

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of :
 :
HARRISON SECURITIES, INC., : INITIAL DECISION
FREDERICK C. BLUMER, : September 21, 2004
and NEBRISSA SONG :
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APPEARANCES: Allan I. Kahn and Richard G. Primoff for the Division of Enforcement, Securities and Exchange Commission.

Frederick C. Blumer, pro se, and as chief executive officer of Harrison Securities, Inc.

Marc S. Gottlieb for Nebrissa Song.

BEFORE: James T. Kelly, Administrative Law Judge.

The Securities and Exchange Commission (SEC or Commission) instituted this proceeding on April 7, 2003, pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 (Exchange Act) and Rule 102(e) of the Commission's Rules of Practice to address violations of the net capital, books-and-records, and financial reporting provisions of the Exchange Act. Named as Respondents are Harrison Securities, Inc. (Harrison), a broker and dealer based in Port Washington, New York; Frederick C. Blumer (Blumer), Harrison's chief executive officer and sole shareholder; and Nebrissa Song (Song), Harrison's financial and operations principal (FINOP) from December 2001 to April 2002.

The Order Instituting Proceedings (OIP) alleges that on at least twenty-two occasions from April 2001 through April 2002, Harrison conducted a securities business while not maintaining sufficient net capital, and that, on at least three occasions, Harrison filed inaccurate Financial and Operational Combined Uniform Single (FOCUS) reports. The OIP also asserts

that Blumer, a certified public accountant (CPA), willfully aided and abetted and caused the firm's violations, and that Song, for the period in which she served as Harrison's FINOP, caused certain of the firm's violations.

The OIP charges that, by operating without sufficient net capital, Harrison willfully violated Section 15(c)(3) of the Exchange Act and Rule 15c3-1(a) thereunder. In addition, it alleges that Harrison willfully violated Section 17(a)(1) of the Exchange Act and Rules 17a-3(a), 17a-4(a) and (f), and 17a-5(a) thereunder by filing inaccurate FOCUS reports and by failing to create and preserve current, accurate books and records. Finally, the OIP asserts that Harrison willfully violated Section 17(a)(1) of the Exchange Act and Rule 17a-11(b) and (d) thereunder by failing to file timely notices with the Commission of its net capital deficiencies and its failure to keep current, accurate books and records.

The OIP alleges that Blumer willfully aided and abetted and caused all of Harrison's violations, and that Song caused Harrison's violations of Sections 15(c)(3) and 17(a)(1) of the Exchange Act and Rules 15c3-1(a), 17a-3(a), 17a-5(a), 17a-11(b), and 17a-11(d) thereunder during the period from December 3, 2001, through April 30, 2002.

Respondents' Positions

Respondents assert that Harrison always operated with sufficient net capital while conducting a securities business (Answer). They also argue that Harrison's FOCUS reports were accurate, and that the firm created and preserved the appropriate financial records (Answer). For those reasons, Respondents claim that Harrison was never under a duty to notify the Commission of any net capital deficiencies or inaccurate books and records.

Harrison and Blumer emphasize that Harrison never handled customer funds (Harrison's and Blumer's Opening Statement, dated Jan. 13, 2004) (Harrison's Opening Statement). They argue that Harrison's customers were never placed at risk by any of the alleged misconduct attributed to them (Harrison's Opening Statement). Harrison and Blumer also contend that the Division's calculations of Harrison's net capital positions are materially inaccurate and unreliable and cannot be used to prove the violations alleged in the OIP (Prehearing Conference of Dec. 16, 2003, at 16-18, 20-22; Harrison's Opening Statement).

Song raises additional defenses. She argues that she acted reasonably and within industry standards at all times. Song also claims that she was frustrated by Blumer's failure to provide her with the financial records she requested. She contends that she did everything she reasonably could have done to have Blumer assist her. When those efforts were unsuccessful, Song maintains that she resigned as Harrison's FINOP effective on April 23, 2002. Song contends that she did not "cause" Harrison's violations, to the extent that Harrison may have committed any such violations during her period of employment.

The Hearing

I held eight days of hearings in New York City during January and March 2004. All parties were represented by counsel at the hearing. The Division introduced 164 exhibits, and Respondents introduced 41 exhibits.¹

The Division presented two witnesses during its case-in-chief. Carol Fava (Fava), a CPA and staff accountant with the Commission's Northeast Regional Office, was the Division's principal witness (Tr. 9-10). Fava testified about the staff's examination of Harrison's books, records, and net capital computations; the OIP's charges of books-and-records, net capital, reporting, and notification violations; the examination staff's report; and communications between Blumer and the examination staff. Fava testified for approximately seventeen hours over five days (Tr. 9-691).

Thomas R. Cassella (Cassella), CPA, was the Division's expert witness. Cassella is a director of public accounting at Grant Thornton LLP in Vienna, Virginia. From 1978 to 1999, Cassella was employed by the National Association of Securities Dealers (NASD), first, as Director of Financial Responsibility (1978-86), and then, as Vice President of Compliance (1987-99). The Division retained Cassella to express an opinion as to whether Harrison created and maintained its books and records in conformity with Generally Accepted Accounting Principles (GAAP),² and whether Harrison violated the books-and-records, net capital, and financial reporting provisions under the Exchange Act. The Division also engaged Cassella to render an opinion as to whether Song fulfilled her responsibilities as Harrison's FINOP under the relevant NASD regulation. Cassella presented his direct testimony in writing (DX 131). He then testified on cross-examination and redirect for approximately four hours (Tr. 691-879).

The individual Respondents testified in their own defense. Blumer testified for approximately eleven hours over two days (Tr. 968-1425). Song testified for four hours (Tr. 1430-1618).

Harrison and Blumer also offered testimony from Richard Gill (Gill), the billing manager for Wexford Clearing Services (Wexford), Harrison's clearing broker, and Nicholas Mazzarella (Mazzarella), Harrison's director of information technology. Gill discussed the information appearing on the clearing broker's monthly statements. He also described the flow of funds between Wexford and Harrison (Tr. 891-930). Mazzarella explained his efforts to identify and eliminate viruses that purportedly infected Blumer's laptop computer during 2001 (Tr. 943-67).

¹ The hearing transcript, as corrected by my Orders of March 29 and April 13, 2004, will be cited as "Tr. ____." The Division's exhibits and Respondents' exhibits will be cited as "DX ____" and "RX ____," respectively.

² GAAP are the basic postulates and broad principles of accounting pertaining to business enterprises. These principles establish guidelines for measuring, recording, and classifying the transactions of a business entity. See SEC v. Arthur Young & Co., 590 F.2d 785, 789 n.4 (9th Cir. 1979).

The Division sponsored two rebuttal witnesses (Tr. 1618-95). Christopher Pagnanelli (Pagnanelli), senior compliance examiner at the NASD, offered evidence to rebut Blumer's claim that Harrison maintained its books and records on a trade date basis. Bonnie Rosen (Rosen), who was formerly the office manager for Harrison's landlord in Port Washington, offered evidence to rebut Blumer's and Mazzarella's testimony about the viruses infecting Blumer's laptop computer during 2001.

Post-Hearing Developments

Following the hearing, the attorney for Harrison and Blumer withdrew from representation (Order of Apr. 14, 2004). From that point, Blumer has appeared pro se and as an officer of Harrison.

The parties have filed proposed findings of fact, conclusions of law, and briefs, and the matter is ready for decision.³ The Division challenges the credibility of Blumer and Mazzarella. The Division argues that all three Respondents should be sanctioned with cease-and-desist orders. It also seeks civil penalties of \$600,000 against Harrison and \$120,000 against Blumer. The Division further contends that Blumer should be barred from association with any broker or dealer. Finally, the Division urges that Blumer should be denied the privilege of appearing and practicing before the Commission pursuant to Rule 102(e)(1)(iii) of the Commission's Rules of Practice.

Respondents argue that the testimony of Fava and Cassella is entitled to little or no weight, and they challenge the veracity of Rosen. Respondents maintain that all charges should be dismissed.

I base my findings and conclusions on the entire record and on the demeanor of the witnesses who testified at the hearing. I applied "preponderance of the evidence" as the standard of proof. See Steadman v. SEC, 450 U.S. 91, 97-104 (1981). I have considered and rejected all arguments, proposed findings, and proposed conclusions that are inconsistent with this decision.

DISCUSSION

³ The Division's Proposed Findings of Fact and Conclusions of Law and the Division's Post-Hearing Memorandum, both dated May 10, 2004, will be cited as "Div. Prop. Find. ____" and "Div. Br. ____," respectively. The Division's Post-Hearing Reply Memorandum, dated June 1, 2004, will be cited as "Div. Reply Br. ____." Harrison's and Blumer's joint Post-Trial Findings of Fact and Conclusions of Law, dated May 5, 2004, will be cited as "Harrison Br. ____." Harrison's and Blumer's joint Reply Brief, dated June 7, 2004, will be cited as "Harrison Reply Br. ____." The revised copy of Song's Post-Trial Memorandum of Law, dated May 10, 2004, will be cited as "Song Br. ____." Song's Post-Trial Reply Memorandum of Law, dated June 4, 2004, will be cited as "Song Reply Br. ____."

Respondents

Harrison has been a registered broker and dealer since 2000 (Answer ¶ III.D; Tr. 975-77). It acts as an introducing broker, effecting securities transactions on a fully disclosed basis through Wexford, its clearing broker (Tr. 978-80). Harrison does not participate in private placements, initial public offerings, or bridge loan financing (Tr. 978). Nor does it make markets in securities or accept order flow payments (Tr. 978). Harrison is a member of the NASD (Answer ¶ III.D). It employs approximately 125 registered representatives and services the accounts of approximately 4,000 retail customers (Answer ¶ III.D). Harrison effected securities transactions on a continuous basis during the period from April 2001 through April 2002 (Answer ¶ III.M). It reported gross revenues of approximately \$8.1 million in 2001 and \$14.1 million in 2002 (DX 60 at ENF 2315; RX 30 at HA 75).

Blumer created Harrison from the ashes of Whitehall Wellington Investments, Inc. (Whitehall Wellington), of Port Washington and D. L. Springate Securities (Springate Securities) of California. Blumer was a founder of Whitehall Wellington in or about 1997 and voluntarily left that firm in or about 1999 (Tr. 971, 1450; DX 2 at 2). He moved to California in 2000 and acquired Springate Securities, an inactive brokerage firm (Tr. 975-76). Blumer changed the name of Springate Securities to Harrison, opened an office in Pasadena, California, and recruited seven or eight registered representatives (Tr. 977). Blumer also hired Daniel L. Springate (Springate), the firm's former owner, as Harrison's president and FINOP (Tr. 980).

Whitehall Wellington ceased conducting a securities business in late December 2000 and withdrew from registration on April 2, 2001 (Tr. 1559; DX 2 at 2-3).⁴ Blumer's former partner persuaded him to take over Whitehall Wellington's office space in Port Washington and hire many of Whitehall Wellington's registered representatives (Tr. 976-77; DX 2 at 3).

During the first half of 2001, Harrison maintained offices in both Port Washington and Pasadena (Tr. 1336, 1407). Because the Pasadena office was losing money, Blumer decided to close it in the summer of 2001 (Tr. 976, 1407). Springate resigned from the firm after declining Blumer's offer to move from California to New York (Tr. 1407). From mid-2001 to the present, Harrison has operated exclusively from the Port Washington office (DX 146).

⁴ On June 19, 2000, the NASD denied the request of Whitehall Wellington for an exemption from the provision of NASD Rule 3010(b)(2) (Taping Rule). In pertinent part, the Taping Rule requires NASD members that employ twenty or more registered persons, twenty percent or more of whom had been employed by "disciplined firms" within the prior three years, to tape-record the telephone conversations of their registered persons with actual or potential customers. The Commission first denied Whitehall Wellington's request for a stay of the NASD order. Whitehall Wellington Investments, Inc., 72 SEC Docket 2669 (July 18, 2000). It then dismissed as unreviewable Whitehall Wellington's application for review of the NASD's order. Whitehall Wellington Investments, Inc., 75 SEC Docket 314 (May 30, 2001).

Blumer, age fifty, is the sole shareholder and chief executive officer of Harrison (Answer ¶ III.E; Tr. 968). He earned a B.A. degree from Queens College, majoring in accounting and economics (Tr. 968-69). From about 1980 to the present, Blumer has been licensed as a CPA by the State of New York (Answer ¶ III.E; Tr. 969-70). Blumer entered the securities industry in the mid-1990s and he holds three NASD licenses, including a general securities principal license (Tr. 969, 971-72). As relevant here, Blumer does not hold the NASD's Series 27 license (limited financial operations principal) (Tr. 980). Blumer controlled all of Harrison's operations, prepared and maintained all of Harrison's books and records, and prepared and filed all of Harrison's periodic reports at the times relevant to the OIP (Answer ¶ III.E; Tr. 979). Apart from this proceeding, Blumer has a clean disciplinary record (Tr. 971, 1561-62).

Song, age forty-one, is an employee of Securities Consulting Group, Inc. (SCG), a company that provides consulting services to small brokers and dealers (Answer ¶ III.F; Tr. 1433; RX 46 at 4-5). She earned a B.S. degree in accounting and finance and passed the NASD's Series 27 examination (Tr. 1431-32). Song also holds several other NASD licenses (Tr. 1432). Before Song associated with Harrison, she had been a FINOP for several other brokers and dealers (Tr. 1436-37; RX 46 at 4-5). Apart from this proceeding, Song also has a clean disciplinary record (Tr. 1438; RX 46).

Pursuant to a consulting agreement between Harrison and SCG, Song served as Harrison's FINOP from December 3, 2001, to late April 2002 (Answer ¶ III.F; Tr. 1416, 1591-92). During that period, Song was simultaneously a FINOP for three other brokers and dealers (Tr. 1516, 1518). Song described herself as an "outside FINOP," meaning that she performed her duties from the New York City office of SCG or from her home, and not from Harrison's office in Port Washington (Tr. 1408, 1433, 1445, 1456, 1591, 1595). At present, Song is an outside FINOP for three brokers and dealers (Tr. 1434, 1440, 1517).

Applicable Regulatory Principles

Brokerage firms must maintain their books and records in accordance with GAAP (Tr. 705-06; DX 131 ¶¶ 12 n.2, 19). Net Capital Requirements for Brokers and Dealers, 25 SEC Docket 468, 468 & n.4 (May 13, 1982). Brokerage firms are required to use the "accrual" method of accounting, pursuant to which the broker must recognize revenues when earned and liabilities when incurred. Clinger & Co., 53 S.E.C. 358, 361 (1997).

Every brokerage firm that fails to make and keep current the required books and records must give notice of that fact the same day to the Commission and to its principal self-regulatory organization. Exchange Act Rule 17a-11(d). The Commission has emphasized the importance of the records maintained by brokers pursuant to the Exchange Act, describing them as the "keystone of the surveillance of brokers and dealers by our staff and by the securities industry's self-regulatory bodies." Edward J. Mawod & Co., 46 S.E.C. 865, 873 n.39 (1977), aff'd, 591 F.2d 588 (10th Cir. 1979).

A brokerage firm's "net capital" is defined under Exchange Act Rule 15c3-1 (Net Capital Rule). Net capital is generally calculated by deducting illiquid assets from the firm's net worth, as determined under GAAP, adding to that amount properly subordinated debt and further

deducting certain percentages (known as “haircuts”) of the market value of the securities held in the firm’s proprietary accounts (Tr. 1462; DX 131 ¶ 12 n.5). See Net Capital Requirements for Brokers and Dealers, 25 SEC Docket at 468. Net capital computations must be based on financial statements that comply with GAAP (Tr. 706, 770-71, 871). See Joseph S. Barbera, 73 SEC Docket 2271, 2273 (Nov. 7, 2000).

The Net Capital Rule is designed to ensure liquidity. A broker or dealer must have sufficient assets that are readily convertible to cash to cover its indebtedness to customers and other brokers and dealers in case of financial difficulty. See Kirk L. Ferguson, 51 S.E.C. 1247, 1249 (1994); Lowell H. Listrom, 50 S.E.C. 883, 886 (1992), aff’d, 975 F.2d 866 (8th Cir. 1992) (table case). The Net Capital Rule, together with the Commission’s other financial responsibility rules, promotes orderly self-liquidation of financially distressed brokerage firms and reduces the likelihood that a failed brokerage firm will have to be liquidated pursuant to the Securities Investor Protection Act. Michael P. Jamroz, The Net Capital Rule, 47 Bus. Law. 863, 863-64 (May 1992).

An introducing broker that does not clear trades or carry customer accounts is required to maintain at all times minimum net capital of \$5,000 or 6-2/3 percent of its aggregate indebtedness, whichever is greater (Answer ¶ III.H; Tr. 983-84). See Exchange Act Rule 17a-3(a)(2)(iii). If a brokerage firm’s net capital declines below the minimum amount required, the firm must give notice of that deficiency that same day to the Commission and to its principal self-regulatory organization. Exchange Act Rule 17a-11(b). A brokerage firm may not conduct a securities business while it is in contravention of any SEC-prescribed financial responsibility requirement. Section 15(c)(3) of the Exchange Act.

In 1975, the Commission adopted the FOCUS report as part of an effort to streamline financial and operational reporting by brokers and dealers. NASD members file FOCUS reports with the NASD, which then forwards such information to the Commission. Since 1975, the FOCUS system has served as a primary tool for financial and operational surveillance of brokers and dealers. Beginning in 1991, NASD members have filed their FOCUS reports with the NASD electronically, not by paper filings. See NASD, Inc., Order Approving Proposed Rule Changes Relating to Electronic Filing of FOCUS Information, 48 SEC Docket 1230 (Apr. 18, 1991).

At the relevant times, Harrison was a \$5,000 broker. It was required to prepare monthly net capital computations and to file quarterly FOCUS reports that included its end-of-quarter net capital calculations (Answer ¶ III.H). It was also required to retain its net capital computations for non-reporting months, and to produce them if a regulator asked to see them (Tr. 861).

The NASD Finds That Harrison Was Undercapitalized on February 28, 2001

The staff of the NASD’s Los Angeles, California, office conducted a routine examination of Harrison during March and April 2001 (DX 2 at 11, DX 147). The NASD’s staff found that Harrison had generally complied with the rules and regulations reviewed, but it issued a letter of caution as to certain minor deficiencies (DX 147).

The NASD's staff also identified one significant deficiency. Because Harrison was an introducing broker, customer checks for securities transactions should have been made payable to Harrison's clearing broker, rather than to Harrison itself (Tr. 982-83). Nonetheless, the NASD's staff determined that Harrison had accepted sixteen checks made payable to it (Tr. 1422-23; DX 2 at 12, DX 141-DX 147). Because Harrison had accepted customer funds, the NASD's staff determined that the firm's minimum net capital requirement should have been \$250,000, rather than \$5,000. The NASD's staff increased Harrison's minimum net capital requirement, which resulted in a net capital deficiency for the period when Harrison was accepting the customer checks (Tr. 1398; DX 2 at 12). As soon as the NASD's staff challenged Harrison's acceptance of customer checks, the firm immediately discontinued the practice (Tr. 1423; DX 2 at 12). The NASD then returned Harrison's minimum net capital requirement to \$5,000 (DX 2 at 12).

On March 5, 2002, Harrison settled a regulatory action brought by the NASD relating to this deficiency (DX 141). Without admitting or denying the NASD's allegations, Harrison consented to findings that it failed to maintain sufficient net capital while conducting a securities business on February 28, 2001, and agreed to pay a \$2,500 fine (Tr. 1423; DX 141, RX 20).

The SEC Staff Examines Harrison in Early 2002

The Commission's staff conducted an examination of Harrison from February 21, 2002, to April 29, 2002 (Tr. 18, 139, 205, 207). The Commission's staff characterized its examination as "oversight" of the NASD's earlier examination (Tr. 270-72, 606-07; DX 2 at 1).

Two examiners from the Commission's Northeast Regional Office were on-site at Harrison's Port Washington office full time for two months (Tr. 18-19, 207-08). A supervisory examiner joined them two or three days a week (Tr. 19, 207-08). The Commission's staff focused its attention on Harrison's financial records and computations of net capital for the period from January 2001 through April 2002 (DX 2 at 3).

On April 22, 2002, the Commission's Associate Regional Director wrote to Harrison and outlined a series of recordkeeping and Net Capital Rule violations discovered during the staff's examination (DX 103). The letter requested Harrison to file a Rule 17a-11(b) notice of net capital violations on various dates between April 2, 2001, and March 19, 2002 (DX 103). In addition, the letter expressed concern about Harrison's removal of tax liabilities from its financial records and the overall accuracy of Harrison's books and records. The Associate Regional Director also requested Harrison to provide a current net capital calculation as of April 23, 2002 (DX 103).

The Division opened its investigation on May 28, 2002 (Division's Privilege Log, dated May 23, 2003). It then invited and received Wells Submissions from all three Respondents between June and October 2002 (DX 112-DX 122). The examination staff wrote its report on October 31, 2002 (DX 2). The deficiencies identified during the staff's examination and the Division's investigation underlie the charges in the OIP.

Harrison's 2001 Annual Audit

At approximately the same time as the Commission's staff was conducting its fieldwork, an independent CPA was auditing Harrison's financial statements for the year ending December 31, 2001. The deadline for filing the audited financial statements with the Commission was February 28, 2002, but Harrison sought and received an extension until March 31, 2002 (DX 60 at ENF 2310). In requesting the extension, the independent CPA represented that his audit to date had not uncovered any deficiencies in Harrison's required net capital or in its maintenance of records (DX 61).

Harrison filed its annual audited financial statements with the Commission in late March 2002 (DX 60). The audited financial statements reflect that Harrison was in net capital compliance as of December 31, 2001. The outside auditor provided an unqualified opinion that Harrison's financial statements were free of material misstatement. The outside auditor also opined that the financial statements presented fairly the results of Harrison's operations in conformity with GAAP (DX 60 at ENF 2313).

