

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934  
Rel. No. 51236 / February 22, 2005

Admin. Proc. File No. 3-11437

In the Matter of the Application of

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For Review of Action Taken by

NASD

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION -- REVIEW OF DENIAL OF  
APPLICATION TO ASSOCIATE

Registered securities association denied member's application to permit employment of individual subject to a statutory disqualification. Held, review proceeding is remanded.

APPEARANCES:

Charles R. Mills, Kathryn A. Sellig, and Jon A. Stanley, of Kirkpatrick & Lockhart LLP, for Harry M. Richardson.

Marc Menchel, Alan B. Lawhead, Deborah F. McIlroy, Leavy Mathews III, and Jennifer C. Brooks for NASD.

Appeal filed: March 18, 2004  
Last brief received: June 29, 2004

Harry M. Richardson ("Richardson") appeals from a denial by NASD of a member firm's application to continue as a member with Richardson as an associated person. The application was necessary because Richardson is subject to two statutory disqualifications: an injunction and a bar order imposed by the Commission with a right to reapply after three years. We base our determinations on an independent review of the record.

## II.

On March 4, 1999, Richardson settled a civil action filed against him by the Commission by consenting to the entry of an injunction against future violations of Section 17(a) of the Securities Act of 1933; Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder; Section 15B(c)(1) of the Securities Exchange Act of 1934, 1/ and Municipal Securities Rulemaking Board ("MSRB") Rules G-17 and G-19. 2/ Richardson also settled a related administrative proceeding without admitting or denying the Commission's allegations that he "in connection with two 'pool' municipal bond offerings made material misrepresentations and omissions pertaining to the size of the pools and the intended use of the bond proceeds, and advised the pools to purchase unsuitable securities." 3/ The Commission further alleged that Richardson "in connection with three land development municipal bond offerings made material misrepresentations and omissions pertaining to the value of the land, developer, and capitalization of the project." 4/ Pursuant to the settlement, Richardson consented to being barred from association with any broker, dealer, investment adviser, investment company or municipal securities dealer, with a right to reapply for association after three years. 5/

In April 2003, more than three years after the entry of the Commission's bar order, Emmett A. Larkin Company, Inc. ("Emmett Larkin" or "the Firm"), applied to NASD to allow the Firm to continue in NASD membership with Richardson as an employee. After obtaining an agreement from Emmett Larkin for special supervisory conditions for Richardson, NASD's Department of Member Regulation recommended that the application be approved. After a hearing, NASD's National Adjudicatory Council ("NAC") in February 2004 denied the Firm's application. The NAC based its decision solely on the municipal bond misconduct underlying both Richardson's injunction and the Commission's bar order, finding that misconduct to be so

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1/ 15 U.S.C. § 77q(a); 15 U.S.C. § 78j(b) and 17 C.F.R. § 240.10b-5; 15 U.S.C. § 78o-4(c)(1).

2/ SEC v. First Cal. Capital Mkts. Group, Inc., C 97-02761 CRB (N.D. Cal., Apr. 5, 1999). The settlement also required Richardson and his employer to disgorge \$600,000, and Richardson to pay a \$40,000 civil penalty.

3/ H. Michael Richardson, Securities Exchange Act Rel. No. 41448 (May 25, 1999), 69 SEC Docket 2622 (order instituting proceedings, making findings and imposing remedial sanctions).

4/ Id. The Commission also alleged that sale of the municipal bonds violated MSRB Rules G-17 and G-19. Id.

5/ Id.

serious that readmitting Richardson would not be in the public interest or consistent with investor protection.

The NASD decision acknowledged the tension between the denial and Commission precedent in Paul Edward Van Dusen. <sup>6/</sup> NASD characterized the holding of Van Dusen as requiring, in cases where the Commission has settled an administrative proceeding involving the same misconduct that underlies a permanent injunction and has imposed a bar with the right to reapply after a specified time, that "NASD may not consider the underlying misconduct in a subsequent application by the barred person to re-enter the securities industry at the expiration of the limited bar." NASD decided to deny the Firm's application on the basis of the underlying misconduct, however, since it

strongly believe[s] that this guidance in Van Dusen fails to take into account properly the separate analysis in which NASD is charged with engaging when an applicant seeks readmission. It conflates two separate processes - the one in which someone is barred from the industry and given the ability after a period of time to reapply, and the separate process by which NASD is charged with the duty to evaluate whether an applicant can be permitted to function in a particular registered capacity consistent with the public interest and investor protection.

This appeal followed.

