BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD

In the Matter of

Department of Enforcement,

Complainant,

vs.

Donner Corporation International
(n/k/a National Capital Securities, Inc.),
Irvine, CA,

Jeffrey L. Baclet,
Reno, NV,

Vincent M. Uberti,
Fountain Valley, CA,

Paul A. Runyon,
Lake Forest, CA,

Respondents.

DECISION

Complaint No. CAF020048

Dated: March 9, 2006

Member firm and registered representatives issued misleading and fraudulent research reports that were available to the public via the Internet. Firm and its president failed to establish and enforce adequate supervisory procedures. Held, findings affirmed and sanctions modified.

Appearances

For the Complainant: Gary A. Carleton, Esq., and Leo F. Orenstein, Esq., NASD Department of Enforcement.

For the Respondents: Pro Se.

DECISION

Pursuant to NASD Procedural Rule 9311, Donner Corporation International ("Donner" or "the Firm"),[1] Jeffrey Baclet ("Baclet"), Vincent M. Uberti ("Uberti"), and Paul A. Runyon ("Runyon") appeal a Hearing Panel's June 7, 2004 decision finding that the respondents issued omissive, misleading, and fraudulent research reports in violation of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), SEC Rule 10b-5, Section 17(b) of the Securities Act of 1933 ("Securities Act") and NASD Conduct Rules 2110, 2120 and 2210. The Hearing Panel also found that Donner and Baclet failed to establish and enforce adequate written supervisory procedures related to the Firm's issuance of research reports in violation of Conduct Rules 2110 and 3010. The Hearing Panel further found Uberti and Runyon, after leaving Donner, formed their own research company and issued omissive, misleading, and fraudulent research reports in violation of Section 10(b) of the Exchange Act, SEC Rule 10b-5, and NASD Conduct Rules 2110, 2120 and 2210. The Hearing Panel expelled Donner from NASD membership, barred Baclet in all capacities, and fined and suspended Uberti and Runyon, with an order that each requalify before reentering the securities industry. After a thorough review of the record in this proceeding, we affirm the Hearing Panel's findings. As discussed below, we modify the sanctions imposed and bar Uberti from associating with any member firm in any capacity.

I. Background

Donner first registered with NASD as a member firm in October 1996. NASD cancelled the Firm's membership in November 2002. Baclet was the Firm's president, sole owner, financial and operations principal, and options principal. Baclet entered the industry in February 1990. Baclet terminated his registration and association with Donner in October 2002. He currently is not associated with any NASD member.

Uberti, Donner's vice president of marketing, first registered as a general securities representative in April 1995. He registered as general securities representative of Donner in April 1998. He registered as a general securities principal of the Firm in July 2001.

Runyon first registered as a general securities representative in October 1998. He associated with Donner as a general securities representative beginning in April 2000.

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[1] Donner changed its name to National Capital Securities, Inc. in May 2002.

Uberti and Runyon terminated their association with Donner in July 2001, when they formed their own research firm, Lincoln Equity Research, LLC ("Lincoln"), and became associated with member firm Lloyd, Scott & Valenti, Ltd. ("Lloyd").[2] Uberti and Runyon were associated with Lloyd from July through November 2001 as general securities representatives and principals. Neither is currently associated with a member firm.

II. Procedural History

The Department of Enforcement ("Enforcement") filed the original complaint in this matter on October 15, 2002, after investigating a referral from NASD's Department of Market Regulation. On October 21, 2002, Enforcement filed an 11-cause amended complaint.

The first three causes of the amended complaint alleged that Donner**,** through Baclet and Uberti, issued 25 research reports (22 reports alleged as to Uberti) that: failed to disclose material information, in violation of Conduct Rules 2110 and 2210(d)(1)(A); contained exaggerated, misleading, and false statements, in violation of Conduct Rules 2110 and 2210(d)(1)(B); and were fraudulent due to these omissions and misstatements, in violation of Section 10(b) of the Exchange Act, SEC Rule 10b-5, and Conduct Rule 2120. Cause four of the amended complaint alleged that, in research reports for 50 companies, Donner, Baclet, and Uberti (43 alleged as to Uberti) concealed compensation arrangements with the subject companies, in violation of Section 17(b) of the Securities Act and Conduct Rule 2110. Cause five alleged that the Firm, Baclet, and Uberti also independently violated Conduct Rule 2110 by undertaking the conduct alleged in causes one through four.

The sixth cause of the amended complaint asserted violations of Conduct Rules 2110 and 2210(b)(1) because Donner and Baclet failed to have the Firm's research reports signed by a principal. Cause seven averred that the Firm and Baclet failed to establish and maintain written supervisory procedures pertaining to the preparation and dissemination of the Firm's research reports, in violation of Conduct Rules 2110 and 3010.

Causes eight through ten of the amended complaint alleged that Uberti and Runyon issued two research reports through Lincoln that: failed to disclose material information, in violation of NASD Conduct Rules 2110 and 2210(d)(1)(A); contained exaggerated, misleading, and false statements, in violation of NASD Conduct Rules 2110 and 2210(d)(1)(B); and were fraudulent due to these omissions and misstatements, in violation of Section 10(b) of the Exchange Act, SEC Rule 10b-5, and NASD Conduct Rule 2120. Finally, cause eleven of the amended complaint alleged that Uberti and Runyon independently violated NASD Conduct Rule 2110 by undertaking the conduct alleged in causes eight through ten.

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[2] Donner did not, however, file a Uniform Termination Notice for Securities Industry Registration ("Form U5") for either individual until May 2002.

Each of the respondents filed an answer denying the allegations and requested a hearing. The Hearing Panel heard testimony during more than five days of evidentiary hearing. On June 7, 2004, the Hearing Panel issued a decision finding the respondents liable for the violations alleged in the complaint and imposed sanctions. This timely appeal followed.

III. Facts

A. The Donner Research Reports

1. Donner's Business Practices

Baclet opened Donner after becoming disenchanted with other firms with which he had been associated. From March 1999 through May 2002, approximately 70 percent of Donner's business involved a practice that Baclet described as "investment banking." Baclet and other Donner employees solicited this business by cold calling "small-cap" issuers whose stock generally sold for less than $5 per share and offering to prepare research reports about these issuers.[3] The issuers executed contracts and agreed to pay Donner a fee in exchange for Donner's preparing a research report, issuing a press release, and posting the report on the Firm's website. In exchange for an ongoing monthly fee, Donner would update the research reports as necessary and discuss the issuers with potential investors.[4]

Baclet acknowledged that issuers paid the Firm to prepare research reports and that issuers would not be willing to pay for negative reports. Baclet testified, however, that he and other members of Donner's staff, including Uberti, conducted "due diligence" research before agreeing to cover an issuer. Baclet stated that Donner covered only issuers that offered viable products and demonstrated promising prospects for future growth. He stated that he rarely analyzed the financial backgrounds of the issuers because Donner's research reports focused more on the underlying products, not the issuers' current financial situation.

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[3] Baclet stated that he sought to provide exposure to issuers about which larger broker-dealers were not interested. Baclet recruited most of the issuers for which Donner ultimately published research reports. Baclet identified many of the targeted issuers by running Internet searches. He then pitched issuers by touting Donner's purported prowess in publicizing issuers and suggesting that Donner had helped many penny stock issuers significantly increase their stock prices. Runyon also identified and contacted potential issuers to generate research-reporting business for Donner.

[4] Donner's fee structure generally included an initial $2,500 fee for research and preparation of a research report. An additional monthly fee of $2,000 to $3,000 bought continuing "coverage" of the issuer. Issuers generally also agreed to pay an additional fee of $2 to $3 for each information packet that the Firm mailed to potential investors. Some agreements further included escalation provisions whereby Donner received additional compensation from the issuer if the issuer's share price exceeded a certain level after Donner commenced coverage of the issuer's stock.

Baclet did not agree to cover every issuer that approached Donner. Donner refused to cover companies that Baclet believed did not offer a viable product or produced products that, in his view, contravened family values or were immoral or unethical. Baclet and Uberti stated that Donner was interested only in covering issuers that were undervalued and, in their opinions, had a promising future.

All of Donner's research reports followed a similar format. Across the top of each report, Donner identified itself and included the subheading "Investment Bankers . . . Institutional Research." Immediately under this subheading, Donner listed its recommendation of buy, speculative buy, or strong buy and the name and symbol of the issuer. The left-hand column of the first page generally listed basic financial and trading data such as the prior year's price range, trading volume, earnings per share for three previous years, and a yearly revenue figure. The right-hand column included the heading "Investment Thesis" and consisted of several bullet points touting the issuer. Most reports described the subject stock as "undervalued" or "highly undervalued" and suggested that the issuer was poised to become a "market leader" in its industry. Generally, Donner's research reports included little other financial information and contained a hyperlink to the covered issuer's most recent financial filings on the Securities and Exchange Commission's EDGAR website. Most of Donner's research reports did not disclose that Donner received compensation for preparing the reports.

Baclet or Uberti arranged for Donner to issue a press release for each research report that the Firm prepared. Generally, the press releases announced that Donner had commenced coverage of the issuer or, if Donner previously had issued a research report about the same issuer, it would announce that Donner had upgraded or reiterated its recommendation. Donner's research reports were available on the Firm's website to anyone interested in reviewing them.

Richard Merrell ("Merrell"), an independent contractor associated with Donner, prepared the majority of Donner's research reports. Merrell began drafting reports for Donner in 1999 and estimated that he prepared a total of 200 reports for Donner. Merrell was not a financial analyst, and he had never written a research report before working with Donner. He has never been registered with NASD. Merrell's background is in quality assurance, and he was employed full time with an orthodontics manufacture and distribution company. Merrell drafted research reports for Donner as a sideline to earn extra money. He worked at home and earned approximately $100 to $150 per report.

Merrell did not receive any training from Donner. Instead, Baclet provided Merrell with a draft research report and told him to follow the same template for future reports. Merrell stated that all of the reports that he drafted for Donner had an overall positive tone and that most included catch phrases such as "undervalued," "well-positioned," and "poised to become a major player." For each report, Baclet dictated whether the recommendation would be "buy,"

"speculative buy," or "strong buy."[5] Merrell conducted no independent analysis for any of the research reports. Merrell stressed that the reports he prepared for Donner were factual, not analytical, and that he never visited the companies, talked to customers or employees, or tested the companies' products. He generally gathered publicly available information and reformatted the information into Donner's research report template. Merrell's main contact at Donner for assignments and feedback was Uberti.

Tony Rhee ("Rhee"), a self-titled equities analyst at Donner, prepared the remaining Donner research reports at issue. Rhee began working at Donner in August 1999, became registered as a general securities representative in August 2000, and registered with the Firm as a general securities principal in May 2001. Rhee prepared research reports for Donner on biotech companies.[6] Generally, Uberti or Baclet assigned companies to Rhee for review. Baclet encouraged Rhee to write positive reports because issuers would not pay for negative coverage and nicknamed him "the Liberator" because he was willing to criticize companies and expose negative information. Rhee stated that, on the occasions when he refused to write a positive report about an issuer, Baclet would reassign the report to Merrell.

Baclet required that Donner provide pre-release drafts of the Firm's research reports to the issuers for comment. Rhee stated that he was not always comfortable with the revisions that the issuers made and that he ultimately left Donner in October 2001 for this and other reasons.[7]

2. Donner's Supervisory Structure

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[5] Merrell stated that Baclet or Uberti occasionally asked him to prepare duplicate reports on certain issuers that would be released under the name of one of three broker-dealers other than Donner. Merrell prepared more than 200 research reports under Donner's name and approximately 25 under the names of the other three broker-dealers. Donner compensated Merrell for all reports, including reports released under the names of broker-dealers other than Donner.

Baclet testified that he ordered the preparation of research reports under the names of broker-dealers other than Donner because he had entered into possible merger negotiations with these other firms.

[6] Rhee has bachelor's and master's degrees in biology-related fields.

[7] Rhee testified, for example, with respect to a research report that he drafted, that he protested after an officer of the issuer edited out references to the company's weak financial condition and the auditor's going-concern qualification on an audited financial statement. Rhee also objected to the officer's adding to the draft research report text regarding the issuer's "impressive" scientific results in clinical trials. Rhee stated that he left Donner because he did not always agree with Baclet's business decisions, and he did not want to be forced to write reports on companies that he did not support. He also felt that he had limited opportunity for advancement at Donner, and he had concerns about Donner's reputation in the industry.

Baclet's, Uberti's, Rhee's, and Merrell's assertions regarding Donner's supervisory structure and legal and compliance departments were inconsistent. The evidence suggests that Brett Saddler ("Saddler"), an unregistered individual employed at Donner through 2000, was Donner's compliance officer. In 2001, Donner employed a law professor, Rebecca Wilson ("Wilson"), as the head of its "legal department," and most of her staff was composed of law student interns or law school graduates who had not been admitted to a state bar.

