

and by failing to pay fines levied against the firm; and (3) McNamara violated Exchange Rule 30 by failing to timely submit required reports on behalf of Vector. An Exchange Disciplinary Panel held a hearing on the charges on April 19, 2005.¹

2. Facts

McNamara initially became a member of the Exchange in 1997. After September 11, 2001, the member organization with which he was then associated failed. In 2002, he decided to become a member again, operating through Vector, an organization he created. Vector, which was organized as a limited liability company under Delaware law, registered with the Securities and Exchange Commission as a broker/dealer in August 2002. (CX 4, 8, 22, 27 at 9-10; RX F, H, I; Tr. 17, 23-32.)

In September 2002, McNamara leased an Exchange membership and he and Vector became members of the Exchange. As a member organization, Vector was required to file certain reports with the Exchange's FRD, including equity computation reports. Vector's first report, reflecting its equity computation as of September 30, 2002, was due in October 2002; Vector did not file that report. It also failed to file its equity computation reports for October 31 and November 30, 2002. (Tr. 67-77; CX 3, 5, 7, 10, 12.)

After Vector failed to file its September 30 report, FRD sent Vector a letter noting that the report had not been filed on time, warning Vector that it could be subject to disciplinary action (including but not limited to a \$50 per day fine) for failure to file

¹ At the hearing, Enforcement offered the testimony of two staff members, while respondents offered McNamara's testimony. Enforcement also offered some, but not all, of the 28 exhibits (CX 1-28) included in its pre-hearing submission, which were admitted in evidence. In the interest of completeness, however, the Panel also considered Enforcement's remaining exhibits, as well as the five exhibits attached to respondents' Joint Answer (RX A-E) and the additional exhibits to McNamara's correspondence dated April 14, 2005 (RX F-K). Because these materials were submitted by the parties in advance of the hearing, they were already part of the record.

reports on a timely basis and advising Vector that “the Exchange allows requests for extensions of time where good cause can be shown,” provided such a request is submitted prior to the deadline for filing the report. On December 4, 2002, after Vector failed to file its report for October 31, FRD sent Vector another letter noting the failure. This letter stated that, because Vector had failed to file two reports, FRD had determined that a fine would be levied against Vector in an amount to be determined after it filed the reports, and FRD requested that Vector file the reports promptly. On January 8, 2003, after Vector failed to file its report for November 30, 2002, FRD sent Vector a third letter noting the three failures and reiterating that a fine would be levied against the firm once it filed the reports. FRD sent all of these letters to the address that was listed for both Vector and McNamara in the Exchange’s records. (CX 3, 11, 13, 14; Tr. 67-77.)

McNamara, on behalf of Vector, sent FRD a letter on January 9, 2003,² after receiving a telephone call earlier that week from an FRD staff member notifying him of Vector’s failure to file the equity computation reports. He stated that he had not previously been aware of the requirement to file such reports and had not received the letters FRD sent to Vector. He enclosed the overdue reports for September 30, October 31 and November 30, 2002, as well as Vector’s report for December 31, 2002, which was not yet due. (CX 15; Tr. 80-81, 123.)

On January 13, 2003, FRD sent Vector a letter stating that it was assessing a \$1,500 fine against Vector for its failure to timely file its October 31 equity computation report and a second letter stating that FRD was assessing an additional \$500 fine on Vector for its failure to timely file its report for November 30, 2002. Attached to each letter was a Disciplinary Notice setting out the charge and the proposed fine, and

² The letter was dated January 9, 2002, but the parties stipulated that was a typographical error.

notifying Vector it could contest the fine and request a hearing, provided it did so by February 2, 2003. FRD delivered the two letters and Disciplinary Notices to McNamara on the Floor of the Exchange on January 14, 2003 and he signed receipts for them. Vector, however, neither paid the fines nor requested a hearing. Later in January, a few days after the Disciplinary Notices were delivered, Vector and McNamara ceased doing business on the Exchange. (CX 16-17, CX 28 at 10; Tr. 82-83, 86-88, 126-27, 171.)

On March 10, 2003, FRD sent Vector a letter noting that it had failed to timely submit its equity computation report for January 31, 2003. Although Vector and McNamara had ceased trading on the Exchange by that date, Vector had not yet terminated its membership, and thus remained responsible for submitting monthly equity computation reports. The March 10 letter advised Vector that another fine would be imposed on it for its late filing in an amount to be determined after it filed the report. (CX 18; Tr. 88-90, 126, 134.)

