

NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

**JEFFREY M. ESPOSITO, SR.
CRD No. 2683912**

Respondent.

**DISCIPLINARY PROCEEDING
No. EAF0400220004**

**HEARING OFFICER –

COMPLAINT**

Upon information and belief, the Complainant alleges as follows:

SUMMARY

1. From approximately February 13, 2003 to October 14, 2003, Respondent Jeffrey M. Esposito, Sr. ("Esposito") was associated with LH Ross & Company, Inc. ("LH Ross"), a former member of NASD. This complaint concerns Esposito's sales to customers of unregistered shares of convertible preferred stock offered by former member firm LH Ross.

RESPONDENT

2. Respondent Esposito was associated with LH Ross & Company, Inc., a former member of NASD, from approximately February 13, 2003 to October 14, 2003. Esposito was registered with NASD as a Series 7, General Securities Representative, and as a Series 24, General Securities Principal. Esposito is not currently associated with a member firm. Esposito's most recent association with a member firm ended on November 29, 2004. Therefore, pursuant to Article V, Section 4 of NASD By-Laws, NASD has jurisdiction to issue this Complaint against Esposito.

FACTS

A. LH Ross's Private Placement Offering

3. In January 2003, LH Ross initiated a private offering consisting of 5,000 units of LH Ross, priced at \$1,400 per unit. According to the 55-page private placement memorandum (2003 PPM) dated January 6, 2003, a unit contained 100 shares of convertible preferred stock, valued at \$14 per share, with a dividend of 6% per annum, payable quarterly. The preferred stock was convertible to two shares of common stock after the closing of a public offering of LH Ross securities that the firm intended "to proceed with at some point in the near future as may be required by the underwriters of the IPO or the NASD." The total amount to be raised in the private offering was \$7 million.

4. According to the 2003 PPM, the offering price was arbitrarily determined by LH Ross and did not "bear a relationship to [the firm's] financial position, book value or any other generally accepted criteria of value." The 2003 PPM indicated that the investment involved a "high degree of risk" and should only be considered by investors who can "afford to sustain a loss of their entire investment ... [and] have no need for liquidity in this investment," as there is "no market for the [u]nits." The units were not registered with the SEC or in any state and could not be sold or transferred until registered or an exemption from registration applied. LH Ross had taken no meaningful steps toward a public offering of its stock. LH Ross had filed no documents with the SEC, NASD or any state regulatory authority to initiate the public offering process.

5. Several "risk factors" specific to LH Ross were outlined in the 2003 PPM. These included the firm's net loss of more than \$2.2 million in fiscal year 2001 and more than \$1.1 million in fiscal year 2002, as well as the possible need for additional financing to fund

operational needs and meet capital requirements, in addition to proceeds from the offering. The 2003 PPM also disclosed that as of January 2003, there were approximately nine arbitration claims pending against the firm, and that it had been involved in actions brought by the following regulatory authorities: NASD (for violating the taping rule, characterized in the PPM as a technical violation), the Utah Division of Securities (temporarily suspended the firm's license for failing to cooperate during an on-site inspection of a branch office, which the firm was contesting), the State of Florida Department of Banking and Finance (for operating unregistered branch offices and selling securities through an unregistered person, which was settled to avoid litigation according to the PPM), and the State of Connecticut Department of Banking (for actions of brokers not registered in the state, which are described in the PPM as mistakes). In addition, the 2003 PPM disclosed that LH Ross had not paid dividends since the end of 2001 and that the promised dividend in the 2003 Offering may be deferred in the sole and absolute discretion of LH Ross's Board of Directors.

6. On July 23, 2004, Enforcement filed a four-count Complaint against LH Ross, alleging that the firm raised millions of dollars in 2003 and 2004 through the sale of unregistered private placement offerings of convertible preferred stock in LH Ross, employing fraudulent and illegal sales practices in soliciting customers, and in some instances, placing unauthorized purchases of LH Ross preferred stock into customers' accounts. Enforcement also charged that LH Ross failed to respond to NASD requests for documents and information related to the private placement self-offerings.