Donner's 1999 and 2001 supervisory procedures listed Baclet as responsible for advertising and research reports. In connection with NASD's investigation of this matter, Donner provided NASD staff with a document explaining who at the Firm was responsible for reviewing the reports at issue. Uberti is listed as having conducted supervisory reviews for the majority of research reports addressed in this case, and Baclet accepted ultimate responsibility for all of the reports as well.

Most of Donner's draft research reports went to Uberti for pre-release review and revision. In pre-hearing, on-the-record testimony, Uberti and Runyon testified that Uberti reviewed Donner's research reports for compliance with NASD rules. Runyon stated that Uberti "had his hands on" every research report that the Firm issued. Uberti testified that his main focus in reviewing Donner's research reports was on the financial information. He also reviewed the reports for factual accuracy and to ensure that all of Donner's standard disclaimers were included. Both Uberti and Runyon agreed that Uberti was not the sole person responsible and that Baclet maintained ultimate responsibility for every research report. At the Hearing Panel hearing, Uberti and Runyon spoke less strongly of Uberti's role at Donner.

Although Baclet accepted ultimate responsibility for the content of all of Donner's research reports, he also admitted that he did not read the final drafts of most of Donner's research reports thoroughly and did not analyze the issuers' financial filings.

B. The Lincoln Research Reports

Uberti and Runyon met while working together at Donner. Both left Donner in July 2001, registered immediately with NASD member firm Lloyd, and formed Lincoln for the purpose of preparing research reports on small-cap companies that, in their view, showed "promise."[8] They believed that they were qualified to operate a research firm and prepare fair and balanced research reports based upon their experiences at Donner. Uberti and Runyon

[8] Uberti and Runyon referred potential investors who reviewed Lincoln's research reports, and were interested in purchasing stock of covered issuers, to Lloyd. Uberti testified that he provided Lloyd with copies of Lincoln's research reports and the investment banking agreements that Lincoln and each issuer executed. The only compensation agreement that Uberti and Runyon had with Lloyd involved their standard commission schedules for securities that they sold as registered representatives of Lloyd. Lloyd did not compensate them for preparing research reports under Lincoln's name.

shared ownership of and responsibility for Lincoln and all research reports that it issued. Uberti and Runyon testified that Lincoln relied mainly on referrals for business. They stated that they would conduct their own "due diligence" before agreeing to issue a research report on a particular issuer. If they could satisfy themselves that the issuer showed promise, they would agree to issue a research report in exchange for a fee.

Like Donner, Uberti and Runyon also hired Merrell to draft research reports for Lincoln. Although Merrell drafted approximately 17 research reports for Lincoln, only two research reports were involved in this action.

Uberti told Merrell to follow the same format that he had followed in drafting Donner's research reports. In all Lincoln research reports, as in all Donner research reports, Merrell included certain positive catch phrases and maintained a positive tone overall. He likewise obtained public information from various sources and repackaged it in Lincoln's standard research report format. Merrell never verified any information that he received on an issuer because the amount of compensation that Lincoln paid did not support his expending time on conducting extensive research. Merrell testified that all of the research reports that he drafted for Lincoln included a "recent development" section that provided information from the issuers' press releases, a "market overview" section that stated that the company is growing in its particular market, and a "company overview" section that explained the company's business and indicated how long the company had been in business. Merrell stated that if he found information about an issuer that suggested that the issuer was losing money, he either excluded it from the issuer's research report or worded the report so as to place the information in a positive light.

Merrell forwarded the reports that he prepared to Uberti or Runyon for review and issuance. Uberti or Runyon reviewed the reports, reviewed the issuers' financial filings, and revised the reports as necessary. Uberti and Runyon generally provided issuers with draft copies of Lincoln's reports before issuing the reports and invited the issuers to suggest revisions. Lincoln made its research reports available to members of the public on its website and heralded its issuance of research reports in press releases.

IV. Discussion

After a thorough review of the record, we affirm the Hearing Panel's findings of violation. We conclude that Donner, Baclet and Uberti violated Conduct Rules 2210(d)(1)(A) and (B), by issuing omissive and misleading research reports on behalf of the Firm during the period of March 1999 through May 2002; that this misconduct was fraudulent, in violation of Section 10(b) of the Exchange Act, SEC Rule 10b-5, and Conduct Rule 2120; and that the conduct contravened high standards of commercial honor and just and equitable principles of trade, in violation of Conduct Rule 2110.[9] We further conclude that Donner, Baclet, and Uberti

[9] NASD Conduct Rue 2110 requires that NASD members shall, in conducting their business, "observe high standards of commercial honor and just and equitable principles of

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violated Section 17(b) of the Securities Act and Conduct Rule 2110 by failing to disclose in Donner's research reports that the Firm received compensation from the covered issuers in exchange for issuing the reports. We also conclude that Donner and Baclet failed to ensure written approval of Donner's research reports, in violation of Conduct Rules 2110 and 2210, and failed to establish and maintain adequate written supervisory procedures, in violation of Conduct Rules 2110 and 3010. Finally, we find that Uberti and Runyon violated Conduct Rules 2210(d)(1)(A) and (B), by issuing omissive and misleading research reports in August and October 2001, that this misconduct was fraudulent, in violation of Section 10(b) of the Exchange Act, SEC Rule 10b-5, and Conduct Rule 2120, and that the conduct contravened high standards of commercial honor and just and equitable principles of trade, in violation of Conduct Rule 2110.

A. Causes One through Seven (Donner Research Reports)

1. Causes One, Two, and Five – 25 Donner Research Reports Omitted Material Information and Contained Misleading Misrepresentations

Donner violated NASD's rules governing communications with the public in 25 research reports.[10]

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trade." NASD Conduct Rule 115 makes all NASD rules, including Conduct Rule 2110, applicable to both NASD members and all persons associated with NASD members.

[10] The allegations in causes one, two, three, and five of the amended complaint relate to the following 25 Donner research reports: (1) Dynamic Web Enterprises (DWEB) – speculative buy issued March 22, 1999; (2) General Automation, Inc. (GAUM) – speculative buy issued June 7, 1999; (3) Medical Science Systems (MSSI) – speculative buy issued June 14, 1999; (4) Imaging Technologies Corporation (ITEC) – speculative buy issued June 23, 1999; (5) ALYN Corporation (ALYN) – speculative buy issued July 7, 1999; (6) Esynch Corporation (ESYN) – speculative buy issued September 27, 1999; (7) Hawaiian Natural Water Co., Inc. (HNWCC) – speculative buy issued October 5, 1999; (8) American Champion Entertainment (ACEI) – speculative buy issued October 18, 1999; (9) StarBase Corporation (SBAS) – speculative buy issued October 21, 1999; (10) Imperial Petroleum (IPTM) – speculative buy issued November 11, 1999; (11) Professional Transportation Group, Ltd. (TRUC) – speculative buy issued January 17, 2000; (12) Dippy Foods, Inc. (DPPI) – speculative buy issued January 31, 2000; (13) Ocean Power Corporation (PWRE) – speculative buy issued February 23, 2000; (14) Ilive.com, Inc. (LIVE) – speculative buy issued March 8, 2000; (15) Itronics Inc. (ITRO) – buy issued March 20, 2000; (16) Genius Products, Inc. (GNUS) – speculative buy issued April 25, 2000; (17) Insider Street.com (NSDR) – speculative buy issued April 26, 2000; (18) Pen Interconnect Inc. (PENC) – speculative buy issued May 23, 2000; (19) ADVB – speculative buy issued August 21, 2000; (20) Far East Ventures, Inc. (FEVI) – speculative buy issued January 10, 2001; (21) Sedona Corporation (SDNA) – speculative buy issued April 25, 2001; (22) Aethlon Medical, Inc. (AEMD) – speculative buy issued June 12, 2001; (23) Advanced Aerodynamics and

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Under the NASD Rule 2200 Series, all member communications with the public[11] must be based on principles of fair dealing and good faith, be fair and balanced, and provide a sound basis for evaluating the facts in regard to the particular securities discussed.[12] No member may omit a material fact if the omission, in the context of the material presented, would cause the communication to be misleading.[13] The Rule 2200 Series also prohibits members from making false, exaggerated, unwarranted, or misleading statements in communications with the public.[14] It is within the context of these rules that we now turn to Donner's violations.

The 25 Donner-issued research reports identified in note 10 failed to conform to these standards. First, the reports omitted material facts that, given the overall positive tone of the research reports and their buy recommendations, rendered them misleading. Most glaring among Donner's omissions was the Firm's failure to disclose that each issuer referenced in these reports had been the subject of an auditor's going concern opinion in a recent audit report and the underlying reasons for the going concern opinions.[15] Although the financial statements of many of the 25 issuers covered by Donner's research reports reported aggregate net losses,

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Structures, Inc. (AASI) – speculative buy issued June 27, 2001; (24) Vital Living, Inc. (VTLV) – speculative buy issued April 24, 2002; and (25) Xechem International Inc. (ZKEM) – speculative buy issued May 16, 2002. The amended complaint alleged that Uberti was responsible for all Donner research reports except for (3) MSSI; (24) VTLV; and (25) ZKEM.

[11] Communications with the public include sales literature disseminated to the public by NASD member firms. "Sales literature" is defined in Rule 2210(a)(2) to include research reports.

[12] *See* Rule 2210(d)(1)(A).

[13] *Id.*

[14] *See* Rule 2210(d)(1)(B).

[15] The federal securities laws require issuers of registered securities annually to file financial statements with the Securities and Exchange Commission. The financial statements must be audited and certified by independent public accounts and must adhere to Generally Accepted Auditing Standards. Exchange Act §13(a)(2), 15 U.S.C. §78m(a)(2); Regulation S-X, 17 C.F.R. §210.2-02(b). In connection with conducting an audit of financial statements in accordance with Generally Accepted Auditing Standards, "[t]he auditor has a responsibility to evaluate whether there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, not to exceed one year beyond the date of the financial statement being audited." Codification of Accounting Standards and Procedures, Statement on Auditing Standards No. 59, §341.02 (Am. Inst. of Certified Pub. Accountants 2002), effective for audits for periods beginning on or after January 1, 1989.

significant operating losses, inadequate working capital, accumulated debt, defaults on payment obligations, and the issuers' needs to rely on short-term borrowing and the issuance of stock for operating capital, the Firm failed to disclose these facts in the research reports.[16] Donner's research reports were also silent concerning key financial barometers, including disclosures in financial filings that it was unlikely that the issuers would generate revenues or profits in the near future and that the issuers were subject to ongoing liquidity concerns.[17]

Donner failed to disclose other important financial information upon which issuers' auditors based their going concern opinions. Donner failed to disclose the existence of pending lawsuits that could materially affect the financial condition of one issuer and was similarly silent in its research reports as to the limited operating histories of other issuers.[18] Nor did Donner's research reports address the development stage status of certain issuers and the reliance of some issuers for a significant portion of company revenues on key customers, employees or officers.[19]

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[16] Donner failed to disclose in its research reports aggregate net losses reported in the financial statements or other filings for: DWEB, ITEC, ALYN, ESYN, HNWCC, ACEI, IPTM, TRUC, LIVE, ITRO, PENC, ADVB, FEVI, AASI, and VTLV. Donner failed to state in its research reports that the following issuers had suffered significant operating losses: DWEB, GAUM, MSSI, ESYN, SBAS, IPTM, SDNA, AEMD, VTLV, and ZKEM. Donner failed in its research reports to indicate that ADVB and AASI had defaulted on some or all of their payment obligations. Donner did not disclose in its research reports covering ESYN, HNWCC, ACEI, SBAS, IPTM, TRUC, GNUS, NSDR, PENC, and VTLV that the issuers were relying on short-term borrowing and the issuance of stock for operating capital. Donner's research reports did not disclose that the following issuers possessed inadequate amounts of working capital: DWEB, GAUM, ITEC, ALYN, ESYN, IPTM, TRUC, DPPI, PENC, ADVB, VTLV, and ZKEM. Donner failed to disclose accumulated deficits in its research reports for the following issuers: MSSI, ALYN, ESYN, ACEI, SBAS, IPTM, DPPI, PWRE, ITRO, PENC, ADVB, AEMD, and ZKEM.

[17] Donner did not state in research reports covering GAUM and LIVE that the issuers were experiencing liquidity problems. Donner did not state in its research reports that the financial statements for the following issuers had indicated that the issuers were unlikely to generate revenues or profits in the near future: DWEB, GAUM, MSSI, ALYN, HNWCC, SBAS, IPTM, NSDR, PENC, ADVB, AASI, and ZKEM.