Harrison's Tax Delinquencies for 2001

At some point in 2001, Harrison fell behind in making payments for the federal, state, and local taxes it withheld from the wages of its employees.⁵ Late in 2001, Harrison requested the Internal Revenue Service (IRS) to accept installment payments (Tr. 1046, 1049-50, 1302, 1377; RX 45).

On March 18, 2002, the IRS demanded that Harrison pay \$335,609 in overdue taxes, penalties, and interest (DX 68; RX 9). Harrison eventually persuaded the IRS to waive the penalties (RX 11). The IRS accepted \$282,106 in full satisfaction of the firm's underpayments and interest on April 23, 2002 (DX 65; RX 10-RX 12A).

Harrison was also late in paying the New York State, City, and disability taxes it had withheld from its employees' wages during 2001 (Tr. 1055-57). Blumer testified that he entered into negotiations with New York tax officials that were similar to his negotiations with the IRS (Tr. 1055-57). Harrison's delinquency was partially resolved on April 24, 2002, by the payment of \$110,000 to the State of New York (Tr. 1056, 1058, 1374-75; DX 80; RX 13).

Harrison obtained an extension of time until September 16, 2002, to file its federal corporate income tax return for 2001 (DX 26 at ENF 210). Harrison did not file its federal return until September 19, 2002 (RX 28).

⁵ Blumer characterized 2001 as a poor year for the stock market (Tr. 977, 1035). He also observed that matters only worsened with the tragedy of September 11, 2001, and the closing of the financial markets for several days thereafter (Tr. 1035, 1050).

Blumer's treatment of these tax liabilities on Harrison's books and records is the most significant issue in this proceeding (OIP ¶ III.K.2; Tr. 709-10).

Harrison Failed to Produce Its General Ledger and Its Backup General Ledger Prior to October 1, 2001.

With the exception of the advances-to-brokers account, Harrison failed to provide the Commission's examination staff with a copy of its general ledger for the period from January 1, 2001, through September 30, 2001. The failure to produce this record continues through the present.

Blumer stored all of Harrison's financial records, including its general ledger, on the hard drive of his laptop computer (Tr. 1078). However, when the Commission's staff examiners requested a copy of Harrison's general ledger, Blumer failed to produce it for the period from January 1, 2001, through September 30, 2001 (Tr. 776). Blumer explained that Harrison's general ledger for that nine-month period was unavailable, as a result of either destruction from a computer virus or other unspecified "technological difficulties" (Answer ¶ III.P; Prehearing Conference of Mar. 1, 2004, at 15-20; Tr. 24, 211-12; DX 2 at 8, DX 26 at ENF 178 n.5). Blumer knew of the problem no later than September 2001. He did not install anti-virus software on his laptop computer until October 2001 (Tr. 964).

The Division contends that the "virus" is a fiction, created by Blumer to conceal Harrison's repeated violations of the Net Capital Rule. Harrison responds that the loss of its general ledger was unintentional and not designed to hide any net capital violations. See Listrom, 50 SEC at 887 n.7 ("[I]n general, if a broker-dealer . . . develops a computer-communications system to facilitate regulatory compliance, failure of that system does not excuse the broker-dealer from its obligation to comply with each of its regulatory responsibilities.").

Blumer testified that he began to experience computer problems "in the middle of 2001," although he could not identify the specific month (Tr. 1079, 1207-08). These problems "started to get worse" in the third quarter of 2001 (Tr. 1210). Mazzarella, Harrison's director of information technology, was ambiguous as to when Blumer first alerted him to a problem, what Blumer said, and the specific nature and identity of the viruses discovered (Tr. 948-49, 953-54, 960-61). Whatever problems Blumer experienced with his laptop computer did not prevent him from generating accurate accounting records before October 2001. Rather, such problems only required additional effort on Blumer's part to create the required records (Tr. 1210, 1214-16).

Blumer's explanation for the missing general ledger is dubious, for several reasons. First, Harrison's outside auditor represented to the NASD that he was not aware of any deficiencies in Harrison's 2001 books and records when he requested an extension of the deadline for filing the firm's 2001 audited financial statements (DX 61). The outside auditor gave Blumer a copy of that letter at the time, and Blumer never notified the NASD that the letter was in error in any respect (Tr. 1272-74). Second, when Harrison's outside auditor certified the firm's 2001 financial statements, he failed to mention that the general ledger had been missing for most of the year (Tr. 1268-70; DX 60 at ENF 2326-27). A thorough audit presumably would have

detected the absence of such a crucial record. Third, Blumer never notified the NASD or the Commission that Harrison was not maintaining its books and records accurately, or on a current basis, because the firm's general ledger was missing. Such notice is required by Rule 17a-11(d).

I find the testimony of Blumer and Mazzarella about the computer virus to be incredible. Harrison's failure to produce the general ledger, a record the firm was required to keep, warrants an adverse inference that the missing document contained evidence adverse to Harrison about several of the net capital violations alleged in the OIP.⁶ In making this adverse inference, I have not relied upon the testimony of Rosen, the Division's rebuttal witness. Rosen was thoroughly impeached on cross-examination. I do not consider her to be a reliable witness (Tr. 1638-95; RX 48-RX 50).

The OIP also alleges that Harrison failed to store a duplicate copy of its general ledger separately from the electronically stored original, as required by Exchange Act Rule 17a-4(f)(3). Blumer maintained that he "periodically" created the required backups for Harrison's general ledger on compact discs or floppies (Tr. 289, 1080-81, 1240-43). However, Blumer testified that the computer viruses that corrupted the electronically stored original for the period before October 1, 2001, also infected the backups, and rendered them unusable (Tr. 288-89, 1240, 1243). Blumer did not produce any duplicates during the staff's examination. He had no idea where the backup computer discs were at the time of the hearing (Tr. 1243). Because Harrison is obligated to store a duplicate copy of its general ledger for six years pursuant to Exchange Act Rule 17a-4, I find that the charge in OIP ¶ III.Q has been sustained.

Harrison used Quick Books, an accounting software package for small businesses, as the only means to keep its financial records (Tr. 988, 990-91, 1078-79). The Quick Books accounting software package permits the adjustment of figures previously entered (Tr. 1406-07). For that reason, I find that Harrison did not maintain its financial records in a "non-rewritable, non-erasable format," as required by Exchange Act Rule 17a-4(f)(2).

Harrison's Financial Records Failed to Comply with GAAP.

The weight of the credible evidence shows that Blumer repeatedly failed to accrue Harrison's expenses and liabilities when they were incurred, posted its expenses and liabilities in amounts that were far less than were accurate, and removed those expenses and liabilities from

⁶ The violation of a record-retention rule creates a presumption that the missing record contains evidence adverse to the violator. Favors v. Fisher, 13 F.3d 1235, 1239 (8th Cir. 1994); Hicks v. Gates Rubber Co., 833 F.2d 1406, 1418-19 (10th Cir. 1987). The Division has shown that Harrison had an obligation to preserve its general ledger, that Harrison had a "culpable state of mind," and that the general ledger is relevant to the Division's claim of net capital deficiencies. Cf. Byrnie v. Town of Cromwell Bd. of Educ., 243 F.3d 93, 107-12 (2d Cir. 2001) (restating the three-part test for an adverse inference). Harrison's loss of its general ledger was at least negligent. Cf. Residential Funding Corp. v. DeGeorge Fin. Corp., 306 F.3d 99, 107-08 (2d Cir. 2002) (holding that the "culpable state of mind" test can be satisfied by a showing of negligence, without a finding of bad faith or gross negligence).

Harrison's books and records before they were paid or otherwise extinguished. As a result, Harrison's books and records violated GAAP and cannot be relied upon for valid net capital computations. The six principal types of accounting errors are summarized below. In some instances, the figures used in this Initial Decision may differ from the figures used by the parties because of rounding. All such differences are less than \$5.00, and are not material to the analysis.

Blumer Regularly Understated Harrison's
Withholding Tax Liability on the Firm's Balance
Sheets and Net Capital Computations

The general presumption of Exchange Act Rule 17a-3 is that a firm's financial records must have accounting integrity, be balanced, have an appropriate audit trail, and be posted correctly. See AICPA Audit and Accounting Guide, Brokers and Dealers in Securities § 2.155. It is improper under GAAP for a firm to maintain inconsistent cash receipts and disbursement blotters, balance sheets, or ledgers (DX 131 ¶ 29).

Blumer provided the Commission's examination staff with a July 31, 2001, balance sheet that reflected federal withholding tax liabilities of \$219,462 (DX 31 at ENF 3427). This was the second balance sheet that Blumer provided the staff as of July 31, 2001 (Tr. 98-99). Blumer created the second balance sheet after the staff informed him that the first balance sheet he prepared showed Harrison had a net capital deficiency as of that date (Tr. 98-99).

Harrison's journal entries and commission reports reflected that Harrison had actually withheld \$319,462 from its employees for federal withholding tax liabilities as of July 31, 2001 (Tr. 107-08, 416-17; DX 30 at ENF 3419). I find that DX 31, the revised balance sheet for July 31, understated Harrison's federal withholding tax liability by \$100,000. I conclude that DX 31 failed to comply with GAAP.

Blumer also provided the Commission's examination staff with an August 31, 2001, balance sheet that reflected federal income, FICA, and New York State and City withholding tax liabilities of \$104,129 (DX 35 at ENF 3512).⁷ This was the second balance sheet that Blumer provided the staff as of August 31, 2001 (DX 34, DX 35). Blumer created the second balance sheet after the staff informed him that the first balance sheet showed Harrison had a net capital deficiency as of that date (Tr. 109-11).

Harrison's journal entries and commission reports reflected that Harrison had actually withheld \$679,129 from its employees for federal income, FICA, and New York State and City withholding tax liabilities as of August 31, 2001 (Tr. 111-12; DX 34 at ENF 3482). I find that DX 35, the revised balance sheet for August 31, understated Harrison's withholding tax liabilities by \$575,000. I conclude that DX 35 failed to comply with GAAP.

⁷ The Federal Insurance Contributions Act (FICA), 26 U.S.C. §§ 3101-3128, is a tax that funds Social Security and Medicare benefits.

Blumer recorded on Harrison's balance sheet as of September 30, 2001, balances of \$104,661 for federal income tax withholding, \$69,952 for FICA withholding, and \$62,398 for New York State, City, and disability withholding (DX 40 at ENF 3554).

Blumer made a complex journal entry on Harrison's general ledger to correct the opening balance on the withholding tax entries as of October 1, 2001 (Tr. 128-30; DX 49 at ENF 3767-69, # 102001). This journal entry increased Harrison's balances for its withholding taxes payable accounts by \$514,762 (Tr. 128-29; DX 41).

The balances Blumer recorded for Harrison's withholding tax liabilities for the corrected opening balance as of October 1, 2001, were \$459,422 for federal income tax withholding, \$179,952 for FICA withholding, and \$112,398 for New York State, City, and disability withholding (DX 49 at ENF 3767-69). These were the amounts that Harrison actually withheld from its employees as of September 30, 2001 (Tr. 418, 1277-78, 1289, 1361-62).

A firm's opening balance on any given business day must be the same as its closing balance on the prior business day (Tr. 130-32, 1149, 1284, 1286; DX 131 ¶ 31). Thus, the October 1 opening balance on Harrison's general ledger for the firm's withholding tax liabilities should have been identical to the closing balance as of September 28, 2001, the immediately preceding business day (Tr. 130-32; DX 131 ¶ 31). However, Blumer did not make any of the adjustments that he had made to the October 1, 2001, opening balance on the firm's general ledger to September 28, the business day on which Harrison's September 30, 2001, FOCUS report was based (Tr. 130-32).

I find that DX 40, Harrison's balance sheet as of September 30, 2001, understated the firm's withholding tax liabilities by \$514,762. I conclude that DX 40 failed to comply with GAAP.

Blumer also provided the Commission's examination staff with a balance sheet and a net capital computation as of October 31, 2001 (Tr. 133-39; DX 51, DX 52). The balance sheet reflected withholding tax liabilities of only \$241,284 (DX 52). However, Harrison's general ledger reflected that the firm had actually withheld \$791,284 from its employees as of October 31, 2001 (DX 49 at ENF 3767-69). I find that the balance sheet and net capital computation that Blumer provided to the staff understated Harrison's withholding tax liabilities by \$550,000. I conclude that DX 51 and DX 52 failed to comply with GAAP.

Blumer provided the Commission's examination staff with a balance sheet and a net capital computation as of November 30, 2001 (Tr. 142-43, 1364-66; DX 56, DX 57). These documents reflected federal income, FICA, New York State, City, and disability tax withholding in the amount of \$335,994 (DX 57, DX 58).

However, Harrison's general ledger reflected withholding tax liabilities of \$845,994 as of November 30, 2001 (Tr. 142-43, 1364-66; DX 49 at ENF 3767-69). I find that the balance sheet and net capital computation that Blumer prepared as of November 30, 2001, understated Harrison's withholding tax liabilities by \$510,000. I conclude that DX 56 and DX 57 failed to comply with GAAP.

Blumer explained that he initially classified many of Harrison's registered representatives as employees, whose wages were subject to tax withholding (Tr. 1030, 1277). Certain of these individuals later became independent contractors, and thus were no longer subject to withholding (Tr. 1021-22, 1029-30). Blumer found it "very time consuming" to keep track of these changes as they occurred (Tr. 1030). Harrison closed its general ledger only at the end of the calendar year (Tr. 1030, 1277). As a result, Harrison's system over-withheld taxes until Blumer made end-of-year "adjusting entries" (Tr. 1029-30).

Blumer's explanation lacks credibility. If Harrison had over-withheld taxes from its registered representatives, the amount over-withheld would still have been a liability of the firm, and should have been recorded in the payable-to-brokers account (Tr. 487-88, 664-65). Moreover, the parties were unable to identify any adjusting entries in Harrison's records reflecting the repayment of allegedly over-withheld taxes at the end of the year or at any other time (Tr. 337-38, 665, 774-75, 1294, 1297, 1299-1300).⁸

Blumer Also Understated Harrison's
Withholding Tax Liability on the
Firm's General Ledger

On December 31, 2001, Blumer made two entries in Harrison's general ledger, the effect of which was to reduce the recorded amount of Harrison's withholding tax liabilities. The first journal entry, # 1219, reduced that liability by a total of \$150,000 against a \$150,000 reduction in the firm's rent expense (Tr. 423-24, 1294-96; DX 49 at ENF 3768, 3774). Blumer acknowledged that the \$150,000 removed from the firm's withholding tax account represented funds taken from Harrison's employees (Tr. 1296). Blumer also admitted that the entry was improper (Tr. 1296-97).

The second journal entry, # 1225, reduced Harrison's federal withholding tax liability by \$93,786 and reclassified that amount as Harrison's federal corporate tax liability (Tr. 422-23, 1298; DX 49 at ENF 3768-69). This sum also constituted money that Harrison had taken from its employees as withholding taxes. It never should have been used to satisfy the corporation's own tax liability. Blumer later decided that Harrison did not need additional funds to pay its federal corporate income tax for 2001 (Tr. 1298-99; RX 28). However, Blumer never returned the money to the withholding tax account, nor did he repay Harrison's employees (Tr. 1299-1300).

⁸ When asked if Harrison and Blumer would produce any documents to support Blumer's testimony, their attorney stated: "I'm not prepared to offer any [documents. Mr. Blumer] may have some, but we are not using them. We are going to have him testify about what happened" (Tr. 337-38). I find that Blumer's testimony on this point was incredible.

Blumer Improperly Used HSI to Remove Liabilities From Harrison's Records

HSI, Inc. (HSI), is a New York corporation that Blumer owns and controls (Answer ¶ III.G). Blumer established HSI in 2000 to pay certain expenses that would otherwise be paid by Harrison, such as rent, utilities, and maintenance (Tr. 1014; DX 26 at ENF 174). HSI does not have an independent source of revenue (DX 26 at ENF 174). HSI is not registered with the Commission in any capacity and is not a member of any self-regulatory organization (Answer ¶ III.G). On October 25, 2001, Blumer granted HSI authority to “process” Harrison’s federal and state tax payments “upon instructions from Harrison” (Tr. 668, 1039; RX 1 at ¶ 2, RX 2). This was approximately the same time that Harrison asked the IRS to accept installment payments for the overdue withholding taxes.

Payable-to-brokers liabilities. On January 11 and 29, 2002, Blumer transferred \$190,000 in cash from Harrison to HSI and reduced Harrison’s payable-to-brokers liability account by the same amount (Tr. 171-73; DX 69 at ENF 3827, 3829, DX 71 at ENF 2620, DX 72). However, HSI never paid Harrison’s registered representatives the \$190,000 that Harrison transferred to it. Rather, Harrison paid its registered representatives from its own funds on January 15, February 15, and March 15, 2002 (Tr. 171, 180-81; DX 69 at ENF 3827-28, DX 78 at ENF 3940-43, DX 82 at ENF 3900).

Tax liabilities for 2001. According to Harrison’s records, the firm owed federal and FICA withholding taxes, corporate income tax, and New York payroll taxes as of December 31, 2001 (DX 60; RX 5). Harrison reduced these liabilities on its books by disbursing funds to HSI during January 2002 (Tr. 1042). The taxing authorities did not receive payment until April 2002 (RX 12, RX 13).

On January 8 and 15, 2002, Blumer transferred a total of \$530,000 in cash from Harrison to HSI and reduced Harrison’s withholding and corporate tax liabilities by the same amount (Tr. 157-60, 169-71, 1366, 1373-74; DX 69 at ENF 3827-28, 3833-34, DX 71 at ENF 2620, DX 72). However, by the end of January 2002, HSI’s bank account held a balance of less than \$14,000 (DX 72). HSI did not pay Harrison’s federal and state tax liabilities until three months later, on April 23 and 24, 2002 (Tr. 160-61, 1366, 1373-75; DX 65, DX 80; RX 12, RX 13). In the meanwhile, Blumer used at least some of the funds Harrison transferred to HSI to pay his own personal debts (Tr. 1377-78).

The Division does not suggest that there is anything inherently wrong with a brokerage firm’s use of an affiliate to pay its bills (Tr. 702-03). However, it vigorously disputes Blumer’s claim that the legal liability to pay the taxes immediately shifted from Harrison to HSI on the day that Harrison transferred funds to HSI (Tr. 810).

The Division alleges that Harrison violated GAAP by removing significant tax liabilities from its balance sheet, even though the liabilities remained outstanding. It relies upon Statement of Financial Accounting Standards No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (Sept. 2000) (FASB No. 140), which became effective on March 31, 2001. Under FASB No. 140 ¶ 16, a debtor is required to maintain a liability on its

books and records until the liability has been extinguished (Tr. 404-07, 738-39, 768, 1367; DX 131 ¶¶ 35-36, DX 156 ¶ 16). As relevant here, a liability has been extinguished if the debtor pays the creditor or is “legally released” from being the primary obligor under the liability, either judicially or by the creditor (DX 156 ¶ 16).

Harrison had not paid, nor was it “legally released” from its duty to pay, either by the judiciary or by its creditor at the relevant times. The IRS did not view the arrangement between Harrison and HSI as relieving Harrison of its tax liabilities, and it continued to look primarily to Harrison for payment (Tr. 571, 768; DX 68). Blumer’s removal of the tax liabilities from Harrison’s balance sheets and general ledger more than three months before these liabilities were paid or otherwise extinguished was thus improper under GAAP (DX 131 ¶¶ 35-36, DX 156 ¶ 16).

When confronted with FASB No. 140, Blumer asserted that the issue was a legal one, not an accounting one (Tr. 1041-42, 1367-69). However, Blumer could not remember if he consulted with an attorney before he removed Harrison’s tax liabilities from the firm’s balance sheet and general ledger in January 2002 (Tr. 1371-72).

I find that Harrison’s balance sheets and general ledgers improperly understated Harrison’s 2001 withholding tax liabilities as of January 31, February 28, March 19, and March 31, 2002 (Tr. 181-82, 188, 192-93; DX 69, DX 75, DX 78, DX 85, DX 86, DX 90, DX 91, DX 94). The same is true of Harrison’s FOCUS report for the quarter ending March 31, 2002 (DX 93).

Blumer Failed to Post Harrison’s Matching FICA Liabilities

The FICA tax has two components: one that an employer withholds from employees when wages are paid, and another, a matching expense incurred by the employer (Tr. 115, 173-74, 1275-76). See 26 U.S.C. §§ 3102(a), 3111.

Between January and March 2001, a period not covered by the OIP, Harrison posted \$14,003 of its matching FICA expense to its general ledger (Tr. 174, 455-57; RX 37). However, from April 2001 through April 2002, the period at issue in the OIP, Harrison failed to post any matching FICA liability to its general ledger (Tr. 457, 1305-08, 1310-14, 1362-63, 1373, 1384-87; DX 49 at ENF 3777).

After the Commission’s examination staff completed its fieldwork, Blumer’s attorney engaged the Regulatory Services Group of Deloitte & Touche to review Harrison’s books and records (Tr. 1311; DX 26 at ENF 171). The examination staff brought Harrison’s failure to post the employer’s matching FICA liability to the attention of Deloitte & Touche (Tr. 174, 457). On June 18, 2002, Harrison belatedly posted to its general ledger \$89,000 in matching FICA liability for the period from January 1, 2002, through June 18, 2002 (Tr. 174, 176-77, 1312-13; DX 79 at

ENF 520).⁹ However, Harrison never posted any correcting entries for the matching FICA expenses it incurred during 2001.

