NASD REGULATION, INC.
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. W.R. HAMBRECHT & CO., LLC (BD #45040), San Francisco, CA and WILLIAM R. HAMBRECHT (CRD #234793) San Francisco, CA, Respondents	:	Disciplinary Proceeding No. C01000011 Hearing Officer - DMF **HEARING PANEL DECISION** January 16, 2001

Digest

The Department of Enforcement filed a two-cause Complaint against NASD member firm W.R. Hambrecht & Co., LLC (WRH), and its president, William R. Hambrecht. The first cause charged that Respondents violated Rule 2110 by failing to comply with a commitment they made to the NASD, in connection with WRH's application for membership, that the firm would "refrain from engaging in any securities sales activities until it … received approval from NASD Regulation, Inc." Enforcement alleged that Respondents violated this commitment when WRH sent a letter and "Investment Memorandum" to 69 persons regarding an opportunity to purchase units in a limited liability company through a private placement offering. The second cause charged that Respondents

violated Article V, Section 1 of the NASD's By-Laws and Rule 2110 by allowing WRH's Director of Corporate Finance to engage in WRH's investment banking or securities business (by sending the letter and Investment Memorandum) without the Director having satisfied the qualification requirements established under Article III, Section 2 of the NASD's By-Laws.

The Hearing Panel found that Respondents violated Rule 2110 as alleged in the first cause, but that Respondents did not violate Article V, Section 1 of the By-Laws or Rule 2110 as alleged in the second cause. As sanctions for the violation, the Hearing Panel fined Respondents $15,000, jointly and severally, and ordered them to pay costs in the amount of $1,930.25.

Appearances

David A. Watson, Regional Counsel, San Francisco, CA (Rory Flynn, Esq., Washington, DC, Of Counsel) for the Department of Enforcement.

David B. Bayless, Esq., Morrison & Foerster, LLP, San Franciso, CA for Respondents.

DECISION

I. Procedural History

On June 27, 2000, the Department of Enforcement filed a two-cause Complaint against NASD member firm W.R. Hambrecht & Co., LLC (WRH), and its president, William R. Hambrecht. The first cause charged that Respondents violated Rule 2110 by failing to comply with a commitment they made to the NASD, in connection with WRH's application for membership, that the firm would "refrain from engaging in any securities sales activities until it … received approval from NASD Regulation, Inc." Enforcement alleged that Respondents violated this commitment when WRH sent a letter and Investment Memorandum to 69 persons regarding an opportunity to purchase units in W.R. Hambrecht/QIC, LLC (an entity in which both WRH and Mr. Hambrecht had interests) through a private placement offering. The second cause charged that Respondents

violated Article V, Section 1 of the NASD's By-Laws and Rule 2110 by allowing JD, who was WRH's Director of Corporate Finance, to engage in WRH's investment banking or securities business (by sending the letter and Investment Memorandum) without JD having satisfied the qualification requirements imposed under Article III, Section 2 of the NASD's By-Laws.

Respondents filed an Answer denying the charges and requested a hearing. A hearing was held in San Francisco, California, on November 1, 2000, before a Hearing Panel composed of a Hearing Officer and two current members of the District Committee for District No. 1. At the hearing, the Panel received in evidence nine joint exhibits (JX 1-9), one Complainant's exhibit (CX 1), and 23 Respondents' exhibits (RX 1- 23), and heard the testimony of three witnesses, Mr. Hambrecht; JD, WRH's Director of Corporate Finance at the relevant time; and RP, an attorney who represented WRH in connection with the transactions underlying the letter and Investment Memorandum cited in both causes of the Complaint. In addition, prior to the hearing the parties filed extensive Stipulations of the Parties (Stip.). Following the hearing, the parties filed post-hearing memoranda addressing District Business Conduct Committee for District No. 3 v. First Capital Funding, Inc. et al., 1990 NASD Discip. LEXIS 119 (Board of Governors Aug. 16, 1990), aff'd, 1992 SEC LEXIS 1369, 50 S.E.C. 1026 (June 17, 1992), which Enforcement relied upon in this proceeding.

