

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 20070094009**

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REGISTRATION & DISCLOSURE

TO: Department of Enforcement
Financial Industry Regulatory Authority ("FINRA")

RE: Donald Craig Korkow, Respondent
CRD No. 2156222

Pursuant to NASD Rule 9216 of FINRA's Code of Procedure, I, Donald C. Korkow ("Korkow"), submit this Letter of Acceptance, Waiver and Consent ("AWC") for the purpose of proposing a settlement of the alleged rule violations described below. This AWC is submitted on the condition that, if accepted, FINRA will not bring any future actions against me alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. I hereby accept and consent, without admitting or denying the findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of FINRA, or to which FINRA is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by FINRA:

BACKGROUND

Korkow was born in [REDACTED]. Korkow entered the securities industry in 1991 as a registered representative ("RR") with the Omaha, Nebraska branch office of Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch" or the "Firm"). Korkow was promoted to senior financial advisor in approximately 1996 and was given the title of vice president in 2000. Korkow is currently employed in the Firm's Omaha, Nebraska branch as a vice president.

Merrill Lynch, a Delaware corporation with its principal place of business in New York, is a member organization of NYSE Euronext¹ ("NYSE") and FINRA. The Firm is a global investment banking and multi-service brokerage firm and,

¹ On March 7, 2006, the NYSE Group, Inc. was formed from the merger of the New York Stock Exchange LLC and Archipelago Holdings, Inc. On April 4, 2007, NYSE Euronext was formed from the merger of NYSE Group, Inc. and Euronext N.V.

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together with its affiliates, operates in over 37 countries employing approximately 55,000 people worldwide, including more than 25,000 registered employees.

OVERVIEW

Korkow recommended unsuitable investment strategies to at least three employees of Allegiance Telecom, Inc. ("Allegiance"). Specifically, for three of his Allegiance customers, Korkow, without regard to each customer's investment objectives, investment experience or sophistication, recommended that they exercise their employer-granted stock options and hold the resulting equity securities in large concentrations on margin without having reasonable grounds to believe that the associated margin borrowing was suitable for each of the customers. Accordingly, these customers lost a sizable amount of money by pursuing the exercise and hold strategy in concentrated positions while on margin.

FACTS

NASD Rule 2310(a) provides that "[i]n recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs."

NASD Rule 2110 provides that "[a] member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade."

Allegiance Employee Stock Option Plan

Allegiance, founded in 1997, was a national telecommunications provider based in Dallas, Texas. It sold local telephone service, long distance, broadband access, web-hosting and telecom equipment with maintenance to small and medium-sized businesses.

In 1998, Allegiance entered into a non-exclusive agreement with the Firm for it to handle its Employee Stock Option Program ("ESOP"). The options were non-qualified and were granted on a quarterly basis to all employees.

At the time that the Firm became involved with Allegiance, Allegiance was considered one of the better known and financed entries in the competitive telecommunications industry. Between July 1, 1998 and March 2, 2000, Allegiance stock went from approximately \$9.00 per share to \$105.75.

However, in 2001, the value of the Allegiance stock plummeted losing nearly 90% of its value. As a result, Allegiance filed for bankruptcy protection in May

2003 and was eventually purchased by XO Communications Inc. ("XO") on February 13, 2004.

Strategies for Handling Allegiance Employee Stock Options

In describing the Firm's program for handling Allegiance ESOP accounts, Korkow outlined the three strategies that were contained in the Firm's marketing materials: 1) exercise and sell; 2) exercise and cover; and 3) exercise and hold. The exercise and sell strategy was the simplest and most understandable strategy. The customer would exercise the option, pay the strike price and sell the stock on the same day in the open market. The cost associated with the exercise, namely, the strike price and applicable taxes, would be deducted from the net proceeds of the sale and the remainder, if any would go into the customer's accounts. The exercise and cover approach would involve the exercise and sale of enough of the exercised options to pay the strike price and income taxes. The remaining shares would then be held free from any debt. The last option, which the customers in this investigation overwhelmingly used to their detriment, is the exercise and hold strategy. Exercise and hold allows the customer to exercise the stock option, yet retain ownership of all of the shares. The customer would accomplish this objective by either paying the costs of the strike price and taxes by cash or borrowing the money from the Firm through a margin loan. The primary benefit gained by the exercise and hold strategy is the favorable tax treatment received by customers who hold the shares for one year after the date of exercise. If the shares are sold after being held for one year, they are considered capital gains and taxed at a lower rate.