The Commission's examination staff did not include this unposted matching FICA liability in its initial calculations of Harrison's net capital deficiencies for any of the dates in question in this proceeding (Tr. 174-75, 205-06). The matching FICA expense issue was not discussed in the staff's examination report, during the Wells Submission process, in the Division's More Definite Statement, or in the testimony of the Division's expert witness (DX 2, DX 26, DX 112-DX 113, DX 129, DX 131).

Nevertheless, the Division now contends that, if the examination staff's net capital computations were adjusted to reflect the matching FICA expenses that Harrison failed to post, Harrison's actual net capital deficiencies would increase over the deficiencies previously calculated (Div. Prop. Find. ## 51, 63, 69, 77, 83, 104, 109, 139, 148, 155, 159, 162, Appendices A1-A11; Div. Br. at 10). The Division argues that Harrison's unposted matching FICA expense was so large on some dates as to put Harrison into a net capital deficit by itself, even if the firm's net capital calculations were otherwise accepted (Tr. 1362-63; Div. Prop. Find. ## 63, 103). The Division also speculates about how Harrison actually funded its matching FICA liability for 2001 (Div. Prop. Find. # 124).

The matching FICA liability issue is within the scope of the OIP. Respondents did not complain during the hearing or in their post-hearing pleadings that the Division was attempting to introduce a new issue into the case at the eleventh hour. I consider the opportunity to raise that objection as waived.

Blumer Prematurely Recorded Cash Deposits

The Division argues that Blumer improperly inflated Harrison's cash position at month's end, just before he computed the firm's net capital. It contends that he did so by including on the firm's cash receipts and disbursements blotter two significant cash deposits that did not actually reach Harrison's bank account until several days or weeks later.

Blumer included a deposit of \$50,000 as additional paid-in capital on Harrison's cash receipts and disbursement blotter as of May 30, 2001 (Tr. 1332; DX 19 at ENF 3371). The deposit involved a transfer from Blumer's account to Harrison's account at the same bank (Tr. 1334-36). Harrison's bank did not actually record the deposit until June 22 or June 26, 2001 (Tr. 1333-36; DX 15, DX 16 at ENF 2582).

⁹ The Division argues that Harrison's 2002 matching FICA liability was \$129,706 in March 2002 and \$139,136 in April 2002 (Div. Prop. Find. ## 155, 159, 162, Appendix, Schedules A-9 to A-11). The fact that Harrison posted \$89,000 to its general ledger on June 18, 2002, thus does not represent a full correction.

Blumer also included a deposit of \$50,000 as additional paid-in capital on Harrison's cash receipts and disbursements blotter as of September 30, 2001 (DX 42 at ENF 3587). However, Harrison's bank did not record the deposit until October 4, 2001 (Tr. 127-28; DX 45, DX 46 at ENF 2600).

According to GAAP, an essential characteristic of an asset is that the transaction or event has already occurred. Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements ¶¶ 25, 26 (2003/2004 ed.) (FASB Con. No. 6). Therefore, an overstated receivable cannot be considered as an asset under GAAP.

Blumer claims that both deposits were properly posted to Harrison's cash receipts and disbursements blotter at month's end because they were "deposits in transit" (Tr. 59, 67-68, 127-28; DX 14, DX 47). A "deposit in transit" indicates that a check has been transmitted for deposit, but that the deposit has yet to appear on a bank statement (Tr. 221-23, 710-11). See James S. Pritula, 53 S.E.C. 968, 972-73 & n.12 (1998) (citing Vincent Musso, 48 S.E.C. 1, 3 (1984)); NASD Guide to Rule Interpretations (1996) at *11 (reporting an April 1986 Commission staff interpretation that a "broker/dealer that, as part of its normal business practice, promptly mails deposits to its bank, may include such deposits in transit as allowable assets in its computation of net capital").

The record shows that Harrison did not have a practice of mailing deposits to the bank (DX 161). Moreover, neither of the \$50,000 transactions involved the prompt use of the mails (Tr. 69, 713, 869-70, 1336-40, 1356-61; RX 24). I agree with the Division's expert witness that Blumer's characterization of these transactions as deposits in transit was improper and not in conformity with GAAP (Tr. 710-14; DX 131 at ¶¶ 20, 25).

Blumer Delayed Recording Cash Disbursements

Blumer repeatedly delayed recording Harrison's cash disbursements at month's end. Instead, he recorded the disbursements during the following month. By waiting to record the disbursements until after the date of the net capital computation, Blumer improperly overstated Harrison's assets at the time of the net capital computation.

Blumer disbursed \$2,000 from Harrison to HSI on June 29, 2001 (DX 27). He did not record the transaction on Harrison's cash receipts and disbursements blotter for June 2001. Instead, he recorded it on July 2, 2001 (Tr. 87-89; DX 28).

Blumer disbursed \$5,000 from Harrison to HSI on September 25, 2001 (DX 44). He did not record the transaction on Harrison's cash receipts and disbursements blotter for September 2001 (DX 42). Instead, he recorded it on October 1, 2001 (Tr. 124-26; DX 43 at ENF 3632).

Harrison's monthly premium for its employees' health insurance was due on January 25, 2002 (DX 77). Blumer eventually disbursed \$28,198 from Harrison to United Health Care on January 30, 2002 (DX 77). However, he failed to record the disbursement on Harrison's general ledger until February 1, 2002 (Tr. 166-68; DX 69 at ENF 3829, DX 78 at ENF 3939). As a result, Blumer improperly overstated Harrison's cash position as of January 31, 2002 (Tr. 1382).

According to GAAP, a firm's records must be posted currently. A firm must therefore record its disbursements when they occur. See FASB Con. No. 6 ¶ 145. Harrison's failure to record these disbursements during the period in which they occurred was improper under GAAP.

Blumer Failed to Respond to the
Examination Staff's Requests for
Explanations and Reconciliations

Throughout the Commission's examination of Harrison, Blumer did not respond to many of the staff's requests for explanations and reconciliations of Harrison's financial records (Tr. 32-34, 103-05, 132, 139, 141, 143-44, 424; DX 106). Specifically, Blumer failed to explain or reconcile:

- Harrison's two sets of balance sheets as of July 31, 2001, and August 31, 2001;
- The October 1, 2001, journal entry that corrected Harrison's opening balance on its general ledger as of that date, but not the closing balance as of September 30, 2001;
- The difference between the withholding liabilities reflected on Harrison's balance sheets and general ledgers as of October 31, 2001, and November 30, 2001;
- The December 31, 2001, entry decreasing Harrison's withholding tax liability by \$150,000 against a reduction in the firm's rent expense; and
- The reasoning behind Harrison reduction of \$190,000 in payable-to-brokers liability on the basis of Blumer's transfer to HSI of cash in that amount in January 2002.

Harrison Used Other Devices to Conceal Violations of the Net Capital Rule.

The weight of the credible evidence shows that Blumer frequently omitted two required steps when computing Harrison's net capital. These omissions made it appear as though Harrison was in compliance with the Net Capital Rule when in fact it was not.

Blumer Frequently Used the Incorrect
Minimum Net Capital Requirement

As noted, an introducing broker that does not handle customer funds or clear customer trades is required to maintain at all times minimum net capital of \$5,000 or 6-2/3 percent of the firm's aggregate indebtedness, whichever is greater (Answer ¶ III.H; Tr. 11). For the months in which Harrison did not file a FOCUS report, Blumer consistently used \$5,000, rather than 6-2/3 percent of aggregate indebtedness, as Harrison's minimum net capital requirement (Tr. 32, 108, 190, 1106; DX 11, DX 56, DX 74, DX 84).

Blumer explained that he performed only rough computations of Harrison's net capital positions for the months in which the firm was not required to file FOCUS reports (Tr. 1075, 1106). He asserted that the difference between the \$5,000 minimum (the figure he used) and Harrison's correct minimum (6-2/3 percent of aggregate indebtedness) "historically . . . isn't that great" (Tr. 1076).

Blumer's testimony was baseless. The Division demonstrated that 6-2/3 percent of Harrison's aggregate indebtedness was consistently greater—by tens of thousands of dollars—than the \$5,000 minimum (Tr. 64, 108, 186, 190, 1340-41; DX 11, DX 13A, DX 56, DX 58, DX 74, DX 76, DX 84, DX 86). As illustrations, the Division established that Harrison's correct minimum was \$33,599 on May 31, 2001; \$77,989 on November 30, 2001; and \$75,702 on February 28, 2002 (DX 13A, DX 58, DX 86).

Harrison's use of \$5,000 as its minimum net capital requirement was improper in these circumstances and substantially contributed to the size of the firm's net capital deficiencies (Tr. 700; DX 131 ¶¶ 15, 16).

Blumer Failed to Deduct Required Haircuts and Undue Concentration Charges

The Net Capital Rule requires a brokerage firm to reduce its net worth by certain percentages, known as “haircuts,” of the market value of its securities and commodities positions (Tr. 51, 698-99; DX 131 ¶ 17). Although the broker should be able to liquidate these positions readily under normal market conditions, the Commission designed the haircuts to take into account the price volatility, liquidity, and credit risk associated with the various proprietary positions of the firm. See Jamroz, 47 Bus. Law. at 863-64. Undue concentration charges are extra deductions for securities positions that are large relative to a brokerage firm's net capital. See *Yoshikawa v. SEC*, 192 F.3d 1209, 1211 n.3 (9th Cir. 1999). Failure to make the required deductions from (or take a “haircut” on) proprietary securities positions has the effect of inflating a firm's reported net capital (DX 131 ¶ 18).

From April 2001 through April 2002, Harrison only deducted haircuts on its FOCUS reports for the quarters ending December 31, 2001, and March 31, 2002—the two FOCUS reports that Song reviewed (Tr. 193, 197, 1112; DX 62 at ENF 3718, DX 93 at ENF 4279-80). At all other times, Blumer failed to deduct required haircuts and undue concentration charges when computing Harrison's net capital position (Tr. 32, 64, 87, 90, 133, 143, 1342, 1352, 1362; DX 11, DX 39 at ENF 3599, DX 56, DX 74, DX 84, RX 41).

Harrison's failure to deduct haircuts and undue concentration charges when required was improper and contributed to the size of its net capital deficiencies (Tr. 700; DX 131 ¶¶ 17, 18).

Respondents' Challenges to the Division's Net Capital Calculations.

Harrison and Blumer made only isolated and perfunctory attempts to demonstrate that Harrison's books and records actually complied with GAAP (*i.e.*, characterizing the removal of withholding tax liabilities as a “legal” question, asserting that Harrison “over-withheld” taxes as its employees became independent contractors, and advancing a “deposit in transit” defense). See supra pp. 12-19.

The core of Respondents' case is an attacking defense that attempts to put the prosecution on trial.¹⁰ In essence, Respondents claim that the staff's examination of Harrison was so bereft of professionalism as to taint the net capital calculations the prosecution presented at the hearing (Harrison Br. at 2, 4-6; Song Br. at 18-29). Respondents never submitted their own set of financial exhibits, as an alternative to the Division's submissions. Rather, Respondents have limited themselves to arguing that the Division failed to make a prima facie case of net capital violations. This is a risky strategy, and, with limited exceptions, it has failed. Certain of Respondents' assertions lack factual support and may be dismissed summarily. Some involve errors that are quantitatively immaterial. Others involve matters that are no longer at issue.

"Shortcuts"

Respondents first claim that the examination staff took inappropriate shortcuts, but they fail to demonstrate how these shortcuts prejudiced their rights or undermined the integrity of the net capital calculations the Division presented at the hearing.

Fava's usual practice when conducting an oversight examination is to begin by reviewing the NASD's work papers (Tr. 607). Although Fava did not do so here, she did speak with an NASD branch chief about the NASD's findings (Tr. 607).

Fava also explained that it is her usual practice to work closely with a firm's principals, or at least some of its principals, when conducting a financial examination (Tr. 17, 597). Fava and Song agreed that it is standard practice for the examination staff to speak with a firm's FINOP when reviewing a firm's FOCUS reports (Tr. 275-76, 1442-43, 1491). Here, of course, Blumer prepared Harrison's FOCUS reports, even though Song was the FINOP.

Fava did not contact Springate or Song during the staff's examination of Harrison, although she could have done so if she wished (Tr. 275, 600, 619-20). Fava explained that she obtained all the information she needed from Blumer, the individual who actually created and maintained Harrison's financial records (Tr. 600, 619). Song could not have provided Fava any more information about Harrison than Fava had already received from Blumer (Tr. 862-63, 1572). Fava also stated that she had interviewed Song during a previous examination of another firm and "that made me question whether or not I wanted to speak with [Song] . . . this time" (Tr. 601).

¹⁰ If the weight of the credible evidence shows that Respondents committed the offenses charged, they cannot seriously expect the Initial Decision to punish allegedly sloppy investigative techniques by dismissing all charges in the OIP. In the criminal law context, the Supreme Court has cautioned against the impulse to place the prosecution on trial. Mabry v. Johnson, 467 U.S. 504, 511 (1984) ("The Due Process Clause is not a code of ethics for prosecutors."). So long as the accused have not been prejudiced, the examination staff's alleged lack of professionalism is not dispositive. Irregularities that do not affect substantial rights are to be disregarded. Cf. United States v. Mechanik, 475 U.S. 66, 71-72 (1986) (applying harmless error rule to errors and irregularities occurring in proceedings before a grand jury).

I have assumed that Blumer also prepared and submitted Harrison's FOCUS reports during Springate's tenure as FINOP (Answer ¶ III.E; Tr. 979). In these circumstances, Fava's "failure" to contact Springate is also irrelevant. I note that the Commission accepted Springate's settlement offer in a related administrative proceeding at the same time as it issued this OIP. See Daniel L. Springate, 79 SEC Docket 3790 (Apr. 7, 2003) (imposing a cease-and-desist order for causing Harrison's violations between April 1 and August 22, 2001).

Respondents next assert that the Commission's staff failed to follow the "standards" governing regulatory examinations of brokerage firms. This charge lacks support in the record. Financial examinations of brokerage firms by the Commission's and the NASD's staffs are not subject to Generally Accepted Auditing Standards, or any of the other requirements that govern independent audits of public companies (Tr. 791-92, 854-56). Thus, the fact that Fava's work papers did not resemble audit work papers was not surprising, because they were never intended to do so (Tr. 763-64). There is no evidence that any standards govern Commission staff examinations of brokerage firms (Tr. 594). Within the NASD, the methodology for conducting financial examinations often differs from district to district (Tr. 762-64).

Respondents also complain about the informality of the staff's work papers (RX 31-RX 40). They observe that the work papers are handwritten and do not employ double-entry bookkeeping (Tr. 273-74, 395-96). They assert that these factors should detract from the weight to be accorded to the net capital computations presented at the hearing. The fact that a work paper is handwritten does not mean that it is necessarily unreliable. It is true that the work papers did not use double entry bookkeeping (Tr. 393-96, 399-400, 457-58). However, it was Harrison's responsibility, not the examination staff's, to maintain an accurate general ledger. The only reason the staff attempted to recreate the general ledger was because Blumer failed to provide the firm's general ledger for the nine months in question.

The Computer Virus Affirmative Defense

Harrison and Blumer contend that the viruses in Blumer's laptop computer infected all of Harrison's financial records before October 2001, and not merely Harrison's general ledger. As a result, Harrison and Blumer claim that there were no reliable records from which the examination staff could have computed Harrison's net capital position before October 2001 (Tr. 363-64, 1006).

Blumer insists that he told Fava he could not vouch for the accuracy of any financial records prepared before October 2001 (Tr. 1081-82, 1216, 1219). Fava denies that Blumer said that (Tr. 212). For the reasons explained below, I credit Fava's testimony on this point, and I reject Blumer's testimony to the contrary.

First, the computer virus defense is inconsistent with the facts admitted in Harrison's and Blumer's Wells Submission and their Answer to the OIP. In those two documents, Respondents stated that Harrison had always been able to maintain its other books and records, notwithstanding the absence of its general ledger before October 2001 (Answer ¶ III.P; DX 26 at ENF 178 n.5). Second, the defense is inconsistent with the fact that Blumer provided Fava with a general ledger account showing Harrison's advances to brokers for the period January 1-

September 30, 2001 (Tr. 23, 305; DX 110). Blumer testified that this document was accurate (Tr. 1266-67). Third, the defense is inconsistent with Blumer's testimony that the month-end file folders he handed Fava for the months before October 2001 were also accurate (Tr. 1216-17). Fourth, the defense is inconsistent with evidence in the record that the examination staff was able to reconcile the pre-October 2001 documents provided by Blumer to Harrison's journal entries (Tr. 119-21, 1116-17; DX 38). See Dillon Sec's, Inc., 51 S.E.C. 142, 147 (1992) ("[W]hen a firm attempts to impeach the accuracy of its own records, it faces a heavy evidentiary burden.").

Blumer also maintains that the examination staff assured him, at the close of its fieldwork, that it sympathized with Harrison's computer virus problems and that it was not concerned about any potential books-and-records or net capital violations that may have occurred before October 2001 (Tr. 1082, 1228-30). The claim is contradicted by the staff's contemporaneous written requests that Blumer furnish reconciliations and explanations of books-and-records discrepancies and net capital deficiencies before October 2001 (Tr. 1231-35; DX 103, DX 104, DX 106). I reject Blumer's testimony on this point as incredible. Even if the examination staff had made such statements, that fact would not preclude the supervisory officials in the Northeast Regional Office from overruling the staff. Nor would such statements bar the Commission from alleging pre-October 2001 violations in the OIP.

Settlement Date Accounting vs. Trade Date Accounting

Harrison and Blumer argue that the examination staff's net capital computations are fundamentally flawed because the staff used settlement date accounting, even though Harrison used trade date accounting. The parties agree that the examination staff must compute a firm's net capital by using the same accounting system as the firm it is examining (Tr. 715).

Generally, a brokerage firm has a choice whether to use settlement date or trade date accounting (Tr. 254-55, 714-15; RX 43). As a matter of practice, most \$5,000 brokerage firms use settlement date accounting (Tr. 725, 1593). The differences between settlement date accounting and trade date accounting are not generally large enough to justify the extra effort it takes such firms to compute their net capital positions on a trade date basis (Tr. 725).

Blumer insisted that Harrison had always used trade date accounting (Tr. 1064-66, 1117). In support of his claim, Blumer cited Harrison's audited financial statements for 2001 and 2002. Both documents state that Harrison recognized revenues on a trade date basis (Tr. 253-54, 720-21, 1066; DX 60 at ENF 2318; RX 30 at HA 78). Blumer denied telling the examination staff that Harrison reported on a settlement date basis (Tr. 1117).

It is undisputed that the examination staff calculated Harrison's required net capital on a settlement date basis (Tr. 251-52, 290, 323-24). Fava did so after Blumer informed her that Harrison used settlement date accounting (Tr. 613, 615). Fava was quite surprised to learn that Harrison and Blumer would defend by claiming that the firm was using the trade date accounting method (Tr. 253-55, 613-14).

Wexford, Harrison's clearing firm, furnished monthly statements to Harrison on a settlement date basis (Tr. 251, 716, 1067-68, 1570). That practice is standard in the industry (Tr. 1571). Blumer initially testified that he regularly adjusted the monthly Wexford statements to accrue for trades that were executed during a month, but did not settle until the following month (Tr. 1067-68, 1072-73). On cross-examination, Blumer ultimately acknowledged that he never made such adjustments to Wexford's statements to accrue revenue from trades executed but not settled in a given month (Tr. 1134-53, 1173-86).

Blumer attempted to explain his inconsistent testimony by stating that, when he prepared Harrison's books and records and net capital computations, he mistakenly assumed that Wexford reported on a trade date basis, not a settlement date basis, and therefore did not realize that he needed to adjust Harrison's financials to accrue for trade date income (Tr. 1176-77). Blumer also stated that, while reviewing the Wexford statements in preparation for the hearing, he learned that Wexford actually reported on a settlement date basis (Tr. 1177-80, 1183). I find this explanation to be contrived.

In October 2002, Blumer assisted Pagnanelli, who was then an NASD field supervisor, in completing Harrison's Member Profile Sheet (Tr. 1627-29; DX 162). The Member Profile Sheet shows that Harrison maintained its financial records on a settlement date basis as of October 30, 2002 (DX 162). I credit Pagnanelli's testimony about this episode. Blumer could not recall his conversation with Pagnanelli (Tr. 1117).

Although the Member Profile Sheet originated six months after the last date at issue in the OIP, it covers the same period as Harrison's audited financial statements for 2002 (RX 30). The 2002 audited financial statements assert that Harrison recognized revenue on a trade date basis (RX 30 at HA 78). Clearly, the Member Profile Sheet and the 2002 audited financial statements cannot both be correct on this point.

I find as a fact that Harrison used settlement date accounting at all relevant times. I further find that Blumer's testimony to the contrary was deliberately false, and that Blumer knew it was false when he gave it. The examination staff's use of settlement date accounting to compute Harrison's Wexford receivable on the dates in question in this proceeding is consistent with the manner in which Blumer computed Harrison's Wexford receivables. I also find that Harrison's audited financial statements for 2001 and 2002 are entitled to no weight, insofar as those documents recite that Harrison used trade date accounting during 2001 and 2002.

Staff's Mathematical Errors

Respondents argue that mathematical errors in the examination staff's net capital computations significantly detract from the weight that those computations should be afforded in this Initial Decision.

The Division caught two such errors fairly early in the proceeding. Six weeks before the hearing, the Division revised its net capital computations for June 1 and June 28, 2001 (DX 13, DX 13A, DX 23, DX 23A; letter from Allan I. Kahn, SEC, to Irving M. Einhorn and Marc S. Gottlieb, dated Dec. 5, 2003). The revised schedule for June 1, 2001, corrected the examination

staff's omission of \$60,000 in Harrison's cash position (DX 13, DX 13A). The revised schedule for June 28, 2002, corrected the examination staff's overstatement of \$2,000 in Harrison's cash position (Tr. 44-46; DX 23, DX 23A). These revisions did not alter the examination staff's view that Harrison was undercapitalized on both dates (Tr. 45; DX 13A, DX 23A). Nor did the revisions persuade Cassella to modify the opinions he had previously expressed in reliance on the examination staff's original net capital calculations for those two dates (Tr. 692-93; DX 13, DX 23).