II. Facts

The relevant facts are not seriously in dispute. WRH is a broker-dealer with its principal place of business in San Francisco, CA. It has been a member of the NASD since July 23, 1998. Mr. Hambrecht is Chief Executive Officer of WRH. He is registered with the NASD as a General Securities Principal and General Securities Representative. He has been employed in the securities industry for some 40 years and has an exemplary record, having served on the NASD Board of

Governors, as well as on the District Business Conduct Committee. He has no prior disciplinary history. (Stip. ¶¶ 1-2.)

Mr. Hambrecht and others formed WRH in early 1998. On March 27, 1998, WRH applied for NASD membership. During the membership application process, WRH submitted to the NASD a document captioned "Securities Sales Activity Statement." The text of the Statement was brief:

> This statement will confirm that W.R. Hambrecht & Company, LLC has not previously engaged in any securities sales activities. Furthermore, W.R. Hambrecht & Company, LLC will refrain from engaging in any securities sales activities until it has received approval from NASD Regulation, Inc.

The Statement was signed and dated May 6, 1998 by Mr. Hambrecht as "Executive Representative" on behalf of WRH. (Stip. ¶¶ 5, 6, 12; JX 5.) As noted above, WRH's NASD membership became effective July 23, 1998, and WRH does not claim that it received any approval from NASD Regulation to engage in "securities sales activities" prior to that date.

While its application for NASD membership was pending, WRH was involved in a business transaction that encompassed the activities that are the subject of this proceeding. In early 1998, Mr. Hambrecht learned of an opportunity to acquire a firm known as Quinton Instrument Company (QIC). QIC manufactures and markets medical instruments used in the diagnosis, treatment and rehabilitation of cardiac-related illnesses. QIC also had a fitness division that manufactured and marketed treadmills to StairMaster Sports/Medical Products, Inc. (Stip. ¶ 7; Tr. 85, 184.) In April 1998, WRH retained attorneys, including RP (who testified at the hearing) to assist in negotiating and structuring the acquisition. (Tr. 32.) JD, WRH's Director of Corporate Finance, took the lead role in this transaction for WRH, consulting with Mr. Hambrecht from time to time, as appropriate. (Tr. 37, 84, 136, 150.)

QIC was to be acquired through QIC Holding, Inc., 81% of which, in turn, would be owned by a new limited liability company, W.R. Hambrecht/QIC, LLC (WRH/QIC). (Stip. ¶ 7.) Initially, financing for WRH/QIC was to come from Mr. Hambrecht, WRH, and ES, an individual who had a long history of investing jointly with Mr. Hambrecht. (Tr. 98, 153.) By May 1998, however, Mr. Hambrecht and WRH had decided to offer a number of friends and business acquaintances of Mr. Hambrecht and JD an opportunity to invest in WRH/QIC through a private placement offering. (Tr. 114, 154.) Accordingly, on May 20, 1998, JD sent a letter and Investment Memorandum to 69 people on behalf of WRH offering them an opportunity to purchase unregistered WRH/QIC membership units. (Stip. 9; JX 6.) JD sent these materials after WRH submitted the Securities Sales Activity Statement to the NASD on May 6, and prior to WRH becoming an NASD member on July 23. JD, who had previously qualified and registered with another NASD member firm, was not yet registered with WRH when he sent the letter and Investment Memorandum, because WRH was not yet an NASD member. JD had already applied for registration with WRH as of May 6, however, and he became registered with WRH on July 23, immediately upon WRH being admitted to NASD membership. (Stip. ¶¶ 3, 12-13; JX 3; Tr. 114.)

