BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of Department of Enforcement, Complainant, vs. Legacy Trading Co., LLC Edmond, OK, and Mark Alan Uselton Edmond, OK, Respondents.	DECISION Complaint No. 2005000879302 Dated: October 8, 2010

Respondents made false statements to FINRA; failed to make affirmative determinations and locate shares prior to effecting short sales; failed to maintain books and records; and failed to establish, maintain, and enforce written supervisory procedures. Uselton also refused to provide testimony to FINRA and failed to update timely his Form U4. Held, findings and sanctions affirmed.

Appearances

For the Complainant: Leo F. Orenstein, Esq., Department of Enforcement, Financial Industry Regulatory Authority

For the Respondents: Pro Se

Decision

Pursuant to NASD Rule 9311(a), Legacy Trading Co., LLC ("Legacy" or "the Firm") and Mark Uselton ("Uselton") (together, "respondents") appeal a March 12, 2009 Extended Hearing

Panel decision.[1] The Hearing Panel found that: (1) respondents made false statements to FINRA, and Uselton failed to provide testimony at an on-the-record interview, in violation of NASD Rules 8210 and 2110; (2) respondents failed to make and annotate affirmative determinations prior to effecting short sales, in violation of NASD Rules 3370 and 2110, and failed to locate shares prior to effecting short sales, in violation of Rule 203(b) of Regulation SHO ("Rule 203(b)") and NASD Rule 2110; (3) respondents failed to maintain books and records, in violation of NASD Rules 3110 and 2110, Section 17 of the Securities Exchange Act of 1934 ("Exchange Act"), and Exchange Act Rules 17a-3 and 17a-4; (4) respondents failed to establish, maintain, and enforce written supervisory procedures, in violation of NASD Rules 3010 and 2110; and (5) Uselton failed to update timely his Uniform Application for Securities Industry Registration or Transfer ("Form U4"), in violation of NASD Rule 2110.

The Hearing Panel expelled Legacy and barred Uselton in all capacities for their false statements to FINRA. The Hearing Panel imposed a separate bar upon Uselton for his failure to provide testimony. The Hearing Panel further fined respondents, jointly and severally, a total of $907,035 for their short sale violations, and ordered that respondents pay $750 in costs.[2] After a thorough review of the record, we affirm the Hearing Panel's findings and sanctions.

I. Respondents' Background

Uselton entered the securities industry in 1992, at which time he became registered as a general securities representative. During all relevant time periods, Uselton was registered with Legacy as a general securities representative, general securities principal, financial and

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[1] Following the consolidation of NASD and the member regulation, enforcement, and arbitration functions of NYSE Regulation into FINRA, FINRA began developing a new "Consolidated Rulebook" of FINRA Rules. The first phase of the new consolidated rules became effective on December 15, 2008. *See FINRA Regulatory Notice 08-57* (Oct. 2008). Because the complaint in this case was filed before December 15, 2008, the procedural rules that apply are those that existed on December 14, 2008. The conduct rules that apply are those that existed at the time of the conduct at issue.

[2] The $907,035 fine for respondents' short sale violations consists of a $10,000 fine plus disgorgement of $897,035 in profits stemming from the short sales. The Hearing Panel also imposed: (1) a $50,000 fine against respondents (payable jointly and severally) and a one-year suspension in all principal capacities upon Uselton for respondents' recordkeeping violations; (2) a $50,000 fine against respondents (payable jointly and severally) and a two-year suspension in all capacities upon Uselton for respondents' supervisory violations; and (3) a $2,500 fine upon Uselton for his failure to update timely his Form U4. As described in Part IV, *infra*, we affirm the sanctions assessed in connection with respondents' recordkeeping violations, supervisory violations, and Uselton's failure to update timely his Form U4, but do not impose them in light of the expulsion and bars imposed for respondents' violations of NASD Rules 8210 and 2110.

operations principal ("FINOP"), and equities trader.[3] Uselton terminated his registrations with Legacy in March 2008, and is not currently registered with another FINRA member firm.

Uselton formed and registered Legacy as a FINRA member in 1999. Uselton wholly owned Legacy, controlled its operations, and was its only officer and director during all relevant time periods. At various times Uselton also served as Legacy's chief financial officer, chief compliance officer, and president. Legacy's business was limited to making inter-dealer markets in corporate securities and over-the-counter securities, and trading securities through its own accounts. Only one person other than Uselton, Stephan Boruchin ("Boruchin"), was registered with Legacy as a general securities principal during the relevant time period. In March 2008, Legacy filed a Uniform Request for Withdrawal from Broker-Dealer Registration. In April 2008, FINRA expelled Legacy for failing to pay fines and costs.

II. Procedural History

Beginning in February 2005, FINRA received the first of several anonymous complaints that Legacy had established an improper profit sharing arrangement with Steven Thorp ("Thorp") and that Legacy was selling stocks short, at the direction of Thorp, without first determining if it could borrow the shares or making an affirmative determination that the shares were available to borrow, in violation of FINRA and Commission rules. Around that time, Pink Sheets LLC ("Pink Sheets") filed a complaint with FINRA raising concerns that respondents were avoiding the anti-manipulation requirements of Exchange Act Rule 15c2-11 by improperly relying upon the unsolicited customer interest exemption to that rule when submitting quotes for securities. FINRA commenced its investigation against respondents in March 2005.

FINRA's Department of Enforcement ("Enforcement") filed a complaint against respondents on July 27, 2007, and an amended complaint on November 30, 2007. The amended complaint alleged that: (1) respondents submitted false information to FINRA, and Uselton refused to answer questions at an on-the-record interview, in violation of NASD Rules 8210 and 2110; (2) respondents effected short sales without first making affirmative determinations that Legacy could borrow or otherwise provide for delivery of the securities by the settlement date and without first locating shares, in violation of NASD Rules 3370 and 2110 and Rule 203(b); (3) respondents failed to maintain books and records, in violation of NASD Rules 3110 and 2110 (Uselton) and NASD Rules 3110 and 2110, Section 17 of the Exchange Act, and Exchange Act Rules 17a-3 and 17a-4 (Legacy); (4) respondents failed to establish, maintain, and enforce written supervisory procedures, in violation of NASD Rules 3010 and 2110; and (5) Uselton

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[3] Pursuant to an Acceptance, Waiver, and Consent ("AWC") dated July 9, 2003 (the "July 2003 AWC"), Uselton's registration as a general securities principal was suspended from August 18, 2003 to November 17, 2003, and his registration as a FINOP was suspended from August 18, 2003 to February 17, 2004. Pursuant to a separate AWC dated February 2, 2004 (the "February 2004 AWC"), Uselton was again suspended as a FINOP from March 15, 2004 to September 14, 2004.

failed to update timely his Form U4, in violation of NASD Rule 2110 and Article V, Section 2(c) of NASD's By-Laws.[4] Respondents denied all allegations.

Respondents initially were represented by counsel, but counsel withdrew and subsequently Uselton represented himself and Legacy. Five days prior to the hearing scheduled before the Hearing Panel, Uselton informed the Hearing Officer that he would "derive no benefit from appearing at this hearing" and would not attend. The Hearing Officer thus deemed respondents to have waived their right to a hearing and canceled the hearing. Instead, the Hearing Officer ordered that the parties file written submissions. Enforcement filed a number of sworn declarations, and Uselton filed several of his own sworn declarations.[5]

On March 12, 2009, an Extended Hearing Panel issued its decision. The Hearing Panel found that respondents engaged in the misconduct specified in the amended complaint. For this misconduct, the Hearing Panel, among other things, expelled Legacy, barred Uselton in all capacities, and fined respondents $907,035. Respondents appealed.[6]

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[4] Enforcement withdrew allegations (which were alleged in the original complaint) that Legacy improperly received payment for acting as a market marker in a security, in violation of NASD Rules 2460 and 2110.

