NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. U.S. RICA FINANCIAL, INC. (CRD No. 38742) San Jose, CA and VINH HUU NGUYEN (CRD No. 2374393) San Jose, CA, Respondents.	Disciplinary Proceeding No. C01000003 **Hearing Panel Decision on Remand** Hearing Officer—Andrew H. Perkins July 9, 2002

U.S. Rica Financial, Inc. and Vinh Huu Nguyen, its chief executive officer and sole general securities principal, represented to customers, on the Firm's website and on trade confirmations, that they would be, or had been, charged commissions in accordance with the Firm's published commission schedule, or that trades would be, or had been, effected for "free." In fact, the Respondents effected 316 customer trades on a riskless principal basis through the Firm's proprietary account and charged the customers undisclosed markups and markdowns, and thereby earned and retained "secret profits" of $58,579.83, as well as commissions, on these trades. Thus, the Respondents violated Section 10(b) of the Securities Exchange Act of 1934, SEC Rules 10b-5 and 10b-10(a)(2)(ii)(A), and NASD Conduct Rules 2110, 2120, 2210(d)(1)(A) and (B), and 2230. The Respondents also failed to make appropriate memoranda of brokerage orders in violation of Section 17(a) of the Exchange Act, SEC Rule 17a-3, and NASD Conduct Rules 3110 and 2110.

The Hearing Panel imposed the following sanctions: (1) U.S. Rica is expelled from membership in NASD; (2) Vinh Huu Nguyen is barred from associating with any member firm in any principal capacity; and (3) the Respondents are, jointly and severally, ordered to pay fines in the total amount of $133,579.83, and hearing costs in the amount of $1,853.94.

Appearances

For the Department of Enforcement: David A. Watson, Regional Attorney, San Francisco, California, and Rory C. Flynn, Chief Litigation Counsel (Of Counsel), NASD, Washington, DC.

For the Respondents: David C. Franceski, Jr. and Thomas W. Dymek, STRADLEY RONON STEVENS & YOUNG, LLP, Philadelphia, PA.

DECISION ON REMAND

I. PROCEDURAL HISTORY

The Department of Enforcement ("Department") brought this disciplinary proceeding against U.S. Rica Financial, Inc. ("U.S. Rica" or the "Firm"), an NASD member firm, and Vinh Huu Nguyen ("Nguyen"), the Firm's chief executive officer and sole general securities principal, for alleged violations of NASD's Conduct Rules in connection with their representations to customers, on the Firm's website and on trade confirmations, that they would be, or had been, charged commissions in accordance with the Firm's published commission schedule, or that trades would be, or had been, effected for "free." According to the twelve-cause Amended Complaint ("Complaint")[1] filed February 2, 2000, the Respondents in fact effected 316 customer trades on a riskless principal basis through the Firm's proprietary account and charged their customers undisclosed markups and markdowns, and thereby earned and retained "secret profits" of $58,579.83, as well as commissions, on these trades. Based on the foregoing, the Complaint

[1] All references to the Complaint are to the Amended Complaint.

charged the Respondents with violating Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), SEC Rules 10b-5 and 10b-10(a)(2)(ii)(A), and NASD Conduct Rules 2110, 2120, 2210(d)(1)(A) and (B), and 2230. The Complaint also alleges that the Respondents failed to make appropriate memoranda of brokerage orders in violation of Section 17(a) of the Exchange Act, SEC Rule 17a-3, and NASD Conduct Rules 3110 and 2110.

The Respondents filed an Amended Answer ("Answer") to the Complaint on March 27, 2000, in which they denied the allegations and requested a hearing. Notwithstanding their Answer, the Respondents thereafter repeatedly admitted the allegations in the Complaint. On May 5, 2000, prior to the hearing, the Department filed a motion for summary disposition, pursuant to NASD Code of Procedure Rule 9264, as to liability only. On May 24, 2000, the Respondents filed a response, stating:

> Respondents admit the factual allegations of the Staff and admit that these facts constituted violations of NASD and SEC Rules. Respondents did advertise a commission schedule without disclosing that some transactions would be effected on a riskless principal basis. When these trades were effected on a riskless principal basis, the confirmations improperly represented that the transactions were agency trades. The agency trade confirmations of riskless principal trades also did not disclose the markups received by the firm. Finally, some inventory account transactions were not supported by orders with timestamps as is required by NASD Rules. (Resp. at 1.)

At a subsequent pre-hearing conference, Respondents' Counsel confirmed, "we are admitting the conduct, and, therefore, the violations, and the issue is sanctions." (Tr. June 8, 2000, at 5.) And, on July 6, 2000, the Parties filed joint stipulations in which the Respondents again admitted that they committed the violations alleged in the Complaint.[2]

On the basis of these admissions, the Hearing Panel granted the Department's motion for summary disposition, stating that the "hearing will proceed as scheduled for the sole purpose of

receiving evidence and hearing argument bearing on the issue of sanctions, including any mitigating or aggravating factors that the Parties wish to bring to the Hearing Panel's attention."

On August 10, 2000, the former Hearing Panel conducted a hearing for the purpose of receiving evidence and hearing argument on the issue of sanctions.[3] The Department offered the testimony of one witness, Bradley Kaiser, a former NASD Supervisor of Examinations, who was responsible for the examination that gave rise to this disciplinary proceeding,[4] and seven exhibits, all of which were admitted in evidence.[5] Nguyen testified on the Respondents' behalf, and they offered 16 exhibits, one of which was admitted in evidence.[6]

Following the hearing and the receipt of the Parties' post-hearing briefs, the Hearing Officer who presided at the hearing left NASD, and a replacement Hearing Officer was appointed. On January 3, 2001, the Hearing Panel issued its Decision ("Decision"), but the replacement Hearing Officer did not participate because he had not taken part in the hearing and therefore had not had the opportunity to observe the witnesses. The Decision reflected the determinations of the remaining two members of the Hearing Panel.

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[2] References to the "Joint Stipulations of the Parties" are cited as "Stip. ¶ ___."

[3] References to the transcript of the original hearing are cited as "Tr. I, at ___," and references to the transcript of the hearing on remand are cited as "Tr. II, at ___."

[4] Tr. I, at 34.