JD's letter to prospective investors explained that "[t]he partners of [WRH] are planning to make an investment which may be of interest to you." In the letter, JD stated, "I have outlined some of the factors which make the acquisition of [QIC] attractive to us in an Investment Memorandum … which is attached." JD's letter explained a bit more about the structure of the transaction, and concluded, "If you would like to invest in WRH/QIC, please contact me at [WRH's telephone number]." (JX 6, p. 1.)

The enclosed Investment Memorandum explained: "Pursuant to this Investment Memorandum, WRH is soliciting investors to purchase membership interests in a newly formed

special purpose liability company called [WRH/QIC]." The Investment Memorandum stated that it had been prepared by WRH and that "[a]ny inquiries regarding [QIC], WRH/QIC or the proposed investment should be directed to [JD at WRH's telephone number]." (JX 6, pp. 2, 3, 5.)

According to the Investment Memorandum, "WRH believes that the Transaction represents an opportunity for (i) a financial restructuring of [QIC], and (ii) the creation of an acquisition/growth vehicle in the medical instruments industry. … WRH believes that [QIC] represents a potential vehicle to establish and grow its presence in the medical instruments industry." (JX 6, p. 5.) The Investment Memorandum also told prospective investors that QIC Holding expected to obtain a bridge loan of up to $20 million in order to close the QIC acquisition, but that "WRH expects repayment of the Bridge Loan will occur with the sale, subsequent to the Closing, of [QIC's] Fitness Division to StairMaster. The sales price for such division is expected to be in excess of the Bridge Loan amount. WRH, on behalf of QIC Holding, and StairMaster have executed a non-binding letter of intent, and the transaction is expected to close on or around June 5." (JX 6, p. 7.)

Of the 69 people to whom JD sent the letter and Investment Memorandum, 54 invested a total of $9,897,500 in WRH/QIC during the period May 26, 1998 through June 2, 1998. (Stip. ¶¶ 9-11; JX 7, 8.) The largest investor was ES, who invested $3 million, followed by Mr. Hambrecht, who invested $1,502,500, and WRH, which invested $1.5 million. Other investors contributed as much as $500,000 and as little as $3,000. (JX 8.) WRH/QIC, rather than WRH, made the actual sales of the units to the investors, and WRH received no commissions on the sale of the units. (Stip. ¶ 11; Tr. 125, 159.) The Investment Memorandum disclosed, however, that QIC would pay WRH $1 million after the acquisition was consummated "as compensation for [WRH's] services," and that WRH/QIC Management, "a California Limited Liability Company … managed by [WRH, JD and SG, another employee of WRH]," would receive a "20% Management Carry." (JX 6 at 4.)

QIC Holding subsequently completed the acquisition of QIC, and, thereafter, QIC paid WRH the $1 million fee disclosed in the Investment Memorandum. (Stip. ¶ 14.) StairMaster did not complete its purchase of the Fitness Division as planned, however, and as a result QIC Holding was unable to repay the bridge loan shortly after the QIC closing, as WRH had forecast in the Investment Memorandum. Through JD's efforts, however, WRH obtained certain concessions from the seller of QIC and ultimately completed the sale of the Fitness Division to StairMaster. (Tr. 90-92.) There is no allegation or evidence that any WRH/QIC investor was misled by the letter or the Investment Memorandum, or that any investor lost any money, or that any investor has made any complaint about WRH's activities in connection with this matter.

III. Discussion

A. First Cause – Securities Sales Activity

In the first cause of the Complaint, Enforcement charges that by sending the letter and Investment Memorandum to prospective purchasers of units in the private placement, WRH violated the commitment it made to the NASD in the Securities Sales Activity Statement that it would "refrain from any securities sales activities until it has received approval from NASD Regulation, Inc." Enforcement argues that WRH thereby failed to "observe high standards of commercial honor and just and equitable principles of trade," as required by Rule 2110. In addition, Enforcement charges that because Mr. Hambrecht was CEO of WRH and signed the Statement on its behalf, he is responsible for WRH's violation.