[5] The record includes several hundred exhibits filed by Enforcement. Respondents did not submit any exhibits.

[6] Respondents requested oral argument on appeal, and missed the initial deadline for filing an appellate brief. Respondents eventually filed a brief with the NAC, but ignored an October 27, 2009 request by FINRA staff to confirm their availability for oral argument sometime in February 2010. FINRA staff thus notified the parties that oral argument would proceed on February 9, 2010. In mid-November 2009, Uselton informed FINRA staff that this date was inconvenient and that respondents might withdraw their appeal. During the next several months, respondents ignored numerous inquiries from FINRA staff and Enforcement concerning whether they intended to pursue their appeal and request for oral argument. Respondents also refused to provide FINRA with an updated address and telephone number, as required by NASD Rule 9141, and FINRA's only confirmed contact information for respondents was Uselton's email address.

Based upon the foregoing, Enforcement filed a motion to cancel oral argument and requested that the matter be decided on the record. The subcommittee of the National Adjudicatory Council ("Subcommittee") empanelled to hear this matter denied Enforcement's motion; however, it ordered that oral argument be conducted telephonically. Respondents failed to participate in oral argument. Nonetheless, the Subcommittee granted respondents an opportunity to file an additional pleading for its consideration. Respondents did not do so, and we have therefore based our decision on a review of the entire record.

III. Discussion

A. NASD Rule 8210 Violations

The Hearing Panel found that respondents made false statements to FINRA, in violation of NASD Rules 8210 and 2110. The Hearing Panel also found that Uselton separately violated NASD Rules 8210 and 2110 by refusing to answer questions during his on-the-record testimony. For the reasons set forth below, we affirm the Hearing Panel's findings.

1. Facts

a. Legacy's Misrepresentations to FINRA

In connection with the investigation of Legacy, FINRA staff sent the Firm numerous requests for information pursuant to NASD Rule 8210.[7] FINRA staff sent the first such request on July 11, 2005. Over the course of the next several months, FINRA sought, among other things: (1) "all records for all accounts held, controlled, or maintained on behalf of Steven Thorp . . . through Legacy" and a description of any current or past relationship between Thorp and Legacy, Uselton, or Boruchin; (2) all emails sent or received by Uselton and Boruchin from March 2004 through July 2005; (3) a list of all email addresses used by all associated persons of Legacy and a list of all email addresses established under Legacy's domain name; (4) a list of all bank accounts owned or controlled by Legacy; (5) information concerning a $300,000 capital contribution to Legacy; (6) bank account statements for all accounts held by Legacy's parent holding company at Citizens Bank of Edmond, including an account into which the $300,000 capital contribution for Legacy was deposited (the "Bank Account"); and (7) copies of all account records for Warrior Capital, LLC ("Warrior Capital").[8]

In October 2005, Legacy (through counsel) informed FINRA in writing that Boruchin made the $300,000 capital contribution and that he obtained the funds as a gift from his family. This information was false, and after several additional NASD Rule 8210 requests to Legacy,

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[7] From July 11, 2005 through May 2006, FINRA sent Legacy and Uselton a total of 18 requests for information, and four requests that Uselton provide on-the-record testimony, pursuant to NASD Rule 8210. Respondents responded partially to certain of these requests, and did not respond to other requests. Respondents are not charged with failing to respond to NASD Rule 8210 requests.

[8] Warrior Capital is a firm owned and operated by Uselton's father (Jack Uselton) and cousin (Darrel Uselton). In July 2007, the Commission charged Jack and Darrel Uselton with engaging in a prolonged "scalping" scheme by obtaining shares of penny stocks and selling those shares into an artificially active market they created through manipulative trading. The State of Texas also charged Jack and Darrel Uselton with securities fraud and other criminal activities.

Boruchin acknowledged that he had borrowed the $300,000 from Thorp.[9] Other than this information, and despite several follow up requests by FINRA staff, Boruchin, Legacy, and Uselton have never provided FINRA with any additional information concerning their relationship with Thorp.

Legacy also provided false information to FINRA regarding emails. The Firm falsely stated that Uselton used his Legacy email address for personal use only and that Boruchin did not have a Legacy email account. This information was false. Uselton used his Legacy email account for business correspondence with Pink Sheets, and Boruchin had a Legacy email account. The Firm also falsely represented that it did not generally use email in the course of conducting its business. Legacy eventually admitted that Uselton and Boruchin used Legacy email accounts in conducting the Firm's business.

Further, Legacy falsely informed FINRA staff that the Bank Account was not related to Legacy's business, and initially refused to produce any account statements for the Bank Account. After repeated requests by FINRA over a six-month period, Legacy finally produced complete statements for the Bank Account. The account statements showed that Legacy paid most of its financial obligations through the Bank Account.

b. Uselton's Misrepresentations to FINRA

Uselton also provided false information concerning respondents' relationship with Warrior Capital. Legacy initially asserted that it did not maintain any accounts for Warrior Capital. FINRA staff further questioned Uselton concerning the relationship between respondents and Warrior Capital during an on-the-record interview conducted in May 2006. During that interview, Uselton testified as follows:

Q: Have you ever conducted any business on behalf of Warrior Capital?

A: No. Act as an agent for them, no.

Q: What is Warrior Capital's business?

A: I don't know. . . .

Q: Is [your father] involved in Warrior Capital in any way?

A: I don't know. I know he works with Darrel. I know they share offices. I've been to see them. But I don't know what they do. . . .

Q: You don't know what line of business [your father is] in?

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[9] Thereafter, FINRA staff sent Boruchin several requests for information pursuant to NASD Rule 8210 and sought to schedule his on-the-record testimony. Boruchin refused to appear and testify, and he later consented to be barred from the securities industry.

A: No. I—I think they have something to do with—I don't know. To be honest with you, I really don't know. . . .

Q: Do they help raise money for companies that want to go public?

A: I don't know. I try to stay out of their business. I really do. I mean, it's—I'm concerned. I hope they are doing well, but I don't have an interest in it. I really—I've heard rumors that they gave some guys some money. I don't know what it was for . . . I don't know what they do specifically. . . .

Q: Do you know what broker/dealer your father bought stock through?

A: No. I don't associate myself with their business. . . .

Q: Have they ever asked you to get involved in anything that you thought was illegal?

A: No. I don't—I don't get involved with them, period. Let me make that perfectly clear. I don't get involved in their business, period.

Uselton's statements were false. In mid-2007, FINRA obtained, for the first time, a number of documents from the Commission, the State of Texas, and the State of Oklahoma in connection with their respective cases concerning, and investigations of, Warrior Capital and Jack and Darrel Uselton. These documents demonstrated that Legacy and Uselton were involved with Warrior Capital and its business, and included: (a) a 2004 Form 1099-MISC from Warrior Capital to Uselton showing $26,000 in non-employee compensation paid by Warrior Capital to Uselton; (b) numerous emails and faxes concerning stock transactions between Darrel Uselton and Warrior Capital, and Legacy and Uselton, in 2004 and 2005; (c) copies of checks and wire transfers in 2004 and 2005 from Warrior Capital to Uselton and his wife; (d) a 2005 email from Darrel Uselton to Jack Uselton discussing a $8,500 transfer to Legacy and an agreement between Uselton and Darrel Uselton for a $30,000 payment to Uselton; and (e) a Strategic Partnership Agreement between Legacy (signed by Uselton) and Warrior Capital dated July 2, 2003.[10]

c. Uselton's Refusal to Answer Questions at his On-the-Record Interview

Based upon the documents obtained by FINRA in mid-2007, FINRA staff requested that Uselton appear at a second on-the-record interview pursuant to NASD Rule 8210. The interview occurred on September 25, 2007. At that time, Uselton confirmed the accuracy of his May 2006 statements that he did not associate with Warrior Capital and had nothing to do with its business. However, when confronted with certain of the documents showing respondents' relationship with Warrior Capital, Uselton claimed that he lacked any knowledge about the documents.