7. On July 23, 2004, Enforcement also filed a Notice initiating a temporary cease and desist proceeding ("TCDO") against LH Ross pursuant to NASD Procedural Rule 9810.

8. On August 30, 2004, an NASD hearing panel imposed a TCDO on LH Ross. The panel found that LH Ross, through its registered representatives, made material misrepresentations and omissions of fact in connection with the offer, sale or purchase of securities issued by LH Ross in private placement self-offerings in 2003 and 2004, in violation of Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5 promulgated thereunder, Section 17(a) of the Securities Act of 1933, and NASD Conduct Rules 2120 and 2110. In addition, the Panel found that LH Ross had placed unauthorized transactions involving securities issued by LH Ross in at least one customer account, in violation of NASD Conduct Rule 2110. Finally, the panel held that the firm's violative conduct or continuation thereof was likely to result in significant dissipation or conversion of assets or other significant harm to investors prior to the completion of the disciplinary proceeding. Accordingly, the panel ordered LH Ross to cease and desist offering or selling any securities issued by LH Ross and to cease and desist placing unauthorized transactions in customer accounts of securities issued by LH Ross. The panel also ordered LH Ross to cease and desist dissipating or converting customers' assets or causing other harm to investors and described in detail certain acts that LH Ross was required to take or refrain from taking based on evidence regarding LH Ross's apparent misuse of proceeds obtained from the private placement self-offerings.

9. On January 14, 2005, the panel issued its decision in the disciplinary proceeding portion of the TCDO. The panel found that LH Ross had violated:

- (1) NASD Conduct Rule 2110 and Section 5 of the Securities Act of 1933, by participating in public offerings and sales of unregistered securities issued by LH Ross through a private placement offering in 2003;
- (2) Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5 promulgated thereunder, and NASD Conduct Rules 2120 and 2110, by making material misrepresentations and omissions of fact in connection

with the offer, sale or purchase of securities issued by LH Ross through private placement offerings in 2003 and 2004;

- (3) NASD Procedural Rule 8210 and NASD Conduct Rule 2110, by failing to respond to request for documents and information; and
- (4) NASD Conduct Rule 2110, by placing an unauthorized transaction in at least one customer account.

The panel expelled LH Ross from NASD membership, fined it \$500,000, ordered LH Ross to pay restitution in the amount of \$11,011,008, plus prejudgment interest of at least \$450,113.87, and imposed a permanent cease and desist order. The decision is final and effective. *DOE v. LH Ross & Company, Inc.* Disciplinary Proceeding No. CAF040056 (OHO Jan. 14, 2005) (available at www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&nodeId=1261).

B. Esposito made material misrepresentations and failed to disclose material facts to customers regarding the private placement offering.

Customer SE of Florida

10. In 2003, SE had an account at LH Ross and Esposito was his assigned registered representative. On or before August 26, 2003, Esposito recommended that SE purchase units in LH Ross's 2003 private placement. Esposito told SE that he (Esposito) had "inside information" that LH Ross was going to merge with a publicly traded broker-dealer in "three months or so." According to Esposito, if SE purchased the LH Ross private placement units he would enjoy a return of at least 20% on his investment when LH Ross went public in the coming months. Esposito advised SE that he had to act quickly to participate in this great opportunity. Based on Esposito's recommendation, SE agreed to purchase 10 units (\$14,000) in the LH Ross 2003 private placement. On August 28, 2003, SE delivered his check in payment for his investment. On or about February 3, 2004, SE received a stock certificate evidencing his ownership of 1,000 units. SE never received a copy of the 2003 PPM.