The first question, therefore, is whether sending the letter and Investment Memorandum amounted to "securities sales activities." Enforcement's argument in that regard is straightforward: the units were securities; they were being offered for sale; and sending the letter and Investment

Memorandum was activity directly related to promoting those sales. In other words, as Respondents note, Enforcement is "taking a very literalist [sic] view of securities sales activity …." (Tr. 26.)

Respondents do not deny that the WRH/QIC units were securities, or that those securities were offered for sale, or that WRH sent the letter and Investment Memorandum to prospective purchasers. They argue, however, that WRH did not have to be an NASD member in order to send the letter and Investment Memorandum, asserting that other entities involved in venture capital and buyouts engage in similar private placement activities without being broker-dealers. Respondents urge that WRH did not engage in what they characterize as broker-dealer activities – that is, WRH did not underwrite the WRH/QIC offering, sell the units directly, or receive any commission on the sales. (Tr. 110, 126.) This leads Respondents to conclude that WRH's actions in sending the letter and Investment Memorandum were, "to be blunt, no business of the NASD." (Tr. 20.)

Because Enforcement did not dispute it, the Hearing Panel will accept, for the sake of argument, Respondents' contention that WRH could have undertaken its activities in connection with the WRH/QIC offering without registering as a broker-dealer or becoming an NASD member. That does not mean, however, that those activities were none of the NASD's business. It is undisputed that by the time WRH sent the letter and Investment Memorandum it had already applied for NASD membership. The NASD's legitimate interest in all of WRH's securities-related activities began when WRH submitted that application. As the NASD's Board of Governors explained in First Capital Funding, "the Association exercises extensive regulatory oversight on a consensual basis as provided in [Rule 2110] over every applicant for membership during the pre-membership qualification process …."

Respondents acknowledge that by sending a letter and Investment Memorandum to prospective purchasers in which it analyzed and recommended a private placement investment,

WRH was engaging in a type of activity often undertaken by NASD members. (Tr. 62-63.) It is well established that the NASD exercises comprehensive oversight of such activity. The NASD's National Adjudicatory Council and its predecessor, the National Business Conduct Committee, have disciplined member firms on many occasions for their actions in promoting private placements. These cases address such issues as whether an offering memorandum disseminated by the member firm to promote a private placement contained misrepresentations; whether the private placement was exempt from registration; whether the private placement was suitable for the investors to whom it was sold; whether the member improperly utilized unregistered individuals in private placement activities; whether the member ensured that the issuer used the proceeds of the private placement in a manner consistent with the offering memorandum; and whether the member ensured that the issuer complied with escrow requirements for funds received from investors. See, e.g., District Business Conduct Committee for District No. 3 v. Kevin D. Kunz, Complaint No. C3A960029 (NAC July 7, 1999); District Business Conduct Committee for District No. 3 v. Brian Prendergast, Complaint No. C3A960033 (NAC July 8, 1999); District Business Conduct Committee for District No. 6 v. Hartman Securities, Inc., Complaint No. C06950018 (NBCC Mar. 12, 1997).

Furthermore, the NASD's oversight is not limited to disciplining members for fraudulent or otherwise unlawful private placement activities. In Hartman, for example, the NBCC held that a member firm violated its restrictive agreement with the NASD, which precluded it from "conducting a securities business," by promoting the sale of limited partnership interests offered through a private placement. In light of these and many other decisions, the Hearing Panel rejects Respondents' argument that WRH's activities in connection with the WRH/QIC offering, while its membership application was pending, were not of legitimate concern to the NASD.

Respondents insist, however, that their commitment not to engage in "any securities sales activities" did not apply to WRH's actions in connection with the WRH/QIC offering. In spite of the language in the Investment Memorandum, they assert that WRH did not "solicit" purchasers for the WRH/QIC offering, but rather merely "informed people what we were doing and invited them to participate …." (Tr. 118; see also Tr. 159 "[W]e invited people who we knew had an interest in the company to participate as partners, put no pressure on them whatsoever, made no attempt to induce them to do it and let in people only if they asked to be put in.").