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[10] In addition, FINRA previously had obtained from Warrior Capital a March 2003 IRS notice of assignment of employer identification number to "Mark A. Ufelton" [sic] on behalf of Warrior Capital.

Uselton then refused to answer any additional questions concerning Warrior Capital and asserted his Fifth Amendment privilege against self-incrimination.

2. Respondents Violated NASD Rules 8210 and 2110

NASD Rule 8210 requires persons subject to FINRA's jurisdiction to provide information requested by FINRA orally or in writing in response to requests for information. As has been often observed, because FINRA lacks subpoena power, it must rely upon NASD Rule 8210 "to police the activities of its members and associated persons." *Joseph Patrick Hannan*, 53 S.E.C. 854, 858-59 (1998). "[C]ompliance with Rule 8210 [is] essential to enable NASD to execute its self-regulatory functions." *PAZ Sec., Inc.*, Exchange Act Rel. No. 57656, 2008 SEC LEXIS 820, at *12 (Apr. 11, 2008), *aff'd*, 566 F.3d 1172 (D.C. Cir. 2009). An associated person is prohibited from providing false or misleading information to FINRA in response to an NASD Rule 8210 request for information or testimony. *See Dep't of Enforcement v. Ortiz*, Complaint No. E0220030425-01, 2007 FINRA Discip. LEXIS 3, at *32 (FINRA NAC Oct. 10, 2007), *aff'd*, Exchange Act Rel. No. 58416, 2008 SEC LEXIS 2401 (Aug. 22, 2008). "Providing false and misleading information to FINRA [] subverts FINRA's ability to carry out its regulatory functions[,]" and is also conduct inconsistent with just and equitable principles of trade under NASD Rule 2110. *Id.* at 33.[11] Likewise, an associated person's failure to provide testimony to FINRA in connection with an investigation is a serious violation of NASD Rules 8210 and 2110. *See Dep't of Enforcement v. Erenstein*, Complaint No. C9B040080, 2006 NASD Discip. LEXIS 31, at *11 (NASD NAC Dec. 18, 2006), *aff'd*, Exchange Act Rel. No. 56768, 2007 SEC LEXIS 2596 (Nov. 8, 2007), *aff'd*, 316 F. App'x 865 (11th Cir. 2008).

Respondents made numerous false statements to FINRA, in violation of NASD Rules 8210 and 2110. In response to FINRA's requests for information, Legacy made false representations concerning the $300,000 capital contribution; misrepresentations concerning the use of email by Legacy, Uselton, and Boruchin; and falsely represented that the Bank Account was not related to Legacy's business. In addition, Uselton falsely denied, at his May 2006 on-the-record interview, that there was any connection with or relationship between respondents and Warrior Capital. All of respondents' misrepresentations are contradicted by undisputed documents in the record. We therefore find that respondents violated NASD Rules 8210 and 2110.

Uselton also separately violated NASD Rules 8210 and 2110 by refusing to answer FINRA's questions concerning Warrior Capital during his September 2007 on-the-record interview. *See Erenstein*, 2006 NASD Discip. LEXIS 31, at *11-12. Uselton's assertion of his

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[11] Generally, a violation of another FINRA rule is also a violation of NASD Rule 2110's requirement that all FINRA members, in conducting their business, "observe high standards of commercial honor and just and equitable principles of trade." *See Joseph Abbondante*, Exchange Act Rel. No. 53066, 2006 SEC LEXIS 23, at *2 (Jan. 6, 2006) (holding that a violation of a FINRA rule also violates NASD Rule 2110). NASD Rule 0115 provides that FINRA's rules apply to all members and persons associated with a member and that such persons have the same duties and obligations as a member under the rules.

Fifth Amendment privilege against self-incrimination does not alter our conclusion. Adjudicators have consistently held that because FINRA is not a state actor, "the constitutional limitations on government action do not apply to NASD." *Dep't of Enforcement v. Fawcett*, Complaint No. C9A040024, 2007 NASD Discip. LEXIS 2, at *14 (NASD NAC Jan. 8, 2007), *aff'd*, Exchange Act Rel. No. 56770, 2007 SEC LEXIS 2598, at *18 (Nov. 8, 2007); *see also D.L. Cromwell Invs., Inc. v. NASD Regulation, Inc.*, 279 F.3d 155, 157-58 (2d Cir. 2002) (holding that NASD is a private actor); *Desiderio v. Nat'l Ass'n of Sec. Dealers, Inc.*, 191 F.3d 198, 206 (2d Cir. 1999) ("The NASD is a private actor, not a state actor."); *Marchiano v. Nat'l Ass'n of Sec. Dealers, Inc.*, 134 F. Supp. 2d 90, 95 (D.D.C. 2001) ("The court is aware of no case . . . in which NASD Defendants were found to be state actors either because of their regulatory responsibilities or because of any alleged collusion with criminal prosecutors.").

Moreover, "the Fifth Amendment restricts only governmental conduct . . . [and] a violation of the Fifth Amendment . . . requires 'state action' on the part of the private entity whose actions are being challenged." *Justin F. Ficken*, Exchange Act Rel. No. 54699, 2006 SEC LEXIS 2547, at *16 (Nov. 3, 2006). In order for the action of a private actor such as FINRA to constitute "state action," there must be "such a close nexus between the State and the challenged action that the seemingly private behavior may be fairly treated as that of the State itself." *Id.* at *16-17. A party attempting to demonstrate that FINRA is a state actor must show that the actions in question "are inextricably intertwined with those of the government," and the burden of demonstrating such joint action is high. *Id.* at *17.

Here, respondents have not met that burden, and their claim that FINRA acted jointly with various governmental entities is not supported by the record. The fact that FINRA may have obtained documents concerning Warrior Capital from the Commission and several state entities does not, without more, render FINRA a state actor. *Cf. id.* at *24 (holding that cooperation between FINRA and a governmental entity is generally insufficient to demonstrate that FINRA is a state actor). We thus find that Uselton's refusal to testify violated NASD Rules 8210 and 2110.[12]

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[12] We also reject Uselton's attempt to blame Boruchin for Legacy's misrepresentations. Legacy (by and through its counsel) provided the responses to FINRA that contained false and misleading information. *Cf. Justine Susan Fischer*, 53 S.E.C. 734, 741 n.4 (1998) (holding that "[a] broker has responsibility for his or her own actions and cannot blame others for [his or] her own failings"); *Thomas E. Warren, III*, 51 S.E.C. 1015, 1019 (1994) (rejecting applicant's attempts to shift blame to others for misconduct). Further, we reject Uselton's attempt to justify his false statements regarding Warrior Capital based upon his allegation that the parties never implemented the Strategic Partnership Agreement. Nothing in the record supports Uselton's claim, and even if the parties did not implement the agreement, the record demonstrates that Uselton misrepresented to FINRA his relationship with Warrior Capital, in violation of NASD Rules 8210 and 2110.

B. Violations Related to Respondents' Short-Selling Activity

The Hearing Panel found that respondents violated NASD Rules 3370(b)(2) and 2110, and Rule 203(b), in connection with 2,192 proprietary short sales executed from May 3, 2004 through August 31, 2005. As described below, we affirm the Hearing Panel's findings.

1. Affirmative Determination and Locate and Delivery Requirements

NASD Rule 3370(b)(2)(B), which governed short sales executed prior to January 3, 2005, provided that for proprietary short sales, a member or associated person must make "an affirmative determination that the member can borrow the securities or otherwise provide for delivery of the securities by the settlement date." This affirmative determination requirement prevented short-selling by those who did not have, and had no intention of delivering, the stock they were selling. *See Dep't of Enforcement v. Fiero*, Complaint No. CAF980002, 2002 NASD Discip. LEXIS 16, at *68-69 (NASD NAC Oct. 28, 2002). To satisfy the affirmative determination requirement, former NASD Rule 3370(b)(4)(B) required that a written record be kept. The rule further provided that the affirmative determination requirement did not apply to bona fide market-making transactions. *See* NASD Rule 3370(b)(2)(B).