[18] Donner did not disclose in a research report covering ITRO that the issuer was the subject of a pending breach of contract lawsuit seeking damages in excess of $5 million plus punitive damages at a time when the company had reported a net loss of $1,024,863. Donner also failed to disclose pending potentially material litigation in its research report for ESYN. Donner failed to state in its research reports for ALYN, DPPI, PWRE, VTLV, and ZKEM that the issuers possessed limited operating histories.

[19] Donner did not mention in its research reports covering LIVE, NSDR, ADVB, and ZKEM the development-stage status of the issuers. Similarly, Donner never mentioned in research reports covering ITEC, TRUC, and NSDR that the issuers relied on one or several key

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Furthermore, Donner did not disclose in numerous research reports that the referenced issuers battled competition from better-established and well-funded companies,[20] suffered from deficiencies in cash flow or negative cash flow from operations,[21] and expected to incur continuing losses or had reported factors that might adversely affect future profitability.[22] Donner neglected to disclose important information that factored into auditors' going concern opinions.

Finally, Donner's research reports did not disclose important information that would have shed light on Donner's objectivity. Although the Firm received compensation from the issuers that it covered, Donner did not disclose to the readers of its research reports that Donner had received, or contracted to receive, remuneration for preparing the research reports.[23]

In addition to these omissions, which caused the reports to be misleading, the Donner research reports at issue also included false, exaggerated, unwarranted, or misleading statements. Many of the research reports depicted the issuers as poised for unchallenged success or as emerging leaders in their industries when in reality the issuers had only recently begun operations or faced significant competition and funding shortfalls. Donner's research reports were replete with representations for which the firm lacked a good faith basis. For example, Donner stated in the DWEB research report that the issuer had enjoyed significant revenue growth and possessed the knowledge to have a great impact on the e-commerce market. DWEB's most recent Form 10-K Annual Report ("Form 10-K"), however, reported net losses and a negative cash flow and stated that DWEB possibly would deplete its resources before

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customers for a large percentage of the issuers' revenues. Donner failed to disclose information regarding key officers or employees who were necessary to the continued operations of the issuers in its research reports covering IPTM and LIVE.

[20] Donner was silent as to the level of competition in research reports for the following issuers: GAUM, MSSI, ALYN, HNWCC, ACEI, TRUC, PWRE, LIVE, ITRO, GNUS, NSDR, ADVB, AASI, and ZKEM.

[21] In research reports for DWEB, ITEC, IPTM, PENC, AEMD, AASI, and VTLV, Donner failed to indicate that the issuers' financial statements reported negative cash flow or cash flow deficiencies from operations.

[22] Donner remained silent as to a reported lack of potential for future profitability and issuers' expectations of continued and increasing losses in research reports that covered the following issuers: DWEB, MSSI, ITEC, ALYN, HNWCC, SBAS, IPTM, PENC, ADVB, AEMD, AASI, VTLV, and ZKEM.

[23] Donner did not disclose in research reports for the following issuers that it had received or had contracted to receive compensation in exchange for preparing the research reports: DWEB, MSSI, ALYN, ESYN, HNWCC, ACEI, SBAS, DPPI, PWRE, LIVE, ITRO, and GNUS.

deriving significant revenues from its products and services. Similarly, Donner's GAUM research report touted increased operating income and the establishment of a leadership position in the data access technology field. GAUM's most recent Form 10-K, however, reported operating losses, suggested that GAUM was not likely to soon achieve or sustain profitable operations, and stated that the company was struggling with liquidity problems.[24]

Donner also falsely depicted many issuers as being well-established entities that were on the brink of overwhelming success when, in fact, many of the issuers were struggling simply to survive. In this regard, for example, Donner stated in its research report concerning HNWCC that the company was "well positioned to garner a substantial share of the multi-billion dollar global beverage market." The financial filings for HNWCC were not so optimistic. They reported significant losses, negative cash flow, and "substantial doubt about whether [HNWCC could] continue as a going concern." The company's most recent Form 10-K also stated that, based on HNWCC's then-current business plan, HNWCC did not anticipate achieving higher sales levels prior to exhausting the capital resources available to it. Donner's ACEI research report boasted that ACEI was "poised to become a major player" in the "booming" market for children's television programming. The report indicated that an enormous market existed for children's programming and related merchandise and that this created a "superior potential for the appreciation of [ACEI's] stock." ACEI's most recent Form 10-K, however, stated that each of the industries in which the company operated was highly competitive and that most of ACEI's competitors had greater financial and other resources than ACEI. ACEI's Form 10-K also reported that if ACEI attempted to expand into other areas, it would face more intense competition from larger and more well established entities.

Donner falsely described the issuers that it touted in its glowing research reports as promising investment opportunities that were "highly undervalued" and future industry leaders in marketable fields.[25] In fact, the substance of each issuer's financial statements contradicted

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[24] The record is replete with other similar examples of misrepresentations in Donner's research reports. Donner's MSSI research report indicated that MSSI's business plan provided the company with multiple opportunities to generate immediate and long-term revenues and predicted that the company would excel in the medical field. MSSI's 10-K, however, reported large operating losses that the company expected would continue and indicated that the company's competitors were numerous and well funded. Donner stated in the ALYN research report that it expected ALYN to "excel in the industry behind the strength of its core product." ALYN's most recent Form 10-K, however, stated that ALYN had an extremely limited operating history that had resulted in very limited revenues and that there was no assurance as to whether or when ALYN's products would achieve meaningful market acceptance. Similarly, in Donner's research report for PWRE, Donner stated that it expected PWRE to become a leading provider of clean water solutions. PWRE's Form 10SB, however, reported that the company had a limited operating history, notable competition, and a significant accumulated deficit.

[25] Donner's research reports touted the stock of the following issuers as being undervalued or highly undervalued: DWEB, GAUM, MSSI, ALYN, ESYN, HNWCC, ACEI, SBAS, IPTM, TRUC, DPPI, PWRE, LIVE, ITRO, GNUS, NSDR, PENC, FEVI, SDNA, AEMD, AASI,

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Donner's optimistic claims. This is demonstrated in Donner's research report for ZKEM. Donner touted ZKEM as being on the verge of tremendous growth and stated that it had positioned itself to be a global leader in pharmaceutical products. ZKEM's most recent Form 10-K was not as promising. It stated that one of ZKEM's main competitors had greater experience, capital resources, research and development capabilities, and manufacturing and marketing resources. The company also reported that its products were development stage and that it had not received federal approval of many of its key drugs. ZKEM also reported in its financial filings significant operating losses, an accumulated deficit, and limited operating history. Similarly, Donner's research report for ESYN discussed ESYN's ability to "rise to the top of the internet utilities and electronic software distribution industry." In contrast, ESYN's financial filings reported significant cash shortfalls, numerous pending lawsuits, and a deficit in working capital. ESYN's most recent Form 10-Q Quarterly Report ("Form 10-Q") also reported that the company's primary activities "ha[d] consisted of raising capital and limited retail and turnkey sales of software." Donner's research report for LIVE stated that Donner expected LIVE to "rise to the top" and to "revolutionize the entire face of" the "iEntertainment" industry. LIVE's recent Form 10SB, however, expressed doubt about the company's ability to continue as a going concern, stated that LIVE would remain an insignificant participant in its industry, noted that the company faced meaningful competition, and stated that the company had no employees.

Donner issued research reports that inaccurately described the issuers as rapidly growing businesses, when in fact their continued existence was in doubt. Donner's research report for IPTM stated that the company was poised for explosive growth. IPTM's most recent Form 10-K did not support Donner's prediction. It reported large net losses, an accumulated deficit, and a deficit in working capital. It stated that IPTM employed only one person, possessed insufficient working capital to support its expenditures, and anticipated continued future losses. Donner's TRUC research report stated that positive financial results and streamlined finances placed the company on "solid ground" for future growth. But TRUC's financial filings reported a liability under the company's line of credit of more than $6 million and stated that, if the company was unable to negotiate an extension on its line of credit agreement, it would require additional third-

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VTLV, and ZKEM. Recent financial filings for these issuers, however, reported concerns about the ability of these issuers to continue as going concerns, significant operating losses, liquidity concerns, cash flow problems, accumulated deficits, and limited operating histories. For example, Donner's statements in the NSDR research report that NSDR was "quickly carving its niche in the rapidly emerging 'stock-marketing' industry" conflicted with financial statements for NSDR and its predecessor, which stated that the company did not have significant cash, other assets, or revenues. NSDR reported that it required additional financing to continue operations. Equally misleading was Donner's research report for PENC, which reported that the company's new business strategy (PENC sold off its manufacturing services and intended to pursue internet entertainment services) was expected to bring immediate profits. PENC's financial filings indicated that PENC had to raise additional capital to sustain the company's growth in operations and pay off creditors from the former operations of the company.

party financing to satisfy its anticipated cash requirements. Donner's research report for DPPI touted a large and lucrative target market, lack of competition, and growing demand for its products. DPPI's financial filings, however, reported limited operating history and going concern doubts. Donner stated in the ITEC research report that ITEC had reduced its costs and was "technically superior, leaner, and more focused" than before. In contrast, the company's most recent Form 10-Q and Form S-3/A reported negative working capital, significant doubt about the company's ability to continue as a going concern, a financial inability to continue operations, and anticipated continuing losses.

Disregarding dire financial and operational predictors, Donner's research reports painted visions of increasing revenue streams and operational growth.[26] In each instance alleged in the complaint, Donner's statements in its research reports overall were contrary to the statements contained in the issuers' financial filings and created an overly optimistic picture of the issuer that was not supported or was contradicted by available facts.[27] Donner's research reports

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[26] In one instance, the SBAS research report touted SBAS' "strong cash position," "expected continued strong revenue growth," "near term profitability," and the potential for expansion. SBAS' financial filings, however, were not as cheerful. The company's most recent 10-K reported that SBAS had had a history of losses since its inception and that there was no assurance that the company's product development effort would result in commercially viable products, generate significant revenues, or enable the company to operate profitably. SBAS reported that it anticipated incurring additional losses and expressed doubts about its ability to continue as a going concern. In a similar manner, Donner predicted explosive growth in a research report regarding SDNA. SDNA's most recent financial filings, however, reported substantial losses. The company indicated that additional financing would be required in order for SDNA even to continue as a going concern. Donner also touted AASI in a research report as positioned to become a worldwide leader. But AASI's financial filings stated that the company's products were still in development stages and that AASI had not yet generated sales revenue. AASI also reported in its financial filings that its products would compete with the products of other companies that were larger and possessed greater financial, technical, marketing, and other resources than AASI.

[27] For example, in the VTLV research report, Donner boasted that VTLV stock offered notable upside potential. Yet, VTLV's financial filings with the SEC reported poor sales of its products, net losses, the company's need for additional capital to continue with its operating plan, and anticipated continued operating losses. Donner's research report for GNUS stated that GNUS held a prominent position in a continually growing baby-consumer market. GNUS' most recent 10-K, however, reported that the company depended on both short-term and long-term financing to continue as a going concern and noted that the company also faced significant competition from well-established and better-funded companies. Similarly, Donner's research report for ITRO stated that the company had no significant competitors. ITRO's most recent 10-K directly contradicted this statement and indicated that ITRO's main business, waste film processing, is an established and competitive industry in which Eastman Kodak is the largest participant. The Donner research report for FEVI also contained misleading information. The report stated that FEVI had entered into an agreement to purchase a privately held company and

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inaccurately portrayed the issuers as promising market leaders and failed to balance the Firm's positive predictions with publicly reported less positive factual recitations.

Donner's omissions and misrepresentations were material. The test for materiality is whether a reasonable investor would consider the information significant with respect to his investment decisions. *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988). A misstated or omitted fact is material if a reasonable investor would have viewed the fact as having altered the "total mix" of information available to him. *TSC Indus., Inc. v. Northway, Inc*., 426 U.S. 438, 449 (1976). A reasonable investor, for instance, would consider significant information pertaining to an issuer's financial condition, profitability, solvency, and potential for success. *Charles E. French*, 52 S.E.C. 858, 863 n.19 (1996); *Dept. of Enforcement v. Reynolds*, Complaint No. CAF990018, 2001 NASD Discip. LEXIS 17, at *29 (NAC June 25, 2001).