The commitment that Respondents made in the Securities Sales Activity Statement, however, was very broad. They promised that WRH would "refrain from any securities sales activities," and, as they acknowledge, this language literally encompasses WRH's activities in connection with the WRH/QIC offering. Furthermore, those activities were neither minor nor ministerial. On the contrary, WRH (itself a substantial investor) identified prospective investors in WRH/QIC, prepared and sent the Investment Memorandum to those prospective investors, and offered its own analysis and endorsement of the investment. These activities, undertaken by an applicant for membership, were of substantial legitimate concern to the NASD, regardless whether the underlying investment was a public offering or a private placement, and regardless whether WRH underwrote the offering, sold the securities, or received commissions on the sales. Therefore, the Hearing Panel concludes that WRH's actions in sending the letter and Investment Memorandum regarding the WRH/QIC offering were "securities sales activities" within the meaning of the Securities Sales Activity Statement.

Respondents also argue that the NASD gave them no notice that it would construe the phrase "securities sales activities" to encompass WRH's actions in this case. The Hearing Panel rejects this argument. As Respondents note, Enforcement's interpretation of that phrase is "a very

literal reading." (Tr. 185) C\onsidering the level of WRH's involvement in the WRH/QIC offering and the extensive NASD case law addressing members' private placement activities discussed above, Respondents were on reasonable notice that NASD intended and would enforce such a literal reading. Furthermore, Mr. Hambrecht, "as a businessman, is responsible for understanding the contents and the implications of [the document], which he signed," and Respondents "cannot shift responsibility to the NASD for complying with relevant rules and regulations." District Business Conduct Committee for District No. 8 v. Freedom Investors Corp., Complaint No. C8A950011 (NBCC Jan. 27, 1997) at n. 23.

The Hearing Panel also notes that Respondents offered no evidence that in sending the letter and Investment Memorandum WRH relied upon some alternative, reasonable interpretation of the phrase "any securities sales activities." On the contrary, Mr. Hambrecht testified that, although he knew JD would be sending the letter and Investment Memorandum to prospective WRC/QIC investors, he gave no thought to the Securities Sales Activity Statement: "[T]o be honest with you, I don't even remember [the Statement]. It was one of a huge stack of papers that you filed, but I did understand that we were not allowed to be a broker dealer or engage in any brokerage business until we got our license." He also testified he did not tell JD or anyone else at WRH that he had signed the Statement: "I don't know why I would have. It was part of the process of registering with the NASD." (Tr. 167.) And he testified he never sought advice from an attorney or anyone else as to whether it was appropriate to send out the letter and Investment Memorandum while WRH's membership application was pending. (Tr. 169.) JD agreed that he was unaware of the Securities Sales Activity Statement when he sent the letter and Investment Memorandum to the prospective WRH/QIC investors. (Tr. 138.)

For these reasons, the Hearing Panel concludes that by sending the letter and Investment Memorandum to prospective WRH/QIC investors WRH violated its commitment to the NASD that it would "refrain from any securities sales activities" while its membership application was pending. The Hearing Panel also concludes that WRH thereby violated NASD Rule 2110. Although Respondents contend that Enforcement has articulated no legal theory to support such a conclusion, the Hearing Panel disagrees.

As the NAC recently explained:

> Conduct Rule 2110 states in its entirety: "A member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade." Thus, the rule's language requires that two tests be met: (1) the misconduct occurred "in the conduct of" the respondent's business; and (2) the misconduct contravened high standards of commercial honor or violated just and equitable principles of trade.