For short sales executed after January 3, 2005, Rule 203(b) applies.[13] Rule 203(b) prohibits a broker-dealer from effecting a short sale order for its own account unless the broker-dealer has: (1) borrowed the security, or entered into an agreement to borrow the security; or (2) reasonable grounds to believe that the security can be borrowed so that it can be delivered on the date delivery is due (the "locate and delivery requirement"). The Commission implemented Rule 203(b) to restrict "naked" short-selling and to reduce short-selling abuses. *See Short Sales*, Exchange Act Rel. No. 50103, 2004 SEC LEXIS 1636, at *9 (July 28, 2004). A broker-dealer must document compliance with Rule 203(b) prior to executing a short sale. *See* Rule 203(b)(1)(iii); *Short Sales*, 2004 SEC LEXIS 1636, at *42; *cf. Ko Secs., Inc.*, Exchange Act Rel. No. 48550, 2003 SEC LEXIS 2291, at *8-9 (Sept. 26, 2003) (holding that, consistent with the rule's purpose, an affirmative determination under NASD Rule 3370(b) must be made before the securities are sold short). As was the case with NASD Rule 3370(b)(2)(B), bona fide market-making transactions are exempt from Rule 203(b). *See* Rule 203(b)(2)(iii).

2. Respondents Failed to Satisfy Affirmative Determination and Locate and Delivery Requirements

FINRA requested that Uselton produce Legacy's written records evidencing its compliance with NASD Rule 3370(b)(2) and Rule 203(b) for trades executed from March 2004 to September 2005. Uselton, who knew that he and Legacy were required to make affirmative determinations and comply with locate and delivery requirements in connection with short sales, initially testified that Legacy kept a log of the Firm's compliance with these rules. Uselton, however, later informed FINRA that the Firm did not maintain such a log. Rather, Uselton

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[13] Rule 203(b) replaced NASD Rule 3370, and NASD Rule 3370 was repealed effective as of January 3, 2005. *See NASD Notice to Members 04-93* (Dec. 2004).

stated that all affirmative determinations were recorded on individual order tickets (which FINRA could obtain from Legacy's clearing firm).

The daily "Stock Locate Logs" produced by Legacy's clearing firm, and the incomplete set of order tickets produced by Legacy during FINRA's investigation, showed that respondents violated NASD Rule 3370(b) and Rule 203(b) in connection with a total of 2,192 short sales (involving more than 63 million shares) effected on behalf of the Firm. Uselton himself made at least 1,216 of the 2,192 total short sales at issue, and all of the sales occurred in his or Boruchin's trading account at Legacy.[14]

Specifically, from May 3, 2004 through January 2, 2005, respondents failed to satisfy the affirmative determination requirement of NASD Rule 3370(b)(2) in connection with 1,002 short sales. In each of the 1,002 short sales, Legacy sold securities without sufficient shares to cover its short position. Of those short sales, respondents: (a) did not, on 955 occasions, even attempt to make an affirmative determination that Legacy could borrow the stock or otherwise provide for its delivery by the settlement date; (b) unsuccessfully attempted to make an affirmative determination, but nonetheless executed short sales, on 41 occasions; and (c) were informed by Legacy's clearing firm that it did not have enough shares available to cover Legacy's short position, but nonetheless executed the short sales, on six occasions.

Similarly, from January 3, 2005 through August 31, 2005, respondents failed to satisfy locate and delivery requirements of Rule 203(b) in connection with 1,190 short sales. For the vast majority of the 1,190 short sales, Legacy sold securities without sufficient shares to cover its short position. Of those short sales, respondents: (i) did not, on 1,110 occasions, even attempt to satisfy locate and delivery requirements; (ii) attempted to satisfy the requirements, determined they were unable to borrow any shares to cover the short sales, but nonetheless executed the short sales on 55 occasions; and (iii) attempted to satisfy the requirements, determined that they were unable to borrow sufficient shares to cover the short positions, but nonetheless executed the short sales on 14 occasions.[15]

Further, respondents have not demonstrated that the short sales at issue were made in connection with bona fide market-making transactions (and thus exempt from the affirmative determination and locate and delivery requirements). The Commission has stated that:

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[14] The record thus contradicts Uselton's unsupported claim that he did not participate in any of the short sales at issue. The record also contradicts Uselton's claim that neither he nor Legacy profited from the short sales; rather, Enforcement has demonstrated, by a preponderance of the evidence, that respondents made $897,035.01 in profits on the violative short sales. *See infra* Part IV.B.

[15] For six of the remaining 11 short sales, the records of Legacy's clearing firm did not indicate how many shares of the stock at issue were available. For the remaining five transactions, Legacy was able to borrow sufficient shares, but did not document its compliance with the rule (as was the case with each of the 2,192 short sales).

> Bona-fide market making activities do not include activity that is related to speculative selling strategies or investment purposes of the broker-dealer and is disproportionate to the usual market making patterns or practices of the broker-dealer in that security. In addition, where a market maker posts continually at or near the best offer, but does not also post at or near the best bid, the market maker's activities would not generally qualify as bona-fide market making for purposes of the exception. . . . Moreover, a market maker that continually executed short sales away from its posted quotes would generally be unable to rely on the bona-fide market making exception.

Short Sales, 2004 SEC LEXIS 1636, at *50 & n.68; *see also Fiero*, 2002 NASD Discip. LEXIS 16, at *70 ("A review of the history of the market maker exemption demonstrates that NASD did not intend the exemption to give market makers *carte blanche* to engage in speculative short selling of securities that could not be borrowed for delivery.").[16]

Respondents have not demonstrated that they made any of the 2,192 short sales at issue in connection with bona fide market-making activities, and the record shows that respondents engaged in these short sales as part of a speculative trading strategy. Legacy almost never posted the inside bid or ask in connection with the short sales, and when the market moved towards Legacy's quote it often moved its quote away.[17] Legacy continually executed short sales away from its posted quotes, and the Firm did not have a sufficient inventory to cover its short balance following virtually all of the short sales at issue. Legacy often ended the trading day with a negative balance for the stocks it sold short, and carried short positions overnight (or longer). The record does not demonstrate that respondents' short sales occurred in connection with bona fide market-making activity, and therefore they were required to satisfy the requirements of NASD Rule 3370(b)(2) and Rule 203(b). *See Fiero*, 2002 NASD Discip. LEXIS 16, at *74-78

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[16] Broker-dealers may sometimes rely upon "Easy to Borrow" lists maintained by their clearing firms. Such lists "are prepared by a firm to indicate that firm's ability to supply the identified securities. Therefore, for example, introducing firms may rely on Easy to Borrow lists of the clearing firms through which they clear and settle transactions unless circumstances indicate that it would not be reasonable to rely on such lists." *See SEC Division of Market Regulation: Response to Frequently Asked Questions Concerning Regulation SHO, available at* http://www.sec.gov/divisions/marketreg/mrfaqregsho1204.htm. Respondents, however, never informed FINRA staff that they relied upon, and never produced any documents showing that they relied upon, an Easy to Borrow list. Moreover, Legacy's clearing firm never provided Legacy with any such lists for the securities sold short by respondents, in violation of FINRA and Commission rules.

[17] Slightly more than half of the 2,192 short sales involved securities quoted on Pink Sheets, where Legacy was often the only market maker or dealer quoting the security based upon an alleged unsolicited customer order. The remaining short sales involved NASDAQ, OTC Bulletin Board, or Consolidated Quotation System securities. Legacy posted inside quotes for less than five percent of the 2,192 short sales.