Other mathematical errors only came to light during the hearing. For example, when the examination staff attempted to calculate the haircut that Harrison should have taken on its proprietary securities positions as of February 28, 2002, the staff made a subtraction error that understated the required haircut by \$1,500 (Tr. 568-69, 589-90, 622; RX 41). The error did not change the basic fact that Harrison had improperly computed its net capital by failing to take any haircut at all (DX 84). Ironically, the staff's error worked in Harrison's favor by understating the firm's net capital deficiency on the date in question.

The most serious mathematical errors identified at the hearing involved Fava's admission that the examination staff had substantially understated Harrison's receivable from Wexford—an allowable asset for net capital computation purposes—on several dates (Tr. 359-62, 371, 376, 462-63) (error of approximately \$175,000 for July 31, 2001). As a direct result of these types of errors, the Division abandoned its efforts to prove net capital violations on seven of the twenty-two dates identified in the OIP (Tr. 371-72, 376).¹¹ Cassella then withdrew the opinions he had expressed in reliance on the staff's net capital calculations for those seven dates (Tr. 692).

Staff's Failure to Give Harrison Credit for Intra-Month Accruals in Its Wexford Receivable Accounts

The OIP alleges that, shortly after Blumer calculated or reported that Harrison had excess net capital for a given month or quarter, he transferred funds to HSI or to himself, usually in an amount greater than Harrison's claimed excess net capital, thereby putting the firm out of net capital compliance (OIP ¶ III.L). Six of the remaining fifteen days on which the OIP alleges that Harrison was undercapitalized required the examination staff to make intra-month calculations of Harrison's net capital position.¹²

On direct examination, Fava testified that she gave Harrison credit for intra-month accruals in its Wexford receivable account before making her net capital calculations for these six dates. Fava explained that she began with the balance of the Wexford receivable, as Wexford reported it to Harrison on the prior month's statement, and then "brought the activity forward" by

¹¹ The Division withdrew the charges that Harrison committed net capital violations on June 28, July 31, August 31, October 31, December 27 and 28, 2001, and April 24, 2002 (Tr. 371-72).

¹² The dates of the staff's calculations of Harrison's intra-month net capital position are April 2 and 3, June 1, and July 3, 2001, and January 8 and February 5, 2002.

giving Harrison credit for accruals from the end of the prior month through the date of her net capital calculation (Tr. 48, 51-52, 65, 76-78, 156, 163, 178).

When Harrison and Blumer challenged Fava to prove that the staff's intra-month restatements of the Wexford receivable were accurate, she was unable to do so. The staff did not give Harrison credit for the commission income, margin interest, or postage and handling rebates that Harrison had earned between the end of the prior month and the dates of its intra-month net capital calculations (Tr. 521-23, 531-32, 537-43, 546, 559). Nor did the staff disclose the omission of these accruals in the notes to its net capital exhibits (Tr. 535-36, 539, 542, 546, 559).

Fava explained that the staff had no way of knowing how much Harrison had actually earned for the fractional parts of the months at issue (Tr. 522, 533-34, 630). She also noted that, if the accrued commissions receivable from Wexford were added to Harrison's Wexford receivable, then those amounts should be offset against the accrued commissions-payable-to-brokers. After "eyeballing" Harrison's monthly Wexford statements, the examination staff concluded that such intra-month accruals would probably result in only a minimal adjustment to Harrison's net capital position (Tr. 631-32). On the basis of these assumptions, the examination staff's net capital computations did not include any accruals for commission income, margin interest, or postage and handling rebates earned during the intra-month periods at issue.

During its redirect examination of Fava, the Division effectively showed that the examination staff's omission of intra-month accruals was immaterial, because Harrison would still have been undercapitalized even if the staff had given Harrison credit for them (DX 151-DX 155).

The Division assumed arguendo that all of Harrison's net commission revenue for a given month had been earned by the date of the staff's intra-month net capital calculation, and none thereafter. It further assumed that no expenses should be deducted from this additional revenue. Even under these circumstances, the Division argued that Harrison still would have had a net capital deficiency. The Division considered such assumptions to be unrealistic, but it wanted to demonstrate that the omitted accruals were insignificant in comparison to Harrison's net capital deficiencies. On five of the six dates in question, the Division's showing was dispositive. See infra pp. 27-39. On the sixth date (January 8, 2002), it was not. That date will be considered separately. See infra pp. 34-35.

Respondents Failed to Prove that Harrison's Minimum Clearing Deposit Was Always \$125,000

The sums receivable from Wexford were one of Harrison's primary allowable assets. For April 2, 2001, the examination staff calculated Harrison's Wexford receivable at only \$103,523 (Tr. 309-10; DX 7). For April 3, 2001, the examination staff allowed Harrison a Wexford receivable of only \$84,376 (DX 7). Harrison and Blumer contend that the staff's figures for these two dates cannot possibly be correct because Wexford required Harrison to maintain a minimum clearing deposit of \$125,000 at all times (Tr. 309, 996, 1093-94, 1202-03, 1319-21, 1325-26).

Respondents relied upon the testimony of Gill and Blumer to establish that Wexford had such a policy. Gill stated that Harrison currently maintains a minimum clearing deposit of \$125,000, but he was unsure if Harrison's minimum clearing deposit had always been at that level (Tr. 918-19, 929-30). Gill acknowledged that Wexford might allow an introducing brokerage firm to dip below its required minimum for a day or two, although Wexford's risk department, which monitors the clearing deposits of introducing firms, is usually quick to insist that an introducing broker replenish its contractual minimum deposit (Tr. 901, 923-24). Gill did not know if Harrison had ever fallen below the minimum that Wexford required (Tr. 923-24).

Gill does not work in Wexford's risk department. As a result, he lacked firsthand knowledge of introducing broker minimum deposits (Tr. 901, 923, 929-30).

Blumer insisted that Wexford would not permit him to transfer money out of Harrison's proprietary accounts if the amount maintained in those accounts fell below \$200,000 (Tr. 1093-94, 1326). The record does not support his claim. Harrison's Wexford receivable balance as reported on Harrison's March 31, 2001, FOCUS report was \$434,488 (Tr. 1318-20; DX 7). Wexford nonetheless permitted wire transfers out of Harrison's account on April 2, 2001, in the amount of \$345,000 (Tr. 1319-20).

Respondents did not offer evidence to show Harrison earned additional income from March 31 through April 3, 2001, sufficient to meet either Wexford's purported \$125,000 minimum deposit requirement, or the \$200,000 floor Blumer described (Tr. 1320-21). Nor did Respondents provide a copy of the Wexford-Harrison clearing agreement (Tr. 900). The terms of that contract might have shed additional light on the minimum clearing balance on the relevant dates.

In these circumstances, Fava's testimony that clearing firms may allow introducing firms to dip below their required minimum is unrebutted (Tr. 540-41). I find that Respondents have failed to show that Wexford required Harrison to maintain a minimum clearing balance of \$125,000 at all relevant times.¹³

Harrison's Specific Net Capital Violations.

Harrison's financial records reflect that the firm had excess net capital on April 2 and April 3, 2001, May 31, 2001, June 1 and June 29, 2001, July 3, 2001, September 28, 2001, November 30, 2001, January 8 and January 31, 2002, February 5 and February 28, 2002, March 19 and March 28, 2002, and April 23, 2002 (Answer ¶ III.J). The Division alleges that Harrison operated on each of these dates with substantial net capital deficiencies.

¹³ Of course, Respondents' argument becomes moot if the examination staff's calculation of Harrison's Wexford receivable on April 2 and April 3 is increased to give Harrison credit for net commission revenue of \$73,668 earned during the entire month of April 2001, as recommended by the Division (DX 152; Div. Prop. Find. # 43). See supra pp. 25-26.

In addition, for the quarters ending June 30, 2001, September 30, 2001, and March 31, 2002, Blumer prepared and filed FOCUS reports on behalf of Harrison. These reports represented that Harrison had excess net capital on June 29, 2001, September 28, 2001, and March 28, 2002, the last business days, respectively, of these quarters (Answer ¶¶ III.I, III.J). The Division alleges that the FOCUS reports were inaccurate because Harrison operated on each of these dates with substantial net capital deficiencies.

April 2 and 3, 2001

Harrison claimed excess net capital of \$18,622 in its FOCUS report for the quarter ending March 31, 2001 (DX 4 at ENF 3275). The examination staff did not challenge that claim (Tr. 46-47).

Blumer transferred \$345,000 from Harrison's Wexford account to the firm's cash account, and then disbursed \$295,000 of that money to himself, and \$50,000 to HSI on April 2 (Tr. 47-48, 53-55, 1331; DX 8 at ENF 1431, DX 9, DX 10). Taking into consideration these transfers, the absence of any other material cash transactions between March 31 and April 2, and assuming that the examination staff accurately calculated Harrison's Wexford receivable on April 2, the Division demonstrated that Harrison had a net capital deficiency of \$267,958 on April 2 (Tr. 47-48, 53-55; DX 7).

On April 3, Blumer deposited \$200,000 into Harrison's account as additional paid-in capital (Tr. 51, 55-56; DX 9 at ENF 3339, DX 10 at ENF 2573). After that deposit, and making the same assumptions as in the immediately preceding paragraph, the Division demonstrated that Harrison still had a net capital deficiency of \$87,098 on April 3 (Tr. 50-51; DX 7).

Harrison and Blumer objected to the Division's net capital calculations for April 2 and 3 because (a) the examination staff did not include the accrued commission revenue from March 31 through April 2 and 3 as an allowable asset (Tr. 48, 51-52, 537-40); and (b) the examination staff gave Harrison credit for a Wexford receivable on those dates of far less than its purported contractual minimum deposit of \$125,000. See supra pp. 25-27.

To rebut the first of these criticisms, the Division showed that Harrison earned net commission revenue of \$73,668 during the entire month of April 2001 (DX 152). Assuming arguendo that all of Harrison's net commission revenue for the month of April were earned by April 2 or 3, and none thereafter, and further assuming that no expenses should be deducted from this additional revenue, Harrison would still have had net capital deficiencies of \$194,290 and \$13,430 on April 2 and 3, respectively (Tr. 640-43; DX 152). As to the second criticism, the weight of the evidence does not demonstrate that there was a contractual minimum deposit.

Harrison had withheld \$47,572 in FICA taxes from its employees as of April 2 and April 3, but it had only recorded \$14,003 as the firm's matching FICA expense on its general ledger (Tr. 455-57, 1313-14, 1322-23; DX 49 at ENF 3777; RX 33, RX 37). Because Harrison's matching FICA expense is approximately equal to its FICA withholding tax obligation on any given day, the firm understated its matching FICA liability as of April 2 and April 3 by \$33,569 (that is, \$47,572 minus \$14,003). If the Division's net capital computations for these two days

were adjusted to reflect the additional matching FICA liabilities of \$33,569, Harrison's net capital deficiencies would increase from the Division's original calculations for April 2 and April 3 by a similar amount (Div. Prop. Find. # 51, Appendix, Schedule A-1).

May 31 and June 1, 2001

Harrison's net capital computation for May 31, 2001, reflected excess net capital of \$28,711 (Tr. 1331-32; DX 11). The Division alleges that Harrison had a net capital deficiency of \$65,640 on that date (Tr. 57; DX 13A).

Blumer provided the examination staff with two different cash receipts and disbursements blotters for May 2001 (DX 17, DX 19). One was printed on July 24, 2001, and the other was printed on August 4, 2001 (Tr. 1332-33).¹⁴

The blotters differ in that the one printed on August 4, 2001, reflects a \$50,000 deposit recorded on May 30 as additional paid-in capital; whereas the blotter printed on July 24, 2001, does not record that deposit (Tr. 60-61, 1332-34; DX 17, DX 19). The ending balance on the August 4 blotter is therefore \$50,000 greater than the one printed on July 24 (DX 17 at ENF 3375, DX 19 at ENF 3371).

To compute Harrison's cash balance for purposes of the May 31 net capital calculation, Blumer used the cash blotter printed on August 4, 2001—the one that included the \$50,000 deposit (Tr. 1332; DX 12). However, the deposit was not actually made until June 22 or June 26, 2001, and did not qualify as a deposit in transit (Tr. 62-63, 67-68, 1336-40; DX 15, DX 16). See supra pp. 17-18. I find that the blotter printed on August 4 overstated Harrison's cash position by \$50,000.

As previously discussed, Blumer was wrong to use \$5,000 as Harrison's minimum net capital requirement for May 31 (Tr. 64, 1340-41; DX 11). If Blumer had computed the minimum correctly (using 6-2/3 percent of aggregate indebtedness), Harrison's minimum net capital requirement on that date would have been \$33,599 (Tr. 64, 1340-41; DX 13A). See supra pp. 19-20.

Blumer also did not deduct the required haircut on May 31 (Tr. 64, 1342). After taking into account Blumer's improper inclusion of the \$50,000 "deposit in transit," his use of the incorrect minimum net capital requirement, and his omission of the required haircut charges of \$15,752, I find that Harrison had a net capital deficiency of \$65,640 on May 31 (DX 13A).

¹⁴ The Division argues that it is impossible for a firm to have two inconsistent sets of blotters for the same period of time and still be maintaining accurate books and records (Tr. 61-62; DX 131 ¶¶ 20, 25). Harrison and Blumer defend on the grounds that the first blotter was erroneous and that Blumer later corrected it (Tr. 1333, 1336-39). I agree with the Division, because the "corrected" blotter does not comply with GAAP.

In addition, Blumer did not post \$68,734 of Harrison's matching FICA liability as of May 31 (Tr. 1341-43; Div. Prop. Find. # 63, Appendix, Schedule A-2 (third column)).¹⁵ Accounting for this additional liability would have aggravated Harrison's net capital deficiency on May 31 by a comparable amount.

On June 1, Blumer disbursed \$55,000 from Harrison to HSI (Tr. 65-66; DX 18 at ENF 2803). Fava testified that the examination staff accounted for this disbursement and a decrease in Harrison's Wexford receivable resulting from activity in the firm's proprietary account through June 1 (Tr. 65). The staff also recalculated Harrison's haircut and minimum net capital requirements (Tr. 67, 70). The staff then computed Harrison's net capital deficiency as \$123,018 on June 1 (Tr. 57, 64-66, 1344; DX 13A, DX 20).

Harrison and Blumer objected to the Division's net capital calculation for June 1 because the examination staff did not include the accrued commission revenue earned from May 31 to June 1 as part of the firm's allowable assets (Tr. 541-43).

To rebut this criticism, the Division showed that Harrison earned net commission income of \$64,566 during the entire month of June 2001 (DX 153). Assuming arguendo that Harrison earned all that net income on June 1, and none thereafter, and further assuming that no expenses should be deducted from that net income, Harrison would still have had a net capital deficiency of \$58,452 on June 1 (Tr. 644-46; DX 153).

The Division also showed that Harrison failed to post \$68,734 of its matching FICA liability through June 1 (Div. Prop. Find. # 69, Appendix, Schedule A-2 (final column)). If this additional liability were also taken into account, Harrison's net capital deficiency on June 1 would increase by a comparable amount.

June 29 and July 3, 2001

Harrison's FOCUS report for the quarter ending June 30, 2001, claimed excess net capital of \$22,981 (DX 21 at ENF 3408). June 30 was a Saturday, and not a day on which Harrison was conducting a securities business (Tr. 70-71). Thus, the examination staff scrutinized Harrison's net capital position as of Friday, June 29, the last business day of the quarter (Tr. 70-71; DX 23A note). Accord Russo Secs., Inc., 75 SEC Docket 1124A, 1124C n.7 (Apr. 17, 2001). The Division alleges that Harrison had a net capital deficiency of \$98,289 on June 29 (Tr. 70-71; DX 23A). It also charges that the FOCUS report is inaccurate.

¹⁵ DX 12 shows the employees' FICA withholding as of May 31, 2001, was \$82,737. The Division's figure of \$68,734 assumes that the employer's matching FICA liability was an equal amount ($\$68,734 = \$82,737 - \$14,003$). I agree with the Division.

The Division demonstrated that Blumer improperly inflated Harrison's Wexford receivable account by \$114,985 as of June 29 (Tr. 72-76, 83-87, 342, 463; DX 23A). Blumer conceded the point (Tr. 1344-51).¹⁶

Blumer disbursed \$2,000 to HSI from Harrison on June 29 that he did not record in Harrison's cash receipts and disbursements blotter for June (Tr. 87-89; DX 23A, DX 27, DX 28). Instead, he recorded it on July 2, 2001 (DX 28). Blumer also failed to deduct the necessary haircut charges of \$4,260 on Harrison's proprietary securities positions as of June 29 (Tr. 87, 90, 92, 1352; DX 23A).

Properly accounting for the \$2,000 disbursement to HSI and properly calculating the firm's required haircut of \$4,260 for that date, I find that Harrison had a net capital deficiency of \$98,289 on June 29, the last business day of the month (DX 23A). I also find that the FOCUS report was inaccurate.

In addition, Blumer failed to post \$91,223 of Harrison's matching FICA expense on June 29. If the omitted portion of the firm's matching FICA expense had been included on the FOCUS report, Harrison's net capital deficiency would have increased by a comparable amount (Tr. 1345, 1352-53; Div. Prop. Find. # 77, Appendix, Schedule A-3 (third column)).

The Division also argued that Harrison had a net capital deficiency of \$146,665 on July 3, 2001 (Tr. 94-95, 98; DX 23A, DX 24). The Division accounted for Harrison's disbursement of \$22,000 to HSI on July 2 and July 3 (Tr. 95-97; DX 23A, DX 28, DX 29). The Division also calculated the correct minimum net capital requirement and deducted haircuts (DX 23A).

Harrison and Blumer objected to the Division's net capital calculations for July 3 because the examination staff did not include commission revenue from June 29 through July 3 in its calculation of the Wexford receivable for July 3 (Tr. 545-46, 1353-54). See supra pp. 25-26.

To rebut this criticism, the Division showed that Harrison earned net commission revenue of \$84,718 during the entire month of July 2001 (DX 154). Assuming arguendo that Harrison earned all that net income during the first few days of July, and none thereafter, and further assuming that no expenses should be deducted, Harrison still would have had a net capital deficiency of \$61,947 as of July 3 (Tr. 646-47; DX 154).

Harrison failed to post \$91,223 of its matching FICA liability on July 3 (Div. Prop. Find. # 83, Appendix, Schedule A-3 (final column)).¹⁷ If that additional liability were added to

¹⁶ The staff disallowed unsubstantiated journal entries that increased the firm's profit and loss account, but did not reconcile to the Wexford statements. In essence, Blumer improperly increased Harrison's June 30 balance by \$193,922, the amount that he posted in journal entry # 617, rather than by accounting for the accruals that were posted to the account in early July (DX 22, DX 25, DX 26 at ENF 172-73, 194, 196).

Harrison's net capital deficiency, as originally calculated by the examination staff, then Harrison's net capital deficiency on July 3 would increase by a comparable amount.

September 28, 2001

Harrison claimed excess net capital of \$66,659 on its FOCUS report for the quarter ending September 30, 2001 (DX 39 at ENF 3600). September 30 was a Sunday, a day that Harrison was not conducting a securities business. Thus, the examination staff scrutinized Harrison's net capital position on Friday, September 28, the last business day of the quarter. The Division alleges that Harrison had a net capital deficiency of \$527,146 on September 28 (Tr. 123; DX 41). It also charges that Harrison's quarterly FOCUS report is inaccurate.

Blumer did not record a \$5,000 check that Harrison disbursed to HSI on September 25 on the firm's September 2001 cash receipts and disbursements blotter (DX 42 at ENF 3586-87, DX 44, DX 45 at ENF 2598). Instead, he recorded it on October 1, 2001 (Tr. 124-26; DX 43 at ENF 3632). This had the effect of overstating Harrison's cash position by \$5,000 on the September 30 FOCUS report.

Blumer did record a deposit of \$50,000 as additional paid-in capital on the firm's September 2001 cash receipts and disbursements blotter (DX 42 at ENF 3587). The deposit was not made until October 4, 2001 (Tr. 127-28; DX 45, DX 46 at ENF 2600). Blumer characterized this transaction as a deposit in transit. However, the deposit was not made by mail, but rather as the result of a faxed request on October 4, 2001 (Tr. 1356-60; RX 24). I reject Blumer's assertion that this transaction should be treated as a deposit in transit.

As previously discussed, Blumer made a complex journal entry (# 102001) on Harrison's general ledger to correct the opening balance as of October 1, 2001 (Tr. 129-30, 1282-83). See supra p. 13. A firm's opening balance on any given business day must be the same as the firm's closing balance on the prior business day (Tr. 1149, 1284, 1286). Thus, the October 1 corrected opening balances for Harrison's withholding tax liabilities were properly the closing balances as of September 28, the immediately preceding business day (Tr. 130-32; DX 131 ¶ 31). However, Blumer did not make any of the adjustments he made to the October 1 opening balance on Harrison's general ledger to September 28, the business day on which the firm's September 30 FOCUS report was based (Tr. 130-32). As a result, Blumer recorded on Harrison's balance sheet and claimed on Harrison's September 30 FOCUS report balances that were approximately \$514,000 less than what he had recorded as the opening balance for October 1 (Tr. 128-32; DX 40 at ENF 3554, DX 41, DX 49 at ENF 3767-69). See supra p. 13.