Here, Donner carefully chose which financial and operational facts it would disclose about each issuer. In general, the Firm erred on the side of presenting inflated revenue predictions and overstated business prospects while ignoring going concern opinions and other negative financial information.[28] The information that Donner omitted or misrepresented provides the basic foundation upon which a reasonable investor assesses the merits of an investment – finances, available capital, business prospects, competition, operating history, and litigation risks. That such information is material to an investor's decision to invest is beyond question.[29] *See Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153-54 (1972) (finding

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expected the purchase to close shortly. FEVI's 10-Q for the same period stated that the company, which had no established source of revenue, would be unable to continue in existence unless it arranged for financing to fund its planned acquisition. Donner stated in the ADVB research report that the company was "not burning money to exist." ADVB's financial filings, however, stated that the company was insufficiently funded to allow it to complete the product development process that it had started and that the company anticipated incurring substantial future losses related to product development.

[28] Donner's research reports included specific misstatements of facts, such as reporting significant revenue growth when in fact the issuer had net losses and a negative cash flow. Others of Donner's misrepresentations were less specific, such as touting a failing issuer as an emerging leader in a particular industry. We find both types of statements in Donner's research reports to be misrepresentations. *Cf. Va. Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1093 (1991) ("[C]onclusory terms in a commercial context are reasonably understood to rest on a factual basis that justifies them as accurate, the absence of which renders them misleading.").

[29] In research reports regarding DWEB, MSSI, ALYN, ESYN, HNWCC, ACEI, SBAS, DPPI, PWRE, LIVE, ITRO, and GNUS, Donner also failed to disclose its receipt of remuneration. A broker-dealer's self-interest in promoting an issuer, other than the regular expectation of receiving a sales commission, is material information that should be disclosed in a

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material information that a reasonable investor might have considered important in the making of an investment decision); *SEC v. Murphy*, 626 F.2d 633, 653 (9th Cir. 1980). Donner's research reports concealed the issuers' true overall financial conditions, understated the risks associated with the investments, and presented unbalanced and misleading overviews that were overly optimistic and not based in fact. *See Sheen Fin. Res.*, 52 S.E.C. 185, 190 (1995). On key subjects, Donner's research reports camouflaged the truth. We therefore conclude that Donner's misrepresentations and omissions are material.

On appeal, respondents argue that the inclusion in the research reports of hyperlinks to the issuers' financial filings on the Securities and Exchange Commission's EDGAR website was sufficient to cure any omissions or misrepresentations made in Donner's research reports. We previously have rejected this argument. In *Dep't of Enforcement v. Reynolds*, we held that the public availability of counterbalancing information does not excuse the omission or misstatement of material information. *Reynolds*, 2001 NASD Discip. LEXIS 17, at *36. The inclusion of hyperlinks to the Commission's website is insufficient to counterbalance respondents' misrepresentations and omissions. We decline to adopt respondents' reasoning. *Cf. Va. Bankshares*, 501 U.S. 1083, 1097 (stating that, in a proxy statement, "not every mixture of the truth will neutralize the deceptive"); *SEC v. Rana Research, Inc.*, 8 F.3d 1358, 1363 (9th Cir. 1993) finding that a "grain of truth" included in an otherwise misleading press release is not curative).

Respondents also argue that their conduct should be excused because NASD provided them with insufficient guidance on drafting research reports. Respondents state that NASD and Commission staff conducted numerous audits of Donner without identifying any of the misconduct alleged in the complaint. We reject this argument as well. Participants in the securities industry have substantial regulatory responsibilities. Noncompliance with regulatory requirements cannot be excused because of a respondent's lack of knowledge or understanding. *Kirk A. Knapp*, 51 S.E.C. 115, 134 (1992). Respondents may not shift responsibility for their rule violations to NASD. *See East/West Sec. Co.*, 54 S.E.C. 947, 952 (2000); *Stephen J. Gluckman*, 54 S.E.C. 175, 184 (1999). As an NASD member, Donner was responsible for complying with NASD's rules regarding communications with the public.

Respondents also argue that the term "speculative" used in the context of a "speculative buy" recommendation connotes a degree of risk. Donner's research reports, however, did not include a definition of "speculative buy" or otherwise explain Donner's use of the term. Furthermore, Donner coupled its speculative buy recommendations with superlatives, such as "highly undervalued," "poised for growth," "a major player," "for the prudent investor," "technically superior," "well positioned to garner a substantial share [of a] multi-billion dollar market," and "superior potential for appreciation of this stock." Conduct Rule 2210 requires that

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research report. *Kevin D. Kunz*, Exchange Act Rel. No. 45290, 2002 SEC LEXIS 104, at *22 (Jan. 16, 2002), *aff'd*, 64 Fed. Appx. 659 (10th Cir. 2003).

sales literature be fair and balanced in its discussion of an investment potential. *Robert L. Wallace*, 53 S.E.C. 989, 994 (1998). Donner's use of the word "speculative" in its buy recommendations did not balance Donner's otherwise grandiose statements and did not remedy Donner's omissions and misrepresentations.

In sum, we find that in the 25 reports at issue in causes one, two, and five of the amended complaint, Donner omitted material facts and misstated material information that, in the context of the information presented, resulted in misleading research reports, in violation of Rules 2110 and 2210(d)(1)(A) and (B).[30]

2. Causes Four and Five – Donner Research Reports for 48 Issuers Failed to Disclose Donner's Receipt of Compensation from the Issuers

Donner violated NASD Rule 2110 and Section 17(b) of the Securities Act by failing to disclose in research reports issued during 1999 and 2000 Donner's receipt of compensation from the issuers in exchange for the Firm's preparation of the research reports.[31]

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[30] The amended complaint alleged in cause five that respondents' rule violations constituted independent violations of Rule 2110 distinct from their violations of Rule 2210. We find that the evidence supports this allegation. Donner produced research reports that did not provide a fair and balanced view of the issuers, most of which were development-stage companies with little operating history and significant sustained financial losses. Donner's reports emphasized positive attributes and sometimes overstated those attributes. Donner downplayed, or ignored, negative information in its research reports and provided readers with an unbalanced view of the issuers' prospects. Respondents' actions were contrary to high standards of commercial honor and just and equitable principles of trade and therefore violated Rule 2110. *Cf. Reynolds*, 2001 NASD Discip. LEXIS 17, at *42 (finding that respondent's failure to make reasonable efforts to ensure that an advertisement did not contain misleading material violated Rule 2110).

[31] The allegations in cause four of the amended complaint relate to research reports that Donner prepared regarding the following issuers: (1) Abaxis, Inc. – speculative buy issued May 4, 1999; (2) ALYN – speculative buy issued July 7, 1999; (3) ACEI – speculative buy issued October 18, 1999; (4) Avcorp Industries, Inc. – speculative buy issued June 7, 1999; (5) B2 Technologies, Inc. – speculative buy issued March 6, 2000; (6) Carbite Golf – speculative buy issued September 13, 1999; (7) China Premium Food Corp. – speculative buy issued February 8, 2000; (8) Comanche Energy, Inc. – speculative buy issued October 27, 1999; (9) Cypros Pharmaceutical Corporation – strong buy issued April 2 and July 23, 1999; (10) Datametrics Corporation – speculative buy issued August 23, 1999; (11) Digital Power Corporation – speculative buy issued July 28, 1999; (12) DPPI – speculative buy issued January 31 and March 27, 2000; (13) Discovery Laboratories, Inc. – speculative buy issued November 30, 1999 and buy issued April 10, 2000; (14) Diversified Senior Services, Inc. – speculative buy issued December 16, 1999; (15) DWEB – speculative buy issued March 22, 1999; (16) ESYN – speculative buy issued September 27, 1999; (17) GAUM – speculative buy issued June 7, 1999, buy issued October 8, 1999, strong buy issued January 25, 2000; (18) Genetronics Biomedical, Ltd. – strong buy issued June 16, 1999; (19) Geo2 Limited – speculative buy issued October 21,

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Section 17(b) of the Securities Act states that it shall be unlawful for any person, by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, to publish, give publicity to, or circulate any notice, circular, advertisement, newspaper, article, letter, investment service, or communication which, though not purporting to offer a security for sale, describes such security for a consideration received or to be received, directly or indirectly, from an issuer, underwriter, or dealer, without fully disclosing the receipt, whether past or prospective, of such consideration and the amount thereof.[32] 15 U.S.C. § 77q(b). It is not necessary to demonstrate scienter to prove a violation of Section 17(b) of the Securities Act. "Section 17(b) 'is particularly designed to meet the evils of

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1999; (20) HNWCC – speculative buy issued October 5, 1999; (21) LIVE – speculative buy issued March 8, 2000; (22) ITEC – speculative buy issued June 23, 1999; (23) Incubator Capital, Inc. – speculative buy issued February 7, 2000; (24) Integrated Special Information Solutions, Inc. – speculative buy issued March 2, 2000; (25) InternetStudios.com, Inc. – speculative buy issued March 2, 2000; (26) ITRO – buy issued March 20, 2000; (27) Lancer Orthodontics – speculative buy issued March 19, 1999; (28) Longport, Inc. – speculative buy issued February 2, 2000; (29) Media Bay, Inc. – buy issued March 9, 2000; (30) MSSI – speculative buy issued June 14, 1999 and buy issued July 12, 1999; (31) Mustang Software, Inc. – speculative buy issued September 21, 1999 and buy issued February 22, 2000; (32) ObjectSoft Corp – speculative buy issued September 13, 1999; (33) PWRE – speculative buy issued February 23, 2000; (34) Orland Predators Entertainment, Inc. – speculative buy issued February 22, 2000; (35) PENC – speculative buy issued September 21, 1999; (36) PharmaPrint, Inc. – speculative buy issued July 23, 1999; (37) Pioneer Behavioral Health – speculative buy issued May 5 and June 21, 1999; (38) PriceNetUSA, Inc. – speculative buy issued March 7, 2000; (39) Retrospettiva, Inc. – speculative buy issued February 23, 2000; (40) SBAS – speculative buy issued October 21, 1999 and buy issued December 16, 1999; (41) SVI Holdings, Inc. – speculative buy issued September 9, 1999 and buy issued February 17, 2000; (42) Titan Pharmaceuticals, Inc. – speculative buy issued June 22, 1999; (43) Tri-Lite, Inc. – speculative buy issued October 19, 1999; (44) Trimedyne, Inc. – buy issued July 27, 1999, February 28 and April 4, 2000; (45) TrimFast Group, Inc. – speculative buy issued March 7, 2000; (46) WaveRider Communications, Inc. – speculative buy issued February 8, 2000; (47) Xybernaut Corporation – speculative buy issued October 12, 1999 and buy issued January 24, 2000; and (48) ZapWorld.com – speculative buy issued February 23, 2000. The amended complaint alleged that Uberti is responsible for failing to disclose Donner's compensation in Donner's research reports for all issuers except for (9) Cypros Pharmaceutical Corporation; (14) Diversified Senior Services, Inc.; (18) Genetronics Biomedical, Ltd.; (30) MSSI; (37) Pioneer Behavioral Health; and (42) Titan Pharmaceuticals, Inc.

[32] Respondents do not dispute that they communicated with issuers, customers, and other members of the public through the use of telephone lines and the U.S. mail service, thereby satisfying the requirement that respondents' conduct involved the use of interstate commerce or U.S. mails. *See SEC v. Hasho*, 784 F. Supp. 1059, 1106 (S.D.N.Y. 1992).

the 'tipster sheet' as well as articles in newspaper [sic] or periodicals that purport to give an unbiased opinion but which opinions in reality are bought and paid for.'" *Daniel R. Lehl*, Exchange Act Rel. No. 45955, 2002 SEC LEXIS 1796, at *39 (May 7, 2002), *citing United States v. Amick*, 439 F.2d 351, 365 (7th Cir. 1971).

Donner received or contracted to receive remuneration in exchange for issuing research reports. Under the terms of Donner's agreements with the subject issuers, Donner prepared and issued research reports in exchange for monetary compensation, securities, precious metals, or other compensation. All of the witnesses testified consistently that Donner received payment from issuers for all of its research reports. The research reports that are the subject of cause four of the complaint stated that Donner might perform "investment banking, corporate finance, provide services for, and solicit investment banking, corporate finance or other business from the issuers . . . for a fee." This disclosure is insufficient to comply with the requirements of Section 17(b) of the Securities Act. *See Lehl*, 2002 SEC LEXIS 1796, at *40 (holding that the disclosure that persons associated with a firm "'may' receive compensation" is inadequate when the firm in fact received or contracted to receive compensation and stock); *Scott P. Flynn & Strategic Network Dev.*, Exchange Act Rel. No. 42000, 1999 SEC LEXIS 2176, at *6-7 (Oct. 13, 1999).