11. Esposito failed to disclose to SE any of the risk factors associated with an investment in the 2003 LH Ross private placement, such as the fact that there was no current market for the shares and that they could not be sold unless and until the firm went public. Moreover, Esposito failed to send or cause to be sent to SE the 2003 PPM. Finally, Esposito misrepresented to SE that LH Ross was going to merge with a publicly traded broker-dealer as there was no reasonable basis in fact that this would occur.

12. As a result of LH Ross's demise, the shares of preferred stock that SE purchased for approximately \$14,000 are essentially worthless.

Customer GP of Florida

13. In 2003, GP had an account with LH Ross. At the time, GP was 81 years old and retired. In early May 2003, Esposito recommended that GP invest in the LH Ross private placement. Esposito told GP that LH Ross would go public within one year and in the meantime GP would enjoy a 6.5% dividend on his money. Esposito told GP that when LH Ross went public GP's investment would double. On or about May 13, 2003, based on Esposito's recommendation, GP agreed to purchase 35 units (\$49,000) of the private placement. On May 13, 2003, GP wired his \$49,000 to pay for his purchase. GP did not receive the 2003 PPM at the time of his investment. On or about June 29, 2003, LH Ross provided GP with the 2003 PPM. GP never received any dividend payments.

14. At the time of his recommendation to GP, Esposito failed to disclose to GP any of the risk factors associated with an investment in the 2003 LH Ross private placement, such as the fact that there was no current market for the shares and GP could lose his entire investment. Esposito also did not disclose that LH Ross had suffered operating losses in 2001 and 2002, had ceased dividend payments in 2001, and that LH Ross had taken no substantial steps toward going

public. Moreover, Esposito failed to send or cause to be sent to GP at the time of his investment a copy of the 2003 PPM.

15. As a result of LH Ross's demise, the shares of preferred stock that GP purchased for approximately \$49,000 are essentially worthless.

Customer NA of California

16. In 2003, NA had an account with LH Ross. Sometime in May 2003 or early June 2003, Esposito recommended that NA invest in LH Ross's 2003 private placement offering. Esposito told NA if he invested in the LH Ross private placement he would recoup losses he suffered on individual stock recommendations previously made by Esposito and another LH Ross broker. Esposito told NA that LH Ross was due to go public in 2-3 months and he would double his investment. Esposito predicted that the LH Ross IPO would be priced at \$28 and quickly go to \$50-51 a share in the aftermarket. Esposito told NA that LH Ross would pay him a 6% dividend while he waited for LH Ross to go public. Finally, Esposito was insistent that NA make a quick decision as there were a limited number of shares left in the offering. On or about June 4, 2003, based on Esposito's recommendation, NA agreed to purchase 10 units (\$14,000) in the 2003 private placement. On June 10, 2003, NA paid for his investment. NA never received a copy of the 2003 PPM. NA never received any dividend payments.

17. Esposito failed to disclose to NA any of the risk factors associated with an investment in the 2003 LH Ross private placement, such as the fact that there was no current market for the shares and NA could lose his entire investment. Esposito also did not disclose that LH Ross had suffered operating losses in 2001 and 2002, had ceased dividend payments in 2001, and that LH Ross had taken no substantial steps toward going public. Moreover, Esposito failed to send or cause to be sent to NA the 2003 PPM. Esposito failed to disclose to NA that LH Ross had

ceased dividend payments in 2001, and that LH Ross had taken no substantial steps toward going public.

18. As a result of LH Ross's demise, the shares of preferred stock that NA purchased for \$14,000 are essentially worthless.

Cause One

Misrepresentations and Omissions of Material Fact and Baseless Predictions of Future Performance

NASD Conduct Rules 2110 and 2120, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder, and Section 17(a) of the Securities Act of 1933

19. Paragraph numbers 1 through 18 above are realleged and incorporated herein by reference.

20. Esposito sold interests in the 2003 Offering to SE (\$14,000), GP (\$49,000), and NA (\$14,000), among others. As set forth above, Esposito made numerous material misrepresentations, including baseless price predictions of future performance, and failed to disclose material facts to his customers. Esposito's material misrepresentations, omissions of material fact and baseless price predictions were intended to induce, and did induce, SE, GP, and NA to purchase LH Ross preferred stock and therefore were made in connection with the offer or sale of a security.