Blumer also failed to deduct the required haircut charges of \$1,259 on the September 30 FOCUS report (Tr. 133, 1362; DX 41). The examination staff calculated Harrison's September 28 net capital based on the corrected October 1 general ledger entries (Tr. 131-32). I find as a

¹⁷ Harrison was liable for \$105,226 of its employees' FICA withholding as of June 30, 2001 (DX 22). The Division's figure of \$91,223 infers that the employer's unposted matching FICA liability was an equal amount ($\$91,223 = \$105,226 - \$14,003$). I agree.

fact that the examination staff's net capital calculations were correct, and that Harrison's FOCUS report was inaccurate.

Finally, Blumer did not record on Harrison's books and records, or report on its FOCUS report, the firm's matching FICA expense as of September 30 (Tr. 1362-63). Harrison's unposted matching FICA expense was \$165,949 on September 30 (Div. Prop. Find. # 104, Appendix, Schedule A-4 (final column)).¹⁸ If the firm's net capital computation as of September 30, 2001, were adjusted to reflect this additional liability, Harrison's net capital deficiency would be \$704,164.

November 30, 2001

Blumer provided the examination staff with a balance sheet and net capital computation as of November 30, 2001 (DX 56, DX 57). These documents purported to show that Harrison had excess net capital of \$198,081 on November 30 (DX 56). The Division alleges that Harrison had a net capital deficiency of \$305,988 on that date (Tr. 142-43; DX 58).

Harrison's balance sheet and net capital computation did not reflect federal, FICA, and New York withholding tax liabilities in the amount of \$845,991 that Blumer had recorded on Harrison's general ledger as of November 30 (Tr. 142-43; DX 49 at ENF 3767-69, DX 56-DX 58). See *supra* p. 14. Instead, the balance sheet and net capital computation prepared by Blumer reflected withholding tax liabilities of only \$335,991 (Tr. 142-43; DX 56-DX 58). Blumer failed to explain or reconcile the differences between the withholding tax liabilities reflected on Harrison's balance sheet and general ledger (Tr. 143-44; DX 106).

Moreover, the net capital computation prepared by Blumer improperly used \$5,000 as the firm's minimum net capital requirement, instead of 6-2/3 percent of aggregate indebtedness. It also failed to deduct a haircut on the firm's proprietary securities positions (DX 56). I agree with the Division that the correct minimum net capital requirement was \$77,989 and the appropriate haircut was \$15,154 (DX 58).

Blumer conceded that the Division's calculations of Harrison's net capital and withholding tax balance on November 30 were correct (Tr. 1364-65). Blumer also conceded that he did not record Harrison's matching FICA expense on the firm's balance sheet as of November 30 (Tr. 1365-66). Including this liability would further increase Harrison's net capital deficiency on November 30 by another \$196,581 (DX 49 at ENF 3768; Div. Prop. Find. # 109, Appendix, Schedule A-5 (final column)).

¹⁸ DX 49 at ENF 3768 shows FICA withholding of \$179,952 as of October 1, 2001. Harrison's unposted matching FICA expense as of September 30, 2001, was thus \$165,949 (or \$179,952 - \$14,003).

January 8, 2002

Harrison claimed excess net capital of \$147,127 in its FOCUS report for the quarter ending December 31, 2001 (DX 60 at ENF 2323, DX 62 at ENF 3719). The OIP does not challenge this claim. Harrison held an impressive \$1.16 million in cash on December 31 (DX 60 at ENF 2314, DX 62 at ENF 3711). Nonetheless, the Division alleges that Harrison had a net capital deficiency of \$58,110 on January 8, 2002—only four business days later (Tr. 156; DX 64).

Blumer transferred \$75,000 from Harrison to HSI on January 2 and 4, 2002 (Tr. 156-57, 159, 1366; DX 69 at ENF 3827). He then transferred another \$415,000 from Harrison to HSI on January 8, 2002 (Tr. 431-32; DX 69 at ENF 3827). Blumer also reduced on Harrison's general ledger the firm's federal and FICA withholding taxes and its corporate income taxes payable by \$415,000 (Tr. 159-60, 429-30, 491-92, 1366; DX 69 at ENF 3827, 3833-34, DX 71 at ENF 2620, DX 72).

Blumer made these cash transfers so that HSI could pay Harrison's federal taxes (Tr. 432-33, 492; RX 1, RX 2). However, HSI did not pay the taxes until late April 2002 (Tr. 160-62, 1366; DX 65). As previously discussed, Blumer's decision to remove the tax liabilities from Harrison's balance sheet and general ledger before the liabilities were paid or otherwise extinguished was improper under GAAP. See supra pp. 15-16.

The examination staff reversed the entries removing Harrison's withholding tax liabilities from the balance sheet and net capital computation (DX 64). As an offsetting entry, the examination staff gave Harrison credit for funds receivable from HSI. However, the effect of the staff's reversal was to replace an allowable asset (cash) with a non-allowable asset (funds receivable from an affiliate). After calculating the required haircut at \$3,552 and computing the minimum net capital requirement at \$71,764, the examination staff determined that Harrison had a net capital deficiency of \$58,110 on January 8 (Tr. 156; DX 64).

Harrison and Blumer objected to the Division's net capital calculation for January 8 because the examination staff did not include the accrued commission revenue from December 31 through January 8 as an allowable asset (Tr. 156, 163, 513-26, 531-39). See supra pp. 25-26.

To rebut these criticisms, the Division attempted to demonstrate that the examination staff's omissions as of January 8, 2002, were immaterial in the same way it proved that similar omissions on April 2 and 3, June 1, and July 3, 2001, were immaterial.

The Division's initial effort to rehabilitate the examination staff's calculations was unsuccessful. The Division established that Harrison earned net commission revenue of \$238,692 during the entire month of January 2002 (DX 155). Assuming arguendo that all of Harrison's net commission revenue for the month of January had been earned by January 8, and none thereafter, and further assuming that no expenses should be deducted from this additional revenue, Harrison would have had substantial excess net capital on January 8 (Tr. 648-49, 651-52; DX 155).

On the other hand, if Harrison's net commission revenue for the entire month of January 2002 were apportioned on a straight-line basis, Harrison would have earned \$43,398 by January 8 ($\$238,692 \times 4/22 = \$43,398$). Giving Harrison credit for the accrual of this additional revenue, and assuming that no expenses should be deducted, Harrison would still have been undercapitalized by \$14,712 ($\$58,110 - \$43,398 = \$14,712$).

The Division also notes that Harrison reported a net loss for calendar year 2002 (RX 30 at HA 75). The Division contends that, if the examination staff had accounted for the additional revenue that Harrison earned during the first four business days of 2002, after deducting for the appropriate expenses on an average basis per day, Harrison's net capital deficiency on January 8 would have increased by a negligible amount from the staff's calculation of \$58,110 (Div. Prop. Find. # 130 n.25).

Of the fifteen net capital violations still at issue in the proceeding, I find that the Division's showing is weakest as to January 8, 2002. Cassella offered only the mildest support for Fava's January 8 net capital calculation (Tr. 800). Nonetheless, the weight of the evidence supports the charge of a net capital violation on this date.

January 31 and February 5, 2002

Harrison claimed excess net capital of \$360,246 as of January 31, 2002 (Tr. 165; DX 74). The Division alleges that Harrison had a net capital deficiency of \$427,903 on that day (Tr. 165; DX 76).

As previously discussed, Blumer improperly reduced Harrison's payable-to-brokers liability account by \$190,000 when he transferred cash in that amount from Harrison to HSI on January 11 and January 29, 2001. HSI did not use these funds to pay Harrison's registered representatives. Rather, Harrison paid the representatives from its own funds in February 2002. See supra p. 15.

Blumer also improperly removed \$530,000 of Harrison's 2001 federal, FICA, and New York withholding taxes from its general ledger and balance sheet on various dates in January 2002, despite the fact that Harrison's tax bill was not satisfied until late April 2002. See supra pp. 15-16.

The Division also alleges that Blumer improperly under-reported Harrison's 2002 withholding tax liabilities by \$69,837 on January 31 (Tr. 173-76; DX 75, DX 76). Blumer did not challenge the staff's calculations (Tr. 1372-73). I therefore accept those calculations as correct.

Blumer next failed to record on the firm's general ledger a \$28,198 check disbursed by Harrison to its health insurance carrier on January 30, 2001 (DX 77). Instead, Blumer recorded the disbursement on February 1, 2001, the day after he had computed the firm's net capital (DX 69, DX 78). See supra p. 18. By doing so, Blumer improperly overstated Harrison's cash position on January 31 by this same amount (Tr. 1382).

Finally, Blumer failed to deduct the required haircut on Harrison's proprietary securities positions and used the incorrect minimum net capital amount in calculating the firm's net capital position (DX 74). I agree with the Division that Harrison had a net capital deficiency of \$427,903 on January 31, after accounting for these discrepancies (Tr. 164-65, 177-78; DX 76).

Blumer did not post Harrison's matching FICA expense at any time at issue in 2002 (Tr. 1311-14, 1373). The firm's matching FICA liability was \$48,946 as of January 31 (Div. Prop. Find. # 139, Appendix, Schedule A-7).¹⁹ If this additional liability were included, it would further increase Harrison's net capital deficiency on January 31 by a comparable amount.

Blumer did not calculate the firm's net capital position on February 5, 2001; rather, the examination staff made its own calculation for that date (Tr. 558). On February 1, 4, and 5, Blumer transferred a total of \$192,500 from Harrison to HSI (Tr. 178-80; DX 78 at ENF 3939, DX 81, DX 82 at ENF 3903). The examination staff made certain adjustments to Harrison's Wexford receivable account to reflect activity from January 31, 2002, through February 5, 2002 (Tr. 178). Accounting for the transfer of \$192,500, the staff's adjustment of the Wexford receivable, and the staff's deduction of required haircuts, the Division alleges that Harrison had a net capital deficiency of \$765,107 on February 5 (Tr. 178; DX 76, RX 42).

Respondents objected to the Division's net capital calculation for February 5 because the examination staff did not include the accrued commission revenue from January 31 through February 5 as an allowable asset (Tr. 178, 559; Song Br. at 24-25). See supra pp. 25-26.

To rebut this criticism, the Division showed that Harrison earned net commission revenue of \$174,850 during the entire month of February 2002 (DX 151). Assuming arguendo that all of Harrison's net commission revenue for the month of February had been earned by February 5, and none thereafter, and further assuming that no expenses should be deducted from this additional revenue, Harrison would still have had a net capital deficit of \$590,257 on February 5.

February 28, 2002

Harrison claimed excess net capital of \$160,354 on February 28, 2002 (DX 84). The Division alleges that Harrison had a net capital deficit of \$784,051 on that date (Tr. 181, 506, 565; DX 86).

The Division demonstrated that Blumer improperly continued to omit Harrison's 2001 federal and state withholding tax liabilities from Harrison's balance sheet and general ledger as of February 28 (Tr. 181-82, 434, 506-07; DX 78 at ENF 3950-51, DX 85, DX 86).

The Division calculated Harrison's payable-to-brokers liability at \$324,822 on February 28 (Tr. 182-84; DX 86, DX 87). Blumer had computed Harrison's payable-to-brokers liability

¹⁹ Harrison's FICA withholding payable as of January 31, 2002, was \$48,946 (DX 75 at ENF 3839, DX 78 at ENF 2950, DX 79 at ENF 505). The Division infers, and I agree, that the employer's matching FICA liability would be an equal amount.

on that date at \$121,559—a difference of \$203,263 (Tr. 182; DX 85, DX 86). The Division explained the basis of its calculation, and Respondents did not challenge it (Tr. 182-84). I thus accept the Division's calculation as correct.

Blumer computed Harrison's 2002 federal and FICA withholding tax liability as \$555 and its 2002 New York withholding tax liability as \$6,775 on February 28 (Tr. 566; DX 78 at ENF 3950-51, DX 85). In contrast, the Division computed Harrison's 2002 federal and FICA withholding tax liability as \$227,378 and its 2002 New York withholding tax liability as \$42,061 on February 28 (DX 86). The differences resulted from the examination staff's disallowance of several of Harrison's journal entries on February 28 (Tr. 186, 433-34; DX 86 note, DX 88 at ENF 3890-91). Respondents failed to rebut the Division's showing that Harrison had understated its 2002 federal and FICA withholding tax liability by more than \$226,000 and its 2002 New York withholding tax liability by more than \$35,000 (Tr. 433-34, 507, 1383-84).

The Division computed haircuts and undue concentration charges of \$11,225 on Harrison's proprietary securities positions on February 28 (DX 86; RX 41). Blumer had not deducted any haircuts or undue concentration charges on that date (Tr. 185-86; DX 84). Respondents demonstrated that the examination staff had made a mathematical error that understated the required haircut by \$1,500 (Tr. 568-69; RX 41). However, the error actually benefited Harrison.

Finally, the Division computed Harrison's minimum net capital requirement at \$75,702 on February 28, using 6-2/3 percent of the firm's aggregate indebtedness (Tr. 186, 567-68; DX 86). Once again, Blumer had used the incorrect minimum of \$5,000 (DX 84). I accept the staff's calculation of the minimum as accurate.

After adjusting for Harrison's failure to account for its withholding tax and payable-to-brokers liabilities, taking the required haircut and undue concentration charges, and applying the correct minimum net capital requirement, I agree with the Division that Harrison's net capital deficiency was \$784,051 on February 28 (DX 86). The deficiency would increase by an additional \$1,500 if the staff's calculation of the haircut were revised.

Blumer did not record Harrison's matching FICA expense for February 28, as he was required to do (Tr. 1384-85). Had he done so, Harrison's net capital deficiency on February 28 would have increased by another \$96,229 (Div. Prop. Find. # 148, Appendix, Schedule A-8 (final column)).

March 19, 2002

At the request of the examination staff, Blumer prepared a net capital calculation as of March 19, 2002 (Tr. 187-88, 570, 576-77). According to Blumer, Harrison maintained excess net capital of \$136,158 on that date (DX 89). The Division alleges that Harrison then had a net capital deficiency of \$640,844 (Tr. 188; DX 91).

The Division demonstrated that Blumer improperly continued to omit Harrison's 2001 federal and state withholding tax liabilities from the firm's balance sheet and general ledger as of

March 19 (Tr. 188; DX 78 at ENF 3950-51, DX 90, DX 91). The Division also established that Blumer understated Harrison's 2002 withholding taxes by \$262,094 on that date (Tr. 188-89, 1385; DX 78 at ENF 3950-51, DX 91).

The Division next computed Harrison's payable-to-brokers liability at \$182,068 on March 19 (Tr. 189; DX 91, DX 92). Blumer had computed Harrison's payable-to-brokers liability on that date as \$123,021—a difference of \$59,047 (DX 90, DX 91). The Division explained the basis of its calculation, and Respondents did not challenge it (Tr. 189, 573-74, 591-93). I thus accept the Division's calculation as correct.

Finally, the Division computed Harrison's minimum net capital requirement at \$63,756 on March 19, using 6-2/3 percent of the firm's aggregate indebtedness (Tr. 190; DX 91). Blumer had used the incorrect minimum of \$5,000 (Tr. 190; DX 89). See supra pp. 19-20. I accept the Division's calculation of the required minimum as accurate.

After adjusting for Harrison's failure to account for its withholding tax and payable-to-brokers liabilities, and applying the correct minimum net capital requirement, I agree with the Division that Harrison's net capital deficiency was \$640,844 on March 19 (DX 91).

Blumer did not record Harrison's matching FICA expense as of March 19, as he was required to do (Tr. 1385-86). Had he done so, Harrison's net capital deficiency on March 19 would have increased by another \$129,706 (Div. Prop. Find. # 155, Appendix, Schedule A-9 (final column)).

March 28, 2002

Harrison claimed excess net capital of \$26,895 on its FOCUS report for the quarter ending March 31, 2002 (DX 93 at ENF 4280). March 31 was a Sunday, a day that Harrison was not conducting a securities business. The financial markets also were closed on March 30, a Saturday, and on March 29 for Good Friday (Tr. 191-92, 1386). The last day of the quarter that Harrison actually conducted a securities business was Thursday, March 28. The Division alleges that Harrison had a net capital deficiency of \$684,751 on March 28 (Tr. 192; DX 94). It also asserts that the quarterly FOCUS report is inaccurate.

The examination staff sought to determine if Harrison was in net capital compliance before Blumer contributed \$50,000 of paid-in capital to Harrison on March 29 (Tr. 194, 582-83, 1387; DX 95, DX 96). Accordingly, the staff reversed the \$50,000 infusion of funds and examined Harrison's financial status on March 28 (Tr. 195, 1388; DX 94 at ENF 2304).

Blumer continued improperly to omit Harrison's 2001 federal, FICA, and New York withholding taxes from the firm's general ledger, balance sheet, and net capital computation on March 31 (Tr. 192-93; DX 79 at ENF 505-08, DX 93, DX 94). Blumer also under-reported Harrison's 2002 federal, FICA, and New York withholding taxes payable as of March 31 (Tr. 192-93; DX 79 at ENF 505-08, DX 93, DX 94). The firm's general ledger also omitted these line items as of March 28. After adjusting for these discrepancies, I agree with the Division that Harrison had a net capital deficiency of \$684,751 on March 28 (Tr. 192; DX 94).

Harrison did not post its matching FICA expense during March 2002 (Tr. 1386-87). If the firm had done so, its net capital deficiency on March 28 would have increased by another \$134,714 (Div. Prop. Find. # 159, Appendix, Schedule A-10).

After giving the firm credit for the \$50,000 infusion of capital on March 29, I also find that Harrison had a net capital deficiency of at least \$634,751 on March 31, the date of the FOCUS report (Tr. 192; DX 94). I find that Harrison's FOCUS report was inaccurate because the firm reported excess net capital as of March 31 (DX 93 at ENF 4280).

April 23, 2002

By letter dated April 22, 2002, the Commission's Associate Regional Director requested Blumer to compute Harrison's net capital position as of April 23, 2002 (DX 103). On April 25, Blumer provided the examination staff with a balance sheet as of April 23 and a profit and loss statement for the period from April 1 through April 23 (Tr. 195-96; DX 97).²⁰

On April 23, HSI finally paid the federal withholding taxes that Harrison owed for 2001 (Tr. 1366; DX 65). On April 24, HSI paid \$110,000 of the \$115,000 in New York withholding taxes that Harrison owed for 2001 (Tr. 1058, 1374-75; DX 80; RX 13). The balance sheet that Blumer prepared as of April 23 improperly removed the 2001 New York withholding tax liability. I agree with the Division that this entry should be disallowed because the New York taxes were not actually paid until the next day. The balance sheet also underreported Harrison's federal and New York withholding taxes for 2002 (Tr. 197, 1390).

After adjusting for the outstanding withholding tax liabilities, I agree with the Division that Harrison had a net capital deficiency of \$219,453 on April 23 (Tr. 196; DX 98).

Blumer did not post Harrison's matching FICA expense for 2002 (Tr. 1313-14). As of April 23, that matching expense was \$139,136 (Div. Prop. Find. # 162, Appendix, Schedule A-11 (final column)). If Harrison had properly posted the liability, its net capital deficiency on April 23 would have been even larger.

Harrison's Notice Violations.

During the period from April 1, 2001, through April 30, 2002, Harrison did not provide notice to the Commission of any net capital violations, books-and-records deficiencies, or inaccurate FOCUS reports. The Division has established that Harrison committed a large number of such violations during the period at issue: fifteen net capital violations, at least that

²⁰ If Blumer actually prepared a net capital computation as of April 23, as Fava says he did (Tr. 195-96), that document is not part of the record. I assume that Fava took Blumer's submissions, did her own net capital calculation using Blumer's numbers, and determined that Harrison was representing that it had excess net capital of \$116,378 as of April 23, 2002 (DX 98).

many books-and-records violations, and three reporting violations. Each of the proven violations required prompt notification to the Commission.

On April 23, 2002, Blumer received a letter from the Commission's Associate Regional Director, requesting Harrison to file notice pursuant to Rule 17a-11(b) that Harrison was not maintaining sufficient net capital on nineteen days between April 2, 2001, and March 19, 2002 (Tr. 36-39, 1233-34; DX 103). The letter also reminded Blumer that Harrison was required to file notice pursuant to Rule 17a-11(d) that Harrison's books and records were not kept current (Tr. 1236-38; DX 103). Harrison did not file the required net capital deficiency notice until July 25, 2002—three months after Blumer received the Associate Regional Director's letter (Tr. 1238-39; DX 108). Harrison never filed any notice pursuant to Rule 17a-11(d).

Harrison cannot excuse its failure to file Rule 17a-11 notification letters on the grounds that the firm did not believe that it had any net capital deficiencies. Once the Associate Regional Director informed Blumer that net capital violations had occurred, Harrison was obliged to give immediate notice of the claimed deficiencies. If Harrison disagreed with the Associate Regional Director's determination, it could have explained its disagreement in the notice. However, Harrison was not free to refuse to send the notice. See First Heritage Inv. Co., 51 S.E.C. 953, 957 & n.16 (1994).

I find that Harrison committed the notification violations alleged in OIP ¶ III.R. The violations were not mooted by the filing of a tardy notice on July 25, 2002.²¹

Song's Conduct.

Song has been employed by SCG since 1988 (Tr. 1592; DX 118 at ENF 298). Her work consists primarily of assisting small brokers and dealers with the preparation of financial statements and FOCUS reports (Tr. 1433). NASD Rule 1022(b) requires NASD member firms to "designate" one of their associated persons as a FINOP (Tr. 1591-92; DX 118 at ENF 298).²²

²¹ The Associate Regional Director's letter requested Harrison to file net capital deficiency notices for two dates on which the OIP did not allege a net capital violation (April 30 and October 1, 2001) and for six other dates on which the Division abandoned the OIP's claim of net capital violations in mid-hearing (June 28, July 31, August 31, October 31, December 27, and December 28, 2001). I have considered Harrison's failure to file the required notice for these claimed deficiencies in imposing cease-and-desist orders. I have not imposed civil monetary penalties for these eight notification violations, because the eight deficiencies claimed in the letter were not proven at the hearing.