Department of Enforcement v. David L. Foran, Complaint No. C8A990017 (NAC Sept. 1, 2000). There is no question that the first test is met in this case: Respondents submitted the Securities Sales Activity Statement to the NASD and sent the letter and Investment Memorandum in the conduct of WRH's business. The second test is also satisfied. "[D]isciplinary hearings to require compliance with 'high standards of commercial honor and just and equitable principles of trade' are ethical proceedings; hence the concern is with ethical implications of [a respondent's] misconduct." In re Timothy L. Burkes, 51 S.E.C. 356, 360 (1993), aff'd, Burkes v. SEC, No. 93-70527 (9th Cir. July 25, 1994). Plainly, serious adverse ethical implications flow from a firm's failure to fulfill its commitments to the NASD. In that regard, it is well established that a member that violates a commitment to the NASD contained in a membership restrictive agreement thereby violates Rule 2110. The Hearing Panel agrees with Enforcement that the same principles apply to a

prospective member's violation of a commitment made to the NASD as a part of the membership application process.

Enforcement also relies on First Capital Funding, where the Board of Governors held that a prospective member violated Article III, Section 1 of the NASD's Code of Procedure (now Rule 2110) by breaching a commitment contained in a letter submitted in connection with the membership application process that the firm would not "engage in a securities business" until it was approved by the SEC and the NASD. Although First Capital Funding is distinguishable from this case in terms of the specific commitment language and the activities that the Board found violated that commitment, the Hearing Panel agrees with Enforcement that the decision supports the general principle that a prospective member violates Rule 2110 if it breaches a commitment made to the NASD in connection with its membership application.

Respondents contend that the Board of Governors' decision in First Capital Funding does not support the charge in this case because the Board's decision rested on Section 15(b)(8) of the Securities Exchange Act (which is not charged in this case) rather than on Article III, Section 1 (now Rule 2110). Respondents are clearly mistaken; the Board of Governors' decision did not even mention Section 15(b)(8), much less rely on it. Rather, the charge and the Board's decision expressly rested on Article III, Section 1.[1] In any event, even if the First Capital Funding decision were distinguishable from this case on that ground, for the reasons set forth above, the Hearing Panel would nevertheless conclude that WRH's failure to fulfill its commitment to the NASD in connection with its application for membership was a violation of Rule 2110.

[1] The SEC's decision affirming the Board of Governors did refer to Section 15(b)(8), as well as Article III, Section 1, but did not indicate that the SEC was basing its affirmance of the Board of Governors on that provision.

Therefore, the Hearing Panel finds that WRH violated Rule 2110, as alleged in the first cause of the Complaint. In addition, it is undisputed that Mr. Hambrecht: (i) was Chief Executive Officer of WRH; (ii) signed the Securities Sales Activity Statement on its behalf; (iii) failed to advise JD or anyone else at WRH of the commitment he had made in the Statement; and (iv) was aware that WRH would be sending the letter and Investment Memorandum to prospective WRH/QIC investors. Based on these facts, the Hearing Panel finds that Mr. Hambrecht bears responsibility for WRH's violation.

B. Second Cause – Permitting Unqualified Individual to Engage in Securities Business

The second cause of the Complaint charges that Respondents violated Article V, Section 1 of the NASD's By-Laws and Rule 2110 by allowing JD to engage in the investment banking or securities business of WRH without having satisfied the qualifications requirements established under Article III, Section 2 of the By-Laws. Like the first cause, this charge rests on JD's sending the letter and Investment Memorandum to 69 potential investors in WRH/QIC.

Article V, Section 1 of the By-Laws provides: "No member shall permit any person associated with the member to engage in the investment banking or securities business unless the member determines that such person satisfies the qualifications requirements established under Article III, Section 2 and is not subject to a disqualification under Article III, Section 4." Article III, Section 2 gives the NASD Board of Governors authority to "adopt rules and regulations applicable to … persons associated with applicants or members establishing specific and appropriate standards with respect to the training, experience, competence, and such other qualifications as the Board finds necessary or desirable …." The Board has implemented this authority through various rules, including Rule 1070, which establishes the obligation of certain persons associated with members to

qualify by passing appropriate qualification examinations. Article III, Section 4 of the By-Laws sets forth a number of circumstances that disqualify a person from being associated with a member firm.