We find that Donner failed to disclose that it received compensation in exchange for drafting and issuing research reports on behalf of issuers, in violation of Section 17(b) of the Securities Act.[33] As alleged in causes four and five of the amended complaint, we also find that Donner's conduct is contrary to high standards of commercial honor and just and equitable principles of trade and violates NASD Conduct Rule 2110.[34]

3. Baclet's and Uberti's Responsibility for Donner's Violations Under Causes One, Two, Four and Five

We hold Baclet and Uberti responsible for Donner's research reports and therefore find that Baclet and Uberti violated Conduct Rules 2110 and 2210 and Section 17(b) of the Securities Act, as alleged in causes one, two, four and five of the amended complaint.

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[33] The complaint alleged that respondents also failed to disclose the Firm's compensation in research reports for PLC Medical Systems, Inc. issued on April 24, 2000, and Interleukin Genetics issued on March 8, 2000. The record contains one research report for PLC Medical Systems, Inc., which Donner issued on May 11, 2000. The record does not include the April 24, 2000 research report for PLC Medical or the March 8, 2000 research report for Interleukin. We therefore have not made findings as to reports covering these two issuers.

[34] Furthermore, violations of federal securities laws are viewed as violations of Conduct Rule 2110 because members of the securities industry are expected and required to abide by applicable rules and regulations. *Dep't of Enforcement v. Shvarts*, Complaint No. CAF980029, 2000 NASD Discip. LEXIS 6, at *12 (NAC June 2, 2000).

During the period at issue, Baclet was president of Donner and ultimately responsible for all of Donner's research reports.[35] *See Michael Ben Lavigne*, 51 S.E.C. 1068, 1071-72 (1994), *aff'd*, 78 F.3d 593 (9th Cir. 1996) (table format) (holding that the president of a broker-dealer is responsible for the firm's compliance with regulatory requirements unless and until he reasonably delegates particular functions to another person and neither knows nor has reason to know that such person's performance is deficient). "[W]hen a person chooses to accept the office of firm president, [he] assumes the obligation of ensuring compliance" with NASD rules. *Everest Sec., Inc.*, 52 S.E.C. 958, 965 (1996), *aff'd*, 116 F.3d 1235 (8th Cir. 1997). Several witnesses testified unanimously that Baclet exercised ultimate authority at Donner. Donner's own supervisory procedures in place during the period at issue confirm this. The written supervisory procedures identified Baclet as the principal responsible for supervising advertising and sales literature.

During NASD's investigation of this matter, Baclet presented NASD with a document that he had prepared. The document listed Baclet and others as responsible for reviewing the research reports at issue. Baclet decided whether and when to issue the research reports, and he controlled the timing and issuance of press releases announcing Donner's coverage of the securities at issue. Baclet testified that he viewed the preparation of Donner's research reports as "team efforts" involving Uberti, himself, and others. He also testified, however, that as owner of Donner, he accepted full responsibility for the Firm's research reports. The evidence supports our conclusion that Baclet was responsible for Donner's research reports.

Uberti shares responsibility for the Firm's research reports. After initially admitting in on-the-record testimony that he served a key role at Donner, at the hearing below, Uberti denied his responsibilities at Donner. He claimed that his position as vice president of marketing was in name only. He stated that he had no supervisory authority and held a ministerial position at the Firm. Uberti's claims are contradicted by significant record evidence.

Uberti held a position of authority at Donner, and he was intimately involved in nearly every aspect of Donner's preparation of the research reports at issue. Uberti was the sole contact for Merrell, the individual who prepared the vast majority of the research reports. Uberti assigned work to Merrell, provided him with guidance and direction, and accepted draft reports from Merrell. He reviewed and edited Merrell's work, added recent news updates and other information to the research reports, interacted with issuers and provided them with copies of

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[35] Donner issued the research reports that are the subject of the complaint between March 1999 and May 2002. Baclet argued that the research reports that Donner issued subsequent to April 1, 2002, were not his responsibility because he had transferred his ownership of Donner to another individual as of April 1, 2002. We disagree. The record shows that in May 2002 Donner sought NASD approval, as required under NASD's Membership Rules, of a transfer in the ownership of Donner from Baclet to another individual. NASD denied Donner's request, and the record does not otherwise support Baclet's assertion that he in fact transferred his ownership interest in Donner as of April 1, 2002. We therefore hold Baclet responsible for all violative Donner research reports.

draft reports, and verified the accuracy of the limited financial information that Donner chose to include in its reports. Uberti admits that, while associated with Donner, he had access to all of Donner's research reports and reviewed at least portions of some of the reports and the entirety of other reports at issue.

During NASD's investigation of Donner, Baclet prepared a document that identified all of the individuals who were responsible for each research report. For each of the research reports alleged as to Uberti, this document identified Uberti as having "worked on" the report or as having reviewed the report for financial, accounting or supervisory purposes. Baclet's document is corroborated by Uberti's own pre-hearing testimony and the pre-hearing testimony of Runyon. Both testified that Uberti reviewed Donner's research reports for compliance with NASD rules, led Donner's research department, and handled research report compliance at Donner.[36]

Other evidence supports our finding regarding Uberti's role at Donner. First, Uberti was authorized by the Firm to identify and recruit issuers for Donner's research business and he in fact recruited some issuers for the Firm. Second, Donner amply compensated Uberti. He received a salary of 50 percent of the revenue generated from the issuers that he helped to cover. Finally, Donner sponsored Uberti to take the principal examination, and Uberti became a general securities principal at Donner on July 17, 2001.

Uberti's efforts to distance himself from responsibility for Donner's research reports is belied by the evidence, including Uberti's own pre-hearing testimony. Uberti was intimately involved in numerous aspects of the reports, including assisting in their distribution to the public. Although he was not the author, Uberti cannot escape responsibility for Donner's research reports. *See Reynolds*, 2001 NASD Discip. LEXIS 17, at *39-40 (holding that respondent could not avoid liability solely because he did not personally make the misleading statements).

In sum, we hold Uberti and Baclet responsible for Donner's research reports and find that they violated Conduct Rules 2110 and 2210 and Section 17(b) of the Securities Act.

4. Cause Three – Donner, Baclet, and Uberti Committed Fraud

We find that Donner's, Baclet's, and Uberti's material omissions and misrepresentations that are the subject of causes one, two, and three of the amended complaint were fraudulently misleading and that respondents acted with scienter.

Section 10(b) of the Exchange Act forbids any person from using or employing, in connection with the purchase or sale of any security, any manipulative or deceptive device or

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[36] Uberti testified that he added financial information to Merrell's draft research reports because "Merrell . . . didn't get too much of the financial part of it. And what he did do, [Uberti] ended up changing anyway." Uberti went on to say that he was responsible for including disclosures, financial information, risk factors, and overall content.

contrivance. SEC Rule 10b-5 prohibits, in addition to nondisclosure and misrepresentation, "any device, scheme, or artifice to defraud" or any practice "which operates or would operate as a fraud or deceit upon any person." 17 C.F.R. § 240.10b-5 (a) and (c). Conduct Rule 2120, NASD's anti-fraud rule, parallels Rule 10b-5, and provides that no member shall effect any transactions, or induce the purchase or sale of any security, by means of any manipulative, deceptive or fraudulent device. The Commission's and NASD's anti-fraud rules are designed to ensure that members of the securities industry fulfill their obligation to the public to be complete and accurate when making statements about securities. *District Business Conduct Committee v. Euripides*, Complaint No. C9B950014, 1997 NASD Discip. LEXIS 45, at *16-17 (NBCC July 28, 1997). In order to establish fraud, we must find that the respondents: (1) made material misrepresentations or omissions (2) in connection with the purchase or sale of a security and (3) acted with scienter. *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1467 (2d Cir. 1996), *cert. denied*, 522 U.S. 812 (1997).[37]

At the outset, we find that Donner's misrepresentations and omissions, for which we have held Baclet and Uberti responsible, were material. As discussed above, the misrepresentations and omissions in Donner's research reports related to key financial and operational facts about the issuers. Donner's misrepresentations and omissions included topics such as the financial health of the issuers, the amount and availability of the issuers' working capital, the issuers' business prospects and level of competition, the viability of the products or services that the issuers offered, the issuers' operating histories, the issuers' prospects for future growth, and litigation risks that the issuers faced. Most importantly, Donner's research reports omitted that the issuers were the subjects of going concern opinions from the issuers' auditors, suggesting that the issuers' continued existence was in substantial doubt. Across the board, Donner's research reports excluded critical information. It is axiomatic that a reasonable investor would view this information as altering the total mix of information available. *See In re Time Warner, Inc. Sec. Litig.*, 9 F.3d 259, 267-68 (2d Cir. 1993); *SEC v. Murphy*, 626 F.2d 633, 653 (9th Cir. 1980); *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 849 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969). We find that respondents' misrepresentations and omissions in Donner's research reports were material.

We also find that these misrepresentations and omissions were made in connection with the purchase or sale of a security. The Supreme Court has construed the "in connection with" requirement broadly. *See Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 12 (1971). The fraudulent device employed need only be "of a sort that would cause reasonable investors to rely thereon" in connection with the decision to buy or sell a security. *Texas Gulf Sulphur Co.*, 401 F.2d at 860. Based on this standard, respondents' representations in Donner's

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[37] Violations of Section 10(b) and Rule 10b-5 also must involve the respondent's use of any means or instruments of transportation or communication in interstate commerce, or the mails, or any facility of any national securities exchange. Respondents do not dispute that they communicated with issuers, customers and other members of the public through the use of telephone lines and the U.S. mail service, thereby satisfying this requirement. *Hasho*, 784 F. Supp. at 1106 (S.D.N.Y. 1992).

research reports were made in connection with the purchase or sale of a security. Donner's research reports were intended to raise investors' awareness about the issuers covered in the reports.[38] Indeed, Donner's ultimate goal was to encourage investors to purchase the stock. We conclude that the facts of this case satisfy the "in connection with" requirement.

We also find that respondents acted with scienter. Scienter is the "intent to deceive, manipulate or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976). Scienter also may be established by a showing that a respondent acted recklessly. *Dane S. Faber*, Exchange Act Rel. No. 49216, 2004 SEC LEXIS 277, at *19 (Feb. 10, 2004). Recklessness is an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers and sellers that is either known to the defendant or is so obvious that the actor must have been aware. *Howard v. Everex Sys., Inc.*, 228 F.3d 1057, 1063 (9th Cir. 2000); *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1569 (9th Cir. 1990). Based on the evidence, we find that Baclet and Uberti were reckless and that the record therefore supports a finding of scienter.

a. Baclet Acted Recklessly

As president and owner of Donner, Baclet accepted ultimate responsibility for Donner's research reports. Donner's written supervisory procedures listed Baclet as the individual with primary responsibility for oversight of the Firm's issuance of research reports. Baclet's conduct was reckless because, instead of reviewing Donner's research reports and the issuers' financial documents himself or delegating the task to a qualified individual, he instead chose to remain ignorant as to the contents of Donner's research reports, delegated drafting and editing responsibilities to unqualified individuals, and allowed Donner to publish only positive-leaning reports.

Baclet testified that he read relatively few of Donner's research reports, and he conceded that he should have been more attentive to compliance concerns. He also did not review the issuers' financial filings, all of which were readily available to him. He relied instead on brief oral summaries that Uberti provided to him on an inconsistent basis. Baclet contends that he had in place a reasonable system for compliance, but the evidence contradicts Baclet's claims. Baclet relied on Merrell, an unregistered individual who was not employed by Donner and who had no experience writing research reports, to prepare the majority of Donner's research reports.[39] Baclet claimed to view the preparation of Donner's research reports as a team effort and contended that Uberti was part of the team. Uberti, however, was not registered as a

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[38] Baclet testified that Donner's agreements with issuers sometimes obligated Donner to talk to potential investors and answer questions regarding the issuers. Some of Donner's agreements with issuers also included clauses whereby Donner received additional remuneration if one of its research reports resulted in an increase in the price of an issuer's stock.

[39] Merrell testified that his only training for writing Donner's research reports was Baclet's direction to him to copy the positive tone and writing style contained in a sample report. Merrell admitted that he did not even know what a going concern opinion was.

principal until July 17, 2001, a date well after the issuance of Donner's 25 research reports. Indeed, Baclet was the only registered principal with responsibility for reviewing and approving Donner's research reports, but he rarely read the reports and ignored the issuers' financial information.

Baclet relied heavily on a group of individuals to whom he referred as his "legal and compliance department." In reality, however, Donner's legal and compliance department was woefully deficient. Baclet staffed the department with individuals who had little or no industry experience, many of whom were law students or had completed law school recently, but had not been admitted to a state bar. Saddler, a key member of Baclet's compliance department, was identified on Baclet's list of individuals who reviewed Donner's research reports. Saddler was an unregistered individual who possessed a law degree, but was not admitted to practice law in any state. A compliance consultant who reviewed Donner's compliance procedures in June 1999 warned Baclet that Saddler was an ineffective compliance person because he was disorganized and unfamiliar with NASD rules. This warning did not deter Baclet from relying on Saddler to conduct a review of many of the research reports at issue in this case.