²² NASD Rule 1022(c)(2) defines a FINOP as a person associated with a member whose duties include: (a) final approval and responsibilities for the accuracy of financial reports submitted to any securities industry regulatory body; (b) final preparation of such reports; (c) supervision of individuals who assist in the preparation of such reports; (d) supervision of and responsibility for individuals who are involved in the actual maintenance of the member's books and records from which such reports are derived; (e) supervision and/or performance of the member's responsibilities under all financial responsibility rules promulgated pursuant to the provisions of

From time to time, brokerage firms contact SCG regarding their need for a FINOP, and Song, as an employee of SCG, is retained to act as the registered FINOP of these firms (DX 118 at ENF 298). The brokerage firms pay SCG, which then splits its fee with Song (Tr. 1592).

Song Registers As Harrison's FINOP

After Springate resigned in August 2001, Harrison was without a registered FINOP for approximately three months (Tr. 1407-08, 1450-51). Blumer searched for a full-time FINOP without success (Tr. 1408). The NASD gave Harrison ninety days to replace Springate and threatened to close down the firm once that time expired (Tr. 666, 1407, 1450-51; DX 118 at ENF 298). Blumer applied to take the NASD Series 27 examination so that he could qualify as Harrison's FINOP (Tr. 1409-10, 1452). In the interim, Blumer turned to SCG, Song's employer, for short-term help (Tr. 1408).

Song had given birth to a son on October 30, 2001, and she was just returning to work a month later (Tr. 1520; DX 118 at ENF 298). She was already the registered FINOP for three other brokerage firms (Tr. 1516, 1518). Song had never served as the FINOP for four brokerage firms at one time (Tr. 1522).

Song knew Blumer from Whitehall Wellington, a firm that had been a client of SCG's for a few years (Tr. 1450, 1557, 1560-61). She also knew that Blumer was an experienced CPA, that he was maintaining Harrison's books and records, and that he was scheduled to take the Series 27 examination (Tr. 1450, 1452, 1454-55). Finally, Song knew that Blumer did not have a disciplinary history (Tr. 1561-62).

The record is ambiguous as to what Song knew about Harrison. Of course, Song knew that Harrison was an SCG client, but there is no explanation as to the type of services that SCG was performing for Harrison at the time. Song testified that she saw Harrison's "most recent financials" and concluded that "they were fine" (Tr. 1462). If Song was referring to Harrison's FOCUS report for the quarter ending September 30, 2001, things were not fine, for the reasons discussed above. Song also testified that she "did a quick net capital computation," and it, too, was "fine" (Tr. 1462). In fact, Harrison was undercapitalized by hundreds of thousands of dollars on September 28 and November 30, 2001, for reasons that are also discussed above.

Song spoke with Blumer several times in late November 2001 (Tr. 1453-55). Blumer represented to Song that he would prepare Harrison's FOCUS reports and electronically transmit them to the NASD (DX 118 at ENF 299). For these reasons, Song anticipated that her time commitment to Harrison's business would be diminished (Tr. 1522-25; DX 118 at ENF 299). Song purportedly told Blumer that it was important for Harrison to maintain daily net capital compliance, to disclose to her any potentially adverse information about the firm, and to provide in a timely manner the underlying documents that she would need to review Harrison's quarterly

the Exchange Act; (f) overall supervision of and responsibility for the individuals who are involved in the administration and maintenance of the member's back office operations; or (g) any other matter involving the financial and operational management of the member.

FOCUS reports (Tr. 1410, 1450, 1452, 1454-56, 1555). This testimony struck me as conveniently self-serving, but I will give Song the benefit of the doubt. Finally, Song explained to Blumer that she wanted to leave her office daily at 5:00 p.m. to be with her infant son (Tr. 1519-20, 1595). According to Song, Blumer understood these conditions for her employment and accepted them (DX 118 at ENF 299).²³

Song registered as Harrison's FINOP on December 3, 2001 (Tr. 1453-54; RX 46). She expected that the position would only last for one or two months (Tr. 1408-10, 1452; DX 118 at ENF 298).

Song Periodically Reviews Some of Harrison's Financial Records

Song performed her services for Harrison from SCG's office in New York City or from her home, and she communicated with Blumer by telephone and facsimile (Tr. 1456, 1520, 1595; DX 118 at ENF 300). During her tenure as Harrison's FINOP, Song did not visit Harrison's office in Port Washington or meet in person with Blumer (Tr. 1591).²⁴ She could have traveled the short distance to Port Washington at any time to inspect Harrison's financial records, but she elected to rely on Blumer to supply her with information (Tr. 1571).

Song periodically reviewed Harrison's profit and loss statements and the monthly statements from Harrison's clearing firm and bank (Tr. 1527, 1529-30). She also reviewed Harrison's commissions-payable-to-brokers account and checked those figures against the firm's commissions-receivable account (Tr. 1459). Song did not compare Harrison's cancelled checks to the firm's invoices to determine if Harrison was paying its bills (Tr. 1530, 1533). She did not review Harrison's general ledger for any period of time, or even ask to see it (Tr. 1533, 1537, 1578). Song was unaware that Harrison had received a significant tax bill from the IRS and was negotiating an abatement (Tr. 1416-17). She was also unaware that Harrison consistently failed to post the employer's matching FICA expenses to its financial records (Tr. 1575-80, 1588).

Song knew that Harrison was undergoing its annual audit in early 2002, but she never spoke with the outside auditor (Tr. 1457-58). Song did not see Harrison's audited financial statements for 2001 until well after she had resigned as FINOP (Tr. 1580; DX 118 at ENF 299).

²³ The consulting agreement was between Harrison and SCG, not between Blumer and Song (Answer ¶ III.F; Tr. 1408, 1591-92). Neither the consulting agreement nor the FINOP engagement contract between Harrison and SCG are a part of the record. If the many "rent-a-FINOP" postings on the Internet are any guide, the typical FINOP engagement contract is written, not oral, and it may be terminated by either party on an agreed-upon amount of advance notice.

²⁴ It is approximately twenty-two miles from SCG's office in midtown Manhattan to Harrison's office in Port Washington (official notice) (www.mapquest.com).

Song Makes Pro Forma Reviews of Harrison's Net Capital Position

Song requested Blumer to provide her with pro forma net capital computations for several days in January 2002 (Tr. 1465, 1473, 1537; DX 118 at ENF 349-50). She received a series of one-page notes, in which Blumer estimated Harrison's net capital position as of December 31, 2001, and then accrued Harrison's revenues and overhead expenses for the relevant days of January 2002 (DX 118 at ENF 351-56). The most striking feature of these one-page notes is how little information they contained. In effect, Song relied on calculations that Blumer had made. She also allowed Blumer to control the flow of information. Blumer's one-page notes consistently represented that Harrison had the required net capital (DX 118 at ENF 351-52).

Song knew that Harrison held more than \$1.1 million in cash on December 31, 2001 (Tr. 1484, 1554; DX 118 at ENF 351). Because Song was not monitoring Harrison's non-allowable assets, she had no idea that Blumer had transferred \$415,000 in cash from Harrison to HSI on January 8, 2002. Nor did she know that Blumer had also reduced on Harrison's general ledger the firm's federal and FICA withholding taxes and its corporate income taxes payable by \$415,000 (DX 69 at ENF 3833-34). Blumer's one-page notes to Song omitted any mention of these transactions. Song never examined Harrison's general ledger, which contained the relevant information (Tr. 1514-16, 1533, 1537, 1578).

Song was satisfied that Blumer had provided her with enough information to make rough estimates of Harrison's net capital positions on several dates in January 2002 (Tr. 1467). Based on this inquiry, Song concluded that Harrison had sufficient net capital as of January 9 and 10, 2002 (Tr. 1474).

Blumer Is Slow to Show Song the December 31, 2001, FOCUS Report and the Supporting Documents

The FOCUS report for the quarter ending December 31, 2001, was the first financial report that Harrison filed with regulators during Song's tenure as FINOP (DX 62). Blumer electronically transmitted the FOCUS report to the NASD on its due date, before Song had an opportunity to see it (Tr. 1476). Song left her office at 5 p.m. on the date the report was due, but Blumer did not complete the report until sometime between 5 p.m. and midnight (Tr. 1463, 1477-78). As a result, Song saw the FOCUS report and the supporting documents for the first time on the next business day (Tr. 1477).

After Song reviewed Blumer's work product, she told him that Harrison needed to reclassify certain expenses and recalculate the haircuts (Tr. 1478-79). Blumer made the requested changes, showed them to Song, and submitted a revised FOCUS report to the NASD on February 5, 2002 (Tr. 1478-79, 1482, 1581-82; DX 62, DX 118 at ENF 357-58).

By transmitting Harrison's FOCUS report to the NASD without first offering Song an opportunity to review it, Blumer had ignored one of the conditions under which Song had

accepted the FINOP position (Tr. 1555-56). Song was disappointed and annoyed and she told Blumer so (Tr. 1412-13, 1556). Blumer assured her it would not happen again (Tr. 1556).

Song Fails to Review Harrison's Month-End Net Capital Position

In contrast to January 2002, when Song made at least some effort to review Harrison's net capital position, she did virtually nothing to monitor the firm's net capital position during February, March, or April 2002.

In mid-February 2002, Song purportedly asked Blumer to send her Harrison's financial statements and a net capital calculation as of January 31, 2002, once they were ready (Tr. 1483, 1541-42, 1545). The Division disputes this (Tr. 1454-55; DX 118 at ENF 300; Div. Reply Br. at 11-12), but I have given Song the benefit of the doubt. In any event, Song never received a net capital calculation for the end of January. She could not recall asking Blumer the follow-up question of whether he had ever prepared one (Tr. 1483, 1551-52). Song merely asked Blumer if Harrison was in ongoing net capital compliance and he stated "yes" (Tr. 1551).

In late February 2002, Song learned from Blumer that the Commission's staff had arrived at Harrison's office to conduct an examination (Tr. 1413, 1547, 1596-98). Song asked if everything was going well with the Commission's examination (Tr. 1492). Blumer told her it was, but stated that the Commission's information requests were consuming all his time (Tr. 1486, 1492, 1547, 1549). Song did not contact the Commission's staff upon learning of the examination (Tr. 1549-50, 1573-74). For its part, the Commission's staff never contacted Song, either (Tr. 275, 600, 619-20). See supra p. 21. Blumer promised that he would try to send Song the materials she requested for the February month-end financial review (Tr. 1483, 1547, 1549). In fact, he never did so.

In mid-March 2002, Song told Blumer she needed to see Harrison's financial statements as of February 28, 2002 (Tr. 1485). By the end of March 2002, Song still had not received copies of Harrison's net capital calculations for either January or February 2002 (Tr. 1553; DX 118 at ENF 300). Song did not follow up by specifically asking Blumer if he had even prepared net capital calculations for the end of February (Tr. 1552).

As far as Song was concerned, Harrison was always in net capital compliance during her tenure as FINOP (Tr. 1462, 1474, 1486, 1512). She assumed that the Commission's staff had calculated Harrison's net capital at the beginning of its examination (Tr. 1444, 1483-84). Song understood that it was customary for regulators to contact a brokerage firm's FINOP during a financial examination (Tr. 1442-43, 1491). Because the staff examiners had not contacted her, Song further assumed that the Commission's staff had not identified any undercapitalization issues at Harrison (Tr. 1484-85).

Song Resigns When Blumer Is Late
in Showing Her the March 31,
2002, FOCUS Report

Harrison's FOCUS report for the quarter ending March 31, 2002, was due by April 23, 2002 (Tr. 1499). As the due date approached, Song reminded Blumer that one of her conditions for becoming Harrison's FINOP was sufficient time to review the FOCUS report before it was electronically filed with the NASD (Tr. 1492-93, 1495). Song again asked Blumer to provide her with the supporting documents and show her the FOCUS report before he transmitted it to the NASD (Tr. 1492-93, 1495).

By this time, Song was growing increasingly frustrated and annoyed with her inability to obtain timely information from Blumer (Tr. 1414-15, 1488, 1494, 1499, 1566). She had already served as Harrison's FINOP beyond the one to two months she originally envisioned. Moreover, Blumer had not passed the Series 27 test (Tr. 1409, 1486-87). When Song learned that Blumer would not have the March 31 FOCUS report ready for her to review before 5:00 p.m. on April 23, she informed him that she could no longer continue as Harrison's FINOP (Tr. 1495, 1499-1500).

At some point on April 23, Song sent a memorandum to Blumer by facsimile, stating that she was resigning as Harrison's FINOP, effective April 30, 2002 (Tr. 1567; DX 118 at ENF 403). The memorandum was written on SCG letterhead (DX 118 at ENF 403). Song testified that she telephoned Blumer later that day to inform him that her resignation was effective immediately (Tr. 1567-68, 1570).

The Division argues that Song is attempting to backdate her resignation from April 30 to April 23 to escape responsibility for the March 31 FOCUS report. It contends that Song's conduct after April 23 is inconsistent with her claim that her resignation took effect immediately. Song received Harrison's FOCUS report on April 24, the next business day (Tr. 1496, 1500). She requested supporting data from Blumer on April 24 and 25, and she reviewed and made changes to the FOCUS report (Tr. 1500, 1568-70; DX 118 at ENF 404-05). Song also participated in a telephone conference with Blumer and the NASD on April 24, and she answered the NASD's questions about Harrison's FOCUS report (Tr. 1500, 1568-69).

Song contends that she "could have disappeared" after April 23 because her resignation as Harrison's FINOP was already effective (Tr. 1569). However, Song knew that the Commission's examination staff was still at Harrison's office in late April 2002 and she "didn't want [the examiners] to think there were any problems other than I could not get the information from [Blumer]" (Tr. 1570). She explained that she was "doing a nice thing" and "just wanted to help out" (Tr. 1502, 1569-70).

On May 13, 2002, Blumer submitted a Form U-5 to the NASD (RX 47). In relevant part, the Form U-5 stated that Song had terminated her employment with Harrison effective on April 23, 2002 (Tr. 1499, 1566, 1606; RX 47). Nine days later, Blumer provided contradictory information. In a May 22, 2002, letter to the NASD, Blumer stated that Song had resigned as Harrison's FINOP on April 30, 2002 (DX 149). The May 22 letter refers to a May 10, 2002,

letter that purportedly says the same thing, but the May 10 letter is not a part of the record. At the hearing, Blumer could not recall the date of Song's resignation (Tr. 1416).

I do not credit Song's testimony that she orally advanced the effective date of her resignation from April 30 to April 23, on a few hours' notice to Blumer. Her facsimile memorandum states that her resignation would become effective on April 30. Her conduct in the days after April 23 was inconsistent with her claim that April 23 was the effective date of her resignation. In Song's Wells Submission, she made no claim that her resignation was effective on April 23. Moreover, the FINOP engagement agreement was between Harrison and SCG. I will not assume that Song was free to act for SCG and terminate that agreement on short oral notice. Finally, I note that April 23 was an unusually busy day for Blumer, as he prepared the quarterly FOCUS report, addressed the Associate Regional Director's request for a net capital computation, and settled Harrison's overdue tax bill with the IRS.

Witness Credibility.

Not one of the four major witnesses at the hearing was fully credible. I have relied on parts of the testimony of each, as explained below.

Respondents vigorously challenge the probative value of Fava's testimony and schedules (Harrison Br. at 5-6; Song Br. at 18-26). I have previously addressed their allegations that the Commission's examination was lacking in professionalism and led to the creation of schedules that cannot support the charges in the OIP. See supra pp. 20-27. The Division has blunted the most severe of these challenges by abandoning several of the net capital violations alleged in the OIP. Nonetheless, on matters that are still contested, Fava occasionally placed herself in predicaments by offering broad statements that failed to withstand close scrutiny. To that extent, I have discounted parts of her testimony.

Fava testified with assurance that Harrison made a particular bank deposit on June 12, 2001 (Tr. 63) ("There was no other \$50,000 deposit that it could have been."). Upon further analysis, the Division now argues that Harrison made that deposit on June 22 or 26, 2001 (Div. Prop. Find. # 56 n.12). Fava also volunteered that the examination staff telephoned Song in June 2002 "to find out what [Song] had to say about our findings" (Tr. 627). After an extended inquiry, Fava withdrew that testimony (Tr. 626-29). Although neither of these instances involves a crucial issue, both are illustrative of the sort of inaccuracies that occurred throughout Fava's extended time on the witness stand.

Fava also asserted that she had reconstructed Harrison's missing general ledger from the firm's journal entries (Tr. 17, 106-07, 113-14, 116, 120, 274). The clear implication of her testimony was that the examination staff had prepared a document that resembled Harrison's general ledger for periods after October 1, 2001, such as DX 49, DX 69, DX 78, and DX 79. The Division provided Fava's work papers to Respondents during the hearing (Tr. 273-74, 285, 292-95, 377-79). However, the work papers that Fava had described as a reconstructed general ledger turned out to be something considerably less than that (Tr. 395-96; RX 31-RX 39). Fava explained that she had meant to testify that she had recreated various accounts of Harrison's general ledger, but not the general ledger in its entirety (Tr. 382-83). Fava also testified that her

supervisors reviewed her work papers (Tr. 18). However, closer questioning by Respondents demonstrated that Fava's supervisors reviewed some, but not all, of her work papers (Tr. 396-99, 532-35, 789-90). I have weighed Fava's testimony accordingly.

Respondents next argue that Cassella's opinion testimony should be given little, if any, weight (Tr. 853-54, 879-88; Harrison Br. at 2, Song Br. at 26-29). I disagree. Cassella's presentation was helpful in explaining that valid net capital computations must be based on financial records that comply with GAAP, and in demonstrating how Harrison's financial records failed to comply with GAAP. Respondents thought they could convert Cassella into their own witness and use him to show that the staff's examination did not comply with the "standards" that govern such examinations. They failed in this endeavor, and their challenges to Cassella's credibility reflect their frustration.

Nonetheless, Respondents were able to show that parts of Cassella's report and testimony should receive reduced weight. The difficulties with Cassella's presentation began with an inaccurate description of his experience and credentials. The Division represented that Cassella had not previously given expert testimony (Division's Statement Pursuant to Rules 222(a) and 222(b), dated July 9, 2003, at 4) (Division's Statement). In fact, Cassella had been an expert witness for the Division in a prior case (Tr. 817-18).²⁵ The Division also represented that Cassella "routinely reviewed staff recommendations to the NASD of enforcement proceedings against broker-dealers who were charged with violating the Net Capital Rule and other financial responsibility rules, and provided advice to the examination staff on a regular basis on the conduct of examinations" (Division Statement at 4). In fact, this overstated Cassella's responsibilities at the NASD (Tr. 755-58, 814-15).

An unidentified Commission employee actually drafted Cassella's direct testimony (Tr. 696-97; DX 131). Of course, a party is not barred from providing assistance to its expert in the preparation of a report, as long as the report accurately reflects the expert's opinions and the expert signs the report. For the most part, that is what happened here (Tr. 696). However, in some instances involving Song, Cassella had to concede that he should have worded his report more carefully (Tr. 832, 848-51; DX 131 ¶¶ 13, 47-48).

Cassella formed his opinions by relying upon information contained in the examination staff's report and schedules, among other things (Tr. 754, 780, 818; DX 131 ¶ 11). He accepted the examination staff's figures and assumed they were accurate. In several instances, this assumption was unwarranted. See supra pp. 24-25. Cassella never saw the examination staff's work papers before the hearing (Tr. 761-62; RX 31-RX 39). He could not recall if he ever reviewed Harrison's and Blumer's supplemental Wells Submission before submitting his report (Tr. 742-43; DX 124, DX 131 ¶ 10).

²⁵ Fed. R. Civ. Pro. 26(a)(2)(B) requires a party to disclose any other cases in which a witness has testified as an expert at trial or by deposition within the preceding four years. Rule 222(b) of the Commission's Rules of Practice uses similar language, but does not contain a four-year time limit. The Division has yet to identify the prior case in which Cassella gave expert testimony.

I have given greater weight to Cassella's hearing testimony than to his written report. In this Initial Decision, I have cited his written report only on books-and-records issues, or on definitional matters that are not controversial. Cassella went to great lengths to avoid testifying that regulators customarily speak with a FINOP during an examination (Tr. 851-53). His guarded testimony on this point was less than candid.

Blumer testified in a generally deceptive manner. I find that his specific testimony about the viruses that infected his laptop computer, the shift of Harrison's registered representatives from employees to independent contractors, and Harrison's use of trade date accounting to be complete fabrications. Blumer's testimony about Harrison's purported use of trade date accounting stands in a class by itself. Blumer offered deliberate falsehoods on direct examination (Tr. 1064-68, 1072-73). Cross-examination exposed his direct testimony as a sham (Tr. 1117-22, 1134-53, 1168-1207).

Blumer also testified in an evasive manner and made no attempt to be forthcoming about his professional dealings with Song. His testimony about Song is replete with such statements as "I'm not sure" or "It's possible" or "I don't remember" (Tr. 1410-17). Other parts of Blumer's testimony were internally inconsistent, or inconsistent with positions he took in his Wells Submission and his Answer to the OIP.

I found Song's testimony generally credible in describing her interactions with Blumer. To the extent that I have doubts, they have been identified above. I also found her credible in claiming that regulators routinely contact FINOPs during financial examinations (Tr. 1442-43).