It is undisputed that, at the relevant time, JD had qualified as a General Securities Representative by passing the appropriate examination, and indeed had been registered in that capacity with another member firm prior to becoming associated with WRH. In addition, there is no allegation or evidence that JD was subject to disqualification under Article III, Section 4.

In its pre-hearing submission, Enforcement explained that the charge that JD was not "qualified" when he sent the letter and Investment Memorandum rests on Rule 1031, which provides: "All persons engaged or to be engaged in the investment banking or securities business of a member who are to function as representatives shall be registered as such with the Association …." There is no dispute that JD was not registered with WRH when he sent the letter and Investment Memorandum.

It is also undisputed, however, that when he sent the letter and Memorandum JD had already applied for registration with WRH, and that the NASD approved his registration with WRH at the same time it approved WRH's membership. Thus, the second cause does not rest on any deficiency in JD's qualifications, but instead on the fact that when JD sent the letter and Investment Memorandum WRH was not yet an NASD member, so no one was or could have been registered with the firm.

Under these circumstances, the Hearing Panel finds that, rather than charging a distinct violation, the second cause of the Complaint represents merely a somewhat different and less satisfactory articulation of the charge made in the first cause of the Complaint. The problem was not that JD was unregistered, but that because WRH was not yet an NASD member it should not have engaged in securities sales activities through JD or anyone else. The Hearing Panel has already

found that WRH thereby violated Rule 2110 as charged in the first cause. To find that Respondents committed another violation based on a different articulation of the same underlying problem would be inappropriate in this case. Therefore, the Hearing Panel will dismiss the second cause in light of the violation found under the first cause. And having dismissed the second cause on this ground, the Hearing Panel finds it unnecessary to address Respondents' other challenges to that cause.

IV. Sanctions

Enforcement requested that the Hearing Panel censure the Respondents and fine them $100,000, jointly and severally. The Respondents, although contesting liability, urged that if the Panel found liability, it should not impose any sanctions.

There are no directly applicable Sanction Guidelines, but the Hearing Panel finds that the Guidelines for Member Agreement Violations provide a helpful analogy. Those Guidelines recommend a fine of $2,500 to $50,000, and also suggest that a member firm may be suspended for a serious breach of a restrictive agreement, or even expelled in egregious cases. NASD Sanction Guidelines at 42 (1998 ed.).

The specific considerations listed in the Guidelines for Member Agreement Violations ask, first, whether Respondents "violated a material provision of the agreement." The Hearing Panel finds that the commitment not to engage in any securities sales activities while its membership application was pending was "material" to WRH's application. The Hearing Panel notes, however, that no such restriction has been formally incorporated in the membership application requirements described in Rules 1011-1019, and that Enforcement failed to offer any evidence to help establish the relative importance of this restriction in the overall membership application process. Therefore, the

Hearing Panel does not find that WRH's commitment was somehow "critical" or "vital" to its membership application.[2]

Looking to the general considerations listed in the Guidelines (pp. 8-9), the Hearing Panel notes the following relevant factors:[3]

- Respondents have not accepted responsibility for their misconduct, which is an aggravating factor.

- There is no evidence the firm had any reasonable supervisory, operational, and/or technical procedures or controls in place to ensure compliance with the commitment they made. On the contrary, it appears that Mr. Hambrecht viewed the Securities Sales Activity Statement as merely part of the paperwork required in the membership application process, and therefore failed to establish any controls to ensure that WRH refrained from securities sales activities. This is an aggravating factor.

- Respondents' conduct was limited to the WRH/QIC offering and took place over a fairly brief period of time, which is a mitigating factor.