Baclet also created an atmosphere at Donner whereby only glowing research reports were acceptable. Baclet readily acknowledged Donner's incentive to produce only positive reports. He stated: "[w]ho is going to pay for a negative report?" Rhee testified that Baclet named him the "Liberator" because Rhee tried to provide honest portrayals of issuers' negative attributes in research reports. Rhee and Merrell testified consistently that negative coverage was not welcome in Donner's research reports. Baclet knew or should have known that the issuers covered by Donner's research reports were small-cap companies with little operating history. Many of the issuers faced significant financial hurdles, regulatory challenges, and stiff competition from better-situated companies. The securities that Donner covered were speculative at best and posed significant risks for potential investors.[40] These facts notwithstanding, Baclet's sole focus at Donner was to pump out positive research reports full of grandiose predictions.

Baclet was a seasoned securities professional with many years of experience. As president of Donner, he was in a position to dictate the contents and quality of Donner's research reports. Instead, he ignored the contents of the reports, relied on unregistered and inexperienced individuals to draft and edit the reports, and disregarded even the most rudimentary standards of quality assurance. We find that his conduct was reckless. *Cf. Coastline Fin., Inc.*, 54 S.E.C. 388, 394 (1999) (finding that the sole owner of a broker-dealer who was in a position to determine the content of promissory notes and how the notes would be sold to investors acted recklessly by allowing inaccuracies of which he was unaware to be included in the notes).

b. Uberti Acted Recklessly

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[40] *See Clinton Hugh Holland*, 52 S.E.C. 562, 565 n.16 (1995), *aff'd*, 105 F.3d 665 (9th Cir. 1997) (holding that securities of development-stage companies with limited operating history and no profitability are speculative).

Uberti reviewed in some capacity most of the research reports that Donner issued, had access to the issuers' financial filings, and had authority to revise the research reports before issuance. We find that Uberti was reckless in that he failed to ensure that Donner's research reports did not contain misrepresentations and omit material information.

Uberti argues that he did not act recklessly because he relied on Baclet to review the research reports. Uberti notes that the Hearing Panel found that his reliance on Baclet was reasonable and considered this fact in mitigation of sanctions. We do not agree. Uberti was a registered person assigned to review and revise Donner's research reports. As a registered person in the securities industry, he had a duty to comply with applicable laws, and that duty cannot be avoided by reliance on an employer. *Richard H. Morrow*, 53 S.E.C. 772, 779 n.10 1998); *see Dep't of Enforcement v. Faber*, Complaint No. CAF010009, 2003 NASD Discip. LEXIS 3, at *31 (NAC May 7, 2003), *aff'd*, 2004 SEC LEXIS 277 (Feb. 10, 2004) (finding that registered principal acted recklessly when he relied on due diligence conducted by his employer and provided misleading information to his customers). As a registered person at Donner with responsibility for and access to Donner's research reports, Uberti had an independent duty to ensure that the information in the reports was not misleading and that material information was not omitted. *See Faber*, 2004 SEC LEXIS 277, at *21.

Independent of Uberti's overall duties as a registered person, Uberti's specific responsibilities at Donner included conducting a review of Merrell's draft research reports. Uberti knew that Merrell had limited experience in drafting reports, and Uberti had access to all of the issuers' financial filings and other information from the issuers. Uberti acknowledged during on-the-record testimony before NASD staff the importance of including accurate financial information and going concern opinions in research reports. He testified that he specifically focused on financial information and going concern opinions when reviewing Donner's research reports. Yet, Uberti made no attempt to halt the issuance of research reports at Donner that included little financial information, soft-pedaled negative information regarding issuer operations, and failed to disclose the existence of going concern opinions. Uberti ignored the plethora of negative information contained in the issuers' financial filings and allowed exceedingly positive reports to continue through the issuance process at Donner. "[Uberti had] a duty to [Donner's] customers to have a reasonable basis for his [and the Firm's] recommendations and to avoid 'recklessly stat[ing] facts about matters of which he [was] ignorant.'" *Donald T. Sheldon*, 51 S.E.C. 59, 71 (1992), *aff'd*, 45 F.3d 1515 (11th Cir. 1995).

Uberti held his finger on the pulse of Donner's research department.[41] He reviewed the reports, he had access to the issuers' financial filings and other information regarding the issuers, and he knew that the corporate culture at Donner stressed the importance of positive reports. He

[41] Runyon in fact testified that Uberti was "in charge" of the research department. Runyon stated in on-the-record testimony before NASD staff that Uberti "probably had his hands on the research reports more than anyone else in the compilation and coordination of putting the report[s] together."

acted recklessly when he turned a blind eye to the misleading nature of the reports and the material information omitted from the reports and enabled Donner to issue materially misleading research reports. *Cf. Dep't of Enforcement v. Golub*, Complaint No. C10990024, 2000 NASD Discip. LEXIS 14, *20 (NAC Nov. 17, 2000) (finding that registered representative acted recklessly when he ignored negative information contained in firm files and failed to inform firm customers of such information); *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1471 (2d. Cir. 1996), *cert. denied*, 522 U.S. 812 (1997) (finding that primary liability for fraud may be imposed not only on person who made the fraudulent misrepresentation, but also on those who had knowledge of the fraud and assisted in its perpetration).

* * *

We find that Baclet and Uberti acted recklessly. We thus find that Donner, through Baclet and Uberti, issued fraudulently misleading research reports, in violation of Conduct Rule 2120, Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5, as alleged in cause three of the complaint.

5. Cause Six – Donner and Baclet Failed to Provide for Principal Approval of Sales Literature

Rule 2210(b)(1) requires that a registered principal approve by signature or initial and date each item of sales literature before its use.[42] Donner issued the research reports at issue in this case during the period between March 1999 and May 2002, yet neither Baclet nor any other principal at Donner signed or initialed and dated the reports. During the period at issue, Baclet was president of and a registered principal at Donner. The Firm's supervisory procedures identified Baclet as the responsible supervisor for the Firm's advertisements and sales literature.

We thus find that Donner, through Baclet, issued research reports without ensuring that Baclet or another principal at Donner approved the reports, thereby violating Rules 2110 and 2210(b)(1).

6. Cause Seven – Donner and Baclet Failed to Establish, Maintain and Enforce Adequate Written Supervisory Procedures

Conduct Rule 3010(b)(1) provides that member firms must "establish, maintain, and enforce written procedures to supervise the types of business in which [they engage] and to supervise the activities of registered representatives and associated persons [reasonably] to achieve compliance with applicable [rules] ." We find that Donner, acting through Baclet, failed to establish, maintain and enforce adequate written supervisory procedures related to the Firm's preparation and issuance of research reports, in violation of Conduct Rules 2110 and 3010.

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[42] Rule 2210(a)(2) defines sales literature to include research reports.

Donner's 1999 and 2001 written supervisory procedures were deficient. Although the procedures identified Baclet as the principal with primary responsibility for research reports and advertisements, the written procedures contained no guidance with respect to the preparation of research reports or details on how the supervisor should carry out his supervisory review of research reports. Instead, Baclet relied on a "worksheet" system to shepherd the research reports through necessary compliance checks. The worksheets, however, were nothing more than administrative checklists that included entries such as "fax invoice," "check mailed," and "e-mail contract." The entries related to ensuring that Donner received payment for its work, not to ensuring compliance with NASD rules.

Baclet also relied on a group to which he referred as his "legal and compliance" team. In reality, the group consisted of unregistered individuals with little or no industry experience or knowledge, many of whom were law student interns or individuals who had completed law school but had not been admitted to a state bar.

Finally, Donner did not provide appropriate training to the individuals that were involved with the preparation and issuance of Donner's research reports. Merrell and Rhee, the individuals who actually prepared first drafts of Donner's research reports, received no training. They were not given written procedures on drafting research reports and were reduced to using old Donner research reports for guidance. Despite performing a supervisory review of many of Donner's research reports, Uberti similarly testified that he never received a written supervisory procedures manual while employed at Donner.

We find that Donner, through Baclet, failed to establish, maintain and enforce adequate written supervisory procedures related to research reports and violated Rules 2110 and 3010.

B. Causes Eight Through 11 (Lincoln Research Reports)

1. Causes Eight, Nine and 11 – Uberti and Runyon Prepared and Issued Two Research Reports that Contained Misleading Misrepresentations and Omitted Material Information

We find that Uberti and Runyon violated NASD Conduct Rules 2110 and 2210(d)(1)(A) and (B) in connection with two research reports involving Dtomi, Inc. ("DTMI") and The Majestic Companies, Ltd. ("MJXC") that were prepared and issued by Uberti and Runyon under Lincoln's name.[43]

NASD Conduct Rule 2210 requires that sales literature, including research reports, be based on principles of fair dealing and good faith, be fair and balanced, and provide a sound basis for evaluating the facts in regard to the particular securities discussed. The rule further

[43] Neither Runyon nor Uberti denied his responsibility for drafting the DTMI and MJXC research reports. They own Lincoln, which is not an NASD member, equally and issued the reports under Lincoln's name.

provides that no member may omit a material fact if the omission would cause the communication to be misleading and prohibits members from making false, exaggerated, unwarranted, or misleading statements in communications with the public.[44] We find that the DTMI and MJXC research reports failed to meet these standards.

We turn first to the research report for DTMI – a speculative buy issued October 30, 2001.[45] Uberti and Runyon misstated or omitted material facts in this research report. Uberti's and Runyon's most glaring omission was their failure to disclose that the most recent audit opinion for Copper Valley, DTMI's predecessor company, contained a going concern clause. They also excluded from the report the auditor's underlying concerns about the issuer's financial condition.[46]

The DTMI research report included other omissions as well. The most recent financial filings with the SEC for Copper Valley indicated that the issuer had a limited operating history, had not achieved revenues or earnings from operations, held no significant assets or financial resources, and required immediate additional financing to enable it to continue as an operating entity. The financial filings further reported that Copper Valley anticipated incurring continued net operating losses until the shell company located and acquired a new business opportunity.

Uberti and Runyon argue that, because the negative financial information related to Copper Valley, DTMI's pre-reverse merger predecessor company, they did not need to disclose it in DTMI's research report. In support, they assert that post-reverse merger, DTMI would have a new board, new products, and improved finances. We reject this argument. The merger had not actually closed as of the date of the research report and in fact did not close for two additional months. In any event, we believe that information on both the potential merger candidate and the pre-merger company is crucial to an investor's decision. *See French*, 52 S.E.C. at 863 (finding material financial information regarding an issuer and the company that planned to acquire the issuer); *Murphy*, 626 F.2d at 653 (finding material information relating to an issuer's financial condition, solvency, and profitability).

Notwithstanding the significant negative financial information disclosed in Copper Valley/DTMI's most recent financial filings, Uberti and Runyon nonetheless described DTMI as poised to become an industry leader. Uberti and Runyon stated that DTMI was "positioned to

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44 *See* Rule 2210(d).

45 Copper Valley Minerals, Ltd. ("Copper Valley") was DTMI's predecessor company. At the time when Uberti and Runyon issued the DTMI report, International Manufacturers Gateway, Inc. ("IMG"), a privately held company, intended to acquire Copper Valley in a reverse merger and change Copper Valley's name to DTMI. The reverse merger closed in December 2001, approximately two months after the issuance of the DTMI research report.

46 DTMI and IMG did not have audited financial filings. Only DTMI's predecessor company, Copper Valley, had audited financial filings.

become the low cost compiler, low cost seller and low cost distributor of data, market intelligence, leads generation and prospect management." They boasted that one of DTMI's products, the Market Intelligence Report, was expected to generate $800,000 in the first 12 months of operations. The most recent Copper Valley Form 10-K, however, revealed a limited operating history and no revenues or earnings from operations. The Form 10-K contained no support for Uberti's and Runyon's claims in the research reports. The DTMI research report stated that the reverse merger with IMG would close by November 12, 2001 when, in fact, Copper Valley's financial reports stated that November 12 was the earliest possible closing date. (The merger closed in December 2001.) The DTMI research report also stated that after the reverse merger, the company was expected to generate "immediate revenues" and "significantly enhance shareholder value." The DTMI research report touted DTMI's aggressive expansion and growth strategy and stated that, "by developing a revolutionary method to transform manufacturing data into market intelligence, [DTMI] has positioned itself to significantly impact the $4 billion market intelligence industry." Nothing in Copper Valley's financial reports supported these statements. Copper Valley/DTMI's Form 10-Q filed September 14, 2001 (one month before Uberti and Runyon issued the research report), reported total cash holdings of $365 and stated that the company would require additional financing to support its post-merger operations.[47] We find that Uberti and Runyon misrepresented DTMI in their research report.