[5] References to the Department's exhibits are cited as "CX ___."

[6] References to the Respondents' exhibits are cited as "RX ___." The Respondents withdrew one of their proposed exhibits (RX 1); two of their proposed exhibits (RX 10 and RX 11) were identical to two of the Department's exhibits (CX 5 and CX 6) that had been admitted in evidence; another of their proposed exhibits was a blank sheet of paper (RX 12); and the Hearing Officer sustained the Department's objections to RX 2-RX 4, RX 6-RX 9, and RX 13-RX 14. (See Tr. I, at 96-104.) The Hearing Panel also rejected the Respondents' proposed exhibit RX 16, which purported to reflect the price and time of transactions in one of the securities that the Respondents placed as riskless principal trades, because it had questions regarding the authenticity of its contents. (Tr. I, at 168-70.) However, since the Department did not object to that exhibit, the Hearing Panel accepted Exhibit 1 to Respondents' post-hearing brief, which Respondents' counsel obtained directly from the NASD, as a substitute for RX 16.

As sanctions for the Respondents' admitted violations, the Hearing Panel expelled U.S. Rica from membership in the NASD and barred Nguyen from associating with any member firm in all capacities. The Hearing Panel also ordered the Respondents, jointly and severally, to pay: (1) disgorgement in the total amount of $58,579.83, plus pre-judgment interest thereon calculated pursuant to 26 U.S.C. § 6621(a)(2) from January 6, 2000 until paid;[7] (2) fines totaling $240,000; and (3) costs.[8]

On January 26, 2001, the Respondents appealed the Decision to the NAC. One of the numerous grounds noted by the Respondents was an objection that the Hearing Panel had erred in deciding the case without the participation of a Hearing Officer. On October 26, 2001, without addressing any of the other issues the Respondents' raised, the NAC remanded the case and directed that "a new hearing limited to sanctions be held before a new Hearing Panel."

In accordance with the NAC's Decision, an entirely new Hearing Panel was appointed and, on March 20, 2002, a new hearing was held in San Francisco, California, on the issue of sanctions. The Department moved into evidence exhibits CX 1 through CX 7, which already had been admitted during the course of the original hearing, and two additional exhibits, CX 8 and CX

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[7] The Hearing Panel further ordered the Respondents to pay the funds disgorged as restitution to the customers identified on Schedules A-D to the Complaint, in an amount equal to the undisclosed markup or markdown the Firm charged on each of the transactions identified on those Schedules (listed under the heading "Secret Profits") plus the pre-judgment interest due on that amount.

[8] In assessing the foregoing sanctions, the Hearing Panel rejected the Respondents' Contested Offer of Settlement. The Hearing Panel concluded that the Respondents' suggested sanctions were too lenient to redress their misconduct and to serve the specific and general deterrent purposes of sanctions. The Respondents first submitted the Offer of Settlement to the Department immediately before the hearing was scheduled to begin, which the Department orally rejected. Then, rather than adjourning the hearing either to require the Department to prepare a written opposition or to require the Parties to attend a settlement conference (as contemplated by Rule 9270(f)), the Hearing Panel told the Respondents that they could argue that the Hearing Panel should impose sanctions consistent with the terms of their contested Offer of Settlement. At the conclusion of the hearing, at the Respondents' request, the Hearing Panel afforded the Parties the opportunity to submit post-hearing briefs, which they filed on August 21, 2000. In their post-

9, which the Hearing Panel admitted. The Department offered no further supplemental evidence. Nguyen testified on the Respondents' behalf, and they offered 14 exhibits into evidence, which the Hearing Panel admitted.[9]

II. FINDINGS OF FACT AND CONCLUSIONS OF LAW

As explained above, the Respondents stipulated to the facts and violations alleged in the Complaint; therefore, the only issue for hearing was sanctions.

A. Respondents

U.S. Rica is a small on-line brokerage firm based in San Jose, California, that Nguyen established in 1996. (Stip. ¶ 1; Tr. I, at 70; Tr. II, at 35, 37-38.) Since May 29, 1996, U.S. Rica has been an NASD member, and Nguyen has served as the Firm's sole General Securities Principal. (Stip. ¶¶ 1-2.) Nguyen has been employed in the securities industry and registered as a General Securities Principal and a General Securities Representative since 1993. (Tr. I, at 70, 142.) For approximately two years before founding U.S. Rica, Nguyen was a branch manager for Thomas White & Co. (Tr. II, at 35.)

In 1999, U.S. Rica had approximately 15 employees. (Tr. I, at 73.) It functioned as an introducing firm and cleared through U.S. Clearing Corp. (Tr. II, at 38.) During the time in question, the Firm serviced about 2500 accounts, and it processed about 200 to 300 orders per day. (Tr. I, at 71-74, Tr. II, at 38.) Approximately 80-90% of the orders were received on-line. (Tr. II, at 38.) Approximately 75% of the orders the Firm received were limit orders. (Tr. II, at 39.)

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hearing brief, the Respondents again sought to present a contested Offer of Settlement to the Hearing Panel. (See Respondents' Post-Hr'g Br., Ex. 2.)

[9] The Hearing Panel admitted Respondents' exhibits R 1, R 4-5, R 7-8, and R 10-18. (See Tr. II, at 152-54.)

B. Jurisdiction

The NASD has jurisdiction of this disciplinary proceeding. U.S. Rica was a member of the NASD, and Nguyen was registered with the NASD, both when the Department filed the Complaint and when the Respondents committed the violations alleged in the Complaint.[10]

C. Background

The violations that are the subject of this proceeding were uncovered during a routine examination of U.S. Rica in March 1999. In preparation for the examination, NASD Staff reviewed U.S. Rica's website and found that, between December 1998 and January 1999, U.S. Rica advertised that it would effect on-line trades for commissions as low as $4.95 per trade. (Tr. I, at 35.) The Staff also found that U.S. Rica advertised that February 17, 1999, was a commission-free trading day. (Id.) The website made no disclosure concerning principal trades. (Id. at 36.) However, upon examination of a sample of order tickets and customer confirmations for December 1998 through January 1999, the Staff discovered that the Respondents appeared to be effecting some trades on a riskless principal basis, without disclosing this fact to its customers and without disclosing the amount of the markups or markdowns. (Id. at 36-37.) The Staff also uncovered some trades where the Firm had charged markups or markdowns exceeding 5%. Accordingly, by letter dated April 14, 1999 (CX 5), NASD advised the Respondents "it appears that the firm engaged in 'riskless' principal transactions with customers and failed to disclose the markups or markdowns as required by SEC Rule 10b-10." NASD further noted that the Firm had advertised, through the Internet, "commission charges of $4.95 on securities transactions without indicating the transactions may be executed on a 'riskless' basis [and that] the firm charged a markup or markdown in addition to the commission" on such transactions. (CX 5.) Finally,

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[10] See NASD By-Laws Articles XII and XIII.

pursuant to NASD Procedural Rule 8210, NASD asked Nguyen to respond and explain how the Firm would insure proper disclosures of riskless principal trades, including information concerning how the Firm set commissions. (Id.)