(holding that respondents engaged in speculative short-selling, not bona fide market-making transactions, and therefore were required to comply with affirmative determination requirements). They did not do so. Consequently, we find that respondents violated NASD Rules 3370(b)(2) and 2110, and Uselton caused Legacy to violate Rule 203(b), in connection with the 2,192 short sales at issue.

C. Books and Record Violations

The Hearing Panel found that respondents failed to retain records related to their reliance on the unsolicited customer order exemption set forth in Exchange Act Rule 15c2-11(f)(2). The Hearing Panel also found that respondents failed to maintain the Firm's email records. In failing to maintain these records, the Hearing Panel held that respondents violated NASD Rules 3110 and 2110, and Exchange Act Rules 17a-3 and 17a-4. We affirm the Hearing Panel's findings.

1. Respondents Failed to Maintain Documents Related to the Unsolicited Customer Order Exemption

NASD Rule 3110(a) generally requires that member firms make and preserve records in conformance with all applicable securities laws and regulations. Exchange Act Rule 17a-3 provides generally that a broker-dealer maintain and keep current certain books and records related to its business.

Exchange Act Rule 15c2-11 generally requires that a broker-dealer, prior to entering a quotation for an over-the-counter security in any inter-dealer quotation medium, gather, review, and retain specific information concerning the security and its issuer. The purpose of the rule is to deter fraudulent and manipulative behavior in connection with companies having little or no assets or operations, and to ensure that quotations in securities of such companies are not clearly inconsistent with their current financial status. *See Initiation or Resumption of Quotations Without Specified Information*, Exchange Act Rel. No. 21470, 31 SEC Docket 1041 (Nov. 8, 1984). Exchange Act Rule 15c2-11(f)(2), however, exempts a quotation submitted by a broker-dealer solely on behalf of a customer that "represents the customer's indication of interest and does not involve the solicitation of the customer's interest[.]" A broker-dealer relying on the unsolicited customer interest order exemption must maintain certain documents demonstrating that the underlying order was in fact unsolicited and entered on behalf of a customer. Specifically, a member firm must "produce documentation demonstrating its knowledge that the underlying order was unsolicited and entered on behalf of a customer. . . . the member . . . [is] required, pursuant to NASD and SEC rules, to create and maintain a memorandum of such customer order regardless of whether the order is ultimately executed."[18]

Respondents failed to maintain the required records necessary to rely upon the exemption contained in Exchange Act Rule 15c2-11(f)(2). Specifically, between March 2004 and August 2005, Uselton submitted (on behalf of Legacy) 138 unsolicited customer orders to Pink Sheets.

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[18] *See* Regulatory and Compliance Alert (Fall 2000), *available at* http://www.finra.org/Industry/Regulation/Guidance/RCA/index.htm.

Respondents admittedly did not keep copies of the customer orders and the forms submitted to Pink Sheets in connection with the unsolicited customer orders.[19] Further, respondents did not maintain any documents that the Firm received from the originating broker-dealer or documents showing the basis for its knowledge that the customer orders were in fact unsolicited and entered on behalf of a customer. Indeed, the only documents submitted by respondents to allegedly document the basis for claiming the exemption were order tickets for 78 of the 138 orders, and the order tickets produced did not demonstrate that respondents performed the necessary diligence under the rule.[20] Consequently, we find that Uselton violated NASD Rules 3110 and 2110, and Legacy violated NASD Rules 3110 and 2110 and Exchange Act Rule 17a-3, by failing to maintain books and records in connection with unsolicited customer orders.[21]

2. Respondents Failed to Maintain E-Mail

Exchange Act Rule 17a-4(b)(4) requires member firms to preserve, for at least three years, all communications sent and received by the member relating to its business, including email communications relating to a member firm's business. *See* Exchange Act Rule 17a-4(b)(4); *Reporting Requirements for Broker or Dealers under the Securities Exchange Act of 1934*, Exchange Act Rel. No. 38245, 62 Fed. Reg. 6469, 6472 (Feb. 12, 1997). Uselton admittedly deleted on a daily basis all Firm emails, including emails between the Firm and its

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[19] In mid-2004, Pink Sheets began requiring its subscribers, such as Legacy, to submit Unsolicited Quote Entry Forms prior to publishing an unsolicited customer order. The form generally requires that the market maker verify that the quote is based on an unsolicited indication of interest from a customer and certain financial and identifying information concerning the issuer. From March 2004 through August 2005, Legacy accounted for approximately 25 percent of all the unsolicited customer quotes Pink Sheets received. Legacy often ignored Pink Sheets' requirements and submitted incomplete forms, and Pink Sheets rejected many of their submissions and ultimately complained to FINRA.

[20] Some of the 78 order tickets produced by Legacy purported to show the first name of the individual at the other broker-dealer who informed Legacy that such order was unsolicited. Such information, however, is insufficient to satisfy the exemption. Further, although Uselton claimed that the Firm's practice generally was to time-stamp order tickets once the order was received, and to stamp it again upon execution, many of the order tickets did not contain two time stamps. For those tickets that did contain two time stamps, the times were often identical or just seconds apart (which could not have left sufficient time for respondents to receive the order from a customer, submit a form to Pink Sheets, and receive approval to post a quote).

[21] Exchange Act Rules 17a-3 and 17a-4 apply to broker-dealers, and not associated persons. *See Davrey Fin. Serv., Inc.*, Exchange Act Rel. No. 51780, 2005 SEC LEXIS 1288, at *12 (June 2, 2005). Individuals may violate NASD Rules 3110 and 2110 when they fail to comply with Exchange Act Rules 17a-3 or 17a-4, or are otherwise responsible for creating and maintaining inaccurate books and records. *See North Woodward Fin. Corp.*, Exchange Act Rel. No. 60505, 2009 SEC LEXIS 2796, at *23 (Aug. 19, 2009). Uselton failed to comply with these Exchange Act rules, and was responsible for creating and maintaining Legacy's books and records.

clearing firm, Pink Sheets, and Warrior Capital, and no system was in place to retain deleted emails. Consequently, we find that Uselton violated NASD Rules 3110 and 2110, and Legacy violated NASD Rules 3110 and 2110, and Exchange Act Rules 17a-3 and 17a-4, by failing to preserve any record of the deleted emails.

D. Respondents Failed to Establish, Maintain and Enforce an Adequate Supervisory System and Procedures

The Hearing Panel found that respondents failed to establish, maintain, and enforce an adequate supervisory system and procedures, in violation of NASD Rules 3010 and 2110. We agree.

NASD Rule 3010(a) "requires member firms to establish and maintain a supervisory system that is reasonably designed to achieve compliance with the applicable securities laws, rules, and regulations." *Dep't of Enforcement v. Strong*, Complaint No. C04050005, 2007 NASD Discip. LEXIS 10, at *11 (NASD NAC Feb. 23, 2007), *aff'd*, Exchange Act Rel. No. 57426, 2008 SEC LEXIS 467 (Mar. 4, 2008). NASD Rule 3010(b) requires that a member firm "establish, maintain, and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of registered representatives and associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable rules of NASD." NASD Rule 3010(d) specifies that member firms establish procedures for the review and endorsement by a registered principal "in writing on an internal record, of all transactions and for the review by a registered principal of incoming and outgoing written and electronic correspondence of its registered representatives with the public" related to the firm's securities business. *See* NASD Rule 3010(d)(1). NASD Rule 3010(d) further requires that member firms develop written procedures for the review of incoming and outgoing electronic correspondence.

