

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2010025332401**

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

RE: Scottrade, Inc., Respondent
(BD No. 8206)

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Scottrade, Inc. (the "firm" or "Scottrade") submits 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 the firm alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. The firm hereby accepts and consents, 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

Scottrade has been a FINRA member firm since 1980. Its principal place of business is in St. Louis, Missouri. It has more than 500 branch offices and employs more than 1,800 registered representatives throughout the United States. As a discount broker-dealer, Scottrade's primary business is to provide an on-line platform for its customers to enter orders to trade securities.

OVERVIEW

Scottrade violated NASD Rule 2110 by violating Section 5 of the Securities Act of 1933, when it participated in the unlawful distribution by three customers of more than \$8.3 million in shares of Industrial Enterprises of America, Inc. (IEAM), from February 2005 to October 2007 (the "review period"). The firm also failed to establish and maintain a reasonable supervisory system and written supervisory procedures designed to achieve compliance with Section 5 of the Securities Act, in violation of NASD Rules 3010(a) and (b) and 2110.

FACTS AND VIOLATIVE CONDUCT

Background of IEAM

IEAM was a publicly traded company that was formed in 2004 through a reverse merger between a company owned by John Mazzuto and a dormant shell company. IEAM's wholly-owned subsidiaries manufactured refrigerant and automotive chemicals and additives and various packaging products. Mazzuto held various positions at IEAM, including CEO, President, Assistant Secretary, and Director. James W. Margulies had a law practice in Cleveland, Ohio, and at various times during the period in which he sold unregistered shares of IEAM through retail accounts at Scottrade, he was IEAM's Chief Financial Officer, its General Counsel, and a member of the company's Board of Directors.

IEAM's revenues for the fiscal year ended June 30, 2006, totaled nearly \$31 million; it had a net loss after accounting for operating expenses of over \$7 million for the year. The company effected a 10-for-1 reverse stock split on its publicly traded shares in June 2006, which resulted in an immediate ten-fold increase in its share price. IEAM's securities were quoted on the OTCBB until April 24, 2007, at which time they were approved for trading on the Nasdaq Capital Market.

In January 2005, IEAM filed a Form S-8 registration statement with the SEC, registering 15 million IEAM shares. Mazzuto and Margulies used the S-8 filing as the basis for an elaborate fraud that was not uncovered until 2010.¹ The S-8 Plan authorized the company to issue securities as compensation and incentive to employees, outside members of the company's Board of Directors, and consultants. Between January 2005 and March 2008, Mazzuto and Margulies invoked the S-8 registration and stock option plan to fraudulently issue millions of shares of IEAM worth tens of millions of dollars to friends, family members, and to shell companies, miscellaneous entities, and accounts that they controlled, instead of to the persons identified in the S-8. They also caused the company to issue shares directly to Margulies, who funneled proceeds from the stock sales back to IEAM.

Unregistered Sales of IEAM Shares

Margulies used three securities accounts at Scottrade to sell a total of 1,138,700 unregistered shares of IEAM for \$4,029,063, from February 2006 to October 2007. In September 2005, he opened a joint account with his wife. In January 2006, Margulies transferred 250,000 shares of IEAM into the joint account via DWAC ("delivery/withdrawal at custodian"), all of which were sold by early March 2006 for \$107,689. During 2007, Margulies made four additional DWAC transfers into the joint account totaling 309,000 shares of IEAM. He sold all but 900 shares of IEAM by October 2007. The joint account's sales of IEAM generated proceeds of \$1,658,659

¹ In May 2010, Mazzuto and Margulies were indicted in New York County Supreme Court on multiple counts of grand larceny, engaging in a scheme to defraud, and generating false business records for IEAM. *People v. Mazzuto and Margulies*, Sup. Ct., N.Y. County, May 24, 2010, Indictment No. 2503-2010. Mazzuto entered a guilty plea in January 2011 and agreed to testify against Margulies. Margulies was convicted in July 2011 after a trial and sentenced to serve seven to 21 years in prison in September 2011. In early 2012, Mazzuto was sentenced to 4½ years in prison.

from February 2006 to October 2007. During the period of selling IEAM, the Margulies joint account did not purchase or sell any other securities besides IEAM.