21. Esposito by engaging in the conduct referenced in paragraphs 10-20, with scienter, directly or indirectly, in connection with the offer or sale of securities, by the use of means or instrumentalities of interstate commerce, or the mails: 1) employed devices schemes or artifices to defraud; 2) made untrue statements of material fact or omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or 3) engaged in acts, practices or courses of business which operated or would

operate as a fraud or deceit upon purchasers or prospective purchasers in violation of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder.

22. The acts, practices and conduct by Esposito alleged in paragraphs 10-20, constitute separate and distinct violations of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder, as well as NASD Conduct Rules 2110 and 2120.

Cause Two

Failure to Appear and Provide On-the-Record Testimony

NASD Conduct Rules 8210 and 2110

23. Paragraph numbers 1 through 22 above are realleged and incorporated herein by reference.

24. On January 4, 2005, NASD staff issued a Rule 8210 letter to Esposito, which requested his appearance for an on-the-record interview on February 24, 2005. The letter was sent via first class and certified mail to Esposito's CRD Residential Address. The certified mailing was returned and marked "Unclaimed." To date, the first class mailing has not been returned.

25. On February 1, 2005, NASD staff issued a letter to Esposito reminding him of his obligation to appear for an on-the-record interview on February 24, 2005. This reminder letter was sent pursuant to NASD Procedural Rule 8210. The letter was sent via first class and certified mail to Esposito's CRD Residential Address. The certified mailing was returned and marked "Unclaimed." To date, the first class mailing has not been returned.

Failure to Appear—February 24, 2005

26. Esposito failed to appear for his on-the-record interview on February 24, 2005. Esposito did not attempt to reschedule or otherwise provide a reason for his failure to appear.
27. On March 29, 2005, NASD staff learned of a possible new address for Esposito.
28. On March 29, 2005, NASD staff issued a Rule 8210 letter to Esposito, which requested his appearance for an on-the-record interview on April 14, 2005. The letter was sent via first class and certified mail to Esposito's CRD Residential Address and to his newly discovered address.
29. The certified mailing sent to the newly discovered address was delivered on April 1, 2005 and signed for by EL. To date, the first class mailing sent to the newly discovered address has not been returned. The certified mailing sent to Esposito's CRD Residential Address was returned and marked as "Unclaimed." To date, the first class mailing sent to the CRD Residential Address has not been returned.

Failure to Appear—April 14, 2005

30. Esposito failed to appear for his on-the-record interview on April 14, 2005. Esposito did not attempt to reschedule or otherwise provide a reason for his failure to appear.
31. The foregoing conduct as described in paragraphs 23-30 above constitutes a violation of NASD Procedural Rule 8210 and NASD Conduct Rule 2110 by Esposito.

Prayer for Relief

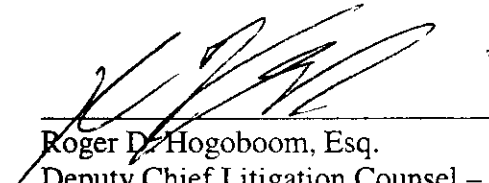
WHEREFORE, Complainant respectfully requests:

- A. Findings of fact and conclusions of law that Respondent committed the violations charged and alleged herein;
- B. An order imposing sanctions upon the Respondent in accordance with NASD Rule 8310;

- C. An order requiring Respondent to make full and complete restitution, together with interest;
- D. An order imposing such costs of any proceeding as are deemed fair and appropriate under the circumstances in accordance with NASD Rule 8330; and
- E. An order imposing any other fitting sanction.

Respectfully submitted,

November 4, 2005



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