From March 2004 through at least August 2005, Legacy operated without a comprehensive set of written supervisory procedures ("WSPs"). Specifically, Legacy's WSPs were incomplete, in draft form, and not tailored specifically to Legacy's business, and Legacy had no system or procedure in place, prior to June 2006, regarding the use and retention of email. Uselton also admitted that he routinely deleted Firm email communications. Similarly, Legacy had no system or procedures to review and endorse unsolicited customer orders pursuant to Exchange Act Rule 15c2-11, and had no procedures relating to the records the Firm needed to retain to comply with the rule.

Uselton admitted that as Legacy's sole officer and director, he was entirely responsible for the Firm's business, but now argues that Boruchin was responsible for supervising Legacy during the period in question because Uselton was suspended as a principal. We reject Uselton's arguments. First, Uselton was suspended as a principal from August 18, 2003 to November 17, 2003. Enforcement alleged, however, that Uselton and Legacy failed to satisfy their obligations under NASD Rule 3010 from March 2004 through August 2005—well after Uselton's suspension as a principal expired.

Second, there is no evidence in the record that Uselton ever delegated any supervisory authority to Boruchin. *See Robert J. Prager*, Exchange Act Rel. No. 51974, 2005 SEC LEXIS

1558, at *43 n.45 (July 6, 2005) (holding that firm's president had final responsibility for the firm's operations unless and until he reasonably delegated the duties to someone else and had no reason to know that the assigned person was not properly performing the delegated functions).

Third, even assuming that the record demonstrated that Uselton delegated authority to Boruchin (it does not), a cursory examination of Legacy's WSPs by Uselton would have shown that they were incomplete and that Legacy's supervisory procedures were woefully inadequate. Indeed, Legacy's WSPs are in draft form and clearly labeled, "Work In Progress." *See id.*; *Ronald Pellegrino*, Exchange Act Rel. No. 59125, 2008 SEC LEXIS 2843, at *47 (Dec. 19, 2008) (holding that "it is not sufficient for the person with overarching supervisory responsibilities to delegate supervisory responsibility to a subordinate, even a capable one, and then simply wash his hands of the matter until a problem is brought to his attention. . . . Implicit is the additional duty to follow-up and review that delegated authority to ensure that it is being properly exercised." (internal quotation and citation omitted)). We therefore find that Legacy and Uselton failed to establish and maintain an adequate supervisory system and procedures, in violation of NASD Rules 3010 and 2110. *See Quest Capital Strategies, Inc.*, Initial Decisions Rel. No. 141, 1999 SEC LEXIS 727, at *54 (Apr. 12, 1999) (holding that failures of firm's owner and president to reasonably supervise are imputed to his firm).

E. Uselton Failed to Update Timely his Form U4

The Hearing Panel found that Uselton failed to update timely his Form U4, in violation of NASD Rule 2110. We agree.

NASD Rule 2110 and IM-1000-1 require associated persons to disclose accurately and fully information required in the Form U4 and to observe high standards of commercial honor and just and equitable principles of trade.[22] Self-regulatory organizations, state regulators, and broker-dealers utilize the Form U4 to determine and monitor the fitness of securities professionals. *See Rosario R. Ruggiero*, 52 S.E.C. 725, 728 (1996). The failure of a registered representative to fully and accurately disclose all information required by the Form U4, including a pending FINRA investigation against an applicant, violates NASD Rule 2110 and IM-1000-1. *See Dep't of Enforcement v. Harvest Capital Inv., LLC*, Complaint No. 2005001305701, 2008 FINRA Discip. LEXIS 45, at *41-42 (FINRA NAC Oct. 6, 2008). Article V, Section 2(c) of NASD's By-Laws required that an associated person keep his Form U4 current at all times and amend the form within 30 days after learning of facts or circumstances giving rise to the amendment.[23] A FINRA form that is inaccurate or incomplete so as to be misleading, or the failure to correct such a filing after notice thereof, may be deemed to be conduct inconsistent with just and equitable principles of trade. *See* NASD IM-1000-1.

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[22] "Because of the importance that the industry places on full and accurate disclosure of information required by the Form U4, we presume that essentially all the information that is reportable on the Form U4 is material." *Dep't of Enforcement v. Knight*, Complaint No. C10020060, 2004 NASD Discip. LEXIS 5, at *13-14 (NASD NAC Apr. 27, 2004).

[23] Article V, Section 2(c) of FINRA's By-Laws contains the same requirement.

We affirm the Hearing Panel's findings that Uselton failed to update timely his Form U4 to reflect FINRA's investigation into certain of the matters that are the subject of this case.[24] Enforcement notified Uselton that it made a preliminary determination to recommend that charges be brought against him related to this case pursuant to a Wells notice dated September 26, 2006. Uselton, however, did not update his Form U4 until December 11, 2006, approximately six weeks after he was required to do so. We reject Uselton's attempt to blame an outside consultant for the failure to timely update his Form U4 as having no basis in fact or law. *See Dep't of Enforcement v. Howard*, Complaint No. C11970032, 2000 NASD Discip. LEXIS 16, at *31-32 (NASD NAC Nov. 16, 2000) (holding that "the responsibility for maintaining the accuracy of a Form U4 lies with each registered representative"), *aff'd*, 55 S.E.C. 1096 (2002), *aff'd*, 77 F. App'x 2 (1st Cir. 2003). Uselton failed to promptly disclose FINRA's investigation, in violation of NASD Rule 2110 and Article V, Section 2(c) of NASD's By-Laws.

IV. Sanctions

A. Respondents' NASD Rule 8210 Violations

The FINRA Sanction Guidelines ("Guidelines") for failing to respond truthfully, completely, or timely to a FINRA request for information state that a bar should be the standard sanction where a respondent does not respond in any manner.[25] If there are mitigating factors present, or the person did not respond in a timely manner, adjudicators should consider suspending the individual in any or all capacities for up to two years.[26] In the case of a firm, the Guidelines state that in egregious cases, adjudicators should consider expulsion. If there are mitigating factors present, adjudicators should consider suspending the firm with respect to any or all activities or functions for up to two years.[27] The Guidelines instruct adjudicators to consider, in addition to the principal considerations and general principles applicable to all violations, the nature of the information requested and whether the information was provided

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[24] Enforcement did not allege, and the record does not demonstrate, that Uselton's failure to timely update his Form U4 was willful.

[25] *FINRA Sanction Guidelines* 35 (2007), http://www.finra.org/web/groups/industry/@ip/@enf/@sg/documents/industry/p011038.pdf [hereinafter *Guidelines*].

[26] *Id.*

[27] *Id.*

and, if so, the number of requests made, the time it took the respondent to respond, and the degree of regulatory pressure required to obtain a response.[28]

We affirm the Hearing Panel's expulsion of Legacy and bar of Uselton for their misrepresentations to FINRA. Legacy made a number of misrepresentations to FINRA concerning several different subject matters, and Uselton falsely stated that he had no relationship with Warrior Capital. Respondents' misrepresentations were intentional, and they demonstrated a pattern of obstruction and prolonged delay.[29] The information sought by FINRA related to serious allegations of misconduct by respondents, and respondents frustrated FINRA's investigation into their alleged misconduct with their false statements and delayed and incomplete response to FINRA's numerous requests.[30] Indeed, FINRA was forced to obtain many of the documents it sought from third parties. Moreover, Uselton attempted to blame Boruchin for the misrepresentations.[31] There are no mitigating factors present, and we find that respondents' false statements to FINRA were egregious. Anything short of an expulsion of Legacy and a bar of Uselton would be insufficient to remedy respondents' misconduct and to deter respondents from engaging in future misconduct. *See Ortiz*, 2008 SEC LEXIS 2401, at *32 ("Because of the risk of harm to investors and the markets posed by such misconduct, we conclude that the failure to provide truthful responses to requests for information renders the violator presumptively unfit for employment in the securities industry."). We therefore expel Legacy from FINRA membership and bar Uselton in all capacities for their false statements to FINRA.