The exercise and hold strategy is not without significant risk, especially if the stock is volatile and the options are being held on margin in a concentrated account. Indeed, if the stock is being held on margin and the value of the stock plummets, this could pose a significant risk for an investor who is not diversified. Because the margin loan is based upon the value of the customer's account, if the account is concentrated then the entire account can be jeopardized resulting in margin calls and the liquidation of the securities account.

The Customers

i. [REDACTED]

At the time that [REDACTED] opened her account with Korkow, in October 1999, [REDACTED] was a twenty-nine year-old senior collocation manager at Allegiance having been hired by Allegiance in December 1997. [REDACTED] graduated in 1992 from Duke University with a B.A. in Electrical Engineering. Her experience in investing included having an employer-sponsored retirement plan pursuant to 26 U.S.C. § 401(k) ("401(k)") and having shares in another telecom company, MFS Communications Company Inc. ("MFS") that were obtained through her participation in MFS' Employee Stock Purchase Plan ("ESPP").

new account documents ("NADs") listed her investment goals as "total growth and "return" and listed her risk tolerance level as "aggressive."

investment portfolio contained large concentrations of Allegiance stock.

first transaction with Korkow was an exercise and sell. Subsequently, Korkow recommended to that she exercise her employer-granted stock options and hold the resulting equity securities in large concentrations and finance the transaction through a margin loan. In light of concentrated positions in Allegiance stock, this particular investment strategy carried significant risk.

At the time that Korkow effected the exercise and hold strategy in securities account, did not understand or appreciate the risks of exercising and holding large concentrations of Allegiance stock and using the resulting equities as the primary collateral for the margin loan.

Between the time of the opening of the account and July 12, 2000, exercised and held on margin a large concentration of Allegiance shares totaling approximately 7,906 shares. Between July and October 2000, the telecom industry stock, in general, began to fall precipitously. Allegiance stock went from \$75.875 on July 17, 2000 to \$23.375 on October 18, 2000.

At the end of October 2000, had a margin call that required a significant deposit of cash or securities. failed to satisfy the margin call which resulted in the liquidation of her account in late October 2000. wound up owing the firm approximately \$22,000 after her securities account was liquidated.

ii.

was about 52 at the time that he opened his securities account with Korkow on April 20, 2000. a high school graduate, had very little investment experience.

NADs listed his investment goals as "total growth" and "return" and listed his risk tolerance level as "aggressive."

investment portfolio was concentrated and consisted entirely of Allegiance stock.

Korkow recommended to that he exercise his employer-granted stock options and hold the resulting equity securities in large concentrations and finance the transaction through a margin loan. In light of concentrated positions in Allegiance stock, this particular investment strategy carried significant risk.

At the time that Korkow effected the exercise and hold strategy in securities account, did not understand or appreciate the risks of exercising

and holding large concentrations of Allegiance stock and using the resulting equities as the primary collateral for the margin loan.

Shortly after [REDACTED] opened his securities account, on or about May 2, 2000 [REDACTED] exercised and held 1,500 shares and financed the transaction with a margin loan. At that time, the market value of the Allegiance stock per share was \$52.000.

Between May and September 2000, [REDACTED] used cash from the sale of Allegiance stock to satisfy margin calls.

On September 12, 2000, [REDACTED] sold his remaining Allegiance shares that he was holding on margin for \$ 33.750 per share and paid off his remaining margin debt.

iii. [REDACTED]

[REDACTED] was forty at the time that his securities account was opened on January 5, 2000. [REDACTED] has a tenth-grade education and obtained his GED in 1981. [REDACTED] never took any business courses or was otherwise trained in business or investing.

[REDACTED] investment product experience prior to opening his account with the Firm was extremely limited. [REDACTED] had a 401(k) with Allied Van Lines Inc. ("Allied") and received approximately 200 shares per year from Allied. Prior to [REDACTED] becoming employed by Allegiance, he sold all of his Allied shares in 1998.

[REDACTED] NADs listed his investment goals as "total growth" and "return" and listed his risk tolerance level as "aggressive."

[REDACTED] investment portfolio was concentrated and consisted entirely of Allegiance stock.