On April 22, 1999, Nguyen responded to the issues raised by NASD.[11] (CX 6.) In substance, Nguyen explained the nature of the Firm's trading and identified himself as the person responsible for setting the Firm's commission policies. With regard to the Firm's website, Nguyen acknowledged that the Firm's website advertisement improperly failed to disclose that trades may be effected on "'riskless basis' with a markup or markdown" and stated: "[w]e are adding this disclosure to our Web site. We are submitting the change to the NASD advertising department for review." (CX 6) (emphasis added.) With regard to the issue of the Firm's disclosure of its capacity on customer confirmations, Nguyen confirmed that he disclosed the Firm's capacity as "agent" and asked whether he instead should be disclosing the Firm's status as "principal."

Nguyen's letter did not alleviate the Staff's concerns about the Firm's possible violation of SEC Rule 10b-10. The Staff thus determined that it should question Nguyen in an on-the-record interview. (Tr. I, at 39.) The Staff conducted the interview on July 28, 1999.[12] During the interview, Nguyen admitted that certain of the questioned trades were riskless principal trades although the Firm had not disclosed them as such on the customer confirmations. (Tr. I, at 43-44.)

In December 1999—eight months after Nguyen represented to NASD that the Firm would correct its website advertisements, and approximately five months after Nguyen testified at his on-

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[11] Nguyen signed the letter that William Carson, the Firm's outside Financial and Operations Principal ("FINOP"), drafted. Carson is an independent consultant retained by U.S. Rica to provide FINOP services. (Tr. I, at 111-12; Tr. II, at 55-56.)

[12] Exhibit R 16 is the transcript of the on-the-record interview.

the-record interview—NASD Staff again reviewed the Firm's website and discovered that the Respondents had not made the promised corrections. Instead, NASD Staff found that, on December 22, 1999, the Respondents had published another false and misleading advertisement. (Stip. ¶ 15.)

The December 22 advertisement stated: "To celebrate the new Millennium and to show our appreciation, U.S. RICA has GREAT news for YOU. Until the End of 1999 All Internet Orders are COMMISSION FREE." Respondents stipulated that, like the prior advertisements, this advertisement failed to disclose that customer transactions might be effected on a riskless principal basis through the Firm's proprietary inventory account and that, with respect to such trades, customers would be charged undisclosed markups or markdowns. (Stip. ¶ 15.) Indeed, Respondents stipulated that on December 23, 1999, they effected, on a riskless principal basis, 21 purchases or sales of securities for which they charged customers undisclosed markups and markdowns, and realized profits of $18,815.63. (Stip. ¶ 17; see Complaint, Schedule C.) And, like the confirmations issued for the riskless principal trades effected during the period from December 29, 1998 to January 21, 1999, and on February 17, 1999, Respondents stipulated that the confirmations the Firm issued to its customers for these 21 trades falsely represented that the Firm was acting in the capacity of an agent and failed to disclose the markups or markdowns charged. The confirmations reflected only that the trades had been effected for "free." (Stip. ¶ 19.)

The Respondents' violations continued unabated until after the Department filed the Complaint. For example, on January 5, 2000—just weeks before this proceeding was instituted—the Respondents falsely represented in connection with six transactions that the Firm charged commissions in accordance with its published commission schedule when, in fact, it effected the transactions on a riskless principal basis and charged the customers undisclosed markups or

markdowns, through which the Firm earned undisclosed profits of $475. (Stip. ¶ 21; see Compl., Schedule D.) And again, the Firm issued confirmations to its customers for these six trades that falsely represented that the Firm was acting in the capacity of an agent and failed to disclose the markups and markdowns charged. (Stip. ¶ 23.)

Finally, in or about February 2000—after this proceeding was instituted and some 10 months after Nguyen represented to NASD that the Firm would correct its false website advertisements—the Respondents began disclosing on the Firm's website that the Firm might effect transactions on a riskless basis,[13] and began issuing confirmations to the Firm's customers that correctly noted the capacity in which the Firm effected trades and any markups or markdowns charged.[14] (Tr. I, at 130.) Two days before the August 10, 2000, hearing the

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[13] The Firm's website advertisement (RX 5) now states:

> If we are able to obtain a price better than the displayed national best bid or offer, we may execute your transaction as a riskless principal trade through our own proprietary inventory account and not as an agency trade. In such a case, you will not be charged a commission and we will retain a mark-up equal to the difference between the price we obtained and the displayed national best bid or offer, which will not exceed 5%. Your confirmation will reflect a principal transaction and the amount of the markup will be disclosed. Your execution will not exceed the displayed national best bid or offer.

The advertisement further explains:

> National best bid or offer means the best price available from brokers making a market on the stock as reflected on the Nasdaq system. Electronic Communications Networks ("ECN") may from time to time offer better prices than available from NASDAQ[.] ECNs involve additional cost and effort to us. If we can locate a price from an ECN which is better than the NASDAQ price, we may purchase the stock from the ECN for our own account and then resell the stock to you at the best NASDAQ price. Your confirmation will identify the trade as a principal trade and will disclose any mark up. The mark up cannot exceed 5%.