### III.

Our review of NASD's denial of the Firm's application is governed by standards set forth in Section 19(f) of the Exchange Act. <sup>7/</sup> We must dismiss Richardson's appeal if we find that the specific grounds on which NASD based its action exist in fact, that the denial is in accordance with NASD rules, and that those rules were applied in a manner consistent with the purposes of

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<sup>6/</sup> 47 S.E.C. 668 (1981).

<sup>7/</sup> 15 U.S.C. § 78s(f).

the Exchange Act, unless we determine that NASD's action imposes an unnecessary burden on competition. 8/

The grounds on which NASD based its decision, Richardson's statutory disqualifications resulting from the injunction and the Commission bar order, exist in fact. 9/ Moreover, the record gives no indication that the proceeding was not in compliance with NASD rules. 10/ Whether NASD's application of its rules in reviewing applications involving certain statutorily disqualified persons was consistent with the purposes of the Exchange Act can be determined by applying the principles set forth in Van Dusen and our subsequent decision in Arthur H. Ross. 11/

Underlying much of NASD's argument is its characterization of Van Dusen as setting forth a rigid "exclusionary rule" that precludes NASD from considering all relevant factors in reviewing applications like the one at issue here. To the contrary, Van Dusen and Ross encourage analysis that looks at all relevant factors, including, among others, misconduct in which a statutorily disqualified person may have engaged since the misconduct that gave rise to the statutory disqualification, the nature and disciplinary history of a prospective employer, and the proposed supervisory structure to which the statutorily disqualified person would be

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8/ Id. Richardson does not claim, and the record does not support a finding, that NASD's action has imposed an unnecessary burden on competition.

9/ Richardson's argument that the events that were the basis for the bar order are "not a legally cognizable basis in fact to deny" his readmission, and therefore no grounds for the denial exist in fact, has no merit. The statutory disqualifications do exist in fact. Moreover, as discussed in more detail infra, Richardson's suggestion that the events underlying the injunction and bar order are "not legally cognizable" as a basis for denying his application overstates the breadth of our holding in Van Dusen.

10/ Although Richardson has not raised the issue, we note that the record does not indicate whether the Hearing Panel or the Statutory Disqualification Committee ever submitted written recommendations as required by NASD Procedural Rule 9524(a)(10), or whether they were considered by the NAC, as required by Rule 9524(b)(1). See Reuben D. Peters, Exchange Act Rel. No. 49819 (June 7, 2004), 82 SEC Docket 3959, 3966 n.15.

Richardson argues that, because NASD "intentionally act[ed] in derogation of . . . controlling Commission precedent," i.e., Van Dusen, its denial of the Firm's application "cannot be deemed to be in accordance with NASD rules." Richardson does not specifically identify any NASD rule that has been violated, and this argument therefore appears to be an assertion that the denial was not consistent with the purposes of the Exchange Act. See infra.

11/ Arthur H. Ross, 50 S.E.C. 1082 (1992). NASD made no reference to Ross in its decision denying the Firm's application.

12/ Van Dusen, 47 S.E.C. at 671-72 (identifying several factors for consideration, but stating that list represented "only some of the matters that must be carefully weighed and considered." Id. at 671. NASD's argument that Commission precedent prevents it from

subject. 12/

Van Dusen and Ross do not preclude consideration of the misconduct that led to the statutory disqualification and the bar with a right to reapply. Rather, these cases require that the misconduct be considered in an appropriate context and given appropriate weight. For example, the misconduct could be considered as forming a part of a pattern, or in evaluating how well the employer firm's proposed scheme of supervision was designed to prevent the type of conduct that had resulted in the bar order. 13/ Quite simply, Van Dusen and Ross instruct that an SRO ordinarily may not deny reentry based solely on the underlying misconduct that led to the statutory disqualification and the conditional bar; something more is needed. 14/

Thus, Van Dusen and Ross recognize that the misconduct underlying a statutory disqualification may play a role in the consideration of an application like the one at issue here. 15/ Requiring that NASD generally consider new information leaves ample room for NASD to consider a wide range of appropriate factors. 16/ Van Dusen and Ross neither force

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considering all relevant factors is ironic, given that in this case it based its decision on a single factor -- the misconduct underlying the statutory disqualification.

13/ Ross, 50 S.E.C. at 1085 n.10.