We turn next to Uberti's and Runyon's coverage of MJXC. On August 30, 2001, Uberti and Runyon issued a speculative buy recommendation for MJXC that excluded pertinent information regarding the financial health of MJXC. Most strikingly, we find that the research report neglected to disclose the existence of an auditor's going concern opinion and the underlying reasons for that opinion.[48] MJXC's most recent Form 10-K identified MJXC as a development-stage company that was subject to risks going forward and stated that, to date, MJXC's operations had not generated sufficient earnings to cover the cost of operations. The Form 10-K also stated that the MJXC management team had no direct operating experience in the manufacture of modular buildings and no direct operating experience in the transportation safety product industry – two lines of business that MJXC intended to pursue. Uberti and Runyon failed to disclose any of these reported facts in the MJXC research report. Also omitted from the research report was certain negative financial information, such as that the company had incurred a net loss of $5,815,893 during the year ended December 31, 1999, that the

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[47] Uberti acknowledged that the risks associated with buying DTMI were not specifically disclosed in the DTMI research report. He stated, however, that a sophisticated and accredited investor, which is the type of investor that Lincoln hoped to attract to its website, would understand the risks without their being specifically disclosed. The Lincoln website was available to the public, however, and Uberti and Runyon had no way of ensuring that only "sophisticated and accredited investors" viewed their research reports.

[48] Before the Hearing Panel, Uberti contended that for penny stocks, such as MJXC, the existence of a going concern opinion is assumed. In on-the-record testimony, however, Uberti claimed that excluding a reference to the MJXC going concern opinion was an oversight and not intentional.

company's liabilities exceeded its assets by $1,449,524 as of December 31, 2000, and that a substantial portion of the company's assets as of that date were illiquid. Also absent from the research report was MJXC's reported accumulated deficit of $14,091,889 as of June 30, 2001.

MJXC's financial filings also disclosed that the company had significant competition from approximately 19 other companies currently building modular structures in the state in which MJXC intended to operate and that the competitors had capital and resources that exceeded those of MJXC. MJXC also reported in its financial filings that it had been named in three legal proceedings seeking a total of $707,000 in damages. Uberti and Runyon failed to include any of these facts in the MJXC research report.[49]

In addition to omitting material facts, Uberti and Runyon also included exaggerated and misleading statements in the MJXC research report. In the face of significant negative financial information, Uberti and Runyon stated in the MJXC research report that MJXC had "significant upside potential" and was "well positioned for growth." The research report touted that MJXC was quickly becoming a recognized leader in its field and that it was well positioned to deliver winning solutions on all fronts. MJXC's most recent Form 10-K, however, stated that MJXC was a development-stage company and that MJXC's operations had not generated sufficient earnings to cover the cost of operations. The report characterized MJXC as a market leader, but the Form 10-K reported that MJXC faced significant competition. Given MJXC's financial and operational status, we find that Uberti and Runyon misrepresented MJXC in their research report.

Uberti's and Runyon's misrepresentations and omissions in the DTMI and MJXC research reports were material. The DTMI and MJXC research reports misrepresented and omitted facts related to the issuers' financial condition, viability as a going concern, profit potential and business prospects. Uberti and Runyon argue that going concern opinions are "forward looking" and therefore not material. We disagree. The materiality of information relating to financial condition, solvency, and profitability is not subject to serious challenge. *See SEC v. United Fin. Group, Inc.*, 474 F.2d 354, 358 n.9 (9th Cir. 1973); *SEC v. Universal Serv. Ass'n*, 106 F.2d 232, 239 (7th Cir. 1939), *cert. denied*, 308 U.S. 622 (1940).

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[49] Uberti testified that he did not view competition as particularly material because all companies, regardless of their line of business, have some competition. Uberti and Runyon also contend that MJXC had two lines of business – safety products and modular buildings – and that MJXC's main competition related to its modular building industry, which it intended ultimately to spin off. This, they state, made MJXC's competition information less relevant. Uberti testified that he did not include information on pending lawsuits in the research report because the principals of MJXC represented to him that they expected the litigation to be resolved. If Uberti and Runyon believed that certain factors mitigated the competition and litigation disclosures in MJXC's financial filings, they could have disclosed the competition and litigation facts in the research report and also included their opinions as to the degree of weight that investors should give those facts. Instead, they excluded all references to the information.

Uberti and Runyon also contend that their inclusion in the DTMI and MJXC research reports of hyperlinks to financial filings on the SEC's EDGAR website is sufficient disclosure of the issuers' negative financial information. As noted above, we previously have rejected this argument. *See Reynolds*, 2001 NASD Discip. LEXIS 17, at *36.

Uberti and Runyon also argue that they relied on member firm Lloyd's compliance department to alert them to problems with the DTMI and MJXC research reports and that they therefore are not responsible. We disagree. First, we note that Uberti testified on the record that Lloyd did not conduct a content review of Lincoln's research reports. Furthermore, Runyon and Uberti were registered professionals when they issued the DTMI and MJXC reports. As registered professionals in the securities industry, and the authors of the research reports, Uberti and Runyon are responsible for their content. *See Larry Ira Klein*, 52 S.E.C. 1030, 1034 (1996) (finding that registered securities professional is responsible for a bond list that he drafted irrespective of whether his supervisors approved of it).

Uberti and Runyon also argue that the DTMI and MJXC reports contain suggestions of caution. They contend that their use of the word "speculative" in connection with the buy recommendation and the inclusion of negative financial information on the cover pages of the research reports were sufficient to alert investors to the speculative nature of the investments. Respondents argue that, in any event, a reasonable investor would never rely solely on a research report to make an investment decision and that reasonable investors should conduct their own due diligence. We do not agree with respondents' assessment. First, we note that the DTMI and MJXC research reports do not define "speculative buy" or provide readers with any particular explanation that would serve to offset positive statements included in the reports. Furthermore, the minimal amount of negative information and concrete facts that Uberti and Runyon included on the cover pages of the reports hardly offset the many superlatives included in the reports. In both reports, the initial block of financial information on the cover page and the "financial" section inside the reports each contained a minimal amount of factual financial information, some of which was negative. The remainder of the documents and the cover pages included grandiose commentary, such as, "significant upside potential, "cutting edge solutions," "unique, high-demand service," and " well positioned for growth." In both research reports, the "rationale for investment," "strategic overlook," "competition," and "corporate overview" sections were replete with inflated predictions and glowing claims. Sales literature must "disclose in a balanced way the risks and rewards of the touted investments." *Fertman*, 51 S.E.C. at 950. On balance, we do not find that Runyon's and Uberti's recommendation of "speculative" buy, coupled with the actual content of the research reports, offered readers a fair and balanced portrayal of DTMI and MJXC.

We find that Uberti and Runyon omitted material facts and included materially misleading misrepresentations in the DTMI and MJXC research reports, and that by doing so they violated Conduct Rules 2110 and 2210(d)(1)(A) and (B).[50]

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[50] The amended complaint alleged as a separate cause of action (cause 11) that respondents' conduct constituted independent violations of Rule 2110 distinct from their violations of Rule

[Footnote continued on next page]

2. Cause Ten – Uberti and Runyon Committed Fraud

We find that Uberti's and Runyon's material misrepresentations and omissions in the DTMI and MJXC research reports were fraudulently misleading and that respondents acted with scienter.

Section 10(b) of the Exchange Act, Rule 10b-5 and Conduct Rule 2120 prohibit the use of manipulative, deceptive or fraudulent devices in the sales of securities. In order to find fraud, we must find that the respondents: (1) made material misrepresentations or omissions (2) in connection with the purchase or sale of a security and (3) acted with scienter. *First Jersey Sec., Inc.*, 101 F.3d at 1467.[51]

First, we find that Uberti's and Runyon's misrepresentations and omissions in the DTMI and MJXC research reports were material. Uberti's and Runyon's misrepresentations and omissions related to DTMI's and MJXC's finances, profitability, business operations, products, competition, and, most importantly, the issuers' abilities to continue as going concerns. Utilizing the "reasonable investor" test, we find that a reasonable investor would consider this type of information – relating to an issuer's profitability, solvency, future business prospects and financial condition – material. *See French*, 52 S.E.C. at 863 n.19 (holding that one cannot successfully challenge the materiality of information about the financial condition, solvency, and profitability of the entity responsible for the success or failure of an enterprise); *Cohen v. Prudential-Bache Sec.*, 713 F. Supp. 653, 658 (S.D.N.Y. 1989).

We also find that Uberti's and Runyon's misrepresentations and omissions were made in connection with the purchase or sale of a security. *See Bankers Life & Cas. Co.*, 404 U.S. at 12. Uberti and Runyon formed Lincoln when they left Donner specifically for the purpose of drafting research reports on small-cap issuers to broaden the issuers' exposure. The general purpose of Lincoln's reports was to make investors aware of the covered issuers. They intended for Lincoln's research reports to serve as vehicles for improving investor awareness and

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2210. We agree. Uberti and Runyon produced two research reports that did not provide a fair and balanced portrayal of the covered issuers. Instead, the research reports were replete with positive catch phrases that were not supported by underlying facts and omitted material negative information. We conclude that Uberti's and Runyon's issuance of misleading research reports contravened high standards of commercial honor and just and equitable principles of trade and therefore violated Rule 2110. *Cf. Reynolds*, 2001 NASD Discip. LEXIS 17, at *42.

[51] Uberti and Runyon communicated with issuers, customers and other members of the public through the use of telephone lines and the U.S. mail service, thereby satisfying the interstate commerce requirement for Section 10(b) and Rule 10b-5. *See Hasho*, 784 F. Supp. at 1106.

ultimately providing more investors for the issuers. We conclude that the DTMI and MJXC research reports meet the "in connection with" requirement.

We also find that Uberti and Runyon acted with scienter by recklessly misleading readers of their research reports.[52]

We find that Uberti and Runyon were reckless in their preparation and dissemination of the DTMI and MJSX research reports because: (1) they relied on an unregistered and inexperienced person to draft the research reports; (2) they had access to and reviewed negative financial information about the issuers but did not include that information in the research reports; and (3) they had little or no compliance procedures in place to ensure that the research reports were fair and balanced.

Merrell had no previous experience in drafting research reports (except for the reports he had drafted at Donner) and Uberti and Runyon offered him no training or guidelines to follow. He drafted his research reports based on a template that he had obtained from an outdated Donner research report. Merrell used similar blanket statements in all of his research reports, such as, "upside potential" and "well positioned for growth." Merrell testified that he did not include references to going concern opinions in research reports because he was not even certain what it meant for an issuer to be the subject of a going concern opinion. Merrell had little experience and no specialized knowledge or training, yet Uberti and Runyon relied on him to draft Lincoln research reports. We find that Uberti's and Runyon's reliance on Merrell to draft the DTMI and MJXC research reports was reckless.

Moreover, Runyon and Uberti reviewed or had available for review financial documents, investor packages, press releases, and other materials related to DTMI and MJXC. They were aware that each issuer had been the subject of going concern opinions, was development-stage, had limited operating history, and faced significant financial hurdles. Yet neither Runyon nor Uberti felt compelled to include this information in a meaningful way in the research reports to balance out the upside potential and promises of prosperity that were included. Indeed, both Runyon and Uberti seem to subscribe to the philosophy that investors should not rely on their research reports alone to make investment decisions and that investors must conduct their own due diligence. "A broker may not satisfy [the obligation to make full disclosure of all material facts] by pointing to bits and pieces of information that appeared in the media or elsewhere and were never brought to the customer's attention." *Richmark Capital Corp.*, Exchange Act Rel. No. 48758, 2003 SEC LEXIS 2680, at *22-24 (Nov. 7, 2003). We find that Uberti and Runyon acted recklessly when they included slanted and incomplete information in the DTMI and MJXC reports.

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[52] Scienter is the "intent to deceive, manipulate or defraud," *Hochfelder*, 425 U.S. at 193, and may be established by a showing that a respondent acted recklessly. *Faber*, 2004 SEC LEXIS 277, at *24.

As registered representatives in the securities industry, Uberti and Runyon had a duty to comply with applicable laws and to ensure that the information in the DTMI and MJXC research reports was not misleading or incomplete. By failing to do so, they acted recklessly. *Faber*, 2004 SEC LEXIS 277, at *21. We conclude that Uberti and Runyon acted recklessly in their preparation and dissemination of the DTMI and MJXC research reports. As equal partners and co-owners of Lincoln, Uberti and Runyon shared responsibility equally for Lincoln's research reports. We thus find that the DTMI and MJXC research reports were fraudulently misleading, and Uberti and Runyon violated Conduct Rule 2120, Section 10(b) of the Exchange Act, and Exchange Act Rule 10b-5.