[14] Nguyen contends that he took reasonable corrective action under the circumstances. According to Nguyen, he retained counsel in November 1999 to prepare adequate disclosure to correct the Firm's website advertisements and to determine what confirmation disclosure was required (Tr. I, at 56, 127-28.) And, in January 2000, the Firm began testing software that would enable it to issue redesigned trade confirmations. (Tr. I, at 129-30.) But the evidence shows that Nguyen intentionally delayed taking corrective action. Assuming Nguyen retained counsel when he said he did, he waited more than five months after representing to NASD Staff that the Firm would correct the misleading advertisements. Moreover, the

Respondents, acting on the advice of counsel, disclosed to the customers identified in Schedules A-D to the Complaint that the Firm had acted in a principal capacity and that it had charged markups and markdowns in addition to commissions on their trades. (Tr. I, at 135-36, 158; Tr. II, at 112-13; R 7; R 8.)

D. Respondents' Misconduct (Based on the Parties' Stipulations)

1. Causes One through Three

During the period from December 29, 1998 through January 21, 1999, the Firm, acting through Nguyen, advertised on the Firm's website that the Firm would effect customer trades of 500 or more shares for the following specific commissions: (a) $4.95 for Internet trades; (b) $10 for touch-tone telephone trades; and (c) $35 for broker assisted trades. With respect to trades of less than 500 shares, the Firm represented that it would charge its customers: (a) $10 for Internet trades; (b) $15 for touch-tone telephone trades; and (c) $35 for broker assisted trades. In fact, the Respondents effected transactions for customers on a riskless principal basis through the Firm's own proprietary account charging undisclosed markups and markdowns on those trades in addition to the advertised commissions. The Respondents thereby violated NASD Rules 2110 and 2210(d)(1)(a), as alleged in Cause One of the Complaint. (Stip. ¶¶ 3-4.)

During the same period, in connection with 263 customer purchases and sales of securities, the Respondents misrepresented to customers that a commission was being charged in accordance with the Firm's published commission schedule, when in fact the transactions were being effected as riskless principal transactions through the Firm's proprietary inventory account, and both commissions and undisclosed markups and markdowns were being charged, resulting in

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Hearing Panel does not believe Nguyen was genuinely concerned about correcting the advertisements before this proceeding was brought: even after he retained counsel, he published the December 22, 1999 advertisement announcing that all trades until the end of the millennium would be "free."

secret profits to the Firm of $37,132.95 on the 263 transactions. The Respondents thereby violated Section 10(b) of the Exchange Act, SEC Rule 10b-5, and NASD Rules 2120 and 2110, as alleged in Cause Two of the Complaint. (Stip. ¶¶ 5-6.)

During the same period, and in connection with the same 263 transactions, the Firm, acting through Nguyen, effected purchases and sales of securities for and with the accounts of customers as a principal for its own account, and not as a market maker. In the confirmations to the customers, however, the Respondents falsely indicated that the Firm had acted as an agent and had charged a commission in accordance with its published commission schedule. The Respondents also failed to disclose that the transactions had been effected on a riskless principal basis through the Firm's proprietary account and that the Firm charged both commissions and undisclosed markups and markdowns on the transactions. The Respondents thereby violated Section 10(b) of the Exchange Act, SEC Rule 10b-10(a)(2)(ii)(A), and NASD Rules 2230 and 2110, as alleged in Cause Three of the Complaint. (Stip. ¶¶ 7-8.)

2. Causes Four through Six

On February 17, 1999, the Firm, acting through Nguyen, advertised on the Firm's website that February 17 was a "commission free day." In fact, on that day the Respondents effected customer transactions on a riskless principal basis through the Firm's proprietary inventory account, charging undisclosed markups and markdowns. The Respondents thereby violated NASD Rules 2110 and 2210(d)(1)(A) and (B), as alleged in Cause Four of the Complaint. (Stip. ¶¶ 9-10.)

On the same date, in connection with 26 customer purchases and sales of securities, the Firm, acting through Nguyen, misrepresented to customers that their transactions were being effected by the Firm as commission free trades when, in fact, the transactions were effected as

riskless principal transactions through the Firm's proprietary inventory account, and the customers were charged undisclosed markups and markdowns, through which the Firm received secret profits of $2,156.25 on the 26 transactions. The Respondents thereby violated Section 10(b) of the Exchange Act, SEC Rule 10b-5, and NASD Rules 2120 and 2110, as alleged in Cause Five of the Complaint. (Stip. ¶¶ 11-12.)

Also on the same date, and in connection with the same 26 transactions, the Firm, acting through Nguyen, effected purchases and sales of securities for and with the accounts of customers as a principal for its own account, and not as a market maker. In the confirmations to the customers, however, the Respondents falsely indicated that the Firm had acted as an agent for free, when in fact the transactions had been effected on a riskless principal basis through the Firm's proprietary account, and the Firm was charging undisclosed markups and markdowns on the transactions. The Respondents thereby violated Section 10(b) of the Exchange Act, SEC Rule 10b-10(a)(2)(ii)(A), and NASD Rules 2230 and 2110, as alleged in Cause Six of the Complaint. (Stip. ¶¶ 13-14.)

3. Causes Seven through Nine

On December 22, 1999, the Firm, acting through Nguyen, advertised on its website: "To celebrate the new Millennium and to show our appreciation, U.S. RICA has GREAT news for YOU. Until the End of 1999 All Internet Orders are COMMISSION FREE." In fact, the Respondents effected such customer Internet trades on a riskless principal basis through the Firm's proprietary inventory account, charging undisclosed markups and markdowns. The Respondents thereby violated NASD Rules 2110 and 2210(d)(1)(A) and (B), as alleged in Cause Seven of the Complaint. (Stip. ¶¶ 15-16.)

On the following day, December 23, 1999, in connection with 21 customer purchases and sales of securities, the Firm, acting through Nguyen, misrepresented to the customers that their Internet transactions were being effected by the Firm for free, when in fact the transactions were being effected as riskless principal transactions through the Firm's proprietary inventory account with undisclosed markups and markdowns, through which the Firm received secret profits of $18,815.63 on the 21 transactions. The Respondents thereby violated Section 10(b) of the Exchange Act, SEC Rule 10b-5, and NASD Rules 2120 and 2110, as alleged in Cause Eight of the Complaint. (Stip. ¶¶ 17-18.)