14/ As we emphasized in Van Dusen, our objective in imposing sanctions pursuant to Exchange Act Section 15 is to "afford investors protection without visiting upon the wrongdoers adverse consequences not required in achieving the statutory objectives." 47 S.E.C. at 671 (quoting Commonwealth Sec. Corp., 44 S.E.C. 100, 101-02 (1969)). In determining that Richardson should be subject to a bar with a right to apply for association in three years, we considered at that time how much protection the public interest requires, based on the nature and seriousness of the misconduct underlying the bar, and weighed the need for that protection against the importance of avoiding adverse consequences to Richardson that are not necessary to protect the public interest. See H. Michael Richardson, Exchange Act Rel. No. 41448 (May 25, 1999), 69 SEC Docket 2622, 2623-24 (noting Commission determination "that it is appropriate and in the public interest to accept Richardson's Offer of Settlement," which included the provision of a right to reapply in three years).

Where an initial public interest determination was made by an entity other than the Commission, different considerations may apply. See Ross, 50 S.E.C. at 1085 & n.13 (NYSE settlement not binding on NASD); see also Stephen R. Flaks, 46 S.E.C. 891, 894 n.6 (1977) (upholding NASD denial of application to associate, even though Commission had granted approval, because denial was based on independent ground of separate NASD bar, rather than on Commission bar).

15/ In rare circumstances, the underlying conduct that led to the statutory disqualification may be sufficiently egregious, in light of the environment at the time of the application to associate, to warrant denial of the application. That is not the case here, however.

16/ See M.J. Coen, 47 S.E.C. 558, 563-64 (1981) ("In cases of this sort, which are based on a prior statutory disqualification, Congress has granted the Association broad discretion.").

nor preclude any particular outcome. 17/

Specifically, Van Dusen involved an NASD denial of association to a person subject to two statutory disqualifications, an injunction and a Commission bar from association with a broker-dealer in a supervisory capacity, with a right to apply after 18 months. 18/ We set aside NASD's denial because it was premised on NASD's finding that the underlying misconduct that had led to Van Dusen's statutory disqualification was sufficiently egregious that Van Dusen's association would not be consistent with the public interest. 19/ We determined that the denial of the application on that basis was inconsistent with the purposes of the Exchange Act and unfair. We were careful to make clear, however, that such applications should not be granted automatically simply because the passage of time had made application possible; instead, a variety of relevant factors should be considered. 20/

Ross involved a person subject to statutory disqualification based on a Commission order that barred him from associating in any proprietary or supervisory capacity, with the right to apply after three and one-half years. 21/ NASD denied Ross's application to perform supervisory functions and become a principal in the firm that employed him. Although the record contained new information that perhaps reflected adversely on Ross's ability to function in his proposed employment in a manner consistent with the public interest, it appeared that "NASD also gave substantial weight to matters related to the Commission Order," and we could not determine the degree to which NASD's action was based upon the behavior that resulted in the bar order rather than the new information. 22/ Because we could not conclude that NASD's

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See also Halpert & Co., 50 S.E.C. 420, 422 (1990) ("Particularly in matters involving a firm's employment of persons subject to a statutory disqualification, it is appropriate to recognize the NASD's evaluation of appropriate business standards for its members."). Moreover, we note that NASD has broad discretion in imposing conditions on the employment relationship of a statutorily disqualified person to the employing firm. See, e.g. Scott E. Wiard, Exchange Act Rel. No. 50393 (Sept. 16, 2004), 83 SEC Docket 2752, 2754.

17/ NASD cites Robert B. Graham, Sr., 51 S.E.C. 449, 454 (1993) to support its argument that the Commission has no power to veto a decision by the NASD to disallow the association of a statutorily disqualified person. The Commission was evenly divided on the issues raised in Graham, so the language on which NASD relies does not represent the position of the Commission. 51 S.E.C. at 456. In any event, since Ross and Van Dusen do not dictate the outcome of NASD proceedings, they do not purport to create veto power in the Commission. We note, however, that, as discussed above, Section 19(f) contemplates that the Commission, under prescribed conditions, will set aside an NASD determination to deny access to a statutorily disqualified person.

18/ Van Dusen, 47 S.E.C. at 669.

19/ Id. at 670-71.

20/ Id. at 671-72.

21/ Ross, 50 S.E.C. at 1083.

22/ Id. at 1084-85.

decision was consistent with the purposes of the Exchange Act, we remanded the proceeding. We stated that "our expressed policy in cases of this type . . . requires that the NASD generally confine its analysis to new information," but explained that the misconduct that led to a statutory disqualification could play a legitimate role in that analysis in appropriate circumstances. 23/

NASD does not attempt to distinguish Richardson's case from Van Dusen and Ross. It argues, instead, that Van Dusen (and implicitly Ross) should be overturned. NASD argues that the Commission "committed two fundamental errors" in deciding Van Dusen. First, NASD argues, the Commission "misread the relevant statutory provision when it imported the requirement [found in Section 19(e)(2) of the Exchange Act, 15 U.S.C. § 78s(e)(2)] that sanctions in [self-regulatory organization or "SRO"] disciplinary actions should not be excessive into its review of the application of a statutorily disqualified individual [under Exchange Act Section 19(f), 15 U.S.C. § 78s(f)]." Second, it argues, the Commission "incorrectly relied on its 1975 policy regarding disqualified individuals who apply directly to the Commission for readmission into the securities industry" because NASD has never adopted such a policy and should be allowed to follow its own policy, "which includes analyzing the seriousness of the misconduct that relates to a permanent injunction."