[REDACTED] completed his first exercise and hold transaction with another broker at the Firm, and Korkow later facilitated the sale of those shares. Korkow, subsequently, recommended to [REDACTED] that he exercise his employer-granted stock options and hold the resulting equity securities in large concentrations and finance the transaction through a margin loan. In light of [REDACTED] concentrated positions in Allegiance stock, this particular investment strategy carried significant risk.

At the time that Korkow effected the exercise and hold strategy in [REDACTED] securities account, [REDACTED] did not understand or appreciate the risks of exercising and holding large concentrations of Allegiance stock and using the resulting equities as the primary collateral for the margin loan.

By approximately October 2000, the Allegiance stock price had drastically declined from over \$100 to \$30. [REDACTED] contacted Korkow to discuss his concerns

regarding the stock's value. Subsequent to that conversation, on October 6, 2000, [REDACTED] exercised and held all of his stock options, 7,601, and financed the transaction with a margin loan.

In March 2001, Allegiance stock continued to drop to below \$20.00 per share resulting in [REDACTED] receiving his first margin call. From March 2001 through the end of August 2001, [REDACTED] did not sell his Allegiance stock positions and satisfied the margin calls by using other financial resources.

In September 2001, [REDACTED] could no longer satisfy the margin calls without selling his Allegiance stock. As a result, [REDACTED] securities account was liquidated leaving a negative balance of \$2,500.

VIOLATIVE CONDUCT BY RESPONDENT

Based on the foregoing conduct, Korkow violated NASD Conduct Rules 2310 and 2110 by recommending to [REDACTED] and [REDACTED] that they exercise their employer-granted stock options and hold the resulting equity securities in large concentrations on margin without having reasonable grounds to believe that the associated margin borrowing was suitable for each of the customers.

B. I also consent to the imposition of the following sanctions:

1. A censure;
2. A three-month suspension from association with any FINRA member in any capacity; and
3. A fine in the amount of \$2,500.

I understand that if I am barred or suspended from associating with any FINRA member, I become subject to a statutory disqualification as that term is defined in Section 3(a)(39) of the Securities Exchange Act of 1934, as amended.

Accordingly, I may not be associated with any FINRA member in any capacity, including clerical or ministerial functions, during the period of the bar or suspension. (See NASD Rule 8310 and IM-8310-1.)

The fine shall be due and payable either immediately upon reassociation with a member firm following the three-month suspension noted above, or prior to any application or request for relief from any statutory disqualification resulting from this or any other event or proceeding, whichever is earlier.

I specifically and voluntarily waive any right to claim that I am unable to pay, now or at any time hereafter, the monetary sanction(s) imposed in this matter.

The sanctions imposed herein shall be effective on a date set by FINRA staff.

II.

WAIVER OF PROCEDURAL RIGHTS

I specifically and voluntarily waive the following rights granted under FINRA's Code of Procedure:

- A. To have a Formal Complaint issued specifying the allegations against me;
- B. To be notified of the Formal Complaint and have the opportunity to answer the allegations in writing;
- C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made and to have a written decision issued; and
- D. To appeal any such decision to the National Adjudicatory Council ("NAC") and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, I specifically and voluntarily waive any right to claim bias or prejudgment of the General Counsel, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

I further specifically and voluntarily waive any right to claim that a person violated the ex parte prohibitions of NASD Rule 9143 or the separation of functions prohibitions of NASD Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

III.

OTHER MATTERS

I understand that:

- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs ("ODA"), pursuant to NASD Rule

9216;

B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against me; and

C. If accepted:

1. this AWC will become part of my permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against me;
2. this AWC will be made available through FINRA's public disclosure program in response to public inquiries about my disciplinary record;
3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with NASD Rule 8310 and NASD IM-8310-3; and
4. I may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. I may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects my right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.

D. I may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. I understand that I may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA or its staff.

I certify that I have read and understand all of the provisions of this AWC and have been given a full opportunity to ask questions about it; that I have agreed to its provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce me to submit it.

10-2-2008
Date

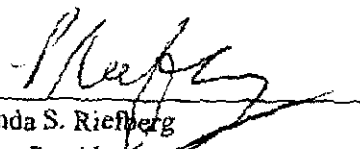
Donald C. Korkow
Respondent
Donald C. Korkow

By: Daniel C. Zinman
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Accepted by FINRA:

10/7/08
Date

Signed on behalf of the
Director of ODA, by delegated authority


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