Around the same time, McNamara received an e-mail from the Exchange advising him that the Exchange had

posted you and your firm to terminate membership effective at the close of business March 13, 2003. However, our finance department has advised us that you and your firm both owe finance bills (total of \$3,796.00.) ... Your seat will not be transferred until this finance matter has been resolved and you will be responsible for any additional Amex fees and seat lease payments to your Lessor.

In response, on March 17, 2003, McNamara sent an e-mail stating that he was unable to pay the outstanding amounts because he had lost all his money through Vector, had no job and was subject to an order in pending divorce proceedings that precluded him from transferring funds. He also stated that his computer was in storage at a friend's house and that he would provide the firm's final equity computation reports once he obtained access

to the computer, a printer and Vector's records. On March 30, McNamara sent a letter to FRD stating that he had obtained access to Vector's records and enclosed the equity computation report for January 31. (CX 19-20; Tr. 93-94.)

On May 8, 2003, FRD sent Vector another letter and Disciplinary Notice imposing an additional fine of \$1,150 for the late filing of Vector's January 31 report. There is no evidence that Vector or McNamara actually received this letter and Disciplinary Notice; once again, Vector neither requested a hearing nor paid the fine. (CX 21; Tr. 95-97.)

In addition to the equity computation reports, Vector was required to file a Financial and Operational Combined Uniform Single (FOCUS) report by March 1, 2003. As noted above, by that date Vector was out of business, but it was still a member organization, and therefore was required to file the report. McNamara was unaware of Vector's obligation to file the FOCUS report, and did not file it on time. After McNamara was informed of Vector's obligation to file the FOCUS report and obtained access to Vector's records, he filed the report with a letter dated March 26, 2004. McNamara also included Vector's equity computation report for the period ending February 28, 2003, which was after Vector ceased doing business, but before it terminated its membership. (CX 22-25; Tr. 99-101, 127-28, 134.)

3. Discussion

When Vector and McNamara became members of the Exchange, they agreed to be bound by its Constitution and Rules. (Exchange Const. Art. IV; CX 3; RX J.) Among other things, the Rules require members to timely file required reports, and authorize Exchange staff to issue Disciplinary Notices under the Exchange's minor rule violation

system imposing fines for any failure to do so. (Exchange Rule 30; CX 26.) A member that receives a Disciplinary Notice assessing a fine may either pay the fine or contest the charge and request a hearing. (Exchange Rule 590, Part 3.) The Exchange's Constitution requires members to pay fines assessed by the Exchange, and authorizes a suspension of any member that fails to do so. (Exchange Const. Art. V, Section 3(e).)

There is no dispute that Vector failed to timely file required equity computation reports in the fall of 2002. Noting the failures, FRD sent Vector warning letters, but McNamara did not receive them. When he learned of the overdue reports, he filed them promptly, and FRD issued Disciplinary Notices imposing fines for the late filings, which were delivered to McNamara on the Floor of the Exchange. Vector could have contested the charges and requested a hearing, or it could have paid the fines, but it did neither. Further, after Vector went out of business, but before it terminated its membership, it failed to timely file additional reports

At the hearing, McNamara argued that (1) when he and Vector became members, the training that Exchange staff provided was inadequate and rushed, so he was unaware of Vector's obligation to file reports; (2) FRD sent its letters to Vector at the wrong address; and (3) he successfully insulated himself from any personal liability for Vector's failure to file timely reports. For the reasons set forth below, the Panel rejects each of these contentions.

Any person or organization that becomes a member of the Exchange is responsible for learning and complying with the member's obligations under the Constitution and Rules. Exchange staff provide information and training to assist

members, but the staff is not responsible for ensuring that members know and comply with their obligations.

FRD conducts an entrance interview with each new member; McNamara participated in such an interview on September 12, 2002. (Tr. 45; CX 5.) According to McNamara, this was

a very rushed meeting. I was interrupted twice, once by a phone call from my lawyer, once by my clearing firm. The FRD staff member was interrupted by phone calls at least twice. We were in a hurry to get me down on the floor trading because I had already been posted personally for membership as of the 13th and I was going to pay for the seat lease without being able to trade.

So in this rushed meeting, at no point were these equity comps discussed. At one point he said to me, do you have an accounting firm? And I said yes I said, I've used them in the past and I'm going to look into using them now. He said, okay, they'll be able to handle all the filings.

(Tr. 121; CX 5.)

In fact, McNamara did not hire an accounting firm to handle Vector's filings, but nevertheless it did not occur to him that he should inform himself of Vector's filing obligations. (Tr. 132.) Having rushed through his introductory meeting in order to begin trading and having failed to fulfill his representation to the staff that he intended to retain an experienced accounting firm to handle Vector's reporting responsibilities, McNamara has no basis for complaining that the staff did not provide adequate training.