Two other accounts involving Margulies were opened at Scottrade – one in Margulies’s name and one in his wife’s name, in January 2007 and April 2007, respectively. The majority of the trading activity in these two accounts involved selling IEAM shares. Using five DWAC transfers from January to June 2007, Margulies deposited a total of 277,500 unregistered shares of IEAM into his personal account. By August 2007, Margulies sold all 277,500 IEAM shares for \$1,208,075.

Between April and October 2007, Margulies arranged for three transfers via DWAC of a total of 450,000 shares of IEAM into his wife’s Scottrade account. Between June and October 2007, Margulies’s wife sold 303,100 shares of IEAM for proceeds of \$1,230,329. The account held onto the remaining 146,900 shares of IEAM.

An information technology consultant who claimed to have provided services to IEAM and to Margulies’s law firm opened a personal account at Scottrade in January 2005. Between July 2006 and June 2007, the consultant transferred a total of 350,050 unregistered shares of IEAM in nine DWAC transactions. From February 2006 to July 2007, he sold all of the shares for proceeds of \$2,024,575. The customer’s trading activity in the account consisted solely of selling shares of IEAM. Using the check writing ability on his securities account, the consultant also wrote two checks directly to IEAM, for \$200,000 and \$58,000, in March and April 2007.

Another account, in the name of River Valley Asset Management, was opened in December 2004, by a Cleveland area real estate developer. River Valley transferred shares of IEAM into the account via DWAC beginning in early 2005. It sold a total of 909,550 unregistered shares of IEAM for proceeds of \$2,271,885, from February 2005 to May 2007. In a three-month period, from December 2006 to March 2007, the River Valley account transferred a total of \$1,275,000 directly back to IEAM using 11 wires. It also wired \$200,000 to Margulies’s law firm in December 2006.

In total, through Margulies’s three family accounts, the information technology consultant’s personal account, and the River Valley account, the three customers sold a total of 2,402,400 unregistered shares of IEAM for proceeds of \$8,393,523, from February 2005 to October 2007. The firm earned commissions of approximately \$11,000 on the customers’ sales of the unregistered IEAM shares.

Scottrade Failed to Fulfill its Obligations Under the Securities Laws

Section 5 of the Securities Act of 1933 prohibits the offer or sale of any security unless there is a registration statement in effect as to that security or there is an exemption available for the transaction. Exemptions to the registration requirement of Section 5 are construed narrowly. A broker who sells securities in violation of Section 5 violates NASD Rule 2110. Because the IEAM S-8 stock was not properly issued pursuant to the S-8 registration, the shares were restricted from resale, absent an applicable exemption from registration. No exemptions applied to the resales.

Scottrade failed to conduct an independent inquiry to determine whether the shares deposited were freely tradable. Margulies was a corporate insider and control person of IEAM. He served as the company's Chief Financial Officer, General Counsel, and Board of Directors member during the period that he sold IEAM through accounts at Scottrade. He deposited 1,286,500 shares of IEAM in his three family accounts, liquidated most of the shares soon after each transfer, and then wired out all of the sales proceeds. The shares deposited and controlled by Margulies alone constituted over 16 percent of the total shares of IEAM that were outstanding as of September 25, 2006. The 1,259,600 shares deposited and sold by the information technology consultant and River Valley accounts constituted an additional 16 percent of IEAM's total shares outstanding as of September 25, 2006.

Scottrade failed to undertake sufficient efforts to ascertain whether the IEAM stock could be properly sold. Without having obtained information regarding the facts and circumstances surrounding Margulies and the other two customers' possession of the stock, Scottrade did not satisfy its duty to conduct a reasonable inquiry that is a crucial part of the brokers' exemption.

By violating Section 5 of the Securities Act of 1933, Scottrade violated NASD Rule 2110.