Also on December 23, and in connection with the same 21 transactions, the Firm, acting through Nguyen, effected purchases and sales of securities for and with the accounts of customers as a principal for its own account, and not as a market maker. In the confirmations to the customers, however, the Respondents falsely indicated that the Firm had acted as an agent for free, when in fact the transactions had been effected on a riskless principal basis through the Firm's proprietary account, and the Firm was charging undisclosed markups and markdowns on the transactions. Respondents thereby violated Section 10(b) of the Exchange Act, SEC Rule 10b-10(a)(2)(ii)(A), and NASD Rules 2230 and 2110, as alleged in Cause Nine of the Complaint. (Stip. ¶¶ 19-20.)

4. Causes Ten and Eleven

On January 5, 2000, in connection with six customer purchases and sales of securities, the Firm, acting through Nguyen, misrepresented to customers that the Firm was charging a commission on the transactions in accordance with the Firm's published commission schedule, when in fact the transactions were effected as riskless principal transactions through the Firm's proprietary account, and both commissions and undisclosed markups and markdowns were being

charged, through which the Firm obtained secret profits of $475 on the six transactions. The Respondents thereby violated Section 10(b) of the Exchange Act, SEC Rule 10b-5, and NASD Rules 2120 and 2110, as alleged in Cause Ten of the Complaint. (Stip. ¶¶ 21-22.)

On the same date, and in connection with the same six transactions, the Firm, acting through Nguyen, effected purchases and sales of securities for and with the accounts of customers as a principal for its own account, and not as a market maker. In the confirmations to the customers, however, the Respondents falsely indicated that the Firm had acted as an agent and was charging a commission in accordance with its published commission schedule, when in fact, the transactions had been effected on a riskless principal basis through the Firm's proprietary account, and the Firm was charging undisclosed markups and markdowns on the transactions. The Respondents thereby violated Section 10(b) of the Exchange Act, SEC Rule 10b-10(a)(2)(ii)(A), and NASD Rules 2230 and 2110, as alleged in Cause 11 of the Complaint. (Stip. ¶¶ 23-24.)

5. Cause Twelve

During the periods: (a) from December 29, 1998 through January 21, 1999; (b) February 17, 1999; (c) December 23, 1999; and (d) January 5, 2000, in connection with the transactions described above, the Firm failed to make a memorandum of each brokerage order reflecting the time of entry and the time of execution of purchases of securities from other broker-dealers into the Firm's inventory account, and sales of securities to other broker-dealers from the Firm's inventory account. Nguyen caused the Firm to fail to make the appropriate memoranda of the brokerage orders. The Respondents thereby violated Section 17(a) of the Exchange Act, SEC Rule 17a-3, and NASD Rules 3110 and 2110, as alleged in Cause Twelve of the Complaint. (Stip. ¶¶ 25-26.)

III. SANCTIONS

A. Principal Considerations

The threshold question is the relative seriousness of the Respondents' misconduct. The Department maintains that severe sanctions are required to remediate the Respondents' misconduct and protect the investing public. The Department insists that the evidence demonstrates the Respondents' persistent violation of the NASD's conduct rules and their willingness to obtain profits through fraud. The Respondents, on the other hand, take a very different view of their violations. The Respondents portray their violations as simple oversights and mistakes, which the NASD has unfairly blown out of proportion. Accordingly, taking into consideration the costs the Respondents incurred in defending themselves, they urge the Hearing Panel not to impose any sanctions.[15]

With reference to the Principal Considerations In Determining Sanctions,[16] the Hearing Panel concludes that the Respondents excessively play down the egregious nature of their misconduct. The Respondents' conduct manifested "a marked insensitivity to their obligation to

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[15] At the conclusion of the original sanctions hearing in August 2000, the Respondents proposed that the Hearing Panel impose sanctions as follows: (1) censure the Firm and Nguyen; (2) suspend Nguyen as a principal for two years and until he requalifies by examination and demonstrates to the satisfaction of the Director of District 1 ("Director") that he is familiar with the rules applicable to the Firm's business; (3) with respect to the trades identified on Schedules A-D to the Complaint, require the Firm to reimburse to any customer the amount of any markup or markdown that was more than 5% over the Firm's cost; (4) fine the Respondents, jointly and severally, $120,000 (i.e., $10,000 for each cause in the Complaint); (5) require the Firm, for a period of two years, to submit to NASD's advertising department and to the Director, and to obtain their pre-use approval of, all advertisements and sales literature; (6) retain a "qualified independent consultant," who is acceptable to the Director or his or her designee, "to design and audit a compliance program" for the Firm's business and certify compliance with the program to the Director on a semi-annual basis; and (7) require the Firm to pay $25,000 to NASD ($5,000 for each year for a period of five years) to cover the costs of annual examinations of the Firm. (See Respondents' [First] Post Hr'g Br. at 11-12 & and Ex. 2; see also Tr. I, at 138-40.) The Respondents abandoned this approach at the sanctions hearing on remand and concluded in their post-hearing brief that, in consideration of the costs they endured in the two hearings and appeal, "additional sanctions will not do further justice to the situation." (Respondents' [second] Post-Hr'g Br. at 16.)

deal fairly with customers."[17] The Respondents engaged in a pattern of intentional misconduct over an extended period. This misconduct continued even after NASD Staff brought to their attention the nature of their wrongdoing. Moreover, after Nguyen assured NASD Staff that the Respondents would take prompt action to correct the false and misleading disclosures on the Firm's website, they failed to do so—or to implement any remedial measures—until after the Department brought this proceeding, and even then they took certain limited corrective actions only in anticipation of the hearing. These circumstances raise the strong likelihood that the Respondents would engage in similar misconduct in the future unless the Hearing Panel imposes appropriate remedial sanctions.

B. Respondents' Mitigation Arguments

The Respondents nonetheless argue that this case presents three reasons why the sanctions, if any, should be minimal. First, the Respondents argue that the rules, regulations, and cases regarding the disclosure of riskless principal trading are unclear. Second, the Respondents assert that they were confused about their disclosure requirements; therefore, their violations were not the product of any intentional disregard of their compliance obligations. Third, the Respondents argue that several policy considerations in the NASD Sanction Guidelines, such as progressive discipline, uniformity, fairness, and credit for cooperation, warrant a restrained approach to sanctions in this case.[18] The Respondents further argue that the Hearing Panel should not impose significant sanctions since, for market orders, the Firm's customers always received the National Best Bid and Offer ("NBBO")—the highest quoted bid price and lowest quoted offer

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[16] NASD Sanction Guidelines at 9-10 (2001 ed.).