NASD misreads Van Dusen by arguing that Van Dusen erroneously applies a standard applicable to our review of sanctions imposed in disciplinary proceedings to the review of denials of applications to continue NASD membership despite the employment of a statutorily disqualified person. In Van Dusen, we discussed the remedial purpose behind disciplinary actions, but we did so in the context of explaining that, in determining a sanction in a disciplinary action, we engage in an analysis that determines the public interest by weighing the alleged misconduct and the need to avoid visiting unnecessarily harsh consequences on wrongdoers. 24/ The reference to disciplinary actions does not suggest that the same analysis used in disciplinary actions should be used in considering applications to associate. To the contrary, the reference acknowledges that an analysis of public interest requirements based solely on the underlying misconduct has already been performed and that an application to associate after the time determined to be in the public interest has expired requires a different analysis.

NASD correctly states that the policy quoted by the Commission in Van Dusen -- "When hereafter the Commission specifies a date after which [an] application [for re-entry] may be made, the Commission upon a proper showing will generally act favorably upon the application" -- originally appeared in a release that dealt with applications for association that were directed to the Commission itself, not an SRO. 25/ By relying on that policy in Van Dusen, however, we clearly indicated our view that it also was relevant in SRO consideration of applications to

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23/ Id.

24/ 47 S.E.C. at 670-71.

25/ Applications for Relief from Disqualification, Exchange Act Rel. No. 11267 (Feb. 26, 1975), 6 SEC Docket 346, quoted in Van Dusen, 47 S.E.C. at 671.

associate. 26/ As explained above, Ross expanded on Van Dusen by suggesting ways in which consideration of the underlying misconduct might appropriately be part of an SRO's process.

NASD also argues that Van Dusen was incorrectly decided because it inappropriately articulated a substantive fairness requirement. NASD contends that the purposes of the Exchange Act do not encompass such a requirement, but only basic procedural guarantees. 27/ We disagree. Congress clearly intended that the substantive fairness of NASD deliberations subject to the Commission's review; one of the goals of the 1975 Amendments was to strengthen the Commission's oversight of SROs. 28/ The Commission has an obligation to ensure "that [self-regulatory power] is used effectively to fulfill the responsibilities assigned to the self-regulatory agencies, and that it is not used in a manner inimical to the public interest or unfair to private interests." 29/ Among the Commission's responsibilities in reviewing SRO actions under Section 19(f) is to determine whether the rules of the SRO have been applied "in a discriminatory or unfair manner," *i.e.*, whether the action is substantively fair. 30/

We also reject NASD's argument that Van Dusen and Ross are inconsistent with the anti-fraud purpose of the Exchange Act and with NASD's duty to protect investors from

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26/ NASD contends that its by-laws, not the policy set forth in Van Dusen, provide the applicable standard for NASD review of applications that would allow the association of statutorily disqualified persons. Congress has made clear, however, that NASD's regulatory authority is subject to Commission oversight. *See* S. Rep. No. 94-75, 23 (cautioning against fallacious impression that industry and government fulfill same function in regulatory framework, enjoy same order of authority, or deserve same degree of deference and noting that SROs "exercise authority subject to SEC oversight" and "have no authority to regulate independently of the SEC's control"). To the extent that NASD by-laws might allow consideration of Richardson's underlying misconduct beyond that permitted under Commission precedent, Commission precedent controls. We note, however, that NASD has not specifically identified anything in its by-laws that is inconsistent with Van Dusen or Ross.

27/ In the alternative, NASD argues that any substantive fairness requirement was satisfied in Richardson's case because evidence of the misconduct that underlies the statutory disqualification is admissible under the Federal Rules of Evidence. *See* Fed. R. E. 403 (allowing exclusion of evidence if probative value is substantially outweighed by danger of unfair prejudice). NASD proceedings are not governed by the Federal Rules of Evidence. Moreover, Van Dusen and Ross do not preclude consideration of the underlying misconduct. They merely provide a context in which it may be considered.