- There is no evidence of customer injury, which is a mitigating factor.

- The misconduct was negligent, rather than intentional or reckless, which is a mitigating factor.

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[2] Two other considerations listed in the Guidelines for Member Agreement Violations are whether the restriction violated by the Respondents "was particular to the firm," and whether the firm had applied for or been denied a waiver when it violated the restriction. In this case, it appears that the restriction on engaging in securities sales activities while a membership application is pending is of general applicability, not particular to WRH (Tr. 77), and there is no dispute that WRH had not applied for or been denied a waiver of the commitment it made in the Securities Sales Activity Statement. The Hearing Panel did not find that either of these circumstances had any significant bearing on the sanctions to be imposed in this case.

[3] The Hearing Panel also notes that Respondents have no relevant disciplinary history, which would have been an aggravating factor, and that Respondents did not demonstrate reliance on competent legal advice, which might have been a mitigating factor.

Taken together, these factors lead the Hearing Panel to conclude that Respondents' violation was not egregious and did not rise to a level that would require suspending the firm. Instead, the Hearing Panel finds that the appropriate sanction is a fine, which should be above the minimum amount recommended in the Guidelines.

Enforcement urges a fine of $100,000, arguing that WRH should be required to disgorge a significant portion of the $1 million fee that QIC paid WRH for its activities in connection with the acquisition. In support, Enforcement relies on a provision of the Guidelines for Member Agreement Violations stating that an adjudicator "may increase the recommended fine amount by adding the amount of a respondent's financial benefit [, which] may include the amount of commissions or other profits that the firm derived from acting in contravention of the member agreement." Guidelines at 42 n. 1.

The Hearing Panel does not find this provision applicable. The record does not establish that WRH derived the $1 million fee, or any part of it, from its securities sales activities. The fee was paid by QIC, not by WRH/QIC, and the only relevant testimony was that QIC paid the fee to WRH for its various activities in connection with the acquisition, not for its services to WRH/QIC in connection with the private placement offering. (Tr. 63-64, 99, 150.) In fact, both JD and Mr. Hambrecht testified, without contradiction, that the acquisition would have been completed (and therefore WRH would have earned the $1 million fee) even if WRH/QIC had not raised funds through sale of the limited partnership units. (Tr. 98, 153-55.) Enforcement failed to offer any basis upon which the Hearing Panel could conclude that WRH derived $100,000 of its fee, or any other amount, from selling the private placement units.

The Hearing Panel concludes that a $15,000 fine, imposed on Respondents jointly and severally, will appropriately serve the NASD's remedial goals in this case. Although the violation

was not egregious, in light of the various factors discussed above, the Hearing Panel believes it was serious enough to require a fine well above the $5,000 minimum recommended in the Guidelines in order "to prevent and discourage future misconduct by [Respondents], to deter others from engaging in similar misconduct, and to improve overall business standards in the securities industry." Guidelines at 3.

V. Conclusion

The Hearing Panel finds that Respondents W.R. Hambrecht & Co., LLC and William R. Hambrecht violated Rule 2110 as alleged in the First Cause of the Complaint. As sanctions, Respondents are censured and fined $15,000, jointly and severally. Respondents are also assessed, jointly and severally, costs in the amount of $1,930.25, which includes an administrative fee of $750 and hearing transcript costs of $1,180.25. The charges in the Second Cause of the Complaint are dismissed. These sanctions shall become effective on a date set by the NASD, but not less than 30 days after this Decision becomes the final disciplinary action of the NASD.[4]

HEARING PANEL

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By: David M. FitzGerald
Deputy Chief Hearing Officer

Copies to:

W.R. Hambrecht & Co., LLC (via overnight delivery and first class mail)
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David A. Watson, Esq. (electronically and via first class mail)
Rory C. Flynn, Esq. (electronically and via first class mail)

[4] 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.