[17] Frank L. Palumbo, 52 S.E.C. 467, 1995 SEC LEXIS 2814, at *35 (1995).

[18] Respondents' [second] Post-Hr'g Br. at 6.

price from among all quotations entered in the Consolidated Quotation Service, and, for limit orders, the customers always got the limit price. Thus, the Respondents contend, the customers suffered no harm. (Tr. II, at 41-42.) For the following reasons, however, the Hearing Panel finds the Respondents' arguments unpersuasive.

1. Riskless Principal Trading

The Respondents' principal defense is that they were confused about the nature of the questioned transactions, which confusion resulted in their disclosing the transactions as agency trades rather than riskless principal trades. Nguyen contends that he considered the trades to be agency trades because the Firm had market-risk exposure. (Tr. II, at 43-44.) As Nguyen explained it, when a customer placed a buy order, he would determine if it looked like he could buy the stock for less. If so, Nguyen would purchase the security in the Firm's proprietary account and sell it to the customer at the order price. (Tr. II, at 37, 39-40.) In such a case, the Firm kept the difference it made between the purchase and sale prices and charged a commission. On the other hand, if it turned out that he could not get the stock for less, the customer nevertheless got the stock at the order price, and the Firm took the loss. Because the Firm could suffer a loss on the trade, Nguyen never considered the difference between what he paid for the stock and what he sold it for to be a markup. (Tr. II, at 43-44.) The Respondents vigorously deny they intentionally misrepresented the nature of the transactions and their compensation.

The Respondents contend that their confusion was reasonable given what they characterize as the confused state of the law surrounding riskless principal trades.[19] Specifically, the Respondents argue that the law is unclear regarding the definition of riskless principal trades, how firms may be compensated for such trades, and what aspects of that compensation must be

disclosed to customers. The Respondents first point to the Buys-MacGregor, MacNaughton-Greenwalt & Co., No Action Letter, 1980 SEC No-Act LEXIS 2851 (Jan. 2, 1980)—which NASD Staff sent to the Respondents with its letter dated April 14, 1999—as a source of confusion. In Buys-MacGregor, the SEC addressed the question of how to determine if transactions are offsetting "contemporaneous" transactions within the meaning of SEC Rule 10b-10. The SEC concluded that trades covered on the same trading day, regardless of sequence, are considered riskless principal trades for which disclosure of remuneration is required under SEC Rule 10b-10 "where the transactions are in fact designed to be offsetting."[20] In contrast, where the covering transaction is effected the next trading day, the SEC stated that it ordinarily should not be construed to be "contemporaneous" with the initial transaction.[21] The SEC also distinguished situations in which a "broker-dealer maintains a bona fide inventory for sale to customers that it established before receiving customer orders and that it periodically replenishes, not on a transaction-by-transaction basis but after effecting a series of transactions with customers."[22]

The Respondents contend that Buys-MacGregor is confusing because it set forth a market-risk test to determine if trades are riskless principal trades, but it failed to articulate standards regarding the test's application to intraday trades, such as the trades at issue in this proceeding. According to the Respondents' interpretation of Buys-MacGregor, Rule 10b-10 does not require the disclosure of markups and markdowns on offsetting trades if the firm has market risk exposure, but the SEC did not define adequately how long a holding period was necessary for a firm to demonstrate that it had assumed market risk on intraday trades.

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[19] Id. at 7.

[20] Buys-MacGregor, 1980 SEC No-Act LEXIS 2851, at *3.

[21] Id. at *4.

The Respondents' argument, however, is based on an incorrect reading of Buys-MacGregor. Contrary to the Respondents' argument, the SEC in Buys-MacGregor did not define the disclosure requirement of markups and markdowns for riskless principal trades solely with reference to the firm's risk. Instead, the SEC advised that Rule 10b-10 applies where the facts and circumstances demonstrate that the firm "designed" the transactions to be offsetting. If so, for the purposes of Rule 10b-10, the transactions are deemed contemporaneous, and hence riskless principal trades. In those cases where the firm's design is not readily apparent, the SEC advised that "[o]ne indication that a firm may have arranged transactions in a fashion that would require disclosure of the mark-up or mark-down under Rule 10b-10 is close time proximity of offsetting transactions."[23]

In this case, the Hearing Panel finds no ambiguity or confusion. Nguyen unequivocally testified that he commenced riskless principal trading after reading about it in an NASD publication. (Tr. II, at 98, 127-29; Tr. I, at 75-76.) Hence, he intended to engage in riskless principal trading. Furthermore, according to Nguyen, the pamphlet described riskless principal trades and how to report them. (Tr. II, at 128-29.) Accordingly, he knew that such trades must be disclosed to customers as riskless principal trades.

The Hearing Panel also finds it significant that Nguyen adopted riskless principal trading as a method of doing business that would allow him to be more competitive. (Id. at 99; Tr. I, at 75-76.) Nguyen testified that when he started the Firm most of its business was agency trades for which he charged $80 per trade. (Tr. I, at 71.) Over time, new competitors, such as E-Trade, introduced lower commissions, which forced Nguyen to lower his commissions to $35 per trade.

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[22] Id. at *4-5.

[23] Id.

(Id. at 74.) At that level, the Firm was barely profitable. Nguyen further testified that the Firm's competitive position further eroded when E-Trade reduced commissions to $14.95 per trade. (Id. at 75-76.) Faced with a loss of customers, Nguyen concluded that he could not compete unless he found a way to increase revenue and reduce commission rates. He saw riskless principal trading as a strategy that would allow him to do just that. (Id.) Nguyen determined that he could undercut competitors such as E-Trade because the Firm also would retain the profits derived from buying or selling the securities in its own account. In other words, by executing the trades on a riskless principal basis, the Firm could charge both a commission and a markup or markdown and thereby remain profitable while charging very low commission rates. And Nguyen knew that the likely success of this strategy would be enhanced if he did not disclose to customers that the Firm, in addition to charging a commission, would receive a markup or markdown on the trades.