C. Procedural Arguments

Respondents raise several arguments concerning the process afforded them during the hearing below. We address each argument in turn.

Uberti and Runyon argue that the Hearing Panel erred in denying their motion to sever the portion of these proceedings dealing with the DTMI and MJXC research reports from the portion of the proceedings dealing with the Donner research reports. Uberti and Runyon moved to sever causes eight through 11, concerning the Lincoln research reports, from causes one through seven, concerning the Donner research reports, for fear that they would be prejudiced by their former association with Donner. The Hearing Panel denied the motion, but divided the hearing below into two phases. The parties presented evidence with respect to causes eight through 11 on days one and two of the hearing. The Hearing Panel deliberated and decided this portion of the case before proceeding with the remainder of the case. The parties presented evidence with respect to causes one through seven during the remainder of the hearing. We reject Uberti's and Runyon's argument. NASD Procedural Rule 9214 states that, when a party files a motion to sever a proceeding, the Chief Hearing Officer will rule on the motion and shall consider: (1) whether the same or similar evidence reasonably would be expected to be offered at each of the possible hearings; (2) whether the severance would conserve the time and resources of the parties; and (3) whether any unfair prejudice would be suffered by one or more parties if the severance is or is not ordered.

In this case, testimony from Merrell, Uberti, and Runyon would have been duplicated at both hearings if the matters had been bifurcated. Furthermore, certain items of documentary evidence, such as on-the-record testimony and Central Registration Depository reports also would have been duplicated. Additionally, Uberti and Runyon met at Donner and published the DTMI and MJXC reports shortly after leaving Donner. Both testified that many of the practices that they followed for drafting and issuing research reports were established while Donner employed them both. Thus, information about Donner's practices was relevant to both portions of the case and would have been offered as to the DTMI and MJSC portion of the case regardless of whether it was severed from the Donner portion of the case. As a result, severance would not have conserved time or resources and in fact duplicate evidence would have been offered at both hearings.

Uberti and Runyon claim that their association with Donner may have tainted them and that this may have prejudiced them in the portion of the case dealing with the DTMI and MJXC

reports. They offer no evidence of any such prejudice. In any event, their association with Donner is part of their employment history and is included in the Central Registration Depository, regardless of whether severance was granted or denied. Furthermore, they based their business methods at Lincoln on the methods that they had learned at Donner and they, like Donner, relied on Merrell to draft research reports. Thus, severance would not have protected them from having to acknowledge their association with, and conduct at, Donner. We do not find that the Hearing Panel erred in denying Uberti's and Runyon's motion for severance. *Cf. Carlton Wade Fleming*, 52 S.E.C. 409, 413 (1995) (finding that NASD frequently holds disciplinary hearings involving multiple respondents, particularly where the complaint raises common questions of law and fact). We reject Uberti's and Runyon's claim of error.

Donner, Baclet, Uberti and Runyon also argue that the complaint contained insufficient detail to place them on notice as to the allegations against them. NASD Procedural Rule 9212 requires that the complaint specify in reasonable detail the conduct alleged to constitute the violative activity and the rule, regulation, or statutory provision that respondent is alleged to have violated. Section 15A of the Exchange Act provides, in pertinent part, that NASD is required to notify a respondent of, and give him an opportunity to be heard upon, the specific charges against him. Early in this proceeding, respondents requested that Enforcement be required to supplement the complaint with detailed information regarding the allegations. The Hearing Panel required Enforcement to supplement the complaint, and Enforcement thereafter filed Exhibits A and B and Schedule 1 to the complaint. Exhibits A and B and Schedule 1: (1) identify, with respect to each respondent, which research reports (by issuer, issuance date, trading symbol and recommendation) were alleged to have violated NASD rules and the securities laws; (2) list specific information alleged to have been omitted from the research reports; and (3) identify the specific sentences or paragraphs of each report that were alleged to have included misrepresentations. Enforcement served on the respondents Exhibits A and B and Schedule 1 to the complaint well in advance of the September 2003 Hearing Panel hearing.[53] "A complaint is alleged in reasonable detail when it provides a respondent sufficient notice to understand the charges and adequate opportunity to plan a defense." *District Business Conduct Committee v. Michael Euripides*, Complaint No. C9B950014, 1997 NASD Discip. LEXIS 45, at *10 (NBCC July 28, 1997). We find that respondents had adequate notice of and opportunity to defend against the allegations against them.

Finally, Uberti and Runyon argue that, because Lloyd was not named as a party to this proceeding, they were not able adequately to defend themselves against the DTMI and MJXC allegations. We disagree that Uberti's and Runyon's defenses were compromised in any way by the fact that Enforcement did not name Lloyd as a party to this proceeding. Procedural Rule 9252 establishes the procedures for a party to a disciplinary proceeding, such as Uberti or Runyon, to request that NASD invoke its authority under Rule 8210 to compel the production of

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[53] Enforcement filed an amended complaint in October 2002, which included Exhibits A and B. Subsequently, in March 2003, Enforcement supplemented the amended complaint with Schedule 1, which identified specific alleged omissions and quoted passages from the research reports that were alleged to have included misrepresentations.

documents or testimony from member firms or associated persons. Thus, if Uberti and Runyon felt that the testimony of individuals associated with Lloyd or documents from Lloyd would assist in their defense, they could have followed the procedures established in Rule 9252 to obtain NASD's assistance in obtaining that information. They did not. We do not find that Runyon and Uberti were prejudiced.

We reject respondents' procedural arguments and find that NASD afforded respondents a full and fair opportunity to defend themselves in this matter.

V. Sanctions

For violations related to the Donner research reports, the Hearing Panel expelled Donner from membership, barred Baclet in all capacities, and suspended Uberti for two years and fined him $20,000. For Uberti's and Runyon's violations related to the DTMI and MJXC research reports, the Hearing Panel suspended them for six months, fined them $20,000 each, and required that they requalify before acting as registered representatives or principals.[54] We affirm the sanctions in part and modify in part as detailed below.

A. Donner Research Reports

We affirm the Hearing Panel's expulsion of Donner and bar of Baclet. For the violations related to the Donner research reports, we eliminate the two-year suspension and $20,000 fine as to Uberti and instead bar Uberti in all capacities.

We turn first to the applicable NASD Sanction Guidelines ("Guidelines"). The Guidelines recommend that we consider whether: respondents engaged in numerous acts or a pattern of misconduct; respondents engaged in misconduct over an extended period of time; respondents acted recklessly; respondents' misconduct resulted in the potential for monetary gain; and respondents' sales literature was widely circulated.[55] Here, respondents produced nearly 50 research reports that omitted material information, included exaggerated and unsubstantiated claims, and failed to disclose information required under NASD's rules and the federal securities laws. Respondents' violations occurred during a period spanning several years, and Donner's research reports were accessible to all members of the public on Donner's website. Particularly troubling to us is Baclet's and Uberti's apparent belief that, provided they included in the research reports hyperlinks to the issuers' financial filings, buyers were "on notice" of auditors' going concern opinions. Their argument suggests that they could make any

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[54] The Hearing Panel also assessed costs of $13,881.69 as follows: $6,331.72 jointly and severally as to Donner and Baclet; $5,090.12 as to Uberti; and $2,459.85 as to Runyon. We affirm the Hearing Panel's assessment of costs.

[55] *See* Guidelines (2001 ed.) at 9-10 (Principal Considerations in Determining Sanctions), 88 (Communication with the Public – Late Filing; Failing to File; Failing to Comply with Rule Standards or Use of Misleading Communications).

statement or omit any material fact in their research reports and not be held accountable if they also included the hyperlink in the reports. This, in our view, suggests that neither appreciates the gravity of his misconduct. On appeal, Uberti argued that investors who buy penny stocks should know enough to exercise caution and that they should realize that the issuers' financial statements might contain negative information not included in research reports. This suggests that Uberti essentially held his clients to a higher standard than he held himself. Uberti's position also suggests to us that his continuance in the securities industry could pose a risk to the investing public.

Respondents produced misleading research reports in exchange for a fee and at the expense of the average investor. Respondents' actions were reckless and contrary to industry standards. We find their misconduct to be so egregious that we conclude that expulsion of the Firm and a bar of Baclet and Uberti is necessary in order to protect the investing public.

The Guideline for use of misleading communications with the public states that, in cases such as this involving numerous acts of intentional or reckless misconduct over an extended period of time, consider suspending the firm and responsible individuals or expelling the firm and barring the responsible individuals.[56] The Guideline for misrepresentations or omissions of fact states that, in egregious cases of intentional or reckless misconduct, consider barring the responsible individuals and expelling the firm.[57] The sanctions that we impose fall squarely within these guidelines.

Thus, we expel Donner and bar Uberti and Baclet for their violations as alleged in causes one through five of the amended complaint. In light of our imposition of these sanctions, like the Hearing Panel, we have not imposed any additional sanctions for Donner's and Baclet's failure to obtain principal approval of research reports and maintain adequate supervisory procedures as alleged in causes six and seven of the amended complaint.

B. DTMI and MJXC Research Reports

For their actions with respect to the DTMI and MJXC research reports, the Hearing Panel fined Uberti and Runyon $20,000 each, suspended them each for six months, and required that they requalify as general securities representatives and principals. We affirm these sanctions. In light of our imposition of a bar of Uberti for conduct alleged in causes one through seven of the amended complaint, however, we consider a suspension, fine, and requalification requirement to be redundant, and we decline to impose them as to Uberti.

We have considered the principal considerations listed in the Guidelines and find that several aggravating factors exist. The DTMI and MJXC research reports were widely circulated because Uberti and Runyon published them on Lincoln's website and made them available to all

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56 *See id.* at 89.

57 *See id.* at 96 (Misrepresentations or Material Omissions of Fact).

members of the public who were interested in viewing them. Both research reports omitted material information, including that company auditors had expressed doubt about the issuers' ability to continue as a going concern, and contained exaggerated and unsubstantiated claims. As with the Donner research reports, we are particularly troubled with Runyon's and Uberti's apparent belief that, provided they included in the research reports hyperlinks to the issuers' financial filings, buyers were "on notice" of auditors' going concern opinions. Uberti and Runyon were motivated by profit when they published these research reports. Their actions were reckless and contrary to industry standards. We find their misconduct to be serious and deserving of the sanctions imposed.

The Guideline for violations involving the use of misleading communications recommends a fine of $10,000 to $100,000 and a suspension of up to two years for reckless misconduct.[58] The Guideline for violations involving misrepresentations and material omissions of fact recommends a fine of $10,000 to $100,000 and a suspension of 10 business days to two years for reckless misconduct.[59] For the misconduct involving the DTMI and MJXC research reports, we affirm the Hearing Panel and fine Runyon $20,000, suspend him for six months in all capacities, and require that he requalify as general securities representative and principal. In light of our bar of Uberti, we will impose these sanctions as to Runyon only. The sanctions that we impose are within the range recommended in the applicable Guidelines.

VI. Conclusion

We find that Donner, Baclet, and Uberti issued numerous research reports that included fraudulently misleading misrepresentations and omissions of material facts and failed to include information regarding Donner's remuneration from issuers. We also find that Donner and Baclet failed to ensure proper review and supervision of Donner's research reports and failed to maintain and enforce adequate supervisory procedures with respect to the preparation of research reports. We further find that Uberti and Runyon issued two fraudulently misleading research reports.[60]

Accordingly, for the violations related to Donner's research reports, we expel Donner and bar Uberti and Baclet. In light of our bar of Uberti, we do not impose additional sanctions as to Uberti. For the DTMI and MJXC research reports, we fine Runyon $20,000, suspend him for six

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58 *See id.* at 89.

59 *See id.* at 96.

60 We have considered and reject without discussion all other arguments advanced by the parties.

Pursuant to NASD Procedural Rule 8320, 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 summarily be revoked for non-payment.

months, and require that he requalify as a general securities representative and principal. We affirm the Hearing Panel's assessment of costs as follows: $6,331.72 jointly and severally as to Donner and Baclet; $5,090.12 as to Uberti; and $2,459.85 as to Runyon. We assess appeal costs of $931.49 as to Uberti and $931.49 as to Runyon. The bars and expulsion shall be effective upon issuance of this decision. The suspension of Runyon shall become effective as of a date set by NASD.

On Behalf of the National Adjudicatory Council,

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Barbara Z. Sweeney, Senior Vice President
and Corporate Secretary

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