162,500 shares of Merlin restricted stock through FIEC as alleged in the complaint The gravamen of the violation is the fact that Gargano failed to disclose her association with a member firm in connection with the transaction, thereby preventing appropriate oversight of the transaction. There is no evidence that Gargano informed FIEC that she was a registered representative of a member firm. During Gargano's investigative testimony, and during her appearance on appeal, she never claimed that she had informed FIEC of her association with Shearson. Nor did Doherty, FIEC's representative in this transaction, who testified that he filled out Gargano's account opening documents in a telephone conversation with her, indicate that Gargano ever told him of such association.

V. Sanctions

In light of the foregoing, we affirm Schreiber's censure, fine of $100,000, imposition of costs of $23,054.46, jointly and severally with Castleton, and bar from association with any NASD member in any capacity. In addition, we assess appeal costs of $750. We find that the sanctions imposed against Schreiber are appropriate given the gravity of his misconduct, the level of scienter demonstrated in connection with his participation in fraudulent and manipulative activities, his lack of candor, and his lack of remorse. We have also considered Schreiber's prior disciplinary history in connection with our determination.[29] We find that a bar in all

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[29] Schreiber has a disciplinary history. On October 5, 1990, the NASD accepted an AWC (Complaint No. NY-9030) in which Schreiber was censured, fined $20,000, and suspended for 10 business days from association with any NASD member as a general securities principal. Without admitting or denying, Schreiber consented to the entry of findings that he modified, without prior NASD approval, a member firm's business activities to include acting as a dealer in government securities; failed to register an individual requiring registration pursuant to Schedule C, Section XI of the NASD By-Laws; failed to obtain the signature of the registered representative introducing six customer accounts, and the signature of an individual accepting these accounts on behalf of the firm; and failed to establish, maintain, and enforce adequate written supervisory

capacities is in the public interest due to the gravity of the misconduct and because Schreiber's continued presence in the securities industry would clearly present additional opportunities for future misconduct. Given the gravity of each of Schreiber's violations, we express the view that even if any reviewing body should determine to modify or set aside any finding of violation, that no reduction in the total sanctions, and in particular the bar in all capacities, be made.

In crafting the foregoing sanctions, we have considered all matters in extenuation, mitigation, and aggravation of the violations. In the exercise of our collective judgment and informed discretion, we have chosen to effect the Association's regulatory purposes by means of the foregoing sanctions because of the extensive nature of the violations and the wilful nature of Schreiber's actions; Schreiber's failure to accept or acknowledge his legal and ethical obligations as a securities professional; and the potential for harm represented by Schreiber's continued association with a member firm. We are also mindful that NASD Regulation, Inc., as an organization entrusted with responsibility for the surveillance and regulation of the over-the-counter securities markets, is obligated not only to detect and prosecute violations, but also to impose sanctions of sufficient moment to deter these respondents and other securities professionals similarly situated from engaging in similar misconduct in the future.

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procedures concerning the activities of associated persons.

On May 26, 1994, the NASD accepted an Offer of Settlement (Complaint No. CMS930031) in which Schreiber was censured, fined $5,000, suspended for five business days from association with any NASD member in any capacity, and required to pay restitution in the amount of $20,000. Without admitting or denying, Schreiber consented to the entry of findings that he effected principal retail transactions at unfair prices, with mark-ups ranging from 5.04 to 70 percent above the prevailing market price, and sold units of an initial public offering that sold at an immediate premium in the secondary market to restricted persons, in contravention of the Board of Governors' Free-Riding and Withholding Interpretation.

In addition, we affirm Gargano's censure and fine of $2,500. We have considered the respondent's lack of prior disciplinary history and the gravity of her misconduct in connection with our determination.[30]

Thus, we affirm the sanctions as to Gargano (censure and $2,500 fine) and Schreiber (censure, fine of $100,000, costs of $23,054.46, jointly and severally with Castleton, appeal costs of $750, and bar in all capacities). Schreiber's bar is effective upon issuance of this decision.

On Behalf of the National Business Conduct Committee,

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Joan C. Conley, Corporate Secretary

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[30] We impose no appeal costs as to Gargano. All of the contentions advanced by the parties have been considered and are rejected or sustained to the extent that they are inconsistent or in accord with the views expressed in this decision.

Pursuant to NASD Procedural Rule 8320, any member who fails to pay any fine, costs, or other monetary sanction imposed in this decision, after seven days' notice in writing, will be summarily suspended or expelled from membership for non-payment. Similarly, the registration of any person associated with a member who fails to pay any fine, costs, or other monetary sanction, after seven days' notice in writing, will be summarily revoked for non-payment.