In summary, the evidence establishes that Nguyen knew exactly what riskless principal trading was and how he could use it to his benefit. Nguyen was not confused in the least. Nguyen intended to engage in riskless principal trading; therefore, he designed the transactions to be offsetting. Thus, they were riskless principal trades for the purposes of SEC Rule 10b-10, and the Respondents therefore were obligated to disclose the markups and markdowns, which they failed to do.[24]

2. Disclosure of Riskless Principal Trades

Next, Nguyen tries to excuse the Respondents' decision not to disclose the markups and markdowns on the confused state of the law regarding such disclosure. The Respondents point to the SEC's decision in Kevin B. Waide,[25] which they claim demonstrates that, 12 years after the

[24] See Buys-MacGregor, 1980 SEC No-Act LEXIS 2851, at *3-4.

[25] Exchange Act Release No. 30,561, 1992 SEC LEXIS 827 (Apr. 7, 1992).

SEC issued the Buys-MacGregor No Action Letter, the NASD still had not settled the issue of how markups should be disclosed on riskless principal trades. The Waide decision, however, addresses "questions concerning the appropriate method of calculating markups when a dealer engages in transactions on a riskless principal basis," not the issue of the requirement to disclose markups under SEC Rule 10b-10.[26] And, to the extend that the Respondents' argument is based on professed confusion about how to calculate markups and markdowns, the Waide decision cuts against the Respondents' argument in at least three important respects. First, Waide identified riskless principal sales as occurring "where a dealer, after receiving a customer order for a security, purchases the security from another firm for its own account, and then contemporaneously sells that security to the customer," a definition that covers the trades in question in this proceeding. Second, in Waide, the SEC affirmed that NASD's overall requirement that members must sell securities at fair prices applies to riskless principal trades.[27] Significantly, the SEC noted that a trade on a riskless principal basis should be treated similarly to an agency transaction, in which a firm may retain no more than a commission computed on the basis of its cost.[28] Thus, for more than six years before the conduct at question here, the fundamental question concerning a member's obligation to charge and disclose fair markups in riskless principal transactions had been settled. The Respondents have no basis to claim that the Waide decision led them to conclude that they did not have to disclose markups and markdowns on riskless principal trades. Finally, in Waide, the SEC clarified that markups on riskless principal

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[26] Waide, 1992 SEC LEXIS 827, at *2.

[27] Id. at *4.

[28] Id. at *9.

trades must be calculated using the firm's contemporaneous cost—the price a firm actually pays in actual transactions closely related in time to its retail sales.

3. Harm to Customers

The Respondents' third mitigation argument is that none of the affected customers suffered economic harm. According to the Respondents, each customer received either their limit order price or the NBBO. Thus, in the Respondents view, their violations were de minimis.

The Hearing Panel finds the Respondents' view too circumscribed. Even accepting the Respondents' assertion that their customers always received the NBBO or limit order price, they nevertheless were harmed by being deprived of material information about their trades. As the SEC pointed out when it amended Rule 10b-10 in 1985, disclosure of transaction costs in principal transactions permits individual investors to compare their broker-dealers' costs with the comparable costs of other broker-dealers and enhances their ability to police the handling of their accounts. Absent this knowledge, an investor's ability to negotiate or obtain competitive transaction charges is limited.[29] Ultimately, the disclosure of this information discourages fraud and enables the market to operate more fairly and efficiently.[30] The Respondents' arguments overlook these factors, which the Hearing Panel finds central to its determination of sanctions in this case.

C. Specific Sanctions Imposed

1. False and Misleading Advertising (Causes One, Four, and Seven)

The applicable NASD Sanction Guidelines recommend that, in cases involving intentional or reckless use of misleading communications to the public, adjudicators should consider

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[29] Exchange Act Release No. 22,397, 33 SEC Docket 1368, 1371-72, 1985 SEC LEXIS 712, at *13-15.
[30] Id. at *14.

suspending the firm and the responsible individual, in any or all activities, functions, or capacities, for up to two years.[31] The Guidelines further advise that "in cases involving numerous acts of intentional or reckless misconduct over an extended period of time" adjudicators should consider expelling the firm and barring the responsible individual.[32]

The Respondents' conduct was egregious. In an effort to solicit business, they intentionally led potential and actual customers to believe that the Firm would effect their securities transactions either for "free" or in accordance with the Firm's published commission schedule when, in fact, some transactions would be effected on a riskless principal basis and customers would be charged undisclosed markups or markdowns. The Respondents' misleading statements and nondisclosure were plainly material. Moreover, the Respondents published these advertisements on the Internet—where they were available worldwide to an enormous number of individuals.

Accordingly, for the violations in First, Fourth, and Seventh Causes of Complaint, the Hearing Panel will expel the Firm from membership in the NASD and bar Nguyen from associating with any NASD member in any principal capacity. The Panel also will order Nguyen to requalify by examination as a General Securities Representative (Series 7) within 90 days of the date this Decision becomes the final decision of the NASD.

In addition, the Hearing Panel determines that the Firm and Nguyen should be jointly and severally liable to pay a total fine of $25,000 for the false and misleading advertisements. In imposing a single fine for these three Causes of Complaint, the Hearing Panel aggregated the advertising violations because they stem from the Respondents' continuous course of conduct.

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[31] NASD Sanction Guidelines 89 (2001 ed.)

[32] Id.

2. Misrepresentations and Omissions (Causes Two, Five, Eight, and Ten)

The applicable Sanction Guidelines recommend that, for intentional or reckless misrepresentations or omissions, adjudicators should consider imposing a suspension in all capacities for 10 business days to two years and that, in egregious cases, adjudicators should consider barring the individual and expelling the firm. As for monetary sanctions, the Guidelines suggest the imposition of fines ranging from $10,000 to $100,000.[33]

The Guidelines also generally recognize that in cases where a respondent, as a result of the misconduct, derived a financial benefit, including profits, compensation, income, fees, or other remuneration, "[a]djudicators may require the disgorgement of such ill-gotten gain by fining away the amount of some or all of the financial benefit derived, directly or indirectly."[34] Disgorgement is an equitable remedy designed to deprive violators of their illegal profits, thereby effectuating the deterrence objectives of the securities laws.[35]

For the reasons articulated above, the Hearing Panel concludes that the Respondents' affirmative false and misleading statements and non-disclosures, made in connection with 316 separate securities transactions, were egregious. The Respondents charged undisclosed markups and markdowns and thereby reaped illicit, undisclosed profits totaling $58,579.83.