We also affirm the Hearing Panel's separate bar of Uselton for his refusal to provide testimony to FINRA during his September 2007 on-the-record interview. When FINRA staff confronted Uselton with documents indicating that his prior statements concerning his lack of a relationship with Warrior Capital were false, Uselton refused to answer any questions. Uselton did so despite knowing that a refusal to respond would subject him to potential disciplinary action and sanctions and was informed as much at his on-the-record interview. Moreover, providing false statements to FINRA, and then refusing to answer FINRA's subsequent questions concerning those false statements, is particularly harmful to FINRA's ability to investigate misconduct. Indeed, Uselton's refusal to answer FINRA's questions further frustrated FINRA's investigation into respondents' misconduct (which by September 2007 had been ongoing for more than two years partly because of respondents' obstructive tactics). There are no mitigating factors, and a separate bar of Uselton for his refusal to provide testimony to FINRA is necessary and appropriately remedial under the circumstances.

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28 *Id.*

29 *See id.* at 6-7 (Principal Considerations in Determining Sanctions, Nos. 8, 9, 10, and 13).

30 *Id.* at 7 (Principal Considerations in Determining Sanctions, No. 12).

31 *Id.* at 6-7 (Principal Considerations in Determining Sanctions, No. 2).

B. Respondents' Violations Related to Their Short-Selling Activity

The Guidelines for short sale violations, including violations of Rule 203(b), recommend a fine of $5,000 to $10,000 for a "first action," $10,000 to $50,000 for a "second action," and $10,000 to $100,000 for "subsequent actions."[32] The Guidelines that addressed violations of former NASD Rule 3370(b) recommended a fine of $1,000 to $2,000 for a first action, $2,000 to $10,000 for a second action, and $5,000 to $100,000 for subsequent actions.[33] Both sets of Guidelines provide that where the short-selling customer is not subject to FINRA jurisdiction, in egregious cases, or where there is evidence of willful misconduct, adjudicators may consider adding the amount of the short-selling customer's transaction profit to the fine for the executing member or associated person.[34] In egregious cases, adjudicators may consider fines greater than the recommended ranges, and may also consider suspending the firm and the responsible individual for up to two years, or expelling the firm and barring the responsible individual.[35]

We affirm the Hearing Panel's imposition of a $907,035.01 fine against respondents (jointly and severally) for their short-selling violations, consisting of a $10,000 fine plus disgorgement of $897,035.01 in profits from respondents' violative short sales. As an initial matter, we disagree with the Hearing Panel's determination that this is a "first action" under the Guidelines. Pursuant to the July 2003 AWC, respondents were each fined $7,500, and Uselton was suspended for three months as a general securities principal and six months as a FINOP, for a number of violations, including failing to make affirmative determinations in connection with proprietary short sales.[36]

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32 *Guidelines*, at 67. The Guidelines recommend considering actions concerning violative events that occurred within three years of the misconduct at issue. "Actions" include AWCs. *See id.* at 9 (Technical Matters).

33 *See NASD Sanction Guidelines*, at 66 (2005) [hereinafter *NASD Guidelines*].

34 *See Guidelines*, at 67; *NASD Guidelines*, at 66. "'Transaction profit' means the profit that the short-selling customer realized. This amount is separate and distinct from the respondent's financial benefit, as described in General Principle No. 6." *Guidelines*, at 67. General Principle No. 6 provides that where the record demonstrates that a respondent has obtained a financial benefit from his misconduct, adjudicators may order that the respondent disgorge any ill-gotten gains (including profits received by the respondent, directly or indirectly, as a result of his misconduct). *Id.* at 6.

35 *Id.* at 67; *NASD Guidelines*, at 66.

36 *See also Guidelines*, at 2 (General Principles Applicable to All Sanction Determinations, No. 2) (recommending more severe sanctions for recidivists); *id.* at 6 (Principal Considerations in Determining Sanctions, No. 8) (instructing adjudicators to consider "[w]hether the respondent engaged in numerous acts and/or a pattern of misconduct."). Generally, Uselton and Legacy have a history of failing to comply with FINRA and Commission rules, including some of the same rules at issue in this case. For instance, and in connection with the July 2003 AWC,

[Footnote continued on next page]

We agree, however, that respondents acted willfully and that their violations of FINRA and Commission rules regarding short sales were egregious.[37] Respondents' short-selling violations occurred over more than 15 months, and involved 2,192 transactions.[38] For the vast majority of the 2,192 short sales, respondents made no effort to affirmatively determine whether Legacy could borrow the stock or otherwise provide for its delivery and no attempt to locate shares of the stock they sold short. In certain instances they executed the short sale despite knowing that they could not satisfy FINRA and Commission rules.

Under the circumstances, and given the differing ranges of fines for violations of NASD Rule 3370 and Rule 203(b), we find that a $10,000 fine for respondents' misconduct is appropriate. We further find that requiring respondents to disgorge the profits from their short sales is appropriate. *See Ko Secs.*, 2004 NASD Discip. LEXIS 21 (imposing a fine that included profits from short sales in connection with respondents' willful and egregious failure to make affirmative determinations).[39] Enforcement has demonstrated that respondents made a profit from the 2,192 short sales totaling $897,035.01, and under the circumstances we find it

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respondents settled allegations that, among other things, they violated short-selling rules, failed to file timely and maintain copies of financial statements, filed inaccurate FOCUS reports, failed to accurately report transactions through the Automated Confirmation Transaction Service ("ACT"), and violated net capital rules. In connection with the February 2004 AWC, Uselton settled allegations that he failed to ensure the preparation and maintenance of accurate books and records, caused his firm to violate net capital rules, and filed inaccurate FOCUS reports. Further, in June 1998, Uselton settled allegations that he failed to implement, enforce, and maintain reasonable and proper supervisory procedures related to his firm's market-making activities, and failed to submit timely and accurate last sales reports through ACT. In July 2005, FINRA fined Legacy $5,000 for "a pattern or practice of late reporting" in failing to transmit through ACT last sale reports, and FINRA suspended Legacy in April 2001 and again in April 2002 for failing to file annual reports. We have considered respondents' disciplinary histories in connection with our sanctions.

37 *See Ko Secs., Inc.*, Complaint No. CMS000142, 2004 NASD Discip. LEXIS 21, at *10 (NASD NAC Dec. 20, 2004) (holding that in connection with a finding that respondents violated short-selling rules, the NAC need only find that respondent intended to commit the act that constituted the violation). We find that respondents intended to engage in the short sales in question.

38 *See Guidelines*, at 6-7 (Principal Considerations in Determining Sanctions, Nos. 8, 9, and 18).

39 *See also Guidelines*, at 5 (General Principles Applicable to All Sanction Determinations, No. 6).

appropriate to order that respondents disgorge these profits.[40] Consequently, we fine respondents a total of $907,035.01, jointly and severally, plus interest, for their short sale violations.[41]

C. Books and Records Violations

For recordkeeping violations, the Guidelines recommend imposing a fine of $1,000 to $10,000, suspending the firm for up to 30 business days, and suspending the responsible individual for up to 30 business days.[42] In egregious cases, the Guidelines recommend imposing a fine of $10,000 to $100,000, and a lengthier suspension (up to two years) or expelling the firm and barring the responsible individual. The Guidelines instruct adjudicators to consider the nature and materiality of inaccurate or missing information.[43]

The Hearing Panel fined respondents $50,000 (jointly and severally) and suspended Uselton in all principal capacities for one year for their recordkeeping violations. We affirm the Hearing Panel's sanctions, and agree that respondents' recordkeeping violations were egregious. Recordkeeping rules are the "keystone of the surveillance of brokers and dealers[.]" *Edward Mawod & Co.*, Exchange Act Rel. No. 13512, 1977 SEC LEXIS 1811, at *16 (May 6, 1977), *aff'd*, 591 F.2d 588 (10th Cir. 1979). Respondents' failure to maintain records documenting their reliance upon the unsolicited customer order exemption to Exchange Act Rule 15c2-11 frustrated rules designed to prevent fraudulent activity. Uselton was well aware of his obligations to maintain such records, yet he continued to knowingly submit orders in reliance upon the exemption without satisfying those obligations. Further, respondents' failure to maintain email communications hindered FINRA's investigation into respondents' misconduct. We also find aggravating Uselton's prior history of recordkeeping violations and that respondents intentionally deleted email communications.[44]

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[40] The Subcommittee ordered, pursuant to NASD Rule 9346(f), that Enforcement supplement the record to more specifically describe its calculations of respondents' profits, and permitted respondents the opportunity to respond to any supplemental information provided by Enforcement. Enforcement submitted detailed calculations setting forth the basis for its calculation of respondents' profits, including the amount earned by respondents in connection with each of the violative 2,192 short sales. Respondents did not file any response to Enforcement's supplemental information.