However, Song made certain statements that call into question her judgment. For example, Song based her view of Blumer's reputable character, in part, on the fact that Whitehall Wellington was always timely in paying its bills to SCG (Tr. 1450, 1556-62). Song also relied on her observation that "the brokerage industry is a small world, and everyone knows everyone" (Tr. 1562). She nonetheless disavowed knowledge of Whitehall Wellington's regulatory difficulties with the NASD, even though Whitehall Wellington had been an SCG client for several years (Tr. 1557, 1560). See *supra* note 4. Song believes that a FINOP is not obligated to review a FOCUS report before it is filed, and that a firm can amend an inaccurate FOCUS report "as many times as it needs to" (Tr. 1463-64, 1493-94). I accept Cassella's testimony that a FINOP must review a FOCUS report before it is filed, not after (Tr. 821). I reject Song's implication that a firm is not really required to file an accurate FOCUS report on the first try, as long as its revised report is eventually accurate. See *Gen. Aircraft Corp. v. Lampert*, 556 F.2d 90, 96 n.9 (1st Cir. 1977) (holding that the obligation to file reports with the Commission includes an obligation that the filings be accurate).

Song tended to evade uncomfortable issues. When asked if she continued to perform frequent *pro forma* net capital computations in February, March, and April 2002, Song offered a lengthy non-answer instead of the simple "no" that was appropriate (Tr. 1484-85).

Song contended that she did more to monitor Harrison's net capital position than a typical FINOP would ordinarily do for a \$5,000 brokerage firm (Tr. 1465-66, 1474, 1537-38). I give very little weight to this self-serving testimony. Even if Song's testimony is accurate, it is not

dispositive of any issue in this proceeding. Song failed to show that the industry norm, as she described it, is reasonable. See SEC v. GLT Dain Rauscher, Inc., 254 F.3d 852, 856-58 (9th Cir. 2001) (holding that the industry standard is a relevant factor for determining the standard of care, but not the controlling factor as standard setters may engage in a “race to the bottom” so as to set the least demanding standard to assess their conduct).

CONCLUSIONS OF LAW

Primary Violations

The OIP charges that Harrison willfully violated Section 15(c)(3) of the Exchange Act and Rule 15c3-1(a) thereunder (OIP ¶ III.V). These provisions do not require proof of intent or scienter. See William H. Gerhauser, Sr., 53 S.E.C. 933, 941-42 (1998); First Heritage, 51 S.E.C. at 957 n.15. The OIP also charges that Harrison willfully violated Section 17(a)(1) of the Exchange Act and several rules thereunder (OIP ¶¶ III.W-III.Y). Scienter is not required to violate these provisions, either. Orlando Joseph Jett, 82 SEC Docket 1211, 1255 & n.45 (Mar. 5, 2004). Willfulness is shown where a person intends to commit an act that constitutes a violation. There is no requirement that the actor also be aware that he is violating any statutes or regulations. See Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000); Tager v. SEC, 344 F.2d 5, 8 (2d Cir. 1965).

For the reasons set forth in the Discussion above, I conclude that Harrison willfully violated Section 15(c)(3) of the Exchange Act and Rule 15c3-1(a) on fifteen dates between April 2001 and April 2002. By use of the mails, or the means or instrumentalities of interstate commerce, Harrison effected transactions in, or induced or attempted to induce the purchase or sale of, securities in contravention of the rules and regulations prescribed by the Commission as necessary or appropriate in the public interest or for the protection of investors to provide safeguards with respect to the financial responsibility and related practices of brokers and dealers.

I further conclude that Harrison willfully violated Section 17(a)(1) of the Exchange Act and Rules 17a-3(a), 17a-4(a) and (f), and 17a-5(a), which require registered brokers and dealers to make, keep current, and preserve books and records relating to their business, and to file certain periodic reports with the Commission.

I further conclude that Harrison willfully violated Section 17(a)(1) of the Exchange Act and Rule 17a-11(b), which require that every registered broker or dealer whose net capital declines below the minimum amount required by Rule 15c3-1(a) give notice of that fact to the Commission the same day.

I further conclude that Harrison willfully violated Section 17(a)(1) of the Exchange Act and Rule 17a-11(d), which require every broker or dealer who fails to make and keep current the books and records required by Rule 17a-3(a) to give notice of that fact to the Commission the same day.

Aiding and Abetting Liability

The OIP alleges that Blumer “knew or recklessly disregarded” that Harrison’s books, records, net capital computations, and quarterly FOCUS reports were inaccurate (OIP ¶ III.T). It further charges that Blumer “willfully aided and abetted” Harrison’s violations (OIP ¶ III.Z).

To show that one respondent willfully aided and abetted the violation of another, the Commission requires the Division to establish three elements: (1) another party has committed a securities law violation; (2) the accused aider and abetter has a general awareness that his role was part of an overall activity that was improper or illegal; and (3) the accused aider and abetter knowingly and substantially assisted the principal violation. See Jett, 82 SEC Docket at 1256 n.46; Abraham & Sons Capital, Inc., 75 SEC Docket 1481, 1492 (July 31, 2001) (citing Graham v. SEC, 222 F.3d 994, 1000 (D.C. Cir. 2000)); Donald T. Sheldon, 51 S.E.C. 59, 66 (1992), aff’d, 45 F.3d 1515 (11th Cir. 1995).

The Commission has held that a showing of recklessness will satisfy the “substantial assistance” prong of the aiding and abetting test. See Sharon M. Graham, 53 S.E.C. 1072, 1084-85 & n.33 (1998), aff’d, 222 F.3d 994, 1004-06 (D.C. Cir. 2000); Russo Sec’s., Inc., 53 S.E.C. 271, 278-79 & n.16 (1997). In footnote 16 of Russo, the Commission explained:

Courts use various formulations of the second two elements of the standard for aiding and abetting. . . . As a result, courts are not uniform as to the precise degree of intent required for each of these two elements. The formulation we have used here is intended as a synthesis of current case law, and reflects the spectrum of analyses.

But see Howard v. SEC, 376 F.3d 1136, 1143 (D.C. Cir. 2004) (holding that “extreme recklessness” may support aiding and abetting liability, but concluding that “aiding and abetting liability cannot rest on the proposition that the person ‘should have known’ he was assisting violations of the securities laws.”).

Irrespective of the level of proof required to establish the primary violation, the Commission has made clear that the accused aider and abetter must have acted with scienter. See Zion Capital Mgmt. LLC, 81 SEC Docket 3063, 3076-77 & n.35 (Dec. 11, 2003) (holding an investment adviser liable for failure to keep books and records (a non-scienter violation) and concluding that the president of the investment adviser was liable as an aider and abetter because his conduct was “at least reckless”); Terence Michael Coxon, 80 SEC Docket 3288, 3300 n.32 (Aug. 21, 2003) (holding an investment adviser liable for violations of Section 206(2) of the Investment Advisers Act of 1940 (Advisers Act), a non-scienter provision; concluding that two of the investment advisers’ partners were liable as aiders and abettors; and stating “to conclude that a respondent aided and abetted another[’s] violation, we must find that he acted with scienter”), appeal pending, No. 03-73732 (9th Cir. filed Oct. 13, 2003); Kingsley, Jennison, McNulty & Morse, Inc., 51 S.E.C. 904, 911 & n.28 (1993) (holding a registered investment adviser liable for willful violations of a non-scienter provision, but ruling that good faith by the firm’s officer “preclude[s] a finding of scienter necessary to hold that . . . [the officer] aided and abetted [the firm’s] various violations”).

All the elements of aiding and abetting liability are established here. Harrison's primary violations have been discussed above. Blumer has been a securities industry professional and a principal of two brokerage firms from the mid-1990s to the present. He is an experienced CPA who has performed audits on many financial service companies and publicly traded companies (DX 149). He claims to have extensive experience in preparing the books and records of brokerage firms, as well as in preparing and filing FOCUS reports (DX 149). In these circumstances, Blumer, as Harrison's chief executive officer, has a level of knowledge of the applicable statutes and regulations far exceeding that of the general public. I conclude that Blumer had far more than a general awareness that his actions and omissions were improper.

Blumer knowingly played a substantial role in Harrison's violations. He personally created the financial records that violated GAAP. The GAAP violations occurred so frequently and were so profound as to warrant a conclusion that they were the result of extremely reckless, if not deliberate, conduct. Blumer also decided when and when not to provide Harrison with additional capital. He made a conscious choice to operate Harrison at and often below the margin of net capital compliance. Blumer could have shut down the firm when it lacked sufficient net capital, but he determined not to do so. Blumer's actions and omissions, like Harrison's, were unquestionably willful within the meaning of Wonsover and Tager.

At the time of the violations, Blumer knew that Harrison was experiencing financial difficulties. The firm was in arrears to the federal and state taxing authorities. Blumer also knew that Harrison had been found to be undercapitalized by the NASD during its examination of March-April 2001. Finally, he knew in February-April 2002 that Harrison had been undercapitalized on several dates between April 2001 and April 2002, because the Commission's examination staff and the Associate Regional Director told him so. I conclude that Blumer knowingly and substantially assisted Harrison's violations. Blumer's misconduct was an extreme departure from the standards of ordinary care. At a minimum, it was extremely reckless, if not knowing and intentional. See Hutchison Fin. Corp., 51 S.E.C. 398, 404 (1993) (holding that the level of attention that a firm's officers must pay to compliance with the net capital requirements is even greater when the firm has been experiencing financial difficulties or is operating close to permissible limits).

Causing Liability

The OIP alleges that Blumer was "a cause" of all of Harrison's violations (OIP ¶ III.Z). It also alleges that Song was "a cause" of certain of Harrison's violations dating from December 3, 2001, through April 30, 2002 (OIP ¶ III.AA). Song is not charged with causing Harrison's violations of Exchange Act Rule 17a-4(a) and (f), or with causing any of Harrison's other violations from April 1 through December 2, 2001.

The Securities Enforcement Remedies and Penny Stock Reform Act of 1990, Pub. L. No. 101-429, 104 Stat. 931 (1990) (Remedies Act), created a distinct class of secondary liability, causing liability, and made it subject to a new administrative remedy, a cease-and-desist order. Section 8A of the Securities Act of 1933, Section 21C(a) of the Exchange Act, Section 203(k)(1) of the Advisers Act, and Section 9(f) of the Investment Company Act of 1940 specify that a

respondent is a cause of another's violation if the respondent knew or should have known that his or her act or omission would contribute to such violation.

The Commission has determined that causing liability under those statutory provisions requires findings that: (1) a primary violation occurred; (2) an act or omission by the respondent contributed to the violation; and (3) the respondent knew, or should have known, that his or her conduct would contribute to the violation. See Robert M. Fuller, 80 SEC Docket 3539, 3545 (Aug. 25, 2003), pet. denied, 2004 U.S. App. LEXIS 12893 (D.C. Cir. Apr. 23, 2004); Erik W. Chan, 77 SEC Docket 851, 859-60 (Apr. 4, 2002).

Negligence is sufficient to establish liability for causing a primary violation that does not require scienter. KPMG Peat Marwick LLP, 74 SEC Docket 384, 421 (Jan. 19, 2001), recon. denied, 74 SEC Docket 1351 (Mar. 8, 2001), pet. denied, 289 F.3d 109 (D.C. Cir. 2002). Negligence is the failure to exercise reasonable care or competence. Byron G. Borgardt, 80 SEC Docket 3559, 3577 & n.35 (Aug. 25, 2003).

The Commission has yet to announce the criteria it will use in deciding whether a secondary actor should have known that specific acts or omissions "would contribute to" a primary violation for purposes of Section 21C(a) of the Exchange Act. However, a proceeding involving this issue is now pending on the Commission's docket. See Jeffrey M. Steinberg, 76 SEC Docket 1538, 1582-89 (Dec. 20, 2001) (Initial Decision) (rejecting the Division's argument that any act that contributes to a primary violation is a cause of that violation for purposes of Section 21C(a) of the Exchange Act; and also requiring the Division to establish "a sufficient nexus between the respondents' alleged conduct and the underlying violation"), review granted.²⁶ See also Simon M. Lorne & W. Hardy Callcott, Administrative Actions Against Lawyers Before the SEC, 50 Bus. Law. 1293, 1308 (Aug. 1995) ("'Causing' liability under the Remedies Act poses several questions that the SEC has not yet finally resolved. . . . [One question] is the issue of how close a nexus must there be between the 'cause' and the underlying violation.").

Blumer was a cause of all of Harrison's violations. In Dominick & Dominick, Inc., 50 S.E.C. 571, 578 n.11 (1991), a settled proceeding, the Commission concluded that one who aids and abets a primary violation is necessarily a cause of the violation. The Commission has subsequently followed that approach in contested cases raising the same issue. See Abraham &

²⁶ The Commission has cited with favor law review commentary suggesting that Congress imported the concept of "causing" liability into the Remedies Act from an analogous statutory source, Section 15(c)(4) of the Exchange Act. See KPMG, 74 SEC Docket at 423 & n.106.

The meaning of the word "cause," as used in former Section 15A of the Exchange Act, has not been the subject of detailed judicial construction. See Berko v. SEC, 316 F.2d 137, 140-41 (2d Cir. 1963) (holding that conduct which "causes" a violation must consist of more than merely conduct which is "to some degree a factor" in the violation); R.H. Johnson & Co. v. SEC, 198 F.2d 690, 696-97 (2d Cir. 1952) (rejecting the contention that "cause" must always be interpreted to mean "an immediate and inducing cause").

Sons, 75 SEC Docket at 1492 & n.25; Graham, 53 S.E.C. at 1085 n.35; Adrian C. Havill, 53 S.E.C. 1060, 1070 n.26 (1998). As to Blumer, the conclusion of Dominick & Dominick and its progeny will be followed here.

Song was also a cause of certain of Harrison’s violations. Song argues that she was not “the cause” or “the causing factor” or “the primary proximate cause” of Harrison’s violations (Song Br. at 6, 10, 17; Song Reply Br. at 4-5, 6). The plain language of Section 21C(a) of the Exchange Act renders this defense irrelevant.

Section 21C(a) only requires the Division to prove that Song was “a cause” of Harrison’s violations. It is inappropriate for Song to engraft additional limitations on the statutory text. Thus, the Division does not fail to meet its burden of proof as to Song merely because Blumer was “an equal cause” or even “a greater cause” of Harrison’s violations. See Chan, 77 SEC Docket at 867 (“[T]he mere fact that others also may have caused [a primary violation of] the securities laws does not insulate Chan from liability for his own acts and omissions.”). Cf. Black’s Law Dictionary 212 (7th Ed. 1999) (defining “contributing cause” as “a factor that—though not the primary cause—plays a part in producing a result”). For the reasons set forth below, I conclude that Song was a contributing cause of Harrison’s violations between December 3, 2001, and April 30, 2002.

Song also focuses on what she “believed” or “was led to believe” (Song Br. at 9, 11-12, 34; Song Reply Br. at 4). Section 21C(a) of the Exchange Act asks only what Song “knew or should have known.” By December 3, 2001, Song knew that the NASD was threatening to close down Harrison because the firm had been without a FINOP for more than ninety days. By offering Harrison the cover of her Series 27 license, even on a temporary basis, Song knew that she was making Harrison’s “NASD problem” disappear. In short, Song was an enabler. Her association with Harrison allowed the firm to continue in business beyond the date that the NASD was otherwise willing to permit.

As Harrison’s FINOP, Song had a duty to inquire carefully into all matters within the scope of NASD Rule 1022(c)(2). However, she knew little about the firm’s books and records, because she failed to review them adequately. She merely asked Blumer to provide her with selected documents. She did not know many of the critical specifics about Harrison’s financial condition, because she was satisfied with an incomplete account from Blumer. She was responsible for supervising Blumer, as he assisted in the preparation of FOCUS reports and the maintenance of books and records, but she exercised that authority sparingly, if at all.

Song engaged in acts and omissions that negligently contributed to Harrison’s violations. These include: performing her FINOP duties exclusively from off-site locations and never once, in four and one-half months, setting foot in Harrison’s office; failing to conduct periodic reviews of Harrison’s general ledger, cash receipts and disbursements blotter, and other financial records, and relying instead on Blumer to send her information; failing to compare Harrison’s cancelled checks with its invoices, to determine whether the firm was paying its bills on time; failing to determine whether Harrison was posting the employer’s matching FICA liability to its financial records; relying on the inadequate information in Blumer’s one-page notes to review Blumer’s intra-month pro forma net capital computations during January 2002; failing to insist that Blumer

compute Harrison's net capital position at any time during February and March 2002; accepting Blumer's word that Harrison was complying with the Net Capital Rule during February, March, and April 2002; and failing to review Harrison's March 31, 2002, FOCUS report before Blumer transmitted the report to the NASD on April 23, 2002.

The standard of care that applies to FINOPs has been set by the Commission on review of NASD disciplinary actions. In Gilad J. Gevaryahu, 51 S.E.C. 710, 712-13 (1993), the Commission upheld the NASD's sanction of a FINOP who claimed that he should not be held responsible for a brokerage firm's violations because the firm's president lied to him and withheld information from him. The FINOP also argued that he was merely an "outsider" performing the duties of FINOP on a part-time basis, and that the relationship of an outside FINOP to a firm is an "inherently weak one" because the FINOP obtains most of his information "second-hand." The Commission rejected this argument:

We do not share Gevaryahu's limited view of his responsibilities. . . . Once Gevaryahu agreed to serve as the firm's FINOP, and for as long as he retained that position, he was responsible for carrying out its attendant duties and obligations. The fact[] that he. . . worked for the firm only on a part-time basis did not lessen his obligations or provide any excuse for failing to meet them. . . .

[Gevaryahu] made no effort to investigate the matter further or obtain supporting documentation. Instead, he simply accepted [the president's] word . . . In our view, Gevaryahu's action amounted to a total abdication of his responsibilities as FINOP.

In George Lockwood Freeland, 51 S.E.C. 389, 392-93 & n.9 (1993), the Commission sustained the NASD's sanction against a FINOP who argued that the firm's owner refused to provide information the FINOP needed to do his job. The Commission held that the FINOP was required to insist on the owner's cooperation and compliance with applicable requirements or to resign. As long as Freeland remained a FINOP, the Commission held, he was responsible for the performance of his duties.

The duties and responsibilities of a FINOP as set forth in NASD Rule 1022(c)(2) apply to all FINOPs, regardless of whether they are employed on-site or off-site and whether they work full-time or part-time. Cf. Barbera, 73 SEC Docket at 2280 ("Barbera undertook the obligation to act as [the firm's] FINOP, knowing that he would maintain an office in New York while [the firm's] office was in Cincinnati."); Arthur Stelmack, 52 S.E.C. 103, 106 n.10 (1994) ("We reject Stelmack's suggestion that the fact that he was a part-time employee . . . who visited the firm just once a month should excuse any dereliction of his FINOP duties.").

Based on the standard of care the Commission applied in Gevaryahu and Freeland, I conclude that Song knew or should have known that her acts and omissions would contribute to Harrison's violations. Song made no effort to review supporting documentation at Harrison's office and only a limited effort to obtain supporting documentation from Blumer. She accepted Blumer's word about Harrison's financial condition with nothing more, and she did not insist on Blumer's full cooperation in February, March, and April 2002.

I have previously rejected Song's claim that her resignation as Harrison's FINOP was effective on April 23, 2002. However, even if April 23 were accepted as the effective date of her resignation, I note that Song has not addressed the implications of her argument. Song cannot seriously suggest that a resignation that became effective on April 23 "wiped the slate clean" for all her acts and omissions dating back to December 3, 2001. As shown below, even a single act or omission can become the predicate for a cease-and-desist order.

As I understand Song's theory: (a) if a FINOP's resignation becomes effective a few hours before the deadline for filing a FOCUS report, and if the FOCUS report inaccurately states that the firm had adequate net capital at the end of the reporting period, then the FINOP is automatically absolved of liability for causing the filing of an inaccurate FOCUS report and for causing the underlying violation of the Net Capital Rule; and (b) a FINOP cannot be a cause of a notification violation if her firm fails to inform the Commission about a net capital deficiency that occurs on the effective date of her resignation.

I reject these arguments. By April 23, 2002, at the very latest, Song should have known that Harrison had inadequate net capital as of March 28, 2002. She also should have known that Harrison was on the verge of filing a FOCUS report that said otherwise. On April 23, 2002, Song also should have known that Harrison was again undercapitalized. Cf. Xerox Corp. v. Genmoora Corp., 888 F.2d 345, 355 n.60 (5th Cir. 1989) (rejecting a theory, by analogy, that if a commercial airliner full of passengers were negligently to hit a mountain, and if the pilot bailed out just before impact, the pilot would not be liable because he was not at the controls when the crash occurred). In effect, Song's theory would allow many potential respondents who have been negligent to avoid causation liability merely by strategically timing their resignations.

As a final matter, there is no merit to Song's claim that Harrison's violations are somehow the fault of the examination staff that uncovered them (Song Br. at 18). In essence, Song argues that she was entitled to collect her fee as Harrison's FINOP, neglect her responsibilities, and expect the Commission's examination staff to protect her from the consequences of her own negligence. Under longstanding Commission precedent, however, regulated entities and their employees cannot shift their compliance responsibility to the NASD or the Commission itself. See First Philadelphia Corp., 46 S.E.C. 767, 770 (1977).

SANCTIONS

To protect the public interest, the Division seeks cease-and-desist orders against all Respondents and an order barring Blumer from association with any broker or dealer. It also seeks an order requiring Harrison and Blumer to pay civil penalties of \$600,000 and \$120,000, respectively. Finally, the Division argues that Blumer should be denied the privilege of appearing and practicing before the Commission pursuant to Rule 102(e)(1)(iii) of the Commission's Rules of Practice.

The severity of sanctions depends on the facts of each case and the value of the sanctions in preventing a recurrence of the violative conduct. See Berko, 316 F.2d at 141. Sanctions should demonstrate to the particular respondent, the industry, and the public in general that

egregious conduct elicits a harsh response. See Arthur Lipper Corp. v. SEC, 547 F.2d 171, 184 (2d Cir. 1976).