Accordingly, for this misconduct, the Hearing Panel concludes that the Firm should be expelled from membership in the NASD and that Nguyen should be permanently barred from associating with any NASD member in any principal capacity. The Hearing Panel further

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[33] Id. at 96.

[34] Id. at 7, General Principle No. 6.

[35] See, e.g., SEC v. Wang, 944 F.2d 80, 85 (2d Cir. 1991). See also, e.g., SEC v. World Gambling Corp., 555 F. Supp. 930, 934 (S.D.N.Y. 1983) (disgorgement is an equitable remedy "uniquely suited to redress or cancel unfairness and promote investor confidence in securities transactions").

determines that Nguyen should be ordered to requalify by examination as a General Securities Representative within 90 days of the date this Decision becomes the final Decision of the NASD.

In addition, the Hearing Panel determines that the Firm and Nguyen should be jointly and severally liable to pay a fine in the total amount of $25,000 for this misconduct. Here also, the Hearing Panel considered the violations in the several counts to stem from the same continuous course of conduct; therefore, the Hearing Panel aggregated the violations for the purposes of imposing a fine.

The Hearing Panel also concludes that the Respondents should be jointly and severally liable to disgorge their ill-gotten gains in the sum of $58,579.83. Thus, the total fine for the Respondents' misrepresentations and omissions is $83,579.83.[36]

3. False Confirmation Disclosures (Causes Three, Six, Nine, and Eleven)

There are no NASD Sanction Guidelines that specifically address false disclosures on trade confirmations. In such circumstances, the Sanction Guidelines encourage adjudicators to look to the guidelines for analogous violations. The Hearing Panel concluded that, in essence, the false confirmation disclosures at issue in this case amounted to a misrepresentation to the customers who received the confirmations. Therefore, the Hearing Panel looked to the Guidelines for "Misrepresentations or Material Omissions of Fact." As noted above, those Guidelines

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[36] The Deparment requested the Hearing Panel to order the Respondents to pay the disgorged profits to the customers identified by account number on Schedules A-D to the Complaint. Although there is general authority for the Department's request, the NAC recently held that ill-gotten gains should be fined away and not paid to victims to compensate them for the respondents' wrongful acts. See Department of Enforcement v. Roger A. Hanson, No. C8A000059, 2002 NASD Discip. LEXIS 5, at *4-5 (Mar. 28, 2002) (holding that where the respondent engaged in private securities transactions the respondent should pay the fine, including the respondent's disgorged financial benefits, to NASD). But cf.. Department of Enforcement v. Luther A. Hanson, No. C9A000027, 2001 NASD Discip. LEXIS 41, at *25 (Dec. 13, 2001) (holding that where the respondent engaged in private securities transactions the respondent's ill-gotten financial benefit added to the fine could be paid to the victims thereby reducing the amount of the fine paid to NASD).

recommend that adjudicators impose a fine of $10,000 to $100,000 for intentional or reckless misrepresentations or omissions, and consider imposing a suspension in any and all capacities for up to 30 business days, or, in egregious cases, a lengthier suspension of up to two years or a bar.

In imposing sanctions for these violations, the Hearing Panel looked at them as distinct from the misrepresentations and omissions for which sanctions have been imposed above. On that basis, the Hearing Panel determined that, for the false confirmations, it would be appropriate to suspend Nguyen from acting as a principal for 30 days and, given his lack of appreciation for the importance of accurate confirmation disclosure, to require him to requalify as a principal by examination. The Hearing Panel will not impose these sanctions, however, because the Panel has already barred Nguyen from acting in a principal capacity as a sanction for the false and misleading advertising violations and the misrepresentation and omission violations.

The Hearing Panel, however, will order that, for this misconduct, the Firm and Nguyen, jointly and severally, pay fines in the total amount of $15,000.

4. Recordkeeping Violations (Cause 12)

The Guideline for recordkeeping violations recommends a fine of $1,000 to $10,000 and a suspension of the responsible individual for up to 30 business days. In egregious cases, the Guideline suggests that adjudicators consider a lengthier suspension or a bar.[37]

Although the Department contends that the Firm's failure to "make and keep" memoranda of brokerage orders reflecting the time of entry and execution of the inter-dealer transactions it effected impeded NASD's examination of the Firm,[38] there is no evidence that the Respondents deliberately failed to prepare these records. Accordingly, the Hearing Panel concludes that the

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[37] Guidelines 34.

[38] See Department of Enforcement's Pre-Hearing Submission at 6.

violations were not egregious, and, therefore, no suspension is required. On the other hand, the pervasiveness of the violations warrants a substantial fine. Thus, the Hearing Panel will order the Firm and Nguyen to pay, jointly and severally, a $10,000 fine.

IV. ORDER

Therefore, having considered all the evidence, U.S. Rica is expelled from membership in NASD, and Vinh Huu Nguyen is barred from associating with any member firm in any principal capacity. In addition, the Respondents are, jointly and severally, ordered to pay fines in the total amount of $133,579.83 and costs in the amount of $1,853.94, which include an administrative fee of $750 and hearing transcript costs of $1,103.94.

These sanctions shall become effective on a date set by the NASD, but not sooner than 30 days from the date this Decision becomes the final disciplinary action of the NASD, except that if this Decision becomes the final disciplinary action of the NASD, the expulsion and bar shall become effective immediately.[39]

HEARING PANEL

By: ________________________
Andrew H. Perkins
Hearing Officer

Copies to:

U.S. Rica Financial, Inc. (via overnight courier and first-class mail)
Vinh Huu Nguyen (via overnight courier and first-class mail)
David C. Franceski, Jr., Esq. (via facsimile and first-class mail)
David A. Watson, Esq. (via electronic and first-class mail)
Rory C. Flynn, Esq. (via electronic and first-class mail)

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[39] The Hearing Panel has considered all of the arguments of the Parties. They are rejected or sustained to the extent they are inconsistent or in accord with the views expressed herein.