The Firm Maintained an Inadequate Supervisory System and Written Supervisory Procedures for Compliance with Section 5

NASD Rule 3010(a) requires member firms to "establish and maintain a system to supervise the activities of each registered representative, registered principal, and other associated persons that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD Rules." Rule 3010(b) requires that firms document the system in the firm's written supervisory procedures.

The firm did not establish and maintain adequate supervisory systems and procedures reasonably designed to comply with Section 5. Scottrade's written supervisory procedures for compliance with Section 5 were limited to two short paragraphs concerning the sale of control or restricted stock. The procedures in place during the review period noted that, "Scottrade does not routinely clear and sell restricted stock. Compliance should be consulted directly for assistance regarding the processing of Rule 144 and Rule 145 sales." The procedures also noted that the firm's new customer account documentation "includes an inquiry whether the customer is an officer, director or major stockholder of the company. The account will be coded to represent that relationship." The procedures briefly described the broad purposes of Rules 144 and 145, but provided for no supervisory structure to ensure overall compliance with Section 5. The firm's procedures did not address compliance generally with Section 5 and were inadequate in setting forth the circumstances under which the firm should inquire into the registration or exemption status of securities in customer accounts. The procedures in place during the review period did not specifically list the factors that the firm was required to evaluate or consider in order to determine whether it needed to inquire further before allowing potentially unregistered securities to be sold by a customer.

Between February 2005 and October 2007, the three firm customers engaged in the unregistered distribution of more than 2.4 million shares of IEAM which generated proceeds to them of over

\$8.3 million. During the unregistered distribution of shares of IEAM, Scottrade's personnel incorrectly assumed that the IEAM shares were freely tradable, without restriction, primarily because the shares were received into the customers' accounts directly from a transfer agent and the customers disclosed to Scottrade that they were not insiders. In allowing the customers to sell their shares, the firm did not consider all of the factors relevant to a determination of whether the IEAM shares were unrestricted and eligible for resale.

Conclusion

By distributing unregistered shares of IEAM, Scottrade violated Section 5 of the Securities Act of 1933, which constitutes a violation of NASD Rule 2110. As a result of its supervisory deficiencies, the firm also violated NASD Rules 3010(a) and (b) and 2110.

B. The firm also consents to the imposition of the following sanctions:

1. A censure; and
2. A \$100,000 fine.

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

The firm agrees to pay the monetary sanction upon notice that this AWC has been accepted and that such payment is due and payable. The firm has submitted an Election of Payment form showing the method by which it proposes to pay the fine imposed.

The firm specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time hereafter, the monetary sanctions imposed in this matter.

II.

WAIVER OF PROCEDURAL RIGHTS

The firm specifically and voluntarily waives the following rights granted under FINRA's Code of Procedure:

- A. To have a Complaint issued specifying the allegations against the firm;
- B. To be notified of the 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 NAC and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, the firm specifically and voluntarily waives 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.

The firm further specifically and voluntarily waives any right to claim that a person violated the *ex parte* prohibitions of FINRA Rule 9143 or the separation of functions prohibitions of FINRA 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

The firm understands 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 FINRA Rule 9216;
- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against the firm; and
- C. If accepted:
 - 1. this AWC will become part of the firm's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against the firm;
 - 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 FINRA Rule 8313; and
 - 4. The firm 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. The firm 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 the firm's: (i) testimonial obligations; or (ii) right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.

- D. The firm may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. The firm understands that it 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.

The undersigned, on behalf of the firm, certifies that a person duly authorized to act on its behalf has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that it has 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 the firm to submit it.

Respondent
Scottrade, Inc.

By: 

Name: Scott Golde

Title: General Counsel

Date: 7/3/13

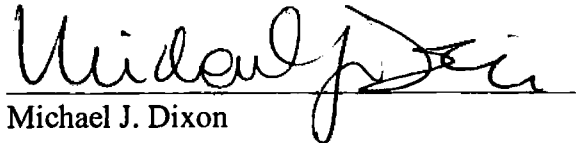
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Accepted by FINRA:

July 9, 2013
Date

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



Michael J. Dixon

Senior Counsel

FINRA, Department of Enforcement

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