[41] The Hearing Panel did not impose any additional sanctions for respondents' short-selling violations. But for the expulsion and bars imposed for respondents' violations of NASD Rules 8210 and 2110, we would impose a separate expulsion and bar upon Legacy and Uselton, respectively, for their egregious, intentional, and extensive violations of rules concerning short sales.

[42] *Guidelines*, at 30.

[43] *Id.*

[44] *See Guidelines*, at 7 (Principal Considerations in Determining Sanctions, No. 13); *North Woodward Fin. Corp.*, No. E8A2005014902, 2008 FINRA Discip. LEXIS 47, at *26 (FINRA

[Footnote continued on next page]

Consequently, we find the sanctions imposed by the Hearing Panel are appropriately remedial, and affirm the $50,000 fine imposed upon respondents and suspension of Uselton in all principal capacities for one year in connection with their recordkeeping violations. In light of the expulsion and bars imposed upon respondents for their violations of NASD Rules 8210 and 2110, however, we do not impose these additional sanctions for respondents' recordkeeping violations.

D. Respondents' Supervisory Violations

For failing to supervise, the Guidelines recommend the imposition of a fine between $5,000 and $50,000 and a suspension in all supervisory capacities for up to 30 business days.[45] In egregious cases, the Guidelines recommend suspending the responsible individual in any or all capacities for up to two years or imposing a bar.[46] The Guidelines also recommend considering, in addition to the general principles and principal considerations applicable to all violations, the nature, extent, and size of the underlying misconduct; whether the respondent ignored red flags; the quality and degree of the supervisor's implementation of the firm's supervisory procedures and controls; and whether the respondent attempted to conceal misconduct.[47] For deficient WSPs, the Guidelines recommend that adjudicators impose a fine between $1,000 and $25,000, and in egregious cases consider suspending the firm for up to 30 business days and the responsible individual for up to one year.[48] The Guidelines also recommend considering whether the supervisory deficiencies allowed violative conduct to occur.[49]

After considering the factors set forth in the Guidelines, we affirm the Hearing Panel's two-year suspension of Uselton in all capacities and $50,000 fine imposed upon respondents (jointly and severally) for their supervisory violations. "Assuring proper supervision is a critical component of broker-dealer operations." *Pellegrino*, 2008 SEC LEXIS 2843, at *33. Uselton, on behalf of Legacy, failed to ensure that the Firm had an appropriate system of supervisory

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NAC Dec. 10, 2008) (stating that although violations of recordkeeping rules are essentially based upon a strict liability standard, where records are irrevocably destroyed "the negligent, reckless, or intentional actions of a violator would be far more important"), *aff'd*, 2009 SEC LEXIS 2796; *supra* note 36.

45 *See Guidelines*, at 108.

46 *Id.*

47 *Id.*

48 *Id.* at 109.

49 *Id.*

procedures and controls in place, and ignored his duties as a supervisor. Legacy's WSPs were incomplete and lacked procedures for the Firm's compliance with the unsolicited customer order exemption, and Uselton ignored numerous warnings from Pink Sheets that he appeared to be ignoring the requirements under Exchange Act Rule 15c2-11. We also find that the misconduct underlying respondents' supervisory violations was extremely serious, and that Legacy's lack of a procedure for retaining email communications helped to conceal respondents' misconduct and frustrated FINRA's investigation. We have also considered Uselton's disciplinary history regarding prior failures to properly supervise, and agree with the Hearing Panel's conclusion that respondents' misconduct was egregious. Consequently, we affirm the Hearing Panel's sanctions. However, in light of the expulsion and bars imposed upon Legacy and Uselton, respectively, for their violations of NASD Rules 8210 and 2110, we assess but do not impose these sanctions.

E. Uselton's Failure to Update Timely his Form U4

For failing to update timely a Form U4, the Guidelines recommend fines ranging from $2,500 to $50,000.[50] The Guidelines recommend that we consider the nature and significance of the information, whether the failure resulted in a statutorily disqualified individual becoming or remaining associated with a firm, and whether the respondent's misconduct resulted in any harm.[51] Although the disclosure of FINRA's investigation into Uselton's misconduct was important, Uselton was not statutorily disqualified, and he filed his amended Form U4 approximately six weeks after the deadline. Under the circumstances, we find that it would be appropriate to fine Uselton $2,500 for failing to file timely his Form U4 amendment. However, in light of the bars imposed upon Uselton for his misrepresentations to FINRA and failure to provide testimony to FINRA, we do not impose the fine.

V. Conclusion

We affirm the Hearing Panel's findings that: (1) respondents made false statements to FINRA, and Uselton failed to provide testimony at an on-the-record interview, in violation of NASD Rules 8210 and 2110; (2) respondents failed to make and annotate affirmative determinations prior to effecting short sales, in violation of NASD Rules 3370 and 2110, and failed to locate shares prior to effecting short sales, in violation of Rule 203(b) and NASD Rule 2110; (3) respondents failed to maintain books and records, in violation of NASD Rules 3110 and 2110 (Uselton) and NASD Rules 3110 and 2110, Section 17 of the Exchange Act, and Exchange Act Rules 17a-3 and 17a-4 (Legacy); (4) respondents failed to establish, maintain, and enforce written supervisory procedures, in violation of NASD Rules 3010 and 2110; and (5) Uselton failed to update timely his Form U4, in violation of NASD Rule 2110 and Article V, Section 2(c) of NASD's By-Laws. We further affirm the Hearing Panel's sanctions imposed upon respondents for their misconduct. Accordingly, we: (a) expel Legacy from FINRA membership; (b) bar Uselton in all capacities; (c) order that Legacy and Uselton pay, jointly and

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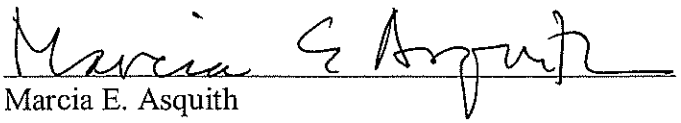
50 *See Guidelines*, at 74.

51 *See id.*

severally, $907,035.01, plus interest at the rate established for the underpayment of income taxes in Section 6621(a) of the Internal Revenue Code, 26 U.S.C. § 6621(a), from September 1, 2005, until paid; and (d) order that Legacy and Uselton pay, jointly and severally, $750 in costs.[52]

On behalf of the National Adjudicatory Council,



Marcia E. Asquith
Senior Vice President and Corporate Secretary

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[52] The expulsion and bars are effective as of the date of this decision. Further, pursuant to FINRA Rule 8320, any member that fails to pay any fine, costs, or other monetary sanction imposed in this decision, after seven days' notice in writing, will summarily be suspended or expelled from membership for non-payment. Similarly, the registration of any person associated with a member who fails to pay any fine, costs or other monetary sanction, after seven days' notice in writing, will summarily be revoked for non-payment.

We also have considered and reject without discussion all other arguments of the parties.