McNamara also complains that FRD should have sent its letters to Vector at a Chicago address for Vector listed in the Central Registration Depository (CRD). McNamara testified that at the time he established Vector, and he and Vector became members of the Exchange, he had recently separated from his then-wife and was temporarily living with a friend in New City, NY. In his application for his own

membership, McNamara listed the New City address as both his home address and the organization mailing address for Vector. He later lived in other locations temporarily, but never notified the Exchange of any different address to which notices should be sent, and in fact continued using the New City address in correspondence to the Exchange. (Tr. 118, 122, 136.)

McNamara testified that when he formed Vector, however, it was with the expectation that another friend, who lived in Chicago, would also become involved, and when Vector registered as a broker/dealer, he entered the friend's Chicago address in the CRD system to be sure that all regulatory notices to Vector would go to that address. (Tr. 119, 138.) There is no dispute that FRD sent all of its letters to Vector to the New City address, rather than the Chicago address. McNamara contends that this was improper.

Article IV, Section 2(1) of the Exchange Constitution provides:

Every member and member organization shall register with the Exchange an address and subsequent changes thereof where notices may be served. Any notice mailed to a member or member organization at the last address registered at the Exchange shall be presumed to have been received by such member or member organization.

Thus, the issue is what address Vector registered with the Exchange.

Unfortunately, Enforcement did not include in its exhibits Vector's membership application, which would have provided an indisputable answer to that question. (Tr. 39-40, 110-11.) The evidence in the record, however, indicates that Vector registered the New City address with the Exchange, rather than the Chicago address listed in CRD. First, the Exchange's records list the New City address as Vector's primary business address (CX 3; Tr. 32-36); second, McNamara listed the New City address as Vector's address on his own membership application (CX 3); third, McNamara listed the New City

address as the return address for Vector in his January 9, 2003 letter to FRD (CX 15); and finally, respondents' own exhibits include a letter from McNamara, on behalf of Vector, to the Exchange in connection with Vector's application for membership giving the New City address as the location of Vector's "principal office" (RX J; Tr. 166). When this last fact was pointed out to McNamara during the hearing, he claimed that Exchange staff insisted on a New York address for Vector (Tr. 146-48), but even if true, that is irrelevant. By providing the New City address, Vector consented to the Exchange sending notices to it there.³ Therefore, the Panel finds that FRD sent its letters to the correct address for Vector, and that Vector was therefore presumed to have received them.

In any event, the letters that FRD sent to Vector did not create the obligation to file monthly equity computation reports, but simply notified Vector that it had failed to submit required reports, and might be subjected to penalties for that failure. Nothing in the Rules requires the staff to send warning letters, so even if FRD had sent them to the wrong address, that would not excuse Vector's failure to file timely reports.

Finally, McNamara relied on the fact that Vector was organized as a Limited Liability Company, and that according to its membership papers, another Limited Liability Company, Vector Capital Management, LLC, was Vector's "Managing Member." McNamara, in turn, identified himself as the "Managing Member of the Managing Member" or the "Managing Director of the Managing Member" of Vector. (CX 3, 15; RX J.) He argued that by incorporating Vector and interposing Vector Capital

³ McNamara also contended that reference to Vector's address in the letter (RX J) somehow related only to Vector's internal operating agreement, not its registered address with the Exchange. This contention is belied by the plain language of the letter, which states: "The following is an outline of the information required by AMEX for membership," followed by the statement that Vector's principal office is located at the New City address.

Management between himself and Vector, he insulated himself from any liability for Vector's failure to meet its obligations. (Tr. 117, 184.)

McNamara, however, was the only individual Exchange member associated with Vector, and he acknowledged that he was the person responsible for ensuring that Vector fulfilled its responsibilities as a member organization of the Exchange. (Tr. 170-71.) As noted above, when he became a member, McNamara agreed to be bound by the Constitution and Rules of the Exchange. Article V, Section 4(r) of the Exchange Constitution provides: "A regular ... member of the Exchange is liable to the same discipline and penalties for any act or omission of his member organization ... as though such act or omission were his own personal act or omission." Therefore, the Panel finds that McNamara, as well as Vector, may be held liable for Vector's failure to file its reports in a timely manner.

The Panel finds that (1) Vector violated Article V, Section 4(f) by failing to file timely reports, notwithstanding warning letters from FRD, and by not paying the fines assessed against it, and (2) that McNamara violated Exchange Rule 30 by failing to ensure that Vector filed its reports in a timely manner.