Changed Circumstances

I have given due consideration to the fact that Harrison has adopted new policies and procedures to address certain of the concerns leading to the OIP. Harrison now employs a full-time, on-site FINOP and an in-house attorney to monitor compliance (Tr. 980-81, 1086). Harrison has also halted the transfer of funds to and from HSI and it has implemented a recordkeeping program to retain all financial records supporting its FOCUS reports in a non-erasable, non-rewritable format (Tr. 1086; DX 26 at ENF 179). Finally, Harrison asserts that it has maintained a strong net capital position since June 2002 (Tr. 1086; DX 26 at ENF 171).

I have also given appropriate weight to the fact that Blumer has enrolled in a continuing education program, sponsored by the NASD's Institute of Professional Development and the Wharton School of the University of Pennsylvania (Tr. 972-73, 1085-86). A candidate who successfully completes all three phases of the program within a three-year time frame will be designated as a Certified Regulatory and Compliance Professional by the NASD Institute and Wharton. In November 2003, Blumer successfully completed Phase I of the program (RX 3). In December 2003, he successfully completed six credit hours of self-study course work (out of the required sixty hours) for Phase II of the program (RX 4).

Cease-and-Desist Orders

As relevant here, Section 21C(a) of the Exchange Act authorizes the Commission to impose a cease-and-desist order upon any person who "is violating, has violated, or is about to violate" any provision of the Exchange Act, or the rules or regulations thereunder. The Commission may also impose a cease-and-desist order against any person that "is, was, or would be a cause of [a] violation" due to an act or omission the person "knew or should have known would contribute to such violation."

In KPMG, 74 SEC Docket at 428-38, the Commission addressed the standard for issuing cease-and-desist relief. It explained that the Division must show some risk of future violations. However, it also ruled that such a showing should be "significantly less than" that required for an injunction and that, "[a]bsent evidence to the contrary," a single past violation ordinarily suffices to establish that the violator will engage in the same type of misconduct in the future. Id. at 430, 435-36.

Along with the risk of future violations, the Commission considers the seriousness of the violation, the isolated or recurrent nature of the violation, the respondent's state of mind, the sincerity of the respondent's assurances against future violations, the respondent's recognition of the wrongful nature of his or her conduct, and the respondent's opportunity to commit future violations. Id. at 436. In addition, the Commission considers whether the violation is recent, the degree of harm to investors or the marketplace resulting from the violation, and the remedial function to be served by the cease-and-desist order in the context of any other sanctions being

sought in the same proceeding. Id. The Commission weighs these factors in light of the entire record, and no one factor is dispositive.

Since issuing its KPMG opinion in January 2001, the Commission has occasionally faced claims that, after adopting a standard for use in determining whether to issue a cease-and-desist order, it has disregarded that standard in determining to sanction a particular violator. See KPMG Peat Marwick LLP, 74 SEC Docket 1351, 1352 (Mar. 8, 2001) (Order Denying Request for Reconsideration). In response to such challenges, the Commission has specifically disavowed the notion that issuance of a cease-and-desist order is automatic on a finding of past violation. Id. at 1360. The U.S. Court of Appeals for the District of Columbia Circuit has insisted that the Commission adhere to the standards it announced in KPMG. See WHX Corp. v. SEC, 362 F.3d 854, 859-60 (D.C. Cir. 2004) (rejecting the Commission's explanation of the risk of future violations and vacating a cease-and-desist order). A similar challenge to the imposition of a cease-and-desist order is now pending before the District of Columbia Circuit. Piper Capital Mgmt., Inc., 80 SEC Docket 3594, 3637-40 (Aug. 26, 2003), appeal pending sub nom. Nelson v. SEC, No. 03-1349 (D.C. Cir. filed Oct. 16, 2003).

Because such challenges continue to be raised, it is somewhat surprising that the Division has so little to say about why cease-and-desist orders are warranted against Harrison, Blumer, and Song in this proceeding (Div. Br. at 38-39). Notwithstanding the paucity of argument presented by the parties, I address the elements of the KPMG standard here.

I conclude that Harrison's violations were egregious. The violations involve provisions of the Exchange Act and the implementing regulations that the courts and the Commission consider extremely important. See Blaise D'Antoni & Assoc., Inc., 289 F.2d 276, 277 (5th Cir. 1961); Wallace G. Conley, 51 S.E.C. 300, 303 (1993). Harrison's net capital violations, in most instances, involved deficiencies of hundreds of thousands of dollars. The firm's recordkeeping violations involved blatant and repeated departures from GAAP.

I further conclude that Harrison's violations, as caused by Blumer, were not isolated. The recordkeeping and net capital violations lasted for over thirteen months. Some of the failure-to-notify violations continued for sixteen months; others are still ongoing. The NASD has previously sanctioned Harrison for a net capital deficiency. Although Harrison's violations do not require a showing of scienter, Blumer demonstrated a high degree of scienter. Acting with extreme recklessness, at a minimum, Blumer created misleading financial records and prepared and submitted misleading FOCUS reports that concealed the true extent of Harrison's net capital deficits. Harrison and Blumer have offered no credible assurances against future violations. In their post-hearing pleadings, Harrison and Blumer continue to insist that their conduct was not wrongful. In the absence of cease-and-desist orders, I consider the likelihood of future violations by Harrison and Blumer to be quite high.

Blumer has an otherwise clean disciplinary record. There is little evidence that Harrison's violations, as caused by Blumer, harmed the investing public, Harrison's clearing

broker, or the marketplace in any quantifiable way.²⁷ These mitigating factors are outweighed by the factors cited in the immediately preceding paragraph. I conclude that a cease-and-desist order is warranted against Harrison and Blumer.

A cease-and-desist order is also appropriate for Song. Harrison's violations during her tenure as FINOP were also egregious and repeated. The books-and-records violations continued throughout Song's four-and-one-half months as FINOP. The Division proved net capital violations on seven days over the same period. Song was "a cause" of each of these violations. Although there is no evidence that Song acted with scienter, her conduct was negligent, at a minimum.

Furthermore, Song does not recognize the wrongful nature of her conduct. She views herself as a victim of Blumer, who was tardy in providing, or who failed to provide, the documents she requested. Song also views herself as the victim of the Commission's examination staff, which never gave her a "heads up" warning about the violations it was uncovering at Harrison during February, March, and April 2002. She still maintains that she took "all reasonable steps" to ensure Harrison's compliance with the Net Capital Rule and the rules requiring current, accurate books and records. Such arguments are evidence of willful blindness on Song's part as to the scope of Harrison's violations and to the breadth of a FINOP's responsibilities under NASD Rule 1022(c)(2).

Song's prior disciplinary record is clean. A cease-and-desist order is the only sanction she faces in this proceeding.

Without a cease-and-desist order, it is highly likely that Song will continue to perform her FINOP duties exactly as she performed them here: never visiting the broker's office, never personally reviewing the broker's books and records in detail, doing little to ensure daily net capital compliance, assuming an active role only as the due date for a quarterly FOCUS report approaches, and insisting that post-filing review of a quarterly FOCUS report is satisfactory. A cease-and-desist order will provide substantial assurance that Song will take more pains the next time to avoid the negligent conduct evident on this record.

Associational Bar

Section 15(b)(6)(A)(i) of the Exchange Act empowers the Commission to impose a sanction against a person associated with a broker or dealer if such person willfully aided and abetted any violation of the Exchange Act or the rules or regulations thereunder. See also Section 15(b)(4)(E) of the Exchange Act. Specifically, the Commission may censure an associated person, place limitations on the activities or functions of that person, suspend that person for a period not exceeding twelve months, or bar that person from being associated with a

²⁷ The Division need not demonstrate actual injury or losses to investors in order to establish liability for the underlying violation. D'Antoni, 289 F.2d at 277. However, harm to others is a relevant consideration under KPMG for purposes of sanctioning.

broker or dealer if the Commission finds, on the record and after notice and opportunity for hearing, that such censure, placing of limitations, suspension, or bar is in the public interest.

The Commission considers several factors to determine the public interest: (1) the egregiousness of the respondent's actions; (2) the isolated or recurrent nature of the infractions; (3) the degree of scienter involved; (4) the sincerity of the respondent's assurances against future violations; (5) the respondent's recognition of the wrongful nature of his or her conduct; and (6) the likelihood that the respondent's occupation will present opportunities for future violations. See Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979), aff'd on other grounds, 450 U.S. 91 (1981). No one factor is controlling. Associational sanctions are not intended to punish a respondent but to protect the public from future harm. See Leo Glassman, 46 S.E.C. 209, 211-12 (1975).

The same facts that warrant a cease-and-desist order against Blumer also warrant an associational bar, and I incorporate my previous discussion here. In addition to the evidence cited above, Blumer failed to provide the Commission's staff with prompt reconciliations and explanations of discrepancies during the examination. Even after the Commission's Associate Regional Director told Blumer that he needed to provide prompt notice of violations, Blumer stonewalled for an additional three months (DX 103, DX 108). Blumer also demonstrated a lack of candor during the hearing. I have given weight to these aggravating factors. I conclude that it is in the public interest to bar Blumer from association with any broker or dealer.

Civil Monetary Penalties

Under Section 21B(a) of the Exchange Act, the Commission may assess a civil monetary penalty if a respondent has willfully violated or willfully aided and abetted any violations of the Exchange Act or the rules or regulations thereunder. The Commission must find that such a penalty is in the public interest. Six factors are relevant to the public interest determination: (1) the deliberate or reckless disregard of a regulatory requirement; (2) harm to others; (3) unjust enrichment; (4) prior violations; (5) deterrence; and (6) such other matters as justice may require. See Section 21B(c) of the Exchange Act. Not all factors may be relevant in a given case, and the factors need not all carry equal weight.

Section 21B(b) of the Exchange Act specifies a three-tier system identifying the maximum amount of a penalty. All of the violations in this proceeding occurred after February 2, 2001.²⁸ For each "act or omission" by a corporation, the adjusted maximum amount of a penalty is \$60,000 in the first tier; \$300,000 in the second tier; and \$600,000 in the third tier. For each "act or omission" by a natural person, the adjusted maximum amount of a penalty is \$6,500 in the first tier; \$60,000 in the second tier; and \$120,000 in the third tier. A second-tier penalty is permissible if the act or omission involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement. A third-tier penalty not only must have involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement, but

²⁸ As required by the Debt Collection Improvement Act of 1996, the Commission increased the maximum penalty amounts for violations occurring after December 9, 1996, and, again, for violations occurring after February 2, 2001. See 17 C.F.R. §§ 201.1001, .1002.

also must have “directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons or resulted in substantial pecuniary gain to the person who committed the act or omission.”

The Division seeks second-tier penalties against Harrison and Blumer (Div. Br. at 39-40). Because Harrison’s and Blumer’s acts and omissions involved the deliberate or reckless disregard of a wide range of regulatory requirements, second-tier penalties are permissible.

The adjusted statutory maximum amount is not an overall limitation, but a limitation per violation. Thus, each of the fifteen dates that Harrison engaged in a securities business without adequate net capital constitutes a separate violation. Each erroneous posting to Harrison’s books and records is also a separate violation, as is each erroneous FOCUS report. Harrison’s missing general ledger and missing backup general ledger constitute additional violations. See Mark David Anderson, 80 SEC Docket 3250, 3270 (Aug. 15, 2003) (imposing a civil penalty of \$1,000 for each of the respondent’s ninety-six violations); cf. United States v. Reader’s Digest Ass’n., 662 F.2d 955, 966, 970 (3d Cir. 1981) (holding that each individual mailing constitutes a separate violation of an FTC consent order). Because multiple acts and omissions are involved here, the Division’s requests for penalties of \$600,000 against Harrison and \$120,000 against Blumer are well within the statutory ceiling.

Addressing the six factors that guide the public interest analysis under Section 21B, I conclude that Harrison’s violations, as willfully aided and abetted by Blumer, involved the deliberate or reckless disregard of regulatory requirements. As previously discussed, Harrison has a prior net capital violation, but Blumer has no prior disciplinary record. I also conclude that significant penalties would serve the goal of deterrence. On the other hand, I conclude that there was no quantifiable harm to others. Harrison and Blumer were not unjustly enriched by the proven violations in any tangible way.

That leaves the “catch-all” factor: such other matters as justice may require. The Division asked for civil penalties of \$600,000 against Harrison and \$120,000 against Blumer both before and after the hearing (Div. Prehearing Br. at 21-23; Div. Br. at 39-41). I reject the Division’s assumption that nothing of any importance transpired at the hearing. In fact, the Division failed to meet its burden of proof as to seven of the twenty-two net capital violations alleged in the OIP. See supra note 11. As a separate matter, justice requires me not to impose any civil penalty for failure-to-notify violations that were alleged in the OIP but not proven at the hearing. See supra pp. 39-40 & note 21. The failure of proof on these charges warrants a proportionate reduction of the civil penalty the Division sought against Harrison before the hearing. After considering all the facts and circumstances, I will impose a penalty of \$400,000 against Harrison.

If a primary violator’s penalty is reduced by one-third, I would ordinarily reduce an aider and abetter’s penalty by one-third, as well. I specifically decline to reduce Blumer’s penalty here, because his lack of cooperation with the examination staff and his mendacity in testifying at the hearing are aggravating factors. These are also matters that justice requires me to consider. I will therefore impose a penalty of \$120,000 against Blumer.

No Issue of Ability to Pay

Under Section 21B(d) of the Exchange Act, in any case in which the Commission may impose a civil penalty, a respondent may present evidence of the respondent's ability to pay the penalty. The Commission may, in its discretion, consider such evidence in determining whether a civil penalty is in the public interest. Such evidence may relate to the extent of the respondent's ability to continue in business and the collectability of the penalty, taking into account any other claims of the United States or third parties upon the respondent's assets and the amount of the respondent's assets.

Well before the hearing, I advised Respondents that, if they intended to claim inability to pay civil penalties, they would have to submit sworn financial statements, as well as supporting income tax returns, at the hearing (Prehearing Conferences of June 30, 2003, at 16-17, and December 17, 2003, at 25-26; Orders of June 30, 2003, October 9, 2003, and December 18, 2003). See Rule 630 of the Commission's Rules of Practice; Terry T. Steen, 53 S.E.C. 618, 626-28 (1998) (holding that an ALJ may require the filing of sworn financial statements). Harrison and Blumer did not submit sworn financial statements. Harrison did provide a corporate income tax return for 2001, but not for 2002 or 2003 (RX 28). Blumer did not submit any income tax returns. I conclude that Harrison and Blumer have waived any claim of inability to pay.

Appearing and Practicing Before the Commission

The Division seeks to deny Blumer the privilege of appearing and practicing before the Commission pursuant to Rule 102(e)(1)(iii) of the Commission's Rules of Practice (Prehearing Conference of May 12, 2003, at 25, 31-32; Div. Br. at 41).

In relevant part, Rule 102(e)(1)(iii) provides that the Commission may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found to have willfully aided and abetted the violation of any provision of the federal securities laws or the rules and regulations thereunder. Rule 102(e) is intended to protect the integrity of the Commission's processes and ensure the competence of the professionals (including accountants) who appear and practice before it; it is not designed to add another weapon to the Commission's enforcement arsenal. See Touche Ross & Co. v. SEC, 609 F.2d 570, 579, 582 (2d Cir. 1979); William R. Carter, 47 S.E.C. 471, 477 (1981).

Blumer has willfully aided and abetted Harrison's violations of the federal securities laws and the Commission's rules, within the meaning of Rule 102(e)(1)(iii), and he is therefore subject to the type of sanction the Division seeks. I agree with the Division that the heart of this case is Blumer's reckless, if not deliberate, violation of settled GAAP requirements for the purpose of falsifying his firm's financial records and concealing his firm's net capital violations. I also agree with the Division that Blumer should be barred from appearing and practicing before the Commission as an accountant.

However, the Division's request for a Rule 102(e) sanction is much broader: it seeks to bar Blumer from appearing and practicing before the Commission in any way, not merely as an accountant. Because the Division has not addressed the issue in any detail, I deny its request for that broader sanction here.

First, the Division has not proven a nexus between the narrow range of misconduct proven in this proceeding—aiding and abetting violations of the net capital, financial recordkeeping, and financial reporting provisions of the Exchange Act—and the broad sanction sought—barring Blumer from appearing and practicing before the Commission “in any way.”

Second, the Division has presented no explanation as to why the broadest possible sanction under Rule 102(e) should always be automatic in every case under Rule 102(e). In essence, it appears that the Division is urging the imposition of collateral bars in the Rule 102(e) context. However, the Division can no longer obtain collateral bars in litigated enforcement proceedings. See Teicher v. SEC, 177 F.3d 1016, 1019-22 (D.C. Cir. 1999).

Third, it is not my intention to bar Blumer from appearing on a pro se basis in future adjudicatory proceedings, if he chooses to do so.

If the associational bar imposed in this Initial Decision eventually becomes final, Blumer would still retain the right to apply to the Commission in the future for consent to associate with a registered entity. See Rule 193 of the Commission's Rules of Practice; Edward I. Frankel, 81 SEC Docket 3778 (Dec. 29, 2003); Ciro Cozzolino, 81 SEC Docket 3769 (Dec. 29, 2003); Stephen S. Wien, 81 SEC Docket 3758 (Dec. 29, 2003). Likewise, if the bar on appearance and practice imposed in this Initial Decision eventually becomes final, Blumer would still retain the right to apply to the Commission for reinstatement “at any time.” See Rule 102(e)(5) of the Commission's Rules of Practice.

Arguably, if I were to bar Blumer from appearing and practicing before the Commission “in any way,” he could not appear on his own behalf in a proceeding under Rule 102(e)(5) or Rule 193, because that might constitute “transacting business with the Commission” within the meaning of Rule 102(f)(1). Arguably, it might also constitute “the preparation of [a] . . . paper . . . by [an] accountant filed with the Commission in [an] . . . application . . .” within the meaning of Rule 102(f)(2).

Blumer has represented himself on a pro se basis in this proceeding after March 2004, and he has done so without incident. To be sure, the Division argues that Blumer has been disingenuous or dishonest in Harrison's Brief. It also contends that Blumer has attempted to contradict matters that he reluctantly admitted during the hearing. Those are valid reasons for denying the relief sought in Harrison's Brief. They are not legitimate reasons to forbid the author of the brief from ever again approaching the Commission. I find that Blumer's pro se representation in this proceeding has not demonstrated any threat to the Commission's processes. I thus bar Blumer only from appearing and practicing before the Commission as an accountant.

RECORD CERTIFICATION

Pursuant to Rule 351(b) of the Commission's Rules of Practice, I certify that the record includes the items set forth in the record index issued by the Secretary of the Commission on April 26, 2004.

ORDER

Based on the findings and conclusions set forth above:

IT IS ORDERED THAT the charges in the Order Instituting Proceedings are dismissed, insofar as they allege that Harrison Securities, Inc., failed to maintain sufficient net capital as required by Section 15(c)(3) of the Securities Exchange Act of 1934 and Rule 15c3-1(a) thereunder on the following dates: June 28, July 31, August 31, October 31, December 27 and 28, 2001, and April 24, 2002;

IT IS FURTHER ORDERED THAT, pursuant to Section 21C of the Securities Exchange Act of 1934, Harrison Securities, Inc., and Frederick C. Blumer shall cease and desist from committing or causing any violations or future violations of Sections 15(c)(3) and 17(a)(1) of the Securities Exchange Act of 1934 and Rules 15c3-1(a), 17a-3(a), 17a-4(a) and (f), 17a-5(a), and 17a-11(b) and (d) thereunder;

IT IS FURTHER ORDERED THAT, pursuant to Section 21C of the Securities Exchange Act of 1934, Nebrissa Song shall cease and desist from committing or causing any violations or future violations of Sections 15(c)(3) and 17(a)(1) of the Securities Exchange Act of 1934 and Rules 15c3-1(a), 17a-3(a), 17a-5(a), and 17a-11(b) and (d) thereunder;

IT IS FURTHER ORDERED THAT, pursuant to Section 15(b) of the Securities Exchange Act of 1934, Frederick C. Blumer is barred from association with any broker or dealer;

IT IS FURTHER ORDERED THAT, pursuant to Section 21B of the Securities Exchange Act of 1934, Harrison Securities, Inc., shall pay a civil penalty of \$400,000 and Frederick C. Blumer shall pay a civil penalty of \$120,000; and

IT IS FURTHER ORDERED THAT, pursuant to Rule 102(e)(1)(iii) of the Commission's Rules of Practice, Frederick C. Blumer is barred from appearing and practicing before the Commission as an accountant.

Payment of the civil penalties shall be made on the first day following the day this Initial Decision becomes final. Payment shall be made by wire transfer, certified check, United States Postal money order, bank cashier's check, or bank money order, payable to the Securities and Exchange Commission. The payments, and a cover letter identifying the Respondents and the proceeding designation, shall be delivered to the Comptroller, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, Virginia 22312. A copy of the cover letter and the instrument of payment shall be sent to the Commission's Division of Enforcement, directed to the attention of counsel of record.

This Initial Decision shall become effective in accordance with and subject to the provisions of Rule 360 of the Commission's Rules of Practice. Pursuant to that Rule, a party may file a petition for review of this Initial Decision within twenty-one days after service of the decision. A party may also file a motion to correct a manifest error of fact within ten days of the initial decision pursuant to Rule 111 of the Commission's Rules of Practice. If a motion to correct a manifest error of fact is filed by a party, then that party shall have twenty-one days to file a petition for review from the date of the undersigned's order resolving such motion to correct a manifest error of fact.

The Initial Decision will not become final until the Commission enters an order of finality. The Commission will enter an order of finality unless a party files a petition for review or a motion to correct a manifest error of fact, or unless the Commission determines on its own initiative to review this Initial Decision as to any party. If any of these events occur, the Initial Decision shall not become final as to that party.

James T. Kelly
Administrative Law Judge