28/ "In the new regulatory environment created by this bill, self-regulation would be continued, but the SEC would be expected to play a much larger role than it has in the past to ensure that there is no gap between self-regulatory performance and regulatory need." S. Rep. No. 94-75, 2.

29/ S. Rep. No. 94-75, 23.

30/ *Id.* at 132.

unreasonable risk by ensuring high ethical standards in the securities industry. <sup>31/</sup> Van Dusen and Ross are not inconsistent with NASD's duty to critically scrutinize applications involving statutorily disqualified persons with a view to protecting investors. Rather, they articulate an analytic framework within which to consider such applications.

NASD's arguments ignore the impact that allowing the conduct underlying a statutory disqualification to provide the sole basis for denial of applications like the one at issue here would have on the Commission's own anti-fraud and investor protection efforts. If persons contemplating settlements with the Commission know that SROs, through denial of reentry applications, may, in effect, routinely extend those persons' bar from the securities industry beyond the period after which the settlement would allow them to reapply, based solely on the misconduct leading to the settlement, the incentive to settle would diminish markedly. Thus, allowing NASD to ignore Van Dusen and Ross would undermine our ability to settle cases in pursuance of our anti-fraud and investor protection goals. <sup>32/</sup>

NASD argues that Van Dusen and Ross, in providing guidance on which factors NASD should examine in statutory disqualification hearings, allow disqualified individuals to craft their applications "to take advantage of Van Dusen." We believe it is entirely appropriate for statutorily disqualified persons to look to our decisions in Van Dusen and Ross and to understand that, before an application to associate will be approved, they will need to demonstrate, among other things, a clean disciplinary history subsequent to the statutorily disqualifying event, and that they would be well-advised to choose to associate with a firm with a good disciplinary record and an appropriate supervisory structure. Moreover, since Van Dusen and Ross do not purport to provide exhaustive lists of factors, applicants must still formulate their applications as their specific circumstances require.

#### IV.

We hold that Van Dusen and Ross remain the appropriate standards by which NASD should evaluate Richardson's application. <sup>33/</sup> NASD did not conduct its evaluation of

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<sup>31/</sup> See United States v. O'Hagan, 521 U.S. 642, 658 (1997) (primary objective of Exchange Act was "to insure honest securities markets and thereby promote investor confidence."); Citadel Sec. Corp., Exchange Act Rel. No. 49666 (May 7, 2004), 82 SEC Docket 3249, 3255 ("[I]n order to ensure the protection of investors, NASD may demand a high level of integrity from securities professionals.").

<sup>32/</sup> Although the decision to settle an administrative proceeding is a complex function of multiple factors, the right to reapply for association is often an important aspect of a settlement. Settlement terms should be administered in accordance with the fair expectations of the settling parties.

<sup>33/</sup> On July 12, 2004, an order was issued, pursuant to delegated authority, denying a motion filed by NASD requesting oral argument in connection with this matter. Pursuant to Rule of Practice 430(a), NASD has requested our review of that order.

Richardson's application consistently with those precedents, instead focusing exclusively on the municipal bond misconduct underlying the Commission bar order against Richardson. Therefore we are unable to determine whether the denial of Richardson's application is consistent with the purposes of the Exchange Act, and accordingly we remand for further consideration not inconsistent with this opinion.

An appropriate order will issue. 34/

By the Commission (Chairman DONALDSON and Commissioners GLASSMAN, GOLDSCHMID, ATKINS, and CAMPOS).

Jonathan G. Katz  
Secretary

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Rule of Practice 451 provides that we will consider appeals (other than those from initial decisions by a Commission hearing officer) on the basis of the papers filed by the parties without oral argument unless we determine that the presentation of facts and legal arguments in the briefs and record and the decisional process would be significantly aided by oral argument. NASD contends that oral argument is necessary because the important policy issues at stake warrant careful consideration that necessarily will be aided by oral argument.

We do not believe that NASD has shown that oral argument will significantly aid our decision-making process. The parties have thoroughly briefed the factual and legal issues in this proceeding, and their contentions are presented before us in a manner that have permitted us to fully evaluate and determine the matters at issue. Accordingly, the request of NASD for oral argument is denied.

34/ We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA  
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ORDER REMANDING APPEAL FROM REGISTERED SECURITIES ASSOCIATION

On the basis of the Commission's opinion issued this day, it is

ORDERED that the review proceeding of the application by Emmett A. Larkin Company, Inc. to employ Harry M. Richardson as a general securities representative is hereby remanded to NASD for further consideration.

By the Commission.

Jonathan G. Katz  
Secretary