Enforcement also argued that by failing personally to pay the fines that the Exchange levied on Vector, McNamara violated Exchange Rule 345(l), which provides:

An employee of a member or member organization who fails to pay a fine within thirty (30) days after the same becomes due and payable may, after written notice mailed to such person at either his office or last place of residence as reflected in the Exchange's records, be summarily suspended from association in any capacity with a member or member organization, or have his approval as a registered employee withdrawn, until such fine is paid.

The Panel rejects Enforcement's construction of this provision of the Rule. Enforcement's interpretation would impose personal financial liability on each employee of a member or member organization for any fine that the Exchange levied against the employer member, and would subject the employee to disciplinary penalties for failing to pay the employer member's fines. Rule 345, as a whole, establishes provisions for disciplining employees for their own misconduct. Therefore, the Panel concludes that the most sensible interpretation of Rule 345(l) is that the words "a fine" refer to a fine imposed against the employee, not the employer member. In that regard, the Panel notes that Article V, Section 3(e) expressly provides for disciplining members who fail to pay their own fines. There is no dispute in this case that all of the fines were imposed on Vector, not McNamara. Therefore, the Panel finds that McNamara did not violate Rule 345(l) by failing to pay Vector's fines.

4. Penalties

Enforcement requested that as penalties the Panel censure Vector and McNamara and fine them \$10,000, jointly and severally. Enforcement did not offer any Exchange precedent or other analysis to support the requested penalties.

In determining the appropriate penalties, the Panel considered several relevant facts. Vector failed to file its first three monthly equity computation reports in the fall of 2002. Although McNamara should have known that Vector was required to file the reports, he did not realize Vector's obligation to file reports, and he did not, in fact, receive the warning letters that FRD sent, which would have alerted him to that obligation. Once he learned of Vector's obligation, he filed the overdue reports, as well as the report due in January 2003, ahead of its due date. During January, Vector ceased

its business at the Exchange, and thereafter failed to file two more equity computation reports and its FOCUS report because McNamara erroneously assumed that Vector, being out of business, was no longer required to file reports. Thus, the violations were negligent, reflecting McNamara's ignorance of the applicable requirements, not intentional.

The Panel also consulted the Exchange's Sanction Guidelines. Those Guidelines do not specifically address the violations here, but the most closely analogous Guidelines, for late trade reporting, recommend a fine of \$1,000 to \$2,000 for a first disciplinary action, a higher fine of \$2,000 to \$10,000 for a second disciplinary action, and a fine of \$5,000 to \$50,000 for subsequent disciplinary actions.⁴ In this case, based on the facts set forth above, the Panel finds that it is appropriate to impose a penalty within the range recommended for second disciplinary actions.

The Panel also considered the fact that Vector failed to either pay or contest the two Disciplinary Notices issued by FRD in January 2003 imposing fines on Vector totaling \$2,000, or the third Disciplinary Notice issued by FRD in March 2003 imposing an additional \$1,150 fine on Vector. The Panel concludes that to accomplish the Exchange's remedial goals, the Panel should impose a fine that exceeds the unpaid fines, which, with interest, total approximately \$3,796. (Tr. 183-184.) The Panel, therefore, will impose a \$5,000 fine on Vector and McNamara, jointly and severally.

McNamara argued that a censure is unwarranted and that it would, as a practical matter, prevent him from obtaining employment in the industry. The Exchange's Sanction Guidelines do not address the circumstances under which it is or is not

⁴ These Guidelines also recommend consideration of a suspension in egregious cases, but the Panel does not find this to be an egregious case.

appropriate to impose a censure, but NASD has addressed that topic in its Sanction Guidelines, which provide that, generally, a censure should not be imposed for late reporting violations where the monetary sanction is \$5,000 or less and no suspension or bar is imposed. NASD Sanction Guidelines at 9, 110 (2005). Under the particular circumstances presented, the Panel finds it appropriate to follow that guidance in this case; therefore, no censure will be imposed.

5. Conclusion

For the reasons set forth above, the Disciplinary Panel, by unanimous vote, finds that Respondent Vector violated Article V, Section 4(f) by failing to file timely reports, notwithstanding warning letters from FRD, and by not paying the fines assessed against it, and finds that Respondent McNamara violated Exchange Rule 30 by failing to ensure that Vector filed its reports in a timely manner. The Disciplinary Panel hereby imposes a \$5,000 fine against respondents Vector Magnitude Funds, LLC, and Michael J. McNamara, jointly and severally.⁵

FOR THE DISCIPLINARY PANEL

David M. FitzGerald, Chair

Copies to: Vector Magnitude Funds, LLC (*via overnight and first class mail*)
 Michael J. McNamara (*via overnight and first class mail*)
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⁵ The Panel has considered and rejects without discussion all of the parties' other arguments.